PRINCIPLES OF ACCOUNTANCY

UNIT-I

Basic Concepts: Fundamentals of Book Keeping-Meaning-Definition-Book-keeping Vs. Accounting- objectives- Advantages and limitations of accounting-Methods of accounting-Double entry system-Meaning-Advantages- Types of accounts- Accounting Rules-Accounting concepts and conventions-Journal- Ledger- Subsidiary books - Trial balance.

UNIT - II

Final accounts of a sole trading concern- Trading, Profit & Loss a/c and Balance sheet with adjustments, Difference between Trading a/c, P&L a/c and Balance sheet.

UNIT-III

Final accounts of Non- trading concerns- Receipts and payments account- Income and expenditure account and Balance Sheet-Difference between Receipts and payments account& Income and expenditure account.

UNIT - IV

Bank Reconciliation statement- Causes for difference- Preparation of Bank Reconciliation statement.

Royalties – Dead rent and short working – Recoupment of short working – Accounting entries in the books of lessee and landlord (excluding sub-lease)

UNIT – V

Depreciation – Meaning-Causes- Characteristics-Objectives- Methods-Fixed - Diminishing - Difference between Straight line method and W.D.V. method -Annuity-Depreciation fund Method- Provisions and reserves.

Note: Distribution of marks - Problems 80% and Theory 20%.

<u>Principles of accountancy</u>

Meaning of Accountancy:

The American Institute of Certified public Accountants committee on terminology proposed in 1941 that accounting may be defined as

"The art of recording , classifying , and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character and interpreting the results thereof".

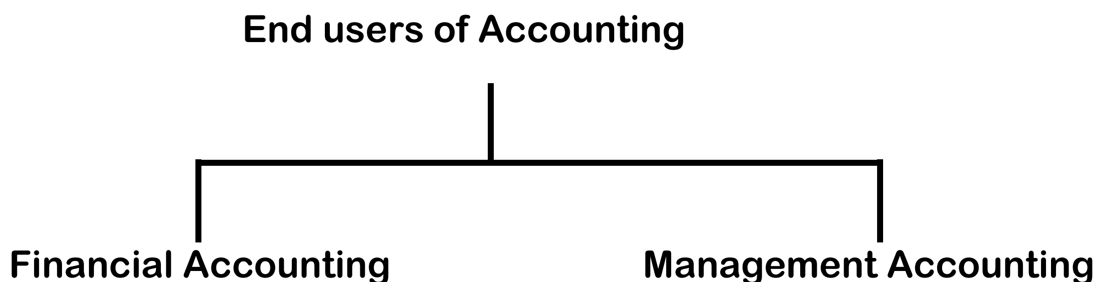
Accounting and Accountancy are often synonymous term. To fulfill the various objectives different uses of accounting have developed.

Book-Keeping Defined:

"Book-Keeping is the art of recording business transactions in a systematic manner". A.H.Rosenkampff.

"Book-keeping is the science and art of correctly recording in books of account all those business transactions that result in the transfer of money or money's worth." R.N.Carter.

Types of Accounting:



Financial Accounting:

The accounting for revenues, expanses, assets and liabilities that is commonly carried on in the general offices of a business is termed as FINANCIAL ACCOUNTING. Its aim is to ascertain the profit or loss and to state the financial position of the business as at a particular date. To achieve these objectives it is necessary to record all business transaction in a systematic manner. The process of recording all transactions of a business in a systematic manner is known as book-keeping. It is the art of recording the transactions in the books of original entry and the ledgers. This work is usually performed by book-keepers or accounts clerks. The work is a mechanical nature and does not require any specialized knowledge of the principles of accountancy.

Accountancy involves the preparation of the profit and loss Account and Balance Sheet of the business. The work of the accountant is not only to supervise the work of book-keepers but also to analyses review and draw useful conclusions from the financial statements. The accountant must have a thorough grasp of the principles of accountancy. Financial accounting includes book-keeping and accountancy.

Management Accountancy:

"Management Accountancy is the term used to describe the accounting modes systems, and techniques which, coupled with special knowledge and ability, assist management in its task of maximizing profits or minimizing losses". **J.Batty.**

Management Accounting has been defined by the Association of Certified and Corporate Accountants as:

"The application of accounting and statistical techniques to the specific purpose of producing and interpreting information designed to assist management in its function of promoting maximum efficiency and in envisaging, formulating and co-ordination future plans and subsequently in measuring their execution".

The tasks of the management accountant are many At the Seventh International Congress of Accountants, held in Amsterdam in **1957;** the following facets of management accounting were emphasized:

1. Cost Accounting
2. Material Control
3. Budgetary Control
4. Interim Reporting
5. Determination of the most efficient and economical accounting system applicable to the particular business.
6. Special cost and economic studies
7. Assisting management in the interpretation of financial data.

Accounting Concepts:

Accounting is the language of business; affairs of a business unit are made understood to others as well as to those who own or manage it through accounting information which has to be suitably recorded, classified, summarized and presented.

1. **Business Entity Concept:** Accountants treat a business as distinct from the persons who own it; then it become possible to record transactions of the business with the proprietor also. Without such distinction, the affairs of the firm will be all mixed up with the private affairs of the proprietor and the true picture of the firm will not be available.

