Senior Secondary Course

ACCOUNTANCY (320)

1

Course Coordinator
Dr. Piyush Prasad

विद्याधनम् सर्वधनं प्रधानम्

NATIONAL INSTITUTE OF OPEN SCHOOLING

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Delhi

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Sh. S.K. Bansal
Lecturer (Retd.)
Commercial Sr. Sec. School
Daryaganj
New Delhi

Dr. Piyush Prasad
Academic Officer
(Accountancy)
NIOS, NOIDA (UP)

COURSE WRITERS/REVIEWERS

Sh. S.K. Bansal
Lecturer (Retd.)
Commercial Senior
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Smt. Siba S.
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HOD Commerce
KMPG, Badalpur

Dr. Shipra Vaidya
Professor, Department of
Social Sciences & Humanities
NCERT, New Delhi 16

Dr. Piyush Prasad
Academic Officer
(Accountancy)
NIOS, NOIDA (UP)

Dr. Neha Agarwal
Financial Expert
GAIL Town Ship
Pata, UP

Sh. Sanjeev Kumar
Vice Principal
Govt. Co-edu. School
Preet Vihar, Delhi

Smt. Alka Rani
PGT, Commerce
JP International School
Meerut

Dr. Amit Agarwal
Lecturer
Govt. Inter College
Champwat, UK

CONTENT EDITOR

Dr. Piyush Prasad
Academic Officer
(Accountancy)
NIOS, NOIDA (UP)

Sh. S.S. Seharawat
Former D. C
KVS, Delhi

Sh. Sanjeev Kumar
Vice Principal
Govt. Co-edu. School
Preet Vihar, Delhi

Dr. Neha Agarwal
Financial Expert
GAIL Town Ship
Pata, UP

Smt. Alka Rani
PGT, Commerce
JP International School
Meerut

GRAPHIC ILLUSTRATOR

M.K. Computers
Shop No. 19, DDA Market
Bhera Enclave, N. Delhi - 87

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 at regular intervals of time. A static curriculum does not serve any purpose, as it does not cater to the current needs and aspirations of the individual and society.

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 2005) 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 currently revised the curricula of Accountancy course at Senior Secondary Level, as per the Common Core Curriculum developed by COBSE (Council of Boards of School Education) and NCERT (National Council for Educational Research and Training) making it current and need based. Textual material production is an integral and essential part of all NIOS programmes offered through open and distance learning system. Therefore, we have 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.

Prof. C.B. Sharma
Chairman
NIOS

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.

The Accountancy course at Senior secondary level has now been revised as per the Common Core Curriculum developed by COBSE (Council of Boards of School Education) and NCERT (National Council for Educational Research and Training) making it current and need based.

The National Curriculum Framework developed by the National Council for Educational Research and Training was kept as a reference point. Leading experts in the subject of the country were involved and with their active involvement, study materials based on the new curriculum have been updated. Old, outdated information has been removed and new, relevant things have been added.

I am happy to place this new revised study material in Accountancy in your hands. I hope you will find the new material that is now in your hands 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)
National Institute of Open Schooling

A Word With You

Dear Learner,

I welcome you to this course in Accountancy for the Senior Secondary level.

We all know the importance of business in our everyday life. It not only fulfills our basic needs of recording transactions but also provides accounting information to users for career decision making. It is a dynamic process that keeps on changing as per the requirements and demands of the society. The procedure and practices of business in the past are completely different from modern days. It is more informative than what it was in past. The use of modern technology, government's policies and the awareness among common masses have made it user friendly. Therefore, a systematic effort is required to understand, analyse and respond to the changes that affect the functioning of accounting in the present day society.

Keeping in mind the above, the curriculum in the subject of Accountancy at Senior Secondary level has been designed. The whole learning material of the subject has been published in the form three volumes for your convenience. The first book has two modules. Learning experiences considered essential for Accountancy are described in the first two modules. The module on Basic Accounting consist lessons on how to record transaction in books of Accounts while the second module of Trial Balance & Computers explain about the pre work done for perfect financial statement with the use of computers in Accounting, and these two modules are Tutor Marked Assignment Based modules.

The second volume which contains three modules are again the core modules. The third module in Financial Statements of Profit & Not for Profit Organisations explains as how the financial statements are prepared by various organisations. The fourth module in Partnership Accounts explains how various types of accounts are maintained by Partnership firm under different situations. The fifth module in Accounting for Shares & Debentures, which contains lessons on different situations in raising capital by way of issue of Shares & Debentures by companies.

The third volume, which is an optional volume consist of two modules as Analysis of Financial Statement and Elementary Cost Accounting. Learners has to opt any one module out of the two. Analysis of Financial Statement consist four lessons as how to analyse the results of Business to corrective measures & take future decisions while the Application of Computer in Financial Accounting again consist of four lessons as how to do accounting with help of computers.

For your practice, a sample question paper along with the question paper design and marking scheme is provided at the end of the second book.

To make your learning process interesting and useful we have changed the layout of the pages. You will also find some attractive icons in the lesson symbolising the content of different sections. The details are given separately under the heading 'How to study your lessons'.

I am sure that you will find the lessons and their approach interesting and would be able to apply your knowledge in the real life situations. So read and practice all the lessons of this course carefully and be prepared for the examination with confidence. If you face any difficulty in your studies, please feel free to write to me. Your suggestions are valuable for us.

Good luck and happy learning.

Dr. Piyush Prasad
Academic Officer

How To Study Your Lessons

Congratulation! You have accepted the challenge to be a self-learner. It means, you have to organise your study, learn regularly, keep up your motivation and achieve your goal. Here it is solely you, who is responsible for your learning. NIOS is with you at every step. It has developed the material in Accountancy. A format supporting independent learning has been followed. You can take the best out of this material if you follow the instructions given below.

Title: The title of the lesson will give a clear indication of the contents within. Do read it.

Introduction: This will introduce you to the lesson and also link it to previous one.

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 the same.

Content: Total content has been divided into sections and sub-sections. A section leads you from one content element to another and sub-section helps you in comprehension of the concepts in the content element. The text in bold, Italics or boxes is important and must be given attention.

Intext Questions: Objective types, 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 the unit again.

Notes: Each page carries empty space on the outer margins for you to write important points or make notes.

What You Have Learnt : It 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 very short, short and long answer type questions that provide you an opportunity to practice for better understanding of the whole topic.

Answers to Intext Questions: These will help you to know, how correctly you have answered the Intext questions.

Activity : Activities, if done by you, will help you to understand the concept clearly.

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Overview of the Learning Material

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Module - I

BASIC ACCOUNTING

Marks 10 **Hours 25**

Accounting is the language of business. It helps the busines not only in finding out profits/losses for a period and its financial position on a particular date but also helps in management of business. It has its own well designed and established principles which are guided by some concepts and conventions Accounting is recording of transactions in a systematic manner in various types of books and their posting to a master book called ledger.

This module has been designed to introduce accounting to the learners. This familiarises the learners with some basic accounting terms, accounting concepts, conventions and standards. This enables them to prepare Journal, Cash Book and Special Purpose Books and their posting to Ledger.

Notes

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ACCOUNTING - AN INTRODUCTION

Whenever your mother asks you to go to the nearby grocery store to buy items of daily use like match box, candle stick, soap cake, coffee, spices etc. you need not pay for these items immediately. When you buy these items, the store owner immediately opens the page of a note book on which your father's name is written. He records the value of items purchased. At the end of the month, your father goes to him. He again opens the same page tells the total amount to be paid and records when your father makes the payment. In a similar manner, he keeps the record of other customers also. Whenever he gets commodities from suppliers he records the same and also records the payment he makes to them. Similarly, every business small or big, sole proprietor or a firm keeps the record of the business transactions. Have you ever thought why do they keep record of business transactions? If they do not keep the record how will they know how much, when and to whom they have to make payments or from whom, how much and when they have to receive payments or what they have earned after a particular period and so on. Recording of transactions by a businessman in proper books and in a systematic manner is known as accounting. In this lesson you will learn about this in detail.

OBJECTIVES

After studying this lesson you will be able to

- explain the meaning of Book-Keeping;
- state the meaning and nature of accounting;
- distinguish between book keeping and accounting;
- explain the advantages & limitations of accounting;
- explain the branches of accounting;

- state the functions and objectives of financial accounting;
- explain accounting as an information system for decision making by the interested users and
- explain various accounting terms.

Notes

1.1 BOOK KEEPING AND ACCOUNTING

A business undertakes number of transactions. Can you estimate the number of transactions a business undertakes? It depends upon the size of a business entity. Every day business transactions may be around hundreds/thousands. Can a businessman remember all these transactions in every respect? Not at all. So it becomes necessary to record these business transactions in details and in a systematic manner. Recording of business transactions in a systematic manner in the books of account is called book-keeping. Book-Keeping is concerned with recording of financial data. This may be defined as.

> "The art of keeping a permanent record of business transactions is book-keepng".

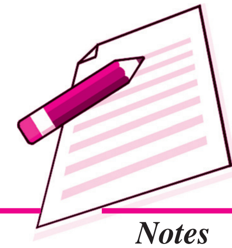
From books of accounts important details such as total sales, total purchases, total cash receipts, total payments, etc. may be ascertained. As you know the main objective of business is to earn profits. In order to ascertain the profit earned during a period, mere recording of business transactions is not enough. Accounting involves not only book keeping but also many other activities. In 1941, the American Institute of Certified Public Accountants (AICPA) defined accounting as

> "The art of recording, classifying, summarising, analysing and interpreting the business transactions systematically and communicating business results to interested users in accounting"

Accounting is identified with a system of recording of business transactions that create economic information about business enterprises to facilitate decision making. The function of accounting is to provide quantitative information, primarily financial in nature, about economic entities, that is intended to be useful in making economic decisions.

The American Accounting Association defined accounting as :

> "It is the process of identifying, measuring, recording and communicating the required information relating to the economic events of an organisation to the interested users of such information.



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In order to appreciate the nature of accounting it is necessary to understand the following relevant aspects of the definition of accounting:

- **Economic events :** It is the occurring of the consequence to a business organisation which consists of transactions that are measurable in monetary terms. Purchase of a Machinery, installing and keeping it ready for manufacturing is an economic event which consists of a number of financial transactions. These transactions are (a) buying the machine, (b) transporting the same, (c) preparing the site for its installation and (d) incurring expenditure on installing the same.

- **Identification, Measurement, Recording and Communication :**

  Identification implies determining what transactions are to be recorded i.e. items of financial character are to be recorded. For example, goods purchased for cash or on credit will be recorded. Items of non-financial character such as changes in managerial policies, etc. are not recorded in the books of accounts.

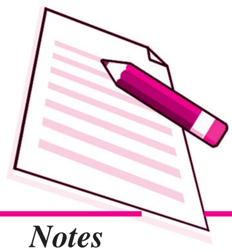
  Measurement means quantification of business transactions into financial terms by using monetary unit. If an event cannot be quantified in monetary terms, it is not considered fit for recording in the books of the firm. That is why important items like appointment, signing of contracts, etc. are not shown in the books of accounts.

  Recording : Having identified and measured the economic events in financial terms, these are recorded in the books of accounts in monetary terms date wise. The recording of the business transactions is done in such a manner that the necessary financial information is summarized according to well established accounting practices.

  Communication : The economic events are identified, measured and recorded in such a manner that the necessary relevant information is generated and communicated in a certain form to the management and other internal and external users of information. The financial information is regularly communicated through accounting reports.

- **Organisation :** refers to a business enterprise whether for profit or not for profit motive.

- **Interested users of information.** Many **users** need financial information to make important decisions. These users can be investors, creditors, labour unions, Trade Associations, etc.



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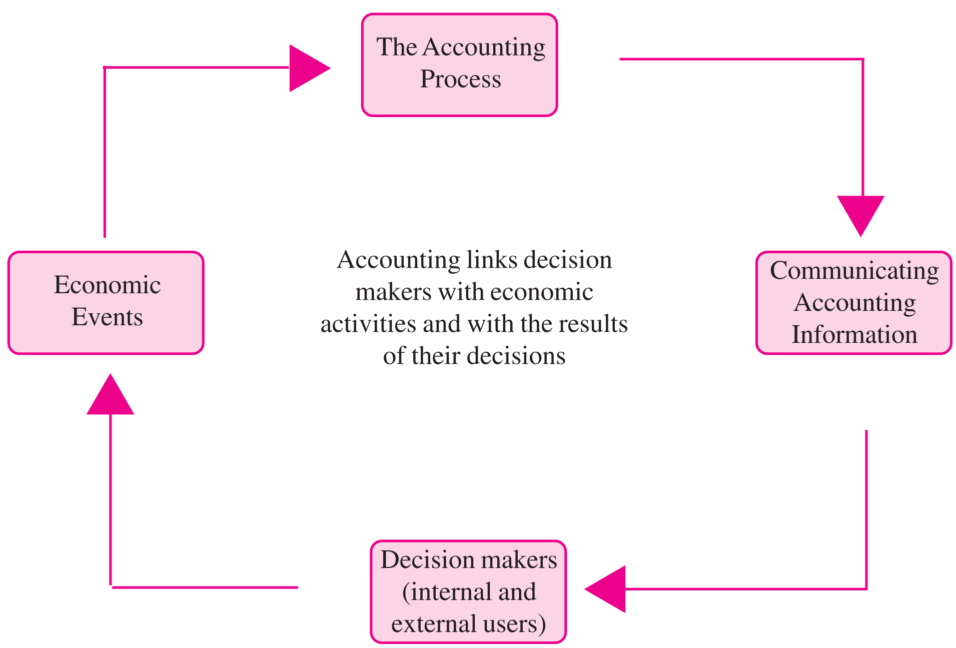
Evolution of Accounting

As per Indian mythology Chitra Gupta is responsible for maintaining accounts in God's court.

A book on Arthashasthra written by Kautilya who was a minister in Chandra Gupta's kingdom twenty three centuries ago mentions about the accounting practices in India. It describes how accounting records have to be maintained. In China and in Egypt accounting was used for maintaining revenue records of the government treasury.

A book on Arithmetica Geometrica, Proportion at Proportionality (Review of Arithmetic and Geometric proportion) by an Italian Luca Pacioli is considered as the first authentic book on double entry book keeping. In his book he used the present day popular terms of accounting Debit (Dr.) and Credit (Cr). He also discussed the details of memorandum, journal, ledger and specialised accounting procedures. He also stated that, "all entries have to be double entries, i.e. if you make one creditor you must make some debtor.

Accounting process can be summarised as



Accounting Process

Difference between book keeping and accounting : Book keeping and accounting can be differentiated on the basis of nature, objective, function, basis, level of knowledge, etc.

Difference between Book Keeping and Accounting

Basis of Difference	Book-keeping	Accounting
Nature	It is concerned with identifying financial transactions; measuring them in monetary terms; recording and classifying them.	It is concerned with summarizing the recorded transactions, interpreting them and communicating the results.
Objective	It is to maintain systematic records of financial transactions.	It aims at ascertaining business income and financial position by maintaining records of business transactions.
Function	It is to record business transactions. So its scope is limited.	It is the recording, classifying, summarizing, interpreting business transactions and communicating the results. Thus its scope is quite wide.
Basis	Vouchers and other supporting documents are necessary as evidence to record the business transactions.	Book-keeping works as the basis for accounting information.
Level of Knowledge	It is enough to have elementary knowledge of accounting to do book-keeping.	For accounting, advanced and in-depth knowledge and understanding is required.
Relation	Book-keeping is the first step to accounting.	Accounting begins where book-keeping ends.

INTEXT QUESTIONS 1.1

I. Fill in the blanks with suitable word/words:

i. Keeping systematic record of business transactions is known as ____________.

ii. The next step after classification of recorded transactions is ____________.

iii. The whole process of recording, classifying, summarizing and interpreting the business transactions systematically and communicating business results to the interested users of financial information is known as ____________.

iv. Interested users of accounting information are ____________.

II. Identify transactions related to book-Keeping or accounting and write B for book-keeping and A for accounting against the space provided:

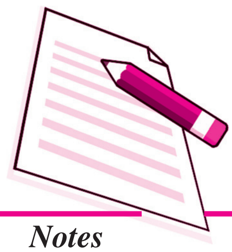
i. Credit Sales/Purchases (................)

ii. Cash Purchases/Sales (................)

iii. Calculation of business profits (................)

iv. Find out total debtors (................)

v. Find out financial position of the business enterprise (..................)



Notes

1.2 BRANCHES AND OBJECTIVES OF ACCOUNTING

Branches of Accounting

The changing requirements of the business over the centuries have given rise to specialized branches of accounting and these are :

Financial Accounting

It is concerned with recording the transactions of financial character, summarising and interpreting them and communicating the results to the users. It ascertains profit earned or loss incurred during a period (usually one year as accounting year) and the financial position as on the date when the accounting period ends. It can provide financial information required by the management and other parties. The word accounting and financial accounting are used interchangeably. At present we are concerned with financial accounting only.

Cost Accounting

It analyses the expenditure so as to ascertain the cost of various products manufactured by the firm and fix the prices. It also helps in controlling the costs and providing necessary costing information to management for decision making.

Management Accounting

It is concerned with generating information relating to funds, cost and profits etc. This enables the management in decision making. Basically, it is meant to assist the management in taking rational policy decisions and to evaluate the impact of its decisions and actions and the performance of various departments.

Tax Accounting

This branch of accounting has grown in response to the difficult tax laws such as relating to income tax, sales tax etc. An accountant is required to be fully aware of various tax legislations.

Social Accounting

This branch of accounting is also known as social reporting or social responsibility accounting. It discloses the social benefits created and the costs incurred by the enterprise. Social benefits include such facilities as medical, housing, education, canteen, provident fund and so on while the social costs may include such matters as exploitation of employees, industrial interest, environment pollution, unreasonable terminations, social evils resulting from setting up industries etc.

Objectives and Functions of Financial Accounting

The main objectives of financial accounting are as under :

Finding out Various Balances

Systematic recording of business transactions provides vital information about various balances like cash balance, bank balance, etc.

Providing Knowledge of Transactions

Systematic maintenance of books provides the details of every transactions.

Ascertaining Net Profit or Loss

Summarisation in form of Profit and Loss Account provides business income over a period of time.

Depicting Financial Position

Balance sheet is prepared to depict financial position of business means what the business owns and what it owes to others.

Information to All Interested Users

After analysis and interpretation, business performance and position are communicated to the interested users.

Fulfilling Legal Obligations

Vital accounting information helps in fulfilling legal obligations e.g. sales tax, income tax etc.

Functions of Accounting

The function of accounting is to provide quantitative information primarily financial in nature about economic entities, which is intended to be useful in making economic decisions. Financial accounting performs the following major functions:

Maintaining SystematicRrecords

Business transactions are properly recorded, classified under appropriate accounts and summarized into financial statements.

Communicating the financial results

It is used to communicate financial information in respect of net profits (or loss), assets, liabilities etc. to the interested parties.

Meeting Legal Requirements

The provisions of various Laws such as Companies Act, 1956 Income Tax and Sales/ VAT Tax Acts, require the submission of various statements i.e. Annual accounts, Income Tax returns, Returns for VAT etc.

Fixing responsibility

It helps in computation of profits of different departments of an enterprise. This facilitates the fixing of the responsibility of departmental heads.

Decision making

It provides the users the relevant data to enable them make appropriate decisions in respect of investment in the capital of the business enterprise or to supply goods on credit or lend money etc.

Notes

Advantages of Accounting

1. **Financial Information about Business :** Financial performance during the accounting period, *i.e.,* profit or loss and also the financial position at the end of the accounting period is known through accounting.
2. **Assistance of Management :** The management makes business plans, takes decision and exercise control on affairs on the basis of accounting information.
3. **Replace Memory :** A systematic and timely recording of transactions obviates the necessity to remember the transactions. The accounting record provides this necessary information.
4. **Facilitates Comparative Study :** A systematic record enables a businessman to compare one year's results with those of other years and locate significant factors leading to the change, if any.
5. **Facilitates Settlement of Tax Liabilities :** A systematic accounting record immensely helps settlement of income tax, sales tax, VAT and excise duty liabilities since it is a good evidence of the correctness of transactions.
6. **Facilitates Loans :** Loan is granted by the banks and financial institutions on the basis of growth potential which is supported by the performance. Accounting makes available the information with respect to performance.
7. **Evidence in Court :** Systematic record of transactions is often accepted by the Courts as good evidence.
8. **Facilitates Sale of Business :** If someone desires to sell his business, the accounts maintained by him will enable the ascertainment of the proper purchase price.
9. **Assistance in the Event of Insolvency :** Insolvency proceedings involve explaining many transactions that have taken place in the past. Systematic accounting records assist a great deal in such a situation.

10. Helpful in Partnership Accounts : At the time of admission of a partner, retirement or death of a partner and dissolution of the firm, accounting records are of vital importance and use. It is so because such records provide the basis to reach a settlement.

Limitations of Accounting

1. **Accounting information is expressed in terms of Money :** Non-monetary events or transactions are completely omitted.

2. **Fixed assets are recorded in the accounting records at the original cost :** Actual amount spent on the assets like building, machinery, plus all incidental charges is recorded. In this way the effect of rise in prices is not taken into consideration. As a result the Balance Sheet does not represent the true financial position of the business.

3. **Accounting information is sometimes based on estimates:** Estimates are often inaccurate. For example, it is not possible to predict the actual life of an asset for the purpose of depreciation.

4. **Accounting information cannot be used as the only test of managerial performance on the basis of mere profits :** Profit for a period of one year can readily be manipulated by omitting certain expenses such as advertisement, research and development, depreciation etc. i.e. window dressing is possible.

5. **Accounting information is not neutral or unbiased :** Accountants ascertain income as excess of revenue over expenses. But they consider selected revenue and expenses for calculating profit of the concern. They also do not include cost of such items as water, noise or air pollution i.e. social cost, they may also use different methods of valuation of stock or depreciations.

INTEXT QUESTIONS 1.2

I. ***Following are the statements relating to various branches of accounting. Write against each the name of the branch of accounting to which the same belongs:***

   i. It analyses the expenditure so as to ascertain the cost of products manufactured by the concern.

   ii. Accounting that discloses the social benefits and the costs incurred by the business enterprises.

iii. Accounting that is concerned with generating information that will enable the management in decision making.

II. How each of the following statements is a limitation of accounting?

i. Fixed assets are recorded in the accounting records at the original cost.

ii. Accounting information is sometimes based on estimates.

iii. Accounting information cannot be used as the only test of managerial performance on the basis of mere profit.

iv. Accounting information is expressed in terms of money.

III. How each of the following statements is an advantage of Accounting :

i. Evidence in Court

ii. Replaces Memory

iii. Financial Information about Business.

1.3 ACCOUNTING AS AN INFORMATION SYSTEM AND ITS USERS

In 1970, the Accounting Principles Board of The American Institute of certified Public Accountants (AICPA) emphasized that the function of accounting is to provide quantitative information, primarily financial in nature, about economic entities, that is intended to be useful in making economic decisions. Accounting is often called the **"Language of Business"**. It is the common language used to communicate financial information to individuals, organisations, government agencies about various aspects of business such as financial position, operating results (i.e. Profit or loss) and cash flows. **Users**, both inside and outside the business, have to make decisions concerning the allocation of limited economic resources. In order to ensure that resources are allocated in an efficient and effective manner, **users require financial information** for the purpose of making decisions. Accounting provides information that is useful in making business and economic decisions. It is the primary means of communicating financial information to owners, lenders, managers,. Government and its regulatory agencies '-and -others- who have interest in an enterprise. It helps the users in taking better decisions by providing relevant, reliable and timely information on the financial and operational position of an enterprise.

It is observed that almost all business enterprises maintain detailed accounting records. Even the most intelligent manager with a sharp memory would find it difficult to remember the daily transactions simply by observing them. So he/she must rely upon the accounting process which begins with the recording of business transactions and ends up with the preparation of summarized financial statements. Thus, Accounting as an information system is necessitated by great complexity of modern business organisations.

Accounting as a Source of Information

"*Accounting is a service activity. It's function is to provide qualitive information, primarily financial in nature, about economic entities that is intended to be useful in making economic decisions.*"

As an information system, accounting collects data and communicates economic information about the organisation to a number of users whose decisions and actions are related to its performance. Accounting begins with the identification of transactions of financial nature and ends with the preparation of financial statements (*i.e.,* Income Statement and Balance Sheet). Each step in the process of accounting generates information. Generation of information is not an end in itself, it is a way to facilitate the dissemination of information among users of accounting information. Accounting information is used for predicting, comparing and evaluating the earning power and financial position of a business enterprise. Therefore, dissemination of information is an essential function of accounting.

INTEXT QUESTIONS 1.3

State whether the following statements are True or False :

i. Systematic record of transactions is often accepted by the Courts as good evidence.

ii. The balance sheet makes available the information about the financial health of the enterprises.

iii. Creditors are internal users of accounting information

Users of Accounting Information

Users of Accounting Information may be categorised into Internal Users and External Users.

Internal Users

i. **Owners :** Owners contribute capital in the business and thus, are exposed to maximum risk. Naturally, they are interested in knowing the profit earned or loss suffered by the business besides the safety of their capital. The financial statements give the information about profit or loss and financial position of the business.

ii. **Management :** The management makes extensive use of accounting information to arrive at informed decisions such as determination of selling price, cost controls and reduction, investment into new projects, etc.

iii. **Employees and Workers :** Employees and workers are entitled to bonus at the year end, which is linked to the profit earned by an enterprise. Therefore, the employees and workers are interested in financial statements. Besides, the financial statements also reflect whether the enterprise has deposited its dues into the provident fund and employees state insurance accounts, etc., or not.

External Users

i. **Banks and Financial Institutions :** Banks and financial institutions are an essential part of any business as they provide loans to the businesses. Naturally, they watch the performance of the business to know, whether it is making progress as projected to ensure the safety and recovery of the loan advanced. They assess it by analysing the accounting information.

ii. **Investors and Potential Investors :** Investment involves risk and also the investors do not have direct control over the business affairs. Therefore, they rely on the accounting information available to them and seek answers to the questions such as - what is the earning capacity of the enterprise and how safe is their investment?

iii. **Creditors :** Creditors are those parties who supply goods or services on credit. Before granting credit, creditors satisfy themselves about the credit worthiness of the business. The financial statements help them immensely in making such an assessment.

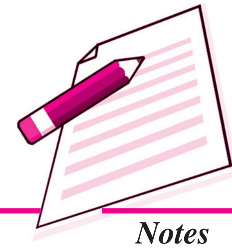
iv. **Government and Its Authorities :** The government makes use of financial statements to compile national income accounts and other informations. The information so available to it enables them to take policy decisions.

Government levies varied taxes such as Excise Duty, VAT, Service Tax and Income Tax. These government authorities assess the correct tax dues from an analysis of financial statements.

v. **Researchers :** Researchers use accounting information in their research work.

vi. **Consumers :** Consumers require accounting information for establishing good accounting control so that cost of production may be reduced with the resultant reduction of the prices of products they buy. Sometimes, prices of some products are fixed by the government, so it needs accounting information to fix fair prices so that consumers and producers are not exploited.

vii. **Public :** They want to see the business running since it makes substantial contribution to the economy in many ways, *e.g.*, employment of people, patronage to suppliers, etc. Thus, financial accounting provides useful financial information to various user groups for decision-making.



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Qualitative Characteristics of Accounting Information

Two fundamental characteristics of financial statements are their truth and fairness. An auditor of the enterprise has to make a statement in his report whether, in his opinion, the financial statements give a true and fair view. It means that the Balance Sheet should give a true and fair view of the state of affairs and the Profit and Loss Account should give the true and correct profit or loss for the period. Besides the above fundamental characteristics, there are other qualitative characteristics (attributes) that make the information content of the financial statements meaningful to its users. There are:

1. Reliability;
2. Relevance;
3. Understandability and
4. Comparability.

Let us discuss these characteristics in detail:

1. **Realiability :** Accounting information must be reliable. the foremost factors that make it reliable are that

   i. it should be verifiable. It means, transactions should be evidenced by documents. For example, purchases be evidenced by bills of purchases, sales be evidenced by sales bills, etc.

   ii. it should be free from personal bias. It means, where personal judgement is to be exercised, it should be independent and free from bias.

   Reliability of the accounting information depends on:

   i. *Neutrality :* Neutrality means that the accounting information made available does not suffer from bias.

   ii. *Prudence :* The accounting information prepared on the principle of prudence (conservatism) means that the accounting information is prepared by providing all prospective losses while leaving all prospective profits.

   iii. *Completeness :* The accounting information given should be complete in all respects as incomplete information may lead to wrong interpretation.

   iv. *Substance Over Form :* The accounting information to be meaningful, should be governed by the substance of the information and not by its legal form alone.

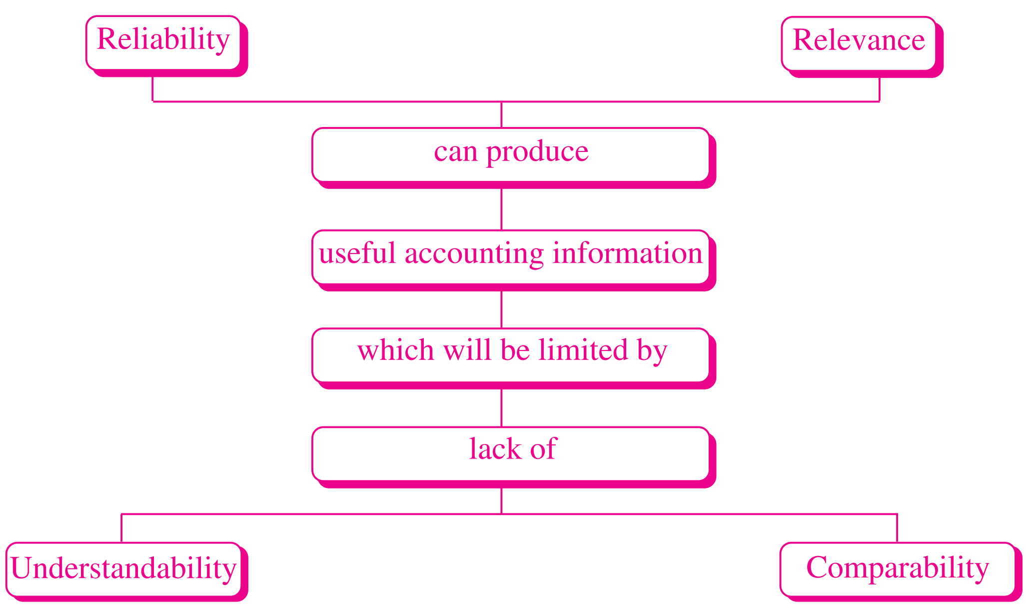
2. **Relevance :** The accounting information, besides disclosing statutorily required disclosures, should disclose other informations, after judging its relevance to the

decision-making need of its users. For example, interest on borrowings is disclosed without stating the rate of interest. Users, therefore, cannot link interest cost to different types of borrowed funds. In the process, they fail to appreciate the rationality of financing decisions. Generally, only the statutory (legal) required information is disclosed. The information disclosure requirements are set after a public debate reflecting the views of cross-sections of users. But, what is relevant information in a particular circumstance cannot be generalised and specified. The management of the enterprise is in the best position to decide the contents of the information. It may be noted that relevance of the information is always guided by the principle of materiality.

3. **Understandability :** Understandability means that the information provided through the financial statements be presented in a manner that the users are able to understand it in the manner it should be. However, if an information is considered relevant for the users' decision-making it must be disclosed even if the information is complex and not readily understandable by common users. The information disclosure requirement of law must be fulfilled howsoever complex such information may be.

4. **Comparability :** Comparability means that the users should be able to compare the accounting information of an enterprise of the period either with that of other periods, known as intra-firm comparison or with the accounting information of other enterprises, known as inter-firm comparison. It is, therefore, necessary to follow standardised accounting policies consistently to the extent possible.

Accounting information to be useful should have all the above characteristics. The accounting information produced in the light of Reliability and Relevance Qualitative Characteristics can be useful but its usefulness shall be limited if it lacks understandability and comparability. We may explain this with the help of a diagram :



1.4 ACCOUNTING TERMS

Transaction

It is an event which involves exchange of some value between two or more entities. It can be purchase of stationery, receipt of money, payment to a supplier, incurring expenses, etc. It can be a cash transaction or a credit transaction.

Purchases

This term is used for goods to be dealt-in i.e. goods are purchased for resale or for producing the finished products which are meant for sale. Goods purchased may be Cash Purchases or Credit Purchases. Thus, Purchase of goods is the sum of cash purchases and credit purchases.

Sundry Creditors

Creditors are persons who have to be paid by an enterprise an amount for providing goods and services on credit.

Sales

Sales are total revenues from goods or services provided to customers. Sales may be in cash or in credit.

Sundry Debtors

Persons who have to pay for goods sold or services rendered or in respect of contractual obligations. It is also termed as debtor, trade debtor, and accounts receivable.

Revenue (Sales)

Sales revenue is the amount by selling products or providing services to customers.

Other items of revenue common to many businesses are: Commission, Interest, Dividends, Royalties, and Rent received, etc.

Expenses

Costs incurred by a business in the process of earning revenue are called expenses. In general, expenses are measured by the cost of assets consumed or services used during the accounting period. The common items of expenses are: Depreciation, Rent, Wages, Salaries, Interest, Cost of Heating, Light and water and Telephone, etc.

Income

The difference between revenue and expense is called income. For example, goods costing ₹ 25000 are sold for ₹ 35000, the cost of goods sold, i.e. ₹ 25000 is expense,

Notes

the sale of goods, i.e. ₹ 35000 is revenue and the difference. i.e. ₹10000 is income. In other words, we can state that

Income = Revenue - Expense

Gain

Usually this term is used for profit of an irregular nature, for example, capital gain.

Loss

It means something against which the firm receives no benefit. It is a fact that expenses lead to revenue but losses do not, such as theft.

Profit

It is the excess of revenue of a business over its costs. It may be gross profit and net profit. Gross profit is the difference between sales revenue or the proceeds of goods sold and/or services provided over its direct cost of the goods sold. Net profit is the profit made after allowing for all types of expenses. There may be a net loss if the expenses exceed the revenue.

Expenditure

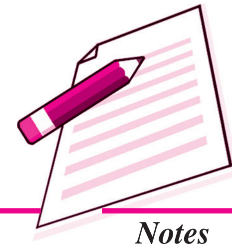
Spending money or incurring a liability for some benefit, service or property received is called expenditure. Payment of rent, salary, purchase of goods, purchase of machinery, etc. are some examples of expenditure. If the benefit of expenditure is exhausted within a year, it is treated as revenue expenditure. In case the benefit of expenditure lasts for more than one year, it is treated as an asset and also known as capital expenditure. Expenditure is usually the amount spent for the purchase of assets. It increases the profit earning capacity of the business. Expense, on the other hand, is an amount to earn revenue. 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.

Drawings

It is the amount of money or the value of goods which the proprietor takes away from business for his/her household or private use.

Capital

It is the amount invested in an enterprise by its owners e.g. paid up share capital in a corporate enterprise. It also refers to the interest of owners in the assets of an enterprise. It is the claim against the assets of the business. Any amount contributed by the owner towards the business unit is a liability for the business enterprise. This liability is also termed as capital which may be brought in the form of cash or assets by the owner.



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Assets

These are tangible objects or intangible rights owned by the enterprise and carrying probable future benefits. Tangible items are those which can be touched and their physical presence can be noted/felt e.g. furniture, machine etc. Intangible rights are those rights which one possesses but cannot see e.g. patent rights, copyrights, goodwill etc. Assets are purchased for business use and are not for sale. They raise the profit earning capacity of the business enterprise.

Assets are broadly categorized as current assets and non-current assets/fixed assets. **Current assets** are those assets which are held for a short period generally one year's time. The balance of such items goes on fluctuating i.e. it keeps on changing throughout the year. The balance of cash in hand may change so many times in a day. Various current assets are cash in hand/at bank, debtors, bills receivable, stock, pre-paid expenses.

Non-current assets : Those assets are acquired for long term use in the business. Such assets raise the profit earning capacity of the business enterprise. Expenditure on such assets is non-recurring and of capital nature. Expenses incurred on acquiring these assets are added to the value of the assets.

Liability

It is the financial obligation of an enterprise other than owners' funds.

Liabilities : Liabilities mean the amount which the business owes to outsiders, that is, except the proprietors. In the words of **Finny and Miller,** *"Liabilities are debts, they are amounts owed to creditors."* Thus, the claims of those who are not owners are called **Liabilities.** This can be expressed as :

Liabilities = Assets – Capital

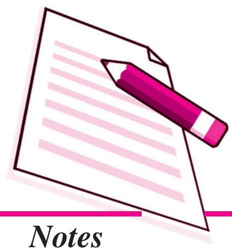
In business, transactions are recorded taking business to be an entity distinct from its owners. Thus, capital invested by the proprietors is a liability but an internal liability. On the other hand, *external liability* is a liability that is payable to outsiders, *i.e.,* other than the proprietors.

External liability arises because of credit transactions or loans raised. Examples of external liabilities are creditors, bank overdraft, bills payable, outstanding liabilities.

Liabilities can be classified into the following :

i. *Long-Term Liabilities :* These are those liabilities which are payable after a long-term, (generally more than a year). Examples of Long-Term Liabilities are long-term loans, debentures, etc.

ii. *Short-Term/Current Liabilities :* These are liabilities which are payable in the near future (generally within a year). Examples of Current Liabilities are creditors, bank overdrafts, bills payable, short-term loans, etc.



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Account : Account is a summarised record of relevant transactions at one place relating to a particular head. It records not only the amount of transactions but also their effect and direction.

Stock or Inventory : Stock is the tangible property held by an enterprise for the purpose of sale in the ordinary course of business or for the purpose of using it in the production of goods meant for sale or services to be rendered. Stock may be *opening stock* or *closing stock*. In case of a manufacturing concern, Closing Stock comprises raw materials, Work-in-Progress (*i.e.,* semi-finished goods) and finished goods in hand on the closing date. Similarly, Opening Stock (beginning inventory) is the amount of stock at the beginning of the accounting period.

Goods : They refer to items forming part of the Stock-in-Trade of an enterprise, which are purchased or manufactured with a purpose of selling. In other words, they refer to the products in which an enterprise is dealing. For an enterprise dealing in home appliances such as T.V., fridge, A.C., etc., these are goods. Similarly, for a stationer, stationery is goods, whereas for others, it is an item of expense (not purchases). An enterprise may purchase assets for use in furtherance of business or stationery for use in the business, but they are not purchases of 'goods' but fixed asset and expense respectively.

Receivables : The term 'Receivables' includes the outstanding amount due from others. Sometimes, a debtor may accept a Bill of Exchange, which is payable after a certain period. Such a bill is known as **Bill Receivable**. Sometimes, a debtor promises to pay the specific amount in writing after a specified period. Such a promise is known as a **Promissory Note** and is recorded as *note receivable*. The term – *accounts receivable* includes trade debtors as well as bills receivable and promissory notes receivable. The term *receivable* includes all the amounts due from others.

Payables : The term 'Payables' include the amounts due to other. *Accounts Payable* includes trade creditors as well as bills payable and promissory notes payable. The term payable includes all the amounts due to others.

Bill Receivable : Bill Receivable means a Bill of Exchange accepted by a debtor the amount of which will be received on the specified date.

Bill Payable : Bill Payable means a Bill of Exchange, the amount of which will be payable on the specified date.

Event : Any transactions in an organisation can be called as an event. Transactions in an organisation have documentary evidence and will create a change in revenue, expense, assets, liabilities and capital.

Cost : It is the amount of expenditure incurred on or is attributed to a specified article; product or activity.

Voucher : It is proof of a business transaction. Cash Memo, Bill/Invoice, Credit/Debit notes etc. are examples of voucher.

Discount : Some customers are allowed reduction in the price of goods by the business. It is called a Discount.

Trade Discount : It is the reduction allowed by the seller to the buyer at the time of sale on the list price of goods. Trade discount is allowed on bulk purchases. Normally, trade discount is deducted from the list price and only the balance is accounted for. Therefore, trade discount will not be shown in the books of accounts.

Cash Discount : It is the deduction allowed by the creditor to the debtor on the amount due by the latter. This concession is given only to those who settle their accounts within a stipulated period. Therefore, cash discount encourage prompt settlement of accounts. For the debtor who pays the amount, it is an income. For creditor, cash discount is an expense.

INTEXT QUESTIONS 1.4

Fill in the blanks :

i. Stock is a ___________ asset.

ii. Liabilities = Assets - ___________

iii. Debentures are ___________ term liabilities.

iv. Creditors are ___________ term liabilities.

Role of an Accountant in Society

The accountant with his specialized knowledge, extensive training and experience is not merely responsible for preparing accounts, rather he/she is the best equipped person to provide other related services normally required by the management. This helps the management to discharge their duties more effectively thereby providing for efficient utilization of resources. The accountants' role in the society includes the following :

- To maintain the proper books of accounts which portray the true and fair view of the results of the business.
- To provide information and reports to management to enable them to discharge their duties more effectively.

- To act as auditor for attestation of accounts as per the requirement of law.
- To act as an internal auditor to assist and strengthen the hands of the management.
- To act as tax consultant to handle the tax matters of the business.
- To act as management consultant to provide services regarding financial planning of the business to their clients.

INTEXT QUESTIONS 1.5

I. Write against the following statements the terms for which these are made in reference to accounting information.

i. It is a common language used to communicate financial information.

ii. Managing Director, functional managers, shareholders etc using the accounting information.

iii. Ability of the firm to meet all its short term or current obligations as and when they fall due.

II. State in each case, whether the items are to be regarded as goods or assets.

i. Furniture purchased by Makhan Singh, a dealer in furniture.

ii. Automatic Machine purchased by a workshop for manufacturing products.

iii. Machine manufactured by a firm for sale to a mill.

iv. Furniture purchased by Malti, a stationery shop-owner.

III. Multiple Choice Questions :

i. Goods in hand at the end of a year is called ___________.

a) Purchases b) cost c) stock d) profit

ii. A Bill of Exchange is considered as _________ from the view point of creditors.

a) Bills receivable b) Bills payable

c) Discounting d) None of the above

iii. A Bill of Exchange is ______________ from the view point of debtors.

a) Bills Receivable b) Bills Payable

c) Endorsement d) None of the above

iv. ____________ are reductions allowed either on selling price or on the amount due.

a) Discount b) Cost

c) Bills d) All of the above

WHAT YOU HAVE LEARNT

- Accounting is the art of recording, classifying and summarizing in terms of money transactions and events of a financial nature and interpreting the results thereof. It is the process of collecting, recording, summarizing and communicating financial information. It is an information system which generates information for decision making by the interested parties.
- Recording of business transactions in a systematic manner in the books of accounts is called book keeping.
- Accounting consists of economic events which are identified, measured, recorded and communicated.
- Branches of accounting : Financial accounting, cost accounting and management accounting are some of the branches of accounting.
- Accounting in modern times is treated as an information system which has transaction, accounting process, decision useful financial information as the necessary ingredients.
- The accountant with his specialised knowledge extensive training and experience helps the management and plays an important role in the society.
- Important accounting terms are : Business entity, transactions, purchases, sales, debtors, creditors, etc.

TERMINAL EXERCISE

1. What is accounting? What are its objectives and limitations?
2. Distinguish between book-keeping and accounting.
3. Explain the different branches of accounting.
4. Explain the role of an accountant in the society.
5. Explain accounting as a system of information. Enlist the parties that are interested in the accounting information.

Notes

6. What is expense? Explain with example.
7. What is meant by liability? Explain with the help of examples.
8. State the meaning of the term 'Asset' with examples.

ANSWERS TO INTEXT QUESTIONS

1.1 I. i. Book keeping ii. Analysing iii. Accounting iv. Investors, Creidtors etc.

II. i. B ii. B iii. A iv. A v. A

1.2 I. i. Cost accounting ii. Social accounting iii. Management accounting

II.
i. The effect of rise in price is not taken into consideration
ii. Estimates are sometimes inaccurate
iii. Profit can be manipulated by window dressing
iv. Non monetary transactions are completely omitted.

III.
i. Systematic records are accepted as evidence in court.
ii. Systematic record keeping replaces memory.
iii. Accounting provides the financial information for decision making.

1.3 i. T ii. T iii. F

1.4 i. current ii. capital iii. long iv. short

1.5 I. i. Accounting ii. users iii. language of business

II. i. Goods ii. Assets iii. Goods iv. Assets

III. i. c ii. a iii. b iv. a

ACTIVITY

One day you have visited your friend Shiva who runs a grocery shop and casually talked about the accounts he maintains of his business unit. You were surprised to note that he did not maintain accounts. Enquire from other businessmen you know about their accounting records and about the uses and purposes of accounting. Explain them to your friend Shiva to motivate him to maintain accounts of his business unit.

Notes

2

ACCOUNTING CONCEPTS

In the previous lesson, you have studied the meaning and nature of business transactions and objectives of financial accounting. In order to maintain uniformity and consistency in preparing and maintaining books of accounts, certain rules or principles have been evolved. These rules/principles are classified as concepts and conventions. These are foundations of preparing and maintaining accounting records. In this lesson we will learn about various accounting concepts, their meaning and significance.

OBJECTIVES

After studying this lesson, you will be able to

- explain the term accounting concept and
- explain the meaning and significance of various accounting concepts : Business Entity, Money Measurement, Going Concern, Accounting Period, Cost Concept, Duality Aspect concept, Realisation Concept, Accrual Concept and Matching Concept.

2.1 MEANING OF ACCOUNTING CONCEPT

Let us take an example. In India there is a basic rule to be followed by everyone that one should walk or drive on the left hand side of the road. It helps in the smooth flow of traffic. Similarly, there are certain rules that an accountant should follow while recording business transactions and preparing accounts. These may be termed as accounting concepts. Thus, it can be said that :

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

The main objective is to maintain uniformity and consistency in accounting records. These concepts constitute the very basis of accounting. All the concepts have been developed over the years from experience and thus, they are universally accepted rules. Following are the various accounting concepts that have been discussed in the following sections :

- Business entity concept
- Money measurement concept
- Going concern concept
- Accounting period concept
- Accounting cost concept
- Duality aspect concept
- Realisation concept
- Accrual concept
- Matching concept

2.2 BUSINESS ENTITY CONCEPT

This concept assumes that, for accounting purposes, the business enterprise and its owners are two separate independent entities. Thus, the business and personal transactions of its 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 from the business cash/goods 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 the person owning the business. This concept is the very basis of accounting.

Let us take an example. Suppose Mr. Sahoo started business investing ₹100000. He purchased goods for ₹40000, Furniture for ₹20000 and plant and machinery of ₹30000. ₹10000 remains in hand. These are the assets of the business and not of the owner. According to the business entity concept ₹100000 will be treated by business as capital i.e. a liability of business towards the owner of the business.

Now suppose, he takes away ₹5000 cash or goods worth ₹5000 for his domestic purposes. This withdrawal of cash/goods by the owner from the business is his private expense and not an expense of the business. It is termed as Drawings. Thus, the business entity concept states that business and the owner are two separate/distinct persons. Accordingly, any expense incurred by owner for himself or his family from business will be considered as expenses and it will be shown as drawings.

Notes

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 restraints 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. The main objective of accounting concepts is to maintain ___________ and ___________ in the accounting record.

iii. ___________ concept assumes that business enterprise and its owners are two separate independent entities.

iv. The goods drawn 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 a 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 ₹200000, purchase of raw materials ₹100000, Rent Paid ₹10000 etc. are expressed in terms of money, and so these 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, loyality, 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 2013, an organisation may have a factory on a piece of land measuring 10 acres, office building containing 50 rooms, 50 personal computers, 50 office chairs and tables, 100 kg of raw materials etc. These are expressed in different units. But for accounting purposes they are to be recorded in money terms i.e. in rupees. In this case, the cost of factory land may be say ₹12 crore, office building of ₹10 crore, computers ₹10 lakhs, office chairs and tables ₹2 lakhs, raw material ₹30 lakhs. Thus, the total assets of the organisation are valued at ₹22 crore and ₹42 lakhs. Therefore, the transactions which can be expressed in terms of money is recorded in the accounts books, that too in terms of money and not in terms of the quantity.

Significance

The following points highlight the significance of money measurement concept :

- This concept guides accountants about 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 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

Put a tick mark (√) against the information that should be recorded in the books of accounts and cross mark (×) against the information that should not be recorded

i. Health of the managing director

ii. Purchase of factory building ₹10 crore

iii. Rent paid ₹100000

iv. Goods worth ₹ 10000 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 purchases a plant and machinery of ₹100000 and its life span is 10 years. According to this concept every year some amount will be shown as expenses 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 will not be proper 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.
- A business is 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)

v. ___________ concept states that business will not be dissolved in near future. (Going concern, Business entity)

Notes

2.5 ACCOUNTING PERIOD CONCEPT

All the transactions are recorded in the books of accounts on the assumption that profits on these transactions are to be ascertained for a specified period. This is known as accounting period concept. Thus, this concept requires that a balance sheet and profit and loss account should be prepared at regular intervals. This is necessary for different purposes like, calculation of profit, ascertaining financial position, tax computation etc.

Further, this concept assumes that, indefinite life of business is divided into parts. These parts are known as Accounting Period. It may be of one year, six months, three months, one month, etc. But usually one year is taken as one accounting period which may be a calender year or a financial year.

> Year that begins from 1st of January and ends on 31st of December, is known as Calendar Year. The year that begins from 1st of April and ends on 31st of March of the following year, is known as financial year.

As per accounting period concept, all the transactions are recorded in the books of accounts for a specified period of time. Hence, goods purchased and sold during the period, rent, salaries etc. paid for the period are accounted for against that period only.

Significance

- It helps in predicting the future prospects of the business.
- It helps in calculating tax on business income calculated for a particular time period.
- It also helps banks, financial institutions, creditors, etc to assess and analyse the performance of business for a particular period.
- It also helps the business firms to distribute their income at regular intervals as dividends.

INTEXT QUESTIONS 2.4

Fill in the blanks with suitable word/words :

i. Recording of transactions in the books of accounts with a definite period is called .... concept.

ii. The commonly accepted accounting period in India is ....

iii. According to accounting period concept, revenue and expenses are related to a .... period.

iv. If accounting year begins from 1st of January, and ends on 31st of December, it is known as ....

v. If accounting year begins from 1st of April and ends on 31st of March of the following year, then accounting year is known as ....

2.6 ACCOUNTING COST CONCEPT

Accounting cost concept states that all assets are recorded in the books of accounts at their purchase price, which includes cost of acquisition, transportation and installation and not at its market price. It means that fixed assets like building, plant and machinery, furniture, etc are recorded in the books of accounts at a price paid for them. For example, a machine was purchased by XYZ Limited for ₹500000, for manufacturing shoes. An amount of ₹1,000 were spent on transporting the machine to the factory site. In addition, ₹2000 were spent on its installation. The total amount at which the machine will be recorded in the books of accounts would be the sum of all these items i.e. ₹503000. This cost is also known as historical cost. Suppose the market price of the same is now ₹ 90000 it will not be shown at this value. Further, it may be clarified that cost means original or acquisition cost only for new assets and for the used ones, cost means original cost less depreciation. The cost concept is also known as historical cost concept. The effect of cost concept is that if the business entity does not pay anything for acquiring an asset this item would not appear in the books of accounts. Thus, goodwill appears in the accounts only if the entity has purchased this intangible asset for a price.

