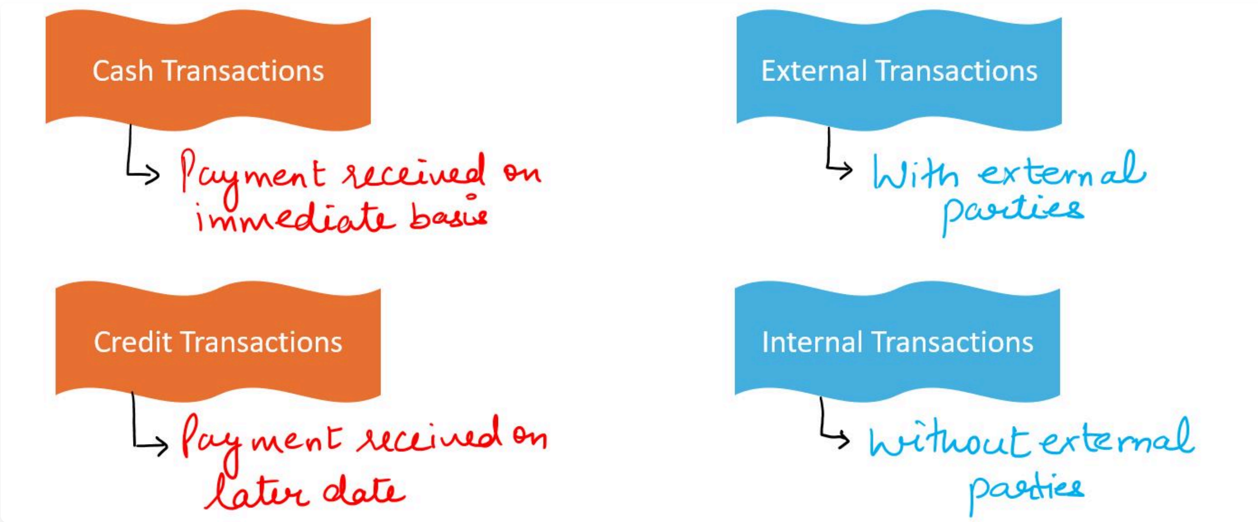
Auditing Course Material

Part 17 of 61 (Chapters 1601-1700)

2. Business Transactions

Business transactions can be categorized as either cash or credit transactions, as well as internal or external transactions.



Cash Transactions vs. Credit Transactions
In a cash transaction, the payment is made or received immediately at the time of the transaction. For example, when you buy groceries at a store and pay with cash, it is a cash transaction.

In a credit transaction, the payment is promised to be made at a later date. This means the goods or services are received now, but payment will occur at a future agreed-upon date. For example, when you buy something with a credit card, you are essentially making a credit transaction because you will pay the credit card company later.

External Transactions vs. Internal Transactions
External Transactions are transactions that involve the exchange of goods, services, or money between the business and an external party, such as customers, suppliers, or lenders. For instance, when a customer purchases a product from a company, it is an external transaction.

Internal Transactions are transactions that occur within the business and do not involve an external party. They are typically related to the internal operations or financial activities of the business. For instance, when funds are transferred between departments within the same organization, there is no involvement of external parties, making it an internal transaction.

Let us now undestand the concept and types of vouchers next.

2. Business Transactions

As discussed, business transactions are usually evidenced by an appropriate documents such as Cash memo, Invoice, Sales bill, Pay-in-slip, Cheque, Salary slip, etc. A document which provides evidence of the transactions is called the **Source Document** or a **Voucher**.

In cases where no formal document exists, such as with minor expenses, a voucher can be created to detail the transaction and must be approved by an appropriate authority within the company. These documents (vouchers) are organized in chronological order, numbered sequentially, and filed separately. All recording in books of account is done on the basis of vouchers.

Preparation of Accounting Vouchers

Accounting vouchers may be classified as cash vouchers, debit vouchers, credit vouchers, journal vouchers, etc. There is no set format of accounting vouchers.

These vouchers must be preserved in any case till the audit of the accounts and tax assessments for the relevant period are completed.

Now a days, accounting is computerised and the necessary accounting vouchers showing the code number and name of the accounts to be debited and credited are prepared for the purpose of necessary recording of transactions.

Transaction Voucher

A transaction with one debit and one credit is a simple transaction and the accounting vouchers prepared for such transaction is known as Transaction Voucher.

A specimen of a simple transaction voucher used in practice is shown in the figure below.

Transaction Voucher
Name of Firm:

Voucher No. :
Date :
Debit Account :
Credit Account :
Amount (Rs.) :
Narration :

Authorized By: Prepared By:

Compound Voucher

Compound voucher records a transaction where more than one account is debited, but only one account is credited. It can also record a transaction where more than one account is credited, but only one account is debited.

Compound voucher may be: (a) Debit Voucher or (b) Credit Voucher; the specimen is shown in figure below.

Debit Voucher
Name of Firm:

Voucher No. : **Date :**
Credit Account :
Amount (Rs.) :

Debit Accounts

Sl. No.	Code	Account Name	Amount (in Rs.)	Narration

Authorized By : **Prepared By :**

Credit Voucher
Name of Firm:

Voucher No. : **Date :**
Debit Account :
Amount (Rs.) :

Credit Accounts

Sl. No.	Code	Account Name	Amount (in Rs.)	Narration

Authorized By : **Prepared By :**

Complex Voucher or Journal Voucher

Transactions with multiple debits and multiple credits are called complex transactions and the accounting voucher prepared for such transaction is known as Complex Voucher/ Journal Voucher.

The format of a complex transaction voucher is shown in figure below.

Journal Voucher
Name of Firm:

Voucher No. : **Date :**

Debit Accounts

Sl. No.	Code	Account Name	Amount (in Rs.)	Narration

Credit Accounts

Sl. No.	Code	Account Name	Amount (in Rs.)	Narration

Authorized By : **Prepared By :**

2. Business Transactions

An accounting voucher must contain the following essential elements:

- Name of the firm must be printed on the top;
- Date of transaction is filled up against the date and not the date of recording of transaction is to be mentioned;
- The number of the voucher is to be in a serial order;
- Name of the account to be debited or credited is mentioned;
- Debit and credit amount is to be written in figures against the amount;
- Description of the transaction is to be given account wise;
- The person who prepares the voucher must mention his name along with signature; and
- The name and signature of the authorised person are mentioned on the voucher.

3. Dual Aspect of Accounting

Under accounting principles, we have already studied the principle of dual aspect of accounting. The dual aspect concept is a fundamental principle in accounting that states every financial transaction affects at least two accounts in a business's books. This concept forms the basis of the double-entry accounting system, where for every debit entry, there is a corresponding credit entry of equal value.

Thus, transactions analyzed in monetary terms and supported by appropriate documentation are entered into the books of accounts using the double-entry system.

To analyze the dual aspect of each transaction, two approaches can be adopted:

(i) the Accounting Equation Approach and
(ii) Journalizing with Traditional Approach or Modern Approach.

The Accounting Equation Approach is associated with identifying and analyzing transactions, which corresponds to Step 1 and 2 of the accounting process.

On the other hand, Journalizing with the Traditional or Modern Approach pertains to recording of transactions, aligning with Step 3 of the accounting process.

These approaches are discussed next one by one.

4. Accounting Equation

Next, we are going to explain the basic tool of accounting, that is, accounting equation.

The **accounting equation** is central to the accounting process as it ensures that every financial transaction maintains the balance between a company's assets, liabilities, and capital. It supports the double-entry bookkeeping system, where each transaction affects at least two accounts to keep the equation balanced.

In other words, all business transactions are written in the form of accounting equation, as this accounting equation illustrates that a business's assets are always equal to the sum of its liabilities and capital (or owner’s equity).

Thus, Accounting Equation is expressed as:

$$A = L + C$$

where:

A = Assets
L = Liabilities
C = Capital

This equation can be rearranged to find missing values, such as:

$$A - L = C$$
$$A - C = L$$

Since the accounting equation depicts the fundamental relationship among the components of the balance sheet, it is also called the **Balance Sheet Equation.** As the name suggests, the balance sheet is a statement of assets, liabilities and capital.

At any point of time, resources of the business entity must be equal to the claims of those who have financed these resources. The proprietors and outsiders provide the resources of the business. The claim of the proprietors is called **capital** or **owner's equity** and that of the outsides is known as **liabilities**.

4. Accounting Equation

Now one can wonder why the two sides of the accounting equation always balance. This is discussed below.

Note that the principle behind why the two sides of the accounting equation always match is the Duality Principle. As discussed earlier, this principle, fundamental to double-entry bookkeeping, states that every financial transaction has a dual effect on the accounting equation, meaning each transaction affects at least two accounts in a way that maintains the balance.

Let us understand the Accounting Equation, with the help of an example.

Rajat starts his business with a capital of Rs. 6,00,000, which is initially in the form of cash. He is later required to acquire asset worth Rs. 10,00,000, including land, building, furniture, and machinery. To finance these assets, he uses Rs. 6,00,000 from his own funds (capital) and borrows Rs. 4,00,000 from outsiders (liabilities). The balance sheet reflects this situation with total assets of Rs. 10,00,000, funded by Rs. 6,00,000 in capital and Rs. 4,00,000 in liabilities, demonstrating that the accounting equation **Assets = Capital + Liabilities** is balanced.

If we put this information in the form of equality of resources and sources, the picture would emerge somewhat as follows:

BALANCE SHEET OF RAJAT

(In Rs)

LIABILITIES	Amount	ASSETS	Amount
Capital	6,00,000	Land	3,00,000
Liabilities	4,00,000	Building	4,00,000
		Furniture	2,00,000
		Machinery	1,00,000
TOTAL	10,00,000	TOTAL	10,00,000

COMBINATION OF

Own Sources

+

Outside Sources

ASSETS FUNDED THROUGH

SOURCES

RESOURCES

To start with, the following transactions are presented below to demonstrate how, with each transaction, the sides of the accounting equation always remain balanced:

(i) Started business with cash of Rs. 1,00,000 – This increases both cash and capital.

(ii) Purchased goods for cash of Rs. 10,000 – This reduces cash but increases stock.

(iii) Obtained a bank loan of Rs. 50,000 – This increases both the loan liability and the cash at the bank.

Sl. No.	Transaction	Assets	=	Liabilities + Capital
		Cash + Stock + Bank		Loan
1.	Started business with Cash for Rs. 1,00,000 Affects 2 Accounts Cash ↑ and Capital ↑	1,00,000		1,00,000
		$\underbrace{1,00,000}_{1,00,000}$	=	$\underbrace{1,00,000}_{1,00,000}$
2.	Purchased goods for Cash for Rs. 10,000 Affects 2 Accounts Cash ↓ and Stock ↑	−10,000 + 10,000		
		$\underbrace{90,000 + 10,000}_{1,00,000}$	=	$\underbrace{1,00,000}_{1,00,000}$
3.	Obtained Bank Loan for Rs. 50,000 Affects 2 Accounts Cash at Bank ↑ Bank Loan ↑	+ 50,000		+ 50,000
		$\underbrace{90,000 + 10,000 + 50,000}_{1,50,000}$	=	$\underbrace{50,000 + 1,00,000}_{1,50,000}$

Let us now understand the concept of Assets, Liabilities and Capital and their relationship with each other in more detail.

4. Accounting Equation

As discussed previously, the components of the accounting equation are assets, liabilities, and capital or owner's equity. The relationship among these components is discussed below.

Assets and Liabilities

Assets are resources that a business owns and expects to benefit from in the future, like cash, inventory, furniture, and land.

These assets are claimed by two types of parties: outsiders and insiders.

Liabilities are the claims of outsiders, such as creditors and lenders who have lent money to the business. For example, if a bakery takes out a loan to buy new equipment, the bank (lender) has a claim on the bakery's assets until the loan is repaid.

Owner's equity (or capital) represents the claims of the business owners, who have invested money into the business. They have a right to a portion of the assets because they own part of the business.

The accounting equation shows how these elements are related: Assets = Liabilities + Owner's Equity.

The equation must always balance, meaning the total value of assets must equal the combined total of liabilities and owner's equity.

Assets	=	Liabilities	+	Owner's Equity
(Economic Resources)		(Claims to Economic Resources)		

Now, let's say if the assets of a business are Rs. 1,70,000 and the liabilities total Rs. 80,000 then the owner's equity will be Rs. 90,000, calculated as follows.

Assets	-	Liabilities	=	Owner's Equity
1,70,000	–	80,000	=	90,000

Similarly, if the owner's equity in a business is Rs. 22,000 and the liabilities are Rs. 36,000, the assets will be Rs. 58,000, computed as follows.

Assets	=	Liabilities	+	Owner's Equity
58,000	=	36,000	+	22,000

What causes changes in Owner's Equity

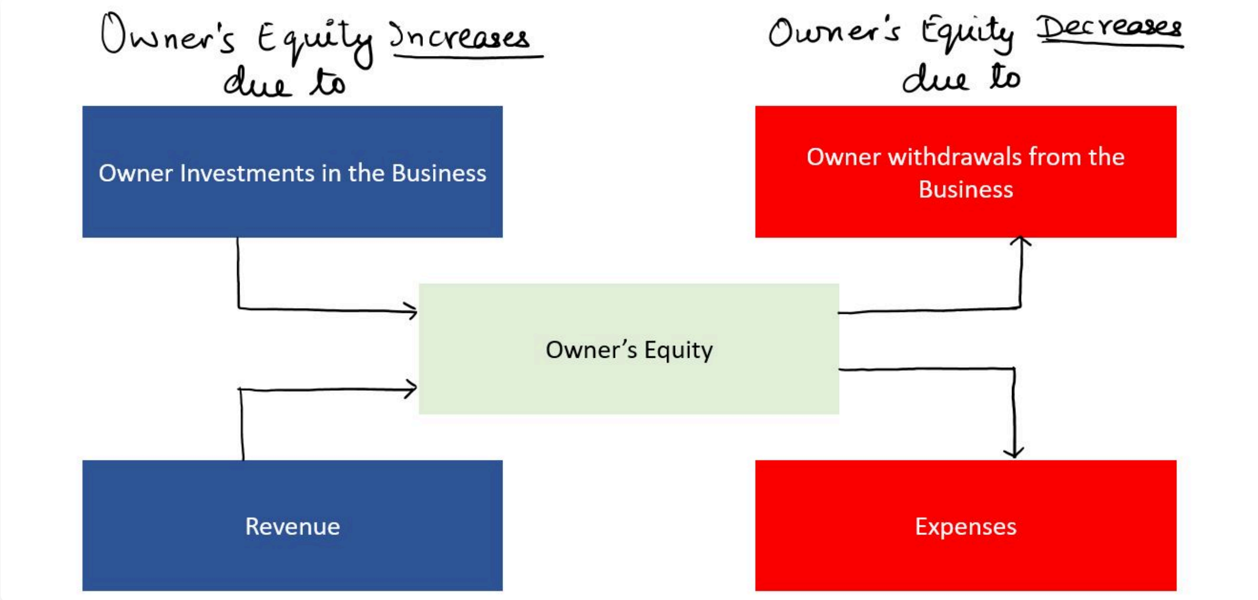
Owner's equity is the amount of an entity's assets that remain after its liabilities are subtracted.

Assets	-	Liabilities	=	Owner's Equity

The purpose of business is to increase owner's equity through revenues.

Revenues are increases in owner's equity earned by delivering goods or services to customers. Revenues also increase assets, or they decrease liabilities. As a result, the owner's share of the business's assets increases.

The figure below shows that owner investments and revenues increase the owner's equity of the business.



It also shows that owner withdrawals and expenses decrease owner's equity. Owner withdrawals are amounts removed from the business by the owner. Withdrawals are the opposite of owner investments.

Expenses are decreases in owner's equity that occur from using assets or increasing liabilities to deliver goods and services to customers. Expenses are the cost of doing business; they are the opposite of revenues.

4. Accounting Equation

Now let us understand some transactions and their impact in accounting equation through a detailed example.

To illustrate, let's take the example of **Ravi Sharma eTravels**. Sharma operates a travel agency. Online customers plan and pay for their trips through the Sharma website. The website is connected to airlines, hotels, and cruise lines, allowing clients to access the latest information 24/7.

Now let's analyze some of Ravi Sharma eTravels' transactions.

Transaction 1: Starting the Business

Ravi Sharma invests Rs. 30,000 of his own money to start the business. He deposits Rs. 30,000 into a bank account titled **Ravi Sharma eTravels**.

The effect of this transaction on the accounting equation of the Ravi Sharma Travels business entity is as follows:

- **Assets** increase by Rs. 30,000 (the amount deposited into the bank account).
- **Owner's Equity** increases by Rs. 30,000 (representing Ravi Sharma's investment in the business).

The effect of this transaction on the accounting equation of Ravi Sharma's eTravel business entity is:

	ASSETS		LIABILITIES	+	OWNER'S EQUITY
	Cash (Rs.)				Ravi Sharma, Capital (Rs.)
[1] Introducing Capital	(+) 30,000	=			(+) 30,000

For every transaction, the amount on the left side of the equation must equal the amount on the right side. The first transaction increases both the assets (in this case, Cash) and the owner's equity (Ravi Sharma, Capital) of the business.

Transaction 2: Purchase of Land

Ravi purchases land for an office location, paying cash of Rs. 20,000. The effect of this transaction on the accounting equation is:

	ASSETS				LIABILITIES	+	OWNER'S EQUITY
	Cash (Rs.)	+	Land (Rs.)				Ravi Sharma, Capital (Rs.)
Old Balance	30,000			=			30,000
[2] Purchase of Land	(-) 20,000		(+) 20,000				
New Balance	10,000		20,000				30,000
	30,000						30,000

The cash purchase of land increases one asset, Land, and decreases another asset, Cash, by the same amount. After the transaction is completed, Ravi's business has cash of Rs. 10,000, land of Rs. 20,000, no liabilities, and owner's equity of Rs. 30,000.

Now the business holds two assets, with the liabilities and owner's equity unchanged.

Note that the sums of the balances on both sides of the equation must always be equal.

Transaction 3: Purchase of Office Supplies

Ravi buys stationery and other office supplies, agreeing to pay Rs. 500 within 30 days. This transaction increases both the assets and the liabilities of the business. Its effect on the accounting equation is:

	ASSETS				LIABILITIES +	OWNER'S EQUITY
	Cash (Rs.) +	Office Supplies (Rs.) +	Land (Rs.)		Accounts Payable (Rs.) +	Ravi Sharma, Capital (Rs.)
Old Balance	10,000		20,000	=		30,000
[3] Purchase of office supplies		(+) 500			(+) 500	
New Balance	10,000	500	20,000		500	30,000
	30,500				30, 500	

Office Supplies is an asset, not an expense, because the supplies can be used in the future. The liability created by this transaction is an account payable. Recall that a payable is a liability.

Transaction 4: Earning of Service Revenue

Ravi Sharma's eTravel earns service revenue by providing travel services for clients. The business earns Rs. 5,500 revenue and collects this amount in cash. The effect on the accounting equation is an increase in the asset Cash and an increase in Ravi Sharma, Capital, as follows:

	ASSETS				LIABILITIES +	OWNER'S EQUITY
	Cash (Rs.) +	Office Supplies (Rs.) +	Land (Rs.)		Accounts Payable (Rs.) +	Ravi Sharma, Capital (Rs.)
Old Balance	10,000	500	20,000	=	500	30,000
[4] Cash Sales	(+) 5,500					(+) 5,500
New Balance	15,500	500	20,000		500	35,500
	36,000				36,000	

A revenue transaction grows the business, as shown by the increases in assets and owner's equity. A company like Amazon.com or Wal-Mart that sells goods to customers is a merchandising business. Its revenue is called sales revenue. By contrast, Ravi Sharma eTravel performs services for clients; this revenue is called service revenue.

Transaction 5: Earning of Service Revenue on account

Ravi performs services for clients who do not pay immediately. In return for his travel services, Ravi receives clients' promises to pay Rs. 3,000 within one month. This promise is an asset to Ravi's business, an account receivable because he expects to collect the cash in the future.

In accounting, we say that Ravi performed this service on account or on credit. When the business performs service for a client, the business earns the revenue. The act of performing the service, not collecting the cash, earns the revenue.

This Rs. 3,000 of service revenue increases the wealth of Ravi's business just like Rs. 5,500 of revenue that he collected immediately in transaction 4. Ravi records Rs. 3,000 of revenue on account as follows:

	ASSETS					LIABILITIES +	OWNER'S EQUITY
	Cash (Rs.)	+ Accounts Receivable (Rs.)	+ Office Supplies (Rs.)	+ Land (Rs.)		Accounts Payable (Rs.) +	Ravi Sharma, Capital (Rs.)
Old Balance	15,500		500	20,000	=	500	35,500
[5] Revenue on account		(+) 3,000					(+) 3,000
New Balance	15,500	3,000	500	20,000		500	38,500
	39,000					39,000	

Transaction 6: Payment of Expenses

During the month, Ravi pays Rs. 3,300 in cash expenses: lease expense on a computer, Rs. 600; office rent, Rs. 1,100; employee salary, Rs. 1,200 (part-time assistant); and utilities, Rs. 400. The effects on the accounting equation are:

	ASSETS					LIABILITIES +	OWNER'S EQUITY
	Cash (Rs.)	+ Accounts Receivable (Rs.)	+ Office Supplies (Rs.)	+ Land (Rs.)		Accounts Payable (Rs.) +	Ravi Sharma, Capital (Rs.)
Old Balance	15,500	3,000	500	20,000	=	500	38,500
[6] Lease Exp.	(-) 600						(-) 600
[6] Rent Exp.	(-) 1,100						(-) 1,100
[6] Salary	(-) 1,200						(-) 1,200
[6] Utilities	(-) 400						(-) 400
New Balance	12,200	3,000	500	20,000		500	35,200
	35,700					35,700	

Expenses have the opposite effect of revenues. Expenses cause the business to shrink, as shown by the decreased balances of assets and owner's equity.

Each expense is recorded separately. The expenses are listed together here for simplicity. We could record the cash payment in a single amount for the sum of the four expenses: Rs.3,300 (Rs. 600 + Rs. 1,100 + Rs. 1,200 + Rs. 400). In all cases, the "balance" of the equation holds, as we know it must.

Transaction 7: Payment on Account

Ravi pays Rs. 300 to the store where he purchased Rs. 500 worth of office supplies in transaction 3. In accounting, we say that he pays Rs. 300 on account. The effect on the accounting equation is a decrease in the asset Cash and a decrease in the liability Accounts Payable, as shown next.

	ASSETS					LIABILITIES +	OWNER'S EQUITY
	Cash (Rs.) +	Accounts Receivable (Rs.) +	Office Supplies (Rs.) +	Land (Rs.)		Accounts Payable (Rs.) +	Ravi Sharma, Capital (Rs.)
Old Balance	12,200	3,000	500	20,000	=	500	35,200
[7] Payment on Account	(-) 300					(-) 300	
New Balance	11,900	3,000	500	20,000		200	35,200
	35,400					35,400	

Transaction 8: Personal Transaction

Ravi remodels her home at a cost of Rs. 40,000, paying cash from personal funds. This event is not a transaction of Ravi Sharma eTravel. It has no effect on the travel agency and therefore is not recorded by the business. It is a transaction of Ravi Sharma personal entity, not Ravi Sharma eTravel. This transaction illustrates the entity concept.

Transaction 9: Collection on Account

In transaction 5, Ravi performed services for a client on account. The business now collects Rs. 1,000 from the client. We say that Ravi collects the cash on account. Ravi will record an increase in the asset Cash. Should she also record an increase in service revenue?

No, because he already recorded the revenue when he earned it in transaction 5. The phrase "collect cash on account" means to record an increase in Cash and a decrease in Accounts Receivable. The effect on the accounting equation of Ravi Sharma eTravel is:

	ASSETS					LIABILITIES +	OWNER'S EQUITY
	Cash (Rs.) +	Accounts Receivable (Rs.) +	Office Supplies (Rs.) +	Land (Rs.)		Accounts Payable (Rs.) +	Ravi Sharma, Capital (Rs.)
Old Balance	11,900	3,000	500	20,000	=	200	35,200
[9] Collection on Account	(+) 1,000	(-) 1,000					
New Balance	12,900	2,000	500	20,000		200	35,200
	35,400					35,400	

Total assets are unchanged from the preceding total. Why? Because Ravi merely exchanged one asset for another. Also, total liabilities and owner's equity are unchanged.

Transaction 10: Sale of Land

Ravi sells some land owned by the travel agency. The sale price of Rs. 9,000 is equal to Ravi's cost of the land. Ravi's business receives Rs. 9,000 cash. The effect on the accounting equation of the travel agency follows:

	ASSETS								LIABILITIES	+	OWNER'S EQUITY
	Cash (Rs.)	+	Accounts Receivable (Rs.)	+	Office Supplies (Rs.)	+	Land (Rs.)		Accounts Payable (Rs.)	+	Ravi Sharma, Capital (Rs.)
Old Balance	12,900		2,000		500		20,000	=	200		35,200
[10] Sale of Land	(+) 9,000						(-) 9,000				
New Balance	21,900		2,000		500		11,000		200		35,200
	35,400								35,400		

Transaction 11: Withdrawal of Cash

Ravi withdraws Rs. 2,000 cash from the business for personal use. The effect on the accounting equation is:

	ASSETS								LIABILITIES	+	OWNER'S EQUITY
	Cash (Rs.)	+	Accounts Receivable (Rs.)	+	Office Supplies (Rs.)	+	Land (Rs.)		Accounts Payable (Rs.)	+	Ravi Sharma, Capital (Rs.)
Old Balance	21,900		2,000		500		11,000	=	200		35,200
[11] Owner's drawings	(-) 2,000										(-) 2,000
New Balance	19,900		2,000		500		11,000		200		33,200
	33,400								33,400		

Ravi's withdrawal of Rs. 2,000 cash decreases the asset Cash and also the owner's equity of the business. The withdrawal does not represent an expense because the cash is used for the owner's personal affairs. We record this decrease in owner's equity as Withdrawals or as Drawings.

4. Accounting Equation

Jayanti Kapoor opens an apartment-locator business near a college campus. She is the sole owner of the proprietorship, which she names Campus Apartment Locators.

During the first month of operations, April 2024, she engages in the following transactions:

a. Kapoor invests Rs. 35,000 of personal funds to start the business.
b. She purchases on account office supplies costing Rs. 350.
c. Kapoor pays cash of Rs. 30,000 to acquire a lot next to the campus. She intends to use the land as a future building site for her business office.
d. Kapoor locates apartments for clients and receives cash of Rs. 1,900.
e. She pays Rs. 100 on the account payable she created in transaction (b).
f. She pays Rs. 2,000 of personal funds for a vacation.
g. She pays cash expenses for office rent, Rs. 400, and utilities, Rs. 100.
h. The business sells office supplies to another business for its cost of Rs. 150.
i. Kapoor withdraws cash of Rs. 1,200 for personal use.

You are required to do the following:

1. Analyze the preceding transactions in terms of their effects on the accounting equation of Campus Apartment Locators. Show balances only after the last transaction.

2. Prepare the income statement, statement of owner's equity, and balance sheet of the business after recording the transactions.

Solution:

1. Analysis of the transactions in terms of their effects on the accounting equation of Campus Apartment Locators.

(Amt. in. Rs.)

	ASSETS					=	LIABILITIES	+	OWNER'S EQUITY
	Cash	+	Office Supplies	+	Land		Accounts Payable	+	Jayanti Kapoor, Capital
(a) Owner's Investment	(+) 35,000								(+) 35,000
(b) On account supplies purchase			(+) 350				(+) 350		
(c) Land Purchase	(-) 30,000				(+) 30,000				
(d) Service Revenue	(+) 1,900								(+) 1,900
(e) Payment towards office supplies	(-) 100						(-) 100		
(g) Expense towards office rent and utilities	(-) 500								(-) 500
(h) Sale of office supplies	(+) 150		(-) 150						
(i) Drawings	(-) 1,200								(-) 1,200
	5,250		200		30,000		250		35,200
	35,450						35,450		

Note: Transaction (f) is not a business transaction.

2. Financial Statements of Campus Apartment Locators

Income Statement for Month ended 31st April 2024		
Revenue		1,900
Service Revenue		
Less: Expenses		
Rent expense	400	
Utilities expense	100	(500)
Net Income		1,400

Statement of Owner's Equity for Month ended 31st April 2024		
Jayanti Kapoor, capital 1st April 2024		-
Add: investment by owner	35,000	
Add: Net income for the month	1,400	36,400
Less: Withdrawal by owner		(1,200)
Jayanti Kapoor, capital 31st April 2024		35,200

Balance sheet 31st April 2024

Liabilities		Assets	
Owner's Equity		Land	30,000
Jayanti Kapoor, Capital	35,200	Office Supplies	200
Other Liabilities		Cash	5,250
Accounts Payable	250		
TOTAL	35,450	TOTAL	35,450

4. Accounting Equation

Prepare accounting equation on the basis of following.
(i) Sahil commences his business with Rs. 50,000 as Capital.
(ii) Purchases furniture for Rs. 5,000 in cash.
(iii) Purchases goods for Rs. 10,000 in cash.
(iv) Purchases goods for Rs. 2,000 on credit.
(v) Sold goods costing Rs. 2,500 on credit for Rs. 4,000.
(vi) Paid Rs.4,000 for rent and Rs. 3,000 as salaries.
(vii) Sahil withdraws Rs. 2,000 for his personal use.

Solution:

We will proceed step by step for each of the transactions given in the question.

(i) Sahil commences his business with Rs. 50,000 as Capital.

	(1)	(2)	(3)
	Total Assets	Liabilities	Owner's Capital
	Cash (Rs.)	(Rs.)	Sahil's (Rs.)
Capital Introduced	50,000	0	50,000

By Accounting Equation ⇒ (1) = (2) + (3)

(ii) Purchases furniture for Rs. 5,000 in cash.

