UNIT - V
INTRODUCTION TO FINANCIAL ACCOUNTING

Meaning of Accounting

Accounting is an art as well as science of recording, classifying and summarizing business transactions which are of financial character and are expressed in terms of money. It also includes interpretation aspect of the recorded information.

Definitions of Accounting:

According to Smith and Ashburne, "Accounting is the science of recording and classifying business transactions and events, primarily of financial character and art of making significant summaries, analysis and interpretations of those transactions and events and communicating the results to persons who must make decisions or form judgements".

According to committee on terminology of American Institute of Certified Public Accountants (AICPA), "Accounting is the art of recording, classifying and summarizing in a significant manner and in terms of money transactions and events which are in part, at least of financial character and interpreting the results thereof."

Another definition given by the same professional body, namely, AICPA stated that: "Accounting is the collection, measurement, recording, classification and communication of economic data relating to an enterprise for the purpose of reporting, decision making and control.

In 1966, the American **Accounting Association** defined accounting as follows: "Accounting is the process of identifying, measuring and communicating economic information to permit informed judgements and decisions by the users of the information."

Objectives of Accounting:

1. **Maintaining proper/systematic record of Business Transactions:** Accounting replaces the limitations of human memory. The main purpose of accounting is to identify business transactions of financial nature and enter them into appropriate books of accounts. Accounting helps to keep record of all financial transactions and events systematically in proper books of accounts.

2. **To ascertain the financial results of the enterprise:** One of the main objects of accounting is to ascertain or calculate the profit or loss of the business enterprise. Income statements are prepared with the help of trial balance (prepared with the balances of ledger accounts). At the end of the accounting period, we prepare trading account and ascertain gross profit or gross loss. Afterwards profit and loss account is prepared to ascertain net profit or net loss.

3. **To ascertain financial position or financial health of the business:** At the end of the accounting period, we prepare position statement. Blance sheet is a statement of assets and liabilities of the business on a particular date and serves as a parameter to measure the financial health of the business.

4. To help in decision making: Accounting serves as an information system for helping to arrive at rational decisions. American Accounting Association also stresses upon this point while defining the term Accounting as "the process of identifying, measuring and communicating economic information to permit informed judgements and decisions by the users of the information. Accounting keeps systematic record of all transactions and events which are used to assist the management in its function of decision making and control.

5. Providing Effective Control over the Business: Accounting reveals the actual performance of the business in terms of production, sales, profit, loss, cost of production and the book value of the sundry assets. The actual performance can be compared with the planned and or desired performance of the business. I t can also be compared with the previous performance. Comparison reveals deviation in terms of weaknesses and plus points.

6. Making Information to various groups: Accounting makes information available to all these interested parties. Proprietors have interest in profit or dividend, debenture holders, lenders and investors are concerned with the safety of money advanced by them to the business and interest thereon. The object of the accounting is to provide meaningful information to all these interested parties.

Advantages of Accounting:

1. **Replacement of memory:** In a large business it is very difficult for a business-man to remember all the transactions. Accounting provides records which will furnish information as and when desired and thus it replaces human memory. All financial transactions are recorded in a systematic manner in books of accounts so that there is no need to relay on memory.

2. **Evidence in court:** Properly maintained accounts are often treated as good evidence in the court to settle a dispute.

3. **Settlement of taxation liability:** If accounts are properly maintained, it will be of great assistance to the businessman in settling the income tax and sale tax liability otherwise tax authorities may impose any amount of tax which the businessman will have to pay.

4. **Comparative study:** Accounting provides the facility of comparative study of the various aspects of the business such as profits, sales, expenses etc. with that of previous year and helps the business man to locate significant factor leading to the change, if any. Systematic maintenance of business records enables the accountant to compare the profit of one year with those of earlier year"s profits and to know the significant facts about the changes. This helps the business to plan its future affairs accordingly.

5. **Sale of the business:** If accounts are properly maintained, it helps to ascertain the proper purchase price in case the businessman is interested to sell his business.

6. Assistance to the insolvent person: If a person is maintaining proper accounts and unfortunately he becomes insolvent (i.e., when he is unable to pay to his creditors), he can explain many things about the past with the help of accounts and can start a fresh life.

7. Assistance to various interested parties: It provides information to various interested parties, i.e., owners, creditors, investors, government, managers, research scholars, public and employees and financial position of a business enterprise from their own view point. Various interested parties or groups are interested in accounting information related to various aspects viz., sales, production, profit etc. Accounting provides suitable information to such interested parties.

