

Chapter 2A

Accounting Process – Basics and Journal

CHAPTER OVERVIEW

(1)	(2)
Basics – Double Entry System	Journal
1. Meaning of Assets, Liabilities, Equity, Incomes and Expenses 2. Double Entry System 3. Meaning of Account 4. 2 Approaches to Dual Aspect – Equation Approach &Golden Rules Approach 5. Traditional Approach – Golden Rules of Accounting 6. Classification of Accounts 7. Determination of Profits and Losses – 2 Approaches	8. Phases in the Accounting Process 9. Journal &Journalising Process 10. List of Journal Entries for various transactions

This Chapter forms the basis for the field of Accountancy. Proper Understanding the principles explained in this Chapter is very crucial for a Student of finance to appreciate the subject of Accountancy and also all related fields. Hence Students are advised to give adequate time to these areas.

Glossary of Significant Terms Used

Term	Meaning
Assets	A resource controlled by the enterprise as a result of past events and from which future economic benefits are expected to flow to the enterprise. (Refer below for Examples and Classification assets)
Debtors	<ul style="list-style-type: none"> Persons to whom Credit Sales of goods are made. Money is receivable from them in future. The group of debtors is called under a single head as "Sundry Debtors".
Prepaid Expenses	Money is paid in advance. But benefit for that payment will be received in the future (within the next 12 months) For eg. Building Rent paid in advance for 3 months. It is a Current Asset . It is also called " Unexpired Insurance "
Accrued Incomes	<ul style="list-style-type: none"> Otherwise called as Outstanding Incomes / Incomes earned but not yet received Here, Sale is made / Service is rendered / Income is earned, but it is not actually received in cash. Treated as income in the year in which they are earned as per accrual concept. It is a "Current Asset"
Goodwill	<ul style="list-style-type: none"> Reputation earned by the business over a period of time for its products, brand, name or quality. It leads to increase in business volume as more no. of customers buy the product for its good name. Example:BMW Cars have a good name in the market and hence the Company can price the cars at a higher rate. Still customers will buy them due to the goodwill enjoyed by the Company. Hence, Goodwill indirectly relates to higher benefits in the form of increase in sales volume. It is an Fixed Asset(intangible), as it leads to long term benefits.
Liabilities	<ul style="list-style-type: none"> It is a present obligationarising from past events,the settlement of which is expected to result in an outflow of resources embodying economic benefits.Example: Creditors, Bank Loan. It implies the amounts which are payable by the business to Outsiders (including owners). Refer below for classification of Liabilities.
Creditors	<ul style="list-style-type: none"> Persons from whom Credit Purchases of goods are made. Money is payable to them in future. The group of Creditors is called under a single head as "Sundry Creditors".
Outstanding Expenses	These are otherwise called " Expenses Payable ". Here, benefits are received but the payment is not yet made to the provider. Hence, in future, money is to be paid to them. These are in the nature of Current Liabilities . For Example, Services rendered by employees, but salary is not yet paid to them.
Incomes received in Advance	These are otherwise called " Advances from Customers ". Here, before making sales / rendering services, money is received from the customers. Hence, in future, the business has an obligation to render services / deliver goods. These are in the nature of Current Liabilities . Example: Building Owner received rent in advance, Interest on Deposits received before maturity, etc.

Term	Meaning
Equity	Residual interest in the assets of the enterprise after deducting its liabilities. Otherwise called as Capital
Income	Increase in Economic Benefits during the accounting period in the form of inflows of Assets or decrease of Liabilities that result in increase in Equity , other than those relating to Contribution from Equity Participants .
Expenses	Decrease in Benefits in the accounting period in the form of outflows or depletions of Assets or incurrence of Liabilities that result in decreases in Equity except those relating to distributions to Equity Participants .
Dividend	It is a share of Income distributed by a Limited Company to its Shareholders (Owners). From the angle of the Shareholder (owner), it is an Income . It is calculated on Face Value / Paid-Up Value of Shares.
Equity Participants	Proprietor in the case of Sole Proprietorship or Partners in the case of Partnership Business, " Shareholders " in the case of Company. (<i>Owners are called as Equity Participants</i>)
Debit	<ul style="list-style-type: none"> In Accountancy, it is the name for one of the 2 aspects of the transaction / event. It is derived from Latin word "Debere", which means Left. Hence, the term "Debit" means "left side"
Credit	<ul style="list-style-type: none"> In Accountancy, it is the name for one of the 2 aspects of the transaction / event. It is derived from Latin word "Credere", which means Right. Hence, the term "Credit" means "Right side".
Discount	It refers to the reduction in the Price of the goods / Reduction in the Amount Due .
Book Value	Value of a Fixed Asset as per Accounts Books. (Historical Cost less Depreciation till date)
Cash Discount	<ul style="list-style-type: none"> Cash Discount Received: The difference between amount payable to a Creditor and amount actually paid. The term "Received" does not mean that cash is received from the Creditor in the name of discount. It just refers to the reduction in the amount payable to the Creditor. (It is reduction in Expense. So it is an Income) Cash Discount Allowed: The difference between amount Receivable from a Debtor and amount actually received. The term "allowed" does not mean that cash is paid to the Debtor in the name of discount. It just refers to the reduction in the amount receivable from the Debtor. (It is reduction in income. So it is an Expense and NOT a loss). <p>Note: Cash Discount is received / allowed for payment / receipt of amount due before the due date.</p>
Bad Debts	<p>It represents the amount receivable from Customers, but could not be recovered due to the insolvency of the customers. It is a LOSS for the business.</p> <p>Example: Credit Sale of ₹ 5,000 made to Mr.C. He becomes insolvent. A first and final payment of 60 paise in a rupee could only be received from the Official Receiver of Mr.C. Here Bad Debts = $5,000 \times 0.40 = ₹ 2,000$; Amount actually received = ₹ 3,000 ($₹ 5,000 \times 0.60$)</p>
Discount Vs Bad Debts	<p>(a) Discount Allowed: Business itself asks the Buyer to pay the reduced amount. The Debtor is solvent.</p> <p>(b) Bad Debts: The Debtor is insolvent. So he cannot pay the dues, even if the business asks him to pay</p>
Full settlement	<p>It means that the Creditor cannot receive any further money from the Debtor. The amount received till now shall be the final amount. The amount not received is treated as "Discount".</p> <p>Example: A sold goods to B for ₹ 10,000. B paid ₹ 9,500 in full settlement of his account. This implies that the balance ₹ 500 will not be paid by B to A and hence treated as "Discount".</p>

1.1 Meaning of Assets and Liabilities

A. Assets – Meaning and Criteria

1. Condition for Assets

Steps	Condition
1	A Resource (Any property from which benefit can be derived)
2	Controlled by the enterprise as a result of past events (Note: Control – The enterprise has complete right to decide how to use or to dispose)
3	From which future economic benefits are expected to flow to the enterprise. (arises within or after the period)

Note: All the 3 Conditions must be satisfied to qualify as an asset. When any of the conditions is not satisfied, then the item shall be treated as "Expense".

2. **Accounting Treatment for Assets:** Assets are **NOT considered** for determination of **profits**. Only Expenses are deducted from incomes while determining the profits.

3. Examples:

Items Criteria	Cash	Debtors (Note 5)	Stock	Machinery	Goodwill (Note 1)	Building Rent (Note 2)	Staff Salary (Note 3)	Advance rent (Note 4)
1	Yes	Yes	Yes	Yes	Yes	No	No	Yes
2	Yes	Yes	Yes	Yes	Yes	Yes	No	Yes
3	Yes	Yes	Yes	Yes	Yes	No	No	Yes
Nature	Asset	Asset	Asset	Asset	Asset	NOT Asset	NOT Asset	Asset

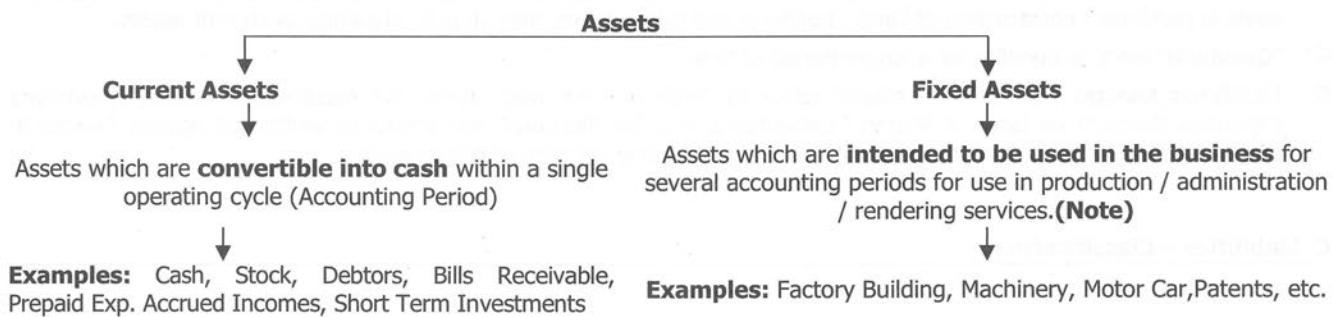
Notes:

- Goodwill** – Goodwill is within the control of the Enterprise. If the Enterprise gives good quality products, the goodwill increases. However, if its products are of poor quality, the goodwill decreases. Hence, Entity has control over goodwill.
- Building Rent** – If rent is paid for one month, building can be occupied for one month. After that, no future benefit can be enjoyed from the building and building to be returned. Hence, there is no future economic benefit from building rent.
- Staff Salary** – Salary is given for the services already rendered by employees. So, there are no future economic benefits.
- Advance Rent** – Assume that rent is paid for 15 months. But as on date, the building is occupied for only 12 months. In this case, the 3 months rent is paid in advance. It is an asset because due to that advance, the benefit can be derived from the building in the future 3 months (future economic benefits exist).
- Debtors** – Credit Sales were made to the Debtors. Hence, the business has to receive money from them. Money is an economic benefit, which has to be received from the Debtors in future.
- Accrued Incomes / Outstanding Incomes – Similar to Debtors.** Hence, considered as "Assets".

Students' Notes: Hence all Prepaid Expenses and Accrued Incomes are considered as "Assets".

B. Assets – Classification and Criteria

1. Classification of Assets



Notes:

- (a) **Intention:** The crucial word in the definition of fixed assets is "intended". It has the following implications –

Sl.No.	Situation	Nature of asset
1	A Motor Car is bought with an intention to use it in the business for longer period of time.	Fixed Asset
2	The Motor Car is bought with an intention to sell within a short span.	Current Asset (otherwise called Goods – Stock). Note: Hence for a motor car dealer, motor car is current assets and not fixed assets.
3	A Motor Car is bought with an intention to use it for longer period but it is actually sold in a single accounting period.	Still a "Fixed Asset" as the intention at the time of purchase was to use it for longer period.

- (b) **Classification of Fixed Assets:** Fixed Assets can be further classified as follows:

Tangible	Fixed Assets which are visible for the eye, e.g. Land, Building, Machinery, Vehicles, etc.
Intangible	Fixed Assets which are not visible for the eye and can only be felt, e.g. Goodwill, Patent, Trademark, Copyright

2. Criteria for classification of assets

Steps	Criteria
1	Check if the asset is a Cash or Bank Balance
2	Check if the asset is to be converted into cash/ converted into any other benefit in the near future
3	Check if the asset is to be consumed in the production of goods / rendering of services
4	Check if the asset is expected to be used for longer time period for production/administration/rendering services / If the benefits from the asset exist for a several accounting periods.
Principal Criteria: Classification is also based on nature of business. (For Building contractor, building is a current asset)	
<ul style="list-style-type: none"> • For Current Assets – Any of the first 3 criteria must be fulfilled. • For Fixed Assets – The fourth criteria must be satisfied. Other criteria should not be satisfied. 	

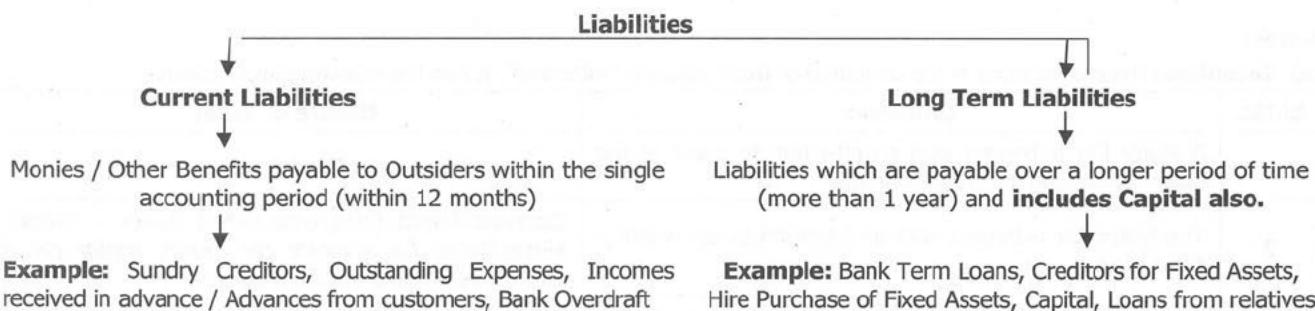
3. Application of above criteria

Assets Criteria	Cash	Debtors	Stock of Raw Materials	Stock of Finished Goods	Prepaid Expenses	Land & Buildings	Goodwill
1	Yes	No	No	No	No	No	No
2	No	Yes	No	Yes	Yes (Note 2)	No (Note 3)	No
3	No	No	Yes	No	No	No (Note 3)	No
4	No	No	No	No	No	Yes (Note 3)	Yes (Note 4)
Nature of Asset	Current	Current	Current	Current	Current	Fixed	Fixed

Notes:

1. **"Accrued Incomes / Outstanding Incomes"** – Similar to Debtors. Hence, considered as Current Assets. **Example:** Interest earned on Fixed Deposits, Commission earned etc.
2. **"Prepaid Expenses"** – Money is paid in advance, but benefit will be received within the next 12 months. Hence, the advance paid will be converted into any other benefit within the next 12 months. **Example:** Money paid now for renting a building for the next 3 months. In this case, the advance money will be used for occupying the building for the next 3 months.
3. **"Land and Buildings"** are normally held for use in the business for a longer time period. However, if the business deals in purchase / construction of Land / buildings and selling them, they shall be classified as current assets.
4. **"Goodwill"** leads to benefits for a longer period of time.
5. **Fictitious Assets:** The Term "Fictitious" refers to "artificial / not real". Items like Accumulated Losses, Preliminary Expenses, Discount on Issue of Shares / Debentures, etc. are "fictitious" and should be written off against Balance in Profit and Loss Account, in accordance with current accounting principles / requirements.

