

ACCOUNTANCY

HIGHER SECONDARY – FIRST YEAR

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Untouchability is a sin
Untouchability is a crime
Untouchability is inhuman



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PREFACE

The book on Accountancy has been written strictly in accordance with the new syllabus framed by the Government of Tamil Nadu.

As curriculum renewal is a continuous process, Accountancy curriculum has undergone various types of changes from time to time in accordance with the changing needs of the society. The present effort of reframing and updating the curriculum in Accountancy at the Higher Secondary level is an exercise based on the feed back from the users.

This prescribed text book serves as a foundation for the basic principles of Accountancy. By introducing the subject at the higher secondary level, great care has been taken to emphasize on minute details to enable the students to grasp the concepts with ease. The vocabulary and terminology used in the text book is in accordance with the comprehension and maturity level of the students.

This text would serve as a foot stool while they pursue their higher studies. Since the text carries practical methods of maintaining accounts the students could use this for their career.

Along with examples relating to the immediate environment of the students innovative learning methods like charts, diagrams and tables have been presented to simplify conceptualized learning.

As mentioned earlier, this text serves as a foundation course which is coupled with sample questions and examples. These questions and examples serve for a better understanding of the subject. **Questions for examinations need not be restricted to the exercises alone.**

Chairperson

SYLLABUS

1. **Introduction to Accounting** *[14 Periods]*
Need and Importance – Book-keeping – Accounting – Accountancy, Accounting and Book-keeping – Users of accounting information – Branches of accounting – Basic accounting terms.
2. **Conceptual Frame work of Accounting** *[7 Periods]*
Basic assumptions – Basic concepts – Modifying principles – Accounting Standards.
3. **Basic Accounting Procedures I**
– **Double Entry System of Book-Keeping** *[7 Periods]*
Double entry system – Account – Golden rules of accounting.
4. **Basic Accounting Procedures II – Journal** *[21 Periods]*
Source documents – Accounting equation – Rules for debiting and crediting – Books of original entry – Journal – Illustrations.
5. **Basic Accounting Procedures III – Ledger** *[21 Periods]*
Meaning – Utility – Format – Posting – Balancing an account – Distinction between journal and ledger.
6. **Subsidiary Books I – Special Purpose Books** *[21 Periods]*
Need – Purchase book – Sales book – Returns books – Bills of exchange – Bills book – Journal proper.
7. **Subsidiary Books II – Cash Book** *[21 Periods]*
Features – Advantages – Kinds of cash books.
8. **Subsidiary Books III – Petty Cash Book** *[7 Periods]*
Meaning – Imprest system – Analytical petty cash book – Format – Balancing of petty cash book – Posting of petty cash book entries – Advantages.
9. **Bank Reconciliation Statement** *[21 Periods]*
Pass book – Difference between cash book and pass book - Bank reconciliation statement – Causes of disagreement between balance shown by cash book and the balance shown by pass book – Procedure for preparing bank reconciliation statement – Format.

10. Trial Balance and Rectification of Errors**[21 Periods]**

Definition – Objectives – Advantages – Methods – Format – Sundry debtors and creditors – Limitations – Errors in accounting – Steps to locate the errors – Suspense account – Rectification of errors.

11. Capital and Revenue Transactions**[7 Periods]**

Capital transactions – Revenue transactions – Deferred revenue transactions – Revenue expenditure, Capital expenditure and Deferred revenue expenditure – Distinction – Capital profit and revenue profit – Capital loss and revenue loss.

12. Final Accounts**[22 Periods]**

Parts of Final Accounts – Trading account – Profit and loss account – Balance sheet – Preparation of Final Accounts.

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CHAPTER -1

INTRODUCTION TO ACCOUNTING

Learning Objectives

After studying this Chapter, you will be able to:

- *understand the Need, Meaning, Definition, Objectives and Advantages of Book-Keeping.*
 - *know the Need, Definition, Objectives and Process of Accounting.*
 - *distinguish between Book-Keeping and Accounting.*
 - *identify the Users of Accounting Information and their Need.*
 - *know the Basic Accounting Terms.*
-

“Accounting is as old as money itself”. Since in early ages commercial activities were based on barter system, record keeping was not a necessity. The Industrial Revolution of 19th century along with rapid rise in population, paved way for the development of commercial activities, mass production and credit terms. Thus recording of business transaction has become an important feature. In recent years with the change of technologies and marketing along with stiff competition, accounting system has undergone remarkable changes.

1.1 Need and Importance of Accounting

When a person starts a business, whether large or small, his main aim is to earn profit. He receives money from certain sources like sale of goods, interest on bank deposits etc. He has to spend money on certain items like purchase of goods, salary, rent, etc. These activities take place during the normal course of his business. He would naturally be anxious at the year end, to know the progress of his business. Business transactions are numerous, that it is not possible to recall his memory as to how the money had been earned and spent. At the same time, if he had noted down his incomes and expenditures, he can readily get the required information. Hence, the details of the business transactions have to be recorded in a clear and systematic manner to get answers easily and accurately for the following questions at any time he likes.

- i. What has happened to his investment?
- ii. What is the result of the business transactions?
- iii. What are the earnings and expenses?

- iv. How much amount is receivable from customers to whom goods have been sold on credit?
- v. How much amount is payable to suppliers on account of credit purchases?
- vi. What are the nature and value of assets possessed by the business concern?
- vii. What are the nature and value of liabilities of the business concern?

These and several other questions are answered with the help of accounting. The need for recording business transactions in a clear and systematic manner is the basis which gives rise to Book-keeping.

1.2. Book-keeping

Book-keeping is that branch of knowledge which tells us how to keep a record of business transactions. It is often routine and clerical in nature. It is important to note that only those transactions related to business which can be expressed in terms of money are recorded. The activities of book-keeping include recording in the journal, posting to the ledger and balancing of accounts.

1.2.1 Definition

R.N. Carter says, "Book-keeping is the science and art of correctly recording in the books of account all those business transactions that result in the transfer of money or money's worth".

1.2.2 Objectives

The objectives of book-keeping are

- i. to have permanent record of all the business transactions.
- ii. to keep records of income and expenses in such a way that the net profit or net loss may be calculated.
- iii. to keep records of assets and liabilities in such a way that the financial position of the business may be ascertained.
- iv. to keep control on expenses with a view to minimise the same in order to maximise profit.
- v. to know the names of the customers and the amount due from them.
- vi. to know the names of suppliers and the amount due to them.
- vii. to have important information for legal and tax purposes.

1.2.3 Advantages

From the above objectives of book-keeping, the following advantages can be noted

i. Permanent and Reliable Record: Book-keeping provides permanent record for all business transactions, replacing the memory which fails to remember everything.

ii. Arithmetical Accuracy of the Accounts: With the help of book keeping trial balance can be easily prepared. This is used to check the arithmetical accuracy of accounts.

iii. Net Result of Business Operations: The result (Profit or Loss) of business can be correctly calculated.

iv. Ascertainment of Financial Position: It is not enough to know the profit or loss; the proprietor should have a full picture of his financial position in business. Once the full picture (say for a year) is known, this helps him to plan for the next year's business.

v. Ascertainment of the Progress of Business: When a proprietor prepares financial statements every year, he will be in a position to compare the statements. This will enable him to ascertain the growth of his business. Thus book keeping enables a long range planning of business activities besides satisfying the short term objective of calculation of annual profits or losses.

vi. Calculation of Dues : For certain transactions payments may be made later. Therefore, the businessman has to know how much he has to pay others.

vii. Control over Assets: In the course of business, the proprietor acquires various assets like building, machines, furnitures, etc. He has to keep a check over them and find out their values year after year.

viii. Control over Borrowings: Many businessmen borrow from banks and other sources. These loans are repayable. Just as he must have a control over assets, he should have control over liabilities.

ix. Identifying Do's and Dont's : Book keeping enables the proprietor to make an intelligent and periodic analysis of various aspects of the business such as purchases, sales, expenditures and incomes. From such analysis, it will be possible to focus his attention on what should be done and what should not be done to enhance his profit earning capacity.

x. Fixing the Selling Price : In fixing the selling price, the businessmen have to consider many aspects of accounting information such as cost of production, cost of purchases and other expenses. Accounting information is essential in determining selling prices.

xi. Taxation: Businessmen pay sales tax, income tax, etc. The tax authorities require them to submit their accounts. For this purpose, they have to maintain a record of all their business transactions.

xii. Management Decision-making: Planning, reviewing, revising, controlling and decision-making functions of the management are well aided by book-keeping records and reports.

xiii. Legal Requirements: Claims against and for the firm in relation to outsiders can be confirmed and established by producing the records as evidence in the court.

1.3 Accounting

Book-keeping does not present a clear financial picture of the state of affairs of a business. When one has to make a judgement regarding the financial position of the firm, the information contained in these books of accounts has to be analysed and interpreted. It is with the purpose of giving such information that accounting came into being.

Accounting is considered as a system which collects and processes financial information of a business. These informations are reported to the users to enable them to make appropriate decisions.

1.3.1 Definition

American Accounting Association defines accounting as “the process of identifying, measuring and communicating economic information to permit informed judgements and decision by users of the information”.

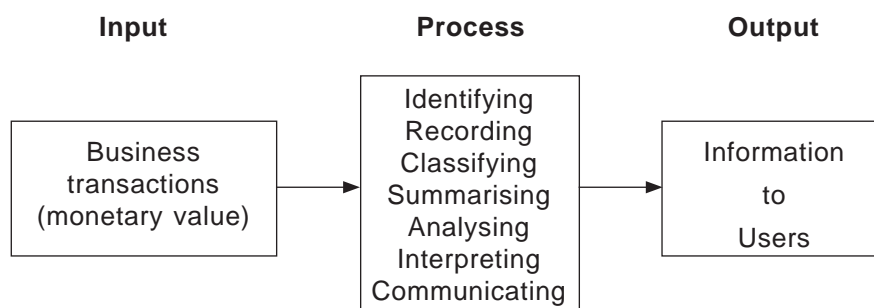
1.3.2 Objectives

The main objectives of accounting are

- i. to maintain accounting records.
- ii. to calculate the result of operations.
- iii. to ascertain the financial position.
- iv. to communicate the information to users.

1.3.3 Process

The process of accounting as per the above definition is given below:



In order to accomplish its main objective of communicating information to the users, accounting embraces the following functions.

i. Identifying: Identifying the business transactions from the source documents.

ii. Recording: The next function of accounting is to keep a systematic record of all business transactions, which are identified in an orderly manner, soon after their occurrence in the journal or subsidiary books.

iii. Classifying: This is concerned with the classification of the recorded business transactions so as to group the transactions of similar type at one place. i.e., in ledger accounts. In order to verify the arithmetical accuracy of the accounts, trial balance is prepared.

iv. Summarising : The classified information available from the trial balance are used to prepare profit and loss account and balance sheet in a manner useful to the users of accounting information.

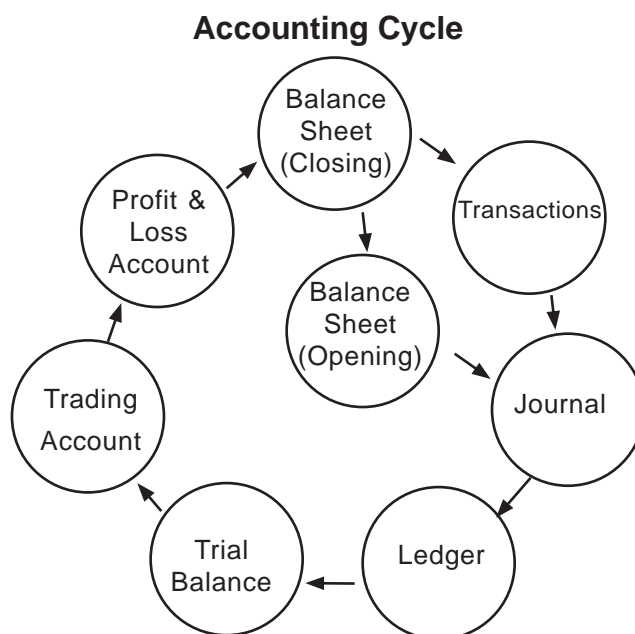
v. Analysing: It establishes the relationship between the items of the profit and loss account and the balance sheet. The purpose of analysing is to identify the financial strength and weakness of the business. It provides the basis for interpretation.

vi. Interpreting: It is concerned with explaining the meaning and significance of the relationship so established by the analysis. Interpretation should be useful to the users, so as to enable them to take correct decisions.

vii. Communicating: The results obtained from the summarised, analysed and interpreted information are communicated to the interested parties.

1.3.4 Meaning of Accounting Cycle

An accounting cycle is a complete sequence of accounting process, that begins with the recording of business transactions and ends with the preparation of final accounts.



When a businessman starts his business activities, he records the day-to-day transactions in the Journal. From the journal the transactions move further to the ledger where accounts are written up. Here, the combined effect of debit and credit pertaining to each account is arrived at in the form of balances.

To prove the accuracy of the work done, these balances are transferred to a statement called trial balance. Preparation of trading and profit and loss account is the next step. The balancing of profit and loss account gives the net result of the business transactions. To know the financial position of the business concern balance sheet is prepared at the end.

These transactions which have completed the current accounting year, once again come to the starting point – the journal – and they move with new transactions of the next year. Thus, this cyclic movement of the transactions through the books of accounts (accounting cycle) is a continuous process.

1.4 Accountancy, Accounting and Book-keeping

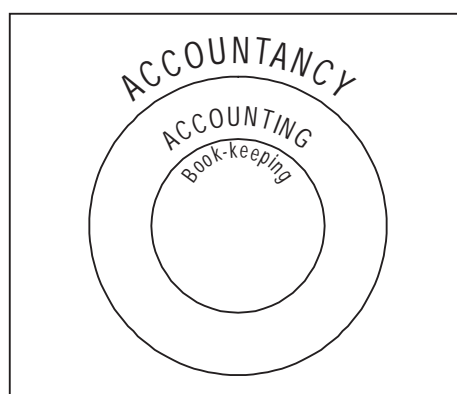
Accountancy refers to a systematic knowledge of accounting. It explains “why to do” and “how to do” of various aspects of accounting. It tells us why and how to prepare the books of accounts and how to summarize the accounting information and communicate it to the interested parties.

Accounting refers to the actual process of preparing and presenting the accounts. In other words, it is the art of putting the academic knowledge of accountancy into practice.

Book-keeping is a part of accounting and is concerned with record keeping or maintenance of books of accounts. It is often routine and clerical in nature.

1.4.1 Relationship between Accountancy, Accounting and Book-keeping

Book-keeping provides the basis for accounting and it is complementary to accounting process. Accounting begins where book-keeping ends. Accountancy includes accounting and book-keeping. The terms Accounting and Accountancy are used synonymously. This relationship can be easily understood with the help of the following diagram.



1.4.2 Distinction between Book-keeping and Accounting

In general the following are the differences between book-keeping and accounting.

Sl.No.	Basis of Distinction	Book-keeping	Accounting
1.	Scope	Recording and maintenance of books of accounts.	It is not only recording and maintenance of books of accounts but also includes analysis, interpreting and communicating the information.
2.	Stage	Primary stage.	Secondary stage.
3.	Objective	To maintain systematic records of business transactions.	To ascertain the net result of the business operation.
4.	Nature	Often routine and clerical in nature.	Analytical and executive in nature.
5.	Responsibility	A book-keeper is responsible for recording business transactions.	An accountant is also responsible for the work of a book-keeper.
6.	Supervision	The book-keeper does not supervise and check the work of an Accountant.	An accountant supervises and checks the work of the book-keeper.
7.	Staff involved	Work is done by the junior staff of the organisation.	Senior staff performs the accounting work.

1.5 Users of Accounting Information

The basic objective of accounting is to provide information which is useful for persons and groups inside and outside the organisation.

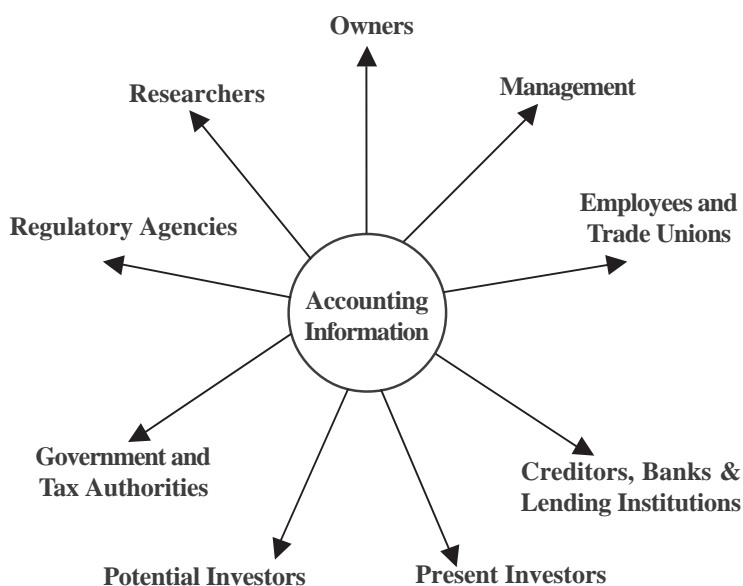
I. Internal users: Internal users are those individuals or groups who are within the organisation like owners, management, employees and trade unions.

II. External users: External users are those individuals or groups who are outside the organisation like creditors, investors, banks and other lending institutions, present and potential investors, Government, tax authorities, regulatory agencies and researchers.

The users and their need for information are as follows:

Users	Need for Information
Internal	
i. Owners	To know the profitability and financial soundness of the business.
ii. Management	To take prompt decisions to manage the business efficiently.
iii. Employees and Trade unions	To form judgement about the earning capacity of the business since their remuneration and bonus depend on it.
External	
i. Creditors, banks and other lending institutions	To determine whether the principal and the interest thereof will be paid in when due.
ii. Present investors	To know the position, progress and prosperity of the business in order to ensure the safety of their investment.
iii. Potential investors	To decide whether to invest in the business or not.
iv. Government and Tax authorities	To know the earnings in order to assess the tax liabilities of the business.
v. Regulatory agencies	To evaluate the business operation under the regulatory legislation.
vi. Researchers	To use in their research work.

Users of Accounting Information



1.6 Branches of Accounting

Increased scale of business operations has made the management function more complex. This has given rise to specialised branches in accounting. The main branches of accounting are Financial Accounting, Cost Accounting and Management Accounting.

1.6.1 Financial Accounting :

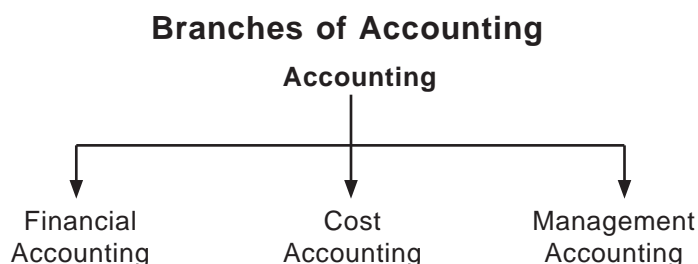
It is concerned with recording of business transactions in the books of accounts in such a way that operating result of a particular period and financial position on a particular date can be known.

1.6.2 Cost Accounting

It relates to collection, classification and ascertainment of the cost of production or job undertaken by the firm.

1.6.3 Management Accounting

It relates to the use of accounting data collected with the help of financial accounting and cost accounting for the purpose of policy formulation, planning, control and decision making by the management.



1.7 Basic Accounting Terms

The understanding of the subject becomes easy when one has the knowledge of a few important terms of accounting. Some of them are explained below.

1.7.1 Transactions

Transactions are those activities of a business, which involve transfer of money or goods or services between two persons or two accounts. *For example*, purchase of goods, sale of goods, borrowing from bank, lending of money, salaries paid, rent paid, commission received and dividend received. Transactions are of two types, namely, cash and credit transactions.

Cash Transaction is one where cash receipt or payment is involved in the transaction. *For example*, When Ram buys goods from Kannan paying the price of goods by cash immediately, it is a cash transaction.

Credit Transaction is one where cash is not involved immediately but will be paid or received later. In the above example, if Ram, does not pay cash immediately but promises to pay later, it is credit transaction.

1.7.2 Proprietor

A person who owns a business is called its proprietor. He contributes capital to the business with the intention of earning profit.

1.7.3 Capital

It is the amount invested by the proprietor/s in the business. This amount is increased by the amount of profits earned and the amount of additional capital introduced. It is decreased by the amount of losses incurred and the amounts withdrawn. *For example*, if Mr.Anand starts business with Rs.5,00,000, his capital would be Rs.5,00,000.

1.7.4 Assets

Assets are the properties of every description belonging to the business. Cash in hand, plant and machinery, furniture and fittings, bank balance, debtors, bills receivable, stock of goods, investments, Goodwill are examples for assets. Assets can be classified into tangible and intangible.

Tangible Assets: These assets are those having physical existence. It can be seen and touched. For example, plant & machinery, cash, etc.

Intangible Assets: Intangible assets are those assets having no physical existence but their possession gives rise to some rights and benefits to the owner. It cannot be seen and touched. Goodwill, patents, trademarks are some of the examples.

1.7.5 Liabilities

Liabilities refer to the financial obligations of a business. These denote the amounts which a business owes to others, e.g., loans from banks or other persons, creditors for goods supplied, bills payable, outstanding expenses, bank overdraft etc.

1.7.6 Drawings

It is the amount of cash or value of goods withdrawn from the business by the proprietor for his personal use. It is deducted from the capital.

1.7.7 Debtors

A person (individual or firm) who receives a benefit without giving money or money's worth immediately, but liable to pay in future or in due course of time is a debtor. The debtors are shown as an asset in the balance sheet. *For example*, Mr.Arul bought goods on credit from Mr.Babu for Rs.10,000. Mr.Arul is a debtor to Mr.Babu till he pays the value of the goods.

1.7.8 Creditors

A person who gives a benefit without receiving money or money's worth immediately but to claim in future, is a creditor. The creditors are shown as a

liability in the balance sheet. In the above example Mr.Babu is a creditor to Mr.Arul till he receive the value of the goods.

1.7.9 Purchases

Purchases refers to the amount of goods bought by a business for resale or for use in the production. Goods purchased for cash are called **cash purchases**. If it is purchased on credit, it is called as **credit purchases**. Total purchases include both cash and credit purchases.

1.7.10 Purchases Return or Returns Outward

When goods are returned to the suppliers due to defective quality or not as per the terms of purchase, it is called as purchases return. To find net purchases, purchases return is deducted from the total purchases.

1.7.11 Sales

Sales refers to the amount of goods sold that are already bought or manufactured by the business. When goods are sold for cash, they are **cash sales** but if goods are sold and payment is not received at the time of sale, it is **credit sales**. Total sales includes both cash and credit sales.

1.7.12 Sales Return or Returns Inward

When goods are returned from the customers due to defective quality or not as per the terms of sale, it is called sales return or returns inward. To find out net sales, sales return is deducted from total sales.

1.7.13 Stock

Stock includes goods unsold on a particular date. Stock may be opening and closing stock. The term opening stock means goods unsold in the beginning of the accounting period. Whereas the term closing stock includes goods unsold at the end of the accounting period. For example, if 4,000 units purchased @ Rs. 20 per unit remain unsold, the closing stock is Rs.80,000. This will be opening stock of the subsequent year.

1.7.14 Revenue

Revenue means the amount receivable or realised from sale of goods and earnings from interest, dividend, commission, etc.

1.7.15 Expense

It is the amount spent in order to produce and sell the goods and services. For example, purchase of raw materials, payment of salaries, wages, etc.

1.7.16 Income

Income is the difference between revenue and expense.

1.7.17 Voucher

It is a written document in support of a transaction. It is a proof that a particular transaction has taken place for the value stated in the voucher. It may be in the form of cash receipt, invoice, cash memo, bank pay-in-slip etc. Voucher is necessary to audit the accounts.

1.7.18 Invoice

Invoice is a business document which is prepared when one sell goods to another. The statement is prepared by the seller of goods. It contains the information relating to name and address of the seller and the buyer, the date of sale and the clear description of goods with quantity and price.

1.7.19 Receipt

Receipt is an acknowledgement for cash received. It is issued to the party paying cash. Receipts form the basis for entries in cash book.

1.7.20 Account

Account is a summary of relevant business transactions at one place relating to a person, asset, expense or revenue named in the heading. An account is a brief history of financial transactions of a particular person or item. An account has two sides called debit side and credit side.

QUESTIONS**I. Objective Type :****a) Fill in the blanks:**

1. The amount which the proprietor has invested in the business is_____.
2. Book-keeping is an art of recording _____ in the book of accounts.
3. _____ is a written document in support of a transaction.
4. Accounting begins where _____ ends.
5. Liabilities refer to the _____ obligations of a business.
6. Owner of the business is called _____.
7. An account is a _____ of relevant business transactions at one place relating to a person, assets, expense or revenue named in the heading.
8. Receipt is an acknowledgement for _____.
9. Income is the difference between revenue and _____.

[Answers: 1. capital; 2. business transactions; 3. voucher; 4. bookkeeping; 5. financial; 6. Proprietor; 7. summary; 8. cash received; 9. expense]

b) Choose the correct answer:

1. The debts owing to others by the business is known as
a) liabilities b) expenses c) debtors
2. Assets minus liabilities is
a) drawings b) capital c) credit
3. A written document in support of a transaction is called
a) receipt b) credit note c) voucher
4. Business transactions may be classified into
a) three b) two c) one
5. Purchases return means goods returned to the supplier due to
a) good quality b) defective quality c) super quality
6. Amount spent in order to produce and sell the goods and services is called
a) expense b) income c) revenue

[Answers: 1. (a), 2. (b), 3. (c), 4. (b), 5. (b), 6. (a)]

II. Other Questions:

1. What is book-keeping?
2. Define Book-keeping.
3. What are the objectives of book-keeping?
4. What are the advantages of book-keeping?
5. What information can a businessman obtain from his book-keeping?
6. What do you mean by accounting?
7. Define Accounting.
8. What is accounting process?
9. What are the differences between book-keeping and accounting?
10. Explain the inter-relationship between book-keeping, accounting and accountancy.
11. Briefly explain the users and their need for accounting information.
12. What are the branches of accounting?

13. Write short notes on :

- a) Debtors b) Creditors c) Stock

14. Briefly explain the following terms

- a) Voucher b) Invoice c) Account

15. Write short note on

- a) Revenue b) Purchase c) Assets

CHAPTER -2

CONCEPTUAL FRAME WORK OF ACCOUNTING

Learning Objectives

After learning this chapter you will be able to:

- *know the Basic Assumptions of Accounting.*
- *understand the Basic Accounting Concepts.*
- *know the Modifying Principles of Accounting.*

Accounting is the language of business. It records business transactions taking place during the accounting period. Accounting communicates the result of the business transactions in the form of final accounts. With a view to make the accounting results understood in the same sense by all interested parties, certain accounting assumptions, concepts and principles have been developed over a course of period.

2.1 Basic Assumptions

The basic assumptions of accounting are like the foundation pillars on which the structure of accounting is based. The four basic assumptions are as follows:

2.1.1 Accounting Entity Assumption

According to this assumption, business is treated as a unit or entity apart from its owners, creditors and others. In other words, the proprietor of a business concern is always considered to be separate and distinct from the business which he controls. All the business transactions are recorded in the books of accounts from the view point of the business. Even the proprietor is treated as a creditor to the extent of his capital.

2.1.2 Money Measurement Assumption

In accounting, only those business transactions and events which are of financial nature are recorded. For example, when Sales Manager is not on good terms with Production Manager, the business is bound to suffer. This fact will not be recorded, because it cannot be measured in terms of money.

2.1.3 Accounting Period Assumption

The users of financial statements need periodical reports to know the operational result and the financial position of the business concern. Hence it becomes necessary to close the accounts at regular intervals. Usually a period of 365 days or 52 weeks or 1 year is considered as the accounting period.

2.1.4 Going Concern Assumption

As per this assumption, the business will exist for a long period and transactions are recorded from this point of view. There is neither the intention nor the necessity to wind up the business in the foreseeable future.

2.2 Basic Concepts of Accounting

These concepts guide how business transactions are reported. On the basis of the above four assumptions the following concepts (principles) of accounting have been developed.

2.2.1 Dual Aspect Concept

Dual aspect principle is the basis for Double Entry System of book-keeping. All business transactions recorded in accounts have two aspects - receiving benefit and giving benefit. For example, when a business acquires an asset (receiving of benefit) it must pay cash (giving of benefit).

2.2.2 Revenue Realisation Concept

According to this concept, revenue is considered as the income earned on the date when it is realised. Unearned or unrealised revenue should not be taken into account. The realisation concept is vital for determining income pertaining to an accounting period. It avoids the possibility of inflating incomes and profits.

2.2.3 Historical Cost Concept

Under this concept, assets are recorded at the price paid to acquire them and this cost is the basis for all subsequent accounting for the asset. For example, if a piece of land is purchased for Rs.5,00,000 and its market value is Rs.8,00,000 at the time of preparing final accounts the land value is recorded only for Rs.5,00,000. Thus, the balance sheet does not indicate the price at which the asset could be sold for.

2.2.4 Matching Concept

Matching the revenues earned during an accounting period with the cost associated with the period to ascertain the result of the business concern is called the matching concept. It is the basis for finding accurate profit for a period which can be safely distributed to the owners.

2.2.5 Full Disclosure Concept

Accounting statements should disclose fully and completely all the significant information. Based on this, decisions can be taken by various interested parties. It involves proper classification and explanations of accounting information which are published in the financial statements.

2.2.6 Verifiable and Objective Evidence Concept

This principle requires that each recorded business transactions in the books of accounts should have an adequate evidence to support it. For example, cash receipt for payments made. The documentary evidence of transactions should be free from any bias. As accounting records are based on documentary evidence which are capable of verification, it is universally acceptable.

2.3 Modifying Principles

To make the accounting information useful to various interested parties, the basic assumptions and concepts discussed earlier have been modified. These modifying principles are as under.

2.3.1 Cost Benefit Principle

This modifying principle states that the cost of applying a principle should not be more than the benefit derived from it. If the cost is more than the benefit then that principle should be modified.

2.3.2 Materiality Principle

The materiality principle requires all relatively relevant information should be disclosed in the financial statements. Unimportant and immaterial information are either left out or merged with other items.

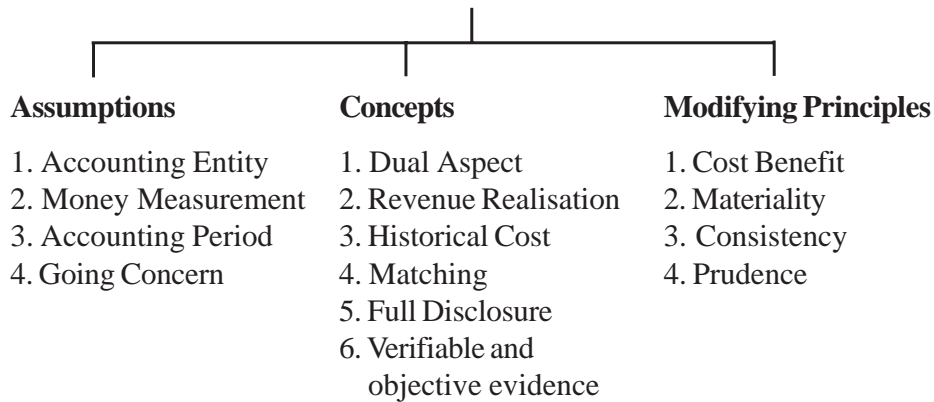
2.3.3 Consistency Principle

The aim of consistency principle is to preserve the comparability of financial statements. The rules, practices, concepts and principles used in accounting should be continuously observed and applied year after year. Comparisons of financial results of the business among different accounting period can be significant and meaningful only when consistent practices were followed in ascertaining them. For example, depreciation of assets can be provided under different methods, whichever method is followed, it should be followed regularly.

2.3.4 Prudence (Conservatism) Principle

Prudence principle takes into consideration all prospective losses but leaves all prospective profits. The essence of this principle is “anticipate no profit and provide for all possible losses”. For example, while valuing stock in trade, market price or cost price whichever is less is considered.

Frame Work of Accounting



2.4 Accounting Standards

To promote world-wide uniformity in published accounts, the **International Accounting Standards Committee (IASC)** has been set up in June 1973 with nine nations as founder members. The purpose of this committee is to formulate and publish in public interest, standards to be observed in the presentation of audited financial statements and to promote their world-wide acceptance and observance. IASC exist to reduce the differences between different countries' accounting practices. This process of harmonisation will make it easier for the users and preparers of financial statement to operate across international boundaries. In our country, the **Institute of Chartered Accountants of India** has constituted **Accounting Standard Board (ASB)** in 1977. The ASB has been empowered to formulate and issue accounting standards, that should be followed by all business concerns in India.

QUESTIONS

I. Objective Type :

a) Fill in the Blanks:

1. Stock in trade are to be recorded at cost or market price whichever is less is based on _____ principle.
2. The assets are recorded in books of accounts in the cost of acquisition is based on _____ concept.
3. The benefits to be derived from the accounting information should exceed its cost is based on _____ principle.
4. Transactions between owner and business are recorded separately due to _____ assumption.

5. Business concern must prepare financial statements at least once in a year is based on _____ assumption.
6. _____ principle requires that the same accounting methods should be followed from one accounting period to the next.

[Answers : 1. prudence, 2. historical cost, 3. cost benefit, 4. business entity, 5. accounting period, 6. consistency]

b) Choose the correct answer:

1. As per the business entity assumption, the business is different from the
 - a) owners
 - b) banker
 - c) government
2. Going concern assumption tell us the life of the business is
 - a) very short
 - b) very long
 - c) none
3. Cost incurred should be matched with the revenues of the particular period is based on
 - a) matching concept
 - b) historical cost concept
 - c) full disclosure concept
4. As per dual aspect concept, every business transaction has
 - a) three aspects
 - b) one aspect
 - c) two aspects

[Answers : 1. (a), 2. (b), 3. (a), 4. (c)]

II. Other Questions :

1. What are the basic assumptions of accounting?
2. What do you mean by business entity assumption?
3. Write short notes on the following assumption.
 - a) Money measurement
 - b) Accounting period
4. What do you mean by going concern assumption?
5. What are the basic concepts of accounting?
6. What do you understand by revenue realisation concept?
7. What do you mean by historical cost concept?
8. Describe the following concepts
 - a) Matching
 - b) Full disclosure
9. What do you understand by verifiable and objective evidence concept?

10. Explain in detail the modifying principles of accounting.
11. What do you mean by materiality principle?
12. What do you understand by consistency principle?
13. Write short notes on
 - a) Prudence principle
 - b) Dual aspect concept
14. Briefly explain the various accounting concepts.
15. Briefly explain the various accounting assumptions.

CHAPTER - 3

BASIC ACCOUNTING PROCEDURES - I

DOUBLE ENTRY SYSTEM OF BOOK KEEPING

Learning Objectives

After learning this chapter you will be able to:

- *understand the Meaning, Features and Advantages of Double Entry System*
- *know the Meaning and Types of Accounts.*
- *identify the Accounting Rules.*

Recording of business transactions has been in vogue in all countries of the world. In India, maintenance of accounts was practised not in such a developed form as we have today. **Kautilya's** famous **Arthasastra** not only relates to Politics and Economics, but also explains the art of account keeping in a separate chapter. Written in 4th century BC, the book gives details about account keeping, methods of supervising and checking of accounts and also about the distinction between capital and revenue, income and expenses etc.

Double entry system was introduced to the business world by an Italian merchant named Lucas Pacioli in 1494 A.D. Though the system of recording business transactions in a systematic manner has **originated in Italy, it was perfected in England** and other European countries during the 18th century only i.e., after the Industrial Revolution. Many countries have adopted this system today.

3.1 Double Entry System

There are numerous transactions in a business concern. Each transaction, when closely analysed, reveals two aspects. One aspect will be “receiving aspect” or “incoming aspect” or “expenses/loss aspect”. This is termed as the “**Debit aspect**”. The other aspect will be “giving aspect” or “outgoing aspect” or “income/gain aspect”. This is termed as the “**Credit aspect**”. These two aspects namely “Debit aspect” and “Credit aspect” form the basis of Double Entry System. The double entry system is so named since it records both the aspects of a transaction.

In short, the basic principle of this system is, for every debit, there must be a corresponding credit of equal amount and for every credit, there must be a corresponding debit of equal amount.

3.1.1 Definition

According to **J.R.Batliboi** “Every business transaction has a two-fold effect and that it affects two accounts in opposite directions and if a complete record were to be made of each such transaction, it would be necessary to debit one account and credit another account. It is this recording of the two fold effect of every transaction that has given rise to the term Double Entry System”.

3.1.2 Features

- i. Every business transaction affects two accounts.
- ii. Each transaction has two aspects, i.e., debit and credit.
- iii. It is based upon accounting assumptions concepts and principles.
- iv. Helps in preparing trial balance which is a test of arithmetical accuracy in accounting.
- v. Preparation of final accounts with the help of trial balance.

3.1.3 Approaches of Recording

There are two approaches for recording a transaction.

- I. Accounting Equation Approach
- II. Traditional Approach

I. Accounting Equation Approach

This approach is also called as the American Approach. Under this method transactions are recorded based on the accounting equation, i.e.,

$$\text{Assets} = \text{Liabilities} + \text{Capital}$$

This will be discussed in detail in the next chapter.

II. Traditional Approach

This approach is also called as the **British Approach**. Recording of business transactions under this method are formed on the basis of the existence of two aspects (debit and credit) in each of the transactions. All the business transactions are recorded in the books of accounts under the ‘Double Entry System’.

3.1.4 Advantages

The advantages of this system are as follows:

- i. **Scientific system:** This is the only scientific system of recording business transactions. It helps to attain the objectives of accounting.

- ii. **Complete record of transactions:** This system maintains a complete record of all business transactions.
- iii. **A check on the accuracy of accounts:** By the use of this system the accuracy of the accounting work can be established by the preparation of trial balance.
- iv. **Ascertainment of profit or loss:** The profit earned or loss occurred during a period can be ascertained by the preparation of profit and loss account.
- v. **Knowledge of the financial position :** The financial position of the concern can be ascertained at the end of each period through the preparation of balance sheet.
- vi. **Full details for control:** This system permits accounts to be kept in a very detailed form, and thereby provides sufficient informations for the purpose of control.
- vii. **Comparative study :** The results of one year may be compared with those of previous years and the reasons for change may be ascertained.
- viii. **Helps in decision making:** The mangement may be able to obtain sufficient information for its work, especially for making decisions. Weaknesses can be detected and remedial measures may be applied.
- ix. **Detection of fraud:** The systematic and scientific recording of business transactions on the basis of this system minimises the chances of fraud.

3.2 Account

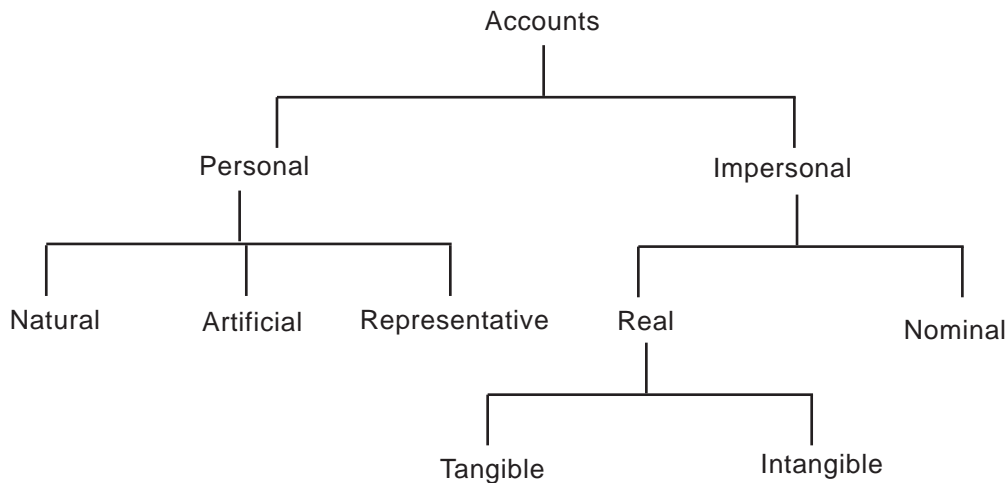
Every transaction has two aspects and each aspect has an account. It is stated that '**an account is a summary of relevant transactions at one place relating to a particular head**'.

3.2.1 Classification of Accounts

Transactions can be divided into three categories.

- i. Transactions relating to individuals and firms
- ii. Transactions relating to properties, goods or cash
- iii. Transactions relating to expenses or losses and incomes or gains.

Therefore, accounts can also be classified into Personal, Real and Nominal. The classification may be illustrated as follows



I. Personal Accounts : The accounts which relate to persons.

Personal accounts include the following.

- i. **Natural Persons :** Accounts which relate to individuals. For example, Mohan's A/c, Shyam's A/c etc.
- ii. **Artificial persons :** Accounts which relate to a group of persons or firms or institutions. For example, HMT Ltd., Indian Overseas Bank, Life Insurance Corporation of India, Cosmopolitan club etc.
- iii. **Representative Persons:** Accounts which represent a particular person or group of persons. For example, outstanding salary account, prepaid insurance account, etc.

The business concern may keep business relations with all the above personal accounts, because of buying goods from them or selling goods to them or borrowing from them or lending to them. Thus they become either Debtors or Creditors.

The proprietor being an individual his capital account and his drawings account are also personal accounts.

