# UNIT- 1

## INTRODUCTION TO FINANCIAL ACCOUNTING: -

### MEANING: -

Financial accounting is **a specialized branch of accounting that keeps track of a company's financial transactions**. Using standardized guidelines, the transactions are recorded, summarized, and presented in a financial report or financial statement such as an income statement or a balance sheet.

### OBJECTIVE OF ACCOUNTING: -

### VARIOUS USERS OF ACCOUNTING INFORMATION: -

Accounting is of primary importance to the owners and managers. However, creditors, bankers, etc. are also interested in the accounting reports of the organization.

Following is the list of Users of Accounting Information

- Owners/Shareholders
- Managers
- Prospective Investors
- Creditors, Bankers, and other Lending Institutions
- Government
- Employees
- Regulatory Agencies
- Researchers
- Customers

### ACCOUNTING TERMINOLOGIES: -

In order to have better understanding of accounting, it is necessary to know the meanings of certain basic terms used in accounting. Accounting is a versatile system which serves a large number of purposes in the modern business world. Hence, the following terminologies need to be understood.

**Transactions**
Exchange of goods and services between two persons or parties for money or money's worth is known as Transactions.

**(a) Monetary Transactions**:
The transaction which involves an exchange of money or money's worth directly or indirectly is called monetary transactions. Only monetary transactions are recorded in the books
of accounts.

**1) Cash Transactions :** A business transaction in which cash is paid or received immediately is known as cash transaction.e.g.

i) Purchase of goods for cash at ` 15,000/-
ii) Payment of salary at ` 5,000/-

**2) Credit Transactions:** A credit transaction is one in which cash is not paid or received immediately at the time of a transaction but it is paid or received at a later date. e.g.,

i) Goods sold on credit to Mr. Aman at ` 8,000/-
ii) Sold machinery to Mr. Amarsingh on credit at ` 20,000/-

**(b) Non-Monetary Transactions:**
The transaction which does not involve an exchange of money or money's worth directly or indirectly are called non-monetary transactions. An exchange of one thing against another
thing is called as Barter transactions.

**1) Entry:** Recording of a business transaction in the proper form or method in the books of accounts is called an entry.

**2) Narration**: A brief explanation of the business transaction for which an entry is passed is called as a narration. It is always given in a bracket below the journal entry and it usually starts with the word "Being" or "For".

**3) Goods**: The term ‘goods’ refers to merchandise, commodities, articles or things in which a trader trade. These are purchased or manufactured for the purpose of sale and to earn profit. E.g.

i) Medicines are goods for the chemist.
ii) Vegetables are goods for the vegetable vendor.
iii) Parts like Tyres, engine gearbox, cables are produced by a vehicle manufacture like Bajaj Auto, Hero Motors.

**Capital and Drawings**:

**a) Capital :** The total amount invested into the business by the owner is called capital. Excess of assets over the liabilities is also called as capital. The equation for this is : Capital = Assets – Liabilities
Capital is a liability of the business as this amount is payable by the business enterprise to the owner at the time of closure of the business.

**b) Drawings :** The amount of cash or value of goods, assets, etc., withdrawn from the business by the owner for personal use called as drawings. E.g. : A proprietor pays colleges fees of his son, or pays for his medical expenses, mobile bills etc, from the business.

**Debtors and Creditors:**

**a) Debtor :** A person who has to pay to the business for getting goods and services on credit is known as debtor. A debtor is a person who owes money to the business.

**b) Creditor:** A person to whom business has to pay for getting goods or services on credit is known as creditor. A creditor is a person to whom business owes money.

**c) Bad Debts :** An irrecoverable amount from a debtor is known as "Bad Debts". It is a revenue loss to the business.

**Expenditure and Types of Expenditure**

**Expenditure:** An amount spent by the business for any consideration received by business is called expenditure.

**i) Capital Expenditure :** This expenditure is incurred to acquire fixed asset or to increase the value of fixed asset. It gives the benefit for a long period of time and it is non-recurring in nature. E.g. : Purchase of Machinery, extension of building, purchase of computer etc.