C. Liabilities – Classification



1.2 Double Entry System of Accounting

- **The Actual Accounting Process commences from this area. A tight grip over the following concepts will be of immense help to the students throughout their Academic Career.**
- **In this area, Students will learn the RULES for accounting the transactions & events in Books of Accounts.**
- **Now on, whenever the term "Transaction" is used, it refers to both transactions and events.**

1. **Origin: Modern Accounting** is based on Double Entry System which was developed in the 15th Century in Italy by Fra Luca Pacioli, a philosopher turned mathematician. His work / treatise "Summa de Arithmetica, Geometrica and Proportioni et Proportionalita", forms the basis of the present day double entry system.
2. **Meaning:**
 - (a) The Double Entry System is a system which analyses transactions and events into two aspects, as per the Dual Aspect Concept (**Refer Chapter 1**). In accounting terms, these two aspects are called **Debit and Credit**.
 - (b) The Double Entry system **recognizes and records** both the aspects (i.e. Debit and Credit) of every transaction and event in a systematic manner.
3. **Significance / Advantages:** The Double Entry System –
 - (a) Ensures **arithmetical accuracy** of accounting process, so that at all points of time the total of Debits equal to the sum of Credits.
 - (b) Provides basis for the fundamental **accounting equation**, i.e. Equity + Liabilities = Assets.
 - (c) Permits maintenance of accounts, in as much details as necessary, and provides a useful **information system** for decision-making process.
 - (d) Provides smooth and effective **comparison** of financial information over various time periods.
 - (e) Helps in ascertainment of the correct **profit / loss**, along with details thereof, i.e. result of operations or performance during the period.
 - (f) Aids in reporting the **financial position** as on a particular date, i.e. Balance Sheet can be prepared.
 - (g) Ensures compliance with **legal requirements**, e.g. Companies Act requires maintenance of accounting records under Double Entry System only.

1.3 Account – Meaning

1. **Meaning:** Under the Double Entry System, the Dual Aspects (Debit and Credit) relating to each transaction under each of Assets / Liabilities / Incomes / Expenses are presented in a "**T Form**". This is called as an **Account**.
2. An "**Account**" represents a detailed record of transactions and changes that have occurred in a particular Asset, Liability, Expense, Loss, Gain or Capital during an accounting period. (**Refer below**)
3. The Left Hand Side of the "**T**" Form Account is called **Debit side (in short Dr.)**, and the Right Hand Side of the Account is called as **Credit Side (in short Cr.)**.
4. The terms Debit (Dr.) and Credit (Cr.) only describe the **two sides** of the Account. (**Note:** Debit and Credit does **not** mean unfavourable and favourable respectively.)

Model Format of an "Account"

Dr.	Left Side		Account		Right Side		Cr.
Date	Particulars	Ref.	Amount(₹)	Date	Particulars	Ref.	Amount(₹)
	Opening Balance		XXX	---- Transactions			XXX
			XXX				XXX
	---- Transactions		XXX				XXX
			XXX		Closing Balance		XXX
	Total		XXXXX		Total		XXXXX

Notes:

- (a) "Ref." represents 'Reference' – The source from which the transactions are recorded in the Account.
- (b) Entries on the left side are prefixed by "**TO**". Entries on the right side are "**BY**".
- (c) Opening Balance will be on the left side for Debit Balance accounts. It will be on credit side for Credit Balance Accounts.

Example: If a Cash Account is prepared, it has the following features:

- It will contain all transactions which involve cash.
- It will also show the **status of the cash balance** i.e. how much cash is left in the business.
- The transactions are recorded date wise (Otherwise called as '**Chronological Order**')

1.4 Approaches to Accounting – 2 Methods

To analyse the Dual Aspect of each transaction, the following approaches can be applied –

1. **Accounting Equation Approach:** Here, the dual aspect of each transaction is identified by reference to the impact on the basic accounting equation, i.e. Equity + Liabilities = Assets.
2. **Traditional Approach:** Each transaction is recorded in the books by reference to the rules of Debit and Credit only. These Rules are called **Golden Rules of Accounting**. (See below for **Rules**)

A. Accounting Equation Approach

- Basis:** The transactions that are to be recorded on the debit side (left side) and on the credit side (right side) depends on the nature of item for which account is to be prepared. i.e. whether the account represents an Asset / Liability / Expense / Income / Capital.
- The rules for debiting / crediting the various account types are given below –(Accounting Equation Approach)

Account Type	Transactions entered on Left Side (i.e. DEBITED)	Transactions entered on Right Side (i.e. CREDITED)
(a) Assets	All transactions which INCREASE the balances of Assets i.e. Purchase of Fixed Assets, Investments, Stock, etc.	All transactions which DECREASE the balances of Assets i.e. Sale of Fixed Assets, Investments, Stock, etc.
(b) Liabilities	Transactions which DECREASE the liabilities i.e. Payment to Creditors, repayment of Loans taken, etc.	All transactions which INCREASE the balances of Liabilities. Purchase of goods on credit, taking fresh loans, etc.
(c) Equity / Capital	Transactions which DECREASE the Capital i.e. withdrawal of Capital by Proprietor, Partners, etc.	Transactions which INCREASE the Capital, i.e. Introduction of fresh Capital.
(d) Incomes / Gains	Transactions which DECREASE the Incomes, i.e. Sales Returns, etc.	Transactions which INCREASE the Incomes, i.e. Sale of goods, Interest, Rent, Dividends, Discount earned, etc.
(e) Expenses / Losses	Transactions which INCREASE the Expenses, i.e. incurring Salary, Rent, Interest, and Other Expenses.	Transactions which DECREASE the Expenses, reimbursement of expenditure by way of grants, etc.

3. Summary of above table:

- Increase in Equity / Liabilities / Incomes represent Credits, while decreases thereof are Debits.
- Increase in Assets / Expenses represent Debits, while decreases thereof are Credits.

B. Example for Accounting using Accounting Equation Approach

Mr.X has the following transactions. Show how the following transactions are to be shown under Cash Account –

Particulars	Impact on Cash	Side (Note)
(a) Cash introduced into the business by X ₹ 1,00,000	Increases (comes into business)	Debit
(b) Cash Purchases made for ₹ 10,000	Decreases (cash goes to supplier)	Credit
(c) Credit Purchases made for ₹ 12,000	No Impact (no cash involved)	N.A.
(d) Cash paid to Creditors ₹ 5,000	Decreases (cash goes to creditor)	Credit
(e) Cash Sales: ₹ 14,000	Increases (cash recd. from customers)	Debit
(f) Credit Sales: ₹ 10,000	No Impact (no cash involved)	N.A.
(g) Cash received from debtors: ₹ 7,000	Increases (cash recd. from customers)	Debit
(h) Expenses paid in cash: ₹ 5,000	Decreases (cash paid to customers)	Credit

Note: Since Cash is an Asset, the Cash Account shall be debited if Cash increases. It shall be credited if it decreases.

Hence, the Cash Account will look as below –

Cash Account				Cr.			
Date	Particulars	Ref.	(₹)	Date	Particulars	Ref.	(₹)
	Opening Balance		Nil		By Cash Purchases		10,000
	To Cash introduced		1,00,000		By Cash paid to Creditors		5,000
	To Cash Sales		14,000		By Expenses paid in cash		5,000
	To Cash received from debtors		7,000		By Closing Balance (Note) (1,21,000 – 20,000)		1,01,000
	Total		1,21,000		Total		1,21,000

Notes:

1. Closing Balance =
 - (a) Debit Side Total – Credit Side Total (if Debit Side Total is higher)
 - (b) Credit Side Total – Debit Side Total (if Credit Side Total is higher)
2. The Closing Balance is entered on the side whose total is lower. In the above case, Debit side total is ₹ 1,21,000, while the credit side total is ₹ 20,000 only. Hence, the debit side total is greater than the credit side total. So, the closing balance has to be entered on the credit side.
3. The above balance implies that the business of Mr.X has a cash balance of ₹ 1,01,000.

C. Nature of Balance in each Nature of Account

1. **Nature of Balance:** An A/c may have **any ONE of the following balances** – (Only one type of balance possible at a time)

(a) "Debit Balance Account"	Total of Debit Side > Total of Credit Side
(b) "Credit Balance Account"	Total of Credit Side > Total of Debit Side
(c) "Nil Balance Account"	Total of Debit Side = Total of Credit Side

2. **Type of Account and Nature of Balance:**

Type of Account	Debit Side Records	Credit Side Records	Nature of Balance
Assets	Increases	Decreases	Debit Balance
Liabilities	Decreases	Increases	Credit Balance
Capital	Decreases	Increases	Credit Balance
Incomes	Decreases	Increases	Credit Balance
Expenses	Increases	Decreases	Debit Balance

3. **Illustration:** Refer Cash A/c above. Cash Account is in the nature of Asset Account. So, it has debit balance.

1.5 Traditional Approach – Golden Rules of Accounting

1. This is the commonly used method for accounting the transactions. These rules form basis for accounting.

2. **Principle:** The **Golden Rules of Accounting** in respect of the Double Entry System are –

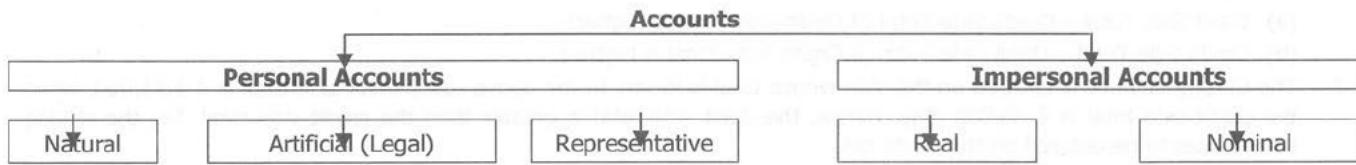
Nature of Account	When Debited	When Credited
1. Personal Account	Debit the Receiver of Benefit	Credit the Giver of Benefit
2. Real Account	Debit What comes in	Credit What goes out
3. Nominal Account	Debit All Expenses and Losses	Credit All Incomes and Gains

Note: Also Refer meaning of the above Rules below

3. *The entries that should come on the Debit and Credit side of an account are based on the nature of that account. Hence, it is essential to understand the meaning of the nature of the Accounts (Refer below)*
4. **Common Sense Rules for Accounting** (Additional Rules): The following rules are in addition to Golden Rules specified above. These will be useful in accounting the transaction.
 - (a) If a Debit Balance Account has to be increased, further debit that Account. (write on left side of the account)
 - (b) If a Debit Balance Account has to be decreased, then credit that account. (write on right side of the account)
 - (c) If a Credit Balance Account has to be increased, further credit that Account. (write on right side of the account)
 - (d) If a Credit Balance Account has to be decreased, then debit that Account. (write on left side of the account)

Students' Notes:

- **Area of Usage:** The Golden Rules and also the Common Sense Rules are applicable for accounting the transactions in Journal and Subsidiary Books. (Discussed later in this chapter).
- Students are advised to remember the above rules clearly to get control over the subject of Accountancy.



These are explained below –

	Type of Account	Description and Examples												
Personal Accounts	(a) Natural Personal Accounts	All Accounts which record transactions of natural human beings , i.e. Ram, Lakshman, Krishna, Joseph, Kabir, Debtors, Creditors, etc.												
	(b) Artificial (Legal) Personal Accounts	All Accounts which record the transactions with other business entities having separate legal status for accounting purposes, i.e. Ram Industries Limited (Company), Aditya & Co, (Partnership Firm), Krishna & Co. (say Proprietary Firm), Co-Operative Societies, Clubs, Government, Banks, Debtors, Creditors etc.												
	(c) Representative Personal Accounts	All Accounts which indirectly represent the persons . Example – <table border="1"> <thead> <tr> <th>Name of the Account</th> <th>Indirectly represents</th> </tr> </thead> <tbody> <tr> <td>Capital Account</td> <td>Owner</td> </tr> <tr> <td>Outstanding Expenses Account</td> <td>Service Provider / Supplier (e.g. O/s Rent represents Landlord)</td> </tr> <tr> <td>Prepaid Expenses/Expenses paid in advance A/c</td> <td>Service Provider / Supplier</td> </tr> <tr> <td>Accrued Incomes</td> <td>Customers</td> </tr> <tr> <td>Incomes received in advance</td> <td>Customers</td> </tr> </tbody> </table>		Name of the Account	Indirectly represents	Capital Account	Owner	Outstanding Expenses Account	Service Provider / Supplier (e.g. O/s Rent represents Landlord)	Prepaid Expenses/Expenses paid in advance A/c	Service Provider / Supplier	Accrued Incomes	Customers	Incomes received in advance
Name of the Account	Indirectly represents													
Capital Account	Owner													
Outstanding Expenses Account	Service Provider / Supplier (e.g. O/s Rent represents Landlord)													
Prepaid Expenses/Expenses paid in advance A/c	Service Provider / Supplier													
Accrued Incomes	Customers													
Incomes received in advance	Customers													
Note: All Liabilities will fall under "Personal Accounts"														
Impersonal Accounts	(a) Real Accounts	All Accounts which record transactions relating to Assets of the Firm (but not except those covered under Personal A/c above – i.e. Debtors, Prepaid expenses etc.) Example: Building, Machinery, Other Fixed Assets, Investments, Cash, Bank, etc.												
	(b) Nominal Accounts	All Accounts which record transactions relating to – <ul style="list-style-type: none"> Incomes / Gains, e.g. Sales, Rent / Interest / Dividend / Commission Received, Profit on Sale of Fixed Assets / Investments, etc. Expenses / Losses, e.g. Salary, Wages, Rent Paid, Insurance, Bad Debts, Depreciation, Discounts allowed, etc. 												