	(1)		(2)	(3)
	Total Assets		Liabilities	Owner's Capital
	Cash (Rs.)	Furniture (Rs.)	(Rs.)	Sahil's (Rs.)
Old Balance	50,000	0	0	50,000
New Transaction	− 5,000	+ 5,000	0	0
New Balance	45,000	5,000	0	50,000

By Accounting Equation ⇒ (1) = (2) + (3)

(iii) Purchases goods for Rs. 10,000 in cash.

(1) (2) (3)

	Total Assets			Liabilities	Owner's Capital
	Cash (Rs.)	Furniture (Rs.)	Stock (Rs.)	Creditors (Rs.)	Sahil's (Rs.)
Old Balance	45,000	5,000	0	0	50,000
New Transaction	−10,000	0	+ 10,000	0	0
New Balance	35,000	5,000	10,000	0	50,000

By Accounting Equation ⇒ (1) = (2) + (3)

(iv) Purchases goods for Rs. 2,000 on credit.

(1) (2) (3)

	Total Assets			Liabilities	Owner's Capital
	Cash (Rs.)	Furniture (Rs.)	Stock (Rs.)	Creditors (Rs.)	Sahil's (Rs.)
Old Balance	35,000	5,000	10,000	0	50,000
New Transaction	0	0	+2,000	+ 2,000	0
New Balance	35,000	5,000	12,000	2,000	50,000

By Accounting Equation ⇒ (1) = (2) + (3)

(v) Sold goods costing Rs. 2,500 on credit for Rs. 4,000.

(1) (2) (3)

	Total Assets				Liabilities	Owner's Capital
	Cash (Rs.)	Furniture (Rs.)	Stock (Rs.)	Debtors (Rs.)	Creditors (Rs.)	Sahil's (Rs.)
Old Balance	35,000	5,000	12,000	0	2,000	50,000
New Transaction	0	0	− 2,500	+4,000	0	+ 1,500
New Balance	35,000	5,000	9,500	4,000	2,000	51,500

By Accounting Equation ⇒ (1) = (2) + (3)

(vi) Paid Rs.4,000 for rent and Rs. 3,000 as salaries.

	(1)				(2)	(3)
	Total Assets				Liabilities	Owner's Capital
	Cash (Rs.)	Furniture (Rs.)	Stock (Rs.)	Debtors (Rs.)	Creditors (Rs.)	Sahil's (Rs.)
Old Balance	35,000	5,000	9,500	4,000	2,000	51,500
New Transaction	– 7,000	0	0	0	0	–7,000
New Balance	28,000	5,000	9,500	4,000	2,000	44,500

By Accounting Equation ⇒ (1) = (2) + (3)

(vii) Sahil withdraws Rs. 2,000 for his personal use.

	(1)				(2)	(3)
	Total Assets				Liabilities	Owner's Capital
	Cash (Rs.)	Furniture (Rs.)	Stock (Rs.)	Debtors (Rs.)	Creditors (Rs.)	Sahil's (Rs.)
Old Balance	28,000	5,000	9,500	4,000	2,000	44,500
New Transaction	–2,000	0	0	0	0	–2,000
New Balance	26,000	5,000	9,500	4,000	2,000	42,500

By Accounting Equation ⇒ (1) = (2) + (3)

4. Accounting Equation

Prepare Accounting Equation on the basis of the following:
(i) Started business with cash Rs. 1,00,000.
(ii) Credit purchases of goods Rs. 25,000.
(iii) Payment made to creditors in full settlement Rs. 24,000.
(iv) Purchase of machinery for cash Rs. 20,000.

Solution:

By Accounting Equation $\Rightarrow$ (1) = (2) + (3)

Sl. No.	Transactions	Total Assets (1)			Liabilities (2)	Owner's Capital (3)
		Cash (Rs.)	Stock (Rs.)	Machinery (Rs.)	Creditors (Rs.)	Capital (Rs.)
1.	Started business with cash Rs. 1,00,000	1,00,000	0	0	0	1,00,000
2.	Credit purchases of goods Rs. 25,000	0	+25,000	0	+25,000	0
	New Equation	1,00,000	25,000	0	25,000	1,00,000
3.	Payment made to creditors in full settlement Rs. 24,000	-24,000	0	0	-25,000	+1,000
	New Equation	76,000	25000	0	0	1,01,000
4.	Purchase of machinery for cash for Rs. 20,000	-20,000	0	20,000	0	0
	New Equation	56,000	25000	20,000	0	1,01,000

4. Accounting Equation

Find out the year ending capital by developing the accounting equation from following information available at the beginning and at the end of the accounting period:

Particulars	(Rs. In '000)	
	Year Beginning	Year Ending
Capital	52,000	?
Loan	12,500	12,500
Trade Payables	5,700	5,900
Fixed Assets	13,800	12,720
Inventory	23,600	22,900
Trade Receivables	17,500	22,500
Cash at Bank	15,300	15,560

Also, prepare Balance Sheet at the end of the accounting period.

Solution:

In Accounting Equation, Assets = Liabilities + Equity

For Year Beginning, $A_0 = L_0 + E_0$

For Year Ending, $A_1 = L_1 + E_1$

Now, $E_0 = 52{,}000$

$L_0 =$ Loan + Trade Payables

$= 12{,}500 + 5{,}700 = 18{,}200$

And, $E_0 + L_0 = 52{,}000 + 18{,}200 = 70{,}200$

$A_0 =$ Fixed Assets + Inventories + Receivables + Cash at Bank

$= 13{,}800 + 23{,}600 + 17{,}500 + 15{,}300 = 70{,}200$

Similarly, $E_1 = ?$

$$L_1 = 12{,}500 + 5{,}900 = 18{,}400$$

$$A_1 = 12{,}720 + 22{,}900 + 22{,}500 + 15{,}600$$

$$= 73{,}720$$

Now, we have $A_1 = L_1 + E_1$

$$73{,}720 = 18{,}400 + E_1$$

Or, $E_1 = 55{,}320$

Now, $\text{Profit} = E_1 - E_0$

$$\text{Profit} = 55{,}320 - 52{,}000 = 3{,}320$$

The Balance Sheet will appear as follows.

Balance Sheet

Liabilities		Amount	Assets	Amount
Capital Balance *Add:* Profit	 52,000 3,320	55,320	Fixed Assets Inventories	12,720 22,900
Loan		12,500	Trade Receivables	22,500
Trade Payables		5,900	Cash at Bank	15,600
		73,720		73,720

5. Using Debit and Credit

As already stated every transaction involves give and take aspect. In double entry accounting, every transaction affects and is recorded in at least two accounts. When recording each transaction, the total amount debited must equal to the total amount credited.

In accounting, the terms — debit and credit indicate whether the transactions are to be recorded on the left hand side or right hand side of the account. In its simplest form, an account looks like the letter T. Because of its shape, this simple form called a **T-account**.

Notice that the T format has a left side and a right side for recording increases and decreases in the item. This helps in ascertaining the ultimate position of each item at the end of an accounting period. For example, if it is an account of a customer all goods sold shall appear on the left (debit) side of customer's account and all payments received on the right side. The difference between the totals of the two sides called balance shall reflect the amount due to the customer.

Debit = Left Side   Credit = Right Side

In a T account, the left side is called **debit** (often abbreviated as Dr.) and the right side is known as **credit** (often abbreviated as Cr.). To enter amount on the left side of an account is to debit the account. To enter amount on the right side is to credit the account.

Dr = Debit	Cr = Credit

The format of T-account is shown below.

Dr.   T-Account Format   Cr.

Date	Particulars	Amount (Rs.)	Date	Particulars	Amount (Rs.)

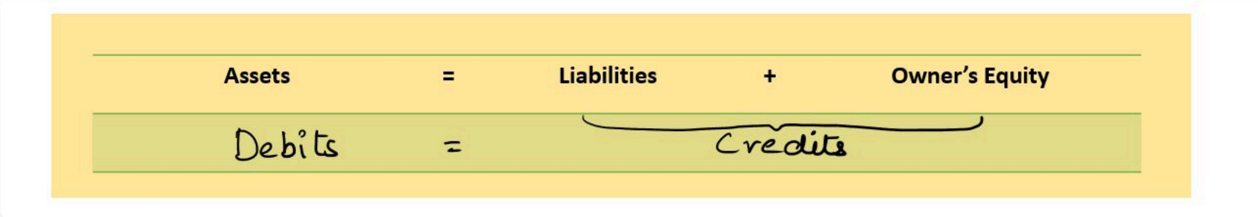
5. Using Debit and Credit

The account category (asset, liability, equity) governs how we record increases and decreases. For any given account, increases are recorded on one side, and decreases are recorded on the other side.

These are the **rules of debit and credit**.

Remember that debit means left side and credit means right side. Whether an account is increased or decreased by a debit or a credit depends on the type of account.

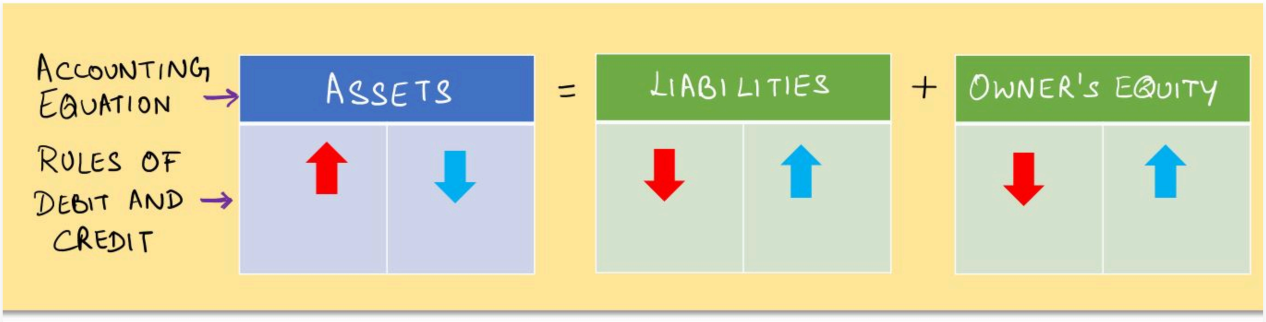
This pattern of recording debits and credits is based on the accounting equation:



Assets are on the opposite side of the equation from liabilities and owner's equity. Therefore, increases and decreases in assets are recorded in the opposite manner from increases and decreases in liabilities and owner's equity. Liabilities and owner's equity are on the same side, so they are treated in the same way.

Relationship between Accounting Equation and Rules of Debit and Credit

The figure shows the relationship between the accounting equation and the rules of debit and credit.



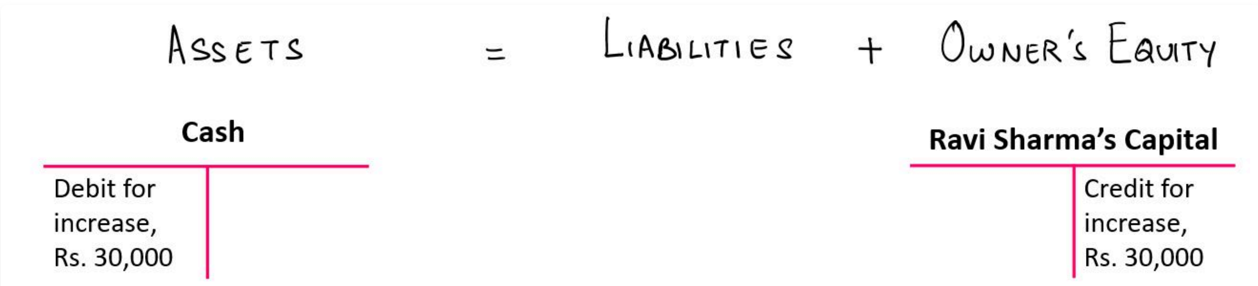
To illustrate the ideas as exhibited above, reconsider the first transaction of Ravi Sharma's eTravel from Accounting Equation.

Ravi Sharma's eTravel received Rs. 30,000 cash from Ravi Sharma and gave it the owner's equity in the business. Remember, we are accounting for the business entity Ravi Sharma eTravel. We are not accounting for Ravi Sharma, the person.

Transaction 1: Starting the Business
Ravi Sharma invests Rs. 30,000 of his own money to start the business. He deposits Rs. 30,000 into a bank account titled Ravi Sharma eTravels.

Now, which accounts of the business are affected? By what amounts? On what side (debit or credit)?

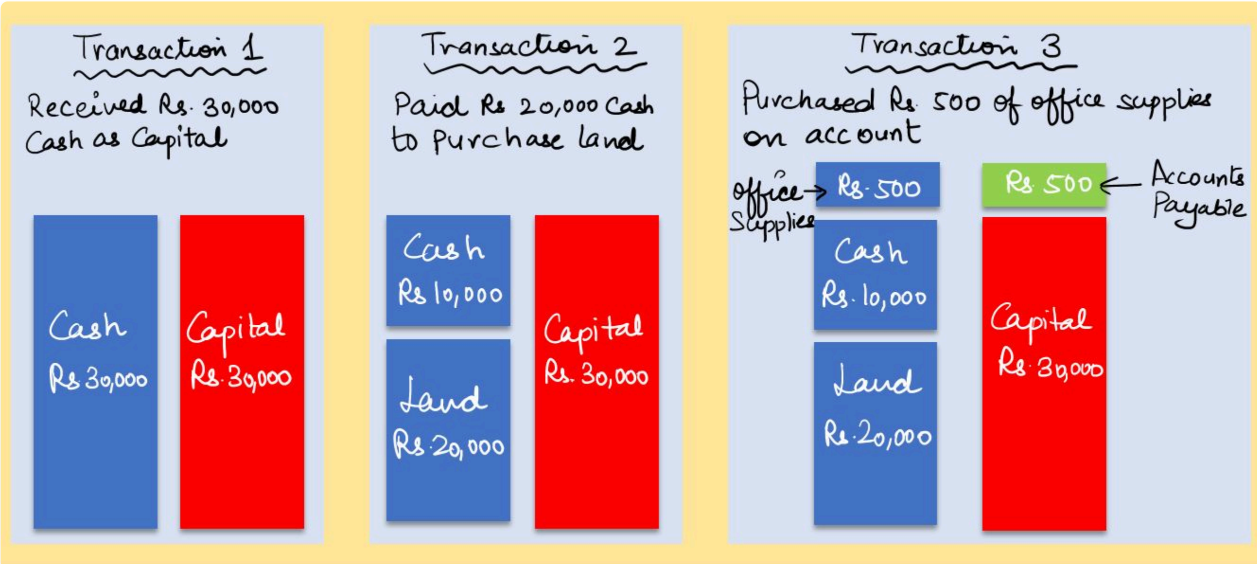
The answer: The business's Assets and Capital would increase by Rs. 30,000, as the T-accounts show.



The amount remaining in an account is called its balance. The first transaction gives Cash a Rs. 30,000 debit balance and Ravi Sharma, Capital a Rs. 30,000 credit balance.

Notice that Assets = Liabilities + Owner's Equity and that total debit amounts = total credit amounts.

The following figure illustrates the accounting equation and Ravi Sharma's eTravel's first 3 transactions.



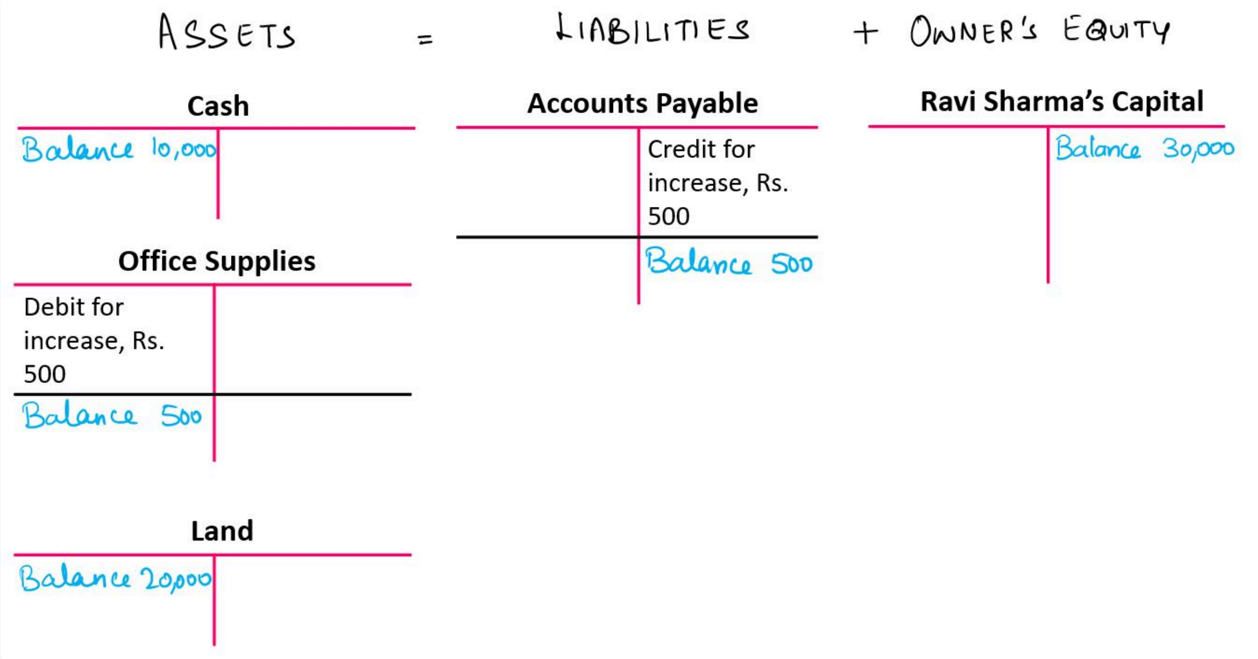
Transaction 2: Purchase of Land
Ravi purchases land for an office location, paying cash of Rs. 20,000.

The second transaction is a Rs. 20,000 cash purchase of land. This transaction decreases (credits) Cash and increases (debits) Land, as shown in the T-accounts:

After this transaction, Cash has a Rs. 10,000 debit balance (Rs. 30,000 debit minus Rs. 20,000 credit), Land has a debit balance of Rs. 20,000, and Ravi Sharma, Capital has a Rs. 30,000 credit balance.

Transaction 3: Purchase of Office Supplies
Ravi buys stationery and other office supplies, agreeing to pay Rs. 500 within 30 days.

Transaction 3 is a Rs. 500 purchase of office supplies on account. This transaction increases the asset Office Supplies and the liability Accounts Payable, as shown in the following accounts and in the right side of following figure:

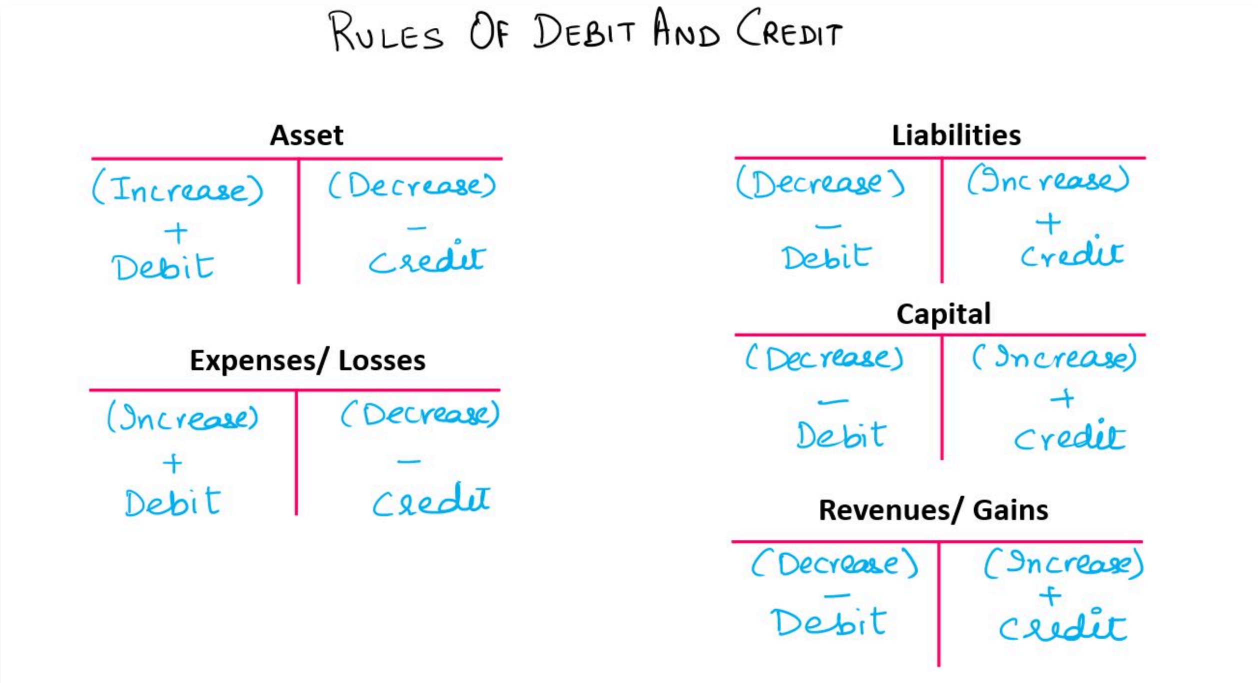


We create accounts as needed. The process of creating a new T-account is called opening the account. For transaction 1, we opened the Cash account and Ravi Sharma, Capital account. For transaction 2, we opened Land, and for transaction 3, Office Supplies and Accounts Payable.

Let us summarize once again!

Whether an entry appears on the debit or credit side of an asset depends on the account type and the nature of the transactions.

Entries on the debit side increase assets or decrease liabilities, while entries on the credit side increase liabilities or decrease assets.



Thus, two fundamental rules are followed to record the changes in these accounts:

(1) For recording changes in Assets/Expenses (Losses):
(i) Increase in asset is debited, and decrease in asset is credited.
(ii) Increase in expenses/losses is debited, and decrease in expenses/losses is credited.

(2) For recording changes in Liabilities and Capital/Revenues (Gains):
(i) Increase in liabilities is credited and decrease in liabilities is debited.

(ii) Increase in capital is credited and decrease in capital is debited.
(iii) Increase in revenue/gain is credited and decrease in revenue/gain is debited.

5. Using Debit and Credit

Let us understand rules of Debit and Credit with the help of following illustration.

1. Mohit started business with cash Rs. 5,00,000

Analysis of Transaction: The transaction increases cash on one hand and increases capital on the other hand. Increases in assets are debited and increases in capital are credited. Therefore, record the transaction with debit to Cash and credit to Mohit's Capital.

Cash Account

(1) 5,00,000	

Capital Account

	(1) 5,00,000

2. Opened a bank account with an amount of Rs. 4,80,000

Analysis of Transaction: The transaction increases the cash at bank on one hand and decreases cash in hand on the other hand. Increases in assets are debited and a decreases in assets are credited. Therefore, record the transactions with debit to Bank account and credit to Cash account.

Cash Account

(1) 5,00,000	(2) 4,80,000

Bank Account

(2) 4,80,000	

3. Bought furniture for Rs. 60,000 and issued cheque for the same

Analysis of Transaction: This transaction increases furniture (assets) on one hand and decreases bank (assets) on the other hand by Rs. 60,000. Increases in assets are debited and decreases are credited. Therefore, record the transactions with debit to Furniture account and credit to Bank account.

Furniture Account

(3) 60,000	

Bank Account

(2) 4,80,000	(3) 60,000

4. Bought Plant and Machinery from Ram lal for the business for Rs. 1,25,000 and an advance of Rs. 10,000 in cash is given.

Analysis of Transaction: This transaction increases plant and machinery (assets) by Rs. 1,25,000, decreases cash by Rs. 10,000 and increases liabilities (M/s Ram Lal as creditor) by Rs. 1,15,000. Increases in assets are debited whereas decreases in assets are credited. On the other hand, increases in liabilities are credited. Therefore, record the transaction with debit to furniture account and with credit to Cash and Ram Lal's account.

Cash Account

(1) 5,00,000	(2) 4,80,000
	(4) 10,000

Plant and Machinery Account

(4) 1,25,000	

Ram Lal's Account

	(4) 1,15,000

5. Goods purchased from Sumit Traders for Rs. 55,000

Analysis of transaction: This transaction increases purchases (expenses) and increases liabilities (M/s Sumit Traders as creditors) by Rs. 55,000. Increases in expenses are debited and increases in liabilities are credited. Therefore, record the transaction with debit to Purchases account and credit to Sumit Traders account.

Purchases Account

(5) 55,000	

Sumit Traders Account

	(5) 55,000

6. Goods costing Rs. 25,000 sold to Neerja Enterprises for Rs. 35,000

Analysis of transaction: This transaction increases sales (Revenue) and increases assets (Neerja Enterprises as debtors). Increases in assets are debited and increases in revenue are credited. Therefore, record the entry with credit to Sales account and debit to Neerja Enterprises account.

Sales Account

	(6) 35,000

Neerja Enterprises Account

(6) 35,000	

7. Paid the monthly store rent Rs. 2,500 in cash

Analysis of transaction: The payment of rent is an expense which decreases capital thus, are recorded as debits. Credit cash to record decrease in assets.

Rent Account

(7) 2,500	

Cash Account

(1) 5,00,000	(2) 4,80,000
	(4) 10,000
	(7) 2,500

8. Paid Rs. 5,000 as salary to the office employees

Analysis of transaction: The payment of salary is an expense which decreases capital thus, are recorded as debits. Credit Cash to record decrease in assets.

Salary Account

(8) 5,000	

Cash Account

(1) 5,00,000	(2) 4,80,000
	(4) 10,000
	(7) 2,500
	(8) 5,000

9. Received cheque as full payment from Neerja Enterprises and deposited same day into bank

Analysis of transaction: This transaction increase assets (Bank) on the one hand and decreases assets (Neerja Enterprises as debtors) on the other hand. Increase in assets is debited whereas decrease in assets is credited. Therefore, record the entry with debit to Bank account and credit to Rajani Enterprises account.

Neerja Enterprises Account

(6) 35,000	(9) 35,000

Bank Account

(2) 4,80,000	(3) 60,000
(9) 35,000	

5. Using Debit and Credit

Analyse the effect of each transaction on assets and liabilities and show that the both sides of Accounting Equation (A = L + C) remains equal:
(i) Introduced Rs. 8,00,000 as cash and Rs. 50,000 by stock.
(ii) Purchased plant for Rs. 3,00,000 by paying Rs. 15,000 in cash and balance at a later date.
(iii) Deposited Rs. 6,00,000 into the bank.
(iv) Purchased office furniture for Rs. 1,00,000 and made payment by cheque.
(v) Purchased goods worth Rs. 80,000 for cash and for Rs. 35,000 in credit.
(vi) Goods amounting to Rs. 45,000 was sold for Rs. 60,000 on cash basis.
(vii) Goods costing to Rs. 80,000 was sold for Rs. 1,25,000 on credit.
(viii) Cheque issued to the supplier of goods worth Rs. 35,000.
(ix) Cheque received from customer amounting to Rs. 75,000.
(x) Withdrawn by owner for personal use Rs. 25,000.

Solution:

Transaction (i) Introduced Rs. 8,00,000 as cash and Rs. 50,000 by stock.

It affects Cash and Inventory on the assets side and Capital on the other hand.

There is increase in cash by Rs. 8, 00,000 and Inventory of goods by Rs. 50,000 on assets side of the equation. Capital is increased by Rs. 8,50,000.

Amt. in Rs

ASSETS			=	LIABILITIES	+	CAPITAL
Cash	+	Inventory (Stock)				
8,00,000		50,000				8,50,000

8,50,000   8,50,000

Transaction (ii) Purchased plant for Rs. 3,00,000 by paying Rs. 15,000 in cash and balance at a later date.

It affects Cash and Plant and Machinery on the assets side and liabilities on the other side of the equation.

There is an increase in plant and machinery by Rs. 3,00,000 and decrease in cash by Rs. 15,000. Liability to pay to the supplier of plant and machinery increases by Rs. 2,85,000.

Amt. in Rs

ASSETS			=	LIABILITIES +	CAPITAL
Cash +	Inventory +	Plant & Machinery			
8,00,000	50,000				8,50,000
(15,000)		**3,00,000**		**2,85,000**	
7,85,000	50,000	3,00,000		2,85,000	8,50,000
11,35,000				11,35,000	

Transaction (iii) Deposited Rs. 6,00,000 into the bank.

It affects assets side only. The composition of the asset side changes.

Cash decreases by Rs. 6,00,000 and by the same amount bank increases.

Amt. in Rs

ASSETS				=	LIABILITIES +	CAPITAL
Cash +	Inventory +	Plant & Machinery +	Bank			
7,85,000	50,000	3,00,000			2,85,000	8,50,000
(6,00,000)			**6,00,000**			
1,85,000	50,000	3,00,000	6,00,000		2,85,000	8,50,000
11,35,000					11,35,000	

Transaction (iv) Purchased office furniture for Rs. 1,00,000 and made payment by cheque.

It affects assets side only. The composition of the asset side changes.

Furniture increases by Rs. 1,00,000 and by the same amount bank decreases.

Amt. in Rs

ASSETS					=	LIABILITIES +	CAPITAL
Cash +	Inventory +	Plant & Machinery +	Bank +	Furniture			
1,85,000	50,000	3,00,000	6,00,000			2,85,000	8,50,000
			(1,00,000)	**1,00,000**			
1,05,000	50,000	3,00,000	5,00,000	1,00,000		2,85,000	8,50,000

11,35,000   11,35,000

Transaction (v) Purchased goods worth Rs. 80,000 for cash and for Rs. 35,000 in credit.

It affects Cash and Inventory on the assets side and liability on the other side.

There is decrease in cash by Rs. 80,000 and increase of inventory of goods by Rs. 1,15,000 on the assts side of the equation. Liabilities increases by Rs. 35,000.