8. Preparation of Financial Statements: Systematic records enable the accountant to prepare financial statements. Trading and Profit and Loss account is prepared for calculating profit or loss during a particular period and Balance sheet is prepared to state the financial position of the business on a particular date.

9. Decision Making: The accountant helps the management by providing the relevant information for solving the day to day problems of the business.

10. Planning and Control of Operations: Planning operations like sales, production, cash requirements for the next account period are achieved with the help of accounting information and estimates can be prepared based on that information.

11. Value of Business: Accounting records kept in a proper way enables a business unit to determine the purchase or sale value of the business in a simple manner.

The following are the limitations OR disadvantages of Accounting.

1. **Records only monetary transactions:** Accounting records only those transactions which can be measured in monetary terms. Those transactions which can not be measured in monetary terms as conflict between production manager and marketing manager , office management etc., may be very important for concern but not recorded in the business books.

2. **Effect of price level changes not considered:** Accounting transactions are recorded at cost in the books. The effect of price level changes is not brought into the books with the result that comparison of various years becomes difficult. For example, the sales to total assets in 2007 would be much higher than in 2003 due to rising prices, fixed assets being shown at cost and not at market price.

3. **No realistic information:** Accounting information may not be realistic as accounting statements are properly prepared by following basic concepts and conventions. For example, going concern concept gives us an idea that the business will continue and assets are to be recorded at cost but the book value which the asset is showing may not be actually realizable. Similarly, by following the principles of conservation the financial statements will not reflect the true position of the business.

4. **No real test of managerial performance:** Profit earned during an accounting period is the test of managerial performance. Profit may be shown in excess by manipulation of accounts by suppressing such costs as depreciation, advertisement and research and development or taking excess value of closing stock. Consequently real idea of managerial performance may not be available by manipulated profit.

5. **Historical in nature:** Usually accounting supplies information in the form of Profit and Loss Account and Balance Sheet at the end of the year. So, the information provided is

of historical interest and only gives post-mortem analysis of the past accounting information. For control and planning purposes management is interested in quick and timely information which is not provided by financial accounting.

6. **Personal bias / judgement of Accountant affects the accounting Statements:** Accounting statements are influenced by the personal judgement of the accountant. He may select any method of depreciation, valuation of stock, amortization of fixed assets and treatment of deferred revenue expenditure. Such judgement based on integrity and competency of the accountant will definitely affect the preparation of accounting statements.

7. **Permits alternative treatments:** Accounting permits alternernative treatments within generally accepted accounting concepts and conventions. For example, method of charging depreciation may be straight line method or diminishing balance method or some other method. Similarly, closing stock may be valued by FIFO(First-in-First Out) or LIFO(Last in First Out) or Average Price Method. Application of different methods may give different results and results may not be comparable.

Double entry book keeping :-

Double entry system is a scientific way of presenting accounts. As such all the business concerns feel it convenient to prepare the accounts under double entry system. The taxation authorities also compel the businessmen to prepare the accounts under Double Entry System. Under dual aspect the Account deals with the two aspects of business transaction i.e., (1) Receiving Aspect and (2) Giving Aspect. Receiving Aspect is known as Debit aspect and Giving Aspect is known as Credit aspect. Under which system these two aspects of transactions are recorded in chronological manner in the books of the business concern is known as Double Entry System. In Double Entry System these two aspects are recorded facilitating the preparation of Trial Balance and the Final Accounts there from.

Principle of Double Entry System

Every business transaction has got two accounts, where one account is debited and the other account is credited. If one account receives a benefit, there should be another account to impart/give the benefit. **The principle of Double Entry** is based on the fact that there can be no giving without receiving nor can there be receiving without something giving. The receiving account is debited (i.e., entered on the debit side of the account) and the giving account is credited (i.e., entered on the credit side of the account).

The principle under which both debit and credit aspects are recorded is known as the principle of double entry. According to this principle **every debit must necessarily have a corresponding credit and vice versa.**

Advantages of Double Entry System:

1. Scientific system: Double entry system records, classifies and summarizes business transactions in a systematic manner and, thus, produces useful information for decision makers. It is more scientific as compared to single entry of book-keeping.

2. Full Information: Full and authentic information can be had about all transactions as the trader maintains the ledger with all types of accounts**.**

3. Assessment of Profit and Loss: The businessman/trader will be able to know correctly whether he had earned profit or sustained loss. It facilitates the trader to take such steps so as to increase the efficiency of the firm.

