LECTURE NOTES: FINANCIAL ACCOUNTING

UNIT ONE

The Nature, Scope and Definition of Accounting:

Accounting in very simple terms can be considered as the financial language of business and other organisation. It is used to assess the financial well-being or otherwise of business and other organisation (and even individuals). Much will be said of this later.

Accounting is the process of recording, classifying, summarizing, analyzing, and interpreting the financial transactions of the business for the benefit of management and those parties who are interested in business such as shareholders, creditors, bankers, customers, employees, and government. Thus, it concerns with financial reporting and decision-making aspects of the business.

The term ‘Accounting’ unless otherwise specifically stated always refers to ‘Financial Accounting’. It concerns with revenues, expenses, assets, and liabilities of a business entity. Also, they have the two-fold objective, thus, to ascertain the profitability of the business, and to know the financial position of the concern.

Business Transaction

Business Transaction is an event which involves the transfer of money or money’s worth of financial events. The following summarises the business transaction that a firm might have:

- Acquisition of assets from owners and other creditors
- Investing resources in assets to produce goods or services
- Using resources to produce goods and services
- Selling goods or services of the firm
- Paying those to whom money is owed
- Returning assets to owners

Identification of business transaction

In accounting, only business transactions are recorded. A transaction is an event which can be expressed in terms of money and which brings change in the financial position of a business enterprise. An event is an incident or a happening which may or may not bring any change in the financial position of a business enterprise. Therefore, all transactions are events but all events are not transactions. A transaction is a complete action, to an expected or possible future action.

In every transaction, there is movement of value from one source to another. For example, when goods are purchased for cash, there is a movement of goods from the seller to the buyer and a movement of cash from buyer to the seller. Transactions may be external (between a business entity and a second party, e.g., goods sold on credit to Kwame or internal (do not involve second party, e.g., depreciation charged on the machinery).

Illustration:

State with reasons whether the following events are transactions or not to Mr. K. Oduro, Proprietor.

1. Mr. Oduro started business with capital (brought in cash) GH₵ 40,000.
2. Paid salaries to staff GH₵ 5,000 by cheque.
3. Purchased machinery for GH₵. 20,000 in cash.
4. Placed an order with Son & Co. for goods for GH₵ 5,000.
5. Opened a Bank account by depositing GH₵ 4,000.
6. Received pay-in-ship book from bank.
7. Appointed Joe as Manager on a salary of GH₵. 4,000 per month.
8. Received interest from bank GH₵ 500.
9. Received a price list from Latif.

Solution:

Here, each event is to be considered from the view point of Mr. Oduro's business. Those events which will change the financial position of the business of Mr. Oduro, should be regarded as transaction.

1. It is a transaction, because it changes the financial position of Mr. Oduro's business. Cash will increase by GH₵ 40,000 and Capital will increase by GH₵ 40,000.
2. It is a transaction, because it changes the financial position of Mr. Oduro's business. Cash will decrease by GH₵ 5,000 and Salaries (expenses) will increase by GH₵ 5,000
3. It is a transaction, because it changes the financial position of Mr. Mondal's business. Machinery comes in and cash goes out.
4. It is not a transaction, because it does not change the financial position of the business.
5. It is a transaction, because it changes the financial position of the business. Bank balance will increase by GH₵ 4,000 and cash will decrease by GH₵ 4,000.

6. It is not a transaction, because it does not change the financial position of Mr. Oduro.
7. It is not a transaction, because it does not change the financial position of Mr. Oduro.
8. It is a transaction, because it changes the financial position of Mr. Oduro's business, thus Bank interest will increase by GH₵ 500 and cash will increase

by the same amount.

9. It is not a transaction, because it does not change the financial position of the business of Mr. Oduro.

In any serious business operation, the business papers often called **source documents**; for example, receipts given by the business to its debtors or received from its creditors, vouchers, purchases and sales invoices, paying-in slips and bank statements, are collected and sorted into similar transaction groups. These analysed transaction groups are then recorded and periodically summarised. Out of the summarised data, financial statements are prepared and interpreted if necessary. From the collection of the source documents to the final stage of financial statements, use is made of appropriate data for decision making. It will however be clearer to you later that it is often the summarised information that is useful for decision making. From the above discussion we can define accounting as the art of collecting, analysing, recording, summarising, presenting and interpreting financial and operating data expressed in terms of money for use by management of economic entities and other interested parties in making decisions or for control purposes.

The term 'Accounting' unless otherwise specifically stated always refers to 'Financial Accounting'. It concerns with revenues, expenses, assets, and liabilities of a business entity. Also, they have the two-fold objective, thus, to ascertain the profitability of the business, and to know the financial position of the concern.

Financial accounting is a useful tool to manage and report to external users such as shareholders, potential owners, creditors, customers, employees, and government. It provides information regarding the results of its operations and the financial status of the business.

Accounting is concerned with:

1. Recording data (collecting, analyzing and recording)
2. Summarizing data (summarizing and presenting)
3. Interpreting data (communicating what has been learned from the data).

What is Bookkeeping?

It is the art of recording in the books of accounts the monetary aspect of commercial or financial transactions. Bookkeeping involves the recording, on a regular basis, of an entity's financial transactions. With proper bookkeeping, entities or business organizations are able to track all information on its books to make key operating, investing, and financing decisions.

Bookkeepers are individuals who manage all financial data for entities. Without bookkeepers, entities would not be aware of their current financial position, as well as the transactions that occur within the company.

Importance of Bookkeeping

Proper bookkeeping gives business organisation a reliable measure of their performance.

It also provides information to make general strategic decisions and a benchmark for its revenue and income goals. In short, once a business is up and running, spending extra time and money on maintaining proper records is critical.

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Differences Between Bookkeeping and Accounting

Bookkeeping and accounting are two functions that are extremely important for every business organization. In the simplest of terms, bookkeeping is responsible for the recording of financial transactions, whereas accounting is responsible for interpreting, classifying, analyzing, reporting, and summarizing financial data.

Bookkeeping and accounting may appear the same profession to an untrained eye. This is because accounting and bookkeeping deal with financial data, require basic accounting knowledge, and classify and generate reports using the financial transactions. At the same time, both of these processes are inherently different and have their own sets of advantages

Definition*:* Bookkeeping is mainly related to identifying, measuring, and recording, financial transactions while Accounting is the process of summarizing, interpreting, and communicating financial transactions which were classified in the ledger account

Decision Making: With bookkeeping management can't take a decision based on the data provided by bookkeeping while with accounting depending on the data provided by the accountants, the management can take critical business decisions

Objective**:** The objective of bookkeeping is to keep the records of all financial transactions proper and systematic while the objective of accounting is to provide the financial situation and further communicate the information to the relevant authorities

Preparation of Financial Statements: Financial statements are not prepared as a part of this process with bookkeeping while in accounting financial statements are prepared during the accounting process

Skills Required: Bookkeeping doesn't require any special skill sets while accounting requires special skills due to its analytical and complex nature.

Analysis: The process of bookkeeping does not require any analysis while accounting uses bookkeeping information to analyze and interpret the data and then compiles it into reports

The Objectives of Accounting

The primary objective of accounting is to provide information for decision making. The information is usually financial, but can also be given in volumes, for example the number of cars sold in a month by a car dealer or the number of cows in a farmer's herd. Accounting has many objectives apart from the main purpose. They include:

a. To facilitate rational decision making

b. To ascertain the operational profit or loss

c. To ascertain the financial position of the business

d. To provide information to various users

e. To comply with the legal, statutory and contractual obligation

f. To help management render reports of their stewardship to the owners of business.

QUALITIES OF ACCOUNTING INFORMATION

Relevance

It must satisfy the needs of the information users.

Accuracy

Accounting information must be accurate to be useful.

Timeless

Accounting information supplied long after the need for it has passed is of little use. Time is of essence if accounting information is to serve its purpose.

Comprehensibility

It must be complete enough for the user to understand, not to much, not too little.

Reliability

Information may be deemed to be more reliable if independently verified. This is what gives credence to the external audit function.

Completeness

The accounts should present a complete picture of its economic activity.

Objectivity

Information should be capable of being independently verified. It must be less subjective and unbiased.

Comparability

Accounting information should be produced on a consistent basis to enable valid comparisons to be made between years and other units or companies in the same industry or similar industry.

Consistency

Applying the same treatment to items of similar nature on regular basis without changing the process.

1.1 USERS OF ACCOUNTING INFORMATION

Users of Accounting Information include the following:

Management

They want to take stock of their daily stewardship and also know the business financial position as at any point in time and plan for the future.

Shareholders

The owners of the business need to measure the performance of the business. This is to assess the efficiency of managements' stewardship, and to decide whether to continue the business, expand or liquidate it.

Creditors

Creditors are interested in the ability of the business to pay its debt as well as how long it takes to do that.

Customers

Customers want to know whether the business is a secure entity to do business with.

Employees

Employees need to have the right information about the business's financial position because their future in terms of job security, hours of work, pay, and number of holidays depend on it.

The Internal Revenue

The Internal Revenue Service needs to know about the profit of the company so as to raise the appropriate tax for payment.

Government

The government is interested in the accounting information because they want to know earnings or sales for a particular period for purposes of taxation.

Banks

Banks use financial information to assess whether to grant the company credit facilities. When initial credit facilities have been granted, banks seek to determine, on the basis of accounting information, whether to continue lending or to stop.

TYPES OF ACCOUNTING

The financial literature classifies accounting into two broad categories, viz, Financial Accounting and Management Accounting. Financial accounting is primarily concerned with the preparation of financial statements whereas management accounting covers areas such as interpretation of financial statements, cost accounting, etc. Both these types of accounting are examined in the following paragraphs.

Financial accounting

As mentioned earlier, financial accounting deals with the preparation of financial statements for the basic purpose of providing information to various interested groups like creditors, banks, shareholders, financial institutions, government, consumers, etc. Financial statements, i.e., the income statement and the balance sheet indicate the way in which the activities of the business have been conducted during a given period of time.

Financial accounting is charged with the primary responsibility of external reporting. The users of information generated by financial accounting, like bankers, financial institutions, regulatory authorities, government, investors, etc. want the accounting information to be consistent so as to facilitate comparison.

Therefore, financial accounting is based on certain concepts and conventions which include separate business entity, going concern concept, money measurement concept, cost concept, dual aspect concept, accounting period concept, matching concept, realization concept and conventions of conservatism, disclosure, consistency, etc. All such concepts and conventions would be dealt with detail in subsequent lessons.

The significance of financial accounting lies in the fact that it aids the management in directing and controlling the activities of the firm and to frame relevant managerial policies related to areas like production, sales, financing, etc. However, it suffers from certain drawbacks. which are discussed in the following paragraphs.

The information provided by financial accounting is consolidated in nature. It does not indicate a break-up for different departments, processes, products and jobs. As such, it becomes difficult to evaluate the performance of different sub-units of the organisation. Financial accounting does not help in knowing the cost behaviour as it does not distinguish between fixed and variable costs.

The information provided by financial accounting is historical in nature and as such the predictability of such information is limited. The management of a company has to solve certain ticklish questions like expansion of business, making or buying a component, adding or deleting a product line, deciding on alternative methods of production, etc. The financial accounting information is of little help in answering these questions.

The limitations of financial accounting above, however, should not lead one to believe that it is of no use. It is the basic foundation on which other branches and tools of accounting analysis are based. It is the source of information, which can be further analysed and interpreted according to the tailor-made requirements of decision-makers.

Management accounting

Management accounting is 'tailor-made' accounting. It facilitates the management by providing accounting information in such a way so that it is conducive for policy making and running the day-to-day operations of the business. Its basic purpose is to communicate the facts according to the specific needs of decision-makers by presenting the information in a systematic and meaningful manner. Management accounting, therefore, specifically helps in planning and control. It helps in setting standards and in case of variances between planned and actual performances, it helps in deciding the corrective action.

An important characteristic of management accounting is that it is forward looking. Its basic focus is one future activity to be performed and not what has already happened in the past. Since management accounting caters to the specific decision needs, it does not rest upon any well- defined and set principles. The reports generated by a management accountant can be of any duration– short or long, depending on purpose. Further, the reports can be prepared for the organisation as a whole as well as its segments.

Cost Accounting

One important variant of management accounting is the cost analysis. Cost accounting makes elaborate cost records regarding various products, operations and functions. It is the process of determining and accumulating the cost of a particular product or activity. Any product, function, job or process for which costs are determined and accumulated, are called cost centres.

The basic purpose of cost accounting is to provide a detailed break- up of cost of different departments, processes, jobs, products, sales territories, etc., so that effective cost control can be exercised. Cost accounting also helps in making revenue decisions such as those related to pricing, product-mix, profit-volume decisions, expansion of business, replacement decisions, etc.

The objectives of cost accounting, therefore, can be summarized in the form of three important statements, viz, to determine costs, to facilitate planning and control of business activities and to supply information for short- and long-term decision.

1.2 Distinction between Financial and Management Accounting

Financial and management accounting can be distinguished on a variety of basis like, users of information, criterion for decision making, behavioral implications, time frame, type of reports. Table 1 presents a summary of distinctions between financial and management accounting.

Table 1: Financial Accounting Vs Management Accounting

Basis of Distinction		Financial accounting	Management accounting
1.	Purpose of Information	To prepare F/S for reporting to external users	To provide cost information to management, that is, for internal use.
2.	Scope	Financial accounting reports describe the whole of the business	Management accounting focuses on all small parts of the organization
3.	Legal Requirements	There is a statutory requirement for public limited companies to produce annual financial reports regardless of whether management regards this information as useful	Management accounting is entirely optional. There is no statutory requirement
4.	Reporting Frequency	Reports are prepared periodically, usually on yearly basis	Reporting is a continuous process and may be weekly, monthly, etc.
5.	Nature of Information	Mostly financial	Both financial and non-financial
6.	Format and Regulation	Financial accounting statements must be prepared to conform with the legal requirements (the companies code in the case of Ghana) and (IFRSs)	Management accountants are not required to adhere to any regulatory and reporting regime (for example, the companies code and the IFRSs)

Disadvantages or Limitations of Financial Accounting:

Financial Accounting suffers from certain drawbacks. which are discussed in the following paragraphs.

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a. It records only quantitative information.
b. The information provided by financial accounting is historical in nature and as such the predictability of such information is limited.

c. It provides information about the whole concern. Product-wise, process-wise, department-wise, or information of any other line of activity cannot obtain separately from financial accounting.
d. Financial accounting does not help in knowing the cost behaviour as it does not distinguish between fixed and variable costs.

The limitations of financial accounting above, however, should not lead one to believe that it is of no use. It is the basic foundation on which other branches and tools of accounting analysis are based. It is the source of information, which can be further analysed and interpreted according to the tailor-made requirements of decision-makers.

MAJOR FINANCIAL REPORTS

The five major financial reports included in financial statements; these are:

- Income statement or profit and loss account
- Balance Sheet or Statement of Financial Position and
- Cash flow Statement
- Changes in Equity Statement
- Notes to the Financial Statement

The Income Statement

An income statement, sometimes called a profit and loss statement (P&L), is a financial document which shows income earned and expenses incurred. A financial statement which represents the revenues and expenses of an enterprise and shows the excess of revenues over expenses or vice-versa. Profit and Loss Account tracks all expenses and incomes and gives the net profit made or net loss suffered by a business during a particular period.

The format normally encountered in financial accounting is reflected in the illustration below

KWANDANBERK COMPANY LIMITED TRADING, PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 2018

	¢'m	¢'m
Sales Revenue (net)	4573	
Less cost of goods sold	2073	
Gross Profit	2500	
Add other incomes	105	
Total gross income		2605
Less other expenses:		
General and administrative	1200	
Selling and distribution	605	1805
Net Profit		**800**

From the illustration above, you realise that the company, called **Kwadanberk**, made a net profit of 800 million cedis. If you consider the sales of 4573 million cedis, the net profit is 17.5% of the year's sales. We can also calculate the percentages of:

(a) Cost of goods sold to sales

(b) General and Administrative Expenses to Sales

(c) Selling and Distribution Expenses to Sales – all for management decision purposes.

