

PRINCIPLES OF BOOK-KEEPING

A **double-entry bookkeeping system** is a set of rules for recording financial information in a financial accounting system in which every transaction or event changes at least two different nominal ledger accounts.

The name derives from the fact that financial information used to be recorded using pen and ink in paper books – hence "bookkeeping" (whereas now it is recorded mainly in computer systems) and that these books were called journals and ledgers (hence nominal ledger, etc.) – and that each transaction was entered twice (hence "double-entry"), with one side of the transaction being called a debit and the other a credit.

It was first codified in the 15th century by the Franciscan Friar, Luca Pacioli. In deciding which account has to be debited and which account has to be credited, the *golden rules of accounting* are used. This is also accomplished using the accounting equation: $\text{Equity} = \text{Assets} - \text{Liabilities}$. The accounting equation serves as an error detection tool. If at any point the sum of debits for all accounts does not equal the corresponding sum of credits for all accounts, an error has occurred. It follows that the sum of debits and the sum of the credits must be equal in value.

Double-entry bookkeeping is not a guarantee that no errors have been made – for example, the wrong ledger account may have been debited or credited, or the entries completely reversed.

Accounting entries

In the double-entry accounting system, each accounting entry records related pairs of financial transactions for asset, liability, income, expense, or capital accounts. Recording of a debit amount to one or more accounts and an equal credit amount to one or more accounts results in total debits being equal to total credits for all accounts in the general ledger. If the accounting entries are recorded without error, the aggregate balance of all accounts having positive balances will be equal to the aggregate balance of all accounts having negative balances. Accounting entries that debit and credit related accounts typically include the same date and identifying code in both accounts, so that in case of error, each debit and credit can be traced back to a journal and transaction source document, thus preserving an audit trail. The rules for formulating accounting entries are known as "Golden Rules of Accounting". The accounting entries are recorded in the "Books of Accounts". Regardless of which accounts and how many are impacted by a given transaction, the fundamental accounting equation $A = L + OE$ will hold, i.e. assets equals liabilities plus owner's equity.

Approaches

There are two different approaches to the double entry system of bookkeeping. They are Traditional Approach and Accounting Equation Approach. Irrespective of the approach used, the effect on the books of accounts remains the same, with two aspects (debit and credit) in each of the transactions.

Traditional (British) approach

Following the traditional approach (also called *British approach*) accounts are classified as real, personal, and nominal accounts. Real accounts are accounts relating to assets and liabilities including the capital account of the owners. Personal accounts are accounts relating to persons or organisations with whom the business has transactions and will mainly consist of accounts of debtors and creditors. Nominal accounts are revenue, expenses, gains, and losses. Transactions are entered in the books of accounts by applying the following golden rules of accounting:

1. Personal account: Debit the receiver and credit the giver
2. Real account: Debit what comes in and credit what goes out
3. Nominal account: Debit all expenses & losses and credit all incomes & gains

Accounting equation approach

This approach is also called the American approach. Under this approach transactions are recorded based on the accounting equation, i.e., $\text{Assets} = \text{Liabilities} + \text{Capital}$. The accounting equation is a statement of equality between the debits and the credits. The rules of debit and credit depend on the nature of an account. For the purpose of the accounting equation approach, all the accounts are classified into the following five types: assets, liabilities, income/revenues, expenses, or capital gains/losses.

If there is an increase or decrease in one account, there will be equal decrease or increase in another account. There may be equal increases to both accounts, depending on what kind of accounts they are. There may also be equal decreases to both accounts. Accordingly, the following rules of debit and credit in respect to the various categories of accounts can be obtained. The rules may be summarised as below:

1. Assets Accounts: debit increases in assets and credit decreases in assets
2. Capital Account: credit increases in capital and debit decreases in capital
3. Liabilities Accounts: credit increases in liabilities and debit decreases in liabilities
4. Revenues or Incomes Accounts: credit increases in incomes and gains and debit decreases in incomes and gains
5. Expenses or Losses Accounts: debit increases in expenses and losses and credit decreases in expenses and losses

These five rules help learning about accounting entries and also are comparable with traditional (Britain) accounting rules.

Books of accounts

Each financial transaction is recorded in at least two different nominal ledger accounts within the financial accounting system, so that the total debits equals the total credits in the General Ledger, i.e. the accounts balance. This is a partial check that each and every transaction has been correctly recorded. The

transaction is recorded as a "debit entry" (Dr) in one account, and a "credit entry" (Cr) in a second account. The debit entry will be recorded on the debit side (left-hand side) of a General ledger and the credit entry will be recorded on the credit side (right-hand side) of a General ledger account. If the total of the entries on the debit side of one account is greater than the total on the credit side of the same nominal account, that account is said to have a debit balance.

Double entry is used only in nominal ledgers. It is not used in daybooks (journals), which normally do not form part of the nominal ledger system. The information from the daybooks will be used in the nominal ledger and it is the nominal ledgers that will ensure the integrity of the resulting financial information created from the daybooks (provided that the information recorded in the daybooks is correct).

The reason for this is to limit the number of entries in the nominal ledger: entries in the daybooks can be totalled before they are entered in the nominal ledger. If there are only a relatively small number of transactions it may be simpler instead to treat the daybooks as an integral part of the nominal ledger and thus of the double-entry system.

However it is still necessary to check, within each day book that the postings from the daybook balance.

The double entry system uses nominal ledger accounts. From these nominal ledger accounts a trial balance can be created. The trial balance lists all the nominal ledger account balances. The list is split into two columns, with debit balances placed in the left hand column and credit balances placed in the right hand column. Another column will contain the name of the nominal ledger account describing what each value is for. The total of the debit column must equal the total of the credit column.

Debits and credits

Double-entry bookkeeping is governed by the accounting equation. If revenue equals expenses, the following (basic) equation must be true:

$$\text{Assets} = \text{liabilities} + \text{equity}$$

For the accounts to remain in balance, a change in one account must be matched with a change in another account. These changes are made by debits and credits to the accounts. Note that the usage of these terms in accounting is not identical to their everyday usage. Whether one uses a debit or credit to increase or decrease an account depends on the normal balance of the account. Assets, Expenses, and Drawings accounts (on the left side of the equation) have a normal balance of *debit*. Liability, Revenue, and Capital accounts (on the right side of the equation) have a normal balance of *credit*. On a general ledger, debits are recorded on the left side and credits on the right side for each account. Since the accounts must always balance, for each transaction there will be a debit made to one or several accounts and a credit made to one or several accounts. The sum of all debits made in each day's transactions must equal the sum of all credits in those transactions. After a series of transactions, therefore, the sum of all the accounts with a debit balance will equal the sum of all the accounts with a credit balance.

Debits and credits are numbers recorded as follows:

- *Debits* are recorded on the left side of a T account in a ledger. Debits increase balances in asset accounts and expense accounts and decrease balances in liability accounts, revenue accounts, and capital accounts.
- *Credits* are recorded on the right side of a T account in a ledger. Credits increase balances in liability accounts, revenue accounts, and capital accounts, and decrease balances in asset accounts and expense accounts.
- *Debit accounts* are asset and expense accounts that usually have debit balances, i.e. the total debits usually exceeds the total credits in each debit account.
- *Credit accounts* are revenue (income, gains) accounts and liability accounts that usually have credit balances.

| | Debit | Credit |
|------------------|--------------|---------------|
| Asset | Increase | Decrease |
| Liability | Decrease | Increase |
| Income (revenue) | Decrease | Increase |
| Expense | Increase | Decrease |
| Capital | Decrease | Increase |

Different type of subsidiary books

Subsidiary book may be defined as a book of prime entry in which transactions of a particular category are recorded. In other words, in order to save time and energy, the transactions which are of similar character are recorded in separate books; these are called subsidiary books or subdivision of journal. A number of subsidiary books are opened to record all business transactions. In practical system of book-keeping, subsidiary books are:

Cash Book:

Transactions held in cash or by cheque are recorded in this book. There are two sides in a cash book. In the left hand side all cash receipts are recorded and in the right hand side all cash payments are recorded. Cash Book is of five types: single column cash book, double column cash book, triple column cash book, bank cash book and petty cash book. In the single column cash book only receipt of cash and payment of cash are recorded.

In the double column cash book, receipt of cash, receipt of cash discount, payment of cash and cash discount allowed are recorded. In the triple column cash book along with the transactions which are recorded in double column cash book, cheque received and cheque paid are recorded. In the bank cash book the receipt of cheque, payment of cheque, cash discount allowed and cash discount

received are recorded. In the petty cash book only small payments of cash are recorded by the petty cashier.

Purchase Book:

All credit purchase of goods is written in this book. Cash purchase of goods and credit purchase of assets are not recorded in this book. Other names of purchase book are purchase day book, purchase journal, bought journal, inward invoice book etc.