Significance

- This concept requires asset to be shown at the price at which it has been acquired, which can be verified from the supporting documents.
- It helps in calculating depreciation on fixed assets.
- The effect of cost concept is that if the business entity does not pay anything for an asset, this item will not be shown in the books of accounts.

INTEXT QUESTIONS 2.5

Fill in the blanks with suitable word/words

i. The cost concept states that all fixed assets are recorded in the books of accounts at their ____________ price.

ii. The main objective to adopt historical cost in recording the fixed assets is that the cost of the assets will be easily verifiable from the ____________ documents.

iii. The cost concept does not show the .... of the business.

iv. The cost concept is otherwise known as .... concept.

Notes

2.7 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 :

Assets = Liabilities + Capital

The above accounting equation states that the assets of a business are always equal to the claims of owner/owners and the outsiders. This claim is also termed as capital or owners 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 helps 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 :

1. Capital brought in by the owner of the business

   The two aspects in this transaction are :

   (i) Receipt of cash

   (ii) Increase in Capital (owners equity)

2. Purchase of machinery by cheque

   The two aspects in the transaction are

   (i) Reduction in Bank Balance

   (ii) Owning of Machinery

3. Goods sold for cash

   The two aspects are

   (i) Receipt of cash

   (ii) Delivery of goods to the customer

4. Rent paid in cash to the landlord

   The two aspects are

   (i) Payment of cash

   (ii) Rent (Expenses incurred).

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.

Significance

- This concept helps accountant in detecting error.
- It encourages the accountant to post each entry in opposite sides of two affected accounts.

INTEXT QUESTIONS 2.6

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)	Rent Received		

Notes

2.8 REALISATION CONCEPT

This concept states that revenue from any business transaction should be included in the accounting records only when it is realised. The term realisation means creation of legal right to receive money. Selling goods is realisation, receiving order is not.

In other words, it can be said that :

> Revenue is said to have been realised when cash has been received or right to receive cash on the sale of goods or services or both have been created.

Let us study the following examples :

i. N.P. Jeweller received an order to supply gold ornaments worth ₹5,00,000. They supplied ornaments worth ₹2,00,000 up to the year ending 31st December 2013 and rest of the ornaments were supplied in January 2014.

ii. Bansal sold goods for ₹1,00,000 for cash in 2013 and the goods have been delivered during the same year.

iii. Akshay sold goods on credit for ₹50,000 during the year ending 31st December 2013. The goods have been delivered in 2013 but the payment was received in March 2014.

Now, let us analyse the above examples to ascertain the correct amount of revenue realised for the year ending 31st December 2013.

i. The revenue for the year 2013 for N.P. Jeweller is ₹200000. Mere getting an order is not considered as revenue until the goods have been delivered.

ii. The revenue for Bansal for year 2013 is ₹1,00,000 as the goods have been delivered in the year 2013. Cash has also been received in the same year.

iii. Akshay's revenue for the year 2013 is ₹50,000, because the goods have been delivered to the customer in the year 2013. Revenue became due in the year 2013 itself. In the above examples, revenue is realised when the goods are delivered to the customers.

> The concept of realisation states that revenue is realized at the time when goods or services are actually delivered.

In short, the realisation occurs when the goods and services have been sold either for cash or on credit. It also refers to inflow of assets in the form of receivables.

Significance

- It helps in making the accounting information more objective.
- It provides that the transactions should be recorded only when goods are delivered to the buyer.

INTEXT QUESTIONS 2.7

Ascertain the amount of current revenue realized for the year ending 31st December 2006

i. An order, to supply goods for ₹20,00,000 is received in the year 2006. The goods have been supplied only for ₹10,00,000 in 2006.

ii. What will be the revenue (i) if the payment of ₹6,00,000 is received in cash in 2006 and the balance payment of ₹4,00,000 received in 2007.

iii. What will be the revenue if the goods have been sold on credit and the payment of ₹1500000 is received in the year 2007, while all the goods of ₹20,00,000 are supplied in the year 2006.

iv. What will be the revenue if an advance payment of ₹100,000 is received in the year 2006 and the balance received in the year 2007.

Notes

2.9 ACCRUAL CONCEPT

The meaning of accrual is something that becomes due especially an amount of money that is yet to be paid or received at the end of the accounting period. It means that revenues are recognised when they become receivable. Though cash is received or not received and the expenses are recognised when they become payable though cash is paid or not paid. Both transactions will be recorded in the accounting period to which they relate. Therefore, the accrual concept makes a distinction between the accrual receipt of cash and the right to receive cash as regards revenue and actual payment of cash and obligation to pay cash as regards expenses.

The accrual concept under accounting assumes that revenue is realised at the time of sale of goods or services irrespective of the fact when the cash is received. For example, a firm sells goods for ₹55000 on 25th March 2014 and the payment is not received until 10th April 2014, the amount is due and payable to the firm on the date of sale i.e. 25th March 2014. It must be included in the revenue for the year ending 31st March 2014. Similarly, expenses are recognised at the time services provided, irrespective of the fact when actual payment for these services are made. For example, if the firm received goods costing ₹20000 on 29th March 2014 but the payment is made on 2nd April 2014 the accrual concept requires that expenses must be recorded for the year ending 31st March 2014 although no payment has been made until 31st March 2014 though the service has been received and the person to whom the payment should have been made is shown as creditor.

Notes

In brief, accrual concept requires that revenue is recognised when realised and expenses are recognised when they become due and payable without regard to the time of cash receipt or cash payment.

Significance

- It helps in knowing actual expenses and actual income during a particular time period.
- It helps in calculating the net profit of the business.

INTEXT QUESTIONS 2.8

Fill in the blanks with suitable word/words :

i. Accrual concept relates to the determination of ....
ii. Goods of ₹50000 are sold on 25th March 2014 but payment is received on 10th April 2014. It will be a revenue for the year ending ....
iii. Accrual concept requires revenue is recognised when .... and expenses are recognised when they become ....

2.10 MATCHING CONCEPT

The matching concept states that the revenue and the expenses incurred to earn the revenues must belong to the same accounting period. So once the revenue is realised, the next step is to allocate it to the relevant accounting period. This can be done with the help of accrual concept.

Let us study the following transactions of a business during the month of December, 2006

(i) Sale : cash ₹2000 and credit ₹1000
(ii) Salaries Paid ₹350
(iii) Commission Paid ₹150
(iv) Interest Received ₹50
(v) Rent received ₹140, out of which ₹40 received for the year 2007
(vi) Carriage paid ₹20
(vii) Postage ₹30
(viii) Rent paid ₹200, out of which ₹50 belong to the year 2005
(ix) Goods purchased in the year for cash ₹1500 and on credit ₹500
(x) Depreciation on machine ₹200

Let us record the above transactions under the heading of Expenses and Revenue.

Expenses		*Amount* ₹	*Revenue*		*Amount* ₹
1. Salaries		350	1. Sales		
2. Commission		150	Cash	2000	
3. Carriage		20	Credit	1000	3000
4. Postage		30	2. Interest received		50
5. Rent paid	200		3. Rent received	140	
Less for 2005	-50	150	Less for 2007	(40)	100
6. Goods purchased					
Cash	1500				
Credit	500	2000			
7. Depreciation on machine		200			
Total		2900	Total		3150

In the above example expenses have been matched with revenue i.e (Revenue ₹3150- Expenses ₹2900) This comparison has resulted in profit of ₹250. If the revenue is more than the expenses, it is called profit. If the expenses are more than revenue it is called loss. This is what exactly has been done by applying the matching concept.

Therefore, the matching concept implies that all revenues earned during an accounting year, whether received/not received during that year and all cost incurred, whether paid/not paid during the year should be taken into account while ascertaining profit or loss for that year.

Significance

- It guides how the expenses should be matched with revenue for determining exact profit or loss for a particular period.
- It is very helpful for the investors/shareholders to know the exact amount of profit or loss of the business.

INTEXT QUESTIONS 2.9

Fill in the blanks with suitable word/words :

i. Expenses are matched with ____________ generated during a period.

ii. Goods sold for cash is an example of ____________.

iii. Salaries paid is an example of ____________.

iv. Income is the excess of ____________ over ____________.

v. ____________ concept states that the revenue and the expenses incurred to earn the revenue must belong to the same accounting period

vi. ____________ concept states how the expenses should be compared with revenues for ascertaining exact profit or loss for a particular period

Notes

WHAT YOU HAVE LEARNT

- Accounting concepts refer to the basic assumptions which serve the basis of recording actual business transactions.
- The important accounting concepts are business entity, money measurement, going concern, accounting period, cost concept, duality aspect concept, realisation concept, accrual concept, and matching concept.
- 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 activities for an indefinite period of time.
- Accounting period concept states that all the business transactions are recorded in the books of accounts on the assumption that profits of transactions is to be ascertained for a specified time period.
- Accounting cost concept states that all assets are recorded in the books of accounts at their cost price.
- Dual aspect concept states that every transaction has a dual effect.
- Realisation concept states that revenue from any business transaction should be included in the accounting records only when it is realised
- Matching concept states that the revenue and the expenses incurred to earn the revenue must belong to the same accounting period

TERMINAL EXERCISE

1. Explain meaning and significance of going concern concept.
2. What do you mean by business entity concept?
3. State meaning and significance of money measurement concept.
4. Write short notes on the following

   (a) Cost concept (b) Accrual concept

(c) Matching concept (d) Accounting period concept

5. What do you mean by accounting concept? Explain any four accounting concepts.

Notes

ANSWERS TO INTEXT QUESTIONS

2.1 (i) rules (ii) uniformity and consistency
(iii) Business entity concept (iv) drawings

2.2 (i) × (ii) √ (iii) √ (iv) √ (v) ×

2.3 (i) for an indefinite time period (ii) cost price
(iii) going concern concept (iv) financial statements (v) Going concern

2.4 (i) accounting period (ii) one year (iii) particular
(iv) calender year (v) financial year

2.5 (i) purchase (ii) supporting (iii) true net worth (iv) historical cost

2.6 (i) Owner's capital, cash (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, rent

2.7 (i) ₹10,00,000 (ii) ₹10,00000 (iii) ₹20,00,000 (iv) ₹1,00,000

2.8 (i) income (ii) 31st March, 2006 (iii) realised, due

2.9 (i) revenue (ii) revenue (iii) expense (iv) revenue, expenses
(v) matching (vi) matching

ACTIVITY

In our country business concerns are not following the same accounting period every year. Enquire from various sources and list various such periods prevailing in our country. One for example is given

1. Year ending 31st March (financial year)
2. ______________________________
3. ______________________________

3

ACCOUNTING CONVENTIONS AND STANDARDS

In the previous lesson, you have studied the accounting concepts like business entity, money measurement, going concern, accounting period, cost, duality, realisation, accrual and matching. These concepts or assumptions or principles are working rules for all accounting activities.

You may visit some business units doing a particular kind of business. Enquire them and find out how unsold goods are being valued. You will find that they follow the same method of valuation of unsold stock of goods. If you ask them, why do they value the unsold goods at cost or market price, whichever is lower, even though the market price is higher than the cost price, the businessman may answer that it is the convention, tradition or practice or custom of the business, that business is following year after year. In accounting, there are many conventions or practices which are used while recording the transactions in the books of accounts. Apart from these, the Institute of Chartered Accountants of India (ICAI), which is the main regulatory body for standardisation of accounting policies in the country has issued a number of accounting standards from time to time to bring consistency in the accounting practices. We shall study about accounting conventions and standards in detail in this lesson.

OBJECTIVES

After studying this lesson, you will be able to :

- explain the meaning of accounting convention;
- explain the meaning and significance of accounting consventions like consistency, full disclosure, materiality and conservatism;
- state the meaning of the term Generally Accepted Accounting Principles (GAAP);

Notes

- explain the concept of accounting standards and enumerate the various accounting standards issued by the Institute of Chartered Accountants of India.

3.1 MEANING OF ACCOUNTING CONVENTIONS

An accounting convention refers to common practices which are universally followed in recording and presenting accounting information of the business entity. They 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 period are :

- Convention of consistency.
- Convention of full disclosure.
- Convention of materiality.
- Convention of conservatism.

3.2 CONVENTION OF CONSISTENCY

The convention of consistency means that same accounting principles should be used 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 undermentioned general practices or methods year after year.

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 particular method year after year. This can be further clarified as : in case of charging depreciation on fixed assets accountant can decide to adopt any one of the methods 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 or whichever is less. However precious metals like gold, diamond, minerals are generally valued at market price only.

Notes

Types of consistency

There are three types of consistency namely :

i. **Vertical consistency (Same organisation) :** It is to be found within the group of inter-related financial statements of an organisation on the same date. It occurs when fixed assets have been shown at cost price and in the interrelated income statement depreciation has also been charged on the historical cost of the assets.

ii. **Horizontal consistency (Time basis) :** This consistency is to be found between financial statements of one entity from period to period. Thus, it helps in comparing performance of the business between two years i.e. current year with past year.

iii. **Dimensional consistency (Two organisations in the same trade) :** This consistency is to be found in the statements of two different business entities of the same period. This type of consistency assists in making comparison of the performance of one business entity with the other business entity in the same trade and on the same date.

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

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

INTEXT QUESTIONS 3.1

Fill in the blanks with suitable word/words

i. Convention of consistency means that same accounting principles should be used for preparing financial statements ...……..

ii. Unsold goods are valued at cost price or ...……… whichever is ...………

iii. Precious metals, like gold, mineral and others are generally valued at………..

iv. As per the convention of ………… year after year same methods are followed.

3.3 CONVENTION OF FULL DISCLOSURE

Convention of full disclosure requires that all material and relevant facts concerning financial statements should be fully disclosed. Full disclosure means that there should be full, fair and adequate disclosure of accounting information. **Adequate** means sufficient set of information to be disclosed. **Fair** indicates an equitable treatment of users. **Full** refers to complete and detailed presentation of information. Thus, the convention of full disclosure suggests that every financial statement should fully disclose all relevant information. Let us relate it to the business. The business provides financial information to all interested parties like investors, lenders, creditors, shareholders etc. The shareholders would like to know profitability of the firm while the creditors would like to know the solvency of the business. In the same way, other parties would be interested in the financial information according to their requirements. This is possible if financial statements disclose all relevant information in full, fair and adequate manner.

Let us take an example. As per accounts, net sales are ₹1,50,000, it is important for the interested parties to know the amount of gross sales which may be ₹2,00,000 and the sales return ₹50,000. The disclosure of 25% sales returns may help them to find out the actual sales position. Therefore, whatever details are available, that must be honestly provided. Additional information should also be given in the financial statements. For example, in a balance sheet the basis of valuation of assets, such as investments, inventories, land and building etc. should be clearly stated. Similarly, any change in the method of depreciation or in making provision for bad debts or creating any reserve must also be shown clearly in the Balance Sheet. Therefore, in order to achieve the purpose of accounting, all the transactions of a business and any change in accounting policies, methods and procedures are fully recorded and presented in accounting.

To ensure proper disclosure of material accounting information, the Companies Act 1956, under schedule VI has provided a format for the preparation of Profit and Loss account and Balance Sheet of a company. It is necessary for every company to follow this format. The regulatory bodies like Securities and Exchange Board of India (SEBI) has also made compulsory for complete disclosures by registered companies.

Significance

- It helps in meaningful comparison of financial statements of the different business units.
- This can also help in the comparison of financial statements of different years of the same business unit.
- This convention is of great help to investor and shareholder for making investment decisions.
- The convention of full disclosure presents reliable information.

Notes

INTEXT QUESTIONS 3.2

Fill in the blanks with appropriate word/words :

i. The shareholders would like to know about the __________ of the business.

ii. The convention of full disclosure requires that there should be full, __________ and __________ disclosure of accounting information.

iii. The creditors are interested to know the __________ of the business.

iv. All relevant material facts should be __________ in the financial statements.

v. The full disclosure convention presents __________ information.

3.4 CONVENTION OF MATERIALITY

The convention of materiality states that, to make financial statements meaningful, only material facts 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 means the information of which 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, these should be recorded in the 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

- It helps in minimising the errors of calculation.
- It helps in making financial statements more meaningful.
- It saves time and resources.

INTEXT QUESTIONS 3.3

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 significant items should be disclosed under ____________.

iii. ___________ convention keeps accounts manager to focus on important /significant items.

iv. ___________ means the information which will influence the decision of its users.

3.5 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 profit shows more than 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 realised. 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

- It helps in ascertaining actual profit.
- It is useful in the situation of uncertainties and doubts.
- It helps in maintaining the capital of the enterprise.

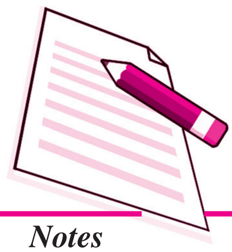
INTEXT QUESTIONS 3.4

Give your decision in the following situations :

i. A business has unsold stock at the end of year. The cost price is ₹2,00,000 and the market price is ₹2,50,000. At which price the unsold stock be recorded ?

ii. What will be your decision if the cost price in the above case is ₹2,10,000 ?

iii. A businessman anticipates that it may not be possible to collect ₹50,000 from one of his debtors. will he record this transaction in the books of accounts and at what value?



Notes

3.6 GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP) AND ACCOUNTING STANDARDS

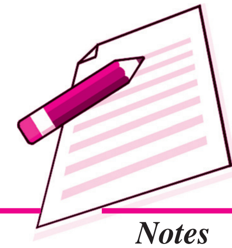
In order to maintain uniformity and consistency in accounting records throughout the world, certain rules and principles have been developed which are generally accepted by the accounting profession. These rules/principles are called by different names such as principles, concepts, conventions, postulates, assumptions. These rules/principles are judged on their general acceptability rather than universal acceptability. Hence, they are popularly called Generally Accepted Accounting Principles (GAAP). The term "generally accepted" means that these principles must have support, that generally comes from the professional accounting bodies. Thus, Generally Accepted Accounting Principles (GAAP) refer to the rules or guidelines adopted for recording and reporting of business transactions of financial statements. These principles have evolved over a long period of time on the basis of past experiences, usages or customs, etc. These principles are also referred as concepts and conventions, which have already been discussed.

Accounting standards : Concept and Objectives

The term standard denotes a discipline, which provides both guidelines and yardsticks for evaluation. As guidelines, accounting standards provide uniform practices and common techniques of accounting. As a general rule, accounting standards are applicable to all corporate enterprises. They are made operative from a date specified in the standards. The Institute of Chartered Accountants of India (ICAI) constituted the Accounting Standards Board (ASB) in April, 1977 for developing accounting standards. However, the International Accounting Standards Committee (IASC) was set up in 1973, with its headquarter in London (U.K.).

The Accounting Standards Board is entrusted with the responsibility of formulating standards on significant accounting matters keeping in view the international developments, and legal requirements in India.

The main function of the ASB is to identify areas in which uniformity in standards is required and to develop draft standards after discussions with representatives of the Government, public sector undertakings, industries and other agencies.



Notes

In the initial years, the standards are of recommendatory in nature. Once an awareness is created about the benefits and relevance of accounting standards, steps are taken to make the accounting standards mandatory for all companies. In case of non compliance, the companies are required to disclose the reasons for deviations and its financial effects:

Till date, the IASC has brought out 40 accounting standards. However, the ICAI has so far issued 29 accounting standards. These are :

AS-1 Disclosure of accounting policies (January 1979). This standard deals with the disclosure of significant accounting policies in the financial statements.

AS-2 Valuation of Inventories (June 1981). This standard deals with the principles of valuing inventories for the financial statements.

AS-3 **(Revised)** Cash flow statement (June 1981, Revised in March 1997). This standard deals with the financial statement which summarises for a given period the sources and applications of an enterprise.

AS-4 Contingencies and events occurring after the Balance Sheet date (November 1982, Revised in April, 1995) This standard deals with the treatment of contingencies and events occurring after the balance sheet date.

AS-5 Net profit or loss for the period, prior period (period before the date of balance sheet) items and changes in accounting policies (November 1982, Revised in February 1997). This standard deals with the treatment in financial statement of prior period and extraordinary items and changes in accounting policies.

AS-6 Depreciation Accounting (November 1982). This standard applies to all depreciable assets. But this standard does not apply to assets in the category of forests, plantations and similar natural resources and wasting assets.

AS-7 Accounting for construction contracts (December 1983, revised in April 2003). This standard deals with accounting for construction contracts in the financial statements of contractors.

AS-8 Accounting for Research and Development (January 1985). This standard deals with the treatment of costs of research and development in financial statements.

AS-9 Revenue Recognition (November 1985). This standard deals with the bases for recognition of revenue in the statement of profit and loss of an enterprise.

AS-10 Accounting for fixed assets (November 1991). This standard deals with recognition of fixed assets grouped into various categories, such as land, building, plant and machinery, vehicles, furniture and gifts, goodwill, patents, trading and designs.

AS-11 Accounting for the effects of change in foreign exchange Rates. (August 1991 and Revised in 1993). This standard deals with the issues relating to accounting for effect of change in foreign exchange rates.

AS-12 Accounting for Government grants (April 1994). This standard deals with the accounting for government grants.

AS-13 Accounting for investments (September 1994). This standard deals with accounting aspect concerning investments in the financial statements. These include classification, determination of cost for initial recognition, disposal and re-classification of investment.

AS-14 Accounting for amalgamation (October 1994). This standard deals with accounting treatment of any resultant goodwill or reserves in amalgamation of companies.

AS-15 Accounting for retirement Benefits in the financial statements of employers (January 1995). This standard deals with accounting for retirement benefits in the financial statements of employers.

AS-16 Borrowing Costs (April 2000). This standard deals with the uses involved relating to capitalization of interest on borrowings for purchase of fixed assets.

AS-17 Segment reporting (October 2000). This standard applies to companies which have an annual turnover of ₹50 crores or more. These companies have to present segment wise financial statements and consolidated financial statements.

AS-18 Related party disclosures (October 2000 revised 1st July 2003). This standard requires certain disclosure which must be made for transactions between the enterprise and related parties.

AS-19 Leases (January 2001). This standard deals with the accounting treatment of transactions related to lease agreements.

AS-20 Earning per share (April 2001). This standard deals with the presentation and computation of earning per share (EPS).

AS-21 Consolidated financial statements (April 2001). This standard deals with the preparation of consolidated financial statements with an intention to provide information about the activities of a group.

AS-22 Accounting for taxes on Income (April 2001). This standard deals with determination of the account of tax expenses for the related revenue.

AS-23 Accounting for investments in Associates in consolidated financial statements (July 2001). This standard deals with the principles and procedures to be followed for recognising, in the consolidated financial statement.

AS-24 Discontinued operations (February 2002). This standard deals with the principles of discontinuing operations of an enterprise with the activities which are continuing.

AS-25 Interim financial reporting (February 2002). This standard deals with the minimum content of interim financial report.

AS-26 Intangible Assets (February 2002). This standard prescribed the accounting treatment for intangible assets which are not covered by any other specific accounting standard.

AS-27 Financial reporting of interest for joint venture (February 2002). This standard sets principles and procedures for accounting for interest in joint venture.

AS-28 Impairment of Assets (2004). This standard prescribed procedures to ensure that an asset is carried at no more than its carrying amount and procedures as to when to recognise an asset as impaired.

AS-29 Provision for contingent labilities and contingent assets (2004). This standard deals with measurement and recognition criteria in three areas, namely provisions, contingent liabilities and contingent assets.

All the above standards issued by the Accounting Standards Board are recommended for use by companies listed on a recognized stock exchange and other large commercial, industrial and business enterprises in the public and private sectors.

INTEXT QUESTIONS 3.5

Fill in the blank with appropriate words

i. AS1 deals with ....

ii. AS29 deals with ....

iii. AS26 deals with ....

iv. AS20 deals with ....

v. AS21 deals with ....

vi. AS22 deals with ....

vii. GAAP stands for ....

viii. Accounting standard Board (ASB) was established ....

ix. International Accounting Standard Committee was established ....

x. AS2 deals with ....

Notes

WHAT YOU HAVE LEARNT

- 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 disclosure states that all material and relevant facts relating to financial statements should be fully disclosed.
- 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 realised. But if business anticipates any loss in near future provision should be made in the books of account.
- Generally accepted accounting principles refer to the rules or guidelines adopted for recording and reporting of business transactions in order to bring uniformity in the preparation and presentation of financial statements.

TERMINAL EXERCISE

1. Explain the convention of consistency with example.
2. Explain the accounting convention of conservatism with example.
3. What do you mean by accounting standards? Enumerate the accounting standard issued by the ASB from time to time.
4. Explains the convention of materiality.
5. Explain the accounting convention of full disclosure with example.

Notes

ANSWERS TO INTEXT QUESTIONS

3.1 (i) year after year (ii) market price, lower
(iii) market price (iv) consistency

3.2 (i) profitability (ii) fair, adequate (iii) solvency
(iv) disclosed (v) reliable

3.3 (i) Materiality (ii) separate head
(iii) Materiality (iv) Material fact

3.4 (i) cost price i.e. ₹2,00,000 (ii) Cost price i.e.₹21,00,000
(iii) Yes, as a bad debt ₹50,000

3.5 (i) Disclosure of accounting policies
(ii) Provisions, contingent liabilities and contingent assets
(iii) Intangible assets (iv) Earning per share
(v) Consolidated financial statements
(vi) Accounting for taxes on income
(vii) Generally Accepted Accounting principle
(viii) April, 1977 (ix) 1973 (x) Inventory valuation

ACTIVITY

Visit a number of business units and enquire from the accountants how do they deal with the following while preparing the accounts :

1. Valuation of the stock at the end of the accounting period.
2. At what intervals do they close their account books?
3. What method of depreciation did they use in the last three or four years?
4. Have they ever suffered losses or earned profits because of the lethargic attitude or loyality towards the organisation?

Complete the answer and draw the conclusion whether they are following some accounting concepts or not. If yes, name the accounting conventions/accounting concepts.

4

ACCOUNTING FOR BUSINESS TRANSACTIONS

You visit the shop of a person known to you and observe the activities he/she is doing. He/she is selling goods for cash and on credit, collecting payments, making payments to suppliers, instructing the worker to deliver the goods in time, making payments for telephone, carriage, etc. These are all business activities, but cash is not involved in all of them at the time of making transactions. Activities which are in cash terms are called business transactions. You will also find that for every transaction, he/she makes use of a document like bills, cash memos, receipts, etc. These are termed as vouchers. In this lesson, you will learn about business transactions, accounting vouchers, accounting equation and the basic mechanism of accounting.

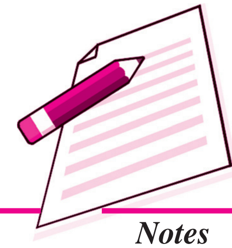
OBJECTIVES

After studying this lesson, you will be able to

- explain the meaning of source documents and accounting vouchers;
- explain the preparation of accounting vouchers;
- explain the meaning of accounting equation;
- explain the effect of business transactions on the accounting equation;
- explain the rules of accounting;
- explain the bases of accounting and
- explain the double entry mechanism.

4.1 SOURCE DOCUMENTS AND ACCOUNTING VOUCHERS

Accounting process begins with the origin of business transactions and it is followed by analysis of such transactions. A business transaction is a transaction, which involves exchange of values between two parties. Every transaction involves Give and Take



aspect. The debit represents Take aspect and credit represents the Give aspect in a transaction. For example, when a computer is purchased for office use for cash, then the delivery of computer represents Take aspect and payment of cash represents Give aspect. Thus , business transactions are exchange of goods or services between two parties and effects of these transactions are recorded in two accounts.

Source Documents and vouchers

All business transactions are based on documentary evidence. A Cash memo showing cash sale, an invoice showing sale of goods on credit, the receipt made out by the payee against cash payment, are all examples of source documents. A document which provides evidence of the transactions is called the Source Document or a voucher. It is the primary evidence in support of a business transaction. A source document is the first record prepared for a business transaction and is the basis for entries in the books of accounts. There are certain items, which have no documentary proof, such as petty expenses. In such case necessary voucher is prepared showing the necessary details. All such documents are kept in a separate file in chronological order and are serially numbered. All recording in books of accounts is done on the basis of accounting vouchers. A Voucher is documentary evidence in support of a transaction. It is a document to record the accounting transaction. A transaction with one debit and one credit is a simple transaction and voucher prepared for such transaction is known as transaction voucher. The format of transaction voucher is as follows:

Transaction Voucher

Firm Name

Voucher No.
Date:
Debit account:
Credit account:
Amount (₹) :
Narration :
Authorised By :   Prepared By:

Specimen of transaction voucher

Preparation of Accounting Vouchers

Accounting vouchers are the written documents containing the analysis of business transactions for accounting and recording purpose. These are prepared by the accountant and countersigned by authorised person. Features of Accounting vouchers are as :

- It is a written document.
- It is prepared on the basis of evidence of the transaction.

- It contains an analysis of a transaction i.e. which account has to be debited and which has to be credited.
- It is prepared by an accountant and countersigned by the authorised signatory.

Accounting voucher may be classified as Cash voucher i.e., debit voucher, credit voucher, and non-cash voucher i.e., transfer voucher.

Types of Accounting Voucher

- Cash Voucher
  - Debit voucher — [For Cash Payments]
  - Credit voucher — [For Cash Receipts]
- Non-Cash Voucher
  - (Transfer voucher) — [For Non-cash Transaction]

Debit Vouchers

These vouchers are prepared for recording of transactions involving cash payments only. Cash payments in the business are made on account of :

- Expenses
- Purchases of Goods
- Purchases of Assets
- Payment to creditors
- Repayment of loans
- Drawings and advances etc.

In 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:

Firm's Name

Debit Voucher

Voucher No. : Date:

Debit Account:

Amount:

Credit Account			
S.No.	*Account Name*	*Amount (₹)*	*Narration (i.e. Explanation)*
Authorised By:			Prepared By:

Specimen of Debit voucher

Illustration 1

On September 21, 2014 M/s Mohit Chemicals paid ₹40,000 in Cash and balance amount of ₹1,60,000 by Banker's Cheque to HT Chemicals Ltd., Prepare Debit Voucher.

Solution:

Mohit Chemicals

Debit Voucher

Voucher No.: 22 Date: 21.9.2014

Debit Account: HT Chemicals Ltd

Amount : ₹ 200000.

Credit Accounts

S.No.	*Account Name*	*Amount (₹)*	*Narration (i.e. Explanation)*
1. 2.	Cash Bank	40,000 1,60,000	Paid Part payment in cash and balance by bank draft.
Authorised By:			Prepared By:

Credit Vouchers

These vouchers are prepared for recording of transactions involving cash-receipts only. Cash receipts in the business are accepted on account of:

- Cash sales of goods
- cash sales of assets

Notes

- revenue income like interest, rent, etc. received in cash
- Cash receipts from debtors.
- Loan taken
- Cash withdrawn from bank
- 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 revenue on account of which cash is received or the property on sale of which cash is received. A format of credit voucher is as follows:

Credit Voucher

Firm Name

Voucher No. : Date:

Debit Account:

Amount:

Credit Account

S.No.	*Account Name*	*Amount (₹)*	*Narration (i.e. Explanation)*

Authorised By: Prepared By:

Fig. 4.3 Specimen of Credit voucher

Illustration 2

₹25000 Office furniture is purchased from Modern Furniture on July 4, 2014 and ₹15000 are paid by cash immediately and ₹10000 is still payable. Prepare Credit Voucher.

Solution:

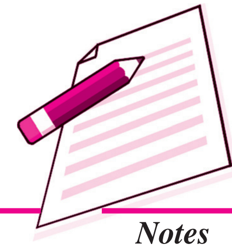
Credit Voucher

Modern Furniture

Voucher No. : 125 Date: July 4,2014

Debit Account: Furniture

Amount: ₹25000.



Notes

Credit Account

S.No.	*Account Name*	*Amount (₹)*	*Narration (i.e. Explanation)*
1. 2.	Cash Modern Furniture	15,000 10,000	Purchase of Office furniture from Modern Furniture. Cash paid. ₹15,000, for the Balance Liability created as per terms of purchase.
Authorised By:			Prepared By:

Transfer Vouchers

With the expansion of business, the role of credit transactions is increasing at a fast pace. For recording of these credit transactions, a voucher is prepared known as transfer voucher. These transfer vouchers are prepared to record non-cash transactions of the business involving:

- Credit purchases
- Credit sales
- Return of goods sold
- Return of goods purchased on credit
- Depreciation on Assets
- Bad Debts etc.

These vouchers are prepared both in debit and credit forms simultaneously.

Firm Name

Transfer Voucher

Voucher No. : Date:

Amount:

Debit Account

S.No.	*Account Name*	*Amount (₹)*	*Narration (i.e. Explanation)*

Notes

Credit account

S.No.	Account Name	Amount (₹)	Narration (i.e. Explanation)

Authorised By: Prepared By:

Fig. 4.4 Specimen of Transfer voucher

Illustration 3

Stationery Mart furnishes the following information:

April 1,2014

Opening Balances:

(i)	Cash	₹13000
(ii)	Bank	₹5000
(iii)	Furniture	₹22000
(iv)	Land and Building	₹125000
(v)	Trade Debtors :	
	Puneet	₹16000
	Mohan	₹14000
(vii)	Secured Bank Loan	₹70000
(viii)	Trade creditors:	
	Gopi	₹18000
	Sumit	₹24000
	Vipin	₹8000

Prepare transfer Voucher.

Solution :

Notes

Stationery Mart

Transfer Voucher

Voucher No. **Date: April 1,2014**

Amount:

Debit Account

S.No.	*Account Name*	*Amount (₹)*	*Narration (i.e. Explanation)*
1	Cash	13000	Opening Balance
2	Bank	5000	Opening Balance
3	Furniture	22000	Opening Balance
4	Land and Building	125000	Opening Balance
5	Trade debtors:	30000	Opening Balance
	Puneet	16000	
	Mohan	14000	

Credit Account

S.No.	*Account Name*	*Amount (₹)*	*Narration (i.e. Explanation)*
1.	Secured Bank Loan		70000 Opening Balance
2	Trade creditors:		
	Gopi	18000	
	Sumit	24000	
	Vipin	8000	50000 Opening Balance
3	Capital	120000	Balancing Figure (i.e.240000-120000)

Authorised By: Prepared By:

INTEXT QUESTIONS 4.1

I. Classify the following into Business and Non-business Transactions:

i. Manav commences business with cash ₹200000.

ii. He deposited cash into bank ₹160000.

iii. He purchased goods for cash ₹25000.

iv. He took out cash from the shop and handed over to his wife for purchasing household goods ₹3000.

v. He attended a family function and got a gift worth ₹1500.

vi. He paid monthly salary to his business employees ₹3,000.

II. Fill in the blanks with suitable word or words:

i. The accounting vouchers are based on ....

ii. Invoice/bill is a .... document.

iii. Both debit and Credit aspects of a transaction are shown by .... Vouchers.

iv. A Credit voucher is prepared for .... receipts.

v. A debit voucher is prepared for .... payments.

Notes

4.2 ACCOUNTING EQUATION AND EFFECTS OF TRANSACTIONS ON IT

The recording of business transactions in the books of account 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 the one side and equity on the other side *i.e.,* the claims of outsider [liabilities] and owners or proprietors funds on the other side. In mathematical form,

Assets = Equity

Equity = Liabilities + Capital

As an asset is introduced in the business, a corresponding liability also emerges.

Effect of business transactions on accounting equation

These transactions increase or decrease the assets, liabilities, or capital. Every business has some assets. For example, Sunil started business with cash ₹3,00,000 as Capital. In this transaction, asset in the form of cash is created for the business. Hence,

Cash (Asset)		Capital (Equity)
₹3,00,000	=	₹3,00,000

Sunil purchased Machinery for ₹40,000 and Furniture for ₹20,000. Thus, the position of the assets and capital is as:

Cash	+	Machinery	+	Furniture	=	Capital
2,40,000	+	40,000	+	20,000	=	3,00,000

The above transaction shows that

Assets = Capital

Or

Capital = Assets

Increase or decrease in capital will result in the corresponding increase or decrease in assets. For example Sunil withdrew cash for personal use ₹5,000. Thus, the position of the assets and capital is as under :

Cash	+	Machinery	+	Furniture	=	Capital
2,40,000	+	40,000	+	20,000	=	3,00,000
[–5,000]	+	0	+	0	=	[–5,000]
2,35,000	+	40,000	+	20,000	=	2.95.000

Business enterprise borrows money in the form of loan from outsiders to carry on its activities. In other words, every business concern owes money from outsiders. Money borrowed from outsiders is called as liability. For example, ₹1,50,000 were borrowed from Shipra. Thus, the position of the assets and capital will be as under

Cash	+	Machinery	+	Furniture	=	Liabilities	+	Capital
2,35,000	+	40,000	+	20,000	=	0		2,95,000
+1,50,000	+	0	+	0	=	1,50,000	+	0
3,85.000	+	40,000	+	20,000	=	1,50,000	+	2,95.000

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

Assets = Liabilities + Capital or A= L+ C

OR

Liabilities = Assets – Capital or L= A – C

OR

Capital = Assets – Liabilities or C = A – L

Expenses and Revenue also affect the accounting equation. Their effect is always on the capital.

A business concern has to meet some expenses in its normal course of operations such as payment of salary, rent, insurance premium, postage, wages, repairs etc. Payment of these expenses reduces the cash. These expenses reduce the net income of the business. All the income is the income of proprietor, which is added in the capital account, so all these expenses are deducted from the capital. Similarly, business concern receives some revenues during normal course of operations, such as rent received, commission received, etc. Revenue is 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. Now, the accounting equation is represented by

Assets	**=**	**Liabilities**	**+**	**Capital**
+ Revenue [Cash]	**=**		**+**	**Revenue**
– Expenses [Cash]	**=**		**–**	**Expenses**

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 shows that every business transaction satisfies the dual aspect concept of accounting. It also serves as the basis for preparing the Balance Sheet.

Effect of Transactions on the 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 asset, liability or capital, but the two sides of the accounting equation always remain equal. Let us verify this fact by taking up some transactions and see how these transactions affect the accounting equation :

1. Namita started business with cash ₹3,50,000 introduced as capital. Thus the equation is as:

Assets	=	Liabilities	+	Capital
3,50,000	=	0	+	3,50,000

This transaction shows that ₹3,50,000 have been introduced by Namita 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 ₹3,50,000.

2. She purchased goods for cash ₹90,000.

   Thus the accounting equation is as :

	Assets			=	Liabilities	+	Capital
	Cash	**+**	**Goods**				
old equation	3,50,000			=	0	+	3,50,000
Effect of Transaction	–90,000	+	90,000	=	0	+	0
New equation	2,60,000	+	90,000	=	0	+	3,50,000

   Goods purchased is an asset and cash paid is also an asset. Hence in this transaction, there is an increase in one asset [Goods] and decrease in the other asset [cash]. There is no change in capital and liabilities. i.e. the other side of the accounting equation.

3. She purchased goods from Mohit for ₹60,000 on credit

   Thus the equation is as:

	Assets			=	Liabilities	+	Capital
	Cash	+	Goods				
Old equation	2,60,000	+	90,000	=	0	+	3,50,000
Effect of Transaction	0	+	60,000	=	60,000	+	0
New equation	2,60,000	+	1,50,000	=	60,000	+	3,50,000

   In this transaction goods have been purchased on credit from Mohit , hence there is an increase in the assets [goods] by ₹60,000 and also an increase in the liabilities by ₹60,000 as the business concern now owes money to Mohit.

4. She sold goods to Anish for ₹40,000 (Cost ₹25,000) and received Cash ₹10,000 and balance after one month. Thus the accounting equation is as:

	Assets					=	Liabilities	+	Capital
	Cash	+	Goods	+	Debtors				
Old equation	2,60,000	+	1,50,000	+	0	=	60,000	+	3,50,000
Effect of Transaction	10,000	+	[–25,000]	+	30,000	=	0	+	15,000
New equation	2,70,000	+	1,25,000	+	30,000	=	60,000	+	3,65,000

Notes

In this transaction goods have been sold on credit and some on cash to Anish, so there is a decrease in the assets [goods] by ₹25,000, and increase in the assets (Anish) by ₹30,000 and [Cash] by ₹10,000. In this process the proprietor has gained an amount of ₹15,000 which is added to his capital.

5. She paid salaries to employees for ₹16,000.

	Assets						=	Liabilities	+	Capital
	Cash	+	Goods	+	Debtors					
Old equation	2,70,000	+	1,25,000	+	30,000		=	60,000	+	3,65,000
Effect of Transaction	[-16,000]	+	0	+	0		=	0	+	[–16,000]
New equation	2,54,000	+	1,25,000	+	30,000		=	60,000	+	3,49,000

In this transaction, salaries paid to employees are expenses for the business concern. Salaries are paid in terms of cash, hence cash as an asset is reduced by ₹16,000 and as all expenses reduce the capital, so capital is also reduced by ₹16,000.

From the above transactions, it is obvious that how every transaction has its effect on the accounting equation without disturbing the equality of the two sides of the equation.

Illustration 4

Prepare accounting equation from the following Transactions:

		₹
1.	Hemant started business with cash	3,00,000
2.	Purchased goods for cash	80,000
3.	Sold goods[costing ₹30,000] for	45,000
4.	Purchased goods from Monika	70,000
5.	Salary paid	7,000
6.	Commission received	5,000
7.	Paid Cash to Monika in full settlement	69,000
8.	Goods sold to Rahul {Costing ₹20,000} for	25,000

Solution

S. No.	Transaction	Assets: Cash	+	Assets: Goods	+	Assets: Debtors	= Total	Equity: Liabilities	+	Equity: Capital	Total
1.	Started business with cash	3,00,000	+	0	+	0	3,00,000	0	+	3,00,000	3,00,000
2.	Purchased goods for cash	-80,000	+	80,000	+	0		0	+	0	
	New Equation	2,20,000	+	80,000	+	0	3,00,000	0	+	3,00,000	3,00,000
3.	Sold goods for cash	45,000	+	-30,000	+	0		0	+	15,000	
	New Equation	2,65,000	+	50,000	+	0	3,15,000	0	+	3,15,000	3,15,000
4.	Purchased goods from Monika	0	+	70,000	+	0		70,000	+	0	
	New Equation	2,65,000	+	1,20,000	+	0	3,85,000	70,000	+	3,15,000	3,85,000
5.	Salary paid	-7,000	+	0	+	0		0	+	-7,000	
	New Equation	2,58,000	+	1,20.000	+	0	3,78,000	70,000	+	3,08,000	3,78,000
6.	Commission received	5,000	+	0	+	0		0	+	5,000	
	New Equation	2,63,000	+	1,20,000	+	0	3,83,000	70,000	+	3,13,000	3,83,000
7.	Paid Cash to Monika in full settlement	-69,000	+	0	+	0		–70,000	+	1,000	
	New Equation	1,94,000	+	1,20.000	+	0	3,14,000	0	+	3,14,000	3,14,000
8.	Goods sold to Rahul	0	+	-20,000	+	25,000		0	+	5,000	
	New Equation	1,94,000	+	1,00,000	+	25,000	3,19,000	0	+	3,19,000	3,19,000

Notes

Illustration 5

Prepare accounting equation from the following Transactions:

	₹
1. Nutan started business with cash	4,00,000
2. Purchased goods from Rohit	60,000
3. Sold goods[costing ₹25,000] for cash	22,000
4. Purchased goods for cash	50,000
5. Salary outstanding	3,000
6. Rent received	6,000
7. Paid Cash to Rohit on account	35,000
8. Goods sold to Bharti {Costing ₹30,000} for	40,000

INTEXT QUESTIONS 4.2

Fill in the blanks with suitable word/words:

i. Accounting equation satisfies the .... concept of accounting.

ii. Assets = ... + Liabilities

iii. Capital = Assets – ....

iv. Accounting Equation serves as a basis for preparing ....

v. Liabilities = ... – Capital

4.3 RULES OF ACCOUNTING

Using Debit and Credit

In Double Entry accounting both the aspects of the transaction are recorded. Every transaction has two aspects and according to this system, both the aspects are recorded. If the business acquires something, it must have been acquired by giving something. While recording each transaction, the total amount debited must be equal to the total amount credited. The terms 'Debit' and 'Credit' indicate whether the transaction is to be recorded on the left hand side or right hand side of the account. In its simplest form, an account looks like the English Language Letter 'T'. Because of its shape, this simple form of account is called T-account (refer figure 4.5) . Have you observed that

Notes

Solution : (Illustration 5)

S.No	Transaction	Assets: Cash		Goods		Debtors	= Total	Equity: Liabilities		Capital	Total
1.	Started business with cash	4,00,000	+	0	+	0	4,00,000	0	+	4,00,000	4,00,000
2.	Purchased goods from Rohit	0	+	60,000	+	0		60,000	+	0	
	New Equation	4,00,000	+	60,000	+	0	4,60,000	60,000	+	4,00,000	4,60,000
3.	Sold goods for cash	22,000	+	[-25,000]	+	0		0	+	[-3,000]	
	New Equation	4,22,000	+	35,000	+	0	4,57,000	60,000	+	3,97,000	4,57,000
4.	Purchased goods for cash	[-50,000]	+	50,000	+	0		0	+	0	
	New Equation	3,72,000	+	85,000	+	0	4,57,000	60,000	+	3,97,000	4,57,000
5.	Salary outstanding	0	+	0	+	0		3,000	+	[-3,000]	
	New Equation	3,72,000	+	85,000	+	0	4,57,000	63,000	+	394,000	4,57,000
6.	Rent received	6,000	+	0	+	0		0	+	6,000	
	New Equation	3,78,000	+	85,000	+	0	4,63,000	63,000	+	4,00,000	4,63,000
7.	Paid Cash to Rohit on account	[-35,000]	+	0	+	0		[-35,000]	+	0	
	New Equation	3,43,000	+	85,000	+	0	4,28,000	28,000	+	4,00,000	4,28,000
8.	Goods sold to Bharti	0	+	[–30000]	+	40,000		0	+	10,000	
	New Equation	3,43,000	+	55,000	+	40,000	4,38,000	28,000	+	4,10,000	4,38,000

the 'T' format has a left side and a right side for recording increases and decreases in the item? This helps in ascertaining the ultimate position of each item at the end of an accounting period. For example, if it is an account of a supplier all goods/materials supplied shall appear on the right (Credit) side of the Supplier's account and all payments made on the left (debit) side.

In a'T' account, the left side is called debit (usually abbreviated as Dr.) and the right side is known as credit (as usually abbreviated Cr.).

Account Title

(Left Side) (Right Side)

Fig.4.5: Specimen of T-account.

Rules of Accounting

All accounts are divided into five categories for the purpose of recording of the business transactions:

(i) Assets, (ii) Liability, (iii) Capital,

(iv) Expenses/Losses, and (v) Revenues/Gains.

Two Fundamental Rules are followed to record the changes in these accounts:

1. For recording changes in Assets/Expenses/Losses

   "Increase in Asset is debited, and decrease in Asset is credited."

   "Increase in Expenses/Losses is debited, and decrease in Expenses/Losses is credited."

2. For recording changes in Liabilities and Capital/Revenue/Gains

   "Increase in Liabilities is credited and decrease in Liabilities is debited."

   "Increase in Capital is credited and decrease in Capital is debited."

   "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

Liabilities

(Decrease)	(Increase)
–	+
Debit	Credit

Capital

(Decrease)	(Increase)
–	+
Debit	Credit

Expenses/Losses

(Increase)	(Decrease)
+	–
Debit	Credit

Revenue/Gains

(Decrease)	(Increase)
–	+
Debit	Credit

I. Analysis of Rule Applied to Assets Accounts

Rohan Purchased Furniture for ₹80,000.

Analysis of Transaction : In this transaction, the 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 credited. Furniture is also an asset and it has increased. As per rule asset if increases the affected account is debited thus, furniture account is debited.

Cash

	Decrease
	80,000
	[–] Credit

Furniture

Increase	
80,000	
[+] Debit	

II. Analysis of Rule Applied to Liabilities Accounts:

Purchased Machinery for ₹60,000 on credit from M/s Indian Machinery Mart.

Analysis of Transaction: In this transaction, the two accounts affected are machinery and M/s Indian Machinery Mart. Machinery is an asset, an asset has increased, therefore machinery account is debited. M/s Indian Machinery Mart is the creditor on account of supply of machinery and constitutes, the liability for the buying firm which

Notes

has increased. Rule is that on increase of liability the concerned account is credited and vice-versa. Thus, M/s Indian Machinery Mart A/c is credited.

M/s Indian Machinery Mart [Liability]		Machinery (Assets)	
	Increase	Increase	
	60,000	60,000	
	[+] Credit	[+] Debit	

III. Analysis of Rule Applied to Capital Accounts:

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

Analysis of Transaction: In this transaction, the two account affected are Cash account and Rakesh [Capital account] . Cash is an asset and Rakesh invested capital. Rule for Capital is that if it increases the account is credited and vice-versa. So, here capital account is credited.

Capital [Rakesh] Account		Cash (Assets)	
	Increase	Increase	
	50,000	50,000	
	[+] Credit	[+] Debit	

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

Paid ₹6000 to the employees as Salary.

Analysis of Transaction: In this transaction, the two accounts affected are salary account and Cash account. Salary account is an expense and has increased. Cash is an asset and has decreased. Rule regarding expenses/losses is that if it increases the account is debited.

Salary Account [Expenses]		Cash (Assets)	
Increase			Decrease
6,000			6,000
[+] Debit			Credit [-]

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

Received interest for the month ₹4000.

Notes

Analysis of Transaction: In this transaction, the two accounts affected are Interest and Cash. Interest is an item of Income and Cash an item of asset. Rule regarding Revenue/profit is, increase in revenue is credited. Cash is an asset and rule for assets is increase in assets is debited.

Interest Account [Revenue]		Cash (Assets)	
	Increase	Increase	
	4,000	4,000	
	[+] Credit	[+] Debit	

Illustration 6

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

		₹
1.	Ankur started business with cash	600000
2	Purchased goods for cash	80000
3.	Paid salaries	10000
4.	Sold goods to Rohit on credit	60000
5	Office machine purchased for cash	12000
6	He took loan from Bank	30,000
7	He received commission	4,000
8.	Postage paid	500
9.	Paid rent	6,000
10	Received cash from Rohit	60000

Solution

Trans-action No	*Names 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 (")	Cash (decrease)

Notes

3	Salaries	Cash	Expense	Asset	Salaries (”)	Cash (decrease)
4	Rohit	Sales	Asset Debtor	Revenue	Rohit (”)	Sales (Increase)
5	Office machine	Cash	Asset	Asset	Office (”) machine	Cash (decrease)
6	Cash	Bank laon	Asset	Liability	Cash (Increase)	Bank loan (Increase)
7	Cash	Commi-ssion	Asset	Revenue	Cash (Increase)	Commission (Increase)
8	Postage	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

INTEXT QUESTIONS 4.3

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.	Office Machine					
iv.	Cash					
v.	Mohan (Supplier)					
vi.	Krishan (Owner)					
vii.	Radha (Customer)					
viii.	Interest received					
ix.	Bank Overdraft					
x.	Commission Earned					
xi.	Discount allowed					

4.4 BASIS OF ACCOUNTING

As we are aware that one of the most significant functions of accounting is to make us know true and fair amount of profit earned by the business entity in a particular period. This Profit or income figure can be ascertained by following

(i) Cash Basis of accounting

(ii) Accrual Basis of accounting

(iii) Hybrid Basis of accounting

I. Cash Basis of accounting

This is a system in which accounting entries are recorded only when cash is received or paid. Revenue is recognized only on receipt of cash. Similarly, expenses are recorded as incurred when they are paid. The difference between the total revenues and total expenses represents profit or loss of an enterprise for a particular accounting period. Outstanding and prepaid expenses and income received in advance or accrued incomes are not considered.