Balance Sheet

A Balance Sheet is a statement of financial position of a business concern at a given date. It shows the assets and liabilities existing on a particular date. Excess of assets over liabilities represent the capital and is indicative of the financial soundness of a company. The statement is so arranged that the total assets value equals the sum of liabilities and capital values. It is a statement and not an account. (Income statement and balance sheet will be later discussed in details). A format of balance sheet is shown below:

KWADANBERK COMPANY LIMITED BALANCE SHEET AS AT DECEMBER 31, 2018

Assets	¢'m	¢'m	**Liabilities and Capital**	¢'m
			Capital	1030
Fixed Assets:			Long-Term Liabilities	
Buildings	600			
Fixtures and fillings	20		Loans (Payable in 2021)	500
Motor Vehicles	380	1,000	Current	
			Liabilities:	150
			Trade	20
			Creditors	
			Expenses owing	
Current Assets				
Stocks	300			
Trade Debtors	250			
Cash	150			
		700		
		1700		**1700**

Cash Flow Statement

A cash flow statement is the financial document that presents income actually received and expenses actually paid. This statement (usually modified for a small business) usually shows beginning cash balances, cash inflows, cash outflows, and ending cash balances. The cash flow statement details any sources of cash coming into the business. There are only a few primary sources of cash: Cash collected from selling goods, Cash collected that was owed on account (debtors), Loans made to the business, or new ownership equity placed into the business by a partner or investor. These cash inflows get added together to produce the total sources of cash for the time period the statement covers.

The cash flow statement next lists any uses of cash by your business. This is cash leaving the business. There are ways in which cash flows out of a business: Purchasing some asset such as equipment, turning cash into inventory, paying for expenses generated by the business, making payments to satisfy any liabilities of the business, or distributing earnings to the owners of the business. These cash outflows get added together to produce the total uses of cash for the time period the statement covers

KWADANBERK COMPANY LIMITED

CASH FLOW STATEMENT FOR THE YEAR ENDED DECEMBER 31, 2018

Sources of Cash (Inflows)			¢'m
From operations: Revenues (less cash used for			560
expenses) From other sources: Investment by	3300		
owners (shares issued)			
Loan (payable 2020)	100	3400	
Total cash inflow during the			
year Uses of cash		3960	
(outflow):			
Acquisition of office equipment	600		
Purchase of land and building	2000		
Total cash used during the year			2600
Change: increase in cash during the year			1360

From the statement above, we observe that we have net cash inflow from operations (for example, trading and incidental activities) of 560 million cedis. Other sources of cash inflow, owners' investment and borrowing provided 3.4 billion cedis. The total cash inflow for 2002 therefore came up to 3.96 billion cedis. Total cash outflow came to 2.60 billion cedis. The net cash flow, or change in cash position (an increase during the year), was therefore 13.6 billion cedis.

Changes in Equity Statement

Statement of Changes in Equity details the change in owners' equity over an accounting period by presenting the movement in reserves comprising the shareholders' equity. The statement of changes in equity is a reconciliation of the beginning and ending balances in a company's equity during a reporting period.

The general calculation structure of the statement is as follows:

Beginning equity + Net income – Dividends +/- Other changes = Ending equity

Movement in shareholders' equity over an accounting period comprises the following elements: Net profit or loss during the accounting period attributable to shareholders, increase or decrease in share capital reserves, dividend payments to shareholders, gains and losses recognized directly in equity, effect of changes in accounting policies and effect of correction of prior period error

Notes to Financial Statements

Also referred to as footnotes. These provide additional information pertaining to a company's operations and financial position and are considered to be an integral part of the financial statements. The notes are required by the full disclosure principle. The notes to the financial statements are a required, integral part of a company's external financial statements. They are required since not all relevant financial information can be communicated through the amounts shown (or not shown) on the face of the financial statements. The notes are also referred to as footnote disclosures. Generally, the notes are the main method for a company to comply with the full disclosure principle.

UNIT TWO

RECORDING BUSINESS TRANSACTIONS

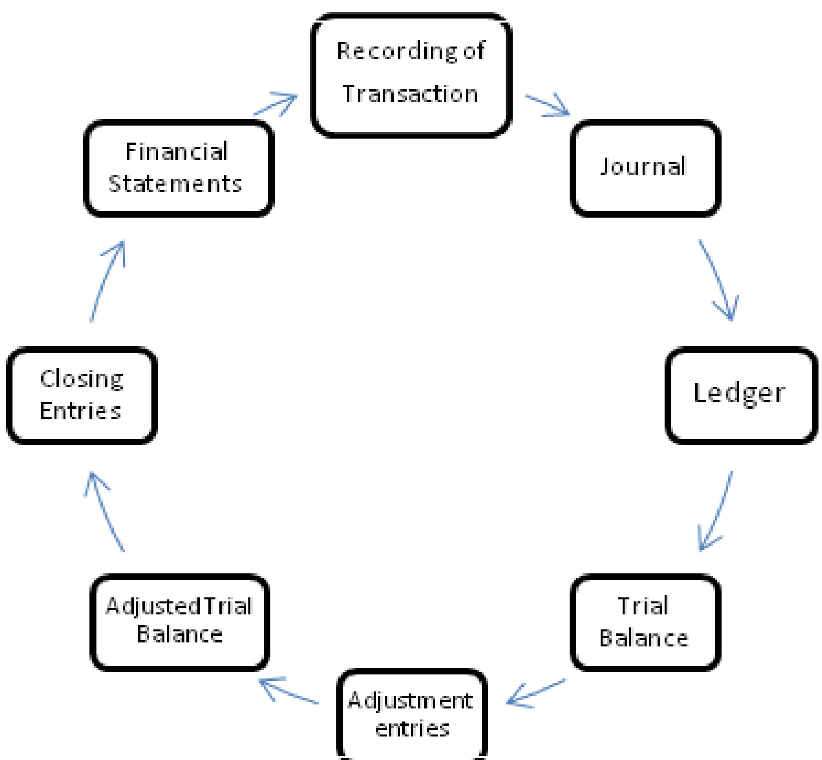
ACCOUNTING CYCLE

When complete sequence of accounting procedure is done which happens frequently and repeated in same directions during an accounting period, it is known as an accounting cycle.

The series of business transactions occurring during the accounting period and its recording is referred to as an accounting cycle or process. An accounting process is a complete sequence of accounting procedures which are repeated in the same order during each accounting period.

Steps/Phases of Accounting Cycle

The steps or phases of accounting cycle can be developed as shown below:



(ii) **Recording of Transaction:** As soon as a transaction happens it is at first recorded in subsidiary book.

(iii) **Journal:** The transactions are recorded in Journal chronologically.

(iv) **Ledger:** All journals are posted into ledger chronologically and in a classified manner.

(v) **Trial Balance:** After taking all the ledger account closing balances, a Trial Balance is prepared at the end of the period for the preparations of financial statements.

(vi) **Adjustment Entries:** All the adjustments entries are to be recorded properly and adjusted accordingly before preparing financial statements.

(vii) **Adjusted Trial Balance:** An adjusted Trail Balance may also be prepared.

(viii) **Closing Entries:** All the nominal accounts are to be closed by transferring to Trading Account and Profit and Loss Account.

Financial Statements: Financial statement can now be easily prepared which will exhibit the true financial position and operating results.

3.4 Source Documents

Meaning of source document: - Business transactions are recorded in the books of accounts on the basis of some written evidence termed as source document. These are written document holding details of the business transactions. Common source documents are: -

Invoice or bill: - When a trader sells goods on credit, he prepares a sales invoice. Similarly, when a trader purchases goods on credit, he receives a credit bill from the supplier of goods.

Receipts: - It is issued when cash is received from the customers.

Debit note: - It is evidence showing that supplier account is debited. It is prepared in case of purchase return.

Credit note: - When goods are received back from a customer a credit note is sent to him showing that his account is credited.

Pay in slip: - It is a source of document which is used for depositing cash or cheque into bank. **Cheque**: - A cheque is an order in writing drawn upon a bank to pay a specified sum to the bearer or the person named in it.

3.5 Voucher:

Voucher is a source by which we record the transactions. Vouchers may be classified as under: Payment voucher; Receipt voucher; and Transfer voucher.

a. A Payment voucher usually on a printed standard form, is a record of payment. When payment is made for an expense, generally a bill is prepared to record full particulars of the claim by the person or organisation receiving payment. From the bill, the accounting department prepares a voucher for each payment to be made, no matter whether the amount that is paid for the goods purchased, or to pay employee's salaries, or to pay for services or to pay for any other asset acquisition.

A Receipt voucher is a document which is issued against cash receipts. It may also be a printed standard form. This document shows that a certain sum of money was received from a person or organisation and also, contains information of the purpose for which the money is received. It is signed by a responsible employee, authorized by the management to receive the money.

b. A Transfer voucher is used to record the residuary transactions. An internal transaction or a transaction not involving any cash payment or cash receipt, is recorded in the transfer voucher. Examples are: Goods purchased on credit; depreciation of assets, outstanding expenses, accrued income, etc.

Classification of Accounts

Personal Accounts

Accounts which are related with accounts of individuals, firms, companies are known as personal accounts. The personal accounts may further be classified into the following:

Natural Personal Accounts: Accounts of individuals relating to natural persons such as Joel's A/c, Kojo's A/c, are natural personal accounts.

Artificial Personal Accounts: Accounts of companies, institutions such as Reliance Industries Ltd; Lions Club, M/s KK & Sons, Natural College account are artificial personal accounts. These exist only in the eyes of law.

Real Accounts

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

3.5.1 Nominal Accounts

The accounts relating to income, expenses, losses and gains are classified as nominal accounts. For example, wages account, rent account, interest account, salary account, bad debts accounts.

Illustration:

How will you classify the following into personal, real and nominal accounts?

- Investments
- Freehold Premises
- Accrued Interest
- AK Agro Industries Corporation
- Janata Allied Mechanical Works
- Salary Accounts
- Machine Accounts
- Fidelity Bank Ltd.
- Capital Account
- Dividend Received Account

The Rules of Debit and Credit for Assets, Liability and Capital Accounts

Debit and credit in accounting simply mean left side and right side. Accountants use the term debit (abbreviated Dr) to mean "place an entry on the left side of the account". They also use the term credit (abbreviated Cr) to mean "place an entry on the right side of the account". Thus, for all accounts a debit entry is an entry on the left side, while a credit entry is an entry on the right side.

An example is shown below:

Account Name

Left or Debit side	Right or Credit side

Double Entry Rule for Assets

To increase assets, debit assets accounts and to decrease assets, credit asset accounts.

This is illustrated below:

Asset Account

Dr Cr

Enter Original amount on this side Enter Increases on this side	Enter decreases on this side

Double Entry Rule for Liabilities

To increase liabilities, enter the increase on the credit side of the account and a reduction is shown on the debit side of the account.

Example

Liability Account

Dr Cr

Enter decreases on this side	Enter original amount on this side Enter increases on this side

Double Entry Rule for Capital

Capital may be defined as the amount contributed by the owner(s) in order to start the business from his private resources. It can also mean what the owner has provided or what belongs to him, or his claims to the assets of the business.

The capital account like the liability A/Cs is increased on the right side or credit side and decreased on the left side or debit side. This is illustrated thus:

Capital Account

Dr Cr

Enter decreases on this side	Enter original amount on this side Enter increases on this side

Example:

Determine the accounts to be debited and accounts to be credited in the following transactions:

(1) owner started business with cash

(2) owner paid cash into business bank A/c

(3) bought buildings paying by cheque.

Solution:

Taking transaction (1): You realise that the owner has increased the capital and therefore the capital A/c will be credited. At the same time cash (an asset) is increased, and hence the cash a/c will be debited

For transaction (2): An asset (cash) is reduced and another asset (Bank) is increased. Hence bank A/c will be debited and cash a/c will be credited. For transaction (3): Here an asset (Bank) is reduced and another asset (Buildings) increased. You, therefore, debit buildings A/c and credit bank A/c.

You have to note that any time a transaction takes place two accounts are affected. One account will be debited and the other account credited to complete the double entry. You should, therefore, examine every transaction carefully and determine which account is to be debited and which a/c is to be credited.

Questions

1. Complete the following table:

(a) Owner started business by paying Cheque into business bank account

(b) Bought office equipment paying by cheque

(c) Owner put more cash into the business

(d) Bought motor Van on credit from X Y Z Ltd

(e) Withdrew cash from Bank for Business use

(f) Sold some of the office equipment for cash

Account to be Debited	Account to be Credited

2. State which account is to be debited and which account is to be credited in the following transaction:

(a) Proprietor started business with cash

(b) Received loan from ADB Ltd and paid it into business bank a/c

(c) Bought Machine paying by cheque

(d) Bought a typewriter on credit from UTC Ltd

(e) Bought shop fittings paying cash

(f) Paid cheque to ADB Ltd as part-payment of the Loan

THE DOUBLE ENTRY FOR REVENUE AND EXPENSES

The Double Entry Rule for Revenue

Revenue may be defined as the income earned from the sale of goods and rendering of services. For many businesses the major revenue comes from sales of their stock. Other sources from which a business can get revenue include:

rent received, discount received, commission received, interest received etc.

Revenues are elements of capital and are increases (credits) to capital. Accordingly increases in revenue accounts are entered on the credit side and decreases on the debit side. You should note that revenues bring in Assets in the form of cash or bank or Debtors. Debtors are created when goods are sold to customers on credit.

Example 1:

Assume a transaction in which goods are sold for cash. Two a/cs are affected; both an asset account (cash) and a revenue a/c (sales) are increased. Cash is debited and sales are credited.

Double Entry Rule for Expenses

All businesses make payments for a number of benefits and services they receive but which do not directly provide an asset owned by the business. Such are called expenses. Expenses can be defined as costs incurred in running the business on day- to- day basis. Examples include wages and salaries, rent, rates, electricity.

Expenses, like revenues are elements of capital, however they are decreases (debits) to capital. Expenses a/cs are increased on the left or debit side and decreased on the right or credit side.

Let us look at a situation where a business pays, cash for wages and salaries to employees of the business.

Here two accounts are affected; an asset account (cash) is reduced and expense account (Wages and salaries) is increased. Hence Wages and Salaries account is debited and cash account is credited. You should note that expenses reduce cash or Bank or create a liability (creditor).

Meaning of Sales and Purchases

In Accounting purchases means goods bought with the intention of selling them for profits. This indicates the purchase of goods in which the business deals. The intention here is for resale, so that if the item bought is not for resale it cannot be termed purchases.

Similarly, "sales" to the accountant means the sale of goods which were purchased with the main intention of resale. In other words. it is the sale of goods in which the business deals so that if the business does not deal in a particular item, the sale of such item cannot be termed sales. Purchases is an expense which increases stock of goods and decreases cash or Bank or create a liability (creditors), while sales as you have seen earlier on is revenue.

The rules for debit and credit for revenue and expenses are as follows

Dr Any Revenue A/c Cr

Decrease side	Increase side Balance side

Dr Any Expense A/c Cr

Increase side Balanc e side	Decrease side

Example

1. Show the account to debit and the account to credit in the following:

(a) Purchased goods for cash

(b) Sold goods receiving cheque

(c) Purchased goods on credit from K. Akom

(d) Sold goods on credit to Yaw Barimah.

Solution

(a) Expense A/c (Purchases) increased while an Asset A/c (cash) is decreased.

Hence Debit purchases and credit cash

(b) Both an asset a/c (Bank) and revenue a/c (sales) are increased. Therefore,

Debit bank and credit sales

(c) Expense A/c (Purchases) increased and a liability A/c (creditor – K. Akom) increased.