Amt. in Rs

ASSETS					=	LIABILITIES +	CAPITAL
Cash +	Inventory +	Plant & Machinery +	Bank +	Furniture			
1,85,000	50,000	3,00,000	5,00,000	1,00,000		2,85,000	8,50,000
(80,000)	**1,15,000**					**35,000**	
1,05,000	1,65,000	3,00,000	5,00,000	1,00,000		3,20,000	8,50,000

11,70,000   11,70,000

Transaction (vi) Goods amounting to Rs. 45,000 was sold for Rs. 60,000 on cash basis.

It affects Cash and Inventory on the assets side and capital on the other side.

There is an increase in cash by Rs. 60,000 and decrease in inventory of goods by Rs. 45,000 on the assets side of the equation. Capital increases by Rs. 15,000.

Amt. in Rs

Cash	Inventory	Plant & Machinery	Bank	Furniture	=	Liabilities	Capital
1,05,000	1,65,000	3,00,000	5,00,000	1,00,000		3,20,000	8,65,000
60,000	**(45,000)**						**15,000**
1,65,000	1,20,000	3,00,000	5,00,000	1,00,000		3,20,000	8,65,000
11,85,000						11,85,000	

Transaction (vii) Goods costing to Rs. 80,000 was sold for Rs. 1,25,000 on credit.

It affects Debtors and Inventory on the assets side and capital on the other side.

There is increase in debtors by Rs. 1,25,000 and decrease in Inventory of goods by Rs. 80,000 on the assets side of the equation. Capital increases by Rs. 45,000.

Amt. in Rs

Cash	Inventory	Plant & Machinery	Bank	Furniture	Debtors	=	Liabilities	Capital
1,65,000	1,20,000	3,00,000	5,00,000	1,00,000			3,20,000	8,65,000
	(80,000)				**1,25,000**			**(45,000)**
1,65,000	40,000	3,00,000	5,00,000	1,00,000	1,25,000		3,20,000	9,10,000
12,30,000							12,30,000	

Transaction (viii) Cheque issued to the supplier of goods worth Rs. 35,000.

It affects Bank on the assets side on one side and liability on the other side.

There is decrease in bank by Rs. 35,000 on the assets side and liability also decreases by Rs. 35,000.

Amt. in Rs

ASSETS						=	LIABILITIES +	CAPITAL
Cash +	Inventory +	Plant & Machinery +	Bank +	Furniture +	Debtors			
1,65,000	40,000	3,00,000	5,00,000	1,00,000	1,25,000		3,20,000	9,10,000
			(35,000)				**(35,000)**	
1,65,000	40,000	3,00,000	4,65,000	1,00,000	1,25,000		2,85,000	9,10,000
11,95,000							11,95,000	

Transaction (ix) Cheque received from customer amounting to Rs. 75,000.

It affects assets side only. The composition of the assets side changes.

Bank increases by Rs. 75,000 and by the same amount Debtors decreases.

Amt. in Rs

ASSETS						=	LIABILITIES +	CAPITAL
Cash +	Inventory +	Plant & Machinery +	Bank +	Furniture +	Debtors			
1,65,000	40,000	3,00,000	4,65,000	1,00,000	1,25000		2,85,000	9,10,000
			75,000		**(75,000)**			
1,65,000	40,000	3,00,000	5,40,000	1,00,000	50,000		2,85,000	9,10,000
11,95,000							11,95,000	

Transaction (x) Withdrawn by owner for personal use Rs. 25,000.

It affects Cash on the asset side and Capital on the other hand.

There is decrease in Cash by Rs. 25,000 on the assets side whereas capital decreases by Rs. 25,000.

Amt. in Rs

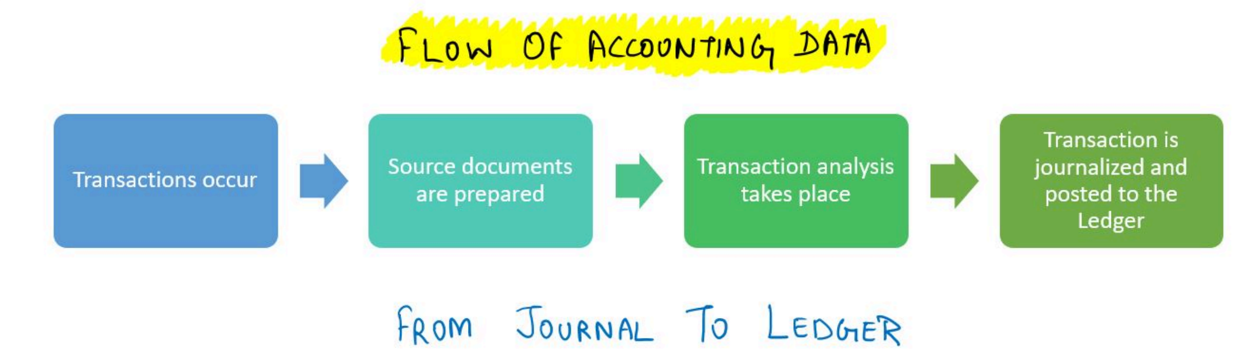
ASSETS						=	LIABILITIES +	CAPITAL
Cash +	Inventory +	Plant & Machinery +	Bank +	Furniture +	Debtors			
1,65,000	40,000	3,00,000	5,40,000	1,00,000	50,000		2,85,000	9,10,000
(25,000)								**(25,000)**
1,40,000	40,000	3,00,000	5,40,000	1,00,000	50,000		2,85,000	8,85,000
11,95,000							11,95,000	

6. Books of Original Entry

The book in which the transaction is recorded for the first time is called **journal** or **book of original entry**. The source document is required to record the transaction in the journal. This practice provides a complete record of each transaction in one place and links the debits and credits for each transaction.

After the debits and credits for each transaction are entered in the journal, they are transferred to the individual accounts. The process of recording transactions in journal is called **journalising**.

Once the journalising process is completed, the journal entry provides a complete and useful description of the event's effect on the organisation.



Process of Journalizing

The **journalizing process** has 3 steps:
1. Specify each account affected and classify each account by type (asset, liability, or owner's equity).
2. Determine whether each account is increased or decreased. Use the rules of debit and credit to debit or credit each account.
3. Record the transaction in the journal, including a brief explanation. The debit side of the entry is entered first and the credit side last. Total debits should always equal total credits.

Step 3, "Recording the transaction in the journal," is also called "making the journal entry" or "journalizing the transaction."

These steps are the same in a computerized system or a manual system. In step 3, the journal entry is generally entered into the computer by account number, and the account name pops up automatically.

6. Books of Original Entry

Now, to understand journalizing, let us start with the journalization of the first transaction of Ravi Sharma's eTravel (from Accounting Equation Chapter)—the receipt of Ravi Sharma's Rs. 30,000 cash investment in the business.

STEP 1 The accounts affected by the receipt of cash from the owner are Cash and Ravi Sharma, Capital. Cash is an asset. Ravi Sharma, Capital is an owner's equity account.

STEP 2 Both accounts increase by Rs. 30,000. Therefore, we debit Cash, the asset account, and we credit Ravi Sharma, Capital, the owner's equity account.

STEP 3 The journal entry is:

Journal Page 1

Date	Particulars	L. F.	Debit (Rs.)	Credit (Rs.)
April 1	Cash Account Dr. (↑ asset ; debit) To Ravi Sharma Capital Account (↑ equity ; credit) (Received investment from owner)		30,000	30,000

↳ Brief Explanation of the transaction

Alongside Cash and Ravi Sharma, Capital, we show an arrow to indicate an increase or a decrease in the account. We also give the type of account and the related debit or credit rule. Note that these parenthetical notations are not part of the formal journal entry and are not required. But they will help you learn how to make journal entries.

The figure below shows how Journal page 1 looks after Ravi Sharma has recorded the first transaction (without the extra notation).

Journal Page 1

Date	Particulars	L. F.	Debit (Rs.)	Credit (Rs.)
April 1	Cash Account Dr. To Ravi Sharma Capital Account (Received investment from owner)		30,000	30,000

6. Books of Original Entry

Now after getting the brief idea of a Journal Entry, let us understand the formal structure or format of Journal.

Journal is the basic book of original entry. In this book, transactions are recorded in the chronological order, as and when they take place. Afterwards, transactions from this book are posted to the respective accounts. Each transaction is separately recorded after determining the particular account to be debited or credited.

The format of Journal is shown below.

JOURNAL

Ledger Folio

Date	Particulars	L. F.	Debit (Rs.)	Credit (Rs.)
--	Name of Account Dr. To name of Other Account (Brief Narration of the entry)	--	--	--

The first column in a journal is **Date** on which the transaction took place. In the **Particulars** column, the account title to be debited is written on the first line beginning from the left hand corner and the word 'Dr.' is written at the end of the column. The account title to be credited is written on the second line leaving sufficient margin on the left side with a prefix 'To'.

Below the account titles, a brief description of the transaction is given which is called **Narration**. Having written the Narration a line is drawn in the Particulars column, which indicates the end of recording the specific journal entry.

The column relating to **Ledger Folio** records the page number of the ledger book on which relevant account is appears. This column is filled up at the time of posting and not at the time of making journal entry.

The **Debit amount** column records the amount against the account to be debited and similarly the **Credit Amount** column records the amount against the account to be credited. It may be noted that, the number of transactions is very large and these are recorded in number of pages in the journal book.

Hence, at the end of each page of the journal book, the amount columns are totaled and carried forward (c/f) to the next page where such amounts are recorded as brought forward (b/f) balances.

Now let us take few other examples to understand the concept of Journal Entry more clearly.

For example, on 1 June, a company paid rent of Rs. 20,000 for the month of June. This transaction will be journalized as follows.

Date	Particulars	L. F.	Debit (Rs.)	Credit (Rs.)
01-06	Rent A/c Dr. To Cash A/c (Being rent Paid in cash)		20,000	20,000

In the above transaction, Rent Expense is an expense account that is increasing. Therefore, it is debited. Cash is an asset account that is decreasing. Therefore, it is credited.

Take another transaction, on 5 June, a customer paid Rs. 800 cash for services the company provided. This transaction will be journalized as follows.

Date	Particulars	L. F.	Debit (Rs.)	Credit (Rs.)
05-06	Cash A/c Dr.		800	
	To Fees Earned A/c			800
	(Being fees earned in cash)			

In the above transaction, cash is an asset account that is increasing. Therefore, it is debited. Fees Earned is a revenue account that is increasing. Therefore, it is credited.

In practice, each transaction follows immediately after the previous one. The same journal continues on from period to period. You do not start a new journal for a new accounting period (month or year).

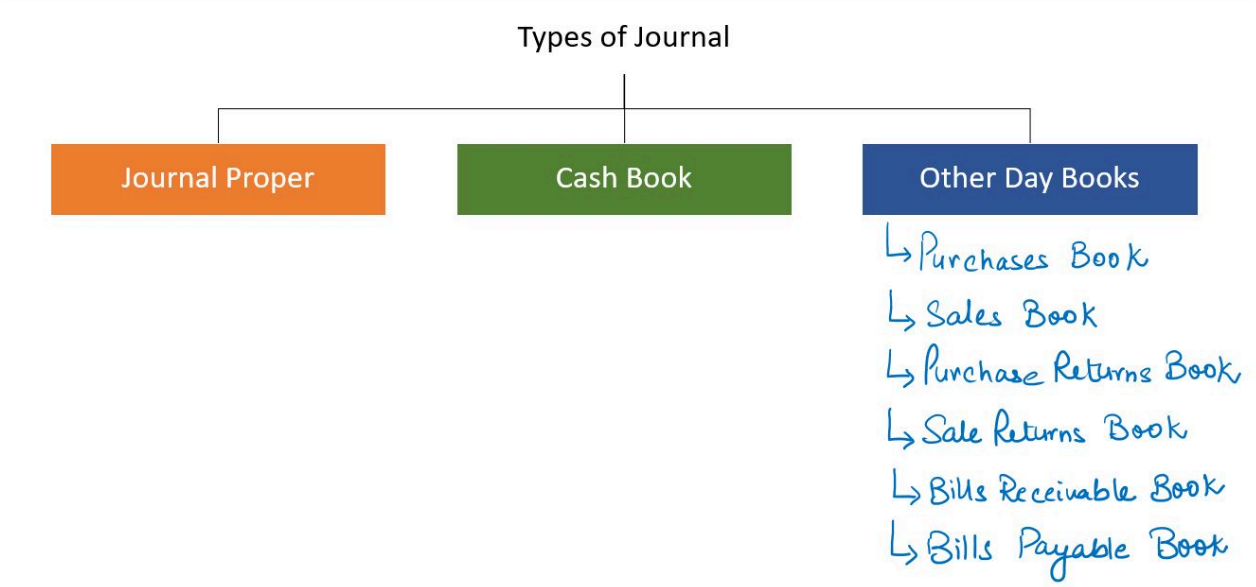
6. Books of Original Entry

A small business may be able to record all its transactions in one book only, i.e., the journal. But as the business expands and the number of transactions becomes large, it may become cumbersome to journalise each transaction. For quick, efficient and accurate recording of business transactions, Journal is sub-divided into special journals.

Many of the business transactions are repetitive in nature. They can be easily recorded in special journals, each meant for recording all the transactions of a similar nature. For example, all cash transactions may be recorded in one book, all credit sales transactions in another book and all credit purchases transactions in yet another book and so on. These special journals are also called **daybooks** or **subsidiary books**.

Note that transactions that cannot be recorded in any special journal are recorded in journal called the **Journal Proper**. Special journals prove economical and make division of labour possible in accounting work.

The journal is subdivided into a number of books of original entry as follows:

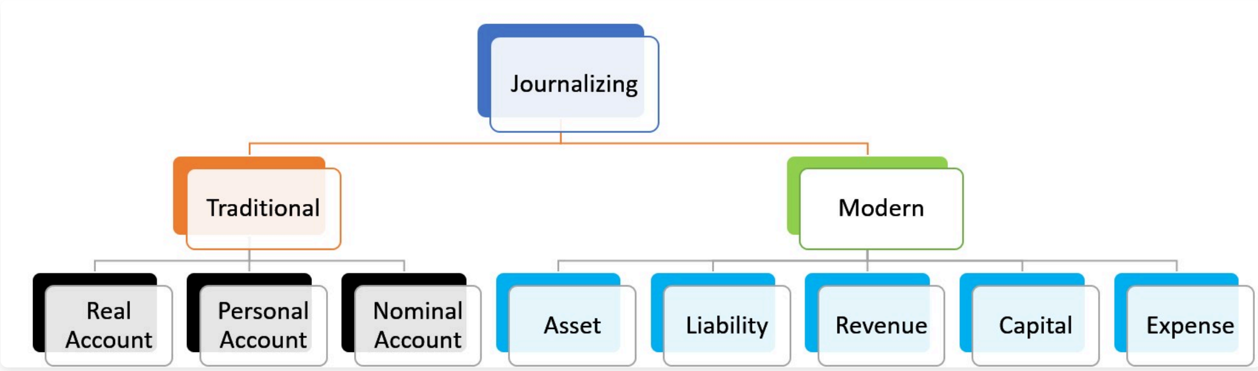


These types of Journal are discussed in separate chapters.

7. Approaches to Journalization

Journalization can be done according to the following 2 approaches:

1. Traditional Approach
2. Modern Approach



These approaches are discussed next.

7. Approaches to Journalization

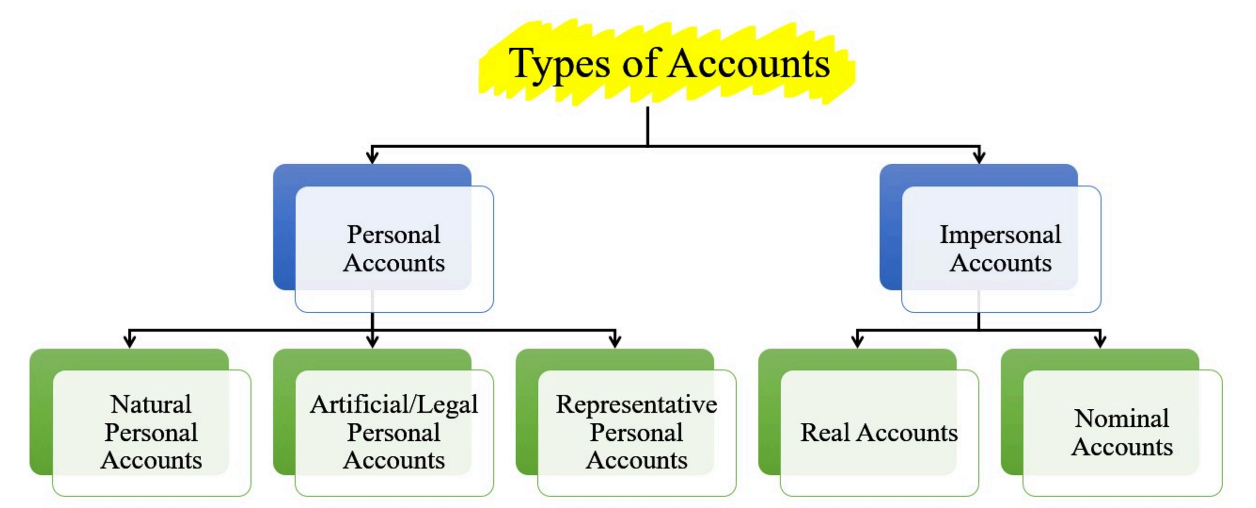
Under traditional approach to recording transactions, it is essential to grasp the concepts of debit and credit along with their associated rules, that we have already discussed.

Transactions entered into the journal are documented according to these principles of debit and credit exclusively.

Besides, under this approach accounts are classified as **personal accounts** and **impersonal accounts**. All the accounts have two rules each, one related to Debit and one related to Credit for recording the transactions which are termed as **golden rules of accounting**, as transactions are recorded on the basis of double entry system.

The classification of accounts under traditional approach are given below,

1. Personal Accounts
2. Impersonal Accounts.



These are discussed below.

1. Personal Accounts

These accounts relate to persons and liabilities. For example, the account of Ram & Co, a credit customer or the account of Jhaveri & Co., a supplier of goods. The capital account is the account of the proprietor and, therefore, it is also personal account but adjustment on account of profits and losses are made in it.

The Personal account can further be classified as follows:

(i) Natural personal accounts
The term 'Natural Persons' means persons who are creation of God. Therefore, natural personal accounts relates to transactions of human beings like Ram, Rita, etc. or include accounts in individual name such as Ram's Account, Rita's Account etc.

(ii) Artificial (legal) personal accounts
For business purpose, business entities are treated to have separate entity. They are recognized as persons in the eyes of law for dealing with other persons. For example, Government, Companies (private or limited), Clubs, Co-operative societies etc.

(iii) Representative personal accounts
These are not in the name of any person or organisation but are represented as personal accounts. For example, outstanding liability account or prepaid account, capital account, drawings account.

2. Impersonal Accounts

Impersonal Accounts are accounts which are not personal such as machinery account, cash account, rent account etc.

These Impersonal Accounts can further be classified as follows:

(i) Real Accounts
Accounts which relate to assets of the firm are called real accounts. For example, cash A/c, bank A/c, machinery A/c, plant A/c, etc.

(ii) Nominal Accounts

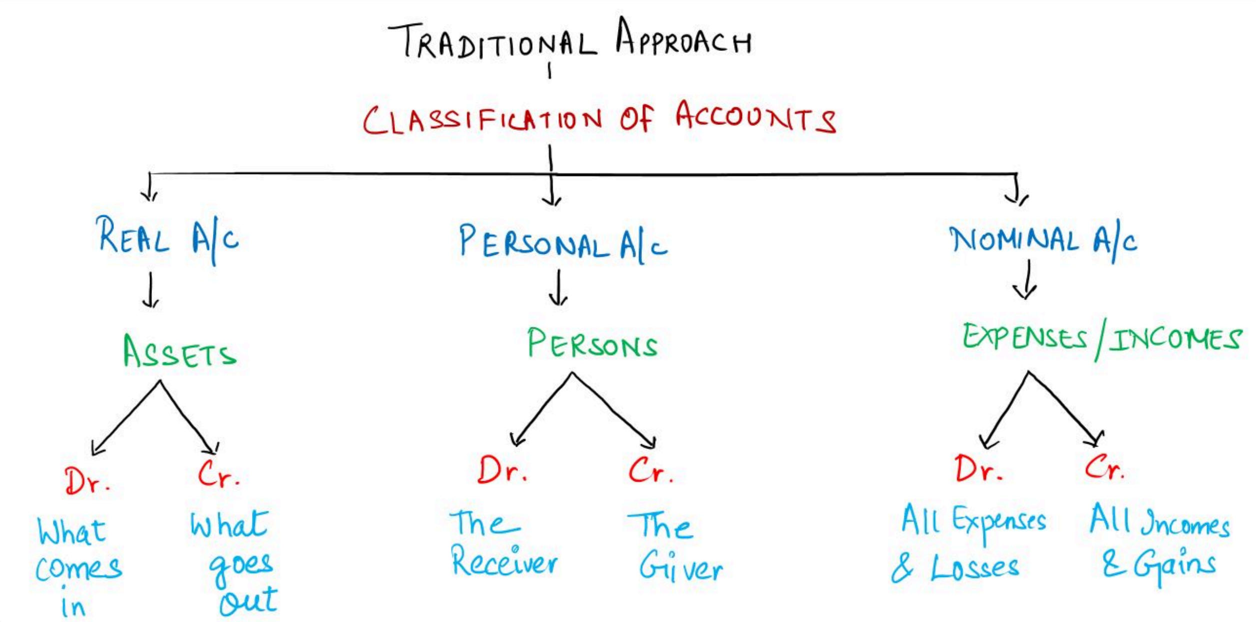
Accounts which relate to expenses, losses, gains and income are called nominal accounts. For example, salary A/c, interest paid A/c, commission received A/c. The net result of balancing of all the nominal accounts is reflected as profit or loss which is transferred to the capital account. Nominal accounts are, therefore, temporary.

7. Approaches to Journalization

Each of the categorized accounts under Traditional Approach adheres to two rules: one governing Debit and the other governing Credit, for the recording of transactions. These rules, known as the **golden rules of accounting**, are employed due to transactions being recorded based on the double-entry system.

TYPES OF ACCOUNT	ACCOUNT TO BE DEBITED	ACCOUNT TO BE CREDITED
Personal	Receiver	Giver
Real	What comes in	What goes out
Nominal	Expenses & Losses	Income and Gains

In other words, the 3 Golden Rules to be followed for journalizing each transaction of the business are as follows:



7. Approaches to Journalization

Journalize and analyze the following transactions, as per Traditional Classification of Accounts.

1. Mayank started business introducing capital of Rs. 2,00,000 in cash.
2. Opened a Bank Account by depositing Rs. 1,50,000 in cash.
3. Received loan of Rs. 1,50,000 from Sameer by Cheque.
4. Purchased furniture for Rs. 20,000 in cash from Rakesh Furniture House.
5. Purchase furniture from Furniture-Mart for Rs. 40,000.
6. Purchased goods for cash Rs. 15,000.
7. Purchased goods from Kamesh Rs. 30,000.
8. Sold goods to Harish for cash Rs. 20,000.
9. Sold goods to Krishna on credit Rs. 20,000.
10. Cash received from Krishna Rs. 15,000.
11. Cash paid to Kamesh Rs. 20,000.

Solution:

Following are the Journal Entrries and their analysis **as per Traditional Approach:**

Sl. No.	Journal Entry	Debit (Rs.)	Credit (Rs.)	Nature of Account	Analysis
1.	Cash A/c Dr. To Capital A/c	2,00,000	2,00,000	Real Personal	Cash is Coming in Mayank is giver
2.	Bank A/c Dr. To Cash A/c	1,50,000	1,50,000	Personal Real	Bank is receiver Cash is going out
3.	Bank A/c Dr. To Loan from Sameer A/c	1,50,000	1,50,000	Personal Personal	Bank is receiver Sameer is giver
4.	Furniture A/c Dr. To Cash A/c	20,000	20,000	Real Real	Furniture is Coming in Cash is going out
5.	Furniture A/c Dr. To Furniture Mart A/c	40,000	40,000	Real Personal	Furniture is coming in Furniture Mart is giver
6.	Purchases A/c Dr. To Cash A/c	15,000	15,000	Nominal Real	Goods come in Cash is going out
7.	Purchases A/c Dr. To Kamesh A/c	30,000	30,000	Nominal Personal	Goods comes in Kamesh is giver

Sl. No.	Journal Entry	Debit (Rs.)	Credit (Rs.)	Nature of Account	Analysis
8.	Cash A/c Dr. To Sales A/c	20,000	20,000	Real Nominal	Cash is coming in Sales is an income
9.	Krishna A/c Dr. To Sales A/c	20,000	20,000	Personal Nominal	Krishna is receiver Sales is an income
10.	Cash A/c Dr. To Krishna A/c	15,000	15,000	Real Personal	Cash is coming in Krishna is giver
11.	Kamesh A/c Dr. To Cash A/c	20,000	20,000	Personal Real	Kamesh is receiver Cash is going out

7. Approaches to Journalization

Analyse transactions of M/s Grover & Co. for the month of March, 2024 on the basis of double entry system by adopting the following approaches:
(A) Accounting Equation Approach.
(B) Traditional Approach.

Transactions for the month of March, 2024 were as follows (figures are in '000):
1. Grover introduced capital through bank of Rs. 40,000.
2. Cash withdrawn from the City Bank Rs. 2,000.
3. Loan of Rs. 5,000 taken from Mr. Y.
4. Salaries paid for the month of March, 2024, Rs. 3,000 and Rs. 1,000 is still payable for the month of March, 2024.
5. Furniture purchased Rs. 5,000.

(C) What conclusions one can draw from the above analysis?

Solution:

(A) Accounting Equation Approach Analysis

		(1)		(2)	(3)
	Total Assets			Liabilities	Owner's Capital
	Cash (Rs.)	Bank (Rs.)	Furniture (Rs.)	Liabilities (Rs.)	Grover's (Rs.)
(a)		+ 40,000			+ 40,000
(b)	+ 2,000	− 2,000			
(c)		+ 5,000		+ 5,000	
(d)		− 3,000		+ 1,000	− 4,000
(e)		− 5,000	+ 5,000		
Balance	2,000	35,000	5,000	6,000	36,000
		42,000		42,000	

(B) Traditional Approach Analysis

Transaction	Analysis	Nature of Account	Rule	Entry
Introduction of capital	Bank received money; Owner given bank balance	Bank – Personal Capital – Personal	Debit the receiver; credit the giver	Bank A/c Dr. To Capital A/c
Cash Withdrawal	Cash comes into business; Bank gives out cash	Cash – Real Bank – Personal	Debit what comes in; Credit the giver	Cash A/c Dr. To Bank A/c
Loan from Y	Bank receives amount; Y gives loan through bank	Bank – Personal Y's Loan – Personal	Debit the receiver; credit the giver	Bank A/c Dr. Y's Loan A/c
Salary paid and due	Paid by bank Rs. 3000; Rest Rs. 1000 still outstanding	Salary – Nominal Bank – Personal Salary o/s – Personal	Debit all expenses; credit the giver; credit the giver	Salary A/c Dr. To Bank A/c To Salary O/s A/c
Furniture purchased	Furniture purchased; Bank gives out money	Furniture – Real Bank - Personal	Debit what comes in; credit the giver	Furniture A/c Dr. To Bank A/c

(C) Conclusion

The analysis above reveals that while the procedures for transaction analysis, account classification, and recording rules differ between the accounting equation approach and the traditional approach, the affected accounts and entries made remain consistent across both methodologies.

Consequently, recording transactions in affected accounts using the double-entry system remains unaffected by the specific analysis method adopted by a business. In essence, the determination of which accounts are debited and credited to record the dual aspect remains unchanged regardless of the approach employed.

7. Approaches to Journalization

The traditional classification of accounts includes real, nominal, and personal accounts. Let's now explore the contemporary and widely accepted classification.

According to the Modern Approach, the accounts are classified into the following 5 categories:

1. Asset
2. Liability
3. Revenue
4. Capital
5. Expense

Modern Rules of Accounting

In the T-accounts (accounts which uses double entry system), increase and decrease due to transactions are made on the left and right side of the accounts for assets respectively and vice-versa for liabilities. But formally accountants use the term Debit (Dr.) to denote an entry on the left side of any account and Credit (Cr.) to denote an entry on the right side of any account.

By deducting the total of liabilities from the total of assets, the amount of capital is ascertained, as is indicated by the accounting equation, i.e.,

ASSETS = LIABILITIES + CAPITAL

The modern rules for each type of account is follows:

- Increases in assets are debit; decreases are credit;
- Increases in liabilities are credit; decreases are debit;
- Increases in owner’s capital are credit; decreases are debit;
- Increases in expenses are debit; decreases are credit; and
- Increases in revenue or incomes are credit; decreases are debit.

7. Approaches to Journalization

Journalize and analyze the following transactions, as per Modern Classification of Accounts.

1. Mayank started business introducing capital of Rs. 2,00,000 in cash.
2. Opened a Bank Account by depositing Rs. 1,50,000 in cash.
3. Received loan of Rs. 1,50,000 from Sameer by Cheque.
4. Purchased furniture for Rs. 20,000 in cash from Rakesh Furniture House.
5. Purchase furniture from Furniture-Mart for Rs. 40,000.
6. Purchased goods for cash Rs. 15,000.
7. Purchased goods from Kamesh Rs. 30,000.
8. Sold goods to Harish for cash Rs. 20,000.
9. Sold goods to Krishna on credit Rs. 20,000.
10. Cash received from Krishna Rs. 15,000.
11. Cash paid to Kamesh Rs. 20,000.