Sales Book:

All sales of goods are written in this book. Cash sale of goods and credit sale of assets are not recorded in this book. Other names of Sales Book are Sales Day Book, Sales Journal, Sold book, Outward Invoice Book etc.

Purchase Return Book:

It may be necessary to return some goods that the firm has bought on credit for a variety of reasons. All returns of such goods are recorded primarily in Return Outward Book. This book is also known as Purchase Return Book.

Sales Return Book:

Goods may be returned by the customers for a variety of reasons. All goods returned from customers are recorded in Sales Return Book. This book is also known as Return Inward Book.

Bills Receivable Book:

When credit sales of goods are made the purchaser gives his guarantee to make payment in future in the form of bill. When the seller receives such bill, it is Bill Receivable for him as he will receive payment in future against such bill. In case a business house receives a number of bills, a Bills Receivable Book is maintained to record all such bills.

Bills Payable Book:

When credit purchases are made by a firm it gives a guarantee to the seller to make payment in future in the form of a bill. This bill is said to be Bills Payable for the firm as he will pay for the bill in future. A Bills Payable Book is opened to record all such bills.

Journal Proper:

It is a subsidiary book maintained to record the transaction which cannot be recorded in other special subsidiary books. Usually the transactions of infrequent character are recorded in the journal proper. The entries like adjustment entries, opening entries, closing entries, transfer entries, purchase and sale of assets on credit, interest on capital, interest of drawing etc. are recorded in journal proper.

Cash Book

Cash book is a book of original entry in which transactions relating only to cash receipts and payments are recorded in detail. When cash is received it is entered on the debit or left

hand side. Similarly, when cash is paid out the same is recorded on the credit or right hand side of the cash book.

The cash book, though it serves the purpose of a cash book of original entry viz., cash journal really it represents the cash account of the ledger separately bound for the sake of convenience. It is more a ledger than a journal. It is journal as cash transactions are chronologically recorded in it. It is a ledger as it contains a classified record of all cash transactions. The balances of the cash book are recorded in the trial balance and the balance sheet.

Vouchers:

For Every entry made in the cash book there must be a proper voucher. Vouchers are documents containing evidence of payment and receipts. When money is received generally a printed receipt is issued to the payer but counterfoil or the carbon copy of it is preserved by the cashier. The copy receipts are called debit vouchers, and they support the entries appearing on the debit side of the cash book. Similarly when payment is made a receipt is obtained from the payee. These receipts are known as credit vouchers. All the debit and credit vouchers are consecutively numbered. For ready reference the number of the vouchers is noted against the respective entries. A column is provided on either side of the cash book for this purpose.

Balancing Cash Book:

The cash book is balanced at the end of a given period by inserting the excess of the debit on the credit side as "by balance carried down" to make both sides agree. The balance is then shown on the debit side by "To balance brought down" to start the next period. As one cannot pay more than what he actually receives, the cash book recording cash only can never show a credit balance.

Format:

The following is the simple format of a cash book:

| Date | Particulars | L.F. | Amount | Date | Particulars | L.F. | Amount |
|------|-------------|------|--------|------|-------------|------|--------|
| | | | | | | | |

Single column cash book records only cash receipts and payments. It has only one money column on each of the debit and credit sides of the cash book. All the cash receipts are entered on the debit side and the cash payments on the credit side.

While writing a single column cash book the following points should be kept in mind:

1. The pages of the cash book are vertically divided into two equal parts. The left hand side is for recording receipts and the right hand side is for recording payments.
2. Being the cash book with the balance brought forward from the preceding period or with what we start. It appears at the top of the left side as "To Balance" or "To Capital" in case of a new business.
3. Record the transactions in order of date.
4. If any amount of cash is received on an account, the name of that account is entered in the particulars column by the word "To" on the left hand side of the cash book.
5. If any amount is paid on account, the name of the account is written in the particulars column by the word "By" on the right hand side of the cash book.
6. It should be balanced at the end of a given period.

Posting:

The balance at the beginning of the period is not posted but other entries appearing on the debit side of the cash book are posted to the credit of the respective accounts in the ledger, and the entries appearing on the credit side of the cash book are posted to the debit of the proper accounts in the ledger.

Format of the Single Column Cash Book:

Following is the format of the single column cash book:

| Date | Particulars | L.F. | Amount | Date | Particulars | L.F. | Amount |
|------|-------------|------|--------|------|-------------|------|--------|
| | | | | | | | |

Example:

Write the following transactions in the simple cash book and post into the ledger:

1991

| | | |
|--------|--------------------------|--------|
| Jan. 1 | Cash in hand | 15,000 |
| " 6 | Purchased goods for cash | 2,000 |

| | | |
|------|----------------------------|-------|
| " 16 | Received from Akbar | 3,000 |
| " 18 | Paid to Babar | 1,000 |
| " 20 | Cash sales | 4,000 |
| " 25 | Paid for stationary | 60 |
| " 30 | Paid for salaries | 1,000 |
| " 31 | Purchased office furniture | 2,000 |

Solution:

Cash Book

| Date | Particulars | L.F. | Amount | Date | Particulars | L.F. | Amount |
|--------|----------------|------|--------|--------|------------------|------|--------|
| 1991 | | | | | | | |
| Jan. 1 | To Balance b/d | | 15,000 | Jan. 6 | By Purchases a/c | | 2,000 |
| 16 | To Akbar | | 3,000 | 18 | By Babar | | 1,000 |
| 20 | To sales a/c | | 4,000 | 25 | By stationary | | 60 |
| | | | | 30 | By Salaries a/c | | 1,000 |
| | | | | 31 | By Furniture a/c | | 2,000 |
| | | | 22,000 | | By Balance c/d | | 15,940 |
| | To Balance b/d | | 15,940 | | | | 22,000 |

Akbar

| | | | | | | |
|--|--|--|---------|---------|--|-------|
| | | | 1991 | | | Rs |
| | | | Jan. 16 | By Cash | | 3,000 |

Sales Account

| | | | | | | |
|--|--|--|--------|---------|--|-------|
| | | | 1991 | | | Rs |
| | | | Jan. 2 | By Cash | | 4,000 |

Purchases Account

| | | | | | |
|----------------|---------|-------------|--|--|--|
| 1991 Jan. 6 | To Cash | Rs 2,000 | | | |
|----------------|---------|-------------|--|--|--|

Babar Account

| | | | | | |
|-----------------|---------|-------------|--|--|--|
| 1991 Jan. 18 | To Cash | Rs 1,000 | | | |
|-----------------|---------|-------------|--|--|--|

Stationary Account

| | | | | | |
|-----------------|---------|----------|--|--|--|
| 1991 Jan. 25 | To Cash | Rs 60 | | | |
|-----------------|---------|----------|--|--|--|

Salaries Account

| | | | | | |
|-----------------|---------|-------------|--|--|--|
| 1991 Jan. 30 | To Cash | Rs 1,000 | | | |
|-----------------|---------|-------------|--|--|--|

Furniture Account

| | | | | | |
|-----------------|---------|-------------|--|--|--|
| 1991 Jan. 31 | To Cash | Rs 2,000 | | | |
|-----------------|---------|-------------|--|--|--|

A **double column cash book** or **two column cash book** is one which consists of two separate columns on the debit side as well as credit side for recording cash and discount. In many concerns it is customary for the trader to allow or to receive small allowance off or against the dues. These allowances are made for prompt settlement of accounts. In certain business almost all receipts or payments are accompanied by such discounts and in order to avoid unnecessary postings separate columns in the cash book are introduced to record the discounts received or allowed. These discount columns are memorandum columns only. They do not form the discount account. The discount column on the debit side of the cash book will record discounts allowed and that on the credit side discounts received.

Posting:

The cash columns will be posted in the same way as single column cash book. But as regards discount column, each item of discount allowed (Dr. side of the cash book) will be posted to the credit of the respective personal accounts. Similarly each item of discount received will be posted to the debit of the respective personal account. Total of the discount column on the debit side of the cash book will be posted to the debit side of the discount account in the ledger and the total of discount column on the credit side of the cash book on

the credit side of the discount account. The discount columns are not balanced like cash column of the two column cash book.

