IV UNIT

4 ①

Chapter- 1

ACCOUNTING PROCESS

INTRODUCTION TO ACCOUNTING

In all activities (whether business activities or non-business activities) and in all organizations (whether business organizations like a manufacturing entity or trading entity or non-business organizations like schools, colleges, hospitals, libraries, clubs, temples, political parties) which require money and other economic resources ? cc u iting is required to account for these resources. In other words, wherever money is ı d. a counting is required to account for it. Accounting is often called the language o' ires . e ic function of any language is to serve as a means of communic tion. Accounting also serves this function.

· Tl iunction of accounting is to provide quantitative information, primarily of financial nature about econ mic entities that is needed to be useful in making economic decisions.

Accounting includes not only recording of business transactions but also summarizing the transactions, analyzing and interpreting their effect on working of the business. Accounting provides all information which enables the management to guide the business on a profitable and solvent course. Accounting is the science as well as the art of recording financial transactions under appropriate accounts.

Definitions of Accounting

(a) "Accounting is the art of recording, classifying and summarizing in a significant manner and in terms of money transactions and events which in part, at least of financial character and interpreting the results there of."

- American Institute of Certified Public Accounts

(b) "Accounting is the process of identifying, measuring and communicating economic information to permit informed judgement and decisions by users of information."

- American Accounting Association (AAA)

(c) "Accounting is a service society. Its function is to provide quantitative information, primarily financial in nature, about economic entities that is useful in making economic decision, in making reasoned choices among alternative courses of action".

- American Accounting Principles Board

NEED FOR ACCOUNTING

The main aim of any business is to make profit. The business may be engaged in purchase and sale of different types of goods or may be engaged in production of variety of goods or may be engaged in the provision of services.

In every business, there are numerous transactions. Since the transactions are numerous in number it is impossible for any trader to remember all these transactions for a long time. When transactions are systematically recorded it is easy for a trader to know his profit or loss at any time. Hence there is a need to record all these business transactions in a systematic way in the books of account.

OBJECTIVES OF ACCOUNTING

Objective of accounting may differ from business to business depending upon their specific requirements. Following are the general objectives of Accounting :

(a) **To Keep Systematic Record :** It is very difficult to remember all the business transactions that take place. Accounting serves this purpose of record keeping by promptly recording all the business transactions in the books of account.

(b) **To Ascertain the Results of the Operation :** Accounting helps in ascertaining result i.e., profit earned or loss suffered in business during a particular period. For this purpose, a business entity prepares either a Trading and Profit and Loss account or an Income and Expenditure account which shows the profit or loss of the business by matching the items of revenue and expenditure for some period.

(c) **To Ascertain the Financial Position of the Business :** In addition to profit, a businessman must know his financial position i.e., availability of cash, position of his assets and liabilities etc. This helps the businessman to know his financial strength.

(d) **To Portray the Liquidity Position :** Financial reporting should provide information about how an enterprise obtains and spends cash, about its borrowing and repayment of borrowing, about its capital transactions, cash dividends and other distributions of resources by the enterprise to owners and about other factors that may affect an enterprise's liquidity and solvency.

(e) **To Protect Business Properties :** Accounting provides up-to-date information about the various assets that the firm possesses and the liabilities the firm owes, so that nobody can claim a payment which is not due to him.

(f) **To Facilitate Rational Decision–Making :** Accounting records and financial statements provide financial information which help the business in making rational decisions about the steps to be taken in respect of various aspects of business.

(g) **To Satisfy the Requirements of Law :** Entities such as companies, societies, public trusts are compulsorily required to maintain accounts as per the law governing their operations such as the Companies Act, Societies Act, and Public Trust Act etc. Maintenance of accounts is also compulsory under the Sales Tax Act and Income Tax Act.

EVOLUTION OF ACCOUNTING

The history of accounting is as old as civilisation. The evolution of accounting can be traced in the following phases :

First Phase

1. The seeds of accounting were first shown in Babylionia and Egypt around 4000 B.C. They recorded the transactions of payment of wages and taxes on clay tablets.

2. Babylonia is called as the "City of Commerce." In Babylonia, accounting was used to uncover losses occured due to frauds and inefficiency.

3. In Greece, accounting was used to maintain records of revenues received in treasuries. The records consisted of opening balance, total receipts, total expenditure and the closing balance.

4. Romans used memorandum or day books where in receipts and payments were recorded. Then posting those entries in the ledger were made on monthly basis.

5. In India, Chanakya is famous for his book "Arthashastra." He defined the existence and the need of accounting and its audting.

6. In Manusanhita, the preparation of accounting and determination of profit were emphasized.

7. In England and Europe, Stewardship accounting was followed for a long period for keeping household account.

8. Double-entry system was developing only in the 15th Century. It was developed by Fra Luca Pacioli (philosopher of Venice). He is recognised as the Father of Accounting.

Second Phase

The concept of financial accounting based on Double Entry Principle was recognised with the introduction of Joint Stock Companies. Here, the ownership was separated from the management. For statutory recognition, accounting information system was developed in the form of Profit and Loss Account and Balance Sheet.

Third Phase

Accounting information was generated to help the management in decision-making. This led to the development of Management Accounting. This contributed a lot of improvement in the quality of management decisions.

Present Phase

Now-a-days business operates in social environment. So, social cost incurred by business and social benefit created by business has to be assessed. This phase led to the development of "Social Responsibility Accounting."

FUNCTIONS OF ACCOUNTING

Some of the important functions performed by Accounting are :

(a) **Keeping Systematic Records :** This is the basic function of accounting. The transactions of the business are properly recorded, classified and summarized into final financial statements i.e. Income Statement and the Balance Sheet.

(b) **Protecting the Business Properties :** An important function of accounting is to protect the properties of the business by maintaining proper record of various assets and thus enabling the management to exercise proper control over them.

(c) **Communicating the Results :** As accounting has been designated as the language of business, its main function is to communicate financial information in respect of net profits, assets, liabilities, etc., to the interested parties.

(d) **Meeting Legal Requirements :** A vital function of accounting is to devise a system which will meet the legal requirements. The provisions of various laws such as the Companies Act, Income Tax Act, etc., require the submission of various statements like Income Tax Returns, Annual Accounts and so on. Accounting system aims at fulfilling this requirement of law.

ADVANTAGES OF ACCOUNTING

(a) **Provides Way for Systematic Records :** Since all the financial transactions are recorded in the books, one need not rely on memory. Any information required is readily available from these records.

(b) **Facilitate the Preparation of Financial Statements :** Profit and Loss Account and Balance Sheet can be easily prepared with the help of the information in the records. This enables the trader to know the net result of business operations during the accounting period and the financial position of the business at the end of the accounting period.

(c) **Less Scope for Fraud or Theft :** It is difficult to hide fraud or the theft etc., because of the balancing of the books of accounts periodically. As the work is divided among many persons, there will be check and counter check.

(d) **Comparative Study :** One can compare the present performance of the organization with that of its past. This enables the managers to draw useful conclusions and make proper decisions.

(e) **Provides the Required Information :** Interested parties such as owners, lenders, creditors etc., get necessary information at frequent intervals.

(f) **Provides Control over Assets :** Accounting provides information regarding cash in hand, cash at bank, stock of goods, accounts receivables from various parties and the amounts invested in various other assets. As the trader knows the values of the assets he will have control over them.

LIMITATIONS/DRAWBACKS/DEMERITS OF ACCOUNTING

Following are some of the limitations of Accounting :

(a) **Does not Record all Events :** Only the transactions of a financial character will be recorded under accounting. So it does not reveal a complete picture about the quality of human resources, locational advantage, business contacts etc.

(b) **Chances of Manipulation :** There are chances of using financial accounts to suit the whims of management.

(c) **Does not Reflect Current Values :** The data available under accounting is historical in nature. So they do not reflect current values.

(d) **Estimates based on Personal Judgement :** The estimates used for determining the values of various items may not be correct.

(e) **Lack of Harmony about Accounting Principles :** Accountants differ on the use of the accounting principles. In spite of the efforts of International Accounting Standards Committee, there is lack of unanimity on the use of accounting principles and procedures.

(f) **Inadequate Information on Costs and Profits :** Accountancy only provides information about the overall profitability of the business. No information is given about the cost and profitability of different activities of products or divisions.

Accounting principles can be divided into two categories. They are:

I. Accounting Conventions

1. Consistency
2. Full Disclosure
3. Conservation
4. Materiality

II. Accounting Concepts

1. Business Entity Concept
2. Going Concern Concept
3. Money Measurement Concept
4. Cost Concept
5. Accounting Period Concept
6. Dual Aspect Concept
7. Matching Concept
8. Realization Concept
9. Accrual Concept
10. Objective Evidence Concept

ACCOUNTING CONVENTIONS

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

(a) Convention of Full Disclosure

(b) Convention of Consistency

(c) Convention of Conservation

(d) Convention of Materiality

(a) **Convention of Full Disclosure :** According to this convention, accounts should be prepared honestly and they should disclose all materials and significant information. Convention of full disclosure requires that all material and relevant facts concerning financial statements should be fully disclosed. Full disclosure means that there should be full, fair and adequate disclosure of accounting information. Adequate means sufficient set of information to be disclosed. Fair indicates an equitable treatment of users. Full refers to complete and detailed presentation of information. Thus, the convention of full disclosure suggests that every financial statement should fully disclose all relevant information.

The business provides financial information to all interested parties like investors, lenders, creditors, shareholders etc. The shareholder would like to know profitability of the firm while the creditor would like to know the solvency of the business. In the same way, other parties would be interested in the financial information according to their requirements. This is possible if financial statement discloses all relevant information in full, fair and adequate manner.

Examples : Following are some examples:

- Contingent liabilities appearing as a note
- Market value of investments appearing as a note
- Schedule of advances in case of banking companies

Significance

- It helps in meaningful comparison of financial statements of the different business units.
- This can also help in the comparison of financial statements of different years of the same business unit.
- This convention is of great help to investor and shareholder for making investment decisions.
- The convention of full disclosure presents reliable information.

(b) Convention of Consistency: According to this concept it is essential that accounting procedures, practices and method should remain unchanged from one accounting period to another.

This enables comparison of performance in one accounting period with that in the past. But consistency never implies inflexibility as not to permit the introduction of improved techniques of accounting. However if introduction of a new technique results in inflating or deflating the figures of profit as compared to the previous methods, the fact should be well disclosed in the financial statement. The same principle and practices should be followed from year to year.

Significance

- It facilitates comparative analysis of the financial statements.
- It ensures uniformity in charging depreciation on fixed assets and valuation of closing stock.

(c) Convention of Conservation : It is a world of uncertainty. So it is always better to pursue the policy of playing safe. This is the principle behind the convention of conservatism. According to this convention the accountant must be very careful while recognizing increases in an enterprise's profits rather than recognizing decreases in profits. For this the accountants have to follow the rule, anticipate no profit, provide for all possible losses, while recording business transactions. This concept affects principally the current assets. This is very important in preparing final accounts.

Significance

- It helps in ascertaining actual profit.
- It is useful in the situation of uncertainties and doubts.
- It helps in maintaining the capital of the enterprise.

(d) **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.

The implication of this convention is that accountant should attach importance to material details and ignore insignificant ones. In the absence of this distinction accounting will unnecessarily be overburdened with minute details. The question as to what is a material detail and what is not is left to the discretion of individual accountant.

Examples :

Some examples of material financial information are: fall in the value of stock, loss of markets due to competition, change in the demand pattern due to change in government regulations, etc.

Some examples of insignificant financial information are: rounding of income to nearest ten for tax purposes etc. Sometimes if it is felt that an immaterial item must be disclosed, the same may be shown as footnote or in parenthesis according to its relative importance.

