

1.13 TERMINAL QUESTIONS

- 1 **Define** Accounting and explain its scope.
- 2 **What** are the objectives of Accounting? Name the different parties **interested** in accounting information **and** state why they want it.
- 3 Write notes on:
 - a) Advantages of Accounting
 - b) Branches of Accounting
 - c) Accounting Process
 - d) Types of Accounts
- 4 **Briefly** explain **the** accounting concepts which guide the accountant at the recording stage.
- 5 **What** do you understand by Dual Aspect Concept? Explain its accounting implications.

Note: These questions will help you to understand the unit better. Try to write answers for them. But do not submit your answers to the University. These **are** for your practice only.

UNIT 2 THE ACCOUNTING PROCESS

Structure

- 2.0 Objectives
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2.0 OBJECTIVES

After studying this unit you should be able to:

- explain what a journal is
- describe how different types of transactions will be recorded in the journal
- post journal entries in the concerned ledger accounts
- balance a ledger account and explain the significance of balances in different types of accounts
- prepare a trial balance to test the arithmetical accuracy of recording in the books of account
- explain what an opening entry is and how it is posted into ledger

2.1 INTRODUCTION

In Unit 1 you learnt that the accounting process involves four stages: (i) recording the transactions, (ii) classifying the transactions, (iii) summarising the transactions, and (iv) interpreting the results. Thus, you are aware that all transactions are recorded first in the books of original entry viz., Journal, and then posted into the concerned accounts in the ledger. You have also learnt the basic accounting concepts to be observed at the recording stage and the rules of debit and credit. With the help of these rules we shall discuss in this unit how various transactions are recorded in the Journal and how they will be posted into the concerned ledger accounts, We shall also explain how to balance different accounts and prepare a Trial Balance in order to test the arithmetical accuracy of the books of account.

2.2 JOURNAL

Journal is a daily record of business transactions. It is also called a 'Day Book' and is used for recording all day to day transactions in the order in which they occur. It is a book of prime entry (also called book of original entry) because all transactions are recorded first in this book. The process of recording a transaction in the journal is called 'Journalising' and the entries made in this book are called 'Journal Entries'. The proforma of Journal is given in Figure 2.1.

Date	Particulars	L. F.	Dr. Amount	Cr. Amount
			Rs.	Rs.

The Journal is divided into five columns. The first column is used for writing the date of the transaction. It is customary to write the year at the top of the column only once and then in the next line the month and date are written.

The second column called 'Particulars' column, The names of the two accounts affected by the transaction are to be recorded in this column. The **name** of the account to be debited is written first. The abbreviation '**Dr.**' for debit is also written against the name of the account to be debited. It is written on the same line very close to the L. F. column. In the next line, the name of the account to be credited is written. It is always preceded by the word 'To'. It is not necessary to write '**Cr.**' against the name of the account to be credited. In the next line, a brief description of the transaction is also given within brackets. It is called 'Narration'. After writing the narration a line is drawn in the particulars column to separate one entry from the other.

The third column L. F. (Ledger Folio) is meant for writing the page number of the ledger where the concerned account appears. This column is filled at the time of posting into the ledger. The fourth and the fifth columns are meant for recording the amounts with which the two accounts have been affected, The amount to be debited is entered in the debit amount column against the name of the account debited, and the amount to be credited is entered in the credit amount column against the name of the account credited. Both the amounts will always be equal.

Let us take a transaction and see how it will be recorded in the Journal.

Purchased Machinery for **Rs.10,000** on May **1,1988**

In this transaction, the two accounts affected are Machinery Account and Cash Account. You know both are real accounts. According to rules relating to real accounts, the Machinery Account is to be debited and the Cash Account is to be credited. The entry will be made in the Journal as follows

Date	Particulars	L.F.	Dr. Amount	Cr. Amount
1988 May 1	Machinery Account Dr. To Cash Account (Being machinery purchased)	22*	Rs. 10,000	Rs. 10,000

*Imaginary figure.

2.2.1 Transactions Relating to Goods

The term goods refer to articles which are traded by the firm **i.e.**, articles bought for resale. For example, for a book-seller books are goods, for an electrical store fans and other electrical items are goods, for a furniture dealer table and chairs are goods. Articles bought for using them in business are not to be treated as goods. They may be fixed assets or consumables and are to be treated as such in books of account.

The transactions relating to goods include purchases, sales, purchases returns and sales returns. Normally, as per rules, when **goods** are bought you will debit the Goods Account and when they are sold you will credit the Goods Account. Similarly, when goods are returned by your customer you will debit the Goods Account and when you return goods to the suppliers, you **will** credit the Goods Account. In other words, for all transaction relating to goods you will **maintain** only one account viz., Goods Account. **But, in practice, five separate account are maintained, as shown below:**

- i) Purchases Account—for recording all purchases of goods
- ii) Sales Account—for recording all sales of goods

- iii) Returns Onwards Account or Purchases Returns Account—for recording goods returned to suppliers
- iv) Returns Inwards Account or Sales Returns Account—For recording goods returned by customers
- v) Stock Account—for goods in stock (unsold goods) as at the end of the year

Thus, when goods are purchased you will debit the Purchases Account and when they are sold you will credit the Sales Account. Similarly, when goods are returned by your customers you will debit the Returns Inwards Account (or Sales Returns Account) and when you return goods to the suppliers you will credit Returns Outwards Account (or Purchases Returns Account). There will be no Goods Account at all. This helps in ascertaining the amount of purchases and sales more quickly and correctly.

2.2.2 Receipts and Payments by Cheque

You must be aware that most of the payments in business are made by cheques these days. This involves the bank where the firm has opened its account. Hence, when payment is made by cheque, you will credit the Bank Account because bank is the giver. Similarly, when payment is received by cheque, the amount will be debited to the Bank Account because cheque is deposited in the bank who is the receiver.