Solution:

Following are the Journal Entrries and their analysis **as per Modern Approach**:

Sl. No.	Journal Entry	Debit (Rs.)	Credit (Rs.)	Nature of Account	Analysis
1.	Cash A/c Dr. To Capital A/c	2,00,000	2,00,000	Asset Capital	Increased Increased
2.	Bank A/c Dr. To Cash A/c	1,50,000	1,50,000	Asset Asset	Increased Decreased
3.	Bank A/c Dr. To Loan from Sameer A/c	1,50,000	1,50,000	Asset Liability	Increased Increased
4.	Furniture A/c Dr. To Cash A/c	20,000	20,000	Asset Asset	Increased Decreased
5.	Furniture A/c Dr. To Furniture Mart A/c	40,000	40,000	Asset Liability	Increased Increased
6.	Purchases A/c Dr. To Cash A/c	15,000	15,000	Expense Asset	Increased Decreased
7.	Purchases A/c Dr. To Kamesh A/c	30,000	30,000	Expense Liability	Increased Increased

Sl. No.	Journal Entry	Debit (Rs.)	Credit (Rs.)	Nature of Account	Analysis
8.	Cash A/c Dr. To Sales A/c	20,000	20,000	Asset Revenue	Increased Increased
9.	Krishna A/c Dr. To Sales A/c	20,000	20,000	Asset Revenue	Increased Increased
10.	Cash A/c Dr. To Krishna A/c	15,000	15,000	Asset Asset	Increased Decreased
11.	Kamesh A/c Dr. To Cash A/c	20,000	20,000	Liability Asset	Decreased Decreased

8. Types of Journal Entry

Journal Entries are of 2 types:

1. Simple Journal Entry.
2. Compound Journal Entry.

1. Simple Journal Entry

It is a journal entry in which one account is debited and another account is credited with an equal amount. For example, purchase of goods of Rs. 10,000 in cash. It affects 2 accounts, i.e.,

Purchases A/c	Expense A/c	To be debited by Rs 10,000
Cash A/c	Real A/c	To be credited by Rs. 10,000

This transaction is recorded in the journal as follows:

Date	Particulars	L. F.	Debit (Rs.)	Credit (Rs.)
	Purchases A/c Dr.		10,000	
	To Cash A/c			10,000
	(Being Purchases made in Cash)			

Note that although the transaction results in an increase in stock of goods, the account debited is purchases, not goods. In fact, the goods account is divided into five accounts, viz. purchases account, sales account, purchases returns account, sales returns account, and stock account.

2. Compound Journal Entry

It is a Journal Entry in which one or more accounts are debited and/or one or more accounts are credited or vice versa. For example, sale of goods to Ramesh for Rs. 10,000. Rs. 3,000 is received in cash and balance to be received later.

This transaction of sale has effect on 3 accounts as follows.

Cash or Bank A/c	Asset A/c	To be debited by Rs. 3,000, it being received Increase in Asset – Debited
Ramesh A/c	Asset A/c	To be debited by Rs 7,000, balance being receivable
Sales A/c	Revenue A/c	To be credited by Rs. 10,000, because it is revenue

This transaction is recorded in the journal as follows:

Date	Particulars	L. F.	Debit (Rs.)	Credit (Rs.)
	Cash A/c Dr.		3,000	
	Ramesh A/c Dr.		7,000	
	To Sales A/c			10,000
	(Being sales of goods in Cash for Rs 3,000 and Rs 7,000 on credit)			

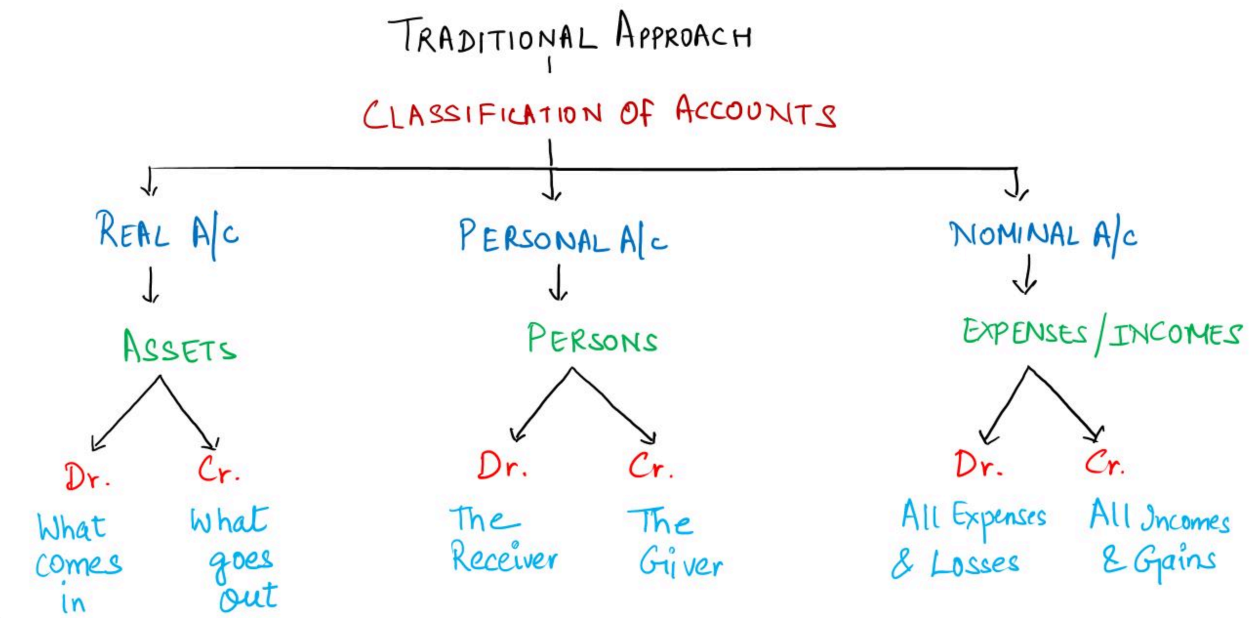
9. Rules for Journal Entries

As we now know, the traditional approach to journalizing classifies accounts into 3 main types: Real Accounts, Personal Accounts, and Nominal Accounts.

To recap:

- Real Accounts pertain to assets.
- Personal Accounts relate to individuals or entities.
- Nominal Accounts are associated with expenses and income.

The rules for each type of account are as follows:



It is important to remember that before diving into journal entries, these rules are often applied together, not separately. In other words, a single journal entry may require the application of multiple rules. For example, you might debit "what comes in" and credit "the giver" or debit "expenses" and credit "what goes out."

Let's go through some journal entries to illustrate the application of accounting rules for each type of account.

Journalizing Transactions for Real Accounts

(As per the rule: Debit what comes in, Credit what goes out)

1. Purchased furniture with cash for Rs. 10,000

Furniture A/c Dr.	10,000		Furniture comes in
To Cash A/c		10,000	Cash goes out

2. Purchased machinery for cash for Rs. 50,000

Machinery A/c Dr.	50,000		Machinery comes in
To Cash A/c		50,000	Cash goes out

3. Machinery sold for cash for Rs. 20,000

Cash A/c Dr. 20,000
To Machinery A/c 20,000
} Cash comes in
Machinery goes out

Journalizing Transactions for Personal Accounts

(As per the rule: Debit the receiver, Credit the giver)

1. Purchased a digital camera from Mohit for Rs. 20,000

Camera A/c Dr. 20,000
To Mohit A/c 20,000
} Camera comes in
Mohit is the giver

2. Purchased furniture from Seema for Rs. 8,000

Furniture A/c Dr. 8,000
To Seema A/c 8,000
} Furniture comes in
Seema is the giver

3. Paid cash to Seema Rs. 8,000

Seema A/c Dr. 8,000
To Cash A/c 8,000
} Seema is the receiver
Cash comes in

4. Machinery sold to Abhinav on credit for Rs. 5,000

Abhinav A/c Dr. 5,000
To Machinery A/c 5,000
} Abhinav is the receiver
Machinery goes out

5. Received cash from Abhinav Rs. 5,000

Cash A/c Dr. 5,000
To Abhinav A/c 5,000
} Cash comes in
Abhinav is the giver

Journalizing Transactions for Nominal Accounts

(As per the rule: Debit all expenses and losses, Credit all incomes and gains)

1. Rent paid Rs. 3,000

Rent A/c Dr. 3,000
To Cash A/c 3,000
} Rent paid is an expense
Cash goes out

2. Interest paid Rs. 10,000

Interest A/c Dr. 10,000
To Cash A/c 10,000
} Interest Paid is an expense
Cash goes out

3. Commission received Rs. 2,000

Cash A/c Dr. 2,000
To Commission Received A/c 2,000
Cash Comes in
Commission received is an income

4. Salary received Rs. 15,000

Cash A/c Dr. 15,000
To Salary A/c 15,000
Cash comes in
Salary received is an income

Key Note

Students should note that whenever a person's name is mentioned in any sale or purchase transaction, it is assumed to be a credit transaction. This is why the person's name is either debited or credited accordingly. In cash transactions, the term "cash" is explicitly mentioned to indicate that the transaction was settled in cash.

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9. Rules for Journal Entries

Two key transactions for any business are the **introduction of capital** and **drawings** by the owner.

- **Capital introduction** refers to when the owner invests money in the business, which increases the capital.
- **Drawings** refer to when the owner withdraws money from the business for personal use, which reduces the capital.

Let's now look at how these journal entries are recorded.

Journal Entries for Capital Introduction and Drawings

1. Started business with cash Rs. 1,00,000

Cash A/c Dr. 1,00,000
To Capital A/c 1,00,000

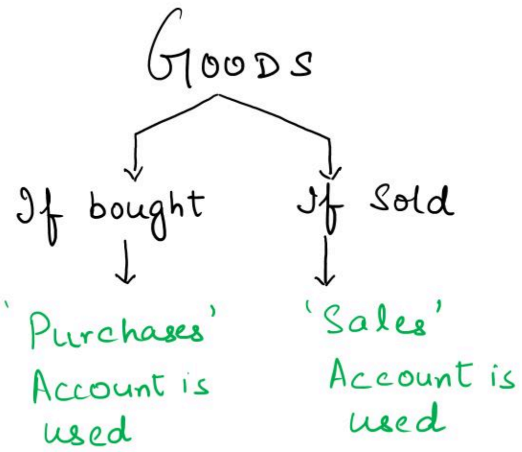
2. Cash withdrawn from business for personal use Rs. 5,000

Drawings A/c Dr. 5,000
To Cash A/c 5,000

---

9. Rules for Journal Entries

Now, let us understand the various journal entries for the purchase and sale of goods in a business. Goods are the primary items in which a business deals. For example, for a furniture seller, "furniture" is considered a good, but other items like stationery or machinery are not. This concept applies similarly to other businesses.

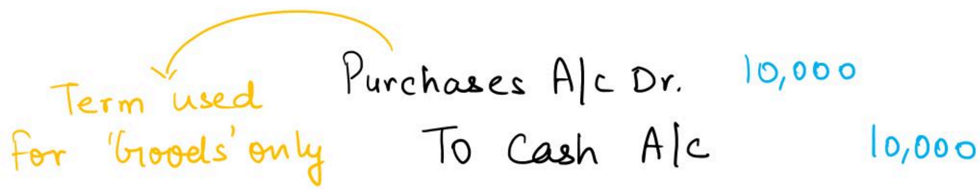


When goods are purchased, the term "purchases" is used, and when goods are sold, the term "sales" is used. Always keep in mind the three basic rules of accounting: Real Account, Personal Account, and Nominal Account.

Journalizing Transactions Related to Purchase and Sale of Goods on a Cash Basis

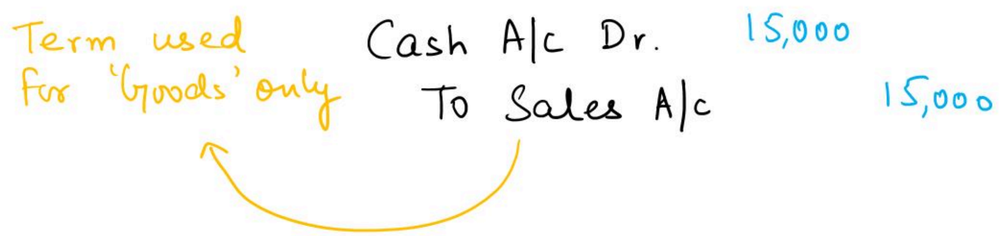
When goods are purchased, the **Purchases Account** is debited (based on the rule: debit all expenses and losses), as the purchase is considered an expense.

1. Goods purchased for cash Rs. 10,000



When goods are sold, the **Sales Account** is credited (based on the rule: credit all incomes and gains), as the sale represents revenue.

2. Goods sold for cash for Rs. 15,000



Journalizing Transactions Related to Purchase and Sale of Goods on a Credit Basis

In credit transactions, instead of cash, the name of the person involved in the transaction is mentioned. Depending on the transaction, the person's account will either be debited or credited.

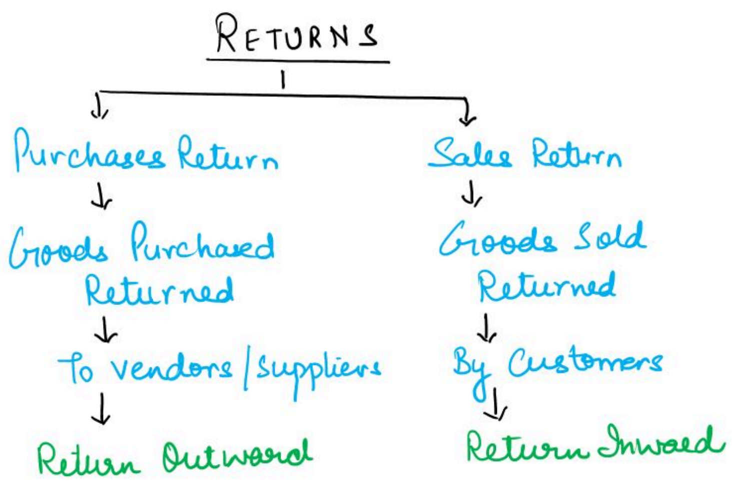
1. Goods purchased from Sagar for Rs. 10,000

Purchases A/c Dr. 10,000
To Sagar's A/c 10,000

2. Goods sold to Sagar for Rs. 7,000

Sagar's A/c Dr. 7,000
To Sales A/c 7,000

Now, when goods bought by a business are returned to the supplier, these are called purchases return.



Similarly, when goods sold by a business are returned by the customer, these are termed as sales return.

Journalizing Transactions Related to Purchase Returns and Sales Returns

A business may return goods it has purchased, or it may receive goods back from a customer. These are known as **Purchases Return** and **Sales Return**, respectively.

1. Himanshu returned goods worth Rs. 4,000 after purchasing goods worth Rs. 10,000. The amount due from Himanshu was received in cash.

Himanshu's A/c Dr. 10,000
To Sales A/c 10,000
(Goods Sold to Himanshu for Rs. 10,000)

Sales Return A/c Dr. 4,000
To Himanshu's A/c 4,000
(Goods Returned by Himanshu for Rs. 4,000)

Cash A/c Dr. 6,000
To Himanshu's A/c 6,000
(Amount due from Himanshu, received)

2. Goods purchased from Heena for Rs. 10,000, goods returned to Heena worth Rs. 6,000. The remaining amount was paid in cash.

Purchases A/c Dr. 10,000
To Heena's A/c 10,000
(Goods purchased from Heena for Rs. 10,000)

Heena's A/c Dr. 6,000
To Purchases Return A/c 6,000
(Goods returned to Heena for Rs. 6,000)

Heena's A/c Dr. 4,000
To Cash A/c 4,000
(Cash due to Heena, duly paid)

These entries show how to record purchases, sales, and returns, whether they are on a cash or credit basis, while applying the rules of Real, Personal, and Nominal accounts effectively.

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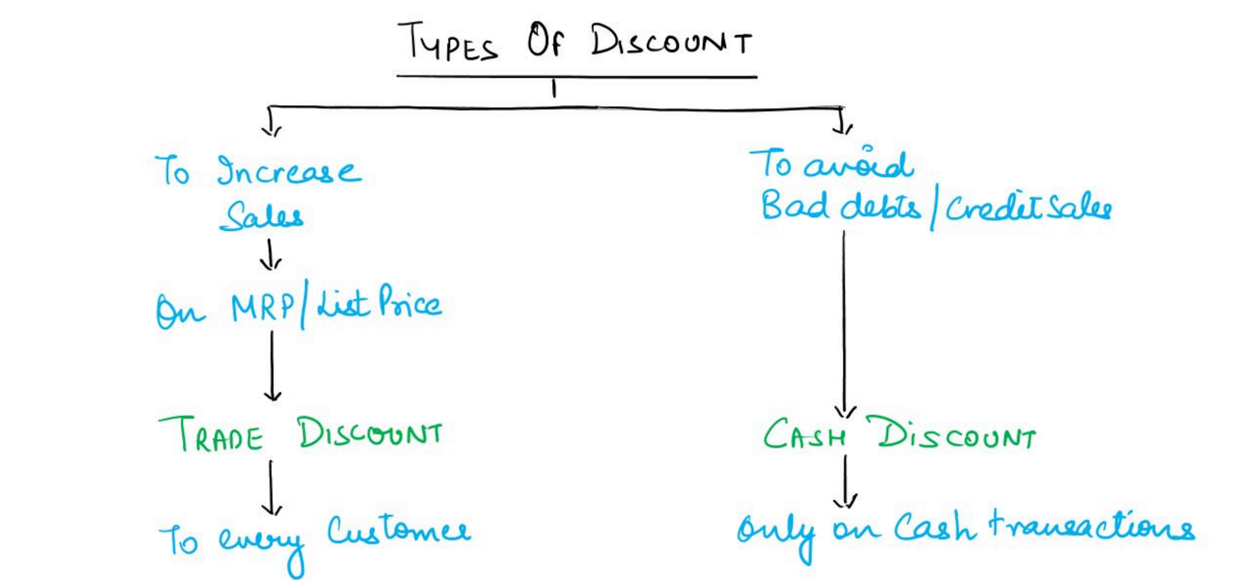
9. Rules for Journal Entries

A **discount** is a reduction in the price of a product or service offered by the seller to the buyer, either as an incentive to encourage sales or as a reward for prompt payment.



Discounts can be classified into two types: **Trade Discount** and **Cash Discount**.

Types of Discounts

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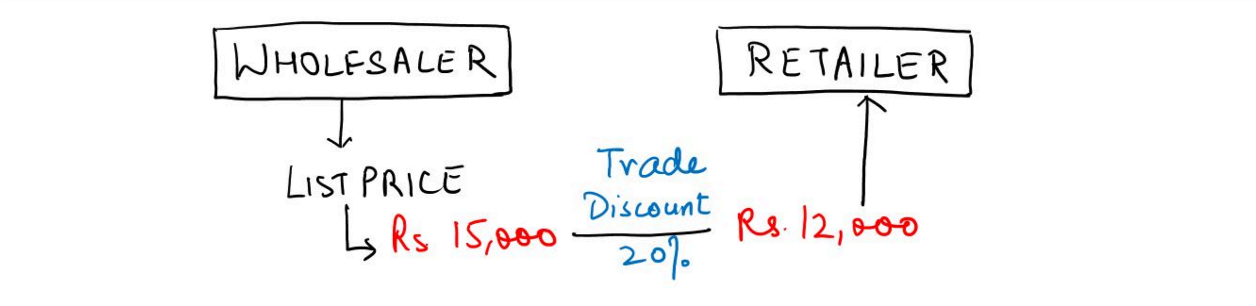
1. Trade Discount

- A trade discount is a reduction in the list price of goods or services to encourage sales.
- It is typically offered to all customers, particularly in wholesale transactions, to promote bulk purchases.
- Trade discounts are **not recorded** in the books of accounts. Transactions are recorded at the discounted price only.



For example, if the list price of goods is Rs. 12,000 after a trade discount, this Rs. 12,000 is recorded without mentioning the trade discount.

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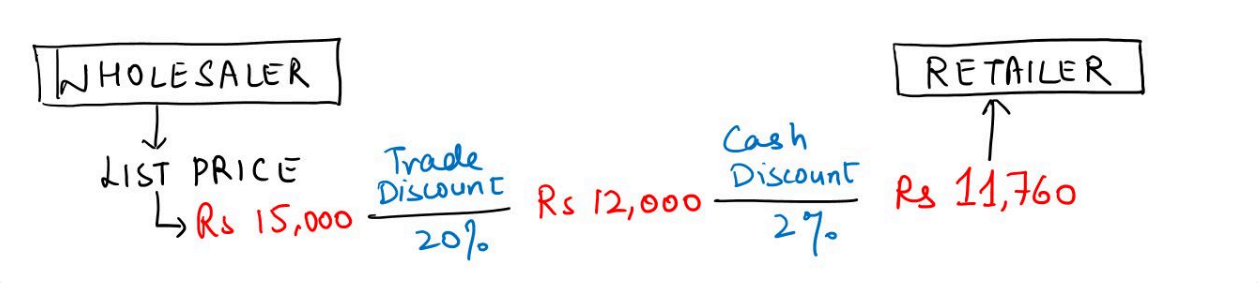
2. Cash Discount

- A cash discount is offered to a buyer as an incentive to pay the amount owed within a specified period.
- The cash discount is usually applied after deducting any trade discount, if applicable.



For example, if the list price is Rs. 15,000, and a 20% trade discount is applied, the trade discount is Rs. 3,000. The cash discount will then be calculated on Rs. 12,000 (after deducting the trade discount). If a 2% cash discount is applied, the cash discount will be Rs. 240 (2% of Rs. 12,000), making the net payment Rs. 11,760.

Note: Cash discounts are **recorded** in the books of accounts.

- When *received* on purchases, it is recorded as *income* (credited).
- When *allowed* on sales, it is recorded as *expense* (debited).

Journal Entries for Trade Discount and Cash Discount received

1. Purchased goods from Heera for Rs. 10,000

Purchases A/c Dr.	10,000	
To Heera's A/c		10,000

2. Purchased goods from Heera for Rs. 10,000 with a 10% trade discount

(Trade discount of Rs. 1,000 applied, so only Rs. 9,000 recorded)

Purchases A/c Dr.	9,000		(10,000 - 10% T.D)
To Heera's A/c		9,000	

3. Purchased goods from Heera for Rs. 10,000 with a 10% cash discount

(Cash payment of Rs. 9,000 made, and Rs. 1,000 discount received)

Purchases A/c Dr.	10,000		
To Cash A/c		9,000	(10,000 – 10% C.D)
To Discount Received A/c		1,000	

4. Purchased goods from Heera for Rs. 10,000 with a 10% trade discount and 10% cash discount

(Trade discount applied first, reducing the amount to Rs. 9,000, then a 10% cash discount on Rs. 9,000 applied)

Purchases A/c Dr.	9,000		(10,000 - 10% T.D)
To Cash A/c		8,100	(10,000 – 10% T.D – 10% C.D)
To Discount Received A/c		900	

(Calculation: Rs. 10,000 - Rs. 1,000 (trade discount) = Rs. 9,000 - Rs. 900 (cash discount) = Rs. 8,100)

Journal Entries for Trade Discount and Cash Discount allowed

1. Goods sold to Neelima for Rs. 10,000

Neelima's A/c Dr. 10,000
To Sales A/c 10,000

2. Goods sold to Neelima with a 10% trade discount

(Trade discount of Rs. 1,000 applied, so Rs. 9,000 is recorded)

Neelima's A/c Dr. 9,000 → (10,000 – 10% T.D)
To Sales A/c 9,000

3. Goods sold to Neelima with a 10% cash discount

(Cash payment of Rs. 9,000 received, and Rs. 1,000 discount allowed)

Cash A/c Dr. 9,000 → (10,000 – 10% C.D)
Discount Allowed A/c Dr. 1,000
To Sales A/c 10,000

4. Goods sold to Neelima with a 10% trade discount and a 5% cash discount

(First, a 10% trade discount is applied, reducing the amount to Rs. 9,000. Then, a 5% cash discount is applied on Rs. 9,000, making the final amount Rs. 8,550)

Cash A/c Dr. 8,550 → (10,000 – 10% T.D – 5% C.D)
Discount Allowed A/c Dr. 450
To Sales A/c 9000

(Calculation: Rs. 10,000 - Rs. 1,000 (trade discount) = Rs. 9,000 - Rs. 450 (cash discount) = Rs. 8,550

Key Note

In the journal entries above, note that the **discount allowed** or **received** always follows the rule of the **Cash Account**.

- If the **Cash Account is debited**, the discount allowed/received will also be **debited**.
- If the **Cash Account is credited**, the discount allowed/received will also be **credited**.

9. Rules for Journal Entries

Journalize the following transactions.

1. Purchased goods from Chirag for Rs. 50,000 @ 10% cash discount

The cash discount is 10% of Rs. 50,000, which amounts to Rs. 5,000. Therefore, Rs. 45,000 is paid in cash, and the discount received is Rs. 5,000.

Journal Entry for Purchase Transaction:

Purchases A/c Dr.	50,000	
To Cash A/c		45,000
To Discount Received A/c		5,000

---

2. Sold goods to Pinky for Rs. 50,000 @ 10% trade discount and @ 10% cash discount

First, a 10% trade discount is applied, reducing the sales amount by Rs. 5,000 (10% of Rs. 50,000), leaving Rs. 45,000.

Then, a 10% cash discount is applied to Rs. 45,000, which amounts to Rs. 4,500. Therefore, the net cash received is Rs. 40,500.

Journal Entry for Sales Transaction:

Cash A/c Dr.	40,500	
Discount Allowed Dr.	4,500	
To Sales A/c		45,000

(Calculation: Rs. 50,000 - Rs. 5,000 (trade discount) = Rs. 45,000 - Rs. 4,500 (cash discount) = Rs. 40,500)

---

3. Sold goods to Ram for Rs. 1,00,000, payment received from Ram after a cash discount of Rs. 2,000

1. Initial Sale Entry

Ram's A/c Dr.	1,00,000	
To Sales A/c		1,00,000

2. Receipt of Payment with Cash Discount

The cash discount is Rs. 2,000, so the net amount received in cash is Rs. 98,000.

Cash A/c Dr.	98,000	
Discount Allowed A/c Dr.	2,000	
To Ram's A/c		1,00,000

---

4. Purchased goods from Rahul for Rs. 1,00,000. Paid to Rahul in full settlement Rs. 94,000

1. Initial Purchase Entry

Purchases A/c Dr. 1,00,000
To Rahul's A/c 1,00,000

2. Payment with Cash Discount

The cash discount in this case is Rs. 6,000. Therefore, the amount paid in cash is Rs. 94,000.

Rahul's A/c Dr. 1,00,000
To Discount Received A/c 6,000
To Cash A/c 94,000

Note that in both sets of transactions, the discount allowed or received is reflected according to the adjustments made in the Cash Account. The entries align with the amount received or paid, ensuring that the discount accounts are accurately recorded.

9. Rules for Journal Entries

Journalize the following transactions.
(i) Received Rs. 18,000 from Mohan on his account for Rs. 20,000.
(ii) Received Rs. 18,000 from Hemant in settlement of his account for Rs. 20,000.
(iii) Paid Rs. 9,000 to Vikrant on his account for Rs. 10,000.
(iv) Paid Rs. 9,000 to Sree in settlement of his account for Rs. 10,000.

Solution:

Date	Particulars	L. F.	Debit (Rs.)	Credit (Rs.)
(i)	Cash A/c Dr. To Mohan A/c (cash received from Mohan on account)		18,000	18,000
(ii)	Cash A/c Dr. Discount Allowed A/c Dr. To Hemant A/c (Being cash received from Hemant in settlement & allowed discount)		18,000 2,000	20,000

Date	Particulars	L. F.	Debit (Rs.)	Credit (Rs.)
(iii)	Vikrant A/c Dr. To Cash A/c (Being cash paid to Vikrant on Account)		9,000	9,000
(iv)	Sree A/c Dr. To Cash A/c To Discount Received A/c (Being cash paid to Sree and received discount of Rs. 1,000)		10,000	9,000 1,000

Note: Serial no. of transactions have been put under date column.

9. Rules for Journal Entries

Banking transactions refer to activities conducted through the bank rather than handling cash directly.

Here's how we record various banking transactions:

1. When cash is deposited into the bank

Bank A/c Dr.
To Cash A/c

2. When cash is withdrawn from the bank

Cash A/c Dr.
To Bank A/c

3. When a cheque is received from a customer

Cheque in Hand A/c Dr.
To Customer's A/c (with its name)

4. When the received cheque is deposited into the bank

Bank A/c Dr.
To Cheque in hand A/c

5. When a cheque is received and deposited into the bank on the same day

Bank A/c Dr.
To customer's A/c (with its name)

6. When drawings are made from the bank

Drawings A/c Dr.
To Bank A/c

7. For bank charges

Bank Charges A/c Dr.
To Bank A/c

8. When income is received directly in the bank (e.g., interest, commission, rent, salary)

Bank A/c Dr.
To Income A/c (with name of income)

9. When any payment is made via cheque

Payment A/c Dr.
To Bank A/c

Note: "Cheque in Hand" is used when a cheque is received, but for payments made by cheque, we directly credit the Bank Account instead of using "Cheque Issued."

10. When a loan is taken from the bank

Bank A/c Dr.
To Bank Loan A/c

11. When a bank loan is repaid

Bank Loan A/c Dr.
To Bank A/c

9. Rules for Journal Entries

Opening Balances refer to the balances carried forward from the immediately preceding year to the next. For instance, if the financial year ends on March 31, 2024, these balances are termed 'closing balances' for the year ending March 2024. These balances are then carried forward to the start of the next year, April 1, 2024, where they are referred to as 'opening balances' for the new financial year.

Note: The transfer of assets and liabilities is recorded with individual asset and liability names in the journal entry.

Journal Entry for Transfer of Opening Balances

Assets A/c Dr.
To Liabilities A/c

If the **debit amount exceeds the credit amount**, the difference represents Capital. In this case, the following entry is made:

Balancing figure in case Dr. Side > Cr. Side	Assets A/c Dr.	5,00,000
	To Liabilities A/c	3,80,000
	To Capital A/c	1,20,000

Conversely, if **the credit amount exceeds the debit amount**, the difference represents Goodwill. The entry in this case would be:

	Assets A/c Dr.	8,00,000
Balancing figure in case Cr. Side > Dr. Side	Goodwill A/c Dr.	2,00,000
	To Liabilities A/c	10,00,000

9. Rules for Journal Entries

Pass the opening entry from the following Account Balances.

