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BBA.HMTCT-IV-SEM

Hotel Accounts

Profit to a business is like food to human body (W.C.F. Hartley). So every business entity's main aim is to earn a maximum amount of profit from the business. For achieving this aim every business entity enters into various types of business transactions with many persons and entities. For example,

- 1. A restaurant purchases groceries , fish, milk etc by paying in cash.**
- 2. It prepares various dishes out of the items purchased by it.**
- 3. It pays wages or salary to cook and stewards.**
- 4. It serves the dishes to customer who pays for it.**

All the above activities are transactions of the restaurant with the object of making profit.

Most of these transactions involve money and hence are called monetary or economic transactions. For example in the aforesaid case , transaction 2 is not a monetary transaction as it does not involve money , whereas all the other transactions are monetary transactions. To find out how much profit has been earned from the business for a particular period all these monetary transactions are to be recorded systematically in the books of accounts. Similarly to know what amount is due from or due to any person or entity as on a particular date can also be found only if these transactions are recorded systematically. So, book-keeping was introduced to have permanent and systematic record of business transactions that would help a businessman to know easily his business transactions, and the profit and financial position i.e. how much is due to him from others and how much he has to pay to others.

Hence, hospitality or hotel industry also being one of the profit seeking business needs to keep track of its economic transactions by book-keeping and accounting.

Objectives

After studying this unit, you will be able to understand:

- ◆ **Definition and Meaning of book keeping**
- ◆ **Functions of book keeping**
- ◆ **Meaning and definition of accounting**
- ◆ **Features of accounting**
- ◆ **Difference between book keeping and accounting**
- ◆ **Advantages and disadvantages of accounting**

- ❖ **Basic Accounting terms**
- ❖ **Basic accounting equation**
- ❖ **Double entry system of book keeping**
- ❖ **Classification of accounts**
- ❖ **Rules or principles of debit or credit**



1.2 Definition and Meaning of Book Keeping

Book-keeping is a part of accounting. So, its very important to have some knowledge about book keeping, before we find out what is accounting.

❖ Book-Keeping is an art of keeping accounts in a regular and systematic manner.❖ This means that business entity has to record each and every transaction or event in such a way that exact picture can be emerge whenever needed.

According to Northcot ❖ Book Keeping is the art of recording in the books of accounts the monetary aspect of commercial and financial transactions❖

According to A J Favell, ❖ Book Keeping is the recording of the financial transactions of a business in a methodical manner so that information on any point or in relation to them may be quickly obtained❖.

According to J R Batliboi  **Book Keeping may be defined as the science as well as the art of recording business transactions under appropriate accounts** 

From the above definitions, it is clear that book-keeping is the process of recording business transactions in proper books of accounts in a systematic manner.

1.2.1 Features of Book Keeping

1. It is concerned only with the recording of business transactions. For example, a restaurant owner will not record his personal or household transactions in his books of account.

2. It is concerned with the recording of only monetary or financial or economic aspects of business transactions. For example, a restaurant cannot record transaction No 2 in its books of account mentioned in page 2 as it is not a monetary transaction.

3. It is the recording of business transactions in terms of money. Thus transactions which cannot be expressed in terms of money cannot be recorded in books of account. For example, additional hours of work voluntarily provided

by an employee of your restaurant cannot be recorded in the books of account as you are not going to pay any wages for him for such additional hours, though such additional hours of service might give you extra profit.

4. It is recording of business transactions in a systematic manner usually on daily basis.

5. It is recording of business transactions with the purpose of finding out financial position and profit or loss of the business.

6. Scope of book keeping is narrower than accounting, because it is concerned only with the recording of transactions.

Self Assessment Questions

- 1. Define Book Keeping.**
- 2. Give any two features of book keeping.**

1.3 Definition and Meaning of Accounting

American Institute of Certified Public Accountants (AICPA) has defined accounting as
◆the art of recording, classifying and summarizing, in a significant manner and in terms of money, transaction and events which are in part at least, of financial character, and interpreting the results thereof◆.

Hence accounting includes book-keeping i.e. recording of transactions and many more processes regarding which we shall study later.

According to American Accounting Association (AAA), Accounting is the process of identifying, measuring and communicating economic information to permit informed judgments and decisions by users of the information.

This definition also identifies some processes undertaken in accounting. But it goes one step further in stating that information obtained through accounting is required for decision-making by users of that information. For example, a hotel might be recording all its monetary transactions systematically. What is the use of such book-keeping unless the owners do not know how much they spend every week or month on various categories of expenses like food and beverage, housekeeping? They would not be able to take any decisions without the knowledge of such information which is churned out only through accounting.

Thus, these two definitions give complete meaning of the term accounting.

So, accounting is identifying, measuring, recording, classifying, summarizing business transactions, analyzing the results thereof, and communicating the results of the interpretations to the end-users for decision-making.

Let us find out some of the processes which are undertaken in accounting

1.3.1 Functions of Accounting

i. Identifying

Identifying business transactions to be recorded in the books of account is an essential aspect of accounting. Identifying means determining whether a transaction is a business or financial transaction that is to be recorded in the books of account. For example, if a hotel provides laundry service to a guest at the hotel it has to identify this transaction is one which is to be recorded in the books of account as the guest has to make payment for the laundry service when he is checking out.

ii. Measuring

Measuring means expressing the value of business transactions in terms of money. Continuing the aforesaid example the hotel must arrive at the amount that is to be recorded in the books of account before it actually records the transaction.

iii. Recording

We have studied that recording transaction is also called as book-keeping. Recording the business transactions as and when they occur is done in the original book of entry called journal. Recording of transactions is done through journal entries. Such recording should be systematic and regular and based on certain rules regarding which we shall study later.

iv. Classifying

Classifying refers to the grouping of transactions of similar nature together. For example, from your records of a restaurant maintained on daily basis, you can pick out transactions pertaining to salary paid to your employees, egg purchases or soft drink sales for a particular period, say, a month. Instead of picking out such items as and when you like, you can regularly classify them while recording the transactions. This helps you to get more meaningful information from your transactions. The classification is done in an accounting book called ledger regarding which we shall study later.

v. Summarizing

Summarizing means summarizing the effect of the business transactions classified. For example, it is not enough if you know how much salary you paid in a month or how much fish purchases you made in a year. What you require, as has been stated earlier is the information as to whether you made a profit or

loss and whether what you have on particular day is more or less than what you owe to others. Summarizing function of accounting achieves this by providing financial statements like Profit and Loss Account and Balance Sheet more about which we shall study later.

vi. Analysis and interpretation

Analysis and interpretation means rearrangement of the information found in the financial statements in a suitable manner, and drawing meaningful conclusions about the profit, the financial position and the future prospects of the business. For example, even after you have come to know what is your profit, you might require information like how much profit you made before paying interest on loans you have taken or taxes you have paid. To find these types of information analysis of financial statements is necessary.

vii. Communicating

Communicating means communicating the end results of interpretation of financial statements to the internal and external end-users for decision making.

Thus accounting is process of identifying, measuring, recording financial transactions, classifying, summarizing and analysis and interpretation of result and communicating results to end users.

1.3.2 Accounting Cycle

The functions of accounting mentioned above are to be undertaken in a

sequentially manner so that correct information is obtained. Such sequence of functions and procedures of accounting is called as Accounting Cycle.

Thus accounting cycle is a sequence of procedures used to record, classify and summarize accounting information in financial reports, on a regular basis.

Steps in accounting cycle

- 1. Analyze the business transactions.**
- 2. Record transactions in a book called journal by means of journal entries.**
- 3. Post these journal entries to various ledger accounts so that proper classification is made.**
- 4. Prepare a statement called trial balance for the purpose of summarizing and also to find out whether the entries made by you are correct.**
- 5. Make adjusting entries to rectify, add or delete any transactions, if necessary.**

6. **Prepare an adjusted trial balance after such adjustments.**

7. **Prepare financial statements to get the summary of your transactions.**



entries.

balance.

Accounting cycle as shown in Fig. 1.1

Figure 1.1: Accounting cycle

1.3.3 Advantages of accounting

- 1. When a business entity keeps accounting records of its business transactions, it has permanent records of its transactions for present and future reference.**
- 2. A business entity can ascertain easily and correctly its profit or loss for any year or period from the complete records of business transactions.**
- 3. Accounting helps to ascertain the financial position of the business.**
- 4. Accounting records enable a business concern to keep a good control over various activities and properties of a business.**
- 5. Accounting records enable a business concern to detect errors or frauds that have taken place in its business and take steps to prevent their recurrence in future.**

1.3.4 Limitations of accounting

Accounting has several advantages, but it has limitations also like

- 1. In accounting, non monetary transactions are not recorded. Only monetary**

transactions are recorded in the books of accounts. So it gives incomplete information to end users. For example, in your hotel if your main and reputed

Continental Cook resigns, the transaction that is recorded in the account books is only as to amount paid to him by way of settlement of his dues. The impact of his resignation on the business of your hotel is not at all found out through accounting records.

2. Accounting records do not give exact information. This happens due to estimated information used in accounting like depreciation, provisions.

3. Accounting methods are static in nature and not flexible. For example, though the market value of your hotel building goes up you cannot record the same in your books of account because of rules and principles to be followed in accounting.

4. Accounting records are subjective and not objective because accounts are influenced by the personal judgments of an accountant. For example, an accountant might call the amount paid to your cook as Salary another might term it as Wages; still another might call it Remuneration. However such subjectiveness is being reduced through Accounting Standards.

1.3.5 Branches of accounting

There are three main branches of accounting. They are:

◆ Financial accounting

◆ Management accounting



Cost accounting

Financial accounting consists of the recording, classification and analysis of the transactions of a business in a systematic manner so as to the present at periodic intervals, a statement of profit or loss of the business and state of its affairs on a specified date.

Management accounting is the accounting which provides necessary information to the management for taking managerial decision, the information being provided through financial accounting and cost accounting records and books of accounts.

Cost accounting is the branch of accounting dealing with the recording, classification, allocation, and reporting of current and prospective costs of products and services of a business. The chief purpose of cost accounting is to help control operations. For example, in your hotel, you might wish to find out what is the cost of per unit of an item in your Menu. This information might not be available in Financial Accounting records as these records contain total

purchases made by you. Hence you might have to maintain cost records to find out these kinds of information.

Self Assessment Questions

- 3. Define accounting.**
- 4. Give any two advantages of accounting**
- 5. State any two disadvantages of accounting**
- 6. What are the steps in accounting cycle?**

1.4 Accounting versus Book Keeping

There is a difference between book keeping and accounting, though many think they are identical terms. Such differences are:

- 1. Book Keeping is just the process of recording and classifying transactions. On the other hand, Accounting also includes summarizing and interpreting, which is beyond the scope of book keeping.**
- 2. Book-keeping is the first stage of maintenance of books of account, where as accounting is the second stage of maintenance of books of account.**

3. A book keeper records and classifies transactions, usually a routine, clerical task, whereas an accountant supervises the work of the book keeper, summarizes the accounting data and interprets the financial statements.

4. Book Keeper does not prepare financial statements like the profit and loss account and balance sheet. But accountant mainly prepares the financial statements.

Thus, the responsibility of an accountant is much greater than those on the book keeper, and the required training is also more extensive.

Self Assessment Question

7. Give any two differences between Book Keeping and Accounting

1.5 Basic Accounting Terms

1. Business Transactions

According to Fieldhouse, Every financial change which occurs in your business is a transaction. From this definition, it is clear that, in accounting, the term Business transaction refers to any activity dealing with or an event which has value measurable in terms of money and which involves exchange of money or money's worth between the business and any other person.

Examples of business transactions:

1. **Capital introduced into the business by the proprietor of hotel**
2. **Purchase of furniture for cash your hotel**
3. **Sale of restaurant building**
4. **Purchase of goods like groceries**
5. **Sales of goods and services like room sales**
6. **Borrowing loan from bank**
7. **Cash paid into bank**
8. **Granting loan**
9. **Amount withdrawn form the business for domestic use by the proprietor.**
10. **Wages paid to workers Etc.**

Types of Business Transactions

Business transactions are classified into four types. They are

- a. **Cash Transactions**
 - b. **Credit Transactions**
 - c. **Barter Transaction**
 - d. **Non cash transaction**
-
- a. **Cash Transactions**

A cash transaction means any business transaction where the value of the transaction is received or paid in cash immediately or readily. In this case there is no postponement of payment or receipts of cash.

Examples:

1. **Purchase of kitchen equipments for cash.**
2. **Food Sale in a restaurant for cash.**
3. **Purchase of Ice creams for cash.**

4. **Bar Sales for cash.**

5. **Receipts of any income in cash or by cheque.**

6. **Payment of any expense in cash or by cheque Etc.**

b. Credit Transactions

A credit transaction refers to any business transaction where the value of the transaction is not received or not paid immediately, but its settlement is postponed to future date.

Examples:

1. **Purchase of an Furniture for your restaurant on credit or on account**
2. **Sale of an asset on credit or on account**
3. **Purchase of provision on credit**
4. **Room Sales on credit**
5. **Any outstanding expenses(for example, wages to cooks yet to be paid)**
6. **Any out standing incomes(for example, car rentals yet to be paid by a guest)**
7. **Interest on loan due to the lender. Etc.**

c. Barter transactions

A barter transaction is a business transaction where, there is an exchange of receiving of some benefit and giving of some benefit, but the exchanged benefit is not in terms of money or in terms money's worth.

Examples:

- 1. Sale of typewriter in exchange of purchase of computer.**
- 2. Giving goods for furniture purchase.**

d. Paper transaction or non cash transaction:

Paper transaction is a business transaction where there is no need of payment or receipt of the value of transaction. Here there is no receipt or payment of cash either immediately or at future date.

Examples:

1 Depreciation charged on fixed asset

2 Bad debt written off

3 Discount allowed to customer

4 Discount earned from customer

5 Loss of goods by fire Etc.

2. Assets

It means enough or sufficient things of value owned by a concern for carrying business. In other words assets are properties and possessions owned by business, the benefit of which occurs in future period also.

Assets may be classified into different types. They are:

a. Tangible Assets: Tangible assets are those that are visible i.e. physical or real properties or things like land, building, furniture, kitchen equipments, motor vehicle, stock, cash etc. owned by the business.

b. Intangible Assets: Intangible assets are those that are invisible and exist by means of rights in certain things or certain rights having money value such as goodwill, patent right, trade marks etc possessed by the business.

c. Debt or amount due to a business from others such as sundry debtors like amount due by guests in a hotel, bills receivable etc.

