Business and Accounting Studies

Grade 10

Educational Publications Department

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1 Background of Business

The following facts are discussed in this chapter.

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- Stakeholders
- Objectives of stakeholders

1.1 Basic Concepts about Businesses

When the social existence of a human develops, individual needs also widened gradually. When the needs and wants were diversified, it was difficult to produce all their needs and wants by themselves. As a remedy to this problem, people started to produce a large quantity of goods that they could produce the best, with the skills and resources they had. Therefore, an excess of goods was created. Then people exchanged their excess goods with others to obtain other goods they wanted. This system of exchanging goods was known as the 'Barter System'.

Even today, no one produces all what he or she wants. The farmer produces rice; the carpenter makes furniture; the teacher teaches. This individual is either a producer or a consumer in different instances. Such producers and consumers fulfill their needs and wants through businesses. Therefore, businesses are given immense importance in the modern society.

Business Concept

Man needs goods and services from birth to death. These needs and wants are fulfilled by the businesses. Businessmen manufacture and distribute various goods and services according to the human needs and wants. The way businesses manufacture and distribute goods and services and the way man fulfills his needs and wants have become different and complex today.

A business is an economic activity which manufactures or provides different goods and services in order to fulfill human needs. Most of the firms are profit oriented whereas some firms are not profit oriented. Especially, most of the businesses in the government sector are driven by the social welfare motive. Even though a majority of private sector businesses are driven by the profit motive, some firms are also driven by the welfare motive.

A majority of production activities carried out manually in the past are now carried out using new technology. Most of the businesses do their transactions through electronic media. Therefore, today, any business activity such as ordering goods, paying money and advertising etc can be performed rapidly and easily through electronic media. Due to the accelerating growth in information and communication technology, the world has become a global village through electronic media. Any individual in any country is now consuming different goods produced in different countries in order to fulfill their needs and wants. The following activity will facilitate you to understand the extent to which your daily life has been connected to the global market today.

Activity 01

List down the names of different goods that you consume within a selected day and write down the country of manufacture of each good in front.

Business Objectives

As a consumer your objective is to obtain a quality product at a reasonable price to satisfy a need. Similarly, consumers and other different stakeholders of businesses have specific objectives to be fulfilled. Every business has a specific objective or set of objectives to be achieved, because the parties such as owners of a business, its managers, employees, customers, government and community expect different returns from a business.

Figure 1.1

The following are some business objectives that can be seen in common in a profit oriented business

01. Earning profits

    Profit earning objective is essential for a business because it has to pay a sufficient return to the owners for their investment.

02. Increasing customer satisfaction

    The survival of a business depends on how it satisfies the needs and wants of its customers.

In achieving the above objectives, businesses need to focus on sub objectives. Some of them are discussed below.

(a) Increasing the quality of goods and services

    Businesses intend to provide quality goods and services at a reasonable price as well as to fulfill consumer needs and wants.

(b) Generating employment opportunities

    Another goal of businesses is to generate different job opportunities from labourers to top managers.

(c) Employee welfare

Providing various welfare facilities in addition to wages to satisfy the employees is another objective of most of the businesses. Food, accommodation facilities, transportation facilities and medical facilities are some examples for those various welfare facilities offered by a business.

Consumer needs and wants

Needs

Human needs are requirements that must be fulfilled essentially for existence. Food, clothing and shelter are considered as the basic human needs and when the society develops, education, health, security, transportation, communication and entertainment are also recognized as human needs. The following characteristics can be seen in human needs.

Figure 1.2

Characteristics of needs

- Being essential - It is essential to fulfill the needs for existence.
- Being common - Needs are common to every individual.
- Cannot be created - Needs will arise naturally and hence cannot be created by businessmen.
- Being limited - Needs are relatively very low in number.

Wants

Wants are different ways of satisfying needs. A single need can be satisfied in different ways.

Examples :-

Needs		**Wants**
Food	-	string hoppers, ice cream, cake
Clothes	-	sarees, uniforms, shoes

Businesses produce different types of goods and services to fulfill human needs and wants of consumers. These wants have following characteristics.

Characteristics of wants

- Not essential

  For existence it is not essential to fulfill a want as that need could be satisfied by another similar want instead.
- Being diverse

  Even though the needs are common to any individual, the way they satisfy them differs depending on their socio - economic condition.
- Can be created

  Businessmen can create wants.
- Being complex

  Due to being unlimited and diverse, fulfillment of wants are also complex.
- Being unlimited

  There are different wants that can be used to fulfill a single need.

Activity 02

01. Write down different ways you follow to satisfy the following needs.

Need	Wants
Food	
Clothing	
Housing	
Education	
Health	
Safety	
Transportation	
Communication	
Entertainment	

Activity 03

Write down four differences between needs and wants

Activity 04

Today, businesses produce various goods and services creatively, which are required to fulfill human needs. Accordingly, compare the various goods and services used to fulfill human needs in the past with those at present.

Manufacturing Businesses

Businesses can be categorized as follows based on the nature of the product produced by a business.

- Commodity manufacturing businesses
- Service providing businesses

Commodity manufacturing businesses

Tangible and physically existing things can be called as commodity whereas, the establishments which produce the commodity required for the fulfillment of human needs and wants are called as commodity manufacturing businesses. These manufacturing businesses produce different types of goods that can satisfy a single need. They produce different goods by considering various tastes of consumers, income level and social status to ease the life style of humans. The following are some examples for different goods produced by businesses.

Figure 1.3

Examples :-

Processed food, automobiles, electric ovens, mobile phones, washing machines, furniture

Activity 05

There are number of goods you consume day to-day in your home. Prepare a list of goods consumed by you, produced within your area.

Activity 06

Using goods with different brand names to fulfill the same need can be seen in the market. List the brand names of goods you consume at home under each category of goods mentioned below. compare the answers with your friend.

Category of goods	Brand name	Reasons for the choice
Soap		
Tooth paste		
Chocolate		
Exercise books		
Pens		

Service Providing Businesses

Any activity or a process rendered to consumers by a business in order to fulfill their needs and wants are known as services. The businesses providing these services are known as service providing businesses.

Examples :-

Wholesale businesses
Retail businesses
Insurance Institutions
Banking Institutions
Beauty salons
Educational Institutions

Figure 1.4

Activity 07

You are required to obtain different services in order to ease the work in your home. Write down different services provided by the businesses in your area.

Factors of Production

Businesses require different resources to produce goods and services. These resources required are known as factors of production. The factors of production can be categorized basically as land, labour, capital and entrepreneurship.

Land

All the natural resources available are considered as land. It includes resources on the surface of the land as well as resources in the inner part of the land.

Examples :-

Minerals, forests, soil

Labour

The mental and physical contribution in a business can be considered as labour in simple terms.

Examples :-

Individuals rendering physical efforts	-	Workers in the mines Sanitary labourers
Individuals rendering mental efforts	-	Accountants Managers

Capital

Anything produced by man in order to facilitate manufacturing process is known as capital.

Examples :-

Machinery, buildings, motor vehicles, money.

Entrepreneurship

Entrepreneurship encompasses the role of organizing factors of production such as land, labour and capital required for production in order to start and conduct a manufacturing process. An entrepreneur takes the risk, creates innovations and takes decisions with regard to the business.

Activity 08

01. Select a business in your area and prepare a list of resources used by that business.
02. Categorize the above identified resources into land, labour, capital and entrepreneurship.
03. Explain the entrepreneurial roles carried out within that business.

1.2 Stakeholders of businesses

Stakeholders are the different parties who are interested in the business activities. These parties are interested in business operations in order to fulfill various objectives.

Figure 1.5 - Stakeholders of a business

Let us study about the stakeholders mentioned in the above figure in detail.

Owners - Owners are the persons providing resources to the business. The owner of a business can be either a single person or a group of persons.

Managers - The business operations are conducted and decisions of the owners are implemented by managers. In large scale businesses, there can be number of managers such as finance manager, marketing manager, etc.

Customers - Customers are the persons who buy goods and services from a business. They can buy these goods either with the re-selling motive or with the motive to use on own consumption.

Suppliers - Suppliers are the providers of raw materials, transport facilities, etc. to a business.

Competitors - Competitors are other businesses producing or selling similar goods or services to a business in operation.

Financial institutions - Financial institutions are the institutions providing required loans, consultancy services etc. to a business.

Employees - Individuals performing the operations of a business are known as employees.

Government - The government propagates policies required to achieve economic growth of a country.

Community - Includes the population living outside of the business in the society

Examples :-

Journalists, environmentalists
pressure groups

Future investors - Individuals and institution willing to invest

All these stakeholders intend to achieve various objectives from the business. Some selected objectives of them are depicted in Table 1.1.

Table 1.1 Stakeholders and examples for their objectives

Stakeholders	Examples for Objectives
Owners	Security of investment Earning a sufficient profit Growth of the business operations in future
Managers	Taking decisions required to achieve the objectives Implementing those decisions Promotions and job satisfaction
Employees	Receiving a fair wage or a salary Job security
Customers	Obtaining products at a reasonable price Obtaining quality products
Suppliers	Securing orders continuously Obtaining money without any delay
Financial Institution	Collecting loans and advances given Providing more loans and advances
Government	Collecting taxes due Generating employment opportunities Increasing the domestic production
Competitors	Determining the prices of own products To face competition
Community	Analysing whether the business activities are conducted in an environmentally friendly manner Analysing whether business contributes to the social welfare
Future investors	Taking decisions on investment

A business is required to conduct its operations in a way that it satisfies various objectives of its stakeholders. In this regard, business also expects certain contributions from its stakeholders. Table 1.2 depicts examples of some contributions expected by a business from some selected stakeholders.

Table 1.2 Expected contributions from stakeholders

Stakeholders	Example for contributions
Owners	Contributing adequate capital Being dedicated and enthusiastic about business activities Supervising business activities
Managers	Implementing business plans appropriately Taking correct decisions
Employees	Appropriately completing the tasks assigned Increasing the productivity of labour
Suppliers	Supplying quality raw materials continuously Supplying raw materials in time
Government	Providing business - friendly incentives

Accordingly, the ability and the future success of a business depends on the mutual relationship between the business and its stakeholders.

Activity 09

Name different stackeholders of your school. Prepare a table indicating the objectives of those stakeholders expected from your school and the expected contribution from them towards the school.

Activity 10

Identify the stakeholders of the following institutions located in your area.

A commercial bank
A factory

2 Business Environment

The following facts are discussed in this chapter.

2.1 Business environment

2.2 Technological and economic environment
- Technological environment
- Economic environment

2.3 Global environment and business activities

2.4 Importance of studying business environment

2.1 Business environment

Any business has an environment related to it. The factors within the business or outside the business affect the existence of a business either directly or indirectly. Hence, the business environment can be defined as the environment in which the factors affecting businesses are activated. The businesses require undergoing changes continuously due to the fact that environmental forces are also dynamic and businesses need to adhere to them.

For a business to be successful, it is essential to pay constant attention to its environment. New business opportunities can be identified through the changes in environmental forces and different trends arising in the environment.Therefore, successful businesses continuously study the business environment and adopt their business activities accordingly.

Classification of business environment

The business environment can be classified mainly as follows.

- Internal environment
- External environment

There are different parties and forces present in both the internal and external environment of a business.This chapter discusses only the following parties and forces.

Business environment

Internal environment	External environment
Owners	Customers
Managers	Suppliers
Employees	Competitors
	Political environment
	Legal environment
	Technological environment
	Economic environment
	Global environment

Figure 2.1 - Classification of business environment

Internal environment

Different parties and forces acting within a business and affecting a business are known as the internal environment. The parties within the internal environment and their impact over the businesses are depicted below.

Owners	Owners are the persons supplying the required capital for a business. Their financial strength, business knowledge and experience will lead to the success of a business.
Managers	Managers are the persons taking decisions to direct the resources of a business in order to achieve the objectives of its owners. The managers are responsible to build a good relationship between the customers and the employees of a business. In certain businesses, owners will also be the managers.
Employees	Employees are persons who duly perform their tasks assigned using their own skills and competencies. Their dedication and good attitudes also matter for a business to be successful.

External environment

Different parties and forces acting outside the business and affecting a business are known as external environment. The impact of these external environmental factors to a business is depicted below.

Customers

Customers buy goods and services from a business. The survival of a business depends on its customers. Therefore, businesses are required to identify different needs and wants of customers and satisfy them appropriately. The changes in the buying patterns of customers will have a close impact over the activities of a business.

Competitors

Competitors are the businesses producing goods or services, which are similar to the goods or services of another business. The way, competitors conduct their business activities, price and quality of the competitor's products, marketing techniques, etc. would closely influence a business.

Suppliers

The parties providing required raw materials and other services to a business are known as suppliers. It is vital to supply raw materials and other services at the right time and to provide quality raw materials to ensure continuous operations of a business.

Political environment

In a country, the policies of a government will have an influence on businesses.The businessmen have to conduct their businesses by considering these policies. The following are some examples for government policies.

Examples :-

Infrastructure development policy
Fiscal policy

Legal environment

The legal environment consists of laws and regulations, enforced in order to protect consumers, to protect domestic manufacturers and business community and to protect the environment. In addition, the government appoints institutions, boards, commissions and responsible authorities and individuals to enact these laws. The following are some examples for such laws and regulations.

Examples :-

Companies Act No. 07 of 2007
Consumer Affairs Authority Act No. 09 of 2003
Shop and Office Employees Act No. 14 of 1954

The following are some designations and institutions appointed to enact these laws and regulations.

Examples :-

- Registrar of Companies
- Public Health Inspector
- Consumer Affairs Authority
- Central Environmental Authority

Due to these legal regulations and institutions, businessmen have limits over their ability to conduct businesses according to their own will. Every businessman is expected to comply with these laws and regulations that are applicable, imposed by the government.

2.2 Technological and economic environment

Technological environment

Figure 2.1

The technological environment grows rapidly due to new innovations.The business activities as well as life style of individuals have changed due to changes in the technological environmental factors. Advancement in computer technology, advancement in communication technology due to internet, advancement in production methods due to nano technology and digital technology and the advancement in transportation technology have significantly changed the business environment.

The following are some examples for the changes occurred in the business environment due to changes in technology.

Examples :-

The fabric manufacturers used simple manual weaving machines in the history. But today, they use modern machines, computer technology etc. to manufacture quality fabric at a low cost within a short period of time.

Businesses now use telephones and e-mails instead of the snail mail used in the past.

In early days, businessmen published their advertisements with their postal mail address. However, today they provide their telephone numbers, e-mail addresses and invite customers to visit their web site for more information.

Today, computers and information systems are used to record accounting information instead of the manual accounting books used in the past. Historical manual production processes are now automated by using computerized machines.

Some goods and services become outdated rapidly due to rapid changes in the technology.

Economic environment

Economic environment consists of economic factors that affect businesses.The government of a country is mainly responsible for setting economic policies.

A set of economic factors can be briefly explained as follows.

Interest rate	It is the interest rate given for bank deposits and charged for bank loans.
Inflation	Inflation is the continuous increase in the general price levels of goods and services.
Income distribution	It is how the national income of a country has been distributed among its people.
Level of employment	If every one expecting a job receives a suitable job, a country will achieve a full employment level.
International relations	International relations are the relationships existing between countries. These relationships are built up through trade zones and trade agreements.
Foreign exchange rate	It is the rate at which the currency of one country is exchanged with the currency of another country.
Savings	It is the proportion of the income that individuals keep without spending on consumption. Higher the savings of a country the higher will be the amount of funds available for investment.

2.3 Global environment and business activities

Globalization is the mutual relationship among countries in terms of economic, social and cultural dimensions. Globalization facilitates the conduct of business activities freely without any cross border or any other restriction. Due to the advancement in information and communication technology, the entire world has now become a single global village. Goods and services, labour and capital, etc. are moved between countries by reducing the distance among the people in different countries. Therefore, changes in different factors in the global environment will have both positive and negative impacts on domestic businesses.

Positive impacts from the global environment on domestic businesses

- Possibility to obtain latest technology
- Possibility to obtain quality raw materials from abroad
- Possibility to obtain efficient machines
- Inflow of foreign capital
- Possibility to find foreign markets for domestic goods and services

Negative impacts from the global environment on domestic businesses

- Creating a highly competitive environment.
- Domestic skilled workers migrating to foreign countries.
- Instability of the existence of domestic businesses.
- Negative changes on the local culture.

Activity 01

Collect the information on the exchange rates relating to the currency with the Sri Lankan Rupee and fill the table.

Foreign Currency	Exchange Rate
US Dollar	....
British Pound	....
Japanese Yen	....
Indian Rupee	....
Euro	....

Activity 02

Write an article to your Wall Paper by collecting news on various incentives given by the government to businesses.

2.4 Importance of studying environment of a business

Every internal and external environment factor mentioned above will have an impact either positively or negatively to businesses.The businessmen are required to study the business environment in order to identify these conditions. The strengths and weaknesses of a business can be identified by studying the internal environment. The strengths can be used to grow a business, whereas weaknesses are to be minimized.

The following are some examples for strengths and weaknesses of a business.

Strengths

- Availability of adequate capital
- Experience of managers
- Specialized knowledge and dedication of employees
- Specialized production methods
- Having a recognized brand name

Weaknesses

- Business knowledge of owners is not sufficient
- Limited financial capability of owners
- Scarcity of trained workers
- Knowledge about new technologies not been updated
- Negative attitudes of workers
- Geographical location of the business is unfavorable

Opportunities and threats available for a business can be identified by analyzing external environment. Hence, the businessmen can exploit the opportunities and face the threats successfully.

The following are some examples for opportunities and threats of a business.

Opportunities

- Changes in the life style of consumers
- Introducing low interest loans by the government
- Providing tax incentives for businesses
- Designing new cities
- Constructing high ways

Threats

- New competitors entering in to the industry
- Natural disasters
- Imposition of international trade embargo
- Difficulties in adapting new technological methods

Clever businessmen continuously pay their attention on the internal and external environment of a business. A business can exploit its strengths and opportunities to achieve growth in the business and take necessary steps to minimize or avoid weaknesses and threats to ensure the business stability.

Activity 03

Observe the strengths, weaknesses, opportunities and threats of a business in your area and complete the table.

Name of the business..........................

Strengths	Weaknesses	Opportunities	Threats
....	....	....	....
....	....	....	....
....	....	....	....
....	....	....	....

Activity 04

Explain five domestic and global environmental changes affecting businesses.

Activity 05

Write an article to the commerce magazine of your school on "The importance of studying business environment."

3 Business Organizations

The following facts are discussed in this chapter.

3.1 Basic information on the types of business organizations
- Classification of business organizations
- Types of business organizations and their characteristics

3.2 Selecting an appropriate business organization
- According to the objectives
- According to the scale
- According to the management procedures

3.3 Registration of a Sole Proprietorship
- Steps to be followed for registration
- Documents needed for registration
- Advantages of registering the business name

3.1 Basic information on the types of business organizations

When the population of a country increases, the process of manufacturing and distributing goods and services expands. Therefore, different types of business organizations are established in order to fulfill the needs and wants of people. A business organization generally consists of an individual or a group of individuals working together to produce goods and services required to fulfill human needs and wants.

Different parties provide funds to businesses. Owners of a business are the individuals or groups who provide funds and assume the risk by involving in business. Based on the ownership, businesses are categorized into several categories.

In addition, businesses are conducted to achieve different objectives of the businessmen. Accordingly, some businesses are carried out to earn profits whereas others are carried out for the well-being of the society.

Further, a businessman can start either a small scale business or a large scale business depending on the amount of resources that he has. Out of different types of business organizations, businessmen should be clever enough to choose an appropriate type.

Classification of business organizations

Businesses are organized in different ways. These different types of business organizations can be classified as follows depending on various criteria.

- Based on the ownership
- Based on the objective
- Based on the scale

Classification of business organizations based on the ownership

The owners are the individuals who provide funds for the business and assume risks by involving in it. The owners enjoy the profits earned by the business and bear the losses of the business as well. Accordingly, business organizations can be categorized as follows based on their ownership.

- Private sector business organizations
- Public sector business organizations

The figure 3.1 depicts different ways of classifying business organizations under above two sectors based on ownership.

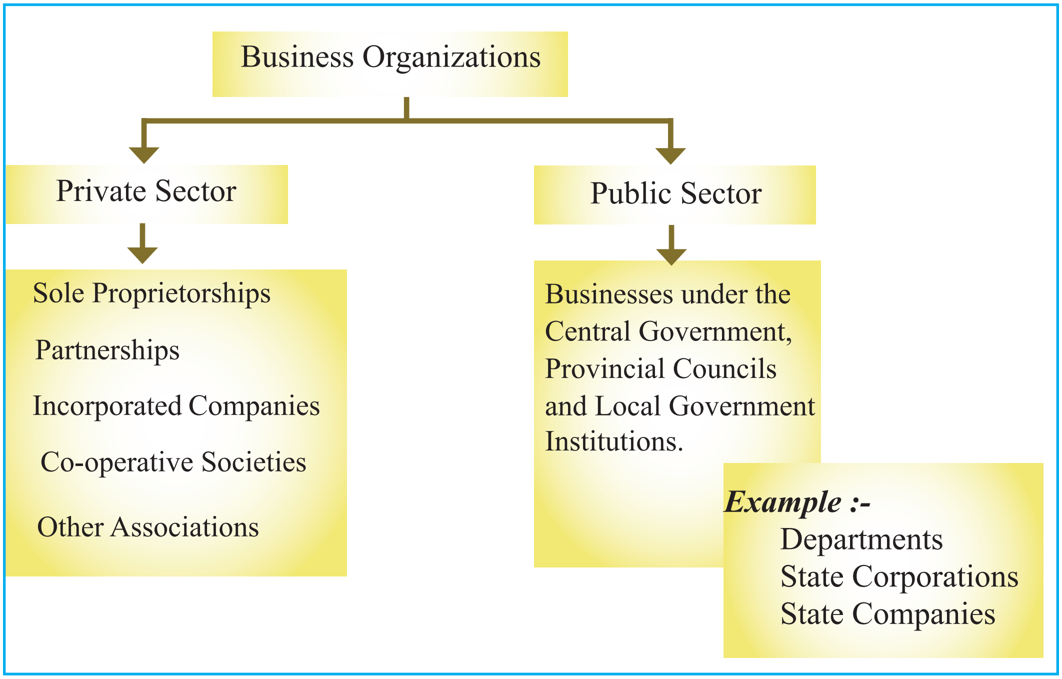


Figure 3.1 Classification of business organizations based on the ownership

Private sector business organizations

Businesses owned by an individual or a group of individuals are known as private sector businesses. Private sector businesses can be further classified as sole proprietorship, partnerships, incorporated companies, cooperative societies and other associations.

Public sector business organizations

Businesses funded and owned by the government are public sector business organizations. State departments, state corporations, state companies, businesses registered and owned under Provincial Councils and Local Government Institutions are the different types of business organizations in the public sector.

Classification of business organizations based on the objectives

Different organizations are established to achieve different objectives. Businesses are also conducted by its owners to achieve an objective. Businesses can be classified as follows based on its objective.

- For profit businesses
- Not for profit businesses

The below Figure 3.2 depicts the classification of business organizations based on the objective.

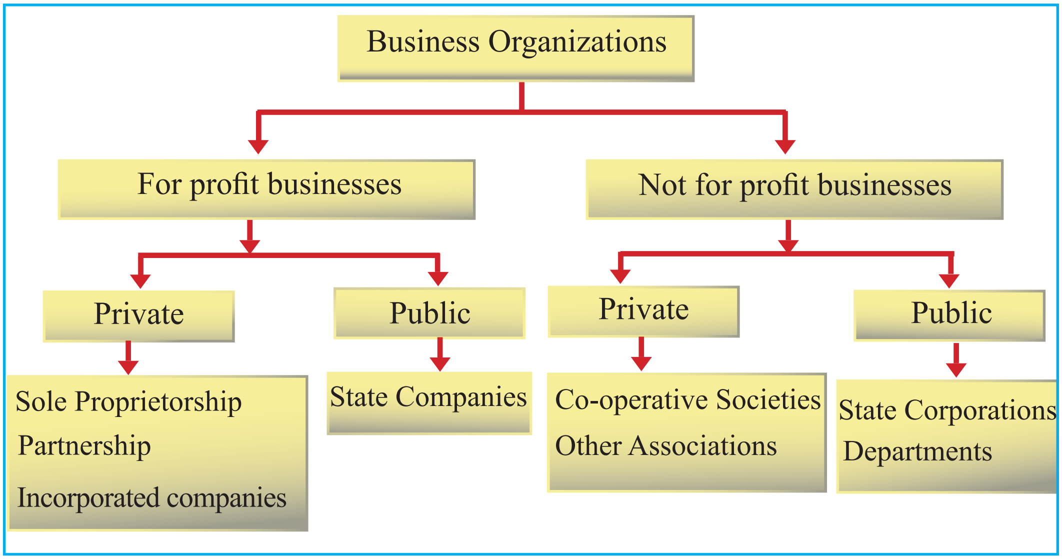


Figure 3.2 Classification of business organizations based on the objective

For profit businesses

When the main objective of the business is to earn profits, they are known as profit oriented businesses. This type of businesses are operated under both private sector and public sector.

Not for profit businesses

The main objective of these businesses is to ensure welfare of members and the society. Not for profit businesses are also conducted both under private sector and public sector.

Classification of business organizations based on the scale

The scale of a business organization depends on different criteria. Some of the criteria used are as follows.

- Amount of capital invested in a business
- Number of employees
- Amount of the energy used
- Market share of the business

Based on the scale, business organizations can be categorized into two parts.