Significance

- It helps in minimizing errors in calculation.
- It helps in making financial statements more meaningful.
- It saves time and resources

Accounting Concepts

Accounting concept refers to the basic assumptions and rules and principles which work as the basis of recording of business transactions and preparing accounts. The concepts help in bringing about uniformity in the practice of accounting. The various accounting concepts which are very useful are as follows:

(a) Business Entity Concept

(b) Going Concern Concept

(c) Money Measurement Concept

(d) Cost Concept

(e) Accounting Period Concept

(f) Dual Aspect Concept

(g) Matching Concept

(h) Realization Concept

(i) Accrual Concept

(j) Objective Evidence Concept

(a) **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.

Significance

Following points highlight the significance of business entity concept :

- This concept helps in ascertaining the profit of the business as only the business expenses and revenues are recorded and all the private and personal expenses are ignored.
- This concept restraints accountant from recording of owner's private/ personal transactions.
- It also facilitates the recording and reporting of business transactions from the business point of view.
- It is the very basis of accounting concepts, conventions and principles.

(b) **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. When final accounts are prepared, record is made for outstanding expenses and prepaid expenses because of the assumption that business will continue. Going concern concept helps other business undertaking to make contracts with specific business unit for business dealing in future.

Significance

- This concept facilitates preparation of financial statements.
- On the basis of this concept, depreciation is charged on the fixed asset.
- It is of great help to the investors, because, it assures them that they will continue to get income on their investments.
- In the absence of this concept, the cost of a fixed asset will be treated as an expense in the year of its purchase.
- A business is judged for its capacity to earn profits in future.

(c) **Money Measurement Concept :** Only those transactions are recorded in accounting which can ~~not~~ be expressed in terms of money. The transactions which can not be expressed in money fall beyond the scope of accounting. One serious short coming of this concept is that the money value of that date is recorded on which transaction has taken place. It does not recognize the changes in the purchasing power of monitory unit.

Significance

- This concept guides accountants what to record and what not to record.
- It helps in recording business transactions uniformly.
- If all the business transactions are expressed in monetary terms, it will be easy to understand the accounts prepared by the business enterprise.
- It facilitates comparison of business performance of two different periods of the same firm or of the two different firms for the same period.

(d) **Cost Concept :** According to this concept, an asset is recorded at its cost in the books of account, i.e., the price, which is paid at the time of acquiring it. In balance sheet, these assets appear not at cost price every year, but depreciation is deducted and they appear at the amount, which is cost less depreciation.

Under this concept, all such events are ignored which affect the business but have no cost. For example, if an important and influential director dies, then the earning capacity and position of the business will be affected. But this event has no cost. Hence it will not be recorded in account books.

Significance

- This concept requires asset to be shown at the price it has been acquired, which can be verified from the supporting documents.
- It helps in calculating depreciation on fixed assets.
- The effect of cost concept is that if the business entity does not pay anything for an asset, this item will not be shown in the books of accounts.

(e) **Accounting Period Concept :** Every businessman wants to know the result of his investment and efforts after a certain period. Usually one-year period is regarded as an ideal for this purpose. It may be 6 months or 2 years also. This period is called accounting period. It depends on the nature of business and object of the proprietor of business. From taxation point of view one year period is necessary as income-tax is payable every year.

Significance

- It helps in predicting the future prospects of the business.

- It helps in calculating tax on business income calculated for a particular time period.
- It also helps banks, financial institutions, creditors, etc. to assess and analyze the performance of business for a particular period.
- It also helps the business firms to distribute their income at regular intervals as dividends.

(f) **Dual Aspect Concept :** Dual aspect is the foundation or basic principle of accounting. It provides the very basis of recording business transactions in the books of accounts. This concept assumes that every transaction has a dual effect, i.e. it affects two accounts in their respective opposite sides. Therefore, the transaction should be recorded at two places. It means both the aspects of the transaction must be recorded in the books of accounts.

For example, goods purchased for cash has two aspects which are

(i) Giving of cash

(ii) Receiving of goods

These two aspects are to be recorded. Thus, the duality concept is commonly expressed in terms of fundamental accounting equation :

$$Assets = Liabilities + Capital$$

Significance

- This concept helps accountant in detecting error.
- It encourages the accountant to post each entry in opposite sides of two affected accounts.

(g) **Matching Concept :** Every businessman is eager to make maximum profit at minimum cost. Hence, he tries to find out revenue and cost during the accounting period. An accountant records all expenses of a year (whether there are paid in cash or are outstanding) and all revenues of a year (whether they are received in cash or accrued). Expenses, which are incurred during a particular accounting period for earning the revenue of the related period, are to be considered.

All expenses incurred during the accounting period must not be taken. Only relevant cost should be deducted from the revenue of a period for periodic income statement. The process of relating costs to revenue is called 'matching process'.

Significance To know profits correct calculation needed regarding revenue & cost

- It guides how the expenses should be matched with revenue for determining exact profit or loss for a particular period.
- It is very helpful for the investors/shareholders to know the exact amount of profit or loss of the business.

(h) **Realization Concept :** This concept emphasizes that profit should be considered when realized. According to this concept, revenue is considered as being earned on the date at which it is realized i.e., on the date when the property in goods passes to the buyer and he becomes legally liable to pay.

Significance

- It helps in making the accounting information more objective.
- It provides that the transactions should be recorded only when goods are delivered to the buyer.

(i) **Accrual Concept :** The essence of the accrual concept is that revenue is recognized when it is realized, that is when sale is complete or services are given and it is immaterial whether cash is received or not. According to this concept, expenses are recognized in the accounting period in which they help in earning the revenue whether cash is paid or not. Expenses

Cash transactions

Significance

- It helps in knowing actual expenses and actual income during a particular time period.
- It helps in calculating the net profit of the business.

(x) **Objective Evidence Concept :** Entries in accounting records and data reported in financial statements must be based on objectively determined evidence. Without close adherence to this principle, the confidence of many users of the financial statements could not be maintained. As far as possible, every entry in accounting records should be supported by some objective evidence. Evidence should be such which will minimize the possibility of error and intentional bias or fraud.

ACCOUNTING STANDARDS - INTRODUCTION

Accounting is the art of recording transactions in the best manner possible, so as to enable the reader to arrive at judgments/come to conclusions. In this regard it is utmost necessary that there are set guidelines. These guidelines are generally called Accounting Policies. The details of accounting policies permitted Companies to alter their accounting principles for their benefit. This made it impossible to make comparisons. In order to avoid the above and to have a uniform accounting principle, Standards needed to be set by recognised accounting bodies. This paved the way for Accounting Standards to come into existence.

Accounting Standards (ASs) are written policy documents issued by expert accounting body or by government or other regulatory body covering the aspects of recognition, measurement, treatment, presentation and disclosure of accounting transactions in the financial statements.

Accounting Standards in India are issued By the Institute of Chartered Accountanst of India (ICAI). At present there are 30 Accounting Standards issued by ICAI.

3. The application of accounting standards would, to a limited extent, facilitate comparison of financial statements of companies situated in different parts of the world and also of different companies situated in the same country. However, it should be noted in this respect that differences in the institutions, traditions and legal systems from one country to another give rise to differences in accounting standards adopted in different countries.

LIMITATIONS OF ACCOUNTING STANDARDS

Accounting standards are very important. However, there are some limitations of setting of accounting standards :

1. Alternative solutions to certain accounting problems may each have arguments to recommend them. Therefore, the choice between different alternative accounting treatments may become difficult.
2. There may be a trend towards rigidity and away from flexibility in applying the accounting standards.
3. Accounting standards cannot override the statute. The standards are required to be framed within the ambit of prevailing statutes.

INDIAN ACCOUNTING STANDARDS

The accounting standards board of the Institute of Chartered Accountants of India has issued the following Accounting Standards :

AS 1 – Disclosure of Accounting policies

AS 2 – Valuation of Inventories

AS 3 – Cash Flow Statement

AS 4 – Contingencies and Events Occurring after the Balance Sheet Date

AS 5 – Net Profit or Loss for the period, Prior Period Items and Changes in Accounting Policies

AS 6 – Depreciation Accounting

AS 7 – Construction Contracts (revised 2002)

AS 8 – Accounting for Research and Development (AS-8 is no longer in force since it was merged with AS-26)

AS 9 – Revenue Recognition

AS 10 – Accounting for Fixed Assets

AS 11 – The Effects of Changes in Foreign Exchange Rates (revised 2003)

AS 12– Accounting for Government Grants

AS 13– Accounting for Investments

AS 14 – Accounting for Amalgamations

AS 15 – Employee Benefits (revised 2005)

AS 16 – Borrowing Costs

AS 17 – Segment Reporting

AS 18– Related Party Disclosures

AS 19 – Leases

AS 20 – Earnings Per Share

AS 21 – Consolidated Financial Statements

AS 22– Accounting for Taxes on Income.

AS 23 – Accounting for Investments in Associates in Consolidated Financial Statements

AS 24 – Discontinuing Operations

AS 25 – Interim Financial Reporting

AS 26 – Intangible Assets

AS 27 – Financial Reporting of Interests in Joint Ventures

AS 28 – Impairment of Assets

AS 29 – Provisions, Contingent` Liabilities and Contingent Assets

AS 30 – Financial Instruments: Recognition and Measurement and Limited Revisions to AS 2, AS 11 revised 2003), AS 21, AS 23, AS 26, AS 27, AS 28 and AS 29

AS 31 – Financial Instruments: Presentation

AS 32 – Financial Instruments: Disclosures, and limited revision to Accounting Standard

CLASSIFICATION OF ACCOUNTS

An account is the record of an individual, a firm, a thing, an item of expense, or an income. Therefore, an account is a summarized record of business transactions that affects a particular type of assets, liability or capital.

The transactions in which a business enterprise may enter can be classified into the following three categories.

(i) Transactions relating to persons or individuals

(ii) Transactions relating to property, assets or possessions, or

(iii) Transactions relating to expenses or income.

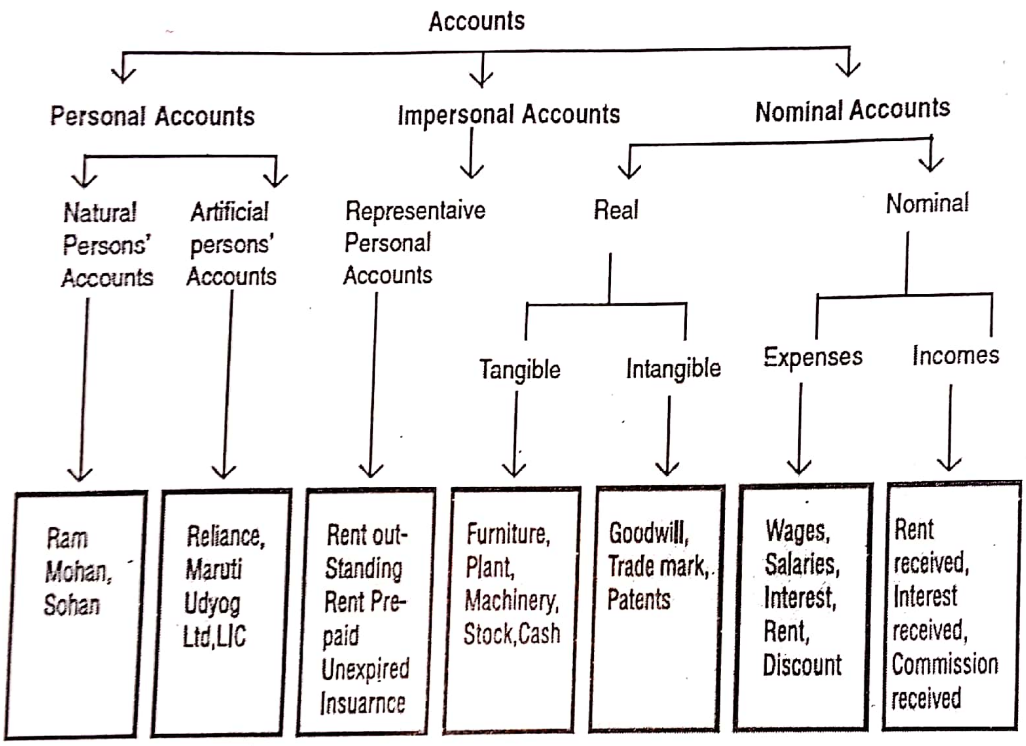
: Rules for maintaining Books of accounts:

Corresponding to the above three categories of transactions, the accounts maintained by a business enterprise are classified into the following three types.