Hence Debit Purchases and credit K. Akom

(d) Revenue A/c (sales) is increased and an asset a/c (Debtor-Yaw Barimah) is increased.

You therefore, Debit Yaw Barimah and credit sales.

3.6 Summary of the Rules for Debit and Credit

(I) Traditional or English Approach: This approach is based on the main principle of double entry system i.e.; every debit has a credit and every credit has a debit. According to this system we should record both the aspects of a transaction whereas one aspect of a transaction will be debited and other aspect of a transaction will be credited.

Type of Accounts	**Rules for Debit**	**Rules for Credit**
Personal Account	Debit the receiver	Credit the giver
Real Account	Debit what comes in	Credit what goes out
Nominal Account	Debit all expenses and Losses	Credit all incomes and Gains

(2) Modern or American Approach: This approach is based on the accounting equation or balance sheet. In this approach accounts are debited or credited according to the nature of an account. In a summarized way the five rules of modern approach are as follows:

Nature of Accounts	**Rules for Debit**	**Rules for Credit**
Assets	Increase	Decrease
Liabilities	Decrease	Increase
Capital	Decrease	Increase
Revenue/income	Decrease	Increase
Expenses/losses	Increase	Decrease

- Increase in asset will be debited and decrease will be credited.
- Increase in the liabilities will be credited and decrease will be debited.
- Increase in the capital will be credited and decrease will be debited.
- Increase in the revenue or income will be credited and decrease will be debited.
- Increase in expenses and losses will be debited and decrease will be credited.

THE ACCOUNTING EQUATION

Introduction

A business can be set up in two ways-

i) Owner supplying all the resources

ii) Owner supplying some of the resources and the rest being supplied by outside parties. The two cases bring out the *accounting equation* also called book- keeping equation

Case one: owner supplying all the resources

In this case we say that-

Resources in the business = Resources supplied by the owner**…………..** **(i)**

Resources in business are called *assets* and resources supplied by the owner are called *capital*

Therefore equation (i) can be re -written as-

ASSETS = CAPITAL

Case two: resources supplied by owner and outside parties

In this case we say that-

Resources in business = Resources supplied by the owner + Resources supplied by out- side parties… (ii)

The new term in the equation is *resources supplied by outside parties*, in accounting, we call them *liabilities.*

Therefore equation (ii) can be re-written as-

ASSETS = CAPITAL + LIABILITIES… **(ii)**

3.2 Components of accounting equations

***Assets**:*

An asset is a resource controlled by a business entity/firm as a result of past events for which economic benefits are expected to flow to the firm.

An example is if a business sells goods on credit, then it has an asset called a debtor. The past event is the sale on credit and the resource is a debtor. This debtor is expected to pay so that economic benefits will flow towards the firm i.e. in form of cash once the customers pay.

Assets are classified into two main types:

iii) Non-current assets (formerly called fixed assets).

iv) Current assets.

Non-current assets

These assets are acquired by the business to assist in earning revenues and not for resale. They are normally expected to be in business for a period of more than one year. Major examples include

- Land and buildings
- Plant and machinery
- Fixtures, furniture, fittings and equipment
- Motor vehicles

Current assets

These assets are not expected to last for more than one year. They are in most cases directly related to the trading activities of the firm. Examples include:

- Stock of goods – for purpose of selling.
- Trade debtors/accounts receivables – owe the business amounts as a resort of trading.
- Other debtors – owe the firm amounts other than for trading.
- Cash at bank.
- Cash in hand.

Liabilities*:*

These are obligations of a business as a result of past events settlement of which is expected to result in an economic outflow of amounts from the firm. An example is when a business buys goods on credit, then the firm has a liability called creditor. The past event is the credit purchase and the liability being the creditor the firm will pay cash to the creditor and therefore there is an out flow of cash from the business.

Liabilities are also classified into two main classes.

i) Non-current liabilities (or long-term liabilities)

ii) Current liabilities.

Non-current liabilities are expected to last or be paid after one year. This includes long-term loans from banks or other financial institutions. Current liabilities last for a period of less than one year and therefore will be paid within one year.

Capital: This is the residual amount on the owner's interest in the firm after deducting liabilities from the assets.

The Accounting equation can be expressed in a simple report called the Statement of financial position (formerly, balance sheet). The basic format is as follows:

Name

Statement of financial position as at 31.12

	GH¢	**GH¢**		**GH¢**
Capital			**<u>Non Current Assets</u>**	
<u>Non Current Liabilities</u>			Land & Buildings	xx
Loan	Xx		Plant & Machinery	xx
<u>Current liabilities</u>			Fixtures, furniture & fittings	xx
Overdraft	Xx		Motor vehicles	xx
Creditors	<u>Xx</u>	<u>Xx</u>		

Capital and Liabilities	Xx	**Current Assets**			
		Stocks	xx		
		Debtors	xx		
		Cash at bank	xx		
		Cash in hand	xx	xx	
		Total assets		xx	

The above format of the statement of financial position is the horizontal format however currently the practice is to present the Statement of financial position using the vertical format which is shown below.

	GH¢	GH¢		GH¢	
Non Current Assets		xx	xx		
Land &			x		
Buildings Plant			x		
& Machinery			x		
Fixtures, furniture & fittings			x	xx	
Motors vehicles			x		
Current Assets			x		
Stocks/inventories					
Debtors/ trade		xx	xx		
receivables Cash at			x		
bank			x		
Cash in hand			x		
			x		
	xx				
Current Liabilities			x		
Bank Overdraft			x		
Creditors/trade payables	xx		xx		
Net Current Assets				xx	xxx
Net assets					x
Capital					x
Non-current liabilities					x
Loan (from bank or other sources)					

Total Capital & liabilities	xx xxx

Pay attention to the format. The non-current *assets* are listed in order of permanence as shown i.e. from Land and Buildings to motor vehicles. The *current assets* are listed in order of liquidity i.e. which asset is far from being converted into cash. Example, stock is not yet sold, (i.e. not yet realised yet) then when it is sold we either get cash or a debtor (if sold on credit). When the debtor pays then the debtor may pay by cheque (cash has to be banked) or cash.

The current liabilities are listed in order of payment i.e. which is due for payment first. Bank overdraft is payable on demand by the bank, then followed by creditors.

Note that in the vertical format, current liabilities are deducted from current assets to give net current assets. This is added to Non-Current assets, which give us net assets. Net assets should be the same as the total of Capital and Non-Current Liabilities

Example 1

Diana sets up a new business. Before she actually sells anything, she has bought motor vehicles of GH¢3, 000, premises of GH¢7, 000, stock of GH¢2,000. She still owes GH¢800 in respect of them. She had borrowed GH¢4,000 from Evans. After the events just described and before trading starts, she had GH¢300 cash in hand and GH¢600 cash at bank.

You are required to calculate the amount of her capital.

Solution

Asset	GH¢	GH¢
Motor Vehicle		3,000
Premises		7,000
Stock		2,000
Cash at bank		600
Cash in hand		300
		12,900
Liabilities		
creditors	800	
Loan- Evans	4,000	-4,800
		8,100
Capital		8,100

Remember the Accounting equation: Assets = Liabilities + Capital.

To get capital we rearrange the equation as follows: Capital = Assets - Liabilities Total

Assets = GH¢.12,900

Total Liabilities = GH¢.4,800 Capital = GH¢. 12,900 - 4,800

= GH¢. 8,100

Example 2

Adwoa Tima has the following assets and liabilities as on 31 April 2022:

	GH¢
Creditors	15,800
Equipment	46,000
Motor Vehicle	25,160
Stock	24,600
Debtors	23,080
Cash at bank	29,120
Cash in hand	160

During the first week of May 2022 Tima:

a. Bought extra equipment on credit for GH¢.5,520.

b. Bought extra stock by cheque GH¢.2,280.

c. Paid creditors by cheque GH¢3,160.

d. Debtors paid GH¢.3,360 by cheque and GH¢.240 by cash.

e. Tima put in extra GH¢.1,000 cash as capital.

Required:

a. Determine the capital as at 1st May 2022.

b. Draw up a statement of financial position after the above transactions have been completed

Solution

Using the accounting equation of Assets = Liabilities + Capital, then assets and liabilities can be listed as follows

Assets	GH¢	Liabilities	GH¢
Equipment	46,000	Creditors	15,800
Motor Vehicle	25,160		
Stock	24,600		
Debtors	23,080		
Cash at bank	29,120		
Cash in hand	160		
	148,120		

Capital = Assets – Liabilities

= GH¢ 148,120 – GH¢.15,800 = GH¢132,320

ii. To draw up the statement of financial position, we consider the effect of the above transactions on the relevant balances:

a. Buying extra equipment means that the equipment balance will increase by GH¢.5,520 and the creditors will also increase by the same amount.

b. Buying extra stock by cheque means that the level of stock goes up by GH¢.2,280 and the balance at bank reduces by the same.

c. Paying creditors by cheque reduces the balance on the creditors account and also reduce the amount at the bank.

d. Debtor paying the firm reduces the debtors balance by GH¢3,600 and increases the cash at bank and cash in hand by GH¢.3,360 and GH¢240 respectively.

e. Additional cash of GH¢1,000 increases the cash in hand balance by GH¢1,000 and the capital balances.

This is also summarized as follows:

Adwoa Tima

Statement of financial position as at 1st May 2022

Assets/Liabilities Sh.	**Opening Balance** GHc	**Adjustment Increase/Decrease** GHc	**Closing Balance** GHc
Equipment	46,000	5,520	51,520
Motor Vehicle	25,160		25,160
Stock	24,600	2,280	26,880
Debtors	23,080	-3,600	19,480
Cash at bank	29,120	(-2,280 – 3,160 + 3,360)	27,040
Cash in hand	160	(+240 + 1000)	1,400
Creditors	15,800	(+5,520 – 3,160)	18,160
Capital	132,320	1,000	133,320

The statement of financial position will therefore be prepared as follows:

Non Current Assets	**GHc**	**GHc**
Equipment		51,520
Motor Vehicle		25,160
		76,680
Current Assets		
Stock	26,880	
Debtors	19,480	
Cash at Bank	1,400	
	74,800	
Current Liabilities		
Creditors	-18,160	
Net Current Assets		56,640
Net Assets		133,320
Capital		133,320

Cause of Changes in Capital

The capital in a business does not remain intact but changes over time due to the following factors: additional investments, profits drawings or losses.

1. *Additional investments (I*)**-**occurs when the owner of the business brings in his personal cash or assets into the business for business use. Additional investment increase the capital of the business.
2. *Profits (P)* **-**defined as the excess revenue obtained after paying costs of a business increase the level of capital and assets of the business.
3. *Drawings (D)*-refer to the money or other assets taken from the business by the owner for personal use. Drawings reduce the business' capital**.**
4. *Losses (l)–*occurs when the cost of goods or services are greater than their sale price . losses reduce the level of business capital

Exercise

You are required to fill the gaps in the table below:

	Assets	Capital	Liabilities
	¢	¢	¢
(a)	20,000,000	15,000,000	?
(b)	35,500,000	?	12,500,000
(c)	?	8,400,000	7,600,000
(d)	64,800,000	?	30,000,000
(e)	?	25,000,000	40,500,000
(f)	250,000,000	135,000,000	?

APPROACHES TO INCOME MEASUREMENT

Net income or net profit, which is the result of operations of an entity for a given period of time, can be measured by two main approaches. This session explains and illustrates these two approaches. You should recall that total assets less total liabilities is the interest of the owner(s), This residual value is called capital or owners' equity. If a business entity earns a profit, the profit goes to increase the owners' equity or capital.

Assets and Liabilities Approach

Recall that total assets less total liabilities is the interest of the owner(s).

We have established that assets = liabilities + capital. For example, if books which cost ¢100,000 are sold for ¢140,000 the assets will increase by ¢40,000 (either cash or trade debtors) but the liabilities will remain unchanged.

So, when the assets and liabilities of an entity or individual at two points in time are known, we can calculate the capital at the said two points. The difference between the two capitals, assuming no additions to capital or no withdrawals from capital, can be explained as the profit made during the period between the two points in time. You should therefore note that in the assets and liabilities approach, net income is a measure of the change in net assets, and therefore capital, from one period to another. In other words, net income is the difference between the ending capital and the beginning capital of a given period, subject to adjustments for additional capital and drawings within the period.

Example

At the beginning of 2016, the assets and liabilities of Kodom Enterprise, a trading concern, were: Premises ¢26m, vehicle ¢15m stocks ¢6.6m, Trade Debtors 17.8m. Trade Creditors ¢12m and Expenses owing ¢6.4m. At the end of the year the assets and liabilities were: Premises ¢23.40m, vehicles ¢23m, stocks ¢ 6.3m Trade Debtors ¢12.60m, Bank ¢7.1m, Trade creditors ¢8.40, Loan ¢10m.

There were no additions to, or drawings from capital. Using the assets- liabilities approach, what is the net profit?

Solution

Capital at Jan 1, 2016 = Assets - liabilities

Capital = ¢ (26+15 + 6.60 + 17.8) - (12 +6.4) m

= ¢65.40m – 18.4m = ¢47m

Capital at Dec 31, 2016 = ¢(23.40+23+6.3+12.6+7.1) - (8.4+10) m

= ¢72.4m - ¢18.4m =¢54m

\Net Profit (income) = change in owner's equity

= ¢54m - ¢47m

= ¢7m

Revenues and Expenses Approach

This is the more popular approach to income determination. Why is it so? It is because the approach provides sufficient details to enable effective decision making. You should recall that the main purpose of accounting information is to provide a basis for decision making.

In the revenues and expenses approach, net income is the difference between the sum of revenues and gains on one hand and the sum of expenses and losses on the other.

Example

At the end of the first operating period, Herdavero Enterprise recorded the following data:

Sales Revenue ¢46.5m, Salaries and Wages ¢7.2m

Office and Trade Expenses ¢4.52m, Rent, Rate and Insurance ¢1.05m Miscellaneous Expenses ¢350,000, Cost of Goods Sold ¢29m Bad Debts ¢110,000; Discount Received ¢250,000; Discount Allowed ¢300,000

Required:

Using the revenues- expenses approach, determine the income of Herdavero's Enterprise for the first year of operation.

Solution

Net Income = (Revenues + Gains) – (Expenses +Losses)

= ¢(46.500 + 0.250)m – (29.000 +7.200 + 4.520 + 1.050 + 0.350 + 0.110 + 0.300)m

= ¢46.750m - ¢42.50m

= **¢4.220m**

Journal

Journal is a historical record of business transaction or events. The word journal comes from the French word "Jour" meaning "day". It is a book of original or prime entry. Journal is a primary book for recording the day-to-day transactions in a chronological order i.e., the order in which they occur. The journal is a form of diary for business transactions. This is called the book of first entry since every transaction is recorded firstly in the journal.

Journal Entry

Journal entry means recording the business transactions in the journal. The process of recording journal entries in the journal is called journalizing. For each transaction, a separate entry is recorded. Before recording, the transaction is analysed to determine which account is to be debited and which account is to be credited. The Pro forma of journal is shown as follows:

Date	Particulars	L.F.	Debit (Amount)	Credit (Amount)

Column 1 (Date): The date of the transaction on which it takes place is written in this column. *Column 2 (Particulars)*: In this column, the name of the accounts to the debited is written first, then the names of the accounts to be credited and lastly, the narration (i.e. a brief explanation of transaction) are entered.

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

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

Column 5 (Cr. Amount): In this column the amount to be credited against the 'Cr.' Account is written along with the nature of currency.

