PGBA (S1) 03-1

Accounting for Managers

SEMESTER - 1

BUSINESS ADMINISTRATION

BLOCK - 1

KRISHNA KANTA HANDIQUI STATE OPEN UNIVERSITY

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MASTER IN BUSINESS ADMINISTRATION

ACCOUNTING FOR MANAGERS

Block 1

DETAILED SYLLABUS

UNIT 1 : Introduction to Fianancial Accounting **Page 7–22**

Meaning of Accounting and Elements of Accounting, Book- keeping and Accounting- Difference, Accounting Process, Objectives of Accounting, Limitations of Accounting, Forms of business organisations, Choice of method of accounting – Cash and Accrual basis of accounting , and Computerized Accounting System

UNIT 2 : Accounting Concept, Priniciples and Policies **Page 23–47**

Components of Financial Statements, Qualitative characteristics of Financial Statements, Fundamental Accounting Concepts, Accounting Principles, Meaning of Accounting Principles,Features of Accounting Principles, Need/ Importance of Accounting Principles, Accounting Policies, Generally Accepted Accounting Principles(GAAP), Accounting Standards Need for Accounting Standards, International Financial Reporting Standards

UNIT 3 : Double Entry Accounting **Page 48–74**

Transactions and Events, Accounting Equation, Meaning of Double Entry Accounting, Meaning of Debit and Credit ,Classification of Accounts under Traditional Approach, Classification of Accounts under Modern Approach , Comparison of Traditional Approach with Modern Approach and Accounting Trail/Process/Cycle

UNIT 4 : Ledger **Page 75–88**

Concept of Ledger, Meaning of Ledger, Need and Subdivision of Ledger, Format of a Ledger Account, Distinction between Journal and Ledger, Ledger Posting, Meaning of Posting and Procedure for Balancing of an Account

UNIT 5 Subsidiary Books **Page 89–111**

Purchases Book,Sales Book or Sales Day Book , Purchase Return Book or Return Outward Book, Sales Return Book or Return Inward Book, Bills Receivable Book, Bills Payable Book, Cash Book, Journal Proper and Bank Reconciliation Statement

COURSE INTRODUCTION

This course is designed to provide a basic understanding of financial accounting, including introductory accounting theory, concepts, principles and procedures. Financial accounting gathers and summarizes financial data to prepare financial reports such as balance sheet and income statement for the firm's management, investors, lenders, suppliersetc. The course consists of 15 units and the course is divided into three blocks :

Block 1 deals with the Fundamentals of Accounting, Accounting Concept, Priniciples and Policies, Double Entry Accounting,Ledger and Subsidiary Books.

Block 2 concentrates on Trial balance, Final Accounts and Management Accounting, Ratio Analysis, Funds Flow Analysis.

Block 3 concentrates on some of the most important concepts of Cash Flow Analysis, Cost , Marginal Costing and Break Even Analysis, Budgetary Control and Standard Costing.

Each unit of these blocks includes some along-side boxes to help you know some of the difficult, unseen terms. Some "EXERCISES" have been included to help you apply your own thoughts. You may find some boxes marked with: "LET US KNOW". These boxes will provide you with some additional interesting and relevant information. Again, you will get "CHECK YOUR PROGRESS" questions. These have been designed to self-check your progress of study. It will be helpful for you if you solve the problems put in these boxes immediately after you go through the sections of the units and then match your answers with "ANSWERS TO CHECK YOUR PROGRESS" given at the end of each unit. you in making your learning more active and efficient. And, at the end of each section, you will get "CHECK YOUR PROGRESS" questions. These have been designed to self-check your progress of study. It will be better if you solve the problems put in these boxes immediately after you go through the sections of the units and then match your answers with "ANSWERS TO CHECK YOUR PROGRESS" given at the end of each unit.

BLOCK INTRODUCTION

This is the First Block of the course **Accounting for Managers**. After completing this block, which consists of five units, you will be able to get a fairidea on the different concepts in financial accounting.

This block comprises the following five units :

The first unit introduces us to the Introduction to Financial Accounting, Meaning of Accounting and Elements of Accounting, Book-keeping and Accounting- Difference, Accounting Process

The second unit gives us a broad overview of the Accounting Concept, Priniciples and Policies, Components of Financial Statements, Qualitative characteristics of Financial Statements

The third unit gives us an idea on Double Entry Accounting, Transactions and Events, Accounting Equation, Meaning of Double Entry Accounting.

The fourth unit will help us in understanding the concept of Ledger, Meaning of Ledger, Need and Subdivision of Ledger, Format of a Ledger Account, Distinction between Journal and Ledger, Ledger Posting, Meaning of Posting and Procedure for Balancing of an Account

The fifth unit gives us a broad overview of Subsidiary Books.

The structure of Block 1 is as follows :

UNIT 1 : Introduction to Financial Accounting

UNIT 2 : Accounting Concept, Priniciples and Policies

UNIT 3 : Double Entry Accounting

UNIT 4 : Ledger

UNIT 5 : Subsidiary Books

UNIT1: INTRODUCTION TO FINANCIAL ACCOUNTING

UNIT STRUCTURE

1.1 Learning Objectives

1.2 Introduction

1.3 Meaning of Accounting and Elements of Accounting

1.3.1 Meaning of Accounting

1.3.2 Elements of Accounting

1.4 Book-keeping and Accounting- Difference

1.5 Accounting Process

1.6 Objectives of Accounting

1.7 Limitations of Accounting

1.8 Forms of business organisations

1.9 Choice of method of accounting – Cash and Accrual basis of accounting

1.10 Computerized Accounting System

1.11 Let Us Sum Up

1.12 Further Readings

1.13 Answers to Check Your Progress

1.14 Model Questions

1.1 LEARNING OBJECTIVES

After going through this unit, you will be able to :

- learn the meaning of book keeping and accounting
- discuss the accounting process
- explain why accounting is needed in an organisation
- outline the limitations of accounting

1.2 INTRODUCTION

In this unit, we are going to learn the basic concept of financial accounting. Accounting is the science and art of measurement of economic effect of transactions and other events occurring in a business from time

to time. Accounting is known as the language of business. This designation is given because it is the method of communicating business results to the owners as well as to other stakeholders in the business like investors, lending institutions, employees, government and its agencies, public etc. Let us discus the concept in detail in the following sections.

1.3 MEANING OF ACCOUNTING AND ELEMENTS OF ACCOUNTING

1.3.1 Meaning of Accounting

Accounting refers to the system involved in making a financial record of business transactions and in the preparation of statements concerning the assets, liabilities, capital and operating results of the business. It deals with ascertainment of business income and values of assets, liabilities and capital. Again, 'Accounting' in business is conceived as a system that provides information on the financial condition and the transactions which have led to that status. This system starts with recording of business transactions and ends with interpreting the results thereof. Accountants engage themselves in recording business transactions and in preparing financial statements. They also provide information on costs and gains from new technologies, mergers and acquisition; track financial performance, tax strategy, and health care benefits etc. to the management. Hence, accounting is defined by the Committee on Terminology of the American Institute of Accountants (later on known as American Institute of Certified Public Accountants, AICPA) as, *"Accounting is the art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character, and interpreting the results thereof."*

Financial accounting measures, translates, and sums up the impact of all business activities into financial terms in the form of financial statements to reflect the financial position and

performance of an entity. Based on this financial information about the financial position and performance, a business formulates its strategies for revenue enhancement, cost economies, efficiency improvements, restructuring of its operations and further expansion or diversification for creating and enhancing the capital of the owners.

As we know that establishment of business and subsequent business operations leads to creation of Assets and Liabilities and generation of Income and incurring of Expenses towards the generation of Income. Therefore, a basic understanding of what these terms 'Assets', 'Liabilities or Equity ', 'Income', and Expenses' mean and convey and how they constitute 'Financial Position' and 'Performance' is important before we proceed further to gain knowledge in the field of Accounting.

1.3.2 Elements of Accounting

Accounting has three basic elements into which the various activities are categorized :

1. **Assets:** It refers to resources controlled by an enterprise as a result of past events, from which future economic benefits are expected to flow to the enterprise. In short, the properties owned by a business enterprise are referred to as assets. Therefore, resources like land, buildings, plant and machinery, vehicles, furniture & fixtures, office equipments, inventories of raw materials and finished goods, amount receivable from customers to whom goods are sold on credit (known as debtors), advances to suppliers of goods, cash and bank balances are all known as 'Assets'. Assets are of two types current assets and non- current assets. Noncurrent assets are again of two types namely fixed assets and long term investments. Further, the fixed assets may be tangible asset (physical assets) or intangible assets (non-physical assets).

Fixed Assets are long lived assets of a business which provides long term economic benefit, usually spanning beyond 12 months and such assets are not meant for sale in the ordinary course of business.

Current Assets are the assets which can be converted into cash within an accounting year. These assets are held for consumption (raw materials or work in progress), or for sale (finished goods), and are expected to be realized in cash (debtors) or in kind, for example through the supplies of raw materials (Advances to suppliers)during the operating cycle.

2. **Liabilities:** The properties owned by a business enterprise are referred to as assets and the rights or claims to the various parties against the assets are referred to as liabilities. Liabilities may be subdivided into two principal types: the rights of creditors and the rights of owners. The right of creditors represents debts of the business and is called liabilities. The rights of the owners are called capital or equity.

   The sources of financing the assets take the character of liabilities like contribution of owner to his business (owner's capital), term loan from a bank (borrowed capital), amount payable to suppliers from whom goods are purchased on credit (creditors). Thus, a liability is an obligation of the business enterprise that arises in the course of its business operations and is to be discharged/ settled in future.

   Liabilities are usually of two types- long term and short term or current liability. Any liability repayable over a period exceeding 12 months is termed as a long term liability like term loan from a bank, debentures etc. Any liability which has to be discharged during the normal operating cycle of the business and in any case within 12 months is termed as current liability like amount payable to suppliers, bills payable, expenses outstanding etc.

3. **Equity/ Capital :** It refers to the residual interest in the assets of the business after deducting all its outside liabilities. Equity or

capital increases when income is earned by a business entity and equity/capital decreases when losses are suffered by a business entity. It is necessary to understand the meaning of the two term 'income' and 'expense'

Income : It represents the increase in economic benefits during the accounting period , in the form of increase in assets or decrease in liabilities (other than those relating to contributions from capital providers), which results in increase in equity/ capital, however , certain receipts though meeting the definition of income do not qualify as income being in the nature of capital receipts as for example premium received on issue of shares, profit on sale of fixed assets etc. Capital receipts do not form part of revenue from operations.

Expenses: It represents the decrease in economic benefits during the accounting period, in the form of decrease of assets or incurring of liabilities (other than those relating to distribution to capital providers), which results in decrease in equity/capital, however , certain expenditures though meeting the definition of expense do not qualify as expenses being in the nature of capital expenditure as for example wages paid to workers engaged in installation of plant & machinery in the factory site, transportation charges paid for bringing machinery to the factory site, preliminary expenses in connection with incorporation of a company etc.

1.4 BOOK- KEEPING AND ACCOUNTING – DIFFERENCE

Different authors and authorities have defined book keeping in different ways. Following are some of the definitions forwarded by them:

In the words of L.N Copper, book keeping is "The science of recording transactions in money's worth in such a manner that at any subsequent date, their nature and effect may be clearly understood, and that when required a combined statement of their results may be prepared."

R.N Cater has defined book keeping as “the science and art of correctly recording in the books of account all those business transactions that result in the transfer of money’s worth.”

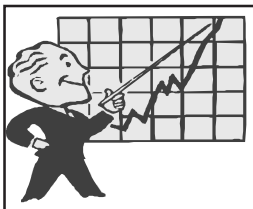
According to J.R Batliboi, “Book keeping is the art of recording business dealings in set of books”

The above definitions clearly defines book-keeping and it is imperative from the definitions that it is the science and art of recording financial transactions in the books systematically and in a chronological order from where we can ascertain the results of the operations and also financial position can be ascertained on a certain date.

Book-keeping is concerned with the recording of transactions. The work of a book-keeper is considered to be of routine and clerical in nature. On the other hand, accounting is considered to be comprehensive and perspective. Accounting involves classifying, summarizing, presenting and even analyzing the information. Hence, the job of accounting requires initiatives and judgement besides having training for that. Therefore, the work of accountants may include some book keeping in the beginning, but accountants must possess a higher level of accounting knowledge, conceptual understanding of the subject and also skill of analysis of the events more than the book-keepers.

The difference between book-keeping and accounting can also be explained in the following points:

- Accounting has a wider scope than that of book-keeping
- Accounting works is done by the senior officers of the organization whereas the work of a book-keeper involves junior staff
- Accountants require comprehensive knowledge but book-keepers require only the simple knowledge
- Accounting starts when book-keeping ends
- We cannot find out the financial position of the organization with the help of book-keeping but with the help of accounting, financial position can be known.



CHECK YOUR PROGRESS

Q1: Define Book Keeping.

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Q2: What is Accounting.

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1.5 ACCOUNTING PROCESS

The accounting process starts with the identification of a transaction up-to the closing of books of accounts. This process from identification of a transaction to closure of the books of accounts is repeated in each of the reporting period and hence, is also called accounting cycle.

The Accounting Process

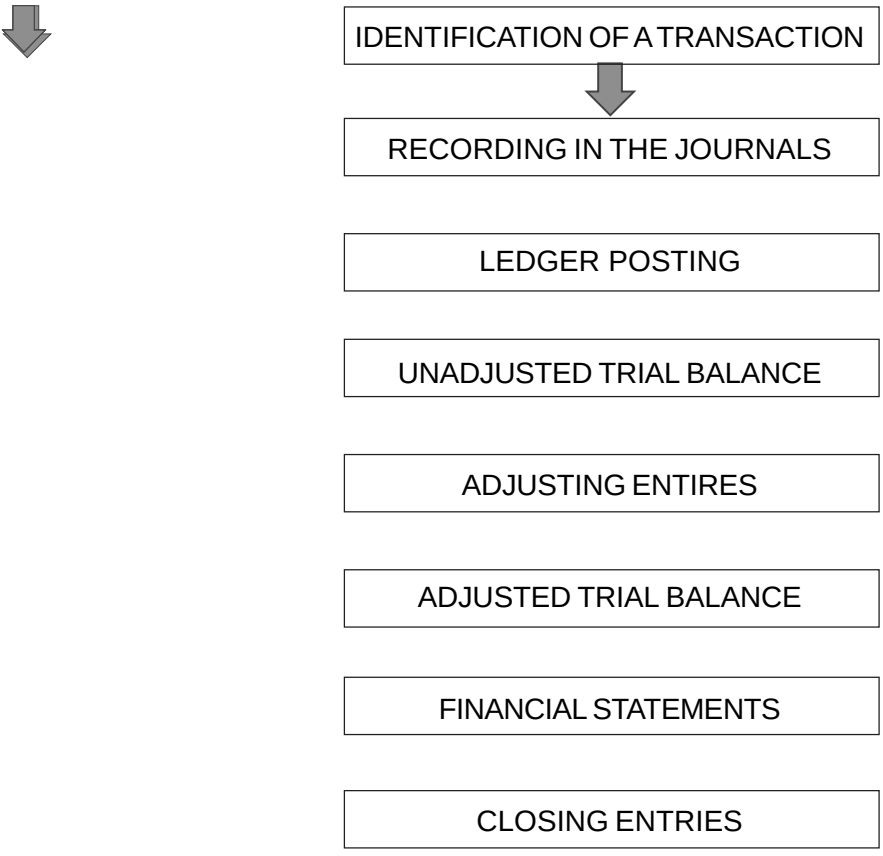


Figure : 1.1 Steps in Accounting process

Identification of the transaction means ascertaining whether a particular transaction is related to the business or not. Only transaction which pertains to the business concern are recorded in the books of accounts. After identification, the transactions are recorded in the journal. From journal, the entries are posted to the ledger. All entries related to a particular nature are classified together in ledger. This is also called classifying. With the help of the balances of the ledger, a trial balance is prepared to test the arithmetical accuracy. After preparing the unadjusted trial balance, adjusting entries are passed. After adjusting entries are made, an adjusted trial balance is prepared before preparing the financial statements. With the help of the adjusted trial balance, financial statements are prepared. The financial statements are considered to be the end products of an accounting system. Thereafter to close the temporary accounts, closing entries are passed.

The steps in the accounting process are discussed below:.

1. **Identification of Transactions:** The very first step in the accounting process is to gather all the documents that are related to financial transactions of the organization. These documents, called source documents, are things like receipts, bank statements, checks, and purchase orders. A business may perform several transactions. Of which, only financial transactions are recorded in accounts. In the first step of the accounting process, therefore, financial transactions are identified. Financial transactions are those which are expressed in monetary terms. They are the items that describe what a transaction was for.
2. **Recording in the Journals:** In the second step of accounting process, all financial transactions performed by the business are systematically recorded in the journal, and subsidiary books. A journal is the book or electronic record that documents all the financial transactions for a company and the accounts that are affected by each transaction. When a journal entry is made, the ‘double-entry’ rule is used. This means that for every one transaction, at least two accounts are affected. There must be a debit and a credit for each transaction, and the total of debits

and credits must equal the amount of the transaction. Journal entries are entered in chronological order, and debits are entered before credits.