Advantages

Following are the advantages of adopting cash basis of accounting:

- It is very simple as no adjustment entries are required.
- It appears more objective as very few estimates and personal judgments are required.
- It is more suitable to those entities which have most of the transactions on cash basis.

Disadvantages

Following are the disadvantages of adopting cash basis of accounting:

- It does not give a true and fair view of profit and loss and the financial position of the business unit as it ignores outstanding and prepaid expenses.
- It does not follow the matching concept of accounting.

Illustration 7

During the financial year 2013-14, Mela Ram had cash sales of ₹580000 and credit sales of ₹265000. His expenses for the year were ₹.460000 out of which ₹60000 are still to be paid. Find out Mela Ram's Income for the year 2013-14 following the cash basis of accounting.

Notes

Solution:

	Amount (₹)
Revenue (in terms of Cash Inflows)	580000
Less: Expenses (Outflow of cash) (i.e. ₹ 460000- 60000)	400000
Net Income	180000

Note : Credit Sales and Outstanding Expenses are not to be considered under cash basis of accounting.

II. Accrual Basis of accounting

Revenue and expense are taken into consideration for the purpose of income determination on the basis of accounting period to which they relate. The accrual basis makes a distinction between actual receipts of cash and the right to receive cash for revenues and the actual payment of cash and the legal obligation to pay expenses. It means the income accrued in the current year becomes the income of the current year whether the cash for that item is received in the current year or it was received in the previous year or it will be received in the next year. The same is true of expense items. Expense item is recorded if it becomes payable in the current year whether it is paid in the current year or it was paid in the previous year or it will be paid in the next year. For example, credit sales are included in the total sales of the period irrespective of the fact when cash on account is received. Similarly, in case the firm has taken benefit of a certain service, but has not paid within that period, the expense will relate to the period in which the service has been utilized and not the period in which the payment for it is made.

Outstanding Expenses are those expenses which have become due during the accounting period but which have yet not been paid off. Prepaid Expenses are those expenses which have been paid in advance. Accrued Income means income which has been earned by the business during the accounting period but has not yet become due for payment and therefore has not yet been received. Income received in advance means income which has been received by the business before being earned. Costs incurred during a particular period should be set out against the revenue of the period to ascertain profit or loss.

Following are the advantages :

- It is based on all business transactions of the year and discloses correct profit or loss.
- This method is used in all types of of business units.
- It is more scientific and rational in application.

Following are the disadvantages :

- It is not simple one and requires the use of estimates and personal judgment.
- It fails to disclose the actual cash flows.

Illustration 8

Taking the data given in the Illustration 7, find out the net income of Mela Ram as per accrual basis of accounting.

Solution

	Amount (₹)
Total Sales:	
Cash Sales (₹ 580000) + Credit Sales (₹ 265000)	845000
Less: Total Expenses for the year 2013-14	460000
Net Income	385000

Note: Outstanding Expenses of ₹60,000 relate to this accounting year and hence are to be charged to the revenues of current year. Similarly, credit sales of ₹2,65,000 are considered for this year as the transaction took place during this current year.

Difference between accrual basis of accounting and cash basis of accounting

Basis of Difference	*Accrual Basis of accounting*	*Cash Basis of accounting*
1. Prepaid, Outstanding and received in advance items	There may be outstanding expense, prepaid expenses, accrued income and income received in advance in the Balance sheet.	There is no outstanding expense, prepaid expenses, accrued income and income received in the Balance Sheet
2. Effect on income of prepaid expenses and accrued income	Income statement will show relatively higher income if there are items of prepaid expenses and accrued income.	Income statement will show relatively lower income if there are items of prepaid expenses and accrued income
3. Effect of outstanding expenses and unearned income	Income statement will show a lower income if there are items of outstanding expenses and unearned income	Income statement will show a higher income if there are items of outstanding expenses and unearned income
4. Legal Position	Companies Act 1956 recognizes this basis of accounting.	Companies Act 1956 does not recognize this basis of accounting.

Notes

5. Option regarding valuation of inventories and methods of depreciation	The business unit has the option to value the inventories at cost or market, whichever is less of depreciation.	No such option is available in regard to inventory valuation and method of depreciation.
6. Reliable	It is a reliable basis of accounting as it records all cash as well credit transactions. It ascertains true profit or loss.	It is not a reliable basis of accounting as only cash transactions are recorded. It fails to ascertain true profit or loss.
7. Users	A business unit with a profit motive ascertains its profit or loss as per accrual basis.	Professional people, small ventures of temporary nature, some Not- for-Profit Organizations ascertain their profit or loss as per cash basis.

III. Hybrid Basis of Accounting

Both cash basis of accounting and accural basis of accounting have their own advantages and limitations. Cash Basis of Accounting can be used only in units which deal exclusively in cash and are very small in size. These days the number of transactions undertaken by an enterprise are very large and are for cash as well as on credit. Hence, an accounting system which is the combination of both cash as well as accural basis is in use. This system is called hybrid basis of accounting. It has advantages of both the systems and is able to eliminate disadvantages of the both the system.

4.5 DOUBLE ENTRY MECHANISM

Double Entry Mechanism entails recording of transactions keeping in mind the debit and credit aspect of the transaction. To record every transaction, one account is debited and the other is credited. This is based on the principle 'every debit has a credit'. The Double entry Book-Keeping seeks to record every transaction in money or money's worth in its dual aspect. The advantages of double entry mechanism are :

- Systematic Record: It records, classifies, and synthesizes the business transaction in a systematic manner. It provides reliable information for sound decision making. It meets the needs of users of accounting information.
- Complete Record: It maintains complete record of a business transaction. It records both the aspects of the transaction with narration.
- Accurate records: By Preparing a Summarised Statement of Account the arithmetical accuracy of the records can be checked.

Notes

- Operational Results: By preparing Income Statement (Profit and Loss Account) the business can know profit or loss due to its operations during an accounting period.
- Financial Position: By preparing Position Statement (Balance Sheet) the business can know what it owns and what it owes to others. What are its assets and what are its Liabilities and Capital.
- Possibility of Fraud: Possibility of Frauds is minimized as complete information is recorded under this system.

INTEXT QUESTIONS 4.4

I. Answer the following with reference to cash basis of accounting

i. How it is simple?

As ____

ii. How it is more objective?

As ____

iii. To which business with it is more suitable?

Which _______________________________________

iv. Which is the concept of accounting it does not follow?

The ____

v. Credit sales of ₹10000 taken into account for calculating profit.

II. State whether the following statements are True or False :

i. Creditors are the internal users of accounting information.

ii. Management are the internal users of accounting information.

iii. Hybrid basis of accounting has advantages of both the systems (Cash & Accural) of accounting.

III. Answer the following question referring to double entry mechanism:

i. How possibility of frauds are minimised.

ii. How can arithmetical accuracy of the records can be checked?

iii. Name the concept on which to record every transaction one account is debited and other is credited is based.

Notes

WHAT YOU HAVE LEARNT

- **Business Transaction :** A business transaction is a transaction, which involves exchange of values between two parties. Every transaction involves Give and Take aspect.

- **Source Documents and vouchers :** All business transactions are based on documentary evidence. A Cash memo showing cash sale, an invoice showing sale of goods on credit, the receipt made out by the payee against cash payment, are all examples of source documents. A Voucher is documentary evidence in support of a transaction.

- **Types of Accounting Vouchers :** Accounting vouchers are the written documents, containing the analysis of business transactions for accounting and recording purpose.

Types of Accounting Vouchers

- Cash Voucher
  - Debit vouchers
    - [For Cash Payments]
  - Credit vouchers
    - [For Cash Receipts]
- Non-Cash Voucher
  - [Transfer vouchers]
    - [For Non-cash Transaction]

- **Accounting Equation :** The recording of business transaction in the books of account is based on a fundamental equation called Accounting Equation.

Assets = liabilities + Capital

- **Rules of Accounting**

  Using Debit and Credit

  Two Fundamental Rules are followed to record the changes in these accounts:

  For recording changes in Assets/Expenses/Losses

  "Increase in Asset is debited, and decrease in Asset is credited."

  "Increase in Expenses/Losses is debited, and decrease in Expenses/Losses is credited."

For recording changes in Liabilities and Capital/Revenue/Gains

"Increase in Liabilities is credited and decrease in Liabilities is debited."

"Increase in Capital is credited and decrease in Capital is debited."

"Increase in revenue/gains is credited and decrease in revenue/gain is debited".

- There can be three basis of Accounting (i) Cash basis (ii) Accrual basis and (iii) Hybrid Basis

  In cash basis accounting entries are recorded only when cash is received or paid.

  In accrual basis of accounting revenue and expense are taken into consideration for the purpose of income determination on the basis of accounting period to which they relate.

- **Hybrid Basis :** This is an accounting system which is the combination of both cash as well as on credit.

  Double Entry Book Keeping Mechanism: Double Entry Book Keeping Mechanism entails recording of transactions keeping in mind the debit and credit aspect of the transaction.

TERMINAL EXERCISE

1. State the meaning of business transaction.
2. What is meant by accounting voucher ? Explain in brief different types of accounting vouchers.
3. State the fundamental rules followed to record the changes in various accounts.
4. Explain in brief cash basis of accounting and differentiate it with accrual basis of accounting.
5. What is meant by double entry mechanism? Give its advantages.
6. "Accounting equation remains intact under all circumstances" Justify the statement with the help of examples.
7. Prepare accounting equation on the basis of the following :

   (i) Anup started business with cash ₹ 2,50,000

   (ii) Purchased goods for cash ₹ 35,000

   (iii) Purchased office furniture for cash ₹ 12,000

   (iv) Paid rent ₹ 7,000

Notes

(v) Sold goods (costing ₹ 30,000) for ₹ 50,000 for cash

8. Show the accounting equation on the basis of the following transactions :

(i)	Manu started business	₹
	Cash	6,00,000
	Goods	1,00,000
(ii)	Purchased office machine for cash	90,000
(iii)	Sold goods (costing ₹ 60000) for credit to Asha	70,000
(iv)	Purchased building for cash	1,30,000
(v)	Cash received from Ashu	80,000
(vi)	Purchased goods on credit from M/S Ashok Traders	70,000
(vii)	Salaries paid	6,000
(viii)	Insurance prepaid	10,000
(ix)	Cash paid to M/s Ashok Traders in full settlement	68,000

9. Prepare necessary accounting vouchers from the following transactions:

(i) Building purchased for ₹ 6,00,000

(ii) Goods sold on credit to M/s Reema Trader ₹ 1,10,000

(iii) Salary paid to ₹ 1,00,000

(iv) Withdrew cash for personal use ₹ 6,000

(v) Cash receipts from debtors M/s Ankit Bros ₹ 22,000

ANSWERS TO INTEXT QUESTIONS

4.1 I. **Business transactions** — **Non-business transactions**

(i), (ii), (iii) — (vi), (iv), (v)

II. (i) supporting document (ii) source (iii) Transfer

(iv) Cash (v) Cash

4.2 (i) Dual (ii) Capital (iii) Liabilities
(iv) Balance sheet (v) Assets

4.3

	Asset	Liability	Capital	Revenue	Expense
(i)					√
(ii)	√				
(iii)	√				
(iv)	√				
(v)		√			
(vi)			√		
(vii)	√				
(viii)				√	
(ix)			√		
(x)				√	
(xi)					√

4.4 I. (i) No adjustment entries are required
(ii) Very few estimates and personal judgement are required.
(iii) Have most of the transactions on cash basis
(iv) Matching concept
(v) Should not

II. (i) False (ii) True (iii) True

III. (i) As complete information is recorded under this system
(ii) By preparing summarised statement of account.
(iii) Every debit has a credit.

ANSWERS TO TERMINAL EXERCISE

7. Assets Cash ₹ 2,46,000 + Goods ₹ 5,000 + Office furniture ₹ 12,000 = Capital ₹ 2,63,000

8. Assets cash ₹ 3,76,000 + Goods ₹ 1,10,000, Office machine ₹ 90,000 + Building ₹ 1,30,000 + Prepaid insurance ₹ 10,000 = liabilities ₹ 7,16,000

5

JOURNAL

In the preceeding lessons you have learnt about various business transactions and Book keeping i.e. recording these transactions in the books of accounts in a systematic manner. Curosity may arise in your mind that what are these books? Why businessman keeps many books? How does he records various transactions in these books? You have learnt about the double entry system of maintaining accounts i.e. rules of debit and credit in relation to various accounts. A book that is prepared by every businessman, small or big. is a book in which business transactions are recorded datewise and in the order in which these transactions take place is known as journal. In this lesson you will learn about its meaning, objectives and its preparation.

OBJECTIVES

After studying this lesson, you will be able to :

- explain the meaning of journal;
- draw format of Journal;
- explain the process of journalising;
- journalise the simple and compound transactions;
- classify journal into Special Journals and Journal Proper.

5.1 JOURNAL : MEANING AND FORMAT

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 their occurence. 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'.

Business transactions of financial nature are classified into various categories of accounts such as assets, liabilities, capital, revenue and expenses. These are debited or credited according to the rules of debit and credit, applicable to the specific accounts. Every business transaction affects two accounts. Applying the principle of double entry, one account is debited and the other account is credited. Every transaction can be recorded in journal. This process of recording transactions in the journal is' known as 'Journalising'.

In small business houses generally one Journal Book is maintained in which all the transactions are recorded. But in case of big business houses as the transactions are quite large in number, therefore journal is divided into various types of books called Special Journals in which transactions are recorded depending upon the nature of transaction i.e. all credit sales in Sales Book, all cash transactions in Cash Book and so on.

Format of Journal

Every page of Journal has the following format. It is a columnar book. Each column is given a name written on its top. Format of journal is given below:

Journal

Date	*Particulars*	*Ledger Folio*	*Dr. Amount (₹)*	*Cr. Amount (₹)*
(1)	(2)	(3)	(4)	(5)

Column wise details of journal is as :

1. Date

In this column, we record the date of the transactions with its month and accounting year. We write year only once at the top and need not repeat it with every date.

Example :

Date

2014

April 15

Notes

2. Particulars

The accounts affected by a transaction i.e the accounts which have to be debited or credited are recorded in this column. It is recorded in the following way :

In the first line, the account which has to be debited is written and then the short form of Debit i.e. Dr. is written against that account's name in the extreme right of the same column.

In the second line after leaving some space from the left of the entry in the first line, the account which has to be credited is written starting with preposition 'To'. Then in the third line, Narration for that entry which explains the transaction, the affected accounts of which are entered, is written within Brackets. Narration should be short, complete and clear. After every journal entry, horizontal line is drawn in the particulars column to separate one entry from the other.

Example : Rent paid in cash on 1st April, 2014

Date	Particulars
2014	Rent A/c .... Dr
April 1	To Cash A/c ....
	(Rent paid in cash)

3. Ledger Folio

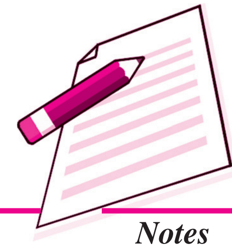
The transaction entered in a Journal is posted to the various related accounts in the 'ledger' (which is explained in another lesson). In ledger-folio column we enter the page-number where the account pertaining to the entry is opened and posting from the Journal is made.

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.



Notes

Example : Paid ₹ 4,000 rent on 1st April 2014.

Journal

Date	*Particulars*	*L.F.*	*Dr. Amount (₹)*	*Cr. Amount (₹)*
2014 April 1	Rent A/c .... Dr		4000	
	To Cash A/c			4000
	(Rent paid in Cash)			

At the end of each page, both the Dr. and Cr. columns are totalled up. The total of both these columns should be equal as the same amount is entered in the debit as well as in the credit columns. The totals are carried forward to the next page with the words 'total carried forward (c/f) and then at the top of the next page in Particulars column, we write totals brought forward (b/f) and the amount of totals is written in the respective amount columns.

INTEXT QUESTIONS 5.1

I. What is journal? Write in your own words.

....

....

II. Complete the following sentences with the appropr:ate word/words:

i. Journalising is the process of entering transactions in

ii. Another name for Journal is ....

iii. Transactions, when recorded in Journal, are known as ....

iv. The explanation of a Journal entry is known as ....

v. In a Journal entry preposition .... is used before the name of the account to be credited

5.2 PROCESS OF JOURNALISING

Following steps are taken for the preparation of a journal :

- **Identify the Accounts :** First of all, the affected accounts of an accounting transaction are identified. For example, if the transaction of "goods worth ₹10000

Notes

are purchased for Cash", then 'Purchases' A/c and 'Cash' A/c are the two affected accounts.

- **Recognise the type of Accounts :** Next we determine the type of the affected accounts e.g. in the above case, 'Purchases A/c and Cash A/c are expense and asset account respectively.
- **Apply the Rules of Debit and Credit :** Then the rules of 'debit' and 'credit' are applied to the affected accounts. You are aware of these rules. However, for the revision purposes, these are given below :

  (a) Assets and Expenses Accounts are debited if there is an increase and credited if there is decrease :

  (b) Liability, Capital and Revenue Accounts are debited if there is decrease and credited if there is increase.

In the example given when goods are purchased, as the assets are increasing, therefore, Purchases Account will be debited and as payment is made in cash, assets are decreasing, Cash Account will be credited.

Now, the journal entry will be made in the Journal alongwith a brief explanation i.e. narration. The corresponding amounts will be written in the debit and credit columns. After completing one entry, an horizontal line is drawn before entry for the next transaction is made in the journal.

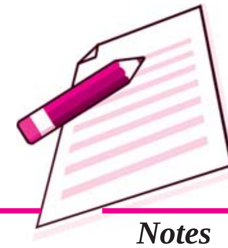
The transaction, given above in the example, is journalised in the following manner:

Date	*Particulars*	*L.F.*	*Dr. Amount (₹)*	*Cr. Amount (₹)*
	Purchases A/c .... Dr		10000	
	To Cash A/c			10000
	(Goods purchased for Cash)			

Illustration 1

Analyse in Tabular form and Enter the following transactions in the Journal of Bhagwat and Sons

2014		₹
January 1	Tarun started business with cash	1,00,000
January 2	Goods purchased for cash	20,000
January 4	Machinery Purchased from Vibhu	30,000



January 6	Rent paid in cash	10,000
January 8	Goods purchased on credit from Anil	25,000
January 10	Goods sold for cash	40,000
January 15	Goods sold on credit to Gurmeet	30,000
January 18	Salaries paid.	12,000
January 20	Cash withdrawn for personal use	5,000

Solution

As explained above, before making the journal entries, it is very essential to determine the kind of accounts to be debited or credited. This is shown in the Table :

Tabular Analysis of Business Transactions

Date	*Transaction*	*Affected Accounts*	*Kind of Accounts*	*Increaseor Decrease in Accounts*	*Debited Accounts Dr.*	*Credited Accounts Cr.*
2014 Jan.1	Cash received from the owner Tarun	Cash Capital	Asset Capital	Increase Increase	Cash A/c	Capital A/c
Jan. 2	Goods purcha-ses for cash	Goods Cash	Asset Asset	Increase Decrease	Purchases A/c	Cash A/c
Jan. 4	Machinery purchased on Credit from Vibhu	Machinery Vibhu	Asset Liability	Increase Increase	Machinery A/c	Vibhu A/c
Jan. 6	Rent paid in cash	Rent Cash	Expense Asset	Increase Decrease	Rent A/c	Cash A/c
Jan. 8	Goods on purchased Credit from Anil	Purchases Anil (creditor)	Asset Liability	Increase Increase	Purchases A/c	Anil A/c
Jan.10	Goods sold for cash Cash	Cash sales	Asset Revenue	Increase Increase	Cash A/c	Sales A/c
Jan.15	Credit sales to Gurmeet	Gurmeet (Debtor) Sales	Asset Revenue	Increase Increase	Gurmeet	Sales A/c
Jan.18	Salaries paid in cash	Salaries Cash	Expense Asset	Increase Decrease	Salaries A/c	Cash A/c

Jan.20	Cash withdrawn for personal use	Drawings Cash	Capital Asset	Decrease Decrease	Drawings A/c	Cash A/c

On the basis of the above table, following entries can be made in the Journal

Journal of Tarun

Date	*Particulars*		*L.F.*	*Dr. Amount ₹*	*Cr. Amount ₹*
2014					
Jan. 1	Cash A/c	Dr.		1,00,000	
	To Tarun Capital A/c				1,00,000
	(Capital brought in by Tarun)				
Jan. 2	Purchases A/c	Dr.		20,000	
	To Cash A/c				20,000
	(Goods purchased for Cash)				
Jan. 4	Machinery A/c	Dr.		30,000	
	To Vibhu's A/c				30,000
	(Machinery purchased from Vibhu on credit)				
Jan. 6	Rent A/c	Dr.		10,000	
	To cash A/c				10,000
	(Rent paid)				
Jan. 8	Purchases A/c	Dr.		25,000	
	To Anil's A/c				25,000
	(Good purchased on credit)				
Jan.10	Cash A/c	Dr.		40,000	
	To Sales A/c				40,000
	(Goods sold for Cash)				
Jan.15	Gurmeet's A/c	Dr.		30,000	
	To Sales A/c				30,000
	(Goods sold on credit to Gurmeet)				
Jan.18	Salaries A/c	Dr.		12,000	
	To Cash A/c				12,000
	(Salaries paid)				
Jan.20	Drawings A/c	Dr		5,000	
	To Cash A/c				5,000
	(Cash withdrawn by the owner for personal use)				
	Total			**2,72,000**	**2,72,000**

Notes

INTEXT QUESTIONS 5.2

I. Below are given certain transactions. Write the names and kinds of affected accounts in the given columns of debit and credit :

	Transaction	Dr.		Cr	
		Name of A/c	*Type of A/c*	*Name of A/c*	*Type of A/c*
i.	Started business with cash	Cash A/c	Assets	Capital	Capital
ii.	Credit purchases of goods				
iii.	Commission paid by cheque				
iv.	Cash deposited into Bank				
v.	Interest received in cash				
vi.	Furniture purchased from Mukesh				
vii.	Goods sold by Ramesh				

II. Write down the narration for the following Journal entries in the space provided :

(i) Cash A/c Dr.
To sales A/c
( )

(ii) Purchases A/c Dr.
To Vinay's A/c
( )

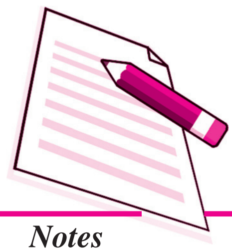
III. Complete the following journal entries :

(i) Amit's A/c Dr.
To .... A/c
(Goods sold to Amit)

(ii) .... Dr.
To Cash A/c
(Commission paid in Cash)

(iii) Cash A/c Dr.
To .... A/c
(Interest received in Cash)

(iv) Goods A/c Dr
To .... A/c
(Goods purchased from Rohit for Cash)



Notes

5.3 COMPOUND AND ADJUSTING ENTRIES

The journal entries that you have learnt so far are simple and affect two accounts only. There can be entries that affect more than two accounts; such entries are called compound or combined entries.

A simple journal entry contains only one debit and one credit. But if an entry contains more than one debit or credit or both, that entry is known as a compound journal entry. Actually, a compound journal entry is a combination of two or more simple journal entries.

Thus, a compound journal entry can be made in the following three ways:

(i) By debiting one account and crediting more than one account.

(ii) By debiting more than one account and crediting one account.

(iii) By debiting more than one account and also crediting more than one account.

Two simple journal entries are as :

Journal

Date	*Particulars*		*L.F.*	*Dr. Amount ₹*	*Cr. Amount ₹*
2014					
Nov. 30	Salary A/c	Dr.		6,000	
	To Cash A/c				6,000
	(Salary paid in Cash)				
Nov. 30	Rent A/c	Dr.		12,000	
	To Cash A/c				12,000
	(Rent paid in Cash)				

The above two simple entries have been converted into compound Journal entry as under :

2014					
Nov. 30	Salary A/c	Dr.		6,000	
	Rent A/c	Dr.		12,000	
	To Cash A/c				18,000
	(Payment of Salary and Rent in Cash)				

Note : To make the compound entry, it is necessary that the transactions must be of the same date and one account is common.

Notes

If you match the first two simple entries with the converted compound entry, you will find that there is no difference between them so far as the accounting effect is concerned. The compound entries save time and space. Such compound entries are made in the following cases:

(a) When two or more transactions occur on the same day.

(b) One aspect i.e. either the Debit account or Credit account is common.

A few more examples of compound entries are :

1. Bad Debts

When a debtor fails to pay the full amount due to him, the unpaid amount is known as bad debts.

For example, A business concern receives ₹ 8000 out of ₹ 10,000 due from Harish. He is unable to pay the balance amount, thus, the remaining amount becomes a bad debts for the business.

The compound entry for this transaction will be :

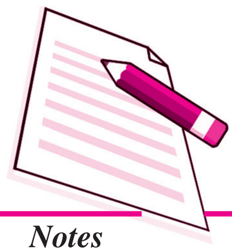
Bank A/c	Dr.	8,000	
Bad Debts A/c	Dr.	2,000	
To Harish's A/c			10,000
(Receipt of ₹ 8,000 from Harish and remaining due amount of ₹ 2,000 is treated as bad debts)			

2. Discount Allowed and Received

To encourage a customer to pay the amount due before due date, discount is allowed. This is called cash discount. If such discount is received the compound entry will be :

a) Creditor A/c Dr.
 To Bank A/c
 To Discount A/c

b) Similarly, when cash discount is allowed, the journal entry will be
 Bank A/c Dr.
 Discount A/c Dr.
 To customer's (Debtor's) A/c



Notes

Note : When the customer buys goods in bulk or in large quantity some discount may be allowed to him. This is to encourage him to buy more and more. This discount is called Trade Discount. When the bill is prepared for the purchase of goods, the amount of trade discount is deducted from the total amount payable. No entry is made for this type of discount in the journal i.e. it is not recorded in the books of accounts.

Illustration 2

Enter the following transactions in the books of Supriya, the owner of the business:

2014

Jan. 8 Purchased goods worth ₹ 5,000 from Sarita on credit.

Jan. 12 Neha Purchased goods worth ₹ 4,000 from Supriya on credit.

Jan. 18 Received a Cheque from Neha in full settlement of her account ₹3,850.
Discount allowed to her ₹150

Jan. 20 Payment made to Sarita ₹ 4,900. Discount allowed by him ₹ 100.

Jan. 22 Purchased goods for cash ₹ 10,000.

Jan. 24 Goods sold to Kavita for ₹ 15,000.
Trade discount @ 20% is allowed to her.

Jan. 29 Payment received from Kavita by Cheque.

Solution

The above transactions will be entered in the journal as follows :

Journal of Supriya

Date	*Particulars*	*L.F.*	*Dr. Amount ₹*	*Cr. Amount ₹*
2014				
Jan.8	Purchases A/c Dr.		5,000	
	To Sarita A/c			5,000
	(Goods Purchased on credit from Sarita)			
Jan. 12	Neha's A/c Dr.		4,000	
	To Sales A/c			4,000
	(Goods sold on credit to Neha)			

Notes

Jan. 18	Bank A/c Dr. Discount A/c Dr. To Neha's A/c (Payment recived from Neha and discount allowed)		3,850 150	 4,000
Jan. 20	Sarita's A/c Dr. To Cash A/c To Discount A/c (Payment made and discount allowed by Sarita)		5,000	 4.900 100
Jan. 22	Purchases A/c Dr. To Cash A/c (Goods purchased for cash)		10,000	 10,000
Jan. 24	Kavita A/c Dr. To Sales A/c (Sold goods to Kavita on credit of ₹ 15000 less Trade Discount @20%)		12,000	 12,000
Jan. 29	Bank A/c Dr. To Kavita's A/c (Payment received from Kavita by Cheque)		12,000	 12,000
	Total		**52,000**	**52,000**

Adjusting Entry

To satisfy the principle of matching cost and revenue, amount of every expense and revenue should pertain to the period for which accounts are being prepared. Thus, there can be two situations : (a) Amount has been received or paid which belongs to more than one accounting year (b) amount of expense or of revenue for the current year stands due and not paid. In the above two cases adjustments need to be made. Any journal entry made to adjust these amounts is called adjusting journal entry.

Journal entries made to adjust for outstanding expenses such as rent outstanding, prepaid expenses such as insurance premium paid in advance, accrued income such as rent (income) has become due but not received and income received in advance such as commission has been received though not yet due are examples of adjusting journal entries.

Following are the items for which adjustment is required :

1. Outstanding Expenses

An expense for the current accounting peirod should be debited (as increase in expense is to be debited). It is immaterial whether it is paid in that accounting period or not. In case the same expense is not paid during the year, it becomes outstanding for that particular year. It is the liability of the business for that year and, thus, expense outstanding account will be credited, because liabilities are credited for increase.

For example, if salaries are outstanding for ₹ 5,000 for December 2014 then the entry will be made as follows:

2014	Salaries A/c	Dr.	5,000	
Dec.31	To Salaries outstanding A/c			5,000
	(Salaries remaining unpaid for the month of December)			

2. Prepaid Expenses

This is an expense relating to the next year that has been paid in advance during the current year. Thus, in such a case, this amount should not be treated as an expense for this year. It should be treated as an asset in the current year as the services will be received only in the next year (but the payment has been made in this year). As an increase in asset is debited, so prepaid expense account will also be debited.

If, for example, Insurance is prepaid for 2015 in 2014 for ₹ 3,000 then entry will be made as follows:

2014	Prepaid Insurance A/c	Dr.	3,000
Dec. 14	To Insurance Premium A/c		3,000
	(Insurance paid in advance)		

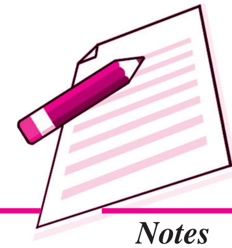
3. Accrued Income

In case, income has been earned but it has not been recieved till now, it is an accrued income. Accrued Income is an asset, as there will be an increase in the asset, it will be debited.

For example, Rent (receivable) is outstanding for the month of November ₹4,000. The entry in such a case will be:

Accrued Rent A/c	Dr.	4,000	
To Rent A/c			4,000
(Being Rent due but not yet received for the period)			

Note : Here Rent Income A/c has been credited for the increase to be made in the amount of Rent for the period of November, which has to be included in the total Rent Income.



Notes

4. Income Received in Advance

Whenever Income is received in advance during the current year i.e. it is received for the next year, it should not be included in the current year's income. As this income pertains to the next year, it cannot be treated as income in the current year, so it becomes a liability. As there is an increase in the liability, it should be credited.

For example, if Rent is received in advance for the period January and February 2015 in December 2014, ₹ 9,000. Then the entry will be

Rent A/c	Dr.	9,000	
To Rent Received in Advance A/c			9,000
(Rent received in advance for January and February 2015 in the month of December 2014)			

Note : Here Rent Income A/c has been debited as it has to be decreased by ₹ 9,000 being Rent in advance for January and February 2015 which should not be included in the month of December 2014 as the services have not yet been rendered.

Miscellaneous Entries

(a) Depreciation

Depreciation means decline in the value of an asset due to its wear and tear. It is an expense for the business. Increase in expenses and losses are debited, so depreciation is also to be debited. The value of the asset will also be reduced because of depreciation. As decrease in assets is credited, so the same asset account will be credited.

For example, Depreciation on furniture ₹ 3,000 is charged for the year, Journal entry will be :

Depreciation A/c	Dr.	3,000	
To Furniture A/c			3,000
(Depreciation charged on furniture)			

(b) Interest on Capital

Business may allow interest to its proprietor on his/her capital. It is an expense for the business. As the expense is debited for the increase, interest on capital will be debited. The other account involved here is capital account. As Capital is increasing, it will be credited with the amount of interest on capital.

For example, Interest allowed on capital is ₹ 2,500. Thus, the journal entry will be :

Interest on Capital A/c	Dr.	2,500	
To Capital A/c			2,500
(Interest on Capital is allowed)			

(c) Drawings

When the proprietor withdraws some money from the business for his personal or domestic use, it is known as Drawings. Drawings reduce the amount of Capital. As decrease in Capital is debited, drawings will also be debited. As Cash will be decreased as an asset, it will be credited.

For example, Cash withdrawn by the proprietor for his peronal use is ₹ 4,000. So the journal entry will be :

Drawings A/c	Dr.	4,000	
To Cash A/c			4,000
(Drawings made in cash)			

INTEXT QUESTIONS 5.3

I. Fill in the blanks with sutiable word/words:

i. A cominbaiton of two or more simple journal entries is known as ....

ii. Bad debts are .... in the journal, as they are loss to the Business.

iii. In journal, only .... discount is recorded.

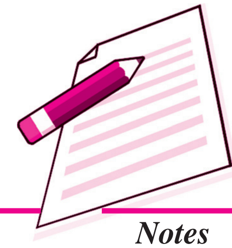
iv. No entry is made for .... discount in the Journal.

v. Prepaid Expenses are .... in the journal.

vi. Accrued Income is .... on the journal.

vii. Depreciation reduces the value of an ....

viii. When the proprietor- withdraws money from the business for his personal use, then .... A/c is debited and .... A/c is credited.



II. Complete the following journal entries:

(i) Drawings A/c .... Dr.

To .... A/c

(Money withdrawn from Bank for Personal use)

(ii) Cash A/c .... Dr.

.... Dr.

To Rohit's A/c

(Payment received form Rohit in full and final settlement of his A/c)

(iii) .... A/c Dr.

To Rent A/c

(Rent paid in advance)

(iv) Interest on Capital A/c Dr.

To .... A/c

(Interest allowed on capital)

(v) .... A/c Dr.

To Commission outstanding A/c

(Commission outstanding for December)

(vi) Cash A/c .... Dr.

.... A/c Dr.

To Satish's A/c

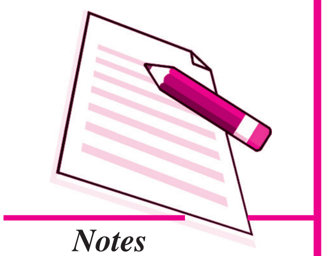
(Part payment of a debt received due to insolvency of Satish)

5.4 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 if the number of transactions is large. To take the benefit of division of labour, journal should be divided into number of journals.

Journal can be classified into various special journals and Journal proper. Special journals are also known as special purpose books.

Classification of Journal can be explained with the help of the following chart:



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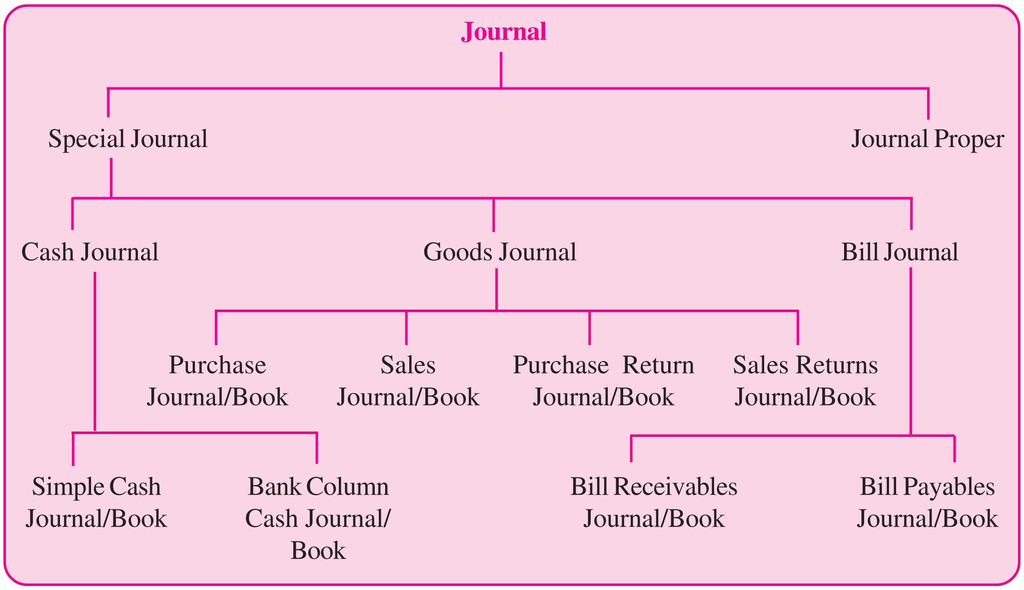


These journals are explained below :

I. Special Journals

Special journals are those journals which are meant for recording all the transactions of a repetitive nature of a particular type. For example, all cash related transactions may be recorded in one book, all credit purchases in another book and so on. These are :

(i) Cash Journal/Cash Book : Cash Journal or Cash Book is meant for recording all cash transactions i.e., all cash-receipts and all cash payments of the 'business. This book helps us to know the balance of Cash in hand at any point of time. It is of two types :

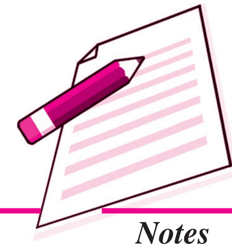
a) **Simple Cash Book :** It records only receipts and payments of cash. It is like an ordinary Cash Account.

b) **Bank Column Cash Book :** This type of Cash Book contains one more column on each side for the Bank transactions. This Book provides additional information about the Bank transactions.

You will learn more details about the Cash Book in the lesson on Cash Book.

ii. Purchases Journal/Purchases Book : This journal is meant for recording all credit purchases of goods only as Cash purchases of goods are recorded in the Cash Book. In this journal, purchases of other things like machinery, typewriter, stationery, etc. are not recorded. Goods means articles meant for trading or the articles in which the business deals.

iii. Sales Journal/Sales Book : This journal is meant for recording all credit sales of goods made by the firm. Cash Sales are recorded in the Cash Book and not



Notes

in the Sales Book. Credit Sale of items other than the goods dealt in like sale of old furniture, machinery, etc. are not entered in the Sales Journal.

iv. **Purchase Returns or Returns Outward Journal :** Whenever, the goods are not as per the specifications, the buyer may return these goods to the supplier. These returns are entered in a book known as Purchase Returns Book. It is also known as Returns Outward Journal/Book.

v. **Sale Returns or Returns Inward Journal :** Sometimes, when the goods are sold to the customer and they are not satisfied with the goods, they may return these goods to the businessman. Such returns are known as Sales Returns. Just like Purchase Returns, they are also recorded in a separate Book which is known as Sales Returns or Returns Inward Journal/Book.

Note : You will learn more details about these Special journals in the subsequent lessons.

vi. **Bill Receivables Journal/Book :** When goods are sold on credit and the date and period of payment is agreed upon between the seller and the buyer, this is duly signed by both the parties. This written document is called a Bill of exchange. For the seller it is a bill receivable and for the buyer it is a bill payable. Bills Receivable Journal/Book and Bills Payable Journal Book are two journals prepared by a businessman. For example : Pranaya sells goods to Gunakshi on credit for ₹5,000 payable after three months. A document is prepared containing these facts and is duly signed by Pranaya and Gunakshi. For Pranaya, it is a Bills Receivable and she will record this transaction in Bill Receivable Book. For Gunakshi, it is a Bill Payable and she will record the transaction in her Bill Payable Book.

vii. **Bill Payable Journal :** This is a journal in which record of those bills is kept on which the firm has given its acceptance for making payments on later dates.

Note : Bill books are not now in practice.

II. Journal Proper

This journal is meant for recording all such transactions for which no special journal has been maintained in the business. Therefore, in this journal, all such transactions are recorded which do not occur frequently and for these transactions, no special journal is required. For example, if Machinery is purchased on credit, it will be recorded in the journal proper, because in the Cash Book, we will record only cash purchases of machinery. Similarly, many other transactions, which do not find their place in the special journals, will be recorded in the Journal Proper such as

(i) Outstanding expenses – Salaries outstanding, Rent outstanding, etc.

(ii) Prepaid expenses – Prepaid Rent, Salaries paid in advance

(iii) Income received in advance – Rent received in advance, interest received in advance, etc.

(iv) Accrued Incomes – Commission yet to be received, interest yet to be received.

(v) Interest on Capital

(vi) Depreciation

(vii) Credit Purchase and Credit Sale of fixed Assets – Machinery, Furniture.

(viii) Bad debts.

(ix) Goods taken by the proprietor for personal use.

INTEXT QUESTIONS 5.6

Fill in the blanks with suitable word/words:

i. Return of goods purchased by the businessman to the suppliers will be entered in ____________ Journal.

ii. In ____________ Journal, credit purchases of assets is not recorded.

iii. When the payment is to be made by the debtor, under a written agreement it is ____________ for him.

iv. An order made by the creditor to his debtor to make the payment on a specified date is known as ____________.

v. In ____________ all such transactions are recorded for which no special journals are maintained.

vi. Assets sold on credit are entered in ____________.

WHAT YOU HAVE LEARNT

- The Book in which all business transactions are recorded, datewise i.e. chronological order is known as Journal.
- A Journal contains the following columns:

  1. Date: 2. Particulars; 3. Ledger folio; 4. Debit Amount; 5. Credit Amount.
- Brief explanation of a journal entry is known as Narration.
- A combination of two or more simple journal entries is known as compound entires.
- Cash discount is recorded in the journal whereas no entry is made for Trade Discount.

- When the amount paid or received is partly utilised by the end of an accounting year, and balance is for services to be provided in the next year or amount is yet to be paid or to be received for the services availed of in the current year, adjustment is required and adjusting entries will be made.
- In big business houses, a journal is classified into various special journals which record transactions of similar and repetitive nature.
- All those transactions which arise occasionally or do not find place in any of the special journals are recorded in Journal proper.
- Special Journals : These are used for recording specific nature transactions:

Cash Book	Purchase Book	Sales Book	Purchase Returns	Sale Returns	Bill Receivable Book	Bill Payable Book

TERMINAL EXERCISE

1. Write the meaning of the following in one sentence each:

   (i) Narration

   (ii) Ledger folio

   (iii) Bad debts

   (iv) Cash Discount

2. The following journal entries have been made by a learner. You are required to make correct entries wherever you think them to be wrong :

   (i) Proprietor brought capital into Business

   Capital A/c .... Dr.

   To Cash A/c

   (ii) Goods Sold for Cash

   Cash A/c .... Dr.

   To Goods A/c

   (iii) Machinery Purchased in Cash

   Purchases A/c .... Dr.

   To Cash A/c

Notes

(iv) Goods sold to Ram for cash

Ram A/c .... Dr.

To Sales A/c

(v) Salary paid to the Accountant

Accountant's personal A/c .... Dr

To Salary A/c

(vi) Rent paid in advance

Prepaid Rent A/c .... Dr

To Cash A/c

3. Distinguish between Special Journals and Journal Proper.
4. Journalise the following transactions :

   (i) Started business with cash ₹ 3,00,000.

   (ii) Bought Goods on credit for ₹ 5,000.

   (iii) Sold Goods for cash ₹ 12,000 and on credit ₹ 8,000.
5. Explain the process of journalising the transactions with suitable examples.
6. What are compound entries? Explain with suitable examples.
7. What are adjusting entries? Give examples of any two such entries.
8. Enter the following transactions in Journal

2014		
Jan. 1	Sushil & Co. started business with cash	1,00,000
Jan. 2	Paid into Bank	60,000
Jan. 4	Purchased Machinery and paid by cheque	30,000
Jan. 6	Bought goods from Naresh	20,000
Jan. 14	Paid salaries	5,000
Jan. 15	Sold goods to Rajesh Kumar	15,000
Jan. 17	Paid for Sundry Expenses	8,500
Jan. 18	Cash deposited into Bank	20,000
Jan. 19	Received Rent	6,000
Jan. 22	Paid Naresh by cheque in full settlement of his A/c	19,750

Jan. 24	Withdrawn cash for personal use	8,000
Jan. 26	Salary paid in advance to Surjeet	2,500
Jan. 28	Rajesh made the payment on A/c	10,000
Jan. 30	Cash Sales for the month	16,500

9. The following are the transactions of Kumar Swami for the month of January 2014. Journalise these transactions.

2014

		₹
Jan. 1	Capital paid into Bank	3,00,000
Jan. 1	Bought Stationery for cash	400
Jan. 2	Bought Goods for cash	25,000
Jan. 3	Bought Postage Stamps	600
Jan. 5	Sold Goods for Cash	10,000
Jan. 6	Bought Office Furniture from Mahendra Bros.	40,000
Jan. 11	Sold goods to Jacob	12,000
Jan. 12	Received cheque from Jacob	12,000
Jan. 14	Paid Mahendra Bros. by cheque	40,000
Jan. 16	Sold goods to Ramesh & Co	5,000
Jan. 20	Bought from S. Seth & Bros	15,000
Jan. 23	Bought Goods for cash from S.Narain & Co	22,000
Jan. 24	Sold Goods to P.Prakash	17,000
Jan. 26	Ramesh & Co. Paid on account	2,500
Jan. 28	Paid S.Seth & Bros. by cheque in full settlement	14,800
Jan. 31	Paid Salaries	2,800
Jan. 31	Rent is due to S. Sharma but not yet paid	2,000

ANSWERS TO INTEXT QUESTIONS

5.1 I. Journal is a book of accounts in which all day to day transactions are recorded in the order of their occurence.

II. (i) the journal (ii) original book of entries/Primary Book of entries (iii) entires (iv) narration (v) 'to'

5.2 I.

	Debit		*Credit*	
S.No.	***Name of A/c***	***Kind of A/c***	***Name of A/c***	***Kind of A/c***
(ii)	Goods A/c	Asset	Creditors A/c	Liability
(iii)	Commission A/c	Expense	Bank A/c	Asset
(iv)	Bank A/c	Asset	Cash A/c	Asset
(v)	Cash A/c	Asset	Interest A/c	Revenue
(vi)	Furniture A/c	Asset	Mukesh A/c	Liability
(vii)	Ramesh A/c	Asset	Goods A/c	Asset

II. (i) Goods sold for cash (ii) Goods purchased from Vinay on credit

III. (i) Goods A/c (ii) Commission A/c (iii) Interest (iv) Cash A/c

5.3 I. (i) Compound entry (ii) Debited (iii) Cash (iv) Trade

(v) Debited (vi) Debited (vii) Asset (viii) Drawings, Cash

II. (i) Cash A/c (ii) Discount (iii) Prepaid Rent
(iv) Capital A/c (v) Commission A/c (vi) Bad Debts A/c

5.4 (i) Purchase Returns - Journal (ii) Purchase Journal

(iii) Bill Payable (iv) Bill of Exchange (v) Journal proper (vi) Journal proper

6

LEDGER

You have learnt that business transactions are recorded in various special purpose books and journal proper. The accounting process does not stop here. The transactions are recorded in number of books in chronological order. Such recording of business transactions serves little purpose of accounting. Items of same title in different books of accounts need to be brought at one place under one head called an account. There are numerous account titles of items/persons or accounts. All the accounts, if brought in one account book, will be more informative and useful. The account book so maintained is called Ledger.

In this lesson, you will learn about Ledger and posting of items entered in various books of accounts to ledger.

OBJECTIVES

After studying this lesson, you will be able to:

- state the meaning, features and importance of ledger;
- enumerate the various types of ledger;
- state the meaning of posting and explain the steps of posting journal into ledger;
- calculate the balance of the account in the ledger.

6.1 LEDGER : MEANING, IMPORTANCE AND TYPES

You have already learnt about accounts. Each transaction affects two accounts. In each account transactions related to that account are recorded. For example, sale of goods taking place number of times in a year will be put under one Account i.e. Sales Account.

Notes

All the accounts identified on the basis of transactions recorded in different journals/books such as Cash Book, Purchase Book, Sales Book etc. will be opened and maintained in a separate book called Ledger. So a ledger is a book of account; in which all types of accounts relating to assets, liabilities, capital, expenses and revenues are maintained. It is a complete set of accounts of a business enterprise.

> Ledger is bound book with pages consecutively numbered. It may also be a bundle of sheets.

Thus, from the various journals/Books of a business enterprise, all transactions recorded throughout the accounting year are placed in relevant accounts in the ledger through the process of posting of transactions in the ledger. Thus, posting is the process of transfer of entries from Journal/Special Journal Books to ledger.

Features of Ledger

- Ledger is an account book that contains various accounts to which various business transactions of a business enterprise are posted.
- It is a book of final entry because the transactions that are first entered in the journal or special purpose Books are finally posted in the ledger. It is also called the Principal Book of Accounts.
- In the ledger all types of accounts relating to assets, liabilities, capital, revenue and expenses are maintained.
- It is a permanent record of business transactions classified into relevant accounts.
- It is the ‘reference book of accounting system and is used to classify and summarise transactions to facilitate the preparation of financial statements.

Format of a Ledger Sheet

The format of a ledger sheet is as follows :

Title of An Account

Dr. Cr.

Date	*Particulars*	*JF*	*Amount* ₹	*Date*	*Particulars*	*JF*	*Amount* ₹

Notes

You must have noticed that the format of a ledger sheet is similar to that of the format of an Account about which you have already learnt. A full sheet page may be allotted to one account or two or more accounts may be opened on one sheet. It depends upon the number of items related to that account to be posted.

Importance of Ledger/Utility of Ledger

Ledger is an important book of Account. It contains all the accounts in which all the transactions of a business enterprise are classified. At the end of the accounting period, each account will contain the entire information of all the transactions relating to it. Following are the advantages of ledger.

- **Knowledge of Business Results :** Ledger provides detailed information about revenues and expenses at one place. While finding out business results the revenue and expenses are matched with each other.
- **Knowledge of Book Value of Assets :** Ledger records every asset separately. Hence, you can get the information about the Book value of any asset whenever you need.
- **Useful for Management :** The information given in different ledger accounts will help the management in preparing budgets. It also helps the management in keeping the check on the performance of business it is managing.
- **Knowledge of Financial Position :** Ledger provides information about assets and liabilities of the business. From this we can judge the financial position and health of the business.
- **Instant Information :** The business always need to know what it owes to others and what the others owe to it. The ledger accounts provide this information at a glance through the account receivables and payables.

Types of Ledger

In large scale business organisations, the number of accounts may run into hundreds. It is not always possible for a businessman to accommodate all these accounts in one ledger. They, therefore, maintain more than one ledger.

These ledgers may be as follows :

1. **Assets Ledger :** It contains accounts relating to assets only e.g. Machinery account, Building account, Furniture account, etc.
2. **Liabilities Ledger :** It contains the accounts of various liabilities e.g. Capital (Owner or partner), Loan account, Bank overdraft, etc.
3. **Revenue Ledger :** It contains the revenue accounts e.g.. Sales account, Commission earned account, Rent received account, interest received account, etc.

Notes

4. **Expenses Ledger :** It contains the various accounts of expenses incurred, e.g. Wages account, Rent paid account, Electricity charges account, etc.

5. **Debtors Ledger :** It contains the accounts of the individual trade debtors of the business. Individuals, firms and institutions to whom goods and services are sold on credit by business become the 'trade debtors' of the business.

6. **Creditors Ledger :** It contains the accounts of the individual trade Creditors of the business. Individuals, firms and institutions from whom a business purchases goods and services on credit are called 'trade creditors' of the business.

