

## Secondary Course

# 224 - Accountancy

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Course Coordinator  
Dr. Piyush Prasad



## NATIONAL INSTITUTE OF OPEN SCHOOLING

(An autonomous organisation under MHRD, Govt. of India)

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---

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---

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Principal, S.L. College  
University of Delhi, Delhi

**Dr. Sunil Kr. Gupta**  
Associate Profesor  
SOMS, IGNOU  
New Delhi

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Associate Professor  
B.R. Ambedkar College  
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Associate Professor  
Saheed Bhagat Singh College (Eve.)  
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Lecturer Commerce  
Govt. Sarvodaya Bal Vidyalaya  
Krishna Nagar, Delhi

---

### GRAPHICS, COVER DESIGN AND DTP

---

**Sh. Mahesh Sharma**  
Graphic Artist  
NIOS, New Delhi

**M.K Computers**  
Shop No. 19, DDA Market  
Bhera Enclave, Paschim Vihar  
New Delhi - 110087

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## Chairman's Message

*Dear learners*

*As the needs of the society in general, and some groups in particular, keep on changing with time, the methods and techniques required for fulfilling those aspirations also have to be modified accordingly. Education is an instrument of change. The right type of education at right time can bring about positivity in the outlook of society, attitudinal changes to face the new/fresh challenges and the courage to face difficult situations. This can be very effectively achieved by the curriculum renewal and by introducing new subjects at regular intervals of time. A static curriculum serves no other purpose than a mere manual of instruments for teaching in which, unless the water is changed at regular intervals of time, the water can not be put to any use. Rather, it starts stinking giving a foul and obnoxious smell.*

*Textual material production is an integral and essential part of curriculum development. Through it, the goals of teaching a particular subject are achieved and it teaches the techniques, rather than employing old and traditional methods which may not suit the situation at all.*

*For this purpose only, educationists from all over the country come together at regular intervals to deliberate on the issues of changes needed and required. As an outcome of such deliberations, the National Curriculum Framework (NCF) came out, which spells out in detail the type of education desirable/needed at various levels of education – primary, elementary, secondary or senior secondary.*

*Keeping this framework and other national and societal concerns in mind, we have introduced few new subjects at the secondary level, making them current and need based. We have also taken special care to make the learning material user friendly, interesting and attractive for you.*

*I would like to thank all the eminent persons involved in making this material interesting and relevant to your needs. I hope you find it appealing and absorbing.*

*On behalf of National Institute of Open Schooling, I wish you all a bright and successful future.*

**Chairman**  
*(National Institute of Open Schooling)*



## *A Note From the Director*

*Dear Learner,*

*The Academic Department at the National Institute of Open Schooling tries to bring you new programmes every now and then in accordance with your needs and requirements. Recently, we undertook the responsibility of revising curriculum in all the subjects at the secondary level as well as to introduce new subjects as per need of learners. In order to bring to you a curriculum which is at par with other boards in the country, we consulted the curriculum in different subjects at the CBSE, the Boards of Secondary Education of Uttar Pradesh, Maharashtra, Madhya Pradesh, Goa, Jammu and Kashmir, West Bengal, etc. The National Curriculum Framework developed by the National Council for Educational Research and Training was kept as a reference point. After making a comprehensive comparative study, we found that our curriculum was functional, related to life situations and simple. The task now was to make it more effective and useful for you. We invited leading educationists of the country and under their guidance, have been able to revise and update the curriculum.*

*At the same time, we have covered all relevant things and have tried to make the learning material attractive and appealing for you.*

*I hope you will find this material interesting and exciting. Any suggestions for further improvement are welcome.*

*Let me wish you all a happy and successful future.*

*(Dr Kuldeep Agarwal)  
Director (Academic)*

## *A Word With You*

*Dear Learner,*

I am happy that you have chosen Accountancy as one of the subjects at Secondary level. Welcome to the course in Accountancy.

You know that all of us have some direct and indirect link with various accounting activities. The environment around us has influenced our lives in many ways. In this context, it is our attempt to develop awareness among the learners about business and accounting, its wide network and also about its ever-changing nature. Introduction to Accounting, Journal, Subsidiary Books, Ledger, Trial Balance, Depreciation and Preparation of Financial Statements with the use of computer in Accounting are covered in this course. It would also give you some idea about how Accountancy provides career opportunities.

This course has six modules, namely Introduction and Basic Concepts, Journal and Other Subsidiary Books, Ledger and Trial Balance, Depreciation, Provisions and Reserves, Preparation of Financial Statements, Computer in Accounting. Each lesson of this subject has been designed keeping in view the requirements of the Self Learners like you through Open and Distance Mode. With a text written in a very simple language, supplemented by pictures/figures, illustrations to make it clear at a glance. All these will include Intext Questions which will appear after every section of the lesson. They will normally be very short answer type questions consisting objective type, true and false, match the column, fill in the blanks and Multiple Choice Questions will help you to understand the extent to which you have learnt the section. You will find the key to these questions at the end of the lesson. If you are able to answer the questions, then you can proceed further otherwise you should learn the section again.

I hope you will find the lessons interesting and would be able to apply your knowledge in the real life situations. So, read, all these lessons carefully and prepare well for examinations.

The examination in Accountancy will consist of one paper which carries 100 marks. For your practice a sample question paper has been given at the end of the book. This is followed by detailed marking scheme, which will tell you how your answers will be evaluated. Try to answer all the questions and compare those with the answer given in the marking scheme.

Do not hesitate to write to me, in case you have any difficulty in your studies.

Happy Studies

Wishing you success.

*(Dr. Piyush Prasad)*  
*Academic Officer*  
*National Institute of Open Schooling*  
*alkaranipiyush@rediffmail.com*

## How to use the Study Material

*Congratulation! You have accepted the challenge to be a self-learner. NIOS is with you at every step and has developed the material in Accountancy with the help of a team of experts, keeping you in mind. A format supporting independent learning has been followed. You can take the best out of this material if you follow the instructions given. The relevant icons used in the material will guide you.*

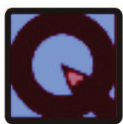
**Content :** Total content has been divided into sections and subsections. Section leads you from one content element to another and subsections help in comprehension of the concepts in the content elements.



**Notes :** Each page carries empty space in the side margins, for you to write important points or make notes.



**Objectives :** These are statements of outcomes of learning expected from you after studying the lesson. You are expected to achieve them, do read them and check if you have achieved.



**Intext Questions :** Very short answer self check questions are asked after every section, the answers to which are given at the end of the lesson. These will help you to check your progress. Do solve them. Successful completion will allow you to decide whether to proceed further or go back and learn again.



**What You Have Learnt :** This is the summary of the main points of the lesson. It will help in recapitulation and revision. You are welcome to add your own points to it also.



**Terminal Questions :** These are long and short questions that provide an opportunity to practice for a clear understanding of the whole topic.



**Key to Intext Questions :** These will help you to know how correctly you have answered the intext questions.

## *Mukta Vidya Vani*



Mukta Vidya Vani is a pioneering initiative of the National Institute of Open Schooling (NIOS) for using Streaming Audio for educational purposes. This application of ICT will enhance accessibility as well as quality of programme delivery of NIOS Programmes. This is a rare accomplishment of NIOS as the first Open and Distance Learning Institute to start a two way interaction with its learners, using streaming audio and the internet.

Keeping in mind the fact that the transmission is done through the web, the NIOS website ([www.nios.ac.in](http://www.nios.ac.in)) has a link that will take any user to the Mukta Vidya Vani. Mukta Vidya Vani thus enables a two way communication with any audience that has access to an internet connection, from the studio at its Headquarters in NOIDA, where NIOS has set up a state-of-art studio, which will be used for this purpose as well as for recording educational audio programmes meant for NIOS learners, though others can also take advantage of this facility.

Mukta Vidya Vani is a modern interactive, participatory and cost effective programme, involving an academic perspective along with the technical responsibilities of production of audio and video programmes, which are one of the most important components of the multi channel package offered by the NIOS. These programmes will attempt to present the topic/ theme in a simple, interesting and engaging manner, so that the learners get a clear understanding and insight into the subject matter.

NIOS has launched a scheme to motivate the learners to participate in the Mukta Vidya Vani by sending their Audio CD's to the respective regional centre on various subjects such as-

1. Poetry / Shloka recitation
2. Story telling
3. Radio Drama
4. Music
5. Talks on various topic related to the NIOS curriculum including Painting, Vocational Subjects etc.
6. Quiz
7. Mathematics puzzles etc.

The selected CD can be webcast on Mukta Vidya Vani and the winner participant be rewarded suitably.

Learners may visit the NIOS website and participate in live programmes from 2pm to 5pm on all week days and from 10.30am to 12.30pm on Saturdays, Sundays and all Public Holidays. The Subject Experts in the Studio will respond to their telephonic queries during this time. A weekly schedule of the programmes for webcast is available on the NIOS website. The Studio telephone number are 0120-4626949 and Toll Free No. 1800-180-2543.



# Contents

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## Module 1 : Introduction and Basic Concepts

<i>Lesson 1.</i>	<i>Introduction to Accounting .....</i>	<i>3</i>
<i>Lesson 2.</i>	<i>Accounting Concepts and Conventions .....</i>	<i>15</i>
<i>Lesson 3.</i>	<i>Accounting Terms.....</i>	<i>27</i>

## Module 2 : Journal and Other Subsidiary Books

<i>Lesson 4.</i>	<i>Accounting Equation .....</i>	<i>38</i>
<i>Lesson 5.</i>	<i>Double Entry System .....</i>	<i>51</i>
<i>Lesson 6.</i>	<i>Journal .....</i>	<i>73</i>
<i>Lesson 7.</i>	<i>Cash Book .....</i>	<i>89</i>
<i>Lesson 8.</i>	<i>Bank Reconciliation Statement .....</i>	<i>110</i>
<i>Lesson 9.</i>	<i>Purchases and Sales Book .....</i>	<i>130</i>

## Module 3 : Ledger and Trial Balance

<i>Lesson 10.</i>	<i>Ledger .....</i>	<i>150</i>
<i>Lesson 11.</i>	<i>Trial Balance and Accounting Errors .....</i>	<i>171</i>

## Module 4 : Depreciation, Provisions and Reserves

<i>Lesson 12.</i>	<i>Depreciation .....</i>	<i>188</i>
<i>Lesson 13.</i>	<i>Provisions and Reserves .....</i>	<i>207</i>

## Module 5 : Preparation of Financial Statements

<i>Lesson 14.</i>	<i>Financial Statements (Without Adjustments) .....</i>	<i>221</i>
<i>Lesson 15.</i>	<i>Financial Statements (With Adjustments) .....</i>	<i>236</i>

## Module 6 : Computer in Accounting

<i>Lesson 16.</i>	<i>Computers in Accounting .....</i>	<i>253</i>
<i>Lesson 17.</i>	<i>Introduction to Tally .....</i>	<i>264</i>
	<i>Curriculum .....</i>	<i>i - v</i>
	<i>Sample Question Paper .....</i>	<i>vi - xi</i>
	<i>Marking Scheme .....</i>	<i>xii - xx</i>

## Awards Won by NIOS

Several projects have been implemented by the NIOS to tap the potential of Information and Communication Technology (ICT) for promoting of Open and Distance Learning (ODL) system. The Ni-On project of NIOS won the National Award for e-governance and Department of Information and Technology, Govt. of India. In further recognition of its On-line initiatives and best ICT practices, the NIOS received the following awards:

### NIOS WINS National Award for e-Governance 2008-09

Silver icon for Excellence in Government Process Re-engineering, Instituted by Government of India Department of Administrative Reforms and Public Grievances & Department of Information Technology.



### NIOS receives NCPEDP MPHASIS Universal Design Awards 2012



National Institute of Open Schooling (NIOS) has been awarded THE NCPEDP - MPHASIS UNIVERSAL DESIGN AWARDS 2012 instituted by National Centre for Promotion of Employment for Disabled People. The award was given by **Sh. Mukul Wasnik, Hon'ble Minister for Social Justice and Empowerment, Govt. of India** on 14th August, 2012. NIOS has been selected for its remarkable work done for the learners with disabilities through ICT by making its web portal

[www.nios.ac.in](http://www.nios.ac.in) completely accessible for such learners.

### The Manthan Award South Asia & Asia Pacific 2012

The Manthan Award South Asia & Asia Pacific 2012 to recognize the best ICT practices in e-Content and Creativity instituted by Digital Empowerment Foundation in partnership with World Summit Award, Department of Information Technology, Govt. of India, and various other stakeholders like civil society members, media and other similar organisations engaged in promoting digital content inclusiveness in the whole of South Asian & Asia Pacific nation states for development. The award was conferred during **9th Manthan Award Gala South Asia & Asia Pacific 2012 at India Habitat Centre on 1st Dec. 2012.**



## MODULE - I

<b>Maximum Marks</b>	<b>Hours of Studies</b>
<b>20</b>	<b>48</b>

### **Introduction and Basic Concepts**

Accounting is indispensable in the modern society. This module will help the students to understand the meaning of various terms used in accounting, meaning, objectives, advantages and limitations of book keeping and accountancy and the difference between the two. The module will also give an insight to the learners about the various concepts and conventions applied in the field of accounting and develop accounting equation on the basis of the knowledge so obtained.

- Lesson 1 : Introduction to Accounting**
- Lesson 2 : Accounting Concepts and Conventions**
- Lesson 3 : Accounting Terms**



## Awards Won by NIOS



**Web Ratna Awards 2012 Platinum Icon under Outstanding Web Content** for Acknowledging exemplary initiatives/practices in the realm of e-Governance for dissemination of information & services instituted by Department of Information Technology, Ministry of Communications & IT (MC&IT) and National Informatic Centre (NIC), Government of India. The award has been conferred by Hon'ble Minister of Communications and Information Technology Shri Kapil Sibal on 10th December 2012 at Dr. D.S Kothari Auditorium, DRDO Bhawan, Dalhousie Road, New Delhi.

### TOI Social Impact Award 2012

NIOS has been selected as winner of the Social Impact Award 2012 instituted by Times of India in partnership with J P Morgan. The Award is given in the recognition of magnificent work done by an individual or groups or institutions making an impact in the society in various segment including Education. NIOS feels honoured to accept the award.



The award was conferred on 28th January 2013 at a function in presence of President of India and high level dignitaries.

### National Awards for the Empowerment of Persons with Disabilities, 2012



The NIOS received the National Award for the Empowerment of persons with disabilities, 2012 Instituted by Ministry Social Justice and Empowerment, Govt. of India. The NIOS got this award under the category of best accessible Website for making its website [www.nios.ac.in](http://www.nios.ac.in) completely accessible for person with disabilities. The website is bilingual in Hindi and English. It also has provisions of Screen Reader, increasing text size, colour contrast scheme etc. for disabled learners. This award was conferred by the Hon'ble President of India at Vigyan Bhawan, New Delhi on 6th February, 2013. Dr. S.S. Jena Chairman, NIOS received the award.



## 1

# INTRODUCTION TO ACCOUNTING

You must have seen a shopkeeper selling goods to earn profit. He/she sells goods for cash and on credit, purchases the goods from suppliers, pays for electricity bills, telephone bills, wages to workers etc. These are all business transactions involving money. A large number of such transactions take place daily. A businessman cannot remember all these transactions, he therefore, keeps a record of all these transactions in writing, so that he can make use of this recorded information later on. The trader would like to know at the end of a period (which is generally one year), what he has earned during this period from his business. He would also like to know the amount he has to pay to his suppliers and the amount his customers have to pay to him. He can get various other information of this kind only if he maintains proper record of business transactions, which have taken place during the year. This is called Book Keeping. This information needs, to be recorded, classified and summarized in a systematic manner. It is called 'Accounting'. In this lesson you will learn the meaning, objectives and uses of Book-keeping and Accounting.



## OBJECTIVES

**After studying this lesson, you will be able to:**

- explain the meaning of business transactions;
- explain the meaning of book-keeping;
- identify the need of book-keeping;
- describe the objectives of book-keeping;
- define the term 'accounting';
- explain the branches of accounting;
- discuss the objectives of accounting;
- describe the advantages and limitations of accounting;
- distinguish between book-keeping and accounting and
- identify the users of accounting information and understand the various uses of accounting information.

## MODULE - I

### *Introduction and Basic Concepts*



#### Notes

## MODULE - I

### Introduction and Basic Concepts



#### Notes



## Introduction to Accounting

### 1.1 BUSINESS TRANSACTIONS

In your own house, you see many transactions taking place, for example, purchase of vegetables, paying for school fee, telephone, rent, etc. Just as many transactions take place in a house, many more transactions take place in a business.

Let us observe the activities of a nearby stationery shop. A customer comes, he buys register and pays money for it. Then, another customer comes, he buys a text-book and pays for it. After sometime, a third customer comes to the shop, he purchases different stationery items like writing pads, pencils, pens, etc., he buys these items on credit. Then, a supplier comes, he supplies various stationery items to the shopkeeper and submits a bill. The shopkeeper keeps the bill and promises to pay after one month. These are some of the important business transactions. There can be many more such activities. You have noticed that these business transactions involve exchange of goods for money or promise for payment in future. These transactions have some important features which are as follows:

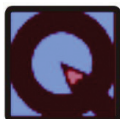
- i. Business transactions are business activities.
- ii. These involve exchange of goods or services like transportation, storage, packaging, etc for money or money's worth.
- iii. These are monetary in nature.
- iv. In cash business transactions, goods or services are exchanged for money.
- v. In credit business transactions, goods or services are exchanged but money is received or paid at a future date.
- vi. All business transactions are recorded in the books of accounts.

You might have noticed that all the above business transactions are with the OUTSIDERS. Sometimes, business transactions pertain to the OWNER. For example, Abhishek starts a small shop with cash ₹1,00,000/-. In exchange, the owner (Abhishek) gets an ownership right against business. Take another example, Abhishek withdraws goods costing ₹5,000/- from the shop for his own use. It is a business transaction. Here, the owner gets goods worth ₹5,000/- while, the business gets a right to receive money from the owner. Thus you may say that business transactions pertain to the outsiders or to the owner. Now, business transaction may be defined as:- “An exchange of goods, services, or any other activity for money or money's equivalent. It involves exchange of money also.” In simple words, it includes all events and activities of business which are financial in nature.

You know that a businessman enters into several transactions in a day. Some of these may be meant for his personal purposes. For example, Abhishek goes to a movie with his friends. This is his personal transaction and not the business transaction. Since a business transaction has an effect on business, therefore, it is recorded in the

## Introduction to Accounting

books of the business. Owner's personal transactions where the money of the business is not affected, are not recorded anywhere in the books of the business. This separation of business transactions and personal transactions is very helpful in recording business transactions.



### INTEXT QUESTIONS 1.1

- I. Find which of the statements are true and which are false:**
- Shifting of goods from one place to another within a shop is business transaction.
  - Profit is the reward to the owner for his business activities.
  - Purchase of vegetables for use at home is not business transaction.
  - Purchase of goods on credit for personal use from his friend is personal transaction.
- II. Classify the following into business and non-business transactions:**
- Rahim starts business with Cash – ₹1,00,000/-
  - He deposits money into the Bank – ₹50,000/-
  - He buys goods for Cash – ₹10,000/-
  - He takes out money from the shop and gives it to his wife for buying a saree – ₹1,000/-
  - He attends a family function and gets present worth – ₹3,000/-
  - He pays salary to his domestic servant – ₹500/- out of his pocket.

## 1.2 BOOK-KEEPING

Some people take book-keeping and accounting as synonymous terms, but they are different from each other. Book-keeping is mainly concerned with recording of financial data relating to the business operations in a significant and orderly manner. Book-keeping involves the systematic recording of the financial transactions and the maintenance of the correct & up-to-date financial records of the organization. Accounting is primarily concerned with designing the systems for recording, classifying and summarizing the data and interpreting them for internal and external end users. Accountants often direct and review the work of the book-keepers.

### Need of Book-keeping

It is significant for a business to have transparent record keeping systems which would make the transaction clear. The need of book-keeping can be understood with the help of the following points:

- i) Helps in Assessing the Financial Position:** Recording the business

## MODULE - I

### Introduction and Basic Concepts



### Notes



## MODULE - I

### Introduction and Basic Concepts



#### Notes

## Introduction to Accounting

transactions would be helpful to businessman for monitoring the financial success or failure of his business. You probably don't know where you are going if you do not realize where you have been. Hence, understanding the existing scenario of financial status of business is of much importance to the business to achieve the objectives and avoid the unexpected losses.

- ii) **Helps in making business decisions :** Keeping a record would help to make future business decision. Business decisions have to be taken by considering the financial consequences that happened earlier and the same can be done only if we maintain the accounting books properly. Without the precise data and financial information, it is extremely difficult to predict the impact of any given action.
- iii) **For Record for Income tax Purposes :** Maintaining books of accounts would help businessmen to file the income tax returns accurately. Every business entity has to file income tax returns and pay income tax. With proper records, it is very easy to prepare the tax returns and filing can also be done on time without any delay.
- iv) **Preparing Budgets :** Keeping the older transactions would help you to plan the budget for forthcoming year. Preparing budget would keep you on the safer side and help you to avoid the unwanted expenditure.
- v) **Tax Assessment :** Keeping good records would help you to prepare payroll, tax returns and sales tax without any delay. If you are doing a partnership business, you can avoid unwanted issues in profit distribution by recording your business transactions accurately.

Moreover, effective book-keeping would help you to identify the activities, which are not profitable, and the unwanted operating expenses. Businessman can avoid such expenditures and prepare an effective budget to optimize business financially. Hence, book-keeping plays an essential role in every business.

### Objectives of Book-keeping

After understanding the need of book-keeping let us now discuss the objectives of book-keeping which are as follows:

- i) **To show permanent record of business :** Book keeping is to record business transactions in proper books of accounts which can be kept safe for years together.
- ii) **To know profit or loss of business :** Various statements are prepared from the information contained in books of accounts called final accounts. One of such statements is called Income Statement or Profit and Loss Account which helps in ascertaining business profit.
- iii) **To know the financial position of business :** Book keeping helps in preparing balance sheet and ascertaining the net capital employed.



## Introduction to Accounting

- iv) **To provide information of total sales and purchases of business :** Businessman is interested in knowing the total sales and total purchases of business which help him in taking decisions regarding sales strategies.
- v) **To provide information about creditors and debtors of business :** Businessman would like to know how much and to whom he owes and how much and who owe to him. Book-keeping records will help in it.
- vi) **To know the quantity and value of stock :** Quantity and value of stock is required to manage stock levels. This can be ascertained by maintaining proper books of accounts.



### INTEXT QUESTIONS 1.2

**Which of the following statements are True and which are False?**

- i. Book-keeping is concerned with recording of business transactions in a systematic and significant manner.
- ii. Book-keeping and accounting are synonymous terms.
- iii. Book-keeping is a broader term than accounting.
- iv. Book-keeping helps in preparing budget of the business.

## 1.3 ACCOUNTING

Accounting has rightly been termed as the language of the business. The basic function of a language is to serve as a means of communication. Accounting communicates the result of business operations to various parties who have some stake in the business. With the help of accounting records the business is able to ascertain the profit or loss and the financial position of the business at the end of a given period and communicate such information to all interested parties. The function of accounting is to provide quantitative information, primarily of financial nature, about economic entities, that is needed to be useful in making economic decisions.

The meaning of accounting was given by the American Institute of Certified Public Accountants (AICPA) in 1961 when it defined accounting as :

“Accounting is the art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events, which are, in part at least, of financial character and interpreting the results thereof”:

American Accounting Association (AAA) has defined Accounting as:

“Accounting is the process of identifying, measuring and communicating economic information to permit informed judgments and decisions by users of the information”.

## MODULE - I

### Introduction and Basic Concepts



Notes



## MODULE - I

### Introduction and Basic Concepts



Notes



## Introduction to Accounting

**Branches of Accounting :** There are three branches of accounting :

- i) **Financial Accounting :** Financial Accounting is concerned with recording financial transactions, summarising and interpreting them and communicating the results to users. It shows the profit or loss of a particular period & the position of the business on a particular date.
- ii) **Cost Accounting :** It helps in finding out the cost of production of a product manufactured or services rendered and helps the management in decision making.
- iii) **Management Accounting :** Management Accounting is concerned with generating accounting information relating to funds, costs, profits etc. as it enables the management in decision making.

You will study only Financial Accounting in this course.

### Objectives of Accounting

The following are the main objectives of accounting:

- i) **To keep systematic records :** Accounting is done to keep a systematic record of financial transactions, like purchase of goods, sale of goods, cash receipts and cash payments.
- ii) **To ascertain the operational profit or loss :** Accounting helps in determining the net profit earned or loss suffered on account of running the business. This is done by keeping a proper record of revenues and expenses of a particular period.
- iii) **To ascertain the financial position of the business :** The businessman is not only interested in knowing the operating result, but also interested in knowing the financial position of his business i.e., where it stands. In other words, he wants to know what the business owes to others and what others owe to business.
- iv) **To facilitate rational decision making :** Apart from the owners, there are various other parties who are interested in knowing about the position of business, such as tax authorities, the management, the bank, the creditors, etc. The required information is furnished to all these parties through accounting system.

### Advantages of Accounting

- i) **Replaces memory :** Since all the financial events are recorded in the books. The books of accounts will serve as historical records. Any information required at any time can be easily collected from these records.
- ii) **Meets the information requirements :** Various interested parties such as owners, lenders, creditors, etc., get the necessary information at frequent intervals which help them in their decision making.

## Introduction to Accounting

- iii) **Assists the management in many other ways :** The accounting information provided to the management helps them in taking rational decisions in planning and controlling all business activities.
- iv) **Facilitates a comparative study :** With the help of accounting information one can compare the present performance of the enterprise with its past performance and also with that of similar organisations. This enables the management to draw useful conclusion about the business and make efforts to improve the performance.
- v) **Acts as reliable evidence :** Systematic record of business transactions is generally treated by courts as good evidence in case of disputes.
- vi) **Tax matters:** The Government levies various taxes such as custom duty, excise duty, sales tax, and income tax. Properly maintained accounting records will help in the settlement of all tax matters with the tax authorities.
- vii) **Ascertaining value of business:** In the event of sale of a business firm, the accounting records will help in ascertaining the correct value of business.

### Limitations of Accounting

- i) **Financial accounting permits alternative treatment :** Accounting is based on concepts and it follows “Generally Accepted Principles” but there exist more than one principle for the treatment of any one item. This permits alternative treatments within the framework of Generally Accepted Principles. For example, the closing stock of a business may be valued by any one of the following methods: FIFO (First-in-First-out), LIFO (Last-in-First-out), Average Price, Standard Price etc., but the results are not comparable.
- ii) **Financial accounting is influenced by personal judgments :** Accounting is influenced by personal judgments as one accountant may consider the life of a particular asset say 5 years whereas another accountant may consider the life of that asset say 6 years and the method of charging the depreciation on asset by both the accountants may also be different.
- iii) **Financial accounting ignores non-monetary information :** Financial accounting does not consider the transactions of non-monetary nature. For example, extent of competition faced by the business, technical innovations possessed by the business, loyalty and efficiency of the employees etc. are the important matters in which management of the business is highly interested but accounting is not tailored to take note of such matters.
- iv) **Financial accounting does not provide timely information :** Financial accounting is designed to supply information in the form of statements (Balance Sheet and Profit and Loss Account) for a period normally one

## MODULE - I

### Introduction and Basic Concepts



### Notes

## MODULE - I

### Introduction and Basic Concepts



#### Notes



## Introduction to Accounting

year. The business requires timely information at frequent intervals to enable the management to plan and take correct action wherever the performance is not as per plans.

### 1.4 DIFFERENCES BETWEEN BOOK KEEPING AND ACCOUNTING

Book keeping and Accounting have the following points of differences :

Basis of distinction	Book-Keeping	Accounting
i) Objective	The objective of Book-keeping is to maintain records of business transactions.	Accounting aims at maintaining business records, calculation of business income, and depiction of financial Position and communication of business results
ii) Function	The function of Book- is to record business transactions.	The function of Accounting is recording, classifying, summarizing interpreting the business transactions and communicating the results.
iii) Scope	Book-keeping has a limited scope.	It has wider scope.
iv) Level of knowledge required.	For, it elementary knowledge of accounting rules is enough.	In accounting, advance and in depth understanding is required.
v) Basis of recording	For recording business transactions, vouchers and other supporting documents are prepared.	Book-keeping serves the basis for accounting information.
vi) Stage	It is primary stage.	It is the final stage.
vii) Level of Person Engaged.	Lower level mainly account clerks.	Higher level mainly qualified accountants.

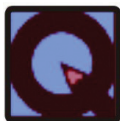
### 1.5 USERS OF ACCOUNTING INFORMATION

Accounting is of primary importance to the proprietors and the managers. There are many more parties who use the accounting information. These parties are as follows:



## Introduction to Accounting

- i) **Investors and Potential Investors :** A person who wants to invest in business will like to know about its profitability and financial position. Basically, investors are interested in the amount of dividends they are likely to get from the business. Hence, they would like to know the profitability of the enterprise which they can get from the income statements of the enterprise for a number of years.
- ii) **Creditors :** Creditors are the persons who have extended credit to the business. They would like to know whether the enterprise will be in a position to meet its commitments well in time towards them both regarding payment of interest and principal. Their main interest lies in liquidity and profitability of business enterprise.
- iii) **Proprietors :** The proprietor is the owner of business who starts the business with an objective to make profit. He is interested in knowing the position of his business as if he is earning profits or incurring loss. The profitability and financial soundness are, therefore, matters of prime importance to the proprietors who have invested their money in the business.
- iv) **Employees :** The employees are interested in the financial statements on account of various profit sharing and bonus schemes. Their interest may further increase in case they purchase shares of the companies in which they are employed. They are interested in more wages or salary, bonus, overtime payments, medical facilities and their demands for these matters are based on profitability as provided by income statement.
- v) **Customers :** They are interested in knowing whether a company will continue to honour product warranties and continue to provide its products in future, and how much profit is made by a company by providing goods and services to them.
- vi) **Government :** The Government is interested in the financial statements of business enterprise on account of taxation, labour and corporate law. The reason is that the Government activities and welfare schemes are financed through collection of different types of taxes. So they would like to know, whether the business is paying appropriate taxes well in time or not.
- vii) **Researchers :** They need accounting information for the purpose of studying the financial aspects of business enterprises and their effect on the economy as a whole, so that the new policies & planning can be made.



### INTEXT QUESTIONS 1.3

- I. **Fill in the blanks:**
  - i. Accounting is the language of the \_\_\_\_\_.
  - ii. Accounting records only transactions which are of a \_\_\_\_\_ character.
  - iii. Accounting starts where \_\_\_\_\_ ends.

## MODULE - I

### Introduction and Basic Concepts



#### Notes



**MODULE - I****Introduction and  
Basic Concepts****Notes****Introduction to Accounting**

- iv. \_\_\_\_\_ is influenced by personal judgments.  
v. \_\_\_\_\_ is concerned only with the recording of business transactions.

**II. Multiple Choice Questions**

- i. Which of the following is an advantage of accounting?  
a) Personal judgements influence it.  
b) Helps in keeping systematic records.  
c) Acts as a reliable evidence.  
d) Shows permanent record of business.
- ii. Which of the following is not an advantage of Accounting?  
a) Replaces memory.  
b) Facilitates a comparative study.  
c) It permits alternative treatments.  
d) Helps in knowing the value of business.
- iii. Which of the following is a limitation of Accounting?  
a) Ascertaining value of business.  
b) It is influenced by personal judgments.  
c) It helps in ascertaining right amount of taxes.  
d) Facilitates a comparative study.
- iv. Which is a correct statement related to book-keeping?  
a) Book keeping is summarizing and analyzing of business transactions, financial in nature.  
b) Book keeping is posting transactions in the ledger.  
c) Book keeping is recording business transactions in an orderly manner.  
d) None of the above.
- v. To ascertain the operational profit or loss is:  
a) An objective of Accounting.  
b) An advantage of Accounting.  
c) A limitation of Accounting.  
d) Need of Accounting.
- vi. Book-Keeping is recording:  
a) All events affecting a business.  
b) All business transactions.  
c) Only business transactions with outsiders.  
d) Only internal business transaction.
- vii. Which of the following is not a business transaction?  
a) Purchase of goods for business.  
b) Sale of goods.  
c) Payment of sales tax.  
d) Payment of house tax belonging to owner.

## Introduction to Accounting

- viii. Which of the following is not an advantage of accounting?
- Facilitates performance comparisons.
  - Acts as reliable evidence.
  - Influenced by personal judgement
  - Replaces memory.



### WHAT YOU HAVE LEARNT

- Business undertakes a series of transactions. It is not possible to remember all the transactions which have taken place over a period of time, and calculate the net effect of all such transactions. i.e., profit or loss. Hence, the need for accounting arises.
- Information about the business enterprise is required for both internal and external use. To get the required information, a systematic record is necessary.
- Accounting is the process of identifying, measuring, recording, classifying, summarising, analysing, interpreting and communicating the results of financial transactions and events.
- The objectives of accounting are: to keep systematic records; to ascertain the profit or loss and also the financial position; and to provide accounting information to interested parties for rational decision-making.
- Book-keeping is a part of accounting. It is the record keeping function of accounting and is limited upto the classifying stage.
- Bookkeeping is largely a mechanical process and does not involve any analysis of the financial transactions whereas, accounting includes the preparation of statements concerning assets, liabilities and the operating results of a business.
- Many groups of people like owners, management, lenders, creditors, investors, tax authorities, employees, etc., are interested in the accounting information of the enterprise.
- There are many advantages of properly maintained accounting system such as it acts as reliable evidence, helps in determining tax liability. It may also lead to many limitations such as influenced by personal judgements, ignores important non-monetary informations etc.



### TERMINAL EXERCISE

- What is meant by book-keeping? State the need of book –keeping.
- Define accounting. What are its objectives?
- How is accounting information useful to Government and Investors?
- Distinguish between accounting and book- keeping.

## MODULE - I

### Introduction and Basic Concepts



### Notes

**MODULE - I****Introduction and  
Basic Concepts****Notes****Introduction to Accounting**

5. Explain the advantages and limitations of accounting.
6. What is a business transaction? Give five examples of business transactions.
7. Explain the different branches of Accounting.
8. Explain how accounting is useful to employees.

**ANSWER TO INTEXT QUESTIONS**

- 1.1 I.** i) False      ii) True      iii) True      iv) True
- II.** i) Business      ii) Business,      iii) Business,      iv) Non-business,  
v) Non-business,      vi) Non-business
- 1.2** i) True      ii) False      iii) False      iv) False
- 1.3 I.** i) Business      ii) Financial      iii) Book-keeping  
iv) Financial accounting      v) Book-keeping
- II.** i) c,      ii) c,      iii) b,      iv) c,      v) a,      vi) b,      vii) d,      viii) c.

**ACTIVITY FOR YOU**

- Visit two small business organisations and meet their Accountants and Senior Accounts officers and identify their accounts maintaining activities.

## 2

# ACCOUNTING CONCEPTS AND CONVENTIONS

In the previous lesson, you studied the meaning and objectives of Financial Accounting. There are some concepts and conventions which are followed in accounting for a long time. These concepts constitute the very basis of accounting. All the concepts have been developed over the years from experience and thus, are universally accepted rules and are termed as 'Generally Accepted Accounting Principle' or GAAP. In accounting, there are many conventions or practices which are used while recording the transactions in the books of accounts. In this lesson you will learn accounting concepts and conventions.



## OBJECTIVES

After studying this lesson, you will be able to :

- understand the meaning of the term accounting concepts;
- explain the meaning and significance of accounting concepts : Business Entity, Money Measurement, Going Concern and Dual Aspect;
- understand the meaning of the term accounting conventions and
- explain the meaning and significance of accounting conventions of Materiality, Conservatism and Consistency.

## 2.1 ACCOUNTING CONCEPTS

Accounting Concepts refer to the basic assumptions, rules and principles which work as the basis of recording of business transactions and preparing accounts.

Main Accounting Concepts are:

- Business Entity Concept
- Money Measurement Concept
- Going Concern Concept
- Dual Aspect Concept

## 2.2 BUSINESS ENTITY CONCEPT

This concept assumes that, for accounting purposes, the business enterprise and its owners are two separate entities. Thus, the business and personal transactions of its

## MODULE - I

### Introduction and Basic Concepts



Notes



## MODULE - I

### Introduction and Basic Concepts



#### Notes

## Accounting Concepts and Conventions

owner are separate, for example, when the owner invests money in the business, it is recorded as liability of the business to the owner. Similarly, when the owner takes away cash/goods from the business for his/her personal use, it is not treated as business expense. Thus, the accounting records are made in the books of accounts from the point of view of the business unit and not from the point of view of the owner.

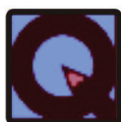
**Let us take an example,** Ms. Sakshi started business by investing ₹ 2,00,000. She purchased goods for ₹ 20,000, Furniture for ₹ 10,000, Plant and Machinery of ₹ 50,000 and ₹ 10,000 remained in hand. These are the assets of the business and not of the owner. According to the business entity concept ₹ 2,00,000 will be treated by business as capital i.e. a liability of business towards the owner of the business.

Now suppose she takes away from business ₹ 5,000 in cash and goods worth ₹5,000 for her domestic purposes. This withdrawal of cash & goods by the owner from the business are her private expenses and not the expenses of the business. These are termed as Drawings. Thus, the business entity concept states that business and the owner are two separate/distinct entities. Accordingly, any expense incurred by owner for himself/herself or for his/her family from business will not be considered as an expense but it will be treated as drawings. Since business and its owners according to this concept are treated as separate entities therefore, the transactions between these two are recorded in the books of accounts.

### Significance

The following points highlight the significance of business entity concept:

- This concept helps in ascertaining the profit of the business as only the business expenses and revenues are recorded and all the private and personal expenses are ignored.
- This concept restrains accountants from recording of owner's private/personal transactions.
- It also facilitates the recording and reporting of business transactions from the business point of view
- It is the very basis of accounting concepts, conventions and principles.



### INTEXT QUESTIONS 2.1

**Fill in the blanks with suitable word/words :**

- i. The accounting concepts are basic \_\_\_\_\_ of accounting.
- ii. \_\_\_\_\_ concept assumes that business enterprise and its owners are two separate independent entities.
- iii. The goods withdrawn from business for owner's personal use are called \_\_\_\_\_.



### 2.3 MONEY MEASUREMENT CONCEPT

This concept assumes that all business transactions must be in terms of money that is in the currency of the concerned country. In our country such transactions are in terms of rupees (₹). Thus, as per the money measurement concept, transactions which can be expressed in terms of money are recorded in the books of accounts.

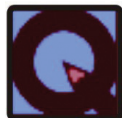
For example, sale of goods worth ₹ 1,00,000, purchase of raw materials ₹ 50,000, rent paid ₹ 20,000 etc. are expressed in terms of money, and so they are recorded in the books of accounts. But the transactions which cannot be expressed in monetary terms are not recorded in the books of accounts. For example, sincerity, loyalty and honesty of employees are not recorded in books of accounts because these cannot be measured in terms of money although they do affect the profits and losses of the business concern.

Another aspect of this concept is that the records of the transactions are to be kept not in the physical units but in the monetary unit. For example, at the end of the year 2011, an organisation may have a factory on a piece of land measuring 5 acres, office building containing 10 rooms, 20 personal computers, 30 office chairs and tables, 50 kg of raw materials etc. These are expressed in different units, but for accounting purposes these are to be recorded in money terms i.e. in rupees (₹). In this case, the cost of factory land may be say ₹ 6 crore, office building ₹ 5 crore, computers ₹ 5 lakhs, office chairs and tables ₹ 1 lakh, raw material ₹ 15 lakhs. Thus, the total assets of the organisation are valued at ₹ 11 crore and ₹ 21 lakhs. Therefore, the transactions which can be expressed in terms of money are recorded in the books of accounts and not in terms of the quantity.

#### Significance

The following points highlight the significance of money measurement concept:

- This concept guides accountants what to record and what not to record.
- It helps in recording business transactions uniformly.
- If all the business transactions are expressed in monetary terms, it will be easy to understand the accounts prepared by the business enterprise.
- It facilitates comparison of business performance of two different periods of the same firm or of the two different firms for the same period.



#### INTEXT QUESTIONS 2.2

**From the following identify the transactions that can be recorded in books of accounts and that cannot be recorded?**

- Health of a Managing Director.
- Purchase of factory building ₹ 5 crore.

## MODULE - I

### Introduction and Basic Concepts



#### Notes



**MODULE - I****Introduction and  
Basic Concepts****Notes****'Going concern' concept**

assumes a business will continue to trade for the foreseeable future	allows costs and revenues to be allocated to future accounting periods	provides a more realistic value of business assets	allows fixed assets to be written off proportionally over their useful life
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**Accounting Concepts and Conventions**

- iii. Rent paid ₹ 20,000.
- iv. Goods worth ₹ 40,000 given as charity.
- v. Delay in supply of raw materials.

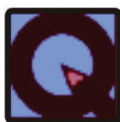
**2.4 GOING CONCERN CONCEPT**

This concept states that a business firm will continue to carry on its activities for an indefinite period of time. Simply stated, it means that every business entity has continuity of life. Thus, it will not be dissolved in the near future. This is an important assumption of accounting, as it provides a basis for showing the value of assets in the balance sheet; For example, a company purchased plant and machinery of ₹ 1,00,000 and its life span is 10 years. According to this concept every year some amount will be shown as expense and the balance amount as an asset. Thus, if an amount is spent on an item which will be used in business for many years, it is not correct to charge the amount from the revenues of the year in which the item is acquired. Only a part of the value is shown as expense in the year of purchase and the remaining balance is shown as an asset.

**Significance**

The following points highlight the significance of going concern concept:

- This concept facilitates preparation of financial statements.
- On the basis of this concept, depreciation is charged on the fixed assets.
- It is of great help to the investors, because, it assures them that they will continue to get income on their investments.
- In the absence of this concept, the cost of a fixed asset will be treated as an expense in the year of its purchase.
- Because of this concept business can be judged for its capacity to earn profits in future.

**INTEXT QUESTIONS 2.3**

**Fill in the blanks by selecting correct words given in the bracket/brackets:**

- i. Going concern concept states that every business firm will continue to carry on its activities \_\_\_\_\_ (for a definite time period, for an indefinite time period)
- ii. Fixed assets are shown in the books at their \_\_\_\_\_ (cost price, market price)
- iii. The concept that a business enterprise will not be closed down in the near future is known as \_\_\_\_\_ (going concern concept, money measurement concept)
- iv. On the basis of going concern concept, a business prepares its \_\_\_\_\_ (financial statements, bank statement, cash statement)



## Accounting Concepts and Conventions

- v. \_\_\_\_\_ concept states that business is a distinct entity from its owner.  
(Going concern, Business entity)

### 2.5 DUAL ASPECT CONCEPT

Dual aspect is the foundation or basic principle of accounting. It provides the very basis of recording business transactions in the books of accounts. This concept assumes that every transaction has a dual effect, i.e. it affects two accounts in their respective opposite sides. Therefore, the transaction should be recorded at two places. It means, both the aspects of the transaction must be recorded in the books of accounts. For example, goods purchased for cash has two aspects which are:

- (i) Giving of cash
- (ii) Receiving of goods.

These two aspects are to be recorded. Thus, the duality concept is commonly expressed in terms of fundamental accounting equation:

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

The above accounting equation states that the assets of a business are always equal to the claims of owner/owners and the outsiders. Owner's claim is also termed as capital or owner's equity and that of outsiders, as liabilities or creditors' equity.

The knowledge of dual aspect helps in identifying the two aspects of a transaction, which help in applying the rules of recording the transactions in books of accounts. The implication of dual aspect concept is that every transaction has an equal impact on assets and liabilities in such a way that total assets are always equal to total liabilities.

Let us analyse some more business transactions in terms of their dual aspect:

- i) **Capital brought in by the owner of the business** : First aspect Receipt of cash, Second aspect Increase in Capital (owner's equity).
- ii) **Purchase of machinery by cheque** : First aspect Owning of Machinery, Second aspect Reduction in Bank Balance.
- iii) **Goods sold for cash** : First aspect Receipt of cash, Second aspect, delivery of goods to the customer.
- iv) **Rent paid in cash to the landlord** : First aspect Rent (Expenses incurred), Second aspect payment of cash.

Once the two aspects of a transaction are known, it becomes easy to apply the rules of accounting and maintain the records in the books of accounts properly. The interpretation of the Dual Aspect Concept is that every transaction has an equal effect on assets and liabilities in such a way that total assets are always equal to total liabilities of the business.

## MODULE - I

### Introduction and Basic Concepts



#### Notes



## MODULE - I

### Introduction and Basic Concepts



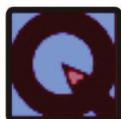
Notes

## Accounting Concepts and Conventions

### Significance

The following points highlight the significance of Dual Aspect Concept

- This concept helps the accountant in detecting errors.
- It encourages the accountant to post each entry in opposite sides of two affected accounts.
- It helps in preparing the Financial Position Statement/ Balance Sheet on a particular date.



### INTEXT QUESTIONS 2.4

Write the two aspects (effects) of the following transactions :

S.No.	Transaction	Ist aspect	IInd aspect
i.	Owner brings cash in business		
ii.	Goods purchased for cash		
iii.	Goods sold for cash		
iv.	Furniture purchased for cash		
v.	Received cash from Sharma		
vi.	Purchased machine from Rama on credit		
vii.	Paid to Ram		
viii.	Salaries paid		
ix.	Rent paid		
x.	Commission received		

### 2.6 MEANING OF ACCOUNTING CONVENTIONS

Accounting conventions refer to common practices which are universally followed in recording and presenting accounting information of the business entity. These are followed like customs, traditions etc. in a society. Accounting conventions are evolved through the regular and consistent practice over the years to facilitate uniform recording in the books of accounts. Accounting conventions help in comparing accounting data of different business units or of the same unit for different periods. These have been developed over the years. The most important conventions which have been used for a long time are:

- Convention of Consistency.
- Convention of Materiality.
- Convention of Conservatism.

### 2.7 CONVENTION OF CONSISTENCY

The convention of consistency means that same accounting principles should be used

## Accounting Concepts and Conventions

for preparing financial statements year after year. A meaningful conclusion can be drawn from financial statements of the same enterprise when there is a comparison between them over a period of time. But this can be possible only when accounting policies and practices followed by the enterprise are uniform and consistent over a period of time. If different accounting procedures and practices are used for preparing financial statements of different years, then the result will not be comparable. Generally a businessman follows the same general practices or methods year after year, for preparing the books of accounts.

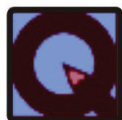
While charging depreciation on fixed assets or valuing unsold stock, once a particular method is used, it should be followed year after year. So that the financial statements can be analysed and compared provided that, the depreciation on fixed assets is charged or unsold stock is valued by using same method year after year. This can be further clarified in case of charging depreciation on fixed assets, accountant can decide to adopt any one method of depreciation such as diminishing value method or straight line method. Similarly, in case of valuation of closing stock it can be valued at actual cost price or market price, whichever is less. However, precious metals like gold, diamond, minerals are generally valued at market price only.

Therefore, as per this convention the same accounting methods should be adopted every year in preparing financial statements. But it does not mean that a particular method of accounting once adopted can never be changed. Whenever a change in method is necessary, it should be disclosed by way of footnotes in the financial statements of that year.

### Significance

The following points highlight the significance of Convention of Consistency

- It facilitates comparative analysis of the financial statements.
- It ensures uniformity in charging depreciation on fixed assets and valuation of closing stock.



### INTEXT QUESTIONS 2.5

Fill in the blanks with suitable word/words:

- i. Convention of consistency means that same accounting principles should be followed for preparing financial statements \_\_\_\_\_.
- ii. Unsold goods are valued at cost price or \_\_\_\_\_ whichever is \_\_\_\_\_.
- iii. Precious metals, like gold, silver etc. are generally valued at \_\_\_\_\_.

## MODULE - I

### Introduction and Basic Concepts



### Notes

**MODULE - I****Introduction and  
Basic Concepts****Notes****Accounting Concepts and Conventions**

- iv. As per the convention of \_\_\_\_\_ year after year same methods of valuation of assets is followed.

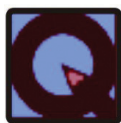
**2.8 CONVENTION OF MATERIALITY**

The convention of materiality states that, to make financial statements meaningful, only material fact i.e. important and relevant information should be supplied to the users of accounting information. The question that arises here is what is a material fact? The materiality of a fact depends on its nature and the amount involved. Material fact refers to the information that will influence the decision of its user. For example, a businessman is dealing in electronic goods. He purchases T.V., Refrigerator, Washing Machine, Computer etc. for his business. In buying these items he uses larger part of his capital. These items are significant items; thus should be recorded in books of accounts in detail. At the same time to maintain day to day office work he purchases pen, pencil, match box, scented stick, etc. For this he will use very small amount of his capital. But to maintain the details of every pen, pencil, match box or other small items is not considered of much significance. These items are insignificant items and hence they should be recorded separately. Thus, the items that are significantly important in recording the details are termed as material facts or significant items. The items that are of less significance are immaterial facts or insignificant items. Thus, according to this convention important and significant items should be recorded in their respective heads and all immaterial or insignificant transactions should be clubbed under a different accounting head.

**Significance**

The following points highlight the significance of Convention of Materiality

- It helps in minimising errors in calculation.
- It helps in making Financial Statements more meaningful.
- It saves time and resources.

**INTEXT QUESTIONS 2.6**

**Fill in the blanks with suitable word/words :**

- i. \_\_\_\_\_ convention states that to make financial statements more meaningful, only significant and important items should be supplied to the users.
- ii. Convention of materiality states that insignificant items should be disclosed under \_\_\_\_\_ .

## Accounting Concepts and Conventions

- iii. \_\_\_\_\_ convention keeps accountants and manager to focus on important/significant items.
- iv. \_\_\_\_\_ means the information which will influence the decision.

### 2.9 CONVENTION OF CONSERVATISM

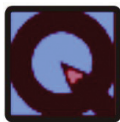
This convention is based on the principle that **“Anticipate no profit, but provide for all possible losses”**. It provides guidance for recording transactions in the books of accounts. It is based on the policy of playing safe in regard to showing profit. The main objective of this convention is to show minimum profit. Profit should not be overstated. If more profit is shown than the actual, it may lead to distribution of dividend out of capital. This is not a fair policy and it will lead to the reduction in the capital of the enterprise.

Thus, this convention clearly states that profit should not be recorded until it is earned. But if the business anticipates any loss in the near future, provision should be made in the books of accounts for the same. For example, valuing closing stock at cost or market price whichever is lower, creating provision for doubtful debts, discount on debtors, writing off intangible assets like goodwill, patent, etc. The convention of conservatism is a very useful tool in situation of uncertainty and doubts.

#### Significance

The following point highlight the significance of convention of conservatism

- It helps in ascertaining actual profit.
- It is useful in the situation of uncertainties and doubts.
- It helps in maintaining the capital at its real value.



#### INTEXT QUESTIONS 2.7

##### I. Give your decision in the following situations :

- (i) A business has unsold stock at the end of year. The cost price is ₹20,000 and its market price is ₹25,000. At which price the unsold stock should be recorded?
- (ii) What is your decision if the cost price in the above case is ₹21,000 ?
- (iii) A businessman anticipates that it may not be possible to collect ₹5,000 from one of his debtors. Will he record this transaction in books of account?

## MODULE - I

### Introduction and Basic Concepts



#### Notes

**MODULE - I****Introduction and  
Basic Concepts****Notes****Accounting Concepts and Conventions****II. Multiple Choice Questions**

- i. According to going concern concept, a business is viewed as having:
  - a) a limited life
  - b) a very long life
  - c) an indefinite life
  - d) a long life
- ii. Valuation of stock at lower of cost or net realizable value is an example of
  - a) Consistency convention
  - b) Conservation convention
  - c) Materiality convention
  - d) None of the above
- iii. According to which of the following concepts the two aspects of a transaction are recorded.
  - a) Matching concept
  - b) Money Measurement concept
  - c) Dual aspect concept
  - d) Realisation concept
- iv. According to which of the following accounting concepts, even the owner of a business is considered as creditor to the extent of his capital.
  - a) Money measurement concept
  - b) Dual aspect concept
  - c) Business entity concept
  - d) Realisation concept
- v. The convention of conservatism takes into account
  - a) All prospective losses but leaves prospective profits
  - b) All prospective profits & leaves prospective losses
  - c) All prospective profits and prospective losses
  - d) Leaves all prospective profits and prospective losses

**WHAT YOU HAVE LEARNT**

- An accounting concept refers to the basic assumptions which serve the basis of recording actual business transactions.
- The important accounting concepts are business entity, money measurement, going concern, dual aspect concept.

## Accounting Concepts and Conventions

- Business entity concept assumes that for accounting purposes, the business enterprise and its owner(s) are two separate entities.
- Money measurement concept assumes that all business transactions must be recorded in the books of accounts in terms of money.
- Going concern concept states that a business firm will continue to carry on its activities for an indefinite period of time.
- Dual aspect concept states that every transaction has a dual effect.
- Accounting conventions are common practices which are followed in recording and presenting accounting information of business.
- Convention of consistency states that the same accounting methods should be adopted every year in preparing financial statements.
- Convention of materiality states that, to make financial statements more meaningful only significant information should be shown in the financial statements.
- Convention of conservatism states that, profit should not be recorded until it is earned. But if business anticipates any loss in near future, provision for it should be made in the books of accounts.



### TERMINAL EXERCISE

1. Explain the meaning and significance of going concern concept.
2. What is meant by business entity concept?
3. State the meaning and significance of money measurement concept.
4. What do you mean by accounting concept? Explain any four accounting concepts.
5. Explain the convention of consistency with the help of an example.
6. Explain the accounting convention of conservatism with example.
7. Explain the convention of materiality.
8. State the meaning and significance of dual aspect concept.



### ANSWER TO INTEXT QUESTIONS

- 2.1** i) Rules ii) Business Entity      iii) Drawings
- 2.2** i) not recorded ii) recorded iii) recorded iv) recorded v) not recorded
- 2.3** i) for an indefinite time period ii) cost price iii) going concern concept  
iv) financial statements v) Business Entity

## MODULE - I

### Introduction and Basic Concepts



### Notes



**MODULE - I****Introduction and  
Basic Concepts****Notes****Accounting Concepts and Conventions**

- 2.4** i) Cash, Owner's capital ii) Goods received, cash  
 iii) Cash received, goods sold iv) Furniture, cash  
 v) Cash, Sharma vi) Machine, Rama  
 vii) Ram, cash viii) Salaries, cash  
 ix) Rent, cash x) Cash, Commission
- 2.5** i) Year after year ii) Market Price, Less  
 iii) Market Price iv) Consistency
- 2.6** i) Materiality ii) Different Accounting Heads  
 iii) Materiality iv) Materiality
- 2.7** **I.** i) ₹ 20,000 ii) ₹ 21,000 iii) yes  
**II.** i) c ii) b iii) c iv) c v) a

**ACTIVITY FOR YOU**

- Enquire from various Business Entities and list various accounting periods in which these entities are not following same accounting practices.



# 3

## ACCOUNTING TERMS

Every subject has certain important basic terms, and Accountancy is no exception. These terms facilitate the understanding of the subject. Hence, this lesson has been designed to acquaint you with the knowledge of some important basic accounting terms. The entire structure of Accounting rests upon these terms. The terms, that we frequently use, are Assets, Liabilities, Revenue and Expenses.



### OBJECTIVES

After studying this lesson, you will be able to :

- define various accounting terms such as Capital, Drawings, Assets, Liability, Revenue, Expenditure, Expense, Profit, Losses, Purchases, Sales, Stock, Debtors, Creditors, Receivables, Payables, Debit, Credit etc. and
- identify these terms through case study.

### 3.1 ACCOUNTING TERMINOLOGY

One should be well aware of the various terms used in accounting so as to feel comfortable with various aspects of accounting and make it clear and understandable.

**Capital :** This is the amount invested by the owners in the business. It is also called as owner's equity. Owner's equity is the owner's stake in the business. It shows how much is his investment in the assets of the business.

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

**Assets :** Any thing that is owned by an individual or business and which can be valued in terms of money is called an asset. In other words, any thing which will enable the firm to get cash or a benefit in future is an asset. For example land, building, machinery, furniture, stock, debtors, bank balance and cash etc.

#### Classification of Assets

i) **Fixed Assets :** The assets which are acquired not for resale but with the

## MODULE - I

### Introduction and Basic Concepts



#### Notes



## MODULE - I

### Introduction and Basic Concepts



Notes



## Accounting Terms

purpose to increase the earning capacity of the business by employing them. For example - land, building, machinery, computer, furniture, vehicles, live stock etc.

- ii) **Current Assets** : Current Assets are those assets which are retained in the business with the purpose to convert them into cash within a short period of time say one year. For example - cash in hand, bills receivables, debtors, stock (goods) etc.
- iii) **Tangible Assets** : The assets which can be seen and touched or have physical existence. For example - building, machinery, furniture, computer etc.
- iv) **Intangible Assets** : The assets which cannot be seen and touched or which do not have physical existence. For example - goodwill, trade mark, patents etc.
- v) **Wasting Assets** : Wasting assets are those assets which are natural resources extracted and consumed as a raw material or otherwise. For example - mines, quarries, oil wells etc.

**Liability** : The assets of a business concern are financed by the funds supplied by the proprietors and outsiders. Money is invested by the proprietor to start his business. Money is also borrowed from others and invested in business. With this money assets are purchased. So the proprietor and outsiders have a claim against the assets of the business. This claim of the proprietor and outsiders is termed as 'Liabilities'. In other words, any amount which the firm owes to the proprietors and outsiders is liability for the business unit. Hence, liabilities are the obligations or debts payable by the business unit in future.

Liabilities have been classified as:

- i) External Liabilities
- ii) Internal Liabilities

### i) External Liabilities

External liabilities are those liabilities which the business owes to the outsiders for goods purchased on credit, for expenses or for loans taken. For example :

**Creditors for goods** : Sundry creditors, bills payable

**Creditors for expenses** : Expenses yet to be paid like outstanding salaries, wages outstanding, rent due but not yet paid.

**Creditors for loans** : Bank loan, Bank overdraft, partners loan, loans taken from other outsiders.

### ii) Internal liabilities

Internal liabilities are those liabilities which the business owe to the owners

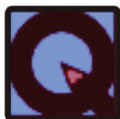
## Accounting Terms

or proprietors. It is the proprietor's claim against the assets of the business. The Business Entity Assumption states that business is separate from its owners. Any amount contributed by the owner towards the business concern is a liability for the business concern. This liability is also termed as Capital. Hence, the owner's claim against the assets of the business unit is called as capital. In case of one man business or sole proprietorship the capital is contributed by the proprietor himself. In case of partnership business firm, capital is contributed by the partners, and in case of companies, capital is contributed by the shareholders. Owners of the business are those who contribute capital. They get profit of the business, for the risk taken by them. So, the owners have a claim against the firm which is a liability for the firm.

Owner's claim can be expressed as:

- a) Capital
- b) Interest on Capital (unpaid)
- c) Profits of the business (undistributed)
- d) Reserves.

Hence, capital is also a liability for the business unit.



### INTEXT QUESTIONS 3.1

#### I. Fill in the blanks with suitable words :

- i. Outsider's and owner's claim against the assets of the firm is called \_\_\_\_\_.
- ii. Liabilities are classified into two categories \_\_\_\_\_ and \_\_\_\_\_.
- iii. Owner's claim is \_\_\_\_\_ liability.
- iv. Outsider's claim is \_\_\_\_\_ liability.
- v. Owner's claim against the assets of the business is also called as \_\_\_\_\_.

#### II. Classify the following items into external and internal liabilities :

- i. Bank loan
- ii. Interest on capital (unpaid)
- iii. Capital
- iv. Sundry Creditors
- v. Outstanding rent
- vi. Undistributed Profits
- vii. Bills Payable
- viii. Bank Overdraft
- ix. Salaries due but not paid
- x. Reserves

## MODULE - I

### Introduction and Basic Concepts



#### Notes



**MODULE - I****Introduction and  
Basic Concepts****Notes****Accounting Terms**

**Revenue :** Revenue refers to the inflow of money or other assets that results from the sale of goods or services or from the use of money. It is the amount realized or receivable from the sale of goods. Amount received from sale of assets or borrowing loan is not revenue. In broader sense, revenue is also used to mean receipt of rent, commission, discount, etc. Such inflows should be regular in nature and should be concerned with the day-to-day affairs of the business. It should be calculated in the period in which it is earned or realized. For example, sale of goods, rent received, interest on investment received, etc.

Revenue should not be confused with income. Income is the difference between revenue and expense.

**Expenses :** Let us consider an example before we understand meaning of expense. Rakesh has a textile mill. He purchases raw cotton and converts it into cloth. For this purpose, he has engaged employees to whom he pays daily wages. He also has a showroom where he sells the cloth that he produces. He has three salesman to whom he pays salaries. In order to sell his product he has given advertisements in the newspapers and television. He has done all this to earn profits. For Rakesh, cost of raw cotton, wages, salaries and advertisement cost are all expenses which he has incurred in order to earn revenue. All costs incurred in earning revenue is called as expense. It refers to the cost which is incurred in acquiring an asset or service, e.g. transportation cost incurred in transferring the raw cotton from the village to the factory. It is the amount spent in order to produce and sell the goods and services to earn the revenue, for example, cost of raw material, carriage, wages, insurance premium, rent paid for office, etc.

**Expenditure:** Expense may be different from expenditure. Expenditure is generally the amount spent for the purchase of assets. It increases the profit earning capacity of the business, for example, furniture purchased, machines purchased, etc. Expense, on the other hand, is an amount to earn revenue. Some examples of expenses are the payments made for rent, wages, salaries, etc.

It can also be said that expenditure is considered as capital expenditure unless it is qualified with words like revenue expenditure on rent, salaries, etc. while expense is always considered as a 'revenue expense' because it is always incurred to earn revenue.

**Profit :** It is the excess of business revenue over the business expenses for a period. It is an addition to the owner's equity.

**Losses :** It is the decrease in the value of net assets. It is the excess of business expenses incurred over the business revenue earned during the year. It decreases the owners equity.

## Accounting Terms

**Purchases :** Purchases always refer to purchases of merchandise. Purchases means the purchases of such goods and services in which a firm deals. Purchases of cars for an automobile dealer are purchases. For any other firm it is not a purchase.

**Sales :** It means exchange of such goods and services for money in which the firm deals in. One of the most important objective of a business is to make profit. This objective is achieved by selling goods and services at a price higher than their cost.

**Stock :** It means, in case of a trader, all the goods or merchandise that he has for sale in the ordinary course of business. In case of a manufacturer, stock may consist of:

- (a) Raw-material to be used for manufacturing goods;
- (b) Semi-finished products or goods (i.e., raw-material in the process of manufacturing and which has not yet been finished and which is not yet fit for sale or subsequent use);
- (c) Finished products or goods.

The goods meant for sale in case of a trader and raw material/semi-finished goods/finished products for sale in case of a manufacturer are stock-in-trade or inventory.

**Receivables :** In addition to debtors there may be some other persons also who owe money to the business. They are called receivables. This includes Bills Receivables also.

**Payables :** In addition to creditors there may be some other persons to whom the business owes money. This includes Bills Payables also. These are called payables.

**Debtor and Creditor :** The two other terms which are quite often used in the recording of transactions are 'debtor' and 'creditor'. A thorough understanding of these terms is very essential.

A debtor is a person *who owes* money. A creditor is a person *to whom* money is *owing*. A person becomes a debtor when he receives some benefit. It may be in the form of money, goods, or services. A person becomes a creditor when he yields (gives) some benefit.

Example – Ram sells goods to Dass on credit.