II. Impersonal Accounts: All those accounts which are not personal accounts. This is further divided into two types viz. Real and Nominal accounts.

- i. **Real Accounts:** Accounts relating to properties and assets which are owned by the business concern. Real accounts include tangible and intangible accounts. For example, Land, Building, Goodwill, Purchases, etc.
- ii. **Nominal Accounts:** These accounts do not have any existence, form or shape. They relate to incomes and expenses and gains and losses of a business concern. For example, Salary Account, Dividend Account, etc.

Illustration : 1

Classify the following items into Personal, Real and Nominal Accounts.

- | | |
|-----------------------------|-----------------------|
| 1. Capital | 2. Sales |
| 3. Drawings | 4. Outstanding salary |
| 5. Cash | 6. Rent |
| 7. Interest paid | 8. Indian Bank |
| 9. Discount received | 10. Building |
| 11. Bank | 12. Chandrasekar |
| 13. Murugan Lending Library | 14. Advertisement |
| 15. Purchases | |

Solution:

- | | |
|----------------------|--------------------------------------|
| 1. Personal account | 2. Real account |
| 3. Personal account | 4. Personal (Representative) account |
| 5. Real account | 6. Nominal account |
| 7. Nominal account | 8. Personal (Legal Body) account |
| 9. Nominal account | 10. Real account |
| 11. Personal account | 12. Personal account |
| 13. Personal account | 14. Nominal account |
| 15. Real account | |

3.3 Golden Rules of Accounting

All the business transactions are recorded on the basis of the following rules.

S.No.	Name of Account	Debit Aspect	Credit Aspect
1.	Personal	The receiver	The giver
2.	Real	What comes in	What goes out
3.	Nominal	All expenses and losses	All incomes and gains.

QUESTIONS

I. Objective Type :

a) Fill in the blanks:

1. The author of the famous book “Arthasastra” is _____.
2. Every business transaction reveals _____ aspects.
3. The incoming aspect of a transaction is called _____ and the outgoing aspect of a transaction is called _____.
4. Traditional approach of accounting is also called as _____ approach.
5. The American approach is otherwise known as _____ approach.
6. Impersonal accounts are classified into _____ types.
7. Plant and machinery is an example of _____ account.
8. Capital account is an example of _____ account.
9. Commission received will be classified under _____ account.

[Answers: 1. Kautilya, 2. two, 3. debit, credit, 4. British, 5. Accounting equation, 6. two, 7. real, 8. personal, 9. nominal]

b) Choose the correct answer:

1. The receiving aspect in a transaction is called as
 a) debit aspect b) credit aspect c) neither of the two
2. The giving aspect in a transaction is called as
 a) debit aspect b) credit aspect c) neither of the two
3. Murali account is an example for
 a) personal A/c b) real A/c c) nominal A/c
4. Capital account is classified under
 a) personal A/c b) real A/c c) nominal A/c
5. Goodwill is an example of
 a) tangible real A/c b) intangible real A/c c) nominal A/c
6. Commission received is an example of
 a) real A/c b) personal A/c c) nominal A/c

7. Outstanding rent A/c is an example for
 - a) nominal account b) personal account
 - c) representative personal account
8. Nominal Account is classified under
 - a) personal A/c b) impersonal A/c c) neither of the two
9. Drawings account is classified under
 - a) real A/c. b) personal A/c. c) nominal A/c.

[Answers : 1. (a), 2. (b), 3. (a), 4. (a), 5. (b), 6. (c), 7. (c), 8. (b), 9. (b)].

II. Other Questions:

1. Explain the meaning of Double Entry System.
2. Define Double Entry System.
3. What are the advantages of Double Entry System?
4. How are accounts classified?
5. Write notes on personal accounts.
6. Write notes on real accounts.
7. Explain nominal accounts.
8. What are the golden rules of Accounting?
9. Classify the following items into real, personal and nominal accounts

a. Capital	f. State Bank of India
b. Purchases	g. Electricity Charges
c. Goodwill	h. Dividend
d. Copyright	i. Ramesh
e. Latha	j. Outstanding rent

[Answers : Personal account – (a), (e), (f), (i), (j)]

Real account – (b), (c), (d)

Nominal account – (g), (h)]

CHAPTER - 4

BASIC ACCOUNTING PROCEDURES - II

JOURNAL

Learning Objectives

After learning this chapter you will be able to:

- *understand the Origin of Transactions – Source Documents.*
- *understand the Concept of Accounting Equation.*
- *know the Rules of Debit and Credit.*
- *know the Meaning and the Preparation of Journal.*
- *bring out the Advantages of Journal.*

Accounting process starts with identifying the transactions to be recorded in the books of accounts. Accounting identifies only those transactions and events which involve money. They should be of financial character. Accountant does so by sorting out various cash memos, invoices, bills, receipts and vouchers.

In the accounting process, the first step is the recording of transactions in the books of accounts. The origin of a transaction is derived from the source document.

4.1 Source Documents

Source documents are the evidences of business transactions which provide information about the nature of the transaction, the date, the amount and the parties involved in it. Transactions are recorded in the books of accounts when they actually take place and are duly supported by source documents. *According to the verifiable objective principle of Accounting*, each transaction recorded in the books of accounts should have adequate proof to support it. These supporting documents are the written and authentic proof of the correctness of the recorded transactions. These documents are required for audit and tax assessment. They also serve as the legal evidence in case of a dispute. The following are the most common source documents.

4.1.1 Cash Memo

When a trader sells goods for cash, he gives a cash memo and when he purchases goods for cash, he receives a cash memo. Details regarding the items, quantity, rate and the price are mentioned in the cash memo.

Cash Memo Vinoth Watch Co., 135, South Usman Road, Thyagaraya Nagar, Chennai-17. No: 52 Date : 18.8.2003 To			
Qty.	Description	Rate Rs.	Amount Rs.
3	Titan Regulia	1,800	5,400
2	Titan Raga	1,200	2,400
			7,800
	Less: Discount 10%		780
5	Total		7020
Goods once sold are not taken back. <div style="text-align: right; margin-top: 10px;"> Manager For Vinoth Watch Co. </div>			

4.1.2 Invoice or Bill

When a trader sells goods on credit, he prepares a sale invoice. It contains full details relating to the amount, the terms of payment and the name and address of the seller and buyer. The original copy of the sale invoice is sent to the purchaser and its duplicate copy is kept for making records in the books of accounts.

Similarly, when a trader purchases goods on credit, he receives a credit bill from the supplier of goods.

INVOICE Ramesh Electronics 306, Anna Salai, Chennai - 600 002.	
No. 405	Date : 20.8.2003
Name & address of the Customer : Bhanu Enterprises <div style="text-align: right; margin-top: 5px;"> 43, Eldams Road, Teynampet, Chennai - 18. </div>	
Terms : 5% cash discount if payment is made within 30 days.	

Qty.	Description	Rate Rs.	Amount Rs.
5	Refrigerators	9,000	45,000
10	Washing Machines	15,000	1,50,000
			1,95,000
	Sales Tax @ 10%		19,500
			2,14,500
	Handling & delivery charges		1,500
15	Total		2,16,000
(Rupees Two lakhs sixteen thousand only)			
<div style="text-align: right;">Partner</div> <div style="text-align: right;">For Ramesh Electronics</div> <div>E&O.E</div>			

Note : E.&O.E., means errors and omissions excepted. In other words, if there is any error in the invoice, the same has to be adjusted accordingly.

4.1.3 Receipt

When a trader receives cash from a customer, he issues a receipt containing the date, the amount and the name of the customer. The original copy is handed over to the customer and the duplicate copy is kept for record. In the same way, whenever we make payment, we obtain a receipt from the party to whom we make payment.

RECEIPT	
Saravana Book House	
43, 1st Main Road, Chennai - 35.	
Receipt No. 315	Date :16.9.2003
Received with thanks a sum of Rs. 15,000 (Rupees fifteen thousand only) from M/s. Sulthan & Sons being the supply of books as per the list enclosed.	
Cheque/DD/No. : 10345 Dt. : 10.9.2003	
Canara Bank, Trichy.	
	<div style="border: 1px solid black; width: 150px; height: 60px; margin: 0 auto; display: flex; align-items: center; justify-content: center;">Signature</div>
	Seal

Note : If the amount is more than Rs.500, affix a revenue stamp.

4.1.4 Debit Note

A **debit note** is prepared by the buyer and it contains the date of the goods returned, name of the supplier, details of the goods returned and reasons for returning the goods. Each debit note is serially numbered. A duplicate copy or counter foil of the debit note is retained by the buyer. On the basis of debit note, the suppliers account is debited in the books.

DEBIT NOTE			
Ganesh Traders 22, Ram Nagar, Chennai - 600 015		No : 315 Date: 14.6.2003	
Name & Address of Supplier : Shanmuga Traders 122, III Street Chennai - 600 021.			
Terms : 5% cash discount if payment is made within 30 days.			
Date	Particulars	Rs.	Rs.
2003 June 14	20 FM Radio sets purchased under your invoice No.394, dated, 2nd June, 2003, now returned, as the sets are not in working conditions @ Rs.75 per set.		
	Add Packing expenses	1,500	
		100	1,600
	Total		1,600
E & O., E		Manager	

4.1.5 Credit Note

A **credit note** is prepared by the seller and it contains the date on which goods are returned, name of the customer, details of the goods received back, amount of such goods and reasons for returning the goods. Each credit note is serially numbered. A duplicate copy of the credit note is retained for the record purpose. On the basis of credit note, the customer's account is credited in the books.

CREDIT NOTE	
No : 243	Date: 15.9.2003
COTTON WORLD 22, Metha Nagar, Chennai - 600 029.	
Name & Address of the Customer : Palanichami & Sons 122, Oppanakkara Street, Coimbatore - 6.	

Terms : 2% cash discount if payment is made within 30 days.			
Date	Particulars	Rs.	Rs.
2003 Sept 15	T-Shirts - 32" - 200 Nos		
	@ Rs.100 each	20,000	
	Less : Discount @10%	2,000	
	(Return due to inferior quality)		18,000
	Total		18,000
E & O., E			
Manager			

4.1.6 Pay-in-slip

Pay-in-slip is a form available in banks and is used to deposit money into a bank account. Each pay-in-slip has a counterfoil which is returned to the depositor duly sealed and signed by the bank official. This source document relates to bank transactions. It gives details regarding date, account number, amount deposited (in cash or cheque) and name of the account holder.

Pay-in-slip

Indian Overseas BankBranch200..... Current Account No of (name)..... Cheque/Cash Rs..... Rupees Cashier Clerk Authorised Official This counter foil is not valid unless signed by an authorised official of the Bank (in addition to the cashier in case of deposit by cash).	Indian Overseas Bank Branch Credit Current Account No. 200..... of (name) Rupees as per details furnished overleaf <div style="text-align: right;">Cheque/Cash</div> <div style="text-align: right;">Rs.....</div> <div style="text-align: right;">L.F Initial </div> <div style="text-align: center; margin: 10px 0;"> <div style="border: 1px solid black; width: 100px; height: 40px; display: flex; align-items: center; justify-content: center;">Seal</div> </div> Depositor's Signature Cashier/Clerk Authorised official Name & Address..... Tel. No.....
---	--

4.1.7 Cheque

A cheque is a document in writing drawn upon a specified banker to pay a specified sum to the bearer or the person named in it and payable on demand. Each cheque book has a counterfoil in which the same details in the cheque are filled. The counterfoil remains with the account holder for his future reference. The counterfoil forms the source document for entries to be made in the books of accounts.

Cheque

Date :	
PAY	
..... OR BEARER	
RUPEES <div style="float: right; border: 1px solid black; padding: 5px; margin-top: 10px;">Rs.</div>	
A/c. No. <div style="border: 1px solid black; width: 60px; height: 20px; display: inline-block;"></div>	INTL. <div style="border: 1px solid black; width: 60px; height: 20px; display: inline-block;"></div>
The Tamil Nadu State Apex Co-operative Bank Ltd., Ashok Nagar, 273-B, 10th Avenue, CHENNAI - 600 083. <div style="text-align: right; margin-top: 10px;">"3 0 8 8 9 4 600091007 " : 10</div>	

4.1.8 Vouchers

A voucher is a written document in support of a business transaction. Vouchers are prepared by an accountant and each voucher is counter signed by an authorised person of the organisation.

No.	<div style="border: 1px solid black; width: 100%; height: 25px;"></div>	VOUCHER
Date	<div style="border: 1px solid black; width: 100%; height: 25px;"></div>	
Rs.	<div style="border: 1px solid black; width: 100px; height: 25px; display: inline-block;"></div> <div style="border: 1px solid black; width: 40px; height: 25px; display: inline-block; margin-left: 10px;"></div>	
Pay to		
Rs. in Words		
being		
and debit		
Authorised by	Received the above sum of Rs.	
<div style="border: 1px solid black; width: 150px; height: 25px;"></div>		
<div style="border: 1px solid black; width: 100%; height: 40px; display: flex; justify-content: space-between; align-items: center;"> <div style="text-align: center;">Paid by</div> <div style="text-align: center;">Drawn on Bank</div> </div> <div style="border: 1px solid black; width: 100%; height: 20px; display: flex; justify-content: space-between; align-items: center;"> <div style="text-align: center;">Cash (or) Cheque</div> <div style="text-align: center;"></div> </div>	<div style="border: 1px solid black; width: 150px; height: 40px; margin: 0 auto;"></div> <div style="margin-top: 10px;">Receiver's Signature</div>	

The vouchers are properly filed according to their serial numbers so that the auditors may easily vouch them and these may also serve as documentary evidence in future.

Bills receivable, bills payable, wage sheet/salaries pay acquittance, correspondence etc., also serve as the source documents. Thus, there must be a source document for each transaction recorded in the books of accounts.

Note : The formats of the source documents are given above, only to know the details but not for the preparation.

4.2 Accounting Equation

The source document is the origin of a transaction and it initiates the accounting process, whose starting point is the accounting equation.

Accounting equation is based on dual aspect concept (Debit and Credit). It emphasizes on the fact that every transaction has a two sided effect i.e., on the assets and claims on assets. Always the total claims (those of outsiders and of the proprietors) will be equal to the total assets of the business concern. The claims are also known as equities, are of two types: i.) Owners equity (Capital); ii.) Outsiders' equity (Liabilities).

$$\text{Assets} = \text{Equities}$$

$$\text{Assets} = \text{Capital} + \text{Liabilities} \quad (A = C+L)$$

$$\text{Capital} = \text{Assets} - \text{Liabilities} \quad (C = A-L)$$

$$\text{Liabilities} = \text{Assets} - \text{Capital} \quad (L = A-C)$$

4.2.1 Effect of Transactions on Accounting Equation :

Illustration 1

If the capital of a business is Rs.3,00,000 and other liabilities are Rs.2,00,000, calculate the total assets of the business.

Solution

$$\text{Assets} = \text{Capital} + \text{Liabilities}$$

$$\text{Capital} + \text{Liabilities} = \text{Assets}$$

$$\text{Rs. } 3,00,000 + \text{Rs. } 2,00,000 = \text{Rs. } 5,00,000$$

Illustration 2

If the total assets of a business are Rs.3,60,000 and capital is Rs.2,00,000, calculate liabilities.

Solution

$$\text{Assets} = \text{Capital} + \text{Liabilities}$$

$$\text{Liabilities} = \text{Assets} - \text{Capital}$$

$$\text{Assets} - \text{Capital} = \text{Liabilities}$$

$$\text{Rs. } 3,60,000 - \text{Rs. } 2,00,000 = \text{Rs. } 1,60,000$$

Illustration 3

If the total assets of a business are Rs.4,50,000 and outside liabilities are Rs.2,50,000, calculate the capital.

Solution:

$$\begin{aligned}\text{Capital} &= \text{Assets} - \text{Liabilities} \\ \text{Assets} - \text{Liabilities} &= \text{Capital} \\ \text{Rs. 4,50,000} - \text{Rs. 2,50,000} &= \text{Rs.2,00,000}\end{aligned}$$

Illustration - 4

Transaction 1: Murugan started business with Rs.50,000 as capital.

The business unit has received assets totalling Rs.50,000 in the form of cash and the claims against the firm are also Rs.50,000 in the form of capital. The transaction can be expressed in the form of an accounting equation as follows:

$$\begin{aligned}\text{Assets} &= \text{Capital} + \text{Liabilities} \\ \text{Cash} &= \text{Capital} + \text{Liabilities} \\ \text{Rs. 50,000} &= \text{Rs. 50,000} + 0\end{aligned}$$

Transaction 2: Murugan purchased furniture for cash Rs.5,000.

The cash is reduced by Rs,5,000 but a new asset (furniture) of the same amount has been acquired. This transaction decreases one asset (cash) and at the same time increases the other asset (furniture) with the same amount, leaving the total of the assets of the business unchanged. The accounting equation now is as follows:

	Assets		=	Capital + Liabilities	
	Cash	Furniture	=	Capital	Liabilities
Transaction 1	50,000	0	=	50,000	0
Transaction 2	(-) 5,000	5,000	=	0	0
Equation	45,000	5,000	=	50,000	0

Transaction 3: He purchased goods for cash Rs.30,000.

As a result, cash balance is reduced by the goods purchased, leaving the total of the assets unchanged.

	Assets			=	Capital + Liabilities	
	Cash	Furniture	Stock (Goods)	=	Capital	Liabilities
Transaction 1&2	45,000	5,000	0	=	50,000	0
Transaction 3	(-) 30,000	0	30,000	=	0	0
Equation	15,000	5,000	30,000	=	50,000	0

Transaction 4: He purchased goods on credit for Rs.20,000.

The above transaction will increase the value of stock on the assets side and will create a liability in the form of creditors.

	Assets			=	Capital + Liabilities	
	Cash + Furniture + Stock			=	Capital +Creditors	
Transaction 1-3	15,000	+	5,000	+	30,000=	50,000 + 0
Transaction 4	0	+	0	+	20,000=	0 + 20,000
Equation	15,000	+	5,000	+	50,000	= 50,000 + 20,000

Transaction 5: Goods costing Rs.25,000 sold on credit for Rs.35,000.

The above transaction will give rise to a new asset in the form of Debtors to the extent of Rs.35,000. But the stock of goods will be reduced by Rs.25,000 i.e., the cost of goods sold. The net increase of Rs.10,000 is the amount of revenue which will be added to the capital.

	Assets = Capital + Liabilities									
	Cash + Furniture + Stock + Debtors = Capital + Creditors									
			</							

Transaction 6: Rent paid Rs.3,000.

It reduces cash and the rent is an expense, it results in a loss which decreases the capital.

Assets = Capital + Liabilities									
Cash + Furniture + Stock + Debtors = Capital + Creditors									
Transaction 1-5	15,000	+	5,000	+	25,000	+	35,000	=	60,000 + 20,000
Transaction 6	− 3,000	+	0	+	0	+	0	= (-)	3,000 + 0
<hr/>									
Equation	12,000	+	5,000	+	25,000	+	35,000	=	57,000 + 20,000
									77,000 = 77,000

From the above transactions, it may be concluded that every transaction has a double effect and in each case - Assets = Capital + Liabilities, i.e., '**Accounting equation is true in all cases**'. The last equation appearing in the books of Mr. Murugan may also be presented in the form of a statement called Balance Sheet. It will appear as below:

Balance Sheet of Mr. Murugan

as on

Liabilities	Rs.	Assets	Rs.
Capital	57,000	Cash	12,000
Creditors	20,000	Stock	25,000
		Debtors	35,000
		Furniture	5,000
	77,000		77,000

Note : Increase in one asset will be automatically either decrease in another asset or increase in liability or increase in capital. Likewise decrease in asset by way of either in increase in another asset or decrease in liability or capital.

Illustration 5

Show the Accounting Equation on the basis of the following transactions and prepare a Balance Sheet on the basis of the last equation.

	Rs.
1. Maharajan commenced business with cash	1,00,000
2. Purchased goods for cash	70,000
3. Purchased goods on credit	80,000
4. Purchased furniture for cash	3,000
5. Paid rent	2,000
6. Sold goods for cash costing Rs.45,000	60,000
7. Paid to creditors	20,000
8. Withdrew cash for private use	10,000
9. Paid salaries	5,000
10. Sold goods on credit (cost price Rs.60,000)	80,000

Solution :

Accounting Equation

S. No.	Transaction	Assets				=	Liabilities	
		Cash +	Stock +	Furniture +	Debtors +	=	Capital +	Creditors
1.	Maharajan commenced business with Rs. 1,00,000/-	1,00,000 +	0 +	0 +	0 +	0 =	1,00,000 +	0
2.	Purchased goods for cash	1,00,000 + (-) 70,000 +	0 + 70,000 +	0 + 0 +	0 + 0 +	0 = 0 =	1,00,000 + 0 +	0
3.	Purchased goods on credit	30,000 + 0 +	70,000 + 80,000 +	0 + 0 +	0 + 0 +	0 = 0 =	1,00,000 + 0 +	80,000
4.	Purchased Furniture	30,000 + (-) 3,000 +	1,50,000 + 0 +	0 + 3,000 +	0 + 0 +	0 = 0 =	1,00,000 + 0 +	80,000
5.	Paid Rent	27,000 + (-) 2,000 +	1,50,000 + 0 +	3,000 + 0 +	0 + 0 +	0 = 0 =	1,00,000 + (-) 2,000 +	80,000
6.	Sold goods for cash	25,000 + (+) 60,000 +	1,50,000 + (-) 45,000 +	3,000 + 0 +	0 + 0 +	0 = 0 =	98,000 + 15,000 +	80,000
7.	Paid to creditors	85,000 + (-) 20,000 +	1,05,000 + 0 +	3,000 + 0 +	0 + 0 +	0 = 0 =	1,13,000 + 0 +	80,000
8.	Withdrew cash for private use	65,000 + (-) 10,000 +	1,05,000 + 0 +	3,000 + 0 +	0 + 0 +	0 = 0 =	1,13,000 + (-) 10,000 +	60,000
9.	Paid Salaries	55,000 + (-) 5,000 +	1,05,000 + 0 +	3,000 + 0 +	0 + 0 +	0 = 0 =	1,03,000 + (-) 5,000 +	60,000
10.	Sold goods on credit costing Rs. 60,000	50,000 + 0 +	1,05,000 + (-) 60,000 +	3,000 + 0 +	0 + 80,000 =	0 = 80,000 =	98,000 + (+) 20,000 +	60,000
	Equation	50,000 +	45,000 +	3,000 +	0 +	80,000 =	1,18,000 +	60,000
					1,78,000 =		1,78,000	

Explanation :

S. No.	Transactions	Accounts Affected	
		Assets	Capital & Liabilities
1.	Capital brought in	Cash increases (comes in)	Capital increases (created)
2.	Cash purchases	Stock increases Cash decreases	—
3.	Credit purchases	Stock increases	Creditors increase
4.	Furniture bought	Cash decreases Furniture increases (comes in)	—
5.	Rent paid	Cash decreases	Capital decreases (Rent is an expenses it results in a loss)
6.	Cash Sales	Cash increases Stock decreases	—
7.	Payment to creditors	Cash decreases	Creditors decrease
8.	Withdrawal of cash for private use (Drawings)	Cash decreases	Capital decreases
9.	Salaries paid	Cash decreases	Capital decreases (Salary is an expense - Loss)
10.	Credit Sales	Stock decreases Debtors increase	—

Balance Sheet of Mr.Maharajan

as on

Capital & Liabilities	Rs.	Assets	Rs.
Capital	1,18,000	Cash	50,000
Creditors	60,000	Stock	45,000
		Furniture	3,000
		Debtors	80,000
	1,78,000		1,78,000

4.3 Rules for Debiting and Crediting

In actual practice, the individual transactions of similar nature are recorded, added and subtracted at one place. Such place is customarily the meaning of debit and credit, it is essential to understand the meaning and form of an account.

An account is a record of all business transactions relating to a particular person or asset or liability or expense or income. In accounting, we keep a separate record of each individual, asset, liability, expense or income. The place where such a record is maintained is termed as an 'Account'.

All accounts are divided into two sides. The left hand side of an account is called Debit side and the right hand side of an account is called Credit side. In the abbreviated form Debit is written as Dr. and Credit is written as Cr. For example, the transactions relating to cash are recorded in an account, entitled 'Cash Account' and its format will be as given below:

Debit (Dr.)	Cash Account	Credit (Cr.)

In order to decide when to write on the debit side of an account and when to write on the credit side of an account, there are two approaches. They are: 1) Accounting Equation Approach, 2) Traditional Approach.

Nature of Account

The accounting equation is a statement of equality between the debits and the credits. The rules of debit and credit depend on the nature of an account. For this purpose, all the accounts are classified into the following five categories in the accounting equation approach:-

1. Assets Accounts
2. Capital Account
3. Liabilities Accounts
4. Revenues or Incomes Accounts
5. Expenses or Losses Accounts

If there is an increase or decrease in one account, there will be equal decrease or increase in another account. Accordingly, the following rules of debit and credit in respect of the various categories of accounts can be obtained.

The rules may be summarised as below :-

1. Increases in assets are debits;
decreases in assets are credits.
2. Increases in capital are credits;
decreases in capital are debits.
3. Increases in liabilities are credits;
decreases in liabilities are debits.
4. Increases in incomes and gains are credits;
decreases in incomes and gains are debits.
5. Increases in expenses and losses are debits;
decreases in expenses and losses are credits.

Elements of Accounting Equation	Debit	Credit
Assets	Increase	Decrease
Liabilities	Decrease	Increase
Capital	Decrease	Increase
Revenues	Decrease	Increase
Expenses	Increase	Decrease

In the traditional approach, all the accounts are classified into the following three types.

1. Personal Accounts
2. Real Accounts
3. Nominal Accounts

Golden Rules for Debit and Credit:

1. Personal Accounts –
 - a) Debit the receiver
 - b) Credit the giver
2. Real Accounts –
 - a) Debit what comes in
 - b) Credit what goes out
3. Nominal Accounts –
 - a) Debit all expenses and losses
 - b) Credit all incomes and gains

4.4 Books of Original Entry

The books in which a transaction is recorded for the first time from a source document are called *Books of Original Entry* or *Prime Entry*. *Journal* is one of the books of original entry in which transactions are originally recorded in a chronological (day-to-day) order according to the principles of Double Entry System.

4.4.1 Journal

Journal is a date-wise record of all the transactions with details of the accounts debited and credited and the amount of each transaction.

4.4.2 Format

Journal

Date	Particulars	L.F.	Debit Amount Rs.	Credit Amount Rs.

Explanation:

1. Date : In the first column, the date of the transaction is entered. The year and the month is written only once, till they change. The sequence of the dates and months should be strictly maintained.

2. Particulars : Each transaction affects two accounts, out of which one account is debited and the other account is credited. The name of the account to be debited is written first, very near to the line of particulars column and the word **Dr.** is also written at the end of the particulars column. In the second line, the name of the account to be credited is written, starts with the word '**To**', a few space away from the margin in the particulars column to make it distinct from the debit account.

3. Narration : After each entry, a brief explanation of the transaction together with necessary details is given in the particulars column with in brackets called **narration**. The words 'For' or 'Being' are used before starting to write down narration. Now, it is not necessary to use the word 'For' or 'Being'.

4. Ledger Folio (L.F): All entries from the journal are later posted into the ledger accounts. The page number or folio number of the Ledger, where the posting has been made from the Journal is recorded in the L.F column of the Journal. Till such time, this column remains blank.

5. Debit Amount : In this column, the amount of the account being debited is written.

6. Credit Amount : In this column, the amount of the account being credited is written.

4.4.3 Steps in Journalising

The process of analysing the business transactions under the heads of debit and credit and recording them in the Journal is called **Journalising**. An entry made in the journal is called a '**Journal Entry**'.

Step 1 → Determine the two accounts which are involved in the transaction.

Step 2 → Classify the above two accounts under Personal, Real or Nominal.

Step 3 → Find out the rules of debit and credit for the above two accounts.

Step 4 → Identify which account is to be debited and which account is to be credited.

Step 5 → Record the date of transaction in the date column. The year and month is written once, till they change. The sequence of the dates and months should be strictly maintained.

Step 6 → Enter the name of the account to be debited in the particulars column very close to the left hand side of the particulars column followed by the abbreviation Dr. in the same line. Against this, the amount to be debited is written in the debit amount column in the same line.

Step 7 → Write the name of the account to be credited in the second line starts with the word '**To**' a few space away from the margin in the particulars column. Against this, the amount to be credited is written in the credit amount column in the same line.

Step 8 → Write the narration within brackets in the next line in the particulars column.

Step 9 → Draw a line across the entire particulars column to separate one journal entry from the other.

4.5 Illustrations

Example 1:

January 1, 2004 – Saravanan started business with Rs. 1,00,000.

Analysis of Transaction

Step 1	Determine the two accounts involved in the transaction.	Cash Account	Capital Account
Step 2	Classify the accounts under personal, real or nominal.	Real Account	Personal Account

Step 3	Find out the rules of debit and credit.	2(a) Debit what comes in.	1(b) Credit the giver
Step 4	Identify which account is to be debited and credited.	Cash A/c is to be debited	Capital A/c is to be credited

Solution :**Journal**

Date	Particulars	L.F	Debit		Credit	
			Rs.	P.	Rs.	P.
2004 Jan 1	Cash A/c Dr.	12	1,00,000	-		
	To Capital A/c (The amount invested in the business)	45			1,00,000	-

The Ledger Folio column indicates 12 against Cash Account which means that Cash Account is found in page 12 in the ledger and this debit of Rs.1,00,000 to Cash A/c can be seen on that page. Similarly 45 against Capital A/c indicates the page number in which Capital account is found and the credit of Rs.1,00,000 indicated there in.

Example 2:

Jan. 3, 2004 : Received cash from Balan Rs. 25,000

Analysis of Transaction

Step 1	Determine the two accounts involved in the transaction.	Cash Account	Balan Account
Step 2	Classify the accounts under personal, real or nominal.	Real Account	Personal Account
Step 3	Find out the rules of debit and credit.	2(a) Debit what comes in.	1(b) Credit the giver
Step 4	Identify which account is to be debited and credited.	Cash A/c is to be debited	Balan A/c is to be credited

Solution :**Journal**

Date	Particulars	L.F	Debit		Credit	
			Rs.	P.	Rs.	P.
2004 Jan 3	Cash A/c Dr.	12	25,000	-		
	To Balan's A/c (Cash received from Balan)	81			25,000	-

The Ledger Folio column indicates 12 against Cash Account which means that Cash Account is found in page 12 in the ledger and this debit of Rs.25,000 to Cash A/c can be seen on that page. Similarly 81 against Balan A/c indicates the page number in which Balan Account is found and the credit of Rs.25,000 indicated there in.

Example 3: July 7, 2004 – Paid cash to Perumal Rs.37,000.

Analysis of Transaction

Step 1	Determine the two accounts involved in the transaction.	Perumal Account	Cash Account
Step 2	Classify the accounts under personal, real or nominal.	Personal Account	Real Account
Step 3	Find out the rules of debit and credit.	1(a) Debit the receiver	2(b) Credit what goes out
Step 4	Identify which account is to be debited and credited.	Perumal A/c is to be debited	Cash A/c is to be credited

Solution :**Journal**

Date	Particulars	L.F	Debit		Credit	
			Rs.	P.	Rs.	P.
2004 July 7	Perumal A/c Dr.	95	37,000	-		
	To Cash A/c (Cash paid to Perumal)	12			37,000	-

Example 4: Feb. 7, 2004 – Bought goods for cash Rs. 80,000.

Analysis of Transaction

Step 1	Determine the two accounts involved in the transaction.	Purchases Account	Cash Account
Step 2	Classify the accounts under personal, real or nominal.	Real Account	Real Account
Step 3	Find out the rules of debit and credit.	2(a) Debit what comes in	2(b) Credit what goes out
Step 4	Identify which account is to be debited and credited.	Purchase A/c is to be debited	Cash A/c is to be credited

Solution:

Journal

Date	Particulars	L.F	Debit		Credit	
			Rs.	P.	Rs.	P.
2004 Feb 7	Purchases A/c Dr.	48	80,000	-		
	To Cash A/c (Cash purchase of goods)	12			80,000	-

Example 5: March 10, 2004 – Cash sales Rs.90,000.

Analysis of Transaction

Step 1	Determine the two accounts involved in the transaction.	Cash Account	Sales Account
Step 2	Classify the accounts under personal, real or nominal.	Real Account	Real Account
Step 3	Find out the rules of debit and credit.	2(a) Debit what comes in	2(b) Credit what goes out
Step 4	Identify which account is to be debited and credited.	Cash A/c is to be debited	Sales A/c is to be credited

Solution:**Journal**

Date	Particulars	L.F	Debit		Credit	
			Rs.	P.	Rs.	P.
2004 Mar 10	Cash A/c Dr. To Sales A/c (Cash Sales)		90,000	-	90,000	-

Example 6: March 15, 2004 – Sold goods to Jaleel on credit Rs.1,00,000.

Analysis of Transaction

Step 1	Determine the two accounts involved in the transaction.	Jaleel Account	Sales Account
Step 2	Classify the accounts under personal, real or nominal.	Personal Account	Real Account
Step 3	Find out the rules of debit and credit.	1(a) Debit the receiver	2(b) Credit what goes out
Step 4	Identify which account is to be debited and credited.	Jaleel A/c is to be debited	Sales A/c is to be credited

Solution :**Journal**

Date	Particulars	L.F	Debit		Credit	
			Rs.	P.	Rs.	P.
2004 March 15	Jaleel A/c Dr. To Sales A/c (Credit Sales)		1,00,000	-	1,00,000	-

Example 7: March 18, 2004 – Purchased goods from James on credit Rs.1,50,000.

Analysis of Transaction

Step 1	Determine the two accounts involved in the transaction.	Purchases Account	James Account
Step 2	Classify the accounts under personal, real or nominal.	Real Account	Personal Account

Step 3	Find out the rules of debit and credit.	2(a) Debit what comes in	1(b) Credit the giver
Step 4	Identify which account is to be debited and credited.	Purchases A/c is to be debited	James A/c is to be credited

Solution :

Journal

Date	Particulars	L.F	Debit		Credit	
			Rs.	P.	Rs.	P.
2004 March 18	Purchases A/c Dr. To James A/c (Credit purchases)		1,50,000	-	1,50,000	-

Example 8: March 20, 2004 – Returned goods from Jaleel Rs.5,000.

Analysis of Transaction

Step 1	Determine the two accounts involved in the transaction.	Sales Return Account	Jaleel Account
Step 2	Classify the accounts under personal, real or nominal.	Real Account	Personal Account
Step 3	Find out the rules of debit and credit.	2(a) Debit what comes in	1(b) Credit the giver
Step 4	Identify which account is to be debited and credited.	Sales return A/c is to be debited	Jaleel A/c is to be credited

Solution :

Journal

Date	Particulars	L.F	Debit		Credit	
			Rs.	P.	Rs.	P.
2004 March 20	Sales return A/c Dr. To Jaleel A/c (Returned goods)		5,000	-	5,000	-

Example 9: March 25, 2004 – Goods returned to James Rs.7,000.

Analysis of Transaction

Step 1	Determine the two accounts involved in the transaction.	James Account	Purchases return Account
Step 2	Classify the accounts under personal, real or nominal.	Personal Account	Real Account
Step 3	Find out the rules of debit and credit.	1(a) Debit the receiver	2(b) Credit what goes out
Step 4	Identify which account is to be debited and credited.	James A/c is to be debited	Purchases return A/c is to be credited

Solution :

Journal

Date	Particulars	L.F	Debit		Credit	
			Rs.	P.	Rs.	P.
2004 March 25	James A/c Dr. To Purchases return A/c (Goods returned)		7,000	-	7,000	-

Example 10: March 25, 2004 – Paid salaries in cash Rs.6,000.

Analysis of Transaction

Step 1	Determine the two accounts involved in the transaction.	Salaries Account	Cash Account
Step 2	Classify the accounts under personal, real or nominal.	Nominal Account	Real Account
Step 3	Find out the rules of debit and credit.	3(a) Debit all expenses & losses	2(b) Credit what goes out
Step 4	Identify which account is to be debited and credited.	Salaries A/c is to be debited	Cash A/c is to be credited

Solution:**Journal**

Date	Particulars	L.F	Debit		Credit	
			Rs.	P.	Rs.	P.
2004 March 25	Salaries A/c Dr. To Cash A/c (Salaries paid)		6,000	-	6,000	-

Example 11: April 14, 2004 – Commission received Rs.5,000.**Analysis of Transaction**

Step 1	Determine the two accounts involved in the transaction.	Cash Account	Commission Account
Step 2	Classify the accounts under personal, real or nominal.	Real Account	Nominal Account
Step 3	Find out the rules of debit and credit.	2(a) Debit what comes in	3(b) Credit all incomes & gains
Step 4	Identify which account is to be debited and credited.	Cash A/c is to be debited	Commission A/c is to be credited

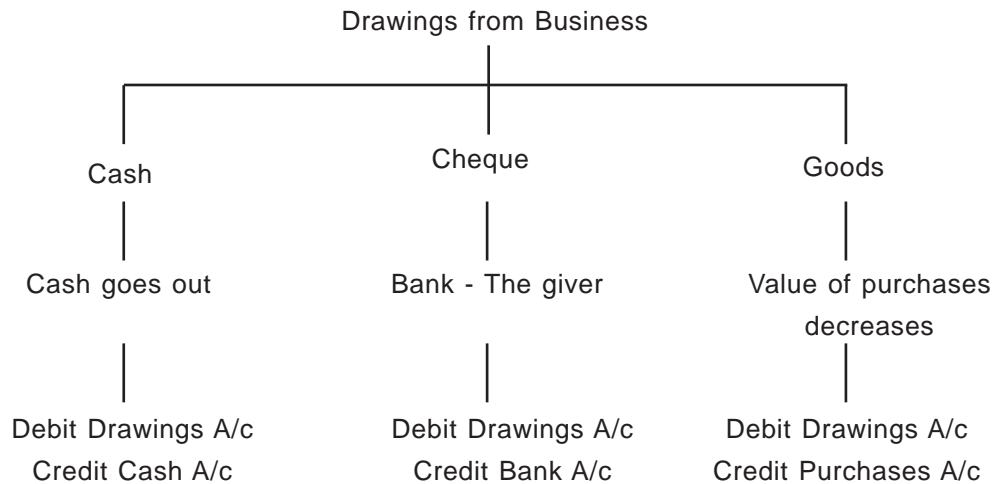
Solution:**Journal**

Date	Particulars	L.F	Debit		Credit	
			Rs.	P.	Rs.	P.
2004 April 14	Cash A/c Dr. To Commission A/c (Commission received)		5,000	-	5,000	-

4.5.1 Capital and Drawings

It is important to note that business is treated as a separate entity from the business man. All transactions of the business have to be analysed from the business point of view and not from the proprietor's point of view. The amount with which a trader starts the business is known as **Capital**. The proprietor may

withdraw certain amounts from the business to meet personal expenses or goods for personal use. It is called **Drawings**.



Example 12: January 31, 2004 – Saravanan withdrew for personal use Rs. 20,000.

Analysis of Transaction

Step 1	Determine the two accounts involved in the transaction.	Drawings Account	Cash Account
Step 2	Classify the accounts under personal, real or nominal.	Personal Account	Real Account
Step 3	Find out the rules of debit and credit.	1(a) Debit the receiver	2(b) Credit what goes out
Step 4	Identify which account is to be debited and credited.	Drawings A/c is to be debited	Cash A/c is to be credited

Solution:

Journal

Date	Particulars	L.F	Debit		Credit	
			Rs.	P.	Rs.	P.
2004 Jan. 31	Drawings A/c Dr. To Cash A/c (The amount withdrawn for personal use)		20,000	-	20,000	-

4.5.2 Bank Transactions

Bank transactions that occur often in the business concerns are cash paid into bank, cheques and bills received from customers paid into bank for collection, payment of cheques for expenses and cheques issued to suppliers or creditors. When a cheque is received treat it as cash.

Example 13: January 18, 2004 – Opened a current account with Indian Overseas Bank Rs.10,000.

Analysis of Transaction

Step 1	Determine the two accounts involved in the transaction.	Bank Account	Cash Account
Step 2	Classify the accounts under personal, real or nominal.	Personal Account	Real Account
Step 3	Find out the rules of debit and credit.	1(a) Debit the receiver	2(b) Credit what goes out
Step 4	Identify which account is to be debited and credited.	Bank A/c is to be debited	Cash A/c is to be credited

Solution:

Journal

Date	Particulars	L.F	Debit		Credit	
			Rs.	P.	Rs.	P.
2004 Jan. 18	Indian Overseas Bank A/c Dr. To Cash A/c (Opened a current A/c.)		10,000	-	10,000	-

Example 14: Feb 3, 2004 – Rent paid by cheque Rs. 5,000.

Analysis of Transaction

Step 1	Determine the two accounts involved in the transaction.	Rent Account	Bank Account
Step 2	Classify the accounts under personal, real or nominal.	Nominal Account	Personal Account

Step 3	Find out the rules of debit and credit.	3(a) Debit all expenses & losses	1(b) Credit the giver
Step 4	Identify which account is to be debited and credited.	Rent A/c is to be debited	Bank A/c is to be credited

Solution:

Journal

Date	Particulars	L.F	Debit		Credit	
			Rs.	P.	Rs.	P.
2004 Feb 3	Rent A/c Dr. To Bank A/c (Rent paid by cheque No.)		5,000	-	5,000	-

Example 15: March 5, 2004 – Received cheque from Elavarasan Rs.20,000.