2.2.3 Transactions with the Proprietor

You have learnt that the business and its proprietor are treated as separate entities. This implies that separate accounts must be maintained in the ledger for recording transactions between the proprietor and the business. Usually, two accounts viz., Capital Account and Drawings Account are maintained for this purpose. Whatever the proprietor brings into the business is treated as his capital and credited to his Capital Account. Similarly, when he withdraws cash from the business for his personal use, he is to be debited with the amount withdrawn by him. Such a debit is given to his Drawings Account. Drawings Account is also debited when the proprietor takes goods from business for domestic use. Note that the proprietor can be charged only by the cost of goods taken and not its selling price. In practice, the cost of such goods are credited to the Purchases Account because it is assumed that it was purchased for him and should therefore be excluded from the purchases for the business.

Look at Illustration 1 and study how various transactions are recorded in the Journal.

Illustration 1

Journalise the following transactions in the journal of Krishna.

1988			Rs.
Jan.	1	Commenced business with cash	10,000
"	2	Paid into Canara Bank	1,000
"	4	Goods purchased for cash	2,000
"	6	Bought furniture and paid by cheque	500
"	9	Bought goods from Anand	5,000
"	10	Sold gbods for cash	4,000
"	16	Sold goods to Sunil	1,000
"	20	Sold goods for cash to Anil	1,500
"	29	Drew cash for private expenses.	500
"	31	Paid salaries	300

Solution:

JOURNAL

Date	Particulars	L. F.	Dr. Amount	Cr. Amount
1988 Jan. 1	Cash Account Dr. To Capital Account (Being capital brought in)		Rs 10,000	Rs. 10,000
" 2	Bank Account Dr. To Cash Account (Being cash deposited into bank)		1,000	1,000

Date	Particulars	L. F.	Dr. Amount	Cr. Amount
1988			Rs.	Rs.
Jan, 4	Purchases Account Dr. To Cash Account (Being purchases of goods for cash)		2,000	2,000
" 6	Furniture Account Dr. To Bank Account (Being furniture purchased and paid by cheque)		500	500
" 9	Purchases Account Dr. To Amand's Account (Being goods bought on credit)		5,000	5,000
" 10	Cash Account Dr. To Sales Account (Being goods sold for cash)		4,000	4,000
" 16	Sunil's Account Dr. To Sales Account (Being goods sold on credit)		1,000	1,000
" 20	Cash Account Dr. To Sales Account (Being goods sold for cash)		1,500	1,500
" 29	Drawings Account Dr. To Cash Account (Being cash withdrawn for personal use)		500	500
" 31	Salaries Account Dr. To Cash Account (Being payment of salaries)		300	300

Note: The following explanations with regard to some transactions will help you to understand their journal entries,

Jan. 1: The credit has been given to Capital Account because Krishna, the proprietor of the business, brought cash into the business.

Jan. 2: Cash deposited in Canara Bank implies that a bank account has been opened for the business. Any money deposited in the bank is debited to Bank Account and any withdrawal from the bank is to be credited to Bank Account.

Jan. 4: When goods are purchased you would normally debit Goods Account as goods come in. But as explained, purchases of goods are debited to Purchases Account since no Goods Account is to be maintained.

Jan. 6: Furniture is not goods for this business. It is a fixed asset and hence debited to Furniture Account and not the Purchases Account. Since the payment has been made by cheque which leads to withdrawal from the bank, the amount has been credited to Bank Account.

Jan. 10: When goods are sold you would normally credit the Goods Account as goods go out. But, as explained earlier, sales of goods are credited to Sales Account since no Goods Account is to be maintained.

Jan. 29: Any amount withdrawn by the proprietor for personal use is treated as drawings by the proprietor and hence debited to Drawings Account.

2.2.4 Transactions Relating to Cash Discount

There are two types of discounts allowed to customers: (i) trade discount, and (ii) cash discount. Trade discount is a reduction in selling price allowed at the time of sale. The buyer pays only the net price and the recording in books is made for the net amount only. No entry is made in books for the trade discount. Cash discount, on the other hand, is a reduction in the net amount due. It is allowed only if the customer makes payment before the due date. Cash discount must be recorded in the books of account. This is because when goods were sold to the customer his account was debited with the net amount due. Later, when he makes the payment and is allowed some cash discount, it must be adjusted in his personal account so that his account stands cleared.

When cash discount is allowed to the debtor, it is a loss to the business. So, it is debited to the Discount Allowed Account and credited to the personal account of the debtor. Similarly, when cash is paid to the creditor (the party from whom goods had been purchased on credit) he may also allow some cash discount to the business. Such discount will be a gain to the business. So, it is credited to the Discount Received Account and debited to the personal account of the creditor. The entries relating to cash discount will be illustrated under Compound Journal Entry (Section 2.2.5).

2.2.5 Compound Journal Entry

Sometimes, two or more transactions of the same nature may occur on the same day. In such a situation instead of passing a separate entry for each transaction we may pass a single journal entry, known as Compound Journal Entry. For example, on May 5, 1988 you sold goods on credit to Ram for Rs. 600 and to Shyam for Rs. 800. Both of these transactions took place on the same day (May 5, 1988) and are of the same nature (credit sale of goods). You can pass compound entry for both the transactions as follows:

		Rs.	Rs.
Ram's Account	Dr.	500	
Shyam's Account	Dr.	800	
To Sales Account			1,300
(Being goods sold on credit to them)			

A compound Journal entry can also be passed for a transaction which involves more than two accounts. For example, paid cash to Ramesh Rs. 950 and he allowed Rs. 50 as discount. This transaction involves three accounts : (i) Ramesh's Account, (ii) Cash Account, and (iii) Discount Received Account. As per rules, Ramesh's Account is to be debited with Rs. 1,000 (Rs. 950 for cash and Rs. 50 for discount), Cash Account is to be credited with Rs. 950, and Discount Received Account is to be credited with Rs. 50. You can pass the following compound journal entry for this transaction :

		Rs.	Rs.
Ramesh's Account	Dr.	1,000	
To Cash Account			950
To Discount Received Account			50
(Being cash paid to him, discount received Rs. 50)			

In practice, a compound journal entry is recorded when

- i) one account is to be debited and two or more accounts are to be credited, or
- ii) two or more accounts are to be debited and one account is to be credited, or
- iii) two or more accounts are to be debited and two or more accounts are to be credited.