   This concept has now been extended to accounting separately for various divisions separately. It has been of immense value in determining results by each responsibility center- Responsibility Accounting.
2. **Money Measurement Concept;** Accounting records only those transactions which are being expressed in monetary terms, though quantitative records are also kept. An event, even though important like a quarrel between the production manager and the sales manager, will not be recorded unless its monetary effect can be measured with a fair

degree of accuracy. It should be remembered that money enables various things of diverse nature to be added up together and dealt with. The use of a building and the use of clerical services can be added up through money values and not otherwise.

3. **<u>Cost Concept:</u> Transactions are entered in books of account at the amount actually involved. Suppose a firm purchases a price of land for Rs. 1, 50,000 but considers it as worth Rs. 3, 00,000. The purchase of land will be recorded at Rs. 1, 50,000 and not any more. This is one of the most important concepts it prevents arbitrary values being put on transactions, chiefly those resulting in acquisition of assets. Another way of saying the same thing would be that the amount to be recorded is objectively arrived at as a result of the mutual agreement of the two parties involved.**
4. **<u>Going Concern Concept:</u> It is assumed that the business will exit for a long time and transactions are recorded from this point of view. It is this that necessitates distinction between expenditure that will render benefit over a long period and that whose benefit will be exhausted quickly, say, within the year. Of course if it is certain that the business will exist only for a limited time, the accounting record will keep the expected life in view.**
5. **<u>Dual-Aspect Concept:</u> Each transaction has two aspects; if a business has acquired an asset, it must have resulted in one of the following:-**

1. Some other asset has been given up;

2. The obligation to pay for it has arisen;

3. There has been a profit, loading to a increase in the amount that the business owes to the proprietor; or

4. The proprietor has contributed money for the acquisition of the asset.

The reverse is also true. If for instance there is an increase in the money owed to others, there must have been an increase in assets or a loss. At any time

ASSETS=LIABILITIES+CAPTIAL

(OR)

CAPITAL=ASSETS-LIABILITIES

In other words, capital, i.e. the owner's share of the assets of the firm is always what is left out of assets after paying off outsiders.

⌖ **Realization Concept:** Accounting is a historical record of transactions; it records what has happened. It does not anticipate events though anticipated adverse effects of events that have already occurred are usually recorded. This is of great importance in stopping business firms from inflating their profits by recording sales and income that are likely to accrue. Unless money has been realized—either cash has been received or a legal obligating to pay has been assumed by the customer—no sale can be said to have taken place and no profit or income can be said to have arisen.

⌖ **Accrual Concept:** Income or profit arises only when there has been an increase in the owner's share of the assets of the firm (called owner's equity) but not if the increase has resulted from money contributed by the owner himself. Any increase in the owner's equity is called revenue and anything that reduces the owner's equity is expense (or loss); profit results only when the total of revenues exceeds the total of expenses or losses.

In addition to the above—mentioned concept, the following should also be noted:-

- Transactions should be recorded in such a manner as to reflect the true legal position. For instance it is not proper to treat sales on hire—purchase business as ordinary sales and the hire—purchase customer as an ordinary debtor since he can always return the goods and put an end to his liability.
- Even though it is assumed that business will continue for a long time, it is necessary to keep accounts in such a manner as to permit results being ascertained and presented for each financial period, usually a year.

Accounts can be divided:

An account is a statement in the Ledger which records the transactions relevant to the person, assets, expense or profit named in the heading. Accounts can be divided into:-

1. **Personal Accounts.**
2. **Impersonal Accounts.**

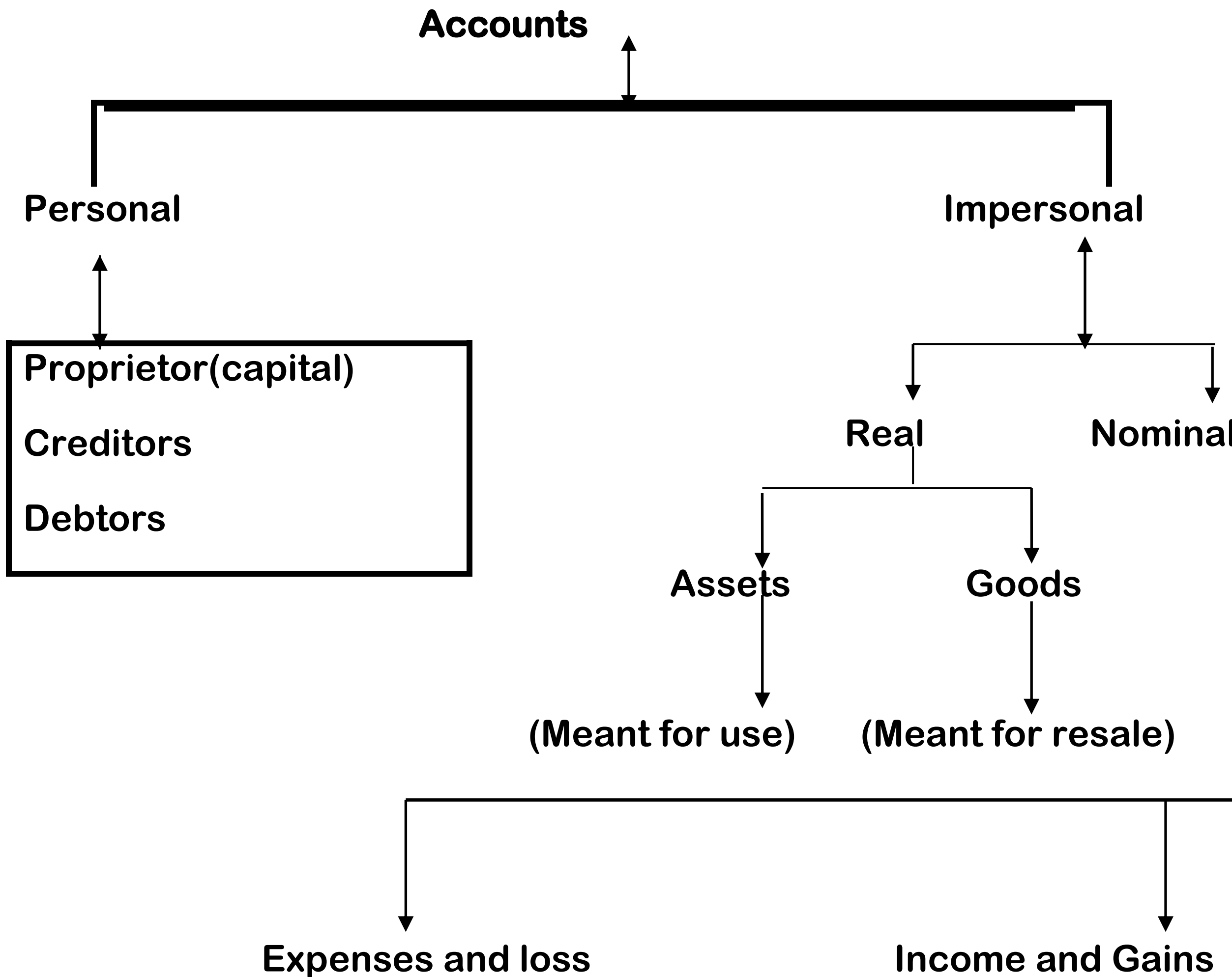
Impersonal Accounts can be further divided into Real and Nominal Accounts. Thus there are three kinds of accounts maintained by a business viz.

