CA foundation
Chapter 2 Accounting Process

Unit I
Basic accounting procedures
(Journal Entries)

Double entry system of accounting - According to it, every transaction has two-fold aspects, debit and credit and both the aspects are to be recorded in the books of accounts. Therefore, in every transaction at least two accounts are effected.

Advantages of double entry system -

1) The accuracy of the accounting work can be established by preparing the trial balance in the debit and credit form.

2) On the basis of the trial balance the financial statements can be prepared which shows the financial position of the entity.

3) On the basis of the financial statements the profit earned or loss incurred during accounting period can be ascertained.

4) Comparative study can be made on the basis of the previous years financial statements.

5) As the two aspects of the transactions are recorded they provide significant information for the control and reporting to the users.

Transactions

Transaction is a two way process in which value is a transferred from one party to another. Transaction is the type of event which is generally external in nature and can be determined in terms of money. Every business has huge number of transactions which are analysed in financial terms and then recorded individually, followed by classification and summarization process to know their impact on the financial statements. Transactions analysed in terms of money and supported by proper documents are recorded in the books of accounts under double entry system.

To analyse the dual aspect of transaction, **two approaches can be followed -**

1) Accounting equation Approach

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2) Traditional Approach

1) Accounting equation Approach

The relationship of assets with that of liabilities and owners equity in the equation form is known as 'Accounting equation'.

Under double entry system every business transaction has two-fold effect on the business enterprise where each transaction affects changes in assets, liabilities or capital in such a way that an accounting equation is completed and equated.

Equity + Labilities = Assets or

Equity + Long term Liabilities = Fixed + Current assets - Current Liabilities

2) Traditional approach

Under traditional approach the transaction is recorded in the books on the basis of rules of debit and credit. For this purpose the transactions are classified in three groups.

A) Personal transactions.

B) Transactions related to Assets and Properties.

C) Transactions related to Expenses/Losses and Incomes/Gains.

Golden rules of accounting

A) Personal account

Debit the Receiver

Credit the Giver be

B) Real account

Debit what Comes In

Credit what Goes Out

C) Nominal accounts

Debit the Expenses or losses

Credit the Incomes or Gains

Journal

Journal is a book of original entry. All the transactions and events are firstly recorded in the journal book. It is also called as primary books of accounts.

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Transactions are first entered in this book to show which account should be debited and which credited. Journal is also called as subsidiary book. Recording of transaction in a journal is termed as journalising the entries. In this book the transactions are entered on daily basis in a chronological order.

Advantages of Journal

1) As the transactions are recorded in chronological order we can get complete information about the business.

2) Transactions on timely basis.

3) Journal forms the basis for posting the entries in the ledger and reduce the chances of error.

4) Journal entries are followed by the narration which give a precise explanation of the transaction.

Accounting for GST

Goods and service tax (GST) is a comprehensive indirect tax which has subsumed some multiple indirect taxes in India such as State value added tax, Excise duty, Service tax etc. It is a single tax on the supply of goods and services write from the manufacturer to consumer.

On 1st July 2017 the Central Government introduced this comprehensive indirect tax.

Sailent features of GST

A) GST is levied on supply i.e, manufacture or sale of goods and provision of services

B) Under GST tax is levied only the value added at each stage of the supply chain.

C) GST is the destination based consumption tax. It is levied at the place where the goods or services are consumed

D) There is no tax on tax or cascading of taxes under GST system

E) Under GST there is hormonization of laws procedures and rates of tax across the country.

Types of taxes under GST

There are three main components of GST which are

1) **Central goods and service tax (CGST)**. It is levied and collected by the centre on the 'Intra -State' supply of goods and services.

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2) **State goods and services tax (SGST)**. It is levied and collected by the state governments on 'Intra -State' supply of goods and services

3) **Union territory goods and services tax (UTGST)**. It is levied and collected by union territories without legislature on 'Intra -State' supply of goods.

