

## CHAPTER - 2

### ACCOUNTING PROCESS

#### UNIT - 1

#### BASIC ACCOUNTING PROCEDURES

#### JOURNAL ENTRIES

#### DOUBLE ENTRY SYSTEM:

⇒ More than 500 years old.

⇒ Luca Pacioli, an Italian friar & mathematician published the first book *Summa de Arithmetica, Geometria, Proportioni, et Proportionalita*.

⇒ Scientific system of accounting.

⇒ Every transactions has two-fold aspects - debit and credit.

⇒ Systematic and has great use for recording the financial affairs for all institutions requiring use of money.

#### ADVANTAGES:

- \* Accuracy of accounting through trial balance.
- \* Profit or loss suffered can be ascertained.
- \* Financial position through balance sheet.

- \* Affords significant information.
- \* Helps in comparison.
- \* Used extensively in all countries.

#### ACCOUNT :

- \* Summary of transactions relating to a particular item grouped at a particular place.
- \* Account is in 'T' form.
- \* Accounts are classified into:

##### i) PERSONAL ACCOUNT :

- a) Natural Personal Accounts.
- b) Artificial Personal Accounts.
- c) Representative Personal Accounts.

##### ii) IMPERSONAL ACCOUNT :

- a) Real account.
- b) Nominal account.

##### i) PERSONAL ACCOUNT :

###### a) NATURAL PERSONAL ACCOUNT :

- \* Relates to transactions of human beings.

Eg: Ram a/c, Sita a/c ....

### b, ARTIFICIAL (LEGAL) PERSONAL ACCOUNT:

- \* Organisations formed by persons.

- \* Recognised as persons in the eye of law.

Eg: Bank, club, ...

### c, REPRESENTATIVE PERSONAL ACCOUNT:

- \* Represented as personal account and behind that there must be a person.

- \* Should be asset or liability.

Eg: Outstanding or prepaid account, capital a/c, drawing a/c, receivables or payables a/c, bank loan, PBDD, fixed deposit, ...

### ii) IMPERSONAL ACCOUNT:

#### a, REAL ACCOUNTS:

- \* Relate to assets of the firm.

Eg: Tangible - land, cash, stock ...

Intangible - trademark, goodwill ...

#### b, NOMINAL ACCOUNTS:

- \* Relate to expenses, revenues, losses or gains.

- \* Temporary account.

\* The net results of all the nominal

accounts is reflected as P/L which is transferred to capital a/c

Eg: salary a/c, interest paid a/c, insurance a/c, telephone expenses a/c ...

#### DEBIT AND CREDIT:

\* The terms debit and credit does not mean favourable or unfavourable thing.

\* They merely describe the two sides of account

#### TRANSACTIONS:

\* Recorded in the books of accounts.

\* Type of event which is external in nature & determined in terms of money.

\* They are analyzed, recorded, classified & summarized.

\* It is a two way process in which value is transferred from one party to another.

\* Supported by source documents like voucher, debit note, credit note, passbook, purchasing invoices, bills, pay-slips, cash-memos ....

## JOURNAL:

- \* Transactions are first entered in journal
- \* Also called as subsidiary book.
- \* It is the book of original entry in which transactions are entered on a daily basis in a chronological order.

## JOURNALISING:

- \* Recording of transaction in journal is called as journalising.

## TYPES OF JOURNAL:

- \* General journal
- \* Specialised journal.

## ADVANTAGES OF JOURNAL:

- \* Helps to get complete information about the business transactions
- \* Narration helps in understanding the entry and to know the correctness of the entry.
- \* Basis for posting the entries in the ledger.
- \* Helps to reduce the chances of error.

## METHODS OF RECORDING THE TRANSACTIONS:

\* Accounting equation approach.

\* Traditional approach

i) Golden rules of accounting.

ii) Modern rules of accounting.

## ACCOUNTING EQUATION APPROACH:

\* The relationship of assets with that of liabilities and owner's equity in the equation form is called accounting equation.

\* Accounting equation holds good at all points of time and for any number of transactions and event except when there are errors in accounting process.

$$\text{EQUITY} + \text{LIABILITIES} = \text{ASSETS}$$

$$\begin{aligned} \text{EQUITY} + \text{LONG TERM LIABILITIES} + \text{SHORT TERM LIABILITIES} \\ = \text{FIXED ASSETS} + \text{CURRENT ASSETS} \end{aligned} \quad \text{- ES}$$

ASSETS → What business owns.