2.2.6 Transactions Relating to Bad Debts

When a debtor becomes insolvent, the business shall not be able to realise the full amount due from him. A part of it remains unrealized. The unrealised amount is called 'bad debts'. For example, Rs, 2,000 was due from Kaushal for the goods sold to him on credit. He became insolvent and only Rs. 1,200 could be realised from him. The remaining amount of Rs. 800 will be treated as bad debts. It is a loss to the business and so debited to Bad Debts Account and credited to the personal account of the debtor. The journal entry for the above transaction will be:

		Rs.	Rs.
Cash Account	Dr.	1,200	
Bad Debts Account	Dr.	800	
To Kaushal's Account			2,000
(Being Kaushal became insolvent and only Rs.1,200 could be recovered)			

If any amount treated as bad debts is recovered later, on, it shall be a gain to the business. Hence, it shall be credited to Bad Debts Recovered Account and debited to Cash Account. Note that the bad debts so recovered shall not be credited to the personal account of the debtor because his account had already been closed. In the example given above, suppose Rs. 800 is recovered from Kaushal later on, the journal entry will be:

		Rs.	Rs.
Cash Account	Dr.	800	
	To Bad Debts Recovered Account		800
	(Being bad debts recovered)		

Look at illustration 2 and note how journal entries for transactions of February 18, 25, 27 and 29 have been made.

Illustration 2

Record the following transactions in the Journal of Sunil Kumar.

1988		Rs.
Feb. 1	Commenced business with cash	70,000
" 2	Paid into Bank	40,000
" 4	Furniture purchased from Keshav	2,000
" 5	Goods purchased for cash	10,000
" 6	Sold goods to Santosh	5,000
" 9	Bought goods from Harish	10,000
" 10	Paid for cartage	50
" 12	Paid for postage	60
" 13	Goods returned by Santosh	500
" 15	Goods returned to Harish	1,000
" 17	Goods sold for cash	5,000
" 18	Paid to Keshav	1,900
	He allowed discount	100
" 20	Sold goods to Akash	2,000
" 25	Received from Santosh	4,300
	Allowed him discount	200
" 27	Cash drawn for personal use	1,000
" 27	Paid to Harish by cheque	9,900
	He allowed us discount	100
" 28	Paid rent by cheque	2,500
" 28	Paid salaries	4,000
" 29	Gkash becomes insolvent and only Rs. 1500 could be realised from him	
" 29	An old debt written off as bad in 1987 is recovered	2,000

Solution:

Journal				
Date	Particulars	L.F.	Dr. Amount	Cr. Amount
1988 Feb. 1	Cash A/c Dr. To Capital A/c (Being business commenced with cash)		Rs. 70,000	Rs. 70,000
" 2	Bank A/c Dr. To Cash A/c (Being cash paid into bank)		40,000	40,000

"		Furniture A/c To Keshav (Being furniture bought on credit)	Dr.	2,000	2,000	The Accounting Profess
"	5	Purchases A/c To Cash A/c (Being goods purchased for cash)	Dr.	10,000	10,000	
"	6	Santosh To Sales A/c (Being goods sold on credit)	Dr.	5,000	5,000	
"	9	Purchases A/c To Harish (Being goods purchased on credit)	Dr.	10,000	10,000	
"	10	Cartage A/c To Cash A/c (Being cartage paid)	Dr.	50	50	
"	12	Postage A/c To Cash A/c (Being postage paid)	Dr.	60	60	
"	13	Returns Inwards A/c To Santosh (Being goods returned by Santosh)	Dr.	500	500	
"	15	Harish To Returns Outwards A/c (Being goods returned to Harish)	Dr.	1,000	1,000	
"	17	Cash A/c To Sales A/c (Being goods sold for cash)	Dr.	5,000	5,000	
"	18	Keshav To Cash A/c To Discount A/c (Being cash paid and discount received)	Dr.	2,000	1,900 100	
"	20	Akash To Sales A/c (Being goods sold on credit)	Dr.	2,000	2,000	
"	25	Cash A/c Discount A/c To Santosh (Being cash received and discount allowed)	Dr. Dr.	4,300 200	4,500	
"	27	Drawings A/c To Cash A/c (Being cash withdrawn for personal use)	Dr.	1,000	1,000	
"	27	Harish To Bank A/c To Discount A/c (Being payment made by cheque and discount received)	Dr.	10,000	9,900 100	
"	28	Rent A/c To Bank A/c (Being rent paid by cheque)	Dr.	2,500	2,500	
"	28	Salaries A/c To Cash A/c (Being salaries paid)	Dr.	4,000	4,000	
"	29	Cash A/c Bad Debts A/c To Akash (Being Akash became insolvent and only Rs. 1,500 could be recovered)	Dr. Dr.	1,500 500	2,000	
"	29	Cash A/c To Bad Debts Recovered A/c (Being the amount treated as bad debts in 1987, now recovered)	Dr.	2,000	2,000	

Note: In this illustration you will notice that

- a) Instead of writing full word 'Account' its abbreviation 'A/c' has been used against the names of the accounts debited and credited. This is a common practice. In fact the latest trend is not to write anything, just the name of the account is enough.
- b) The word Account or its abbreviation 'A/c' has not been written against personal names. This again is a common practice. Writing 'A/c' is confined to the real and nominal accounts only.

Check Your Progress A

1 What is Journal?

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2 What is the purpose of writing narration?

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3 Name the five accounts which are maintained in lieu of Goods Account.

- i)
- ii)
- iii)
- iv)
- v)

4 Distinguish between trade discount and cash discount.

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5 Indicate the correct alternative in the following cases by putting a **tick** at the number:

- a) Sale of goods to **Rakesh** for cash should be debited to
 - i) **Rakesh's** Account
 - ii) Cash Account
 - iii) Sales Account
- b) Purchase of machinery should be debited to
 - i) Machinery Account
 - ii) Goods Account
 - iii) Equipment Account
- c) Goods returned by **Mahesh** should be debited to
 - i) **Goods** Account
 - ii) **Mahesh's** Account
 - iii) **Returns** Inwards Account