4. Knowledge of Debtors: The trader will be able to know exactly what amounts are owed by different customers to the firm. If any amount is pending for a long time from any customer, he may stop credit facility to that customer.

5. Knowledge of Creditors: The trader is also knows the exact amounts owed by the firm to others and he will be able to arrange prompt payment to obtain cash discount.

6. Arithmetical Accuracy: The arithmetical accuracy of the books can be proved by the trial balance.

7. Assessment of Financial Position: The trader will be able to prepare the Balance Sheet which will help the interested parties to know fully about the financial position of the firm.

8. Comparison of Results: It facilitates the comparison of current year results with those of previous years.

9. Maintenance according to Income Tax Rules: Proper maintenance of books will satisfy the tax authorities and facilitates accurate assessment. In India Joint stock companies should maintain accounts under double entry system.

10. Detection of Frauds: The systematic and scientific recording of business transactions on the basis of this system minimizes the chances of embezzlement and frauds or errors. The frauds or errors can be easily detected by vouching, verification and auditing of accounts.

Limitations / Disadvantages of Double Entry System:

The Double Entry System however may not provide any solution to the following errors.

1. Not Practical to All Concerns: This system requires the maintenance of a number of books of accounts which is not practical in small concerns.

2. Costly system: This system is costly because of a number of records are to be maintained.

3. No guarantee of Absolute Accuracy of the Books of Account: There is no guarantee of absolute accuracy of the books of account inspite of agreement of the trial balance because of there are some errors like errors of principles, errors of omission, compensating errors etc., which remain understand inspite of agreement of trial balance.

4. Errors of Omission: In case the entire transaction is not recorded in the books of accounts, the mistake cannot be detected by accounting. The Trial Balance will tally inspite of the mistakes.

5. Errors of Principle: Double entry is based upon the fact that every debit has its corresponding credit and vice versa. It will not be able to detect the mistake such as debiting Ram‟s account instead of Rao‟s account or Building account in place of Repairs account.

6. Compensating Errors: If Rahim‟s account is by mistake debited with Rs. 15 lesser and Mohan‟s account is also by mistake credited with Rs.15 lesser, the Trial Balance will tally but mistake will remain in accounts.

Process of accounting.

Accounting Process consists of the following stages:

1. Recording of entries for all business transactions in Journal.
2. Posting of entries into Ledger.
3. Balancing of accounts.
4. Preparing of Trial Balance with the help of different accounts to know the arithmetical accuracy.

Preparing final accounts with the help of Trial Balance.

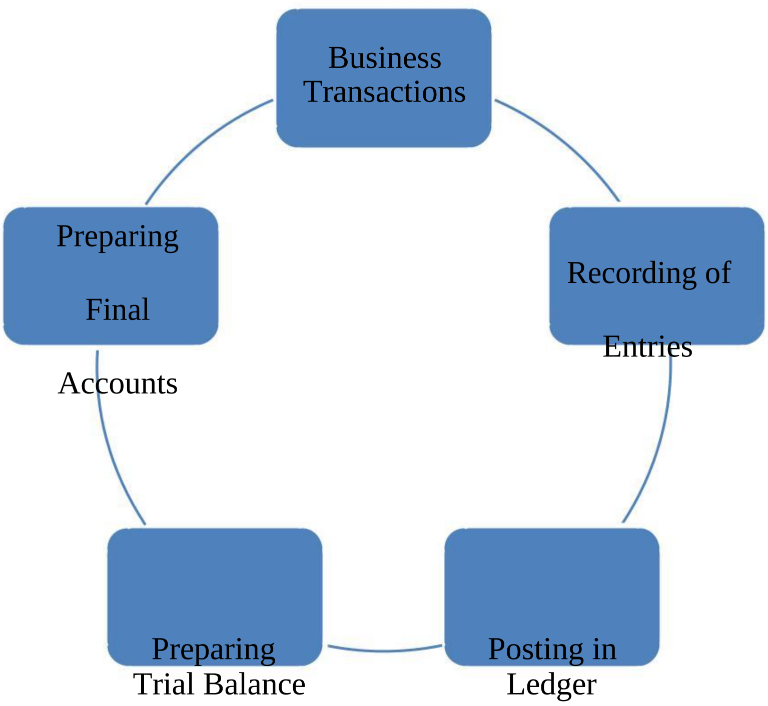
-Trading and Profit and Loss Account is prepared to know the Profit or Loss.

-Balance Sheet is prepared to know the financial position of the Business concern. Accounting Process is also known as accounting cycle.

Accounting Cycle.