From the point of view of Ram, Dass is a debtor, as Dass is receiving a benefit in the form of goods.

From the point of view of Dass, Ram is a creditor, as Ram is yielding a benefit in the form of goods.

## MODULE - I

### Introduction and Basic Concepts



### Notes

**MODULE - I****Introduction and  
Basic Concepts**

Notes

**Accounting Terms**

**Debit and Credit :** You should observe that every business transaction involves a debit and a credit. The debit amounts are equal to credit amounts. This practice of having equal debits and credits is called Double Entry Book-keeping. Under this system every transaction has two aspects - as debit aspect and credit aspect and at the time of recording a transaction, both these aspects are recorded.

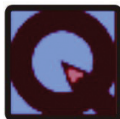
**3.2 CASE STUDY**

Jay started a business with cash ₹ 2,00,000 on 1.4.2012. He opened a bank account by depositing ₹ 50,000 on the same date. On 2.4.2012 he obtained a loan of ₹ 1,00,000 from SBI. On 3.4.2012 he purchased goods of ₹ 70,000 from Ravi on credit. On the same date he gave a bills payable to Ravi which will become due after two months. On 12.4.2012 the machinery purchased from M/s Kailash Stores on credit for ₹ 50,000. On 13.4.2012 he sold goods for cash ₹ 12,000 and on credit to Ram ₹ 9,000. On the basis of your knowledge about basic accounting terms identify the accounting terms involved in the above transaction of Jay.

**Solution**

On the basis of above case study the following accounting terms can be identified:

	₹
Capital	2,00,000
Bank Balance	1,50,000
Loan (Liability)	1,00,000
Ravi Creditor (Liability)	70,000
Bills Payable (In lieu of Ravi Creditor liability)	70,000
Machinery (Assets)	50,000
Kailash Stores (Liability)	50,000
Sales (Revenue)	21,000
Cash (Assets)	12,000
Ram (Debtor)	9,000

**INTEXT QUESTIONS 3.2****I. Fill in the blanks with suitable words :**

- i. Inflow of money from sale of goods is called as \_\_\_\_\_ .
- ii. Outflow of money to earn profit is called as \_\_\_\_\_ .
- iii. Expense is incurred in order to earn \_\_\_\_\_ .
- iv. Money spent in order to purchase assets is called \_\_\_\_\_ .

**II. From the following identify revenues, expenses and expenditure.**

- i. Rent Received

## Accounting Terms

- ii. Salaries Paid
- iii. Cost of Raw Material
- iv. Furniture Purchased
- v. Commission Received
- vi. Insurance Premium Paid
- vii. Machines Purchased
- viii. Advertising

### III. Classify the given items into assets, liabilities, capital, revenue and expense.

- i. Stock-in-hand
- ii. Rent Paid
- iii. Advertising
- iv. Creditors
- v. Outstanding Expense (rent)
- vi. Interest Received
- vii. Capital Introduced
- viii. Furniture and Fittings
- ix. Insurance Premium Prepaid
- x. Commission Received in Advance
- xi. Debtors
- xii. Dividend Received
- xiii. Cash at bank
- xiv. Salaries Paid
- xv. Discount Received
- xvi. Land and Building

### IV. Multiple Choice Questions

- i. Capital is the
  - a) Amount invested in business by people other than the owner.
  - b) Amount invested by the owners in the business.
  - c) Loan obtained by the business from bank.
  - d) Loan obtained by business from government.
- ii. The accounting equation states that
  - a) Assets are equal to capital plus liabilities.
  - b) Assets are equal to capital minus liabilities.
  - c) Liabilities are equal to capital plus assets.
  - d) Capital minus liabilities is equal to assets.
- iii. Out of the following which is not an external liability of the business:
  - a) Outstanding rent
  - b) Bank loan
  - c) Capital
  - d) Outstanding salary.

## MODULE - I

### Introduction and Basic Concepts



### Notes



**MODULE - I****Introduction and  
Basic Concepts****Notes****Accounting Terms**

- iv. Out of the following which is an item of expenditure.
- Rent paid
  - Commission paid
  - Goods purchased
  - Furniture purchased
- v. Out of the following which is not an item of revenue:
- Sale of goods.
  - Rent received.
  - Sale of old furniture.
  - Commission received.

**WHAT YOU HAVE LEARNT**

- Capital : Amount invested by the owner(s) in the business:
- Drawing : Amount of cash or goods taken away by the owner for personal use.
- Liability : Obligations of the business.
- External Liabilities : Obligations or amount which the business owes to outsiders.
- Revenue : Inflow of money as a result of sale of goods or providing of services.
- Expense : Cost incurred in earning revenue.
- Expenditure : Amount spent for purchase of assets.
- Profit : Excess of revenue over expense.
- Loss : Excess of expense over revenue.
- Purchases : Acquisition of such goods or services in which the business deals.
- Sale : Exchange of merchandise either for cash or on credit to customer.
- Stock : Value of merchandise available for sale, work in progress in the manufacturing process, raw material.
- Debtors : Customers to whom goods have been sold on credit & from whom payment is to be received.
- Creditors : Suppliers of goods from whom goods have been purchased on credit and to whom payment is to be made.

**TERMINAL EXERCISE**

1. Define the following terms:
  - Capital
  - Drawings

## Accounting Terms

- iii. Debtors
- iv. Creditors
2. Define liability, revenue & expense.
3. What is meant by Double Entry Book Keeping?
4. Give any five examples of external liabilities.
5. With the help of examples give the meaning of internal and external liabilities.
6. Give two examples each of the following:
  - i. Creditors for goods;
  - ii. Creditors for expenses;
  - iii. Creditors for loans.



## ANSWER TO INTEXT QUESTIONS

- 3.1 I.** i) liability      ii) external, internal      iii) internal  
 iv) external      v) owner's equity/capital
- II.** i) external      ii) internal      iii) internal      iv) external  
 v) external      vi) internal      vii) external      viii) external  
 ix) external      x) internal
- 3.2 I.** i) revenue      ii) expense      iii) profit      iv) expenditure
- II.** i) revenue      ii) expense      iii) expense      iv) expenditure  
 v) revenue      vi) expense      vii) expenditure      viii) expense
- III.** i) asset      ii) expense      iii) expense      iv) liability  
 v) liability      vi) revenue      vii) capital      viii) asset  
 ix) asset      x) liability      xi) asset      xii) revenue  
 xiii) asset      xiv) expense      xv) revenue      xvi) asset
- IV.** i) b      ii) a      iii) c      iv) d      v) c

## ACTIVITY FOR YOU

- Visit a business organization in a nearby area and identify the different terms which you have studied in this chapter.

## MODULE - I

### Introduction and Basic Concepts



### Notes

## Success Stories



**Kavya Madhavan**  
**Enrolment No. 090008103065**

Kavya Madhavan is a highly acclaimed actress in the Malayalam film world. Making her debut as a child artiste, Kavya quickly managed to find a place in the hearts of Malayalees. However, all this was at the cost of dropping out of school at the Secondary level. Like many others, she too nurtured a dream of acquiring a college degree. Motivated to join the National Institute of Open Schooling (NIOS), Kavya Madhavan appeared for the Senior secondary level examination in Malayalam medium and emerged successful. But this was not achieved easily, she says.

Thanks to the Open Schooling system, Kavya Madhavan has now registered for B.Com in M.G. University, Kottayam, Kerala.



**Ganesh**  
**Enrolment No. Secondary Course: 25001292005**  
**Senior Secondary Course: 250012103570**

Ganesh has cleared the Secondary course of NIOS with first division and has now appeared in 4 subjects of Senior Secondary course. What differentiates Ganesh from other students is that he is suffering from a non-healing ulcer of bone infection. There is no treatment for his ailment; his lower part below the belt has not grown. The puss leaks from his body continuously. He cannot move, and even has no sensation in the lower part of his body. He has to be carried to be moved from one place to another.

However, support from his family members and the Chief Commissioner of Disabilities facilitated his enrollment as a student under Sarva Shiksha Abhiyan as a private candidate, thereby enabling him to clear Class 5 and Class 8. It was at this point that NIOS came to his rescue by providing the flexibility of studying at his own pace through credit accumulation. He could also study subjects of his own choice and was further allowed to appear for the examination in his house. UT Chandigarh continued to support him by providing him with the facility of tutors, who taught him Maths and Science.

With a keen interest in religion, he has read about the various *Puranas*, *Ramayana* etc., from which he has derived a lot of internal strength.

Ganesh is certainly determined to study further and wishes to pursue a course in Computer Science after clearing his Senior Secondary course from the NIOS.

## MODULE - II

Maximum Marks

25

Hours of Studies

60

### Journal and Other Subsidiary Books

This module will help the students to understand the rules of Debit and Credit and develop the skill of applying these rules in recording the transactions in journal and other subsidiary books. It will also help them in preparing the different subsidiary books such as Cash Book, Purchase Book, Sales Book, Purchase Return Book and Sales Return Book.

- Lesson 4** : **Accounting Equation**
- Lesson 5** : **Double Entry System**
- Lesson 6** : **Journal**
- Lesson 7** : **Cash Book**
- Lesson 8** : **Bank Reconciliation Statement**
- Lesson 9** : **Purchase and Sales Book**

## MODULE - II

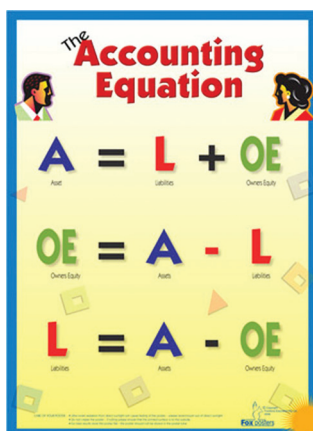
### Journal and Other Subsidiary Books



Notes

4

# ACCOUNTING EQUATION



You have already studied about Dual Aspect Concept and the various basic Accounting terms viz Assets, Liabilities, Capital, Expenses and Revenue. According to this concept, every transaction affects the business in two ways by the same amount. Suppose, a businessman starts his business with ₹ 3,00,000. In the books of accounts, ₹3,00,000 will be recorded as an asset (Cash) and equivalent amount will be shown as liability towards the owner. In this example, you have noted that assets are equal to liabilities. We can present it in mathematical form as **Assets = Liabilities** this mathematical expression is called Accounting Equation.

Every transaction has its effect on the Accounting equation in such a manner that both sides remain equal. Now, we shall take different business transactions and see their subsequent effect on the accounting equation.



## OBJECTIVES

After studying this lesson, you will be able to :

- state the meaning of accounting equation;
- appreciate the importance of accounting equation;
- point out the effect of each aspect of a transaction on the accounting equation;
- establish that assets are equal to liabilities and capital and
- prepare accounting equation from given transactions.

## 4.1 ACCOUNTING EQUATION

The recording of business transaction in books of accounts is based on a fundamental equation called Accounting Equation. *Whatever business possesses in the form of assets is financed by proprietor or by outsiders.* This equation expresses the equality of assets on one side and the claims of outsiders (liabilities) and owners or proprietors (capital) on the other side. Thus, an Accounting Equation is a mathematical expression which shows that the assets and liabilities of a firm are equal. In Mathematical form,

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

## Accounting Equation

Whenever an asset is introduced in the business, a corresponding liability also appears. A business does not have any amount of its own. Hence, we can say that

Business owns Nothing, And Owes Nothing, (In simple words it can be said that on a particular date any business does not have neither any liability nor any asset of its own)

### What it owns and what it owes ?

Let us see the effect of business transactions on Accounting equation. These transactions increase or decrease the assets, liabilities or capital. Every business has certain assets. For example, Sunita started business by contributing ₹2,00,000 as capital. It can be said that asset in the form of Cash has been created for the business concern.

$$\begin{array}{rclcl} \text{Hence,} & \text{Cash} & = & \text{Capital} & \\ & ₹2,00,000 & = & ₹2,00,000 & \end{array}$$

Sunita later on purchases furniture for ₹20,000 and machinery for ₹60,000. Now the position of the assets is as follows:

$$\begin{array}{rclclcl} \text{Capital} & = & \text{Cash} & + & \text{Furniture} & + & \text{Machinery} \\ 2,00,000 & = & 1,20,000 & + & 20,000 & + & 60,000 \\ & & (2,00,000 - 80,000) & & & & \end{array}$$

From the above business transactions, we find that

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

Or

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

Increase or decrease in capital will result in the corresponding increase or decrease in assets. For example, Sunita introduces ₹50,000 as additional capital. Then

$$\begin{array}{rclclcl} \text{Capital} & = & \text{Cash} & + & \text{Furniture} & + & \text{Machinery} \\ 2,00,000 & = & 1,20,000 & + & 20,000 & + & 60,000 \\ + 50,000 & & + 50,000 & & & & \\ \hline 2,50,000 & = & 1,70,000 & + & 20,000 & + & 60,000 \end{array}$$

Every business concern, generally borrows money from outsiders in order to carry on its activities. In other words, every business concern owes money to outsiders. The assets are financed by the funds supplied by proprietors and outsiders. Money borrowed from outsiders is called liability.

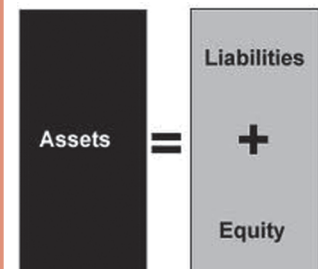
For example, Sunil started business by investing ₹5,00,000 and borrowed from Ajay ₹1,00,000. Hence the amount of asset (cash) is ₹6,00,000. The accounting equation of these two transactions will be :

## MODULE - II

### Journal and Other Subsidiary Books



### Notes

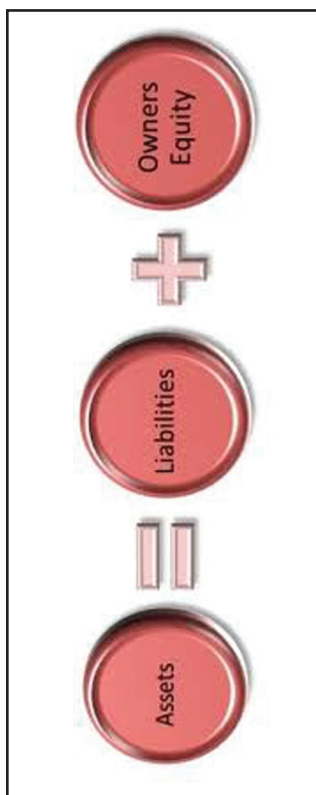


## MODULE - II

### Journal and Other Subsidiary Books



#### Notes



### Accounting Equation

$$\begin{array}{rclcl} \text{Asset (cash)} & = & \text{Capital} & + & \text{Liability (Loan from Ajay)} \\ 6,00,000 & = & 5,00,000 & + & 1,00,000 \end{array}$$

The fact that business receives funds from proprietors and creditors and retains all of them in the form of various assets, it can be presented in terms of an equation as

$$\begin{array}{rclcl} \text{Assets} & = & \text{Capital} & + & \text{Liabilities} & \text{or} & A = C + L \\ \text{Liabilities} & = & \text{Assets} & - & \text{Capital} & \text{or} & L = A - C \\ \text{Capital} & = & \text{Assets} & - & \text{Liabilities} & \text{or} & C = A - L \end{array}$$

Let us consider some more examples :

Rahul started business by introducing ₹3,00,000 as capital. He also invested ₹2,00,000 which he borrowed from Shweta.

$$\begin{array}{rclcl} \text{Assets} & = & \text{Capital} & + & \text{Liabilities (Loan from Shweta)} \\ 5,00,000 & = & 3,00,000 & + & 2,00,000 \end{array}$$

He purchases goods for cash ₹50,000

$$\begin{array}{rclcl} & \text{Assets} & = & \text{Capital} & + & \text{Liabilities} \\ & \text{Cash} + \text{Goods} & & & & \\ \text{Old equation} & 5,00,000 & = & 3,00,000 & + & 2,00,000 \\ \text{effect of} & (-)50,000 + 50,000 & = & 0 & & \\ \text{transaction} & & & & & \end{array}$$

---


$$\text{New Equation } 4,50,000 + 50,000 = 3,00,000 + 2,00,000$$


---

He paid Shweta ₹50,000

$$\begin{array}{rclcl} & \text{Assets} & = & \text{Capital} & + & \text{Liabilities} \\ & \text{Cash} + \text{Goods} & & & & \\ \text{Old equation} & 4,50,000 + 50,000 & = & 3,00,000 & + & 2,00,000 \\ \text{effect of} & (-) 50,000 + 0 & = & 0 & & (-)50,000 \\ \text{transaction} & & & & & \end{array}$$

---


$$\text{New Equation } 4,00,000 + 50,000 = 3,00,000 + 1,50,000$$


---

In the above example, expenses and revenue have not been considered. They also affect the accounting equation.

Every business concern has to meet certain expenses in its day-to-day operations such as payment of salaries, rent, insurance premium, postage, wages, repairs of machines, etc. These expenses are paid regularly. All expenses reduce the cash balance as they are paid in cash. These expenses reduce the net income of the business. As the net income is the income of proprietor, which is represented by the capital account, so all expenses are deducted from the Capital account.

Similarly, every business concern receives certain revenues during its day to day operations, such as rent received, commission received, etc. Revenue is



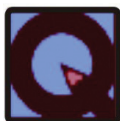
## Accounting Equation

added to the cash balance as it is received in terms of cash. Revenue increases the net income of the business and hence, it is added to the capital account.

Now, the Accounting Equation is represented by

$$\begin{array}{rclcl} \text{Assets} & = & \text{Capital} & + & \text{Liabilities} \\ + \text{ revenue (cash)} & & + \text{ revenue} & & \\ - \text{ expenses (cash)} & & - \text{ expenses} & & \end{array}$$

Accounting equation is thus, affected by every business transaction. Any increase or decrease in assets, liabilities and capital can be identified by preparing accounting equation. It also shows that every business transaction satisfies the dual aspect concept of accounting. It also serves as a basis for preparing the Balance Sheet is also called as balance sheet equation.



### INTEXT QUESTIONS 4.1

#### I. Fill in the blanks with correct words :

- i. Accounting equation is also called as \_\_\_\_\_ equation.
- ii. Asset = \_\_\_\_\_ + Liabilities
- iii. Accounting equation satisfies the \_\_\_\_\_ concept of accounting.
- iv. Accounting equation serves as a basis for preparing \_\_\_\_\_.
- v. Capital = Assets - \_\_\_\_\_
- vi. Liabilities = \_\_\_\_\_ - Capital.

#### II. Multiple Choice Questions

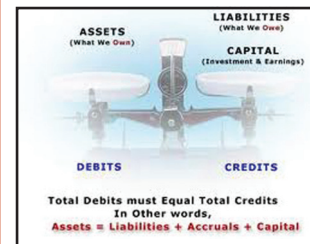
- i. In accounting equation, assets are equal to
  - a. Capital only
  - b. Capital + Liabilities
  - c. Capital – Liabilities
  - d. Liabilities – Capital
- ii. Which of the following lists is a list of assets only?
  - a. Cash, Stock, Debtors, Machinery
  - b. Cash, Creditors, Loan
  - c. Capital, Furniture, Bill payable
  - d. Capital, Prepaid Expenses, Outstanding Expenses
- iii. Which of the following lists is a list of liabilities only?
  - a. Cash, Stock, Debtors
  - b. Cash, Loan, Creditors
  - c. Creditors, Loan, Bank Overdraft, Bills Payable
  - d. Prepaid Rent, Salary, Outstanding Bills receivables

## MODULE - II

### Journal and Other Subsidiary Books



#### Notes

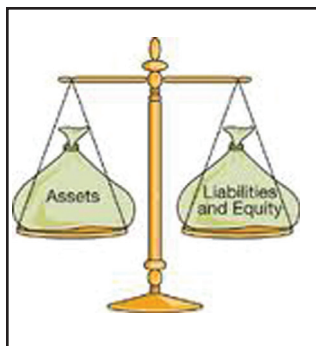


## MODULE - II

### Journal and Other Subsidiary Books



Notes



## Accounting Equation

### 4.2 EFFECT OF TRANSACTIONS ON ACCOUNTING EQUATION

You have learnt that assets, liabilities and capital are the three basic elements of every business transaction, and their relationship is expressed in the form of accounting equation which always remains equal at any point of time, there can be a change in the individual assets, liability or capital, but the two sides of the accounting equation always remain equal. Let us examine this fact by taking up some more transactions and see how these transactions affect the accounting equation.

Suppose, Rajni starts her business and the following transactions take place:

1. She started business with cash ₹5,00,000 introduced as capital.

	Assets (cash)	=	Liabilities	+	Capital
Effect of the transaction	₹5,00,000	=	0	+	₹ 5,00,000

This transaction means that ₹5,00,000 have been introduced by Rajni in terms of cash, which is the capital for the business concern. Hence on one hand, the asset (cash) has been created to the extent of ₹5,00,000.

2. She purchased furniture for cash worth ₹50,000

	Assets	=	Capital	+	Liabilities
	Cash + Furniture				
Old equation	5,00,000 + 0	=	5,00,000	+	0
Effect of the transaction	(-) 50,000 + 50,000	=	0	-	0
New equation	4,50,000 + 50,000	=	5,00,000	+	0

This transaction has its effect only on the assets, as one asset has been purchased against the other. In this transaction, furniture is purchased against cash. Furniture and cash both are assets. Hence, furniture is increased by ₹ 50,000 and cash is decreased by ₹ 50,000.

3. She purchased goods for cash ₹10,000

	Assets	=	Capital	+	Liabilities
	Cash + Furniture + Goods	=	Capital	+	Liabilities
Old equation	4,50,000 + 50,000 + 0	=	5,00,000	+	0
Effect of the transaction	- 10,000 + 0 + 10,000	=	0	+	0
New equation	4,40,000 + 50,000 + 10,000	=	5,00,000	+	0

Goods purchased is an asset and in return cash paid is also an asset.

## Accounting Equation

Hence in this transaction, there is an increase in one asset (goods) and decrease in the other asset (cash) by ₹10,000 leaving the capital and liabilities untouched.

4. She purchased goods from Rohit for ₹40,000

	Asset			=	Capital	+	Liabilities (Rohit) Creditors
	Cash	+ Furniture	+ Goods				
Old equation	4,40,000	+ 50,000	+ 10,000	=	5,00,000	+	0
Effect of transaction	0	+ 0	+ 40,000	=	0	+	40,000
<b>New equation</b>	<b>4,40,000</b>	<b>+ 50,000</b>	<b>+ 50,000</b>	<b>=</b>	<b>5,00,000</b>	<b>+</b>	<b>40,000</b>

In this transaction, goods have been purchased on credit from Rohit, hence there is an increase in the assets (goods) by ₹40,000 as the business concern now owes money to Rohit.

In any transaction, whenever cash payment is not mentioned and the name of the seller is given, then the transaction is always a credit transaction.

5. She sold goods to Rahul for ₹20,000 costing ₹15,000.

	Assets				=	Capital	+	Liabilities (Rohit)
	Cash	+ Furniture	+ Goods	+ Debtors (Rahul)				
Old equation	4,40,000	+ 50,000	+ 50,000	+ 0	=	5,00,000	+	40,000
Effect of the Transaction	0	+ 0	- 15,000	+ 20,000	=	+ 5,000	+	0
<b>New equation</b>	<b>4,40,000</b>	<b>+ 50,000</b>	<b>+ 35,000</b>	<b>+ 20,000</b>	<b>=</b>	<b>5,05,000</b>	<b>+</b>	<b>40,000</b>

In this transaction, goods have been sold on credit to Rahul, so there is a decrease in the assets (goods) by ₹15,000, and an increase in the assets Rahul (Debtors) by ₹20,000 as money has to be collected from Rahul. In this process, the proprietor has a gain of ₹5,000 which is added to the capital.

Whenever goods are sold and nothing about cash received is mentioned and the name of the purchaser is given then that transaction is treated as credit transaction.

6. She paid salaries to clerks for ₹12,000

	Assets				=	Capital	+	Liabilities (Rohit)
	Cash	+ Furniture	+ Goods	+ Debtors (Rahul)				
Old Equation	4,40,000	+ 50,000	+ 35,000	+ 20,000	=	5,05,000	+	40,000
Effect of the transaction	- 12,000	+ 0	+ 0	+ 0	=	- 12,000	+	0
<b>New Equation</b>	<b>4,28,000</b>	<b>+ 50,000</b>	<b>+ 35,000</b>	<b>+ 20,000</b>	<b>=</b>	<b>4,93,000</b>	<b>+</b>	<b>40,000</b>

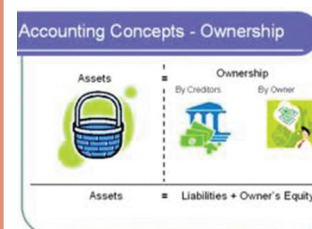
In this transaction, salaries paid to clerks is an expense for the business concern. Since salary is paid in terms of cash, hence cash as an asset is reduced by ₹12,000 and as all expenses reduce the capital, so capital is also reduced by ₹12,000.

## MODULE - II

### Journal and Other Subsidiary Books



### Notes



## MODULE - II

### Journal and Other Subsidiary Books



#### Notes

ALORE Acronym		If You		You Must	
A/c Type		Dr	Cr	Cr	Dr
Assets	Liabilities	Dr	Cr	Cr	Dr
Owners Equity	Revenue	Cr	Cr	Dr	Dr
	Expense	Cr	Dr	Dr	Cr

## Accounting Equation

### 7. Cash paid to Rohit ₹20,000

	Assets				=	Capital	+	Liabilities (Rohit)
	Cash	Furniture	Goods	Debtors (Rahul)				
Old Equation	4,28,000	+ 50,000	+ 35,000	+ 20,000	=	4,93,000	+	40,000
Effect of the transaction	- 20,000	+ 0	+ 0	+ 0	=	0	-	(-) 20,000
New Equation	4,08,000	+ 50,000	+ 35,000	+ 20,000	=	4,93,000	+	20,000

In this transaction, cash has been paid to the creditors, (Rohit) ₹20,000, hence cash as an asset is reduced by ₹20,000 and also the liability (Rohit) is reduced by ₹20,000.

From the above transactions, now you are clear as to how every transaction has its effect on the accounting equation without disturbing the equality of the two sides.

### 4.3 COMBINATIONS OF THE EQUATION

The inter-relationship between assets, liabilities and capital can be expressed in various forms. Nine combinations can be created.

Increase or decrease in one has a corresponding increase or decrease in itself or the other.

Let us study the nine combinations with examples.

- i) Increase in asset with corresponding increase in capital  
**Example :** Started business with cash.
- ii) Increase in asset with corresponding increase in liabilities.  
**Example :** Goods purchased on credit.
- iii) Decrease in asset with corresponding decrease in capital  
**Example :** Cash withdrawn from the business by the proprietor for personal use.
- iv) Decrease in asset with corresponding decrease in liability  
**Example :** Cash paid to the creditor.
- v) Increase and decrease in assets  
**Example :** Furniture purchased for cash, Goods purchased for cash, etc.
- vi) Increase and decrease in liabilities  
**Example :** Payment made to creditors by taking loan from bank.
- vii) Increase and decrease in capital.  
**Example :** Interest on Capital
- viii) Increase in liabilities and decrease in capital.  
**Example :** Wages due but not yet paid, outstanding salaries
- ix) Increase in capital and decrease in liabilities.  
**Example :** Conversion of loan (provided by the owner) into capital.

Let us consider another Illustration and study the accounting equation once again :

## Accounting Equation

### Rules for Accounting Equations

- i. **Capital** : When capital is increased, it is credited (+) and when some part of the capital is withdrawn, i.e., drawings are made, it is debited (-).
- ii. **Revenue** : Owner's equity (Capital) is increased by the amount of revenue.
- iii. **Expenses** : Owner's equity (Capital) is decreased by the amount of expenses.
- iv. **Outsider's Equity** : When liabilities are increased, outsiders' liabilities are credited (+).
- v. **Assets** : If there is an increase in Assets, the increase is debited (+) in the Asset Account. If there is decrease in Assets, the decrease is credited (-) in the Asset Account.
- vi. **Effects of Outstanding Expenses** : Increase in liabilities and decrease in capital.
- vii. **Accrued Income** : Increase in asset and increase in capital.
- viii. **Income Received in Advance** : Increase in asset (as cash) and increase in liabilities.
- ix. **Interest on Capital** is an expense for the business, and thus, profit is reduced by the amount and since interest on capital is an income for the owner it is added to capital. So the net effect of this transaction is nil on capital.
- x. **Asset and Liabilities** will not be affected by interest on capital and interest on drawings.

**Illustration 1** : Show the effect of following transactions on the Accounting Equation.

1. Shashi started business with :	₹
Cash	2,00,000
Goods	1,20,000
Machine	80,000
2. He purchased goods for cash	50,000
3. He sold goods (costing ₹20,000)	25,000
4. He purchased goods from Ravi	70,000
5. He paid cash to Ravi in full settlement	69,000
6. He sold goods to Vikas (costing ₹54,000)	60,000
7. He received payment from Vikas and discount allowed ₹2,000	58,000
8. Salaries paid by him	40,000
9. Rent outstanding	4,000
10. Prepaid insurance	1,000
11. Commission received by him	3,000
12. Amount withdrawn by him for personal use	30,000
13. Interest on capital invested by him	2,000

## MODULE - II

### Journal and Other Subsidiary Books



### Notes

## MODULE - II

### Journal and Other Subsidiary Books



#### Notes

## Accounting Equation

### Solution

S.No.	Transaction	Assets				=			Liabilities			+ Capital		
		Cash	+ Goods	+ Machine	+ Debtors	+ Prepaid expense	= Creditors	+ Outstanding expense	+ Capital	+ Capital				
1.	Started business with Cash ₹ 2,00,000 Goods ₹ 1,20,000 Machine ₹ 80,000	2,00,000	+	1,20,000	+	80,000	+	0	+	0	+	0	+	4,00,000
2.	Goods purchased for ₹ 50,000 New Equation	-50,000	+	50,000	+	0	+	0	+	0	+	0	+	0
		1,50,000	+	1,70,000	+	80,000	+	0	+	0	+	0	+	4,00,000
3.	Sold goods (Cost ₹ 20,000) for ₹ 25,000 New Equation	25,000	-	20,000	+	0	+	0	+	0	+	0	+	5,000
		1,75,000	+	1,50,000	+	80,000	+	0	+	0	+	0	+	4,05,000
4.	Purchased goods from Ravi ₹ 70,000 New Equation	0	+	70,000	+	0	+	0	+	70,000	+	0	+	0
		1,75,000	+	2,20,000	+	80,000	+	0	+	70,000	+	0	+	4,05,000
5.	Payment made to Ravi in full settlement ₹ 69,000 New Equation	-69,000	+	0	+	0	+	0	+	-70,000	+	0	+	1,000
		1,06,000	+	2,20,000	+	80,000	+	0	+	0	+	0	+	4,06,000
6.	Goods of ₹ 54,000 Sold for ₹ 60,000 New Equation	0	-	54,000	+	0	+	60,000	+	0	+	0	+	6,000
		1,06,000	+	1,66,000	+	80,000	+	60,000	+	0	+	0	+	4,12,000

## Accounting Equation

7. Payment of ₹ 58,000 received from Vikas and discount ₹ 2,000 is allowed New Equation	58,000	+	0	+	0	-	60,000	+	0	=	0	+	0	+	-2,000
8. Salaries paid ₹ 40,000 New Equation	1,64,000	+	1,66,000	+	80,000	+	0	+	0	=	0	+	0	+	4,10,000
9. Rent Outstanding ₹ 4,000 New Equation	-40,000	+	0	+	0	+	0	+	0	=	0	+	0	-	40,000
10. Prepaid Insurance ₹ 1,000 New Equation	1,24,000	+	1,66,000	+	80,000	+	0	+	0	=	0	+	0	+	3,70,000
11. Commission received ₹ 3,000 New Equation	0	+	0	+	0	+	0	+	0	=	0	+	4,000	-	4,000
12. Amount with drawn ₹ 30,000 New Equation	1,24,000	+	1,66,000	+	80,000	+	0	+	0	=	0	+	4,000	+	3,66,000
13. Interest on Capital ₹ 2,000 New Equation	-1,000	+	0	+	0	+	0	+	1,000	=	0	+	0	-	0
<b>Total</b>	1,23,000	+	1,66,000	+	80,000	+	0	+	1,000	=	1,000	+	4,000	+	3,66,000
	3,000	+	0	+	0	+	0	+	0	=	0	+	0	+	3,000
	1,26,000	+	1,66,000	+	80,000	+	0	+	1,000	=	0	+	4,000	+	3,69,000
	-30,000	+	0	+	0	+	0	+	0	=	0	+	0	-	30,000
	96,000	+	1,66,000	+	80,000	+	0	+	1,000	=	0	+	4,000	+	3,39,000
	0	+	0	+	0	+	0	+	0	=	0	+	0	+	-2,000
	96,000	+	1,66,000	+	80,000	+	0	+	1,000	=	1,000	+	4,000	-	3,39,000
															<b>3,43,000</b>
															<b>3,43,000</b>

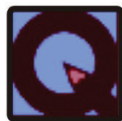
## MODULE - II

Journal and Other  
Subsidiary Books



### Notes



**MODULE - II***Journal and Other  
Subsidiary Books***Notes****Accounting Equation****INTEXT QUESTIONS 4.2****Multiple Choice Questions**

- i. Goods purchased from Ritu for ₹60,000. What effect will the transaction have on the Accounting Equation?
  - a) Increase in assets and increase in liability.
  - b) Increase and decrease in asset.
  - c) Increase and decrease in liability.
  - d) Decrease in asset and decrease in liability.
- ii. Rent outstanding ₹ 2,000. What effect will this transaction have on the Accounting Equation?
  - a) Increase and decrease in asset.
  - b) Increase and decrease in liability.
  - c) Increase in liability and increase in asset.
  - d) Increase in liability and decrease in Capital.
- iii. Interest on drawings amounted to ₹5,000. What effect will this transaction have on the Accounting Equation?
  - a) Increase and decrease in asset.
  - b) Increase and decrease in liability.
  - c) Increase and decrease in Capital.
  - d) Increase in asset and Increase in liability.

**WHAT YOU HAVE LEARNT**

- Business transaction means exchange of goods and/or services for value and any other financial activity undertaken in the course of the business.
- Every business transaction is recorded on the basis of Accounting Equation.
- Accounting equation is a statement showing the equality of assets on one hand and the capital and liabilities on the other.
- $\text{Assets} = \text{Capital} + \text{Liabilities}$  ( $A = C + L$ )
- Every business transaction has its effect on the Accounting Equation.
- Business owns nothing and owes nothing. What it owns and what other owes to business.
- Under any circumstance, the equality of the Accounting Equation remains same.
- The effect of expenses and revenue is always on the Capital Account. Expenses reduce the Capital and revenues increase it.
- Every business transaction satisfies the Dual Aspect Concept.

## Accounting Equation

- Any increase or decrease in one element of Accounting Equation has a corresponding increase or decrease on the other element or itself.



### TERMINAL EXERCISE

- Answer the following question in (1-10 words).
  - If a firm borrows a sum of money, what will be its effect on the Accounting Equation?
  - Give two examples – one showing the effect only on assets and the other on liabilities only.
  - How will you show income received in advance in the accounting equation?
  - If goods costing ₹. 8,000 are sold for ₹ 8,500, how will the capital be affected?
- Answer the following in (30-50 words)
  - What is an Accounting Equation?
  - How are revenue and expense treated in Accounting Equation?
- “Accounting Equation remains intact under all circumstances” Justify this statement with the help of examples (100-150 words)
- Prepare Accounting Equation on the basis of the following:
  - Karan started business with cash ₹1,60,000.
  - He purchased furniture for cash ₹16,000.
  - He paid rent ₹1,600.
  - He purchased goods on credit ₹24,000.
  - He sold goods costing ₹16,000 for ₹40,000 for cash.
- Akshay had the following transactions:

	₹
i. Commenced business with cash	2,50,000
ii. Purchased goods for cash	1,00,000
iii. Salaries paid	2,500
iv. Sold goods for cash ₹2,00,000 costing	1,50,000
v. Rent outstanding	500
vi. Purchased goods on credit	1,50,000
vii. Purchased Machinery on credit	25,000
viii. Purchased Motorcycle for personal use	25,000
ix. Purchased building for cash	1,00,000

Use Accounting Equation to show the effect of the above transactions on the assets, liabilities and capital.

## MODULE - II

### Journal and Other Subsidiary Books



### Notes

## MODULE - II

### Journal and Other Subsidiary Books



Notes

## Accounting Equation

6. Show the Accounting Equation on the basis of the following transactions :

	₹
i. Shivam Started business	
Cash	5,00,000
Goods	2,00,000
ii. He purchased machinery for cash	2,50,000
iii. He purchased goods from Ramesh	1,00,000
iv. He sold goods to Suresh (Cost ₹25,000)	30,000
v. Paid insurance premium	5,000
vi. Salary outstanding	10,000
vii. Depreciation of Machinery	25,000
viii. Interest on Capital	3,000
ix. Amount withdrawn for personal use	18,000
x. Interest on drawings	900
xi. Rent received in advance	1,500
xii. Cash paid to Ramesh	50,000
xiii. Cash received from Suresh	15,000



## ANSWER TO INTEXT QUESTIONS

- 4.1 I.** (i) balance sheet (ii) capital  
(iii) dual aspect (iv) balance sheet  
(v) liabilities (vi) assets

- II.** (i) b (ii) a (iii) c

- 4.2** (i) a (ii) d (iii) c

## ACTIVITIES FOR YOU

- Enquire from various business organisations and list various methods of maintaining the record of transactions.
- Write down ten business transactions and prepare the accounting equation for them and ensure that they are equal at each and every step.

## 5

**DOUBLE ENTRY SYSTEM****MODULE - II***Journal and Other  
Subsidiary Books***Notes**

As stated earlier, in accounting, transactions are recorded in a systematic manner. But then what is that system. The system of accounting which has universal application is termed as, double entry system. This system is based on the basic concept of accounting i.e. dual aspect concept. In this lesson you will learn about double entry system of accounting, accounts and their types, accounting vouchers and method of preparing the vouchers.

**OBJECTIVES**

**After going through this lesson you will be able to :**

- state the meaning of double entry systems of book keeping;
- explain the advantages and limitations of double entry system;
- classify the accounts in different categories;
- know the rules for debit and credit;
- identify the source documents;
- understand the meaning of accounting vouchers;
- understand the different types of vouchers and
- know the method of preparation of voucher.

**5.1 MEANING OF DOUBLE ENTRY SYSTEM OF BOOK-KEEPING**

The double entry system of bookkeeping can be defined as the system of recording transactions having two fundamental aspects - one involving the receiving of a benefit and the other giving the benefit - in the same set of books. In this theory, as the two fold aspects of each transaction are recorded, therefore it is called 'double entry system'.

As per dual aspect concept of accounting every transaction involves two aspects, an aspect of receiving and an other aspect of giving. One who receives is a debtor and one who gives is a creditor. Under the double entry system, both the aspects of giving and receiving are recorded in terms of accounts. The account which

## MODULE - II

### Journal and Other Subsidiary Books



#### Notes

## Double Entry System

receives the benefit is debited and the account which gives the benefit is credited. It is the ultimate result of this system that every debit must have corresponding credit and vice versa thus, on any particular day the total of the debit entries and the credit entries on the various accounts must be equal.

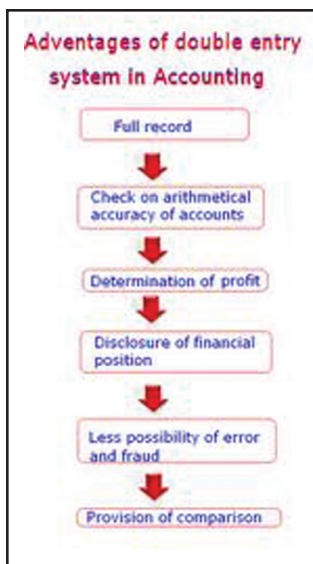
For example, we bought machinery of ₹ 30,000 for business. It has brought two changes, machinery increases by ₹ 30,000 and cash decreases by an equal amount. While recording this transaction in the books of accounts, both the changes must be recorded. In accounting language, these two changes are termed as “a debit change” & “a credit change”. Here machinery account will be debited and cash account will be credited.

Thus, we see that for every transaction there will be two entries, one debit entry and another credit entry. For each debit there will be a corresponding credit entry of an equal amount. Conversely, for every credit entry there will be a corresponding debit entry of an equal amount. So, the system under which both the changes in a transaction are recorded together, one change is debited, while the other change is credited with an equal amount, is known as double entry system of book-keeping. Double entry system is based on the principle that “Every debit has a credit and every credit has a debit.”

## 5.2 ADVANTAGES & LIMITATIONS OF DOUBLE ENTRY SYSTEM

The main advantages of double entry system of book keeping are as follows:

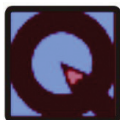
1. The nominal aspects of transactions being recorded make it possible to prepare Trading and Profit and Loss Account from which the Gross Profit and Net Profit earned by the business during a particular period can be easily ascertained.
2. As all personal accounts of debtors and creditors as well as real accounts are kept, it is possible to prepare Balance Sheet.
3. The transactions being recorded in the most scientific and systematic way give the most reliable information of business.
4. It prevents frauds because doing alterations in any account becomes difficult.
5. It enables the trader to compare the different items, such as sales, purchases, opening stock and closing stock of one period with similar items of preceding period and the trader may thus, know whether his business is progressing or not.
6. Trial balance can be prepared on any day to prove the arithmetical accuracy of accounting records.



## Double Entry System

**The main limitations of double entry system of book keeping are as follows:**

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



### INTEXT QUESTIONS 5.1

**Complete the sentences :**

- i. The Double entry theory of book-keeping is a system of recording transactions having \_\_\_\_\_.
- ii. One who receives is a \_\_\_\_\_ and who gives is a \_\_\_\_\_.
- iii. The Double entry system prevents frauds by not rendering \_\_\_\_\_.
- iv. There is \_\_\_\_\_ of absolute accuracy of the books of accounts inspite of agreement of trial balance.

## 5.3 MEANING AND CLASSIFICATION OF ACCOUNTS

An accounting system records, retains and reproduces financial information relating to financial transaction flows and financial position. Financial transaction flows encompass primarily inflows on account of incomes and outflows on account of expenses. Elements of financial position, including property, money received, or money spent, are assigned to one of the primary groups i.e. assets, liabilities, and equity.

Within these primary groups each distinctive asset, liability, income and expense is represented by its respective “account”. An account is simply a record of financial inflows and outflows in relation to the respective asset, liability, capital, income and expense. It is a record of all business transaction relating to a particular person or item. In accounting we keep a separate record of each individual, asset, liabilities, expense or income. The place where such a record is maintained is termed as an ‘Account’. Such as the Account of Madan, the Account of Brij, the Account of Building, the Account of Rent, the Account of Discount and likewise. All transactions entered into with Madan will be recorded in the Account of Madan and similarly, all transactions relating to Brij will be recorded in the Account of Brij. Thus, an account is a systematic record of transactions pertaining to a particular item or person, which can be measured in terms of money during a particular period of time. Account is a head under which particular type of transactions are consolidated, classified and recorded. Example: A sales account is opened for recording the sales of goods or services. Similarly expenses during the financial period are

## MODULE - II

### Journal and Other Subsidiary Books



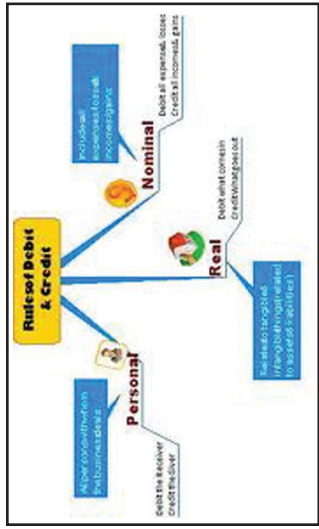
### Notes

# MODULE - II

## Journal and Other Subsidiary Books



### Notes



<b>Nominal accounts</b>	Debit the expenses Credit the gains
<b>Personal accounts</b>	Debit the receiver Credit the giver
<b>Real accounts</b>	Debit what comes in Credit what goes out

# Double Entry System

recorded using the respective expense accounts. The account may be classified in two ways:

- i. Traditional classification
- ii. Modern classification.

## Classification of Accounts Based on Nature or Traditional Classification

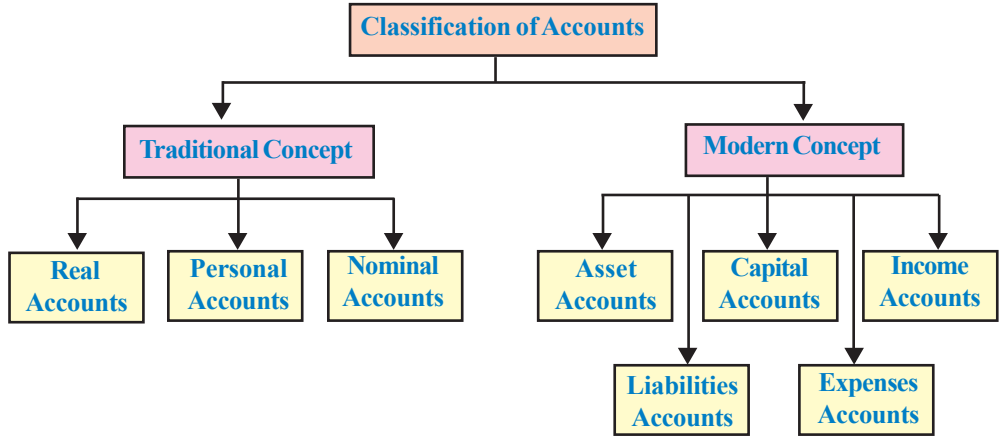
On the basis of their nature accounts are of the following three types :

- i) **Personal Accounts :** Accounts in the name of individuals or group of individuals are called personal accounts e.g. Ramesh, Mahesh, M/s M.K. Computers etc.
- ii) **Nominal Accounts :** Accounts of expenses or losses incomes or gains are called nominal accounts e.g. wages paid, commission received etc.
- iii) **Real Accounts :** Accounts of assets are called real accounts e.g. building, furniture etc.

## Modern Classifications

On the basis of this classification accounts are divided into five categories as given below :

- i. Capital, ii. Assets, iii. Liabilities, iv. Expenses and v. Income



- The further classification of accounts is based on the periodicity of their inflows or outflows in the context of the accounting year.
- Income is immediate inflow during the accounting year.
- Expense is the immediate outflow during the accounting year.
- An asset is a long-term inflow with implications extending beyond the financial period.
- Liability is long term outflow with implications extending beyond the financial period.



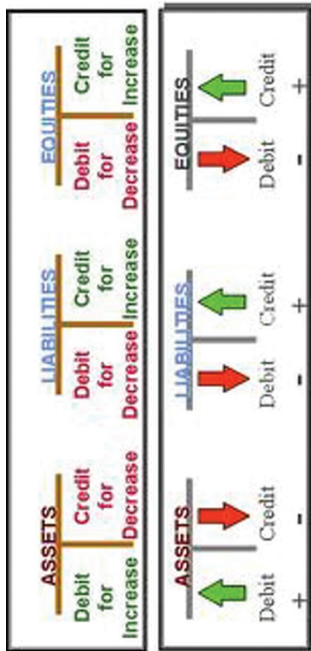


## MODULE - II

### Journal and Other Subsidiary Books



#### Notes



## Double Entry System

“Increase in Revenue/Gains is credited and decrease in Revenue/Gain is debited”.

The rules applicable to the five kinds of accounts are summarised in the following chart:

### Rules of Accounting

Assets	
(Increase) +	(Decrease) -
Debit	Credit

Expenses/Losses	
(Increase) +	(Decrease) -
Debit	Credit

Capital	
(Decrease) -	(Increase) +
Debit	Credit

Liabilities	
(Decrease) -	(Increase) +
Debit	Credit

Revenue/Gains	
(Decrease) -	(Increase) +
Debit	Credit

#### I. Analysis of Rule Applied to Assets Accounts

##### Rohit Purchased Furniture for ₹ 80,000.

**Analysis of Transaction :** In this transaction, the two affected accounts are Cash account and Furniture account. Cash account is an assets account and has decreased. As per rule if asset decreases the affected account is credited, so cash account should be credited. Furniture is also an asset and it has increased. As per rule if asset increases the affected account is debited thus, furniture account is to be debited.

Cash	
Dr.	Cr
	80000
	(Decrease)

Furniture	
Dr	Cr
80000	
(Increase)	

#### II. Analysis of Rule Applied to Liabilities Accounts

##### Purchased Machinery for ₹ 60,000 on credit from M.B. Machinery Mart.

**Analysis of Transaction :** In this transaction, the two affected accounts are machinery and M.B. Machinery Mart. Machinery is an asset, an asset has increased therefore, machinery account is debited. M.B. Machinery Mart is the creditor on account of supply of machinery and constitutes the liability for the buying firm which has increased. Rule is that on increase of liability the concerned liability account is credited and vice-versa, therefore M.B. Machinery Mart A/c is credited.

## Double Entry System

Machinery A/c	
Dr	Cr
60000 (Increase)	

M.B.Machinery Mart A/c	
Dr	Cr
	60000 (Increase)

### III. Analysis of Rule Applied to Capital Accounts

Cash of ₹ 50,000 introduced in business as Capital by Suman Sharma.

**Analysis of Transaction :** In this transaction, the two affected accounts are Cash account and Suman Sharma [Capital account]. Cash is an asset which increase when invested in business as per rule if an asset increases it is debited therefore cash account will be debited. Suman Sharma invested capital which increase the capital account, and as per rule if capital increases it is credited therefore capital account will be credited.

Cash A/c	
Dr	Cr
50000 (Increase)	

Capital A/c	
Dr	Cr
	50000 (Increase)

### IV. Analysis of Rule Applied to Expenses/Losses Accounts

Paid ₹6000 to the employees as Salary.

**Analysis of Transaction :** In this transaction, the two affected accounts are Salary account and Cash account. Salary account is an expense and has increased. As per rule if expenses increase it will be debited. Cash is an asset and has decreased, as per rule if assets decrease, it will be credited.

Salary A/c	
Dr	Cr
6000 (Increase)	

Cash A/c	
Dr	Cr
	6000 (Decrease)

### V. Analysis of Rule Applied to Revenue/Profit Accounts

Received interest for the month ₹4000.

**Analysis of Transaction :** In this transaction, the two affected accounts are Interest and Cash. Interest is an item of Income and Cash an item of asset, as per rule if revenue increases it will be credited and if asset increases it will be debited.

Cash A/c	
Dr	Cr
4000 (Increase)	

Interest A/c	
Dr	Cr
	4000 (Increase)

## MODULE - II

### Journal and Other Subsidiary Books



### Notes

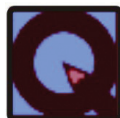
## MODULE - II

### Journal and Other Subsidiary Books



Notes

## Double Entry System



### INTEXT QUESTIONS 5.2

#### I. Fill in the blanks:

- i. On the basis of traditional classification accounts can be classified as –
  - a) \_\_\_\_\_
  - b) \_\_\_\_\_
  - c) \_\_\_\_\_
- ii. On the basis of Modern classification accounts can be classified as:
  - a) \_\_\_\_\_
  - b) \_\_\_\_\_
  - c) \_\_\_\_\_
  - d) \_\_\_\_\_
  - e) \_\_\_\_\_
- iii. \_\_\_\_\_ is immediate inflow while \_\_\_\_\_ is immediate outflow.
- iv. Increase in assets is \_\_\_\_\_ and decrease in Asset is \_\_\_\_\_.
- v. Left hand side of an account is called \_\_\_\_\_ and right hand side of account is called \_\_\_\_\_.

#### II. A list of the accounts is given below. Tick the category to which each of the account belongs:

##### Type of Account

Name of Account	Asset	Liability	Capital	Revenue	Expense
i. Wages					
ii. Building					
iii. Cash					
iv. Gupta (Supplier)					
v. Sharma (Owner)					
vi. Sugam (Customer)					
vii. Interest received					
viii. Commission Earned					
ix. Discount allowed					
x. Rent Paid					

#### Illustration 1

From the following transactions, state the titles of the accounts that will be affected, types of the accounts and the account to be debited and the account to be credited:

## Double Entry System

Transaction	₹
1. Ankur started business with cash	6,00,000
2 Purchased goods for cash	80,000
3. Paid salaries	10,000
4. Sold goods to Rohit on credit	60,000
5 Office machine purchased for cash	2,000
6 Ankur took loan from Bank	30,000
7 Ankur received commission	4,000
8. Paid for printing and stationary	500
9. Paid rent	6,000
10 Received cash from Rohit a debtor	60,000

### Solution

Tran. No.	Name of Accounts		Type of Accounts		Rules applicable to A/cs in Debit/Credit items of Increase/Decrease	
	1	2	1	2	1	2
1	Cash	Capital	Asset	Capital	Cash (Increase)	Capital (Increase)
2	Purchases	Cash	Expense	Asset	Purchase (Increase)	Cash (Decrease)
3	Salaries	Cash	Expense	Asset	Salaries (Increase)	Cash (Decrease)
4	Rohit	Sales	Asset (Debtor)	Revenue	Rohit (Increase)	Sales (Increase)
5	Office machine	Cash	Asset	Asset	Office machine (Increase)	Cash (Decrease)
6	Cash	Bank Loan	Asset	Liability	Cash (Increase)	Bank Loan (Increase)
7	Cash	Commission	Asset	Revenue	Cash (Increase)	Commission (Increase)

## MODULE - II

### Journal and Other Subsidiary Books



### Notes

**MODULE - II***Journal and Other  
Subsidiary Books***Notes****Double Entry System**

8	Printing & Stationary	Cash	Expense	Asset	Printing and Stationery (Increase)	Cash (Decrease)
9	Rent	Cash	Expense	Asset	Rent (Increase)	Cash (Decrease)
10	Cash	Rohit	Asset	Asset	Cash (Increase)	Rohit (Decrease)

**5.5 SOURCE DOCUMENTS**

Accounting process begins with the origin of a business transaction and is followed by analysis of such transaction. First, there should be a document showing that an accounting event took place. Such a document is usually called a source document. Source documents serve as a basis for an accounting entry. Source documents are documents on the basis of which the accountants record accounting transactions. Source documents are also called as business documents. Some examples of source documents are invoices, material requisition forms, bank statements, cash memos, receipts etc.

Each transaction in a business is supported by the documentary evidence, which are considered source documents. Examples of source documents are an invoice shows sale of goods on credit, a Cash Memo shows cash sales and the receipt issued by the payee shows the transaction against cash payment etc. Thus, documents which facilitate evidence of the transactions are known as the source documents. These are the primary evidence in support of the concerned business transactions, and are also termed as vouchers. Vouchers may be divided into two categories (a) Supporting vouchers and (b) Accounting vouchers.

**Supporting Vouchers**

The vouchers which support the business transactions are called supporting vouchers. Examples of supporting vouchers are: Rent receipt, Cash memo invoice etc

**Accounting Vouchers**

These are the source documents on the basis of which transactions are recorded in the books of accounts. Accounting vouchers are the written documents containing the analysis of business transactions for accounting and recording purposes prepared by the accountants on the basis of supporting vouchers and signed by another authorised person.

**Features of an Accounting Voucher are as follows:**

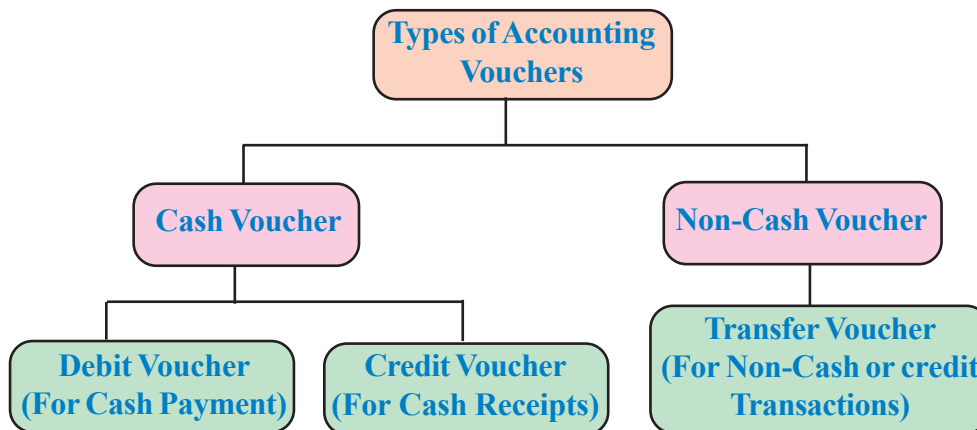
1. It is a written document.
2. It is the base for entries in the books of accounts.

## Double Entry System

3. It is prepared on the basis of evidence of the transaction.
4. It contains analysed information of a transaction so that the concerned accounts could be debited and credited.
5. It is prepared by an accountant and countersigned by the authorised signatory.

### 5.6 TYPES OF ACCOUNTING VOUCHERS

Accounting vouchers may be classified as cash vouchers and non-cash vouchers. There are two types of cash vouchers) debit vouchers and ii) credit vouchers. The non-cash vouchers are also called as transfer vouchers.



#### Debit Voucher

Debit Vouchers are prepared for recording of transactions involving cash payments only. Cash payments in the business are made on account of Payment to creditors, Purchases of goods, Purchases of assets, Repayment of loans, Depositing cash into Bank, Drawings & advances and expenses etc.

In case of all cash payments, one aspect is cash and the other is either the party to whom the payment is made, or an expense or an item of property for which the payment is made. A format of debit voucher is as follows:

(3) DEBIT VOUCHER	
Received Rs.	<b>Hari Narayan &amp; Sons</b> <b>Darya Ganj, New Delhi 100 002</b>
	<b>Voucher No. 5</b>
	<b>Date 10.6.2012</b>
	<b>Amount (₹)</b>
	<b>10,000</b>
Debit : Furniture A/c _____ (Being the furniture Purchased vide Cash Memo No. 15) _____	<b>10,000</b>
<b>Total</b>	<b>10,000</b>
<b>Sd/- Manager</b>	<b>Sd/- Accountant</b>
(10)	(8)
	(7)

## MODULE - II

### Journal and Other Subsidiary Books



#### Notes



## MODULE - II

### Journal and Other Subsidiary Books



Notes

## Double Entry System

A Debit Voucher gives the following information:

1. Name and Address of the Organisation.
2. Date of Preparing the Voucher.
3. Accounting Voucher Number.
4. Title of the Account Debited.
5. Net Transaction Amount.
6. Narration, *i.e.*, a brief description of the transaction.
7. Signature of the Person Preparing it.
8. Signature of the Authorised Signatory.
9. Supporting Voucher Number.
10. A Document in lieu of the Supporting Voucher.

### Illustration 2

The following transactions took place in M/s. Tarun Retailers. Prepare debit voucher:

2012		₹
Jan. 1	Bought materials for cash vide Cash Memo No. 20	17,200
Jan. 5	Wages paid for the month of December 2011, vide Wage Sheet No. 35	5,000

### Solution :

(i)

M/s. Tarun Retailers		
Received Rs. ....	<b>Voucher No. 1</b> <span style="float: right;"><b>Date 1.1.2012</b></span> <span style="float: right;"><b>Amount (₹)</b></span>	
Revenue Stamp	Debit : Purchases A/c (Being the materials purchased vide Cash Memo No. 20)	17,200
		17,200
	<b>Sd/- Manager</b>	<b>Sd/- Accountant</b>

(ii)

M/s. Tarun Retailers		
Received Rs. ....	<b>Voucher No. 2</b> <span style="float: right;"><b>Date 5.1.2012</b></span> <span style="float: right;"><b>Amount (₹)</b></span>	
Revenue Stamp	Debit : Wages A/c (Being wages paid for December 2011 vide Wage Sheet No. 35)	5,000
		5,000
	<b>Sd/- Manager</b>	<b>Sd/- Accountant</b>

## Double Entry System

### Illustration 3

The following transactions took place in M/s. Sunil Traders. Prepare debit vouchers:

2012		₹
Jan. 1	Bought furniture from Relax Furniture for cash vide Cash Memo No. 24	9,500
Jan. 7	Wages paid for the month of December, 2011, vide Wage Sheet No. 30	3,500
Jan. 10	Paid cash to Hari & Sons A/c vide Cash Receipt No. 70	5,000
Jan. 15	Paid for Postage	720

### Solution :

(i)	Received Rs. ....  Revenue Stamp	<b>M/s. Sunil Traders</b>	
		<b>Voucher No. 1</b>	<b>Date 1.1.2012</b> <b>Amount (₹)</b>
		Debit : Furniture A/c (Being furniture purchased vide Cash Memo No. 24)	9,500
			9,500
		<b>Sd/-</b> <b>Manager</b>	<b>Sd/-</b> <b>Accountant</b>
(ii)	Received Rs. ....  Revenue Stamp	<b>M/s. Sunil Traders</b>	
		<b>Voucher No. 2</b>	<b>Date 7.1.2012</b> <b>Amount (₹)</b>
		Debit : Wages A/c (Being wages paid for December 2011 vide Wage Sheet No. 30)	3,500
			3,500
		<b>Sd/-</b> <b>Manager</b>	<b>Sd/-</b> <b>Accountant</b>
(iii)	Received Rs. ....  Revenue Stamp	<b>M/s. Sunil Traders</b>	
		<b>Voucher No. 3</b>	<b>Date 10.1.2012</b> <b>Amount (₹)</b>
		Debit : Hari & Sons A/c (Being amount paid vide Cash Receipt No. 70)	5000
			5000
		<b>Sd/-</b> <b>Manager</b>	<b>Sd/-</b> <b>Accountant</b>

## MODULE - II

### Journal and Other Subsidiary Books



### Notes

## MODULE - II

### Journal and Other Subsidiary Books



#### Notes

## Double Entry System

(iv)

Received Rs. ....  Revenue Stamp	<b>M/s. Sunil Traders</b>	
	<b>Voucher No. 4</b>	<b>Date 15.1.2012</b> <b>Amount (₹)</b>
	Debit : Postage A/c (Being the amount paid for Postage)	720
		720
	<b>Sd/- Manager</b>	<b>Sd/- Accountant</b>

### Credit Vouchers

These vouchers are prepared for recording of transactions involving only cash receipts. Cash receipts in the business take place on account of Cash sales of goods, Cash receipts from debtors, Cash sales of assets, Cash withdrawn from bank for office use, Revenue income like interest, rent etc. received in cash, Loan taken and Receipts of advances etc.

In all cash receipts, one aspect is cash and the other is either person or party from whom cash is received or item of revenue on account of which cash is received or the property on the sale of which cash is received. A format of credit voucher is as follows:

**CREDIT VOUCHER**

<b>Ram Narayan Printers</b> <b>7, Karol Bagh, New Delhi</b>		(1)
<b>Voucher No. 302</b>	<b>Date 4.2.2012</b> <b>Amount (₹)</b>	(2)
Credit : Sales A/c _____	12,000	(4)
(Being goods sold for _____)		(6)
cash vide _____		
Bill No. 15) _____		(9)
Total	12,000	(5)
<b>Sd/- Manager</b>	<b>Sd/- Accountant</b>	
(8)	(7)	

The Credit Voucher gives the following information:

1. Name and Address of the Organisation.
2. Date of Preparing the Voucher.
3. Accounting Voucher Number.
4. Title of the Account Credited.
5. Net Amount of the Transaction.
6. Narration, i.e., a brief description of the transaction.

