This system owes its origin to an Italian merchant named Luco Pacioli w[ho] [w]rote the first book entitled 'De Computis et Scripturis' on double entry accounti[ng] [in] the year 1494. We have seen earlier that every business transaction has t[wo as]pects, i.e., when we receive something, we give something else in return. F[or ex]ample, when we purchase goods for cash, we receive goods and give cash [in re]turn ; similarly in a credit sale of goods, goods are given to the customer and t[he cu]stomer becomes debtor for the amount of goods sold to him. This method [of wr]iting every transaction in two accounts is known as Double Entry System [of a]ccounting. Of the two accounts, one account is given debit while the ot[her ac]count is given credit with an equal amount. Thus, on any date, the total of [de]bits must be equal to the total of all credits because every debit has a co[rresp]onding credit.

[R]ules of the Double Entry System

There are separate rules of the double entry system in respect of personal, r[eal] and nominal accounts which are discussed below :—

1. *Personal Accounts.* These accounts record a business's dealings [with] persons or firms. The person receiving something is given debit and the [one] giving something is given credit. For example, if Vijay sells goods to Vi[ney on] credit, Viney's Account will be given debit (in Vijay's books) as he is the rece[iver of] goods and Vijay's Account will be credited (in Viney's books) as he is the g[iver of] goods. When Viney makes the payment for these goods, Vijay's Account w[ill be] debited in Viney's books as he is the receiver of cash and Viney's Accoun[t will be] given credit in Vijay's books as he is the giver of cash.

To make a corr[ect ...] [a]nalysed. The followin[g ...]

(*i*) Which are the [...]

(*ii*) Whether the tw[o ...] [n]ominal ?

(*iii*) What rules of d[...]

(*iv*) Which account [...]

The above method [...] [e]asy. The chart given [...] [tr]ansactions.

[A]ccounting Equation

American accounta[nts ...] [a]ccounting equation whic[h ...]

Assets [...]

The equation is bas[ed ...] [a]nd rights to property an[d ...] [th]e rights to the properti[es ...] [a]nd the rights to properti[es ...]

Equities may be div[ided ...] [b]usiness known as liabiliti[es ...] view the two types of e[quities ...]

Assets=

should always be fixed on the basis of accounting data to get the reasonable margin of profit on sales.

3. *Employees.* Employees are interested in the financial position of a concern they serve particularly when payment of bonus depends upon the size of the profits earned. They seek accounting information to know that the bonus being paid to them is correct.

Limitations of Accounting

The following are the main limitations of accounting :

1. Accounting records only those transactions which can be measured in monetary terms. Those transactions which cannot be measured into monetary terms as conflict between production and marketing manager, efficient management etc. may be very important for a concern but not recorded in the business books.

2. Accounting transactions are recorded at cost in the books. The effect of price level changes is not brought into the books with the result that comparison of the various years becomes difficult. For example, the sale to total assets in 1983 would be much higher than in 1970 due to rising prices, fixed assets being shown at cost and not at market price.

3. Accounting information may not be realistic as accounting statements are prepared by following basic concepts and conventions. For example, going concern concept gives us an idea that the business will continue and assets are to be recorded at cost but the book value which the asset is showing may not be actually realisable. Similarly, by following the principle of conservatism the financial statements will not reflect the true position of the business.

4. Accounting statements are influenced by the personal judgement of the accountant. He may select any method of depreciation, valuation of stock, amortisation of fixed assets, treatment of deferred revenue expenditure. Such judgement if based on integrity and competency of the accountant will definitely affect the preparation of accounting statements.

Systems of Accounting

The following are the main systems of recording business transactions :—

Accounting Association defines accounting as "the proces of identifying, measuring, and communicating economic information to permit informed judgements and decisions by users of the information".

From the above the following attributes of accounting emerge :

(i) *It is the art of recording and classifying business transactions and events.* Business transactions are analysed in such a way that it may be possible to determine profit or loss made by the business and its financial condition on a specified date. Business transactions may relate to the receipt and payment of cash, purchase or sale of goods on credit, incurring an expense or receiving an income or relating to miscellaneous items.