CAPITAL & LIABILITIES → What business owes.

CAPITAL → Contribution by owner.

LOANS OR LIABILITIES → Borrowings.

SHORT TERM LOANS → Repayable within 1 year.

LONG TERM LOANS → Repayable after 4 or 5 years.

FIXED ASSETS → Lasts more than 1 year.

CURRENT ASSETS → Will not remain fixed for long.

EQUITY → Owner's claim or fund.

OWNER'S CLAIM → Capital invested plus profit minus loss.

$$\text{ASSET} = \text{LIABILITIES} + \text{CAPITAL / EQUITY}$$

$$\text{ASSET} = \text{LIABILITIES} + \text{CONTRIBUTED CAPITAL} + \text{BEGINNING RETAINED EARNINGS} + \text{REVENUE} - \text{EXPENSE} - \text{DIVIDENDS}$$

CONTRIBUTED CAPITAL → Original capital introduced by the owner.

BEGINNING RETAINED EARNINGS<sup>N</sup> → Previous earnings not distributed to the shareholders.

## TRADITIONAL APPROACH:

### i) GOLDEN RULES OF ACCOUNTING:

TYPES OF ACCOUNT	ACCOUNT TO BE DEBITED	ACCOUNT TO BE CREDITED
PERSONAL ACCOUNT	Receiver	Giver.
REAL ACCOUNT	What comes in	What goes out.
NOMINAL ACCOUNT	Expenses & losses	Incomes & gains

### ii) MODERN RULES OF ACCOUNTING:

TYPES OF ACCOUNT	ACCOUNT TO BE DEBITED WHEN THERE IS:	ACCOUNT TO BE CREDITED WHEN THERE IS
ASSETS	Increase	Decrease
LIABILITIES	Decrease	Increase
CAPITAL	Decrease	Increase
REVENUE	Decrease	Increase
EXPENDITURE	Increase	Decrease
WITHDRAW	Increase	Decrease



## FORMAT OF JOURNAL :

DATE	PARTICULARS	L.F	DR. AMOUNT	CR. AMOUNT

### NOTE :

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

\* If journal entries are recorded in several pages, then both the amount column of each page should be totalled & the balance should be written at the end of that page with the words 'carried forward' and also that the same total should be written the beginning of the next page with the words 'brought forward'.

- \* When journal entry for two or more transactions are combined, it is called composite journal entry.
- \* Purchase/sales a/c is a real account as they represents 'flow of goods'.
- \* Adjusted purchase/sales a/c is a nominal account as they are closed by transferring to 'Trading & profit or loss a/c'.
- \* Discount, bad debts, bad debts recovered, depreciation, drawings are temporary capital.
- \* In a transaction, if only the name of the debtor or creditor is given without mentioning whether it is cash/credit purchase/sales, then, the transaction should be treated as credit purchase/sales.
- \* Trade discount should not be entered in the books of accounts.
- \* In journal, amounts should be entered in cost price.
- \* Adjusted purchase is an expense & purchase is an asset.
- \* Free samples - Advertisement expenses account.

## UNIT - 2

### LEDGERS

#### LEDGER :

\* After recording the transactions in the journal, recorded entries are classified and grouped into by preparation of accounts.

\* The book which contains all set of accounts is known as ledger.

\* It is known as principal books of account.

#### FORMAT OF LEDGER ACCOUNT :

Dr.		ACCOUNT				Cr.	
DATE	PARTICULARS	J-F	AMOUNT	DATE	PARTICULARS	J-F	AMOUNT
			(₹)				(₹)

#### POSTING :

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

\* The concerned account debited in the journal should also be debited in the ledger but reference should be of the respective credit account.

#### BALANCING AN ACCOUNT:

\* If the credit side is bigger than the debit side, it is a credit balance.

\* If the debit side is bigger than the credit side, it is a debit balance.

\* Only real & personal accounts are balanced.

\* Nominal accounts are not balanced. The balance in the end are transferred to the profit & loss account.

#### NOTE:

\* Ledger records transactions in analytical order.

## UNIT-3

### TRIAL BALANCE

#### TRIAL BALANCE:

- \* Contains various ledger balances on a particular date.
- \* Basis for preparing final accounts
- \* Checks arithmetical accuracy of the books.
- \* Third phase of the accounting process.
- \* If the trial balance tallies, the accounting work is free from clerical errors.
- \* Though, errors of principle and compensating errors may still remain.
- \* Trial balance is statement and not an account.
- \* Though a trial balance can be prepared any time, it is preferable to prepare it at the end of the year.