## Double Entry System

7. Signature of the Person Preparing it.
8. Signature of the Authorised Signatory.
9. Supporting Voucher Number.

### Illustration 4

Prepare Credit Vouchers from the source vouchers of M/s. M.K. Computers, Paschim Vihar, New Delhi based on the following transactions:

2012		₹
May 5	Sold Hard disks for cash vide Cash Memo No. 10	72,000
May 16	Sold old Computer Monitor for cash vide cash Memo No. 34	13,000
May 30	Withdrawn cash from Bank for office use vide cheque No. 300407	8,700

### Solution :

(i)

M.K. Computers Paschim Vihar, New Delhi	
Voucher No. 1	Date : 5.5.2012 Amount (₹)
Credit : Sales A/c (Being the amount of Cash Sales vide Cash Memo No. 10)	72,000
	72,000
Sd/- Manager	Sd/- Accountant

(ii)

M.K. Computers Paschim Vihar, New Delhi	
Voucher No. 2	Date : 16.5.2012 Amount (₹)
Credit : Old Computer Monitors A/c (Being old Computer Monitor sold for cash vide Cash Memo No. 10)	13,000
	13,000
Sd/- Manager	Sd/- Accountant

## MODULE - II

### Journal and Other Subsidiary Books



### Notes

## MODULE - II

### Journal and Other Subsidiary Books



Notes

## Double Entry System

<b>M.K. Computers</b> Paschim Vihar, New Delhi	
<b>Voucher No. 3</b>	<b>Date : 30.5.2012</b> <b>Amount (₹)</b>
Credit : Bank A/c (Being Cash withdrawn from Bank vide Cheque No. 300407)	8,700
	8,700
<b>Sd/-</b> <b>Manager</b>	<b>Sd/-</b> <b>Accountant</b>

### Illustration 5

Prepare Credit Vouchers from the following information, gathered from supporting vouchers of M/s. Genius Leather Stores, Meerut.

2012	₹
(i) July 5 Received cash from Sohan & Co. on Account vide cash receipt No. 35	12,000
(ii) July 10 Commission received vice cash receipt No. 74	3,500
(iii) July 15 Sold leather purses for cash vide Cash Memo No. 412	4,500
(iv) July 24 Sold two old leather colouring machines vide Cash Memo No. 3714	12,500

### Solution :

<b>M/s. Genius Leather Stores, Meerut</b>	
<b>Voucher No. 1</b>	<b>Date : 5.7.2012</b> <b>Amount (₹)</b>
Credit : M/s. Sohan & Co. (Being Cash received on account from Sohan & Co. vide cash receipt No. 35)	12,000
	12,000
<b>Sd/-</b> <b>Manager</b>	<b>Sd/-</b> <b>Accountant</b>

<b>M/s. Genius Leather Stores, Meerut</b>	
<b>Voucher No. 2</b>	<b>Date : 10.7.2012</b> <b>Amount (₹)</b>
Credit : Commission A/c. (Being the amount of commission received vide cash receipt No. 74)	3,500
	3,500
<b>Sd/-</b> <b>Manager</b>	<b>Sd/-</b> <b>Accountant</b>

## Double Entry System

## MODULE - II

*Journal and Other  
Subsidiary Books*



Notes

(iii)

M/s. Genius Leather Stores, Meerut	
<b>Voucher No. 3</b>	<b>Date : 15.7.2012</b>
	<b>Amount (₹)</b>
Credit : Sales A/c. (Being the amount of cash sales vide Cash Memo No. 412)	4,500
	4,500
<b>Sd/- Manager</b>	<b>Sd/- Accountant</b>

(iv)

M/s. Genius Leather Stores, Meerut	
<b>Voucher No. 4</b>	<b>Date : 24.7.2012</b>
	<b>Amount (₹)</b>
Credit : Leather Colouring Machine (Being two old leather colouring machine sold for cash vide Cash Memo No. 3714)	12,500
	12,500
<b>Sd/- Manager</b>	<b>Sd/- Accountant</b>

### Transfer Voucher or Non Cash Voucher

Non cash vouchers refer to vouchers prepared for transactions not involving cash. They are also called transfer vouchers. The transfer vouchers are prepared to record non-cash transactions of the business involving Credit sales, Credit purchases, Depreciation on assets, Return of goods purchased on credit, Bad debts, Return of goods sold on credit etc.

These vouchers are prepared both in debit and credit forms simultaneously. A format of Transfer Voucher is given as follows:

(3) **TRANSFER VOUCHER**

Radhika Pearls Store 32, Vikas Nagar, Lucknow	
<b>Voucher No. ....</b>	<b>Date 1.4..2012</b>
	<b>Amount (₹)</b>
Debit : Machinery A/c _____	-----
	-----
Credit : Raman _____ (Being the machinery purchased _____ vide Cash Memo No. ....)	-----
	-----
<b>Sd/- Manager</b>	<b>Sd/- Accountant</b>

(8) (7)

## MODULE - II

### Journal and Other Subsidiary Books



Notes

## Double Entry System

A Non-Cash Voucher gives the following information:

1. Name and Address of the Organisation.
2. Date of Preparing Voucher.
3. Accounting Voucher Number.
4. (a) Title of the Account Debited.  
(b) Title of the Account Credited.
5. Net Transaction Amount.
6. Narration, *i.e.*, a brief description of the transaction.
7. Signature of the Person Preparing it.
8. Signature of the Authorised Signatory.
9. Supporting Voucher Number.

### Illustration 6

Prepare Transfer Vouchers of Sunny Garments, Kanpur from the source vouchers based on the following transactions:

2012		₹
Jan 3	Purchased goods from M/s. Jim & Joney vide Bill No. 20	47,000
Jan. 8	Sold goods to M/s. Sita Ram vide Invoice No. 4171	13,980

### Solution:

Sunny Garments, Kanpur	
Voucher No. ....	Date: 3.1.2012 Amount (₹)
Debit : Purshases A/c	47,000
	47,000
Credit : M/s. Jim & Joney (Being goods purchased from M/s. Jim & Joney vide Bill No. 20)	47,000
	47,000
Sd/- Manager	Sd/- Accountant

Sunny Garments, Kanpur	
Voucher No. ....	Date: 8.1.2012 Amount (₹)
Debit : M/s. Sita Ram	13,980
	13,980
Credit : Sales A/c (Being the amount of credit sales vide Invoice No. 4171 to M/s. Sita Ram)	13,980
	13,980
Sd/- Manager	Sd/- Accountant



## Double Entry System

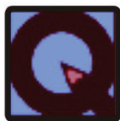
### Illustration 7

Prepare a transfer Voucher from the following supporting voucher.

Ratan & Sones			
Sale Invoice No. 121 To M/s. Naresh Brothers		Date : 15.3.2012	
Qty.	Particulars	Rate (₹)	Amount (₹)
120 Nos.	Cricket balls	100	12,000
70 Nos.	Full size bat	1000	70,000
			82,000
Sd/- Ratan & Sons			

### Solution :

Ratan & Sons	
Voucher No. 1	Date : 15.3.2012 Amount (₹)
Debit : M/s. Naresh Brothers	82,000
	82,000
Credit : Sales A/c (Being the credit sales vide Invoice No. 121 to M/s. Naresh Brothers)	82,000
	82,000
Sd/- Manager	Sd/- Accountant



## INTEXT QUESTIONS 5.3

- I. Which of the following statements is true and which is false?
  - i. For every transaction there will be two entries.
  - ii. 'One who gives is a debtor and one who receives is a creditor'.
  - iii. A system is called 'double entry system' because the two fold aspect of each transaction are recorded.
  - iv. The totals of debit entries on any day need not be equal to credit entries related to various accounts.
  
- II. Put a mark against each transaction in the column of correct type of voucher.

## MODULE - II

### Journal and Other Subsidiary Books



### Notes

## MODULE - II

### Journal and Other Subsidiary Books



#### Notes

## Double Entry System

	Debit Vouchers	Credit Vouchers	Transfer Vouchers
1. Purchase furniture for cash			
2. Sale of goods for cash			
3. Sale of goods to Vikram			
4. Depreciation charged on Building			
5. Withdrew cash from Bank for office use.			

### III. Multiple Choice Questions

- i. Which English alphabet is similar to the shape of an account?
  - a) I                      b) T                      c) H                      d) D
- ii. How many sides does an account have?
  - a) One                    b) Two                    c) Three                    d) Four
- iii. Where are all the transactions of a particular account recorded?
  - a) Under the particular account    b) Under any account
  - c) Under more than two accounts    d) Under many accounts
- iv. Under how many heads accounts can be grouped under Modern System of accounting:
  - a) Two                    b) Three                    c) Four                    d) Five
- v. Treatment of assets account is similar to
  - a) Expenses            b) Revenue            c) Capital            d) Liabilities



### WHAT YOU HAVE LEARNT

- System under which both the changes in a transaction are recorded together, one change is debited while the other change is credited with equal amount is known as double entry system.
- Account is a head under which particular type of transactions classified and consolidated are recorded.
- Traditional classifications of the accounts are as: personal, real and nominal.
- On the basis of modern classification accounts are divided into assets, liabilities, revenue, expense and capital.
- Effects of debits and credits on various types of accounts.

## Double Entry System

Assets		Expenses	
Debit (increase) +	Credit (decrease) -	Debit (increase) +	Credit (decrease) -

Capital		Liabilities		Revenue	
Debit (decrease) -	Credit (increase) +	Debit (decrease) -	Credit (increase) +	Debit (decrease) -	Credit (increase) +

- Source Document and Vouchers: A document evidencing that an accounting event took place is called source document i.e. cash memo, invoice, receipt, Debit Note, Credit Note, Cheque and Pay-in slip.
- A voucher is documentary evidence in support of a transaction. They are cash voucher (Dr & Cr voucher) and transfer voucher for credit transaction.



### TERMINAL EXERCISE

1. Define double entry system.
2. State various advantages of double entry system.
3. State the limitations of double entry system.
4. What is meant by an account?
5. Explain the modern classification of different types of Accounts.
6. State the fundamental rules, followed to record the changes (increase / decrease) in various accounts.
7. What is accounting voucher? Explain in brief different types of accounting vouchers.
8. Prepare debit vouchers from the following transactions:
  - i) Goods purchased for cash ₹1,50,000
  - ii) Cash paid to Raghav (creditor) ₹1,00,000
  - iii) Paid for office expense ₹15,000.
9. Prepare credit vouchers from the following transactions:
  - i) Additional capital introduced ₹2,00,000
  - ii) Compensation received from the Insurance company ₹50,000
  - iii) Drew cash for office from Bank ₹1,50,000
10. Prepare transfer vouchers from the following transactions:
  - i) Goods purchased from Mehta & Co. ₹25,000
  - ii) Sales return from customers ₹1,500
  - iii) Goods given as charity ₹3,000

## MODULE - II

### Journal and Other Subsidiary Books



### Notes



## 6

**JOURNAL****MODULE - II***Journal and Other  
Subsidiary Books***Notes**

You have learnt that business transactions are recorded in various books of accounts in a systematic manner. You have also learnt the double entry system of accounting. Now, you would like to know what are those books of accounts? How are these prepared? What transactions are recorded in each such book. One of these books is Journal. This is a book which is prepared by every businessman small or big. Business transactions are recorded in this book date wise and in the order in which these transactions take place. In this lesson you will learn the meaning of journal, its purpose and the method of preparing the journal.

**OBJECTIVES**

After studying this lesson you will be able to:

- explain the meaning of journal with its purpose;
- draw journal as per format;
- explain the process of journalising;
- journalise the simple and compound transactions and
- classify journal into special journal and journal proper.

**6.1 MEANING OF JOURNAL**

Journal is a book of accounts in which all day to day business transactions are recorded in a chronological order i.e. in the order of occurrence. Transactions when recorded in a journal are known as ‘entries’. It is the book in which transactions are recorded for the first time. Journal is also known as ‘Book of Original Record’ or ‘Book of Primary Entry’.

You have learnt that business transactions of financial nature are classified into various categories of accounts such as assets, liabilities, capital, revenue and expenses. All business transactions belonging to any of these categories can be recorded in a journal. The process of recording transactions in the journal is known as ‘Journalising’.

## MODULE - II

### Journal and Other Subsidiary Books



#### Notes

General Journal				
Transaction Details		GL Ref	Debit	Credit
Year	Day	Account Name	Account Name	
Month	30		XXXX	XXXX
March				

Annotations:

- Amounts debited and credited (points to Debit and Credit columns)
- General Ledger account number (points to GL Ref column)
- Name of account credited (points to Debit column)
- Short description of transaction (points to Description Of Transaction column)
- Name of account debited (points to Credit column)

## Journals

Small business units generally maintain one journal in which all the business transactions are recorded. But in case of big business houses as the transactions are large in number, the journal is divided into various books which are called special journals. Different transactions are recorded in these books depending upon the nature of transactions for example all credit sales of goods are recorded in Sales Book, all credit purchases of goods are recorded in Purchase Book and Cash transactions in Cash Book and so on.

### Purpose of Preparing Journal

1. It provides the date wise record of all the business transactions.
2. It gives complete information about a transaction at one place and also provides an explanation of the transaction.
3. It helps in the understanding of the principles of Double Entry System as entries in Journal are classified into Debit and Credit.
4. It is easier to post the entries of this book into ledger without any difficulty.

## 6.2 FORMAT OF JOURNAL

Every page of journal has the following format :

### Journal

Date	Particulars	L.F.	Dr. Amount ₹	Cr. Amount ₹
(1)	(2)	(3)	(4)	(5)

You see that journal is a columnar book. Each column is given a name which is written on its top. Column wise details of journal is as follows :

1. **Date:** In this column we record the date of the transaction with its month and accounting year. Year is written only once. Month is also written only once for all the transactions belong to a particular month.
2. **Particulars:** The accounts affected by a transaction i.e. the accounts which have to be debited and credited are recorded in this column. In the first line write the name of the account to be debited against which Dr is written. In the second line after leaving some space name of the account which has to be credited is written. The word 'To' may be prefixed with it. In the next line narration is written. Narration is the explanation of a particular journal entry. It should be short, complete and clear. A line is drawn before making the next entry so as to separate the two.

**Note :** As per modern concept of Accounting you may write journal entry even without writing 'To' for a credit entry.

3. **Ledger folio:** The transaction in the journal is posted in the ledger. Page number of ledger on which the two accounts are opened is written in the column of ledger folio.

## Journals

4. **Dr. Amount :** In this column the amount to be debited is written against the same line in which the debited account is written.
5. **Cr. Amount :** In this column, the amount to be credited is written against the same line in which the credited account is written

You can understand the journalising of a transaction with the help of the following example:

2012

April 1 Commenced business with cash ₹10,000.

In this transaction two affected accounts are Capital A/c and Cash A/c. The journal entry for the same will be.

### Journal

Date	Particulars	L.F.	Dr. Amount ₹	Cr. Amount ₹
2012 April 1	Cash A/c... Dr. Capital A/c (Business commenced with cash)		10,000	10,000

At the end of each page the two columns are totalled and are carried forward to the next page with words 'carried forward' (c/f). This total is written in the next page on its top with words 'brought forward' (b/f).



### INTEXT QUESTIONS 6.1

- I. **Complete the sentences stating the meaning of journal**
  - i. Journal is book of accounts in which \_\_\_\_\_.
  - ii. Narration is the \_\_\_\_\_.
  - iii. Ledger folio column is used \_\_\_\_\_.
- II. **Following statements about journal are incorrect, correct them:**
  - i. Only cash transactions are recorded in journal
  - ii. There is no other name of journal
  - iii. Every businessman big or small maintains one journal book.

## 6.3 PROCESS OF JOURNALISING

Following steps are taken while preparing a journal.

- i) **Identify the accounts :** First of all the affected accounts of an accounting transaction are identified. For example 'Goods of ₹5000 sold for cash

## MODULE - II

### Journal and Other Subsidiary Books



### Notes



## MODULE - II

### Journal and Other Subsidiary Books



#### Notes

## Journals

is a transaction. The affected accounts are Sales A/c and Cash A/c.

- ii) **Recognize the Account :** Now the type of two accounts are ascertained i.e. as asset, liability, capital, expense or revenue. In the given example Cash A/c is an asset A/c and Sales A/c is a revenue A/c.
- iii) **Apply the rules of Debit and Credit :** You have learnt the rules of Debit and Credit. Now ascertain which account is to be debited and which is to be credited. In our example, sales account will be credited as sales (a revenue item) is increasing and cash A/c will be debited as cash (is an asset) is also increasing.

Now, the Journal entry will be recorded and narration will be written. Amounts will be written against the two accounts in their respective columns.

Journal entry of the above given transaction will be recorded as follows:

#### Journal

Date	Particulars	L.F.	Dr. Amount ₹	Cr. Amount ₹
	Cash A/c... Dr. Sales A/c (Goods sold for cash)		5,000	5,000

#### Illustration 1

Analyse the following transactions using the Modern Approach for classification of Accounts in a Tabular Form.

2012		₹
Jan 1	Amogh started business with cash	50,000
Jan 2	Paid into Bank	20,000
Jan 4	Goods purchased for cash	10,000
Jan 8	Machinery purchased and paid by cheque	5,000
Jan 12	Sold goods to Pranaya	12,000
Jan 15	Purchased goods from Gunakshi	16,000
Jan 18	Sold goods for cash	8,000
Jan 20	Received cash from Pranaya	12,000
Jan 31	Withdrew cash for personal use	2,400
Jan 31	Rent Paid	2,000

## Journals

### Solution

Let us first analyze the transactions.

#### Tabular Analysis of Business Transactions

Date	Transaction	Affected Accounts	Kinds of Accounts	Increase/Decrease	Account to be Debited	Account to be Credited
<b>2012</b>						
Jan. 1	Cash Received from owner Amogh	Cash Capital	Asset Capital	Increase Increase	Cash A/c	Capital A/c
Jan. 2	Paid into Bank	Bank Cash	Asset Asset	Increase Decrease	Bank A/c	Cash A/c
Jan. 4	Goods Purchased for cash	Purchases Cash	Expense Asset	Increase Decrease	Purchases A/c	Cash A/c
Jan. 8	Machinery Purchased and paid by cheque	Machinery Bank	Asset Asset	Increase Decrease	Machinery A/c	Bank A/c
Jan. 12	Sold goods to Pranaya	Pranaya Sales	Pranaya (Debtor) Sales (Revenue)	Increase Increase	Pranaya	Sales A/c
Jan. 15	Purchased goods from Gunakshi	Purchases Gunakshi	Expenses Gunakshi (Creditor)	Increase Increase	Purchases A/c	Gunakshi
Jan. 18	Sold goods for cash	Cash Sales	Asset Revenue	Increase Increase	Cash A/c	Sales A/c
Jan. 20	Cash received from Pranaya	Cash Pranaya	Asset Pranaya (Debtor)	Increase Decrease	Cash A/c	Pranaya
Jan. 31	Withdrew cash for personal use	Drawings Cash	Capital Asset	Decrease Decrease	Drawings A/c	Cash A/c
Jan. 31	Rent Paid	Rent Cash	Expense Asset	Increase Decrease	Rent A/c	Cash A/c

### Illustration 2

On the basis of above analysis now you can prepare journal which will be as follows:

## MODULE - II

### Journal and Other Subsidiary Books



### Notes

## MODULE - II

### Journal and Other Subsidiary Books

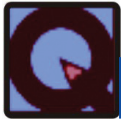


Notes

## Journals

### Journal of Amogh

Date	Particulars	L.F.	Dr. Amount ₹	Cr. Amount ₹
<b>2012</b>				
Jan. 1	Cash A/c ... Dr. Capital A/c (Capital brought in by Amogh)		50,000	50,000
Jan. 2	Bank A.c ... Dr. Cash A/c (Cash paid into bank)		20,000	20,000
Jan. 4	Purchase A/c ... Dr. Cash A/c (Goods purchase for cash)		10,000	10,000
Jan. 8	Machinery A/c ... Dr. Bank A/c (Machinery purchased & paid by cheque)		15,000	15,000
Jan. 12	Pranaya A/c ... Dr. Sales A/c (Goods sold on credit)		12,000	12,000
Jan. 15	Purchases A/c ... Dr. Gunakshi (Goods purchased on credit)		16,000	16,000
Jan. 18	Cash A/c ... Dr. Sales A/c (Goods sold for cash)		8,000	8,000
Jan. 20	Cash A/c ... Dr Pranaya A/c (Cash received from debtor Pranaya)		12,000	12,000
Jan. 31	Drawings A/c ... Dr. Cash A/c (Cash withdrawn for personal use)		2,400	2,400
Jan. 31	Rent A/c ... Dr. Cash A/c (Rent paid)		2,000	2,000
			<b>1,47,400</b>	<b>1,47,400</b>


**INTEXT QUESTIONS 6.2**

Given below are some transactions. Write the names and types of accounts affected in the given debit and credit columns.

Transaction	Dr.		Cr.	
	Name of A/c	Type of A/c	Name of A/c	Type of A/c
i. Purchased goods and paid by cheque.				
ii. Paid salary.				
iii. Cash received from Apoorva a debtor.				
iv. Goods sold to Maya				
v. Cash withdrawn for personal use.				

**Notes**

**Compound Entries**

The journal entries which you have learnt so far affect two accounts only. There can be entries that affect more than two accounts. Such entries are called 'Compound' or 'Combined' entries. A compound entry contains more than one debit or credit or both, for example :-

- Cash paid for rent ₹2,000 and for salary ₹4,000.
- The Affected accounts are Rent A/c which is to be debited and Salary A/c which is also to be debited as both are items of expense and are increasing.
- Cash A/c is to be credited as Cash A/c is an asset A/c and it decreases by the total of Salary and Rent paid.

**Journal entry**

Rent A/c	Dr.		2,000	
Salary A/c	Dr.		4,000	
Cash A/c				6,000
(Cash paid for rent and salary)				

Similarly cash paid to Vikram ₹ 4900. He allowed us discount ₹100. Journal entry will be :

Vikram	Dr.		5,000	
Cash A/c				4,900
Discount A/c				100
(Cash paid to Vikram and discount allowed by him)				

## MODULE - II

### Journal and Other Subsidiary Books



Notes

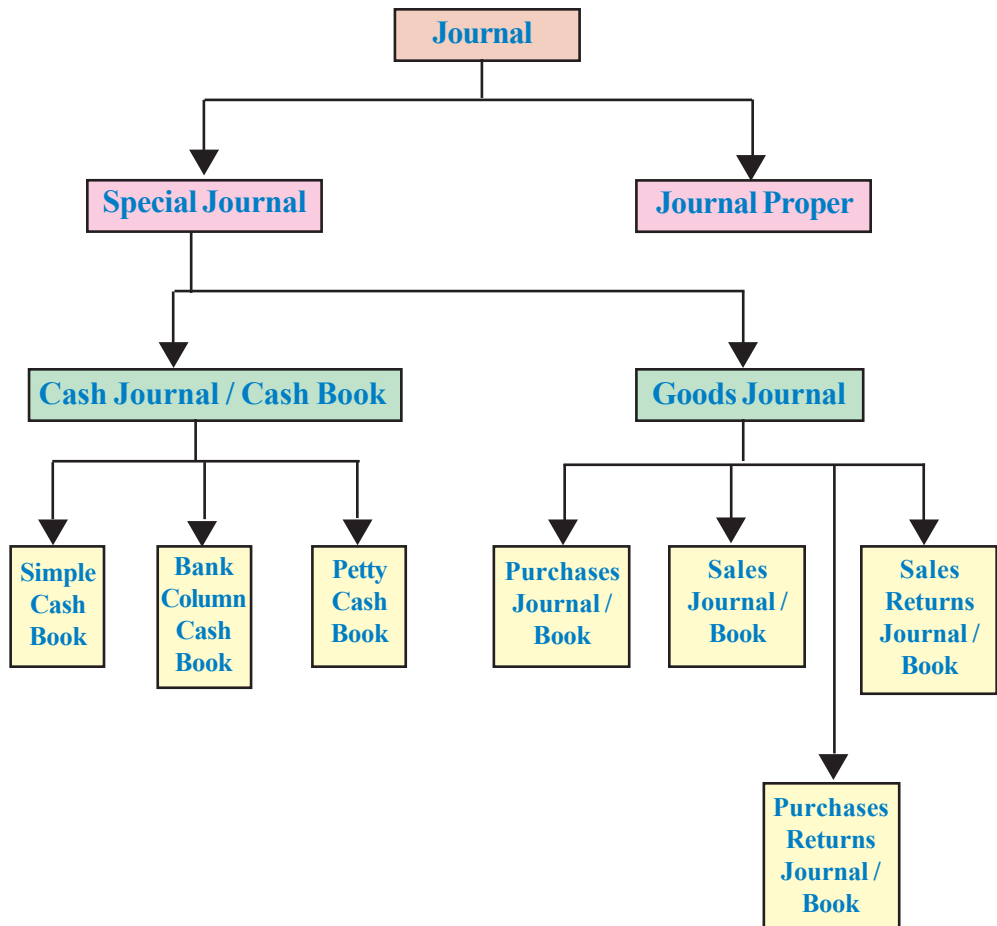
Thus, from the above examples you can understand that the entries having more than one debit or credit are known as compound entries.

### 6.4 CLASSIFICATION OF JOURNAL

Journal is a book in which transactions are recorded in chronological order date wise, therefore, it will be practically difficult to record all transactions in journal if the number of transactions are large. Hence, arises the need to divide journal into various journals each called a subsidiary book or Special Purpose Book and the journal itself is called Journal Proper. Following are the important subsidiary books (Journals) used by a business enterprise :

- i. Cash book
- ii. Sale book
- iii. Purchases book
- iv. Sale Returns book or Returns Inward book.
- v. Purchases Returns Book or Returns Outward book.
- vi. Journal proper or General Journal.

Chart Showing the Classification of Journal



## Journals

Some basic transactions with their Journal Entries.

### Journal Entries

Transactions	Journal Entry
1. Purchase of goods on credit	Purchases A/c ...Dr. Supplier A/c
2. Sale of goods of credit	Customer's A/c ...Dr. Sales A/c
3. Cash purchase of assets	Sundry Assets A/c ...Dr. Cash A/c
4. Started business with capital	Cash A/c ...Dr. Capital A/c
5. Collection of cash/cheque from customers (and discount allowed, if any)	Cash/Bank A/c (Net amount) ...Dr. Discount Allowed A/c (Discount) ...Dr. Customer's A/c
6. Goods purchased for cash	Purchases A/c ...Dr. Cash A/c
7. Cash sales	Cash A/c ...Dr. Sales A/c
8. Opening a Bank Account	Bank A/c ...Dr. Cash A/c
9. Recovery of Bad Debt	Cash A/c ...Dr. Bad Debt Recovered A/c
10. For payment of cash/cheque to suppliers (and discount received, if any)	Supplier ...Dr. Cash/Bank A/c (Net Amount) Discount Received A/c (Discount)
11. Bad Debts	Bad Debts A/c ...Dr. Customer's A/c
12. Distribution of goods as free samples.	Free Samples A/c / Advertisement A/c ...Dr. Purchases A/c
13. Purchase of machinery for cash	Machinery A/c ...Dr. Cash A/c

## MODULE - II

### Journal and Other Subsidiary Books



### Notes

## MODULE - II

### Journal and Other Subsidiary Books



#### Notes

### Journals

14. Depreciation charged on fixed assets	Depreciation A/c ...Dr. Asset A/c
15. Withdrawal of cash from bank for business	Cash A/c ...Dr. Bank A/c
16. Sale or disposal of any old asset at a profit	Cash A/c ...Dr. Asset A/c Profit on Sale of Asset A/c
17. Giving goods or cash in charity	Charity A/c ...Dr. Cash A/c Purchases A/c
18. Goods returned to the supplier	Supplier's ...Dr. Returns Outward A/c
19. Sale or disposal of any old asset at a loss	Cash/Bank A/c ...Dr. Loss on Sale or Assets A/c ...Dr. Asset A/c
20. Goods returned by the customer	Returns Inward A/c ...Dr. Customer's A/c

#### Illustration 3

Journalise the following transactions in the books of Pranaya:

2012	₹
Jan. 1 Commenced business with cash	50,000
Jan. 3 Paid into bank	25,000
Jan. 5 Purchased furniture for cash	5,000
Jan. 8 Purchased goods and paid by cheque	15,000
Jan. 8 Paid for carriage	500
Jan. 14 Purchased goods from Gaurav	35,000
Jan. 18 Cash Sales	32,000
Jan. 20 Sold goods to Amol on credit	28,000
Jan. 25 Paid cash to Gaurav in full settlement	34,200
Jan. 28 Cash received from Amol	27,500
Discount allowed to him	500
Jan. 31 Paid rent for the month	2,000
Jan. 31 Withdrew from the bank for private use	2,500



## Journals

## MODULE - II

### Journal and Other Subsidiary Books



### Solution

Date	Particulars	L.F.	Dr. Amount ₹	Cr. Amount ₹
<b>2012</b>				
Jan. 1	Cash A/c Dr. Capital A/c (Commenced business with cash)		50,000	50,000
Jan. 3	Bank A/c Dr. Cash A/c (Cash paid in the bank)		25,000	25,000
Jan. 5	Furniture A/c Dr. Cash A/c (Purchased furniture for cash)		5,000	5,000
Jan. 8	Purchases A/c Dr. Bank A/c (Purchased goods and paid cheque)		15,000	15,000
Jan. 8	Carriage A/c Dr. Cash A/c (Cash paid for carriage charge)		500	500
Jan. 14	Purchases A/c Dr. Gaurav (Goods purchased on credit)		35,000	35,000
Jan. 18	Cash A/c Dr. Sales A/c (Goods sold for cash)		32,000	32,000
Jan. 20	Amol Dr. Sales A/c (Goods sold to Amol on credit)		28,000	28,000
	<b>C/F</b>		<b>1,90,500</b>	<b>1,90,500</b>

Notes

## MODULE - II

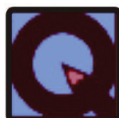
### Journal and Other Subsidiary Books



Notes

## Journals

	B/F	1,90,500	1,90,500
Jan. 25	Gaurav Dr. Cash A/c Discount A/c (Cash paid to Gaurav and discount allowed by him)	35,000	34,200 800
Jan. 28	Cash A/c Dr. Discount A/c Dr. Amol (Cash received from Amol and discount allowed to him)	27,500 500	28,000
Jan. 31	Rent A/c Dr. Cash A/c (Cash paid for rent)	2,000	2,000
Jan. 31	Drawings A/c Dr. Bank A/c (Cash withdrawn from bank for domestic use)	2,500	2,500
		<b>2,58,000</b>	<b>2,58,000</b>



### INTEXT QUESTIONS 6.3

#### Multiple Choice Questions

- i. Purpose of preparing Journal is
  - a) To provide date wise record of all the business transactions.
  - b) To know Profit or Loss of business.
  - c) To know financial position of business.
  - d) To ascertain cash availability on a particular date.
- ii. Compound Journal entry is an entry which
  - a) Contains more than one debit
  - b) Contains more than one credit
  - c) Contains more than one debit or credit or both.
  - d) Does not contain more than one debit or credit.
- iii. Journal is also known as
  - a) Book of secondary entry.
  - b) Book of Primary entry.
  - c) Book of Primary and secondary entry.
  - d) None of the above.



## MODULE - II

### Journal and Other Subsidiary Books



Notes

## Journals

2012

	₹
Apr. 1 Commenced business with cash	80,000
Apr. 3 Paid into Bank	50,000
Apr. 6 Purchased goods for cash	20,000
Apr. 9 Purchased furniture and paid for it by cheque	15,000
Apr. 14 Sold goods to Neha	18,000
Apr. 19 Purchased goods from Nirmal	24,000
Apr. 21 Withdraw cash for private use	8,000
Apr. 24 Received cheque from Neha	17,600
Allowed her discount	400
Apr. 26 Paid to Nirmal by cheque	16,300
She allowed discount	700
Apr. 27 Sold Goods to Maya for cash	80,000
Apr. 30 Paid Telephone bill	4,200

6. Journalise the following transactions in the journal of Mr. Ram Kumar.

	₹
Commenced business with cash	1,50,000
Purchased goods for cash	1,00,000
Purchased goods from Mohan on credit	26,000
Deposited into bank	15,000
Purchased furniture	72,000
Goods sold for cash	7,000
Goods sold to Kaushik on credit	5,000
Sale of old furniture	3,500
Received from Kamal	3,000
Paid salary	3,100
Paid Rent	4,200
Paid telephone bill	1,800

7. Journalise the following transactions in the books of Smt. Sheela.

	₹
Commenced business with cash	1,30,000
Paid into bank	21,000
Purchase goods	1,500
Withdrew cash from bank	3,000
Sold goods to Sharma	1,000
Purchased goods from Deepak	1,500
Received cash from Sharda	3,000
Paid to Malik	1,475
Rent paid	2,000

## Journals

Salary paid to clerk	4,500
Paid for postage	1,000

8. Journalise the following transactions.

**2012**

	₹
July 1 Commenced business with cash	2,00,000
July 2 Purchased goods on credit from Vivek	1,00,000
July 8 Sold goods for cash	22,400
July 9 Sold goods on credit to Ms/ Anuj & Co.	10,000
July 15 Paid to M/s Balbir Singh & Sons.	11,900
Discount allowed by them	100
July 25 Sold goods to M/s Balkrishan & Sons	5,600
July 27 Received cheque from M/s Anuj & Co. in full settlement of amount due from them	9,750
July 31 Paid for electric charges	3,100
July 31 Paid Salary	2,000
July 31 Paid rent of building by cheque half of the building is used by the proprietor for residential use	5,000
July 31 Withdrew for private use	3,500

9. The following are the transactions of Ranbeer Singh for the month of August. You are required to journalise the same.

**2012**

	₹
Aug. 1 Started business with cash	2,80,000
Aug. 1 Cash paid into bank	50,000
Aug. 1 Bought stationery for cash	300
Aug. 2 Bought goods for cash	20,000
Aug. 3 Bought postage stamps	100
Aug. 5 Sold goods for cash	7,500
Aug. 6 Bought office furniture from Bhalla furnitures	25,000
Aug. 11 Sold goods to Bhatia Traders	10,000
Aug. 12 Received cheque from Bhatia Traders	10,000
Aug. 14 Paid Bhalla Furnitures	24,500
Aug. 16 Sold goods to Bharat Bhushan	50,000
Aug. 20 Bought goods from Seth & Bros.	27,000
Aug. 23 Bought goods for cash from Ram Narain & Co.	22,500
Aug. 24 Sold goods to Prakash Electric Store	3,500
Aug. 26 Bhatia Traders paid on account	8,000
Aug. 28 Paid Sethi & Bros. by cheque in full settlement	25,000
Aug. 31 Paid salaries to office staff	25,000
Aug. 31 Rent paid for shop	5,000

## MODULE - II

### Journal and Other Subsidiary Books



### Notes

**MODULE - II****Journal and Other  
Subsidiary Books****Notes****Journals**

10. Shivali Chadha commenced business on 1st January, 2012. Her transactions for the month are given below. Pass necessary journal entries for the same.

**2012**

	₹
Jan. 1 Commenced business with cash	2,50,000
Jan. 2 Cash Paid into bank	35,000
Jan. 3 Bought goods from Praveen Chauhan	54,000
Jan. 3 Sold goods to Rajesh Agarwal	48,000
Jan. 7 Bought goods from Ram Chand Sahai	16,450
Jan. 8 Paid wages in cash	8,000
Jan. 8 Sold goods to Manish Chugh	15,000
Jan. 10 Received cheque from Rajesh Agarwal	47,800
Jan. 10 Paid into bank	10,000
Jan. 11 Paid to Ramesh	7,000
Jan. 12 Paid rent	4,000
Jan. 13 Bought from Khanna & Khanna	17,400
Jan. 15 Paid Electricity bill	2,800

**ANSWER TO INTEXT QUESTIONS**

- 6.1 I.** i. all transactions are recorded in chronological order.  
ii. explanation of journal entry.  
iii. to record page number of ledger on which journal entry is posted.
- II.** i. All transactions are recorded in journal.  
ii. Journal is also known as Day Book.  
iii. Small businesses maintain one journal while big businesses maintain different special journals.
- 6.2** i. Purchase - Expense - Bank - Asset  
ii. Salary - Expenses - Cash - Asset  
iii. Cash - Asset - Apporva - Asset  
iv. Maya - Asset - Sales - Revenue  
v. Drawing - Capital - Cash - Asset
- 6.3** i) a, ii) c, iii) b, iv) c, v) b.

**ACTIVITY FOR YOU**

- Observe any ten activities, of a near by shop which can be termed as transactions of business and record them on a page as journal.

## 7

## CASH BOOK

## MODULE - II

*Journal and Other  
Subsidiary Books*

## Notes

In the preceding lesson you have already learnt that business transactions are recorded in Journal. In the case of a small business concern, where the number of business transactions are less, the work relating to Journalizing of all business transactions is easy. As the business grows, the number of business transactions increase and recording all the transactions only in the Journal becomes very inconvenient and cumbersome. It needs to be divided into many books. There are various kinds of journals that are maintained where the transactions are recorded according to their nature, such as Cash Book for cash transactions, Sales Book for credit sales of goods; Purchase Book for credit purchases of goods and so on. In this lesson you will learn about Cash Book, its meaning and preparation.



## OBJECTIVES

After studying this lesson, you will be able to:

- understand the meaning of Cash Book;
- enumerate the types of Cash Books;
- state the meaning of and prepare a Simple Cash Book;
- state the meaning and prepare a Cash Book with Bank Column and
- describe the meaning of Petty Cash Book and its preparation.

## 7.1 MEANING OF CASH BOOK

Suppose you received your first salary in cash from your employer. Also you got back some money that you had given to your friend as loan. You spent this money in buying mobile phone and clothes and went to see movie with your friends. You purchased some toys for your nephew. As per habit you noted down all receipts and payments in your note book. At the end of the month, you may wish to calculate the balance of cash in the note book and compared it with the actual cash balance with you. You may maintain a separate book to record these items of receipts and payments. Such a book will be known as Cash Book.





## MODULE - II

### Journal and Other Subsidiary Books



Notes

## Cash Book

Cash Book is a book of account maintained for recording transactions involving receipt and payment of cash. It is also one of the books of original entry. When a cash book is maintained, cash transactions are not recorded in the Journal, and no cash or bank account is required to be maintained in the ledger as Cash Book serves the purpose of Cash Account also.

### 7.2 CASH BOOK: TYPES AND PREPARATION

Cash Books are of the following types:

- Simple Cash Book.
- Bank Column Cash Book.
- Petty Cash Book.

#### Simple Cash Book

This records only cash receipts and cash payments. It has two sides, namely debit and credit. Cash receipts are recorded on the debit side i.e. left hand side and cash payments are recorded on the credit side i.e. right hand side. In a simple cash book there is only one amount column each on its debit side and on the credit side. The format of a Simple Cash Book is as under:

#### Format of a Simple Cash Book

Dr.					Cr.				
Receipts					Payments				
Date	Particulars	V. No.	L.F.	Amount (₹)	Date	Particulars	V. No.	L.F.	Amount (₹)

Column-wise explanation is as follows:

#### Date

In this column Year, Month and Date of transactions are recorded in chronological order.

#### Particulars

The name of the account under which cash has been received or payment has been made is written. Account pertaining to the receipts of cash is recorded on the debit side and those pertaining to cash payments on the credit side.

#### Voucher No. (V. No.)

The document supporting a transaction is called a voucher. Generally, a voucher has a serial number which is written in this column.

## Cash Book

### Ledger Folio

In this column is recorded the page number of the ledger book on which relevant entry is posted.

### Amount

Amount column on debit side records cash received where as, amount column on credit side records cash payments.

### Steps in Preparation of Simple Cash Book

- i. On the debit side in the particulars column, the name of the account, form which cash is received, is recorded.
- ii. On the credit side, in the particulars column the name of account for which cash is paid, is recorded.
- iii. In the amount column of debit side the amount of cash received is recorded and in the amount column of credit side the amount of cash paid is recorded.
- iv. At the end of the period, the total of the debit side of the cash book is compared with the total of the credit side and the difference if any, is entered on the credit side of the cash book under the particulars column as balance c/d.
- v. In case of Simple Cash Book, the total of debit side is generally more than the total of the credit side, since the payment can never exceed the available cash. The difference is written in the amount column and total of both the sides of cash book becomes equal.
- vi. The closing balance of the credit side if any becomes the opening balance for the next period and is written as Balance b/d on the Debit side of the Cash Book for the next period.

### Illustration 1

Enter the following transactions in the cash book of M/s Ashok Traders:

Date	Details	Amount
<b>2011</b>		<b>₹</b>
Dec. 01	Cash in Hand	30,000
Dec. 05	Cash received from Tanvi	12,000
Dec. 08	Insurance Premium Paid	2,500
Dec. 10	Furniture Purchased	7,000
Dec. 14	Sold Goods for cash	16,500
Dec. 18	Purchased Goods from Mithun for cash	26,000
Dec. 22	Cash paid to Yash	3,200
Dec. 25	Sold Goods to Vineet for cash	18,700
Dec. 28	Cash Deposited into Bank	6,000
Dec. 30	Rent paid	4,000
Dec. 31	Salary paid	7,000

## MODULE - II

### Journal and Other Subsidiary Books



### Notes

## MODULE - II

### Journal and Other Subsidiary Books



Notes

## Cash Book

### Solution

#### Dr. Cash Book of M/s Ashok Traders Cr.

Receipts					Payments				
Date	Particulars	V. No.	L.F.	Amount (₹)	Date	Particulars	V. No.	L.F.	Amount (₹)
2011					2011				
Dec.01	Balance b/d			30,000	Dec. 08	Insurance			
Dec.05	Tanvi			12,000		Premium A/c			2,500
Dec.14	Sales A/c			16,500	Dec. 10	Furniture A/c			7,000
Dec.25	Sales A/c			18,700	Dec. 18	Purchases A/c			26,000
					Dec. 22	Yash			3,200
					Dec. 28	Bank A/c			6,000
					Dec. 30	Rent A/c			4,000
					Dec. 31	Salary A/c			7,000
					Dec. 31	Balance c/d			21,500
2012				77,200					77,200
Jan. 01	Balance b/d			21,500					

### Illustration 2

Record the following transactions in a Simple Cash Book of M/s Suresh & Co.

Date	Details	Amount (₹)
2012		
Jan. 01	Cash in Hand	22,000
Jan. 05	Received from Ramesh (after allowing a discount ₹ 200)	3,000
Jan. 07	Paid Rent	300
Jan. 08	Sold Goods	3,000
Jan. 10	Paid Sanjay	7,000
Jan. 27	Purchased Furniture	2,000
Jan. 31	Paid Salaries	1,000

### Solution

#### Dr. Cash Book of M/s Suresh & Co. Cr.

Receipts					Payments				
Date	Particulars	V. No.	L.F.	Amount (₹)	Date	Particulars	V. No.	L.F.	Amount (₹)
2012					2012				
Jan.01	Balance b/d			22,000	Jan. 07	Rent A/c			300
Jan.05	Ramesh			3,000	Jan. 10	Sanjay			7,000
Jan.08	Sales A/c			3,000	Jan. 27	Furniture A/c			2,000
					Jan. 31	Salary			1,000
					Jan. 31	Balance c/d			17,700
				28,000					28,000
Feb.01	Balance b/d			17,700					

**Note :** Jan. 05 entry of discount will not be shown in Cash Book but it will be shown separately in journal proper.

## Cash Book

## MODULE - II

Journal and Other  
Subsidiary Books



**Notes**

### Illustration 3

Record the following in the Cash Book of Ranveet and show the balance:

Date	Details	Amount
		(₹)
2012		
Oct. 01	Balance of cash in hand	25,000
Oct.08	Purchased goods for cash from X	3,200
Oct. 15	Sold goods to Y	4,800
Oct. 20	Received commission	650
Oct. 20	Paid commission	550
Oct. 28	Paid to Suresh on account	7,150
Oct. 31	Paid salary to the office clerk ₹1,000 and office rent ₹ 600	

### Solution

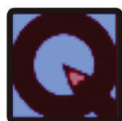
#### Cash Books of Ravneet

Dr.

Cr.

Receipts					Payments				
Date	Particulars	V. No.	L.F.	Amount (₹)	Date	Particulars	V. No.	L.F.	Amount (₹)
Oct. 1	Balance b/d			25,000	Oct. 8	Purchases A/c			3,200
Oct.20	Commission A/c			650	Oct. 20	Commission A/c			550
					Oct. 28	Suresh			7,150
					Oct. 31	Salary A/c			1,000
					Oct. 31	Office Rent A/c			600
					Oct. 31	Balance c/d			13,150
				<b>25,650</b>					<b>25,650</b>
Nov.1	Balance b/d			13,150					

**Note :** Transaction dated Oct. 15 has not been recorded in the cash book because it is a credit transaction.



### INTEXT QUESTIONS 7.1

#### Fill in the blanks :

- i. Simple cash book records only cash \_\_\_\_\_ and cash \_\_\_\_\_
- ii. In a simple cash book all \_\_\_\_\_ are recorded in debit side and all \_\_\_\_\_ are recorded in credit side.
- iii. The total of \_\_\_\_\_ side of the simple column cash book is generally more than the total of its \_\_\_\_\_ side.
- iv. Closing balance of cash book becomes the \_\_\_\_\_ balance of next period.

## MODULE - II

### Journal and Other Subsidiary Books



Notes

## Cash Book

### Illustration 4

Prepare Cash Book of Kuldeep for the month of April 2011 from the following particulars :

Date	Details	Amount (₹)
2012		
Apr. 01	Cash in hand	17,600
Apr. 03	Purchased Goods for cash from Santosh	7,500
Apr. 06	Sold Goods to Rohit	6,000
Apr. 10	Wages paid in cash	500
Apr. 15	Cash paid to Naveen	3,500
Apr. 17	Cash sales	10,000
Apr. 19	Commission paid	700
Apr. 21	Cash received from Tanya	1,500
Apr. 25	Furniture Purchased for cash	1,700
Apr. 28	Rent paid	3,000
Apr. 30	Paid Electricity bill in cash	1,300

### Solution

### Cash Book of Kuldeep

Dr.					Cr.				
Receipts					Payments				
Date	Particulars	V. No.	L.F.	Amount (₹)	Date	Particulars	V. No.	L.F.	Amount (₹)
2012					2012				
Apr. 1	Balance b/d			17,600	Apr. 03	Purchases A/c			7,500
Apr. 17	Sales A/c			10,000	Apr. 10	Wages A/c			500
Apr. 21	Tanya			1,500	Apr. 15	Naveen			3,500
					Apr. 19	Commission A/c			700
					Apr. 25	Furniture A/c			1,700
					Apr. 28	Rent A/c			3,000
					Apr. 30	Elect. Bill A/c			1,300
					Apr. 30	Balance c/d			10,900
				<b>29,100</b>					<b>29,100</b>
May 01	Balance b/d			10,900					

**Note:** Credit transactions are not recorded in cash Book (i.e. a credit sales to Rohit ₹6000 on April 6, 2012).

### Illustration 5

Naresh started a business with ₹20,000 on 1st April 2012. Out of this he deposited ₹15,000 into his Bank Account. His cash transactions during the week were:

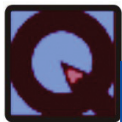
## Cash Book

Date	Details	Amount
<b>2012</b>		
Apr.01	Purchased stationery for cash	100
Apr.01	Purchased goods for cash	2,500
Apr.02	Cash sales	1,500
Apr.03	Cash Received from Shiv on account	1,000
Apr.04	Paid to Ram	2,200
Apr.05	Paid for advertisement	400
Apr.06	Cash sales	1,800
Apr.06	Purchased old machinery for cash	800

### Solution

### Cash Book of Naresh

Dr.					Cr.				
Receipts					Payments				
Date	Particulars	V. No.	L.F.	Amount (₹)	Date	Particulars	V. No.	L.F.	Amount (₹)
Apr. 01	Capital A/c			20,000	Apr. 01	Bank A/c			15,000
Apr. 02	Sales A/c			1,500	Apr. 01	Stationery A/c			100
Apr. 03	Shiv			1,000	Apr. 01	Purchases A/c			2,500
Apr. 06	Sales A/c			1,800	Apr. 04	Ram			2,200
					Apr. 05	Advertisement A/c			400
					Apr. 06	Machinery A/c			800
				<b>24,300</b>	Apr. 06	Balance c/d			3,300
Apr. 07	Balance b/d			3,300					<b>24,300</b>



## INTEXT QUESTIONS 7.2

### I. Multiple Choice Questions

- i. Simple Cash Book generally shows :
  - a) Debit or Credit balances
  - b) Credit balance
  - c) Debit balance
  - d) Both the balances
- ii. Cash book is a :
  - a) Subsidiary journal
  - b) Subsidiary journal and ledger
  - c) Ledger only
  - d) None of these
- iii. Cash sales are recorded in :
  - a) Sales book
  - b) Cash book
  - c) Journal
  - d) None of these
- iv. The Cash Book records :
  - a) All cash receipts & payment
  - b) Cash and credit sales of goods
  - c) Only cash receipts
  - d) None of these

## MODULE - II

### Journal and Other Subsidiary Books



### Notes

## MODULE - II

### Journal and Other Subsidiary Books



Notes

## Cash Book

- v. The balance in the Cash Book is :  
a) An expense    b) A profit    c) An asset    d) A liability
- vi. If Sonu has sold goods for cash, the entry will be recorded :  
a) In the Cash Book    b) In the Sales Book  
c) In the proper Journal    d) None of the above
- vii. Cash Book is a part of :  
a) Journal    b) Ledger  
c) both Journal & Ledger    d) None of the above

### II. Some transactions are given below. On which side of the Cash Book would you record them? Put the tick mark in appropriate column.

S.No.	Transactions	Debit Side	Credit Side
(i)	Mukesh started business with cash		
(ii)	Goods purchased for cash		
(iii)	Goods sold for cash		
(iv)	Closing cash balance		
(v)	Cash received from Ankur		

### 7.3 BANK COLUMN CASH BOOK

When the number of bank transactions are large in an organization, it is necessary to have a separate book to record bank transactions. Instead of having a separate book to record Bank transactions, a Bank column is added on each side of the Simple Cash Book. This type of cash book is known as Bank column Cash Book. All payments into Bank are recorded on the debit side and all withdrawals / payments through the Bank are recorded on the credit side of the cash book. The format of a Bank column Cash Book is as under:

#### Format of a Bank Column Cash Book

Dr.					Cr.				
Receipts					Payments				
Date	Particulars	L.F.	Cash (₹)	Bank (₹)	Date	Particulars	L.F.	Cash (₹)	Bank (₹)

#### Accounting Technique

- i) **Payment in cash or by cheque :** Payment by cheque will be entered in the Bank column and those payments made in cash will be written in the cash column, on the credit side.



## Cash Book

- ii) **Received Cash or Cheque :** Cheque received will be recorded in the Bank column and cash received will be recorded in the cash column, on the debit side.
- iii) **Cash withdrawn from Bank :** There are two accounts involved in it. Firstly, the amount of cash at bank will reduce and secondly the amount of cash in hand will increase. It will first be written on the debit side in the cash column and then on the credit side in 'bank column'. This is because both the accounts involved in this transaction are there in this Cash Book viz. – Cash Account and Bank Account. As per double entry system one account will be debited and the other account will be credited. Cash in hand is increasing and 'Cash at Bank' is decreasing. Therefore, on the credit side in the particulars column "By Cash" will be written and the amount will be entered in the bank column, on the debit side in the particulars column 'To Bank' will be written and the amount will be entered in the "Cash Column". This is called a 'Contra-Entry' i.e., entry in both sides of the Cash Book once in the 'Cash Column' and once in the 'Bank Column'. This fact is denoted by writing letter (C) in the L.F. columns on both sides.
- iv) **Cash Paid-into Bank :** This will also be recorded through a contra entry as explained above. Here also there are two accounts involved – 'Cash in hand' and 'Cash at Bank'. First of all amount of cash in hand will reduce and secondly the amount of cash at bank will increase. Both these accounts are there in this Cash Book. Cash at bank is increasing therefore, the amount will be written in the bank column on the debit side by writing 'To Cash' in the particulars column. Cash in hand is reducing therefore, the amount will be written in the cash column on the credit side by writing 'By Bank' in the particulars column. As it is a contra entry letter (C) will be written in the L.F. column on both sides.
- v) **Dishonors of a Cheque :** (a) If any cheque sent to the bank is dishonored and is sent back by the bank, its amount will be entered in the 'bank column' on the credit side. In the particulars column the name of the party, who gave the cheque, will be written. (b) If any cheque issued by the firm to a creditor is dishonored and is returned by the creditor, it will be entered in the bank column on the debit side. The name of the creditor will be written in the particulars column.
- vi) **Bank Charges :** Bank charge some money for the services provided by it. Every half year some amount is charged by them. This amount will be written in the bank column on the credit side because cash at bank is reduced. In the particulars column 'By Bank Charges Account' will be written.
- vii) **Cheques Received but not Sent to Bank :** Such cheques should be crossed and kept under lock and key and should be straight away entered

## MODULE - II

### Journal and Other Subsidiary Books



### Notes

## MODULE - II

### Journal and Other Subsidiary Books



#### Notes

## Cash Book

into bank column the next day when it is sent to bank. As the cheque is crossed, there is no danger of its being misused. This is the best course. However, if the cheque is treated as cash and is entered in the cash column on the day it is received, the cash in hand will increase which will be different from the actual cash in hand. This is not desirable. Moreover, next day it will have to be sent to the bank by passing a contra-entry. This increases the work unnecessarily. Therefore, the first approach is the best.

- viii) Endorsement of cheque :** If a received cheque is to be endorsed, then it is not deposited in bank account but is to be recorded in cash column Dr. side of Cash Book and simultaneously in cash column Cr side of Cash Book.
- ix) Balancing the Cash Book :** Both the 'cash' column and the 'bank' column will be balanced.
- Total of the debit side of 'Cash' column will generally be more than the total of credit side of cash column. It will be totalled first and the same total will be written just opposite to it in the cash column on the credit side. The balance will be calculated on the credit side above the total by writing "By Balance c/d" in the particulars column. This balance will be carried forward to the next date and will be taken to the debit side below the total and 'To Balance b/d' will be written in the particulars column.
  - In case of bank column, the total of any side may be more. In case the debit side bank column is more, it means that there is a balance in the bank. The balancing will be done just in the same way as in the case of cash column as described above.

If the total of credit side bank column is more this means that there is an overdraft from the bank. In this case first total the bank column on the credit side. Then put the same total in the bank column on the debit side in front of each other. The balance will be calculated on the debit side above the total and phrase, 'To Balance c/d' will be written in the particulars column. This balance of overdraft will be carried to the next date on the credit side below the total of the bank column and the phrase 'By Balance b/d' will be written in the particulars column.

### Illustration 6

Enter the following transactions in the Two Column Cash Book of Ratan for the month of June 2012 :

## Cash Book

Date 2012	Detail	Amount (₹)
June 1	Balance of Cash in hand	12,000
June 1	Balance of Cash at Bank	1,80,000
June 2	Bought goods by cheque	15,000
June 4	Bought goods by cash	8,000
June 5	Cash Sales	28,000
June 8	Sold goods by cheque	10,000
June 9	Paid wages in cash	400
June 15	Paid salaries by cheque	8,000
June 20	Paid cash into Bank	20,000
June 21	Paid for stationery by cheque	1,200
June 21	Paid to Naresh by cheque	1,280
June 22	Cash purchases	8,000
June 23	Received a cheque from Gopal and deposited the same into bank	1,880
June 24	Withdrew cash from bank	35,000
June 26	Drawings in cash for personal use	4,000
June 28	Purchases by cheque	9,500
June 29	Received cheque from Sohan	4,600
June 30	Paid rent by cheque for the month	1,200

## MODULE - II

*Journal and Other  
Subsidiary Books*



### Notes

### Solution

### Cash Book of Ratan

Dr.

Cr.

Receipts					Payments				
Date 2012	Particulars	L.F.	Cash (Rs.)	Bank (Rs.)	Date 2012	Particulars	L.F.	Cash (Rs.)	Bank (Rs.)
June1	Balance b/d		12,000	1,80,000	June2	Purchase A/c		---	15,000
June5	Sales A/c		28,000		June4	Purchase A/c		8,000	
June8	Sales A/c			10,000	June9	Wages A/c		400	
June20	Cash A/c	(C)		20,000	June15	Salaries A/c			8,000
June23	Gopal			1,880	June20	Bank A/c	(C)	20,000	
June24	Bank A/c	(C)	35,000		June21	Stationery A/c			1,200
June29	Sohan			4,600	June21	Naresh			1,280
					June22	Purchase A/c		8,000	
					June24	Cash A/c	(C)		35,000
					June26	Drawings A/c		4,000	
					June28	Purchases A/c			9,500
					June30	Rent A/c			1,200
					June30	Balance c/d		34,600	1,45,300
			75,000	2,16,480				75,000	2,16,480
July 1	Balance c/d		34,600	1,45,300					

## MODULE - II

### Journal and Other Subsidiary Books



Notes

## Cash Book

### 7.4 PETTY CASH BOOK

The Business enterprises which prefer to maintain Bank column cash book feel the necessity of having another Cash book for recording small payments. A large number of repetitive small payments such as, for conveyance, cartage, postage, telegrams, courier and other expenses are made. These organizations appoint an assistant to the Head Cashier. The appointed assistant is known as petty cashier. He makes payments of these expenses and maintains a separate cash book to record these transactions. Such a cash book is called Petty Cash Book.

The petty Cash Book is generally prepared on imprest basis. Under this system initially a fixed amount is given to the petty cashier. He makes the petty payments out of this amount. When he uses approximately the whole amount he hands over the payment vouchers to the main cashier and the main cashier reimburses the total amount of payments to the petty cashier. The format of the petty Cash Book is given below:

Date	Particulars	Amt. (₹)	Conveyance (₹)	Cartage (₹)	Postage (₹)	Telegram (₹)	Refreshment (₹)	Courier (₹)	Total (₹)

#### Illustration 7

On 1.1.2012 an imprest of ₹500 was given by the main cashier to the petty cashier. The petty cashier made the following payments:

Date	Detail	Amount (₹)
2012		
Jan 1	Paid Conveyance	130
Jan 2	Paid for refreshments	45
Jan 3	Paid for postage stamps	45
Jan 15	Paid for courier	35
Jan 17	Paid for telegram	25
Jan 18	Paid for cartage	12
Jan 20	Paid for conveyance	21
Jan 21	Paid cartage	57
Jan 27	Paid for refreshment	28
Jan 28	Paid for Courier	14

Prepare a Petty Cash Book.

## Cash Book

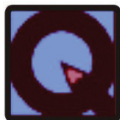
### Solution

#### Petty Cash Book

Date 2012	Particulars	Amt. (₹)	Conveyance (₹)	Cartage (₹)	Postage (₹)	Telegram (₹)	Refreshment (₹)	Courier (₹)	Total (₹)
Jan.1	Cash	500							
Jan.1	Conevyance		130						130
Jan.2	Refreshment						45		45
Jan.3	Postage Stamp				45				45
Jan.15	Courier							35	35
Jan.17	Telegram					25			25
Jan.18	Cartage			12					12
Jan.20	Conevyance		21						21
Jan.21	Cartage			57					57
Jan.27	Refreshment						28		28
Jan.28	Courier							14	14
Jan.28	Total	500	151	69	45	25	73	49	412
	Balance								88
		500							500
Jan.29	Balance b/d	88							
Feb.01	Cash	412							



### Notes



### INTEXT QUESTIONS 7.3

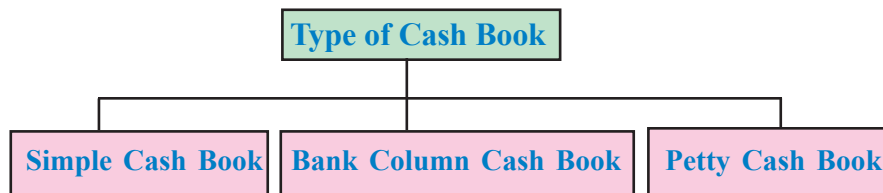
#### Fill in the blanks with suitable word/words:

- i. In Bank column cash book, Bank and \_\_\_\_\_ columns are shown on each side.
- ii. The Bank column cash book records transactions relating to \_\_\_\_\_ as well as \_\_\_\_\_.
- iii. A separate cash book maintained to record small transactions is called \_\_\_\_\_.



### WHAT YOU HAVE LEARNT

- Cash Book is a Book in which all cash receipts and cash payments are recorded. It is also a book of original entry.



**MODULE - II****Journal and Other  
Subsidiary Books****Notes****Cash Book**

- **Simple Cash Book**  
A Simple Cash Book records only cash receipts and cash payments. It has two sides, namely debit and credit.
- **Bank Column Cash Book**  
In this type of Cash Book, Bank and Cash columns are shown on each side.
- **Petty Cash Book** : In business organizations, a large number of repetitive small payments such as, for conveyance, cartage, postage, telegrams and other expenses are made. These organizations appoint an assistant to the Head Cashier. The so appointed cashier is known as petty cashier. He makes payment of these expenses and maintains a separate cash book to record these transactions. Such a cash book is called Petty Cash Book.

**TERMINAL EXERCISE**

1. What is meant by a Cash Book? Explain the types of Cash Book.
2. What is meant by a 'Bank Column Cash Book' ? Draw the format of 'Bank Column Cash Book'.
3. What do you mean by Petty Cash Book?
4. State the meaning of a 'Contra Entry' with the help of an example.
5. Enter the following transactions in the Simple Cash Book of M/s Ronark Traders:

<b>Date</b>	<b>Details</b>	<b>Amount</b>
<b>2012</b>		<b>(₹)</b>
Jun. 01	Started Business with cash	30,000
Jun. 02	Goods purchased for Cash	10,000
Jun. 03	Furniture Purchased	1,000
Jun. 06	Goods Sold for Cash	7,000
Jun. 09	Cartage Paid	200
Jun. 10	Postage Paid	100
Jun. 12	Cash Sales	3,000
Jun. 14	Cash withdrawn for Personal use	2,000
Jun. 18	Deposited into Bank	10,000
Jun. 22	Goods purchased for Cash	13,000
Jun. 25	Wages paid	500
Jun. 27	Rent Paid	3,000
Jun. 28	Cash Sales	2,000

## Cash Book

6. Enter the following in Srinath's cash book and show the balance:

Date	Details	Amount
<b>2012</b>		
Oct. 01	Balance of cash in hand	25,000
Oct. 08	Purchased goods for cash from X	3,200
Oct. 15	Sold goods to Y	4,800
Oct. 20	Received commission	650
Oct. 20	Paid Commission	550
Oct. 28	Paid to Suresh on account	7,150
Oct. 31	Paid salary to the office clerk and office Rent	1,000 600

7. From the following transactions prepare Simple Cash Book:

Date	Details	Amount
<b>2012</b>		
Mar.01	Cash in Hand	32,500
Mar. 08	Cash paid to Sumit	8,000
Mar. 12	Goods Purchased	3,000
Mar. 15	Cash received from Nidhi	2,000
Mar. 18	Cash Sales	4,000
Mar. 22	Paid Wages	4,000
Mar. 25	Salary Paid	3,000
Mar. 28	Cash paid to Nitin	3,500
Mar. 31	Rent Paid	2,500

8. Enter the following transactions in a Single Column Cash Book :

Date	Details	Amount
<b>2012</b>		
Apr. 01	Cash in Hand	15,000
Apr. 05	Cash Purchases	1,000
Apr. 08	Cash Sales	800
Apr. 10	Received from Munish	1,000
Apr. 15	Purchased Furniture	500
Apr. 22	Paid Wages	200
Apr. 25	Received Commission	100
Apr. 30	Paid Rent	600

## MODULE - II

### Journal and Other Subsidiary Books



Notes



## MODULE - II

### Journal and Other Subsidiary Books



Notes

## Cash Book

9. Enter the following transactions in a Petty Cash Book of Manohar.

Date 2012	Details	Amount (₹)
Jan 1	Imprest received	1,000
Jan 1	Paid Cartage	200
Jan 2	Paid Postage	102
Jan 4	Paid Conveyance	22
Jan 8	Paid for refreshments	115
Jan 9	Paid for courier	27
Jan 10	Paid for telegram	17
Jan 12	Paid Conveyance	38
Jan 20	Paid for refreshment	124
Jan 21	Paid Conveyance	127
Jan 22	Paid Postage	34
Jan 27	Paid Cartage	120

10. Enter the following transactions in the Bank Column Cash Book of Mohan for the month of September 2012 :

Date 2012	Details	Amount (₹)
Sept. 1	Balance of Cash in hand	1,20,000
Sept. 1	Balance of Cash at Bank	1,80,000
Sept. 2	Bought goods by cheque	15,000
Sept. 4	Bought goods by cash	18,000
Sept. 5	Cash Sales	28,000
Sept. 8	Sold goods by cheque	70,000
Sept. 9	Paid wages in cash	11,400
Sept. 10	Purchased furniture and paid by cheque	20,000
Sept. 12	Received a cheque from Suresh for ₹ 10,000, which was endorsed to Naresh on the same day.	
Sept. 15	A debtor Harish deposited ₹ 5,000 directly in our bank account.	
Sept. 20	Bank charges ₹ 200 for issuing a new cheque book.	
Sept. 24	Goods sold for ₹ 30,000, as 1/3 cash and 2/3 on credit to Gurdeep.	
Sept. 25	Received a cheque from Chunnu for ₹ 8,000 goods sold to him before one month, deposited in bank.	
Sept. 28	Cheque received from Chunnu was dishonoured for which bank charges ₹ 50.	