Note: For the sake of convenience in accounting, the above type of accounts are summarized as –

(a) Personal Accounts, (b) Real Accounts, and (c) Nominal Accounts.

Note: Classification of Accounts in Specified Cases

Account Head	Type of A/c	Nature of A/c	Nature of balance
1. Tangible Fixed Assets, e.g. Land, Building, Machinery, Plant, Furniture etc.	Assets	Real	Debit
2. Intangible Fixed Assets, e.g. Goodwill, Trademarks, Patents, Copyrights etc.	Assets	Real	Debit
3. Investments e.g. Fixed Deposits, Government Bonds, Shares etc.	Assets	Real	Debit
4. Stock in Trade / Stock in Hand (i.e. Closing Stock)	Assets	Real	Debit
5. Sundry Debtors/Trade Debtors (arising due to credit sales made by Firm)	Assets	Personal*	Debit
6. Prepaid Expenses / Advance given to Suppliers / Service providers	Assets	Personal*	Debit
7. Loans and Advances Receivable (i.e. Loans given by the Firm to outsiders, and receivable subsequently)	Assets	Personal*	Debit
8. Accrued Incomes (i.e. Sales/Services rendered, but amount not received)	Assets	Personal*	Debit
9. Bank Balances (Positive Bank Balance)	Assets	Personal*	Debit
10. Capital (or) Equity, i.e. Capital of Proprietor / Partners, Equity / Preference Share Capital in case of Company	Liabilities	Personal	Credit

Account Head	Type of A/c	Nature of A/c	Nature of balance
11. Long Term Loans taken, i.e. Bank Term Loan, Machinery Loan, Building loan	Liabilities	Personal	Credit
12. Loans and Advances Payable (i.e. Loans taken by the Firm from outsiders, and repayable subsequently)	Liabilities	Personal	Credit
13. Sundry Creditors / Trade Creditors (i.e. arising out of purchases made by the Firm on credit)	Liabilities	Personal	Credit
14. Expense Creditors, i.e. Outstanding Expenses like Rent Payable, Salaries and Wages Payable, Tax Payable, etc.	Liabilities	Personal	Credit
15. Income received in advance / Advances received from customers	Liabilities	Personal	Credit
16. Bank Overdraft (Negative Bank Balance)	Liabilities	Personal	Credit
17. Bank Loan (Indirectly represents Bank. So Representative Personal A/c)	Liabilities	Personal	Credit
18. Income Accounts, e.g. Sales, Interest received, Dividend, etc.	Incomes	Nominal	Credit
19. Gains , e.g. Profit on Sale of Fixed Assets	Gains	Nominal	Credit
20. Expenditure Accounts, e.g. Purchases, Interest paid, Salary, Rent, etc.	Expenses	Nominal	Debit
21. Losses , e.g. Loss due to fire, Bad Debts, Accidents, etc.	Losses	Nominal	Debit

* **Note:** Such accounts though fall under the category of "Assets", they shall fall under "Personal Account", since they directly / indirectly represent persons (natural or artificial persons). Loans given indirectly represent the person who received it.

Refer the end of this chapter for Types, Nature of Accounts and Balances of various items.

1.7 Determination of Profits and Losses – 2 Approaches

Meaning of Profits / Losses and Financial Position

- Profit / Losses:** The Main Purpose of a business is to achieve profits. "Profits" means Excess of Incomes over expenses. "Losses" refers to excess of Expenses over Incomes. Hence, **Profits / Losses are concerned with Incomes / Gains and Expenses / Losses of the business. (Otherwise called as Operating Results)**
- Financial Position:** It refers the wealth of the business. A business is wealthier when it has more assets and less outside liabilities. Hence, **Financial Position is concerned with the assets and Liabilities of the business.**

Determination of Profits / Losses and Financial Position

- The Operating Results and Financial Position of the business can be determined through any of the following methods
(a) Accounting Equation Approach (b) Traditional Approach.

2. Using Accounting Equation Approach:

Purpose	Method of Determination
Determination of Profits / Losses	Step I: Find the difference between [Closing Capital – Opening Capital] Step II: If above difference > 0 \Rightarrow Profits; If Difference < 0 \Rightarrow Losses Note: Capital = Total Assets – Total Liabilities
Determination of Financial Position	A Statement is prepared showing all ASSETS on right side and all LIABILITIES on left side . The Total of Assets and Liabilities shall be equal.

3. Using Traditional Approach: (This is the popular method)

Purpose	Method of Determination
Determination of Profits / Losses	<ul style="list-style-type: none"> Prepare two Accounts—"Trading Account and Profit & Loss Account". Those two accounts compare the Incomes and Expenses to ascertain the profits.
Determination of Financial Position	<ul style="list-style-type: none"> Balance Sheet is prepared: It is a Statement showing all ASSETS on right side and all LIABILITIES on left side. The Total of Assets and Liabilities shall be equal.

Set the Accounting Equation for the following data and calculate the Profit for the year. (Information in ₹)

Particulars	As at the beginning of the year	As at the end of the year
Machinery	1,00,000	90,000
Furniture and Fixtures	60,000	50,000
Stock	85,000	1,25,000
Trade Debtors / Receivables	38,000	56,000
Cash and Bank Balances	25,000	28,000
Bank Loan (long-term)	75,000	50,000
Trade Creditors	35,000	42,000
Expense Creditors	15,000	18,000

Solution:

(a) **Determination of Profits – Comparison of Opening and Closing Capital –**

Particulars	Beginning of the year	End of the year
Fixed Assets:		
Machinery	1,00,000	90,000
Furniture & Fixtures	60,000	50,000
Current Assets:		
Stock	85,000	1,25,000
Trade Debtors / Receivables	38,000	56,000
Cash and Bank Balances	25,000	28,000
Total Assets (A)	3,08,000	3,49,000
Liabilities:		
Bank Loan (Long-Term)	75,000	50,000
Trade Creditors (Short-Term)	35,000	42,000
Expense Creditors (Short-Term)	15,000	18,000
Total Liabilities (B)	1,25,000	1,10,000
Capital (or) Equity = A – B	1,83,000	2,39,000

Profit earned during the year = Closing Capital – Opening Capital = 2,39,000 – 1,83,000 = **56,000**.

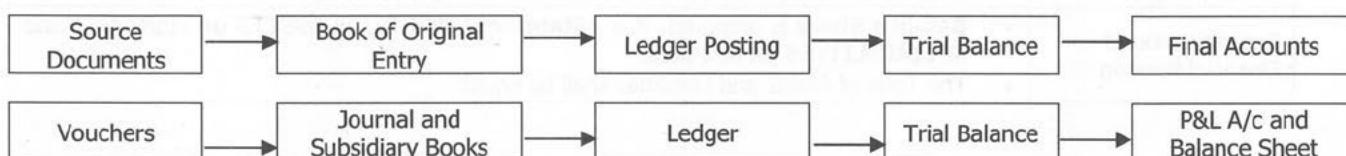
(b) **Determination of Financial Position at the YEAR END— Preparation of Statement containing Assets and Liabilities –**

Liabilities	₹	Assets	₹
Capital (Opening Capital + Profits)	2,39,000	Fixed Assets:	
		Machinery	90,000
		Furniture & Fixtures	50,000
Other Liabilities:		Current Assets:	
Bank Loan (Long-Term)	50,000	Stock	1,25,000
Trade Creditors (Short-Term)	42,000	Trade Debtors / Receivables	56,000
Expense Creditors (Short-Term)	18,000	Cash and Bank Balances	28,000
Total Liabilities	3,49,000	Total Assets	3,49,000

2. Journal

2.1 Phases in the Accounting Process – Traditional Approach

The following Accounts Books / Phases to be followed for determination of Profits / Financial Position of the business.



- Journalisation of Transactions and Events:** Journal is the **Initial Accounts Book** in which the transactions are **RECORDED** on their occurrence. It is similar to a **Financial Diary**. Here Transaction is recorded date-wise. In certain cases, **Subsidiary Books** are prepared instead of Journal.
- Ledger Posting and Balancing:** Based on the entries in the Journal, **Accounts are prepared** in the Ledger. Here, all transactions related to a particular Account Head are grouped under a particular account. For Example, all transactions involving cash will be recorded under "Cash Account". Bank transactions recorded under "Bank Account".
- Preparation of Trial Balance:** After ledger posting, a **Statement** called as "**Trial Balance**" is prepared, which contains the balances in all the ledger accounts. Debit Balances and Credit Balances are grouped under separate columns. The total of Debit Balance Column must be equal to the Total of the Credit Balance Column. Hence, Trial Balance is a consolidation of all ledger account balances.
- Preparation of Financial Statements:** For Determination of Operating Results and the Financial Position of the business, the following accounts or statements are prepared –

(a) Performance Statement i.e. Trading Account and Profit & Loss Account	To find out the profit made or loss sustained in a particular accounting period through transactions and events,
(b) Position Statement , i.e. the Balance Sheet	To explain the financial position of the reporting entity at the end of the accounting period, and
(c) Cash Flow Statement	To analyse the pattern of movement in cash and Bank

2.2 Journal – Meaning

- Meaning:**
 - Journal is the Book of Primary Entry / Book of Original Entry.**
 - It is the **Initial Accounts Book** in which the transactions are **RECORDED** on their occurrence.
 - Entry** is made in this book to show which Account should be debited and which Account should be credited.
- Features of Journal:**
 - Once a transaction happens, it is analysed to determine the Debit aspect and Credit aspect and entered in Journal.
 - All transactions are first recorded in the Journal Book as and when they occur. Hence, the Journal is maintained in **chronological**, i.e. Date-wise order.
 - The Journal is referred to as **Subsidiary Book**(as entries are posted from this book into **Ledger** subsequently.)
- Purposes of Journal:** Based on Dual Aspect Concept, every transaction has two equal aspects – Debit and Credit. Hence, it is essential to identify the accounts which are involved and to decide the accounts to be debited / credited.
- Journalising:** Recording entries in Journal is called "Journalising the Entries". Each entry is called as "Journal Entry".
- Source for recording:** The sources available for recording in the Journal are (a) Vouchers (b) Documents (c) Invoices.

6. The format of the Journal is as under –

Date	Particulars	Ledger Folio (LF)	Debit Amt (₹)	Credit Amt (₹)
(1)	(2)	(3)	(4)	(5)
31.01.11	Cash A/c Dr. To Ramesh A/c (Being Cash received from Ramesh)	100 250	10,000 ← → 10,000	

↓ ↓ ↓
Narration **Cash A/c is in 100th Page in Ledger** **EQUAL**

Column	Explanation
(1)	Date on which the particular transaction happens
(2)	<ul style="list-style-type: none"> Details of which account is to be debited and credited is given here. Debit Account is written first as..... Credit Account is written next as Explanation relating to the transaction is given in brief. This is called Narration. This is very crucial for understanding the Journal Entry. An Entry without Narration is not valid.

Column	Explanation
(3)	This Column stands for the Page Number in the Ledger in which the posting is given subsequently. This Column is intended only to track and trace the entry into the Ledger.
(4)	Amounts to be debited in the various accounts are recorded in this Column.
(5)	Amounts to be credited in the various accounts are recorded in this Column.

Notes:

- Debit and Credit Totals of the Journal Entry should always tally.
- When Journal Entries run to various pages, the total of each page (debit and credit totals separately) should be carried forward to the next page.

7. Types of Journal Entries:

Type	Meaning	Example
Simple Journal Entry	One Debit and One Credit present for equal amount	Refer Journal Entries under "Capital"
Compound or Composite Journal Entry	It is a journal entry which contains one debit and two or more credits / two or more debits and one credit / two or more debits and credits.	Refer Journal Entry for "Profit / Loss on sale of fixed assets" (below)

8. Advantages of Journal:

- Since Journal is maintained in chronological, i.e. datewise order, **complete information** on day-to-day transactions can be obtained.
- Journal forms the basis for posting the entries into the **Ledger** subsequently.
- Narration to Journal Entries provides explanation for the **nature and purpose** of transaction.