Land and Building Rs. 4,00,000
Plant and Machinery Rs. 10,00,000
Stock Rs. 2,00,000
Creditors A: Rs. 6,00,000; B. 2,00,000; C: 1,00,000
Bills Payable Rs. 4,00,000
Bank Loan Rs. 6,00,000
Furniture Rs. 8,00,000
Cash Rs. 4,00,000
Debtor X: Rs. 1,00,000; Debtor Y: 1,00,000; Debtor Z: 2,00,000

Solution:

The required journal entry will be as follows.

Land & Building A/c	Dr.	4,00,000	
Plant & Machinery A/c	Dr.	10,00,000	
Stock A/c	Dr.	2,00,000	
Furniture A/c	Dr.	8,00,000	
Cash A/c	Dr.	4,00,000	
X's A/c	Dr.	1,00,000	
Y's A/c	Dr.	1,00,000	
Z's A/c	Dr.	2,00,000	
To A's A/c			6,00,000
To B's A/c			2,00,000
To C's A/c			1,00,000
To Bills Payable A/c			4,00,000
To Bank Loan A/c			6,00,000
To Capital (Bal.fig)			13,00,000

In this case, the debit side totals Rs. 32,00,000, while the credit side totals Rs. 19,00,000. The balancing figure of Rs. 13,00,000 is credited to the Capital Account, reflecting the owner's capital in the business.

9. Rules for Journal Entries

Pass the Opening Journal Entry from the following balances.

Cash Rs. 3,00,000
Bank Rs. 7,00,000
Debtors Rs. 50,000
Bills Payable Rs. 8,50,000
Creditors Rs. 5,50,000
Bills Receivable Rs. 50,000
Bank Loan given Rs. 1,00,000
Bank Loan taken Rs. 15,00,000
Unearned Income Rs. 2,00,000
Plant & Machinery Rs. 20,00,000
Outstanding Expenses Rs. 4,00,000

Solution:

The following journal entry will be passed:

Cash A/c	Dr.	3,00,000	
Bank A/c	Dr.	5,00,000	
Debtors A/c	Dr.	50,000	
Bills Receivables A/c	Dr.	50,000	
Bank Loan given A/c	Dr.	1,00,000	
Plant & Machinery A/c	Dr.	10,00,000	
Goodwill A/c (Bal. fig.)	Dr.	15,00,000	
To Bills Payable A/c			8,50,000
To Creditors A/c			5,50,000
To Bank Loan taken A/c			15,00,000
To Unearned Income A/c			2,00,000
To Outstanding Expenses A/c			4,00,000

Note:

1. **Unearned Income** refers to income received in advance, and it is recorded as a liability.

2. **Outstanding Expenses** are expenses that have been incurred but not yet paid, and they are also recorded as liabilities.

9. Rules for Journal Entries

Bad debts refer to the situation where credit sales made to customers are not collected because the customers are either unable or unwilling to pay the amount owed. When debts turn bad, they are recognized as a loss for the business, which is why the "Bad Debt Account" is debited, following the accounting principle that requires all expenses and losses to be debited.

Under normal circumstances, when a debtor repays, say Rs. 10,000, the journal entry is:

Cash A/c Dr. 10,000
To Debtor's A/c (with its name) 10,000

However, if debtors fail to repay the amount due to the business, the following journal entry is made:

Bad debts A/c Dr. 10,000
To Debtor's A/c (with its name) 10,000

If the same debtor later repays the amount that was previously written off as a bad debt, the appropriate journal entry is:

Cash A/c Dr. 10,000
To Bad Debts Recovered A/c 10,000

In this last entry, the "Bad Debts Recovered A/c" is credited instead of the "Debtor's Account." This is because, in the earlier entry, the debtor's account was already written off when the amount was deemed uncollectible. When the debtor unexpectedly pays the amount later, it is no longer treated as a repayment of a debtor but as a recovery of a loss that had been previously recognized. Hence, the "Bad Debts Recovered A/c" is credited to reflect this recovery, effectively reversing the earlier loss recorded in the "Bad Debts A/c."

9. Rules for Journal Entries

Journalize the following transactions:
(i) Rs. 10,000 due from Rakesh are irrecoverable.
(ii) Mohan declared insolvent. Received from his official receiver 60 paisa rupee on a debt of Rs. 20,000.
(iii) Received cash for a bad debt written off last year Rs. 1,100.

Solution:

Date	Particulars	L. F.	Debit (Rs.)	Credit (Rs.)
(i)	Bad debts A/c Dr. To Rakesh A/c (Being bad debts written off)		10,000	10,000
(ii)	Cash A/c Dr. Bad debts A/c Dr. To Mohan A/c (Being cash dividend of 60P in a Rupee received from Mohan)		12,000 8,000	20,000
(iii)	Cash A/c Dr. To Bad debts recovered A/c (Being Cash recovered on account of bad debts written off last year)		1,100	1,100

Note: Serial no. of transactions have been put under date column.

9. Rules for Journal Entries

Here, we are discussing journal entries related to outstanding expenses and prepaid expenses.

Outstanding Expenses are expenses that have been incurred but not yet paid, representing a liability. For example, if rent is due but not yet paid, the journal entry is:

Rent A/c Dr.
    To Outstanding Rent A/c
    Liability

Prepaid Expenses are expenses paid in advance, representing an asset. For example, if rent is paid for the next six months, the journal entry is:

Asset
Prepaid Rent A/c Dr.
    To Rent A/c

---

9. Rules for Journal Entries

Here, we are discussing the journal entries in relation to Accrued Income and Unearned Income.

Accrued Income is income earned but not yet received, representing an asset. For example, if commission income is earned but not yet received, the journal entry is:

Asset
Accrued Commission A/c Dr.
    To Commission A/c

Unearned Income is income received in advance, representing a liability. For example, if a company receives commission in advance, the journal entry is:

Commission A/c Dr.
    To Unearned Commission A/c
    Liability

---

9. Rules for Journal Entries

Depreciation refers to the allocation of the cost of a fixed asset over its useful life, representing the reduction in value of an asset due to wear and tear or obsolescence.

For example, if a company’s machinery costing Rs. 1,00,000 has a useful life of 10 years, the annual depreciation expense would be Rs. 10,000.

The journal entry to record depreciation for various assets is:

Depreciation A/c Dr.
To Asset A/c [with its name]

---

9. Rules for Journal Entries

By now, we understand the concepts of Capital and Drawings. Let's explore the journal entries related to interest paid on Capital and interest received on Drawings.

Interest paid on Capital refers to the interest expense incurred on the amount of capital invested in the business by the owner. This interest is paid to compensate the owner for tying up their funds in the business rather than investing them elsewhere.

The journal entry for **Interest paid on Capital** is:

Interest on Capital A/c Dr.
To Capital A/c

Interest received on Drawings refers to the interest earned on the amounts withdrawn by the owner from the business. This interest is credited to the owner as a form of compensation for withdrawing funds from the business, which might otherwise have been used for generating income.

The journal entry for **Interest received on Drawings** is:

Drawings A/c Dr.
To Interest on Drawings A/c

---

9. Rules for Journal Entries

Here are some essential points to consider regarding Journal Entries:

1. Narration is mandatory: Every journal entry must include a narration to explain the transaction.

2. Capitalizing Asset Costs: Any expense incurred before an asset is put into use should be added to the cost of the asset rather than recorded as an expense. For instance, transportation and installation costs of machinery are included in the Machinery Account. For example, if a company purchases machinery for ₹5,00,000 and incurs ₹10,000 in transportation and ₹5,000 in installation costs, these amounts are added to the Machinery Account:

Machinery A/c Dr.	5,15,000	
To Cash A/c		5,15,000

Actual Cost
+ Transportation Cost
+ Installation Cost

This rule does not apply to the purchase of goods, where such expenses are recorded separately as costs.

3. Drawings: The term "drawings" can encompass various personal expenses such as household expenses, LIC premiums, income tax payments, etc.

4. Newspapers: When newspapers are sold, credit the account 'Miscellaneous Income'. When newspapers are purchased, debit the account 'Miscellaneous Expenses'.

5. Furniture: Use the account 'Furniture' for assets like tables, chairs, and desks.

6. Office Equipment: Use the account 'Office Equipment' for items like computers and printers.

7. Fixtures: Use the account 'Fixtures' for assets such as electric fans, tube lights, and ceiling fans.

8. Stationery: Use the account 'Stationery' for items like pens, pencils, notebooks, and registers.

9. Postage: Use the account 'Postage' for postage stamps and related expenses.

9. Rules for Journal Entries

Pass Journal Entries for following transactions.

1. Deepak started business with Rs. 70,000 as Capital, in cash
2. Deepak introduced further capital of Rs. 80,000 by Cheque
3. Deposited Rs. 15,000 in bank
4. Purchased goods of Rs. 10,000 in cash
5. Purchased goods of Rs. 20,000 against cheque
6. Purchased goods of Rs. 5,000 in cash from Rakesh
7. Goods costing Rs. 1,500 returned to Rakesh
8. Sold goods for Rs. 15,000 in cash
9. Sold goods for Rs. 40,000 against cheque
10. Sold goods to Ram for Rs. 5,000 against cash
11. Sold goods to Raja for Rs. 3,000
12. Raja returned goods of Rs. 1,000
13. Paid salaries Rs. 5,500 in cash
14. Withdrew cash Rs. 3,000 for personal expenses
15. Withdrew goods costing Rs. 5,000 for personal use.

Solution:

1. Deepak started business with Rs. 70,000 as Capital, in cash

Date	Particulars	L. F.	Debit (Rs.)	Credit (Rs.)
	Cash A/c Dr. To Capital A/c (Being capital introduced in cash)		70,000	70,000

2. Deepak introduced further capital of Rs. 80,000 by Cheque

Date	Particulars	L. F.	Debit (Rs.)	Credit (Rs.)
	Bank A/c Dr. To Capital A/c (Being capital introduced by Cheque)		80,000	80,000

3. Deposited Rs. 15,000 in bank

Date	Particulars	L. F.	Debit (Rs.)	Credit (Rs.)
	Bank A/c Dr. To Cash A/c (Being cash deposited in Bank)		15,000	15,000

4. Purchased goods of Rs. 10,000 in cash

Date	Particulars	L. F.	Debit (Rs.)	Credit (Rs.)
	Purchases A/c Dr. To Cash A/c (Being goods purchased in Cash)		10,000	10,000

5. Purchased goods of Rs. 20,000 against cheque

Date	Particulars	L. F.	Debit (Rs.)	Credit (Rs.)
	Purchases A/c Dr. To Bank A/c (Being goods purchased against Cheque)		20,000	20,000

6. Purchased goods of Rs. 5,000 in cash from Rakesh

Date	Particulars	L. F.	Debit (Rs.)	Credit (Rs.)
	Purchases A/c Dr. To Cash A/c (Being goods purchased in Cash)		5,000	5,000

7. Goods costing Rs. 1,500 returned to Rakesh

Date	Particulars	L. F.	Debit (Rs.)	Credit (Rs.)
	Rakesh A/c Dr. To Purchases Returns A/c (Being goods returned to Rakesh for Rs 1,500)		1,500	1,500

8. Sold goods for Rs. 15,000 in cash

Date	Particulars	L. F.	Debit (Rs.)	Credit (Rs.)
	Cash A/c Dr. To Sales A/c (Being goods sold in cash)		15,000	15,000

9. Sold goods for Rs. 40,000 against cheque

Date	Particulars	L. F.	Debit (Rs.)	Credit (Rs.)
	Bank A/c Dr. To Sales A/c (Being goods sold against cheque)		40,000	40,000

10. Sold goods to Ram for Rs. 5,000 against cash

Date	Particulars	L. F.	Debit (Rs.)	Credit (Rs.)
	Cash A/c Dr. To Sales A/c (Being goods sold on cash basis)		5,000	5,000

11. Sold goods to Raja for Rs. 3,000

Date	Particulars	L. F.	Debit (Rs.)	Credit (Rs.)
	Raja A/c Dr. To Sales A/c (Being goods sold on credit)		3,000	3,000

12. Raja returned goods of Rs. 1,000

Date	Particulars	L. F.	Debit (Rs.)	Credit (Rs.)
	Sales Return A/c Dr. To Raja A/c (Being goods sold on credit returned for Rs. 1,000)		1,000	1,000

13. Paid salaries Rs. 5,500 in cash

Date	Particulars	L. F.	Debit (Rs.)	Credit (Rs.)
	Salaries A/c Dr. To Cash A/c (Being Salaries paid in cash)		5,500	5,500

14. Withdrew cash Rs. 3,000 for personal expenses

Date	Particulars	L. F.	Debit (Rs.)	Credit (Rs.)
	Drawings A/c Dr. To Cash A/c (Being cash withdrawn for personal use)		3,000	3000

15. Withdrew goods costing Rs. 5,000 for personal use

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

9. Rules for Journal Entries

Journalize the following transactions.

1. Mohit started business with cash Rs. 5,00,000
2. Opened a bank account with an amount of Rs. 4,80,000
3. Bought furniture for Rs. 60,000 and issued cheque for the same
4. Bought Plant and Machinery from Ram lal for the business for Rs. 1,25,000 and an advance of Rs. 10,000 in cash is given.
5. Goods purchased from Sumit Traders for Rs. 55,000
6. Goods costing Rs. 25,000 sold to Neerja Enterprises for Rs. 35,000
7. Paid the monthly store rent Rs. 2,500 in cash
8. Paid Rs. 5,000 as salary to the office employees
9. Received cheque as full payment from Neerja Enterprises and deposited same day into bank.

Solution:

The Journal of Mohit will appear as follows.

Books of Mohit
Journal

Date	Particulars	L. F.	Debit (Rs.)	Credit (Rs.)
1.	Cash A/c Dr. To Capital A/c (Business started with cash)		5,00,000	 5,00,000
2.	Bank A/c Dr. To Cash A/c (Opened bank account)		4,80,000	 4,80,000
3.	Furniture A/c Dr. To Bank A/c (Purchased furniture and made payment through bank)		60,000	 60,000
	Total c/f		10,40,000	10,40,000

Date	Particulars	L. F.	Debit (Rs.)	Credit (Rs.)
	Total b/f		10,40,000	10,40,000
4.	Plant and Machinery A/c Dr. To Cash A/c To Ram Lal A/c (Bought Plant and Machinery from M/s Ram Lal, made an advance payment by cash for Rs. 10,000 and balance at the later date)		1,25,000	 10,000 1,15,000
5.	Purchases A/c Dr. To M/s Sumit Traders A/c (Goods bought on credit)		55,000	 55,000
6.	Neerja Enterprises A/c Dr. To Sales A/c (Goods sold on profit)		35,000	 35,000
	Total c/f		12,55,000	12,55,000

Date	Particulars	L. F.	Debit (Rs.)	Credit (Rs.)
	Total b/f		12,55,000	12,55,000
7.	Rent A/c Dr. To Cash A/c (Rent paid in cash)		2,500	2,500
8.	Salary A/c Dr. To Cash A/c (Salary paid to employees)		5,000	5,000
9.	Bank A/c Dr. To Neerja Enterprises A/c (Received cheque as full payment from Neerja Enterprises and deposited same day into bank)		35,000	35,000
	TOTAL		12,97,500	12,97,500

9. Rules for Journal Entries

Krishna Mart furnishes the following information.

Transactions during the month of April, 2024 are as under:

01.04.2024 Business started with cash Rs.1,50,000.
01.04.2024 Goods purchased form Manisha Rs.36,000.
01.04.2024 Stationery purchased for cash Rs.2,200.
02.04.2024 Open a bank account with SBI for Rs.35,000.
02.04.2024 Goods sold to Priya for Rs. 16,000.
03.04.2024 Received a cheque of Rs.16,000 from Priya.
05.04.2024 Sold goods to Nidhi Rs.14,000.
08.04.2024 Nidhi pays Rs.14,000 cash.
10.04.2024 Purchased goods for Rs.20,000 on credit from Ritu.
14.04.2024 Insurance paid by cheque Rs.6,000.
18.04.2024 Paid rent Rs.2,000.
20.04.2024 Goods costing Rs. 1,500 given as charity.
24.04.2024 Purchased office furniture for Rs.11,200.
29.04.2024 Cash withdrawn for household purposes Rs.5,000.
30.04.2024 Interest received cash Rs. 1,200.
30.04.2024 Cash sales Rs. 2,300.
30.04.2024 Commission paid Rs. 3,000 by cheque.
30.04.2024 Telephone bill paid by cheque Rs. 2,000.
30.04.2024 Payment of salaries in cash Rs. 12,000.

Pass the necessary journal entries.

Solution:

The Journal of Krishna Mart will appear as follows.

Books of Krishna Mart
Journal

Date	Particulars	L. F.	Debit (Rs.)	Credit (Rs.)
01 April 2024	Cash A/c Dr. To Capital A/c (Business started with Cash)		1,50,000	1,50,000
01 April 2024	Purchases A/c Dr. To Manisha A/c (Goods purchased on Credit)		36,000	36,000
01 April 2024	Stationery A/c Dr. To Cash A/c (Purchased of Stationery for cash)		2,200	2,200
	Total c/f		1,88,200	1,88,200

Date	Particulars	L. F.	Debit (Rs.)	Credit (Rs.)
	Total b/f		1,88,200	1,88,200
02 April 2024	Bank A/c Dr. To Cash A/c (Opened a bank account with SBI)		35,000	35,000
02 April 2024	Priya A/c Dr. To Sales A/c (Goods sold to Priya on credit)		16,000	16,000
03 April 2024	Bank A/c Dr. To Priya A/c (Cheque received from Priya)		16,000	16,000
	Total c/f		2,55,200	2,55,200

Date	Particulars	L. F.	Debit (Rs.)	Credit (Rs.)
	Total b/f		2,55,200	2,55,200
05 April 2024	Nidhi A/c Dr. To Sales A/c (Sale of Goods to Nidhi on credit)		14,000	14,000
08 April 2024	Cash A/c Dr. To Nidhi A/c (Cash received from Nidhi)		14,000	14,000
10 April 2024	Purchases A/c Dr. To Ritu A/c (Purchase of goods on credit)		20,000	20,000
	Total c/f		3,03,200	3,03,200

Date	Particulars	L. F.	Debit (Rs.)	Credit (Rs.)
	Total b/f		3,03,200	3,03,200
14 April 2024	Insurance Premium A/c Dr. To Bank A/c (Payment of Insurance Premium by cheque)		6,000	6,000
18 April 2024	Rent A/c Dr. To Cash A/c (Rent paid)		2,000	2,000
20 April 2024	Charity A/c Dr. To Purchases A/c (Goods given as charity)		1,500	1,500
	Total c/f		3,12,700	3,12,700

Date	Particulars	L. F.	Debit (Rs.)	Credit (Rs.)
	Total b/f		3,12,700	3,12,700
24 April 2024	Furniture A/c Dr. To Cash A/c (Purchase of office furniture)		11,200	11,200
29 April 2024	Drawings A/c Dr. To Cash A/c (Withdrawal of cash from the business for personal use of the proprietor)		5,000	5,000
30 April 2024	Cash A/c Dr. To Interest Received A/c (Interest received)		1,200	1,200
	Total c/f		3,30,100	3,30,100

Date	Particulars	L. F.	Debit (Rs.)	Credit (Rs.)
	Total b/f		3,30,100	3,30,100
30 April 2024	Cash A/c Dr. To Sales A/c (Sale of Goods for cash)		2,300	2,300
30 April 2024	Commission A/c Dr. To Bank A/c (Commission paid by cheque)		3,000	3,000
30 April 2024	Telephone Expenses A/c Dr. To Cash A/c (Payment of Telephone bill)		2,000	2,000
30 April 2024	Salaries A/c Dr. To Cash A/c ((Payment of salary to the office persons)		12,000	12,000
	TOTAL		3,49,400	3,49,400

10. Ledger Posting

Now we get to know that Journal is a book in which transactions are recorded in chronological order, i.e., in the order in which they are entered. Journal is called the **Book of Original Entry** (or book of primary entry) since all transactions are intially recorded in it. Rules of debit and credit are applied to each transaction at the time of recording in the books of account. The transactions recorded in Journal are transferred (posted) in Ledger Accounts.

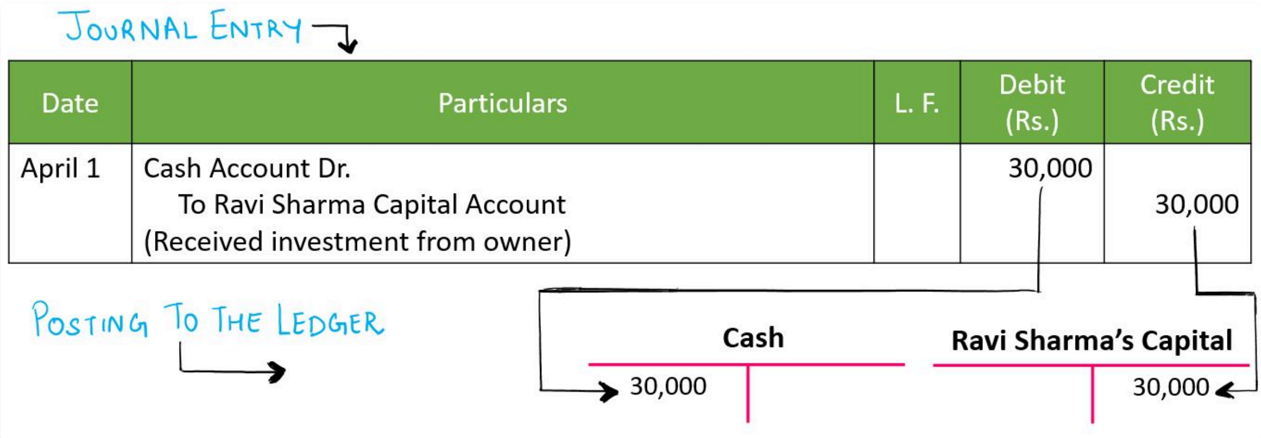
The transfer of Journal Entry to Ledger Accounts is called **Posting**. Information relating to a particular head is known after posting of transactions in ledger accounts. Thus, Journal is not a substitute of ledger.

Note that Ledger is called **Principal Book of accounts** as any accounting information can be extracted from it.

Both Journal and Ledger are essential to complete a system of accounting.

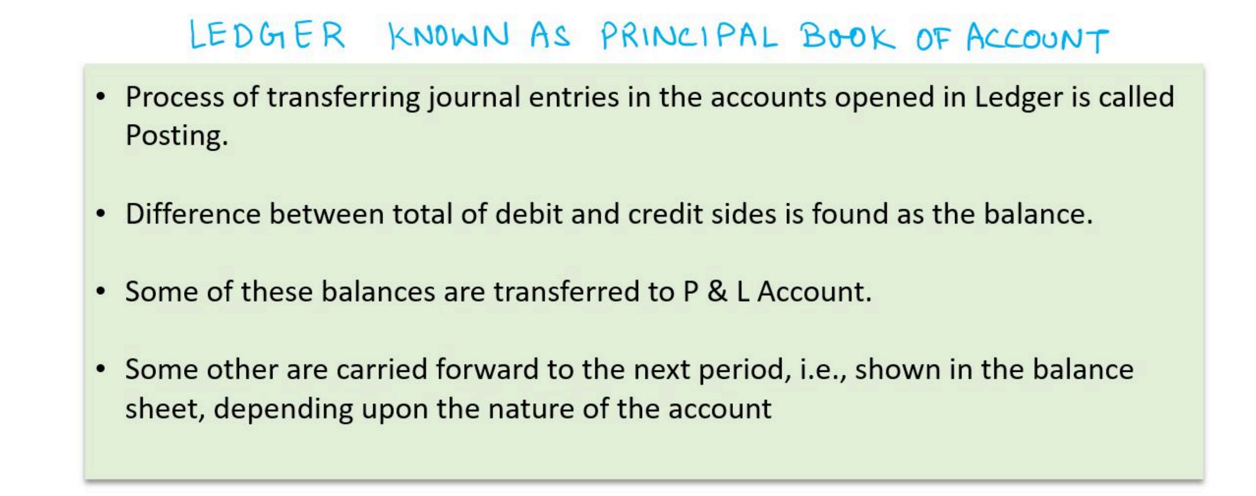
Posting from Journal to Ledger

Posting in accounting means to copy the amounts from the journal to the ledger. Debits in the journal are posted as debits in the ledger, and credits in the journal are credits in the ledger. Debits never become credits, and credits never become debits. The investment transaction of Ravi Sharma's eTravel is posted to the ledger is shown below.



10. Ledger Posting

The ledger is the principal book of accounting system, where individual accounts are maintained to record all transactions related to each account. It consolidates all accounts that have been debited or credited in the general journal and various special journals.



A ledger can be organized in various formats, such as a bound register, cards, or loose-leaf sheets in a binder. Ideally, each account is opened on a separate page or card for clarity.

This is the most important book of the business and hence is rightly called the “King of All Books”. It is also Known as Book of Final Entry.

Importance of Ledger

The ledger plays a crucial role in any organization, as it allows the net effect of all transactions related to a specific account to be determined as of a particular date. For instance, if management wants to know how much is owed by a specific customer or how much the company owes a supplier, this information can only be obtained from the ledger. The journal, which records transactions chronologically, makes it difficult to categorize and retrieve such details.

To facilitate easy posting and reference, accounts in the ledger are usually organized systematically, often in the same sequence as they appear in the profit and loss statement or the balance sheet. An index is also typically provided at the beginning for quick access, and in large organizations, each account is assigned a unique code number for easy identification.

We will discuss about ledgers in detail next.

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10. Ledger Posting

The main features of Ledger are given below.

1. **Master Record:** The ledger is a master record of all the accounts of the business.
2. **Prepared from Journal:** It is prepared using entries from the journal.
3. **Current Balance:** Ledger accounts show the current balance in each account.
4. **Basis for Trial Balance:** The trial balance is prepared from the ledger accounts.
5. **Foundation for Final Accounts:** Final accounts, such as the income statement and balance sheet, are prepared from the ledger accounts.

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10. Ledger Posting

Format of the Ledger account is shown below.

FORMAT OF LEDGER ACCOUNTS

Dr. Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)

A ledger account has two sides-debit (left side of the account) and credit (right side of the account).

According to this format the columns will contain the information as given below:

An account is debited or credited according to the rules of debit and credit already explained in respect of each category of account.

Title of the account: The Name of the item is written at the top of the format as the title of the account. The title of the account ends with suffix 'Account'.

Dr./Cr.: Dr. means Debit side of the account that is left side and Cr. means Credit side of the account, i.e. right side.

Date: Year, Month and Date of transactions are posted in chronological order in this column.

Particulars: Name of the item with reference to the original book of entry is written on debit/credit side of the account.

Journal Folio: It records the page number of the original book of entry on which relevant transaction is recorded. This column is filled up at the time of posting.

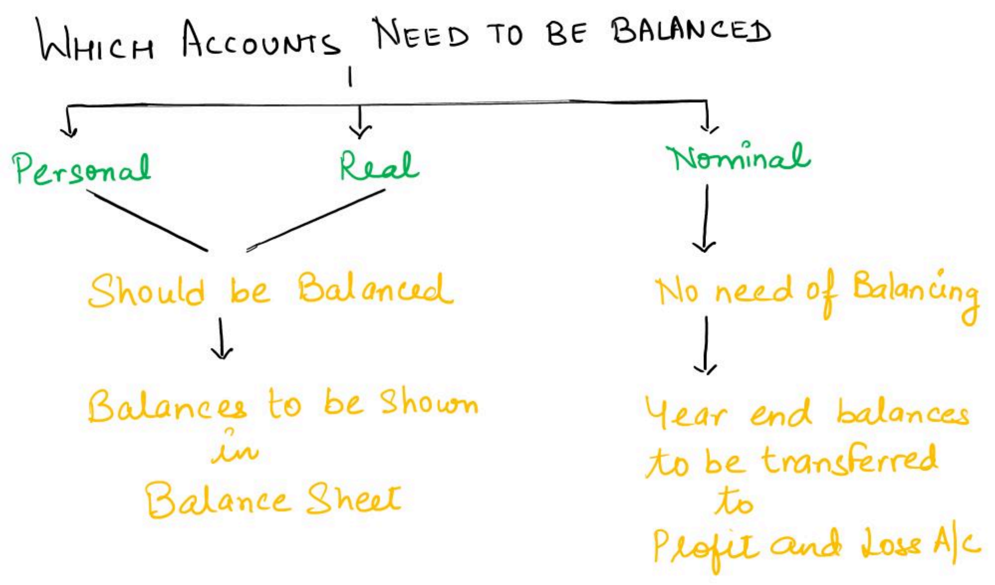
Amount: This column records the amount in numerical figure, corresponding to what has been entered in the amount column of the original book of entry.

10. Ledger Posting

According to **Modern Approach of Journalizing**, all ledger accounts are put into 5 categories namely, assets, liabilities, capital, revenues/gains and expense losses. All these accounts may further be put into two groups, i.e. permanent accounts and temporary accounts.

All permanent accounts are balanced and carried forward to the next accounting period. The temporary accounts are closed at the end of the accounting period by transferring them to the trading and profit and loss account. All permanent accounts appears in the balance sheet. Thus, all assets, liabilities and capital accounts are permanent accounts and all revenue and expense accounts are temporary accounts.

Based on **Traditional Approach of Journalizing**, the Accounts can be classifed as Personal, Nominal and Real Account.



The nominal accounts are not balanced; the balance in the end are transferred to the profit and loss account.

Only personal and real accounts are balanced and their balances are ultimately shown in the balance sheet at the end of the accounting period.

