CHAPTER - 2

By this time, you must have understood that accounting is the process of identifying, measuring, recording, classifying, summarising, analysing, interpreting and communicating the financial transactions and events. Accounting helps in keeping systematic records to ascertain financial performance and financial position of an entity and to communicate the relevant financial information to the interested user groups. Transactions and events recorded by suitable account headings are analysed in term of debit and credit; and thus assets become equal to equity and liabilities. Accounts are classified as personal, real and nominal types. Transactions and events are first journalised, then posted to suitable ledgers accounts and all accounts are balanced at the end of year. Generally balances of the nominal accounts are transferred to profit and loss account for determination of profit or loss and balance of personal and real accounts are carried to balance sheet.

The process of accounting, depicting how information flows from the source documents up to the stage where final accounts are prepared, can be shown as:

Source Documents ↓	Represents all documents in business which contains financial records and act as evidence of the transactions which have taken place.
Book of Original Entry ↓	These are books which are used in recording the transactions for the first time. The books are maintained for memorandum purpose only and will not form part of the double entry system. Examples include; Purchase day book, Cash book, Sales day book and purchases return day book
Ledger Accounts ↓	These form part of double entry system and used to record the transactions for the period. These are accounts where information relating to a particular asset, liability, capital, income and expenses are recorded.
Trial Balance ↓	Contains the totals from various ledger accounts and act as a preliminary check on accounts before producing final accounts.
Final Accounts	Financial Statements are produced to show the financial performance and financial position of a business entity.

All the above mentioned steps of the accounting process have been discussed in detail in the subsequent units of this chapter. The students are advised to observe the whole sequence or cycle of accounting, starting from journal to the preparation of trial balance (units 1 to 5 of this chapter). The preparation of final accounts will be discussed in chapter 6 of the Study Material.

CHAPTER - 2

ACCOUNTING PROCESS

Unit 1
Basic Accounting Procedures – Journal Entries

Learning Objectives

After studying this unit, you will be able to :

- understand meaning and significance of Double Entry Systems.
- familiarige with the term 'account' and understand the classification of accounts into personal, real and nominal.
- note the utility of such classification and sub-classifications,
- understand how debits and credits are determined from transactions and events.
- observe the points to be taken care of while recording a transaction in the journal.

1. DOUBLE ENTRY SYSTEM

Double entry system of book-keeping has emerged in the process of evolution of various accounting techniques. It is the only scientific system of accounting. According to it, every transaction has two-fold aspects–debit and credit and both the aspects are to be recorded in the books of accounts. For example, if a business acquires something then either it must have been given by someone or it must have been acquired by giving up something. On purchase of furniture either the cash balance will be reduced or a liability to the supplier will arise. This has been made clear already, the Double Entry System is so named since it records both the aspects. We may define the Double Entry System as the system which recognises and records both the aspects of transactions. This system has proved to be systematic and has been found of great use for recording the financial affairs for all institutions requiring use of money.

2. ADVANTAGES OF DOUBLE ENTRY SYSTEM

This system affords the under mentioned advantages:

(i) By the use of this system the accuracy of the accounting work can be established, through the device of the trial balance.

(ii) The profit earned or loss suffered during a period can be ascertained together with details.

(iii) The financial position of the firm or the institution concerned can be ascertained at the end of each period, through preparation of the balance sheet.

(iv) The system permits accounts to be kept in as much details as necessary and, therefore affords significant information for the purposes of control etc.

(v) Result of one year may be compared with those of previous years and reasons for the change may be ascertained.

It is because of these advantages that the system has been used extensively in all countries.

3. ACCOUNT

We have seen how the accounting equation becomes true in all cases. A person starts his business with say, ₹ 10,000; capital and cash are both ₹ 10,000. Transactions entered into by the firm will alter the cash balance in two ways, one will increase the cash balance and other will reduce it. Payment for goods purchased, for salaries and rent, etc., will reduce it; sales of goods for cash and collection from customers will increase it.

We can change the cash balance with every transaction but this will be cumbersome. Instead it would be better if all the transactions that lead to an increase are recorded in one column and those that reduce the cash balance in another column; then the net result can be ascertained. If we add all increases to the opening balance of cash and then deduct the total of all decreases we shall know the closing balance. In this manner, significant information will be available relating to cash.

The two columns which we reffered above are put usually in the form of an account, called the 'T' form. This is illustrated below by taking imaginary figures:

CASH			
	Increase (Receipt) ₹		*Decrease (Payment)* ₹
Opening Balance	10,000		1,000
	2,500		300
	2,000		200
	50		500
	1,350		
	400	Total	2,000
		New or Closing Balance	14,300
	16,300		16,300

What we have done is to put the increase of cash on the left hand side and the decrease on the right hand side; the closing balance has been ascertained by deducting the total of payments, ₹ 2,000 from the total of the left - hand side. Such a treatment of receipts and payment of cash is very convenient.

The proper form of an account is as follows:

ACCOUNT

Dr. Cr.

Date	*Particulars*	*Ref.*	*Amount*	*Date*	*Particulars*	*Ref.*	*Amount*
			₹				₹

The columns are self-explanatory except that the column for reference (Ref.) is meant to indicate the sources where information about the entry is available.

4. DEBIT AND CREDIT

We have seen that by deducting the total of liabilities from the total of assets the amount of capital is ascertained, as is indicated by the accounting equation.

Assets = Liabilities + Capital

or

Assets – Liabilities = Capital

We have also seen that if there is any change on one side of the equation, there is bound to be similar change on the other side of the equation or amongst items covered by it. This is again illustrated below:

Transactions	*Total Assets* ₹	*= Liabilities* ₹	*+ Owner's Capital* ₹
(1) Started business with cash ₹ 10,000	10,000		10,000
(2) Borrowed ₹ 5,000	+ 5,000	+ 5,000	
(3) Withdrew cash from business ₹ 2,000	- 2,000		- 2,000
(4) Loan repaid to the extent of ₹ 1,000	- 1,000	- 1,000	
Balance	12,000	= 4,000	+ 8,000

As has been seen previously, what has been given above is suitable only if the number of transactions is small. But if the number is large, a different procedure of putting increases and decreases in different columns will be useful and this will also yield significant information. The transactions given above are being shown below according to this method.

	Total Assets		*= Liabilities*		*+ Owner's Capital*	
	Increase ₹	*Decrease* ₹	*Decrease* ₹	*Increase* ₹	*Decrease* ₹	*Increase* ₹
(1)	10,000					10,000
(2)	5,000			5,000		
(3)		2,000			2,000	
(4)		1,000	1,000			
Total	15,000	3,000	1,000	5,000	2,000	10,000
Balance	12,000		=	4,000		+ 8,000

It is a tradition that:

(i) increases in assets are recorded on the left-hand side and decreases in them on the right-hand side; and

(ii) in the case of liabilities and capital, increases are recorded on the right-hand side and decreases on the left-hand side.

When two sides are put together in T form, the left-hand side is called the 'debit side' and the right hand side is 'credit side'. When in an account a record is made on the debit or left-hand side, one says that one has debited that account; similary to record an amount on the right-hand side is to credit it.

From the above, the following rules can be obtained:

(i) When there is an increase in the amount of an asset, its account is debited; the account will be credited if there is a reduction in the amount of the asset concerned : Suppose a firm purchases furniture for ₹ 800, the furniture account will be debited by ₹ 800 since the asset has increased by this amount. Suppose later the firm sells furniture to the extent of ₹ 300, the reduction will be recorded by crediting the furniture account by ₹ 300.

(ii) *If the amount of a liability increases, the increase will be entered on the credit side of the liability account, i.e. the account will be credited :* similarly, a liability account will be debited if there is a reduction in the amount of the liability. Suppose a firm borrows ₹ 500 from Mohan; Mohan's account will be credited since ₹ 500 is now owing to him. If, later, the loan is repaid, Mohan's account will be debited since the liability no longer exists.

(iii) *An increase in the owner's capital is recorded by crediting the capital account :* Suppose the proprietor introduces additional capital, the capital account will be credited. If the owner withdraws some money, i.e., makes a drawing, the capital account will be debited.

(iv) *Profit leads to an increase in the capital and a loss to reduction :* According to the rule mentioned in (iii) above, profit may be directly credited to the capital account and losses may be similarly debited.

However, it is more useful to record all incomes, gains, expenses and losses separately. By doing so, very useful information will be available regarding the factors which have contributed to the year's profits and losses. Later the net result of all these is ascertained and adjusted in the capital account.

(v) *Expenses are debited and Incomes are credited :* Since incomes and gains increase capital, the rule is to credit all gains and incomes in the accounts concerned and since expenses and losses decrease capital, the rule is to debit all expenses and losses. Of course, if there is a reduction in any income or gain, the account concerned will be debited; similarly, for any reduction in an expenses or loss the concerned account will be credited.

The rules given above are summarised below:

(i) Increases in assets are debits; decreases are credits;

(ii) Increases in liabilities are credits; decreases are debits;

(iii) Increases in owner's capital are credits; decreases are debits;

(iv) Increases in expenses are debits; decreases are credits; and

(v) Increases in revenue or incomes are credits; decreases are debits.

The terms debit and credit should not be taken to mean, respectively, favourable and unfavourable things. They merely describe the two sides of accounts.

Illustration 1

2015		₹
April		
1.	R. started business with	10,000
2.	He purchased furniture for	2,000
3.	Paid salary to his clerk	100
4.	Paid rent	50
5.	Received interest	20

Solution

2015 April	*Explanation*	*Accounts Involved*	*Nature of Accounts*	*How affected*	*Debit* ₹	*Credit* ₹
1.	₹ 10,000 cash invested in business	Cash and R's	Asset Proprietorship	Increased Increased	10,000	10,000
2.	Purchased furniture for ₹ 2,000	Furniture and Cash	Asset Asset	Increased Decreased	2,000	2,000
3.	Paid ₹ 100 to clerk for salary	Salary & Cash	Expense Asset	Increased Decreased	100	100
4.	Paid Rent ₹ 50	Rent & Cash	Expense Asset	Increased Decreased	50	50
5.	Received interest ₹ 20	Cash & Interest	Asset Income	Increased Increased	20	20

5. TRANSACTIONS

In the system of book-keeping, students can notice that **transactions** are recorded in the books of accounts. A transaction is a type of event, which is generally external in nature and can be determined in terms of money. In an accounting period, every business has huge number of transactions which are analysed in financial terms and then recorded individually, followed by classification and summarisation process, to know their impact on the financial statements. A transaction is a two way process in which value is transferred from one party to another. In it either a party receives a value in terms of goods etc. and passes the value in terms of money or vice versa. Therefore, one can easily make out that in a transaction, a party receives as well as passes the value to other party. For recording transaction it is very important that they are supported by a substantial document like purchasing invoices, bills, pay-slips, cash-memos, passbook etc.

Transactions analysed in terms of money and supported by proper documents are recorded in the books of accounts under double entry system. To analyse the dual aspect of each transaction, two approaches can be followed:

(1) Accounting Equation Approach.

(2) Traditional Approach.

6. ACCOUNTING EQUATION APPROACH

The relationship of assets with that of liabilities and owners' equity in the equation form is known as 'Accounting Equation'. Basic accounting equation comes into picture when sum total of capital and liabilities equalises assets, where assets are what the business owns and capital and liabilities are what the business owes. Under double entry system, every business transaction has two-fold effect on the business enterprise where each transaction affects changes in assets, liabilities or capital in such a way that an accounting equation is completed and equated. This accounting equation holds good at all points of time and for any number of transactions and events except when there are errors in accounting process.

Let us suppose that an individual started business by contributing ₹ 5,00,000 and taking loan of ₹1,00,000 from a bank to be repayable, after 5 years. He purchased furniture costing ₹ 1,00,000, and merchandise worth ₹ 5,00,000. For purchasing the merchandise he paid ₹ 4,00,000 to the suppliers and agreed to pay balance after 3 months. Assume that all these transactions and events occurred at to, base point of time.

The contribution by the owner is termed as capital; the borrowings are termed as loans or liabilities. Whenever the loan is repayable in the short-run, say within one year, it is called short-term loan or liability. On the other hand, if the loan is repayable within 4 or 5 years or more, it would be termed as long term loan or liability.

Some other short-term liabilities relating to credit purchase of merchandise are popularly called as trade payables, and for other purchases and services received on credit as expense payables. These short-term liabilities are also termed as current liabilities.

On the other hand, money raised has been invested in two types of assets–fixed assets and current assets. Furniture is a fixed asset, if it lasts long, say more than one year, and has utility to the business, while inventory and cash balance will not remain fixed for long as soon as the business starts to roll-these are current assets.

Often the owner's claim or fund in the business is called equity. Owner's claim implies capital invested plus any profit earned minus any loss sustained.

Now at to we have an equation:

Equity + Liabilities = Assets

or, Equity + Long-Term Liabilities = Fixed Assets + Current Assets - Current Liabilities

Check : L.H.S.

Equity	₹ 5,00,000
Long – Term Liabilities	₹ 1,00,000
Current Liabilities	₹ 1,00,000
	₹ 7,00,000
R.H.S.	
Fixed Assets:	
Furniture	₹ 1,00,000
Current Assets:	
Inventory	₹ 5,00,000
Cash	₹ 1,00,000
	₹ 7,00, 000

Cash = Capital + Loan - Furniture - Payment to Trade payables

= ₹ 5,00,000 + ₹ 1,00,000 - ₹ 1,00,000 - ₹ 4,00,000 = ₹ 1,00,000

Let us use E_o, L_o and A_o to mean Equity, Liabilities and Assets respectively at t_0. Thus the basic accounting equation becomes

$E_0 + L_0 = A_0$

or $E_0 = A_0 - L_0$ ...(Eq. 1)

Now, let us suppose that at the end of period inventory valuing ₹ 2,50,000 is in hand, cash ₹ 2,00,000, trade payables, ₹ 50,000 bank loan ₹ 1,00,000 (interest was properly paid), furniture ₹ 80,000 (₹ 20,000 is taken as loss of value due to use). So at t_1 -

Assets:	
Fixed assets/ Furniture	₹ 80,000
Current assets/ Inventory	₹ 2,50,000
Cash	₹ 2,00,000
	₹ 5,30,000
Liabilities:	
Long–Term Liabilities	₹ 1,00,000
Current Liabilities	₹ 50,000
	₹ 1,50,000
	₹ 3,80,000

Equity = Assets - Liabilities

i.e., $E_1 = A_1 - L_1$

or $E_1 + L_1 = A_1$ ...(Eq. 2)

Let us compare E_1 with E_0. Equity is reduced by ₹ 1,20,000 (5,00,000 - 3,80,000). Reduction in equity is termed as loss.

Since the business sustained loss during the period, E_2 becomes less than E_0.

$E_1 < E_0$ implies loss during t_{01}

Similarly, $E_2 < E_1$ implies loss during t_{12} and so on.

On the other hand, $E_1 > E_0$ implies profit earned by business during t_{01}, $E_2 > E_1$ implies profit earned during t_{12} and so on.

So if $E_n > E_{n-1}$, in general terms, equity has increased, while $E_n < E_{n-1}$ implies that equity has declined. Increase in equity is termed as profit while decrease in equity is termed as loss.

Illustration 2: Develop the accounting equation from following information available at the beginning of accounting period:

	₹
Capital	1,00,000
Loan	50,000
Trade payables	70,000
Fixed Assets	80,000
Inventory	60,000
Trade receivables	50,000
Cash and Bank	30,000

At the end of the accounting period the balances appear as follows :

	₹
Capital	?
Loan	50,000
Trade payables	80,000
Fixed Assets	72,000
Inventory	90,000
Trade receivables	50,000
Cash at Bank	60,000

(a) Reset the equation and find out profit.

(b) Prepare Balance Sheet at the end of the accounting period.

Solution

(a) Accounting equation is given by

Equity + Liabilities = Assets

Let us use E_0, L_0 and A_0 to mean equity, liabilities and assets respectively at the beginning of the accounting period.

E_0 = ₹ 1,00,000

L_0 = Loan + Trade payables

= ₹ 50,000 + ₹ 70,000

= ₹ 1,20,000

A_0= Fixed Assets + Inventories + Trade receivables + Cash at Bank

= ₹ 80,000 + ₹ 60,000 + ₹ 50,000 + ₹ 30,000

= ₹ 2,20,000

So, at the beginning of accounting period

$E_0 + L_0 = A_0$

i.e., ₹ 1,00,000 + ₹ 1,20,000 = ₹ 2,20,000

Let us use E_1, L_1, A_1 to mean equity, liabilities and assets respectively at the end of the accounting period.

L_1 = Loan + Trade payables

= ₹ 50,000 + ₹ 80,000

= ₹ 1,30,000

A_1= Fixed Assets + Inventories + Trade receivables + Cash at Bank

= ₹ 72,000 + ₹ 90,000 + ₹ 50,000 + ₹ 60,000

= ₹ 2,72,000

E_1 = A1 - L_1 = ₹ 2,72,000 - ₹ 1,30,000 = ₹ 1,42,000

Profit = E_1 - E_0 = ₹ 1,42,000 - ₹ 1,00,000 = ₹ 42,000

(b) **Balance Sheet**

	₹	₹	*Assets*	₹
Capital			Fixed Assets	72,000
Balance	1,00,000		Inventories	90,000
Add: Profit	42,000	1,42,000	Trade receivables	50,000
Loan		50,000	Cash at Bank	60,000
Trade payables		80,000		
		2,72,000		2,72,000

7. TRADITIONAL APPROACH

Under traditional approach of recording transactions one should first understand the term debit and credit and their rules. The term debit and credit have already been explained in para 4 of this Unit.

Transactions in the journal are recorded on the basis of the rules of debit and credit only. For the purpose of recording, these transactions are classified in three groups:

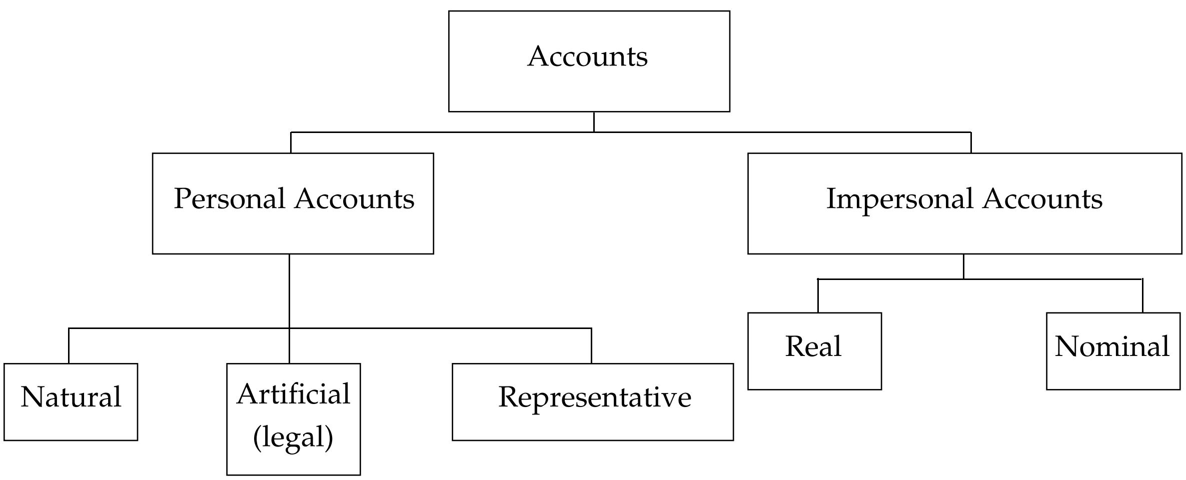
(i) Personal transactions.

(ii) Transactions related to assets and properties.

(iii) Transactions related to expenses, losses, income and gains.

7.1 CLASSIFICATION OF ACCOUNTS

(i) Personal Accounts: Personal accounts relate to persons, trade receivables or trade payables. Example would be; the account of Ram & Co., a credit customer or the account of Jhaveri & Co., a supplier of goods. The capital account is the account of the proprietor and, therefore, it



is also personal but adjustment on account of profits and losses are made in it. This account is further classified into three categories:

(a) Natural personal accounts: It relates to transactions of human beings like Ram, Rita, etc.

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

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

(ii) Impersonal Accounts: Accounts which are not personal such as machinery account, cash account, rent account etc. These can be further sub-divided as follows:

(a) **Real Accounts:** Accounts which relate to assets of the firm but not debt. For example, accounts regarding land, building, investment, fixed deposits etc., are real accounts. Cash in hand and Cash at the bank accounts are also real.

(b) **Nominal Accounts:** Accounts which relate to expenses, losses, gains, revenue, etc. like salary account, interest paid account, commission received account. The net result of all the nominal accounts is reflected as profit or loss which is transferred to the capital account. Nominal accounts are, therefore, temporary.

7.2 GOLDEN RULES OF ACCOUNTING

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

1. Personal account is governed by the following two rules:

   Debit the receiver

   Credit the giver

2. Real account is governed by the following two rules:

   Debit what comes in

   Credit what goes out

3. Nominal account is governed by the following two rules:

   Debit all expenses and losses

   Credit all incomes and gains.

8. JOURNAL

Transactions are first entered in this book to show which accounts should be debited and which credited. Journal is also called subsidiary book. Recording of transactions in journal is termed as journalizing the entries.

8.1 JOURNALISING PROCESS

All transactions are first recorded in the journal as and when they occur; the record is chronological; otherwise it would be difficult to maintain the records in an orderly manner. The form of the journal is given below :

JOURNAL

Date	*Particulars*	*L.F.*	Dr. *Amount* ₹	Cr. *Amount* ₹
(1)	*(2)*	*(3)*	*(4)*	*(5)*

The columns have been numbered only to make clear the following but otherwise they are not numbered. The following points should be noted:

(i) In the first column the date of the transaction is entered-the year is written at the top, then the month and in the narrow part of the column the particular date is entered.

(ii) In the second column, the names of the accounts involved are written; first the account to be debited, with the word "Dr" written towards the end of the column. In the next line, after leaving a little space, the name of the account to be credited is written preceded by the word "To" (the modern practice shows inclination towards omitting "Dr." and "To"). Then in the next line the explanation for the entry together with necessary details is given-this is called narration.

(iii) In the third column the number of the page in the ledger on which the account is written up is entered.

(iv) In the fourth column the amounts to be debited to the various accounts concerned are entered.

(v) In the fifth column, the amount to be credited to various accounts is entered.

8.2 POINTS TO BE TAKEN INTO CARE WHILE RECORDING A TRANSACTION IN THE JOURNAL

1. Journal entries can be single entry (i.e. one debit and one credit) or compound entry (i.e. one debit and two or more credits or two or more debits and one credit or two or more debits and credits). In such cases, it is important to check that the total of both debits and credits are equal.

2. If journal entries are recorded in several pages then both the amount column of each page should be totalled and the balance should be written at the end of that page and also that the same total should be carried forward at the beginning of the next page.

An entry in the journal may appear as follows:

			₹	₹
May 5	Cash Account	Dr.	450	
	To Mohan			450
	(Being the amount received from Mohan in payment of the amount due from him)			

We will now consider some individual transactions.

(i) Mohan commences business with ₹ 5,000. This means that the firm has ₹ 5,000 cash. According to the rules given above, the increase in an asset has to be debited to it. The firm also now owes ₹ 5,000 to the proprietor, Mohan as capital. The rule given above also shows that the increase in capital should be credited to it. Therefore, the journal entry will be:

Cash Account Dr.	₹ 5,000	
To Capital Account		₹ 5,000
(Being capital introduced by Shri Mohan)		

(ii) Out of the above, ₹ 500 is deposited in the bank. By this transaction the cash balance is reduced by ₹ 500 and another asset, bank account, comes into existence. Since increase in assets is debited and decrease is credited, the journal entry will be:

Bank Account Dr.	₹ 500	
To Cash Account		₹ 500
(Being cash deposited in Bank)		

(iii) Furniture is purchased for cash ₹ 200. Applying the same reasoning as above the entry will be:

Furniture Account Dr.	₹ 200	
To Cash Account		₹ 200
(Being Furniture purchased vide CM No....)		

(iv) Purchased goods for cash ₹ 400. The student can see that the required entry is:

Purchases Account Dr.	₹ 400	
To Cash Account		₹ 400
(Being goods purchased vide CM No....)		

(v) Purchased goods for ₹ 1,000 credit from M/s. Ram Narain Bros. Purchase of merchandise is an expense item so it is to be debited. ₹ 1,000 is now owing to the supplier; his account should therefore be credited, since the amount of liabilities has increased. The entry will be:

Purchases Account Dr.	₹ 1,000	
To M/s Ram Narain Bros.		₹ 1,000
(Being goods purchased vide Bill No.....)		

(vi) Sold goods to M/S Ram & Co. for cash ₹ 600. The amount of cash increases and therefore, the cash amount should be debited; sale of merchandise is revenue item so it is to be credited. The entry will be:

Cash Account Dr.	₹ 600	
To Sales Account		₹ 600
(Being goods s old vide CM No....)		

(vii) Sold goods to Ramesh on credit for ₹ 300. The Inventories of goods has decreased and therefore, the goods account has to be credited. Ramesh now owes ₹ 300; that is an asset and therefore, Ramesh should be debited. The entry is:

Ramesh Dr.	₹ 300	
To Sales Account		₹ 300
(Being goods sold vide Bill No....)		

Note : There are two views on classificaion of "Purchase Account" and "Sales Account". One view is that they represents "flow of goods", so they should be classified as 'Real A/c'. However, others are of the oinion that only nominal a/cs are closed by tranferring to 'Trading or Profit and Loss A/c'. Therefore, purchases and sales shall be classified as Nominal A/cs. However, in both the views, there will be debit balance of Purchase A/c and credit balance of Sales A/c.

(viii)Received cash from Ramesh ₹ 300. The amount of cash increased therefore the cash account has to be debited. Ramesh no longer owes any amount to the firm, i.e., this particular form of assets has disappeared; therefore, the account of Ramesh should be credited. The entry is:

Cash Account Dr.	₹ 300	
To Ramesh		₹ 300
(Being cash received against Bill No....)		

(ix) Paid to M/s Ram Narain Bros. ₹ 1,000. The liability to M/S Ram Narain Bros. has been discharged; therefore this account should be debited. The cash balance has decreased and, therefore, the cash account has to be credited. The entry is:

M/S Ram Narain Bros. Dr.	₹ 1,000	
To Cash Account		₹ 1,000
(Being cash paid against Bill No....)		

(x) Paid rent ₹ 100. The cash balance has decreased and therefore, the cash account should be credited. No asset has come into existence because of the payment; the payment is for services enjoyed and is an expense. Expenses are debited. Therefore, the entry should be:

Rent Account Dr.	₹ 100	
To Cash Account		₹ 100
(Being rent paid for the month of ....)		

(xi) Paid ₹ 200 to the clerk as salary. Applying the reasons given in (x) above, the required entry is:

Salary Account Dr.	₹ 200	
To Cash Account		₹ 200
(Being salary paid to Mr..... for the month of ....)		

(xii) Received ₹ 20 interest. The cash account should be debited since there is an increase in the cash balance. There is no increase in any liability; since the amount is not returnable to any one, the amount is an income, incomes are credited. The entry is :

Cash Account Dr.	₹ 20	
To Interest Account		₹ 20
(Being interest received from........ for the period ....)		

When transactions of similar nature take place on the same date, they may be combined while they are journalised. For example, entries (x) and (xi) may be combined as follows:

Rent Account Dr.	₹ 100	
Salary Account Dr.	₹ 200	
To Cash Account (Being expenses done as per detail attached)		₹ 300

When journal entry for two or more transactions are combined, it is called composite journal entry. Usually, the transactions in a firm are so numerous that to record the transactions for a month will require many pages in the journal. At the bottom of one page the totals of the two columns are written together with the words "Carried forward" in the particulars column. The next page is started with the respective totals in the two columns with the words "Brought forward" in the particulars column.

Illustration 3

Analyse transactions of M/S Sahil & Co. for the month of March, 2015 on the basis of double entry system by adopting the following approaches:

(A) Accounting Equation Approach.

(B) Traditional Approach.

Transactions for the month of March, 2015 were as follows:

1. Sahil introduced cash ₹ 40,000.

2. Cash deposited in the City Bank ₹ 20,000.
3. Cash loan of ₹ 5,000 taken from Mr. Y.
4. Salaries paid for the month of March, 2015, ₹ 3,000 and ₹ 1,000 is still payable for the month of March, 2015.
5. Furniture purchased ₹ 5,000.

What conclusions one can draw from the above analysis?