9. Subsidiary Books: In certain cases, instead of Journal, Subsidiary Books are maintained.

2.3 Steps for a Journal Entry

Steps	Procedure
Step I	Determine whether a transaction is Financial/Non-Financial transaction. Only Financial Transaction is recorded in the Journal.
Step II	Analyse the transaction to identify what are the two Aspects / accounts involved in the transaction. (a) One Aspect / Account can be easily identified from the reading of the transaction itself (b) Second Account can be found out by asking any of the questions – "For What / By What/ Of What/ For Whom / By Whom / To Whom / On What" – Answer to these questions will identify another A/c
Step III	Determine the nature of the each of the two accounts involved in the transaction. i.e. whether the account belongs to Personal Account / Real Account / Nominal Account. (For classification, refer earlier discussions)
Step IV	Determine the accounts which are to be Debited and Credited. For this, Apply the Golden Rules / Common Sense Rules of Accounting based on the nature of accounts (as identified above). (For Golden Rules and Common Sense Rules, Refer earlier discussions)
Step V	Identify the amount involved. Ensure that the amount of debit and credit must be equal. Then write the Journal Entry along with the narration in the format mentioned above

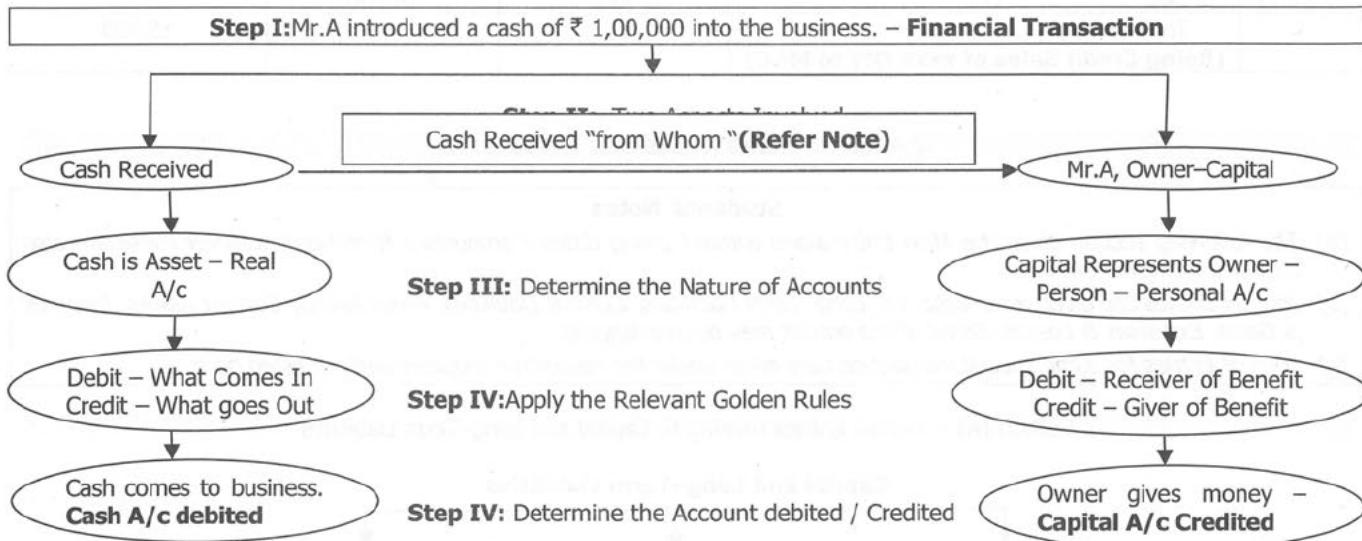
2.3.1 Meaning of the Golden Rules of Accounting

Nature	Rule	Meaning of the Rule
Personal A/c	Debit the Receiver of Benefit	Write on the Debit / Left side of an Account which represents a person, if that person receives money from the business.
	Credit the Giver of Benefit	Write on the Credit / Right side of an Account which represents a person, if that person gives money to the business.
Real Account	Debit What Comes In	Write on the Debit / Left side of a Real A/c, if an asset comes into business (Increases)
	Credit What Goes out	Write on the Credit / Right side of a Real A/c, if an asset goes out of business (Decreases)
Nominal Account	Debit all Expenses and Losses	Write on the Debit / Left side of an account, which represents an expense / loss. Note: Reduction in incomes is considered as Expenses / Losses (For eg. Sales Returns)
	Credit all Incomes and Gains	Write on the Credit / Right side of an account, which represents an income / gain Note: Reduction in Expenses / Losses is considered as Incomes. (For eg. goods purchased drawn for personal use, Purchase Returns)

2.3.2 Steps for Journal Entry

Transaction I: Mr.A introduced a cash of ₹ 10,000 into the business A & Co. on 31st January

The Process of Journal Entry is as under – (Compare steps below with the format for understanding)



Date	Particulars	Ledger Folio (LF)	Debit Amt (₹)	Credit Amt (₹)
(1)	(2)	(3)	(4)	(5)
31.01.11	Cash A/c Dr.	xxx	1,00,000	
	To Capital A/c	xxx		1,00,000

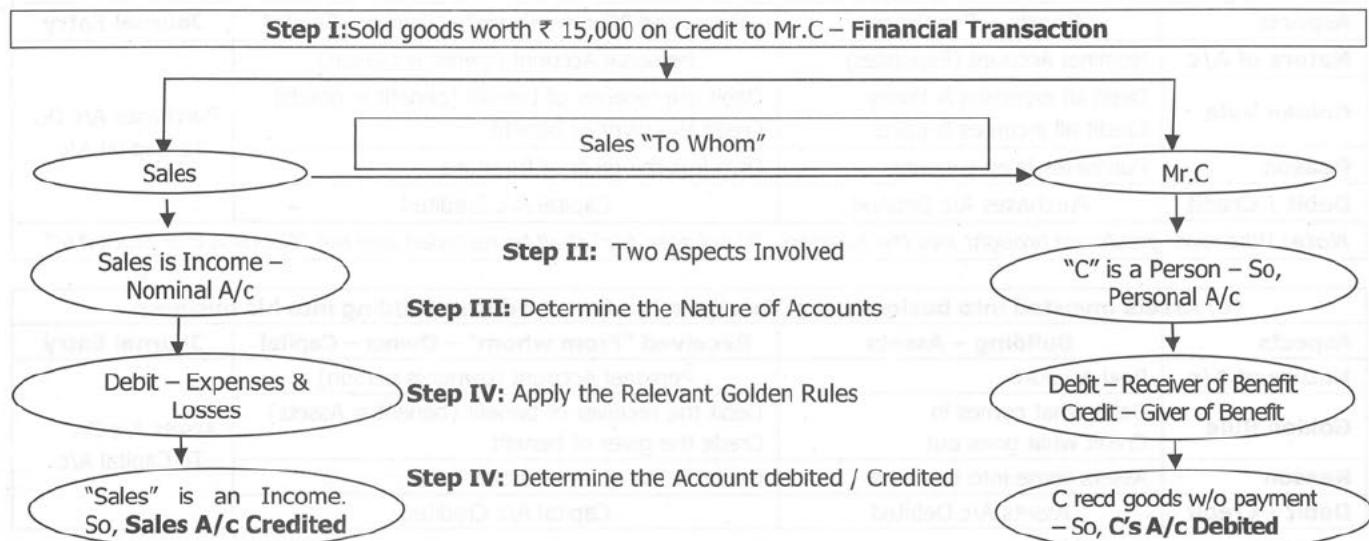
(Being cash invested by A as capital)

Note – Identification of Two Accounts involved:

- (a) **One Account involved – Cash Account** (identified as the term "Cash" is specified)
- (b) **Second Account involved –** Sequentially ask the questions given above. The proper question is "By Whom" i.e. introduced cash of ₹ 10,000 into the business – By Whom? The Answer will be "**Mr.A, the Owner**"
- (c) **Hence, two aspects / accounts involved are (a) Cash (b) Mr.A, the owner.**

Transaction II: Sold goods worth ₹ 15,000 on Credit to Mr.C on 2nd February

The Process of Journal Entry is as under – (Compare steps below with the format for understanding)



Step V: Amount Involved – ₹ 15,000; Hence the Journal Entry looks as under –

Date	Particulars	Ledger Folio (LF)	Debit Amt (₹)	Credit Amt (₹)
(1)	(2)	(3)	(4)	(5)
02.02.11	C's A/c Dr.	xxx	15,000	
	To Sales A/c	xxx		15,000
	(Being Credit Sales of xxxx Qty to Mr.C)			

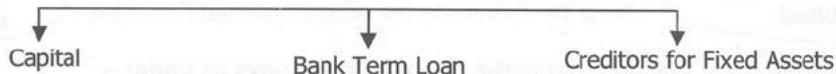
2.4 Journal Entries for Business Transactions

Students' Notes

- (a) The following section gives the Main Entry alone without giving dates / amounts / Narration. However these are also part of the Journal Entries.
- (b) Journal Entries are given area-wise. i.e. Long-Term Liabilities, Current Liabilities, Fixed Assets, Current Assets, Incomes & Gains, Expenses & Losses. Some of the entries may be overlapping.
- (c) Journal Entries for some special transactions are given under the respective chapters and not listed here.

Section (A) – Journal Entries relating to Capital and Long-Term Liabilities

Capital and Long-Term Liabilities



(A.I.) Transactions related to Capital

1. Capital brought into business (Both at the time of commencement of business and subsequently)

(a) Cash invested into business

Aspects	Cash	Received "From whom" – Owner – Capital	Journal Entry
Nature of A/c	Real Account (Asset)	Personal Account (owner is person)	
Golden Rule	Debit what comes in Credit what goes out	Debit the receiver of benefit (benefit = money) Credit the giver of benefit	
Reason	Cash comes into business	Owner is the giver of money	
Debit / Credit	Cash A/c Debited	Capital A/c Credited	Cash A/c Dr. To Capital A/c

(b) Goods invested into business, e.g. Furniture Dealer introduces Furniture as capital

Aspects	Goods – Purchases	Received "From whom" – Owner – Capital	Journal Entry
Nature of A/c	Nominal Account (Expenses)	Personal Account (owner is person)	
Golden Rule	Debit all expenses & losses Credit all incomes & gains	Debit the receiver of benefit (benefit = goods) Credit the giver of benefit	
Reason	Purchases is an expense	Owner is the giver of furniture	
Debit / Credit	Purchases A/c Debited	Capital A/c Credited	Purchases A/c Dr. To Capital A/c

Note: Whenever goods are brought into the business, "Purchases A/c" shall be recorded and not "Goods A/c or Stock A/c"

(c) Assets invested into business, e.g. Furniture Dealer introduces Building into his business

Aspects	Building – Assets	Received "From whom" – Owner – Capital	Journal Entry
Nature of A/c	Real Account	Personal Account (owner is person)	
Golden Rule	Debit what comes in Credit what goes out	Debit the receiver of benefit (benefit = Assets) Credit the giver of benefit	
Reason	Assets come into business	Owner is the giver of assets	
Debit / Credit	Assets A/c Debited	Capital A/c Credited	Assets A/c Dr. To Capital A/c

2. Withdrawals by the Owner from the business

(a) Cash / Assets withdrawn by Owner for personal purposes / Cash paid from business for personal use

Aspects	Cash / Assets	Paid "For whom" – Owner – Capital	Journal Entry
Nature of A/c	Real Account (Assets)	Personal Account (owner is person)	Capital A/c (OR) Drawing A/c Dr. To Cash A/c (OR) Assets A/c
Golden Rule	Debit what comes in Credit what goes out	Debit the receiver of benefit (benefit = Assets) Credit the giver of benefit	
Reason	Cash Goes out of business	Owner is the receiver of cash	
Debit / Credit	Cash A/c / Assets A/c Credited	Capital A/c Debited (OR) Drawings A/c Debited	

Note: "Income Tax paid" by the business is considered as expenses by the owner for personal purposes. Since Income Tax is a personal liability of the owner, payment towards it is considered drawings.

(b) Goods withdrawn by the Owner for personal purposes

Aspects	Goods – Purchases	Withdrawn "By whom" – Owner – Capital	Journal Entry
Nature of A/c	Nominal Account (Expenses)	Personal Account (owner is person)	Capital A/c Dr. To Purchases A/c
Golden Rule	Debit all expenses & losses Credit all incomes & gains	Debit the receiver of benefit (benefit = goods) Credit the giver of benefit	
Reason	"Purchases" is an Expense. But it is reduced. So it is an Income (Refer Golden Rules)	Owner is the receiver of goods	
Debit / Credit	Purchases A/c Credited	Capital A/c Debited	

(A.II.) Transactions related to Bank Term Loans

1. Term Loans received from Bank (Loan received in Cheque)

Aspects	Cheque – Bank	Received "From whom" – Lender	Journal Entry
Nature of A/c	Personal Account (Bank is person)	Personal Account (Lender is person)	Bank A/c Dr. To Bank Loan A/c
Golden Rule	Debit the Receiver of benefit Credit the Giver of benefit	Debit the Receiver of benefit (benefit = Money) Credit the Giver of benefit	
Reason	Bank receives money on our behalf and keeps in our Bank A/c	Bank is the Giver of money	
Debit / Credit	Recipient Bank A/c Debited	Bank Loan A/c Credited	

Note: The Loan cheque given by one bank is deposited into a Bank Account kept with the same Bank / another Bank.