#### OBJECTIVES OF PREPARING THE TRIAL BALANCE:

- \* Helps to establish arithmetical accuracy of the books.

- \* Helps in preparation of financial statements.
- \* Serves as a summary of what is contained in the ledger.

#### LIMITATIONS OF TRIAL BALANCE:

- \* Transaction has not been entered at all in the journal.
- \* An entry has not at all been mentioned in the journal.
- \* A wrong amount has been written in both columns of the journal.
- \* A wrong account has been mentioned in the ledger.
- \* Entry is posted twice in the ledger.

Even though trial balance is prepared to check the arithmetical accuracy of the books, these errors may still remain.

## FORMAT OF TRIAL BALANCE :

### TRIAL BALANCE AS AT .....

S.NO	LEDGER ACCOUNTS	L.F	DR. AMOUNT	CR. AMOUNT
			(Total or balance)	(Total or balance)
			₹	₹

## METHODS OF PREPARATION OF TRIAL BALANCE :

### 1, TOTAL METHOD :

\* Every ledger account is totalled and that total amount of both debit & credit side is transferred to trial balance.

\* This method is not commonly used as it cannot help in the preparation of the financial statements.

### 2, BALANCE METHOD :

\* Every ledger account is balanced and those balances are only carried forward to the <sup>trial</sup> balance  
^

\* This method is commonly used as it helps in preparing the financial statements.

### 3. TOTAL AND BALANCE METHOD:

\* Under this method the above two methods are combined and statement of trial balance contains seven columns instead of five columns.

### ADJUSTED TRIAL BALANCE:

\* If the trial balance does not agree after transferring all the ledger balances and errors are not located timely, then the difference of debit & credit side is <sup>transferred</sup> to an account known as suspense account.

\* This is a temporary account opened to prepare financial statements timely.



## UNIT-4

### SUBSIDIARY BOOKS

#### SUBSIDIARY BOOKS:

\* A separate register to record cash receipts and payments, sale of goods and their purchases is called subsidiary book.

\* It is 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.

\* There is no departure from the rules of the double entry system.

#### ADVANTAGES OF SUBSIDIARY BOOKS:

\* Division of work.

\* Specialization & efficiency.

\* Saving of the time.

\* Availability of information.

\* Facility in checking.

### DIFFERENCE BETWEEN SUBSIDIARY BOOKS & PRINCIPAL BOOKS :

\* The books in which transactions are first recorded to enable processing are called subsidiary books.

\* The books which furnish information for preparation of the trial balance and financial statements are called principal books.

### PURCHASE BOOK :

\* Only credit purchase of goods are recorded.

\* The particulars column is meant to record the name of the supplier and name of the articles purchased and the respective quantities.

\* The details column is meant to enter the amount in respect of each article.

\* The amount column is meant to enter amount of single purchase including amount for packing, or other charges is added and the amount for trade discount is deducted.

### FORMAT OF PURCHASE BOOK:

#### PURCHASE DAY BOOK

DATE	PARTICULARS	INVOICE NO.	L.F.	DETAILS ₹	AMOUNT ₹

### SALES BOOK:

- \* Only credit sale of goods are recorded.
- \* The particulars column will record the name of the customers concerned together with particulars and quantities of the goods sold.
- \* The details column is meant to enter the amount in respect of each sale.
- \* The amount column is meant to enter total amount for one sale; charges for packing, etc. are added and the trade discount, if any is deducted.

### FORMAT OF SALES BOOK:

- \* Same format as like the purchase day book.

### PURCHASE RETURN BOOK :

\* Shows the total <sup>Purchase</sup> returns made.

\* When goods are returned to suppliers, the firm returning goods will issue a debit note to the supplier, indicating the amount for which the supplier is liable on account of the return.

### FORMAT OF PURCHASE RETURN BOOK:

#### PURCHASE RETURN BOOK

DATE	PARTICULARS	DEBIT NOTE NO.	L.F	DETAILS (₹)	AMOUNT (₹)

### SALES RETURN BOOK :

\* Shows total sales return made.

\* When goods are returned by customers, credit note is issued to the customers concerned, indicating the amount to be credited to the customer's account.