1. **Personal Accounts.**
2. **Real Accounts and**
3. **Nominal Accounts.**

Accounts of persons with whom the business deals are known as Personal Accounts. The word person is used in a special sense here. It includes individuals, partnerships, companies, co-operatives, and state enterprises. E.g. Capital Account, Drawings Account, Bank **Account, Chitra & co. Account, E.I.D. Parry & co. Ltd. Account etc.**

Accounts in which the business records the real things owned by it i.e. the Assets of the business are known as Real Accounts. E.g. Building Account, Car Account, Machinery Account, Furniture and Fittings Account etc.

Accounts which record expenses, losses, incomes and gains of the business are known as Nominal Accounts. E.g. Real Accounts, Salaries Accounts, Telephone Bill Account, Post Account, Advertising Account, Commission Received Account, Interest Received Account, etc.



Stock: 2mark

The balance of unsold goods is known as Stock. Hence it is clear that a Trader would like to maintain five separate accounts in respect of Goods in order to have a complete picture of commodities or merchandise bought for resale.

Double Entry:

Double Entry is based on the fact that there can be no giving without receiving nor can there be receiving without someone giving. The receiving aspect is known as 'Debit' and is entered on the Debit side of the account. The giving aspect is known as 'Credit' and is entered on the credit side of the account. The principle under which both Debit and Credit aspects are recorded is known as the Principle of

Double Entry. Every debit must have a corresponding Credit and Vice Versa.

Single Entry:

If the accounts are not maintained under this system, then the records are incomplete and known as Single Entry which is Unscientific.

Sl.no	Double Entry	Single Entry
01	For every debit there is a corresponding credit and vice versa.	Debit and credit do not agree.
02	Maintains a complete Record of a)Personal Accounts b)Real Accounts and c)Nominal Accounts.	An incomplete record. Only personal accounts and cash accounts are maintained.
03	A Balance Sheet and profit and loss Statement can be prepared conveniently since the books of accounts present a complete picture.	A Balance Sheet and Profit and Loss Statement cannot be conveniently prepared since the accounting records are incomplete.

04	Double Entry is the only Scientific system of keeping Books of accounts.	Single entry is not a system. It is incomplete and unscientific.

Advantages of the Double Entry system:

1 .A business can know at any time how much profit it has earned or how much loss it has suffered in a particular period.
2. The Balance Sheet can be prepared which will disclose the Fixed and Current Assets of the business, on the right hand side and the Liabilities and Capital on the left hand side. A comparative study of the balance sheets will show the progress of the business.
3. The account books will reveal the amount due by customers. Reminders can be sent to the debtors who do not settle their accounts promptly.
4. The trader can ascertain from the account books the sums he owes his creditors and make proper arrangements to pay them promptly.
5. Under the Double entry system 'Entry debit has a corresponding credit'. The arithmetical accuracy of the books can be tested by preparing a statement called Trial Balance.
6. It prevents and discovers errors and frauds.
7. The businessman can satisfy the tax authorities if he maintains his account books properly under the Double Entry system.

Rules for Debit and Credit:

Personal Accounts	Debit the Receiver	Credit the Giver.
Real Accounts	Debit what comes in	Credit what goes out.
Nominal Accounts	Debit Expenses and Losses	Credit Income and Gains.