3. **Ledger Posting:** The third step in the accounting cycle is to transfer information from the journal to the ledger. A ledger is a book or an electronic record of all the accounts that a company has. These accounts are broken down by account number and class. When the information from the journal is transferred to the ledger, it is transferred to each account that was affected by a transaction.
4. **Unadjusted Trial Balance:** A trial balance is a list of all the company's accounts and their balance at the time the trial balance is prepared. An unadjusted trial balance is a trial balance that is prepared before adjusting entries are made into accounts. This information comes directly from the ledger. The total debit balance and total credit balance must be equal.
5. **Adjusting entries:** Adjusting entries are entries that are made in the journal and posted in the ledger. The purpose of these entries is to bring account balances to the proper amounts. Not all accounts will have an adjusting entry. Adjusting entries are made at the end of the accounting period but not the end of the accounting cycle.
6. **Adjusted Trial Balance:** Remember, the trial balance is a list of all accounts and their balances after adjustments have been made. This trial balance is prepared to check and make sure that debits and credits equal after adjusting entries are made. It is used to prepare the financial statements.
7. **Prepare Financial Statements:** These are prepared in a specific order because information from one financial statement is often used in preparing another financial statement.

1.6 OBJECTIVES OF ACCOUNTING

Different objectives of accounting can be summed up in the following points:

1. **Maintaining Accounting Records:** Accounting maintains systematic record of the business relating to financial transactions, assets and liabilities. In the modern business organisations, due to increase in the

volume of operations, it is always preferred to have written accounting records of the day to day affairs of the business.

2. **Ascertainment of Profit or Loss:** By preparing the income Statement which is also known as Profit and Loss Account, a business firm can calculate the profit earned or loss suffered during a particular period of time. For this, the business expenses are matched with the revenues during a particular accounting period. Thus accounting helps the business firm to find out the result of operations (profit or loss) by maintaining a systematic record of incomes and expenses.
3. **Ascertainment of Financial Position:** With the help of the Balance Sheet which is also known as the Position Statement, accounting evaluates the financial strength and weakness of a business firm. The Balance Sheet comprises of the resources (assets) and the sources of financing those resources. The business may be interested to know what it owns, what are the dues to outsiders and also the position of the capital employed. With the help of systematic records of assets, liabilities and capital a Balance Sheet can be prepared and the financial position of the business can be ascertained.
4. **Communication of Information:** After preparation of necessary books of accounts and the position statement, accounting communicates those information to the appropriate users. The users can make use of the accounting information as per their requirements.

1.7 LIMITATIONS OF ACCOUNTING

The limitations of accounting can be understood in the following points:

1. **Qualitative Assessment not Possible:** Accounting deals with the monetary events only. In the process, many important qualitative matters like efficient management, good public relations, efficient labour force do not find its place in the accounting records.
2. **Influenced by Personal Judgement:** In some cases of accounting records, personal judgement plays an important role. Again, personal judgement may vary person to person. Hence, the profit disclosed by accounting may end up as an approximation only.

3. **Shows Estimated Position:** Accounting does not show the real position. It shows the estimated position only since it is prepared on going concern basis.
4. **Inflation is Ignored:** Inflation is an important factor in the economy. But accounting information ignores the impact of inflation. It is so because of the fact that accounting records are historical in nature.
5. **Risk of Window Dressing:** By entering false figures, the value of assets, liabilities, profits or loss can be increased or decreased. Hence, sometimes the income statement and the balance sheet fail to provide the true and fair view of the business.

CHECK YOUR PROGRESS

Q3: Write any four limitations of Accounting.

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Discuss about Accounting process.

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Q5: Write any two objectives of Accounting.

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1.8 FORMS OF BUSINESS ORGANISATIONS

An Entrepreneur having a viable business plan needs capital. He can choose from various business structures depending on the capital required and the desired level of control in the business as well as the desired flexibility of operation.

Generally, we have four different forms of business organisation:

- Sole proprietorship firm (i.e. a single person is the owner of the business and his liability is unlimited). Unlimited Liability means that the creditors

of the proprietorship firm can take recourse to proprietor's personal estate to recover the amount due from the proprietorship firm.

- Partnership firm (i.e. two or more persons agreeing to share the profits of a business carried on by all or any one of them acting for all) . The liability of partners are unlimited. Unlimited Liability means that the creditors of the partnership firm can take recourse to the partner's personal estate to recover the amount due from the firm. The partners enter into partnership contract which may be written or oral. The partnership contract contains details regarding distribution of profits, capital contribution by each partner, nature of business etc. The partnership firm is governed by the Partnership Act,1932). A Conceptual knowledge of the Partnership Act,1932 is necessary for maintaining accounts of Partnership Business.
- Limited Liability Partnership(LLP) (A LLP is run like a general partnership and has a similar degree of management flexibility. It facilitates partnership among individuals who want to have their liability towards the partnership business as limited. Limited liability means the liability of the partners is limited to the extent of capital contributed to the firm and the partners are not personally liable for the debt of the firm. A Conceptual knowledge of the Partnership Act,1932 as well as LLP Act,2009 is necessary for preparation and presentation of accounts of a LLP.
- Companies in India are primarily governed by the Companies Act, 2013. The term 'company' is used to refer to a limited liability company unless otherwise specified. A company is an artificial person created by law and enjoys limited liability. It is a legal entity distinct from its shareholders or members who are the owners of the company.

Any individual or other entity dealing with the company knows that the liability of the owners (promoters and other shareholders) is limited to their commitment to contribute to the capital of the company.

Directors are elected by shareholders who exercise their voting rights to elect the directors. Under the companies act one share has one vote. A company acts through its Board of Directors (BOD) who delegate

some powers , particularly those related to operating decisions, to the chief executive officer (CEO). A company ceases to exist only when it is liquidated through a legal process. Companies which list their securities in the capital markets are called listed companies or publicly held companies and the listed companies are governed by securities and exchange board of India (SEBI) over and above the companies act,2013. A Conceptual knowledge of the Companies Act,1956/2013 as well as SEBI Act,1992 & SEBI rules & regulations is necessary for preparation and presentation of annual accounts of companies .

1.9 CHOICE OF METHOD OF ACCOUNTING – CASH AND ACCRUAL BASIS OF ACCOUNTING

Accounting may be done either on cash basis or accrual basis.

Cash basis of accounting is a method of accounting where transactions are recorded in the books of account as and when cash is actually received or paid and not when the transactions take place. For example under this method, an income is not considered to be earned until payment is actually received. Similarly, it is not necessary to accrue expenses incurred but not paid within the accounting year. This system of accounting is unscientific and hence inappropriate for most of the businesses. This is the reason why this method is not recognized by GAAPs all over the world. However, this method is used by service providers like doctors, lawyers etc. because of simplicity in accounting.

Accrual basis of accounting is a system in which revenues and expenses are recognized as and when they are earned or incurred, irrespective of date of cash receipt or payment. This method is concerned with the impact of transactions on the net income for an accounting period. This method is universally recognized and is the most scientific way of recording business transactions. All business houses has to maintain their accounts using this method because of its acceptance by government authorities for tax purposes and legal requirements under law governing the business entity.

1.10 COMPUTERIZED ACCOUNTING SYSTEM

Journal, Ledger, and Trial Balance can be prepared based on Computerized Accounting System. The computer software is programmed in such a way that once a voucher (A voucher is a a documentary evidence of a business transaction) is entered in the system journal, ledger and trial balance are automatically generated. The system thus works online and provides the books of account for any given period.

Computerised system has its own procedural features to prepare books of account for any given period.

'Tally' is one of the most widely used computer software in India for accounting through computers. Today, almost every business of a reasonable size uses computer software for accounting because of end number of advantages and no major disadvantages.



1.11 LET US SUM UP

In this unit we have discussed the following:

- Accounting deals with ascertainment of business income and values of assets, liabilities and capital.
- Book-keeping is concerned with the recording of transactions. The work of a book-keeper is considered to be of routine and clerical in nature. On the other hand, accounting is considered to be comprehensive and perspective. Accounting involves classifying, summarizing, presenting and even analyzing the information.
- The accounting process starts with the identification of a transaction up-to the closing of books of accounts. This process from identification of a transaction to closure of the books of accounts is repeated in each of the reporting period and hence, is also called accounting cycle.



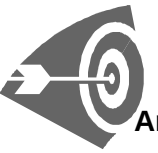
1.12 FURTHER READINGS

1. B. B Dam and H C Gautam, '*Theory and Practice of Financial Accounting*', Capital Publishing Company, Guwahati.
2. Hanif and Mukherjee (2003), '*Financial Accounting*' , Tata McGraw Hill Education.
3. P.C Tulsian (2002) , '*Financial Accounting*', Pearson Education India.

1.13 ANSWERS TO CHECK YOUR PROGRESS

Ans to Q1: Book-keeping is the the science and art of correctly recording in the books of account all those business transactions that result in the transfer of money's worth."

Ans to Q2: 'Accounting' in business is conceived as a system that provides information on the financial condition and the transactions which have led to that status.



Ans to Q3: The limitations of Accounting are :

a. Qualitative Assessment not Possible
b. Influenced by Personal Judgement
c. Shows Estimated Position
d. Inflation is Ignored

Ans to Q4: The steps in the accounting process are :

a. Identification of Transactions
b. Recording in the Journals
c. Ledger Posting
d. Unadjusted Trial Balance
e. Adjusting entries
f. Adjusted Trial Balance
g. Prepare Financial Statements

Ans to Q5: The two objectives of Accounting are:

a. Ascertainment of Profit or Loss
b. Maintaining Accounting Records



1.14 POSSIBLE QUESTIONS

1. Define Accounting. What is the difference between book keeping and Accounting.
2. What do you mean by Accounting process?
3. What are the objectives of Accounting?
4. What are the limitations of Accounting?

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UNIT 2: ACCOUNTING CONCEPTS, PRINCIPLES AND POLICIES

UNIT STRUCTURE

2.1 Learning Objectives

2.2 Introduction

2.3 Components of Financial Statements

2.4 Qualitative characteristics of Financial Statements

2.5 Fundamental Accounting Concepts

2.6 Accounting Principles

- 2.6.1 Meaning of Accounting Principles
- 2.6.2 Features of Accounting Principles
- 2.6.3 Need/ Importance of Accounting Principles

2.7 Accounting Policies

2.8 Generally Accepted Accounting Principles(GAAP)

2.9 Accounting Standards

- 2.9.1 Need for Accounting Standards
- 2.9.2 Development of Accounting Standards at International Level
- 2.9.3 Development of Accounting Standards at International Level

2.10 International Financial Reporting Standards (IFRS)

2.11 Let Us Sum Up

2.12 Further Readings

2.13 Answer to Check your progress

2.14 Model Questions

2.1 LEARNING OBJECTIVES

After going through this unit, you will be able to

- learn the types of accounting concepts,
- discuss the principles, policies and standards
- describe International Financial Reporting Standards

2.2 INTRODUCTION

In the earlier unit, we had discussed the basic concept6s of accounting, its objectives, limitations and the process of accounting. In this unit you will get the idea on the concepts like accounting principles, accounting policies, accounting standards and international Financial Reporting Standards.

In today's dynamic and complex business environment, the financial statements are no longer meant for just the owners of a business, but, they are also needed by investors, lenders, suppliers, customers, government agencies, employees and other such stakeholders. It, therefore, becomes imperative in such a dynamic and complex environment to have a solid conceptual base for financial accounting and preparation and presentation of financial statements.

While preparing and presenting such financial statements certain concepts and conventions, accounting principles and accounting policies are considered.

In fact, the application of accounting standards and the principal qualitative characteristics normally result in financial statements that convey what is generally understood as a true and fair view.

2.3 COMPONENTS OF FINANCIAL STATEMENTS

Financial statements are the most important part of financial reporting. A complete set of financial statements normally comprises:

1. **Balance sheet:** Balance Sheet is a statement of the assets, liabilities, and capital of an organization at one particular point in time. This statement gives an idea as to what the company owns and owes and also the amount of shareholding. The critical components of this statement are as below.

   Assets: *An asset can be tangible or intangible and is often owned or controlled with the belief that it would provide some future benefit and can be tangible or intangible. While the former includes current assets*

and fixed assets, the latter refers to rights and other non physical resources that provide value to the business. Current assets consist of inventory, accounts receivables and other short term investments. Fixed assets could be buildings, equipment and other physical resources. Intangible assets usually include goodwill, copyright, trademarks and patents.

Liabilities: Liabilities are a company's legal debts or obligations that might arise during the course of business operations. These are usually settled over time through the transfer of economic benefits like cash, goods or services. Liabilities include accounts payable, salaries or wages payable, interest due, customer deposits and other such obligations to third parties. Liabilities might be of two types – current or long term. While the former could be liquidated within a year, the latter can be repaid only in the long term (more than a year). Long-term liabilities include long-term bonds issued by the firm, notes payables, leases, pension obligations, and long-term product warranties.

Equity or owner's equity: It is the residual assets of an entity that remain after deducting liabilities. Theoretically, this is the capital available for distribution to shareholders. Hence, from a company's liquidation perspective, equity would be considered the residual claim on the assets of a business, available to shareholders, after liabilities have been paid.

2. **Income statement (or Profit & Loss Account):** This statement is a summary of the financial performance of a business over time. This is usually prepared after every quarter or year. The components in this statement include:

   Revenues: The amount of cash that a company actually receives during a specific period, through the sale of goods or services, is referred to as the company's revenue. This would include discounts and deductions for returned merchandise. Revenues would also include the amount received as a result of using the capital or assets of the business as part of the operations of the business. Revenue is the "top line" or "gross income" of the business.

Expenses: The outflow of money or incurring of liabilities (or a combination of both) through production of goods, rendering services, or carrying out any activity that would form a part of the business's operations, are the expenses of the company. Typical business expenses include wages or salaries, utilities such as rent, depreciation of capital assets, and interest paid on loans. The purchase of an asset such as a building or equipment is not an expense. Expenses also include the Cost of Goods Sold (COGS), which is the cost incurred for selling goods during the period, and includes import duties, freight, handling and other costs for converting inventory to finished goods.

Gains: A company's gain is an increase in equity through peripheral or incidental transactions by a firm, other than those from revenue or investments by owners (shareholders). It refers to any economic benefit that is outside the normal operations of a business. Typically, gains refer to unusual and nonrecurring transactions, such as gain on sale of land, change in a stock's market price or a gift. It is often shown in the P&L statement as non operating income.

Losses: A company's losses are decreases in equity through peripheral or incidental transactions carried out by the firm, other than those from expenses or distributions to owners. This could be loss on sale of an asset, writing down of assets or a loss from lawsuits. It could also include costs that give no benefit. It is often shown in the P&L statement as non-operating expense.

3. **Cash flow statement:** This statement is a summary of the actual or anticipated inflows and outflows of cash in a firm over an accounting period. This could be prepared at the end of a month, quarter or year. The cash flow statement would reflect the liquidity position of the business. This is used as the basis for budgeting and business-planning. The components in this statement include:

   (a) Cash Flow from Operating Activities: Operating activities of a business refer to the production, sales and delivery of the finished product and collection of payment from customers. Cash outflows here could include purchasing raw materials, advertising, and cost of shipping

the product. They might not include payment to suppliers, employees and interest payments. Depreciation and amortization are also included in the cash flow statement. Cash inflows here consist of receipt from sale of goods and services and interest received.

(b) Cash Flow from Investing Activities: These are cash flows related to investments and include purchase of assets, gains or losses through investments in the financial market or in subsidiaries, and other related items.

(c) Cash Flow from Financing Activities: This would account for activities that aid a firm in raising capital and repaying investors. The cash flow might include cash dividends, adding or changing loans or issue of stock. Cash flow from financing activities reveals the company's financial strength. Financing activities that produce positive cash flow include cash from issued stocks and bonds. Financing activities that produce negative cash flow include cash for repurchasing stock, paying off debt or interest or payment of dividend to shareholders.

4. Notes to Accounts and accounting policies and other statements and explanations including information based on or derived from and to be read along with the financial statements.

2.4 QUALITATIVE CHARACTERISTICS OF FINANCIAL STATEMENTS

1. **Relevance:** Financial statements should be relevant to the objectives of the enterprise. This will possible when the person preparing these statements is able to properly utilize the accounting information. The information which is not relevant to the statements should be avoided, otherwise it will be difficult to make a distinction between relevant and irrelevant data.
2. **Materiality:** Financial statements are prepared to help its users in making economic decisions. All such information which can be reasonably expected to affect decisions of the users of financial statements is material and this property of information is called materiality. Materiality is a key concept in accounting because it helps

accountants and auditors in deciding which figures need separate reporting and what is the maximum amount above which errors or omissions should be avoided at all costs.

3. **Understandability:** The information must be readily understandable to users of the financial statements. This means that information must be clearly presented, with additional information supplied in the supporting footnotes as needed to assist in clarification.
4. ***Reliability*:** Reliability with its implications in terms of Faithful representation, Substance over Form, Neutrality, Prudence, Completeness and Comparability. The information must be free of material error and bias, and not misleading. Thus, the information should faithfully represent transactions and other events, reflect the underlying substance of events, and prudently represent estimates and uncertainties through proper disclosure.

2.5 FUNDAMENTAL ACCOUNTING CONCEPTS

Accounting is the language of business. The affairs of a business unit are communicated to others as well as to owners, managers, etc. through accounting information which has to be suitably recorded, classified, summarized and presented. If the language is to be understood by all, it must contain certain concepts which are universally understandable. So, the accountants have agreed upon a number of concepts which they try to follow in accounting. The generally accepted accounting principles and concepts are explained below:

1. **Business Entity Concept:** For accounting purposes, every business enterprise is considered and treated as a separate entity which is distinct from the owner/s and also from another business. This requires that for accounting purpose, a distinction should be made between personal transactions and business transactions and also transaction of one business and another business. This point of view in accounting is called business or accounting entity concept.