Format of the Double Column Cash Book:

| Debit Side | | | | | | Credit Side | | | | | |
|------------|-------------|------|------|----------|------|-------------|-------------|------|------|----------|------|
| Date | Particulars | V.N. | L.F. | Discount | Cash | Date | Particulars | V.N. | L.F. | Discount | Cash |
| | | | | | | | | | | | |

Example of Two Column Cash Book:

From the following transactions write up a two column cash book and post into ledger:

1991

- Jan. 1 Cash in hand Rs2,000
- " 7 Received from Riaz & Co. Rs200; discount allowed Rs10
- " 12 Cash sales Rs1,000
- " 15 Paid Zahoor Sons Rs500; discount received Rs15
- " 20 Purchased goods for cash Rs300
- " 25 Received from Salman Rs500; discount allowed Rs15
- " 27 Paid Hussan & Sons Rs300.
- " 28 Bought furniture for cash Rs100
- " 31 Paid rent Rs100

Solution:

Cash Book

Debit Side

Credit Side

| Date | Particulars | V.N. | L.F. | Discount | Cash | Date | Particulars | V.N. | L.F. | Discount | Cash |
|----------------|----------------|------|------|----------|-------|----------------|------------------|------|------|----------|-------|
| 1991 Jan. 1 | To Balance b/d | | | | 2,000 | 1991 Jan. 5 | By Zahoor & Sons | | | 15 | 500 |
| " 7 | To Riaz & Co. | | | 10 | 200 | " 20 | By purchase a/c | | | | 300 |
| " 12 | To Sales a/c | | | | 1,000 | " 27 | By Hussan&Sons | | | | 300 |
| " 25 | To Salman | | | 15 | 500 | " 28 | By Furniture a/c | | | | 100 |
| | | | | | | " 31 | By Rent a/c | | | | 100 |
| | | | | | | | By Balance c/d | | | | 2,400 |
| 1991 Feb 1 | To Balance b/d | | | 25 | 3,700 | | | | | 15 | 3,700 |
| | | | | | 2,400 | | | | | | |

Riaz & Co.

| | | | | | | |
|--|--|--|--|----------------|-------------|-----------|
| | | | | 1991 Jan. 7 | By Cash | Rs 200 |
| | | | | | By Discount | 10 |

Sales Account

| | | | | | | |
|--|--|--|--|-----------------|---------|-------------|
| | | | | 1991 Jan. 12 | By Cash | Rs 1,000 |
|--|--|--|--|-----------------|---------|-------------|

Salman Account

| | | | | | | |
|--|--|--|--|-----------------|-------------|-----------|
| | | | | 1991 Jan. 25 | By Cash | Rs 500 |
| | | | | | By Discount | 15 |

Babar Account

| | | | | | | |
|-----------------|---------|--|--|-------------|--|--|
| 1991 Jan. 18 | To Cash | | | Rs 1,000 | | |
|-----------------|---------|--|--|-------------|--|--|

Zahoor Account

| | | | | | | |
|-----------------|----------|--|--|-----------|--|--|
| 1991 Jan. 15 | To Cash | | | Rs 500 | | |
| | Discount | | | 15 | | |

Purchases Account

| | | | | | | |
|-----------------|---------|--|--|-----------|--|--|
| 1991 Jan. 20 | To Cash | | | Rs 300 | | |
|-----------------|---------|--|--|-----------|--|--|

Hussan & Sons

| | | | | | |
|-----------------|---------|-----------|--|--|--|
| 1991 Jan. 27 | To Cash | Rs 300 | | | |
|-----------------|---------|-----------|--|--|--|

Furniture Account

| | | | | | |
|-----------------|---------|-----------|--|--|--|
| 1991 Jan. 28 | To Cash | Rs 100 | | | |
|-----------------|---------|-----------|--|--|--|

Rent Account

| | | | | | |
|-----------------|---------|-----------|--|--|--|
| 1991 Jan. 31 | To Cash | Rs 100 | | | |
|-----------------|---------|-----------|--|--|--|

Discount Account

| | | | | | |
|-----------------|---------------------------------|----------|-----------------|---------------------------------|----|
| 1991 Jan. 31 | To Sundries as per Cash book | Rs 25 | 1991 Jan. 31 | By Sundries as per cash book | 15 |
|-----------------|---------------------------------|----------|-----------------|---------------------------------|----|

A **three column cash book** or **treble column cash book** is one in which there are three columns on each side - debit and credit side. One is used to record cash transactions, the second is used to record bank transactions and third is used to record discount received and paid.

When a trader keeps a bank account it becomes necessary to record the amounts deposited into bank and withdrawals from it. For this purpose one additional column is added on each side of the cash book. One of the main **advantages of a three column cash book** is that it is very helpful to businessmen, since it reveals the cash and bank deposits at a glance

Writing a Three column Cash Book:

Opening Balance:

Put the opening balance (if any) on cash in hand and cash at bank on the debit side in the cash book and bank columns. If the opening balance is credit balance (overdraft) then it will be put in the credit side of the cash book in the bank column.

Cheque/Check or Cash Received:

If a cheque is received from any person and is paid into the bank on the same date it will appear on the debit side of the cash book as "To a Person". The amount will be shown in the bank column. If the cheque received is not deposited into the bank on the same date then

the amount will appear in the cash column. Cash received will be recorded in the usual manner in the cash column.

Payment by Cheque/Check or Cash:

When we make payment by cheque, this will appear on the credit side "By a person" and the amount in the bank column. If the payment is made in cash it will be recorded in usual manner in the cash column.

Contra Entries:

If an amount is entered on the debit side of the cash book, and the exact amount is again entered on the credit side of the same account, it is called "contra entry". Similarly an amount entered on the credit side of an account also may have a contra entry on the debit side of the same account.

Contra entries are passed when:

1. **Cash is deposited into bank by office:** It is payment from cash and receipt in bank. Therefore, enter on credit side, cash column "By Bank" and on debit side bank column "To Cash". The reason for making two entries is to comply with the principle of double entry which in such transactions is completed and therefore, no posting of these items is necessary. Such entries are marked in the cash book with the letter "C" in the folio column
2. **Cheque/Check is drawn for office use:** It is payment by bank and receipt in cash. Therefore, enter on the debit side, cash column "To Bank" and on credit side, bank column "By Cash".

Bank Charges and Bank Interest Allowed:

Bank charges appear on the credit side, bank column "Bank Charges." Bank interest allowed appears on the debit side, bank column "To Interest".

Posting:

The method of posting three column cash book into the ledger is as follows:

1. The opening balance of cash in hand and cash at bank are not posted.
2. Contra Entries marked with "C" are not posted.
3. All other items on the debit side will be posted to the credit of respective accounts in the ledger and all other items on the credit side will be posted to the debit of the respective accounts.
4. As regards discounts the total of the discount allowed will be posted to the debit of the discount account in the ledger and total of the discount received to the credit side of the discount account.

Format of the Three Column Cash Book:

| Debit Side | | | | | | Credit Side | | | | | | | |
|------------|-------------|------|------|---------------|------|-------------|------|-------------|------|------|---------------|------|------|
| Date | Particulars | V.N. | L.F. | Dis- count | Cash | Bank | Date | Particulars | V.N. | L.F. | Dis- count | Cash | Bank |
| | | | | | | | | | | | | | |

Example of Three Column Cash Book:

On January 1, 1991 Noorani Stores cash book showed debit balance of cash Rs1,550 and bank Rs13,575. During the month of January following business was transacted.

1991

- Jan.1 Purchased office typewriter for cash Rs750; cash sales Rs315
- " Deposited cash Rs500
- " 4 Received from A. Hussan a cheque for Rs2,550 in part payment of his account
- " 6 Paid by cheque for merchandise purchased worth Rs1,005
- " 8 Deposited into bank the cheque received from A. Hussan.
- " 10 Received from Hayat Khan a cheque for Rs775 in full settlement of his account and allowed him discount Rs15.
- " 12 Sold merchandise to Divan Bros. for Rs1,500 who paid by cheque which was deposited in the bank.
- " 16 Paid Salman Rs915 by cheque, discount received Rs5
- " 27 Paid to Gulzar Ahmad by cheque Rs650
- " 30 Paid salaries by cheque Rs1,750
- " 31 Deposited into bank the cheque of Hayat Khan.
- " 31 Drew from bank for office use Rs250.

You are required to enter the above transactions in three column cash book and balance it.