- Small and medium scale businesses
- Large scale businesses

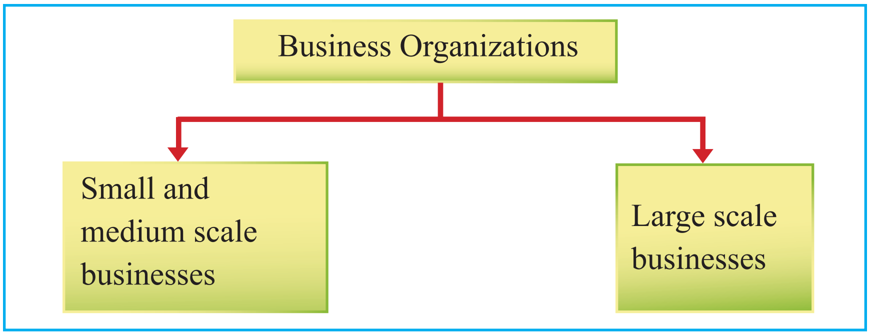


Figure 3.3 Classification of business organizations based on scale

Small and medium scale businesses

Different institutions have identified different criteria in classifying small and medium scale businesses. Accordingly, businesses with a small amount of capital invested, with a small number of employees and having a small market share relative to large scale businesses are known as small and medium scale businesses.

Figure 3.4

Example :-

Businesses employing less than 25 employees according to the Census and Statistics Department are considered as small scale businesses.

Large scale businesses

Figure 3.5

Businesses that have invested a large amount of capital, have employed a large number of employees, have a large market share and have the ability to influence the respective industry are known as large scale businesses.

Example :-

A factory employing a large number of workers

Next, the above mentioned types of business organisations will be discussed in detail.

Sole proprietorship

Figure 3.6 - A small retail shop

Businesses owned by an individual are known as sole proprietorship. This is the most common type of business organization in almost all the countries in the world. This type of business organization is common because it is easy to commence, requires only a small amount of capital and can take independent decisions. The success of this business depends on the skills and dedication of its owner.

Characteristics of sole proprietorship

The following characteristics can be seen in sole proprietorship.

- **Capital is provided by a single person who is the owner**

  The owner is required to find the necessary capital for the business individually. Savings or borrowed funds by the owner can be invested as the capital to the business.

- **Profits or losses to be born alone**

  All the profits earned by a sole proprietorship belong to the owner. Also, if there is a loss, the owner should bear it alone.

- **Unlimited liability of the owner**

  In a sole proprietorship, the owners' liability is unlimited. Accordingly, the liability is not limited only for the capital that had been invested. In order to settle liabilities of the business, the owner might require to use his properties external to the business and there is no limit for such commitment.

- **No legal personality**

  A sole proprietorship cannot conduct any legal operations by its business name. It can do so only by the personal name of the owner. For example, entering in to contracts, purchase of vehicles, obtaining bank loan, filing cases should be done in the personal name of the owner.

- **No continued existence**

  Due to such reasons as the death of the owner, being mentally unsound to conduct the business etc. the business operations of a sole proprietorship will be discontinued.

- **Not mandatory to register**

  In general, it is not mandatory to register a sole proprietorship.

In addition to the above mentioned characteristics, there are some other characteristics of a sole proprietorship such as the ability to take decisions alone, controlling is done by the owner and owner has the opportunity to discontinue the business at any time he requires.

Advantages of sole proprietorship businesses

Sole proprietorships have following main advantages compared to other types of business organizations.

- **Convenient to start**

  Since the legal requirements are minimal and the cost of establishing is low compared to other business organizations, it is easy to commence a sole proprietorship.

- **All the profits belong to the owner**
  All the profits earned by a sole proprietorship are enjoyed solely by the owner.

- **Privacy of the business information is secured**
  Since all the management and administrative activities of a sole proprietorship are usually done by its owner, it is less likely that the business information to be transmitted to external parties.

- **Ability to use own skills at the best**
  Since all benefits accrue to himself, the owner renders his skills and dedication at his best to achieve the growth of the business.

- **Independent decision making**
  The owner can take decisions quickly, since all the decisions regarding the business are taken by its owner himself.

Disadvantages of sole proprietorship

Sole proprietorships have following main disadvantages compared to other business organizations.

- **Unlimited liability of the owner**
  The owner is personally liable for all the debts of the business. If the level of debt is higher than the value of all the assets of the business, the owner must sacrifice even his private properties to pay off debts.

- **Difficulties in raising capital**
  The financial strength of an individual is limited. In addition, it is difficult to raise capital from external parties such as banks, due to the higher level of risk involved in sole proprietorships and due to the unlimited liability of its owner.

- **No continuous existence**
  The business operations of a sole proprietorship could be discontinued due to the death of its owner or owner being mentally incapable.

- **No legal personality**
  A sole proprietorship does not have a legal personality. Therefore, all the legal activities of the business have to be conducted under the personal name of its owner.

- **Individual decisions of the owner can be unsuccessful**
  There is a possibility that the individual decisions taken based only on the knowledge and experience of an individual can become unsuccessful compared to collective decisions.

Partnerships

The relationship among persons conducting a business in common with an objective to earn profit is known as a partnership. The Partnership Ordinance of 1890 affects partnerships. Professionals such as accountants, lawyers, tax officers and doctors may also conduct their practice as a partnership.

Example:

A set of chartered accountants carrying out an audit firm.

Figure 3.7

Characteristics of partnerships

The following special characteristics can be seen in partnerships compared to other business organisations.

- **Number of members in a partnership**

  There should be 2 members minimum and according to the Companies Act No. 07 of 2007, a maximum of 20 members to commence a partnership.

- **Partnership Agreement**

  A partnership commences with an agreement among its partners, which is known as the partnership agreement.This agreement can be in written, oral or implied. According to the Prevention of Fraud Ordinance if the initial capital of the partnership is greater than Rs. 1000, a partnership is required to be conducted under a written agreement. This written agreement is known as partnership deed.

- **Unlimited liability of partners**

  Partners are unlimitedly liable for the debts of a partnership. If the assets of the business are not sufficient to pay off its debts, partners are liable to sacrifice their private properties even to pay off debts.

- **Not mandatory to register a partnership**

  If a partnership is conducted under the full names of all the partners, it is not required to register. However, if a partnership is conducted under a different name, the business name should be registered. Registrar of the respective Provincial Council is the authorized officer to register business names.

- **No separate legal identity**

  A partnership is not considered as a legal person in front of law. Therefore, a partnership is unable to perform any legal activities in its business name. Partners are required to use their personal names in legal matters.

- **No continued existence**

  The existence of a partnership will be ceased due to the death of a partner or a partner being mentally unstable.

Advantages of partnership businesses

The partnerships have following advantages compared to other business organizations.

- **Convenient to commence**

  Partnership businesses are also easy to commence like sole proprietorships. The legal regulations pertaining to the commencement and conduct of partnerships are comparatively low.

- **Can raise more capital**

  Since a partnership consists of two or more members, they can raise more capital compared to a sole proprietorship.

- **Can utilize different skills of partners**

  As various individuals involve in a partnership, special skills of them can be utilized.

- **Shared liability among partners**

  The liabilities arising from operations of a partnership will be shared among all the partners in the business.

- **Can take collective decisions**
  More accurate decisions can be taken in a partnership by considering the views of all the partners collectively.

Disadvantages of partnership businesses

- **Unlimited liability**
  Partners in a partnership are also unlimitedly liable regarding the debts of the business. Therefore, when the debts of the business are more than the capital partners have provided, they are liable to sacrifice their personal properties to pay off that debt.

- **Profit shared among partners**
  Even though the owner of a sole proprietorship enjoys all the profits earned, in a partnership, the profits earned are shared among the partners.

- **Conflicts among partners**
  Conflicts could arise among the partners of a partnership due to certain decisions taken when conducting the business. These conflicts will cause a business to become a failure.

- **No continued existence**
  A partnership may be dissolved due to the death of a partner or a partner being mentally instable.

- **No legal personality**
  Since a partnership is not accepted as a legal person in front of law, the partners are required to use their own personal names in all legal activities of the partnership.

Incorporated companies

A firm which is registered under the Companies Act No. 07 of 2007, with a legal personality, can raise capital by issuing shares and the liability of the shareholders being limited, is an incorporated company. The owners of these limited companies are the shareholders. Their liability is limited to the amount they have paid or liable to pay for the shares they have purchased.

Characteristics of incorporated companies

The following are some major characteristics that are common in incorporated companies.

- **Incorporation under the Companies Act**

  In order to commence an incorporated company, it is required to be incorporated under the Companies Act No. 07 of 2007. As per the provisions in the Act, the duly completed relevant documents should be submitted to the Registrar of Companies.

- **Continued existence**

  Since a company is considered as a separate legal entity from its owners, the death of shareholders or shareholders being bankrupt shall not affect to the continued existence of its business activities.

- **Ability to register with limited liability**

  Shareholders have a limited liability with regard to the debt and other liabilities of a company. The liability of shareholders is limited to the value of the shares they have purchased. Hence, they are not required to sacrifice their private properties unlike in sole proprietorships and partnerships.

- **Can raise capital by issuing shares**

  An incorporated company can raise capital by issuing shares.

Advantages of incorporated companies

The following advantages can be seen in incorporated companies compared to other business organizations.

- **Can raise more capital**

  A higher level of capital can be raised by issuing shares. Due to the higher recognition of the incorporated companies, it is easy to raise funds by obtaining loans from external parties as well.

- **Receiving legal personality**

  A company is considered as a legal person in the presence of law. Therefore, a company can enter into contracts, can appoint agents, can acquire assets and can pay taxes etc. in its name.

- **Continued existence**

  The continued existence of a company will not be disrupted by the death of its shareholders or due to bankruptcy. Therefore, a company can conduct their operations continuously.

- **Limited liability**
  The liability of shareholders of an incorporated company are limited to the amount of capital they have invested in the company.

- **Managed by a Board of Directors**
  The business activities of a company are managed by a Board of Directors selected and appointed by the shareholders of a company.

Disadvantages of incorporated companies

The following are some of the disadvantages that can be seen in limited companies compared to other business organizations.

- **Greater level of legal provisions**
  Since the legal provisions relevant for starting a company, conducting operations and winding up of a company are comparatively higher, conducting a limited company is more complex compared to other forms of business organizations.

- **Profits and ownership are shared**
  In the case of an incorporated company that has a large number of shareholders, the ownership and profits are shared among them.

Cooperative Societies

A cooperative society is a democratically controlled independent organization. Further, it aims to achieve common needs of a group of individuals voluntarily gathered and enjoy a collective ownership. A cooperative society can be started with at least ten members and the capital is mainly provided by the membership subscriptions. In addition, cooperative societies are required to be registered under the Cooperative Societies Act No. 05 of 1972.

Examples :-

Sri Lanka Multi Purpose Cooperative Societies

Sri Lanka Coconut Producers' Cooperative Society

Thrift and Credit Cooperative Societies (SANASA)

Characteristics of cooperative societies

The following are some unique characteristics of cooperative societies.

- **Democratic control**
  The democratic control is that the cooperative society will be controlled by a Board of Directors elected by its members and the decisions are taken based on the consent of the majority.

- **Voluntary and open membership**
  Any individual can obtain membership and any member can withdraw from the membership voluntarily.

- **Collective ownership of members**
  A cooperative society is owned by its members and all its assets are also owned by all the members.

- **Common expectations and needs**
  The main objective of a cooperative society is to achieve the well being of its members and facilitate development of society.

Advantages of cooperative societies

The following advantages can be seen in cooperative societies compared to other business organizations.

- **Democratic control**
  Board of Directors can be elected and decisions will be taken based on the consent of the majority of members.

- **Acting for the well being of members**
  Since cooperative societies are established with common goals, it will carry out its operations emphasizing the social responsibility and equity to all.

- **Government provides various incentives for conducting cooperative societies**

- **Shared economic benefits**
  Excess profit earned through the business activities of a cooperative society will be distributed among the members in different forms.

Disadvantages of cooperative societies

- **Limited capital**
  Since the capital is raised only by the membership subscriptions of members, the amount of capital that can be collected is limited.

- **Should adhere only to the stipulated cooperative policies**
  This type of business organizations are based on cooperative policies. It is not possible to change the business operations in order to face competitive business environment, since it is required to adhere to these policies.

Associations

Associations are organizations with the objective of social well-being. These associations are established especially in order to achieve well-being of the members, to accomplish a community service or a charitable activity.

Examples :-

Sports Clubs
Farmer's Associations

State corporations

Businesses fully owned or the majority is owned by the government are known as state corporations. A state corporation is controlled by a Board of Directors appointed by the government. These businesses will be commenced under a general or special Act of the Parliament. These are also known as state corporations, commissions, authorities, boards and bureaus.

Examples :-

1. Sri Lanka Rupavahini Corporation
2. Sri Lanka Ports Authority
3. Coconut Development Authority
4. State Pharmaceuticals Corporation of Sri Lanka
5. Sri Lanka Bureau of Foreign Employment
6. Export Insurance Board

Characteristics of state corporations

The following characteristics can be seen in state corporations compared to other business organizations.

- **Government ownership and control**
  The full or majority of ownership and control is vested with the government. In some instances, the private sector also hold a minority of shares.

- **Objective of providing services in common**
  Most of the state corporations are aimed at providing services in common to the general public.

- **Legal personality**
  In legal activities, a state corporation has a separate legal identity.

- **Can commence either under a special Act or a general existing Act**

- **Continued existence**
  Since state corporations are established under an Act of Parliament, they have a continued existence.

Advantages of state corporations

- **Appropriate for the provision of essential services**
  State corporations are suitable to provide essential services, which may not be provided by the private sector to the general public.

- **To reduce the monopoly effects of private sector**
  State corporations can be used to create a competitive environment to reduce unfavorable influences arising through private sector monopolies.

  Example :-
  Sri Lanka Transport Board

- **Profits owned by the public**
  A portion of the profits earned by a state corporation will be credited to the Consolidated Fund of the government.

Disadvantages of state corporations

- Absence of independence in decision making
- Need to adhere to financial regulations of the government

Departments

The state departments are institutions that will be directly and fully governed by the government under a ministry. Departments are operated in order to provide various services to the general public.

Examples :-

Sri Lanka Railway Department
Sri Lanka Postal Department

Characteristics of state departments

The following characteristics can be seen in state departments compared to other business organizations.

- **Ownership and control vested with the government**
  Departments are fully owned by the government and directly governed by the Parliament and the respective ministry. The management and administration is done through the Heads of departments.
- **In legal activities, the head of the department should represent the department using his designation.**
- **Continued existence**
  The existence of a department depends on the discretion of the government.
- **Funded by the government**
  The required funds will be allocated by the annual budget of the government.

Advantages of state departments

- The departments provide essential services to the public that will not be otherwise provided by the private sector.

- The departments will handle long term development activities which require a larger amount of funds.

- A large number of employees are working in departments providing more employment opportunities.

- The departments provide services for the well being of the general public without a profit motive.

Disadvantages of departments

- The decision making will be delayed due to the approval required from the Parliament and the respective ministry.

- The departments have to conduct activities in accordance with the provisions in government Financial Regulations, Establishment Code and different circulars.

3.2 Selecting an appropriate business organization

The different types of business organizations that can be organised to fulfill the needs and wants of humans were discussed previously in this chapter. The following are some factors that should be considered by businessmen when selecting an appropriate type of business organization.

- Based on the objective
- Based on the scale
- Based on who will perform management activities

Selecting a business organisation based on the objective

There are two main objectives affecting the choice of a business organisation.

- Profit objective
- Social welfare objective

Profit objective

Most of the businessmen expect to earn profit in doing business activities. The maximization of profits is the objective of these businessmen. The previously mentioned sole proprietorships, partnerships, incorporated companies and state companies are generally established with a motive to earn profits.

Social welfare objective

There are business organizations that operate to fulfil human needs and wants while concerning the well-being of the society. These oraganizations have objectives such as facilitating well-being of the members and providing relief services for the people facing disasters and unrest. These businesses operate both in the private and public sectors.

Examples :-

Farmers' Associations, Sports Clubs etc
Cooperative Societies
State departments

Selecting a business organization based on the scale

It is required to consider the scale of a business when selecting a type of business organization. Determining the scale of a business depends on several factors. The financial strength, skills and experiences and various relationships of the owner are some of the major factors. In addition, the quantity of goods and services produced by the business, market share of the respective product will also be considered when deciding the scale of the business. Accordingly, there are two major types of businesses that can be identified based on the scale.

- Small scale businesses
- Large scale businesses

Small scale businesses

Businesses are generally started as small scale businesses. Most of the small scale businesses are sole proprietorships. The ease of starting with less capital, with less legal influences are some reasons for selecting sole proprietorships.

Large scale businesses

A large scale business can be commenced with a large pool of resources owned by the businessman, experiences obtained by working in other businesses, network of relationships that stimulate businesses and with the infrastructure facilities and other incentives provided by the government.

Selecting a business organization depending on who will perform management activities

Management is a process of planning, organising, leading and controlling the resources of a business in order to achieve the objectives of a business.

A sole proprietorship will be managed by its owner. He can take all the decisions of the business independently. In addition, he will be the owner, leader as well as the manager of the business. As the owner, he has the freedom to take decisions regarding the sources of a business.

If a business is expected to be managed by a group of individuals, a partnership or an incorporated company would be the appropriate type. Here, decisions can be taken with the consent of all partners or the directors of the board.

3.3 Registration of a sole proprietorship

If a sole proprietorship is conducted in a different name other than the full name of its owner, it is mandatory to register the name of the business.

Example : -

If Gayal Perera conducts his business under the name of 'Gayal Stores', the business name is required to be registered.

This is only a registration of the business name and hence will not provide a legal personality for the business.

Legal procedure of registering a sole proprietorship

If a sole proprietorship is conducted in a name other than the full name of its owner, it is required to register. Registrar of the respective Provincial Council is the authorized officer to register business names. The application form required for the registration can be collected from the office of the Divisional Secretariat. The registration fee will be determined by the respective Provincial Council within the authority given to them. Further, it is required to submit an application to register the business name within 14 days of commencing a sole proprietorship.

The following procedure will be followed when registering a sole proprietorship.

01. Obtain the relevant application form from the respective Divisional Secretariat office.

The following two documents are required to submit for this purpose.

i An application form to register the business name of a sole proprietorship.

ii An application form to obtain the required report from Grama Niladharee regarding the registration of the business name.

02. Handing over the certified report of the Grama Niladharee and the duly completed application form along with the registration fee to the Divisional Secretary.

03. After considering above documents, the Divisional Secretary will issue the Certificate of Registration of Business Name. It is required to display this certificate at the business place.

Advantages of registering the business name

The following advantages can be achieved by registering the business name of a sole proprietorship.

- **Provides an identity and recognition**
  A business can be separately identified from other businesses by using the business name.

- **Provides an ownership of the business name**
  Since the business name is registered under the name of the owner, this ensures the ownership of the business name.

- **Provides a qualification to obtain incentives given by the government**
  The government provides various incentives for the businesses. The registered businesses will be given the priority when giving such facilities.

- **Easy to obtain loans**

  Since there is a higher trust on businesses that have registered their business names, lenders prefer to supply loans to such businesses.

Activity 01

Consider a sole proprietorship that can be commenced utilising the resources available in your area.

01. Suggest a suitable name for the business.

02. Explain the advantages of commencing a sole proprietorship.

03. Can there be disadvantages of commencing such a business as a sole proprietorship? Justify your answer.

04. Is the business name of that sole proprietorship required to be registered? Justify your answer.

05. If the name of the business needs to be registered, explain the procedure that needs to be followed.

Activity 02

Prepare a table by listing similarities and differences among business organizations under the below mentioned dimensions.

Dimension	Sole proprietorship	Partner-ship	Limited companies	State corporations	State department
Ownership					
Financing					
Liability					
Management					
Legal Personality					
Continuity					

Activity 03

The following are the names of businesses.

- Nandu Company Limited
- Janahitha Stores
- Silva and Sons
- Cooperative Society of Fisheries
- Sri Lanka Railway Department
- Sri Lanka Broadcasting Corporation

01. Name the type of business organization of each business mentioned above.
02. Classify the above businesses based on the ownership.
03. Classify the businesses based on the objective.
04. From the above businesses, which businesses have a legal personality?
05. State how each business raise the required capital

Activity 04

Pahan prefers to take collective decisions by listening to all and prefers to share the risk. He believes in group work and has the ability to act with others with a mutual understanding and even would accept a responsibility of a friend.However, Pahan has a limited amount of savings.

Dinuka prefers to take individual decisions and could face any risk alone. He is always dedicated to be succesful in every thing he does. Pahan owns a large amount of savings.

Pahan and Dinuka both expect to start a business

01. Suggest the appropriate types of business organization for Pahan and Dinuka. Give reasons.
02. If Pahan and Dinuka Start those businesses, what are the advantages and disadvantages that they will receive?

4 Introduction to Accounting

The following facts are discussed in this chapter.

4.1 Accounting

4.2 Objectives and need of accounting

4.3 Business transactions

4.4 Assets, liabilities, equity, income and expenses that arose through various business transactions

In this book 'Accounting' is referred only to include financial accounting.

4.1 Accounting

Accounting can be explained as a process of providing information required by the interested parties of a business for their decision making. Financial information is very important in decision making in a business. Accounting that mainly provides financial information is called as Financial Accounting.

4.2 Objectives and need of Accounting

As mentioned above, Accounting is needed to provide useful information to interested parties of a business for their decision making. Further, the business activities also impact various other parties. All these parties including owners and debt holders are named as interested parties (stakeholders) of a business. Owners, debt holders, investors, customers, suppliers, employees and the government are usually considered as key interested parties among other parties. Each party takes decisions in various nature and for that they require information. Accordingly, providing information for decesion making is the main objective of accounting. Based on this main objective, there are various other objectives and few of such objectives are given below.

- To know whether the business has earned an adequate profit
- To know whether the financial position of the business is sound
- To fulfill legal requirements (presentation of financial reports is a mandatory requirement by law for some organisations)
- To minimize disadvantages arising through ommission and commission of transactions, and to organize financial activities

In order to fulfill above objectives, accounting provides various types of reports to the interested parties. These reports are generally termed as Financial Statements. These financial statements are based on business transactions.

4.3 Business transactions

When a business carries out its activities, it requires to exchange resources with various parties. For example, when a business purchases goods on cash basis, cash and goods are exchanged between the business and the supplier. Accordingly, a transaction can be identified as an exchange of resources between a business and other parties.

In a business, there can be various types of transactions. Among those transactions, the transactions of which their value can be measured in terms of money, are considered in accounting.

Examples :-

Sales of goods for Rs 100 000
Monthly salary payment of Rs 50 000
Obtain a bank loan of to Rs 300 000
Electricity payment of Rs 5 000

In addition, to the exchange of resources mentioned above, some events that had occurred in businesses are also considered in accounting.

Examples :-

Damage of trade stocks - Rs. 10 000
A trade receivable that becomes a bad debt - Rs. 3 000

These events are also considered as transactions in a broader sense in accounting. Most of the transactions that occur in a business are associated with purchases and sales of goods and providing services. Such transactions could be made either on cash or credit basis. If the value of the transaction is settled at the point of the transaction, it will be considered as a transaction on cash basis. On the other hand, if the settlement is made later, it will be considered as a transaction on credit basis.

4.4 Assets, liabilities, equity, income and expenses, that arise from various transactions

As a result of transactions following accounting elements arise.

- Assets
- Liabilities
- Equity
- Income and Expenses.

Assets

The resources that are generated as a result of a past transaction are simply called assets.

Examples :-

Purchase of a machine by a business
Purchase of a motor vehicle by a business

In order to recognize an asset in accounting reports, its cost/value should be able to be measured reliably. Assets generate future economic benefits to the business.

Examples :-

If a machine that had been purchased by a business is used to manufacture and sell goods, the cash that flows to the business in future from that machine.

The profits that are generated by the future sale of purchased stocks.

If any item does not generate future economic benefits, that item cannot be considered as an asset. Further, the item should be controlled by the business. This means, the business should be able to use that asset according to the discretion of the business and to take decisions on the asset. For example, the above mentioned machine and the stock should be able to be used by the business according to the discretion of the business. A building on a rental basis cannot be considered as an asset as it is not controllable by the business.

The following characteristics are observed of an asset.

- Arose as a result of a past transaction
- Controlled by the business
- Inflow of future economic benefit to the business

Accordingly,
an asset could be defined as follows.

An asset is a resource controlled by the business as a result of a past transaction and from which future economic benefits are expected to flow to the business.

Examples :-

Land and buildings, machinery, furniture, equipment, stocks, debtors including receivables, cash at bank, cash in hand.

The assets of a business can be categorised into two types as follows.

- Current Assets
- Non-current Assets

Current Assets

The assets that are expected to be used, sold or converted into cash within a short time period as 12 months in the ordinary activities of a business are classified as current assets.

Examples :-

Stocks to be resold, Trade receivable that needs to be recovered within 12 months.

Non-current Assets

All the assets that cannot be considered as current assets are considered as non-current assets.

Examples :-

Land and buildings, machinery, furniture, equipment, motor vehicles.

Liabilities

Payables of a business that had arose as a result of past transactions could be simply considered as liabilities.

Examples :-

A loan obtained from a bank

The business is bound to repay these liabilities in future. Therefore, these are considered as current obligations.When these liabilities are settled, the resources which generate future economic benefits (assets) will flow out from the business. Further, in order to show a liability in the accounts, its amount should be able to be measured reliably.

Example :-

In settling a bank loan, it requires to pay cash and cash outflows from the business.

Accordingly,

following characteristics are observed of a liability

- Arose as a result of a past transaction
- Outflow of economic resources when settlement is made
- Having a current obligation

Examples :-

Bank loans, Trade creditors

Liabilities also can be categorised into two types as follows.

- Current Liabilities
- Non-current Liabilities

Current Liabilities

The liabilities that should be settled within a short period of time as within 12 months are classified as current liabilities. These are also termed as short-term liabilities.

Examples :-

Trade creditors that arise when goods are purchased on credit for resale, accrued electricity expense.