Advantages of Using Journal

Journal is used because of the following advantages:

a. A journal contains a permanent record of all the business transactions.

b. The journal provides a complete chronological (in order of the time of occurrence) history of all business transactions and the task of later tracing of some transactions is facilitated.

c. Complete information relating to one single business transaction is available in one place with all its aspects.

d. The transaction is provided with an explanation technically called a narration.

e. Use of the journal reduces the possibility of an error when transactions are first recorded in this book.

f. The journal establishes the quality of debits and credits for a transaction and reconciles any problems. If a business purchases a bicycle, it is necessary to decide whether the bicycle represents ordinary goods or machinery. Further any amount paid is debited to bicycle account and credited to cash account.

g. The use of journals avoids omission or duplication of transactions or parts of transaction. Without the journal the accountant would be forced to go to the individual account to enter debits and credits. Therefore, it is possible for accountant to miss part of a transaction, duplicate all or part of a transaction or incorrectly record debits and credits. Even with the Journal, it is still possible to omit transactions and make other errors. However, the Journal reduces these problems.

h. Once a transaction is recorded in the journal, it is not necessary to post it immediately in the ledger accounts. In this, way, the journal allows the delayed posting.

Steps in Journalizing:

Steps involved in Journalizing are:

1. Determine the accounts that are affected by a transaction.
2. Determine the nature of the accounts affected.
3. Determine the account to be debited and credited by applying the rules of debit and credit.
4. Determine the amount by which the accounts are to be debited and credited.

5. Record the date and month of the transaction in the 'Date' column and the year at the top.
6. Record in the 'Particulars' column the name of the account to be debited. Along with the name of the account, the abbreviation 'Dr.' also should be written in the same line against the name of the account. Write the amount to be debited in the 'Debit Amount' column.
7. Record in the 'Particulars' column the name of the account to be credited. The name of the account to be credited should be written in the next line proceeded by the word 'To'. The word 'To' is written towards the right after leaving a few spaces. Write the amount to be credited in the 'Credit Amount' column.
8. Record a brief description of the transaction starting from the next line in the 'Particulars' column. This brief description of the transaction is called narration.
9. Draw a line across the "Particulars" column to separate one Journal entry from the other.

UNIT THREE
SUBSIDIARY BOOKS OF ACCOUNTS, LEDGERS AND TRIAL BALANCE

Learning Objectives:

Upon completion of this unit, you will be able to

- Identify the main data sources and records in an accounting system
- Describe the content and purpose of different types of business documentation
- Record transactions using the day books
- Post day books totals to the ledgers accounts
- Explain division of the ledger accounts

Introduction

All business transactions, at the first stage, are recorded in the book of original entry i.e., Journal and then posted into the ledger under the double entry system of book- keeping: This procedure is easy and practicable in small business where the number of business transactions are less and when a single person can handle the business transactions. But it is practically very difficult, rather impossible, to record all the business transactions of a day in the Journal of a large business where the number of business transactions are varied and huge. Classification of the recorded transactions is made in the ledger.

The system of recording all transactions in a journal requires

1. writing down of the name of the account involved as many times as the transactions occur; and
2. an individual posting of each account debited and credited and hence, involves the repetitive journalising and posting labour

The journal becomes bulky and voluminous, therefore, to overcome the shortcomings of the use of the journal as the only book of original entry, the journal is subdivided into special journals. It is divided in such a way that a separate book is used for each category of business transactions which are repetitive in nature, similar and are sufficiently large in number.

Special journals refer to the journals meant for recording specific business transactions of similar nature. These special journals are also known as "Subsidiary Books" or "Day Books". Subsidiary books are books of original entry. In the normal course of business, a majority of transactions are either relate to sales, purchases or cash. So we record transactions of the same or similar nature in one place, i.e. the subsidiary book. And we record these transactions in chronological order.

This actually saves a lot of man-hours and tiresome clerical work. Instead of journalizing each entry, they are recorded into various subsidiary books. Think of your subsidiary book as sub- journals that record only one type of transaction. The main types of special journals are as follows.

Cash Book: It records all those transactions which are in cash or by cheques. *Purchases Book*: It records all transactions relating to goods purchased on credit. *Sales Book*: It records all transactions relating to goods sold on credit.

Purchases Return Book: It records return of goods to suppliers.

Sales Return Book: It records return of goods by the customers.

Bills Receivable Book: Its records entries regarding bills receivables. The details of bills are given in this book.

Bills Payable Book: All bills which are accepted and payable by a business house are recorded in this book.

Journal Proper: Those transactions which are not recorded in any of the above- mentioned books are recorded in the Journal Proper.

Goods: It refers to items forming part of the stock-in-trade of a business which are purchased and are to be resold at a profit. A business may purchase fixed assets or stationery for use in business, but they are not purchases of goods.

Purchases: It refers to the purchase of goods for resale, and not the purchase of assets or stationery. The Purchases Account, therefore, only contains purchases of goods for resale.

Sales: It refers to the sale of goods which form part of the stock-in-trade of the business.

The advantages of using special journals are as under:

1. Facilitates division of work: The accounting work can be divided among many persons.
2. Time and labour saving in journalising and posting: For instance, when a sales book is kept, the name of the sales account will not be required to be written down in the journal as many times as the sales transactions occur and at the same time, sales account will not be required to be posted again and again since, only a periodic total of sales book is posted to the sales account.
3. Permits the use of specialised skill: The accounting work requiring specialised skill may be assigned to a person possessing the required skill. With the use of a specialised skill, prompt, economical and more accurate supply of accounting information may be obtained.

4. Permits the installation of internal check system: The accounting work can be divided in such a manner that the work of one person is automatically checked by another person. With the use of internal check, the possibility of occurrence of error/fraud may be avoided.

Cash Book

The cash book is used to record receipts and payments of cash. It works as a book of original entry as well as a ledger account. The entries related to receipt and payment of cash are first recorded in the cash book and then posted to the relevant ledger accounts. Moreover, a cash book is a substitute for cash account in the ledger. A company that properly maintains a cash book does not need to open a cash account in its ledger.

A cash book is a special journal which is used for recording all cash receipts and cash payments. Cash Book serves dual role of journal as well ledger. Cash Book is the book of original entry (Journal) since transactions are recorded for the first time from the source documents. It is a ledger in the sense that it is designed in the form of Cash Account and records cash receipts on the debit side and cash payments on the credit side.

Features of the Cash Book

- Only cash transactions are recorded in the Cash Book.
- It performs the functions of both journal and the ledger at the same time.
- All cash receipts are recorded on the debit side and all cash payments are recorded on the credit side.
- The Cash Book, recording only cash transactions can never show a credit balance.

Kinds of Cash Book

Single Column Cash Book - For recording cash transactions only. Single column cash- book contains only the cash transactions done by the business. Single column cash- book has only a single money column on debit and credits both sides. It does not record the transaction-related, which involves banks or discounts. The transactions which are done on credit are not recorded while preparing the single column cash –book.

Double (Two) Column Cash Book - For recording cash and bank transactions. Double column cash-book contains two money column both on the debit side as well as the credit side. One column is for the transactions related to the cash, and the other column is for the transactions related to the bank account of the business. So, under double- column cash-book, not only cash transactions but transaction through the bank is done by the business is also recorded. The transactions which are done on credit are not recorded while preparing the double column cash – book.

Triple (Three) Column Cash Book - For recording cash and bank transactions involving gain or loss on account of discount. It is also referred to as a three-column cash book format, and it is a most exhaustive form which has three columns of money on both receipt and payment sides and record transactions about the cash, bank, and discounts. This book is generally maintained by the large firms that do transactions in cash mode as well as through the bank and frequently allows and receives cash discounts.

Petty Cash Book- For recording petty expenses. Petty cash book is a type of cash book that is used to record minor regular expenditures such as office teas, bus fares, fuel, newspapers, cleaning, pins, and causal labor etc. These small expenditures are usually paid using coins and currency notes rather than checks. The person responsible for spending petty cash and recording it in a petty cash book is known as petty cashier.

Advantages of Cash Book

a. It helps in saving time and labor as in case of recording cash transactions in the journal, tremendous time and labor are required, whereas, in the case of cashbook, cash transactions are recorded straight away that is in the form of the ledger.

b. Management can know the balances of cash and bank at any time. It helps in effective cash management.

c. Cashbook is balanced regularly, which helps in avoiding fraud. Also, discrepancies, if any, arises can be found and rectified.

Single Column Cash Book:

Illustration 4.5.1

Enter the following transactions in the cash book of Mr. Adjei Business March 1 Mr. Adjei commenced business with CashGH₵ 6,500

March 3	Bought goods for cash	685
March 4	Paid to Morgan	95
March 6	Deposited in the bank	4,000
March 6	Purchased office furniture on cash	465
March 9	Sold goods for cash	3,000
March 12	Paid wages in cash	120
March 13	Paid for stationary	40
March 15	Sold goods for cash	2,500
March 17	Paid for miscellaneous expenses	45
March 19	Received cash from Taller	485
March 21	Withdrew for domestic use	250
March 22	Paid salary	400
March 25	Paid rent	90
March 28	Paid electricity bill	35
March 29	Paid for advertising	40
March 31	Paid into bank	2,500

Solution 4.5.1

2006	Details	Amount	2006	Details	Amount
March 1	Capital A/c	6,500	March 3	Purchases A/c	685
March 9	Sales A/c	3,000	March 4	Mogan's A/c	95
March 15	Sales A/c	2,500	March 6	Bank A/c	4,000
March 19	Taller's A/c	485	March 6	Furniture A/c	465
			March 12	Wages A/c	120
			March 13	Stationery A/c	40
			March 17	Misc. Expenses A/C	45
			March 21	Drawings A/c	250
			March 22	Salaries A/c	400

			March 25	Rent A/c	90
			March 28	Electricity A/c	35
			March 29	Advertisement A/C	40
			March 31	Bank A/c	2,500
			March 31	Balance c/d	3,720
		12,485			**12,485**
April 1	Balance b/d	3,720			

Illustration 3.1

The Harper Company uses a single column cash book to record all cash transactions. It engaged in the following cash transactions during the month of September 2020.

Sep.01: Cash in hand at start of the month Gh₵4,654.

Sep.02: Paid salaries to employees for the last month Gh₵ 3,000.

Sep.05: Cash received from S & Co. for a previous credit sale Gh₵ 2,720. Sep.06: Merchandise purchased for cash Gh₵ 1,400.

Sep.07: Merchandise sold for cash Gh₵ 4,700.

Sep.10: Office furniture purchased for cash Gh₵ 3,080. Sep.12: Stationary purchased for cash Gh₵ 170.

Sep.15: Merchandise sold for cash Gh₵ 9,000.

Sep.17: Cash paid to A & Co. for a previous credit purchase Gh₵ 1,780. Sep.20: Merchandise purchased for cash Gh₵ 2,460.

Sep.21: Merchandise sold for cash Gh₵ 4,680.

Sep.24: Cash received from S & Co. for a previous credit sale Gh₵ 2,400. Sep.28: Cash paid for office rent Gh₵ 1,600.

Sep.30: Merchandise sold for cash Gh₵ 7,200

Required: Record the above transactions in a single column cash book.

Solution 3.1:

Cash Book of The Harper Company

2020	Details	Amount Gh ₵	2020	Details	Amount Gh ₵
Sept 1	Balance	4,654	Sept 2	Salaries	3,000
Sept 5	S & Co	2,720	Sept 6	Purchases	1,400
Sept 7	Sales	4,700	Sept 10	Office furniture	3,080
Sept 15	Sales	9,000	Sept 12	Stationary	170
Sept 21	Sales	4,680	Sept 17	A & Co	1,780
Sept 24	S & Co	2,400	Sept 20	Purchases	2,460
Sept 30	Sales	7,200	Sept 28	Rent	1,600
			Sept 30	Balance c/d	21,864
		35,354			**35,354**

Illustration 3.2

Enter the following transactions in a single column cash book for the month of January, 2021 from the following particulars:

1, Cash in hand GhȻ1,000

2, Goods sold GhȻ 8,000

4, Paid salaries to employees GhȻ 15,000

6, Payment made to a creditor A by cheque GhȻ 5,000

8, Cash sales of GhȻ 30,000 out of which GhȻ 5,000 immediately deposited into bank.

9, Cash sales of GhȻ 28,000 out of which GhȻ 10,000 was deposited into bank on 12th January

15, Purchased goods from Hari Ram GhȻ 7,000 18, Paid to transporter GhȻ 1,000

20, Sold goods to Manik Chand GhȻ 3,000

28, Paid electricity bill GhȻ 500

30, Paid to Mr. Sharma GhȻ 140 and discount received GhȻ 10

Two Column (Double Column) Cash Book:

Illustration 3.3

Write up a two-column cash book of DEBS from the following details and balance of as the end to the month, September, 2019.

Sept 1: Proprietor puts capital into a bank account for the business GHȻ940 Sept 2: Received cheque from M. Boon GHȻ115

Sept 4: Cash Sales GHȻ102

Sept 6: Paid rent by cash GHȻ35

Sept 7: Banked GHȻ50 of the cash held by the firm

Sept 15: Cash sales paid direct into the bank GHȻ40 Sept

23: Paid cheque to S Wills GHȻ277

Sept 29: Withdrew cash from bank for business use GHȻ120

Sept 30: Paid wages in cash GHȻ118

Solution 3.3

Cash Book of DEBS

2020	Details	Cash Gh ₵	Bank Gh ₵	2020	Details	Cash Gh ₵	Bank Gh₵
Sept 1	Capital		940	Sept 6	Rent	35	
Sept 2	M. Boon		115	Sept 7	Bank	50	
Sept 4	Sales	102		Sept 15	Bank	40	
Sept 7	Cash		50	Sept 23	S Wills		277
Sept 15	Sales	40		Sept 29	Cash		120
Sept 15	Cash		40	Sept 30	Wages	118	
Sept 29	Bank	120		Sept 30	Balance c/d	19	748
		262	**1,145**			**262**	**1,145**

Illustration 3.4:

Write up a two-column cash book of Pretty Lady from the following transaction in 2017

Nov	1	Balance brought forward from last month: cash GH₵ 105: Bank GH₵ 2,164
Nov	2	Cash Sale GH₵ 605
Nov	3	Took GH₵ 500 out of the cash till and paid it into the bank
Nov	4	J Matthews paid us by cheque GH₵ 217
Nov	5	We paid for postage stamps in cash GH₵ 60
Nov	6	Bought office equipment by cheque GH₵ 189
Nov	7	We paid J Lucas by cheque GH₵ 50
Nov	9	Received rates refund by cheque GH₵ 72
Nov	11	Withdrew GH₵ 250 from the bank for business use.
Nov	12	Paid wages in cash GH₵ 239
Nov	14	Paid motor expenses by cheque GH₵ 57
Nov	16	L Levy lent us GH₵ 200 in cash
Nov	20	R Norman paid us by cheque GH₵ 112
Nov	28	We paid general expenses in cash GH₵ 22
Nov	30	Paid insurance by cheque GH₵ 74

4.7.1. Three Column (Triple Column) Cash Book:

Illustration 3.5:

Enter the following transactions in the cashbook of Good News Enterprise for the month of July 2018 and balance off at the end the period.

July 1: Balance brought down Cash GH₵200, Bank GH₵ 4400. July 2: Cash sales paid direct into the bank GH₵ 280.

July 3: The following paid us by cheque in each case deducting a 10% cash discount, Forson GH₵ 2000, Okai GH₵ 600, Quaye GH₵ 360, Leonards GH₵ 1200.

July 5: Paid rent by cash GH₵ 180.

July 6: We paid the following accounts by cheque in each case deducting 2.5% cash discount, Martins GH₵ 700, Johnson GH₵ 1000, and Ansah GH₵ 400.

July 8: Withdrew cash from the bank for business use GH₵ 500. July 10: Cash sales GH₵ 600. July 12: Bought stationery paying by cash GH₵ 160. July 12: Received GH₵ 200 cheque from D Steel.

July 14: Cash sales GH₵ 116.

July 16: We paid the following accounts by cheque, Lucas GH₵ 230 less cash discount 9, Bolton GH₵ 306 less cash discount GH₵ 10.

July 20: Bought Land by cheque GH₵ 16000.

July 24: Bought photocopier machine paying by cheque GH₵ 12,300. July 26: Paid insurance by cash GH₵ 450.