Solution

(A) Analysis of Business Transaction: *Accounting Equation Approach*

Transaction	***Analysis***	***Account Affected and Nature of Account***	***Rule***	***Entry***
Introduction of ₹ 40,000 cash by the Proprietor	Cash received Investment by owner	Cash – Asset Capital – Capital	Debit increase in asset Credit increase in capital	Debit Cash Credit Capital
Cash deposited in bank ₹ 20,000	Bank balance increases Cash balance decrease	Bank – Asset Cash – Asset	Debit increase in asset Credit decrease in asset	Debit Bank Credit Cash
Loan from Y ₹ 5,000	Cash balance increases Creates an obligation to repay Y	Cash – Asset Y's Loan Liability	Debit increase in assets Credit increase in liabilities	Debit Cash Credit Y's Loan
Salaries paid ₹ 3,000 and outstanding ₹ 1,000	Salaries for services received ₹ 4,000 paid ₹ 3,000 Obligation to pay ₹ 1,000	Salary Temporary capital (Expense) Cash–Asset Salaries outstanding Liability	Debit increase in expenses Credit decrease in asset Credit increase in liabilities	Debit Salary (₹ 4,000) Credit Cash (₹ 3,000) Credit Salaries outstanding (₹ 1,000)
Furniture purchased ₹ 5,000	Increases furniture owned Cash decreases	Furniture–Asset Cash–Asset	Debit increase in asset Credit decrease in asset	Debit Furniture Credit Cash

(B) Analysis of Business Transactions: *Traditional Approach*

Transaction	***Analysis***	***Account Affected and Nature of Account***	***Rule***	***Entry***
Introduction of ₹ 40,000 cash by the proprietor	Cash is received by business Owner has given cash	Cash–Real Capital–Personal	Debit what comes in Credit the giver	Debit Cash Credit Capital
Cash deposited in bank ₹ 20,000	Bank receives cash Cash goes out of business	Bank–Personal Cash–Real	Debit the receiver Credit what goes out	Debit Bank Credit Cash
Loan from Y ₹ 5,000	Business gets cash Y pays cash	Cash–Real Y's Loan–Personal	Debit what comes in Credit the giver	Debit Cash Credit Y's Loan
Salary paid ₹ 3,000 and still payable ₹ 1,000	Cost of services used ₹ 4,000 Cash goes out ₹ 3,000 Still payable or outstanding for services received ₹ 1,000	Salary Nominal Cash–Real Salary Outstanding Personal	Debit all expenses Credit what goes out Credit the giver	Debit Salary (₹ 4,000) Credit Cash (₹ 3,000 Credit Salary outstanding (₹ 1,000)
Furniture purchased ₹ 5,000	Furniture is purchased Cash is paid	Furniture Real Cash–Real	Debit what comes in Credit what goes out	Debit Furniture Credit Cash

Conclusion:

It is evident from above analysis that procedure for analysis of transactions, classification of accounts and rules for recording business transactions under accounting equation approach and traditional approach are different. But the accounts affected and entries in affected accounts remain same under both approaches. Thus, the recording of transactions in affected accounts on the basis of double entry system is independent of the method of analysis followed by a business enterprise. In other words, accounts to be debited and credited to record the dual aspect remain same under both the approaches.

Illustration 4

Journalise the following transactions. Also state the nature of each account involved in the Journal entry.

1. December 1, 2015, Ajit started business with Cash ₹ 40,000.

2. December 3, he paid into the Bank ₹ 2,000.
3. December 5, he purchased goods for cash ₹ 15,000.
4. December 8, he sold goods for cash ₹ 6,000.
5. December 10, he purchased furniture and paid by cheque ₹ 5,000.
6. December 12, he sold goods to Arvind ₹ 4,000.
7. December 14, he purchased goods from Amrit ₹ 10,000.
8. December 15, he returned goods to Amrit ₹ 5,000.
9. December 16, he received from Arvind ₹ 3,960 in full settlement.
10. December 18, he withdrew goods for personal use ₹ 1,000.
11. December 20, he withdrew cash from business for personal use ₹ 2,000.
12. December 24, he paid telephone charges ₹ 1,000.
13. December 26, cash paid to Amrit in full settlement ₹ 4,900.
14. December 31, paid for stationery ₹ 200, rent ₹ 500 and salaries to staff ₹ 2,000.
15. December 31, goods distributed by way of free samples ₹ 1,000.

Solution

JOURNAL

Sl. No	*Date*	*Particulars*		*Nature of Account*	*L.F.*	Dr. *Debit (₹)*	Cr. *Credit (₹)*
1.	Dec. 1	Cash Account To Capital Account (Being commencement of business)	Dr.	Real A/c Personal A/c		40,000	 40,000
2.	Dec. 3	Bank Account To Cash Account (Being cash deposited in the Bank)	Dr.	Personal A/c Real A/c		2,000	 2,000
3.	Dec. 5	Purchases Account To Cash Account (Being purchase of goods for cash)	Dr.	Real A/c Real A/c		15,000	 15,000
4.	Dec. 8	Cash Account To Sales Account (Being goods sold for cash)	Dr.	Real A/c Real A/c		6,000	 6,000

5.	Dec. 10	Furniture Account To Bank Account (Being purchase of furniture, paid by cheque)	Dr.	Real A/c Personal A/c	5,000	 5,000
6.	Dec. 12	Arvind To Sales Account (Being sale of goods)	Dr.	Personal A/c Real A/c	4,000	 4,000
7.	Dec. 14	Purchases Account To Amrit (Being purchase of goods from Amrit)	Dr.	Real A/c Personal A/c	10,000	 10,000
8.	Dec. 15	Amrit To Purchases Returns Account (Being goods returned to Amrit)	Dr.	Personal A/c Real A/c	5,000	 5,000
9.	Dec. 16	Cash Account Discount Account To Arvind (Being cash received from Arvind in full settlement and allowed him ₹ 40 as discount)	Dr. Dr.	Real A/c Nominal A/c Personal A/c	3,960 40	 4,000
10.	Dec. 18	Drawings Account To Purchases Account (Being withdrawal of goods for personal use)	Dr.	Personal A/c Real A/c	1,000	 1,000
11.	Dec. 20	Drawings Account To Cash Account (Being cash withdrawal from the business for personal use)	Dr.	Personal A/c Real A/c	2,000	 2,000
12.	Dec. 24	Telephone Expenses Account To Cash Account (Being telephone expenses paid)	Dr.	Nominal A/c Real A/c	1,000	 1,000
13.	Dec. 26	Amrit To Cash Account To Discount Account (Being cash paid to Amrit and he allowed ₹ 100 as discount)	Dr.	Personal A/c Real A/c Nominal A/c	5,000	 4,900 100

14.	Dec. 31	Stationery Expenses	Dr.	Nominal A/c	200	
		Rent Account	Dr.	Nominal A/c	500	
		Salaries Account	Dr.	Nominal A/c	2,000	
		To Cash Account		Real A/c		2,700
		(Being expenses paid)				
15.	Dec. 31	Advertisement Expenses Account	Dr.	Nominal A/c	1,000	
		To Purchases Account		Real A/c		1,000
		(Being distribution of goods by way of free samples)				
		Total			1,03,700	1,03,700

Illustration 5

Show the classification of the following Accounts under traditional and accounting equation approach:

(a) Building; (b) Purchases; (c) Sales; (d) Bank Fixed Deposit; (e) Rent; (f) Rent Outstanding; (g) Cash; (h) Adjusted Purchases; (i) Closing Inventory; (j) Investments; (k) Trade receivables; (l) Sales Tax Payable, (m) Discount Allowed; (n) Bad Debts; (o) Capital; (p) Drawings; (q) Interest Receivable account; (r) Rent received in advance account; (s) Prepaid salary account; (t) Bad debts recovered account; (u) Depreciation account, (v) Personal income-tax account.

Solution

Nature of Account

Sl. No.	*Title of Account*	*Traditional Approach*	*Accounting Equation Approach*
(a)	Building	Real	Asset
(b)	Purchases	Real	Asset
(c)	Sales	Real	Temporary Capital (Revenue)
(d)	Bank Fixed Deposit	Real	Asset
(e)	Rent	Nominal (Expense)	Temporary Capital (Expense)
(f)	Rent Outstanding	Personal	Liability
(g)	Cash	Real	Asset
(h)	Adjusted Purchases	Nominal (Expense)	Temporary Capital (Expense)
(i)	Closing Inventory	Real	Asset
(j)	Investment	Real	Asset
(k)	Trade receivables	Personal	Asset

(l)	Sales Tax Payable	Personal	Liability
(m)	Discount Allowed	Nominal (Expense)	Temporary Capital (Expense)
(n)	Bad Debts	Nominal (Expense)	Temporary Capital (Expense)
(o)	Capital	Personal	Capital
(p)	Drawings	Personal	Temporary Capital (Drawings)
(q)	Interest receivable	Personal	Asset
(r)	Rent received in advance	Personal	Liability
(s)	Prepaid salary	Personal	Valuation (Asset)
(t)	Bad debts recovered	Nominal (Gain)	Temporary Capital (Gain)
(u)	Depreciation	Nominal (Expense)	Temporary Capital (Expense)
(v)	Personal Income Tax	Personal (Drawing)	Temporary Capital (Drawings)

Illustration 6

Transactions of Ramesh for April are given below. Journalise them.

2015			₹
April	1	Ramesh started business with	10,000
"	2	Paid into bank	7,000
"	3	Bought goods for cash	500
"	5	Drew cash from bank for credit	100
"	13	Sold to Krishna goods on credit	150
"	20	Bought from Shyam goods on credit	225
"	24	Received from Krishna	145
"		Allowed him discount	5
"	28	Paid Shyam cash	215
"		Discount allowed	10
"	30	Cash sales for the month	800
		Paid Rent	50
		Paid Salary	100

Solution

JOURNAL

Date	Particulars		L.F.	Dr. Amount	Cr. Date
2015				₹	₹
April 1	Cash Account	Dr.	1	10,000	
	To Capital Account		4		10,000
	(Being the amount invested by Ramesh in				
	the business as capital)				
" 2	Bank Account	Dr.	5	7,000	
	To Cash Account		1		7,000
	(Being the amount paid into bank)				
" 3	Purchases Account	Dr.	7	500	
	To Cash Account				500
	(Being goods purchased for cash)				
" 5	Cash Account	Dr.	1	100	
	To Bank Account		5		100
	(Being cash withdrawn from bank)				
" 13	Krishna	Dr.	9	150	
	To Sales Account		7		150
	(Being goods sold to Krishna on credit)				
" 20	Purchases Account	Dr.	7	225	
	To Shyam		10		225
	(Being goods bought from Shyam on credit)				
" 24	Cash Account	Dr.	1	145	
	Discount Account	Dr.	12	5	
	To Krishna		9		150
	(Being cash received from Krishna and				
	discount allowed to him)				
" 28	Shyam	Dr.	10	225	
	To Cash Account		1		215
	To Discount Account		12		10
	(Being cash paid to Shyam and discount				
	allowed by him)				
" 30	Cash Account	Dr.	1	800	

	To Sales Account		7		800
	(Being goods sold for cash)				
" 30	Rent Account	Dr.	15	50	
	Salaries Account	Dr.	10	100	
	To Cash Account		1		150
	(Being the amount paid for rent and salary)				
	Total			19,300	19,300
	(Ledger Folio imaginary)				

Illustration 7

Pass Journal Entries for the following transactions in the books of Gamma Bros.

(i) Employees had taken inventory worth ₹ 10,000 (Cost price ₹ 7,500) on the eve of Deepawali and the same was deducted from their salaries in the subsequent month.

(ii) Wages paid for erection of Machinery ₹ 8,000.

(iii) Income tax liability of proprietor ₹ 1,700 was paid out of petty cash.

(iv) Purchase of goods from Naveen of the list price of ₹ 2,000. He allowed 10% trade discount, ₹ 50 cash discount was also allowed for quick payment.

Solution

Journal Entries in the books of Gamma Bros.

	Particulars		*Dr. Amount* ₹	*Cr. Amount* ₹
(i)	Salaries A/c	Dr.	7,500	
	To Purchase A/c			7,500
	(Being entry made for inventory taken by employees)			
(ii)	Machinery A/c	Dr.	8,000	
	To Cash A/c			8,000
	(Being wages paid for erection of machinery)			
(iii)	Drawings A/c	Dr.	1,700	
	To Petty Cash A/c			1,700
	(Being the income tax of proprietor paid out of business money)			
(iv)	Purchase A/c	Dr.	1,800	
	To Cash A/c			1,750
	To Discount Received A/c			50
	(Being the goods purchased from Naveen for ₹ 2,000 @ 10% trade discount and cash discount of ₹ 50)			

9. ADVANTAGES OF JOURNAL

In journal, transactions recorded on the basis of double entry system, fetch following advantages:

1. As transactions are recorded on chronological order, one can get complete information about the business transactions on time basis.
2. Entries recorded in the journal are supported by a note termed as **narration**, which is a precise explanation of the transaction for the proper understanding of the entry. One can know the correctness of the entry through these narrations.
3. Journal forms the basis for posting the entries in the ledger. This eases the accountant in their work and reduces the chances of error.

SELF EXAMINATION QUESTIONS

I. Pick up the correct answer from the given choices:

(i) The rent paid to landlord is credited to

(a) Landlord's account. (b) Rent account. (c) Cash account. (d) None of the above.

(ii) In case of a debt becoming bad, the amount should be credited to

(a) Trade receivables account. (b) Bad debts account. (c) Cash account. (d) Sales account.

(iii) Sunset Tours has a ₹ 3,500 account receivable from Mohan. On January 20, the Rotary makes a partial payment of ₹ 2100 to Sunset Tours The journal entry made on January 20 by Sunset Tours to record this transaction includes:

(a) A credit to the cash received account of ₹ 2,100.

(b) A credit to the Accounts receivable account of ₹ 2,100.

(c) A debit to the cash account of ₹ 1,400.

(d) A debit to the Accounts receivable account of ₹ 1,400.

(iv) Which financial statement represents the accounting equation -

Assets = Liabilities + Owner's equity:

(a) Income Statement (b) Statement of Cash flows

(c) Balance Sheet (d) None of the above

(v) Which account is the odd one out?

(a) Office furniture & Equipment. (b) Freehold land and Buildings.

(c) Inventory of materials. (d) Plant and Machinery.

(vi) The debts written off as bad, if recovered subsequently are

(a) Credited to Bad Debts Recovered Account (b) Credited to Trade receivables Account.

(c) Debited to Profit and Loss Account (d) None of the above

[Ans: 1: (i)-(c), (ii)-(a), (iii)-(b), (iv)-(c), (v)-(c), (vi)-(a)]

II. From the given information, choose the most appropriate answer.

1. Classify each of the following items under:
   (i) Prepaid salary account.
   (a) Personal (b) Real (c) Nominal (d) None of the above
   (ii) Bill payable account.
   (a) Personal (b) Real (c) Nominal (d) None of the above
   (iii) Rent account.
   (a) Personal (b) Real (c) Nominal (d) None of the above
   (iv) Proprietor's account
   (a) Personal (b) Real (c) Nominal (d) None of the above
   (v) Patents account.
   (a) Personal (b) Real (c) Nominal (d) None of the above
   [Ans. **1:** (i)-(a), (ii)-(a), (iii)-(c), (iv)-(a), (v)-(b)]
2. Classify each of the following items under:
   (i) Salaries.
   (a) revenue(R) (b) expense (E) (c) asset (A) (d) liability (L) or
   (ii) Equipment.
   (a) revenue(R) (b) expense (E) (c) asset (A) (d) liability (L) or
   (iii) Accounts payable.
   (a) revenue(R) (b) expense (E) (c) asset (A) (d) liability (L) or
   (iv) Membership fees earned.
   (a) revenue(R) (b) expense (E) (c) asset (A) (d) liability (L) or
   (v) Inventory.
   (a) revenue(R) (b) expense (E) (c) asset (A) (d) liability (L) or
   (vi) Accounts receivable.
   (a) revenue(R) (b) expense (E) (c) asset (A) (d) liability (L) or
   (vii) Building.
   (a) revenue(R) (b) expense (E) (c) asset (A) (d) liability (L) or
   (viii) Profits.
   (a) revenue(R) (b) expense (E) (c) asset (A) (d) owner's capital (OC) item.
   [Ans.**2:** (i)-(b), (ii)-(c), (iii)-(d), (iv)-(a), (v)-(c), (vi)-(c), (vii)-(c), (viii)-(d)]
3. In each of the following, indicate the alternative which you consider to be correct:
   (a) In Double Entry System of Book-keeping every business transaction affects:
   (i) Two accounts. (ii) Two sides of the same account.
   (iii) The same account on two different dates. (iv) All of the above
   (b) A sale of goods to Ram for cash should be debited to:
   (i) Ram (ii) Cash (iii) Sales (iv) Capital
   (c) A withdrawal of cash from business by the proprietor should be credited to:
   (i) Drawing Account (ii) Capital Account
   (iii) Cash Account (iv) Purchase Account
   [Ans:**3:** (a)(i), (b)(ii), (c)(iii)]

CHAPTER - 2

ACCOUNTING PROCESS

Unit 2

Ledgers

Learning Objectives

After studying this unit, you will be able to :

- Understand the concept of Ledgers.
- Learn the technique of ledger posting sand how to balance an account.
- Learn the technique of opening accounts each year taking closing balances of the previous year. Note also the use of 'balance c/d' and 'balance b/d'.

1. INTRODUCTION

After recording the transactions in the journal, recorded entries are classified and grouped into by preparation of accounts and the book, which contains all set of accounts (viz. personal, real and nominal accounts), is known as Ledger. It is known as principal books of account in which account-wise balance of each account is determined.

2. SPECIMEN OF LEDGER ACCOUNTS

A ledger account has two sides-debit (left part of the account) and credit (right part of the account). Each of the debit and credit side has four columns. (i) Date (ii) Particulars (iii) Journal folio i.e. page from where the entries are taken for posting and (iv) Amount.

Dr. **Account** Cr.

Date	*Particulars*	*J.F.*	*Amount (₹)*	*Date*	*Particulars*	*J.F.*	*Amount (₹)*

3. POSTING

The process of transferring the debit and credit items from journal to classified accounts in the ledger is known as posting.

3.1 RULES REGARDING POSTING OF ENTRIES IN THE LEDGER

1. Separate account is opened in ledger book for each account and entries from ledger posted to respective account accordingly.
2. It is a practice to use words ‘To’ and ‘By’ while posting transactions in the ledger. The word ‘To’ is used in the particular column with the accounts written on the debit side while ‘By’ is used with the accounts written in the particular column of the credit side. These ‘To’ and ‘By’ do not have any meanings but are used to represent the account debited and credited.
3. The concerned account debited in the journal should also be debited in the ledger but reference should be of the respective credit account. For example: Rent paid by cash ₹ 500. The journal entry for this transaction would be.

4. BALANCING AN ACCOUNT

At the end of the each month or year or any particular day it may be necessary to ascertain the balance in an account. This is not a too difficult thing to do; suppose a person has bought goods worth ₹ 1,000 and has paid only ₹ 850; he owes ₹ 150 and that is balance in his account. To ascertain the balance in any account, what is done is to total the sides and ascertain the difference; the difference is the balance. If the credit side is bigger than the debit side, it is a credit balance. In the other case it is a debit balance. The credit balance is written on the debit side as, "To Balance c/d"; c/d means "carried down". By doing this, two sides will be equal. The totals are written on the two sides opposite one another.

Then the credit balance is written on the credit side as "By balance b/d (i.e., brought down)". This is the opening balance for the new period. The debit balance similarly is written on the credit side as "By Balance c/d", the totals then are written on the two sides as shown above as then the debit balance written on the debit side as, "To Balance b/d", as the opening balance of the new period.

It should be noted that nominal accounts are not balanced; the balance in the end are transferred to the profit and loss account. Only personal and real accounts ultimately show balances. In the illustration given above, one will have noticed that the capital account, the purchases account, sales account, the discount account, the rent account and the salary account have not been balanced. The capital account will have to be adjusted for profit or loss and that is why it has not been balanced yet.

Illustration 1

Prepare the Stationery Account of a firm for the year ended 31.12.2015 duly balanced off, from the following details:

2015		₹
Jan. 1	Inventory	480
April 5	Purchase of stationery by cheque	800
Nov. 15	Purchase of stationery on credit from Five Star Stationery Mart	1,280
Dec. 31	Inventory	240

Solution

Stationery Account

Dr.							*Cr.*
Date		***Particulars***	₹	***Date***		***Particulars***	₹
1.1.2015	To	Balance b/d	480	31.12.2015	By	Profit and loss A/c (Balancing figure)	2,320
5.4.2015	To	Bank A/c	800				
15.11.2015	To	Five Star Stationery Mart A/c	1,280	31.12.2015	By	Balance c/d	240
			2,560				2,560
1.1.2015	To	Balance b/d	240				

Illustration 2

Journalise the following transactions in the books of a trader

Debit Balance on January 1, 2015

Cash in Hand ₹ 8,000, Cash at Bank ₹ 25,000, Inventory of Goods ₹ 20,000, Building ₹ 10,000. Trade receivables: Vijay ₹ 2,000 and Madhu ₹ 2,000.

Credit Balances on January 1, 2015:

Trade payables: Anand ₹ 5,000. Capital ₹ 55,000

Following were further transactions in the month of January, 2015:

Jan. 1	Purchased goods worth ₹ 5,000 for cash less 20% trade discount and 5% cash discount.
Jan. 4	Received ₹ 1,980 from Vijay and allowed him ₹ 20 as discount.
Jan. 8	Purchased plant from Mukesh for ₹ 5,000 and paid ₹ 100 as cartage for bringing the plant to the factory and another ₹ 200 as installation charges.
Jan. 12	Sold goods to Rahim on credit ₹ 600.
Jan. 15	Rahim became insolvent and could pay only 50 paise in a rupee.
Jan. 18	Sold goods to Ram for cash ₹ 1,000.

Solution

Cash Account

Dr. *Date* 2015	*Particulars*	*L.F.*	₹	*Date* 2015	*Particulars*	*L.F.*	*Cr.* ₹
Jan. 1	To Balance b/d		8,000	Jan. 1	By Purchases A/c		3,800
Jan. 4	To Vijay		1,980	Jan. 8	By Plant A/c		300
Jan. 15	To Rahim		300	Jan. 31	By Balance c/d		7,180
Jan. 18	To Sales A/c		1,000				
			11,280				11,280
Feb. 1	To Balance b/d		7,180				

Bank Account

Dr. *Date*	*Particulars*	*L.F.*	₹	*Date*	*Particulars*	*L.F.*	*Cr.* ₹
Jan. 1	To Balance c/d		25,000	Jan. 31	By Balance c/d		25,000
			25,000				25,000
Feb. 1	To Balance b/d		25,000				

Inventory Account

Dr. *Date*	*Particulars*	*L.F.*	₹	*Date*	*Particulars*	*L.F.*	*Cr.* ₹
Jan. 1	To Balance b/d		20,000	Jan. 31	By Balance c/d		20,000
			20,000				20,000
Feb. 1	To Balance b/d		20,000				

Building Account

Date		Particulars	L.F.	₹	Date	Particulars	L.F.	₹
Dr.								*Cr.*
Jan. 1	To	Balance b/d		10,000	Jan. 31	By Balance c/d		10,000
				10,000				10,000
Feb. 1	To	Balance b/d		10,000				

Vijay

Date		Particulars	L.F.	₹	Date	Particulars	L.F.	₹
Dr.								*Cr.*
Jan. 1	To	Balance b/d		2,000	Jan. 4	By Cash A/c		1,980
						By Discount A/c		20
				2,000				2,000

Madhu

Date		Particulars	L.F.	₹	Date	Particulars	L.F.	₹
Dr.								*Cr.*
Jan. 1	To	Balance b/d		2,000	Jan. 31	By Balance c/d		2,000
				2,000				2,000
Feb. 1	To	Balance b/d		2,000				

Capital Account

Date		Particulars	L.F.	₹	Date	Particulars	L.F.	₹
Dr.								*Cr.*
Jan. 31	To	Balance c/d		55,000	Jan. 1	By Balance b/d		55,000
				55,000				55,000
					Feb. 1	By Balance b/d		55,000

Purchases Account

Date		Particulars	L.F.	₹	Date	Particulars	L.F.	₹
Dr.								*Cr.*
Jan. 1	To	Cash		3,800				
Jan. 1	To	Discount		200	Jan. 31	By Balance c/d		4,000
				4,000				4,000
Feb. 1	To	Balance b/d		4,000				

Discount Account

Date		Particulars	L.F.	₹	Date	Particulars	L.F.	₹
Dr.								*Cr.*
Jan. 4	To	Vijay		20	Jan. 1	By Purchases A/c		200
Jan. 31	To	Balance c/d		180				
				200				200
					Feb. 1	By Balance b/d		180

Plant Account

Dr. *Date*		*Particulars*	*L.F.*	₹	*Date*	*Particulars*	*L.F.*	*Cr.* ₹
Jan. 8	To	Mukesh		5,000	Jan. 31	By Balance c/d		5,300
Jan. 8	To	Cash A/c		300				
				5,300				5,300
Feb. 1	To	Balance b/d		5,300				

Mukesh

Dr. *Date*		*Particulars*	*L.F.*	₹	*Date*	*Particulars*	*L.F.*	*Cr.* ₹
Jan. 31	To	Balance c/d		5,000	Jan. 8	By Plant A/c		5,000
				5,000				5,000
					Feb. 1	By Balance b/d		5,000

Sales Account

Dr. *Date*		*Particulars*	*L.F.*	₹	*Date*	*Particulars*	*L.F.*	*Cr.* ₹
Jan. 31	To	Balance c/d		1,600	Jan. 12	By Rahim		600
					Jan. 18	By Cash A/c		1,000
				1,600	Feb. 1	By Balance b/d		1,600

Rahim

Dr. *Date*		*Particulars*	*L.F.*	₹	*Date*	*Particulars*	*L.F.*	*Cr.* ₹
Jan. 12	To	Sales A/c		600	Jan. 15	By Cash A/c		300
					Jan. 15	By Bad Debts A/c		300
				600				600

Bad Debts Account

Dr. *Date*		*Particulars*	*L.F.*	₹	*Date*	*Particulars*	*L.F.*	*Cr.* ₹
Jan. 15	To	Rahim		300	Jan. 31	By Balance c/d		300
				300				300
Feb. 1	To	Balance b/d		300				

Illustration 3

The following data is given by Mr. S, the owner, with a request to compile only the two personal accounts of Mr. H and Mr. R, in his ledger, for the month of April, 2015.

1 Mr. S owes Mr. R ₹ 15,000; Mr. H owes Mr. S ₹ 20,000.

4 Mr. R sold goods worth ₹ 60,000 @ 10% trade discount to Mr. S.

5 Mr. S sold to Mr. H goods prices at ₹ 30,000.

17 Record a purchase of ₹ 25,000 net from R, which were sold to H at a profit of ₹ 15,000.

18 Mr. S rejected 10% of Mr. R's goods of 4th April.

19 Mr. S issued a cash memo for ₹ 10,000 to Mr. H who came personally for this consignment of goods, urgently needed by him.

22 Mr. H cleared half his total dues to Mr. S, enjoying a ½% cash discount (of the payment received, ₹ 20,000 was by cheque).

26 R's total dues (less ₹ 10,000 held back) were cleared by cheque, enjoying a cash discount of ₹ 1,000 on the payment made.

29 Close H's Account to record the fact that all but ₹ 5,000 was cleared by him, by a cheque, because he was declared bankrupt.

30 Balance R's Account.

Solution

In the books of Mr. S

Mr. H Account

Dr.						*Cr.*
Date		*Particulars*	₹	*Date*	*Particulars*	₹
1.4.2015	To	Balance b/d	20,000	22.4.2015	By Bank A/c	20,000
5.4.2015	To	Sales A/c	30,000	22.4.2015	By Cash A/c (Note 2)	24,775
17.4.2015	To	Sales A/c	40,000	29.4.2015	By Discount Allowed A/c	225
				29.4.2015	By Bank A/c	40,000
				29.4.2015	By Bad Debts A/c	5,000
			90,000			90,000

Mr. R Account

Dr.						*Cr.*
Date		*Particulars*	₹	*Date*	*Particulars*	₹
18.4.2015	To	Purchase Returns A/c	5,400	1.4.2015	By Balance b/d	15,000
				4.4.2015	Purchases A/c	54,000
26.4.2015	To	Bank A/c	77,600	17.4.2015	Purchases A/c	25,000
26.4.2015	To	Discount Received A/c	1,000			
30.4.2015	To	Balance c/d	10,000			
			94,000			94,000
				1.5.2015	By Balance b/d	10,000

Working Notes:

(1) Sale of ₹ 10,000 on 19th April is a cash sales, therefore, it will not be recorded in the Personal Account of Mr. H; and (2) On 22nd April, Mr. H owes Mr. S ₹ 90,000, amount paid by Mr. H ½ of ₹ 90,000 less ½% discount i.e., ₹ 45,000– ₹ 225 = ₹ 44,775. Out of this amount, ₹ 20,000 paid by cheque and the balance of ₹ 24,775 in cash.