Non-current Liabilities

All of the liabilities that cannot be considered as current liabilities are classified as non-current liabilities.

Example :-

The portion of a bank loan that needs to be settled after one year.

Equity

If the business has liabilities, a part of its assets has to be used to settle those liabilities. After the settlement of such liabilities the assets that remain belongs to the owners of the business.

The value of assets that belongs to owners of the business is termed as equity.

Example :-

Let us assume that a business has Rs. 500 000 worth of assets and a bank loan amounting to Rs. 200 000. Rs. 200 000 out of Rs. 500 000 of assets has to be used to settle the bank loan and therefore, the remaining of assets worth of Rs. 300 000 belongs to the owners.

Equity	=	Assets	-	Liabilities
	=	Rs 500 000	-	Rs 200 000
	=	Rs 300 000		

In a sole proprietorship, the capital invested represents the equity.

Income and Expenses

Profit of a business is the difference between income and expenses.
Accordingly,

Profit = Income - Expenses

Profit belongs to the owners of the business. Therefore, profit must be added to the equity. Profit can be calculated separately and thereby it can be added to the equity. Alternatively, income could be added to the equity and expenses could be deducted from the equity. In other words, equity is increased by income and decreased by expenses.

As mentioned above, income belongs to the owners. Therefore, it should be added to the equity. As a result, equity increase. However, an increase of equity does not occur only from receipt of income. When owners bring additional capital to the business it causes to increase the equity. This increase in equity is not considered as income.

Therefore, income can be defined as an increase in equity except due to the increases from capital introductions by owners.

Examples :-

- ☆ Sales
- ☆ Interest received
- ☆ Rent received
- ☆ Commission received

As income belongs to the owners, expenses should also be born by the owners. Therefore, expenses should be deducted from the equity and it causes to reduce the equity. However, a decrease of equity does not occur only from expenses. When owners take goods or cash out of the business for their private use (which is termed as drawings), equity decreases.

Therefore, expenses can be defined as a reduction in equity except due to drawings.

Examples :-

- ☆ Salaries and wages
- ☆ Insurance expenses
- ☆ Cost of goods sold
- ☆ Interest expenses

The difference between income and expenses is identified as the profit or loss. If it is a profit, it belongs to owners and if it is a loss, owners have to bear that as well. Therefore, profit or loss should be ultimately adjusted to the equity. Then, what remain are assets, liabilities and equity. The relationship among these assets, liabilities and equity could be shown in an equation. This equation is named as the Accounting Equation. You can learn about the accounting equation in the next chapter.

Activity 01

Following are some items of Yeshika's business who carries out a canteen.

Electricity expense

Investments

Commission received

Sales

Advertising expense

Bank loans

Capital

Creditors

Commission paid

Vehicles

Vehicle repair expense

Investment interest income

Debtors

Interest paid on bank loan

Using a tabular format categorise each of the above items under the columns of assets, liabilities, equity, income and expenses.

Activity 02

Sajini Perera is carrying out a business of selling garments. Classify following items under the given categories.

Item	Assets		Liabilities	
	Current assets	Non current assets	Current liabili-ties	Non Current liabili-ties
Stock of garments				
Cash counting machines used by the cashier				
Amount payable for the credit purchases of fabrics				
Bank loan that was obtained to expand the business				
The building owned by the business				
Point of sales machines				

5 Accounting Equation

The following facts are discussed in this chapter.

5.1 Accounting equation

The assets and the ownership of those assets of a business are shown in accounting records of that business. All assets should belong to some party of the business. Therefore, assets of a business should be equal to the total ownership of those assets. To show this relationship, an equation is used, which is called as the Accounting Equation.

5.2 Construction of accounting equation

If all assets are financed by the owner of the business, the accounting equation can be presented as follows.

Assets = Equity

Example :-

Amal started a business investing Rs.500 000 in cash. Here, assets (cash) of the business is equal to Rs. 500 000 and this total amount belongs to the owner, Amal. Accordingly,

Assets	=	Equity
Rs.		Rs.
Cash 500 000	=	Capital 500 000

When a business expands, the resources invested by owners would not be adequate. Therefore, the business will have to obtain resources from external parties. When the business borrows money, liabilities arise. When there are liabilities in the business, a part of its assets belong to debt holders. Remaining of the assets belongs to owners. In such a situation, accounting equation can be built as follows.

Assets = Equity + Liabilities

Example :-

With reference to the above example, if Amal had obtained a bank loan of Rs. 300 000, assets of Amal's business are increased by Rs. 300 000 (cash). On the other hand, it increases liabilities (bank loan) of the business by Rs. 300 000.

Accordingly, the accounting equation including the second transaction is now depicted as,

Assets	=	Equity	+	Liabilities
Rs.		Rs.		Rs.
Cash 800 000	=	Capital 500 000	+	Bank loan 300 000

5.3 How do business transactions affect the accounting equation

The value of assets, liabilities and equity are changed due to business transactions. Accordingly, the accounting equation changes due to the business transactions. Let us understand these changes using the following examples.

Example 1 :-

Owner invested Rs. 800 000 as capital.

Asset	=	Equity	+	Liabilities
Rs.		Rs.		Rs.
Cash 800 000	=	Capital 800 000	+	______

Example 2 :-

Purchased furniture for Rs. 100 000.

The accounting equation changes as follows,

	Assets			=	Equity	+	Liabilities
	Rs.				Rs.		Rs.
	Furniture	+	Cash	=	Capital	+	Liabilities
Balance at the beginning	-	+	800 000	=	800 000	+	-
Purchase of furniture	100 000		(100 000)	=	-	+	-
Equation	100 000	+	700 000	=	800 000	+	-

Example 3 :-

Obtained a bank loan of Rs. 300 000.

	Assets			=	Equity	+	Liabilities
	Rs.				Rs.		Rs.
	Furniture	+	Cash	=	Capital	+	Bank loan
Balance at the beginning	100 000	+	700 000	=	800 000	+	-
Bank loan	-	+	300 000	=	-	+	300 000
Equation	100 000	+	1 000 000	=	800 000	+	300 000

Example :-

Nehara started a business to repair computers. The following transactions are given to you for the first month of the business.

01. Invested Rs. 500 000 as the capital
02. Obtained a bank loan of Rs. 200 000
03. Deposited Rs. 100 000 in a fixed deposit account
04. Earned a cash income Rs. 60 000 from computer repairs
05. Paid Rs. 10 000 as the monthly rent of the business
06. Nehara withdrew Rs. 20 000 from the business for her private use
07. Purchased equipment at Rs. 100 000
08. Paid Rs. 5 000 of the telephone bill of the month
09. Nehara invested an additional capital of Rs. 50 000
10. Settled Rs. 20 000 of the bank loan

The impacts of the above transactions to the accounting equation are shown below.

	Assets Rs.			= Equity + Liability Rs.	
	Equipment	+ Fixed deposit	+ Cash	Equity	+ Bank loan
1			+ 500 000	+ 500 000	
2			+ 200 000		+ 200 000
3		+ 100 000	- 100 000		
4			+ 60 000	+ 60 000	
5			- 10 000	- 10 000	
6			- 20 000	- 20 000	
7	+ 100 000		- 100 000		
8			- 5 000	- 5 000	
9			+ 50 000	+ 50 000	
10			- 20 000		- 20 000
Closing balance	100 000	+ 100 000	+ 555 000	= 575 000	+ 180 000

Example :-

The following balances were extracted as at 01.08.20xx from Sandamini's business.

		Rs.
Assets -		
	Furniture	300 000
	Stocks	200 000
	Debtors	100 000
	Cash	200 000
Liabilities -		
	Bank loan	300 000
	Creditors	100 000

The following transactions occurred in the first week of August 20xx

01. Purchased goods at Rs. 100 000 to sell
02. Sold goods which were purchased at Rs. 100 000 for Rs. 125 000
03. Settled Rs. 50 000 of the bank loan
04. Paid Rs. 10 000 as salaries
05. Sandamini withdrew goods at a cost of Rs. 20 000 for her private use.
06. Purchased furniture at Rs. 50 000 for the use of the business
07. Purchased goods at Rs. 200 000 on credit basis.
08. Sold goods at Rs. 100 000 on credit basis. These goods had been purchased at Rs. 60 000
09. Received Rs. 80 000 from debtors
10. Paid Rs. 50 000 to creditors

The procedure of calculating the owner's equity as at 01.08.20xx and the affects of the above transaction on the accounting equation are as follows.

01. The equity as at 01.08.20xx

Equity = Assets - Liabilities
= (200 000 + 100 000 + 200 000 + 300 000) – (300 000 +100 000)
= 800 000 - 400 000
= Rs. 400 000

02. Impact of the transactions on the accounting equation

	Assets Rs.				= Equity	+ Liability Rs.	
	Furniture	+ Stock	+ Debtors	+ Cash	Equity	+ Bank loan	+ Creditors
Opening balance	300 000	+200 000	+100 000	+200 000	+400 000	+300 000	+100 000
1		+100 000		-100 000			
2		-100 000		+125 000	+25 000		
3				-50 000		-50 000	
4				-10 000	-10 000		
5		-20 000			-20 000		
6	+50 000			-50 000			
7		+200 000					+200 000
8		-60 000	+100 000		+40 000		
9			-80 000	+80 000			
10				-50 000			-50 000
Closing balance	350 000	+320 000	+120 000	+145 000 =	435 000	+250 000	+250 000

Example :-

The following balances were shown as at 01.07.20xx of Ruwanthi's business.

	Rs.
Motor vehicles	500 000
Stocks	200 000
Cash	100 000
Bank loan	200 000
Creditors	100 000
Capital	500 000

The following transactions occurred in July 20xx.

01. Owner invested Rs. 200 000 as additional capital
02. Paid Rs. 20 000 bank loan installment including Rs. 2 000 as the interest.
03. Purchased goods at Rs. 100 000 on credit basis
04. Paid Rs. 50 000 to creditors
05. The owner gave Rs. 200 000 worth of his private motor bicycle to the business
06. Sold goods which cost Rs. 100 000 at Rs. 150 000 on credit basis
07. Paid Rs. 10 000 for insurance
08. Received Rs. 70 000 from debtors
09. Paid Rs. 5 000 from business for the electricity bill of owner's house
10. Received sales commission income of Rs. 10 000

See below how the above transactions affect the accounting equation.

Impacts of transactions on the accounting equation as follows.

Number	Assets Rs.				= Equity + Liability Rs.		
	Motor vehicles	+ Stock	+ Debtors	+ Cash	Equity	+ Bank loan	+ Creditors
Opening balance	500 000	+200 000		+100 000	+500 000	+200 000	+100 000
1				+200 000	+200 000		
2				-20 000	-2 000	-18 000	
3		+100 000					+100 000
4				-50 000			-50 000
5	+200 000				+200 000		
6		-100 000	+150 000		+50 000		
7				-10 000	-10 000		
8			-70 000	+70 000			
9				-5 000	-5 000		
10				+10 000	+10 000		
Closing balance	700 000	+200 000	+80 000	+295 000 =	943 000	+182 000	+150 000

It is also important to identify the transactions which have been presented in the accounting equation.

See the following example,

Example :-

The following accounting equation of Aloka's business shows the impacts of transactions occurred in January.

	Assets Rs.				= Equity + Liability Rs.		
	Land and buildings	+ Stock	+ Debtors	+ Cash	Equity	+ Bank loan	+ Creditors
Opening balance	1 000 000	+300 000	+200 000	+300 000	+1 200 000	+500 000	+100 000
01.03		+200 000		-100 000			+100 000
01.07				-20 000	-20 000		
01.10				-60 000	-10 000	-50 000	
01.14		-200 000	+300 000		+100 000		
01.18				+300 000	+300 000		
01.21				-100 000			-100 000
01.25			-400 000	+400 000			

The owner has not made drawings in the month.

Transactions assumed to be taken place in each day can be presented as follows.

Jan 03 - Purchased goods at Rs. 100 000 on cash basis and at Rs. 100 000 on credit basis

Jan 07 - Paid Rs. 20 000 of expense.

Jan 10 - Paid Rs. 60 000 of bank loan installment including Rs. 10 000 as the interest.

Jan 14 - Sold goods which cost Rs. 200 000 at Rs. 300 000 on credit basis.

Jan 18 - Invested Rs. 300 000 as additional capital.

Jan 21 - Paid Rs. 100 000 to creditors.

Jan 25 - Received Rs. 400 000 from debtors.

5.4 Situations that change the equity

By studying the above facts, you may have understood the transactions that affect to increase or decrease the owner's equity. The following transactions affect to change the equity of the business.

- Introduction of additional capital
- Drawings
- Income
- Expenses

The owner has to invest cash or other assets according to the needs of the business. It increases the owners equity.

The owner may withdraw money or other assets from the business for his personal use. This is called drawings. It decreases the owner's equity.

Equity is increased by income and decreased by expenses.

Example :-

Following are some details of Binuri Enterprises for the Year 20xx.

Capital (01.01.20xx)	358 500
Expenses for the year	128 300
Income for the year	254 620
Cash invested by the owner on 30th June	75 000

The owners equity can be calculated as follows as at 31st of December 20xx

Capital (01.01.20xx)	358 500
+ Income	254 620
Additional Capital	75 000
	688 120
- Expenses	(128 300)
Owners equity as at 31st of Dec.20xx	559 820

Activities 01

02. The following accounting equation of Jayantha's business shows the impacts of transactions occurred in April 20xx

	Assets Rs.			=	Equity + Liabilities Rs.	
	Motor vehicles	+ Stock	+Debtors	+ Cash	Equity	+ Creditors
Balance as at 1st April	500 000	+200 000		+200 000	+700 000	+200 000
04.03				+300 000	+300 000	
04.05		+100 000				+100 000
04.08				-50 000		-50 000
04.10				-10 000	-10 000	
04.11		-60 000	+100 000		+40 000	
04.17	+200 000				+200 000	
04.19		-20 000			-20 000	
04.23			-20 000	+20 000		
04.28		-5 000			-5 000	
04.30					+50 000	-50 000
Closing balance	700 000	215 000	80 000	460 000	1 255 000	200 000

Note - Owner has not taken any cash drawings during the month.
Required - Describe the each transaction with the related amounts.

Activities 02

The following are the transactions relevant to the month of January 20xx of Thisuri's business.

Jan 01	Invested Rs. 300 000 as capital
Jan 04	Purchased goods at Rs. 50 000
Jan 09	Paid Rs. 10 000 of monthly rent
Jan 13	Sold goods which cost Rs. 40 000 at Rs. 60 000
Jan 19	Obtained a bank loan of to Rs. 300 000
Jan 21	Paid Rs.10 000 from the business for telephone bill of Thushari's house
Jan 28	Received Rs. 30 000 from debtors
Jan 30	Paid interest of to Rs. 5 000 for the bank loan
Jan 31	Paid electricity bill Rs. 5 000

Required :-

Show the impact of each of transactions with amounts in the accounting equation.

Activity 03

Following details are extracted from Jeewantha's business for the year of 20xx.

Capital (as at 01.01.20xx)	415 000
Income of the year	210 300
Expenses of the year	122 000
Additional capital	50 000

Required :-

Calculate the owner's equity as at 31st December 20xx.

Activity 04

The following table shows the impacts of transactions to accounting equation of a business.

Date	**Assets**	=	**Equity**	+	**Liability**
June 1	Increase Decrease				
June 2	Decrease	=	Decrease		
June 3	Increase	=			Increase
June 4	Increase	=	Increase		
June 5	Decrease	=			Decrease

According to this equation, write two possible transactions with amounts that may have taken place during each day.

6 Dual Impact of Transactions

The following facts are discussed in this chapter.

6.1 Introduction to the dual impacts of business transactions

6.2 Double entry system

6.3 Account

6.4 Types of accounts

6.5 Recording transactions in accounts

6.1 Dual impact of business transactions

Many transactions occur daily in a business. As a result of these transactions, the values of assets, liabilities, equity, income and expenses are changed. In accounting, these changes are identified as a dual impact of a transaction. As explained earlier, each transaction causes change to two items of the accounting equation. This is termed as the dual impact of a transaction.

Examples :-

Investing Capital	Asset (cash) increases	Equity increases
Purchase of furniture	Asset (furniture) increases	Asset (cash) decrease
Payment of Salary	Asset (cash) decreases	Equity decreases

Because of this dual impact of each transaction, the value of each transaction should be written in two places. This means there should be two entries for each transaction. However, when the business expands, a large number of transactions could take place. In such a case, recording those transactions in an accounting equation may not be practical. Even though we could record those transactions in the accounting equation, it is very difficult to obtain information clearly whenever necessary. Therefore, the dual impact of transactions are usually recorded in accounts according to the double entry system.

6.2 Double entry system

As mentioned above, there is a dual impact of each transaction to the accounting equation and this dual impact should be recorded in accounts. When recording the dual impact of a transaction, the same amount has to be recorded in two separate accounts. Each account has a debit and a credit side. If a value of a transaction is debited to a particular account, that value also should be credited to another account. The accounting system, which records the same amount in debit and credit sides of accounts is called as the double entry system.

6.3 Account

An account is a commonly accepted structure that is used to record the change (increase or decrease) of an asset, an equity, a liability, an income or an expense for a time period. An account can be prepared as follows.

Dr. .... Account Cr.

Date	Description	L.F.	Value (Rs.)	Date	Description	L.F.	Value (Rs.)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)

(1) and (5) - The date of the transaction

(2) and (6) - The name of the account which is used to record the other entry of the double entry.

The description in the credit side of an account is the name of the account which is used to record the debit entry of the transaction and vice versa.

(3) and (7) - The ledger folio (page number) of the account that is used to record the other entry of the transaction.

(4) and (8) - The value of the transaction.

6.4 Types of accounts

We already discussed that assets, equity, liabilities, income and expenses arise due to business transactions. Accounts are used to record the changes of assets, equity, liabilities, income and expenses due to transactions. All these accounts can be classified into five types.

- **Asset accounts**

Examples :- Building account, Debtors account, Cash account

- **Liability accounts**

Examples :- Bank loan account, Creditors account, Electricity expense payable account

- **Equity accounts**

Examples :- Capital account, Drawings account

- **Income accounts**

Examples :- Sales account, Sales commission income account, Interest income account

- **Expenses accounts**

Examples :- Salary expense account, Insurance charges account, Electricity expense account

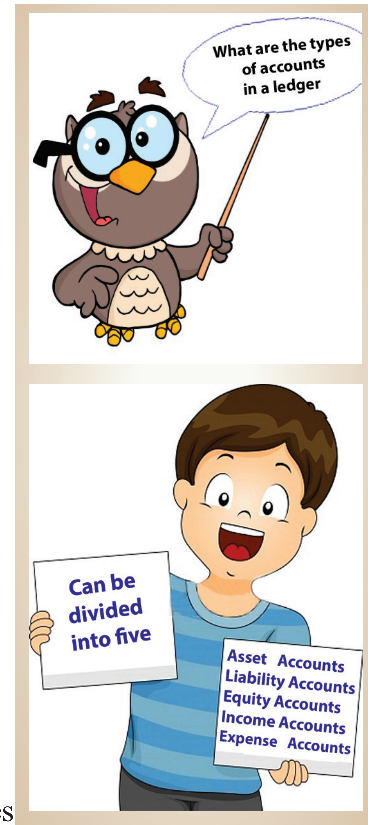


Figure - 6.1

When recording business transactions in accounts, the value of a transaction should be either recorded in the debit side or the credit side of the relevant account. Let us consider how to record such transactions in accounts.

6.5 Recording transactions in accounts

Accounts are debited or credited to show the increase or decrease of assets, equity, liabilities, income or expenses due to transactions. However, debiting an account does not always mean an increase. To show an increase, some accounts are debited and also to show a decrease some accounts are debited. This is same with crediting an account. This creates a problem. The problem is to decide what is debited or what is credited to show this changes. There are some generally accepted principles in accounting which address this problem. These principles are called as the principles of Double Entry. There are five principles for the five types of accounts. They are shown in the following table.

Type of account	Increase	Decrease
Asset accounts	Debit	Credit
Liability accounts	Credit	Debit
Equity accounts	Credit	Debit
Income accounts	Credit	Debit
Expenses accounts	Debit	Credit

Figure - 6.2

Example :-

Purchased a machine on 03. 01. 20xx at Rs. 500 000

Double entry Machinery account (Asset increases) Dr. Rs. 500 000
Cash book (Asset decreases) Cr. Rs. 500 000

Debit Machinery account Credit

Date	Description	L.F.	Value Rs.	Date	Description	L.F.	Value Rs.
03.01.20xx	Cash book		500 000				

Debit Cash book Credit

Date	Description	L.F.	Value Rs.	Date	Description	L.F	Value Rs.
				03.01.20xx	Machinery account		500 000

Example :- Obtained a bank loan of Rs. 200 000 on 04.01.20xx

Double entry Cash book (Asset increases) Dr. Rs. 200 000
Bank loan account (Liability increases) Cr. Rs. 200 000

Debit — Cash book — Credit

Date	Description	L.F.	Value Rs.	Date	Description	L.F.	Value Rs.
03.01.20xx	Bank loan account		200 000				

Debit — Bank loan account — Credit

Date	Description	L.F.	Value Rs.	Date	Description	L.F.	Value Rs.
				03.01.20xx	Cash book		200 000

Example :- The owner invested Rs. 300 000 as the capital on 5.01.20xx

Double entry Cash book (Asset increases) Dr. Rs. 300 000
Capital account (Equity increases) Cr. Rs. 300 000

Debit — Cash account — Credit

Date	Description	L.F	Value Rs.	Date	Description	L.F	Value Rs.
05.01.20xx	Capital account		300 000				

Debit — Capital account — Credit

Date	Description	L.F	Value Rs.	Date	Description	L.F	Value Rs.
				05.01.20xx	Cash book		300 000

Example :- Received an interest income of Rs. 20 000 on 05.01.20xx

Double entry Cash account (Asset increases) Dr. Rs. 20 000
Interest income account (Income increases) Cr. Rs. 20 000

Debit				Cash Account			Credit
Date	Description	L.F.	Value Rs.	Date	Description	L.F.	Value Rs.
05.01.20xx	Interest income account		20 000				

Debit				Interest income account			Credit
Date	Description	L.F.	Value Rs.	Date	Description	L.F.	Value Rs.
				05.01.20xx	Cash book		20 000

Example :- 06.01.20xx paid salaries Rs. 20 000

Double entry Salary account (Expense increases) Dr. Rs. 20 000
Cash account (Asset increases) Cr. Rs. 20 000

Debit				Salary account			Credit
Date	Description	Page No.	Value Rs.	Date	Description	Page No.	Value Rs.
06.01.20xx	Cash account		20 000				

Debit				Cash account			Credit
Date	Description	Page No.	Value Rs.	Date	Description	Page No.	Value Rs.
				06.01.20xx	Salary account		20 000

The Ledger

A separate account has to be maintained for each type of asset. Accordingly, there can be many asset accounts in a business such as motor vehicle account, furniture account, cash account, etc. Similarly, there can be many accounts for each type of equity, liability, income and expenses in a business. A collection of all accounts is called as the ledger. Therefore, recording business transactions in accounts is also named as recording business transactions in the ledger.

Figure - 6.3

Activity 01

Write whether the increase and decrease of each of following accounts should be written in the debit side or credit side of the account.

Serial No.	Account name	Increases	Decreases
1	Building account		
2	Bank loan account		
3	Sales account		
4	Electricity charges		
5	Interest received account		
6	Vehicle account		
7	Purchase account		
8	Capital account		
9	Drawings account		
10	Debtors account		

Activity 02

Following are the transactions that occurred in a business during the month of March of 20xx. Write the double entry of each transaction.

March 01. Introduced capital by the owner Rs. 200 000
02. Cash purchases Rs. 50 000
03. Payment of monthly rental Rs. 10 000
04. Cash sales Rs. 70 000
05. Purchased goods on credit Rs. 80 000
06. Withdrew money by the owner for personal use Rs. 10 000
07. Paid monthly salaries Rs. 20 000
08. Obtained a bank loan Rs. 200 000
09. Invested in a fixed deposit Rs. 10 000
10. Credit sales Rs. 60 000

Activity 03

Following are some transactions occurred in Namal's business

Jan 01. Introduced capital Rs. 300 000
02. Purchased equipment for use in the business Rs. 50 000
03. Purchased goods on credit Rs. 80 000
04. Paid telephone bill of the owner's house using cash of the business Rs. 5 000
05. Cash sales Rs. 50 000
06. Paid insurance Rs. 7 000
07. Cash purchases Rs. 40 000
08. Paid creditors Rs. 20 000

Record the above transactions in accounts.

Activity 04

Following cash book has been prepared by the accounts clerk of the Sameera's business by including transactions that have occurred during the month of January 20xx.

Debit Cash book Credit

Date	Description	L. F.	Value Rs.	Date	Description	L. F.	Value Rs.
Jan 01	Capital account		80 000	Jan 09	Purchases account		50 000
06	Sales account		60 000	12	Equipment account		80 000
07	Bank loan account		100 000	15	Electricity charges acc.		10 000
27	Interest income acc.		12 000	18	Investment account		40 000
30	Debtor's account		4 000	22	Bank loan interest acc.		10 000
				25	Creditor's account		5 000

You are required to :-

1. Describe the transaction for each entry listed in the cash account in chronological order.

2. Record the other entries relevant to the transactions listed in the above cash account in the respective other accounts in the ledger of sameera's business.

7 Prime Entry Books

The following facts are discussed in this chapter.

7.1 Introduction to prime entry books

7.2 Necessity of prime entry books

7.3 Source documents

7.4 Uses of source documents

7.1 Introduction to prime entry books

There may be issues in recording the business transactions in the ledger accounts directly as they take place. Hence, before the transactions are recorded in ledger accounts, they should be recorded in a separate set of books known as "the prime entry books."

The prime entry books are the books in which the transactions of a business are recorded at first, according to the order in which each transaction had occurred by using a generally accepted method before recording them in the ledger accounts.