Analysis of Transaction

Step 1	Determine the two accounts involved in the transaction.	Cash Account	Elavarasan Account
Step 2	Classify the accounts under personal, real or nominal.	Real Account	Personal Account
Step 3	Find out the rules of debit and credit.	2(a) Debit what comes in	1(b) Credit the giver
Step 4	Identify which account is to be debited and credited.	Cash A/c is to be debited	Elavarasan A/c is to be credited

Solution:**Journal**

Date	Particulars	L.F	Debit		Credit	
			Rs.	P.	Rs.	P.
2004 March 5	Cash A/c Dr. To Elavarasan A/c (Cheque received but not paid into bank)		20,000	-	20,000	-

Example 16: March 15, 2004 – Cheque received from Santhosh Rs.30,000 and immediately banked.

Analysis of Transaction

Step 1	Determine the two accounts involved in the transaction.	Bank Account	Santhosh Account
Step 2	Classify the accounts under personal, real or nominal.	Personal Account	Personal Account
Step 3	Find out the rules of debit and credit.	1(a) Debit the receiver	1(b) Credit the giver
Step 4	Identify which account is to be debited and credited.	Bank A/c is to be debited	Santhosh A/c is to be credited

Solution:**Journal**

Date	Particulars	L.F	Debit		Credit	
			Rs.	P.	Rs.	P.
2004 March 15	Bank A/c Dr. To Santhosh A/c (Cheque received and immediately banked)		30,000	-	30,000	-

4.5.3 Compound Journal Entry

When two or more transactions of similar nature take place on the same date, such transactions can be entered in the journal by means of a combined journal entry is called **Compound Journal Entry**. The only precaution is that the total debits should be equal to total credits.

Example 17: June 1, 2004 – Anju contributed capital Rs. 50,000

Manju contributed capital Rs. 70,000

Solution:

Journal						
Date	Particulars	L.F	Debit		Credit	
			Rs.	P.	Rs.	P.
2004 June 1	Cash A/c Dr.		1,20,000	-		
	To Anju's Capital A/c				50,000	-
	To Manju's Capital A/c				70,000	-
	(The amount invested by Anju & Manju)					

Example 18:

July 1, 2004 – Ajay contributed capital – Cash Rs. 90,000
 Furniture Rs. 20,000
 Vijay contributed capital – Cash Rs. 50,000
 Stock Rs. 70,000

Solution:

Journal						
Date	Particulars	L.F	Debit		Credit	
			Rs.	P.	Rs.	P.
2004 July 1	Cash A/c Dr.		1,40,000	-		
	Stock A/c Dr.		70,000	-		
	Furniture A/c Dr.		20,000	-		
	To Ajay's Capital A/c				1,10,000	-
	To Vijay's Capital A/c				1,20,000	-
	(Capital introduced by Ajai & Vijay)					

Example 19: July 13, 2003 – Received cash Rs.24,700 from Shanthi in full settlement of her account of Rs.25,000.

Here cash received is Rs.24,700 in full settlement of Rs.25,000 so the difference Rs.300 is discount allowed.

Solution:

Journal

Date	Particulars	L.F	Debit		Credit	
			Rs.	P.	Rs.	P.
2003 July 13	Cash A/c Dr.		24,700	-		
	Discount allowed A/c Dr. To Shanthi's A/c		300	-	25,000	-
	(Shanthi settled her account)					

Example 20: July 14, 2003 – Paid cash to Thenmozhi Rs.14,500, in full settlement of her account of Rs.15,000.

Here cash paid Rs.14,500 in settlement of Rs.15,000 so the difference Rs. 500 is discount received.

Solution:

Journal

Date	Particulars	L.F	Debit		Credit	
			Rs.	P.	Rs.	P.
2003 July 14	Thenmozhi A/c Dr.		15,000	-		
	To Cash A/c				14,500	-
	To Discount received A/c. (Settled Thenmozhi's account)				500	-

Bad Debts

When the goods are sold to a customer on credit and if the amount becomes irrecoverable due to his insolvency or for some other reason, the amount not recovered is called **bad debts**. For recording it, the bad debts account is debited because the unrealised amount is a loss to the business and the customer's account is credited.

Example 21 : Jamuna who owed us Rs.10,000 is declared insolvent and 25 paise in a rupee is received from her on 15th July, 2003.

Solution:**Journal**

Date	Particulars	L.F	Debit		Credit	
			Rs.	P.	Rs.	P.
2003 July 15	Cash A/c Dr.		2,500	-		
	Bad Debts A/c Dr. To Jamuna A/c (25 paise in a rupee received on her insolvency)		7,500	-	10,000	-

Bad Debts Recovered

Some times, it so happens that the bad debts previously written off are subsequently recovered. In such case, cash account is debited and bad debts recovered account is credited because the amount so received is a gain to the business.

Example 22: Received cash for a Bad debt written off last year Rs.7,500 on 18th January, 2004.

Solution:**Journal**

Date	Particulars	L.F	Debit		Credit	
			Rs.	P.	Rs.	P.
2004 Jan 18	Cash A/c Dr.		7,500	-		
	To Bad debts recovered A/c (Bad debts recovered)				7,500	-

4.5.5 Opening Entry

Opening Entry is an entry which is passed in the beginning of each current year to record the closing balance of assets and liabilities of the previous year. In this entry asset accounts are debited and liabilities and capital account are credited. If capital is not given in the question, it will be found out by deducting total of liabilities from total of assets.

Example 23: The following balances appeared in the books of Malarkodi as on 1st January 2004 – Cash Rs. 7,000, Bank Rs.70,000, Stock Rs.80,000, Furniture Rs.10,000, Computer Rs.50,000, Debtors Rs.33,000 and Creditors Rs.90,000.

The opening entry is

Journal

Date	Particulars	L.F	Debit		Credit	
			Rs.	P.	Rs.	P.
2004 Jan 1	Cash A/c Dr.		7,000	-		
	Bank A/c Dr.		70,000	-		
	Stock A/c Dr.		80,000	-		
	Debtors A/c Dr.		33,000	-		
	Furniture A/c Dr.		10,000	-		
	Computer A/c Dr.		50,000	-		
	To Creditors A/c				90,000	-
	To Capital A/c (Balancing figure)				1,60,000	-
	(Assets and liabilities brought forward)					

4.5.6 Advantages

The main advantages of the Journal are:

1. It reduces the possibility of errors.
2. It provides an explanation of the transaction.
3. It provides a chronological record of all transactions.

4.5.7 Limitations

The limitations of the Journal are:

1. It will be too long if all transactions are recorded here.
2. It is difficult to ascertain the balance of each account.

QUESTIONS

I. Objective Type:

a) Fill in the Blanks :

1. The source document gives information about the nature of the _____.
2. The accounting equation is a statement of _____ between the debits and credits.

3. In double entry book-keeping, every transaction affects at least two _____.
4. Assets are always equal to liabilities plus _____.
5. A transaction which increases the capital is called _____.
6. The journal is a book of _____.
7. Recording of transaction in the journal is called _____.
8. The _____ column of journal represents the place of posting of an entry in the ledger account.
9. _____ account is debited for the amount not recovered from the customer.
10. The assets of a business on 31st December, 2002 were worth Rs.50,000 and its capital was Rs.35,000. Its liabilities on that date were Rs. _____.

[Answer : 1. transactions, 2. equality, 3. accounts, 4. capital, 5. revenue or income, 6. original entry, 7. journalising, 8. L.F, 9. bad debts, 10. Rs.15,000]

b) Choose the correct answer:

1. The origin of a transaction is derived from the
 - a) Source document b) Journal c) Accounting equation
2. Which of the following is correct?
 - a) Capital = Assets + Liabilities b) Capital = Assets – Liabilities
 - c) Assets = Liabilities – Capital
3. Amount owned by the proprietor is called
 - a) Assets b) Liabilities c) Capital
4. The Accounting Equation is connected with
 - a) Assets only b) Liabilities only
 - c) Assets, Liabilities and capital
5. Goods sold to Srinivasan should be debited to
 - a) Cash A/c b) Srinivasan A/c. c) Sales A/c.
6. Purchased goods from Venkat for cash should be credited to
 - a) Venkat A/c b) Cash A/c c) Purchases A/c

7. Withdrawals of cash from bank by the proprietor for office use should be credited to
 - a) Drawings A/c b) Bank A/c c) Cash A/c
8. Purchased goods from Murthy on credit should be credited to
 - a) Murthy A/c b) Cash A/c c) Purchases A/c
9. An entry is passed in the beginning of each current year is called
 - a) Original entry b) Final entry c) Opening entry
10. The liabilities of a business are Rs.30,000; the capital of the proprietor is Rs.70,000. The total assets are:
 - a) Rs.70,000 b) Rs.1,00,000 c) Rs.40,000

[Answers : 1. (a), 2. (b), 3. (c), 4. (c), 5. (b), 6. (b), 7. (b), 8. (a), 9.(c), 10 (b)]

II. Other Questions :

1. Explain the meaning of source documents.
2. What is cash memo?
3. What is an invoice?
4. What is a receipt?
5. What is pay-in-slip?
6. What is a debit note?
7. What is a credit note?
8. Explain the meaning of Accounting Equation.
9. What is a Journal?
10. Mention the five categories of Accounts.
11. How is the Journal ruled?
12. What is Journalising?
13. What do you mean by L.F.? How do you fill in this column?
14. What is a narration?
15. What is capital?
16. What is drawings?
17. What is a Compound Journal Entry?

18. Explain the rules for journalising.
19. Explain the steps in journalising?
20. Bring out the advantages and the limitations of journal.

III. Problems:

1. On 31st December 2003, the total assets and liabilities were Rs.1,00,000 and Rs.30,000 respectively. Calculate capital.
2. Indicate how assets, liabilities and capital are affected by each of the following transactions with an accounting equation:
 - i. Purchase of machinery for cash Rs. 3,00,000.
 - ii. Receipt of cash from a debtor Rs. 50,000.
 - iii. Cash payment of a creditor Rs.30,000.
3. Give transactions with imaginary figures involving the following:
 - i. Increase in assets and capital,
 - ii. Increase and decrease in assets,
 - iii. Increase in an asset and a liability,
 - iv. Decrease of an asset and owner's capital.
4. Supply the missing amounts on the basis of Accounting Equation

$$\text{Assets} = \text{Liabilities} + \text{Capital}$$

Assets	=	Liabilities	+	Capital
i. 20,000	=	15,000	+	?
ii. ?	=	5,000	+	10,000
iii. 10,000	=	?	+	8,000
5. State the nature of account and show which account will be debited and which account will be credited?
 1. Rent received
 2. Building purchased
 3. Machinery sold
 4. Discount allowed
 5. Discount received

6. Correct the following entries wherever you think:

i. Brought capital in to business:

Capital A/c Dr.

To Cash A/c

ii. Cash Purchases:

Cash A/c Dr.

To Sales A/c

iii. Salaries paid to clerk Mr.Kanniyappan:

Salaries A/c Dr.

To Kanniyappan A/c

iv. Paid carriage:

Carriage A/c Dr.

To Cash A/c

7. What do the following Journal Entries mean?

i. Cash A/c Dr.

To Furniture A/c

ii. Rent A/c Dr.

To Cash A/c

iii. Bank A/c Dr.

To Cash A/c

iv. Tamilselvi A/c Dr.

To Sales A/c

8. Show the accounting equation on the basis of the following transactions.

	Rs.
i. Ramya started business with cash	25,000
ii. Purchased goods from Shobana	20,000
iii. Sold goods to Amala costing Rs.18,000	25,000
iv. Ramya withdrew from business	5,000

[Assets Rs. 47,000 = Capital Rs.27,000 + Liabilities Rs.20,000]

9. Prepare accounting equation and balance sheet on the basis of the following :

	Rs.
i. Pallavan started business with cash	60,000
ii. He purchased furniture	10,000
iii. He paid rent	2,000
iv. He purchased goods on credit from Mr.Mahendran	30,000
v. He sold goods (cost price Rs.20,000) for cash	25,000

[Assets Rs. 93,000 = Capital Rs.63,000 + Liabilities Rs.30,000]

10. Journalise the following Opening Entry:

	Rs.
Cash in hand	2,000
Plant	50,000
Furniture	5,000
Creditors	13,000
Debtors	18,000

11. Journalise the following transactions in the books of Tmt.Amutha

	Rs.
2004, Jan. 1 Tmt.Amutha commenced business with cash	50,000
2 Purchased goods for cash	10,000
5 Purchased goods from Mohan on credit	6,000
7 Paid into Bank	5,000
10 Purchased furniture	2,000
20 Sold goods to Suresh on credit	5,000
25 Cash sales	3,500
26 Paid to Mohan on account	3,000
31 Paid salaries	2,800

12. Journalise the following transactions of Mrs.Rama

	Rs.
2004, Jan 1 Mrs.Rama commenced business with cash	30,000
2 Paid into bank	21,000
3 Purchased goods by cheque	15,000
7 Drew cash from bank for office use	3,000
15 Purchased goods from Siva	15,000
20 Cash sales	30,000
25 Paid to Siva	14,750
Discount Received	250
31 Paid rent	500
Paid Salaries	2,000

13. Journalise the following transactions of Mr.Moorthi

	Rs.
2004, June 3 Received cash from Ramkumar	60,000
4 Purchased goods for cash	15,000
11 Sold goods to Damodaran	22,000
13 Paid to Ramkumar	40,000
17 Received from Damodaran	20,000
20 Bought furniture from Jagadeesan	5,000
27 Paid rent	1,200
30 Paid salary	2,500

14. Journalise the following in the Journal of Thiru.Gowri Shankar

	Rs.
2003, Oct. 1 Received cash from Siva	75,000
7 Paid cash to Sayeed	45,000
10 Bought goods for cash	27,000
12 Bought goods on credit from David	48,000
15 Sold goods for cash	70,000

15. Record the following transactions in the Journal of
Tmt.Bhanumathi.

2004, Feb. 3 Bought goods for cash Rs.84,500

7 Sold goods to Dhanalakshmi on credit Rs.55,000

9 Received commission Rs.3,000

10 Cash Sales Rs.1,09,000

12 Bought goods from Mahalakshmi Rs.60,000

15 Received five chairs from Revathi & Co.at Rs.400 each

20 Paid Revathi & Co., cash for five chairs

28 Paid Salaries Rs.10,000

Paid Rent Rs.5,000

16. Journalise the following transactions in the books of
Thiru.Kalyanasundaram.

2004, March 1 Sold goods on credit to Mohanasundaram Rs.75,000.

12 Purchased goods on credit from Bashyam Rs.70,000.

15 Sold goods for cash from David Rs.50,000.

20 Received from Mohanasundaram Rs.70,000.

25 Paid to Bashyam Rs.50,000.

CHAPTER - 5

BASIC ACCOUNTING PROCEDURES - III

LEDGER

Learning Objectives

After studying this chapter you will be able to:

- *understand the Meaning and Procedure for posting.*
 - *know the Procedure for Balancing and the Significance of Balances.*
 - *know the Relationship between Journal and Ledger.*
-

In the Journal, each transaction is dealt with separately. Therefore, it is not possible to know at a glance, the net result of many transactions. So, in order to ascertain the net effect of all the transactions relating to a particular account are collected at one place in the Ledger.

A Ledger is a book which contains all the accounts whether personal, real or nominal, which are first entered in journal or special purpose subsidiary books.

According to **L.C. Cropper**, 'the book which contains a classified and permanent record of all the transactions of a business is called the Ledger'.

The ledger that is normally used in a majority of business concern is a bound note book. This can be preserved for a long time. Its pages are consequently numbered. Each account in the ledger is opened preferably on a separate page. If one page is completed, the account will be continued in the next or some other page. But in bigger concerns, it is not practical to keep the ledger as a bound note book, Loose-leaf ledger now takes the place of a bound note book. In a loose-leaf ledger, appropriate ruled sheets of thick paper are introduced and fixed up with the help of a binder. Whenever necessary additional pages may be inserted, completed accounts can be removed and the accounts may be arranged and rearranged in the desired order. Therefore, this type of ledger is known as **Loose-leaf Ledger**.

5.1 Utility

Ledger is a principal or main book which contains all the accounts in which the transactions recorded in the books of original entry are transferred. Ledger is also called the '**Book of Final Entry**' or '**Book of Secondary Entry**', because the transactions are finally incorporated in the Ledger. The following are the advantages of ledger.

i. Complete information at a glance:

All the transactions pertaining to an account are collected at one place in the ledger. By looking at the balance of that account, one can understand the collective effect of all such transactions at a glance.

ii. Arithmetical Accuracy

With the help of ledger balances, Trial balance can be prepared to know the arithmetical accuracy of accounts.

iii. Result of Business Operations

It facilitates the preparation of final accounts for ascertaining the operating result and the financial position of the business concern.

iv. Accounting information

The data supplied by various ledger accounts are summarised, analysed and interpreted for obtaining various accounting information.

5.2 Format

Dr.				Name of Account				Cr.			
Date	Particulars	J.F	Amount Rs. P.	Date	Particulars	J.F	Amount Rs. P.	Date	Particulars	J.F	Amount Rs. P.
Year Month Date	To (Name of Credit Account in Journal)			Year Month Date	By (Name of Debit account in Journal)						

Explanation:

- Each ledger account is divided into two parts. The left hand side is known as the debit side and the right hand side is known as the credit side. The words 'Dr.' and 'Cr.' are used to denote Debit and Credit.
- The name of the account is mentioned in the top (middle) of the account.
- The date of the transaction is recorded in the date column.
- The word 'To' is used before the accounts which appear on the debit side of an account in the particulars column. Similarly, the word 'By' is used before the accounts which appear on the credit side of an account in the particulars column.

- v. The name of the other account which is affected by the transaction is written either in the debit side or credit side in the particulars column.
- vi. The page number of the Journal or Subsidiary Book from where that particular entry is transferred, is entered in the Journal Folio (J.F) column.
- vii. The amount pertaining to this account is entered in the amount column.

Personal Accounts

Santhosh Account

Dr.	Cr.
Debit Santhosh when he receives goods, money or value from the business	Credit Santhosh when he gives goods, money or value to the business

Real Accounts

Computer Account

Dr.	Cr.
Debit Purchase of asset	Credit Sale of asset

Nominal Accounts

Salaries Account

Dr.	Cr.
Debit expenses or losses	

Commission Received Account

Dr.	Cr.
	Credit incomes or gains

5.3 Posting

The process of transferring the entries recorded in the journal or subsidiary books to the respective accounts opened in the ledger is called **Posting**. In other words, posting means grouping of all the transactions relating to a particular account at one place. It is necessary to post all the journal entries into various accounts in the ledger because posting helps us to know the net effect of various transactions during a given period on a particular account.

5.3.1 Procedure of posting

The procedure of posting is given as follows:

I. Procedure of posting for an Account which has been debited in the journal entry.

Step 1 → Locate in the ledger, the account to be debited and enter the date of the transaction in the date column on the debit side.

Step 2 → Record the name of the account credited in the Journal in the particulars column on the debit side as "To..... (name of the account credited)".

Step 3 → Record the page number of the Journal in the J.F column on the debit side and in the Journal, write the page number of the ledger on which a particular account appears in the L.F. column.

Step 4 → Enter the relevant amount in the amount column on the debit side.

II. Procedure of posting for an Account which has been credited in the journal entry.

Step 1 → Locate in the ledger the account to be credited and enter the date of the transaction in the date column on the credit side.

Step 2 → Record the name of the account debited in the Journal in the particulars column on the credit side as "By..... (name of the account debited)"

Step 3 → Record the page number of the Journal in the J.F column on the credit side and in the Journal, write the page number of the ledger on which a particular account appears in the L.F. column.

Step 4 → Enter the relevant amount in the amount column on the credit side.

Illustration 1

Mr. Ram started business with cash Rs. 5,00,000 on 1st June 2003.

The above transaction will appear in Journal and Ledger as under.

Solution :**In the Books of Ram****Journal**

Date	Particulars	L.F	Debit	Credit	
			Rs.	Rs.	P.
2003 June 1	Cash A/c. Dr. To Ram's Capital A/c (Ram started business with Rs.5,00,000)		5,00,000	5,00,000	-

Note: Here two accounts are involved, Cash Account and Ram's capital account, so we should allot in the ledger a page for each account.

Ledger**Dr. Cash Account Cr.**

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2003 June 1	To Ram's Capital A/c		5,00,000				

Dr. Ram's Capital Account Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
				2003 June 1	By Cash A/c		5,00,000

Illustration 2:

Journalise the following transactions in the books of Amar and post them in the Ledger:-

2004

March 1 Bought goods for cash Rs. 25,000

2 Sold goods for cash Rs. 50,000

3 Bought goods for credit from Gopi Rs.19,000

5 Sold goods on credit to Robert Rs.8,000

7 Received from Robert Rs. 6,000

9 Paid to Gopi Rs.5,000

20 Bought furniture for cash Rs. 7,000

Solution :

Journal of Amar

Date	Particulars	LF.	Debit		Credit	
			Rs.	P.	Rs.	P.
2004 Mar 1	Purchases A/c Dr. To Cash A/c (Cash purchases)		25,000	—	25,000	—
2	Cash A/c Dr. To Sales A/c (Cash Sales)		50,000	—	50,000	—
3	Purchases A/c Dr. To Gopi A/c (Credit purchases)		19,000	—	19,000	—
5	Robert A/c Dr. To Sales A/c (Credit Sales)		8,000	—	8,000	—
7	Cash A/c Dr. To Robert A/c (Cash received)		6,000	—	6,000	—
9	Gopi A/c Dr. To Cash A/c (Cash paid)		5,000	—	5,000	—
20	Furniture A/c. Dr. To Cash A/c (furniture purchased)		7,000	—	7,000	—

Explanation : There are six accounts involved: Cash, Purchases, Sales, Furniture, Gopi & Robert, so six accounts are to be opened in the ledger.

Ledger of Amar**Cash Account**

Dr.

Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2004				2004			
Mar 5	To Sales A/c		50,000	Mar 1	By Purchases A/c		25,000
7	To Robert A/c		6,000	9	By Gopi A/c		5,000
				20	By Furniture A/c		7,000

Purchases Account

Dr.

Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2004							
Mar 1	To Cash A/c		25,000				
3	To Gopi A/c		19,000				

Sales Account

Dr.

Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
				2004			
				Mar 2	By Cash A/c		50,000
				5	By Robert A/c		8,000

Furniture Account

Dr.

Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2004							
Mar 20	To Cash A/c		7,000				

Gopi Account

Dr.

Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2004				2004			
Mar 9	To Cash A/c		5,000	Mar 3	By Purchase A/c		19,000

Robert Account

Dr.

Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2004				2004			
Mar 5	To Sales A/c		8,000	Mar 7	By Cash A/c		6,000

5.3.2 Posting of Compound Journal Entries

Compound or Combined Journal Entry is one where more than one transactions are recorded by passing only one journal entry instead of passing several journal entries. Since every debit must have the corresponding equal amount of credit, special care must be taken in posting the compound journal entry, where there may be only one debit aspect but many corresponding credit aspects of equal value or vice versa. The posting of such transactions is done in the same way as already explained.

Illustration 3 : Jan. 12, 2003, Cash sales Rs.10,000, Cash received from Kannan Rs.5,000 and commission earned Rs.2,500.

Journal

Date	Particulars	L.F	Debit Rs.	Credit Rs.
2003 Jan 12	Cash A/c. Dr. To Sales A/c. To Kannan's A/c. To Commission A/c. (Received cash for sale, from Kannan and as commission)		17,500	10,000 5,000 2,500

Solution :

Ledger
Cash Account

Dr.

Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2003 Jan 12	To Sales A/c To Kannan's A/c. To Commission A/c		10,000 5,000 2,500				

Sales Account

Dr.

Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
				2003 Jan 12	By Cash A/c		10,000

Kannan's Account

Dr.

Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
				2003 Jan 12	By Cash A/c		5,000

Commission Account

Dr.

Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
				2003 Jan 12	By Cash A/c		2,500

Note: In the above transactions, there is only one debit aspect namely cash account and three credit aspects. Therefore, while posting in the cash account, the names of three credit aspects are entered in the cash account on the debit side, thus having a total of Rs.17,500 which is equal to the amount in the debit column of the journal.

The cash account is written on the credit side of the three accounts, namely, Sales, Kannan and Commission received, as it acts as an opposite and corresponding accounts for Sales Rs.10,000, Kannan Rs.5,000 and Commission Rs.2,500 respectively which are equal to the amount in the credit column of the journal.

5.3.3 Posting the Opening Entry

The opening entry is passed to open the books of accounts for the new financial year. The debit or credit balance of an account what we get at the end of the accounting period is known as closing balance of that account. This **closing balance becomes the opening balance in the next accounting year.**

The procedure of posting an opening entry is same as in the case of an ordinary journal entry. An account which has a **debit balance**, the words '**To balance b/d**' are recorded on the debit side in the particulars column. An account which has a **credit balance**, the words "**By balance b/d**" are recorded in the particulars column on the credit side. Infact opening entry is not actually posted but the accounts are merely incorporated in the ledger, if the ledger is a new one or old.

Illustration 4

Post the opening entry into the ledger of Rajan as on 1st April 2003, cash in hand Rs. 10,000; Loan Rs. 1,00,000.

Solution:

In the Books of Rajan

Cash Account

Dr.

Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2003 Apr 1	To Balance b/d		10,000				

Loan Account

Dr.

Cr.

Date	Particulars	J.F	Amount Rs. P.	Date	Particulars	J.F	Amount Rs. P.
				2003 Apr 1	By Balance b/d		1,00,000

5.4 Balancing an Account

Balance is the difference between the total debits and the total credits of an account. When posting is done, many accounts may have entries on their debit side as well as credit side. The net result of such debits and credits in an account is the balance.

Balancing means the writing of the difference between the amount columns of the two sides in the lighter (smaller total) side, so that the grand totals of the two sides become equal.

5.4.1 Significance of balancing

There are three possibilities while balancing an account during a given period. It may be a debit balance or a credit balance or a nil balance depending upon the debit total and the credit total.

i. Debit Balance : The excess of debit total over the credit total is called the **debit balance**. When there is only debit entries in an account, the amount

itself is the balance of that account, i.e., the debit balance. It is first recorded on the credit side, above the total. Then it is entered on the debit side, below the total, as the first item for the next period.

Cash Account

Dr.

Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2003 Mar 2	To Sales A/c		15,000	2003 Mar 15	By Purchase A/c		8,000
12	To Kumar's A/c		4,000	28	By Salary A/c		2,500
				31	By Balance c/d		8,500
			19,000				19,000
Apr 1	To Balance b/d		8,500				

ii. Credit Balance : The excess of credit total over the debit total is called the **credit balance**. When there is only credit entries in an account, the amount itself is the balance of that account i.e., the credit balance. It is first written in the debit side, as the last item, above the total. Then it is recorded on the credit side, below the total, as the first item for the next period.

Capital Account

Dr.

Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2004 Mar 31	To Balance c/d		50,000	2003 Apr 1	By Cash		50,000
			50,000				50,000
				2004 Apr 1	By Balance b/d		50,000

iii. Nil Balance : When the total of debits and credits are equal, it is closed by merely writing the total on both the sides. It indicates the equality of benefits received and given by that account.

Shankar Account

Dr.

Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2003 Mar 20	To Sales A/c		6,000	2003 Mar 25	By Cash		6,000
			6,000				6,000

5.4.2 Balancing of different accounts

Balancing is done periodically, i.e., weekly, monthly, quarterly, halfyearly or yearly, depending on the requirements of the business.

i. Personal Accounts : These accounts are generally balanced regularly to know the amounts due to the persons (**creditors**) or due from the persons (**debtors**).

ii. Real Accounts : These accounts are generally balanced at the end of the financial year, when final accounts are being prepared. However, cash account is frequently balanced to know the **cash on hand**. A debit balance in an asset account indicated the **value of the asset** owned by the business. Assets accounts always show debit balances.

iii. Nominal Accounts : These accounts are in fact, not to be balanced as they are to be closed by transfer to final accounts. A debit balance in a nominal account indicates that it is **an expense or loss**. A credit balance in a nominal account indicates that it is **an income or gain**.

All such balances in personal and real accounts are shown in the Balance Sheet and the balances in nominal accounts are taken to the Profit and Loss Account.

5.4.3 Procedure for Balancing

While balancing an account, the following steps are involved:

Step 1 → Total the amount column of the debit side and the credit side separately and then ascertain the difference of both the columns.

Step 2 → If the debit side total exceeds the credit side total, put such difference on the amount column of the credit side, write the date on which balancing is being done in the date column and the words **“By Balance c/d”** (c/d means carried down) in the particulars column.

OR

If the credit side total exceeds the debit side total, put such difference on the amount column of the debit side, write the date on which balancing is being done in the date column and the words **“To Balance c/d”** in the particulars column.

Step 3 → Total again both the amount columns, put the total on both the sides and draw a line above and a line below the totals.

Step 4 → Enter the date of the beginning of the next period in the date column and bring down the debit balance on the debit side along with the words **“To Balance b/d”** (b/d means brought down) in the particulars column and the credit balance on the credit side along with the words **“By balance b/d”** in the particulars column.

Note: In the place of **c/d** and **b/d**, the words **c/f** or **c/o** (carried forward or carried over) and **b/f** or **b/o** (brought forward or brought over) may also be used. When the balance is carried down **in the same page**, the words **c/d** and **b/d** are used, while balance is carried over **to the next page**, the term **c/o** and **b/o** are used. When balance is carried forward to **some other page** either in same book or some other book, the abbreviations **c/f** (carried forward) and **b/f** (brought forward) are used.

Illustration 5 : Balance the following Ledger Account as on 31st March 2003.

Siva's Account

Dr.

Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2003 Mar 5 21	To Sales A/c To Sales A/c		1,50,000 10,000	2003 Mar. 8 12 20	By Sales Returns A/c By Cash A/c By Bank A/c		10,000 25,000 50,000

Explanation : The steps involved in balancing Siva's Account.

Step 1 → Total the amount column of the debit side	Rs. 1,60,000
Total the amount column of the credit side	Rs. <u>85,000</u>
Balance / Difference	Rs. <u>75,000</u>

Since the total of debit amount column exceeds the total of credit amount column, the difference is Debit balance.

Step 2 → Enter the date of balancing, which is normally the last date of the accounting period (i.e., 31st March 2003) in the date column, “By Balance c/d” in the particulars column, and the difference in the amount column on the credit side.

Step 3 → Total both the amount columns and draw a line above and a line below the totals.

Step 4 → Enter the date of the beginning of the next period in the date column (i.e., 1st April 2003) , ‘To Balance b/d’ in the particulars column and enter the balance amount in the amount column on the debit side.

After taking into consideration of the above steps, Siva’s Account will appear as follows:-

Siva’s Account

Dr.

Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2003 Mar 5	To Sales A/c		1,50,000	2003 Mar 8	By Sales Return A/c		10,000
21	To Sales A/c		10,000	12	By Cash A/c		25,000
				20	By Bank A/c		50,000
				31	By Balance c/d		75,000
			1,60,000				1,60,000
2003 April 1	To Balance b/d		75,000				

Illustration 6 : Balance the ledger accounts for Illustration 2.

Solution:

Cash Account

Dr.

Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2004 Mar 5 7	To Sales A/c To Robert A/c		50,000 6,000	2004 Mar 1 9 20 31	By Purchases A/c By Gopi A/c By Furniture A/c By Balance c/d		25,000 5,000 7,000 19,000
			56,000				56,000
April 1	To Balance b/d		19,000				

Purchases Account

Dr.

Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2004 Mar 1 3	To Cash A/c To Gopi A/c		25,000 19,000	2004 Mar 31	By Balance c/d		44,000
			44,000				44,000
April 1	To Balance b/d		44,000				

Sales Account

Dr.

Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2004 Mar 31	To Balance c/d		58,000	2004 Mar 2 5	By Cash A/c By Robert A/c		50,000 8,000
			58,000				58,000
				April 1	By Balance b/d		58,000

Furniture Account

Dr.

Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2004				2004			
Mar 20	To Cash A/c		7,000	Mar 31	By Balance c/d		7,000
			7,000				7,000
Apr 1	To Balance b/d		7,000				

Gopi Account

Dr.

Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2004				2004			
Mar 19	To Cash A/c		5,000	Mar 3	By Purchases A/c		19,000
31	To Balance c/d		14,000				
			19,000				19,000
				April 1	By Balance b/d		14,000

Robert Account

Dr.

Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2004				2004			
Mar 5	To Sales A/c		8,000	Mar 7	By Cash A/c		6,000
				31	By Balance c/d		2,000
			8,000				8,000
Apr 1	To Balance b/d		2,000				

5.5 Distinction between Journal and Ledger :

Books of original entry (Journal) and Ledger can be distinguished as follows:

Basis of Distinction	Journal	Ledger
1. Book	It is the book of prime entry.	It is the main book of account.
2. Stage	Recording of entries in these books is the first stage.	Recording of entries in the ledger is the second stage.
3. Process	The process of recording entries in these books is called "Journalising".	The process of recording entries in the ledger is called "Posting".
4. Transactions	Transactions relating to a person or property or expense are spread over.	Transactions relating to a particular account are found together on a particular page.
5. Net effect	The final position of a particular account can not be found.	The final position of a particular account can be ascertained just at a glance.
6. Next Stage	Entries are transferred to the ledger.	From the Ledger, first the Trial Balance is drawn and then final accounts are prepared.
7. Tax authorities	Do not rely upon these books	Rely on the ledger for assessment purpose.

QUESTIONS

I. Objective Type:

a) Fill in the blanks:

- Ledger is the _____ book of account.
- The process of transferring entries from Journal to the Ledger is called _____.
- c/d means _____ and b/d means _____.
- c/f means _____ and b/f means _____.

5. Debiting an account signifies recording the transactions on the _____ side.
6. The left hand side of an account is known as _____ and the right hand side as _____.
7. Credit Balance means _____ is heavier than _____.
8. Real accounts cannot have _____ balance.
9. Account having debit balance is closed by writing _____.
10. L.F. column in the journal is filled at the time of _____.

[Answers: 1. principal, 2. posting, 3. carried down; brought down, 4. carried forward; brought forward, 5. debit side, 6. debit side; credit side, 7. credit total; debit total, 8. credit, 9. By Balance c/d, 10. posting]

b) Choose the correct answer :

1. Ledger is a book of :
a. original entry b. final entry c. all cash transactions.
2. Personal and real accounts are:
a. closed b. balanced c. closed and transferred
3. The column of ledger which links the entry with journal is
a. L.F column b. J.F column c. Particulars column
4. Posting on the credit side of an account is written as
a. To b. By c. Being
5. Nominal account having credit balance represents
a. income / gain b. expenses / losses c. assets
6. Nominal account having debit balance represents
a. income / gain b. expenses / losses c. liability
7. Real accounts always show
a. debit balances b. credit balances c. nil balance.
8. Account having credit balance is closed by writing
a. To Balance b/d b. By Balance c/d c. To Balance c/d
9. When the total of debits and credits are equal, it represents
a. debit balance b. credit balance c. nil balance

10. The balances of personal and real accounts are shown in the
 a. profit and loss account b. balance sheet c. both.

[Answers: 1 (b), 2. (b), 3. (b), 4. (b), 5. (a), 6. (b), 7. (a), 8. (c), 9. (c), 10. (b)]

II. Other Questions:

1. What is ledger?
2. Define ledger.
3. Explain the utilities of a ledger.
4. What is a Loose-Leaf Ledger?
5. What is posting?
6. What are the steps in posting?
7. Explain the meaning of balancing an account.
8. Explain the steps in balancing.
9. What is debit balance?
10. What is credit balance?
11. Explain the significance of debit and credit balances of various types of accounts.
12. Indicate the nature of normal balance in the following accounts.

a. Cash	f. Debtors
b. Creditors	g. Purchases
c. Sales	h. Capital
d. Furniture	i. Salaries paid
e. Commission received	j. Computer
13. Explain the posting of a compound journal entry with an example.
14. Distinguish Journal with Ledger.

III. Problems:

1. Journalise the following transactions of Mr.Ravi and post them in the ledger and balance the same.

2004, June 1 Ravi invested Rs.5,00,000 cash in the business

3 Paid into Bank Rs.80,000

5 Purchased building for Rs.3,00,000

7 Purchased goods for Rs.70,000

10 Sold goods for Rs.80,000

15 With drew cash from bank Rs.10,000

25 Paid electric charges Rs.3,000

30 Paid Salary Rs. 15,000

2. Record the following transactions in the Journal of Mr.Radhakrishnan and post them in the ledger and balance the same.

2004, Jan. 1 Radhakrishnan commenced business with cash,
Rs.15,00,000.

3 Paid into Bank Rs.5,00,000

5 Bought goods for Rs.3,60,000

7 Paid travelling charges Rs.5,000

10 Sold goods for Rs.2,50,000

15 Sold goods to Balan Rs.2,40,000

20 Purchased goods from Narayanan Rs.2,10,000

25 Withdrew cash Rs.60,000

3. Journalise the following transactions in the Journal of Mr.Shanmugam, post them in the ledger and balance them.

2003, Aug. 1 Started business with Rs.4,50,000

3 Goods purchased Rs.70,000

5 Goods sold Rs.51,000

10 Goods purchased from Rangasamy Rs.2,00,000

16 Goods returned to Rangasamy Rs.5,000

- 23 Drew from bank Rs.30,000
- 26 Furniture purchased Rs.10,000
- 27 Settled Rangasamy's account
- 31 Salaries paid, Rs.12,000

4. Journalise the following transactions in Tmt.Rani's Journal and post them to ledger and balance them.

		Rs.
2003, Sept. 1	Tmt. Rani started business with	3,00,000
5	Opened a current account with Indian Overseas Bank	50,000
12	Bought goods from Tmt.Sumathi	90,000
18	Paid to Tmt. Sumathi	90,000
20	Sold goods to Tmt.Chitra	1,26,000
28	Tmt.Chitra settled her account	

5. Journalise the following transactions in Thiru.Manikandan's books and post them to ledger and balance them.

2003, Aug 5	Sold goods to Arumugam on Credit Rs.17,500
9	Bought goods for cash from Chellappan Rs.22,500
12	Met Travelling expenses Rs. 2,500
15	Received Rs.80,000 from Sivakumar as loan
21	Paid wages to workers Rs.3,000

6. Enter the following transactions in journal and post them in the ledger of Mr.Govindarajan and balance them.

2003, Aug 1	Govindarajan commenced his business with the following assets and liabilities.
	Plant and Machinery Rs.2,50,000.
	Stock Rs. 90,000.
	Furniture Rs.7,000.
	Cash Rs. 50,000.
	Sundry creditors Rs. 1,50,000.

- 2 Sold goods to Sundar Rs. 1,50,000.
- 3 Bought goods from Natarajan Rs.65,000.
- 4 Sundar paid cash Rs. 1,25,000.
- 6 Returned damaged goods to Natarajan Rs.2,000.
- 10 Paid to Natarajan Rs.28,000.
- 31 Paid rent Rs. 5,000.
- Paid salaries Rs. 9,000.

7. Post the following transactions direct into ledger of Thiru.Karthik and balance them.

- 2003, Oct 1 Received cash from Ramesh Rs.1,60,000.
- 5 Bought goods for cash Rs.60,000.
- 7 Sold to Suresh Rs.30,000.
- 15 Bought from Dayalan Rs.40,000.
- 18 Sold to Ganesan Rs. 50,000.
- 20 Withdrew cash for personal use Rs.18,000.
- 25 Received commission Rs.20,000.
- 30 Paid rent Rs.5,000.
- 31 Paid salary Rs.10,000.

Prepare the necessary accounts in the ledger and bring the balances for

- 8. Problem No.11 in Chapter 4.
- 9. Problem No.12 in Chapter 4.
- 10. Problem No.13 in Chapter 4.
- 11. Problem No.14 in Chapter 4.
- 12. Problem No.15 in Chapter 4.

CHAPTER - 6

SUBSIDIARY BOOKS I - SPECIAL PURPOSE BOOKS

Learning Objectives

After learning this chapter you will be able to:

- *understand the Meaning, Kinds and Advantages of Subsidiary Books*
 - *know the Purpose, Format, Posting and Balancing of Purchases, Sales, Purchases Return and Sales Return Books.*
 - *understand Bill of exchange and the Different Terms involved in Bill transactions.*
 - *know the Meaning, Purpose and Posting of entries in Journal Proper.*
-

For a business having a large number of transactions it is practically impossible to write all transactions in one journal, because of the following limitations.

- i. Periodical details of some important business transactions cannot be known, from the journal easily, e.g., monthly sales, monthly purchases.
- ii. Such a system does not facilitate the installation of an internal check system since the journal can be handled by only one person.
- iii. The journal becomes bulky and voluminous.

6.1 Need

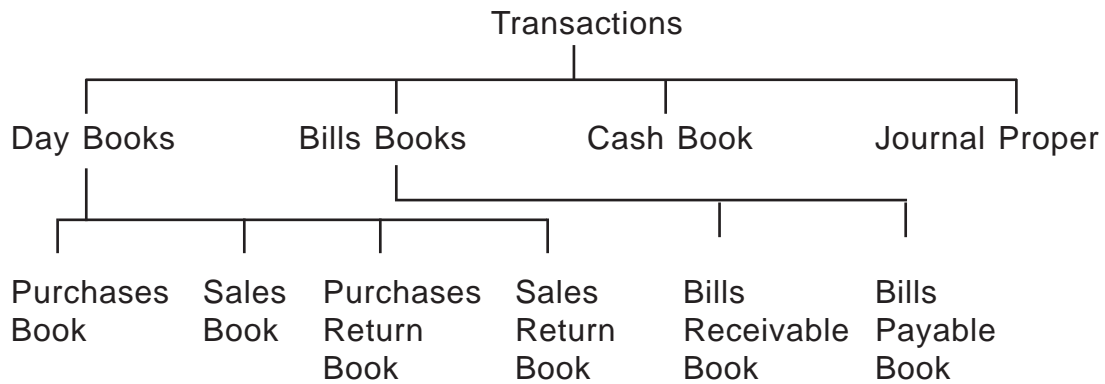
Moreover, transactions can be classified and grouped conveniently according to their nature, as some transactions are usually of repetitive in nature. Generally, transactions are of two types:

Cash and Credit. Cash transactions can be grouped in one category whereas credit transactions can be grouped in another category. Thus, in practice, the main journal is sub-divided in such a way that a separate book is used for each category or group of transactions which are repetitive and sufficiently large in number.