4) **integrated goods and service taxes (IGST)** It is the GST levied on the 'Intra -State' supply of goods and services and is collected by the centre..IGST is equivalent to the sum total of CGSTand SGST.

UNIT 2

LEDGERS

After recording the original transactions in the journal, all recorded entries are classified and grouped into by preparation of accounts called as summarisation of the transactions.

The book which contains all set of accounts is known as 'ledger'. It is known as a principal books of accounts in which account-wise balance of each account is determined.

A Ledger account has the two sides. The left hand side is called as debit and the right hand side called as a credit.

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

If the debit side of any account exceeds than the credit side the balance amount called as "Debit Balance" and vice versa "Credit Balance".

Unit 3

Trial balance

Preparation of trial balance is the third phase in the accounting process. After posting the accounts in the ledger a statement is prepared to show separately the debit and credit balances. Such a statement is known as the 'Trial balance'. Trial balance is an extract of ledger balances in the debit and credit form. Generally to check the arithmetically accuracy of accounts trial balance is prepared at monthly intervals.

Once the trial balance is tally there is a reasonable conclusion that the accounting

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work is a free from clerical errors.Though it is not a proof of cent percent accuracy of the transactions. Trial balance is statement and not an account.

Objectives of preparing the trial balance

1. To ascertain the Arithmetical Accuracy: The trial balance acts as a check to ensure that the double-entry book keeping system has been applied correctly.

2. To detect the error : While not foolproof, the trial balance helps in locating errors that might occur during the recording of transactions or the balancing of ledger accounts.

3. To Prepare the Financial Statements: The trial balance provides a summary of all the ledger balances, which is essential for preparing the final financial statements.

4. To summarize the financial transactions: The trial balance consolidates all the financial transactions recorded in the ledger accounts, providing a snapshot of the business's financial activity during a specific period.

5. To supporting the audit process: The trial balance is a key document for auditors, who use it to verify the accuracy of the accounting records and to plan their audit procedures.

Limitations of trial balance

One should remember that the agreement of trial balance is not a conclusive proof of accuracy. In other words, In spite of the agreement of the trial balance some errors may be precluded in the books of accounts. These may be due to the following limitations or reasons

1) Errors of omission

If the transaction has not be entered at all in the journal book, the trial balance should not be agreed.

2) Compensating Errors:

If one error cancels out another (e.g., overstating one account and understating another by the same amount), the trial balance will still balance.

3) Errors of Principle:

If a transaction is recorded in the wrong type of account (e.g., debiting an expense account instead of an asset account), the trial balance will still balance.

4) Errors in Recording (Wrong Amount in Original Entry):

If a wrong amount is recorded in the journal, and that same wrong amount is used

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for both debit and credit, the trial balance will balance.

5) Errors in Posting (Wrong Account):

If an amount is posted to the wrong account but on the correct side (debit or credit), the trial balance will still balance.

6) Double Posting (Correct Amount, Correct Side, Wrong Account):

If an entry is posted twice, but the amounts and sides are correct, the trial balance will still balance.

Methods of preparation of trial balance

1) Total method

Under this method every ledger account is totalled and that total amount both of debit side and credit side is transferred to trial balance. This method is not commonly used as for the preparation of the financial statements.

2) Balance method

Under his method every ledger account is balanced and those balances only are carried forward to the trial balance. This method is commonly used and helps in the preparation of the financial statements.

3) Total and Balance method

Under this method the above two explained methods are combined. It is a time consuming method. It never used for the preparation of the financial statements.

Adjusted trial balance

If the trial balance does not agree after transferring the balance of all ledger accounts and also errors are not detected timely, then the trial balance is tallied by transferring the difference of debit and credit side to an account known as 'suspense account'. This is a temporary account open to prepare the financial statements. It is called as the 'Adjusted Trial Balance' .

Unit 4

Subsidiary Books

It is a sub - division of journal. When the business transactions are numerous, these are recorded under the different books called as a 'Subsidiary Books'.