## FORMAT OF SALES RETURN BOOK:

### SALES RETURN BOOK

DATE	PARTICULARS	CREDIT NOTE NO	L.F	DETAILS (₹)	AMOUNT (₹)

## BILLS RECEIVABLE BOOK:

\* 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.

## BILLS PAYABLE BOOK:

\* If promissory notes or hundies are frequently issued, the Bills Payable Book will be convenient.

## JOURNAL PROPER:

- \* Opening entries
- \* Closing entries

\* Rectification entries.

\* Transfer entries.

\* Adjusting entries.

\* Entries on dishonour of bills.

\* Miscellaneous entries.

FORMAT OF BILLS RECEIVABLE BOOK:

BILLS RECEIVABLE BOOK (FOLIO NO...)

DATE OF RECEIPT	V. No.	PARTY FROM WHOM RECEIVED	ACCEPTOR	DATE OF BILL	DUE DATE	PLACE OF PAYMENT	Amt.	L.F.	MODE OF DISPOSAL

FORMAT OF BILLS PAYABLE BOOK:

BILLS PAYABLE BOOK (FOLIO NO...)

DATE OF ACCEPTANCE	DRAWER	PAYEE	DATE OF BILL	DUE DATE	PLACE OF PAYMENT	Amt.	L.F.	MODE OF DISPOSAL

## UNIT-5

### CASH BOOK

#### CASH BOOK:

\* Cash book is a subsidiary book as cash transactions are straightaway recorded in the cash book & on the basis of such a record, ledger accounts are prepared.

\* Cash book is a principal book as the cash book itself serves as the cash account & bank account.

\* Thus, cash book is both a subsidiary book and a principal book.

#### KINDS OF CASH BOOK:

##### \* MAIN CASH BOOK:

i) Simple cash book.

ii) Two-column cash book.

iii) Three-column cash book.

##### \* SUBSIDIARY BOOK:

i) Petty cash book.

### SIMPLE CASH BOOK:

\* Only cash receipts and cash payments are recorded.

\* Always shows debit balance, i.e., the total of debit side is always greater than the total of credit side since the payment cannot exceed the available cash.

\* It is like an ordinary cash account.

### FORMAT OF SIMPLE CASH BOOK:

Dr.		CASH BOOK				Cr.	
DATE	RECEIPTS	L.F	AMOUNT	DATE	PAYMENTS	L.F	AMOUNT
			(₹)				(₹)

### TWO-COLUMN CASH BOOK:

\* Along with amount column to record cash receipts & payments, amount column to record discount allowed & received or to record bank receipts & payments is added.



\* Discount columns in the cash book are not balanced. They are only totalled.

\* Their totals are entered in the discount received/paid account in the ledger.

### FORMAT OF TWO-COLUMN CASH BOOK:

Dr.		TWO-COLUMN CASH BOOK						Cr.	
DATE	RECEIPTS	L.F.	BANK/ DISCOUNT	AMOUNT	DATE	PAYMENTS	L.F.	BANK/ DISCOUNT	AMOUNT
			(₹)	(₹)				(₹)	(₹)

### THREE-COLUMN CASH BOOK:

\* There are three amount columns, namely cash receipts & payments, discount received & allowed, bank receipts & payments.

\* 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".

\* When cash is deposited in bank, the amount is recorded in the bank column on the receipt side and in the cash column on the payment side.

\* Likewise, when cash is withdrawn from the bank, the amount is recorded in the cash column on the receipt side and in the bank column on the payment side.

\* These are called contra entries and against such entries, the letter "c" <sup>should</sup> be written in the I.F column, to indicate that these are contra transaction & no further posting is required for them.

\* In three-column cash book, discount columns are not balanced but totalled.

\* Cash & bank column are balanced in the same manner as cash account.

## FORMAT OF THREE - COLUMN CASH BOOK :

Dr.		THREE - COLUMN CASH BOOK									Cr.	
DATE	RECEIPTS	LF	DISCOUNT	CASH	BANK	DATE	PAYMENTS	LF	DISCOUNT	CASH	BANK	
			(₹)	(₹)	(₹)				(₹)	(₹)	(₹)	

## PETTY CASH BOOK :

- \* For small payments, petty cash book is maintained separately recording the particulars of payment and its amount.
- \* The fixed amount is given to the petty cashier for making small payments in the beginning of the period.
- \* The amount spent is replenished so that he will have again the fixed sum in the beginning of the next period.
- \* This system is known as imprest system of petty cash book.
- \* This system is very useful specially if an analytical petty cash book is used.