Assets also can be classified as current assets and non current assets or fixed assets

Current assets : Current assets are those that are expected to be converted into cash within a year, such as

i) Inventory or Stock

- ii) **Cash**
- iii) **Bank balance**
- iv) **Bills receivable**
- v) **Sundry debtors**
- vi) **Prepaid expenses**
- vii) **Out standing incomes etc.**

Non-current assets or fixed assets: Fixed assets are those that are expected to have life of greater than one year. Such as

- i) **Furniture**
- ii) **Land**
- iii) **Building**
- iv) **Plant**
- v) **Machinery**

vi) **Hotel equipment**

vii) **Utensils**

viii) **Linen**

ix) **China and cutlery**

x) **Motor vehicle etc**

3. Liabilities

In general Liabilities are the obligations of the business. In other words Liabilities means claims of others against a business which bind the business to others. Example: loan, bank over draft, creditors bills payment etc.

Liabilities also classified into two types. They are

Current liabilities: Current liabilities are those that are expected to be paid off within a year. Such as

i) **Bank overdraft**

ii) **Sundry creditor like amount due to your supplier**

iii) **Bills payable**

iv) **Out standing expenses like amount due to your cook**

v) **Incomes received in advance etc. advance received by your guest**

Fixed liabilities / Long term liabilities: Fixed liabilities are obligations at the balance sheet date that are expected to be paid off beyond next one year. Such as

i) **Long term loan borrowed**

ii) **Debentures**

iii) **Bonds payable etc**

4. Owner's Capital/Equity

Owner's capital is the amount invested in the business by the proprietor at any time. In other words money or money's worth such as cash, stock of goods, furniture machinery etc, invested by the proprietor in the business at the time of commencement of business or any time later

Capital is also called as owner's equity, i.e. owner's claim against the assets of the business. Capital can also be defined as the excess of total assets over total liabilities

5. Drawings

It refers to cash, goods or any other things withdrawn by the proprietor or trader from his business for his personal or domestic uses or personal purpose.

6. Debtor

Debtor is a person who owes money to the business. In other words he is a person who has received benefit from the business.

Debtor may be sundry debtor or trade debtor, a loan debtor, a debtor for an asset sold on credit or a debtor for the service rendered on credit.

a) **Trade debtor is a person who owes money to the business for the good sold to him on credit.**

b) **Loan debtor is a person who owes money to the business for the loan advanced to him.**

c) **Debtor for asset sold is a person who owes money to the business for any asset, say sale of furniture on credit to him.**

d) **Debtor for service rendered is a person who owes money to the business for the service rendered to him on credit like a guest in a hotel.**

7. Debt

The amount due from debtor to the business is called \diamond Debt \diamond .

8. Book Debt

Its is a debt as per books of account. 9. Good Debt

Good debt refers to fully recoverable debt. 10. Bad Debt

Bad debt is irrecoverable (not recoverable) debt. 11. Doubtful Debt

Recovery is doubtful. The debtor may pay or may not, it is doubtful. 12. Creditors

Creditor is a person to whom the business owes money. Creditor may be

a. **Trade creditor: A trade creditor is a person to whom the business owes money for goods purchased from him on credit.**

b. **Loan creditor: A Loan creditor is a person to whom the business owes money for the loan taken from him.**

c. **Creditor for asset purchased: Creditor for asset purchased is a person to whom the business owes money for any asset purchased from him on credit.**

d. **Expense creditor: Expense creditor is a person to whom the business owes money for any service received from him on credit.**

13. Solvent

A businessman is said to be solvent when he is able to pay his liabilities in full.

14. Insolvent

A businessman is said to be insolvent when he is not able to pay his liabilities in full.

15. Goods

It refers to commodities, products, articles or things in which trader deals. In other words, it refers to commodities or things meant for sale. For example, for the stationery merchant, stationery articles like paper, books, pencils, pens etc. are his goods, for jeweler gold or silver ornaments are his goods, for hotelier provisions, vegetables, etc which are used for preparing food are his goods.

In the context of goods, it should be noted that, if a single account called goods account is used to record all the transactions relating to goods, it will not serve any purpose in providing useful information. So goods account is divided into six categories viz. purchases, sales, purchase returns, sales return, opening stock and closing stock.

- a. **Purchases: Goods purchased by a business are called purchases.**

- b. **Sales: Goods sold by business are called sales**

- c. **Sales Return: Goods returned by customer or purchaser are called sales return. Sales return is also called as return inwards or returns from customer.**

- d. **Purchase Return: Goods returned by business to supplier or seller are called purchase return. Purchase return is also called as return outwards or return to supplier**

- e. **Opening Stock : Unsold goods lying in the business at the beginning of the year are called opening stock.**

- f. **Closing Stock: Unsold goods lying in the business at the end of year are called closing stock.**

16. Income

It refers to earnings of a business from the sale of goods or rendering services to customer. For example, sale proceeds of goods, receipts for services rendered and earnings from interest, dividend, rent, discount, commission etc.

17. Expenses

Expenses are the costs incurred in connection with the earnings of revenue. In other words an expense refers to an expenditure in return for which some benefit is or is to be received. For example, cost of goods sold, salaries paid, printing and stationery, postage and telegram, rent, interest, commission etc.

18. Loss

It refers to money or money's worth given up without getting any benefit in return. Usually excess of expenses over income is loss. Some times, by selling assets below its cost or book value also loss occurs

19. Gain

Gain is revenue which is not generated through routine or regular business activities. Usually it is excess of income over expenses. Some times, by selling assets above its cost or book value also gain occurs.

20. Debit (Dr)

The term **debit is derived form the Latin word **debere** which means**

what is due or to owe. So, the term debit means the amount owed by or due from an account for the benefit received by that account. In accounting, the term debit means entering the transactions on the debit side or left hand side of an account more regarding which we shall study later.

21. Credit (Cr)

The term credit is derived from the Latin word credere which means trust or belief. So the term credit means the amount owed to an account for the benefit given by that account in belief that its value will be returned at a later date. In accounting, the term credit means entering the transactions on the credit side or right hand side of an account more regarding which we shall study later.

22. Account (A/c or a/c)

It is a summarized or classified record of all the transactions relating to particular person thing or a service. In other words it is a summary statement of all the transactions relating to a particular a person, an income or an expense, an asset or a liability, which have taken place during a given period of time, showing their net effect.

23. Journal

A Journal is a daily record of business transactions. It is a book of prime or first entry in which all types of transactions of business are first entered in specified manner chronologically.

24. Ledger

A group of accounts is defined as a ledger. A ledger is a books of account, in which all the accounts are maintained. It contains all the accounts of a business in well arranged form. The ledger is the group of all accounts that include accounts for assets, liabilities, owner's equity, revenue, expenses and owner's drawings.

25. Entry

It is the record of a transaction made in any book of an account, either in the journal or in the subsidiary book or in the ledger.

26. Journalizing

Passing a journal entry or making an entry in the journal book is called journalizing.

27. Narration

It is a brief description or explanation to a journal entry, given below the journal entry, within brackets. Narration becomes necessary as the accountant should be able to recall and explain to others the details or context in which particular transaction was recorded.

28. Posting

It is the process of transferring an entry from journal to ledger is called as posting. In other words, process of entering in the ledger the information, which is already recorded in the journal. Through posting classification of transactions is possible.

29. Voucher

A voucher is a business's written authorization to make a cash payment. In other words, voucher refers to any written document in support of a business transaction. It is an evidence or proof that a particular transaction has taken place or of the value stated therein.

30. Receipt

A receipt is a written acknowledgement of the receipt of money or the acceptance of the delivery of goods given by the receiver.

31. Folio

The page of a journal or a ledger is called as Folio.

32. Carried forward

The term carried forward (c/f) is used at the footer of a page to indicate that the total amount at the end of that page has been carried forward to the top of the next page. More regarding this we shall study later.

33. Brought forward

The Brought forward (b/f) is used at the top of page to indicate that the total amount at the top of page has been brought forward from the footer of previous page. More regarding this we shall study later.

34. Balance

It is the difference between total of debits and credits in an account made in specific period. More regarding this we shall study later.

35. Carried down

The term carried down (c/d) is written in a ledger account at the time of extracting its balance to indicate that balance in that account has been carried down to the next period. More regarding this we shall study later.

36. Brought down

The term brought down (b/d) is written in a ledger account at the time of opening such account in the beginning of next period to indicate the balance in that account has been brought down from the previous period.

Self Assessment Questions

8. What is business transaction?

9. What is liability?

10. What is debt?

11. Give any two examples for credit transactions.

12. Classify the following assets into current assets and fixed assets:

Cash, furniture, Building, Debtor, Stock and Equipment

1.6 Basic Accounting Equations

A business entity requires assets (resources) for carrying the business. The assets are acquired through the finance or funds provided by two sources, viz., proprietor (proprietors' capital) and outsiders i.e. creditors (i.e. liabilities).

Thus, in accounting there is always equality between the resources and the sources of fund or finance. This equality of assets and liabilities (including owner's capital) is called Accounting Equation. In short accounting equation is:

is:

Resource of the business = Sources of finance for the business

OR

Assets = Owners' capital + Liabilities

The above accounting equation signifies that total assets of business concern are always equal to the total liabilities i.e. owners' capital and outsiders' liabilities.

The accounting equation is also called as balance sheet equation, because the accounting equation indicates the equality between the balance sheet items i.e. assets and liabilities (capital and other liabilities) more regarding which we shall study later.

The accounting equation $\text{Assets} = \text{Liabilities} + \text{Capital}$, can also be expressed in in two other ways.

1) **Assets** \diamond **Liabilities** = **Capital**

2) **Assets** \diamond **Capital** = **Liabilities**

The equation can be expressed in the form of a statement called **Balance Sheet** as follows

Liabilities(Source of funds)	Rs.	Assets (Resources of business)	Rs.
Capital	XXX	Fixed Assets	XXX
Outsider liabilities	XXX	Current Assets	XXX
Total	XXX	Total	XXX

Note that the two totals must be always equal because of Accounting Equation.

Before discussing effects of business transaction on accounting equation, let us define assets, liabilities, and owner's equity:

Assets, simply stated, are anything of value owned by a business. They include both current assets and fixed assets such as:

1. **Cash**

2. **Inventory or stock**

i. Food inventory

ii. Beverage inventory

3. **Sundry Debtor**

4. **Bills receivable**

5. **Bank balance**

6. **Investment**

7. **Equipement**

8. **Machinery**

9. **Utensil**

10. **Linen**
11. **China and Cutlery**
12. **Building**
13. **Land and so forth**

Liabilities are obligations of a business to pay money or other assets, or to render services, to an outsider. They include both current liabilities and fixed liabilities such as

1. **Sundry creditors**
2. **Bills payable**
3. **Bank overdraft**
4. **Out standing expenses**
5. **Loan borrowed and so forth**

Owner's Equity or capital is the money introduced by the owner of the business in his business. It is also expressed as the excess of assets over liabilities. Net result of transactions for a specific period result in either profit or loss which

belongs to owner of the business. Thus profit increases owner's equity whereas loss decreases it. Similarly money withdrawn by proprietor for his

personal use decreases it whereas owner introduces additional money into business capital increases.

1.6.1 Effects of financial transaction on Accounting Equation

Each financial transaction affects at least one of the elements of the accounting equation. A business transaction results in a change in all or any of the components of the equation. Therefore, the different business transactions may result into following affects on the accounting equation.

- 1. Increase in one asset might result in a Decrease in another asset**
- 2. Increase in one liability might result in a Decrease in another liability**
- 3. Increase in one item of owner's equity might result in a Decrease in another item of owner's equity**
- 4. Increase in one item of owner's equity might result in a Decrease in liability**
- 5. Increase in a liability might result in a decrease in owner's equity**
- 6. Increase in asset might result in an increase liability**
- 7. Increase in asset might result in increase in proprietors equity**
- 8. Decrease in assets might result in decrease liability**
- 9. Decrease in asset might result in decrease in proprietors equity**

It's important to understand affects of business transactions on the accounting equation by considering few examples:

Suppose, the business receives Rs.50,000 from the owner as capital. In this case, on the one hand, the assets of the business increase by Rs.50,000 on account of receipts of cash(an asset) and on the other hand, the capital of the owner increases by Rs.50,000. If these two effects of this transaction are put in the form of an equation, the equation will be

Assets = Liabilities + Capital

Cash = Liabilities + Capital

Rs. 50,000 = 0 + Rs.50,000

Now, let us assume the business borrows Rs.10,000 from some lender. In this case, the assets of the business increase by Rs.10,000 and become Rs60000 on account of the receipt of cash, and the liabilities of the business also increases by Rs.10,000 because of the borrowing of loan while capital remains at

Rs.50,000. If the dual effect of this transaction is recorded, the accounting equation on the business will be:

Asset = Liabilities + Capital

Cash = Loan + Capital

50,000+10,000 = 10,000 + 50,000

Thus every transaction ultimately effects the Accounting Equation.

Steps to be followed for the development of accounting equation

- 1. First, ascertain the items, i.e. capital, assets or liabilities, involved in the transaction.**
- 2. Secondly, find out the effect of the transaction that means increase or decrease, in the capital, assets or liabilities, involved in the transaction.**
- 3. Thirdly, state the final position of capital, assets or liabilities, after taking into account the effect of the transaction on the capital, assets, liabilities, in the form of accounting equation.**

Illustration 1

Show the effect of accounting equation on the following transactions and present the balance sheet of each accounting equation.

- 1. Ramesh commenced hotel business with Rs.1,00,000**
- 2. Purchased goods on credit Rs.5,000**
- 3. Paid salaries cook and stewards Rs.5,000**
- 4. Purchased furniture for cash Rs.4,000**

Solution:

1. In this transaction, the asset i.e. cash increases by Rs.1,00,000; the capital increase by Rs.1,00,000. So, the accounting equation will be:

Assets = Liabilities + Capital

Cash = Nil + Ramesh's capital

1,00,000 = 0 + 1,00,000

The effect of this transaction on balance sheet is:

Balances Sheet as on 

Liabilities	Rs.	Assets	Rs.
Capital	1,00,000	Cash	1,00,000
Total	1,00,000	Total	1,00,000

2. This transaction brings in stock of goods (an asset) worth Rs.5,000; increases the liabilities (creditors) by Rs.5,000; it does not result in any change in owner's capital. So, the final accounting equation will be.