(ii) *The transactions or events of a business must be recorded in monetary terms.* If there are certain events which cannot be measured in terms of money, they will not be recorded in financial accounting. For example, a quarrel between production manager and financial manager may be affecting the business but it cannot be measured in terms of money and thus will not be recorded in the books of accounts.

(iii) *It is an art of making summaries, analysis and interpretation of these transactions.* The accounting information must be summarised, analysed and interpreted by calculating various ratios and percentages or other relationship in order to evaluate the past performance of the business and to make sound plans for the future.

(iv) *The results of such analysis must be communicated to the persons who are t make decisions or form judgements.* All information must be provided in time a presented to the different categories of the persons so that appropriate decisions m be taken at the right time.

Distinction between Book-keeping and Accountancy

Book-keeping is recording of the financial transactions of a business in a methodical manner so that information on any point in relation to them may be quickly obtained. A book-keeper may be responsible for keeping all the financial

2. *Real Accounts.* These are the accounts of assets. Asset entering the business is given debit and asset leaving the business is given credit. For example, when goods are sold for cash, Cash Account will be given debit as cash comes in and Goods Account will be credited as goods go out. So, the rule is : debit what comes in and credit what goes out.

3. *Nominal Accounts.* These accounts deal with expenses, incomes, profits and losses. Accounts of expenses and losses are debited and accounts of incomes and gains are credited. For example, when rent is paid to the landlord, Rent Account will be debited as it is an expense and Cash Account (real account) will be credited as it goes out. Similarly, when commission is received, Cash Account will be debited as cash is received and Commission Account will be credited as it is an income. Thus, the rule is : debit all expenses and losses and credit all incomes and gains.

The rules of double entry system are shown in the following chart :

RULES OF DOUBLE ENTRY

Personal Accounts		Real Accoonts		Nominal Accounts	
Debit	Credit	Debit	Credit	Debit	Credit
Receiver	Giver	What Comes In	What Goes Out	Expenses and Losses	Incomes and Gains

LEDGER

As we know, Journal records all business transactions separately and datewise. The transactions pertaining to a particular person, asset, expense or income are recorded at different places in the journal as they occur on different dates. Hence, journal fails to bring the similar transactions together at one place. Thus, to have a consolidated view of the similar transactions different accounts are prepared in the ledger. *A ledger account may be defined as a summary statement of all the transactions relating to a person, asset, expense or income which have taken place during a given period of time and shows their net effect.*

Thus, a journal is maintained only to facilitate the passing of entries in the ledger, so every entry recorded in the journal must be posted into the ledger. Ledger is a register having a number of pages which are numbered consecutively. One account is usually assigned one page in the ledger. However, if the transactions pertaining to a particular account are more, it may be assigned more than one page in the ledger. An index of various accounts opened in the ledger is given at the beginning of the ledger for the purpose of easy reference. It is the principal book of accounts because it helps us in achieving the objectives of accounting. It gives answers to the following pertinent questions :

(1) What are the total sales to an individual customer ?
(2) What are the total purchases from an individual supplier ?
(3) How much amount is owed by others ?
(4) How much amount is owed to others ?
(5) What is the amount of profit or loss made during a particular period ?

Business transactions are recorded either in the journal or subsidiary books.

JOURNAL

Journal is derived from the French word 'Jour' which means a day. Journal, therefore, means a daily record of business transactions. Journal is a book of original entry because transaction is first written in the Journal from which it is posted to the ledger at any convenient time. The ruling of the journal is as follows :

JOURNAL

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

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

Column 2—(Particulars) : In this column, the name of the account to be debited ... close to the line marked (A). The word Dr. is ... the account to be credited ...

TRIAL BALANCE

We know that the fundamental principle of Double Entry System of Accounting is that for every debit, there must be a corresponding credit. Thus, for every debit or a series of debits given to one or several accounts, there is a corresponding credit or a series of credits of an equal amount given to some other account or accounts and vice versa. It follows, therefore, that the sum total of debit amounts should equal the credit amounts of the ledger at any date. But if the various accounts in the ledger are balanced, then the total of all debit balances must be equal to the total of all credit balances if the books of accounts are arithmetically accurate.