Each one of the subsidiary books is a special journal and a book of original or prime entry. Though the usual type of journal entries are not passed in these sub-divided journals, the double entry principles of accounting are strictly followed.

6.1.1 Kinds of Subsidiary Books

The number of subsidiary books may vary according to the requirements of each business. The following are the special purpose subsidiary books.



6.1.2 Purpose

- i. **Purchases Book** records only credit purchases of goods by the trader.
- ii. **Sales Book** is meant for entering only credit sales of goods by the trader.
- iii. **Purchases Return Book** records the goods returned by the trader to suppliers.
- iv. **Sales Return Book** deals with goods returned (out of previous sales) by the customers.
- v. **Bills Receivable Book** records the receipts of bills (Bills Receivable).
- vi. **Bills Payable Book** records the issue of bills (Bills Payable).
- vii. **Cash Book** is used for recording only cash transactions i.e., receipts and payments of cash.
- viii. **Journal Proper** is the journal which records the entries which cannot be entered in any of the above listed subsidiary books.

6.1.3 Advantages

The advantages of maintaining subsidiary books can be summarised as under :

- i. **Division of Labour** : The division of journal, resulting in division of work, ensures more clerks working independently in recording original entries in the subsidiary books.

ii. Efficiency : The division of labour also helps the reduction in work load, saving in time and stationery. It also gives advantages of specialisation leading to efficiency.

iii. Prevents Errors and Frauds : The accounting work can be divided in such a manner that the work of one person is automatically checked by another person. With the use of internal check, the possibility of occurrence of errors and frauds may be avoided.

iv. Easy Reference : It facilitates easy references to any particular item. For instance total credit sales for a month can be easily obtained from the Sales Book.

v. Easy Postings : Posting from the subsidiary books are made at convenient intervals depending upon the nature of the business.

6.2 Purchases Book

Purchases book also known as Bought Day Book is used to record all credit purchases of goods which are meant for resale in the business. Cash purchases of goods, cash and credit purchases of assets are not entered in this book.

Before discussing the Purchase Day Book, in detail we are to explain the most significant terms, Trade Discount and Cash Discount.

6.2.1 Trade Discount

Trade discount is an allowance or concession granted by the seller to the buyer, if the customer purchases goods above a certain quantity or above a certain amount. The amount of the purchase made, is always arrived at after deducting the trade discount, i.e., only the net amount is considered. For example, if the list price (price prescribed by the manufacturers or wholesalers) of a commodity is Rs.100, and trade discount granted by manufacturer to the wholesaler is 20% then cost price of the commodity to the wholesaler is Rs.80. Trade discount is not recorded in the books. They are used for determining the net price.

6.2.2 Cash Discount

Sale of goods on credit is a common phenomenon in any business. When goods are sold on credit the customers enjoy a facility of making payment on some date in the future. In order to encourage them to make the payment before the expiry of the credit period a deduction is offered. The deduction so made is known as cash discount. For example, If Ram purchases goods worth Rs.5,000 on 30 days credit then, as per the terms of contract, he is authorised to make payment 30 days after the date of purchase. If he is offered a **cash discount** of 2% on payment within 10 days and if he does so, he is entitled to deduct Rs.100 from the invoice price and pay Rs.4,900. In this case Rs.100 is cash discount. But if he does not choose to make payment within 10 days then he will not get any cash discount. In this case he will pay Rs.5,000 after 30 days.

6.2.3 Distinction between cash discount and trade discount

Trade discount differs from cash discount in the following respects.

S.No	Basis of Distinction	Trade Discount	Cash Discount
1.	Parties	It is a reduction granted by a manufacturer/ supplier	It is a reduction granted by a whole- saler (creditor) to the buyer (debtor).
2.	Purpose	To help the retailer to earn some profit.	To encourage prompt payment within a stipulated period.
3.	Time when allowed	It is allowed on the purchase of goods.	It is allowed when payment is made within the specified period.
4.	Variation	It is usually given at the same rate which is applicable to all customers and will vary with the quantity purchased.	It varies from customer to customer depending on the time and period of payment.
5.	Disclosure	It is shown by way of deduction in the invoice itself.	It is not shown in the invoice.
6.	Ledger Account	A separate Account is not opened in the Ledger.	A separate Account is opened in the Ledger for discount received and discount allowed.

6.2.4 Format

Purchases Book

Date	Particulars	Inward Invoice No.	L.F.	Amount		Remarks
				Details Rs.	Total Rs.	

- i. Date Column – Represents the date on which the transaction took place.
- ii. Particulars Column – This column includes the name of the seller and the particulars of goods purchased.
- iii. Inward Invoice No.Column – Reveals the serial number of the inward invoice.
- iv. LF. Column – This column shows the page number of the suppliers account in the ledger accounts.
- v. Details Column – Reveals the amount of goods purchased and the amount of trade discount.
- vi. Total Column – This column represents the net price of the goods, i.e, the amount which is payable to the creditors after adjusting discount and expenses if any.
- vii. Remarks Column – Contains any extra information.

At the end of each month, the purchase book is totalled. The total shows the total amount of goods or materials purchased on credit.

6.2.5 Posting and Balancing

Once transactions are properly recorded in purchases journal, they are posted into the ledger. The procedure for posting is stated as under.

Step 1 → Entries will be posted to the credit side of the respective creditors (supplier) account in the ledger by writing “By Purchases A/c” in the particulars column.

Step 2 → Periodic total is posted to the debit of purchases account by writing “To sundries as per purchases book” in the particulars column.

Illustration 1: From the following transactions of Ram for July, 2003 prepare the Purchases Book and ledger accounts connected with this book.

2003

- July 5 Purchased on credit from Kannan & Co.
50 Iron boxes @ Rs. 500
10 Grinders @ Rs. 3,000
- 6 Purchased for cash from Siva & Bros.
25 Fans @ Rs. 1,250
- 10 Purchased from Balan & Sons on credit
20 Grinders @ Rs. 2,500
10 Mixie @ Rs. 3,000
- 20 Purchased, on credit, one Computer from Kumar for Rs. 35,000.

Solution :

**In the books of Ram
Purchases Book**

Date	Particulars	Inward Invoice No.	L.F.	Amount	
				Details Rs.	Total Rs.
2003 July 5	Kannan & Co. 50 Iron boxes @ Rs. 500 10 Grinders @ Rs. 3,000 Goods purchased vide their bill No..... Dated.....			25,000 30,000	55,000
10	Balan & Co. 20 Grinders @ Rs.2,500 10 Mixie @ Rs. 3,000 Goods purchased vide their bill No..... Dated.....			50,000 30,000	
Total					1,35,000

Ledger Accounts

Dr. **Purchases Account** Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2003 July 31	To Sundries as per Purchases Book		1,35,000				

Dr. **Kannan & Co. Account** Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
				2003 July 5	By Purchases A/c		55,000

Dr. **Balan & Co. Account** Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
				2003 July 10	By Purchases A/c		80,000

Note : July 6th transaction is a cash transaction and July 20th transaction is purchase of an asset, so both will not be recorded in the purchases book.

6.3 Sales Book

The sales book is used to record all credit sales of goods dealt with by the trader in his business. Cash sales, **cash and credit sales of assets are not entered in this book.** The entries in the sales book are on the basis of the invoices issued to the customers with the net amount of sale. The format of sales book is shown below:-

6.3.1 Format

Sales Book

Date	Particulars	Outward Invoice No.	L.F.	Amount		Remarks
				Details Rs.	Total Rs.	

- i. Date Column – Represents the date on which the transaction took place.
- ii. Particulars Column – This column includes the name of purchasers and the particulars of goods sold.
- iii. Outward Invoice No.Column – Reveals the serial number of the outward invoice.
- iv. L.F. Column – The page number of the customers accounts in the Ledger is recorded.
- v. Details Column – Contains the amount of goods sold and the amount of trade discount if any.
- vi. Total Column – This column shows the net amount which is receivable from the customers.
- vii. Remarks Column – Any other extra information will be recorded.

6.3.2 Posting and Balancing

At the end of the month the individual entries and the total of the sales book column are posted into the ledgers as under.

Step 1 → Individual amounts are daily posted to the debit of Customers' Accounts by writing "To Sales A/c" in the particulars column.

Step 2 → Grand total of the sales book is posted to the credit of sales account by writing "By Sundries as per Sales Book" in the particulars column.

Illustration 2 From the transactions given below prepare the Sales Book of Ram for July 2003.

2003

- July 5 Sold on credit to S.S. Traders
 10 Chairs @ Rs. 250 Less 10%
 10 Tables @ Rs. 850 Discount
- 8 Sold to Raja for cash
 15 Chairs @ Rs. 250
- 20 Sold to Mohan & Co.
 5 Almirah @ Rs. 2,200
 10 Tables @ Rs. 850
- 23 Sold on credit to Narayanan old computer for Rs. 5,000
- 28 Sold to Kumaran for cash
 15 Chairs @ Rs. 250

Solution :

In the books of Ram Sales Book

Date	Particulars	Outward Invoice No.	L.F.	Amount	
				Details Rs.	Total Rs.
2003					
July 5	S.S. Traders & Co. 10 Chairs @ Rs. 250 10 Tables @ Rs. 850			2,500 8,500	
				11,000	
	Less : 10% Discount			1,100	

	Sold to S.S. Traders, Invoice No..... dated				9,900
20	Mohan & Co. 5 Almirah @ Rs. 2,200 10 Tables @ Rs. 850 Sales as per Invoice No..... dated			11,000 8,500	19,500
Total					29,400

Ledger Accounts

Dr. **Sales Account** Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
				2003 July 31	By Sundries as per sales book		29,400

Dr. **S.S. Trader's Account** Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2003 July 5	To Sales A/c		9,900				

Dr. **Mohan & Co.'s Account** Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2003 July 5	To Sales A/c		19,500				

6.4 Returns Books

Returns Books are those books in which the goods returned to the suppliers and goods returned by the customers are recorded.

The reasons for the return of goods are

- i. not according to the order placed.
- ii. not upto the samples which were already shown.
- iii. due to damage condition.
- iv. due to difference in the prices charged.
- v. undue delay in the delivery of the goods.

6.4.1 Kinds of Returns Books

The following are the kinds of Returns Books;

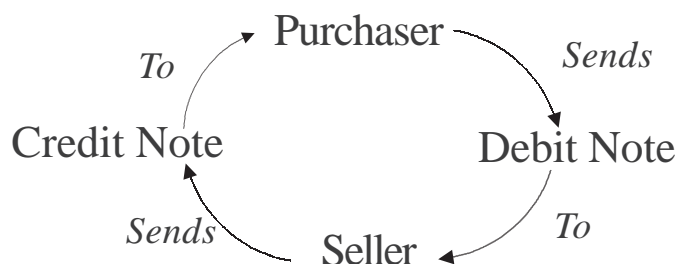
- i. **Purchases Return or Returns outward book**
- ii. **Sales Return or Returns inward book**

When the business concern returns a part of the goods purchased on credit, the returns fall under the category **Purchases Return or Returns Outward**.

When the business concern receives a part of the goods sold on credit, the returns fall under the category of **Sales Return or Returns Inward**.

6.4.2 Purchases Return Book

This book is used to record all returns of goods by the business to the suppliers. The entries in the Purchases Returns Book are usually made on the basis of debit note issued to the suppliers or credit note received from the suppliers. We call it a debit note because the party's (supplier) account is debited with the amount written in this note. The same note is termed as credit note from the receiving party's point of view because he will credit the account of the party from whom he has received the note together with goods. The flow of notes is as follows.



6.4.2.1 Format**Purchases Return Book**

Date	Particulars	Debit Note No.	L.F.	Amount		Remarks
				Details Rs.	Total Rs.	

Note : The reason for goods returned is recorded in Remarks column.

Posting and Balancing

The individual entries and the periodic total of the Purchase Return Book are posted into the Ledger as under:

- Step 1 → Individual amounts are daily posted to the debit of supplier accounts by writing “To Purchases Return A/c” in the particulars column.
- Step 2 → Periodic total is posted to the credit of purchases return account by writing “By Sundries as per Purchases Return Book” in the particulars column.

Illustration 3

Enter the following transactions in the purchases return book of Hari and post them into the ledger.

- 2003 Jan 5 Returned goods to Anand 5 chairs @ Rs.200 each, not in accordance with order.
- 14 Returned goods to Chandran 4 chairs @ Rs.200 each and 10 tables @ Rs.350 each, due to inferior quality.

Solution :

In the books of Hari
Purchases Return Book

Date	Particulars	Debit Note No.	L.F.	Amount		Remarks
				Details Rs.	Total Rs.	
2003 Jan 5	Anand 5 Chairs @ Rs.200				1,000	Not in accordance with order
14	Chandran 4 Chairs @ Rs.200 10 Tables @ Rs.350			800 3,500		Due to inferior quality
					4,300	
Total					5,300	

Ledger Accounts

Dr. Purchases Return Account Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
				2003 Jan 31	By Sundries as per Purchases return book		5,300

Dr. Anand Account Cr.

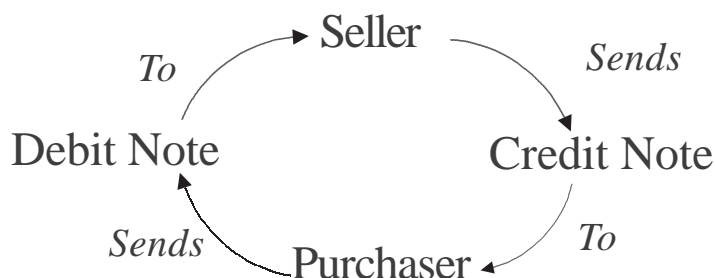
Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2003 Jan 5	To Purchases Return A/c		1,000				

Dr. Chandran Account Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2003 Jan 14	To Purchases Return A/c		4,300				

6.4.3 Sales Return Book

This book is used to record all returns of goods to the business by the customers. The entries in the sales return book are usually on the basis of credit notes issued to the customers or debit notes issued by the customers.



6.4.3.1 Format

Sales Returns Book

Date	Particulars	Credit Note No.	L.F.	Amount		Remarks
				Details Rs.	Total Rs.	

Note : Remarks column is meant to record the reason for return of goods.

Posting and Balancing

The individual entries and the periodic total of sales return book are posted into the ledger as under.

Step 1 → Individual amounts are daily posted to the credit of customers account by writing “By Sales return A/c” in the particulars column.

Step 2 → Periodic total is posted to the debit of sales return account by writing “To Sundries as per sales return book “ in the particulars column.

Illustration 4

Enter the following transactions in Returns Inward Book:

2003

April 6 Returned by Shankar 30 shirts each costing Rs.150, due to inferior quality.

- 8 Amar Tailors returned 10 Baba suits, each costing Rs.100, on account of being not in accordance with their order.
- 21 T.N. Stores returned 12 Salwar sets each costing Rs.200, being not in accordance with order.

Solution:**Sales Return Book**

Date	Particulars	Credit Note No.	L.F.	Details Rs.	Amount Rs.	Remarks
2003 April 6	Shankar 30 shirts @ Rs.150			4,500		Due to inferior quality
8	Amar Tailors 10 Baba suits @ Rs. 100			1,000		Not in accordance with the order
21	T.N Stores 12 Salwar sets @ Rs.200			2,400		Not in accordance with the order
					7,900	
	Total				7,900	

Ledger Accounts

Dr.				Sales Return Account				Cr.			
Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.				
2003											
April 30	To Sundries as per Sales return book		7,900								

Dr. **Shankar Account** Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
				2003 April 6	By Sales Return A/c		4,500

Dr. **Amar Tailors Account** Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
				2003 April 8	By Sales Return A/c		1,000

Dr. **T.N. Stores Account** Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
				2003 April 21	By Sales Return A/c		2,400

6.5 Bill of exchange

When one wants to increase the business transactions, credits may be allowed and the amounts are received after some time. If the amount involved in the credit transaction is large, the seller needs security and evidence over the dealings. Here the Bill of Exchange solves the problems of the seller.

6.5.1 Definition

According to the Negotiable Instruments Act, 1881, '**Bill of Exchange** is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of a certain person or to the bearer of the instrument'.

An analysis of the definition given above highlights the following important features of a bill of exchange.

- i. It is a written document.
- ii. It is an unconditional order.
- iii. It is an order to pay a certain sum of money.

- iv. It is signed by the drawer.
- v. It bears stamp or it is drafted on a stamp paper.
- vi. It is accepted by the acceptor.
- vii. The amount is paid to drawer or endorsee.

6.5.2 Format

Bill of Exchange

<div style="border: 1px solid black; width: 80px; margin: 0 auto; padding: 2px;">Stamp</div> <p>Rs. 10,000/-</p>	<p style="transform: rotate(-15deg);">Accepted Sundaram 4/6/2003</p>	<p>328, Bazaar Street, Trichy - 4, 01.06.2003</p>
<p>Three months after date pay to me or to my order the sum of Rupees Ten Thousand only for value received.</p>		
<p>To Thiru.Sundaram, 430, Mint Street, Chennai - 1.</p>	<p>Damodaran</p>	

6.5.3 Important terms

Explanation of some terms connected with bill of exchange is given below.

1. Drawing of a Bill

The seller (creditor) prepares the bill in the form presented above. The act of preparing the bill in its complete form with the signature is known as '**drawing**' a bill.

2. Parties

There are three parties to a bill of exchange as under.

- i. **Drawer:** The person who prepares the bill is called the drawer i.e., a creditor.
- ii. **Drawee:** The person who has to make the payment or who accepts to make the payment is called the drawee i.e., a debtor.
- iii. **Payee:** The person who receives the payment is payee. He may be a third party or the drawer himself.

In the above format drawer and payee is Damodaran. Sundaram is the drawee.

3. Acceptance

In a bill drawee gives his acceptance by writing the word '**accepted**' and also puts his signature and the date. Now the bill becomes a legal document enforceable in the court of law.

4. Due date and Days of grace

When a bill is drawn payable after a specified period the date on which the payment should be made is called '**Due Date**'. In the calculation of the due date three extra days are added to the specified period of the bill are known as '**Days of Grace**'. If the date of maturity falls on a holiday, the bill will be due for payment on the preceeding day.

Example :

Date of Bill	Period of Bill	Days of Grace	Due date
1st March	2 month	3	4th May
12th July	1 month	3	14th Aug. since 15th Aug. (being independence day) is a public holiday.
1st Oct.	30 days	3	3rd November

5. Endorsement

Endorsement means writing of one's signature on the face or back of a bill for the purpose of transferring the title of the bill to another person. The person who endorses is called the "**Endorser**". The person to whom a bill is endorsed is called the "**Endorsee**". The endorsee is entitled to collect the money.

6. Discounting

When the holder of a bill is in need of money before the due date of a bill he can convert it into cash by discounting the bill with his banker. This process is referred to as discounting of bill. The banker deducts a small amount of the bill which is called discount and pay the balance in cash immediately to the holder of the bill.

7. Retiring of Bill

An acceptor may make the payment of a bill before its due date and discharge his liability, it is called as **retirement of a bill**. Usually the holder of the bill allows a concession called rebate to the drawee for the unexpired period of the bill.

8. Renewal

When the acceptor of a bill knows in advance that he will not be able to meet the bill on its due date, he may approach the drawer with a request for extension of time for payment. The drawer of the bill may agree to cancel the original bill and draw a new bill for the amount due with interest thereon. This is referred to as **renewal**.

9. Dishonour

Dishonour of the bill means the non-payment of bill, when it is presented for payment.

10. Noting and Protesting

If a bill is dishonoured, the drawer may approach the court, and file a suit against the drawee. In order to collect documentary evidence, the drawer may approach a lawyer and explain the fact of the dishonour of the bill. The lawyer will take the bill to the drawee and ask for the payment. If the drawee does not make the payment, the lawyer will note the statement of the drawee and get the statement signed by him. The lawyer will then put his signature. The statement noted by the lawyer will be the documentary evidence for the dishonour of the bill. Writing this statement by the lawyer is known as noting of the bill. The lawyer performing this work of noting the bill is called as the '**Notary Public**'. A notary public is an official appointed by the Government.

After recording a note of dishonour on the dishonoured bill, the Notary Public issues a certificate to this effect which is called **protest**. A protest is a certificate issued by the Notary Public attesting that the bill has been dishonoured.

6.6 Bills Books

When the number of bills received or issued is large journalising of all bill transactions will result in enormous waste of time. Hence, suitable registers like bills receivable book and bills payable book are maintained to record the receipt of bills receivable and issue of bills payable respectively. These books are also called Bills Journals / Books.

6.6.1 Bills Receivable Book

Bills receivable (B/R) book is used for the purpose of recording the details of bills receivable. The individual accounts of parties from whom bills are received will be credited with the amount in the bills receivable book. The periodic total is posted to the debit of bills receivable account in the ledger by writing "To sundries as per Bills Receivable Book".

6.6.2 Bills Payable Book

Bills payable (B/P) book is used for the purpose of recording the details of bills payable. The individual accounts of the parties to whom the bills are issued will be debited with the corresponding amount in the bills payable book. The periodic total is posted to the credit of bills payable account in the ledger by writing “By Sundries as per Bills Payable Book”.

6.7 Journal Proper

Journal proper is used for making the original record of such transactions for which no special journal has been kept in the business. The usual entries that are put through this journal is explained below.

1. Opening Entries

Opening entries are used at the beginning of the financial year to open the books by recording the assets, liabilities and capital appearing in the balance sheet of the previous year.

Example:

Mr. Ramnath commenced business with the following items, make the opening entries in journal proper as on 1st January 2003.

Cash	Rs. 30,000
Stock	Rs. 15,000
Furniture	Rs. 3,000
Sundry creditors	Rs. 10,000

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
2003 Jan. 1	Cash A/c Dr.		30,000	
	Stock A/c Dr.		15,000	
	Furniture A/c Dr.		3,000	
	To Sundry creditors A/c			10,000
	To Capital A/c (Commencement of business with assets & liabilities)			38,000

2. Closing Entries

Closing entries are recorded at the end of the accounting year for closing accounts relating to expenses and revenues. These accounts are closed by transferring the balances to the Trading, Profit and Loss Account.

Example : Salaries paid Rs.15,000. Give the closing entry as on Dec. 31, 2003.

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
2003 Dec.31	Profit & Loss A/c Dr. To Salaries A/c (Closing entry for salaries paid)		15,000	15,000

3. Adjusting Entries

To arrive at a correct figure of profits and loss, certain accounts require some adjustments. Entries for making such adjustments are called as adjusting entries. These are needed at the time of preparing the final accounts.

Example : Provide depreciation on furniture Rs.1,00,000 @ 10% per annum. Give adjustment entry as on Dec. 31, 2003.

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
2003 Dec.31	Depreciation A/c Dr. To Furniture A/c (Depreciation written off)		10,000	10,000

4. Transfer Entries

Transfer entries are passed in the journal proper for transferring an item entered in one account to another account.

Example : When the proprietor takes goods Rs.5,000 for personal use. Give transfer entry on Dec. 31, 2003.

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
2003 Dec.31	Drawings A/c Dr. To Purchases A/c (Goods withdrawn for personal use)		5,000	5,000

5. Rectifying Entries

Rectifying entries are passed for rectifying errors which might have committed in the book of accounts.

Example : Purchase of furniture for Rs.10,000 was debited to Purchases Account. Pass rectifying entry on Dec. 31, 2003.

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
2003 Dec.31	Furniture A/c Dr. To Purchases A/c (Wrong debit to purchases account rectified)		10,000	10,000

6. Miscellaneous Entries or Entries of Casual Nature

These are entries of casual nature which do not occur so frequently. Such transactions include the following:

- i. Credit purchases and credit sale of assets which cannot be recorded through purchases or sales book
- ii. Endorsement, renewal and dishonour of bill of exchange which cannot be recorded through bills book.
- iii. Other adjustments like interest on capital and loan, bad debts, reserves etc.

QUESTIONS

I. Objective Type:

a) Fill in the blanks:

1. Sub division of the journals into various books for recording transactions of similar nature are called _____.
2. The total of the _____ book is posted to the debit of purchases account.
3. The person who prepares a bill is called the _____.
4. Days of grace are _____ in number.

[Answers : 1. subsidiary books, 2. purchases, 3. drawer, 4. three]

b) Choose the correct answer :

1. Purchase of machinery is recorded in
 a) sales book b) journal proper c) purchases book
2. Purchases book is kept to record
 a) all purchases b) only cash purchases
 c) only credit purchases
3. Credit sales are recorded in
 a) sales book b) cash book c) journal proper
4. Goods returned by customers are recorded in
 a) sales book b) sales return book
 c) purchases return book
5. On 1st January 2003, Chandran draws a bill on Sundar for 3 months, its due date is _____
 a) 31st March 2003 b) 1st April 2003 c) 4th April 2003

[Answers : 1. (b), 2. (c), 3. (a), 4. (b), 5. (c)]

II. Other Questions:

1. What are the various types of subsidiary books?
2. What are the advantages of subsidiary books?
3. What is cash discount?
4. What are the differences between Trade Discount and Cash Discount?

5. What is Purchases Book?
6. What is Sales Returns Book?
7. Define a bill of exchange. What are its features?
8. Write notes on parties involved in a bill of exchange.
9. What is Days of grace?
10. What is endorsement?
11. Write notes on retiring of a bill.
12. Write notes on renewal of a bill of exchange.
13. What is Journal Proper? For what purpose it is used?
14. Write notes on closing entries.
15. Write notes on rectifying entries.

III. Problems:

1. Enter the following transactions in the Purchase Book of
M/s.Subhashree.

2003

- | | | |
|-------|-----|---|
| March | 1 | Purchased 100 Kg. of coffee seeds from Suresh @ Rs.40 per Kg. |
| | 5 | Purchased 80 Kg. of tea dust from Hari @ Rs.20 per Kg. |
| | 12 | Bought from Rekha Sugars, Trichy 1,200 Kg.of Sugar @ Rs.8 per Kg. |
| | 18 | Bought from Perumal Sweets, Chennai, 40 tins of Sweets @ Rs.200 per tin. |
| | 20. | Purchased from Govinda Biscuit Company, Chennai 20 tins of biscuits @ Rs.400 per tin. |

[Answer : Purchases book total Rs.31,200]

2. From the following particulars prepare the sales book of Modern Furniture Mart

2003

- | | | |
|------|---|--|
| June | 5 | Sold on credit to Arvind & Co.
20 tables @ Rs.600 per table
20 chairs @ Rs.300 per chair |
|------|---|--|

- 7 Cash sales to Anand & Co.,
10 tables @ Rs.300 per table
20 chairs @ Rs.150 per chair
- 10 Sold to Baskar & Co., on credit
10 almirahs @ Rs.3,000 per almirah
10 tables @ Rs.200 per table
- 15 Sold old typewriter for Rs.1,000 to Madan on credit
- 20. Sold to Gopinath on credit.
10 tables @ Rs.1,000 per table
2 revolving chairs @ Rs.1,200 per chair

[Answer : Sales book Rs.62,400]

3. Enter the following transactions in proper subsidiary books.

2003

- March 1 Purchased goods from Balaraman Rs.2000
- 2 Sold goods to Senthil Rs.1,000
- 3 Goods purchased from Durai Rs.1,000
- 5 Sold goods to Saravanan Rs.700
- 8 Sold goods to Senthil Rs.500
- 10 Purchased goods from Elangovan Rs.600
- 14 Purchased goods from Parthiban Rs.300
- 20 Sold goods to Sukumar Rs.600

[Answer : Purchase book Rs.3,900; Sales book Rs.2,800]

4. Record the following transactions in the proper subsidiary books of M/s.Ram & Co., and post them to the ledger.

2003

- April 1 Goods sold to Ramesh Rs.1,000
- 5 Sold goods to Kumar Rs.2,200
- 8 Sold goods to Shankar Rs.300
- 10 Goods returned by Kumar Rs.600
- 15 Credit Note sent to Shankar for Rs.200 being the invoice overcharged.

[Answer : Sales book Rs.3,500; Sales return book Rs.800]

5. Write the following transactions in proper subsidiary books of Mr.Rajasekaran.

2003

- May 10 Purchased goods from Raman Rs.15,000
 14 Returned goods to Raman Rs.500
 18 Purchased goods from Sekaran Rs.10,000
 20 Pradeep sold goods to us Rs.20,000
 24 Sent a debit note to Sekaran for goods damaged in transit Rs.1,000.

[Answer : Purchases book Rs.45,000; Purchases return book Rs.1,500]

6. Enter the following transactions in the proper subsidiary books of Mr.Somu

2003

- Nov. 1 Bought from Gopal 300 bags of wheat Rs.1,000 per bag less trade discount 10%
 3 Purchased from Madhavan 150 bags of rice Rs.900 per bag less trade discount 10%
 5 Returned to Gopal 10 bags of wheat which were purchased on 1.11.03.
 7 Sold to Shiva 50 bags of rice Rs.1,200 per bag less Trade Discount 5%.
 12 Sold to Sharma 25 bags of Wheat Rs.1,300 per bag less Trade Discount 10%.
 14 Returned 15 bags of rice to Madhavan.
 15 Shiva returned 5 bags of rice.
 17 Bought from Rajan 200 bags of wheat Rs.950 per bag
 24 50 bags of wheat returned to Rajan

[Answer : Purchases book Rs.5,81,500; Sales book Rs.86,250;
 Purchases return book Rs.68,650; Sales return book Rs.5,700]

7. Enter the following transactions in the appropriate Special Journal of M/s. Sita & Co.

2002

- | | | |
|-----|----|--|
| Oct | 2 | Bought goods from Satish Rs.2,400 as per invoice No.63. |
| | 4 | Sold to Sivagami goods Rs.1,600 as per invoice No.71. |
| | 7 | Returned to Satish goods of Rs.250 as per debit note No.4 |
| | 8 | Sivagami returned goods Rs.150 as per credit note No.8 |
| | 12 | Sold to Vijaya goods of Rs.950 as per invoice No.72 |
| | 14 | Purchased from Velan goods worth Rs.1,100 |
| | 18 | Returned to Sampath goods of Rs.150 as per debit note No.5 |
| | 22 | Vijaya returned goods of Rs.240 Credit Note No.9 |

[Answer : Purchases book Rs.3,500; Sales book Rs.2,550;
Purchases return book Rs.400; Sales return book Rs.390]

CHAPTER -7

SUBSIDIARY BOOKS II - CASH BOOK

Learning Objectives

After learning this chapter you will be able to:

- *understand the Need and Meaning of the various Kinds of Cash Book.*
- *prepare the various Kinds of Cash Books.*

In every business house there are cash transactions as well as credit transactions. All credit transactions will become cash transactions when payments are made to creditors or cash received from debtors. Since, cash transactions will be numerous, it is better to keep a separate book to record only the cash transactions.

7.1 Features

A cash book is a special journal which is used to record all cash receipts and cash payments. The cash book is a book of original entry or prime entry since transactions are recorded for the first time from the source documents. The cash book is a ledger in the sense that it is designed in the form of a cash account and records cash receipts on the debit side and cash payments on the credit side. **Thus, the cash book is both a journal and a ledger. Cash Book will always show debit balance**, as cash payments can never exceed cash available. In short, cash book is a special journal which is used for recording all cash receipts and cash payments.

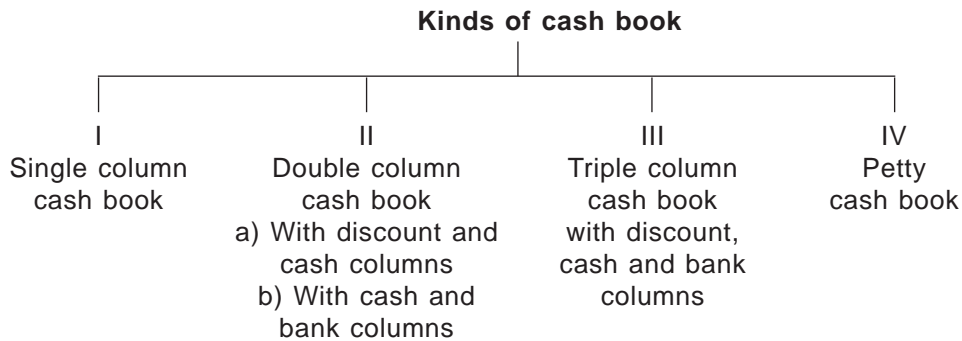
7.2 Advantages

- 1. Saves time and labour:** When cash transactions are recorded in the journal a lot of time and labour will be involved. To avoid this all cash transactions are straight away recorded in the cash book which is in the form of a ledger.
- 2. To know cash and bank balance:** It helps the proprietor to know the cash and bank balance at any point of time.
- 3. Mistakes and frauds can be prevented:** Regular balancing of cash book reveals the balance of cash in hand. In case the cash book is maintained by business concern, it can avoid frauds. Discrepancies if any, can be identified and rectified.

- 4. Effective cash management:** Cash book provides all information regarding total receipts and payments of the business concern at a particular period. So that, effective policy of cash management can be formulated.

7.3 Kinds of Cash Book

The various kinds of cash book from the point of view of uses may be as follow:



7.3.1 Single Column Cash Book

Single column cash book (simple cash book) has one amount column in each side. All cash receipts are recorded on the debit side and all cash payments on the credit side. In fact, this book is nothing but a Cash Account. Hence, there is no need to open cash account in the ledger. The format of a single column cash book is given below.

Format

Debit Side **Single Column Cash Book of** Credit Side

Date	Particulars	R. N.	L. F.	Amount Rs.	Date	Particulars	V. N.	L. F.	Amount Rs.

Explanation :

- i. **Date** : This column appears in both the debit and credit side. It records the date of receiving cash at debit side and paying cash at credit side.

- ii. **Particulars** : This column is used at both debit and credit side. It records the names of parties (personal account), heads (nominal account) and items (real account) from whom payment has been received and to whom payment has been made.
- iii. **Receipt Number (R.N)**: This refers to the serial number of the cash receipt.
- iv. **Voucher Number (V.N)** : This refers to the serial number of the voucher for which payment is made.
- v. **Ledger Folio (L.F)**: This column is used in both the debit and credit side of cash book. The ledger page (folio) of every account in the cash book is recorded against it.
- vi. **Amount** : This column appears in both sides of the cash book. The actual amount of cash receipt is recorded on the debit side. The actual payments are entered on the credit side.

Balancing :

The cash book is balanced like any other account. The total of the receipt (debit side) column will always be greater than the total of the payment column (credit side). The difference will be written on the credit side as “By Balance c/d”. In the beginning of the next period, to show the cash balance in hand, the balance amount is recorded in the debit side as “To balance b/d”.

Illustration 1

Enter the following transactions in a single column cash book of Mr.Kumaran.

2004 Jan	1	Started business with cash	... Rs. 1,000
	3	Purchased goods for cash	... Rs. 500
	4	Sold goods	... Rs. 1,700
	5	Cash received from Siva	... Rs. 200
	12	Paid Balan	... Rs. 150
	14	Bought furniture	... Rs. 200
	15	Purchased goods from Kala on credit	... Rs. 2,000
	20	Paid electric charges	... Rs. 225
	24	Paid salaries	... Rs. 250
	28	Received commission	... Rs. 75

Solution:

Cash Book
of Mr. Kumaran

Dr.

Cr.

Date	Particulars	R. N.	L. F.	Amount Rs.	Date	Particulars	V. N.	L. F.	Amount Rs.
2004 Jan 1					2004 Jan 3	By Purchases A/c			
4	To Capital A/c			1,000	12	„ Balan A/c			500
5	To Sales A/c			1,700	14	„ Furniture A/c			150
28	To Siva A/c			200	20	„ Electric charges A/c			200
	To Commission A/c			75	24	„ Salaries A/c			225
					31	„ Balance c/d			250
									1,650
				2,975					2,975
2004 Feb 1	To Balance b/d			1,650					

Note : The transaction dated January 15th will not be recorded in the cash book as it is a credit transaction.

7.3.2 Double Column Cash Book

The most common double column cash books are

- i. Cash book with discount and cash columns
- ii. Cash book with cash and bank columns.

i. Cash Book with discount and cash columns

On either side of the single column cash book, another column is added to record discount allowed and discount received. The format is given below.

Format

Double Column Cash Book
(Cash book with Discount and Cash Column)

Debit						Credit					
Date	Particulars	R. N.	L. F.	Dis- count Allowed Rs.	Amount Rs.	Date	Particulars	V. N.	L. F.	Dis- count Allowed Rs.	Amount Rs.

It should be noted that in the double column cash book, cash column is balanced like any other ledger account. But the discount column on each side is merely totalled. The total of the discount column on the debit side shows the total discount allowed to customers and is debited to Discount Allowed Account. The total of the discount column on the credit side shows total discount received and is credited to Discount Received Account.

Illustration 2: Prepare a Double Column Cash Book from the following transactions of Mr.Gopalan:

		Rs.
2004		
Jan. 1	Cash in hand	4,000
6	Cash Purchases	2,000
10	Wages paid	40
11	Cash Sales	6,000
12	Cash received from Suresh and allowed him discount	1,980 20
19	Cash paid to Meena and discount received	2,470 30
27	Cash paid to Radha	400
28	Purchased goods for cash	2,070

Solution:**Double Column Cash Book of Mr.Gopalan**

(Cash book with Discount Column)

Dr							Cr				
Date	Particulars	R.N.	L.F.	Dis- count Allowed	Amount ₹	Date	Particulars	V.N.	L.F.	Dis- count Allowed	Amount Rs.
2004 Jan 1	To Balance b/d				4,000	2004 Jan 6	By Purchases A/c				2,000
11	To Sales A/c				6,000	10	By Wages A/c				40
12	To Suresh A/c			20	1,980	19	By MeenaA/c			30	2,470
						27	By Radha A/c				400
						28	By Purchases A/c				2,070
						31	By Balance c/d				5,000
										30	11,980
Feb 1	To Balance b/d				5,000						

ii. Cash Book with Cash and Bank Columns

When bank transactions are more in number, it is advisable to open a cash book by providing a separate column on either side of the cash book to record the bank transactions therein.

In such case, it is not necessary to open a separate Bank Account in the Ledger because the two columns in the cash book serve the purpose of Cash Account and Bank Account respectively. It is a combination of Cash Account and Bank Account. The format of this cash book is given below.

Double Column Cash Book

Debit Side (Cash book with Cash and Bank Columns) Credit Side

Date	Particulars	R. N.	L. F.	Cash Rs,	Bank Rs,	Date	Particulars	V. N.	L. F.	Cash Rs,	Bank Rs,

There are two amount columns on debit side one for cash receipts and the other for bank deposits (i.e., payment made into Bank Account). Similarly there are two amount columns on the credit side, one for payments in cash and the other for payments by cheques respectively.

Contra Entry

When an entry affect both cash and bank accounts it is called a **contra entry**. Contra in Latin means opposite. In contra entries both the debit and credit aspects of a transaction are recorded in the cash book itself.

Example 1: Cash paid into bank

Bank A/c	Dr.	x x x
To Cash A/c		x x x

(Cash paid into bank)

This is a contra entry. As the cash book with cash and bank columns is a combined cash and bank account, both the aspects of the transaction will be entered in the same book. In the debit side 'To Cash A/c' will be entered in the particulars column and the amount will be entered in the bank column. In the

credit side 'By Bank A/c' will be entered in the particulars column and the amount will be entered in the cash column.

Such contra entries are denoted by writing the letter 'C' in the L.F. column, on both sides of the cash book. They indicate that no posting in respect thereof is necessary in the ledger.

Example 2: Cash withdrawn from bank for office use.

Cash A/c	Dr.	x x x
To Bank A/c		x x x

(Cash withdrawn for office use)

This is also a contra entry. In the debit side 'To Bank A/c' will be entered in the particulars column and the amount will be entered in the cash column. In the credit side 'By Cash A/c' will be entered in the particulars column and the amount will be entered in the bank column.

Such contra entries are denoted by writing the letter 'C' in the L.F. column, on both sides of the cash book. They indicate that no posting in respect thereof is necessary in the ledger.

Illustration 3

Enter the following transactions in the double column cash book of Mr. Rajesh and balance it.

2003

- | | |
|--------|--|
| Aug. 1 | Opening Balance : Cash in Hand Rs.4,250 |
| | Cash at Bank Rs.13,750 |
| 2 | Paid to petty cashier Rs.2,500 |
| 2 | Cash sales Rs.1,750 |
| 3 | Paid to Arun by cheque Rs.3,750 |
| 3 | Received a cheque from Mr. Ram Babu Rs.4,500 paid into bank. |
| 5 | Received cheque from Mr. Jayaraman Rs.6,000 paid into bank |
| 8 | Cash purchases Rs.2,500 |
| 8 | Paid rent by cheque Rs. 2,500 |
| 9 | Cash withdrawn from bank for office use Rs.2,500 |
| 10 | Cash sales Rs.3,750 |
| 14 | Stationery purchased Rs.1,000 |
| 20 | Cash sales Rs.6750 |
| 21 | Paid into bank Rs.10,000 |
| 23 | Withdrew cash for personal use Rs.1,000 |
| 25 | Salaries paid by cheque Rs.9000. |

Solution: **Double Column Cash Book of Mr.Rajesh**
(Cash book with Cash and Bank Column)

Dr. Cr.