July 28: Withdrew GH₵ 200 from the bank for business use.

Solution 3.5

Cash Book of Good News Enterprise

Date	Details	Dis. All	Cash	Bank	Date	Details	Dis. Rec	Cash	Bank
		GH₵	GH₵	GH₵			GH₵	GH₵	GH₵
Jul-01	Bal b/d		200	4400	Jul-02	Bank		280	
Jul-02	Sales		280		Jul-05	Rent		180	
Jul-02	Cash			280	Jul-06	Martins	17.5		682.5
Jul-03	Forson	200		1800		Johnson	25		975
	Okai	60		540		Ansah	10		390
	Quaye	36		324	Jul-08	Cash			500
	Leonards	120		1080	Jul-12	Stationery		160	
Jul-08	Bank		500		Jul-16	Lucas	9		230
Jul-10	Sales		600			Bolton	10		306
Jul-12	D Steel			200	Jul-20	Land			16000
Jul-14	Sales		116		Jul-24	Photocopier			12300
Jul-28	Bank		200		July 26	Insurance		450	
Jul-31	Bal c/d			22959.5	Jul-28	Cash			200
					Jul-31	Bal c/d		826	
		416	**1896**	**31583.5**			**71.5**	**1896**	**31583.5**
Aug-01	Bal b/d		826		Aug- 01	Bal b/d			22959.5

Illustration 4.1

Write up a three-column cash book of Joy Daddy from the following transaction in 2015. March

Balance brought forward: Cash GH₵ 230; Bank GH₵ 4,756

March 2 The following paid their accounts by cheque, in each case deducting 5% cash Discount: R Burton GH₵ 140; E Taylor GH₵ 220; R Harris GH₵ 300

March 4 Paid rent by cheque GH₵ 120

March 6 J Cotton lent us GH₵ 1,000 paying by cheque

March 8 We paid the following accounts by cheque in each case deducting 2 $^{1}/2$% cash discount: N Black GH₵ 360; P Towers GH₵ 480; C Rowse GH₵ 800 March 10 Paid motor expenses in cash GH₵ 44

March 12 H Hankins pays his account of GH₵ 77, by cheque GH₵ 74, deducting GH₵ 3 cash discount. March 15 Paid wages in cash GH₵ 160

March 18 The following paid their accounts by cheque, in each case deducting 5% cash discount: C Winston

GH₵ 260; R Wilson & Son GH₵ 340; H Winter GH₵ 460.

March 21 Cash withdrawn from the bank GH₵ 350 for business use.

March 24 Cash drawings GH₵ 120

March 25 Paid T Briers his account of GH₵ 140 by cash GH₵ 133, having deducted GH₵ 7 cash discount

March 29 Bought fixtures paying by cheque GH₵ 650

March 30 Received commission by cheque GH₵ 88

Illustration 4.2:

Enter the following in three-column cash book of BSc Waakye Enterprise. Balance off the cash book at the end of the June, 2018

June 1 Balance brought forward: Cash GH₵ 97; Bank GH₵ 2,186

June 2 The following paid us by cheque in each case deducting a 5% cash discount R Harris GH₵ 1,000; C White GH₵ 280; P Peers GH₵ 180; O Hardy GH₵ 600

June 3 Cash sales paid direct into the bank GH₵ 134

June 5 Paid rent by cash GH₵ 88

June 6 We paid the following accounts by cheque, in each case deducting 2 1/2% cash Discount: J Charlton GH₵ 400; H Sobers GH₵ 640; D Shallcross GH₵ 200.

June 8 Withdrew cash from the bank for business use GH₵ 250

June 10 Cash sales GH₵ 206

June 12 D Deeds paid us their account of GH₵ 89 by cheque less GH₵2 cash discount.

June 14 Paid wages by cash GH₵ 250

June 16 We paid the following accounts by cheque: L Lucas GH₵ 117 less cash discount GH₵ 6; D Fisher GH₵ 206 less cash discount GH₵ 8.

June 20 Bought fixtures by cheque GH₵ 8,000

June 24 Bought motor lorry paying by cheque GH₵ 7,166

June 29 Received GH₵ 169 cheque from D Steel

June 30 Cash sales GH₵ 116

June 30 Bought stationery paying by cash GH₵ 60.

Petty Cash Book

Petty Cash Book is the book which is used for the purpose of recording expenses involving petty amounts such as Postage, Cartage, Telegram etc. The person who records these transactions is known as Petty Cashier. Recording of Petty Cash: Petty cash given to the Petty Cashier for small payments is recorded on the credit side of the Cash Book as 'By Petty Cash Account' and is posted to the debit side of the Petty Cash Account in the Ledger. System of Petty Cash: Petty Cash Book may be maintained by ordinary system or by imprest system. Imprest System: Under this system an estimate is made of amount required for petty expenses for a certain period.

Illustration 4.8.1

From the following information, write up a Simple Petty Cash Book for the first week of Jan 2021:

Date	Particulars	GHC
Jan 1	Received GHC 8,000 from Chief Cashier for Petty Cash	
Jan 2	Bought Postage stamps	2000
Jan 4	Paid bus fare	1200
Jan 5	Purchased stationery for office use	1000
Jan 6	Paid for milk and sugar for office tea	600
Jan 7	Paid to window cleaner	800

Amount Rec.	Date 2021	Particulars	Voucher No	Amount Paid Gh ₵
8,000	Jan 1	Cash		
	Jan 2	Postage A/c		2,000
	Jan 4	Travelling Exp		1,200
	Jan 5	Stationery A/c		1,000
	Jan 6	Office Expenses A/c		600
	Jan 7	Miscellaneous Exp A/c		800
	Jan 7	Balance		2,400
8,000				**8,000**

The system of petty cash payments along with the imprest system offers the following advantages:

a. The money in the hands of the petty cashier is limited to the imprest amount.

b. As the periodical reimbursements are the actual expenses paid and not mere advances on account only, they are as such brought prominently to the notice of Chief Cashier.

c. The Chief Cashier, by handing over a fixed sum, is relieved of the cumbersome work of petty disbursements.

d. The main cash book is not unnecessarily clogged with the large number of small items. Even in the ledger, only the totals are posted.

e. At all time, the amount of cash in hand plus expenses not reimbursed must equal the imprest amount, thus, facilitating a simple check.

f. The maximum liability of the petty cashier can never exceed the imprest amount.

g. The regular check of the petty cash book creates a sense of responsibility inthe petty cashier.

All the heads of expenses are totaled periodically and such periodic totals are individually posted to the debit side of the concerned ledger accounts in the ledger by writing ‘To Petty Cash A/c’ in the particulars column. The Petty Cash Account in the ledger is credited with the total expenditure incurred during the period by writing ‘By Sundries as per Petty Cash Book’ in the particular’s column. The ledger folio number is written under every total amount of expense to indicate that the entry has been posted in the ledger. In the folio column of the ledger account, the page number of the petty cash book is written

Sales Day Book

Sales day book is also known as a sales book, sales journal, sold book etc. It is a subsidiary book, i.e., a book of original entry. It is a manually maintained account, with the purpose of recording all credit sales of the business in one place. This means all the sales of the firm done on credit are recorded in the sales day book. No cash sales will be recorded here, they are recorded in the cash book. And only the sale of goods on credit will be recorded in the sales journal or sales day book.

Illustration 3.6

Enter the sales journal from the following records of ABC Ltd for March 2019. March 1 Credit sales to J Gordon GH₵ 187

March 3 Credit sales to G Abrahams GH₵ 166

March 6 Credit sales to V White GH₵ 12

March 10 Credit sales to J Gordon GH₵ 55

March 17 Credit sales to F Williams GH₵ 289

March 19 Credit sales to U Richards GH₵ 66

March 27 Credit sales to V Wood GH₵ 28

March 31 Credit sales to L Simes GH₵ 78

Solution 3.6

Sales Journal

Date 2019	Details/Particulars	L.F	Amount Gh₵
March 1	J Gordon A/c		187
March 3	G Abrahams A/c		166
March 6	V White		12
March 10	J Gordon		55
March 17	F Williams		289
March 19	U Richards		66
March 27	V Wood		28
March 31	L Simes		78
	Total Transferred to Sales A/c		881

Illustration 3.7

From the following transactions make the sales day book for ABC and Co. May 1: Sold goods to X for Gh₵ 600 on credit

May 4: A credit sale of 10 units to Y for Gh₵ 35 per unit May 20: Sold 50 units to Z for 1350 per unit for cash May 22: Q bought units worth Gh₵ 500 on credit

Illustration 3.8

The following sales were made by TTT on credit during the month of Sept, 2016. Sept. 1: To Kate, invoice No. 001 at GH₵50,000

Sept. 6: To Harry Ltd, Invoice No. 002 at GH₵25,000 Sept. 13: To Graham, Invoice No. 003at GH₵30,000 Sept. 14: To Kate Invoice No. 004 at GH₵ 17,000

Sept. 17: To Stella Invoice No. 005 for GH₵30,000 at a trade discount of 3% Sept. 22: To Damson Ltd, Invoice No. 006 at GH₵ 85,000

Sept. 30: To Kate, Invoice No. 007 at 60,000

Purchases Day Book

Purchases journal (also known as purchases book and purchases day book) is a special journal used by businesses to record all credit purchases. All cash purchases are recorded in another special journal known as cash payment journal or cash disbursements journal. When merchandise and their invoice are received from supplier, responsible personnel from receiving department compares them with the copy of the order placed by the purchase department. If quantity and quality of merchandise conform to the order, the merchandise are accepted and transferred to the warehouse. After it, an entry is immediately made in the purchases journal on the basis of information obtained from the invoice provided by the seller. Like sales journal, purchases journal contains transactions net of trade discounts (i.e., after deduction of any trade discount but before any cash discount).

Posting

After recording transactions in the Purchases Book, the posting in ledger accounts will be made. The posting from the Purchases Book is made as follows:

a) Debit the Purchases Account with the periodical totals of the Purchases Book. On the debit side of the Purchases Account, write "Total as per Purchase Book" or "Sundries" in the particulars column.

b) Personal accounts of each individual supplier is credited with the net amount of Inward Invoice recorded in Purchases Book by writing "Purchases".

Illustration 3.9

B Mann has the following purchases from the month of May 2018.

May 1 From K King: 4 radio at GHS 30 each, 3 music centers at GHS 160 each. Less 25% trade discount.

May 3 From A Bell: 2 washing machines at GHS 200 each, 5 vacuum cleaners at GHS 60 each, 2 dishwashers at GHS 150 each. Less 20% trade discount

May 15 From J Kelly: 1 music centre at GHS 300 each, 2 washing machines at GHS 250 each. Less 25% trade discount

May 20 From B Powell: 6 radios at GHS 70 each. Less 30% trade discount.

May 30 From B Lewis: 4 dishwashers at GHS 200 each. Less 20% trade discount.

Solution 3.9

Purchases Journal

Date	Details/Particulars	Invoice No	L.F	Amount GhȻ
May 1	K King			450
May 3	A Bell			800
May 15	J Kelly			600
May 20	B Powell			294
May 30	B Lewis			640
	Total Transferred to Purchases A/c			2,784

Workings

K King: 4 radio × 30 each = 120

3 music × 160 each = 480

= 600

Less trade discount 25% × 600 = (150)

Total = 450

A Bell: 2 washing machines × 200 each = 400

5 vacuum cleaners × 60 each = 30

2 dishwashers × 150 each = 300

= 1000

Less trade discount 20% × 1000 = (200)

Total = 800

J Kelly: 1 music centre × 300 each = 300

2 washing machines × 250 each = 500

800

Less 25% trade discount × 800 = (200)

Total = 600

B Powell: 6 radios × 70 each = 420

Less 30% trade discount × 420 = (126)

Total = 294

B Lewis: 4 dishwashers × 200 each = 800

Less 20% trade discount = (160)

Total = 640

Illustration 3.10

The following purchases were made by KKK on credit during in October, 2019 Oct. 1: From Asempa Ltd, 150 bags of cement, invoice No. 868 at GH₵4,500

Oct. 6: From Yaw Ltd 200 packets of roofing sheets Invoice No. 356 at GH₵19,000 Oct. 13: From Gam Ltd 80 bags of cements Invoice No. 076 at GH₵3,000

Oct. 14: From Yaw Ltd. 300 packets of roofing sheets Invoice No. 369 at GH₵ 27,000 Oct. 17: From Sampson Ltd. Iron rods Invoice No. 43 for GH₵50,000 at a trade discount of 2%

Oct. 22: From Benita Ltd, 180 packets of roofing sheets Invoice No. 23 at GH₵ 8,000 Oct. 31: From Asempa Ltd, 400 bags of cement, Invoice No. 981 at 20,000

Purchase Return Book

In every business, it is not uncommon to find that the goods are returned by a business enterprise to the supplirs because of many reasons such as goods are defective, goods are not according to order. If the returns are frequent in a business, in that case a separate book may be maintained to record this type of transactions which is known as Purchases Returns Book or Returns Outward Book.

The entries in the Purchases Returns Book are usually made on the basis of debit notes issued to the supplier when a firm returns some goods to it suppliers, it prepares a debit note in duplicate. The original copy is sent to the supplier to whom the goods are returned. The Debit Note is so called because the supplier's account is debited with the amount of the goods returned. After recording the transaction in Purchases Returns Book, posting to the ledger involves the following:

a. The periodical total of the Purchases Return Book is posted to the credit of the Purchases Return Account in the ledger.
b. The personal account of each individual suppliers is debited with the amount of Debit Note.

Illustration 3.10.1:

The following purchases returns were made by KKK during October, 2019.

Oct. 3: Returned 10 bags of cement to Asempa Ltd, Debit Note No. 34 at GH₵500 Oct. 17: Returned 6 bags of cement to Gam Ltd Debit Note No. 10 at GH₵300

Oct. 31: Returned 25 bags of cement to Asempa Ltd, Debit Note No. 39 at GH₵1,500 Prepare a Purchases Return Journal and post to the relevant ledgers

Solution 3.10.1

Purchases Return Journal (Return Outward Book)

Date 2019	Details/Particulars	Debit Note No	L.F	Amount Gh₵
Oct 3	Asempa Ltd	34		500
Oct 17	Gam Ltd	10		300
Oct 31	Asempa Ltd	39		1500
Oct 31	Total Transferred to Purchases Return A/c			**2,300**

Sales Return Book

Sales Return Book or Returns Inwards Book is meant for recording return of goods sold on credit. The goods which are sold for cash if returned are either exchanged for new goods or parties are paid in cash do not find a place in the Sales Return Journal. The columns used in this book are similar to Sales Book except that in place of Invoice No. the Credit Note number is recorded. Credit Note is just reverse of Debit Note and is sent by the seller to the buyer.

It is an acknowledgment of the goods returned as well as information to the debtor that his account is being credited with the amount mentioned in it. Thus, the party towhom a Credit Note is sent become a creditor. The posting from the Sales Return Book will be done periodically to the debit side of the Sales Returns Account in the ledger and the individual accounts of the customers will be credited with their respective amounts.

Illustration 3.10.2:

The following sales returns were made by TTT during the month of Sept, 2019. Sept. 5: From Kate, good worth GH₵5,000 Credit Note No. 001

Sept. 16: From Graham, Credit Note No. 002 at GH₵3,000 Sept. 18: From Stella, Credit Note No. 003 GH₵ 7,000 Prepare a Sales Return Journal and post to the relevant ledgers

Solution 3.10.2:

Sales Return Journal (Return Inward Book)

Date 2019	Particulars	Debit Note No	L.F	Amount Gh₵
Sep 5	Kate	001		5,000
Sep 16	Graham	002		3,000
Sep 18	Stella	003		7,000
Sep 30	Total transferred to Sales Return A/c			**13,000**

Journal Proper or General Journal

Journal Proper is a residuary book in which those transactions are recorded which cannot be recorded in any other subsidiary book such as (a) Cash Book, (b) Purchases Book, (c) Sales Book, (d) Purchases Returns Book, (e) Sales Returns Book.