**ii) Revenue Expenditure :** Revenue expenditure is an expenditure from which no future benefit is expected but having immediate or short term benefit may be less than one year. It does not increase profit earning capacity of an organization. These are normal day to day operating expenses of a business organization and appear on the debit side of Trading A/c or Profit and Loss A/c. E.g. : Rent paid, Salary paid, Wages paid etc.

**iii) Deferred Revenue Expenditure:** An expenditure which is basically revenue in nature but benefit of which is not exhausted within one year is called as Deferred Revenue Expenditure. Such expenditure is written off over number of years. Such written off amount is shown on debit side of profit and loss a/c and unwritten amount is shown on asset side of the Balance Sheet. E.g. : Heavy expenditure on advertising, heavy legal expenses.

**Cash Discount and Trade Discount :**
Discount is a concession or allowance given by the seller to purchaser. There are two types of discounts.

**i) Trade Discount :** It is an allowance given on catalogue price or list price of goods. This discount is allowed at the time of purchase/sale of goods. Value of goods purchased/sold recorded is net value payable i.e. after deduction of amount of trade discount allowed. If goods of ` 1000/- are sold at 5% trade discount, the value of goods that will be recorded will be ` 950/- both by the purchaser and the seller and not ` 1000/-. Hence, trade discount does not appear in the books of accounts separately.

**ii) Cash Discount:** It is the amount deducted from the final amount due at the time of receipt. It is the concession given for encouraging prompt payment. It is given either for the spot payment or for payment within a specific period. Cash discount is calculated after deducting trade discount, since it is loss to the seller and gain to the buyer, cash discount appears in the books of accounts.

**Solvent and Insolvent**:

**i) Solvent:** If a person's assets are more than his liabilities, or equal to his liabilities, he is called as a solvent person. Solvent person is financially sound and is in a position to pay off all his
debts. E.g.: A person's total assets have been calculated to ` 50,00,000/- and his total debts were 30,00,000/- since his position is sound he is able to pay off his debts therefore he is called Solvent.

**ii) Insolvent:** A person whose liabilities are more than his assets is an insolvent person. Such person's liabilities are more than his assets. E.g. : A person's total assets or property have been calculated to ` 20,00,000/- and his total debts were ` 50,00,000/- and if he is not in a position to get any amount from any sources and if the court is so satisfied then he will be declared as an insolvent person.

**Accounting Year:**

It is the period of 12 months for which accounts are maintained and closed by the proprietor. Earlier the proprietors were following any accounting year i.e. calendar year, or financial year or any other year as per tradition. But now for income tax purpose an accounting year starts on 1st April and end on 31st March. At the end of accounting year a proprietor has to prepare Trading account, Profit and Loss account and Balance Sheet to find out the financial position of the business.

**Trading Concern and Not for Profit Concerns.**

**i) Trading Concern:** A business concern established with an object of earning profit by selling goods is known as Trading concern. It is also called as commercial organization or profit-making organization.

**ii) Not for Profit Concern:** It is an organization not established for making profit but for rendering services to the society. An organization may be formed for promoting a useful object like art, science, sports, culture, charity, profession etc. e.g Schools, Hospitals, Sports Club etc.

**Goodwill:**

Goodwill may be described as the aggregate of those intangible attributes of a business which contributes to its superior earning capacity over a normal return on investment. It may arise from such attributes as favorable locations, the ability and skill of its employees and management, quality of its products and services, customer satisfaction etc.

1. Goodwill is the reputation of business expressed in terms of money.

2. Goodwill is an intangible asset.

**Profit or Loss**

**a) Profit :** When the selling price of goods is more than the cost price it is a profit. Profit increases the capital of the business. e.g. If goods are sold for ` 50,000/- and all expenses during the period amounted to 30,000/- then the profit is ` 20,000

b **Loss :** When cost price of goods is more than its selling price it is a loss.

Loss decreases the capital of business e.g. If goods are sold for ` 50,000/- and all expenses during the period amounted to 60,000/, then the loss will be ` 10,000/-

**c) Income:** It is revenue arising as a result of business transactions. It is the amount receivable or realized from services provided and earnings from interest, dividend, commission, etc.