Solution:

**Noorani Stores
Cash Book**

Debit Side

Credit Side

| Date | Particulars | V.N. | L.F. | Dis- count | Cash | Bank | Date | Particulars | V.N. | L.F. | Dis- count | Cash | Bank |
|---------------|---------------|------|------|---------------|-------|--------|---------------|------------------|------|------|---------------|-------|--------|
| 1991 Jan.1 | To Balanceb/d | | | | 1,550 | 13,575 | 1991 Jan.1 | By Office Equip. | | | | 750 | |
| " 1 | To Sales a/c | | | | 1,315 | | " 3 | By Bank | | C | | 500 | |
| " 3 | To Cash a/c | | C | | | 500 | " 6 | By Purchases a/c | | | | | 1,005 |
| " 4 | To A Hussan | | | | 2,550 | | " 8 | By Bank | | C | | 2,550 | |
| " 10 | To Cash | | C | | | 2,550 | " 16 | By Salman | | | 5 | | 915 |
| " 12 | To Hayat Khan | | | 15 | 775 | | " 27 | By Gulzar | | | | | 650 |
| " 31 | To Sales a/c | | | | | 1,500 | " 30 | By Salaries a/c | | | | | 1,750 |
| " 31 | To Cash | | C | | | 775 | " 31 | By Bank | | C | | 775 | |
| | To Bank | | C | | 250 | | | By Cash | | C | | | 250 |
| | | | | | | | | By Balanced c/d | | | | 1,865 | 14,330 |
| | | | | 15 | 6,440 | 18,900 | | | | | 5 | 6,440 | 18,900 |
| 1991 Feb.1 | To Balanceb/d | | | | 1,865 | 14,330 | | | | | | | |

Sales Account

| | | | | | |
|--|--|--|--------|---------|-------|
| | | | 1991 | | Rs |
| | | | Jan. 1 | By Cash | 1,315 |
| | | | " 12 | By Cash | 1,500 |

A. Hussan

| | | | | | |
|--|--|--|--------|---------|-------|
| | | | 1991 | | Rs |
| | | | Jan. 4 | By Cash | 2,550 |

Hayat Khan

| | | | | | |
|--|--|--|---------|-------------|-----|
| | | | 1991 | | Rs |
| | | | Jan. 10 | By Cash | 775 |
| | | | | By Discount | 15 |

Office Equipment Account

| | | | | | |
|--------|---------|-----|--|--|--|
| 1991 | | Rs | | | |
| Jan. 1 | To Cash | 750 | | | |

Purchase Account

| | | | | | |
|--------|---------|-------|--|--|--|
| 1991 | | Rs | | | |
| Jan. 6 | To Cash | 1,005 | | | |

Salman

| | | | | | |
|---------|-------------|-----|--|--|--|
| 1991 | | Rs | | | |
| Jan. 16 | To Cash | 915 | | | |
| | To Discount | 5 | | | |

Gulzar Ahmad

| | | | | | |
|---------|---------|-----|--|--|--|
| 1991 | | Rs | | | |
| Jan. 27 | To Cash | 650 | | | |

Salaries Account

| | | | | | |
|---------|---------|-------|--|--|--|
| 1991 | | Rs | | | |
| Jan. 30 | To Cash | 1,750 | | | |

Discount Account

| | | | | | |
|---------|------------------------------|----|------|---------|------------------------------|
| 1991 | | Rs | | | |
| Jan. 31 | To Sundries as per Cash book | 15 | 1991 | Jan. 31 | By Sundries as per cash book |
| | | | | | 5 |

Petty Cash Book: In almost all businesses, it is found necessary to keep small sums of ready money with the cashier or petty cashier for the purpose of meeting small expenses such as postage, telegrams, stationary and office sundries etc. The sum of money so kept in hand generally termed as petty cash and book in which the petty cash expenditures are recorded is termed as **petty cash book**.

In large business houses, the cashier has to handle every day a large number of receipts and payments and if in addition to this he is further saddled with petty cash payments, his position becomes embarrassing. Besides, it is most common to find with large commercial establishments that all receipts and payments are made through bank. Since expenses like postage, telegrams, traveling etc, cannot be made by means of cheques, the maintenance of a small cash balance to meet these petty payments becomes all the more necessary.

A petty cash book is generally maintained on a columnar basis - a separate column being allotted for each type of expenditure. There is only one money column on the debit side and all sums received from time to time by the petty cashier from the chief cashier are entered in it. The credit side consists of several analysis columns. Every payment made by the petty cashier is entered on this side twice - Firstly it is recorded in the total column and then to the appropriate column to which the expense is concerned. The total of the "total column" will naturally agree with the total of all subsidiary columns. The difference between the total of the debit items and that of the "total column" on the credit side at any time will represent the balance of the petty cash in hand and this should tally with the petty cashier's actual holding of cash.

The posting from the petty cash book to the respective accounts in the ledger are made directly in total at the end of every month or any other fixed period.

The Imprest System:

The more scientific method of maintaining petty cash so far introduced into practice is the **imprest system**. Under this system a fixed sum of money is given to the petty cashier to cover the petty expenses for the month. At the end of a month the petty cashier submits his statement of petty expenses to the chief cashier. The chief cashier on the receipt of such statement refunds to the petty cashier the exact amount spent by him during the month, thus making the imprest for the next month the same as it was at the beginning of the current month.

It is to be noted that the amount of cash in the hands of the petty cashier is a part of the cash balance, therefore it should be included in the cash balance when the latter is shown in the trial balance and the balance sheet. It should also be kept in mind that petty cash book is not like the cash book. It is a branch of cash book.

Advantages of Imprest System:

The main advantages of imprest system of petty cash are as follows:

1. As the petty cashier has to produce to the chief cashier the petty cash book for inspection, it acts as a healthy check on the petty cashier.
2. As the petty cashier has to account for his expenses, before he can draw further sums, the petty cash book remains up to date.
3. As the petty cashier cannot draw as and when he likes, it prevents unnecessary accumulation of cash in his hand thus the chances of defalcation of cash are minimised.

Format of the Petty Cash Book:

The following is the simple format of a petty cash book:

| Amount Received | Date | Particulars | V.N. | Total | Postage | Printing and Stationary | Cartage | Traveling Expenses | Misc. |
|-----------------|------|-------------|------|-------|---------|-------------------------|---------|--------------------|-------|
|-----------------|------|-------------|------|-------|---------|-------------------------|---------|--------------------|-------|

| | | | | | | | | | |
|--|--|--|--|--|--|--|--|--|--|
| | | | | | | | | | |
|--|--|--|--|--|--|--|--|--|--|

Example:

Enter the following transactions in the columnar petty cash book of a cashier who was given Rs100 on 1st March, 1991 on the imprest system: -

1991

| | | |
|---------|---------------------------------|----|
| March 2 | Paid for postage stamps | 8 |
| " 2 | Paid for stationary | 10 |
| " 3 | Paid for cartage | 4 |
| " 3 | Paid for postage stamps | 6 |
| " 8 | Paid for paper | 1 |
| " 12 | Paid for cartage | 6 |
| " 18 | Paid for trips to office peons | 2 |
| " 23 | Paid for ink and nibs | 4 |
| " 25 | Paid for Tiffin to office peons | 6 |
| " 26 | Paid for train fair | 5 |
| " 28 | Paid for bus fair | 4 |
| " 29 | Envelops and letter heads | 6 |
| " 30 | Printing address on above | 4 |
| " 31 | Taxi fare to manager | 10 |

Solution:

| Amount Received | Date | Particulars | V.N. | Total | Postage | Printing and Stationary | Cartage | Traveling Expenses | Misc. |
|-----------------|------|-------------|------|-------|---------|-------------------------|---------|--------------------|-------|
|-----------------|------|-------------|------|-------|---------|-------------------------|---------|--------------------|-------|

| | | | | | | | | | |
|-------|---------|-------------------|-----|----|----|----|----|----|---|
| Rs | 1991 | | | | | | | | |
| Rs100 | March 1 | To Cash | | | | | | | |
| | " 2 | By Postage | 8 | 8 | | | | | |
| | " 2 | By Stationary | 10 | | 10 | 4 | | | |
| | " 3 | By Cartage | 4 | | | | | | |
| | " 3 | By Postage | 6 | 6 | | | | | |
| | " 3 | By Paper | 1 | | 1 | | | | |
| | " 12 | By Cartage | 6 | | | 6 | | | |
| | " 18 | By Tip to peon | 2 | | | | | | 2 |
| | " 23 | By Ink & nibs | 4 | | 4 | | | | 6 |
| | " 25 | By Tiffin to Peon | 6 | | | | | 5 | |
| | " 26 | By train fair | 5 | | | | | 4 | |
| | " 28 | By bus fair | 4 | | | | | | |
| | " 29 | By Envelops et. | 6 | | 6 | | | | |
| | " 30 | By printing | 4 | | 4 | | | | |
| | " 31 | By Taxi fair | 10 | | | | | 10 | |
| | " 31 | By balance c/d | 24 | | | | | | |
| 100 | | | 100 | 14 | 25 | 10 | 19 | | 8 |
| 24 | April 1 | To Balance b/d | | | | | | | |
| 76 | " 1 | To Cash | | | | | | | |

Purchases book or **purchases day book** is a **book of original entry** maintained to record credit purchases. You must note that cash purchases will not be entered in purchases day book because entries in respect of cash purchases must have been entered in the cash book. At the end of each month, the purchases book is totaled. The total shows the total amount of goods purchased on credit. Purchases book is written up daily from the invoices received. The invoices are consecutively numbered. The invoice of each number is noted in the purchases book.

Ruling:

It is not ruled like the ordinary journal. The first column in this book is for date. In the second column, the name of the supplier or the seller, quantity of each article bought, description of the article, rate etc., are recorded. Sometimes a separate column to record the details of the transactions is added in the purchases day book. The third column is for invoice number. The fourth column is for ledger folio. The last column gives the total amount to the supplier.

