

PROCESSING TRANSACTIONS

An Account & a Ledger

- An **account** records increases and decreases in specific asset, liability, and equity items
- An **accounting system** has separate accounts for revenue, expenses, asset, liability and equity items
- A **ledger** is the file or binder containing the entire group of accounts of a business, particularly in manual accounting system

Commonly Used Accounts

- **Assets** – **Fixed** (Buildings, Equipments) & **Current** (Prepaid expenses, accounts receivable, cash).
- **Liabilities** – **Long-term** (Debentures, loans from Fls) & **Short-term** (Creditors, Bills Payable, Unearned Revenue).
- **Owners' Equity** – **Capital**, **Retained earnings** (Revenues & Expenses).
- Accounts in the ledger are represented through a **Chart of Accounts** in an organization with certain codes.

Assets:

Equipments	103
Inventory	109
Cash	113

Liabilities:

Creditors	201
Expenses:	
Advertisement	509

The Double Entry System

- Each transaction is recorded in two accounts so that the Accounting Equation i.e. “Assets = Liabilities + Owners’ Equity” is being preserved.
- Number of times an aircraft takes off must equals to the number of times it lands – Principle of Duality – applicable to any complex business transaction.
- Luca Pacioli (1445-1515) codified and published the system of Benefit & Sacrifice in his book ‘*Summa de Arithmetica, Geometrica, Proportioni et Proportionalita*’ in 1494 – earned him the title ‘Father of Accounting’.

The Double Entry System.....

- Every transaction must be recorded with equal debits and credits and the total of debits must be equal to total of credits.
- Left hand side of any account is arbitrarily called 'Debit Side' (dr.) and the right hand side is called 'Credit Side' (cr.).
- 'T Form' of Account
- Standard form of an account:

Date	Explanation	Ref.	Dr.	Cr.	Bal.

Debit & Credit Rules

- $A = L + OE$ or, $A = L + OE + RE$
- Or, $A = L + OE + (Rev. - Exp.)$
- Or, $A = L + OE - Div. - Draw. + Rev. - Exp.$
- $A + D + D + E = L + OE + R$
- Debit to Increase (LHS) Credit to Increase (RHS)
- Credit to Decrease (RHS) Debit to Decrease (LHS)

Accounting Equation, Debits and Credits, Increases and Decreases

Assets		=	Liabilities		+	Shareholders' Equity			
<u>Assets</u>			<u>Liabilities</u>			<u>Paid-In Capital + Retained Earnings</u>			
Debit	Credit		Debit	Credit		Debit	Credit	Debit	Credit
+	-		-	+		-	+	-	+
						<u>Expenses and Losses Revenues and Gains</u>			
						Debit	Credit	Debit	Credit
						+	-	-	+

Permanent Accounts—assets, liabilities, paid-in capital, retained earnings
Temporary Accounts-revenues, gains, expenses, losses

Processing Transactions

- **The Journal:** A chronological record of firm's transactions (latin word '*diurnalis*' i.e. '*diurnal*' referring 'of or during the day time')
- **A Journal entry** has the transaction date, the individual accounts & the related debit & credit amount & a brief explanation of the transaction
- **Journalizing** is the process of recording transactions in the journal
- Subsequently transferring them to different **Ledger Accounts** (in the form of 'T')

Journal Entry

Date	V/R No.	Particulars	L/F	Debit Amount (in Rs.)	Credit Amount (in Rs.)
June 15, 20XX	-	Cash Account Dr. Capital Account Cr. [Cash brought in to the business as capital]		90,000	90,000

Recording of Transactions – July 1

$$(A + D + \textcolor{red}{D} + E = L + OE + R)$$

- At the beginning of July 20XX, Gibson decided to open an advertising agency called The Best Agency. During the month following transactions occurred, which need to be recorded in journals and subsequently posted in various ledgers.
- **July 1 - Gibson and his family members invested \$320,000 cash in the company in exchange of 3,200 shares of stock.**
- Cash, an asset ↑ by \$320,000 & Capital, the OE ↑ by \$320,000.
- ↑ in asset needs to be recorded in LHS (Dr side) & ↑ in Capital to be recorded in RHS (Cr side).
- Debit Cash for \$320,000 & Credit Capital for \$320,000.