- d) Wages paid to **Rahim** should be debited to
 - i) **Rahim's** Account
 - ii) Wages Account
 - iii) Repairs Account
- e) Loan taken from Vikas should be credited to
 - i) Vikas's Account
 - ii) Cash Account
 - iii) Loan from Vikas Account
- f) Cash discount allowed by a creditor should be credited to
 - i) Creditors Account
 - ii) Discount Received Account
 - iii) Allowance Account
- g) The amount of bad debts should be debited to
 - i) Debtor's Account
 - ii) Bad Debts Account
 - iii) Discount Account
- h) Rupees 500 received from **Gopal** whose account was previously written off as bad debts should be credited to
 - i) **Gopal's** Account
 - ii) Bad **Debts** Account
 - iii) Bad Debts Recovered Account

2.3 LEDGER

You know that the Journal is just a chronological record of all business transactions. It does not provide all information regarding a particular item at one place. This makes it difficult to know the net effect of various transactions affecting a particular item. For example, if you want to know the amount due to a particular supplier or the amount due from a particular customer, you will have to go through the whole journal. To overcome this difficulty, we maintain another book called 'Ledger'. In this book we open separate accounts for each item and all transactions **related** to a particular item as recorded in journal are posted in the concerned account. For example, all transactions related to a particular supplier, say Mohan, are posted to Mohan's Account. Similarly, all cash payments and cash receipts can be posted to Cash Account. Thus, you will have no problem in knowing the amount due to Mohan or the balance in Cash Account, and so on.

Thus, ledger is a book where all accounts relating to different items are maintained and into which all journal entries must be posted. In fact, ledger is the principal book of entry which provides complete information about various transactions relating to all parties and all items of asset, incomes and expenses. Some persons have even suggested that we should record all transactions directly into ledger and do away with Journal. But, it is not advisable because in that case we will not have any date-wise record of the transactions and the details thereof. Such record is considered necessary for future reference.

You learnt about the "T" **form** of an account which divides it into two parts. The left hand side is called the debit side and the right hand side the credit side. The proper **form of** a ledger account is **given in** Figure 2.2.

Figure 2.2 : LEDGER

Name of the Accopnt							
Dr.				Cr.			
Date	Particulars	F	Amount	Date	Particulars	F	Amount
			Rs.				Rs.

You will notice that both sides of the account have date, particulars, folio and amount columns. Now, let us see how postings are made into the ledger accounts.

2.3.1 Posting into Ledger

The journal entries form the basis for recording in the ledger accounts, and the process of entering transaction in the ledger is called 'Posting'. When a journal entry has to be posted in the concerned ledger accounts, the following procedure is adopted.

- 1 Every journal entry will have to be posted into all those accounts which have been debited and credited in the journal entry. For example, for cash sales, Cash Account is debited and Sales Account is credited in the journal. When this entry is posted in the ledger, it must be posted in Cash Account as well as in Sales Account.
- 2 Posting will be made on the debit side of the account which has been debited in the journal, and the credit side of the account which has been **credited** in the journal. In case of the above example of cash sales, posting will be made on the debit side of Cash Account, as it has been debited in journal and the credit side of Sales Account, as it had been credited in the journal.
- 3 Whether the posting is made on the debit side or the credit side, first of all the date of the transaction (as given in the journal) will be entered in the date column. The method of recording the date in the ledger account is the same as in the journal.
- 4 While posting on the debit side of an account in the particulars column, we shall write the name of the account which had been credited in the journal and add the word 'To' before the **name**. **Similarly**, while posting on the credit side of an account, we shall write the name of the account which **has** been debited in the journal and add the word 'By' before the name. In case of the above example, we shall write 'To Sales **A/c**' in the particulars column on the debit side of Cash Account, and 'By Cash **A/c**' in the Particulars Column on the credit side of the Sales Account.
- 5 The journal entries contain 'narration'. But it is not required in the ledger accounts. Similarly, there is no need to draw a line between the two entries in an account as is done in the journal. Note that posting in the ledger account is considered complete only when both the debit and the credit aspects of all journal entries have been posted.
- 6 In the folio column, we shall mention the page number of the journal where concerned journal entry appears. At the same time, the page number of the ledger accounts will be entered in the 'L. F.' column in the journal so as to complete the cross reference.
- 7 The amount involved in the journal entry shall be entered in amount columns of both the accounts.

Now let us **take** a transaction, journalise it, and then show how the posting is done in the ledger.

Purchased machinery for cash, Rs. 50,000 on April 4, 1988: This transaction will appear in the journal and the ledger as under :-

JOURNAL

Date	Particulars	L.F	Dr. Amount	Cr. Amount
1988 April 4	Machinery A/c To Cash A/c (Being machinery purchased)	Dr.	Rs. 50,000	Rs. 50,000

LEDGER

Machinery Account

Dr.				Cr.			
Date	Particulars	F	Amount	Date	Particulars	F	Amount
1988 Apr. 4	To Cash A/c		Rs. 50,000				

Cash Account

Date	Particulars	F	Amount	Date	Particulars	F	Amount
				1988 Apr. 4	By Machinery A/c		Rs. 50,000

2.3.2 Balancing Ledger Accounts

Whenever one wants to know the net effect of various **transactions** in a particular account, we have to work out its balance. Balance is the difference between the totals of the debit and the credit side of an account. The process of finding out the balance is known as **balancing**. The procedure for balancing is as follows:

- Total the two sides of an account.
- Find out the difference between the totals of **the two** sides.
- Put **the** difference in the amount column of **the** side showing less total.
- If** the difference is entered on the debit side, write against it in the particulars column 'To Balance **c/d**' (**c/d** stands for carried down). In case the difference is entered on the credit side, write against it in the particulars column 'By Balance **c/d**'.
- Now, total both the sides and you will find that both the totals are **equal**.
- The closing balance (balance **c/d**) is going to be **the** opening balance for the subsequent period. The opening balance is shown on the next date in the account by writing 'To Balance **b/d**' (**b/d** stands for brought down) or 'By Balance **b/d**' as the case may be. Note that if the closing balance was on the debit side, the opening balance would be shown **on** the credit side and if the closing balance was shown on the credit side, the opening balance would be shown on the debit side. In fact, an account is said to have a debit **balance** if its debit side total is bigger and a credit balance if its credit side total is bigger. Thus, the opening balance is shown according to the **nature** of the balance **i.e.**, the debit balance on the debit side and the credit balance on the credit side.
- Sometimes** the totals of the debit side and the credit side of an account are equal. It implies that the account has nil balance. In such a situation the account is said to have closed having no closing and opening balances.