An Accounting cycle is a complete sequence beginning with the recording of the transactions and ending with the preparation of the final accounts. The sequential steps involved in an accounting cycle are as follows:

Accounting Cycle Chart:



Step 1: Journalizing: Record the transactions and events in the Journal.

Step 2: Posting: Transfer the transactions in the respective accounts opened in the ledger.

Step 3: Balancing: Ascertain the difference between the total of debit amount column and the total of credit amount column of a ledger account.

Step 4: Trial Balance: Prepare a list showing the balance of each and every account to verify whether the sum of the debit balances is equal to the sum of the credit balances.

Step 5: Income Statement: Prepare Trading and Profit and Loss account to ascertain the profit or loss for accounting period.

Step 6: Position Statement/Balance Sheet: Prepare the Balance Sheet to ascertain the financial position as at the end of accounting period.

Meaning of an Account:

- An account is a classified summary of business transactions relating to a particular person or property or an income or an expense Or An Account is a classified record of business transactions which are relating to a particular person or an Item or a thing.
- It is vertically divided into two halves/parts.
- It is prepared in the form of Alphabet T.
- The left side of this account is known as Debit side and right side of the account is known as Credit side.
- Debit is the Receiving Aspect / Benefit and Credit is the Giving Aspect / Benefit.
- The word Dr should be written at the top left hand corner side of the account.
- The word Cr should be written at the top right hand corner side of the account.
- The title or name of the account should be written at the top in the middle of the account.
- The word „To‟ should be written on the debit side of an account in the particulars column.
- The word „By‟ should be written on the credit side in the particulars column of an account.
- All the Receiving Aspects are entered on the debit side and all the Giving Aspects are entered on the credit side of the account in the particulars column.
- All accounts are maintained in Ledger. So they are called "Ledger accounts".

Proforma of an Account: An account contains the following columns on the following columns on either side. 1) Date column 2) Particulars column 3) ledger Folio column 4) Amount column. The format or ruling of an account is as follows:

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
	To Particulars of benefits received		Xxxxxx		By Particulars of benefits given		xxxxxx

Classification of Accounts: Broadly speaking accounts are classified into two types. They are I. Personal Accounts

II. Impersonal Accounts. Impersonal accounts are again divided into Real Accounts and Nominal Accounts. Thus accounts are of Three types.

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

   Real and Nominal Accounts are collectively called "Impersonal Accounts".

1. **Personal Accounts: Personal Accounts are those which are opened in the names of persons.** These are accounts of persons and institutions with whom the business deals. A separate account is kept for each person. Personal accounts can be also sub classified into three categories:

They are i) Natural personal accounts ii) Artificial Personal accounts iii) Representative Personal accounts.

i) **Natural Personal Accounts:** The term Natural Persons means who are creations of Gods. For example Ravi Account, Rani Account, Raghu account Nagarjuna Account etc., are called as Natural Personal Accounts.

ii) **Artificial Personal Accounts:** These accounts include accounts of corporate bodies or institutions which are recognized as persons in business dealings. The account of a Limited Company, the accounts of co-operative society, the accounts of clubs, the account of Government, the account of insurance company, the account of Colleges, Schools, Universities and Hotels etc., are examples of Artificial Personal Accounts.

iii) **Representative Personal Accounts:** These are accounts which represent a certain person or group of persons. For example, Outstanding expenses A/c, Prepaid expenses A/c, Income Receivable A/c and Income received in advance A/c, Drawings A/c and Capital A/c are termed as Representative Accounts.

Principle/ Rule of Personal Account:

1. Debit the receiver and
2. Credit the giver.

For example, if cash has been paid to Raja, the account of Raja will have to be debited since Raja is the receiver of cash.

Similarly, if cash received from Krishna, the account of Krishna will have to be credited since Krishna is the giver of cash.

2. **Real Account: Real Accounts are those which are relating to Properties and Asset of the business concern.** Accounts relating to properties or assets or possessions of the firm are called Real Accounts. Every business firm needs Fixed Assets such as Land and Buildings, Plant and Machinery, Furniture and Fixtures etc for running its business. A separate account is maintained for each asset. There are Four types of Assets. They are

Fixed Assets: Those assets which are acquired for long term use by the business concern are known as Fixed assets. For example Land and Buildings, Plant and Machinery, Furniture and Fixtures etc are called as Fixed Assets.

Current Assets: Those assets which are possible to convert into cash are known as known as Current assets. For example cash in hand, cash at Bank, Stock in trade, Debtors, Bills Receivable etc., are called as current assets.