2. Interest Paid / Payable on Term Loans – Refer under Expenses

3. Repayment of Term Loans by Cheque

Aspects	Term Loan – represents lender	Paid "By What" – Cheque – implies Bank	Journal Entry
Nature of A/c	Personal A/c (Lender is person)	Personal Account (Bank is person)	Bank Loan A/c Dr. To Bank A/c
Golden Rule	Debit the Receiver of benefit Credit the Giver of benefit	Debit the Receiver of benefit (benefit = Money) Credit the Giver of benefit	
Reason	Lender receives money	Bank is the Giver of that money	
Debit / Credit	Bank Loan A/c Debited	Giver Bank A/c Credited	

(A.III.) Transactions related to "Creditors for Fixed Assets"

1. Purchase of Fixed Assets on Credit, e.g. Purchase of Machinery, Motor Vehicle on credit

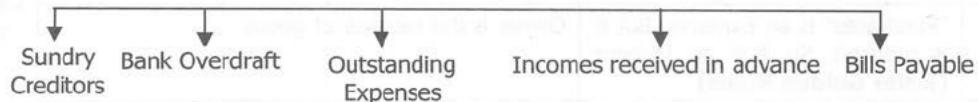
Aspects	Fixed Asset	Received "From whom" – Creditor for F.A.	Journal Entry
Nature of A/c	Real Account (Asset)	Personal Account (Creditor is Person)	
Golden Rule	Debit what comes in Credit what goes out	Debit the receiver of benefit (benefit =F.A.) Credit the giver of benefit	Fixed Asset A/c Dr. To Creditor for Fixed Asset A/c
Reason	Fixed Asset comes into business	Creditor is the giver of Fixed asset on credit	
Debit / Credit	Fixed Asset A/c Debited	"Creditor for Fixed Asset A/c" Credited	

2. Interest Paid / Payable on Term Loans – Refer under Expenses

3. Repayment of Term Loans by Cheque – Same as Repayment of Bank Term Loans

Section (B) – Journal Entries relating to Current Liabilities

Current Liabilities



(B.I.) Transactions related to "Sundry Creditors"

1. Purchase of Goods on Credit (i.e. Pen Dealer purchased pens on credit from Mr.Z for ₹ 10,000)

Aspects	Goods (Pens) – Purchases	Received "From whom" – Creditor (Z)	Journal Entry
Nature of A/c	Nominal Account (Expenses)	Personal Account (Creditor is person)	Purchases A/c Dr. To Creditors A/c
Golden Rule	Debit all Expenses and Losses Credit all Incomes and Gains	Debit the receiver of benefit (benefit =Goods) Credit the giver of benefit	For Example: Purchases A/c Dr. To Z A/c
Reason	"Purchases" is business expense	Creditor is the giver of Goods	
Debit / Credit	Purchases A/c Debited	"Creditors Account" Credited	

2. Settlement of amount due to Creditor by Cash for ₹ 9,500

Aspects	Cash	Paid "To whom" – Creditor (Z)	Journal Entry
Nature of A/c	Real Account (Asset)	Personal Account (Creditor is person)	Creditors A/c Dr. To Cash A/c
Golden Rule	Debit what comes in Credit what goes out	Debit the receiver of benefit (benefit =Cash) Credit the giver of benefit	For Example: Z A/c Dr. To Cash A/c
Reason	Cash Goes out of business	Creditor is now receiving money	
Debit / Credit	Cash A/c Credited	"Creditors Account" Debited	

3. Settlement of amount due to creditor by Cheque

Aspects	Cheque – Bank	Paid "To whom" – Creditor (Z)	Journal Entry
Nature of A/c	Personal Account (Bank is person)	Personal Account (Creditor is person)	Creditors A/c Dr. To Bank A/c
Golden Rule	Debit the receiver of benefit Credit the giver of benefit	Debit the receiver of benefit (benefit =Cash) Credit the giver of benefit	For Example: Z A/c Dr. To Bank A/c
Reason	Bank Pays money on our behalf	Creditor is now receiving money	
Debit / Credit	Bank A/c Debited	"Creditors Account" Debited	

4. Discount Received; Example: Credit Purchases: ₹ 10,000, Payment: ₹ 9,500, Discount: ₹ 500

Aspects	Discount Received	Allowed "By whom" – Creditor (Z)	Journal Entry
Nature of A/c	Nominal Account (Income)	Personal Account (Creditor is person)	
Golden Rule	Debit all Expenses and Losses Credit all Incomes and Gains	Debit the Receiver of benefit (benefit =Cash) Credit the Giver of benefit	Creditors A/c Dr. To Discount Received A/c
Reason	Reduction in Purchases amount. So, reduction in expense = Income	Creditor receives money before the due date. So, he gets the benefit of early receipt of cash.	
Debit / Credit	Discount Received A/c Credited	Creditors Account Debited	

Note: One more reason for debiting Mr.Z Account – (with the help of example mentioned above)

- (a) At the time of Credit Purchases, Z account is Credited with ₹ 10,000
- (b) Now, at the time of Settlement, Z account is debited with ₹ 9,500
- (c) Hence, there is still a credit balance of ₹ 500 in Z's Account [10,000 (Cr.) – 9,500 (Dr.)]. But this amount will not be paid to Z as discount is allowed for the balance ₹ 500. Hence, Strictly, Z's Account must show **Zero Balance**.
- (d) So, the Credit Balance of ₹ 500 in Z's A/c to be decreased to Zero. As per Common Sense Rules, if a Credit balance account to be decreased, then we have to debit that account. So, Z's A/c is debited with ₹ 500.

(B.II.) Transactions in "Bank Overdraft"

Same as the Journal Entries under "Bank A/c" in Current Assets

(B.III.) Transactions related to "Outstanding Expenses"

1. Expenses due but not yet paid(e.g. Rent ₹ 1,000 p.m. paid for 11 months, Last Month Outstanding)

Aspects	Rent	Payable "To whom" – Land Lord	Journal Entry
Nature of A/c	Nominal Account (Expenses)	Personal Account (Creditor is person)	
Golden Rule	Debit all Expenses and Losses Credit all Incomes and Gains	Debit the Receiver of benefit (benefit =Goods) Credit the Giver of benefit	Expenses A/c Dr.To O/s Expense A/c
Reason	"Rent" is business expense	Landlord is the giver of building for use.	For Example: Rent A/c Dr.1,000 To O/s Rent A/c
Debit / Credit	Rent A/c Debited	Hence, he is to be credited. So, a Representative Personal Account "Outstanding Rent" credited	

2. Payment of Outstanding Expenses

Aspects	Cash	Paid "To whom" – Landlord	Journal Entry
Nature of A/c	Real Account (Asset)	Personal Account (Creditor is person)	
Golden Rule	Debit what comes in Credit what goes out	Debit the receiver of benefit (benefit =Cash) Credit the giver of benefit	O/s Expense A/c Dr. To Cash A/c
Reason	Cash Goes out of business	Landlord is now receiving money	For Example: O/s Rent A/c Dr. To Cash A/c
Debit / Credit	Cash A/c Credited	Hence, a representative Personal Account "Outstanding Rent" Credited	

(B.IV.) Transactions related to "Incomes received in advance"

1. Sales not yet made. But Customer has given the money(e.g. Cash Received as advance from Y ₹ 20,000)

Aspects	Cash /Cheque	Received "From whom" – Customer	Journal Entry
Nature of A/c	Real Account (Asset)	Personal Account (Customer is person)	
Golden Rule	Debit what comes in Credit what goes out	Debit the receiver of benefit (benefit =cash) Credit the giver of benefit	Cash A/c Dr.20,000 To Income received in advance A/c
Reason	Cash comes into the business	Customer is the giver of money.	
Debit / Credit	Cash A/c Debited	Hence, he is to be credited. However, a Representative Personal Account "Income received in advance A/c" credited	

Note: Alternative Journal Entry exists for receipt of advances. Refer Chapter on Financial Statements for discussion.

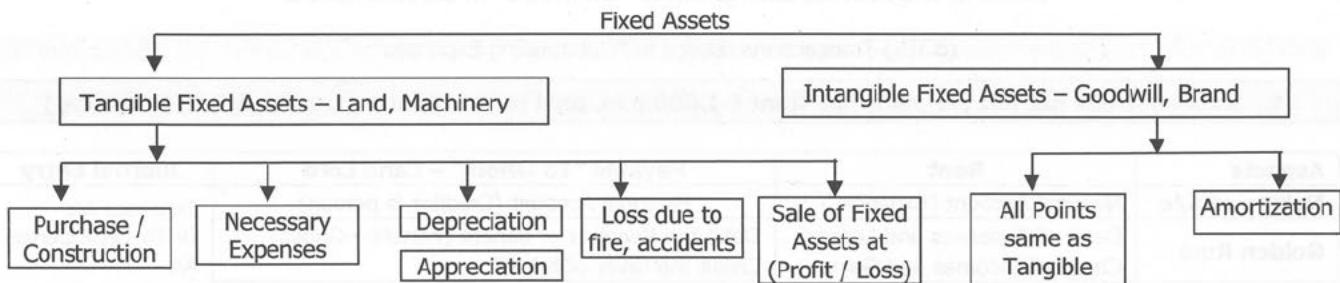
2. When Sales actually made / Services actually rendered
 (e.g. in the above case, Sales made a week after receipt of advance – ₹ 20,000)

Aspects	Sales	Receivable "From whom" – Customer	Journal Entry
Nature of A/c	Nominal Account (Income)	Personal Account (Customer is person)	
Golden Rule	Debit all Expenses & Losses Credit all Incomes & Gains	Debit the Receiver of benefit (benefit =Cash) Credit the Giver of benefit	Income received in advance A/c Dr. To Income A/c Eg.
Reason	Sales is an Business Income	Customer has already paid money. Hence, the income due from him will be adjusted against the advances given)	Income received in advance A/c Dr. 20,000 To Sales A/c
Debit / Credit	Sales A/c Credited	Hence, the Representative Personal Account "Income Received in advance A/c" Debited	

(B.V.) Transactions related to "Bills Payable"

Refer Chapter on "Bills of Exchange"

Situation (C) – Transactions related to Fixed Assets



Accounting for Investments: Journal Entries for Investments are same as given for Fixed Assets. Investments A/c should be accounted instead of Fixed Assets A/c. For Investments, Necessary expenses include Brokerage charges, which should be debited to Investments Account and not to the Brokerage Expenses Account.

(C.I.) Transactions related to "Tangible Fixed Assets"

1. Purchase / Construction of Fixed Assets for Cash

Aspects	Fixed Assets	Purchased "By What" – Cash	Journal Entry
Nature of A/c	Real Account (Asset)	Cash – Real A/c	
Golden Rule	Debit what comes in Credit what goes out	Debit what comes in Credit what goes out	Fixed Assets A/c Dr. To Cash A/c
Reason	Fixed Assets come into business	Cash Goes out of business	
Debit / Credit	Fixed Assets A/c Debited	Cash A/c is credited	

Note: If the Fixed Assets are purchased by cheque, then Bank A/c will be credited instead of Cash A/c.

2. Purchase of Fixed Assets for Credit – Refer the Journal Entry under "Creditors for Fixed Assets"

3. Expenses necessary for Purchase / Construction of Fixed Assets –
 (e.g. Freight, Installation Charges, etc. – DEBITED to Fixed Asset A/c and NOT DEBITED to Expenses)

Aspects	Expenses for Fixed Assets	Paid "By What" – Cash	Journal Entry
Nature of A/c	Treated as Fixed Asset itself – Real Account	Cash – Real A/c	
Golden Rule	Debit what comes in Credit what goes out	Debit what comes in Credit what goes out	Fixed Assets A/c Dr. To Cash/Bank/Creditors A/c
Reason	Fixed Assets come into business	Cash Goes out of business	
Debit / Credit	Fixed Assets A/c Debited	Cash A/c is credited	

Note:

- **Expenses which are necessary for creation of fixed assets shall be added to the cost of such fixed asset. Hence, such amounts are debited to the Fixed Asset A/c and not to the respective Expenses Account.**
- **If expenses are paid by Cheque – Bank A/c Credited; If they are not paid, but due to creditor – Creditor A/c credited.**

4. Depreciation on Fixed Assets (See Chapter 5 for detailed discussions)

Aspects	Depreciation	On What – Fixed Assets	Journal Entry
Nature of A/c	Nominal A/c (Expense)	Real A/c (Assets)	
Golden Rule	Debit all Expenses & Losses Credit all Incomes & Gains	Debit what comes in Credit what goes out	Depreciation A/c Dr. To Fixed Assets A/c
Reason	Depreciation is an Expense	Value of Fixed Asset decreases. (Note 2)	
Debit / Credit	Depreciation A/c Debited	Fixed Assets A/c is credited	

Note:

1. Depreciation means the reduction in the value of fixed assets due to use, wear & tear, technological improvement etc. **It is an expense and NOT a loss, as the reduction is due to use of the fixed assets** (Hence, benefit derived).
2. **Why Fixed Asset is to be credited in the above Journal Entry** – Fixed Asset A/c, being in the nature of "Assets", normally has a debit balance. As the value of Fixed Asset goes down, the Debit Balance in Fixed Assets A/c has to be reduced. So, If a debit balance a/c has to be decreased, it has to be credited.
3. **Appreciation on Fixed Assets** – Increase in Market value of Fixed Assets w.r.t. Book Value– **NO JOURNAL ENTRY**. **Reason:** The increase represents notional profit which is not realized. Hence, as per Realisation Concept and Conservatism Convention, unrealized profits are not accounted.