\* The petty cashier should not be allowed to receive any cash except for reimbursement.

#### POSTING THE PETTY CASH BOOK:

\* From the petty cash book the total of the various columns may be directly debited to the concerned accounts; or

\* 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 account.

#### ADVANTAGES OF PETTY CASH BOOK:

\* Saving of time of the chief cashier.

\* Saving in labour in writing up the cashbook and posting into the ledger.

\* Control over small payments.

## FORMAT OF PETTY CASH BOOK:

### PETTY CASH BOOK

RECEIPTS	DATE	V.NO	PARTICULARS	TOTAL	CONVEYANCE	CARTAGE	STATIONERY	POSTAGE	WAGES	SUNDRIES
(₹)				(₹)	(₹)	(₹)	(₹)	(₹)	(₹)	(₹)

## ENTRIES FOR SALE THROUGH DEBIT & CREDIT CARDS:

\* 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.

\* 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 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 customer has to countersign the form. One carbon copy of the form is given to the customer for the record.

\* 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.

ENTRY:

1. Bank a/c

Dr.

To sales a/c

[Sales made through credit / debit card]

2. Commission a/c

Dr.

To Bank a/c

[Commission charged by bank]

## UNIT-6

### RECTIFICATION OF ERRORS.

#### STAGES OF ERRORS:

1, AT THE STAGE OF RECORDING THE TRANSACTIONS

IN JOURNAL:

\* Errors of principle.

\* Errors of omission.

\* Errors of commission.

2, AT THE STAGE OF POSTING THE ERRORS:

\* Errors of omission

a, Partial omission.

b, Complete omission.

\* Errors of commission.

a, Posting to wrong account.

b, Posting on the wrong side.

c, Posting of wrong amount.

3, AT THE STAGE OF BALANCING THE LEDGER

ACCOUNTS:

\* Wrong totalling of accounts

\* Wrong balancing of accounts.

#### 4. AT THE STAGE OF PREPARING THE TRIAL

##### BALANCE:

- \* Errors of omission.
- \* Errors of commission.
  - a. Taking wrong account.
  - b. Taking wrong amount.
  - c. Taking to the wrong side.

##### TYPES OF ERRORS:

- \* Errors of principle.
- \* Clerical errors.
  - a. Errors of omission.
  - b. Errors of commission.
  - c. Compensating errors.

##### TYPES OF ERRORS FROM ANOTHER POINT OF VIEW:

- \* Errors affecting the trial balance.
- \* Errors does not affecting the trial balance.

##### RECTIFICATION OF ERROR:

- \* If the errors are located after some time, the correction should be made by making another suitable entry, called rectification entry.



\* It is better to begin the checking with the nominal accounts.

\* 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.

i) Before preparation of trial balance.

ii) After trial balance but before the final accounts are drawn.

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

#### BEFORE THE PREPARATION OF TRIAL BALANCE:

\* Errors that are detected before the preparation of trial balance can be rectified without opening suspense account either through rectification statements or through rectification entries.

#### AFTER THE PREPARATION OF TRIAL BALANCE:

\* Opening balance in the suspense account will be equal to the difference in trial balance.

\* If the question is silent as to whether a suspense account has been opened, we have to make a assumption that it is stated clearly & then proceed.

**AFTER THE PREPARATION OF FINAL ACCOUNTS:**

\* Correction of all amounts concerning nominal accounts, i.e., expenses & incomes should be through a special account styled as "Prior period items" or "profit & loss adjustment account".

\* "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 period.

BASIS	BEFORE TRIAL BALANCE	AFTER TRIAL BALANCE	AFTER FINAL ACCOUNTS
RULE:	Perfect journal entry is not needed.	There must be a perfect journal entry.	Expenses/income = Profit/loss adjustment a/c.

1. Purchase day	Purchase a/c DY	Purchase a/c 100	P/1 adj/a/c DY 100
book undercast	₹ 100 .	To suspense a/c 100	To suspense a/c 100
by ₹ 100 .			
2. wages paid for	Machinery a/c DY 100	Machinery a/c DY 100	Machinery a/c DY 100
the erection of	To wages a/c 100	To wages a/c 100	To wages a/c 100
the machinery ₹ 100			
wrongly debited			
to wages a/c .			