Tangible Assets: Tangible assets are those which relate to such things which can be touched, felt, measured etc., Tangible assets have physical existence. Hence these assets may be transferred from one place to another place. Fixed assets and Current assets are the examples of Tangible assets.

Intangible Assets: These accounts represent such things which cannot be touched. Of course, they can be measured interms of money. Intangible assets haven’t any physical existence. Goodwill, copy rights, patents and trademarks are the examples of Intangible assets.

Principle/Rule of Real Account:

1. Debit what comes into the business and
2. Credit what goes out of the business.

For example, if machinery has been purchased for cash, machinery account should be debited since Machinery is coming into the business, while cash account should be credited since cash is going out of the business.

If furniture is sold for cash, cash account should be debited since cash is coming into the business, while Furniture account should be credited since furniture is going out of the business.

3. Nominal Accounts: Nominal accounts include accounts of all Expenses, Losses, Incomes and Profits or Gains.

The examples of Expenses and Losses are salaries, wages, rent, taxes, lighting charges, transport charges, travelling charges, coolie charges, warehouse rent, insurance, advertisement paid, Bad debts, commission paid, Discount allowed, interest paid, interest paid on capital,

The examples of Incomes and Profits are rent received, interest received, commission received, discount received, dividend received, interest on investment received, bad debts recovered etc.,

These accounts are opened in the books to simply explain the nature of the transactions. They do not really exist. For example, in a business when salary is paid to the manager, commission is paid to the salesmen, rent is paid to landlord, cash goes out of the business and it is something real, while salary, commission, or rent as such does not exist. The accounts of these items are opened simply to explain how the cash has been spent. In the absence of such information, it may be difficult for the cashier to explain how the cash at his disposal was utilized. Nominal accounts are also called Fictitious Accounts.

Principle or Rule of Nominal Account:

1. **Debit all Expenses and Losses and**
2. **Credit all Incomes and Profits/Gains.**

For example when salaries paid in cash, salaries account should be debited since Salaries is an expenditure to the business, while cash account should be credited since cash is going out of the business.

For example If Rent received in cash, Cash account should be debited since cash is coming into the business, while rent account should be credited since Rent Received is an income to the business.

The principle of Nominal account is quite opposite to the principles of personal account and real account. As per the principle of Nominal account receiving aspects (Incomes and profits) are credited and giving aspects (expenses and losses) are debited. But as per the principles of personal account and real account, receiving aspect is debited and giving aspect is credited. Hence the rule of Nominal account is different from the principles of Real account and Nominal account.

VARIOUS FUNCTIONS OF ACCOUNTING ARE AS FOLLOWS:

1. Systematic record of business transactions / Recording: Recording is the basic function of accounting. Accounting records business transactions in terms of money. It is essentially concerned with ensuring that all business transactions of financial nature are properly recorded. Recording is done in **Journal** or **subsidiary books** in chronological order. To keep systematic record of transactions, post them into ledger and ultimately to prepare the final accounts is the first function of accounting.

2. Classifying: Accounting also facilitates classification of all business transactions recorded in the journal. Items of similar nature are classified under appropriated heads. It deals with classification of recorded transactions so as to group similar transactions at one place. The work of classification is done in a book called the Ledger, where similar transactions are recorded at one place under individual account heads. Eg. In sales account all sale of goods are recorded. In purchases account all purchase of goods are recorded.

3. Summarizing: It involves presenting classified transactions in a manner useful to both its internal and external users. It involves preparation of financial statements i.e profit& loss account and Balance sheet etc., Accounting summarizes the classified information. This process leads to the preparation of Trial balance, Income statement and balance sheet.

4. Analyzing: The recorded data in financial statement is analyzed to make useful interpretation. The figures given in financial statements need to be put in a simplified manner. Eg. All items relating to fixed assets are placed at one place while long term liabilities are placed at one place.

5. Interpretation: It deals with explaining the meaning and significance of the data simplified. The accountants should interpret the statements in a manner useful to the users. Interpretation of data helps management, outsiders and shareholders in decision making. It aims at drawing meaningful conclusions from the information. Different parties can make meaningful judgments about the financial condition and profitability of business operations.

6. Communicating Results to Interested Parties:

Accounting also serves as an information system. It is the language of the business. It supplies the meaningful information about the financial activities of the business to varies parties i.e., owners, creditors, investors, employees, government, public, research scholars and managers at the right time. It is a service function. It is not an end itself but a means to an end. It involves preparation and distribution of reports to the users to make decisions.