Date	Particulars	R. N.	L.F	Cash Rs.	Bank Rs.	Date	Particulars	R. N.	L.F	Cash Rs.	Bank Rs.
2003						2003					
Aug 1	To Balance b/d					Aug 2	By Petty Cash A/c				
2	" Sales A/c					3	" Arun's A/c			2,500	3,750
3	" Ram Babu's A/c					8	" Purchases A/c			2,500	
5	" Jayaramans A/c					8	" Rent A/c				2,500
9	" Bank A/c					9	" Cash A/c		C		2,500
10	" Sales A/c		C	2,500		14	" Stationery A/c			1,000	
20	" Sales A/c			3,750		21	" Bank A/c		C	10,000	
21	" Cash A/c		C	6,750		23	" Drawings A/c				1,000
						25	" Salary A/c				9,000
						31	" Balance c/d			3,000	15,500
										19,000	34,250
Sep 1	To Balance b/d			3,000							

Points to be remembered while preparing cash book:

S. No.	Transaction	Debit/Credit side of cash book	The column in which the amount to be entered
1.	Cash/ M.O./P.O. - received	Debit	Cash
2.	Cash paid	Credit	Cash
3.	Discount allowed	Debit	Discount allowed
4.	Discount received	Credit	Discount received
5.	Cash deposited in the bank	Debit (C) Credit (C)	Bank Cash
6.	Cash withdrawn for office use	Debit (C) Credit (C)	Cash Bank
7.	Cheque received	Debit	Cash
8.	Cheque deposited into bank	Debit (C) Credit (C)	Bank Cash
9.	Cheque received and deposited into bank for collection immediately	Debit	Bank
10.	Cheque issued	Credit	Bank
11.	Customer directly paid into bank	Debit	Bank
12.	Cheque deposited and dishonoured	Credit	Bank
13.	Cheque issued and dishonoured	Debit	Bank
14.	Bank charges	Credit	Bank
15.	Interest allowed by bank	Debit	Bank
16.	Interest on overdraft	Credit	Bank
17.	Payments directly made by the bank as per standing instructions	Credit	Bank
18.	Amounts directly received by bank as per standing instructions	Debit	Bank

7.3.3 Triple Column Cash Book

Large business concerns receive and make payments in cash and by cheques. Where cash discount is a regular feature, a Triple Column Cash Book is more advantageous. This cash book has three amount columns (cash, bank

and discount) on each side. All cash receipts, deposits into bank and discount allowed are recorded on debit side and all cash payments, withdrawals from bank and discount received are recorded on credit side.

The format is given in the next page.

Triple Column Cash Book of Mr.....

(Cash book with Discount, Cash and Bank Columns)

Format :

Dr.

Cr.

Date	Particulars	R. N.	L. F.	Dis. Allowed	Cash Rs.	Bank Rs.	Date	Particulars	V. N.	L. F.	Dis. Received Rs.	Cash Rs.	Bank Rs.

Illustration 4

Compile three column cash book of Mr.Sundar from the following transactions:

2002

- Aug 1 Sundar started business with cash Rs.2,00,000
- 2 Deposited into Bank Rs.50,000.
- 4 Cash purchases Rs.5,000.
- 5 Purchases by cheque Rs.6,000.
- 6 Goods sold to Nathan on credit Rs. 5,000.
- 8 Received cheque from Mano Rs.490, Discount allowed Rs.10.
- 10 Paid carriage Rs.1,000.
- 12 Withdrew from Bank for office use Rs.10,000.
- 15 Paid to Sundari Rs.4,960, Discount allowed by her Rs.40.
- 20 Received a cheque for Rs.4950 from Nathan in full settlement of his account, which is deposited into Bank.

Triple Column Cash Book of Mr.Sundar

Dr.**Cr.**

Date	Particulars	R. N.	L. F	Dis. Allo wed	Cash Rs.	Bank Rs.	Date	Particulars	V. N.	L. F	Dis. Recei ved	Cash Rs.	Bank Rs.
2002 Aug 1	To Capital A/c						2002	By Bank A/c					
2	„ Cash A/c		C		2,00,000	50,000	Aug 2	„ Purchases A/c		C		50,000	
8	„ Mano's A/c			10	490		4	„ Purchases A/c				5,000	6,000
12	„ Bank A/c		C		10,000		5	„ Carriage A/c				1,000	
20	„ Nathan's A/c			50		4,950	10	„ Cash A/c		C			10,000
							12	„ Sundari's A/c			40	4,960	
							15	„ Balance c/d					
							31					1,49,530	38,950
				60	2,10,490	54,950					40	2,10,490	54,950
Sep 1	To Balance b/d				1,49,530	38,950							

Note : Transaction dated 6th August will not appear in the cash book as it is a credit transaction

Illustration 5

Enter the following transactions in three column cash book of Mr.Muthu and balance the same.

2003

- Aug 1 Cash in hand Rs.75,000
 Cash at bank Rs.40,000
- 4 Paid into bank Rs.20,000.
- 6 Purchased machinery by cheque Rs.10,000.
- 8 Received from Mohan Rs.2,560
 Discount allowed Rs. 40.
- 10 Paid to Somu by cheque Rs.3,970 in full settlement of his account Rs.4,000.
- 11 Withdrew cash from Bank for personal use Rs.5,000.
- 15 Received cheque from Balan Rs.4,900.
 Allowed him discount Rs.100.
- 19 Balan's cheque deposited into Bank
- 24 Anandan our customer has paid directly into our bank account Rs.10,000.
- 27 Rent paid by cheque Rs.3,000.

Solution:

Dr.

Cr.

Date	Particulars	R. N.	L. F	Dis. Allowed	Cash Rs.	Bank Rs.	Date	Particulars	V. N.	L. F	Dis. Received	Cash Rs.	Bank Rs.
2003 Aug 1	To Balance b/d						2003 Aug 4	By Bank A/c		C		20,000	10,000
4	„ Cash A/c		C		75,000	20,000	6	„ Machinery A/c					3,970
8	„ Mohan's A/c			40	2,560		10	„ Somu's A/c			30		5,000
15	„ Balan's A/c			100	4,900		11	„ Drawings A/c					
19	„ Cash A/c		C			4,900	19	„ Bank A/c		C		4,900	
24	„ Anandan's A/c					10,000	27	„ Rent A/c					3,000
							31	„ Balance c/d				57,560	52,930
				140	82,460	74,900					30	82,460	74,900
Sep 1	To Balance b/d				57,560	52,930							

Illustration 6

Prepare three column cash book of Mrs.Eswari from the following transactions and balance the cash book on 30th June 2003.

2003

- | | |
|--------|---|
| June 1 | Cash in hand Rs.50,000 |
| | Bank overdraft Rs.15,000 |
| 3 | Paid into bank Rs.25,000 |
| 5 | Parthiban settled his account for Rs.3,750 by giving a cheque for Rs.3,690. |
| 8 | Parthiban's cheque sent to bank for collection. |
| 10 | Cash withdrawn from bank Rs.8,000. |
| 14 | Parthiban's cheque returned dishonoured |
| 15 | Received from Ramesh a currency note for Rs.5,000 and gave him a change for it. |
| 18 | Paid rent Rs.500. |
| 20 | Bank charges as per pass book Rs.150. |
| 30 | Deposited into Bank all cash in excess of Rs.5,000. |

Soulution: Triple Column Cash Book of Mrs.Eswari

Dr.

Cr.

Date	Particulars	R. N.	L. F	Dis. Allowed	Cash Rs.	Bank Rs.	Date	Particulars	V. N.	L. F	Dis. Recei ved	Cash Rs.	Bank Rs.
2003 June 1	To Balance b/d				50,000		2003 June 1	By Balance b/d					
3	,, Cash A/c		C			25,000	3	,, Bank A/c		C		25,000	15,000
5	,, Parthiban's A/c			60	3,690		8	,, Bank A/c		C		3,690	8,000
8	,, Cash A/c		C			3,690	10	,, Cash A/c		C			3,690
10	,, Bank A/c		C		8,000		14	,, Parthiban's A/c					
30	,, Cash A/c		C			27,500	18	,, Rent A/c				500	150
							20	,, Bank Charges				27,500	
							30	,, Bank A/c		C		5,000	29,350
							30	,, Balance c/d					
July 1	To Balance b/d			60	61,690	56,190						61,690	56,190
					5,000	29,350							

Note : Transaction dated 15th June will not be recorded in the cash book.

Illustration 7

Enter the following transactions in three column cash book of Mrs.Anu Radha.

2002

- Sep 1 Cash in hand Rs.50,000
 Bank balance Rs.15,000
- 2 Sold goods to Udayakumar for Rs.15,000, cash discount allowed 1% and received cash for the balance.
- 3 Tax paid Rs.1,000.
- 7 Bought goods from Munuswamy for Rs.2,400, cash discount received 2% and paid cheque for the balance.
- 9 Received repayment of loan from Elangovan Rs.10,000.
- 12 Paid into Bank Rs.5,000.
- 14 Paid Rs.1,400 to Aravind & Co., half by cash and half by cheque.
- 16 Dividend collected by the Bank as per pass book Rs.2,000.
- 18 Sold goods for cash and deposited into the bank on the same day Rs.5,000.
- 20 Sent to Bharathi by money order Rs.460, the money order commission being Rs.20.

Soulution: Triple Column Cash Book of Mrs.Anu Radha

Dr. **Cr.**

Date	Particulars	R. N.	L. F	Dis. Allowed	Cash Rs.	Bank Rs.	Date	Particulars	V. N.	L. F	Dis. Recei ved	Cash Rs.	Bank Rs.
2002							2002						
Sep 1	To Balance b/d					15,000	Sept 3	By Tax A/c				1,000	
2	„ Sales A/c			150	50,000		7	„ Purchases A/c			48		2,352
9	„ Elangovan's Loan				14,850		12	„ Bank A/c		C		5,000	
12	„ Cash A/c		C		10,000		14	„ Aravind & Co. A/c				700	700
16	„ Dividend A/c					5,000	20	„ Bharathi A/c				460	
18	„ Sales A/c					2,000	20	„ Money Order Com				20	
						5,000	30	„ mission A/c				67,670	23,948
								„ Balance c/d A/c					
				150	74,850	27,000					48	74,850	27,000
Oct 1	To Balance b/d				67,670	23,948							

Illustration 8

From the following information show how Mr.Venu Gopal's triple column cash book would appear for the week ended 7th October 2002 and close the cash book for the day.

2002

- | | | |
|-----|---|---|
| Oct | 1 | Cash in hand Rs.30,000
Bank balance Rs.1,000 |
| | 2 | Sivan, our customer has paid directly into our bank account Rs.5,000. |
| | 3 | Paid rent by cheque Rs.500. |
| | 4 | Cheque issued in favour of Bharathi for purchase of furniture Rs.2,400. |
| | 5 | Received from Vinoth Rs.2,225
Discount allowed Rs.75. |
| | 6 | Paid into bank Rs.4,000 |
| | 7 | Cash withdrawn from bank Rs.2,000.
Bharathi, to whom we have issued a cheque of Rs.2,400
has reported that our cheque is dishonoured. |

Soultion: Triple Column Cash Book of Mr.Venu Gopal

Dr. **Cr.**

Date	Particulars	R. N.	L. F	Dis. Allo wed	Cash Rs.	Bank Rs.	Date	Particulars	V. N.	L. F	Dis. Recei ved	Cash Rs.	Bank Rs.
2002 Oct 1	To Balance b/d				30,000	1,000	2002 Oct 3	By Rent A/c					500
2	„ Sivan's A/c					5,000	4	„ Bharathi A/c					2,400
5	„ Vinoth's A/c			75	2,225		6	„ Bank A/c		C		4,000	
6	„ Cash A/c					4,000	7	„ Cash A/c		C			2,000
7	„ Bank A/c		C		2,000								
7	„ Bharathi A/c					2,400	7	„ Balance c/d				30,225	7,500
				75	34,225	12,400						34,225	12,400
Oct 8	To Balance b/d				30,225	7,500							

7.3.4 Postings from cash book to concerned ledger accounts

1. Opening (Cash and Bank) balance appearing in the cash book is not posted to any account in the ledger.
2. Contra entries are not posted to any account.
3. Each item of discount allowed appearing on the debit side of the cash book will be posted to the credit of respective personal account. Total of discount allowed column should be posted to the debit side of discount allowed account with the words "To Sundry Accounts".
4. Each item of discount received appearing on the credit side of the cash book will be posted to the debit of respective personal account. Total of discount received column should be posted to the credit of discount received account with the words "By Sundry Accounts".
5. The other transactions recorded on the debit side of the cash book are posted to the credit of the respective accounts in the ledger.
6. The other transaction recorded on the credit side of the cash book are posted to the debit of the respective accounts in the ledger.

QUESTIONS

I. Objective Type:

a) Fill in the Blanks:

1. Discount allowed column appears in _____ side of the cash book.
2. In the triple column cash book, when a cheque is received the amount is entered in the _____ column.
3. Discount received column appears in _____ side of the cash book.
4. A cheque received and paid into the bank on the same day is recorded in the _____ column of the three column cash book.
5. When a cheque received from a customer is dishonoured, his account is _____.
6. Cash Book is one of the _____ books.

[Answers : 1. debit, 2. cash, 3. credit, 4. bank, 5. debited, 6. subsidiary]

b) Choose the correct answer:

1. The cash book records
 - a) all cash payments b) all cash receipts
 - c) all cash receipts & payments
2. When goods are purchased for cash, the entry will be recorded in the
 - a) cash book b) purchases book c) journal
3. The balance of cash book indicates
 - a) net income b) cash in hand
 - c) difference between debtors and creditors
4. In triple column cash book, cash withdrawn from bank for office use will appear in
 - a) debit side of the cash book only
 - b) both sides of the cash book.
 - c) credit side of the cash book only.
5. If a cheque sent for collection is dishonoured, the debit is given to
 - a) suppliers A/c b) bank A/c c) customers A/c
6. If a cheque issued by us is dishonoured the credit is given to
 - a) supplier's A/c b) customer's A/c c) bank A/c

[Answers : 1. (c), 2. (a), 3. (b), 4. (b), 5. (c), 6. (a)]

II. Other Questions:

1. What is cash book? What are its features?
2. What are the advantages of cash book?
3. What are the various kinds of cash book?
4. What is single column cash book?
5. What is double column cash book?
6. What is triple column cash book?
7. Write notes on 'contra entry'.
8. Give the specimen of 'triple column cash book'.
9. What are the rules for making entries in the double column cash book with cash and bank column?
10. How are postings made from the cash book?

III. Problems:

1. From the following particulars, prepare single column cash book of Ms.Kokila.

2002

Mar. 1	Cash in hand Rs.20,000.
4	Cash purchases Rs.4,000.
7	Cash sales Rs.8,000.
8	Paid to Balan Rs. 5,000
9	Received cash from Cheran Rs.10,000.
13	Paid into bank Rs.10,000.
14	Cash withdrawn from bank Rs.4,000.
18	Paid salaries Rs.1,000.
20	Bought furniture Rs.3,000.
28	Rent paid Rs. 1,000.

(Answer : Cash balance Rs. 18,000)

2. Enter the following transactions in the single column cash book of Mrs. Lalitha.

2002

Aug. 1	Cash in hand Rs.46,000.
3	Paid in to Bank Rs.12,000
4	Cash sales Rs. 24,000.
5	Credit sales to Mani Rs.3,000.
7	Printing charges Rs.3,000.
9	Received cheque from Natesan Rs.8,000
12	Dividend received Rs.2,000.
14	Computer purchased Rs.35,000.
17	Cash received from Mani Rs.3,000.
24	Cash withdrawn from bank Rs.2,000.

(Answer : Cash balance Rs.35,000)

3. Prepare a single column cash book from the following particulars of Mr.Chandran.

2002

Dec	1	Cash balance Rs.80,000.
	7	Bought goods for cash Rs.25,000
	9	Purchased goods on credit from Guru Rs.6,000.
	12	Sold goods to Somu on credit Rs.8,000.
	14	Paid Guru Rs.6,000.
	17	Cash received from Somu Rs.8,000.
	20	Paid trade expenses Rs.10,000.
	21	Received cheque from Krishna Rs.10,000.
	27	Commission received Rs.5,000.

(Answer : Cash balance Rs.62,000)

4. Enter the following transactions in the double column cash book of Mr.Srinivasan.

2002

May	1	Cash in hand Rs.50,000.
	3	Cash paid to Rajan Rs.6,000. Discount allowed by him Rs. 100.
	6	Cash purchases Rs.10,000.
	10	Received cash from Arun Rs.2,900 and allowed him discount Rs.100.
	13	Cash sales Rs.15,000.
	15	Electricity charges paid Rs.1,000.
	18	Paid for miscellaneous expenses Rs.2,000.
	20	Received cash from Murali Rs.3,450 Discount allowed Rs.50.

(Answer : Cash balance Rs.52,350)

5. Enter the following transactions in cash book with cash and discount column of Mr.Nandakumar.

2003

- Jan 1 Cash in hand Rs.60,000.
- 3 Bought goods from Premnath Rs.10,000.
- 4 Opened a current account with bank Rs.15,000.
- 7 Withdraw from bank Rs.5,000.
- 8 Sold goods to Kandan for Rs.10,000 credit on terms 2% cash discount if payable within two weeks.
- 10 Paid cash to Premnath, less 1% C.D.
- 14 Received a cheque from Arul Rs.3,400, allowed him discount Rs.100.
- 15 Kandan settled his account.

(Answer : Cash balance Rs.53,300)

6. Enter the following transaction in the Cash Book with Discount and Cash Columns of Mr.Guru.

2003

- Sep 1 Cash in hand Rs.19,000.
- 3 Sold goods for cash Rs.10,000.
- 4 Credit purchases from Venkat Rs.18,000.
- 6 Received from Mohan Rs.4,160
Discount allowed to him Rs.40.
- 8 Paid for Electricity charges Rs.850.
- 9 Cash deposited in bank Rs.20,000.
- 14 Paid cash to Venkat Rs.17,600 in full settlement.
- 24 Received cash from Vel Murugan Rs.4,800.
- 26 Salaries paid Rs.4,000.
- 28 Cash drawn from bank Rs.5,000.

[Answer : Cash balance Rs. 510]

7. Enter the following transactions in Cash Book with cash and bank columns:
Balance the cash book.

2003

- May 1 Cash in hand Rs.30,000.
2 Paid into bank Rs.10,000.
3 Cash purchases Rs.2,500.
4 Loan obtained from Vasan Rs.10,000.
5 Cash deposited in bank Rs.7,500.
6 Cash sales Rs.2,500.
8 Rent paid by cheque Rs.2,000.
10 Cash withdrew for office use Rs.4,000.
14 Paid Nataraj Rs.300 by M.O.
15 Akilan directly paid into our bank account Rs.3,000.
25 Cash withdrawn from bank Rs. 5,000.

(Answer : Cash balance 31,200, Bank balance Rs. 9,500)

8. Record the following transactions in Sujatha's cash book with cash and bank columns.

2002

- Mar 1 Cash Balance Rs.45,000.
Bank Balance Rs.42,000.
3 Cash paid into bank Rs.5,000.
5 Purchases by cheque Rs.9,000.
8 Cash sales, deposited in the bank Rs.13,500.
10 Furniture purchased Rs.600.
14 Cheque received from Ramu Rs.2550.
17 Ramu's cheque deposited in the bank for collection.
18 Cash withdrawn for personal use by cheque Rs.750.
20 Cash withdrawn from bank Rs.3,000.
26 Ramu's cheque was returned by bank as dishonoured.

(Answer : Cash balance Rs.42,400; Bank Balance Rs.47,750)

9. Prepare Double Column Cash Book with cash and bank columns from the following:

2003

- | | | |
|-----|----|--|
| Jan | 1 | Cash in hand Rs.22,000 |
| | | Cash at bank Rs.5,000. |
| | 2 | Sold goods for cash Rs.15,000. |
| | 4 | Cash withdrawn from bank Rs.2,000. |
| | 5 | Credit purchases from Deena Rs.15,000. |
| | 6 | Cash deposited into bank Rs.5,000. |
| | 10 | Paid wages by cheque Rs.10,000. |
| | 14 | Cash received from sale of furniture Rs.10,000 and out of it paid into bank Rs.2,000. |
| | 18 | Bank charges charged by the bank Rs.1,300. |
| | 20 | Cheque issued to Deena Rs.15,000. |
| | 24 | Received a cheque for Rs.1,000 from Pasubathy, deposited into the bank. |
| | 28 | Deena, to whom we have issued a cheque for credit purchases has reported that our cheque is dishonoured. |

(Answer : Cash balance Rs.42,000; Bank balance (Cr) Rs.300)

10. Prepare a cash book with cash, bank and discount columns from the transactions given below:

2002

- | | | |
|-----|----|--|
| Jan | 1 | Cash Balance Rs.75,000. |
| | | Bank Balance Rs. 45,000. |
| | 3 | Deposited into bank Rs.60,000. |
| | 4 | Bought furniture and paid by cheque Rs.7,500 |
| | 5 | Paid for repair Rs.650. |
| | 6 | Goods purchased and paid by cheque Rs.12,500. |
| | 10 | Received a cheque for Rs.21,000 from Chandran and allowed him discount Rs.200. |
| | 13 | Gave Muthu a cheque for Rs.11,500 and received a discount of Rs.150. |

- 15 Sarathy directly paid into our bank account Rs.15,000.
 20 Withdrew from bank for office use Rs.2,500.
 28 Withdrew from bank for personal use Rs.500.

(Answer : Cash balance Rs.37,850; Bank balance Rs.85,500)

11. Enter the following transactions in Muralis cash book with column for discount, cash & bank.

2002

- April 1 Cash balance Rs.4,000.
 Bank overdraft Rs.10,500.
 4 Received Rs.2,000 from Manoj in cash. Allowed him discount of Rs.100.
 7 Cash sales Rs.2,000.
 10 Furniture purchased Rs.800 by cheque.
 12 Paid rent by cheque Rs.1,500.
 15 Paid Rs.2,500 to Karthikeyan half cash and half by cheque.
 18 Cash sales Rs.15,000.
 20 Paid packing charges Rs.500.
 24 Paid Murugan Rs.4,000. Discount allow by him Rs.50.
 26 Paid into bank Rs.5,000.

(Answer : Cash balance Rs.12,250;

Bank balance (Cr.) Rs. 9,050)

12. Enter the following transactions in the Three Column Cash Book of Mr.Albert.

2002

- May 1 Cash in hand Rs.30,000.
 Cash at bank Rs.2,000
 3 Received cheque for goods sold to Arun and banked it Rs.1000.
 5 Paid into bank Rs.4,000.
 9 Paid cash to David from whom goods worth Rs.6,000 were purchased for credit on 1st May on term 2% cash discount within two weeks.

- 10 Paid to Robert by cheque Rs.2,400 in full settlement of his account of Rs.2,500.
- 12 Received cash from Nathan Rs.4,750. Discount allowed Rs.250.
- 19 Interest allowed by bank Rs.200.
- 20 Robert to whom we have issued a cheque has reported that our cheque is dishonoured.
- 22 Roshan got exchange a five hundred rupee note.
- 31 Paid into bank all cash in excess of Rs.5,000.

(Answer : Cash balance Rs.5,000. Bank balance Rs.27,070.

Deposited into bank Rs.19,870)

13. Enter the following transactions in the Triple Column Cash Book of Mr.Raja Durai.

2002

- May 1 Cash balance Rs.6,000.
Bank balance Rs.4,000.
- 2 Withdrew from Bank Rs.2,000.
- 3 Abdulla directly paid into our bank account Rs.3,000.
- 4 Cheque received from Daniel Rs.5,000 sent to bank.
- 7 Cheque received from Ramakrishnan for sales Rs.8,000.
- 8 Received cash from Subramaniam Rs.2,800. Discount allowed Rs.200.
- 10 Ramakrishnan's cheque sent to bank for collection.
- 14 Paid to Balu by cheque Rs.13,900. Discount received Rs.100.
- 17 Withdrew cash for personal use Rs.1,500 and by cheque Rs.12,500.
- 27 Rent paid Rs.2,000.

(Answer : Cash balance Rs.7,300; Bank balance (cr) Rs.8,400)

CHAPTER - 8

SUBSIDIARY BOOKS III - PETTY CASH BOOK

Learning Objectives

After studying this chapter, you will be able to:

- *understand the Meaning and Uses of Petty Cash Book.*
- *know the Procedure for Recording in Petty Cash Book.*

In every business, of whatever size, there are many small cash payments such as conveyance, carriage, postage, telegram, etc. These expenses are generally repetitive in nature. If all these small payments are recorded in the cash book, it will be difficult for the cashier to maintain the records all by himself. In order to make the task of the cashier easy, these small and recurring expenses are recorded in a separate cash book called “**Petty Cash Book**” and the person who maintains the petty cash is called the “**Petty Cashier**”.

Petty means ‘small’. The petty cash book is a book where small recurring payments like carriage, cartage, postage and telegram, printing and stationery etc., are recorded by the petty cashier, a person other than the main cashier.

8.1 Imprest System

Imprest means ‘money advanced on loan’. Under this system the amount required to meet out various petty expenses is estimated and given to the petty cashier at the beginning of the specified period, usually a month. All the payments are supported by vouchers. At the end of the given period or earlier, when the petty cashier has spent the petty cash amount, he closes the petty cash book for the period and balances it. Then he submits the accounts to the cashier. He verifies the petty cash book with the vouchers. After satisfying himself as to the correctness and genuineness of the payments an amount equal to the cash spent is given to the petty cashier. This amount together with the unspent amount will bring up the cash in hand to the amount with which he originally started i.e., **the imprest amount**. Thus the system of reimbursing the amount spent by the petty cashier at fixed period, is known as the **imprest system of petty cash**.

For example, On June 1, 2002, Rs.1,000 was given to the petty cashier. He had spent Rs.940 during the month. He will be paid Rs.940 on 30th June by the cashier so that he may again have Rs.1,000 for the next month i.e., July.

8.2 Analytical Petty Cash Book

As in the case of any other cash book, petty cash book also has the debit side and the credit side. The debit side is smaller and has very infrequent entries because cash receipt by the petty cashier is mainly from the cashier at the beginning or close of a specified period. The credit side is bigger and thus has many columns. For each important petty expenses there is a separate column, and therefore columnar cash book is another name for this petty cash book. These analytical columns helps to know the actual amount spent on each and every type of petty expenses for the specified period. Each petty payment is first entered in the total payments column, and then recorded in the respective analytical column, so that :

- i. the total amount spent on each expenses for a particular period can be easily ascertained by adding up the respective column.
- ii. only the periodical total of each column is posted to the ledger.
- iii. the total petty payment for any period can be easily ascertained from the total payments column.

The analytical petty cash book may be designed according to the requirements of the business.

8.3 Format

The format is given in the next page.

Explanation of columns in the analytical petty cash book

1. **Receipts:** This is the first column of the petty cash book. Amount received by the petty cashier for meeting petty expenses and the opening balance of petty cash will be recorded in this column.
2. **C.B.F.N:** This refers to Cash Book Folio Number. In this column we write the page number of the cash book where cash paid by the cashier is recorded.
3. **Date:** In this column, the date of receipt / payment of cash is recorded.
4. **Particulars:** This column records the details of the receipts / payments. Cash received in the beginning is shown as 'To cash' and all the petty expenses are shown as 'By expenses' (name of the expense).

Analytical Petty Cash Book of.....

Dr.	Receipt	C.B.F.N.	Date	Particulars	V.N.	Cr.		Analysis of Payments	
	Rs. P.					Rs.	P.		
Personal Accounts						Rs.	P.		
L.F.									
Sundries						Rs.	P.		
Office Expenses & Repairs						Rs.	P.		
Travelling expenses						Rs.	P.		
Carriage						Rs.	P.		
Printing and Stationary						Rs.	P.		
Postage and Telegrams						Rs.	P.		
Total Payments						Rs.	P.		

5. **V.N.:** The serial number of the voucher (cash payment) is written in this column.
6. **Total Payments:** This column records the amount of every expense. At the end of the week or month expenses are totalled and afterwards balanced. The total expenses of the week or the month is compared with the total of the receipts column and the balance is obtained.
7. **Postage and Telegrams:** This column records postal expenses like post card, envelope, inland letter, postage stamps, registered letter, parcel, telegrams and telephone charges.
8. **Printing & Stationery:** It includes expenses incurred for purchasing materials such as paper, ink, pencil, eraser, carbon paper and other items of stationery.
9. **Cartage / Freight / Carriage:** In this column carriage inward of goods is recorded. It includes cartage paid to coolie, tempo charges etc.
10. **Travelling Expenses / Conveyance:** In this column fare for hiring autorickshaw, bus, train, taxi etc., are recorded.
11. **Office Expenses & Repairs:** Minor repairing charges and petty office expenses like cleaning are included in this column.
12. **Sundry Expenses / Sundries:** Generally columns of important petty expenses of the business according to the nature and type of business are prepared. In addition to these important expenses, there may be certain expenses, which may not have specific columns for them. Expenses like refreshment, charity, tips, amount paid to scavengers etc., are recorded in this column.
13. **L.F.:** This refers to the page number of the ledger where the respective account is recorded.
14. **Personal Accounts :** Small amount of money paid to individuals are entered in this column.

8.4 Balancing Petty Cash Book

At the end of the period i.e., week or month the total payments column and individual expenses columns are totalled. It should be ascertained that the total of petty expenses column must be equal to the total of payments column. The total payments column is compared with the total of receipts column and balance is obtained. The closing balance is shown as 'By Balance c/d'. The closing balance is carried forward to the beginning of the next week or month. It is shown as 'To Balance b/d'.

Illustration 1 : A Petty cash book is kept on Imprest system, the amount of imprest being Rs.1,000 and has seven analysis columns for Postage and Telegrams, Printing and Stationery, Travelling Expenses, Repairs, Carriage, Sundry Expenses and Personal Accounts. Enter the following transactions:

2003

- March 1. Petty cash in hand Rs.350
1. Received cash to makeup imprest Rs.650
 3. Paid for stationery Rs.155
 5. Paid office expenses Rs. 78
 8. Bought stamps Rs. 50
 13. Paid for railway fare Rs.256
 16. Paid to Shankar Rs. 100
 20. Paid for carriage Rs.45
 25. Paid for printing charges Rs. 175
 27. Paid for telegram Rs. 65

Solution:

Analytical Petty Cash Book

Dr.		C.B.F.N.		Date	Particulars	V.N.	Cr.												Analysis of Payments											
Receipt							Total Payments		Postage and Telegrams		Printing and Stationery		Carriage		Travelling expenses		Office Expenses & Repairs		Sundries		L.F.	Personal Accounts								
Rs.	P.						Rs.	P.	Rs.	P.	Rs.	P.	Rs.	P.	Rs.	P.	Rs.	P.	Rs.	P.		Rs.	P.							
350	00			2003 Mar 1	To balance b/d	-																								
650	00			1	To cash A/c		155	00	-	-	155	00		-		-														
				3	By Stationery		78	00	-	-				-		-														
				5	By Office Expn.		50	00	-	-				-		-														
				8	By stamps		256	00	50	00	-	-		-		-														
				13	By Railway fare		100	00	-	-	-	-		-	256	00	-													
				16	By Shankar		45	00	-	-	-	-		45	00	-														
				20	By carriage		175	00	-	-	-	-		-		-														
				25	By Print.		65	00	-	-	175	00		-		-														
				27	By Telegrams				65	00	-	-		-		-														
							924	00	115	00	330	00	45	00	256	00						100	00							
1000	00			31	By balance c/d		76	00																						
							1000	00																						
76	00			Ap. 1	To Balance b/d																									
924	00			1	To cash A/c																									

8.5 Posting of Entries in the Petty Cash Account

I. When petty cash is advanced at the beginning

A separate petty cash account is opened in the ledger. When advance is received by the petty cashier petty cash account will be debited and cash account will be credited.

II. When individual expenses column are periodically totalled

The total of various petty expenses are debited and the petty cash account is credited with the total of the payments made.

The petty cash account will show the balance of cash. This balance will be shown in the balance sheet as part of cash balance.

Illustration 2: Record the following transactions in the analytical petty cash book of Mr. Manoharan. Balance the book on 6th May, 2003. Give Journal entries and post the balances to concerned ledger accounts.

2003

- | | | |
|-----|----|--|
| May | 1. | Received for petty cash payment Rs.1,500 |
| | 2. | Paid taxi hire Rs. 250 |
| | 3. | Bought stamps Rs. 75 |
| | 4. | Paid for carriage Rs. 120 |
| | 4. | Paid for Telegrams Rs. 75 |
| | 4. | Paid for auto Rs. 125 |
| | 5. | Paid for carriage Rs. 300 |
| | 6. | Bought revenue stamps Rs. 50 |

Solution:**Analytical Petty Cash Book of Mr. Manoharan**

Dr.

Cr. Analysis of Payments

Receipts	C.B.F.N.	Date	Particulars	V.N.	Total Payments		Postage and Telegrams		Printing and Stationery		Carriage		Travelling expenses		Office Expenses & Repairs		Sundries		L.F.	Personal Accounts	
					Rs.	P.	Rs.	P.	Rs.	P.	Rs.	P.	Rs.	P.	Rs.	P.	Rs.	P.		Rs.	P.
1,500 00		2003 May	To cash A/c.	-	250	00	-	-	-	-	-	-	250	00	-	-	-	-		-	-
		1	By Taxi Hire	-	75	00	75	00	-	-	-	-	-	-	-	-	-	-	-	-	-
		2	By Stamps	-	120	00	-	-	-	-	120	00	-	-	-	-	-	-	-	-	-
		3	By Carriage	-	75	00	75	00	-	-	-	-	-	-	-	-	-	-	-	-	-
		4	By Telegrams	-	125	00	-	-	-	-	-	-	125	00	-	-	-	-	-	-	-
		4	By Auto fare	-	300	00	-	-	-	-	-	-	-	00	-	-	-	-	-	-	-
		4	By Carriage	-	50	00	-	-	-	-	300	00	-	00	-	-	-	-	-	-	-
		5	By Revenue stamps	-	995	00	200	00	-	-	420	00	375	00	-	-	-	-	-	-	-
		6	By balance c/d		505	00															
1,500 00					1500	00															
505 00		7	To Balance b/d																		
995 00		7	To Cash A/c																		

In the Books of Mr. Manoharan

Journal

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
2002 May 1	Petty cash A/c. Dr. To cash A/c (Cash received for petty expenses)		1,500	1,500
6	Postage & Telegrams Dr. Carriage Dr. Travelling Exp. Dr. To Petty cash A/c (Expenses incurred as per petty cash book)		200 420 375	995

Ledger

Dr. Petty Cash Account				Cr.			
Date	Particulars	J.F.	Amount Rs.	Date	Particulars	J.F.	Amount Rs.
2002 May 1	To cash A/c		1,500	2002 May 6	By Sundries: Postage and telegram		200
					Carriage		420
					Travel Exp.		375
					By Bal c/d		505
			1,500				1,500
7	To balance b/d		505				

Postage and Telegrams Account

Dr.

Cr.

Date	Particulars	J.F.	Amount Rs.	Date	Particulars	J.F.	Amount Rs.
2002 May 6	To Petty cash A/c		200				

Carriage Account

Dr.

Cr.

Date	Particulars	J.F.	Amount Rs.	Date	Particulars	J.F.	Amount Rs.
2002 May 6	To Petty cash A/c		420				

Travelling Expenses Account

Dr.

Cr.

Date	Particulars	J.F.	Amount Rs.	Date	Particulars	J.F.	Amount Rs.
2002 May 6	To Petty cash A/c		375				

8.6 Advantages

The advantages of analytical petty cash book is given below:

- i. **Simple Method:** It is a simple method of recording petty expenses. The maintenance of petty cash book does not require specialised knowledge of accounting.
- ii. **Economy of Time:** It requires lesser time in recording and also saves the time of the main cashier.
- iii. **Lesser chances of mistakes:** The petty cash book is checked by the main cashier at the end of the specified period. This process minimises the chances of mistakes.
- iv. **Frauds can be minimised:** Recording transactions on the basis of vouchers and checking of cash book by the main cashier minimises the chances of fraud.

Illustration 3: Prepare Petty Cash Book on imprest system from the following particulars.

2003

- | | |
|----------|---|
| Sept. 1. | Received for petty cash payments Rs.1,000 |
| 4. | Paid for stationery Rs. 140 |
| 9. | Paid for postage Rs.80 |
| 10. | Paid for printing charges Rs. 150 |
| 11. | Paid for carriage Rs. 125 |
| 17. | Paid for telegrams Rs.25 |
| 20. | Purchased envelopes Rs. 30 |
| 21. | Paid for coffee to office staff Rs. 30 |
| 22. | Paid for office cleaning Rs. 50 |
| 30. | Paid to Rajesh Rs. 200 |

Analytical Petty Cash Book

Dr.

Cr. Analysis of Payments

Receipt	C.B.F.N.	Date	Particulars	V.N.	Total Payments		Postage and Telegrams		Carriage		Travelling Expenses		Repairs		Printing & Stationery		Sundries		L.F.	Personal Accounts	
Rs.	P.				Rs.	P.	Rs.	P.	Rs.	P.	Rs.	P.	Rs.	P.	Rs.	P.	Rs.	P.		Rs.	P.
1,000	00	2003	To Cash	-																	
		Sep 1	By Stationery	-	140	00	-	-	-	-	-	-	-	-	140	00	-	-	-	-	-
		4	By Postage	-	80	00	80	00	-	-	-	-	-	-	-	-	-	-	-	-	-
		9	By Printing char.	-	150	00	-	-	-	-	-	-	-	-	150	00	-	-	-	-	-
		10	By Carriage	-	125	00	-	-	125	00	-	-	-	-	-	-	-	-	-	-	-
		11	By Telegrams	-	25	00	25	00	-	-	-	-	-	-	-	-	-	-	-	-	-
		17	By Envelops	-	30	00	30	00	-	-	-	-	-	-	-	-	-	-	-	-	-
		20	By Coff. to Staff	-	30	00	-	-	-	-	-	-	-	-	-	-	30	00	-	-	-
		21	By Cleaning ch.	-	50	00	-	-	-	-	-	-	-	-	-	-	50	00	-	-	-
		22	By Rajesh	-	200	00	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
		30																		200	00
		30	By Balance		830	00	135	00	125	00	-	-			290	00	80	00		200	00
					170	00															
1,000	00				1,000	00															
170	00	Oct 1	To Balance b/d																		
830	00	1	To Cash																		

QUESTIONS

I. Objective type :

a) Fill in the blanks :

1. The book that records all small payments is called _____.
2. The person who maintains petty cash book is known as _____.
3. Analytical petty cash book is just like the _____.
4. The periodic total of each column in the analytical petty cash book is posted to the concerned _____ accounts.
5. The petty cashier generally works on _____ system.

[Answers: 1. Petty cash book, 2. Petty cashier, 3. Cash book, 4. Nominal, 5. Imprest]

b) Choose the correct answer:

1. Petty cash may be used to pay
 - a) salaries to staff
 - b) purchase of furniture and fittings
 - c) expenses relating to post and telegrams
2. The balance in the petty cash book is
 - a) an asset
 - b) a liability
 - c) an income
3. On Jan 1st 2002, Rs.1,000 given to petty cashier. He has spent Rs.860 during the month of January. On Feb 1st to make the imprest he will receive cheque for Rs._____.
 - a) Rs. 1,000
 - b) Rs. 860
 - c) Rs. 1,860

[Answer: 1.(c), 2. (a), 3 (b)]

II. Other Questions:

1. What is petty cash book?
2. Explain the imprest system.
3. Give a specimen of analytical petty cash book.
4. Write notes on posting the petty cash book.
5. What are the advantages of petty cash book?
6. What purpose does an analytical petty cash book serve?

III. Problems:

1. Enter the following transactions in a petty cash book of Mr. Jack with analytical columns. The petty cashier begins with an imprest amount of Rs.1,000.

2002		Rs.
June 4	Postage stamps	40
	5 Travelling expenses	75
	6 Lunch expenses	150
	8 Labour charges for bringing office tables	50
	10 Repair charges to fax machine	250
	12 Postage stamps	20
	15 Cleaning the office	50
	17 Stationary purchased	175
	27 Paid to Ravi	150

[Answer : Balance Rs. 40]

2. Prepare petty cash book on imprest system from the following particulars given below:

2002		Rs.
Dec. 1	Balance on hand	25
	1 Received cheque to make the imprest	975
	2 Paid for postage	40
	4 Paid for stationery	225
	6 Paid for wages	140
	8 Paid for carriage	130
	10 Paid for travelling expenses	150
	11 Paid for telegrams expenses	50
	12 Coffee to office staff	45
	19 Taxi hire	150

[Answer: Balance Rs. 70]

3. Prepare the analytical petty cash book of Mrs.Mala from the following:

2002		Rs.
Dec.	1 Cash in hand	435
	1 Received from cashier	1,065
	4 Bought postage stamps	75
	7 Paid for stationery	135
	8 Paid to Manimaran on account	475
	13 Tea to sales agents	25
	20 Bought ink & paper	43
	21 Paid for carriage	45
	24 Sent a telegram to Madurai	25
	26 Paid for stationery	120
	29. Paid for registered post	50

[Answer: Balance Rs.507]

4. Enter the following Petty transactions in the Analytical Petty Cash Book of Mr. Elangovan

2002		Rs.
Oct.	1 Balance in hand	410
	1. Received from the head cashier	1090
	3. Paid electricity charges	335
	5. Bought stationery	128
	8. Printing charges	150
	9. Postage stamps purchased	65
	13. Repairs to furniture	125
	14. Telegram sent to suppliers	50
	15. Repairs to computer	250

[Answer : Balance Rs. 397]

5. Prepare petty cash book of Mr.Nandakumar with suitable columns and enter therein the following transactions. Balance the book on 10th March 2001.