Thus, at the end of the financial year or at any other time, the balances of all the ledger accounts are extracted and are written up in a statement known as Trial Balance and finally totalled up to see if the total of debit balances is equal to the total of credit balances. A Trial Balance may thus be defined as a statement of debit and credit totals or balances extracted from the various accounts in the ledger with a view to test the arithmetical accuracy of the books.

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

(*i*) To have balances of all the accounts of the ledger in order to avoid the necessity of going through the pages of the ledger to find it out.

(*ii*) To have a proof that the double entry of each transaction has been recorded because of its agreement.

(*iii*) To have arithmetic accuracy of the books of accounts because of the agreement of the trial balance.

(*iv*) To have material for preparing the profit and loss account and balance sheet of the business.

Limitations of Trial Balance

The following are the main limitations of the trial balance :

TRADING ACCOUNT

For the year ended 31st December, 1984

Particulars	Amount Rs.	Pariculars	Amount Rs.
To Opening Stock		By Sales	
,, Purchases		*Less* Sales Returns	
Less Purchases Returns		,, Closing Stock	
,, Direct Expenses :		,, Gross Loss c/d	
Carriage Inward			
Wages			
Fuel and Power			
Manufacturing Expenses			
Coal, Water and Gas			
Motive Power			
Octroi			
Import Duty			
Custom Duty			
Consumable Stores			
Foremen/Works Manager's Salary			
Royalty on manufactured Goods			
Gross Profit c/d			

Detailed Study of the Items posted to the Debit Side of Trading Account

... of goods in hand at the beginning of

Review of Accounting Cycle– Final Accounts

Final accounts are prepared to achieve the objectives of accountancy. In order to know the profit or loss earned by a firm, Income Statement or Trading and Profit and Loss account is prepared. Balance Sheet or Position Statement will portray the financial condition of the firm on a particular date. These two statements *i.e.* Trading and Profit and Loss Account and Balance Sheet are prepared to give the final results of the business, that is why both these are collectively called as final accounts. Thus, final accounts include the preparation of :

(*i*) Trading and Profit and Loss Account ; and

(*ii*) Balance Sheet.

Final accounts are the means of conveying to management, owners and interested outsiders a concise picture of profitability and financial position of the business. The preparation of the final accounts is not the first step in the accounting process but they are the end products of the accounting process which give a concise accounting information of the accounting period after the accounting period is over. These accounts summarise all the accounting information recorded in the subsidiary books and the ledger running into hundreds or thousands of pages.

Trading and Profit and Loss Account

As the name of this account itself indicates, it is made up of two accounts *i.e.* Trading Account and Profit and Loss Account. Trading concerns *i.e.* those concerns which purchase goods from one market and sell it in another market, prepare this account.

Trading Account

This account is prepared to know the trading results of the business *i.e.* how much gross profit the business has earned from buying and selling during a particular period. The difference between the sales and cost of goods sold is gross profit. For the purpose of calculating cost of goods sold, we take into consideration opening stock, purchases, direct expenses on purchasing or manufacturing the goods and closing stock. The balance of this account represents gross profit or loss and is transferred to the profit and loss account. The specimen proforma of a trading account is given on the next page.

Less Purchases Returns
" Direct Expenses :
Carriage Inward
Wages
Fuel and Power
Manufacturing Expenses
Coal, Water and Gas
Motive Power
Octroi
Import Duty
Custom Duty
Consumable Stores
Foremen/Works Manager's Salary
Royalty on manufactured Goods
Gross Profit c/d

Detailed Study of the Items poste

1. **Opening Stock**. This
the period for which the trading
the Trial Balance. There wil
Opening stock consists of Raw

2. **Purchases** : It inclu
are for resale purposes. Purcha
be deducted from purchases
in the outer column. The wor

(*i*) *Goods purchased* but
better to debit the Goods in T
such goods. Goods in Transi
as a liability in the Balance S

(*ii*) Goods purchased

PROFIT AND LOSS A/c.