The various examples of transactions entered in a Journal Proper are given below:

a. Opening entry: An Opening Entry is passed in the journal for bringing the balances of various assets, liabilities and capital appearing in the Balance Sheet of the previous accounting period, in the books of current accounting period.

b. Closing entries: Closing Entries are passed in the journal for closing the nominal accounts by transferring them to the Trading and Profit and Loss Account. These are needed at the end of the accounting year, when the final accounts are prepared.

c. Transfer entries: Transfer Entries are passed in the journal for transferring an amount from one account to another account, i.e. Transfer of Total Drawings from Drawings Account to Capital Account.

d. Adjusting entries: Adjusting Entries are passed in the journal to bring into the books of accounts certain unrecorded items like closing stock, depreciation on fixed assets, outstanding and prepaid items. These are needed at the time of preparing the final accounts.

e. Rectifying entries: Rectifying Entries are passed in the journal to rectify the various errors committed while posting, totaling, balancing etc.

f. Miscellaneous entries: This includes the following:

- Capital brought in kind. If the proprietor of the business brings in his capital contribution in kind and not in cash, such transaction can be recorded only in the Journal Proper and not in the Cash Book since this transaction does not involve any cash inflow.
- Purchase of Assets (other than Stock-in-trade) on credit (e.g., land, building, plant and machinery, furniture and fixture). Such transactions can neither be recorded in the Purchase Book (since no goods have been purchased) nor recorded in the Cash Book (since this transaction does not involve anycash outflow).
- Sales of Assets (other than Stock-in-trade) which were sold on credit. Such transaction can neither be recorded in the Sales Book (since no goods have been sold) nor can be recorded in the Cash Book (since this transaction does not involve any cash inflow).
- Return of Assets (other than Stock-in-trade) which were sold on credit. Such transactions cannot be recorded in the Return Inwards Book since no goods have been returned.
- Return of Assets (other than Stock-in-trade) which were bought on credit. Such transactions cannot be recorded in the Return Outwards book since, no goods have been returned.
- Endorsement of Bills Receivable to a creditor.
- Dishonour of Bills Receivables (not discounted with bank).
- Cancellation of Bills Payable.

- Abnormal Loss of Stock-in-trade/other assets by theft, accident, fire, etc.
- Writing-off Bad Debts.

Illustration 4.14.1

Enter the following transactions in proper Subsidiary Books, post them into Ledger Accounts, balance the accounts and prepare a Trial Balance.

June 1. Assets: Cash in hand GHC 20,000; Debtors: Amit and Co. GHC 15,000, Sammy GHC 30,000, Stock GHC 1,75,000, Machinery GHC 1,20,000, Furniture GHC 40,000.

Liabilities: Bank overdraft GHC 33,000, Creditors: Virat and Co. GHC 24,000, Vishi GHC 16,000.

June 2 Purchased from Ramesh and Sons goods of the list price of GHC 20,000 at 10% trade discount.

June 5 Returned to Ramesh & Sons goods of the list price of GHC 2,000.

June 10 Issued a cheque to Ramesh and Sons in full settlement of their account. June 12 Sold to Amit and Co., goods worth GHC 25,000.

June 15 Received cash GHC 10,000 and a cheque for GHC 8,000 from Amit and Co. The cheque was immediately deposited into the bank.

June 16 Withdrawn for personal use cash GHC 5,000 and goods of GHC 3,000. June 17 Paid Virat and Co. cash for the amount due to him and received discount of

GHC2,000

June 18 Received from Sammy cheque amount due allowing him 1,200 June 19 Sold to Mutari Ltd., goods for GHC 16,000.

June 20 Cash purchases GHC 15,000.

June 22 Withdrawn from bank for office use GHC 10,000 June 23 Purchased from Vishil goods valued at GHC 24,000. June 24 Amit and Co. returned goods worth GHC 2,000.

June 25 Received from Mutari ltd. GHC 10,000 cash. June 27 Paid Vishi cash for GHC 25,000 June 27. Paid by cheque, Rent GHC 2,800

June 27 Received Commission in Cash GHC 800 June 30 Paid salaries GHC 5,000 by cheque.

Ledgers

Recording is made in Journal, which has been explained in the preceding lesson. Classification of the recorded transactions is made in the ledger. A ledger may be defined as a "book or register which contains, in a summarized and classified form, a permanent record of all transactions." It is the most important book of accounts. As the trial balance is prepared from it and from the trial balance, financial statements are prepared. Hence, the ledger is called the Principal Book. By this classification/collective effect we can know the following:

g. The amount is due from a customer
h. The amount is owed to a particular supplier.
i. The amount of purchase and sales during a particular period.
j. The amount has been incurred on a particular head of expenditure.
k. The amount has been earned on account of a particular head of income.
l. Position of assets liabilities and capital.

Division of the Ledger

When a business is small one ledger can be kept for all the accounts. But as the business expands and the ledger contains more accounts, it needs dividing up into manageable sections. Dividing the ledger makes it easier to trace an account and also divide the work between different bookkeepers for effective control. The divisions of the ledger may depend on the type of the business but basically there are four divisions. These are the cashbook; sales ledger; purchases ledger and the general ledger.

The Cash Book

This section of the ledger contains the cash account and the bank account. The cash book records receipts and payments of money whether in the form of cash or cheque.

Sales Ledger (Debtors Ledger)

This contains all the accounts of the firm's debtors, that is, the customers who bought goods on credit and therefore, owe the firm. The sales ledger does not contain the sales account.

Purchases Ledger (Bought Ledger)

It contains all personal accounts of the firm's creditors or suppliers from whom goods have been purchased on credit. The purchases ledger does not contain the purchases account.

The General Ledger (Nominal)

This contains all accounts that do not appear in the other three divisions. It contains accounts for assets such as Land and Building, plant and machinery, motor vehicle and for liabilities such as loans and capital. Other account that can be found in the general ledger include the sales, purchases, expenses, revenue, drawings and trading and profit/loss accounts.

Posting

The term 'Posting' means transferring the debit and credit items from the Journal to their respective accounts in the ledger. It is important to note that the exact names of accounts used in the Journal should be carried to the ledger. For example: If in the Journal, Salary Account has been debited, it would not be correct to debit the Outstanding Salary Account in the Ledger. Therefore, the correct course would be to use the same account in both the Journal and Ledger.

Ledger posting may be done at any time. However, it must be completed before the annual financial statements are prepared. It is advisable to keep the more active accounts posted up-to date. The examples of such accounts are the cash account, personal accounts of various parties, etc.

The Ledger posting may be made by the book-keeper from the Journal to the Ledger by any of the following methods:

- He may take a particular side first. For example, he may take the debits first and make the complete postings of all debits from Journal to the Ledger.
- He may take a particular account first and post all debits and credits relating to that account appearing on one particular page of Journal. He may then take some other account and follow the same procedure.
- He may complete posting of each journal entry before proceeding to the next entry.

It is advisable to follow the last method. Further, one should post each debit and credit item as it appears in the Journal.

The Ledger Folio (L.F.) column in the Journal is used at the time when debits and credits are posted to the Ledger. The page number of the Ledger on which the posting has been done is mentioned in the L.F. Column of the Journal. Similarly, a folio column in the Ledger can also be kept where the page from which posting has been made from the Journal. Thus, these are cross references in both the Journal and the Ledger. A proper index must be maintained in the Ledger giving the names of the accounts and the page number. A specimen of Ledger is given below: Dr

Name of Account Cr

Date	Particulars	L.F	Amount GhȻ	Date	Particulars	L.F	Amount GhȻ

Each ledger account is divided into two equal parts.

- Left Hand Side--Debit side (Dr)
- Right Hand Side-- Credit side (Cr)

4.14 Rules Regarding Posting

The following rules must be observed while posting transactions in the Ledger from the Journal:

a. Separate accounts should be opened in the Ledger for posting transactions relating to different accounts recorded in the Journal. For example, separate accounts may be opened for sales, purchases, sales returns, purchases return, salaries, rent, cash, etc.

b. The concerned account which has been debited in the Journal should also be debited in the Ledger. However, a reference should be made of the other account which has been credited in the Journal. For example, for salaries paid, the salaries account should be debited in the Ledger, but reference should be given of the Cash Account which has been credited in the Journal.

c. The concerned account, which has been credited in the Journal; should also be credited in the Ledger, but reference should be given of the account, which has been debited in the Journal. For example, for salaries paid, Cash Account has been credited in the Journal. It will be credited in the Ledger also, but reference will be given of the Salaries Account in the Ledger. Thus, it may be concluded that while making posting in the Ledger, the concerned account which has been debited or credited in the Journal should also be debited or credited in the Ledger, but reference has to be given of the other account which has been credited or debited in the Journal, as the case may be.

This will be clear with the following example:
Suppose on Jan 1, 2013 salaries of GH₵ 10,000 have been paid in cash, the following entry will be passed in the Journal:

Salaries Account Dr. GH₵10,000 and Cash Account Cr GH₵10,000

In the Ledger two accounts will be opened (i) Salaries Account, and (ii) Cash Account. Since Salaries Account has been debited in the Journal, it will also be debited in the Ledger. Similarly, Cash Account has been credited in the Journal and, therefore, it will also be credited in the Ledger, but reference will be given of the other account involved. Thus, the accounts will appear as follows in the Ledger:

Salaries Account

2013		GH₵	
Jan 1	Cash A/c	10,000	

Cash Account

	2013		GH₵ 10,000
	Jan 1	Salaries A/c	

4.15 Balancing of An Account

In business, there may be several transactions relating to one particular account. In Journal, these transactions appear on different pages in a chronological order while they appear in a classified form under that particular account in the Ledger. At the end of a period (say a month, a quarter or a year), the businessman will be interested in knowing the position of a particular account. This means, he should total the debits and credits of his account separately and find out the net balance. This technique of finding out the net balance of an account, after considering the totals of both debits and credits appearing in the account is known as 'Balancing the Account'.

Normally after every month or whenever a businessman is interested in knowing the position of various accounts, the accounts are balanced. The steps for this purpose are:

1. Debit and Credit sides of each Account are totalled.
2. The difference between the two sides is written on the side which is shorter so as to make their totals equal.
3. The words "Balance C/d" i.e. the balance carried down and written against the amount of difference.
4. In the next period, the balance is brought down on the other side by writing the words 'Balance b/d'.
5. If the Debit side exceeds the Credit Side the difference is a Debit Balance whereas.
6. If the Credit side exceeds the Debit side the difference is a Credit Balance.

Illustration 4.19.1

Journalize the following transactions, post them in the Ledger and balance the accounts as on 31st March, 2016.

1. Joshua started business with a capital of Gh₵10,000.
2. He purchased goods from Mohan on credit Gh₵ 2,000.
3. He paid cash to Mohan Gh₵ 1,200.
4. He sold goods to Suresh. Gh₵ 5,000.
5. He received cash from Suresh Gh₵ 3,000.
6. He further purchased goods from Mohan Gh₵ 2,000.
7. He paid cash to Mohan Gh₵ 1,000.
8. He further sold goods to Suresh Gh₵ 2,000.
9. He received cash from Suresh Gh₵ 1,000

4.16 Trial Balance

A trial balance is a bookkeeping worksheet in which the balance of all ledgers are compiled into debit and credit account column totals that are equal. A company prepares a trial balance periodically, usually at the end of every reporting period. It is a statement which is prepared at a particular date with the ledger account balances to test the arithmetical accuracy of the ledger accounts and also to facilitate preparation of financial statements is called a trial balance.

In case, the various debit balances and the credit balances of the different accounts are taken down in a statement, the statement so prepared is termed as a 'Trial Balance'. In other words, Trial Balance is a statement containing the various ledger balances on a particular date.

4.17 Objectives of Preparing a Trial Balance

(i) Checking of the arithmetical accuracy of the accounting entries. Trial Balance helps in knowing the arithmetical accuracy of the accounting entries. This is because according to the dual aspect concept for every debit, there must be an equivalent credit. Trial Balance represents a summary of all ledger balances and, therefore, if the two sides of the Trial Balance tally, it is an indication of this fact that the books of accounts are arithmetically accurate. Of course, there may be certain errors in the books of accounts in spite of an agreed Trial Balance. For example, if a transaction has been completely omitted, from the books of accounts, the two sides of the Trial Balance will tally, in spite of the books of accounts being wrong.

(ii) Basis for financial statements

Trial Balance forms the basis for preparing financial statements such as the Income Statement and the Balance Sheet. The Trial Balance represents all transactions relating to different accounts in a summarized form for a particular period. In case, the Trial Balance is not prepared, it will be almost impossible to prepare the financial statements as stated above to know the profit or loss made by the business during a particular period or its financial position on a particular date.

(iii) Summarised ledger

It has already been stated that a Trial Balance contains the ledger balances on a particular date. Thus, the entire ledger is summarized in the form of a Trial Balance. The position of a particular account can be judged simply by looking at the Trial Balance. The Ledger may be seen only when details regarding the accounts are required.

A specimen of trial balance is given below:

Particulars	Dr Amount (Gh₵)	Cr Amount (Gh₵)

Illustration 4.3

Journalise the following transactions in the books of trade. Also make their Ledger Postings and prepare a Trial Balance.

Debit Balances as at Jan. 1, 2018: Cash in hand GH₵ 8,000; Cash at Bank GH₵ 25,000; Stock of goods GH₵ 20,000; Furniture GH₵ 2,000; Building GH₵ 10,000; Sundry Debtors - Vic GH₵ 2,000, Ani GH₵ 1,000 and Maa GH₵ 2,000.

Credit Balances on Jan. 1, 2018: Sundry Creditors - Anado GH₵ 5,000; Loan from Babu GH₵ 10,000.

The following were further transactions in the month of Jan, 2013:

Jan. 1: Purchased goods worth GH₵ 5,000 for cash less 5% cash discount. Jan. 4:
Received GH₵ 1,980 from Vic and allowed her GH₵ 20 as discount. Jan. 6:
Purchased goods from Abass GH₵ 5,000.

Jan. 8: Purchased plant from Kingsley for GH₵ 5,000 Jan. 12:
Sold goods to Rahim on credit GH₵ 600.

Jan. 15: Rahim became insolvent and paid only GHC50.

Jan. 18: Sold goods to Fiifi for cash GH₵ 1,000 Jan. 20:
Paid salary to Radan GH₵ 2,000

Jan. 21: Paid Anado GH₵ 4,800 in full settlement. Jan. 26:

Interest received from Maa GH₵ 200

Jan. 28: Paid to Babu interest on Loan GH₵ 500 Jan. 31:

Sold goods for cash GH₵ 500

Jan. 31: Withdraw goods from business for personal use GH₵ 200

Errors NOT affecting Trial Balance Agreement

1. *Error of Complete omission* – a transaction is not recorded at all.
2. *Error of commission* – an item is entered to the correct side of the wrong account (there is a debit and a credit here, so the records balance) eg. Sakodie eg paid us by cheque $100, correctly entered in the cash book, but it entered wrongly into the account of Sakore.
3. *Error of principle* – an item is posted to the correct side of the wrong type (nature) of account. Example: when cash paid for plant repairs (expense) is debited to plant account (asset). Errors of principle are really a special case of errors of commission, and once again there is a debit and a credit.
4. *Error of original entry* – an incorrect figure is entered in the records and then posted to the correct account Example: Cash $1,000 for plant repairs is entered as $100; plant repairs account is debited with $100
5. *Complete Reversal of entries* – the amount is correct, the accounts used are correct, but the account that should have been debited is credited and vice versa. Example: We paid cheque of $200 on 20 May 2005 to Jones and was treated as Debit: Bank Credit: Jones.
6. *Compensating errors* – two equal and opposite errors leave the trial balance balancing. (this case is rare) Example: Purchases and Sales were overstated by $100.