Look at **Illustration 3** and study how various transactions have **been** recorded in the Journal, posted into various accounts in the ledger, and how ledger **accounts** are balanced.

Illustration 3

Journalise the following transactions, post them into ledger and balance the accounts.

	1987		Rs.
Dec.	1	Anil commenced business with cash	1,00,000
"	2	Purchased goods from Prakash	30,000
"	2	Purchased furniture for cash	7,000
"	3	Goods sold to Prem	6,000
"	4	Sold goods to Ramlal	5,000
"	5	Goods purchased from Ramesh for Cash	5,000
"	7	Paid wages	100
"	11	Sold goods to Ashok	8,000
"	13	Ashok returned goods	500
"	14	Received from Ram Lal in full settlement	4,950
"	15	Stationery purchased for cash	400
"	17	Goods sold to Arun for cash	4,000
"	20	Withdrew for personal use	1,000
"	22	Paid to Prakash	20,000
"	23	Sold goods to Prem	2,000
"	25	Received from Prem	5,000
"	26	Cash sales	8,000
"	27	Paid for interest	500
"	28	Received from Ashok	7,000
"	29	Paid rent	2,000
"	30	Paid salaries for the month	3,000
"	31	Prem becomes insolvent and a dividend of 50 paise in the rupee is received.	

Solution:

JOURNAL

Date	Particulars	L. .	Dr. Amount	Cr. Amount
1987 Dec. 1	Cash A/c To Capital A/c (Being capital brought in) Dr.		Rs. 1,00,000	Rs. 1,00,000
" 2	Purchases A/c To Prakash (Being goods purchased on credit) Dr.		30,000	30,000
" 2	Furniture A/c To Cash A/c (Being furniture purchased for cash) Dr.		7,000	7,000
" 3	Prem To Sales A/c (Being goods sold on credit) Dr.		6,000	6,000
" 4	Ram Lal To Sales A/c (Being goods sold on credit) Dr.		5,000	5,000
" 5	Purchases A/c To Cash A/c (Being goods purchased for cash) Dr.		5,000	5,000
" 7	Wages A/c To Cash A/c (Being wages paid) Dr.		100	100

"	11	Ashok To Sales A/c (Being goods sold on credit)	Dr.	8,000	8,000
"	13	Returns Inwards A/c To Ashok (Being goods returned by him)	Dr.	500	500
"	14	Cash A/c Discount A/c To Ram Lal (Being cash received in full settlement of his account)	Dr. Dr.	4,950 50	5,000
"	15	Stationery A/c To Cash A/c (Being stationery purchased)	Dr.	400	400
"	17	Cash A/c To Sales A/c (Being goods sold for cash)	Dr.	4,000	4,000
"	20	Drawings A/c To Cash A/c (Being cash withdrawn for personal use)	Dr.	1,000	1,000
"	22	Prakash To Cash A/c (Being cash paid to Pmkash)	Dr.	20,000	20,000
"	23	Prem To Sales A/c (Being goods sold on credit)	Dr.	2,000	2,000
"	25	Cash A/c To Prem (Being cash received from Prem)	Dr.	5,000	5,000
"	26	Cash A/c To Sales A/c (Being goods sold for cash)	Dr.	8,000	8,000
"	27	Interest A/c To Cash A/c (Being interest paid)	Dr.	500	500
"	28	Cash A/c To Ashok (Being cash received)	Dr.	7,000	7,000
"	29	Rent A/c To Cash A/c (Being rent paid)	Dr.	2,000	2,000
"	30	Salaries A/c To Cash A/c (Being salaries paid)	Dr.	3,000	3,000
"	31	Cash Account Bad Debts Account To Prem (Being a dividend of 50 paise in a rupee received from Prem)	Dr. Dr.	1,500 1,500	3,000

The Accounting Process

Notes:

- Transaction on December 14: Ram Lal paid Rs. 4,950 in full settlement of Rs. 5,000 due from him on account of the goods sold to him on December 4. It implies that Rs. 50 (Rs. 5000- Rs. 4,950) was allowed to him as cash discount,
- Transaction on December 30 : Prem becomes insolvent. The firm could recover only 50 paise in a rupee i.e., 50% of the amount due, Goods worth Rs. 8,000 were sold to him (Rs. 6,000 on December 3 and Rs. 2,000 on December 23). He paid Rs. 5,000 on December 25 leaving a balance of Rs. 3,000. Of this, the firm could recover Rs. 1,500 (50% of Rs. 3,000). The remaining amount of Rs. 1,500 has been treated as bad debts.

Cash Account

Dr.

Cr.

1987			Rs.	1987			Rs.
Dec. 1	To capital A/c		1,00,000	Dec. 2	By Furniture A/c		7,000
" 14	To Ram Lal		4,950	" 5	By Purchases A/c		5,000
" 17	To Sales A/c		4,000	" 7	By Wages A/c		100
" 25	To Prem		5,000	" 15	By Stationery A/c		400
" 26	To Sales A/c		8,000	" 20	By Drawings A/c		1,000
" 28	To Ashok		7,000	" 22	By Prakash		20,000
" 30	To Prem		1,500	" 27	By Interest A/c		500
				" 29	By Rent A/c		2,000
				" 30	By Salaries A/c		3,000
				" 31	By Balance c/d		91,450
			1,30,450				1,30,450
1988							
Jan. 1	To Balance b/d		91,450				

Purchases Account

1987			Rs.	1987			Rs.
Dec. 2	To Prakash		30,000	Dec. 31	By Balance c/d		35,000
" 5	To Cash A/c		5,000		By Ba		
			35,000				35,000
1988							
Jan. 1	To Balance b/d		35,000				

Furniture Account

1987			Rs.	1987			Rs.
Dec. 2	To Cash A/c		7,000	Dec. 31	By Balance c/d		7,000
1988							
Jan. 1	To Balance b/d		7,000				

Wages Account

1987			Rs.	1987			Rs.
Dec. 7	To Cash A/c		100	Dec. 31	By Balance c/d		100
1988							
Jan. 1	To Balance b/d		100				

Returns Inwards Account

1987			Rs.	1987			Rs.
Dec. 13	To Ashok		500	Dec. 31	By Balance c/d		500
1988							
Jan. 1	To Balance b/d		500				

Prem's Account

1987			Rs.	1987			Rs.
Dec. 3	To Sales A/c		6,000	Dec. 25	By Cash A/c		5,000
" 23	To Sales A/c		2,000	" 31	By Cash A/c		1,500
				" 31	By Bad Debts A/c		1,500
			8,000				8,000