SELF EXAMINATION QUESTIONS

I. Pick up the correct answer from the given choices:

(i) The process of transferring the debit and credit items from a Journal to their respective accounts in the ledger is termed as

(a) Posting
(b) Purchase
(c) Balancing of an account
(d) Arithmetically accuracy test

(ii) The technique of finding the net balance of an account after considering the totals of both debits and credits appearing in the account is known as

(a) Posting
(b) Purchase
(c) Balancing of an account
(d) Arithmetically accuracy test.

(iii) Journal and ledger records transactions in

(a) A chronological order and analytical order respectively.
(b) An analytical order and chronological order respectively.
(c) A chronological order only
(d) An analytical order only.

(iv) Ledger book is popularly known as

(a) Secondary book of accounts
(b) Principal book of accounts
(c) Subsidiary book of accounts
(d) None of the above

(v) At the end of the accounting year all the nominal accounts of the ledger book are

(a) Balanced but not transferred to profit and loss account
(b) Not balanced and also the balance is not transferred to the profit and loss account
(c) Balanced and the balance is transferred to the balance sheet
(d) Not balanced and their balance is transferred to the profit and loss account.

[Ans: (i)-(a), (ii)-(c), (iii)-(a), (iv)-(b), (v)-(d)]

CHAPTER - 2

ACCOUNTING PROCESS

Unit 3

Trial Balance

Learning Objectives

After studying this unit, you will be able to :

- ♦ Understand what is trial balance and what purposes it can serve,
- ♦ Learn the technique of taking balances from ledger accounts to prepare trial balance.

1. INTRODUCTION

Preparation of trial balance is the third phase in the accounting process. After posting the accounts in the ledger, a statement is prepared to show separately the debit and credit balances. Such a statement is known as the trial balance. It may also be prepared by listing each and every account and entering in separate columns the totals of the debit and credit sides. Whichever way it is prepared, the totals of the two columns should agree. An agreement indicates reasonable accuracy of the accounting work; if the two sides do not agree, then there is simply an arithmetic error(s).

This follows from the fact that under the Double Entry System, the amount written on the debit sides of various accounts is always equal to the amounts entered on the credit sides of other accounts and vice versa. Hence the totals of the debit sides must be equal to the totals of the credit sides. Also total of the debit balances will be equal to the total of the credit balances. Once this agreement is established, there is reasonable confidence that the accounting work is free from clerical errors, though is not proof of cent per cent accuracy, because some errors of principle and compensating errors may still remain. Generally, to check the arithmetic accuracy of accounts, trial balance is prepared at monthly intervals. But because double entry system is followed, one can prepare a trial balance any time. Though a trial balance can be prepared any time but it is preferable to prepare it at the end of the accounting year to ensure the arithmetic accuracy of all the accounts before the preparation of the financial statements. It may be noted that trial balance is a statement and not an account.

2. OBJECTIVES OF PREPARING THE TRIAL BALANCE

The preparation of trial balance has the following objectives:

(i) Trial balance enables one to establish whether the posting and other accounting processes have been carried out without committing arithmetical errors. In other words, the trial balance helps to establish arithmetical accuracy of the books.

(ii) Financial statements are normally prepared on the basis of agreed trial balance; otherwise the work may be cumbersome. Preparation of financial statements, therefore, is the second objective.

(iii) The trial balance serves as a summary of what is contained in the ledger; the ledger may have to be seen only when details are required in respect of an account.

The form of the trial balance is simple as shown below:

TRIAL BALANCE

as at......................

S. No	Ledger Accounts	L.F.	Dr. Amount (Total or Balance) ₹	Cr. Amount (Total or Balance) ₹

The under mentioned points may be noted:

(i) A trial balance is prepared as on a particular date which should be mentioned at the top

(ii) In the second column the name of the account is written.

(iii) In the fourth column the total of the debit side of the account concerned or the debit balance, if any is entered.

(iv) In the next column, the total of the credit side or the credit balance is written.

(v) The two columns are totalled at the end.

(vi) The first and third column needs no explanation.

3. LIMITATIONS OF TRIAL BALANCE

One should note that the agreement of Trial Balance is not a conclusive proof of accuracy. In other words, in spite of the agreement of the trial balance some errors may remain. These may be of the following types:

(i) Transaction has not been entered at all in the journal.

(ii) A wrong amount has been written in both columns of the journal.

(iii) A wrong account has been mentioned in the journal.

(iv) An entry has not at all been posted in the ledger.

(v) Entry is posted twice in the ledger.

Still, the preparation of the trial balance is very useful; without it, the preparation of financial statement, the profit and loss account and the balance sheet, would be difficult.

4. METHODS OF PREPARATION OF TRIAL BALANCE

1. TOTAL METHOD

Under this method, every ledger account is totaled and that total amount (both of debit side and credit side) is transferred to trial balance. In this method, trial balance can be prepared as soon as ledger account is totaled. Time taken to balance the ledger accounts is saved under this method as balance can be found out in the trial balance itself. The difference of totals of each ledger account is the balance of that particular account. This method is not commonly used as it cannot help in the preparation of the financial statements.

Illustration 1

Given below is a ledger extract relating to the business of X and Co. as on March, 31, 2016. You are required to prepare the Trial Balance by the Total Amount Method.

Cash Account

Dr. Particulars	₹	Particulars	*Cr.* ₹
To Capital A/c	10,000	By Furniture A/c	3,000
To Ram's A/c	25,000	By Salaries A/c	2,500
To Cash Sales	500	By Shyam's A/c	21,000
		By Cash Purchases	1,000
		By Capital A/c	500
		By Balance c/d	7,500
	35,500		35,500

Furniture Account

Dr. Particulars	₹	Particulars	*Cr.* ₹
To Cash A/c	3,000	By Balance c/d	3,000
	3,000		3,000

Salaries Account

Dr. Particulars	₹	Particulars	*Cr.* ₹
To Cash A/c	2,500	By Balance c/d	2,500
	2,500		2,500

Shyam's Account

Dr. Particulars	₹	Particulars	*Cr.* ₹
To Cash A/c	21,000	By Purchases A/c	25,000
To Purchase Returns A/c	500	(Credit Purchases)	
To Balance c/d	3,500		–
	25,000		25,000

Purchases Account

Dr. Particulars	₹	Particulars	*Cr.* ₹
To Cash A/c (Cash Purchases)	1,000	By Balance c/d	26,000
To Sundries as per Purchases Book (Credit Purchases)	25,000		–
	26,000		26,000

Purchases Returns Account

Dr. Particulars	₹	Particulars	Cr. ₹
To Balance c/d	500	By Sundries as per Purchases Return Book	500
	500		

Ram's Account

Dr. Particulars	₹	Particulars	Cr. ₹
To Sales A/c (Credit Sales)	30,000	By Sales Returns A/c	100
		By Cash A/c	25,000
		By Balance c/d	4,900
	30,000		30,000

Sales Account

Dr. Particulars	₹	Particulars	Cr. ₹
To Balance c/d	30,500	By Cash A/c (Cash Sales)	500
		By Sundries as per Sales Book (Credit sales)	30,000
	30,500		30,500

Sales Returns Account

Dr. Particulars	₹	Particulars	Cr. ₹
To Sundries as per Sales Returns Book	100	By Balance c/d	100
	100		100

Capital Account

Dr. Particulars		₹	Particulars	Cr. ₹
To	Cash A/c	500	By Cash A/c	10,000
To	Balance c/d	9,500		–
		10,000		10,000

Solution

Trial Balance of X and Co. as at 31.03.2016

Sl. No.	*Name of Account*	*Total Debit Items* ₹	*Total of Credit Items* ₹
1.	Cash A/c	35,500	28,000
2.	Furniture A/c	3,000	
3.	Salaries A/c	2,500	
4.	Shyam's A/c	21,500	25,000
5.	Purchases A/c	26,000	
6.	Purchases Returns A/c		500
7.	Ram's A/c	30,000	25,100
8.	Sales A/c		30,500
9.	Sales Returns A/c	100	
10.	Capital A/c	500	10,000
		1,19,100	1,19,100

2. BALANCE METHOD

Under this method, every ledger account is balanced and those balances only are carry forward to the trial balance. This method is used commonly by the accountants and helps in the preparation of the financial statements. Financial statements are prepared on the basis of the balances of the ledger accounts.

Illustration 2

Taking the same information as given in Illustration 1, prepare the Trial Balance by Balance Method.

Solution

Trial Balance of X and Co. as at 31.03.2016

Sl. No.	*Name of Account*	*Debit Balance* ₹	*Credit Balance* ₹
1.	Cash A/c	7,500	
2.	Furniture A/c	3,000	
3.	Salaries A/c	2,500	
4.	Shyam's A/c		3,500
5.	Purchases A/c	26,000	
6.	Purchases Returns A/c		500
7.	Ram's A/c	4,900	
8.	Sales A/c		30,500
9.	Sales Returns A/c	100	
10.	Capital A/c	–	9,500
		44,000	44,000

3. TOTAL AND BALANCE METHOD

Under this method, the above two explained methods are combined. Under this method statement of trial balance contains seven columns instead of five columns. This has been explained with the help of the following example:

Trial Balance of X as at 31.03.2016

Sl. No.	*Heads of Account*	*L.F.*	*Debit Balance (₹)*	*Credit Balance (₹)*	*Debit Total (₹)*	*Credit Total (₹)*
1.	Cash Account		7,500		35,500	28,000
2.	Furniture Account		3,000		3,000	
3.	Salaries Account		2,500		2,500	
4.	Shyam's Account			3,500	21,500	25,000
5.	Purchases Account		26,000		26,000	
6.	Purchase Returns Account			500		500
7.	Ram's Account		4,900		30,000	25,100
8.	Sales Account			30,500		30,500
9.	Sale Returns Account		100		100	
10.	Capital Account			9,500	500	10,000
	Total		44,000	44,000	1,19,100	1,19,100

5. ADJUSTED TRIAL BALANCE (THROUGH SUSPENSE ACCOUNT)

If the trial balance do not agree after transferring the balance of all ledger accounts including cash and bank balance and also errors are not located timely, then the trial balance is tallied by transferring the difference of debit and credit side to an account known as **suspense account.** This is a temporary account opened to proceed further and to prepare the financial statements timely.

6. RULES OF PREPARING THE TRIAL BALANCE

While preparing the trial balance from the given list of ledger balances, following rules should be taken into care:

1. The balances of all (i) assets accounts (ii) expenses accounts (iii) losses (iv) drawings (v) cash and bank balances are placed in the debit column of the trial balance.
2. The balances of all (i) liabilities accounts (ii) income accounts (iii) profits (iv) capital are placed in the credit column of the trial balance.

Illustration 3

From the following ledger balances, prepare a trial balance of Anuradha Traders as on 31st March, 2016:

Account Head	₹
Capital	1,00,000
Sales	1,66,000
Purchases	1,50,000
Sales return	1,000
Discount allowed	2,000
Expenses	10,000
Trade receivables	75,000
Trade payables	25,000
Investments	15,000
Cash at bank and in hand	37,000
Interest received on investments	1,500
Insurance paid	2,500

Solution

Trial Balance of Anuradha Traders as on 31.03.2016

Dr. balance	₹	*Cr. balance*	₹
Purchases	1,50,000	Capital	1,00,000
Sales return	1,000	Sales	1,66,000
Discount allowed	2,000	Trade payables	25,000
Expenses	10,000	Interest received on investments	1,500
Trade receivables	75,000		
Investments	15,000		
Cash at bank and in hand	37,000		
Insurance paid	2,500		
Total	2,92,500		2,92,500

Illustration 4

One of your clients, Mr. Singhania has asked you to finalise his accounts for the year ended 31st March, 2016. Till date, he himself has recorded the transactions in books of accounts. As a basis for audit, Mr. Singhania furnished you with the following statement.

	Dr. Balance (₹)	Cr. Balance (₹)
Singhania's Capital		1,556
Singhania's Drawings	564	
Leasehold premises	750	
Sales		2,750
Due from customers		530
Purchases	1,259	
Purchases return	264	
Loan from bank		256
Trade payables	528	
Trade expenses	700	
Cash at bank	226	
Bills payable	100	
Salaries and wages	600	
Inventories (1.4.2015)		264
Rent and rates	463	
Sales return		98
	5,454	5,454

The closing Inventory on 31st March, 2016 was valued at ₹ 574. Mr. Singhania claims that he has recorded every transaction correctly as the trial balance is tallied. Check the accuracy of the above trial balance.

Solution

Corrected Trial Balance of Mr. Singhania
as on 31st March, 2016

Particulars	*Dr. Amount* ₹	*Cr. Amount* ₹
Singhania's Capital		1,556
Singhania's Drawings	564	
Leasehold premises	750	
Sales		2,750
Due from customers	530	
Purchases	1,259	
Purchases returns		264
Loan from Bank		256
Creditor/Suppliers		528
Trade expenses	700	
Cash at Bank	226	
Bills payable		100
Salaries and Wages	600	
Inventory (1.4.2015)	264	
Rent and rates	463	
Sales return	98	
	5,454	5,454

Reasons:

1. Due from customers is an asset, so its balance will be a debit balance.
2. Purchases return account always shows a credit balance because assets go out.
3. Balance in Creditors Account is a liability, so its balance will be a credit balance.
4. Bills payable is a liability, so its balance will be a credit balance.
5. Inventory (opening) represents assets, so it will have a debit balance.
6. Sales return account always shows a debit balance because assets come in.

Illustration 5

An inexperienced bookkeeper has drawn up a Trial Balance for the year ended 30th June, 2015.

	Dr. (₹)	*Cr.* (₹)
Provision For Doubtful Debts	200	–
Bank Overdraft	1,654	–
Capital	–	4,591
Trade payables	–	1,637
Trade receivables	2,983	–
Discount Received	252	–
Discount Allowed	–	733
Drawings	1,200	–
Office Furniture	2,155	–
General Expenses	–	829
Purchases	10,923	–
Returns Inward	–	330
Rent & Rates	314	–
Salaries	2,520	–
Sales	–	16,882
Inventory	2,418	–
Provision for Depreciation on Furniture	364	–
Total	24,983	25,002

Required:

Draw up a 'Corrected' Trial Balance, debiting or crediting any residual errors to a Suspense Account.

Solution

Trial Balance as on 30th June, 2015

Heads of Accounts	*Dr.* ₹	*Cr.* ₹
Provision for Doubtful Debts	–	200
Bank overdraft	–	1,654
Capital	–	4,591
Trade payables	–	1,637
Trade receivables	2,983	–
Discount Received	–	252
Discount allowed	733	–
Drawings	1,200	–
Office furniture	2,155	–
General Expenses	829	–
Purchases	10,923	–
Returns Inward	330	–
Rent & Rates	314	–

Salaries	2,520	–
Inventory	2,418	–
Provision for Depreciation on Furniture	–	364
Sales	–	16,882
Suspense Account (Balancing figure)	1,175	–
Total	25,580	25,580

SELF EXAMINATION QUESTIONS

I. Pick up the correct answer from the given choices:

(i) A trial balance will not balance if
- (a) Correct journal entry is posted twice.
- (b) The purchase on credit basis is debited to purchases and credited to cash.
- (c) ₹ 500 cash payment to creditor is debited to Trade payables for ₹ 50 and credited to cash as ₹ 500.
- (d) None of the above.

(ii) ₹ 1, 500 received from sub-tenant for rent and entered correctly in the cash book is posted to the debit of the rent account. In the trial balance
- (a) The debit total will be greater by ₹ 3,000 that the credit total.
- (b) The debit total will be greater by ₹ 1,500 than the credit total.
- (c) Subject to other entries being correct the total will agree.
- (d) None of the above.

(iii) After the preparation of ledgers, the next step is the preparation of
- (a) Trading accounts
- (b) Trial balance
- (c) Profit and loss account
- (d) None of the above

(iv) After preparing the trial balance the accountant finds that the total of debit side is short by ₹ 1,500. This difference will be
- (a) Credited to suspense account
- (b) Debited to suspense account
- (c) Adjusted to any of the debit balance account
- (d) Adjusted to any of the credit balance account

(v)

S. No.	*Account heads*	*Debit (₹)*	*Credit (₹)*
1.	Sales		15,000
2.	Purchases	10,000	
3.	Miscellaneous expenses	2,500	
4.	Salaries		2,500
	Total	12,500	17,500

The difference in trial balance is due to
- (a) Wrong placing of sales account
- (b) Wrong placing of salaries account
- (c) Wrong placing of miscellaneous expenses account
- (d) Wrong placing of all accounts

[Ans: (i)-(c), (ii)-(a), (iii)-(b), (iv)-(b), (v)-(b)]

CHAPTER - 2

ACCOUNTING PROCESS

Unit 4

Subsidiary Books

Learning Objectives

After studying this unit, you will be able to :

- Understand the techniques of recording transactions in Purchase Book, Sales Book; Returns Inward Book and Returns outward book; Bills Receivable and Bills Payable book.
- Learn the technique of posting from Subsidiary Books to Ledger.
- Understand that even if subsidiary books are maintained, journalisation is required for many other transactions and events.
- Learn the difference between the subsidiary books and principle books.

1. SUBSIDIARY BOOKS AND THEIR ADVANTAGES

In a Business most of the transactions generally relate to receipts and payments of cash, sale of goods and their purchase. It is convenient to keep a separate register for each such class of transactions one for receipts and payments of cash, one for purchase of goods and one for sale of goods. A register of this type is called a book of original entry or of prime entry. For transactions recorded in such books there will be no journal entry. The system by which transactions of a class are first recorded in the book, specially meant for it and on the basis of which ledger accounts are then prepared is known as the Practical System of Book keeping or even the English System. It should be noted that in this system, there is no departure from the rules of the double entry system.

These books of original or prime entry are also called subsidiary books since ledger accounts are prepared on their basis and, without the further process of ledger posting, a trial balance cannot be taken out. Normally, the following subsidiary books are used in a business:

(i) Cash book to record receipts and payments of cash, including receipts into and payments out of the bank.

(ii) Purchases book to record credit purchases of goods dealt in or of the materials and stores required in the factory.

(iii) Purchase Returns Books to record the returns of goods and materials previously purchased.

(iv) Sales Book to record the sales of the goods dealt in by the firm.

(v) Sale Returns Book to record the returns made by the customers.

(vi) Bills receivable books to record the receipts of promissory notes or hundies from various parties.

(vii) Bills Payable Book to record the issue of the promissory notes or hundies to other parties.

(viii) Journal (proper) to record the transactions which cannot be recorded in any of the seven books mentioned above.

It may be noted that in all the above cases the word "Journal" may be used for the word "book"

Advantages of Subsidiary Books

The use of subsidiary books affords the undermentioned advantages :

(i) *Division of work :* Since in the place of one journal there will be so many subsidiary books, the accounting work may be divided amongst a number of clerks.

(ii) *Specialisation and efficiency :* When the same work is allotted to a particular person over a period of time, he acquires full knowledge of it and becomes efficient in handling it. Thus the accounting work will be done efficiently.

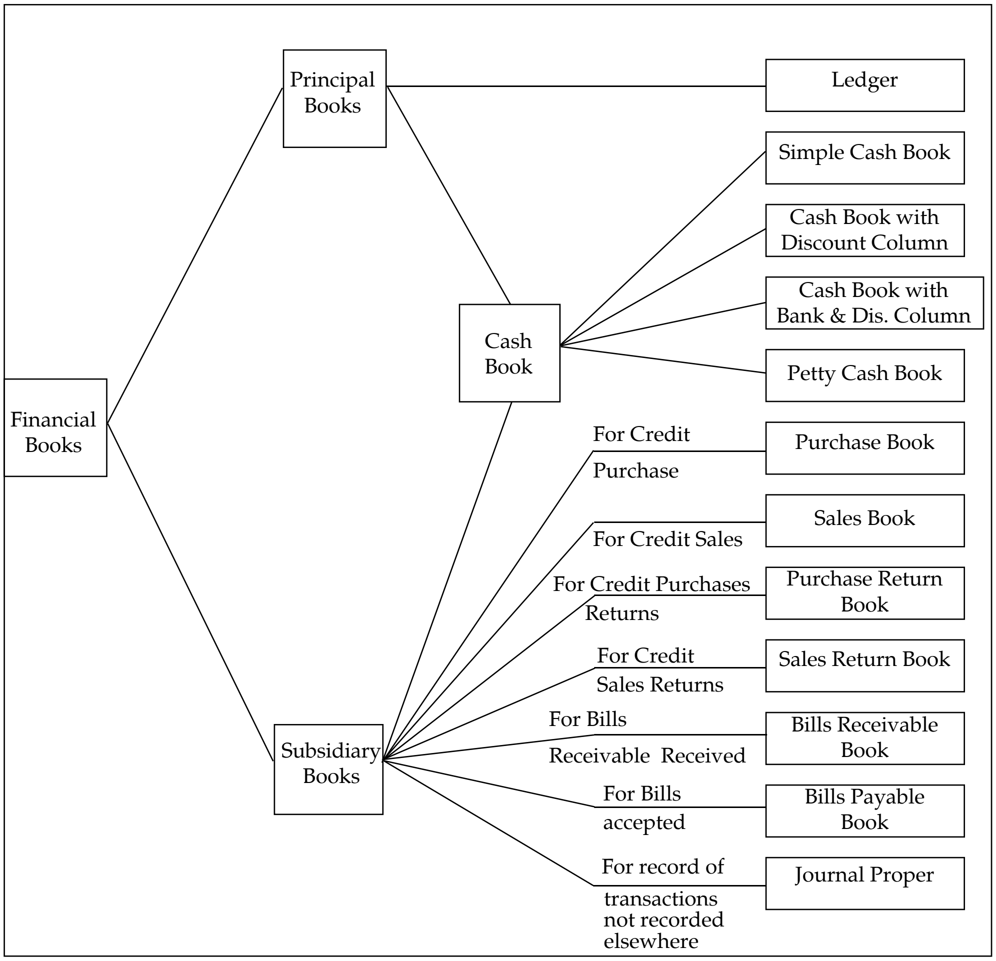
(iii) *Saving of the time :* Various acconting processes can be undertaken simultaneously because of the use of a number of books. This will lead to the work being completed quickly.

(iv) *Availability of informations :* Since a separate register or book is kept for each class of transactions, the information relating to each transactions will be available at one place.

(v) *Facility in checking:* When the trial balance does not agree, the location of the error or errors is facilitated by the existence of separate books. Even the commission of errors and frauds will be checked by the use of various subsidiary books.

2. DISTINCTION BETWEEN SUBSIDIARY BOOKS AND PRIMARY BOOKS

The books in which transactions are first recorded to enable processing are called subsidiary books. The ledger and the cash book are the principle books since they furnish information for preparation of the trial balance and financial statements. The following chart will help you in understanding the difference between Subsidiary Books and Primary Books.



3. PURCHASES BOOK

To record the credit purchases of goods dealt in or materials and stores used in the factory, a separate register called the Purchases Book or the Purchases Journal, is usually maintained by firms. The ruling is given below:

Date	Particulars	L.F.	Details ₹	Amount ₹

It should be remembered that :

(i) Cash purchases are not entered in this book since these will be entered in the cash book; and

(ii) Credit purchases of things other than goods or materials, such as office furniture or typewriters are journalised -they also are not entered in the Purchases Book.

The particulars column is meant to record the name of the supplier and name of the articles purchased and the respective quantities. The amount in respect of each article is entered in the details column. After totaling the various amounts included in a single purchase, the amount for packing, or other charges is added and the amount for trade discount is deducted. The net amount is entered in the extreme right-hand column. The total in this column shows the total purchase made in a period.

Illustration 1

The Rough Book of M/s. Narain & Co. contains the following :

2016

Feb. 1. Purchased from Brown & Co. on credit :
5 gross pencils @ ₹ 10 per gross,
1 gross registers @ ₹ 24 per doz.
Less : Trade Discount @ 10%

2. Purchased for cash from the Stationery Mart;
10 gross exercise books @ ₹ 3 per doz.

3. Purchased typewriter for office use from M/s. office
Goods Co. on credit for ₹ 800.

4. Purchased on credit from The Paper Co.
5 reams of white paper @ ₹ 10 per ream.
10 reams of ruled paper @ ₹ 15 per ream.
Less : Trade Discount @ 10%

5. Purchased one dozen ink-pots @ ₹ 1.50 each from
M/s. Verma Bros. on credit.
Make out the Purchase Book of M/s. Narain & Co.

Solution

PURCHASES BOOK

Date	*Particulars*		*L.F.*	*Amount*
2016		₹		₹
Feb. 1	M/s. Brown & Co.			
	5 gross pencils @ ₹ 10 per gross	50.00		
	1 gross registers @ ₹ 24 per doz.	288.00		
		338.00		
	Less : 10% trade discount	(33.80)		304.20
"4	The Paper Co.			
	5 reams white paper @ ₹ 10 per ream	50.00		
	10 reams ruled paper @ ₹ 15 per ream	150.00		
		200.00		
	Less : 10% trade discount	(20.00)		180.00
5	M/s. Verma Bros.			
	1 doz. ink-pots @ ₹ 1.50 each	18.00		18.00
		Total		502.20

Note : Purchases of cash and purchase for typewriter cannot be entered in the Purchase Book.

Illustration 2

Enter the following transactions in Purchase Book and post them into ledger.

2015	
April 4	Purchased from Ajay Enterprises, Delhi
	100 Doz. Rexona Hawai Chappal
	@ ₹ 120 per Doz.
	200 Doz. Palki Leather Chappal
	@ ₹ 300 per Doz.
	Less : trade discount @ 10%
	Freight charged ₹ 150.
April 15	Purchased from Balaji Traders, Delhi
	50 Doz. Max Shoes
	@ ₹ 400 per Doz.
	100 pair Sports Shoes.
	@ ₹ 140 per paid.
	Less : trade discount @ 10%.
	Freight charged ₹ 200.
April 28	Purchased from Tripti Industries, Bahadurgarh

40 pair leather shoes
@ ₹ 400 per pair
100 Doz. Rosy Hawai Chappal
@ ₹ 180 per Doz.
Less : trade discount @ 10%.
Freight charged ₹ 100.
Purchases are subject to Sales Tax @ 10%.

Solution

Purchase Book

Date 2015	*Particulars*	*Gross Amount*	*Trade Discount*	*Net Price*	*Sales Tax*	*Freight*	*Total Amount*
April 4	Ajay Enterprises 100 Doz chappal @ ₹ 120 per Doz - ₹ 12,000 200 Doz Palki Leather Chappal @ ₹ 300 per Doz - ₹ 60,000 Less trade discount @ 10%	72,000	7,200	64,800	6,480	150	71,430
April 15	Balaji Traders, Delhi 50 Doz Max Shoes @ ₹ 400 per Doz - ₹ 20,000 100 pair Sports shoes @ ₹ 140 per pair - ₹ 14,000 Less trade discount @ 10%	34,000	3,400	30,600	3,060	200	33,860
April 28	Tripti Industries, Bahadurgarh 40 pair Leather shoes @ ₹ 400 per pair - ₹ 16,000 100 DOZ Rosy Hawai Chappal @ ₹ 180 per DOZ - ₹ 18,000 Less trade discount @ 10%	34,000	3,400	30,600	3,060	100	33,760
		1,40,000	14,000	1,26,000	12,600	450	1,39,050

Ledgers

Purchases A/c

Dr.		₹	Cr.
2015			
April 30	To amount as per purchase book	1,38,600	

Freight A/c

2015		₹
April 30	To amount as per purchase book	450

Ajay Enterprises

	2015		₹
	April 4	By purchase A/c	71,280
		By Freight A/c	150

Balaji Traders

	2015		₹
	April 15	By purchase A/c	33,660
		By Freight A/c	200

Tripati Industries

	2015		₹
	April 28	By purchase A/c	33,660
		By Freight A/c	100

Purchase Account will be debited by net price and sales tax because sales tax is a part of cost of goods purchased.

3.1 POSTING THE PURCHASES BOOK

The Purchases Book shows the names of the parties from whom goods have been purchased on credit. These parties are now trade payables. Their accounts have to be credited for the respective amounts shown in the purchase book. The total of the amounts column shows the total purchases made in a period. The amount is debited to the Purchase Account to indicate receipt of goods. In illustration 11, the Purchases Account is debited by ₹ 502.12, M/s. Brown & Co. is credited by ₹ 304.12, the Paper Company by ₹ 180 and M/s. Verma Bros. by ₹ 18. The total of the amounts put on the credit side equals the debit. Thus the double entry is completed.