4.18 Errors Affecting Trial Balance Agreement

1. *Addition errors* – figures are incorrectly added in a ledger account. e.g. overcast or under-cast
2. *Posting error* – a) debit but no credit; credit but no debit and b) enter a different amount on the debit side from the amount on the credit side. Example: cash $10,000 entered in the cash book for the purchase of a car is: a) posted to Motor cars account as

$1,000 only, no posted to cash book

3. *Trial balance errors* – a balance is omitted, posting an amount incorrectly, or posting a balance to wrong side of the trial balance

UNIT FOUR

PREPARATION OF FINAL ACCOUNTS

Introduction

The transactions of a business enterprise for the accounting period are first recorded in the books of original entry, then posted therefrom into the ledger and lastly tested as to their arithmetical accuracy with the help of trial balance. After the preparation of the trial balance, every businessman is interested in knowing about two more facts. They are:

i. Whether he has earned a profit or suffered a loss during the period covered by the trial balance, and
ii. Where does he stand now? In other words, what is his financial position? For the above said purposes, the businessman prepares financial statements for his business i.e. the business man he prepares the Trading and Profit and Loss Account and Balance Sheet at the end of the accounting period. These financial statements are popularly known as final accounts. The preparation of financial statements depends upon whether the business concern is a trading concern or manufacturing concern. If the business concern is a trading concern, it has to prepare the following accounts along with the Balance Sheet: (i) Trading Account; and (ii) Profit and Loss Account. But, if the business concern is a manufacturing concern, it has to prepare a Manufacturing Account in addition to two accounts.

Financial statements are those statements that show the financial position and result of business activities at the end of accounting period.

i. The profit earned or loss incurred from the business operations during an accounting period. It is known from the Profit and Loss account. Few enterprises also prepare Trading Account in addition to the Profit and Loss Account, and
ii. The financial position, by preparing the Balance Sheet.

Objectives and Importance

a) Trading, Profit and Loss Account

i. Determine Gross Profit or Gross Loss
ii. Determine Net Profit or Net Loss: Profit and Loss Account shows the net profit earned or net loss incurred by the business during the accounting period.

iii. Comparison with the Previous Year's Profit

iv. Calculation of Ratios: For financial analysis, several ratios are calculated with the help of information/data provided in the Profit or Loss Account.

b) Balance Sheet

i. Ascertaining Financial Position

ii. Comparison with Previous Year

iii. Analysis of Individual Items

iv. Calculating Ratios: The Balance Sheet enables calculation of financial position ratios such as Debt-Equity Ratio (to determine whether debts are sufficiently covered); current ratio (to determine working capital adequacy)

Trading Account, Profit and Loss Account (Income Statement)

This is made of two accounts prepared consecutively or in a continuous fashion as a single statement. Its components are Trading, Profit and Loss account.

Trading Account

The trading account shows the result of buying and selling of goods. This is prepared to ascertain the gross profit.

- Gross Profit = Net Sales – Cost of Sales.
- Net Sales = Total Sales – Sales Returns
- Cost of Sales = Opening Stock + Net Purchases – Closing Stock
- Net Purchases = Total Purchases + Carriage Inwards – Purchases Returns

Format of Trading Account (Horizontal Presentation)

TRADING ACCOUNT for the year ended……………………………..

Particulars	GhȻ	Particulars	GhȻ
Opening stock Purchases …… Less Purchases returns …….	………. …….	Sales …... Less Return inwards …..	 ……
Add Carriage inwards	……	Gross Loss trans to P&L A/c	……
Less Closing Stock	……		
Gross profit transferred to P&L	……		

Vertical Presentation

TRADING ACCOUNT for the year ended……………………………..

Gh₵ Gh₵

Sales xxx

Less Sales Returns (xxx)

Net Sales xxx

Cost of Sales:

Opening Stock xxx

Purchases xxx

Less Purchases returns (xxx) Carriage Inwards xxx xxx

Goods Available for Sales xxx

Less Closing Stock (xxx)

Cost of Goods Sold xxx

Gross Profit xxx

Profit and Loss Account

A Profit and Loss Account is an account into which all gains and losses are collected in order to ascertain the excess of gains over losses or vice versa. It is prepared to ascertain net profit earned or net loss incurred by the business during the accounting period.

Net Profit (or Loss) = Gross Profit + Other Income –Expenses

Other Income includes Commission received, Discount received, rent received, interest received and other gains or income

Expenses include carriage outwards, discount allowed, lighting, salaries, postage, etc. Format of Profit and Loss Account (Horizontal)

Presentation of the Trading Profit and Loss Account: The Horizontal Style

HERDAVERO ENTERPRISE: TRADING PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED ………….. 20…………..

	₵'000	₵'000		₵'000
Opening stock		xxx	Sales	xxx
Purchases	xxx		Less: sales returns	xxx
Add Carriage Inwards	xxx		Net Sales	xxx
	xxx			
Less: Purchases Returns	xxx			
Net Purchases		xxx		
Cost of goods available for sale		xxx		
Less Closing Stock		xxx		
Cost of Sales		xxx		
Gross Profit c/d		xxx		
		xxx		xxx
Office expenses		xxx		
Lighting		xxx		
Carriage outwards		xxx	Gross profit b/d	xxx
Rates and insurance		xxx	Commission received	xxx
Motor vehicle expenses		xxx	Discount received	xxx
General expenses		xxx	Interest received	xxx
Salaries		xxx	Rent received	xxx
Interest on loan		xxx		
Discount allowed		xxx		
Postage		xxx		
Net Profit		xxx		
		xxxx		xxxx

Vertical Presentation

Profit And Loss Account For The Year Ended ……………..

Gross Profit (Loss)			xxx
Rent Received		xx	
Discount Received		xx	
Commission Earned		xx	
Interest Received		xx	
Other Income		xx	
			xxx
			xxx
Less Expenses:			
Salaries	xx		
Rent & Rates	xx		
Stationery & Printing	xx		
Postage & Telegrams	xx		
Audit Fees	xx		
Legal Charges	xx		
Telephone Expenses	xx		
Insurance Premium	xx		
Advertisement	xx		
Repairs and Renewals	xx		
Depreciation	xx		
Interest	xx		
Sundry Expenses	xx		
Carriage outwards	xx		
Discount allowed	xx		
			xxx
Net Profit (or Loss)			xxx

The two accounts are put together to form Income Statement

Trading, Profit And Loss Account For The Year Ended ………………..

Sales xxx	
Less Cost of Sales	(xxx)
Gross Profit	xxx
Less Expenses	(xxx)
Net Profit (Loss)	xxx

Balance Sheet (Statement of Financial Position)

Having prepared the trading and profit and loss account, balance sheet is prepared. It is a statement prepared showing the financial position of the business on a certain date.

Characteristics

The balance sheet has certain characteristics which should be noted. These are:

1. It is prepared at a particular date and not for a particular period.
2. It is prepared after the preparation of profit and loss account. This is the reason why the profit and loss account and the balance sheet are together called the Financial Accounts.
3. It shows the financial position of a business as a going concern
4. The balance sheet is not an account but only a statement of assets and liabilities.
5. The total of the assets side must be equal to the total liabilities side.

Grouping and Marshalling (Arrangement) of Assets and Liabilities

'Grouping' means putting items of a similar nature under a common accounting head. The arrangement of assets and liabilities in a particular order in the Balance sheet is called Marshalling. By convention, items in the Balance Sheet arranged in the illiquidity or permanence. This means that items which cannot be turned into cash quickly (liquidity) and therefore have to be retained for long periods of time in the business is stated first. This is done for both assets and liabilities and also within each group.

Classification of Assets

Fixed Assets (Non-current Assets): Fixed assets are those assets that are required for continued use and are not meant for resale, though later it may be decided to sell a particular asset.

a. Tangible Fixed Asset refer to those fixed assets which can be seen and touched,
e.g. Land and building, Plant and Machinery, furniture & fixtures etc

b. Intangible Fixed Assets refer to those fixed assets which are not in a physical form, i.e. they can neither be seen nor touched e.g. Patent, goodwill of a firm.

Current Assets: These are those assets of the business which are kept for resale or for converting into cash. eg. stock, bank, cash, receivables (debtors), etc

5.2 Classification of Liabilities:

Non-current liabilities or fixed liabilities: These liabilities are not payable by the business in the next year.

Current liabilities: these are liabilities payable by the business within a year. Examples are trade creditors (payable), expenses outstanding, and bank overdraft etc.

Owner's funds: The amount owing to the proprietors as capital is a class by itself, it will include undistributed profits and reserves also. Balance Sheet Format

BALANCE SHEET AS AT ……………………………

Non-Current Asset:

Goodwill		xxx
Land and Building		xxx
Equipment		xxx
Fixtures and fittings		xxx
Motor Vehicles		xxx
		xxx
Current Assets:		
Stock	xxx	
Receivables (Debtors)	xxx	
Cash at Bank	xxx	
Cash in Hand	xxx	xxx
Finance by		
Capital		xxx

Net Profit		xxx
		xxx
Less Drawings		(xxx)
		xxx
Non-Current Liabilities:		
Long term Loans		xxx
Current Liabilities:		
Creditors	xxx	
Accruals	xxx	xxx
		xxx

Illustration 5.4.1

From the following trial balance of Rock Enterprise, prepare trading and profit and loss A/c for the year ending 31st December 2020.

Particulars	Dr (GhȻ)	Cr (GhȻ)
Stock (as at 31/12/19)	16,000	
Purchases	55,000	
Sales		108,000
Purchases returns		1,000
Sales Returns	2,000	
Carriage Inwards	3,500	
Commission		4,500
Salaries	27,000	
Printing and stationery	3,400	
Trade expenses	2,000	
Cash in hand	3,500	
Sundry Debtors	22,000	
Sundry Creditors		20,000
Land and buildings	30,000	
Plant and machinery	20,000	
Bank Loan		20,000
Drawings	8,000	
Furniture and fixtures	10,600	
Rent and taxes	6,500	
Capital		56,000
Total	**209,500**	**209,500**

The closing stock as at 31st December, 2020 was GhȻ 10,000

Solution 5.4.1

Trading, Profit and Loss Account for The Year Ended 31st December, 2020

	(GhȻ)	(GhȻ)	(GhȻ)
Sales			108,000
Less Sales Returns			(2,000)
			106,000
Less Cost of Sales:			
Opening Stock		16,000	
Purchases	55,000		
Less Purchases Returns	(1,000)		
	54,000		
Carriage Inwards	3,500		
		57,500	
		73,500	
Less Closing Stock		(10,000)	
			63,500
Gross Profit			42,500
Commission			4,500
			47,000
Expenses:			
Salaries	27,000		
Printing and stationery	3,400		
Trade expenses	2,000		
Rent and taxes	6,500		
			38,900
Net Profit			8,100

Balance Sheet as at 31st December, 020 (GhȻ)

Non-Current Assets:	(GhȻ)	(GhȻ)
Land and buildings		30,000
Plant and machinery		20,000
Furniture and fixtures		10,600
		60,600
Current Assets:		

Stock	10,000	
Sundry Debtors	22,000	
Cash in hand	3,500	
		35,500
Total Assets		**96,100**
Financed by: Capital		
		56,000
Net Profit		8,100
		64,100
Less Drawings		8,000
		56,100
Non-Current Liabilities:		
Bank Loan		20,000
Current Liabilities: Sundry Creditors		
		20,000
		96,100

Illustration 5.4.2

From the following trial balance of "Today is Today Enterprise" for the year ended 31 December 2019.

	Dr	Cr
	GhȻ	GhȻ
Stock 1 January 2019	2,368	
Carriage outwards	200	
Carriage inwards	310	
Returns inwards	205	
Returns outwards		322
Purchases	11,874	
Sales		18,600
Salaries and wages	3,862	
Rent	304	
Insurance	78	
Motor expenses	664	
Office expenses	216	
Lighting and heating expenses	166	
General expenses	314	
Premises	5,000	
Motor vehicles	1,800	
Fixtures and fittings	350	
Debtors	3,896	
Creditors		1,731
Cash at bank	482	
Drawings	1,200	
Capital		12,636
	33,289	33,289

Stock at 31 December 2019 was GHȻ 2,946

a. Draw up a Trading and profit and loss account.

b. Balance sheet as at that date

5.3 Adjustments

A fundamental principle for preparing the Trading and Profit and Loss Account is that the expenses and incomes for the full trading period, but only for the trading period, are taken to the Trading Account and the Profit and Loss Account. This means that if an expense has been incurred but not yet paid for, a liability for the unpaid amount must be created before the accounts can be said to show a true picture.

All expense accounts should be properly adjusted. It is a common practice, for example, to pay salaries for a month on the first of the next month. Salaries for March are generally paid in April. If accounts are being made up to 31st March, one must take into account the as yet unpaid salaries for March. Treatment of items of Adjustment outside the trial balance

No.	Adjustment	Treatments
1	Closing Stock	Credit Side of Trading (Deduct from Goods available) and Asset Side of B/S as current Assets
2	Outstanding expenses	Added to concerned item in trading or profit a loss a/c and liabilities side of B/S as a current liability
3	Prepaid expenses (Unexpired Exp.)	Less from concerned item in trading or profit and loss a/c and assets side of B/S as a current asset
4	Accrued Income (income earned but not received)	Add to concerned income in P&L and Assets side of B/S as a current asset
5	Income received in advance (Unearned Income)	Less from concerned item in P&L and Liabilities Side of B/S as current liabilities.
6	Depreciation	Dr. side of P&L A/C & Deduct from concerned assets
7	Bad Debts	Dr. side of P&L A/C & Deduct from debtors in balance sheet.
8	Provision for doubtful debts	Dr. side of P&L A/C & Deduct from debtors
9	Provision for discount on	Dr. side of P&L A/C & Deduct from debtors

	debtors	
10	Manager's Commission	Dr. side of P&L A/C & Liabilities side of B/S as a current liability.

Illustration 5.7.1

From the following figures prepare Koofori Trading and Profit and Loss Account for the year ended 31st March, 2014 and a Balance Sheet as on that date:

	Dr (GhȻ)	Cr (GhȻ)
Capital		86,800
Drawing	15,000	
Investments	14,000	
Cash	8,000	
Rent and Insurance	3,000	
Opening Stock	36,600	
Purchases	186,000	
Sales		305,000
Sales return	5,000	
Purchases return		4,200
Wages	22,000	
Carriage	4,200	
Bad debts	700	
Bad debts provision	2,100	
Sundry debtors	40,400	
Sundry creditors		25,700
Furniture	8,000	
Plant and machinery	50,000	
Salaries	11,000	
Advertisement	4,400	
Goodwill	6,000	
Carriage Outwards	6,300	
Commission (Cr.)		1,000
Total	**422,700**	**422,700**

Adjustments:

1. Stock on 31st march 2014 was GhȻ 31,500
2. Salary and wages for March 2010 were unpaid.
3. Rent outstanding amounted to GhȻ 600 and insurance unexpired amounted to GhȻ 400.
4. Commission amounting to GhȻ 200 has been received in advance.
5. Write off GhȻ 400 as bad debts and create provision for doubtful debts at 5% on sundry debtors.
6. Depreciate furniture and plant and machinery by 10%

UNIT FIVE

BANK RECONCILIATION STATEMENT

Bank Reconciliation Statement Meaning

Bank Reconciliation Statement is a record book of the transactions of a bank account. This statement helps the account holders to check and keep track of their funds and update the transaction record that they have made. Bank Reconciliation statement is also known as bank passbook. The balance mentioned in the bank passbook of the statement must tally with the balance mentioned in the cash book. In the statement, all the deposit will be shown in the credit column and withdrawals will be shown in the debit column. However, if the withdrawal exceeds deposit it will show a debit balance (overdraft).

Bank reconciliation statement is a statement that depositors prepare to find, explain and understand any differences between the balance in bank statement and the balance in their accounting records. All transactions between depositor and the bank are entered separately by both the parties in their records. These records may disagree due to various reasons and show different balances. The purpose of preparing a bank reconciliation statement is to find and understand the reasons of this difference in account balance.