(a) Personal Accounts

(b) Real or Property Accounts

(c) Nominal Accounts



Real and nominal accounts taken together are also categorized as impersonal accounts.

(a) **Personal Accounts :** Personal accounts record the dealings of the enterprise with persons or firm. These can be further subdivided into the following types.

i. **Natural Persons Accounts :** The accounts in the name of natural persons are called natural persons accounts. For proprietors' account, suppliers account, receivers' account (like Ram's account, Shyam's account, Sohan's account).

ii. **Artificial Persons and Body of Persons Accounts:** Accounts in the name of artificial persons and body of persons come under this category i.e. any limited company's accounts (like Reliance Ltd. account, Wipro account), bank account (like State Bank of India account), insurance company's account (like LIC account), any firm's account (like Gopal Das Firm account), any government or institution's account, any clubs account (like Sports Club of Hyderabad account).

iii. **Representative Personal Accounts :** When an account represents a certain person or persons it is called a representative personal account. In such accounts, in the books of the firm, the names of actual individuals appear but since they are of the same nature and large in number, the balances standing in these accounts are added and put under one common head.

For example, if a business is not able to pay the salary for the last one month to its employees, such employees will be treated as its creditors (since they have provided their service to the business but in exchange have not been paid for the same) The amount due to these employees will be put under one common head called 'Salaries Outstanding Account'. Thus salaries outstanding account is a personal account representing the employees of the enterprise.

Basic Rule :		
Debit	-	The Receiver
Credit	-	The Giver

b) **Real Accounts :** These are also called as property accounts as they are accounts of properties, assets or possessions. Real accounts represent items which are more or less permanent in nature. A separate account is kept for each type of asset such as land, building, furniture, plant and machinery, cash, stock etc. so that by recording each such asset received or disposed off, the firm can ascertain the value of a particular asset on a give date. Real accounts can be of the following two types.

(i) **Tangible Real Accounts:** These are accounts of such things which can be touched or felt, measured etc.,

Tangible Assets Classified into :

(a) Fixed Assets

(b) Current Assets

Example, Land, Building, Plant, Machinery, Cash, Stock etc.

(ii) **Intangible Real Accounts:** These are accounts of such things which cannot be touched in the physical sense but can of course be measured in monetary terms.

Example : Goodwill, Trade Marks, Patent Rights etc.

Basic Rule :		
Debit	-	What comes in
Credit	-	What goes out

(c) **Nominal Accounts :** These are the accounts of expenses or losses and incomes and gains. These accounts are in name only and are also called as fictitious accounts, for e.g., wages account, salary account, rent account, interest account, commission account, discount account, insurance premium account, etc.

Basic Rule :

Debit - All Expenses and Losses

Credit - All Incomes and Gains

DIFFERENCES BETWEEN TYPES OF ACCOUNTS

Personal Accounts	Real Accounts	Nominal Accounts
Personal accounts refer to accounts of a person, a firm or a company and contain transactions relating to those persons, firm or company.	Real accounts contain transaction relating to assets.	Nominal accounts record transactions relating to any income, gain, expense or loss.
They include debtors' accounts having debit balances and creditors' accounts having credit balances.	They always have debit balances and never credit balances. Any asset being sold at a price above the book value may cause credit balance in the asset account.	They may have debit or credit balances – expenses and losses accounts have debit balances and incomes and gains accounts have credit balances.
From personal account balances, money payable to or receivable from third parties can be known.	From balances of real accounts, the values of assets in possession as on a particular date can be known.	From the balances of nominal accounts net profit or net loss for the accounting period is ascertained.
They are kept both under double entry and single entry methods.	Real accounts except cash book are kept under double entry method.	They are kept under double entry method but not under single entry method.
Personal accounts balances are shown in balance sheet.	Real accounts balances are also known in balance sheet.	Since the nominal accounts balances are closed to final accounts, their balances do not appear in balance sheet.
They are kept in separate ledger called personal ledger.	They are kept in general ledger along with nominal accounts.	They are kept in general ledger along with real accounts.

ACCOUNTING EQUATION

Accounting is built upon the fundamental accounting equation. This equation must remain in balance and for that reason our modern accounting system is called a dual-entry system. This means that every transaction that is recorded in accounting records must have at least two entries; if it only has one entry the equation would necessarily be unbalanced.

Parts of Accounting Equation

The equation's three parts are explained as follows :

(a) **Assets** = what the business has or owns (equipment, supplies, cash, accounts receivable)

(b) **Liabilities** = what the business owes outsiders (bank loan, accounts payable)

(c) **Owner's Equity** = what the owner owns (investment and business profit)

The accounting equation can be expressed in 3 ways:

i. Assets = Liabilities + Owners' Equity

ii. Liabilities = Assets - Owners' Equity

iii. Owners' Equity = Assets - Liabilities

RULES OF ACCOUNTING EQUATION

1. **Assets :** Increases in assets are debits and decreases in assets and credits.
2. **Liabilities :** Increases in liabilities are credits and decreases in liabilities are debits.
3. **Capital :** Increases in capital are credits and decreases in capital are debits.
4. **Expenses :** Increases in expenses are debits and decreases in expenses are credits.
5. **Incomes or Profits :** Increases in incomes or profits are credits and decreases in incomes or profits are debits.

Illustration 1 :

ABC LTD purchases a machine costing ₹ 1,000 for cash.

Before Transaction: Assets ₹10,000 - Liabilities ₹5,000 = Equity ₹5,000

After Transaction: Assets ₹10,000 - Liabilities ₹5,000 = Equity ₹5,000

Assets ₹10,000 = ₹10,000 + ₹1,000 (Machine) - ₹1,000 (Cash)

Illustration 2 :

Use Accounting Equation to show the effect of following transactions on assets, liabilities and capital and also show the final Balance Sheet:

(a)	Started business with cash	70,000
(b)	Purchased goods on credit	18,000
(c)	Purchased machinery	20,000
(d)	Payment made to creditors in full settlement	17,500
(e)	Depreciation on machinery	2,000

Solution:

Assets = ₹ 68,500 and Capital = ₹ 68,500

Illustration 3 :

Prove that the Accounting Equation is satisfied in all the following transactions of Suresh:

(a) Commenced business with cash ₹ 60,000.

(b) Paid rent in advance ₹ 500.

(c) Purchased goods for cash ₹ 30,000 and credit ₹ 20,000.

(d) Sold goods for cash ₹ 30,000, costing ₹ 20,000.

(e) Paid salary ₹ 500 and salary outstanding ₹ 100.

(f) Bought motorcycle for personal use ₹ 5,000.

Solution:

Assets = ₹ 84,500; Liabilities =-₹ 20,100; Capital = ₹ 64,400

Illustration 4 :

Anil had the following transactions:

(a) Commenced business with on cash ₹ 50,000.

(b) Purchased goods for cash ₹ 20,000 and on credit ₹ 30,000.

(c) Sold goods for cash ₹ 40,000 costing ₹ 30,000.

(d) Rent paid ₹ 500 and Rent outstanding ₹ 100.

(e) Bought furniture ₹ 5,000 on credit.

(f) Bought refrigerator for personal use ₹ 5,000.

(g) Purchased building for cash ₹ 20,000.

Use Accounting Equation to show the effect of the above transactions on the assets, liabilities and capital and also show his final Balance Sheet.

Solution:

Assets = ₹ 89,500; Liabilities = ₹ 35,100; Capital = ₹ 54,400

ACCOUNTING SYSTEM

Accounting systems are used to record business transactions. The trader has to choose which accounting system he has to use. The various accounting systems are as follows :

1. Single Entry System
2. Double Entry System

1. **Single Entry System :** It is an incomplete system of accounting which recognizes cash and personal aspects of transactions and ignores impersonal aspects of transactions.

2. **Double Entry System :** Double entry system is the most popular system of accountancy to record business transactions. It is now in use in all most all the big business concerns. According to this system, every transaction has twofold aspect i.e., one party receiving benefit and the other party giving the benefit. When we receive something we give something else in return. For example, when we purchase goods for cash, we receive goods and give cash in return. When we sell goods on credit, goods are given and the customer becomes debtor. This method of writing every transaction in two accounts is known as Double Entry System.

SINGLE ENTRY SYSTEM

Single Entry System is an incomplete system of accounting which recognizes cash and personal aspects of transactions and ignores impersonal aspects of transactions. Single entry is a crude for of accounting under which personal accounts are maintained besides the cost account. Single entry system is not a recognized system of accountancy. It is simply a Memoranda Account for reference purposes, how much amount is payable to any individual or concern or receivable from any individual or concern.

Example : If wages are paid, the entry is made in cash book; the corresponding entry is not made in the wages account because it not opened at all. It is only when personal accounts and the cash account are both involved that both the aspects of transaction are recorded. If cash if received from Mr. X, the entry is recorded in cash account and X account. In all other cases only one aspect of the transaction is recorded.

ADVANTAGES OF SINGLE ENTRY SYSTEM

1. Single entry system is a very simple and easy method of recording the transactions. It does not require special accounting knowledge.
2. It is very economical method when the business transactions are minimum.
3. Secrecy can be maintained as no outsider can have access to the accounts and records.
4. One of the main advantages of single entry system is that it consumes less time as it maintains limited number of books.
5. As the number of accounts kept is minimum, the profit or loss can be determined easily through arithmetical processes. This can be useful in abnormal situations like loss of accounts, damage of books of accounts by fire, floods etc.

LIMITATIONS OF SINGLE ENTRY SYSTEM

1. It is not possible to test the arithmetical accuracy of the accounts as the single entry system does not follow the two-fold aspect of the transactions. As a result it encourages frauds and misappropriation.
2. It does not provide the true financial position of the firm.
3. As the nominal accounts are not kept, trading and Profit and Loss Account cannot be prepared.
4. As real accounts are not kept, Balance Sheet cannot be completely prepared.
5. It is difficult to ascertain the value of goodwill.
6. Single entry system is not suitable for all types of firms like joint stock companies.
7. Tax authorities and banks do not recognize single entry system.
8. Internal check on accounts is not possible.

DOUBLE-ENTRY SYSTEM

Double entry is the fundamental concept underlying present-day bookkeeping and accounting. Double-entry accounting is based on the fact that every financial transaction has equal and opposite effects in at least two different accounts. It is used to satisfy the equation Assets = Liabilities + Equity, in which each entry is recorded to maintain the relationship.

The double-entry system is the most popular accounting system which enjoys the following advantages :

1. Double entry system helps to maintain a complete and accurate record for all business transactions.
2. It provides not only complete, but also reliable record of all transactions of a concern.
3. The trader can find out his financial position by preparing a Balance Sheet on a particular date.
4. As both the aspect of every transaction is recorded, it is possible to prepare trial balance and check the arithmetical accuracy of books of accounts.
5. The trader can know his debtors and creditors from time to time.
6. As systematic record of all transactions is kept, possibilities for misappropriation and fraud are reduced to the minimum.
7. It minimizes the chances of embezzlement and frauds.
8. This system helps to prepare the Trial Balance to prove the arithmetical accuracy of books of account.

ACCOUNTING CYCLE

The accounting cycle is the name given to the collective process of recording and processing the accounting events of a company. The series of steps begin when a transaction occurs and end with its inclusion in the financial statements.