Posting:

The total of the purchases book is posted to the debit of purchases account. Names of the suppliers appear in the purchases book. These parties have supplied the goods. They are, therefore, credited with the amount appearing against their respective names. The double entry will thus be completed.

Format:

The following is the format of purchases day book:

| Date | Particulars | Inv.No. | L.F. | Amount |
|------|-------------|---------|------|--------|
| | | | | |

Example:

From the following transactions of a trader prepare the purchases day book and post it into ledger: -

| 1991 | | Rs |
|-----------|------------------------------------|-------|
| January 5 | Purchased goods from Rasool & Co. | 2,400 |
| " 15 | Purchased goods from Iqbal Bros. | 6,000 |
| " 25 | Purchased goods from More & Co. | 1,500 |
| " 30 | Purchased goods from Maqbool & Co. | 3,000 |

Solution:

Purchases Day Book

| Date | Particulars | Inv.No. | L.F. | Amount |
|----------------|------------------------------------------------------------|---------|------|----------------------------------------|
| 1991 Jan. 5 | Rasool & Co. Iqbal Bros. More & Co. Maqbool & Co. | | | Rs 2,400 6,000 1,500 3,000 |

Purchases Account

| | | | | | |
|-----------------|---------------------------|--------------|--|--|--|
| 1991 Jan. 31 | To Sundries as per P/Book | Rs 12,900 | | | |
|-----------------|---------------------------|--------------|--|--|--|

Rasool & Co.

| | | | | | |
|--|--|--|----------------|--------------|-------------|
| | | | 1991 Jan. 5 | By Purchases | Rs 2,400 |
|--|--|--|----------------|--------------|-------------|

Iqbal Bros.

| | | | | | |
|--|--|--|-----------------|--------------|-------------|
| | | | 1991 Jan. 15 | By Purchases | Rs 6,000 |
|--|--|--|-----------------|--------------|-------------|

More & Co.

| | | | | | |
|--|--|--|-----------------|--------------|-------------|
| | | | 1991 Jan. 31 | By Purchases | Rs 1,500 |
|--|--|--|-----------------|--------------|-------------|

Maqbool & Co.

| | | | | | |
|--|--|--|-----------------|--------------|-------------|
| | | | 1991 Jan. 30 | By Purchases | Rs 3,000 |
|--|--|--|-----------------|--------------|-------------|

Purchases returns book is a book in which the goods returned to suppliers are recorded. It is also called **returns outward book** or **purchases returns day book**. Goods may be returned because they are of the wrong kind or not up to sample or because they are damaged etc. The ruling of this book is absolutely the same as of purchases day book. The book and entries are made therein just the same as those made in the purchases day book.

Posting:

The total of the purchases returns or returns outwards book is credited to returns outward account or purchases return account (being the goods sent out). Individual suppliers to whom goods are returned are debited (because they receive the goods).

Debit Note:

When the goods are returned to the suppliers, an intimation is sent to them through what is known as a **debit note**. These debit notes serve as vouchers for these entries. A debit note is a statement sent by a businessman to another person, showing the amount debited to the account of the latter. Debit notes are usually serially numbered and are prepared in the same form as that of the invoice.

Form of the Debit Note:

Debit Note

Messrs Rehman & Sons
Standard Road
Multan

Lahore,
March 19, 1991.

To goods returned:

10 shirts at Rs12

10 pairs trousers at Rs20

Goods returned as per R/R No.....dated.....

120

200

320

For Good Luck & Co.
Partner

E & O. E

Format of Purchases Returns Book:

The following is the format of purchases Returns book:

| Date | Particulars | D/N | L.F. | Amount |
|------|-------------|-----|------|--------|
| | | | | |

Example:

From the following transactions of a trader prepare the purchases returns day book and post it into ledger: -

| 1991 | | | Rs |
|-----------|-----------------|--|-----|
| January 8 | Karim & Sons | | 135 |
| " 20 | Fazal Din & Co. | | 150 |
| " 31 | Saeed Bros. | | 250 |

Solution:

Purchases Day Book

| Date | Particulars | D/N | L.F. | Amount |
|--------|-----------------|-----|------|--------|
| 1991 | | | | Rs |
| Jan. 8 | Karim & Sons | | | 135 |
| " 20 | Fazal Din & Co. | | | 150 |

| | | | | | |
|---|----|-------------|--|--|-----|
| " | 31 | Saeed Bros. | | | 250 |
| | | | | | 535 |

Purchases Returns Account

| | | | | | |
|--|--|--|-----------------|----------------------------|-----------|
| | | | 1991 Jan. 31 | By Purchases as per P.R.B. | Rs 535 |
|--|--|--|-----------------|----------------------------|-----------|

Karim & Sons

| | | | | | |
|----------------|----------------------|-----|--|--|--|
| 1991 Jan. 8 | To Purchases returns | 135 | | | |
|----------------|----------------------|-----|--|--|--|

Fazal Din & Co.

| | | | | | |
|-----------------|----------------------|-----------|--|--|--|
| 1991 Jan. 20 | To Purchases Returns | Rs 150 | | | |
|-----------------|----------------------|-----------|--|--|--|

Saeed Bros.

| | | | | | |
|-----------------|--------------|-----------|--|--|--|
| 1991 Jan. 31 | To Purchases | Rs 250 | | | |
|-----------------|--------------|-----------|--|--|--|

A **sales book** is also known as **sales day book** is a **book of original entry** in which are recorded the details of credit sales made by a businessman. Total of sales book shows the total credit sales of goods during the period concerned. Usually the sales book is totaled every month. The sales day book is written up daily from the copies of invoices sent out.

Posting:

The total of the sales book is credited to sales account. Customers whose names appear in the sales book are debited with the amount appearing against their names. Double entry is thus completed.

Format of Sales Day Book:

The following is the format of sales day book:

| Date | Particulars | Inv. No. | L.F. | Amount |
|------|-------------|----------|------|--------|
| | | | | |

Example:

From the following transactions of a trader prepare the sales day book of M. Amin and post it into ledger: -

| 1991 | | | Rs |
|-----------|-------------------------------|--|-----|
| January 5 | Sold goods to ideal college | | 200 |
| " 10 | Sold goods to Ahmad & Co. | | 100 |
| " 20 | Credit sales to Karim Bakhish | | 400 |
| " 31 | Sold goods to cheap stores | | 100 |

Solution:

Purchases Day Book

| Date | Particulars | Inv.NO. | L.F. | Amount |
|----------------|---------------|---------|------|-----------|
| 1991 Jan. 5 | Idea college | | | Rs 200 |
| " 10 | Ahmad & Co. | | | 100 |
| " 20 | Karim Bakhish | | | 400 |
| " 31 | Cheap stores | | | 100 |
| | | | | 800 |

Sales Account

| | | | | |
|--|--|-----------------|---------------------------|-----------|
| | | 1991 Jan. 31 | By Sundries as per s/Book | Rs 800 |
|--|--|-----------------|---------------------------|-----------|

Ideal College

| | | | | |
|----------------|----------|-----|--|--|
| 1991 Jan. 5 | To Sales | 200 | | |
|----------------|----------|-----|--|--|

Ahmad & Co.

| | | | | | |
|-----------------|----------|-----------|--|--|--|
| 1991 Jan. 10 | To Sales | Rs 100 | | | |
|-----------------|----------|-----------|--|--|--|

Karim Bakhish

| | | | | | |
|-----------------|----------|-----------|--|--|--|
| 1991 Jan. 20 | To Sales | Rs 400 | | | |
|-----------------|----------|-----------|--|--|--|

Cheap Stores

| | | | | | |
|-----------------|----------|-----------|--|--|--|
| 1991 Jan. 31 | To Sales | Rs 100 | | | |
|-----------------|----------|-----------|--|--|--|

Sales returns book is also called **returns inwards book**. It is used for recording goods returned to us by our customers. The ruling of this book is exactly as for sales day book.

Posting:

The total of the returns inwards book or sales returns book is debited to returns inwards account or sales returns account. The customers who have returned the goods are credited with the amount shown against their names.

Credit Note:

Customers who return goods should be sent a **credit note**. It is a statement sent by a business to another person showing the amount credited to the account of the later. Credit notes are serially numbered and are similar in form to the invoices. These are usually printed in red ink. Credit notes issued to customers are vouchers for the entries appearing in the sales returns book.