## Cash Book

11. Prepare a Bank column Cash Book from the following transactions :

Date	Details
<b>2012</b>	
Mar. 1	Cash in hand ₹ 2,780, Bank overdraft ₹ 3,125
Mar. 2	Cheque of ₹ 400 issued to the petty cashier.
Mar. 5	₹ 350 was paid to Hari for the repair of electricity.
Mar. 12	Received ₹ 1200 for sale of goods.
Mar. 17	Received ₹ 950 from Sheila after allowing a rebate of ₹ 20 on account of retering a bill of exchange.
Mar. 24	Girdhari Lal paid ₹ 2000 in cash and ₹ 3000 in cheque, for the sale of goods to him.
Mar. 25	Bought goods worth ₹ 1700 from Rahim and paid by cheque.
Mar. 30	Interest on overdraft ₹ 50 was charged by Bank
Mar. 31	Cash in excess of ₹ 1000 was deposited into the Bank

12. Prepare a Bank column Cash Book from the following transactions particulars.

Date	Details	Amount (₹)
<b>2012</b>		
Mar. 1	Cash in hand ₹ 70,000 and at Bank ₹ 80,000.	
Mar. 5	Bought goods for cheque	10,000
Mar. 10	Sold goods for cash	20,000
Mar. 12	Received a cheque for sale of goods	40,000
Mar. 15	Paid Hari Om by cheque	7,000
Mar. 16	Paid telephone bill	2,000
Mar. 17	Received from Malti	4,000
Mar. 18	Received a cheque from Shweta	8,000
Mar. 20	Withdrawn from Bank for office use	12,000
Mar. 22	Paid wages to workers	18,000
Mar. 25	Cheque of Shweta returned dishonoured	—
Mar. 25	Banks debits the accounts for bank charges	120
Mar. 30	Interest collected by bank	190
Mar. 31	Cash sales	4,000

13. Prepare a Bank column Cash Book from the following transactions:

Date	Details	Amount (₹)
<b>2012</b>		
Jan. 1	Cash in hand ₹ 26,800 and at Bank ₹ 72,400	
Jan. 5	Discounted a bill receivable for ₹ 8,000 at 3% through Bank for two months	

## MODULE - II

### Journal and Other Subsidiary Books



### Notes

## MODULE - II

### Journal and Other Subsidiary Books



#### Notes

### Cash Book

Jan. 8	Bought goods for cheque	4,000
Jan. 10	Purchased goods for cash	7,000
Jan. 13	Paid by cheque for a bill payable	12,000
Jan. 15	Paid trade expenses in cash	9,000
Jan. 17	Paid cash into bank	10,000
Jan. 19	Jacky who owed us ₹ 600 became insolvent and paid only 50 P in the rupee.	
Jan. 20	Received ₹ 4,800 from Gianchand	
Jan. 22	Paid ₹ 2,390 to Malika Singh	
Jan. 25	Withdrew Cash from bank for office	6,000
Jan. 25	Withdrew cash from bank for private use	7,000
Jan. 28	Sold goods for cash	20,000
Jan. 28	Received a cheque for sale of goods	18,000
Jan. 30	Received a refund of Loan of ₹ 15,000 and deposited ₹ 13,000 in the bank.	

14. From the following transactions prepare Bank column Cash Book.

Date 2012	Details	Amount (₹)
Feb. 1	Cash in hand	10,000
Feb. 1	Bank Balance	40,000
Feb. 3	Cash Sales	13,000
Feb. 4	Deposited into Bank	17,000
Feb. 8	Jimmy settled his account by giving a cheque	12,000
Feb. 12	Bought goods by cheque	10,000
Feb. 15	Purchased stationery for cash	5,000
Feb. 20	Jimmy's cheque returned dishonoured with bank charges of ₹ 50	
Feb. 20	Received a cheque from Janakidas	11,000
Feb. 26	Withdrew from Bank for office use	16,000
Feb. 29	Paid salary by cheque ₹ 11,200 and rent in cash ₹ 7,240	

15. Prepare a Bank column Cash Book from the following transactions:

Date 2012	Details	Amount (₹)
Oct. 1	Cash in hand	27,100
Oct. 1	Cash at Bank	72,000
Oct. 6	Bought goods by cheque	14,000
Oct. 7	Bought goods for cash	15,000

## Cash Book

Oct. 15	Paid trade expenses	4,150
Oct. 16	Paid into Bank	2,000
Oct. 19	Ram who owed us ₹ 8,000 became insolvent and paid only 60 paise in the rupee.	
Oct. 21	Received cash from Malti	5,800
Oct. 24	Withdrew from Bank	7,500
Oct. 25	Paid cash to Das & Co.	4,490
Oct. 28	Withdrew from Bank for private use	13,000
Oct. 28	Sold goods for cash	14,000
Oct. 28	Received cheque for goods sold	10,000
Oct. 30	Received refund of loan of ₹ 18,000 and deposited ₹ 6,000 into Bank.	
Oct. 31	Bank charges	250

16. Prepare Bank column Cash Book:

Date 2012	Details	Amount (₹)
Apr. 1	Cash in hand ₹ 26,500 and balance in Bank Current Account ₹ 46,400	
Apr. 3	Received from Neeraj Singh	7,900
Apr. 10	Paid salaries to the staff	18,000
Apr. 12	Cash Sales	3,750
Apr. 15	Paid to Vivek by cheque	4,200
Apr. 16	Cash purchases	3,300
Apr. 18	Paid bill payable by a cheque	6,400
Apr. 18	Paid to Meena by cheque	1,685
Apr. 19	Cash Sales	8,680
Apr. 19	Paid cash for cartage and coolie	450
Apr. 20	Withdrew cash from bank for office use	7,000
Apr. 20	Paid rent for the month in cash	2,500
Apr. 21	Cash sales	19,000
Apr. 22	Received cheque form Manish	2,694
Apr. 23	Deposited cash into Bank	3,400
Apr. 24	Purchased a Scooter and paid by a cheque	26,800
Apr. 25	Collections by Bank	18,000
Apr. 25	Received a cheque from Alok Gupta in full settlement of his account of ₹ 8,000.	7,900
Apr. 25	Cash Sales	2,700
Apr. 27	Bank notifies that Alok Gupta's cheque has been dishonoured	

## MODULE - II

### Journal and Other Subsidiary Books



### Notes

## MODULE - II

### Journal and Other Subsidiary Books



#### Notes

### Cash Book

- Apr. 28 Deposited Cash in the Bank 5,400  
Apr. 29 Paid wages 8,200
17. Enter the following transaction in Petty Cash Book. The imprest amount is ₹ 5,000.

Date	Details	Amount (₹)
<b>2012</b>		
Aug. 1	Peon's wages	1,400
Aug. 3	Pencils and Pens	70
Aug. 5	Carriage on goods	250
Aug. 10	Postage Stamps bought	135
Aug. 12	Telegrams & Telephones	210
Aug. 14	Sundry Expenses	900

18. A petty cashier received ₹ 8,000 as imprest amount on September 1, 2012. During the week, his expenses were as follows:

Date	Details	Amount (₹)
<b>2012</b>		
Sept. 1	Taxi Charges	400
Sept. 2	Wages to casual labourers	250
Sept. 4	Bus fare to peon	20
Sept. 4	Stationery purchased	300
Sept. 5	Postage stamps bought	75
Sept. 5	Revenue stamps bought	25
Sept. 5	Repair to furniture	830
Sept. 5	Paid electricity bill	1,400
Sept. 6	Wages paid for coolie-hire	150
Sept. 6	Taxi hire	400
Sept. 6	Telegram	80
Sept. 6	Locks & Keys purchased	70
Sept. 6	Stationery bought	140
Sept. 7	Refreshments to customers	350



### ANSWER TO INTEXT QUESTIONS

- 7.1 (i) Receipts, Payments (ii) Receipts, Payments  
(iii) Debit, Credit (iv) Opening

- 7.2 I. i) c ii) b iii) b iv) a  
v) c vi) a vii) c

## Cash Book

II.	S.No.	Transactions	Debit Side	Credit Side
	(i)	Mukesh started Business with cash	✓	
	(ii)	Goods Purchased for cash		✓
	(iii)	Goods sold for cash	✓	
	(iv)	Closing Cash Balance		✓
	(v)	Cash received from Ankur	✓	

7.3 (i) Cash (ii) Cash, Bank (iii) Petty Cash Book



### ANSWER TO TERMINAL EXERCISE

5. Closing Cash in hand ₹ 2,200
6. Closing Cash in hand ₹. 13,150
7. Closing Cash in hand ₹ 14,500
8. Closing Cash in hand ₹ 14,600
9. Cash in hand ₹ 74
10. Cash in hand ₹ 1,28,600 and Bank Balance ₹ 2,19,750
11. Cash in hand ₹ 1,000 and Bank Balance ₹ 3,305
12. Cash in hand ₹ 90,000 and Bank Balance ₹ 91,070
13. Cash in hand ₹ 33,900 and Bank Balance ₹ 89,970
14. Cash in hand ₹ 14,760 and Bank Balance ₹ 25,750
15. Cash in hand ₹ 45,560 and Bank Balance ₹ 55,250
16. Cash in hand ₹ 34,280 and Bank Balance ₹ 29,809
17. Cash in hand ₹ 2,035
18. Cash in hand ₹ 3,510

### ACTIVITY FOR YOU

- Every Student gets pocket money on regular basis from his parents and spends it judiciously on purchasing different type of goods/services. You may also be receiving money from your grandparents and / or from grand maternal parents and maintain a record of the money spent by you. Procure the note book/diary in which you keep the notes regarding receipts and payments and prepare a Cash Book on the basis of your receipts and payments for a month.

## MODULE - II

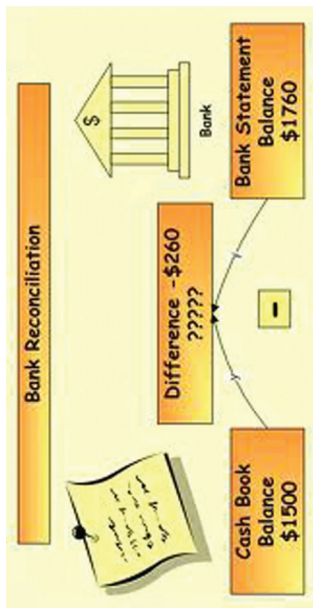
### Journal and Other Subsidiary Books



### Notes

**MODULE - II***Journal and Other  
Subsidiary Books*

Notes

**8****BANK RECONCILIATION  
STATEMENT**

If you are a businessman, you must be having a bank account. Whatever banking transactions you do, you record them in bank column of the cash book, while the bank is having account in your name in its ledger, copy of your account in the form of pass book or bank statement is sent to you. If you record all the transactions correctly in your cash book and bank in its ledger both will show same balance on any date. But if you find a difference then what will you do? You will compare the two and find out the reasons of difference. You can prepare a statement putting up all items of difference in such a way that you can ascertain the correct balance. This statement is called Bank Reconciliation Statement.

In this lesson you will learn the meaning of Bank Reconciliation Statement, objectives of preparing it, main reasons of difference between cash book balance and pass book balance and preparation of the statement.

**OBJECTIVES**

**After studying this lesson, you will be able to**

- state the meaning and need of preparing Bank Reconciliation Statement;
- explain the reasons for difference between the balances of Cash Book and Pass Book and
- understand the preparation of Bank Reconciliation Statement.

**8.1 BANK RECONCILIATION STATEMENT - MEANING AND NEED**

Bank Reconciliation Statement is a statement prepared, periodically with a view to enlist the reasons for difference between the balances as per the bank column of the cashbook and pass book/bank statement on any given date.

**Need of preparing Bank Reconciliation Statement**

A Bank Reconciliation Statement is a statement reconciling the balance as shown by the bank passbook and the balance as shown by the Bank column of the



## Bank Reconciliation Statement

Cashbook. The objective of preparing such a statement is to know the causes of difference between the two balances and to reconcile these differences.

### 8.2 CAUSES OF DIFFERENCES BETWEEN CASH BOOK AND PASS BOOK

The reasons for difference in balance of the cash book and pass book are as under:

- i) **Cheques issued by the Trader but not yet presented for payment :**  
When cheques are issued by Trader in favour of his creditors, these are shown on the payment side of the bank column of the cash book. It reduces the bank balance as per cash book. The bank will debit the firm's account when these cheques are presented for payment. There is a time period between the issue of cheque and its being presented in the bank for payment. This may cause difference to the balance of cash book and pass book.
- ii) **Cheques deposited into bank but not yet collected or credited by the Bank :** When cheques are deposited into bank, the firm immediately enters it on the debit side of the bank column of cash book. It increases the bank balance as per the cash book. However, it takes time in, collecting the amount of cheques, so Bank Balance does not increase on the same date on which cheque has been deposited in the bank. This may cause the difference between cash book and pass book balance.
- iii) **Amount directly deposited by customers/debtors in the bank account:**  
When the debtors of the businessman have been given the authority to deposit the amount due from them in the firm's account with the bank, the bank credits the firm's account with the amount deposited but the same amount is not recorded in the cash book on the day it is deposited. As a result the balance in the cash book will be less than the balance shown in the Pass book.
- iv) **Bank charges charged by the Bank :** The bank charges, fees or commission from time to time for various services provided to the customer and debits the customers' account without intimation to the firm/customer. As a result, the balance of the cash book will be more than the balance of the pass book.
- v) **Interest and dividend received by the bank on behalf of the customer:**  
The interest on debentures or dividend on shares held by the account holder is directly deposited by the company in the bank account of customer through Electronic Clearing System (ECS). But there may not be any entry in the cash book for such items because the firm does not get the information till it receives the bank statement. As a consequence, the firm enters it in its cash

## MODULE - II

### Journal and Other Subsidiary Books



#### Notes

## MODULE - II

### Journal and Other Subsidiary Books

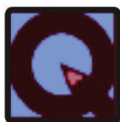


#### Notes

### Bank Reconciliation Statement

book on a date later than the date on which it is recorded by the bank. As a result, the balance as per cash book and pass book will differ.

- vi) **Direct payments made by the bank on behalf of the customer :** The firm may give standing instructions to its banker to make payment of telephone bills, rent, insurance premium, taxes, etc. On making such payments, the bank will debit the firm's account immediately, but the firm will record the same on receiving information from the bank in the form of Pass Book or bank statement. As a result, the balance of the pass book is less than that of the balance shown in the bank column of the cash book.
- vii) **Dishonour of cheques deposited with bank :** A firm may receive a number of cheques from its customers. Some of the cheques deposited by the firm with the bank may be dishonoured. In this case, the Bank debits firm's account. But the firm records the same when it receives the information from the bank. As a result, the balance as per cash book and that of pass book will differ.
- viii) **Errors committed in recording transactions by the firm :** The firm may commit certain errors e.g., omission or wrong recording of transactions relating to cheques deposited, cheques issued and wrong balancing etc. In this case, there would be a difference between the balances as per Cash Book and as per Pass Book.
- ix) **Errors committed in recording transactions by the Bank :** The bank may also committ errors while recording transactions in the customer's account, e.g., omission or wrong recording of transactions relating to cheques deposited etc. As a result, the balance of the bank pass book and cash book will not agree.



### INTEXT QUESTIONS 8.1

- I. **In each of the following cases indicate the alternative which you consider to be correct.**
  - i. A bank reconciliation statement is prepared to know the causes for the difference between :
    - a) the balance as per cash column of the cash book and pass book
    - b) the balance as per bank column of the cash book and pass book
    - c) neither of the two .

## Bank Reconciliation Statement

- ii. Bank reconciliation statement is :
  - a) a Ledger account
  - b) a part of the cash book
  - c) a statement separately prepared to find out the causes of difference between bank column of cash book and pass book.
- iii. A bank reconciliation statement is prepared with the help of :
  - a) Bank pass book and bank column of cash book,
  - b) Bank pass book and cash column of cash book
  - c) Neither of the two.

### II. Fill in the blanks with suitable word/words

- i. The copy of customers account with the bank is called \_\_\_\_\_
- ii. The cheques deposited are entered on the \_\_\_\_\_ of the bank column of cash book.
- iii. Bank reconciliation statement is prepared to \_\_\_\_\_ the bank balance as shown by the cash book and the bank statement.

### III. Given below are statements. Some of these statements are true and some are false. Write 'T' for True and 'F' for false statements.

- i. Bank credits trader's account as soon as it receives cheques from the firm.
- ii. Bank makes certain payments on behalf of the customer under his standing instructions.
- iii. Bank charges are never entered in the cash book.
- iv. Direct receipts by the bank on behalf of customer would increase the balance shown by pass-book.

## 8.3 PREPARATION OF BANK RECONCILIATION STATEMENT

Before preparing Bank Reconciliation Statement first we should check whether balance is positive or negative.

- I. **Favourable balances :** There are two possibilities :
  - a. Debit balance as per cash book is given and the balance as per pass book is to be ascertained.
  - b. Credit balance as per pass book is given and the balance as per cash book is to be ascertained.

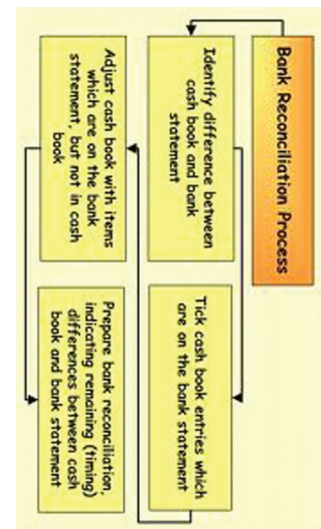
As you have already studied that the Bank Reconciliation statement is prepared to reconcile the differences in the balances of Cash Book and Pass Book. If Cash Book Debit balance or balance as per cash book is given then we have to reconcile with the balance of Pass Book.

## MODULE - II

### Journal and Other Subsidiary Books



### Notes



**MODULE - II****Journal and Other  
Subsidiary Books****Notes****Bank Reconciliation Statement**

To reconcile the Cash Book's balance with the balance of the Pass Book take up all the points of differences and add all the amounts to the balance of cash book which are credited in the Pass Book but not in the Cash Book balance and subtract all such items which are showing less balance in Pass Book for example –

- i. A cheque amounting to ₹ 5,000 was issued but it was not presented into the bank for payment. It shows that the Cash Book will be showing lesser balance than Pass Book balance. Therefore, ₹ 5,000 will be added to the balance of cash book & balances of both the books will be the same.
- ii. On the other hand a customer of the account holder has deposited ₹ 3,000 directly into the Bank under standing orders of the businessman. The result will be more balance in Pass Book than cash book's balance. If this amount ₹ 3000 is added with the balance of Cash Book, then both the books will show the same balance.
- iii. In case of Bank charges etc. Pass Book's balance is decreased by the Bank. In such a case to reconcile the balance of the Cash Book with Pass Book, the Cash Book's balance will be decreased.

To summaries, it is suggested that if the balance of Cash Book is given, and we have to reconcile with Pass Book. Then the causes of differences of all the transaction will have to be checked and the item which are added in the balance of Pass Book will be added, the items which are subtracted from Pass Book will be deducted from the balance of the Cash Book, as it is clear from the above examples.

**Note :** If overdraft as per cash book is given, only the overdraft amount will be written in Minus (-) columns, rest of the activities will be the same.

In case of Pass book's credit balance or balance as per Pass Book is given, the reverse steps will be taken to reconcile the balance of the Pass Book with Cash Book. Same steps will be applied in case of an overdraft as per Pass Book to reconcile with Cash Book.

**Format of Bank Reconciliation Statement**

Bank reconciliation statement is a statement, not an account. It can be prepared by using various methods. Thus, different formats are used for preparing it. A simple format of Bank Reconciliation Statement is given as follows:

## Bank Reconciliation Statement

### Bank Reconciliation Statement as on .....

Particulars	Plus Items (+) (₹)	Minus Items (-) (₹)
Balance as per Cash Book/Pass Book (i.e. given Balance)		
Add : ..... (Effect or ..... causes of ..... Difference		
Less : ..... i.e. Plus or Minus) ..... .....		
<b>Total</b>	.....	.....
Balance as per Pass Book/ Cash Book		

In case Cash Book shows a credit bank balance or Pass Book shows a debit balance, while preparing Bank reconciliation statement, it will be shown in the minus column.

The following illustrations will help you to understand the preparation of Bank Reconciliation Statement with the favourable balance as per cash book or pass book.

#### Illustration 1 (Balance as per Cash Book) :

From the following particulars of M/s ABC Ltd., prepare bank reconciliation statement as on 31.7.2012

- i. Bank balance as per cash book ₹ 62,500
- ii. Cheques deposited into bank but not credited upto 31.7.2012 ₹ 8,900
- iii. Cheques issued but not presented for payment till 31.7.2012 ₹ 12,500
- iv. Bank credited ₹ 5,000 for receiving dividend.
- v. Bank charges debited by Bank ₹ 400.

#### Solution

#### Bank Reconciliation Statement of M/s ABC Ltd. As on July 31, 2012

Particulars	(Plus) (₹)	(Minus) (₹)
i. Balance as per cash book	62,500	
ii. Cheques deposited but not credited by the Bank		8,900
iii. Cheques issued but not presented for payment	12,500	

## MODULE - II

### Journal and Other Subsidiary Books



#### Notes



## MODULE - II

### Journal and Other Subsidiary Books



Notes

## Bank Reconciliation Statement

iv. Dividend received	5,000	
v. Bank charges debited by bank		400
Balance as per pass book		70,700
<b>Total</b>	<b>80,000</b>	<b>80,000</b>
(as the total of plus column is greater than the total of minus column.)		

### Illustration 2 (Balance as per Cash Book)

From the following particulars of Deep Traders, prepare a bank reconciliation statement on June 30, 2012.

- Balance as per the cash book ₹ 1,00,000
- Cheques for ₹ 17,550 are deposited in the bank but not yet collected by the Bank.
- ₹ 5250 charges for Credit Card fee is debited by bank, which is not recorded in cash book.
- There was also a debit in the pass book of ₹ 40,000 in respect of a discounted bill dishonoured.

### Solution

#### Bank Reconciliation Statement of M/s Deep Traders as on June 30, 2012

Particulars	(Plus) (₹)	(Minus) (₹)
i. Balance as per cash book	1,00,000	
ii. Cheques deposited but not credited by the Bank		17,550
iii. Credit card fee charges debited by the Bank		5,250
iv. Discounted bill dishonoured recorded only in Pass book.		40,000
Balance as per Pass Book		37,200
<b>Total</b>	<b>1,00,000</b>	<b>1,00,000</b>

### Illustration 3 (Balance as per Pass Book)

From the following particulars of M/s XYZ Ltd., prepare bank reconciliation statement as on 31.7.2012.

- Balance as per pass book i.e. ₹ 70,700 as the starting point.
- Cheques deposited into bank but not credited upto 31.7.2011 ₹ 8,900
- Cheques issued but not presented for payment till 31.7.2011 ₹ 12,500.
- Bank credited ₹ 5,000 for receiving dividend.
- Bank charges debited by Bank ₹ 400



## Bank Reconciliation Statement

### Solution

#### Bank Reconciliation Statement of M/s XYZ Ltd. As on 31<sup>st</sup> July 2012

Particulars	(Plus) (₹)	(Minus) (₹)
i. Balance as per pass book	70,700	
ii. Cheques deposited but not credited by the Bank	8,900	
iii. Cheques issued but not presented for payment		12,500
iv. Dividend received		5,000
v. Bank charges debited by bank	400	
Balance as per cash book		62,500
<b>Total</b>	<b>80,000</b>	<b>80,000</b>

#### Illustration 4 (Balance as per Pass Book)

Bank Pass book of M/s Telex Industries showed a credit balance of ₹ 1,27,350 on July 31, 2012. The following differences were found on that date between the cash book and the pass book balances :

- Cheques issued before July 31, 2012, amounting to ₹ 79,000 had not been presented for payment.
- Two cheques of ₹ 5,000 and ₹ 3,500 were deposited into bank on July 31, but the bank credited for the same in August.
- Insurance premium directly paid by bank ₹ 5,000
- ₹ 2,000 wrongly debited to the firm account by the Bank.

Prepare Bank Reconciliation Statement as on July 31, 2012.

### Solution

#### Bank Reconciliation Statement of M/s Telex Industries As on July 31, 2012

Particulars	(Plus) (₹)	(Minus) (₹)
i. Balance as per Pass Book	1,27,350	
ii. Cheques issued but not presented for payment		79,000
iii. Cheques deposited but credited by the bank in August.	8,500	
iv. Insurance premium directly paid by Bank	5,000	
v. Wrongly debited by the bank.	2,000	
Balance as per cash book		63,850
<b>Total</b>	<b>1,42,850</b>	<b>1,42,850</b>

## MODULE - II

### Journal and Other Subsidiary Books



### Notes

Cash Book - January					
Day	Details	Inflow	Day	Details	Outflow
1	Opening Balance	111	1	Janet	320
2	Harold	1560	3	Agrera	45
5	Lone G	810	6	Maxim	1800
14	Boby G	665	8	Wanderland	200
17	Xavier	2340	10	Novel	1507
21	Lisa	94	15	Gedret	311
27	Big Bang	124	24	Faust	98
31	Ball	1566	28	Logan	224
31	Closing balance	2018	31	Oliver	540

Bank Statement - January					
Day	Details	Outflow	Inflow	Balance	
1		320		1560	234
2	234				234
3	Cheques received		45		180
4	45				1474
7	1800				1429
7	Cheques received		610		171
9	200				439
11	257				239
11	257				239
11	British way	600			-1328
15	Cheques received		665		-1428
16	629				-563
18	Cheques received		2340		-874
22	Cheques received		54		-2466
23	BC Way		1000		1500
26	530				2520
28	Cheques received		124		2546

Adjusted Cash Book - January					
Day	Details	Inflow	Day	Details	Outflow
31	Non-adj. balance	2438			
31	BC Way	1000			
31	Adjusted balance	3338	31	British way	100

## MODULE - II

### Journal and Other Subsidiary Books



Notes

## Bank Reconciliation Statement

### II. When there is a Situation of Bank Overdraft

When there is overdraft as per Cash Book or Pass Book it will be written in the Minus Column as it is a negative balance. Different items will be accordingly added or subtracted from the given overdraft as the case may be. However, it may be noted that when overdraft is treated as a negative balance and written in the minus column, all those items which appear in the minus column get added to it automatically. Similarly, all items written in the plus column get deducted out of it.

#### Illustration 5 (Overdraft as per Cash Book)

From the following particulars, ascertain the balance as would appear in the Pass Book of Manav Industrial Works on 31st July, 2012.

- Credit Balance as per Cash Book on 31st July, 2012 was ₹ 4,299
- Cheques issued but not cashed prior to 31st July, 2012 amounted to ₹ 1,151
- Cheques paid into Bank but not collected before 31st July amounted to ₹ 858
- There was a debit of ₹ 40 for Bank charges in the Pass Book.

#### Solution

#### Bank Reconciliation Statement of Manav Industrial Works As on 31 July 2012

Particulars	Amount (₹)	Amount (₹)
<b>Overdraft as per Cash Book</b>		4,299
i. Cheques issued but not yet presented for payment	1,151	
ii. Less cheques paid into Bank but not collected		858
iii. Bank Charges recorded in Pass Book only but not in cash Book.		40
<b>Overdraft as per Pass-Book</b>	4046	
<b>Total</b>	<b>5197</b>	<b>5197</b>

#### Illustration 6 : (Overdraft/Unfavourable balance as per pass book)

From the following particulars of Aman and Sons prepare bank reconciliation statement as on 31<sup>st</sup> December, 2012

	₹
i. Overdraft as per pass book (31 <sup>st</sup> Dec., 2012)	10,000
ii. Cheques issued but not presented	6,000
iii. Cheques deposited but not collected	1,800
iv. Dividends collected and credited by the bank which did not appear in the cash book	500



## Bank Reconciliation Statement

- |     |  |       |
|-----|--|-------|
| v.  | Bank charges debited in the pass book but not yet recorded in the cash book                              | 200   |
| vi. | A bank draft on the request of Aman was issued by the bank which has not been recorded in the cash book. | 1,000 |

### Solution

#### Bank Reconciliation Statement As on 31<sup>st</sup> December, 2012

Particulars	Plus (₹)	Minus (₹)
<b>Overdraft (Dr. balance) as per Pass Book</b>		10,000
<b>Add:</b> i. Cheques paid into bank but not collected	1,800	
ii. Bank charges debited in pass book	200	
iii. Draft issued by bank not recorded in the cash book	1,000	
<b>Less:</b> i. Cheques issued but not presented for payment		6,000
ii. Dividend collected and credited by bank		500
<b>Cr. Balance as per Cash Book</b>	13,500	
<b>Total</b>	<b>16,500</b>	<b>16,500</b>

### Illustration 7 : (Unfavourable balance of pass book)

Prepare Bank Reconciliation statement from the following :

- |  |       |
|--|-------|
|  | ₹     |
| i. Overdraft as per Pass Book on 31 <sup>st</sup> Dec., 2012                         | 5,200 |
| ii. Cheque issued but not presented  | 1,200 |
| iii. Interest collected by bank  | 500   |
| iv. Interest charged on overdraft  | 430   |
| v. Bank column of receipt side of Cash Book is overcast                              | 100   |
| vi. Bank column of payment side of Cash Book is undercast                            | 40    |
| vii. Bank issued draft to supplier as per instruction                                | 2,000 |
| viii. A cheque of ₹ 600 banked and credited, but omitted to be recorded in Cash book |       |

### Solution

#### Bank Reconciliation Statement As on 31<sup>st</sup> December, 2012

Particulars	Plus (₹)	Minus (₹)
<b>Overdraft as per Pass Book</b>		5,200
<b>Add :</b> (i) Interest Charged by bank on overdraft	430	

## MODULE - II

### Journal and Other Subsidiary Books



### Notes

## MODULE - II

### Journal and Other Subsidiary Books



Notes

### Bank Reconciliation Statement

(ii) Bank column of receipt side of cash book is overcast	100	
(iii) Bank column of payment side of cash Bank is undercast	40	
(iv) Bank issued a draft	2,000	
<b>Less:</b> (i) Cheque issued but not presented		1,200
(ii) Interest collected by bank		500
(iii) Cheque credited in bank omitted to recorded in Cash Books		600
<b>Overdraft as per Cash Book</b>	4,930	
<b>Total</b>	<b>7,500</b>	<b>7,500</b>

#### Illustration 8 : (Unfavourable balance as per Cash Book)

Prepare a Bank Reconciliation Statement from the following particulars:

- On 31<sup>st</sup> March, 2012, the Cash Book showed a credit bank balance (i.e., bank overdraft) of ₹ 2,000
- Out of the total cheques amounting to ₹ 20,000 drawn, cheques aggregating ₹ 13,000 were encashed in March, cheques aggregating ₹ 4,000 were encashed in April and the rest have not been presented at all.
- Out of the total cheques amounting to ₹ 15,000 deposited, cheques aggregating ₹ 11,500 were credited in March, cheques aggregating ₹ 2,000 were credited in April, and the rest have not been collected at all.
- The bank has debited ₹ 1,500 on account of interest on overdraft and Rs. 100 as bank charges.
- The bank has credited ₹ 1,700 on account of interest collected on securities.
- A Bill Receivable of ₹ 1,000 (discounted with the bank in January) dishonoured on 31<sup>st</sup> March (but not yet recorded in the Cash Book).

#### Solution

#### Bank Reconciliation Statement As at 31<sup>st</sup> March, 2012

Particulars	Plus (₹)	Minus (₹)
<b>Overdraft as per Cash Book (Cr.)</b>		2,000
(i) Cheques drawn but not presented for payment till 31 <sup>st</sup> March	7,000	
(ii) Interest on securities collected by the Bank	1,700	
(iii) Cheques deposited but not collected till 31 <sup>st</sup> March		3,500
(iv) Interest on overdraft and bank charges		1,600
(v) Discounted bill receivable dishonoured		1,000
<b>Overdraft as per Pass Book (Cr.)</b>		600
<b>Total</b>	<b>8,700</b>	<b>8,700</b>

## Bank Reconciliation Statement

### Illustration 9 : (Unfavourable balance as per Cash Book)

Comparing Ram's Cash Book with the Bank Statement of his account for the month of November, 2012 the followings were noticed :

- Cash Book showed an overdraft of ₹ 45,000.
- A cheque for ₹ 17,500 drawn on his saving account has been shown as drawn on his Current Account.
- Cheques amounting to ₹ 70,000 drawn and entered in the Cash Book have not been presented.
- Cheques amounting to ₹ 60,000 sent to the bank for collection, which though entered in the Cash Book have not been credited by the bank.
- Bank charges of ₹ 1,750 as per Bank Statement have not been recorded in the Cash Book.
- Payment side of the Cash Book was by under cash ₹ 1,500.
- ₹ 35,000 dividend were collected by the bank on behalf of the customer.

### Solution

#### Bank Reconciliation Statement As at 30<sup>th</sup> November, 2012

Particulars	Plus (₹)	Minus (₹)
<b>Overdraft as per Cash Book (Cr.)</b>		45,000
i. Payment side of the Cash Book is undercast		1,500
ii. Cheques drawn on saving account but wrongly shown as drawn on Current Account	17,500	
iii. Cheques issued but not yet presented for payment	70,000	
iv. Cheques paid into the bank but not yet credited		60,000
v. Bank charges		1,750
vi. Direct payment of dividend into the bank	35,000	
<b>Overdraft as per Pass Book (Cr.)</b>		14,250
<b>Total</b>	<b>1,22,500</b>	<b>1,22,500</b>

### Illustration 10 : (Overdraft as per Pass Book)

On March 31, 2012 there is an Overdraft of ₹ 15,000 in the Pass Book of Sh. Jagdish Kumar. On comparison with the Cash Book, it was found that

- The bank has charged interest on overdraft for ₹ 600.
- Cheques for ₹ 80,000 were issued and out of these cheques only for ₹ 8,000 have been encashed.
- Cheques for ₹ 4,500 were deposited into bank but cheques for ₹ 500 only were cleared.
- The bank collected interest on his investments ₹ 600 and a direct payment was made into his account by a debtor of ₹ 900.

## MODULE - II

### Journal and Other Subsidiary Books



### Notes

**MODULE - II****Journal and Other  
Subsidiary Books****Notes****Bank Reconciliation Statement**

- v. He had received a cheque for ₹ 1,200 which he entered in the Cash Book but he forgot to send the cheque to the bank.

Prepare Bank Reconciliation Statement.

**Solution**

**Bank Reconciliation Statement  
As on March 31, 2012**

Particulars	Plus (₹)	Minus (₹)
<b>Overdraft as per Pass Book</b>		15,000
i. Interest on overdraft	600	
ii. Cheques issued but not presented for payment (₹ 80,000 – ₹ 8,000)		72,000
iii. Cheques deposited but not cleared and collected (₹ 4,500 – ₹ 500)	4,000	
iv. Interest collected by the bank		600
v. Direct payment into the bank		900
vi. Cheques entered in Cash Book but not sent to Bank	1,200	
<b>Overdraft as per Cash Book</b> (because 'minus' column total is more than 'plus' column)	82,700	
<b>Total</b>	<b>88,500</b>	<b>88,500</b>

**Illustration 11 : (Overdraft as per Pass Book)**

On March 31, 2012 the pass book of Rajat showed an overdraft of ₹ 5,000. The following discrepancies were noted on comparing with the Cash Book :

- i. Cheques issued before March 31, 2012 for ₹ 1,900 were presented for payment on April 4, 2012.
- ii. Cheques for ₹ 8,200 deposited in the bank but cleared on April 2, 2012.
- iii. Interest on overdraft ₹ 1,500 but it doesn't appear in Cash Book.
- iv. Dividend of ₹ 6,000 collected by bank and entered in Pass Book. This is not there in Cash Book.
- v. Locker rent ₹ 80 not entered in Cash Book.
- vi. A cheque of ₹ 7,800 was dishonoured but it does not appear in Cash Book.

Prepare Bank Reconciliation Statement as on March 31, 2012.

## Bank Reconciliation Statement

### Solution

#### Bank Reconciliation Statement As on March 31, 2012

Particulars	Plus (₹)	Minus (₹)
<b>Overdraft as per Pass Book</b>		5,000
i. Cheques issued but not presented for payment		1,900
ii. Cheques deposited but not yet cleared	8,200	
iii. Interest on Overdraft	1,500	
iv. Dividend collected by the bank		6,000
v. Locker rent charged by bank.	80	
vi. Cheques dishonoured	7,800	
<b>Balance as per Cash Book</b> (as total of 'plus' column is more than that of 'minus' column)		4,680
<b>Total</b>	<b>17,580</b>	<b>17,580</b>



### Notes

#### Illustration 12 : (Overdraft as per Cash Book)

On September 30, 2012 there was an Overdraft at ₹ 7,700 as per the Cash book of a businessman. When it was compared with Pass Book it was discovered that:

- Cheques amounting to ₹ 3,500 were paid into Bank but those for only ₹ 1,000 were credited in Pass Book so far.
- Cheques amounting to 6,500 were issued in September but only cheques of ₹ 2,650 were presented for payment.
- A cheque received for ₹ 2,000 was entered in the Cash Book but was not sent to the bank at all.
- There is a debit in the Pass Book for ₹ 65 for bank charges and ₹ 35 for interest.
- ₹ 2,400 have been directly deposited into bank by somebody. It does not appear in the Cash Book.
- Insurance premium has been paid by the bank ₹ 1,500 under his standing instructions.

Prepare Bank Reconciliation Statement as on September 30, 2012.

### Solution

#### Bank Reconciliation Statement As on September 30, 2012

Particulars	Plus (₹)	Minus (₹)
<b>Overdraft as per Cash Book</b>		7,700
i. Cheques deposited but not cleared (₹ 3,500 – ₹ 1,000)		2,500

## MODULE - II

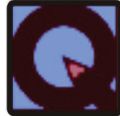
### Journal and Other Subsidiary Books



Notes

## Bank Reconciliation Statement

ii. Cheques issued but not encashed till date (₹ 6,500 – ₹ 2,650)	3,850	
iii. Cheque entered in Cash Book but not sent to bank.		2,000
iv. Bank charges		65
v. Interest charged by bank		35
vi. Amount directly deposited by some customer	2,400	
vii. Insurance premium paid by Bank under his standing Instruction.		1,500
<b>Overdraft as per Pass Book</b> (because the total of 'minus' column is more than the total of 'plus' column).	7,550	
<b>Total</b>	<b>13,800</b>	<b>13,800</b>



### INTEXT QUESTIONS 8.2

- I. You are given the balance as per Pass Book and balance as per Cash Book is to be ascertained by you. Out of the following transactions, write 'A' against those amounts which will be added to the balance of Pass Book and 'R' against those by which balance of Pass Book will be reduced.**
- Bank charges.
  - Cheques issued but not encashed.
  - Cheques deposited with bank and dishonoured
- II. Multiple Choice Questions**
- Which of the following is a correct statement related to 'bank reconciliation statement'?
    - It is prepared after every month.
    - It is prepared after every six month.
    - It is prepared at the end of the year.
    - It is prepared periodically.
  - If balance as per Cash Book is ₹ 8000. Cheque of ₹ 5000 and cheque of ₹ 18000 were issued, but were not presented for payment what will be the balance as per pass book after reconciliation?
 

a) ₹ 8000	b) ₹ 13000
c) ₹ 23000	d) ₹ 31000
  - While preparing bank reconciliation statement from the pass book balance which of the following items will be subtracted?
    - Cheques deposited but not credited.
    - Cheque issued but not presented for payment.
    - Bank Charges
    - Insurance Premium paid by the bank.

## Bank Reconciliation Statement

- iv. Which of the following statements related to bank reconciliation statement is correct?
- It is prepared to ascertain profit of the business concern.
  - It is prepared to calculate the balance as per cash book at the end of the month.
  - It is prepared to reconcile the balance as per cash book and as per pass book.
  - It is prepared to ascertain the financial position of the business.
- v. The pass book shows a debit balance of ₹ 4,500 and a customer has directly deposited ₹ 2,000 in the bank account which is not recorded in cash book. What will be the balance as per cash book?
- ₹ 6,500
  - ₹ 2,500 (for favourable)
  - ₹ 6,500 (over draft)
  - ₹ 2,500 (overdraft)



### WHAT YOU HAVE LEARNT

- Bank Reconciliation Statement is a statement prepared, periodically with the purpose to enlist the reasons of difference between the balances as per the bank column of the cash book and pass book on any given date.
- A Bank Reconciliation Statement is a statement reconciling the balance as shown by the bank passbook and the balance as shown by the Bank column of the Cash book. The objective of preparing such a statement is to know the causes of difference between the two balances and to reconcile them.
- The reasons for difference in balance of the cash book and pass book are as under:
  - Cheques issued by the Trader but not yet presented for payment
  - Cheques deposited into Bank but not yet collected or credited by the Bank
  - Amount directly deposited by customers in the Bank account
  - Bank Charges charged by the Bank
  - Interest and dividend received by the Bank
  - Direct payments made by the Bank on behalf of the customers
  - Dishonour of Cheques/Bill discounted
  - Errors committed in recording transactions by the firm
  - Errors committed in recording transactions by the Bank



### TERMINAL EXERCISE

- What is meant by a Bank Reconciliation Statement?
- What is the need of preparing Bank Reconciliation Statement?

## MODULE - II

### Journal and Other Subsidiary Books



### Notes



**MODULE - II****Journal and Other  
Subsidiary Books****Notes****Bank Reconciliation Statement**

3. Enumerate the causes of difference in the balances of cash book and pass book.
4. From the following particulars, prepare Bank Reconciliation Statement as on December 31, 2012.
  - (i) Balance as per Cash Book ₹ 4,200
  - (ii) Cheques issued but not presented for payment ₹ 2,000
  - (iii) Cheques deposited but not collected ₹ 3,000
  - (iv) Bank Charges debited by the Bank ₹ 250
5. Prepare Bank Reconciliation statement as on March 31, 2012. On this date the passbook of M/s Birla Industries showed a balance of ₹ 27,500
  - (a) Cheques of ₹ 14,000 directly deposited by a customer.
  - (b) Cheques for ₹ 13,500 were issued during the month of March but of these cheques for ₹ 1,500 were not presented by the end of March.
  - (c) The Bank collected ₹ 2,500 as dividend on shares.
  - (d) Cheques of ₹ 17,500 were paid into bank but of ₹ 8,500 were realised in the month of April, 2012.
6. From the following particulars, ascertain the balance as would appear in the Pass Book of Adani Industrial works on 31st January, 2012.
  - (a) Balance as per Cash Book on 31st January 2012 was ₹ 4,000
  - (b) Cheques issued but not cashed prior to 31st January, 2010 amounted to ₹ 1,000
  - (c) Cheques paid into Bank but not collected before 31st January amounted to ₹ 800.
  - (d) There was a debit of ₹ 400 for Bank charges in the Pass Book.
7. From the following particulars prepare Bank Reconciliation statement as on 31st March, 2012 :
  - i. Overdraft as per Cash Book ₹ 12,500
  - ii. Cheques of ₹ 18,000 were issued but were not presented for payment.
  - iii. Cheques of ₹ 24,000 were paid into bank but were not credited till 31 March 2012.
  - iv. Bank charges ₹ 1,500.
8. The bank column of a Cash Book showed a debit balance of ₹ 1,49,000 on June 30, 2012. Entries in the Cash Book and the Pass Book were compared and the following differences were noticed:
  - i. Cheques of Shyam ₹ 9,000 and of Mohani ₹ 15,000 were deposited but were not collected upto June 30, 2012.
  - ii. Ram, a creditor, deposited a cheque of ₹ 8,000 directly into the bank.
  - iii. Bank allowed an interest of ₹ 1,500.



## Bank Reconciliation Statement

- iv. Cheque for ₹ 10,000 issued to Radhey was not presented for payment.
- v. Bank debited the account by ₹ 8,000, being insurance premium.
- vi. Bank debited the account by ₹ 700, being bank charges.

You are required to prepare a Bank Reconciliation Statement as on June 30, 2012.

9. From the following particulars ascertain the balance that would appear in the Bank Pass Book of Arun on 31<sup>st</sup> March, 2012.
- i. The bank overdraft as per Cash Book on 31<sup>st</sup> March, 2012 ₹ 60,200
  - ii. Interest on overdraft for 6 months ending 31<sup>st</sup> March, 2012, ₹ 10,000 entered in the Pass Book.
  - iii. Bank charges of ₹ 1,300 for the above period are debited in the Pass Book.
  - iv. Cheques issued but not cashed prior to 31<sup>st</sup> March, 2012, amounted to ₹ 10,620.
  - v. Cheques paid into the bank but not cleared before 31<sup>st</sup> March, 2012, were for ₹ 16,500.
  - vi. Interest on investment collected by the bank and credited in the Pass Book, ₹ 11,000
10. From the following particulars, prepare a bank reconciliation statement as on 31-3-2012:
- i. Balance as per pass book on 31<sup>st</sup> March, 2012 overdrawn ₹ 10,266.
  - ii. Cheques drawn on 31<sup>st</sup> March, 2012 but not cleared till 2<sup>nd</sup> April, 2012, ₹ 120; ₹ 10,211; ₹ 981 and ₹ 1,128.
  - iii. Interest on bank overdraft not entered in the cash book ₹ 1,510.
  - iv. Out-station cheques for ₹ 21,000 lodged in the bank on 30<sup>th</sup> March, 2012 but credited in April, 2012.
  - v. ₹ 100 being chamber of commerce subscription paid by the bank under a standing order on 31<sup>st</sup> March, 2012 was not entered in the cash book.
  - vi. A hundi of ₹ 2,500 due on 31<sup>st</sup> March, 2012 was sent to the bank for collection on 29<sup>th</sup> March, 2012 and entered in the cash book forthwith, but the proceeds thereof were not credited in the pas book till 2<sup>nd</sup> April, 2012.
11. Prepare a bank reconciliation statement from the following particulars:  
On 31<sup>st</sup> December, 2016 I had overdraft of ₹ 750 as shown by my pass book. I had issued cheques amounting to ₹ 250 of which ₹ 200 worth only seem to have been presented for payment. Cheques amounting to ₹ 100 had been paid in by me on 30<sup>th</sup> December, but of these only ₹ 75 were credited in the pass book. I also find that a

## MODULE - II

### Journal and Other Subsidiary Books



### Notes

**MODULE - II****Journal and Other  
Subsidiary Books****Notes****Bank Reconciliation Statement**

cheque for ₹ 10 which I had debited to bank account in my books has been omitted to be banked. There is a debit in my pass book of ₹ 25 for interest. An entry of ₹ 30 of a payment by a customer direct into the bank appears in the pass book. My pass book also shows a credit of ₹ 60 to my account for interest on investments directly collected by my bankers.

12. The pass book of Rita & Sons showed a balance of ₹ 8,500 on 31<sup>st</sup> May, 2012. Cheques amounting to ₹ 2,750 were deposited into the bank on 27<sup>th</sup> May but Cheque worth ₹ 510 were credited on 2<sup>nd</sup> June and one cheque of ₹ 150 was returned by them as dishonoured on 5<sup>th</sup> June. Cheques drawn but not presented for payment amounted to ₹ 6,000. A B/P paid by the bank but not entered in the cash book ₹ 1,500. Credit side of bank column of cash book was cast ₹ 100 short. Preeti Bros. the firm's agent were requested to remit ₹ 4,000 through telegraphic transfer but they have remitted only ₹ 2,500 for which there was no entry in the cash book. Find out the balance as per cash book and ascertain the correct balance of cash book as on 31-5-2012.
13. On 30<sup>th</sup> June, 2012 the cash book of a merchant disclosed a balance of ₹ 5,820. On checking entries in the cash book with the bank statement, it was ascertained that :
  - i. Cheque for ₹ 2,200 deposited into bank, had not yet been cleared.
  - ii. Cheques issued but not presented for payment ₹ 1,600.
  - iii. A dividend of ₹ 380 by collected to the bank had not been recorded in the cash book.
  - iv. Bank charges ₹ 40 have not been recorded in the cash book.
  - v. A B/R of ₹ 2,500 discounted with the bank is entered in the cash book without recording the discount charge of ₹ 100

You are required to prepare a bank reconciliation statement.
14. From the following particulars, prepare a bank reconciliation statement as on 31<sup>st</sup> March, 2012 and show necessary adjustments in cash book to find out correct balance:
  - i. Bank balance as per pass book (overdraft) ₹ 3,000.
  - ii. A cheque of ₹ 2,000 was credited in the pass book on 28-3-2012, later dishonoured and was debited in the pass book on 1-4-2012. There was no entry of this dishonoured cheque in the cash book within the date.
  - iii. The bank collected ₹ 1,000 by way of interest and credited the amount but the same was not recorded in the cash book within 31<sup>st</sup> March, 2012.
  - iv. A cheque of ₹ 25,000 was lodged in the bank on 31<sup>st</sup> March, 2012 but the same was credited in the pass book only on 7<sup>th</sup> April, 2012.

## Bank Reconciliation Statement

- v. Of the cheques drawn on 28<sup>th</sup> March, 2012 for ₹ 8,000, a cheque of ₹ 2,000 was presented for payment on 7<sup>th</sup> April, 2012.
- vi. On scrutiny it was further found that the banker has given a wrong credit for ₹ 500 and a wrong debit for ₹ 200 in the pass book which have not been recorded in the cash book within 31<sup>st</sup> March, 2012.



### ANSWER TO INTEXT QUESTIONS

- 8.1 I. i) b ii) c iii) a  
 II. i) pass book ii) Debit side iii) reconcile  
 III. i) F ii) T iii) F iv) T.
- 8.2 I. i) A ii) R iii) A  
 II. i) d ii) d iii) b iv) c v) c



### ANSWER TO TERMINAL EXERCISE

4. Balance as per Pass Book ₹ 2,950.
5. Balance as per Cash Book ₹ 18,000.
6. Balance as per Pass Book ₹ 4,600.
7. Overdrafts per Pass Book ₹ 20,000.
8. Balance as per Pass Book ₹ 1,35,800.
9. Overdraft as per Pass Book ₹ 66,380.
10. Overdrafts as per Cash Book ₹ 2,404.
11. Overdrafts as per Cash Book ₹ 830.
12. Balance as per Cash Book ₹ 2,260.
13. Balance as per Pass Book ₹ 5,460.
14. Balance as per Cash Book ₹ 19,300.

### ACTIVITY FOR YOU

- Visit any nearby business establishment. Compare its Cash Book (bank column) with the Pass Book. Find out the entries which have been made in the Cash Book but not in the Pass Book and also the entries which have been made in the pass book but not in the Cash Book. Make a list of these entries along with the amount involved.

## MODULE - II

### Journal and Other Subsidiary Books



### Notes

**MODULE - II***Journal and Other  
Subsidiary Books*

Notes

## 9

**PURCHASES AND SALES BOOK**

In the previous chapters you have learnt that journal can be classified into various special journals/books and journal proper. These special journals/books are also known as special purpose books. In this lesson you will learn about various types of special journals/books such as Purchases Book, Purchase Returns Book, Sales Book, and Sale Returns Book. A business can divide its journals into many more books according to requirement, if the number of business transactions of similar nature are quite large and repetitive in nature.

**OBJECTIVES**

**After studying this lesson you will be able to :**

- understand the meaning of Purchases Book and Purchases Returns Book;
- prepare Purchases Book and Purchases Returns Book;
- understand the meaning of Sales Book and Sales Returns Book and
- prepare Sales Book and Sales Returns Book

**9.1 MEANING OF PURCHASES BOOK AND PURCHASES RETURNS BOOK**

If your firm deals in purchasing of goods on credit involving large number of transactions, it will be convenient to maintain Purchases Book as a journal of original entry for recording all transactions of goods purchased on credit by your firm. Transactions related to purchasing good by cash are not recorded in Purchases Book, these are recorded in Cash Book. Similarly, any credit purchases of items which are not related to resale as goods will also not be recorded in the Purchases Book, these are recorded in Journal Proper.

When the goods are purchased on credit, an invoice/bill issued by the supplier, is received. Such invoice/bill contains detailed information related to transaction such as details of items purchased, list price, various discounts if any, various applicable charges, net amount payable, terms and conditions, date and serial number of invoice/ bill etc. Thus, necessary information required for recording into Purchases

## Purchases and Sales Book

Books are available with the invoice/bill. A specimen format of Purchase Book is given as under:

### Purchase (Journal) Book

Date	Invoice No.	Voucher No.	Particulars (Name of Supplier)	L.F.	Detail (₹)	Total (₹)

The explanations of above mentioned columns of the Purchase Book are as follows:

**Date :** In this column, the day, month and year of the transactions are recorded in chronological order.

**Invoice Number :** In this column, Invoice/bill number is entered.

**Voucher Number :** In this column, voucher number is entered.

**Particulars (Name of Supplier) :** In this column, the name of supplier-firm, from whom the goods were purchased, is written in bold letters or underlined. Below this, the details of goods purchased are written in serial order.

**Ledger Folio :** In this column, the page number of the ledger book or ledger account number of the supplier party is put up for the purpose of cross-reference.

**Details :** Any trade discount allowed by the supplier is to be deducted from the total of particulars column. The net amount after deducting trade discount (if any) is taken to this column.

**Amount :** The net amount which is payable to the supplier, is mentioned in the appropriate currency as shown in the invoice/bill.

**Note :** After calculating the net amount of purchases, the amount charged by the seller for sales tax/VAT is also added to the net amount payable to the supplier. If there are some packing charges claimed by the seller, they will also be included with the net amount payable.

### Illustration 1

Prepare a purchases book from the following transactions of Sonu Electric Stores, New Delhi.

## MODULE - II

### Journal and Other Subsidiary Books



### Notes

## MODULE - II

### Journal and Other Subsidiary Books



#### Notes

## Purchases and Sales Book

### 2012

- Jan. 4 Bought from Malik dealers, Delhi, on credit :  
100 Table fans @ ₹ 300 each  
50 Tubelights @ ₹ 25 each  
40 Electric irons @ ₹ 60 each  
Trade discount 20%
- Jan. 11 Purchased from Jawa Electric Store, Gaziabad, on credit:  
20 Ceiling fans @ ₹ 500 each  
50 Heaters @ ₹ 80 each  
20 Mixy @ ₹ 1,000 each  
Trade discount 10%  
Sales tax 12%
- Jan. 14 Purchased from Jain Hind Traders, New Delhi on credit:  
20 dozen Bulbs @ ₹ 50 per dozen  
10 dozen Lamps @ ₹ 40 per dozen  
Add : Packing charges ₹ 15
- Jan. 25 Bought from Asha Electric Appliances, Faridabad  
5 Washing machines @ ₹ 1,200 each, and paid in cash
- Jan. 31 Bought from Babu Furniture House, on credit:  
8 Chairs at ₹ 80 per chair  
2 Tables at ₹ 500 per table.

### Solution

### Purchases Book

Date 2012	Invoice No.	Voucher No.	Particulars (Name of Supplier)	L.F.	Details (₹)	Total (₹)
Jan. 04			<b>Malik Dealers, Delhi :</b> 100 Table fans @ ₹ 300 each 50 Tubelights @ ₹ 25 each 40 Electric irons @ ₹ 60 each		30,000 1,250 2,400 33,650	26,920
			<b>Less :</b> Trade discount @ 20%		6,730	
Jan. 11			<b>Jawa Electric Store, Gaziabad :</b> 20 Ceiling fans @ ₹ 500 each 50 Heaters @ ₹ 80 each 20 Mixy @ ₹ 1,000 each		10,000 4,000 20,000 34,000	34,272
			<b>Less :</b> Trade discount @ 10%		3,400	
			<b>Add :</b> Sales tax @ 12%		3,672	
Jan. 14			Jai Hind Traders, New Delhi : 20 dozen Bulbs @ ₹ 50 per dozen 10 dozen Lamps @ ₹ 40 per dozen		1,000 400 1,400	1,415
			<b>Add :</b> Packing charges		15	
Jan. 31			Purchases A/c	Dr.		62,607

## Purchases and Sales Book

- Note :**
1. Since cash purchases are not recorded in this book, hence, goods purchased for cash on 25<sup>th</sup> January have not been recorded.
  2. Since purchase of asset is also not recorded in this book, hence, furniture purchased on 31<sup>st</sup> January has not been entered in this book.
  3. Trade discount should be calculated and deducted before packing, forwarding and other charges, are added to the bill.

### Posting from Purchase Book or Journal into Ledger

Posting of necessary details from Purchases Book/Journal is made on daily basis into the relevant ledger accounts of suppliers on the credit side with the amount, date and number of the invoice putting also page number of the Purchase Book into the appropriate column of the ledger. Every transaction recorded in the Purchases Book must be posted into the ledger account of the concerned supplier. For this purpose every credit purchase which is recorded in the Purchases Book is posted into the credit side of the respected creditor's A/c by writing "Purchases A/c". At the end of the month, the grand total of the Purchases Book is posted to the debit side of Purchase Account in the ledger writing in the particular column "Sundries as per Purchase Book".

To illustrate the posting from Purchase Book to concerned Ledger accounts may be refer on the basis of previous Illustration No. 1 as follows :

### Ledger

Dr.				Cr.			
Malik Dealers							
Date	Particulars	L.F.	Amount (₹)	Date	Particulars	L.F.	Amount (₹)
2012				2012 Jan.04	Purchases A/c		26,920

Dr.				Cr.			
Jawa Electric Store							
Date	Particulars	L.F.	Amount (₹)	Date	Particulars	L.F.	Amount (₹)
2012				2012 Jan.11	Purchases A/c		34,272

Dr.				Cr.			
Jai Hind Traders							
Date	Particulars	L.F.	Amount (₹)	Date	Particulars	L.F.	Amount (₹)
2012				2012 Jan.14	Purchases A/c		1,415

## MODULE - II

### Journal and Other Subsidiary Books



### Notes



## MODULE - II

### Journal and Other Subsidiary Books



Notes

## Purchases and Sales Book

Dr.				Purchases Account				Cr.	
Date	Particulars	L.F.	Amount (₹)	Date	Particulars	L.F.	Amount (₹)		
2012 Jan.31	To Sundries as per Purchases Book		62,607	2012					

### Purchases Return Book or Return Outwards Book or Purchases Return Journal

Sometimes goods purchased from the supplier are returned fully or partially on account of various reasons such as supply of defective goods, spoiled in transit or it is not upto mark as per our order etc. Such goods are returned to the supplier. For this purpose a debit note, containing the required details of returned goods, is also prepared and sent to the supplier for making necessary entries. If the number of purchases returns is very few, it is recorded into the Journal Proper. But if the number of Purchases returns is very high, the recording of such returned goods is done into the Purchase Return Book. A specimen format of Purchase Returns Book is given as under:

### Purchase Returns Book

Date	Particulars (Name of Supplier)	Debit Note No.	L.F.	Details (₹)	Total (₹)

The explanation of above mentioned columns of the Purchase Returns Book is given as follows:

**Date :** In this column, the day, month and year of the purchase returns transaction is recorded in chronological order.

**Particulars (Name of Supplier) :** In this column, the names of supplier-firms, to whom the goods were returned, are recorded.

**Debit Note Number :** In this column, debit note number is entered.

**Ledger Folio :** In this column, the page number of the ledger book or ledger account number is recorded for the purpose of cross-reference.

**Details :** The net amount after trade discount is recorded in this column.

**Amount :** In this column, net amount of Purchase Returns which is recoverable from the supplier, is mentioned.

**Illustration 2**

Enter the following transactions in purchases return book :

**2012**

- Mar. 09 Goods Returned to Bala Ji ₹ 1,900.
- Mar. 11 Goods returned to Kishan being not according to sample worth ₹ 1,400.
- Mar. 28 Allowance claimed from Mahabir and Bros. on account of mistake in the invoice ₹ 200.
- Mar. 31 Returned goods to Madan Lal & Sons, Delhi for ₹ 1,700 less trade discount @ 10%.

**Solution**
**Purchases Returns Book**

Date	Particulars	Debit Note No.	L.F.	Details (₹)	Total (₹)
<b>2012</b>					
Mar. 09	Bala Ji				1,900
Mar. 11	Kishan				1,400
Mar. 28	Mahabir & Brothers				200
Mar. 31	Madan Lal & Sons, Delhi			1,700	
	<i>Less : Trade discount @ 10%</i>			170	1,530
Mar. 31	Purchases Returns A/c Cr.				5,030

**Posting from Purchase Returns Book /Journal into ledger**

Posting of necessary details from Purchase Returns Book/Journal is made at the time of goods returns, into the returned ledger account of supplier on the debit side with the amount, date and number of the debit note. Page number of the Purchases Returns Book is also put into the appropriate column of the ledger. At the end of the month, the grand total of the Purchases Returns Book is posted to the credit side of Purchase Returns Account in the ledger writing in the particular column “Sundries as per Purchases Return Book”.

**LEDGER**

Dr.				Bala Ji				Cr.			
Date	Particulars	L.F.	Amount (₹)	Date	Particulars	L.F.	Amount (₹)				
<b>2012</b>				<b>2012</b>							
Mar.09	To Purchase Return A/c.		1,900								


**Notes**

## MODULE - II

### Journal and Other Subsidiary Books



Notes

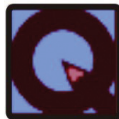
## Purchases and Sales Book

Dr.				Kishan				Cr.			
Date	Particulars	L.F.	Amount (₹)	Date	Particulars	L.F.	Amount (₹)	Date	Particulars	L.F.	Amount (₹)
2012 Mar.12	To Purchase Return A/c.		1,400	2012							

Dr.				Mahabir & Bros.				Cr.			
Date	Particulars	L.F.	Amount (₹)	Date	Particulars	L.F.	Amount (₹)	Date	Particulars	L.F.	Amount (₹)
2012 Mar.28	To Purchase Return A/c.		200	2012							

Dr.				Madan Lal & Sons				Cr.			
Date	Particulars	L.F.	Amount (₹)	Date	Particulars	L.F.	Amount (₹)	Date	Particulars	L.F.	Amount (₹)
2012 Mar.31	To Purchase Return A/c.		1,530	2012							

Dr.				Purchases Returns Account				Cr.			
Date	Particulars	L.F.	Amount (₹)	Date	Particulars	L.F.	Amount (₹)	Date	Particulars	L.F.	Amount (₹)
2012				2012 Mar. 31	By Sundries as per Purchases Returns Book		5,030				



### INTEXT QUESTIONS 9.1

Which of the following transactions will be entered in the Purchases Book or Purchases Returns Book or none of the said books?