Prime entry books are also named as journals, day books, and subsidiary books.

It is not suitable to record all the transactions in a single prime entry book. Hence, the transactions have to be classified and recorded based on their nature and other common characteristics. Accordingly, the transactions which are similar in nature and occur recurrently should be recorded in different prime entry books.

The following table shows various types of transactions and the relevant prime entry books in which those transactions should be recorded.

Table 7.1 - Various types of transactions and the relevant prime entry book

Type of transaction	Prime entry book
Transactions related to the receipt and payment of cash	Cash book
Transactions carried out through the bank current account	Bank account
Petty cash transactions	Petty cash book
Purchases of trade goods on credit	Purchases journal
Sales of trade goods on credit	Sales journal
Other transactions	General journal

7.2 Necessity of prime entry books

The recording of transactions in prime entry books is necessary due to the following reasons.

- Similar types of transactions of a period need to be classified and recorded.
- Posting transactions to the ledger becomes systematical and convenient after recording them in the prime entry book.
- Responsibility of preparing each prime entry book can be assigned distinctly to various individuals and accordingly, the business could minimize possible errors and frauds.
- It is easy to maintain the ledger because the totals of prime entry books are posted to the ledger, which minimizes the number of entries posted.
- Minimizes the occurrence of accounting errors and it is easy to find out such errors.

Information of the transactions is obtained from source documents to record them in the prime entry books. Therefore, it is important to understand the relationship between the prime entry books and the source documents.

7.3 The source documents

As and when transactions take place in a business, the documents prepared by including all the details of such transactions and authorized by a person-in-charge are known as source documents.

Each source document prepared by a business is assigned a serial number. Source documents are used as a basis for recording the transactions in the prime entry books of a business.

Source documents include the following details.

- Name and address of the business
- Serial number
- The date on which the transaction had taken place
- The details of the other party that is connected to the transaction
- Description of the transaction
- The monetary value of the transaction
- Signature of the officer who is responsible for the transaction

The table given below shows examples of various source documents used for recording transactions in different types of prime entry books.

Table 7.2 - Examples for various source documents used for recording transactions in different types of prime entry books

Prime entry book	Source document
Cash book	Receipt , payment voucher
Bank account	Deposit slip, payment voucher, bank statement, cheque return notification
Petty cash book	Petty cash payment voucher
Purchases journal	Purchase invoice
Sales journal	Sales invoice
General journal	Journal voucher

7.4 Uses of source documents

Source documents could be used for following purposes

* Can be used as an initial document for a transaction
* Can be used as a written evidence of the transactions
* Additional information on transactions can be obtained
* Can be used for recording transactions in the prime entry books
* Responsibility can be assigned to a specific officer as it is authorized by that person.

You can study each of the prime entry books mentioned above in detail in the next chapters.

Activity 01

Read and understand each of the following statement related to prime entry books and state whether they are true or false.

01. Prime entry books are used to record transactions by classifying them according to their nature and common characteristics.
02. Prime entry books are prepared instead of ledger accounts.
03. The sales journal is used to record the trade goods purchased on credit.
04. Prime entry books are also known as journals or day books.
05. All transactions that had taken place in a business should be recorded first in prime entry books.
06. The transactions are recorded in the prime entry books using source documents.
07. After recording transactions of a business in prime entry books they should be posted to ledger accounts.
08. A responsible officer should authorize a source document for it to become an acceptable document.

Activity 02

List 6 items that are generally included in a source document.

Activity 03

Write examples for transactions that are recorded in each of the following prime entry book.

Prime entry book	**Examples of transactions**
Petty cash book	
General journal	
Sales journal	
Bank account	
Cash book	
Purchases journal	

Activity 04

In the following table, column "A" shows the prime entry books and column "B" shows the source documents. Match each in column A with B.

Prime entry books (A)	**Source documents (B)**
Cash book	Purchase invoice
Bank account	Journal voucher
Petty cash book	Debit note
Purchases Journal	Sales invoice
Sales Journal	Receipts
General journal	Petty cash payment vouchers
	Credit note
	Deposit slips

8 The Cash Book and the Petty Cash Book

The following facts are discussed in this chapter.

8.1 Cash book

- Introduction of cash book
- Dual function of cash book
- Recording transactions in the cash book
- Balancing off the cash book and other accounts
- Recording transactions related to cash discounts

8.2 Petty cash book

- Petty cash imprest
- Preparation of a petty cash book with analysis columns

8.1 Cash book

This is the prime entry book in which the receipts and payments of cash (currency) are recorded. A business has various sources of cash receipts as well as different ways of payments.

Examples for sources of cash receipts of a business

- The owner's capital
- Cash sales
- Cash received from debtors
- Borrowing money
- Cash receipts for rent income, investment income and income on commissions

Examples for payments a business makes

- Purchase of goods for cash
- Repayment of loans
- Cash payment to creditors
- Payments made for expenses such as salaries for employees, electricity, etc.
- Payments made for purchasing fixed assets such as furniture, equipment, etc.
- Withdrawal of cash by the owner for personal use (drawings)

The receipts and payments of cash by the business are recorded in the cash book using receipts and payment vouchers respectively as source documents.

Receipts

When a business receives cash the business would issue a document called a 'receipt' to the party who gave money to the business, as evidence for such a receipt.

A serial number in consecutive order is printed on it. Further, this receipt is issued with the details such as date of cash receipt, the reason why it was received, the amount received and the signature of the cashier. This is also known as the cash receipt or cash memo. Receipt is the written evidence of cash received by the business. A duplicate of the receipt should be received by the accounts branch and it should be used as a source document to record the receipt of cash in the cash book. Receipts can be prepared in different formats according to the nature and requirement of the business. There is no specific format for a receipt. A business could use a receipt that has a general format as indicated below. Please refer them.

Receipt

Serial No. 20513

Anoma books shop
82, Araliya Road,
Maharagama.
T. P. No: 0112090278
Date: ………………..

Received with thanks , the sum of Rs.……………………….(in words) receivable for the invoice No. ………………………….. by cash/cheque.

Rs. …………………… (in number) ………………………………

Prepared by ....
Checked by ....

Signature of the
Authorized Officer

CASH MEMO

Serial No.4856

Damindu Enterprise
245, Sahana Mawatha, Maharagama.
T. P. No: 011-2266782

Date ....

Name

Item No.	Description	Quantity	Unit Price Rs.	Total Value Rs.
	Total			

Prepared by...........................
Checked by ....

....
Signature of the
Authorised Officer

Activity 01

When you or your family members buy goods by paying money from various organizations. Different types of receipts are issued by those organizations.

01. Collect such receipts.
02. See whether the above mentioned contents are there in those receipts.

Payment voucher

The payment voucher is a document prepared by businesses with the relevant details as an evidence that cash payments are made, which also should be authorized by a responsible officer.

Every payment voucher is given a consecutive serial number. This is a written evidence of such payments, because it should be authorized by a responsible person.

There is no commonly accepted format for payment vouchers, but a voucher could be prepared based on the following general format.

Priyani Company Ltd.
Maharagama.

Serial No. 1255 Date. ....

To pay Mr./Mrs. ....

Details	Amount paid

Cheque No................................

.... Signature of the Preparer

.... Signature of the Officer who Authorized the Payment

.... Signature of Certifying Officer

Dual function of the cash book

Cash book functions as a prime entry book as business records the receipts and payments of cash at first in the cash book in a sequential order using the receipts and payment vouchers as source documents.

Cash book also functions as a ledger account as it has both the debit and the credit sides. Therefore, cash book performs two functions.

- Performs the function as a prime entry book
- Performs the function as a ledger account

Recording of cash transactions

Cash is an asset of the business. The receipt of cash increases assets and the payment of cash decreases assets. Therefore, the double entry principle for asset accounts should be applied for recording cash transactions in the cash book.

Cash received – Cash book debit [the rule, the increase of asset – debited]
Payment of cash – Cash book credit [the rule, the decrease of asset – credited]

Accordingly, all the cash receipts should be debited and all the cash payments should be credited in the cash book.

Since the cash book functions as a ledger account, when the business receives cash, the debit entry of the double entry for that transaction entered in the cash book. Only the credit entry of the relevant account has to be posted in the ledger. Similarly, the payment of cash is credited in the cash book and the credit entry of the double entry entered in the cash book. Only the debit entry of the relevant account has to be posted in the ledger.

Accordingly,

- The values that are debited in the cash book should be credited to the relevant accounts in the ledger
- The values that are credited in the cash book should be debited to the relevant accounts in the ledger

Example:-

Following transactions in cash took place during the month of January in Lakshini's business which was commenced on the 01st of January 20xx.

Date	Receipt no.	Voucher no.	Details
01.01.20xx	01		Capital invested Rs. 80 000
02.01		001	Bought goods for resale Rs. 45 000
04.01	02		Obtained a bank loan Rs. 50 000
08.01		002	Bought furniture for Rs. 8 000
15.01		003	Rent paid Rs. 6 000
18.01	03		Goods sold for cash Rs. 40 000
20.01	04		Cash received from a debtor, Pawan Rs. 30 000
24.01		004	Cash paid to creditor, Surath Rs. 34 000
25.01		005	Cash taken for personal use Rs. 5 000
26.01	05		Interest income received Rs. 3 000
28.01		006	Repayment of bank loan Rs. 6 000

The transactions which are given in the example above are recorded in the cash book and the relevant ledger accounts of Lakshini's business are presented below.

Dr. Cash book Cr.

Date	Receipt No.	Description	L.F.	Amount Rs.	Date	Voucher No.	Description	L.F.	Amount Rs.
01.01.20xx	01	Capital		80 000	02.01.20xx	001	Purchases		45 000
04.01	02	Bank loan		50 000	08.01	002	Furniture		8 000
18.01	03	Sales		40 000	15.01	003	Shop rent		6 000
20.01	04	Debtor- Pawan		30 000	24.01	004	Creditor-Surath		34 000
26.01	05	Interest income		3 000	25.01	005	Drawings		5 000
					28.01	006	Bank loan		6 000

Dr. Capital account Cr.

Date	Description	L.F.	Value Rs.	Date	Description	L.F.	Value Rs.
				01.01.20xx	Cash		80 000

Dr. Purchase account Cr.

Date	Description	L.F.	Value Rs.	Date	Description	L.F.	Value Rs.
02.01.20xx	Cash		45 000				

Dr. Bank Loan account Cr.

Date	Description	L.F.	Value Rs.	Date	Description	L.F.	Value Rs.
28.01.20xx	Cash		6 000	04.01.20xx	Cash		50 000

Dr. Furniture account Cr.

Date	Description	L.F.	Value Rs.	Date	Description	L.F.	Value Rs.
08.01.20xx	Cash		8 000				

Dr. Rent expense account Cr.

Date	Description	L.F.	Value Rs.	Date	Description	L.F.	Value Rs.
15.01.20xx	Cash		6 000				

Dr. Sales account Cr.

Date	Description	L.F.	Value Rs.	Date	Description	L.F.	Value Rs.
				18.01.20xx	Cash		40 000

Dr. Debtor - Pawan Cr.

Date	Description	L.F.	Value Rs.	Date	Description	L.F.	Value Rs.
				20.01.20xx	Cash		30 000

Dr. Creditor Surath Cr.

Date	Description	L.F.	Value Rs.	Date	Description	L.F.	Value Rs.
24.01.20xx	Cash		34 000				

Dr. Drawings account Cr.

Date	Description	L.F.	Value Rs.	Date	Description	L.F.	Value Rs.
25.01.20xx	Cash		5 000				

Dr. Interest income account Cr.

Date	Description	L.F.	Value Rs.	Date	Description	L.F.	Value Rs.
				26.01.20xx	Cash		3 000

Balancing off the accounts

The value of transactions are debited and credited in the accounts according to the principle of double entry. At the end of the period, the difference of the total values of debit and credit entries in accounts should be calculated. This difference is known as the balance of the account. Balancing off of an account is required to calculate the balance of that account.

Example :-

The total receipt of cash is Rs. 50 000. The total payment of cash is Rs. 33 000. Then the balance of cash is Rs. 17 000. This is considered to be the balance of the cash book.

Examine how the following accounts have been balanced.

Dr. Capital account Cr.

Date	Description	L.F.	Value Rs.	Date	Description	L.F.	Value Rs.
31.01.20xx	Balance c/d *		80 000	01.01.20xx	Cash		80 000
			80 000				80 000
				01.02.20xx	Balance b/f *		80 000

* Balance c/d - Balance carried down

* Balance b/f - Balance brought forward

Dr.			Leasing account				Cr.
Date	Description	L.F.	Value Rs.	Date	Description	L.F.	Value Rs.
03.01.20xx	Cash		18 000	31.01.20xx	Balance c/d		18 000
			18 000				18 000
01.02.20xx	Balance b/f		18 000				

Dr.			Cash account				Cr.
Date	Description	L.F.	Value Rs.	Date	Description	L.F.	Value Rs.
01.01.20xx	Capital		80 000	03.01.20xx	Leasing		18 000
				31.01.20xx	Balance c/d		62 000
			80 000				80 000
01.02.20xx	Balance b/f		62 000				

Accordingly,

- If the value of the debit side of an account is higher than the value of the credit side, the balance we get is a debit balance
- If the value of the credit side of an account is higher than the value of debit side, then the balance we get is a credit balance

Activity 02

Following are the details of the cash transactions of the business started by Purnima on 01.05.20xx. Following are the transactions that took place during the month ended on 31.05.20xx.

Date	Rec. No	Vou. No.	Description
01.05.20xx	001		Started business investing Rs. 60 000
02.05		01	Bought stock of goods for Rs. 35 000
04.05	002		Obtained a bank loan Rs. 40 000
08.05	003		Cash sales Rs. 13 000
12.05		02	Paid wages Rs. 5 000
15.05		03	Bought equipment for business use Rs. 12 000
20.05	004		Received rental income Rs. 6 000
22.05	005		Cash sales Rs. 18 000
25.05		04	Repayment of part of the bank loan Rs. 5 000
30.05	006		Commission income received Rs. 14 000

Required :-

01. Post the transactions to the ledger accounts and balance them off.

Discounts

A discount can be explained in brief as the deduction of value from the value of a transaction (i.e. listed price) when it takes place. Discounts can be classified into two main categories as trade discounts and cash discounts. Discounts are further classified as discount received and discount allowed.

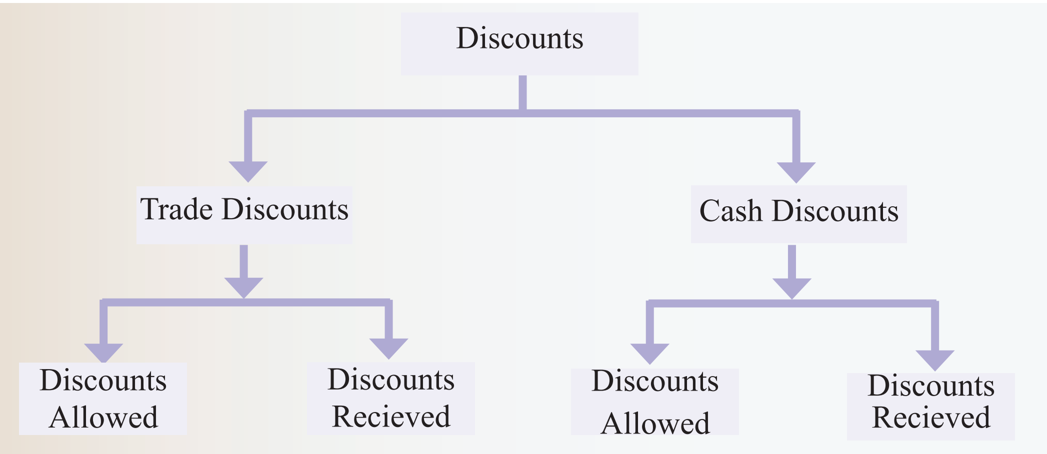


Figure 8.1 - Discounts

Trade Discounts

Most businesses sell goods deducting a certain amount from the listed price. The deduction which was made from the listed price is called as trade discount. This deduction is a trade discount allowed from the point of view of the seller and a trade discount received from the buyer's point of view.

The value to be recorded in the sales or the purchase accounts should be the net value after deducting the trade discount. Therefore, trade discounts are not recorded in accounts.

Example :-

Listed price of goods	= Rs. 20 000
Trade discount to be deducted	= 10%
According to that,	
the value of trade discount: $20\,000 \times \frac{10}{100}$	= Rs. 2 000
Net value paid after the trade discount	= Rs. 18 000

This Rs. 18 000 should only be recorded in the accounts.

Dr.			Purchase account				Cr.
Date	Description	L.F.	Value Rs.	Date	Description	L.F.	Value Rs.
	Cash		18 000				

Dr.			Cash account				Cr.
Date	Description	L.F.	Value Rs.	Date	Description	L.F.	Value Rs.
					Purchase account		18 000

Cash discounts

Cash discounts come in to being when amounts are received from debtors and paid to creditors.

There are certain instances where a condition is included in the invoice to encourage the customers to settle their outstanding balances such that a percentage from the outstanding balance would be deducted from the amount due if that amount is paid within a specific period of time set by the business. This amount which is deducted from the amount due is called a cash discount.

Cash discounts can be classified into two,

- Discounts allowed
- Discounts received

Discounts allowed

The deduction made on the amount receivable from the debtors, if such amount is settled within a time allowed by the business, is called a discount allowed. It is an expense from the point of view of the business.

Accordingly, since discounts allowed are generated when cash is received from debtors, it is easy to record the discount allowed in the cash book. A separate column for discounts allowed is drawn in the debit side of the cash book and discounts allowed are recorded in it.

Discounts received

Discount received is the amount deducted by the creditors from the amount payable to them if it is paid by the business within the time allowed by the creditors. It is an income in the point of view of the business.

Discounts received are created when creditors are paid. Therefore it is easy to record the discount received in the cash book. Discounts received are recorded in the discount received column, which is separately drawn in the credit side of the cash book.

These discount columns are considered as memorandum columns. These columns serve only the purpose of a prime entry book. Since discount columns do not serve the purpose of a ledger account, mere recording a value in them do not complete even one entry of the double entry. Therefore the double entries for these items in the discount columns should be entered in the ledger accounts separately.

Recording of discounts in the accounts

The total of the debit side discount column in the cash book should be debited in discount allowed account which is opened in the ledger. Debiting of discount allowed account conforms to the double entry principle on increase of an expense. Credit entries should be made in each of the debtors accounts. This is done because the decrease of asset is credited in that account as per the rules of double entry.

Accordingly, the double entry for discount allowed is,

Discount allowed account	Dr.
Debtors' accounts	Cr.

The total of credit side discount column in the cash book is credited in the discount received account opened in the ledger. Discount received is an income and increase of income is credited according to the double entry rule for income. Debit entries for these should be made in each of the creditor's account. This is due to decrease of liability should be debited in the liability account.

Therefore, the double entry for the discount received is as followers.

Creditors accounts	Dr.
Discount received account	Cr.

Example :-

Saranga's business had the following balances as at 01.03.20xx

		Rs.
Debtor's balances		
	Buddhi	40 000
	Sanod	30 000
Creditor's balances		
	Maneesha	45 000
	Sithumini	35 000
Cash in hand		50 000

Following transactions took place during the month of March.

05.03	Cash received from Buddhi	Rs. 12 500
	Discount allowed	Rs. 2 500
08.03	5% discount deducted when cash is received from Sanod in respect of Rs. 10 000 receivable from him.	
10.03	Cash paid to Maneesha	Rs. 12 600
	Discount received	Rs. 1 400
15.03	5% discount deducted when Sithumini was paid for Rs. 20 000	

The following show how the above transactions are recorded and balanced of the cash book and other relevant ledger accounts.

Dr. Cash Book Cr.

Date	Description	L.F.	Discou. allowed	Cash	Date	Description	L.F.	Discou. received	Cash
01.03.20xx	Balance b/f			50 000					
05.03	Buddhi		2 500	12 500	10.03.20xx	Maneesha		1 400	12 600
08.03	Sanod		500	9 500	15.03	Sithumini		1 000	19 000
					31.03	Balance c/d			40 400
			3 000	72 000				2 400	72 000
01.04	Balance b/f			40 400					

Dr. Buddhi (Debtors) account Cr.

Date	Description	L.F.	Value	Date	Description	L.F.	Value
01.03.20xx	Balance b/f		40 000	05.03.20xx	Cash		12 500
				05.03	Discount allowed		2 500
				31.03	Balance c/d		25 000
			40 000				40 000
01.04	Balance b/f		25 000				

Dr. **Sanod (Debtors) account** Cr.

Date	Description	L.F.	Value	Date	Description	L.F.	Value
01.03.20xx	Balance b/f		30 000	08.03.20xx	Cash		9 500
				08.03	discount allowed		500
				31.03	Balance c/d		20 000
			30 000				30 000
01.04	Balance b/f		20 000				

Dr. **Maneesha (Creditor) account** Cr.

Date	Description	L.F.	Value	Date	Description	L.F.	Value
10.03.20xx	Cash		12 600	01.03.20xx	Balance b/f		45 000
10.03	Discount received		1 400				
31.03	Balance c/d		31 000				
			45 000				45 000
				01.04	Balance b/f		31 000

Dr. **Sithumini (Creditor) account** Cr.

Date	Description	L.F.	Value	Date	Description	L.F.	Value
15.03.20xx	Cash		19 000	01.03.20xx	Balance b/f		35 000
15.03	Discount received		1 000				
31.03	Balance c/d		15 000				
			35 000				35 000
				01.04	Balance b/f		15 000

Dr. **Discount allowed account** Cr.

Date	Description	L.F.	Value	Date	Description	L.F.	Value
31.03.20xx	Debtors		3 000	31.03.20xx	Balance c/d		3 000
			3 000				3 000
01.04	Balance b/d		3 000				

Dr. **Discount received account** Cr.

Date	Description	L.F.	Value	Date	Description	L.F.	Value
31.03.20xx	Balance c/d		2 400	31.03.20xx	Creditors		2 400
			2 400				2 400
				01.04	Balance b/f		2 400

Example :-

Sapumalee's business has the following balances as at 01.03.20xx

Debtors balance (Dr.)	Rs. 40 000
Creditors balance (Cr.)	Rs. 50 000
Cash balance (Dr.)	Rs. 30 000

05.03.20xx Cash received from debtors Rs. 7 600. Discount deducted Rs. 400

08.03 Cash is received from debtors to settle Rs. 10 000 subject to 5% discount.

10.03 Cash paid to creditors Rs. 4 700 and discount received Rs. 300

15.03 Cash is paid to creditors to settle Rs.12 000 had been subject to 10% discount.

The following show how the above transactions are recorded and balanced in the cash book and the relevant ledger accounts.

Dr. Cash book Cr.

Date	Description	Discount allowed	Cash	Date	Description	Discount received	Cash
01.03.20xx	Balance b/f		30 000	10.03.20xx	Creditors	300	4 700
05.03	Debtors	400	7 600	15.03	Creditors	1 200	10 800
08.03	Debtors	500	9 500	31.03	Balance c/d		31 600
		900	47 100			1 500	47 100
01.04	Balance b/f		31 600				

Dr. Debtors account Cr.

Date	Description	L.F.	Cash	Date	Description	L.F.	Cash
01.03.20xx	Balance b/f		40 000	05.03.20xx	Cash		7 600
				05.03	Discount Allowed		400
				08.03	Cash		9 500
				08.03	Discount Allowed		500
				31.03	Balance c/d		22 000
			40 000				40 000
01.04	Balance b/f		22 000				

Creditors account

Dr. | Cr.

Date	Description	L.F.	Cash	Date	Description	L.F.	Cash
10.03.20xx	Cash		4 700	01.03.20xx	Balance b/f		50 000
10.03	Discount received		300				
15.03	Cash		10 800				
15.03	Discount received		1 200				
31.03	Balance c/d		33 000				
			50 000				50 000
				01.04	Balance b/f		33 000

Discount allowed account

Dr. | Cr.

Date	Description	L.F.	Cash	Date	Description	L.F.	Cash
31.03.20xx	Debtors		900	31.03.20xx	Balance c/d		900
			900				900
01.04	Balance b/f		900				

Discount received account

Dr. | Cr.

Date	Description	L.F.	Cash	Date	Description	L.F.	Cash
31.03.20xx	Balance c/d		1 500	31.03.20xx	Creditors		1 500
			1 500				1 500
				01.04	Balance b/f		1 500

A business receives cash as well as cheques from the debtors. At the same time cheques may also be received from cash sales. If the cheques so received are not banked on the same day then they can be used as currency notes. Therefore, cheques received should be recorded in the cash book similar to recording of receipts of cash. There will be discounts allowed when cheques are received from debtors. These discounts are recorded in the discount allowed column of the cash book.

Example :-

Hiruni's business has the following balances as at 01.03.20xx

		Rs.
Capital		100 000
Creditors -	Suranga	25 000
	Tharanga	15 000
Cash		80 000
Debtors -	Malka	40 000
	Imalka	20 000

The following transactions took place during the month of march

Date	Receipt No.	Voucher No.	Description
02.03.20xx	65		Received from Malka Rs. 8 000.
05.03		40	Bought goods for cash Rs. 35 000.
08.03		41	Paid Suranga Rs. 6 000.
10.03	66		Gave 5% discount to Imalka to settle the amount due Rs. 12 000.
12.03		42	8% discount received when settling a creditor Tharanga Rs. 10 000.
15.03	67		Cheque received from sale Rs. 16 000.
18.03	68		Received cash from Malka Rs. 6 650 and discount allowed Rs. 350.
20.03		43	When the amount owed to Suranga Rs. 8 000 was settled. The discount Rs. 400 was received from him.
24.03	69		Cash and cheque received from sale of goods Rs. 16 000 and Rs. 7 000 respectively
29.03	70		Hiruni brought an additional capital of Rs. 20 000

The following show how the transactions given in the above example are recorded in the cash book with discount columns and in the appropriate ledger accounts.