Form of Credit Note:

Messrs Ideal Traders, Peshawar
Cr. in account with Messrs Good luck & Co.. Lahore

Lahore,
March 19, 1991

By 100 shirt at Rs2
Goods returned as per I/No.....Dated.....
Dollars two hundred only

200

E. & O. E.

For Good luck & Co.
Partner

Format of Sales Returns Book:

The following is the format of sales returns book:

| Date | Particulars | C/N | L.F. | Amount |
|------|-------------|-----|------|--------|
| | | | | |

Example:

From the following transactions of a trader prepare the sales returns book and post it into ledger: -

| | | |
|-----------|-----------------------------------------------------|-----|
| 1991 | | Rs |
| January 8 | Goods returned by Parker & Co. | 40 |
| " 20 | Goods returned by Ideal Traders Rs52 | 52 |
| " 31 | Allowance granted to Riaz & Co., for short delivery | 100 |

Solution:

Sales Returns Book

| Date | Particulars | D/N | L.F. | Amount |
|----------------|---------------|-----|------|----------|
| 1991 Jan. 8 | Parker & Co. | | | Rs 40 |
| " 20 | Ideal Traders | | | 52 |
| " 31 | Riaz & Co. | | | 100 |
| | | | | 192 |

Sales returns Account

| | | | | | |
|-----------------|--------------------------|-----------|--|--|--|
| 1991 Jan. 31 | By Sundries as per S.R.B | Rs 192 | | | |
|-----------------|--------------------------|-----------|--|--|--|

Parker & Co.

| | | | | | |
|--|--|--|----------------|------------------|----------|
| | | | 1991 Jan. 8 | By Sales returns | Rs 40 |
|--|--|--|----------------|------------------|----------|

Ideal Traders

| | | | | | |
|--|--|--|-----------------|------------------|----------|
| | | | 1991 Jan. 20 | By Sales returns | Rs 52 |
|--|--|--|-----------------|------------------|----------|

Riaz & Co.

| | | | | | |
|--|--|--|-----------------|------------------|-----------|
| | | | 1991 Jan. 31 | By Sales returns | Rs 100 |
|--|--|--|-----------------|------------------|-----------|

Bills receivable book is used to record the bills received from debtors. When a bill is received, details of it are recorded in the bills receivable book.

Posting:

In the ledger the account of the person from whom each bill is received is credited with the amount of that bill and the periodical total of the book is posted to the debit of bills receivable account.

The bills receivable book is ruled according to the requirements of a particular account.

Format of Bills Receivable Book:

The following is the format of bills receivable book:

(1) Bills Receivable Book

| No. of Bills | Date | From whom received | Drawer | Acceptor | Where payable | Term | Due date | L.F. | Amount | Remarks |
|--------------|------|--------------------|--------|----------|---------------|------|----------|------|--------|---------|
| | | | | | | | | | | |

(2) Bills Receivable Book

| Date | From whom received | Term | Due date | L.F. | Amount |
|------|--------------------|------|----------|------|--------|
| | | | | | |

Example:

From the following transactions of a trader prepare the bills receivable book and post it into ledger: -

1991

- January 5 Drew a bill on Abdullah & Co. at 2 m/d for Rs700.
- " 10 Acceptance received from Rahim Bakhish at 3 m/d for Rs 1,000.
- " 20 A. Riaz gives his acceptance at 3 m/d for Rs 800.
- " 30 Bill at 2 m/d for Rs100 is drawn on Bashir.

Solution:

Bills Receivable Book

| Date | Particulars | Term | Due Date | L.F. | Amount |
|--------|----------------|-------|----------|------|--------|
| 1991 | | | | | Rs |
| Jan. 5 | Abdullah & Co. | 2 m/d | March 8 | | 700 |
| " 10 | Rahim Bakhish | 3 m/d | April 13 | | 1,000 |
| " 20 | A. Riaz | 3 m/d | " 21 | | 800 |
| " 30 | Bashir | 2m/d | March 3 | | 100 |
| | | | | | 2,600 |

Bills Receivable Account

| | | | | | |
|---------|-----------------------------|-------|--|--|--|
| 1991 | | Rs | | | |
| Jan. 30 | By Sundries as per B/R Book | 2,600 | | | |

Abdullah & Co.

| | | | | | |
|--|--|--|--------|--------------------|-----|
| | | | 1991 | | Rs |
| | | | Jan. 5 | By Bill receivable | 700 |

Rahim Traders

| | | | | | |
|--|--|--|-----------------|--------------------|-------------|
| | | | 1991 Jan. 10 | By Bill receivable | Rs 1,000 |
|--|--|--|-----------------|--------------------|-------------|

A. Riaz

| | | | | | |
|--|--|--|-----------------|--------------------|-----------|
| | | | 1991 Jan. 30 | By Bill receivable | Rs 800 |
|--|--|--|-----------------|--------------------|-----------|

Bashir

| | | | | | |
|--|--|--|-----------------|--------------------|-----------|
| | | | 1991 Jan. 30 | By Bill receivable | Rs 100 |
|--|--|--|-----------------|--------------------|-----------|

Bills payable book is used to record bill accepted by us. When a bill drawn by our creditor is accepted particulars of the same are recorded in this book.

Posting:

In the ledger, the account of each person whose bill has been accepted is debited with the amount of the bill. The monthly total of the bills accepted is credited to the bills payable account ledger.

Format of Bills Receivable Book:

The following is the ruling and format of bills payable book:

(1) Bills Payable Book

| Date | To whom given | Drawer | Payee | Where payable | Term | Due date | L.F. | Amount | Remarks |
|------|---------------|--------|-------|---------------|------|----------|------|--------|---------|
| | | | | | | | | | |

(2) Bills Payable Book

| Date | To whom given | Term | Due date | L.F. | Amount |
|------|---------------|------|----------|------|--------|
|------|---------------|------|----------|------|--------|

| | | | | | |
|--|--|--|--|--|--|
| | | | | | |
|--|--|--|--|--|--|

Example:

From the following transactions of a trader prepare the bills payable book and post it into ledger: -

1991

- January 5 Accepted a bill at 3 m/d for Rs200 drawn by Rahmat & Co.
 " 20 gave acceptance at 2 m/d for Rs500 to Kamal.
 " 30 Acceptance at 1 m/d for Rs 500 given to Feroz & Co.

Solution:

Bills Payable Book

| Date | Particulars | Term | Due Date | L.F. | Amount |
|----------------|--------------|-------|----------|------|-----------|
| 1991 Jan. 5 | Rahmat & Co. | 3 m/d | April 8 | | Rs 200 |
| " 20 | Kamal | 2 m/d | March 23 | | 500 |
| " 30 | Feroz & Co. | 1 m/d | " 30 | | 500 |
| | | | | | 1,200 |

Bills Payable Account

| | | | | |
|--|--|-----------------|-----------------------------|-------------|
| | | 1991 Jan. 31 | By Sundries as per B/p Book | Rs 1,200 |
|--|--|-----------------|-----------------------------|-------------|

Rahmat & Co.

| | | | | | |
|----------------|-----------------|-----------|--|--|--|
| 1991 Jan. 5 | By Bill Payable | Rs 200 | | | |
|----------------|-----------------|-----------|--|--|--|

Kamal

| | | | | | |
|-----------------|-----------------|-----------|--|--|--|
| 1991 Jan. 20 | By Bill Payable | Rs 500 | | | |
|-----------------|-----------------|-----------|--|--|--|

Feroz & Co.

| | | | | | |
|-----------------|-----------------|-----------|--|--|--|
| 1991 Jan. 31 | By Bill Payable | Rs 500 | | | |
|-----------------|-----------------|-----------|--|--|--|

Journal proper is book of original entry (simple journal) in which miscellaneous credit transactions which do not fit in any other books are recorded. It is also called miscellaneous journal. The form and procedure for maintaining this journal is the same that of simple journal.

The use of *journal proper* is confined to record the following transactions: -

1. Opening entries
2. Closing entries
3. Transfer entries
4. Adjustment entries
5. Rectification entries
6. Entries for which there is no special journal
7. Entries for rare transactions

Opening Entries:

When a businessman wants to open the book for a new year, it is necessary to Journalise the various assets and liabilities before the new accounts are opened in the ledger. The journal entries so passed are called "opening entries". Suppose a businessman opens a new set of books on January 1, 1991 with cash in hand Rs100, debtors Rs200, stock in trade Rs320, machinery Rs700, furniture Rs150, bank loan Rs300, capital Rs1,070 the respective opening entry in the journal will be:

| | | | | | |
|---------------------|----|---------|-----------|--|-------|
| Cash | | | | | 100 |
| Sundry | | | debtors | | 200 |
| Stock | in | | trade | | 320 |
| Machinery | | | | | 700 |
| Furniture & fitting | | | | | 200 |
| | To | Sundry | creditors | | 150 |
| | To | Bank | loan | | 300 |
| | To | Capital | | | 1,070 |

(Being the incorporation of assets and liabilities at this date)

Closing Entries:

When the books are balanced at the close of the accounting period with a view to paper final accounts it is necessary that balance of all the income and expenses accounts must be transferred to trading and profit and loss account. The process of transferring balances to the trading and profit and loss account at the end of year is called closing the books and entries passed at that time are called closing entries. For example on 31st December, 1991 the balance in expenses accounts are: Salary Rs500; rent Rs200; Stationary Rs50; legal charges Rs100; and income accounts are: commission received Rs50. These balance will be recorded in profit and loss account through the following closing entries:

| | | | | | |
|--------|-----|----------|------------|-----|-----|
| Profit | and | loss | account | 850 | |
| | | | To Salary | | 500 |
| | | To | Rent | | 200 |
| | | To | Stationary | | 50 |
| | | To Legal | charges | | 100 |

(Being the closing entry)

| | | | | | |
|------------|----------|---------|------|---------|----|
| Commission | received | account | 50 | | |
| To | Profit | and | loss | account | 50 |

(Being the closing entry)

Transfer Entries:

When accounts are transferred from one account to another for combination of allied items, it is necessary to pass transfer entry. For example, Drawings Rs500 is transferred from the drawings account to the capital account to find out the net capital. The transfer entry will be passed as follows:

| | | | | |
|---------|----------|---------|-----|-----|
| Capital | | Account | 500 | |
| To | Drawings | account | | 500 |

(Being the transfer entry)

Adjusting Entries:

Modification of the accounts at the end of an accounting period is called adjustments. If there be any event affecting the related period of accounts but left out of the books, the same should be incorporated in the books before the preparation of the final accounts. This is done by means of adjusting entries through the journal proper. For example at the end of the year it is found that rent Rs50 is outstanding. It is not recorded in the books. It will be taken into account by means of adjusting entry which is as follows:

| | | | | |
|------|-------------|---------|---------|----|
| Rent | | account | 50 | |
| To | Outstanding | rent | account | 50 |

(Being outstanding rent recorded)

Rectification Entries:

When an error is detected in the books, the same is rectified through an entry in the journal proper; thus is called rectification entry. For example, it was detected that an expenditure of Rs 100 on repair to building was charged to building account. It is corrected through the following entry in the journal proper:

| | | | | |
|----------|---------------------|---------|-----|-----|
| Building | repair | account | 100 | |
| | To Building account | | | 100 |

Entries of which there is no special Journal:

When a trader cannot record the entries in the above mentioned sub-journals, the same are entered in the journal proper. The common transactions which cannot be recorded in any of the book of original entry are:

- Distribution of goods as free sample.
- Distribution of goods as charity.
- Goods destroyed by fire.
- Goods stolen away by employees.
- Exchange of one asset for another asset etc.

Entries for Rare Transactions:

In a business it may happen sometimes that transactions are usually rare. Journal proper is used for such rare transactions.

Preparing Trial Balance / Accuracy of Ledger:

Learning Objectives:

1. Define and explain trial balance.
2. What are the advantages of preparing a trial balance?
3. What are the different methods of preparing trial balance?

Definition and Explanation:

Having posted all the transactions into the ledger, it is necessary to check the correctness of the work done before proceeding further. In order to test the arithmetical accuracy of our ledger we should prepare a statement called **trial balance**.

A trial balance is a statement prepared by taking out the debit and credit balances of all accounts appearing in the ledger.

Objectives and Advantages of Preparing a Trial Balance:

The following are the main objectives of preparing a trial balance.

1. Trial balance helps in knowing the arithmetical accuracy of the accounting entries. Trial balance represents a summary of all ledger balances and, therefore, if the two sides of the trial balance tally, it is an indication of this fact that the books of accounts are arithmetically accurate.
2. Trial balance forms the basis for preparing financial statements such as income statement / Trading and profit and loss account and balance sheet. In case, the trial balance is not prepared, it will be almost impossible to prepare the financial statements.
3. The entire ledger is summarised in the form of a trial balance. Thus the position of a particular account can be judged simply by looking at the trial balance.

Proof of Accuracy:

If the debit and credit totals of the trial balance are equal and also correspond with the total of journal, we may be satisfied that the posting have been properly made and are arithmetically accurate.

How to Prepare a Trial Balance - An Example:

The trial balance is usually prepared on a loose sheet of paper. The ruling of trial balance is similar to that of a journal. We may prepare a trial balance in one of the following forms:

1. Total Trial Balance Method
2. Balance Trial Balance Method

Total Trial Balance Method:

According to total trial balance method two sides of each ledger account i.e., debit and credit side are added up and debit and credit totals so obtained are placed in the debit and credit columns of the trial balance respectively. Thus we may draw the following trial balance by taking out the debit side total and credit side total of each account in the ledger

Trial Balance

| Ledger Account | J.F | Total Debits | Total Credits |
|----------------|-----|--------------|---------------|
|----------------|-----|--------------|---------------|

| | Rs | Rs |
|--------------------------|-----------|-----------|
| Cash Account | 12,453 | 8,436 |
| Sundry Debtors Account | 43,675 | 34,453 |
| Sundry Creditors Account | 23,654 | 31,298 |
| Discount Account | 430 | 550 |
| Purchases Account | 26,670 | -- |
| Sales Account | -- | 32,145 |
| Machinery Account | 10,000 | -- |
| Building Account | 20,000 | -- |
| Capital Account | -- | 35,000 |
| Rent Account | 3,400 | -- |
| Wages Account | 600 | -- |
| Salaries Account | 1,000 | -- |
| | 1,141,882 | 1,141,882 |

One clear defect of this method is that mistakes may be committed more often while preparing the trial balance, because large number of figures would be required to be enlisted. Thus, the process becomes unwieldy and cumbersome.

Balance Trial Balance Method:

The task of preparing a trial balance under balance - trial balance method is much simplified. There is well known axiom that if equals are subtracted from equals the remainders are equal. On this assumption, in place of writing against each account the debit as well as the credit total the balance alone is written. The difference between the two sides of an account is called the balance. If the debit side of an account is greater than the credit side, the balance falls on the debit side and is known as "debit balance." If the credit side of an account is greater than the debit, the balance is on the credit side and is called "credit balance."

Rules of Balancing Accounts: Rules of balancing each account is as follows:

1. Add up both sides of the account
2. Find out the difference in a separate slip.
3. Put the difference on the lighter side.
4. Add up both sides again.
5. Rule off.

The trial balance prepared above, if prepared with the balance of accounts will appear as under:

Trial Balance

| Ledger Account | J.F | Dr. Balance | Cr. balance |
|--------------------------|-----|-------------|-------------|
| | | Rs | Rs |
| Cash Account | | 4,017 | -- |
| Sundry Debtors Account | | 9,222 | -- |
| Sundry Creditors Account | | -- | 7,644 |
| Discount Account | | -- | 120 |
| Purchases Account | | 26,670 | -- |
| Sales Account | | -- | 32,145 |
| Machinery Account | | 10,000 | -- |
| Building Account | | 20,000 | -- |
| Capital Account | | -- | 35,000 |
| Rent Account | | 3,400 | -- |
| Wages Account | | 600 | -- |
| Salaries Account | | 1,000 | -- |
| | | 74,909 | 74,909 |

The second method has the added advantages and is the one that is generally used. There are comparatively less chances of committing errors. As the magnitude of figures is smaller the process is not cumbersome. It does not appear to be unwieldy. Moreover, in a trial balance, the exact position of any account on the date of trial balance can be determined at a glance.

Bank Reconciliation Statement:

Learning Objectives:

1. Define and explain bank reconciliation statement.
2. What are the reasons of disagreement of the balances of cash book and bank statement.
3. Prepare the format of the statement.
4. Prepare bank reconciliation statement.

1. Definition and explanation
2. Causes of disagreement between cash book balance and bank statement balance
3. How to prepare a bank reconciliation statement
4. Example1
5. Example 2

Definition and Explanation:

From time to time the balance shown by the bank and cash column of the cash book required to be checked. The balance shown by the cash column of the cash book must agree with amount of cash in hand on that date. Thus reconciliation of the cash column is simple matter. If it does not agree it means that either some cash transactions have been omitted from the cash book or an amount of cash has been stolen or lost. The reason for the difference is ascertained and cash book can be corrected. So far as bank balance is concerned, its reconciliation is not so simple. The balance shown by the bank column of the cash book should always agree with the balance shown by the bank statement, because the bank statement is a copy of the customer's account in the banks ledger. But the bank balance as shown by the cash book and bank balance as shown by the bank statement seldom agree. Periodically, therefore, a statement is prepared called **bank reconciliation statement** to find out the reasons for disagreement between the bank statement balance and the cash book balance of the bank, and to test whether the apparently conflicting balance do really agree.

Causes of Disagreement Between Bank statement and Cash book:

Usually the reasons for the disagreement are:

1. That our banker might have allowed interest which has not yet been entered in our cash book.
2. That our banker might have debited our account for any such item as interest on overdraft, commission for collecting cheque, incidental charges etc., which we have not entered in the cash book.
3. That some of the cheque which we drew and for which we credited our bank account prior to the date of closing, were not presented at the bank and therefore, not debited in the bank statement.
4. That some cheques or drafts which we have paid into bank for collection and for which we debited our bank account, were not realised within the due date of closing and therefore, not credited by the bank.
5. The banker might have credited our account with amount of a bill of exchange or any other direct payment into bank and the same may not have been entered in the cash book.
6. That cheques dishonoured might have been debited in the bank statement but have not been given effect to in our books.