7. Compliance with legal requirements: The accounting system must aim at fulfilling the requirements of law. Under the provisions of law, the business man has to file various statements such as income-tax returns, sales tax returns etc.

8. Protecting the property of the business: For performing this function the accountant is required to devise such a system of recording information so that assets of the business are not put to wrong use and a complete record of the assets of the concern is available without any difficulty.

DIFFERENT TYPES OF ACCOUNTING CONCEPTS:-

Account is a system evolves to achieve a set of objectives. In order to achieve the goals, we need a set of rules or guide lines. These guide lines are termed as "Basic accounting concepts". The term concept means an idea or thought. Basic accounting concepts are the fundamental ideas or basic assumptions underlying theory and practice of financial accounting.

These concepts are termed as "generally accepted accounting principles". These are broad working rules of accounting activity. They are evolved over a period in response to changing business environment. They are developed and accepted by accounting profession. The concepts guide the identification of events and transactions to be accounted for.

The concepts help in bringing about uniformity in the practice in accounting. In accountancy following concepts are quite popular.

1. Business Entity Concept: Business is treated separate from the proprietor. All the transactions are recorded in the books of the proprietor. The proprietor is also treated as a creditor for the business. When he contributes capital, he is treated as a person who has invested his amount in the business. Therefore, capital appears in the liabilities of balance sheet of the proprietor.

Effects of this Concept:

a) **Financial position of the business can be easily found out.**
b) **Earning position of the business can be easily ascertained.**

2. **Going Concern Concept:** This concept relates with the long life of the business. The assumption is that business will continue to exist unlimited period unless it is dissolved due to some reason or the other.

DIFFERENT TYPES OF ACCOUNTING CONVENTIONS:-

In accounting, convention means a custom or tradition, used as a guide for the preparation of accounting statement. The following are the accounting conventions:

1. Convention of Full Disclosure: Accounting to this convention, accounts should be prepared honestly and they should disclose all materials and significant information. Every company shall keep proper books of accounts. Auditor records expenses, incomes, profits, losses, assets and liabilities. The essential items to be disclosed in the Profit and Loss Account are given. There is legal form for the balance sheet.

2. **Convention of Consistency:** In every business, the management draws important conclusion from the financial statements, regarding working of the concern, for this purpose in preparing the final accounts.

The same principle and practices should be followed from year to year.

3. **Convention of Conservation:** This is very important in preparing final accounts. This term suggests caution. All prospective profits should be ignored. All outstanding expenses should be taken into account. Adequate reserves or provisions should be provided for. This means that there should be no window dressing and secret reserves.

4. **Convention of Materiality:** This is also called the convention of reasonable

degree of accuracy. According to this, the information given in the accounts should be reasonable accurate. All the entries should be exact. Fraction of a rupee is avoided.

5. **Convention of Relevance:** As per this convention, the firm should give relevant accounting information whenever required with documentary evidence like, purchases or sales invoices, vouchers etc., as documentary proof of a transaction.

JOURNAL :-

The word Journal is derived from the French word „Jour" which means a day. Journal, therefore, means a daily record of business transactions. Journal is a book of original entry/prime entry because transaction is first written in the journal from which it is posted to the ledger at any convenient time. The journal is a complete and chronological record of business transactions. It is recorded in a systematic manner. The process of recording a transaction in the journal is called **Journalising**. The entries made in the book are called **Journal Entries**.

Proforma of Journal

Journal Entries in the books of-------------------

Date	Particulars	L.F	Debit (Rs.)	Credit (Rs.)

Advantages of Journal/ Importance of Journal

The main advantages of Journal are given below:

1. Availability of Full information/Complete Record: All business transactions date-wise will be recorded in the Journal As such the total information for every transaction can be obtained very easily without late. So Journal serves as a complete record. It provides a chronological record of all transactions and hence provides permanent record.

2. Posting becomes easy: When once the transactions are entered in the Journal, recording the same in the relevant accounts in the ledger can be made easily. The businessman can have an understanding on debit and credit principles in the beginning itself. It provides information of debit and credit in an entry and an explanation to make it understandable properly.

3. Explanation of the transaction: Every Journal entry will be briefly explained with a narration. Narration helps in proper understanding of the entry.

4. Location of the errors easy: Journal helps to locate the errors easily. Both debit and credit aspects of a transaction are recorded in the journal. Since the amount recorded in debit amount column and credit amount column must be equal. Therefore, the possibility of committing errors is reduced and the detection of errors, if any, committed becomes easy.