7. **General Ledger :** It contains all those accounts which are not covered under any of the above types of ledger. For example Landlord A/c, Prepaid insurance A/c etc.

INTEXT QUESTIONS 6.1

I. Fill in the blanks with a suitable word or words :

i. Ledger contains various .... in it.

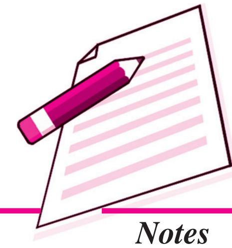
ii. The process of transfer of entries from Journal and special purpose books to ledger is called ....

iii. Ledger is also called ....

iv. Ledger is a .... book of accounting system.

II. Match the column A with column B :

	A		B
i.	Book containing accounts	(a)	Ledger
ii.	Pages number of the ledger	(b)	Liabilities ledger
iii.	Machinery account, Building account, furniture Accounts, etc.	(c)	Revenue ledger
iv.	Loan's account, Bank overdraft account, etc.	(d)	Expenses ledger
v.	Rent paid, wages paid, electricity charges	(e)	Folio
vi.	Sales account, commission account, interest received account etc.	(f)	Assets ledger



6.2 POSTING OF JOURNAL PROPER INTO LEDGER

You know that the purpose of opening an account in the ledger is to bring all related items of this account which might have been recorded in different books of accounts on different dates at one place. The process involved in this exercise is called posting in the ledger. This procedure is adopted for each account.

To take the items from the journal to the relevant account in the ledger is called posting of journal. Following procedure is followed for posting of journal to ledger :

1. Identify both the accounts 'debit' and 'credit' of the journal entry. Open the two accounts in the ledger.
2. Post the item in the first account by writing date in the date column, name of the account to be credited in the particulars column and the amount in the amount column of the 'debit' side of the account.
3. Write the page number of the journal from which the item is taken to the ledger in Folio column and write the page number of the ledger from which account is written in L.F. column of the journal.
4. Now take the second Account and give the similar treatment. Write the date in the 'date' column, name of the account to be debited in the particulars column and the amount in the 'particulars' column of the account on its credit side in the ledger.
5. Write page number of journal in the 'folio' column of the ledger and page number of the ledger in the 'LF' of column of the journal.

Illustration 1

Journalise the following transactions.

2014		₹
January 1	Commenced business with cash	50,000
January 3	Paid into bank	25,000
January 5	Purchased furniture for cash	5,000
January 8	Purchased goods and paid by cheque	15,000
January 8	Paid for carriage	500
January 14	Purchased Goods from K. Murthy	35,000
January 18	Cash Sales	32,000
January 20	Sold Goods to Ashok on credit	28,000

Notes

January 25	Paid cash to K. Murthy in full settlement	34,200
January 28	Cash received from Ashok	20,000
January 31	Paid Rent for the month	2,000
January 31	Withdrew from bank for private use	2,500

Solution :

Journal

Date	Particulars	LF	Dr. Amount ₹	Cr Amount ₹
2014				
Jan 1	Cash A/c Dr.		50,000	
	To Capital A/c			50,000
	(Commenced business with cash)			
Jan 3	Bank A/c Dr		25,000	
	To cash A/c			25,000
	(Cash paid into the Bank)			
Jan 5	Furniture A/c Dr		5,000	
	To Cash A/c			5,000
	(Purchased furniture for cash)			
Jan 8	Purchases A/c Dr		15,000	
	To Bank A/c			15,000
	(Purchased goods and paid by cheque)			
Jan 8	Carriage A/c Dr		500	
	To Cash A/c			500
	(Cash paid for carriage charges)			
Jan 14	Purchases A/c Dr		35,000	
	To K. Murthy			35,000
	(Goods purchased on credit)			
Jan 18	Cash A/c Dr		32,000	
	To Sales A/c			32,000
	(Goods sold for cash)			

Jan 20	Ashok Dr To Sales A/c (Goods sold to Ashok credit)		28,000	 28,000
Jan 25	K Murthy Dr To Cash A/c To Discount A/c (Cash paid to K. Murthi and discount allowed by them)		35,000	 34,200 800
Jan 28	Cash A/c Dr To Ashok (Cash received from Ashok on Account)		20,000	 20,000
Jan 31	Rent A/c Dr To Cash A/c (Cash paid for rent)		2,000	 2,000
Jan 31	Drawings A/c Dr To Bank A/c (Cash withdrawn from bank for domestic use)		2,500	 2,500

INTEXT QUESTIONS 6.2

I. State the meaning of ledger posting :

____

____

II. Following are the steps of posting of journal to ledger but are not in proper order. Write them in correct order :

i. Write the page number of journal in the JF column of ledger and that of ledger on which account has been taken from journal.

ii. Identify the two affected accounts in the journal and open these accounts in the ledger

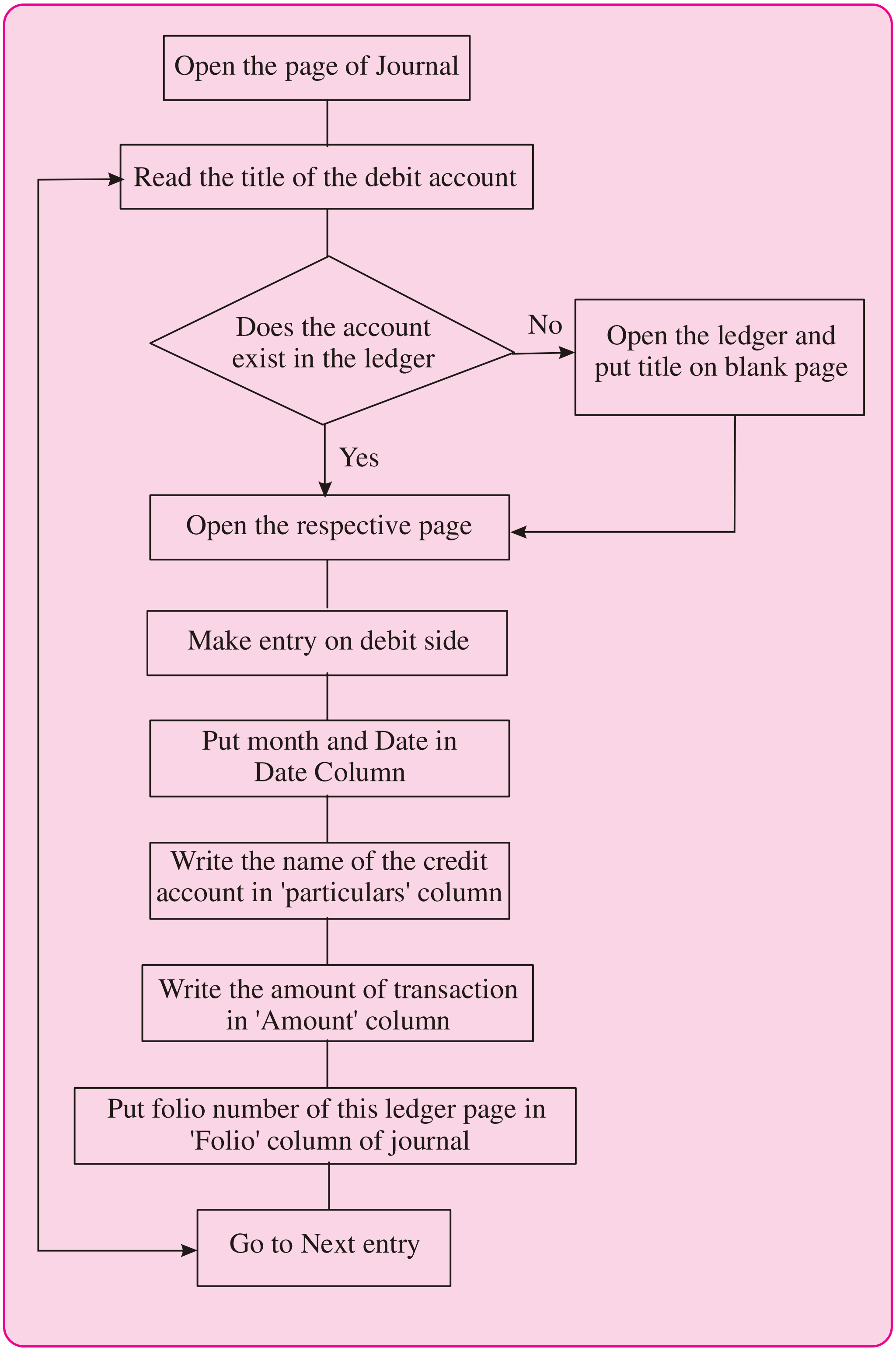
iii. Take date and amount of the debit account, and name of the credit account from journal to ledger in their respective columns.

iv. While posting the credit account from journal in the ledger write page number of the journal from which item is taken to ledger in JF column of ledger and page number of ledger on which item is taken on the LF column of the journal.

Notes

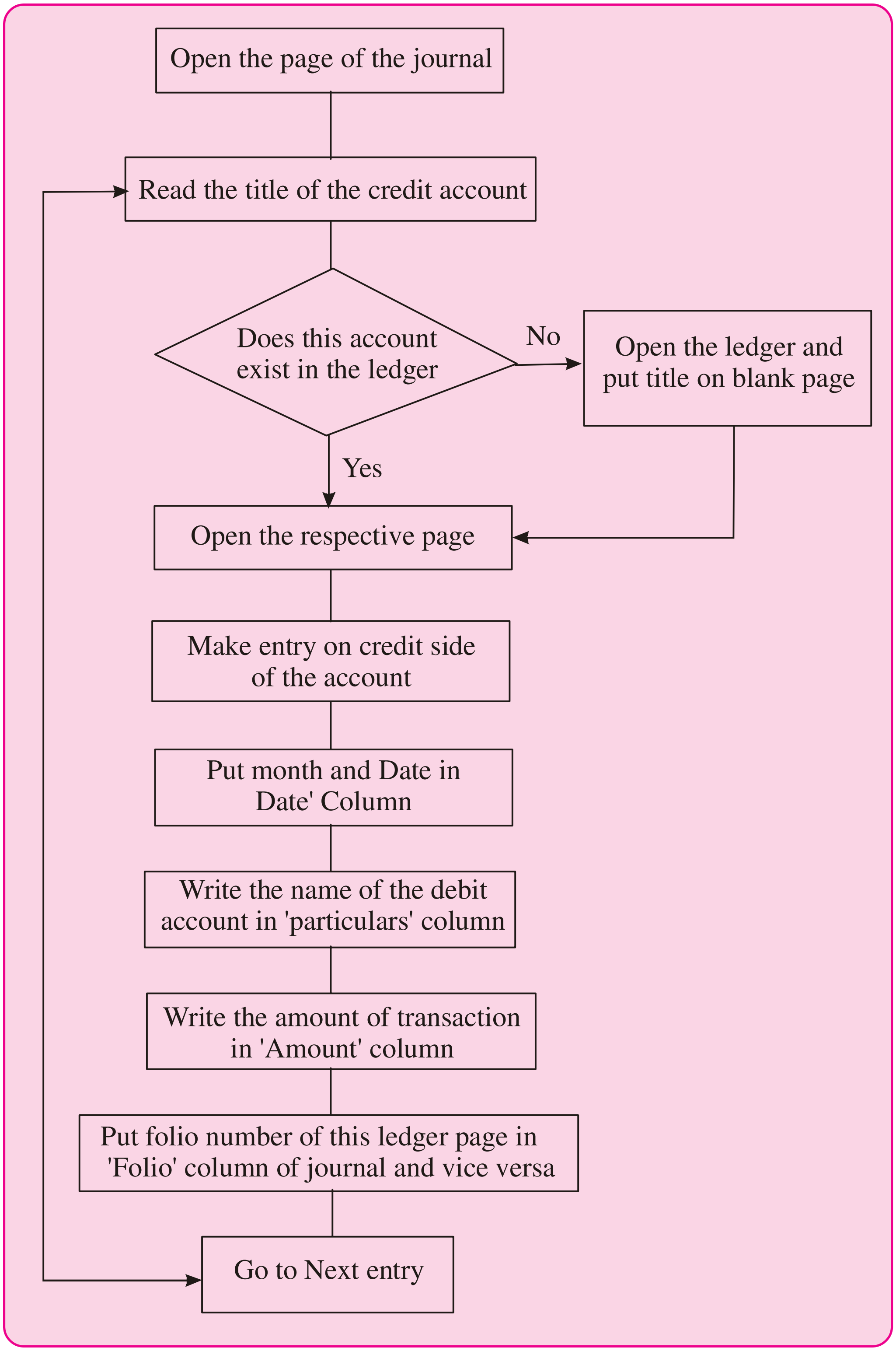
Posting Scheme

Posting from the Journal to the ledger-Dedit Account



Posting Scheme

Posting from the Journal to the ledger-Credit Account



6.3 BALANCING OF AN ACCOUNT

Balancing of an account is the process of finding out the difference between the total of debits and total of credits of an account. If debit side total is more than the credit side, the account shows a debit balance. Similarly, the balance will be credit balance if the credit side total of an account is more than the debit side total. This process of ascertaining and writing the balance of each account in the ledger is called balancing of an account. An account has two sides : debit and credit. Items by which this account is debited are entered on its debit side with their amounts and items by which this account is credited are entered on its credit side with their amounts so all items related to an account are shown at one place in the ledger. But then you would like to know the net effect of this account i.e. the balance between its debit amount and credit amount. The following steps are followed in Balancing the Ledger Account :

- Total the two sides of an Account on a rough sheet.
- Determine the difference between the two sides. If the credit side is more than the debit side, the balance calculated is a credit balance.
- Put the difference on the 'Shorter side' of the account such that the totals of the two sides of the account are equal.
- If the difference amount is written on debit side (i.e., if credit. side is bigger) then write as "Balance c/d" (c/d stands for carried down). If difference is written on the credit side (i.e., if debit side is bigger) then write it as "Balance c/d.
- Finally at the end of the year all the ledger accounts are closed by taking out the balance of each account.
- The Balance then should be brought down or carried forward to the next period. If the difference was put on credit side as "Balance c/d" it should now be written on the debit side of the account as "Balance b/d" (b/d stands for brought down) and vice-a-versa. Thus, debit balance will automatically be brought down on the debit side and a credit balance on the credit side.

Balancing of Different Types of Accounts

Assets : All asset accounts are balanced. These accounts always have a debit balance.

Liabilities : All Liability accounts are balanced. All these accounts have a credit balance.

Capital : This account is always balanced and usually has a credit balance.

Expense and Revenue : These Accounts are not balanced but are simply totalled up. The debit total of Expense/Loss will show the expense/Loss. In the same manner, credit total of Revenue/Income will show increase in income. At the time of preparing the Trial Balance, the totals of these are taken to the Trial Balance.

Notes

The Balance of Assets, Liabilities and Capital Accounts will be shown in Balance Sheet whereas total of Expense/Loss and Revenue/Income will be taken to the Trading and Profit and Loss Account. These Accounts are, thus, closed.

If two sides of an Account (usually Assets, Liabilities and Capital) are equal there will be no balance. The Account is then simply closed by totalling up of the two sides of the account.

Illustration 2 : Taking ledger accounts of illustration 1, ledger posting and balancing is as follows :

Solution

Ledger : Cash A/c

Dr. Cr.

Date	*Particulars*	*JF*	*Amount* ₹	*Date*	*Particulars*	*JF*	*Amount* ₹
2014				2014			
Jan 1	Capital A/c		50,000	Jan 3	Bank A/c		25,000
” 18	Sales A/c		32,000	Jan 5	Furniture		5,000
” 28	Ashok		20,000	Jan 8	Carriage		500
				Jan 25	K. Murthi		34,200
				Jan 31	Rent A/c		2,000
				Jan 31	Balance c/d		35,300
			1,02,000				1,02,000
Feb 1	Balance b/d		35,300				

Capital A/c

Dr. Cr.

Date	*Particulars*	*JF*	*Amount* ₹	*Date*	*Particulars*	*JF*	*Amount* ₹
2014				2014			
Jan 31	Balance c/d		50000	Jan 1	Cash A/c		50000
			50000				50000
				Feb 1	Balance b/d		50000

Notes

Bank A/c

2014				2014			
Jan 2	Cash A/c		25000	Jan 8	Purchases A/c		15000
				Jan 31	Drawings A/c		2500
				Jan 31	Balance c/d		7500
			25000				25000
Feb 1	Balance b/d		7500				

Furniture A/c

Dr. Cr.

Date	*Particulars*	*JF*	*Amount* ₹	*Date*	*Particulars*	*JF*	*Amount* ₹
2014	Cash A/c		5000	2014	Balance c/d		5000
Jan 1			5000	Jan 31			5000
Feb 1	Balance b/d		5000				

Purchase A/c

Dr. Cr.

Date	*Particulars*	*JF*	*Amount* ₹	*Date*	*Particulars*	*JF*	*Amount* ₹
2014				2014			
Jan 8	Bank		15,000		Trading A/c		50,000
Jan 14	K. Murthy		35,000				
			50,000				50,000

Carriage A/c

Dr. Cr.

Date	*Particulars*	*JF*	*Amount* ₹	*Date*	*Particulars*	*JF*	*Amount* ₹
2014				2014			
Jan 8	Cash		500		Trading A/c		500
			500				500

Notes

K. Murthy A/c

Dr. Cr.

Date	*Particulars*	*JF*	*Amount* ₹	*Date*	*Particulars*	*JF*	*Amount* ₹
2014				2014			
Jan 25	Cash		34,200	Jan 14	Purchases		35,000
Jan 25	Discount		800				
			35,000				35,000

Sales A/c

Dr. Cr.

Date	*Particulars*	*JF*	*Amount* ₹	*Date*	*Particulars*	*JF*	*Amount* ₹
2014				2014			
Jan 1	Trading A/c		60,000	Jan 18	Cash		32,000
				Jan 20	Ashok		28,000
			60,000				60,000

Ashok A/c

Dr. Cr.

Date	*Particulars*	*JF*	*Amount* ₹	*Date*	*Particulars*	*JF*	*Amount* ₹
2014				2014			
Jan 20	Sales A/c		28,000	Jan 28	Cash		20,000
				Jan 31	Balance c/d		8,000
			28,000				28,000
Feb 1	Balance b/d		8,000				

Rent A/c

Dr. Cr.

Date	*Particulars*	*JF*	*Amount* ₹	*Date*	*Particulars*	*JF*	*Amount* ₹
2014				2014			
	Cash A/c		2,000		Profit and Loss A/c		2,000
			2,000				2,000

Notes

Drawing A/c

Dr. Cr.

Date	*Particulars*	*JF*	*Amount* ₹	*Date*	*Particulars*	*JF*	*Amount* ₹
2014				2014			
Jan 10	Bank		2,500	Jan 31	Balance c/d		2,500
			2,500				2,500
Feb 1	Balance b/d		2,500				

INTEXT QUESTIONS 6.3

I. Fill in the blanks with suitable word/words :

i. The debit accounts from the journal are entered on the ___________ side of respective account in the ledger.

ii. The ___________ of the account in the ledger should be the same as that is used in the Journal.

iii. The page number of the journal is entered in the ___________ column in the ledger account.

iv. The Figures appearing in the amount column of the ___________ and the amount column of the respective ___________ in the ledger must be the same.

II. Fill in the blanks with suitable word or words :

i. The balance of asset accounts are .... balance.

ii. The balance of liability accounts are always .... balance.

iii. The capital Account generally has .... balance.

iv. The Revenue and expense accounts are closed by taking the balances to ....

WHAT YOU HAVE LEARNT

- Ledger is a register with pages ruled in account form to enable the preparation of accounts.

- Ledger is a permanent record of business transactions which are classified according to various accounts to which they pertain.
- Ledger may be Assets Ledger, Liabilities Ledger, Revenue ledger, Expense ledger, Debtors' ledger, Creditors' ledger and General ledger.
- 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.
- The page No. of journal from where entries are being posted is entered in folio column of the various relevant accounts.
- In the ledger Book, the balances of Assets, Liabilities and Capital are carried forward to the next period. Revenue and Expense accounts are closed by transferring their totals to Trading and Profit and Loss A/c.
- The balance of an account is written on the side having lower total, so that its total becomes equal to the total of the other side.

TERMINAL EXERCISE

1. What is meant by ledger? Why is ledger prepared?
2. Why is ledger known as the primary book or the principal -book of accounts? Can profit of the business and its financial position be known without maintaining ledger?
3. Enumerate the various types of ledgers which may be maintained by a business.
4. What is the rule for posting the debit account from the journal into the ledger account?
5. What is rule for posting the credit items of the journal into the ledger accounts?
6. What are the advantages of maintaining a ledger?
7. What is meant by balancing of an account? Explain the various steps taken while balancing accounts.
8. How do we balance the following types of accounts?

   (a) Assets (b) expense (c) capital (d) Revenue

9. Following are the transactions of Dhani Ram and Sons for the month of July 2014. Make journal entries, post them into ledger and balance the account.

2014		₹
July 1	Commenced business with cash	60,000
July 2	Paid into bank	40,000
July 5	Purchased furniture for cash	5000
July 7	Purchased Goods and paid for them by cheque	20000
July 10	Sold Goods to Lata Gupta for cash	12000
July 12	Sold Goods to Mahavir on credit	24000
July 18	Purchased Goods from Harish	30000
July 19	Withdrew cash for domestic use	2500
July 20	Received a cheque from Mahavir on account	18900
	Allowed him discount	100
July 27	Paid to Harish cash on account	16800
	Discount allowed by him	200
July 31	Paid salary by cheque	1800
	Paid cash for telephone bill	600

ANSWERS TO INTEXT QUESTIONS

6.1 I. (i) accounts (ii) posting (iii) Principal Book of Account (iv) reference book

II. (i) a (ii) e (iii) f (iv) b (v) d (vi) c

6.2 I. Taking the items from the journal to the relevant account in the ledger is called ledger posting

II. Correct order b, c, a, d

6.3 I. (i) credit (ii) ledger (iii) JF (iv) journal, account

II. (i) debit (ii) credit (iii) credit (iv) Trading and Profit and Loss A/c

ANSWERS TO TERMINAL EXERCISE

9. Total of journal ₹ 2,25,400

Notes

ACTIVITY

Contact someone who may be your friend's father or a relative who is in business. He operates his accounts and he collects computerised statements received from the banks. You compare their format with the ledger accounts which you have learnt in your school or the businessman in question are maintaining and find the difference with regards to :

	Traditional A/c	*Computerised A/c*
1. Format of the account		
2. How the accounts are debited/credited		
3. Balancing of accounts		
4. Additional information		

7

CASH BOOK

A person after passing his/her senior secondary examination started a grocery store. The transactions were limited in number and he/she maintained only one register to record them i.e., Journal. As the business grows, the number of business transactions increases. 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 books that are maintained where the transactions will be recorded in these books according to their nature, such as Cash book for cash transactions, Sales Book for credit sales; Purchases Book for credit Purchases and so on. Out of these books, Cash Book plays a significant role because it records large number of cash items of a business concern. In this lesson you will learn about Cash Book, its meaning and preparation.

OBJECTIVES

After studying this lesson, you will be able to:

- state the meaning of Cash Book;
- enumerate the types of Cash Book;
- state the meaning and draw Simple Cash Book as per format;
- state the meaning and draw Cash Book with Bank Column as per format;
- prepare Simple Cash Book and Cash Book with Bank column;
- posting of Cash Book in the ledger;
- describe the meaning and need of Petty Cash Book;
- prepare the Petty Cash Book.

Notes

7.1 CASH BOOK : MEANING AND SIMPLE CASH BOOK

On your birthday you got gift in the form of cash from your parents, grand parents and some of your relatives. In the meantime, you got back some money that you have given to your friend as a loan. You spent this money in buying books and clothes. You went to see movies with your friends. You purchased some toys for your niece. As per habit you noted down all receipts and payments in your note book. At the end of the month, you calculated the balance of cash in hand and tallied it with the actual cash balance with you. You may maintain separate book to record these items of receipts and payments, this book is known as Cash Book.

Cash Book is a Book in which all cash receipts and cash payments are recorded. It is also one of the books of original entry. It starts with the cash or bank balance at the beginning of the period. In case of new business, there is no cash balance to start with. It is prepared by all organisations. 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.

Cash Book : Types and Preparation

Cash Books may be of the following Types:

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

Simple Cash Book

A Simple Cash Book 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 this book there is only one amount column 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

Date	*Particulars*	*L.F.*	*Amount (₹)*	*Date*	*Particulars*	*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 : In this column, the name of the account in respect of 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.

Ledger Folio : In this column, it records the page number of the ledger book on which relevant account is prepared.

Amount : In this column, it records the amount received on debit side and cash paid on its credit side.

Preparation of Simple Cash Book

Cash Book is in a way, a cash account with debit and credit side and Cash account is an asset account, so the rule followed is 'Increase in assets to be debited and Decrease in asset is to be credited'. This implies that Cash Book is a book where all the receipts in terms of cash are recorded on the debit side of the Cash Book and all the payments in terms of cash are recorded on its credit side. This means:

> Cash Book records all transactions related to receipts and payments in terms of Cash only.

On the debit side in the particulars column, the name of the account, for which cash is received is recorded. Similarly, on the credit side, the name of account for which cash is paid, is recorded. In the amount column the actual cash paid or received is recorded. At the end of the month, cash book is balanced. The cash book is balanced in the same manner an account is balanced in the ledger. 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'. In case of Simple Cash Book, the total of debit side is always 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 the both sides of the cash book becomes equal. The closing balance of the credit side 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 following period.

Recording of cash transactions in the Simple Cash Book and its balancing is illustrated with the help of the following illustrations :

Illustration 1

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

Date	Details	(₹)
2014		
December 01	Cash in Hand	27,500
December 05	Cash received from Nitu	12,000
December 08	Insurance Premium paid	2,000
December 10	Furniture purchased	6,000
December 14	Sold Goods for cash	16,500
December 18	Purchased Goods from Naman for cash	26,000
December 22	Cash paid to Rohini	3,200
December 25	Sold Goods to Kanika for cash	18,700
December 28	Cash Deposited into Bank	5,000
December 30	Rent paid	4,000
December 31	Salary paid	7,000

Solution:

Books of M/s. Rohan Traders

Cash Book

Dr. Cr.

Date	*Particulars*	*L.F.*	*Amount (₹)*	*Date*	*Particulars*	*L.F.*	*Amount (₹)*
2014				2014			
Dec.01	Balance b/d		27,500	Dec.08	Insurance premium		2,000
Dec.05	Nitu		12,000	Dec.10	Furniture		6,000
Dec.14	Sales		16,500	Dec.18	Purchases		26,000
Dec.25	Sales		18,700	Dec.22	Rohini		3,200
				Dec.28	Bank A/c		5,000
				Dec.30	Rent		4,000
				Dec.31	Salary		7,000
				Dec.31	Balance c/d		21,500
			74,700				74,700
2015							
Jan. 01	Balance b/d		21,500				

Notes

Illustration 2

Prepare Cash Book for the month of April 2014 from the following particulars :

Date	Details	(₹)
2014		
April 01	Cash in hand	17,600
April 03	Purchased Goods for cash from Rena	7,500
April 06	Sold Goods to Rohan	6,000
April 10	Wages paid in cash	500
April 15	Cash paid to Neena	3,500
April 17	Cash Sales	10,000
April 19	Commission paid	700
April 21	Cash received from Teena	1,500
April 25	Furniture Purchased for cash	1,700
April 28	Rent paid	3,000
April 30	Paid Electricity bill in cash	1,300

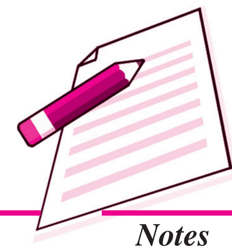
Solution:

Cash Book

Dr. Cr.

Date	*Particulars*	*L.F.*	*Amount (₹)*	*Date*	*Particulars*	*L.F.*	*Amount (₹)*
2014				2014			
Apr. 01	Balance b/d		17,600	Apr. 03	Purchases		7,500
Apr. 17	Sales		10,000	Apr. 10	Wages		500
Apr. 21	Teena		1,500	Apr. 15	Neena		3,500
				Apr. 19	Commission		700
				Apr. 25	Furniture		1,700
				Apr. 28	Rent		3,000
				Apr. 30	Electricity Bill		1,300
				Apr. 30	Balance c/d		10,900
			29,100				29,100
2014							
May 01	Balance b/d		10,900				

Note : Credit transactions are not recorded in cash book (i.e. a credit sales to Rohan ₹ 6,000 on April 6, 2014)



Notes

Posting of Cash Book in the Ledger

As we know that cash receipts are shown on debit side of Cash Book and the cash payments are shown on the credit side of Cash Book. Account appearing on the debit side of the Cash Book is posted on the credit side in the relevant ledger. Similarly, account appearing on the credit side of Cash Book is posted on the debit side of the relevant ledger.

Cash Book in itself is a Cash account, so no separate cash account will be maintained in the ledger.

For the posting of various cash book entries in the ledger, refer illustration No. 2.

(a) Posting of Debit side of Cash Book :

Sales Account

Dr. Cr.

Date	*Particulars*	*L.F.*	*Amount (₹)*	*Date*	*Particulars*	*L.F.*	*Amount (₹)*
				2014 April 17	Cash		10,000

Teena Account

Dr. Cr.

Date	*Particulars*	*L.F.*	*Amount (₹)*	*Date*	*Particulars*	*L.F.*	*Amount (₹)*
				2014 April 21	Cash		1,500

(b) Posting of credit sides of cash Book

Purchases Account

Dr. Cr.

Date	*Particulars*	*L.F.*	*Amount (₹)*	*Date*	*Particulars*	*L.F.*	*Amount (₹)*
2014 April 03	Cash		7,500				

Notes

Wages Account

Dr. Cr.

Date	*Particulars*	*L.F.*	*Amount (₹)*	*Date*	*Particulars*	*L.F.*	*Amount (₹)*
2014							
April 10	Cash		500				

Neena's Account

Dr. Cr.

Date	*Particulars*	*L.F.*	*Amount (₹)*	*Date*	*Particulars*	*L.F.*	*Amount (₹)*
2014							
April 10	Cash		3,500				

Commission Account

Dr. Cr.

Date	*Particulars*	*L.F.*	*Amount (₹)*	*Date*	*Particulars*	*L.F.*	*Amount (₹)*
2014							
April 19	Cash		700				

Furniture Account

Dr. Cr.

Date	*Particulars*	*L.F.*	*Amount (₹)*	*Date*	*Particulars*	*L.F.*	*Amount (₹)*
2014							
April 25	Cash		1,700				

Rent Account

Dr. Cr.

Date	*Particulars*	*L.F.*	*Amount (₹)*	*Date*	*Particulars*	*L.F.*	*Amount (₹)*
2014							
April 28	Cash		3,000				

Electricity Bills Account

Dr. Cr.

Date	*Particulars*	*L.F.*	*Amount (₹)*	*Date*	*Particulars*	*L.F.*	*Amount (₹)*
2014							
April 30	Cash		1,300				

Notes

INTEXT QUESTIONS 7.1

I. Complete the following sentences with the suitable words:

i. Cash Book starts with the ___________ Balance at the beginning of the period.

ii. When a Cash Book is maintained, cash transactions are not recorded in ___________.

iii. Simple Cash Book records only Cash ___________ and Cash ___________.

iv. The total of ___________ side of the Simple column Cash Book is always more than the total of its ___________ side.

v. Closing Balance of Cash Book becomes the opening balance of next period and is written as ___________.

II. Some transactions are given below. On which side of the Cash Book would you record them. Tick [√] the correct side:

S.No.	Transactions	Debit side	Credit side
i.	Saniya started business with Cash		
ii.	Goods Purchased for cash		
iii.	Goods sold for Cash		
iv.	Cash deposited into Bank		
v.	Rent paid		
vi.	Purchased Computer		
vii.	Closing Cash Balance		
viii.	Cash received from Mohit.		

Notes

7.2 BANK COLUMN CASH BOOK

When the number of bank transactions is large in an orgnisation, it is necessary to have a separate book to record bank transactions. Instead of having a separate book to record bank transactions, a 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

Date	*Particulars*	*L.F*	*Cash (₹)*	*Bank (₹)*	*Date*	*Particulars*	*L.F*	*Cash (₹)*	*Bank (₹)*

Preparation of Bank Column Cash Book

In Bank column Cash Book, the cash transactions are recorded in a similar manner as are recorded in the Simple cash book. The difference is that Bank column cash book records transactions relating to Bank also. There are some special business transactions which need special treatment in the Bank column of the Cash Book:

(i) Opening balance

(ii) Receipts of cheques

(iii) Contra entries

(iv) Endorsement of cheques

(v) Bank charges

The treatment given to these special transactions is as under :

Opening Balance

The opening cash and bank balances are recorded on the debit side of the cash book. Sometimes a businessman withdraws excess amount from the bank (from his bank account) and the closing bank balance of a month is a credit balance. This balance amount is called 'Bank overdraft'. It is written on the credit side of the bank column of the cash book as opening balance. For example, if a business firm has ₹ 12,000 as cash in hand and ₹15,000 as overdraft (credit balance) in the bank, it will be recorded as under:

Notes

Bank Column Cash Book

Dr. Cr.

Date	Particulars	L.F	Cash (₹)	Bank (₹)	Date	Particulars	L.F	Cash (₹)	Bank (₹)
	Balance b/d		12,000			Balance b/d			15,000

Receipt of Cheques

All cash receipts are entered in the cash column and cheques received in the bank column of Cash Book. If the cheques deposited in bank on the same date, it is entered on the debit side of bank column of the cash book. If the cheques received from customer are not deposited in the bank on same day, they are included in cash and written on the debit side in the cash column of cash book. For example: On May 2, 2014 a cheque received from Tarun for ₹ 7,000 and deposited on same date.

Bank Column Cash Book

Dr Cr

Date	Particulars	L.F	Cash (₹)	Bank (₹)	Date	Particulars	L.F	Cash (₹)	Bank (₹)
2014									
May 2	Tarun			7,000					

In case, this cheque is deposited on May 10, 2014 the entry on May 02, 2014 is as under:

Bank Column Cash Book

Dr Cr

Date	Particulars	L.F	Cash (₹)	Bank (₹)	Date	Particulars	L.F	Cash (₹)	Bank (₹)
2014									
May 2	Tarun		7,000						

Contra Entries

When there is a transaction that relates to both cash and bank, this will be written on one side of Bank Column and on other side of Cash Column, Such transactions are known as 'Contra entries'. In case, cash is withdrawn from bank for office use, it is entered on the credit side of bank column and also in the debit side of cash column of the cash Book. In case, cash is deposited in the bank, the amount is recorded on the debit side of bank column and on the credit side of cash column of the cash book. The letter 'C' is written in the LF column on both sides against these entries. These entries are not to be posted into ledger. For example: On May 15, 2014 Cash withdrawn from bank for office use is ₹2,000. In this case the transaction recorded is as under:

Bank Column Cash Book

Dr Cr

Date	*Particulars*	*L.F*	*Cash (₹)*	*Bank (₹)*	*Date*	*Particulars*	*L.F*	*Cash (₹)*	*Bank (₹)*
2014									
May					May				
15	Bank	C	2,000		15	Cash	C		2,000

Endorsement of Cheques

When cheque received from customer is given to some other party i.e. endorsed, on receipt, it is recorded on the debit side of cash column. On endorsement of cheque, the amount is recorded on the credit side of the cash column of Cash Book. For example, on May 22, 2014 a cheque of ₹ 8,000 is received from M/s J.P Traders. On May 27,2014 it was endorsed in favour of M/s Kapila Traders. In this case the transaction recorded is as under:

Bank Column Cash Book

Dr Cr

Date	*Particulars*	*L.F*	*Cash (₹)*	*Bank (₹)*	*Date*	*Particulars*	*L.F*	*Cash (₹)*	*Bank (₹)*
2014					2014				
May					May				
22	J.P.Traders (Cheque)		8,000		27	Kapila Traders (Cheque)		8,000	

Bank Charges

If bank charges any interest, outstation cheque collection charges etc., are entered on the credit side of the Bank column of the Cash Book. Similarly, if bank gives interest, collects commission etc., these will be recorded on the debit side on the Bank column of Cash Book.

Illustration 3

Record the following transactions in the Bank column Cash Book of M/s Time Zone for the month of January 2014.

Date		Details	(₹)
2014			
January	01	Bank Balance	32,500
	01	Cash Balance	12,300
	03	Purchased Goods by cheque	5,300
	08	Goods Sold for cash	9,500
	10	Purchased Typewriter by Cheque	5,400
	15	Sold Goods and received Cheque (deposited on the same day)	7,900
	17	Purchased Stationery by Cheque	1,000
	20	Cash deposited into bank	10,000
	22	Paid Cartage	500
	24	Cheque given to Mudit	7,000
	28	Rent paid by Cheque	3,000
	30	Paid Salary	3,500

Solution

Bank Column Cash Book

Dr Cr

Date	*Particulars*	*L.F*	*Cash (₹)*	*Bank (₹)*	*Date*	*Particulars*	*L.F*	*Cash (₹)*	*Bank (₹)*
2014					2014				
Jan.1	Balance b/d		12,300	32,500	Jan.3	Purchases			5,300
Jan.8	Sales		9,500		Jan.10	Typewriter			5,400
Jan.15	Sales			7,900	Jan.17	Stationery			1,000
Jan.20	Cash	C		10,000	Jan.20	Bank	C	10,000	
					Jan.22	Cartage		500	
					Jan.24	Mudit			7,000
					Jan.28	Rent			3,000
					Jan.30	Salary		3,500	
					Jan.31	Balance c/d		7,800	28,700
			21,800	50,400				21,800	50,400
Feb 1	Balance b/d		7,800	28,700					

Notes

Illustration 4

Enter following transactions in the Bank column cash Book of M/s Tea Traders for April 2014

Date	Details	Amount (₹)
2014		
April 01	Commenced business with Cash	60,000
April 03	Opened Bank account with SBI	45,000
April 05	Purchased Goods by Cash	7,000
April 10	Purchased Office Machine for cash	5,000
April 15	Sold Goods to Manjula and received cheque	6,000
April 18	Cash Sales	10,000
April 20	Manjula's Cheque deposited into Bank	
April 22	Paid Wages by cheque	300
April 25	Cash withdrawn from Bank for personal use	3,000
April 30	Rent paid by Cheque	2,000

Solution

Bank Column Cash Book

Dr   Cr

Date	*Particulars*	*L.F*	*Cash (₹)*	*Bank (₹)*	*Date*	*Particulars*	*L.F*	*Cash (₹)*	*Bank (₹)*
2014					2014				
Apr. 1	Capital A/c		60,000		Apr. 3	Bank	C	45,000	
Apr. 3	Cash	C		45,000	Apr.5	Purchases		7,000	
Apr. 15	Sales		6,000		Arp.10	Office Machine		5,000	
Apr. 18	Sales		10,000		Apr.20	Bank (Cheque)	C	6,000	
Apr. 20	Cash (cheque)	C		6,000	Apr.22	Wages			300
					Apr.25	Drawings			3,000
					Apr.30	Rent			2,000
					Apr.30	Balance c/d		13,000	45,700
			76,000	51,000				76,000	51,000
May 1	Balance b/d		13,000	45,700					

Illustration 5

Prepare Bank Column Cash Book from the following information for December 2014

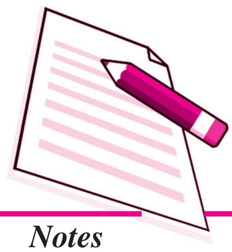
Date	Details	(₹)
2014		
Dec 1	Cash in hand	10,500
1	Bank Overdraft	9,500
4	Paid Wages	400
6	Cash Sales	10,000
9	Cash deposited into Bank	5,000
13	Purchased Goods and paid by cheque	6,000
15	Cash deposited into Bank	4,000
18	Paid Trade Expenses by cheque	1,200
22	Rent paid	2,300
25	Received Cash from Rahul	1,500
27	Commission paid	2,000
29	Salary paid	3,500
31	Bought Goods by Cheque	3,000

Solution

Bank Column Cash Book

Dr Cr

Date	Particulars	L.F	Cash (₹)	Bank (₹)	Date	Particulars	L.F	Cash (₹)	Bank (₹)
2014					2014				
Dec 1	Balance b/d		10,500		Dec 1	Balance b/d			9,500
Dec.6	Sales		10,000		Dec.4	Wages		400	
Dec.9	Cash	C		5,000	Dec.9	Bank	C	5,000	
Dec.15	Cash	C		4,000	Dec.13	Purchases			6,000
Dec.25	Rahul		1,500		Dec.15	Bank	C	4,000	
Dec.31	Balance b/d			10,700	Dec.18	Trade Expenses			1,200
					Dec.22	Rent		2,300	
					Dec.27	Commission		2,000	
					Dec.29	Salary		3,500	
					Dec.31	Purchases			3,000
					Dec.31	Balance c/d		4,800	
2015			22,000	19,700	2015			22,000	19,700
Jan 1	Balance b/d		4,800		Jan 1	Balance b/d		–	10,700



Notes

Posting of Bank column Cash book in the Ledger

Like Cash account no separate Bank account will be opened. Account relating to Contra entries on either side of Cash book need not be posted. Other accounts on either side of Bank column of the Cash book will be maintained in the ledger in the same manner which we adopted in the case of Simple cash Book.

For the posting of various cash book items in the ledger refer to illustration No.5.

(a) Posting of Debit side of Bank column Cash Book

Sales Account

Dr. Cr.

Date	*Particulars*	*L.F*	*Amount (₹)*	*Date*	*Particulars*	*L.F*	*Amount (₹)*
				2014			
				Dec. 6	Cash		10,000

Rahul's Accounts

Dr. Cr.

Date	*Particulars*	*L.F*	*Amount (₹)*	*Date*	*Particulars*	*L.F*	*Amount (₹)*
				2014			
				Dec. 25	Cash		1,500

(b) Posting of Credit Side of Bank Column Cash Book

Purchases account

Dr. Cr.

Date	*Particulars*	*L.F*	*Amount (₹)*	*Date*	*Particulars*	*L.F*	*Amount (₹)*
2014							
Dec.13	Bank		6,000				
Dec.31	Bank		3,000				

Wages Account

Dr. Cr.

Date	*Particulars*	*L.F*	*Amount (₹)*	*Date*	*Particulars*	*L.F*	*Amount (₹)*
2014							
Dec. 4	Cash		400				

Notes

Trade Expenses Account

Dr. Cr.

Date	*Particulars*	*L.F*	*Amount* (₹)	*Date*	*Particulars*	*L.F*	*Amount* (₹)
2014							
Dec.18	Bank		1,200				

Commission Account

Dr. Cr.

Date	*Particulars*	*L.F*	*Amount* (₹)	*Date*	*Particulars*	*L.F*	*Amount* (₹)
2014							
Dec. 27	Cash		2,000				

Salary Account

Dr. Cr.

Date	*Particulars*	*L.F*	*Amount* (₹)	*Date*	*Particulars*	*L.F*	*Amount* (₹)
2014							
Dec.29	Cash		3,500				

Rent Account

Dr. Cr.

Date	*Particulars*	*L.F*	*Amount* (₹)	*Date*	*Particulars*	*L.F*	*Amount* (₹)
2014							
Dec. 22	Cash		2,300				

INTEXT QUESTIONS 7.2

Fill in the blanks with suitable word/words:

i. In Bank Column Cash Book ____________ columns are shown on each side.

ii. The Bank column Cash book records transactions relating to ____________ as well as ____________.

iii. Credit balance of Bank Column of Cash Book is called ____________.

iv. When a cheque is received from a customer but not deposited into the Bank on the same day, it will be recorded on ___________ side in ___________ column.

v. When transactions relate to both cash and bank side of Bank Column Cash Book, Such transactions are known as ___________.

vi. When cheque received from customer is given to some other party it is called ___________.

7.3 PETTY CASH BOOK : MEANING AND NEED

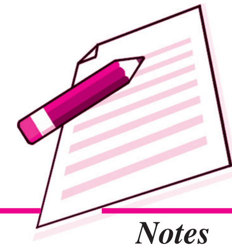
In big business organisations, a large number of repetitive small payments such as, for conveyance, cartage, postage, telegrams, courier and other expenses are made. These organisations appoint an assistant to the Head Cashier. The appointed cashier is known as petty cashier. He makes payments of these expenses and maintains a separate cash book to record these transactions. Such a cash book is called Petty Cash Book. The petty cashier works on the imprest system. Under this system, a definite sum, say ₹ 4000/- is given to the petty cashier at the beginning of the period. This amount is called imprest money. The petty cashier meets all small payments out of this imprest amount, At the end of the period say one month he presents the account to the Head Cashier and gets reimbursed from the Head Cashier. Suppose out of ₹ 4,000 he has spent ₹ 3,850 by the end of the month. He will get ₹ 3,850 from the head cashier. Thus, again he has the full imprest amount in the beginning of the next period. The process of reimbursement can be weekly, fortnightly or monthly depending upon the frequency of small payments. The Petty Cashier is authorised to sanction and disburse small payments. Assignment of the task of making of petty expenses to a person and the maintenance of petty cash book by him reduces the burden of the Head Cashier.

The petty cash book has a number of columns for the amount on the payment side. Each of the amount columns is allotted to items of specific payments, which are common. The last column is allotted for miscellaneous payments. At the end of the period, all amount columns are totalled. The total of the amount paid shown in column 5 is deducted from the column 1. At the opening of the month the total amount paid in the previous month is reimbursed by the Head Cashier.

Format of a Petty Cash Book is given as under:

Petty Cash Book (Format)

Amount Received	*Date*	*Particulars*	*Voucher No,*	*Amount paid (Rs)*	*Analysis of Payments*				
					Postage	*Tele phone Telegram*	*Convey ance*	*Station ery*	*Miscella neous Expenses*
1	2	3	4	5	6	7	8	9	10



Notes

Illustration 6

Mr. Sumit the Petty Cahier of M/s Travels India received ₹ 2,000 on April 1, 2014 from the Head Cashier. Prepare Petty Cash Book on Imprest System from the petty payments during the month of April 2014 for the following items:

Date		Details	(₹)
2014			
April	2	Auto fare	200
	3	Courier services	50
	4	Postage stamps	95
	5	Pencils/Pads	65
	6	Speed Post Charges	40
	8	Taxi fare (205+90)	295
	9	Refreshments	310
	11	Auto fare	60
	13	Telegram	64
	16	Computer stationery	165
	19	Bus fare	40
	21	STD Call Charges	205
	23	Refreshment	80
	25	Photostat Charges	45
	28	Courier services	40
	30	Bus fare	40

Solution:

Petty Cash Book

Amount Received	*Date*	*Particulars*	*Voucher No.*	*Amount paid (₹)*	*Analysis of Payments*				
					Postage	*Telephone & Telegram*	*Conveyance*	*Stationery*	*Miscellaneous Expenses*
	2014								
	April								
2,000	01	Cash received							
	02	Auto fare		200			200		

Notes

	03	Courier services		50	50				
	04	Postage stamps		95	95				
	05	Pencils/Pads		65				65	
	06	Speed Post Charges		40	40				
	08	Taxi fare		295			295		
	09	Refreshments		310					310
	11	Auto fare		60			60		
	13	Telegram		64		64			
	16	Computer stationery		165				165	
	19	Bus fare		40			40		
	21	STD Call Charges		205		205			
	23	Refreshment		80					80
	25	Photostat Charges		45					45
	28	Courier services		40	40				
	30	Bus fare		40					
				1,794	225	269	595	230	435
	30	Balance c/d		206					
2,000				2,000					
206	May	Balance b/d							
1,794	01	Cash received							

INTEXT QUESTIONS 7.3

Fill in the blanks with suitable word/words:

i. The assistant of the Head Cashier is known as ....

ii. A separate cash book to record small transactions is called ....

iii. The amount which is paid to the petty cashier at the beginning of a period is known as ....

iv. Under Imprest system of Petty Cash Book, the Petty Cashier is reimbursed with the amount equivalent to what he spent during the ....

WHAT YOU HAVE LEARNT

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

Type of Cash Book

Simple Cash Book | Bank Column Cash Book | Petty 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.
- **Contra Entries :** Transactions that relate to both cash and bank and are entered on cash column of one side and bank column of other side of 'Bank Column Cash Book'. Recording of such transactions is known as 'Contra entries'.
- In big business organisations, a large number of repetitive small payments such as, for conveyance, cartage, postage, telegrams and other expenses are made. These organisations 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 Cash Book? Explain the different types of Cash Book.
2. Draw the format of 'Bank Column Cash Book' and write at least five items in it.
3. What is Contra entry? How will you deal with this entry while preparing Bank Column Cash Book?
4. What do you mean by Petty Cash Book ? Explain the imprest system of Petty Cash Book.
5. Enter the following transactions in the Simple Cash Book of M/s Golden Traders:

2014			₹
April	1	Started Business with Cash	30,000

Notes

April	2	Goods Purchased for Cash	10,000
April	3	Furniture Purchased	1,000
April	6	Goods Sold for Cash	7,000
April	9	Cartage paid	200
April	10	Postage	100
April	12	Cash Sales	3,000
April	14	Cash withdrawn for Personal use	2,000
April	18	Deposited into Bank	10,000
April	22	Goods purchased for Cash	13,000
April	25	Wages paid	500
April	27	Rent paid	3,000
April	28	Cash Sales	2,000
April	30	Commission received	500

6. From the following transactions prepare Simple Cash Book :

2014			₹
March	01	Cash in hand	32,500
March	08	Cash paid to Rohan	8,000
March	12	Goods Purchased	3,000
March	15	Cash received from Tanaya	2,000
March	18	Cash Sales	4,000
March	22	Paid wages	4,000
March	25	Salary paid	3,000
March	28	Cash paid to Manish	3,500
March	31	Rent paid	2,500

7. Prepare Bank Column Cash Book from the following transactions:

2014			₹
July	1	Cash in hand	18,000
		Cash at Bank	27,500
July	3	Goods sold for cash	10,000

July	6	Bought Goods by Cheque	16,000
July	8	Cash deposited into Bank	20,000
July	10	Paid Trade Expenses through Cheque	2,000
July	12	Paid Audit Fee for Cash	1,000
July	14	Cheque received from Garima and deposited into bank	4,700
July	18	Withdrew from bank for personal use	2,000
July	20	Purchased office machine by Cheque	5,000
July	22	Wages paid	1,000
July	26	Cash Sales	5,000
July	28	Received Cheque from Mahesh	2,000
July	29	Salary Paid	5,000
July	30	Mahesh's Cheque deposited into Bank	
July	31	Rent paid	2,000

8. Prepare Bank column Cash Book of M/s Style India from the following transactions for the month of April 2014 :

2014			₹
August	1	Cash in hand	18,000
		Cash at Bank	27,500
August	3	Cash Sales	10,000
August	5	Furniture purchased by cheque	8,700
August	8	Paid by cheque to Sonu	13,500
August	12	Received Cheque from Ashima and deposited into Bank	13,000
August	15	Cash Sales	7,000
August	18	Deposited into Bank	8,000
August	20	Withdrawn from Bank for personal use	7,000
August	22	Cheque received from Naveen	7,000
August	24	Rent paid	5,000

August 26	Naveen's Cheque deposited into Bank	
August 28	Withdrawn from Bank for office use	5,000
August 29	Salary paid	3,000
August 31	Cash paid for Electric Bill	500
August 31	Cash paid for Telephone bill	1,000

Notes

9. Prepare Bank Column Cash Book from the following transactions for the month of March 2014 :

2014		₹
March 1	Cash in hand	3,200
	Bank Overdraft	16,500
March 4	Cash Sales	4,000
March 7	Cheque received from Babli	6,000
March 10	Goods Purchased by Cheque	2,000
March 12	Babli's Cheque deposited into Bank	
March 14	Cash Sales	5,000
March 18	Cash deposited into Bank	8,000
March 20	Salary paid	2,000
March 22	Wages paid	150
March 23	Interest charged by Bank	300
March 27	Cash Sales	2,500
March 29	Telephone Bill paid by cash	100
March 31	Purchase of Goods on cash	2,000

10. Prepare Petty Cash Book on imprest system for the month of September 2014 from the following items of petty payments:

2014		₹
Sept. 2	Postage	130
Sept. 4	Stationery	50
Sept. 6	Auto fare	60
Sept. 8	Refreshments	210
Sept. 10	Courier Services	60

Sept.	12	Speed Post Charges	90
Sept.	15	Telegram	20
Sept.	18	Bus fare	30
Sept.	19	Postage	20
Sept.	21	Photostat Charges	30
Sept.	23	Bus fare	20
Sept.	25	STD Call Charges	35
Sept.	27	Taxi fare	110
Sept.	29	Cartage	35
Sept.	30	Computer Stationery	120

The petty cashier received ₹ 1200 from the Head cashier on September 01, 2014.