**d) Revenue:** It is income that a business has from its normal business activities usually from the sale of goods and services to customer.

**Assets, Liabilities, Net Worth:**

**Assets:-**Any physical thing or right owned that has a monetary value is called as an asset. The
ownership of the Asset must be with business unit. E.g. Land, Goodwill, Patents, Computers etc.

**Types of assets**

**a) Fixed Assets/Noncurrent Assets :** The assets which give long term benefit to the business are known as fixed assets e.g. Land and Building, Plant & Machinery, Goodwill etc. These assets may be tangible or intangible.

**b) Current Assets :** Assets which are held in the business for the operating year and can be converted into cash very easily are called as current assets. e.g. Debtors, Bills Receivable Cash in Hand, Cash at Bank, Stock etc.

**c) Fictitious Assets :** These assets are not represented by tangible possession or property. They are imaginary assets but do not have any realizable value. e.g. Deferred revenue expense like advertisement paid for 4 years.

**Liabilities:** Amount payable by the business to others is known as liability. It is a debt or amount due from the business to others for the benefit received by the business unit. e.g. Loan taken, Creditors, Bank Overdraft, Outstanding Expenses etc.

**iv) Types of Liabilities**:

**a) Fixed Liabilities :** One of the major source of funds in the business is fixed liabilities. It may be in the form of capital, secured loans, long term loans from banks and from financial institutions etc.

**b) Current Liabilities:** Short term liabilities payable within a year are called current liabilities. Current liabilities arise in the regular current operations of the business. These liabilities are not normally secured. E.g. Creditors, Bills Payable etc.

**v) Net worth or Owners Equity or Capital**:
The amount or funds provided by the proprietor in the business is called as "Capital" as well as the excess of assets over liabilities of the business is also known as "Capital" or "Net Worth" Net worth includes Capital and Reserves. Capital can be in the form of cash or in kind.

Net worth = Owner's Equity = Capital

OR

Owner's Equity (Capital)= Total Equity (Assets) – Creditors Equity ( Liabilities)

e.g. a) If the Capital of the business is ` 4,00,000 and Creditors ` 2,00,000 then Total Equity(Assets) = Liabilities + Capital 6,00,000 = 2,00,000 + 4,00,000

b) If total assets are ` 1,50,000 and Capital is ` 1,00,000 then Creditors Equity (liabilities) will be Creditors Equity (liabilities) = Assets – Capital
` 50,000 = ` 1,50,000 - ` 1,00,000

c) If total assets of the business are ` 5,00,000 and Outside liabilities are ` 2,00,000 then Owner's Equity(Capital) will be Owner's Equity (Capital) = Assets – Liabilities ` 3,00,000 = ` 5,00,000 – ` 2,00,000

**Contingent Liabilities:**
A liability which may arise in future depends on happening or non-happening of certain event is called as contingent liability. As it is not confirmed or perfect liability, it does not affect the financial position of the business and therefore, it is not shown on the liability side of the Balance Sheet. But it is shown by way of foot note to Balance Sheet simply as information.
e.g. A worker makes a claim for compensation of ` 5,000/- against the business and the decision is pending in the court. It may be a future liability for business on happening of an event i.e. "Court Verdict".

## ACCOUNTING CONCEPTS AND CONVENTIONS:-

### Meaning and Importance of Accounting Concepts

Accounting is means of communicating the results of business operations to various parties interested in or connected with the business viz., the owners, creditors, investors, banks and financial institutions, Government and other agencies. Hence, it is rightly called as the language of business. Accounting is not only associated with business, but also with everybody, who is interested in keeping an account of the monetary transactions. Generally the term 'accounting' refers to financial accounting. Book-keeping and Accountancy is an art of recording, classifying and summarizing transactions of business concern in a systematic manner.