Chronological order: Transactions are recorded in a chronological order in the Journal. Hence, when any information is required, the information can be traced out quickly and easily.

6. **Eliminates the need for reliance on memory:** It eliminates the need for a reliance on memory of the accounts keeper. Some transactions are of a complicated nature and without the journal, the entries may be difficult, if not impossible.

7. Journal provides information relating to the following aspects:

(a) Credit sale and purchase of fixed assets, investment or any thing else not dealt in by the firm.

(b) Special allowances received from suppliers or given to the customers.

(c) Writing off extra-ordinary losses viz. losses due to fire, earth quakes, theft etc., and bad debts.

(d) Recording in the reduction of the assets i.e., depreciation.

(e) Receipt and issue of bills of exchange, promissory notes, hundies and their dishonour, renewal etc.,

(f) Transactions with Bank(unless bank column added to the cash book)

(g) Income earned but not received in cash.

(h) Expenses incurred but not yet paid for in cash and other similar adjusting entries.

(i) Transfer entries viz. posting total of subsidiary books to the respective impersonal accounts in the ledger at the end of every month, transfer of gross profit or loss to the Profit & Loss A/c and net profit or net loss and also drawings A/c to the Capital A/c at the end of the trading period.

(j) Closing entries-entries to close the books at the time of preparing trading and profit &loss account.

LIMITATIONS / DISADVANTAGES OF JOURNAL:

The following are the main limitations of the journal.

1. The Journal will be too long and becomes unwieldy if all transactions are recorded in the journal.

The Journal is unable to ascertain daily cash balance. That is why cash transactions are directly recorded in a separate cash book so that daily cash balances may be available.

3. It becomes difficult in practice to post each and every transaction from the Journal to the ledger. Hence in order to make the accounting easier and systematic, transactions are recorded in total in different books.

LEDGER :-

The Third stage in the accounting cycle is ledger posting it means posting transactions entered in the journal into their respective accounts in the ledger. It is the book of final entry. The Ledger is designed to accommodate the various accounts maintained by a trader. It contains the final and permanent record of all transactions in duly classified form. A ledger is a book which contains various accounts. The process of transferring the entries from the journal into the ledger is called posting.

A Ledger may be defined as a summary statement of all the transactions relating to a person, asset, expense or income which have taken place during a given period of time and shows their net effect. The up to date state of any account can be easily known by referring to the ledger.

Features of a Ledger:

i. Ledger contains all the accounts-personal, real and nominal accounts.

ii. It is a permanent record of business transactions.

iii. It provides a means of easy reference.

iv. It provides final balance of the accounts.

Ledger is the principal book of accounts because it helps us in achieving the objectives of accounting. It gives answers to the following pertinent questions.

a. How much amount is due from others to the business?
b. How much amount is owed to others?
c. What are the total sales to an individual customer and what are the total purchases from an individual supplier?

4. What is the amount of profit or loss made during a particular period?

5. What is the financial position of the firm on a particular date?

Advantages/ Utilities/Importance of Ledger

The following are the main utilities of Ledger

1. It provides complete information about all accounts in one book.
2. It is easy to ascertain how much money is due to suppliers (trade creditors from creditors‟ ledger) and how much money is due from customers (trade debtors from debtors‟ ledger).
3. It enables to ascertain, what are the main items of revenues/incomes (Nominal accounts).
4. It enables to ascertain, What are the main items of expenses(Nominal accounts)
5. It enables to know the kind of assets the enterprise holds and their respective values(Real Accounts)
6. It facilitates preparation of trial balance and thereafter preparation of financial statements i.e., profit and loss account and balance sheet.

Differences between Journal and Ledger

Sl.No.	Point of difference	Journal	Ledger
1.	Nature	It is a book of original entry	It is a book of final entry
2.	Object	It is prepared to record all the transactions.	It is prepare to know the net effect of various transactions affecting a particular account.
3.	Basis of preparation	It is prepared on the basis of source document (voucher) of transaction.	It is prepared on the basis of journal.
4.	Stage of recording	Recording in the journal is the first stage.	Recording in the ledger is the second stage.
5.	Balancing	Journal is not balanced.	All ledger accounts are balanced.
6.	Narration	Narration is written for each entry.	No narration is given.
7.	Format	In journal there are five columns viz.,date,particulars, ledger folio, debit and credit.	In the ledger there are four columns on debit and credit side viz., date, particulars, journal folio and amount.
8.	Name of the process of recording entries	The process of recording in journal is called journalizing.	The process of recording in the ledger is called posting.
9.	Basis of preparation of final accounts	Journal direcly does not serve as basis for preparation of final accounts.	