Notes

ANSWERS TO INTEXT QUESTIONS

7.1 I. (i) Cash (ii) Journal (iii) Receipts, Payments
(iv) Debit, Credit (v) Balance b/d

II.

S.No	Debit Side	Credit Side
(i)	√	
(ii)		√
(iii)	√	
(iv)		√
(v)		√
(vi)		√
(vii)		√
(viii)	√	

7.2 (i) Bank/Cash (ii) Cash, Bank (iii) Overdraft
(iv) Debit, Cash (v) Contra entry (vi) endorsement

7.3 (i) petty cashier (ii) petty cash book (iii) Imprest amount
(iv) previous month

ANSWERS TO TERMINAL EXERCISE

5. Closing Cash in hand ₹ 2,700
6. Closing Cash in hand ₹ 14,500
7. Closing Cash in hand ₹ 4,000, Closing Bank Balance ₹ 29,200
8. Closing Cash in hand ₹ 3,060,Closing Bank Balance ₹ 48,300
9. Closing Cash in hand ₹ 2,550, Bank overdraft ₹ 4,800
10. Closing Cash Balance ₹480

ACTIVITY

If you ask your friends you may come across a friend who gets pocket allowance on regular basis from his prarents and who spends it judiciously and maintains a record of the money spent. He may also be receiving money from his grand parents and/or from grand maternal parents. Procure the note book/diary in which your friend keeps the notes regarding receipts and payments and prepare a Cash Book on the basis of the given information.

8

SPECIAL PURPOSE BOOKS

In the previous lesson you have learnt that Journal can be divided into different Journals/Books, so that we may get information separately as per the nature of transactions. These journals/books are called Special Purpose Books or subsidiary books. You have already learnt one such special purpose book i.e., Cash Book. In this lesson you will learn other such books like Purchases Book, Purchase Returns Book, Sales Book and Sales Returns Book. A business organisation can divide the journal into many more journals, if the number of transactions of similar nature is quite large.

OBJECTIVES

After studying this lesson, you will be able to :

- state the meaning of Purchases Book and Purchase Returns Book;
- prepare Purchases Book and Purchases Returns Book as per format and its ledger posting;
- state the meaning of Sales Book and Sales Returns Book;
- prepare Sales Book and Sales Returns Book as per format and its ledger posting;
- state the meaning of Bills receivable and bills payable book with its format and
- state the meaning of Journal Proper and its preparation.

8.1 PURCHASES AND PURCHASES RETURNS BOOK

Purchases (journal) book is also a book of original entry. This book records only credit purchases of goods in which the firm deals. Cash purchases of goods are recorded in the cash book. Credit purchases of items not for resale are not recorded in the Purchases Book e.g, If a firm deals in Computer parts, any item of furniture purchased on credit is not recorded in this book. These are recorded in another book which is known as 'journal proper'.

In case of Purchase of goods on credit, an Invoice or Bill prepared by the supplier is received. It contains information about the date of transaction, details of items purchased at List Price less trade discount, if any, Invoice Number, and the net amount payable. Trade discount and other details of invoice need not be recorded in this book. Format of Purchases Book is as under:

Notes

Purchases (Journal) Book

Date	*Invoice No.*	*Name of supplier*	*L.F.*	*Details*	*Amount (₹)*

Column-wise explanation is as follows :

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

Invoice Number : In this column, Invoice number is entered.

Name of Supplier : In this column, the name of the supplier from whom the goods were purchased is written.

Ledger Folio : In this column, it records the page number of the ledger book in which suppliers account is maintained.

Detail : The amount in respect of each article is written in this column. If the seller has allowed a Trade Discount it is also deducted in this column itself.

Amount : In this column, it records the net amount payable to the supplier.

Illustration 1

Record the following transactions for the Month of August 2014 in the Purchases Book of M/s Harsha Electronics :

Date	Details
2014	Purchased from M/s.Naresh Electronics (Invoice No. 250)
August 5	5 Colour T.V @ ₹ 12500 per piece.
	Trade Discount on all items @20%.

Notes

August 10 Bought from M/s Capital Electronics: (Invoice No. 826)

20 Tape Recorders @ ₹ 1650 per piece

Trade Discount 10% on purchases.

August 17 Purchased from M/s. East Electronics: (Invoice No. 456)

15 Stereos @ ₹ 4000 per piece

2 Color T.V. 14″ @ ₹ 10500 per piece

Trade Discount @5%.

August 25 Purchased form M/s. Naresh Electronics: (Invoice No. 294)

10 Small T.V. @ ₹ 1,200 per piece

3 Colour T.V. 17″ @ ₹ 12000 per piece

Trade Discount 10%.

August 30 Bought from M/s Pavitra Electronics: (Invoice No. 82)

20 Video cassettes @ ₹ 150 per piece Net.

Solution:

Books of M/s Harsha Electronics
Purchases (Journal) Book

Date	*Invoice No.*	*Name of supplier*	*L.F.*	*Detail*	*Amount (₹)*
2014					
August 5	250	**Naresh Electronics**		5 x 12,500 = 62,500	
		5 Clr. TV. @ 12,500		(-) 20% Discount = 12,500	50,000
August 10	826	**Capital Electronics**		20 x 1,650 = 33,000	
		20 Tap rec. @ 1,650		(-)10% Discount = 3,300	29,700
August 17	456	**East Electronics**		15 x 4,000 = 60,000	
		15 Steros @ 4,000		2 x 10,500 = 21,000	
		20 Clr. T.V @ 10,500		81,000	
				(-) 5% Discount = 4,050	76,950
August 25	294	**Naresh Electronics**		10 x 1,200 = 12,000	
		10 Small T.V. @ 1,200		3 x 12,000 = 36,000	
		3 Clr. T.V @ 12,000		48,000	
				(-) 10% Discount = 48,00	43,200
August 30	82	**Pavitra Electronics**		20 x 150	3,000
		20 Video Cas. @ 150			2,02,850

Notes

Posting of Purchases Journal/Book into Ledger

Posting from the Purchases Journal/Book is done daily to relevant supplier's accounts on the credit side with the Invoice amount at the end of the month, the grand total of the Purchases Journal/Book is posted to the Debit side of Purchases Account in the ledger, and written in the Particulars column "Sundries as per Purchases Book".

For the posting of Purchase Journal/ Book items into the ledger refer to Illustration No. 1.

Books of M/s Harsha Electronics
M/s. Naresh Electronics

Dr. Cr.

Date	Particulars	L.F.	Amount (₹)	Date	Particulars	L.F.	Amount (₹)
				2014			
				Aug.05	Purchases		50,000
				Aug.25	Purchases		43,200

M/s. Capital Electronics

Dr. Cr.

Date	Particulars	L.F.	Amount (₹)	Date	Particulars	L.F.	Amount (₹)
				2014			
				Aug.10	Purchases		29,700

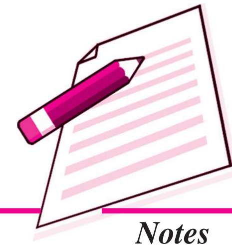
M/s.East Electronics

Dr. Cr.

Date	Particulars	L.F.	Amount (₹)	Date	Particulars	L.F.	Amount (₹)
				2014			
				Aug.17	Purchases		76,950

M/s.Pavitra Electronics

Date	Particulars	L.F.	Amount (₹)	Date	Particulars	L.F.	Amount (₹)
				2014			
				Aug.30	Purchases		3,000



Purchases Account

Dr. Cr.

Date	Particulars	L.F.	Amount (₹)	Date	Particulars	L.F.	Amount (₹)
2006							
Aug.31	Sundries as per Purchases Book		2,02,850				

Purchase Returns Journal

Return of goods purchased is recorded in this book. Sometimes goods purchased from the supplier are returned for various reasons such as goods are not as per our order, or are defective. These goods are returned to the supplier. For this purpose a debit note is prepared and sent to the supplier for making necessary entries. The record of such return of goods in a journal is called Purchase Returns journal, the format of which is as under :

Purchase Return (Journal) Book

Date	*Debit Note No.*	*Name of supplier*	*L.F.*	*Deatil*	*Amount (₹)*

Column-wise explanation is as follows :

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

Debit Note Number : In this column, the debit note number is written.

Name of Supplier : In this column, the Name of the supplier from whom the goods were purchased is written.

Ledger Folio : In this column, the page number of the ledger book on which supplier account is prepared is recorded.

Deatil : In this column the details of the goods returned to the supplier is recorded.

Amount : In this column, it records the amount of the total goods returned to the supplier.

Illustration 2

The Details submitted by M/s. Harsha Electronics for the month of August 2014 are as under :

Notes

Date	Details
2014	Goods returned to M/s. Capital Electronics vide Debit note
August 17	No.016/2014
	5 Tape Recorders @ ₹1650 per piece
	Trade Discount @ 10% on purchases.

Solution

Books of M/s Harsha Electronics
Purchases Returns (Journal) Book

Date	*Debit Note No.*	*Name of supplier*	*L.F.*	*Detail*	*Amount (₹)*
2014					
Aug. 17	016	Capital Electronics		5 x 1,650 = 8,250	
		5 Tape Recorders @ 1,650		(-) 10% Discount = 825	7,425
					7,425

Posting of Purchase Returns Journal/Book into Ledger

The monthly total of Purchase Returns Journal/Book is credited to the Purchase Return account in the ledger. Supplier account to whom the goods are returned is debited with the net amount of goods returned.

For the posting of Purchase Returns Journal/Book into the ledger refer Illustration No.2.

Solution

M/s.Capital Electronics

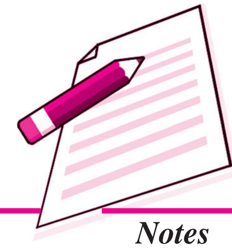
Dr. Cr.

Date	*Particulars*	*L.F.*	*Amount (₹)*	*Date*	*Particulars*	*L.F.*	*Amount (₹)*
2014							
Aug. 17	Purchase Returns		7,425				

Purchases Returns Account

Dr. Cr.

Date	*Particulars*	*L.F.*	*Amount (₹)*	*Date*	*Particulars*	*L.F.*	*Amount (₹)*
				2014			
				Aug.31	Sundries as Per Purchase returns Book		7,425



Notes

Illustration 3

Enter the following transactions in the Special Journal/Books of M/s Mohit Stationery Mart of June 2014, prepare Purchases Book and Purchase Returns Book.

Date 2014	Details
June 01	Purchased from M/s.Seema Stationers as per Invoice No. 031 50 Paper Rim @ ₹ 100 Per Rim. 60 Simple Books @ ₹ 20 Each 100 Pkt Pencils @ ₹ 50 Per Pkt.
June 12	Bought from M/s Nisha Paper Mart as per Invoice No. 1202 200 Files @ ₹ 12 per file Trade Discount @ 5% on purchases.
June 22	Purchased from M/s. Bansal Stationers as per Invoice No. 3211 500 Drawing Paper @ ₹ 4 each 100 Pkt Pencil Color @ ₹ 20 per pkt. Trade Discount 5%.
June 23	Goods Returned to M/s Nisha paper Mart as per Debit Note No. 002 50 Files @ ₹ 12 each Trade Discount 5%.
June 24	Purchased from M/s. Stationery Zone as per Invoice No. 6783 200 pkt Pens @ ₹ 100 per pkt. Trade Discount 10%
June 27	Purchased form M/s. Sumit Paper Mart as per Invoice No. 2340 100 pkt water Color @ ₹ 50 per pkt. 50 pkt Paint Brushes @ ₹ 40 per pkt. Trade Discount 10%
June 28	Goods Returned to M/s Bansal Stationers as per Debit Note No. 042 50 Pkt Pencil Color @ ₹ 20 per pkt. Trade Discount 5%.
June 30	Bought from M/s Handa File Trader as per Invoice No. 1321 200 Plastic Files @ ₹ 25 per file Trade Discount 10%

Solution:

Books of M/s Mohit Stationery Mart
Purchase (Journal) Book

Date	*Invoice No.*	*Name of supplier*	*L.F.*	*Details (₹)*	*Amount*
2014					
June 01	031	**Seema Stationers**			
		50 Paper Rim @ 100		50 x 100 = 5,000	
		60 Sim. Books @ 20		60 x 20 = 1,200	
		100 Pkt. Pencil @ 50		100 x 50 = 5,000	11,200
June 12	1202	**Nisha Paper Mart**			
		200 files @ 12		200 x 12 = 2,400	
				(-) 5% Discount = 120	2,280
June 22	3211	**Bansal Stationers**			
		500 Draw. Paper @ 4		500 x 4 = 2,000	
		100 Pkt. Pencil @ 20		100 x 20 = 2,000	
				4,000	
				(-)Trade Disc. 5% = 200	3,800
June 24	6783	**Stationery Zone**			
		200 Pkt. Pens @ 100		200 x 100 = 20,000	
				(-) Trade Disc. 10% = 2,000	18,000
June 27	2340	**Sumit Paper Mart**			
		100 Pkt. Water Clr. @ 50		100 x 50 = 5,000	
		50 Pkt Paint Brush @ 40		50 x 40 = 2,000	
				7,000	
				(-) Trade Disc. 10% = 700	6,300
June 30	1321	**Handa File Trader**			
		200 Plastic Files @ 25		200 x 25 = 5000	
				(-) Trade Disc. 10% = 500	4,500
					46,080

Purchase Returns (Journal) Book

Date	*Debit Note No.*	*Name of supplier*	*L.F.*	*Details (₹)*	*Amount*
2014					
June 22	002	**Nisha Paper Mart**		50 x 12 = 600	
		50 fiels @ 12		(-) Trade Disc. 5% = 30	570
June 28	042	**Bansal Stationers**		50 x 20 = 1000	
		50 Pkt. Pencil Clr. @ 20		(-) Trade Disc. 5% = 50	950
					1,525

INTEXT QUESTIONS 8.1

Which of the following transactions will be entered in the Purchases Book or Purchase Returns Book? If the transaction is not to be entered in any of the two write None of these.

i. Furniture purchased from M/s. Modern Furnishers.

ii. Goods purchased from M/s Sell Well were returned to them as goods were not according to the specifications.

iii. Goods of ₹ 6,000 were purchased from M/s Rohit Brothers for Cash.

iv. M/s. Ravi & Sons supplied goods on Credit.

v. Purchased goods from Himanshu on Credit.

8.2 SALES JOURNAL/BOOK AND SALES RETURNS JOURNAL

Transactions relating to Sale of goods on credit are recorded in the Sales Journal. Cash sales are recorded in the Cash Book. It means that Sales Journal records only credit sales of goods. For example sale of old furniture by a firm which is dealing in computers is not treated as goods and items relating to computer are regarded as goods.

In case of sale of goods on credit, one copy of an Invoice or Bill prepared by the vendor firm is given to the customer. It contains information about the date of transaction, details of items sold at List Price less trade discount if any. Invoice Number and the amount receivable or payable by customer.

When a customer purchases goods in bulk, the vendor may allow him a discount, which is called trade discount. In the invoice, trade discount is deducted from the list price of the goods and the customer is debited only with the net amount. This discount is quite different from the cash discount, which is allowed for payment within a stipulated period. The format of the Sales Journal/Book is given as under :

Sales (Journal) Book

Date	*Invoice No.*	*Name of customer*	*L.F.*	*Details*	*Amount (₹)*

Column-wise explanation is as follows :

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

Invoice No. : In this column, Invoice number is written.

Name of Customer : In this column, Name of the Customer is recorded.

L.F. : In this Column, page number of the ledger book in which debtor's account is maintained.

Detail : For each item the amount is recorded in the detail column, after totalling the amount of sale to one customer, charges for packing etc., are added and the trade discount, if any is deducted.

Amount : In this column, the amount of the total goods sold to the customer is recorded.

Illustration 4

M/s Furniture Mart wants you to prepare Sales journal for the month ended March 2014, from the following details of sale of goods :

Date	Details
2014	
March 4	Sold on Credit to M/s Mena Traders : Vide Invoice No.213 (a) Two Double Beds @ ₹ 7,100 each. (b) Five Chairs @ ₹ 260 each
March 9	Sold on Credit to M/s Kohli Furniture : Vide Invoice No. 278 5 Tables @ ₹ 1,400 Each
March 24	Sold on Credit to M/s Handa Furniture Mart : Vide Invoice No. 302 4 Sofa Sets @ ₹ 18,000 each
March 30	Sold on Credit to M/s Furniture Traders : Vide Invoice No. 327, 6 Single Beds @ ₹ 6,000 each

Solution:

Books of M/s Furniture Mart
Sales (Journal) Book

Date	*Invoice No.*	*Name of customer*	*L.F.*	*Details*	*Amount (₹)*
2014					
March 4	213	**Mena Traders**			
		2 Double Bed @ 7,100		2 x 7,100 = 14,200	
		5 Chairs @ 260		5 x 260 = 1,300	15,500
March 9	278	**Kohli Furniture**			
		5 Tables @ 1,400		5 x 1,400	7,000
March 24	302	**Handa Furniture Mart**			
		4 Sofa Sets @ 18,000		4 x 18,000	72,000

March 30	327	**Furniture Traders** 6 Single Beds @ 6,000			6 x 6,000	36,000
						1,30,500

Notes

Posting of Sales Journal/Book into Ledger

The monthly total of the Sales Book is posted to the credit side of the Sales account in the ledger. The net amount due from each customer is debited to customer account individually. The customer's account is generally posted daily. For the posting of Sales Journal/Book into the ledger refer to Illustration No. 4.

Books of M/s Furniture Mart
M/s. Mena Traders

Dr. Cr.

Date	*Particulars*	*L.F.*	*Amount (₹)*	*Date*	*Particulars*	*L.F.*	*Amount (₹)*
2014 March 4	Sales		15,500				

M/s. Kohli Furniture

Date	*Particulars*	*L.F.*	*Amount (₹)*	*Date*	*Particulars*	*L.F.*	*Amount (₹)*
2014 March 9	Sales		7,000				

M/s. Handa Furniture Mart

Dr. Cr.

Date	*Particulars*	*L.F.*	*Amount (₹)*	*Date*	*Particulars*	*L.F.*	*Amount (₹)*
2014 March 24	Sales		72,000				

M/s. Furniture Traders

Dr. Cr.

Date	*Particulars*	*L.F.*	*Amount (₹)*	*Date*	*Particulars*	*L.F.*	*Amount (₹)*
2014 March 30	Sales		36,000				

Sales Account

Dr. Cr.

Date	*Particulars*	*L.F*	*Amount (₹)*	*Date*	*Particulars*	*L.F.*	*Amount (₹)*
				2014 Mar. 31	Sundries as per Sales Book		1,30,500

Sales Returns Journal/Book

Goods returned by the customers are recorded in the Sales returns journal/book. The Sales returns Book does not record the return of goods sold on cash basis. Goods supplied to the customer (Debtors) may not be as per specifications of the order, or some of the goods may get damaged during transit. The Customer returns these goods. For this purpose a credit note is made in favour of the customer. The format of Sales returns Book is as under :

Sales Return (Journal) Book

Date	*Credit Note No.*	*Name of customer*	*L.F.*	*Detail*	*Amount (₹)*

Column-wise explanation is as follows :

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

Credit Note No. : In this column, the Credit note number is written.

Name of Customer : In this column, the Name of the customer is written.

Ledger Folio : In this column, it records the page number of the ledger book on which customer account is prepared.

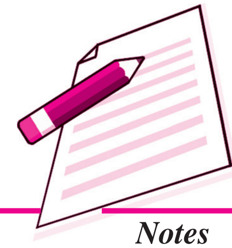
Detail : For each item the amount is recorded in the detail column, after totalling the amount for the goods received from customer and deducting the amount of discount allowed at the time of sale.

Amount : In this column, it records the amount of the total goods returned from customer.

Illustration 5

The Details submitted by M/s Furniture Mart for the month of March 2014 are as under :

Date	Details
2014	Returns from M/s Kohli Furniture : 2 Tables @ ₹ 1,400 Each
March 18	Vide Credit Note No. 019



Notes

Solution:

Books of M/s Furniture Mart
Sales Returns (Journal) Book

Date	*Debit Note No.*	*Name of supplier*	*L.F.*	*Detail*	*Amount (₹)*
2014					
March 18	019	**Kohli Furniture**			
		2 Tables @ ₹ 1,400		2 x 1400	2,800
					2,800

Posting of Sales Returns Journal/Book into Ledger

The total of the Sales Returns Journal/Book is debited to the Sales Returns account in the ledger. Each customer account from whom the goods are returned is credited with the net amount of the returns.

For the posting of Sales Journal/Book into the ledger refer to illustration No.5.

Solution :

Books of M/s Furniture Mart
M/s. Kohli Furniture

Dr. Cr.

Date	*Particulars*	*L.F.*	*Amount (₹)*	*Date*	*Particulars*	*L.F.*	*Amount (₹)*
				2014			
				Mar. 18	Sales Returns		2,800

Sales Return Account

Dr. Cr.

Date	*Particulars*	*L.F.*	*Amount (₹)*	*Date*	*Particulars*	*L.F.*	*Amount (₹)*
2014							
Mar. 31	Sundries as per Sales Returns Book		2,800				

Illustration 6

Enter the following transactions in Special Purpose Book of M/s Goel Electronic for the month of August 2015

Date	Details
2015	
August 4	Sold on Credit to M/s.Tanaya Electronics as per Invoice No. 1248 12 Set [6"] B.W. T.V. @ ₹ 900 per set. 5 set DVD Players @ ₹ 2,500 per set Less trade Discount 5%

Notes

August 10 Sold on Credit to M/s Kanshik Electronics as per Invoice No. 1278
5 Washing Machines @ ₹ 4,500 Per Machine
2 Color T.V. 29" @ ₹ 16,500 Per T.V.
Less 10% Trade Discount

August 12 M/s.Tanaya Electronics returned goods as per credit Note No.73
1 Set DVD Player @ ₹ 2,500 per set
1 Set [6"] BW T.V. @ ₹ 900 per set.
Trade Discount allowed @ 5%

August 18 Sold on Credit to M/s Diamond Electronic as per Invoice No. 1290
5 Tape Recorders @ ₹ 1,000 each
10 Two-in One @ ₹ 1,800 each
Less Trade Discount 5%

August 25 Sold on Credit to M/s Electronic Zone as per Invoice No. 1299
5 Water cooling Machines @ ₹ 7,000 each

August 28 Sold on Credit to M/s North East Electronics as per Invoice No. 1308
10 Music Systems @ ₹ 3,000 each
Less Trade Discount 10%

August 31 M/s. Electronic Zone returned goods as per credit Note No.93
1 Water cooling Machine @ ₹ 7,000 each

Solution

Books of M/s Goel Electronic
Sales (Journal) Book

Date	*Invoice No.*	*Name of customer*	*L.F.*	*Detial*	*Amount (₹)*
2015					
August 4	1248	**Tanaya Electronics**			
		12 T.V. @ 900		12 x 900 = 10,800	
		5 DVD @ 2,500		5 x 2,500 = 12,500	
				23,300	
				(-)5% T. Disc. = 1,165	22,135
August 10	1278	**Kanshik Electronics**			
		5 W. Machine @ 4,500		5 x 4,500 = 22,500	
		2 Clr. T.V. @ 16,500		2 x 16,500 = 33,000	
				55,500	
				(-)10% T.Disc = 5,550	49,950

August 18	1290	**Diamond Electronics**			
		5 Tape Rec. @ 1,000		5 x 1,000 = 5,000	
		10 Two in One @ 1,800		10 x 1,800 = 18,000	
				23,000	
				(-)5% T. Disct.= 1,150	21,850
August 25	1299	**Electronic Zone**			
		5 Water Cooling			
		Machine @ 7,000		5 x 7,000	35,000
August 28	1308	**North East Electronics**			
		10 Music System @ 3,000		10 x 3,000 = 30,000	
				(-) T. Disc. 10% = 3,000	27,000
				Total	1,55,935

Books of M/s Goel Electronic
Sales Returns (Journal) Book

Date	*Debit Note No.*	*Name of supplier*	*L.F.*	*Detail*	*Amount (₹)*
2015					
August 12	73	**Tanaya Electronics**			
		1 DVD Player @ 2,500		1 x 2500 = 2,500	
		1 T.V. @ 900		1 x 9 = 900	
				3,400	
				(-)5% T. Disc. = 170	3,230
August 31	93	**Electronic Zone**			
		1 Water Cooling			
		Machines @ 7,000		1 x 7,000	7,000
				Total	10,230

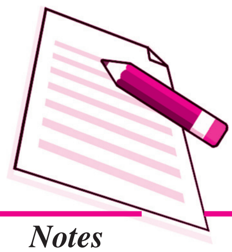
8.3 BILLS RECEIVABLE BOOK AND BILLS PAYABLE BOOK

Any enterprise which will accept/draw a number of bills will record these transactions in special subsidiary books. Bills receivable are recorded in the Bills Receivable Book. Bills payable are recorded in the Bills payable book.

Bills Receivable Book

Like Purchases Book, where all credit purchases of goods are firstly recorded, the Bills Receivable Book is maintained for recording the receipts of all bills of exchange. Bills Receivable Book is maintained, where the number of bill transactions

Notes



Notes

is sufficiently large. Each bill received is posted only in the credit side of the party's account from the bills receivable book. At the end of the period, the amount of bills received as per the bills receivable book, is debited in the bills receivable account in the ledger.

Usual Format of Bill Receivable Books is given below :

Bills Receivable Book

S. No.	Date of Receipt	From whom received	Name of Acceptor	Date of Bill Drawn	Term	Date of Maturity	Where Payable	Amount (₹)	How Disposed

Ledger Posting of Bills Receivable Book

1. At the end of a month, total amount of Bills Receivable book is debited to the Bills Receivable Account by writing, 'To sundries as per the Bills receivable book'.
2. The debtors or customers account is credited by writing 'By Bills Receivable Account'.

Illustration 7

A received the following Bills of Exchange. Record them in Bills Receivable Book and post them into the Ledger:

2014

Jan. 1 Drawn on Raman a Bill of Exchange at 3 months which was accepted and returned by him on January 1, 2014. The amount of the bill is ₹ 10,000.

Jan. 10 Drawn on Savita a Bill of Exchange for ₹ 5,000 at 2 months, which was accepted on the same day. The bill is payable at Punjab National Bank.

Jan. 12 Raman's acceptance endorsed in favour of Hari Kumar in full settlement of a debt of ₹ 10,250.

Solution :

Bills Receivable Book

S. No.	From whom received	Name of Acceptor	Date of Bill	Term	Date of Maturity	Amount (₹)	How Disposed
			2014				
	Raman	Raman	Jan. 1	3 months	April 4	10,000	Endorsed to
	Savita	Savita	Jan. 10	2 months	March 14	5,000	Hari Kumar
						15,000	

Dr. **Bills Receivable Accounts** Cr.

Date	*Particulars*	*J.F.*	₹	*Date*	*Particulars*	*J.F.*	₹
2014 Jan. 31	To Sundries as per B/R Book		15,000				

Dr. **Raman** Cr.

Date	*Particulars*	*J.F.*	₹	*Date*	*Particulars*	*J.F.*	₹
				2014 Jan. 1	By Bills Receiv- able A/c		10,000

Dr. **Savita** Cr.

Date	*Particulars*	*J.F.*	₹	*Date*	*Particulars*	*J.F.*	₹
				2014 Jan. 10	By Bills Receiv- able A/c		5,000

Bills Payable Book

It is a special journal for recording the acceptance of the bills drawn by the creditors. Each Bill payable is entered in this book and from here it is posted to the debit side of creditor's account. The total amount of bills payable for the period is credited in the Bills Payable Account.

Usual Format of Bills Payable Book is given below :

Bills Payable Book

S. No.	*Date of issue*	*To whom given*	*Payee*	*Term*	*Date of Maturity*	*Where payable*	*Amount ₹*	*Remarks*

Ledger Posting of Bills Payable Book.

1. The amount column of the Bills Payable Book is totalled and credited to the Bills payable account by writing 'By sundries as per Bills Payable Book.'
2. The creditor's or seller's account is debited writing 'To Bills Payable Account'.

Illustration 8

A accepted the following bills. Enter them in Bills Payable Book and post them into the Ledger :

2013

April 10 Accepted Vivek's bill for ₹ 20,000 due at 2 months.

April 24 Accepted the bill drawn by Chunnu for ₹10,000 at 1 month payable at Punjab National Bank.

Solution

Bills Payable Book

S. No.	Date of issue	To whom given	Payee	Term	Date of Maturity	Where payable	Amount ₹	Remarks
	2013							
1.	April 10	Vivek	Vivek	2 months	June 13	....	20,000	
2.	April 24	Chunnu	Chunnu	1 month	May 27	P.N. Bank	10,000	
							30,000	

Posting of Bills Payable Book :

Dr. **Bills Payable Account** Cr.

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
				2013			
				Apr.30	By Sundries as per Bills Payable Book		30,000

Dr. **Vivek Account** Cr.

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
2013							
Apr.10	To Bills Payable A/c		20,000				

Journal Proper

A Book maintained to record transactions, which do not find place in Special Journals is known as Journal Proper. Following transactions are recorded in the Journal proper:

1. *Opening Entry* : In order to open new set of books at the beginning of new accounting year and record therein opening balances of Assets, Liabilities and Capital, one opening entry is made in the Journal.

2. *Adjustment Entries* : In order to update ledger accounts on accrual basis, entries are made at the end of the accounting period. Entry for Rent outstanding, Prepaid insurance, Depreciation and Commission received in advance is made in the journal.

3. *Rectification entries* : To rectify any accounting error, entries are made in the journal proper.

4. *Transfer entries* : Drawing account is transferred to capital account at the end of the accounting year. Expenses accounts and revenue accounts which are not balanced at the time of balancing are opened to record specific transactions. Accounts relating to operation of business such as Sales, Purchases, Opening Stock, Income, Gains and Expenses etc and drawing are closed at the end of the year and their Total/balances are transferred to Trading, Profit and Loss account by making the journal entries. These are also called **closing entries**.

5. *Other entries* : In addition to the above mentioned entries recording of the following transaction is done in the journal proper :

   - At the time of a dishonour of a cheque the entry for cancellation of discount received or discount allowed earlier.
   - Purchase/sale of items other than goods dealt- in on credit.
   - Goods withdrawn by the owner for personal use.
   - Goods distributed as samples for sales promotion.
   - Endorsement and dishonour of bills of Exchange.
   - Transactions in respect of consignment and Joint Venture, etc.
   - Loss of goods by fire/theft/spoilage.
   - For recording amounts which have become irrecoverable.

Illustration 9

Record the following transactions in the Journal Proper of M/s Nishant Electronics:

(i) Purchased furniture from M/s Furniture House for ₹ 6,000.

(ii) Purchased stationery for office use from M/s Stationery Mart ₹ 700.

(iii) Made full and final payment to M/s Furniture House by Cheque discount allowed by them ₹ 200.

(iv) Prepaid Insurance ₹1,000.

(v) Depreciation on Machinery ₹ 3,000.

(vi) Goods ₹ 5,000 withdrawn by the partner for personal use.

(vii) ₹ 600 not recovered from a debtor.

Solution

Books of M/s Nishant Electronics
Journal Proper

Date	*Particulars*	*L.F.*	*Debit amount (₹)*	*Credit amount (₹)*
(i)	Furniture A/c Dr. To M/s Furniture House (Purchase of Furniture on Credit)		6,000	6,000
(ii)	Stationery A/c Dr. To M/s Stationery Mart (Purchase of Stationery on Credit)		700	700
(iii)	M/s Furniture House Dr. To Discount Received A/c (Discount received)*		200	200
(iv)	Prepaid Insurance A/c Dr. To Insurance Premium A/c (Insurance premium prepaid)		1,000	1,000
(v)	Depreciation A/c Dr. To Machinery A/c (Depreciation charged on Machinery)		3,000	3,000
(vi)	Partner's Capital A/c/Drawings Dr. To Purchases A/c (Goods withdrawn for personal use)		5,000	5,000
(vii)	Bad Debts A/c Dr. To Debtors A/c (Amount not recovered from Debtors)		600	600

** Entry for payment to M/s Furniture House by Cheque is made in the Bank column Cash Book.*

INTEXT QUESTIONS 8.2

I. Which of the following transactions will be entered in the Sales Book, Sales Returns Book or Journal Proper? If the transaction can not to be entered in any of the three write None of these.

(i) Goods sold to Nitin on credit for one month.

(ii) Old furniture sold to Dinesh on credit.

(iii) Salary pre-paid.

(iv) Goods sold to M/s Ramesh Bros.

(v) M/s.Jindal Traders returned goods.

(vi) Depreciation charged on Building.

(vii) Goods destroyed by fire.

(viii) Discount received from M/s N Zone.

(ix) Cash received from M/s Ramesh Bros.

II. Multiple Choice questions :

i. Acceptance by debtors for credit sales of trading items made by the seller have to be recorded in _____________ books.

a) Bills Receivable book   b) Bills Payable book

c) Purchases Book   d) Journal

ii. Acceptance by debtors for credit purchases of trading items made by the purchaser have to be recorded in ___________ book.

a) Bills Receivable book   b) Purchases Book

c) Bills Payable book   d) Sales book

WHAT YOU HAVE LEARNT

- **Purchase Journal/Book :** Purchase (journal) book is also a book of original entry. This book records only Credit purchase of goods in which the firm deals.
- **Purchase Returns Journal/Book :** Purchase returns of goods is recorded in this book. Sometimes goods purchased by the supplier are returned for various reasons such as goods are not as per our order, or are defective.
- **Sales Journal :** Transactions relating to Sale of goods dealt-in on credit is recorded in the sales journal.
- **Sale Returns Journal/Book :** Goods returned by the customers are recorded in the Sales return journal/book. The sales returns book does not record the return of goods sold on cash basis.
- When credit sale takes place, a bill of exchange is prepared by the seller of goods and accepted by the purchaser.

- A Bill of Exchange received is recorded in Bills Receivable book. It is posted in the credit side of party's account from the Bills Receivable book.
- A Bill payables is recorded in Bills payable book. It is posted on the debit side of creditors account from Bills Payable book.
- **Journal Proper :** A Book maintained to record transactions, which do not find place in Special Journals, is known as Journal Proper.

TERMINAL EXERCISE

1. State the meaning of Purchases Book and draw the format of Purchases Book.
2. State the meaning of Purchase Returns Book. Draw the format of Purchase Returns Book.
3. State the meaning of Sales Book and draw its format.
4. State the meaning of Sales Returns Book. Draw the format of Sales Returns Book.
5. Explain the meaning of Journal proper.
6. State the purpose of preparing Bills Receivable and Bills Payble Books.
7. Enter the following transactions in the proper Book of M/s Tina Traders for the month of July 2014 :

2014

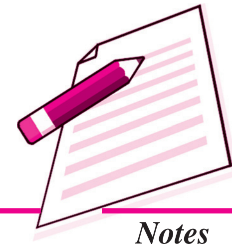
July 01 Bought from M/s.Soniya Traders as per Invoice No.10456
100 Note Books @ ₹ 30 each
50 Gel Pen @ ₹ 10 each
100 Pkt. Color Pencil @ ₹ 15 per pkt.
Trade Discount 10%

July 14 Bought from M/s Lazer Stationery as per Invoice No.2301
100 files @ ₹ 12 per file
10 Rim Paper @ ₹ 300 per rim.
Trade Discount 5%.

July 21 Returned Goods to M/s.Soniya Trader as per Debit Note No.0054
10 Pkt. Color Pencil @ ₹ 15 per pkt.
Trade discount 10%

July 26 Bought from M/s.Shimla paper Mart as per Invoice No.9870
50 pkt water color @ ₹ 50 per pkt.net.

July 31 Returned Goods to M/s. Lazer Stationery as per Debit Note No.0152
3 Rim Paper @ ₹ 300 per rim.
Trade Discount 5%.



Notes

8. Enter the following transactions in the proper Book of M/s Electronic Gallery for the month of March 2014 and post them into ledger.

    2014

    March 02 Sold to M/s Amisha Electronics as per Bill No.0457
    4 machine Air Conditioners @ ₹ 15,000 per machine
    Trade discount 3%

    March 09 Sold to M/s Naman Trader as per Bill No.0475
    5 Washing Machines @ ₹ 9,000 per machine set.

    March 15 Sold to M/s.Electronic Zone as per Invoice No.486
    10 Juicer Mixer Grinders @ ₹ 1,000 each
    Trade discount 5%.

    March 20 M/s Amisha Electronics returned the goods as per Credit Note No. 112
    1 machine Air Conditioner @ ₹ 15,000 per machine
    Trade discount 3%

    March 25 Sold to M/s Bansal Electronics as per Invoice No.486
    5 TV set Color @ ₹ 9,500 per set.
    Trade discount 4%

    March 31 M/s.Electronic Zone returned the goods as per Credit Note No. 116
    2 Juicer Mixer Grinder @ ₹ 1,000 each
    Trade discount 5%.

9. Pawan received the following Bills of Exchange. Record them in Bills Receivable Book.

    2014

    July 01 Drawn on Manish a Bill of Exchange at 2 months which was accepted and returned by him on July 1, 2014 for a sum of ₹ 15,000

    July 15 Drawn on Sukant Singh a Bill of Exchange for ₹ 12,000 at 2 months, which was accepted on the Same Day.

    July 20 Drawn on Azmat a Bills of Exchange for ₹ 60,000 at 3 months which was accepted and returned by her on July 20 it self.

10. Pawan Singh accepted the following bills. Enter them in Bills Payable Book.

    2015

    April 05 Accepted Shifali's bill for ₹ 17,000 due at 2 months.

    April 13 Accepted the bill drawn by Preena for ₹ 19,000 at 45 days Payable at SBI Aligunj, Lucknow.

    April 23 Accepted Rajeev's bill for ₹ 35,000 due at 3 months.

Notes

ANSWERS TO INTEXT QUESTIONS

8.1 (i) Purchases Book (ii) Purchase Returns Book
(iii) None of these (iv) Purchases Book (v) Purchases Book

8.2 I. (i) Sales Book (ii) Journal Proper (iii) Journal Proper
(iv) Sales Book (v) Sales Returns Book
(vi) Journal proper (vii) Journal proper
(viii) Journal proper (ix) None of these.

II. (i) a (ii) c

ANSWERS TO TERMINAL EXERCISE

7. Total of Purchases Book ₹ 10,990, Total of Purchase Returns Book ₹ 990

8. Total of Sales Book ₹ 1,58,300, Total of Sale Returns Book ₹16,450

ACTIVITY

Visit a number of shops/establishments of your areas and enquire whether they are maintaining only journal proper or other special purpose books. Ascertain whether the books maintained by them will serve the purpose or not. If not give suggestions.

	Name of the establishment visited	Number of transactions		Books mentioned	Sufficient/ not sufficient	If not sufficient book to be mentioned
		Quite large	Limited			
1.						
2.						
3.						
4.						
5.						

Module - II

TRIAL BALANCE AND COMPUTERS

Marks 10 **Hours 25**

Our important element of accounting process is summarising for which ledger accounts are prepared which are finally balanced and are shown in the form of a statement called trial balance. Businessman want to know the correct bank balance on a particular date for which bank reconciliation statement is prefared. Business is mostly on credit which means involvement of more capital, solution lies in the use of credit instruments like Bills of Exchange. Knowledge of their accounting is thus very important.

Accounting is another name of accuracy but then to err is human and there can be accounting errors. Knowledge of their rectification, necessary so as to enable achieving the aim of presenting correct true, and fair view of business.

Growing use of computer has actually revolutionalised the accounting of business transactions and computers are fast replacing the mannual accounting. True knowledge of computerised accounting has become our cherished goal.

This module has been designed to prepare trial balance and detect accounting errors and their rectifications. The learner will also know the meaning and purpose of preparing Bank Reconcilation statement and its preparation. It contains accounting of bills of exchange. This will also expose the learner to the utility of computers in accounting.

9

TRIAL BALANCE

Whenever you attempt a question in arithmetic you try to verify whether your answer is correct or not. If you attempt to solve any other type of problem you want to ensure that it has been correctly solved. For this you try to find out some ways or means. Similarly an accountant also wants to be sure that the ledger accounts he/she has prepared are correct in respect of amount, side, balance, etc. To check the accuracy of posting in the ledger a statement is prepared. This statement is called Trial Balance. You also know that accounts are prepared by applying double entry system. According to this system every debit of a transaction has corresponding credit for the same amount. Hence, the total of debit balances of different accounts in the ledger must be equal to the total of the credit balances in the remaining accounts, provided transactions have been correctly posted in the ledger. A statement is prepared containing these balances with two columns i.e. debit column containing debit balances and credit column containing credit balances and the debit column total is compared with credit column total. If the columnar totals are same it implies that ledger accounts are arithmetically accurate.

In this lesson, you will learn about meaning, objectives and preparation of Trial Balance.

OBJECTIVES

After studying this lesson you will be able to :

- state the meaning of Trial Balance;
- explain the objectives of preparing Trial Balance
- prepare a Trial Balance as per the format;
- identify the need for a Suspense A/c in case the Trial Balance does not tally and
- infer the possibility of errors even if the Trial Balance tallies.

9.1 MEANING AND OBJECTIVES OF PREPARING TRIAL BALANCE

If you recall the steps in the accounting procedure you find that at first the transactions are entered in the Journal and Special Purpose Books like Cash Book, Purchases Book, Sales Book, etc. From these books items are posted in the ledger in their respective accounts. Finally, at the end of the accounting year these accounts are balanced. To check the accuracy of posting in the ledger a statement is prepared with two columns i.e. debit column and credit column which contains debit balances of accounts and credit balances of accounts respectively. Total of the two columns are if equal, it means the ledger posting is arithmetically correct. This statement is called Trial Balance.

> Trial Balance may be defined as a statement which contains balances of all ledger accounts on a particular date.

Trial Balance consists of a debit column with all debit balances of accounts and credit column with all credit balances of accounts. The totals of these columns if tally it is presumed that ledger has been maintained correctly. However, Trial Balance proves only the arithmetical accuracy of posting in the ledger.

Objectives of Preparing a Trial Balance

Following are the objectives of preparing Trial Balance

(i) **To Check Arithmetical Accuracy :** Arithmetical accuracy in ledger posting means writing correct amount, in the correct account and on its correct side while posting transactions from various original books of accounts, such as Cash Book, Purchases Book, Sales Book, etc. It also means not only the correct balance of ledger account but also the totals of the special purpose Books.

(ii) **To Help in Preparing Financial Statements :** The ultimate objective of the accounting is to prepare financial statements i.e. Trading and Profit and Loss Account, and Balance sheet of a business enterprise at the end of an accounting year. These statements contain balances of various ledger accounts. As Trial Balance contains balances of all ledger accounts, in financial statements the balances of ledger accounts are carried from the Trial balance for proper analysis.

(iii) **Helps in Locating Errors :** If total of two columns of the trial balance agrees it is a proof of arithmetical accuracy in the ledger posting. However, if the totals of the two columns do not tally it indicates that there are some mistake in the ledger accounts. This prompts the accountant to find out the errors.

(iv) **Helps in Comparison :** Comparison of ledger account balances of one year with the corresponding balances with the previous year helps the management taking some important decisions. This is possible by using the Trial Balances of the two years.

(v) **Helps in Making Adjustments :** While making financial statements adjustments regarding closing stock, prepaid expenses, outstanding expenses etc are to be made. Trial balance helps in identifying the items requiring adjustments in preparing the financial statements.

Trial Balance is generally prepared at the end of the year. However it can be prepared at any time during the accounting year to check the accuracy of the posting.

Notes

INTEXT QUESTIONS 9.1

Fill in the blanks with suitable word or words :

(i) Trial balance has .... column and .... column of balances of accounts.

(ii) If totals of two columns of Trial Balance are equal it means the .... is correct.

(iii) Trial Balance proves only the .... accuracy of ledger posting.

(iv) One of the objectives of preparing Trial Balance is helping to locate ....

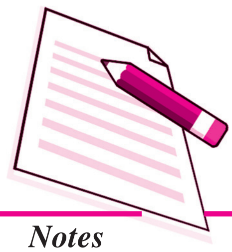
(v) While preparing .... the ledger account balances are carried from the Trial Balance.

9.2 PREPARATION OF TRIAL BALANCE

Trial Balance is not an account. It is only a list or schedule of balances of ledger accounts including cash and bank balances. It is prepared on a particular date. The accounts having a debit balance are entered in the debit amount column and credit balance accounts are entered in the credit amount column. The totals of the two sides of the accounts may also be used to prepare trial balance. The sum of each column should be equal. The standard format of a trial blance is given below :

Trial Balance of ....
As at ....(closing date)

Name of the Account	*LF*	*Dr. Balance (₹)*	*Cr. Balance (₹)*



Notes

The name of the business firm is written on the top of the statement with Trial Balance. Under this we write the date on which Trial Balance is prepared.

Trial Balance has three columns : Name of the Ledger Account, Debit Amount and Credit Amount.

In the ledger account column we write the name of the account. In the Debit amount column we write the amount of debit balance of the account (or the total of the debit side of the account). Similarly in the credit amount column we write the amount of credit balance of the account (or the total of the credit side of the account.

Finally, columnar total is done and compared.

Steps to prepare Trial Balance

(i) At first ascertain the balance account wise of all the ledger accounts.

(ii) Write the name of the ledger account in the ledger account column.

(iii) Write against the name of the ledger account, the balance amount/total amount, debit balance/total in the debit column; and credit balance/total in the credit column.

(iv) Add the debit balance/total amount column and credit balance/total amount column.

There are three methods of preparing Trial Balance

(i) Balance Method : In Balance method, the balance of each account (which may be debit balance or credit balance) is extracted and written against each account; we write debit balance in the debit column and credit balance in the credit column.

(ii) Total Method : In this method the total of both sides of every account in the ledger is written against the name of the respective account without balancing them in the form of debit and credit balances respectively.

(iii) Balance Total Method : Trial Balance is prepared by combining the first and second methods.

However, in practice the trial balance is prepared with debit and credit balances of various accounts in the ledger. Normally balance method is used.

Illustration 1

From the following ledger accounts of a trader closed as on 31st January, 2014, prepare Trial Balance.