Assets = Liabilities + Capital

Cash + Stock = Creditors + Ramesh's capital

1,00,000+5,000 = 5,000 + 1,00,000

The balance sheet after this transaction is looks as follows:

Balances Sheet as on 

3. This transaction reduces the cash by Rs.5,000 and does not result in any change in

liabilities; but reduces the owner's capital by Rs.5,000, because an expense, will reduce the profit, and thereby, will reduce the owner's capital. So, the final accounting equation is :

Assets = Liabilities + Capital

Cash + Stock = Creditors + Ramesh's capital

(1,00,000-5,000)+5,000 = 5,000 + (1,00,000 -5,000)

1,00,000 = 5000 + 95000

The balance sheet after this transaction is:

Balances Sheet as on ???

Liabilities	Rs.	Assets	Rs.
Creditors	5,000	Cash	95,000

Capital	95,000	Stock of Goods	5,000
Total	1,00,000	Total	1,00,000

4. This transaction decreases one asset i.e. cash by Rs. 4,000 and brings in another asset, viz., furniture worth Rs. 4,000; it does not result in any change in liabilities and capital. Therefore, ultimate equation will be:

Assets = Liabilities + Capital

Cash + Stock + Furniture = Creditors + Ramesh's capital

(95,000-4,000)+5,000+ 4,000 = 5,000 + 95,000

1,00,000 = 5000 + 95000

The balance sheet of this transaction is:

Balances Sheet as on

Liabilities	Rs.	Assets	Rs.
Creditors	5,000	Cash	91,000
Capital	95,000	Stock of Goods	5,000
		Furniture	4,000
Total	1,05,000	Total	1,05,000

Self Assessment Questions

13. **What is the basic accounting equation?**
14. **Find out capital, if liabilities Rs.2,00,000 and assets are Rs.3,50,000**
15. **Purchased Van for cash. This transaction _____ an asset _____ and
_____ an asset _____**

1.7 Double entry system of book keeping

1.7.1 Meaning of double entry system of accounting

The first function of accounting is recording the transactions and last function is to present the financial information in a manner, which helps to end users for taking financial decisions. The recording transactions in books of accounts follow a definite rule. Each and every transaction has two contracting parties. For each contracting party, a business transaction involves exchange of equal value or benefit. That means receiving of some benefit of some value and giving of some benefit of same value. For example purchase of furniture for cash. The

purchaser receives furniture of some value and gives cash of same value. The seller gives furniture of some value and receives cash of same value. So for each contracting parties, every business transaction has two aspects 1) receiving of some benefit called receiving aspect or debit and 2) giving of some other benefit called giving aspect or credit aspect.

In short every business transaction has two aspects \diamond debit and credit. The receiving and giving aspects or debit and credit aspects of a transaction concerning each of contracting parties affect two items or two accounts in two opposite directions or sides. The system of making two entries of equal value in two different accounts in opposite sides in the books of each contracting parties is known as double entry system of accounting.

1.7.2 Features of double entry system of accounting

- 1. The double entry system is based upon the generally accepted accounting concept i.e. the accounting equation concept or dual aspect concept.**
- 2. According to this system, each business transaction has two aspects, the debit aspect and the credit aspect.**
- 3. In every transaction, there are two accounts involved. One of the accounts receives the benefit of the transaction and is debited, and another account gives the benefit of the transaction and is credited.**
- 4. This system based upon dual aspect concept. According to this concept**

◆ for every debit, there is a credit◆. That is why each transaction is recorded

simultaneously on the debit side of one account and the credit side of another account.

5. Under this system, the total of debits to all the accounts must always be equal to the total of credits to all the accounts.

1.7.3 Advantages of double entry system of accounting

1. It provides full record of all the business transactions as it records both the aspects of each and every transaction.

2. It helps in preparation of financial statements.

3. It helps in calculation of profit or loss of the business.

4. It helps in preparation of trial balance which check accuracy of books of accounts.

5. It provides complete information about assets, liabilities and capital .

6. When books of accounts are maintained under double entry system, it becomes easy for a business concern to comply the rules provided by laws like the income tax and sales tax.

1.7.4 Disadvantages double entry system of accounting

- 1. Double entry system is difficult to understand.**

- 2. It is very costly, because it involves maintenance of a number of account books.**

- 3. This system requires strict adherence to the principles of accountancy. As such, a person without adequate knowledge of the principles of accountancy cannot maintain accounts under this system.**

Though such limitations exist, double entry system of accounting is based upon universally accepted accounting principles, and gives complete financial information of business transaction and hence is universally followed.

Self Assessment Questions

- 16. What is double entry system of accounting ?**

- 17. Give any two advantages of double entry system.**

1.8 Types of Accounts

We have studied that an Account is a summarized or classified record of all the transactions relating to particular person thing or a service. Before discussing the types of accounts let us understand why accounts are classified into different types. The reasons are as follows:

- ◆ The debit and credit aspect of transactions can be determined easily.**

- ◆ The rules of debit and credit can be understood easily.**

- ◆ The nature of balance of an account can be determined easily by the type to which the account belongs.**

- ◆ It helps the business to divide the ledger (book containing accounts) into different sub-ledgers and maintain different types of accounts in such different**

sub-ledger.

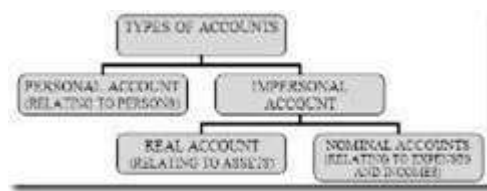
Classification of accounts into different types can be made in two ways:

- 1. Traditional approach**

 - 2. Modern approach or American approach or Equation approach**
-
- 1. Classification of accounts as per traditional approach**

Every business concern deals with different person, firm or companies. It may purchase goods from other party or it may lend money to other firm or it may sell goods to other party. Secondly, every business owns certain assets or properties such as building, furniture, machinery, motor vehicle etc. to carry their business. Thirdly, every business incurs expenses to get some benefit and earns income from giving benefit to others.

From the above discussion, it is clear that every business concern deals with three class or types of transactions, viz., transactions relating to persons, transactions relating to assets and transaction relating to expenses and incomes. So, concern must keep record of all three types of transactions.



various classes, as shown below in Fig. 1.2

Figure 1.2: Classification of Accounts into different types

1. Personal Accounts: Personal Accounts are accounts of persons with whom a business entity enters into business transactions. Personal Accounts may be relating to physical Personal accounts, artificial personal accounts and representative personal accounts.

a) **Physical personal accounts are accounts of natural persons or physical persons i.e. human beings.**

b) **Artificial personal accounts i.e. accounts of legal persons, such as accounts of partnership firm, companies, banks, government institutions, school and colleges etc.**

c) **Representative personal accounts are accounts of accrued expenses, outstanding incomes, prepaid incomes and income received in advance. These accounts are called representative personal accounts, as they represent certain persons behind them. For example: Prepaid rent account represents the account of the landlord to whom rent has been paid in advance.**

Examples:

Physical or natural personal accounts	Artificial personal account	Representative personal accounts
Ram's account (say cook of your hotel)	Canara trading company's A/c	Out standing wages A/c (assume payable to cook)
Shyam's account (assume a supplier to your restaurant)	Tata coffee etc A/c	Out standing salary A/c (assume payable to Manager of your hotel)
Anil's account (customer of your restaurant)	National hotel etc A/c	Prepaid rent
Ashok's account (a lender to your hotel)	National bank A/c	A/c (Assume payable to owner of your restaurant building)
Ramesh's account	Etc.	Commission received in advance A/c
Etc.		Etc.

2. Real Accounts: Real Accounts are accounts of assets or properties owned by

concern and through which the business is carried on. Assets accounts may be of all types of assets ♦ tangible or visible and intangible or invisible assets. For

example cash account, furniture account, hotel equipment account, utensils account, china and cutlery accounts, building account machinery accounts (all tangible and visible assets), goodwill account and patent right account (intangible or invisible accounts) etc.

3. Nominal Accounts: Nominal Accounts are accounts of expenses or losses which a business incurs and incomes and gains which a business earns in the course of business. For example, salary paid account, commission received account, rent paid account etc.

Illustration 2

Classify the following accounts into personal accounts, real accounts and nominal accounts as per traditional approach and state the reasons for such classification also.

1. **Furniture Account**
2. **Salaries Account**
3. **outstanding Wages Account**
4. **National Trading Co Ltd. Account**
5. **Stationery Account**
6. **Prepaid Insurance Account**
7. **Capital Account**
8. **Interest Paid Account**
9. **Buildings Account**
10. **Purchases Account**

11. **Cash Account**

12. **Bank Account**
13. **Sales Account**
14. **Commission Received in Advance Account**
15. **Discount allowed Account**
16. **Drawings Account**
17. **Loan Account**
18. **Mysore Store's Account**
19. **Repairs to machinery**
20. **Stock account**

Solution 2

S.No.	Name of the account	Type of account	Reason
1.	Furniture Account	Real Account	Account of an asset.

2.	Salaries Account	Nominal Account	Account of an expense.
3.	Outstanding Wages Account	Personal Account	Account representing the persons. i.e., the workers, to whom wages are to be paid.
4.	National Trading Co Ltd. Account	Personal Account	Account of company, i.e., Account of an artificial person.
5.	Stationery Account	Nominal Account	Account of an expense.
6.	Prepaid Insurance Account	Representative personal account	Account representing the person. i.e., the insurance. company to which insurance has been paid in advance.
7.	Capital Account	Personal Account	Proprietor's account i.e., account of a person.

8.	Interest Paid Account	Nominal Account	Account of an expenses
9.	Buildings Account	Real Account.	Account of an asset.
10.	Purchases Account	Real Account or Nominal account	Account of goods. i.e.. account of an asset. Purchase can be treated as expense and hence nominal a/c
11.	Cash Account	Real Account	Account of an asset.
12.	Bank Account	Personal or Real Account	Account of a bank, i.e. account of a person. Also account of an asset ie. bank balance
13.	Sales Account	Real Account/ Nominal account	Account of goods, i.e. account of an asset. Sales can be treated as income and hence nominal a/c
14.	Commission Received in Advance Account	Personal Account	Account representing the persons from whom commission has been received in advance.
15.	Discount allowed Account	Nominal Account	Account of an expense.
16.	Drawings Account	Personal Account	Drawings are amounts withdrawn by proprietor for his personal use out of business funds Account of the proprietor. i.e.. the account of a person.

17.	Loan Account	Personal Account.	Account of a person from whom loan has been borrowed or to whom loan has been
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			granted.
18.	National hotel Ltd. Account	Personal Account	Account of a concern. i.e. account of an artificial person.
19.	Repairs to machinery	Nominal account	Account of an expense.
20.	Stock account	Real account	Account of an asset i.e. account of goods.

2. Classification of accounts as per Modern approach or American approach
According to American or modern approach assets are classified as follows

- 1) **Assets accounts**
- 2) **Liabilities account**
- 3) **Expenses account**
- 4) **Income accounts**
- 5) **Capital account**

Self Assessment Questions

18. **What are the various classes of accounts under traditional approach?**

19. **What are the various classes of accounts under American approach?**

20. **Classify the following accounts as personal accounts, real accounts and nominal accounts**

a)Furniture account

b) **Ideal Ice-cream parlor account**

c) **Out standing salaries account**

d) **Utensils account**

e) **Cash account.**

f) **Loan account**

g)Wages account

1.9 Rules or Principles of Debit and Credit

Every business transaction has two aspects, one is receiving and the other is giving. The two aspects of each transaction affect two accounts. As such, to have complete record of each transaction in the books of each of the contracting parties, the two aspects of every transaction have to be recorded in two different accounts in opposite sides.

The basic rule of the double entry system or rule of debit and credit is that the account which receives the benefit of the transaction must be debited (because that account, person, asset, expense or loss owes certain benefit to business) and the account which gives the benefit of the transaction must be credited (because that account, person liability, income or gain has given benefit which is to be believed, acknowledged by the business, may be for returning it later say in case of liabilities).

**◆ For every debit, there is an opposite and equal reaction called a credit.◆
The double entry accounting system provides system of checks and balances. By totaling up all of the debits and totaling all the credits and comparing both the total, one can detect and has opportunity to correct many common accounting errors.**

There are clear rules as to when to debit the account and when to credit the account. According to traditional approach, rules of accounts are as follows.

Rule for Personal A/c. ◆ Debit the receiver

◆ Credit the giver

Rule for Real A/c. ◆ Debit what comes in

◆ **Credit what goes out**

Rule for Nominal A/c. ◆ Debit all expenses & losses

◆ **Credit all incomes & gains.**

Rule of accounts according to American approach

American accountants have developed alternative rules of debit and credit for recording various transactions. They have classified the accounts into five categories.

1. **Assets ◆ Debit increases an asset and credit decreases an asset**
2. **Liabilities ◆ A debit decreases a liability and a credit increases a liability**

3. **Capital** ♦ A debit the decreases owner♦s equity while a credit increases owner♦s equity

4. **Income and Gains** ♦ A debit decreases an income or gain and a credit increases an income or a gain

5. **Expenses and loss** ♦ A debit increases an expense or loss and a credit decreases an expense or loss

Illustration 3

State which account should be debited and which account should be credited according to traditional approach.