2. **Going Concern Concept:** In an ordinary situation, accounting assumes that the business will continue to exist and carry on its activities for an indefinite period of time in the future. It is assumed that the business has neither the intention nor the necessity of liquidation or closing down its activities in the near future. Business purchase and hold assets for use in its operations. The market value of those assets may change over the time. But the accounting records for those assets are not adjusted to reflect the change in the market price of the assets. This is because of the going concern concept. A balance sheet is prepared under the assumption that the business for which it is prepared will continue in operation for long. As a going concern, the assets used in carrying on the operation of the business are not intended to be sold. Therefore, since the assets are held for use in the business and are not intended to be sold, their current market price is not relevant and need not be shown in the books.
3. **Money Measurement Concept:** Only monetary transactions are recorded in the books of accounts. This is the reason why this concept is called the money measurement concept. Under money measurement concept, only those transactions that are capable of being measured or expressed in terms of money are recorded. Expressing all assets and liabilities in terms of money creates a common measure. Hence, any event however important it may be, if it cannot be expressed in terms of money is not recorded in the books of accounts. But at the same time, a small even which can be expressed in monetary terms is recorded in the books of accounts.
4. **Periodicity Concept:** Periodicity concept is also called accounting period concept or time period concept. Though the life of the business is perpetual but still it has to report the results of the activity undertaken in specific period, normally one year. According to this concept, the life of an enterprise is divided into periods for preparing financial statements. This period is normally of one year. Hence, the annual financial reports are prepared on the basis of this concept.

5. **Accrual Concept:** Accounting recognizes non-cash events and circumstances as they occur. Accrual is concerned with the receipts and payments which is expected in the future. This is the process of recognizing assets, liabilities, revenues and expenses which is expected to be received or paid in the future. The examples of such accruals may be purchases and sales of goods or services on credit, interest or rent not yet paid etc. Hence, accounting records all expenses and revenues relating to the concerned accounting period even if the expenses are not paid or the revenues are not received during the accounting period.
6. **Revenue Recognition Concept:** As per this concept, profit should be considered only when it is realized. Profit is deemed to have accrued only when property in goods have transferred to the buyer. According to this concept, revenue is measured by the amount charged for goods sold or services rendered to customers. It state that revenue should be recognized in the period when the sale is made, and specifies that revenues should be measured as the cash received or cash equivalent of other item received. Also, the revenue should be recognized in the period in which the sales is deemed to have occurred.
7. **Matching Concept:** According to this concept, the expenses of a particular period should be matched with the incomes of that period. It means that the expenses should be recognized and matched with the revenues of the same period. It attempts to charge to an accounting period only those expenses which are consumed during the period. So cost can be classified into expired and unexpired. Expired costs are those costs which are applicable to the current accounting period irrespective of paid or not yet paid. Unexpired costs are those costs which have been paid but not yet consumed until a further accounting period. Thus, matching concept recognizes only those costs and revenues which are consumed or earned during the accounting period.
8. **Historical Cost Concept:** Historical cost concept says that an asset should be recorded in the books of accounts at the cost at which it was acquired. So the cost of the asset at the time of acquisition is taken as the amount to be recorded in the books of accounts. The historical

cost or the cost at the time of acquisition is carried forward year after year even if the market price increase or decrease. Use of cost as the basis of recording transaction is reliable, definite and verifiable.

9. **Dual Aspect Concept:** Dual means two. Dual aspect concept means, every transaction must have two aspects in it- Debit and Credit. Every debit must have a corresponding credit. The total amount debited for a transaction must be equal to the total amount credited for the same. This concept resulted in accounting equation which states that at any point of time the assets of any entity must be equal to the total of owner's equity and outsider's liabilities. ach transaction has two aspects. If a business has acquired an asset, it must have resulted in any one of the following:

   (a) Some other asset has been given up; or

   (b) Obligation to pay for it has arisen; or

   (c) There has been a profit, which the business owes to the proprietor; or

   (d) The proprietor has contributed for the acquisition of the asset.

   The reverse is also true. So the equation is—

   Assets = Liabilities + Capital.

   Or

   Capital = Assets – Liabilities.

   The above equation is called the accounting equation which is explained later on.

2.6 ACCOUNTING PRINCIPLES

2.6.1 Meaning of Accounting Principle

Principle means a general law or rule adopted or professed as a guide to action 'a settled ground or a basis of conduct or practice'. The word 'Principle' when applied in accounting may have different meanings in different contexts. It is not used in the sense of a fundamental accounting truth – it connotes a guiding influence or an accepted rule of action or conduct.

Accounting principles have been defined as the body of doctrine, commonly associated with the theory and procedure of accounting, serving as an explanation of current practices and as a guide for the selection of conventions or procedures where alternative exist. In simple words, 'Accounting Principles' may be defined as those rules of conduct or procedure which are adopted by the accountants universally for recording and reporting of financial data.

The following are the accounting principles with a condensed explanation of each.

1. **The Principle of Materiality:** The principle of materiality is basically an exception to the principle of full disclosure. The principle of full disclosure requires that all facts which are necessary to ensure that the financial information are fair, must be disclosed. On the other hand the principle of materiality says that only material events are to be disclosed in the financial statements. This means that items having an insignificant economic impact or not being relevant to the need of the user need not be disclosed. According to this principle, all material or relevant items which can influence the decision of the users of the financial statements should be disclosed. Which information is material and which one is immaterial is a matter of judgement.
2. **Principle of Full Disclosure:** This principle of accounting says that financial statements should convey and not conceal. It should convey all the relevant and reliable information to the users of the accounting information so that the information becomes useful. In order to achieve this, it is important that the information is accounted for and presented in accordance with its substance and economic reality and not merely with its legal form. The disclosure should be full and correct so that the users of the accounting information can make use of the information to have a correct assessment of the performance and position of the enterprise concerned.

3. **Principle of Consistency:** This principle holds that in the accounting process, all concepts, principles and measurement approach should be applied in a similar or consistent way from one period to the next for assuring that the data reported in the financial statements are reasonably comparable over time. That means, the figures should be used on consistent basis for facilitating comparison and for this accounting statements should be prepared on the same basis as that of the preceding period. Consistent use of accounting principles and procedures is necessary in achieving comparability.
4. **Principle of Conservatism or prudence:** "Anticipate no profit but provide for all possible losses" is the idea of this principle. This principle requires that the business transactions should be recorded in a conservative manner which means, profits and assets should not be overstated and the losses and liabilities should also not be understated.
5. **Principle of Objectivity:** The principle of objectivity requires that accounting data should be verifiable and bias-free. That means, accounts which are prepared should be capable of independent verification. Accounting must be carried out on objective and factual basis.

2.6.2 Features of Accounting Principles

The features of Accounting Principles are as follows :

a. Accounting principles are made and developed by men (accountants) and, as such, they do not have the authoritativeness of universal principles, like other natural sciences, viz. Physics, Chemistry, Mathematics etc. It is an empirical science i.e. based on what is experienced or seen.
b. The general acceptance of an accounting principle usually depends on how well it satisfies three criteria: Relevance, Objectivity and Feasibility. The word 'relevant' implies that the information will be useful to the users. The word 'objectivity'

implies that the recorded data are reliable and verifiable. The word 'feasibility' implies that the implementation of the principle in practice will be without much complexity and cost.

c. Accounting principles cannot be validated /proved by reference to natural laws, as in the case of physical sciences. They are the best possible suggestions based on practical experiences, reasons and observations which have been developed by the persons/authorities engaged in the accounting profession over the years.

d. Accounting principles are developed for common usage to ensure uniformity and understandability.

e. Accounting principles are in the process of evolution, i.e., are not in their finished form. On the other hand, they are fast developing.

f. They are not rigid.

2.6.3 Need / Importance of Accounting Principles

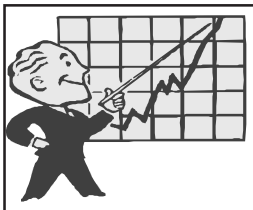
a. Uniformity of Accounting: Accounting is considered as the language of business. Accounting as a language, should be understandable to all, must follow certain principles uniformly all over the world. Therefore, accounting principles bring about the uniformity in accounting practices.

b. Comparability of accounting information: Accounting principles, if consistently followed, will make the accounting information comparable over a number of periods. Therefore, accounting information must satisfy the criteria of comparability so that it can be useful to the users.

c. Reliability of Accounting Information: Financial statements show operational results and financial position for the users. Therefore, this information must be uniform and reliable for any decision making purposes. Accounting principles make the financial statements more reliable and non-biased.

d. Neutrality in Accounts: Financial information is required by different classes of users having conflicting interests. Accounting principle help to maintain neutrality in presenting the financial information and leave little scope for statements becoming biased to a particular class of users.

e. Guidelines to Accountants: Accounting principles provides guidelines to the accountants in preparing and presenting financial statements in different situations. Thus the scope of personal choice is reduced to the minimum.



CHECK YOUR PROGRESS

Q1: Write any four importance of Accounting Principles

a. ……

b. ……

c. ……

d. ……

Q2: Write any four features of Accounting Principles

a. ……

b. ……

c. ……

d. ……

Q3: Define Accounting Principles.

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2.7 ACCOUNTING POLICIES

Every business has to set certain principles, rules and procedures in the accounting process which are implemented in preparation of financial statements. These principles, rules and procedures adopted by the business

are known as accounting policies. Accounting policies may include any method, measurement system or procedures for presenting financial statements. The difference between accounting principles lies in the fact that accounting principles are said to be the rules in accounting and accounting policies are the ways in which a particular business firm adhere to those accounting principles.

As such, accounting policies basically refers to the standards a particular business firm adopts while preparing financial statements. These policies may be related to selection of a particular method of depreciation, recognition of goodwill, inventory valuation and the method of consolidation of financial statements. Accounting policies of two firms may differ but they must conform to the Generally Accepted Accounting Principles (GAAP). Hence, accounting policies are the framework within which a business firm is expected to operate. A business firm may chose the appropriate policy suitable for it keeping itself within the larger framework of GAAP. A firm having specific accounting policies always increases the confidence of the users of its financial statements. The accounting policies should be disclosed in the annual financial statements.

2.8 GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP)

The same accounting event is capable of being recorded on different basis by different accountants and hence comparability of accounting information as reflected in the financial statements of two or more firms become difficult. The need for comparability and uniform accounting policies has led to the evolution of Generally Accepted Accounting Principles (GAAP) i.e. Accounting practices need to follow certain guidelines.

GAAP are rules governing how accounting personnel measure, process, and report financial information. In other words, GAAPs are rules of action or conduct which are adopted by the accountants universally while recording accounting transactions. GAAP do not cover specific accounting situations, but provide broad principles that govern the choice of specific

accounting policies. It must also be understood that as the business environment is getting more and more complex, accounting principles are also evolving to keep pace with the changing environment.

The preparation of financial statements is guided by the Generally Accepted Accounting Principles (GAAPs).GAAP originated in 1929 when the US stock market crashed. Accounting professionals of the United States realized the need to adopt a standardized set of principles of accounting across all companies. The American Institute of Certified Public Accountants (AICPA) was asked to draw up a uniform code of accounting principles to guide accounting professional. The United States thus took the lead in formulating GAAP. The early years of standard setting in the U.K, Australia, Canada and other countries by and large followed the trend set by the American standard-setting bodies to ensure the desired level of uniformity in accounting practice.

The accounting framework in India is very much regulated like in other countries. The regulatory authorities that guide the Indian accounting standards and policies are the Institute of Chartered Accountants of India (ICAI), the Indian Cost Accounting and Works Accountant body (ICWA). These guidelines are aligned with the International Accounting Standard Board (IASB), The American Institute of Certified Public Accountants (AICPA), The Financial Accounting Standard Board (FASB).

While there is no specific definition of what constitutes GAAPs, the accounts and financial statements are said to have been prepared and presented on the basis of Indian GAAP, when they comply with the :

- ✓ Accounting concepts and conventions
- ✓ Applicable accounting standards (IFRS converged IND AS)
- ✓ Requirements of companies act,2013, wherever, applicable
- ✓ Directives of regulatory bodies like SEBI, RBI,IRDA, wherever applicable
- ✓ Requirements of Income Tax Act and Rules made there under.
- ✓ Others rules and regulations applicable from time to time.

An effective formulation of GAAPs assumes great importance in view of their far reaching impact on the quality of earnings and true and fair view of annual accounts of a business house.

2.9 ACCOUNTING STANDARDS

Accounting is the language of business and it communicates the financial performance and position of a business enterprise to various user groups. In the process of development of accounting, the experience of various practicing accountants played an important role. As such, as the language of accounting emerged, the variety of accounting methods used by different organizations also differed. This variation in preparation and presentation of financial statements led to difficulties to the users of those statements. It was, then, felt the necessity of some standardized set of rules and accounting principles to reduce or eliminate the variations. This was how accounting standards were developed.

Hence, an accounting standard is a principle that guides and standardizes accounting practices. These are selected set of accounting policies or broad guidelines to choose the required methods out of alternatives. The setting of accounting standards is a social decision and should have a reasonable degree of flexibility, should consider the changes in economic environment, social needs, legal requirements and technological developments. Accounting standards are principles and norms of standard benchmark treatment of financial accounting, reporting, and disclosure issues which have to be followed to ensure that the financial statements are prepared and presented as per generally accepted accounting standards.

Accounting Standards are written policy documents issued by expert accounting body or by government or its regulatory body covering such aspects as recognition, measurement, presentation, and disclosure of accounting transactions in the financial statements.

The Institute of Chartered Accountants of India (ICAI), with a view to harmonize the diverse accounting policies and practices used by business houses in India started formulating Accounting Standards (AS) by constituting a committee in the year 1977 under it known as Accounting Standard Board (ASB). Accounting standards issued by the ICAI are formulated by ASB after taking into consideration the applicable laws,

customs, usages and more importantly the business environment prevailing in India. Until 1995, there were only 5 accounting standards that were mandatory in India.

2.9.1 Need for Accounting Standards

Basically accounting standards are needed to bring uniformity in accounting practices and presentation of financial statements. The following specific needs are worth mentioning:

1. Comparison between two firms is possible if they prepare their books of accounts following accounting standards.
2. Compliance to accounting standards reduces the variations in preparation and presentation of financial statements.
3. It facilitates better understanding of the financial statements.
4. Accounting standards are regarded as a means to establish collective wisdom and experience irrespective of individual viewpoint of the accountants.

The accounting standards are considered to be mandatory in nature. The application of accounting standards is primarily on the accounts of limited companies. In case of sole proprietorship or a partnership firm, if the books of accounts are required to be audited, then they must follow the accounting standards while preparing the books of accounts.

2.9.2 Development of Accounting Standards at the International level

At the international level, International Accounting Standards Committee (IASC) was formed in the year 1973 for developing International Accounting Standards (IAS). It was represented by professional accounting bodies of various countries including India. IAS were the older set of standards stating how particular type of transactions and other events should be reflected in the financial statements.

Since the year 2001, the International Accounting Standards Board (IASB) took over the responsibility of setting international accounting standards from the IASC. The standards set by the IASB are known as the International Financial Reporting Standards (IFRS). We will have further discussion in IFRS in the later part of this unit.

2.9.3 Development of Accounting Standards at the National level

In India, the accounting standards are issued under the supervision and control of the Accounting Standards Board (ASB). The Accounting Standards Board (ASB) was constituted in the year 1977. The ASB is a committee under the Institute of Chartered Accountants of India (ICAI) consisting of various representatives from government departments, academicians, other professional bodies and industry representatives. The functions/objectives or terms of reference of the Accounting Standards Board (ASB) as stated in the official website of the ICAI are:

- To conceive of and suggest areas in which Accounting Standards need to be developed.
- To formulate Accounting Standards with a view to assisting the Council of the ICAI in evolving and establishing Accounting Standards in India.
- To examine how far the relevant International Accounting Standard/International Financial Reporting Standard can be adapted while formulating the Accounting Standard and to adapt the same.
- To review, at regular intervals, the Accounting Standards from the point of view of acceptance or changed conditions, and, if necessary, revise the same.
- To provide, from time to time, interpretations and guidance on Accounting Standards.
- To carry out such other functions relating to Accounting Standards.

Mandatory Indian Accounting Standards issued by the Accounting Standards Board (ASB): However, presently there are 32 accounting standards issued by the ASB and the auditors have to ensure their compliance by the companies in preparing their accounts and financial statements. The table below provides the list of AS :

Sl. No.	AS No.	Title
1	AS 1	Disclosure of Accounting Policies
2	AS 2	Valuation of Inventories
3	AS 3	Cash flow Statement
4	AS 4	Contingencies and Events Occurring after the Balance Sheet Date
5	AS 5	Net profit or loss for the period, Prior Period Items and Changes in Accounting Policies
6	AS 6	Depreciation Accounting
7	AS 7	Construction Contracts
8	AS 8	Research and Development
9	AS 9	Revenue Recognition
10	AS 10	Accounting for fixed assets
11	AS 11	The effects of changes in Foreign Exchange Rates
12	AS 12	Accounting for Government Grants
13	AS 13	Accounting for Investments
14	AS 14	Accounting for Amalgamations
15	AS 15	Employee Benefits
16	AS 16	Borrowing Costs
17	AS 17	Segment Reporting
18	AS 18	Related Party Disclosures

19	AS 19	Leases
20	AS20	Earnings per share
21	AS 21	Consolidated Financial Statements
22	AS 22	Accounting for taxes on Income
23	AS 23	Accounting for Investments in associates in consolidated Financial Statements
24	AS24	Discontinuing Operations
25	AS25	Interim Financial Reporting
26	AS26	Intangible Assets
27	AS 27	Financial Reporting of Interests in Joint Ventures
28	AS 28	Impairments of assets
29	AS 29	Provisions, Contingent Liabilities and Contingent assets
30	AS30	Financial Instruments: Recognition and Measurements
31	AS31	Financial Instruments: Presentations
32	AS32	Financial Instruments: Disclosures

2.10 INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

Globalization and Liberalization of the economy forced to take efforts towards global harmonization of accounting standards and the accounting bodies across the world started to work on it.