The capital account is adjusted for profit or loss (i.e., net of nominal accounts) at the end of accounting period.

This classification is also relevant for preparing the financial statements.

It is important to note that regardless of whether accounts are classified using the traditional or modern approach, the method for balancing accounts remains unchanged.

10. Ledger Posting

The Journal and the Ledger are the most important books of the double entry mechanism of accounting and are indispensable for an accounting system.

Points of Comparison

Following points of comparison are worth noting:
1. The Journal is the book of first entry (original entry); the ledger is the book of second entry.
2. The Journal is the book for chronological record; the ledger is the book for analytical record.
3. The Journal, as a book of source entry, gets greater importance as legal evidence than the ledger.
4. Transaction is the basis of classification of data within the Journal; Account is the basis of classification of data within the ledger.
5. Process of recording in the Journal is called Journalising; the process of recording in the ledger is known as Posting.

11. Mechanism of Ledger Posting

Ledger posting refers to the procedure of transferring information from the journal to the ledger. It involves copying individual entries from the journal to the appropriate ledger accounts, adhering to the principle of double-entry bookkeeping.

In other words, posting means grouping of all the transactions in respect to a particular account at one place for meaningful conclusion and to further the accounting process. Posting from the journal is done periodically, may be, weekly or fortnightly or monthly as per the requirements and convenience of the business.

Process of Posting

The complete process of posting from journal to ledger has been discussed below:

Transaction: Rent paid in cash for Rs. 10,000.

The journal entry for this transaction would be:

JOURNAL (Page 60)

Date	Particulars	L. F.	Debit (Rs.)	Credit (Rs.)
Jan 15	Rent A/c Dr. To Cash A/c (Salaries paid in cash)	35 36	10,000	 10,000

We will open 2 ledger accounts here, i.e., Rent Account and Cash Account. Let us see how posting of Transactions is done into ledger accounts.

LEDGER

Dr. RENT ACCOUNT (Page 35) Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
Jan15	To Cash A/c	60	10,000				

Dr. CASH ACCOUNT (Page 36) Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
Jan15					By Rent A/c	60	10,000

Step 1: Locate in the ledger, the account to be debited as entered in the journal.

Step 2: Enter the date of transaction in the date column on the debit side.

Step 3: In the 'Particulars' column write the name of the account through which it has been debited in the journal.

Now, in Rent Account on the debit side in the particulars column 'Cash' will be entered signifying that cash is paid towards rent. In Cash Account, in the ledger on the credit side in the particulars column, the word, rent will be recorded. The same procedure is followed in respect of all the entries recorded in the journal.

Step 4: Enter the page number of the journal in the folio column and in the journal write the page number of the ledger on which a particular account appears.

Step 5: Enter the relevant amount in the amount column on the debit side.

It may be noted that the same procedure is followed for making the entry on the credit side of that account to be credited. An account is opened only once in the ledger and all entries relating to a particular account is posted on the debit or credit side, as the case may be.

Next we are discussing the rules of ledger posting for more clarity.

11. Mechanism of Ledger Posting

Consider the following transaction and journal entry to understand rules of ledger posting one by one.

Transaction: Salaries paid by cheque for Rs. 2,00,000 on 5th May 2024.

Required Journal Entry

Date	Particulars	L. F.	Debit (Rs.)	Credit (Rs.)
5 May 2024	Salaries A/c Dr. To Bank A/c (Salaries Paid)		2,00,000	2,00,000

Required Ledgers

LEDGER

SALARIES ACCOUNT

Dr.							Cr.
Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
5 May 2024	To Bank A/c		2,00,000				

BANK ACCOUNT

Dr.							Cr.
Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
				5 May 2024	By Salaries A/c		2,00,000

Now, let us understand the above ledger posting through rules rules for posting journal entries into the ledger, which are given below.

1. Separate Accounts

Open a separate account in the ledger book for each distinct account, and post entries from the journal to the respective accounts accordingly.

Dr. **SALARIES ACCOUNT** Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
5 May 2024	To Bank A/c		2,00,000				

Dr. **BANK ACCOUNT** Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
				5 May 2024	By Salaries A/c		2,00,000

As we can see in the above example, 2 separate accounts are opened i.e., one is Salary Account and the other is Cash Account and the journal entry is posted to respective ledger accounts accordingly.

2. Use of "To" and "By"

Use the words 'To' and 'By' while posting transactions in the ledger. 'To' is used in the particulars column for entries on the debit side, while 'By' is used for entries on the credit side. These words indicate whether the account is debited or credited.

Dr. **SALARIES ACCOUNT** Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
5 May 2024	To Bank A/c		2,00,000				

Dr. **BANK ACCOUNT** Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
				5 May 2024	By Salaries A/c		2,00,000

In the above example, 'To' word is used for entries on the debit side, while 'By' word is used for entries on the credit side, to indicate that Rent account is debited and the cash account is credited.

3. Consistent Debiting and Crediting

The account that is debited in the journal should also be debited in the ledger, with a reference to the corresponding credit account.

Salaries A/c is debited but with corresponding Bank A/c Name

Dr. SALARIES ACCOUNT Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
5 May 2024	To Bank A/c		2,00,000				

Bank A/c is credited but with corresponding Salaries A/c Name

Dr. BANK ACCOUNT Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
				5 May 2024	By Salaries A/c		2,00,000

If we observe the above example, we can see that both Rent Account and Cash Account are debited and credited respectively in the Ledger with the same amount, as per Journal Entry, however, Rent Account in its debit column has a reference of corresponding Cash Account, while Cash Account in its credit column has reference of corresponding Rent Account.

11. Mechanism of Ledger Posting

Pass the Journal Entry for purchase of Stationery in cash to the tune of Rs. 2,500 on May 24, 2024. Also post the journal entry into necessary ledger accounts.

Solution:

Journal Entry

Date	Particulars	L. F.	Debit (Rs.)	Credit (Rs.)
24 May 2024	Stationery A/c Dr. To Cash A/c (Stationery Purchased)		2,500	2,500

Ledger posting

In the Salaries Account on the debit side in the Particulars Column, we will write 'To Bank Account'. In the Bank Account on the credit side in the Particulars Column: 'By Salaries Account' will be written.

The two accounts will, thus, appear as follows.

Dr. STATIONERY ACCOUNT Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
24 May 2024	To Cash A/c		2,500				

Dr. CASH ACCOUNT Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
				24 May 2024	By Stationery A/c		2,500

11. Mechanism of Ledger Posting

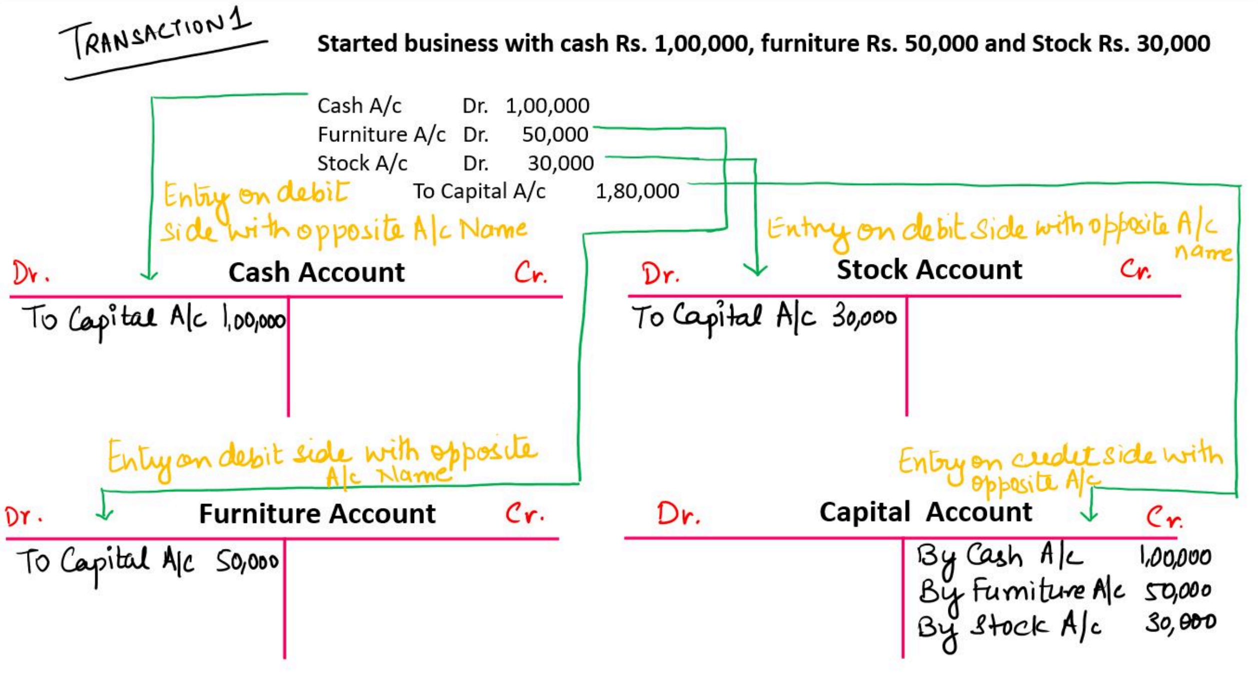
Till now we have understood ledger posting of simple journal entries.

Let us now understand ledger posting of compound journal entries with the help of following illustrative journal entries one by one.

A compound journal entry is used to record multiple transactions in one entry, affecting more than two accounts.

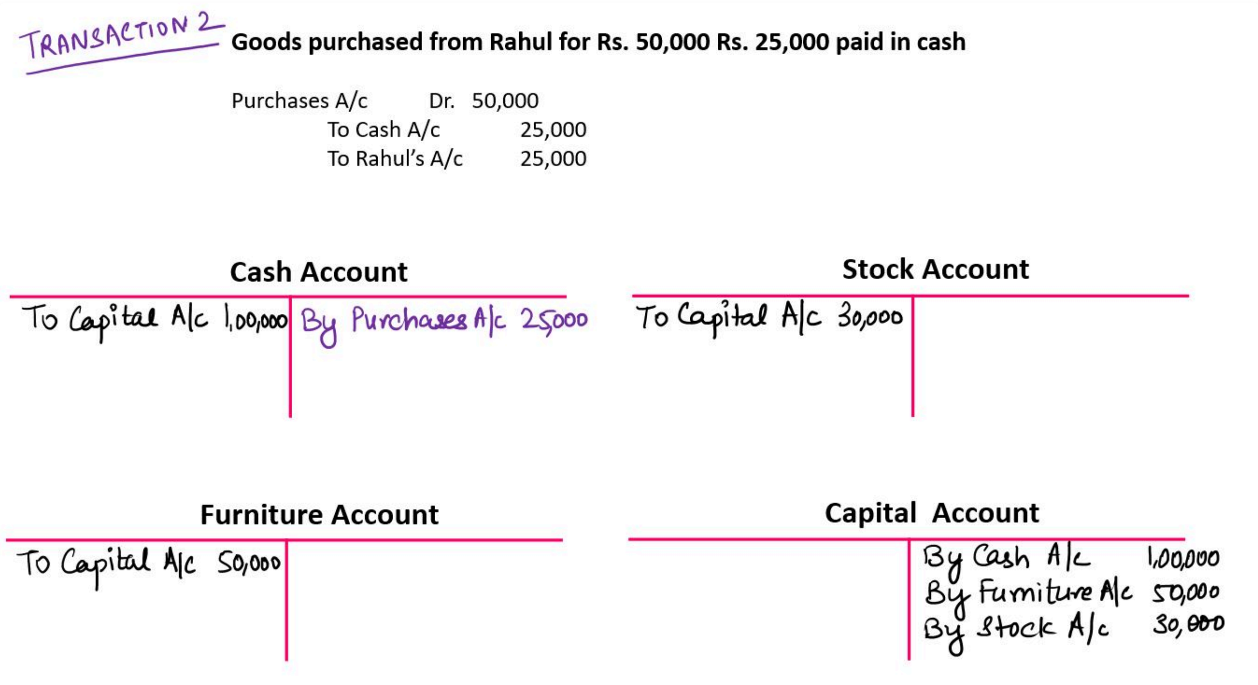
1. Started business with cash Rs. 1,00,000, furniture Rs. 50,000 and Stock Rs. 30,000

With this transaction, 4 accounts will be opened, cash account, furniture account, stock account and capital account. The accounts affected and the corresponding amounts for each are illustrated below.



2. Goods purchased from Rahul for Rs. 50,000 Rs. 25,000 paid in cash

With this transaction, two additional accounts will be created: one for Rahul's account and another for the purchases account. Cash account is already opened.



Purchases Account

To Cash A/c	25,000		
To Rahul's A/c	25,000		

Rahul's Account

		By Purchases A/c	25000

3. Goods sold to Pritam for Rs. 40,000, Rs. 30,000 received in cash

With this transaction, two additional accounts will be created: one for Pritam's account and another for the sales account.

TRANSACTION 3

Goods sold to Pritam for Rs. 40,000, Rs. 30,000 received in cash

Cash A/c	Dr.	30,000	
Pritam's A/c	Dr.	10,000	
To Sales A/c			40,000

Cash Account

To Capital A/c	1,00,000	By Purchases A/c	25,000
To Sales A/c	30,000		

Stock Account

To Capital A/c	30,000		

Furniture Account

To Capital A/c	50,000		

Capital Account

		By Cash A/c	1,00,000
		By Furniture A/c	50,000
		By Stock A/c	30,000

Purchases Account

To Cash A/c	25,000		
To Rahul's A/c	25,000		

Rahul's Account

		By Purchases A/c	25000

Pritam's Account

To Sales A/c	10,000		

Sales Account

		By Cash A/c	30,000
		By Pritam A/c	10,000

4. Salary of Rs. 5,000 and Rent of Rs. 3,000 paid in cash

With this transaction, two additional accounts will be created: one for the salary account and another for the rent account.

TRANSACTION 4

Salary of Rs. 5,000 and Rent of Rs. 3,000 paid in cash

Salary A/c	Dr. 5,000	
Rent A/c	Dr. 3,000	
To Cash A/c		8,000

Cash Account

To Capital A/c	1,00,000	By Purchases A/c	25,000
To Sales A/c	30,000	By Salary A/c	5,000
		By Rent A/c	3,000

Stock Account

To Capital A/c	30,000		

Furniture Account

To Capital A/c	50,000		

Capital Account

		By Cash A/c	1,00,000
		By Furniture A/c	50,000
		By Stock A/c	30,000

Purchases Account

To Cash A/c	25,000		
To Rahul's A/c	25,000		

Rahul's Account

		By Purchases A/c	25000

Pritam's Account

To Sales A/c	10,000		

Sales Account

		By Cash A/c	30,000
		By Pritam A/c	10,000

Salary Account

To Cash A/c	5,000		

Rent Account

To Cash A/c	3,000		

5. Goods withdrawn for personal use for Rs. 5,000

With this transaction, a new account will be created for the drawings account.

TRANSACTION 5

Goods withdrawn for personal use for Rs. 5,000

Drawings A/c Dr. 5,000
To Cash A/c 5,000

Cash Account

To Capital A/c	1,00,000	By Purchases A/c	25,000
To Sales A/c	30,000	By Salary A/c	5,000
		By Rent A/c	3,000
		By Drawings A/c	5,000

Stock Account

To Capital A/c	30,000		

Furniture Account

To Capital A/c	50,000		

Capital Account

		By Cash A/c	1,00,000
		By Furniture A/c	50,000
		By Stock A/c	30,000

Purchases Account

To Cash A/c	25,000		
To Rahul's A/c	25,000		

Rahul's Account

		By Purchases A/c	25000

Pritam's Account

To Sales A/c	10,000		

Sales Account

		By Cash A/c	30,000
		By Pritam A/c	10,000

Salary Account

To Cash A/c	5,000		

Rent Account

To Cash A/c	3,000		

Drawings Account

To Cash A/c	5,000		

In this way, we understood that to post a compound journal entry in ledger accounts, first identify all the accounts affected by the transaction. Prepare the journal entry, listing each account with its corresponding debit and credit amounts.

When posting, the entry will be made to the debit or credit side of the respective ledger accounts, depending on the nature of the journal entry, but always include the name of the reverse account. Update the balances accordingly, and verify that the total debits equal the total credits to ensure accuracy in the accounting records.

11. Mechanism of Ledger Posting

On 1st June 2024, Mahesh paid to Heera by cheque Rs. 28,300 in settlement of Rs. 30,000. Pass Journal Entry and post it in Ledger Accounts of Mahesh.

Solution:

Journal Entry

(Page 87)

Date	Particulars	L. F.	Debit (Rs.)	Credit (Rs.)
1st June 2024	Heera A/c Dr.	30	30,000	
	To Bank A/c	20		28,300
	To Discount Received A/c	22		1,700
	(Cheque issued to Heera in settlement)			

Ledger Accounts of Mahesh

Dr. HEERA (Page 30) Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
01-06-2024	To Bank A/c	87	28,300				
	To Discount Received A/c	87	1,700				

Dr. BANK ACCOUNT (Page 20) Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
				01-06-2024	By Heera	87	28,300

Dr. DISCOUNT RECEIVED ACCOUNT (Page 22) Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
				01-06-2024	By Heera	87	1,700

12. Ledger Account Balances

In addition to the ledger posting rules, it is important to understand the typical balance type (debit or credit) associated with different types of accounts based on their nature. Additionally, increases or decreases in each account must be recorded on the appropriate side—either debit or credit—depending on the nature of the account.

The following are typical relationships between types of account and types of respective balances:

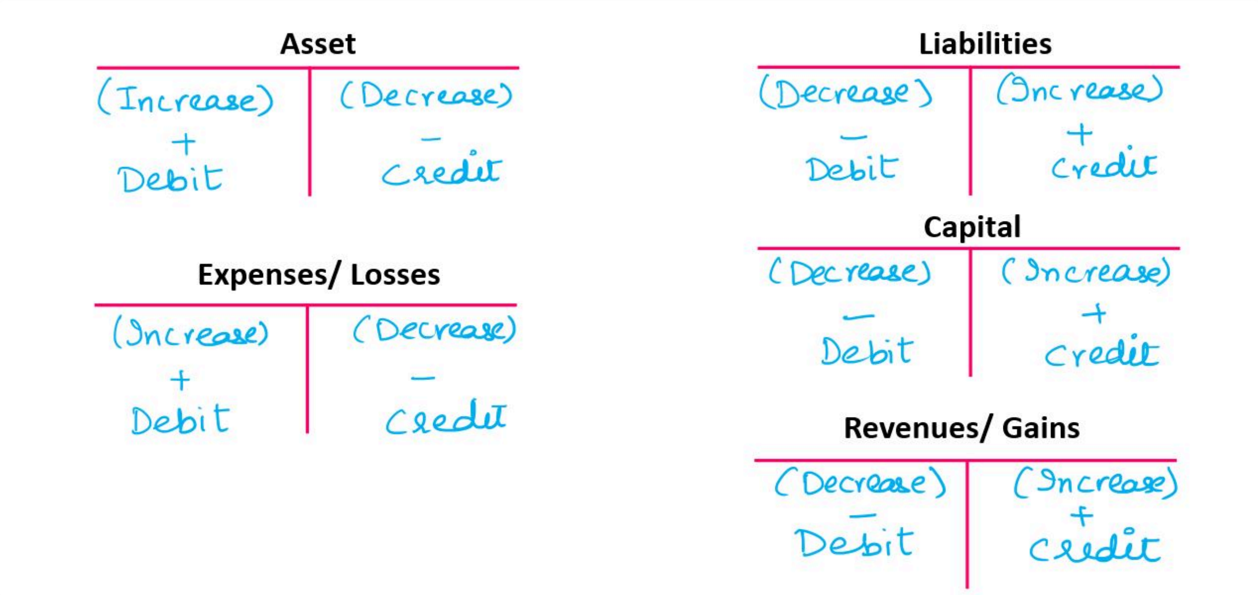
Type of Account	Type of Balance
All Assets accounts	Debit Balance
All Liability accounts	Credit Balance
Capital and Owner's Equity account	Credit Balance
Expenses or Loss accounts	Debit Balance
Income accounts	Credit Balance

Writing up Accounts

The rules for writing up accounts of various types are discussed below.

- *Assets:* Increases on the left-hand side or the debit side and decreases on the credit side or the right-hand side.
- *Liabilities:* Increases on the credit side and decreases on the debit side.
- *Capitals:* Increases on the credit side and decreases on the debit side.
- *Expenses:* Increases on the debit side and decreases on the credit side.
- *Incomes:* Increases on the credit side and decrease on the debit side.

Rules for writing up Accounts can be summarized in the form of T-Account as follows.



12. Ledger Account Balances

An opening entry in accounting is the initial journal entry recorded at the beginning of an accounting period. This entry is made to transfer the balances of the previous period's ending balances of assets, liabilities, and equity to the new accounting period.

As discussed earlier, all Asset Accounts will show a debit balance. An account for each asset will be opened and the relevant amount will be written on the debit side as 'To balance brought down (b/d)'.

On the contrary, the Liability Accounts will show credit balance. An account for each liability will be opened and the relevant amount will be written on the credit side as 'By Blance brought down'.

Let us understand this with the help of an illustration given next.

12. Ledger Account Balances

Pass the Opening Entry on 1st April, 2024 on the basis of the following information taken from the books of Aman. Also, post the opening entry.

	Amount (in Rs.)
Cash in Hand	40,000
Sundry Debtors	80,000
Stock of Goods	60,000
Plant	70,000
Land and Building	1,20,000
Sundry Creditors	1,20,000

Solution:

The required Journal Entry will be as follows.

Date	Particulars	L. F.	Debit (Rs.)	Credit (Rs.)
01-04-2024	Cash A/c Dr.		40,000	
	Sundry Debtors A/c Dr.		80,000	
	Stock A/c Dr.		60,000	
	Plant A/c Dr.		70,000	
	Land & Building A/c Dr.		1,20,000	
	To Sundry Creditors A/c			1,20,000
	To Capital A/c (See Note)			2,50,000
	(Previous year's balances brought Forward)			

Note: The excess of assets over liabilities of Rs. 2,50,000 (i.e., 40,000 + 80,000 + 60,000 +70,000 + 1,20,000 - 1,20,000) is the proprietor's capital and is credited to his capital account.

The ledger Accounts will appear as follows.

CASH ACCOUNT

Dr. | | | | | | | Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
01-04-24	To balance b/d		40,000				

SUNDRY DEBTORS ACCOUNT

Dr. | | | | | | | Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
01-04-24	To balance b/d		80,000				

STOCK ACCOUNT

Dr. | | | | | | | Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
01-04-24	To balance b/d		60,000				

PLANT ACCOUNT

Dr. | | | | | | | Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
01-04-24	To balance b/d		70,000				

LAND AND BUILDING ACCOUNT

Dr. | | | | | | | Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
01-04-24	To balance b/d		1,20,000				

SUNDRY CREDITORS ACCOUNT

Dr. | | | | | | | Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
				01-04-24	By balance b/d		1,20,000

CAPITAL ACCOUNT

Dr. | | | | | | | Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
				01-04-24	By balance b/d		2,50,000

13. Balancing Ledger Account

After posting the transactions, accounts are balanced after a certain period but certainly at the end of the year. Balancing an account means that the two sides of an account are totalled and the difference in total of the two sides is written on the side whose total is less.

For example, if the total of the credit side is more than the total of debit side of any account, the difference of amount will be recorded as Balance c/d on the debit side and vice versa on the credit side.

If the total of the debit side of any account is more than the total of credit side, it means that the account has debit balance and if the total of the credit side of any account is more, it will show a credit balance.

Rules of Balancing of Ledger Accounts

The following rules are considered while balancing a ledger account:

1. The debit or credit balance of an account that we get at the end of the accounting period is known as closing balance of that account, the closing balance of the current year is treated as the opening balance of next accounting year.

2. Balancing of accounts is done to find the difference between debit side total and credit side total of an account.

3. The following are abbreviations used to denote the balances that would appear in accounts:

- **b/f (Brought-forward):** The balance brought forward for a new accounting period is the balance carried forward from the previous accounting period. When one starts any account with the balance from old Books of Accounts or previous year, or, from the balance that was appearing on the earlier page, the balance is mentioned as b/f (balance brought forward).
- **b/d (Brought down):** When any account is opened with the balance from that of previous month, or from the balance appearing immediately above, such balance is mentioned as balance brought down.
- **c/f (Carried-forward):** When totaling of the debit & credit sides of an account is done, the difference on the shorter side, so as to match the totals, the difference is mentioned as c/f (balance carried-forward), if it is to be carried forward to a new books of account or next year or to a new page.
- **c/d (Carried down):** When totaling of the debit & credit sides of an account is done, the difference on the shorter side, so as to match the totals of both sides, such difference is mentioned as c/d (balance carried-down). Such balance is to be carried forward to next month or a line below in the same page.

Note: A b/f is followed by c/f and b/d is followed by c/d.

13. Balancing Ledger Account

The process of Balancing Ledger Accounts is as follows.

1. Total both the sides of a Ledger Account.
2. Find out the difference.
3. If the debit side Total is more than the Credit Side Total, write the Difference on the Credit Side as 'By balance c/d'.
4. On the other hand, if the Credit side Total is more than the Debit Side Total, write the Difference on the Debit Side as 'To Balance c/d'.
5. Make the total of the Debit side equal to the total of the credit side.
6. Draw a double line after both the totals.
7. Bring forward the balance on the next date.
8. If there is Debit Balance, write on the Debit Side as 'To Balance b/d'.
9. If there is Credit Balance, write on the Credit Side as 'By Balance b/d.

Let us understand the process of balancing with the help of following example. A Cash Account is given below but without balancing.

Dr. Cash Account Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
2024				2024			
April 1	To Capital A/c		1,00,000	April 2	By Bank A/c		70,000
April 4	To Bank A/c		1,000	April 3	By Purchases A/c		5,000
April 24	To Hari		1,500	April 28	By Sohan		2,150
April 30	To Sales A/c		8,000	April 30	By Rent A/c		500
				April 30	By Salaries A/c		3,000

Let us understand the balancing of ledger account by balancing above Cash Account.

Dr. Cash Account Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
2024				2024			
April 1	To Capital A/c		1,00,000	April 2	By Bank A/c		70,000
April 4	To Bank A/c		1,000	April 3	By Purchases A/c		5,000
April 24	To Hari		1,500	April 28	By Sohan		2,150
April 30	To Sales A/c		8,000	April 30	By Rent A/c		500
				April 30	By Salaries A/c		3,000
					By balance c/d		29,850
			1,10,500				1,10,500
May 1	To balance b/d		29,850				

Balance brought down

Balancing figure

1,10,500 80,650

DIFFERENCE

29,850

Observe the Cash Account above, total of the debit side of this accont is Rs. 1,10,500 and total of the credit side is Rs. 80,650 (i.e., Rs. 70,000 + Rs. 5,000 +Rs. 2,150 + Rs. 500 + Rs. 3,000).

Therefore, the total of the debit side exceeds the total of credit side by Rs. 29,850 (i.e., Rs. 1,10,500 - Rs. 80,650). Thus, Cash Acount shows debit balance of Rs. 29,850.

Note that the balance of an account is always known by the side which is greater.

13. Balancing Ledger Account

1. Journalize the following transactions, post them in the Ledger and balance the accounts.
1. X started business with a capital of Rs. 20,000
2. He purchased goods from Y on credit Rs. 4,000
3. He paid cash to Y Rs. 2,000
4. He sold goods to Z Rs. 4,000
5. He received cash from Z Rs. 6,000
6. He further purchased goods from Y Rs. 4,000
7. He paid cash to Y Rs. 2,000
8. He further sold goods to Z Rs. 4,000
9. He received cash form Z Rs. 2,000.

Solution:

Required Journal Entries are as follows.

Date	Particulars	L. F.	Debit (Rs.)	Credit (Rs.)
	Cash A/c Dr. To Capital A/c (Commencement of Business)		20,000	20,000
	Purchases A/c Dr. To Y's A/c (Purchase of goods on credit)		4,000	4,000
	Y's A/c Dr. To Cash A/c (Being amount paid to Y)		2,000	2,000
	Z's A/c Dr. To Sales A/c (Goods sold to Z)		4,000	4,000
	Cash A/c Dr. To Z's A/c (Amount received from Z)		6,000	6,000
	Total c/f		36,000	36,000

Date	Particulars	L. F.	Debit (Rs.)	Credit (Rs.)
	Total b/f		36,000	36,000
	Purchases A/c Dr. To Y's A/c (Purchase of goods on credit)		4,000	4,000
	Y's A/c Dr. To Cash A/c (Being amount paid to Y)		2,000	2,000
	Z's A/c Dr. To Sales A/c (Goods sold to Z)		4,000	4,000
	Cash A/c Dr. To Z's A/c (Being cash received from Z)		2,000	2,000
	TOTAL		48,000	48,000

The required Ledger Accounts are as follows.

Cash Account

Dr. | Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
	To Capital A/c		20,000		By Y		2,000
	To Z		6,000		By Y		2,000
	To Z		2,000	Jan.31	By Balance c/d (Bal. fig.)		24,000
			28,000				28,000
Feb.1	To Balance b/d						

Capital Account

Dr. | Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
Jan.31	To Balance c/d (Bal. fig.)		20,000		By Cash A/c		20,000
			20,000				20,000

Purchase Account

Dr. | Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
	To Y		4,000	Jan. 31	By Balance c/d (Bal. fig)		8,000
	To Y		4,000				
			8,000				8,000
Feb. 1	To Balance b/d		8,000				

Y's Account

Dr. | Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
	To Cash		2,000		By Purchases		4,000
	To Cash		2,000		By Purchases		4,000
Jan.31	To Balance c/d (Bal. fig.)		4,000				
			8,000				8,000
					By Balance b/d		4,000

Dr. **Z's Account** Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
	To Sales		4,000		By Cash A/c		6,000
	To Sales		4,000		By Cash A/c		2,000
			8,000				8,000

Dr. **Sales Account** Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
Jan.31	To Balance c/d (Bal. fig.)		8,000		By Z		4,000
					By Z		4,000
			8,000				8,000
					By Balance b/d		8,000

14. Trial Balance

In earlier chapters, we have learned about the foundational principle of accounting: for every debit, there is an equal and opposite credit. This principle ensures that the total debits equal the total credits, providing a check on the accuracy of ledger postings.