Recording of Transactions – July 1

$$(A + D + \textcolor{red}{D} + E = L + OE + R)$$

Journal entry					
Date	Description	LF	Dr. Bal	Cr. Bal	
July 1	Debit Cash	1	320,000		
	Credit Capital	2		320,000	
	(Being equity invested by owner)				
Ledger Accounts					
Dr.	(1) Cash	Cr.	Dr.	(2) Capital	Cr.
July 1	320,000			July 1	320,000

Recording of Transactions – July 2

$$(A + D + \textcolor{red}{D} + E = L + OE + R)$$

- July 2-The local bank lent the corporation \$100,000.
- Cash, an asset ↑ by $\textcolor{brown}{\$100,000}$ & the LT Debt ↑ by $\textcolor{brown}{\$100,000}$.
- ↑ in asset needs to be recorded in LHS (Dr side) & ↑ in LT Debt (Liability) to be recorded in RHS (Cr side).
- Debit Cash for $\textcolor{brown}{\$100,000}$ & Credit Capital for $\textcolor{brown}{\$100,000}$.

Recording of Transactions – July 2

(A + D + D + E = L + OE + R)

Journal entry

Date	Description	LF	Dr. Bal	Cr. Bal
July 2	Debit Cash	1	100,000	
	Credit Long Term Debt	3		100,000
	(Long term loan taken from bank)			

Ledger Accounts

Dr.	(1) Cash	Cr.	Dr.	(3) Long Term Debt	Cr.
July 1	320,000			July 2	100,000
July 2	100,000				

Recording of Transactions – July 5

- July 5- The cash from the sale of stock and the bank loan was used to purchase land for \$ 50,000, a building for \$ 100,000 and office furniture and fixtures for \$ 80,000.
- Cash of \$ 230,000 ↓ as three new assets – land, building and F&F are created.
- Asset ↓ to be recorded in RHS or Cr. Side & creation of 3 new assets to be put in LHS or Dr. side.

Journal entry					
Date	Description		LF	Dr. Bal	Cr. Bal
July 5	Debit Land		4	50,000	230,000
	Debit Building		5	100,000	
	Debit Furniture & Fixture		6	80,000	
	Credit Cash		1		
	(Land, building & F& F purchased by cash)				
Ledger Accounts					
Dr. (1) Cash		Cr.	Dr. (4) Land		Cr.
July 1	320,000	July 5	230,000	July 5	50,000
July 2	100,000				
Dr. (5) Building		Cr.	Dr. (6) Furniture & Fixture		Cr.
July 5	100,000			July 5	80,000

Recording of Transactions – July 7

- July 7 - The firm purchased another \$ 50,000 of furniture and fixtures on account, all of which will be paid next month.
- F&F (Asset) ↑ by \$50,000 & Accounts Payable(Current Liabilities) ↑ by \$50,000
- ↑ in F&F will be put in Dr. (LHS) side & ↑ in AP will be put in Cr.(RHS) side

Journal entry					
Date	Description	LF	Dr Amount	Cr Amount	
July 07	Debit Furniture & Fixture Credit Accounts Payable (F&F purchased on credit)	6 7	50,000	50,000	
Ledger Accounts					
Dr.	(7) Accounts Payable	Cr.	Dr.	(6) Furniture & Fixture	Cr.
	July 7	50,000	July 5	80,000	
			July 7	50,000	

Recording of Transactions – July 12

- **July 12 - Advertising materials purchased amounting to \$60,000.**
- **New asset in the form of Inventory of Advt Materials created – to be put in the Dr. (LHS) side of the newly created Inventory (AM) Account.**
- **Since Cash has been utilized, current asset in the form of cash, has been reduced; hence amount to be put in Cr. (RHS) side of Cash Account.**

Journal entry						
Date	Description		LF	Dr Bal	Cr Bal	
July 12	Debit Inventory (AM)		8	60,000		
	Credit Cash		1		60,000	
	(Inventory of Materials purchased)					
Ledger Accounts						
Dr.	(1) Cash		Cr.	Dr.	(8) Inventory (AM)	Cr.
July 1	320,000	July 5	230,000	July 12	60,000	
July2	100,000	July 12	60,000			

Recording of Transactions – July 17

- **July 17 - Purchased office supplies of \$ 5,000**
- **New asset in the form of Inventory of Office Supplies created – to be put in the Dr. (LHS) side of the newly created Inventory (OS) Account**
- **Since Cash has been utilized, current asset in the form of cash, has been reduced; hence amount to be put in Cr. (RHS) side of Cash Account**