The International Accounting Standard Board (IASB), earlier known as the International Accounting Standards Committee (IASC) was established in 1973 to formulate standards to be followed in the preparation of financial statements, and to promote their worldwide acceptance and observance. At present, accounting bodies in more than 140 countries across the world are members of the IASB.

The standards issued by IASC were known as International Accounting Standards (IAS) and now as International Financial Reporting Standards (IFRS).

US is the most developed economy. It has set the benchmarks for the rest of the world by issuing about 150 statements of Financial accounting standards (FASs) under its board called Financial Accounting Standard Board (FASB). The FASs form part of US GAAP.

Many of the big Indian listed companies translate their Indian GAAP financial statements into US GAAP financial statements or IFRS financial statements, depending upon the company's specific need. Such restatement of financial statements by Indian listed companies as per US GAAP is necessary for an American listing of securities, and as per IFRS for European listing.

As businesses have become more complex and globalized world need comprehensive accounting standards that can be consistently applied globally to facilitate comparability. In tune with the global developments and in pursuance of G-20 commitment given by India the ICAI has prepared IFRS converged 39 Accounting Standards known as IND AS.

The Company's Act,2013 allowed recognition, measurement, presentation and disclosures of financial statements as per IND AS by inserting enabling provisions u/s 133 of the companies act, 2013 and accordingly the Ministry of Corporate Affairs (MCA) notified the companies (INDIAN ACCOUNTING STANDARDS) Rules,2015 along with elaborate 39 IND AS.

The era implementation of IFRS converged IND AS has begun in our country from 1.4.2016 for certain classes of companies i.e. Companies having net worth of Rs. 500 crore or more. Under phase II all listed companies and companies having net worth of 250 crore or more but less than Rs. 500 crore , implementation of IND AS has also begun from 1.4.2017 onwards and Banks, NBFC s, and Insurance companies would be required to comply with IND AS from 1.4.2018 onwards. The IFRS converged Indian Accounting Standards (IND AS) will result in :

- Quantum of disclosures in financial statements will increase multifold.
- It will end up in high quality and transparent Financial Reporting.

The following table provides the list of IND AS issued by the ICAI

Sl. No.	Ind AS No.	Title
1	Ind AS 1	Presentation of financial statements
2	Ind AS 2	Inventories
3	Ind AS 7	Statement of cash flow
4	Ind AS 8	Accounting policies, changes in Accounting estimates and Errors
5	Ind AS 10	Events after the Reporting period
6	Ind AS 11	Construction contracts
7	Ind AS 12	Income Taxes
8	Ind AS 16	Property, Plant and Eqipment
9	Ind AS 17	Leases
10	Ind AS 18	Revenue
11	Ind AS 19	Employee benefits
12	Ind AS 20	Accounting for government Grants and Disclosure of Government Assistance
13	Ind AS 21	The effects of changes in Foreign exchange rates
14	Ind AS 23	Borrowing costs
15	Ind AS 24	Relates party disclosures
16	Ind AS 27	Consolidated and separate Financial statements
17	Ind AS 28	Investments in Associates
18	Ind AS 29	Financial Reporting in hyperinflationary Economies
19	Ind AS 31	Interests in Joint Ventures
20	Ind AS 32	Financial Instruments: Presentation

21	Ind AS 33	Earnings per share
22	Ind AS 34	Interim Financial Reporting
23	Ind AS 36	Impairment of assets
24	Ind AS 37	Provisions, Contingent Liabilities and contingent assets
25	Ind AS 38	Intangible assets
26	Ind AS 39	Financial Instruments : Recognition and Measurement
27	Ind AS 40	Investment Property
28	Ind AS 101	First time Adoption of Indian Accounting Standards
29	Ind AS 102	Share based payment
30	Ind AS 103	Business combinations
31	Ind AS 104	Insuarance contracts
32	Ind AS 105	Non-current Assets Held for Sale and Discontinued Operations
33	Ind AS 106	Exploration for and evaluation of Mineral Resources
34	Ind AS 107	Financial Instruments: Disclosures
35	Ind AS 108	Operating Segments



2.11 LET US SUM UP

In this unit we have discussed the following:

- The fundamental principles and concepts of accounting are called Generally Accepted Accounting Principles (GAAP). The general acceptability of the accounting principles or practices depend upon how well they meet the three criterion of Relevance, Objectivity and Feasibility.
- Accounting policies are the framework within which a business firm is expected to operate.

- An accounting standard is a principle that guides and standardizes accounting practices.
- In India, the accounting standards are issued under the supervision and control of the Accounting Standards Board (ASB).



2.12 FURTHER READINGS

1. B. B Dam and H C Gautam, '*Theory and Practice of Financial Accounting*', Capital Publishing Company, Guwahati.
2. Hanif and Mukherjee (2003), '*Financial Accounting*' , Tata McGraw Hill Education.
3. P.C Tulsian (2002) , '*Financial Accounting*', Pearson Education India.

2.13 ANSWER TO CHECK YOUR PROGRESS

Ans to Q1: The four importance of accounting principles are:

a. Uniformity of Accounting
b. Comparability of accounting information
c. Reliability of Accounting Information
d. Neutrality in Accounts

Ans to Q2: The features of accounting principles are:

a. The general acceptance of an accounting principle usually depends on how well it satisfies three criteria: Relevance, Objectivity and Feasibility.
b. Accounting principles cannot be validated /proved by reference to natural laws
c. Accounting principles are developed for common usage to ensure uniformity and understandability.
d. Accounting principles are made and developed by men (accountants)

Ans to Q3: Accounting Principles is defined as those rules of conduct or procedure which are adopted by the accountants universally for recording and reporting of financial data.



2.14 MODEL QUESTIONS

1. Discuss the various concepts and conventions of accounting.
2. What do you mean by accounting policies?
3. What are accounting standards? How are they set?
4. What is IFRS?

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UNIT 3: DOUBLE ENTRY ACCOUNTING

UNIT STRUCTURE

3.1 Learning Objectives

3.2 Introduction

3.3 Transactions and Events

- 3.3.1 Meaning of Transaction
- 3.3.2 Meaning of Events
- 3.3.3 Difference between Transaction and Events

3.4 Accounting Equation

3.5 Meaning of Double Entry Accounting

3.6 Meaning of Debit and Credit

3.7 Classification of Accounts

- 3.7.1 Classification of Accounts under Traditional Approach
- 3.7.2 Classification of Accounts under Modern Approach

3.8 Golden rules of Accouting

3.9 Accounting Trail/Process/Cycle

3.10 Introduction to the books of Accounts

3.11 Journal

- 3.11.1 Format of Journal
- 3.11.2 Process of Journalizing

3.12 Let Us Sum Up

3.13 Further Reading

3.14 Answer to check your Progress

3.15 Model Questions

3.1 LEARNING OBJECTIVES

After going through this unit, you will be able to

- discuss the meaning of double entry accounting
- learn of traditional approach and modern approach of Accounts
- absorb the concept of accounting equations

3.2 INTRODUCTION

In the earlier unit, we got an idea about the concept of accounting, its scope and functions, the various accounting principles and financial

statement. Business activities usually increase with their growth in size and volume. As they grow it becomes impossible for a businessman to keep in memory all such activities for a long period of time. Hence, the recording of these activities is necessary. If you are a businessman, keeping accurate and organised records is vital to the success of your business. From such records, the businessman can ascertain the amount receivable from various parties, or the amount payable to the suppliers of goods from the records. He can also ascertain the result of the business and the financial position of his business at the end of a given period. Besides, he can use such information as needed to get finance from the banks. From memory it is not possible to do all these unless proper records are maintained. Accounting takes care of all these functions.

In this unit we are going to learn on double entry accounting system. Accounting system is a means for identifying, measuring, recording and storing the financial transactions for communicating accounting information through financial statements. Therefore, the accounting system should be capable of identifying, measuring, recording and storing the economic events and prepare statements to communicate the performance and financial position of the business entity. Accounting system are of following two types:

1. Single Entry System
2. Double Entry System.

The Single Entry System of accounting refers to the system of incomplete and unscientific accounting system which records only one aspect of the transaction.

3.3 TRANSACTIONS AND EVENTS

3.3.1 Meaning of Transaction

As from the earlier units we got n idea that, the main function of an accountant is to record properly the financial transactions of a business concern in the books of accounts and to ascertain its true result at the year end. Thus transaction is the foundation of accounting - the first and formest element of accounting. In a word, it is the life

and blood of Accounting. Hence the accountant must have a fair idea about the term “transaction.”

In ordinary language “transaction” means exchange of something. But in Accounting it is used in a special sense. If the financial position of a business concern changes on the happening of an event which is measurable in terms of money, that event is regarded as a “transaction” in Accounting. A transaction is a type of external event which can be expressed in monetary terms. Transactions bring change in the financial position of a business. Transaction involves transfer of something of value between two or more entities. In a business external transaction means a transaction between the business and a second party, e.g. goods sold to Mr. Das. Transaction may also be internal, e.g. the depreciation charged on furniture.

3.3.2 Meaning of Event

An event is an occurrence, happening, change or incident which may or may not bring any financial changes. Events may also be internal like change in the composition of material for production, threat of labour strike etc. External events involve interaction between the business and the environment in which it works. Examples of external events may be, change in the price of raw material, launch of a new product by the competitor etc.

So we can say that ‘Transactions’ are events that:

- Cause an immediate change in the financial resources or obligations of the business.
- Can be measured objectively in monetary terms.

In business accounting only those events which change the financial position of the business and which call for accounting are recognized as “Events”. In other words, all monetary events are regarded as “business transactions.”

3.3.3 Difference between Events and Transaction

We can differentiate between Events and Transactions in the following way:

- All events are not transactions whereas all transactions are events.
- An event may or may not bring change in the financial position but a transaction must bring change in the financial position.
- Events are used in wider sense whereas transactions are used in comparatively narrower sense.
- All events may not be recorded in the books of accounts, but all transactions must be recorded in the books of accounts.
- Events are not always supported by evidence, but transactions must be supported by evidence.

Sl.No	Transaction	Event
1	All transactions are events.	All events are not transactions.
2	Every transaction must be recorded in the books of accounts; otherwise accurate results cannot be ascertained from the books of accounts.	It is. not necessary that every event will be recorded in the books of accounts.
3	The financial changes caused by transactions is measured in terms of money.	Financial changes caused by events may or may not be measured in terms of money.
4	Transactions are used in a narrow sense.	(4) Events are used in a wider sense.
5	In the case of transaction two parties are must.	It may or may not require two parties for the occurrence of an event.
6	Transfer of goods or service is a must in the occurrence of Transaction.	Transfer of goods or services may or may not occur for an event.
7	The scope of the transaction is limited.	The scope of the event is very wide.
8	Business transactions must be supported by evidence.	Transactions related to events are not always supported by evidence.

3.4 ACCOUNTING EQUATION

Accounting Equation is a statement of equality between the resources and the various sources which finance those resources. It can also be said that an accounting equation is a statement of equality between the debits and credits. Balance sheet of an enterprise shows Assets equal to the total of the liabilities and the owner's equity (capital). This is true because for a business, its economic resources are financed by its creditors or its owners or by both. The equation may be shown in equal form as follows:

Assets = Liabilities + Owner's Equity (Capital)
or, Liabilities = Assets - Owner's Equity (Capital)
or, Owner's Equity (Capital) = Assets - Liabilities

This equation is fundamental since it gives foundation to the double entry system. The accounting equation holds good for all transactions and events and at all periods of time. The double entry rules mean that in recording a transaction at least two changes must be made in the assets, liabilities or owner's equity. Accounting equation depicts the fundamental relationship among the components of the balance sheet. This is the reason why it is also called balance sheet equation.

Let us take the following transactions to understand the concept clearly and prove that the accounting equation is satisfied:

Exercise 3.1

1. Mr. Baruah commenced business with Rs. 40,000.
2. Paid advance rent Rs. 1,000.
3. Purchased goods for cash Rs. 20,000.
4. Purchased goods from Das & Sons on credit for Rs. 15,000.
5. Sold goods for cash Rs. 30,000, costing Rs. 22,000.
6. Paid salary Rs. 1,000.
7. Drawings for personal use Rs. 2,000.
8. Outstanding wages Rs. 200.
9. Received dividend Rs. 700.

Solution:

Transactions	Assets					=	Liabilities			+	Capital
	Cash	+	Goods	+	Adv. Rent	=	Creditors	+	Outs. Wages		
1	+40,000	+	0	+	0	=	0	+	0	+	+40,000
2	-1,000	+	0	+	+1,000	=	0	+	0	+	0
3	-20,000	+	+20,000	+	0	=	0	+	0	+	0
4	0	+	+15,000	+	0	=	+15,000	+	0	+	0
5	+30,000	+	-22,000	+	0	=	0	+	0	+	+8,000
6	-1,000	+	0	+	0	=	0	+	0	+	-1,000
7	-2,000	+	0	+	0	=	0	+	0	+	-2,000
8	0	+	0	+	0	=	0	+	+200	+	-200
9	+700	+	0	+	0	=	0	+	0	+	+700
Ending Equation	46,700	+	13,000	+	1,000	=	15,000	+	200	+	45,500

3.5 MEANING OF DOUBLE ENTRY ACCOUNTING

Double entry system of accounting is a system where dual aspect of a transaction are recorded. It is a system of recording business transactions which says that each and every transactions has dual or two aspects. The dual or two aspects that is referred here are the debit and credit aspects. The double entry rules states that when recording each transaction the total amount of the debit entries must be equal to the total amount of the credit entries for that transaction. The golden rule for double entry is that every debit should have a credit and every credit should have a debit. A double entry has to be used to transfer an amount from one account to another. The double entry system use the left-hand side of an account for debits and the right-hand side of the account for credit. Account is used to accumulate and store the accounting information. It is a feature of the double entry system that each transaction is posted twice and on the opposite sides of different accounts, reflecting different aspects of each transactions.

Features of Double Entry System:

1. Double entry system record twofold aspects of a transaction.
2. Equal debit and credit entries are made in two different accounts.
3. Full record of all transactions are made under this system.
4. Trial balance can be prepared to check the arithmetical accuracy.
5. Profit and Loss account can be found by classifying all expenses and revenues.
6. Financial position can be ascertained by preparing balance sheet.

Advantage or Importance of Double Entry System:

The double entry system has the following advantages or importance:

1. Double entry system helps to keep record of both personal as well as impersonal monetary transactions of the business. Hence, it helps in recording the transactions relating to debtors, creditors, assets, liabilities, expenses, losses, incomes and gains.
2. It helps to know the exact amount of trade debtors and creditors.
3. This system helps to determine the value of closing stock and also the purchases and sales value.
4. Trial balance cane be prepared under this system. A trial balance helps in checking the arithmetical accuracy and errors if found can be rectified.
5. Double entry system not only helps to prevent and discover errors but also to prevent and discover frauds and manipulations.
6. With the help of income statement, profit made or loss suffered can be calculated.
7. With the help of balance sheet, the financial position of the business concerned can be known.
8. Double entry system helps the management and the owners of the business to take important business decisions.
9. This system can be applied to any form of organization.
10. Under double entry system, the private transactions of the owner/s of the business do not get mixed up with the business transactions.

3.6 MEANING OF DEBIT AND CREDIT

Under the double-entry system every business transaction is recorded in at least two accounts. One account will receive a “debit” entry, meaning the amount will be entered on the left-hand side of that account.

Another account will receive a "credit" entry, meaning the amount will be entered on the right-hand side of that account. The initial challenge with double-entry is to know which account should be debited and which account should be credited. Debit and credit means simply an addition to an account or a subtraction from an account.

Debit increases Assets and Expenses or Losses while it decreases Liabilities, Income or Revenue and Capital. On the other hand Credit increases Liabilities, Income or Revenue and Capital while it decrease Assets and Expenses or Losses.

Hence, from the above discussion it can be understood that debit and credit change their role account to account. In one account, it may lead to increase whereas in another account, it may result in decrease.

CHECK YOUR PROGRESS

Q1: What is meant by "double Entry System " of accounting?

……

……



Define Transaction.

……

……

Q3: Define Event.