4. SALES BOOK

The Sales Book is a register specially kept to record credit sales of goods dealt in by the firm,cash sales are entered in the Cash Book and not in the Sales Book. Credit sales of things, other than the goods dealt in by the firm are not entered in the Sales Book ; they are journalised. The ruling is the same as for the Purchases Book.

Entries in the sales book are also made in the same manner as in the Purchase Book. The particulars column will record the name of the customers concerned together with particulars and quantities of the goods sold. For each item, the amount is entered in the details column ; after totalling the amounts for one sale, charges for packing etc; are added and the trade discount, if any is deducted: the net amount is put in the outer column. The total of this column will show the total credit sales for a period.

Illustration 3

The following are some of the transaction of M/s Kishore & Sons of the year 2015 as per their Waste Book. Make out their Sales Book.

Sold to M/s. Gupta & Verma on credit:

30 shirts @ ₹ 8 per shirt.

20 trousers @ ₹ 10 per trouser.

Less : Trade Discount @ 10%

Sold furniture to M/s. Sehgal & Co. on credit ₹ 80.

Sold 50 shirts of M/s. Jain & Sons @ ₹ 8 per shirt.

Sold 13 shirts to Cheap Stores @ ₹ 7.50 each for cash.

Sold on credit to M/s. Mathur & Jain.

100 shirts @ ₹ 7.50 per shirt

10 overcoats @ ₹ 50 per overcoat.

Less: Trade Discount @ 10%

Solution

SALES BOOK

Date	*Particulars*	*Details* ₹	*L.F.*	*Amount* ₹
2015	M/s. Gupta & Verma			
	30 shirts @ ₹ 8	240.00		
	20 Trousers @ ₹ 10	200.00		
		440.00		
	Less : 10%	(44.00)		
	Sales as per invoice no. dated			396.00
	M/s. Jain & Sons			
	50 shirts @ ₹ 8			
	Sale as per invoice no. dated			400.00
	M/s Mathur & Jain			
	100 shirts @ ₹ 7.50	750.00		
	100 overcoats @ ₹ 50	500.00		
		1,250.00		
	Less : 10%	(125.00)		
	Sales as per invoice no. dated......			1,125.00
		Total		1,921.00

Note : Cash sale and sale of furniture are not entered in Sales Book.

4.1 POSTING THE SALES BOOK

The names appearing in the Sales Book are of those parties which have received the goods. The accounts of the parties have to be debited with the respective amounts. The total of the Sales Book shows the credit sales made during the period concerned; the amount is credited to the Sales Account. In the illustration 12, ₹ 1,921 is credited to the Sales Account; ₹ 396 is debited to M/s. Gupta and Verma ₹ 400 to M/s Jain and Sons and ₹ 1,125 to M/s Mathur & Jain. The amount put on the credit side is equal to the total of the amount put on the debit side. Thus, the double entry principle is followed correctly.

4.2. SALES BOOK WITH SALES TAX COLUMN

Sales Tax is one levied at the point of sales. Sales tax is collected by the seller from the customers on sales of goods and deposited the same with the state government. Sales tax is charged at a fixed percentage on the net price of the goods. It is calculated after giving trade discount, if any. Generally a separate column is provided in the Sales Book for sales tax so that a proper record is maintained regarding sales tax collected. Rates of sales tax vary from item to item and also on local sales and interstate sales (or say central sales). A separate column in sales book for each rate of sales tax helps the dealer in calculating sales tax liability accurately.

At the end of a certain period, generally quarterly or monthly, the total of sales tax column is credited to the Sales Tax Account. When sales tax is deposited with the sales tax department, the Sales Tax Account is debited and Cash/Bank Account is credited. When there is any credit balance in Sales Tax Account, it shows the amount payable as sales tax and hence be shown in the Balance Sheet as a liability.

Illustration 4

Record the following transactions in Sales Book.

February 2, 2016 :	Sold to South Indian Toys 500 toys @ ₹ 60 each; Less: Trade Discount @ 5%; Sales tax to be charged @ 10%.
February 10, 2016 :	Sold to Ria Sisters 100 kg. of wheat @ ₹ 40 per kg.; Less: 5% Trade Discount; Sales tax charged @ 5% .
February 15, 2016 :	Sold to Raj Bros. 20 bags of White Cement Powder; @ ₹ 2,000 per bag; Less: 2% Trade Discount; Sales tax @ 8%.
February 27, 2016 :	Sold to Sen & Co. 10 chests of tea @ ₹ 500 per chest less 10% Trade Discount; Sales tax is charged @ 5%.

Solution

Sales Book

Date	Particulars	Details	Amount
February 2, 2016	South Indian Toys		
	500 toys @ ₹ 60 each	30,000	
	Less: Trade discount @ 5%	(1,500)	
		28,500	
	Add: Sales tax @ 10%.	2,850	31,350

February 10, 2016	Ria Sisters		
	100 kg. wheat @ ₹ 40 per kg.	4,000	
	Less: Trade discount @ 5%.	(200)	
		3,800	
	Add: Sales tax @ 5%.	190	3,990
February 15, 2016	Raj Bros.		
	20 bags of cement @ ₹ 2,000 per bag	40,000	
	Less: Trade discount @ 2%	(800)	
		39,200	
	Add: Sales tax @ 8%.	3,136	42,336
February 27, 2016	Sen & Co.		
	10 chests of tea @ ₹ 500 per chest.	5,000	
	Less: Trade discount @ 10%.	(500)	
		4,500	
	Add: Sales tax @ 5%	225	4,725
	Total		82,401

Illustration 5

Enter the following transactions in Sales Book of M/s. Pranat Engineers Ltd., Delhi -

2016

Jan. 2. Sold to M/s. Ajanta Electricals, Delhi 5 pieces of colour T.V. @ ₹ 6,000/- each less trade Discount @10%

8 Sold to M/s. Ajanta Electricals Plaza, 10 pieces of Washing Machines @ ₹ 8,000/- each less trade discount 5%.

15 Sold to M/s. Haryana Traders, 5 pieces of Black & White T.V. @ ₹ 3,500/- each less trade discount @ 10%.

All sales are subject to 10% Sales Tax and 10% surcharge on sales tax.

Solution

Sales Book

Date	*Particulars*	*Gross Amount*	*Trade Discount*	*Net Price*	*Sales Tax + Surcharge*	*Total Amount*
2016						
Jan. 2	Ajanta Electricals 5 pieces of					
	Colour T.V. @ ₹ 6,000/- each					
	Less 10% discount	30,000	3,000	27,000	2,970	29,970
8	Electronics Plaza 10 pieces of					
	Washing Machines @ ₹ 8,000/-					
	each, less 5% trade discount	80,000	4,000	76,000	8,360	84,360
15	Haryana Traders 5 pieces of					
	Black & White T.V. @ ₹ 3,500/-					
	each, less 10% trade discount	17,500	1,750	15,750	1,732.50	17,482.50
		1,27,500	8,750	1,18,750	13,062.50	1,31,812.50

Posting

If separate column of sales tax is provided then, each individual Trade receivable account will be debited by the total amount of respective sales bill, Sales Account and Sales Tax Payable Account shall be credited with the total of column of net sales and sales tax respectively.

Illustration 6

Post into the ledger the entries of Sales Book prepared in illustration 5.

Ledger

Dr. Cr.

Ajanta Electricals

Date	*Particulars*	*L.F.*	*Amount*	*Date*	*Particulars*	*L.F.*	*Amount*
2016			*(₹)*				*(₹)*
Jan. 2	To Sales A/c		27,000				
	To Sales Tax Payable A/c		2,970				

Electronics Plaza

Date	*Particulars*	*L.F.*	*Amount*	*Date*	*Particulars*	*L.F.*	*Amount*
2016			*(₹)*				*(₹)*
Jan. 8	To Sales A/c		76,000				
	To Sales Tax Payable A/c		8,360				

Haryana Traders

Date	Particulars	L.F.	Amount	Date	Particulars	L.F.	Amount
2016			(₹)				(₹)
Jan. 15	To Sales A/c		15,750				
	To Sales Tax Payable A/c		1,732.50				

Sales Account

Date	Particulars	L.F.	Amount	Date	Particulars	L.F.	Amount
			(₹)	2016			(₹)
				Jan 31	*By Sundries* (As per Sales Book)		1,18,750

Sales Tax Payable A/c

Date	Particulars	L.F.	Amount	Date	Particulars	L.F.	Amount
			(₹)	2016			(₹)
				Jan 31	*By Sundries* (As per Sales Book)		13,062.5

5. SALES RETURNS BOOK OR RETURNS INWARD BOOK

If customers frequently return the goods sold to them, it would be convenient to record the returns in a separate book, which is named as the Sales Returns Book or the returns Inward Book. The ruling of the book is similar to the Purchases or the Sales Book and entries are also made in the same manner. The following, assumed figures, will illustrate this:

RETURNS INWARD BOOK

Date	Particulars	Details	L.F.	Amount
2015				₹
June 7	Sunil Bank & Co.			
	6 Copies-Double Entry			
	Book keeping by T.S. Grewal @ ₹ 7	42.00		
	Less : Trade Discount 10%	(4.20)		37.80
	(returns as per debit note no.......)			
	Kailash & Co.			
	1 Copy-Business Methods			
	by R.K. Gupta			3.50
	(returns as per debit note no.......)	Total		41.30

6. PURCHASE RETURNS OR RETURNS OUTWARD BOOK

Such a book conveniently records return of goods or material purchased to the suppliers-if however, the returns are not frequent, it may be sufficient to record the transaction in the journal. The ruling of the Purchase Returns or Returns Outward Book is similar to that of the Purchase Book; entries are also similarly made, as the illustration given below shows:

RETURNS OUTWARD BOOK

Date 2015	*Particulars*	₹	*Amount* ₹
June 2	Premier Electric Co.		175.00
	One 36″ Usha Ceiling Fan		
″ 28	Mohan Electric Co.		
	Ten Iron Heaters	150.00	
	Less : Discount	(15.00)	135.00
	Total		310.00

6.1 POSTING OF THE RETURN BOOKS

The Sales Return Book will show the total of the returns made by customers. Really, the total of the returns is in reduction of the sales. Properly, therefore, the amount may be debited to the Sales Account but, usually, a separate account called Returns Inward Account is opened and the total of the sales returns is debited to this accounts. The customers who have returned the goods are credited with the respective amounts.

It should be noted that on goods being received and accepted back from the customers, a credit note is issued to the customers concerned. This shows the amount to be credited to the customer's account.

Similarly, when goods are returned to suppliers they will issue the necessary credit note; also the firm returning the goods will issue a debit note to the supplier, indicating the amount for which the supplier is liable on account of the return.

The total of Returns Outwards Book shows the total returns made. The amount can be credited to the purchase Account, but in practice, is credited to a separate account called Purchase Returns or Returns Outward Account. The suppliers whose names appear in the Book have received the goods, so their accounts have to be debited. This is shown in the illustration given below :

Illustration 7

Post the following into the ledger

RETURNS OUTWARD BOOK

Date 2015	*Particulars*	*L.F.*	*Details* ₹	*Amount* ₹
Nov. 20	Rajindra Prakash & Sons			
	One 36″ Usha Ceiling Fan		200.00	
	Less : Trade Discount @ 10%		(20.00)	180.00
″ 30	Modern Electric Company			100.00
	Total			280.00

Solution

LEDGER

RAJINDRA PARKASH & SONS.

Dr.							Cr.
Date 2015	*Particulars*	*Folio*	*Amount*	*Date*	*Particulars*	*Folio*	*Amount*
Nov. 20	To Returns Outward A/c		180.00				

MODERN ELECTRIC CO.

Dr.							Cr.
Date 2015	*Particulars*	*Folio*	*Amount*	*Date*	*Particulars*	*Folio*	*Amount*
Nov. 30	To Returns Outward A/c		100.00				

RETURNS OUTWARD ACCOUNT

Dr.							Cr.
Date	*Particulars*	*Folio*	*Amount*	*Date 2015*	*Particulars*	*Folio*	*Amount*
				Nov. 30	By Sundries as per Returns Outward A/c		280.00

6.2 BILLS RECEIVABLE BOOKS AND BILLS PAYABLE BOOKS

If the firm usually receives a number of promissory notes or hundies, it would be convenient to record the transaction in a separate book called the Bills Receivable Book. Similarly, if promissory notes or hundies are frequently issued, the Bills Payable Book will be convenient. This will be discussed later.

7. IMPORTANCE OF JOURNAL

Students are now familiar with the journal. They also know that :

(i) Cash transactions are recorded in the cash book;

(ii) Credit purchases of goods or materials are recorded in the purchases book;

(iii) Credit sales of goods are recorded in the sales book ;

(iv) Returns from customers are recorded in the sale returns book; and

(v) Returns to suppliers are entered in the purchase returns book.

Bill transactions are entered in the bills receivable books or the bills payable books, if these are maintained. Apart from the transactions mentioned above, there are some entries also which have to be recorded. For them the proper place is the journal. In fact, if there is no special book meant to record a transaction, it is recorded in the journal (proper). The role of the journal is thus restricted to the following types of entries :

(i) **Opening entries :** When books are started for the new year, the opening balance of assets and liabilities are journalised.

(ii) **Closing entries :** At the end of the year the profit and loss account has to be prepared. For this purpose, the nominal accounts are transferred to this account. This is done through journal entries called closing entries.

(iii) **Rectification entries :** If an error has been committed, it is rectified through a journal entry.

(iv) **Transfer entries :** If some amount is to be transferred from one account to another, the transfer will be made through a journal entry.

(v) **Adjusting entries :** At the end of the year the amount of expenses or income may have to be adjusted for amounts received in advance or for amounts not yet settled in cash. Such an adjustment is also made through journal entries. Usually, the entries pertain to the following:

(a) Outstanding expenses, i.e., expenses incurred but not yet paid;

(b) Prepared expenses, i.e., expenses paid in advance for some period in the future;

(c) Interest on capital, i.e., the interest which the proprietor thinks proper to allow on his investment; and

(d) Depreciation, i.e., fall in the value of the assets used on account of wear and tear.

For all these, journal entries are necessary.

(vi) **Entries on dishonour of Bills :** If someone who accepted a promissory note (or bill) and is not able to pay in on the due date,a journal entry will be necessary to record the non-payment or dishonour.

(vii) **Miscellaneous entries :** The following entries will also require journalising:

(a) Credit purchase of things other than goods dealt in or materials required for production of goods e.g. credit purchase of furniture or machinery will be journalised.

(b) An allowance to be given to the customers or a charge to be made to them after the issue of the invoice.

(c) Receipt of promissory notes or issue to them if separate bill books have not been maintained.

(d) On an amount becoming irrecoverable, say, because, of the customer becoming insolvent.

(e) Effects of accidents such as loss of property by fire.

(f) Transfer of net profit to capital account.

Illustration 8

From the following transactions, prepare the Purchases Returns Book of Alpha & Co., a Saree dealer and post them to ledger :

Date	*Debit Note No.*	*Particulars*
04.01.2016	101	Returned to Goyal Mills, Surat - 5 polyester sarees @ ₹ 100.
09.01.2016		Garg Mills, Kota - accepted the return of goods (which were purchased for cash) from us - 5 Kota sarees @ ₹ 40.
16.01.2016	102	Returned to Mittal Mills, Bangalore -5 silk sarees @ ₹ 260.
30.01.2016		Returned one typewriter (being defective) @ ₹ 3,500 to B & Co.

Solution

Purchase Returns Book

Date	*Debit Note No.*	*Name of supplier*	*L.F.*	*Amount*
2016				
Jan. 4	101	Goyal Mills, Surat		500
Jan. 16	102	Mittal Mills, Bangalore		1,300
Jan. 31		Purchases Returns Account (Cr.)		1,800

SELF EXAMINATION QUESTIONS

1. In which book of original entry, will you record the following transactions?

   (i) The debit note issued are used to prepare

   (a) Sales return book. (b) Purchase return book.

   (c) Sales book. (d) Purchases book.

   (ii) An allowance of ₹ 50 was offered for an early payment of cash of ₹ 1,050.

   (a) Sales Book (b) Cash Book

   (c) Journal Proper (General Journal) (d) Purchase Book

   (iii) A second hand motor car was purchased on credit from B Brothers for ₹ 10,000.

   (a) Journal Proper (General Journal) (b) Sales Book

   (c) Cash Book (d) Purchase Book

   (iv) Goods were sold on credit basis to A Brothers for ₹ 1,000.

   (a) Cash Book (b) Journal Proper (General Journal)

   (c) Sales Book (d) Bills Receivable Book

(v) Accounting for partial recovery from Mr. C of an amount of ₹ 2,000 earlier written off as bad debt.

(a) Journal Proper (General Journal) (b) Sales Book

(c) Purchase Book (d) Cash Book

(vi) Credit purchase of stationery worth ₹ 5,000 by a stationery dealer.

(a) Purchase Book (b) Sales Book

(c) Cash Book (d) Journal Proper (General Journal)

(vii) A bills receivable of ₹ 1,000, which was received from a debtor in full settlement for a claim of ₹ 1,100, is dishonoured.

(a) Purchases Return Book (b) Bills Receivable Book

(c) Purchases Book (d) Journal Proper (General Journal)

(viii) Purchased goods from E worth ₹ 5,000 on credit basis.

(a) Bills Receivable Book (b) Purchases Book

(c) Journal Proper (General Journal) (d) Purchases Return

(ix) Unpaid salary for ₹ 340 is to be provided for in the accounts.

(a) Bills Receivable Book (b) Purchases Book

(c) Journal Proper (General Journal) (d) Purchases Return

(x) A debit note for ₹ 2,000 issued to Mr. F for goods returned by us is to be accounted for

(a) Bills Receivable Book (b) Purchases Book

(c) Journal Proper (General Journal) (d) Purchases Return

(xi) Goods Outward Journal is meant for recording all returns of goods

(a) Sold on credit (b) Purchased on credit

(c) Purchased on cash (d) None of the above

(xii) The total of the purchases day book is posted periodically to the debit of:

(a) Purchases account. (b) Cash book.

(c) Journal proper. (d) None of these.

(xiii) Purchases day book records:

(a) All cash purchases. (b) All credit purchases

(c) Credit purchases of goods in trade. (d) None of the above

[Ans 1: (i)-(b), (ii)-(b), (iii)-(a), (iv)-(c), (v)-(d), (vi)-(a), (vii)-(d), (viii)-(b), (ix)-(c), (x)-(d), (xi)-(b), (xii)-(a), (xiii)-(c)]

2. Choose the most appropriate answer from the given options :

   (i) In Purchases Book the record is in respect of

   (a) Cash purchase of goods, (b) Credit purchase of goods dealt in,

   (c) All purchases of goods.

   (ii) The Sales Returns Book records

   (a) The return of goods purchased, (b) Return of anything purchased,

   (c) Return of goods sold.

   (iii) The Sales Book

   (a) Is a part of journal, (b) Is a part of the ledger,

   (c) Is a part of the balance sheet.

   (iv) The weekly or monthly total of the Purchase Book is

   (a) Posted to the debit of the Purchases Account,

   (b) Posted to the debit of the Sales Account,

   (c) Posted to the credit of the Purchases Account.

   (v) The total of the Sales Book is posted to

   (a) The credit of the Sales Account,

   (b) Credit of the Purchases Account,

   (c) Credit of the Capital Account

[Ans: 2: (i), (b); (ii), (c); (iii), (a); (iv), (a); (v), (a)]

CHAPTER - 2

ACCOUNTING PROCESS

Unit 5

Cash Book

Learning Objectives

After studying this unit you will be able to :

- Understand that a Cash Book is a type of subsidiary book but treated as a principal book.
- Be familiar with various kinds of Cash Books, viz., Simple Cash Book, Two-column Cash Book and Three-column Cash Book.
- Learn the technique of preparation of Simple Cash Book and how to balance it.
- See how Double-Column Cash Book is a prepared adding discount column alongwith cash column.
- Understand the techniques of preparing Three-column Cash Book.
- Understand what is a Petty Cash Book and the Imprest System of Petty Cash.
- Note the advantages of the Petty Cash Book.
- Learn how to maintain a Petty Cash Book and how to post the entries of the Petty Cash Book in the ledger.
- Understand the accounting of credit/debit sales transactions.

1. CASH BOOK - A SUBSIDIARY BOOK AND A PRINCIPAL BOOK

Cash transactions are straightaway recorded in the Cash Book and on the basis of such a record, ledger accounts are prepared. Therefore, the Cash Book is a subsidiary book. But the Cash Book itself serves as the cash account and the bank account; the balances are entered in the trial balance directly. The Cash Book, therefore, is part of the ledger also. Hence, it has also to be treated as the principal book. The Cash Book is thus both a subsidiary book and a principal book.

2. KINDS OF CASH BOOK

The main Cash Book may be of the three types:

(i) Simple Cash Book;

(ii) Two-column Cash Book;

(iii) Three-column Cash Book.

In addition to the main Cash Book, firms also generally maintain a petty cash book but that is purely a subsidiary book.

2.1 SIMPLE CASH BOOK

Such a cash book appears like an ordinary account, with one amount column on each side. The left-hand side records receipts of cash and the right hand side the payments.

Balancing of the Cash Book: The cash book is balanced like other accounts. The total of receipts column is always greater than total of payments column. The difference is written on the credit side as 'By balance c/d'. The totals are then entered in the two columns opposite one another and then on the debit side the balance is written as "To Balance b/d", to show cash balance in hand in the beginning of next period.

Illustration 1

Enter the following transactions in a Simple Cash Book:

2016		₹
Jan.1	Cash in hand	1,200
"5	Received from Ram	300
"7	Paid Rent	30
"8	Sold goods for cash	300
"10	Paid to Shyam	700
"27	Purchased Furniture	200
"31	Paid Salaries	100
"31	Rent due, not yet paid, for January	30

Solution

CASH BOOK

Dr. Date 2016	*Receipts*	*L.F.*	*Amount* ₹	*Date 2016*	*Payments*	*L.F.*	*Cr.* *Amount* ₹
Jan. 1	To Balance b/d		1,200	Jan. 07	By Rent A/c		30
" 5	To Ram A/c		300	" 10	By Shyam A/c		700
" 8	To Sales A/c		300	" 27	By Furniture A/c		200
				" 31	By Salaries A/c		100
				" 31	By Balance c/d		770
			1,800				1,800
2016							
Feb. 1	To Balance b/d		770				

Note: One can see the following:

(i) In the simple cash book only the cash receipts and cash payment are recorded.

(ii) The total of debit side is always greater than the total of credit side since the payment cannot exceed the available cash.

(iii) The simple cash book is like an ordinary account.

2.2 DOUBLE- COLUMN CASH BOOK

If along with columns for amounts to record cash receipts and cash payments another column is added on each side to record the cash discount allowed or the discount received, or a column on the debit side showing bank receipts and another column on the credit side showing payments through bank. It is a double column cash book.

Cash discount is an allowance which often accompanies cash payments. For example, if a customer owes ₹ 500 but is promised that 2% will be deducted if payment is made within a certain period, the customer can clear his account by paying promptly ₹ 490. Cash received will be ₹ 490 and ₹ 10 will be the discount for the firm receiving the payment discount is a loss; for the person making the payment it is a gain. Since cash discount is allowed only if cash is paid, it is convenient to add a column for discount allowed on the receipt side of the cash book and a column for discount received on the payment side of the cash book.

In the cash column on the debit side, actual cash received is entered; the amount of the discount allowed, if any, to the customer concerned is entered in the discount column. Similarly, actual cash paid is entered in the cash column on the payments side and discount received in the discount column. Also the bank column on the debit side records all receipts through bank and the same column on the credit side shows payment through bank.

Balancing: It should be noted that the discount columns are not balanced. They are merely totalled. The total of the discount column on the receipts side shows total discount allowed to customers and is debited to the Discount Account. The total of the column on the payments side shows total discount received and is credited to the Discount Account. The Cash columns are balanced, as already shown. The bank columns are also balanced and the balancing figure is called bank balance. Thus a double column cash book should have two columns on each side comprising of either cash and discount transaction or cash and bank transactions.

Illustration 2

Ganesh commenced business on 1st April, 2015 with ₹ 2,000 as capital. He had the following cash transactions in the month of April 2015:

		₹			₹
April 1	Purchased furniture		April 7	Paid for petty expenses	15
	and paid cash	250	" 8	Cash purchases	150
"2	Purchased goods	500			
"4	Sold goods for cash	950			
			13	Paid for Typewriter	1,000
"5	Paid cash to Ram Mohan	560			
"6	He allowed discount	10	""	Paid Ali & Sons	400
"6	Received cash from				
	Krishna & Co.	600	""	They allowed discount	8
	Allowed discount	20			

Make out the two-column Cash Book (Cash and discount column) for the month of April, 2015.

Solution

CASH BOOK

Dr. Date 2015	Receipts	L.F.	Discount ₹	Amount ₹	Date 2015	Payments	L.F.	Discount ₹	Cr. Amount ₹
April 1	To Capital A/c			2,000	April 1	By Furniture A/c			250
" 4	To Sales A/c			950	" 2	By Purchases A/c			500
" 6	To Krishna A/c		20	600					
					" 5	By Ram Mohan		10	560
					" 7	By Petty Expenses A/c			15
					" 8	By Purchases A/c			150
					" 13	By Typewriter A/c			1,000
					" 13	By Ali & Sons		8	400
					" 30	By Balance c/d			675
			20	3,550				18	3,550
May 1	To Balance b/d			675					

To summarise :

(i) the discount columns in the cash book are not accounts;

(ii) they are not balanced; and

(iii) their totals are entered in the discount received/paid account in the ledger.

Note : The person who pays, is credited by both the cash paid by him and the discount allowed to him. Similarly, the person to whom payment is made, is debited with both the amount paid and the discount allowed by him.

2.3 THREE-COLUMN CASH BOOK

A firm normally keeps the bulk of its funds at a bank; money can be deposited and withdrawn at will if it is current account. Probably payments into and out of the bank are more numerous than strict cash transactions. There is only a little difference between cash in hand and money at bank. Therefore, it is very convenient if, on each side in the cash book, another column is added to record cash deposited at bank (on the receipt side of the cash book) and payments out of the bank (on the payment side of the cash book).

For writing up the three-column cash book the under mentioned points should be noted:

1. While commencing a new business, the amount is written in the cash column if cash is introduced and in the bank column if it is directly put into the bank with the description "To Capital Account". If a new cash book is being started for an existing business, the opening balances are written as : "To Balance b/d".

2. All receipts are written on the receipts side, cash in the cash column and cheques in the bank column. If any discount is allowed to the party paying the amount, the discount is entered in the discount column. In the particulars column the name of the account in respect of which payment has been received is written.

3. All payments are written on the payments side, cash payment in the cash column and payments by cheques in the bank column. If some discount has been received from the party receiving the payment, it is entered in the discount column.

4. *Contra Entries:* Often cash is withdrawn from bank for use in the office. In such a case the amount is entered in the bank column on the payments side and also in the cash column on the receipts side. In the reverse case of cash being sent to the bank, the amount is recorded in the bank column on the receipts side and in cash column on payment side. Against such entries, the letter "C" should be written in the LF. column, to indicate that these are contra transaction and no further posting is required for them.

   Note : If initially cheques received are entered in the cash column and then sent to the bank, the entry is as if cash has been sent to the bank.

   While recording contra entries, the basic but important rules should be followed -

(a)	The Receiver	Dr.
	The Giver	Cr.
(b)	All what comes in	Dr.
	All what goes out	Cr.

   e.g. where a Cash Book with separate columns for Bank Account is maintained.

   (a) If cash is deposited in Bank Account, the Bank will be the Receiver, hence it will be Debited and as the cash is going out, cash will be credited.

   (b) If cash is withdrawn from the Bank Account, the Bank will be the Giver, hence it will be Credited and, as the cash is coming in, cash will be Debited.

5. If some cheque sent to the bank is dishonoured, i.e., the bank is not able to collect the amount, it is entered in the bank column on the credit side with the name of the related party in the particulars column.

6. If some cheque issued by the firm is not paid on presentation, it is entered in the Bank column on the debit side with the name of the party to whom the cheque was given.

7. In a rare case, a cheque received may be given to some other party, i.e., endorsed. On receipt, it must have been entered in the bank column on the debit side; on endorsement the amount will be written in the bank column on the credit side.

   The advantages of such type of Cash Book are that -

   (a) the Cash Account and the Bank Account are prepared simultaneously, therefore the double entry is completed in the Cash Book itself. Thus the contra entries can be easily cross-checked in Cash column in one side and the Bank column in the other side of the Cash Book. Also the chances of error are reduced.