The trial balance is an important tool in this verification process, serving as an arithmetic check within the double-entry accounting system to ensure that every transaction has been accurately recorded on both the debit and credit sides.

Meaning of Trial Balance

A trial balance is a statement that lists the balances or totals of debits and credits for all accounts in the ledger, aimed at verifying the arithmetic accuracy of these postings. It is crucial in the accounting process because it displays the final position of all accounts, thereby simplifying the preparation of final financial statements. By taking the balances from the trial balance, accountants can avoid the time-consuming process of going through the entire ledger.

Usually, a trial balance is prepared at the end of an accounting year, but organizations may choose to prepare it at other intervals such as monthly, quarterly, or half-yearly, depending on their needs.

The main purposes of preparing a trial balance are to:

1. Verify the Accuracy of Entries

The trial balance helps to verify that the total of all debit balances equals the total of all credit balances. This equality is crucial because, in double-entry bookkeeping, every transaction affects at least two accounts with equal debits and credits.

2. Detect Errors

While a trial balance cannot catch all errors (such as those where equal debits and credits are made to the wrong accounts), it can highlight discrepancies in the recording process. For instance, if the debit and credit totals do not match, it indicates that there has been an error in journalizing or posting transactions.

3. Facilitate Financial Statement Preparation

The trial balance serves as a preliminary step before the preparation of financial statements. It helps in summarizing the ledger balances, which are then used to create the income statement, balance sheet, and other financial reports.

Components of a Trial Balance

A trial balance typically includes the following columns:

Account Name: Lists the names of all general ledger accounts.
Debit Balance: The balance of accounts with debit entries.
Credit Balance: The balance of accounts with credit entries.

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14. Trial Balance

A Trial Balance is an important financial report that offers several key features:

1. Statement of Debit and Credit Balances

The Trial Balance lists all the debit and credit balances extracted from various ledger accounts. This means it summarizes the financial transactions recorded in the ledgers to provide a snapshot of the balances in each account.

2. Establishing Arithmetical Accuracy

The primary purpose of a Trial Balance is to ensure that the total debits equal the total credits in the accounting records. This helps verify the mathematical accuracy of the bookkeeping entries made during a specific period.

3. Not Conclusive Evidence of Accuracy

While the Trial Balance can help identify some types of errors, it is not foolproof. Certain errors, such as errors of principle (where a transaction is recorded in the wrong account) and compensating errors (where two or more errors cancel each other out), are not detected by simply checking if debits equal credits.

4. A Statement, Not an Account

The Trial Balance is not an actual account but rather a statement that lists the balances of all accounts. It serves as a summary and verification tool rather than a transaction record itself.

5. Not Part of Final Statements

Although crucial for internal checks, the Trial Balance is not included in the final financial statements. It is a preparatory document used to ensure that the accounts are balanced before preparing the Profit and Loss Account and the Balance Sheet.

6. Flexible Preparation Timing

While traditionally prepared at the end of the accounting year, a Trial Balance can be created at any time to check the accuracy of the ledgers. Businesses may prepare it weekly, monthly, quarterly, or half-yearly, depending on their needs.

7. Link Between Books and Financial Statements

The Trial Balance acts as a bridge connecting the detailed records in the books of accounts with the summary financial statements. It helps in transferring the account balances into the Profit and Loss Account and the Balance Sheet, ensuring that all recorded transactions are accurately reflected in the final statements.

14. Trial Balance

It is important to understand that the agreement of a Trial Balance does not guarantee complete accuracy. Despite the totals of debits and credits matching, certain types of errors can still exist, including:

1. Unrecorded Transactions
If a transaction has not been recorded in the journal at all, it will not appear in the Trial Balance, and the error will go unnoticed.

2. Errors of Amount
If an incorrect amount is recorded in both the debit and credit columns of the journal, the Trial Balance will still agree, masking the error.

3. Errors of Account
If a transaction is recorded in the wrong account, the totals in the Trial Balance will match, but the financial data will be inaccurate.

4. Omissions in the Ledger
If an entry is completely omitted from the ledger, it won't be reflected in the Trial Balance, even though the totals may still agree.

5. Duplicated Entries
If an entry is posted twice in the ledger, it will not cause an imbalance in the Trial Balance but will distort the financial information.

Despite these limitations, preparing a Trial Balance is highly beneficial. It serves as an essential step in verifying the mathematical accuracy of the accounting records and aids in the preparation of financial statements. Without a Trial Balance, compiling accurate financial statements would be challenging.

15. Steps to Prepare Trial Balance

Following are the steps involved in preparation of Trial Balance.

1. **Ascertain Account Balances:** Determine the balances of each account in the ledger.

2. **List Accounts and Balances:** List each account and place its balance in either the debit or credit column, as appropriate. Accounts with a zero balance can be included with a zero in the relevant column.

3. **Compute Debit and Credit Totals:** Calculate the total of the debit balances column and the total of the credit balances column.

4. **Verify Totals:** Ensure that the sum of debit balances equals the sum of credit balances. Discrepancies indicate errors that need to be checked and corrected.

It may be noted that all assets expenses and receivables account shall have debit balances whereas all liabilities, revenues and payables accounts shall have credit balances.

Format of Trial Balance

The format of the trial balance is as outlined below:

Trial Balance
as at ....

Sl. No.	Ledger Accounts	L. F.	Debit Total (Rs.)	Credit Total (Rs.)
	TOTAL			

The following points should be observed:
(i) A trial balance is prepared as of a specific date, which should be indicated at the top.
(ii) The name of each account is listed in the second column.
(iii) The total of the debit side of each account, or any debit balance, is entered in the third column.
(iv) The total of the credit side, or any credit balance, is recorded in the fourth column.
(v) The totals of the third and fourth columns are calculated at the end.

Key Points

Note the following key points in relation to preparation of Trial Balance:

- **Assets, Expenses, and Receivables**: These accounts typically have debit balances.
- **Liabilities, Revenues, and Payables**: These accounts generally have credit balances.

15. Steps to Prepare Trial Balance

From the following information, draw up a Trial Balance in the books of Sanjeev as on 31st March 2024:

Capital Rs. 1,41,200; Purchases Rs. 46,000; Discount Allowed Rs. 1,400; Carriage Inward Rs. 12,000; Sales Rs. 70,000; Return Inward Rs. 1,300; Returns Outward Rs. 1,700; Plant and Machinery Rs. 1,15,300; Stock on Ist April, 2023 Rs. 16,700; Sundry Debtors Rs. 30,200; Sundry Creditors Rs. 22,000; Investments Rs. 3,600; Commission Received Rs. 1,800; Cash in Hand Rs. 100; Cash at Bank Rs. 10,100 and Stock on 31st March, 2024 (not adjusted) Rs. 20,500.

Solution:

Trial Balance as at 31.03.2024

Sl. No.	Name of Account	L. F.	Debit Total (Rs.)	Credit Total (Rs.)
1.	Capital			1,41,200
2.	Purchases		46,000	
3.	Discount Allowed		1,400	
4.	Carriage Inwards		12,000	
5.	Sales			70,000
6.	Return Inward		1,300	
7.	Return Outward			1,700
8.	Plant and Machinery		1,15,300	
9.	Stock (01.04.2023)		16,700	
10.	Sundry Debtors		30,200	
11.	Sundry Creditors			22,000
12.	Investments		3,600	
13.	Commission Received			1,800
14.	Cash in hand		100	
15.	Cash at Bank		10,100	
	TOTAL		2,36,700	2,36,700

Note: Closing Stock will not be taken in the Trial Balance because it is a part of the goods purchased but not yet sold. As the opening stock and purchases are given in the Trial Balance, Closing Stok will not be shown in the Trial Balance. It is shown in the Trial Balance only if Adjusted Purchases is given, where adjusted purchases = Stock + Net Purchases - Closing Stock.

15. Steps to Prepare Trial Balance

A bookkeeper prepared the following Trial Balance as on 31.03.2024:

Sl. No.	Name of Account	L. F.	Debit Total (Rs.)	Credit Total (Rs.)
1.	Furniture		20,000	--
2.	Capital		--	2,00,000
3.	Debtors		2,00,000	--
4.	Stock (01.04.2023)		1,04,000	--
5.	Creditors		--	80,000
6.	Trade Expenses		50,000	--
7.	Sales		--	8,58,000
8.	Wages		30,000	--
9.	Stock (31.03.2024)		98,000	--
10.	Machinery		--	50,000
11.	Purchases		6,25,000	--
12.	Wife's Loan to the business		50,000	--
13.	Discount allowed		--	4,000
14.	Drawings made by the Proprietor		--	45,000
15.	Motor Van		60,000	--
	TOTAL		**12,37,000**	**12,37,000**

You are required to:

(i) Identify the errors giving reasons;
(ii) Redraft the Trial Balance correctly.

Solution:

(i) Identify the errors giving reasons.

(a) Stock on 31st March 2024 will not be shown in the Trial Balance because it is the goods purchased but yet not sold. Since, purchases have been included in the Trial Balance, Closing Stock will not be shown in the Trial Balance.

(b) Machinery is an asset and thus will be shown in the debit column.

(c) Wife' Loan to the business is a liability. It will be shown in the credit column.

(d) Discount allowed, being an expense, will be shown in the debit column.

(e) Drawings made by the proprietor is a decrease of capital (i.e., decrease of proprietor's claim from the business). It will be shown in the debit column.

(ii) Redraft the Trial Balance correctly.

The correct Trial Balance is as follows.

Trial Balance as at 31.03.2024

Sl. No.	Name of Account	L. F.	Debit Total (Rs.)	Credit Total (Rs.)
1.	Furniture		20,000	
2.	Capital			2,00,000
3.	Debtors		2,00,000	
4.	Stock (01.04.2023)		1,04,000	
5.	Creditors			80,000
6.	Trade Expenses		50,000	
7.	Sales			8,58,000
8.	Wages		30,000	
9.	Machinery		50,000	
10.	Purchases		6,25,000	
11.	Wife's Loan to the business			50,000
12.	Discount allowed		4,000	
13.	Drawings made by the Proprietor		45,000	
14.	Motor Van		60,000	
	TOTAL		11,88,000	11,88,000

15. Steps to Prepare Trial Balance

Prepare a Trial Balance as on 31st March 2024, from the following Ledger Balances of Simple Bros.:

	Amount (in Rs.)
Computers A/c	2,46,000
Capital A/c	2,50,000
Debtors A/c	28,000
Creditors A/c	26,000
Purchases A/c	35,000
Sales A/c	53,000
Return Outward A/c	500
Bank Overdraft A/c	6,000
Cash in hand	1,000
Opening Stock A/c	7,500
Salaries A/c	15,000
Rent A/c	3,000

Solution:

Trial Balance as at 31.03.2024

Sl. No.	Name of Account	L. F.	Debit Total (Rs.)	Credit Total (Rs.)
1.	Computers A/c		2,46,000	–
2.	Capital A/c		–	2,50,000
3.	Debtors A/c		28,000	–
4.	Creditors A/c		–	26,000
5.	Purchases A/c		35,000	–
6.	Sales A/c		–	53,000
7.	Return Outward A/c		–	500
8.	Bank Overdraft A/c		–	6,000
9.	Cash in hand		1,000	–
10.	Opening Stock A/c		7,500	–
11.	Salaries A/c		15,000	–
12.	Rent A/c		3,000	–
	TOTAL		3,35,500	3,35,500

15. Steps to Prepare Trial Balance

Following Trial Balance is drawn from the books of Jeewan Traders:

Debit Balances	Rs.	Credit Balances	Rs.
Building	60,000	Capital	73,600
Machinery	17,000	Fixtures	5,600
Returns Outward	2,600	Sales	1,04,000
Bad Debts	2,800	Debtors	60,000
Cash	400	Interest Received	2,600
Discount Received	3,000		
Bank Overdraft	10,000		
Creditors	50,000		
Purchases	1,00,000		
TOTAL	**2,45,800**		**2,45,800**

You are required to comment whether it is correct or not. If this Trial Balance is not correct, draw the correct one.

Solution:

Even though the debit and credit sides tally, the Trial Balance is incorrect. Assets, i.e., Fixtures and Debtors are wrongly shown on the credit side and Returns Outward, Discount Received, Bank Overdraft and Creditors on the debit side.

The corrected Trial Balance is as follows.

Corrected Trial Balance of Jeewan Traders
as at ....

Debit Balances	Rs.	Credit Balances	Rs.
Building	60,000	Capital	73,600
Machinery	17,000	Sales	1,04,000
Fixtures	5,600	Creditors	50,000
Debtors	60,000	Bank Overdraft	10,000
Bad Debts	2,800	Discount Received	3,000
Cash	400	Interest Received	2,600
Purchases	1,00,000	Returns Outward	2,600
TOTAL	2,45,800	**TOTAL**	2,45,800

16. Balances in Trial Balance

The table below presents an overall view of various accounts along with their respective debit or credit balances. Note that this has already been discussed under topics 'Journalizing' and 'Ledger Posting'.

Name of Accounts	L.F.	Debit Balance (in Rs.)	Credit Balance (in Rs.)
Capital			✓
Land and Buildings		✓	
Plant and Machinery		✓	
Equipment		✓	
Furniture and Fixtures		✓	
Cash in Hand		✓	
Cash at Bank		✓	
Debtors		✓	
Bills Receivable		✓	
Stock of Raw Materials		✓	
Stock of Finished Goods		✓	
Purchases		✓	
Carriage Inwards		✓	
Carriage Outwards		✓	
Sales			✓
Sales Return		✓	
Purchases Return			✓
Interest Paid		✓	
Commission/Discount Received			✓
Salaries		✓	
Long Term Loan			✓
Bills Payable			✓
Creditors			✓
Advances from Customers			✓
Drawings		✓	
Total			

16. Balances in Trial Balance

State whether the balances of the following accounts should be placed in the debit or the credit columns of the Trial Balance.

1. Furniture	9. Carriage Outwards
2. Plant and Machinery	10. Carriage Inwards
3. Discount Allowed	11. Sales
4. Salary	12. Purchases
5. Bank Overdraft	13. Discount Received
6. Cash in hand	14. Interest Received
7. Creditors	15. Interest Paid
8. Sundry Debtors	16. Bad Debts

Solution:

Sl. No.	Name of Account	Nature	Debit Balance	Credit Balance
1.	Furniture	Asset	✓	
2.	Plant and Machinery	Asset	✓	
3.	Discount Allowed	Expense	✓	
4.	Salary	Expense	✓	
5.	Bank Overdraft	Liability		✓
6.	Cash in hand	Asset	✓	
7.	Creditors	Liability		✓
8.	Sundry Debtors	Asset	✓	
9.	Carriage Outwards	Expense	✓	
10.	Carriage Inwards	Expense	✓	
11.	Sales	Income		✓
12.	Purchases	Expense	✓	
13.	Discount Received	Income		✓
14.	Interest Received	Income		✓
15.	Interest Paid	Expense	✓	
16.	Bad Debts	Loss	✓	

17. Methods of Preparing Trial Balance

Theoretically, a trial balance can be prepared using the following 3 methods:

1. Totals Method
2. Balances Method
3. Totals-cum-Balances Method.

These methods are explained next one by one.

17. Methods of Preparing Trial Balance

In this method, the total of each ledger account's debit and credit sides is transferred to the trial balance. This approach allows the trial balance to be prepared as soon as the ledger accounts are totaled, saving the time required to balance each ledger account individually.

The balance of each account is determined by the difference between the debit and credit totals.

However, this method is not commonly used because financial statements require the net balance of each ledger account. Consequently, a trial balance prepared using this method cannot be directly used for preparing financial statements.

17. Methods of Preparing Trial Balance

Mr. Jain's ledger shows the following accounts for his business. Prepare his trial balance using Totals Method.

Dr. **Jain's Capital Account** Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
31.03.24	To Balance c/d (bal. fig.)		80,000	01.04.24	By Balance b/d By Cash		50,000 30,000
			80,000				80,000
				01.04.25	By Balance b/d		80,000

Dr. **Ronit's Account** Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
 31.03.24	To Cash To Balance c/d (bal. fig.)		50,000 30,000	01.04.24	By Balance b/d By Purchases		20,000 60,000
			80,000				80,000
				01.04.25	By Balance b/d		30,000

Dr. **Machinery Account** Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
01.04.24	To Balance b/d		30,000	 31.03.24	By Depreciation By Balance c/d (bal. fig.)		13,000 17,000
			30,000				30,000
01.04.25	To Balance b/d		17,000				

Dr. **Chirag's Account** Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
01.04.24	To Balance b/d To Sales		20,000 70,000	 31.03.24	By Cash By Balance c/d (bal. fig.)		65,000 25,000
			90,000				90,000
01.04.25	To Balance b/d		25,000				

Dr. **Sales Account** Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
				2024	By Chirag By Cash		70,000 20,000
							90,000

Dr. **Cash Account** Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
01.04.24	To Balance b/d To Capital To Chirag To Sales		20,000 30,000 65,000 20,000	2024	By Ronit By Wages By Purchases By Balance c/d (bal. fig.)		50,000 15,000 22,000 48,000
			1,35,000				1,35,000
01.04.25	To Balance b/d		48,000				

Dr. **Wages Account** Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
2024	To Cash		15,000				
			15,000				

Dr. **Depreciation Account** Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
2024	To Machinery		13,000				
			13,000				

Dr. **Purchases Account** Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
2024	To Ronit To Cash		60,000 22,000				
			82,000				

Solution:

The Trial Balance under the Totals Method is given below.

TRIAL BALANCE (USING TOTALS METHOD)

Sl. No.	Name of Account	L. F.	Debit Total (Rs.)	Credit Total (Rs.)
1.	Capital A/c		–	80,000
2.	Ronit A/c		50,000	80,000
3.	Machinery A/c		30,000	13,000
4.	Chirag A/c		90,000	65,000
5.	Sales A/c		–	90,000
6.	Cash A/c		1,35,000	87,000
7.	Wages A/c		15,000	–
8.	Depreciation A/c		13,000	–
9.	Purchases A/c		82,000	–
	TOTAL		4,15,000	4,15,000

Note that same illustration has been used to illustrate all 3 methods of preparation of Trial Balance to bring out distinction between the methods clearly.

17. Methods of Preparing Trial Balance

This is the most commonly used method in practice. In this approach, a trial balance is prepared by listing the balances of all ledger accounts and then totaling the debit and credit columns to ensure their accuracy. The account balances are used because they summarize the net effect of all transactions related to an account, aiding in the preparation of financial statements.

It is important to note that, in a trial balance, instead of showing balances for individual debtor accounts, a single figure for sundry debtors is displayed, and similarly, a single figure for sundry creditors is shown instead of individual creditor accounts.

17. Methods of Preparing Trial Balance

Mr. Jain's ledger shows the following accounts for his business. Prepare his trial balance using Balances Method.

Dr. **Jain's Capital Account** Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
31.03.24	To Balance c/d (bal. fig.)		80,000	01.04.24	By Balance b/d By Cash		50,000 30,000
			80,000				80,000
				01.04.25	By Balance b/d		80,000

Dr. **Ronit's Account** Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
 31.03.24	To Cash To Balance c/d (bal. fig.)		50,000 30,000	01.04.24	By Balance b/d By Purchases		20,000 60,000
			80,000				80,000
				01.04.25	By Balance b/d		30,000

Dr. **Machinery Account** Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
01.04.24	To Balance b/d		30,000	 31.03.24	By Depreciation By Balance c/d (bal. fig.)		13,000 17,000
			30,000				30,000
01.04.25	To Balance b/d		17,000				

Dr. **Chirag's Account** Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
01.04.24	To Balance b/d To Sales		20,000 70,000	 31.03.24	By Cash By Balance c/d (bal. fig.)		65,000 25,000
			90,000				90,000
01.04.25	To Balance b/d		25,000				

Dr. **Sales Account** Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
				2024	By Chirag By Cash		70,000 20,000
							90,000

Dr. **Cash Account** Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
01.04.24	To Balance b/d To Capital To Chirag To Sales		20,000 30,000 65,000 20,000	2024	By Ronit By Wages By Purchases By Balance c/d (bal. fig.)		50,000 15,000 22,000 48,000
			1,35,000				1,35,000
01.04.25	To Balance b/d		48,000				

Dr. **Wages Account** Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
2024	To Cash		15,000				
			15,000				

Dr. **Depreciation Account** Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
2024	To Machinery		13,000				
			13,000				

Dr. **Purchases Account** Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
2024	To Ronit To Cash		60,000 22,000				
			82,000				

Solution:

The Trial Balance under the Balances Methods is given below.

TRIAL BALANCE (USING BALANCES METHOD)

Sl. No.	Name of Account	L. F.	Debit Total (Rs.)	Credit Total (Rs.)
1.	Capital A/c		–	80,000
2.	Ronit A/c		–	30,000
3.	Machinery A/c		17,000	–
4.	Chirag A/c		25,000	–
5.	Sales A/c		–	90,000
6.	Cash A/c		48,000	
7.	Wages A/c		15,000	
8.	Depreciation A/c		13,000	
9.	Purchases A/c		82,000	
	TOTAL		2,00,000	2,00,000

17. Methods of Preparing Trial Balance

This method combines the totals method and the balances method. It involves preparing four columns for amounts: two columns for recording the debit and credit totals of various accounts, and two columns for recording the debit and credit balances of these accounts.

However, this method is not commonly used in practice because it is time-consuming and offers little additional benefit.

17. Methods of Preparing Trial Balance

Mr. Jain's ledger shows the following accounts for his business. Prepare his trial balance using Totals-cum-Balances Method.

Dr. **Jain's Capital Account** Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
31.03.24	To Balance c/d (bal. fig.)		80,000	01.04.24	By Balance b/d By Cash		50,000 30,000
			80,000				80,000
				01.04.25	By Balance b/d		80,000

Dr. **Ronit's Account** Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
 31.03.24	To Cash To Balance c/d (bal. fig.)		50,000 30,000	01.04.24	By Balance b/d By Purchases		20,000 60,000
			80,000				80,000
				01.04.25	By Balance b/d		30,000

Dr. **Machinery Account** Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
01.04.24	To Balance b/d		30,000	 31.03.24	By Depreciation By Balance c/d (bal. fig.)		13,000 17,000
			30,000				30,000
01.04.25	To Balance b/d		17,000				

Dr. **Chirag's Account** Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
01.04.24	To Balance b/d To Sales		20,000 70,000	 31.03.24	By Cash By Balance c/d (bal. fig.)		65,000 25,000
			90,000				90,000
01.04.25	To Balance b/d		25,000				

Dr. **Sales Account** Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
				2024	By Chirag By Cash		70,000 20,000
							90,000

Dr. **Cash Account** Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
01.04.24	To Balance b/d To Capital To Chirag To Sales		20,000 30,000 65,000 20,000	2024	By Ronit By Wages By Purchases By Balance c/d (bal. fig.)		50,000 15,000 22,000 48,000
			1,35,000				1,35,000
01.04.25	To Balance b/d		48,000				

Dr. **Wages Account** Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
2024	To Cash		15,000				
			15,000				

Dr. **Depreciation Account** Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
2024	To Machinery		13,000				
			13,000				

Dr. **Purchases Account** Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
2024	To Ronit To Cash		60,000 22,000				
			82,000				

Solution:

Solution:

The Trial Balance under the Totals-cum-Balances Methods is given below.

TRIAL BALANCE (USING TOTALS-CUM-BALANCES METHOD)

Sl. No.	Name of Account	L. F.	Debit Total (Rs.)	Credit Total (Rs.)	Debit Balance (Rs.)	Credit Balance (Rs.)
1.	Capital A/c		-	80,000	-	80,000
2.	Ronit A/c		50,000	80,000	-	30,000
3.	Machinery A/c		30,000	13,000	17,000	-
4.	Chirag A/c		90,000	65,000	25,000	
5.	Sales A/c		-	90,000		90,000
6.	Cash A/c		1,35,000	87,000	48,000	
7.	Wages A/c		15,000	-	15,000	
8.	Depreciation A/c		13,000	-	13,000	
9.	Purchases A/c		82,000	-	82,000	
	TOTAL		4,15,000	4,15,000	2,00,000	2,00,000

18. Financial Statements

The goal of journalizing, posting to the ledgers, and preparing the trial balance is to gather the information necessary to produce the financial statements.

Financial Statements are prepared by an enterprise at the end of an accounting year to assess the performance and status of assets and liabilities are termed as Financial Statement. It is categorized as **Income Statement** (Trading and Profit and Loss account) and **Position Statement** (Balance Sheet).

The Companies Act, 2013 defines the term 'financial statements' as follows.
Financial statement in relation to a company, includes—

(i) a balance sheet as at the end of the financial year;
(ii) a profit and loss account, or in the case of a company carrying on any activity not for profit, an income and expenditure account for the financial year;
(iii) cash flow statement for the financial year;
(iv) a statement of changes in equity, if applicable; and
(v) any explanatory note annexed to, or forming part of, any document referred to in sub-clause (i) to sub-clause (iv)

The financial statement, with respect to One Person Company, small company and dormant company, may not include the cash flow statement.

Financial Statements are prepared from the Trial Balance. Accounts in the Trial Balance are transferred either to Trading Account or to Profit & Loss Account or shown in the Balance Sheet.

Entries (items) in the Trial Balance which are of revenue nature are transferred either to Trading Account or to Profit & Loss Account while entries of capital nature are shown in Balance Sheet.

These financial statements are discussed next one by one.

Note that a brief overview of Financial Statements is given in this chapter. A detailed chapter on financial statements is also covered separately.

18. Financial Statements

It is necessary to determine the net profit or the net loss at the end of the accounting period. For this purpose, the first step is to know the gross profit or gross loss. Gross Profit is the difference between the selling price and the Cost of Goods Sold.

Trading Account is prepared to ascertain Gross Profit (or loss) for the year.

Cost of Goods sold = Opening Inventory + Net purchases + Direct Expenses − closing stock

Gross Profit = Net Sales − Cost of Goods sold

Trading account represents these two formulas in the form of an account. The Pro-forma of Trading Account is provided below.

Dr.	Proforma of Trading Account of .... for the year ended		Cr.
Particulars	**Amount in Rs.**	**Particulars**	**Amount in Rs.**
To Opening Stock		By Sales *Less:* Return Inwards/ Sales Return	
To Purchases *Less*: Returns outwards or Purchase Returns		By closing stock	
To Direct expenses: Freight & Carriage Wages Gas, Water & Fuel Factory Expenses Royalty on production			
To Gross Profit c/d*		By Gross Loss c/d*	
Total		**Total**	

*Only one will appear at a time
**If Closing Stock appears in the Trial balance: The closing inventory is then not entered in the trading account, it is shown only in the balance sheet. This is because it has already been adjusted to arrive at Cost of Goods Sold.

18. Financial Statements

From the following information, prepare Trading Account for the year ended 31.03.2024.

Cash Purchases Rs. 1,50,000; Credit Purchases Rs. 9,00,000; Returns Inward Rs. 20,000; Cash Sales Rs. 1,60,000; Credit Sales Rs. 11,00,000; Returns Outward Rs. 10,000; Freight Inwards Rs. 3,000; Carriage Inwards Rs. 3,000; Wages and Salaries Rs. 4,000; Opening Stock Rs. 1,50,000; Closing Stock was Rs. 88,000 at cost but its net realisable value (market value) was Rs. 84,000.

Solution:

Dr. TRADING ACCOUNT FOR THE YEAR ENDED 31.03.2024 Cr.

Particulars		₹	Particulars		₹
To Opening stock		1,50,000	By Sales:		
To Purchases:			Cash Sales	1,60,000	
Cash Purchases	1,50,000		Credit Sales	11,00,000	
Credit Purchases	9,00,000			12,60,000	
	10,50,000				
Less: Return outward	10,000	10,40,000	Less: Returns Inward	20,000	12,40,000
To Freight Inwards		3,000	By Closing stock*		84,000
To Carriage Inwards		3,000			
To Wages & Salaries		4,000			
To Gross Profit c/d (transferred to P&L A/c) (Bal. figure)		1,24,000			
		13,24,000			13,24,000

*As per Prudence Concept, Closing Stock is valued at cost or net realisable value (market value), whichever is less.

18. Financial Statements

From the following information, prepare Trading Account for the year ended 31.03.2024.

Adjusted Purchases Rs. 11,00,000; Sales Rs. 12,50,000; Carriage Inwards Rs. 6,000; Wages Rs. 14,000; Cartage Outwards Rs. 5,000; Closing Stock Rs. 1,00,000

Solution:

TRADING ACCOUNT OF .....
for the year ended 31-03-2024

Dr. Cr.

Particulars	₹	Particulars	₹
To Adjusted Purchases	11,00,000	By Sales	12,50,000
To Carriage Inwards	6,000		
To Wages	14,000		
To Gross Profit c/d (Transfered to P&L A/c)	1,30,000		
	12,50,000		12,50,000

Notes:

1. Adjusted Purchases = Opening Stock + Net Purchases - Closing Stock
2. Closing Stock has not been shown on the credit side of the Trading Account because it has already been adjusted in Adjusted Purchases.
3. Cartage Outwards are indirect expenses and hence are not transferred to Trading Account.

18. Financial Statements

The Profit and Loss Account starts with gross profit on the credit side; and if there is gross loss, it will be written on the debit side. After that, all those expenses and losses which have not been entered in the Trading Account will be written on the debit side of Profit and Loss Account and incomes and gains, other than sales, will be written on the credit side. We should have proper understanding of the 'expenses' to distinguish between the items that will be debited to the Profit and Loss Account and those that will be shown as Assets in the Balance Sheet. The expenses which are personal in nature will not be charged to Profit and Loss Account.