For the year ended 31st December, 1984

	Rs.		Rs.
Gross Loss b/d		By Gross Profit b/d	
Selling and Distribution Expenses :		,, Interest Received	
Advertisement		,, Discount	
Travellers' Salaries, Expenses & Commission		,, Commission	
Bad Debts		,, Rent from Tenants	
Godown Rent		,, Income from Investments	
Export Expenses		,, Apprenticeship Premium	
Carriage Outwards		,, Interest on Debentures	
Bank Charges		,, Income from any other Source	
Agent's Commission		,, Miscellaneous Revenue Receipts	
Upkeep of Motor Lorries		,, By Net Loss transferred to Capital A/c	
Mangement Expenses :			
Rent, Rates and Taxes			
Heating and Lighting			
Office Salaries			
Printing & Stationery			
Postage & Telegrams			
Telephone Charges			
Legal Charges			
Audit Fees			
Insurance			
General Expenses			
Depreciation and Maintenance :			
Depreciation			
Repairs & Maintenance			
Financial Expenses :			
Discount Allowed			
Interest on Capital			
Interest on Loans			
Discount on Bills			
Extraordinary Expenses :			
Loss by fire (not covered by Insurance)			
Cash defalcations			
Net profit transferred to Capital A/c			

If ... certain facilities to the employees certain items of incomes and expenses of the business which ... business must be ... consideration for calculating net profit of the business. These are of indirect ... *i.e.* concerning the whole business and relating to various activities which ... by the business for the purpose of making the goods available to the ... Indirect expenses may be selling and distribution expenses, management ... financial expenses, extraordinary losses and expenses to maintain the ... working order. This account is prepared from nominal accounts and its ... transferred to capital account as the whole profit or loss will be that of owner ... will increase or decrease his capital. The specimen proforma of this account ... on the next page.

Important Points in Profit and Loss Account

(*i*) *Salaries*. These include salaries paid to office, godown and warehouse ... and should be shown in Profit and Loss Account being indirect expenses.

Salaries to partners must be debited separately.

Salaries and wages are treated as unproductive and shown in Profit and Loss Account.

If salaries are paid after deduction of Income tax or Provident Fund ... these should be added back to the salaries in order to have gross figure of salaries ... be shown in Profit and Loss Account.

Balance Sheet

A Balance Sheet is a statement prepared with a view to measure the financial position of a business on a certain fixed dated. The financial position of a concern is indicated by its assets on a given date and its liabilities on that date. Excess of assets over liabilities represent the capital and is indicative of the financial soundness of a company. A Balance Sheet is also described as a '*statement showing the sources and application of capital*'. It is a statement and not an account and prepared from real and personal accounts. The left hand side of the balance sheet may be viewed as a description of the sources from which the business has obtained the capital with which it currently operates and the right hand side as a description of the form in which that capital is invested on a specified date.

On the left hand side of the balance sheet, the several liability items describe how much capital was obtained from trade creditors, from banks, from bill holders and other outside parties. The owner's equity section shows the capital supplied by the owner.

Capital obtained from various sources has been invested according to management's best judgement of the optimum mix or combination of assets for the business. A certain fraction is invested in buildings, another fraction in stock, another fraction is retained as cash for current needs of the business and so on. The assets, side of the balance sheet, therefore, shows the result of these management judgements as on the date of the balance sheet.

A properly drawn up balance sheet *gives information* relating to (*i*) the nature and value of asset, (*ii*) the nature and extent of liabilities, (*iii*) whether the firm is solvent, (*iv*) whether the firm is overtrading.

(iii) *Long Term Liabilities.* Those liabilities which are not payable within the accounting period but will be payable within next five to ten years are called ...term liabilities such as debentures.

(iii) *Current Liabilities.* Those liabilities which are payable out of current ... within the next accounting period usually year or already due are called ...t liabilities. Sundry creditors, bills payable, short term bank overdraft are ...ples of such liabilities.

(iv) *Contingent Liabilities.* A contingent liability is one which is not an ...al liability but which will become an actual one on the happening of some ... which is uncertain. Thus such liabilities have two characteristics : (*a*) ...tainty as to whether the amount will be payable at all, and (*b*) uncertainty ... the amount involved. It is sufficient if the amount of such liability is stated ... face of the Balance Sheet by way of a note unless there is a probability that ... will materialise. In that event it is no more a contingent liability and a ...fic provision should be made therefor. Examples of such liabilities are :

(*a*) Claims against the companies not acknowledged as debts.