Journal entry					
Date	Description	LF	Dr Bal	Cr Bal	
July 17	Debit Inventory (OS) Credit Cash (Office Supplies purchased)	9 1	5,000	5,000	

Ledger Accounts					
Dr. (1) Cash		Cr.	Dr. (9) Inventory (OS)		Cr.
July 1	320,000	July 5	230,000	July 17	5,000
July 2	100,000	July 12	60,000		
		July 17	5,000		

Recording of Transactions – July 27

- July 27-** Commission earned during the period \$ 130,000 of which, \$ 120,000 had been collected in cash by selling some advertising materials. The firm expects to collect the remaining cash early next month
- Increase in Sales Revenue by \$1,30,000 – Credit Sales Revenue**
- Increase in cash by \$120,000 – Debit Cash**
- Increase in Receivables by \$10,000 – Debit Receivables**

Journal entry							
Date	Description			LF	Dr Bal	Cr Bal	
July 27	Debit Cash			1	120,000	130,000	
	Debit Debtors			10	10,000		
	Credit Sales Revenue			11			
	(Sales revenue generated through cash as well as credit sales)						
Ledger Accounts							
Dr.	(1) Cash		Cr.	Dr.	(10) Debtors		Cr.
July 1	320,000		July 5	230,000	July 27	10,000	
July 2	100,000		July 12	60,000			
July 27	120,000		July 17	5,000			
Dr.	(11) Sales Revenue		Cr.				
			July 27	130,000			

Recording of Transactions – July 27

- **July 27-** Operating expense of (Rent - \$5,000, Insurance premium- 2,700, Electricity bill – 3,300) were incurred and paid in cash during the month
- Increase in Expenses to be debited & reduction in cash to be credited

Journal entry							
Date	Description			LF	Dr Bal	Cr Bal	
July 27	Debit Rent Expense			12	5,000		
	Debit Insurance Expense			13	2,700		
	Debit Electricity Expense			14	3,300		
	Credit Cash			1			
	(Rent, Insurance and electricity expenses are paid)					11,000	
Ledger Accounts							
Dr.	(1) Cash		Cr.	Dr.	(12) Rent Exp		Cr.
July 1	320,000		July 5	230,000		July 27	5,000
July 2	100,000		July 12	60,000			
July 27	120,000		July 17	5,000			
			July 27	11,000			
Dr.	(13) Insurance Exp		Cr.	Dr.	(14) Electricity Exp		Cr.
July 27	2,700			July 27	3,300		

Recording of Transactions – July 30

- July 30 – Salaries to office staff paid for the month was \$8,000 and for two staff salaries of July to be paid in next month was \$4,000.
- Salaries Expense - \$12,000 – to be debited
- Cash paid \$8,000 – Cash reduced – to be credited
- Salaries Payable – New current liability – to be credited

Recording of Transactions – July 30

Journal entry						
Date	Description	LF	Dr Bal	Cr Bal		
July 30	Debit Salary Expense	15	12,000			
	Credit Salary Payable	16		4,000		
	Credit Cash	1		8,000		
	(Salary being paid partially)					
Ledger Accounts						
Dr.	(1) Cash		Cr.	Dr.	(15) Salary Exp	Cr.
July 1	320,000	July 5	230,000	July 30	12,000	
July2	100,000	July 12	60,000			
July 27	120,000	July 17	5,000			
		July 27	11,000			
		July 30	8,000			
Dr.	(16) Salary Payable		Cr.			
July 30	4,000					

Recording of Transactions – July 31

- **July 31** – Unused advertising materials during the period was \$1,500.
- Inventory of materials (a current asset), when consumed by the business becomes an expense, which is known as Cost of goods sold. Since it is a new expense, it needs to be debited.
- Since Inventory of materials reduced to \$1,500, the reduction in amount should be credited.