- Furniture purchased from M/S Saurabh Furniture.
- Goods purchased from M/S Keshav were returned to them as goods were not according to the specifications.
- Goods of ₹12, 000 were purchased from M/S Warner Brothers for cash.
- M/S Puri & Sons supplied goods on credit for ₹ 1,500.
- Purchased goods from Kwatra on credit for ₹ 2,000.



**9.2 SALES BOOK/JOURNAL**

If your firm transacts its sales on credit basis with large number of customers, it will be convenient to maintain Sales Book as a journal of original entry for recording all transactions of goods sold on credit by your firm. Transactions related to selling of goods against cash are not recorded in Sales Book; these are recorded in Cash Book. Similarly, any credit sales of items which are not related to business goods will also not be recorded in the Sales Book; these are recorded in Journal Proper.

When the goods are sold on credit, a copy of invoice/bill issued to customer is kept by the seller; as an evidentiary proof to support concerned journal entry in the sales book/journal. Such copy of invoice/bill contains various detailed information related to transaction such as details of items sold, sales value, various discounts (if any), various applicable charges, net amount receivable, terms and conditions, date and serial number of invoice/ bill etc. Thus, all these necessary information required for recording into Sales Book are available with the invoice/ bill.

A specimen format of Sales Book is given as under:

**Sales (Journal) Book**

Date	Invoice No.	Particulars (Name of Customer)	L.F.	Details (₹)	Total (₹)

The explanation of above mentioned columns of the Sales Book is as follows:

**Date :** In this column, the day, month and year of the transaction is recorded in chronological order.

**Invoice Number :** In this column, Invoice/bill number is entered.

**Particulars (Name of Customer) :** The name of customer firm, to whom the goods were sold, is written first in this column and is underlined. It is followed by the detail of different items with their rates.

**Ledger Folio :** In this column, the page number of the ledger book or ledger account number of the customer party is put up for the purpose of cross-references.

**Details :** Only the net amount after trade discount if any should be recorded.

**Amount :** In this column, net receivable amount of the total goods sold to customer, is mentioned in the appropriate currency as shown in the invoice/bill.

## MODULE - II

### Journal and Other Subsidiary Books



Notes

## Purchases and Sales Book

### Illustration 3

Following are the transactions of M/s. Kamal & Bros. Prepare their Sales Day Book :

Sold to M/s. Gupta & Sharma on Credit :

30 shirts @ ₹ 1,500 each

20 trousers @ ₹ 1,300 each

**Less :** Trade Discount @ 10%

Sold old furniture to M/s. Palik & Co. on credit ₹ 8,000.

Sold 50 shirts on credit to M/s. John & Sons @ ₹ 1,600 each

Sold on credit to M/s. Mahar and Nahar :

100 shirts @ ₹ 1,750 each

10 overcoats @ ₹ 1,500 each

**Less :** Trade Discount @ 10%

### Solution

#### Sales Book

Date	Invoice No.	Particulars (Name of Customer)	L.F.	Details (₹)	Total (₹)
		<b>M/s. Gupta &amp; Sharma :</b> 30 shirts @ ₹ 1,500 each 20 trousers @ ₹. 1,300 each		45,000 26,000 71,000	63,900
		<b>Less:</b> Trade Discount @ 10% Sales as per Invoice No. .... dated .....		7,100	
		<b>M/s John &amp; Sons :</b> 50 shirts @ ₹ 1,600 each Sales as per Invoice No. .... dated .....			80,000
		<b>M/s. Mahar &amp; Nahar :</b> 100 shirts @ ₹ 1,750 each 10 overcoats @ ₹ 1,500 each		1,75,000 15,000 1,90,000	1,71,000
		<b>Less :</b> Trade Discount @ 10% Sales as per Invoice No. .... dated .....		19,000	
		Sales A/c ... Cr.			3,14,900

### Posting from Sales Book or Sales Journal into ledger

Posting of necessary details from the Sales Book/Journal is made on daily basis into the relevant ledger accounts of the customer on the debit side with the amount, date and number of the invoice putting also page number of the Sales Book into the appropriate column of the ledger. At the end of the month, the grand total of the Sales Book is posted to the credit side of Sales Account in the ledger writing in the particular column “Sundries as per Sales Book”.

## Purchases and Sales Book

### Ledger of M/s. Kamal & Bros.

Dr. <span style="float: right;">M/s. Gupta &amp; Sharma</span> <span style="float: right;">Cr.</span>							
Date	Particulars	L.F.	Amount (₹)	Date	Particulars	L.F.	Amount (₹)
	To Sales A/c.		63,900				

Dr. <span style="float: right;">M/s. John &amp; Sons</span> <span style="float: right;">Cr.</span>							
Date	Particulars	L.F.	Amount (₹)	Date	Particulars	L.F.	Amount (₹)
	To Sales A/c.		80,000				

Dr. <span style="float: right;">M/s. Mahar &amp; Nahar</span> <span style="float: right;">Cr.</span>							
Date	Particulars	L.F.	Amount (₹)	Date	Particulars	L.F.	Amount (₹)
	To Sales A/c.		1,71,000				

Dr. <span style="float: right;">Sales Account</span> <span style="float: right;">Cr.</span>							
Date	Particulars	L.F.	Amount (₹)	Date	Particulars	L.F.	Amount (₹)
					Sundries as per Sales Book of the month of February.		3,14,900

### Sales Returns Book or Returns Inwards Book

When goods returned by the customers generally are recorded in a separate book, named as 'Sales Returns Book'. It is also called as 'Sales Returns Journal' or 'Returns Inward Book'. The rules of recording in sales return Book is same as of Purchase Return Journal. For this purpose a credit note, containing the required details of returned goods, is also prepared and sent to the customer for making necessary entries. The recording of such returned goods is done into the Sales Return Book on the basis of information provided in the Credit Note. A specimen format of Sales Returns Book is given as under:

#### Sales Returns Book

Date	Credit Note No.	Particulars (Name of Customer)	L.F.	Details (₹)	Amount (₹)

## MODULE - II

### Journal and Other Subsidiary Books



### Notes

## MODULE - II

### Journal and Other Subsidiary Books



#### Notes

## Purchases and Sales Book

The explanations of above mentioned columns of the Sales Returns Book are given as follows:

**Date :** In this column, the day, month and year of the sales returns transaction is recorded in chronological order.

**Credit Note Number :** In this column, credit note number is entered.

**Particulars (Name of Customer) :** In this column, the names of customer-firms, by whom the goods were returned, are written in bold letters or underline it. Just below it write the complete details of the goods returned including their price and quantity.

**Ledger Folio :** In this column, the page number of the ledger book or ledger account number of the customer party is put up for the purpose of cross-references.

**Details :** Only the net amount after the trade discount should be recorded. The prices should be the same at which the goods were sold.

**Amount :** In this column, net amount of sales returns, which is payable to the customer, is mentioned in the appropriate currency as shown in the credit note.

#### Illustration 4

Prepare the sales Return Book in the books of Lal & Co. from the following transactions:

#### 2012

April 06 Goods returned by Pawan & Co. :

2 Table Fans @ ₹ 600 each

Less : Trade Discount 15%

April 12 Laxman Oil Mills returned defective goods valued ₹ 4,250.

#### Solution

#### Sales Return Book or Return Inwards Book

Date	Credit Note No.	Particulars (Name of Customer)	L.F.	Details (₹)	Amount (₹)
<b>2012</b> April 06		<b>Pawan &amp; Co. :</b> 2 Table Fans @ ₹ 600 each Less : Trade Discount 15%		1,200 180	1,020
April 12		<b>Laxman Oil Mills</b>			4,250
April 30		Sales Return A/c ...Dr.			5,270




**Posting from Sales Returns Book into Ledger Accounts**

Each customer's account who returned the goods is credited with the net amount of the returns. The total of the Sales Returns Book at the end of a specified period is debited into the Sales Return Account in the ledger.

**Illustration 5**

Record the following in the Return Inwards Book.

**2012**

- Jan. 01 M/s. Ghanshyam & Co. returned 500 units  
Sold @ ₹ 50 per unit.
- Jan. 25 M/s. Narain & Co. returned 300 units  
Sold @ ₹ 55 pr unit.

**Solution**
**Sales Return Book**

Date	Credit Note No.	Particulars (Name of Customer)	L.F.	Details (₹)	Amount (₹)
<b>2012</b> Jan. 01		M/s. Ghanshyam & Co. : 500 Units @ ₹ 50 per unit			25,000
Jan. 25		M/s. Narain & Co. : 300 Units @ ₹ 55 per unit			16,500
Jan. 31		Sales Return A/c ... Dr.			41,500

**Ledger Book**
**Dr. Ghanshyam & Co. Cr.**

Date	Particulars	L.F.	Amount (₹)	Date	Particulars	L.F.	Amount (₹)
<b>2012</b>				<b>2012</b> Jan. 01	By Sales Return A/c.		25,000

**Dr. Narain & Co. Cr.**

Date	Particulars	L.F.	Amount (₹)	Date	Particulars	L.F.	Amount (₹)
<b>2012</b>				<b>2012</b> Jan. 25	By Sales Return A/c.		16,500

**Dr. Sales Returns Account Cr.**

Date	Particulars	L.F.	Amount (₹)	Date	Particulars	L.F.	Amount (₹)
<b>2012</b> Jan. 31	To sundries as per Sales Return Book		41,500	<b>2012</b>			

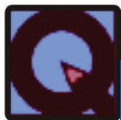
**MODULE - II****Journal and Other  
Subsidiary Books****Notes****Purchases and Sales Book****Journal Proper**

So far we have discussed that transactions of a particular nature are recorded in a special journal maintained for the purpose.

1. Cash transactions are recorded in the Cash Book.
2. Credit purchases of goods or materials dealt in are recorded in the Purchases Day Book.
3. Credit sales of goods are recorded in the Sales Day Book.
4. Returns from customers are recorded in the Sales Return Book.
5. Returns to suppliers are entered in the Purchases Return Book.

Apart from the above transactions, there are other transactions, which have to be recorded. For them, the proper place is the journal proper. Entries recorded in the Journal Proper are :

- |   |                               |
|---|-------------------------------|
| i. Opening Entry                                | ii. Closing Entry             |
| iii. Transfer Entries                           | iv. Adjusting Entries         |
| v. Rectifying Entries                           | vi. Credit Purchase of Assets |
| vii. Credit Sale of Worn-out or Obsolete Assets |                               |

**INTEXT QUESTIONS 9.2**

**I. Which of the following transactions will be entered in the Sales Book or Sales Returns Book? If the transaction is not to be entered in any of two, write None of These.**

- i. Goods sold to Raghav on credit for one month.
- ii. Old furniture sold to Rajesh on credit.
- iii. Goods sold for cash.
- iv. Goods sold to M/s Kapoor Pvt. Ltd.
- v. M/S Deshbandhu & Sons Ltd. returned goods to us.
- vi. Goods received back from Raghav due to defective consignment.
- vii. Goods destroyed due by fire.
- viii. Discount received from Suresh.
- ix. Cash received from M/S Kapoor Pvt. Ltd.

**II. Multiple Choice Questions**

- i. Total of these transactions is posted in purchases account :  
 a) Cash purchase of Stationary    b) Purchase Returns  
 c) Credit Purchases                      d) Purchase of Machinery
- ii. The individual entries from the Sales Day Book are :  
 a) Not posted in any Account  
 b) Posted on the Credit side of Individual Account



**MODULE - II****Journal and Other  
Subsidiary Books****Notes****Purchases and Sales Book**

5. M/S Tyagi Furniture wants you to prepare sales journal for the month ended 31st March 2012, from the following details of sale of goods:

<b>Date</b>	<b>Details</b>
<b>2012</b>	

- |         |  |
|---------|--|
| Mar. 4  | Sold on credit to M/S Mona Traders: Vide Invoice No. 330<br>(a) Two double beds @ ₹ 7,100 each.<br>(b) Five chairs @ ₹ 260 each. |
| Mar. 9  | Sold on credit to M/S Kishan Furniture: Vide Invoice No. 238<br>5 tables @ ₹ 1,400 each.   |
| Mar. 24 | Sold on credit to M/S Darshan Furniture: Vide Invoice No. 340<br>4 sofa sets @ ₹ 18,000 each.                                    |
| Mar. 30 | Sold on credit to M/S Gopal Furniture: Vide Invoice No. 485<br>6 single beds @ ₹ 6,000 each.                                     |
6. Enter the following transactions in the proper books of M/S Devika Ltd. for the month of July 2012:
- |         |   |
|---------|---|
| July 01 | Bought from Kuldeep Traders as per invoice no. 7669<br>100 note books @ ₹ 20 each.<br>50 gel pens @ ₹ 10 each.<br>100 packets of color pencils @ ₹ 15 per packet.<br>Trade discount 10% |
| July 12 | Bought from Abhimanyu Stationers as per invoice no. 3450<br>100 files @ ₹ Rs.12 per file<br>10 rim paper @ ₹ 300 per rim.<br>Trade Discount 5%  |
| July 17 | Returned to Savita Traders as per debit note no. 281<br>10 packets of color pencils @ ₹ 15 per packet.<br>Trade Discount @ 10%  |
| July 22 | Bought from Manik Stationery as per invoice no. 8760<br>50 packs of water color @ ₹ 50 per pack Net.  |
| July 31 | Returned to M/S Ritu Stationers as per debit note no. 340<br>3 rim paper @ ₹ 300 per paper.<br>Trade Discount 5%  |
7. Prepare Purchases Book from the following transactions and post it into ledger :
- |        |   |
|--------|---|
| May 02 | Bought from Dhria & Co., Noida :<br>110 quintal rice @ ₹ 2,000 per quintal<br>115 quintal sugar @ ₹ 1,500 per quintal<br>Trade discount 10% |
|--------|---|


**Notes**

- May 09 Purchased from Amit Kumar & Co., Alwar :  
30 quintal wheat @ ₹ 1,800 per quintal.  
20 quintal gram @ ₹ 1,700 per quintal.
- May 15 Bought for cash from Gopal Agencies, Hisar:  
220 tins ghee @ ₹ 500 each tin.
- May 20 Bought furniture for office use from Bhagwati Furniture, Bhiwani:  
70 chairs @ ₹ 200 each.  
20 tables @ ₹ 1,200 each  
Trade discount 10%
- May 25 Bought from Gupta Traders, Ambala :  
440 quintal rice @ ₹ 1,500 per quintal  
210 quintal sugar @ ₹ 1,400 per quintal  
Trade discount 10%, Sales tax 5%
8. Prepare Purchases Book of Electronics Bhiwani from the following transactions of:  
**2012**
- Jan. 03 Bought from Sun Electricals, Ghaziabad :  
100 tube lights @ ₹ 40 each.  
500 table fans @ ₹ 500 each.  
Trade discount @ 10%
- Jan. 11 Purchased goods from Ravi Electric Company, Amroha :  
300 bulbs @ ₹ 10 each.  
240 Irons @ ₹. 200 each  
Trade Discount @ 15%
- Jan. 15 Bought furniture from Modern Furniture House, Delhi :  
10 chairs @ ₹ 1,200 each  
3 tables @ ₹ 4,000 each
- Jan. 20 Bought from Raftar Fans India, Delhi for cash :  
50 fans @ ₹ 1,400 each
- Jan. 28 Bought from Ram and Laxman Co., Delhi :  
250 tube lights @ ₹ 45 each
9. Suresh Chand is trading as furniture dealer. The following information is available :  
**2012**
- Nov. 06 Returned to Alok Kumar 50 chairs @ ₹ 230 per chair being not of specified quality.
- Nov. 14 Sent back one dining table to Gulshan Grover, Ludhina for not being polished @ ₹ 4,300 and 10 chairs @ 250 each.
- Nov. 21 Returned to Amrit Kaur & Co., Bhatinda, being not according to sample :  
30 chairs @ ₹ 425 each.  
25 dressing tables @ ₹ 2,200 each

**MODULE - II****Journal and Other  
Subsidiary Books****Notes****Purchases and Sales Book**

- Nov. 27 Returned 12 study tables to Satkshi Furniture, Baurot @ ₹ 1,500 being not of specified quality.  
Record the above information in proper subsidiary books.
10. Enter the following transactions in returns inward book of Balwant Singh.  
**2012**
- Sept. 07 Subhash and Sons, Kanpur returned goods being not according to sample ₹ 12,000.
- Sept. 18 Allowance claimed by Gandhi & Co., Delhi on account of mistake in the invoice ₹ 1,000.
- Sept. 21 Goods sold to Hari Ram Gopi Chand, Mumbai and returned by him being defective in colour ₹ 1,800.
- Sept. 28 Goods returned to us by Kamal & Bros., Kerala worth ₹ 1,500 less 10% trade discount.
11. Prepare Returns Inward and Returns Outward Book from the following transactions:  
**2012**
- Jan. 04 Returned to Gopal Furniture, Hari Nagar :  
40 chairs @ ₹ 200 each  
Less : Trade Discount 10%
- Jan. 11 Rihan & Bros. returned us :  
4 tables @ ₹ 1,800 each  
15 chairs @ ₹ 1,500 each
- Jan. 16 Goyal & Co. returned the following :  
2 Sofa Sets @ ₹ 13,000 each less 10% trade discount
- Jan. 21 Returned to Premi Furniture House, Noida  
10 tables @ ₹ 700 each  
20 chairs @ ₹ 1,150 each  
Less : Trade Discount 10%
12. Enter the following transactions in Subsidiary Books.  
**2012**
- Sept. 01 Sold to Republic Furnishings, Noida :  
2 bed @ ₹ 500 each  
10 dining tables @ ₹ 3,000 each
- Sept. 05 Purchase from Kaveri Furnitures, Meerut :  
1 Dressing table ₹ 250 (net)
- Sept. 08 Mohan Furniture invoiced the following :  
1 office table @ ₹ 150
- Sept. 10 Returned to Tara Chand & Co. :  
7 bed-room suites @ ₹ 4,300 each  
5 dinning tables @ ₹ 5,000 each

## Purchases and Sales Book

- Sept. 16 Sold to Brij Mohan a dinning table for ₹ 5,000  
 Sept. 18 Purchased from Lalit Khanna & Co. a delivery van for ₹ 85,000.  
 Sept. 22 Cash sales ₹ 12,000  
 You are required to prepare :
- Purchases Book
  - Sales Book
  - Purchases Returns Book



### ANSWER TO INTEXT QUESTIONS

- 9.1** (i) None (ii) Purchases Return Book (iii) None  
 (iv) Purchases Book (v) Purchases Book
- 9.2 I.** (i) Sales Book (ii) None (iii) None  
 (iv) Sales Book (v) Returns Inward Book  
 (vi) Returns Inward Book (vii) None (viii) None  
 (ix) None
- II.** (i) c (ii) c (iii) b (iv) a (v) b



### ANSWER TO TERMINAL EXERCISE

- Total of Sales Book ₹ 1,18,500
- Total of Purchases Book ₹ 10,090; Total of Purchases Returns Book ₹ 990.
- Total of Purchases Book ₹ 13,42,780.
- Total of Purchases Book ₹ 3,53,200.
- Total of Purchases Returns Book ₹ 1,04,050
- Total of Return Inward Book ₹ 16,150.
- Total of Return Inward Book ₹ 53,100; Total of Return Outward Book ₹ 34,200.
- Total of Purchases Book ₹ 400; Total of Sales Book ₹ 36,000; Total of Purchas Returns Book ₹ 55,100.

## ACTIVITIES FOR YOU

- Visit some business units of your areas and enquire whether they are maintaining only journal proper or other special purpose books. Ascertain whether the books maintained by them serve the purpose or not. If not, give suggestions.
- Asuming that your uncle is engaged in the business of stationary shop. Sit with him for a week and prepare the list of items purchased and sold by him through the week. Record all those transation in appropriate books.

## MODULE - II

### Journal and Other Subsidiary Books



### Notes



## Success Stories

### Jaspal Singh

**Enrolment No.: Secondary - 27020212195**

**Senior Secondary – 92279300066**



Forced to discontinue his tenth class in 1993 in order to earn a livelihood to support his family, when his parents met with an accident, Jaspal Singh resumed his studies in 2003 by enrolling for the Secondary level course in NIOS. The flexibility of the NIOS system enabled him to pursue his studies along with his vocation. He acquired skills in fashion designing while working as a freelancer in garment export houses.

Having completed his Senior Secondary course from the NIOS and moved by the desire to continue studies, Jaspal Singh has managed to obtain admission to a three year course in Fashion Management at the University of Thames Valley, London.

### Ms. Sudha

**Enrolment No. : 27029182593**



Ms. Sudha was a only housewife until such time that her husband passed away and she was offered the job of a constable in the Delhi Police. She then took up the job to support the family consisting of her two children.

Sudha who had not completed her schooling was motivated by her children to join the NIOS. She then passed the Secondary examination from NIOS in April 2009. A resident of Sant Nagar, Burari, Delhi and posted at the Rohini Court, Delhi, Sudha today feels more confident and empowered by the qualification acquired by her through the NIOS.

## MODULE - III

Maximum Marks

14

Hours of Studies

34

### Ledger and Trial Balance

This module will enable the learners to develop the skill of preparing the ledger and trial Balance. They will be able to identify the different accounting errors, classify the same and learn the ways to rectify the errors.

**Lesson 10 : Ledger**

**Lesson 11 : Trial Balance and Accounting Errors**

**MODULE - III****Ledger and Trial Balance**

Notes

10

**LEDGER**

You have learnt to record business transactions in various books of accounts such as Cash Book, Purchases Book, Sales Book, Journal etc. But the record in these books is scattered. Purpose of accounting is to enable the businessman to get knowledge of various items of revenue, expenditure, debtors, creditor, assets etc. This can be made possible if all the concerned amounts recorded in different books on different dates are brought under the respective heads at one place. This process is called 'posting' and the book that contains the various account heads is called ledger. In this lesson you will learn the meaning of ledger and the purpose of preparing the ledger.

**OBJECTIVES**

**After studying this lesson, you will be able to :**

- understand the meaning and purpose of Ledger;
- differentiate between Journal and Ledger;
- able to do the posting from Journal to Ledger and
- develop the skill of balancing of Accounts in the Ledger.

**10.1 MEANING AND PURPOSE OF LEDGER**

All transactions related to a head of account are recorded in different books. To know the total volume and value of transactions pertaining to a particular account these have to be brought at one place. The book in which all accounts are maintained is called Ledger. It contains the complete set of accounts for a business entity. The process of preparing necessary ledger accounts and transferring the information recorded in day books to these accounts according to accounting rules is called ledger posting.

Ledger is the principal Book of double entry accounting system. It may be in the form of a book or a bound register of separate sheets. Each account is opened on a separate page or card.



## Ledger

### Purpose of Ledger

- i) **Quick information about various transactions :** Ledger sets the relationship between the business enterprise and business transactions with the help of an account.
- ii) **Proper control over transactions :** Separate ledger accounts are maintained for each type of transaction.
- iii) **Helpful in preparing Trial Balance :** The final balances of all ledger accounts are shown in the Trial balance, which helps in ensuring that books are arithmetically correct.
- iv) **Helpful in preparing Financial Statements :** The financial statements of a business concern are prepared with the help of trial balance which in turn is prepared on the basis of the balance of different ledger accounts.

### Format of a Ledger Account

Ledger account is prepared in 'T' shape, which is basically divided into two parts. Left side is known as Debit side and right side is known as Credit side.

The format of a ledger account is as follows :

#### Title of Account

Dr				Cr			
Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)

The following information is recorded in the various columns on both sides of a ledger account :

**Date :** In this column, the date of a transaction is recorded.

**Particulars :** in this column the details of the transaction is recorded, on the debit side, the word 'To' and on credit side, the word 'By' are prefixed.

**Journal Folio (J.F.) :** In this column the page number of book of original entry is recorded.

**Amount :** The Amount of the transaction is recorded in this column.

## 10.2 DIFFERENCE BETWEEN JOURNAL AND LEDGER

S. No	Basis of Difference	Journal	Ledger
1.	Entry	Journal is the Book of Original entry	Ledger is the Book of Secondary Entry

## MODULE - III

### Ledger and Trial Balance



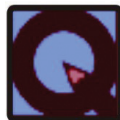
#### Notes

**MODULE - III****Ledger and Trial Balance**

Notes

**Ledger**

2.	Record	Journal is the Book for Chronological record	Ledger is the Book of analytical record
3.	Classification of Data	Transaction is the basis of recording in the journal	Journal is the basis of posting in the ledger
4.	Process of Recording	Process of recording in the Journal is called journalizing	Process of recording in the ledger is known as ledger posting

**INTEXT QUESTIONS 10.1****Fill in the blanks with a suitable word**

- The book of account in which all accounts are maintained is called \_\_\_\_\_.
- Ledger is the \_\_\_\_\_ of double entry accounting system.
- Process of Recording in the Ledger is known as \_\_\_\_\_.
- \_\_\_\_\_ is the basis of posting in the ledger.
- Ledger is the book of \_\_\_\_\_ record.

**10.3 POSTING OF THE JOURNAL ENTRIES INTO LEDGER**

Ledger is the principal book of account. It is necessary to post the entire information recorded in journal into different accounts in ledger. All the five types of accounts – Assets, Revenues, Expenses, Liabilities and Capital are opened in the ledger. They will provide useful information when the entire information is posted into them. Journal is the book of first entry (original entry) while the ledger is the book of Final Entry. It gives the final position of each account relating to any change in the account. Posting of Journal is the process of transferring the entire information recorded in journal to the relevant accounts in ledger.

**Procedure for Posting the Journal**

There are two parts of a journal entry:

- the debit part which comes first and
- the credit part which comes later.

**i) Posting the Debit Part**

- Debit part will be posted on the debit side of the relevant account in ledger. After writing the date, record the name of the account credited in journal in the particulars column. Add prefix 'To' before writing the name of the account. Then write the account e.g., "To (name of the account)". Then write the amount in the amount column.
- For reference record the page number of journal in the Folio Column before amount column on the debit side.

## Ledger

### ii) Posting the Credit Part

- a) The credit part will be posted on the credit side of the relevant account in ledger. After writing the date the name of the account debited in journal will be written in the particulars column of the account. The prefix 'By' is generally used before the name of the account in the particulars column e.g., "By (name of the account)". Then write the amount in the 'amount' column.
- b) For reference record the page number of Journal in the 'Folio' column on the credit side.

**Example :** Post the following journal entry into ledger.

### JOURNAL

Dr.		Cr.		
Date	Particulars	L.F.	Dr. Amount (₹)	Cr. Amount (₹)
2012 Mar. 20	Cash Account Jankidas (Being Cash received from Jankidas)	Dr.	2,700	2,700

### LEDGER

Dr.				Cr.			
CASH ACCOUNT							
Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
2012 Mar. 20	To Jankidas (name of the account credited in journal.)		2,700				

Dr.				Cr.			
JANKIDAS							
Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
				2012 Mar. 20	By Cash Account (Name of the account debited in journal.)		2,700

### Posting of the compound Entry into Ledger from Journal

If more than two accounts are involved in a transaction and only one entry has been made for the transaction, it is called 'compound entry'. There may be two accounts in the debit part of the journal entry and one account in the credit part or there may be one account in the debit part and two accounts in the credit part. Rule of posting is the same as before, only the amounts are to be carefully written.

## MODULE - III

### Ledger and Trial Balance



### Notes

## MODULE - III

### Ledger and Trial Balance



Notes

## Ledger

**Example :** Post the following journal entries into ledger.

Dr.		Cr.		
Date	Particulars	L.F.	Dr. Amount (₹)	Cr. Amount (₹)
<b>2012</b>				
May 15	Bank Account Dr. Discount Allowed Account Dr. Hari Mohan (Being cheque received from Hari Mohan and allowed him discount).		29,000 1,000	30,000
May 15	Kamal Dr. Bank Account Discount Received Account (Being cheque given to Kamal and he allowed discount of Rs. 100)		15,000	14,900 100

### Solution

#### Posting into Ledger

Dr.		Bank Account				Cr.	
Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
<b>2012</b>							
May 15	To Hari Mohan		29,000	May 15	By Kamal		14,900

Dr.		Hari Mohan				Cr.	
Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
<b>2012</b>							
				May 15	By Bank A/c By Discount Allowed A/c		29,000 1000

Dr.		Kamal				Cr.	
Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
<b>2012</b>							
May 15	To Bank A/c		14,900				
May 15	To Discount Received A/c.		100				

Dr.		Discount Allowed Account				Cr.	
Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
<b>2012</b>							
May 15	To Hari Mohan		1,000				



## Ledger

Dr.				Discount Received Account				Cr
Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)	
				2012 May 15	By Kamal		100	

### Illustration 1

Pass the necessary journal entries for the following transactions and post them into ledger :

Date	Transaction	Amount (₹)
2012		
Jan. 15	Received cash from Mohan & Co. and Discount allowed to them.	25,600 400
Jan. 16	Purchased Goods on Credit from Babu.	20,000
Jan. 17	Goods returned to Babu	5,000
Jan. 18	Drawings made for personal use in the form of :	
	Goods	1,000
	Cash	1,000
Jan. 23	Paid rent	1,000
	Paid Salaries	1,000

### Solution

#### Journal

Date	Particulars	L.F.	Dr (₹)	Cr (₹)
<b>2012</b>				
Jan.15	Cash A/c Discount Allowed A/c Mohan and Co. (Being cash received and discount allowed)	Dr. Dr.	25,600 400	26,000
Jan.16	Purchases A/c Babu (Being good Purchased on Credit)	Dr.	20,000	20,000
Jan.17	Babu Purchases Returns A/c (Being goods returned to Babu)	Dr.	5,000	5,000
Jan. 18	Drawings A/c Cash A/c Purchases A/c (Being Cash and goods withdrawn by proprietor for his personal use)	Dr.	2,000	1,000 1,000

## MODULE - III

### Ledger and Trial Balance



### Notes

## MODULE - III

### Ledger and Trial Balance



Notes

## Ledger

Jan. 23	Rent A/c	Dr.	1,000	
	Salaries A/c	Dr.	1,000	
	Cash A/c			2,000
	(Being rent & salaries paid in Cash)			

### LEDGER POSTING

#### Dr. Cash Account Cr

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
<b>2012</b>				<b>2012</b>			
Jan. 15	To Mohan & Co.		25,600	Jan. 18	By Drawing A/c		1,000
				Jan. 23	By Rent A/c		1,000
					By Salaries A/c		1,000

#### Dr. Discount Allowed Account Cr

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
<b>2012</b>							
Jan. 15	To Mohan & Co.		400				

#### Dr. Mohan & Co. Cr

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
				<b>2012</b>			
				Jan. 15	By Cash A/c.		25,600
					By Discount Allowed A/c.		400

#### Dr. Purchases Account Cr

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
<b>2012</b>				<b>2012</b>			
Jan. 16	To Babu		20,000	Jan. 18	By Drawing		1,000

#### Dr. Babu Cr

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
<b>2012</b>				<b>2012</b>			
Jan. 17	To Purchases Return A/c		5,000	Jan. 16	By Purchase A/c.		20,000

## Ledger

## MODULE - III

### Ledger and Trial Balance



### Notes

Dr. Purchase Return Account				Cr			
Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
				2012 Jan. 17	By Babu		5,000

Dr. Drawing Account				Cr			
Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
2012 Jan. 18	To Cash A/c To Purchases A/c		1,000 1,000				

Dr. Rent Account				Cr			
Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
2012 Jan. 23	To Cash A/c.		1,000				

Dr. Salaries Account				Cr			
Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
2012 Jan. 23	To Cash A/c.		1,000				

### Illustration 2

Pass the necessary journal entries for the following transactions and post them into ledger :

Date	Particulars	Amount (₹)
2012		
Feb. 1	Paid cash to Dinesh	16,800
	Discount received	200
Feb. 2	Goods sold to Dinesh	20,000
Feb. 3	Goods returned by Dinesh	500
Feb. 5	Purchased goods on Credit from :	
	Ram	15,000
	Hari	5,000
Feb. 6	Received commission in Cash	600

## MODULE - III

### Ledger and Trial Balance



Notes

Ledger

### Solution

#### Journal

Date 2012	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Feb. 1	Dinesh Cash A/c Discount Received A/c (Being cash paid to Dinesh and discount received)	Dr.	17,000	16,800 200
Feb. 2	Dinesh Sales A/c (Being goods sold to Dinesh)	Dr.	20,000	20,000
Feb. 3	Sales Return A/c Dinesh (Being goods returned by Dinesh)	Dr.	500	500
Feb. 5	Purchases A/c Ram Hari (Being goods purchase on credit)	Dr.	20,000	15,000 5,000
Feb. 6	Cash A/c Commission Received A/c (Being commission received)	Dr.	600	600

#### Ledger Posting

Dr. Dinesh Cr

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
<b>2012</b>				<b>2012</b>			
Feb. 1	To Cash A/c.		16,800	Feb. 3	By Sales's Return's A/c.		500
Feb. 1	To Discount Received A/c.		200				
Feb. 2	To Sales A/c.		20,000				

Dr. Cash Account Cr

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
<b>2012</b>				<b>2012</b>			
Feb. 6	To Commission Received A/c.		600	Feb. 1	By Dinesh		16,800

## Ledger

## MODULE - III

### Ledger and Trial Balance



### Notes

Dr.				Discount Received Account				Cr	
Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)		
2012				2012 Feb. 1	By Dinesh		200		

Dr.				Sales Account				Cr	
Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)		
				2012 Feb. 2	By Dinesh		20,000		

Dr.				Sales Returns Account				Cr	
Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)		
2012 Feb. 3	To Dinesh		500						

Dr.				Purchase Account				Cr	
Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)		
2012 Feb. 5	To Ram To Hari		15,000 5,000						

Dr.				Ram				Cr	
Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)		
				2012 Feb. 5	By Purchase A/c.		15,000		

Dr.				Hari				Cr	
Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)		
				2012 Feb. 5	Purchases A/c.		5,000		

Dr.				Commission Received Account				Cr	
Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)		
				2012 Feb. 6	By Cash A/c.		600		

## MODULE - III

### Ledger and Trial Balance



Notes

Ledger



### INTEXT QUESTIONS 10.2

Following are the steps of posting of journal to ledger but are not in proper order. Write them in correct order :

- Write the page number of journal in JF column of ledger account and that of ledger in the LF column of journal.
- Open the two affected accounts in the ledger.
- Write date, amount of the debit account and have the credit account in the ledger in their respective columns.

### Posting of Opening Entry

In the beginning of every accounting period of a continuing business a journal entry is passed to record the opening balance of all the assets and liabilities. This entry is called 'opening entry'. The posting of an opening entry is done altogether in a different way. As all assets have debit balance so account of each asset is opened in the ledger, on debit side by writing the word 'To Balance b/d'. Similarly, the liabilities and capital account have credit balance so account of each liability is opened in the ledger on the credit side by writing the word 'By Balance b/d'.

In this way, posting of an opening entry is completed. All other entries are posted in the usual way.

**Example :** Post the following opening entry into ledger:

#### Journal

Date 2012	Particulars	L.F.	Dr. (₹)	Cr. (₹)
April 1	Cash Account Dr.		70,000	
	Machine Account Dr.		2,10,000	
	Bank Account Dr.		70,000	
	Vipin (Debtor) Dr.		1,00,000	
	Capital Account			3,80,000
	Hari Ram			50,000
	Loan from HDFC Bank			20,000
	(Being the opening entry)			

## Ledger

## MODULE - III

### Ledger and Trial Balance



Notes

### Solution

#### Posting into Ledger

#### Dr. Cash Account Cr

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
2012 Apr. 1	To Balance b/d		70,000				

#### Dr. Machine Account Cr

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
2012 Apr. 1	To Balance b/d		2,10,000				

#### Dr. Bank Account Cr

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
2012 Apr. 1	To Balance b/d		70,000				

#### Dr. Vipin Cr

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
2012 Apr. 1	To Balance b/d		1,00,000				

#### Dr. Capital Account Cr

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
				2012 Apr. 1	By Balance b/d		3,80,000

#### Dr. Hari Ram's Account Cr

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
				2012 Apr. 1	By Balance b/d		50,000

#### Dr. Loan Account (HDFC Bank) Cr

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
				2012 Apr. 1	By Balance b/d		20,000

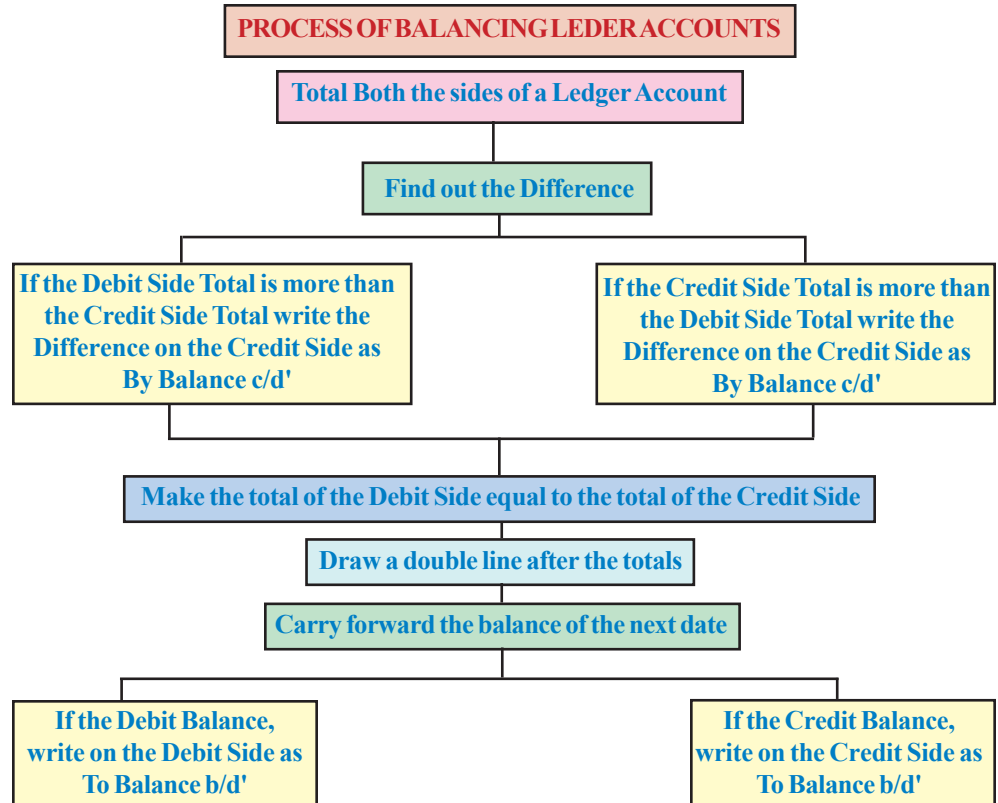


Notes

**10.4 BALANCING OF AN ACCOUNT**

Balancing of accounts means totalling the two sides of an account and putting the difference on shorter side. All Ledger accounts are usually closed and balanced at the end of an accounting period. The following steps are taken for balancing the accounts: -

- Calculate the total of both the sides of a Ledger account, and find out the difference.
- If the debit side total exceeds the credit side total, write the difference on credit side as “By Balance” c/d
- If the credit side total exceeds the debit side total write the difference on debit side as ‘To Balance’ c/d
- Write total amount on both the sides of the account.
- Draw double line after the totals of an account.
- Bring forward the balance on the next date on the other side. If debit balance is brought down write ‘To Balance b/d and if credit balance brought down write ‘By Balance b/d.



**Types of Accounts that are Balanced :** Normally, Capital account, Assets and Liabilities accounts are balanced. Revenue and Expenses accounts are not balanced but are closed by transferring the balance to Trading or Profit and Loss Account at the end of the accounting year.



## Ledger

### Illustration 3

The following balances existed in the books of Good Look Garments on April 1, 2012.

**Assets** : Cash ₹ 5,800, Stock ₹ 5,000, Bheem ₹ 2,500, Dinesh ₹ 3,200, Furniture ₹ 1,600

**Liabilities** : Suman Printers ₹ 3,600

Following transaction took place in April, 2012

- April 2 Bought goods of the list price of ₹ 10,000 from Sat Narain, less 10% trade discount and 2% cash discount and paid 60% price at the same time.
- April 6 Sold goods for cash ₹ 8,000 and on credit to Bheem for ₹ 4,600
- April 10 Bought goods from Suman Printers, list price ₹ 4,000 valued at ₹ 3,800.
- April 16 Paid cash to Suman Printers ₹ 3,400.
- April 18 Sold goods for ₹ 1,200 to Krishna for Cash.
- April 25 Bheem cleared his account in full, by payment of ₹ 7,000.
- April 30 Paid salary for the current month ₹ 7,500.

Journalise the above transactions, post them into ledger, balance the accounts.

### Solution

#### Journal of Good Look Garments

Date 2012	Particulars	L.F.	Dr. (₹)	Cr. (₹)
April 1	Cash A/c	Dr.	5,800	
	Stock A/c	Dr.	5,000	
	Bheem	Dr.	2,500	
	Dinesh	Dr.	3,200	
	Furniture A/c	Dr.	1,600	
	Suman Printers			3,600
	Capital A/c (Balancing figure) (Opening entry recorded in journal)			14,500
April 2	Purchases A/c	Dr.	9,000	
	Cash A/c			5,292
	Discount A/c			108
	Sat Narain			3,600
	(Goods purchased and 60% amount paid immediately at 2% cash discount)			
April 6	Cash A/c	Dr.	8,000	
	Bheem	Dr.	4,600	
	Sales A/c (Goods sold)			12,600

## MODULE - III

### Ledger and Trial Balance



### Notes

## MODULE - III

### Ledger and Trial Balance



Notes

## Ledger

April 10	Purchases A/c Suman Printer (Goods purchased from Suman Printers)	Dr.		3,800	3,800
April 16	Suman Printers Cash A/c (Cash paid to Suman Printers)	Dr.		3,400	3,400
April 18	Cash A/c Sales A/c (Goods sold to Krishna for cash)	Dr.		1,200	1,200
April 25	Cash A/c Discount A/c Bheem (Cash received & discount allowed to Bheem)	Dr. Dr.		7,000 100	7,100
April 30	Salary A/c Cash A/c (Salary paid)	Dr.		7,500	7,500
			<b>Total</b>	<b>62,700</b>	<b>62,700</b>

### Ledger of Good Look Garments

Dr. Cr **Cash Account**

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
<b>2012</b>				<b>2012</b>			
Apr. 1	To Balance b/d		5,800	Apr. 2	By Purchases A/c		5,292
Apr. 6	To Sales A/c		8,000	Apr. 16	By Suman Printers		3,400
Apr. 18	To Sales A/c		1,200	Apr. 30	By Salary A/c		7,500
Apr. 25	To Bheem		7,000	Apr. 30	By Balance c/d		5,808
			22,000				22,000
May 1	To Balance b/d		5,808				

Dr. Cr **Stock Account**

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
<b>2012</b>				<b>2012</b>			
Apr. 1	To Balance b/d		5,000	Apr. 30	By Trading A/c (Transfer)		5,000
			5,000				5,000

## Ledger

## MODULE - III

### Ledger and Trial Balance



Notes

Dr.				Bheem				Cr			
Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
2012				2012							
Apr. 1	To Balance b/d		2,500	Apr. 25	By Cash A/c		7,000				
Apr. 6	To Sales A/c		4,600	Apr. 25	By Discount A/c		100				
			7,100				7,100				

Dr.				Dinesh				Cr			
Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
2012				2012							
Apr. 1	To Balance b/d		3,200	Apr. 30	By Balance c/d		3,200				
May 1	To Balance b/d		3,200								

Dr.				Furniture Account				Cr			
Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
2012				2012							
Apr. 1	To Balance b/d		1,600	Apr. 30	By Balance c/d		1,600				
May 1	To Balance b/d		1,600								

Dr.				Suman Printers				Cr			
Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
2012				2012							
Apr. 16	To Cash A/c		3,400	Apr. 1	By Balance b/d		3,600				
Apr. 30	To Balance c/d		4,000	Apr. 10	By Purchases A/c		3,800				
			7,400				7,400				
				May 1	By Balance b/d		4,000				

Dr.				Capital Account				Cr			
Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
2012				2012							
Apr. 30	To Balance c/d		14,500	Apr. 1	By Balance b/d		14,500				
				May 1	By Balance b/d		14,500				

Dr.				Purchases Account				Cr			
Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
2012				2012							
Apr. 2	To Cash A/c		5,292	Apr. 30	By Trading A/c (Transfer)		12,800				
Apr. 2	To Discount A/c		108								
Apr. 2	To Sat Narain		3,600								
Apr. 10	To Suman Printers		3,800								
			12,800				12,800				

## MODULE - III

### Ledger and Trial Balance



Notes

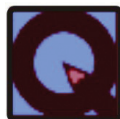
## Ledger

Dr.				Discount Account				Cr
Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)	
<b>2012</b>				<b>2012</b>				
Apr. 25	To Bheem		100	Apr. 12	By Purchases A/c		108	
Apr. 30	To P&L A/c (Transfer)		8					
			108				108	

Dr.				Sat Narain				Cr
Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)	
<b>2012</b>				<b>2012</b>				
Apr. 30	To Balance c/d		3,600	Apr. 2	By Purchases A/c		3,600	
				May 1	By Balance b/d		3,600	

Dr.				Sales Account				Cr
Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)	
<b>2012</b>				<b>2012</b>				
Apr. 30	To Trading A/c (Transfer)		13,800	Apr. 6	By Cash A/c		8,000	
				Apr. 6	By Bheem		4,600	
				Apr. 18	By Cash A/c		1,200	
			13,800				13,800	

Dr.				Salary Account				Cr
Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)	
<b>2012</b>				<b>2012</b>				
Apr. 30	To Cash A/c		7,500	Apr. 30	By Profit & Loss A/c		7,500	
			7,500		(Transfer)		7,500	



### INTEXT QUESTIONS 10.3

#### I. Fill in the blanks with suitable word / words :

- i. Assets accounts always have \_\_\_\_\_ balance.
- ii. Liability accounts always have \_\_\_\_\_ balance.
- iii. The capital account generally has \_\_\_\_\_ balance.
- iv. The revenue and expenses accounts are closed by taking the balances to \_\_\_\_\_.

## Ledger

## MODULE - III

### Ledger and Trial Balance



Notes

### II. Balance the following accounts

Dr. Joginder's Account				Cr			
Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
2012 Feb. 1	To Sales A/c		6,000	2012 Feb. 10	By Cash A/c By Discount		4,980 20

Dr. Rent Receivable Account				Cr			
Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
2012				2012 Feb. 20	By Cash A/c		2,000

### III. Multiple choice questions

- The book in which all accounts of the firm are maintained is known as :
  - Cash Book
  - Ledger
  - Journal
  - Day Book
- Which of the following is not the basic objective of preparing ledger?
  - To know debtors and creditors of the business.
  - To know financial position of the business.
  - To know effects of common transactions of the business.
  - To know whether proprietor has sold his house to invest money in business.
- The ledger is a book of :
  - Original entry
  - Secondary entry
  - All cash transactions
  - Petty cash transactions
- Writing a transactions in the ledger is called
  - Casting
  - Balancing
  - Journalising
  - Posting
- Basically ledger account is divided into two parts. Left side is known as
  - Credit side
  - Debit side
  - Wrong side
  - Right side



### WHAT YOU HAVE LEARNT

- The book in which all accounts are maintained is called 'ledger'.
- The process of opening necessary ledger accounts and transferring the information recorded in day books to these accounts according to accounting rules is called ledger posting.

**MODULE - III****Ledger and Trial Balance****Notes****Ledger**

- Purpose of ledger is :
  - To have information about various transactions.
  - Proper control over transactions.
  - Helpful in preparing Trial Balance.
  - Helpful in preparing Financial Statements.
- The debit item of journal is posted to the credit side of the relevant account in the ledger.
- The credit item of journal is posted to the debit side of the relevant account in the ledger.
- Name of the account in the journal is entered in particulars column of the relevant account in the ledger.

**TERMINAL EXERCISE**

1. What is meant by Ledger? Why is Ledger prepared.?
2. Draw the Format of Ledger Account.
3. What is the difference between Journal and Ledger?
4. What is meant by balancing of an Account?
5. Journalize the following transactions and post them into Ledger and balance the accounts :

<b>2012</b>	<b>Particulars</b>	<b>₹</b>
Apr. 1	Commenced business with cash	1,00,000
Apr. 3	Paid into Bank	30,000
Apr. 5	Purchased furniture for Cash	5,000
Apr. 8	Purchased goods and paid by cheque	15,000
Apr. 14	Purchased goods from Hari	35,000
Apr. 18	Cash sales	32,000

6. Journalise the following transactions of Rathore and Post them into Ledger

<b>2012</b>	<b>Particulars</b>	<b>₹</b>
Jan. 1	Cash in hand	1,50,000
Jan. 1	Goods in hand	80,000
Jan. 1	Outstanding wages	20,000
Jan. 4	Paid for Charity	501
Jan. 4	Purchased goods from Akash	20,000
Jan. 5	Received rent from tenant	5,000
Jan. 18	Paid Cash to Akash on account	17,000
Jan. 22	Received interest on loan	1,750
Jan. 24	Magan returned goods	1,250
Jan. 26	Goods returned to Akash	2,000

## Ledger

- Jan. 29 Ram owed ₹ 4,000 became insolvent, and a final composition of 40 paise in a rupee was received
- Jan. 31 Purchase of a Motor-cycle by Rathore for his son 42,000

7. On July 1, 2012; the following were ledger balances of Krishna. Cash in hand ₹ 2,000; Cash at bank ₹ 12,000. Bills Payables ₹ 4,000; Ashok (Debtor) ₹ 2,500; Stock ₹ 10,000; Charu (Creditor) ₹ 2,000; Other transactions during the month were as follows:

2012	Particulars	₹
July 1	Bought goods from Charu	10,000
July 2	Sold goods to Surinder	21,000
July 3	Bought goods from Ram Lakhan	16,000
July 6	Sold goods to Paresha	8,000
July 12	Paid to Charu by cheque	16,000
July 20	Received from Surinder by cheque	8,900
	Allowed him discount	,100
July 24	Sold goods to Surinder	18,000
July 25	Paid rent by cheque	2,000
July 25	Sold goods to Paresha	15,000
July 31	Paid Salaries	5,000

Give journal entries and post them to ledger.

8. Prepare Journal and post into ledger the following transaction of Mr. Garib Chand and Sons.

2012	Particulars	₹
Apr. 1	Cash in hand	11,500
Apr. 1	Stock of goods in hand	12,500
Apr. 1	Bank Balance	20,000
Apr. 1	Due to Ramesh	1,000
Apr. 1	Due from Tara Chandani	2,000
Apr. 2	Sold goods to Manmohan	15,000
Apr. 4	Cash sales	7,000
Apr. 7	Sold to Raghuvanshi	4,000
Apr. 9	Bought goods from Ramesh	1,250
Apr. 15	Sold goods to Tara Chandani	2,000
Apr. 18	Wages paid	400
Apr. 21	Received from Manmohan	6,000
Apr. 28	Proprietor took goods for personal use	1,000
Apr. 30	Paid Income Tax	5,000

## MODULE - III

### Ledger and Trial Balance



### Notes

**MODULE - III****Ledger and Trial Balance****Notes****Ledger****ANSWER TO INTEXT QUESTIONS**

**10.1** (i) ledger (ii) Principal Book (iii) Ledger posting  
(iv) Journal (v) Analytical

**10.2** b, c, a

**10.3 I.** (i) debit (ii) credit (iii) credit  
(iv) Trading and Profit & Loss A/c

**II.** By balance c/d Rs. 1,000, To balance c/d Rs. 2,000

**III.** i) b ii) d iii) b iv) d v) b

**ACTIVITY FOR YOU**

- Visit a shopping mall and observe the various activities performed by businessmen/ shopkeepers. note down the activities with imaginary figures. Prepare the journal of at least fifteen such activities and post these entries from journal into ledger.



# 11

## TRIAL BALANCE AND ACCOUNTING ERRORS

You have learnt the method of recording transactions in journal and its sub-divisions. You have also learnt their posting to various accounts in the ledger. This process of recording and posting continues throughout the year. At the end of the year it becomes necessary to check the arithmetical accuracy of the books of accounts before the preparation of final accounts. For this purpose we prepare a statement called Trial Balance. In this unit you will learn about the preparation of Trial Balance and the extent up to which it can be relied upon for testing the accuracy of accounts. You will also learn about the errors that may be disclosed and that may not be disclosed by the preparation of Trial Balance and the method of locating such errors.



### OBJECTIVES

After studying this chapter, you will be able to:

- define trial balance;
- describe the objectives of preparing a trial balance;
- explain the causes of disagreement of a trial balance;
- identify the types of errors disclosed and not disclosed by a trial balance;
- describe the procedure for locating the errors;
- explain the limitations of trial balance;
- prepare the trial balance and
- explain the meaning and disposal of suspense account.

### 11.1 MEANING OF TRIAL BALANCE

Numerous transactions take place in business everyday. They are first recorded in books of original entry i.e., Journal Proper or one of its sub-divisions. Then they are posted to the appropriate accounts in the ledger. Each ledger account is balanced periodically so as to ascertain the net effect of various transactions posted therein. In the process, some accounts may get closed; the final accounts are prepared for ascertaining the profit or loss and the financial position of the business. The quality and reliability of the results obtained depend, largely on the correctness of the entries made

## MODULE - III

### Ledger and Trial Balance



### Notes

ENGLAND TOBACCO COMPANY Post-Closing Trial Balance December 31, 20X3		
	Debit	Credit
Cash	\$ 10,000	
Accounts receivable	4,000	
Equipment	40,000	
Accumulated depreciation		5,000
Accounts payable		4,000
Notes payable		2,000
Interest payable		1,200
Notes payable		20,000
Unearned revenue		1,200
Capital stock		20,000
Retained earnings		1,000
	\$ 55,000	\$ 55,000

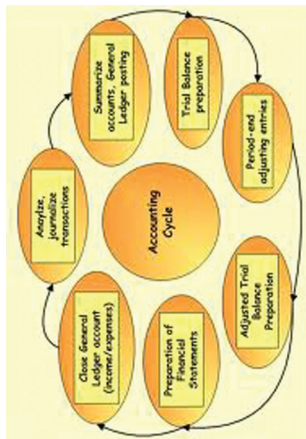
Bear Students, both side of Trial Balance must agree the above \$ 55,000.00. - 16/02/2023

## MODULE - III

### Ledger and Trial Balance



#### Notes



## Trial Balance & Accounting Errors

in various books of accounts and their ledger posting. Hence, it is necessary to ascertain the accuracy of these entries and ledger postings before we proceed with the preparation of final accounts. For this purpose, we prepare a statement called 'Trial Balance', which shows balances of all the ledger accounts. The names of each account having debit balances are shown in the debit column and if it shows a credit balance, the amount is entered in the credit balances column. You know that the total of the debit balances column must tally with the total of the credit balance column, because for every debit there is a corresponding credit and vice versa. When the two totals tally, it is considered as a preliminary proof of the arithmetical accuracy of the accounts. It is an assurance that entries in the journal and posting into ledger have been correctly done and that equality between debits and credits has been maintained throughout. However, if the two totals do not tally it implies that there are some errors in the books of accounts.

Trial Balance can thus, be defined as a statement (or a schedule) listing, in separate columns, the debit and credit balances of all ledger accounts on a particular date. It indicates that the books of accounts have been prepared in accordance with the rules of double entry and ensures, to a great extent, the arithmetical accuracy of accounting entries. Trial Balance provides a check on arithmetical accuracy of the recording of financial transactions in different books such as journal and the ledger. Such a check can be performed by preparing a statement called trial balance. Trial balance is a statement prepared by taking up the debit and credit totals or balances of all ledger accounts on a particular date.

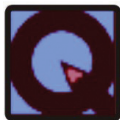
### 11.2 OBJECTIVES OF PREPARING A TRIAL BALANCE

- i) **To check arithmetical accuracy :** With the help of trial balance we can identify the arithmetical error, committed by the accountant or his assistant, because in such a situation the trial balance will not agree. Under such situations it is assumed that some errors have been committed. After identifying such errors the same are rectified.
- ii) **To prepare final accounts of the enterprise :** Trial balance becomes the basis of preparing final accounts. If we do not prepare trial balance and just start preparing final accounts, it may be possible that we forget to record some transactions that were not recorded while preparing the final accounts because information about the same was not available at that time.
- iii) **Comparative study of each account :** Trial balance helps in comparing the present balance of an account with the previous period balance. By preparing trial balance, we can estimate whether closing balance of accounts will increase or decrease within two accounting periods. It can also be used as a tool to decide whether there is need to decrease the rate

## Trial Balance & Accounting Errors

of depreciation for showing improved profit position.

- iv) **To make financial budget :** Previous years trial balance figures are also helpful to estimate the future amount. In other words, we can make different financial budgets with the help of trial balance.



### INTEXT QUESTIONS 11.1

Given below are some statements. Some of these statements are correct and some of these statements are incorrect. Write 'correct' if the statement is correct and 'incorrect' if it is not correct.

- i. Trial Balance is an essential part of the accounting process.
- ii. Trial Balance is prepared only once in a year.
- iii. If the totals of the two columns of a Trial Balance are equal it means the posting has been done correctly.
- iv. Debit Balances of the accounts are written in the Debit column and Credit balances in the credit column of the Trial Balance.
- v. The Assets and Expenses accounts have the credit balance.

## 11.3 CAUSES FOR THE DISAGREEMENT OF A TRIAL BALANCE

As mentioned earlier, when the Trial Balance does not tally it means that some errors have been committed while preparing the accounts. Let us, now analyze the errors which usually affect the Trial Balance and lead to its disagreement.

- i) **Omission of posting in one account :** You are aware that both the debit and credit aspects of a transaction have to be posted in the ledger accounts. If you post it to the debit of one account and forget its posting to the credit of the other concerned account, it is bound to affect the Trial Balance. For example, an amount of ₹ 200 received from Ali, correctly entered on the debit side of the cash book but is not posted to the credit side of Ali's Account, because of this error the totals of the debit column of the trial balance will be more than the total of the credit column and hence the trial balance will not agree.
- ii) **Double posting in one account :** If by mistake you post an entry two times to the debit or to the credit of an account it would result in extra debit or credit and as such cause disagreement in the Trial Balance for example ₹ 4000 received from Ashok were credited twice in his account will increase the total of the credit column by ₹ 4000 and the trial balance will not agree.
- iii) **Posting in the wrong side of an account :** When an entry is posted in the

## MODULE - III

### Ledger and Trial Balance



### Notes

## MODULE - III

### Ledger and Trial Balance



#### Notes

### Trial Balance & Accounting Errors

wrong side of an account i.e. instead of debit side it is posted in the credit side and vice-versa, it would also cause disagreement of the Trial Balance. In such a situation, the difference will be for double the amount. For example, ₹ 300 received from Khan which is correctly entered on the debit side of the Cash Book, but while posting it to Khan's Account it is wrongly posted to the debit side of his account instead of the credit side. This would mean that a debit of ₹ 600 (₹ 300 in Cash Account and ₹ 300 in Khan's Account) has no corresponding credit. With the result the total of the Credit column of the trial balance will be lesser by ₹ 600.

- iv) **Posting wrong amount in an account :** If you post an entry to the correct side of an account but commit an error in writing the amount, this would affect the Trial Balance. Suppose, in the above example you post the entry correctly on the credit side of Khan's Account but the amount is wrongly written as ₹ 200. It would cause a difference of ₹ 100. In the Trial Balance, the credit side will be lesser by ₹ 100.
- v) **Wrong Casting of the subsidiary books :** If any subsidiary book is overcast or undercast, it affects the concerned account in ledger. Suppose the correct total of Sales Journal is ₹ 5,600, but it has been totalled as ₹ 5,300 when now posted to the credit of Sales Account, the Sales Account will be short by ₹ 300, and the Trial Balance will not tally.
- vi) **Omitting to post the total of a subsidiary book :** If the total of a subsidiary book is not posted to the concerned account, it would affect the Trial Balance. Such mistake relates only to the account where posting was to be done and as such affects only one account. For example, if the totals of the Sales Book ₹ 18,900 are not posted to the credit of Sales Account, the credit side on the Trial Balance will be lesser by ₹ 18,900.
- vii) **Wrong totaling or balancing of an account :** When an account is wrongly totaled or wrongly balanced, this would affect the Trial Balance. Suppose total of the debit side of Shyam's Account has been written as ₹ 1,300 instead of ₹ 1,100. It would lead to wrong balance in Shyam's Account. Consequently, the debit total in the Trial Balance will be higher by ₹ 200. Similarly, if the totaling is correctly done but a mistake is committed in balancing the account, it would also cause a difference in the Trial Balance.
- viii) **Omission of an account from Trial Balance :** You know that all accounts which show some balance must be included in the Trial Balance. If you forget to write the balance of any account in the Trial Balance, it will not tally. In practice cash book balances are often omitted from Trial Balance.

## Trial Balance & Accounting Errors

- ix) **Writing the balance of an account in the wrong column of the Trial Balance :** If the balance of an account which is to be shown in the debit column of the Trial Balance is actually shown in the credit column, the Trial Balances will not tally. It will be affected by double the amount.
- x) **Wrong totaling of the Trial Balance :** If an error is committed in totaling the amount columns of the Trial Balance itself, the Trial Balance will not tally.

Thus, you have learnt about various errors which may cause difference in the Trial Balance. Note that these errors affect only one aspect (debit or credit). This upsets the debit-credit equality leading to the disagreement of the Trial Balance

### 11.4 ERRORS NOT DISCLOSED BY TRIAL BALANCE

Agreement of the trial balance is not a conclusive proof of the accuracy of the accounts. There may be certain errors which might have been crept into the accounts but do not affect the agreement of the trial balance. Such errors have been discussed below :

- i) **Errors of Complete Omission :** If a transaction is completely omitted from being recorded in the books of accounts, such an omission will not affect the agreement of the trial balance for example a credit purchase of ₹ 6000 from Ravi was omitted from being recorded in the Purchase Book. Because of this omission the totals of the purchases book and Ravi's account will not be affected and hence trial balance will also not be affected.
- ii) **Errors of commission :** These types of errors happen due to the negligence of accountants and cannot be located by preparing trial balance. Suppose a sales of ₹ 10,000 was recorded in books as ₹ 100. The balances both the accounts i.e sales account and cash account will be affected only by ₹ 100 and hence the trial balance will not be affected.
- iii) **Compensating Errors :** Suppose, an accountant posted ₹ 500 less in the debit side of purchase account and at the same time he also posted ₹ 500 less in credit side of sales account. In this case an error has been compensated by another error. Such errors are called compensating error and will not affect the trial balance.
- iv) **Errors of principles :** When an accounting principle has been violated while recording a transaction in the books of accounts, such errors are called errors of principle e.g. the purchase of an asset if recorded in the purchases account will be an error of principle but since the purchase account will be debited and the suppliers accounts will be credited with the same amount this error will not affect the trial balance

## MODULE - III

### Ledger and Trial Balance



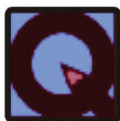
#### Notes

**MODULE - III****Ledger and Trial Balance****Notes****Trial Balance & Accounting Errors****11.5 ERRORS DISCLOSED BY TRIAL BALANCE**

If the Trial Balance does not tally, it will indicate that certain errors have been committed which have affected the agreement of the Trial Balance. The accountant will then proceed to locate such errors. On location such errors are rectified. Errors disclosed by trial balance have been explained below:

- i) **Wrong Casting :** If the total of the Cash Book or some other Subsidiary Book is casted wrong, the Trial Balance will not tally. For example, the total of the Purchase book has been casted ₹ 2000 more. When this total will be posted to the debit side of the purchase account, it will also show an excess debit of ₹ 2000 and hence, the Trial Balance will not agree.
- ii) **Posting to the Wrong Side of an Account :** If instead of posting an amount on the debit side of an account, it is posted on the credit side, or vice versa, the Trial balance will not tally. For example, goods for ₹ 2,000 purchased from Sohan. If instead of posting the amount on the credit side of Sohan's account it is posted to his debit, the debit side of the Trial Balance will exceed the credit side by ₹ 4,000.
- iii) **Posting of Wrong Amount :** The Trial Balance will not tally if the posting in an account is made with an incorrect amount. For example, goods for ₹ 600 have been purchased from Anil. If, it has been correctly entered in the Purchase Book or purchase account, but while posting to Anil's account, in credit side (correct side) the amount posted is ₹ 60 instead of ₹ 600, the Trial Balance will not tally.
- iv) **Omission of Posting of One aspect of a Transaction :** For example, if ₹ 500 has been received from Shyam and correctly entered in the Cash Book but if it is omitted to be posted on the credit side of Shyam's Account, the Trial Balance will not tally.
- v) **Posting an amount twice in an Account :** For example ₹ 500 has received from Vinod and correctly entered in the Cash Book, but if it is posted twice on the credit side of Vinod's account, the Trial Balance will not tally.
- vi) **Errors of Totaling and Balancing of Accounts in the Ledger :** Errors may occur in the totaling of debit or credit sides of accounts in the Ledger or in the balancing of accounts in the Ledger. Because the balances of accounts are transferred to the Trial Balance, resulting in transferring wrong balances in the Trial Balance. This will result into the disagreement of the trial balance.