……

……

3.7 CLASSIFICATION OF ACCOUNTS

For the purpose of recording and ascertaining the two-fold effects, classification of accounts (account head) are necessary. There are two approaches for classification of accounts. They are:

A. English Approach or Traditional Approach; and

B. American Approach or Modern Approach.

3.7.1 Classification of Accounts under Traditional Approach

Under traditional approach, accounts are classified in the following way:

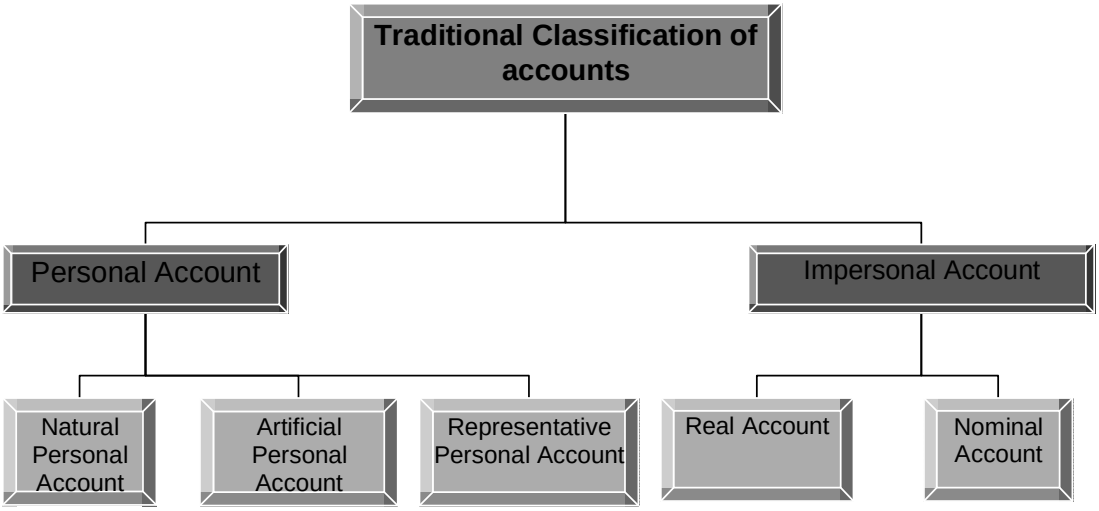


Figure 3.1: Classification of Acccounts Under Traditional Approach

The above chart describes the classification of accounts under traditional approach. Under traditional approach, accounts are basically of two types: Personal and Impersonal. Impersonal accounts are further sub-divided into two parts, i.e. Real and Nominal.

Classification of accounts discussed below:

1. **Personal Accounts:** Personal accounts record transactions relating to individuals or firms or companies. It includes natural persons and human beings, artificial persons like limited companies, bank, firm, institution, club etc. An account which represents a person such as 'Wages outstanding' or 'Insurance prepaid' etc. also comes under the personal accounts. The rule for debit and credit in personal accounts is: *DEBIT* the account of the person who receives something and *CREDIT* the account of the person who gives something. The following are the element or account which represents person or organizations.
   a. **Accounts of Natural persons:** Account heads recording the transactions of individual human beings fall into the category of natural persons. For example, accounts of Ram, Jadu, Suresh, Jayanta, Raja etc.

b. Accounts of Artificial persons: Accounts recording the transactions concerning a firm, company, institution, association, organization etc. fall into this category. For example, Gauhati Commerce College A/c, J.B. College A/c, M/s. Baruah Brothers A/c, Assam Tea Company A/c, N.F. Railway A/c.

c. Representative Personal Accounts: These are the accounts which represent a certain person or a group of persons although the names of the concerned person or persons are not mentioned in the account head. Such type of account head occurs in cases of outstanding expenses, prepaid expenses, income receivable and income received in advance. For example Wages outstanding. For example; Outstanding Salary, Salary Repaid, Unexpired Insurance or Insurance paid in Advance, Commission Received in Advance etc.

2. Impersonal Accounts: All those accounts which are not personal accounts. This is further divided into two type's viz. real and nominal accounts.

a. Real Accounts: Real accounts are the accounts of assets and properties. The accounts recording transactions relating to tangible assets which can be touched, purchased or sold such as goods, cash, building, machinery etc. are tangible real accounts. On the other hand, transactions recording intangible assets such as goodwill, copy rights, patents etc. are classified as intangible real accounts. The rules for debit and credit in real accounts is: DEBIT the account of the asset which comes into the business or added to the existing value of the asset and CREDIT the account which goes out of the business or reduce the existing value of the asset. The 'account heads' recording transactions relating to tangible things (which can be seen, touched or physically exchanged such as goods, cash, land, building, machinery,

etc. are classified as real accounts). There are some intangible items which do not have a physical shape and which cannot be seen or touched but the presence can be felt and can be bought and sold. For example; goodwill, patents, trademarks, copyrights, etc. They also fall within the category of real accounts.

b. **Nominal Accounts:** Nominal accounts record transactions relating to the losses, gains, expenses and incomes. Examples of nominal accounts are wages, salaries, rent, commission, interest etc.The rules for debit and credit in nominal accounts is: DEBIT the accounts of expenses and losses and CREDIT the accounts of incomes and gains.

Rules of Debit and Credit on the basis of Account

Account	Debit	Credit
Personal Account	The Receiver	The Giver
Real Account	What comes in	What goes out
Nominal Account	Expenses and losses	Incomes and gains

3.7.2 Classification of Accounts under Modern Approach

Under modern approach the accounts are classified into five categories. The rules of debit and credit also depend on the nature of the transaction. Accounts are classified into the following categories under the modern approach:

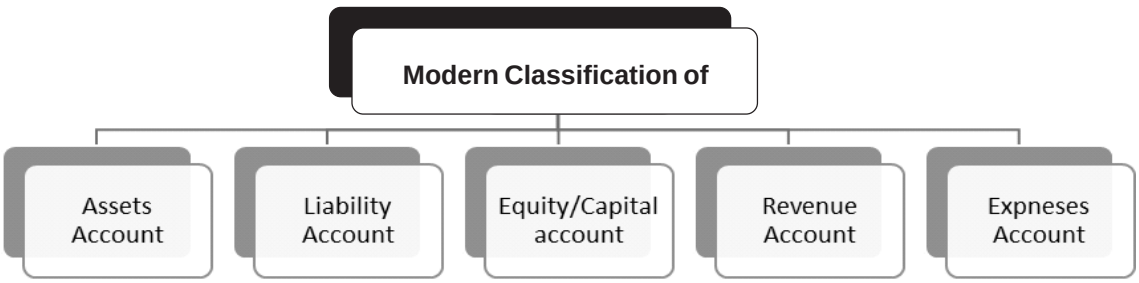


Figure 3.2: Classification of Accounts under Modern Approach

Under the modern approach, accounts are classified into five categories, namely: Assets Account, Liabilities Account, Capital Account, Revenue Account and Expense Account.

a. **Assets Account:** These accounts are the accounts of assets or properties such as building, machinery, patent, investments, cash, inventory etc. held by an entity. This category also includes the accounts of debtors
b. **Liabilities Account:** Liabilities accounts are the accounts pertaining to the liabilities of the entity to lenders, creditors for goods, creditors for assets, creditors for expenses, etc.
c. **Capital Account:** Capital is the amount with which the business is started. It is the account of the owner who invests money in the business as capital.
d. **Revenue Account:** Revenue Accounts are the accounts of incomes and gains. For example, sales, discount received, interest received, Commission received etc. These accounts are taken into account for preparation of Trading & Profit and Loss Account.
e. **Expense Account:** Expense Accounts are the accounts of expenses incurred and losses suffered by an entity. For examples; purchases, wages paid, depreciation, rent paid, rates and taxes, etc. like Revenue Account, expense accounts are also taken into account for preparation of Trading & Profit and Loss Account.

However, in case of sole proprietorship/ partnership form of business, another account called 'Drawings Account' is also maintained in order to record the transactions relating to withdrawals of cash or goods made by the proprietor / partners for their personal use.

3.8 GOLDEN RULES OF ACCOUNTING

The rules of debit and credit under English Approach or Traditional Approach are termed as 'Golden Rules of Debit and Credit'. These rules are as under:

A. English Approach or Traditional Approach:

The rules for debit and credit under the modern approach is given in the following chart:

Sl. No	Name of the account	Debit Aspect	Credit Aspect
1	Personal	The receiver of benefit	The giver of benefit
2	Real	What comes in	What goes out
3	Nominal	All Expenses and Loses	All income and gains

B. American Approach or Modern Approach:

The rules for debit and credit under the modern approach are given in the following chart:

Types of Account	Debit	Credit
Assets Account	When Increases	When Decreases
Liabilities Account	When Decreases	When Increases
Capital Account	When Decreases	When Increases
Revenue Account	When Decreases	When Increases
Expense Account	When Increases	When Decreases

3.9 ACCOUNTING TRAIL/PROCESS/CYCLE

The sequence of accounting procedures used to record, classify, and summarize accounting information is often termed as the accounting trail or accounting process or accounting cycle. The accounting cycle begins with the initial recording of the business transactions and concludes with the preparation of set of formal financial statements which summarizes the effects of financial transactions upon the assets, liabilities and owner's equity of the business. The accounting cycle or process or trail includes:

- Identification of Business Transaction.
- Documentation and preparation of vouchers supporting evidence.
- Recording the transactions in the book of original entry, i.e., journal and subsidiary books.
- Posting into ledger accounts.
- Preparation of trial balance.

- Passing necessary adjustment entries
- Preparation of adjusted trial balance, and
- Preparation of final accounts.
- Passing closing entries

The accounting trail/ process or cycle is shown in the following diagram:

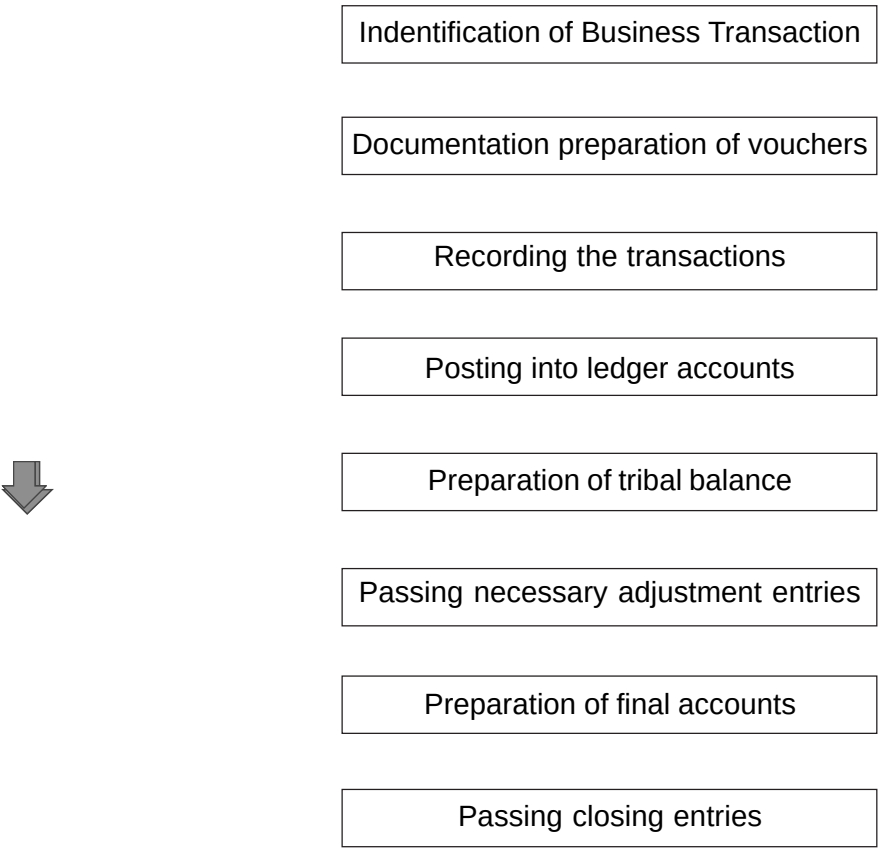


Figure 3.3: Process of Accouting.

3.10 INTRODUCTION TO THE BOOKS OF ACCOUNTS

Recording of transaction is a process of entering the transactions in the proper books of accounts in a systematic manner. It means putting into black and white the transactions that take place in course of business activities. Normally transactions are first recorded in a book of original entry, called Journal.

Books of accounts are specially printed and ruled books where the accounts of a firm are kept or written up. The two main books of accounts of a business entity are Journal and Ledger.

Different classes of books of accounts:

There are two different classes of books of accounts which are maintained by a business entity. They are:

(a) Books of original entry or Primary book (Journal); and

(b) Principal book or book of Final entry (Ledger).

3.11 JOURNAL

Books of original entry means the books of accounts where the transactions are recorded as and when they take place. The first book of original entry is called 'Journal'.

Journal is a book of original entry in which transactions are originally recorded in chronological order (in order of date) from source documents showing the accounts to be debited and credited in a systematic manner. Thus, the Journal provides a date-wise record of all the transactions with details of the accounts and amounts debited and credited for each transaction with a short explanation.

The word 'Journal' has been derived from the French word **'JOUR'** means daily records. Journal is a book of primary entry for daily records.

3.11.1 Format of Journal

The following is the format of journal:

Format of Journal

Date	Particulars	L.F	Amount	
			Debit Rs.	Credit Rs.
(i)	(ii)	(iii)	(iv)	(iv)

The format of journal is sub-divided into five columns. These five columns are (i) Date, (ii) Particulars, (iii) Ledger Folio (L/F), (iv) Amount (Debit) and (Credit). In these columns following information is recorded:

(i) Date: In this column, the date of the transaction with its month and year is recorded. The year is not repeated against every entry because the year is almost the same. The sequence of the dates and months should be strictly maintained i.e., transaction taking place on January 2, 2005 and so on will be recorded. For example, transactions took place in a business on 3rd January 2005, 10th January 2005, 5th February 2005, and 9th February 2005.

The date of the above transactions will be recorded as under:

Date
2005
Jan. 3
" 10
Feb. 5
" 9

(ii) Particulars: In this column, both the debit aspect and credit aspect of each transaction is recorded. The name of account to be debited followed by the word 'Dr.' against that account is written in the first line. In the second line, the account to be credited is written. However, the word 'Cr.' Is not written against this account. In the next line, an explanation to the

entry called 'narration' is given to explain the transaction. For example, Machinery has been purchased in cash. This transaction will be recorded in the particulars column of the journal as under:

Date	Particulars	L.F	Amount	
			Debit Rs.	Credit Rs.
(i)	(ii) Machinery A/c Dr. To Cash A/c (Being Machinery purchased)	(iii)	(iv)	

(iii) Ledger Folio (L.F.): Journal is the original record of the business transactions. All entries from the journal are posted in the ledger accounts. The page number and folio number of the ledger account where the posting has been made from the journal is recorded in the L.F. column of the Journal. For example, if posting is made in Machinery Account appearing at page number 15 of the ledger and Cash A/c appearing at Page 6 of the ledger, 15 will be entered in the L.F. column in the journal against Machinery A/c and 6 will be entered against Cash A/c in the ledger folio column in the journal.

(iv) Amount (Debit) and (Credit) : Every transaction has got debit and its corresponding credit for the same amount. The amount of the account debited is written at the debit column of the amount column and the amount of the account credited is written at the credit column meant for writing the amount.

(v) Narration: After every journal entry, a brief explanation of the transaction for which the entry has been passed is given. It

enables the persons going through the journal entry to have an idea about the transaction. This explanation is known as 'narration'. Narration is preceded by the words 'Being' / 'For'. After the narration, a horizontal line is drawn in the particulars column only to separate one journal entry from the other.

3.11.2 Process of Journalizing

The process of journalizing means the steps to be followed for ascertaining the account heads to be debited / credited for a particular transaction. There are three steps involved in the process of journalizing a transaction.

Step 1: Identification of accounts or 'account heads' affected by the transaction.

Step 2: Classification of accounts or account heads.

Step 3: Application of Rules for Debit and Credit.

A. Types of Journal entries:



Entries recorded in the journal may be of two types:

a) Simple Journal Entry; and

b) Compound Journal Entry.

a) Simple Journal Entry: When a transaction affects only one aspect/ account in the debit and on aspect / account in the credit, it is known as Simple Journal Entry.

b) Compound Journal Entry: When a transaction affects more than two accounts at a time – one or more accounts being debited/ one or more accounts being credited, such entry is known as Compound Journal Entry.

Exercise: 3.1

Journalize the following transactions in the books of Mr. A. Bora.

2017		Amount (Rs)
April		
2	Took a Bank Loan at 10% interest	20,000

20	Advanced a Loan at 12% to Madhu	10,000
21	Goods distributed as charity	300
22	Goods distributed as free samples	500
23	Loss of cash by theft	1800
25	Loss of goods by theft	2000
28	Loss of goods by fire	7000

Solution: **Journal**

In the books of Mr A. Bora Journal

Date	Particulars	L.F.	Debit (Rs.)	Credit (Rs.)
2017 Aug. 2	To Cash A/C Dr. To 10% Bank Loan A/c (Being Bank Loan taken at 10% interest p.a.)		20,000	20,000
April 20	12% Loan to MadhuA/c Dr. To Cash A/c (Being loan advanced to Madhu at 12% Interest p.a.)		10,000	10,000
April 21	Charity A/c Dr. To Purchase A/c (Being goods distributed as charity)		300	300
April 22	Free Samples/Advertise A/c Dr. To purchase A/c (being goods distributed as free samples)		500	500
April 23	Loss by Theft A/c Dr. To cash A/c (being the loss of cash be theft)		1,800	1,800

April 25	Loss by Theft A/c Dr. To Purchases A/c (being the loss of goods by fire)		2,000	2,000
April 28	Loss by Fire A/c Dr. To Purchases A/c (Being the loss of goods by fire)		7,000	7,000

Explanation:

1. **Apr. 2:** The two account heads involved are 'Cash A/c' and '10% Bank loan A/c.' is an asset account. Cash A/c is to be debited as the asset increases. '10% Bank A/c' is a liability A/c. '10% Bank Loan A/c' is to be credited as the liability increase.
2. **Apr.20:** The two account heads involved are '12% Loan to Madhu A/c' and 'Cash A/c'. 12% Loan to Madhu A/c is an asset account. 12% loan to Madhu is a loan or advance given by the business to Madhu and it will be receivable in future from Madhu. Such advance is treated as an asset. Therefore, it is to be debited as the asset increases. Cash A/c is an asset account. Cash A/c is to be credited as the asset decreases.
3. **Apr.21:** The two account heads involved are 'Charity' A/c and 'Purchase A/c' Charity A/c is an expense Account. Charity A/c is to be debited as the expense increases.
4. **Apr.22:** The two account heads involved are 'Free Sample A/c' or 'Advertisement A/c' and 'Purchases A/c'

   Free Sample/Advertisement is an expense account. It is to be debited as the expense increases. Purchase A/c is an expense account. Purchase A/c is to be credited as the expense decreases.