Chapter - 2

JOURNAL AND LEDGER

JOURNAL

Journal means a day book or daily record. It is the book wherein all the transactions are first recorded in chronological order. It is a book of prime, original or first entry, as all business transactions are first recorded in the journal. Recording each transaction in the Journal is called ***Journalizing***. The entries made in the Journal are called ***Journal Entries***.

Journal has been derived from the French word 'Jour' which means 'day'. Hence, it is a book for recording daily business transactions according to double entry system.

Definitions of Journal

i. "A Journal is a book, employed to classify or sort out transactions in a form convenient for their subsequent entry in the ledger."

- L.C. Cropper

ii. "The Journal is originally used, as a book of prime entry in which transactions are copied in order of date from a memorandum or waste book. The entries as they are copied are classified into debits and credits, so as to facilitate them being correctly posted, afterwards in the ledger".

- Professor Cartor

FUNCTIONS OF JOURNAL

Following are the functions of a journal :

(a) **Analytical Work :** Journal is used for anlaytical work. This work includes :

i. identification of accounts involved in the transaction by examining the description of the transaction

ii. ascertainment of debit and credit in the transaction and

iii. making a draft of the description of the transaction to be incorporated in the primary recording as narration

(b) **Recording Work :** Journal is also for recording work. This work includes – making records in the journal of the transaction. It shows the accounts debited and credited with amount of the transaction and giving the description of the transaction.

(c) **Historical Work :** As incidents taking place are incorporated in history according to dates of incidents, records of transactions are also made serially in chronological order. Recording of transactions in chronological order is historical work.

FEATURES OF JOURNAL

The features of journal are :

1. Journal is the medium of primary recording.
2. Order of transactions decides order of journal entries.
3. Journal is the only place for recording details of transactions.
4. Journal shows the account debited and account credited.
5. Journal is the basis of accounting, because all subsequent entries originate from journal.

ADVANTAGES OF JOURNAL

Following are the advantages of journal :

1. Journal makes ledger posting easy, because in journal the account debited and account credited are shown.
2. Since journal contains details of the transactions, various information regarding transactions can be obtained from it.
3. Transactions are recorded in the chronological order, thus reducing the chances of omitting any transaction.
4. Transactions are accompanied by narration. Thus, the entry is supplemented with basic information regarding the transactions.
5. Debit and credit amounts are written side by side. It minimizes the chances of entering wrong amount

LIM PR D Co Co

LIMITATIONS OF JOURNAL

Following are the limitations of Journal :

1. **Bulk and Voluminous:** Journal is the main book of original entry which records all business transactions. Sometimes, it becomes so bulky and voluminous that it cannot be handled easily.

2. **Information in Scattered Form:** In this book, all information is recorded on daily basis and scattered form. Hence it is very difficult to locate a particular transaction unless one remembers the date of occurrence of that transaction.

3. **Time Consuming :** Unlike posting from subsidiary books, posting the transactions from journal to ledger accounts take too much time because every time one has to post the transactions in different ledger accounts.

4. **Lack of Internal Control :** Unlike other books of original entries like subsidiary books and cash book, journal does not facilitate the internal control, because in journal only transactions are recorded in chronological order. However, subsidiary books an cash book gives a clear picture of special type of transactions recorded therein.

PROFORMA OF JOURNAL

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

Column (1) - Date : The date on which the transaction took place in entered in this column. The year is written on the top, then the date column is divided in two parts, the first is divided into two parts, the first part is used for writing the month and the second part is used for writing the date.

Column (2) - Particulars : In this column, the name of the account to be debited is written. The word 'Dr' (Debit) is written at the end of the First line. In the second line some space is left and the word 'To' is written before the name of the account to be credited. Then the name of the account to be credited is written. A brief explanation, usually beginning with the word. 'Being' or 'For' is written called 'narration'. The 'narration' explains the reason for debiting and crediting the particular accounts and helps one to understand the nature and purpose of the Journal entry at a future date. To separate one entry from another, a line is drawn below every entry to cover particulars column only. The line does not extend to other columns.

4 13

Column (3) - L.F. : The L.F. stand for "Ledger Folio" in this column the page numbers on which the various accounts appear in the Ledger are entered.

Column (4) - Debit Amount : In this column the amount to be debited against the debit account is written.

Column (5) - Credit Amount : In this column the amount to be credited against the credit account is written.

PROCESS OF JOURNALIZING

Following steps are taken for the preparation of a journal :

(a) **Identify the Accounts -** First of all, the affected accounts of an accounting transaction are identified. For example, if the transaction of "goods worth ₹ 10000 are purchased for Cash", then 'Purchases' A/c and 'Cash' A/c are the two affected accounts.

(b) **Recognize the Type of Accounts -** Next we determine the type of the affected accounts e.g. in the above case, 'Purchases A/c and Cash A/c are both asset accounts.

(c) **Apply the Rules of Debit and Credit -** Then the rules of 'debit' and 'credit' are applied to the affected accounts. You are aware of these rules. However, for the revision purposes, these are given below :

i. **Assets and Expenses** Accounts are debited if there is an increase and credited if there is decrease.

ii. **Liability, Capital and Revenue** Accounts are debited if there is decrease and credited if there is increase.

Now, the journal entry will be made in the Journal along with a brief explanation i.e. narration. The corresponding amounts will be written in the debit and credit columns. After completing one entry, a horizontal line is drawn before entry for the next transaction is made in the journal.

RULES OF JOURNALIZING

Personal Account

Debit	-	The Receiver
Credit	-	The Giver

Real Account

Debit	-	What comes in
Credit	-	What goes out

Nominal Accounts

Debit	-	All Expenses and Losses
Credit	-	All Incomes and Gains

SPECIAL TRANSACTIONS RELATING TO GOODS

1. **Drawings in Goods :** Sometimes the proprietor withdraws goods from the business for his personal use.

   The entry for recording this transaction will be :

   Drawings A/c Dr. xxx

   To Purchases A/c xxx

   (Goods taken for personal use)

2. **Goods given away as Charity :** Charity is an expense of the business because such charity account will be debited. Goods are going out of the business at cost price, hence purchases are reduced to that extent. So purchases account will be credited.

   The entry will be :

   Charity A/c Dr. xxx

   To Purchases A/c xxx

   (Goods given away as Charity)

3. **Goods distributed as free sample :** Sometimes the goods are distributed as free samples to the potentital buyers in order to promote sales. As such, free samples can be treated as expenses on advertisement.

   The entry will be :

   Advertisement Expenses A/c Dr. xxx

   To Purchases A/c xxx

   (Goods distributed as free samples)

4. **Loss of Goods by Theft or Loss by Fire :**

   The entry will be :

   Loss by Theft A/c Dr. xxx

   Loss by Fire A/c Dr. xxx

   To Purchases A/c xxx

   (Goods lost by theft and goods destroyed by fire)

   In case goods were insured :

   Insurance Company A/c Dr. xxx

   To Loss by Theft or Loss by Fire xxx

   If the full amount of claim is received from the Insurance Company :

   Bank A/c Dr. xxx

   To Insurance Company A/c xxx

If the Insurance Company does not admit full claim :

Bank A/c	Dr.	xxx	(Amount received for claim admitted)
Profit and Loss A/c	Dr.	xxx	(Claim not admitted)
To Insurance Company A/c			xxx

Illustration 1 :

Journalize the following transactions in the books of 'X' with narrations.

2008		₹
March 1	'X' started business with	50,000
March 3	Bought goods from 'Y'	20,000
March 4	Purchased a typewriter for office use	5,000
March 5	Paid Telephone Rent	300
March 8	Sold goods to Rajkumar & Co.	10,000

Solution :

Journal Entries in the Books of 'X'

Date	Particulars		LF No.	Debit Amount	Credit Amount
2008					
March 1	Cash A/c	Dr.		50,000	–
	To Capital A/c			–	50,000
	(Being Business Commenced with cash)				
March 3	Purchases A/c	Dr.		20,000	–
	To 'Y' A/c			–	20,000
	(Being goods purchased from 'Y')				
March 4	Typewriter A/c	Dr.		5,000	–
	To Cash A/c			–	5,000
	(Being Typewriter purchased)				
March 5	Telephone Rent A/c	Dr.		300	–
	To Cash A/c			–	300
	(Being Telephone rent paid)				
March 8	Rajkumar & Co. A/c	Dr.		10,000	–
	To Sales A/c			–	10,000
	(Being goods sold to Rajkumar & Co.)				

Illustration 2 :

Journalize the following transactions in the books of Gopal

1999			₹
Sept.	1	Gopal commenced business with	75,000
"	2	Deposited into bank	30,000
"	5	Purchased furniture and paid by cheque	1,500
"	7	Goods purchased from Srividya	20,000
"	9	Goods returned to Srividya	400
"	13	Paid to Srividya in full settlement	19,500
"	17	Goods sold to Prakash	500
"	20	Goods distributed by way of free samples	1,000
"	24	Commission received	250
"	30	Paid salaries	5,000

Solution :

Journal

Date	Particulars		LF No.	Debit Amount	Credit Amount
1999					
Sept. 1	Cash A/c	Dr.		75,000	
	To Capital A/c				75,000
	(Being cash invested by Gopal)				
" 2	Bank A/c	Dr.		30,000	
	To Cash A/c				30,000
	(Being cash deposited into bank)				
" 5	Furniture A/c	Dr.		1,500	
	To Bank A/c				1,500
	(Being furniture purchased and paid by issue of cheque)				
" 7	Purchases A/c	Dr.		20,000	
	To Srividya's A/c				20,000
	(Being goods purchased)				
" 9	Srividya's A/c	Dr.		400	
	To Purchases Returns A/c				400
	(Being goods returned)				
" 13	Srividya's A/c	Dr.		19,600	
	To Cash A/c				19,500
	To Discount A/c				100
	(Being cash paid to Srividya and she allowed ₹100 as discount)				

" 17	Prakash A/c Dr. To Sales A/c (Being goods sold to Prakash)		500	500
" 20	Advertisement A/c Dr. To Purchases A/c (Being goods distributed as free samples)		1,000	1,000
" 24	Cash A/c Dr. To Commission A/c (Being commission received)		250	250
" 30	Salaries A/c Dr. To Cash A/c (Being salaries paid)		5,000	5,000

Illustration 3 :

Enter the following transactions in the Journal of Hari :

2005		₹
April 1	Purchased goods from Vinod of the list price of ₹40,000 at 10% trade discount	
April 2	Returned goods to Vinod of the list price of ₹1,000	
April 6	Paid cash to Vinod ₹34,000 in full settlement of his account	

Solution :

Journal of Hari

Date	Particulars	LF No.	Debit Amount	Credit Amount
2005 April 1	Purchases A/c Dr. To Vinod A/c (Goods of the list price of ₹ 40,000 purchased at 10% trade discount)		36,000	36,000
April 2	Vinod A/c Dr. To Purchases Return A/c (Goods of the list price of ₹1,000 returned to Vinod; Actual price being ₹1,000 less 10% trade discount)		900	900
April 6	Vinod A/c Dr. To Cash A/c To Discount Received A/c (See Note 1) (Cash paid to Vinod and discount received from him)		35,100	34,000 1,100

Note 1 : Discount received from Vinod has been calculated as follows :

	₹
Purchases	36,000
Less : Purchases Return	900
Net Amount due to Vinod	35,100
Less : Amount paid in full settlement of his account	34,000
Discount received from him	1,100

Illustration 4 :

Pass Journal Entries for the following transactions :

(a) Bought goods from Mohan of the list price of ₹10,000 at 15% trade discount.

(b) Settled the account of Mohan by paying cash under a discount of 4%.

(c) Bought goods for cash of the list price of ₹ 50,000 at 20% trade discount and 5% cash discount.

(d) Sold goods for cash of the list price of ₹ 20,000 at 10% trade discount and 3% cash discount.