Dr. Cash book Cr.

Date	Re. No.	Description	Discount	Cash	Date	Vou. No.	Description	Discount	Cash
01.03.20xx		Balance b/f		80 000	05.03.20xx	40	Purchase		35 000
02.03	65	Malka		8 000	08.03	41	Suranga		6 000
10.03	66	Imalka	600	11 400	12.03	42	Tharanga	800	9 200
15.03	67	Sale (cheque)		16 000	20.03	43	Suranga	400	7 600
18.03	68	Malka	350	6 650	31.03		balance c/d		97 250
24.03	69	Sale		6 000					
		Sale (cheque)		7 000					
29.03	70	Capital		20 000					
			950	155 050				1200	155 050
01.04		Balance b/f		97 250					

Dr. Capital account Cr.

Date	Description	L.F.	Value	Date	Description	L.F.	Value
				01.03.20xx	Balance b/f		100 000
				29.03	Cash		20 000

Dr. Discount allowed account Cr.

Date	Description	L.F.	Value	Date	Description	L.F.	Value
31.03.20xx	Debtors		950				

Dr. Malka (Debtor) Cr.

Date	Description	L.F.	Value	Date	Description	L.F.	Value
01.03.20xx	Balance b/f		40 000	02.03.20xx	Cash		8 000
				18.03	Cash		6 650
				18.03	Discount allowed		350

Dr. Imalka (Debtor) Cr.

Date	Description	L.F.	Value	Date	Description	L.F.	Value
01.03.20xx	Balance b/f		20 000	10.03.20xx	Cash		11 400
				10.03	Discount allowed		600

Dr. **Discount received account** Cr.

Date	Description	L.F.	Value	Date	Description	L.F.	Value
				31.03.20xx	Creditors		1 200

Dr. **Suranga (creditor) account** Cr.

Date	Description	L.F.	Value	Date	Description	L.F.	Value
08.03.20xx	Cash		6 000	01.03.20xx	Balance b/f		25 000
20.03	Cash		7 600				
20.03	Discount received		400				

Dr. **Tharanga (creditor) account** Cr.

Date	Description	L.F.	Value	Date	Description	L.F.	Value
12.03.20xx	Cash		9 200	01.03.20xx	Balance b/f		15 000
12.03	Discount received		800				

Dr. **Sales account** Cr.

Date	Description	L.F.	Value	Date	Description	L.F.	Value
				15.03.20xx	Cash		16 000
				24.03	Cash		13 000

Dr. **Purchases account** Cr.

Date	Description	L.F.	Value	Date	Description	L.F.	Value
05.03.20xx	Cash		35 000				

Activity 03

Anuradha's business has the following balances as at 01.07.20xx

	Rs.
Cash	70 000
Debtors-Hasala	22 000
Raveesha	28 000
Capital	75 000
Creditors - Sahasra	25 000
Kawmadi	20 000

Following transactions took place during the month of July.

03.07.20xx	Bought goods for cash Rs. 28 000
08.07	Cash received from Hasala Rs. 7 000
12.07	Cash Sales Rs. 12 000
16.07	10% discount was allowed when the amount owed to Kawmadi of Rs. 8 000 was settled.
18.07	5% discount was allowed to Raveesha when he settled his due of Rs. 10 000.
20.07	Shop rent paid Rs. 4 000.
25.07	Rs. 500 discount was deducted when Kawmadi was settled of Rs. 8 000
26.07	Raveesha had sent a cheque of Rs. 7 200 after deducting Rs. 8 00 as discount
28.07	A 5% discount received when Rs. 2 000 was settled with Kawmadi

Required :-

01. Write up the cash book with discount column and balance off as at 31.07.20xx

02. Write up the ledger accounts that involved the above cash transactions

8.2 Petty Cash Book

Out of the payments made by a business, some of the payments are of small in amount and would occur frequently.

Examples :-

Payment of cleaning expenses of Rs. 150
Payment of postal charges of Rs. 60

Accordingly, postal charges. cleaning expenses, travelling expenses, entertainment expenses and stationery expenses are some examples for the day to day expenses of small values.

The petty cash book is the prime entry book in which the payments of cash with small values that occur frequently are recorded. Petty cash book also functions as a ledger account. Therefore, it also has a dual role like cash book.

The responsibility of maintaining a petty cash book is assigned to a petty cashier, who is under the main cashier. A voucher has to be prepared for each and every petty cash payment. It is known as the petty cash voucher. It is the source document for the payments to be recorded in the petty cash book.

Petty cash imprest

For purpose of carrying the petty cash payments with a control, a specific amount of cash is given to the petty cashier by the main cashier to make petty cash payments, which is known as the petty cash imprest. It is the duty of the petty cashier to make petty cash payments out of this petty cash imprest as well as and to maintain the petty cash book.

Reimbursement of petty cash imprest

The petty cashier has to request again cash from the main cashier before the petty cash imprest is over. The petty cashier should be given the amount equivalent to the amount of payments made at that time and with that the imprest will be reimbursed. This is known as reimbursement of the petty cash imprest.

Example :-

The petty cash imprest of the business of Lihini was Rs. 2 000. The following payments were made out of this imprest received.

	Rs.
Stationery expenses	250
Cleaning expenses	600
Entertainment expenses	400
Travelling expenses	350
Total petty cash expenses	1 600

Accordingly, total petty cash expenses was Rs. 1 600. When the petty cashier requests again for cash from the main cashier, the main cashier will give the petty cashier only Rs. 1600, which is the amount spent. This is reimbursement of the petty cash imprest.

Then,

Petty cash balance in hand	Rs. 400
Petty expenses reimbursed	Rs. 1 600
Petty cash imprest	Rs. 2 000

The petty cashier should submit a payment voucher that includes all petty cash vouchers to date relevant to the petty cash payments to the main cashier for the reimbursement.

Activity 04

Sarasi Co. Ltd. maintains a petty cash book under a petty cash imprest system for making petty cash payments. Particulars related to the petty cash transactions are as follows.

As at 1st January 20xx, the petty cash-in-hand balance was Rs. 330. In the petty cash voucher, total expenses during the month of January was Rs. 1 670.

Answer following questions using the above information.

01. How much is the petty cash imprest ?

02. How much will be the reimbursement made by the main cashier as at 31.01.20xx

03. If the petty cash imprest was decided to be increased by Rs. 500 on 01.02.20xx, then how much will be the value of reimbursement?

04. If the petty cash balance was Rs. 729 as at the 01.03.20xx. Then, how much should to be reimbursed?

Preparation of petty cash book

Different columns are maintained to record similar types of payments, so that the payments can be posted to the ledger easily. These columns are known as analysis columns.

Examples :-

Stamp charges, postal charges, purchases of envelops and other similar types of expenses could be identified and recorded in the analysis column named as postal charges.

If any petty cash payments cannot be entered in any of the analysis columns, a separate column known as the sundry expense column could be drawn for such payments. Any other expenses, which cannot be included in any of the analysis columns but need to be separately posted to the relevant ledger accounts are recorded in the column named as the other ledger account column.

Examples :-

Cash paid to creditors, purchase of assets of small value, carriage inwards.

Study the format of a petty cash book given below.

Petty Cash Book

Receipt Rs.	L. F.	Date	Description	V. N.	Pay-ments Rs.	Analysis columns					L. F.
						Stationeries	Postage	Travel	Sundry	Other Ledger account	

Like the cash book, the petty cash book also performs a dual function. Accordingly, both the functions of a prime entry book and a ledger account is fulfilled by the petty cash book.

- As the receipt of petty cash imprest and the payment of petty cash payments are first recorded in the petty cash book, it performs the task of a book of prime entry.

- Petty cash book also has both debit and credit sides, and entries are recorded according to the principle of double entry for assets. Therefore, it performs the function of a ledger account.

Petty cash transactions are recorded based on the following double entries.

When the petty cash imprest is received and the reimbursement is made,

Petty Cash book	Debit
Cash book	Credit

The payments credited in the petty cash book should be debited in the relevant ledger accounts. The totals of each analysis column should be posted to the relevant ledger accounts. Accordingly, the double entry is,

Relevant expense account	Debit
Petty Cash book	Credit

The values recorded in the other ledger account column should be separately debited to the relevant ledger accounts.

When the petty cash book is balanced at the end of a time period, the total of the debit side is transferred to in the total of the credit column and the difference should be brought forward as the b/f balance.

Example :-

Following are the information regarding payments of petty cash payments of the business of Nethmi during the month of March 20xx.

Petty cash imprest was Rs. 2 000 which was received on 01.03.20xx

Date	Voucher No.	Description	Rs.
04.03.20xx	01	Postal charges	120
05.03	02	Travelling expenses	160
08.03	03	Refreshment expenses	260
10.03	04	Stamps	140
15.03	05	Travelling	60
18.03	06	To Vimukthi	200
22.03	07	Trishow charges	240
25.03	08	Carriage inwards	200
26.03	09	Refreshment expenses	180
28.03	10	Pens and Pencils	150
30.03	11	Cleaning expenses	200
01.04		Expenses reimbursed	

How the petty cash book is prepared with the analysis columns of postal charges, travelling expenses , entertainment expenses, miscellaneous expenses and other ledger accounts and how they are posted to the ledger accounts are depicted as follows.

Dr. Petty Cash book Cr.

Received Rs.	L/F	Date	Descriptions	Voucher No.	Payments Rs.	Analysis Columns					Page No.
						Postal Rs.	Travelling Rs.	Entertainment Rs.	Miscellaneous Rs.	Ledger Acc. Rs.	
2 000		01.03.20xx	Cash								
		04.03	Postal charge	1	120	120					
		05.03	Travelling	2	160		160				
		08.03	Refreshments	3	260			260			
		10.03	Stamps	4	140	140					
		15.03	Travelling	5	60		60				
		18.03	Vimukthi	6	200					200	12
		22.03	Trishow charges	7	240		240				
		25.03	Carriage inwards	8	200					200	13
		26.03	Refreshment	9	180			180			
		28.03	Pen and Pencils	10	150				150		
		30.03	Cleaning expenses	11	200				200		
					1 910	260	460	440	350	400	
		31.03	Balance c/d		90	L.P.	L.P.	L.P.	L.P.		
2 000					2 000						
90		01.04	Balance b/f								
1 910		01.04	Cash								

Dr. Cash book Cr.

Date	Description	L/F	Value Rs.	Date	Description	L/F	Value Rs.
				01.03.20xx	Petty cash		2 000
				01.04	Petty cash		1 910

Dr. Postal charges account Cr.

Date	Description	L/F	Value Rs.	Date	Description	L/F	Value Rs.
31.03.20xx	Petty cash		260				

Dr. Travelling expenses account Cr.

Date	Description	L/F	Value Rs.	Date	Description	L/F	Value Rs.
31.03.20xx	Petty cash		460				

Dr. Entertainment expenses account Cr.

Date	Description	L/F	Value Rs.	Date	Description	L/F	Value Rs.
31.03.20xx	Petty cash		440				

Dr. Miscellaneous expenses account Cr.

Date	Description	L/F	Value Rs.	Date	Description	L/F	Value Rs.
31.03.20xx	Petty cash		350				

Dr. **Vimukthi's account** Cr.

Date	Description	L/F	Value Rs.	Date	Description	L/F	Value Rs.
31.03.20xx	Petty cash		200				

Dr. **Carraige Inwards account** Cr.

Date	Description	L/F	Value Rs.	Date	Description	L/F	Value Rs.
31.03.20xx	Petty cash		200				

Activity 05

Harini's business has the following details.

* Petty cash imprest of Rs. 3 000
* Total payment for petty cash expenses for the month of January 20xx is Rs. 2 400.
* Petty cash expenses were reimbursed on 01.02.20xx and 01.03.20xx

Petty cash expenses for the month of February 20xx are as follows.

Date	Description	
03.02.20xx	Stationeries bought	60
05.02.20xx	Travelling expenses	125
08.02.20xx	Two pens were bought	40
12.02.20xx	Trishow charges	300
15.02.20xx	Bought two cakes of soap	60
18.02.20xx	Bought half-sheets	250
23.02.20xx	Cleaning expenses	150
24.02.20xx	Entertainment expense	350
25.02.20xx	For soft drinks	220
26.02.20xx	Bus fare	170
27.02.20xx	Paid to Viran	500

Required :-

01. Prepare a petty cash book that is based on the imprest system by limiting to four analysis columns and balance it as at 28.02.20xx.

02. Prepare the relevant ledger accounts.

9 Bank Account and the Bank Reconciliation Statement

The following facts are discussed in this chapter.

9.1 Bank Account
- Recording of cash deposits in the bank account
- Recording of cheque deposits in the bank account
- Issuing of cheques for payments
- Dishonouring of cheques
- Bank overdraft

9.2 Bank Reconciliation Statement
- Bank Statement
- Reasons for the difference between the balance of bank statement and the bank account of the business
- Adjusting the bank account balance
- Preparation of bank reconciliation statement

9.1 Bank Account

Most businesses like to conduct cash transactions conveniently and securely by opening a current account. The bank account and the cash book are considered as asset accounts. Therefore, when the transactions are carried out through the bank account, they should be recorded according to the double entry principle for assets.

Let us understand how the transactions that are conducted through bank current account are recorded in a business.

01. Deposit of cash in the bank

A specified amount of cash has to be deposited to open a current account. In addition, cash received by the business would be deposited in the current account. When a business deposits cash in the current account, the balance in the current account increases and the cash balance decreases.

The double entry for deposit of cash is as follows.

Bank account	Dr.
Cash book	Cr.

When depositing cash, a deposit slip has to be completed and submitted along with cash to the bank. The bank returns a duplicate of the deposit slip to the business (depositor) immediately. This document is used as a source document for the recording of the cash deposit.

02. Deposit of cheques received by the business

Balance in the bank account of the business will increase when cheques are deposited. As explained earlier, when cheques from debtors and cash sales are received, they are first debited to the cash book.

When these cheques are deposited to the bank later, the double entry should be as follows.

Bank account	Dr.
Cash book	Cr.

However, if the received cheques are deposited to the bank at the time of receipt, instead of debiting to the cash book, they can be directly debited to the bank account of the business.

Example :-

The cheque received from the sales amounting to Rs. 10 000 was deposited to the bank account immediately.

Then the double entry is,

Bank account	Dr. 10 000
Sales account	Cr. 10 000

When received cheques are deposited, a cheque deposit slip should be completed and submitted to the bank along with the cheques. A duplicate of the deposit slip is given to the business (depositor) by the bank. This document is used as a source document when the business records the deposited cheque in the bank account of the business.

Observe the following cheque deposit slip

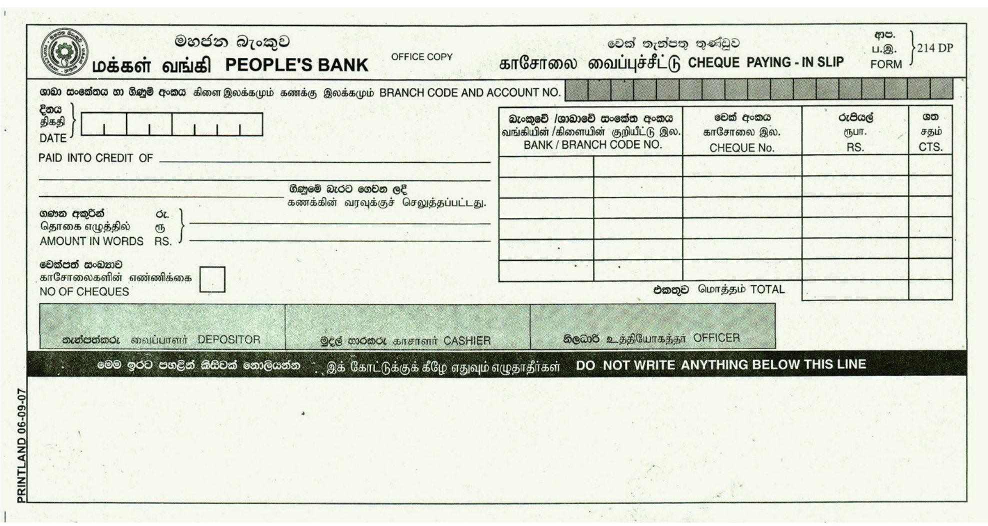


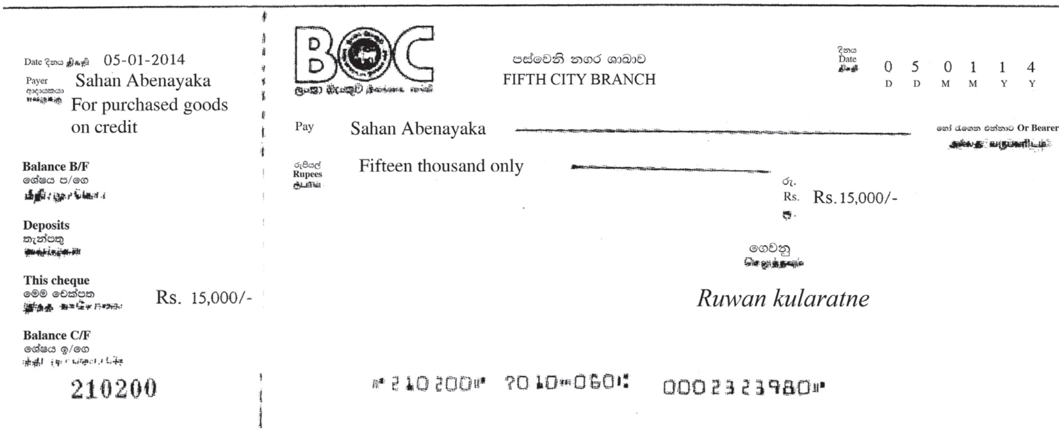
Figure 9.1 - A copy of a cheque Deposit Slip

03. Issuing of cheques

Payments can be made to creditors, purchases and expenses by issuing cheques. When a cheque is issued, it is a common practice to complete the cheque and its counterfoil, which is the remainder of the cheque leaf in the cheque book.

Observe the following cheque and its counter foil

Part I Part II


Date 05-01-2014
Payer Sahan Abenayaka
For purchased goods on credit
Balance B/F
Deposits
This cheque Rs. 15,000/-
Balance C/F
210200

BOC
පස්වෙනි නගර ශාඛාව
FIFTH CITY BRANCH
Date 0 5 0 1 1 4
D D M M Y Y
Pay Sahan Abenayaka Or Bearer
Rupees Fifteen thousand only
Rs. Rs. 15,000/-
Ruwan kularatne

Figure 9.2 - A copy of a cheque

The details of payments made by cheques are recorded in payment vouchers. Accordingly, when payments are paid by cheques, the payment voucher is used as the source document to record such transactions in the bank account of the business.

When payments are made by cheques, the balance in the bank account of the business decreases.

Accordingly, The relevant double entry is as follows.

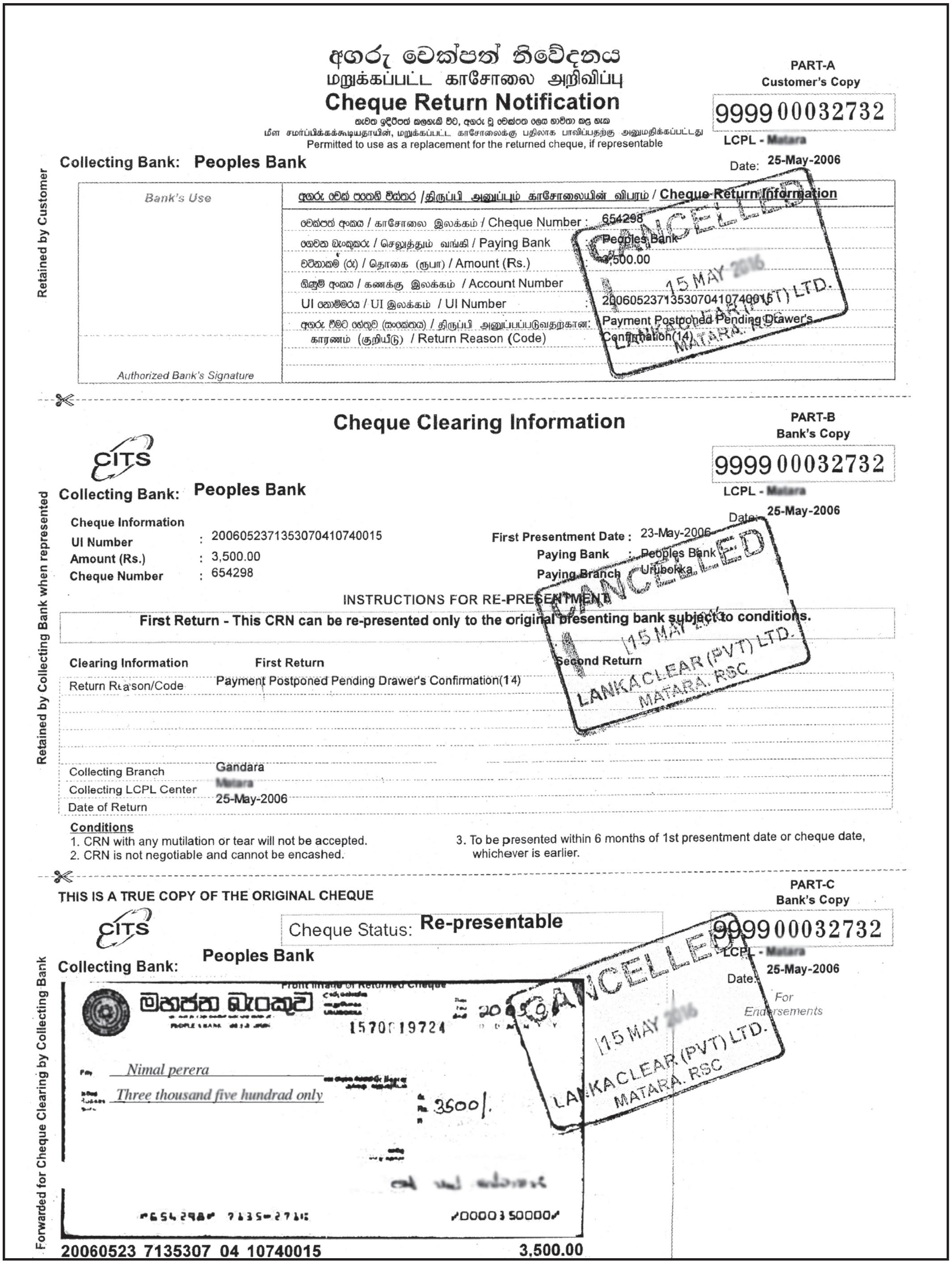
Expense account or the relevant payment account	Dr.
Bank account	Cr.

04. Dishonouring of cheques

There are situations where a bank refuses cheques due to cheques being written disorderly, insufficient balance in the current account, signature on the cheque is different from the specimen signature, etc. This is known as dishonouring of cheques.

Accordingly, cheques deposited as well as cheques issued may be dishonoured by the bank. A cheque return notification is sent by the bank to the business to inform about dishonoured cheques.

Observe the following copy of the cheque return notification.



අගරු චෙක්පත් නිවේදනය
மறுக்கப்பட்ட காசோலை அறிவிப்பு
Cheque Return Notification
නැවත ඉදිරිපත් කළහැකි විට, අගරු වූ චෙක්පත ලෙස භාවිතා කළ හැක
மீள சமர்ப்பிக்கக்கூடியதாயின், மறுக்கப்பட்ட காசோலைக்கு பதிலாக பாவிப்பதற்கு அனுமதிக்கப்பட்டது
Permitted to use as a replacement for the returned cheque, if representable

PART-A
Customer's Copy
9999 00032732
LCPL - [redacted]
Date: 25-May-2006

Retained by Customer

Collecting Bank: **Peoples Bank**

Bank's Use

Authorized Bank's Signature

අගරු චෙක් පතෙහි විස්තර / திருப்பி அனுப்பும் காசோலையின் விபரம் / **Cheque Return Information**

චෙක්පත් අංකය / காசோலை இலக்கம் / Cheque Number	: 654298
ගෙවන බැංකුකරු / செலுத்தும் வங்கி / Paying Bank	: Peoples Bank
වටිනාකම (රු) / தொகை (ரூபா) / Amount (Rs.)	: 3,500.00
ගිණුම් අංකය / கணக்கு இலக்கம் / Account Number	:
UI නොම්මරය / UI இலக்கம் / UI Number	: 2006052371353070410740015
අගරු වීමට හේතුව (සංකේතය) / திருப்பி அனுப்பப்படுவதற்கான காரணம் (குறியீடு) / Return Reason (Code)	: Payment Postponed Pending Drawer's Confirmation(14)

CANCELLED
15 MAY
LANKACLEAR (PVT) LTD.
MATARA. RSC

Cheque Clearing Information

PART-B
Bank's Copy
9999 00032732
LCPL - [redacted]
Date: 25-May-2006

Retained by Collecting Bank when represented

CITS

Collecting Bank: **Peoples Bank**

Cheque Information

UI Number	: 20060523713530704107400015
Amount (Rs.)	: 3,500.00
Cheque Number	: 654298
First Presentment Date	: 23-May-2006
Paying Bank	: Peoples Bank
Paying Branch	: Uruborka

INSTRUCTIONS FOR RE-PRESENTMENT

First Return - This CRN can be re-presented only to the original presenting bank subject to conditions.

Clearing Information	**First Return**	**Second Return**
Return Reason/Code	Payment Postponed Pending Drawer's Confirmation(14)	
Collecting Branch	Gandara	
Collecting LCPL Center	[redacted]	
Date of Return	25-May-2006	

CANCELLED
15 MAY
LANKACLEAR (PVT) LTD.
MATARA. RSC

Conditions

1. CRN with any mutilation or tear will not be accepted.
2. CRN is not negotiable and cannot be encashed.
3. To be presented within 6 months of 1st presentment date or cheque date, whichever is earlier.