(b) the information regarding Cash in Hand and the Bank Balance can be obtained very easily and quickly as there is no need to prepare Ledger of the Bank Account.

In case of maintaining more than one Bank Account, separate column can be add for each Bank Account. Transactions between these two or more Bank Accounts can be recorded and tallied with a much less effort.

Suppose, there are two Bank Accounts namely PNB Current Account and SBI-Cash Credit Account. Now, if a cheque is deposited from PNB cheque Book to SBI Account, the receiver - i.e., PNB Account will be debited and the giver i.e. the SBI Account shall be credited.

Balancing: The discount columns are totalled but not balanced. The cash columns are balanced exactly in the same manner as indicated for the simple cash book. The process is similar for balancing the bank columns also. It is possible, however, that the bank may allow the firm to withdraw more than the amount deposited i.e., to have an overdraft, In such a case, the total of the bank column on the credit side is bigger than the one on the debit side. The difference is written on the debit side as “To Balance c/d.” Then the totals are written on the two sides opposite one another, the balance is then entered on the credit side as “By Balance b/d.”

However, the usual case is that payments into the bank will exceed the withdrawals or payments out of the bank. Then the bank columns are balanced just like the cash columns.

Illustration 3

Enter the following transactions in Cash Book with Discount and Bank Columns. Cheques are first treated as cash receipt.

2016		₹
Jan.1	Chandrika commences business with Cash	20,000
“3	He paid into Current A/c	19,000
“4	He received cheque from Kirti & Co. on account	600
“7	He pays in bank Kirty & Co’s cheque	600
“10	He pays Rattan & Co. by cheque and is allowed discount ₹ 20	330
“12	Tripathi & Co pays into his Bank A/c	475
“15	He receives cheque from Warshi and allows him discount ₹ 35	450
“20	He receives cash ₹ 75 and cheque ₹ 100 for cash sale	
“25	He pays into Bank, including cheques received on 15th and 20th	1,000
“27	He pays by cheque for cash purchase	275
“30	He pays sundry expenses in cash	50

Solution

CASH BOOK

Dr. *Date*	*Receipts*	*L.F.*	*Discount* ₹	*Cash* ₹	*Bank* ₹	*Date*	*Payments*	*L.F.*	*Discount* ₹	*Cash* ₹	*Cr.* *Bank* ₹
2016						*2016*					
Jan. 1	To Capital A/c			20,000		Jan. 3	By Bank A/c	C		19,000	
3	To Cash	C			19,000	7	By Bank A/c	C		600	
4	To Kirti & Co.			600		10	By Ratan & Co.		20		330
7	To Cash	C			600	25	By Bank A/c	C		1,000	
12	To Tripathi & Co.				475	27	By Purchases A/c			275	
15	To Warshi		35	450		30	By S. Exp. A/c			50	
20	To Sales A/c			175							
25	To Cash	C			1,000						
						31	By Balance c/d			300	20,745
			35	21,225	21,075				20	21,225	21,075
Feb. 1	To Balance b/d			300	20,745						

3. POSTING THE CASH BOOK ENTRIES

Students would have seen that the cash columns in the cash book is actually the cash account and the bank column is actually bank account. Also, the discount columns are memorandum columns, meant only to provide information about the total discount allowed and total discount received.

The debit side columns for cash and bank indicate receipts. Therefore, the amounts debited in the cash book should be put to the credit of the account in respect of which cash or cheque has been received. For instance, in the cash book given above we see that ₹ 175 have been received for sale of goods. For posting, the amount is credited to the Sales Account as "By Cash ₹ 175." We also see M/s. Warsi have paid ₹ 450 and also they have been allowed ₹ 35 as discount; thus they have discharged a debt of ₹ 485. In the account of M/s. Warsi, the posting is on the credit side as

By Cash	₹ 450
By Discount	₹ 35
or as :	
By Sundries	₹ 485

All payments are recorded on the credit side. The particulars columns show on what account payments have been made. In the ledger accounts concerned the amount in put on the debit side. For example, the cash book shows that a cheque for ₹ 330 has been issued to M/s. Ratan & Co. and also that they have allowed a discount of ₹ 20; thus an obligation of ₹ 350 has been met. In the account of M/s. Ratan & Co. the posting is :

To Bank	₹ 330
To Discount	₹ 20
Or	
To Sundries	₹ 350

The rule thus develops: From the debit side of the cash book credit the various accounts with their respective amounts (including any discount that may have been allowed); from the credit side of cash book the posting will be to the debit of the accounts mentioned in the particular column with their respective amounts (including the discount which may have been received).

As has been shown already, the total of the discount columns on the debit side is debited to the discount account; the total of the column on the credit side is credited to the discount account. From the cash book given on the previous page ₹ 35 is debited and ₹ 20 be credited to the discount account.

4. PETTY CASH BOOK

In a business house a number of small payments, such as for telegrams, taxi fare, cartage, etc., have to be made. If all these payments are recorded in the cash book, it will become unnecessarily heavy. Also, the main cashier will be overburdened with work. Therefore, it is usual for firms to appoint a person as 'Petty Cashier' and to entrust the task of making small payments say below

₹ 25, to him. Of course he will be reimbursed for the payments made. Later, on an analysis, the respective account may be debited.

4.1 IMPREST SYSTEM OF PETTY CASH

It is convenient to entrust a definite sum of money to the petty cashier in the beginning of a period and to reimburse him for payments made at the end of the period. Thus, he will have again the fixed amount in the beginning of the new period. Such a system is known as the imprest system of petty cash.

The system is very useful specially if an analytical Petty Cash Book is used. The book has one column to record receipt of cash (which is only from the main cashier) and other columns to record payments of various types. The total of the various columns show why payments have been made and then the relevant accounts can be debited.

(i) The amount fixed for petty cash should be sufficient for the likely small payments for a relatively short period, say for a week or a fortnight.

(ii) The reimbursement should be made only when petty cashier prepares a statement showing total payments supported by vouchers, i.e., documentary evidence and should be limited to the amount of actual disbursements.

(iii) The vouchers should be filed in order.

(iv) No payment should be made without proper authorization. Also, payments above a certain specified limit should be made only by the main cashier.

(v) The petty cashier should not be allowed to receive any cash except for reimbursement.

In the petty cash book the extreme left-hand column records receipts of cash. The money column towards the right hand shows total payments for various purposes; a column is usually provided for sundries to record infrequent payments. The sundries column is analysed. At the end of the week or the fortnight the petty cash book is balanced. The method of balancing is the same as for the simple cash book.

Illustration 4

Shri Ramaswamy maintains a Columnar Petty Cash Book on the Imprest System. The imprest amount is ₹ 500. From the following information, show how his Petty Cash Book would appear for the week ended 12th September, 2015:

		₹
7-9-2015	Balance in hand	134.90
	Received Cash reimbursement to make up the imprest	365.10
	Stationery	49.80
8-9-2015	Miscellaneous Expenses	20.90
9-9-2015	Repairs	156.70
10-9-2015	Travelling	68.50
11-9-2015	Stationery	71.40
12-9-2015	Miscellaneous Expenses	6.30
	Repairs	48.30

Solution

PETTY CASH BOOK

Date 2015	*Receipts*	*Amount* ₹	*Date 2015*	*Payments*	*Total Amount* ₹	*Stationery* ₹	*Travelling* ₹	*Misc Exps.* ₹	*Repairs* ₹
Sept. 7	To Balance b/d	134.90	7	By Stationery	49.80	49.80			
	To Reimbursement	365.10	8	By Misc. Expenses	20.90			20.90	
			9	By Repairs	156.70				156.70
			10	By Travelling	68.50		68.50		
			11	By Stationery	71.40	71.40			
			12	By Misc. Expenses	6.30			6.30	
				By Repairs	48.30				48.30
					421.90	121.20	68.50	27.20	205.00
				By Balance c/d	78.10				
		500.00			500.00				
13	To Balance b/d	78.10							

Illustration 5

Prepare a Petty Cash Book on the imprest System from the following:

2016		₹
Jan. 1	Received ₹ 100 for petty cash	
" 2	Paid bus fare	.50
" 2	Paid cartage	2.50
" 3	Paid for Postage & Telegrams	5.00
" 3	Paid wages for casual labourers	6.00
" 4	Paid for stationery	4.00
" 4	Paid tonga charges	2.00
" 5	Paid for the repairs to chairs	15.00
" 5	Bus fare	1.00
" 5	Cartage	4.00
" 6	Postage and Telegrams	7.00
" 6	Tonga charges	3.00
" 6	Cartage	3.00
" 6	Stationery	2.00
" 6	Refreshments to customers	5.00

Solution

PETTY CASH BOOK

Receipts ₹	Date 2016	V. No.	Particulars	Total ₹	Conveyance ₹	Cartage ₹	Stationery ₹	Postage & Telegrams ₹	Wages ₹	Sundries ₹
100	Jan.1		To Cash							
	2	1	By Conveyance	.50	.50					
		2	By Cartage	2.50		2.50				
	3	3	By Postage and Telegrams	5.00				5.00		
		4	By Wages	6.00					6.00	
	4	5	By Stationery	4.00			4.00			
		6	By Conveyance	2.00	2.00					
	5	7	By Repairs to Furniture	15.00						15.00
		8	By Conveyance	1.00	1.00					
		9	By Cartage	4.00		4.00				
	6	10	By Postage and Telegrams	7.00				7.00		
	"	11	By Conveyance	3.00	3.00					
	"	12	By Cartage	3.00		3.00				
	"	13	By Stationery	2.00			2.00			
	"	14	By General Expenses	5.00						5.00
				60.00	6.50	9.50	6.00	12.00	6.00	20.00
			By Balance c/d	40.00						
100				100.00						
40.00			To Balance b/d							
60.00	8		To Cash							

4.2 ADVANTAGES OF PETTY CASH BOOK

There are mainly three advantages:

(i) Saving of time of the chief cashier;

(ii) Saving in labour in writing up the cash book and posting into the ledger; and

(iii) Control over small payments.

4.3 POSTING THE PETTY CASH BOOK

In the ledger, a petty cash account is maintained; when an amount is given to the petty cashier, the petty cash account is debited. Each week or forthnight, the total of the payments made is credited to this account. The petty cash account will then show the balance in the hand of the cashier; on demand he should be able to produce it for counting. At the end of the year, the balance is shown in the balance sheet as part of cash balance.

Of course, the payments must be debited to their respective amounts as shown by the petty cash book. For this two methods may be used:

(i) From the petty cash book the total of the various columns may be directly debited to the concerned accounts; or

(ii) A journal entry may first be prepared on the basis of the petty cash book, debiting the accounts shown by the various analysis columns, and crediting the total of the payment of the petty cash accounts.

For Illustration 5 the journal entry and relevant accounts are as follows:

2016			₹	₹
Jan. 6	Conveyance Account	Dr.	6.50	
	Cartage account	Dr.	9.50	
	Stationery account	Dr.	6.00	
	Postage and Telegrams account	Dr.	12.00	
	Wages Account	Dr.	6.00	
	Repairs Account	Dr.	15.00	
	General Expenses Account	Dr.	5.00	
	To Petty Cash Account			60.00
	(Being the analysis of the Petty Cash Book for the week ending Jan. 6)			
	Entry for cash handed over to the Petty Cashier			
	Petty Cash Account	Dr.	100	
	To Cash Account			100
	(Being Cash received)			

Petty Cash Account

Date 2016	*Particulars*	*Folio*	*Amount ₹*	*Date 2016*	*Particulars*	*Folio*	*Amount ₹*
Jan.1	To Cash		100.00	Jan.6	By Sundries:		
"8	To Cash		60.00		Conveyance		6.50
					Cartage		9.50
					Stationery		6.00
					Postage and Telegrams		12.00
					Wages		6.00
					Repairs		15.00
					General Expenses		5.00

5. ENTRIES FOR SALE THROUGH CREDIT/DEBIT CARDS

Now-a-days sales through Credit/Debit Cards are issued by almost every Bank in India either directly or with collaboration of some other agencies. HSBC Card, SBI Card, BOB Card, ICICI Bank Card, HDFC Card and Andhra Bank Card are some of the popular Cards.

The procedure for issuing Credit/Debit Cards are as follows -

1. A small Plastic Card, called Credit Card is issued by bank to a prospective customer, after verifying his credibility, which is generally measured by his income sources. Debit Card is issued by bank to a customer who has an account with the bank, maintaining a minimum balance. Now a days ATM Card issued by the bank can also be used as Debit Card. This card would contain an embossed 16 digit number and also the name of the cardholder.
2. Generally Bank charges annual subscription fees from the credit card holder. No fee is charged in case of Debit Card, though some banks charge a nominal fee on Debit Card.
3. When the Card holder intends to buy some goods or services through Credit or Debit Card, the seller fills in a form, generally in triplicate, the details of the goods a with the amount of sales and uses the embossed card with the help of the Credit Card machine to print the data on that form. Also the customer has to countersign the form. One carbon copy of the form is given to the customer for the record.
4. The seller sums up the different amounts sold like this and submits, generally everyday, to his bank all the forms. The amount is credited by the bank to the seller's account and debited to the account of the Bank or the company issuing the Credit/Debit Card.
5. The bank issuing the Card, charges commission for each such transaction, which varies between 1% to 4% and is immediately debited to seller's bank account.
6. The bank sends a monthly statement to the card holder. In case of Debit Card the account is immediately debited to the card holder's account, whereas in case of Credit Card, card

holder has to pay the amount in full or part. However, if not paid in full, the interest is charged.

5.1 ACCOUNTING FOR CREDIT/DEBIT CARD SALE

From the seller's point of view, this type of sale is equivalent to a cash sale. Commission charged by the bank will be treated as selling expenses. The following journal entries will be made in the seller's books of accounts

1. Bank A/c Dr.

   To Sales Account

   (Sales made through Credit/Debit Card)

2. Commission Account Dr.

   To Bank Account

   (Commission charged by bank)

Illustration 7

Enter the following transaction in Cash Bank with Discount and Bank columns. Cheques are first treated as cash receipts -

2016		₹
March 1	Cash in Hand	15,000
	Overdraft in Bank	500
2	Cash Sales	3,000
3	Paid to Sushil Bros. by cheque	3,400
	Discount received	100
5	Sales through credit card	2,800
6	Received cheque from Srijan	6,200
7	Endorsed Srijan's cheque in favour of Adit	
9	Deposit into Bank	6,800
10	Received cheque from Aviral and deposited the same into Bank by allowing discount of ₹ 50	3,600
11	Adit informed that Srijan's cheque is dishonoured and paid to Adit through own cheque	
15	Sales through Debit Card	3,200
24	Withdrawn from Bank	1,800
28	Paid to Sanchit by cheque	3,000
30	Bank charged 1% commission on sales through Debit/Credit Cards	

Solution

CASH BOOK

Dr. Date	Particulars	L.F.	Discount ₹	Cash ₹	Bank ₹	Date	Particulars	L.F.	Discount ₹	Cash ₹	Cr. Bank ₹
2016						*2016*					
March 1	To Balance c/d			15,000		March 1	By Balance b/d				500
2	To Sales			3,000		3	By Sushil Bros.		100		3,400
5	To Sales				2,800	7	By Adit			6,200	
6	To Srijan			6,200		9	By Bank	C		6,800	
9	To Cash A/c	C			6,800	12	By Adit				6,200
10	To Aviral		50		3,600	24	By Cash A/c	C			1,800
12	Adit			6,200		28	By Sanchit				3,000
15	To Sales A/c				3,200	30	By Commission				60
24	To Bank A/c	C		1,800		31	By Balance c/d			19,200	1,440
			50	32,200	16,400				100	32,200	16,400

SELF EXAMINATION QUESTIONS

Pick up the correct answer from the given choices:

1. (i) The total of discounts column on the debit side of the cash book, recording cash discount deducted by customers when paying their accounts, is posted to the
   (a) Credit of the discount allowed account.
   (b) Debit of the discount received account.
   (c) Credit of the discount received account.
   (d) Debit of the discount allowed account.

   (ii) Which of the following is the kind of a cash book ?
   (a) Simple column cash book
   (b) Double-column cash book
   (c) Three-column cash book
   (d) All of the above

   (iii) Cash book is a type of __________ but treated as a ____________ of accounts.
   (a) Subsidiary book, principal book
   (b) Principal book, subsidiary book
   (c) Subsidiary book, subsidiary book
   (d) Principal book, principal book

   (iv) Which of the following is not a column of a three-column cash book?
   (a) Cash column
   (b) Bank column
   (c) Petty cash column
   (d) Discount column

   (v) Salaries due for the month of March will appear
   (a) On the receipt side of the cash book
   (b) On the payment side of the cash book
   (c) As a contra entry
   (d) Nowhere in the cash book

   (vi) Contra entries are passed only when
   (a) Double-column cash book is prepared
   (b) Three-column cash book is prepared
   (c) Simple cash book is prepared
   (d) None of the above

2. Choose the most appropriate answer from the given choices.

   (i) The Cash Book records

      (a) All cash receipts

      (b) All cash payments

      (c) All cash receipts and payments

      (d) Cash and credit sale of goods.

   (ii) The balance in the petty cash book is

      (a) An expense

      (b) A profit

      (c) An asset

      (d) A liability.

   (iii) If Ram has sold goods for cash, the entry will be recorded

      (a) In the Cash Book

      (b) In the Sales Book

      (c) In the Journal

      (d) In the Inventory Book.

ANSWERS

1					
(i) (d)	(ii) (d)	(iii) (a)	(iv) (c)	(v) (d)	(vi) (b)
2					
(i) (c)	(ii) (c)	(iii) (a)			

CHAPTER - 2

ACCOUNTING PROCESS

Unit 6

Capital and Revenue Expenditures and Receipts

Learning Objectives

After studying this unit you will be able to :

- Learn the criteria for identifying Revenue Expenditure and distinguishing from Capital Expenditure.
- Be familiar with the term Deferred Revenue Expenditure.
- Learn the distinction between capital and revenue receipts.
- Understand the linkage of such distinction with the preparation of final accounts.

1. INTRODUCTION

Accounting aims in ascertaining and presenting the results of the business for an accounting period. For ascertaining the periodical business results, the nature of transactions should be analysed whether they are of capital or revenue nature. The Revenue Expense relates to the operations of the business of an accounting period or to the revenue earned during the period or the items of expenditure, benefits of which do not extend beyond that period. Capital Expenditure, on the other hand, generates enduring benefits and helps in revenue generation over more than one accounting period. Revenue Expenses must be associated with a physical activity of the entity. Therefore, whereas production and sales generate revenue in the earning process, use of goods and services in support of those functions causes expenses to occur. Expenses are recognised in the Profit & Loss Account through matching principal which tells us when and how much of the expenses to be charged against revenue. A part of the expenditure can be capitalised only when these can be traced directly to definable streams of future benefits.

The distinction of transaction into revenue and capital is done for the purpose of placing them in Profit and Loss account or in the Balance Sheet. For example: revenue expenditures are shown in the profit and loss account as their benefits are for one accounting period i.e. in which they are incurred while capital expenditures are placed on the asset side of the balance sheet as they will generate benefits for more than one accounting period and will be transferred to profit and loss account of the year on the basis of utilisation of that benefit in particular accounting year. Hence, both capital and revenue expenditures are ultimately transferred to profit and loss account.

Revenue expenditures are transferred to profit and loss account in the year of spending while capital expenditures are transferred to profit and loss account of the year in which their benefits are utilised. Therefore we can conclude that it is the time factor, which is the main determinant for transferring the expenditure to profit and loss account. Also expenses are recognized in profit and loss account through matching concept which tells us when and how much of the expenses to be charged against revenue. However, distinction between capital and revenue creates a considerable difficulty. In many cases borderline between the two is very thin.

2. CONSIDERATIONS IN DETERMINING CAPITAL AND REVENUE EXPENDITURES

The basic considerations in distinction between capital and revenue expenditures are:

(a) Nature of business: For a trader dealing in furniture, purchase of furniture is revenue expenditure but for any other trade, the purchase of furniture should be treated as capital expenditure and shown in the balance sheet as asset. Therefore, the nature of business is a very important criteria in separating an expenditure between capital and revenue.

(b) Recurring nature of expenditure: If the frequency of an expense is quite often in an accounting year then it is said to be an expenditure of revenue nature while non-recurring expenditure is infrequent in nature and do not occur often in an accounting year. Monthly salary or rent is the example of revenue expenditure as they are incurred every month while purchase of assets is not the transaction done regularly therefore, classified as capital expenditure unless materiality criteria defines it as revenue expenditure.

(c) Purpose of expenses: Expenses for repairs of machine may be incurred in course of normal maintenance of the asset. Such expenses are revenue in nature. On the other hand, expenditure incurred for major repair of the asset so as to increase its productive capacity is capital in nature. However, determination of the cost of maintenance and ordinary repairs which should be expensed, as opposed to a cost which ought to be capitalised, is not always simple.

(d) Effect on revenue generating capacity of business: The expenses which help to generate income/revenue in the current period are revenue in nature and should be matched against the revenue earned in the current period. On the other hand, if expenditure helps to generate revenue over more than one accounting period, it is generally called capital expenditure.

When expenditure on improvements and repair of a fixed asset is done, it has to be charged to Profit and Loss Account if the expected future benefits from fixed assets do not change, and it will be included in book value of fixed asset, where the expected future benefits from assets increase.

(e) Materiality of the amount involved: Relative proportion of the amount involved is another important consideration in distinction between revenue and capital.

3. CAPITAL EXPENDITURES AND REVENUE EXPENDITURES

As we have already discussed, capital expenditure contributes to the revenue earning capacity of a business over more than one accounting period whereas revenue expense is incurred to generate revenue for a particular accounting period. The revenue expenses either occur in direct relation with the revenue or in relation with accounting periods, for example cost of goods sold, salaries, rent, etc. Cost of goods sold is directly related to sales revenue whereas rent is related to the particular accounting period. Capital expenditure may represent acquisition of any tangible or intangible fixed assets for enduring future benefits. Therefore, the benefits arising out of capital expenditure last for more than one accounting period whereas those arising out of revenue expenses expire in the same accounting period.

4. DEFERRED REVENUE EXPENDITURES

Deferred revenue expenditure is that expenditure for which payment has been made or a liability incurred but which is carried forward on the presumption that it will be of benefit over a subsequent period or periods. In short, it refers to that expenditure that is, for the time being, deferred from being charged against income. Such suspension of 'charging of' operation may be due to the nature of expenses and the benefits expected there from.

Deferred revenue expenditure should be revenue expenditure by nature in the first instance. But its matching with revenue may be deferred considering the benefits to be accrued in future.

A thin line of difference exists between deferred revenue expenses and prepaid expenses. The benefits available from prepaid expenses can be precisely estimated but that is not so in case of deferred revenue expenses. For example, insurance premium paid say, for the year ending 30th June, 2015 when the accounting year ends on 31st March, 2015 will be an example of prepaid expense to the extent of premium relating to three months' period i.e. from 1st April, 2015 to 30th June, 2015. Thus the insurance protection will be available precisely for three months after the close of the Year and the amount of the premium to be carried forward can be calculated exactly.

> As per para 56 of AS 26 "Intangible Assets", in some cases expenditure is incurred to provide future economic benefits (for more than one accounting period) which does not create an asset to be recognized in the books of an entity. Such expenses, should be charged to profit and loss account in the year the amount is incurred.
>
> However, it may be noted that accounting issues of specialised nature such as accounting for discount or premium relating to borrowings and ancillary costs incurred in connection with the arrangement of borrowings, share issue expenses and discount allowed on the issue of shares may be deferred for more than one accounting period.

Illustration 1

State with reasons whether the following statements are 'True' or 'False'.

(1) Overhaul expenses of second-hand machinery purchased are Revenue Expenditure.

(2) Money spent to reduce working expenses is Revenue Expenditure.

(3) Legal fees to acquire property is Capital Expenditure.

(4) Amount spent as lawyer's fee to defend a suit claiming that the firm's factory site belonged to the plaintiff's land is Capital Expenditure.

(5) Amount spent for replacement of worn out part of machine is Capital Expenditure.

(6) Expense incurred on the repairs and white washing for the first time on purchase of an old building are Revenue Expenses.

(7) Expenses in connection with obtaining a license for running the cinema is Capital Expenditure.

(8) Amount spent for the construction of temporary huts, which were necessary for construction of the Cinema House and were demolished when the cinema house was ready, is Capital Expenditure.

Solution

(1) **False:** Overhaul expenses are incurred to put second-hand machinery in working condition to derive endurable long-term advantage. So it should be capitalised.

(2) **False:** It may be reasonably presumed that money spent for reducing revenue expenditure would have generated long-term benefits to the entity. It becomes part of intangible fixed assets if it is in the form of technical know-how and tangible fixed assets if it is in the form of additional replacement of any of the existing tangible fixed assets. So this is capital expenditure.

(3) **True:** Legal fee paid to acquire any property is part of the cost of that property. It is incurred to possess the ownership right of the property and hence a capital expenditure.

(4) **False:** Legal expenses incurred to defend a suit claiming that the firm's factory site belongs to the plaintiff is maintenance expenditure of the asset. By this expense, neither any endurable benefit can be obtained in future in addition to that what is presently available nor the capacity of the asset will be increased. Maintenance expenditure in relation to an asset is revenue expenditure.

(5) **False:** Amount spent for replacement of any worn out part of a machine is revenue expense since it is part of its maintenance cost.

(6) **False:** Repairing and white washing expenses for the first time of an old building are incurred to put the building in usable condition. These are the part of the cost of building. Accordingly, these are capital expenditure.

(7) **True:** The Cinema Hall could not be started without license. Expenditure incurred to obtain the license is pre-operative expense which is capitalised. Such expenses are amortised over a period of time.

(8) **True:** Cost of temporary huts constructed which were necessary for the construction of the cinema house is part of the construction cost of the cinema house. Therefore such costs are to be capitalised.

Illustration 2

State with reasons whether the following are Capital or Revenue Expenditure:

(1) Expenses incurred in connection with obtaining a license for starting the factory for ₹ 10,000.

(2) ₹ 1,000 paid for removal of Inventory to a new site.

(3) Rings and Pistons of an engine were changed at a cost of ₹ 5,000 to get fuel efficiency.

(4) Money paid to Mahanagar Telephone Nigam Ltd. (MTNL) ₹ 8,000 for installing telephone in the office.

(5) A factory shed was constructed at a cost of ₹ 1,00,000. A sum of ₹ 5,000 had been incurred in the construction of temporary huts for storing building material.

Solution

(1) Money paid ₹ 10,000 for obtaining license to start a factory is a capital expenditure. This is an item of expenditure incurred to acquire the right to carry on business.

(2) ₹ 1,000 paid for removal of Inventory to a new site is revenue expenditure. This is neither bringing enduring benefit nor enhancing the value of the asset.

(3) ₹ 5,000 spent in changing Rings and Pistons of an engine to get fuel efficiency is capital expenditure. This is an expenditure on improvement of a fixed asset. It results in increasing profit-earning capacity of the business by cost reduction.

(4) Money deposited with MTNL for installation of telephone in office is not expenditure. This is treated as an asset and the same is adjusted over a period of time against actual telephone bills.

(5) Cost of construction of building including cost of temporary huts is capital expenditure. Building is fixed asset which will generate enduring benefit to the business over more than one accounting period. Construction of temporary huts is incidental to the main construction. Such cost is also capitalised with the cost of building.

5. CAPITAL RECEIPTS AND REVENUE RECEIPTS

Just as a clear distinction between Capital and Revenue expenditure is necessary, in the same manner capital receipts must be distinguished from revenue receipts.

Receipts which are obtained in course of normal business activities are revenue receipts (e.g. receipts from sale of goods or services, interest income etc.). On the other hand, receipts which are not revenue in nature are capital receipts (e.g. receipts from sale of fixed assets or investments, secured or unsecured loans, owners' contributions etc.). Revenue and capital receipts are recognised on accrual basis as soon as the right of receipt is established. Revenue receipts should not be equated with the actual cash receipts. Revenue receipts are credited to the Profit and Loss Account.

On the other hand, Capital receipts are not directly credited to Profit and Loss Account. For example, when a fixed asset is sold for ₹ 92,000 (cost ₹ 90,000), the capital receipts ₹ 92,000 is not credited to Profit and Loss Account. Profit/Loss on sale of fixed assets is calculated and credited to Profit and Loss Account as follows:

Sale Proceeds	₹ 92,000
Cost	(₹ 90,000)
Profit	₹ 2,000

Illustration 3

Good Pictures Ltd., construct a cinema house and incur the following expenditure during the first year ending 31st March, 2016.

(i) Second-hand furniture worth ₹ 9,000 was purchased; repainting of the furniture costs ₹ 1,000. The furniture was installed by own workmen, wages for this being ₹ 200.