Accounting Terminology:

It is necessary to understand some basic accounting terms which are

routinely used in business world. The following are some of the important terms which enable a student to comprehend accounting in a better way:-

1. **Capital:** It represents owners' funds invested in a business. It may be the original amount invested by the owner or original contribution adjusted for profit and drawings. It is also known as Owners equity or not worth. Capital represents owners' claim against the assets of the business. It is equal to the total assets minus outside liabilities.
2. **Liability:** It represents temporary interest of outside creditors in the assets of a business. In the words of Finny and Miller, "Liabilities are debts; they are amounts owed to creditors; thus the claims of those who are not owners are called Liabilities".

   In simple terms, debts repayable to outsiders by the business are called Liabilities.
3. **Assets:** Assets are defined as 'anything of value owned by a business. According to Finny and Miller, "Assets are future economic benefits, the rights, which are owned or controlled by an organization or individual.
4. **Revenue:** It is defined as the inflow of assets which results in an increase in the owners' equity. It includes all incomes like sales receipts, interest, commission, brokerage etc. However, receipts of capital nature like additional capital, sale of assets etc., are not part of revenue.
5. **Expense:** It is any amount spent in order to produce and sell the goods and services which bring in the revenue. Expense may be defined as the cost of the use of things or services for the purpose of generating revenue.

   Expense can be capital expense and revenue expense. Capital expense generates revenue over several accounting years. Revenue expense generates revenue in the current accounting year.

   Capital expense includes acquisition of long term assets like machinery whereas revenue expense includes current expense like salary, rent, lighting etc.
6. **Debtors:** A person who receives a benefit without giving money or money's worth immediately but, liable to pay in future is a debtor. Debtor can be a 'trade debtor' if he buys goods on credit. Others are non trade debtors.
7. **Creditors:** A person who gives a benefit without receiving money or money's worth immediately but, liable to claim in future is a creditor.

Creditor can be a 'trade creditor' if he supplies goods on credit. Others are non trade creditors.

8. **Tangible Assets:** Assets which have physical existence. I.e. they can be seen or felt or touched, are termed as tangible assets. Example: cash, machinery, buildings.
9. **Intangible Assets**: Assets which have physical existence. I.e. they cannot be seen or felt or touched, are termed as intangible assets. Example: goodwill, patent rights, copyrights.
10. **Fictitious Assets:** Items show along with other assets on the assets side of a balance sheet, but actually representing unadjusted losses are termed as fictitious assets. Example: preliminary expense, profit and loss account debit balance etc.
11. **Wasting Assets:** Those assets which certainly lose value with usage are termed as wasting assets. Mines, forests etc., become waste once the mineral is fully extracted or the timber is full cut.
12. **Fixed Assets:** Assets acquired for income generation, but not for resale are called fixed assets. The benefit from them is derived for a longer period than one year. (e.g.) machinery.
13. **Current or Floating Assets**: Those assets which are converted into cash in normal course of business in less than one year are termed as current or floating assets. (e.g.) stock, debtors.
14. **Purchases:** Buying of goods with the intention of resale is called Purchases. If cash is paid immediately for the purchase, it is cash purchase. If the payment is postponed. It is credit purchases.
15. **Sales:** Selling of goods in the normal course of business is termed as sales. If the sale is for immediate cash payment, it is cash sales. If payment for sales is postponed it is credit sales.
16. **Stock:** The term 'stock' refers to goods lying unsold on a particular date. The stock of goods at the end of the accounting period is called '**closing stock'** and the stock of goods at the beginning of an accounting period is called '**opening stock'**.
17. **Losses:** 'Loss really indicates something against which a firm receives no benefit. It represented money given up without any return. It may be noted that expense leads to revenue but losses do not. (e.g.) loss

due to fire, theft and damages payable to others.

18. **Drawings:** Any amount of money or money's worth withdrawn by the owners of the business is termed as drawings. It is usually subtracted from capital.

19. **Invoice:** It is a statement prepared by a seller of goods to be sent to the buyer. It shows details of quantity, price, value etc., of the goods and any discount given, finally showing the net amount payable by the buyer.

20. **Voucher:** It is the written record and evidence of a transaction. So, documentary evidence of any transaction is called a Voucher. Vouchers are essential for audit of accounts. Example: cheque book counterfoils, cash receipts, invoices.

21. **Goods:** The term 'goods' includes all merchandise, commodities etc., in which a trader deals in the normal course of business. Thus, commodities bought for resale are treated as goods. For a furniture dealer, furniture is goods but, for other firms furniture is an asset.

22. **Current Liabilities:** Those liabilities which are payable within one year in the normal course of a business are termed as current liabilities. Example: trade creditors, bills payable.

23. **Long Term Liabilities:** Liabilities repayable beyond a period of one year are treated as long term liabilities. Example: bank loans, mortgage loans.

24. **Solvent:** A person who has assets with realizable values which exceed his liabilities is solvent.

25. **Insolvent:** A person whose liabilities are more than the realizable values of his assets is called an insolvent.

Accounting Conventions

1. **Convention of Full Disclosure:**

According to this convention, all accounting statement should be prepared honestly. This should be evident through the transparency of the statement. The statement should disclose fully all the significant information. Facts, figures and the details which are of material interest to the owners, investors, creditors etc., must be clearly presented in the statement.

2. **Convention of Consistency:**

The basic aim of the doctrine of consistency is to preserve the comparability and reliability of financial statements. Accounting to this convention, the rules, practices and concepts used in accounting should be continuously observed and applied year after year.