Solution :

Journal of ________

Date	Particulars	LF No.	Debit Amount	Credit Amount
(a)	Purchases A/c Dr.		8,500	
	To Mohan A/c			8,500
	(Goods of the list price of ₹ 10,000 bought at 15% trade discount)			
(b)	Mohan A/c Dr.		8,500	
	To Cash A/c			8,160
	To Discount Received A/c			340
	(Cash paid and discount received @ 4% on ₹ 8,500)			
(c)	Purchases A/c Dr.		40,000	
	To Cash A/c			38,000
	To Discount Received A/c			2,000
	(Goods of the list price of ₹50,000 bought at 20% trade discount and 5% cash discount)			

Working Notes :

	₹
List Price	50,000
Less : Trade Discount @ 20%	10,000
	40,000
Less : Cash Discount @ 5% on ₹ 40,000	2,000
	38,000

Illustration 5 :

Pass Journal Entries for the following transactions :

(a) Proprietor withdrew for his personal use cash ₹ 2,000 and goods worth ₹ 1,000.

(b) Goods for ₹ 5,000 were given away as Charity. (Sale price ₹ 6,0000)

(c) Goods worth ₹ 2,500 were distributed as free samples.

(d) Goods worth ₹ 5,000 and cash ₹ 2,000 were stolen by an employee.

(e) Goods worth ₹ 10,000 were destroyed by fire, Insurance Company admitted and paid claim for 60% amount.

Solution :

Journal of ________

Date	Particulars	LF No.	Debit Amount	Credit Amount
(a)	Drawings A/c Dr.		3,000	
	To Cash A/c			2,000
	To Purchases A/c			1,000
	(Cash and goods taken away for personal use)			
(b)	Charity A/c Dr.		5,000	
	To Purchases A/c			5,000
	(Goods given away as Charity)			
(c)	Advertisement Expenses A/c Dr.		2,500	
	To Purchases A/c			2,500
	(Goods distributed as free samples)			
(d)	Loss by Theft A/c Dr.		7,000	
	To Purchase A/c			5,000
	To Cash A/c			2,000
	(Goods and Cash stolen by an employee)			

(e)	Loss by Fire A/c Dr.		10,000	
	To Purchases A/c			10,000
	(Goods destroyed by fire)			
	Insurance Company A/c Dr.		10,000	
	To Loss by Fire A/c			10,000
	(Insurance claim lodged with the Insurance Company)			
	Bank A/c Dr.		6,000	
	Profit and Loss A/c Dr.		4,000	
	To Insurance Company A/c			10,000
	(Insurance claim of ₹ 10,000 accepted and received at ₹ 6,000)			

VALUE ADDED TAX (VAT)

Value Added Tax (VAT) is the tax charged on sales made within the same state. VAT paid on purchases is adjusted against VAT collected on sales. Thus, VAT paid is an asset whereas VAT collected is a liability for the business. If the balance in VAT Collected A/c is more than the balance in VAT Paid A/c, the difference is deposited in Government A/c.

On the other hand, if the balance in VAT Paid A/c is more than the balance in VAT Collected A/c, it will be carried forward to the next year as recoverable.

Following entries are passed in such a case :

1. When VAT is paid at the time of purchase :

Purchases A/c	Dr.	xxx	
VAT Paid A/c	Dr.	xxx	
To Cash A/c / Bank A/c / Creditor A/c			xxx

2. When VAT is collected at the time of sale :

Cash A/c / Bank A/c / Creditor A/c	Dr.	xxx	
To Sales A/c			xxx
To VAT Collected A/c			xxx

3. When VAT is paid to the Government :

(a) For adjustment of VAT paid against VAT collected :

VAT Collected A/c	Dr.	xxx	
To VAT Paid A/c			xxx

(b) For depositing the balance amount into Government A/c :

VAT Collected A/c	Dr.	xxx		(VAT Collected - VAT Paid)
To Cash A/c/Bank A/c			xxx	

Illustration 6 :

Pass Journal Entries for the following transactions in the books of Varsha Ltd.:

(a) Purchased goods from Azad Ltd. for ₹40,000, less trade discount 15% plus VAT @ 10%.

(b) Sold goods costing ₹ 9,000 for ₹12,000 and charged VAT @ 10%. Paymentis received by cheque which is immediately deposited into bank.

(c) Sold the balance goods to Vishal Ltd. for ₹ 30,000 plus VAT @ 10%.

(d) Deposited the VAT into Government A/c through cheque.

Solution :

Books of Varsha Ltd.

Journal

Date	Particulars		LF No.	Debit Amount	Credit Amount
(a)	Purchases A/c (Check Working Notes)	Dr.		34,000	
	VAT Paid A/c	Dr.		3,400	
	To Azad Ltd.				37,400
	(Goods purchased from Azad Ltd. at 15% trade discount plus VAT @ 10%)				
(b)	Bank A/c	Dr.		13,200	
	To Sales A/c				12,000
	To VAT Collected A/c				1,200
	(Goods sold and charged VAT @10%)				
(c)	Vishal Ltd.	Dr.		33,000	
	To Sales A/c				30,000
	To VAT Collected A/c				3,000
	(Sale of balance goods plus VAT @ 10%)				
(d)	VAT Collected A/c	Dr.		3,400	
	To VAT Paid A/c				3,400
	(Adjustment of VAT paid against VAT Collected)				
(e)	VAT Collected A/c	Dr.		800	
	To Bank A/c				800
	(VAT collected minus VAT paid deposited into Government A/c)				

LEDGER

A number of transactions take place daily in a business. All these transactions are recorded in the journal in a chronological order. Transactions relating to particular account may take place in different dates and hence they are entered in different pages of the journal. By referring to the journal, it will not be possible to find out the position relating to any particular account on given date. To overcome this, it is necessary to classify of various transactions relating to a particular account to one place. This is done by posting them into ledger.

Ledger is a book which contains various accounts. Ledger is a set of accounts. It contains all accounts of the business whether Real, Nominal or Personal. With the help of ledger the trader can ascertain the true position of any account on any date. Ledger contains classified summary of the transactions which are recorded in the journal.

Ledger is the principal books of accounts where similar transactions relating to a particular person or thing are recorded. It helps the trader to achieve the objects of book-keeping.

FEATURES OF LEDGER

Various features of ledger are :

1. Ledger is an account book that contains various accounts to which various business transactions of a business enterprise are posted.
2. It is a book of final entry because the transactions that are first entered in the journal or special purpose Books are finally posted in the ledger.
3. It is also called the Principal Book of Accounts.
4. In the ledger all types of accounts relating to assets, liabilities, capital, revenue and expenses are maintained.
5. It is a permanent record of business transactions classified into relevant accounts.
6. It is the "Reference Book" of accounting system and is used to classify and summarize transactions to facilitate the preparation of financial statements.

SIGNIFICANCE/IMPORTANCE OF LEDGER

Ledger is an important book of Account. It contains all the accounts in which all the business transactions of a business enterprise are classified. At the end of the accounting period, each account will contain the entire information of all the transactions relating to it.

Following points highlight the importance of ledger :

1. **Knowledge of Business Results :** Ledger provides detailed information about revenues and expenses at one place. While finding out business results the revenue and expenses are matched with each other.
2. **Knowledge of Book Value of Assets :** Ledger records every asset separately. Hence, you can get the information about the Book value of any asset whenever you need.

3. **Useful for Management :** The information given in different ledger accounts will help the management in preparing budgets. It also helps the management in keeping the check on the performance of business it is managing.

4. **Knowledge of Financial Position :** Ledger provides information about assets and liabilities of the business. From this we can judge the financial position and health of the business.

5. **Instant Information :** The business always need to know what it owes to others and what the others owe to it. The ledger accounts provide this information at a glance through the account receivables and payables.

POSTING

The process of entering in the ledger accounts, the entries made in the journal is called Posting. It means transferring the debit and credit items from the journal to their respective accounts in the ledger. It should be remembered that the exact names of accounts used in the journal should be carried to ledger. Since all the transactions are appeared in the classified form in the ledger one can very easily find out the position of any account at any time from the ledger.

STEPS IN LEDGER POSTING

(a) **Date Column :** The date of the transaction as noted in Journal is recorded in the date column.

(b) **Particulars Column :** Every entry on the debit side of this column must begin with the word "to" and on credit side with the word "By"

i. On the debit side of the account after the word "To" write "Name of the credit part of the journal entry."

ii. On the credit side of the account, after the word "By" write "Name of the debit part of the Journal entry."

(c) **Ledger Folio Column :** write here the page number of the Journal from where the entry is posted.

(d) **Amount Column :** The amount of the transactions is recorded in amount column. The amount in the debit column of the Journal is entered on the debit side. The amount in the credit column of the journal is entered on the credit side. A proper index should be maintained in the ledger giving the names of the accounts and page numbers.

PROFORMA OF LEDGER ACCOUNT

Dr. **Cr.**

Date	Particulars	L.F.	Amt. ₹	Date	Particulars	L.F.	Amt. ₹

Illustration 7 :

Pass necessary Journal entries for the following transactions and post them in the appropriate ledger accounts of Lal.

2014		₹
Jan. 1	Lal started business with cash	40,000
" 4	Goods purchased from Gopal	23,000
" 6	Goods sold to Prakash	16,000
" 8	Goods returned to Gopal	5,000
" 10	Gods returned by Prakash	800
" 13	Deposited into bank	3,000
" 15	Interest received	50
" 31	Salaries paid	5,000

Solution :

Journal Entries

Date	Particulars		LF No.	Debit Amount	Credit Amount
2014					
Jan. 1	Cash A/c	Dr.		40,000	
	To Capital A/c				40,000
	(Being cash brought into business)				
" 4	Purchases A/c	Dr.		23,000	
	To Gopal A/c				23,000
	(Being goods purchased for Gopal)				
" 6	Prakash A/c	Dr.		16,000	
	To Sales A/c				16,000
	(Being goods sole to Prakash)				
" 8	Gopal A/c	Dr.		5,000	
	To Purchases Returns A/c				5,000
	(Being goods returned to Gopal)				
" 10	Sales Returns A/c	Dr.		800	
	To Prakash A/c				800
	(Being goods returned by Prakash)				
" 13	Bank A/c	Dr.		3,000	
	To Cash A/c				3,000
	(Being cash deposited into Bank)				

" 15	Cash A/c	Dr.		50	
	To Interest A/c				50
	(Being interest received)				
" 31	Salaries A/c	Dr.		5,000	
	To Cash A/c				5,000
	(Being salaries paid)				

Cash A/c

Dr. **Cr.**

Date	Particulars	L.F.	Amt. ₹	Date	Particulars	L.F.	Amt. ₹
2014				2014			
Jan. 1	To Capital A/c		40,000	Jan. 1	By Bank A/c		3,000
Jan. 15	To Interest A/c		50	Jan. 31	By Salaries A/c		5,000
				Jan. 31	By Balance (c/d)		32,050
			40,050				40,050
Feb. 1	To balance (b/d)		32,050				

Capital A/c

Dr. **Cr.**

Date	Particulars	L.F.	Amt. ₹	Date	Particulars	L.F.	Amt. ₹
2014				2014			
Jan. 31	To Balance (c/d)		40,000	Jan. 1	By Cash A/c		40,000
			40,000				40,000
				Feb. 1	By Balance (b/d)		40,000

Purchase A/c

Dr. **Cr.**

Date	Particulars	L.F.	Amt. ₹	Date	Particulars	L.F.	Amt. ₹
2014				2014			
Jan. 4	To Gopal A/c		23,000	Jan. 31	By Balance (c/d)		23,000
			23,000				23,000
Feb. 1	To Balance (b/d)		23,000				

Gopal A/c

Dr. **Cr.**

Date	Particulars	L.F.	Amt. ₹	Date	Particulars	L.F	Amt. ₹
2014				2014			
Jan. 8	To Purchase Returns A/c		5,000	Jan. 4	By Purchases A/c		23,000
Jan. 31	To Balance c/d		18,000				
			23,000				23,000
				Feb. 1	By Balance (c/d)		18,000