5. Loss of Fixed Assets due to Accidents, Fire etc.

Aspects	Loss due to fire / accidents	Loss "On what" – Fixed Assets	Journal Entry
Nature of A/c	Nominal A/c (Losses)	Real A/c	
Golden Rule	Debit all Expenses & Losses Credit all Incomes & Gains	Debit what comes in Credit what goes out	Loss due to fire / accident A/c Dr.
Reason	The amount represents a loss	Fixed Assets Lost – Goes out of business	To Fixed Asset A/c
Debit / Credit	"Loss due to fire/accident A/c" Debited	Fixed Assets A/c is credited	

6. Sale of Fixed Assets for Cash and Profit earned on such Sale

Example: A & Co., a Pen Dealer, sold a car for ₹ 50,000; Its Book Value (B.V.) ₹ 35,000; Profit = ₹ 15,000

Aspects	Cash A/c – ₹ 50,000	Fixed Assets – ₹ 35,000 (B.V.)	Profit on Sale of F.A. – ₹ 15,000	Journal Entry
Nature of A/c	Real A/c (Asset)	Real A/c (Asset)	Nominal A/c (Gain)	
Golden Rule	Debit what comes in Credit what goes out	Debit what comes in Credit what goes out	Debit all Expenses and losses Credit all Incomes and Gains	Cash A/c Dr. 50,000 To F.A. A/c 35,000 To Profit on Sale of F.A. A/c 15,000
Reason	Cash comes into business	Fixed Asset goes out	Profit is a gain for business	
Debit / Credit	Cash A/c is Debited	Fixed Asset A/c Credited	Profit on Sale of F.A. A/c Credited	

Note:

1. **Sale of Fixed Assets will not be credited to Sales A/c, as the term "Sales" is used only for Sale of Goods. The above entry is called Compound Journal Entry, wherein two credits and one debit are involved.**
2. **Profit or Loss on Sale of Fixed Assets = Sale Value – Book Value; If Sale Value > Book Value, the difference is Profits.**

7. Sale of Fixed Assets for Cash and Loss suffered on such Sale

Example: A & Co., a pen dealer, sold a car for ₹ 30,000; Its Book Value (B.V.) ₹ 35,000; Loss = ₹ 5,000

Aspects	Cash A/c – ₹ 30,000	Fixed Assets – ₹ 35,000 (B.V.)	Loss on Sale of F.A. – ₹ 5,000	Journal Entry
Nature of A/c	Real A/c (Asset)	Real A/c (Asset)	Nominal A/c (losses)	
Golden Rule	Debit what comes in Credit what goes out	Debit what comes in Credit what goes out	Debit all Expenses and losses Credit all Incomes and Gains	Cash A/c Dr. 30,000 Loss on Sale of F.A. A/c Dr. 5,000
Reason	Cash comes into business	Fixed Asset goes out	Loss suffered due to sale	
Debit / Credit	Cash A/c is Debited	Fixed Asset A/c Credited	Loss on Sale of F.A. A/c Debited	To F.A. A/c 35,000

Note: Profit or Loss on Sale of Fixed Assets = Sale Value – Book Value; If Sale Value < Book Value, the difference is Losses.

(C.II.) Transactions under "Intangible Fixed Assets"

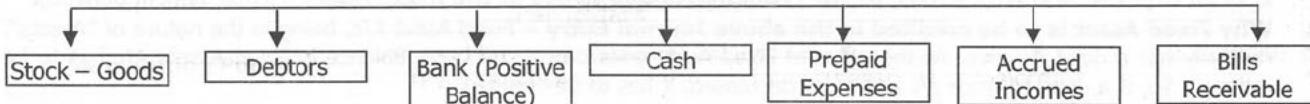
– SAME AS Tangible Fixed Assets

Additional Term – Amortisation on Intangible Fixed Assets

- The meaning of the terms "Amortisation" and "Depreciation" are similar. Journal Entries are same.
- Depreciation – REDUCTION** in value of TANGIBLE Fixed Assets.
- Amortisation – CHANGES** in value of INTANGIBLE Fixed Assets. (Changes may be Increase or Decrease)

Situation (D) – Transactions related to Current Assets

Current Assets



(D.I.) Transactions related to "Stock – Goods"

(Raw Materials / Finished Goods / Work-In-Progress)

1. Purchases of Goods for Cash / Cheque from X

Aspects	Goods Purchased – Purchases	"For What" – Cash	Journal Entry
Nature of A/c	Nominal Account (Expense)	Cash – Real A/c	
Golden Rule	Debit all Expenses and Losses Credit all Incomes and Gains	Debit what comes in Credit what goes out	Purchases A/c Dr. To Cash A/c / Bank A/c
Reason	Purchase is an Business Expense	Cash is paid to Supplier – Cash goes out	
Debit / Credit	Purchases A/c Debited	Cash A/c is credited	

Notes:

- If the Goods are purchased by cheque, then Bank A/c will be credited instead of Cash A/c.
- Whenever **Cash Purchase is made**, the supplier's name is not relevant for accounting.

2. Purchases of Goods for Credit from X

Aspects	Goods Purchased – Purchases	"From Whom" – Supplier – X	Journal Entry
Nature of A/c	Nominal Account (Expense)	Personal A/c (X – natural / artificial)	
Golden Rule	Debit all Expenses and Losses Credit all Incomes and Gains	Debit the Receiver of Benefit Credit the Giver of Benefit	Purchases A/c Dr. To Creditor / Supplier A/c
Reason	Purchase is an Business Expense	X is the giver of goods on credit	
Debit / Credit	Purchases A/c Debited	X (Supplier) A/c is credited	

Note: If the goods are purchased on Credit, then the **Supplier's Name is relevant** for accounting.

3. Return of Goods Purchased – Purchase Returns

Aspects	Purchase Returns	"To Whom"– Supplier / Creditor	Journal Entry
Nature of A/c	Nominal Account (Income)	Personal A/c	Creditor / Supplier A/c Dr. To Purchase Returns A/c
Golden Rule	Debit all Expenses and Losses Credit all Incomes and Gains	Debit the Receiver of Benefit Credit the Giver of Benefit	
Reason	When goods are returned, total purchase value comes down. So, reduction in expense is an income.	Creditor is the Receiver of the goods returned.	
Debit / Credit	Purchases Returns A/c Credited	Supplier A/c / Creditor is Debited	

Note: Normally goods purchased on credit are returned. If Cash Purchases are returned, then cash a/c is credited

4. Sales of Goods for Cash to Y

Aspects	Goods Sold – Sales	"For What"– Cash	Journal Entry
Nature of A/c	Nominal Account (Income)	Real A/c (Asset)	Cash A/c Dr. To Sales A/c
Golden Rule	Debit all Expenses and Losses Credit all Incomes and Gains	Debit What Comes in Credit What Goes Out	
Reason	Sales is a Business Income	Cash is received – Comes in	
Debit / Credit	Sales A/c Credited	Cash A/c credited	

Notes:

- If the Goods are sold for cheque, then Bank A/c will be debited instead of Cash A/c.
- Whenever **Cash Sale is made**, the **Customer's name is not relevant for accounting**.

5. Sales of Goods for Credit to Y

Aspects	Goods Sold – Sales	"To Whom"– Customer – Y	Journal Entry
Nature of A/c	Nominal Account (Income)	Personal A/c (Y – natural / artificial)	Customer / Debtors A/c Dr. To Sales A/c
Golden Rule	Debit all Expenses and Losses Credit all Incomes and Gains	Debit the Receiver of Benefit Credit the Giver of Benefit	
Reason	Sales is a Business Income	Y is the Receiver of goods on credit	
Debit / Credit	Sales A/c Credited	Y (Customer) A/c is Debited	

Note: If the **goods are Sold on Credit**, then the **Customer's name is relevant** for accounting.

6. Returns of Goods Sold – Sales Returns

Aspects	Sales Returns	"From Whom" – Debtors	Journal Entry
Nature of A/c	Real A/c (Reduction in Sales)	Personal A/c (Debtor is a person)	Sales Returns A/c Dr. To Debtors A/c
Golden Rule	Debit what comes in Credit what goes out	Debit the Receiver of Benefit Credit the Giver of Benefit	
Reason	Sales Returns represent returns of some part of goods sold. Hence, it is a reduction in income. So it is an expense	Debtor is returning the goods. Hence, he is the giver of goods	
Debit / Credit	Sales Returns A/c Debited	Debtor A/c is credited	

Notes: Normally **goods sold on credit are returned**. (If cash sales is returned, then credit Cash Account)

7. Loss of Goods due to Fire / Accident / Theft (Also refer detailed discussions in separate Chapter)

Aspects	Loss due to fire / accidents	Loss "On what" – Goods – Purchases	Journal Entry
Nature of A/c	Nominal A/c (Losses)	Nominal A/c	Loss due to — A/c Dr. To PurchasesA/c
Golden Rule	Debit all Expenses & Losses Credit all Incomes & Gains	Debit all Expenses & Losses Credit all Incomes & Gains	

Aspects	Loss due to fire / accidents	Loss "On what" – Goods – Purchases	Journal Entry
Reason	The amount represents a loss	Purchased goods are reduced due to loss – Reduction in Expense – Income	
Debit / Credit	"Loss due to — A/c" Debited	Purchase A/c is credited	
Note: Loss of goods due to fire /accident / theft is also called as "Abnormal Loss".			

8. Withdrawal of goods by owner for personal use – Drawings – Refer Journal Entries under "Capital"

9. Use of Goods for Construction of Fixed Assets

Example: Brick Dealer using bricks for construction of his Factory Building

Aspects	Goods – Purchases	"For what" – Construction of Fixed Assets	Journal Entry
Nature of A/c	Nominal Account	Real A/c (Asset)	
Golden Rule	Debit All Expenses & losses Credit All Incomes & Gains	Debit What Comes In Credit What Goes Out	
Reason	Purchase Expense is reduced. Hence, it is income	Fixed Assets come into existence after construction	
Debit / Credit	Purchases A/c Credited	Fixed Assets Account Debited	Fixed Assets A/c Dr. To Purchases A/c

10. Closing Stock of Goods (Refer Detailed Discussions in Chapter 4)

Aspects	Closing Stock	Stock "Of what" – Goods – Purchases	Journal Entry
Nature of A/c	Real A/c (Asset)	Nominal A/c	
Golden Rule	Debit What Comes In Credit What Goes Out	Debit all Expenses & Losses Credit all Incomes & Gains	
Reason	Closing Stock is a property, which arises at year end.	As some of the purchased goods are lying with the business, the entire purchases cannot be considered as expense. Hence, Reduction in Expense – Income	
Debit / Credit	Closing Stock debited	Purchase A/c is credited	Closing Stock A/c To Purchases A/c

(D.II.) Transactions related to "Debtors"

1. Credit Sales to Debtors – Refer under "Stock – Goods" – Eg. Credit Sales to "M" – ₹ 10,000

2. Sales Returns of Goods – Refer under "Stock – Goods"

3. Receipt of Cash / Cheque from Debtors for Credit Sales – Eg. Cash Received from "M" – ₹ 9,500

Aspects	Cash	"From Whom" – Debtors	Journal Entry
Nature of A/c	Cash – Real A/c	Personal Account (Debtor is a person)	
Golden Rule	Debit what comes in Credit what goes out	Debit the Receiver of Benefit Credit the Giver of Benefit	
Reason	Cash is received from customers	The debtor is the giver of cash to business	
Debit / Credit	Cash A/c Debited	Debtor A/c is credited	Cash A/c / Bank A/c Dr. To Debtors A/c 9,500
Notes: If Cheque is received from Debtors, then Bank Account will debited instead of Cash Account			

4. Discount Allowed; Example: Credit Sales: ₹ 10,000, Receipt: ₹ 9,500, Discount: ₹ 500

Aspects	Discount Allowed	Allowed "To whom" – Debtor (M)	Journal Entry
Nature of A/c	Nominal Account (Expense)	Personal Account (Creditor is person)	
Golden Rule	Debit all Expenses and Losses Credit all Incomes and Gains	Debit the receiver of benefit (benefit =Cash) Credit the giver of benefit	
Reason	Reduction in Sales amount. So, reduction in Income = Expense	The Debtor pays money before the due date. So, he gives the benefit of cash earlier.	
Debit / Credit	Discount Received A/c Credited	Debtors Account Credited (M A/c)	Dis. allowed A/c Dr. To Debtors A/c For Example: Dis. All. A/c Dr. 500 To M A/c 500

Note: One more reason for Crediting Mr.M's Account – (with the help of example mentioned above)

- (a) At the time of Credit Sales, M's account is debited with ₹ 10,000
- (b) Now, at the time of Receipt, M's account is credited with ₹ 9,500
- (c) Hence, there is still a debit balance of ₹ 500 in M's Account [10,000 (Dr.) – 9,500 (Cr.)]. But this amount will not be received from M as discount is allowed to him for balance ₹ 500. So, Strictly, M's Account must show **Zero Balance**.
- (d) So, the Debit Balance of ₹ 500 in Z's A/c to be decreased to Zero. As per Common Sense Rules, if a Debit Balance Account to be decreased, then we have to Credit that account. So, M's A/c is Credited with ₹ 500.

5. Bad Debts –

Example: Credit Sale of ₹ 5,000 made to Mr.C. He becomes insolvent and his dues could not be recovered

Aspects	Bad Debts	On What – Debtors	Journal Entry
Nature of A/c	Nominal Account (Loss)	Personal Account (Debtor is a person)	
Golden Rule	Debit all Expenses and Losses Credit all Incomes and Gains	Debit the receiver of benefit Credit the giver of benefit	
Reason	Amount due to the business not recoverable. Hence, It's a loss.	If a Debit Balance A/c to be decreased, that A/c is to be Credited. (Refer Note)	
Debit / Credit	Bad Debts A/c Debited	Debtors Account Credited (C A/c)	Bad Debts A/c Dr. To Debtors A/c For Example: Bad Debts A/c Dr. 5000 To C A/c 5000

Note: One more reason for Crediting Mr.C's Account – (with the help of example mentioned above)

- (a) At the time of Credit Sales, C's account is debited with ₹ 5,000 ⇒ C's A/c has a debit balance of ₹ 5,000
- (b) Now, C has become insolvent and ₹ 5,000 cannot be recovered from him. So, C's A/c balance **should become Zero**.
- (c) So, the Debit Balance of ₹ 5,000 in C's A/c to be decreased to Zero. As per Common Sense Rules, if a Debit Balance Account to be decreased, then we have to Credit that account. So, C's A/c is Credited with ₹ 5,000.