THIS IS A TRUE COPY OF THE ORIGINAL CHEQUE

PART-C
Bank's Copy
9999 00032732
LCPL - [redacted]
Date: 25-May-2006

CITS

Cheque Status: **Re-presentable**

Collecting Bank: **Peoples Bank**

Forwarded for Cheque Clearing by Collecting Bank

Front Image of Returned Cheque

මහජන බැංකුව
1570 19724
Pay Nimal perera
Three thousand five hundrad only
Rs. 3500/.
⑈654298⑈ 7135=271⑆ ⑇0000350000⑇

20060523 7135307 04 10740015 3,500.00

For Endorsements

CANCELLED
15 MAY
LANKACLEAR (PVT) LTD.
MATARA. RSC

Figure 9.3 - A copy of a Cheque Return Notification

Dishonouring of Deposited Cheques

When cheques are received from cash sales, debtors, etc. and when those cheques are deposited in the bank, they are debited to the bank account of the business. This is because the balance in the bank account is increased. However, when a cheque is dishonored by the bank, in fact, the bank balance does not increase. Therefore, when a deposited cheque is dishonored, the debit entry made in the bank account of the business should be reversed. Here, the value of the dishonored cheque should be cancelled from the bank account and should be recorded as a receivable from the party who had given the cheque. Accordingly, the double entry for the dishonoured deposited cheque should be recorded as follows

Debtors/Relevant account	Dr.
Bank account	Cr.

Example :-

A cheque received from a debtor for Rs. 8 000 and deposited in the bank had been dishonoured by the bank. The double entry for recording of this dishonoured cheque is as follows.

Debtor's account	Dr. 8 000
Bank account	Cr. 8 000

Dishonouring of issued cheques

It is already discussed that when cheques are issued, the relevant expense account or other relevant account should be debited and the bank account should be credited. When such an issued cheque is dishonoured by the bank, entries that were originally recorded should be reversed. This is done by a reversal entry to the entry that was recorded originally when the cheque was issued. Accordingly, when an issued cheque is dishonoured it should be recorded as follows.

Bank account	Dr.
Expense account/Relevant other account	Cr.

Example :-

A cheque issued by the business to a creditor of Rs. 15 000 was dishonoured when presented to the bank.

When this information is received, the double entry for this dishonored cheque is as follows.

Bank account	Dr. 15 000
Creditors account	Cr. 15 000

Example :-

Nethmi's business had the following balances as at 01.06.20xx

Cash	Rs. 185 000
Debtors	Rs. 55 000
Creditors	Rs. 85 000

The following transactions had taken place during the month of June.

02.06.20xx Opened a bank current account by depositing Rs. 22 000
03.06 Received a cheque bearing No. 455 from a debtor for Rs. 9 000.
04.06 Deposited the cheque No. 455 of Rs. 9 000 that was received from a debtor
08.06 The cheque No. 562 of Rs. 12 000 that is received for sales has been deposited at the time of receipt.
12.06 Deposited cash of Rs. 15 000 in the bank current account.
15.06 A creditor was paid by cheque No. 301 amounting to Rs. 7 600 and a discount of Rs. 400 was received.
18.06 Issued a cheque bearing the No. 302 for the payment of electricity bill of Rs. 5 000.
20.06 The cheque issued for the payment of the electricity bill has been dishonoured by the bank.
24.06 A cheque bearing the No. 415 was received from a debtor for Rs. 13 000
26.06 Deposited the cheque No. 415 received from a debtor
28.06 The cheque No. 415 has been dishonoured by the bank
29.06 The cheque bearing the No. 632 was received from a debtor for Rs. 5 700.The discount of Rs. 300 has been allowed. This cheque has been deposited at the time of receipt.

Recording the above transactions in the bank account and posting them to the relevant ledger accounts are as follows.

Dr. Bank account Cr.

Date	Description	L. F.	Dis. allo.	Value Rs.	Date	Description	L. F.	Dis. rece.	Value Rs.
02.06.20xx	Cash			22 000	15.06.20xx	Creditor (301)		400	7 600
04.06	Cash (455)			9 000	18.06	Electricity (302)			5 000
08.06	Sales (562)			12 000	28.06	Debtor (415)			13 000
12.06	Cash			15 000					
20.06	Electricity (302)			5 000					
26.06	Cash (415)			13 000					
29.06	Debtor (632)		300	5 700					

Dr. Cash Book Cr.

Date	Description	L. F.	Dis. allo.	Value Rs.	Date	Description	L. F.	Dis. rece.	Value Rs.
01.06.20xx	Balance b/f			185 000	02.06.20xx	Bank			22 000
03.06.	Debtors 455			9 000	04.06	Bank (455)			9 000
24.06	Debtors 415			13 000	12.06	Bank			15 000
					26.06	Bank (415)			13 000

Dr. **Debtors account** Cr.

Date	Description	L. F.	Value Rs.	Date	Description	L. F.	Value Rs.
01.06.20xx	Balance b/f		55 000	03.06.20xx	Cash		9 000
28.06	Debtor (415)		13 000	24.06	Bank		13 000
				29.06	Bank		5 700
				29.06	Discounts allo. acc.		300

Dr. **Creditors account** Cr.

Date	Description	L. F.	Value Rs.	Date	Description	L. F.	Value Rs.
15.06.20xx	Bank account (301)		7 600	01.06.20xx	Balance b/f		85 000
15.06	Discount rec. acc.		400				

Dr. **Sales account** Cr.

Date	Description	L. F.	Value Rs.	Date	Description	L. F.	Value Rs.
				08.06.20xx	Bank (562)		12 000

Dr. **Electricity charges account** Cr.

Date	Description	L. F.	Value Rs.	Date	Description	L. F.	Value Rs.
18.06.20xx	Bank account (302)		5 000	20.06.20xx	Bank		5 000

Dr. **Discounts allowed account** Cr.

Date	Description	L. F.	Value Rs.	Date	Description	L. F.	Value Rs.
30.06.20xx			300				

Dr. **Discounts received account** Cr.

Date	Description	L. F.	Value Rs.	Date	Description	L. F.	Value Rs.
				30.06.20xx	Creditors		400

Activity 01

The following balances were in the books of Sahan Abeynayaka's business as at 01.06.20xx

	Rs.
Cash	90 000
Debtors	60 000
Capital	70 000
Creditors	80 000

The following transactions were taken place during the month of June 20xx

05.06.20xx - Opening a bank current account by depositing Rs. 25 000

08.06 - Bought goods for resale by issuing a cheque No. 40 amounting to Rs. 20 000

10.06 - Deposited the following cheques
Cheque No. 68 of Rs. 12 000 received from a debtor
Cheque No. 75 of Rs. 18 000 received from the cash sales of goods
Cheque No. 66 of Rs. 18 000 received from a debtor

15.06 - Rs. 10 000 of cash was deposited in the current account

16.06 - A cheque received (Cheque No. 68) from a debtor and had been deposited in the bank was dishonoured by the bank.

20.06 - Issuing of the following cheques
Cheque No. 41 Rs. 8 000 for rent
Cheque No. 42 Rs. 15 000 to the creditors

24.06 - The Cheque issued for payment for rent has been dishonoured Rs. 8 000

28.06 - A new cheque bearing rent No. 43 for Rs. 8 000 was issued instead of the dishonoured cheque.

27.06 - The cheque valued Rs. 17 000 bearing the No. 105 received from cash sales was deposited at the same time

Required,

01. Prepare the bank account for the month ended 30.06.20xx and balance it.
02. Post the entries to other ledger accounts and balance them.

Bank overdraft

There are situations where banks allow their customers to issue cheques for more than the existing balance in their current accounts. This facility is known as a bank over draft. If the business issues cheques exceeding the existing bank balance, the total of the credit side of the bank account of the business exceeds the total of the debit side of the bank account. As a result, a credit balance appears in the bank account. This credit balance of the bank account is known as bank overdraft, which is considered as a liability of the business. Accordingly, when cheques are issued in excess of the existing bank balance and when the bank makes payment on them, the account holder becomes a debtor to the bank and that debit balance in the bank is known as the bank overdraft.

Example :-

There was a favourable balance (debit balance) in the bank account of Samadhi's business of Rs 12 000 as at 01.07.20xx. Following transactions took place during the month of July.

05.07.20xx Cash deposited in the bank Rs 8 000

Deposited cheques

08.07.20xx Cheque that had been received from cash sales Rs. 9 000 (Cheque No. 20)
15.07.20xx Cheque that had been received for rent of income Rs. 7 000 (Cheque No. 114)
20.07.20xx A cheque that had been received from a debtor Rs. 6 000 (Cheque No. 95)

Issued Cheques

12.07.20xx To pay the creditors Rs 16 000 (Cheque No. 33)
22.07.20xx To pay the salary Rs. 15 000 (Cheque No. 34)
25.07.20xx For purchases Rs. 25 000 (Cheque No. 35)

Dr. Bank account Cr.

Date	Description	L/F	Value Rs.	Date	Description	L/F	Value Rs.
01.07.20xx	Balance b/f		12 000	12.07.20xx	Creditors (35)		16 000
05.07	Cash		8 000	22.07	Salary (34)		15 000
08.07	Cash (20)		9 000	25.07	Purchases (35)		25 000
15.07	Cash (114)		7 000				
20.07	Cash (95)		6 000				
31.07	balance c/d		14 000				
			56 000				56 000
				01.08	balance b/f		14 000

As shown in the above example, the total of the credit side of the bank account is Rs. 56 000 and the total of the debit side is Rs. 42 000. There is a deficit of Rs. 14 000 in the debit side than the credit side. As a result, a credit balance of Rs. 14 000 appears in the bank account. This is the bank overdraft. This is a liability as the business has to pay it back to the bank.

Activity 02

Viran carries out a business of sales of textiles. He can obtain a bank overdraft of Rs. 100 000 as he maintains his current account in an orderly manner for a long period.

He had a bank balance of Rs. 45 000 in his bank account as at 01.05.20xx. Following transactions were carried out through his current account during the months of May.

Deposits

02.05.20xx	Cash Rs. 14 000
11.05	Cheque deposited Rs. 15 000
21.05	Cheque deposited Rs. 16 000

Cheques Issued

05.05.20xx	To Mr. Fernando a creditor for Rs. 12 000
13.05	To pay salary of Rs. 20 000
18.05	To pay rent of Rs. 10 000
22.05	To purchase goods of Rs. 34 000

All the deposited cheques were added and all cheques issued were deducted from the current account of the bank.

Required,

01. Enter the transactions given above in the bank account and balance it off.

02. Indicate the bank overdraft, if he had issued a cheque on 25.05.20xx for Rs. 45 000 for the purchase of equipment.

9.2 Bank reconciliation statement

You have already studied how the transactions are recorded in the bank account wich are carried out through the current account of a business. The favorable balance of the bank account of a business is an asset to the business. Transactions should be recorded in the bank account according to the double entry principle for assets. The transactions which increase the balance in the bank account are debited and the transactions which decrease the bank balance should be credited to the bank account.

Now let us study how transactions are recorded in the books of a commercial bank which maintains a current account on behalf of a business. The bank also records in its own books the transactions of the business operated through the current account by a business. The account that is maintained by the bank of the business is treated as a liability account of the bank. Therefore, the bank records the transactions of the business according to the double entry principle for liabilities. Accordingly, the transactions that increase the bank balance should be credited and the transactions that decrease the bank balance should be debited.

Accordingly, let us study how a bank has recorded few bank transactions of a business in its books. See the statement below.

Current Account

Date	Description	Dr.	Cr.	Balance
	Opening balance (Cr.) favorable			xxx
	Cash deposit		xxx	xxx
	Cheque deposit		xxx	
	Cheque payment	xxx		
	Direct deposit		xxx	
	Bank charges	xxx	xxx	
	Charges for cheque book	xxx		xx
				xxx
				xxx

The values which are debited in the bank account that is maintained by the business are credited by the bank in the account maintained by the bank. The values which are credited by the business in the bank account are debited by the bank in the account. Finally, if there is a debit balance in the bank account maintained by the business, there will be a credit balance in the bank account maintained by the bank for the business.

Bank Statement

Usually, banks send a statement called a bank statement to their current account holders once a month. The bank statement shows the opening balance, items which are debited and credited by the bank during the month and the closing balance.

At present, banks send a computer printout to the business that holds a current account. The statement that is sent by the bank is known as the bank statement or the statement of accounts.

Examine the following bank statement carefully.

STATEMENT OF ACCOUNT [redacted]

Branch Name / Code [redacted] CITY BRANCH

Account Number [redacted]

Date 30/08/2013

Currency LKR

Date	Particulars	Payments	Receipts	Balance
31/07	BALANCE B/F			34,654.10DR
01/08	CASH DEPOSIT	.00	13,000.00	21,654.10DR
01/08	ACH CLR 0174024	39,000.00	.00	60,654.10DR
02/08	CASH DEPOSIT	.00	10,000.00	50,654.10DR
05/08	CASH DEPOSIT	.00	7,000.00	43,654.10DR
06/08	ACH CLR 0174023	20,800.00	.00	64,454.10DR
06/08	CASH DEPOSIT	.00	9,000.00	55,454.10DR
07/08	CASH DEPOSIT	.00	5,000.00	50,454.10DR
08/08	CASH DEPOSIT	.00	5,000.00	45,454.10DR
12/08	CASH DEPOSIT	.00	5,000.00	40,454.10DR
13/08	CASH DEPOSIT	.00	12,000.00	28,454.10DR
14/08	CASH DEPOSIT	.00	29,000.00	545.90
15/08	CHQ BOOK CHARGES	375.00	.00	170.90
22/08	CASH DEPOSIT	.00	12,000.00	12,170.90
23/08	ACH CLR 0182330	25,000.00	.00	12,829.10DR
23/08	CASH DEPOSIT	.00	13,000.00	170.90
26/08	CASH DEPOSIT	.00	10,000.00	10,170.90
27/08	ACH CLR 0182327	4,000.00	.00	6,170.90
27/08	CASH DEPOSIT	.00	10,000.00	16,170.90
27/08	ACH CLR 0182329	9,595.00	.00	6,575.90
29/08	ACH CLR 0182334	5,400.00	.00	1,175.90
30/08	CASH DEPOSIT	.00	10,000.00	11,175.90
30/08	OD CHG SYS-GENERATED	425.79	.00	10,750.11
30/08	BALANCE C/F			10,750.11
	TOTAL UNREALIZED CHEQUES			**.00**
	TOTAL DEPOSITS 14 items		**150,000.00**	
	TOTAL WITHDRAWALS 7 items	**104,595.79**		

END OF STATEMENT

For clarifications if any, please contact the Branch Manager on [redacted]

All the transactions shown on the statement should be verified and the Bank notified of any discrepancy immediately.
Any query relating to transactions beyond 03 months may be subject to levy of a fee.
Unrealised cheque deposits, if any are included in the Closing balance.

Figure 9.4 - A copy of a bank statement

The bank account of the business shows the cash at the bank when balancing off its bank account. The bank statement sent by the bank shows the money at bank of the business according to the books of the bank. If both parties had recorded all transactions related to the current account, these two balances should be similar. However, in practice, the bank account balance of the business and the balance in the bank statement may differ. The reason for this difference is that certain transactions which have been recorded in the bank account are not recorded in the bank statement and certain other transactions recorded in the bank statement are not recorded in the bank account of the business.

The reasons for the difference between the final balance of the bank account and the final balance of the bank statement

01. The cheques issued but not presented to the bank for payment

When a business issues cheques, they are credited to the bank account. Then, the balance of the bank account maintained by business decreases. There are instances where some of these cheques issued by the business may have not been presented to the bank for encashment even at the end of the period. These are known as the cheques issued but not presented or as unpresented cheques. Since the bank has not paid for these cheques, they are not recorded as payments in the bank statement.

Therefore, the balance of the bank account of the business should be less than the balance in the bank statement.

02. The cheques deposited but not realised

When received cheques are deposited in the bank, the bank account of the business should be debited. Then, the balance in the bank account increases. Some of these cheques that were deposited may have not been realised by the end of the time period. Realisation of cheques refers to the process that the amount mentioned in the cheque has been collected and added to the current account in the bank. It would take few days for the amount of the cheque to be collected and added to the balance in the bank current account. Therefore, it is possible that the bank has not recorded the value of the cheques deposited in the books of the bank even at the end of the relevant time period. These cheques are identified as the cheques deposited but not realised. Therefore, cheques deposited but not yet realized are not recorded as deposits in the bank statement.

Therefore, the balance of the bank account of the business should be higher than the balance in the bank statement.

03. Direct remittances

There are occasions when some customers deposit their dues directly to the current account at the bank. Similarly receivables such as rent, interest and dividends, etc., are sometimes directly remitted to the current account. These are known as direct remittances. A business realizes such direct remittances after the receipt of the bank statement. Although, such direct deposits have been recorded as reciepts in the bank statement they have not been recorded in the bank account of the business.

Therefore, the bank account balance of the business is less than the balance in the bank statement.

04. Payments on standing orders

Standing orders refers to an order made to the bank in writing by the business to pay certain regular amounts such as repayment of instalments of bank loans, leasing instalments, insurance premiums and other similar payments from the cash in the current account. The business gets to know of these payments, after recieving the bank statement. The bank deducts (debits) the value from the current account after payment of such standing orders. Although the payments on standing orders have been deducted (debited) in the bank statement, these have not been added (credited) in the bank account yet.

Therefore, the balance in the bank account of the business is higher than the balance in the bank statement.

05. Bank charges and the charges on cheque book

The charges that a bank deducts from the current account for the services rendered by the bank to the current account holder is known as bank charges. The amount charged for the cheque books issued by a bank to the business is called charges for cheque books. The business realizes know these charges after the receipt of the bank statement. These charges have been debited in the bank statement as payments. They have not been recorded in the bank account of the business by the end of the time period.

Therefore, the balance of the bank account of the business should be higher than the balance in the bank statement.

The final balance of the bank account of the business and the final balance in the bank statement may differ due to the above stated reasons.

The reasons for the difference between these balances can be identified only after the comparison of the bank account of the business and the bank statement sent by the bank. Accordingly, the reasons for the difference should be identified first by comparing the bank account and the bank statement.

For that,

- Debit column of the bank account should be compared with the credit column of the bank statement
- Credit column of the bank account should be compared with the debit column of the bank statement.

Therefore, each value in the bank account should be checked to see whether those values have been included in the bank statement. The items which have been recorded in both should be marked. The items remaining unmarked in both the bank account and the bank statement are the items which have been recorded only in one of the books. Those unmarked items are the reasons for the difference between the two final balances. An understanding of this can be obtained through the following exercise.

Example :-

The bank account and the bank statement of Nadeeka's business for the month of July 20xx are given below.

Dr. Bank Account Cr.

Date	Description	L/F	Value Rs.	Date	Description	L/F	Value Rs.
01.07.20xx	Balance b/f		15 000	06.07.20xx	Creditor (112)		10 000
05.07	Cash deposit		8 000	18.07	Creditor (113)		4 000
12.07	Cheque deposit (65)		12 000	23.07	Creditor (114)		16 000
13.07	Cheque deposit (46)		5 000	31.07	Balance c/d		31 000
20.07	Cash deposit		7 000				
28.07	Cheque deposit (58)		14 000				
			61 000				61 000
01.08	Balance b/f		31 000				

Bank statement for the month of July 20xx

Date	Description	Dr.	Cr.	Balance
01.07.20xx	Balance b/f			15 000
05.07	Cash		8 000	23 000
07.07	Cheque - 112	10 000		13 000
15.07	Cheque - 65		12 000	25 000
16.07	Cheque - 46		5 000	30 000
18.07	Direct remittance from a debtor		11 000	41 000
20.07	Cash deposit		7 000	48 000
22.07	Cheque - 113	4 000		44 000
25.07	Standing order (Bank loan instalment)	18 000		26 000
31.07	Bank Charges	3 000		23 000

According to the above example,

31.07.20xx A favourable balance of Rs. 31 000 exists based on the bank account in the business.

31.07.20xx The balance based on the bank statement is Rs. 23 000

Reasons for the difference between the balances should be identified. That is done as follows.

Dr. Bank Account Cr.

Date	Description	L/F	Value Rs.	Date	Description	L/F	Value Rs.
01.07.20xx	Balance b/f		15 000 ✓	06.07.20xx	Creditor (112)		10 000 ✓
05.07	Cash deposit		8 000 ✓	18.07	Creditor (113)		4 000 ✓
12.07	Cheque deposit (65)		12 000 ✓	23.07	Creditor (114)		16 000
13.07	Cheque deposit (46)		5 000 ✓	31.07	Balance c/d		31 000
20.07	Cash deposit		7 000 ✓				
28.07	Cheque deposit (58)		14 000				
			61 000				61 000
01.08	Balance b/f		31 000				

Bank statement for the month of July 20xx

Date	Description	Dr.	Cr.	Balance
01.07.20xx	Balance b/f			15 000 ✓
05.07	Cash		8 000 ✓	23 000
07.07	Cheque - 112	10 000 ✓		13 000
15.07	Cheque - 65		12 000 ✓	25 000
16.07	Cheque - 46		5 000 ✓	30 000
18.07	Direct remittance from a debtor		11 000	41 000
20.07	Cash deposit		7 000 ✓	48 000
22.07	Cheque - 113	4 000 ✓		44 000
25.07	Standing order (Bank loan instalment)	18 000		26 000
31.07	Bank Charges	3 000		23 000

The Reasons for this difference are,

01. When the debit side of the bank account and the credit column of the bank statement are compared,

- Cheque deposited but not realised was (Cheque No. 58) Rs. 14 000.
- A direct remittance to the current account in the bank by a debtor was Rs. 11 000.

02. When the credit side of the bank account and the debit side of the bank statement are compared.

- Unpresented cheque to the bank (Cheque No. 114) was Rs. 16 000.
- The payment on standing order for bank loan instalment not recorded in the bank account was Rs. 18 000.
- Bank charges not recorded in the bank account was Rs. 3 000.

To adjust and compare these reasons, two steps have to be followed. They are,

01. Adjusting the bank account balance of the business.

02. Preparation of bank reconciliation statement based on the adjusted bank balance obtained under Step 1 above.

Adjusting the bank account balance of the business

Among the reasons that have caused a difference between the bank account balance and the current account balance, there may be some errors or omissions in the bank account of the business.

Due to these errors or ommissions, the bank account balance becomes incorrect. Therefore, the bank account balance should be adjusted. This is known as adjusting of the balance of the bank account of the business.

According to the above example, values of the following causes should be adjusted in the bank account of the business.

01. Direct remittances (Debtors' remittance)
02. Standing order (Bank loan instalment)
03. Bank charges

The bank account balance should increase by the receipt of the direct remittance. Therefore, the direct remittance should be debited to the bank account of the business.

Payment on the standing order and charges made by the bank should decrease the bank balance. Therefore, the payment on the standing order and charges should be credited to the bank account of the business. We get the adjusted balance of the bank account after these adjustments.

Based on this example, the bank account of the business is adjusted as follows.

Dr.			Bank account (Adjusted)				Cr.
Date	Description	L/F	Value Rs	Date	Description	L/F	Value Rs
01.08.20xx	Balance b/f		31 000	25.07.20xx	Bank loan		18 000
18.07	Debtor		11 000	31.07	Bank charges		3 000
				01.08	Balance c/d		21 000
			42 000				42 000
01.08	Balance b/f		21 000				

Preparation of the bank reconciliation statement using the adjusted balance of the bank account

After adjusting the bank account, if the adjusted balance of the bank account is not similar to the balance of the bank statement, following will be the main reasons for the difference.

- The values of the cheques which have been deposited but not realised
- The values of the cheques which have been issued but not presented to the bank for payment

However, the above two reasons are not errors or omissions and therefore, the bank account balance is not adjusted. Therefore, a statement should be prepared including the above two reasons to reconcile between the balance of the adjusted bank account and balance of the bank statement. This statement is identified as the bank reconciliation statement. By the preparation of the bank reconciliation statement, the accuracy of the balances can be ensured.

Accordingly,

The bank account balance is less than the balance of the bank statement due to the cheques which have been issued but not presented to the bank for payment. Therefore, the cheques which have not been presented to the bank should be shown as an addition to the adjusted bank balance in the bank reconciliation statement.

The bank account balance is higher than the balance of the bank statement due to the cheques which have been deposited but have not been realised within that period. Therefore, the cheques deposited but not realised should be shown as a deduction from the adjusted bank balance in the bank reconciliation statement.

The balance we get after preparing the bank reconciliation statement including the above two reasons should be the balance mentioned in the bank statement.

Let us see how the bank reconciliation statement is prepared using the adjusted bank account balance based on the example given earlier.

Business of Nadeeka
Bank reconciliation statement for the month of July 20xx

	Rs.	Rs.
Adjusted bank balance		21 000
Add- cheque not presented to the bank (Cheque No.114)	16 000	16 000
		37 000
Less - Unrealised cheque (Cheque No. 58)	14 000	14 000
Bank balance as per the bank statement as at 31.07.20xx		23 000

Accordingly, if the bank balance of the business at the end of a certain time period does not agree with the balance in the bank statement, following steps should be followed to reconcile these balances.

- See whether there is a difference between the balance of the bank account and the balance of the bank statement.
- Identify the reasons for the difference, comparing the bank account and the bank statement.
- Adjusting the final balance of the bank account.
- Preparation of the bank reconciliation statement using the adjusted bank account balance.

Activity 03

Sewwandi Perera's business has a favourable bank account balance of Rs. 45 000 at the end of the month of July 20xx. However, the bank statement has a different balance. Following reasons are identified for this difference.