How to Prepare a Bank Reconciliation Statement:

To prepare the bank reconciliation statement, the following rules may be useful for the students:

1. Check the cash book receipts and payments against the bank statement.
2. Items not ticked on either side of the cash book will represent those which have not yet passed through the bank statement.
3. Make a list of these items.

4. Items not ticked on either side of the bank statement will represent those which have not yet been passed through the cash book.
5. Make a list of these items.
6. Adjust the cash book by recording therein those items which do not appear in it but which are found in the bank statement, thus computing the correct balance of the cash book.
7. Prepare the bank reconciliation statement reconciling the bank statement balance with the correct cash book balance in either of the following two ways:
 - (i) First method (Starting with the cash book balance)
 - (ii) Second method (Starting with the bank statement balance)

First Method (Starting With the Cash Book Balance):

- (a) If the cash balance is a debit balance, deduct from it all cheques, drafts etc., paid into the bank but not collected and credited by the bank and added to it all cheques drawn on the bank but not yet presented for payment. The new balance will agree with bank statement.
- (b) If the bank balance of the cash book is a credit balance (overdraft), add to it all cheques, drafts, etc., paid into the bank but not collected by the bank and deduct from it all cheques drawn on the bank but not yet presented for payment. The new balance will then agree with the balance of the bank statement.

Second Method (Starting With the Bank Statement Balance):

- (a) If the bank statement balance is a debit balance (an overdraft), deduct from it all cheques, drafts, etc., paid into bank but not collected and credited by the bank and add to it all cheques drawn on the bank but not yet presented for payment. The new balance will then be agree with the balance of the cash book.
- (b) If the bank statement balance is a credit balance (in favor of the depositor), add to it all cheques, drafts, etc., paid into the bank but not collected and credited by the bank and deduct from it all cheques drawn on the bank but not yet presented for payment. The new balance will agree with the balance of the cash book.

Alternatively:

| Information | Cash book shows debit balance i.e., bank statement shows credit balance | | Cash book shows credit balance i.e., bank statement shows debit balance | |
|----------------------------------------------|-------------------------------------------------------------------------|----------|-------------------------------------------------------------------------|----------|
| | CB to BS | BS to CB | CB to BS | BS to CB |
| Cheques issued but not presented in the bank | Add | Less | Less | Add |

| | | | | |
|-------------------------------------------------------------------|------|------|------|------|
| Cheques paid into bank but not collected and credited by the bank | Less | Add | Add | Less |
| Credit, if any in the bank statement | Add | Less | Less | Add |
| Debit, if any in the bank statement | less | Add | Add | Less |

Example 1:

On December 31 1991 the balance of the cash at bank as shown by the cash book of a trader was Rs1,401 and the balance as shown by the bank statement was 2,253.

On checking the bank statement with the cash book it was found that a cheque for Rs116 paid in on the 31st December was not credited until the 1st January, 1992 and the following cheques drawn prior to 31 December were not presented at the bank for payment until the 5th January 1992. Rashid & Sons Rs29, Bashir & Co. Rs801, MA Jalil Rs6, Khalid Bros., Rs132.

Prepare a statement recording the two balances:

Solution:

Bank Reconciliation Statement on 31st December 1991

First Method:

| | |
|----------------------------------------|-------|
| Balance as per cash book - Dr. | 1,401 |
| Less cheques paid in but not collected | 116 |
| | 1,285 |

Add cheques drawn but not presented:

| | | |
|---------------|-----|-----|
| Rashid & Sons | 29 | |
| Bashir & Co. | 801 | |
| MA Jalil | 6 | |
| Khalid Bros. | 132 | 968 |

| | |
|---------------------------------------|-------|
| Balance as per bank statement - Cr. | 2,253 |
| Second Method: | |
| Balance as per bank statement - Cr. | 2,253 |
| Less cheques drawn but not presented | 968 |
| | 1,285 |
| Add cheques paid in but not collected | 116 |
| | 1,401 |
| Balance as per cash book - Dr. | 1,401 |

Example 2:

On 31st March, 1991 the bank statement showed the credit balance of Rs10,500. Cheque amounting to Rs2,750 were deposited into the bank but only cheque of Rs750 had not been cleared up to 31st March. Cheques amounting to Rs3,500 were issued, but cheque for Rs1,200 had not been presented for payment in the bank up to 31st March. Bank had given the debit of Rs35 for sundry charges and also bank had received directly from customers Rs800 and dividend of Rs130 up to 31st March. Find out the balance as per cash book.

Solution:

Bank Reconciliation Statement as on 31st March, 1991

| | |
|----------------------------------------|--------|
| Balance as per bank statement - Cr. | 10,500 |
| Add cheques deposited but not credited | 750 |
| | 11,250 |
| Less cheques issued but not presented | 1,200 |
| | 10,050 |
| Add bank charges made by the bank | 35 |

| | |
|--------------------------------------------|--------|
| | 10,085 |
| Less omission in cash book (Rs800 + Rs130) | 930 |
| | 9,155 |
| Balance as per cash book | 9,155 |

Note:

1. Charges made by the bank Rs35 have not been recorded in the cash book, therefore, the balance in cash book is more. Add to bank statement balance also.
2. Dividend and amount from customers received by the bank have not been recorded in the cash book. Therefore, in the cash book there is no entry of Rs930 (800 + 130). Deduct from the bank statement balance to adjust it according to cash book balance.

Deferred Revenue Expenditure: - In some cases, the benefit of a revenue expenditure may be available for period of two or three or even more years. Such expenditure is then known as "Deferred Revenue Expenditure" and is written off over a period of a few years and not wholly in the year in which it is incurred. For example, a new firm may advertise very heavily in the beginning to capture a position in the market. The benefit of this advertising campaign will last quite a few years. It will be better to write off the expenditure in three or four and not in the first year. When loss of a specially heavy and exceptional nature is sustained, it can also be treated as deferred revenue expenditure. But, it should be noted, loss resulting from transactions entered into, such as speculative purchase or sale of a large quantity of a commodity, cannot be treated as deferred revenue expenditure. Only loss arising from circumstances beyond one's control can be so treated.

The concept of deferred revenue expenditure is not in the Income Tax Act. So, there is no clear provision under the I.T. act about its allowance from business income. The concept of deferred revenue expenditure is essentially an accounting concept and alien to the Act.

The nature of expenditure such as **advertisement or exhibition, sales promotion or fixed deposit etc.** is such that, although the benefit arising there from may extend over several accounting periods, the same cannot be clearly and definitively assigned over time since the same is intangible in nature.

The concept of deferred revenue expenditure is essentially an accounting concept and alien to the Act. Deferred revenue expenditure denotes expenditure for which a payment has been made or a liability incurred, which is essentially revenue in nature but which for various reasons like quantum and period of expected future benefit etc, is written-off over a period of time e.g. expenditure on advertisement, sales promotion etc.

However, law is settled that accounting practice cannot determine allowability of an expense under Income Tax Act.

Basic principal of Deferred Revenue Expenditure

The basic principle which determines whether differed revenue expenditure can be allowed in full can be summed up as follows:-

1. Where expenditure treated as "deferred revenue expenditure" results in the creation of any capital asset (tangible or intangible), a case can be made out to treat the same as a capital expenditure with corresponding allowability of depreciation in accordance with law;
2. In cases where the nature of the revenue expenditure is such that the same can be clearly and unambiguously identified over specified future time periods (e.g. discount on issue of debentures) akin to prepaid expenses the same would be allowable over the period to which these relate proportionately, applying the matching principle.
3. In other cases where the same does not result in the creation of any capital asset or where the same is not allocable over defined future time periods there can be no case for amortizing the same under the Act over the expected period over which the benefit is likely to arise there from since in such cases the expenditure is essentially revenue in nature but is amortized in the books only on account of some other considerations.

Therefore, one can say that in every case where the expenditure on sales promotions, advertisements etc are made and no capital asset is generated out of it , in that case even if the assessee has amortized the expense over a number of years, expense can be claimed as fully allowable expense in the year in which it is actually incurred.

Differed revenue considered as fictitious asset

Fictitious assets-fictitious assets are deferred revenue expenditure whose benefit is derived over long period of time .Even accumulated losses are also fictitious assets as they are written off over a period of time. All fictitious assets are intangible but all intangible assets are not fictitious (ex goodwill, patents, trademarks, copyrights are intangible but not fictitious. Following are the examples of fictitious assets are-preliminary expenses, discount on issue on debenture and shares, underwriting commission, miscellaneous expenditure, profit and loss (dr).

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