## INTEXT QUESTIONS 11.2

Fill in the blanks with suitable word or words

- i. Trial Balance is said to have agreed when its \_\_\_\_\_ are equal.
- ii. The agreement of Trial Balance is a proof of \_\_\_\_\_ accuracy of the ledger posting.
- iii. There is a \_\_\_\_\_ column and a \_\_\_\_\_ column for balances of accounts in a Trial Balance.
- iv. Cash in hand is written in the \_\_\_\_\_ column of the Trial Balance.

### 11.6 PROCESS OF LOCATING THE ERRORS

If an error exists in the books, it affects the accuracy of results of business operations revealed by the financial statements. Therefore, the errors must be located for rectification. The task of locating errors is, however not easy. The location of errors will be easier if the following steps are systematically taken.

- i. Check the total of the trial balance.
- ii. Compare the ledger account balances carried to the trial balance.
- iii. Verify the total of subsidiary books and their posting to ledger accounts.
- iv. Verify that all journal entries have been correctly posted to the different ledger accounts.
- v. If you find that you have an unbalanced trial balance, in other words the debits don't equal the credits, it indicates that some errors have been committed during the course of accounting process. Such errors have to be found and corrected. The first step in finding an error is to simply add the credit and debit columns again to verify your totals. If they still don't agree then subtract the smaller totals from the bigger and look for the missing amount in the smaller column. If you find it, you've found your error.
- vi. There are other standard techniques to track down an error in a trial balance. If the debits and credits are not equal, see if the numeral 2 divides equally the difference. If it does, look for an account, incorrectly in the column with the larger total that equals half the difference. If you find this, you've found your error.
- vii. Another technique is to use the numeral 9 to find a transposition error. If the numeral 9 divides evenly the difference between the credits and debits, you have a transposition error. Go back over your credit and debit entries to try to find your transposition error.



Notes

## MODULE - III

### Ledger and Trial Balance



Notes

S Firm Trial balance as at 31/12/2011		
	debits	credits
Petty cash	25	
Bank overdraft	4130	
Accounts receivable		4500
Land & buildings	35000	
Office equipment	1500	
Accounts payable		3700
Mortgage	2000	
Drawings	800	
Salaries	8200	
Rent received		250
Office expenses	1200	
Purchases	52000	
Sales		85000
Stock	3000	
Sales discount		250
Purchases returns	200	
Sales returns		350
Purchases discount	120	
Capital - S Firm		8345

## Trial Balance & Accounting Errors

### 11.7 PREPARATION OF A TRIAL BALANCE

After recording all financial transactions in the subsidiary books and journal proper the same are posted into the ledger. The ledger accounts are then, balanced. The Balances of the ledger accounts are then transferred to the relevant columns of the trial balance to verify that the debits are equal to the credits. The trial balance is the next step in the accounting cycle. Trial balance is not an account. It is only a statement that lists the balances of ledger accounts including cash and bank balances. It is prepared on a particular date. It is prepared on a sheet with two amount columns for debit and credit balances. The accounts having debit balances are entered in the debit amount column and the accounts having credit balances are entered in the credit amount column. The sum of each column should be equal. It is actually the first step in the “end of the accounting period” process. In practice the trial balance is prepared with debit and credit balances of various accounts in the ledger along with balances in the cash book. The following is the format of a Trial Balance :

#### Trial Balance of (Name of the Firm) As on (Date of Preparation)

Name of the Account	Debit Balance Amount (₹)	Credit Balance Amount (₹)

It can be well understood with the help of the following example.

Example: Journalise the following transactions, post them into ledger, balance the accounts and prepare a trial balance :

Date	Particulars	Amount (₹)
2012		
May 1	Commission received	10,000
May 2	Rent paid	5,000
May 5	Interest received	6,000
May 7	Brokerage paid	2,000



**Solution**

**JOURNAL**

Dr.			Cr.		
Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)	
<b>2012</b>					
May 1	Cash Account Dr. To Commission received Account (Being commission received)		10,000		10,000
May 2	Rent Account Dr. To Cash Account (Being rent paid)		5,000		5,000
May 5	Cash Account Dr. To Interest received Account (Being interest received)		6,000		6,000
May 7	Brokerage Account Dr. To Cash Account (Being brokerage paid)		2,000		2,000



**Notes**

Dr.			Rent Account				Cr.	
Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)	
<b>2012</b>				<b>2012</b>				
May 2	To Cash A/c		5,000	May 31	By Balance c/d		5,000	
			5,000				5,000	
June 1	To Balance b/d		5,000					

Dr.			Commission Account				Cr.	
Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)	
<b>2012</b>				<b>2012</b>				
May 31	To Balance c/d		10,000	May 01	By Cash A/c		10,000	
			10,000				10,000	
				June 1	Balance b/d		10,000	

## MODULE - III

### Ledger and Trial Balance



Notes

## Trial Balance & Accounting Errors

Dr.				Interest Received Account				Cr			
Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)				
2012				2012							
May 31	To Balance c/d		6,000	May 5	By Cash		6,000				
			6,000				6,000				
				June 1	By Balance b/d		6,000				

Dr.				Brokerage Account				Cr			
Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)				
2012				2012							
May 7	To Cash		2,000	May 31	By Balance c/d		2,000				
			2,000				2,000				
June 1	To Balance b/d		2,000								

Dr.				Cash Account				Cr			
Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)				
2012				2012							
May 1	To Commission A/c		10,000	May 2	By Rent		5,000				
May 5	To Interest Received A/c		6,000	May 7	By Brokerage		2,000				
			16,000	May 31	By Balance c/d		9,000				
June 1	To Balance b/d		9,000				16,000				

### Trial Balance as on 31<sup>st</sup> May 2012

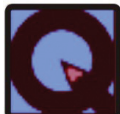
Name of Account	Debit Balance (₹)	Credit Balance (₹)
Rent A/c	5,000	
Brokerage A/c	2,000	
Cash A/c	9,000	
Commission A/c		10,000
Interest Received A/c		6,000
<b>Total</b>	<b>16,000</b>	<b>16,000</b>

## 11.8 LIMITATIONS OF A TRIAL BALANCE

- i) As there are certain errors which are not disclosed by a trial balance. Therefore again it can be said that the agreement of a trial balance is not a conclusive proof of the accuracy of accounts.
- ii) A trial balance gives only condensed information of each account.

## Trial Balance & Accounting Errors

- iii) It does not give the information about the profit or loss made by the business in the accounting period.
- iv) If trial balance is not prepared accurately, the final accounts prepared from such a trial balance would not be reliable.
- v) It does not ensure that all the transactions have been actually recorded in the subsidiary books.
- vi) It is prepared only by those enterprises which make use of double entry system.



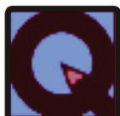
### INTEXT QUESTIONS 11.3

**Few errors have been committed in the books of Ram. State with reasons which errors would affect the trial balance.**

- i. Sales ₹ 2500 to Shyam omitted from being recording in the books of accounts.
- ii. Purchase journal was overcast by ₹ 2000.
- iii. Sales journal was under cast by ₹ 3000
- iv. Amount paid to Anil wrongly posted to the debit of Sunil's account.
- v. Bank overdraft shown in the debit column in the trial balance.
- vi. Sales of ₹ 3000 to Rohtas entered in sales journal as sales to Ram.
- vii. Wages paid for installation of machine debited to wages account.

## 11.9 SUSPENSE ACCOUNT

When the trial balance does not agree, because of errors committed by the accountant during the accounting process and he decides to prepare the final accounts then the difference is written on the shorter column against an account called 'Suspense Account'. After wards the errors that affect the trial balance are rectified through the suspense account. Once all such errors are rectified the suspense account opened to artificially balance the trial balance will finally be balanced.



### INTEXT QUESTIONS 11.4

**I. Fill in the blanks with suitable word or words :**

- i. If there is the error in totaling the Subsidiary Day Books, the totals of Trial Balance will \_\_\_\_\_.
- ii. The Trial Balance will not agree if there is an error in carrying out \_\_\_\_\_ from ledger.
- iii. Agreement of Trial Balance is not a \_\_\_\_\_ of the correctness of posting.

## MODULE - III

### Ledger and Trial Balance



### Notes

**MODULE - III****Ledger and Trial Balance****Notes****Trial Balance & Accounting Errors**

- iv. When the total of the two columns of Trial Balance are not equal, the difference is put in \_\_\_\_\_ Account to make the Trial Balance agree.

**II. Multiple Choice Questions**

- i. Which of the following errors will not affect the Trial Balance.
- Wrong balancing of an account
  - Writing an amount in the wrong account but on the correct side
  - Wrong totaling of an account
  - None of the above
- ii. Which of the following is not the main objective of preparing a Trial Balance ?
- To check arithmetical accuracy
  - To prepare final accounts
  - To have comparative study of each account
  - To present trial balance in court as a proof of transaction
- iii. Which of the following errors will affect the Trial Balance?
- Repairs to buildings have been debited to building account
  - The total of purchases journal is Rs. 10,000 short
  - Carriage paid on new machinery has been debited to the carriage account.
  - None of the above
- iv. Which of the following errors will be disclosed by Trial Balance?
- Error of complete omission
  - Wrong casting
  - Compensating error
  - Error of Principles
- v. Which of the following errors will not be disclosed by Trial Balance?
- Error of complete omission
  - Posting of wrong amount
  - Posting an amount twice in an account
  - Posting to the wrong side of an account

**WHAT YOU HAVE LEARNT**

- It is necessary to prepare a Trial Balance before preparing the final accounts. It verifies the arithmetical accuracy of the books of accounts.

## Trial Balance & Accounting Errors

- When a Trial Balance does not tally, it means there are errors in books of account. A series of steps are taken to locate such errors.
- There are certain errors which affect the Trial Balance and there are some which do not.
- Errors of principle, errors of complete omission, certain errors of commission in subsidiary books, and the compensating errors are not disclosed by the Trial Balance.
- The limitations of a trial balance are that it does not give the information about the profit or loss made by the business in the accounting period and trial balance gives only condensed information in a summary form for each account.
- **Errors :**
  - **Compensating Errors :** A group of errors wherein the effect of an error is counter-balanced (or compensated) by the effect of one or more errors, as a result of which the agreement of Trial Balance remains unaffected.
  - **Errors of Principle :** An error committed by ignoring or misapplying some principle of accounting while recording a transaction in the books of account.
  - **Errors of Complete Omission :** When a transaction is completely omitted from being recorded in the books of accounts the resultant errors are called errors of complete omission.
  - **Errors of Partial Omission :** When transaction is partly omitted from being recorded in the books of accounts the resultant errors are errors of partial omission.
  - **Errors of Commission :** A clerical error committed by the accountant while recording or posting of a transaction is called error of commission.



### TERMINAL EXERCISE

1. Why do you consider Trial Balance as a test of the arithmetical accuracy of the books of accounts? List the errors that will be disclosed by the Trial Balance.
2. If the Trial Balance does not tally, it means there are some errors in books of accounts. State the procedure of locating errors.
3. State the limitations of Trial Balance.
4. Is the Trial Balance a conclusive proof of the accuracy of the books of accounts? Discuss the errors not disclosed by the Trial Balance.

## MODULE - III

### Ledger and Trial Balance



#### Notes

## MODULE - III

### Ledger and Trial Balance



#### Notes

## Trial Balance & Accounting Errors

5. Explain with examples the different types of errors that are usually committed in recording of transactions?
6. What do you mean by Trial Balance? Discuss the objectives of preparing a Trial Balance.
7. What is a Suspense Account? What does its appearance in Trial Balance indicate?
8. Prepare a Trial Balance of M/s Jai Jawan Jai Kisan Enterprises as on 31.12.2012 from the following balances.

Account	Amount ₹	Account	Amount ₹
Cash in hand	31,000	Sales A/c	76,000
Cash at Bank	12,000	Opening Stock	10,000
Capital A/c	80,000	Rent A/c	2,000
Drawings A/c	28,000	Wages A/c	6,000
Debtors A/c	20,800	Carriage Inward A/c	500
Creditors A/c	17,800	Machine A/c	1,500
Purchases A/c	62,000		
Closing Stock	5,000		

9. Prepare a Trial Balance as on 31.3.2013 from the following balances :

Account	Amount ₹
Cash in Hand	3,200
Cash at Bank	12,600
Capital A/c	27,450
Furniture A/c	12,300
Building A/c	15,000
Wages A/c	3,500
Sales A/c	20,000
Rent A/c	250
Bank Charges A/c	400
Depreciation A/c	200



### ANSWER TO INTEXT QUESTIONS

- 11.1** (i) correct      (ii) incorrect      (iii) incorrect      (iv) correct      (v) incorrect
- 11.2** (i) debit and credit totals      (ii) arithmatic      (iii) debit, credit  
(iv) debit
- 11.3** Errors ii), iii) and v) would affect the trial balance.

## Trial Balance & Accounting Errors

11.4 I. (i) not agree (ii) balance (iii) proof (iv) suspense

II. (i) b (ii) d (iii) b (iv) b (v) a.



### ANSWER TO TERMINAL EXERCISE

8. Total of Trial Balance ₹ 1,73,800.
9. Total of Trial Balance ₹ 47,450.

### ACTIVITY FOR YOU

- Ask your parents regarding the various expenditure and income of a particular month, pass journal entries for the same and then post them in the ledger. After closing the ledger accounts find the balances and prepare a trial balance, which should be tallied, so as to ensure that the books of accounts prepared by you are arithmetically correct.

## MODULE - III

### *Ledger and Trial Balance*



### Notes

## *Mukta Vidya Vani*



Mukta Vidya Vani is a pioneering initiative of the National Institute of Open Schooling (NIOS) for using Streaming Audio for educational purposes. This application of ICT will enhance accessibility as well as quality of programme delivery of NIOS Programmes. This is a rare accomplishment of NIOS as the first Open and Distance Learning Institute to start a two way interaction with its learners, using streaming audio and the internet.

Keeping in mind the fact that the transmission is done through the web, the NIOS website ([www.nios.ac.in](http://www.nios.ac.in)) has a link that will take any user to the Mukta Vidya Vani. Mukta Vidya Vani thus enables a two way communication with any audience that has access to an internet connection, from the studio at its Headquarters in NOIDA, where NIOS has set up a state-of-art studio, which will be used for this purpose as well as for recording educational audio programmes meant for NIOS learners, though others can also take advantage of this facility.

Mukta Vidya Vani is a modern interactive, participatory and cost effective programme, involving an academic perspective along with the technical responsibilities of production of audio and video programmes, which are one of the most important components of the multi channel package offered by the NIOS. These programmes will attempt to present the topic/ theme in a simple, interesting and engaging manner, so that the learners get a clear understanding and insight into the subject matter.

NIOS has launched a scheme to motivate the learners to participate in the Mukta Vidya Vani by sending their Audio CD's to the respective regional centre on various subjects such as-

1. Poetry / Shloka recitation
2. Story telling
3. Radio Drama
4. Music
5. Talks on various topic related to the NIOS curriculum including Painting, Vocational Subjects etc.
6. Quiz
7. Mathematics puzzles etc.

The selected CD can be webcast on Mukta Vidya Vani and the winner participant be rewarded suitably.

Learners may visit the NIOS website and participate in live programmes from 2pm to 5pm on all week days and from 10.30am to 12.30pm on Saturdays, Sundays and all Public Holidays. The Subject Experts in the Studio will respond to their telephonic queries during this time. A weekly schedule of the programmes for webcast is available on the NIOS website. The Studio telephone number are 0120-4626949 and Toll Free No. 1800-180-2543.





## MODULE - IV

Maximum Marks

12

Hours of Studies

32

### Depreciation, Provisions and Reserves

This module will help the learners to understand the methods of spreading the cost of fixed assets throughout their working life using the concept of Depreciation. They will also be able to describe the need and importance of creating Provisions and Reserves.

- Lesson 12 : Depreciation**  
**Lesson 13 : Provisions and Reserves**

**MODULE - IV***Depreciation, Provision  
and Reserves*

Notes



12

**DEPRECIATION**

Expenditure on assets of the business like furniture, fixtures and fittings of the shop, motor vans, machines and equipments are neither goods nor expenses of a year. Expenditures of this nature give services to the business for many years and therefore called fixed assets. If the expenditure on the fixed assets is deducted from the profit of any one year, it would be wrong. Since their benefit is enjoyed by the business for more than one years. The correct thing will be to distribute their cost over the years of their useful life to the business. The portion of the cost of fixed assets charged each year as expense is named as depreciation.

In this lesson you will learn about the meaning and methods of charging depreciation and how depreciation is recorded in the books of accounts, together with the preparation of Fixed Assets account.

**OBJECTIVES**

**After studying this lesson you will be able to:**

- understand the meaning and concept of depreciation;
- explain the causes of depreciation;
- explain the objectives of depreciation;
- learn methods of charging depreciation and
- prepare fixed asset account showing the amount of depreciations charged for every year.

**12.1 MEANING OF DEPRECIATION**

You already know the meaning of terms assets and liabilities. Assets are broadly divided in to two categories- current assets (cash, debtors or customers balances, stock of materials and goods) and fixed assets (buildings, furniture and fixtures, machinery and plant, motor vehicles).

Fixed assets are also called long term assets as they provide benefits to the business for more than one year. Most fixed assets loose their value over time as these are put in use and as the years pass by. The fixed assets loose their

## Depreciation

usefulness due to arrival of new technologies and change of fashions etc. These are then generally required to be replaced, as their useful life is over. Hence, the cost of a fixed asset is allocated over its useful life. Each year's allocation of the cost is charged as depreciation expense for that year.

For example an office chair is purchased for ₹ 2,500 and it is estimated that after ten years it will be scrapped. The useful life of the chair is ten years over which the cost of ₹ 2,500 will be distributed. Each year's allocation may be calculated as:-

$$\text{Depreciation} = \frac{\text{Cost of Assets} - \text{Scrap Value (if any)}}{\text{Life of Assets}}$$

$$\frac{\text{₹ 2500}}{10} = \text{₹ 250}$$

Thus ₹ 250 is the depreciation expense for each year.

Thus, depreciation is an expense charged during a year for the reduction in the value of fixed assets, arising due to:

- Normal wear and tear out of its use and passage of time
- Obsolescence due to change in technology, fashion, taste and other market conditions

## 12.2 CAUSES OF DEPRECIATION

Following are the causes for which depreciation is provided in accounts.

### i) Normal wear and tear

- Due to usage - Every asset has a life for which it can run, produce or give service. Thus, as we put the asset to use its worth decreases. Like decrease in the efficiency and functioning of a bicycle due to its running and usage.
- Due to passage of Time – As the time goes by elements of nature, wind, sun, rain etc, cause physical deterioration in the worth of an asset. Like reduction in the worth of a piece of furniture due to passage of time even when it is not used.

### ii) Obsolescence

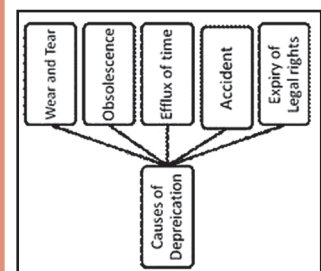
- Due to development of improved or superior equipment : Sometimes fixed assets are required to be discarded before they are actually worn out due to either of the above reasons. Arrival of superior equipments and machines etc. allow production of goods at lower cost. This makes older equipments worthless as production of goods with their use will be costlier and non

## MODULE - IV

### Depreciation, Provision and Reserves



### Notes



## MODULE - IV

### Depreciation, Provision and Reserves



#### Notes

## Depreciation

competitive. For example, Steam engines became obsolete with the arrival of diesel and electric locomotives.

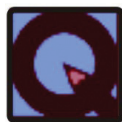
- (b) Due to change in fashion, style, taste or market conditions : Obsolescence may also result due to decline in demand for certain goods and services with a change in fashion, style, taste or market conditions. The goods and services that are no longer in vogue lead to decrease in the value of the assets which were engaged in their production - like factories or machines meant for making old fashioned hats, shoes, furniture etc.

Loss in the value of fixed assets for such reasons is called obsolescence and also charged as depreciation.

### 12.3 OBJECTIVES OF DEPRECIATION

Following are the objectives of charging depreciation of Assets:

- i) **To show the True Financial Position of the Business :** As are Fixed Assets have some effective working life during which it can be economically operated. Depreciation is the gradual loss in the value of fixed assets. If depreciation is not provided, profit and loss A/c will not disclose the true profit made during the accounting period. At the same, the Balance Sheet will not disclose the true Financial position as Fixed assets appearing in the Balance Sheet will be over valued. If depreciation is ignored year after year, ultimately when asset is worn out, the proprietor will not be in a position to continue the business smoothly.
- ii) **To retain funds in the business for replacement of the asset :** Net profit is the yield of the capital invested by proprietor and may be wholly withdrawn by him in the form of cash. If depreciation is provided, this figure of net profit will be reduced and the amount withdrawn by the proprietor will also be decreased. As such the cash equivalent to the change for depreciation will be left over the business. This accumulated amount will enable the proprietor to replace a new asset.



### INTEXT QUESTIONS 12.1

**Fill in the blanks :**

- i. Depreciation represents a \_\_\_\_\_ in the value of fixed assets.
- ii. Scrap value of an asset means the \_\_\_\_\_ that it fetched on sale at the end of its \_\_\_\_\_.
- iii. Depreciation is calculated as cost of assets less scrap value divided by \_\_\_\_\_.

## Depreciation

- iv. Obsolescence is one of the situations on fixed assets which arises due to change in \_\_\_\_\_, and fashion, taste and other market conditions.

### 12.4 FACTORS AFFECTING THE DEPRECIATION

Following are the factors that affect the amount of depreciation of an asset.



- i) **Cost of Asset :** Cost of asset is the purchase price of the asset and includes all such expenses which are incurred before it is first put to use. For example expenses on loading, carriage, installation, transportation and unloading of the asset up to the point of its location, expense on its erection and assembly.
- ii) **Useful Life of the Asset :** Useful life is the expected number of years for which the asset will remain in use.
- iii) **Scrap Value :** Scrap value is the residual value at which the asset could be sold to scrap dealer (*Kabari*) after its useful life.
- iv) **Depreciable value of asset :** Depreciable value is the cost of asset minus the scrap value.

#### Illustration 1

A generator was purchased for ₹ 5,00,000. ₹ 1,500 was paid for the crane for its loading on the truck, ₹ 7,000 was paid for transporting the generator to the factory. ₹ 2,000 was spent on its unloading at the factory site. The generator was estimated to run for 10 years and thereafter would be saleable for ₹ 60,000. Calculate the depreciable value of the generator.

The cost of the asset is :	Purchase price	₹ 5,00,000
	Expenses on Loading	₹ 1,500
	Transportation	₹ 7,000
	Expenses on unloading	₹ 2,000
	<b>Total</b>	<b>₹ 5,10,500</b>

The useful life of the generator is 10 years

The scrap value is ₹ 60,000.

Depreciable value of the generator = ₹ 5,10,500 – ₹ 60,000 = ₹ 4,50,500

## MODULE - IV

### Depreciation, Provision and Reserves



#### Notes

## MODULE - IV

Depreciation, Provision  
and Reserves

Notes

## Depreciation

## 12.5 METHOD OF CHARGING DEPRECIATION

Most popularly used methods for charging depreciation are: i. Straight Line Method and ii. Diminishing Balance Method

## Straight Line Method of Depreciation

Under this method, the amount of depreciation is uniform from year to year. Suppose, if an asset costs ₹ 1,00,000 and depreciation is fixed @ 10%, then ₹ 10,000 would be written off every year. That is why this method is also called 'Fixed Installment Method' or 'Original Cost Method'. In this method, the amount to be written off every year is arrived at as under:

$$\text{Depreciation of Each Year} = \frac{\text{Cost of Assets} - \text{Estimated Scrap Value}}{\text{Number of years of expected life}}$$

Out of the cost of the asset, its scrap value is deducted and it is divided by the number of years of its estimated life.

**For example:** a machine is purchased for ₹ 1,20,000 and it is estimated that its useful life is 10 years. After its useful life its scrap value is ₹ 20,000. Depreciation of one year can be calculated as under:

$$\text{Depreciation of one Year} = \frac{\text{₹ 1,20,000} - \text{₹ 20,000}}{\text{₹ 10}} = \text{₹ 10,000}$$

If its scrap cannot be sold or no money can be realized from its scrap, then depreciation of one year is:

$$\text{Depreciation of one Year} = \frac{\text{₹ 1,20,000}}{\text{₹ 10}} = \text{₹ 12,000}$$

In this method the amount of depreciation is same for each year. Therefore this method is called Straight Line Method, Fixed Installment Method or Original Cost Method.

## Illustration 2

A machine was purchased on January 1, 2011 for ₹ 1,00,000 and its useful life is 10 years. After completing its useful life the machine will be scraped and nothing will be realized from it. It is decided to charge depreciation on this machine @ 10% p. a. on Straight Line Method.

Calculate amount of depreciation for each year during the useful life of this machine.

Year	Rate of Depreciation	Amount of Depreciation (₹)
2011	10%	10,000

## Depreciation

2012	10%	10,000
2013	10%	10,000
2014	10%	10,000
2015	10%	10,000
2016	10%	10,000
2017	10%	10,000
2018	10%	10,000
2019	10%	10,000
2020	10%	10,000

Amount of depreciation is same in every year, so this method is called 'Straight Line Method' or 'Fixed Installment Method' or 'Original Cost Method'.

### 12.6 MERITS OF STRAIGHT LINE METHOD

- i) **Simplicity :** Calculation of depreciation under this method is very simple and therefore the method is widely popular. Once the amount of depreciation is calculated, the same amount is written off as depreciation each year. Hence this method is simple and calculations are easier to understand.
- ii) **Asset is completely Written Off :** Under this method, the book value of an asset is reduced to net scrap value or zero value. In other words, in the books of accounts the value of the asset at the end of its useful life is equal to zero or its residual value.

### 12.7 LIMITATIONS OF STRAIGHT LINE METHOD

- i) **Difficulty in Computation :** When there are various machines having different life-spans, the computation of depreciation becomes complicated because the depreciation on each machine will have to be calculated separately for each asset.
- ii) **Illogical :** It is well known that the expense on its repairs and maintenance increases as the asset becomes older. Thus, the total burden on Profit and Loss Account, depreciation plus repair expenses, is more in later years in comparison to earlier years. This is illogical because the efficiency and productivity of the asset is more in earlier years and less in later years.

#### Illustration 3

X limited purchased a machine on April 1, 2011 for ₹ 1,00,000 whose life was expected to be 10 years. Its estimated scrap value at the end of 10 years was ₹ 10,000. Find the amount of depreciation to be charged to Profit and Loss Account every year. Calculate the rate on which depreciation is to be charged every year.

## MODULE - IV

### Depreciation, Provision and Reserves



#### Notes

## MODULE - IV

### Depreciation, Provision and Reserves



Notes

## Depreciation

### Solution

In this question the information available is as under: The amount of depreciation that will be charged to Profit and Loss Account will be calculated as :

#### (i) Calculation of amount of depreciation

$$\begin{aligned} \text{Annual Depreciation} &= \frac{\text{Cost of Machine} - \text{Estimated Scrap Value}}{\text{Expected Life of the Asset}} \\ &= \frac{\text{₹ 1,00,000} - \text{₹ 10,000}}{\text{₹ 10}} = \text{₹ 9,000} \end{aligned}$$

#### (ii) Calculation of Rate of Depreciation

$$\begin{aligned} \text{Rate of Depreciation} &= \frac{\text{Annual Depreciation Amount} \times 100}{\text{Cost Asset}} \\ &= \frac{\text{₹ 9,000} \times 100}{\text{₹ 1,00,000}} = 9\% \end{aligned}$$

### Illustration 4

Salman and Usman Bros. acquired a machine on July 1, 2008 at a cost of ₹ 70,000 and spent ₹ 5,000 on its installation. The firm writes off depreciation @ 10% on straight line method. The books are closed on December 31 every year. Show the machinery and depreciation account for three years.

### Solution

Cost of Machine	₹ 70,000
Cost of Installation	₹ 5,000
Total	₹ 75,000

Rate of Depreciation is 10%.

Then annual depreciation will be 10% of 75000 = ₹ 7,500.

Dr.				Depreciation Account				Cr.	
Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount		
<b>2008</b>				<b>2008</b>					
Dec. 31	To Machinery A/c		3,750	Dec.31	By P & L A/c				3,750
<b>2009</b>				<b>2009</b>					
Dec. 31	To Machinery A/c		7,500	Dec.31	By P & L A/c				7,500
<b>2010</b>				<b>2010</b>					
Dec. 31	To Machinery A/c		7,500	Dec.31	By P & L A/c				7,500



## Depreciation

## MODULE - IV

### Depreciation, Provision and Reserves



#### Notes

Dr. Machinery Account				Cr.			
Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
<b>2008</b> July 01	To Bank A/c		70,000	<b>2008</b> Dec. 31	By Depreciation A/c		3,750
					$7000 \times \frac{10}{100} \times \frac{6}{12}$		
July 01	To Bank A/c		5,000	Dec. 31	By Balance c/d		71,250
			75,000				75,000
<b>2009</b> Jan. 01	To Balance b/d		71,250	<b>2009</b> Dec. 31	By Depreciation A/c		7,500
					$75000 \times \frac{10}{100}$		
					By Balance c/d		63,750
			71,250				71,250
<b>2010</b> Jan. 01	To Balance b/d		63,750	<b>2010</b> Dec. 31	By Depreciation A/c		7,500
					$75000 \times \frac{10}{100}$		
				Dec. 31	By Balance c/d		56,250
			63,750				63,750

### Illustration 5

On April 1, 2006, a company purchases machinery worth ₹ 1,00,000 . On October 1, 2008, it purchased additional machinery worth ₹ 20,000 and spends ₹ 2,000 on its erection. The accounts are closed each year on March 31. Assuming the annual depreciation to be 10%, show the Machinery Account for 5 years under the straight line method.

### Solution

Dr. Machinery Account				Cr.			
Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
<b>2006</b> Apr. 01	To Bank A/c		1,00,000	<b>2007</b> Mar. 31	By Depreciation A/c		10,000
					$100000 \times \frac{10}{100}$		
				Mar. 31	By Balance c/d		90,000
			1,00,000				1,00,000
<b>2007</b> Apr. 1	To Balance b/d		90,000	<b>2008</b> Mar. 31	By Depreciation A/c		10,000
					$100000 \times \frac{10}{100}$		
				Mar. 31	By Balance c/d		80,000
			90,000				90,000

## MODULE - IV

### Depreciation, Provision and Reserves



#### Notes

## Depreciation

<b>2008</b>				<b>2009</b>			
Apr. 1	To Balance b/d		80,000	Mar. 31	By Depreciation A/c		11,100
Oct. 1	To Bank A/c		20,000		$100000 \times \frac{10}{100}$		
					$22000 \times \frac{10}{100} \times \frac{6}{12}$		
	To Bank A/c		2,000	Mar. 31	By Balance c/d		90,900
			1,02,000				1,02,000
<b>2009</b>				<b>2010</b>			
Apr. 1	To Balance b/d		90,900	Mar. 31	By Depreciation A/c		12,200
					$100000 \times \frac{10}{100}$		
					$22000 \times \frac{10}{100} \times \frac{6}{12}$		
				Mar. 31	By Balance c/d		78,700
			90,900				90,900
<b>2010</b>				<b>2011</b>			
Apr. 1	To Balance b/d		78,700	Mar. 31	By Depreciation A/c		12,200
					$100000 \times \frac{10}{100}$		
					$22000 \times \frac{10}{100} \times \frac{6}{12}$		
				Mar. 31	By Balance c/d		66,500
			78,000				78,700
<b>2011</b>							
Apr. 1	To Balance b/d		66,500				

### Illustration 6

On 1<sup>st</sup> January, 2003 a Company purchased a plant for ₹ 20,000. On 1<sup>st</sup> July in the same year, it purchased additional plant worth ₹ 8,000 and spent ₹ 2,000 on its erection. On 1<sup>st</sup> July, 2004, the plant purchased on 1<sup>st</sup> Jan., 2003 having become obsolete, was sold off for ₹ 12,500. On 1<sup>st</sup> October, 2005, fresh plant was purchased for ₹ 28,000 and on the same date, the plant purchased on 1<sup>st</sup> July, 2003 was sold at ₹ 6,000.

Depreciation is provided at 10% per annum on original cost on 31<sup>st</sup> December every year. Show the plant account for 2003 to 2005.

## Depreciation

## MODULE - IV

### Depreciation, Provision and Reserves



### Solution

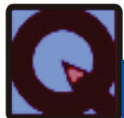
Dr. Plant Account Cr.

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
<b>2003</b>				<b>2003</b>			
Jan. 01	To Cash A/c		20,000	Dec. 31	By Depreciation A/c		
July 01	To Cash A/c		8,000		(i) for a year 2,000		
	To Cash A/c (expenses)		2,000		(ii) for six months 500		2,500
					By Balance c/d		
					(i) 18,000		
					(ii) 500		27,500
			30,000				30,000
<b>2004</b>				<b>2004</b>			
Jan. 1	To Balanc b/d			July 1	By Cash A/c (sale)		12,500
	(i) 18,000			Dec. 31	By Depreciation A/c (i)		1,000 <sup>1</sup>
	(ii) 9,500		27,500		By Profit & Loss A/c		4,500 <sup>1</sup>
				July 1	By Depreciation A/c (ii)		1,000
				Dec. 31	By Balance c/d		
					(₹9,500 - ₹1,000)		8,500
			27,500				27,500
<b>2005</b>				<b>2005</b>			
Jan. 1	To Balance b/d (ii)		8,500	Oct. 1	By Cash A/c (sale)		6,000
Oct. 1	To Cash A/c (iii)		28,000	Oct. 1	By Depreciation A/c (ii)		750 <sup>2</sup>
				Oct. 1	By Profit & Loss A/c (loss)		1,750
				Dec. 31	By Depreciation A/c (iii)		
					(28,000 x 10/100 x 3/12)		700
				Dec. 31	By Balance c/d		
					(₹28,000 - ₹700)		27,300
			36,500				36,500

### Notes

**Note :** Calculation of loss on sale of plant :

	₹
(i) On 1-1-2004 book value of the plant sold [Plant (i)]	18,000
Less : Depreciation for 6 months <i>i.e.</i> 20,000 x 10/100 x 6/12	1,000
On 1-7-2004 book value of plant sold	17,000
Less : Sale price of plant	12,500
Loss on sale of plant	4,500
(ii) On 1-1-2005 book value of plant sold [Plant (ii)]	8,500
Less : Depreciation for 9 months is 10,000 x 10/100 x 9/12	750
On 1-10-2005 book value of plant sold	7,750
Less : Sale Price	6,000
Loss on Sale of Plant	1,750

**MODULE - IV****Depreciation, Provision  
and Reserves****Notes****Depreciation****INTEXT QUESTIONS 12.2****Fill in the blanks :**

- i. The assumption underlying the fixed installment method of depreciation is that the amount of the fixed assets over different years of its useful life remain the \_\_\_\_\_.
- ii. Straight line method of charging depreciation is also known as \_\_\_\_\_ or \_\_\_\_\_.
- iii. Under straight line method the value of the assets at the end of its useful life is equal to \_\_\_\_\_ or its \_\_\_\_\_.
- iv. Under straight line method the total burden on Profit and Loss Account in Comparison to earlier years is \_\_\_\_\_.

**12.8 DIMINISHING BALANCE METHOD**

Under this method, as the value of asset goes on diminishing year after year, the amount of depreciation charged every year goes on declining. The amount of depreciation is calculated as a fixed percentage of the diminishing value of the asset shown in the books at the beginning of each year. Under this method the value of an asset never comes to zero.

Suppose, the cost of the asset is ₹ 40,000 and the percentage to be written off each year is 10%. In the first year the amount of the depreciation will be ₹ 4,000 i.e., 10% of ₹ 40,000. This will reduce the book value to ₹ 36,000 i.e. ₹ 40,000 – ₹ 4,000. Now, at the beginning of the next year the book value is ₹ 36,000. The amount of the depreciation for the next year will be ₹ 3,600, i.e., 10% of ₹ 36,000. Thus, every year the amount of the depreciation will go on reducing. This method of charging depreciation is also known as Reducing Balance Method or written down value method.

**Illustration 7**

A machine was purchased on January 1, 2011 for ₹ 1,00,000 and its useful life is 10 years. After completing its useful life the machine will be scrapped and ₹ 4,000 will be realized from it. It is decided to charge depreciation on this machine @ 10% p. a. on Diminishing Balance Method.

Calculate amount of depreciation for each year during the useful life of this machine.

## Depreciation

### Solution

Year	Rate of Depreciation	Amount of Depreciation
2011	10%	10,000
2012	10%	9,000
2013	10%	8,100
2014	10%	7,290
2015	10%	6,561
2016	10%	5,905
2017	10%	5,314
2018	10%	4,783
2019	10%	4,305
2020	10%	3,874

Amount of depreciation is decreased year after year in this method that is why this method is called 'Diminishing Balance Method' or 'Reducing balance method' or 'written down value method'.

### 12.9 MERITS OF DIMINISHING BALANCE METHOD

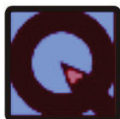
#### i) Equal Burden on Profit & Loss Account

The productivity of the asset is more hence its contribute to profit is also relatively greater. Therefore the cost charged in terms of depreciation should also be greater.

In the initial year, the depreciation charges are more and repair expenses are less. In later years, depreciation charges are less and repair expenses are more. Hence the total burden, depreciation plus repair expenses, is some what equal on Profit & Loss Account for each year.

### 12.10 DEMERITS OF DIMINISHING BALANCE METHOD

- i) **Asset cannot be completely written off :** Under this method, the value of an asset is not reduced to zero even when there is no scrap value.
- ii) **Complexity :** Under this method, the rate of depreciation cannot be determined easily.



### INTEXT QUESTIONS 12.3

#### Fill in the blanks with suitable words

- (i) Depreciation represents a \_\_\_\_\_ in the value of fixed assets.
- (ii) The amount of depreciation on machinery is credited to \_\_\_\_\_ account.
- (iii) Depreciation is calculated on \_\_\_\_\_ under the straight line method.



## MODULE - IV

### Depreciation, Provision and Reserves



#### Notes

- (iv) Depreciation is calculated on \_\_\_\_\_ under the diminishing balance method.
- (v) The value of an assets is not reduced to \_\_\_\_\_ even when there is no scrap value in diminishing balance method of depreciation.

#### Illustration 8

Wisdon enterprise purchases Plant and Machinery for ₹ 1,00,000 on 1<sup>st</sup> October 2012. It decides to write off depreciation 20% per annum on Written Down Value Method. On 1<sup>st</sup> January, 2015 purchases additional Machinery for ₹ 40,000.

Show Machinery Account upto the year ending 31<sup>st</sup> March, 1996. The accounting year ends on 31<sup>st</sup> March.

#### Solution

Dr.				Plant and Machinery Account				Cr.			
Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹				
<b>2012</b>				<b>2013</b>							
Oct. 01	To Bank		1,00,000	Mar. 31	By Depreciation (for six months)		10,000				
					By Balance c/d		90,000				
			1,00,000				1,00,000				
<b>2013</b>				<b>2014</b>							
Apr. 01	To Balance b/d		90,000	Mar. 31	By Depreciation (on ₹ 90,000 for one year)		18,000				
					By Balance c/d		72,000				
			90,000				90,000				
<b>2014</b>				<b>2015</b>							
Apr. 01	To Balance b/d		72,000	Mar. 31	By Depreciation (On ₹ 72,000) for one year ₹ 14,400 On ₹ 40,000 for 3 months ₹ 2,000		16,400				
<b>2015</b>					By Balance c/d		95,600				
Jan. 01	To Bank		40,000				1,12,000				
			1,12,000								
<b>2015</b>				<b>2016</b>							
Apr. 01	To Balance b/d		95,600	Mar. 31	By Depreciation (On ₹ 96,600 for one year)		19,120				
					By Balance c/d		76,480				
			95,600				95,600				
<b>2016</b>											
Apr. 01	To Balance b/d		76,480								

## Depreciation

### Illustration 9

On April 1, 2009 Ganga Bros. purchased two machines for ₹ 75,000 each. Depreciation at the rate of 10% on diminishing balance method was provided. On March 31, 2011, one machine was sold for ₹ 55,000. An improved model with a cost of ₹ 80,000 was purchased on the same day. You are required to show the Machinery Account for 2009-10 to 2010-11.

### Solution

Dr.				Machinery Account				Cr.			
Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹				
<b>2009</b>				<b>2010</b>							
Oct. 01	To Bank		1,50,000	Mar. 31	By Depreciation A/c		15,000				
				Mar. 31	By Balance c/d		1,35,000				
			1,50,000				1,50,000				
<b>2010</b>				<b>2011</b>							
Apr. 01	To Balance b/d		1,35,000	Mar. 31	By Depreciation A/c		13,500				
Mar. 31	To Bank A/c		80,000	Mar. 31	By Bank A/c		55,000				
					By P & L A/c		5,750				
					By Balance c/d		1,40,750				
			2,15,000				2,15,000				
<b>2011</b>											
Apr. 01	To Balance b/d		1,40,750								

**Note :** Calculation of loss on sale of machine :

Initial Cost	75,000
Dep. in 2010	- 7,500
	67,500
	- 6,750
	60,750
	- 55,000
Loss on Sale	5,750

### Illustration 10

On October 1, 2008, the Akash Transport Company purchased a Truck for ₹ 8,00,000. On April 1, 2010, this Truck was involved in an accident and was completely destroyed and ₹ 6,00,000 were received from Insurance Company in full settlement. On the same date another Truck was purchased by the company for ₹ 10,00,000. The company writes off 20% depreciation p. a. on written down value method. Give the Truck Account from 2008 to 2010.

## MODULE - IV

### Depreciation, Provision and Reserves



### Notes

## MODULE - IV

### Depreciation, Provision and Reserves



Notes

## Depreciation

### Solution

Dr.				Truck Account				Cr.			
Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹				
<b>2008</b>				<b>2008</b>							
Oct. 01	To Bank A/c		8,00,000	Dec. 31	By Depreciation A/c		40,000				
					$8,00,000 \times \frac{20}{100} \times \frac{3}{12}$						
				Dec. 31	By Balance c/d		7,60,000				
			8,00,000				8,00,000				
<b>2009</b>				<b>2009</b>							
Jan. 01	To Balance b/d		7,60,000	Dec. 31	By Depreciation A/c		1,52,000				
					$7,60,000 \times \frac{20}{100}$						
				Dec. 31	By Balance c/d		6,08,000				
			7,60,000				7,60,000				
<b>2010</b>				<b>2010</b>							
Jan. 01	Balance b/d		6,08,000	Apr. 01	By Bank A/c		6,00,000				
Apr. 01	To P & L A/c		22,400	Apr. 01	By Depreciation A/c		30,400				
					$6,08,000 \times \frac{20}{100} \times \frac{3}{12}$						
				Dec. 31	By Depreciation A/c		1,50,000				
Apr. 01	To Bank A/c		10,00,000		$1,00,000 \times \frac{20}{100} \times \frac{9}{12}$						
				Dec. 31	By Balance c/d		8,50,000				
			16,30,400				16,30,400				

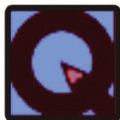
### Distinction between Straight Line Method and Diminishing Balance Method

Basis	Straight Line Method	Diminishing Balance Method
Basis of Calculation	Depreciation is calculated on original cost of the asset.	Depreciation is calculated on original cost in first year and on written down value of the asset in subsequent years.
Amount of Depreciation	The amount of depreciation remains the same for all years.	The amount of depreciation goes on reducing year after year.
Value of Asset	The book value of the asset can be reduced to zero.	The book value of the asset can never be reduced to zero.



## Depreciation

Depreciation and Repairs	The combined cost on account of depreciation and repairs is lower in the initial years and higher in the later years.	The combined cost on account of depreciation and repairs remains, more or less, equal throughout the period.
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### INTEXT QUESTIONS 12.4

#### I. State which of the following statements are true and which are false:

- i. Amount of depreciation goes on reducing year after year in Straight Line Method.
- ii. The amount of depreciation remains the same for all years in Diminishing Balance Method.
- iii. The book value of the asset can be reduced to zero in Straight Line Method.
- iv. The book value of the asset can never be reduced to zero in Diminishing Balance Method.

#### II. Multiple Choice Questions

- i. Depreciation is charged on :
  - a) Stock of Goods
  - b) Current Assets
  - c) Fixed Assets
  - d) Liquid Assets
- ii. Obsolescence term is used for :
  - a) Tear and wear of the Assets
  - b) Decrease in the value of the assets which are engaged in production
  - c) Development of improved or superior quality of equipment.
  - d) Due to usage and age of assets
- iii. Changing depreciation on Fixed Assets by Straight line method. The value of the asset is taken into consideration:
  - a) Original value
  - b) Diminished value
  - c) Scrap value
  - d) Book value
- iv. Charging depreciation on Fixed assets by Reducing balance method, the value of the asset is taken into consideration.
  - a) Original cost method
  - b) Diminished value
  - c) Scrap value
  - d) Book value
- v. The amount calculated for charging depreciation :
  - a) Includes the amount of scrap value of the Asset
  - b) Do not include the amount of scrap value of the asset
  - c) Cost of assets less scrap value
  - d) None of the above.

## MODULE - IV

### Depreciation, Provision and Reserves



#### Notes

## MODULE - IV

### Depreciation, Provision and Reserves



#### Notes

## Depreciation

- vi. Out of the following which is not the cause of depreciations:
  - a) Normal wear and tear
  - b) Obsolescence
  - c) Cost of asset.
  - d) Decrease or increase in market price
- vii. Out of the following what will be before annual depreciations :
  - a) Total Depreciation + Plus installation charges cost
  - b) Total cost – Scrap value ÷ Expected life
  - c) Total cost + Scrap value ÷ Expected life
  - d) None of the above.
- viii. Which one of the following is not a factor affecting annual depreciation on an asset.
  - a) Cost of the Asset
  - b) Scrap Value of the asset
  - c) Useful life of the asset
  - d) Annual maintenance on the asset.
- ix. Out of the following on which asset depreciation will be charged :
  - a) Stock
  - b) Debtors
  - c) Machinery
  - d) Land
- x. Out of the following assets on which depreciation will not be charged:
  - a) Machinery
  - b) Plant
  - c) Photo Copier
  - d) Stock



### WHAT YOU HAVE LEARNT

- Depreciation is the gradual and permanent decrease in the value of an asset due to defluxion of time, wear and tear, obsolescence or any other reason.
- **Causes of Depreciation**
  - Physical Wear and Tear due to usage
  - Physical wear and tear due to passage of time
  - Obsolescence due to advancement in technology
- **Objective of Depreciation**
  - To show the True Financial Position of the business.
  - To retain funds in the business for replacement of the Asset.
- **Methods of Charging Depreciation**
  - Straight Line Method
  - Diminishing Balance Method
- **Merits of Straight Line Method**
  - Simplicity
  - Assets can be Completely Written Off
- **Demerits of Straight Line Method**
  - Difficulty in Computation
  - Illogical

## Depreciation

- **Merits of Diminishing Balance Method**
  - Equal burden on Profit & Loss Account.
  - Balance of Asset is never written Off to Zero
- **Demerits of Diminishing Balance Method**
  - Asset can not be completely written off
  - Complexity



### TERMINAL EXERCISE

1. What is depreciation? Write the various objectives of providing depreciation.
2. What are the causes of providing depreciation?
3. What are the two methods of providing depreciation? Explain their merits and demerits.
4. What are the objectives of providing depreciation?
5. Distinguish between Straight Line Method and Diminishing Balance Method of Depreciation.
6. Krishnamohan Limited purchased a machinery on October 1, 2008 for ₹ 90,000 and spent ₹ 10,000 on its erection. The depreciation is to be charged @ 10% p. a. on original cost. Show the Machinery Account for three years if books are closed on March 31 every year.
7. On April 1, 2008 Asahi Limited purchased a machinery for ₹ 80,000 and spent ₹ 20,000 on its repairs and installation. On September 30, 2011, the machinery was sold for ₹ 60,000. Prepare Machinery Account for the year 2008 to 2011, if depreciation is charged @ 10% p. a. by Straight Line Method.
8. Ajay Kumar and Company purchased machinery for ₹ 20,000 on April 1, 2007. The Machinery is depreciated at 10% per annum on the straight line method. On October 1, 2010, the machinery was sold for ₹ 8,000. Give the Machinery Account if books are closed on March 31 every year.
9. A Plant is purchased for ₹ 80,000 on January 1, 2008. It is estimated that the residual value of the plant at the end of its working life of 10 years will be ₹ 27,894. Depreciation is to be provided at 10% p.a. on diminishing balance method.  
You are required to show the Plant Account for 4 years assuming that the books are closed on March 31 every year.
10. On January 1, 1987 Machinery Account showed a balance of ₹ 10,000. On 1<sup>st</sup> July, 1988, a new machine costing ₹. 6,000 was purchased. On 30<sup>th</sup> June, 1990, Machinery other than the machine bought on 1<sup>st</sup> July, 1988, was disposed of for ₹ 6,000.

## MODULE - IV

### Depreciation, Provision and Reserves



### Notes

**MODULE - IV****Depreciation, Provision  
and Reserves****Notes****Depreciation**

Show the Machinery Account for four years. The accounting year ends on 31<sup>st</sup> December, and depreciation is to be provided at 10% p.a. on written down value.

**ANSWER TO INTEXT QUESTIONS**

- 12.1** i) Diminution    ii) Amount, life    iii) Life of assets    iv) Technology
- 12.2** i) Same  
ii) Fixed in statement method, Original cost method  
iii) Zero, Net Scrap value    iv) More
- 12.3** i) Falls    ii) Machinery    iii) Original cost  
iv) Opening balance of the year    v) Zero
- 12.4** **I.**    i) False    ii) False    iii) True    iv) True
- II.**    i) c    ii) c    iii) a    iv) b    v) c  
vi) d    vii) b    viii) d    ix) c    x) d

**ACTIVITY FOR YOU**

- Ask your parents about the date of various fixed assets purchased by them like T.V., Fridge, Motorcycle, Car etc., with its useful life and then calculate the amount of depreciation to be charged on each asset.

## 13

# PROVISIONS AND RESERVES

## MODULE - IV

### Depreciation, Provision and Reserves



#### Notes

You know that businessmen prepare their accounts on the basis of going concern concept assuming that their business will continue for an indefinite period. Hence, in order to ascertain the net profit for each year, businessmen need to take into account not only the current contingencies but future contingencies also. In fact, provisions and reserves are such considerations which actually relate to the future needs for which a part of the current earnings has to be set aside.



### OBJECTIVES

After studying this lesson you will be able to

- understand the meaning and need of provision;
- understand the meaning of reserves;
- explain types of reserves and
- know the difference between provisions and reserves.

### 13.1 PROVISION : MEANING AND NEED

As you know in our daily routine life we make various arrangements for the future expected needs. For example, if your father wants to give you higher education such as Engineering, Doctorate, or any other professional course, he will need a lot of money. Now question arises how would your father be able to arrange such an amount? Yes, you are thinking right, he will start saving money from today and every year he will do the same. The events which are about to happen in the future are planned in the present with the help of available resources. In the same way these things are followed in a business also. When there are certain expected losses/expenses, these are planned to be managed in advance from the current year's profits/surplus. The amount which is kept separately to meet such expected losses/expenses is called a Provision.

If an amount is payable in the future and the amount is certain, it is a liability. For example, October month's rent, totaling Rs. 2,000. is payable on 31<sup>st</sup> October. The enterprise will debit Rent Account and Credit Rent Outstanding Account as it is a

**MODULE - IV****Depreciation, Provision  
and Reserves****Notes****Provisions & Reserves**

definite liability. However, if the amount in respect of a liability or expected loss is not certain, an estimated amount is set aside by debiting the Profit and Loss Account. The amount so set aside is known as a Provision. Thus, 'Provision' means an estimated amount to meet an uncertain loss or expense in future. Some of the examples of Provisions are: Provision for Doubtful Debts on Debtors, Provision for Discount on Debtors, Provision for Depreciation.

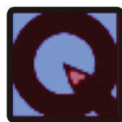
**Needs of Provision**

Provisions are provided for:

- i) Depreciation, renewal or reduction in the value of assets.
- ii) A known liability, the amount of which cannot be determined with substantial accuracy.
- iii) A disputed claim.
- iv) Specific loss on realization of an asset or on payment of taxes.
- v) Redeeming the liability.
- vi) Writing off bad-debts/doubtful debts.
- vii) Contingent liabilities.

**General rules in creation of Provisions:**

- i) It is created by debiting the profit and loss account.
- ii) It is created to meet a known liability or a specific contingency, e.g. 'Provision for bad and doubtful debts' and 'provision for depreciation' etc.
- iii) A provision is created irrespective of whether there is profit or loss in the business.
- iv) It is not available for distribution as dividend among shareholders.
- v) A provision is made for a definite amount and, therefore, a definite sum is set aside every year to meet the known contingency.
- vi) Making of a provision is must to meet known liability or contingency.
- vii) The provision is generally shown on the liability side of the balance sheet.

**INTEXT QUESTIONS 13.1****Fill in the blanks with suitable words:**

- i. Provision means an estimated amount to meet an uncertain \_\_\_\_\_ or \_\_\_\_\_ in future.
- ii. A provision may be provided for a \_\_\_\_\_ claim.
- iii. A provision is created by debiting \_\_\_\_\_ account.
- iv. A provision is not available for distributions as dividend among \_\_\_\_\_.
- v. A provision is generally shown on \_\_\_\_\_ side of the balance sheet.



### 13.2 MEANING OF RESERVE

Our future is uncertain. There are a lot of contingencies, various needs and requirements in the future. Sometime we estimate for some unexpected losses/ expenses we may have to bear in the future. For this, we save some money from our current earning. If the unexpected event happens, we can use this saved money. Suppose your father earns Rs.20,000 in a month and he does not set some money aside for any type of unexpected happening. In the mid of the month you get ill then how will your father manage for the various medical expenses for your treatment. Definitely, he will have to ask for money from friends, relatives etc. If they do not help your father, then think what will happen?

If your father had kept some money for these kinds of unexpected happenings, he would not have to face such types of troubles. Thus, an amount which is kept aside from our current income to meet the unexpected happening in the future is the reserve.

Future is uncertain, in the business there are a lot of happenings which may happen unexpectedly. For this arrangement of funds in a well planned manner is necessary. Some amount of total earned fund in a year is needed to set aside as a reserve.

Reserves are the amounts set aside out of profits. It is an appropriation of profits or accumulated profits to strengthen the financial position of the business. It is not a charge against profits. Reserves are not meant to cover any liability or depreciation in the value of assets. Examples are General Reserves, Reserves for Expansion, Reserve for Equalization of Dividends, Reserve for Increased Costs of Replacement, etc.

### 13.3 TYPES OF RESERVES

Sometimes business, likely or certainly, has to anticipate some known or unknown future contingencies/emergencies. To meet this, business set aside a part of the profits and other surpluses which is called a reserve. Reserve is an appropriation of the profits and not a charge to it because it is not supposed to meet any known liability or diminution in the value of an asset. It is that part of profits that is kept aside to meet an unknown liability or for future emergency. It is created by debiting the P&L Appropriation A/c. It can be created only when there is profit in the business. It is usually shown on the liability side of the balance sheet. Reserves can be categorized into:

- |                     |                     |                     |
|---------------------|---------------------|---------------------|
| i. General Reserve  | ii. Capital Reserve | iii. Secret Reserve |
| iv. Revenue Reserve | v. Specific Reserve | vi. Reserve Fund    |
| vii. Sinking Fund   |                     |                     |



## MODULE - IV

### Depreciation, Provision and Reserves



#### Notes

## Provisions & Reserves

i) **General reserve:** As the name suggests, the general reserve is not tied down to any specific purpose. It can be utilised to meet any future contingency or unknown liability. It is not legally mandatory to create a general reserve. It is created only when there is sufficient profit. It is shown on the debit side of P&L Appropriation A/c.

- It is created not for any specific purpose but for meeting future contingencies.
- It can be utilized for meeting any future loss.
- It is created only when there are sufficient profits.
- It is created only when there are profits i.e. it depends upon profits.
- It is shown on the debit side of profit and loss appropriation account.
- Only distributable profits are reduced because of it.

This reserve is created by setting aside revenue profits. The object is to strengthen the general financial position of the business. It is not for a specific purpose. It is a free reserve. It acts as a safety cushion against all unforeseen contingencies in the future. It is immediately available for distribution as dividend profit.

General Reserves are retained profits. They are part of the surplus. They are the amount kept aside from profits. There can be no reserves if there are no profits. Reserves are undistributed profits. They are appropriations of profits. While provisions are a pre-profit matter, reserves are a post-profit matter. One cannot talk of creating reserves, without first finding out profits. It is a good business policy to create reserves. Reserve strengthen the financial position of the business. Reserves are created for different purposes. They may be for expansion of business; they may be for equalization of dividends or they may be for redemption of debentures or loans. Again, reserves may be created out of capital profits or out of revenue profits. The reserves created out of capital profits are called capital reserves, whereas, others are called revenue reserves.

ii) **Capital Reserve :** A capital reserve is generally created out of profits which are of capital nature only, such as capital gains, premium on issue of shares and debentures, profits prior to incorporation, profits on revaluation of assets and liabilities etc. It should not be distributed as dividend among the shareholders. It is used to strengthen the financial position of business, to write off capital losses or losses of abnormal nature.



Thus, the Capital Reserves

- Are appropriations from profits which cannot be distributed by way of cash dividends.
- Arise mainly from (i) equity transactions between the enterprise and its shareholders; (ii) from adjustments arising in accounting for business combinations; (iii) from differences arising on transactions of foreign currency operations; (iv) from surpluses arising from asset revaluation; (iv) any unrealized gain which has not been included in income.
- Examples of capital reserves includes: security premium, capital redemption reserves, capital reserves arising on merger and acquisition of a business, **statutory reserves**, asset revaluation reserve and exchange fluctuation reserves.

Capital reserves are created out of capital profits. Capital profits are not regular trading profits. They are profits on rare transactions. Capital reserves are generally not available for distribution as dividend. They are set aside to strengthen the financial position of the business or to meet capital losses.

The following are the examples of capital profits :

- a) Profit on sale of fixed' assets.
- b) Profit prior to incorporation.
- c) Profit on redemption of debentures.
- d) Premium on issue of shares or debentures.
- e) Profit on forfeiture of shares.
- f) Profit on acquisition of business.
- g) Profit which have not been earned in the regular course of business.

Capital reserves can be utilized in the following ways:

- a) Issue of bonus shares.
- b) Writing off goodwill.
- c) Writing off preliminary expenses.
- d) Writing off shares/debentures issue expenses.
- e) Writing off losses prior to incorporation.

**iii) Secret Reserve :** Sometimes, a firm creates a reserve which is not shown in the balance sheet; it is known as secret reserve or hidden reserve or internal reserve. The existence of this reserve is not disclosed in the financial statements. It strengthens the financial position of the business, promotes confidence and stability. It is not created by joint stock companies except banking, insurance and financing companies.

**iv) Revenue Reserves :** Revenue Reserves are appropriation from revenue profits which can be distributed by way of cash dividends although



## MODULE - IV

### Depreciation, Provision and Reserves



#### Notes

## Provisions & Reserves

some may be set aside for other purposes.

- v) **Specific Reserve :** As the name suggests, the Specific Reserve is created for a specific purpose. It is utilised for only that purpose for which it has been created and not for purpose other than that. Whether a firm earns profit or suffers losses, it is obligatory for it to create specific reserve. It is shown on the debit side of P&L A/c. Examples of such reserves are- dividend equalization reserves, investment fluctuation reserves, plant replacement reserves and reserves for redemptions of debentures.
- It is created for a specific purpose.
  - It is utilized for that specific purpose, for which it was created.
  - Whether profit or no profits, it must be created.
  - It is necessary to create in order to ascertain profit.
  - It is shown on the debit side of profit and loss account.
  - Net profits are reduced because of it.

This too is created by setting aside revenue profits. But it is for a specific purpose. This is not immediately available for distribution. For example, reserve created for redemption of debentures. During the period of liability, this reserve is not available for distribution. It becomes a general reserve on the redemption of debentures. Similarly, a reserve may be created for equalization of dividend.

- vi) **Reserve Fund :** When a part of the profit set aside and used in the business, it is a reserve. But when a part of profits and other surplus is set aside and invested outside the business then it is known as reserve fund. In this case, the retained amount is invested in safe securities which are readily and easily realisable. Investments are not being carried for definite period. The purpose is to strengthen the financial position of the business house. Thus, the use of the term 'fund' indicates investment of reserve outside the business. Reserve fund Investments are not made for definite period. It is created always out of divisible profits. Interest received on investments representing reserve fund may not be re-invested.

Profit set aside and used in the business is a reserve. But profit set aside and invested outside the business is a reserve fund.

- Investments are not for definite period.
- It is created always out of divisible profits.
- Interest received on investments representing reserve fund may not be re-invested.

- vii) **Sinking Fund** : A sinking fund is established for the future redemption of the long-term debts or liabilities or for replacement of assets or to renew a lease. A sinking fund is a fund built up by annual contributions. The contributions are invested outside the business in readily realizable securities. Interest received on investments is reinvested in the same securities. Thus a sinking fund may be (i) for replacement of fixed assets or (ii) for the redemption of debentures or repayment of loan. A sinking fund for the replacement of a fixed asset is a provision. But a sinking fund for redemption of debentures or repayment of loan is an appropriation of profits. The company does not require creating sinking fund.

Reserves are appropriations of profit namely when profits have been ascertained after deducting all expenses which includes provision and others. Reserves are residual earnings after all expenses and taxation which belongs to the owners namely the shareholders.

- a) Sinking fund Investments are for a definite period.
- b) It is not always out of divisible profit e.g. sinking fund for replacement of asset is provision for depreciation, it must be created even if there are no profits.
- c) In case of sinking fund, interest is always re-invested.

A sinking fund is a fund built up by annual contributions. The contributions are invested outside the business in readily realizable securities. Interest received on investments is reinvested in the same securities.