(*b*) Uncalled liability on partly paid up shares.

(*c*) Arrears of fixed cumulative dividend.

(*d*) Estimated amount of contracts remaining to be executed on capital ...unt and not provided for.

(*e*) Liability of a case pending in the court.

(*f*) Bills of exchange, guarantees given against a particular firm or person.

...ing and Marshalling of Assets & Liabilities

The arrangement of assets and liabilities in certain groups and in a particular ... is called Grouping and Marshalling of the Balance Sheet of a business. Assets ...bilities can be arranged in the Balance Sheet into two ways :

(i) In order of liquidity

(ii) In order of permanence.

(*i*) *In order of liquidity.* When assets and liabilities are arranged according to ...ment preferences, such an order is called liquidity order. ... in Balance Sheet (I). ... that what is

…assets exceed the liabilities, the firm is solvent *i.e.*, able to pay its debts in … A business is, therefore, solvent by the amount of ownership capital in it, as it … excess of assets over liabilities. The last point *i.e.* (*iv*) concerns the stability … the business. If the total of the debts due to creditors (including bank overdraft) … greater than the liquid assets (*i.e.* cash, investments, bills etc.) the position of the … may be financially unsound: Where the debts are being incurred without sufficient means of payment, the firm is said to be overtrading. For the position to … quite sound, there should be some working capital *i.e.* some spare liquid assets available for current expenditure. It is not a wise policy to lock up the capital in fixed assets. The concern may be solvent without being sound.

Classification of Assets and Liabilities

Assets. Assets are property and possession of a business. Stock, land and buildings, books debts, cash, bills receivable are some examples of assets. The classification of assets depends on their nature. The various types of assets are :

(*i*) *Fixed Assets*. Those assets which are acquired and held permanently in the business and are used for the purpose of earning profits are called fixed assets. Land and buildings, machinery, furniture and fixtures are some examples of these assets.

(*ii*) *Current Assets*. Those assets such as cash, debotrs and stock that can be realised and readily available to discharge liabilities are called current assets.

(*iii*) *Tangible Assets*. These are definite assets which can be seen, touched and have volume such as machinery, cash, stock, etc.

(*iv*) *Ficitious Assets*. These assets are fictitious in nature *i.e.* they are virtually not assets. These are either the past accumulated losses or expenses which are incurred once in the life of a business and are capitalized for the time being. Profit and loss account (debit balance), organisation expenses, discount on the issue of shares, advertisement expenses capitalized for the time being are examples of such assets.

(*v*) *Intangible Assets*. Those assets which cannot be seen, touched and have no volume but have value are called intangible assets. Goodwill, patents and trade marks are examples of such assets but quite valuable to the undertaking. An intangible asset may not be fictitious. If on account of the past goodwill purchased along with an existing concern, sales are readily effected and profit is readily earned, the asset is certainly not fictitious though it is intangible. However, if the amount of goodwill was paid in repect of a losing concern, the aset would be fictitious.

(*vi*) *Wasting Assets*. Those assets such as mines, quarries etc that become exhausted or reduce in value by their working are called wasting assets.

(*vii*) *Liquid Assets*. These are cash or such items as marketable securities which can be converted into cash quickly.

(*viii*) *Contingent Asset*. It is an asset the existence value and ownership of which is dependent on the occurrence or non-occurrence of a specified act. Suppose a firm has filed a suit for some specified property now in possession of someone else. If the suit is decided in firm's favour, the firm will get the property. At the moment it is a contingent asset. Similar would be the position of a patent applied for arising of the firm's own research effort. Contingent liability in respect of a contract for capital expenditure already entered into will give rise to an asset on payment, at present it is only a contingent asset.