01. The following cheques have been deposited but have not been realised as at 31.07.20xx.

Cheque No. 48 - Rs. 7 500
Cheque No. 94 - Rs. 8 600

02. Following cheques have been issued during the month, but they have not been presented to the bank for payment as of 31.07.20xx

Cheque No. 45 - Rs. 11 400
Cheque No. 49 - Rs. 8 600

03. The following items appeared in the bank statement have not been entered in the bank account

- The insurance premium paid by the bank on a standing order of Rs. 8 000.
- The direct remittance of Rs. 8 000 to the bank as dividends of Rs. 4 200.
- Bank charge deducted by the bank Rs. 2 500.

Required,

01. Adjust the bank account.
02. Prepare a bank reconciliation statement as at 31.07.20xx using the adjusted bank account balance.

Activity 04

Following are extracted from the bank account of Jayarathna Silva's business and the bank statement received from the bank as at 31.07.20xx.

Bank Account

Date	Description	L/F	Value Rs.	Date	Description	L/F	value Rs.
01.05.20xx	Balance b/f		16 000	04.05.20xx	Salaries (501)		8 500
06.05	Cash		20 000	09.05	Creditor (502)		17 500
12.05	Cheq. deposited(142)		14 000	18.05	Rent (503)		9 000
24.05	Cheq. deposited (234)		15 000	26.05	Purchases (505)		12 000
29.05	Cheq. deposited (184)		18 000	27.05	Creditor (506)		17 000
				31.05	Balance c/d		19 000
01.06	Balance b/f		83 000				83 000
			19 000				

Bank Statement

Jayarathna Silva
No. 45
Galle.

People's Bank
Galle Branch

Date	Description	Dr. Rs.	Cr. Rs.	Balanced Rs.
01.05.20xx	Balance b/f			16 000
06.05.20xx	Cash deposit		20 000	36 000
10.05.20xx	Cheque Payment(501)	8 500		27 500
12.05.20xx	Cheque Payment (502)	17 500		10 000
14.05.20xx	Cheque deposit (142)		14 000	24 000
15.05.20xx	Standing order (Bank loan)	19 000		5 000
26.05.20xx	Cheque deposit (234)		15 000	20 000
27.05.20xx	Direct remittance by a debtor		8 000	28 000
28.05.20xx	Cheque deposit (505)	12 000		16 000
30.05.20xx	Bank Charges	2 000		14 000

Required

01. State the reasons for the difference between the balances as at 31.05.20xx.
02. Adjust the bank account balance as at 31.05.20xx.
03. Prepare the bank reconciliation statement using the adjusted bank balance.

Activity 05

Assume that the bank has sent a bank statement which includes the transactions carried out through the bank current account in the month of March 20xx. Your verification revealed that the bank account balance is different from the bank statement balance.

01. State the possible reasons for the difference between the bank account balance and the balance of the bank statement.

02. From the above identified reasons, select and list the reasons cause the balance of bank statement exceeds the balance of the bank account.

10 Purchases Journal, Sales Journal and General Journal

The following facts are discussed in this chapter.

10.1 Purchases Journal
- Source documents required to prepare the Purchases Journal
- Posting the items in the Purchases Journal to the ledger accounts

10.2 Sales Journal
- Source documents required to prepare the Sales Journal
- Posting the items in the Sales Journal to the ledger accounts

10.3 General Journal

10.4 Instant cash transactions conducted via technological means

10.1 Purchases Journal

Businesses purchase goods with the objective of reselling. These goods are purchased either on cash basis or on credit basis. Goods purchased on credit basis are recorded in a separate record named as the Purchases Journal. This is also known as the Purchases Day Book.

The purchases of trade goods on credit basis are initially recorded in the Purchase Journal.

Example :-

If a business buys and resells stationeries ,the purchase of stationeries on the credit basis is recorded in the Purchases Journal.

If a business buys and resells automobiles, the purchase of auto mobiles on credit basis is recorded in the Purchase Journal.

When purchasing goods on credit basis, the parties providing goods are known as suppliers or trade creditors. The amount payable to creditors are liabilities of a business. Suppliers, when providing goods on credit, prepare and send a source document including information about supply. This source document is the 'invoice'. In the perspective of the purchasing business, it is the purchase invoice. The information in the purchase invoice is required to be recorded in the Purchases Journal at first. Thereafter, those transactions are posted into the ledger later.

Study the format of the invoice given below.

Invoice No. 120

DESHAN BOOKSHOP
MAIN STREET
DEHIWELA
T.P - 011- 2895942

The Manager
Rashmi Book Shop
Maharagama

With reference to your order No. A/485 dated 01.02.20xx

Serial No.	Description	Quantity	Unit Price - Rs.	Value - Rs.
	Drawing books	40	100	4 000
	CR books	200	130	26 000
	Exercise books	120	60	7 200
				37 200
	Less - 10% Trade discount			3 720
				33 480

(All cheques should be written in favour of Deshan book shop and crossed)

Condition : 5/30 net 60

.....*Nirmal perera*..........
Manager

Figure 10.1

The condition '5/30 net 60' indicates that the purchaser should settle the credit within 60 days and if he/she settles within 30 days, a 5% cash discount will be given.

The trade discount is the reduction in the listed price of a good at the time of purchasing on credit. This trade discount is deducted in the invoice and not recorded in accounts. After deducting the trade discount the net purchase value of an invoice will be recorded in the Purchase Journal.

Study the format of a Purchase Journal given below.

Purchases Journal

Date	Invoice No.	Supplier	Total value Rs.	Ledger Page

Example :-

The following information is of Lihini's business which buys stationeries for reselling.

01.03.20xx The net value of the Invoice No.115, under which goods are bought from Namal is Rs. 22 000.

10.03.20xx The net value of the Invoice No.65, under which goods are bought from Sahan is Rs. 28 000.

20.03.20xx The net value of the Invoice No.43, under which goods are bought from Purnima is Rs. 26 000.

25.03.20xx The net value of the Invoice No.48, under which goods are bought from Purnima is Rs. 12 000.

The Purchases Journal will be prepared as follows.

Purchases Journal

Date	Invoice No.	Supplier	Total Value Rs.	Ledger page
01.03.20xx	115	Namal	22 000	
10.03.20xx	65	Sahan	28 000	
20.03.20xx	43	Purnima	26 000	
25.03.20xx	48	Purnima	12 000	
31.03.20xx		Debited to the Purchases account	88 000	

Posting of transactions recorded in the Purchases Journal to the Ledger.

The total in the Purchases Journal will be debited to Purchases Account. Thereafter, each value will be credited separately to the respective account of the creditor.

The total in the Purchases Journal will be debited to the purchase account. Creditors accounts are liability accounts. Therefore, an increase in the liability is recorded in the credit side of creditors account.

Accordingly, the values recorded in the Purchase Journal will be posted to the ledger as follows.

Dr. Purchases Account Cr.

Date	Description	L.F.	Value Rs.	Date	Description	L.F.	Value Rs.
31.03.20xx	Creditors		88 000				

Dr. Namal's account Cr.

Date	Description	L.F.	Value Rs.	Date	Description	L.F.	Value Rs.
				01.03.20xx	Purchases		22 000

Dr. Sahan's account Cr.

Date	Description	L.F.	Value Rs.	Date	Description	L.F.	Value Rs.
				10.03.20xx	Purchases		28 000

Dr. Purnima's account Cr.

Date	Description	L.F.	Value Rs.	Date	Description	L.F.	Value Rs.
				20.03.20xx	Purchase		26 000
				25.03	Purchase		12 000

Activity 01

Prepare the Purchases Journal with the information given below of Indika's Business and post them into the ledger.

Date	Invoice No.	Supplier	Net value mentioned in the invoice Rs.
06.05.20xx	82	Amaranayaka	15 000
12.05	45	Wijenayaka	18 000
20.05	36	Karunaratna	34 000
26.05	73	Hewavasam	9 000
28.05	94	Abeynayaka	20 000

Activity 02

Prepare the Purchases Journal for the month of May 20xx of Sewwandi's Business using the information given below and post them into the ledger.

Date	Invoice No.	Supplier	Other details
06.05.20xx	65	Piyal	20 packets of photocopy papers at Rs. 200 each (10% trade discount)
12.05.20xx	38	Sunil	30 packets of photocopy papers at Rs. 250 each (5% trade discount)
15.05.20xx	43	Ranil	30 calculators at Rs. 400 each
20.05.20xx	168	Piyal	20 packets of half sheet at Rs. 240 each (10% trade discount)
28.05.20xx	140	Sunil	20 calculators at Rs. 400 each

10.2 Sales Journal

When a business sells trading goods on credit, such transactions are first recorded in the Sales Journal.

When selling trading goods on credit, an invoice is issued to debtors. This document is known as the sales invoice. The business retains a copy of the sales invoice. This sales invoice is the source document for recording transactions in the Sales Journal.

The price mentioned in the invoice may also be reduced by a certain percentage when selling on a credit basis. This reduction is the trade discount. The net value after deducting this trade discount is recorded in the Sales Journal.

The transactions recorded in the Sales Journal are posted into the ledger periodically.

Example :-

The following invoices with net values are issued by Amarasinghe's Business which buys and sells consumer goods.

Date	Invoice No.	Buyer	Value Rs.
02.05.20xx	35	Rathna	5 000
08.05	36	Kumara	12 000
10.05	37	Rathna	8 000
21.05	38	Mahanama	13 000
23.05	39	Indika	17 000
25.05	40	Mahanama	6 000
28.05	41	Indika	7 000

The sales Journal for the month ended at 31.05.20xx can be prepared and posted to the ledger as follows.

Sales Journal

Date	Invoice No.	Buyer	Total Value Rs.	Ledger page
02.05.20xx	35	Rathna	5 000	
08.05	36	Kumara	12 000	
10.05	37	Rathna	8 000	
21.05	38	Mahanama	13 000	
23.05	39	Indika	17 000	
25.05	40	Mahanama	6 000	
28.05	41	Indika	7 000	
31.05 Credited to the sales account			68 000	

Dr. Sales account Cr.

Date	Description	L.F.	Value Rs.	Date	Description	L.F.	Value Rs.
				31.05.20xx	Debtors		68 000

Dr. Rathna's account Cr.

Date	Description	L.F.	Value Rs.	Date	Description	L.F.	Value Rs.
02.05.20xx	Sales		5 000				
10.05	Sales		8 000				

Dr. Kumara's account Cr.

Date	Description	L.F.	Value Rs.	Date	Description	L.F.	Value Rs.
08.05.20xx	Sales		12 000				

Dr. Mahanama's account Cr.

Date	Description	L.F.	Value Rs.	Date	Description	L.F.	Value Rs.
21.05.20xx	Sales		13 000				
25.05	Sales		6 000				

Dr.			Indika's account				Cr.
Date	Description	L.F.	Value Rs.	Date	Description	L.F.	Value Rs.
23.05.20xx	Sales		17 000				
28.05	Sales		7 000				

Activity 03

The following is the file of source documents of Nirmalee's Business.

Nirmalee Traders
Maharagama.

Gayashan Centre
Nugegoda.

No. 1820
Date - 02.03.20xx

Invoice

Serial No.	Description of goods	Quantity	Unit Price Rs.	Value Rs.
01	Television sets	10	15 000	150 000
02	Computers	10	30 000	300 000
				450 000
	Less - 10% trade discount			(45 000)
				405 000

If payment is made before the 30.04.20xx
a 4% discount would be allowed.

Sudesh Karunatilaka
....
Sales Manager

Nirmalee Traders
Maharagama.

Nilooshan Centre, No. 1821
Dehiwela. Date - 16.03.20xx

Invoice

Serial No.	Description of goods	Quantity	Unit Price Rs.	Value Rs.
01	Cassette Recorder	20	3 000	60 000
02	Radio	30	2 000	60 000
				120 000
	Less - 5% Trade discount			(6 000)
				114 000

If the payment is made before the 30.04.20xx
a 4% discount would be allowed.

Sudesh Karunatilaka
Sales Manager

Nirmalee Traders
Maharagama.

Dilshan Centre, No. 1822
Dilkwella. Date - 18.03.20xx

Invoice

Serial No.	Description of goods	Quantity	Unit Price Rs.	Value Rs.
01	Photocopy Machines	08	50 000	400 000
02	Television sets	10	20 000	200 000
				600 000

If the payment is made before the 30.04.20xx
a 4% discount would be allowed.

Sudesh Karunatilaka
Sales Manager

Required :-

01. Prepare the Sales Journal using the following format.

Date	Invoice No.	Customer	Total Value	Ledger page

02. Prepare the respective ledger accounts.

10.3 General Journal

The above sections discussed how to record day-to-day transactions of a business in the Purchase Journal and Sales Journal. These journals are used to record only one type of transaction. Hence, they are known as specialized journals.

Example :-

Sales Journal is used to record only credit sales of trade goods.

There may be some other transactions other than the transactions recorded in those journals. These transactions cannot be recorded in these journals.

Examples :-

- ☆ Purchase of a machine on credit basis to be used in the business.
- ☆ Purchase of a land on credit basis to expand the business activities.
- ☆ Owner uses goods of the business for his own purpose.

These transactions should be recorded in a separate prime entry book. The prime entry book used to record these transactions is known as the General Journal.

Accordingly, transactions that are not recorded in other prime entry books are recorded at first in the General Journal.

The source document used in recording transactions in the General Journal is the journal voucher. A General Journal can be prepared as follows.

General Journal

Date	Voucher No.	Description	Led- ger Page	Dr. Rs.	Cr. Rs.
01	02	03	04	05	06

01. Transaction date
02. Number of the Journal Voucher
03. Accounts to be debited and credited with the narration
04. Respective ledger page numbers of accounts

05. and 06. Value of the transaction

For every transaction recorded in the General Journal, a brief description known as narration is written.

Example :-

Purchase of an equipment on credit for the business use for Rs. 10 000 from Silva and Company Private Limited on 28.02.20xx.

General Journal

Date	Voucher No.	Description	L.P.	Dr. Rs.	Cr. Rs.
28.02.20xx		Equipment account (Dr)		10 000	
		Silva Co. Ltd. account			10 000
		(Recording of equipment bought from Silva and Co. Ltd on credit at a cost of Rs. 10 000)			

There are several transactions that are recorded in a General Journal. Out of these, corrections of accounting errors and adjustment entries are discussed at this level.

10.4 Instant cash transactions through the electronic methods of technology.

The methods of conducting business activities have changed with the development of technology. Today there is a trend of conducting business activities via technological methods. Following are some instances where transactions are conducted using technology.

- Computerised accounting process instead of manual recording in books.
- Use of telephones, text messages and e-mails instead of communicating through letters with customers and suppliers.
- Payment of water bills and electricity bills through the Internet.
- Use of cheques, debit cards and credit cards instead of currency notes and coins.
- Obtain account details and conduct transactions through the Internet without going to the bank.
- Conduct sales through electronic equipment such as point of sales machines.

These transactions conducted using these technologies should also be recorded in the prime entry books and posted to ledger accounts.

Transactions conducted through mobile phones

Spread of mobile phone network all over Sri Lanka has revolutionised the day to day life of everyone. Mobile phones with latest technology has vastly changed the business world as well.

The vastly used mobile phones in Sri Lanka are now used to settle payments in businesses. This mobile based settlement system was first introduced to Sri Lanka by a private telecommunication service provider in 2012.

Figure 10.2

Use of mobile phones makes it easy to conduct business activities. The following are some advantages.

- Ability to communicate information quickly with any party related to the business
- Easy to conduct banking activities via mobile phones
- Easy to obtain required information to take business decisions by browsing Internet through data connection of mobile phones

At present, most banks provide mobile banking facilities to their customers. These services are known as tele banking services. The following tasks can be accomplished using the tele-banking facility.

- Check the bank account balance
- Obtain bank statements
- Payment of electricity bills and water bills
- Transfer of funds from one account to another account
- Place orders for cheque books

Advantages of tele-banking facility

- Ability for businessmen to control their funds without going to the bank at anytime and anywhere.
- Easy to conduct transactions.
- Financial transactions can be fulfiled quickly.
- Save time and effort
- Problems of safety when transporting coins and notes is absent when using the tele-banking facility

Computer Aided Accounting (CAA)

Currently, most businesses have computerised their accounting activities. Accounting data, the input is entered to an accounting software and the required accounting outputs are obtained. The day to day transactions are entered into the computer system. These data is recorded, stored, interpreted and communicated to the stakeholders of a business using computers.

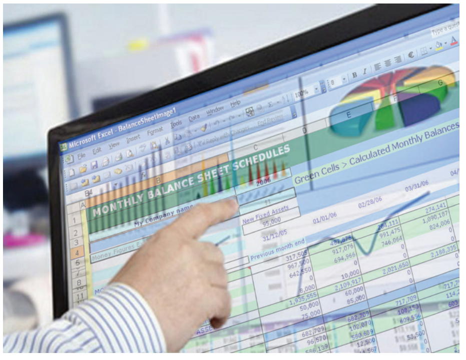


Figure 10.3

At the end of an accounting period, financial statements would be prepared automatically by computers. The following accounting packages are being used at present for this purpose.

- Accpac
- Quickbook
- MyOB
- Sage

Advantages and disadvantages of computerised accounting are as follows.

Advantages

- Time is saved as transactions are quickly recorded in the accounting system and financial reports are automatically prepared.
- Money is saved through reduced labour requirement
- High level of accuracy in accounting reports is possible because those reports are automatically prepared.
- Ability to obtain the relevant data easily and quickly.

Disadvantages

- The risk of deletion of data due to power failures, computer viruses and other technical faults.
- Risk of unauthorized access and changing of computer data
- A large sum of money is required to purchase computer software.

Activity 04

01. List down some advantages of tele banking.

02. It would be beneficial for a business to record transactions using computers rather than recording in books manually. Debate on this statement with your friends.

11 Trial Balance

The following facts are discussed in this chapter.

11.1 Introduction to the trial balance
11.2 Posting transactions from prime entry books to the ledger
11.3 Balancing off of ledger accounts
11.4 Preparation of the trial balance

11.1 Introduction to trial balance

When preparing ledger accounts based on the double entry principles, the value of a transaction is recorded in the debit side of one account and in the credit side of the other relevant account. As a result of this, after balancing off the ledger accounts, there are debit and credit balances. If the transactions are recorded and ledger accounts are balanced correctly the totals of debit and credit balances should be equal. The list which is prepared at the end of the period by including all the debit and credit balances of ledger accounts is called as the trial balance. The trial balance is not an account. It is merely a list of balances and could be considered as a summary of the ledger.

If the debit and credit entries have been recorded correctly in ledger accounts and those accounts have been balanced correctly, the total of the debit column of the trial balance should agree with the total of the credit column of the trial balance.
If the trial balance agrees, following two facts can be confirmed.

1. The values debited to the accounts are equal to the values credited to the accounts
2. Ledger accounts have been balanced correctly (i.e. there is mathematical accuracy).

Following are the balances of accounts of Janakantha's business as at 30.06.20xx who commenced his business on 01.01.20xx

	Rs.
Cash	40 000
Purchases	150 000
Sales	365 000
Debtors	35 000
Creditors	24 000
Insurance charges	6 000
Furniture	20 000
Discounts received	8 000
Discounts allowed	4 000
Motor vehicles	400 000
Rent payments	30 000
Stationery expenses	5 000
12 % Investments	50 000
Investment income	3 000
15 % Bank loan	90 000
Capital as at 01.01.20xx	250 000

The trial balance prepared by including the above balances is shown below.

Janakantha's Business

The trial balance as at 30.06.20xx

Description	L.P.	Debit Rs.	Credit Rs.
Cash		40 000	
Purchases		150 000	
Sales			365 000
Debtors		35 000	
Creditors			24 000
Insurance Charges		6 000	
Furniture		20 000	
Discounts received			8 000
Discounts allowed		4 000	
Motor vehicles		400 000	
Rent payments		30 000	
Stationery expenses		5 000	
12% Investment		50 000	
Investment income			3 000
15% Bank loan			90 000
Capital			250 000
		740 000	740 000

11.2 Posting transactions from prime entry books to the ledger

Transactions that take place in an accounting period are recorded in the prime entry books and thereafter recorded in the ledger accounts. Let us study how to record transactions in prime entry books, how to post transactions to the ledger and how to prepare a trial balance using the balances of the accounts in the ledger.

Example :-

The following are the transactions that had occurred in the month of January, 20xx of Samanala's Business.

Cash receipts and cash payments

01.01.20xx	Started the business by investing Rs. 200 000.
02.01	Purchased goods on cash basis Rs. 85 000.
03.01	Opened a bank current account by depositing Rs. 20 000.

04.01	Obtained a bank loan of Rs. 50 000
05.01	Cash sales Rs. 150 000.
08.01	Payment of shop rent Rs. 2 000.
10.01	Received Rs. 11 600 from Priyani (a debtor). Discount allowed Rs. 400.
12.01	Repayment of bank loan instalment Rs. 3 000.
20.01	Received a cheque worth of Rs. 9 000 from Imasha (a debtor)
25.01	Paid Rs. 7 600 to Surangi (a creditor) and the discount deducted was Rs. 400.
26.01	Received 5% discount when paid money to settle Rs. 12 000 debts of Vijitha (a creditor).

Transactions relevant to the bank current account

08.01.20xx	Purchased goods for sale by issuing a cheque of Rs. 15 000
11.01	Received a cheque amounting to Rs. 6 200 from Priyani and discount deducted was Rs. 300. This cheque was deposited in the bank current account immediately.
18.01	Issued a cheque amounting to Rs. 2 000 for shop rent
27.01	Deposited the cheque received from Imasha on 20.01.20xx in the bank current account.

Transactions relating to credit purchases of trading goods.

06.01.20xx	From Surangi under invoice	No. 45	Rs. 24 000
08.01	From Vijitha under invoice	No. 116	Rs. 20 000

Transactions relating to credit sales of trading goods

05.01.20xx	To Priyani under invoice No. 01	Rs. 19 000
09.01	To Imasha under invoice No. 02	Rs. 25 000

Required

Prepare the following for the month ended 31.01.20xx

01. Cash book with discount columns
02. Bank account with discount columns
03. Purchases Journal
04. Sales Journal
05. Relevant ledger accounts
06. Trial balance as at 31.01.20xx

Cash book

Dr. | Cr.

Date	Description	Discount	Cash	Date	Description	Discount	Cash
01.01.20xx	Capital		200 000	02.01.20xx	Purchases		85 000
04.01	Bank loan		50 000	03.01	Bank		20 000
05.01	Sales		150 000	08.01	Rent		2 000
10.01	Priyani (Debtor)	400	11 600	12.01	Bank loan		3 000
20.01	Imasha (Cheque)		9 000	25.01	Surangi (Creditors)	400	7 600
				26.01	Wijitha (Creditors)	600	11 400
				27.01	Bank (Imasha)		9 000
				31.01	Balance c/d		282 600
		400	420 600			1000	420 600
01.02	Balance b/f		282 600				

Bank account

Dr. | Cr.

Date	Description	Discount	Cash	Date	Description	Discount	Cash
03.01.20xx	Cash		20 000	08.01.20xx	Purchases		15 000
11.01	Priyani (Debtors)	300	6 200	18.01	Rent		2 000
27.01	Cash (Imasha)		9 000	31.01	Balance c/d		18 200
			35 200				35 200
01.02	Balance b/f		18 200				

Purchases journal

Date	Invoice No.	Description	Value Rs.
06.01.20xx	45	Surangi	24 000
08.01	116	Wijitha	20 000
31.01		Debited to purchases account	44 000

Sales journal

Date	Invoice No.	Description	Value Rs.
05.01.20xx	01	Priyani	19 000
09.01	02	Imasha	25 000
31.01		Credited to sales account	44 000

Capital Account

Dr. | Cr.

Date	Description	Value Rs.	Date	Description	Value Rs.
31.01.20xx	Balance c/d	200 000	01.01.20xx	Cash	200 000
		200 000			200 000
			01.02	Balance b/f	200 000

Dr. **Purchases account** Cr.

Date	Description	Value Rs.	Date	Description	Value Rs.
02.01.20xx	Cash	85 000	31.01.20xx	Balance c/d	144 000
08.01	Bank	15 000			
31.01	Creditors	44 000			
		144 000			144 000
01.02	Balance b/f	144 000			

Dr. **Bank loan account** Cr.

Date	Description	Value Rs.	Date	Description	Value Rs.
12.01.20xx	Cash	3 000	04.01.20xx	Cash	50 000
31.01	Balance c/d	47 000			
		50 000			50 000
			01.02	Balance b/f	47 000

Dr. **Priyani (Debtor)** Cr.

Date	Description	Value Rs.	Date	Description	Value Rs.
05.01.20xx	Sales	19 000	10.01.20xx	Cash	11 600
			10.01	Discount	400
			11.01	Bank	6 200
			11.01	Discount	300
			31.01	Balance c/d	500
01.02		19 000			19 000
	Balance b/f	500			

Dr. **Imasha (Debtor)** Cr.

Date	Description	Value Rs.	Date	Description	Value Rs.
09.01.20xx	Sales	25 000	20.01.20xx	Cash	9 000
			31.01	Balance c/d	16 000
		25 000			25 000
01.02	Balance b/f	16 000			

Dr. **Surangi (Creditor)** Cr.

Date	Description	Value Rs.	Date	Description	Value Rs.
25.01.20xx	Cash	7 600	06.01.20xx	Purchases	24 000
25.01	Discount	400			
31.01	Balance c/d	16 000			
		24 000			24 000
			01.02	Balance b/f	16 000

Dr. **Vijitha (Creditor)** Cr.

Date	Description	Value Rs.	Date	Description	Value Rs.
26.01.20xx	Cash	11 400	08.01.20xx	Purchases	20 000
26.01	Discount	600			
31.01	Balance c/d	8 000			
		20 000			20 000
			01.02	Balance b/f	8 000

Dr. **Discount allowed account** Cr.

Date	Description	Value Rs.	Date	Description	Value Rs.
31.01.20xx	Debtors	400	31.01.20xx	Balance c/d	700
31.01	Debtors	300			
		700			700
01.02	Balance b/f	700			

Discount received account

Dr. Cr.