**Importance of Accounting Concepts**:

1) Reliable financial statements.
2) Uniformity in presentation.
3) Generally acceptable basis of measurement

4) Proper information to all.
5) Valid and appropriate assumption

## Some of the important concepts are as follows :

**1. Business Entity:** This concept implies that a business unit is separate and distinct from the owner or owners, that is, the persons who supply capital to it. Based on this concept, accounts are prepared from the point of view of the business and not from the owner's point of view. Hence, the business is liable to the owner for the capital contributed by him/her. According to this concept, only business transactions are recorded in the books of accounts. Personal transactions of the owners are not recorded. But, their transactions with the business such as capital contributed to the business or cash withdrawn from the business for the personal use will be recorded in the books of accounts. It implies that the business itself owns assets and owes liabilities. e.g. Half of the building is used for business office and other half of the building is used for the residence of the proprietor. It the total rent of the building is ` 50,000/- then only ` 25,000/- will deducted as drawings from proprietor’s capital.

**2) Money Measurement:** This concept implies that only those transactions, which can be expressed in terms of money, are recorded in the books of accounts. Since money serves as the medium of exchange transactions expressed in money are recorded and the ruling currency of a country is the measuring unit for accounting. Transactions which do not involve money will not be recorded in the books of accounts. For example, working conditions in the work place, strike by employees, efficiency of the management, etc. will not be recorded in the books, as they cannot be expressed in terms of money. It helps in understanding of the state of affairs of the business as money serves as a common measure by means of which heterogeneous facts about the business are recorded.
For example, if a business has 5 computers, 2 tables and 3 chairs, the assets cannot be added to give useful information, unless, they are expressed in

monetary terms ` 1,50,000/- for computers, `15,000/- for tables and ` 2,500/- for chairs.

**3) Cost Concept :** An asset is recorded in the books on the basis of the historical cost, that is, the acquisition cost. Cost of acquisition will be the base for all further accounting. It does not mean that the asset will always be shown at cost. It is recorded at cost at the time of its purchase, but is systematically reduced in its book value by charging depreciation.
e.g.: Furniture is purchased for ` 3,00,000/- and same cost has been recorded in the books. In case the market value goes to ` 1,00,000/- or ` 1,50,000/- It will not be considered.

**4) Consistency Concept:** Any policy adopted for accounting should be continuous or consistent throughout the business and it need not be changed generally unless and until circumstances demand. However, it does not stop any improvement of new techniques. But that should be disclosed with a note. e.g. : A company adopts fixed installment method for charging depreciation on fixed asset from the beginning till the end of estimated life of asset.

**5) Conservatism:** While recording the business transactions we have to anticipate no profit but provide for all possible losses. It encourages the certain secret reserves by making excess provision to prevent losses. The income statement may show lower income and the Balance Sheet overstates the liabilities and understates the assets. This policy of recording is asking the accountant 'to play safe' while writing the accounts.
e.g. : The closing stock in the factory is valued at ` 25,000/- at cost price and ` 35,000/- at its market price. But while recording in the books the value of ` 25,000/- will be considered being the lowest of all.

**6) Going Concern:** It is the basic assumption that business is a going concern and will continue its operations for future. Going concern concept influences accounting practices in relation to valuation of assets and liabilities, depreciation of the fixed assets, treatment of outstanding and prepaid expenses and accrued and unearned revenues. For example, assets are generally valued at historical cost. Any increase or decrease in the value of assets in the short period is ignored.

**7) Realization:** Income is recorded only when it is realized i.e. either it is received or earned. Revenues are recorded only when sale are affected or the services are rendered. Sales revenues are considered as recognized when sales are affected during the accounting period irrespective
of the fact whether cash is received or not. e.g. : A company gets an order for sale of goods ` 1,00,000/- in May 2017. Goods of only ` 60,000/- are sold and delivered in June 2017. Cash is received for ` 60,000/- in Sept, 2017.
As per the principle of realization, sale is to be recorded in June 2017.

**8) Accrual:** Income is recorded when it accrues(earned) and expenses are recorded when they accrue (become payable). All expenses and revenues related to the accounting period are to be considered irrespective of the fact the revenues are received in cash or not or expenses are paid
in cash or not. e.g. : A company invested ` 100,000/- with a bank for one year on 1stOct 2015, Bank has to pay interest at 10% p.a on its maturity i.e 30th Sept, 2016.