Prakash A/c

Dr. **Cr.**

Date	Particulars	L.F.	Amt. ₹	Date	Particulars	L.F.	Amt. ₹
2014				2014			
Jan. 6	To Sales A/c		16,000	Jan. 10	By Sales Return A/c		800
				Jan. 31	By Balance c/d		15,200
			16,000				16,000
Feb. 1	To Balance (b/d)		15,200				

Sales A/c

Dr. **Cr.**

Date	Particulars	L.F.	Amt. ₹	Date	Particulars	L.F.	Amt. ₹
2014				2014	By Purchases		
Jan. 31	To Balance (c/d)		16,000	Jan. 6	By Prakash A/c		16,000
			16,000				16,000
				Feb. 1	By Balance (b/d)		16,000

Purchases Returns A/c

Dr. **Cr.**

Date	Particulars	L.F.	Amt. ₹	Date	Particulars	L.F.	Amt. ₹
2014				2014			
Jan. 31	To Balance c/d		5,000	Jan. 8	By Gopal A/c		5,000
			5,000				5,000
				Feb. 1	By Balance (b/d)		5,000

Sales Returns A/c

Dr. Date	Particulars	L.F.	Amt. ₹	Date	Particulars	L.F.	Amt. ₹ Cr.
2014 Jan. 10	To Prakash A/c		800	2014 Jan. 31	By Balance (c/d)		800
			800				800
Feb. 1	To Balance (b/d)		800				

Bank A/c

Dr. Date	Particulars	L.F.	Amt. ₹	Date	Particulars	L.F.	Amt. ₹ Cr.
2014 Jan. 13	To Cash A/c		3,000	2014 Jan. 31	To Balance (c/d)		3,000
			3,000				3,000
Feb. 1	To Balance (b/d)		3,000				

Interest A/c

Dr. Date	Particulars	L.F.	Amt. ₹	Date	Particulars	L.F.	Amt. ₹ Cr.
2014 Jan. 31	To Balance c/d		50	2014 Jan. 15	By Cash A/c		50
			50				50
				Feb. 1	By Balance (b/d)		50

Salaries A/c

Dr. Date	Particulars	L.F.	Amt. ₹	Date	Particulars	L.F.	Amt. ₹ Cr.
2014 Jan. 31	To Cash A/c		5,000	2014 Jan. 31	By Balance c/d		5,000
			5,000				5,000
Feb. 1	To Balance (b/d)		5,000				

Illustration 8 :

Enter the following transactions into the ledger accounts.

1999			₹
Dec.	1	Commenced business with cash	45,000
"	4	Purchased goods for cash	25,000
"	5	Paid for wages	500
"	9	Goods sold for cash	8,000
"	11	Purchased goods from Lalitha	7,000
"	15	Goods sold to Sekhar	5,000
"	23	Received cash from Sekhar	1,000
"	31	Paid office Rent	400
"	31	Paid salaries	1,000

Solution :

Capital A/c

Dr. **Cr.**

Date	Particulars	L.F.	Amt. ₹	Date	Particulars	L.F.	Amt. ₹
1999				1999			
Dec. 31	To Balance (c/d)		45,000	Dec. 1	By Cash A/c		45,000
			45,000				45,000
				2000			
				Jan. 1	By Balance (b/d)		45,000

Cash A/c

Dr. **Cr.**

Date	Particulars	L.F.	Amt. ₹	Date	Particulars	L.F.	Amt. ₹
1999				1999			
Dec 1	To Capital A/c		45,000	Dec. 4	By Purchase A/c		25,000
Dec 9	To Sales A/c		8,000	Dec. 4	By Wages A/c		500
Dec23	To Sekhar A/c		1,000	Dec.31	By Office rent A/c		400
				Dec. 31	By Salaries A/c		1,000
				Dec. 31	By Balance (c/d)		27,100
			54,000				54,000
Jan. 2000	To Balance (b/d)		27,100				

Purchase A/c

Dr. **Cr.**

Date	Particulars	L.F.	Amt. ₹	Date	Particulars	L.F.	Amt. ₹
1999				1999			
Dec. 4	To Cash A/c		25,000	Dec. 31	By Balance (c/d)		32,000
Dec. 11	To Lalitha's A/c		7,000				
			32,000				32,000
2000							
Jan. 1	To Balance (b/d)		32,000				

Sales A/c

Dr. **Cr.**

Date	Particulars	L.F.	Amt. ₹	Date	Particulars	L.F.	Amt. ₹
1999				1999			
Dec. 31	To Balance (c/d)		13,000	Dec. 9	By Cash A/c		8,000
				Dec.15	By Sekhar A/c		5,000
			13,000				13,000
					By Balance (b/d)		13,000

Wages A/c

Dr. **Cr.**

Date	Particulars	L.F.	Amt. ₹	Date	Particulars	L.F.	Amt. ₹
1999				1999			
Dec. 5	To Cash		500	Dec. 31	By Balance (c/d)		500
			500				500
2000							
Jan. 1	To Balance (b/d)		500				

Lalitha's A/c

Dr. **Cr.**

Date	Particulars	L.F.	Amt. ₹	Date	Particulars	L.F.	Amt. ₹
1999				1999	By Purchases		
Dec. 31	To Balance (c/d)		7,000	Dec. 11	A/c		7,000
			7,000				7,000
				2000			
				Jan. 1	By Balance (b/d)		7,000

Sekhar's A/c

Dr. **Cr.**

Date	Particulars	L.F.	Amt. ₹	Date	Particulars	L.F.	Amt. ₹
1999				1999			
Dec. 15	To Sales A/c		5,000	Dec. 23	By Cash A/c		1,000
				Dec. 31	By Balance (c/d)		4,000
			5,000				5,000
2000							
Jan. 1	To Balance (b/d)		5,000				

Office Rent A/c

Dr. **Cr.**

Date	Particulars	L.F.	Amt. ₹	Date	Particulars	L.F.	Amt. ₹
1999				1999			
Dec. 31	To Sales A/c		400	Dec. 31	By Balance (c/d)		400
			400				400
2000							
Jan. 1	To Balance (b/d)		400				

Salaries A/c

Dr. **Cr.**

Date	Particulars	L.F.	Amt. ₹	Date	Particulars	L.F.	Amt. ₹
1999				1999			
Dec. 31	To Cash A/c		1,000	Dec. 31	To Balance (c/d)		1,000
			1,000				1,000
2000							
Jan. 1	To Balance (b/d)		1,000				

4 22

Chapter - 3

TRIAL BALANCE

TRIAL BALANCE

The transactions which were recorded in prime entry books using source documents are posted to the ledger accounts under the double entry system. The collection of these accounts can be identified as the ledger. It includes various types of accounts. As the changes of transactions are recorded in the ledger accounts we can see a summary of such transactions in a ledger account. Using the balances of ledger accounts for a specific day, the trial balance is prepared to ensure the arithmetic accuracy of transactions recorded under the double entry system. The trial balance is very useful for the preparation of remaining accounting records in a business.

Trial balance is a statement which shows debit balances and credit balances of all accounts in the ledger. Since, every debit should have a corresponding credit as per the rules of double entry system, the total of the debit balances and credit balances should tally (agree). In case, there is a difference, one has to check the correctness of the balances brought forward from the respective accounts. Trial balance can be prepared in any date provided accounts are balanced.

A business prepares a statement including all the balances of ledger accounts at the end of certain accounting period. This statement is called Trial Balance. The balances of assets and expenditure accounts are recorded in the debit column of the trial balance and the balances of income, liabilities and equity accounts are recorded in the credit column of the trial balance.

If there are credit entries corresponding to the debit entries of the period, the totals of the debit and credit columns of the trial balance will be equal. It is important to emphasize that the trial balance is not a ledger account. It is a statement only.Trial Balance is generally prepared at the end of the year. However it can be prepared at any time during the accounting year to check the accuracy of the posting.

Definitions

1. "Trial balance is a statement, prepared with the debit and credit balances of ledger accounts to test the arithmetical accuracy of the books"

- J.R. Batlibol.

2. "It a statement containing the balances of all Ledger accounts, as at any given date, arranged in the form of debit and credit columns laced side by side and prepared with the object of checking the arithmetical accuracy of the Ledger postings.

- M.S. Gosav

OBJECTIVES OF TRIAL BALANCE

The objectives of preparing a trial balance are:

(a) **To check Arithmetical Accuracy :** Arithmetical accuracy in ledger posting means writing correct amount, in the correct account and on its correct side while posting transactions from various original books of accounts, such as Cash Book, Purchases Book, Sales Book, etc. It also means not only the correct balance of ledger account but also the totals of the special purpose Books.

(b) **To help in preparing Financial Statements :** The ultimate objective of the accounting is to prepare financial statements i.e. Trading and Profit and Loss Account, and Balance sheet of a business enterprise at the end of an accounting year. These statements contain balances of various ledger accounts. As Trial Balance contains balances of all ledger accounts, in financial statements the balances of ledger accounts are carried from the Trial balance for proper analysis.

(c) **Helps in Locating Errors :** If total of two columns of the trial balance agrees it is a proof of arithmetical accuracy in the ledger posting. However, if the totals of the two columns do not tally it indicates that there is some mistake in the ledger accounts. This prompts the accountant to find out the errors.

(d) **Helps in Comparison :** Comparison of ledger account balances of one year with the corresponding balances with the previous year help the management taking some important decisions. This is possible by using the Trial Balances of the two years.

(e) **Helps in Making Adjustments :** While making financial statements adjustments regarding closing stock, prepaid expenses, outstanding expenses etc. are to be made. Trial balance helps in identifying the items requiring adjustments in preparing the financial statements.

REASONS FOR THE PREPARATION OF TRIAL BALANCE

Following are the reason why a trial balance has to be prepared :

(a) It ensures that the transactions recorded in the books of accounts have identical debit and credit amount.

(b) Balance of each ledger account has been computed correctly.

(c) Balance of each and every ledger account has been transferred accurately and on the correct side of the sheet on which trial balance has been prepared.

(d) The debit and the credit columns of trial balance have been added up correctly.

(e) Preparation of final accounts is not possible without preparing trial balance first.

(f) Agreed trial balance is a prima facie evidence of the arithmetical accuracy of the accounting books maintained.

(g) Errors which are revealed by preparing trial balance (listed below) are rectified even before the preparation of final accounts.

FEATURES OF TRIAL BALANCE

Following are the essential features of trial balance :

- It is a statement and not a part of the double entry system of book-entry.
- It can be prepared at regular interval.
- It contains the summary of all ledger accounts.
- Its purpose is to find out the arithmetical accuracy of the books of accounts.
- It shows the debit balances and the credit balances in two separate columns.
- In the trial balance the ledger folio number of each ledger account is noted beside its name, to facilitate easy reference.

UTILITY / ADVANTAGES OF TRIAL BALANCE

The following are the advantages of using Trial Balance :

1. It helps to ascertain the arithmetical accuracy of the book-keeping work done during the period.
2. It supplies in one place ready reference of all the balances of the ledger accounts.
3. It is the basis on which final accounts are prepared.
4. Where a trial balance has agreed, there can be no reason why a balance sheet should not agree.

5. Final accounts and balance sheet can be prepared on the basis of the balances as shown in the trial balance.

6. From a trial balance all ledger accounts balances including cash and bank balances can be obtained.

7. It ensures that the transactions recorded in the books of accounts have identical debit and credit amount.

8. Balance of each ledger account has been computed correctly.

9. The debit and the credit columns of trial balance have been added up correctly.

10. Errors which are revealed by preparing trial balance (listed below) are rectified even before the preparation of final accounts.

LIMITATIONS OF TRIAL BALANCE

Following are the limitations of Trial Balance :

1. All transactions have been correctly analyzed and recorded in proper accounts. For example wages paid for installation of fixed asset might have wrongly been debited to wages account.