1. **Rajesh commenced business with cash Rs.10,000**

2. **Purchased goods from Kanav on credit Rs.1,000**

3. **Sold goods for cash Rs.500**

4. **Cash purchases Rs.600**

5. **Sold machinery to Ramesh on credit Rs.4,000**

6. **Withdrew cash from business for personal use Rs.200**

7. **Paid rent to land lord Rs.1,000**
8. **Cash paid into bank Rs.7,000**
9. **Received loan from Ragu Rs.3,000.**
10. **Received commission Rs.500**

Solution 3

Sl. No.	Two accounts involved in the transaction	Types of accounts	Rule for debit and credit	Accounts to be debited	Accounts to be credited	Reason
1. a)	Cash A/c	Real A/c	Debit	Cash	Capital	Cash comes
b)	Capital A/C	Personal A/c	what comes in Credit giver of benefit			Owner gives

2. a)	Purchases	Real A/c	Debit	Purchases	Kanav A/c	Goods
b)	A/c Kanav A/c	Personal A/c	what comes in credit the giver	A/c		comes in Kanav gives
3. a)	Cash A/c	Real A/c	Debit	Cash A/c	Sales A/c	Cash comes
b)	Sales A/c	Real A/c	what comes in credit what goes out			Goods goes out
4. a)	Purchases A/c	Real A/c	Debit	Purchases A/c	Cash A/c	Goods comes
b)	Cash A/c	Real A/c	what comes in Credit what goes out			Cash goes out
5. a)	Ramesh A/c	Personal A/c	Debit the receiver	Ramesh A/c	Sales A/c	Ramesh receiver
b)	Sales A/c	Real A/c	Credit what goes out			Goods goes out
6. a)	Drawings A/c	Personal A/c	Debit the receiver	Drawings A/c	Cash A/c	Ramesh is receiver
b)	Cash A/c	Real A/c	Credit what goes out			Cash goes out
7. a)	Rent A/c	Nominal A/c	Debit all expenses	Rent A/c	Cash A/c	Rent is an expense
b)	Cash A/c	Real A/c	& losses			Cash goes

			Credit what goes out			out
8. a)	Bank A/c	Personal A/c	Debit the	Bank A/c	Cash A/c	Bank is

b)	Cash A/c	Real A/c	receiver Credit what goes out			receiver Cash goes out
9. a) b)	Cash A/c Ram's loan A/c	Real A/c Personal A/c	Debit what comes in Credit the giver	Cash A/c	Ram's Loan A/c	Cash comes in Ram is giver
10. a) b)	Cash A/c Commission A/c	Real A/c Nominal A/c	Debit what comes in Credit all expenses and losses	Cash A/c	Commis-sion A/c	Cash comes in Commission received is an income

Self Assessment Questions

21. **Explain the rules of debit and credit under the Traditional approach.**
22. **Explain the rules of debit and credit under the American approach.**
23. **Find out the which account should be debited and which account should be Credited in the following cases**

a. Kiran commenced business with cash Rs.10,000

b.Cash purchases Rs.1,000

c. Discount allowed to Mohan Rs.50

d.Gave loan to Subhish Rs.10,000

e.Sale of goods for cash Rs.2,000

1.10 Summary

All types of business entities use accounting to account for their business activities or transactions. Accounting is the process of identifying, measuring, recording, classifying, summarizing business transactions, analyzing the results thereof, and communicating the results of the interpretations to the end-users for decision-making. Book-keeping is an aspect of accounting which is involved in the activity up to classifying of the transactions in the books of account.

Basic accounting equations are as follows:

1. **Liabilities + Capital = Assets**
2. **Assets \rightleftharpoons Liabilities = Capital**
3. **Assets \rightleftharpoons Capital = Liabilities**

These equations describe the financial position of the business and the effect of any business transaction.

The system of making two entries of equal value in two different accounts in opposite sides in the books of each contracting parties is known as double entry system of accounting.

Accounts and rules as to debit and credit are classified into three types under traditional approach as follows

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

These rules are based upon the dual aspect concept.

1.11 Terminal Questions

1. Distinguish between assets and liabilities

2. Show the effect of the following transaction on balance sheet. based on accounting equation

1st January 2006 Rajan started business with Rs.2,00,000


2nd January 2006 purchased goods on credit from Akash Rs.10,000

5th January 2006 sold goods on credit Rs.7,500

15th January 2006 purchased furniture for cash Rs.25,000

1.12 Answers

Self Assessment Questions

1. According to Northcot  Book Keeping is the art of recording in the books of accounts the monetary aspect of commercials and financial transactions 

Or

According to J R Batliboi ♦ **Book Keeping may be defined as the science as well as the art of recording business transactions under appropriate accounts** ♦

2. Features of Book Keeping are

- i) It is the recording of only business transactions**

- ii) It is the recording of only monetary or financial aspects of business transactions**

- iii) It is the recording of business transactions in terms of money**

3. American Institute of Certified Public Accountants (AICPA) has defined accounting as ♦ **the art of recording, classifying and summarizing, in a**

significant manner and in terms of money, transaction and events which are in part at least, of financial character, and interpreting the results thereof ♦.

4. 1. When a business entity keeps accounting records of its business transactions, it has permanent records of its transactions for present and future reference.

2. A business entity can ascertain easily and correctly its profit or loss for any year from the complete records of business transactions

5. (a) In accounting, non monetary transactions are not recorded. Only monetary transactions are recorded in the books of accounts. So it gives incomplete information to end users.

(b) Accounting records do not give exact information.

(c) Accounting methods are static in nature and not flexible.

6. Steps in accounting cycle are

1. Analyze the business transactions

2. Record transactions in journal

3. Post journal entries to ledger accounts

4. Prepare a trial balance

5. make adjusting entries

6. Prepare an adjusted trial balance.

7. Prepare financial statements.

8. Recording and post closing entries

9. Prepare post closing Trial balance

7. There is a difference between book keeping and accounting, though many think they are the same thing. They are:

I Book Keeping is just the process of recording and classifying transactions. On the other hand, Accounting also includes summarizing and interpreting, which is beyond the scope of book keeping.

II Book-keeping is the first stage of maintenance of books of account, where as accounting is the second stage of maintenance of books of account.

8. Business transaction refers to any activity dealing or event which has value

measurable in terms of money and which involves exchange of money or money's worth between the business and any other person.

9. In general Liabilities are the obligations of the business. In other words Liabilities means claims of others against a business which bind the business to others. Example : loan, bank over draft, creditors bills payment etc.

10. The amount due from debtor to the business is called Debt.

11. (i) Purchase of an asset on credit or on account

(ii) Sale of an asset on credit or on account 12.

Current assets		Fixed assets	
Cash		Furniture	
Debtor		Building	
Stock		Equipment	

13. Basic accounting equations are as follows

1. **Liabilities + Capital = Assets**
2. **Assets \diamond Liabilities = Capital**
3. **Assets \diamond Capital = Liabilities**

14. **Capital = Assets \diamond**

Liabilities Capital = 3,50,000 \diamond
2,00,000

= 50,000

15. **Purchase of Van for cash. This transaction increases an asset i.e. van and decreases an asset i.e. cash.**

16. The system of making two entries of equal value in two different accounts in opposite sides in the books of each contracting parties is known as double entry system of accounting.

17. (i) It provides full record of all the business transactions as it records both the aspects of each and every transaction.

(ii) It helps for preparation of financial statements

18. i) Real account

ii) Personal account

iii) Nominal account

19. According to American or modern approach assets are classified as follows

1) Assets accounts

2) Liabilities account

3) Expenses account

4) Income accounts

5) Capital account

20.

a.	Furniture account	Real Account
b.	Ideal Ice-cream parlor account	Personal Account
c.	Out standing salaries account	Personal Account
d.	Utensils account	Real Account
e.	Cash account	Real Account
f.	Loan account	Personal Account
g.	Wages account	Nominal Account

21. Accounts are classified into three types under traditional approach

1. **Real account** ◆ Debit what comes in and credit what goes out
2. **Personal account** ◆ Debit the receiver and Credit receiver
3. **Nominal account** ◆ Debit all expenses and losses and credit all incomes and gains.

22. American accountants have developed alternative rules of debit and credit for recording various transactions. They have classified the accounts into five categories.

1. **Assets** ❖ **Debit increases in an assets and credit decreases in an asset**
2. **Liabilities** ❖ **A debit decreases a liability and a credit increases a liability**
3. **Capital** ❖ **A debit the decreases in owner❖s equity while a credit increases in owner❖s equity**
4. **Income and Gains** ❖ **A debit decreases in an income and a credit increases in an income**
5. **Expenses and loss** ❖ **A debit increases in an expenses and a credit decreases an expense.**

23. a. Kiran commenced business with cash Rs.10,000

❖ **Cash account debited**

❖ **Capital account credited**

b. Cash purchases Rs.1,000

❖ **purchase account debited**

❖ **Cash account credited**

c. Discount allowed to Mohan Rs.50

❖ **discount allowed account debited**

❖ **Mohan account credited**

d. Gave loan to Subhish Rs.10,000

❖ **Subhish's loan account debited**

❖ **Cash account credited**

e. Sale of goods for cash Rs.2,000

❖ **cash account debited**

❖ **Sales account credited**

Terminal Question Answers

1. Assets refer to enough or sufficient things of value owned by a concern for carrying business. In other words assets as properties and possessions owned by business which benefit future period. On the other hand, Liabilities are the

obligations of the business. In other words Liabilities means claims of others against a business which bind the business to others. Example : loan, bank over draft, creditors bills payment etc.

2. Solution:

date	Transactions	Assets =	Liabilities + Owner's Equity
1/1/06	Commencement <small>of business</small>	Cash 2,00,000	Rajan's capital 2,00,000
2/01/06	Purchased <small>goods on credit from Anand</small>	Cash + stock 2,00,000+ 10,000	Creditor + Rajan's <small>capital</small> 10,000 +2,00,000
5/01/06	Sold goods on <small>credit</small>	Cash + stock + debtors 2,00,000+ (10,000-7,500)+7,500	Creditor +Rajan's <small>capital</small> 10,000 +2,00,000
15/1/06	Purchased <small>furniture for cash</small>	Cash + stock + debtors +Furniture (2,00,000-25,000)+ 2,500+ 7,500 + 25,000	Creditor + Rajan's <small>capital</small> 10,000 +2,00,000
	Ending	2,10,000	2,10,000

2.1 Introduction

It has been discussed in unit 1, that accounting is the art of recording, classifying, analyzing, summarizing the business transactions and interpreting the results thereof. Thus, an accountant does the following functions:

- 1. Recording the business transactions**
- 2. Classifying the business transactions**
- 3. Summarizing transactions**
- 4. Interpreting the result to end-users**

The first function of accounting is to record all the transactions in the books of accounts. So, all the business transactions are first recorded in one book called journal. Recording the transaction, is the most important function of accounting as any error created at this stage would make information obtained in later stages erroneous, which in turn would lead to wrong decision making. For example, in your hotel if the amount of purchases made by the hotel is recorded wrongly, later you would not be able to arrive at correct profit, correct amount to be paid to your supplier etc. Thus one should know how to record the transactions in the books of accounts.

Objectives:

After studying this unit, you will be able to understand

- ◆ **Meaning of journal**

- ◆ **Features of journal**

- ◆ **Objectives of preparing journal**

- ◆ **Advantages of journal**

- ◆ **Limitations of journal**

- ◆ **Format of Journal**

- ◆ **Steps required for journalizing**

◆ Preparation of journal

2.1 Meaning of journal

The word ◆Journal◆ is derived from the French word ◆Jour◆, which means a day book or a daily record. So, journal is a point of entry of business transactions into the accounting system. It is a chronological record of transactions with an explanation of each transaction. The journal is a book of original entry in which transactions are first entered chronologically from the document or voucher which is the evidence of a transaction.

For example, in a restaurant the bill raised on guests is the evidence of sale transaction. This bill is a document based on which this sale transaction is entered in journal.

The process of entering the transactions in the journal book is called journalizing.

Self Assessment Question

1. What is journal?

2.3 Features of journal

- 1. It is a day book which records each day's transactions on the same day on which they take place.**
- 2. It is a chronological record, as it records the transactions chronologically, that as they occur.**
- 3. It provides complete information of each transaction, as it contains both the aspects of each transaction i.e. debit and credit at one place with a brief description.**
- 4. Journal is a book of original entry or first entry. But it is only a subsidiary book, i.e. a book which is subordinate to the ledger. This is because through journal you cannot summarize the end result of transactions of your business whereas through ledger, a book which classifies the transactions into various types of accounts, you can prepare financial statements and obtain the end result like whether your business made profit or loss.**
- 5. The journal records the various transactions and splits them into their debits and credits so that they can be easily transferred to the proper accounts in the ledger.**

Self Assessment Question

- 2. State any two features of journal.**

2.4 Objectives of Journal

- 1. To record each and every transactions of a business in the order in which they occur.**
- 2. To provide a chronological record of all the business transactions**
- 3. To serve as a book of original or first entry.**
- 4. To categorize the transactions as per their nature into debit and credit so that they can be easily posted to the appropriate accounts in the ledger.**

Self-Assessment Question

3. What are the objectives of journal?

2.5 Advantages of Journal

- 1. As the business transactions are recorded in the journal in the chronological order the journal facilitates quick and easy reference to any transaction.**

2. As both the debit and credit aspects of each transaction are recorded in the journal simultaneously in one entry, journal provides a complete record of each transaction in one place.

3. Journal helps in understanding accounting principle of dual aspect concept i.e. double entry system.

4. Any mistake in the ledger can be easily detected with the help of the entry in the journal. This is because accounts in the ledger are prepared from the entries in the journal.

5. It helps to prevent or locate errors as to debit and credit amounts for each entry can be compared. Thus even in journal if mistakes occur while entering the amount pertaining to two accounts, it can be detected later by verifying the journal entries made. This is because rules as to debit and credit stipulate that the both the aspects have equal value. So the amount debited should be equal to amount credited in a journal entry.

Self Assessment Question

4. Give any two advantages of Journal.

2.6 Limitations of Journal

1. If all the business transactions are recorded in journal, the journal book will become bulky. To avoid this problem, these days many other types of subsidiary ledgers are being used regarding which we shall study later.

2. **The work of recording transactions in journal is laborious and tedious.**

3. **Journal will not provide separately the balances of purchases, sales, cash, as all the transactions are recorded in a single book.**

4. **Journal is a just subsidiary book; it is not a book of final entry that means journal will not provide final result of the business.**

Self Assessment Question

5. What are the limitations of journal?

2.7 Format of Journal

1	2	3	4	5
Date	Particulars	L.F	Debit	Credit
			Rs.	Rs.
1-1-2007	Cash Account Dr. To Capital Account (Being Cash introduced by the proprietor in the business)		10000	10000

Table 2.1: Format of a journal

How you record a transaction in a journal has been provided here

1. **First column, i.e. Date column is used for recording date on which a particular business transaction takes place. (Please note it is not the date on which you are making a record of the transaction) For example, in the above format date 1-1-2007 indicates the date of the transaction and not dates when the accountant entered it in the journal.**

2. **Second column i.e. Particulars column is used for recording two aspect of the transactions i.e. the account to be debited, the account to be credited and the explanation for the transaction. While, writing in the Particulars column, in the first line, the name of the account to be debited is written. In the next line, the name of account to be credited is written, after leaving little space to the left.**

To link the two accounts, which are written in two different lines, the word **Dr. is written at the extreme right of the first line after the name of the**

account to be debited and at the beginning of the second line, before the name of the account to be credited, the word **To is written. These two words mean **Debtor To**, and provide the link between two accounts. Or in other**

words, these words indicate that these accounts are two aspects of a single

transaction. Brief explanation about the transaction, usually, beginning with the word **Being or **For** is written in the Particulars column within the brackets. This brief explanation is called **Narration**. Narration should be written below**

the second line.