A sinking fund may be (i) for replacement of fixed assets or (ii) for the redemption of debentures or repayment of loan. A sinking fund for the replacement of a fixed asset is a provision. But a sinking fund for redemption of debentures or repayment of loan is an appropriation of profits. A sinking fund represents amount invested outside the business.

#### General rules in creation of Reserves

- i) It is created by debiting the profit and loss appropriation account.
- ii) It is created to meet an unknown liability, or to strengthen the financial position of the company or for equalization of dividends etc.
- iii) A reserve is created only when there is profit in the business.
- iv) It can be distributed among shareholders as dividend.
- v) The reserve is created without taking into consideration the actual amount required except in the case of redemption of debentures when a definite sum is set aside.
- vi) Creation of reserve depends upon the financial policy of the business and discretion of its management.



## MODULE - IV

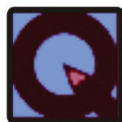
### Depreciation, Provision and Reserves



Notes

## Provisions & Reserves

- vii) It is usually shown on the liability side of the balance sheet as it is not a specific reserve.



### INTEXT QUESTIONS 13.2

**Fill in the blanks with suitable words :**

- An amount kept aside from current income to meet unexpected happening in future is called \_\_\_\_\_.
- It is not legally mandatory to create a \_\_\_\_\_.
- \_\_\_\_\_ reserve is created out of \_\_\_\_\_ profit.
- Profit on sale of fixed assets is \_\_\_\_\_ profit.
- \_\_\_\_\_ reserve is not shown in the financial statement.
- Profit set aside and used in business is called a \_\_\_\_\_.
- Profit set aside and invested outside the business is called \_\_\_\_\_.
- Sinking Fund Investments are for a \_\_\_\_\_ period.

### 13.4 DIFFERENCES BETWEEN PROVISION AND RESERVE

S. No.	Provisions	Reserves
1.	It is created by debiting the Profit & Loss A/c.	It is created by debiting the Profit & Loss Appropriation A/c.
2.	It is a charge against the profits without which true profit or loss of the business can't be ascertained.	It is an appropriation of profits and doesn't require to be created to ascertain true profit or loss.
3.	It has to be provided even if there is loss or no profit in the business. It is created irrespective of whether there is profit or loss in the business.	It can be created only when there is profit in the business.
4.	It can't be available to be distributed as dividend among the shareholders.	It can be distributed as dividend among the shareholders.
5.	It is a sum for known liability or for specific contingency e.g. provision for bad and doubtful debts, or provision for depreciation etc.	It is a sum to meet an unknown future liability or contingency or to strengthen the financial position of the business or for equalization of dividends etc.

## Provisions & Reserves

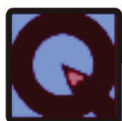
6.	Making of a provision is a legal necessity for the management.	It is not legally obligatory to create a reserve. It depends upon the financial policy of the business and discretion of its management.
7.	Provision can be on a liability side or on the assets side but as a negative asset. In general, these are shown on the liability side of the balance sheet.	Reserves belong to the owners' equity side. So, It is usually shown on the liability side of the balance sheet as it is not a specific reserve.
8.	It is an amount written off or retained by way of providing for depreciation, renewal, diminution in the asset value or for any known liability, the amount of which cannot be accurately ascertained.	It does not include any amount written off or retained by way of providing for depreciation, renewal, diminution in the asset value or for any known liability, the amount of which cannot be accurately ascertained.
9.	Amount can't be utilized for purposes other than that for which they are created.	Amount can be utilized for any purpose because they represent undistributed profits.
10.	Purpose is to meet out a specific loss on realization of an asset or for payment of taxes etc.	Purpose is to strengthen the financial position of the business.
11.	It is set aside for meeting out an anticipated loss or liability.	It increases working capital of the business.
12.	Amount can't be determined with substantial accuracy though liability is known.	Amount depends upon financial policy and discretion of management.
13.	Provision is a known diminution in value of an asset or a known liability.	Reserves are surpluses not yet distributed and, in some cases (e.g., share premium account or capital redemption reserve), not distributable.
14.	A provision is made for a definite amount and, therefore, a definite sum is set aside every year to meet the known contingency.	The reserve is created without taking into consideration the actual amount required, except in the case of redemption of debentures when a definite sum is set aside.

## MODULE - IV

### Depreciation, Provision and Reserves



#### Notes

**MODULE - IV****Depreciation, Provision  
and Reserves****Notes****INTEXT QUESTIONS 13.3****I. State whether the following statements are True or False :**

- i. Provisions are the charges against profits for all apprehended losses.
- ii. All reserves appear on the liability side of the balance sheet.
- iii. Capital reserves are freely distributed as profits.
- iv. The purpose of reserve is generally to strength the financial position of a business enterprise.
- v. A provision is made for a definite amount and therefore, a definite sum is set aside every year the meet the know contingency.

**II. Multiple Choice Questions:**

- i. Out of the following which is not a provision:
  - a) Provision for bad debts.
  - b) Provision for discount on debtors.
  - c) Dividend Equalization Reserve.
  - d) Provision for Depreciation.
- ii. Out of the following which is not a reserve:
  - a) Reserve for Expansion.
  - b) Dividend Equalization Reserve
  - c) Secret Reserve
  - d) Provision for bad debts.
- iii. Out of the following name the reserve which is created not for any specific purpose but for meeting future contingencies:
 

a) General Reserve	b) Capital Reserve
c) Specific Reserve	d) Secret Reserve
- iv. Out of the following name the reserve which can be utilised for issue of bonus shares:
 

a) General Reserve	b) Capital Reserve
c) Secret Reserve	d) Sinking Fund
- v. Out of the following identify the item which is created by debiting the profit and loss appropriations Account:
  - a) Provision for bad debts
  - b) Provision for discount on debtors
  - c) Provision for Income tax
  - d) General Reserve



### WHAT YOU HAVE LEARNT

- Provision is an estimated amount to meet an uncertain loss or expense of future e.g., Provision for Doubtful Debts on Debtors, Provision for Discount on Debtors, Provision for Depreciation, etc. Provisions are created out of profits and are generally shown on the liability side of the balance sheet. Making a provision is must to meet a known liability in future.
- An amount which is kept aside from current income to meet the unexpected happening in the future is called a reserve e.g. General Reserve, reserve for expansion, reserve for equalization of dividend etc. General Reserve is undistributed or retained profits. No reserve can be created if there is no profit. Reserves strengthen the financial positions of the business. Capital reserves are created out of capital profits eg. Capital gains, premiums on issue of shares and debentures, profits prior to incorporation etc. These reserves are not available for distribution of dividend. Secret reserve is not shown in the balance sheet. Revenue reserves are appropriations of profits which can be distributed as dividends. Specific reserve is created for a specific purpose e.g. dividend equalization reserve, investment reserve, investment fluctuation reserve etc. When a part of the profit is set aside and invested outside the business then it is known as a reserve fund. A Sinking fund is established for the future redemption of long term debts or liability or replacement of assets etc.



### TERMINAL EXERCISE

1. What is meant by Reserve Fund?
2. What is meant by a provision?
3. Give the meaning of reserves.
4. State the purposes for which provision are created?
5. Why an organisation creates reserves? Explain briefly.
6. State the purposes for which capital reserves can be utilized.
7. Distinguish between provision and reserve (any four points).
8. Describe briefly the following:
  - i. Secret Reserves
  - ii. Revenue Reserves
  - iii. Specific Reserves
  - iv. Sinking Fund



**MODULE - IV****Depreciation, Provision  
and Reserves****Notes****Provisions & Reserves****ANSWER TO INTEXT QUESTIONS**

- 13.1** i) Loss/expense      ii) Disputed      iii) Profit and Loss  
iv) Owner/Shareholder      v) Liability
- 13.2** i) Reserve      ii) General Reserve      iii) Capital, Capital  
iv) Capital      v) Secret      vi) Reserve  
vii) Reserve Fund      viii) Definite
- 13.3** **I.**      i) True      ii) True      iii) False      iv) True      v) True  
**II.**      i) c      ii) d      iii) a      iv) b      v) d

**ACTIVITY FOR YOU**

- Your parents from their regular income make some savings for the known or unknown expenses/liability to meet out in future. Prepare a list of past three months savings with reasons and differentiate them in reserves or provisions keeping in view the principles of the same, so that you may be clear about the term reserve & provisions.



## MODULE - V

<b>Maximum Marks</b>	<b>Hours of Studies</b>
<b>20</b>	<b>48</b>

### **Preparation of Financial Statements**

This module will enable the learners to understand the meaning and need for preparing financial statements which are the final outcome of the accounting practice. They will learn the steps of the preparation of Income statement and Balance Sheet. The learners will also learn to adjust the different items of adjustment which are provided in the form of additional information (adjustment).

- Lesson 14 : Financial Statements (Without Adjustments)**
- Lesson 15 : Financial Statements (With Adjustments)**

## Awards Won by NIOS

Several projects have been implemented by the NIOS to tap the potential of Information and Communication Technology (ICT) for promoting of Open and Distance Learning (ODL) system. The Ni-On project of NIOS won the National Award for e-governance and Department of Information and Technology, Govt. of India. In further recognition of its On-line initiatives and best ICT practices, the NIOS received the following awards:

### NIOS WINS National Award for e-Governance 2008-09

Silver icon for Excellence in Government Process Re-engineering, Instituted by Government of India Department of Administrative Reforms and Public Grievances & Department of Information Technology.



### NIOS receives NCPEDP MPHASIS Universal Design Awards 2012



National Institute of Open Schooling (NIOS) has been awarded THE NCPEDP - MPHASIS UNIVERSAL DESIGN AWARDS 2012 instituted by National Centre for Promotion of Employment for Disabled People. The award was given by **Sh. Mukul Wasnik, Hon'ble Minister for Social Justice and Empowerment, Govt. of India** on 14th August, 2012. NIOS has been selected for its remarkable work done for the learners with disabilities through ICT by making its web portal

[www.nios.ac.in](http://www.nios.ac.in) completely accessible for such learners.

### The Manthan Award South Asia & Asia Pacific 2012

The Manthan Award South Asia & Asia Pacific 2012 to recognize the best ICT practices in e-Content and Creativity instituted by Digital Empowerment Foundation in partnership with World Summit Award, Department of Information Technology, Govt. of India, and various other stakeholders like civil society members, media and other similar organisations engaged in promoting digital content inclusiveness in the whole of South Asian & Asia Pacific nation states for development. The award was conferred during **9th Manthan Award Gala South Asia & Asia Pacific 2012 at India Habitat Centre on 1st Dec. 2012.**



## 14

## FINANCIAL STATEMENTS (WITHOUT ADJUSTMENTS)

In the previous lessons you have learnt to record the business transactions in different books of accounts and their posting into the main book i.e. ledger. You have also learnt the balancing of accounts and preparation of trial balance. One of the important purposes of accounting is to find out the profit or loss of a business for a particular accounting period and also to know its financial position on a particular date.

For this purpose, Income Statement and Position Statement are prepared every year by all business organisations. Income statement is divided into two parts, which are as follows:

- (i) Trading Account and
- (ii) Profit and Loss Account.

Income Statement is prepared to know the earnings of a business during a particular accounting year or the loss suffered during the year. Position Statement, also known as Balance Sheet, is prepared to know the financial position of a business on a particular date.

In this lesson you will learn as to how the financial statements are prepared to find out the profit for an accounting year and to know its financial position on a particular date.



### OBJECTIVES

**After studying this lesson you will be able to:**

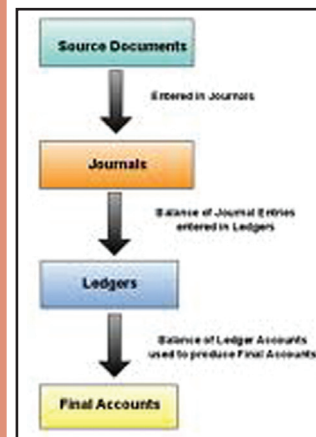
- explain the meaning of financial statements;
- explain the objectives of financial statements;
- classify the financial statements into Trading Account, Profit and Loss Account and Balance Sheet and
- prepare Trading Account, Profit and Loss Account and Balance Sheet.

## MODULE - V

### Preparation of Financial Statements



#### Notes



**MODULE - V****Preparation of  
Financial Statements****Notes****Financial Statements (Without Adjustment)****14.1 MEANING OF FINANCIAL STATEMENTS**

Like a student who eagerly waits for his/her annual examination result, every businessman also eagerly waits to know the result of his business for a particular financial year. The businessman also wants to know the financial position of his business on a particular date. This date is normally the last date of the financial year for which the accounts have been prepared. The statements, prepared to know the result of the business and the financial position of the business, are called financial statements. The statement prepared to ascertain gross profit/loss is called Trading Account. The statement prepared to ascertain the net profit is called Profit and Loss Account. Trading and Profit and Loss Account taken together is called the Income Statement. Statement prepared to know the financial position of the business is called the Balance Sheet or Position Statement.

**14.2 OBJECTIVES OF FINANCIAL STATEMENTS**

Following are the objectives of preparing financial statements:

- i) Ascertain the result of business activities :** One of the important objectives of preparing financial statements is to ascertain the Income. Financial statements provide information about the profit earned or loss incurred during a particular accounting period or year.
- ii) Ascertain the financial position of business :** Balance Sheet provides information about the financial position of business on a particular date.
- iii) Correct decision making :** Financial statements are helpful in decision making for the business on the basis of the information provided by financial statements, future decisions can be taken correctly.
- iv) Judging the performance of management :** Financial statements are helpful in judging the performance of management and utilization of resources of a business house.
- v) Ascertaining the cash position of business :** The cash position indicated by the financial statements helps the business in planning the payment of cash to creditors, suppliers etc.

**14.3 CLASSIFICATION OF FINANCIAL STATEMENTS**

Financial Statements of a sole trader comprise of the following statements:

- I. Income Statement
  - (i) Trading Account and
  - (ii) Profit and loss Account
- II. Position Statement or Balance Sheet

## Financial Statements (Without Adjustment)

### Income Statement

Income statement is prepared to find out the profit or loss of business for a particular accounting year. Income statement is made up of the following accounts:

- Trading Account and
- Profit and loss Account

**a) Trading Account :** Trading Account is prepared to find out the Gross profit earned or Gross loss suffered by the business from business activities during an accounting year. This account is prepared in T-form. Following is the proforma of a Trading Account:

#### Trading Account of M/s XYZ for the year ending.....

Dr.

Cr.

Particulars	Amount (₹)	Particulars	Amount (₹)
To Opening Stock		By Sales	
To Purchases		(i) Cash Sales	
(i) Cash Purchases		(ii) Credit Sales	
(ii) Credit Purchases		Total Sales	
Total Purchases		Less Sales Returns	
Less Purchase Returns		Net Sales	
Net Purchases		By Closing Stock	
Direct Expenses :		By Gross Loss transferred to P & L A/c (Balancing fig.)	
To Wages			
To Freight/Freight Inward			
To Carriage/Carriage Inward			
To Fuel & Power			
To Factory Rent			
To Gross Profit transferred to P & L A/c (Balancing fig.)			

### Illustration 1

From the following balances extracted from the books of M/s Luxmi & Sons, prepare a Trading Account for the year ended 31<sup>st</sup> March, 2012.

Particulars	Amount (₹)
Opening stock	6,500
Purchases	45,000
Sales	72,000
Purchases Returns	500
Sales Returns	1,500
Carriage	1,200
Wages	4,800
Fuel & Power	3,200
Closing stock	8,000



## MODULE - V

### Preparation of Financial Statements



Notes

## Financial Statements (Without Adjustment)

### Solution

#### Trading Account of M/s Luxmi & Sons for the year ended March 31, 2012

Dr.		Cr.	
Particulars	Amount (₹)	Particulars	Amount (₹)
To Opening Stock	6,500	By Sales	72,000
To Purchases	45,000	Less : Returns	1,500
Less : Returns	500	By Closing Stock	8,000
To Carriage	1,200		
To Wages	4,800		
To Fuel & Power	3,200		
To Gross Profit transferred to P & L A/c (Balancing Figure)	18,300		
	<b>78,500</b>		<b>78,500</b>

### Illustration 2

From the following balances extracted from the books of M/s Bhanu Bros, prepare a Trading Account for the year ended 31<sup>st</sup> March, 2012.

Particulars	Amount (₹)
Opening Stock as on 1.4.2011	32,000
Purchases	1,65,000
Freight	4,000
Power	6,500
Custom Duty	5,500
Sales	80,000
Closing Stock as on 31 <sup>st</sup> March, 2012	30,000

### Solution

#### Trading Account of M/s Bhanu Bros. for the year ended March 31, 2012

Dr.		Cr.	
Particulars	Amount (₹)	Particulars	Amount (₹)
To Opening Stock	32,000	By Sales	80,000
To Purchases	1,65,000	By Closing Stock	30,000
To Freight	4,000	By Gross Loss transferred to P & L A/c (Balancing Figure)	1,03,000
To Power	6,500		
To Custom Duty	5,500		
	<b>2,13,000</b>		<b>2,13,000</b>



Notes



**INTEXT QUESTIONS 14.1**

Fill in the blanks with suitable word/words :

- i. Carriage is debited to \_\_\_\_\_ account.
- ii. Total Sales – Sales Returns = \_\_\_\_\_
- iii. Wages are debited to \_\_\_\_\_ account.
- iv. Closing stock is shown on the \_\_\_\_\_ side of Trading Account.
- v. Total Purchases – Purchase Returns = \_\_\_\_\_

**b) Profit and Loss Account :** After finding out the gross profit/ gross loss by preparing the Trading Account, Profit and Loss Account is prepared to find out the net profit / net loss of the business during an accounting year. This account is also prepared in T-form. Following is the proforma of a Profit and loss Account

**Profit and loss Account of M/s ABC  
for the year ended \_\_\_\_\_**

Dr.

Cr.

Particulars	₹	Particulars	₹
To Gross Loss transferred from Trading A/c	_____	By Gross profit transferred from Trading A/c	_____
To Salaries	_____	By Commission Received	_____
To Office Rent	_____	By Discount received from creditors	_____
To Printing & Stationery	_____	By Rent Received	_____
To Insurance Premium	_____	By Interest Received	_____
To Interest Paid	_____	By Net Loss Transferred to Capital Account (Balancing Figure)	_____
To Freight outwards	_____		
To carriage outwards	_____		
To Discount Allowed to customers	_____		
To Postage	_____		
To Telephone Charges	_____		
To Office Expenses	_____		
To Sales Expenses	_____		
To Net Profit Transferred to Capital Account (Balancing Figure)	_____		
	_____		_____

**Illustration 3**

From the following information, prepare Profit and loss Account of M/s Sahil Bros for the Year ending on 31.03.2012.

	₹
Gross Profit	97,000
Discount allowed to customers	2,000
Printing and stationery	2,000
Officerent	5,000

## MODULE - V

### Preparation of Financial Statements



Notes

## Financial Statements (Without Adjustment)

Repair	2,400
Insurance Premium	5,100
Telephone Charges	1,000
Discount received from Creditors	3,000
Interest earned during the year	5,000

### Solution

#### Profit and loss Account of M/s Sahil Bros. for the year ended March 31, 2012

Dr.	₹	Cr.	₹
<b>Particulars</b>	<b>₹</b>	<b>Particulars</b>	<b>₹</b>
To Discount allowed to customers	2,000	By Gross profit transferred from Trading A/c	97,000
To Printing and Stationery	2,000	By Discount received from creditors	3,000
To Office Rent	5,000	By Interest earned during the year	5,000
To Repairs	2,400		
To Insurance Premium	5,100		
To Telephone Charges	1,000		
To Net Profit transferred to Capital A/c (Balancing fig.)	87,500		
	<b>1,05,000</b>		<b>1,05,000</b>

### Illustration 4

From the following information, prepare Profit & Loss Account of M/s Sarthak Traders for the year ending on 31.03.2012

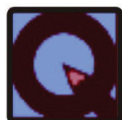
	₹
Gross Profit	43,000
Discount allowed to customers	7,000
Salaries	45,000
Interest paid on loan	13,000
Postage	2,400
Discount received from creditors	6,000
Commission received	1,000
Sales expenses	10,000

### Solution

#### Profit and loss Account of M/s Sarthak Traders for the year ended March 31, 2012

Dr.	₹	Cr.	₹
<b>Particulars</b>	<b>₹</b>	<b>Particulars</b>	<b>₹</b>
To Discount allowed to customers	7,000	By Gross profit transferred from Trading A/c	43,000
To Salaries	45,000	By Discount received from Creditors	6,000
To Interest on loan	13,000	By Commission Received	1,000
To Postage	2,400	By Net Loss transferred to capital A/c	27,400
To Sales expenses	10,000		
	<b>77,400</b>		<b>77,400</b>





## INTEXT QUESTIONS 14.2

State whether the following statements are True or False:

- i. Carriage inward is shown in Profit & Loss Account.
- ii. Telephone expenses are shown in Trading Account.
- iii. Carriage outward is shown in P&L A/c.
- iv. Gross Profit is transferred from Profit & Loss Account to Trading Account.

### Distinction between Trading Account and Profit and Loss Account

The distinction between Trading A/c and Profit & Loss A/c is as follows:

S.No.	Trading Account	Profit and Loss Account
1.	This account shows the gross profit or gross loss for an accounting year.	This account shows the net profit or net loss for an accounting year.
2.	All direct expenses relating to business are shown on the debit side of this account.	All indirect expenses relating to business are shown on the debit side of this account.
3.	All direct revenue items are shown on the credit side of this account.	All indirect revenue items are shown on the credit side of this account.
4.	The balance of this account i.e. gross profit or gross loss is transferred to P&L A/c.	The balance of this account i.e. net profit or net loss is transferred to the capital account of the proprietor.

## II. Position Statement or Balance Sheet

Balance Sheet or Position Statement is prepared to find out the financial position of a business on a particular date. Generally it is prepared on the last date of an accounting year. It is prepared after preparing Trading Account and Profit & Loss Account.

Balance Sheet has two sides. Left hand side is known as Liabilities side and right hand side is known as Assets side.

The Liabilities side is used for showing liabilities of the business. The term liabilities include 'Internal Liabilities' and 'External Liabilities' of the business. Internal liabilities means the amount payable by the business to its owner, while external liabilities mean the amount payable to outsiders.



Notes

## MODULE - V

### Preparation of Financial Statements



Notes

## Financial Statements (Without Adjustment)

### Classification of Internal and External Liabilities

Internal liabilities		External liabilities	
a.	Capital	Creditors	
b.	Profits of business	Bank loan and other loans	
c.	Reserves of business	Expenses payable or due	

The Assets side is used for showing the assets of the business. The term assets includes fixed assets and current assets of the business.

### Classification of Assets

Fixed Assets		Current Assets	
a.	Land and building	Cash in hand	
b.	Plant & Machinery	Cash at Bank	
c.	Furniture	Stock of goods	
d.	Motor Vehicles etc.	Debtors etc.	

### Objectives of Preparing Balance Sheet

Balance sheet is prepared to achieve following objectives:

- i) To know the financial position of the business.
- ii) To know the position of internal liabilities and external liabilities of the business so that timely arrangement can be made for their payment.
- iii) To know the position of fixed assets and current assets.
- iv) To plan activities for future on the basis of present financial position.

### Proforma of Balance Sheet

Balance Sheet of M/s \_\_\_\_\_  
as on \_\_\_\_\_

Liabilities	₹	Assets	₹
Bank overdraft	_____	Cash in hand	_____
Creditors	_____	Cash at Bank	_____
Loans/Bank Loan	_____	Debtors	_____
Capital	_____	Stock	_____
Add : Net Profit	_____	Investments	_____
Less : Net Loss	_____	Furniture	_____
Less Drawings	_____	Motor Vehicles	_____
	_____	Plant & Machinery	_____
	_____	Land & Building	_____
	_____		_____

## Financial Statements (Without Adjustment)

### Illustration 5

From the following information supplied by Mr. Roshan Lal, prepare a Balance Sheet of Mr. Roshan Lal as on 31<sup>st</sup> March, 2012

	₹
Capital	50,000
Furniture	15,000
Debtors	25,000
Creditors	30,000
Plant and Machinery	58,000
Investments	5,000
Cash in hand	1,000
Cash at Bank	1,000
Stock at the end	10,000
Bank Overdraft	8,000
Bank Loan	20,000
Net Profit	10,000
Drawings	3,000

### Solution

**Balance Sheet of Mr. Roshan Lal  
as on March 31, 2012**

Dr.

Cr.

Liabilities	₹	Assets	₹
Bank overdraft	8,000	Cash in hand	1,000
Creditors	30,000	Cash at Bank	1,000
Bank Loan	20,000	Debtors	25,000
Capital	50,000	Stock	10,000
Add : Net Profit	10,000	Investments	5,000
	60,000	Furniture	15,000
Less Drawings	- 3,000	Plant & Machinery	58,000
	<b>1,15,000</b>		<b>1,15,000</b>

### Illustration 6

From the following information supplied by Mr. Arun Kumar, prepare a Balance Sheet as on 31<sup>st</sup> March, 2012.

	₹
Creditors	30,000
Debtors	35,000
Cash in hand	24,500
Cash at Bank	27,500
Stock	22,500
Furniture	25,000

## MODULE - V

### Preparation of Financial Statements



Notes

## MODULE - V

### Preparation of Financial Statements



Notes

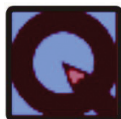
## Financial Statements (Without Adjustment)

Loan	50,000
Plant & Machinery	32,500
Land & Building	52,000
Capital	1,37,000
Net Profit	12,000
Drawings	10,000

### Solution

#### Balance Sheet of Mr. Arun Kumar as on March 31, 2012

Dr.		Cr.	
Liabilities	₹	Assets	₹
Creditors	30,000	Cash in hand	24,500
Loan	50,000	Cash at Bank	27,500
Capital	1,37,000	Debtors	35,000
Add : Net Profit	12,000	Stock	22,500
	1,49,000	Furniture	25,000
Less : Drawings	10,000	Plant & Machinery	32,500
	1,39,000	Land & Building	52,000
	<b>2,19,000</b>		<b>2,19,000</b>



### INTEXT QUESTIONS 14.3

#### I. Fill in the Blanks :

- Assets are shown on the \_\_\_\_\_ side of the Balance Sheet.
- Capital is shown on the liabilities side of \_\_\_\_\_ .
- Total of Assets side and liabilities side of balance sheet are always \_\_\_\_\_.
- Stock is an example of \_\_\_\_\_ asset.
- Furniture is an example of \_\_\_\_\_ asset.

#### II. Classify the following assets as fixed assets and current assets:

Assets	Type of Asset (Fixed or Current)
i. Debtors	
ii. Land & Building	
iii. Plant & Machinery	
iv. Cash at Bank	
v. Motor Vehicle	
vi. Cash in hand	

## Financial Statements (Without Adjustment)

### Illustration 7

From the following Balances of M/s Pawan Sales on 31/3/2012, prepare a Trading and Profit & Loss Account and a Balance Sheet as on that date.

Particulars	Amount (₹)	Particulars	Amount (₹)
Drawings	8,000	Sales	2,58,000
Capital	48,000	Return Inwards	2,000
Sundry Creditors	80,000	Return Outwards	2,200
Sundry Debtors	1,26,000	Office Salaries	18,000
Bills Receivable	10,000	Manufacturing Wages	8,000
Opening stock	90,000	Commission	9,000
Fixtures and Fittings	13,000	Trade Expenses	5,000
Cash in hand	2,000	Rent	4,400
Machinery	24,800	Discount received	8,000
Bank Overdraft	10,000	Bills Payable	14,000
Purchases	1,00,000		

The closing stock on 31.3.2012 was ₹ 1,04,000

### Solution

#### Trading and Profit and Loss A/c M/s Pawan for the year ended March 31, 2012

Dr.		Cr.	
Particulars	Amount (₹)	Particulars	Amount (₹)
To Opening Stock	90,000	By Sales	2,58,000
To Purchases	1,00,000	Less : Returns	2,000
Less : Returns	2,200	By Closing Stock	1,04,000
To Manufacturing Wages	8,000		
To Gross Profit c/f	1,64,200		
	<b>3,60,000</b>		<b>3,60,000</b>
To Office Expenses	18,000	By Gross Profit b/f	1,64,200
To Commission	9,000	By Discount received	8,000
To Trade Expenses	5,000		
To Rent	4,400		
To Net Profit c/f	1,35,800		
	<b>1,72,200</b>		<b>1,72,200</b>

#### Balance Sheet as on March 31, 2012

Liabilities	₹	Assets	₹
Bills Payables	14,000	Cash in hand	2,000
Sundry Creditors	80,000	Bills Receivable	10,000
Bank Overdraft	10,000	Sundry Debtors	1,26,000

## MODULE - V

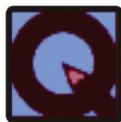
### Preparation of Financial Statements



Notes

**MODULE - V****Preparation of  
Financial Statements****Notes****Financial Statements (Without Adjustment)**

Capital	48,000		Stock	1,04,000
Less : Drawings	8,000		Fixtures and Fittings	13,000
	<u>40,000</u>			
Add : Net Profit	1,35,800	1,75,800		
		<b>2,79,800</b>		<b>2,79,800</b>

**INTEXT QUESTIONS 14.4****I. Mention whether following statements are True or False :**

- i. A Balance Sheet shows the financial position of a business for the whole year.
- ii. Both P & L Account and Balance Sheet are position statements.
- iii. Asset side of a balance sheet shows only the fixed assets of a business.
- iv. Liabilities side of a Balance Sheet shows both internal and external liabilities.

**II. Multiple Type Questions**

- i. Which of the following financial statement is prepared to ascertain gross profit of a business?
  - a) Profit and Loss Account
  - b) Trading Account
  - c) Balance Sheet
  - d) None of the above
- ii. Which of the following financial statements is prepared to ascertain the positions of assets and liabilities of the business?
  - a) Balance Sheet
  - b) Profit and Loss Account
  - c) Trading Account
  - d) None of the above
- iii. Gross profit is the difference between
  - a) Total assets and total liabilities
  - b) Sales and all expenses
  - c) Sales and indirect expenses
  - d) Sales and cost of goods solds
- iv. Which of the following is not an indirect expense?
  - a) Freight inward
  - b) Discount allowed
  - c) Rent paid
  - d) Commission paid
- v. Which of the following is a current asset?
  - a) Land
  - b) Building
  - c) Cash at bank
  - d) Machinery


**WHAT YOU HAVE LEARNT**

- Financial Statements are prepared to ascertain the Gross Profit and Net profit earned by a business enterprise during a period and the positions of its assets and liabilities on a particular date, generally on the last date of the accounting year.
- Trading account is prepared to ascertain gross profit earned or gross loss suffered during a period and profit and loss account is prepared to ascertain the net profit earned or net loss suffered by the business during a period. Trading and profit and loss account taken together is called income statement.
- Balance sheet is prepared to know the position of assets and liabilities of the business on a particular date. This is called the position statement.
- Financial statements are prepared to know the result of business activities, to know the financial position of the business, to help in decision making, to judge the performance of the management, to know the cash position of the business etc.


**Notes**

**TERMINAL EXERCISE**

1. What do you mean by term financial statements?
2. State the objectives of preparing financial statements.
3. State the objectives of preparing Balance Sheet.
4. Distinguish between direct expenses and indirect expenses.
5. Distinguish between Trading Account and Profit and Loss Account.
6. Give five examples each of fixed assets and current assets.
7. Give three examples each of internal liabilities and external liabilities.
8. From the following balances prepare trading account for the year ended 31<sup>st</sup> March 2012

Particulars	₹	Particulars	₹
Opening Stock	6,000	Purchases	11,500
Purchase return	500	Sales	48,000
Sales return	600	Freight & Octroi	500
Carriage on purchases	1,000	Wages	2,500
Factory lighting	600	Import duty	900
Office rent	1,200	Carriage on sales	3,000
Coal, gas & water	800		

## MODULE - V

### Preparation of Financial Statements



Notes

## Financial Statements (Without Adjustment)

9. Prepare Profit and Loss account for the year ended 31<sup>st</sup> March 2012 from the following particulars.

Particulars	₹	Particulars	₹
General Expenses	800	Gross Profit	32,100
Charity	100	Carriage on sales	900
Electricity charges	175	Office expenses	650
Law charges	180	Insurance premium	1,200
Advertisement	440	Telephone expenses	600
Commission	870	Sales tax	800
Rent	1,800	Establishment expenses	700
Interest on investment	700	Miscellaneous expenses	750
Sundry receipts	700	Discount received	1,090
Indirect expenses	340	Traveller salary	300
Printing and stationary	65	Repair	270

10. From the following trial balance of Gopal Nath and Sons, prepare Trading and Profit and Loss Account for the year ending 31<sup>st</sup> December 2012 and a Balance Sheet as at that date:

Particulars	₹	Particulars	₹
Opening Stock	4,000	Bills Payable	1,200
Purchases	12,000	Purchase return	300
Carriage	1,170	Sundry creditors	2,700
Wages	1,000	Sales	20,000
Sales return	200	Capital	30,000
Drawings	1,500	Commission received	120
Office expenses	250		
Salaries	1,600		
Discount	300		
Repairs	1,200		
Advertisements	500		
Sundry debtors	6,000		
Plant & Machinery	12,000		
Building	10,000		
Cash in hand	600		
Cash at bank	2,000		
	<b>54,320</b>		<b>54,320</b>

The value of stock in hand on 31<sup>st</sup> December 2012 was ₹ 6,000.




**ANSWER TO INTEXT QUESTIONS**

- 14.1** (i) Trading Account (ii) Net Sales (iii) Trading Account  
(iv) Credit Side (v) Net Purchases
- 14.2** (i) False (ii) False (iii) True (iv) False
- 14.3** **I.** (i) Right hand side (ii) Balance Sheet (iii) Equal  
(iv) Current (v) Fixed
- II.** (i) Current (ii) Fixed (iii) Fixed  
(iv) Current (v) Fixed
- 14.4** **I.** (i) False (ii) False (iii) False (iv) True
- II.** (i) b (ii) a (iii) d (iv) a (v) c


**ANSWER TO TERMINAL EXERCISE**

8. Gross Profit Rs. 24,100
9. Net Profit Rs. 24,450.
10. Gross Profit Rs. 7,930; Net Profit Rs. 4,200; Total of Balance Sheet Rs. 36,600.

**ACTIVITY FOR YOU**

- Visit a small business organisation in a nearby area, request them to show you their final accounts, with the help of an accountant learn the technique of preparing the final accounts.

**MODULE - V***Preparation of  
Financial Statements*

Notes

15

## FINANCIAL STATEMENTS (WITH ADJUSTMENTS)

You have learnt in the previous lesson, how to prepare Trading A/c, Profit & Loss A/c and Balance Sheet.

These financial statements are prepared with the help of a given Trial Balance. It is possible that the expenses given in the Trial Balance may not be the total expenses for that accounting year for which trial balance has been prepared.

Similarly a portion or part of the expenses given in the Trial Balance may relate to future year(s).

If Financial Statements are prepared with the help of such a Trial balance, they will not present a correct picture of the business. The income statement will not show correct net profit or net loss. Similarly the Balance sheet will not show the correct financial picture of the business.

So, before preparing the financial statement, it is necessary to find out the items of expenses which relate to the current year but have not been paid.

Similarly it is necessary to find out the items of expenses which relate to future year but have been paid or received during current year.

Therefore, it becomes necessary to make some 'adjustments' in respect of some items of expense and income. These are called accounting adjustments.



### OBJECTIVES

**After studying this lesson you will able to :**

- understand the need for accounting adjustments;
- understand the adjustments relating to closing stock, outstanding expenses, prepaid expenses and depreciation on fixed assets;
- explain adjustment entries relating to above adjustments and
- understand the accounting treatment of the adjustments in Trading A/c, Profit and Loss A/c and Balance Sheet.



**Notes**

**15.1 NEED FOR ACCOUNTING ADJUSTMENTS**

Accounting adjustments are required because of the following purposes:

- i) To know the correct net profit or net loss of the business for an accounting year.
- ii) To know the correct financial position of the business.
- iii) To record the expenses which have become due but have not been paid
- iv) To record the expenses which have been paid in advance for future year(s)
- v) To provide for depreciation on fixed assets.

**15.2 TYPES OF ADJUSTMENTS**

The number and nature of adjustments will differ from business to business. You will study the following common adjustments in this lesson :

- i) Closing Stock
- ii) Outstanding Expenses
- iii) Prepaid Expenses
- iv) Depreciation on Fixed assets

Let us discuss the above items of adjustments and their accounting treatment in the financial statements.

**i) Closing Stock**

Closing stock is the stock of goods which remains unsold at the end of the accounting year. This item is, normally, not shown inside the Trial balance. It appears outside the trial balance as additional information. For example the books of Mr. X showed the value of closing stock as on 31.3.2012 ₹30,000.

The accounting treatment of closing stock in the financial statements of Mr. X., will be as follows:

- (a) The following adjustment entry will be passed at the end of the year:

31.3.2012	Closing Stock A/c	Dr.	30,000	
	To Trading A/c			30,000
	(For Closing stock transferred to Trading A/c)			

- (b) Trading A/c of Mr. X for the year ending 31.3.2012

Dr.		Cr.	
Particulars	Amount (₹)	Particulars	Amount (₹)
		By Closing Stock	30,000

## MODULE - V

### Preparation of Financial Statements



Notes

## Financial Statements (With Adjustments)

### (c) Balance Sheet of Mr. X as on 31.3.2012

Liabilities	Amount (₹)	Assets	Amount (₹)
		Closing Stock	30,000

**Note :** If Closing stock is given inside the Trial balance, the above mentioned adjustment entry will not be passed and the closing stock will not be shown on the credit side of Trading A/c. The closing stock will be shown on the assets side of Balance Sheet only.

### ii) Outstanding Expenses

An expense which relates to the current year but has not been paid till the end of the accounting year is known as outstanding expenses such as Factory rent, Wages, Salaries, Office rent, Telephone charges etc. for current year may not have been paid till the end of the accounting year, for example the books of accounts of Mr. X showed that, Wages paid during the year 2011-2012 ₹ 45,000. Wages outstanding for the year 2011-2012 ₹ 5,000.

The accounting treatment of wages outstanding in the books of Mr.X will be as follows:

(a) The adjustment entry will be:

31.3.2012	Wages A/c	Dr.	5,000	
	Wages outstanding A/c			5,000
	(For wages outstanding for the year 2011-12)			

### (b) Trading A/c of Mr. X for the year ending 31.3.2012

Dr.		Cr.	
Particulars	Amount (₹)	Particulars	Amount (₹)
Wages : 45,000			
(+) Wages O/S : 5,000	50,000		

### (c) Balance Sheet of Mr. X as on 31-3-2012

Liabilities	Amount (₹)	Assets	Amount (₹)
Wages Outstanding	5,000		

## Financial Statements (With Adjustments)

Let us take another example, regarding outstanding salary which affects the net profit.

Example: The books of accounts of Mr.X showed the following:

Salaries for the year 2011-12 already paid during the year ₹ 1,00,000. Salaries for 2011-12 due but not paid till 31-3-12 ₹ 10,000. Its accounting treatment in the books of Mr.X will be as follows.

(a) Adjustment entry will be as under:

31.3.2012	Salaries A/c	Dr.	10,000	
	To Salaries outstanding A/c			10,000
	(For salary outstanding for the year 2011-12)			

(b) **Profit & Loss A/c for Mr.X**  
**For the year ending 31-3-2012**

Particulars	Amount (₹)	Particulars	Amount (₹)
To Salaries : 1,00,000			
(+) Salaries O/S : 10,000	1,10,000		

(c) **Balance Sheet**  
**as on 31-3-2012**

Liabilities	Amount (₹)	Assets	Amount (₹)
Salaries Outstanding	10,000		



### INTEXT QUESTIONS 15.1

Give exact term for your answer :

- Stock remains unsold at the end of year.
- Amount not paid for the good or services whose benefits was already availed.
- Value of unsold goods shown outside the trial balance as additional information.
- Transaction shown outside the trial balance to be incorporated before the preparation final accounts.

### iii) Prepaid Expenses

Sometimes, a part of the expenses given in the trial balance may relate to future year(s). Such part of expenses is known as 'Prepaid Expenses' or 'Expense paid in

## MODULE - V

### Preparation of Financial Statements



### Notes

## MODULE - V

### Preparation of Financial Statements



Notes

## Financial Statements (With Adjustments)

Advance' such as, out of the salaries paid during the current year, a part may relate to next accounting year. Similarly factory rent, wages, office rent, insurance premium, taxes, etc. may be prepaid in some cases. For example the books of accounts of Mr.X showed the following:

Total salaries paid during the accounting year 2011-2012 ₹ 2,00,000 out of which ₹ 25,000 relates to the next accounting year, i.e, 2012-13. The accounting treatment, of prepaid salaries in the books of Mr. X will be as follows:

(a) Adjustment entry for prepaid salaries will be as under:

31.3.2012	Prepaid Salaries A/c	Dr.	25,000	
	To Salaries A/c			25,000
	(For salaries paid in advance for next year 2012-13)			

(b) **Profit & Loss A/c for Mr.X  
for the year ending 31-3-2012**

Particulars	Amount (₹)	Particulars	Amount (₹)
To Salaries : 2,00,000			
(-)Prepaid Salaries : 25,000	1,75,000		

(c) **Balance Sheet of Mr.X  
as on 31-3-2012**

Liabilities	Amount (₹)	Assets	Amount (₹)
		Prepaid Salaries	25,000

iv) **Depreciation on Fixed Assets**

The value of fixed assets such as Plant and Machinery, Building, Furniture, Computers, Motor Vehicles, etc. goes on decreasing or reducing every year due to their use, wear and tear. This decrease in the value of assets is called depreciation.

Depreciation is an expense like any other expense of the business.

Depreciation on various fixed assets is shown on the debit side of P&L A/c.

The amount of depreciation on fixed asset is deducted from the concerned or related asset on the asset side of Balance Sheet. For example the books of accounts of Mr. X showed the following:

## Financial Statements (With Adjustments)

The value of Plant and Machinery is ₹ 5,00,000 as on 31-3-2012 and value of Furniture is ₹ 50,000 as on 31-3-2012. Depreciation is to be charged on these assets @10% p.a. The accounting treatment of depreciation in the financial statements of Mr. X, will be as follows :

(a) Entry for charging depreciation will be as under:

31-3-2012	Depreciation A/c	Dr.	55,000	
	To Plant&Machinery A/c			50,000
	To Furniture A/c			5,000
	(For depreciation charged on Plant and Machinery and Furniture @10% for one year)			

(b) **Profit & Loss A/c for Mr. X**  
for the year ending 31-3-2012

Dr.		Cr.	
Particulars	Amount (₹)	Particulars	Amount (₹)
To Depreciation on Plant & Machinery	50,000		
Furniture	5,000		

(c) **Balance Sheet of Mr.X**  
as on 31-3-2012

Liabilities	Amount (₹)	Assets	Amount (₹)
		Plant & Machinery	5,00,000
		(-) Dep.	50,000
		Furniture	50,000
		(-) Dep.	5,000
			45,000



### INTEXT QUESTIONS 15.2

Match column 'A' with column 'B'

- | 'A'  |                      | 'B' |   |
|------|----------------------|-----|---|
| i.   | Closing Stock        | (a) | Deducted from the value of assets   |
| ii.  | Outstanding Expenses | (b) | Those expenses which have not become due but have been paid during the accounting year in question. |
| iii. | Depreciation         | (c) | Those expenses which have become due but have not been paid in the concerned accounting year.       |
| iv.  | Prepaid expenses     | (d) | Shown on the credit side of Trading A/c.  |

## MODULE - V

### Preparation of Financial Statements



### Notes

## MODULE - V

### Preparation of Financial Statements



Notes

## Financial Statements (With Adjustments)

### Illustration 1

From the following trial balance of M/s Kaushal Traders, prepare Trading and Profit and Loss Account for the year ended 31<sup>st</sup> March 2012 and a Balance Sheet as on that date :

Dr. Balances	₹	Cr. Balances	₹
Opening stock on 1st April, 2011	16,000	Capital	80,000
Purchases	75,000	Sales	2,00,000
Sales returns	5,000	Purchases returns	2,000
Carriage inwards	1,500	Discount	500
Plant and Machinery	40,000	Sundry creditors	10,000
Furniture and fixtures	5,000	Bills payable	1,500
Freehold property	45,650		
Cash in hand	5,000		
Carriage outwards	400		
Wages	30,000		
Salaries	18,000		
Lighting (factory)	800		
Sundry debtors	28,000		
Travelling expenses	1,200		
Rent and taxes	4,800		
Drawings	5,000		
Insurance	450		
General expenses	12,200		
	<b>2,94,000</b>		<b>2,94,000</b>

Adjustments :

- Stock on 31st March 2012 was valued at ₹ 38,000 (market value ₹ 20,000).
- Wages amounting to ₹ 2,000 and salaries amounting to ₹ 1,500 are outstanding.
- Prepaid insurance amounted to ₹ 150.
- Provide depreciation on plant and machinery at 5% and on furniture and fixtures at 10%.

### Solution

#### Trading and Profit and Loss Account for the year ending 31st March, 2012

Dr.		Cr.	
Particulars	Amount ₹	Particulars	Amount ₹
To Opening stock	16,000	By Sales	2,00,000
To Purchases	75,000	<i>Less</i> : Sales returns	<u>5,000</u>
<i>Less</i> : Purchases returns	<u>2,000</u>	By Closing stock	20,000 <sup>1</sup>
To Carriage inwards	1,500		
To Wages	30,000		
<i>Add</i> : Outstanding wages	<u>2,000</u>		
To Factory lighting	800		
To Gross profit c/d	91,700		
	<b>2,15,000</b>		<b>2,15,000</b>



## Financial Statements (With Adjustments)

To Carriage outwards	400	By Gross profit b/d	91,700
To Salaries 18,000		By Discount	500
Add : Outstanding salaries 1,500	19,500		
To Travelling expenses	1,200		
To Rent and taxes	4,800		
To Insurances 450			
Less : Prepaid insurance 150	300		
To General expenses	12,200		
To Depreciation on :			
Plant and machinery 2,000			
Furniture and fixtures 500	2,500		
To Net profit transferred to Capital A/c	51,300		
	<b>92,200</b>		<b>92,200</b>

### Balance Sheet as on 31st March 2012

Liabilities	Amount ₹	Assets	Amount ₹
Bills payable	1,500	Cash in hand	5,000
Sundry creditors	10,000	Sundry debtors	28,000
Outstanding wages	2,000	Closing stock	20,000 <sup>1</sup>
Outstanding salaries	1,500	Prepaid insurance	150
Capital 80,000		Furnitures and fixtures 5,000	
Add : Net profit 51,300		Less : Depreciation 500	4,500
	1,31,000	Plant and machinery 40,000	
Less : Drawings 5,000	1,26,300	Less : Depreciation 2,000	38,000
		Freehold property	45,650
	<b>1,41,300</b>		<b>1,41,300</b>

**Note :** (1) Closing stock is valued at cost price or market price whichever is less.

### Illustration 2

From the following trial Balance of M/s. Gupta Furnitures as on 31st December, 2012 you are required to prepare a Trading and Profit & Loss A/c for the year ended 31st Dec. 2012 and a Balance Sheet as at that date after making the necessary adjustments. Trial Balance of M/s. Gupta Furniture as at 31.12.2012.

Particulars	Dr (₹)	Cr. (₹)
Capital A/c of Mr. Gupta		80,000
Cash in hand	540	
Cash in bank	2,630	
Purchase A/c	43,120	
Sales A/c		78,100
Wages A/c	10,480	
Fuel and Power A/c	4,730	

## MODULE - V

### Preparation of Financial Statements



### Notes

## MODULE - V

### Preparation of Financial Statements



Notes

## Financial Statements (With Adjustments)

Carriage on Sales A/c	3,200	
Carriage on Purchase A/c	2,040	
Stock (on 1-1-2012)	5,760	
Land & Building A/c	40,000	
Machinery A/c	20,000	
Salaries A/c	15,000	
Insurance A/c	600	
Sundry Debtors A/c	20,000	
Sundry Creditors A/c		10,000
	<b>1,68,100</b>	<b>1,68,100</b>

Taking into consideration the following adjustments, make necessary journal entries and prepare final accounts.

- Stock on hand 31.12.2012 is ₹ 5,000
- Machinery is to be depreciated @ 10% p.a.
- Salaries for the month of December outstanding amounted to ₹ 3,500.
- Insurance prepaid for 3 months.

### Solution

2012	Adjusting Entries	(₹)	(₹)
Dec. 31	Closing stock A/c Dr. To Trading A/c (For closing stock taken into account)	5,000	5,000
Dec. 31	Depreciation A/c Dr. To Machinery (For depreciation charged on machinery @ 10%)	2,000	2,000
Dec. 31	Salaries A/c Dr. To Salaries Outstanding (For outstanding salaries provided for)	3,500	3,500
Dec. 31	Prepaid Insurance A/c Dr. To Insurance A/c (For prepaid insurance taken into account)	150	150

### Trading Account of M/s. Gupta Furnitures for the year ended on 31st Dec. 2012

Dr.		Cr.	
Particulars	Amount (₹)	Particulars	Amount (₹)
To Stock (1.1.12)	5,760	By Sales	78,100
To Purchases	43,120	By Stock (31.12.12)	5,000

## Financial Statements (With Adjustments)

To Wages	10,480		
To Fuel and Power	4,730		
To Carriage on Purchase	2,040		
To Gross Profit transferred to Profit & Loss A/c	16,970		
	<b>83,100</b>		<b>83,100</b>

## MODULE - V

### Preparation of Financial Statements



Notes

### Profit and Loss A/c for the year ended on 31st December, 2012

Particulars	Amount (₹)	Particulars	Amounts (₹)
To Carriage on Sales	3,200	By Gross Profit b/d	16,970
To Salaries 15,000		By Net Loss transferred to capital A/c of Mr. Gupta	7,180
Add : Outstanding 3,500	18,500		
To Insurance 600			
Less : Prepaid 150	450		
To Depreciation on Machinery	2,000		
	<b>24,150</b>		<b>24,150</b>

### Balance Sheet of M/s. Gupta Furnishers as on 31st December, 2012

Liabilities	Amount (₹)	Assets	Amount (₹)
Sundry Creditors	10,000	Cash in hand	540
Outstanding Salaries	3,500	Cash at bank	2,630
Capital A/c of Mr. Gupta 80,000		Sundry Debtors	20,000
Less : Net Loss 7,180	72,820	Closing Stock	5,000
		Prepaid Insurance	150
		Land and Building	40,000
		Machinery A/c 20,000	
		Less : Depreciation 2,000	18,000
	<b>86,320</b>		<b>86,320</b>

## MODULE - V

### Preparation of Financial Statements



Notes

## Financial Statements (With Adjustments)



### INTEXT QUESTIONS 15.3

#### I. Mention whether the following statements are True or False

- i. Financial statements prepared without considering adjustments do not reflect the correct financial positions of the business.
- ii. The accounting treatment of adjustments is done only in Balance Sheet.
- iii. The Accounting treatment of adjustment entry is done only in Trading Account or Profit & Loss Account.
- iv. Adjustments are always related to future.

#### II. Fill in the blanks

- i. Closing stock is shown on the ..... side of Balance sheet.
- ii. Outstanding Expenses are shown on the ..... side of Balance Sheet.
- iii. Prepaid expenses are shown on the ..... side of Balance sheet.
- iv. Depreciation is shown on the..... side of profit and loss A/c.
- v. Closing stock is shown on the asset side of.....
- vi. The decrease in the value of fixed asset due to their use is called.....
- vii. Adjustments are made to know the correct.....of a business.
- viii. Outstanding wages shown on the..... of the .....
- ix. Outstanding office Rent will be shown on the.....side of.....and ..... side of Balance sheet.
- x. Profit and Loss A/c is prepared to know .....of an accounting year.

#### III. Multiple Choice Questions

- i. When no adjustment is done for outstanding wages. Gross profit ascertained will be
 

a) more than the actual	b) less than the actual
c) equal to the actual	d) will not be affected
- ii. Prepaid expenses are expenses
 

a) paid in advance	b) outstanding expenses
c) expenses incurred for the current year	d) expenses paid for the previous year
- iii. Depreciation is debited to
 

a) Trading account	b) profit and loss account
c) concerned asset account	d) none of the above

## Financial Statements (With Adjustments)

- iv. An item of adjustment is shown
- only in trading account
  - only in profit and loss account
  - only in balance sheet
  - in trading account or P&L A/c and also in Balance Sheet



### WHAT YOU HAVE LEARNT

- Necessary adjustments are required at the time of preparation of financial statements in order to ascertain the correct profit and financial position of the business.
- Closing stock is the stock of goods which remains unsold at the end of an accounting year. Adjustment is done in Trading Account and Balance Sheet.
- Outstanding Expenses refer to the expenses relating to current year but which have not been paid during the current year. Adjustments is done in Trading Account, Profit and Loss Account and Balance Sheet.
- Prepaid Expenses or expense paid in advance refer to those expenses which relate to future year. Adjustments is done in trading account, profit & loss account and balance sheet.
- Depreciation on fixed Assets refers to Decrease in the value of fixed assets due to their use, wear and tear. Adjustment is done in profit and loss account and balance sheet.



### TERMINAL EXERCISE

- What is meant by an adjustment entry?
- Why is it necessary to pass adjusting entries in financial statements?
- Write short notes on :-
  - Outstanding Expenses
  - Prepaid Expenses
- Explain the following adjustments and their treatment in the financial statements : a) Closing Stock      b) Depreciation
- From the following trial balance of M/s Sakshi Garments. Prepare Trading & Profit and Loss Account for the year ending 31<sup>st</sup> March 2012 and Balance Sheet as on that date.

Particulars	Dr. (₹)	Particulars	Cr. (₹)
Stock (1.4.2011)	13,800	Capital	65,000
Purchases	52,000	Sales	74,400
Wages	4,000	Purchase return	1,500

## MODULE - V

### Preparation of Financial Statements



### Notes

**MODULE - V****Preparation of  
Financial Statements****Notes****Financial Statements (With Adjustments)**

Sales Returns	2,400	Discount	450
Land & Building	40,000	Creditors	6,500
Plant & Machinery	24,500	Interest	600
Debtors	5,250	Commission	700
Cash in hand & bank	8,750	Bank Loan	26,000
Office Rent	2,200		
Postage	400		
Insurance	1,500		
Freight	1,400		
Fuel & Power	2,450		
Furniture	4,500		
Motor Car	12,000		
	<b>1,75,150</b>		<b>1,75,150</b>

**Adjustments**

- i. Stock on 31.3.2012 ₹ 25,000
  - ii. Write off depreciation on furniture 10% and on Plant & Machinery 20%
  - iii. Wages outstanding amounted to ₹ 650 and rent outstanding was ₹200. Pre-paid insurance amounted to ₹ 300.
6. From the following particulars for the year ending 31.3.2012 of M/s Pant. Bros. prepare Trading Account, Profit & Loss Account and a Balance Sheet as on 31.3.2012

Particulars	Dr. (₹)	Particulars	Cr. (₹)
Capital	4,00,000	Salaries	1,20,000
Opening Stock	85,000	Rent & Taxes	40,000
Purchases	4,20,000	Postage & Telegrams	25,000
Creditors	75,000	Interest Paid	20,000
Debtors	1,20,000	Furniture	2,00,000
Sales	8,10,000	Insurance	1,00,000
Discount received	18,000	Freight	20,000
Discount allowed	16,000	Cash in hand	50,000
Purchases Returns	20,000	Cash at bank	47,000
Sales Returns	10,000	Motor car	50,000

**Adjustments**

1. Closing stock valued as on 31.3.2012 ₹ 1,70,000
2. Salaries outstanding ₹ 12,000
3. Charge depreciation on Motor Car @ 10% P.A.

## Financial Statements (With Adjustments)

7. From the following information of M/s Bhanumati Traders you are required to prepare Trading Account, Profit & Loss Account and Balance Sheet as on 31<sup>st</sup> March 2012.

Particulars	(₹)	Particulars	(₹)
Capital	2,00,000	Stock on 1-4-11	62,000
Drawings	10,000	Purchases	1,40,000
Plant & Machinery	1,00,000	Sales	2,30,000
Salaries	14,000	Purchases Returns	2,600
Printing & Stationery	2,000	Sales Returns	4,200
Discount Allowed	1,500	Freight	1,200
Debtors	25,000	Cash in hand	32,000
Creditors	40,000	Cash at bank	50,000
Insurance	3,000	Land & Building	50,000
Postage	600		
Office Rent	2,600		

### Adjustments

Outstanding wages as on 31 March 2012 - ₹ 2,500

Outstanding Salaries ₹ 700

Prepaid Insurance ₹ 400

Closing stock ₹ 44,000

8. From the following information received from the books of Mr. Sahil on 31.3.2012, you are required to prepare the Trading Account & Profit & Loss Account for the year ending 31.3.2012 and a Balance Sheet as on 31.3.2012

Particulars	(₹)	Particulars	(₹)
Opening Stock	37,000	Capital	1,62,000
Purchases	93,500	Drawings	1,60,000
Wages	28,000	Discount received	1,600
Sales	2,49,000	Sundry Creditors	43,000
Salaries	11,000	Loan	30,000
Rent	5,500	Cash in hand	37,300
Interest Paid	2,700	Cash at bank	37,300
Discount Allowed	2,400	Debtors	86,000
Postage & Telegram	2,000	Furniture	21,400
Printing & Stationery	1,800	Motor Car	20,000
Sales Expenses	2,200	Building	60,000
Insurance Premium	5,500	Plant & Machinery	16,000

## MODULE - V

### Preparation of Financial Statements



### Notes

**MODULE - V****Preparation of  
Financial Statements****Notes****Financial Statements (With Adjustments)****Adjustments**

- i. Closing stock was valued at ₹ 30,000
- ii. Depreciate
  - (a) Building by 5% p.a.
  - (b) Furniture – 10% p.a.
  - (c) Land & Building – 15% p.a.
  - (d) Motor Car – 20% p.a.
- iii. Rent outstanding ₹1,500
- iv. Prepaid Insurance ₹ 300

**ANSWER TO INTEXT QUESTIONS**

**15.1** (i) closing stock (ii) outstanding expenses  
(iii) closing stock (iv) adjustments

**15.2** (i) d (ii) c (iii) a (iv) b

**15.3 I.** (i) True (ii) False (iii) False (iv) False

**II.** (i) asset (ii) Liability (iii) Asset (iv) Debit  
(v) Balance Sheet (vi) Depreciation  
(vii) Financial position (viii) Liability side, Balance Sheet  
(ix) Debit side Trading A/c, Liability  
(x) Profit or Losses

**III.** (i) a (ii) a (iii) a (iv) d

**ACTIVITY FOR YOU**

- Assuming that your father is a businessmen, running a small shop as a sole proprietor and maintains the accounts of the business of his own. As a student of Accountancy one day you came to know that no adjustment entry was done by your father while preparing final accounts of his business. You are required to reprepare the final accounts by passing necessary adjustment entries in your father business books of account.



## MODULE - VI

Maximum Marks

9

Hours of Studies

18

### Computer in Accounting

This module will enable the learners to understand the meaning and characteristics of a computer with its components and limitations. It also emphasises on use of computers in Accounting. It will also make you to learn the difference between manual accounting and computerised accounting. One should be able to know the basic requirements of computerised accounting. Once you are able to know the use and importance of computers in accounting you must understand the meaning, features and important steps for starting Tally ERP 9.0, together with how to create a company in Tally.

**Lesson 16** : **Computers in Accounting**  
**Lesson 17** : **Introduction to Tally**

## Awards Won by NIOS



**Web Ratna Awards 2012 Platinum Icon under Outstanding Web Content** for Acknowledging exemplary initiatives/practices in the realm of e-Governance for dissemination of information & services instituted by Department of Information Technology, Ministry of Communications & IT (MC&IT) and National Informatic Centre (NIC), Government of India. The award has been conferred by Hon'ble Minister of Communications and Information Technology Shri Kapil Sibal on 10th December 2012 at Dr. D.S Kothari Auditorium, DRDO Bhawan, Dalhousie Road, New Delhi.

### TOI Social Impact Award 2012

NIOS has been selected as winner of the Social Impact Award 2012 instituted by Times of India in partnership with J P Morgan. The Award is given in the recognition of magnificent work done by an individual or groups or institutions making an impact in the society in various segment including Education. NIOS feels honoured to accept the award.



The award was conferred on 28th January 2013 at a function in presence of President of India and high level dignitaries.

### National Awards for the Empowerment of Persons with Disabilities, 2012



The NIOS received the National Award for the Empowerment of persons with disabilities, 2012 Instituted by Ministry Social Justice and Empowerment, Govt. of India. The NIOS got this award under the category of best accessible Website for making its website [www.nios.ac.in](http://www.nios.ac.in) completely accessible for person with disabilities. The website is bilingual in Hindi and English. It also has provisions of Screen Reader, increasing text size, colour contrast scheme etc. for disabled learners. This award was conferred by the Hon'ble President of India at Vigyan Bhawan, New Delhi on 6th February, 2013. Dr. S.S. Jena Chairman, NIOS received the award.

## 16

## COMPUTERS IN ACCOUNTING

With the expansion of business, the number of transactions have increased and as a result the manual method of keeping and maintaining records has become unmanageable. With the introduction of computers in business, the manual method of accounting is being gradually replaced. The database technology has revolutionized the accounts department of the business enterprises. In this lesson, we will study about the features of a computer, role of computers in accounting, need of computerized accounting, etc.



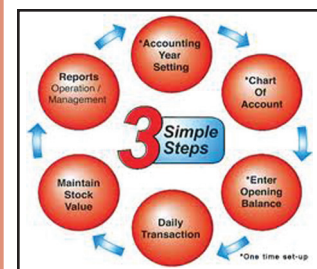
## OBJECTIVES

After studying this lesson, you will be able to:

- state the meaning and characteristics of a computer;
- describe the components of a computer;
- explain the limitations of a computer;
- explain the role of computers in accounting;
- differentiate between manual accounting and computerized accounting;
- state the need for computerized accounting and
- describe the basic requirements of computerized accounting.

## 16.1 COMPUTER AND ITS CHARACTERISTICS

Computer is an electronic device that can perform a variety of operations in accordance with a set of instructions called programme. It is a fast data processing electronic machine. It can provide solutions to all complicated situations. It accepts data from the user, converts the data into information and gives the desired result. Therefore, we may define computer as a device that transforms data into information. Data can be anything like marks obtained in various subjects. It can also be name, age, sex, weight, height, etc. of all the students, savings, investments, etc., of a country. Computer is defined in terms of its functions. Computer is a device that accepts data, stores data, processes data as desired, retrieves the stored data as and when required and prints the result in desired format.