2001		Rs.
Mar	1 Balance in hand	158
	Received from chief cashier	592
	2 Paid for postage stamps	50
	5 Paid for stationery	105
	6 Paid for carriage	65
	7 Paid for postage stamp	75
	Paid for telegrams	35
	8 Paid for carriage	50
	9 Paid for stationery	78

[Answer : Balance Rs. 292]

6. Record the following transactions in an analytical petty cash book of Mr.Senthil and balance the same. On 1st April 2003 the petty cashier started with an imprest of Rs. 1,500.

2003		Rs.
April	1 Postage stamps purchased	50
	3 Sweeper and scavanger paid	25
	5 Conveyance to manager	457
	6 Telegram to Mumbai	44
	7 Stationery purchased	68
	10 Lorry hire for goods sent	250
	13 Cartage and cooly on goods bought	75
	18 Repair to cycles	30
	19 Service charges to Typewriters	75
	22 Ink and Gum purchased	23
	24 Advertisement charges	100
	27 Subscription paid to The Hindu	125
	28 Tea to customers	12

[Answer : Balance Rs. 166]

7. Enter the following transactions in a petty cash book of Mr. Murugan maintained on imprest system with analytical columns:

2003		Rs.
July	15 Cash in hand	143
	Received from the chief cashier	607
	16 Bought stamps	25
	17 Paid cartage	40
	18 Tea and lunch expenses to customers	74
	19 Telegram sent	23
	20 Paid taxi hire	150
	21 Purchased envelopes	22
	22 Paid for repairs of typewriter	65
	23 Purchased one bottle of ink	12
	27 Paid Railway fare to manager	187
	31 Paid to coolie	20

[Answer : Balance Rs.132]

CHAPTER - 9

BANK RECONCILIATION STATEMENT

Learning Objectives

After studying this Chapter, you will be able to:

- *know the Importance and Need of Bank Reconciliation Statement.*
- *understand the Causes for Disagreement between Cash Book and Pass Book Balances.*
- *prepare Bank Reconciliation Statement.*

Cash book with cash and bank columns have been explained in the earlier chapter. On the debit side of the cash book, the bank column represents:

1. Cheques deposited into bank for collection.
2. Cash paid into bank and
3. Some entries that are made only after receiving the information from the bank viz.,
 - i. Amounts collected by the bank on our behalf as per the standing instructions, for example, Interest collected on investment.
 - ii. Interest given by the banker for the balance kept by us in our bank account.
 - iii. The amount paid by our customers directly into our bank account.

On the other hand, on the credit side of the cash book, represents:

1. Cheques issued for payment.
2. Cash withdrawn from bank for office use and personal use.
3. In addition, some entries are made after receiving information from the bank viz.,
 - i. Amounts paid by the bank on our behalf as per the standing instructions, for example, payment of insurance premium.

- ii. Interest charged by the bank for the amount drawn over and above the actual balance kept in the bank account.
- iii. Bank charges payable for the agency and utility services rendered by the bank.

9.1 Bank Pass Book

Bank Pass Book (statement of account) is merely a copy of the customer's account in the books of a bank. It shows all the deposits, withdrawals and the balance available in the customers account.

9.1.1 Format

Bank Pass Book

Date	Particulars	Dr. Withdrawals Rs.	Cr. Deposits Rs.	Balance Dr / Cr Rs.	Initials

In the date column, the dates of the transactions are recorded. In the particulars column withdrawals and deposits are recorded. The balance after each transaction is recorded in the next column and the bank official signs in the last column.

Following the principles of Double Entry, banker credits the account of the customer for all the amounts received from the customer and on his behalf. Similarly the banker debits the account of the customer for all withdrawals and amounts paid to others on behalf of the customers.

The main point to be remembered is that entries are made only after cash is received or paid, except in the case of interest and bank charges. Interest and bank charges are mere book adjustments and in these ,there are neither receipt of cash nor payment of cash.

9.2 Difference between Cash Book and Pass Book

S.No	Basis of Distinction	Cash Book (Bank Column)	Pass Book
1.	Maintained by	Cashier	Banker
2.	Deposits of Cash	Entered on the debit side of the cash book.	Entered on the credit column of the pass book.

3.	Withdrawals of Cash	Entered on the credit side of the cash book.	Entered on the debit column of the pass book.
4.	Cheques deposited for collection	Entered on the debit side of the cash book on the date of depositing the cheques into the bank.	Entered in the pass book only on the date of the realisation of the cheque.
5.	Cheques issued	Entered on the credit side of the cash book on the date of issuing the cheque to the creditors.	Entered on the debit column of the pass book only on the date on which they are presented and paid.
6.	Collections and payments as per customers standing instructions	Entered in the Cash book after seeing the pass book.	Entered in the Pass book first.
7.	Signature	It is not signed by the cashier	It is signed by the Bank official after each transaction.
8.	Balancing	It is balanced at the end of a specified period.	It is balanced after each transaction

9.3 Bank Reconciliation Statement

The balance of the bank column in the double or triple column cash book represents the customers cash balance at bank. It should be the same as shown by his bank pass book on any particular day. For every entry made in the cash book if there is a corresponding entry in the pass book(maintained by the banker) or vice versa, the bank balance will be the same in both the books.

However, it must be noted that the cash book and the pass book are maintained by two different parties and hence it is not certain that entry in one book will always have a corresponding entry in the other. Normally entries in the cash book should tally (agree) with those in the pass book and the balances shown by both the books should be the same. But in practice, the balances generally differ. In case of disagreement in the balance of the cash book and the pass book, the need for preparing Bank Reconciliation Statement arises.

9.3.1 Definition

‘Bank reconciliation statement is a list in which the various items that cause a difference between bank balance as per cash book and pass book on any given date are indicated’.

9.3.2 Need and Importance

After tracing the various items of difference, a bank reconciliation statement is prepared. The following are its advantages in which lies its importance.

- i. The errors that might have taken place in the cash book in connection with bank transactions can be easily found.
- ii. Regular preparation of bank reconciliation statement prevents frauds.
- iii. It indirectly imposes moral check on the accounting staff.
- iv. By the preparation of bank reconciliation statement, uncredited cheque can be detected and steps can be taken for their collection.

9.4 Causes of disagreement between the balance shown by the cash book and the balance shown by the pass book

1. Cheques paid into bank but not yet collected

The cheques paid into bank for collection but not credited into the account of the customer, because the cheque is

- i. not collected and credited till that date.
- ii. collected but the bank staff has forgotten to make entry.
- iii. collected but credited to wrong account.
- iv. dishonoured.
- v. collected for No.I account but credited to No.II account of the same customer.

As soon as the cheques are sent to the bank, entries are made in the debit side of the cash book (bank column). But, usually bank credit the customers account only when they have received payment from the bank concerned, in other words, when the cheques have been collected. Hence, there will be a time gap between the depositing of the cheques and the collection by the bank.

For example, Bharat Company Limited deposited a cheque on March 28, 2003 for a sum of Rs.3,000. The cheque was collected on April 4, 2003. In case the bank sends a statement of account upto March 31, 2003, there will be a difference of Rs 3,000 between the balance shown by the cash book and the pass book.

2. Cheques issued but not yet presented for payment

The cheques issued but not debited customers account may be because the cheque is

- i. not cashed till date.
- ii. not presented till date.
- iii. presented but dishonoured for some reasons or other.
- iv. lost by the party to whom the cheque was issued.
- v. cashed out of No.I account but wrongly debited to No.II account of the same customer.

In all of the above cases, the entry in the cash book is made immediately on the issue of cheque but naturally the entry will be made by bank only when the cheque is presented for payment. Thus there will be a gap of some days between the entry for issue of cheque in the cash book and the entry for payment made in the pass book.

For example, Bharat Company Limited issued a cheque in favour of Mr.Krishna on March 28, 2003 for a sum of Rs.5,000. The cheque is presented for payment at the bank on April 4, 2003. In case, bank sends a statement of account upto March 31, 2003, there will be a difference of Rs.5,000 between the balance as shown by the cash book and the balance as shown by the pass book.

3. Amount credited by the banker in the pass book without the immediate knowledge of the customer

The following are some of the examples for the above statement

- i. The bank might have collected rent, dividend, bills of exchange, interest etc., due for the customer as per standing instructions .
- ii. Some debtors might have directly paid into bank.
- iii. Bank credits interest on the credit balance of the customer's account.
- iv. The banker has wrongly credited this account instead of some other account.

In all the above cases, the entry will be first entered in the pass book. The customer will know this only after he verifies the entries in the pass book. So there may be a time gap of some days before the customer includes entries made in the pass book.

For example, the bank has credited Bharat Company Limited's account for interest amounting to Rs.500 on March 31, 2003. The bank prepares and sends a

statement of account on March 31, 2003. If the customer receives the statement of account on April 4, 2003, there will be a difference of Rs 500 between the balance shown by the cash book and the balance shown by the pass book.

4. Amounts debited by the banker in the pass book without the immediate knowledge of the customer

The following are some of the examples for this.

- i. The banker has recorded bank charges, interest on overdraft etc.
- ii. The banker has paid insurance premium, subscription for periodicals, etc. on behalf of the customer as per the standing instructions.
- iii. The banker has wrongly debited this account instead of some other account.
- iv. The banker has paid the bills payable of the customer as per standing instructions .
- v. Dishonour of a cheque deposited and discounted bills receivable.

In all the above cases, the entry will be first entered in the pass book of the customer. And the customer will know only after he verifies the entries in the pass book or statement of account . So there may be a time gap of some days before the customer includes the entries made in the pass book.

For example, the bank has debited Bharat Company Limited's account for its charges amounting to Rs. 250 on March 31, 2003. In case, the bank sends a statement of account upto March 31, 2003, there will be a difference of Rs.250 between the balance as per the cash book and the balance as per the pass book.

For example, A cheque for Rs.5,000 dishonoured on March 28, 2003. In case, the bank sends a statement of account upto March 31, 2003 there will be a difference of Rs.5,000 between the balance as shown by the cash book and the balance as shown by the pass book.

After tracing the various items of differences, a Bank reconciliation statement is prepared by starting with the balance shown by any of the two books. But in actual practice, a Bank reconciliation statement is prepared by the customer starting with the balance as per cash book and will ensure that the balance as per pass book is arrived at.

Bank Overdraft

Bank overdraft is an amount drawn over and above the actual balance kept in the bank account. This facility is available only to the current account holders. Interest will be charged for the amount overdrawn i.e., overdraft. The Cash book will show a credit balance i.e., unfavourable balance. The pass book will show a debit balance.

A summary of the transactions and the reconciliation procedure is given in the table below.

9.5 Procedure for Preparing Bank Reconciliation Statement

S. No	Transactions	Entries by customer in the cash book (Bank column)	Entries by Bank in the pass book	Effect	Procedure to ascertain the balance as per pass book from cash book	
					Favourable balance	Unfavourable balance (over-draft)
1.	When cash is deposited	Customer enters in the debit side	Bank enters in credit column	Cash book = Pass book	-	-
2.	When cash is withdrawn	Customer enters in the credit side	Bank enters in debit column	Cash book = Pass book	-	-
3.	Issue of cheque	Customer enters in the credit side immediately	Bank enters in the debit column only on the date when presented for payment	Cash book < Pass book	Add	Less
4.	Cheque received and entered in cash book and sent to bank for collection	Customer debits cash book	Only after collection, the amount will be entered in the credit column of the pass book because the process takes some time	Cash book > Pass book	Less	Add
5.	Bank charges for services rendered by bank	No entry can be found in cash book till the pass book is verified	Entered in the debit column of the passbook immediately.	Cash book > Pass book	Less	Add

6.	Interest, dividend etc collected by bank on behalf of customer	No entry can be found in cash book till the pass book is verified.	These are entered in the credit column of the passbook immediately after receiving the amount	Cash book < Pass book	Add	Less
7.	Interest allowed by bank	No entry is made unless pass book is verified.	Entered in the credit column of the pass book first.	Cash book < Pass book	Add	Less
8.	Amount directly remitted into bank	No entry is found in cash book till the pass book is verified.	Entered in the credit column of the pass book on the same day of receipt.	Cash book < Pass book	Add	Less
9.	Subscription, premium etc paid by the banker as per the standing instructions of the customer	Entry is made only after the pass book is verified.	Entered in the debit column of the pass book on the same day of payment	Cash book > Pass book	Less	Add
10.	Dishonour of bills receivable or cheques paid into bank	No entry in the cash book till the customer is intimated by the banker	Entered in the debit column of the pass book immediately	Cash book > Pass book	Less	Add
11.	Dishonour of bills payable or cheques issued	No entry in the cash book till the customer is intimated by the banker	Entered in the credit column of the pass book immediately	Cash book < Pass book	Add	Less

12.	Wrong credit in the pass book	No entry is found in cash book unless it is verified with the pass book.	Entered (wrongly) in the credit column in the pass book	Cash book < Pass book	Add	Less
13.	Wrong debit in the pass book	No entry is found in cash book unless it is verified.	Entered (wrongly) in the debit column in the pass book	Cash book > Pass book	Less	Add

9.6 Format

The format of Bank Reconciliation Statement when bank balance as per cash book is taken as the starting point.

Bank Reconciliation Statement as on

Particulars		Amount Rs.	Amount Rs.
A	Balance as per Cash Book		***
B	Add: Cheques issued but not presented for payment	***	
	Interest credited by bank but not recorded in cash book	***	
	Debtors directly paid into bank but not recorded in cash book	***	
	Wrong credit by banker	***	
	Collections by banker as per customer standing instructions	***	
	Total (B)		***
C	(Total A + B)		***
D	Less: Cheques deposited but not credited by the bank	***	
	Dishonoured cheques appeared in the pass book but not entered in the cash book	***	
	Bank charges as per pass book	***	
	Wrong debit by banker	***	
	Payments as per standing instructions	***	
	Total (D)		***
E	Balance as per pass book (C- D)		***

Points to be noted:

To work out the problems on Bank Reconciliation Statement, the following points are to be remembered.

- i. The heading is given as “Bank Reconciliation Statement as on _____”
- ii. All items to be added are grouped together and shown in the inner column and the total is taken to the outer column for the purpose of addition (B).
- iii. All items to be deducted are grouped together in the inner column and the total can be shown in the outer column for deduction.(D).
- iv. **Favourable balance** means the cash book will have a debit balance and the passbook will have a credit balance.
- v. **Bank overdraft or unfavourable** balance means cash book will have a credit balance and passbook will have debit balance.

For easy reference the table given below will be useful.

Book	Favourable Balance	Unfavourable Balance (overdraft)
Cash	Debit	Credit
Pass	Credit	Debit

Illustration 1: When balance as per cash book is favourable.

From the following details, make out a bank reconciliation statement for M/s.Elavarasan & Company as on December 31, 2003 to find out the balance as per pass book.

	Rs.
1. Cheques deposited but not yet collected by the bank	1,500
2. Cheque issued to Mr.Raju has not yet been presented for payment	2,500
3. Bank charges debited in the pass book	200
4. Interest allowed by the bank	100
5. Insurance premium directly paid by the bank as per standing instructions	500
6. Balance as per cash book	200

Solution**Bank Reconciliation Statement as on December 31, 2003**

Particulars		Amount Rs.	Amount Rs.
A	Balance as per Cash Book		200
B	Add: Cheques issued to Mr.Raju but not presented for payment	2,500	
	Interest allowed by bank but not recorded in cash book	100	
			2,600
C	Less: Cheques deposited but not credited by the bank	1,500	2,800
	Bank has paid insurance premium as per standing instructions	500	
	Bank charges as per pass book	200	
			2,200
D	Balance as per Pass Book		600

Illustration 2: When balance as per pass book (favourable) is given

Mrs.Jame's pass book showed a balance of Rs 25,000 on June 30, 2003. Her cash book shows a different balance. On examination, it is found that

1. No record has been made in the cash book for a dishonour of a cheque for Rs.250
2. Cheques paid into bank amounting to Rs. 3,500 were paid into the bank on June 28, 2003 and the same had not been entered in the pass book.
3. Bank charges of Rs. 300 have not been entered in the cash book.
4. Cheques amounting to Rs. 9,000 issued to Ms.Devi has not been presented for payment still.
5. Mr. Balu who owed Rs. 3,000 has directly paid the sum into the bank account.

You are required to prepare a Bank reconciliation statement and ascertain the balance as per cash book.

Solution

Bank Reconciliation Statement as on June 30, 2003

Particulars	Amount Rs.	Amount Rs.
Balance as per Cash Book		25,000
Add: Dishonour of cheque not recorded in cash book	250	
Cheques paid into bank, not collected	3,500	
Bank charges as per pass book not entered in the cash book	300	
		4,050
		29,050
Less: Cheques issued but not presented for payment	9,000	
Amount directly paid by Mr.Balu into the bank	3,000	
		12,000
		17,050
Balance as per cash Book		

Illustration 3: When overdraft as per cash book is given

Prepare a Bank Reconciliation Statement as at June 30, 2003 for M/s.Jothi Sales Private Limited from the information given below

	Rs.
1. Bank overdraft as per cash book	1,10,450
2. Cheques issued on June 20, 2003 but not yet presented for payment	15,000
3. Cheques deposited but not yet credited by bank	22,750
4. Bills receivable directly collected by bank	47,200
5. Interest on overdraft debited by bank	12,115
6. Amount wrongly debited by bank	2,400

Solution**Bank Reconciliation Statement as on June 30, 2003**

Particulars	Amount Rs.	Amount Rs.
Overdraft balance as per cash book		1,10,450
Add: Cheques deposited but not yet credited	22,750	
Interest on overdraft debited by bank	12,115	
Wrong debit by bank	2,400	
		37,265
		1,47,715
Less: Cheques issued but not presented for payment	15,000	
Bills receivable collected by bank	47,200	
		62,200
Overdraft balance as per bank pass book		85,515

Illustration 4: When overdraft as per Pass Book is given

Ms.Haritha gives you the following information regarding her bank account. It shows an overdraft balance of Rs.6,500 on March 31, 2003. This does not agree with the cash book balance.

1. Cheques amounting to Rs.15,000 were paid into bank out of which, only cheques amounting to Rs.4,500 were credited by the bank.
2. Cheques issued during March amounted in all to Rs.11,000, out of these, cheques amounting to Rs.3000 were unpaid till March 31, 2003.
3. The bank has wrongly debited account No.1 with Rs.500 in respect of a cheque drawn on account No.2.
4. The account stands debited with Rs.150 for interest and Rs.30 for bank charges.
5. The bank has paid the annual subscription of Rs.100 to club according to instructions.

You are required to ascertain balance as per cash book

Solution**Bank Reconciliation Statement as on March 31, 2003**

Particulars	Amount Rs.	Amount Rs.
Overdraft balance as per pass book		6,500
Add: Cheques issued but not presented	3,000	
		3,000
Less: Cheques paid into bank but not collected (Rs.15000-Rs.4500)	10,500	9,500
Wrong debit in pass book in account No.1 instead of account No.2	500	
Interest and bank charges not entered in the cash book (Rs.150+Rs.30)	180	
Subscription paid as per standing instruction	100	11,280
Balance as per cash book (Favourable)		(1780)

When an extract of cash book (bank column) and pass book is given.

Illustration 5: Given below are the entries in the bank column of the cash book and the pass book. Prepare a Bank Reconciliation Statement of Mr.Sekar as on August 31, 2003.

Cash Book

Dr.

(Bank Columns)

Cr

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2003			2003		
Aug 1	To Balance b/d	20,525	Aug 8	By Kokila A/c	12,000
18	To Shanker A/c	6,943	26	By Geetha A/c	9,740
19	To Sales A/c (Rajan)	450	28	By Latha A/c	11,780
20	To Commission A/c (Babu)	200	30	By Salaries A/c (Amala)	720
20	To Nirmala A/c	7,810	31	By Balance c/d	1,688
		35,928			35,928
Sept 1	To Balance b/d	1,688			

Pass Book

Date	Particulars	Dr. Withdrawals Rs.	Cr. Deposits Rs.	Balance Dr./Cr. Rs.	Initials
01.08.03	By balance b/d			20,525 Cr	
09.08.03	To Kokila	12,000		8,525 Cr	
19.08.03	By Shankar		6,943	15,468 Cr	
25.08.03	By Rajan		450	15,918 Cr	
26.08.03	To Geetha	9,740		6,178 Cr	
27.08.03	By Babu		200	6,378 Cr	
28.08.03	To Amala	720		5,658 Cr	
30.08.03	By B/R		20,000		
	By Interest		25		
	By Interest on Investment		1,820	27,503 Cr	
31.08.03	To B/P	4,000		23,503 Cr	

Solution :

In the above problem, an extract of the cash book (bank column) and the pass book of Mr.Sekar is given. The items given on the debit side of the cash book should match with the items given on the credit column of the pass book and vice versa. The items, which do not match, cause the difference between both the balances.

Bank Reconciliation Statement as on August 31, 2003

Particulars	Amount Rs.	Amount Rs.
Balance as per cash book		1,688
Add: Bills receivable collected, not entered in cash book	20,000	
Interest collected, not entered in cash book	25	
Interest on investment collected, not entered in cash book	1,820	
Cheques issued but not collected – Latha	11,780	
		33,625
Less: Cheques paid into bank, bu not collected – Nirmala	7,810	35,313
Bills payable paid, not entered in cash book	4,000	
		11,810
Balance as per pass book		23,503

QUESTIONS

I. Objective type:

a) Fill in the blanks:

- The bank statement is sent by _____ to the customer.
- Overdraft means credit balance as per _____ book.
- When cash is withdrawn from the bank, the bank _____ the customer's account.
- _____ balance in pass book shows bank overdraft.
- For the purposes of reconciliation only the _____ column of the cash book are to be considered.
- A bank reconciliation statement is prepared by the _____.

[Answers : 1. bank, 2. cash, 3. debits, 4. debit, 5. bank, 6. customers]

b) Choose the correct answer:

1. Bank Reconciliation statement is prepared by the
 a) bank b) creditor of a business c) customer of a bank
2. Debit balance in the Cash Book means
 a) overdraft as per Pass Book
 b) credit balance as per Pass Book
 c) overdraft as per Cash Book
3. When balance as per Cash Book is the starting point, to ascertain balance as per pass book interest allowed by Bank is
 a) subtracted b) added c) not adjusted
4. When balance as per Cash Book is the starting point, to ascertain the balance as per pass book interest charged by Bank is:
 a) added b) subtracted c) not adjusted
5. When the balance as per Cash Book is the starting point to ascertain balance as per pass book, direct deposits by customers are:
 a) added b) subtracted c) not adjusted
6. When the balance as per Cash Book is the starting point to ascertain balance as per pass book, direct payment by bank are:
 a) added b) subtracted c) not adjusted
7. A bank pass book is a copy of
 a) the cash column of a customer's cash book.
 b) the bank column of a customer's cash book.
 c) the customer's account in the bank's ledger.
8. The bank statement shows an overdrawn balance of Rs.2,000. A cheque for Rs.500 drawn in favour of a creditor has not yet been presented for payment. When the creditor presents the cheque for payment, the bank balance will be
 a) Rs. 1,500 b) Rs. 2,500 (overdrawn) c) Rs.2,500

[Answers : 1. (c), 2. (b), 3. (b), 4. (b), 5. (a), 6. (b), 7. (c), 8. (b)]

II. Other Questions :

1. What is a Bank Pass Book?
2. What is a Bank Reconciliation Statement?
3. When can a bank reconciliation be prepared?
4. Who prepares a bank statement?
5. Why is the preparation of Bank Reconciliation Statement necessary?
6. List the five items having the effect of higher balance in the Cash Book.
7. List the five items having the effect of lower balance in the Pass Book.
8. State any two causes of disagreement between the balances shown by the Cash Book and Pass Book.

III. Problems:

1. Make a bank reconciliation statement of Mr. Udayakumar from the following particulars.
 - a) Balance as per cash book Rs. 1,500.
 - b) Cheques deposited but not cleared Rs. 100.
 - c) Cheques issued but not presented for payment Rs. 150.
 - d) Interest allowed by bank Rs. 20.

[Answer : Balance as per pass book Rs. 1,570]

2. Prepare a bank reconciliation statement of Mr. Goutham from the following data as on 31.12.2003.

	Rs.
a) Balance as per cash book	12,500
b) Cheques issued but not presented for payment	900
c) Cheques deposited in bank but not collected	1,200
d) Bank paid insurance premium	500
e) Direct deposit by a customer	800
f) Interest on investment collected by bank	200
g) Bank charges	100

[Answer : Balance as per pass book Rs. 12,600]

3. From the following particulars, ascertain the bank balance as per cash book of Mr.Muthu as at 31st March 2003.

Rs.

- a) Credit balance as per pass book as on 31.3.2003 Rs. 2,500.
- b) Bank charges of Rs.60 had not been entered in the cash book.
- c) Out of the cheques of Rs.3,500 paid into the bank, a cheque of Rs.1,000 was not yet credited by the banker.
- d) Out of the cheques issued for Rs.4,500, cheques of Rs.3,800 only were presented for payment.
- e) A dividend of Rs.400 was collected by the banker directly but not entered in the cash book.
- f) A cheque of Rs.600 had been dishonoured prior to 31.3.2003, but no entry was made in the cash book.

[Answer : Balance as per cash book Rs. 3,060]

4. On 31st March 2004 the cash book of Fashion World showed a balance of Rs.1,500 as cash at bank, but the bank pass book as on that date showed that cheques for Rs.185, Rs.175 and Rs.100 had not been presented for payment. Also cheques to the mount of Rs.410 paid into the bank had not been cleared. Find out the balance as per pass book as on that date.

[Answer : Balance as per pass book Rs.1,550]

5. On 31st December 2003 the pass book of Ms.Rosy shows a credit balance of Rs.3,357.

The cheques sent to the bank but not collected and credited amounted to Rs.790 and three cheques drawn for Rs.300, Rs.150 and Rs.200 respectively were not presented for payment till 31st January 2004.

Bank has paid a bill payable amounting to Rs.1,000 but it has not been entered in the Cash Book and a bill receivable of Rs.500 which was discounted with the bank was dishonoured by the drawee on due date.

The bank has charged Rs.12 as its commission for collecting outstation cheques and has allowed interest Rs.10 on the trader's balance.

Prepare a Bank Reconciliation Statement and show the balance as per cash book.

[Answer : Balance as per cash book Rs.4,999]

6. From the following particulars of Mr.Manikandan, prepare a Bank Reconciliation Statement as on March 31, 2003:
- The following cheques were paid into the firm's current A/c in March but were credited by the bank in April: Anbu Rs. 250, Balu Rs.350 and Chandru Rs.190.
 - The following cheques were issued by the firm in March and were cashed in April: Prince Rs. 250, Queen Rs. 450 and Raja Rs.400.
 - A cheque for Rs.100 which was received from a customer was entered in the bank column of the cash book in March but the same was paid into the bank in April.
 - The pass book shows a credit of Rs. 250 for interest and a debit of Rs. 100 for bank charges.
 - The balance as per Cash Book was Rs. 18,000 as on 31.3.2003.

[Answer : Balance as per pass book Rs. 18,360]

7. From the following particulars, ascertain the balance that would appear in the Bank Pass Book of Cotton World Ltd. at 31st December, 2003.
- The bank overdraft as per Cash Book on 31st December, Rs. 1,26,800.
 - Interest on overdraft for 6 months ending 31st December, Rs.3,200 is entered in the Pass Book.
 - Bank charges of Rs.600 for the above period are debited in the Pass Book.
 - Cheques issued but not cashed prior to 31st December, amounted to Rs.23,360.
 - Cheques paid into bank but not cleared before 31st December, were for Rs. 43,400.
 - Interest on investments collected by the bank and credited in the Pass Book, Rs. 24,000.

[Answer : Overdraft as per pass book Rs. 1,26,640]

8. The Cash Book of Mr.Elavarasan showed that he had an Overdraft of Rs.8,000 on 31st October, 2003. On verification of the Cash Book and the Bank Pass Book the following points were noticed:
- Cheques worth Rs.1,400 paid into the Bank had not been collected till 31st October.
 - Cheques worth Rs. 720 issued before 31st October had not been presented for payment.

- c) Interest on Overdraft Rs. 110 charged by the Bank was not entered in the Cash Book.
- d) A Bill Receivable worth Rs. 800 discounted on 1st September was dishonoured.
- e) A customer had paid into the Bank directly Rs. 450 and this was not entered in the Cash Book.

Prepare a Bank Reconciliation Statement as on 31.10.73.

[Answer : Overdraft balance as per cash book Rs. 9,140]

9. The Cash book of Dhandapani showed an Overdraft of Rs.15,000. The Cash Book entries were checked with the entries in the Pass Book. The following details were disclosed. Prepare a Bank Reconciliation Statement to show the Bank Balances as per Pass Book as on 30th June, 2003.

- a) Out of the four cheques issued on 27th June, 2003 for Rs.21,000, two cheques for 12,000 alone were presented for payment on 29th June, 2003.
- b) Cheques paid into the Bank amounted to Rs.17,800. But the Bank had not cashed and credited in the Pass Book before that date.
- c) There was an entry on the debit side of the Pass Book for Bank Charges, Rs.150.
- d) The Bank had also debited the account for Interest on O/D for Rs.280.
- e) It was also noticed that the Bank had paid Rs.2,750 as Insurance premium as per standing instructions on 29th June, 2003.

[Answer : Overdraft balance as per pass book Rs. 26,980]

10. From the following particulars of Mr.Jacob, ascertain the Bank Balance as per Pass Book on December 31, 2003.

- a) The Bank balance as per Cash Book was Rs.11,500 on December 31, 2003.
- b) Cheques issued but not cashed before that date amounted to Rs.1,750.
- c) Cheques paid into Bank, but not cleared before December 31, 2003 amounted to Rs.2,150.
- d) Interest on Investments collected by the Bank but not entered in the Cash Book amounted to Rs.275.
- e) Local cheque paid in but not entered in the Cash Book Rs.250.
- f) Bank Charges debited in the Pass Book Rs.95.

[Answer : Balance as per pass book Rs. 11,530]

11. Prepare a Bank Reconciliation Statement of Mr.Srinivasan.

Cash Book

Dr.

Cr.

2003			2003		
Feb 1	To Bal. b/d	22,148	Feb 1	By Mani	2,822
18	To Kumar	12,000	15	By Giri	750
19	To Sales- Raman	200	20	By Chidambaram	87
28	To Balu	8,345	20	Purchases - Padma	182
28	To Commission		26	Salaries - Somu	150
28	Babu	810	26	Chandra	8,820
	To Venkatesh	3,412	28	Rangan	2,346
				By Bal. c/d	31,758
		46,915			46,915
Mar 1	To Bal. b/d	31,758			

Pass Book

Date	Particulars	Dr. With drawals Rs.	Cr. Deposits Rs.	Dr./Cr. Balance Rs.
2004				
Feb 1	By Balance b/d			22,148
2	To Mani	2,822		19,326
16	To Giri	750		18,576
19	By Kumar		12,000	30,576
20	By Raman		200	
20	To Chidambaram	87		
20	To Padma	82		30,507
26	To Somu	150		30,357
28	To Insurance Premium	92		
	To B/P A/c	2,500		
	By Babu		810	
	By Muthu		1,200	
	By Interest		32	
	By Interest on investment		135	
	By B/R A/c.		750	30,692 Cr.

CHAPTER - 10

TRIAL BALANCE AND RECTIFICATION OF ERRORS

Learning Objectives

After learning this chapter you will be able to:

- *know the Meaning, Objectives and Preparation of Trial Balance.*
 - *identify the Kinds of Errors.*
 - *understand the Procedure for Rectification of Errors.*
-

In the previous chapters, you have learnt how to record and classify the transactions in the various accounts along with balancing thereof. The next step in the accounting process is to prepare a statement to check the arithmetical accuracy of the transactions recorded so far. This statement is called ‘**Trial Balance**’.

Trial balance is a statement which shows debit balances and credit balances of all accounts in the ledger. Since, every debit should have a corresponding credit as per the rules of double entry system, the total of the debit balances and credit balances should tally (agree). In case, there is a difference, one has to check the correctness of the balances brought forward from the respective accounts. Trial balance can be prepared in any date provided accounts are balanced.

10.1 Definition

“**Trial balance** is a statement, prepared with the debit and credit balances of ledger accounts to test the arithmetical accuracy of the books” – **J.R. Batliboi**.

10.2 Objectives

The objectives of preparing a trial balance are:

- i. To check the arithmetical accuracy of the ledger accounts.
- ii. To locate the errors.
- iii. To facilitate the preparation of final accounts.

10.3 Advantages

The advantages of the trial balance are

- i. It helps to ascertain the arithmetical accuracy of the book-keeping work done during the period.
- ii. It supplies in one place ready reference of all the balances of the ledger accounts.
- iii. If any error is found out by preparing a trial balance, the same can be rectified before preparing final accounts.
- iv. It is the basis on which final accounts are prepared.

10.4 Methods

A trial balance can be prepared in the following methods.

- i. **The Total Method** : According to this method, the total amount of the debit side of the ledger accounts and the total amount of the credit side of the ledger accounts are recorded.
- ii. **The Balance Method** : In this method, only the balances of an account either debit or credit, as the case may be, are recorded against their respective accounts.

The balance method is more widely used, as it supplies ready figures for preparing the final accounts.

10.5 Format

Trial Balance of ABC Ltd.

as on

Sl.No	Name of Account	L.F	Debit Rs.	Credit Rs.

Points to be noted :

- i. Date on which trial balance is prepared should be mentioned at the top.
- ii. Name of Account column contains the list of all ledger accounts.
- iii. Ledger folio of the respective account is entered in the next column.
- iv. In the debit column, debit balance of the respective account is entered.
- v. Credit balance of the respective account is written in the credit column.
- vi. The last two columns are totalled at the end.

10.6 Sundry Debtors and Sundry Creditors

In the ledger there are many personal accounts, some of them may show debit balances, some others may show credit balances. If all the names are to be written in the trial balance it will be unduly long. Therefore, a list of names with the debit balances is prepared. This list is known as '**Sundry Debtors**' (Sundry means 'many'). Similarly, a list of names with the credit balances is prepared. This list is known as '**Sundry Creditors**'.

Illustration 1

The following balances were extracted from the ledger of Rahul on 31st March, 2003. You are requested to prepare a trial balance as on that date in the proper form.

	Rs.		Rs.
Salaries	36,320	Purchases	1,44,670
Sales	1,73,500	Sundry Debtors	1,430
Plant & Machinery	34,300	Travelling Expenses	2,630
Commission Paid	1,880	Carriage Inward	240
Stock on 1.4.2002	11,100	Sundry Creditors	14,260
Repairs	1670	Capital, 1.4.2002	62,500
Sundry Expenses	460	Drawings	3,500
Returns Inward	1,000	Cash at Bank	1,090
Discount Allowed	1,150	Returns Outward	400
Rent and Rates	3,220	Investments	6,000

Solution:

Trial Balance of Rahul
as on 31st March, 2003

S. No.	Name of the Account	L. F.	Dr. Rs.	Cr. Rs.	Nature of Balance (Why Dr. or Cr.)
1.	Salaries		36,320	–	Nominal A/c-expense
2.	Sales		–	1,73,500	Real A/c - goods
3.	Plant and Machinery		34,300	–	Real A/c - asset
4.	Commission Paid		1,880	–	Nominal A/c expense
5.	Stock on 1.4.2002		11,100	–	Real A/c - goods
6.	Repairs		1,670	–	Nominal A/c-expense
7.	Sundry Expenses		460	–	Nominal A/c-expense
8.	Returns Inward		1,000	–	Real A/c - goods
9.	Discount Allowed		1,150	–	Nominal A/c - loss
10.	Rent & Rates		3,220	–	Nominal A/c-expense
11.	Purchases		1,44,670	–	Real A/c - goods
12.	Sundry Debtors		1,430	–	Personal A/c – customers
13.	Travelling Expenses		2,630	–	Nominal A/c-expense
14.	Carriage Inward		240	–	Nominal A/c-expense
15.	Sundry Creditors		–	14,260	Personal A/c – suppliers
16.	Capital 1.4.2002		–	62,500	Personal A/c - owner
17.	Drawings		3,500	–	Personal A/c - owner
18.	Cash at Bank		1,090	–	Real A/c - asset
19.	Returns Outward		–	400	Real A/c - goods
20.	Investments		6,000	–	Real A/c. - asset
	TOTAL		2,50,660	2,50,660	

Note: The last column given in the solution does not appear in practice. It is included here to illustrate the following generalised rules, that

- i) a debit balance is either an asset or loss or expense; and
- ii) a credit balance is either a liability or income or gain.

10.7 Limitations

Though the trial balance helps to ensure the arithmetical accuracy of the books of accounts, it is possible only when the accountant has not committed any error. As all the errors made are not disclosed by the trial balance, it would not be regarded as a conclusive proof of correctness of the books of accounts maintained.

10.8 Errors in Accounting

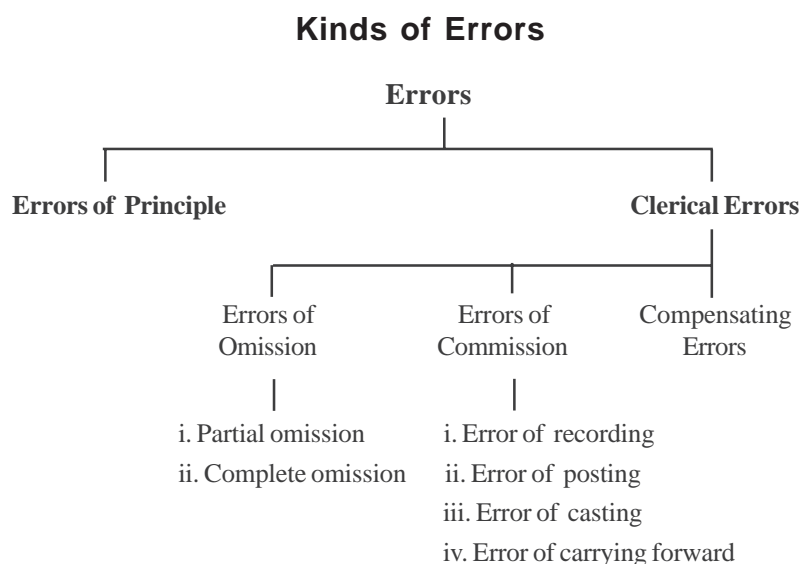
The fundamental principle of the double-entry system is that every debit has a corresponding credit of equal amount and vice-versa. Therefore, the total of all debit balances in different accounts must be equal to the total of all credit balances in different accounts, i.e., the total of the two columns should tally (agree).

The tallying of the two totals (debit balances and credit balances) of the trial balance ensures only arithmetic accuracy but not accounting accuracy. If however, the two totals do not tally, it implies that some errors have been committed while recording the transactions in the books of accounts. The following are the various kinds of errors.

10.8.1. Kinds of Errors

Keeping in view the nature of errors, all the errors committed in the accounting process can be classified into two.

- i. Errors of Principle and
- ii. Clerical Errors



I. Errors of Principle

Transactions are recorded as per generally accepted accounting principles. If any of these principles is violated or ignored, errors resulting from such violation are known as **errors of principle**. For example, Purchase of assets recorded in the purchases book. It is an error of principle, because the purchases book is meant for recording credit purchases of goods meant for resale and not fixed assets. A trial balance will not disclose errors of principle.

II. Clerical Errors

These errors arise because of mistakes committed in the ordinary course of accounting work. These can be further classified into three types as follows.

a) *Errors of Omission*

This error arises when a transaction is completely or partially omitted to be recorded in the books of accounts. Errors of omission may be classified as below.

i. Error of Complete Omission: This error arises when a transaction is totally omitted to be recorded in the books of accounts. For example, Goods purchased from Ram completely omitted to be recorded. This error does not affect the trial balance.

ii. Error of Partial Omission: This error arises when only one aspect of the transaction either debit or credit is recorded. For example, a credit sale of goods to Siva recorded in sales book but omitted to be posted in Siva's account. This error affects the trial balance.

b) *Errors of Commission*

This error arises due to wrong recording, wrong posting, wrong casting, wrong balancing, wrong carrying forward etc. Errors of commission may be classified as follows:

i. Error of Recording: This error arises when a transaction is wrongly recorded in the books of original entry. For example, Goods of Rs.5,000, purchased on credit from Viji, is recorded in the book for Rs.5,500. This error does not affect the trial balance.

ii. Error of Posting: This error arises when information recorded in the books of original entry are wrongly entered in the ledger. Error of posting may be

- i. Right amount in the right side of wrong account.
- ii. Right amount in the wrong side of correct account
- iii. Wrong amount in the right side of correct account
- iv. Wrong amount in the wrong side of correct account
- v. Wrong amount in the wrong side of wrong account
- vi. Wrong amount in the right side of wrong account, etc.