For example in the above format the transaction to be recorded is pertaining to introduction cash into the business by proprietor. You have to identify the accounts involved in this transaction are Cash and Capital. Cash Account is Debited because cash comes in and Capital Account is credited because Proprietor is the giver of benefit. These accounts are written in the first and second lines in the manner mentioned in the format.

Please note that the account to be debited is written first and account to be credited is written in the second line. If you change the order it would lead to a serious mistakes later.

3. Third column i.e. L.F means ledger folio. This column is left blank when journal entry is made and is used later when the journal entries are posted to the ledger accounts. More regarding this we shall see later.

4. Fourth column i.e. Debit column is used for recording the amount to be debited. The amount to be debited is entered against the name of the account to

be debited. In the above example, Rs.10,000 in debit column written against Cash Account indicates that Cash received is Rs.10,000

5. Fifth column i.e. Credit column is used for recording the amount to be credited. The amount to be credited is entered against the name of the account to be credited. In the above example, Rs.10,000 in credit column written against Capital Account indicates the Capital introduced by the proprietor is Rs.10,000

2.8 Simple Journal entry and compound journal entry

Simple or single journal entry contains only one debit and one credit. For example the aforesaid journal entry is a simple journal entry as only cash and capital account are involved in this journal entry. A compound journal entry is a combination of two or more simple journal entries. Two or more simple journal entries are combined into a compound journal entry when two or more journal entries are passed on the same date and when there is a common account. This is done to avoid repetition and redundancy.

For example, assume transactions in a day are as follows:

Salary Paid Rs.10,000 in cash

Rent Paid Rs.5,000 in cash

Electricity Charges Paid Rs.1,000 in cash

Normally these transactions should have been entered in the journal as follows

Salary Paid A/c	Dr	10,000	
To Cash			10,000
Rent Paid A/c	Dr	5,000	
To Cash			5,000
Electricity Charges	Dr	1,000	
To Cash			1,000

If you observe these journal entries, one account is common in all these journal entries. Therefore instead of passing three journal entries as above, you can save time and space by combining these entries into one compound entry as follows.

Rent Paid A/c	Dr.	5,000	
Electricity Charges	Dr.	1,000	
To Cash			16,000
(Being Salary, Rent and Electricity Charges Paid in cash)			

Please note that Cash Account is to be credited by Rs.16,000 as two amounts i.e. debit and credit in a journal entry should always be equal.

2.9 Steps required for journalizing

1. First, we should find out the two accounts involved in the transaction. It may be noted that, while ascertaining the two accounts involved in the business transaction, the account of the concern or firm should not be taken into account, as the entry is passed in the books of that firm. For example, if you start a business called Hotel Raj Bhavan by introducing cash Rs.10,000 you do not credit Hotel Raj Bhavan because it is Hotel Raj Bhavan which is recording the entries of the transaction. Instead you are treated as an outsider and your account (capital account) is credited. So only account of the other persons with whom the firm deals, the accounts of assets or liabilities or capital or the accounts of income and accounts of expense should be considered.

According to business entity concept, the business is distinct from the owner, so the owner is considered as outsider for the business.

2. Secondly, after ascertaining the two accounts involved in the transaction, we should ascertain the nature of the accounts, like whether the accounts involved are personal account, real account or nominal account.

3. Thirdly, we should ascertain which rule of debit and credit is applicable to each of the account involved in the transaction.

4. Fourthly, we should apply the relevant rule of debit and credit, and find out which account is to be debited and which account is to be credited.

5. Finally, the entry should be passed in the journal.

6. It is important to note Narration should be provided in every case so that later one is not confused as to why he entered a particular transaction in the journal.

7. After passing several such journal entries in journal book, the totaling of last two columns i.e. debit and credit is essential. Both columns' totals must be

equal. If the totals are unequal it indicates that there is/are errors in making journal entries.

2.10 Illustrations

1. Journalise the following transaction

- 1. 2006 Jan 1 Mr. Sudhir commenced business with cash Rs.5,00,000.**

- 2. Jan 2 Purchased goods on credit from Mr. Jeevan Rs.50,000.**

- 3. Jan 5 Paid into bank Rs.10,000.**

- 4. Jan 7 Bought office furniture for cash Rs.5,000.**

- 5. Jan 8 Sold goods for cash Rs.6,000.**

- 6. Jan 9 Sold goods to Mr. Krishna on credit Rs.4,000.**

- 7. Jan 15 Bought goods from Vishnu on credit Rs.5,000.**

- 8. Jan 16 Bought goods from Ramesh for Rs.3,000.**

- 9. Jan 25 Paid postage Rs.50.**

- 10. Jan 26 Withdrew cash from office for personal use Rs.200.**

11. Jan 28 Sold good to Rajesh for cash Rs.6,000.

12. Jan 31 Paid salaries Rs.3,000.

Solution

Date	Step 1 Two accounts involved	Step 2 Name of A/c	Step 3 Rule to be applied	Step 4 Account to be debited	Step 5 Account to be Credited
Jan 1	Cash A/c Capital A/c	Rajesh A/c Partners A/c	Debit what you sell Credit the giver	Cash A/c	Capital A/c
Jan 2	Purchases Sundry A/c	Rajesh A/c Partners A/c	Debit what you buy Credit the giver	Purchases A/c	Sundry A/c
Jan 3	Bank A/c Cash A/c	Partners A/c Rajesh A/c	Credit the receiver Debit what you buy	Bank A/c	Cash A/c
Jan 7	Purchases A/c Cash A/c	Rajesh A/c Rajesh A/c	Debit what you buy Credit what you pay	Purchases A/c	Cash A/c
Jan 8	Cash A/c Sundry A/c	Rajesh A/c Rajesh A/c	Debit what you sell Credit what you pay	Cash A/c	Sundry A/c
Jan 9	Salaries A/c Sundry A/c	Partners A/c Rajesh A/c	Debit the receiver Credit what you pay	Salaries A/c	Sundry A/c
Jan 15	Purchases A/c Sundry A/c	Rajesh A/c Partners A/c	Debit what you buy Credit the giver	Purchases A/c	Sundry A/c
Jan 28	Purchases A/c Partners A/c	Rajesh A/c Partners A/c	Debit what you buy Credit the giver	Purchases A/c	Partners A/c
Jan 29	Partners A/c Cash A/c	Partners A/c Rajesh A/c	Debit what you pay Credit what you pay	Partners A/c	Cash A/c
Jan 28	Drawings A/c Cash A/c	Partners A/c Rajesh A/c	Debit the receiver Credit what you pay	Drawings A/c	Cash A/c
Jan 30	Cash A/c Sundry A/c	Rajesh A/c Rajesh A/c	Debit what you sell Credit what you pay	Cash A/c	Sundry A/c

After following the above steps 1-4, journal entries for the above transactions will be:

14	Being goods sold to Raman on credit. Particulars Account	Dr	Cr
	To Raman's account	4,000	
	By Sales Account		4,000
15	Being goods purchased from Ramesh on credit. Particulars Account	Dr	Cr
	To Ramesh's account	3,000	
	By Purchases Account		3,000
16	Being cash paid to Ramesh. Particulars Account	Dr	Cr
	To Ramesh's account	500	
	By Cash Account		500
17	Being cash paid to Ramesh for claim. Particulars Account	Dr	Cr
	To Ramesh's account	3,000	
	By Cash Account		3,000
18	Being cash paid to Ramesh. Particulars Account	Dr	Cr
	To Ramesh's account	500	
	By Cash Account		500
	Total	8,000	8,000

2. Journalize the following transactions.

1. **2006 March 1 sold goods to Raman Rs.4,000**
2. **2 bought goods for cash Rs.3,000**
3. **6 Paid for repairing machine Rs.500**

4. ❖ ❖ 7 Drew for office use Rs.1,000
5. ❖ ❖ 15 Paid advertisement Rs.100
6. ❖ ❖ 25 Received loan from Mr. Bharath Rs.200
7. ❖ ❖ 28 Paid to Mahesh Rs.2,000
8. ❖ ❖ 31 purchased stationery Rs.50 and paid rent Rs.1,000

Solution

	Step 1	Step 2	Step 3	Step 4	
Date	Two accounts involved	Nature of A/c	Rule	Debited	Credited
2006 March 1	Raman's A/c Sales A/C	Personal A/c Real A/c	Debit the receiver Credit what goes out	Ramesh's A/c	Sales A/c
March 2	Purchases A/c Cash A/c	Real A/c Real A/c	Debit what comes in Credit what	Purchases A/c	Cash A/c

			goes out		
March 6	Repairs A/c Cash A/c	Nominal A/c Real A/c	Debit all expenses Credit what goes out	Repairs A/c	Cash A/c
March 7	Cash A/c Bank A/c	Real A/c Personal A/c	Debit what comes in Credit the giver	Cash A/c	Bank A/c
March 15	Advertisement A/c Cash A/c	Nominal A/c Real A/c	Debit all expenses Credit what goes out	Advertisement A/c	Cash A/c
March 25	Cash A/c Bharath's Loan A/c	Real A/c Personal A/c	Debit what comes in Credit the giver	Cash a/c	Bharath's Loan A/c
March 28	Mahesh's A/c Cash A/c	Personal A/c Real A/c	Debit the receiver Credit the giver	Mahesh's A/c	Cash a/c
March 31	Stationery A/c Rent A/c Cash A/c	Nominal A/c Nominal A/c Real A/c	Debit all expenses Debit all expenses Credit what goes out	Stationery A/c Rent A/c	Cash A/c

After following the above steps, journal entries for the above transactions will be:

	Account Name	Dr	Cr	
25	To Cash A/c (Being cash paid for advertisement)		400	400
	Cash A/c	Dr		
	To Bhupendra's Loan A/c (Being loan received from Bhupendra)		200	200
29	Stationery A/c	Dr		
	To Cash A/c		2,000	2,000
31	Stationery A/c	Dr		
	To Cash A/c (Being cash paid in Mykhala)		1,000	1,000
	Stationery A/c	Dr		
	Rent A/c	Dr		
	To Cash A/c (Being stationery purchased and rent paid in cash)		1,000	1,000
	Total		11,800	11,800

Stationery A/c	Dr	50	
To Cash			50
And			
Rent a/c	Dr	1,000	
To cash			1,000

31st march is a compound journal entry accounts. The same compound entry can be follows

3. Journalize the following transactions. (Banking transactions)

2006 March 1 Opened an account in a bank with Rs.5,000

- ◆ ◆ **2 Withdrew from bank for office use Rs.1,000**

- ◆ ◆ **5 Withdrew from bank for personal use Rs.500**
- ◆ ◆ **7 Paid Sunil on account by Cheque Rs.300**

- ◆ ◆ **10 Bank collected interest on investment on behalf of customer Rs.200**
- ◆ ◆ **15 Loan taken from the bank Rs.10,000**
- ◆ ◆ **20 Deposited cash into bank Rs.2,000**
- ◆ ◆ **25 Repaid part of bank loan in cash Rs.1,000**
- ◆ ◆ **31 Bank charges Rs.20**

Solution:

13	Bank A/c	Dr	200	
	To Interest on investment A/c			200
	Being bank collected interest on investment on behalf of customer			
14	Bank A/c	Dr	10,000	
	To Bank Loan A/c			10,000
	Being cash received from bank			
20	Bank A/c	Dr	1,000	
	To Cash A/c			1,000
	Being cash paid into bank			
28	Bank A/c	Dr	1,000	
	To Cash A/c			1,000
	Being cash paid from bank into cash			
29	Bank Charges A/c	Dr	20	
	To Bank A/c			20
	Being bank charges charged to the bank			
	Total		20,200	20,200

4. Journalise the following transactions.

1. Loss of goods by fire Rs.250

2. Bad debts written off Rs.200

3. Goods distributed as samples Rs.100

4 Depreciation charged on machinery Rs.1,000

Journal Entries

Date	Particular	L.F	Debit	Credit
1	Loss by fire A/c Dr To Purchases A/c (Being loss of goods by fire)		250	250
2	Bad debt A/c Dr To Sundry Debtors A/c (Being bad debt written off)		200	200
3	Advertisement A/c Dr To Purchases A/c (Being the goods distributed as free samples)		100	100
4	Depreciation A/c Dr To Machinery A/c (Being the depreciation charged on machinery)		1,000	1,000
5	Loss by theft A/c Dr To Cash A/c (Being the loss of cash by theft)		500	500
	Total		2,850	2,850

0

2.11 Summary

Journal is a book of original entry which is used for recording each days transactions on the same day. Recording of transactions is done based on the documents evidencing the transactions like bills, vouchers. While recording the types of accounts involved, rules as to debit and credit are to be considered.

Narration is the brief explanation to the journal entry which is written in the particular column of journal book after recording the entry.

Compound journal entry contains two or more simple journal entries.

2.12 Terminal questions

1. **What is Narration?**

2. **Journalize the following**

1. **Capital invested in to a hotel business by selling off a private property Rs.2,00,000.**

2. **Rent paid to the land lord Rs.50,000**

3. **Bought provisions from Green Stores Rs.2,40,000**

4. **Repaid loan of Mr.Manohar Rs.50,000 and an interest of Rs.10,000**

5. **A hotel equipment is stolen. The book value of this is Rs.30,000**

3. Journalize the following:

1. **Hareesh, a customer remitted directly to our bank on our behalf Rs.4,850**

2. **Paid Income Tax Rs.4,000**

3. **Received a cheque from Mr. Ameen Rs.4,000**

4. **Paid carriage on machinery purchased Rs.2,000**

5. **Received interest Rs.100**

2.13 Answers

Self Assessment Questions

1. **Journal is a chronological record of transactions showing both the aspects of a transaction with an explanation of each transaction**

2. **Features of journal**

1. **It is a day book which contains each day's transactions as and when they occur.**

2. **It is chronological record, as it records the transactions chronologically that means according to their occurrence.**

3. It provides complete information of each transactions, as it contains both the aspects of each transactions i.e. debit and credit at one place with a brief description.

3. Objectives of Journal

1. To record each and every transactions of a business in the order in which they occur.

2. To provide a chronological record of all the business transactions

3. To serve as a book of original or first entry.

4. To analyze the transactions into their nature debit and credit. So that they can be easily posted to the appropriate accounts in the ledger easily.