(ii) Expenses in connection with obtaining a license for running the cinema worth ₹ 20,000. During the course of the year the cinema company was fined ₹ 1,000, for contravening rules. Renewal fee ₹ 2,000 for next year also paid.

(iii) Fire insurance, ₹ 1,000 was paid on 1st October, 2015 for one year.

(iv) Temporary huts were constructed costing ₹ 1,200. They were necessary for the construction of the cinema. They were demolished when the cinema was ready.

Point out how you would classify the above items.

Solution

1. The total cost of the furniture should be treated as ₹ 10,200 i.e., all the amounts mentioned should be capitalised since without such expenditure the furniture would not be available for use. If ₹ 1,000 and ₹ 200 have been respectively debited to the Repairs Account and the Wages Account, these accounts will be credited to the Furniture Account.
2. License for running the cinema house is necessary, hence its cost should be capitalised. But the fine of ₹ 1,000 is revenue expenditure. The renewal fee for the next year is also revenue expenditure but pertains to the next year; hence, it is a prepaid expense.
3. Half of the insurance premium pertains to the year beginning on 1st April, 2016. Hence such amount should be treated as prepaid expense. The remaining amount is revenue expense for the current year.
4. Since the temporary huts were necessary for the construction, their cost should be added to the cost of the cinema hall and thus capitalised.

Illustration 4

State with reasons, how you would classify the following items of expenditure:

1. Overhauling expenses of ₹ 25,000 for the engine of a motor car to get better fuel efficiency.
2. Inauguration expenses of ₹ 25 lacs incurred on the opening of a new manufacturing unit in an existing business.
3. Compensation of ₹ 2.5 crores paid to workers, who opted for voluntary retirement.

Solution

1. Overhauling expenses are incurred for the engine of a motor car to derive better fuel efficiency. These expenses will reduce the running cost in future and thus the benefit is in form of endurable long-term advantage. So this expenditure should be capitalised.
2. Inauguration expenses incurred on the opening of a new unit may help to explore more customers This expenditure is in the nature of revenue expenditure, as the expenditure may not generate any enduring benefit to the business over more than one accounting period.
3. The amount paid to workers on voluntary retirement is in the nature of revenue expenditure. Since the magnitude of the amount of expenditure is very significant, it may be better to defer it over future years.

Illustration 5

Classify the following expenditures and receipts as capital or revenue:

(i) ₹ 10,000 spent as travelling expenses of the directors on trips abroad for purchase of capital assets.

(ii) Amount received from Trade receivables during the year.

(iii) Amount spent on demolition of building to construct a bigger building on the same site.

(iv) Insurance claim received on account of a machinery damaged by fire.

Solution

(i) Capital expenditure.

(ii) Revenue receipt.

(iii) Capital expenditure.

(iv) Capital receipt.

Illustration 6

Are the following expenditures capital in nature?

(i) M/s ABC & Co. run a restaurant. They renovate some of the old cabins. Because of this renovation some space was made free and number of cabins was increased from 10 to 13. The total expenditure was ₹ 20,000.

(ii) M/s New Delhi Financing Co. sold certain goods on installment payment basis. Five customers did not pay installments. To recover such outstanding installments, the firm spent ₹ 10,000 on account of legal expenses.

(iii) M/s Ballav & Co. of Delhi purchased a machinery from M/s Shah & Co. of Ahmedabad. M/s Ballav & Co. spent ₹ 40,000 for transportation of such machinery.

(iv) M/s Dogra & Co. installed a machinery for ₹ 5,00,000 on 1.1.2009. They were charging deprecation on straight line basis taking useful life of the machine as 10 years In December, 2015 they found that the machine became obsolete which could not be used. The machine can fetch only ₹ 50,000.

Solution:

(i) Renovation of cabins increased the number of cabins. This has an effect on the future revenue generating capability of the business. Thus the renovation expense is capital expenditure in nature.

(ii) Expense incurred to recover installments due from customer do not increase the revenue generating capability in future. It is a normal recurring expense of the business. Thus the legal expenses incurred in this case is revenue expenditure in nature.

(iii) Expenses incurred on account of transportation of fixed asset is capital expenditure in nature.

(iv) Loss arising out of obsolescence of machinery is revenue expenditure. This loss is to be charged against revenue of the year in which such loss is recognised. In this case, loss due to obsolescence is:

	₹
Cost	5,00,000
Less: Depreciation 2009-2015	(3,50,000)
Written down value at the end of 2015	1,50,000
Less: Estimated scrap value	(50,000)
	1,00,000

This loss is revenue loss in nature.

Illustration 7

Are the following expenses capital in nature?

(i) Wages paid for installation of fixed assets.

(ii) Expenses of trial run of a newly installed machine.

(iii) Money deposited with the wholesaler as security.

(iv) Money paid to Mahanagar Telephone Nigam Ltd. (MTNL) ₹ 8,000 for installing Telephone in the office.

(v) Diwali advance to employees.

(vi) Money advanced to suppliers for booking of goods.

Solution:

(i) Expenses incurred including wages for installation of any fixed asset is capital expenditure in nature.

(ii) Expenses incurred for trial run of a newly installed machinery is capital expenditure in nature.

(iii) Money deposited as security is not an expenditure item.

(iv) Money deposited with MTNL for installation of telephone is not expenditure item. This is treated as an asset.

(v) Diwali advance to employees is not an expense item.

(vi) Money advanced to supplies for booking goods is not an expense item.

SELF EXAMINATION QUESTIONS

Pick up the correct answer from the given choices:

1. Classify the following expenditures and receipts as capital or revenue:

   (i) Money spent ₹ 10,000 as traveling expenses of the directors on trips abroad for purchase of capital assets is

   (a) Capital expenditures (b) Revenue expenditures

   (c) Deferred revenue expenditures (d) None of the above

(ii) Amount of ₹ 5,000 spent as lawyers' fee to defend a suit claiming that the firm's factory site belonged to the plaintiff's land is

(a) Capital expenditures | (b) Revenue expenditures
(c) Deferred revenue expenditures | (d) None of the above

(iii) Entrance fee of ₹ 2,000 received by Ram and Shyam Social Club is

(a) Capital receipt | (b) Revenue receipt
(c) Capital expenditures | (d) Revenue expenditures

(iv) Subsidy of ₹ 40,000 received from the government for working capital by a manufacturing concern is

(a) Capital receipt | (b) Revenue receipt
(c) Capital expenditures | (d) Revenue expenditures

(v) Insurance claim received on account of machinery damaged completely by fire is

(a) Capital receipt | (b) Revenue receipt
(c) Capital expenditures | (d) Revenue expenditures

(vi) Interest on investments received from UTI is

(a) Capital receipt | (b) Revenue receipt
(c) Capital expenditures | (d) Revenue expenditures

(vii) Amount received from IDBI as a medium term loan for augmenting working capital is

(a) Capital expenditures | (b) Revenue expenditures
(c) Capital receipt | (d) Revenue receipt

(viii) A bad debt recovered during the year will be

(a) Capital expenditures | (b) Revenue expenditures
(c) Capital receipt | (d) Revenue receipt

(ix) A second hand car is purchased for ₹ 10,000, the amount of ₹ 1,000 is spent on its repairs, ₹ 500 is incurred to get the car registered in owner's name and ₹ 1,200 is paid as dealer's commission. The amount debited to car account will be

(a) ₹ 10,000. (b) ₹ 10,500. (c) ₹ 11,500. (d) ₹ 12,700.

(x) Revenue from sale of products, ordinarily, is reported as part of the earning in the period in which

(a) The sale is made. | (b) The cash is collected.
(c) The products are manufactured. | (d) The planning takes place.

(xi) If repair cost is ₹ 25,000, whitewash expenses are ₹ 5,000, cost of extension of building is ₹ 2,50,000 and cost of improvement in electrical wiring system is ₹ 19,000; the amount to be expensed is

(a) ₹ 2,99,000. (b) ₹ 44,000. (c) ₹ 30,000. (d) ₹ 49,000.

[Ans. 1: (i)-(a), (ii)-(b), (iii)-(a), (iv)-(b), (v)-(a), (vi)-(b), (vii)-(c), (viii)-(d), (ix)-(d), (x)-(a), (xi)-(c)]

2. Out of the following which are (1) capital expenditure; (2) revenue expenditure; and (3) deferred revenue expenditure?

(i) ₹ 1,200 spent on the repairs of machine is

(a) Capital expenditure; (b) Revenue expenditure;

(c) Deferred revenue expenditure; (d) None of the above.

(ii) ₹ 2,500 spent on the overhaul of machines purchased second-hand is

(a) Capital expenditure; (b) Revenue expenditure;

(c) Deferred revenue expenditure; (d) None of the above.

(iii) Whitewashing expenses are

(a) Capital expenditure; (b) Revenue expenditure;

(c) Deferred revenue expenditure; (d) None of the above.

(iv) Paper purchased for use as stationery is

(a) Capital expenditure; (b) Revenue expenditure;

(c) Deferred revenue expenditure; (d) None of the above.

[Ans: 2**:** (ii) Is a capital expenditure and Item no. and remaining items are revenue expenditures.]

CHAPTER - 2

ACCOUNTING PROCESS

Unit 7

Contingent Assets and Contingent Liabilities

Learning Objectives

After studying this unit you will be able to :

- Understand the meaning of the terms 'Contingent Assets' and 'Contingent Liabilities'.
- Distinguish 'Contingent Liabilities' with 'Liabilities' and 'Provisions'.

1. CONTINGENT ASSETS

A contingent asset may be defined as a possible asset that arises from past events and whose existence will be confirmed only after occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise. It usually arises from unplanned or unexpected events that give rise to the possibility of an inflow of economic benefits to the business entity. For example, a claim that an enterprise is pursuing through legal process, where the outcome is uncertain, is a contingent asset.

As per the concept of prudence as well as the present accounting standards, an enterprise should not recognise a contingent asset. These assets are uncertain and may arise from a claim which an enterprise pursues through a legal proceeding. There is uncertainty in realisation of claim. It is possible that recognition of contingent assets may result in recognition of income that may never be realised. However, when the realisation of income is virtually certain, then the related asset no longer remains as contingent asset.

A contingent asset need not be disclosed in the financial statements. A contingent asset is usually disclosed in the report of the approving authority (Board of Directors in the case of a company, and the corresponding approving authority in the case of any other enterprise), if an inflow of economic benefits is probable. Contingent assets are assessed continually and if it has become virtually certain that an inflow of economic benefits will arise, the asset and the related income are recognised in the financial statements of the period in which the change occurs.

2. CONTINGENT LIABILITIES

The term 'Contingent liability' can be defined as

"(a) a possible obligation[1] that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; or

(b) a present obligation[2] that arises from past events but is not recognised because:

  (i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or

  (ii) a reliable estimate of the amount of the obligation cannot be made."

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[1] *Possible Obligation: An obligation is a possible obligation if, based on the evidence available, its existence at the balance sheet date is considered not probable.*

[2] *Present Obligation: An obligation is a present obligation if, based on the evidence available, its existence at the balance sheet date is considered probable, i.e., more likely than not.*

A contingent liability is a possible obligation arising from past events and may arise in future depending on the occurrence or non-occurrence of one or more uncertain future events [part (a) of the definition]. A contingent liability may also be a present obligation that arises from past events [(part (b) of the definition)].

An enterprise should not recognise a contingent liability. A Contingent liability is required to be disclosed unless possibility of outflow of a resource embodying economic benefits is remote. These liabilities are assessed continually to determine whether an outflow of resources embodying economic benefits has become probable. If it becomes probable that an outflow or future economic benefits will be required for an item previously dealt with as a contingent liability, a provision is recognised in financial statements of the period in which the change in probability occurs except in the extremely rare circumstances where no reliable estimate can be made.

3. DISTINCTION BETWEEN CONTINGENT LIABILITIES AND LIABILITIES

The distinction between a liability and a contingent liability is generally based on the judgement of the management. A liability is defined as the present financial obligation of an enterprise, which arises from past events. The settlement of a liability results in an outflow from the enterprises of resources embodying economic benefits. On the other hand, in the case of contingent liability, either outflow of resources to settle the obligation is not probable or the amount expected to be paid to settle the liability cannot be measured with sufficient reliability. Examples of contingent liabilities are claims against the enterprise not acknowledged as debts, guarantees given in respect of third parties, liability in respect of bills discounted and statutory liabilities under dispute etc. In addition to present obligations that are recognised as liabilities in the balance sheet, enterprises are required to disclose contingent liability in their balance sheets by way of notes.

4. DISTINCTION BETWEEN CONTINGENT LIABILITIES AND PROVISIONS

Provision means "any amount written off or retained by way of providing for depreciation, renewal or diminution in the value of assets or retained by way of providing for any known liability of which the amount cannot be determined with substantial accuracy".

It is important to know the difference between provisions and contingent liabilities. The distinction between both of them can be explained as follows:

	Provision	Contingent liability
(1)	Provision is a present liability of uncertain amount, which can be measured reliably by using a substantial degree of estimation.	A Contingent liability is a possible obligation that may or may not crystallise depending on the occurrence or non-occurrence of one or more uncertain future events.
(2)	A provision meets the recognition criteria.	A contingent liability fails to meet the same.
(3)	Provision is recognised when (a) an enterprise has a present obligation arising from past events; an outflow of resources embodying economic benefits is probable, and (b) a reliable estimate can be made of the amount of the obligation.	Contingent liability includes present obligations that do not meet the recognition criteria because either it is not probable that settlement of those obligations will require outflow of economic benefits, or the amount cannot be reliably estimated.
(4)	If the management estimates that it is probable that the settlement of an obligation will result in outflow of economic benefits, it recognises a provision in the balance sheet.	If the management estimates, that it is less likely that any economic benefit will outflow the firm to settle the obligation, it discloses the obligation as a contingent liability.

Let us take an example to understand the distinction between provisions and contingent liabilities. The Central Excise Officer imposes a penalty on Alpha Ltd. for violation of a provision in the Central Excise Act. The company goes on an appeal. If the management of the company estimates that it is probable that the company will have to pay the penalty, it recognises a provision for the liability. On the other hand, if the management anticipates that the judgement of the appellate authority will be in its favour and it is less likely that the company will have to pay the penalty, it will disclose the obligation as a contingent liability instead of recognising a provision for the same.

SELF EXAMINATION QUESTIONS

Pick up the correct answer from the given choices:

1. (i) Contingent asset usually arises from unplanned or unexpected events that give rise to

   (a) The possibility of an inflow of economic benefits to the business entity.

   (b) The possibility of an outflow of economic benefits to the business entity.

   (c) Either (a) or (b)

   (d) None of the above.

(ii) If an inflow of economic benefits is probable then a contingent asset is disclosed

(a) In the financial statements.

(b) In the report of the approving authority (Board of Directors in the case of a company, and the corresponding approving authority in the case of any other enterprise).

(c) In the cash flow statement.

(d) None of the above.

(iii) In the case of ___________, either outflow of resources to settle the obligation is not probable or the amount expected to be paid to settle the liability cannot be measured with sufficient reliability.

(a) Liability.

(b) Provision.

(c) Contingent liabilities.

(d) Contingent assets.

(iv) Present liability of uncertain amount, which can be measured reliably by using a substantial degree of estimation is termed as ________.

(a) Provision.

(b) Liability.

(c) Contingent liability.

(d) None of the above.

(v) In the financial statement, contingent liability is

(a) Recognised

(b) Not recognised.

(c) Adjusted.

(d) None of the above.

ANSWERS

(i)	(a)	(ii)	(b)	(iii)	(c)	(iv)	(a)	(v)	(b)	

CHAPTER - 2

ACCOUNTING PROCESS

Unit 8

Rectification of Errors

Learning Objectives

After studying this unit, you will be able to :

- ♦ Understand different types of errors which may occur in course of recording transactions and events.
- ♦ Be familiar with the steps involved in locating errors.
- ♦ Learn the nature of one-sided errors and two-sided errors.
- ♦ Understand why suspense account is opened for rectification of errors.
- ♦ Understand the technique of correcting errors of one period in the next accounting period.

1. INTRODUCTION

Unintentional omission or commission of amounts and accounts in the process of recording the transactions are commonly known as errors These various unintentional errors can be committed at the stage of collecting financial information/data on the basis of which financial statements are drawn or at the stage of recording this information. Also errors may occur as a result of mathematical mistakes, mistakes in applying accounting policies, misinterpretation of facts, or oversight. To check the arithmetic accuracy of the journal and ledger accounts, trial balance is prepared. If the trial balance does not tally, then it can be said that there are errors in the accounts which requires rectification thereof. Some of these errors may affect the Trial Balance and some of these do not have any impact on the Trial Balance although such errors may affect the determination of profit or loss, assets and liabilities of the business.

Illustrative Case of Errors and their Nature

We have seen that after preparing ledger accounts a trial balance is taken out where debit and credit balances are separately listed and totalled. If the two totals do not agree, it is definite that there have been some errors We shall now study the types of errors which may be committed and how they may be rectified. For this purpose, the working of the following illustrative cases should be carefully seen.

Illustrative Cases of Errors

(a) Wrong Entry: Let us start from the first phase in the accounting process. Wrong entry of the value of transactions and events in the subsidiary books, Journal Proper and Cash Book may occur.

Example 1: Credit purchases ₹ 17,270 are entered in the Purchases Day Book as ₹ 17,720. Credit sales of ₹ 15,000 gross less 1% trade discount are wrongly entered in Sales Day Book at ₹ 15,000. Cheque issued ₹ 19,920 are wrongly entered in the credit of bank column in the Cash Book as ₹ 19,290.

(b) Wrong positing from subsidiary books: Subsidiary books are totalled periodically and posted to the appropriate ledger accounts. There may arise totalling errors. Totalling errors may arise due to wrong entry or simply these may be independent errors.

Example 2: For the month of January, 2011 total of credit sales are ₹ 1,75,700, this is wrongly totalled as ₹ 1,76,700 and posted to sales account as ₹ 1,76,700.

(**c**) **Wrong casting of subsidiary book:** For example, wrong castings of the Cash Book result in balancing error.

Example 3: The following cash transactions of M/s Tularam & Co. occurred:

2015

Jan. 1	Balance - cash ₹ 1,200 bank ₹ 16,000;
Jan. 2	Cheque issued to M/s Bholaram & Co., a supplier, for ₹ 22,500;
Jan. 6	Cheque collected from M/s Scindia & Bros. ₹ 42,240 and deposited for clearance;
Jan. 7	Cash sales ₹ 27,200 paid wages ₹ 12,400;
Jan. 8	Cash sales ₹ 37,730 cash deposited to bank ₹ 35,000.

The following Cash Book entries are passed:

Cash Book

Dr. Date 2015	*Particulars*	*Cash* ₹	*Bank* ₹	*Date* 2015	*Particulars*	*Cash* ₹	*Cr.* *Bank* ₹
Jan. 1	To Balance b/d	1,200	16,000	Jan. 2	By M/s Bholaram & Co. A/c		22,500
Jan. 6	To M/s Scindia & Bros A/c		**42,420**		By Wages A/c	**12,200**	
Jan. 7	To Sales A/c	27,200			By Bank A/c	**34,500**	
Jan. 8	To Sales A/c	**37,370**			By Balance c/d	19,070	71,420
Jan. 8	To Cash A/c		**34,500**				
		65,770	**93,920**			65,770	**93,920**

Wrong entries and casting are shown in bold prints. However, errors of cash entries generally are not carried. Usually cash balances are tallied daily. So errors are identified at an early stage. But bank balance cannot be checked daily and thus errors may be carried until bank reconciliation is made. In the above example, there are four wrong entries and one wrong casting Bank and cash balances are affected by these errors.

(d) Wrong casting of ledger balances: Likewise Cash Book, any ledger account balance may be cast wrongly. Obviously wrong postings make the balance wrong; but that is not wrong casting of balances. Whenever there arises independent casting error as in the case of bank column in the Cash Book of example (4), that is called wrong casting of ledger balances.

Example 4: The following are the credit purchases of M/s Ballav Bros.:

2015

Jan. 1 Purchases from M/s Saurabh & Co.- gross ₹ 1,00,000 less 1% trade discount.

Jan. 3 Purchases from M/s Netai & Co.- gross ₹ 70,000 less 1% trade discount.

Jan. 6 Purchases from M/s Saurabh & Co.- gross ₹ 60,000 less 1% trade discount

Let us cast M/s Saurabh & Co.'s Account:

M/s Saurabh & Co. Account

Dr. *Date*	*Particulars*	*Amount* ₹	*Date*	*Particulars*	*Cr.* *Amount* ₹
2015			***2015***		
Jan. 1	To Balance c/d	1,55,000	Jan. 1	By Purchases A/c	99,000
			Jan. 6	By Purchases A/c	59,000
		1,55,000			1,55,000

While casting the credit side an error has been committed and so the account is wrongly balanced.

Example 5: Goods are purchased on credit from M/s Saurabh & Co. for ₹ 27,030 and from M/s Karnataka Suppliers for ₹ 28,050. The following Day Book is prepared:

Purchases Day Book

Date	*Particulars*	*Amount* ₹
	M/s Saurabh & Co.	27,050
	M/s Karnataka Suppliers	28,030
		55,080

In the Day Book both the transactions are entered wrongly but the first error has been compensated by the second. Even if these errors are not rectified Trial Balance would tally.

Trial Balance

Particulars	*Dr.* ₹	*Cr.* ₹
M/s Saurabh & Co.		27,050
M/s Karnataka Suppliers		28,030
Purchases Account	55,080	
	55,080	55,080

2. STAGES OF ERRORS

Errors may occur at any of the following stages of the accounting process:

2.1 AT THE STAGE OF RECORDING THE TRANSACTIONS IN JOURNAL

Following types of errors may happen at this stage:

(i) Errors of principle,

(ii) Errors of omission,

(iii) Errors of commission.

2.2 AT THE STAGE OF POSTING THE ENTRIES IN LEDGER

(i) Errors of omission:

- (a) Partial omission,
- (b) Complete omission.

(ii) Errors of commission:

- (a) Posting to wrong account,
- (b) Posting on the wrong side,
- (c) Posting of wrong amount.

2.3 AT THE STAGE OF BALANCING THE LEDGER ACCOUNTS

- (a) Wrong Totalling of accounts,
- (b) Wrong Balancing of accounts.

2.4 AT THE STAGE OF PREPARING THE TRIAL BALANCE

- (a) Errors of omission,
- (b) Errors of commission:
  1. Taking wrong account,
  2. Taking wrong amount,
  3. Taking to the wrong side.

On the above basis, we can classify the errors in four broad categories:

1. Errors of Principle,
2. Errors of Omission,
3. Errors of Commission,
4. Compensating Errors.

3. TYPES OF ERRORS

Basically errors are of two types:

(a) **Errors of principle:** When a transaction is recorded in contravention of accounting principles, like treating the purchase of an asset as an expense, it is an error of principle. In this case there is no effect on the trial balance since the amounts are placed on the correct side, though in a wrong account. Suppose on the purchase of a typewriter, the office expenses account is debited; the trial balance will still agree.

(b) **Clerical errors:** These errors arise because of mistake committed in the ordinary course of the accounting work. These are of three types:

   (i) *Errors of Omission:* If a transaction is completely or partially omitted from the books of account, it will be a case of omission. Examples would be: not recording a credit purchase of furniture or not posting an entry into the ledger.

   (ii) *Errors of Commission:* If an amount is posted in the wrong account or it is written on the wrong side or the totals are wrong or a wrong balance is struck, it will be a case of "errors of commission."

   (iii) *Compensating Errors:* If the effect of errors committed cancel out, the errors will be called compensating errors. The trial balance will agree. Suppose an amount of ₹ 10 received from A is not credited to his account and the total of the sales book is ₹ 10 in excess. The omission of credit to A's account will be made up by the increased credit to the Sales Account.

From another point of view, error may be divided into two categories:

(a) Those that affect the trial balance - because of the errors that trial balance does not agree; and

   (i) Wrong casting of the subsidiary books [see (b) above.]

   (ii) Wrong balancing of an account [see (a) above.]

   (iii) Posting an amount on the wrong side [see (d) above.]

   (iv) Wrong posting, ie., writing the wrong amount [see (d) above.]

   (v) Omitting to post an amount from a subsidiary book.

   (vi) Omitting to post the totals of subsidiary book.

   (vii) Omitting to write the cash book balances in the trial balance.

   (viii) Omitting to write the balance of an account in the trial balance.

   (ix) Writing a balance in wrong column of the trial balance.

   (x) Totalling the trial balance wrongly.

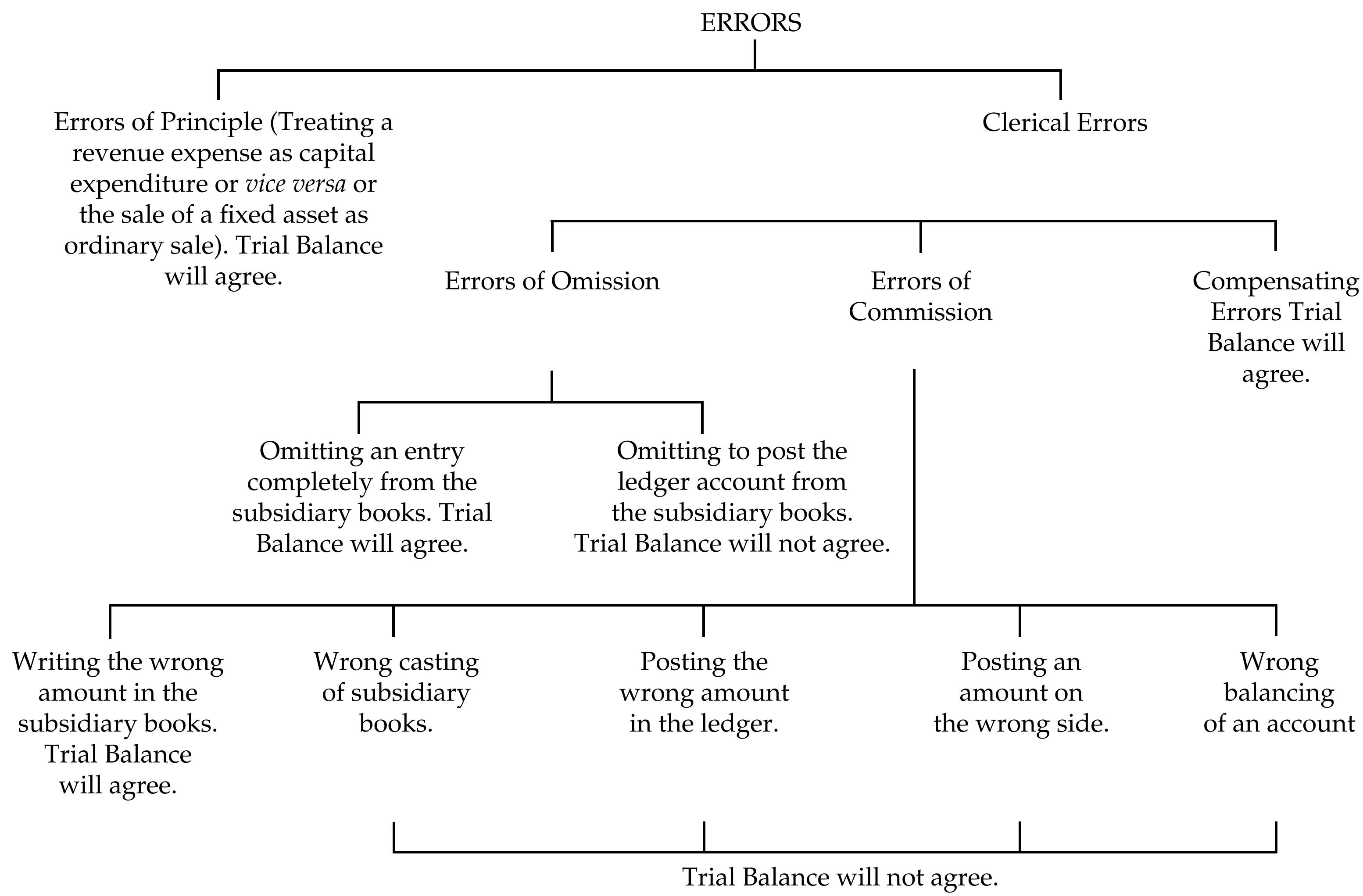
(b) The errors that do not affect the trial balance are the following:

   (i) Omitting an entry altogether from the subsidiary book [see (i) above.]

   (ii) Making an entry in the wrong subsidiary book [see (ii) above.]

   (iii) Posting an amount in a wrong account but on the correct side, e.g., an amount to be debited to A is debited to B, the trial balance will still agree.