Sales Account

1987			Rs.	1987			Rs.
Dec. 31	By Balance c/d		33,000	Dec. 3	By Prem		6,000
				" 4	By Ram Lal		5,000
				" 11	By Ashok		8,000
				" 17	By Cash A/C		4,000
				" 23	By Prem		2,000
				" 26	By Cash A/c		8,000
			33,000				33,000
				1988			
				Jan. 1	By Balance b/d		33,000

Capital Account

1987			Rs.	1987			Rs.
Dec. 31	To Balance c/d		1,00,000	Dec. 1	By Cash A/c		1,00,000
			1,00,000				1,00,000
				1918			
				Jnn. 1	By Balance b/d		1,00,000

Prakash's Account

1987.			Rs.	1987			Rs.
Dec. 22	To Cash A/c		20,000	Dec. 2	By Purchases A/c		30,000
" '31	To Balance c/d		10,000				
			30,000				30,000
				1988			
				Jan. 1	By Balance b/d		10,000

Ram Lal's Account

1987			Rs.	1987			Rs.
Dec. 4	To Sales A/c		5,000	Dec. 14	By Cash A/c		4,950
			5,000	Dec. 14	By Cash A/c		4,950
				" 14	By Discount		
			5,000				5,000

Ashok's Account

1987			Rs.	1987			Rs.
Dec. 11	To Sales A/c		8,000	Dec. 13	By Returns		
					Inwards A/c		500
				" 28	By Cash A/c		7,000
				" 31	By Balance C/d		500
			8,000				8,000
1988							
Jan. 1	To Balance b/d		500				

Discount Allowed Account

1987			Rs.	1987			Rs.
Dec. 14	To Ram Lal		50	Dec. 31	By Balance c/d		50
1988							
Jan. 1	To Balance b/d		50				

The Accounting Process

Stationery Account

1987	Dec. 15	To Cash A/c		Rs.	1987	Dec. 31	By Balance c/d	Rs.
		To Cash A/c		400				400
1988	Jan. 1	To Balance b/d		400				

Drawings Account

Dec. 20	To Cash A/c		1,000	Dec. 31	By Balance c/d		Rs.
							1,000
Jan. 1	To Balance b/d		1,000				

Interest Account

1987	Dec. 27	To Cash A/c		Rs.	1987	Dec. 31	By Balance c/d	Rs.
		To Cash A/c		500				500
1988	Jan. 1	To Balance b/d		500				500

Rent Account

1987	Dec. 29	To Cash A/c		Rs.	1987	Dec. 31	By Balance c/d	Rs.
		To Cash A/c		2,000				2,000
1988	Jan. 1	To Balance b/d		2,000				

Salaries Account

1987	Dec. 30	To Cash A/c		Rs.	1987	Dec. 31	By Balance c/d	Rs.
		To Cash A/c		3,000				3,000
1988	Jan. 1	To Balance b/d		3,000		31		

Bad Debts Account

1987	Dec. 30	To Prem			1987	Dec. 31	By Balance c/d	Rs.
		To Prem						1,500
1988	Jan. 1	To Balance b/d						

Note: Nominal accounts like Wages Account, Discount Account, Stationery Account, etc. and the accounts relating to purchases, sales and returns of goods are not to be balanced. As per rules, they are simply closed by transfer to the Trading and Profit and Loss Account at the time of preparing the final accounts. In the above illustration, however, they have been balanced for the purpose of preparing the Trial Balance which is being discussed in the next section,

2.3.3 Significance of Balances

You have learnt that the 'balance' in an account signifies the net effect of all transactions related to it during a given period. It may be a debit balance or a credit balance or a nil balance depending upon whether the debit or the credit total is higher. Let us now understand the significance of a balance in respect of the various types of accounts in the ledger.

Personal Accounts: Personal accounts are more frequently balanced as compared to any other class of accounts. Balance in a personal account indicates whether the party concerned

owes to thk business or the business is owing to him. When it shows a debit balance, it means that the party owes that amount to the business and he is a debtor to the business. Similarly, when it shows a credit balance, it would mean that the business owes that amount to him and he is a creditor of the business. If, however, the account shows a nil balance, it means that the account has been cleared, nothing is due to him or due from him.

Real Accounts: Real accounts are **normally** balanced at the end of the accounting period primarily for the purpose of preparing the final accounts. The Cash Account, however, is balanced everyday because the actual cash is to be verified and confirmed with the closing balance shown by Cash Account. All real accounts **show** a debit balance as these are assets (property) accounts.

Nominal Accounts: Nominal accounts are not to be balanced. They are simply closed by transfer to the Trading and Profit and Loss Accounts, at the time of preparing the final accounts. However, for the **purpose** of understanding the procedure involved, nominal accounts have also been balanced. Even otherwise, the difference between the debit side and credit side totals have to be worked out for preparing the Trial Balance. Note that the accounts which relate to expenses or losses will show a debit balance; whereas those **relating** to incomes and gains will have a credit balance. This is because all expenses and losses are debited and all incomes and gains are credited.

Check Your Progress B

- 1 State whether each of the following statements is True or False.
- i) Ledger is the principal book of entry.

ii) Process of journalising is called posting.

iii) Posting will be made on the debit side of the account that had been debited in the Journal

iv) The word 'By' is written before the name of an account in the particulars column while posting on the credit side of an account

v) Writing narration is necessary while posting into ledger accounts

vi) Real accounts always show debit balances

2 Why do you balance an account?

What do you mean by a debit balance of an account?

2.4 TRIAL BALANCE

After posting the journal entries into the ledger and balancing all accounts, we prepare a statement called Trial Balance. This statement shows the balances of all the accounts which appear in the ledger. The debit balances are shown in one column and the credit balances in the other. It is usually prepared just before **preparing** the final accounts. **The** purpose is to check the arithmetical accuracy of the books of account.