Capital A/c

Dr. Cr

Date	*Particulars*	*J.F.*	*Amount* ₹	*Date*	*Particulars*	*J.F.*	*Amount* ₹
2014				2014			
Jan .31	Balance c/d		1,00,000	Jan.31	Bank A/c		1,00,000
			1,00,000				1,00,000
				Feb. 1	Balance b/d		1,00,000

Sales A/c

Dr. Cr

Date	*Particulars*	*J.F.*	*Amount* ₹	*Date*	*Particulars*	*J.F.*	*Amount* ₹
2014				2014			
Jan .31	Balance transferred to Trading A/c		70,000	Jan. 8	Bank A/c		24,000
				Jan. 15	Vikram's A/c		46,000
			70,000				70,000

Purchases A/c

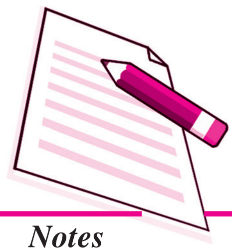
Dr. Cr

Date	*Particulars*	*J.F.*	*Amount* ₹	*Date*	*Particulars*	*J.F.*	*Amount* ₹
2014				2014			
Jan. 5	Pranaya's A/c		40,000	Jan. 31	Stock A/c		15,000
Jan. 14	Bank A/c		55,000	Jan. 31	Balance transferred to Trading A/c		80,000
			95,000				95,000

Vikram's A/c

Dr. Cr

Date	*Particulars*	*JF*	*Amount* ₹	*Date*	*Particulars*	*JF*	*Amount* ₹
2014				2014			
Jan. 15	Sales A/c		46,000	Jan. 31	Balance cld		46,000
			46,000				46,000
Feb. 1	Balance b/d		46,000				



Notes

Pranaya's A/c

Dr. Cr

Date	Particulars	J.F.	Amount ₹	Date	Particulars	J.F.	Amount ₹
2014				2014			
Jan. 31	Balance cld		40,000	Jan. 5	Purchases A/c		40,000
			40,000				40,000
				Feb. 1	Balance b/d		40,000

Rent Received A/c

Dr. Cr

Date	Particulars	J.F.	Amount ₹	Date	Particulars	J.F.	Amount ₹
2014				2014			
Jan. 31	Balance transferred to Profit and Loss A/c		1,500	Jan. 31	Bank A/c		1,500
			1,500				1,500

Bank A/c

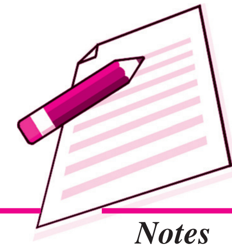
Dr. Cr

Date	Particulars	J.F.	Amount ₹	Date	Particulars	J.F.	Amount ₹
	Capital A/c		1,00,000		Purchases A/c		55,000
	Sales A/c		24,000		Commission A/c		1,800
	Rent received		1,500		Drawings A/c		2,000
					Balance c/d		66,700
			1,25,500				1,25,500

Commission A/c

Dr. Cr

Date	Particulars	J.F.	Amount ₹	Date	Particulars	J.F.	Amount ₹
2014				2014			
Jan. 20	Bank A/c		1,800	Jan. 31	Balance transferred to Profit and Loss A/c		1,800
			1,800				1,800



Notes

Stock A/c

Dr. Cr

Date	Particulars	J.F.	Amount ₹	Date	Particulars	J.F.	Amount ₹
2014				2014			
Jan. 31	Purchases A/c		15,000	Jan. 31	Balance c/d		15,000
			15,000				15,000
Feb. 1	Balance b/d		15,000				

Drawings A/c

Dr. Cr

Date	Particulars	JF	Amount ₹	Date	Particulars	JF	Amount ₹
2014				2014			
Jan. 31	Bank A/c		2,000	Jan. 31	Balance c/d		2,000
			2,000				2,000
Feb. 1	Balance b/d		2,000				

Solution :

Trial Balance *as on 31 Jan. 2014*

Name of the Ledger Account	*Dr. Balance (₹)*	*Cr. Balance (₹)*
Capital		1,00,000
Sales		70,000
Purchases	80,000	
Vikram	46,000	
Pranaya		40,000
Commission	1,800	
Rent received		1,500
Drawings	2,000	
Closing Stock	15,000	
Cash at Bank	66,700	
	2,11,500	2,11,500

Illustration 2

From the following ledger accounts of Rohan Bros prepare Trial Balance by (i) total method (ii) combined method (both balance method and total method) :

Cash A/c

Dr. Cr

Date	*Particulars*	*J.F.*	*Amount* ₹	*Date*	*Particulars*	*J.F.*	*Amount* ₹
2014				2014			
Jan. 1	Capital A/c		50,000	Jan. 2	Bank A/c		40,000
Jan. 28	Ranjeet		9,900	Jan. 12	Freight A/c		200
				Jan. 31	Salary A/c		3,000
				Jan.31	Rent A/c		2,400
			59,900				45,600

Bank A/c

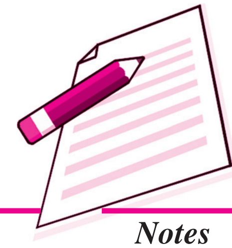
Dr. Cr

Date	*Particulars*	*J.F.*	*Amount* ₹	*Date*	*Particulars*	*J.F.*	*Amount* ₹
2014				2014			
Jan.2	Cash A/c		40,000	Jan. 8	Furniture A/c		12,000
Jan.14	Sales A/c		16,000	Jan. 10	Purchases A/c		20,000
				Jan.20	Vikas		12,000
				Jan.31	Drawings		4,000
			56,000				48,000

Furniture A/c

Dr. Cr

Date	*Particulars*	*J.F.*	*Amount* ₹	*Date*	*Particulars*	*J.F.*	*Amount* ₹
2014				2014			
Jan. 8	Bank A/c		12,000				
			12,000				



Notes

Capital A/c

Dr. Cr

Date	*Particulars*	*J.F.*	*Amount* ₹	*Date*	*Particulars*	*J.F.*	*Amount* ₹
				2014			
				Jan. 1	Cash A/c		50,000
							50,000

Purchases A/c

Dr. Cr

Date	*Particulars*	*J.F.*	*Amount* ₹	*Date*	*Particulars*	*J.F.*	*Amount* ₹
2014							
Jan. 10	Bank A/c		20,000				
Jan.12	Vikas		15,000				
			35,000				

Sales A/c

Dr. Cr

Date	*Particulars*	*J.F.*	*Amount* ₹	*Date*	*Particulars*	*J.F.*	*Amount* ₹
				2014			
				Jan. 14	Bank A/c		16,000
				Jan.20	Ranjeet		14,000
							30,000

Vikas A/c

Dr. Cr

Date	*Particulars*	*J.F.*	*Amount* ₹	*Date*	*Particulars*	*J.F.*	*Amount* ₹
2014				2014			
Jan. 20	Bank A/c		12,000	Jan. 12	Purchases A/c		15,000
			12,000				15,000

Ranjeet A/c

Dr. Cr

Date	*Particulars*	*J.F.*	*Amount* ₹	*Date*	*Particulars*	*J.F.*	*Amount* ₹
2014				2014			
Jan. 20	Sales A/c		14,000	Jan. 25	Cash A/c		9,900
				Jan.28	Discount A/c		100
			14,000				10,000

Freight A/c

Dr. Cr

Date	*Particulars*	*J.F.*	*Amount* ₹	*Date*	*Particulars*	*J.F.*	*Amount* ₹
2014				2014			
Jan. 12	Cash A/c		200				
			200				

Salary A/c

Dr. Cr

Date	*Particulars*	*J.F.*	*Amount* ₹	*Date*	*Particulars*	*J.F.*	*Amount* ₹
2014							
Jan. 31	Cash A/c		3,000				
			3,000				

Rent A/c

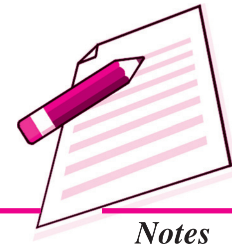
Dr. Cr

Date	*Particulars*	*J.F.*	*Amount* ₹	*Date*	*Particulars*	*J.F.*	*Amount* ₹
2014							
Jan. 31	Cash A/c		2,400				
			2,400				

Drawings A/c

Dr. Cr

Date	*Particulars*	*J.F.*	*Amount* ₹	*Date*	*Particulars*	*J.F.*	*Amount* ₹
2014				2014			
Jan. 31	Bank A/c		4,000				
			4,000				



Discount A/c

Dr. Cr

Date	Particulars	J.F.	Amount ₹	Date	Particulars	J.F.	Amount ₹
2014							
Jan. 28	Ranjeet		100				
			100				

Solution.

i. (Total Method) **Trial Balance of Rohan Brothers as on 31st January, 2014**

Name of the Ledger Account	*Dr. Balance (₹)*	*Cr. Balance (₹)*
Cash	59,900	45,600
Bank	56,000	48,000
Furniture	12,000	–
Capital	–	50,000
Purchases	35,000	–
Sales		30,000
Vikas	12,000	15,000
Ranjeet	14,000	10,000
Freight	200	–
Salary	3,000	
Rent	2,400	
Drawings	4,000	
Discount	100	
	1,98,600	1,98,600

ii. (Combine Method) Trial Balance of Rohan Brothers as on 31st January, 2014

Name of the Ledger Account	*Dr.*		*Cr.*	
	Total (₹)	*Amounts* (₹)	*Balance* (₹)	*Amounts* (₹)
Cash	59,900	45,600	14,300	–
Bank	56,000	48,000	8,000	–
Furniture	12,000	–	12,000	–
Capital	–	50,000	–	50,000
Purchases	35,000	–	35,000	–
Sales		30,000	–	30,000
Vikas	12,000	15,000	–	3,000
Ranjeet	14,000	10,000	4,000	–
Freight	200	–	200	–
Salary	3,000	–	3,000	–
Rent	2,400	–	2,400	–
Drawings	4,000	–	4,000	–
Discount	100	–	100	–
	1,98,600	1,98,600	83,000	83,000

INTEXT QUESTIONS 9.2

Fill in the blanks with suitable word/words :

(i) Trial Balance has .... columns.

(ii) There are .... methods of preparing Trial Balance.

(iii) In practice, method of preparing Trial Balance is .... used.

(iv) The last step of preparing trial balance is to ascertain the .... of its two amount columns.

9.3 TRIAL BALANCE AND ERRORS

You have learnt that if the sum of the two columns of Trial Balance is equal i.e. the Trial Balance is in agreement, it can be assumed that the accounting entries have been arithmetically correct and correctly posted in the ledger. If the totals do not tally it means there are some errors in recording and/or in posting in the ledger of the business transactions.

The reasons due to which the totals of the two columns of Trial balance may not agree can be listed as follows :

(i) The totals of the Special Purpose Books like Sales Book, Purchases Book, etc are not done correctly or there is some mistake in the posting of these totals in their respective accounts in the ledger.

(ii) The items from different Special Purpose Books and Journal may be posted to the wrong side of the account or a wrong amount is posted or posted to the wrong account.

(iii) The balancing of an account is not done correctly.

(iv) There may be mistake in carrying balance from the ledger account to the Trial Balance.

You may conclude that if the trial balance is in agreement, the business transactions have been correctly recorded or posted into ledger. However, the agreement of Trial Balance is not a conclusive proof of the correctness of recording and posting of business transactions. There can be errors and the sum of each column of the Trial Balance may still be equal. As you have learnt that business transactions are so recorded that all debits have the credits for the same amount and vice-a-versa. So the Trial Balance must necessarily agree. But if the debits are matched by credits though there are mistakes in recording and posting the Trial balance will still agree. For example, if goods have been purchased from Surender, and if not entered in the Purchases Book, this error will not affect the agreement of the Trial Balance.

Trial Balance and Suspense A/c

Now suppose the Trial Balance does not agree i.e. there is a difference of some amount in the totals of the two columns of the Trial Balance. What will you do with this difference? A different account i.e Suspense Account is opened with the difference in amount put in this account. This will result in agreement of Trial Balance. The suspense account with the amount of difference will be put on the shorter side of the Trial Balance. For example total of the debit column exceeds the total of the credit column by Rs.500. This amount of Rs 500 will be written on the credit column against Suspense Account to make the Trial Balance agree.

The suspense A/c is however a temporary arrangement to make the Trial Balance agree. This account will show balance till the error or errors are rectified, this account will disappear as soon as all the errors are rectified.

Illustration 3

From the following Cash Book and Accounts prepare the Trial Balance as on 31st Jaunary 2014.

Cash Book

Dr. Cr

Date	*Particulars*	*L.F.*	*Amount* ₹	*Date*	*Particulars*	*L.F.*	*Amount* ₹
2014				2014			
Jan. 1	Capital A/c		75,000	Jan. 10	Furniture A/c		15,000
Jan. 10	Sales A/c		25,000	Jan. 15	Purchases A/c		25,000
				Jan. 31	Rent A/c		2,000
				Jan. 31	Telephone expenses A/c		1,000
					Balance cld		57,000
			1,00,000				1,00,000

Ledger

Capital A/c

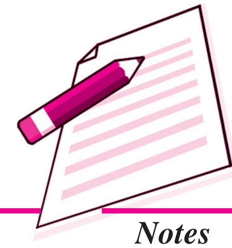
Dr. Cr

Date	*Particulars*	*L.F.*	*Amount* ₹	*Date*	*Particulars*	*L.F.*	*Amount* ₹
2014				2014			
Jan. 31	Balance cld		75,000	Jan. 1	Amount as per Cash Book		75,000
			75,000				75,000
				Feb. 1	Balance b/d		75,000

Sales A/c

Dr. Cr

Date	*Particulars*	*L.F.*	*Amount* ₹	*Date*	*Particulars*	*L.F.*	*Amount* ₹
2014				2014			
Jan. 31	Trading A/c		25,000	Jan. 10	Amount as per Cash Book		25,000
			25,000				25,000



Notes

Purchases A/c

Dr. Cr

Date	Particulars	L.F.	Amount ₹	Date	Particulars	L.F.	Amount ₹
2014				2014			
Jan. 15	Amount as per Cash Book		25,000	Jan. 31	Trading A/c		25,000
			25,000				25,000

Furniture A/c

Dr. Cr

Date	Particulars	L.F.	Amount ₹	Date	Particulars	L.F.	Amount ₹
2014				2014			
Jan. 10	Amount as per Cash Book		15,000	Jan. 31	Balance cld		15,000
			15,000				15,000

Rent A/c

Dr. Cr

Date	Particulars	L.F.	Amount ₹	Date	Particulars	L.F.	Amount ₹
2014				2014			
Jan. 31	Amount as per Cash Book		200	Jan. 31	Profit and Loss A/c		200
			200				200

Telephone charges A/c

Dr. Cr

Date	Particulars	L.F.	Amount ₹	Date	Particulars	L.F.	Amount ₹
2014				2014			
Jan. 31	Amount as per Cash Book		1,000	Jan. 31	Profit and Loss A/c		1,000
			1,000				1,000

Solution

Trial Balance
As on 31st Jan. 2014

Name of the Account	*Dr. Balances (₹)*	*Cr. Balances (₹)*
Capital		75,000
Sales		25,000
Purchases	25,000	
Furniture	15,000	
Commission		
Rent	200	
Telephone charges	1,000	
Cash in hand	57,000	
Suspense	1,800	
	1,00,000	1,00,000

In the above example we see that the totals of the two columns of the Trial Balance do not tally. Credit side is more than that of debit side by ₹1800. It is to make the two columns of the trial balance equal, suspense A/c is written in the column against it is written the amount of ₹1800 in the debit column. As soon as error/errors are detected and rectified, this suspense A/c will show no balance.

Illustration 4

From the following balances extracted from the books of a trader, prepare Trial Balance as on 31st March, 2014.

	₹
Cash in hand	4,200
Cash at Bank	16,800
Bills Receivable	18,000
Bills payable	16,000
Sundry debtors	24,600
Sundry creditors	32,400
Capital	50,000

Drawings	18,000
Sales	1,05,000
Purchases	75,000
Carriage Inward	2,700
Salaries	12,000
Advertisement	2,400
Insurance	1,600
Furniture	7,500
Stock	18,600
Office Rent	2,000

Solution :

Trial Balance

Name of the Account	***Dr. Balances (₹)***	***Cr. Balances (₹)***
Cash	4,200	
Bank	16,800	
Bills Receivable	18,000	
Bills payable		16,000
Sundry Debtors	24,600	
Sundry creditors		32,400
Capital		50,000
Drawings	18,000	
Sales		1,05,000
Purchases	75,000	
Carriage Inward	2,700	
Salaries	12,000	
Advertisement	2,400	
Insurance	1,600	
Furniture	7,500	
Rent	2,000	
Stock	18,600	
Total	2,03,400	2,03,400

INTEXT QUESTIONS 9.3

Answer the following in one or two words :

(i) If the totals of two amount columns of trial balance do not agree, in which account the difference amount is written?

(ii) If the total of the debit column of a trial balance is more than the total of its credit column in which of the two amount of columns of the trial balance will you write the difference in amount?

(iii) If the total of the Purchases Book is posted to Purchases Account wrongly,. will the trial balance still agree?

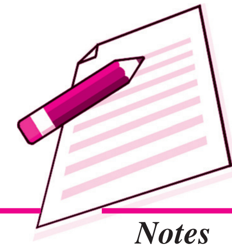
(iv) When the accounting error or errors are rectified what happens to the suspense A/c?

WHAT YOU HAVE LEARNT

- Trial balance is a statement containing balances of all ledger accounts of a business concern on a particular date.
- Trial Balance is prepared to check the arithmetical accuracy of the ledger posting, it helps in preparing financial statements; it helps in locating accounting errors; helps in management as it enables comparison of account balances of different periods and helps in making adjustments while preparing financial statements.
- The totals of two columns of a trial balance should be equal because for each transaction there is debit and credit for the same amount.
- If the totals of two columns of trial Balance tally it means the ledger posting has been correctly done.
- If the totals of two columns of Trial Balance do not agree, it means there is some mistake in the ledger posting.
- If the totals of two columns of Trial Balance do not agree the amount of difference is put to suspense A/c and the totals of Trial Balance are equated.

TERMINAL EXERCISE

1. State the meaning of Trial Balance.
2. Explain in brief the objective of preparing Trial Balance.



3. Why do the totals of two sides of Trial Balance are equal ? Explain.

4. 'Agreement of Trial Balance is not the conclusive proof of the accuracy of accounts'. Comment.

5. What is Suspense A/c ? What is its role in preparing Trial Balance ?

6. Explain the steps that are taken to prepare a Trial Balance.

7. List the various reasons because of which the totals of two columns of Trial Balance do not tally.

8. Prepare Trial Balance of M/s Multiplying enterprise as on 31st December, 2014.

Accounts	***Balances (₹)***	***Accounts***	***Balances (₹)***
Cash in hand	2,500	Debtors	18,200
Cash at Bank	14,500	Creditors	16,600
Capital	70,000	Opening stock	8,700
Drawing	9,000	Wages	6,700
Purchases	60,000	Rent	5,000
Sales	82,000	Salary	8,400
Machine	35,000	Bills Payable	11,400
Furniture	12,000		

9. Prepare Trial Balance as on 31st March, 2014 from the following balances of Sabana :

Accounts	***Dr. Balances (₹)***	***Cr. Balances (₹)***
Cash in hand	3,100	
Bank overdraft		18,250
Opening stock	24,600	
Purchases	59,800	
Sales		72,350
Sabana's Capital		50,000
Drawings	12,000	
Carriage Inward	1,600	
Rent	2,400	
Commission		2,100

Interest	780	
Furniture	5,220	
Creditors		13,600
Debtors	27,800	
Building	20,000	1,000
Suspense	1,57,300	1,57,300

ANSWERS TO INTEXT QUESTIONS

9.1 (i) debit, credit (ii) ledger posting (iii) arithmetical
(iv) accounting errors (v) financial statements

9.2 (i) Three (ii) Three (iii) balance (iv) sum

9.3 (i) Suspense A/c (ii) Credit side (iii) No (iv) Suspense A/c disappears

ANSWERS TO TERMINAL QUESTIONS

8. Total of two columns are ₹ 180000 each

9. Total of Dr column ₹ 157300
   Total of Cr column ₹ 156300
   Suspense A/c Cr ₹ 1000

ACTIVITY

Talk to your friends who are working as accounts clerk in various firms, and seek answers of the following questions :

1. Do they prepare trial balance?
2. How many times they prepare it in a year and at what intervals?
3. Which method they use total method or balance method?
4. What do they do if Trial Balance does not agree?
5. How many of them prepare the financial statements without preparing Trial balance?

On the basis of the answers prepare a report.

10

BANK RECONCILIATION STATEMENT

You operate a bank account in which you deposit money and withdraw money from time to time. You maintain a record with yourself of these deposits and withdrawals. One day when you got your pass-book (statement issued by the bank) updated you were surprised to find that the balance shown by the pass book was different from what it should have been as per your records. What will you do in this case? It is obvious that you will compare the two sets of records and find out items which are recorded in one but not in the other. Similar situation may arise in case of a business concern which operates a bank account. These business concerns maintain record of all of their banking transactions in their bank column of the cash book. On any particular date the bank balance shown by the bank column of cash book and that shown by the pass book should be the same. But if there is difference between the two, the business concern will find out the reasons to reconcile the balance. In this lesson you will learn about reasons for difference and prepare the reconciliation statement called Bank Reconciliation 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
- prepare the Bank Reconciliation Statement.

10.1 BANK RECONCILIATION STATEMENT - MEANING AND NEED

Business concern maintains the cash book for recording cash and bank transactions. The Cash book serves the purpose of both the cash account and the bank account. It

Notes

shows the balance of both at the end of a period. Bank also maintains an account for each customer in its book. All deposits by the customer are recorded on the credit side of his/her account and all withdrawals are recorded on the debit side of his/her account. A copy of this account is regularly sent to the customer by the bank. This is called 'Pass Book' or Bank statement. It is usual to tally the firm's bank transactions as recorded by the bank with the cash book. But sometimes the bank balances as shown by the cash book and that shown by the pass book/bank statement do not match. If the balance shown by the pass book is different from the balance shown by bank column of cash book, the business firm will identify the causes for such difference. It becomes necessary to reconcile them. To reconcile the balances of Cash Book and Pass Book a statement is prepared. This statement is called the 'Bank Reconciliation Statement. It can be said that :

> Bank Reconciliation Statement is a statement prepared to reconcile the difference between the balances as per the bank column of the cash book and pass book on any given date.

Need of preparing Bank Reconciliation Statement

It is neither compulsory to prepare Bank Reconciliation Statement nor a date is fixed on which it is to be prepared. It is prepared from time to time to check that all transactions relating to bank are properly recorded by the businessman in the bank column of the cash book and by the bank in its ledger account. Thus, it is prepared to reconcile the bank balances shown by the cash book and by the bank statement. It helps in detecting, if there is any error in recording the transactions and ascertaining the correct bank balance on a particular date.

INTEXT QUESTIONS 10.1

Fill in the blanks with suitable word/words :

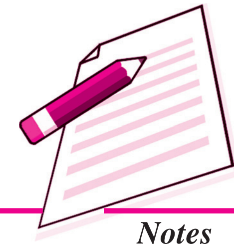
i. The copy of customer's account with the Bank is called ....

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.

iv. Cheques issued are posted on the .... side of the bank column of Cash Book.

v. The credit column of pass book should be equal to .... column of cash book and debit column of pass book should equal to .... column of cash book, if there are no differences.



Notes

10.2 REASONS FOR DIFFERENCE

When a businessman compares the Bank balance of its cash book with the balance shown by the bank pass book, there is often a difference. As the time period of posting the transactions in the bank column of cash book does not correspond with the time period of posting in the bank pass book of the firm, the difference arises. The reasons for difference in balance of the cash book and pass book are as under :

i. **Cheques Issued By The Firm But Not Yet Presented For Payment :** When cheques are issued by the firm, these are immediately entered on the credit side of the bank column of the cash book. Sometimes, receiving person may present these cheques to the bank for payment on some later date. 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 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 :** 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. But, the bank credits the firm's account after these cheques are actually realised. A few days are taken in clearing of local cheques and in case of outstation cheques few more days are taken. This may cause the difference between cash book and pass book balance.

iii. **Amount Directly Deposited in The Bank Account :** Sometimes, the debtors or the customers deposit the money directly into firm's bank account, but the firm gets the information only when it receives the bank statement. In this case, the bank credits the firm's account with the amount received but the same amount is not recorded in the cash book. As a result the balance in the cash book will be less than the balance shown in the Pass book.

iv. **Bank Charges :** The bank charge in the form of fees or commission is charged from time to time for various services provided from the customers' account without the intimation to the firm. The firm records these charges after receiving the bank intimation or statement. Example of such deductions is : Interest on overdraft balance, credit cards' fees, outstation cheques, collection charges, etc. 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 :** Sometimes, the interest on debentures or dividends on shares held by the account holder is directly deposited by the company through Electronic Clearing System (ECS). But the firm does not get the information till it receives the bank statement. As a consequence, the firm enters it in its cash book on a date later than the date 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 Customers :** Sometimes, bank makes certain payments on behalf of the customer as per standing instructions. Telephone bills, rent, insurance premium, taxes, etc are some of the expenses. These expenses are directly paid by the bank and debited to the firm's account immediately after their payment. 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/Bill discounted :** If a cheque deposited by the firm or bill receivable discounted with the bank is dishonoured , the same is debited to firm's account by the bank. 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 :** There may be certain errors from firm's side, 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 :** Sometimes, bank may also commit errors, 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 10.2

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

i. Bank credits firm's account as soon as it receives cheques from the firm.

ii. Bank charges are never entered in the Cash Book.

iii. Banks make certain payments on behalf of the customer under his standing instructions.

iv. In case of cheques issued but not encashed, the balance of pass book will be less than the balance of Cash Book.

v. Direct deposits in the bank by a customer would increase the balance shown by the Pass Book.

10.3 PREPARATION OF BANK RECONCILIATION STATEMENT

To reconcile the bank balance as shown in the pass book with the balance shown by the cash book, Bank Reconciliation Statement is prepared. After identifying the reasons of difference, the Bank Reconciliation statement is prepared without making change in the cash book balance.

We may have the following different situations with regard to balances while preparing the Bank Reconciliation statement. These are:

1. Favourable Balances

(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.

2. Unfavourable Balance/Overdraft Balance

(a) Credit balance as per cash book (i.e. overdraft) is given and the balance as per pass book is to be ascertained.

(b) Debit balance as per pass book (i.e. overdraft) is given and the balance as per cash book is to be ascertained.

The following steps are taken to prepare the bank reconciliation statement:

Favourable Balances : When debit balance as per cash book or credit balance as per pass book is given :

(a) Take balance as a starting point say Balance as per Cash Book.

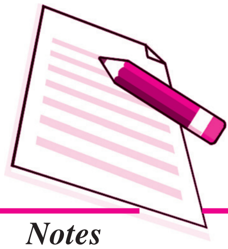
(b) Add all transactions that have resulted in increasing the balance of the pass book.

(c) Deduct all transactions that have resulted in decreasing the balance of pass book.

(d) Extract the net balance shown by the statement which should be the same as shown in the pass book.

In case balance as per pass book is taken as starting point all transactions that have resulted in increasing the balance of the Cash book will be added and all transactions that have resulted in decreasing the balance of Cash book will be deducted. Now extract the net balance shown by the statement which should be the same as per the Cash book.

The following illustration helps to understand dealing with the favourable balance as per cash book or pass book.



Notes

Illustration 1

From the following particulars of M/s Ananaya Industries, prepare bank reconciliation statement as on December 31, 2014

1. Bank balance as per cash book ₹ 32,500
2. Cheques deposited into bank but not credited upto December 31, 2014 ₹8,900.
3. Cheques issued but not presented for payment ₹ 12,500.
4. Bank credited ₹ 5,000 for receiving dividend through Electronic Clearing System.
5. Bank charges debited by Bank ₹ 400.

Solution

Bank Reconciliation statement of M/s Ananaya Industries
as on December 31, 2014

Particulars	*Plus Amount (₹)*	*Minus Amount (₹)*
1. Balance as per cash book	32,500	
2. Cheques deposited but not credited by the bank		8,900
3. Cheques issued but not presented for payment	12,500	
4. Dividend received through ECS	5,000	
5. Bank charges debited by bank		400
Balance as per pass book		40,700
	50,000	**50,000**

Illustration 2

Take the figures given in illustration number 1. prepare bank reconciliation statement taking balance as per pass book i.e. ₹ 40,700 as the starting point,

Solution

Bank Reconciliation statement of M/s Ananava Industries
as on December 31, 2014

Particulars	*Plus Amount (₹)*	*Minus Amount (₹)*
1. Balance as per pass book	40,700	

2. Cheques deposited but not credited by the bank	8,900	
3. Cheques issued but not presented for payment		12,500
4. Dividend received through ECS		5,000
5. Bank charges debited by bank	400	
Balance as per Cash book		32,500
	50,000	**50,000**

Notes

Illustration 3

From the following particulars of Reema Traders, prepare a bank reconciliation statement on June 30,2014

1. Balance as per the cash book ₹ 35,750
2. ₹ 250 charges for Credit card fee is debited by bank, which is not recorded in cash book.
3. Cheques for ₹ 7,550 are deposited in the bank but not yet collected by the Bank.
4. There was also a debit in the pass book of ₹ 3,500 in respect of a discounted bill dishonoured.

Solution

Bank Reconciliation statement of M/s Reema Traders
as on June 30, 2014

Particulars	*Plus Amount (₹)*	*Minus Amount (₹)*
1.Balance as per Cash book	35,750	
2.Cheques deposited but not credited by the bank		7,550
3.Credit card fee charges debited by the bank		250
4.Discounted bill dishonoured recorded only in Pass Book		3,500
Balance as per Pass book		24,450
	35,750	**35,750**

Illustration 4

Bank Pass book of M/s. Brham Industries showed a credit balance of ₹ 27,350 on July 31,2014. The following differences were found on that date between the cash book and the pass book:

1. Cheques issued before July 31, 2014, amounting to ₹ 19,000 had not been presented for payment.
2. Two cheques of ₹ 5,000 and ₹ 3,500 were deposited into bank on July 31, but the bank gives credit for the same in August.
3. Insurance premium directly paid by bank ₹ 5,000.
4. ₹ 2,000 wrongly debited to the firm account by the bank.

Prepare Bank Reconciliation Statement as on July 31, 2014.

Solution:

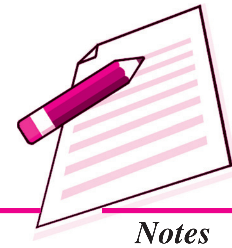
Bank Reconciliation statement of M/s Brahm Industries
as on July 31, 2014

Particulars	*Plus Amount (₹)*	*Minus Amount (₹)*
1. Balance as per pass book	27,350	
2. Cheques issued but not presented for payment		19,000
3. Cheques deposited but credited by the bank in August	8,500	
4. Insurance premium directly paid by bank	5,000	
5. Wrongly debited by the bank.	2,000	
Balance as per Cash book		23,850
	42,850	**42,850**

INTEXT QUESTIONS 10.3

You are given the balance as per Pass Book as the starting point and balance as per Cash Book has 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 :

1. Interest allowed by Bank
2. Cheques deposited with bank and dishonoured
3. Cheques issued but not encashed
4. Bank charges
5. Insurance premium paid by bank
6. Dividends on share collected by bank.


Notes

10.4 UNFAVOURABLE BALANCE/OVERDRAFT BALANCE

Sometimes a businessman withdraws excess amount from the bank account and the closing bank balance of a month is a debit balance. This balance amount is called 'overdraft balance' as per Pass Book. This is shown in the cash book as a credit balance.

Credit balance as per cash book/Debit balance as per Pass Book.

Overdraft balance is shown in the minus column of statement as the starting point. The other steps shall remain same.

The following illustration will help to understand dealing with the unfavourable balance as per cash book and pass book.

Illustration 5

On December 31, 2014, the cash book of the M/s. Mona Plastics shows the credit balance ₹ 6,500. Cheques amounting to ₹ 3,500 deposited into bank but were not collected by the bank. Firm issued cheques of ₹ 1,000 which were not presented for payment. There was a debit in the pass book of ₹ 200 for interest and ₹ 400 for bank charges. Prepare Bank Reconciliation Statement.

Solution:

Bank Reconciliation statement of M/s Mona Plastics as on December 31,2014

Particulars	*Plus Amount (₹)*	*Minus Amount (₹)*
1. Overdraft as per cash book		6,500
2. Cheques issued but not presented for payment	1,000	
3. Cheques deposited but not credited by the bank		3,500
4. Bank charges and interest charged		600
Overdraft balance as per Bank Pass book	9,600	
	10,600	**10,600**

Illustration 6

Prepare Bank Reconciliation Statement of M/s Ashima Travels, from the following informations:

Bank overdraft as per Cash Book on 31st July, 2014 ₹ 45,000

Cheques issued but not presented for payment ₹ 17,500

Cheques deposited but not yet collected by the bank ₹ 9,600

Interest on investment collected by the bank ₹ 2,300

Bank charges ₹ 350 debited by the bank not yet entered in the cash book.

Solution:

Bank Reconciliation statement of M/s Ashima Travels
as on July 2014

Particulars	*Plus Amount (₹)*	*Minus Amount (₹)*
1. Overdraft as per cash book		45,000
2. Cheques issued but not presented for payment	17,500	
3. Cheques deposited but not credited by the bank		9,600
4. Interest on investment collected by the bank	2,300	
5. Bank charges		350
Overdraft balance as per Bank Pass book	35,150	
	54,950	**54,950**

Illustration 7

From the following particulars of Neha and Co. prepare Bank Reconciliation Statement on March 31,2014

	₹
Overdraft as per pass book	16,500
Interest on overdraft	1,600
Insurance premium paid by the bank	800
Cheques deposited but not yet credited	5,500
Cheques issued but not present for payment	6,000
Wrong credit to firm account by the bank	1,000

Solution:

Bank Reconciliation Statement of M/s Neha & Co as on March 31, 2014

Particulars	*Plus Amount (₹)*	*Minus Amount (₹)*
1. Overdraft as per pass book		16,500
2. Interest on overdraft	1,600	
3. Insurance premium paid by bank	800	
4. Cheques deposited but not credited by the bank	5,500	
5. Cheques issued but not presented for payment		6,000
6. Wrongly credited by the bank		1,000
Overdraft balance as per cash book	15,600	
	23,500	**23,500**

INTEXT QUESTIONS 10.4

Fill in the blanks choosing correct word from the words given in brackets:

i. Overdraft means .... balance. [Favourable/unfavourable].

ii. The balance of cash book is .... in case of overdraft. [debit/ credit].

iii. Bank charges will .... in case of overdraft as per Cash Book [increase/decrease].

iv. Cheques issued but not encashed will .... in case of the overdraft as per Pass Book. [increase/decrease]

v. Interest allowed by bank .... in case of the favourable balance of cash book. [adds to/reduces]

WHAT YOU HAVE LEARNT

- Bank Reconciliation Statement is a statement prepared to reconcile the difference between the balances as per the bank column of the cash book and pass book on any given date.

- There are certain reasons due to which a difference in the balance of Pass Book and Cash Book take place. These are as follows:

  (a) Cheques issued by the firm but not yet presented for payment.

  (b) Cheques deposited into bank but not yet collected.

  (c) Amount directly deposited in the bank account.

  (d) Bank Charges

  (e) Interest and dividend received by the bank.

  (f) Direct payments made by the bank on behalf of the customer.

  (g) Cheques/discounted bills dishonoured.

  (h) Errors committed in recording transactions by the firm.

  (i) Errors committed in recording transactions by the Bank

- Different situations for preparing the Bank Reconciliation statement. These are:

  Favourable balances

  (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.

  Unfavourable balance/overdraft balance

  (a) Credit balance as per cash book (i.e. overdraft) is given and the balance as per pass book is to be ascertained.

  (b) Debit balance as per pass book (i.e. overdraft) is given and the balance as per cash book is to be ascertained.

TERMINAL EXERCISE

1. What is meant by a Bank Reconciliation statement?
2. What is the need of preparing Bank Reconciliation statement?
3. Enumerate the causes of difference in the balance of cash book and pass book.
4. From the following particulars, prepare Bank Reconciliation statement as on December 31, 2014.

   (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, 2014. On this date the passbook of M/s Noopur 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 ₹17500 were paid into bank but of ₹ 8500 were realised in the month of April.

6. On April 1, 2014, Rohan had an overdraft of ₹16,000 as shown by the cash book. Cheques amounting to ₹ 6,000 had been paid by him but not collected by the bank till date. He issued cheques of ₹ 8,000 which were not presented to the bank for payment. There was a debit in his passbook of ₹ 500 for interest and ₹ 200 for bank charges and a cheque of ₹ 5000 was paid into bank but the same was debited twice in the cash book. Prepare Bank Reconciliation Statement.

7. Overdraft shown by the passbook of M/s.Mohit traders is ₹ 40,000. Prepare Bank Reconciliation statement on December 31,2014.

(a) Bank charges debited as per pass book ₹ 1,000

(b) Received a payment directly from customer ₹ 7,000

(c) Cheques wrongly recorded in debit side of cash book ₹ 4,000

(d) Cheques issued but not presented for payment ₹ 9,800

(e) Cheques deposited with the bank but not collected ₹ 12,500

(f) Insurance premium paid by the bank ₹3,500

ANSWERS TO INTEXT QUESTIONS

10.1 (i) Pass Book (ii) Debit side (iii) reconcile (iv) credit (v) Debit, credit

10.2 (i) F (ii) F (iii) T (iv) F (v) T

10.3 (i) R (ii) A (iii) R (iv) A (v) A (vi) R

10.4 (i) Unfavourable (ii) Credit (iii) Increase
(iv) Decrease (v) Adds to

Notes

ANSWERS TO TERMINAL QUESTIONS

4. Balance as per pass Book ₹ 2,950
5. Balance as per Cash Book ₹ 9,500
6. Overdraft as per pass Book ₹ 23,200
7. Overdraft as per cash book ₹ 40,800

ACTIVITY

You know that businessman generally visit their banks to get updated position regarding their bank account. Visit any bank and enquire from the bank officer what discrepencies generally they notice in the items. They have recorded or not recorded the items or not recorded by their customers. Make a list of the discrepencies and show the effect on the bank balance.

S.No.	*Reason of discrepency/actual difference in the bank balance and the balance expected by the customer*	*Effect on account*	
		Plus	*Minus*
1.			
2.			
3.			
4.			
5.			
6.			
7.			

11

BILLS OF EXCHANGE

You know that now-a-days in business transactions on credit are on the rise. When goods are sold on credit a huge amount of capital is blocked. Then there is no certainity when the amount will be paid. A solution of the problem is giving this fact in writing in proper form so that the buyer or debtor has to pay a definite sum to the seller/creditor on demand or after the expiry of a certain period. Such a formal document duly signed by both the parties is called a Bill of Exchange.

When such a document is given by the debtor/buyer from his own side it is called a promisory note. These two documents when prepared as per provisions of the Negotiable Instruments Act, 1881 attains the position of money and are used for settlement of the amount due. In this lesson you will learn about these two instruments and their accounting treatment in the books of parties concernced.

OBJECTIVES

After studying this lesson you will be able to:

- define the terms 'Bill of Exchange' and 'Promissory Notes';
- distinguish between 'Bill of Exchange' and 'Promisory Note';
- define the terms such as drawer, drawee, days of grace, noting charges etc;
- make enteries in the books of drawer and drawee/payee with respect to drawing & accepting the bill of exchange and meeting the bill of exchange on maturity;
- dishonour of a Bill;
- renewal of Bill;
- insolvency of the acceptor;

- retiring a bill under rebate;
- discounting the bill from bank; and
- dishonour of bill in various conditions.

11.1 BILLS OF EXCHANGE - MEANING

According to section 5 of the Negotiable Instruments Act, 1881, a bill of exchange is an instrument is writing containing an unconditional order signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of, a certain person, or to the bearer of the instrument.

Features of Bill of Exchange

1. It is an instrument drawn by the creditor upon his debtor.
2. It contains an unconditional order to pay a specified amount.
3. The specified amount is payable to the person named in the bill or to his order or to the bearer.
4. The bill must be signed/accepted by the maker.
5. The bill specifies the date by which the amount should be paid.
6. It can be payable to the bearer.

Parties to a Bill of Exchange

1. **Drawer :** Drawer is a person who writes/makes the Bill of Exchange. He is generally the creditor who had sold goods on credit.
2. **Drawee :** Drawee is a person upon whom the bill is drawn. He is generally the debtor to whom goods have been sold on credit. Bill is generally signed and accepted by the Drawee.
3. **Acceptor :** He is the person who accepts the bill of exchange. Generally debtor/drawee is the acceptor but sometimes a bill of exchange may be accepted by some one also on behalf of the debtor/drawee. Normally the drawee and acceptor are the same parties.
4. **Payee :** Payee is the person named in the Bill of exchange. The amount in the bill is paid to the payee. In most cases Drawer and the payee will be the same.

SPECIMEN OF A BILL OF EXCHANGE

New Delhi, June 17, 2014

₹ 45,000

Stamp

Three months after date pay Sh. Raj Kumar or order the sum of Rupees Forty Five Thousand only, value received.

To Rohit Banerji

Shri Nand Kishor
Shakarpur, Delhi

11.1.1. Promissory Note

According to secton 4 of the Negotiable Instruments Act, 1881, A Promissory Note is an instrument in writing (not being a bank note or a currency note) containing an unconditional undertaking signed by the maker to pay a certain sum of money only to or to the order of a certain person.

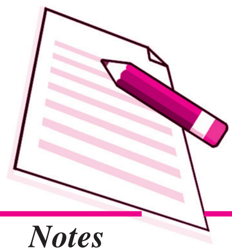
Promissory Note is an unconditional undertaking in writing by the maker to pay the specified amount to the specified person or to the bearer of the promissory note.

Features of a Promissory Note

1. It is an unconditional written undertaking to pay the specified amount.
2. It is drawn and signed by the maker/promisor.
3. It specifies the name of the payee.
4. The specific amount is payable to the specified person or to his order or to the bearer.
5. Proper stamp duty is paid on Promissory Note.
6. It is not payable to the bearer.

Parties of a Promissory Note

1. **Drawer :** He is the person who makes the promise to pay the amount. He is the debtor.
2. **Drawee :** He is the person in whose favour the promissory note is drawn. Generally he is the creditor. In a promissory note the drawee and payee are the same parties.
3. **The Payee :** The payee is a person to whom payment is to be made. He is the creditor.



Notes

SPECIMEN OF A PROMISSORY NOTE

New Delhi, June 17, 2014

₹ 25,000

Stamp

Three months after date we promise to pay M/s Rajesh Enterprises or order a sum of Rupees Twenty Five Thousand only with interest at ten percent per annum, value received.

Rahim Brothers

11.1.2 Difference between Bill of Exchange and Promissory Note

Bill of Exchange	*Promissory Note*
1. It contains an order to pay.	1. It contains a promise to pay.
2. It requires acceptance.	2. It does not need acceptance.
3. Creditor is the Drawer.	3. Debtor is the drawer.
4. The liability of the drawer arises only if the acceptor does not pay.	4. The promisor has the primary liability to pay.
5. The drawer, and payee are generally the same parties. Acceptor and draweer is the Same party.	5. Drawee and Payee are the parties

INTEXT QUESTIONS 11.1

Fill in the blanks :

i. Acceptance is not required in ________________.

a) Bill of Exchange b) Promissory Note

c) Receipt d) None of the above

ii. _____________ prepares the bill of exchange

a) Drawer b) Drawee c) Endorsee d) Bank

iii. Payment of the bill is made to _____________.

a) Drawee b) Endorsee c) Payee d) Bank

11.2 TERMS OF BILL

1. **Due Date :** It is the date on which the payment of the bill becomes due.

2. **Days of Grace :** To ascertain the period of the bill, three extra days are added, which can be called as 'Days of Grace' to calculate the date of maturity.

3. **Bill at Sight :** Bills which are payable on presentation to the Drawee are known as 'Bill at Sight or Demand'.

4. **Bill After Date :** The period is counted from the date of acceptance of the bill in 'Bill After Date'.

5. **Discounting of Bill :** The process of receving the bill amount at a date earlier than the due date from the bank, is known as 'Discounting the Bill'. When the bill is discounted the bank credits the trader's account after decucting some discount. The discount is calculated at the lending rate of the bank for the period that extends between the date of discounting of the bill to the date of maturity.

6. **Endorsement of the Bill :** The drawer may transfer the bill in favour of his creditor to settle the creditor's account. The process of transferring the ownership of the bill in favour of somebody by putting the signature of the holder at the back of the instrument and delivering the same to transferee is known as endorsing the bill. The person who delivers it is endorser and the person to whom it is delivered is called the endorsee.

7. **Terms of the Bill :** Bills is generally drawn for a certain period, say for two months or three months. Bills may be drawn payable at sight on demand, on presentation, after date and so on.

8. **Date of Maturity :** It is the date of which the payment of the bill is due. It is calculated by adding three days of grace. For example a bill drawn on 1.1.2013 for a period of two months will mature on (2 months + 3 days) 3rd March, 2013.

9. **Dishonour of a Bill :** Dishonour means that the bill is not paid by a Drawee on the due date. It arises when the acceptor refuses or is unable to pay the amount of bill, *i.e.,* Bill of Exchange, Promissory Note or cheque.

10. **Notary Public :** Notary Public is an officer appointed by the Central or State Government to exercise the power and functions relating to noting and protesting of negotiable instruments for dishonour. 'Noting' authenticates the fact of dishonour.

11. **Noting Charges :** Noting Charges is the fee paid to the Notary Public for noting and protesting the Bill of Exchange of it's dishonour.

12. **Renewal of Bill :** When the acceptor of a bill is not in a position to meet the bill on due date, he may, with the consent of the holder accept a fresh bill in place of

the old bill, it is called **Renewal of a Bill**. The fresh bill may include interest for the extended period (or it may be paid separately), stamp duty and other incidental expenses incurred by the holder.

13. **Retirement of Bill :** When the Drawee pays the bill before its due date, it is called **Retirement of a Bill**. The holder allows him a rebate of certain amount calculated at a certain rate per cent per annum, from the date of retirement to the date of maturity.

11.3 RECORDING OF BILL TRANSACTIONS

Before starting recording the bill transactions there are certain important aspects related to recording that you must understand clearly. A bill transaction can be recorded in the books of all the parties related to a bill of exchange if that transaction affects the concerned party in any way. As you know that the person who draws the bill of exchange is called the drawer. He is generally a creditor of the person upon whom the bill of exchange is drawn. The person upon whom bill of exchange is drawn is called the drawee. He is generally the debtor of the person who draws the bill of exchange. For the drawer who receives the bill of exchange after its acceptance by the drwee, the bill of exchange is a bills receivable since he will receive the payment on the maturity of the bill. Bills receivables are assets. For the drawee upon whom the bill of exchange is drawn and who accepts it, the bill of exchange becomes a bills payable because he has to make the payment of the amount on the maturity of the bill when the bill will be presented to him. Bills payables are liabilities. The following procedure is followed for recording the bill transactions boths in the books of the drawer/creditor and drawee/acceptor/debtor in a comparative form.

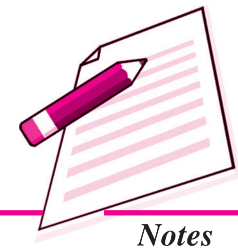
Books of Seller/Creditor/Drawer		*Books of Buyer/Drawee/Acceptor/Debtor*	
i. For Sale of goods		i. For purchase of goods	
Buyer's A/c	Dr.	Purchases A/c	Dr.
To Sales A/c		To Seller's A/c	
ii. For drawing and receiving bill		ii. For accepting bill	
Bills Receivables A/c	Dr.	Seller's A/c	Dr.
To Buyer's A/c		To Bills Payable A/c	

A bills receivable can be treated by its receiver in any of the following ways before its maturity.

i. He may retain the bill with him till the date of its maturity and present the same to the acceptor for payment on the date of its maturity.

ii. He may discount the bill with his bank.

iii. He may endorse the bill in favour of his creditor.



Notes

iv. A few days before the maturity he may send the bill to his bank for the purpose of collection.

The following accounting treatment will be done under the different situations given above.

(i) When the bill in retained by the drawer till its maturity and presented to the drawee/acceptor on its maturity.

Books of drawer/creditor		***Books of drawee/acceptor/payee***	
Bank A/c	Dr.	Bills Payable A/c	Dr.
To Bills Receivable A/c		To Bank	

(ii) On Discounting the Bill : The receiver of the bill may get the bill discounted from its bank at any time before its maturity. The bank charges discount at the pervailing rate of lending and credits the remaining amount in the account of the customer. The following entry will be passed.

Books of drawer/creditor		***Books of drawee/acceptor/debtor***
Banks A/c	Dr.	No entry will be made since he is not
Discount A/c	Dr.	affected on the discounting of the bill.
To Bills Receivable A/c		

On the date of maturity the bill, will be presented by the bank to the acceptor for payment.

Books of drawer	***Books of acceptor/drawee***	
No entry	Bills Payable A/c	Dr.
Since he had already discounted	To Bank	
the bill from the bank, hence no		
entry will be passed.		

(iii) When the bill is endorsed by the receiver in favour of his creditor.

Books of Receiver/Drawer		***Books of Acceptor/Drawee***
Creditor's A/c	Dr.	No entry. Since he will not be affected
To Bills Receivable		by the endorsement of the bill.

On maturity of the bill, the bill will be presented by the creditor, to the acceptor for money payment. The following entry will be made.

Books of drawer		
No entry.	Bills Payable A/c	Dr.
Since he is not affected	To Bank	

(iv) When the bill is sent to the bank for collection a few days before maturity.

Books of Receiver/Creditor	*Banks of drawee/acceptor*
a) For sending Bill sent for collection Dr. To Bills Receivable	No entry. Since he is not effected.
b) For collection of bill by bank Bank A/c Dr. To Bills sent for collection.	Bills Payable A/c Dr. To Bank

INTEXT QUESTIONS 11.2

I. Choose the correct option from the following alternatives:

i. Which account is debited in the books of drawer when a bill is drawn.
   a) Endorsee b) Bills Receivable
   c) Drawee d) Bank

ii. When the acceptor pays the bill amount, which account is credited in the books of drawee.
   a) Bills Payable b) Bills Receivable
   c) Bank d) Name of the above

II. Fill in the blanks with correct word:

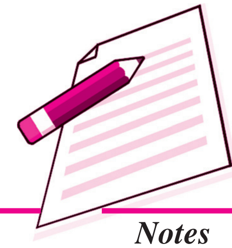
i. The status of acceptor of a bill is that of a ________.
   a) Debtor b) Creditor
   c) Maker d) None of the above

ii. The drawer of a bill of exchange is the __________.
   a) Debtor b) Creditor
   c) Endorsee d) All of the above

iii. _________ is the person to whom payment is made.
   a) Buyer b) Drawee
   c) Payee d) None of the above

Illustration 1

Ravi sold goods ₹ 5000 to Mohan on credit. He drew a bill of exchange for the same amount upon Mohan payable after date two months. Mohan accepted the bill and returned the same to Ravi. On the due date the bill was presented to Mohan who met the same.



Pass the necessary journal entries in the books of Ravi and Mohan under the following circumstances.

i. When the bill was retained by Ravi till the date of its maturity.

ii. When Ravi discounted the bill from the bank on the same day at 6% p.a.

iii. When Ravi endorsed the bill in favour of his creditor Mukesh.

iv. When Ravi sent the bill a few days before its maturity to its bank for collections.

Solution :

Books of Ravi
Journal

Date	*Particulars*	*L.F.*	*Debit Amount ₹*	*Credit Amount ₹*
	(a) (i)			
	Mohan's Ac. Dr.		5,000	
	To Sales			5,000
	(Sold goods to Mohan)			
	(ii)			
	Bills Receivables A/c Dr.		5,000	
	To Mohan's A/c			5,000
	(Received Mohan's acceptance payable after two months)			
	Cash/Bank A/c Dr.		5,000	
	To Bills eceivable			5,000
	(Mohan met his acceptance on maturity)			
	(b) Entry (i) & (ii) will be same			
	Bank A/c Dr.		4,950	
	Discount A/c Dr.		50	
	To Bill Receivable A/c			5,000
	(Mohan's acceptance discounted with Bank)			
	(c) Entry (i) & (ii) to will be same as in (a) above.			

	Mukesh A/c	Dr.		5,000	
	To Bills Receivable A/c				5,000
	(Mohan's acceptance in our favour endorsed in favour of Mukesh)				
	(d) Entry (i) & (ii) will be same as in (a) above				
	Bills sent for collection	Dr.		5,000	
	To Bills Receivable A/c				5,000
	(Mohan acceptance in our favour sent to bank for collection)				

Books of Mohan
Journal

	(a) (b) (c) & (d)				
	Purchases A/c	Dr.		5,000	
	To Ravi's A/c				5,000
	(Purchased goods)				
	Ravi's A/c	Dr.		5,000	
	To Bills Payable				5,000
	(Accepted Ravis draft)				
	Bills Payable A/c	Dr.		5,000	
	To Cash/Bank				5,000
	(Our acceptance in favour of Ravi met on maturity)				

Note : Whatever may happen to the bill before the date of maturity the acceptor is not affected. He will meet the bill on maturity & pass the same entry is all the cases.

11.4 DISHONOUR OF A BILL

If the acceptor fails to pay the amount of the bill on the due date, the bill is said to have been dishonored. When the bill is dishonoured all the previous transactions in connection with the bill are treated as cancelled. Hence, the acceptor is liable to the drawer, the drawer to the endorsee and the endorsee to the bank, with which it is discounted.

The dishonoured bill must be noted with the Notary Public. When the dishonoured bill is noted with the Notary Public, it is a valid evidence of dishonour. The fees charged by the Notary Public is termed as 'Noting Charges.'

On Dishonour of a bill the journal entries will be as under :

In the books of Drawer

a) When the bill was retained by drawer and dishonoured and noting charges are paid

Drawee	Dr.
To Bills Receivable	
To Cash	
(Being B/R dishonoured on due date and noting charges paid)	

b) When the bill was endorsed and dishonoured and noting charges are paid by endorsee.

Drawee	Dr.
To Endorsee	
(Being B/R received from drawee and endorsed is dishonoured, noting charges ₹ ....)	

c) When the bill was discounted with the bank and dishonoured and bank paid noting charges

Drawee	Dr.
To Bank	
(Being discounted bill is dishonoured and noting charges being ₹ ....)	

d) When the bill was sent to bank for collection and dishonoured and bank paid noting charge.

Drawee	Dr.
To Bills sent for collection	
To Bank	
(Being B/R sent to bank for collection is dishonoured and noting charges Rs .... paid by bank)	

In the books of Drawee, the journal entry will be as under in all the four conditions:

Bills Payable	Dr.
Noting Charges	Dr.
To Drawer/creditor	
(Being B/P dishonoured and noting charges ₹ ....)	