3. **Convention of Materiality:**

Materiality means 'relative importance'. All important items and facts should be disclosed in accounting statements. Unimportant and immaterial details need not be separately given. Otherwise, the accountant becomes over burdened with unnecessary details. For example, a plastic container for drinking water can be clubbed with general expenses instead of separately being disclosed as an asset.

4. **Convention of Conservation:**

According to Kohler, "conservatism is a guideline which chooses between acceptable accounting alternatives for recording events and transactions so that the least favorable immediate effect on assets, income and owner's equity is reported". **Accounting Equation**

American accountants have derived the rules of debit and credit through a 'novel' medium i.e., accounting equation. The equation is as follows:

Assets = Equities

The basic for the equation is the principle of 'Rights'. Accounting deals with property and rights to property. The total of the properties owned by a business is equal to the total of the 'Rights' to the properties. The properties owned by a business are called assets. The rights to properties are called equities.

Equities can be sub-division into equity of the owners which is known as capital and equity of creditors who represent the debts of the business known as liabilities. These equities may also be called internal equity and external equity. Internal equity represents the owners' equity in the assets and external equity represents the outsides' interest in the assets. Based on the bifurcation of

equity, the accounting equation can be restated as follows:

Assets = Liabilities + Capital

(or)

Capital = Assets – Liabilities

Journal:

The French word **"Jour"** 'means' "**Day".** Journal therefore means a daily record of business transactions.

Journal is a book of '**primary entry'** or **'original entry'**. All transactions are initially recorded in the Journal. The ruling of the journal is such that any business transaction can be analyzed under the heads of debit and credit. A thorough understanding of the principle of debit and credit which are the basic for Journal is essential for every student of accountancy to get a thorough grasp of the subject. The following is a specimen ruling of Journal.

Ledger:

'Ledger' is the second important stage in the accounting cycle or process. In this stage of accounting cycle, all recorded business transactions or entries are grouped on a predetermined basis. Such classification or grouping takes the form of "Accounts" in a separate book known as "Ledger". The 'accounts' in the ledger provide identifiable 'grouping' to the numerous business transactions.

Distinction between Journal and Ledger:

1. **Primacy:** Journal is the book of original entry; ledger is dependent on journal for data.

2. **Recording:** In the journal, recording is in chronological order- as and when transactions take place. In ledger recording is analytical. Transactions relating to particular accounts are entered in those accounts. No specific order is followed.

3. Evidence value: A book of primary entry, journal has better 'evidence value' in case of legal problems. However, ledger is the primary source for assessing business results.

4. Focus: In journal the focus is on 'transaction'. Both aspects-debit and credit - of a transaction are to be recorded. In ledger, the focus is on account. All dealings relating to an account must be recorded in the account.

5. Terminology: Recording in journal is called 'journalizing'. Recording in ledger is called 'Posting'.

6. Importance: Ledger is the main book of accounts. Journal is 'subsidiary' which means secondary.

7. Timing: Journalizing is a continuous process. It has to be done day after day, as and when transactions take place. Ledger can be intermittent. It can be done any time – either daily or once in a while, according to need or convenience.

SUBSIDIARY BOOKS:

Maintaining a single 'journal book' in which journal entries are written for each transaction and posting them to ledger is practicable in small businesses where a single accountant can maintain accounts or the owner himself can do the accounts work. In bigger businesses, transaction are so numerous and varied that a single journal book is absolutely inadequate and cumbersome.

It may be necessary to group similar transaction even at journal stage in the shape of "**special journals"** to minimum and facilitate ledger wok.

Subsidiary books comprise of the following:

- Purchases book to record credit purchases of goods;
- Sales book to record credit sales of goods;
- Purchases returns book to record returns to suppliers.
- Sales returns book to record returns from customers.
- Cash book to record all cash receipts and payments.
- Bills receivable book to record bills received.
- Bills payable book to record bills payable accepted
- General journal or journal proper to record any other transactions which cannot be entered in the above

specialized subsidiary books.

Benefits of Subsidiary books:

Subsidiary books result in the following benefits:

- **Reduction in work:** Overall work reduces in this system compared to a single journal because one positing alone is made on the date of the transactions. Consolidated monthly posting is made for the second aspect.
- **Permits group work:** Single journal can be written by one person alone. Work on subsidiary books can be carried on by many accountants.
- **Accuracy:** Accounts will be more accurate because of specialized work and monthly summarized postings.
- **Better information:** A lot of useful data like total credit sales, credit purchases, returns, etc., is made available which is not possible in journal system.
- **Cash book:** Cash book itself take the place of journal as well as ledger account. Thus separate cash account is not needed. In case of three column cash book, even bank A/c is not needed in the ledger.

Basic documents for subsidiary books:

- **Inward invoice:** This is the document sent by the suppliers of goods giving details of goods sent, price, value, discount etc. It is the basis for entries in purchases book.
- **Outward invoice:** This is a document sent by the firm to the customers, showing the details of goods supplied their price and value, discounts, etc. It is the basis for writing sales book.
- **Debit note:** When goods purchased from suppliers are returned, a debit note is sent to them showing the goods returned and their values. It is the basis for purchase returns book.
- **Credit note:** When customers return goods, a credit note is prepared by the firm and sent to them based on the goods received as returns. This note is the basis to write sales returns book.
- **Cash receipts and vouchers:** These are the vouchers and receipts for cash received and paid. Entries in cash book are made on the strength of the vouchers and receipts. They are

also useful for auditing purpose.