Normally the following subsidiary books are used in a business -

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1) Cash book

It is used to record receipt and payment of cash including out of the bank.

2) Purchase book

It is used to record the credit purchase of goods dealt in or the materials and stores required in the factory.

3) Sale book

It is used to record the sale of the goods dealt in by the entity.

4) Purchase Return Book

It is used to record the returns of goods and materials previously purchased from the suppliers.

5) Sale Return Book

It is used to record the returns of goods made by the customers sold them earlier.

6) Bills Receivable Book

It is used to record the receipts of promissory notes or bills of exchange from the various parties.

7) Bills Payable Book

It is used to record the issue of the promissory notes or bills of exchange in favour of other parties.

8) Journal proper

It is used to record the transactions or events which cannot be recorded in any of the previous above mentioned seven books. Generally the following types of entries are recorded

1) Opening entries

When books are started for the new year the opening balances of Assets and liabilities are journalised.

2) Closing entries

At the end of the year, the nominal accounts are closed by transferring to the income statement this is done through closing entries.

3) Transfer Entries

If some amount is to be transferred from one account to another account the

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transfer will be made through this entry.

4) Rectification entries

If an error has been committed in the books of accounts, it can be rectified through a journal entry.

5) Adjusting entries

At the end of the year amount of expense or income may have to be adjusted for amounts not yet settled or or received in advance for this purpose adjusting entries are to be passed.

Advantages of subsidiary book

1) Division of work

Since in the place of one journal there will be so many subsidiary books, the accounting work may be divided amongst a number of clerks

2) Specialisation and efficiency

When the same work is allotted to a particular work over period of time, he acquires full knowledge of it and becomes efficient in handling it.

3) Saving of the time

Various accounting processes can be undertaken simultaneously because of the use of a number of books. This will lead to a work being completed quickly.

4) Availability of information

Since a separate register or book is kept for each class of transaction the information relating to each class of transaction is available at one place.

5) Facility in checking

When the trial balance does not agree the location of the errors is facilitated by the existence of separate books. Even the commission of errors are frauds will be checked by the use of various subsidiary books.

Unit 5

Cash Book

Cash book is a subsidiary book. It serves the both purpose i.e., Journal as well as Ledger. It records the transactions relates to cash and bank. The balances are directly entered in the trial balance. The cash book is thus both a subsidiary book

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and a principal book.

Kinds of Cash Book

The main cash book may be of **three types**

1) Simple Cash book

2) Two -Columnar cash book

3) Three - Columnar cash book

1) Simple Cash book

Such a cash book appears like an ordinary account with one amount column on each side. The left hand side records receipt of cash and right hand side the payment of cash. The cash book is balanced like other accounts. The total of receipt column is always greater than total of payments columns. The difference is written on the credit side as "by balance c/d". It shows the cash balance in hand in the beginning of next period.

2) Double column cash book

It is also called as two columnar cash book. It includes -

A) Cash and Discount columns

B) Bank and Discount columns

C) Cash and Bank columns

On each side the two amount columns are to be drawn. The cash and bank columns is balanced. The discount column is never balanced. The total of debit side discount column is called as "Discount allowed" and the total of credit side discount column is called as "Discount received".

3) Triple column cash book

It is also called as three columnar cash book. On each side, there are three amount columns to record the cash, bank and discount transactions. At the end of the accounting period, the cash and Bank columns are balanced and the total of discount column debit side termed as "Discount allowed" and credit side term as "Discount received".

Contra entries

When an entry is passed on the both side of the two columnar or three columnar cash book in the different columns then it is called as the contra entry.

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This entry is recorded on the both sides of the cash book whenever the cash or cheque is deposited or cash withdrawn from the bank.

Petty cash book

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

At the end of certain period the petty cash year prepares a book called as "Petty Cash Book".