A chart of the types of errors is given below:



4. STEPS TO LOCATE ERRORS

Even if there is only a very small difference in the trial balance, the errors leading to it must be located and rectified. A small difference may be the result of a number of errors. The following steps will be useful in locating errors :

(i) The two columns of the trial balance should be totalled again. If in place of a number of accounts, only one amount has been written in the trial balance the list of such accounts should be checked and totalled again. List of Trade receivables is the example from which Trade receivable balance is derived.

(ii) It should be seen that the cash and bank balances have been written in the trial balance.

(iii) The exact difference in the trial balance should be established. The ledger should be gone through; it is possible that a balance equal to the difference has been omitted from the trial balance. The difference should also be halved; it is possible that balance equal to half the difference has been written in the wrong column.

(iv) The ledger accounts should be balanced again.

(v) The casting of subsidiary books should be checked again, especially if the difference is ₹ 1, ₹ 100 etc.

(vi) If the difference is very big, the balance in various accounts should be compared with the corresponding accounts in the previous period. If the figures differ materially the cases should be seen; it is possible that an error has been committed. Suppose the sales account for the current year shows a balance of ₹ 32,53,000 whereas it was ₹ 36,45,000 last year; it is possible that there is an error in the Sales Account.

(vii) Postings of the amounts equal to the difference or half the difference should be checked. It is possible that an amount has been omitted to be posted or has been posted on the wrong side.

(viii) If there is still a difference in the trial balance, a complete checking will be necessary. The posting of all the entries including the opening entry should be checked. It may be better to begin with the nominal accounts.

5. RECTIFICATION OF ERRORS

Errors should never be corrected by overwriting. If immediately after making an entry it is clear that an error has been committed, it may be corrected by neatly crossing out the wrong entry and making the correct entry. If however the errors are located after some time, the correction should be made by making another suitable entry, called rectification entry. In fact the rectification of an error depends on at which stage it is detected. An error can be detected at any one of the following stages:

(a) Before preparation of Trial Balance.

(b) After Trial Balance but before the final accounts are drawn.

(c) After final accounts, i.e., in the next accounting period.

5.1 BEFORE PREPARATION OF TRIAL BALANCE

There are some errors which affect one side of an account or which affect more than one account in such a way that it is not possible to pass a complete rectification entry. In other words, there are some errors which can be corrected, if detected at this stage, by making rectification statement in the appropriate side(s) of concerned account(s). It is important to note here that such errors may involve only one account or more than one account. Read the following illustrations:

(i) The sales book for November is undercast by ₹ 200. The effect of this error is that the Sales Account has been credited short by ₹ 200. Since the account is posted by the total of the sales book, there is no error in the accounts of the customers since they are posted with amounts of individual sales. Hence only the Sales Accounts is to be corrected. This will be done by making an entry for ₹ 200 on the credit side: "By undercasting of Sales Book for November ₹ 200".

(ii) While posting the discount column on the debit side of the cash book the discount of ₹ 10 allowed to Ramesh has not been posted. There is no error in the cash book, the total of discount column presumably has been posted to the discount account on the debit side. The error is in not crediting Ramesh by ₹ 10. This should now be done by the entry "By omission of posting of discount on ----- ₹ 10".

(iii) ₹ 200 received from Ram has been entered by mistake on the debit side of his account. Since the cash book seems to have been correctly written, the error is only in the account of Ram - he should have been credited and not debited by ₹ 200. Not only is the wrong debit to be removed but also a credit of ₹ 200 is to be given. This can be done now by entering ₹ 400 on the credit side of his account. The entry will be "By Posting on the wrong side - ₹ 400".

(iv) ₹ 50 was received from Mahesh and entered on the debit side of the cash book but was not posted to his account. By the error, which affects only the account of Mahesh, ₹ 50 has been omitted from the credit side of his account. The rectification will be by the entry. "By Omission of posting on the ₹ 50."

(v) ₹ 51 paid to Mohan has been posted as ₹ 15 to the debit of his account. Mohan has been debited short by ₹ 36. The rectifying entry is "To mistake in posting on ₹ 36".

(vi) Goods sold to Ram for ₹ 1,000 was wrongly posted from sales day book to the debit of purchase account. Ram has however been correctly debited. Here the error affects two accounts, viz., purchases account and sales account but we cannot pass a journal entry for its rectification because both the accounts need to be credited . The rectification will be by the entry "By wrong posting on ₹ 1,000" in the credit of purchases account and also "By omission of posting on - ₹ 1,000" in the credit sales account.

(vii) Bills receivable from Mr. A of ₹ 500 was posted to the credit of Bills payable Account and also credited to A account. Here also although two accounts are involved we cannot pass a complete journal entry for rectification. The rectification will be by the entry "To wrong posting on ₹ 500" in debit of Bills payable Account and also "To omission of posting on ₹ 500" in the debit of Bills Receivable Account.

(viii) Goods purchased from Vinod for ₹ 1,000 was wrongly credited to Vimal account by ₹ 100. Again we cannot pass a complete journal entry for rectification even though two accounts are involved. The rectification will be done by the entry "To wrong posting on ₹ 100" in the debit of Vimal account and "By omission of posting on ₹ 1,000" in the credit of Vinod account.

Thus, from the above illustrations we are convinced that the general rule that errors affecting two accounts can always be corrected by a journal entry is not always valid.

Illustration 1

How would you rectify the following errors in the book of Rama & Co.?

1. The total to the Purchases Book has been undercast by ₹ 100.
2. The Returns Inward Book has been undercast by ₹ 50.
3. A sum of ₹ 250 written off as depreciation on Machinery has not been debited to Depreciation Account.
4. A payment of ₹ 75 for salaries (to Mohan) has been posted twice to Salaries Account.
5. The total of Bills Receivable Book ₹ 1,500 has been posted to the credit of Bills Receivable Account.
6. An amount of ₹ 151 for a credit sale to Hari, although correctly entered in the Sales Book, has been posted as ₹ 115.
7. Discount allowed to Satish ₹ 25 has not been entered in the Discount Column of the Cash Book. It has been posted to his personal account.

Solution

1. The Purchases Account should receive another debit of ₹ 100 since it was debited short previously :
   "To Undercasting of Purchases Book for the month of --- ₹ 100."
2. Due to this error the Returns Inward Account has been posted short by ₹ 50 : the correct entry will be :
   "To Undercasting of Returns Inward Book for the month of --- ₹ 50."
3. The omission of the debit to the Depreciation Account will be rectified by the entry :
   "To Omission of posting on ₹ 250".
4. The excess debit will be removed by a credit in the Salaries Account by the entry :
   "By double posting on ₹ 75".
5. ₹ 1,500 should have been debited to the Bills Receivable Account and not credited. To correct the mistake, the Bills Receivable Account should be debited by ₹ 3,000 by the entry:
   "To Wrong posting of B/R received on ₹ 3,000"
6. Hari's personal A/c is debited ₹ 36 short. The rectification entry will be :
   "To Wrong posting ₹ 36".
7. Due to this error, the discount account has been debited short by ₹ 25. The required entry is :
   "To Omission of discount allowed to Satish on ₹ 25."

So far we have discussed the correction of errors which affected only one Account of more than one account but for which rectifying entries were not complete journal entries in fact that rectifying entry is made directly in the account(s) concerned. We shall now take up the correction of errors which affect more than one account in such a way that complete journal entries are possible for their rectification. Read the following illustrations :

(i) The purchase of machinery for ₹ 2,000 has been entered in the purchases book. The effect of the entry is that the account of the supplier has been credited by ₹ 2,000 which is quite correct. But the debit to the Purchases Account is wrong : the debit should be to Machinery Account. To rectify the error, the debit in the purchases Account has to be transferred to the Machinery Account. The correcting entry will be to Credit Purchases Account and debit the Machinery Account. Please see the three entries made below: the last entry rectifies the error:

		₹	₹
Wrong Entry :			
Purchases Account	Dr.	2,000	
To Trade Payable			2,000
Correct Entry :			
Machinery Account	Dr.	2,000	
To Trade Payable			2,000
Rectifying Entry :			
Machinery Account	Dr.	2,000	
To Purchases Account			2,000

(ii) ₹ 100 received from Kamal Kishore has been credited in the account of Krishan Kishore. The error is that there is a wrong credit in the account of Krishan Kishore and omission of credit in the account of Kamal Kishore; Krishan Kishore should be debited and Kamal Kishore be credited. The following three entries make this clear :

		₹	₹
Wrong Entry :			
Cash Account	Dr.	100	
To Krishan Kishore			100
Correct Entry :			
Cash Account	Dr.	100	
To Kamal Kishore			100
Rectifying Entry :			
Krishan Kishore	Dr.	100	
To Kamal Kishore			100

(iii) The sale of old machinery, ₹ 1,000 has been entered in the sales book. By this entry the account of the buyer has been correctly debited by ₹ 1,000. But instead of crediting the Machinery Account. Sales Account has been credited. To rectify the error this account should be debited and the Machinery Account credited. See the three entries given below:

		₹	₹
Wrong Entry :			
Buyer's Account	Dr.	1,000	
To Sales Account			1,000
Correct Entry :			
Buyer's Account	Dr.	1,000	
To Machinery Account			1,000
Rectifying Entry :			
Sales Account	Dr.	1,000	
To Machinery Account			1,000

Illustration 2

The following errors were found in the book of Ram Prasad & Sons. Give the necessary entries to correct them.

(1) ₹ 500 paid for furniture purchased has been charged to ordinary Purchases Account.

(2) Repairs made were debited to Building Account for ₹ 50.

(3) An amount of ₹ 100 withdrawn by the proprietor for his personal use has been debited to Trade Expenses Account.

(4) ₹ 100 paid for rent debited to Landlord's Account.

(5) Salary ₹ 125 paid to a clerk due to him has been debited to his personal account.

(6) ₹ 100 received from Shah & Co. has been wrongly entered as from Shaw & Co.

(7) ₹ 700 paid in cash for a typewriter was charged to Office Expenses Account.

Solution

JOURNAL

	Particulars	*L.F.*	*Dr.* ₹	*Cr.* ₹
(1)	Furniture A/c	Dr.	500	
	To Purchases A/c			500
	(Correction of wrong debit to Purchases A/c for furniture purchased)			
(2)	Repairs A/c	Dr.	50	
	To Building A/c			50
	(Correction of wrong debit to building A/c for repairs made)			
(3)	Drawings A/c.	Dr.	100	
	To Trade Expenses A/c			100
	(Correction of wrong debit to Trade Expenses A/c for cash withdrawn by the proprietor for his personal use)			
(4)	Rent A/c	Dr.	100	
	To Landlord's Personal A/c			100
	(Correction of wrong debit to landlord's A/c for rent paid)			
(5)	Salaries A/c	Dr.	125	
	To Clerk's (Personal) A/c			125
	(Correction of wrong debit to Clerk's personal A/c for salaries paid)			

	Particulars	L.F.	Dr. ₹	Cr. ₹
(6)	Shaw & Co.	Dr.	100	
	To Shah & Co.			100
	(Correction of wrong credit to Shaw & Co. Instead of Shah & Co.)			
(7)	Typewriter A/c	Dr.	700	
	To Office Expenses A/c			700
	(Correction of wrong debit to Office Expenses A/c for purchase of typewriter)			

Illustration 3

Give journal entries to rectify the following :

(1) A purchase of goods from Ram amounting to ₹ 150 has been wrongly entered through the Sales Book.

(2) A Credit sale of goods amounting ₹ 120 to Ramesh has been wrongly passed through the Purchase Book.

(3) On 31st Dec. 2011 goods of the value of ₹ 300 were returned by Hari Saran and were taken inventory on the same date but no entry was passed in the books.

(4) An amount of ₹ 200 due from Mahesh Chand, which had been written off as a Bad Debt in a previous year, was unexpectedly recovered, and had been posted to the personal account of Mahesh Chand.

(5) A Cheque for ₹ 100 received from Man Mohan was dishonoured and had been posted to the debit of Sales Returns Account.

Solution

JOURNAL

	Particulars		L.F.	Dr. ₹	Cr. ₹
(1)	Purchases A/c	Dr.		150	
	Sales A/c	Dr.		150	
	To Ram				300
	(Correction of wrong entry in the sales Book for a purchases of goods from Ram)				
(2)	Ramesh	Dr.		240	
	To Purchases A/c				120
	To Sales A/c				120
	(Correction of wrong entry in the Purchases Book of a credit sale of goods to Ram)				
(3)	Returns Inwards A/c	Dr.		300	
	To Hari Saran				300
	(Entry of goods returned by him and taken in Inventory omitted from records)				

	Particulars		L.F.	Dr. ₹	Cr. ₹
(4)	Mahesh Chand	Dr.		200	
	To Bad Debts Recovered A/c				200
	(Correction of wrong credit to Personal A/c in respect of recovery of previously written off bad debts)				
(5)	Man Mohan	Dr.		100	
	To Sales Return A/c				100
	(Correction of wrong debit to Sales Returns A/c for dishonour of cheque received from Man Mohan)				

Thus it can be said that errors detected before the preparation of trial balance can be rectified either through rectification statements (not entries) or through rectification entries.

5.2 AFTER TRIAL BALANCE BUT BEFORE FINAL ACCOUNTS

The method of correction of error indicated so far is appropriate when the errors have been located before the end of the accounting period. After the corrections the trial balance will agree. Sometimes the trial balance is artificially made to agree inspite of errors by **opening a suspense account** and putting the difference in the trial balance to the account - the suspense account will be debited if the total of the credit column in the trial balance exceeds the total of the debit column; it will be credited in the other case.

One must note that such agreement of the trial balance will not be real. Effort must be made to locate the errors.

The rule of rectifying errors detected at this stage is simple. Those errors for which complete journal entries were not possible in the earlier stage of rectification (i.e., before trial balance) can now be rectified by way of journal entry(s) with the help of suspense account, for it these errors which gave rise to the suspense account in the trial balance. The rectification entry for other type of error i.e. error affecting more than one account in such a way that a complete journal entry is possible for its rectification, can be rectified in the same way as in the earlier stage (i.e. before trial balance).

In a nutshell, it can be said that each and every error detected at this stage can only be corrected by a complete journal entry. Those errors for which journal entries were not possible at the earlier stage will now be rectified by a journal entry(s), the difference or the unknown side is being taken care of by suspense account. Those errors for which entries were possible even at the first stage will now be rectified in the same way.

Suppose, the sales book for November, 2015 is cast ₹ 100 short; as a consequence the trial balance will not agree. The credit column of the trial balance will be ₹ 100 short and a Suspense Account will be credited by ₹ 100. To rectify the error the Sales Account will be credited (to increase the credit to the right figure. Since now one error remains, the Suspense Account must be closed- it will be debiting the Suspense Account. The entry will be :

Suspense Account	Dr.	₹ 100	
To Sales Account			₹ 100
(Correction of error of undercasting the sales Book for Nov. 2015)			

Illustration 4

Correct the following errors (i) without opening a Suspense Account and (ii) opening a Suspense Account :

(a) The Sales Book has been totalled ₹ 100 short.

(b) Goods worth ₹ 150 returned by Green & Co. have not been recorded anywhere.

(c) Goods purchased ₹ 250 have been posted to the debit of the supplier Gupta & Co.

(d) Furniture purchased from Gulab & Bros, ₹ 1,000 has been entered in Purchases Day Book.

(e) Discount received from Red & Black ₹ 15 has not been entered in the Discount Column of the Cash Book.

(f) Discount allowed to G. Mohan & Co. ₹ 18 has not been entered in the Discount Column of the Cash Book. The account of G. Mohan & Co. has, however, been correctly posted.

Solution

If a Suspense Account is not opened.

(a) Since sales book has been cast ₹ 100 short, the Sales Account has been similarly credited ₹ 100 short. The correcting entry is to credit the Sales Account by ₹ 100 as "By wrong totalling of the Sales Book ₹ 100".

(b) To rectify the omission, the Returns Inwards Account has to be debited and the account of Green & Co. credited. The entry :

Returns Inward Account	Dr.	₹ 150	
To Green & Co.			₹ 150
(Goods returned by the firm, previously omitted from the Returns Inward Book)			

(c) Gupta & Co. have been debited ₹ 250 instead of being credited. This account should now be credited by 500 to remove the wrong debit and to give the correct debit. The entry will be on the credit side... "By errors in posting ₹ 500".

(d) By this error Purchases Account has to be debited by ₹ 1,000 whereas the debit should have been to the Furniture Account. The correcting entry will be :

Furniture Account	Dr.	₹ 1,000	
To Purchases Account			₹ 1,000
(Correction of the mistake by which purchases Account was debited instead of the Furniture Account)			

(e) The discount of ₹ 15 received from Red & Black should have been entered on the credit side of the cash book. Had this been done, the Discount Account would have been credited (through the total of the discount column) and Red & Black would have been debited. This entry should not be made :

Red & Black Dr. ₹ 15
To Discount Account ₹ 15
(Rectification of the error by which the discount allowed by the firm was not entered in Cash Book)

(f) In this case the account of the customer has been correctly posted; the Discount Account has been debited ₹ 18 short since it has been omitted from the discount column on the debit side of the cash book. The discount account should now be debited by the entry; "To Omission of entry in the Cash Book ₹ 18."

If a Suspense Account is opened :

	Particulars		***L.F.***	***Dr.*** ₹	***Cr.*** ₹
(a)	Suspense Account	Dr.		100	
	To Sales Account				100
	(Being the correction arising from under-casting of Sales Day Book)				
(b)	Return Inward Account	Dr.		150	
	To Green & Co	.			150
	(Being the recording of unrecorded returns)				
(c)	Suspense Account	Dr.		500	
	To Gupta & Co.				500
	(Being the correction of the error by which Gupta & Co. was debited instead of being credited by ₹ 250).				
(d)	Furniture Account	Dr.		1,000	
	To Purchases Account				1,000
	(Being the correction of recording purchase of furniture as ordinary purchases)				
(e)	Red & black	Dr.		15	
	To Discount Account				15
	(Being the recording of discount omitted to be recorded)				
(f)	Discount Account	Dr.		18	
	To Suspense Account				18
	(Being the correction of omission of the discount allowed from Cash Book customer's account already posted correctly).				

Suspense Account

Dr. Date	Particulars	Amount ₹	Date	Particulars	Cr. Amount ₹
	To Sales A/c	100		By Difference in	
	To Gupta & Co.	500		Trial Balance	582
				By Discount A/c	18
		600			600

Note :

(i) One should note that the opening balance in the Suspense Account will be equal to the difference in the trial balance.

(ii) If the question is silent as to whether a Suspense Account has been opened, the student should make his assumption, state it clearly and then proceed.

Illustration 5

Correct the following errors found in the books of Mr. Dutt. The Trial Balance was out by ₹ 493 excess credit. The difference thus has been posted to a Suspense Account.

(a) An amount of ₹ 100 was received from D. Das on 31st December, 2015 but has been omitted to enter in the Cash Book.

(b) The total of Returns Inward Book for December has been cast ₹ 100 short.

(c) The purchase of an office table costing ₹ 300 has been passed through the Purchases Day Book.

(d) ₹ 375 paid for Wages to workmen for making show-cases had been charged to "Wages Account".

(e) A purchase of ₹ 67 had been posted to the trade payables' account as ₹ 60.

(f) A cheque for ₹ 200 received from P. C. Joshi had been dishonoured and was passed to the debit of "Allowances Account".

(g) ₹ 1,000 paid for the purchase of a motor cycle for Mr. Dutt had been charged to "Miscellaneous Expenses Account".

(h) Goods amounting to ₹ 100 had been returned by customer and were taken in to Inventory, but no entry in respect there of, was made into the books.

(i) A sale of ₹ 200 to Singh & Co. was wrongly credited to their account.

Solution

(a) Journal Entries

Particulars		L.F.	₹	₹
Cash Account	Dr.		100	
To D. Das				100
(Being the amount received)				

(b)	Returns Inward Account	Dr.		100	
	To Suspense Account				100
	(Being the mistake in totalling the Returns Inward Book corrected)				
(c)	Furniture Account	Dr.		300	
	To Purchases Account				300
	(Being the rectification of mistake by which purchase of furniture was entered in Purchases book and hence debited to Purchases Account)				
(d)	Furniture Account	Dr.		375	
	To Wages Account				375
	(Being the wages paid to workmen for making show-cases which should be capitalised and not to be charged to Wages Account)				
(e)	Suspense Account	Dr.		7	
	To Creditors (personal) Account				7
	(Being the mistake in crediting the Trade payables Account less by ₹ 7, now corrected)				
(f)	P.C. Joshi	Dr.		200	
	To Allowances Account				200
	(Being the cheque of P.C. Joshi dishonoured, previously debited to Allowances Account)				
(g)	Drawings Account	Dr.		1,000	
	To Miscellaneous Expenses				1,000
	(Being the motor cycle purchased for Mr. Dutt debited to his Drawings Account instead of Miscellaneous Expenses Account as previously done by mistake)				
(h)	Returns Inward Account	Dr.		100	
	To Debtors (Personal) Account				100
	(Correction of the omission to record return of goods by customers)				
(i)	Singh & Co.	Dr.		400	
	To Suspense Account				400
	(Being the correction of mistake by which the account of Singh & Co. was credited by ₹ 200 instead of being debited)				

Suspense Account

Dr. Date 2015	Particulars	Amount ₹	Date 2015	Particulars	Cr. Amount ₹
Dec.31	To Difference in Trial Balance	493	Dec. 31	By Returns Inwards A/c	100
" "	To Trade Payables A/c	7	" "	By Singh & Co.	400
		500			500

Illustration 6

The following errors, affecting the account for the year 2015 were detected in the books of Jain Brothers, Delhi:

(1) Sale of old Furniture ₹ 150 treated as sale of goods.

(2) Receipt of ₹ 500 from Ram Mohan credited to Shyam Sunder.

(3) Goods worth ₹ 100 brought from Mohan Narain have remained unrecorded so far.

(4) A return of ₹ 120 from Mukesh posted to his debit.

(5) A return of ₹ 90 to Shyam Sunder posted as ₹ 9 in his account.

(6) Rent of proprietor's residence, ₹ 600 debited to rent A/c.

(7) A payment of ₹ 215 to Mohammad Sadiq posted to his credit as ₹ 125.

(8) Sales Book added ₹ 900 short.

(9) The total of Bills Receivable Book ₹ 1,500 left unposted.

You are required to pass the necessary rectifying entries and show how the trial balance would be affected by the errors.

Solution

JOURNAL

	Particulars		L.F.	Dr. Amount ₹	Cr. Amount ₹
(1)	Sales Account	Dr.		150	
	To Furniture Account				150
	(Rectification of sales of furniture treated as sales of goods)				
(2)	Shyam Sunder	Dr.		500	
	To Rama Mohan				500
	(Rectification of a receipt from Ram Mohan credited to Shyam Sunder)				

(3)	Purchases Account To Mohan Narain (Purchases of goods from Mohan Narain unrecorded)	Dr.		100	 100
(6)	Drawing Account To Rent Account (Rectification of Payment of rent of proprietor's residence treated as payment of office rent)	Dr.		600	 600

N.B. : For 4, 5, 7, 8, 9 no journal entry can be passed as they affect a single account. The correction will be as under:

(4) Credit Mukesh's Account with ₹ 240.

(5) Debit the account of Shyam Sunder by ₹ 81.

(7) Debit the account of Mohammad Sadiq by ₹ 340.

(8) Credit Sales Account by ₹ 900.

(9) Debit Bills Receivable Account with ₹ 1,500.

Effect of the Errors on Trial Balance

1. No effect
2. No effect
3. No effect
4. Trial Balance credit total short by ₹ 240.
5. Trial Balance debit total short by ₹ 81.
6. No effect
7. Trial Balance debit total short by ₹ 340.
8. Trial Balance credit total short by ₹ 900.
9. Trial Balance debit total short by ₹ 1,500.

Illustration 7

The trial balance of Mr. W & H failed to agree and the difference ₹ 20,570 was put into suspense pending investigation which disclosed that :

(i) Purchase returns day book had been correctly entered and totalled at ₹ 6,160, but had been posted to the ledger.

(ii) Discounts received ₹ 1,320 had been debited to discounts allowed.

(iii) The Sales account had been under added by ₹ 10,000.

(iv) A credit sale of ₹ 1,470 had been debited to a customer account at ₹ 1,740.

(v) A vehicle bought originally for ₹ 7,000 four years ago and depreciated to ₹ 1,200 had been sold for ₹ 1,500 in the beginning of the year but no entries, other than in the bank account had been passed through the books.

(vi) An accrual of ₹ 560 for telephone charges had been completely omitted.

(vii) A bad debt of ₹ 1,560 had not been written off and provision for doubtful debts should have been maintained at 10% of Trade receivables which are shown in the trial balance at ₹ 23,390 with a credit provision for bad debts at ₹ 2,320.

(viii) Tools bought for ₹ 1,200 had been inadvertently debited to purchases.

(ix) The proprietor had withdrawn, for personal use, goods worth ₹ 1,960. No entries had been made in the books.

Required :

(i) Pass rectification entries without narration to correct the above errors before preparing annual accounts.

(ii) Prepare a statement showing effect of rectification on the reported net profit before correction of these errors.

Solution

	Particulars		*Dr.*	*Cr.*
(i)	Suspense Account	Dr.	6,160	
	To Return Outward A/c			6,160
(ii)	Suspense Account	Dr.	2,640	
	To Discount Allowed Account			1,320
	To Discount Received Account			1,320
(iii)	Suspense Account	Dr.	10,000	
	To Sale Account			10,000
(iv)	Suspense Account	Dr.	270	
	To Customer Account			270
(v)	Suspense Account	Dr.	1,500	
	To Vehicle Account			1,200
	To Profit on Sale of Vehicle Account			300
(vi)	Telephone Charges Account	Dr.	560	
	To Outstanding Expenses Account			560
(vii)	Bad Debts Account	Dr.	1,560[1]	
	To Trade receivables Account			1,560
	Provision for Doubtful Debts Account	Dr.	164[2]	
	To Profit and Loss Account			164
(viii)	Loose Tools Account	Dr.	1,200	
	To Purchases Account			1,200
(ix)	Drawings Account	Dr.	1,960	
	To Purchases Account			1,960

[1] *Bad debts will be debited in the profit and loss account.*

[2] *Provision @ 10% of ₹ 2,156; Excess provision ₹ 164.*

Working Notes :

(i)	Trade receivables as per books		23,390
	Deduction vide item (iv)	270	
	Bad Debts	1,560	1,830
			21,560

(ii) **Suspense Account**

	₹		₹
To Return outward Account	6,160	By balance b/d	20,570
To Discount allowed Account	1,320		
To Discount Received Account	1,320		
To Sales	10,000		
To Customers	270		
To Vehicles	1,200		
To Profit on Sale of Vehicle	300		
	20,570		20,570

Illustration 8

Show by means of Journal entries how the following matters should be adjusted when preparing the Annual Accounts of a firm for the year ended 30th September, 2015.

(a) Goods sold and recorded as sales for ₹ 4,000, were packed. However, Inventory taking intervened and the parcel of goods was not despatched but was included in Inventories. The title of goods has not been transferred to the buyer.

(b) Several employees took their salary in advance in the month of September, 2015 which was payable to them in October, 2015 amounting to ₹ 2,500.

(c) A cheque of ₹ 2,500 received for a loss of Inventory sustained by fire has been paid by the proprietor into his private bank account and not recorded in the business books.

(d) A cheque for ₹ 1,250 received as Insurance claim for loss of goods in transit at the time of import was recorded in the books. However, the same was deposited by the proprietor into his private bank account. The full value of the invoice was passed through the purchase book.

(e) A purchase was made for a staff member of ₹ 1,000 and the cost was included in purchases. A deduction of similar amount was made from his salary and the net payment to him posted to salaries account.

(f) Bill received from Mr. Anup for repairs to furniture ₹ 300 and new furniture supplied for ₹ 1,000 was entered in the invoice book as ₹ 1,100.

(g) Furniture which stood in the books at ₹ 500 was sold for ₹ 275 in part exchange of new furniture costing ₹ 875 and the new invoice of ₹ 600 was passed through the purchase book.