11.5 RENEWAL OF BILL

If the acceptor finds it difficult to honour the bill on the due date, he can request the drawer or the holder of the bill to substitute the old bill with a new one *i.e.,* to extend the period of the bill. When the drawer agrees to extend the period of the bill, the old bill is cancelled and a new bill is drawn. When the old bill is cancelled, it is treated as dishonoured. Drawee will be charged with interest for the extended period. If the interest is not paid in cash, the new bill amount will include interest also. Therefore, the cancellation of the existing bill and drawing a new bill in its place to allow more time to the acceptor is known as renewal of the bill. On renewal of a bill the entries will be as under :

In the books of Drawer	*In the books of Drawee*
i. Drawee Dr. To Bills Receivable (Being old bill cancelled)	i. Bill Payable Dr. To Drawer (Being cancellation of bill payable)
ii. Drawee Dr. To Interest (Being interest charged for the extended period)	ii. Interest Dr. To Drawer (Being interest due to Drawer for the extended period)
iii. Bills Receivable Dr. To Drawee (Being a new bill received from Drawee including the interest)	iii. Drawer Dr. To Bills Payable (Being a new bill issued for the amount plus interest)

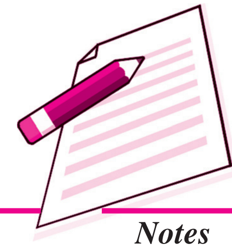
Illustration 2

A sold goods to B for ₹ 10,000 and drew a bill on him for the same amount for 3 months. Before the due date, B requests A to cancel the bill, to accept ₹ 3,000 as part payment and to draw a fresh bill on him for ₹ 7,200 for a further period of 2 months - ₹ 200 being the interest for the extended period. A agrees to the proposal. The new bill is duly honoured. Pass the necessary Journal entries and other party's account in the books of both the parties.

Solution :

In the Books of *A*
JOURNAL

Date	*Particulars*	*L.F.*	*Dr. (₹)*	*Cr. (₹)*
	B ...Dr. To Sales A/c (Being the goods sold to *B* on credit)		10,000	 10,000
	Bills Receivable A/c ...Dr. To *B* (Being the bill drawn on B for 3 months)		10,000	 10,000



	B ...Dr. To Bill Receivable A/c (Old bill cancelled)		10,000	10,000
	Cash/Bank A/c ...Dr. To *B* (Being cash received as a part-payment)		3,000	3,000
	B ...Dr. To Interest A/c (Being the interest charged for the extended period)		200	200
	Bills Receivable A/c ...Dr. To *B* (Being a new bill drawn for the balance plus interest)		7,200	7,200
	Cash/Bank A/c ...Dr. To Bills Receivable A/c (Being the new bill honoured)		7,200	7,200

Dr. ***B's Account*** Cr.

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
	To Sales A/c		10,000		By Bills Receivable A/c		10,000
	To Bills Receivable A/c		10,000		By Cash/Bank A/c		3,000
	To Interest A/c		200		By Bills Receivable A/c		7,200
			20,200				20,200

In the Books of *B*
JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Purchases A/c ...Dr. To *A* (Being the goods pruchased on credit from *A*)		10,000	10,000
	A ...Dr. To Bills Payable A/c (Being the acceptance of a bill from A)		10,000	10,000
	Bills Payable A/c ...Dr. To *A* (Being the bill cancelled for renewal)		10,000	10,000

	A ...Dr. To Cash/Bank A/c (Being a part payment made)		3,000	3,000
	Interest A/c ...Dr. To *A* (Being the interest payable to *A* for the extension period)		200	200
	A ...Dr. To Bills Payable A/c (Being the acceptance of a new bill for the balance plus interest)		7,200	7,200
	Bills Payable A/c ...Dr. To Cash/Bank A/c (Being the new bill honoured by payment)		7,200	7,200

Dr. **A's Account** **Cr.**

Date	*Particulars*	*J.F.*	₹	*Date*	*Particulars*	*J.F.*	₹
	To Bills Payable		10,000		By Purchases		10,000
	To Bank		3,000		By Bills Payable		10,000
	To Bills Payable		7,200		By Interest		200
			20,200				20,200

Illustration 3 : (When the bill is renewed)

B owed to *A* ₹ 60,000 on 1st January, 2009. On the same date, *A* drew upon *B* a bill for the amount at 2 months and *B* returned the bill duly accepted. *A* got the bill discounted at his bank @ 15% p.a. Before the bill was due for payment, *B* told *A* that he was not able to pay the full amount and requested *A* to accept ₹ 20,000 immediately and drew upon him another bill for the remaining amount for 2 months together with interest @ 18% p.a. *A* agreed. The second bill was duly met. Give the Journal entries in the books of both *A* and *B*.

Solution :

A's JOURNAL

Date	*Particulars*	*L.F.*	*Dr. (₹)*	*Cr. (₹)*
2009 Jan. 1	Bills Receivable A/c ...Dr. To *B* (Being the receipt of *B*'s acceptance to clear the amount due from him)		60,000	60,000

Jan. 1	Bank A/c ...Dr. Discount on Bill A/c ...Dr. To Bills Receivable A/c (Being discounting of the bill @ 15% p.a.)		58,000 1,500	 60,000
Mar. 4	*B* ...Dr. To Bank A/c (Being the dishonour [for renewal] of *B*'s Bill)		60,000	 60,000
Mar. 4	Cash/Bank A/c ...Dr. To *B* (Being the receipt of ₹ 20,000 from *B*)		20,000	 20,000
Mar. 4	*B* ...Dr. To Interest A/c (Being the interest due from *B* for 2 months on ₹ 40,000 @ 18% p.a.)		1,200	 1,200
Mar. 4	Bills Receivable A/c ...Dr. To *B* (Being the new acceptance received from *B* for ₹ 40,000 balance, plus ₹ 1,200 interest)		41,200	 41,200
May 7	Cash/Bank A/c ...Dr. To Bill Receivable A/c (Being the amount of the bill received)		41,200	 41,200

B's JOURNAL

Date	*Particulars*	*L.F.*	*Dr.* (₹)	*Cr.* (₹)
2009				
Jan. 1	*A* ...Dr. To Bills Payable A/c (Being the acceptance of *A*'s draft)		60,000	 60,000
Mar. 4	Bills Payable A/c ...Dr. To *A* (Being the entry required to got the bill renewed)		60,000	 60,000
Mar. 4	*A* ...Dr. To Cash/Bank/A/c (Being the amount paid to *A* as per arrangement)		20,000	 20,000

Mar. 4	Interest A/c ...Dr. To *A* (Being the amount of interest due to *A* on ₹ 40,000 for 2 months @ 18%)		1,200	1,200
Mar. 4	*A* ...Dr. To Bills Payable A/c (Being the new acceptance in favour of *A*)		41,200	41,200
May 7	Bills Payable A/c ...Dr. To Cash/Bank A/c (Being the payment of the bill due this day)		41,200	41,200

INTEXT QUESTIONS 11.3

Fill in the blanks :

i. Acceptance is not required in __________.

a) Bill of Exchange b) Promissory Note
c) Receipt d) None of the above

ii. __________ prepares the bill of exchange.

a) Drawer b) Drawee c) Endorsee d) Bank

iii. Payment of the bill is made to __________.

a) Drawee b) Endorsee c) Payee d) Bank

iv. The number of days allowed as Days of Grace of Bill of Exchange is ______.

a) One b) Two c) Three d) Five

v. When the amount in a bill of exchange is received from the bank on a date earlier than the due date, it is called ________.

a) Retiring the bill b) Renewing the bill
c) Discounting the bill d) None of the above

vi. The process in which the drawer puts his signature in the bill indicating that the bill should be paid to the person whose name is written at the back of bill is called __________.

a) Discounting the bill b) Endorsing the bill
c) Retiring the bill d) Renewing the bill

11.6 INSOLVENCY OF THE ACCEPTOR

If the acceptor is unable to meet his liabilities, the court declares him as insolvent. In case the acceptor becomes bankrupt, his bills payable are considered as dishonoured. Any amount received from the insolvent person's property, will be debited in the cash account and credited in the Acceptor's Account. Any balance in his account, which is irrecoverable, is written off as bad debts. The Acceptor will transfer the balance in the account of the drawer to Deficiency Account.

The entries relating to insolvency are as follows :

In the books of Drawer

Drawee Dr.
  To Bill Receivable
(Cancellation of bill)

Cash Dr.
Bad Debts Dr.
  To Drawee
(Being the amount received and the amount written off on ___'s insolvency)

In the books of Drawee

Bills Payable A/c Dr.
  To Drawer's A/c
(Cancellation of own acceptance)

Drawer Dr.
  To Cash
  To Deficiency A/c
    or
  To Profit & Loss A/c
(Being the final payment to drawer and the balance transferred to deficiency A/c)

Notes

Illustration 4

Journalise the following in the books of Mohan :

(i) Mohan's acceptance to Sohan for ₹ 20,000 renewed at 3 months together with interest @ 18%.

(ii) Shyam requests Mohan to renew his acceptance for ₹ 15,000 for 2 months. Mohan agrees to it, provided interest is paid @ 10% in cash.

Solution :

JOURNAL OF MOHAN

Date	*Particulars*	*L.F.*	*Dr. (₹)*	*Cr. (₹)*
(i)	Bills Payable A/c ...Dr.		20,000	
	To Sohan			20,000
	(Being cancellation of acceptance in favour of Sohan for purposes of renewal)			

	Interest A/c ...Dr. To Sohan (Being interest due to Sohan @ 18% for 3 months on ₹ 20,000)		900	900
	Sohan ...Dr. To Bills Payable A/c (Being new bill accepted in favour of Sohan)		20,900	20,900
(ii)	Shyam ...Dr. To Bills Receivable A/c (Being cancellation of Shyam's acceptance for purpose of renewal)		15,000	15,000
	Shyam ...Dr. To Interest A/c (Being interest due from Syam @ 10% for two months, the period of the new bill)		250	250
	Bills Receivable A/c ...Dr. Cash/Bank A/c ...Dr. To Shyam (Being cash ₹ 250 and new bill for ₹ 15,000 received from Shyam)		15,000 250	15,250

11.7 RETIRING A BILL UNDER REBATE

Sometimes the acceptor pays the amount of his bills payable before the due date. The payment of bill amount by the acceptor to the holder before the due date, is known as 'retiring the bill'. In such cases, the holder of the bill would grant some concession to the acceptor. This concession is called as rebate. Rebate is a loss to the holder. It will be a gain to the acceptor.

Entries for rebate are

In the books of Drawer

Cash Dr.
Rebate Dr.
To Bills Receivable
(Being the B/R retired under rebate)

In the books of Drawee

Bills Payable Dr.
To Cash
To Rebate
(Being B/P retired)

Illustration 5

Rohit draws a bill on Vikram for ₹ 10,000 payable 3 months after date. The bill is duly accepted by Vikram. One month before due date Vikram meets the bill and gets a rebate @ 12% p.a. Make Journal entries in the books of Rohit and Vikram.

In the books of Rohit

Bills Receivable	...Dr.	10,000	
To Vikram			10,000
(Received Vikram's acceptance)			
Cash A/c	...Dr.	9,900	
Rebate A/c	...Dr.	100	
To B/R A/c			10,000

In the books of Vikarm

Rohit	...Dr.	10,000	
To B/P A/c			10,000
(Accepted Rohit's draft)			
B/P A/c	...Dr.	10,000	
To Cash A/c			9,900
To Rebate A/c			100

INTEXT QUESTIONS 11.4

Fill in the blanks :

i. ___________ acount is debited in the books of drawer when bill is duly met and the bill is retained up to the maturity date.

a) Cash b) Cash and Discount

c) Discount d) Bills Receivable

ii. In the books of endorsee when endorsement occurs _______ account is credited.

a) Bills Receivable b) Bills Payable

c) Endorsee d) Endorser

iii. The balance in the Bills sent for collection Account is shown in Balance Sheet as ___________.

a) Asset b) Liability

c) Capital d) None of the above

iv. If the payment of the bill is not made on the due date, it is called __________.

a) Discounting the bill b) Dishonour of a bill

c) Retiring the bill d) Renewal of a bill

v. In the books of drawer, when a bill is dishonoured ________ account is debited.

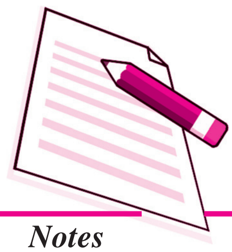
a) Drawee's b) Cash

c) Discount d) None of the above

vi. When the acceptor request the holder to extend the period of bill, it is called.

a) Retiring the bill b) Discounting the bill

c) Renewing the bill d) Endorsing the bill



Notes

vii. When the acceptor is declared as insolvent, the entry in the books of drawer is debited with __________.

a) Cash   b) Bad debt

c) Cash and bad debt   d) Drawee

viii. If the acceptor pays the bill amount before the due date, it is called _________.

a) Discounting the bill   b) Retiring the bill

c) Renewing the bill   d) Endorsing the bill

WHAT YOU HAVE LEARNT

- A Bill of Exchange is an instrument in writing containing an unconditional order signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of, a certain person or to the bearer of the instrument.
- Parties to a Bills of Exchange are :
  - i. The Drawer : The party who makes the bill.
  - ii. The Drawee : The party upon whom the bill is drawn.
  - iii. The Payee : The party to whom the amount is to be paid.
  - iv. The Acceptor : The person who accepts the bill. Generally the drawee and acceptor may be the same parties.
- There may be four situations of a bill drawn :
  - i. It may be retained till due date.
  - ii. It may be discounted with bank.
  - iii. It may be endorsed.
  - iv. It may be sent to bank for collection.

TERMINAL EXERCISE

1. What do you mean by a bill of exchange. Distinguish between Bill of Exchange and Promissory Note.
2. Define Bill of Exchange. What are the features of Bill of Exchange?
3. Explain Bill of Exchange along with its advantages and disadvantages.

4. Who are the parties to bill of exchange? Explain them.
5. Explain the following terms :

i.	Renewal of a bill	ii.	Retirement of a bill
iii.	Noting charges	iv.	Days of grace

6. What is meant by a Promissory Note? Describe the parties to a Promissory Note.
7. Briefly explain the characteristics of a Promissory Note.
8. On 1st January, 2008, *A* sold goods to *B* for ₹ 5,000 and drew upon him a bill for this amount payable 3 months after date. The bill was duly accepted by *B*. *A* retained the bill till due date. On the due date, the bill was paid.

   Pass the Journal entries in the books of *A* and *B*. Also, show the necessary accounts in the books of both parties.
9. Dinesh received from Shridhar an acceptance for ₹ 3,000 on 1st September, 2008 at 3 months. Dinesh got the acceptance discounted at 9% p.a. from his bank. On the due date, Shridhar paid the required amount.

   Give the Journal entries in the books of Dinesh and Shridhar.
10. *A* sold goods to *B* for ₹ 20,000 on credit of 3 months. He drew on the latter a bill for the amount. The bill was endorsed in favour of *C*, who got the payment on maturity. Give the Journal entries in the books of *A*.
11. *A* sold goods to *B* for ₹ 2,000. *B* accepts two bills of ₹ 1,000 each for 3 months. A endorsed one bill to *C*. On due date both bills are met.

    Pass the entries in the books of *A* and *B*.
12. Mohan Singh draws a bill on Jagat for ₹ 1,000 payable 2 months after date. Immediately after its acceptance, Mohan Singh sends the bill to his bank for collection. On due date, bank gets the payment. Make the entries in the books of all the parties.
13. On 1st March, 2009 *R* accepted a Bill of Exchange of ₹ 20,000 from *S* payable 3 months after date in full settlement of his dues. On the same day *S* endorsed the Bill of Exchange to *T* together with a cheque for ₹ 5,000 in settlement of his debt to the latter. On 2nd March, 2009, *T* discounted the bill of exchange @ 6% p.a. with his bankers. On maturity the Bill of Exchange was dishonoured.

    Pass the Journal entries in the books of S and R.
14. Record the following transactions in the books of Mehra :

    i. Ram's acceptance for ₹ 20,000 renewed for 3 months, plus interest at 5% p.a.

ii. Shyam's acceptance for ₹ 4,500, due this day, returned dishonoured. Noting charges, ₹ 10.

15. *A* sold goods to the value of ₹ 12,000 to *B*, taking a bill at 3 months, therefore dated 1st July, 2009. On 4th August, *A* discounted the bill at 5% p.a. with his bankers. At maturity the bill was renewed and drew another bill dishonoured, *B* paid Rs. 3,000 and noting charges and accept another bill at 3 months for ₹ 9,000 at 6% interest, but before maturity he had become insolvent, and ultimately paid his creditors 75 paise in the rupee.

Make the entries in *A*'s Journal recording the above transactions.

ANSWERS TO INTEXT QUESTIONS

11.1	(i) b	(ii) a	(iii) c		
11.2	**I.**	(i) b	(ii) c		
	II.	(i) a	(ii) b	(iii) b	
11.3	(i) b	(ii) a	(iii) c		
	(iv) c	(v) c	(vi) b		
11.4	(i) a	(ii) b	(iii) d	(iv) a	(v) b
	(vi) a	(vii) c	(viii) c	(ix) b	

12

ERRORS AND THEIR RECTIFICATION

You did not take your studies seriously that is why you could not get good marks. You committed an error. You fell in some bad company. You may commit many such errors in your day to day life. Similarly, an accountant can also commit errors while recording business transactions in books of accounts, in their posting or balancing the accounts and so on. These errors should be located and corrected as soon as possible so that accounts give true and fair results of the operations of the business enterprise. You have learnt that in case Trial Balance does not agree it means there are some accounting errors. There can be some errors which do not affect the Trial Balance i.e. trial balance still tallies. In this lesson you will learn about locating, classifying and analysing accounting errors and their rectification.

OBJECTIVES

After studying this lesson you will be able to :

- state the meaning of accounting error and method of location of the accounting error/errors;
- classify the accounting errors;
- explain the meaning and methods of rectification of errors and
- prepare suspense account.

12.1 MEANING OF ACCOUNTING ERRORS AND THEIR LOCATION

In our life we make many mistakes. As soon as these are detected, he/she corrects them. In the similar manner, an accountant can also make mistakes or commit errors while recording and posting transactions. These are called 'Accounting Errors'. So accounting errors are the errors committed by persons responsible for recording and maintaining accounts of a business firm in the course of accounting process. These errors may be in the form of omitting the transactions to record, recording in wrong books, or wrong account or wrong totalling and so on.

Accounting errors can take the following forms:

- Omission of recording a business transaction in the Journal or Special purpose Books
- Not posting the recorded transactions in various books of accounts to the respective accounts in ledger
- Mistakes in totalling or in carrying forward the totals to the next page
- Mistake in recording amount wrongly, writing it in a wrong account or on the wrong side of the account.

Again there may be two types of accounting errors (i) That cause the disagreement of trial balance, (ii) That do not affect the agreement of Trial Balance.

Locating Errors

It is obvious that if there are errors they must be located at the earliest. After locating the errors, they are to be rectified. In accounting also once it is established there are some accounting errors these need to be located and detected as early as possible. How to locate the errors?

Steps to be taken to locate the accounting errors can be stated as follows:

(A) When the Trial Balance does not Agree

(i) Check the columnar totals of Trial Balance

(ii) Check that the balances of all accounts (including cash and bank balances) in the ledger have been written and are written in the correct column of trial balance i.e. debit balance in the debit column and credit balance in the credit column.

(iii) Find the exact figure of difference with trial balance and see that:

  (a) No account of a similar balance has been omitted to be shown in the Trial Balance or

  (b) A balance amount which is half of the amount of difference amount but is written on the wrong side of the trial Balance.

(iv) Recheck the totals of Special Purpose Books.

(v) Check the balancing of the various accounts in the ledger.

(vi) If difference is still not traced, check each and every posting from the Journal and various Special Purpose Books, one by one in the ledger.

(B) When the Trial Balance Agrees

You have already learnt that if the totals of the two amount columns of trial balance tally it is no conclusive proof of the accuracy of accounts. There may still be some accounting errors. These errors may not be immediately traced but may be detected at much later stage. These are rectified as and when detected.

Following are the errors which don't affect the trial balance :

(i) Omission to record a transaction in a journal or in a Special Purpose Book. For example, goods purchased on credit but are not recorded in the Purchases Book at all.

(ii) Recording a wrong amount of an item in journal or in a Special Purpose Book. For example, sale of ₹ 2550 on credit entered in the Sales Book as ₹ 5250.

(iii) Posting the correct amount on the correct side but in wrong account. For example, cash received from Jagannathan was credited to Vishvanathan.

(iv) An item of Capital Expenditure recorded as an item of Revenue Expenditure and vice-a-versa. For example, Repairs to Building was debited to Building A/c.

Why does the trial balance still agree though there may be above stated errors? Reason is that in the above cases the debits and credits are affected simultaneously by the same amount.

INTEXT QUESTIONS 12.1

Do the following errors affect the trial balance or do not affect the trial balance? Write 'Yes' if it affects and 'No' if does not affect.

i. Sold goods of ₹ 3200 to Anil Nayar, but it is not entered in the Sales Book.

ii. Purchased goods of ₹ 2400 from Simran and is correctly entered in the Purchases Book but posted to the credit of her account in the ledger as ₹3400.

iii. Total of the Purchases Book is incorrect.

iv. An amount of repair to building is debited to Building Account.

12.2 CLASSIFICATION OF ACCOUNTING ERRORS

Various accounting errors can be classified as follows :

A. On the basis of their nature

Notes

(a) Errors of omission

(b) Errors of commission

(c) Errors of principle

B. On the basis of their impact on ledger accounts

(a) One sided errors

(b) Two sided errors.

A. On the basis of their nature

(a) Errors of omission : As a rule, a transaction is first recorded in books of accounts. However, accountant may not record it at all or record it partially. It is called an error of omission. For example, goods purchased on credit are not recorded in Purchases Book or discount allowed to a customer was not posted to Discount A/c in the ledger.

In the first case it is a complete omission. Therefore, both debit and credit are affected by the same amount. Therefore, it does not affect the Trial Balance.

The second example is the example of partial omission. It affects only one account i.e. Discount A/c. Therefore it affects Trial Balance.

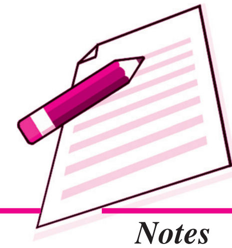
(b) Errors of commission : When the transaction has been recorded but an error is committed in the process of recording, it is called an error of commission. Error of commission can be of the following types:

(i) Errors committed while recording a transaction in the Special Purpose books. It may be :

- Recording in the wrong book for example purchase of goods from Rakesh on credit is recorded in the Sales Book and not in the Purchases Book.
- Recording in the book correctly but wrong amount is written. For example, goods sold to Shalini of ₹ 4200 was recorded in the Sales Book as ₹ 2400

In the above two cases two accounts are affected by the same amount, debit of one and the credit of the other. Therefore, trial balance will not be affected.

(ii) Wrong totalling : There may be a mistake in totalling Special Purpose Book or accounts. The totalled amounts may be less than the actual amount or more than the actual amount. First is a case of undercasting and the other of overcasting. For example, the total of Purchases Book is written as ₹ 44800 while actual total is ₹ 44300, the total of Sales Day Book is written as ₹52500 while it is ₹ 52900.



It is a case of an error affecting one account hence it affects trial balance.

(iii) Wrong balancing : While closing the books of accounts at the end of the accounting period, the ledger accounts are balanced. Balance is calculated of the totals of the two sides of the account. It may be wrongly calculated. For example, the total of the debit column of Mohan's A/c is ₹ 8,600 and that of credit column is ₹ 6,800. The balance calculated is as ₹ 1,600 while the actual balance is ₹1,800.

It has affected one account only, therefore, the Trial Balance gets affected.

(iv) Wrong carry forward of balances or totals : Totals or balances are carried forward to the next page. These may be carried forward incorrectly. For example, the total of one page of the Purchases Book of ₹ 35,600 is carried to next page as ₹ 36,500.

Again the error affects one account only. Therefore, Trial Balance gets affected.

(v) Wrong Posting : Transactions from the journal or special purpose books are posted to the respective accounts in the ledger. Error may be committed while carrying out posting. It may take various forms such as, posting to wrong account, to the wrong side of the account or posted twice to the same account. For example goods purchased of ₹ 5400 from Rajesh Mohanti was posted to the debit of Rajesh Mohanti or posted twice to his account or posted to the credit of Rakesh Mohanti.

In the above examples, only one account is affected because of the error therefore, Trial Balance is also affected.

Compensating Errors

Two or more errors when committed in such a way that there is increase or decrease in the debit side due to an error, also there is corresponding decrease or increase in the credit side due to another error by the same amount. Thus, the effect on the account is cancelled out. Such errors are called compensating errors. For example, Sohan's A/c is debited by ₹ 2500 while it was to be debited by ₹ 3500 and Mohan's A/c is debited by ₹ 3500 while the same was to be debited by ₹ 2500. Thus, excess debit of Mohan's A/c by ₹1000 is compensated by short credit of Sohan's A/c by ₹1000.

As the debit amount and the credit amount are equalised, such errors do not affect the agreement of Trial Balance, but the fact remains that there is still an error.

(c) ***Error of Principle :*** Items of income and expenditure are divided into capital and revenue categories. This is the basic principle of accounting that the capital receipts and capital expenditure should be recorded as capital item and revenue

income and revenue expenditure should be recorded as revenue item. If transactions are recorded in violation of this principle, it is called error of principle i.e. the capital item has been recorded as revenue item and revenue item is recorded as capital item. For example, ₹ 5000 spent on the repairs of building is debited to Building A/c while it should have been debited to Repair to Building A/c. It is a case of error of principle because expenditure on repairs of building is a revenue expenditure, while it has been debited to Building A/c taking it as an item of capital expenditure.

As both the sides i.e. credit as well as debit remain affected, the trial Balance also is not affected by such errors.

B. On the basis of impact on ledger accounts

Errors may affect one side i.e. either debit or credit side of an account or its two sides i.e. both debit and credit thus errors may be divided as:

(a) ***One sided errors :*** Accounting errors that affect only one side of an account which may be either its debit side or credit side, is called one sided error. The reason of such error is that while posting a recorded transaction one account is correctly posted while the corresponding account is not correctly posted. For example, Sales Book is overcast by ₹ 1000. In this case only Sales A/c is wrongly credited by excess amount of ₹ 1000 while the corresponding account of the various debtors have been correctly debited. Another example of one sided error is ₹ 2500 received from Ishita is wrongly debited to her account. In this case, only Ishita's account is affected, amount in the cash-book is correctly written. This type of error does affect the trial balance.

(b) ***Two sided errors :*** The error that affects two separate accounts, is called two sided error. Example of such error is purchase of machinery for ₹ 1000 has been entered in the Purchases Book. In this case, Purchases A/c is wrongly debited while Machinery A/c has been omitted to be debited. So two accounts i.e. Purchases A/c and the Machinery A/c are affected.

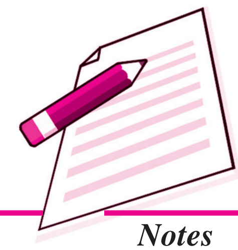
INTEXT QUESTIONS 12.2

Following are some accounting errors. Write against each error the type i.e. error of omission, error of principle, compensatory error, error of commission as per the nature of error:

(i) Purchase of Furniture is entered in the Purchase Book (Error of ....)

(ii) Repairs of building is debited to Building A/c. (Error of ....)

(iii) Sales Book is totalled ₹ 15,000 instead of its ₹ 14,600. (Error of ....)



Notes

(iv) Mohan's A/c was to be debited by ₹ 4500 and Sohan A/c was to be debited by ₹ 5500 while Mohon's A/c was debited by ₹ 5500 and that of Sohan's A/c by ₹ 4500. (Error of ....)

12.3 RECTIFICATION OF ACCOUNTING ERRORS

By now you must have understood well that every business enterprise prepares its financial statements to provide information of profit earned or loss incurred by it during an accounting period and its financial position on the relevant date. This information will be most useful only if the information is accurate. How can the business concern achieve this objective if there are number of errors in the accounting? Your immediate response will be that errors in accounts should be detected at the earliest and be corrected before preparing the financial statements.

It should be clear in your mind that the errors should never be rectified by erasing or overwriting because it will encourage manipulations and frauds in accounts.

In accounting practice there are some definite methods to rectify the accounting errors. These are based on accounting practices and procedures. Rectification of errors using these methods is called rectification of accounting errors. So it is a process of rectification. It is generally done by passing an entry to nullify the effect of error.

Methods of rectification of accounting errors :

I. Before preparing Trial Balance

(i) instant correction (ii) correction in the affected account

II. After preparing Trial Balance

I. Before preparing Trial Balance

(i) Instant correction : If the error is detected immediately after making an accounting entry, it may be corrected by neatly crossing out the wrong entry and making the correct entry and the accountant should put his initials. For example, an amount of ₹ 3,500 is written as ₹ 5,300. This can be corrected as ₹ 3,500.

(ii) Correction in the affected accounts : In case error is detected on a date later than the date on which the transaction was recorded but before the Trial Balance, the rectification will be made by making a correction in the affected account. A few Illustrations of accounting errors corrected by this method are as follows :

Illustration 1

Purchases book is overcast for the month of July, 2014 by ₹ 8,000.

Notes

Solution

Accounts Affected : The total of the Purchase Book is posted to the debit of Purchase A/c. Therefore Purchase A/c is affected.

Rectification : To nullify the effect of the error, the entry of ₹ 8,000 will be made on the credit side of the Purchase A/c. With the words written as. "The amount of Purchase Book is overcast for the month of July 2014."

Purchase A/c

Dr Cr

Date	*Particulars*	*F*	*Amount (₹)*	*Date*	*Particulars*	*F*	*Amount (₹)*
					Amount as per Purchase Book for the month of July, 2014		8,000

Illustration 2

A sum of ₹ 1,200 paid to Ashok has been wrongly credited to his account.

Solution

Accounts Affected : Ashok A/c is affected because his account has been credited instead of being debited.

Rectification : In this case Ashok A/c is to be debited to nullify the effect of its being wrongly credited at the same time it is to be debited for cash payment. Rectification is done as under :

Ashok A/c

Dr Cr

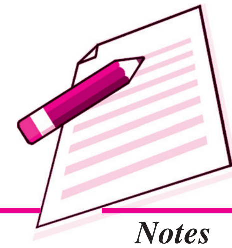
Date	*Particulars*	*F*	*Amount (₹)*	*Date*	*Particulars*	*F*	*Amount*
	Amount paid wrongly credited		2,400		Cash A/c		1,200

Illustration 3

Purchase of furniture of ₹ 5,000 was entered in the Purchases Book.

Solution

Accounts Affected : Furniture Account and Purchases account have been affected. Furniture Account has been omitted to be debited while Purchases account is wrongly debited.



Notes

Rectification : In this case Purchases account is credited to nullify as it is wrongly debited as furniture account is debited in it was to be debited but was omitted.

Furniture A/c

Dr | Cr

Date	*Particulars*	*F*	*Amount* (₹)	*Date*	*Particulars*	*F*	*Amount* (₹)
2014							
Jan 15	Amount transferred Purchase A/c		5,000				

Purchases A/c

Dr | Cr

Date	*Particulars*	*F*	*Amount* (₹)	*Date*	*Particulars*	*F*	*Amount* (₹)
				2014			
				Jan 15	Amount transferred to Furniture A/c		5,000

Rectification Through Journal entry

In case of the above illustration journal entry for rectification made is :

Date	*Particulars*	*L.F.*	*Dr. Amount* ₹	*Cr. Amount* ₹
2014				
Jan 15	Furniture A/c		5,000	
	To Purchases A/c			5,000
	(Furniture purchased on credit is wrongly entered in the purchases Book is now corrected)			

Illustration 4

Amount of ₹ 15,000 received from Govind was credited to Har Govind.

Solution

The two accounts affected are Govind's A/c which is not credited and Har Govind's A/c which is wrongly credited.

Notes

Rectification entry in Journal is :

Har Govind's A/c	Dr	15,000	
To Govind's A/c			15,000
(Amount received from Govind wrongly credited to Har Govind is now rectified.)			

Illustration 5

Following are some accounting errors. Rectify them by making journal entries :

(i) Sales for ₹ 20,000 made to Malvika was not entered in the Sales Book.

(ii) Salary of ₹ 7,500 paid to Accountant Raman was debited to his personal account

(iii) Old furniture sold for ₹ 2,800 was entered in the Sales Book.

(iv) Carriage paid ₹ 500 on purchase of a Machine was debited to Carriage A/c

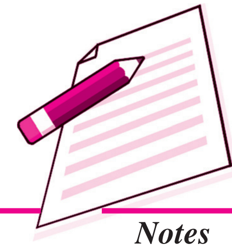
(v) Cash ₹ 50,000 paid to the creditor Atulya Ghosh was debited to Praful Ghosh's A/c

Solution

Journal

Date	*Particulars*	*L.F.*	*Amount* ₹	*Amount* ₹
(i)	Malvika Dr To Sales A/c (Sale to Malvika omitted to be entered in Sales Book is corrected)		20,000	 20,000
(ii)	Salary A/c Dr To Raman (Salary paid to Raman was debited to his personal account is now corrected)		7,500	 7,500
(iii)	Sales A/c Dr To Furniture A/c (Old furniture sold was entered in the sales Book is now corrected)		2,800	 2,800
(iv)	Machine A/c Dr To Carriage A/c (Amount paid for carriage on purchase of machine is debited to carriage A/c is now corrected)		500	 500

(v)	Atulya Ghosh Dr		50,000	
	To Praful Ghosh			50,000
	(Amount paid to Atulya Ghosh was debited to Praful Ghosh is corrected)			



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INTEXT QUESTIONS 12.3

i. Cash received from Ashok ₹ 2,500 were posted to his account as ₹ 5,200. Accountant erased amount of ₹ 5,200 and wrote ₹ 2,500 in its place. Is he justified in doing so?

ii. Accountant corrected an error of writing ₹ 7,200 instead of ₹ 5,200 in the following manner, is he justified to do so?

~~₹ 7,200~~

₹ 5,200

iii. Total of the Sales Book was overcast by ₹ 1,000. Accountant corrected the error in the following manner :

Amount as per Sales Book ₹ 1,000

On which side of the Sales A/c he should write the above amount?

iv. Wages paid ₹ 1,200 were omitted to be recorded in the Cash Book. What journal entry will be made to rectify the error?

12.4 RECTIFICATION OF ERRORS THROUGH SUSPENSE ACCOUNT

You have learnt that the Trial Balance prepared at the end of a period by the business concern must agree. It means the sum of its debit column and sum of credit column should agree. But if the totals do not agree the difference amount is written in a new account. This account is called Suspense Account. If the total of the debit side of the Trial Balance is more than the total of its credit side, the difference amount will be written in Suspense A/c on its credit side i.e. Suspense A/c is credited and vice-versa. You have also learnt that the two sides of the Trial Balance do not agree because there is some error or errors in the accounts, which is reflected in the Suspense Account. Thus, Suspense A/c is a summarised account showing net effect of errors.

Opening of a Suspense Account is a temporary arrangement. As soon as the errors that has led to creation of Suspense Account are rectified, this account will disappear. One point needs to be noted that balance shown in Suspense Account is the net result of one sided errors. So one sided errors are corrected through Suspense A/c. Completing the double entry when an error is corrected by placing the correct amount on the debit of the proper account, the credit is placed in Suspense Account or vice-versa. For example, Gopal's Account was debited short by ₹ 100. The error will be rectified through Suspense A/c by debiting Gopal A/c and crediting Suspense A/c by ₹ 100.

Journal entry for the same is as follows :

Gopal' A/c	Dr.	100	
To Suspense A/c			100

(Gopal's A/c debited short is now corrected)

Similarly, while correcting as one sided error the proper account is credited with the correct amount, the debit is placed in the Suspense A/c. For example, Sales Book for December, 2014 is undercast by ₹ 500. The error will be rectified by debiting Suspense A/c and crediting Sales A/c.

Journal Entry for the same will be as follows :

Suspense A/c	Dr.	500	
To Sales A/c			500

(Sales Book undercast is rectified)

Illustration 6

Following are some accounting errors. Rectify the same through Suspense A/c

(i) Purchases Book has been overcast by ₹ 200

(ii) Goods purchased from Manohar of ₹ 2,500 have been posted to the debit of his account.

(iii) Cash of ₹ 4,500 paid to Munish was credited to Manish.

(iv) Discount ₹ 100 allowed to Anthony was not debited to discount account.

Solution

(i) ***Accounting Effect :*** Purchases A/c has been debited in excess by ₹ 200

Rectification : Purchases A/c is credited by ₹ 200 and Suspense A/c is debited by ₹ 200.

Journal Entry

Suspense A/c	Dr	200	
To Purchases A/c			200

(Purchases Book overcast is now corrected)

(ii) ***Accounting Effect :*** Manohar A/c has been debited by ₹ 2,500 instead of it being credited by the same amount.

Rectification : Manohar A/c is credited by ₹ 5,000

Journal Entry

Suspense A/c	Dr	5,000	
To Manohar A/c			5,000
(Goods purchased from Manohar wrongly debited to his account now rectified)			

(iii) ***Accounting Effect :*** Manish A/c is credited by ₹ 4,500 while Manish A/c was to be debited by the same amount.

Rectification : Manish A/c is to be debited by ₹ 4,500 and Manish A/c is also be debited by ₹ 4,500 and Suspense A/c to be credited by ₹ 9,000

Journal Entry

Manish	Dr	4,500	
Manish	Dr	4,500	
To Suspense A/c			9,000
(Cash paid to Manish was wrongly credited to Manish, now corrected)			

(iv) ***Accounting Effect :*** Discount A/c is omitted to be debited by ₹ 100. This account is debited and Suspense A/c is credited.

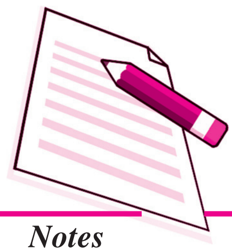
Journal Entry

Discount A/c	Dr	100	
To Suspense A/c			100
(Discount allowed is not debited to discount A/c.)			

Illustration 7

Rectify the following accounting errors through Suspense Account by making journal entries :

1. Purchase of goods from Mohit for ₹ 2,500 was entered in the Sales Book, however Mohit's Account was correctly credited.
2. Cash received from Anil a debtor ₹ 3,200 was correctly entered in the Cash Book but was omitted to be posted to his account.
3. Sales Book was overcast by ₹ 1,500.



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4. Cash of ₹ 4,000 paid to Hanif was credited to Rafique A/c as ₹ 1,400.
5. The total of Purchase Returns Book of ₹ 3,150 was carried forward as ₹1,530.
6. Namita was paid cash ₹ 6,500 but Sumita was debited by ₹ 6,000.

Solution

Date	Particulars		L.F.	Amount Dr. (₹)	Amount Cr. (₹)
1.	Purchases A/c	Dr		2,500	
	Sales A/c	Dr		2,500	
	To Suspense A/c				5,000
	(Purchase of good was entered in the the sale book now corrected)				
2.	Suspense A/c	Dr		3,200	
	To Anil A/c				3,200
	(Anil's account omitted to be credited now rectified				
3.	Sales A/c	Dr		1,500	
	To Suspense A/c				1,500
	(Sales Book overcast is corrected)				
4.	Hanif A/c	Dr		4,000	
	Rafique A/c	Dr		1,400	
	To Suspense A/c				5,400
	(Cash paid to Hanif was wrongly credited to Rafique the error is now rectified)				
5.	Suspense A/c	Dr		1,620	
	To Purchases Returns A/c				1,620
	(Purchase Return Book undercast is now rectified)				
6.	Namita A/c	Dr		6,500	
	To Sumita A/c				6,000
	To Suspense A/c				500
	(Cash paid to Namita ₹ 6,500 was debited to Sumita by ₹ 6,000 the error is rectified)				

Rectification of Two Sided Errors

Error which affects two different accounts on the same sides or different sides is called two sided error.

Illustration 8

Furniture purchased from M/s Furniture House on 15th January, 2014 for ₹ 5000 was wrongly entered in the Purchases Book.

Solution

Accounts affected are Furniture A/c which is omitted to be debited and Purchase A/c which is wrongly debited.

Rectification through Journal Entry

Furniture A/c	Dr	5000	
To Purchases A/c			5000
(Furniture purchased wrongly entered in the Purchases Book now rectified)			

INTEXT QUESTIONS 12.4

Answer the following in one sentence :

i. When is Suspense A/c opened?

ii. When does Suspense A/c disappear?

iii. What are two sided errors?

iv. What type of errors are rectified through Suspense A/c?

WHAT YOU HAVE LEARNT

- Accounting errors are the errors committed by persons responsible for recording and maintaining accounts of a business firm in the course of accounting process.
- Errors can be in the form of omission of recording of transaction in various books or posting in ledger or mistake in totalling or recording wrong amount or in wrong account.
- There can be accounting errors which affect the agreement of trial balance and errors which do not affect the agreement of Trial Balance.
- On the basis of nature accounting errors can be

  (a) Errors of omission (b) Errors of commission

  (c) Errors of principle (d) Compensating errors.

Notes

- On the basis of impact on ledger accounts errors can be :

  (a) one sided errors (b) two sided errors

- Errors should never be rectified by erasing or overwriting.
- Methods of rectification of errors are

  (a) Before preparing trial balance, instant correction and correction in the affected account.

  (b) After preparing trial balance through passing a rectifying journal entry.

TERMINAL EXERCISE

1. State the meaning of Accounting Errors.
2. Explain the following types of errors with suitable examples:

   (a) Error of omission

   (b) Compensating errors

   (c) Error of principle
3. A businessman has prepared trial balance of his business firm that has agreed? He is satisfied that now there are no accounting errors. Do you agree with him? If not list the errors that do not affect the agreement of the trial balance.
4. When is a suspense Account opened? How are errors rectified through Suspense A/c?
5. Rectify the following errors :

   (i) Goods purchased on credit for ₹ 8,200 not recorded in the Purchases Book.

   (ii) Purchase Returns Book is overcast by ₹ 1,000.

   (iii) Salary of ₹ 3,200 paid to Gopal the accountant was debited to his personal account

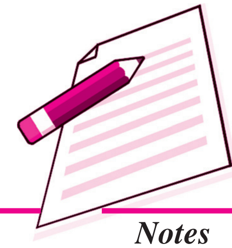
   (iv) Sales to Shakila of ₹ 2,400 was posted to her account

   (v) Cash received from Suresh ₹ 2,000 was not entered in the books.
6. Rectify the following errors :

   (i) Purchases Book is undercast by ₹ 1,500

   (ii) Sales Return Book is overcast by ₹ 1,000

   (iii) Sales Book is added short by ₹ 100



(iv) The total of Purchases journal of ₹ 7,580 has been posted to Purchases Account as ₹ 5,780

(v) The total of the page of Sales journal of ₹ 24,750 was carried to next page as ₹ 27,450

7. Pass necessary journal entries to rectify the following errors :

(i) Sale of an old machine for ₹ 4,500 was posted to Sales account

(ii) Rent of proprietors residence of ₹ 12,000 was posted to Rent Account.

(iii) A credit to Brij Mohan of ₹ 6,750 was posted to his account as ₹4,750

(iv) Furniture purchased from M/s Decorates for ₹ 22,500 was entered in the Purchases Book

(v) Salary paid to the accountant Sushil Gupta of ₹ 6,500 was debited to his personal Account.

8. The Book keeper of a firm found that his trial balance did not agree. Its credit total exceeded the debit total by ₹ 2,850. He placed the amount in Suspense A/c and subsequently found the following errors.

(i) A credit item of ₹ 3,490 has been debited to his personal Account as ₹ 4,390.

(ii) A sum of ₹ 2,650 written off as depreciation on machine has not been posted to Depreciation A/c.

(iii) Goods of ₹ 5,300 sold were returned by the customer and were taken into stock before closing the books but were not entered in the books.

(iv) ₹ 4,800 due from Lakhan Pal which had been written off as bad debt in a previous year was unexpected recorded and had been posted to the personal account of Lakhan Pal.

(v) Sales Book is undercast by ₹ 1,500.

(vi) ₹ 4,000 withdrawn for domestic use by the proprietor was debited to General Expenses A/c.

(vii) Machine Purchased from Machine Mart for ₹ 18,000 were entered in the Purchases Book.

(viii) Cash paid ₹ 1,200 to Lakshman was credited to Ram as ₹ 2,100.

ANSWERS TO INTEXT QUESTIONS

12.1 (i) No (ii) Yes (iii) Yes (iv) No

12.2 (i) Principle (ii) Principle
(iii) Commission (iv) Compensating Error

12.3 (i) No (ii) Yes (iii) Debit side

(iv) Wages A/c	Dr.	1200	
To Cash A/c			1200

12.4 (i) When trial Balance does not agree.
(ii) When errors responsible for suspense account are rectified.
(iii) Errors which affect two different accounts on same sides or different sides.
(iv) One sided errors.

ACTIVITY

Your father has appointed a person to maintain accounts of his business but he is not very competent due to which offen he commits accounting errors. Your father has asked you to look into the accounts and make a list of various errors he commits. Find out which type of errors he commits more frequently. Classify these errors and explain to him how not to make such errors in future.

13

COMPUTER AND COMPUTERISED ACCOUNTING SYSTEM

With the expansion of business the number of transactions increased. The manual method of keeping and maintaining records was found to be unmanageable. With the introducton of computers in business, the manual method of accounting is being gradually replaced. And finally, the database technology has revolutionised the accounts department of the business. organisations. In this lesson, we will study about characteristics of computer, role of computers in accounting, need of computerised accounting, etc.

OBJECTIVES

After studying this lesson, you will be able to:

- state the meaning and characteristics of computer;
- describe the components of Computer and limitations of computer;
- explain the role of computer in accounting;
- explain the meaning and features of computerised Account.
- differentiate between manual accounting and computerised accounting;
- explain the Accounting Information System;
- describe the basic requirements of computerised accounting and
- understand the sourcing of accounting system.

13.1 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

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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.

Characteristics of Computer

A Computer is better than human being. It possesses some characteristics. These 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 organisation, often it is the same computer that is used for diverse purposes such as accounting, playing games, preparing electric bills, sending e-mail 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 computer.

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 organisations,

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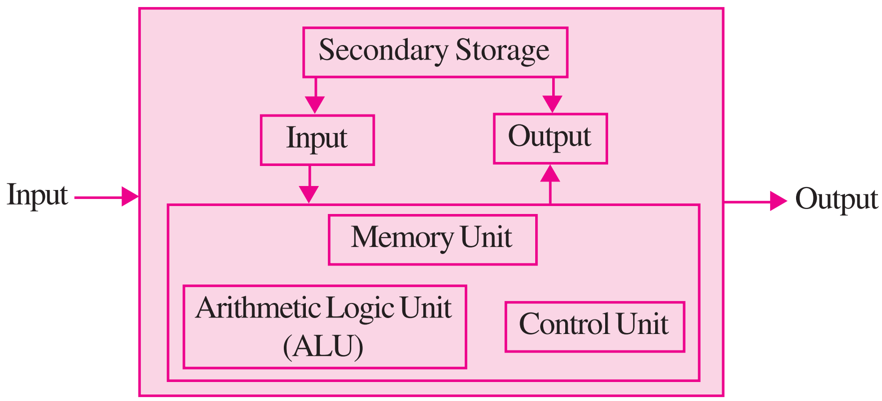
and today, their reach is so extensive that they are used almost everywhere. In the course of this evolution, they have become faster, smaller, cheaper, more reliable and user friendly.

13.2 COMPONENTS OF COMPUTER

A computer consists of the major components *i.e.,* Input Unit, Central Processing Unit and Output Unit. Diagrammatically, these components may be presented as follows:



Components of Computer

- **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. 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. Central Processing Unit is to computer as the brain is to human body. This is used to store program, photos, graphics, and data and obey the instructions in program. It is divided into three subunits :

  (a) ***Control Unit :*** Control unit controls and co-ordinates the activities of all the components of the computer. This unit accepts input data and converts it into computer binary system.

  (b) ***Memory Unit :*** This unit stores data before being actually processed. The data so stored is accessed and processed according to instructions which are also stored in the memory section of computer well before such data is transmitted to the memory from input devices.

(c) ***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 also called Visual Display Unit, printer etc.

INTEXT QUESTIONS 13.1

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.

13.3 LIMITATIONS OF A COMPUTER AND COMPURISED ACCOUNTING

The limitations of computer are depending upon the operating environment they work in. These limitations are given below as :

- **Cost of Installation :** Computer hardware and software needs 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 from time to time.
- **Cost of Training :** To ensure efficient use of computer in accounting, new versions of hardware and software are introduced. This requires training and cost is incurred to train the staff personnel.
- **Self Decision Making :** The computer cannot make a decision like human beings. It is to be guided by the user.
- **Maintenance :** Computer requires to be maintained properly to help maintain its efficiency. It requires a neat, clean and controlled temperature to work efficiently.

- **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.

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13.4 ROLE OF COMPUTERS IN ACCOUNTING

The most popular system of recording of accounting transactions 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 advanced technology involves various machines capable of performing different accounting functions, for example, a billing machine. 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 to number of growing successful organisations. A newer version of machine is evolved with increased speed, storage, and processing capacity. A computer to which they were connected operated these machines. As a result, the maintenance of accounting data on a real-time basis became almost essential. Now maintaining accounting records become more convenient with the computerised accounting.

The computerised accounting uses the concept of databases. For this purpose an accounting software is used to implement a computerised 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, etc.

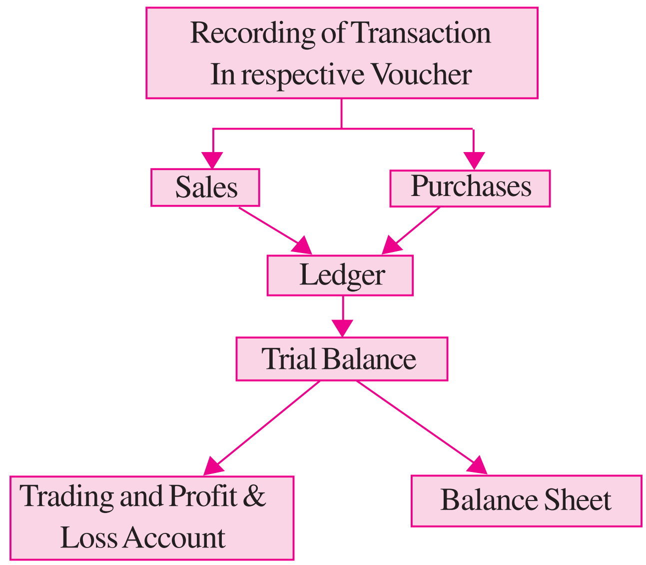
Accounting software is used to implement computerised accounting. The computerised accounting is based on the concept of database. It is basic software which allows access to the data contained in the data base. It is a system to manage collection of data ensuring at the same time that it remains reliable and confidential.

Following are the components of Computerised accounting software:

1. **Preparation of Accounting Documents :** Computer helps in preparing accounting documents like Cash Memo, Bills and invoices etc., and preparing accounting vouchers.