**9) Dual Aspect:** According to this concept, every transaction or event has two aspects, i.e., dual effect. For example, when Akshay starts a business with cash ` 5,00,000/- , on one hand, the business gets cash of ` 5,00,000/- and on the other hand, a liability arises, that is, the business has to pay Akshay a sum of ` 5,00,000/-. This is the concept which recognizes the fact that for every debit, there is a corresponding and equal credit. This is the basis of the entire system of double entry book-keeping. From this concept the basic accounting equation, arises that is, Capital + Liabilities = Assets.

**10) Disclosure:** The accounts must disclose all material information. The accounting reports should disclose full and fair information to the related parties. The financial position and performance should be disclosed very

honestly to all the users. The financial position means the Balance Sheet of the business and financial performance means business results in terms of profits or losses and income and expenses in profit and loss account.
All the information disclosed should be relevant, reliable, comparable and understood by all the concerned authorities.

**11) Materiality:** According to this convention, financial statements should disclose all material items which might influence the decisions of the users of financial statements. Hence, any item which is not significant and is not relevant to the users need not be disclosed in the financial statements.
This principle is basically an exception to the full disclosure principle. The term materiality is subjective in nature. Materiality depends on the amount involved in the transaction, size of the business, nature of information, requirements of the person making decision, etc. An item material to one person may be immaterial to another person.

**12) Matching Concept:** According to this concept, revenues during an accounting period are matched with expenses incurred during that period to earn the revenue during that period. This concept is based on accrual concept and periodicity concept. Periodicity concept fixes the time frame for measuring performance and determining financial status. All expenses paid during the period are not considered, but only the expenses related to the accounting period are considered. On the basis of this concept, adjustments are made for outstanding and prepaid expenses and accrued and unearned revenues. Also due provisions are made for depreciation of the fixed assets, bad debt, etc., relating to the accounting period. Thus, it matches the revenues earned during an accounting period with the expenses incurred during that period to earn the revenues before sharing any profit or loss.

## DOUBLE ENTRY SYSTEM: -

Definition of Double Entry System is as follows-
"Every business transaction has a two fold effect and that it affects two accounts in opposite directions and if a complete record is to be made of each

such transaction it would be necessary to debit one account and credit another account. It is this recording of two fold effect of every transaction that has given rise to the term Double Entry.” – J.R. Batliboi.

**Principles of Double Entry Book-keeping System**

1) In every business transaction there must be minimum two effects i.e debit and credit.
2) Two Accounts means one is the Receiver of the benefit and other is the Giver of the benefit.
3) If one account is debited other account must be credited.
4) Every debit has a equal and corresponding credit of the same amount.

**Advantages of Double Entry Book-keeping System:**

**1) Complete Record:**
Under this system all business transactions are recorded. This method is scientific and records both the aspects of each transaction.

**2) Accuracy:**
In this system both aspects are recorded in the books of accounts so it gives complete accuracy in accounting work. It also checks arithmetical accuracy.

**3) Business Results:**
All expenses, losses, income, gains, liabilities, assets, debtors and creditors all these transactions are recorded, therefore it helps to find out accurate business results of particular accounting period.

**4) Common Acceptance**:
It is widely accepted since it follows universal accounting principles. Double Entry System is accepted by financial institutions, government authorities etc.

**Conventional Accounting System (Traditional):**

Conventional Accounting System is based on practicability. Accounting convention means rules which by common agreement are used in accounting. However, there is no clear information of rules between concepts and convention. Indian system of accounting is the example of conventional accounting. This system does not follow principles of double entry system. It is incomplete system of recording the business transactions