## MODULE - VI

### Computer in Accounting



#### Notes

## Computers in Accounting

### Characteristics of Computer

A computer is better than human being in various aspects and it possesses some characteristics, which are as follows:

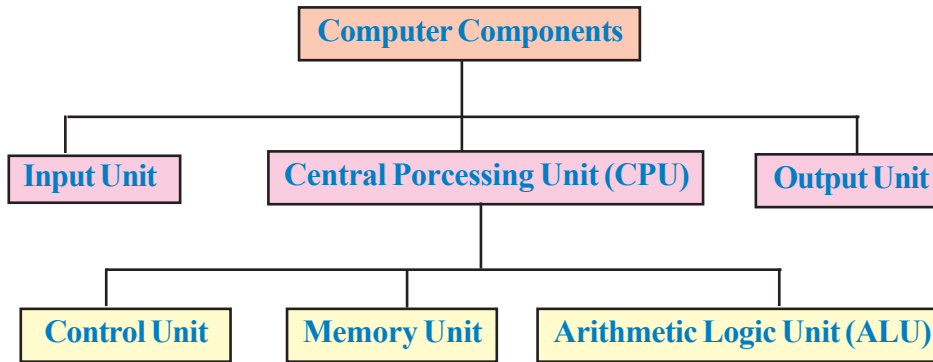
- i) **Speed** : It can access and process data millions times faster than humans can. It can store data and information in its memory, process them and produce the desired results. It is used essentially as a data processor. All the computer operations are caused by electrical pulses and travels at the speed of light. Most of the modern computers are capable of performing 100 million calculations per second.
- ii) **Storage** : Computers have very large storage capacity. They have the capability of storing vast amount of data or information. Computers have huge capacity to store data in a very small physical space. Apart from storing information, today's computers are also capable of storing pictures and sound in digital form.
- iii) **Accuracy** : The accuracy of computer is very high and every calculation is performed with the same accuracy. Errors occur because of human beings rather than technological weakness; main sources of errors are wrong program by the user or inaccurate data.
- iv) **Diligence** : A computer is free from tiredness and lack of concentration. Even if it has to do 10 million calculations, it will do even the last one with the same accuracy and speed as the first.
- v) **Versatility** : Computer can perform wide range of jobs with speed, accuracy, and diligence. In any organization, often it is the same computer that is used for diverse purposes such as accounting, playing games, preparing electric bills, sending e-mails and so on.
- vi) **Communication** : Computers are being used as powerful communication tools. All the computers within an office are connected by cable and it is possible to communicate with others in the office through the network of computers.
- vii) **Processing Power** : Computer has come a long way today. They began as mere prototypes at research laboratories and went on to help the business enterprises, and today, their reach is so extensive that they are used almost everywhere. In the course of this evolution, they have become faster, smaller, cheaper, more reliable and user friendly.

### 16.2 COMPONENTS OF A COMPUTER

A computer consists of three major components i.e., Input Unit, central Processing Unit and Output Unit. Diagrammatically, these components may be presented as follows:



Notes



### Input Unit

Input unit is controlling the various input devices which are used for entering data into the computer. The mostly used input devices are keyboard, mouse and scanner. Other such devices are magnetic tape, magnetic disk, light pen, bar code reader, smart card reader, etc. Besides, there are other devices which respond to voice and physical touch for e.g. Physical touch system is installed at airport for obtaining the online information about departure and arrival of flight. The input unit is responsible for taking input and converting it into binary system.

### Central Processing Unit (CPU)

The CPU is the control centre for a computer. It guides, directs and governs its performance. It is the brain of the computer. The main unit inside the computer is the Central Processing Unit. This is used to store program, photos, graphics, and data and obey the instructions in program. It is divided into three sub units: i) Control Unit ii) Memory Unit and iii) Arithmetic Logic Unit (ALU).

- i) **Control Unit** : Control Unit controls and co-ordinates the activities of all the components of the computer.
- ii) **Memory Unit** : This unit stores data before being actually processed. The data so stored is accessed and processed according to instruction which are also stored in the memory section of computer well before such data is transmitted to the memory from input devices.
- iii) **Arithmetic and Logic Unit** : It is responsible for performing all the arithmetical calculations and computations such as addition, subtraction, division and multiplication. It also performs logical functions involving comparisons among variable and data items.

### Output Unit

After processing the data, it ensures the convertibility of output into human readable form that is understandable by the user. The commonly used output devices include monitor, plotter, printer, speaker, etc.



## MODULE - VI

### Computer in Accounting



Notes

## Computers in Accounting



### INTEXT QUESTIONS 16.1

#### Fill in the blanks with correct word/words

- i. Computer is a fast data \_\_\_\_\_ electronic machine.
- ii. All the computer operations are caused by \_\_\_\_\_ pulses and travels at the speed of light.
- iii. A computer is free from \_\_\_\_\_ and lack of concentration.
- iv. Computers are being used as powerful \_\_\_\_\_ tools.
- v. The mostly used input devices are keyboard, \_\_\_\_\_ and scanner.
- vi. Central Processing Unit is to computer, as the \_\_\_\_\_ is to human body
- vii. The commonly used output devices include \_\_\_\_\_ printer etc.

### 16.3 LIMITATIONS OF A COMPUTER

The limitations of computer are due to the operating environment they work in. These limitations are given as below :

- i) **High Cost of Installation :** Computer hardware and software need to be updated from time to time with availability of new versions. As a result heavy cost is incurred to purchase a new hardware and software every time there is a change in the existing version.
- ii) **High Cost of Training :** To ensure efficient use of computers in accounting, new versions of hardware and software are introduced. This requires training and cost is incurred to train the personnel.
- iii) **Self Decision Making Not Possible :** The computer cannot make a decision like human beings. It is to be guided by the user, and work only the way it is programmed to function.
- iv) **Costly Maintenance :** Computers require to be maintained properly to help maintain its efficiency. It requires a neat, clean and controlled temperature to work efficiently which results into costly maintenance.
- v) **Dangers for Health :** Extensive use of computer may lead to many health problems such as muscular pain, eyestrain, and backache, etc. This affects adversely the working efficiency and increasing medical expenditure.

### 16.4 APPLICATIONS OF COMPUTER IN ACCOUNTING

The most popular system of recording of accounting transaction is manual which requires maintaining books of accounts such as Journal, Cash Book, Special purpose books, Ledger and so on. The accountant is required to prepare summary of transactions and financial statements manually. The advance technology involves various machines capable of performing different



## Computers in Accounting

accounting functions, for example, a billing machine known as computer. This machine is capable of computing discount, adding net total and posting the requisite data to the relevant accounts.

With substantial increase in the number of transactions, a machine was developed which could store and process accounting data in no time. Such advancement leads into the growth of successful enterprises. A newer version of machine is evolved with increased speed, storage, and processing capacity. A computer to which these were connected operated these machines. As a result, the maintenance of accounting records become more convenient with the computerized accounting.

The computerized accounting uses the concept of databases. For this purpose an accounting software is used to implement a computerized accounting system. It does away the necessity to create and maintain journals, ledgers, etc., which are essential part of manual accounting. Some of the commonly used accounting softwares are Tally, Cash Manager, Best Books, Busy, etc.

Accounting software is used to implement computerized accounting. The computerized accounting is based on the concept of database. It is basic software which allowed access to the data contained in the data base. It is a system to manage collection of data ensuring at the same time that it remains reliable and confidential.

Following are the applications of computers in accounting:

- i) **Preparation of accounting documents :** Computer helps in preparing accounting documents like Cash memo, Bills, and Invoices etc., and preparing accounting vouchers.
- ii) **Recording of transactions :** Everyday business transactions are recorded with the help of computer software. Logical scheme is implied for codification of accounts and transaction. Every account and transaction is assigned a unique code which put that account in a particular group. This process simplifies the work of recording the transactions.
- iii) **Preparation of Trial Balance and Financial Statements :** After recording of transaction, the data is transferred into ledger accounts automatically by the computer. Trial balance is prepared by the computer to check accuracy of the records. With the help of the trial balance the computer can be programmed to prepare Trading and Profit and Loss Account and Balance Sheet.

## 16.5 COMPUTERIZED ACCOUNTING

Transaction processing system (TPS) is the first stage of computerized accounting system. The purpose of any TPS is to record, process, validate and store transaction that occur in various functional areas of a business for subsequent retrieval and

## MODULE - VI

### Computer in Accounting



### Notes



## MODULE - VI

### Computer in Accounting



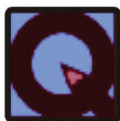
#### Notes

## Computers in Accounting

usage. TPS involves following steps in processing a transaction: Data Entry, Data Validation, Processing and Revalidation, Storage, Information and Reporting. It is one of the transaction processing systems which is concerned with financial transactions only. When a system contains only human resources it is called manual system; when it uses only computer resources, it is called computerized system and when it uses both human and computer resources, it is called computer-based system. These steps can be explained with an example making use of automatic Teller Machine (ATM) facility by a Bank-customer.

- i) **Data Entry :** Processing presumes data entry. A bank customer operates an ATM facility to make a withdrawal. The actions taken by the customer constitute data which is processed after validation by the computerized personal banking system.
- ii) **Data Validation :** It ensures the accuracy and reliability of input data by comparing the same with some predefined standards or known data. This validation is made by the 'Error Detection' and 'Error Correction' procedures. The control mechanism, wherein actual input data is compared with predetermined norms is meant to detect errors while error correction procedures make suggestions for entering correct data input. The Personal Identification Number (PIN) of the customer is validated with the known data. If it is incorrect, a suggestion is made to indicate the PIN is invalid. Once the PIN is validated, the amount of withdrawal being made is also checked to ensure that it does not exceed a pre-specified limit of withdrawal.
- iii) **Processing and Revalidation :** The processing of data occurs almost instantaneously in case of Online Transaction Processing (OLTP) provided a valid data has been fed to the system. This is called check input validity. Revalidation occurs to ensure that the transaction in terms of delivery of money by ATM has been duly completed. This is called check output validity.
- iv) **Storage :** Processed actions, as described above, result into financial transaction data i.e. withdrawal of money by a particular customer, are stored in transaction database of computerized personal banking system. This makes it absolutely clear that only valid transactions are stored in the database.
- v) **Information :** The stored data is processed making use of the Query facility to produce desired information.
- vi) **Reporting :** Reports can be prepared on the basis of the required information content according to the decision usefulness of the report.





## INTEXT QUESTIONS 16.2

Fill in the blanks with correct word/words:

1. Computer hardware and \_\_\_\_\_ need to be updated from time to time.
2. The \_\_\_\_\_ cannot make a decision itself like human beings.
3. \_\_\_\_\_ requires a neat, clean and controlled temperature to work efficiently.
4. The most popular system of recording of accounting transactions is \_\_\_\_\_.
5. The computerized accounting uses the concept of \_\_\_\_\_.
6. Accounting \_\_\_\_\_ is used to implement a computerized accounting.

### 16.6 NEED AND REQUIREMENTS OF COMPUTERIZED ACCOUNTING

The need for computerized accounting arises from advantages of speed, accuracy and lower cost of handling the business transactions. These have been explained below:

- i) **Numerous transactions** : The computerized accounting system is capable of handling large number of transactions with speed and accuracy.
- ii) **Instant reporting** : The computerized accounting system is capable of offering quick and quality reporting because of its speed and accuracy.
- iii) **Reduction in paper work** : A manual accounting system requires large physical storage space to keep accounting records/books and vouchers/documents. The requirements of stationary and books of accounts along with vouchers and documents is directly dependent on the volume of transactions beyond a certain point. There is a need to reduce the paper work and dispense with large volume of books of accounts. This can be achieved by introducing computerized accounting system.
- iv) **Flexible reporting** : The reporting is flexible in computerized accounting system as compared to manual accounting system. The reports of a manual accounting system reveal balances of accounts on periodic basis while computerized accounting system is capable of generating reports of any balance as and when required and for any duration which is within the accounting period.
- v) **On-line facility** : Computerized accounting system offers online facility to store and process transaction data so as to retrieve information to generate and view financial reports.
- vi) **Scalability** : Computerized accounting systems are fully equipped with handling the growing transactions of a fast growing business enterprise. The requirement of additional manpower in Accounts department is



Notes

## MODULE - VI

### Computer in Accounting



#### Notes



## Computers in Accounting

restricted to only the data operators for storing additional vouchers. There is absolutely no additional cost of processing additional transaction data.

- vii) **Accuracy :** The information content of reports generated by the computerized accounting system is accurate and therefore quite reliable for decision making. In a manual accounting system the reports and information are likely to be distorted, inaccurate and therefore cannot be relied upon. It is so because by many people, especially when the number of transactions to be processed to produce such information and report is quite large.
- viii) **Security :** Under manual accounting system it is very difficult to secure such information because it is open to inspection by any one dealing with the books of accounts. However, in computerized accounting system only the authorized users are permitted to have access to accounting data. Security provided by the computerized accounting system is far superior compared to any security offered by the manual accounting system.

### 16.7 BASIC REQUIREMENTS OF THE COMPUTERIZED ACCOUNTING SYSTEM

The basic requirements of any computerized accounting system are the following:-

- i) **Accounting framework :** It is the application environment of the computerized accounting system. A healthy accounting framework in terms of accounting principles, coding and grouping structure is a pre-condition for any computerized accounting system.
- ii) **Operating procedure :** A well-conceived and designed operating procedure blended with suitable operating environment of the enterprise is necessary to work with the computerized accounting system. The computerized accounting is one of the database-oriented applications wherein the transaction data is stored in well-organized database. The user operates on such database using the required interface and also takes the required reports by suitable transformations of stored data into information.

### 16.8 DIFFERENCE BETWEEN MANUAL ACCOUNTING AND COMPUTERIZED ACCOUNTING

Basis	Manual Accounting	Computerized Accounting
1. Recording	Recording of financial transactions is through books of original entry.	Data content of these transactions is stored in well designed data base.

## Computers in Accounting

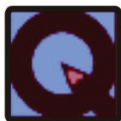
2. Classification	Transactions recorded in the books of original entry are further classified by posting them into ledger accounts.	No such data duplications is made. In order to produce ledger accounts the stored transaction data is processed to appear as classified so that same is presented in the form of report.
3. Summarising	Transactions are summarized to produce trial balance by ascertaining the balances of various accounts.	The generation of ledger accounts is not a necessary condition for preparation of Trial Balance.
4. Adjusting	Adjusting entries are made to adhere to the principle of matching.	There is nothing like making adjusting entries for errors and rectifications.
5. Financial Statements	The preparation of financial statements assumes availability of trial balance.	The preparation of financial statements is independent of producing the trial balance.

## MODULE - VI

### Computer in Accounting



### Notes



## INTEXT QUESTIONS 16.3

### I. Fill in the blanks with correct word/words :

- i. In a manual accounting system, transactions recorded in the books of \_\_\_\_\_.
- ii. The generation of ledger accounts is not a necessary condition for making \_\_\_\_\_ in a computerized accounting system.
- iii. The computerized accounting system is capable of handling \_\_\_\_\_ of transactions.
- iv. The \_\_\_\_\_ accounting system is capable of offering quick and quality reporting.
- v. Computerized accounting system offers \_\_\_\_\_ facility to store transaction data.
- vi. Computerized accounting system is \_\_\_\_\_ to the manual accounting system.
- vii. The computerized accounting is one of the \_\_\_\_\_ oriented applications.

### II. Multiple Choice Questions

- i. Which one is not the characteristic of computer?
  - a) Speed
  - b) Artificial Intelligence
  - c) Storage
  - d) Versality

**MODULE - VI****Computer in  
Accounting****Notes****Computers in Accounting**

- ii. Central Processing Unit (CPU) does not include
  - a) Control Unit
  - b) Memory Unit
  - c) Arithmetic Logic Unit
  - d) Output Unit
- iii. The main limitation of computer is
  - a) Speed
  - b) Storage
  - c) Self decision making not possible
  - d) versatility
- iv. Commonly accounting software is
  - a) Tally
  - b) Window
  - c) Easy Books
  - d) Credit Manager
- v. Which one is not the basic requirements of Computerized Accounting System?
  - a) Accounting framework
  - b) Operating Procedure
  - c) Well Organised database
  - d) Bank account

**WHAT YOU HAVE LEARNT**

- Computer is an electronic device that can perform a variety of operations in accordance with a set of instructions called programme. It is a fast data processing electronic machine. It can provide solutions to all complicated situations.
- Characteristics of Computer : Speed, storage, accuracy, diligence, versatility, communication, processing, power
- Components of Computer : Input Unit, Central Processing Unit, Output Unit, Control Unit, Memory, Arithmetic Unit and Logic Unit
- Limitations of a Computer : Cost of maintenance, installation, training, dangers for health, self-decision making not possible
- Computerized Accounting : Transaction Processing System (TPS) is the first stage of computerized accounting system.
- Need for computerized accounting : Numerous, instant reductions, flexible, online, accuracy, security, transactions reporting in paper, reporting facility.
- Difference between manual accounting and computerized accounting on the basis of recording, classification, summarizing, adjusting and financial statement

**TERMINAL EXERCISE**

1. What is meant by a Computer?
2. State the characteristics of a Computer.
3. Explain the components of computer.

## Computers in Accounting

4. Explain the limitations of a computer.
5. Explain the role of computers in accounting.
6. Differentiate between manual accounting and computerized accounting system.
7. Enumerate the basic requirements of any computerized accounting system.
8. Briefly explain the applications of computerized accounting.
9. Describe the stages of transaction processing system.
10. Why is computerized accounting needed? Explain.



### ANSWER TO INTEXT QUESTIONS

- 16.1** (i) Processing (ii) Electrical (iii) Tiredness (iv) Communication  
(v) Mouse (vi) Brain (vii) Monitor
- 16.2** (i) Software (ii) Computer (iii) Computer (iv) Manual  
(v) Databases (vi) Software
- 16.3 I.** (i) Original entry (ii) Trial balance (iii) Large number  
(iv) Computerized (v) Online (vi) Superior  
(vii) Database
- II.** (i) b (ii) d (iii) c (iv) a (v) d

### ACTIVITY FOR YOU

- Visit a shop or business organisation near your residence where computer are used to maintain accounts and note ten points as benefits of using computers in accounting than manual accounting.

## MODULE - VI

### Computer in Accounting

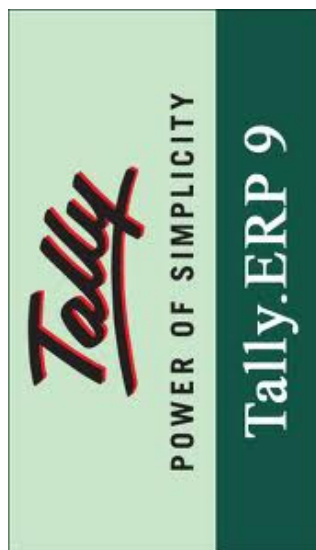


### Notes

**MODULE - VI***Computer in  
Accounting*

Notes

17

**INTRODUCTION TO TALLY**

As we discussed earlier how we maintain the accounts in Double Entry System. But all of us know that if there is some difference in the Trial Balance than we have to consume so much time and energy to find out that reason of difference. Tally is the solution of all those problems. In Tally as we enter the transaction, that transaction is duly posted in ledger and also enters in the trial balance. That transaction is duly recorded in Trading & Profit and Loss A/c and Balance Sheet also. If we want to see the Trial Balance or Balance Sheet after some transactions than we have to click only some keys. So we can say that Tally solve our so many problems.

Tally is a financial accounting software package designed by Tally Solutions mainly for small and medium businesses and shops. Tally Software is used by over 2 million users, in 90 countries. Tally ERP 9.0 is the latest version to date. Tally is a complete business accounting and inventory management software that provides various facilities like Govt. supported formats, multilingual operations, online functions and processing for small and medium business.

**OBJECTIVES**

**After studying this lesson you will be able to :**

- state the meaning of Tally;
- features of Tally;
- important steps for starting Tally;
- getting started with Tally;
- important steps to open Tally;
- how to create a company;
- what is company Info;
- short-cut Keys.

**17.1 MEANING OF TALLY**

Tally is accounting software that is designed to integrate and automate all your business transactions. Every business has various processes which can range from simple to complex. As your business grows, acquires new customers, and enters new markets, you need to maintain highly accurate and up-to-date accounting and inventory records.

## Introduction to Tally

Accounting software, such as tally helps you to simplify, integrate, and streamline all your business transactions in an easy and cost-effective manner. Tally ERP 9 is the latest version of Tally, which comes in various enhancements to make handling and processing of business transactions even easier and quicker. It can handle the accounts of more than one company simultaneously. It is very simple to use and allows you to enter data in various formats. In addition, you can view information of any period, compare data across companies and financial periods, maintain account details and generate reports.

### 17.2 FEATURES OF TALLY

Main features of Tally are as under:-

- i) It maintains all the primary books of accounts, like Cash Book and Bank Book.
- ii) Tally maintains all registers like Purchase Register, Sales Register and Journal Registers.
- iii) Tally maintains all statement of accounts like Balance Sheet, Profit and Loss A/c and Trial Balance, Cash Flow(In cash flow statement we see the flow of cash i.e. the inflow and outflow of the cash) Stock Statement(In stock statement we maintain the proper record of all inventory) and Ratio Analysis.
- iv) A Tally can maintain 'Outstation Reports'.
- v) It may provide complete bill-wise information of amounts receivable as well as payable either party-wise or group-wise.
- vi) It can provide a report for a particular date or reports for any range of dates.
- vii) It provides the facility of Bank Reconciliation.



### INTEXT QUESTIONS 17.1

State the following sentences True or False:

- i. Tally is an accounting hardware.
- ii. We can also maintain the record of inventory in Tally.
- iii. There is no provision of 'outstation Report' in Tally.
- iv. Tally provides the facility of Bank Reconciliation.
- v. Tally maintains all the primary books of accounts.
- vi. Tally provides a report for a particular date.

## MODULE - VI

### Computer in Accounting



### Notes





## MODULE - VI

### Computer in Accounting



#### Notes



## Introduction to Tally

### 17.3 GETTING STARTED WITH TALLY

First of all we have to install a Tally.ERP 9 by default in which program files required to run Tally are saved. The user can specify the location of the data directory to save these files and install the program file on any drive. It does not take more than a minute to install Tally.ERP 9 on the local hard disk and uses up only about 40 MB of space.

Following is the list of basic hardware requirements to run Tally.ERP 9 on a computer system:-

Hardware Requirement	Configuration
Processor	Intel Pentium IV or Higher
Memory	256 MB RAM or more
Free Hard Disk	Space 40 MB minimum (excluding the data)
Monitor Resolution	Recommended 1024*768 pixels or higher

In order to install Tally.ERP 9 on a computer, you must have sufficient user-rights so that you can make necessary changes during the installation process. Also, ensure that the operating system you employ supports Tally.ERP 9 FOR MULTILINGUAL support.

### 17.4 IMPORTANT STEPS TO OPEN A TALLY

Perform the following steps to open Tally.ERP 9:

- i) Click the Start button on the **taskbar**. A Start menu appears.
- ii) Move the mouse-pointer over the All Programs option in the start menu.
- iii) Move the mouse-pointer over the Tally.ERP 9 folder and click it.
- iv) Move the mouse-pointer over the Tally.ERP 9 option and click it.

The Tally.ERP 9 window opens on your screen.

### 17.5 CREATE COMPANY

After installing Tally, the first task you need to carry out is to create a company. In Tally, the first term company signifies an entity for which an independent set of accounts is maintained. It may be a company, a partnership firm, an industry, or even a branch office for which a set of accounts is maintained.

So, let's now learn to create a company in Tally.

On the home page of Tally screen 'Create Company' option is available under the title 'Company Info'.



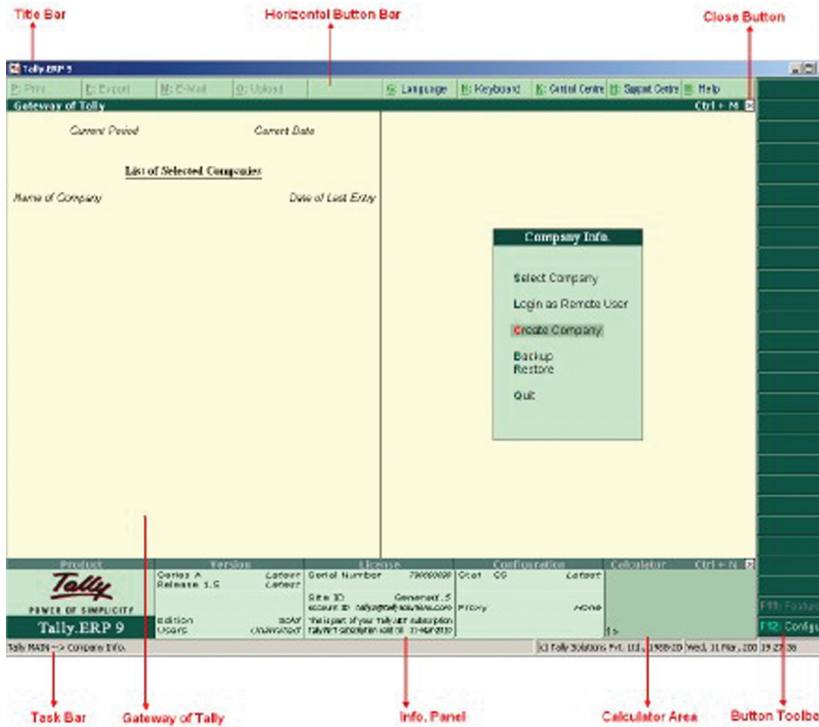
# Introduction to Tally

## MODULE - VI

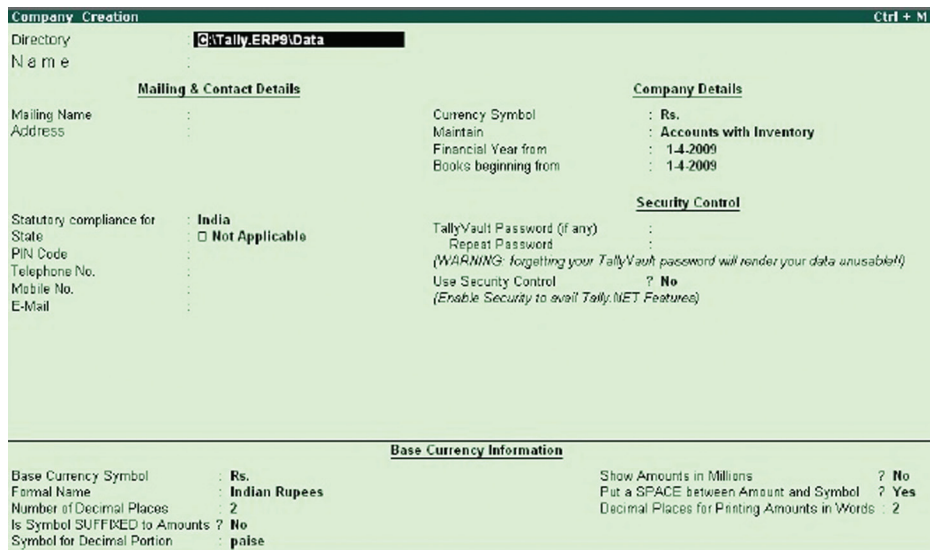
### Computer in Accounting



#### Notes



When you click at ‘Create Company’ option, a following window will appear with various items on the screen.



Some important ones are discussed below:-

**Name :** Type the name of the company you want to create.

**Mailing Name :** The mailing name by default is the same as the name mentioned above. You can type some other mailing name of the company.

**Address :** Type mailing address of the company. There is no limit on the number of lines used.

## MODULE - VI

### Computer in Accounting



#### Notes

## Introduction to Tally

**Maintain :** In Tally, accounts can be maintained in a two different ways:-

- Accounts Only
- Accounts with inventory.

In Accounts you can maintain Accounts only; there is no record of inventory. In second option we record all Accounts with all inventories.

**Use Security Control :** This option provides security control to your company accounts by offering a comprehensive password based access control

After filing all the required information press enter. A new window will appear asking for confirmation.

Accept?

‘YES’/ NO

After press OK or ENTER KEY your Company will be created.

### 17.7 COMPANY INFO

Once you get your company created, the heading ‘Company Info’ has a content of some new options. These options are as follows:-

- **Select Company :** This option permits you to load any company, which was created earlier, from the list of companies listed.
- **Shut Company :** It allows you to exit, from the companies not in use, from the dialog box.
- **Create Company :** (same as done above under same heading).
- **Alter :** It allows you to change the information of an existing company, filled at the time of creation of company.
- **Change Tally Vault :** To change the password, given earlier at the time of creating the company.
- **Split Company Data :** Split the companies to form two companies out of the existing one; after the data specified by the user. In this process the closing balance of the first company will become the opening balance of the second company.
- **Backup/Restore :** This option allows the user to take a backup either on local hard disk or on any external media. The backup of one or more companies can be taken under a single directory.

### 17.8 SHORT-CUT KEYS

In Tally there are so many short-cut keys. By using those keys we can save our time.

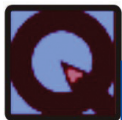
Uses of some keys are as follows:-

- F1** : For Select and Shut Companies  
**F2** : For Date and Period

## Introduction to Tally

- F 3** : For Company and Company Info  
**F 11** : Features  
**F 12** : Configure

After creating a company in Tally, we can start the work in our company by IST prepare the accounts. Thereafter you have to classify the nature of account. You have to create all accounts either they are personal or impersonal. In Tally we have to pass only voucher entry. The Trial Balance, Trading and P&L a/c and Balance Sheet will be automatically done. We can see the Trial Balance and Balance Sheet whenever required.



### INTEXT QUESTIONS 17.2

#### Multiple Choice Questions

- If we want to change the company profile than what command
  - Alter command
  - Edit command
  - Change command
  - Create Company
- For go on Features which short cut key will you use
  - F 1
  - F 12
  - F 11
  - F 3
- Which short cut key we will use for configure?
  - F 3
  - F 1
  - F 11
  - F 12
- What short cut key we would use for Select and Shut Company?
  - F 1
  - F 2
  - F 3
  - F 12
- What short cut key we would use for Date and Period?
  - F 1
  - F 2
  - F 3
  - F 11



### WHAT YOU HAVE LEARNT

- Tally is a financial accounting software package designed by Tally Solutions mainly for small and medium businesses and shops. Tally Software is used by over 2 million users, in 90 countries.
- Tally maintains all statement of accounts like Balance Sheet, Profit and Loss A/c and Trial Balance, Cash Flow, Stock Statement and Ratio Analysis.
- It can provide a report for a particular date or reports for any range of dates. First of all we have to install a Tally.ERP 9 by default in which program files required to run Tally are saved. The user can specify the location of the data directory to save these files and install the program file on any drive. After installing Tally, the first task you need to carry out is to create a company. In Tally, the first term company signifies an entity for which an independent set of accounts is maintained.

## MODULE - VI

### Computer in Accounting



#### Notes

**MODULE - VI****Computer in  
Accounting****Notes****Introduction to Tally**

- Uses of some important keys are as follows: - F 1, F 2, F 3, F 11 and F 12.

**TERMINAL EXERCISE**

1. Define Tally.
2. What do you mean by Tally ERP 9?
3. Write any four features of Tally.
4. What are the basic hardware requirements configuration of Tally ERP 9?
5. Explain in detail as how the company is created in Tally.

**ANSWER TO INTEXT QUESTIONS**

**17.1** (i) False (ii) True (iii) False (iv) True (v) True (vi) True

**17.2** (i) b (ii) c (iii) d (iv) a (v) b

**ACTIVITY FOR YOU**

- Using a tally software create a company and pass 10 entries from previous chapters of your learning material and try to have practice on it to get perfection.

# CURRICULUM ACCOUNTANCY (SECONDARY COURSE)

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## 1. Rationale

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Today's business environment is very complex but at the same time the growth and development through business, profession and vocational activities have made our lives very comfortable. Recording, grouping and analyzing of monetary transactions for both business and non-business have become very significant. As a result of this growth and development. Accountancy as an optional elective subject has become a main part of curriculum for students at Secondary and Senior Secondary level since the switching over of the school system from Higher Secondary to 10+2 system.

NIOS already imparting education offers Accountancy as an optional elective subject at Senior Secondary level but not at Secondary level. Now, a new subject titled as 'Accountancy' is being offered to the students of NIOS at the Secondary level. Accountancy being the language of business to knowledge at Secondary level has become significant. Its knowledge empowers; the learners in recording, group and analyzing the business transactions, so that quick and correct business decisions could be taken. The elementary knowledge of accountancy at Secondary level will enable the learners to understand, the complexities of the subject. And to deal with the situations of the present days accounting.

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## 2. Objectives

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The broader objectives of teaching Accountancy at Secondary level are to enable the learners to:

- to understanding the meaning, objectives, advantages, term used and basic concepts and connections of Accountancy;
- to develop the skill of preparing the accounting equation;
- classify the accounts into different categories, understand the rules of debit and credit and develop the skill of preparing accounting vouchers;
- have practical knowledge of preparing the various books of accounts like journal; cash book other subsidiary books and ledger;
- appreciate the need of preparing bank reconciliation statement;
- learn the technique of posting of the transactions from journal and other subsidiary books to ledger and prepare the trial balance;
- Identify the accounting errors to learn their rectification;
- understand the need for charging depreciation and the straight line and diminishing balance methods of charging depreciation;
- appreciate the need for creating provisions and reserves and rules to do so;
- preparing of Financial statements of a sole trader without and with adjustments ;
- understand the need, importance and advantages of computerized accounting and use of software Tally;

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## 3. Course Structure

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The syllabus of Accountancy is divided into six modules .

Module	Title	Marks	Hours
1.	Introduction and basic concepts	20	48
2.	Journal and other subsidiary books	25	60
3.	Ledger, Trial Balance and Accounting Errors	14	34
4.	Depreciation, Provisions and Reserves	12	32
5.	Financial Statements	20	48
6.	Computers in Accounting	09	18
<b>Total</b>		<b>100</b>	<b>240</b>

#### 4. Evaluation

Evaluation for this subject would consist of internal evaluations through Tutor Marked Assignments (TMA) and external examination. The external examinations will be conducted twice a year i.e. in the months of April and October. TMA will be treated as a learning tool. It will enable the learners to know their progress and to prepare well for the examination. The project work will help the learners in recording, group and analyzing the monetary transactions on the basis of the final products in the form of financial statements. Besides the above strategies of evaluation, certain inbuilt components for self evaluation in the form of Intext Questions, Terminal Questions and Activity for learners would also be provided in each lesson.

#### 5. Course Description

##### 5.1 Introduction and Basic Concepts 20 Marks 48 Hours

Accounting is indispensable in the modern society. This module will help the students to understand the meaning of various terms used in accounting, meaning, objectives, advantages and limitations of book keeping and accountancy and the difference between the two. The module will also give an insight to the learners about the various Concepts and Conventions applied in the field of accounting and develop accounting equation on the basis of the knowledge so obtained.

##### 5.1.1 Introduction to Accounting

- Book Keeping : Meaning, Need, Objectives and advantages
- Accounting : Meaning, Objectives, advantages and limitations
- Difference between Book Keeping and accounting
- Users of Accounting information and their needs.

##### 5.1.2 Accounting Concepts and Conventions

- Concepts: Dual Aspect, Money Measurement, Business entity and Going Concern.
- Conventions : Materiality, Conservatism and Consistency

##### 5.1.3 Accounting Terms

- Accounting Terminology : Capital, Drawing, Assets and Liabilities, Asset, Revenue, Expenditure, Expense, Profit, Loss, Purchases, Sales, Stock, Debtors, Creditors, Receivables, Payables, Debit and Credit.
- Case Study

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## **5.2 Journal and other subsidiary Books.**

**25 Marks**

**60 Hours**

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This module will help the students to understand the rules of Debit and Credit and develop the skill of applying these rules in recording the transactions in journal and other subsidiary books. It will also help them in preparing the different subsidiary books such as Cash Book, Purchase Book, Sales Book, Purchase Book, Return Book and Sales Return Book.

### **5.2.1 Accounting Equation**

- Meaning of Accounting Equation
- Effects of transactions on Accounting Equation
- Preparation of Accounting Equation.

### **5.2.2 Double Entry System**

- Meaning and classification of Accounts
- Rules of Debit and Credit
- Source Documents
- Accounting Vouchers : Meaning, types and Preparation

### **5.2.3 Journal**

- Journal : Meaning and Format
- Journal entries

### **5.2.4 Cash Book**

- Meaning, Types of Cash Book
- Preparation of Simple Cash Book
- Preparation of Cash Book with Bank Column
- Preparation of Petty Cash Book

### **5.2.5 Bank Reconciliation Statement**

- Meaning and Purpose
- Preparation of Bank Reconciliation Statement.

### **5.2.6 Purchase and Sales Book**

- Meaning and types
- Preparation of Purchase Book, Sales Book, Purchase Return Book and Sales Return Book

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## **5.3 Ledger and Trial Balance**

**14 Mark**

**34 hours**

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This module will enable the learners to develop the skill of preparing the ledger and trial Balance. They will be able to identify the different accounting errors, classify the same and learn the ways to rectify the errors.

### **5.3.1 Ledger**

- Meaning and Purpose
- Difference between Journal and Ledger
- Posting of Journal and Other subsidiary books to ledger
- Balancing of ledger accounts



### 5.3.2 Trial Balance and Accounting Errors

- Trial Balance : Meaning, Objective and limitations
- Preparation of Trial Balance
- Suspense Account
- Types of Accounting Errors and their rectification

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## 5.4 Depreciation, Provisions and Reserves

14 Marks

32 Hrs.

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This module will help the learners to understand the methods of spreading the cost of fixed assets throughout their working life using the concept of Depreciation. They will also be able to describe the need and importance of creating Provisions Reserves.

### 5.4.1 Depreciation: Meaning, Causes and Objectives

- Method of Charging depreciation : Straight line and diminishing Balance
- Accounting Treatment

### 5.4.2 Provisions and Reserves

- Provisions : Meaning and need
- Reserves : Meaning and Types
- Difference between Provisions and Reserves

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## 5.5 Preparation of Financial Statements

20 Marks

48 Hrs.

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This module will enable the learners to understand the meaning and need for preparing financial statements which are the final outcome of the accounting practice. They will learn the steps of the preparation of Income statement and Balance Sheet. The learners will also learn to adjust the different items of adjustment which are provided in the form of additional information (adjustment).

### 5.5.1 Financial Statements (without adjustments)

- Financial Statements : Meaning and users
- Preparation of Trading and Profit and Loss Account of a Sole Trader.
- Preparation of a Balance Sheet of a Sole Trader.

### 5.5.2 Financial Statements (with adjustments)

- Preparation of Trading and Profit and Loss Account and
- Account and Balance Sheet of a Sole Proprietor with simple adjustments for
- Closing Stock: Outstanding expenses. Prepaid Expenses and Depreciation

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## 5.6 Computer in Accounting

Marks 9

Hours 18

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This module will enable the learners to understand the meaning and characteristics of a computer with its components and limitations. It also emphasises on use of computers in Accounting. It will also make you to learn the difference between manual accounting and computerised accounting. One should be able to know the basic requirements of computerised accounting. Once you are able to know the use and importance of computers in accounting you must understand the meaning, features and important steps for starting Tally ERP 9.0, together with how to create a company in Tally.



### **5.6.1 Computers in Accounting**

- Application of Computer in Accounting
- Comparison of Manual and Computerized Accounting

### **5.6.2 Introduction to Tally**

- Introduction to Tally
- Features and important steps for starting Tally.
- Creation of a company in Tally.

# SAMPLE QUESTION PAPER

## ACCOUNTANCY

### SECONDARY COURSE

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Learners, a new course at Secondary level is introduced in Accountancy with effect from the year 2013-14. The course is designed to cater the need of youth at Secondary level together with the demand of stakeholders. This course is a base for you to adopt and understand accountancy in much more easier way at Sr. Secondary level. In the following pages you will find a question paper design followed by sample question paper and marking scheme. The question paper design will guide you about the type of questions, number of questions along with the marks assigned to each question and the marks allotted to each module.

This sample question paper consists the same number and similar type of question paper that you find in your final examination. For example, you will get 6 questions of multiple choice each carrying one mark, 5 questions of very short answers type each carrying 3 marks, 2 question of short answer types each carrying 4 marks, 5 long questions of 5 marks, 6 long questions of 6 marks and one very long question of 10 marks. So you will get 25 questions and the total marks are 100.

The sample question paper is followed by a marking scheme in which expected answers (value points) to the questions are given. This has been given here to illustrate how to attempt the questions. The distribution of marks according to the value points of each answer have also been given.

We hope you will find the Marking Scheme useful in completing this course. In case you have any problem fell free to write NIOS.

# SAMPLE QUESTION PAPER

**Subject: Accountancy**

**Class: X**

**Maximum Marks: 100**

**Time: 3 hrs.**

## 1. Weightage by Objectives

Objectives	Marks	% of total marks
Knowledge	30	30
Understanding	50	50
Application	20	20
	<b>100</b>	<b>100</b>

## 2. Weightage by types of Questions

Types of Question	No. of Questions	Marks per questions	Total marks	Estimated time a candidate is expected to take
M.C.Q.	6	1	6	
V.S.A.	5	3	15	
S.A.	2	4	8	
Long Answer I	5	5	25	
Long Answer II	6	6	36	
V.L.A	1	10	10	
	<b>25</b>		<b>100</b>	<b>165+15=180</b>

## 3. Weightage by Contents

Modules	Marks
1. Introduction to Accounting	20
2. Journal and Other Subsidiary Books	25
3. Ledger, Trial Balance and Accounting Errors	14
4. Depreciation, Provisions and Reserves	12
5. Financial Statements	20
6. Computer in Accounting	09

# SAMPLE QUESTION PAPER

## ACCOUNTANCY

### (SECONDARY COURSE)

**Time : 3 Hours**

**Maximum Marks: 100**

**Answer all the questions**

1. Which of the following is a fixed asset? (1)  
 a) Cash            b) Machinery            c) Creditor            d) Capital
2. Which of the following account always has a Credit Balance ? (1)  
 a) Asset account            b) Liability account            c) Expense accounts            d) Personal account
3. The Trial Balance Shows : (1)  
 a) both debit and Credit Balances            b) only debit Balances  
 c) only credit Balances            d) none of the above
4. Depreciation arises due to : (1)  
 a) Efflux of time            b) Fall in the market value of an asset  
 c) Fall in the value of money            d) All of the above
5. The loss or sale of an old motor car is debited to : (1)  
 a) Profit and Loss Account            b) Motor Car Account  
 c) Depreciation Account            d) Trading Account
6. Which of the following is not an input device: (1)  
 a) Scanners            b) Key boards            c) Printer            d) Light Pen
7. Find out the missing information from the following data            A            =            L            + C (3)  
 a) ₹ 10,000            =            ₹ 7500            +            ?  
 b) ₹10,000            =            ₹ 2500            +            ?  
 c) ₹. 5000            =            ?            +            ₹. 4000
8. Classify the following into Assets, Liabilities, Revenue and Expenses : (3)  
 a) Machinery            b) Purchases            c) Stock            d) Sales            e) Cash f) Creditors
9. On which side will the increase in the following accounts be recorded : (3)  
 a) Machinery account            b) Creditors account            c) Mohan (Proprietor)  
 d) Salary            e) Sales            f) Cash
10. Distinguish between trading Account and Profit & Loss Account (any three) (3)
11. How do you open a Tally. ERP9? (3)
12. Explain the Business entity and Going concern concepts. (4)

13. Enter the following transactions in a Bank column Cash Book. (4)

**2009**

		₹
January 01	Cash in Hand	12,000
January 05	Received from Ram	3,000
January 07	Paid Rent	300
January 07	Cash Deposited into Bank	10,000
January 08	Sold goods for cash	3,000
January 10	Paid to Shyam	7,000
January 27	Purchased Furniture for cash	2,000
January 27	Withdraw from Bank for personal use	5,000
January 31	Paid Salaries	1,000
January 31	Received a cheque from Mohan Brothers and deposited into Bank on the same date	20,000

14. Record the following transactions in the Subsidiary Books of Javed. (5)

**2012**

- August 1. Purchased goods of list price ₹ 10,000 at a trade discount of 20% from Mohan.  
 August 2. Purchased goods of list price ₹ 20,000 from Sketa at a trade discount @ 30%.  
 August 3. Sold goods of list price ₹ 5000 to Manas at 5% Trade discount.  
 August 4. Purchased goods from Shanker list price ₹ 7,000 at 25% trade discount.  
 August 5. Sold goods to Ravi list price ₹ 4000 at 10% trade discount.  
 August 6. Sold to Manoranjan goods list price ₹ 300 at 5% trade discount.  
 August 7. Returned to Mohan goods of list price ₹ 500.  
 August 8. Mohan returned goods of list price ₹ 50.  
 August 9. Returned to Shanker goods of list price ₹ 200.  
 August 10. Ravi returned goods of list price ₹ 80.

15. The following balances were extracted from the books of Shri S. Pal on 31<sup>st</sup> March 2009. You are required to prepare a Trial Balance. The amount required to balance should be entered as capital.

(5)

<b>Particulars</b>	<b>₹</b>
Purchases	17,000
Stock (April 1, 2008)	24,000
Sales	1,05,000
Sundry Debtors	23,800
Discount Received	3,500
Carriage Outward	700
Cash in hand	3,500
Machinery	1,24,500
Provision for Depreciation	24,200
Drawings	7,700
Return inward	3,500
Premises	5,28,000
Sundry Creditors	16,100
Discount Allowed	2,800
Carriage inward	1,400

Cash at Bank	17,500
General Expenses	2,100
Bad debts. Written off	2,450
Provision for Doubtful Debts	2,380
Capital (Balancing figure)	7,60,770

16. What is meant by the term accounting errors? Explain in brief the errors which are not disclosed by the Trial Balance. (1 +4 = 5)

17. Ram Brothers acquired a machine on 1<sup>st</sup> July 2006 at a cost of ₹ 1,40,000 and spent ₹ 10,000 on its installation. The firm writes off Depreciation @10% p.a. on original cost every year. The books are closed on 31<sup>st</sup> December every year. Show the Machinery Account and Depreciation Account for 3 years. (5)

18. Differentiate between Manual accounting and computerized accounting system? (5)

19. Explain the following : (6)

- i. Convention of Consistency
- ii. Convention of Conservatism
- iii. Convention of Materiality

20. Develop accounting equation from the following transaction : (6)

	₹
i) Mohan commenced business with cash	50,000
ii) Purchased goods for cash	30,000
iii) Purchased goods on credit from Govind	20,000
iv) sold goods for cash	12,000
v) Bought furniture on credit from Kapil	2,000
vi) Paid cash to creditor (Govind)	15,000

21. Record the following transactions in the journal of Vishal : (6)

<b>2010</b>		₹
May 1	Commenced business with cash	5,00,000
May 2	Goods purchased from Mohan for cash	50,000
May 3	Goods purchased from Ajay	1,20,000
May 4	Goods returned to Ajay	20,000
May 15	Goods sold to Rajiv	4,000
May 25	Paid Salaries	500

22. Prepare Credit Vouchers from the following information, gathered from supporting vouchers of M/s. Genius Leather Stores, Meerut. (6)

<b>2012</b>		₹
(i)	July 5 Received cash from Sohan & Co. on Account vide cash receipt No. 35	12,000
(ii)	July 10 Commission received vice cash receipt No. 74	3,500
(iii)	July 15 Sold leather purses for cash vide Cash Memo No. 412	4,500
(iv)	July 24 Sold two old leather colouring machines vide Cash Memo No. 3714	12,500

23. What is meant by 'Provisions'? Give any two points of difference between 'Provisions' and 'Reserves'. (6)
24. Give the meaning of Financial statements and state its objectives. (6)
25. From the following Trial Balance of Sri. R. Rajan, prepare the Trading and Profit and Loss Account for the year ended 31<sup>st</sup> March 2009 and the Balance sheet as on that date after taking into account the adjustments given below: (10)

**TRIAL BALANCE**  
**As at 31<sup>st</sup> March 2012**

Particulars	Dr.	Cr.
Rajan's Capital		2,90,000
Rajan's Drawings	7,600	
Purchase and Sales	89,000	1,50,000
Sales and Purchase returns	2,800	4,500
Stock (1 <sup>st</sup> April 2008)	12,000	
Wages	8,000	
Building	2,20,000	
Freight & Carriage	20,000	
Trade Expenses	2,000	
Advertisement	2,400	
Interest received		3,500
Taxes and Insurance	1,300	
Debtors and Creditors	65,000	12,000
B/R and B/P	15,000	7,000
Cash at Bank	12,000	
Cash in hand	1,900	
Salaries	8,000	
	<b>4,67,000</b>	<b>4,67,000</b>

**Adjustments:**

- i) Stock on 31<sup>st</sup> March, 2009 was valued at ₹ 15,000.
- ii) Insurance was prepaid to extent of ₹ 400
- iii) Outstanding liabilities were: Salaries ₹ 2,000 and Taxes ₹ 1300.
- iv) Depreciate Building at 2% p.a.

OR

- i) State the objectives of preparing balance sheet.
- ii) Pass necessary adjustment entries from the following information at 31.3.2012 for preparing financial statements of M/S Ram & Sons
  - a) Closing stock was ₹ 5,000.
  - b) Depreciation of ₹ 3,000 was to be charged on Machinery.
  - c) Salary outstanding was ₹ 1,000.
  - d) Insurance included ₹ 500 for the next year.
  - e) Wages outstanding were ₹ 2,000.

# MARKING SCHEME

## ACCOUNTANCY

### (SECONDARY COURSE)

Q.N.	Expected Value Points	Marks
1.	(b) Machinery	(1)
2.	(a) Liability account	(1)
3.	(a) both debit and credit balances	(1)
4.	(a) efflux of time	(1)
5.	(a) Profit and loss account	(1)
6.	(c) Printer	(1)
7.	a) ₹ 2,500                      b) ₹ 7,500                      c) ₹ 1,000	(1 X 3 = 3)
8.	a) Assets                      b) Expenses                      c) Assets d) Revenue                      e) Assets                      f) Liability	( $\frac{1}{2}$ X 6 = 3)
9.	a) Debit side                      b) Credit side                      c) credit side d) Debit side                      e) Credit side                      f) Debit side	( $\frac{1}{2}$ X 6 = 3)
10.		(1 x 3 = 3)

S.No.	Trading A/c	Profit and Loss A/c
i.	This account shows the gross Profit or gross loss for an accounting year	This account shows the net Profit or net loss for an accounting year
ii.	All direct revenue items are shown on the credit side of this account	All Indirect revenue items are shown on the credit side of this account
iii.	All direct expenses related to business are shown on debit side of this account	All Indirect Expenses related to business are shown on the debit side of this account

11. Perform the following steps to open Tally ERP 9 : (3)
- i. Click the start button on the taskbar. A start menu appears.
  - ii. Move the mouse pointer over the all programs option in start menu.
  - iii. Move the mouse pointer over the Tally, ERP 9 folder and click it.
  - iv. The Tally, ERP 9, Window opens on your screen.
12. (2 + 2 = 4)
- i. Business entity concept - refer to old material
  - ii. Going concern concept - refer to old material



13.

### Cash Book

Dr.

Cr.

Receipts				Payment			
Date	Particulars	Bank	Cash	Date	Particulars	Bank	Cash
<b>2009</b>				<b>2009</b>			
Jan. 1	To Bal b/d		12,000	Jan. 7	By Rent		300
Jan. 5	To Ram		3,000	Jan. 7	By Bank		10,000
Jan. 7	To Cash	10,000		Jan. 10	By Shyam		7,000
Jan. 8	To sales A/c		3,000	Jan. 27	By furniture A/c		2,000
Jan. 31	Mohan Bros.	20,000		Jan. 31	By Drawings	5,000	
				Jan. 31	By Salaries A/c		1,000
					By Bal c/d	25,000	7,700
		<b>30,000</b>	<b>18,000</b>			<b>30,000</b>	<b>18,000</b>
Feb.	Bal b/d	25,000	7,700				

14.

### PURCHASE BOOK

Date	Particulars	L.F.	Amount	Amount
<b>2012</b>			₹	₹
Aug. 1	<b>Mohan</b>		<b>10,000</b>	
	(-) Trade discount 20 %		2,000	8,000
Aug. 2	<b>Ekta</b>		<b>20,000</b>	
	(-) Trade Discount 30 %		6,000	14,000
Aug. 4	<b>Shankers</b>		<b>7,000</b>	
	(-) Trade discount 25 %		1,750	5,250
	Purchase a/c	Dr.		27,250

### SALES BOOK

<b>2012</b>				
Aug. 3	<b>Manas</b>		<b>5,000</b>	
	(-) Trade discount 5%		250	4,750
Aug. 5	<b>Ravi</b>		<b>4,000</b>	
	(-) Trade discount 10 %		400	3,600
Aug. 6	<b>Manorama</b>		<b>3,000</b>	
	(-) Trade discount 5%		150	2,850
	Sales a/c	Cr.		11,200

### PURCHASE RETURN BOOK

2012				
Aug. 7	<b>Mohan</b>		<b>500</b>	
	(-) Trade discount 20%		100	400
Aug. 9	<b>Shankar</b>		<b>200</b>	
	(-) Trade discount 25%		50	150
	Purchase Return A/c	Cr.		550

### SALES RETURN BOOK

2012				
Aug. 8	<b>Ravi</b>		<b>500</b>	
	(-) Trade discount 10%		50	450
Aug. 10	<b>Manorama</b>		<b>800</b>	
	(-) Trade discount 5%		40	760
	Sales Return a/c	Dr.		1,210

15.

### TRIAL BALANCE

*As at March 31, 2009*

Particulars	Dr. Balance ₹	Cr. Balance ₹
Purchases	17,000	-
Stock (April 1, 2008)	24,000	-
Sales	-	1,05,000
Sundry Debtors	23,800	-
Discount Received	-	3,500
Carriage Outward	700	-
Cash in hand	3,500	-
Machinery	1,24,500	-
Provision for Depreciation	-	24,200
Drawings	7,700	-
Return inward	3,500	-
Premises	5,28,000	-
Sundry Creditors	-	16,100
Discount Allowed	2,800	-
Carriage inward	1,400	-
Cash at Bank	17,500	-
General Expenses	2,100	-
Bad debts. Written off	2,450	-
Provision for Doubtful Debts	-	2,380
Capital (Balancing figure)	-	7,60,770
	<b>9,11,950</b>	<b>9,11,950</b>

16. Error which makes the trial balance to disagree and due to which the result of business are misleading is known as accounting error.

Errors which are not disclosed by the trial balance are : (with brief explanation)

- i) **Errors of Complete Omission**
- ii) **Errors of Commission**
- iii) **Compensating Errors**
- iv) **Errors of Principles**

- 17.

**Machinery A/c**

Dr.

Cr.

Date	Particulars	Amount	Date	Particulars	Amount
<b>2006</b>			<b>2006</b>		
July 1	To Bank A/c	1,40,000	Dec. 31	By Depreciation	7,500
July 1	To Bank A/c			$1,50,000 \times \frac{10}{100} \times \frac{6}{12}$	
	Installation and Expenditure	10,000	Dec. 31	By Balance c/d	1,42,500
		1,50,000			1,50,000
<b>2007</b>			<b>2007</b>		
Jan. 1	To Balance b/d	1,42,500	Dec. 31	Depreciation A/c	15,000
		1,42,500	Dec. 31	Balance c/d	1,27,500
					1,42,500
<b>2008</b>			<b>2008</b>		
Jan. 1	To Balance b/d	1,27,500	Dec. 31	By Depreciation A/c	15,000
		1,27,500	Dec. 31	Balance c/d	1,12,500
					1,27,500
<b>2009</b>			<b>2009</b>		
Jan. 1	To Balance b/d	1,12,500			

**Depreciation A/c**

<b>2006</b>			<b>2006</b>		
Dec. 31	To Machinery A/c	7,500	Dec. 31	By Profit and Loss A/c	7,500
<b>2007</b>			<b>2007</b>		
Dec. 31	To Machinery A/c	15,000	Dec. 31	By Profit and Loss A/c	15,000
<b>2008</b>			<b>2008</b>		
Dec. 31	To Machinery A/c	15,000	Dec. 31	By Profit and Loss A/c	15,000

18. Comparison of Manual and Computerised Accounting System :

- i. **Identifying Financial Transaction** : Identifying Financial Transactions and recording in the books of A/c by applying principles common under both the process.
- ii. **Recording** : The Process of recording in the books of original entry, posting, them in the ledger account, performing mathematical functions. In computers processed transactions are recorded in

the books of a/c and the remaining functions are performed without any further process.

- iii. **Clarification :** In the manual process the transactions are recorded in the books of original entry and posted into the ledger a/c. In computerized accounting the posting process is carried out by internal sorting of data.
- iv. **Summarizing :** In the manual system of accounting the data under each ledger is summarized and in computerized accounting a transaction or event once recorded is sorted in the order in the data base.
- v. **Adjustment Entries :** Adjustment entries are passed to rectify an error or to follow the matching concept of Accounting. The process of passing adjustment entries can be equated with the recording process.

19. i. **Dual aspect concept :** According to this concept every business transaction is recorded as having a dual aspect. In other words, every transaction affects, atleast two accounts. One account is debited and the other account is credited.
- ii. **Sales :** The term 'sales' is used only for the sales of those goods which are purchased for resale purpose. It also includes revenues from services provided to customers. It includes both cash and credit sales.
- iii. **Business Entity Concept :** According to this concept, business is treated as a unit separate and distinct from its owners.
- iv. **Money Measurement Concept :** Only those transactions and events are recorded in accounting which are capable of being expressed in terms of money. An event, even though it may be very important for the business, will not be recorded in the books of business.

S.No.	Transaction	Assets	Liabilities+Capital
1.	Mohan commenced business with ₹ 50,000	Cash + stock + furniture	= Capital
2.	New equation Purchased goods for cash for ₹ 30,000	50,000 (-) 30,000 + 30,000 + 0	= 0 + 50,000 = 0 + 50,000
3.	New equation Purchased goods on Credit for ₹ 20,000	20,000 + 30,000 + 0 + 20,000	= 0 + 50,000 = 20,000
4.	New equation Sold goods for cash for ₹ 12,000	20,000 + 50,000 + 0 12,000 - 12,000 + 0	= 20,000 + 50,000 = 20,000 + 50,000
5.	New equation Bought furniture on Credit for ₹ 2,000	32000 + 38000 + 0 0+0+2000	= 20,000 + 50,000 = 2,000 + 0
6.	New equation Paid Cash to creditors	32,000 + 38,000 + 2,000 -15,000 + 0 + 0	= 22,000 + 50,000 -15,000 + 0
	Final equation	17,000 + 38,000 + 2,000	= 7,000 + 50,000

21.

Date	Particulars	L.F.	Amount	Amount
1 May	Cash a/c Dr. To Capital a/c (Amount brought in by vishal as capital)		50,000	50,000
2 May	Purchases A/c Dr. To cash A/c (goods purchased from Mohan for cash)		50,000	50,000
3 May	Purchases A/c Dr. To Ajay (goods purchased from Ajay)		1,20,000	1,20,000
4 May	Ajay Dr. To Purchase Return A/c (for good return to Ajay)		20,000	20,000
15 May	Rajiv Dr. To Sales A/c (Goods sold to Rajiv)		5,000	5,000
25 May	Salaries A/c Dr. To cash A/c (for salaries paid)		500	500
			<b>6,94,500</b>	<b>6,94,500</b>

22. **Solution :**

(i)

**M/s. Genius Leather Stores, Meerut**

Voucher No. 1	Date : 5.7.2012
	Amount (₹)
Credit : M/s. Sohan & Co. (Being Cash received on account from Sohan & Co. vide cash receipt No. 35)	12,000
	12,000
Sd/- Manager	Sd/- Accountant

(ii) **M/s. Genius Leather Stores, Meerut**

<b>Voucher No. 2</b>		<b>Date : 10.7.2012</b>	
		<b>Amount (₹)</b>	
Credit : Commission A/c. (Being the amount of commission received vide cash receipt No. 74)		3,500	
		3,500	
<b>Sd/- Manager</b>		<b>Sd/- Accountant</b>	

(iii) **M/s. Genius Leather Stores, Meerut**

<b>Voucher No. 3</b>		<b>Date : 15.7.2012</b>	
		<b>Amount (₹)</b>	
Credit : Sales A/c. (Being the amount of cash sales vide Cash Memo No. 412)		4,500	
		4,500	
<b>Sd/- Manager</b>		<b>Sd/- Accountant</b>	

(iv) **M/s. Genius Leather Stores, Meerut**

<b>Voucher No. 4</b>		<b>Date : 24.7.2012</b>	
		<b>Amount (₹)</b>	
Credit : Leather Colouring Machine (Being two old leather colouring machine sold for cash vide Cash Memo No. 3714)		12,500	
		12,500	
<b>Sd/- Manager</b>		<b>Sd/- Accountant</b>	

23. When there are certain expected losses/ expenses, these are planned to be managed in advance from the current year's profits/ surplus. The amount which is kept separately to meet such expected losses/expenses is called a Provision.

<b>S. No.</b>	<b>Provisions</b>	<b>Reserves</b>
1.	It is created by debiting the Profit & Loss A/c.	It is created by debiting the Profit & Loss Appropriation A/c.
2.	It is a charge against the profits without which true profit or loss of the business can't be ascertained.	It is an appropriation of profits and doesn't require to be created to ascertain true profit or loss.

24. The statements, prepared to know the result of the business and the financial position of the business, are called financial statements. Following are the objectives of preparing financial statements:
- i) Ascertain the result of business activities
  - ii) Ascertain the financial position of business
  - iii) Correct decision making
  - iv) Judging the performance of management
  - v) Ascertaining the cash position of business

25. **Solution :**

**Trading & Profit and Loss A/c of R. Rajan for  
the year ended 31.3.2009**

Dr. Particular	Amount	Particular	Amount	Cr.
To Opening Stock	12,000	By Sales	1,50,000	
To Purchase 89,000	89,000	Sales Returns	<u>-2,800</u>	1,47,200
Purchase Returns <u>- 4,500</u>	84,500	By Closing Stock		15,000
To Wages	8,000			
To Freight and Carriage	20,000			
To Gross Profit T/F to P/L A/c	37,700			
	1,62,200			1,62,200
To Trade Expenses	2,000	By Gross Profit		37,700
To Advertisement	2,400	By Interest Received		3,500
To Taxes and Insurance 1,300				
Add : Unpaid Taxes & Ins. 1,300				
Less : Prepaid Ins. Taxes <u>- 400</u>	2,200			
To Salaries 8,000				
Add : Unpaid Salaries <u>2,000</u>	10,000			
To Depreciation on Building	4,400			
To Net Profit transferred to Capital A/c	20,200			
	<b>41,200</b>			<b>41,200</b>

**Balance Sheet of R. Rajan as at 31.3.2009**

Liabilities	Amount	Assets	Amount
Current Liabilities		Current Assets	
Creditors	12,000	Cash in hand	1,900
Bill Payable	7,000	Cash at Bank	12,000
Outstanding Liability		Bill Receivable	15,000
Taxes 1,300		Debtors	65,000
Salaries <u>2,000</u>	3,300	Prepaid Insurance	400
Capital Opening Bal. 2,90,000		Closing Stock	15,000
Add : Net Profit <u>20,200</u>		Fixed Asset :	
Less : Drawing 7,600	3,02,600	Building	2,20,000
		Less : Depreciation	<u>4,400</u>
	<b>3,24,900</b>		<b>2,15,600</b>
			<b>3,24,900</b>

OR

- i) Balance sheet is prepared to achieve following objectives:
- To know the financial position of the business.
  - To know the position of internal liabilities and external liabilities of the business so that timely arrangement can be made for their payment.
  - To know the position of fixed assets and current assets.
  - To plan activities for future on the basis of present financial position.

- ii) (a) The following adjustment entry will be passed at the end of the year:

31.3.2012	Closing Stock A/c	Dr.	5,000	
	To Trading A/c			5,000
	(For Closing stock transferred to Trading A/c)			

- (b) Entry for charging depreciation will be as under:

31-3-2012	Depreciation A/c	Dr.	3,000	
	To Plant&Machinery A/c			3,000
	(For depreciation charged on Machinery)			

- (c) Adjustment entry will be as under:

31.3.2012	Salaries A/c	Dr.	1,000	
	To Salaries outstanding A/c			1,000
	(For salary outstanding for the year 2011-12)			

- (d) Adjustment entry for prepaid Insurance will be as under:

31.3.2012	Prepaid Insurance A/c	Dr.	500	
	To Insurance A/c			500
	(For Insurance paid in advance for next year 2012-13)			

- (e) The adjustment entry will be:

31.3.2012	Wages A/c	Dr.	2,000	
	To Wages outstanding A/c			2,000
	(For wages outstanding for the year 2011-12)			