Items should be recorded and distinguished according to the various functions, such as administration, selling and financing which will make it easier for the users of accounting information to understand the financial statement and assist them in taking better decisions. This rule should be followed wherever the number of items is rather large.

On the income side of the Profit and Loss Account, besides the Gross Profit, there can also be income in the form of interest received, discount received, rent from subletting of premises, miscellaneous incomes such as from sale of junk material etc. Interest on fixed deposits, interests on income from investments and other interest should be shown separately. Similarly, items which must be debited/credited to the proprietor should be segregated from other items. Examples would be interest charged on drawings, interest allowed on capital and charges for services rendered by the firm to the proprietor personally.

Dr. **Proforma Profit and Loss Account of .... for the year ended ....** **Cr.**

Particulars	**Amount in Rs.**	**Particulars**	**Amount in Rs.**
*To Gross Loss b/d**		*By Gross Profit b/d**	
Management expenses:		*Other Income:*	
To Office rent, rates and taxes		By Discount Received	
To Printing and stationery		By Commission Received	
To Telephone charges		*Non-trading Income:*	
To Postage and telegrams		By Bank Interest	
To Insurance		By Rent of property let-out	
To Audit fees		By Dividend from shares	
To Legal charges		*Abnormal Gains:*	
To Electricity charges		By Profit on sale of machinery	
Maintenance expenses:		By Profit on sale of investment	
To Repairs & renewals		*By Net Loss** (transferred to capital A/c)*	
To Depreciation on:			
Office equipment			
Office furniture			
Office buildings			
Selling and Distribution expenses:			
To Salaries (selling staff)			
To Advertisement			
To Rent			
To Carriage Outward			
To Bad Debts			
To Provision for bad debts			
To Selling commission			
Financial expenses:			
To Bank charges			
To Interest on loans			
To Discount on bills			
To discount allowed to customers			
Abnormal Losses:			
To Loss on sale of machinery			

To Loss on sale of investment To loss by fire *To Net Profit** (transferred to Capital A/c)*			
Total		Total	

*Gross loss appears on the debit side of the Profit and Loss Account at the top; while Gross Profit on the credit side.
**Net loss appears on the credit side of the Profit and Loss Account; while Net profit on debit side as balancing figures.

Appropriation of profit: It is the distribution of net profit to various heads. It is made only if there is a profit. For example, Preference dividend, Retained earnings, Ordinary dividend, Transfer to General Reserve, etc.

Charge against profit: It is the deduction from revenue to ascertain net profit or net loss. For example, Interest on loan will be paid even if there is a loss in P/L account.

Operating Profit and Net Profit

Profit may be divided into:

(i) Operating Profit; and

(ii) Net Profit.

Operating Profit is the profit earned by the enterprise from its operating, i.e., business activities. It is calculated by deducting the Operating Expenses from the Gross Profit.

OPERATING PROFIT = GROSS PROFIT – OPERATING EXPENSES

Net Profit is the profit earned through operating (business) and non-operting (non-business) activities of the enterprise.

Operating Expenses are the expenses incurred by an enterprise that are associated with its operating activities. For example, rent, repairs, depreciation etc.

Non-operting Expenses are the expenses which do not relate to the main activity of the enterprise such as interest on loan, charity, donation, loss on sale of fixed assets, loss by fire or theft etc.

Operating Incomes are the incomes earned by an enterprise from its operating (or business) activities. For example, a retail store's main or operating activity is buying and selling of goods.

Non-operating Incomes are incomes earned and which do not relate to the operating (or business) activities. For example, interest received on investments, gain on sale of fixed assets etc.

18. Financial Statements

Ascertain Cost of Goods Sold from the following.

Indirect Expenses Rs. 15,200; Sales Rs. 1,20,000; Return Inwards Rs. 12,000; Opening Inventory Rs. 16,000; Direct Expenses Rs. 18,600; Net Purchases Rs. 72,000; Return Outwards Rs. 8,000; Closing Inventory Rs. 25,000.

Solution:

Cost of Goods Sold = Opening Inventory
+ Net Purchases
+ Direct Expenses
− Closing Inventory

= 16,000 + 72,000 + 18,600 − 25,000

= Rs. 81,600

18. Financial Statements

From the following Trial Balance of Shekhar, prepare Trading and Profit & Loss Account for the year ended 31.03.2024.

Debit Balances	Rs.	Credit Balances	Rs.
Stock (01.04.2023)	2,00,000		
Cash at Bank	1,00,000		
Cash in hand	44,000		
Machinery A/c	6,00,000		
Furniture and Fittings A/c	1,36,000		
Purchases A/c	15,00,000	Capital A/c	10,00,000
Wages A/c	10,00,000	Discount Received A/c	30,000
Power and Fuel A/c	3,00,000	Sales A/c	50,00,000
Factory Lighting A/c	20,000	Sundry Creditors	6,20,000
Salaries A/c	7,00,000		
Discount Allowed A/c	50,000		
Advertising A/c	5,00,000		
General Expenses A/c	4,00,000		
Sundry Debtors	11,00,000		
	66,50,000		66,50,000

Closing Stock as on 31.03.2024 was valued at Rs. 2,70,000.

Solution:

Dr. TRADING ACCOUNT FOR THE YEAR ENDED 31-03-2024 Cr.

Particulars	₹	Particulars	₹
To stock	2,00,000	By Sales	50,00,000
To Purchases	15,00,000	By closing stock	2,70,000
To Wages	10,00,000		
To Power & Fuel	3,00,000		
To Factory Lighting	20,000		
To Gross Profit c/d (Transferred to P&L A/c)	22,50,000		
	52,70,000		52,70,000

PROFIT & LOSS ACCOUNT
for the year ended 31-03-2024

Dr. Cr.

Particulars	₹	Particulars	₹
To Salaries	7,00,000	By Gross Profit b/d	22,50,000
To Discount Allowed	50,000	By Discount Received	30,000
To Advertising	5,00,000		
To Sundry office Expenses	4,00,000		
To Net Profit (tfrd to Capital A/c)	6,30,000		
	22,80,000		22,80,000

18. Financial Statements

The Balance Sheet is a statement which sets out the assets and liabilities of a firm or an institution as at a certain date. The Balance Sheet is true only at a point of time, since even a single transaction will make a difference to some of the assets or liabilities, and that is the significance of the word "as at."

When preparing a balance sheet for a sole proprietor firm, the assets are shown on the right-hand side and liabilities and capital on the left-hand side.

Note: In case of Companies, the Companies Act, 2013 has prescribed the formats by way of Schedule III, for Profit and Loss Statement and Balance Sheet which must be strictly adhered to by the companies registered under the Companies Act, 2013.

Proforma Balance sheet of .... as on ....

Liabilities	**Amount in Rs.**	**Assets**	**Amount in Rs.**
		Non-Current Assets:	
Capital A/c:		Land and Building	
Balance		Plant and Machinery	
Add: Net Profit		Furniture and Fixture	
Less: Net Loss		Vehicles	
Less: Drawings		*Intangibles:*	
Noncurrent Liabilities & Provision		Goodwill	
Long Term Loans & borrowing		Patent Rights	
Provisions for Retirement Benefits		Designs and Brand Names	
Current Liabilities & Provision:		*Investments:*	
Short-term Loans & borrowings		Long term investments	
Cash Credit Overdrafts		*Current Assets:*	
Trade payables		Inventory in Trade	
Outstanding Expenses		Trade Receivables	
Advances Taken		Short Term Investments	
Provisions:		Bank Balances	
Provisions for Bad Debts		Cash in Hand	
Provision for Taxation		*Prepayments:*	
		Advances paid	
		Prepaid expenses	
Total		Total	

Note: There is no hard and fast rule regarding presentation of assets, liabilities and equities in the Balance sheet (except in case of Companies or corporate or non-corporate entities covered under different acts). However, proper presentation of Balance Sheet items improves understandability of the information desired to be communicated to the users of accounting.

18. Financial Statements

Grouping means putting items of a similar nature under a common accounting head.

Marshalling of Balance Sheet means placing of assets and liabilities either in the order of permanence or in the order of liquidity.

Assets and liabilities are shown in any of the 2 orders:

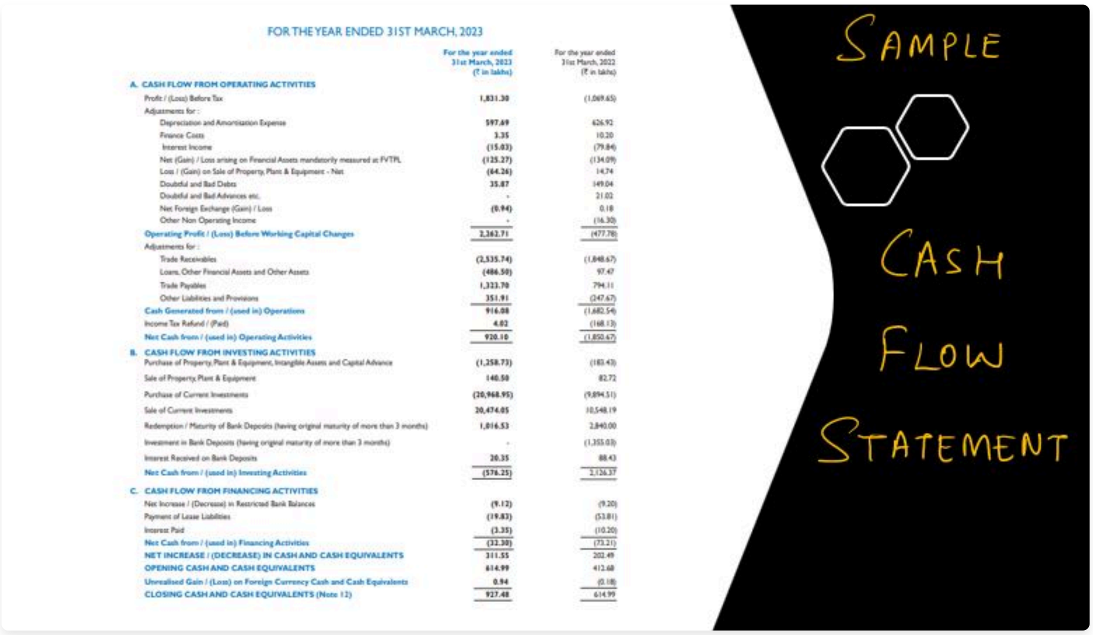
1. In order of Liquidity

Under this method, the asset, which can be converted into cash first or liability whose payments must be made early, is presented first. Those Assets & Liabilities, which are most difficult in this respect, are presented at the bottom.

2. In order of Permanence

Under this approach, the Assets & Liabilities, which are to be used, for long term in the business and are not meant to be sold or repaid early are presented first. Assets, which are most liquid, such as cash in hand and Liabilities which are to be paid on urgent basis, such as bank overdraft, Trade payables are presented at the bottom.

18. Financial Statements



FOR THE YEAR ENDED 31ST MARCH, 2023

	For the year ended 31st March, 2023 (₹ in lakhs)	For the year ended 31st March, 2022 (₹ in lakhs)
A. CASH FLOW FROM OPERATING ACTIVITIES		
Profit / (Loss) Before Tax	1,831.30	(1,069.65)
Adjustments for :		
Depreciation and Amortisation Expense	597.69	626.92
Finance Costs	3.35	10.20
Interest Income	(15.03)	(79.84)
Net (Gain) / Loss arising on Financial Assets mandatorily measured at FVTPL	(125.27)	(134.09)
Loss / (Gain) on Sale of Property, Plant & Equipment - Net	(64.26)	14.74
Doubtful and Bad Debts	35.87	149.04
Doubtful and Bad Advances etc.	-	21.02
Net Foreign Exchange (Gain) / Loss	(0.94)	0.18
Other Non Operating Income	-	(16.30)
Operating Profit / (Loss) Before Working Capital Changes	2,262.71	(477.78)
Adjustments for :		
Trade Receivables	(2,535.74)	(1,848.67)
Loans, Other Financial Assets and Other Assets	(486.50)	97.47
Trade Payables	1,323.70	794.11
Other Liabilities and Provisions	351.91	(247.67)
Cash Generated from / (used in) Operations	916.08	(1,682.54)
Income Tax Refund / (Paid)	4.02	(168.13)
Net Cash from / (used in) Operating Activities	920.10	(1,850.67)
B. CASH FLOW FROM INVESTING ACTIVITIES		
Purchase of Property, Plant & Equipment, Intangible Assets and Capital Advance	(1,258.73)	(183.43)
Sale of Property, Plant & Equipment	140.50	82.72
Purchase of Current Investments	(20,968.95)	(9,894.51)
Sale of Current Investments	20,474.05	10,548.19
Redemption / Maturity of Bank Deposits (having original maturity of more than 3 months)	1,016.53	2,840.00
Investment in Bank Deposits (having original maturity of more than 3 months)	-	(1,355.03)
Interest Received on Bank Deposits	20.35	88.43
Net Cash from / (used in) Investing Activities	(576.25)	2,126.37
C. CASH FLOW FROM FINANCING ACTIVITIES		
Net Increase / (Decrease) in Restricted Bank Balances	(9.12)	(9.20)
Payment of Lease Liabilities	(19.83)	(53.81)
Interest Paid	(3.35)	(10.20)
Net Cash from / (used in) Financing Activities	(32.30)	(73.21)
NET INCREASE / (DECREASE) IN CASH AND CASH EQUIVALENTS	311.55	202.49
OPENING CASH AND CASH EQUIVALENTS	614.99	412.68
Unrealised Gain / (Loss) on Foreign Currency Cash and Cash Equivalents	0.94	(0.18)
CLOSING CASH AND CASH EQUIVALENTS (Note 12)	927.48	614.99

The cash flow statement provides a detailed account of the cash inflows and outflows of a company during a specific accounting period.

It categorizes these cash flows into 3 main sections: operating activities, investing activities, and financing activities.

1. Operating Activities

This section includes cash flows generated from the company's primary business operations, such as sales revenue, payments to suppliers, salaries paid to employees, and taxes paid.

2. Investing Activities

This section accounts for cash flows related to the company's investments in assets, such as property, plant, and equipment (capital expenditures), as well as investments in securities and other financial instruments.

3. Financing Activities

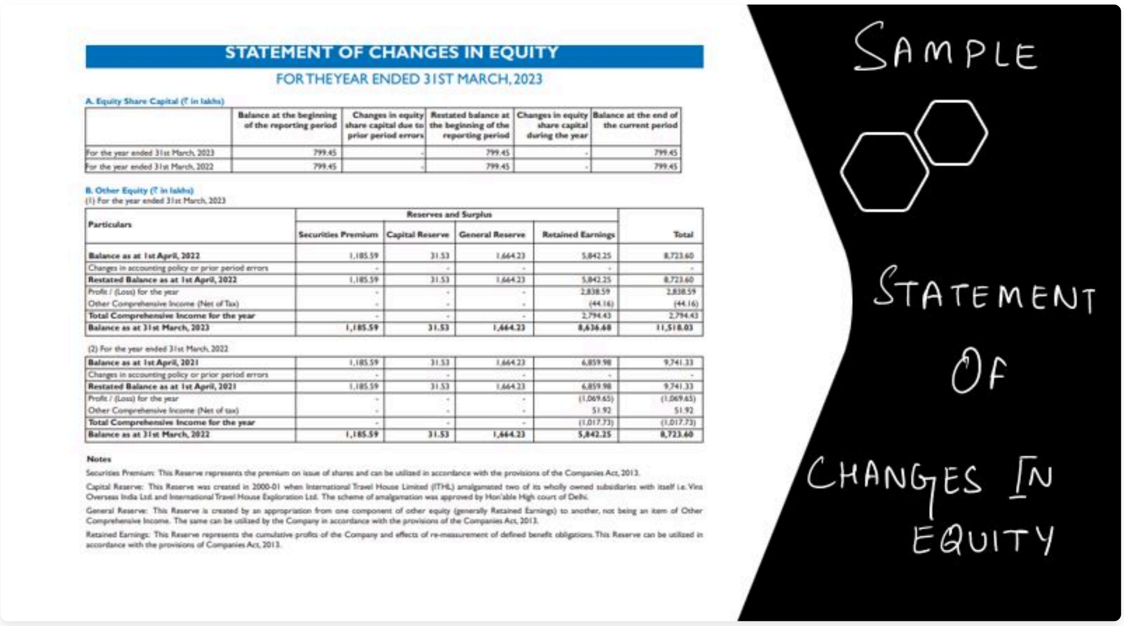
This section covers cash flows related to the company's financing activities, such as proceeds from issuing debt (loans, bonds) or equity (issuing shares), repayment of debt, payment of dividends to shareholders, and repurchase of company shares.

The cash flow statement provides insights into how the company manages its cash resources, its ability to generate cash from its core operations, and how it finances its investments and operations.

Note that Cash Flow Statement is discussed in detail in later chapters.

18. Financial Statements

The statement of changes in equity, also known as the statement of retained earnings or statement of shareholders' equity, presents a summary of the changes in the equity section of the company's balance sheet during a specific accounting period.



STATEMENT OF CHANGES IN EQUITY

FOR THE YEAR ENDED 31ST MARCH, 2023

A. Equity Share Capital (₹ in lakhs)

	Balance at the beginning of the reporting period	Changes in equity share capital due to prior period errors	Restated balance at the beginning of the reporting period	Changes in equity share capital during the year	Balance at the end of the current period
For the year ended 31st March, 2023	799.45	-	799.45	-	799.45
For the year ended 31st March, 2022	799.45	-	799.45	-	799.45

B. Other Equity (₹ in lakhs)

(1) For the year ended 31st March, 2023

Particulars	Reserves and Surplus				Total
	Securities Premium	Capital Reserve	General Reserve	Retained Earnings	
Balance as at 1st April, 2022	1,185.59	31.53	1,664.23	5,842.25	8,723.60
Changes in accounting policy or prior period errors	-	-	-	-	-
Restated Balance as at 1st April, 2022	1,185.59	31.53	1,664.23	5,842.25	8,723.60
Profit / (Loss) for the year	-	-	-	2,838.59	2,838.59
Other Comprehensive Income (Net of Tax)	-	-	-	(44.16)	(44.16)
Total Comprehensive Income for the year	-	-	-	2,794.43	2,794.43
Balance as at 31st March, 2023	**1,185.59**	**31.53**	**1,664.23**	**8,636.68**	**11,518.03**

(2) For the year ended 31st March, 2022

Particulars	Securities Premium	Capital Reserve	General Reserve	Retained Earnings	Total
Balance as at 1st April, 2021	1,185.59	31.53	1,664.23	6,859.98	9,741.33
Changes in accounting policy or prior period errors	-	-	-	-	-
Restated Balance as at 1st April, 2021	1,185.59	31.53	1,664.23	6,859.98	9,741.33
Profit / (Loss) for the year	-	-	-	(1,069.65)	(1,069.65)
Other Comprehensive Income (Net of tax)	-	-	-	51.92	51.92
Total Comprehensive Income for the year	-	-	-	(1,017.73)	(1,017.73)
Balance as at 31st March, 2022	**1,185.59**	**31.53**	**1,664.23**	**5,842.25**	**8,723.60**

Notes

Securities Premium: This Reserve represents the premium on issue of shares and can be utilized in accordance with the provisions of the Companies Act, 2013.

Capital Reserve: This Reserve was created in 2000-01 when International Travel House Limited (ITHL) amalgamated two of its wholly owned subsidiaries with itself i.e. Vira Overseas India Ltd. and International Travel House Exploration Ltd. The scheme of amalgamation was approved by Hon'able High court of Delhi.

General Reserve: This Reserve is created by an appropriation from one component of other equity (generally Retained Earnings) to another, not being an item of Other Comprehensive Income. The same can be utilized by the Company in accordance with the provisions of the Companies Act, 2013.

Retained Earnings: This Reserve represents the cumulative profits of the Company and effects of re-measurement of defined benefit obligations. This Reserve can be utilized in accordance with the provisions of Companies Act, 2013.

This statement includes:

- Beginning balance of equity
- Net income or loss for the period
- Dividends paid to shareholders
- Issuance of new shares or repurchase of existing shares
- Other adjustments affecting equity, such as changes in accounting policies or revaluations

The statement of changes in equity helps stakeholders understand how the company's equity position has changed over time, including the impact of profits, dividends, share issuances, and other equity-related transactions.

1. Meaning of Cash Book

Cash Book is a book in which all transactions relating to cash receipts and cash payments are recorded. It starts with the cash or bank balances at the beginning of the period.

Receipts are recorded on the debit side of Cash Book while payments are recorded on the credit side.

Cash transactions are recorded in cash column and bank transactions are recorded in the bank column.

Generally, Cash Book is made on monthly basis. This is a very popular book and is maintained by all organizations, big or small, profit or not-for profit. It serves the purpose of both Journal as well as the ledger (cash) account.

When a cashbook is maintained, transactions of cash are not recorded in the journal, and no separate account for cash or bank is required in the ledger.

Balancing of Cash Book

The cash book is balanced like other accounts. The total of receipts column is always greater than total of payments column. The difference is written on the credit side as 'By balance c/d'. The totals are then entered in the two columns opposite one another and then on the debit side the balance is written as "To Balance b/d", to show cash balance in hand in the beginning of next period.

2. Features of Cash Book

The Cash Book has the following features:

1. Only cash and bank transactions are recorded
The Cash Book exclusively records transactions involving cash and bank accounts, capturing all cash receipts, cash payments, bank deposits, and bank withdrawals.

2. Debit side and credit side entries
Cash receipts and cheques deposited into the bank are recorded on the debit side, while cash payments and cheques issued are recorded on the credit side. This distinction helps in maintaining a clear record of incoming and outgoing funds.

3. Records only one aspect of the transaction (cash)
The Cash Book focuses solely on the cash aspect of transactions. It does not record other aspects such as sales, purchases, or expenses directly; instead, it reflects the cash flow resulting from these transactions.

4. Chronological order
Transactions are recorded in the Cash Book in the order they occur. This chronological recording ensures an accurate and systematic tracking of all cash and bank activities over time.

5. Functions as both Journal and Ledger
The Cash Book serves a dual purpose. It acts as a Journal, where transactions are initially recorded, and as a Ledger, where these transactions are classified and summarized. This dual function simplifies the bookkeeping process and reduces the need for separate entries in both the Journal and Ledger.

6. Subsidiary as well as a Principal Book
Cash transactions are directly recorded in the Cash Book, which serves as the basis for preparing ledger accounts. Because of this role, the Cash Book is considered a subsidiary book. However, the Cash Book also functions as the cash account and the bank account within the ledger. The balances from the Cash Book are entered directly into the trial balance.

Due to this dual role, the Cash Book is part of the ledger, making it a principal book as well. Therefore, the Cash Book is both a subsidiary book, because it initially records transactions, and a principal book, because it maintains the cash and bank balances used in the trial balance.

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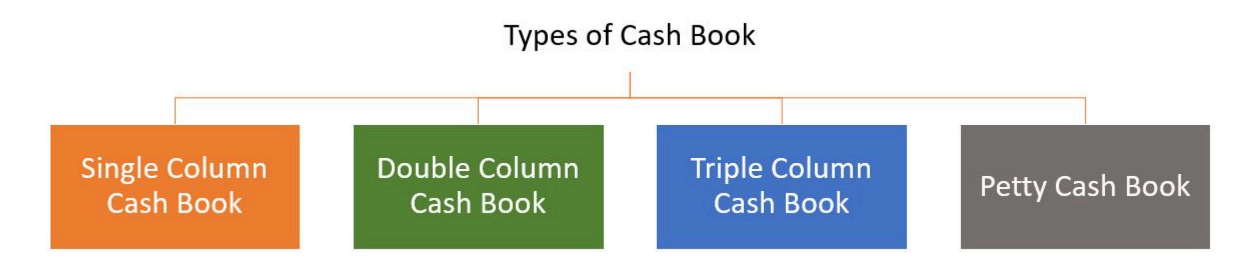
3. Types of Cash Book

There are different types of Cash Book, which are as follows:



These Cash books are discussed next one by one.

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4. Single Column Cash Book

Single Column Cash Book is used for recording cash transactions only. It has one amount column on each side.

All cash receipts are recorded on the debit side and all cash payments on the payment side. Note that Cash Book will not have a credit balance, i.e., Cash in Hand, because cash paid cannot exceed Cash in Hand.

Dr. **Format of Single Column Cash Book** Cr.

Date	Receipts	L. F.	Cash (Rs.)	Date	Payments	L. F.	Cash (Rs.)

In addition, Cash Account is a Real Account (Under Traditional Classification) and an Asset Account (Under Modern Classification). Therefore, at the time of recording cash transactions in the Cash Book, the rule followed is 'Debit what comes in and Credit what goes out' or 'Increases in assets are debited and decreases are credited'. For example, when cash is received from a customer, cash is debited, i.e., cash is recorded in Cash Column in the receipts (debit) side of the Cash Book.

This book is nothing but a Cash Account and there is no need to open separate cash account in the ledger. This is also known as Simple Cash Book.

4. Single Column Cash Book

Enter the following transactions in a Simple Cash Book.

2024		Amount (in Rs.)
March 1	Cash in hand	1,300
March 5	Received from Jyoti	400
March 8	Paid Rent	130
March 15	Sold goods for cash	400
March 21	Paid to Kamal	800
March 24	Purchased Furniture	300
March 31	Paid Salaries	200
March 31	Rent due, not yet paid, for March	130

Solution:

The Single Column Book is as follows.

Dr. Cash Book Cr.

Date	Receipts	L. F.	Amount (Rs.)	Date	Payments	L. F.	Amount (Rs.)
01.03.24	To Balance b/d		1,300	08.03.24	By Rent A/c		130
05.03.24	To Jyoti A/c		400	21.03.24	To Kamal A/c		800
15.03.24	To Sales A/c		400	24.03.24	By Furniture A/c		300
			800	31.03.24	By Salaries A/c		200
				31.03.24	By Balance c/d (Bal. fig.)		1,470
			2,900				2,900
01.04.24	To Balance b/d		1,470				

Following points are noteworthy:
(i) In the simple cash book only the cash receipts and cash payments are recorded.
(ii) The total of debit side is always greater than the total of credit side since the payment cannot exceed the available cash.
(iii) The simple cash book is like an ordinary account.
(iv) Rent due not yet paid for March has not been recorded in the cash book because no cash has been paid, hence it will be recorded through normal Journal entry.

4. Single Column Cash Book

Enter the following transactions in a Single Column Cash Book and post them in the Ledger.

2024		Amount (in Rs.)
April 1	Cash in hand	60,000
April 5	Cash Purchases	20,000
April 8	Cash Sales	8,000
April 15	Purchased Furniture	5,000
April 25	Received commission	1,000
April 30	Paid Rent	6,000

Solution:

The single column Cash book along with other ledger accounts is as follows.

Dr. Cash Book Cr.

Date	Receipts	L. F.	Amount (Rs.)	Date	Payments	L. F.	Amount (Rs.)
01.04.24	To Balance b/d		60,000	05.04.24	By Purchases A/c		20,000
08.04.24	To Sales A/c		8,000	15.04.24	By Furniture A/c		5,000
25.04.24	To Commission Received A/c		1,000	30.04.24	By Rent Account		6,000
				30.04.24	By Balance c/d (Bal. fig.)		38,000
			69,000				69,000
01.05.24	To Balance b/d		38,000				

Dr. Purchases Account Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
05.04.24	To Cash A/c		20,000				

Dr. Sales Account Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
				08.04.24	By Cash A/c		8,000

Dr. Furniture Account Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
15.04.24	To Cash A/c		5,000				

Dr. **Commission Received Account** Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
				25.04.24	By Cash A/c		1,000

Dr. **Rent Account** Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
30.04.24	To Cash A/c		6,000				

5. Double Column Cash Book

A double-column cash book includes an additional column on each side of the traditional cash book to record cash discounts. One column is for "Amount," which tracks cash receipts and cash payments, while the other column records either cash discounts allowed or received.

Alternatively, one column on the debit side can record bank receipts, and another column on the credit side can show bank payments.

Format of Double Column Cash Book
(with cash and discount columns)

Dr. Cr.

Date	Receipts	L. F.	Discount (Rs.)	Cash (Rs.)	Date	Payments	L. F.	Discount (Rs.)	Cash (Rs.)

[OR]

Format of Double Column Cash Book
(with cash and bank columns)

Dr. Cr.

Date	Receipts	L. F.	Cash (Rs.)	Bank (Rs.)	Date	Payments	L. F.	Cash (Rs.)	Bank (Rs.)

Now, let us understand what is a cash discount.

A cash discount is an allowance given for prompt payment. For instance, if a customer owes Rs. 500 but is offered a 2% discount for early payment, the customer can settle the account by paying Rs. 490. The cash received would be Rs. 490, with Rs. 10 as the discount. For the firm receiving the payment, the discount is a loss, while for the payer, it is a gain. Since cash discounts are given only for cash payments, it is practical to include a column for discounts allowed on the receipt side and a column for discounts received on the payment side of the cash book.

It should be noted that the discount columns are not balanced. They are merely totalled. The total of the discount column on the receipts side shows total discount allowed to customers and is debited to the Discount Account. The total of the column on the payments side shows total discount received and is credited to the Discount Account.

The Cash columns are balanced, as already discussed. The bank columns are also balanced and the balancing figure is called bank balance. Thus a double column cash book should have two columns on each side comprising of either cash and discount transaction or cash and bank transactions.

In addition, note that if a firm has more than one bank account, the Cash Book is suitably amended to record bank transaction through different banks separately. For example, if a business enterprise has two bank accounts, one with SBI and another with PNB, the bank columns on debit side as well as credit side shall be as follows.

Dr. **Cash Book** Cr.

Date	Receipts	L. F.	Cash (Rs.)	Bank		Date	Payments	L. F.	Cash (Rs.)	Bank	
				SBI (Rs.)	PNB (Rs.)					SBI (Rs.)	PNB (Rs.)