**CLASSIFICATION OF ACCOUNTS:-**

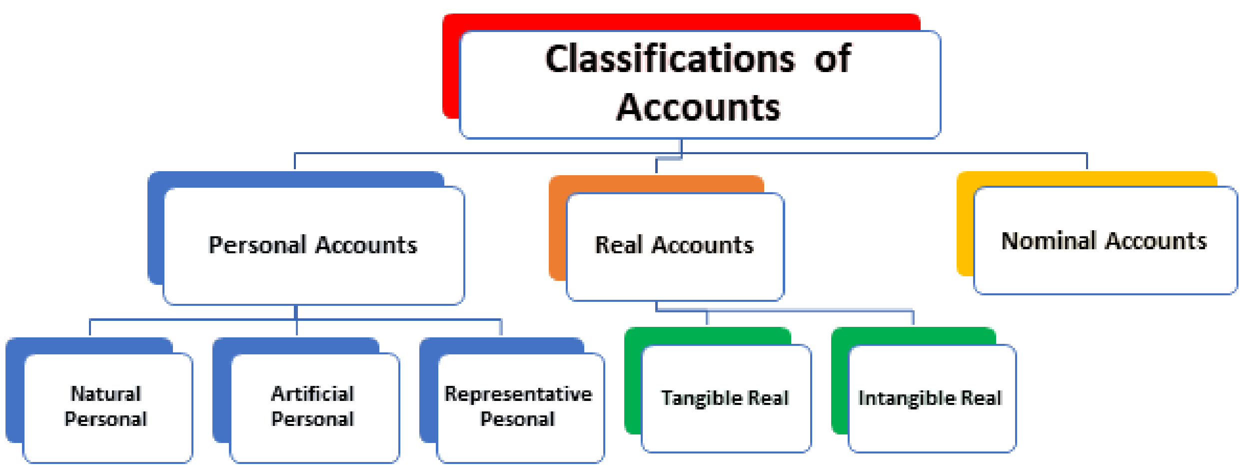
**Meaning of Account:**

An account is a summarized record of transactions relating to a particular person, asset, liability, particular head of expense or income recorded at one place. In day-to-day business activity large number of business transactions takes place. It affects the several accounts. At the end of certain period of time, it is necessary for the businessman to balance the accounts to find out the information. like total capital, total liabilities and assets, total incomes and expenses etc. of the business.

**Definition of Account:**

"An account is summarized record of transactions affecting one person, one kind of property or one class of gain or loss." – G.R.Batliboi

"An account is a ledger record in a summarized form of all the transactions that have taken place with the particular person or thing specified." – Carter.



Each type of accounts is explained below with examples-

**1) Personal Account:**
This account represents a person and group of persons with whom business deals. These accounts are classified into following three categories:-
**a) Natural Person's Account:**
Accounts relating to individual human beings. for e.g. Rajesh’s A/c, Sumit's A/c, Sushma's A/c, Vaibhav’s A/c etc.

**b) Artificial Person's Account:**
Artificial persons means includes accounts of organizations, associations which are created by law, for E.g. Bank of Maharashtra A/c, ABC & Co A/c, Recreation Club A/c.

**c) Representative Personal Account**:
These Accounts represent a certain person or group of person in business dealing. Accounts relating to outstanding and prepaid items are called representative personal account E.g. Outstanding Rent A/c, Income received in advance A/c, Prepaid Wages A/c etc.

**2) Impersonal Account:**

Impersonal Accounts are classified into following two categories;-
**1. Real Accounts:**
This account represents assets and properties owned by the business. The following are the types
of Real Account.

**a) Tangible Real Account:**
Tangible real account means the Assets and properties, which can be seen, touched and felt. e.g., Machinery A/c, Motor Car A/c, Stock of Goods A/c etc.

**b) Intangible Real Account:**

Intangible Real account means assets which cannot be seen, touched, or felt but they can be measured in terms of money e.g. Goodwill A/c, Patents A/c, Trademark A/c, Copyrights A/c.

**2. Nominal Accounts**:

The account of expenses, losses, income and gains are called as Nominal accounts e.g. Wages A/c, Stationery A/c, Salary A/c, Depreciation A/c Commission Received A/c, Discount Received A/c etc.

**Debit and Credit**

1) Debit (Dr.):

Left hand side of an Account is called Debit (Dr) side.

2) Credit (Cr):

Right hand side of an Account is called Credit (Cr) side.