TRIAL BALANCE :-

Trial Balance is a statement in which debit and credit balances of all ledger accounts are shown to test the Arithmetical accuracy of the books of account. Trial Balance is not conclusive proof of accuracy of books of accounts.

Definitions of Trial Balance:

According to J.R.Batliboi, " A Trial Balance is a statement of Debit and Credit balances extracted from the various accounts in the ledger with a view to test the arithmetical accuracy of the books."

According to Spicer and Peglar, " A Trial Balance is a list of all the balances sttanding on the ledger accounts and cash book of a concern at any given date."

Features of a Trial Balance:

1. It is not an account., it is only a statement which is prepared to veryfy the arithmetical accuracy of ledger accounts.
2. It contains debit and credit balances of ledger account.
3. It is prepared on a particular date generally at the end o f business year.

4. Trial Balance helps in preparing final accounts.

5. As it is prepared by taking up the ledger account balances, both debit and credit side of a Trial Balance are always equal.

The preparation of Trial Balance is not compulsory. There is no hard fast rule in this regard.

Importance / Merits /Advantages of Trial Balance:

1. **Proof of Arithmetical accuracy:** It helps in checking the arithmetical accuracy of books of accounts.

2. **Preparation of financial statements:** It helps in the preparation of final accounts i.e., Trading Account, Profit & Loss Account and Balance Sheet.

3. **Detection of Errors:** It will help in detection of errors in the books of accounts and in their rectification.

4. **Rectification of Errors:** It serves as instrument for carrying out the job of rectification of errors.

5. **Easy Checking:** It is possible to find out the balances of various accounts at one place.

Limitations of Trial Balance:

1. Trial balance can be prepared only in those concerns where double entry system of accounting is adopted. This system is **very costly** and **time consuming**. It cannot be adopted by the small business concerns.

2. Though Trial Balance gives arithmetical accuracy of the books of accounts but there are certain errors which are not disclosed by Trial Balance. That is why it is said that Trial balance is not a conclusive proof of the accuracy of the books of accounts.

3. If Trial Balance is not prepared correctly then the final accounts prepared will not reflect the true and fair view of the state of the affairs/financial position of the business. Whatever conclusions and decisions are made by the various groups of persons will not be correct and will mislead such persons.

4. Trial Balance tallies even though errors are existing in the books of accounts.

Even some transactions are omitted the Trial Balance tallies.

The following are the **main objectives** of preparing the Trial Balance.

1. To have balances of all the accounts of the ledger in order to avoid the necessity of going through the pages of the ledger to find it out.
2. To have a proof that the double entry of each transaction has been recorded because of its agreement.

3. To have arithmetical accuracy of the books of accounts because of the agreement of the Trial Balance.

4. To have material for preparing the profit or loss account and balance sheet of the business.

Methods of preparing Trial Balance:
There are two methods of preparing Trial Balance;

1. **Totals Method:** Under this method the total of debits and credits of all ledger accounts are shown in the debit and credit side of the Trial Balance. The Trial Balance prepared under this method is known as gross Trial Balance.

2. **Balance Method:** Under this method all the balances of each and every account will be shown against the debit or credit side of the Trial Balance. If an account has no balance then it will not be shown in the Trial Balance. This method is more convenient and commonly used.

3. **Total and Balance Method:** Under this method, the above two methods are combined. Under this method statement of trial balance contains seven columns instead of two columns.

Rules of Preparing Trial Balance:
While preparing the trial balance from the given list of ledger balances, following rules should be taken into care:
The balances of all (i) assets accounts (ii) expenses accounts (iii) Losses (iv) drawings (v) cash and bank balances are placed in the debit column of the trial balance. 2. The balances of all (i) liabilities accounts (ii) incomes accounts (iii) profits (iv) capital are placed in the credit column of trial balance.

Proforma of Trial Balance
Trial Balance of X as on -------------------

Serial No.	**Heads of Accounts**	**L.F**	**Debit Balance Rs.**	**Credit Balance Rs.**
1.	Drawings		**xxxxxx**	
2.	Capital			xxxxxx
3.	Assets		xxxxxx	
4.	Liabilities			xxxxxx
5.	Expenses		xxxxxx	
6.	Losses		xxxxxx	
7.	Incomes			xxxxxx
8.	Profits			xxxxxx
	Total		xxxxxxx	xxxxxxx