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 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. 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.

Generally, while making a comparison between the company’s cash book and bank balance, the balance does not tally. Therefore, it is important to determine the cause for the difference and display them in the bank reconciliation statement and then tally the two balances. The bank reconciliation statement helps in explaining the differences in the amount between the company’s cash book and bank balance. The cash book and the bank passbook differences are caused by: The difference in timing recording the transactions: The difference in timing can be caused by many factors which are:

a. Bank-issued cheque but not yet deposited for payment
b. Paid cheque in the bank but yet not cleared
c. Bank made direct debit from the customer’s side
d. Cheque/ amount deposited directly to the bank account
e. Dividends and Interest collected by the bank
f. Bank made direct payment from the customer’s side
g. Cheques deposited/bills discounted dishonoured
h. Errors made by the company or by the bank: In a few occasions, the error in two balances can be made from the bank side or in the company’s cash book. Few errors are as follows:

- Errors made while registering the transaction by the company
- Errors made while registering the transaction by the bank

Reasons of difference between bank statement and depositor's record:

Unpresented Cheques

Cheques issued by the firm (Business) 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/bank statement.

Example:

You issued a check to Mr X (one of your creditors) for $500 on 30th January 2015 and entered it immediately in your accounting records. Mr. X did not present or deposit that check in his account before the end of January. Your bank statement for the month of January would not show the entry for that $500 because Mr. X did not present this check before the end of January. It would create a difference of $500 between the balance in your accounting records and the balance in the bank statement.

Uncredited Cheques

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.

Example:

You received $800 from Mr. Y (one of your debtors) on 31 January 2015 and recorded it immediately in your accounting records. You then sent this cash to your bank to be deposited into your account but it reached too late to be entered in your bank statement for the month of January. The balance in your accounting record would be different from your bank statement.

Direct Credit/Credit Transfer

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.

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.

6.4.1. 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.

Standing Order

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.

Dishonour of Cheques/Bill discounted

If a cheque deposited by the firm or bill receivable discounted with the bank is dishonored, 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.

Errors committed in recording transactions by the firm (Business)

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.

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.

Types of Bank Reconciliation Statement

The Bank Reconciliation Statement can be prepared in 2 ways: Documenting of bank reconciliation statement without adjusting the cash book balance and filing of bank reconciliation statement after adjusting the cash book balance.

Steps to Prepare Bank Reconciliation Statement:

1. First, the date on which the statement is recorded is mentioned.
2. After which the balance displayed in the cash book is mentioned in the statement. Sometimes, the balance mentioned in the passbook can also be mentioned.
3. The deposited cheques which are not collected are deducted.
4. Then the cheques issued but the deposited for payment, but amount directly deposited in the bank account are recorded
5. All the transactions like overdraft interest, amount debited by the bank but not recorded in the cash book, cheques and bills dishonoured are deducted.
6. All the credits and profit collected by the company and directly deposited in the bank is added.

7. Adjustments of errors are made
8. Now the balance between the cash book and statement should be equal or the same

Illustration 6.1

The bank statement of the Fast Company shows a balance of $10,000 on 31 January 2015 whereas the company's ledger shows a balance of $8,525. The following reasons have been identified for this discrepancy.

1. An amount of $822 sent to the bank for deposit on January 31, 2015 does not appear in the bank statement.
2. The following checks issued during the month of January have not yet been cleared by the bank.

a. Cheque No: 201, Issue date: 15 January 2015, Amount; $200;
b. Cheque No: 212, Issue date: 19 January 2015, Amount; $20;
c. Cheque No: 216, Issue date: 25 January 2015, Amount; $610;

3. A note receivable amounting to $1,588 has been collected by bank for the company.
4. The bank statement shows that interest amounting to $50 has been earned on average account balance during January.
5. The bank has charged $10 for the collection of a note.
6. A check of $100 deposited by the company has been charged back as NSF.
7. An amount of $25 has been deducted by bank as service charges for the month of January.
8. The check no. 220 is issued to electricity company. The check is in the amount of $95 but is erroneously recorded in the cash payments journal as $59.

Required: Prepare a bank reconciliation statement for the Fast Company using above information.

Solution 6

Fast Company

Bank Reconciliation Statement, 31st January 2015

	GH₵	GH₵
Balance as per bank statement, 31st January, 2015		10,000
Add Deposit in transit		822
		10,822
Less Outstanding cheques		
Cheque No. 201	200	
Cheque No. 212	20	
Cheque No. 216	610	830
Adjusted Cash Balance		9,992

Balance as per depositor's record 31st January 2015		8,525
Add: Notes receivable collected by bank	1,588	

Interest earned during January	50	1,638	
		10,163	
Deduct: Collection charges	10		
Dishonored cheques	100		
Service charges	25		
Errors on cheque No 220	36	171	Adjusted cas

Illustration 6.2

On 31st December 2019 the bank column of Tench's Cashbook showed a debit balance of GH₵ 1,500.

The monthly bank statement written up to 31st December 2019 showed a credit balance of GH₵ 2,950.

On checking the Cashbook with the bank statement, it was discovered that the following transactions has not been entered in the cashbook:

Dividends of GH₵ 240 has been paid directly to the bank.

A credit transfer - Customs and Excise VAT refund of GH₵ 260 had been collected by the bank. Bank charges GH₵ 30.

A direct debit of GH₵ 70 for the Lion's Club subscription had been paid by the bank.

A standing order of GH₵ 200 for Tench's loan repayment had been paid by the bank. Tench's deposit account balance of GH₵ 1,400 was transferred into his bank current account. A further check revealed the following items:

Two cheques drawn in favour of Cod GH₵ 250 and Haddock GH₵ 290 had been entered in the cashbook but had not been presented for payment.

Cash and Cheques amounting to GH₵ 690 had been paid into the bank on 31 December 2019 but were not credited by the bank until 2nd January 2021.

Requirement:

a. Starting with the debit balance of GH₵ 1,500 bring the cashbook (bank column) up to date and then balance the bank account.

b. Prepare a bank reconciliation statement as at 31st December 2019.

UNIT SIX

BUDGET: DEFINITION, PURPOSE, ELEMENTS AND STEPS

Budget

Budget refers to an estimated statement. It is prepared by companies as well as government. It is for the purpose of attaining some goal. Budget can be defined as a financial and / or quantitative statement prepared and approved prior to a defined period of time of the policy to be pursued during that period for the purpose of attaining a given objective. It may include income, expenditure and employment of capital. It is often used for control purpose.

A Budget is a plan expressed in quantitative usually monetary terms, covering a specified period of time, usually one year. Many companies refer to their annual budget as a profit plan since it shows the planned activities that the company expects to undertake in its responsibility centers in order to obtain its profit goals.

In the words of Charles T. Horngren, "A budget is a formal quantitative expression of management plans". The Chartered Institute of Management Accountant of London (CIMA) defines a Budget in the following words.

"A Budget is a plan quantified in monetary terms, prepared and approved prior to a defined period of time, usually showing planned income to be generated and/or expenditure to be incurred during that period and the capital to be employed to attain a given objective."

"A budget is a pre-determined statement of management policy during a given period which provides a standard for comparison with the result actually achieved." —J.R. Brown and L.R. Howard. Therefore, preplanning is a cardinal feature of budgetary control.

Budgetary Control

It is a process in which budget is set and actual is compared with budget to analyse variances. It means the establishment of budgets relating the responsibilities of executives to the prerequisite of policy and the continuous evaluation of actual with budgeted results either to secure by individual action the objective of that policy or to provide a base for its revision.

Objectives of Budget

Planning: A set of targets/goals is often essential to lead and focus individual and group actions. Planning not only motivates the employees but also improves overall decision making.

Directing: Business is very complex and requires more formal direction and coordination. Once the budgets are in place they can be used to direct and coordinate operations in order to achieve the stated targets.

Controlling: The actual performance can be compared with the planned targets. This provides prompt feedback about performance. budget also prevents unplanned adhoc expenditure

Purposes of a Budget:

The budget of an enterprise serves the following purposes:

a. Budget is an aid in making and coordinating short-range plans.
b. It is a device for communicating these plans to the responsibility center managers.
c. Budget is a way of motivating managers to achieve their responsibility centers goals.
d. It is a bench mark for controlling on-going activities.
e. Budget is a basis for evaluating the performance of responsibility centres and their managers.
f. It is a means of educating the managers in an organisation.
g. Under suitable condition, standard costing and budgetary control may go hand in hand and can harmonies and make the planning and control more effective.

7.2 Elements of a Budget:

A budget is defined as a "comprehensive and coordinated plan, expressed in financial terms, for the operations and resources, of an enterprise for some specified period in the future". —J.M. Fremgen. According to the above definition, the essential elements of a budget that average are:

a. Plan;
b. Operations and resources;
c. Financial terms;
d. Specified future period;
e. Comprehensiveness;
f. Coordination.

Plan:

The term 'plan' with reference to budgeting has a specific connotation. Budgetary plan includes two aspects which have a bearing on the operations of an enterprise. One set of factors that determine a firm's future operations are wholly external and beyond firm's control like general business conditions, government policy and size and composition of population.

The second set of factors that affect future activities are within the firm's control and discretion, i.e., they are internal like promotional programmes, manufacturing processes etc. Thus, budgeting not only suggests what will happen but should also make things happen. A budget is an expression partly of what the management expects to happen and partly of what the management intends to happen.

Operations and Resources:

A budget is a mechanism to plan for the firm's operations and resources. A budget should qualify the revenues to be realised from products/services and the expenses to be incurred on goods or services used in generating revenues. It also covers the resources of the firm. The budget makes plan for various assets to be used in its operations and the sources of funds to finance the assets both fixed and current assets.

Financial Terms:

Budgets are always prepared in financial terms i.e., in terms of monetary value such as rupee, dollar, sterling etc.

Specified Future Period:

Budget is prepared for a specified period of time, usually for a year. Sales budget, production budget, cash budgets are all prepared for a financial period of one year.

Comprehensiveness:

A budget is comprehensive i.e., all the activities and operations of an organisation are included in the budget. Budgets are prepared for each segment, facet, activity, division' of an organisation. These activities, segments are integrated into an overall budget for the entire organisation. This overall budget is known as master budget.

Coordination:

The budget coordinates the various operational activities of an enterprise so as to take care of the situations and problems of each component. The budgets for each of the components are prepared in harmony with each other to make budgets more effective and meaningful.

Advantages of Budgetary Control System

1. Enables the managers/ administrators to conduct activities in efficient manner.
2. Provides yardstick for measuring and evaluating the performance of individuals and their departments.
3. Reveals the deviations, from the budget by comparing with actuals; Helps in prompt review process.
4. Creates suitable conditions for the implementation of standard costing system.
5. Acts as systematic base for framing future policies and targets.
6. Inculcates the feeling of cost consciousness and goal orientation.
7. Leads to effective utilization of various resources, as the activities are planned and executed effectively.

Components of Budgetary Control System

The policy of a business for a defined period is represented by the master budget, the details of which are given in a number of individual budgets called functional budgets. These functional budgets are broadly grouped as physical, cost and profit budgets.

Physical Budgets- Those budgets which contains information in terms of physical units about sales, production etc. For example, quantity of sales, quantity of production, inventories and manpower budgets are physical budgets.

Cost budgets - Budgets which provides cost information in respect of manufacturing, selling, administration etc. For example, manufacturing cost, selling cost, administration cost and research and development cost budgets are cost budgets.

Profit budgets - Budgets which enables in the ascertainment of profit, for example, sales budget, profit and loss budget, etc.

Types of Budget Fixed Budget

A fixed budget is the budget designed to remain unchanged irrespective of level of activity actually attained. Such budget is suitable for Fixed Expenses. It is also known as Static budget. A fixed budget is not suitable in dynamic environment and for a longer period because of its rigidity. It is not suitable where labour cost, material cost and other factors are constantly changing.

Flexible Budget

Flexible budget shows the expected results of responsibility centre for several activity level. Flexible budget is the series of static budgets for different level of activity. While preparing flexible budget the revenues and expenses are classified into Fixed, Variable and Semi-variable categories. In most cases, the level of activity during the period varies from period to period due to change in demand or seasonal nature or changing circumstances. In such industries/ government organisations flexible budget is suitable

Functional Budget

Budgets which relate to the individual function/task in an organisation are known as Functional Budgets. For example, purchase budget, sales budget, production budget, plant utilization budget, cash budget.

Master Budget

It is a consolidated summary of the various functional budgets. It is based on goals set. It serves as the basis upon which budgeted P & L A/c and forecasted Balance Sheet are built up.

Long-Term Budget

The budget which are prepared for periods longer than a year are called long-term budget. Such budgets are helpful in business forecasting and strategic planning. E.g. Capital expenditure budget, Research and Development budget.

Short-Term Budget

Budgets which are prepared for periods less than a year are known as short term budgets. E.g., Cash Budget. Such budgets are prepared regular comparison and action to bring variation under control.

Current Budget

A budget which is established for use over a short period of time and is related to the current conditions is called current budget.

Zero Base Budgeting (ZBB)

It refers to budgeting from scratch. ZBB is a method of budgeting which requires each cost element to be specifically justified, as though the activities to which the budget relates were being undertaken for the first time. To receive funding during budgeting process, each activity must be justified in terms of continued usefulness. Under ZBB, the budget for virtually every activity is initially set to zero.

Advantages of Budgets

- Provides a systematic approach for evaluation of different activities and ranks them in order of preference for allocation of scare resources.
- Ensures that every activity/ function undertaken is critical for the achievement of objectives.
- Provides an opportunity to allocate resources for various activities / functions only after having a thorough cost benefit analysis.
- Wasteful expenditure can be easily identified and eliminated.

Steps in Budgeting:

The exhibit indicates that the first stage of budgeting exercise is the determination of the 'key' factors or constants which impose overall limits to the budget plan. Among these factors are the productive capacity of the plant, the finance available to the firm, and, of course, the market conditions that impose a total limit on the output the firm is able to sell.

Normally from the management point of view, the critical question is 'what is the firm able to sell in the budget period?', and this question summarizes all the limits to the budget plan.

It is for this reason that the sales budget is at once the starting point and the fulcrum of the budgeting process. The arrows in the above exhibit indicate the flow of relevant information. Once the level of sales is established, selling and distribution cost may be ascertained.

The production budget itself is determined by the sales forecast, the desired level stock of finished goods and plant capacity. From the production budget may be estimated the production costs and cost schedules for materials, labour, and overheads.

In addition, the budgeting process for capital expenditure reflects decision taken in developing the long-range plan. The capital expenditure budget is concerned with expenditure during the budget period on the maintenance and improvement of the existing productive capacity. Moreover, Research and Development costs for improving methods of production and product improvement are associated with this budget.

From a financing point of view, the cash surplus or deficit arising out of the overall budget are revealed by the cash budget which incorporates all cash revenues and cash expenditures. This enables the firm to arrange its financial needs accordingly.

Finally, the projected results in terms of the overall net profits, and the changes in the structure of the firm's assets and liabilities are expressed in the budgeted profit and loss account and the budgeted balance sheet at the end of the budget period.

Budget coordinates the various activities of the firm in a simplified manner. So, budgetary planning is an activity which is of critical importance to the firm, and the problems involved are often complex and difficult ones to resolve. For example, a firm's sales policy cannot be considered in isolation from its pricing policy and its cost structure.

The firm's production costs in relation to the required output may be too high to reach the profit target.

The role of the budget committee is, therefore, a very important and crucial one. It has not only to harmonize all the divisional budgets into an overall planning framework, but it has to deal with the numerous adjustments which may have to be made if the overall budget fails to meet some of the firm's stated objectives.

Hence, the role of the budget committee is not only important in a practical sense, it embraces important and sensitive areas of policy making and management.

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