Date	Description	Value Rs.	Date	Description	Value Rs.
31.01.20xx	Balance c/d	1 000	31.01.20xx	Creditors	1 000
		1 000			1 000
			01.02	Balance b/f	1 000

Dr. **Sales account** Cr.

Date	Description	Value Rs.	Date	Description	Value Rs.
31.01.20xx	Balance c/d	194 000	05.01.20xx	Cash	150 000
			31.01	Debtors	44 000
		194 000			194 000
			01.02	Balance b/f	194 000

Dr. **Shop rent account** Cr.

Date	Description	Value Rs.	Date	Description	Value Rs.
08.01.20xx	Cash	2 000	31.01.20xx	Balance c/d	4 000
18.01	Bank	2 000			
		4 000			4 000
01.02	Balance b/f	4 000			

Samanala Business
The trial balance as at 31.01.20xx

Description	L.P.	Dr. Rs.	Cr. Rs.
Cash		282 600	
Bank balance		18 200	
Capital			200 000
Discounts allowed		700	
Discounts received			1 000
Purchases		144 000	
Sales			194 000
Rent		4 000	
Debtors - Priyani		500	
Imasha		16 000	
Creditors - Surangi			16 000
Vijitha			8 000
Bank loan			47 000
		466 000	466 000

Activity 01

Prepare the trial balance using the following balances as at 30.09.20xx of Rosal's business

	Rs.
Debtors	80 000
Fixed deposits	158 000
Creditors	60 000
Discount allowed	4 000
Purchases	250 000
Machinery	120 000
Discount received	9 000
Bank overdraft	15 000
Salaries	20 000
Capital as at 01.01.20xx	200 000
Interest income	8 000
Cash	40 000
Sales	380 000

Activity 02

The following balances were available as at 31.03.20xx of Thisara enterprises, which is engaged in purchasing and selling ready made garments.

	Rs.
Cash in hand	80 000
Bank balance	60 000
Debtors - Pubudu	50 000
- Kumudu	40 000
Capital	150 000
Creditors - Anushka	45 000
- Kanishka	35 000

The transaction occurred in March 20xx are as follows

Credit purchases

Date	Invoice No.	Listed Value Rs.	Other information
05.03.20xx	45 (Anushka)	38 000	Trade discount deducted 10%
08.03	56 (Kanishka)	42 000	-
12.03	48 (Anushka)	34 000	Trade discount deducted 5%
18.03	59 (Kanishka)	25 000	Trade discount deducted 4%

Credit sales

Date	Invoice No.	Other information
07.03.20xx	62 (Pubudu)	20 shirts at Rs. 1 500 each
10.03	63 (Kumudu)	25 trousers at Rs. 2 000 each
15.03	64 (Pubudu)	40 children ware at Rs. 600 each
20.03	65 (Kumudu)	20 sarees at Rs. 1 800 each

The sales policy of the business is to give a 10% trade discount for all credit sales.

Receipts and other related information

Date	Cash Rs.	Cheque Rs.	Other information
02.03 Sales	20 000	5 000	Deposited the cheque immediately in the bank
03.03 From Pubudu	8 500		
06.03 From Kumudu		12 400	This cheque was deposited on 06.03.20xx in the bank current account
07.03 From Pubudu	16 000	12 000	Cheque was deposited on 10.03.20xx in the bank current account
13.03 From Kumudu	8 000		

Payments and related information

Date	Cash Rs.	Cheque Rs.
09.03 To Anushka	-	13 000
10.03 To Kanishka	15 400	-
11.03 Purchases	16 000	14 000
20.03 Salary	8 000	12 000
22.03 To Kanishka		16 000

Required :-

01. Cash book
02. Bank account
03. Purchase journal
04. Sales journal
05. Relevant ledger accounts
06. The trial balance as at 31.03.20xx

12 Correction of Accounting Errors

The following facts are discussed in this chapter.

12.1 The need to correct accounting errors

12.2 The occasions when accounting errors occur

12.3 Identification of accounting errors

12.4 Errors that do not affect the agreement of trial balance

12.5 Accounting errors that affect the agreement of the trial balance

12.1 The need to correct accounting errors

Accounting is expected to provide accurate information to stakeholders in making decisions. However, errors may occur when business transactions are recorded in prime entry books, posted to the ledger, balancing the ledger accounts as well as when extracting accounting balances for the trial balance. If such errors had occurred in the accounting process, correct information cannot be provided to the stakeholders to make decisions. Therefore, such errors should be corrected before the financial statements are prepared.

12.2 The occasions when accounting errors may occur

The occasions when accounting errors may occur is stated below.

01. When transactions are recorded in the prime entry books

Errors may occur when recording transactions in prime entry books.

Examples :-

A sales invoice of Rs. 20 000 of credit sales has not been recorded in the sales journal.

A purchase invoice of Rs. 50 000 has been entered erroneously as Rs. 5 000 in the purchases journal.

02. When the transactions are posted to the ledger from the prime entry books

Errors may occur when transactions are posted to the ledger accounts.

Examples :-

The total of the purchases journal that amounts to Rs. 50 000 has not been posted to the purchases account.

The total of the sales journal that amounts to Rs. 155 000 has been entered erroneously as Rs. 150 000 in the sales account.

03. When balancing of ledger accounts

Errors may arise when balancing ledger accounts at the end of the period.

Examples :-

Total of the sales account has been totalled less by Rs. 10 000
Total of the rent account is overstated by Rs. 5 000

04. When the trial balance is prepared

Errors may occur in the preparation of the trial balance using the balances of the ledger accounts.

Examples :-

The balance of the electricity bill account of Rs. 15 000 has not been extracted to the trial balance.

The balance of the insurance account of Rs. 10 000 has been entered as Rs. 1 000 in the trial balance.

Errors may occur in this way at different stages in the accounting process. Therefore, as the first step, a business should identify such errors.

12.3 Identification of accounting errors

Transactions of a business are recorded according to the double entry principle. Accordingly, every debit entry should have a corresponding credit entry. As a result, the total of the debit column should be equal to the total of the credit column of the trial balance prepared by the business.

If both the totals are not equal, it is an indication that errors have occurred in the accounting process. However, even if the totals agree, still there might be errors. Hence, the agreement of credit and debit balances in the trial balance only confirms that similar value of debits have been recorded as credits and the accounts are balanced.

Accordingly, accounting errors can be categorized in to two.

- Errors that do not affect the agreement of the trial balance
- Errors that affect the agreement of the trial balance

Accordingly, errors should be corrected using the general journal. Thereafter, the erroneous ledger accounts need to be corrected.

Now, let us study how each of the errors mentioned above is corrected.

12.4 Errors that do not affect the agreement of trial balance

Some errors that occur in the accounting process might not affect the agreement of the trial balance. Therefore, even if such errors had occurred, the total of the debit column would be equal to the total of the credit column of the trial balance. These errors are also known as "the errors that are not revealed by the trial balance." Examples for such errors are stated below.

01. A complete ommission of a transaction from the books

If a particular transaction is not recorded in the prime entry book, such a transaction would not be entered in the ledger accounts as well. These errors are known as "errors of omission." The double entry of the omitted transaction should be entered properly in the relevant ledger accounts to correct this error.

Example :-

An invoice of credit purchase Rs. 50 000 has been completely omitted from the accounting books.

The above error is corrected as,

General Journal

Date	Voucher No.	Description	L/F	Dr. Rs.	Cr. Rs.
		Purchases account Dr. Creditor's account (Correction of error of omission of purchase invoice of Rs. 50 000)		50 000	 50 000

02. Recording incorrect value of a transaction in the prime entry books

This refers to recording lesser or higher than the correct value of the transaction in the prime entry books. Then, both the values entered as debit and credit entries have the erroneous value. However, there is no impact on the agreement of the trial balance because both the values recorded as debits and credits are the same. Therefore, recording the difference between the correct and incorrect value that was recorded is sufficient to correct the error.

Example :-

A credit sales invoice of Rs. 20 000 has been recorded as Rs. 2 000 in error in the sales journal.

Here, both the debtor's account and the sales account have been understated by Rs. 18 000 (Rs. 20 000 - Rs. 2 000) and therefore, both accounts should be corrected by recording Rs. 18 000. The journal entry to correct this error is as follows.

General Journal

Date	Voucher No.	Description	L/F	Dr. Rs.	Cr. Rs.
		Debtor's account Dr.		18 000	
		Sales account			18 000
		(Correction of under statement of sales and debtor's account by Rs. 18 000)			

Example :-

The discount received of Rs. 1 500 from a creditor has been recorded as Rs. 1 300 in the discount received column of the cash book.

Here, both creditors and the discount received accounts have been recorded less by Rs. 200 (Rs. 1 500 - Rs. 1 300) and should be adjusted in both accounts.

General Journal

Date	Voucher No.	Description	L.P.	Dr. Rs.	Cr. Rs.
		Creditor's account Dr.		200	
		Discount received account			200
		(Correction of the recording less of Rs. 200 in creditor's and discount received accounts)			

03. Recording same transaction twice in the accounting books

Sometimes, a transaction might have been recorded twice in the prime entry books, and accordingly, posted to ledger accounts twice. This error can be corrected by reversing the additional entry with the value of the transaction in both of the relevant accounts.

Example :-

Purchase invoice of Rs. 10 000 on credit has been entered twice in the books.

General Journal

Date	Voucher No.	Description	L/F	Dr. Rs.	Cr. Rs.
		Creditor's account Dr. Purchases account (Correction of recording a purchase invoice of Rs. 10 000 on credit twice in the accounts)		10 000	 10 000

04. Recording the value of a transaction in an incorrect account instead of the relevant account

There are occasions when the value of a transaction is recorded in an incorrect account instead of the relevant account. However, there is no impact on the agreement of the trial balance due to this error, as the same value had been recorded as both debit and credit entries.

Example :-

Office equipments that had been purchased for the business use for Rs. 200 000 is debited in the purchases account.

The purchases account shows the value of the goods bought for the purpose of resale by the business. Here, the office equipment were purchased only for the business use, and therefore, it should be debited to the asset account known as the office equipment account.

General Journal

Date	Voucher No.	Description	L/F	Dr. Rs.	Cr. Rs.
		Office equipments Dr. Purchases account (The correction of recording Rs. 200 000 worth of office equipment that was purchased for the business use, which was erroneously recorded in the purchases account)		200 000	 200 000

Activity 01

An apprentice bookkeeper has prepared a trial balance on 31-12-20xx and says that it is not necessary to check again the accounts as both the balances of debit and credit columns of the trial balance agree, as well as the final accounts can be prepared correctly.

Comment on the above statement.

Activity 02

Even though the totals of the trial balance prepared by a business as at 31-12-20xx agree, the following errors were identified subsequently.

i. A purchase invoice of Rs. 20 000 has been completely omitted from the books of accounts.

ii. A computer bought for office use to the cost of Rs. 40 000 has been debited to the purchases account.

iii. Payment of electricity charges of Rs. 5 000 has been erroneously debited to the Insurance charges account.

iv. Withdrawals of goods worth of Rs. 12 000 by the owner for his own use has not been recorded in the books.

Required:

Write the necessary journal entries to correct of the above errors.

12.5 Accounting errors that affect the agreement of the trial balance

A difference would arise between the total of debit and credit columns of a trial balance due to certain errors that had occurred in the process of accounting. These errors are known as the errors which affect the agreement of the trial balance. The ledger accounts should be checked to identify what such errors are. However, it would take a considerable amount of time to detect such errors. Therefore, such a difference should be posted to a suspense account until those errors are identified and corrected.

Suspense account

When there is a difference between the totals of debit and credit balances in the trial balance, that difference should be recorded temporarily into an account called the Suspense account until such errors are identified and corrected.

A suspense account is created in the following way.

i. Identify the difference between the totals of the debit and credit balances of the trial balance.

ii. Insert that difference on the side where the deficit exists in the trial balance and balance the trial balance.

iii. As the reason for this shortage is not known yet write the words "Suspense account" in front of the difference in the trial balance.

iv. Then, record the value of the shortage in a separate Suspense account.

Accordingly, if a difference exists on the credit column of the trial balance, record such difference on the credit side of the suspense account. On the other hand, if the difference exists on the debit column of the trial balance insert such difference on the debit side of the suspense account.

The trial balance as at 31^{st} of December 20xx of Janaka's business is given below. It has been balanced temporarily by writing Suspense account in front of the difference of the trial balance.

Janaka's Business
Trial balance as at 31.12.20xx

Accounts	Dr. Rs.	Cr. Rs.
Cash account	50 000	
Transport expense account	11 000	
Sales account		350 000
Purchase account	130 000	
Capital account		360 000
Motor vehicle account	520 000	
Bank loan account		190 000
Drawings account	24 000	
Equipment account	140 000	
Electricity expense	20 000	
Suspense account	5 000	
	900 000	900 000

The difference of the above trial balance should be recorded in a suspense account as follows.

Dr. Suspense account Cr.

Date	Description	L/F	Value Rs.	Date	Description	L/F	Value Rs.
	The difference in the trial balance		5 000				

Activity 03

Following are the totals of the debit and the credit balances of the trial balance prepared as at 31.03.20xx for Naveen's business.

Total of the debit column - Rs. 545 000
Total of the credit column - Rs. 520 000

Find the value of the difference and record it in a suspense account.

Correction of accounting errors that affect the agreement of trial balance

The reason or reasons for the difference in the trial balance should be identified after recording the difference in a suspense account. Therefore, certain entries have to be made in the suspense account to correct the errors. The suspense account will be eliminated from the books of accounts after the correction of all accounting errors that affect the agreement of the trial balance. Therefore, when such errors are corrected one of the double entries for the correction should be entered in the suspense account.

Let us now consider the errors that are revealed by the trial balance and how such errors are corrected.

01. Omission of one entry from books

Example :-

Payment of telephone charges of Rs. 15 000 has been recorded only in the cash book.

Here, the relevant value is not debited to the telephone charges account. Therefore, the telephone charges account should be debited to correct this error. On the other hand, the cash book is already credited correctly. The total of the debit column of the trial balance is less by Rs. 15 000 due to this error. As a result, a debit balance of Rs. 15 000 appears in the suspense account. Accordingly, the relevant general journal entry to correct this error is shown below, credit entry of Rs. 15 000 should be made to correct this in the suspense account.

Figure 12.1

General Journal

Date	Voucher No.	Description	L/F	Dr. Rs.	Cr. Rs.
		Telephone charges account Dr. Suspense account (Correction of the ommision of the telephone charges of Rs. 15 000 in the telephone charges account)		15 000	15 000

02. Making one of the double entries with the correct value and the other entry with the incorrect value of a transaction.

Example :-

Cash sales for Rs. 54 000 has been debited in the cash book correctly and has been credited incorrectly as Rs. 45 000 in the sales account.

Here, the sales account has been credited less of Rs. 9 000. Due to crediting Rs. 9 000 less in the sales account, the total of credit column of the trial balance is Rs. 9 000 less and a balance of Rs. 9 000 would appear in the credit side of the suspense account. To correct the error, the suspense account should be debited with Rs. 9 000 and the sales account should be credited Rs. 9 000. By doing this, the suspense account will be removed.

Figure 12.2

The relevant general journal entry to correct this error is as follows

General Journal

Date	Voucher No.	Description	L/F	Dr. Rs.	Cr. Rs.
		Suspense account Dr.		9 000	
		Sales account			9 000
		(Correction of sales account by Rs. 9 000, which was recorded less erroneously)			

03. Recording of the double entries of a transaction in the same side of the accounts

Both the entries of a transaction may have been entered in the same side of the accounts in error.

Example :-

Cash received from the debtors of Rs. 5 000 has been debited to both the cash book and the debtor's account.

Due to the above error, each account has been debited by Rs. 5 000. No account has been credited. Therefore, the total of the credit column of the trial balance is understated by Rs. 10 000. Therefore, the suspense account has a credit balance of Rs. 10 000. Accordingly, Rs. 10 000 should be debited to cancel the suspense account. Rs. 5 000 should be credited to the debtor's account to cancel the amount debited incorrectly. In addition, Rs. 5 000 should be credited to the debtor's account to correct the error. Accordingly, the debtors account should be credited a total of Rs. 10 000 to correct the error. The general journal entry is shown below.

Figure 12.3

General Journal

Date	Voucher No.	Description	L/F	Dr. Rs.	Cr. Rs.
		Suspense account Dr.		10 000	
		Debtors account			10 000
		(Correction of the erroneous debiting of Rs. 5 000 in the debtor's account for the receipt of cash to the debtors account)			

04. Errors which arise when balancing off the accounts

Example :-

The correct total of the purchases account of Rs. 25 000 has been erroneously totalled posted as Rs. 5 000 in the purchases account.

The total of the debit column of the trial balance is Rs. 20 000 less due to the shortage of Rs. 20 000 in the purchase account. Therefore, the suspense account has a debit balance of Rs. 20 000. Rs. 20 000 should be credited to the suspense account to cancel this balance. The purchase account should be debited by Rs. 20 000 to correct the purchase account as it is understated by Rs. 20 000.

Figure 12.4

General Journal

Date	Voucher No.	Description	L/F	Dr. Rs.	Cr. Rs.
		Purchases account Dr. Suspense account (Correction of erroneous total of Rs. 5 000 in the purchase account for the correct value of Rs. 25 000)		20 000	 20 000

05. Errors that arise when preparing the trial balance

Although all ledger accounts are correct, there is the possibility of errors to occur when preparing the trial balance.

Following errors may occur when preparing the trial balance,

- Certain accounts balances have not been extracted to the trial balance
- Entering incorrect values of account balances in the trial balance
- Entering value of account balances to the incorrect column of the trial balance

Errors that occur when the trial balance is prepared have a special feature in correction when compared with other errors. Here, no error has occurred in the relevant ledger accounts. The errors had occurred only in the trial balance. Therefore, correction of ledger accounts is not required. Nevertheless, the difference in the totals of the trial balance have to be recorded in the suspense account.

Example :-

The balance in the building rent expense account of Rs. 10 000 has not been extracted to the trial balance.

Here, as there is no impact on the building rent expense account, it is not necessary to correct it. However, the suspense account has a debit balance due to the debit column of the trial balance being understated by Rs. 10 000. Therefore, the error of understatement can be cancelled by crediting Rs. 10 000 to the suspense account and entering the building rent expense account to the trial balance.

Figure 12.5

General Journal

Date	Voucher No.	Description	L/F	Dr. Rs.	Cr. Rs.
		Suspense account (Correction of the error for not extracting the building rent expense account balance to the trial balance)			10 000

Figure 12.6

When correcting errors that affect the agreement of the trial balance, one entry is recorded in the suspense account and the other entry is recorded in the relevant ledger account.

However, when correcting the errors which do not affect the agreement of the trial balance, only the two accounts which are affected should be identified and corrected, and no entries are required in the suspense account.

Example :-

The trial balance prepared as at 31st of December 20xx by Kasuni's business did not balance. That trial balance is given below.

Kasuni's Business
trial balance as at 31-12-20xx

Description	Dr. Rs.	Cr. Rs.
Cash account	56 000	
Telephone charges account	5 000	
Sales Account		300 000
Purchases account	150 000	
Capital account		400 000
Land and building account	500 000	
Bank loan account		200 000
Drawings account	34 000	
Furniture and equipment account	130 000	
Interest income account	10 000	
Suspense account	15 000	
	900 000	900 000

The following accounting errors have been identified,

01. The balance of the electricity bill account of Rs. 16 000 has not been extracted to the trial balance.

02. The balance of the interest income account of Rs. 10 000 has been entered in the debit column of the trial balance.

03. Repayment of bank loan of Rs. 30 000 has been recorded only in the cash book.

04. The balance of the purchases account of Rs. 130 000 has been entered in the trial balance as Rs. 150 000 in error.

05. The drawings account has been balanced erroneously as Rs. 34 000, instead of the correct value of Rs. 43 000.

The correction of above errors of Kasuni's business can be explained as follows.

01. The total of debit column of the trial balance has been understated by Rs. 16 000 due to not entering the balance of the electricity bill account. Therefore, Rs. 16 000 should be included in the debit column of the trial balance and credited to the suspense account.

02. Interest income account is an income account and should be shown on the credit column of the trial balance. Therefore, the credit column total of the trial balance is in short of Rs. 20 000 because of entering the interest income account balance of Rs. 10 000 in the debt column of the trial balance. Accordingly, Rs. 20 000 should be entered in the credit column of the trial balance and the suspense account should be debited with this value.

03. When the part of the bank loan is repaid, the bank loan account should be debited. However, the bank loan account is not debited with repayment of Rs. 30 000. Accordingly, the bank loan account is overstated by Rs. 30 000. Further, as a result, the credit column of the trial balance is overstated by Rs. 30 000 and is therefore included in the suspense account. Therefore, to correct this error, the bank loan account should be debited and the suspense account should be credited with Rs. 30 000.

04. The total of the debit column of the trial balance is overstated by Rs. 20 000 due to entering the purchase account balance as Rs. 150 000 instead of the correct value of Rs. 130 000. This error has to be corrected.

05. The total of the debit column of the trial balance has been understated by Rs. 9 000 due to the understatement in the drawings account by Rs. 9 000. Therefore, Rs. 9 000 should be credited to the suspense account and debited to the drawings account.

The journal entries to correct accounting errors explained above are shown below.

General journal

Date	Voucher No.	Description	L/F	Dr. Rs.	Cr. Rs.
		Suspense account (correction of not extracting the balance of the electricity bill account of Rs. 16 000 to the trial balance)			16 000
		Suspense account Dr. (Correction of extracting the balance of Rs. 10 000 of the interest income account to the debit column of the trial balance)		20 000	
		Bank loan account Dr. Suspense account (Correction of not debiting the loan repayment of Rs. 30 000 to the bank loan account)		30 000	30 000
		Suspense account Dr. (Correction of recording of the purchases account balance as Rs. 150 000 erroneously, instead of Rs. 130 000)		20 000	
		Drawings account Dr. Suspense account (Correction of understating the total of the drawings account by Rs. 9 000)		9 000	9 000

The suspense account prepared based on the above correction entries is as follows,

Dr. Suspense account Cr.

Date	Description	E/P	Value Rs.	Date	Description	E/P	Value Rs.
	The difference in trial bal.		15 000		....		16 000
	....		20 000		Bank loan account		30 000
	....		20 000		Drawings account		9 000
			55 000				55 000

Activity 04

The trial balance prepared as at 31 of December 20xx of Samitha's business did not tally. The difference of the trial balance of Rs. 5 500 was credited to the suspense account. On subsequent examination, the following errors were found.

01. Total of the telephone charges account is understated by Rs. 5 000.

02. Payment of building repair expense of Rs. 30 000 has been correctly credited to the cash account, but it has been debited to building account in error.

03. A cheque issued for purchases of Rs. 45 000 of trade stocks has been correctly recorded in the bank account, but it has been debited to the purchases account as Rs. 54 000.

04. The balance of the salary account of Rs . 5 000 has been extracted to the trial balance as Rs. 500.

05. The total of the sales account has been understated by Rs. 6 000.

Required :-

1. Write the journal entries for the correction of the above errors.
2. Write-up the suspense account.

Activity 05

The total of the debit column of the trial balance of a business exceeds the total of the credit column by Rs 8 000.

Later, following errors were revealed.

i. Insurance premium paid of Rs 5 600 has been debited in the insurance account as Rs. 6 500.

ii. Rent received of Rs. 9 000 has been debited only in the cash book.

iii. The cash drawings of Rs. 1 500 is recorded only in the cash book.

iv. The debit entry for the cash payment of Rs. 7 500 for the loan repayment has not been made.

v. Balance of the salary account Rs. 7 100 has not been extracted to the trial balance.

Required :-

1. Journal entries for the correction of the above errors.
2. Suspense account.

Activity 06

The trial balance prepared for Dinithi's business as at 31.12.20xx did not balance and the difference was posted to a suspense account. Later the reasons were found and corrected by passing journal entries.

Following suspense account is prepared by the accounts clerk when the errors were corrected.

Dr. Suspense account Cr.

Date	Description	L/F	Value Rs.	Date	Description	E/P	Value Rs.
	Sales account		11 000		Office equipment acc.		10 000
	Insurance account		2 000		Wages account		5 000
					Purchases account		4 000

Answer the following questions.

1. What was the difference in the trial balance before these corrections were made?
2. Which column of the trial balance is understated?
3. If the total of the debit column of the trial balance is Rs. 25 455 before the difference is entered in the suspense account, what should have been the total of the credit column?
4. List out possible errors that might have occurred in the ledger accounts of this business. Get the help of your friend in answering this question.

Activity 07

The totals of the debit and the credit columns of the trial balance which was prepared for Sanduni's business as at 31.12.20xx did not tally. The difference was posted to a suspense account and the following errors were identified later.

01. Machine repair expense of Rs. 20 000 has been debited to the machine account.

02. The total of the purchase account has been overstated by Rs. 5 000.

03. Payments of electricity bill of Rs. 7 000 has been debited as Rs. 700 in the electricity charges bill account.

04. Payment of telephone charges of Rs. 8 000 has been recorded as Rs. 10 000 in the telephone charges account and interest income received Rs. 16 000 has been credited in the interest income account as Rs. 18 000.

05. Withdrawal of goods by the owner for his personal use has been debited twice in the drawings account.

06. A credit sale of goods for Rs. 25 000 has been completely omitted from the books.

07. Additional capital of Rs. 60 000 invested by the owner has been debited to the cash account and credited to the sales account.

08. Travelling expenses of Rs. 250 in the petty cash book (total of the travelling expense column) has not been entered in the travelling expense account.

Required :-

01. List the errors and give the journal entries for the correction of errors above that do not affect the agreement of the trial balance.

02. Write-up the suspense account and find the difference which had existed between the totals of the trial balance.