Journal entry								
Date	Description		LF	Dr Bal	Cr Bal			
July 31	Debit COGS		17	58,500				
	Credit Inventory		8		58,500			
	(Inventory consumed during the period)							
Ledger Accounts								
Dr.	(8) Inventory		Cr.	Dr.	(17) COGS	Cr.		
July 12	60,000		July 31	58,500		July 31	58,500	

Recording of Transactions – July 31

- July 31- Interest expenses of \$ 1,000 on the bank loan was incurred but remained unpaid at. Taxes of \$ 2,000 were incurred and paid during the month.
- Interest expense on bank loan – new expense– to be debited
- Since it was unpaid, it becomes payable for the firm in this accounting period under the accounting head Interest payable

Journal Entry					
Date	Description	LF	Dr Bal	Cr Bal	
July 31	Debit Interest Expense	18	1,000		
	Credit Interest Payable (Interest payable during the period)	19		1,000	
Ledger Accounts					
Dr.	(18) Interest Expense	Cr.	Dr.	(19) Interest Payable	Cr.
July 31	1,000			July 31	1,000

Recording of Transactions – July 31

- July 31- Interest expenses of \$ 1,000 on the bank loan was incurred but remained unpaid at. Taxes of \$ 2,000 were incurred and paid during the month.
- Tax expense – a new expense– to be debited & as it is paid – cash to be credited

Journal entry							
Date	Description			LF	Dr Bal	Cr Bal	
July 31	Debit Tax Expense			20	2,000		
	Credit Cash			1		2,000	
	(Tax paid during the month)						
Ledger Accounts							
Dr.	(1) Cash		Cr.	Dr.	(20) Tax Expense		Cr.
July 1	320,000		July 5	230,000	July 31	2,000	
July 2	100,000		July 12	60,000			
July 27	120,000		July 17	5,000			
			July 27	11,000			
			July 30	8,000			
			July 31	2,000			

Recording of Transactions – July 31

- July 31 - The firm paid dividends of \$ 5,000 during the month.
- Dividend payment – to be debited
- Since it is paid – Cash to be reduced – cash to be credited

Journal entry							
Date	Description			LF	Dr Bal	Cr Bal	
July 31	Debit Dividend			21	5,000		
	Credit Cash			1		5,000	
	(Dividend paid during the month)						
Ledger Accounts							
Dr.	(1) Cash		Cr.	Dr.	(21) Dividend		Cr.
July 1	320,000	July 5	230,000	July 31	5,000		
July 2	100,000	July 12	60,000				
July 27	120,000	July 17	5,000				
		July 27	11,000				
		July 30	8,000				
		July 31	2,000				
		July 31	5,000				

Account Balancing

Dr.		(1) Cash	Cr.
July 1	320,000	July 5	230,000
July 2	100,000	July 12	60,000
July 27	120,000	July 17	5,000
		July 27	11,000
		July 30	8,000
		July 31	2,000
		July 31	5,000
		July 31 Bal Fig (Closing Bal)	<u>219,000</u>
	<u>540,000</u>		<u>540,000</u>
August 1	219,000		
(Opening Balance)			

Account Balancing

Dr.		(2) Capital		Cr.	
July 31 (Balancing Fig)		320,000	July 1	320,000	
		<u>320,000</u>	August 1 (Opening Balance)	<u>320,000</u>	

You need to close all the accounts you have created by now (by transferring the journal entries) and identify the Debit/credit Balance, each account is showing to prepare a **TRIAL BALANCE**

Trial Balance

- **Trial Balance** is list of all accounts in the general ledger with their balances reflected either in 'dr.' or in 'cr.' column.
 1. It shows whether the equality of debits and credits has been maintained;
 2. It provides a convenient summary transcript of the ledger records as a basis of making the adjusting and closing entries.

Trial balance of The Best Agency for the month ended July 31, 20xx

S No.	Accounts		Dr. (\$)	Cr. (\$)
1.	Cash A/c	(Asset)	219,000	-
2.	Capital A/c	(OE)	-	320,000
3.	Long Term Debt A/c	(Liability)	-	100,000
4.	Land A/c	(Asset)	50,000	
5.	Building A/c	(Asset)	100,000	-
6.	Furniture & Fixture A/c	(Asset)	130,000	
7.	Accounts Payable A/c	(Liability)	-	50,000
8.	Inventory (Advt. Mat) A/c	(Asset)	1,500	-
9.	Inventory (Office Supp) A/c	(Asset)	5,000	-
10.	Debtors A/c	(Asset)	10,000	-
11.	Sales Revenue A/c	(Rev)	-	130,000
12.	Rent A/c	(Exp)	5,000	-
13.	Insurance A/c	(Exp)	2,700	-

Trial balance of The Best Agency for the month ended July 31, 20xx.....