5. **Apr.23:** The two account heads involved are 'Loss by theft A/c' and 'Cash A/c'. Loss by Theft A/c is an expense account. It is to be debited as the expense increases. Cash A/c is an asset account. So it is to be credited as the asset decreases.
6. **Apr.25:** The two account heads involved are 'Loss by Theft A/c' and 'Purchases A/c'. Loss by Theft A/c is an expense account. It is to be debited as the expense increases. Purchase A/c is an expense A/c. so it is to be credited as the expense decreases.
7. **Apr.28:** The two account heads involved are 'Loss by Fire A/c' and 'Purchase A/c'.

   Loss by Fire A/c is an expense A/c. So, it is to be debited as the expense increases. Purchases A/c is an expense A/c. So it is to be credited as the expense decreases.



Exercise: 3.2

Journalize the following transatcions for the month of Dec. 2016. Also stse the nature of each account invoved in the journal entry.

Dec 1: Ajay Started business with Cash 40,000.

Dec 3: He paid into the Bank 2000.

Dec 5: He purchased goods for cash 15,000.

Dec 8: He sold goods for Cash 6,000

Dec10: He purchased furniture and paid by cheque 5,000

Dec 12: He sold goods to Arvind 4000

Dec 14: He purchased goods from Rahul 10,000

Dec 15: He returned goods to Rahul 5000

Dec 16: He recevied from Arvind 3960 in full settlement.

Dec 18: He withdrew goods for personal use Rs 1000

Dec 20: He withdrew cash from business for personal use Rs. 2000.

Dec 24: He paid telephone charges Rs 1000

Dec 26: Cash paid to Rahul in full settlement Rs 4900

Dec 31: Paid for stationary Rs 200 , rent Rs 500 and salaries Rs 2000

Dec 31: Goods distributed by way of free samples Rs 1000

Solution:

In the books of ..... Journal

Date	Particulars	L.F.	Debit (Rs.)	Credit (Rs.)
Dec 1	Cash A/C Dr. To Capital A/c (*Being Comencement of the business)*		40000	40000
Dec 3	Bank A/C Dr. To Cash A/c (*Being Cash deposited in the bank)*		2000	2000
Dec 5	Purchases A/C Dr. To Capital A/c (*Being purchase of goods for cash)*		15000	15000
Dec 8	Cash A/c Dr. To Sales A/c (*Being goods sold for cash)*		6000	6000
Dec 10	Furniture A/c Dr. To Bank A/c (*Being purchase of furnirure, paid by cheque)*		5000	5000
Dec 12	Arvind Dr To Sales A/c (*Being sale of goods)*		4000	4000
Dec 14	Purchases A/c Dr To Rahul		10000	10000

	(*Being purchase of goods From Rahul)*			
Dec 15	Rahul Dr. To Purchases Returns A/c (*Being goods returned to Rahul)*		5000	 5000
Dec 16	Cash A/c Dr. Discount A/c To Arvind (*Being cash received from Arvind in full settlement and allowed him Rs 40 as discount)*		3960 40	 4000
Dec 18	Drawings A/c Dr. To Purchases (*Being withdrawal of goods for personal use)*		1000	 1000
Dec 20	Drawings A/c Dr. To Cash A/c (*Being cash withdrawal from the business for personal use)*		2000	
Dec 24	Telphone Expenses A/c To Cash A/c (*Being Telephone expenses paid)*		Dr.	1000 1000
Dec 26	Rahul Dr. To Cash A/c To Discount A/c (*Being cash paid to Rahul and he allowed Rs 100 as discount)*		5000	 4900 100
Dec 31	Stationary Expenses Dr. Rent A/c Dr. Salaries A/c Dr. To Cash A/c (*Being expenses paid)*		200 500 2000	 2700

Dec 31	Advertisement Expenses A/c Dr. To Purchases A/c (*Being distribution of goods by way of free samples)*		1000	1000



Exercise: 3.3

Pass journal entries for the following transactions in the books of 'Rajiv Trading Company (Proprietor: Sri Rajiv)': 2016

April 1 Rajiv started business with Rs. 10,00,000 in cash in the name of Rajiv Trading Concern.

April 2 Opened a bank account with Rs. 9,00,000.

April 5 Purchased furniture worth Rs. 20,000 and paid through cheque.

April 6 Bought goods in cash Rs. 50,000 and on credit from Shyam Rs. 5,00,000.

April 10 Sold goods in cash Rs. 2,00,000

April 14 Sold goods to Mukesh worth Rs. 4,00,000.

April 20 Purchased goods for Rs. 6,00,000 and paid through cheque

April 25 Paid wages in cash Rs. 500

April 26 Sold goods Rs. 8,00,000 and payment received through cheque

April 30 Paid salary Rs. 5,000 and rent Rs. 8,000 in cash.

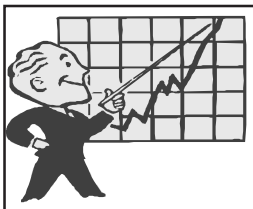
Solution:

In the books of Rajiv Trading Concern

Journal Entries

Date	Particulars	L.F.	Debit (Rs.)	Credit (Rs.)
2016 01/04	Cash A/c Dr. To Proprietor's Capital A/c (Being starting of business by Rajiv with cash)		10,00,000	10,00,000

02/04	Bank A/c Dr. To Cash A/c (Being bank account opened with cash)		9,00,000	9,00,000
05/04	Furniture A/c Dr. To Bank A/c (Being furniture purchased and paid through cheque)		20,000	20,000
06/04	Purchase A/c Dr. To Cash A/c To Shyam A/c (Being goods purchased in cash and from Shyam on credit)		5,50,000	50,000 5,00,000
10/04	Cash A/c Dr. To Sales A/c (Being cash sales)		2,00,000	2,00,000
14/04	Mukesh A/c Dr. To Sales A/c (Being goods sold to Mukesh on Credit)		4,00,000	4,00,000
20/04	Purchase A/c Dr. To BankA/c (Being goods purchased and payment made through cheque)		6,00,000	6,00,000
25/04	Wages A/c Dr. To Cash A/c (Being wages paid)		500	500
26/04	Bank A/c Dr. To Sales A/c (Being goods sold and payment received through cheque)		8,00,000	8,00,000
30/04	Salary A/c Dr. Rent A/c To Cash A/c (Being salary and wages paid)		5,000 8,000	13,000



CHECK YOUR PROGRESS

Q4: What are the approaches of classification of Accounts

.....

.....

Q5: What is Personal Accounts?

.....

.....

Q6: Discuss the Accounting Cycle or the Process.

.....

.....



3.12 LET US SUM UP

- Accounting system should be capable of identifying, measuring, recording and storing the economic events and prepare statements to communicate the performance and financial position of the business entity.
- All events are not transactions whereas all transactions are events.
- Accounting Equation is a statement of equality between the resources and the various sources which finance those resources. It can also be said that an accounting equation is a statement of equality between the debits and credits.
- Debit and Credit change their role account to account. In one account, it may lead to increase whereas in another account, it may result in decrease.
- The sequence of accounting procedures used to record, classify, and summarize accounting information is often termed as the accounting trail or accounting process or accounting cycle.



3.13 FURTHER READINGS

1. B. B Dam and H C Gautam, '*Theory and Practice of Financial Accounting*', Capital Publishing Company, Guwahati.
2. Hanif and Mukherjee (2003), '*Financial Accounting*' , Tata McGraw Hill Education.

3. P.C Tulsian (2002) , '*Financial Accounting*', Pearson Education India.

3.14 ANSWERS TO CHECK YOUR PROGRESS

Ans to Q1: Double entry system of accounting is a system where dual aspect of a transaction are recorded. It is a system of recording business transactions which says that each and every transactions has dual or two aspects.

Ans to Q2: "Transaction" means exchange of something. A transaction is a type of external event which can be expressed in monetary terms.

Ans to Q3: An event is an occurrence, happening, change or incident which may or may not bring any financial changes.

Ans to Q4: There are two approaches of classification of accounts : i) Traditional Approach ii) Modern Approach.

Ans to Q5: Personal accounts record transactions relating to individuals or firms or companies. It includes natural persons and human beings, artificial persons like limited companies, bank, firm, institution, club etc.

Ans to Q6: The accounting cycle or process or trail includes:

- Identification of Business Transaction.
- Documentation and preparation of vouchers supporting evidence.
- Recording the transactions in the book of original entry, i.e., journal and subsidiary books.
- Posting into ledger accounts.
- Preparation of trial balance.



3.15 MODEL QUESTIONS

1. What do you mean by transactions and events?
2. What is double entry system?
3. What do you mean by accounting equation?
4. What are the various types of accounts?
5. How are accounts classified under modern approach?

****

UNIT 4: LEDGER

UNIT STRUCTURE

4.1 Learning Objectives

4.2 Introduction

4.3 Concept of Ledger

- 4.3.1 Meaning of Ledger
- 4.3.2 Need and Subdivision of Ledger
- 4.3.3 Format of a Ledger Account
- 4.3.4 Distinction between Journal and Ledger

4.4 Ledger Posting.

- 4.4.1 Meaning of Posting
- 4.4.2 Procedure for Balancing of an Account

4.5 Let Us Sum up

4.6 Further Reading

4.7 Answers To Check Your Progress

4.8 Model Questions

4.1 LEARNING OBJECTIVES

After going through this unit, you will be able to :

- learn then concept ledger
- understand the format of ledger account
- discuss the difference between Journal and Ledger
- describe ledger posting and the procedure for balancing an account

4.2 INTRODUCTION

In the earlier unit, we had discussed the concepts like double entry system, journal, format journal and process journalizing. Now, in this unit we are going to learn the concept of and formatting a ledger account. Again, we will get a fair idea on the difference between journal and ledger.

At the end of this unit you will be able to discuss procedure for balancing an account

4.3 CONCEPT OF LEDGER

4.3.1 Meaning of ledger

According to V.G. Vickery, “Ledger is a book of account which contains in a suitably classified form, the final and permanent record of trader’s transactions”. It is essentially a collection of five types of accounts – Assets, Liabilities, Capital, Revenue and Expenses.

According to William Pickles – “A Ledger is a most important book of account and is the destination of the entries made in the subsidiary books.”

Thus, Ledger is a book which contains records of all transactions permanently in a summarized and classified form. It is the book of final entry and is the principal book of accounts.

4.3.2 Need and Sub division of ledger

A. Need for Ledger:

A Journal fails to give complete information regarding an account at a glance at a particular point of time because of the scattered entries of the transactions in different pages. This defect gives birth to ledger. The ledger brings together these dispersed entries regarding an account from the Journal to a place in a condensed and summarized form and gives a complete picture including its final position at a glance. The necessity of obtaining summarized and condensed information in respect of each class of transactions at a particular point in the need of a ledger. All information regarding any account which is available from Ledger is called the king of all books.

B. Sub Division of Ledger:

Ledger can be primarily subdivided into two:

(i) Personal Ledger; and

(ii) General Ledger.

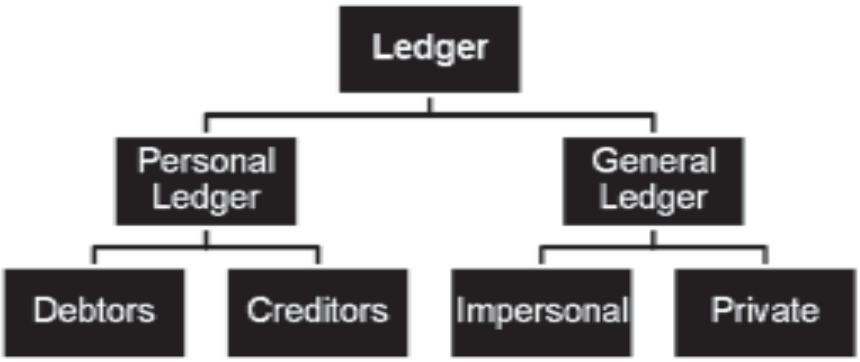


Figure : 4.1 Division of Ledger

(i) Personal Ledger: The Ledger which contains the accounts of persons or organizations is called Personal Ledger. These Accounts are relating to persons or organizations whom goods are bought or to whom goods are sold on credit. The Personal Ledger is again subdivided into (a) Debtors Ledger and (b) Creditors Ledger.

(a) Debtors Ledger: It contains the accounts of debtors to whom goods are sold on credit. It is also called Sales or Sold Ledger. The name "Debtors Ledger" is more appropriate than Sales or Sold Ledger as it contains Debtors' Accounts and not the Sales Accounts.

(b) Creditors Ledger: It contains the accounts of creditors from whom goods are bought on credit. It is also called Purchases or Bought Ledger. The name "Creditors Ledger" is more appropriate as it contains the Creditors' Accounts, Purchases Account.

(ii) General Ledger: The general ledger, sometimes known as the nominal ledger, is the main accounting record of a business which uses double-entry bookkeeping. It will usually include accounts for such items as current assets, fixed assets, liabilities, revenue and expense items, gains and losses.

General ledger may be subdivided into:-

(a) Impersonal Ledger: Impersonal Ledger contains the accounts relating to Assets, Expenses, Incomes, Cash Book and Petty Cash Book.

(b) Private Ledger: It contains the accounts of confidential nature like Capital, Drawing and Profit and Loss Accounts.

4.3.3 Format of a Ledger Account

There are two types of forms for writing up Ledger Accounts namely:

(a) Horizontal form; and (b) Vertical or T shaped form.

These are discussed below:

(a) A Horizontal Ledger Account is ruled out as follows:

"AB & Co" Account

Date	Particulars	J.F.	Debit Amount (Rs.)	Credit Amount (Rs.)	Debit or Credit	Balance (Rs.)
1	2	3	4	5	6	7

In this form of ledger, balance is ascertained after every transaction. This method is generally used in bank. Where the accounts are maintained in computers through the use of accounting software like Tally, accounts are also prepared in this form.

(b) A Vertical or T shaped form is ruled as under:-

Dr. **"AB & Co" Account** **Cr.**

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
1	2	3	4	1	2	3	4

4.3.4 Distinction between Journal and Ledger

Following are the distinctions between a journal and a ledger.

Sl. No.	Points of Distinction	Journal	Ledger
(i)	Nature	Journal is a book of primary entry	Ledger is a book of final entry.
(ii)	Basis of Recording	In Journal, transactions are recorded on the basis of voucher	Here transaction are recorded from the journal
(iii)	Manner of Recording	Here transactions are recorded in order to happening i.e. date wise	Here transactions are recorded on the basis of 'account heads'
(iv)	Narration	Every entry in the journal is followed by a narration	Posting in the Ledger is not followed by any narration
(v)	Form of Information	It provides information in scattered form	It provides information in a summarised and classified form

4.4 LEDGER POSTING

In the following sections we are going to discuss the concept of ledger posting, its meaning, and the procedure for balancing of an account.

4.4.1 Meaning of Posting

Posting is a process of transferring debit and credit aspects of the entries appearing in the journal and other books of original entry to the debit and credit sides of the relevant accounts in the ledger. Postings are made using the word 'To' and 'By' as a prefix on the debit side and credit side respectively. The aim of posting is to make a classified and summarized record of all business transactions under appropriate account heads.

Basic Points Regarding Posting:

Basic points to be kept in mind before posing are:

(1) **Opening of separate accounts:** Separate accounts should be opened for different 'account heads' in the ledger for posting the different transactions recorded in the journal. For Example; Cash A/c, Salary A/c, Purchases A/c etc.

(2) **One account for each kind of transactions:** One account should be opened for each kind of transaction. Transactions taking place during an accounting period relating to that particular account should be posted to that account only. If more than one account is opened for one kind of transactions, the object of summarization of transactions of similar nature will not be achieved. For example, it may be found that in the journal, Cash A/c has been debited during a week, say on six different dates and the same account has been credited on four different dates. For recording in Cash A/c, only one Cash A/c will be opened for transactions taking place on all the days and posting of all entry relating to Cash A/c will be made in that account only.

(3) **Accounting period:** All recording in the Journal and post in the ledger is done for a particular 'Accounting Period'. For every accounting period separate set of books should be maintained. Posting of all transactions taking place in a particular accounting period must be made in one set of books.