(D.III.) Transactions related to "Bank"

1. Payments for Expenses / Purchases by cheque / through Bank – Cheque Issued

Aspects	Expenses / Purchases	"By What" – Cheque – Bank	Journal Entry
Nature of A/c	Nominal Account	Personal Account (Bank is a person)	
Golden Rule	Debit All Expenses and Losses Credit All Incomes and Gains	Debit the Receiver of Benefit Credit the Giver of Benefit	Expenses A/c / Purchases A/c Dr.
Reason	Expenses	Bank is the Giver of money for us	To Bank A/c
Debit / Credit	Expenses A/c Debited	Bank A/c is credited	

Note: Whenever payment is made immediately on incurring of expenses, the Party's A/c will not come.

2. Payments to Creditors for PURCHASES by Cheque – Cheque Issued

Aspects	Creditors	"By What" – Cheque – Bank	Journal Entry
Nature of A/c	Personal Account (Person)	Personal Account (Bank is a person)	Creditors A/c Dr. To Bank A/c
Golden Rule	Debit the Receiver of Benefit Credit the Giver of Benefit	Debit the Receiver of Benefit Credit the Giver of Benefit	
Reason	Creditor is the receiver of money	Bank is the giver of money for us	
Debit / Credit	Creditors A/c Debited	Bank A/c is credited	

Note:Where payment is made later (i.e. not at purchase), the party's A/c is debited at the time of payment

3. Payments for OUTSTANDING EXPENSES by Cheque – Cheque Issued

Aspects	Outstanding Expenses	"By What" – Cheque – Bank	Journal Entry
Nature of A/c	Personal Account (Person)	Personal A/c (Bank is a person)	Outstanding Expenses A/c Dr. To Bank A/c
Golden Rule	Debit the Receiver of Benefit Credit the Giver of Benefit	Debit the Receiver of Benefit Credit the Giver of Benefit	
Reason	Creditor is the receiver of money	Bank is giver of money for us	
Debit / Credit	Representative Personal A/c "Outstanding Expenses A/c" Debited	Bank A/c is credited	

Note:Where payment is made later (i.e. not while incurring expenses), "O/s Expenses A/c" is debited during such payment

4. Cash withdrawn from Bank for Official Use

Aspects	"From Whom" – Bank ←	Cash	Journal Entry
Nature of A/c	Personal A/c (Bank is a person)	Real Account (Asset)	Cash A/c Dr. To Bank A/c
Golden Rule	Debit the Receiver of Benefit Credit the Giver of Benefit	Debit What Comes In Credit What Goes Out	
Reason	Bank is giver of money for us	Cash comes into business from Bank	
Debit / Credit	Bank A/c is credited	Cash A/c Debited	

5. Cash withdrawn from Bank for Personal Use

Aspects	Bank	"For Whom" – Owner	Journal Entry
Nature of A/c	Personal A/c (Bank is a person)	Personal A/c (Owner is person)	Capital A/c/ Drawings A/c Dr. To Bank A/c
Golden Rule	Debit the Receiver of Benefit Credit the Giver of Benefit	Debit the Receiver of Benefit Credit the Giver of Benefit	
Reason	Bank is giver of money for us	Owner is receiver of money	
Debit / Credit	Bank A/c is credited	Capital A/c / Drawing A/c is Debited	

Note:If Cash is withdrawn by the owner for personal use, money does not come into business. The business money kept in the Bank Account goes directly to the owner. Hence, it is drawings by the owner from business's bank account.

6. Cash Deposited into Bank

Aspects	Cash	Given "To Whom" – Bank	Journal Entry
Nature of A/c	Real Account (Asset)	Personal A/c (Bank is a person)	Bank A/c Dr. To Cash A/c
Golden Rule	Debit What Comes In Credit What Goes Out	Debit the Receiver of Benefit Credit the Giver of Benefit	
Reason	Cash goes out of business	Bank is receiver of money	
Debit / Credit	Cash A/c Credited	Bank A/c is Debited	

Note:Sometimes, When cheque is deposited into bank, the above journal entry is passed. Because, at the time of receipt of cheque from the customer, it is treated like a "Cash Receipt".

7. Cheque Received on Sales made

Aspects	Cheque received – Bank	"For What" – Sales made	Journal Entry
Nature of A/c	Personal A/c (Bank is a person)	Nominal Account (Income)	
Golden Rule	Debit the Receiver of Benefit Credit the Giver of Benefit	Debit All Expenses and Losses Credit All Incomes and Gains	Bank A/c Dr.
Reason	Bank will receive money for us	Sales is an Income for the business	To Sales A/c
Debit / Credit	Bank A/c is Debited	Sales A/c is credited	

Note: Sometimes, the cheque received by the business is debited in the Cash Account and then transferred to the Bank Account at the time of deposit of such cheque into the Bank.

8. Dishonour of Cheque Received from the Debtor

Aspects	Cheque Dishonoured – Bank	Receivable "From Whom" – Debtors	Journal Entry
Nature of A/c	Personal A/c (Bank is a person)	Personal Account (Debtor is a person)	
Common Sense Rule	If a Debit Balance A/c is to be reduced, it is to be credited	If a Debit Balance A/c is to be increased, it is be debited	Debtors A/c Dr.
Reason	Earlier, at the time of receipt of cheque, Bank is debited. As it is rejected, Bank is to be credited	Earlier, at the time of receipt of cheque, Debtors A/c is credited. Since it is now rejected, debtors A/c is to be debited .	To Bank A/c
Debit / Credit	Bank A/c is Credited	Debtors A/c is Debited	

"Dishonour" refers to rejection of cheque by Bank for Insufficiency of Funds in the account of person who prepared it / for errors in cheque etc. So, the Recipient Bank will not receive any money for the business. The cheque is returned as such.

9. Dishonour of Cheque issued

Aspects	Cheque Issued – Bank	Payable "To Whom" – Creditor	Journal Entry
Nature of A/c	Personal A/c (Bank is a person)	Personal Account (Creditor is a person)	
Golden Rule	If a Debit Balance A/c is to be Increased, it is to be debited	If a Credit Balance A/c is to be increased, it is be Credited	Bank A/c Dr.
Reason	Earlier, at the time of issue of cheque, Bank is credited. As the cheque is rejected, Bank is to be debited.	Earlier, at the time of issue of cheque, Creditor is debited. As the cheque is rejected, Creditor is to be Credited.	To Creditors A/c
Debit / Credit	Bank A/c is Debited	Creditor A/c is credited	

10. Bank Charges levied by the Bank (for Chq Book, Folio Charges, SMS alerts, etc.)

Aspects	Bank Charges	Payable "To Whom" – Bank	Journal Entry
Nature of A/c	Nominal Account (Expense)	Personal A/c (Bank is a person)	
Golden Rule	Debit All Expenses & Losses Credit All Incomes and Gains	Debit the Receiver of Benefit Credit the Giver of Benefit	Bank Charges A/c Dr.
Reason	Bank Charges is an expense	Bank charges is payable for the services rendered by bank. Hence, bank is the giver of those services.	To Bank A/c
Debit / Credit	Bank Charges A/c is debited	Bank A/c is Credited	

11. Interest charged by the Bank (on Loans, Overdraft, etc.)

Aspects	Bank Interest Charged	Payable "To Whom" – Bank	Journal Entry
Nature of A/c	Nominal Account (Expense)	Personal A/c (Bank is a person)	
Golden Rule	Debit All Expenses & Losses Credit All Incomes and Gains	Debit the Receiver of Benefit Credit the Giver of Benefit	Bank Interest Dr.
Reason	Interest charged is an expense	Bank Interest is payable for the money given by bank for a given period. So, bank is the giver of the money.	To Bank A/c
Debit / Credit	Bank Charges A/c is debited	Bank A/c is Credited	

12. Bank Interest received from the Bank (normally through bank account)

Aspects	Bank Interest Received	Bank	Journal Entry
Nature of A/c	Nominal Account (Income)	Personal A/c (Bank is a person)	Bank A/c Dr. To Interest received A/c
Golden Rule	Debit All Expenses & Losses Credit All Incomes and Gains	Debit the Receiver of Benefit Credit the Giver of Benefit	
Reason	Interest received is an Income	Interest received from the bank is kept in the Bank Account itself. Hence, Bank is the receiver of money.	
Debit / Credit	Interest received A/c Credited	Bank A/c is Debited	

13. Endorsement of cheque received from Debtor in favour of the Creditor

Aspects	Received from Debtor	Given To –Creditor	Journal Entry
Nature of A/c	Personal (Debtor is a person)	Personal A/c (Creditor is a person)	Creditor A/c Dr. To Debtor A/c
Golden Rule	Debit the Receiver of Benefit Credit the Giver of Benefit	Debit the Receiver of Benefit Credit the Giver of Benefit	
Reason	Debtor is the giver of cheque	Creditor is the receiver of cheque	
Debit / Credit	Debtor A/c Credited	Creditor A/c is Debited	
1. Endorsement – A cheque is received from the debtor. The same cheque is given to the creditor for settlement of dues.			
2. Bank Account shall not be involved as the cheque directly goes from debtor to creditor.			

(D.IV.) Transactions related to "Cash" – All Transactions are similar to Bank

Instead of Bank Account, Cash Account will appear in all the above journal entries. (Cash A/c is a Real A/c)

1. Additional Transaction – Loss of cash due to Embezzlement i.e. theft

Aspects	Loss due to theft	"On What" –Cash	Journal Entry
Nature of A/c	Nominal Account	Real Account	Loss due to theft A/c To Cash A/c
Golden Rule	Debit all Expenses & Losses Credit all Incomes & Gains	Debit What Comes In Credit What Goes Out	
Reason	Losses	Cash is lost – Goes out of business	
Debit / Credit	Loss due to theft A/c Debited	Cash A/c is Credited	

(D.V.) Transactions related to "Prepaid Expenses"

1. Expenses paid in advance by Cash / Cheque – Before incurring the liability

e.g. Rent for 12 Months – ₹ 12,000; Rent paid for 15 Mon. – ₹ 15,000; Advance Rent: ₹ 3,000 (3 Mon.)

(a) At the time of Payment of ₹ 15,000

Aspects	Cash	"For What" – Rent	Journal Entry
Nature of A/c	Real Account	Nominal Account	Expenses A/c / Rent A/c Dr. 15,000
Golden Rule	Debit What Comes In Credit What Goes Out	Debit All Expenses and Losses Credit All Incomes and Gains	
Reason	Cash Goes Out of Business	Rent is an Expense	
Debit / Credit	Cash A/c Credited	Rent (Expenses) A/c Debited	
Note: While making payment, the full amount is taken to the Expenses Account. However, the actual expenses is only ₹ 12,000. Hence, the balance ₹ 3,000 has to be reversed from Expenses Account to Rent Paid in Advance Account. (Refer below)			

(b) At the End of the year – Advance Rent to be reduced from Total Amount of Rent

Aspects	Rent Account	Paid "To Whom" – Landlord	Journal Entry
Nature of A/c	Nominal Account	Personal Account	
Golden Rule	Debit All Expenses and Losses Credit All Incomes and Gains	Debit the Receiver of benefit Credit the Giver of Benefit	Prepaid Expenses A/c To Expenses A/c OR Prepaid Rent A/c Dr. 3,000 To Rent A/c 3,000
Reason	Here, Rental expenses reduced as some part of it represents advance. Reduction in expense is an income.	Here, the Landlord received the rent money in advance. Landlord is represented by "Prepaid Rent A/c"	
Debit / Credit	Expenses (Rent A/c) Credited	Prepaid Rent Account is Debited	

2. At the time of incurring the liability – Adjustment of Advance Rent against Rent Liability
Example: The Land is used for further 3 Months, without paying any rent

Aspects	Rental Expense	Payable "to Whom" – Landlord	Journal Entry
Nature of A/c	Nominal Account	Personal Account	
Golden Rule	Debit All Expenses and Losses Credit All Incomes and Gains	Debit the receiver of benefit Credit the giver of benefit	Expenses A/c Dr. To Prepaid Expenses A/c OR Rent A/c Dr. 3,000 To Prepaid Rent A/c 3,000
Reason	Rent incurred for 3 months	Landlord is the giver of land. But he is represented by "Prepaid Rent A/c"	
Debit / Credit	Expenses (Rent A/c) Credited	Prepaid Rent A/c Credited	

Note: Prepaid Rent has a debit balance of ₹ 3,000. However, after adjustment for 3 months, the advance rent shall become zero. As per common sense rule, if a Debit Balance A/c is to be reduced, it has to be credited. Hence, if the Prepaid Rent A/c of ₹ 3,000 is to be decreased to zero, it shall be credited with ₹ 3,000

(D.VI.) Transactions related to "Accrued Incomes" – Income earned but not received

1. Credit Sales – Refer under "Current Assets – Goods" / Cash Sales – Refer under "Current Assets – Bank"**2. Interest, Commission, Dividend etc. earned**

Aspects	Income (Interest, Comm.)	Receivable "From Whom" – Beneficiary	Journal Entry
Nature of A/c	Nominal Account	Personal Account (beneficiary is a person)	
Golden Rule	Debit All Expenses & Losses Credit All Incomes and Gains	Debit the receiver of benefit Credit the giver of benefit	
Reason	Income	The person, from whom the income is to be received, has used the business money / other services. Hence, he is the receiver of benefit. But he is represented by "Accrued Income A/c"	Accrued Inc. A/c Dr. To Income A/c
Debit / Credit	Income A/c Credited	Accrued Income A/c Debited.	

Note: If money is receivable for goods sold, then the respective debtor will be debited with the name. However, if it is receivable for any other income, then the "Accrued Income" will be debited and not to the person's name account.