S No.	Accounts		Dr. (\$)	Cr. (\$)
14	Electricity A/c	(Exp)	3,300	-
15	Salary A/c	(Exp)	12,000	
16	Salary Payable A/c	(Liability)	-	4,000
17	COGS A/c	(Exp)	58,500	
18	Interest expense A/c	(Exp)	1,000	-
19	Interest Payable A/c	(Liability)	-	1,000
20	Tax expense A/c	(Exp)	2,000	-
21	Dividend A/c	(RE → OE)	5,000	-
	TOTAL		605,000	605,000

Now, from this TRIAL BALANCE, you can prepare the four Financial Statements

Income Statement of The Best Agency

for the month ended July 31, 20xx (Amount in \$)

Sales Revenue

	Cash sales	120,000	
	Credit Sales	10,000	130,000
Less	Cost of Goods Sold		(58,500)
	Gross Income		71,500
Less	Operating Expenses		
	Rent Expenses	5,000	
	Insurance Expenses	2,700	
	Electricity Expenses	3,300	
	Salary Expenses	12,000	
	Interest Expenses	1,000	
	Tax Expense	2,000	(26,000)
	Net Income		45,500

Statement of Retained Earnings of The Best Agency
for the month ended July 31, 20xx

Opening Balance of Retained earnings	NIL
Add, Net Income generated for the period	\$ 45,500
Less, Dividend distributed during the period	(\$ 5,000)
Closing Balance of Retained earnings to be shown in the balance Sheet	\$40,500

Cash Flows Statement of The Best Agency for the month ended July 31, 20xx

Sl. No.	Cashflows for different Activities (Amount in \$)	Inflows/ Outflows	Net Cashflow
1.	Net Cash flows from Operating Activities		34,000
	Inflows through cash sales	120,000	
	Outflows- payment for Inventory of Ad materials & OS	(65,000)	
	Outflows for Operating Expenses (Rent – 5,000 + Insur – 2,700 + Electricity – 3,300 + Salary – 8,000 + Tax – 2,000)	(21,000)	
2.	Net Cash flows from Investing Activities		(230,000)
	Inflows through Investing activities	NIL	
	Outflows for purchase of (Land -50,000 + Buildings – 100,000 + Furniture & Fixture -80,000)	(230,000)	
3.	Net Cash flows from Financing Activities		415,000
	Cash Inflows (capital Investment - 320,000 + Long-term Debt – 100,000)	420,000	
	Cash Outflows for payment of Dividend	(5,000)	
	Total Cashflows of the business during the period		219,000

**Balance Sheet of The Best Agency
as on July 31, 20xx**

Assets (\$)		Liabilities & Owner's Equity (\$)	
Cash	219,000	Salary Payable	4,000
Inventory (Advt. Mat)	1,500	Interest Payable	1,000
Inventory (Office Supplies)	5,000	Accounts Payable	50,000
Debtors (Credit Customers)	10,000	Long Term Debt	100,000
Land	50,000	Owner's Equity – 320,000 Add, Ret Earnings –40,500	360,500
Building	100,000		
Furniture & Fixtures	130,000		
TOTAL	515,500	TOTAL	515,500

Errors in Recording Process

- If trial balance total does not agree, following errors may be taking place:
 1. A debit may be posted in an account as a credit or vice-versa
 2. An account balance may be computed incorrectly
 3. Amount of an account balance may be recorded incorrectly

Errors in Recording Process.....

- Even if the Trial Balance agrees, there may also be the possibility of any of the following errors:
 1. **Error of Principle-** Posting a journal entry to a wrong account
 2. **Errors of Omission & Repetition** – Complete omission of a transaction or recording of the same transaction more than once
 3. **Compensatory Errors** – Recording of same erroneous amount for both debit and credit of a transaction

Correcting Errors

1. Identify the incorrect entry;
2. Pass Correct Entry & Compare;
3. Pass an additional correcting error entry to neutralize the effect.

Example: A repair Expense was erroneously debited to equipment on July 27; error was discovered on July 31

- **Erroneous Entry:**

27/7 Equipment500
 Cash500

- **Correct Entry:**

27/7 Repair Expense.....500
 Cash500

- **Correcting Entry:**

31/7 Repairing Expense.....500
 Equipment.....500