You know that under the Double Entry System for every debit there is an equal and corresponding credit. So, the total of debits given to different accounts must be equal to the

total of credits given to different accounts. Similarly, the total of debit balances in different accounts must be equal to the total of credit balances in different accounts. Now if the Trial Balance tallies i.e., the total of its debit balances column is equal to the total of its credit balances column, it would mean that both the aspects of each transaction have been correctly recorded in the ledger. If, however, the two totals do not tally it implies that some errors have been committed while posting the transactions into ledger.

There are two methods of preparing the Trial Balance: (i) Totals Method, and (ii) Balances Method. Under the first method we show the totals of each side of an account in the Trial Balance. The debit side total of an account is shown in the debit column of the Trial Balance and the credit side total of the account in the credit column. Under the second method we show only the balances of each account in the Trial Balance. The second method is more convenient and commonly used because it eliminates all those accounts which have nil balance.

Now, let us prepare the Trial Balance from the ledger accounts prepared. Under Illustration 3 you will notice that all the accounts which appear in the ledger have been included and their balances entered in the appropriate column. The total of debit balances column in the Trial Balance is equal to the credit balances column. This means that all postings have been correctly made in different ledger accounts.

Trial Balance as on December 31,1987

S. No.	Name of Account	L.F.	Dr. Balance	Cr. Balance
			Rs.	Rs.
1	Cash Account		91,450	
2	Capital Account			1,00,000
3	Furniture Account		7,000	
4	Purchases Account		35,000	
5	Sales Account			33,000
6	Prakash's Account			10,000
7	Wages Account		100	
8	Returns Inwards Account		500	
9	Ashok's Account		500	
10	Discount Account		50	
11	Stationery Account		400	
12	Drawings Account		1,000	
13	Interest Account		500	
14	Rent Account		2,000	
15	Salaries Account		3,000	
16	Bad Debts Account		1,500	
	Total		1,43,000	1,43,000

25, OPENING ENTRY

When an accounting year begins, the previous year's balances in different accounts are brought forward to the new books of account. This is done by means of a journal entry—all assets accounts are debited and all liabilities accounts (including the proprietor's capital account) are credited. In case the Capital Account balance is not given, it can be calculated by deducting the other liabilities from the total assets. This will be clear from Illustration 4.

Illustration 4

Ashok has the following balances on December 31, 1987: Cash in hand Rs. 5,000; Debtors Rs. 7,200 (Ramesh Rs. 6,000; Lalwani Rs. 1,200); Stock of goods Rs. 18,800; Machinery Rs. 8,000; Furniture Rs. 3,000; Creditors Rs. 1,500 (Ravi & Co.) ; Bank Loan Rs. 3,000. Pass the opening entry on January 1,1988.

JOURNAL

Date	Particulars	L.F.	Dr. Amount	Cr. Amount
1988			Rs.	Rs.
Jan. 1	Cash Account Dr.		5,000	
	Ramesh Dr.		6,000	
	Lalwani Dr.		1,200	
	Stock Account Dr.		18,800	
	Machinery Account Dr.		8,000	
	Furniture Account Dr.		3,000	
	To Ravi & Co.			1,500
	To Bank Loan Account			3,000
	To Capital Account			37,500
	(For the balance brought forward from the previous year)			

Posting the Opening Entry into Ledger: The posting of an Opening entry into ledger is slightly different from the posting of other journal entries. We have to open the accounts for all items that appear in **the** opening entry. Then, in the accounts which **have been** debited in opening entry, we shall write 'To **Balance b /f**' on their debit side, and in the account which have been credited in the opening entry, we shall write 'By Balance **b/f**' on their credit side. The date, folio and amount columns are completed in the usual manner. As a matter of fact, the **accounts** which have been debited and credited through the opening entry merely represent the closing balances of various personal and real accounts **from** the **previous** year. **The posting** of the opening entry as given in Illustration 4 will be made as follows:

Cash Account

	Dr.				Cr.
1988		Rs.			
Jan. 1	To Balance b/f	5,000			

Ramesh's Account

1988		Rs.			
Jan. 1	To Balance b/f	6,000			

Lalwani's Account

1988		Rs.			
Jan. 1	To Balance b/f	1,200			

Stock Account

1988		Rs.			
Jan. 1	To Balance b/f	18,800			

Machinery Account

1988		Rs.			
Jan. 1	To Balance b/f	8,000			

Furniture Account

1988		Rs.			
Jan. 1	To Balance b/f	3,000			

Ravi & Co.'s Account

			1988		Rs.
			Jan. 1	By Balance b/f	1,500

Bank Loan Account

			1988		Rs.
			Jan. 1	By Balance b/f	3,000

Capital Account

			1988		Rs.
			Jan. 1	By Balance b/f	37,500

2.6 LET US SUM UP

Journal is a book of original entry wherein all business transactions are recorded in a chronological order. The journal shows the accounts to be debited and those to be credited in respect of each transaction. The journal does not provide all information regarding a particular item at one place. Hence, we maintain another book called Ledger. In this book we open separate accounts for each item. An account has two sides, the debit side and the credit side. When an account is balanced, it shows the net effect of all transactions relating to that account during a given period. Before preparing a summary in the form of final accounts, a statement called Trial Balance is prepared to check the arithmetical accuracy of posting into Ledger. This statement shows the balances of all the accounts and if the total of debit balances tally with the total of credit balances it is assumed that the transactions have been correctly recorded in the ledger.

2.7 KEY WORDS

- Bad Debt: The amount of debt which is irrecoverable.
- Cash Discount: An allowance given by the creditor to the debtor for making prompt payment of the amount due from him.
- Cheque: An instrument used for withdrawing money from the bank.
- Compound Entry: A journal entry involving more than two accounts.
- Drawings: Amount withdrawn by the proprietor from the business for personal use.
- Insolvent: A person who is not in a position to, pay his debts in full and is so declared by the Court.
- Opening Entry: A journal entry passed at the beginning of the year to bring forward the previous year's assets and liabilities.
- Posting: The process of entering transactions into the ledger accounts.
- Returns Inwards; Goods returned by customers i.e., sales returns.
- Returns Outwards: Goods returned to suppliers i.e., purchase returns.
- Stock: Goods lying unsold with the business. It also includes unused raw materials and the stock for semi-finished goods.