(4) **Same account heads in both the books:** Posting in the ledger should be made in the same account heads as appearing in the journal. No change in the name of the 'account head' should be made.

(5) **Postings made conveniently:** Posting may be done at any time but it should be completed before the end of the accounting period. For example the accounts upto date, posting should be made immediately after recording the transactions in the journal.

4.4.2 Procedure for Balancing an Account

Balancing of an account implies the process of ascertaining the net difference of an account after totaling of both sides – viz. debit side and credit side.

In simple words, balancing means the insertion (writing) of the difference between the total of amount columns of the two sides in the smaller (smaller total) side, so that the (grand) totals of the two sides becomes equal.

Balancing is done periodically, i.e., weekly, monthly, quarterly, half-yearly or yearly, depending on the requirements of the business. The 'balance' is a term used in accounting which means the difference between the two sides of any account, or the total of the account containing only debits and only credits.

A computerized system will usually print the balance of the account after each transaction, but in a manual system we must calculate the balance. The balance of an account shows the position of an account on the particular day.

Procedure for Balancing an Account:

The following procedure is to be followed for balancing of an account

(i) **Totaling the amount columns outside:** On a rough sheet of paper, the total of the amount column of two sides of the account concerned are to be ascertained.

(ii) **Determining the balance:** The difference of the total of two sides, called balance is then found out.

(iii) **Entering the balance on the smaller side:** If the total of the debit side is more, the difference is to be put in the amount column on the credit side, by writing the words 'By Balance c/d' in particulars column. If the total of the credit side is more, the difference is to be put in the amount column on the debit side by writing the words 'To Balance c/d' in particulars column. This will be done on the date of

balancing and the date will be entered in the date column.

(iv) Totaling both the columns: After putting the difference in the appropriate side of the account, both sides of the account is to be totaled. The total of both the sides will be equal. A thin line above the total and two parallel lines below the total are to be drawn.

(v) Taking the balance on the opposite side: Lastly, on the next day of the balancing, the debit balance will be written on the debit side by writing the words 'To Balance b/d' in the particulars column. Similarly, the credit balance will be brought down on the credit side by writing the words 'By Balance b/d' in the particulars column.

If the Balance b/d (brought down) appears on the debit side, it indicates that the account has a Debit Balance. On the other hand, if the balance b/d (brought down) appears on the credit side, it indicates that the account has Credit Balance.



Exercise: 4.1

Journalize the following transactions in the books of Mr. A. Bora.

2017

Jan. 30. Received cash on account of Sales Rs. 8000;
Commission received Rs. 500, Interest received Rs. 4,000.

Jan. 31 Paid cash on account of Purchase Rs. 5,000;
Commission paid Rs. 1,000, Interest paid Rs. 2,000.

Pass Journal entries and post them in the ledger, also balance them on January 31, 2017

Solution:

Journal

Date	Particulars	L.F.	Dr. (Rs.)	Cr. (Rs.)
2017				
Jan 30	Cash A/c Dr.		12,000	
	To Sales A/c			8,000
	To Commission received A/c			500
	To Interest Received A/c			4,000
	(Being the receipt of cash on account of sales, commission and interest)			
	Purchases A/c Dr.			
Jan 31	Commission Allowed A/c Dr.		5,000	
	Interest Allowed A/c Dr.		1,000	
	To Cash A/c		2,000	
	(Being cash paid on account of purchases, commission and interest)			8,000

Cash Account

Dr. **Cr.**

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
2017				2017			
Jan.30	To Sales A/c		8,000	Jan.31	By Purchase A/c		5,000
	To Interest received A/c		4,000		By Interest Paid A/c		2,000
	To Commission Received A/c		500		By Commission paid A/c		1,000
					By Balance c/d		4,500
			12,500				12,500
Feb.1	To Balance b/d		4,500				

Sales Account

Dr. **Cr.**

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
2017				2017			
Jan.31	To Balance c/d		8,000	Jan.30	By Cash A/c		8,000
			8,000				8,000
				Feb.1	By Balance b/d		8,000

Purchase Account

Dr. **Cr.**

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
2017				2017			
Jan.31	To Cash A/c		5,000	Jan.31	By Balance c/d		5,000
			5,000				5,000
Feb.1	By Balance b/d		5,000				

Commission Received Account

Dr. **Cr.**

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
2017				2017			
Jan.31	To Balance c/d		500	Jan.31	By Cash Account		500
			500				500
				Feb.1	By Balance c/d		500

Interest Received Account

Dr. **Cr.**

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
2017				2017			
Jan.31	To Balance c/d		4,000	Jan.30	By Cash Account		4,000
			4,000				4,000
				Feb.1	By Balance c/d		4,000

Interest Paid Account

Dr. **Cr.**

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
2017				2017			
Jan.31	To Cash account		2,000	Jan.31	By Balance c/d		2,000
			2,000				2,000
Feb.1	By Balance b/d		2,000				

Commission Paid Account

Dr. **Cr.**

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
2017				2017			
Jan.31	To Cash account		1,000	Jan.31	By Balance c/d		1,000
			1,000				1,000
Feb.1	By Balance b/d		1,000				

CHECK YOUR PROGRESS

Q1. The two main books of accounts are:

a) .....

b) .....

Q2. Write down the two types of journal entries.

a) .....

b) .....

Q3. What do you mean by Ledger?

.....

.....

Q4. Ledgers are primarily divided into:

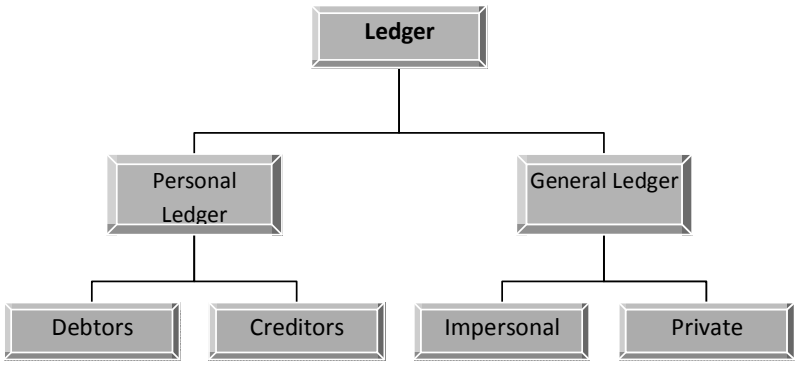
a) .....

b) .....



4.5 LET US SUM UP

- In this unit we discussed on the concept of Ledger. Ledger is a book which contains records of all transactions permanently in a summarized and classified form.
- We also discussed the need for ledger and subdivision of Ledger. Ledger can be primarily subdivided into two:
  a) Personal Ledger; and
  b) General Ledger



There are two types of forms for writing up Ledger Accounts namely: (a) Horizontal form; and (b) Vertical or T shaped form.

- Basic points regarding ledger posting and learned the procedure for balancing an Account.
- And finally the distinction between Ledger and journal were discussed



4.6 FURTHER READING

1. Ashis Bhattacharya (2006), *"Financial Accounting"*, Prentice hall of India Pvt. Ltd, New Delhi.
2. S. N. Maheshwari (2014), "*Financial Accounting"*, Vikash Publishing House Pvt. Ltd., New Delhi.
3. B. B Dam and H C Gautam,"*Theory and Practice of Financial Accounting*",Capital Publishing Company, Guwahati
4. R. L. Gupta and M. Radhaswamy (2017), "*Advance Accountancy*", Sultan Chand & Sons, New Delhi.
5. Jain & Narang (2006),"*Accounting Theory and Management Accounting*",Kalayani Publishers.

4.7 ANSWERS TO CHECK YOUR PROGRESS

Ans Q1. a) Journal b) Ledger

Ans Q2. a) Simple Journal entries b) Compound Journal entries

Ans Q3. Ledger is a book which contains records of all transactions permanently in a summarized and classified form

Ans Q4. a) Personal Ledger b) General Ledger



4.8 MODEL QUESTIONS

1. Define Ledger. Why do we need a ledger?
2. Explain the subdivision of Ledger

3. What are the two types of ledger account? Explain
4. Explain the procedure for balancing an account
5. Distinguish between Journal and ledger.

****

UNIT 5: SUBSIDIARY BOOKS

UNIT STRUCTURE

5.1 Learning Objectives

5.2 Introduction

5.3 Subsidiary Books : An Introduction

5.4 Need and Advantages of Subsidiary Books

5.5 Purchase Book or Purchase Day Book

5.6 Sales Book or Sales Day Book

5.7 Purchase Return Book or Return Outward Book

5.8 Sales Return Book or return Inward Book

5.9 Bills Receivable Book and Bills Payable Book

5.10 Cash Book and Types of Cash Book

- 5.10.1 Single Column Cash Book
- 5.10.2 Double Column Cash Book
- 5.10.3 Triple Column Cash Book
- 5.10.4 Petty Cash Book

5.11 Journal Proper

5.12 Let Us Sum Up

5.13 Further Readings

5.14 Answer to check your progress

5.15 Model Questions

5.1 LEARNING OBJECTIVES

After going through this unit, you will be able to:

- learn about subsidiary books
- discuss the cash discount and trade discount along with their difference
- prepare cash book
- outline journal proper.

5.2 INTRODUCTION

In this unit, we are going to discuss the Purchases Book or Purchases Day Book Cash Discount, Difference between Cash Discount

and Trade Discount, Sales Book or Sales Day Book, Purchase Return Book and Sales Return Book, Bills Receivable Book, Bills Payable Book, Cash Book and Bank Reconciliation Statement.

In a practical business environment, we face many repetitive transactions. These repetitive transactions are of similar nature and mostly affect the same accounts. For each particular class of transactions of similar nature, separate books are kept which are known as subsidiary books. Each of these separate book is meant to record transaction of a particular class in the book of original entry. Such book of original entry is also known as subsidiary book or special journal or sub-journal or sub-division of journal. Let us discuss these concepts in detail in the following sections.

5.3 SUBSIDIARY BOOKS: AN INTRODUCTION

Subsidiary book is the sub division of Journal. These are known as books of prime entry or books of original entry as all the transactions are recorded in their original form. In these books the details of the transactions are recorded as they take place from day to day in a classified manner. The following are some of the subsidiary books.

Sub division of Subsidiary books :

1. Purchase Book or Purchase Day Book
2. Sales Book or Sales Day Book
3. Purchase Return Book or Return Outward Book
4. Sales Return Book or Return Inward Book
5. Bills receivable Book
6. Bills Payable Book
7. Cash Book
8. Journal Proper

These subsidiary books are maintained because it may be impossible to record each transaction into the ledger as it occurs. And these books record the details of the transactions and therefore help the ledger to become brief. Future reference and any desired analysis becomes easy as transactions of similar nature are recorded together. We will discuss these subsidiary books in the following sections.

5.4 NEED AND ADVANTAGES OF SUBSIDIARY BOOKS

Need for Subsidiary Books: For a business where the number of transactions is very large, it may not be practically possible to record all transactions through one journal. So, by dividing the journal into various segments, the accountants get rid of various inconveniences. Repetitive transactions are clubbed at one place so as to get the information on a prompt basis. Sub-division of journal is also necessary since it reduces the size of the main journal becoming bulky and voluminous.

Advantages of Subsidiary Book: Subsidiary books have the following advantages:

- By having subsidiary books, the division of work is possible among the clerical staff since they can be allotted the job of writing different books.
- The division of work increases the efficiency of the person doing that work. Since the work can be done quickly, precious time can be saved.
- Increased efficiency leads to reduction in overall cost.
- Access to the information of a particular type of transactions become easy.
- Checking for errors become easy.

5.5 PURCHASE BOOK OR PURCHASE DAY BOOK

Purchase Book is also known as Purchase Day Book or Purchase Journal. The Purchase Book is used in recording only one type of transaction: Purchase of goods on credit. All purchase of goods on credit which are meant for resale are recorded in this book. The following points need to be taken into account:

- Cash purchases are not recorded in the Purchase Book.
- Purchase of assets are not recorded in the Purchase Book.

Format of a Purchase Book: The format of a Purchase Book or Purchase Journal is the same as that of a general journal. The format is given below:

Purchase Day Book

Date	Particulars	Inward Invoice No.	L.F.	Amount (Rs)

Date: Date of the Purchase

Particulars: Details about the supplier along with Invoice No.

L.F.: Folio or page number of the ledger where the supplier's account appears

Amount: Amount of purchase invoice net of trade discount, if any.



Exercise 5.1

Now, let us enter the following transactions into the purchase book:

2017

Jan 1 Purchased goods from Ram & Company of Jorhat for Rs. 6,000.

Jan 5 Purchased goods from Hari Brothers of Tezpur

(a) 100 numbers of umbrellas @ Rs. 150 per umbrella.

(b) 20 raincoats @ Rs. 400 each.

Jan. 6 Purchased goods from Gupta Traders of Tinsukia

(a) Shoes- 10 pairs @ Rs. 500 per pair.

(b) Sandals- 30 pairs @ Rs. 130 per pair.

Solution :

Purchase Book

Date	Particulars	L.F.	Amount (Rs.)
2017			
Jan.1	Ram & Company, Jorhat Goods as per Invoice No…….		6,000
Jan 5	Hari Brothers, Tezpur Goods as per Invoice No…….		23,000

Jan 6	Gupta Traders, Tinsukia Goods as per Invoice No……		8,900
	Total: Purchase Account Debit		37,900

Posting Entries from the Purchase Book: Purchase book is a book of original entry for the credit purchases of goods meant for resale. So, it is necessary to post the entries in purchase book to respective ledger accounts. The credit purchases of goods affect on the debit side of purchase account and credit side of the suppliers account. Posting to respective suppliers account is done daily with the relevant amount on the credit side. The total of the purchase book is periodically posted to the debit of purchase account as sundries.

Debit the Purchases Account with the periodical total

and

Credit the personal accounts of the suppliers with the individual amount

The various ledger accounts will appear as shown below:

1. In General Ledger:

Date	Particulars	F.No.	Amount (Rs.)	Date	Particulars	F.No.	Amount (Rs.)
				2016 Jan 31	By Purchases A/c		37900

Dr. **a) Purchase A/C** **Cr.**

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
2017 Jan 31	To Sundry Creditors a/c		37,900				

Dr. **b) Sundry Creditors A/C** **Cr.**

2. Creditors Ledger:

Dr. **a) Ram & Company account** **Cr.**

7

Dr. **b) Hari Brothers Account** **Cr.**

7

Dr. **c) Gupta Traders Account** **Cr.**

7

In this context, let us understand the concept of Trade Discount and Cash Discount anlso the difference between the two.

Trade Discount: Trade Discount is an allowance made by the supplier to the customers (wholesaler or retailer) off the invoice/list/catalogue price. Trade discount is offered without reference to the time factor within which supplier expect to receive the payment to enable the wholesaler or retailer to sell the goods to the customers at this price and still leave margin for meeting business expenses and profit. Trade discount is not recorded in journal entry as it is deducted from invoice price.

Cash Discount: Cash Discount is an allowance made by the debtor to the creditor at the time of settlement of the debt. Cash discount is offered with a view to encourage prompt settlement of debt. It is a concession allowed

on payments being made within certain period and not deducted from the invoice. A separate ledger account is maintained for recording the cash discount.

Difference between Trade Discount and Cash Discount

Trade Discount	Cash Discount
It is a concession 'off invoice price' and allowed on purchases.	It is a concession allowed on payment being made within certain period.
It is not recorded in the ledger accounts.	Ledger account is maintained for discount allowed and discount received.
It is deducted from the invoice.	It is not deducted from the invoice.
It is neither loss nor gain.	It is a loss if allowed to a debtor and gain if received from creditor.

CHECK YOUR PROGRESS



Q1: What is meant by Subsidiary books?

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Q2: What is Trade Discount?

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Q3: What is Purchase book?

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5.6 SALES BOOK OR SALES DAY BOOK

Sales Day Book or Sales Book is used for recording sale of goods on credit. Only credit sale of goods are recorded in this book. If it is a cash sale, it is recorded in the cash book. The format of the Sales Day book is

similar to the Purchase Day book as already discussed. The format is given below:

Sales Day Book

Date	Particulars	L.F.	Amount (Rs.)

The entries in the Sales Day Book are made from the net amount of the copies of the invoices which have been sent to the customers along with the goods. Such copies of the invoices may be termed as outgoing or outward invoice. The detailed of invoice need not be recorded in this book. If more information about the transaction is required, it can be obtained by referring to the file copy of the sales invoice. The Journal entry passed will be:

Debit the personal accounts of the customers with the individual amount

and

Credit Sales account with the periodical total

Exercise 5.2

Now let us record the following transactions in the Sales Day Book:

2017

Jan 1 Sold goods to David & Company of Jorhat for Rs. 10,000.

Jan 5 Sold goods to Das Brothers of Tezpur

(a) 100 numbers of umbrellas @ Rs. 150 per umbrella.

(b) 20 raincoats @ Rs. 400 each.

Jan. 6 Sold goods to Bhuyan Traders of Tinsukia

(a) Shoes- 10 pairs @ Rs. 500 per pair.

(b) Sandals- 30 pairs @ Rs. 130 per pair.