Solution

JOURNAL

Adjustment Entries

Date 2015	*Particulars*		*Dr.* ₹	*Cr.* ₹
Sep. 30				
(a)	Sales Account*	Dr.	4,000	
	To Debtors Account			4,000
	(Entry for credit sales reversed as goods have not been despatched to the customer)			
(b)	Prepaid Salaries Account	Dr.	2,500	
	To Salaries Account			2,500
	(Salaries paid in advance for Oct. and debited to Salaries Account, now transferred to Prepaid Salaries Account)			
(c)	Drawings Account	Dr.	2,500	
	To Insurance Company Account			2,500
	(Being the rectification of cheque received for loss of Inventory due to fire deposited in the private account of the proprietor)			
(d)	Drawings Account	Dr.	1,250	
	To Purchases Account			1,250
	(Being the rectification of cheque received as insurance claim for loss of goods in transit deposited into private bank Account of the proprietor)			
(e)	Salaries Account	Dr.	1,000	
	To Purchases Account			1,000
	(Goods purchased for staff-member recorded as trade purchases, new charged to Salaries Account)			
(f)	Repairs Account	Dr.	300	
	Furniture Account	Dr.	1,000	
	To Purchases Account			1,100
	To Mr. Anup			200

Note : * In (a) above, goods recorded as sales may not be reversed, instead may be excluded from closing Inventory, as the goods have been ascertained and appropriated according to the contract if the title in the goods would have already passed to customer.

	(Being the rectification of Bill received from Mr. Anup for repairs to furniture ₹ 300 and new furniture supplied for ₹ 1,000 entered in the purchases book at ₹ 1,100)			
(g)	Furniture Account	Dr.	375	
	Loss on sale of Furniture Account	Dr.	225	
	To Purchases Account			600
	(Being the rectification of net exchange of old and new furniture passed through purchases day book)			

Illustration 9

On going through the Trial balance of Ball Bearings Co. Ltd. you find that the debit is in excess by ₹ 150. This was credited to "Suspense Account". On a close scrutiny of the books the following mistakes were noticed:

(1) The totals of debit side of "Expenses Account" have beeen cast in excess by ₹ 50.

(2) The "Sales Account" has been totalled in short by ₹ 100.

(3) One item of purchase of ₹ 25 has been posted from the day book to ledger as ₹ 250.

(4) The sale return of ₹ 100 from a party has not been posted to that account though the Party's account has been credited.

(5) A cheque of ₹ 500 issued to the Suppliers' account (shown under Trade payables) towards his dues has been wrongly debited to the purchases.

(6) A credit sale of ₹ 50 has been credited to the Sales and also to the Trade receivables Account.

(i) Pass necessary journal entries for correcting the above;

(ii) Show how they affect the Profits; and

(iii) Prepare the "Suspense Account" as it would appear in the ledger.

JOURNAL ENTRIES

Particulars		*L.F.*	*Dr.* ₹	*Cr.* ₹
Suspense Account	Dr.		50	
To Expenses Account				50
(Being the mistake in totalling of Expenses Account, rectified)				

Suspense Account	Dr.		100	
To Sales Account				100
(Being the mistake in totalling of Sales Accounts rectified)				
Supplier*	Dr.		225	
To Suspense Account				225
(Being the mistake in posting from Day Book to Ledger rectified)				
Sales Returns Account	Dr.		100	
To Suspense Account				100
(Being the sales return from a party not posted to "Sales Returns" now rectified)				
Trade payables Account	Dr.		500	
To Purchases Account				500
(Being the payments made to supplier wrongly posted to purchases now rectified)				
Trade receivables Account	Dr.		100	
To Suspense Account				100
(Being the sales wrongly credited to Customer's Account now rectified)				

Suspense Account

Dr.	₹		*Cr.* ₹
To Expenses Account	50	By Difference in Trial Balance	150
To Sales Account	100	By Trade payables	225
To Balance c/d	425	By Sales Returns Account	100
		By Trade receivables	100
	575		575
		By Balance b/d	425

Since the Suspense Account does not balance, it is clear that all the errors have not been traced.

* *It is assumed that the day-book is the Purchase Day Book in which case only the supplier's account would be posted wrongly (creditor of ₹ 250 instead of ₹ 25). If however, by day-book is meant a book in which all transactions are recorded and posted at the ledger therefrom, it would mean that both the Supplier's Account and Purchases Account are wrongly posted.*

As a result of the above corrections the Net Profit will be :

	Increased by ₹	Decreased by ₹
Mistake in totalling in "Expenses"	50	
Mistake in totalling in "Sales"	100	
Mistake in posting from day book to Ledger under "Purchases"	500	
Omission in posting under "Sales Returns"		100
	650	100
Net Increase	550	

As a result of these adjustments, the Profits will be increased by ₹ 550.

Illustration 10

Write out the Journal Entries to rectify the following errors, using a Suspense Account.

(1) Goods of the value of ₹ 100 returned by Mr. Sharma were entered in the Sales Day Book and posted therefrom to the credit of his account;

(2) An amount of ₹ 150 entered in the Sales Returns Book, has been posted to the debit of Mr. Philip, who returned the goods;

(3) A sale of ₹ 200 made to Mr. Ghanshyam was correctly entered in the Sales Day Book but wrongly posted to the debit of Mr. Radheshyam as ₹ 20;

(4) Bad Debts aggregating ₹ 450 were written off during the year in the Sales ledger but were not adjusted in the General Ledger; and

(5) The total of "Discount Allowed" column in the Cash Book for the month of September, 2015 amounting to ₹ 250 was not posted.

Solution

JOURNAL

	Particulars		*L.F.*	*Dr.* ₹	*Cr.* ₹
(1)	Sales Account	Dr.		100	
	Sales Returns Account	Dr.		100	
	To Suspense Account				200
	(The value of goods returned by Mr. Sharma wrongly posted to Sales and omission of debt to Sales Returns Account, now rectified)				

(2)	Suspense Account To Mr. Philip (Wrong debit to Mr. Philip for goods returned by him, now rectified)	Dr.		300	 300
(3)	Mr. Ghanshyam To Mr. Radheshyam To Suspense Account (Omission of debit to Mr. Ghanshyam and wrong credit to Mr. Radhesham for sale of ₹ 200, now rectited)	Dr.		200	 20 180
(4)	Bad Debts Account To Suspense Account (The amount of Bad Debts written off not adjusted in General Ledger, now rectified)	Dr.		450	 450
(5)	Discount Account To Suspense Account (The total of Discount allowed during September, 2015 not posted from the Cash Book; error now rectified)	Dr.		250	 250

Illustration 11

The Trial balance of Messrs. A, B and C did not agree. A Suspense Account was opened with the amount of the difference. The following errors were discovered on scrutiny:

(1) The addition of the Analysis Column of the Tabular Purchase Journal posted to Goods Purchased for Resale Account was found to be short by ₹ 150 though the addition of the total column was correct.

(2) A dishonoured B/R for ₹ 400 returned to the firm by bank had been credited to Bank Account for collection of bills and debited to B/R Account. A cheque was later received from the customer for ₹ 400 and was duly paid into the firm's bank account.

(3) An amount of ₹ 450 treated as paid in advance on account of insurance in the previous year was not brought forward.

(4) Sales on approval amounting to ₹ 2,000 were included in the Sales Account. Half of these were returned but no entries were passed in respect of these goods. However, the returned goods have been included in the closing Inventory at their cost price of ₹ 500.

(5) ₹ 1,260 represent credits given to customers when the payments against sales invoices were received. However, these invoices themselves were not entered in the books. A discount of 10% is allowed on the selling price in all such invoices.

You are required to pass rectifying entries making use, of the Suspense Account, wherever necessary.

Solution

Journal of M/s. A, B and C

	Particulars		*L.F.*	*Dr.* ₹	*Dr.* ₹
1.	Purchase for Resale A/c	Dr.		150	
	To Suspense Account				150
	(Short debit to 'purchases for Resale Account' on account of undercasting on now corrected)				
2.	Customers A/c	Dr.		400	
	To Bill Receivable A/c				400
	(Amount of dishonoured bill receivable previously debited to Bills Receivable Account, error now rectified)				
3.	Insurance Account	Dr.		450	
	To Suspense Account				450
	(Prepaid insurance in the previous year not brought forward now debited to the Insurance Account)				
4.	Sales Accounts	Dr.		1,000	
	To Customer's Account				1,000
	(Goods worth ₹ 1,000 returned by a customer on sale or return basis, previously omitted to be recorded; error now rectified)				
5.	Discount Account	Dr.		140	
	Customers Account	Dr.		1,260	
	To Sales Account				1,400
	(Credit sales of ₹ 1,400 previously omitted from the books, error now corrected)				

Note : Payment being equal to 90% of the gross sale is ₹ 1,400, i.e., 1,260 × 100/90. 1/10 of this amount is discount.

Since the discount of 10% is allowed in all cases, it would be better to treat the sale to be ₹ 1,260 and not ₹ 1,400, the discount is trade discount for which no account is opened, the sales being recorded, at the net amount.

Illustration 12

The trial balance of Anil Traders did not agree. The difference was put in the Suspense Account and the following trial balance was drafted :

Trial Balance as on 31st March, 2015

	Dr.	*Cr.*
Capital Account		45,000
Drawing Account	6,500	
Purchases Account	92,750	
Sales Account		1,07,200
Salaries and Wages Account	12,250	
Furniture and Fittings Account	17,500	
Debtors Account	30,250	
Creditors Account		21,250
Stationery Account	1,250	
Cash at Bank	5,700	
Cash in Hand	2,300	
Bills Receivable Account	15,750	
Bills Payable Account		9,000
Rent and Rates Account	3,200	
Suspense Account		5,000
	1,87,450	1,87,450

On scrutiny the following errors were subsequently detected :

(a) Goods drawn by Mr. Anil, the proprietor, for personal consumption of ₹ 1,500 have not at all been recorded.

(b) Goods sold to Ram for ₹ 1,250 on credit was debited to Rahim account for ₹ 250 only.

(c) Wages paid for fittings ₹ 500 was debited to salaries and wages account.

(d) Goods purchased from Atul for ₹ 2,500 on credit was wrongly debited to his account.

(e) Bill received from Arun, a debtor/customer, for ₹ 500 was debited to Ajay’s account.

(f) A credit sale of ₹ 1,500 was recorded in Purchased Day Book and a credit purchase of ₹ 2,000 was entered in Sales Day Book.

You are required to pass the rectification entries and redraft the trial balance.

Solution

M/s Anil Traders

Journal

	Particulars		*L.F.*	*Cr.* ₹	*Dr.* ₹
(a)	Drawings Account	Dr.		1,500	
	To Purchases Account				1,500
	(Goods withdrawn for personal consumption by the proprietor, now recorded)				
(b)	Ram (Debtor) Account	Dr.		1,250	
	To Rahim (Debtor) Account				250
	To Suspense Account				1,000
	(Goods sold to Ram for ₹ 1,250 wrongly debited to Rahim account for ₹ 250, now rectified)				
(c)	Furniture and Fittings Account	Dr.		500	
	To Salaries and Wages Account				500
	(Wages paid for fittings wrongly debited to salaries and wages account, now rectified)				
(d)	Suspense Account	Dr.		5,000	
	To Atul (Creditor) Account				5,000
	(Goods brought on credit from Atul wrongly debited to his account, now rectified)				
(e)	Suspense Account	Dr.		1,000	
	To Arun (Debtor) Account				500
	To Ajay (Debtor) Account				500
	(Bill received from Arun wrongly debited to Ajay Account, now rectified)				
(f)	Purchases Account	Dr.		500	
	Sales Account	Dr.		500	
	To Debtors Account*				500
	To Creditors Account*				500
	(A credit sale and a credit purchase wrongly entered in purchases day book and sales day book respectively, now rectified)				

* In the debtors' ledger and creditors' ledger, the affected individual accounts should be rectified with the full amount. In other words, in the debtors' ledger the concerned debtors account should be debited by ₹ 1,500 for credit sales and the debtors' account wrongly debited for credit purchase should be credited by ₹ 2,000.

Trial Balance of M/s. Anil Traders as on 31.3.2015

Particulars	*Dr.* ₹	*Cr.* ₹
Capital Account		45,000
Drawings Account	8,000	
Purchases Account	91,750	
Sales Account		1,06,700
Salaries and Wages Account	11,750	
Furniture and Fittings Account	18,000	
Debtors Account	29,750	
Creditors Account		26,750
Stationery Account	1,250	
Cash at Bank	5,700	
Cash in Hand	2,300	
Bills Receivable Account	15,750	
Bills Payable Account		9,000
Rent and Rates Account	3,200	
	1,87,450	1,87,450

Working Notes :

1. **Suspense Account**

Dr.	₹		*Cr.* ₹
To Atul Account (entry 'd')	5,000	By Balance b/d	5,000
To Arun Account (entry 'e')	500	By Ram Account (entry 'b')	1,000
To Ajay Account (entry 'e')	500		
	6,000		6,000

2. **Corrected Ledger Balances**

	Balance as per given trial balance ₹	*Rectification effect* ₹	*Reference (entry no.)*	*Rectified balance* ₹
Drawings	6,500	(+) 1,500	(a)	8,000
Purchases	92,750	(-) 1,000	(a) & (f)	91,750
Debtors	30,250	(-) 500	(b), (e) & (f)	29,750
Furniture & Fittings	17,500	(+) 500	(c)	18,000
Salaries & Wages	12,250	(-) 500	(c)	11,750
Creditors	21,250	(+) 5,500	(d) & (f)	26,750
Sales	1,07,200	(-) 500	(f)	1,06,700

5.3 CORRECTION IN THE NEXT ACCOUNTING PERIOD

Rectification of errors discussed so far assumes that it was carried out before the books were closed for the concerned year. However, sometimes, the rectification is carried out in the next year, carrying forward the balance in the Suspense Account or even transferring it to the Capital Account. Suppose, the Purchase Book was cast short by ₹ 1,000 in December, 2010 and a Suspense Account was opened with the difference in the trial balance. If the error is rectified next year and the entry passed is to debit Purchase Account (and credit Suspense Account), it will mean that the Purchases Account for year 2011 will be ₹ 1,000 more than the amount relating to year 2011 and thus the profit that year 2011 will be less than the actual for that year. Thus, correction of errors in this manner will 'falsify' the Profit and Loss Account.

To avoid this, correction of all amounts concerning nominal accounts, i.e., expenses and incomes should be through a special account styled as "Prior Period Items" or "Profits and Loss Adjustment Account". The balance in the account should be transferred to the Profits and Loss Account. However, these Prior Period Items should be charged after deriving net profit of the current year. 'Prior Period items' are material income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more periods. Prior Period Items should be separately disclosed in the current statement of profit and loss together with their nature and amount in a manner that their impact on current profit or loss can be perceived.

Illustration 13

Mr. A closed his books of account on September 30, 2014 in spite of a difference in the trial balance. The difference was ₹ 830 the credits being short; it was carried forward in a Suspense Account. In 2015 following errors were located :

(i) A sale of ₹ 2,300 to Mr. Lala was posted to the credit of Mrs. Mala.

(ii) The total of the Returns Inward Book for July, 2010 ₹ 1,240 was not posted in the ledger.

(iii) Freight paid on a machine ₹ 5,600 was posted to the Freight Account as ₹ 6,500.

(iv) White carrying forward the total in the Purchases Account to the next page, ₹ 65,590 was written instead of ₹ 56,950.

(v) A sale of machine on credit to Mr. Mehta for ₹ 9,000 was not entered in the books at all. The book value of the machine was ₹ 7,500. The firm has the practice of writing off depreciation @10% on the balance at the end of the year.

Pass journal entries to rectify the errors. Have you any comments to make?

Solution

Journal of Mr. A

Date	*Particulars*		*L.F.*	*Dr.*	*Cr.*
				₹	₹
2015 (i)	Mrs. Mala	Dr.		2,300	
	Mr. Lala	Dr.		2,300	
	To Suspense A/c				4,600
	(Correction of error by which a sale of ₹ 2,300 to Mr. Lala was posted to the Credit of Mrs. Mala)				
(ii)	Profit and Loss Adjustment A/c	Dr.		1,240	
	To Suspense A/c				1,240
	(Rectification of omission to post the total of Returns Inward Book for July, 2010)				
(iii)	(a) Machinery A/c	Dr.		5,600	
	Suspense A/c	Dr.		900	
	To Profit & Loss Adjustment A/c				6,500
	(Correction of error by which freight paid for a machine ₹ 5,600 was posted to Freight Account at ₹ 6,500 instead of capitalising it)				
	(b) Profit & Loss Adjustment A/c	Dr.		560	560
	To Plant and Machinery A/c				
	(Depreciation @ 10% charged on freight paid on a machine capitalised)				
(iv)	Suspense A/c	Dr.		8,640	
	To Profit & Loss Adjustment A/c				8,640
	(Correction of wrong carry forward of total in the purchase Account to the next page ₹ 65,590 instead of ₹ 56,950)				
(v)	Mr. Mehta	Dr.		9,000	
	To Plant & Machinery A/c				6,750
	To Profit & Loss Adjustment A/c				2,250
	(Correction of omission of a sale of machine on credit to Mr. Mehta for ₹ 9,000 with a book value of ₹ 7,500 on which depreciation @ 10% has been charged in 2010)				

Comments

The Suspense Account will now appear as shown below :

Suspense Account

Dr. Date	Particulars	Amount ₹	Date	Particulars	*Cr.* Amount ₹
2015	To Profit and Loss Adjustment A/c	900	2014	By Balance b/d	830
	To Profit and Loss Adjustment A/c	8,640	Oct. 1	By Sundries	
				Mrs. Mala	2,300
				Mr. Lala	2,300
				By Profit and Loss Adjustment A/c	1,240
				By balance c/d	2,870
		9,540			9,540

Since the Suspense Account still shows a balance, it is obvious that there are still some errors left in the books.

Profit & Loss Adjustment A/c

(For Prior Period Items)

Dr. Date 2015	Particulars	Amount ₹	Date 2015	Particulars	*Cr.* Amount ₹
	To Suspense A/c	1,240		By Machinery A/c	5,600
	To Plant and Machinery A/c	560		By Suspense A/c	900
				By Suspense A/c	8,640
	To Balance c/d	15,590		By Mr. Mehta	2,250
		17,390			17,390

Illustration 14

A merchant's trial balance as on June 30, 2015 did not agree. The difference was put to a Suspense Account. During the next trading period, the following errors were discovered :

(i) The total of the Purchases Book of one page, ₹ 4,539 was carried forward to the next page as ₹ 4,593.

(ii) A sale of ₹ 573 was entered in the Sales Book as ₹ 753 and posted to the credit of the customer.

(iii) A return to a creditor, ₹ 510 was entered in the Returns Inward Book; however, the creditor's account was correctly posted.

(iv) Cash received from C. Dass, ₹ 620 was posted to the debit of G. Dass.

(v) Goods worth ₹ 840 were despatched to a customer before the close of the year but no invoice was made out.

(vi) Goods worth ₹ 1,000 were sent on sale or return basis to a customer and entered in the Sales Book. At the close of the year, the customer still had the option to return the goods. The sale price was 25% above cost.

You are required to give journal entries to rectify the errors in a way so as to show the current year's profit or loss correctly.

Solution

Journal Entries

	Particulars		*L.F.*	*Dr.* ₹	*Cr.* ₹
(i)	Suspense Account	Dr.		54	
	To Profit and Loss Adjustment A/c				54
	(Correction of error by which Purchase Account was over debited last year- ₹ 4,593 carried forward instead of ₹ 4,539)				
(ii)	Profit & Loss Adjustment A/c	Dr.		180	
	Customer's Account	Dr.		1,326	
	To Suspense Account				1,506
	(Correction of the entry by which (a) Sales A/c was over credited by ₹ 180 (b) customer was credited by ₹ 753 instead of being debited by ₹ 573)				
(iii)	Suspense Account	Dr.		1,020	
	To Profit & Loss Adjustment A/c				1,020
	(Correction of error by which Returns Inward Account was debited by ₹ 510 instead of Returns Outwards Account being credited by ₹ 510)				
(iv)	Suspense Account	Dr.		1,240	
	To C. Dass				620
	To G. Dass				620
	(Removal or wrong debit to G. Dass and giving credit to C. Dass from whom cash was received).				

(v)	Customer's Account	Dr.		840	
	To Profit & Loss Adjustment A/c				840
	(Rectification of the error arising from non-preparation of invoice for goods delivered)				
(vi)	Profit & Loss Adjustment A/c	Dr.		200	
	Inventory Account	Dr.		800	
	To Customer's Account				1,000
	(The Customer's A/c credited with ₹ 1,000 for goods not yet purchased by him; cost of the goods debited to Inventory and "Profit" debited to Profit & Loss Adjustment Account)				
(vii)	Profit & Loss Adjustment A/c	Dr.		1,534	
	To Capital Account				1,534
	(Transfer of the Profit & Loss Adjustment A/c balance to the Capital Account)				

Will the students find out the difference in the Trial Balance?[1]

Illustration 15

Mr. Roy was unable to agree the Trial Balance last year and wrote off the difference to the Profit and Loss Account of that year. Next Year, he appointed a Chartered Accountant who examined the old books and found the following mistakes :

(1) Purchase of a scooter was debited to conveyance account ₹ 3,000.

(2) Purchase account was over-cast by ₹ 10,000.

(3) A credit purchase of goods from Mr. X for ₹ 2,000 entered as a sale.

(4) Receipt of cash from Mr. A was posted to the account of Mr. B ₹ 1,000.

(5) Receipt of cash from Mr. C was posted to the debit of his account, ₹ 500.

(6) ₹ 500 due by Mr. Q was omitted to be taken to the trial balance.

(7) Sale of goods to Mr. R for ₹ 2,000 was omitted to be recorded.

(8) Payment of ₹ 2,395 for purchase was wrongly posted as ₹ 2,593.

[1] *Credit side is short by ₹ 808*

Mr. Roy used 10% depreciation on vehicles. Suggest the necessary rectification entries.

Solution

Journal Entries in the books of Mr. Roy

Date	*Particulars*			*Dr.* ₹	*Cr.* ₹
(1)	Motor Vehicles Account	Dr.		2,700	
	To Profit and Loss Adjustment A/c				2,700
	(Purchase of scooter wrongly debited to conveyance account now rectified-capitalisation of ₹ 2,700, i.e., ₹ 3,000 less 10% depreciation)				
(2)	Suspense Account	Dr.		10,000	
	To Profit & Loss Adjustment A/c				10,000
	(Purchase Account overcast in the previous year; error now rectified).				
(3)	Profit & Loss Adjustment A/c	Dr.		4,000	
	To P's Account				4,000
	(Credit purchase from P ₹ 2,000, entered as sales last year; now rectified)				
(4)	B's Account	Dr.		1,000	
	To A's Account				1,000
	(Amount received from A wrongly posted to the account of B; now rectified)				
(5)	Suspense Account	Dr.		1,000	
	To C's Account				1,000
	(₹ 500 received from C wrongly debited to his account; now rectified)				
(6)	Trade receivables (Q)	Dr.		500	
	To Suspense Account				500
	(₹ 500 due by Q not taken into trial balance; now rectified)				
(7)	R's Account	Dr.		2,000	
	To Profit & Loss Adjustment A/c				2,000
	(Sales to R omitted last year; now adjusted)				
(8)	Suspense Account	Dr.		198	
	To Profit & Loss Adjustment A/c				198
	(Excess posting to purchase account last year, ₹ 2,593, instead of ₹ 2,395, now adjusted)				
(9)	Profit & Loss Adjustment A/c	Dr.		10,898	
	To Roy's Capital Account				10,898
	(Balance of Profit & Loss Adjustment A/c transferred to Capital Account)				
(10)	Roy's Capital Account	Dr.		10,698	
	To Suspense Account				10,698
	(Balance of Suspense Account transferred to the Capital Account)				

Note : Entries No. (2) and (8) may even be omitted; but this is not advocated, Entry (6) will not be posted in Q's Account.

Profit and Loss Adjustment Account
(Prior Period Items)

	₹		₹
To P	4,000	By Motor Vehicles A/c	2,700
To Roy's Capital (transfer)	10,898	By Suspense A/c	10,000
		By R	2,000
		By Suspense Account	198
	14,898		14,898

Suspense Account

	₹		₹
To Profit & Loss Adjustment Account	10,000	By Trade Receivables (Q)	500
To C	1,000	By Roy's Capital Account (Transfer)	10,698
To Profit & Loss Adjustment Account	198		
	11,198		11,198

SELF EXAMINATION QUESTIONS

I. Pick up the correct answer from the given choices:

1. (i) Goods purchased from A for ₹ 10,000 passed through the sales book. The error will result in

(a) Increase in gross profit. (b) Decrease in gross profit.

(c) No effect on gross profit. (d) Either (a) or (b).

(ii) If a purchase return of ₹ 1,000 has been wrongly posted to the debit of the sales returns account, but has been correctly entered in the suppliers' account, the total of the

(a) Trial balance would show the debit side to be ₹ 1,000 more than the credit

(b) Trial balance would show the credit side to be ₹ 1,000 more than the debit.

(c) The debit side of the trial balance will be ₹ 2,000 more than the credit side.

(d) The credit side of the trial balance will be ₹ 2,000 more than the debit side.

(iii) If the amount is posted in the wrong account or it is written on the wrong side of the account, it is called

(a) Error of omission. (b) Error of commission.

(c) Error of principle. (d) Compensating error.

[Ans 1 : (i)-(a), (ii)-(c), (iii)-(b)]

2. Choose the most appropriate option from the given choices:

(i) ₹ 200 paid as wages for erecting a machine should be debited to

(a) Repair account. (b) Machine account.

(c) Capital account. (d) Furniture account

(ii) On purchase of old furniture, the amount of ₹ 1,000 spent on its repair should be debited to

(a) Repair account; (b) Furniture account;

(c) Cash account; (d) Bank account

(iii) Goods worth ₹ 50 given as charity should be credited to

(a) Charity account; (b) Sales account;

(c) Purchase account. (d) Cash account

(iv) Goods worth ₹ 100 taken by proprietor for domestic use should be credited to

(a) Sales account; (b) Proprietor's personal expenses;

(c) Purchases account (d) Expenses account.

(v) Errors of commission do not permit;

(a) Correct totalling of the balance sheet; (b) Correct totalling of the trial balance;

(c) The trial balance to agree. (d) None of the above.

(vi) The preparation of a trial balance is for:

(a) Locating errors of commission; (b) Locating errors of principle;

(c) Locating clerical errors. (d) All of the above

(vii) ₹ 200 received from Smith whose account, was written off as a bad debt should be credited to :

(a) Bad Debts Recovered account; (b) Smith's account;

(c) Cash account. (d) Bad debts account

(viii) Purchase of office furniture ₹ 1,200 has been debited to General Expense Account. It is :

(a) A clerical error; (b) An error of principle;

(c) An error of omission. (d) Compensating error.

(ix) Sales of office furniture should be credited to

(a) Sales Account; (b) Furniture Account.

(c) Purchase Account. (d) Cash Account

[Ans: **2 :** (i) (b); (ii) (b); (iii) (c); (iv) (c); (v) (c); (vi) (c); (vii) (a); (viii) (b); (ix) (b)]

II. From the given information, choose the most appropriate answer.

1. Classify the following errors under (a) Errors of omission, (b) Errors of commission and (c) Errors of principle, (d) Compensating errors

(i) The total of sales book was not posted to the ledger.

(ii) Sales to Heena ₹ 143 was posted to Meena as ₹ 143.

(iii) Goods taken away by the proprietor for personal use not recorded anywhere.

(iv) The total of a folio in the sales book ₹ 1,000 was carried forward as ₹ 100.

(v) Repairs of newly purchased second-hand machinery debited to repairs accounts.

[Ans: 1: (i)-(a), (ii)-(b), (iii)-(a), (iv)-(b), (v)-(c)]

2. Point out the type of the errors given below: (put 1 against errors of omission, 2 against errors of commission, 3 against errors principle, 4 if it is not an error).

(a) Sale of ₹ 120 was written in the purchases book.

(b) Salary paid to Ram, has been debited to his account.

(c) Purchase of furniture has been entered in the purchases book.

(d) ₹ 120 received from Ganesh has been debited to his account.

(e) Freight paid on machinery has been debited to the freight account.

(f) The discount columns of the cash book have not been posted.

(g) Repairs to buildings have been debited to the buildings account.

(h) The total of the Sales Book is ₹ 100 short.

(i) The sale of worth ₹ 337 has been posted as ₹ 373.

(j) The amount of a dishonoured bill has been debited to general expenses account.

[Ans : 2 : 1 : (f); 2 : (a) (d) (h) (i); 3 : (b) (c) (e) (g) (j)]

III. Given below are the questions containing multiple answers. Choose the correct answer(s).

1. Which of the following errors will not be revealed by the Trial Balance:

   (a) Compensating errors; (b) Errors of principle;

   (c) Wrong balancing of an account; (d) Wrong totalling of an account;

   [Ans : 1 : (a) and (b) will not be revealed]

2. Which of the following errors will be revealed by the Trial Balance:

   (a) Compensating errors; (b) Errors of principle;

   (c) Wrong balancing of an account; (d) Wrong totalling of an account;

   [Ans : (c) and (d) will be revealed]

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