4. Advantages of Journal

1. As the business transactions are recorded in the journal in the chronological order the journal facilitates quick and easy reference to any transaction.

2. As both the debit and credit aspects of each transaction are recording in the journal together in one entry, journal provides a complete record of each transaction in one place.

5. Limitations of Journal

1. If all the business transactions are recorded in journal, the journal book will become bulky.

2. The work of recording transactions in journal is laborious and tedious. Terminal Questions

Journal Entries				
Sl.No.	Particular	L.F	Debit	Credit
			Rs	Rs
1	Cash A/c Dr To Capital A/c (Being cash invested in the hotel)		2,00,000	2,00,000
2	Rent A/c Dr To Cash A/c (Being cash paid for rent)		50,000	50,000
3	Purchases A/c Dr To Green stores A/c (Being provisions bought from Green stores on credit)		2,40,000	2,40,000
4	Manohar's Loan A/c Dr Interest A/c Dr To Cash A/c (Being loan repaid and interest paid to Manohar)		50,000 10,000	60,000
5	Loss by theft A/c Dr To Hotel Equipment A/c (Being loss of equipment by theft)		30,000	30,000
	Total		5,80,000	5,80,000

tion of transaction, which is written in the two accounts of debit and credit.

Note : in case of transaction 5 Loss by theft A/c is debited as losses are to be debited , Hotel equipment account is credited as Hotel Equipment goes out .

3. Solution:

	expense)			
3	Bank A/c	Dr	4 000	4 000
	To Ameer's A/c			
	(Being cheque received from Ameer)			
4	Cartage on Machinery A/c	Dr	2 000	2 000
	To Cash A/c			
	(Being cash paid for cartage on machinery purchased)			
5	Bank A/c	Dr	100	100
	To Interest A/c			
	(Being interest received from bank)			
	Total		14 500	14 500

UNIT 3

3.1 Introduction

We have studied in Unit 2 that mere recording of transactions in books of account is not enough. The businessman has to know the summary of the transactions like whether he made profit or how much is due to him from his customers. These types of information are not available in Journal. Hence he has to classify the transactions into various categories called Accounts. This classification, the second important process of accounting, is made in a book called Ledger. After entering all business transactions in the journal, all journal entries are transferred to appropriate accounts, in the ledger, the book of final entry, regularly, say weekly, fortnightly, monthly or quarterly, to know the exact picture of each account on a particular date. However, it is important to note that in today's information technology scenario the computers i.e. software itself does this work of transfer to ledger instantaneously while the journal entries are being made. Similarly, summary of all accounts is provided in a statement called Trial Balance so that the businessman would be able to prepare financial statements like Profit and Loss Account and Balance Sheet. Hence it is very important for us to study the details of ledger and trial balance.

Objectives

After studying this unit, you will be able to understand

- ◆ Meaning and definition of ledger**

- ◆ Features of ledger**

- ◆ Advantages of ledger**

- ❖ **Format of ledger**
- ❖ **Posting of ledger**
- ❖ **Steps to be followed for posting**
- ❖ **Steps in Preparation of ledger**
- ❖ **Meaning of trial balance**
- ❖ **Steps in Preparation of trial balance**

3.2 Meaning of ledger account

The word **Ledger** is derived from the Dutch word **Legger**, which means to lie. So, ledger means a book where the various accounts are maintained. We have studied that accounts are of three types-personal, real and nominal accounts. The rules of debit or credit as to these accounts are also known to us. We also know that the nature of these accounts do fall under any of the six categories - income, expense, asset or liability, loss or gain. We can have any number of accounts to suit our purposes, the nature of which would be within the three types and six categories mentioned above.

For example one restaurant might open an account **Sales** and credit all types of sales to same sales A/c. Another hotel might create different accounts for **Food sales**, **Beverage Sales** and **Room Sales**. Still another hotel might have a detailed system of accounting where it may have accounts like **Fish Sales**, **North Indian Dish Sales**, **South Indian Thali Sales**, **Economy Room-Sales**, **Deluxe Room Sales**, **Suite**

Sales ♦ etc

The basic idea of defining such accounts is enable classification of all the transactions as far as possible and to get a summary of the transactions of a particular account for a specific period. For example if you have a ♦ Fish Sales account ♦ in your hotel, you can always find out the value of fish sales made during a particular week or month. In the absence of such account you have go through restaurant bills containing fish sales and add them up. Thus it always better that a business manager creates accounts which are required for his decision making.

Thus the term ♦ account ♦ refers to a statement, which contains all transactions relating to a particular item or aspect involved in a transaction for a particular period and all transactions neatly arranged into debits and credits.

Hence it is necessary that you create Accounts, classify all your transactions in terms of those accounts and then find out the from the ledger the summary of

these transactions pertaining to a particular Account, so that you get the required information.

Meaning of ledger

A book containing a group of accounts is defined as a ledger. The ledger is the group of accounts that includes various accounts of assets, liabilities, owners' equity, revenues, expenses, and owner's drawing. Hence a ledger is book containing various accounts where all the transactions recorded in the journal are replicated Account-wise and not chronologically as in the case of a journal.

Self assessment questions

1. What is ledger?

3.3 Features of ledger

1. Ledger is a derived or secondary record, as the entries in the ledger are derived from the entries in the journal.

2. It is a permanent record book, In the words of Arthur Fieldhouse, Ledger is the permanent storehouse of all the transactions.

3. No doubt, ledger is derived book. But it is the principal book of

accounts, because from this book we can obtain the final information relating to the profit and loss and the financial position of the business.

4. It is a book of final entry. This is because no more entries are to be made in books of account after the entry in ledger is made. Whatever process is undertaken after this stage is only extracting the information contained in ledger or journal.

Self assessment questions

2. State any two features of ledger

3.4 Need for maintaining ledger accounts

In the journal each transaction is dealt with separately and individually. On perusing the journal one cannot obtain any idea of the net effect of the transactions since it records only which account is to be debited and which to be credited. The record is made in chronological order i.e. date wise. Transactions of a similar nature will be recorded in different pages if they occur on different dates. Transactions on one day will be rather diverse in character, e.g., purchases of machinery, sale of goods, payment of expenses, etc. To get the whole picture, the entries recorded in journal have to be processed or sorted

further. Therefore it is necessary to bring all similar transactions together by preparing ledger accounts.

For example, in case of Restaurant the ledger would contain Income Accounts like North Indian Dish Sales, Chat item sales, Ice cream Sales; expense accounts like Grocery and Provision, Milk Purchases; asset accounts like Furniture, Kitchen Equipments, Freezers and Coolers, Air conditioners, Delivery Vehicles; Liability accounts like Bank Overdraft, Bank Term Loan. The restaurant accountant would be recording the transactions on day to day basis pertaining to these and similar accounts. The transactions pertaining to say Ice cream sales would have occurred on different dates. And you would not be able to find the value of ice cream sales in a week through journal easily. However while writing the ledger, the accountant would be recording the transactions account-wise and all ice cream sales of a week or month would appear together in ledger account of ice-cream sales and hence he would be able to provide you the value of ice cream sales in a week or in a month.

3.5 Advantages of ledger

- 1. A ledger provides complete information regarding all accounts in one book.**
- 2. It is a permanent record book of all the transactions of a business.**
- 3. It provides balance of each account at any particular date. For example the balance of cash, the amount of purchases, the amount of sales for a**

particular period can be found through ledger accounts

4. Ledger is helpful in preparing trial balance.

5. It is helpful in preparing the financial statements i.e. balance sheet and profit and loss account.

3.6 Difference between journal and ledger

Journal	Ledger
1. A journal is a book of first entry, as all the transactions are recorded first in the journal.	1. A ledger is a book of final entry, as all the transactions recorded finally in the ledger.
2. It is not a permanent book of account	2. It is a permanent book of account.
3. It is a daily record.	3. It is a prepared periodically says, weekly, fortnightly,
4. Recording of transactions in	monthly or quarterly according

5. No narration is written in the ledger.

Self assessment questions

3. Give any two differences between journal and ledger

3.7 Types of ledgers

Ledger can be sub-divided into three categories. They are as follows

4. Recording of transactions in the ledger is called posting.

5. Narration is written in the journal

the journal is called journalizing. to the convenience of the

business concern.

1. **Debtor's Ledger, or customer's ledger or sales ledger: Debtor ledger contains the accounts of all the trade debtors or customer to whom goods are**

sold on credit.

2. **Creditor's Ledger or supplier's ledger or purchases ledger:**

Creditor's ledger contains the accounts of all the trade creditors from whom goods are

bought on credit.

3. **Impersonal ledger or general ledger: General ledger contains all other accounts except personal accounts of trade debtors and trade creditors. In other word, General ledger contains accounts of assets and accounts of nominal accounts.**

But in small concerns the only one ledger called General Ledger would be maintained wherein all types of accounts would be maintained.

3.8 Format of Ledger Account

A ledger account of Mr. A, customer of your Restaurant is provided here

The first column, i.e. the Date column, is meant for recording the date of the transaction. For example the date 1-1-2007 is the date of transaction when you sold Ice creams to A on credit

The second column i.e. the Particular column is meant for recording the name of the other account involved in the transaction. For example, in the case of transaction on 1-1-2007 the journal entry is

Here A's A/c is debited. Hence you have to record this transaction on the debit side (left hand side) of his ledger account. The other account involved in this

transaction is Ice cream sales a/c. Hence you mention the other account i.e. Ice cream Sales A/c in the ◆particulars◆ column.

The meaning of such recording is that A◆s A/c is debited due to Ice cream sales made to him.

The third column, i.e. the J.F. column (journal folio column), is meant for recording the page number of the journal from where the transaction is posted or transferred. For example, in the above case, the number 1 in J.F column indicates the aforesaid journal entry was made in page number 1 of the journal of your restaurant.

The forth column, i.e. the ◆Amount◆ column is used for recording amount of the transaction.

3.9 Steps to be followed while preparing ledger accounts

1. In the ledger, a separate account should be opened for each account recorded in the primary book or journal. For example cash, furniture, rent, salaries, purchases, sales, machinery etc. Generally in each page of ledger one account will be opened.

2. For all the transactions relating to any particular account, only one account should be maintained. For example transactions relating to purchase of goods are recorded only in one account i.e. purchases account. For example, you do not maintain two purchases accounts in a ledger.

The name of account should be written at the top and in the center of each account.

3. **The word **Dr** should be written at the left hand side top corner of each account, which indicates debit side of the account, and the word **Cr** should be**

written right hand top corner of each account, which indicates credit side of the account.

4. **The journal entry should be posted to the respective ledger accounts in the order of their dates.**

5. **While posting an entry to any ledger account, the name of that account should never appear on both the sides of that account in the **particulars** column. This**

is due to the fact that any transaction would involve two accounts and no transaction is possible where only one account is involved.

6. **Every entry made on the debit side of account should starts with the word **To** in the particular column to indicate that the account owes the**

amount to the other account and every entry made on the credit side of an

account should start with the word **By** in the particular column. In this context, it may be noted that there is no necessity to write again and again the word **To** and **By** for subsequent entries. The sign **↔** may be used instead.

7. While transferring to the debit side of an account, the name of the account, which is credited in the journal, should be written in the particular column and While transferring the credit side of an account, the name of the account, which is debited in the journal, should be written in the particular column. For example, please refer to example provided in section 3.8.

8. A compound journal entry has to be posted in the same manner as a simple journal entry. For example the journal entry is as follows

A's a/c will appear as follows

Similarly if the journal entry is as follows

Mr A's A/c would appear as follows

When posting an opening entry, the following points should be kept in mind.

Each account is to be balanced in the manner explained in 3.13 later. The balance of previous period is brought down to the succeeding period.

If the opening balances of each account is debit balance that should be entered on debit side of the account as **↔ To Balance b/d ↔.**

If the opening balance of each account is credit balance that should be entered on credit side of the account as \diamond By Balance b/d \diamond in the particular column.

The page number of the journal from where the entry is posted should be written in the J.F. column.

9. Every ledger should be balanced periodically in the manner explained in section 3.13.

3.10 Maintenance of ledger accounts

A ledger may be maintained in the form of bound book or in the form of a loose-leaf book or in the form of cards. But usually in every business concern, whether small or big, ledger is kept in the form of a bound book with pages numbered continuously. But maintenance of bound book is quite inconvenient for a big concern, which has to maintain a large number of accounts. So, big concerns have started using loose-leaf ledgers. The loose-leaves of the ledger are punched and inserted in a binder in such a way that the leaves can be taken out or inserted easily. For example, banks follow this system as they have a large number of customers \diamond accounts to be maintained.

Of Late, some big concerns maintain ledgers in the form of cards. Under this system of ledger, a separate card is provided for each ledger account. Various cards are properly filed in cabinets. The cards can be taken out or inserted easily.

3.11 Arrangement of accounts

According to size of the business or number of business transactions, in the ledger, each account is allotted one or more pages.

Accounts are usually arranged in the ledger in any systematic manner. Some business firms arrange the accounts in the alphabetical order and some arrange according to nature of accounts like Personal accounts, Real accounts and Nominal accounts. Most of the concerns arrange the accounts in the following manner.

Personal accounts are shown first, then Real accounts next and finally Nominal accounts.

However if an alphabetical index is maintained in the ledger, it would be easier to locate the page where a particular account is maintained.

3.12 Posting

The process of transferring entries from journal to ledger is called Posting. Posting is done periodically, sometimes daily, weekly, monthly, quarterly, half-

yearly or yearly, depending upon the convenience and the requirements of business concern. It should be noted that posting is the basic process of maintaining the ledger and classifying the transactions. Without posting no ledger would exist.

Matters to be considered while posting are as follows:

- 1. Page number of the Ledger i.e. Ledger Folio should be mentioned in the Journal so that it is easy to locate the particular journal entry in the ledger later.**
- 2. Similarly the page number of Journal i.e. Journal Folio should be mentioned in the ledger so that it would be easier to locate the journal entry based on the records in the ledger.**

For example, in the aforesaid ledger account of Mr. A, the journal folio number 1 indicates that the journal entry as to ice creams sales of 1-1-07 is written in page number 1 of journal. Similarly if the page number of A's a/c in the ledger is say, 10. the same would be mentioned in the LF column in journal.

The process of posting is not required due to use of computers these days for financial accounting transactions. The process of posting is automatically done by the software in the computer, the moment you make a journal entry.