Liabilities. A liability is an amount which a business is legally bound to pay. It is a claim by an outsider on the assets of a business. Liabilities may be classified into four categories :

(*i*) *Fixed Liabilities*. These are those liabilities which are payable only on the termination of the business such as capital which is a liability to …

(*ii*) … accounting period …
next accounting … term liabilities such…

(*iii*) *Current Liabi*…
… within the next …
current liabilities. Sun…
examples of such liabil…

(*iv*) *Contingent L*…
actual liability but whi…
event which is unce…
uncertainty as to wheth…
about the amount invo…
on the face of the Bala…
a loss will materialise…
specific provision shou…

(*a*) Claims again…

(*b*) Uncalled liab…

(*c*) Arrears of fi…

(*d*) Estimated …
account and not prov…

(*e*) Liability of a…

(*f*) Bills of exch…

Grouping and Marsha…

The arrangeme… order is called Group… and liabilities can be…

(*i*) In order of…

(*ii*) In order o…

(*i*) *In order of* … their realisability a… Such arrangement …

(*ii*) *In order* … followed in case o… in case of joint sto… also. Fixed asse… be sold or paid … given on the …

(ii) *Long Term Liabilities.* Those liabilities which are not payable within the ...accounting period but will be payable within next five to ten years are called ...term liabilities such as debentures.

(iii) *Current Liabilities.* Those liabilities which are payable out of current ... within the next accounting period usually year or already due are called ...nt liabilities. Sundry creditors, bills payable, short term bank overdraft are ...ples of such liabilities.

(iv) *Contingent Liabilities.* A contingent liability is one which is not an ...al liability but which will become an actual one on the happening of some ... which is uncertain. Thus such liabilities have two characteristics : (*a*) ...tainty as to whether the amount will be payable at all, and (*b*) uncertainty ... the amount involved. It is sufficient if the amount of such liability is stated ...e face of the Balance Sheet by way of a note unless there is a probability that ... will materialise. In that event it is no more a contingent liability and a ...ific provision should be made therefor. Examples of such liabilities are :

(*a*) Claims against the companies not acknowledged as debts.

(*b*) Uncalled liability on partly paid up shares.

(*c*) Arrears of fixed cumulative dividend.

(*d*) Estimated amount of contracts remaining to be executed on capital ...nt and not provided for.

(*e*) Liability of a case pending in the court.

(*f*) Bills of exchange, guarantees given against a particular firm or person.

...ing and Marshalling of Assets & Liabilities

The arrangement of assets and liabilities in certain groups and in a particular ... is called Grouping and Marshalling of the Balance Sheet of a business. Assets ...liabilities can be arranged in the Balance Sheet into two ways :

(*i*) In order of liquidity

(*ii*) In order of permanence.

(*i*) ***In order of liquidity.*** **When assets and liabilities are arranged according to ...realisability and payment preferences, such an order is called liquidity order.** ... the next page in Balance Sheet (I).

... reversed from that what is ... order is followed

BALANCE SHEET (I)

Liabilities	Rs.	Assets	Rs.
Current Liabilities :		*Liquid Assets :*	
Bill Payable		Cash in Hand	
Sundry Creditors		Cash at Bank	
Bank Overdraft		*Floating Assets :*	
Long Term Liabilites :		Sundry Debtors	
Loan from Bank		Investments	
Debentures		Bills Receivable	
Fixed Liabilities :		Stock in Trade	
Capital		Prepaid Expenses	
		Fixed Assets :	
		Machinery	
		Building	
		Furniture & Fixtures	
		Motor Car	
		Fictitious Assets :	
		Advertisement	
		Misc. Expenses	
		Profit & Loss A/c	
		Intangible Assets :	
		Goodwill	
		Patents	
		Copyright	
Total		Total	

Note for contingent liabilities, if any.

BALANCE SHEET (II)

Liabilities	Rs.	*Assets*	Rs.
1. Fixed Liabilities		1. Intangible Assets	
2. Long Term Liabilities		2. Fictitious Assets	
3. Current Liabilities		3. Fixed Assets	
		4. Floating Assets	
		5. Liquid Assets	

Note for contingent liability, if any.

Illustration 3. From the following particulars, prepare a Balance Sh... 31st December, 1984.

	Rs.
Capital	50,000
Business Premises	
Furniture & Fixtures	
Bills Rec...	