**GOLDEN RULES OF ACCOUNTING: -**

**BOOKS OF PRIME ENTRY: -**

In business, there are numerous daily financial transactions. So, there is a separate book to keep the track of the receipts and payments of this transaction. The ledger accounts in a business are the main source of information that is used to prepare financial statements. While, if a business is required to update their ledgers, then each time a transaction occurs, the ledger accounts would quickly become clustered and chances of errors might be made. This would also be a very lengthy process. To avoid all such complications, the transactions are first recorded in a book of prime entry.

The main books of prime entry are:

Sales daybook

Purchase daybook

Sales return daybook

Purchases return daybook

Bank Book

Cash Receipts book

Cash Payments Book

Petty Cash Receipts Book

Petty Cash Payments Book

Journal

**Importance of Books of Prime Entry**

Now we are quite sure that the Books of Prime Entry are very much prevalent in the business, for their advantageous characteristics. The following are the advantages of a journal:

1. Provides a Chronological Record: Journal book records transactions in the occurrence of their date. Hence, it is possible to get day-to-day information.
2. The Book of Prime Entry Minimizes the possibility of errors: The nature of the transaction affects the financial position of the business; this is ascertained by recording and analyzing the transaction.

3. Helps to finalize the accounts: With the book of prime entry, it provides a basis for ledger posting and the ultimate draft of the Trial Balance.
4. Future references: References can be given to the financial transactions that become easy as these transactions are similar and are recorded in one journal.
5. Few mistakes and can be detected easily: With the help of Prime Entry, the mistakes in the ledger accounts can be easily detected
6. Lessens the chance of business fraud, negligence, and mistakes: The Chronological recording of the financial transactions reduces the chance of business frauds, negligence, and mistakes.
7. Journals are shown in clarity: Journals show all these transactions in great detail so the business is not mandated to rewrite them in detail in the ledger section, thus it keeps the ledger accounts brief and uncluttered.
8. Perfect back-up of each other: If records are by chance lost then along with the ledger and the books of original entry the organization will get through. They act as a perfect backup for each other.
9. Bases the control on one ground: Handling of each type of journal entry by a different member of the staff causes variation, this prevents a single person from having exclusive control on the accounting system. This leads to fraud and is difficult to make. Hence, it is more likely that errors would be identified by this system.
10. Ensuring that the documents are not skipped: To ensure that the documents do not go unrecorded, the source of documents are normally copied twice with consecutive numbers and are noted in day books while recording the transactions.

**The Significance of Prime Entry Books and Ledgers in both Integrated and Interlocking Accounting Systems**

The term 'ledger' refers to a book. There are commonly three ledgers in accounting systems: Wages, sales, purchases, electricity, travel, advertising, rent, insurance, repairs, receivables, payables, and non-current assets are all recorded in the General or nominal ledger. Although cash and bank accounts are legally part of this ledger, they are frequently kept in a separate book due to the volume of cash and bank transactions. The Payables ledger (sometimes known as the creditors' ledger or the purchase ledger) is a record of all payments made to creditors. Although the overall amount owing to suppliers is noted in the general ledger, the specifics of what is owed to whom are documented here as well. Each supplier has his or her account. The payables balance in the general ledger should match the total of the amounts owed in this ledger. The Receivables ledger (also known as the debtors' ledger or the sales ledger) is a book that keeps track of money owed to you. The overall amount owed by customers is recorded in the general ledger, but the specifics of what is owed from whom are also noted here. Each credit consumer has his or her account. The total of the sums owing in this ledger should match the main ledger's receivables balance.

## SUBSIDIARY BOOKS AND LEDGER CREATION: -

### INTRODUCTION

A small business may be able to record all transactions in single Journal but as the business expands the number of transactions becomes so large, that the Journal is required to be sub-divided into Special Journals which are called Subsidiary Books.

### Meaning :

The sub division of Journal on the basis of nature of transaction is known as Subsidiary Books. These books are also called as Books of Original entries or Prime entries because the transactions are first recorded in Subsidiary Books and then posted in the Ledger.

### Need for maintaining Subsidiary Books:

**1) Specialization:** When the staff is appointed for same type of work it leads to specialization and increase in efficiency.

**2) Time saving and economical :** Different accounting procedures can be taken up at the same time. This will save time and prove to be economical.