Petty Cash Book

'**Petty'** is a derivation of the fresh word "**PETIT'** which mean small. So it is meant to be a small cash book not in physical size but in recording 'small payment'. A business makes numerous routine small payments day after day like postage, stationery, cartage, refreshments, cleaning, bulky and the principal cashier becomes overburdened.

In most of the medium and large sized business establishments separate cashiers is entrusted with the job of making all the small routine payments and maintain accounts for them. He is called '**petty cashier'** and the book he maintains is called "**petty cash book".**

Journal entries:

Sl.no	Particulars	Amount	Amount
01	Started business Cash a/c Dr To capital a/c Cr (being cash brought in capital)	 xxx	 xxx
02	Deposited into bank Bank a/c Dr To cash a/c Cr (being deposited into bank)	 xxx	 xxx
03	Purchase goods for cash Purchase a/c Dr To cash a/c Cr (being goods bought for cash)	 xxx	 xxx
04	Sales goods for cash: Cash a/c Dr To sales a/c Cr (being goods sold for cash)	 xxx	 xxx

05	**Purchase good of Mr. X:** **Purchase a/c Dr** **To Mr. X a/c Cr** **(being goods bought on credit)**	**xxx**	**xxx**
06	**Paid Mr. X cash discount allowed by him:** **Mr. X a/c Dr** **To cash a/c Cr** **To discount a/c Cr** **(being payment made to Mr. x and discount received from him)**	**xxx**	**xxx** **xxx**
07	**Sold good to Mr. Y:** **Mr. Y a/c Dr** **To sales a/c Cr** **(being good sold on credit)**	**xxx**	**xxx**
08	**Received cash from Mr. Y allowed him discount:** **Cash a/c Dr** **Discount allowed a/c Dr** **To Mr. Y a/c Cr** **(being amount received from Mr. Y and discount allowed to him)**	**xxx**	**xxx** **xxx**

09	Paid expenses like stationary, salary, fright, advertisement, rent, etc. Expenses a/c Dr To cash a/c Cr (being expenses paid in cash)	xxx	xxx
10	Received (Rs.-----)from Mr. Z as interest: Cash a/c Dr To interest a/c Cr (being interest received from Mr. Z)	xxx	xxx
11	Sales return of goods by Mr. A: Sales return a/c Dr To Mr. A a/c Cr (being good returned by Mr. A)	xxx	xxx
12	Purchases return of needs by Mr. A: Mr. A a/c Dr To purchase a/c Cr (being goods returned by Mr. A)	xxx	xxx
13	Cash withdraw from bank: Cash a/c Dr To bank a/c Cr (being cash withdraw from bank)	xxx	xxx

14	Cash withdraw from bank for personal use of the proprieties: Drawing a/c Dr To bank a/c Cr (being cash withdraw from bank for personal use)	xxx	xxx
15	Any of the payment paid by cheque like paid rent by cheque: Rent a/c Dr To bank a/c Cr (being the amount paid as rent by cheque)	xxx	xxx
16	Bank charges debited by bank: Bank charges a/c Dr To bank a/c Cr (being bank charges debited by bank)	xxx	xxx
17	Stock in hand at the end of the year Rs…? Closing stock a/c Dr To trading a/c Cr (being stock at the end brought into books)	xxx	xxx

18	Outstanding, salary, rent wages(etc at end of the year): Salary a/c Dr To outstanding salary a/c Cr (being salary outstanding brought into books)	xxx	xxx
19	Charge interest on capital @ 10% pa for month: Interest on capital a/c Dr To capital a/c Cr (being interest on capital @ 10% charged)	xxx	xxx
20	Interest to be changed on drawings: Drawing a/c Dr To interest on drawing a/c Cr (being interest on drawings)	xxx	xxx
21	Prepaid insurance premium: Prepaid insurance a/c Dr To insurance a/c Cr (being insurance premium paid in advance)	xxx	xxx
22	Depreciation on fixed assets like furniture, machinery, plant etc:		

	Depreciation a/c Dr **To fixed assets a/c Cr** **(being depreciation fixed assets)**	**xxx**	 **xxx**
23	**Good used for personal use:** **Drawings a/c Dr** **To purchase a/c cr** **(being goods used for personal use)**	 **xxx**	 **xxx**

Preparation of individual subsidiary books:

Purchases Book:

Purchases book is also known as "**bought book**" '**purchases day book**', **invoice book**'; and '**purchases journal**'.

- ❖ All credit purchases of goods are recorded in this book. Periodical total of this book provides total credit purchase of goods made by the firm.
- ❖ Cash purchase of goods and credit or cash purchase of assets are ignored in this book.
- ❖ 'Inward invoice' received from suppliers, duly verified, form the basis for entries in purchase book.

Method of Recording:

In the chronological order of goods purchased on credit, the names of suppliers with details of goods bought and number of inward invoice are recorded in the book with net amount payable. Any trade discount allowed is deducted from the gross invoice value of goods received.

Date	Name of the suppliers	L.F	Inward Invoice no	Details	Amount

B)Sales book

Sales book is also known as "**day book**", '**sales day book**', '**sold book**', '**sale journal**' etc.

- ❖ All credit sales of goods are recorded in this book. Periodical totals of this book provide the total credit sales of goods by the firm.

- Cash sales of goods and credit sales of assets are not shown in this book.
- 'Outward invoices' form the basis for making entries in the sales book. The invoices must be properly authenticated.