Solution:

Sales Day Book

Date	Particulars	L.F.	Amount (Rs.)
2016			
Jan.1	David & Company, Jorhat		10,000
	Goods as per outgoing Invoice No…….		
Jan 5	Das Brothers, Tezpur		23,000
	Goods as per outgoing Invoice No…….		
Jan 6	Bhuyan Traders, Tinsukia		8,900
	Goods as per outgoing Invoice No…….		
	Total: Sales Account Credit		41,900

The various ledger accounts will appear as follows:

1. **In General Ledger:**

Dr. **a) Sales Account** **Cr.**

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
2016 Jan 31	By Sales a/c		41,900	2017 Jan 31	By Sundry debtors a/c		41,900

Dr. **a) Sundry Debtors a/c** **Cr.**

7

2. **In Debtors Ledger :**

Dr. **a) David & Company Account** **Cr.**

7			

Dr. **b) Das Brothers Account** **Cr.**

7			

Dr. **c) Bhuyan Traders Account** **Cr.**

7			

5.7 PURCHASE RETURN BOOK OR RETURN OUTWARD BOOK

Purchase Return Book or Return Outward Book records all purchase returns or return outwards which were purchased on credit.

The format of the Purchase Return Book is given below:

Purchase Return Book

Date	Particulars	L.F.	Amount (Rs.)

Debit Note: When goods are returned to the supplier, the transaction is known as purchase return or return outward. For every return, a debit note

is prepared in duplicate and the original one is sent to the supplier for required entries in its books. The debit note contains the name and address of the supplier, the detailed description of the goods returned and also the reason for such return. So a debit note is a source document for recording entries in the Purchase Return Book. Each debit note is serially numbered and dated.

The following journal entry is passed to record the purchase return:

Debit the personal accounts of the suppliers with the individual amount

and

Credit Purchase Return or Return Outward account with the periodical total

5.8 SALES RETURN BOOK OR RETURN INWARD BOOK

This journal is used for recording the sales return from the customers of the goods which were sold on credit to them.

The format of the Sales Return Book or Return Inward Book is given below:

	Sales Return Book		
Date	**Particulars**	**L.F.**	**Amount (Rs.)**

Credit Note: When a customer is credited with the value of sales return, the customer is sent an intimation to this effect. This is done through a statement called Credit Note. The credit note is also prepared in duplicate and contains details relating to the name of the customer, details of the goods received back and the account. It is a source document for recording entries in the sales return book.

The following journal entry is passed to record the sales return:

Debit the sales return account with the periodical total

and

Credit the personal accounts of the customers with the individual amount

5.9 BILLS RECEIVABLE BOOK AND BILLS PAYABLE BOOK

Bills Receivable Book :

A Bills Receivable Book is one of the subsidiary books which is used for the purposes of recording details of bills receivable in favour of a person who is maintaining the Bills Receivable Book. Individual amounts are posted to the credit of the accounts of individual debtors from whom the bills are received. Periodic total is posted to the debit of Bills Receivable Account in the ledger.

The journal entry will be:

Debit the Bills Receivable account with the periodical total

and

Credit the individual accounts of the debtors from whom the bills are received

Bills Payable Book :

Bills Payable Book is one of the subsidiary books which is used for the purposes of recording the details of bills payable accepted by the person who is maintaining the Bills Payable Book. Individual amounts are posted to the debits of the accounts of individual creditors to whom acceptances have been given. The periodic total is posted to the credit of Bills Payable Account in the ledger.

The journal entry will be:

Debit the individual accounts of the creditors to whom acceptances are given

and

Credit the Bills Payable account with the periodical total

5.10 CASH BOOK AND TYPES OF CASH BOOK

A Cash Book records all cash transactions- Cash Receipts and Cash Payments. Every cash transactions are first entered in the Cash Book and then from there they are posted to the ledger. A Cash Book is maintained in the form of a ledger with narration. It is the only book which serves the dual

purpose of journal as well as ledger. This book enables us to know the balance of cash in hand and at bank at any point of time. It is a substitute of Cash Account in the ledger.

Types of Cash Book

Cash Book can be of different types. The type of cash book used by a business depend upon the nature and requirement of the business concerned. Generally, cash books are of the following types:

- *Single Column Cash Book*- which records cash transactions only.
- *Double Column Cash Book*- with Cash and Bank column for recording cash and bank transactions.
- *Triple Column Cash Book*- with Cash, Bank and Discount column for recording cash and bank transactions as well as cash discount received and discount allowed.
- *Petty Cash Book*- for recording petty expenses and receipts.

Let us discuss it in detail in the following sections :

5.10.1 Single Column Cash Book

The Single Column Cash Book is a record of only cash transactions with narration. It is just like any other account. All cash receipts are recorded in the left hand side (debit) and all cash payments are recorded in the right hand side (credit).

The format of a Single Column Cash Book is given below:

Dr. **Cash Book (Single Column)** **Cr.**

Date	Particulars	Vr. No.	L.F	Amount	Date	Particulars	Vr. No.	L.F	Amount

Entries in the cash book are made as in cash ledger account. That is, receipts of cash are entered on the debit side beginning by “To” on the particulars column and payments on the credit side with “By” along with date of transaction and amount in the amount column. The voucher number is also recorded. The ledger folio number is recorded to locate the ledger entry.

5.10.2 Double Column Cash Book:

A Cash Book having cash and bank column is called a Double Column Cash Book. So, it is a cash book where both cash and bank transactions are shown in columnar fashion. A Double Column Cash Book represents two separate accounts and the transactions are recorded as being either cash or bank transactions. The advantage of a double column cash book is that since the cash and bank column are prepared side by side, we can see how much cash and bank balance is available at a particular time.

The format of a double column cash book is given below:

Dr. **Cash Book (Single Column)** **Cr.**

Contra Entry: 'Contra' means opposite. Contra entry is such an entry in a cash book which represents the reversal or cancellation of an entry on the other side. The debit and credit aspects of a transaction are recorded in the same account but in different columns, a contra entry takes place. Cash deposit in the bank or withdrawal of cash for office use from the bank leads to contra entry. Deposit of cash into the bank account will decrease the cash available in hand but will increase the bank balance. Both the entries are recorded in the same cash book, one on the debit side and another on the credit side. Again, withdrawal of cash from bank for office use will decrease the bank balance but increase the cash available in hand. Here also both the entries are recorded in the opposite sides of the cash book. This kinds of entries in the cash book is known as Contra Entry. To distinguish contra entries from the rest of the entries, the letter 'C' is written against in the Ledger Folio column of the cash book.

Example 5.3:

Let us record the following transactions in a Double Column Cash Book:

2017

June 1 Balance of Cash in Hand Rs. 4,250.

Balance at Bank Rs. 17,820

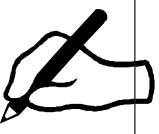
June 2 Issued cheque for Rs. 2,500 in favour of Mr. Hazarika.

June 5 Deposited into the bank Rs. 3,000.

June 7 Purchased goods for Rs. 1,850 and issued cheque for Rs. 1,825 deducting Rs. 25 as cash discount.

June 10 Paid wages Rs. 125 in cash.

June 12 Sold goods for Rs. 600 in cash.



June 16 Sold goods for Rs. 1,000 and received cheque.

June 19 Withdrew from bank Rs. 1,200 for office use

June 24 Withdrew from bank Rs. 400 for personal use of the proprietor.

June 25 Received cash from Mr. Chandra Rs. 4,000.

June 27 Deposited into the bank Rs. 3,500.

June 30 Paid to Mr. Gopal Rs. 2,800 by cheque.

June 30 Sold goods for Rs. 750 in cash.

Solution:

In the books of ……..

Dr. Cash Book (Double Column) Cr.

Date	Particulars	Vr. No	L.F.	Cash	Bank	Date	Particulars	Vr. No	L.F.	Cash	Bank
2017							2017				
01/06	To Balance b/d			4,250	17,820	02/06	By Hazarika A/c (Being paid by cheque)				2,500
05/06	To Cash A/c (Being cash deposited)		c		3,000	05/06	By Bank (Being cash deposited)			3,000	
12/06	To Sales A/c (Being goods sold)			600		07/06	By Purchases A/c (Being purchase through cheque)				1,825
16/06	To Sales A/c (Being goods sold)				1,000	10/06	By Wages A/c (Being wages paid)			125	
19/06	To Bank A/c (Being cash withdrawn)		c	1,200		19/06	By Cash A/c (Being cash withdrawn)		c		1,200
25/06	To Mr. Chandra A/c (Being cash received)			4,000		24/06	By Drawings A/c (Being cash drawings)				400
27/06	To Cash A/c (Being cash deposit into bank)		c	3,500		27/06	By Bank A/c (Being cash deposit into bank)			3,500	
30/06	To Sales A/c (Being cash sales)			750		30/06	By Mr. Gopal A/c (Being paid through cheque)				2,800
						30/06	By Balance c/d			4,175	16,595
				10,800	25,320					10,800	25,320
01/07	To Balance b/d			4,175	16,595						

5.10.3 Triple Column Cash Book

These days, bank transactions are more numerous than cash transactions. Bank transactions refer to payments into and out of bank. So most firm maintain cash book with cash, bank and discount column. The transactions relating to cash, bank and discounts are inter related. Hence, it is convenient and appropriate

to have Triple Column Cash Book having Discount, Cash and Bank column. A format of a Triple Column Cash Book is given below:

Dr. **Cr.**

Cash Book (Triple Column)

ticulars	Vr. No	L. F.	Disc	Cash	Bank	Date	Particulars	Vr. No	L. F.	Disc	Cash	Bank

The Cash column and the bank column are balanced as in the case of double column cash book. But the discount column of a Triple Column Cash Book is not balanced. Simply the debit and credit side of the discount column is totaled. The debit total of the discount column indicate total discount allowed and the credit total indicate total discount received.

2016	
	Cash balance Rs. 8,000; Bank balance Rs. 14,500.
	Cash received from sales Rs. 6,000.
April 3	Paid into the bank Rs. 5,000.
April 3	Paid to Mr. Ray by cheque Rs. 1,200.
April 4	Paid wages by cash Rs. 250.
April 8	Received cash Rs. 980 from Mr. Arjun and allowed him a discount of Rs. 20.
April 18	Bought goods for cash Rs. 600.
April 19	Paid to Ramesh by cheque Rs. 370 and received discount of Rs. 25.
April 19	Drew from bank Rs. 300.
April 20	Drew cash for personal use Rs. 200.
April 24	Cash sales Rs. 170.
April 25	Paid into the bank Rs. 1,700.
April 26	Issued cheque for cash purchase Rs. 200.
April 26	Received cash from Mr. Ashish Rs. 400.
April 27	Drew cheque for office use Rs. 300.
April 28	Paid salaries by cash Rs. 325.
April 30	Paid rent by cheque Rs. 600.

ions of Mr. Gogoi for the

Book:

Solution:

In the books of Mr. Gogoi

Cash Book (Triple Column)

For April, 2016

Dr. Cr.

Date	Particulars	Vr. No	L.F.	Dis	Cash	Bank	Date	Particulars	Vr. No	L.F.	Disc	Cash	Bank
2016													
01/04	To Balance b/d				8,000	14,500	03/04	By Bank A/c (Being cash deposited)		c		5,000	
02/04	To Sales A/c (Being goods sold)				6,000		03/04	By Mr. Ray A/c (Being cheque paid)					1,200
03/04	To Cash A/c (Being cash deposited)		c			5,000	04/04	By Wages A/c (Being wages paid)				250	
08/04	To Mr. Arjun A/c (Being cheque received and discount allowed)			20	980		18/04	By Purchases A/c (Being cash purchases)				600	
19/04	To Bank A/c (Being cash drawn)		c		300		19/04	By Mr. Ramesh A/c (Being payment to Ramesh and discount received)			25		370
24/04	To Sales A/c (Being cash sales)					1,700	19/04	By Cash A/c (Being cash drawn)		c			300
25/04	To Cash A/c (Being cash paid into the bank)		c		400		20/04	By Drawings A/c (Being drawings for personal use)					200
26/04	To Mr. Ashish A/c (Being cheque received)		c		300		25/04	By Bank A/c (Being cash paid into the bank)		c		1,700	
27/04	To Bank A/c (Being cash drawn for office use)						26/04	By Purchases A/c (Being cash purchase)					200
							27/04	By Cash A/c (Being cash drawn for office use)					300
							28/04	By Salaries A/c (Being salary paid)				325	
							30/04	By Rent A/c (Being rent paid)					600
							30/04	By Balance c/d				8275	18030
				20	16150	21200					25	16150	21200
01/05	To Ballance b/d				8275	18030							

Total discount received during April, 2016 = Rs. 25

Total discount allowed during April, 2016 = Rs. 20

5.10.4 Petty Cash Book

Every business is required to make payments involving petty amounts. That is, a firm has to make a large number of small payments like bus fare, carriage, postage etc. Such payments by their very nature cannot be made by cheque. Again, if these petty cash transactions are recorded in the main cash book, the size of the main cash book will be too large and unmanageable. That is why a separate cashier is normally assigned to make those petty payments and record them in a separate cash book known as Petty Cash Book. The cashier assigned to make and record petty cash payments is known as Petty Cashier.

Objectives of maintaining Petty Cash Book: Following are the major objectives of maintaining Petty Cash Book:

- To make easy for small payments in cash.
- To lessen the use of cheques for small payments.
- To separate small payments from the main cash book
- Reducing the workload of the main cashier.

Systems of Petty Cash: The cashier who maintains the petty cash book is given cash either on the ordinary system or on the imprest system.

1. Ordinary System of Petty Cash: Under the ordinary system, the petty cashier is given a lump sum amount of cash. After spending the whole amount, the petty cashier is required to submit the account to the main cashier or the head cashier.

2. Imprest System of Petty Cash: The best system of petty cash is the imprest system. Under imprest system, the petty expenses are reimbursed periodically. Under this system, the petty cashier is provided with a fixed amount of money which is known as the imprest money which is sufficient to meet the needs of the balancing period. Balancing period may be a week or month. At the end of the balancing

period, the petty cashier is given a cheque equal to the amount of payments made during the same period.



CHECK YOUR PROGRESS

Q4: Write the objectives of maintaining Petty cash book.

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Q5: What is contra entry?

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5.11 JOURNAL PROPER

Journal proper is one of the important subsidiary books. It is a subsidiary book in which not all but only a few types of transactions are recorded. There are certain types of transactions which are not recorded in other subsidiary books but are recorded in the journal proper. These transactions, for example, include the transactions relating to drawings, outstanding expenses, accrued incomes, reserves, provisions, interest on capital, drawing of goods and assets by proprietor, loss of goods by some reasons, and credit purchase and sale of other assets such as land, buildings, machinery, and furniture. In journal proper book, the transactions are recorded by passing journal entries based on the rules of debit and credit. Formally, thus, the journal paper may be defined as a subsidiary book in which not all but only a few types of financial transactions of the business are recorded systematically in a chronological order as and when they take place.

It is a residuary book in which those transactions are recorded which cannot be recorded in any other subsidiary book. Any transactions which do not form part of cash book, purchase book, sales book, purchase returns,

sales returns, bills receivables and bills payable are recorded in journal proper. Listed are types of transactions which finds place in journal proper

- **Opening entries:** To bring the closing balances of all accounts in the new book in the new financial year from the previous year, opening entries are passed.
- **Closing entries:** Closing entries are recorded at end of the accounting year for closing the accounts relating to expenses and revenues. These accounts are closed by transferring the balances to the trading and profit and loss account.



CHECK YOUR PROGRESS

Q6: What is Journal Proper?

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5.12 LET US SUM UP

In this unit we have discussed the following":

- For each particular class of transactions of similar nature, separate books are kept which are known as subsidiary books. Each of these separate book is meant to record transaction of a particular class in the book of original entry. Such book of original entry is also known as subsidiary book or special journal or sub-journal or sub-division of journal.
- Trade Discount is an allowance made by the supplier to the customers (wholesaler or retailer) off the invoice/list/catalogue price.
- Cash Discount is an allowance made by the debtor to the creditor at the time of settlement of the debt. Cash discount is offered with a view to encourage prompt settlement of debt.

- A Cash Book records all cash transactions- Cash Receipts and Cash Payments. Every cash transactions are first entered in the Cash Book and then from there they are posted to the ledger.
- Contra entry is such an entry in a cash book which represents the reversal or cancellation of an entry on the other side.



5.13 FURTHER READINGS

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5.14 ANSWERS TO CHECK YOUR PROGRESS

Ans to Q1: Subsidiary book is the sub division of Journal. These are known as books of prime entry or books of original entry as all the transactions are recorded in their original form. In these books the details of the transactions are recorded as they take place from day to day in a classified manner.

Ans to Q2: Trade Discount is an allowance made by the supplier to the customers (wholesaler or retailer) off the invoice/list/catalogue price.

Ans to Q3: The Purchase Book is used in recording only one type of transaction: Purchase of goods on credit. All purchase of goods on credit which are meant for resale are recorded in this book.

Ans to Q4: Following are the major objectives of maintaining Petty Cash Book:

- To make easy for small payments in cash.
- To lessen the use of cheques for small payments.

- To separate small payments from the main cash book
- Reducing the workload of the main cashier.

Ans to Q5: Contra entry is such an entry in a cash book which represents the reversal or cancellation of an entry on the other side. The debit and credit aspects of a transaction are recorded in the same account but in different columns, a contra entry takes place.

Ans to Q6: Journal proper is one of the important subsidiary books. It is a subsidiary book in which not all but only a few types of transactions are recorded.



5.15 MODEL QUESTIONS

1. What are subsidiary books? Why are they prepared?
2. What is the difference between trade discount and cash discount?
3. What does the discount column in a triple column cash book mean?
4. What is a contra entry?
5. What is a petty cash book?

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