This error may or may not affect the trial balance.

iii. Error of Casting (Totalling) : This error arises when a mistake is committed while totalling the subsidiary book. For example, instead of Rs.12,000 it may be wrongly totalled as Rs.13,000. This is called **overcasting**. If it is wrongly totalled as Rs.11,000, it is called **undercasting**.

iv. Error of Carrying Forward : This error arises when a mistake is committed in carrying forward a total of one page to the next page. For example, Total of purchase book in page 282 of the ledger Rs.10,686, while carrying forward the balance to the next page it was recorded as Rs.10,866.

c) Compensating Errors

The errors arising from excess debits or under debits of accounts being neutralised by the excess credits or under credits to the same extent of some other account is compensating error. Since the errors in one direction are compensated by errors in another direction, arithmetical accuracy of the trial balance is not at all affected inspite of such errors. For example, If the purchases book and sales book are both overcast (excess totalling) by Rs.10,000, the errors mutually compensate each other. This error will not affect the agreement of trial balance.

10.8.2 Errors disclosed and not disclosed by trial balance

If the impact of the errors on trial balance is considered, errors may be classified into two categories – Errors disclosed by trial balance, and Errors not disclosed by trial balance.

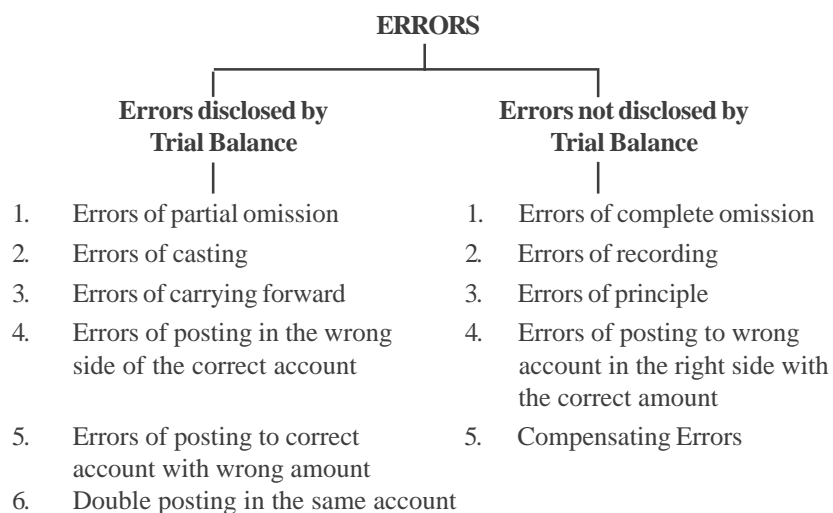


Illustration 2

State the type of error involved in the following transactions and say whether it will affect the agreement of the trial balance or not.

1. The sales book is undercast by Rs. 2,000.
2. The purchases book is overcast by Rs. 1,500.

3. The purchases return book is overcast by Rs.5,000.
4. The sales return book is overcast by Rs.1,000.
5. Goods returned by Vani worth Rs.1,500 were not entered.
6. Goods returned by Venu & Co. Rs.4,000 were not posted.
7. Goods sold to Robin for Rs. 2,600 has been debited to Robert's A/c.
8. A credit sale to Basha for Rs. 3,500 was entered as Rs.5300.
9. A purchase of Machinery for Rs.50,000 has been entered in the purchases book.
10. A credit purchase from Senthil for Rs. 6,250 was debited to Santhosh's A/c. from purchases book.
11. Cash received for commission Rs.2,735 was posted to the commission account as Rs. 2,375.
12. The monthly total of discount column on the debit side of the cash book Rs. 1,350 was credited to discount allowed account.
13. Cash paid for insurance Rs. 6,310 was posted to the insurance A/c. as Rs. 6,130.
14. The monthly total of discount column on the credit side of the cash book Rs. 22,500 was debited to discount received account.
15. A sale to Kaveri Rs. 6,900 has been entered in the purchases book.

Solution:

1. This is an error of casting and it affect sales account only. The trial balance will not tally.
2. This is an error of casting and it affect purchases account only. The trial balance will not agree.
3. This is an error of casting and it affect purchases return account only. The trial balance will not agree.
4. This is an error of casting and it affect sales return account only. The trial balance will not agree.
5. This is an error of complete omission. Since both the aspects have been omitted, this error will not affect the agreement of the trial balance.
6. This is an error of partial omission. Since the principles of double entry is not completed, this error will affect the agreement of the trial balance.

7. This is an error of posting i.e., right amount in the right side of the wrong account. This error will not affect the agreement of the trial balance.
8. This is an error of recording i.e., wrong entry in the subsidiary book. Since the mistake is found in both debit and credit aspects to the same extent. The agreement of the trial balance will not be affected.
9. This is an error of principle. This error will not affect the agreement of the trial balance.
10. This is an error of recording i.e., wrong entry in the subsidiary book. Since, the mistake is found in both debit and credit aspects to the same extent. The agreement of the trial balance will not be affected.
11. This is an error of posting involving posting of wrong amount. Since the commission account has an excess credit of Rs.360, the trial balance will be affected.
12. This is an error of posting involving posting on the wrong side of an account. The amount must have been debited to discount allowed account. The trial balance will not agree to the extent of Rs.2,700 i.e., twice the amount of the transaction.
13. This is an error of posting involving posting of wrong amount. Since the insurance account has a short debit of Rs.180, the trial balance will be affected.
14. This is an error of posting involving posting on the wrong side of an account. The amount must have been credited to discount received account. The trial balance will not agree to the extent of Rs.45,000, i.e., twice the amount of the transaction.
15. This is an error of recording. In this transaction, error is made in the book of original entry, the trial balance will not be affected. An entry has been made wrongly in the purchases book instead of the sales book. To rectify this, Kaveri A/c is to be debited with Rs.13,800 and Purchases A/c. and Sales A/c. are to be credited with Rs.6,900 each.

10.9 Steps to Locate the Errors:

If the trial balance does not tally, it means there are some errors in the books of accounts. The various steps which may be taken to locate the errors include the following:

- Step 1 → Check the total of the trial balance and ascertain the exact amount of difference in the trial balance.

- Step 2 → The difference is halved to find out whether there is any balance of the same amount in the trial balance. It is because, such a balance might have been recorded on the wrong side of the trial balance and hence, the difference is double the amount.
- Step 3 → If the second step fails to locate the error, the difference in the trial balance is divided by 9. If it is divisible by 9 without any remainder, the error is due to transposition of figures. For example, transposition of figures represents writing of Rs.780 for Rs.870.
- Step 4 → See whether the balance of all ledger accounts including cash and bank balances are included in the trial balance.
- Step 5 → Ensure that all the opening balances have been correctly brought forward in the current year's books.
- Step 6 → If the difference in the trial balance is of large amount, the trial balance of the current year is compared with that of the previous year and an account showing a large difference over the figure in the previous year's trial balance should be rechecked.
- Step 7 → If the error is not detected by the above steps, care should be taken to scrutinise the
- i. totals of all the subsidiary books.
 - ii. posting made from the journal and the subsidiary books to the relevant ledger accounts.
 - iii. balances extracted from the various ledger accounts.
 - iv. totalling of the ledger balances.

Even after following the above steps, if the error could not be located, the whole of the prime entry must once again be checked and in case of need, the posting to the ledger should be rechecked thoroughly.

10.10 Suspense Account

When it is difficult to locate the mistakes before preparing the final accounts, the difference in the trial balance is transferred to newly opened imaginary and temporary account called '**Suspense Account**'. Suspense account is prepared to avoid the delay in the preparation of final accounts. If the total debit balances of the trial balance exceeds the total credit balances, the difference is transferred to the credit side of the suspense account. On the other hand, if the total credit balances of the trial balance exceeds the total debit balances the difference is transferred to the debit side of the suspense account.

When the errors affecting the suspense account are located, they are rectified with suspense account. Suspense account is continued in the books until the errors are located and rectified. Such balance will be shown in the balance sheet. Debit balance will be shown on the asset side and the credit balance will be shown on the liability side. When all the errors affecting the trial balance are located and rectified, the suspense account automatically gets closed.

The following illustration will help to understand the suspense account :

Illustration 3

The following balances were extracted from the ledger of Mr. Ramakrishna as on 31st March 2003. You are required to prepare a trial balance as on that date.

	Rs.		Rs.
Drawings	60,000	Salaries	95,000
Capital	2,40,000	Sales return	10,000
Sundry creditors	4,30,000	Purchases return	11,000
Bills payable	40,000	Commission paid	1,000
Sundry debtors	5,00,000	Trading expenses	25,000
Bills receivable	52,000	Discount earned	5,000
Plant & Machinery	45,000	Rent	20,000
Opening stock	3,70,000	Bank overdraft	60,000
Cash in hand	9,000	Purchases	7,08,000
Cash at bank	25,000	Sales	11,80,000

Solution :

In the books of Mr. Ramakrishna

Trial Balance as on 31st March 2003

S. No.	Name of the Account	L. F.	Dr. Rs.	Cr. Rs.
1.	Capital		—	2,40,000
2.	Drawings		60,000	—
3.	Sundry creditors		—	4,30,000
4.	Bills payable		—	40,000
5.	Sundry debtors		5,00,000	—

6.	Bills receivable		52,000	—
7.	Plant & machinery		45,000	—
8.	Opening stock		3,70,000	—
9.	Cash in hand		9,000	—
10.	Cash at Bank		25,000	—
11.	Sales		—	11,80,00
12.	Salaries		95,000	—
13.	Sales return		10,000	—
14.	Purchases return		—	11,000
15.	Commission paid		1,000	—
16.	Trading expenses		25,000	—
17.	Discount earned		—	5,000
18.	Rent		20,000	—
19.	Purchases		7,08,000	—
20.	Bank overdraft		-	60,000
21.	Suspense A/c.		46,000	—
	TOTAL		19,66,000	19,66,000

Note : The difference in the Trial Balance is transferred to suspense account to avoid delay in the preparation of final accounts.

10.11 Rectification of Errors

Correction of errors in the books of accounts is not done by erasing, rewriting or striking the figures which are incorrect. Correcting the errors that has occurred is called **Rectification**. Appropriate entry is passed or suitable explanatory note is written in the respective account or accounts to neutralise the effect of errors. From the point of rectification, errors may be classified as follows:

- i. **Single sided errors** are errors which affect one side of an account.
- ii. **Double sided errors** are errors which affect both the accounts in a transaction.

Basic Principles for Rectification of Errors

All errors, whatever may be their kind or nature, result in one of the following four positions in one or more accounts.

- i. **Excess debit in one or more accounts:** This must be rectified by 'crediting' the excess amount to the respective account or accounts.

- ii. **Short debit in one or more accounts:** This must be rectified by a 'further debit' to the respective account or accounts involved.
- iii. **Excess credit in one or more accounts:** This can be rectified by 'debiting' the respective account with the excess amount involved.
- iv. **Short credit in one or more accounts:** This can be rectified by a 'further credit' to the respective account or accounts involved.

The following three steps may be adopted while attempting to rectify an error:

- i. Ascertain what has actually been done, i.e. **what is the error?**
- ii. Make sure what ought to have been done, i.e., **the correct record.**
- iii. Decide what is to be done in view of what has been done and what ought to have been done. i.e., **rectification.**

Stages of Rectification

The stage in which rectification is done depends on identification or locating the error. Rectification of errors may be explained in two stages.

- i. **Rectification before the preparation of trial balance :** In this stage errors are located before transferring the difference in the trial balance to Suspense Account.
- ii. **Rectification after the preparation of trial balance:** In this stage the difference in the trial balance would have been transferred to Suspense Account. So wherever applicable suspense account is used while passing rectification entries.

Stage at which the errors are rectified	Manner in which the errors are rectified
i. When the errors are rectified before transferring the difference in the trial balance to the suspense account	By debiting or crediting the respective account with the required amount by giving an explanatory note in the particulars column.
ii. When the errors are rectified after transferring the difference in the trial balance to the suspense account	By writing a journal entry with the respective account or accounts affected by the errors and suspense account.

Illustration 4

Rectify the following errors:

- i. Purchases book overcast by Rs.1,300
- ii. Sales book undercast by Rs.2,500.

iii. Purchases return book overcast by Rs.750.

iv. Sales return book undercast by Rs.600.

Solution:

S. No.	Nature of mistake	Effect of mistake	Rectification
1.	Overcasting of purchases book	Excess debit in Purchases A/c	Credit the Purchases A/c.
2.	Undercasting of sales book	Short credit in Sales A/c	Give further credit Sales A/c.
3.	Overcasting of purchases return book	Excess credit in Purchases Return A/c	Debit Purchases Return A/c
4.	Undercasting of sales return book	Short debit in Sales Return A/c	Give further debit to Sales Return A/c.

To rectify the errors:

i. Credit – Purchases A/c with Rs.1,300.

ii. Credit – Sales A/c with Rs.2,500.

iii. Debit – Purchases return A/c with Rs.750.

iv. Debit – Sales return A/c with Rs.600.

Illustration 5

Rectify the following errors:

i. Purchases book is carried forward Rs.850 less.

ii. Sales book total is carried forward Rs.2,500 more.

iii. A total of Rs.7,580 in the purchases book has been carried forward as Rs.8,570.

iv. The total of the sales book Rs.7,550 on page 20 was carried forward to page 21 as Rs.5,570.

v. Purchases return book was carried forward as Rs.1,520 instead of Rs.5,120.

Solution:

S. No.	Nature of mistake	Effect of mistake	Rectification
1.	Carrying forward lower amount in purchases book	Short debit in Purchases A/c	Give further debit on Purchases A/c
2.	Carrying forward higher amount in sales book	Excess credit in Sales A/c.	Debit sales A/c
3.	Carrying forward higher amount in purchases book	Excess debit in Purchases A/c	Credit purchases A/c
4.	Carrying forward lower amount in sales book	Short credit in Sales A/c.	Give further credit to Sales A/c
5.	Carrying forward lower amount in purchases return book	Short credit in Purchases return A/c	Credit Purchases return A/c

Rectification:

- i. Debit – Purchases A/c with Rs.850.
- ii. Debit – Sales A/c with Rs.2,500.
- iii. Credit – Purchases A/c with Rs.990.
- iv. Credit – Sales A/c with Rs.1,980.
- v. Credit – Purchases return A/c with Rs.3,600.

Illustration 6:

Rectify the following errors:

- i. Purchases from Bagavathi for Rs.4,500 has been posted to the debit side of her account.
- ii. Sales to Vijay for Rs.1,520 has been posted to his credit as Rs.1,250.
- iii. Purchases from Shakila for Rs.750 has been omitted to be posted to the personal A/c.
- iv. Sales to Khader for Rs.780 has been posted to his account as Rs.870.

Solution:

- i. Purchases from Bagavathi should have been posted to the credit of Bagavathi's A/c., but it has been debited. Hence, Credit Bagavathi's A/c with double the amount i.e, Rs.9,000.
- ii. Sales to Vijay has to be debited in Vijay's account but his account is credited with Rs.1,250. Hence, Debit Vijay's A/c with Rs.1,250 + Rs.1,520 i.e, Rs.2,770.
- iii. This is an error of omission. Posting must be to the credit of Shakila's A/c. Hence, post Rs.750 to the credit of Shakila's A/c.
- iv. Here Khader's A/c has been debited with a wrong amount i.e., with excess amount. To rectify this error, the excess amount must be credited to his account. Hence, credit Khader's A/c with Rs.90.

Illustration 7

The following errors were found in the books of Prabhu. Give the necessary entries to correct them:

- i) Salary of Rs.10,000 paid to Murali has been debited to his personal account.
- ii) Rs.3,500 paid for a typewriter was charged to office expenses account.
- iii) Rs.8,000 paid for furniture purchased has been charged to purchases account.
- iv) Repairs made were debited to building account for Rs.500.
- v) An amount of Rs.5,000 withdrawn by the proprietor for his personal use has been debited to trade expenses account.
- vi) Rs.2,000 received from Shanthi & Co. has been wrongly entered as from Shakila & Co.

Solution:

In the Books of Prabhu
Rectifying Journal Entries

Errors	Particulars	L.F	Debit Rs.	Credit Rs.
i.	Salaries A/c To Murali A/c. [Correction of wrong debit to Murali's personal A/c for salaries paid]		10,000	10,000

ii.	Typewriter A/c To Office expenses A/c [Correction of wrong debit to office expenses A/c for purchase of typewriter]	Dr.	3,500	3,500
iii.	Furniture A/c To Purchases A/c [Correction of wrong debit to purchases account for furniture purchased]	Dr.	8,000	8,000
iv.	Repairs A/c To Building A/c [Correction of wrong debit to building Account for repairs made]	Dr.	500	500
v.	Drawings A/c To Trade expenses A/c [Correction of wrong debit to Trade Expenses A/c. for cash withdrawn by the proprietor for his personal use]	Dr.	5,000	5,000
vi.	Shakila & Co. A/c. To Shanthi & Co. A/c [Correction of wrong credit to Shakila & Co. instead of Shanthi & Co.]	Dr.	2,000	2,000

Illustration 8

Give journal entries to rectify the following errors:

- Purchase of goods from Devi amounting to Rs.25,000 has been wrongly passed through the sales book.
- Credit sale of goods Rs.30,000 to Rajan has been wrongly passed through the purchases book.
- Sold old furniture for Rs.3,500 passed through the sales book.
- Paid wages for the construction of Building debited to wages account Rs. 1,00,000.
- Paid Rs.10,000 for the installation of Machinery debited to wages account.
- On 31st Dec. 2003 goods worth Rs.5,000 were returned by Manjula and were taken into stock on the same date, but no entry was passed in the books.

Solution:**Rectifying Journal Entries**

Errors	Particulars	L.F	Debit Rs.	Credit Rs.
i.	Purchases A/c Dr. Sales A/c Dr. To Devi A/c [Correction of wrong entry in sales book for a credit purchase from Devi]		25,000 25,000	50,000
ii.	Rajan A/c Dr. To Purchases A/c To Sales A/c [Correction of wrong entry in purchases book for credit sale to Rajan]		60,000	30,000 30,000
iii.	Sales A/c Dr. To Furniture A/c [Correction of wrong credit to sales account for sale of old furniture]		3,500	3,500
iv.	Building A/c Dr. To Wages A/c [Correction of wrong debit to wages account for wages paid for construction of building]		1,00,000	1,00,000
v.	Machinery A/c Dr. To Wages A/c [Correction of wrong debit to wages account for wages paid for installation of machinery]		10,000	10,000
vi.	Sales Return A/c Dr. To Manjula A/c [Entry for goods returned and taken into stock]		5,000	5,000

Illustration 9

An accountant could not tally the Trial balance. The difference of Rs.5,180 was temporarily placed to the credit of suspense account for preparing the final accounts. The following errors were later located.

- i. Commission of Rs.500 paid, was posted twice, once to discount allowed account and once to commission account.
- ii. The sales book was undercast by Rs.1,000.
- iii. A credit sale of Rs.2,780 to Roja though correctly entered in sales book, was posted wrongly to her account as Rs.3,860.
- iv. A credit purchase from Nataraj of Rs.1,500, though correctly entered in purchases book, was wrongly debited to his personal account.
- v. Discount column of the payments side of the cash book was wrongly added as Rs.2,800 instead of Rs.2,400.

You are required to:

- i. Pass the necessary rectifying entries.
- ii. Prepare Suspense Account

Solution:**Rectifying Journal Entries**

Errors	Particulars	L.F	Debit Rs.	Credit Rs.
i.	Suspense A/c Dr. To Discount allowed A/c [Amount wrongly debited to discount account, now rectified]		500	500
ii.	Suspense A/c Dr. To Sales A/c [Sales book undercast by Rs.100, now rectified]		1,000	1,000
iii.	Suspense A/c Dr. To Roja A/c [Wrong posting of sale of Rs.2,780 to Roja as Rs.3,860, now rectified]		1,080	1,080

iv.	Suspense A/c To Nataraj A/c [Credit purchase of Rs.1,500 from Nataraj wrongly debited to his personal account now rectified]	Dr.	3,000	3,000
v.	Discount received A/c To Suspense A/c [Excess credit in discount account, now rectified]	Dr.	400	400

Suspense Account

Dr.

Cr.

Date	Particulars	L.F	Date	Particulars	L.F	Rs.
	To Discount allowed A/c		500	By Balance b/d		5,180
	To Sales A/c		1,000	By Discount received A/c		400
	To Roja A/c		1,080			
	To Nataraj A/c		3,000			
			5,580			5,580

QUESTIONS

I. Objective Type:

a) Fill in the blanks:

1. Trial Balance should be tallied by following the rules of _____.
2. If the total debits exceeds the total credits of trial balance, suspense account will show _____ balance.
3. Suspense account having debit balance will be shown on the _____ side of balance sheet.
4. If the total debit balances of the trial balance exceeds the total credit balances, the difference is transferred to the _____ side of the suspense account.
5. Suspense account having credit balance will be shown on the _____ side of the balance sheet.
6. Short credit of an account decreases the _____ column of the trial balance.

7. When errors are located and rectified, _____ automatically gets closed.
8. Journal entries passed to correct the errors are called _____.
9. Excess debit of an account can be rectified by _____ the same account.
10. Short debit of an account can be rectified by _____ of the same account.

[Answers : 1. double entry system, 2. credit, 3. assets, 4. credit, 5. liabilities, 6. credit, 7. suspense account, 8. rectifying entries, 9. credit (the excess amount in), 10. further debit (the short amount)]

b) Choose the correct answer:

1. Trial balance is prepared to find out the
 - a) profit or loss
 - b) financial position
 - c) arithmetical accuracy of the accounts
2. Suspense account in the trial balance is entered in the
 - a) Trading A/c
 - b) Profit and loss A/c
 - c) Balance sheet
3. Suspense account having credit balance will be shown on the
 - a) Credit side of the profit and loss A/c
 - b) Liabilities side of the balance sheet
 - c) Assets side of the balance sheet
4. State which of the following errors will not be revealed by the Trial Balance.
 - a) Errors of complete omission.
 - b) Error of carrying forward.
 - c) Wrong totalling of the purchases book.
5. Errors which affect one side of an account are called
 - a) Single sided errors
 - b) Double sided errors
 - c) None of the above.
6. Amount spent on servicing office Typewriter should be debited to:
 - a) Miscellaneous Expenses Account
 - b) Typewriter Account.
 - c) Repairs Account.

7. Wages paid to workers for the installation of a new Machinery should be debited to:
 - a) Wages Account
 - b) Machinery Account
 - c) Factory Expenses Account
8. Salary paid to Manager must be debited to
 - a) Manager's Account
 - b) Office Expenses Account
 - c) Salary Account.
9. Goods taken by the proprietor for domestic use should be credited to
 - a) Proprietor's Drawings Account.
 - b) Sales Account.
 - c) Purchases Account.
10. Cash received from Mani whose account was previously written off as a Bad Debt should be credited to:
 - a) Mani's Account.
 - b) Miscellaneous Income Account.
 - c) Bad Debts Recovered Account.

[Answers: 1. (c), 2. (c), 3. (b), 4. (a), 5. (a), 6. (c), 7. (b), 8. (c), 9. (c), 10. (c)]

II. Other Questions :

1. What is a Trial Balance?
2. What are the objectives of preparing a Trial Balance?
3. What are the advantages of a Trial Balance?
4. Why is it said that the trial balance is not a conclusive proof of the accuracy of the account books?
5. Explain the principle on which the agreement of trial balance is based.
6. Name the different kinds of errors?
7. Explain the different kinds of errors.
8. Write short notes on
 - i. Error of Principle ii. Compensating error
 - iii. Error of casting. iv. Error of Posting
9. What are the errors disclosed by the Trial Balance?
10. What are the errors not disclosed by the Trial Balance?

11. What is a Suspense Account? When is it opened?
12. What do you mean by Rectification of Errors?
13. In what ways may the errors be rectified?

III. Problems

1. Prepare Trial Balance as on 31.12.2000 from the following balances of Mr.Balan.

	Rs.		Rs.
Capital	3,40,000	Purchases	94,000
Creditors	13,000	Sales Returns	3,400
Drawings	4,000	Purchases Return	2,400
Salaries	38,200	Carriage inwards	1,400
Bill Receivable	5,800	Printing & Stationery	5,000
Bills Payable	7,000	Stock	29,900
Debtors	16,000	Machinery	50,000
Sales	1,44,000	Wages	5,000
Insurance	2,200	Rent	1,600
Land	2,50,000	Interest received	1,700
Commission received	800	Electricity charges	2,400

[Answer : Rs. 5,08,900]

2. The following balances are extracted from the books of Mr.Senthil. Prepare Trial Balance as on 30.6.2004.

	Rs.		Rs.
Capital	4,70,200	Machinery	1,58,800
Cash in hand	6,000	Sundry Debtors	48,000
Building	3,20,000	Repairs	5,400
Stock	33,000	Insurance premium	3,300
Sundry creditors	26,000	Sales	2,90,000
Commission paid	750	Telephone charges	6,450
Rent & Taxes	6,300	Furniture	11,000

Purchases	1,65,000	Discount earned	1,100
Salaries	70,600	Loan from Mohammed	51,000
Discount allowed	650	Reserve fund	5,900
Drawings	5,000	Bills receivable	8,600
Bad debts	1,350	Bills payable	6,000

[Answer : Rs. 8,50,200]

3. Prepare Trial Balance as on 31.3.2004 from the books of Mrs.Chitra.

	Rs.		Rs.
Capital	2,49,000	Drawings	24,000
General expenses	97,000	Building	78,000
Machinery	1,18,680	Stock	1,32,400
Wages	14,400	Insurance	2,610
Bad debts	1,100	Creditors	5,000
Sales	3,30,720	Loan (Cr.)	75,000
Commission	5,500	Purchases	2,10,800
Bills payable	7,700	Reserve Fund	15,000
Bank overdraft	28,600	Cash in hand	25,320
Discount	1,210		

[Answer : Rs. 7,11,020]

4. Prepare Trial Balance as on 31.12.2002 from the following balances of Ms. Fathima.

	Rs.		Rs.
Drawings	74,800	Purchases	2,95,700
Stock (1.1.2000)	30,000	Discount received	1,000
Capital	2,50,000	Discount allowed	950
Furniture	33,000	Sales	3,35,350
Sundry creditors	75,000	Rent	72,500
Printing charges	1,500	Sundry expenses	21,000
Bank loan	1,20,000	Bills receivable	52,500
Freight	3,500	Carriage outwards	1,500

Income tax	9,500	Insurance	1,200
Machinery	2,15,400	Bills payable	31,700

[Answer : Rs. 8,13,050]

5. Prepare trial balance as on 31.3.2003 from the following balances of Mrs.Sujatha.

	Rs.		Rs.
Drawings	43,000	Purchases	2,98,000
Capital	2,12,000	Sales	3,64,000
Sundry creditors	61,500	Salaries	44,950
Bills Payable	22,000	Sales return	500
Sundry Debtors	55,000	Purchases return	2,550
Bills Receivable	72,600	Travelling expenses	12,300
Loan from Shameem	2,50,000	Commission paid	250
Furniture & Fittings	12,250	Discount earned	2,000
Opening stock	2,23,500	Cash in hand	65,450
Cash at bank	86,250		

[Answer : Rs. 9,14,050]

6. Prepare Trial Balance from the following balances of Mrs.Dilshad as on 31.12.2002.

	Rs.		Rs.
Capital	4,20,000	Cash in hand	25,000
Building	1,15,000	Cash at bank	84,700
Machinery	60,000	Salaries	94,000
Furniture	11,000	Rent	48,000
Car	68,000	Commission	1,400
Opening stock	86,000	Rates and Taxes	2,600
Purchases	94,000	Bad debts	3,200
Sales	1,96,000	Insurance	2,400
Sundry debtors	16,200	General Expenses	800
Reserve for doubtful debts	7,300	Sundry Creditors	68,000

[Answer : Suspense account (credit) Rs.21,000]

7. Rectify the following journal entries.

		Rs.	Rs.
i. Purchases A/c	Dr.	6,000	
	To Cash A/c		6,000
(Purchase of furniture)			

		Rs.	Rs.
ii. Arul A/c	Dr.	10,000	
	To Cash A/c		10,000
(Salary paid to Arul)			

		Rs.	Rs.
iii. Ravi A/c	Dr.	1,500	
	To Cash A/c		1,500
(Rent paid)			

		Rs.	Rs.
iv. Sales A/c	Dr.	12,000	
	To Cash A/c		12,000
(Credit sale to Navin)			

		Rs.	Rs.
v. Cash A/c	Dr.	8,000	
	To Babu A/c		8,000
(Cash sales)			

8. Rectify the following errors which are located in the books of Mr.Ganesh.

- i. The purchases return book overcast by Rs.1,500.
- ii. Received Rs.2,000 from Shankar debited to his account.
- iii. The sales book undercast by Rs.1,500.
- iv. Rs.1,500 received from Geetha was entered on the debit side of the cash book. No posting was done to Geetha's A/c.
- v. Sale of old furniture for Rs.2,000 treated as sale of goods.

9. Rectify the following errors:
 - i. Rs.12,000 paid of salary to cashier Govind, stands debited to his personal account.
 - ii. An amount of Rs.5,000 withdrawn by the proprietor for his personal use has been debited to trade expenses A/c.
 - iii. Cash received from Bala Rs.300 was credited to Balu.
 - iv. A credit sale of Rs.2,000 to Janakiram has been wrongly passed through the purchases book.
10. Rectify the following errors :
 - i. Repairs made were debited to building account Rs.5,000.
 - ii. Mahesh returned goods worth Rs.2,000. No entry was passed in the books to this effect.
 - iii. Purchase of goods from Antony amounting to Rs.1,500 has been debited to his account.
 - iv. Rs.5,200 paid for the purchase of typewriter was charged to office expenses account.
11. Rectify the following errors :
 - i. Credit purchase of goods from Madhan of Rs.300 has been wrongly entered in the sales book.
 - ii. Rs.500 received from Selvam has been credited to Selvi's account.
 - iii. Rs.1,000 received as interest was credited to commission account.
 - iv. Sales book total Rs.878 was wrongly totalled as Rs.788.
 - v. The total of the discount column, on the debit side of the cash book has been added short by Rs.400.
12. Rectify the following errors without using a suspense account:
 - i. Purchases Rs.5,000 from Sheela wrongly entered in the sales book.
 - ii. Goods taken by the proprietor Rs.1,000 not recorded in the books at all.
 - iii. Discount Rs.50 allowed to Mala has been credited to discount account.
 - iv. Credit sales to Leela Rs.1,500 wrongly posted to the credit of her account.

13. A bookkeeper found his Trial Balance not balanced, placed the difference amount in the Suspense Account and subsequently found the following errors:
- Sales Book was overcast by Rs.1,500.
 - Rs.2900 received from Vani in full settlement of his account of Rs.3,000 was posted in cash book but omitted to be entered in her account.
 - The total of the sales book Rs.12,000 was debited to sales returns account.
 - Rs.1,000 received as interest was credited to interest account as Rs.100.

Give rectifying entries and show the Suspense Account.

14. An Accountant could not tally the trial balance. The difference of Rs.520 was temporarily placed to the credit of suspense account and subsequently found the following errors.
- The total of the Discount column on the credit side of the Cash Book Rs.230 was not posted in the ledger.
 - The total of the Discount Column on the debit side of the Cash Book Rs.150 was omitted to be posted in the ledger.
 - The total of the purchases book was short by Rs.600.
 - A sale of Rs.675 to Kalpana was entered in the Sales book as Rs.975.
 - A sale of Rs.500 to Vimala has been entered in the Purchase Book.

Rectify the above errors through Suspense Account. Also give journal entries for rectification.

CHAPTER - 11

CAPITAL AND REVENUE TRANSACTIONS

Learning Objectives

After studying this chapter, you will be able to:

- *identify Capital, Revenue and Deferred Revenue Expenditures.*
 - *understand Capital and Revenue receipts*
-

Once the trial balance is prepared the next step is to find out the net result (profit or loss account) and financial position (balance sheet) of the business concern. The business concern's financial position is bound to be affected by the result of its operations. '**Matching Principle**' governs the preparation of these two statements. According to this principle the revenues and relevant expenditures incurred during a particular period should be matched. Thus a proper distinction must be accounted for between capital and revenue transactions. Business transactions can be capital transactions or revenue transactions.

11.1 Capital Transactions

The business transactions, which provide benefits or supply services to the business concern for more than one year or one operating cycle of the business, are known as capital transactions.

The transactions which relate to capital are again sub-divided into capital expenditure and capital receipt.

11.1.1 Capital Expenditure

Capital expenditure consist of those expenditures, the benefit of which is carried over to several accounting periods. In other words the benefit of which is not consumed within one accounting period. It is non-recurring in nature.

Characteristics

In other words, it refers to the expenditure, which may be

- i. purchase of a fixed asset.
- ii. not acquired for sale.
- iii. it is non-recurring in nature.
- iv. incurred to increase the operational efficiency of the business concern.

Examples

- i. Expenses incurred in the acquisition of Land, Building, Machinery, Furniture, Car, Goodwill, Copyright, Trade Mark, Patent Right, etc.
- ii. Expenses incurred for increasing the seating accommodation in a cinema hall.
- iii. Expenses incurred for installation of fixed assets like wages paid for installing a plant.
- iv. Expenses incurred for remodelling and reconditioning an existing asset like remodeling a building.

11.1.2. Capital Receipt

Capital receipt is one which is invested in the business for a long period. It includes long term loans obtained from others and any amount realised on sale of fixed assets. It is generally non-recurring in nature.

Characteristics

- i. Amount is not received in the normal course of business.
- ii. It is non-recurring in nature.

Examples

- i. Capital introduced by the owner
- ii. Borrowed loans
- iii. Sale of fixed asset

11.2 Revenue Transactions

The business transactions, which provide benefits or supplies services to a business concern for an accounting period only, are known as revenue transactions. Revenue transactions can be Revenue Expenditure or Revenue Receipt.

11.2.1 Revenue Expenditure

Revenue expenditures consist of those expenditures, which are incurred in the normal course of business. They are incurred in order to maintain the existing earning capacity of the business. It helps in the upkeep of fixed assets. Generally it is recurring in nature.

Characteristics

- i. It helps in maintaining the earning capacity of the business concern.
- ii. It is recurring in nature.

Examples

- i. Cost of goods purchased for resale.
- ii. Office and administrative expenses.
- iii. Selling and distribution expenses.
- iv. Depreciation of fixed assets, interest on borrowings etc.
- v. Repairs, renewals, etc.

11.2.2 Revenue Receipt

Revenue receipt is the receipt of income which is earned during the normal course of business. It is recurring in nature.

Characteristics

- i. It is received in the normal course of business.
- ii. It is recurring in nature.

Examples

- i. Sale of goods or services.
- ii. Commission and Discount received.
- iii. Dividend and interest received on investments etc.

11.3 Deferred Revenue Expenditure

A heavy revenue expenditure, the benefit of which may be extended over a number of years, and not for the current year alone is called deferred revenue expenditure. For example, a new firm may advertise very heavily in the beginning to capture a position in the market. The benefit of this advertisement campaign will last for quite a few years. It will be better to write off the expenditure in three or four years and not only in the first year.

Characteristics

- i. Benefit is enjoyed for more than one year
- ii. It is non-recurring in nature

Examples

- i. Expenses incurred on research and development
- ii. Abnormal loss arising out of fire or lightning (in case the asset has not been insured).
- iii. Huge amount spent on advertisement.

11.4 Revenue expenditure, Capital Expenditure and Deferred revenue expenditure – Distinction

S.No.	Basis of Distinction	Capital Expenditure	Revenue Expenditure	Deferred Revenue Expenditure
1.	Period of benefit	Benefit is enjoyed beyond the accounting year, lasts for a long time.	Benefit is consumed during the current year only.	Benefit enjoyed for more than one year.
2.	Purpose	Relates to the acquisition of fixed assets.	Incurred for the purpose of generating revenue.	Relates to the capturing or retaining the market.
3.	Nature of occurrence	Non-recurring in nature.	Recurring in nature	Non-recurring in nature.
4.	Aim	Helps to increase the earning capacity of the business.	Helps to earn the existing revenue.	Helps to increase the earning capacity of the business.
5.	Convertibility	Converted into cash.	Cannot be converted into cash.	Cannot be converted into cash.

11.5 Capital profit and Revenue profit

In order to find out the correct profit and the true financial position, there must be a clear distinction between capital profit and revenue profit.

11.5.1 Capital profits

Capital profit is the profit which arises not from the normal course of the business. Profit on sale of fixed asset is an example for capital profit.

11.5.2 Revenue profits

Revenue profit is the profit which arises from the normal course of the business. i.e, Net Profit – the excess of revenue receipts over revenue expenditures.

11.6 Capital loss and Revenue loss

In order to ascertain the loss incurred by a firm it is important to distinguish between capital losses and revenue losses.

11.6.1 Capital Losses

Capital losses are the losses which arise not from the normal course of business. Loss on sale of fixed asset is an example for capital loss.

11.6.2 Revenue Losses

Revenue losses are the losses that arise from the normal course of the business. In other words, 'net loss' – i.e., excess of revenue expenditures over revenue receipts.

Illustration 1:

Shyam & Co., incurred the following expenses during the year 2003. Classify the following items under capital or revenue

- i. Purchase of furniture Rs.1,000.
- ii. Purchase of second hand machinery Rs.4,000.
- iii. Rs.50 paid for carriage on goods purchased.
- iv. Rs.175 paid for repairs on second hand machinery as soon as it was purchased.
- v. Rs.600 wages paid for installation of plant.

Solution

- i. Capital expenditure – as it results in the acquisition of fixed asset.
- ii. Capital expenditure – as it results in the acquisition of fixed asset.
- iii. Revenue expenditure – expenses incurred on purchases of goods for sale.
- iv. Capital expenditure – as it is spent for bringing the asset into working condition.
- v. Capital expenditure – as it is spent for bringing the asset into working condition.

Illustration 2

Prasad Pictures Ltd. constructed a cinema house and incurred the following expenditures during the year ended 31.12.2003.

- i. Second hand furniture purchased worth Rs.3,00,000.
- ii. Expenses in connection with obtaining a license were Rs.30,000.
- iii. Fire insurance, Rs.2500 was paid on 1st January 2003 for one year.
- iv. During the first week after the release of the cinema, free tickets worth

Rs.30,000 were distributed to increase the publicity of the cinema house.

- v. The manager's salary for the year was Rs.60,000.

Classify the above transactions into capital, revenue and deferred revenue expenditures.

Solution

- i. Capital expenditure – as the amount spent results in acquisition of fixed assets.
- ii. Capital expenditure – as the amount was spent on acquiring a right to carry on business.
- iii. Revenue expenditure – amount spent relates to only one year.
- iv. Deferred revenue expenditure – it is a heavy advertising expenditure as the benefit will last more than one year.
- v. Revenue expenditure–incurred for the functioning of business.

Illustration 3

Hari & Co. incurred the following expenses during the year 2003 Classify the expenses as capital and revenue.

- i. Rs.750 spent towards replacement of a worn out part in a machinery.
- ii. Rs.1,500 spent for legal expenses in relation to raising of a loan for the business.
- iii. Rs.300 spent for ordinary repairs of plant.
- iv. Rs.6,000 spent on replacing a petrol driven engine by a diesel driven engine.
- v. Electricity charges Rs.1,200 per month.

Solution

- i. Capital expenditure – as it helps to increase the working condition of the machinery.
- ii. Capital expenditure – as it is spent as it helps to get a capital receipt.
- iii. Revenue expenditure – as it is spent for the maintenance of the asset.
- iv. Capital expenditure – as it helps to reduce cost of production.
- v. Revenue expenditure – expenditure incurred in the normal course of the business.

Illustration 4

Fashion Textiles gives the following transactions of their firm during the year 2003, you are required to classify the transactions into capital or revenue.

- i. Rs.2,500 spent on purchasing a tyre for their lorry.
- ii. They had old machinery of value Rs.10,000 was sold for Rs.9,500.
- iii. They received Rs.5000 towards dividend form their investments in shares.
- iv. They were able to sell cotton 'T' shirts (cost Rs. 1,200) for Rs.1,500.
- v. Rs.600 was spent on alteration of a machinery in order to reduce power consumption.

Solution

- i. Revenue expenditure – as it spent to replace a part of the lorry.
- ii. Capital loss Rs.500 – as they have incurred a loss on sale of fixed asset and Rs.9,500 will be a capital receipt as it is a sale of fixed asset.
- iii. Revenue receipt – earned in the ordinary course of business.
- iv. Revenue receipt – Rs.300 is received in the ordinary course of business.
- v. Capital expenditure – as it reduces cost of production.

Illustration 5

Bharat company has incurred the following expenditure you are required to identify the capital, revenue and deferred revenue expenses.

- i. Rs.60,000 travelling expenses of their sales manager who travelled to Japan to attend a meeting in order to increase sales – trip was quite successful.
- ii. Rs.500 spent for installing machinery.
- iii. Rs.6,00,000 spent on research and development.
- iv. Rs.500 paid for fuel.

Solution

- i. Deferred revenue expenditure – benefit likely to be enjoyed for more than one year
- ii. Capital expenditure- amount is spent to bring the asset into use.
- iii. Deferred revenue expenditure – the benefit can be spread for more than one year
- iv. Revenue expenditure- spent for the normal functioning of the firm

QUESTIONS

I. Objective Type

a) Fill in the blanks:

1. Amount spent on acquiring a copy right is an example for _____.
2. Capital expenditure is _____ in nature.
3. Revenue transactions can be _____ or _____.
4. Depreciation on fixed asset is a _____ expenditure.
5. Expenses on research and development will be classified under _____.