Imprest system of Petty Cash Book

At the beginning of a certain period, the chief or head cashier hands over a certain/ definite sum of money to the Petty Cashier to met the small payments. This amount is termed as a "Float amount".

During the certain period, out of the float amount the Petty Cashier makes the small payments and record it in the petty cash book.

At the end of the period, he presents the petty cash book to the head cashier, thereafter the head cashier reimburses him an amount by cheque to maintain the float amount for payment to be made in the next accounting period.

Advantages of petty cash book

1) It saves the time and efforts of the chief cashier.

2) It saves in labour in writing of the cash book and posting into the ledger.

3) The chief cashier can control the small payments.

Unit 6

Rectification of errors

Unintentional omission or commission of amounts and accounts in the process of recording the transactions are commonly known as errors.

Errors can be committed at the stage of collecting financial information, classification of accounts, recording to journals, posting to the ledgers, totalling and balancing of the ledger accounts.

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To check the arithmetical accuracy of the journal and ledger accounts trial balance is prepared. If the trial balance does not tally, then it can be said that there are errors in the accounts which require rectification thereof.

Some of the errors may affect the trial balance and some of these errors do not have any impact on the trial balance. All those errors may affect the determination of profit or loss, assets and liabilities of the business.

Stages of errors

1) At the stage of recording the transaction in journal. It includes

a) Errors of principle

b) Errors of omission

c) Errors of commission

2) At the stage of posting the entries in ledger. It includes

a) Errors of omission - partial or complete omission.

b) Errors of commission

posting to wrong account

posting on the he wrong side

posting of the wrong amount.

3) At the stage of balancing the ledger accounts

i) Wrong totalling of accounts

ii) Wrong balancing of accounts

4) At the stage of preparing the trial balance

i) Errors of omission

ii) Errors of commission

Taking wrong account

Taking wrong amount

Taking to the wrong side

Types of Errors

A) Errors of principle

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When a transaction is recorded in contravention of accounting principles that is by wrong observance of classification of accounts (personal real or nominal). It is an error of principle.

In this case there is no effect on the trial balance since the amounts are place on the correct side, though in a wrong account.

B) Clerical errors -These errors arise because of mistake committed in the ordinary course of the accounting process. These are of three types

a) Errors of omission

If a transaction is completely or partially omitted from the books of accounts, it will be a case of "Errors of omission".

b) Errors of commission

If an amount is posted in the wrong account or it is written on the wrong side or the totals are wrong or a wrong balance is a struck, it will be a case of "Errors of Comission".

c) Compensating errors

If the effect of errors committed cancel out, the errors will be called "Compensating Errors". The trial balance will agree.

Rectification of errors

Error should never be corrected by overwriting. The correction should be made by making another suitable entry called as "rectification entry". An error can be detected at any of the following stages.

A) Before preparation of trial balance

B) After trial balance but before the final accounts are drawn

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

A) Before preparation of trial balance

Some errors affect one side of an account or more than one account, in such a way that it is not possible to pass a complete rectification entry. These errors are to be corrected at the detected stage by making rectification statement in the appropriate sides of the concerned accounts. As the trial balance has not been prepared it is possible to correct at the detected stage.

B) After trial balance but before the final accounts are drawn

Some errors have been detected after the trial balance but before preparation of

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the final accounts. Such errors can be corrected by passing a rectification entry. Sometimes the trial balance is artificially made to agree despite of errors by opening a suspense account and putting the difference in the trial balance to the account - the suspense account.

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

After so many efforts if the errors are not detected, the business entity cannot postponed work of finalization of accounts. Hence the balance in the trial balance for the time being is transferred to a separate account called suspense account. Then in the next accounting period whenever the errors are detected the entries are made against suspense account. The corrected amount of Real and Personal accounts are adjusted through the balance sheet and the corrected amount of nominal accounts are transferred to a separate account called as "prior period items or profit and loss adjustment account". After all the rectification entries are passed the balance of profit and loss adjustment account is transferred to a capital account.

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