Self assessment questions

4. What is posting?

3.13 Balancing of a ledger accounts

After transferring or posting all entries from journal to ledger, each ledger accounts are balanced, that means finding out the difference between the total of debit side and the total of credit side. This act is called as balancing of a ledger account. In the other words, Balancing of a ledger account is a process of ascertaining the difference between the total of debit side and the total of credit side. The ledger accounts are balanced daily, weekly, monthly, quarterly, half-yearly or yearly, depending upon the convenience and the requirements of business concern.

Basic need for balancing of a ledger account is that finding the position of an account on any particular date. In other words, to find out the net effect of the entries in an account, it is necessary to balance that account on the given date.

For example, in the aforesaid case of A's A/c the balance is Rs.1,000 as total of debit side is Rs.1,000 and total of credit side is Rs. Nil and hence the difference is Rs.1,000

Steps to be followed while balancing of a ledger account

1. First, each of the two sides of the account i.e. the debit side and credit side is totaled up roughly on separate paper.

2. Then, the difference between the two totals is ascertained. If the credit total is more than debit total the difference is called Credit balance. If the debit total

is more than credit total that difference is called Debit balance. For example in the aforesaid case of A's A/c the debit side total is more than credit side total .

Hence the difference of Rs.1,000 is Debit Balance

3. Then, the amount of difference between two sides is entered in the amount column of the lesser side to make the two total of the both the sides equal. An example is provided here as to balancing of accounts

4. Then, To balance carried down if it is credit balance and Or By balance carried down if it is debit balance is written against the amount in the particular column.

For example, in the case of A's A/c the debit balance of Rs.1,000 is indicated on the credit side as By balance carried down . The date 31-1-2007 represents the date of balancing.

5. Again, at the beginning of the next period, the balance is written on the opposite side as To balance brought down, if it is a debit balance Or By balance brought down, if it is a credit balance in the particular column to indicate that the balance of the account has been brought down from the previous period.

For example in the case of A's a/c the balance being the debit balance of Rs1000 is brought down as follows in the succeeding period as follows

Nature and significance of balance of various types of ledger accounts

1. A personal account may show a debit balance or credit balance. A debit balance in a personal account indicates that the person concerned has received more benefits from the business than what he has given to the business. A credit balance in a personal account indicates that the person concerned has given more benefits to the business than what he has received from the business. Though the owner's capital account is personal account, it generally shows a credit balance indicating the business owes money to its owner. But some times it may show debit balance Owner's drawings accounts will show a debit balance.

For example, in case of a hotel generally customers' accounts show debit balance as money is due from them. Similarly suppliers' accounts show credit balance as money is due to them.

2. All Real accounts or assets accounts generally show a debit balance (It may be noted that an asset account shows a credit balance only when asset sold and a profit is made on such sale which is yet to be accounted separately).

Accounts relating to goods are- purchases, sales, sales return, purchases return, opening stock and closing stock. Purchases account will show a debit balance, sales account will show a credit balance, purchases return will show a credit balance, sales return will show a debit balance, opening stock will show a debit balance and closing stock will show a debit balance.

3. A nominal account may show a debit or a credit balance. A debit balance in a nominal account indicates the amount of expense or loss under that item. For example, in a restaurant Salary, Power and Fuel, Repairs and Maintenance etc are expenses and hence show debit balance.

A credit balance in a nominal account represents the amounts of income or gain under that item. For example, in a hotel, accounts pertaining to service charges received, commission received on travel bookings, interest received from bank on deposits etc are incomes and show credit balance.

3.14 Illustrations

1. Journalise the following transactions and post them to ledger and balance the accounts.

2006, January 1 Commenced business with cash Rs.20,000

- 5 Goods purchased for cash Rs.6,000**
- 10 Cash Sales Rs.2,500**
- 15 Purchased goods from Shiva Rs.2,000**
- 31 Sold goods to Manoj Rs.4,500**

Solution

Posting to ledger

2. Journalize the following transactions and post them into the ledger.

1. 2006 Jan 1 Mr. Sujay commenced business with cash Rs.1,00,000

2. Jan 2 Purchased goods on credit from Mr. Jeevan Rs.10,000

3. Jan 5 Paid into bank Rs.10,000

4. Jan 7 Bought office furniture for cash Rs.1,000

5. Jan 8 Sold goods for cash Rs.2,000

6. Jan 9 Sold goods to Mr. Kiran on credit Rs.4,000

7. Jan 15 Bought goods from Vishwas on credit Rs.5,000

8. Jan 16 Bought goods from Rajan for Rs.3,000

9. Jan 25 Paid interest Rs.50

10. Jan26 Withdrew cash from office for personal use Rs.200

11. Jan 28 Sold good to Rajesh for cash Rs.6,000

12. Jan 31 Paid salaries Rs.3,000

Posting to Ledger

From the above journal book, we can prepare following ledger accounts

**Personal accounts: Sujay's capital a/c, Sujay's drawings a/c, bank a/c,
Jeevan's a/c, Kiran's A/c, Vishwas's a/c, Rajan's a/c,**

**Real Accounts: Cash a/c, Office Furniture a/c, purchases a/c, sales
a/c, Nominal accounts: Interest a/c, Salaries A/c**

3. Prepare personal account of Mr. Murthy from the following transactions in the books of Keerthy.

1st October 2006 Credit balance brought down Rs.2,500

5th ? ? Bought goods worth Rs.650 from Murthy

15th ? ? Returned goods worth Rs.160 to Murthy

20th ? ? Sold goods worth Rs.750 to Murthy

25th ? ? Received goods returned by Murthy Rs.45

30th ? ? Paid to Murthy Rs.2,260 and discount allowed by him Rs.25

Ledger (in the books of Keerthy)

Explanation:

1. The first transaction, the opening balance given is a credit balance, so that should

be brought down on the credit side as **By Balance b/d**. (it may be noted

that if there is a debit balance that should be brought down on the debit side as **To balance b/d**).

2. **Second transaction, goods purchased on credit from Murthy, this should be entered on credit side as **By Purchases A/c**. as the journal entry is **Purchase a/c Dr To Murthy's A/c**.**

3. **Third transaction, goods returned to Murthy, Purchases returns A/c should be entered on debit side as **To Purchases Returns A/c**. The journal entry here is **Murthy's a/c Dr To Purchase Returns a/c**(because goods goes out).**

4. **Fourth transaction, sold goods to Murthy, an entry should be made on debit side as **To Sales A/c**. **Murthy's a/c Dr To Sales a/c**.**

5. **Fifth transaction, an entry should be made on credit side as **By Sales returns A/c**. The journal entry here is **Sales Returns a/c Dr (as goods come into the business) To Murthy's a/c**.**

6. **In last transaction there are two transactions, one is payment of cash and other for receipt of discount. The compound journal entry is **Murthy's account****

Dr Rs.2,285 To cash Rs.2,260 To Discount Received Rs.25. So an entry should be made on debit side of Murthy's a/c as To Cash A/c for Rs.2,260 and To Discount a/c for Rs. 25 .

7. In this problem there is no balance in Murthy's A/c because the total of both the sides is equal. That means person concerned has received benefit from the

business is equal to what benefits he has given to the business.

8. Rama, owner of a hotel entered into the following transactions with Kishan on the following dates. Prepare ledger account of Kishan and the balance the same.

2007

Jan 1 Opening debt of Kishan to Rama Rs.1,000

Jan 5 Sold goods to Kishan Rs.990

Jan 8 Kishan returned goods Rs.90

Jan 15 Sold goods to Kishan for cash and received Rs.1,000

Jan 25 Kishan became insolvent and Rama realized from his asset Rs.800

Note: In this case also no balance is left because Kishan has become insolvent and only Rs.1,000 is received from his assets. The balance of Rs.1,900 still due by him cannot be recovered . Hence the same is treated as Bad Debt (a loss account) and the amount of Rs1,900 is debited to that account.

3.15 Trial balance

After preparing different ledger accounts, the debit balances and the credit balances of all ledger accounts are listed in a statement called Trial balance to verify arithmetical accuracy of all ledger accounts and also to enable the preparation of financial statements. So, Trial balance is a statement containing the various ledger balances on a particular date.

According to R.N. Carter, ♦A trial balance is a schedule or list of balances, both debit and credit, extracted from the accounts in the ledger, including cash and bank balances from the cash book♦.

According to Eric L. Kohler, ♦A trial balance is a list or abstract of the balances or of total debits and total credits to the accounts in a ledger, the purpose being to determine the equality of posted debits and credits and to establish a basic summary for financial statements♦.

Above definitions clearly give the meaning of trial balance as a list of debit and credit totals, or list of debit and credit balances, of all the ledger accounts

prepared on any particular date to verify whether the entries in the books of account are arithmetically correct.

Self assessment questions

5. Define Trial balance

3.15.1 Features of Trial balance

- 1. A trial balance is just a statement, and not an account.**

- 2. It is prepared as on a particular date**

- 3. A trial balance is prepared at any time and for any number of times during a year.**

- 4. It is not prepared in any book of account. It is prepared in a separate sheet of paper.**

- 5. It is the list of all balances of ledger accounts including cash and bank balance of cash book.**

3.15.2 Objectives of preparing a Trial Balance

- 1. To provide complete information relating to balances of all ledger accounts at a glance.**
- 2. To check the arithmetical accuracy of accounting entries.**
- 3. To help in preparing financial statements.**
- 4. To help in finding errors in various ledger account.**
- 5. To help in making adjustments while preparing final accounts.**

3.15.3 Advantages of Trial Balance

- 1. It facilitates quick and easy reference to balances of ledger accounts.**
- 2. It facilitates easy and quick preparation of financial statements or final accounts.**
- 3. It verifies the arithmetical accuracy of balances of ledger accounts.**
- 4. The errors can be detected easily through trial balance and are rectified prior to preparation of the final accounts.**

3.15.4 Limitations of Trial Balance

A trial balance suffers from certain limitations. They are:

- 1. A trial balance is not useful for those concerns, where single entry system of accounting is adopted.**
- 2. The major limitation of a trial balance is that a tallied trial balance is not a conclusive evidence of the accuracy of the books of account, because certain types of errors, such as errors of principle, compensating errors, error of omission etc. remain even when the trial balance tallies.**
- 3. It is not part of books of account maintained under the double-entry system.**

3.15.5 Format of Trial balance

- 1. First column i.e. Sl.No. column is used for recording serial number of ledger accounts.**
- 2. Second column i.e. Name of account is used for recording name of all ledger accounts.**
- 3. Third column i.e. L.F. (Ledger Folio) column is used for recording page no of ledger account.**
- 4. Forth column i.e. Debit column is used for recording amount of debit balance of a ledger account.**

5. **Fifth column i.e. Credit column is used for recording amount of balance of ledger account which shows credit balance.**

3.15.6 Steps to be followed for the preparation of a Trial Balance

1. **Only those ledger accounts that show balances should appear in the trial balances. If a ledger accounts shows a debit balance, it should appear in debit column of the trial balance. On the other hand, if a ledger account shows a credit balance, it should appear in credit column of the trial balance.**

2. **In this context of ledger balance, it is necessary to know the nature of the balances of the various ledger accounts.**

❖ **All accounts of assets including current assets and fixed assets shows debit balance and all accounts of expenses and losses shows debit balance, so they**

should appear in the debit column of the trial balance.

❖ **All accounts of liabilities including current liabilities and fixed or long term liabilities show credit balance and all accounts of incomes and gains shows**

credit balance, so they should appear in the credit column of the trial balance.

◆ Owner's capital accounts will show a credit balance. Therefore, it should appear in the credit column of the trial balance.

◆ Owner's drawings account will show a debit balance. Therefore, it should appear in the debit column of the trial balance.

3. After transferring all ledger balances to the trial balance, total both the sides and verify that they are equal.

4. If any difference is found, it indicates there is one or more errors while making journal entries or while posting them to various ledger accounts or in balancing of these ledger accounts. Errors might occur while totaling of journal or ledger also. Hence all these items are to be once again checked to locate the difference.

5. If still any difference is found, then the difference can be treated as ◆ Suspense A/c◆ and shown on the side where a deficit exists so that trial

balance is tallied. Suspense account is only a temporary treatment or adjustment until error is located as mentioned in Step 4.

3.15.6 Preparation of trial balance

Solution

In the above illustration, the type of balance of different accounts is not

mentioned. We have to decide the type of balances based on our knowledge of nature of different types of accounts. The solution has been provided here below as follows.

Note: Provision for bad debt is liability.

1. Prepare a Trial Balance from the following information.

Note: In this case since the total of debit side of trial balance is short by Rs1,200, the difference has been shown under the head Suspense a/c on the debit side so that the totals of both sides are same. Later the Accountant would have to locate the cause for such difference in Trail Balance.

3. Prepare a trial balance for the Spring Valley resort from the below given balances:

Rs.

Salaries 9,500

Cash at Bank 1,600

Stock 3,900

Bank overdraft 5,000

Building 5,000

Creditors 1,500

Sales 5,000

Capital 6,500

Sundry debtors 5,000

Bills payable 7,000

3.16 Summary

The ledger is the group of accounts that include accounts of assets, liabilities, owners' equity, revenues, expenses, and owners' drawing.

Posting is the process of transferring the transactions from journal to ledger to respective ledger accounts

A Trial Balance is a schedule or list of balances, both debit and credit, extracted from the accounts in the ledger, including cash and bank balances from the cash book.

3.17 Terminal questions

1. Raman, owner of hotel entered into the following transaction with Krishnan on the following dates. Prepare ledger account of Krishnan and the balance the same.

2007 Jan 1 Opening debt of Krishnan to Rama Rs.1,000

Jan 5 Sold goods to Krishnan Rs.990

Jan 8 Krishnan returned goods Rs.90

Jan 15 Sold goods to Krishnan and received Rs.1,000

Jan 25 Krishnan became insolvent and Raman realized from his asset Rs.800

2. Following is a Trial balance as on 31st March 2006, prepared by an incompetent accountant. You are required to re-write trial balance in its correct form.