Method of Recording:

According to the dates and time of credit sales taking place, they are recorded in the sales book. The name of customer with details of goods sold and the net amount receivable is recorded. Trade discount if any is deducted in arriving at the net sale value.

Sales Book:

Date	Name of the customer	L.F	Outward invoice no	Details	Amount

c) purchases returns book

It is also called '**Returns outward book'** and **'purchase returns journal'**.

- Goods returned to suppliers which were originally purchased on credit are recorded in this book. Periodical totals of this book provide data on purchase returns by the firm.
- 'Debit notes' sent by the firm to the suppliers when goods are returned form the basis entries in this book.

Method of recording:

As per the dates of returns mode, entries are recorded in purchase returns book. Name of supplier, with details of goods returned and the relevant debit note number are show along with the net amount.

Date	Name of the supplier	Debit Note No	L.F	Amount

D)Sales returns book

This book is also called **'Returns Inward Book'** and **'sales returns journal'.**

- Goods returned to customer which were originally sold on credit are recorded in this book. Monthly totals of this book provide data on 'sales returns'.
- 'Credit notes' sent to the customer after receiving the goods returned by them forms the basis for entries in this book.

Method of recording:

According to the dates of returns received from customers, entries are made in sales returns book. Name of customer, with details of goods returned and credit note number are show along with the net amount.

Date	Name of the customer	Credit Note No	L.F	Amount

E)Cash Book

Business firms of every size have a large number of payments and receipts—either in the form of cash or thought bank. In the traditional journal—ledger system, writing entries for every receipt and payment and posting them to cash and bank Accounts in the ledger constitutes majority of the accounting work. In the subsidiary book system, the entire work relating to cash and bank transactions is minimized and simplified through '**cash book'.**

Cash book plays a '**dual role'** by serving as a subsidiary book and also as a ledger account.

It is the book of original entry because receipts and payments are recorded in the cash book and they are posted to the different accounts in the ledger.

There are four types of cash book:

- Simple cash book or single column cash book.
- Two column cash book with cash and discount columns.
- Two column cash book with bank and discount columns. And
- Three column cash book with cash, bank and discount columns.

A) **Simple cash book:**

This type of cash book contains debit side and credit side. Showing all receipts of cash on debit side and payments of cash on credit side. Debit side is called receipts side and credit side is called **Payments side.**

B) **Two column cash book with cash and discount columns:**

The method of maintaining this cash book is almost like simple cash book. However on the debit side as well as on credit side a discount column is maintained. When payments are made, discount received on payments is shown in the discount column on the credit side. Similarly, when cash is received discount may be allowed to the customer which is recorded in the discount column on the debit side.

C) <u>**Two column cash book with bank and discount columns:**</u>

Larger corporations and big firms usually make all payments through cheques and receipts are also through cheques. Such companies and firms maintain a cash book with bank and discount columns only. All cheques issued are shown on payments side, all cheques received and deposited in bank are shown on the receipts side. Discount allowed and received columns are also maintained on the receipts side and payments side respectively.

Postings from the cash book are made into the ledger as and when transactions take place.

D) **Three columnar cash book:**

This type of cash book is of maximum utility because it minimizes work relating to accounts and presents a summarized picture of the liquidity position of a business.

On both side of the cash book. Separate columns are opened for discount, cash and bank. All deposits—both cash and cheques are show on the debit side in the bank column. Discount received on both cash and a cheque issued is shown on credit side.

CASH BOOK (Single Column)

Date	Particulars	R.N	L.N	Amount	Date	Particulars	V.N	L.F	Amount

DOUBLE COLUMN

Date	Particulars	R.N	L.F	Discount allowed	cash	Date	particulars	V.N	L.F

Discount Received	Cash

THREE COLUMN

Date	Particulars	R.N	L.F	Discount Allowed	Cash Rs	Bank Rs	Date	Particulars

V.N	L.N	Discount Received	Cash Rs	Bank Rs

Note: R.N =Receipt No

V.N =Voucher No

L.F =Ledger No

TRIAL BALANCE

Definition:

According to **M. S. GOSAV** (the substance of accountancy) " Trial balance is a statement containing the balances of all ledger accounts, as the any given date, arranged in the form of debit and credit columns placed side by side and prepared with the object of checking the arithmetical accuracy of ledger postings."

Methods of preparation of Trial Balance:

The following are the methods of preparing the trial balance:

1. **Total Method:** Under this method, the total of debit and credit of all accounts are shown in the trial balance respectively in the debit and credit side of the trial balance. The trial balance prepared under this method is known as **gross trial balance.**
2. **Balance Method:** Under this method, only balance of cash account of ledger is recorded in trial balance. Some accounts may have debit balance and the others may have credit balance. All these debit and credit balance are recorded in it. This method is widely used.

Total Method

S.No	Name of Account	L.F	Debit Total Amount (Rs)	Credit Total Amount(Rs)

BALANCE METHOD

S.NO	Name of Account	L.F	Debit Balance (Rs)	Credit Balance (Rs)

UNIT- II

FINAL ACCOUNTS

Meaning:

The primary function of accounting is to accumulate accounting data in a manner that the amount of profit made or loss suffered during a period can be determined. The manner in which the amount of profit or loss has been arrived at is disclosed in the statement of accounts, prepared at the end of the accounting year. The various items of income and expenditure which arose during the accounting period are detailed out therein, grouped under significant heads. These two statements i.e., trading and profit and loss account and balance sheet are prepared to give the final results of the business. That is why both are collectively called final accounts.