2. **Recording of Transactions :** Every day business transactions are recorded with the help of computer software. Logical scheme is implied for codification of account and transaction. Every account and transaction is assigned a unique code. The grouping of accounts is done from the first stage. This process simplifies the work of recording the transactions.

3. **Preparation of Trial Balance and Financial Statements :** After recording of transaction, the data is transferred into Ledger account automatically by the computer. Trial Balance is prepared by the computer to check accuracy of the records. With the help of trial balance the computer can be programmed to prepare Trading, Profit and Loss Account and Balance Sheet. These components can be shown as:



Components of Computerised Accounting Software

13.5 SALIENT FEATURES OF CAS

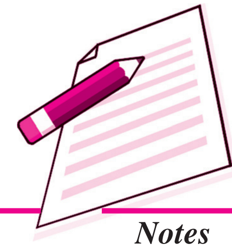
Following are the salient features requied for CAS software:

1. **Simple and Integrated :** CAS is designed to automate and integrate all the business operations, such as sales, finance, purchase, inventory and manufacturing. CAS is integrated to provide accurate, up-to-date business information rapidly. The CAS may be integrated with enhanced MIS (Management Information System), Multi-lingual and Data Organisation capabilities to simplify all the business processes of the organisation easily and cost-effectively.

2. **Transparency and Control :** CAS provides sufficient time to plan, increases data accessibility and enhances user satisfaction. With computerised accounting, the organisation will have greater transparency for day-to-day business operations and access to the vital information.

3. **Accuracy and Speed :** CAS provides user-definable templates (data entry screens or forms) for fast, accurate data entry of the transactions. It also helps in generalising desired documents and reports.

4. **Scalability :** CAS enables in changing the volume of data processing in tune with the change in the size of the business. The software can be used for any size of the business and type of the organisation.



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5. **Reliability :** CAS makes sure that the generalised critical financial information is accurate, controlled and secured.

6. **Performing various Functions with Accuracy :** Accounting software is used to perform the function of accounting. The software functions on the concept of database. As discussed above, accounting software eliminates the process of posting a transaction into the Ledger Account, that is, when a transaction is entered in the computer system, the posting in the Ledger Account is automatic. The software is so designed that a transaction, once entered, is automatically transported to the Ledger Account also. In the present times, a number of accounting packages are available off-the-shelf in the market. They do a variety of jobs, listed below, for the end users :

   i. Online Input and Storage of Accounting Data;

   ii. On Screen or Physical Output Generation;

   iii. Printout of Vouchers and Invoices;

   iv. Printout of Ledgers and other books of accounts;

   v. Updating of customer accounts in Sales Ledger and supplier accounts in Purchase Ledgers;

   vi. Recording of Suppliers Invoices;

   vii. Recording of Bank Receipts;

   viii. Making payments to supplier and for the expenses;

   ix. Writing Day Books and General Ledger;

   x. Maintenance of Stock Accounts;

   xi. Aged Debtor Summary (who owes what and since when);

   xii. Preparation of Trial Balance, Profit and Loss Accounts and Balance Sheet;

   xiii. Stock Valuations;

   xiv. Payroll Analysis; and

   xv. Statutory Returns, such as VAT and Service Tax.

13.6 GROUPING OF ACCOUNTS

The increase in the number of transaction changes the volume and size of the business. Therefore, it becomes necessary to have proper classification of data. The basic classifications of different accounts embodied in a transaction are resorted through accounting equation.

Accounting Equation

The modern accounting is based on double-entry system, which implies equality of assets and equities (liabilities and capital), i.e.

$$A = E$$

Where **E** = **L + C**

Now **A** = **L + C**

Where A = Assets

E = Equities

C = Capital

L = Liabilities

Thus, **Assets = Liabilities + Capital**

In this equation the *Liabilities* means claims on the firm by *creditors* and the *Capital* means claims of owners. The claims of owners keep on changing due to success (profit) or failure (loss) of the firm. This is reflected by the income statement, which provides the summary of income and expenses of business for a given accounting period. Keeping this in view, the above equation can be re-written as :

Assets = Liabilities + Capital + (Revenues - Expenses)

Each component of the above equation can be divided into group of accounts as follows:

> ***Revenue*** *means inflow of resources, which results from the sale of goods or services in the normal course of business and increase in capital. Expenses imply consumption of resources in generating revenues.*

- **ASSETS**
  - **Fixed Assets**
    - ➔ Land
    - ➔ Buildings
    - ➔ Plant and Machinery
    - ➔ Equipments
    - ➔ Furniture and Fixtures
    - ➔ Others

- **Current Assets**
  - Cash
  - Bank
  - Debtors
  - Inventories
  - Loans and Advances
- **CAPITAL**
  - **Share Capital**
  - **Reserve and Surplus**
    - Capital Reserve
    - General Reserve
    - Balance of Profit and Loss Account
- **LIABILITIES**
  - Secured Loans
  - Unsecured Loans
  - Creditors
  - Provisions
- **REVENUES**
  - Sales
  - Other Income
- **EXPENSES**
  - Material Consumed
  - Salary and Wages
  - Manufacturing Expenses
  - Depreciation
  - Administrative Expenses
  - Interest
  - Selling and Distribution Expenses

There is a hierarchical relationship between the groups and its components. In order to maintain the hierarchical relationships between a group and its sub-groups, proper codification is required to ensure neatness of classification.

Main Code	Sub-Code	Account Code	Main Head	Sub Head	Account Head
1			Assets		
	1			Fixed Assets	
		001			Land
		002			Buildings
		003			Plant and Machinery
		004			Electrical Installation
		005			Vehicles
		006			Furniture and Fixtures
		007			Computers

As an example, code for Land Account will be 11001. In the above codification. It has been considered that the enterprise is a single unit enterprise. If the enterprise has more than one unit, then a code may be given for the unit also. Codes may similarly be given for investments, current assets, etc., in the assets side.

Let us take an example of codification of liabilities, say Secured Loan:

Main Code	Sub-Code	Account Code	Main Head	Sub Head	Account Head
2			Liabilities		
	1			Secured Loan	
		001			State Bank of India
		002			Punjab Natonal Bank
		003			ICICI Bank Ltd.
		004			Axis Bank Ltd.

As an example, a transaction with State Bank of India will be given accounting code of 21001. For example, a cheque is deposited in State Bank of India and therefore, State Bank of India is to be debited. Account with code 21001 will be debited.

Same procedure is followed when codification is done for items of Trading, Profit and Loss Account.

Let us take an example of codification of Incomes Head, say Sales for a dealer in electronic goods:

Main Code	Sub-Code	Account Code	Main Head	Sub Head	Account Head
3			Income		
	1			Sales	
		001			Refrigerator Sale
		002			Air-Conditioner Sale
		003			Video Camera Sale
		004			Digital Camera Sale
		005			Plasma TV Sale
		006			TV Sale

As an example, a sale transaction of refrigerator will be given a code 31001.

Let us take an example of codification of Expense Head, say Administration and General Expenses:

Main Code	Sub-Code	Account Code	Main Head	Sub Head	Account Head
4			Expenses		
	6			Administration and General Expenses	
		001			Telephone Expenses
		002			Postage and Telegram
		003			Internet Expenses
		004			Newspaper and Periodicals
		005			Conveyance Expenses
		006			Travelling Expenses

As an example, an expense on telephone will be given a code 46001.

It is not necessary that codification be done using numerical number only it can be using alphabet as codes or even alphanumeric codes. For example, Assets sides may be given a code say 'A'. Fixed Assets may be given 'F' and individual assets accounts be given numeric codes as are given in the illustration. The code for Land Account in the above illustration will be 'AF001'.

Account if wrongly coded, will lead to errors of principle whereby an item of liability may be treated as income and vice versa. Similarly, an item of asset may be treated as expense and vice versa. The financial statements prepared without rectifying such errors will reveal incorrect financial results and position. Therefore, extreme caution needs to be exercised when grouping of accounts is done and also when the transaction is recorded using computers.

The process of 'Grouping of Accounts' is the basic or fundamental requirement for producing financial statements. The second stage of application of computers in accounting is to record individual transactions using the accounting software. But always bear in mind that accounting concepts shall always be followed.

Using Software of CAS

There are two basic activities in using software of CAS - One time activities and recurring activities. One time activities include creation of Organisation details, accounting year, type of ledger (also called "creation of master files"), et. While recurring activities include entry of transactions and generation of reports. The transactions are recorded on the basis of Cash Vouchers, Bank Vouchers, Purchase Vouchers, Sales Vouchers, Journal Vouchers, etc. Reports include generation of Day books, Ledger, Trial Balance, Profit and Loss Account, Balance Sheet, and Cash Flow Statement.

Security Features of CAS Software

Every accounting software ensures data security, safety and confidentiality. Therefore every, software provides the following:

- **Password Security :** Password is a mechanism, which enables a user to access a system including data. The system facilitates defining the user rights according to organisation policy. Consequently, a person in an organisation may be given access to a particular set of a data while he may be denied access to another set of data.

  Password *is the key (code) to allow the access to the system.*

- **Data Audit :** This feature enables one to know as to who and what changes have been made in the original data thereby helping and fixing the responsibility of the person who has manipulated the data and also ensures data integrity. Basically, this feature is similar to Audit Trial.

- **Data Vault :** Software provides additional security through data encryption.

> ***Encryption*** *essentially scrambles the information so as to make its interpretation extremely difficult (almost impossible). Thus,* ***Encryption*** *ensures security of data even if it lands in wrong hands, because the receiver of data will not be able to decode and interpret it.*

13.7 SOFTWARES OF COMPUTERISED ACCOUNTING SYSTEM

Computers, with the help of Application Software, perform the same functions that are carried out when accounting is done manually. Let us discuss these.

i. **Payroll Processing :** Payroll Procesing means preparation of salaries and wages, accounting along with the leave records, deduction of provident fund, ESI, etc. Leave records are part of payroll as salaries and wages are prepared taking into account the leaves taken. ESI and Provident Fund are statutory deductions out of salaries and wages and also contribution by the employers.

   Computer takes the data such as Employee's Name, Father's Name, Employee code, Basic Salary, Perquisites, Percentage of deduction for Provident Fund, ESI and advance, etc., from the Master Data and the number of days from the attendance record. It not only produces the salary and wages sheet timely but also accurately. The entry in the financial books of account is recorded from the payroll processing.

ii. **Transaction Recording :** Transactions are recorded using the utility or application software. Transaction recording under the computerised environment is not only accurate but is also less time consuming. It is so because two time consuming processes under the manual system namely posting of entries into ledger accounts and casting (totalling and balancing) are automated by the software. Software are designed in the manner that the process of posting and casting is carried out simultaneously with recording of transaction.

   A functional key is provided to record transactions relating to cash, purchase, sale and journal. It means that if cash transactions are to be recorded the functional key when operated will open the cash book.

iii. **Ledger :** The software is designed in such a manner that the transaction is posted to the ledger account and the ledger account is casted simultaneously with the recording of transaction. We had discussed in this chapter about grouping of accounts. Posting of transaction into ledger account is carried out as guided by the account code given to the transaction.

iv. **Trial Balance :** Posting of transaction into ledger account and also casting of ledger account is carried out simultaneously with the recording of transaction. It means that a trial balance can be extracted even after every transaction without any efforts.

v. **Financial Statements :** Financial Statements, *i.e.,* Trading, Profit and Loss Account and the Balance Sheet like extracting a trial balance can also be extracted after every transaction.

13.8 ADVANTAGES OF COMPUTERISED ACCOUNTING SYSTEM

A computerised accounting system has many advantages, as discussed below:

i. **Large Volume of Transactions :** In the present-day business environment, the transactions of a business are normally large in volume. The computerised accounting system can store and process such voluminous transactions with speed and accuracy.

ii. **Scalability :** A computerised accounting system is scalable to handle the growing transactions.

iii. **Security :** The accounting data under the computerised environment is safer than the accounting data under the manual system. The data can be kept secure by using a password, *i.e.,* allowing only authorised users to access the data.

iv. **Timely Reporting :** Availability of reports on time enables the management to take quick decisions, which is an important element for the success of an enterprise. A computerised accounting system makes these reports available as and when required.

v. **Lower Cost :** The cost of maintaining books of accounts under the computerised process is lower than in comparison to the manual process.

vi. **Less Paper Work :** Under the computerised process, there is less paper work as compared to the paper work in the manual process.

vii. **Flexible Reporting :** Reporting under the computerised process is flexible in comparison to the manual process. The database can be processed further to obtain the desired report. For example, data relating to debtors can be analysed to ascertain the list of customers to whom sales above Rs. 1,00,000 has been made in an accounting year or of the regular customers of the enterprises and so on.

viii. **Queries :** Replies to queries based on external factors can be obtained easily under a computerised process. For example, list of debtors who have not paid on time can be taken out by processing the database.

ix. **Accurate :** Computer statements are far more accurate in comparison to manual statements.

x. **Updating :** Updating and treatment of wrong transactions are easily done.

xi. **Financial Statements :** From the day book, the Voucher Posting software can manage the General Ledger, Trial Balance and Balance Sheet.

13.9 LIMITATIONS OF COMPUTERISED ACCOUNTING SYSTEM

However, computerised accounting suffers from the following limitations :

i. **Controls :** If adequate controls are not built and, where build, are not followed, it can lead to loss of data. It is important to take back-ups at regular intervals to avoid such a situation.

ii. **Data Corruption :** The data can get corrupted through viruses that may come in through the internet or the use of external input devices without scanning them for viruses.

iii. **Trained Computer Operators :** Untrained computer operators can lead to loss of data.

iv. **Limitations of Software :** The software is developed on the basis of the experiences of the team of developers. As such, it may not be able to deal with a specific problem that may arise.

13.10 ACCOUNTING INFORMATION SYSTEM (AIS)

Accounting Information System (AIS) and its various sub-systems may be implemented through Computerised Accounting System. The subsystems of AIS are briefly described:

i. **Cash and Bank Sub-System :** It deals with the receipt and payment of cash both physical cash and electronic fund transfer. Electronic fund transfer takes place without having the physical entry or exit of cash by using the credit cards or electronic banking.

ii. **Sales and Accounts Receivable Sub-system :** It deals with recording of sales, maintaining of sales ledger and receivables. It generates periodic reports about sales, collections made overdue accounts and receivables position as also ageing schedule or receivables/debtors.

iii. **Inventory Sub-system :** It deals with the recording of different items purchased and issued specifying the price, quantity and date. It generates the inventory position and valuation report.

iv. **Purchase and Accounts Payable Sub-system :** It deals with the purchase and payments to creditors. It provides for ordering of goods, sorting of purchase expenses and payment to the creditors. It also generates periodic reports about the performance of suppliers, payment schedule and position of the creditors.

v. **Payroll Accounting Sub-system :** It deals with payment of wages and salary to employees. A typical wage report details information about basic pay, dearness allowance, and other allowances and deductions from salary and wages on account of provident fund, taxes, loans, advances and other charges. The system generates reports about wage bill, overtime payment and payment on account of leave encashment, etc.

vi. **Fixed Assets Accounting Sub-system :** It deals with the recording of purchases, additions, deletions, usage of fixed assets such as land and buildings, machinery and equipments, etc. it also generates reports about the cost, depreciation, and book value of different assets.

vii. **Expense Accounting Sub-system :** This sub-system records expenses under broad groups such as manufacturing administrative, financial, selling and distributions and others.

viii. **Tax Accounting Sub-system :** This sub-system deals with compliance requirement value-added tax (VAT), excise, customs and income tax. This sub-system is used in large size organisation.

ix. **Final Accounts Sub-system :** This subsystem deals with the preparation of Profit and Loss accounts, Balance Sheet and cash flow statements for reporting purposes.

x. **Costing Sub-system :** It deals with the ascertainment of cost of goods produced. It has linkages with other accounting sub-systems for obtaining the necessary information about cost of material, labour, and other expenses. This system generates information about changes in the cost that takes place during the period under review.

xi. **Budget Sub-system :** It deals with the preparation of budget for the coming financial year as well as comparison with the current budget of the actual performances.

xii. **Management Information System :** Management Information System (MIS) deals with generation and processing of reports that are vital for management decision-making. The Information system should be so flexible as to provide

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customised reports to support various managerial functions such as planning, organising, staffing, oversight, control and decision-making including operational, functional and strategic nature.

On the basis of the discussions, these are the following differences between manual accounting and computerised accounting.

13.11 COMPARISON OF THE MANUAL AND COMPUTERISED ACCOUNTING SYSTEMS

Accounting is a process of identifying, recording, classifying and summarising financial transactions to produce financial statements. Let us discuss the processes of under the two accounting processes, *i.e.*, manual process and computerised process, for the purpose of comparison.

- **Identifying Financial Transactions :** Identifying Financial Transactions and recording them in the books of accounts by applying the principle of accounting is a manual process carried out by an authorised person or on the basis of the accounting manual. This process is, thus, common under both the processes.
- **Recording :** The process of Recording transaction in the books of original entry, posting them in the ledger accounts, performing mathematical functions, *i.e.,* adding, subtraction and totalling, are carried out manually under the manual process. In the computerised process, transactions are recorded in the books of accounts and the remaining functions are performed without any further process or command being carried out manually.
- **Classification :** In the manual process, the transactions are recorded in the book of original entry and are posted into the ledger accounts. It means that, after recording the transaction, another process of posting process is carried out by internal sorting of data, *i.e.,* with the help of utility or application software, without any further process.
- **Summarising :** In the manual system of accounting, the data under each Ledger is summarised and a balance of each account is ascertained to prepare a Trial Balance. As a result, preparing ledger accounts is essential to prepare a Trial Balance. In the computerised process, a transaction or event, once recorded, is stored in the database and can be processed to produce a Trial Balance directly.
- **Adjustments Entries :** Adjustment Entries are passed to rectify an error or to follow the matching concept of accounting, *i.e.,* matching the cost with revenue, The process of passing adjustment entries can be equated with the recording process. These entries are identified and recorded in the books of accounts. The remaining process is the same as discussed above.

- **Grouping of Accounts :** One of the basics of correct accounting is determining whether a transaction is capital or revenue in nature and, accordingly, which account head is to be debited or credited. Once this decision is taken, the account is grouped as an asset, a liability, an income or an expense at the time of preparing the financial statements. The above process is followed when the manual system of accounting is adopted. However, in computerised accounting, whether an account head is an asset, a liability, an income or an expense, is decided at the time the transaction takes place, as in the case of manual accounting. It is also defined whether the particular head of account shall be shown as an asset or liability, or an income or expense.

- **Financial Statements :** In the manual process, availability of the Trial Balance is essential to prepare the Financial Statements. In the computerised process, financial statements are generated from the system itself and, hence, there is no need to have a Trial Balance.

Difference between Manual Accounting and Computerised Accounting

Point of Difference	*Manual Accounting*	*Computerised 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.
2. Classification	Transactions recorded in the books of original entry are further classified by posting them into ledger accounts. This results in transaction data duplicity.	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 summarised to produce trial balance by ascertaining the balances of various accounts.	The generation of ledger accounts is not necessary condition for trial balance.
4. Adjusting entries	Adjusting entries are made to adhere the principle of matching.	There is nothing like making adjusting entries for errors and rectifications.
5. Financial statements	The preparation of financial statements assumes the availability of trial balance.	The preparation of financial statements is independent of producing the trial balance.

13.12 ACCOUNTING SOFTWARES

Accounting Software can be categorised into :

1. **Readymade Software :** Readymade Softwares are the softwares that are developed not for any specific user but for the users in general. Since, the readymade softwares are for general user, it is not necessary that all the modules of such softwares are of use for every user. It is likely that a particular module say 'Payroll' may not be used because the enterprise has very few employees. Similarly, a service enterprise will not require VAT module while a retail enterprise will not require Service Tax module. Some of the Readymade Software available are Tally, Ex, Busy and Professional Accountant. Out of these, Tally is very widely used.

   Readymade Software has its own advantages and disadvantages. *The advantages are :*

   i. **Readymade Softwares are economical :** Readymade Software are prepared not for particular user but for the user in general. It means development cost of the software is not loaded on a single software for determining the cost and thus selling price. The price of the software is determined on the basis of number of pieces expected to be sold. On the other hand, user specific softwares are expensive as the development cost is loaded on one software.

   ii. **Readymade Software are Available off-the-shelf :** It therefore, saves time that may be required for development of tailor-made softwares or for customisation. Development of a software consumes considerable time both at the user end and software development end. User will have to explain its requirements to software developer who on the basis of his understanding will develop software, test it with a dummy data, debug the software to the best of his understanding before handing it to the user. All these activities consume time. On the other hand, Readymade Software requires only installation and are ready for use.

   iii. **Readymade Software are Development by a Group of Experienced Professionals :** It therefore, addresses the problem that may get overlooked if the user specific software is developed.

   iv. **Software Like Any Other Product, Requires Maintenance :** Readymade Softwares being sold to a number of users, has better and economical after sales maintenance service. After sales maintenance service, in the case of user specific softwares will not only be expensive but time consuming as well.

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v. **Readymade Softwares are Used by a Number of Users :** Therefore, trained accounting persons are easily available. On the other hand, in the case of tailormade softwares, every time a new person is recruited, training will have to be imported.

The disadvantages of Readymade Softwares are :

i. Readymade Softwares are Window-based softwares, which support only Laserjet printers for-outputs in physical form (printout). Printing by laserjet printers is more expensive than Dot-Matrix printers.

ii. Normally, Readymade Softwares do not have the facility of secondary back-up. It means, in case of data loss, the entire data may not be recovered. But, this limitation can be overcome by taking regular back-up of accounting data.

2. **Customised Software :** The term Customised Software means making changes in the readymade software to suit the specific requirements of the user, *i.e.,* making it user-specific. The software available off-the-shelf is modified to suit the requirements of the user. For example, the design of the invoice is changed to specifications of the user. The developer, to meet specific user requirements, can modify all the readymade softwares. However, the user has to bear the cost of such changes. The advantages and disadvantages of readymade software are also the advantages of Customised Software.

3. **Tailor-made Software :** The term Tailor-made Software refers to designing and developing user-specific software. These softwares, being user-specific, are not available off-the-shelf but are developed to meet the requirement of the user on the basis of discussion between the user and developers.

Advantages of Tailor-made Software are :

i. It, being user specific, takes care of the accounting reports and MIS that may be required by the user and the management of the enterprise.

ii. The software being tailor-made, the enterprise may have to engage a software engineer to maintain it. In other words, the problem faced can be countered immediately.

iii. Well-trained users use the softwares and, therefore, they can maximise software utilization.

Disadvantages of Tailor-made Software are :

i. The development cost of the software is much higher than the cost of readymade or customised software.

ii. In case the accounting person leaves the job, it takes some time before the new person becomes fully conversant with the software.

iii. Development and maintenance costs are higher than in the case of readymade or customised software.

13.13 FACTORS AFFECTING THE DECISION OF SELECTION AN ACCOUNTING SOFTWARE

It is essential to consider some factors before Sourcing an Accounting Software, *i.e.,*

i. **Flexibility :** A computerized accounting system must be flexible in respect of data entry, retrieval of data and generating designs of report. The user should be able to run the software on a variety of computer environments and machines, that is, on any configuration of computers and available operating systems.

ii. **Cost of Installation and Maintenance :** It is a must to consider that the cost of the accounting software, its relevant hardware and the maintenance, cost of addition of dodules, training of staff, updating of versions and data recovery in case of data failure are negotiable and within the ability of the organization to afford it.

iii. **Size of Organization :** An accounting system must be according to the size of the organization, *i.e.,* volume of business transactions, multi-user requirements.

iv. **Ease of Adaptation and Training Needs :** Some accounting softwares are user-friendly and require a simple training to the users. However, some other complex software packages, linked to other information systems, require intensive training on a continuous basis. The software must be capable of attracting users.

v. **Expected Level of Secrecy (Software and Data) :** Security features of an accounting system software are also important. Software should ensure that it prevents unauthorized access and manipulation of data. In tailored software, the user rights may be restricted according to the departments and their relevant accounting software functions.

vi. **Exporting/Importing Data Facility :** The software should allow easy data transfer option for flexible reporting, such as transfer of information directly from the ledger into the spreadsheet software like Lotus or Excel.

13.14 COMPUTERISED ACCOUNTING

Transaction processing system (TPS) is the first stage of computerised accounting system. The purpose of any TPS is to record, process, validate and store transactions that occur in various functional areas of a business for subsequent retrieval and 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 computerised 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 AutomatedTeller Machine (ATM) facility by a Bank-Customer.

1. **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 computerised personal banking system.

2. **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 norm 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.

3. **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.

4. **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.

5. **Information :** The stored data is processed making use of the Query facility to produce desired information.

6. **Reporting :** Reports can be prepared on the basis of the required information content according to the decision usefulness of the report.

INTEXT QUESTIONS 13.2

Fill in the blanks with correct word/words :

i. Computer hardware and .... need to be updated from time to time.

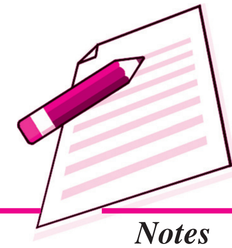
ii. The .... cannot make a decision itself like human beings.

iii. .... requires a neat, clean and controlled temperature to work efficiently.

iv. The most popular system of recording of accounting transactions is ....

v. The computerised accounting uses the concept of ....

vi. Accounting .... is used to implement a computerised accounting.



Notes

13.15 NEED AND REQUIREMENTS OF COMPUTERSIED ACCOUNTING

The need for computerised accounting arises from advantages of speed, accuracy and lower cost of handling the business transactions.

- **Numerous Transactions :** The computerised accounting system is capable of handling large number of transactions with speed and accuracy.
- **Instant Reporting :** The computerised accounting system is capable of offering quick and quality reporting because of its speed and accuracy.
- **Reduction in Paper Work :** A manual accounting system requires large physical storage space to keep accounting records/books and vouchers/ documents. The requirement of stationery and books of accounts along with vouchers and documents is directly dependent on the volume of transactions beyond a certain point. There is a dire need to reduce the paper work and dispense with large volumes of books of accounts. This can be achieved by introducing computerised accounting system.
- **Flexible Reporting :** The reporting is flexible in computerised accounting system as compared to manual accounting system. The reports of a manual accounting system reveal balances of accounts on periodic basis while computerised accounting system is capable of generating reports of any balance as when required and for any duration which is within the accounting period.
- **Accounting Queries :** There are accounting queries which are based on some external parameters. For example, a query to identify customers who have not made the payments within the permissible credit period can be easily answered by using the structured query language (SQL) support of database technology in the computerised accounting system. But such an exercise in a manual accounting system is quite difficult and expensive in terms of manpower used. It will still be worse in case the credit period is changed.
- **On-line Facility :** Computerised accounting system offers online facility to store and process transaction data so as to retrieve information to generate and view financial reports.

- **Scalability :** Computerised accounting system are fully equipped with handling the growing transactions of a fast growing business enterprise. The requirement of additional manpower in Accounts department is restricted to only the data operators for storing additional vouchers. There is absolutely no additional cost of processing additional transaction data.

- **Accuracy :** The information content of reports generated by the computerised 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 it is being processed by many people, especially when the number of transactions to be processed to produce such information and report is quite large.

- **Security :** Under manual accounting system it is very difficult to secure such information because it is open to inspection by any eyes dealing with the books of accounts. However, in computerised accounting system only the authorised users are permitted to have access to accounting data. Security provided by the computerised accounting system is far superior compared to any security offered by the manual accounting system.

Basic Requirements of the Computerised Accounting System

The basic requirements of any computerised accounting system are the followings:

- **Accounting Framework :** It is the application environment of the computerised accounting system. A healthy accounting framework in terms of accounting principles, coding and grouping structure is a pre-condition for any computerised accounting system.

- **Operating Procedure :** A well-conceived and designed operating procedure blended with suitable operating environment of the enterprise is necessary to work with the computerised accounting system.

The computerised 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. Therefore, the fundamentals of computerised accounting include all the basic requirements of any database-oriented application in computers.

INTEXT QUESTIONS 13.3

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 computerised accounting system.

iii. The computerised accounting system is capable of handling .... of transactions.

iv. The .... accounting system is capable of offering quick and quality reporting.

v. Computerised accounting system offers .... facility to store transaction data.

vi. Computerised accounting system is .... to the manual accounting system.

vii. The computerised accounting is one of the .... oriented applications

II. Give any two advantages & two limitations of Computerised Accounting System.

III. Define Management Information System.

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
    - Control unit
    - Memory unit
    - Arithmetic and logic unit
  - Output unit

- **Limitations of a Computer**
  - Cost of Installation
  - Cost of Training
  - Self-Decision Making
  - Maintenance
  - Dangers for Health

- Salient features of CAS simple & Integrated Transparency and Control Accuracy & Speed Scalability Reliability.
- Accounting Equation is A = L + C
- **Computerised Accounting :** Transaction Processing System (TPS) is the first stage of computerised accounting system.
- **Need for Computerised Accounting**
  - Numerous transactions
  - Instant reporting
  - Reduction in paper work
  - Flexible reporting
  - Online facility
  - Accuracy
  - Security
- Advantages of CAS include speed, efficiency, arithmetic accuracy, cost saving, confidentiality of data.
- Limitation of CAS include provision for (a) fast obsolescence of technology, (b) data loss due to either power interruption or damage to hard disk, (c) virus and other security hazards.
- Accounting Information System is an integration of various sub-systems such as : (i) cash sub-system, (ii) sales and accounts receivable sub-system, (iii) inventory sub-system, (iv) purchase and accounts payable sub-system, (v) payroll accounting sub-system, (vi) fixed asset accounting sub-system, (vii) expense accounting sub-system, (viii) tax accounting sub-system, (ix) final accounts sub-system, (x) costing sub-system, (xi) budget sub-system, (xii) management information sub-system.
- Difference between manual accounting and computerised accounting
  - Recording
  - Classification
  - Summarising
  - Adjusting entries
  - Financial statement

TERMINAL EXERCISE

1. State the meaning and characteristics of Computer.
2. Explain the components of computer.
3. Explain the limitations of a Computer.
4. Explain the role of Computers in Accounting.
5. Differentiate between Manual accounting and Computerised accounting system.
6. Enumerate the basic requirements of any computerised accounting system.

7. Explain the components of Computerised Accounting Software.
8. Describe the salient features of Computerised Accounting Software.
9. How does Computerised Accounting Software ensures data security, safety and confidentiality ? Explain.
10. Explain in brief various softwares of Computerised Accounting Software.
11. Describe any six sub systems of Accounting Informations Systems.

ANSWERS TO INTEXT QUESTIONS

13.1 (i) processing (ii) electrical (iii) tiredness

(iv) communication (v) mouse (vi) brain (vii) monitor

13.2 (i) software (ii) computer (iii) computer

(iv) manual (v) databases (vi) software

13.3 I. (i) original entry (ii) trial balance (iii) large number

(iv) computerised (v) online (vi) superior

(vii) database

II. a) Limitations of Computer : High cost of installation, High cost of training, Dangers for Health.

b) Components of Computerised Accountancy System : Recording of transactions, Preparation of Trial Balance & Financial statement.

c) 1. Accuracy & Speed 2. Scalability 3. Reliability

d)

Fixed Asset	(i) Land	(ii) Building
Current Asset	(i) Cash	(ii) Debtors
Revenue & surplus	(i) Sales	(ii) Other Incomes

APPENDIX-B

QUESTION PAPER DESIGN
Class : Senior Secondary

Subject : Accountancy

Time : 3 Hours *Marks : 100*

1. Weightage by Objectives

Objective	*K*	*U*	*A*	*Total*
Percentage of marks	20%	30%	50%	100%

2. Weightage to form questions

Total no. of questions 27 (core – 22 + optional – 5) for 100 marks paper

Form of questions	*VLA*	*LA*	*SA2*	*SA1*	*MCQ*
	10	6	5	3	1

3. Distribution of marks

100 marks paper	*CORE MODULES*	*OPTIONAL MODULE*
	$1 \times 9 = 09$	$1 \times 1 = 01$
	$3 \times 3 = 09$	$3 \times 1 = 03$
	$5 \times 6 = 30$	$5 \times 2 = 10$
	$6 \times 2 = 12$	$6 \times 1 = 06$
	$10 \times 2 = 20$	
	22 80	5 20

4. Time allocation

Total time	*180 minutes*
LA2 (10 marks)	30 minutes
LA1 (6 marks)	30 minutes
SA2 (5 marks)	60 minutes
SA1 (3 marks)	35 minutes
MCQ (1 marks)	15 minutes
Reading & revision	10 minutes
	180

5. Weightage by Content

Weightage allocated to each module in curriculum.

	Core Modules	
I	Basic Accounting	10
II.	Trial Balance and Computers	10
III.	Financial Statements	20
IV.	Partnership Accounts	20
V.	Company Accounts	20
		80
	Total Marks	**100**

	Optional Modules	
VI.	Analysis of Financial Statements	20
VII.	Application of Computers in Financial Accounting	20

CURRICULUM IN ACCOUNTANCY

(320)

RATIONALE

The last decade has witnessed tremendous changes in business education. The liberalisation and globalisation have been the primary cause for such changes. With the fast changing economic scenario, the elementary business education along with Accountancy 'as a language of business' is gaining its importance. The curriculum in Accountancy provides a firm foundation in basic accounting concepts and also keeps them informed of changes in its methodology concerning particular aspects of the subject.

The thrust of the course follows new trends in accounting practices and developing a basic understanding of the nature and purpose of the accounting information and reporting. Further, information technology has occupied a vital place in business activities. Therefore, a lesson designed on computer and computerised accounting shall expose the learners to the basic knowledge about the utility of computers in the business world. The course in Accountancy will prepare learners to logically analyse, evaluate and respond to changes which affect business operations. It opens the doors for higher education as well as sharpens the skills for those who are going for self-employment.

COURSE OBJECTIVES

This course aims at enabling the learners to:

- familiarise towards the usage of basic accounting terminology;
- develop the skills of recording of business transactions and preparation of the financial statements and their analysis thereof;
- provide firm base for higher education;
- inculcate values and ethics of accounting system;
- make aware about the utility of computers in the business world;
- join professional courses in Accounting.

COURSE STRUCTURE

S.No.	*Modules*	*Study hours*	*Marks*
	Core Modules		
1.	Basic Accounting	25	10
2.	Trial Balance and Computers	25	10
3.	Financial Statements	50	20
4.	Partnership Accounts	50	20
5.	Company Accounts	50	20
	Sub total	**200**	**80**
	Optional Module		
6.	Analysis of Financial Statements	50	20
	or	or	or
7.	Application of Computers in Financial Accounting	50	20
	Grand Total	**250**	**100**

Note : The learner will prepare Tutor Marked Assignment in module 1 & 2 for 20 marks and TMA will have 20 percent weightage. 80 percent weightage will be for Module 3 to 7 and will be of 100 marks and for a duration of 3 hours.

COURSE DESCRIPTION

PART - A

MODULE 1 : BASIC ACCOUNTING

25 Hrs. **10 Marks**

Approach

Accounting is the language of business. It helps the busines not only in finding out profits/losses for a period and its financial position on a particular date but also helps in management of business. It has its own well designed and established principles which are guided by some concepts and conventions Accounting is recording of transactions in a systematic manner in various types of books and their posting to a master book called ledger.

This module has been designed to introduce accounting to the learners. This familiarises the learners with some basic accounting terms, accounting concepts conventions and standards. This enables them to prepare Journal, Cash Book and Special Purpose Books and their posting to Ledger.

1.1 Accounting - An Introduction

- Accounting : Meaning, Objectives, Types of accounting information, advantages and limitations. Users of Accounting information and their needs. Double Entry system. Basis of accounting-Cash basis, accrual basis and hybrid basis.
- Basic Accounting Terms: Business transaction, Event, Account, Capital, Drawings, Liability : Internal & External, Long term & Short term, Asset (Intangible & Tangible, Fixed Current, Liquid, Fictitious) Receipts (Capital & Revenue), Expenditure (Capital, Revenue & Deferred Revenue), Expense, Income, Profits, Losses, Purchases, Sales, Stock, Debtors,Bills Receivables, Creditors, Bills Payables, Goods, Cost, Vouchers, Discount (Trade, Cash, Received & Allowed).

1.2 Accounting Concepts

- Fundamental Accounting Assumptions: Going concern, Consistency, Accrual.
- Accounting Principles: Accounting Entity, Money Measurement, Accounting Period, Full Disclosure, Materiality, Prudence, Cost Concept, and Dual Aspect.

1.3 Accounting Conventions and Standards

- Accounting conventions : consistency, Full Disclosure, Materiality, Conservatism.
- Accounting Standards: Concept & objective

1.4 Accounting for Business Transactions

- Accounting Equation: Meaning, Analysis of transactions using Accounting Equation.
- Rules of Debit and Credit: For Assets, Liabilities, Capital Revenue and Expenses.
- Origin of transaction-Source Documents (Invoice, Cash memo, Pay in slip, Cheque), Preparation of Vouchers-cash (Debit & Credit), Non Cash (Transfer).

1.5 Journal

- Journalising the simple and compound transactions, classification of journal into special journal & journal proper.
- Books of Original Entry : Meaning, Format and Process of Journalising

1.6 Ledger

- Meaning, Utility, Format, Posting from Journal into ledger.

1.7 Cash book

- Simple, Cash book with Bank Column, Petty Cash Book.

1.8 Special Purpose Books

- Purchases Book , Sales Book, Purchases Returns Book, Sales Returns Book, Bills Receivable Book, Bills Payable Book and Journal Proper, with formats & recording of transactions.

MODULE 2 : TRIAL BALANCE AND COMPUTERS

25 Hrs. **10 Marks**

Approach

Our important element of accounting process is summarising for which ledger accounts are prepared which are finally balanced and are shown in the form of a statement called trial balance. Businessman want to know the correct bank balance on a particular date for which bank reconciliation statement is prepared. Business is mostly on credit which means involvement of more capital, solution lies in the use of credit instruments like Bills of Exchange. Knowledge of their accounting is thus very important.

Accounting is another name of accuracy but then to err is human and there can be accounting errors. Knowledge of their rectification, necessary so as to enable achieving the aim of presenting correct, true and fair view of business.

Growing use of computer has actually revolutionalised the accounting of business transactions and computers are fast replacing the mannual accounting. True knowledge of computerised accounting has become our cherished goal.

This module has been designed to prepare trial balance and detect accounting errors and their rectifications. The learner will also know the meaning and purpose of preparing Bank Reconcilation statement and its preparation. It contains accounting of bills of exchange. This will also expose the learner to the utility of computers in accounting.

2.1 Trial balance

- Meaning, Objectives and Preparation

2.2 Bank Reconciliatation Statement

- Meaning, Objectives, Causes of differences between Cash Book and Balances as per Pass Book/Bank Statement and Methods of Preparing Bank Reconciliatation Statement.

2.3 Bills of Exchange

- Bills of Exchange and Promissory Note: Definition, Feature, Parties, Specimen and Distinction.
- Important Terms: Term of Bill, Due date, Days of Grace, Date of Maturity, Bill at Sight, Bill after Date, Discounting of Bill, Endorsement of Bill, Bill Sent for Collection, Dishonour of Bill, Noting of Bill, Insolvency of Acceptor, Retirement and Renewal of a bill, Accounting Treatment of bill transactions.

2.4 Errors and Their Rectification

- Errors and their types: Errors not affecting trial balance and Errors affecting trial balance.
- Rectification of errors before and after the preparation of financial statements.
- Suspense account: Meaning, preparation and treatment of suspense account balance in final statements.

2.5 Computers and Computerised Accounting System

- Introduction to Computer Accounting System: Components of CAS, Features, Grouping of Accounts, Using Software of CAS, Advantages & Limitations CAS, Accounting Information System.
- Application of computers in Accounting – Automation of accounting process, designing

accounting reports, data exchange with other information systems.

- Comparison of accounting processes, manual and computerized accounting highlighting advantages and limitations of automation.
- Sourcing of accounting system: Readymade, customized, tailor-made accounting system. Advantages and Disadvantages of each option.

MODULE 3 : FINANCILA STATEMENTS

50 Hrs. **20 Marks**

Approach

One of the basic functions of preparing accounts is to know the financial results of business for a particular period which is generally one year and ascertaining financial position on a particular date. For this financial statements are prepared called income statement and position statement. These are called Final accounts. Small business enterprises generally donot follow double entry system hence the method of accounting followed by them is called single entry system. Their method of preparing final accounts (financial statements) is different from business entities whose accounts are based on double entry system. They prepare trading and profit & loss account to know the performance results of business and Balance Sheet to know the net capital employed in business.

Not for profit organisations like clubs, hospitals, schools etc too prepare final accounts such as Income and Expenditure account to know the result of these activities in the form of surplus or deficit and Balance Sheet to ascertain the financial position. While preparing financial statements some adjustments are required to be made. Prominent among them are depreciation-position of the value of fixed asset to be appropriated to are accounting year and provision and reserves - position of profits to be appropriated to provisions for some expected expenses and losses and regime to meet contingencies. Thus this module is so designed that it trains the learners how to prepare final accounts from incomplete records, of business entities following double entry system and of not for profit organisations. It exposes the learners to the concepts of depreciation, provisions and reserves.

3.1 Depreciation

- Depreciation: Meaning, Need and Factors affecting depreciation.
- Methods of computation of Depreciation: Straight Line Method, Written Down Value Method (Excluding Change in method)
- Accounting Treatment of Depreciation: By charging to asset account, by creating Provision for depreciation/accumulated depreciation account, Preparation of Asset Disposal Account.

3.2 Provision and Reserves

- Meaning, Objective and Difference between Provisions and Reserves.
- Types of Reserves: Revenue Reserve, Capital Reserve, General Reserve, Specific reserves, Secret reserves.

3.3 Financial Statement - An Introduction

- Financial Statements: Meaning, Objective and Importance.
- Trading and Profit and Loss account: Gross Profit, Operating Profit and Net Profit.
- Balance Sheet

3.4 Financial Statements - I

- Preparing Trading Account and Profit & Loss Account
- Balance Sheet: Need, Grouping, Marshalling of Assets and Liabilities.

3.5 Financial Statements - II

- Adjustments in Preparation of Financial Statements: With respect to closing stock, outstanding expenses, prepaid expenses, accrued income, income received in advance, depreciation, Bad debts, provision for doubtful debts, provision for discount on debtors, manager's commission, abnormal loss, goods taken for personal use, goods distributed as free Sample.
- Preparation of Trading and Profit and Loss Account and Balance Sheet of Sole Proprietorship Concerns.

3.6 Not for Profit Organisations - An Introduction

- Not For Profit Organisations: Concept.
- Receipts and Payment Account: Meaning and Features.
- Balance Sheet: Meaning and Features
- Income and Expenditure Account: Meaning and Features, Preparation of Income and Expenditure Account and Balance Sheet from the given Receipt and payment Account with additional information.

3.7 Accounts From Incomplete Records

- **Incomplete Records:** Meaning, Uses and Limitations.
- Ascertainment of Profit/Loss by Statement of Affairs Method.
- Preparation of Trading and Profit and Loss Account and Balance Sheet (with reference to missing figures in total debtors account, total creditors account, Bills Receivable A/C, Bills Payable A/C, Cash Book and Opening Statement of Affairs).

MODULE 4 : PARTNERSHIP ACCOUNTS

50 Hrs. **20 Marks**

Approach

You are well aware that one important form of organisation which is widely practiced in our country is 'partnership'. While the learner should know the meaning, and features of partnership. They should also know about the partnership deed and its provisions affecting accounting a partnership firm such as calculating interest on drawings and capitals, preparing capital accounts of partners when their capitals are fixed and when these are fluctuating. When ever there is reconstitution of a partnership firm due to admission of a partner, retirement of a partner, death of a partner, the effect of this is to be reflected in accounts in the form of goodwill, revaluation of assets and liabilities and adjustment of partners capitals. If a firm is dissolved that too requires special accounting treatment.

This module has been so designed that the learner will be able to understand the meaning of partnership and partnership deed, accounting treatment of certain items if there is no provision in partnership deed such as partners salary, profit sharing ratio etc. The learner will know the accounting procedure regarding admission, retirement, and death of a partner and dissolution of the partnership firm.

4.1 Partnership - An Introduction

- Meaning: Partnership, Partners, Firm, Partnership Deed.
- Provisions of The Indian Partnership Act 1932 affecting Accounts in the absence of Partnership Deed.
- Fixed v/s Fluctuating Capital Accounts, Division of Profit among partners, Guarantee of profits, Past adjustments (Relating to interest on capital, interest on drawing, salary and Profit sharing Ratio), Preparation of P & L Appropriation Account.

- Goodwill: Nature, Factors affecting and Methods of valuation – Average profit, super profit, and capitalization.

4.2 Admission of a Partners

- Change in the Profit Sharing Ratio among the existing partners – sacrificing ratio, Gaining Ratio, Accounting for Revaluation of Assets and Re-assessment of Liabilities and Distribution of Reserves and Accumulated profits.
- Admission of a Partner-Effect of admission of a Partner on: change in the Profit Sharing Ratio, Treatment of goodwill (As per AS 26), treatment for Revaluation of Assets and Re-assessment of Liabilities, Treatment of Reserves and Accumulated profits, Adjustment of Capital Account and Preparation of Balance Sheet.

4.3 Retirement and Death of a Partner

- Effect of Retirement/Death of a partner – change in Profit Sharing Ratio, Treatment of goodwill, treatment for Revaluation of Assets and Re-assessment of Liabilities, Adjustment of Accumulated Profit and Reserves. Calculation of deceased partner's share of profit till the date of death. Preparation of Deceased partner's Executor's account and Preparation of Balance Sheet.

4.4 Dissolution of Partnership Firm

- Meaning and Types of Dissolution of firm. Settlement of accounts –Preparation of Realization account, and related accounts as Capital, Cash & Bank (excluding piecemeal distribution, sale to a company and insolvency of partners).

MODULE 5 : COMPANY ACCOUNTS

50 Hrs. **20 Marks**

Approach

While sole proprietorship and partnership are the old forms of organisations, to meet the organisational needs of the modern day business run on large scale requiring huge amount of capital, joint stock company form of organisation was designed. The most important methods of raising finance by a company are issue of shares, and debentures. The present module of the Company Accounts explain about the company with its brief introduction and how the company issues shares to raise capital from capital market and in case the shareholders failed to pay calls on due date the company forfeit those shares & reissue them again an another date. It also explains about the issue of debentures by company and its entries in the books of accounts.

5.1 Company - An Introduction

- Meaning of company form of business organisation, characteristics of company, types of companies, difference between public & private company, various types of shares issued by company with the type of share capital.

5.2 Issue of Shares

- Meaning, Nature and Types
- Accounting for Share Capital: Issue and Allotment of Equity shares, Private placement of Shares. Public Subscription of shares-over subscription and Under subscription of shares. Issue at Par and Premium, calls in advance and arrears, Issue of shares for consideration other than cash.

5.3 Forfeiture of Shares

- Meaning of forfeiture shares, Various situations in which share can be forfeited.

5.4 Reissue of Forfeited Shares

- Meaning of reissue of Shares, Minimum price of which a company can reissue its forfeited shares and accounting treatment of reissue of shares in different situations.
- Disclosure of Share capital in Company's Balance Sheet (Vertical form)

5.5 Issue of Debentures

- Meaning & types of debentures, procedure of Issue of debentures and its accounting treatment. Issue of debentures for consideration other than cash, Debentures as collateral security accounting treatment for writing off discount & loss on Issue of debentures. Interest on Debentures.

PART B

MODULE 6 : ANALYSIS OF FINANCIAL STATEMENTS

50 Hrs. **20 Marks**

Approach

Analysis of Financial Statement is a systematic process of analysing the financial information in the financial statements to understand and make decision regarding the operations of the enterprise. The analysis of Financial Statements is a study of relationship among various financial figures as set out in the financial statements *i.e.,* Balance Sheet and Statements of Profit & Loss. The complex data given in the Financial Statement is bifurcated, divided and broken into simple and valuable elements and relationships are established between the elements of the same statements or different financial statement.

This module deals with the tools and teachniques of analysing the financial statement such as Ratios, Cash Flow Statements, Comparative Statements etc. Using these tools, the process of division, establishing, relationships and interpretation thereof to understand the working and financial position of a business is Analysis of Financial Statements.

6.1 Financial Statements Analysis - An Introduction

- Balance Sheet of a Company in the prescribed Vertical Form with major headings and sub headings (As per Schedule VI of The Companies Act 1956).
- Financial Statement Analysis: Meaning, Objectives and Limitations.
- Tools for Financial Statement Analysis: Comparative Statements, Common Size Statements, Cash Flow Analysis, Ratio Analysis.

6.2 Accounting Ratios - I

- Accounting Ratios: Objectives and Classification of Ratios.
- Liquidity ratios: Current and Quick Ratio.

6.3 Accounting Ratios - II

- Solvency Ratios: Debt to Equity Ratio, Total Asset to Debt Ratio, Proprietory Ratio, Interest Coverage Ratio.
- Activity ratios: Stock Turnover Ratio, Debtors Turnover Ratio, Creditors Turnover Ratio, Working Capital Turnover Ratio.
- Profitability Ratios: Gross Profit Ratio, Operating Ratio, Operating Profit Ratio, Net Profit Ratio.

6.4 Cash Flow Statement

- Meaning Objective and preparation of Cash Flow Statement.

PART - C

MODULE 7 : APPLICATION OF COMPUTERS IN FINANCIAL ACCOUNTING

50 Hrs. **20 Marks**

Approach

In the modern world of machines, computers are the part and parcel of Human being. We cannot imagine any organisation working without the use of computers. The same is the case with business, Due to various advantages, computers are very widely used in Business Organisation. This module of Application of Computers in Financial Accounting is designed to explain as how the computers can be effectively used in accounting of business transactions. Computerised Accounting System refers to the processing of accounting transactions, the use of hardware and software in order to produce accounting records and reports.

In modern business accounting transactions are processed through computers. Usage of Computers and Information Technology (IT) enables a business to quickly, accurately and timely access the information that helps in decision making. This sharpens the competitive edge and enhances profitability. The computer systems work with the data which is processed by the hardware commanded by the users through software. This module explains the use of Electronic Spread Sheet & its applications in Business, together with how to prepare Graphs & Charts for Business and as how to use Data Base Management System for Accounting.

7.1 Electronic Spread Sheet

- Concept, Data Entry Text Management and Cell formatting, Data Formatting, Output Reports, Preparation of Reports Using Pivot table, Common Errors in Spread Sheet.

7.2 Use of Spreadsheet in Business Application

- Payroll Accounting, Asset Accounting.

7.3 Graphs And Charts for Business

- Data Graphs and Charts, Preparation of Graphs and Charts using Excel, Advantages of using Graphs and Charts.

7.4 Data Base Management System for Accounting

- Defining Database Requirements, Identification of data to be stored in Tables, Structuring of Data.
- Creating data tables for accounting, Using queries, forms and reports for generating accounting information with the help of Microsoft Access Software.

Scheme of Evaluation

The learner will be evaluated through Public examination as well as continuous, and comprehensive. Evaluation in the form of Tutor Marked Assignments (TMA's)

Exanination	Marks	Duration	Paper	Assessment
Public Exam	100	3 Hrs.	One	External
TMA	20	Self paced	One	By tutor of Study Centre

There are three parts in Accountancy (320). Part A is compulsory to all, while the learner has to choose any one part from B or C respectively, during Public Examination.