3. Receipt of Cash / Cheque towards the income due

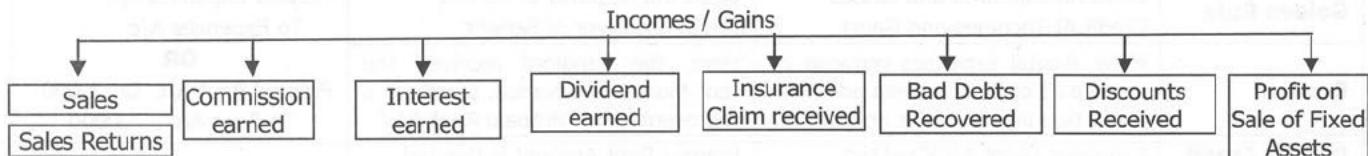
Aspects	Cash	Received "From Whom" – Beneficiary	Journal Entry
Nature of A/c	Real Account (Asset)	Personal Account	
Golden Rule	Debit What Comes In Credit What Goes Out	Debit the receiver of benefit Credit the giver of benefit	Cash A/c Dr.
Reason	Cash comes into business	The beneficiary has now given the money, Hence, he is the giver of benefit. But he is represented by "Accrued Income A/c"	To Accrued Income A/c
Debit / Credit	Cash A/c Credited	Accrued Income A/c Credited.	

Note: If cheque is received, then Bank Account will be debited instead of Cash Account

(D.VII.) Transactions related to "Bills Receivable"

Refer Chapter on "Bills of Exchange"

Situation (E) – Transactions related to Incomes / Gains



(E.I.) Transactions related to "Incomes / Gains"

1. Sales – Cash / Credit – Refer under "Goods"

2. Sales Returns – Refer under "Goods"

3. Interest, Commission, Dividend etc. earned and Cash Received immediately

Aspects	Income (Interest, Comm.)	Received "For What" – Cash	Journal Entry
Nature of A/c	Nominal Account	Personal Account (beneficiary is a person)	Cash A/c Dr. To Income A/c
Golden Rule	Debit All Expenses & Losses Credit All Incomes and Gains	Debit the receiver of benefit Credit the giver of benefit	
Reason	Income	Cash comes into business	
Debit / Credit	Income A/c Credited	Cash Account Debited	

4. Interest, Commission, Dividend etc. earned and not yet received – Refer under "Accrued Incomes"

5. Insurance Claim Received against Abnormal Losses – Refer under "Expenses / Losses"

6. Bad Debts Recovered by Cash / Cheque

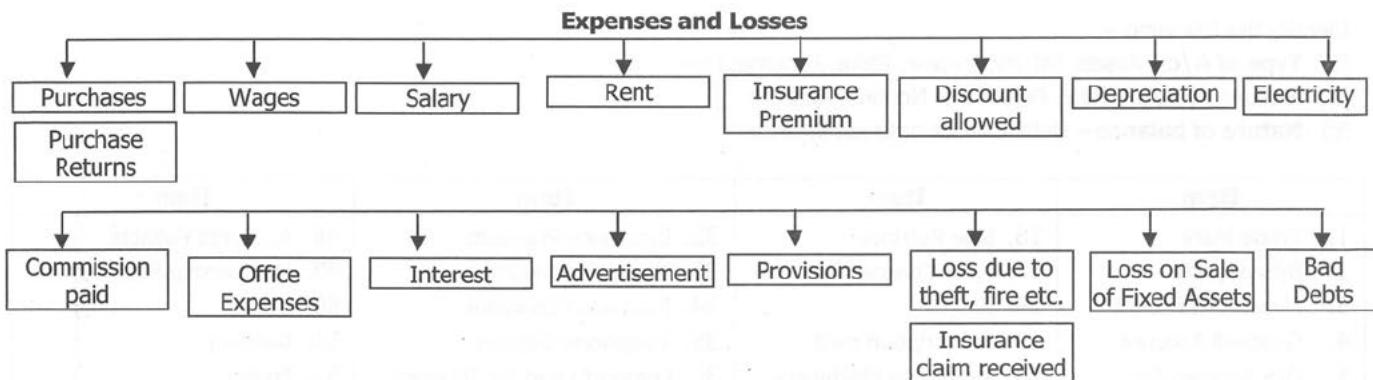
Aspects	Cash	"On What" – Bad Debts Recovered	Journal Entry
Nature of A/c	Real Account	Nominal Account	Cash A/c Dr. To Bad Debts Recovered A/c
Golden Rule	Debit What Comes In Credit What Goes Out	Debit all Expenses and Losses Credit all Incomes and Gains	
Reason	Cash comes into business	Recovery of loss is considered as Income	
Debit / Credit	Cash A/c Debited	Bad Debts Recovered Account Credited	

Note: At the time of Bad Debts, it is a loss and then Debtors A/c is closed. At the time of recovery of bad debts, it is considered as income and credited to Bad Debts Recovered A/c. Debtors account cannot be credited as it is already closed.

7. Discount Received – Refer under "Sundry Creditors – Current Liabilities"

8. Profit on Sale of Fixed Assets – Refer under "Fixed Assets"

Situation (F) – Expenses and Losses



Transactions related to Expenses and Losses

- Purchases** – Cash / Credit – Refer under "Current Assets – Goods and Bank"
- Purchase Returns** – Refer under "Current Assets – Goods"
- Expenses** – Wages, Salary, Rent, Insurance Premium, Electricity, Commission, Interest, Advertisement
 - Paid through Cash / Cheque** – Refer under "Current Assets – Bank / Cash"
 - If not yet paid** – Refer under "Current Liabilities – Outstanding Expenses"
- Discount Allowed** – Refer under "Current Assets – Sundry Debtors"
- Depreciation** – Refer under "Fixed Assets"
- Provisions** – Refer Chapter on "Financial Statements"
- Loss due to fire, theft etc.** – Refer under "Fixed Assets / Goods / Cash"
- Bad Debts** – Refer under "Debtors"

9. Insurance Compensation Received against the loss – Cash / Cheque received

Aspects	Cash	"For What" – Abnormal Loss	Journal Entry
Nature of A/c	Real Account	Nominal Account	
Golden Rule	Debit What Comes In Credit What Goes Out	Debit all Expenses and Losses Credit all Incomes and Gains	Cash A/c Dr. To Abnormal Loss A/c
Reason	Cash comes into business	Insurance compensation is recovery of loss. Hence, loss is reduced to that extent of compensation. So, a debit balance a/c to be reduced, it is to be credited.	
Debit / Credit	Cash A/c Debited	Abnormal Loss A/c Credited	

Note:

If Cheque is received instead of cash, Bank Account will be debited.

Sometimes, instead of crediting abnormal loss account, a separate account "Insurance Compensation" may be credited.

10. Insurance Compensation Receivable against the loss – Cash / Cheque not yet received

Aspects	Insurance claim receivable	"For What" – Abnormal Loss	Journal Entry
Nature of A/c	Personal Account (receivable from Insurance Co.)	Nominal Account	
Golden Rule	Debit the Receiver of Benefit Credit the Giver of Benefit	Debit all Expenses and Losses Credit all Incomes and Gains	
Reason	As the money is due from Insurance Co., Insurance Co. has to be debited.	Insurance compensation is recovery of loss. Hence, loss is reduced to that extent of compensation. So, a debit balance a/c to be reduced, it is to be credited.	Insurance Claim receivable A/c Dr. To Abnormal Loss A/c
Debit / Credit	However, the Representative Personal A/c debited.	Abnormal Loss A/c Credited	

Note: Sometimes, instead of crediting abnormal loss A/c, a separate account "Insurance Compensation" may be credited.

Identify the following –

- Type of A/c** – Assets, liability, Income, Gains, Expense, Loss
- Nature of A/c** – Real, Persona or Nominal Account
- Nature of balance** – Debit Balance or Credit Balance

Item	Item	Item	Item
1. Trade Mark	16. Sale Returns	32. Insurance Premium	48. Accounts Payable
2. Bills payable	17. Bank Charges Account	33. Unexpired Insurance	49. Membership Fees earned
3. Livestock Account	18. Wages	34. Insurance Company	50. Stock
4. Goodwill Account	19. Subscription paid	35. Telephone Deposit	51. Building
5. O/S Salaries A/c	20. Repairs to Machinery	36. Lease of Land for 20 years	52. Profits
6. Machinery	21. Prepaid Salary	37. Receipt of loan	53. Theft of cash
7. Rent	22. Stationery	38. Loan to Contractor	54. Depreciation
8. Cash	23. Loans given	39. Current A/c of Partner	55. Discount received
9. Creditor	24. Drawings	40. Current A/c with Bank	56. Bank Fixed Deposits
10. Patent Right	25. Interest received	41. Interest recd. in advance	57. Loans taken
11. Vikas & Co.(creditor)	26. Gavaskar (Debtor)	42. Reserve for doubtful debts	58. Company Shares / Bonds
12. Bank Overdraft	27. Bank Account	43. Typewriter purchased	59. Investments
13. Compensation to injured workers	28. Interest paid	44. Advertising	60. Bad Debts
14. Bills Receivable	29. Rent for premise sublet	45. Carriage Inwards	
15. Salaries	30. Fixtures	46. Accounts Receivable	
	31. Accrued Interest	47. Equipment	

Types of Accounts					
Assets	Liabilities	Incomes	Gains	Expenses	Losses
1, 3, 4, 6, 8, 10, 14, 21, 23, 26, 27, 30, 31, 33, 34, 35, 36, 38, 40, 43, 46, 47, 50, 51, 56, 58, 59	2, 5, 9, 11, 12, 24, 37, 39, 41, 42, 48, 57	25, 29, 49, 55	52	7, 15, 16, 17, 18, 19, 20, 22, 28, 32, 44, 45, 54	13, 53, 60

Nature of Balance	
Debit Balance	Credit Balance
1, 3, 4, 6, 7, 8, 10, 13, 14, 15, 16, 17, 18, 19, 20, 21, 22, 23, 26, 27, 28, 30, 31, 32, 33, 34, 35, 36, 38, 40, 43, 44, 45, 46, 47, 50, 51, 53, 54, 56, 58, 59, 60	2, 5, 9, 11, 12, 24, 25, 29, 37, 39, 41, 42, 48, 49, 52, 55, 57

Nature of Accounts		
Personal Account	Real Account	Nominal Account
2, 5, 9, 11, 12, 14, 21, 23, 24, 26, 27, 31, 33, 34, 35, 37, 38, 39, 40, 41, 42, 46, 48, 57	1, 3, 4, 6, 8, 10, 30, 36, 43, 47, 50, 51, 56, 58, 59	7, 13, 15, 16, 17, 18, 19, 20, 22, 25, 28, 29, 32, 44, 45, 49, 52, 53, 54, 55, 60

Question Types in this Chapter

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|--|
| 1. Direct Theory Questions – Journal, its various names, Golden Rules of Accounting, Accounting Equations |
| 2. Conceptual Questions – Nature of Accounts, Nature of Balances |

Illustrations: Journal Entries

1. Prepare Journal Entries for the following transactions in the books of Brahma & Co.

- (i) Employees had taken stock worth ₹ 1,00,000 (Cost price ₹ 75,000) on the eve of Pongal and the same was deducted from their salaries in the subsequent month.
- (ii) Wages paid for erection of Machinery ₹ 80,000
- (iii) Income tax liability of proprietor ₹ 17,000 was paid out of petty cash.
- (iv) Purchase of goods from Saraswati & Co of the list price of ₹ 20,000. He allowed 10% trade discount, ₹ 500 cash discount was also allowed for quick payment. [RTP]

Journal Entries in the books of Brahma & Co.

Date	Particulars	LF	Debit ₹	Credit ₹
(1)	(2)	(3)	(4)	(5)
(i)	Salaries A/c To Purchase A/c (Being entry made for stock taken by employees)	Dr.	75,000	75,000
(ii)	Machinery A/c To Cash A/c (Being wages paid for erection of machinery)	Dr.	80,000	80,000
(iii)	Drawings A/c To Petty Cash A/c (Being the income tax of proprietor paid out of business money)	Dr.	17,000	17,000
(iv)	Purchase A/c To Cash A/c To Discount Received A/c (Being the goods purchased from Saraswati & Co for ₹ 20,000 @ 10% trade discount and cash discount of ₹ 500)	Dr.	18,000	17,500 500

2. Pass a journal entry in each of the following cases.

- (i) A running business was purchased by Keshava with following assets and liabilities:
Cash ₹ 3,000, Land ₹ 6,000, Furniture ₹ 1,500, Stock ₹ 3,000, Creditors ₹ 1,500, Bank Overdraft ₹ 3,000.
- (ii) Goods distributed by way of free samples, ₹ 1,500.
- (iii) Trivikrama became an insolvent and could pay only 50 paise in a rupee. Amount due from him ₹ 900. [RTP]

Date	Particulars	LF	Debit ₹	Credit ₹
(1)	(2)	(3)	(4)	(5)
(i)	Cash A/c Land A/c Furniture A/c Stock A/c To Creditors To Bank overdraft To Capital A/c (Being commencement of business by Keshava by taking over a running business).	Dr. Dr. Dr. Dr. Dr. Dr. Dr.	3,000 6,000 1,500 3,000 1,500 3,000 9,000	
(ii)	Advertisement Expenses A/c To Purchases A/c (Being Goods Distributed as Free Samples)	Dr. Dr.	1,500	1,500
(iii)	Cash A/c Bad Debts A/c To Trivikrama A/c (Being Trivikrama being Insolvent, paid only 50 paise in a rupee)	Dr. Dr.	450 450	900