Thus, preparation of final accounts is the last step in the

accounting cycle. In fact, final accounts include a number of accounts such as **(i) Trading account (ii) profit and loss account and (iii) balance sheet.** Though balance sheet is a statement, for all practical purposes, it is treated as one of the final accounts.

Work-in- progress:(partly finished stock)

In a manufacturing business concern, there are always some unfinished goods, the cost of closing work-in-progress is credited in the account, shown in the balance sheet and debited to the manufacturing account of the next year as an opening balance.

TRADING ACCOUNT

'Dr' Trading account for the year ended--------- 'Cr'

Date	Particulars	Rs	Rs	Date	Particulars	Rs	Rs
	To open stock		xxx		By sales	xxx	
	To purchases	xxx			Less: sales returns	xxx	xxx
	Less: purchase return	xxx	xxx		By closing stock		xxx
					By Gross loss c/d		xxx
	To direct expenses:						
	Carriage inwards		xxx				
	Wages		xxx				
	Freight		xxx				
	Import duty		xxx				
	Gas fuel		xxx				
	Royalty on production		xxx				
	Factory expenses etc		xxx				
	To Gross profit c/d(transferred to profit and loss a/c)		xxx				xxx
			xxx				

BALANCE SHEET

Balance sheet of------ as on-------

Liabilities	Rs	Rs	Assets	Rs
Capital	xxx		Fixed assets:	
Add: Net profit	xxx		Good will	xxx
Add: Interest on capital	xxx		Land & buildings	xxx
Less: Drawings	xxx		Loose tools	xxx
Less: Interest on drawing	xxx		Furniture & fixtures	xxx
Less: Loss if any	xxx	xxx	Vehicles	xxx
Long term liabilities:			Patents	xxx
Loan on mortgage		xxx	Trade marks	xxx
Bank loan		xxx	Long term loans (advances)	xxx
Current liabilities:			Investments:	
Sundry creditors		xxx	Current assets:	
Bills payable		xxx	Closing stock	xxx
Bank overdraft		xxx	Sundry debtors	xxx
Creditors for outstanding expenses		xxx	Bills receivable	xxx
			Prepaid expenses	xxx
Income received in advance		xxx	Accrued income	xxx
			Cash at bank	xxx
			Cash in hand	xxx
			Fictitious assets:	
			Preliminary expenses	xxx
			Advertising expenses	xxx
			Underwriting commission	xxx
			Discount on issue on share	xxx
			Discount on issue of debentures	xxx
		xxx		xxx

ADJUSTMENTS

- **Closing stock:**

The value of closing stock will on the assets side of balance sheet and on the credit side of the trading account.

Closing stock a/c Dr xxx

To trading a/c Cr xxx

- **Outstanding expenses:**

Expenses outstanding are added to the respective expenses accounts in trading or profit & loss a/c and also shown on the liabilities side of the balance sheet.

Expenses a/c Dr xxx

To expenses outstanding a/c Cr xxx

- **Prepaid expenses:**

Prepaid expenses account is shown on the assets side of balance sheet and is shown as a deduction from the respective expenses account in trading and profit & loss a/c.

Prepaid expenses a/c Dr xxx

To expenses a/c Cr xxx

- **Accrued income:**

Accrued income is shown on the assets side of balance sheet and it is added to the respective income account in profit & loss a/c credit side.

Accrued income a/c Dr xxx

To income a/c Cr xxx

- **Income received in advance:**

Income received in advance is shown on the as deduction from the respective income in profit & loss a/c and is shown on the liabilities side of balance sheet.

Income a/c Dr xxx

To income received in advance a/c Cr xxx

- **Deprecation of assets:**

Deprecation is shown on the debit side of profit & loss a/c and its

deducted from the asset in the balance sheet.

Deprecation a/c Dr xxx
To asset a/c Cr xxx

- **Interest on capital:**

Interest on capital is shown on the debit side of profit & loss account and it is added to the capital on the liabilities side of balance sheet.

Interest on capital a/c Dr xxx
To capital a/c Cr xxx

- **Interest on drawings:**

Interest on drawings is shown on the credit side of profit & loss account and it is deducted to the capital account on the liabilities side of balance sheet.

Capital a/c Dr xxx
To interest on drawing a/c Cr xxx

- **Bad debts;**

Bad debts is shown on the debit side of profit & loss a/c and also deducted from debtors in the balance sheet.

Provision for doubtful debts a/c Dr xxx
To bad debts a/c Cr xxx

- **Provision for bad and doubtful debts:**

This provision is shown as a deduction from existing debtors on the assets side of balance sheet.

Provision for doubtful debts a/c Dr xxx
To profit and loss a/c Cr xxx

- **Provision for discount on debtors:**

The provision for discount on debtors is shown as a deduction from good debtors on the assets side of balance sheet and is debited to profit & loss a/c.

Profit & loss a/c Dr xxx
To provision for discount on debtors a/c Cr xxx

- **Provision for discount on creditors:**

The provision for discount on creditors is shown as a deducted from sundry creditors on the liabilities side of balance sheet

and is credited to profit & loss a/c.

Profit and loss a/c (debit side)

	Rs	Rs
Bad debts (as per trial balance)	xxx	
Add: Bad debts (as per adjustments)	xxx	
Add: New provision required	xxx	
Less: existing provision (given in trial balance)	xxx	
Net debit to profit & loss a/c	xxx	
		xxx