2. All the transactions have been recorded and nothing has been omitted.

3. Certain types of errors remain undetected even after the preparation of trial balance.

4. Entry might be posted twice in the ledger.

5. An entry has not at all posted in the ledger.

Thus it is quite well known and said that "agreement of trial balance is not the conclusive proof of the accuracy of the books maintained."

PREPARATION OF TRIAL BALANCE

A trial balance can be prepared in the following two ways :

(i) Total Method

(ii) Balances Method

(i) **Total Method :** Under this method, total of each side in the ledger (debit and credit) is ascertained separately and shown in the trial balance in the respective columns. The total of debit column of trial balance should agree with the total of credit column in the trial balance because the accounts are based on double entry system. However, this method is not widely used in practice, as it does not help in assuming accuracy of balances of various accounts and and preparation of the financial statements.

(ii) **Balances Method :** This is the most widely used method in practice. Under this method trial balance is prepared by showing the balances of all ledger accounts and then totalling up the debit and credit columns of the trial balance to assure their correctness.

The account balances are used because the balance summarizes the net effect of all transactions relating to an account and helps in preparing the financial statements. It may be noted that in trial balance, normally in place of balances in individual accounts of the debtors, a figure of sundry debtors is shown, and in place of individual accounts of creditors, a figure of sundry creditors is shown.

POINTS TO BE NOTED FOR THE PREPARATION OF TRIAL BALANCE

In order to prepare a trial balance following steps are taken :

1. Ascertain the balances of each account in the ledger.
2. List each account and place its balance in the debit or credit column, as the case may be. (If an account has a zero balance, it may be included in the trial balance with zero in the column for its normal balance).
3. Compute the total of debit balances column.
4. Compute the total of the credit balances column.
5. Verify that the sum of the debit balances equal the sum of credit balances. If they do not tally, it indicates that there are some errors.
6. So one must check the correctness of the balances of all accounts.
7. 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

Following is the format of trial balance :

Particulars	L.F.	Debit Balances	Credit Balances

Generally the following items will appear in the Debit and Credit side of Trial Balance :

Debit Balances	Credit Balances
Opening Stock	Capital
Purchases	Sundry Creditors
Carriage Inwards → Transportation	Bills Payable
Wages	Carriage Outwards
Octroi → Importing charges	(Purchase Return)
Gas and Fuel	Bank Overdraft
Salaries	Loans
Postage and Telegrams	Sales
Printing and Stationery	Discount Received
Rent, Rates and Taxes	Rent Received
Carriage Outwards - sellers	Interest Received
Discount Allowed	Provision for Doubtful debts
Bad debts	General Reserves
Commission Paid	Transfer Fees
Return Inwards (Sales Return)	Any other Incomes
Plant and Machinery	and
Land and Buildings	Liabilities
Furniture and Fittings	
Leasehold Property	
Cash in hand	
Cash at Bank	
Sundry Debtors	
Bills Receivable	
Investments	
Goodwill	
Drawings	
Prepaid Expenses	
Any other Assets	
and	
All Expenses (direct or Indirect Expenses)	

Illustration 1 :

From the following balances in the books of M/s Kulkarni Agencies, Hyderabad, prepare its trial balance as on 31st March, 2014.

Name of Accounts	₹	Name of Accounts	₹
Opening Stock D	3,460	Motor Vehicle	6,250
Purchases D	5,475	Building	7,500
Purchase Returns C	125	Bills Receivable	3,640
Capital C	12,500	Bills Payable	3,000
Drawings D	800	Sales	15,450
Salaries D	2,500	Sales Returns	200
Debtors — D	3,800	Bad Debts	125
Bank Overdraft — C	2,850	Discount Received	200
Commission-Cr.	375	Cash in Hand	650
Rent	782	Creditors	2,500
Advertisement	450	Interest on Overdraft	118
Wages	250	Insurance	1,000

Solution :

Trial Balance of M/s Kulkarni Agencies as on 31st March, 2014

S.No.	Name of Ledger Accounts	L.F.	Balances Dr. ₹	Balances Cr. ₹
1.	Opening Stock		3,460	
2.	Purchases		5,475	
3.	Purchases returns			125
4.	Capital			12,500
5.	Drawings		800	
6.	Salaries		2,500	
7.	Debtors		3,800	
8.	Bank overdraft			2,850
9.	Commission			375
10.	Rent		782	
11.	Advertisement		450	
12.	Wages		250	
13.	Motor vehicle		6,250	
14.	Building		7,500	
15.	Bills receivable		3,640	
16.	Bills payable			3,000
17.	Sales			15,450
18.	Sales returns		200	
19.	Bad debts		125	
20.	Discount received			200
21.	Cash in hand		650	
22.	Creditors			2,500
23.	Interest on overdraft		118	
24.	Insurance		1,000	
			37,000	37,000

Illustration 2 :

Prepare the trial balance of the following balances for the year ended 31st March, 2012 :

Name of Accounts	₹	Name of Accounts	₹
Opening Stock	20,000	Furniture	6,000
Purchases	85,000	Machinery	62,000
Purchases Returns	5,000	Debtors	36,000
Sales	1,60,000	Creditors	12,750
Sales Returns	6,200	Bills Receivable	4,600
Rent	1,200	Bills Payable	2,500
Salaries	5,700	Cash in Hand	5,220
Advertisement	880	Bank Overdraft	10,000
Commission Received	1,440	Interest on Overdraft	1,800
Discount Cr.	710	Capital	50,000
		Drawings	7,800

Solution : **Trial Balance as on 31st March, 2012**

Name of Ledger Accounts	L.F.	Balances Dr. ₹	Balances Cr. ₹
Opening Stock		20,000	
Purchases		85,000	
Purchases Returns			5,000
Sales			1,60,000
Sales Returns		6,200	
Rent		1,200	
Salaries		5,700	
Advertisement		880	
Commission Received			1,440
Discount (Cr.)			710
Furniture		6,000	
Machinery		62,000	
Debtors		36,000	
Creditors			12,750
Bills Receivable		4,600	
Bills Payable			2,500
Cash in Hand		5,220	
Bank Overdraft			10,000
Interest on Overdraft		1,800	
Capital			50,000
Drawings		7,800	
	Total	2,42,400	2,42,400

BEFA UNIT IV

Prepare the Trial Balances for the following examples:

Example 1. Prepare a trial balance as on 31-12-2014 from the below information.

Particulars	Rs	Particulars	Rs
Sundry debtors	32000	Bills payable	7500
Stock	22000	Purchases	218870
Cash in hand	35	Cash at bank	1545
Plant and machinery	17500	Sundry creditors	10650
Trade expenses	1075	Sales	234500
Salaries	2225	Carriage outward	400
Rent	900	Discounts (Dr)	1100
Capital	79500	Premises	34500

Solution:

Trial Balance as on 31-12-2014

Debit balances	Rs	Credit balances	Rs
Sundry debtors	32000	Bills payable	7500
Stock	22000	Sales	234500
Cash in hand	35	Sundry creditors	10650
Plant and machinery	17500	Capital	79500
Trade expenses	1075		
Cash at bank	1545		
Rent	900		
Salaries	2225		
Purchases	218870		
Carriage outward	400		
Discounts	100		
Premises	34500		
	332150		**332150**

Example 2. Make a trial balance from the below balances of accounts.

Particulars	Rs	Particulars	Rs
Capital	100000	Machinery	30000
Stock	16000	Wages	50000
Carriage inward	500	Salaries	5000
Factory rent	2400	Repairs	400
Fuel and power	2500	Buildings	40000
Sundry debtors	20000	Sales	203600
Purchases	122000	Creditors	12500
Returns outwards	2000	Returns inwards	3600
Drawings	2000	Discount allowed	750

Discount received	250	Office expenses	1000
Manufacturing expenses	600	Bills payable	3000
Bills receivable	5000	Cash in hand	2400
Cash at bank	15400	Office rent	1800

Solution: **Trial Balance as on ------------------**

Debit balances	Rs	Credit balances	Rs
Machinery	30000	Capital	100000
Stock	16000	Sales	203600
Wages	50000	Creditors	12500
Carriage inward	500	Returns outwards	2000
Salaries	5000	Discount received	250
Factory rent	2400	Bills payable	8500
Repairs	400		
Fuel and power	2500		
Buildings	40000		
Sundry debtors	20000		
Purchases	122000		
Returns inwards	3600		
Drawings	2000		
Discounts allowed	750		
Office expenses	1000		
Manufacturing expenses	600		
Bills receivable	5000		
Cash in hand	2400		
Cash at bank	15400		
Office rent	1800		
	321350		**321350**

FINAL ACCOUNTS

In every business, the business man is interested in knowing whether the business has resulted in profit or loss and what the financial position of the business is at a given time. In brief, he wants to know (i)The profitability of the business and (ii) The soundness of the business.

The trader can ascertain this by preparing the final accounts. The final accounts are prepared from the trial balance. Hence the trial balance is said to be the link between the ledger accounts and the final accounts. The final accounts of a firm can be divided into two stages. The first stage is preparing the trading and profit and loss account and the second stage is preparing the balance sheet.

BEFA UNIT IV

TRADING ACCOUNT

The first step in the preparation of final account is the preparation of trading account. The main purpose of preparing the trading account is to ascertain gross profit or gross loss as a result of buying and selling the goods.

Finally, 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. The up-to-date state of any account can be easily known by referring to the ledger.

PROFIT AND LOSS ACCOUNT:

The business man is always interested in knowing his net income or net profit.Net profit represents the excess of gross profit plus the other revenue incomes over administrative, sales, Financial and other expenses. The debit side of profit and loss account shows the expenses and the credit side the incomes. If the total of the credit side is more, it will be the net profit. And if the debit side is more, it will be net loss.

Format of Trading and Profit & Loss A/C of ....for the year ending ....

Particulars		Amount	Particulars		Amount
To Opening stock		xxxx	By Sales	xxxx	
To Purchases	xxxx		Less: Returns	xxxx	xxxx
Less: Returns	xxxx	xxxx	By Closing stock		xxxx
To Carriage inwards		xxxx	By Gross loss (c/d)		xxxx
To Freight, cartage		xxxx			
To Customs duty		xxxx			
To Clearing charges		xxxx			
To Octroi		xxxx			
To Wages		xxxx			
To Gas, water, coal, light		xxxx			
To Factory rent		xxxx			
To Works manager salary		xxxx			
To Factory supervision		xxxx			
To consumable stores		xxxx			
To Plant depreciation		xxxx			
To Gross profit (c/d)		xxxx			
		xxxx			xxxx
To Gross loss(b/d)		xxxx	By Gross profit(b/d)		xxxx
To Salaries		xxxx	By Discount received		xxxx
To Rent, Taxes		xxxx	By Interest received		xxxx
To Insurance		xxxx	By Dividend received		xxxx
To Printing stationery		xxxx	By Rent received		xxxx

To Advertisement	xxxx	By Commission received	xxxx
To Carriage outward	xxxx	By Net loss (c/d)	xxxx
To Bad debts	xxxx		xxxx
To Repairs	xxxx		xxxx
To Depreciation	xxxx		xxxx
To Discount allowed	xxxx		xxxx
To Commission allowed	xxxx		xxxx
To Interest paid	xxxx		xxxx
To Provision for doubtful debts	xxxx		xxxx
To Postage	xxxx		xxxx
To General expenses	xxxx		xxxx
To Net profit (c/d)	xxxx		xxxx
	xxxx		xxxx

BALANCE SHEET:

The second point of final accounts is the preparation of balance sheet. It is prepared often in the trading and profit, loss accounts have been compiled and closed. A balance sheet may be considered as a statement of the financial position of the concern at a given date.

A balance sheet is an item wise list of assets, liabilities and proprietorship of a business at a certain state.

Balance Sheet of..................company as on ....