[Answers : 1. capital expenditure, 2. non-recurring, 3. revenue expenditure, revenue receipt, 4. revenue expenditure, 5.deferred revenue expenditure.

b) Choose the correct answer:

1. Transaction which provide benefit to the business for more than one year is called as
 a) capital transaction b) revenue transaction
 c) neither of the two.
2. Amount spent on remodelling an old car is example of
 a) deferred revenue expenditure b) revenue expenditure
 c) capital expenditure
3. Shankar introduces Rs.50,000 as additional capital in the business. This amount will be considered as _____.
 a) capital receipt b) revenue receipt c) both
4. Revenue receipts are _____ in the business.
 a) non-recurring b) recurring c) neither of the above.
5. Venkatesh purchases goods worth Rs.80,000 for the purpose of selling. This amount will be treated as
 a) capital expenditure b) revenue expenditure
 c) deferred revenue expenditure
6. Expenses on advertisement will be classified under
 a) capital expenditure b) revenue expenditure
 c) deferred revenue expenditure

7. An plant worth Rs.8,000 is sold for 8,500 the capital receipt amounts to
 a) Rs. 8,000 b) Rs. 8,500 c) Rs. 500
8. Revenue expenditure is intended to benefit.
 a) subsequent year b) previous year c) current year
9. An asset worth Rs.1,00,000 is sold for Rs.85,000 the capital loss amounts to
 a) Rs. 85,000 b) Rs. 1,00,000 c) Rs. 15,000
10. The net loss which arises in a business is an example of
 a) revenue loss b) capital loss c) neither of the two

[Answers : 1.(a), 2. (c), 3. (a), 4. (b), 5. (b), 6. (c), 7. (b), 8. (c), 9. (c), 10. (a)]

II. Other Questions:

1. Write the characteristics of Capital Expenditure.
2. What is a revenue expenditure?
3. Write a note on deferred revenue expenditure.
4. Differentiate Capital, Revenue & Deferred revenue expenditure.
5. What are Capital profits?
6. What is revenue loss?

III. Problems:

1. Classify the following into capital and revenue
 - i. Rs.560 spent on replacement of a worn out part of a plant
 - ii. Rs.1,500 spent on complete overhauling of a second hand machinery just bought.
 - iii. Carriage expenses Rs.230
 - iv. Profit on sale of asset Rs.700
 - v. Rs.250 loss on sale of furniture

[Answers : Capital expenditure – (i), (ii); Revenue expenditure – (iii);

Capital profit – (iv); Capital loss – (v)]

2. Raju gives you the following expenses which were incurred in his business during the year 2003, classify them into capital, revenue or deferred revenue
- i. Rs.12,000 spent on purchasing a patent right
 - ii. Freight charges paid on new plant amounts to Rs.700
 - iii. Repairs of Rs.575 for furniture
 - iv. Rs.5,000 spent towards expenses connected with rain water harvesting as per Government orders
 - v. Rs.7,500 spent towards initial advertising expenses

[Answers : Capital expenditure—(i), (ii), (iv); Revenue expenditure—(iii); Deferred revenue expenditure – (v)]

3. Vasudevan gives you the following transactions in his business, classify into capital or revenue
- i. Purchases of goods worth Rs.7,000 for the purpose of selling.
 - ii. Rs.1200 fire insurance for the building for business.
 - iii. Renewal of magazine subscription fee Rs.75.
 - iv. Cost of Rs.1,00,000 on building a godown.
 - v. Purchased land for Rs.1,00,000.

[Answers : Capital expenditure—(iv), (v);
Revenue expenditure – (i), (ii), (iii)]

4. Classify the following expenses into Capital and revenue.
- i. registration expenses incurred for the purchase of land.
 - ii. repairing charges paid for remodelling the purchased old building.
 - iii. profit earned on the sale of old furniture.

[Answers : Capital expenditure – (i), (ii); Capital profit – (iii)]

5. State whether the following are capital or revenue
- i. repairs made on second hand plant purchased
 - ii. wages paid to workmen for setting up a new plant
 - iii. replacement of old furniture
 - iv. salary paid to staff

- v. amount received as rent during the year for letting out a portion on sub rent

[Answers : Capital expenditure – (i), (ii), (iii); Revenue receipts – (v);

Revenue expenditure –(iv)]

6. Classify as capital and revenue

- i. carriage paid on goods purchased
- ii. legal expenses paid for raising of loans
- iii. cost of maintenance of building
- iv. investments costing Rs 40,000 were purchased a few years back, were sold for Rs 50,000
- v. annual white washing charges amounted to Rs 1,000

[Answers : Capital expenditure – (ii); Revenue expenditure –(i), (iii), (v); Capital profit (iv)]

CHAPTER - 12

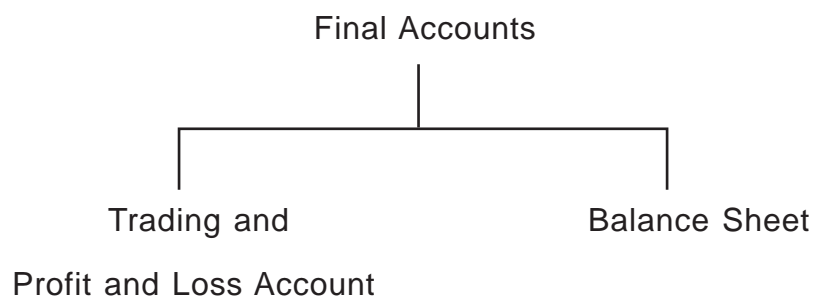
FINAL ACCOUNTS

Learning Objectives

After learning this Chapter, you will be able to:

- *know the Meaning, Purpose, Content and Format of Trading, Profit and Loss Account and Balance Sheet.*
- *understand the Differences between Trial Balance and Balance Sheet.*
- *prepare the Final Accounts*

Trial balance proves the arithmetical accuracy of the business transactions, but it is not the end. The businessman is interested in knowing whether the business has resulted in profit or loss and what the financial position of the business is at a given period. In short, he wants to know the profitability and the financial soundness of the business. The trader can ascertain these by preparing the final accounts. The final accounts are prepared at the end of the year from the trial balance. Hence the trial balance is said to be the connecting link between the ledger accounts and the final accounts



12.1 Parts of Final Accounts

The final accounts of business concern generally includes two parts. The first part is Trading and Profit and Loss Account. This is prepared to find out the net result of the business. The second part is Balance Sheet which is prepared to know the financial position of the business. However manufacturing concerns, will prepare a Manufacturing Account prior to the preparation of trading account, to find out cost of production

12.2 Trading Account

Trading means buying and selling. The trading account shows the result of buying and selling of goods.

12.2.1 Need

At the end of each year, it is necessary to ascertain the net profit or net loss. For this purpose, it is first necessary to know the gross profit or gross loss. The trading account is prepared to ascertain this. The difference between the selling price and the cost price of the goods is the gross earning of the business concern. Such gross earning is called as gross profit. However, when the selling price is less than the cost of goods purchased, the result is gross loss.

12.2.2 Format

Trading Account for the year ending 31st March 2003

Dr.

Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Opening Stock		xxx	By Sales	xxx	
To Purchases	xxx		Less : Returns		
Less: Returns			Inward	xxx	xxx
outward	xxx	xxx			
To Wages		xxx	By Closing stock		xxx
To Freight		xxx	By Gross Loss c/d		xxx
To Carriage Inwards		xxx	(transferred to P&L A/c)		
To Clearing charges		xxx			
To Packing charges		xxx			
To Dock dues		xxx			
To Power (factory)		xxx			
To Octroi Duty		xxx			
To Gross Profit c/d		xxx			
(transferred to P&L A/c)					
		xxx			xxx

Items appearing in the debit side

1. **Opening stock:** Stock on hand at the beginning of the year is termed as opening stock. The closing stock of the previous accounting year is brought forward as opening stock of the current accounting year. In the case of new business, there will not be any opening stock.
2. **Purchases:** Purchases made during the year, includes both cash and credit purchases of goods. Purchase returns must be deducted from the total purchases to get net purchases.
3. **Direct Expenses:** Expenses which are incurred from the stage of purchase to the stage of making the goods in saleable condition are termed as direct expenses. Some of the direct expenses are:
 - i. **Wages:** It means remuneration paid to workers.
 - ii. **Carriage or carriage inwards:** It means the transportation charges paid to bring the goods from the place of purchase to the place of business.
 - iii. **Octroi Duty:** Amount paid to bring the goods within the municipal limits.
 - iv. **Customs duty, dock dues, clearing charges, import duty etc.:** These expenses are paid to the Government on the goods imported.
 - v. **Other expenses :** Fuel, power, lighting charges, oil, grease, waste related to production and packing expenses.

Items appearing in the credit side

- i. **Sales:** This includes both cash and credit sale made during the year. Net sales is derived by deducting sales return from the total sales.
- ii. **Closing stock:** Closing stock is the value of goods which remain in the hands of the trader at the end of the year. It does not appear in the trial balance. It appears outside the trial balance. (As it appears outside the trial balance, first it will be recorded in the credit side of the trading account and then shown in the assets side of the balance sheet).

Illustration 1

Prepare a Trading Account from the following information of a trader.

Total purchases made during the year 2003 Rs.2,00,000.

Total sales made during the year 2003 Rs.2,50,000

Solution:

Trading Account for the year ending 31st March 2003

Dr.		Cr.	
Particulars	Rs.	Particulars	Rs.
To Purchases	2,00,000	By Sales	2,50,000
To Gross profit c/d (transferred to P&L A/c)	50,000		
	2,50,000		2,50,000

Illustration 2

From the following information, prepare a Trading Account for the year ended 31.12.2003.

2003 Jan 1 Opening stock Rs.15,000

2003 Dec 31 Purchases Rs.16,500

Sales Rs. 30,600

Closing stock Rs. 13,500

Solution:

Trading Account for the year ending 31.12.2003

Particulars	Rs.	Particulars	Rs.
To Opening stock	15,000	By Sales	30,600
To Purchases	16,500	By Closing stock	13,500
To Gross profit c/d (transferred to P&L A/c)	12,600		
	44,100		44,100

Illustration 3

Prepare Trading Account for the year ending 31st March 2002 from the following information.

Opening stock Rs. 1,70,000 Purchases return Rs. 10,000

Sales Rs.2,50,000 Wages Rs. 50,000

Sales return Rs. 20,000 Purchases Rs. 1,00,000

Carriage inward Rs. 20,000 Closing stock Rs. 1,60,000

Solution:

Trading Account for the year ending 31st March 2002

Dr.

Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Opening stock		1,70,000	By Sales	2,50,000	
To Purchases	1,00,000				
Less Purchases return	10,000		Less Sales return	20,000	2,30,000
		90,000	By closing stock		1,60,000
To Wages		50,000			
To Carriage inwards		20,000			
To Gross profit c/d (transferred to P&L A/c)		60,000			
		<u>3,90,000</u>			<u>3,90,000</u>

12.2.3 Balancing

The difference between the two sides of the Trading Account, indicates either Gross Profit or Gross Loss. If the credit side total is more, the difference represents Gross Profit. On the other hand, if the total of the debit side is more, the difference represents Gross Loss. The Gross Profit or Gross Loss is transferred to Profit & Loss Account.

12.2.4 Closing Entries

Like ledger accounts, trading account will be closed by transferring the gross profit or gross loss to the profit and loss account.

- i. If gross profit

Trading A/c.....Dr	x x x	
To profit and loss account		x x x
(Gross Profit transferred to Profit and loss A/c)		

- ii. If gross loss.

Profit and loss A/c.....Dr	x x x	
To Trading A/c		x x x
(Gross Loss transferred to Profit and loss A/c)		

12.3 Profit and Loss Account

After calculating the gross profit or gross loss the next step is to prepare the profit and loss account. To earn net profit a trader has to incur many expenses apart from those spent for purchases and manufacturing of goods. If such expenses are less than gross profit, the result will be net profit. When total of all these expenses are more than gross profit the result will be net loss

12.3.1 Need:

The aim of profit and loss account is to ascertain the net profit earned or net loss suffered during a particular period.

12.3.2 Format

Profit and Loss Account
for the year ended

Dr.		Cr.	
Particulars	Rs.	Particulars	Rs.
To Trading A/c (Gross Loss)	x x x	By Trading A/c (Gross profit)	x x x
To Salaries	x x x	By Commission earned	x x x
To Rent & rates	x x x	By Rent received	x x x
To Stationeries	x x x	By Interest received	x x x
To Postage expenses	x x x	By Discount received	x x x
To Insurance	x x x	By Net Loss	
To Repairs	x x x	(Transferred to Capital A/c)	x x x
To Trading expenses	x x x		
To Office expenses	x x x		
To Interest paid	x x x		
To Bank charges	x x x		
To Sundry expenses	x x x		
To Commission paid	x x x		
To Discount allowed	x x x		
To Advertisement	x x x		
To Carriage outwards	x x x		
To Travelling expenses	x x x		
To Distribution expenses	x x x		
To Repacking charges	x x x		
To Bad debts	x x x		
To Depreciation	x x x		
To Net Profit (transferred to Capital A/c)	x x x		
	x x x		x x x

Items appearing in the debit side

Those expenses which are chargeable to the normal activities of the business are recorded in the debit side of profit and loss account. They are termed as **indirect expenses**.

- i. **Office and Administrative Expenses** : Expenses incurred for the functioning of an office are office and administrative expenses – office salaries, office rent, office lighting, printing and stationery, postages, telephone charges etc.
- ii. **Repairs and Maintenance Expenses** : These expenses relates to the maintenance of assets - repairs and renewals, depreciation etc.
- iii. **Financial Expenses** : Expenses incurred on borrowings – Interest paid on loan.
- iv. **Selling and Distribution Expenses** : All expenses relating to sales and distribution of goods - advertising, travelling expenses, salesmen salary, commission paid to salesmen, discount allowed, repacking charges etc.

Items appearing in the credit side

Besides the gross profit, other gains and incomes of the business are shown on the credit side. The following are some of the incomes and gains.

- i. Interest received on investment
- ii. Interest received on fixed deposits.
- iii. Discount earned.
- iv. Commission earned.
- v. Rent Received

Illustration 4

Prepare Profit and Loss Account, from the following balances of Mr.Kandan for the year ending 31.12.2003.

Office rent	Rs. 30,000	Salaries	Rs. 80,000
Printing expenses	Rs. 2,000	Stationeries	Rs. 3,000
Tax, Insurance	Rs. 4,000	Discount allowed	Rs. 6,000
Advertisement	Rs. 36,000	Travelling expenses	Rs. 26,000
Gross Profit	Rs.2,50,000	Discount received	Rs. 4,000

Solution:

Profit and Loss Account of Mr. Kandan
for the year ending 31st Dec 2003

Dr.		Cr.	
Particulars	Rs.	Particulars	Rs.
To Salaries	80,000	By Gross profit	2,50,000
To Office rent	30,000	(transferred from the	
To Stationaries	3,000	Trading A/c)	
To Printing expenses	2,000	By Discount received	4,000
To Tax, insurance	4,000		
To Discount allowed	6,000		
To Travelling expenses	26,000		
To Advertisement	36,000		
To Net profit (transferred to capital A/c)	67,000		
	2,54,000		2,54,000

Illustration 5

Prepare Trading and Profit Loss Account for the year ending 31st March 2002 from the books of Mr. Siva Subramanian.

	Rs.		Rs.
Stock (31.3.2001)	15,000	Carriage outwards	4,000
Purchases	1,65,000	Wages	30,000
Purchases return	10,000	Sales return	5,000
Postage	3,000	Salaries	20,000
Discount received	5,000	Stationeries	2,000
Bad debts	1,000	Interest	8,000
Sales	3,00,000	Insurance	4,000
Stock (31.3.2002)	80,000		

Solution :

Trading and Profit & Loss A/c of Mr. Siva Subramanian
for the year ended 31st March 2002

Dr.			Cr.		
Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Opening stock		15,000	By Sales	3,00,000	
To Purchases	1,65,000		Less returns	5,000	2,95,000
Less returns	10,000	1,55,000			
To Wages		30,000	By Closing stock		80,000
To Gross profit (transferred to P&L A/c)		1,75,000			
		3,75,000			3,75,000
To Salaries		20,000	By Gross profit (transferred from trading A/c)		1,75,000
To Postage		3,000	By Discount received		5,000
To Bad debts		1,000			
To Carriage outwards		4,000			
To Stationeries		2,000			
To Interest		8,000			
To Insurance		4,000			
To Net profit (transferred Capital A/c)		1,38,000			
		1,80,000			1,80,000

Illustration 6

From the following trial balance of Mr. John, prepare Trading, Profit and Loss Account for the year ending 31.12.2002.

Particulars	Debit Rs.	Particulars	Credit Rs.
Purchases	5,40,000	Sales	10,40,000
Salaries & wages	3,50,000	Returns outward	12,000
Office expenses	4,000	Discount received	6,000
Trading expenses	8,000	Interest received	3,000
Factory expenses	11,000	Capital	1,78,000
Carriage inwards	8,000		
Returns inward	12,000		
Discount allowed	4,000		
Commission	2,000		
Stock	60,000		
Income tax	40,000		
Cash in hand	2,00,000		
	12,39,000		12,39,000

Closing stock is valued at Rs. 1,35,000.

Solution:

Trading, Profit & Loss Account of Mr. John
for the year ending 31.12.2002

Dr.			Cr.		
Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Stock		60,000	By Sales	10,40,000	
To Purchases	5,40,000		Less Sales return	12,000	10,28,000
Less Purchases return	12,000	5,28,000			
To Trading expenses		8,000	By Closing stock		1,35,000
To Factory expenses		11,000			
To Carriage inwards		8,000			
To Gross profit (transferred to P&L A/c)		5,48,000			
		11,63,000			11,63,000

To Salaries & wages	3,50,000	By Gross profit (transferred from trading A/c)	5,48,000
To Office expenses	4,000	By Discount received	6,000
To Discount allowed	4,000	By Interest received	3,000
To Commission	2,000		
To Net profit (transferred to capital A/c)	1,97,000		
	5,57,000		5,57,000

Note:

- If trial balance shows both trading expenses as well as office expenses, the trading expenses should be shown in the trading account and office expenses should be shown in profit & loss account. On the other hand, if the trial balance shows only trading expenses, it should be shown in the profit & loss account.
- If in the trial balance, wages are clubbed with salaries and shown as '**wages and salaries**'. This item is shown in trading account. On the other hand, if it appears as '**salaries and wages**', this item is recorded in the profit & loss account.
- Income tax paid by a proprietor is considered as personal expenses. So it should be deducted from the capital.

12.3.3 Balancing

The difference between the two sides of profit and loss account indicates either net profit or net loss. If the total on the credit side is more the difference is called net profit. On the other hand if the total of debit side is more the difference represents net loss. The net profit or net loss is transferred to capital account.

12.3.4 Closing Entries

Profit and loss account should be closed by transferring the net profit or net loss to capital account.

- If net profit

Profit and Loss A/c.....Dr	x x x	
To Capital A/c		x x x
(Net profit transferred to capital A/c)		

- ii. If net loss

Capital A/c.....Dr.	x x x	
To Profit and loss A/c		x x x
(Net loss transferred to capital A/c)		

12.4 Balance Sheet:

This forms the second part of the final accounts. It is a statement showing the financial position of a business. Balance sheet is prepared by taking up all personal accounts and real accounts (assets and properties) together with the net result obtained from profit and loss account. On the left hand side of the statement, the liabilities and capital are shown. On the right hand side, all the assets are shown. Balance sheet is not an account but it is a statement prepared from the ledger balances. So we should not prefix the accounts with the words 'To' and 'By'.

Balance sheet is defined as 'a statement which sets out the assets and liabilities of a business firm and which serves to ascertain the financial position of the same on any particular date'.

12.4.1 Need :

The need for preparing a Balance sheet is as follows:

- To know the nature and value of assets of the business
- To ascertain the total liabilities of the business.
- To know the position of owner's equity.

12.4.2 Format

The Balance sheet of a business concern can be presented in the following two forms

- Horizontal form or the Account form
- Vertical form or Report form

i) Horizontal form of Balance Sheet:

The right hand side of the balance sheet is asset side and the left hand side is liabilities side. All accounts having debit balance will appear in the asset side and all those having credit balance will appear in the liability side.

Balance Sheet of

as on

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Sundry creditors		xxx	Cash in hand		xxx
Bills payable		xxx	Cash at bank		xxx
Bank overdraft		xxx	Bills receivable		xxx
Outstanding expenses		xxx	Sundry debtors		xxx
Mortgage loans		xxx	Investments		xxx
Reserve fund		xxx	Closing stock		xxx
Capital	xxx		Prepaid expenses		xxx
Add: Net profit (or)			Furniture & fittings		xxx
Less: Net loss	xxx		Plant & machinery		xxx
			Land & buildings		xxx
	xxx		Business premises		xxx
Less: Drawings	xxx		Patents & trade marks		xxx
			Good will		xxx
Less: Income tax	xxx	xxx			
		x x x			x x x

ii) Vertical form of Balance Sheet

In this, Balance Sheet is presented in a statement form.

Balance Sheet as on

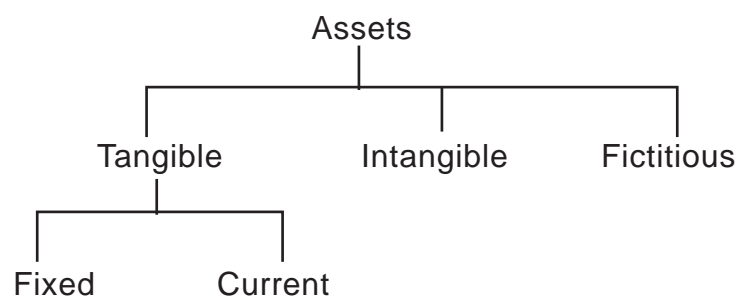
Particulars	Rs.	Rs.
Current Assets:		
Stock-in-Trade	xxx	
Sundry Debtors	xxx	
Prepaid Expenses	xxx	
Accrued Income	xxx	
Bills Receivable	xxx	
Cash at Bank	xxx	
Cash in Hand	xxx	
Total Current Assets		xxx

Less: Current Liabilities:		
Sundry Creditors	xxx	
Bills Payable	xxx	
Bank Overdraft	xxx	
Outstanding Expenses	xxx	
Total Current Liabilities		xxx
Net Working Capital:		xxx
Add: Fixed Assets:		
Goodwill	xxx	
Land and Building	xxx	
Plant and Machinery	xxx	
Furniture	xxx	
Investment	xxx	
Total Fixed Assets		xxx
Capital Employed		xxx
(Both owner's and outsiders)		
Less: Long Term Liabilities		
Debentures	xxx	
Loans	xxx	
Total Long Term Liabilities		xxx
Net Assets		xxx
Represented by:		
Owner's Capital	xxx	
Reserves and surplus	xxx	
Shareholders Funds		xxx

12.4.3 Classification of Assets and Liabilities Assets

Assets

Assets represents everything which a business owns and has money value. In other words, asset includes possessions and properties of the business. Asset are classified as follows:



a) Tangible Assets:

Assets which have some physical existence are known as tangible assets. They can be seen, touched and felt, e.g. Plant and Machinery Tangible assets are classified into

i. Fixed assets :

Assets which are permanent in nature having long period of life and cannot be converted into cash in a short period are termed as **fixed assets**.

ii. Current assets :

Assets which can be converted into cash in the ordinary course of business and are held for a short period is known as **current assets**. This is also termed as **floating assets**. For example, cash in hand, cash at bank, sundry debtors etc

b) Intangible Assets

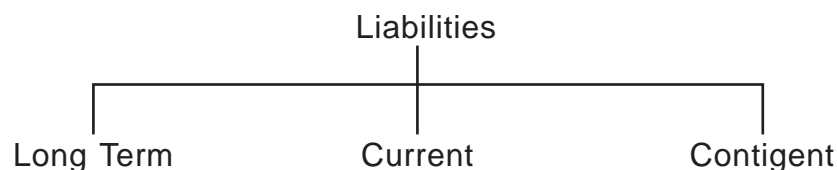
The assets which have no physical existence and cannot be seen or felt. They help to generate revenue in future, e.g. goodwill, patents, trademarks etc.

c) Fictitious Assets

These assets are nothing but the unwritten off losses or non-recoupable expenses. They are really not assets but are worthless items. For example, Preliminary expenses.

Liabilities

The amount which a business owes to others is liabilities. Credit balance of personal and real accounts together with the capital account are liabilities.



a) Long Term Liabilities

Liabilities which are repayable after a long period of time are known as **Long Term Liabilities**. For example, capital, long term loans etc.

b) Current Liabilities

Current liabilities are those which are repayable within a year. For example, creditors for goods purchased, short term loans etc.

c) Contingent liabilities

It is an anticipated liability which may or may not arise in future. For example, liability arising for bills discounted. Contingent liabilities will not appear in the balance sheet. But shown as foot note.

12.4.4 Marshalling of Assets and Liabilities

The term '**Marshalling**' refers to the order in which the various assets and liabilities are shown in the balance sheet. The assets and liabilities can be shown either in the order of liquidity or in the order of permanence.

a) In order of liquidity

Liquidity means convertability into cash. Assets will be said to be liquid if it can be converted into cash easily, they are placed at the top of the balance sheet. Liabilities are arranged in the order of their urgency of payment. The most urgent payment to be made is listed at the top of the balance sheet.

b) In order of permanence

This order is exactly the reverse of the above. Assets and liabilities are recorded in the order of their life in the business concern.

12.4.5 Balance Sheet Equation

An important thing to note about the Balance Sheet is that, the total value of the assets is always equal to the total value of the liabilities. This is because the liability to the owner - capital, is always made up of the difference between assets and liabilities. Thus,

$$\text{Assets} = \text{Liabilities} + \text{Capital}$$

or

$$\text{Capital} = \text{Assets} - \text{Liabilities}$$

While preparing the trial balance in case it does not tally the difference is transferred to an imaginary account called as suspense account. In case the suspense account is not closed before the preparation of the final accounts then it has to be placed in the balance sheet, so that it can be rectified later. If suspense account has a debit balance it will appear as the last item in the asset side. In case it shows a credit balance it will appear as the last item in the liability side.

12.5 Difference between Trial Balance and Balance Sheet

S. No.	Basis Distinction	Trial balance	Balance sheet
1.	Objective	To know the arithmetical accuracy of the accounting work.	To know the true and fair financial position of a business.
2.	Format	The columns are debit balances and credit balances.	The two sides are assets and liabilities.
3.	Content	It is a summary of all the ledger balances – personal, real and nominal accounts.	It is a statement showing closing balances of personal & real accounts.
4.	Stage	It is the middle stage in the preparation of accounts.	It is the last stage in the preparation of accounts.
5.	Period	It can be prepared periodically, say at the end of the month, quarterly or half yearly, etc.	It is generally prepared at the end of the accounting period.
6.	Preparation	It is prepared before the preparation of trading, profit and loss account.	It is prepared after the preparation of trading, profit and loss account.
7.	Stock	It shows opening stock only.	It shows closing stock only.
8.	Order	Balances shown in the trial balance are not in order.	Balances shown in the balance sheet must be in order.
9.	Evidence	It cannot be produced as a documentary evidence in the court.	It can be produced as a documentary evidence.
10.	Compulsion	Preparation of trial balance is not compulsory.	Preparation of the balance sheet is a must.

Illustration 7

From the following Trial Balance of M/s. Ram & Sons, prepare trading and profit and loss account for the year ending on 31st March 2002 and the balance sheet as on the date:

Trial Balance as on 31st March 2002

Particulars	Debit Rs.	Credit Rs.
Opening Stock (1.4.2001)	5,000	
Purchases	16,750	
Discount allowed	1,300	
Wages	6,500	
Sales		30,000
Salaries	2,000	
Travelling expenses	400	
Commission	425	
Carriage inward	275	
Administration expenses	105	
Trade expenses	600	
Interest	250	
Building	5,000	
Furniture	200	
Debtors	4,250	
Creditors		2,100
Capital		13,000
Cash	2,045	
	45,100	45,100

Stock on 31st March 2002 was Rs. 6,000.

Solution :

M/s. Ram & Sons
Trading and Profit and Loss Account
for the year ending 31st March 2002

Dr.		Cr.	
Particulars	Rs.	Particulars	Rs.
To Opening stock	5,000	By Sales	30,000
To Purchases	16,750	By Closing stock	6,000
To Wages	6,500		
To Carriage inward	275		
To Gross profit c/d (transferred to P&L A/c)	7,475		

	36,000		36,000
To Discount	1,300	By Gross profit	7,475
To Salaries	2,000	(transferred from	
To Travelling expenses	400	P&L A/c)	
To Commission	425		
To Administration expenses	105		
To Trade expenses	600		
To Interest	250		
To Net profit	2,395		
(transferred to capital A/c)			
	7,475		7,475

Balance Sheet as on 31st March 2002

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Creditors		2,100	Cash		2,045
Capital	13,000		Debtors		4,250
Add Net profit	2,395		Stock		6,000
		15,395	Furniture		200
			Building		5,000
		17,495			17,495

QUESTIONS

I. Objective Type:

a) Fill in the blanks:

- _____ account enables the trader to find out gross profit or loss.
- By preparing profit and loss account _____ can be found out.
- Closing stock is _____ in the trading account.
- Direct expenses appear in the debit side of the _____ account.
- Indirect expenses appear in the _____ side of the profit and loss account.
- All incomes are _____ in the profit and loss account.

7. Bad debt is a _____ expense.
8. 'Salaries and wages' appear on the _____ account.
9. Balance sheet shows the _____ of a business

[Answers: 1. Trading, 2. net profit or loss, 3. credited, 4. Trading, 5. debit,
6. credited, 7. selling, 8. profit and loss account, 9. financial position]

b) Choose the correct answer:

1. Trading account is prepared to find out
 - a) gross profit or loss
 - b) net profit or loss
 - c) financial position
2. Wages is an example of
 - a) capital expenses
 - b) indirect expenses
 - c) direct expenses
3. Opening stock is
 - a) debited in trading account
 - b) credited in trading account
 - c) credit in profit and loss account
4. Balance sheet is a
 - a) statement
 - b) account
 - c) ledger
5. Fixed assets have
 - a) short life
 - b) long life
 - c) no life
6. Cash in hand is an example of
 - a) current assets
 - b) fixed assets
 - c) current liability
7. Capital is a _____
 - a) income
 - b) assets
 - c) liability
8. Drawing must be deducted from
 - a) net profit
 - b) capital
 - c) gross profit
9. Current liabilities are recorded in the balance sheet on
 - a) not recorded
 - b) liability side
 - c) assets side
10. Net profit is added to
 - a) gross profit
 - b) drawings
 - c) capital

[Answers: 1.(a), 2.(c), 3.(a), 4.(a), 5.(b), 6. (a), 7.(c), 8.(b), 9.(b), 10.(c)]

II. Other Questions:

1. Explain the need of trading account.
2. What is trading account? What are its uses?
3. What are the items appearing in the debit and credit side of trading account?
4. What are the merits of profit and loss account?
5. What are direct and indirect expenses?
6. Write the difference between trial balance and balance sheet.
7. What do you mean by current assets.
8. Explain the term liabilities.
9. Draw the format of vertical balance sheet.
10. What do you mean by Assets? Classify the assets with suitable examples.

III. Problems:

1. Prepare a trading account of Mr.Vasu from the following figures.

	Rs.
Opening stock	500
Purchases	2,500
Sales	3,600
Closing stock	300

[Answer : Gross profit Rs.900]

2. Prepare a trading account of Mr.Devan for the year ended 31st December 2002.

	Rs.
Opening stock	5,700
Purchases	1,58,000
Purchases returns	900
Sales	2,62,000
Sales returns	600

Closing stock was valued at Rs.8,600.

[Answer : Gross profit Rs. 1,07,200]

3. The following are some of the balances extracted from the ledger of Mr.Sundaram as on 31st December 2000. Prepare a trading account.

Particulars	Debit Rs.	Credit Rs.
Stock 1.1.2000	12,500	
Purchases	1,00,000	
Sales		1,50,000
Returns outwards		5,000
Returns inwards	10,000	
Salaries	4,400	
Wages	7,500	
Rent	2,750	
Carriage inwards	2,500	
Carriage outwards	750	
Power, coal, gas	1,000	

Stock on 31.12.2000 was valued at Rs.14,000.

[Answer : Gross profit Rs. 35,500]

4. Prepare profit and loss account of Mrs.Nalini for the year ended 31st Dec. 2001 from the following.

	Rs.		
Gross profit	1,25,000	Discount paid	600
Salaries	15,000	Discount received	1,000
Rent	5,000	Interest paid	500
Carriage outwards	1,000	interest received	700
Selling expenses	500	Commission earned	2,000
Income from investment	1,500		

[Answer : Net profit Rs.1,07,600]

5. The following balances are taken from the books of M/s. RSP Ltd. Prepare profit and loss account for the year ended 31st March 2002.

Gross profit	5,25,000	Salaries & wages	1,00,000
Rent	10,000	Depreciation	5,000
Interest on loan	5,000	Office expenses	1,500
Distribution charges	2,500	Salesman salary	8,000
Bad debts	2,200	Stationery and printing	500
Commission received	3,000	Discount received	2,000

Interest received	5,000	Advertising	9,000
Taxes and insurance	2,000		

[Answer : Net profit Rs. 3,89,300]

6. From the following particulars, prepare a balance sheet of Mr.Venugopal as on 31st December 2003.

Capital	40,000	Drawings	4,400
Debtors	6,400	Creditors	4,200
Cash in hand	360	Cash at bank	7,200
Furniture	3,700	Plant	10,000
Net profit	1,660	General reserve	1,000
Closing stock	14,800		

[Answer : Balance sheet Rs. 42,460]

7. From the following information prepare balance sheet of Mrs.Nasreen Khan as at 31st Dec. 2003.

	Rs.		Rs.
Goodwill	10,000	Sundry debtors	25,000
Capital	90,000	Drawings	15,000
Cash in hand	10,000	Land & Buildings	30,000
Investment	500	Bank	10,000
Net profit	46,900	Creditors	31,500
Bills receivable	6,500	Plant & machinery	20,000
Bills payable	5,350	Closing stock	40,000
Furniture	6,750		

[Answer : Balance Sheet Rs.1,58,750]

8. Given below is the trial balance of Shri.Hari Prakash. Prepare trading and profit and loss account for the year ended 31st March 2002.

Particulars	Dr. Rs.	Cr. Rs.
Stock as on 1.4.2001	50,000	
Sales		2,90,000
Sales returns	10,000	
Purchases	2,45,000	
Purchase returns		5,000
Carriage inwards	4,000	
Carriage outwards	6,000	
Wages	12,000	

Particulars	Dr. Rs.	Cr. Rs.
Salaries	18,000	
Printing and stationary	900	
Discount allowed	900	
Discount received		600
Depreciation	3,000	
Buildings	2,08,100	
Trade Expenses	5,600	
Capital		2,72,900
Bills receivables	20,000	
Bills Payable		15,000
	5,83,500	5,83,500

Closing Stock on 31.3.2002 Rs. 65,000.

[Answe: Gross Profit Rs. 39,000, Net Profit 5,200]

9. The following information was extracted from the books of M/s.Sudha Ltd. Prepare final accounts on 31.3.2002.

Particulars	Debit Rs.	Particulars	Credit Rs.
Opening stock	12,500	Sales	1,89,000
Depreciation	7,000	Commission	2,000
Carriage inwards	700	Capital	1,71,300
Furniture	8,000	Creditors	17,500
Carriage outwards	500	Bills payable	5,000
Plant & machinery	2,00,000	Return outwards	13,800
Cash	8,900		
Salaries	7,500		
Debtors	19,000		
Discount	1,500		
Bills receivable	17,000		
Wages	16,000		
Sales returns	14,000		
Purchase	86,000		
	3,98,600		3,98,600

Closing stock on 31.12.2002 Rs.45,000.

[Answer : Gross profit Rs. 1,18,600, Net profit Rs.1,04,100,

Balance sheet Rs. 2,97,900]

10. The trial balances of Mr. Uma Shankar shows the following balances on 31st March 2000. Prepare final accounts.

Debit Balance	Rs.	Credit Balance	Rs.
Purchases	70,000	Capital account	56,000
Sales returns	5,000	Sales	1,50,000
Opening stock	20,000	Purchase returns	4,000
Discount allowed	2,000	Discount received	1,000
Bank charges	500	Sundry creditors	30,000
Salaries	4,500		
Wages	5,000		
Freight inwards	4,000		
Freight outwards	1,000		
Rent, rates and taxes	5,000		
Advertising	6,000		
Cash in hand	1,000		
Plant and machinery	50,000		
Sundry debtors	60,000		
Cash at bank	7,000		
	2,41,000		2,41,000

Closing stock on 31st March 2000 was Rs. 30,000.

[Answer: Gross profit Rs.80,000, Net profit Rs.62,000,
Balance sheet Rs. 1,48,000]

11. The following trial balance extracted from the books of Murugan, prepare trading, profit and loss a/c for the year ended 31st Dec. 2001 and balance sheet as on that date.

Particulars	Debit Rs.	Credit Rs.
Drawings	20,000	
Capital		1,89,000
Plant & machinery	80,000	
Sundry debtors	70,000	
Sundry creditors		50,000
Purchases	1,03,000	
Sales		2,20,000
Sales returns	10,000	
Wages	40,000	
Cash in hand	5,000	
Cash at bank	10,000	

Salaries	38,000	
Stock	45,000	
Rent	10,000	
Manufacturing expenses	7,000	
Bills receivable	12,000	
Bills payable		20,000
Bad debts	5,000	
Carriage inwards	9,000	
Furniture	15,000	
	4,79,000	4,79,000

Closing stock as on 31.12.2001 Rs. 50,000.

[Answer : Gross profit Rs. 56,000, Net profit Rs. 3,000,
Balance sheet Rs.2,42,000]

12. The following balances were extracted from the books of Mr.Chandran on 31.3.2001.

Particulars	Debit Rs.	Credit Rs.
Capital		1,41,000
Buildings	80,000	
Machinery	70,000	
Furniture	15,000	
Stock	50,000	
Power	10,000	
Wages	70,000	
Carriage	8,000	
Rent and rates	17,000	
Salaries	35,000	
Bank Charges	1,000	
Income tax	2,000	
Bad debts	5,000	
Commission received		9,000
Purchases	1,50,000	
Sales		3,40,000
Bills receivable	20,000	
Bank overdraft		50,000
Cash in hand	2,000	
Purchase returns		10,000
Sales returns	15,000	
	5,50,000	5,50,000

The closing stock was valued at Rs.60,000. You are required to prepare final accounts for the year ended 31st March 2001.

[Answer : Gross profit Rs.1,07,000, Net profit Rs.58,000,
Balance sheet Rs.2,47,000]

13. The following balances are extracted from the books of Mr.Ramasamy on 31.12.2001. Prepare final accounts

Particulars	Debit Rs.	Particulars	Credit Rs.
Stock on 1.1.2001	17,000	Sales	60,000
Manufacturing wages	10,000	Creditors	20,000
Factory rent	2,000	Bills payable	10,000
Factory lighting	3,000	Capital	43,000
Purchase	30,000		
Carriage	3,000		
Salary	2,000		
Office rent	2,000		
Printing & stationery	1,000		
Bad debts	1,000		
Land	10,000		
Buildings	20,000		
Plant & machinery	15,000		
Furniture	5,000		
Depreciation	2,000		
Debtors	5,000		
Cash in hand	5,000		
	1,33,000		1,33,000

Closing stock was valued at Rs.19,000.

[Answer : Gross profit Rs. 14,000, Net profit Rs.6,000,
Balance sheet Rs.79,000]

14. Prepare Trading and Profit and Loss Account and Balance Sheet of Mr.Venkat as on 31st March 2000.

Particulars	Debit Rs.	Credit Rs.
Venkat Capital		35,000
Free hold premises	45,000	
Goodwill	20,000	
Machinery and plant	17,000	
Opening stock	18,000	
Bills receivable and payable	4,000	6,000
Sundry debtors and creditors	16,000	24,000
Purchases and sales	80,000	1,50,000
Returns	1,000	2,000
Carriage outwards	500	
Freight, duty etc	1,200	
Manufacturing wages	22,800	
Factory expenses	6,000	
Salaries	24,000	
Commission	2,500	
Discount		9,000
Stationery and printing	4,500	
Trading expenses	1,800	
Cash in hand	700	
Suspense A/c		39,000
	2,65,000	2,65,000

Closing stock was valued at Rs.70,000.

[Answer : Gross profit Rs.93,000, Net profit Rs.68,700,
Balance sheet Rs.1,72,700]

15. From the following balances extracted from the books of Mrs.Mala, prepare final accounts for the year ending 31st March 2003. Closing stock as on 31.03.2003 was Rs.72,500.

Particulars	Debit Rs.	Credit Rs.
Mrs.Mala's Capital		95,000
Plant & Machinery	37,000	
Repairs to Machinery	9,150	
Wages	42,000	
Salaries	6,000	
Income tax	750	
Cash and bank balances	3,000	
Land and building	1,11,750	
Purchases	1,80,000	
Purchase Returns		3,000
Sales		3,75,000
Interest	2,250	
Bills receivable	15,000	
Bills payable		4,500
Commission (Cr)		6,000
Debtors	52,500	
Creditors		40,650
Opening Stock as on 1.4.2003	55,500	
Drawings	12,000	
Suspense account		2,750
	5,26,900	5,26,900

[Answers : Gross profit Rs.1,73,000; Net profit Rs.1,61,600; Balance sheet Total Rs. 2,91,750]

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