**3) Division of work :** The writing of Subsidiary Books can be conveniently divided among different clerks. Hence it is easy to keep the Books up to date.

**4) Quick information and future reference:** Subsidiary Books gives quick information relating to the accounts and makes future reference easy.

**5) Internal check:** Verification of correctness can be made more effectively.

## LEDGER

**Introduction: -**

In the process of accounting, all the business transactions are recorded in chronological order in Journal. These business transactions are recorded in proper books of accounts. The books of accounts can be grouped as follows:

Books of accounts

1. Subsidiary books (primary books)
2. Ledger (final books)

We are aware that all types of business transactions are recorded in Journal e.g. Transactions related to assets, liabilities, expenses, income, cash or credit etc. At the end of the particular period if we want to know what is the total amount spent on particular type of expense, or what is the amount payable to particular person /party? These types of questions cannot be answered easily through Journal. So, to overcome these limitations of Journal we need Ledger. A Ledger is called as the main Book of Accounts. Once the transactions are recorded in Journal or Subsidiary books the next stage is transfer of those transactions in their respective accounts opened in the Ledger.

**Meaning and Importance of Ledge**r

**Meaning and Definitions :**

Ledger is the Principal Book of accounts. It is also called as book of final entry. It is summarized record which contains all the accounts e.g. Assets A/c, Liabilities A/c, Capital A/c, Revenue A/c Expenses A/c

The word ‘LEDGER’ is derived from Latin word ‘Ledger’ which means ‘to contain’ As the
ledger is the collection of all the accounts so ‘it contains’ and hence the name signifies.
1. “A Ledger Account may be defined as a summary, statement of all the transactions relating to persons, assets, expenses or incomes which have taken place during a given period to time and shows their net effect”.- S. P. Jain, K. L. Narang –Advanced Accountancy

2. “Main record of the accounts of a business, traditionally, a ledger was a large book with
separate pages for each account. In modern systems ledger may consist of separate cards or computer records’- Oxford Dictionary

3. “A Ledger containing accounts in which all the transactions of a business enterprises or other accounting units are classified either in detail or in summary form”- E. L. Kohler- A Dictionary for Accountants

**Importance of Ledger**

1. It is the summarized record of all the transactions in form of Asset A/c, Liabilities A/c, Expenses/c, Income A/c etc.

2. The ultimate object of Book-Keeping is to ascertain with the least trouble, what is the amount owed to the supplier, what is the amount receivable from the customer and so on. In the process of posting information collected is condensed in form of Debtors A/c , Creditors A/c to get the ready results.

3. It is necessary for preparation of Trial Balance.

4. The financial position of the business can be easily known with the help of various types of Assets A/c and Liabilities A/c

5. It is possible to prepare various types of income statement on the basis of balances shown by different ledger Accounts.

6. Ledger can be used as a control tool as it shows accounts of various expenses with the balance.

7. On the basis of the results shown in the Ledger it is useful for the management to forecast or plan the future plan of action.

**Contents of Ledge**r

Ledger is a bound book which contains several pages. Each page of a ledger is serially numbered.
For each account separate page is allotted. The page number of the ledger is called as 'Ledger Folio'
(L.F.) Each ledger account is divided into two sides. The left side is known as debit side and the right
side is known as credit side. This is indicated by writing the abbreviations 'Dr.' on the left side top corner and 'Cr.' on the right-side top corner.
Every Ledger has an index. Index is prepared in the alphabetical order. The page number on which a particular account appears is shown against the name of the account shown in index. This facilitates quick reference.
Both the sides of the ledger have four columns. These columns are: -
1) Date: In this column the date of the transaction is written. The year, month and date should be clearly mentioned.

2) Particulars: In this column, the name of the account in which the corresponding credit or debit is found under double entry principle will be mentioned. The posting on the debit side begins with 'To' and on the credit side with 'By'.

3) Journal Folio (J.F.): Folio means page number. In Journal Folio (J.F.) column, page number of journal from where we have transferred the entry into Ledger is to be written.

4) Amount: In the column, the amount for which an account is debited or credited is entered.