Capital & Liabilities		Amount	Assets	Amount
Capital	xxxx		Land and buildings	xxxx
Add: Net profit	xxxx		Furniture	xxxx
	xxxx		Plant and machinery	xxxx
Less: Drawings	xxxx	xxxx	Land	xxxx
Loans		xxxx	Vehicles	xxxx
Bank Over Draft		xxxx	Debtors	xxxx
Bills payable		xxxx	Investments	xxxx
Creditors		xxxx	Bills receivables	xxxx
Outstanding expenses		xxxx	Goodwill	xxxx
Incomes received in advance		xxxx	Patents	xxxx
All reserves		xxxx	Copyright	xxxx
			Trade marks	xxxx
			Prepaid expenses	xxxx
			Incomes receivables	xxxx
			Securities	xxxx
			Closing stock	xxxx
			Cash in hand	xxxx
			Cash at bank	xxxx
		xxxx		xxxx

A 23

BEFA UNIT IV

IMPORTANT ADJUSTMENTS:

1. **Outstanding expenses**

    a) Add to respective expense account in Trading & Profit & Loss account

    b) Show as a liability in Balance Sheet

Note:- If it is given only in trial balance, show as a liability in the balance sheet

2. **Prepaid expenses**

    a) Deduct from the respective expenses account in Trading and P/L account

    b) Show as an asset in Balance Sheet

Note:- If it is given only in trial balance, show only as an asset in B/S

3. **Accrued incomes or incomes receivables**

    a) Add to the respective income A/C in P/L Account

    b) Show as an asset in B/S

Note:- If it is only given in trial balance, show as an asset in B/S

4. **Incomes received in advance**

    a) Deduct from the respective income A/C in P/L Account

    b) Show as a liability in B/S

Note:- It is given only in trial balance, show as a liability in B/S

5. **Closing stock**

    a) Show on the credit side of trading A/C

    b) Show as an asset in B/S

Note:- If it is given only in trial balance, show as an asset in B/S

6. **Interest on capital**

a) Show on the debit side of P/L A/C

b) Add to capital in B/S

Note:- If it is given only in trial balance, show only in P/L A/C

7. **Depreciation**

a) Show on the debit side of P/L A/C

b) Deduct from respective asset in B/S

Note:- If it is given only in trial balance, show only on the debit side of P/L A/C)

8. **I) Bad debts (when given only in adjustments)**

a) Show on the debit side of P/L A/C

b) Deduct from debtors in B/S

II) Bad debts (when given only in trial balance)

Show on the debit side of P/L A/C only

III) Bad debts (when given in both trial balance and adjustments)

a) Add " Bad debts given in adjustments" to " Bad debts in trial balance" on the debit side of P/L A/C

b) Deduct " Bad debts in adjustments" from the debtors in B/S

9. **Provision/Reserve for bad debts (RBD)**

A) When RBD is given only in trial balance

a) Deduct from the debtors in B/S

B)When RBD is given only in adjustments

a) Show on the debit side of P/L A/C

b) Deduct from the debtors in B/S

BEFA UNIT IV

C)When RBDs are given in both trial balance (RBD old) and adjustments (RBD New)

a) Compare both RBDs, show the difference on the debit side of P/L A/C if RBD new is excess than RBD old. Show the difference on the credit side of P/L A/C in RBD old is excess than RBD new.

b) Deduct always only RBD new from debtors in B/S

PROCEDURE FOR PREPARING TRADING ACCOUNT

1. Show opening stock and net purchases (purchases less purchase returns) on the debit side.
2. Show net sales (sales – sales returns) and the closing stock given in the adjustments on the credit side.
3. Show all the direct expenses with adjustments on the debit side.
4. Balance the account and carry forward the balance to P/L A/C

PROCEDURE FOR PREPARING PROFIT AND LOSS ACCOUNT

1. Show all the remaining expenses with adjustments on the debit side.
2. Show all the remaining incomes with adjustments on the credit side
3. See whether all adjustments are taken once in any of the Trading Account and Profit & Loss Account
4. Balance the P/L A/C and transfer the balance to capital in B/S

PROCEDURE FOR PREPARING BALANCE SHEET

1. Show all the assets with adjustments on the assets side.
2. Show all the liabilities with adjustments on the liabilities side.
3. See whether all items of trial balance are taken once and whether all adjustments are taken twice.
4. Add both the columns of assets and liabilities.

BEFA UNIT IV

Example 1: From the following trial balance and additional information of Mr. Arun, prepare his final accounts for the year ending 31-3-2015.

Particulars	Rs	Particulars	Rs
Building	280000	Capital	250000
Furniture	60000	Sales	265000
Opening stock	25000	Bank loan	100000
Advertising	5000	Commission	6000
Salaries	14000	Creditors	8000
Wages	3000		
Purchases	190000		
Discount	4000		
Bad debts	2000		
Interest on loan	6000		
Returns inwards	10000		
Debtors	30000		
	629000		629000

Adjustments:

1. Stock on 31-3-2015 was Rs. 35000.
2. Wages outstanding Rs. 1000.

BEFA UNIT IV

Solution: Trading and Profit & Loss A/C of Mr. Kiran for the year ending 31-3-2015.

Dr | Cr

Particulars		Amount	Particulars		Amount
To Opening Stock		25000	By Sales	265000	
To Purchases		190000	Less: Returns	10000	255000
To Wages	3000		By Closing Stock		35000
Add: Outstanding	1000	4000			
To Gross Profit (b/d)		71000			
		290000			290000
To Salary		14000	By Gross Profit (c/d)		71000
To Advertisement		5000	By Commission		6000
To Discount		4000			
To Interest on loan		6000			
To Bad debts		2000			
To Net Profit (c/d)		46000			
		77000			77000

Balance Sheet of Mr. Arun as on 31-3-2015.

Liabilities & Capital		Amount	Assets	Amount
Capital	250000		Building	280000
Add: Net Profit	46000	296000	Furniture	60000
Outstanding wages		1000	Debtors	30000
Bank loan		100000	Closing Stock	35000
Creditors		8000		
		405000		405000

Example 2: From the following data and additional information of Mr. Kiran, prepare his final accounts for the year ending 31-3-2015.

Building	70000	Carriage inwards	1291
Furniture	1640	Establishment expenses	2135
Debtors	15600	Carriage outwards	800
Creditors	18852	Insurance	783
Stock	15040	Interest (Cr)	340
Cash in hand	988	Bad debts	613
Cash at bank	24534	Audit fee	400
Bills receivables	5844	General expenses	3050
Purchases	85522	Discount (Dr)	945
Sales	121850	Investments	8922
Capital	92000	Returns inwards	285
Bills payable	6250	Rent	900

Adjustments:

1. Stock on 31-3-2015 was Rs. 35000.
2. Prepaid insurance Rs. 100.
3. Depreciation on furniture Rs. 10%
4. Interest accrued but not received Rs. 100

Solution: **Trading and Profit & Loss A/C of Mr. Kiran for the year ending 31-3-2015.**

Dr Cr

Particulars		Amount	Particulars		Amount
To Opening Stock		15040	By Sales	121850	
To Purchases		85522	Less: Returns	285	121565
To Carriage inward		1291	By Closing Stock		35000
To Gross Profit (b/d)		54712			
		156565			156565
To Establishment expenses		2135	By Gross Profit (c/d)		54712
To Carriage outward		800	By Interest	340	
To Insurance	783		Add: Interest to be received	100	440
Less: Prepaid	100	683			
To Bad debts		613			
To Audit fee		400			
To General expenses		3050			
To Discount		945			
To Rent		900			
To Depreciation on plant		164			
To Net Profit (c/d)		45462			
		55152			55152

Balance Sheet of Mr. Kiran as on 31-3-2015.

Liabilities & Capital		Amount	Assets		Amount
Capital	92000		Building		70000
Add: Net Profit	45462	137462	Furniture	1640	
Creditors		18852	Less: Depreciation	164	1476
Bills payables		6250	Debtors		15600
			Cash in hand		988
			Cash at bank		24534
			Bills receivables		5844
			Investments		8922
			Closing stock		35000
			Prepaid insurance		100
			Interest accrued		100
		162564			162564

BEFA UNIT IV

Example 3: From the following trial balance and additional information, prepare final accounts for the year ending 31-12-2014.

Particulars	Rs	Particulars	Rs
Sundry debtors	64000	Discount received	9000
Stock (1-1-2014)	44000	Bank over draft	15000
Cash in hand	3160	Long term loan	25300
Wages	35000	Sales	365000
Trade expenses	2150	Capital	150000
Gas, water, power	4450		
Sales returns	800		
Bank charges	1800		
Purchases	237740		
Advertisements	2200		
Premises	160000		
Drawings	9000		
	564300		564300

Adjustments:

1. Bank charges outstanding Rs.150,
2. Write off bad debts Rs. 500
3. Provide 5% for doubtful debts.

Solution: Trading and Profit & Loss A/C for the year ending 31-12-2014.

Dr | Cr

Particulars		Amount	Particulars		Amount
To Opening Stock		44000	By Sales	365000	
To Purchases		237740	Less: Returns	800	364200
To Wages		35000			
To Trade expenses		2150			
To Gas, water, power		4450			
To Gross Profit (b/d)		40860			
		364200			364200
To Bank charges	1800		By Gross Profit (c/d)		40860
Add: Outstanding	150	1950	By Discount		9000
To Advertisements		2200			
To Bad debts		500			
To Provision for bad debts (64000-500)x5/100		3175			
To Net Profit (c/d)		42035			
		49860			49860

Balance Sheet as on 31-12-2014.

Liabilities & Capital		Amount	Assets		Amount
Capital	150000		Debtors	64000	
Add: Net Profit	42035		Less: Bad debts	500	
	192035			63500	
Less: Drawings	9000	183035	Less: Provision for bad debts	3175	60325
Bank Over Draft		15000	Cash in hand		3160
Long term loans		25300	Premises		160000
Bank charges outstanding		150			
		223485			223485

Example 4: From the following data prepare final accounts for the year ending 31-12-2014.

Particulars	Rs	Rs
Drawings and capital	12000	80000
Opening stock	12000	
Investments	30600	
Stationery	12000	
Carriage	3000	
Returns	6000	2600
Purchases and sales	120000	160000
Loans	2400	10000
Debtors and creditors	60000	25000
Discount allowed	2200	
Freight in	10400	
Freight out	6000	
Charity	28000	
Reserve for doubtful debts		2000
Bills payables		25000
	304600	**304600**

Adjustments:

1. Closing stock Rs. 20000
2. Appreciate investment by 10%
3. Maintain reserve for doubtful debts at the rate of 5%
4. Provide 5% as interest on capital

A 32

BEFA UNIT IV

Solution: Trading and Profit & Loss A/C for the year ending 31-12-2014.

Dr Cr

Particulars		Amount	Particulars		Amount
To Opening Stock		12000	By Sales	160000	
To Purchases	12000		Less: Returns	6000	154000
Less: Returns	2600	117400	By Closing stock		20000
To Freight in		10400			
To Gross Profit (b/d)		34200			
		174000			174000
To Stationery		12000	By Gross Profit (c/d)		34200
To Carriage		3000	By Investments appreciation (30600x10/100)		3060
To Discount		2200			
To Freight out		6000	To Net Loss (c/d)		18940
To Charity		28000			
To Reserve for bad debts (3000-2000)		1000			
To Interest on capital (80000x5/100)		4000			
		56200			56200

Balance Sheet as on 31-12-2014.

Liabilities & Capital		Amount	Assets		Amount
Capital	80000		Investments	30600	
Less: Net Loss	18940		Add: Appreciation	3060	33660
	61060		Loan		2400
Add: Interest	4000		Debtors	60000	
	65060		Less: Reserve for bad debts	3000	57000
Less: Drawings	12000	53060			
Loan		10000	Closing stock		20000
Creditors		25000			
Bills payables		25000			
		113060			113060

BEFA UNIT IV

ACCOUNTING PROCESS/CYCLE

Accounting process involves a sequence of activities which are repeated in every accounting period. So it is known as accounting cycle.