Trade Discount: An **allowance** given by the seller to the buyer on the list price at the time of sale.

Good: Articles bought for resale and usually traded by the business unit.

2.8 SOME USEFUL BOOKS

1 Maheshwari, S.N., 1986. *Introduction to Accounting*, Vikas Publishing House: New Delhi. (Chapters 3,4)

2 Patil, V.A. and J.S. Korlahalli, 1986. *Principles and Practice of Accounting*, R. Chand & Co., New Delhi. (Chapters 4,5)

3 Gupta R.L. and M. Radhaswamy 1986. *Advanced Accountancy*, Sultan Chand & Sons: New Delhi. (Chapter 3)

2.9 ANSWERS TO CHECK YOUR PROGRESS

A 3 Purchases Account, **Sales** Account, Purchases Returns Account, Sales Returns Account and Stock Account.

- 5 (a) ii (b) i (c) iii (d) ii
- (e) iii (f) ii (g) ii (h) iii

- B 1 (i) True (ii) False (iii) True
- (iv) **True** (v) **False** (vi) True

2.10 TERMINAL QUESTIONS/EXERCISES

Questions

- 1 “Ledger is said to **be** the principal **book** of entry and the transactions can even **be** directly entered into the ledger account.” Elaborate on the statement and explain why Journal is necessary.
- 2 **What** does balancing **an** account mean? Explain how an account **is** balanced?
- 3 What is the significance of debit and credit **balance** in different types of accounts?
- 4 What do you **understand** by **an** opening entry? How is an opening entry posted into the ledger?
- 5 What is Trial Balance? Explain how it is prepared?

Exercises

- 1 Journalise the following transactions :

1988	Rs.
Jan. 1 Mohan commenced business with cash	1,00,000
” 2 Paid into bank	50,000
” 3 Purchased goods for cash	10,000
” 4 Bought furniture from Karim for cash	3,000
” 5 Sold goods for cash	2,000
” 8 Sold goods to Rakesh	4,000
” 10 Paid cartage	50
” 11 Purchased goods from Sunil	6,000
” 15 Purchased stationery	100
” 18 Received commission	50

Jan. 20	Received from Rakesh	3,900
	Allowed him discount	100
" 25	Returned goods to Sunil	500
" 28	Paid to Sunil in full settlement	5,450
" 30	Paid rent by cheque	1,000
" 30	Paid wages	2,000
" 31	Paid salaries	5,000

2 Journalise the following transactions:

1988		Rs.
Jan. 1	Gopal Rao commenced business with cash	60,000
" 2	Bought a building	20,000
" 4	Purchased furniture from Lalaji on credit	2,000
" 5	Purchased goods for cash	15,000
" 6	Sold goods to Ranga Rao on credit	5,000
" 6	Sold goods to Augustine & Co. on credit	8,000
" 8	Purchased goods from Manohar Singh on credit	5,000
" 9	Goods returned by Ranga Rao	1,000
" 15	Goods returned to Manohar Singh	500
" 17	Purchased goods from Krishna Rao	20,000
" 20	Purchased investments	10,000
" 25	Paid to Manohar Singh	4,500
" 26	Received from Augustine by cheque	7,000
" 27	Amount drawn for personal use by the proprietor	500
" 27	Stationery purchased	400
" 28	Paid to Lalaji in full settlement of his account	1,950
" 30	Salaries paid to clerk	1,200
" 30	Electricity charges paid	200
" 31	Ranga Rao became insolvent, Received final composition of 50 paise in a rupee.	

Hint: You can pass a compound journal entry for sales made to Ranga Rao and Augustine & Co. on January 6, 1988.

3 For the following transactions, pass journal entries, prepare ledger accounts and balance them.

1987		Rs.
Dec. 1	Nagender commenced business with cash	2,00,000
" 2	Bought building	30,000
" 3	Bought machinery	40,000
" 4	Purchased typewriter for cash	5,000
" 6	Purchased stationery	200
" 7	Goods purchased from Mahender	15,000
" 9	Goods sold for cash	10,000
" 10	Goods returned to Mahender	500
" 11	Goods sold to Rameswar	5,000
" 12	Goods purchased from Mahender for cash	5,000
" 13	Goods returned by Rameswar	1,000
" 14	Received from Rameswar	4,000
" 16	Amount paid to Mahender	5,000

Dec. 20	Amount drawn for personal use of Nagender	1,000
" 22	Telephone bill paid	600
" 24	Municipal taxes paid	200
" 26	Goods sold for cash	6,000
" 27	Advertisement expenses paid	400
" 28	Paid for printing & stationery	500
" 30	Salaries paid to sales girls	2,000
" 31	Commission received	500

- 4 **Journalise** the following transactions, enter them in the Ledger and prepare the Trial Balance.

1988		Rs.
Jan. 1	Siva Prasad started business with	2,50,000
" 2	Bought buildings	1,00,000
" 2	Deposited into bank	1,00,000
" 3	Purchased furniture and paid by cheque	50,000
" 4	Purchased stationery	250
" 5	Purchased goods on credit from Balaji & Co.	25,000
" 6	Purchased goods on cash	15,000
" 7	Sold goods to Venkateswara & Co.	20,000
" 8	Sold goods on cash	5,000
" 9	Goods returned by Venkateswara & Co.	2,000
" 11	Goods returned to Balaji & Co.	1,500
" 13	Purchased goods from Vivekananda & Co.	20,000
" 15	Sold goods to Balaji & Co.	10,000
" 16	Repairs paid	2,000
" 18	Goods returned by Balaji & Co.	500
" 20	Paid to Balaji & Co. by cheque	14,000
" 22	Goods returned to Vivekananda & Co.	2,000
" 25	Paid to Vivekananda & Co.	14,000
" 27	Cash received from Venkateswara & Co.	10,000
" 28	Municipal taxes paid	1,000
" 30	Salaries paid	5,000
" 30	Telephone charges paid	450
" 30	Electricity bills paid	500

(Answer : Total of Trial Balance Rs. 2,92,500)

Note: These questions and exercises will help you to understand the unit better. Try to write answers for them. But do not send your answers to the University. These are for your practice only.