3.18 Answers

Self assessment questions

1. **The ledger is the group of accounts that includes accounts of assets, liabilities, owners' equity, revenues, expenses, and owner's drawing.**

2. **Features of ledger are as follows:**

1. **Ledger is a derived or secondary record, as the entries in the ledger derived from the entries in the journal.**

2. **It is a permanent record book, In the words of Arthur Fieldhouse, Ledger is the permanent storehouse of all the transaction.**

3. **1. A journal is a book of first entry, as all the transactions are recorded first in the journal, but a ledger is a book of final entry, as all the transactions are recorded finally in the ledger.**

2. **Journal is not a permanent book of account, on the other hand, ledger is a permanent book of account.**

4. **The process of transferring entries from journal to ledger is called Posting.**

5. **According to R.N. Carter, A trial balance is a schedule or list of balances,**

both debit and credit, extracted from the accounts in the ledger, including cash and bank balances from the cash book.

UNIT 4

4.1 Introduction

According to traditional accounting system, all type of transactions are recorded in the original book called journal. The use of only one journal to record all type of transactions and later posting them accounts maintained in the ledger is possible in small concerns. However if the transactions of similar nature are voluminous making similar journal entries repetitively and posting them to ledger is waste of time and resources. Hence instead of recording the transactions in one journal the transactions of similar nature are recorded in different journals maintained for that purpose. These journals are called Subsidiary Books or special journals. This system of book keeping is called Modern or Practical System of Book keeping. Since in tourism industry voluminous transactions of similar types like cash transactions, restaurant sales, purchases of different types usually occur it is necessary that the students learn more about these subsidiary books.

Objectives

After studying this unit, you will be able to understand:

- ◆ **Meaning of subsidiary books**

- ◆ **Features of subsidiary books**

- ◆ **Advantages of subsidiary books**

- ◆ **Usual subsidiary books**

- ◆ **Steps in Preparation of purchases book, sales book, purchase returns books, sales return book**

4.2 Meaning of subsidiary Books

Subsidiary books or special journals are the various books of original entry maintained under the modern and practical system of accounting for recording directly in these books the various business transactions, as and when they take place. The subsidiary books are also called as special journals, as each book is maintained for recording special or specific type of transactions.

For example, in your restaurant everyday there would be hundreds of cash sales transactions. Instead of making hundreds of journal entries in one journal, you can maintain a separate Cash Sales Journal or Register where you record only cash sales transactions directly as and when they occur. You can total the amount of all transactions entered in this book at the end of the day and find out the total cash sales, which would not have been possible if you had entered them to ledger as the ledger posting and balancing is done

usually weekly or monthly. Similarly you can maintain a separate Subsidiary Book for cash transactions in a book called Cash Book. This would enable you to make only one entry in the cash book for all the cash sales transaction of the day as the total of cash sales transactions of the day is arrived by totaling the Cash Sales Register.

Similarly you can maintain subsidiary books for purchases, sales, purchase returns, sales returns etc.

Self assessment question

1. What are subsidiary book?

4.3 Features of Special Journals or subsidiary books

1. The special journals are books of original entry or first entry, because all transactions are first recorded in these books before they are recorded in their respective accounts in the ledger.

2. **Subsidiary books are considered as sub division of journal, because they do not provide the final accounting information relating to a business like in the case of journal.**

3. **Each subsidiary book is maintained for recording a special or specific type of transaction.**

4. **Subsidiary books are called daybooks, as transactions are recorded in these books daily or on the same day on which they take place.**

4.4 Advantages of special journals or subsidiary books

◆ Creation of useful information

It helps in creating useful information needed by decision makers or the owners. For example, in the case of Cash Sales Register or Credit Sales Register maintained in your restaurant you would be able to find out daily the amount of cash sales or credit sales.

◆ Division of work and simplification of work

Special journal provides an opportunity to divide accounting work among different persons. It results in specialization of work and efficient functioning.

For example, your cash sales register can be maintained by restaurant supervisor. Your cash book can be maintained by accountant in the back office.

◆ Minimum errors and frauds

Systematic recording of business transaction in special journal reduces the possibility of errors and frauds. For example, If there is any error in your cash sales register or cash book it would be easily found out as the total physical cash would not be equal to the one handed over by restaurant supervisor. Similarly chances of frauds by restaurant supervisor or main cashier are reduced as one of them would detect the fraud done by the other.

◆ Time saving

Due to division of work, it is possible to perform various accounting process simultaneously. Thus, lesser time is required to complete accounting records.

Self assessment questions

2. State the advantages of subsidiary books.

4.5 Usual Subsidiary Books

Very important subsidiary books are as follows

Subsidiary books	Nature of transactions Recorded
1. The Purchases book	1 Credit purchases of goods.
2. The Sales book	2 Credit sales of goods.
3. The Purchases Returns book	3 Goods returned to suppliers
4. The Sales returns book	4 Goods returned by customer
5. Cash Book	5 Cash Receipts and Payments

Note : Though Cash Book is a subsidiary book, most of the business concerns consider it as different from other subsidiary books as cash transactions are common in every type of business. More regarding cash book we shall study later.

Self assessment questions

3. Name different subsidiary books.

4.6 Purchases Book

Purchases book is also called as purchases day book, purchases journal, bought book, Inward invoice book.

Purchases book is used for recording only credit purchases of goods. Cash purchases of goods should be recorded in the cash book or cash purchases book and not in the purchases book. Credit purchases of things other than goods i.e. stationery items purchased for office on credit and assets like furniture, machinery etc purchased for office use on credit & not for resale should not be recorded in the purchases book.

Entries in the Purchases book are made with the help of invoices received from supplier of goods.

4.6.1 Invoice or Bill

Invoice or Bill is a statement, which gives the particulars like quantity, quality and price of goods. Invoice received by purchaser is called Inward Invoice.

Contents of invoice

- 1. The number of invoice.**
- 2. The date of invoice.**

3. **The name and address of the seller or supplier.**
4. **The name and address of the purchaser.**
5. **A brief description of quantity, quality and price of the goods.**
6. **The rate/price and the value of each goods mentioned in the invoice**
7. **Trade discount if any allowed by the purchaser**

INVOICE				
Large provision stores Ltd K. X. Rao road Mangalore				
Invoice No: 123				Date: 9-10-2000
To,				
Modern stores 10				
Chokpet				
Bangalore				
Terms: 2% cash discount for payment within a week.				
Serial No.	Description	Qty. in Skg	Rate	Amount
1	Rice	50	50	5,000
2	Wheat flour	50	100	7,000
				6,000
	Less: Trade Discount 10%			600
				5,400
	Add: Packing charges			100
	(Rupees five thousand five hundred only)			5,500
For SRS & Dry Goods		For Large provision stores Ltd		
		S. Kumar		
		Sales manager		
E.A.C.E.				

charges.

Self assessment questions

4. **What is invoice or Bill?**

5. **What is inward invoice?**

4.6.2 Advantages of purchases book

1. **Purchases book provides periodical total credit purchases.**

2. **When purchases book is maintained, each item of credit purchases is not posted to credit purchases account maintained in the ledger separately. Only the periodical total of credit purchases account is posted to such account.**

That means, much time and labour involved in posting to purchases account is saved.

3. Because of the purchases book, the number of pages of credit-purchases account in ledger is reduced.

4. From the purchases book, the total amount of credit purchases during a particular period can be known at a glance.

5. The possibility of any omission to record any credit purchase in purchases book is rare as this work can be delegated to /supervised by a specialist like accountant -purchases.

4.6.3 Format of Purchases book

Purchases Book				
Date	Particulars	Inward invoice No.	Ledger Folio	Amount
				Rs.

Date column is used for recording the date on which the invoice received.

Particulars column is used for recording the name of the supplier of goods.

Inward invoice No column is used for recording the serial number of invoice received.

Ledger folio column is used for recording the page no of ledger where supplier's account is maintained.

Amount column is used for recording the net amount (Net amount means amount after deducting packing and forwarding charges) of the invoice. 4.6.4

Trade Discount

Before discussing preparation of purchases book, it is necessary to know about trade discount. Trade discount is an allowance or deduction made from the invoice price, or list price of goods sold. It is allowed by the manufacturer or distributor to the purchaser.

Accounting treatment for trade discount

Trade discount should not appear in the books of both the parties, i.e. the seller and purchaser. Trade discount should be deducted from the invoice price or list price. The seller should record his sale in his books at the net value, and the purchaser should record his purchases in his books at the net cost.

Self assessment questions

6. What is trade discount?

4.6.5 Illustrations as to Purchases Book

Problem 1: Record the following transactions for the month of March 2006 in the purchases book of Modern Hotels.

March 5 Purchased from Nelson Provision Shop

5 bags of Rice at Rs.150 per bag

10 bags of Wheat at Rs.200 per bag

March 15 Purchased from Ravi Stores

10 kg. of coffee powder at Rs.100 per kg

Purchases Book					
Date	Particulars	Inward invoice No.	L.F.	Details	Amt.
				Rs.	Rs.
2006					
March 5	Nelson Provision Shop				
	5 bags of rice at 150 per bag			750	
	10 bags of Wheat at Rs 200 per bag			2 000	2 750
March 15	Ravi Stores				1 000
	10 kg coffee powder at Rs.100 per kg				
March 25	Suni stores				
	5 bags of sugar at Rs 250 per bag			1 250	
	Less: Trade discount at 10%			125	1 125
Total credit purchases					4 875

stores.

0 per bag. Trade discount at 10%

Note: In the ledger Accounts of Nelson Provision Shop, Ravi Stores, Sunil stores will be maintained and credit with the respective amounts on respective dates. Similarly credit purchase account is maintained in the ledger but only one entry for Rs.4,875 will be debited to that account for all credit purchases done in the month of March.

Problem 2. Record the following transactions for the month of March 2006 in the purchases book of National Hotels.

March 5 Purchased from Maharaja Provision Shop

5 bags of Wheat at Rs.150 per bag

10 bags of rice at Rs.200 per bag

Trade discount at 10%

March 15 Purchased from Kavita Stores

5 kg coffee powder at Rs.100 per kg

March 25 Purchased from Sudhir Stores

10 bags of sugar at Rs.250 per bag.

Entries in the Sales book are made with the help of duplicates of invoices (original is sent to the customer). Duplicate invoice retained with the trader is called as outward invoice or sales invoice.

4.7.1 Advantages of Sales Book

- 1. Total credit sales of goods during a particular period can be obtained easily and quickly from the sales book.**
- 2. Sales book helps to reduce the time and labour involved in posting to sales account.**
- 3. Because of sales book the pages of sale account in ledger kept small.**
- 4. The possibility of any omission to record any credit Sales in Sales book is rare as this work can be delegated to /supervised by a specialist like accountant-sales.**

Date	Particulars	Outward Invoice No.	Ledger Folio	Amount

Date column is used for recording the date on which the invoice sent.

Particulars column is used for Recording the name of the purchaser or the buyer of goods.

Outward invoice No. column is used for recording the serial number of invoice sent.

Ledger folio column is used for recording the page no of ledger where credit customers a/c is maintained

Amount column is used for recording the net amount (Net amount means amount after deducting packing and forwarding charges) of the invoice.

4.7.3 Illustrations as to sales book

Problem 1. From the following transactions prepare sales book

2006 Jan 1 Sold goods to Krishna Rs.1,000

Jan 5 Sold goods to Raghuveer Rs.2,500

Jan 15 Sold goods to Kumaran Rs.5,000 subject to trade discount at 5 %.

Sales Book					
Date	Particulars	Outward Invoice No.	Ledger Folio	Details	Amount
2006					Rs.
Jan 1	Krishna				1,000
Jan 5	Raghuveer				2,500
Jan 15	Kumaran			5,000	
	Less Trade discount at 5%			250	4,750
Total credit sales					7,750

ash Rs.3,500

Note: Transaction on 25th Jan 2006 is a cash transaction, so, it should not be recorded in sales book but it should be recorded in cash book or cash sales register.

Note: In ledger accounts of Krishna, Raghuveer and Kumaran is to be maintained and debited with respective amounts on respective dates. Similarly credit sales a/c would be maintained in the ledger but only one entry for Rs.7,750 would be credited for total credit sales of January 2006.

Problem 2. Prepare sales book from the following information.

June 1 Sold to Shanthi 5 chocolate ice-creams at Rs.25 each

June 5 Sold to Ajay 10 Dilkush at Rs.50 each

June 20 Sold to Avinash 5 Vanilla ice-cream at Rs.30 each and 10 strawberry ice-creams at Rs.30 each



Solution :

June 1	Sinathi (5 chocolate ice-creams at 25 each)			125
June 5	Ajay (10 Dilkush at Rs 50 each)			500
June 20	Avinash 5 Vanilla ice-cream at Rs 30 each		150	
	10 strawberry ice-creams at Rs 30 each		300	450
Total credit sales				1,075

4.8 Purchase Returns Book

Purchases Returns Book is intended for recording only return of goods bought on credit and allowances claimed in connection with goods bought on credit. Goods can be returned if goods supplied are not up to the sample or if the goods received are of wrong kind or the goods received are damaged in transit. Similarly, it may become necessary for a trader to claim allowance from his supplier for breakage, shortage or overcharge.

4.8.1 Debit note

Whenever goods are returned to a supplier or when an allowance is claimed from a supplier, a statement is prepared by a trader known as  Debit note . This statement is known as debit note because it informs the supplier that his account has been debited for the goods returned or for the allowance claimed

and the balance payable to him is reduced to that extent.

Self assessment questions

7. What is debit Note?

Date	Particulars	Debit note No.	Ledger folio	Amount

book

Date column is used for recording the date on which the debit note is sent.

Particulars column is used for recording the name of the supplier to whom goods are returned or from whom allowance are claimed.

Debit Note is used for recording the serial number of debit note sent.

Ledger folio column is used for recording the page no of ledger where the account of the supplier is maintained.

Amount column is used for recording the value of goods returned to supplier or amount of allowance claimed from the supplier.

4.8.3 Illustrations as to Purchase Returns Book

Problem 1. Enter the following transactions in the Purchases Returns Book.

2007 Feb 1 Returned goods worth Rs.100 to Divya and Co. Bangalore.

Feb 5 Returned goods worth Rs.50 to Poornima and Co Mangalore.

Date	Particulars	Debit note No.	Ledger Folio	Amount
2007				Rs.
Feb 1	Divya and Co. Bangalore			100
Feb 5	Poornima and Co Mangalore			50
Feb 25	Raviraj and Co. Udupi			300
	Total purchases Returns			450

Raviraj and Co, Udupi Rs.300 for shortage.

In ledger accounts of Divya & Co, Poornima & Co and Raviaraj & Co is to be debited with respective amounts on respective dates. Similarly Purchase Return a/c would be maintained in the ledger but only one entry for Rs.450 would be credited for total Purchase Returns of February 2006

Problem 2. Prepare Purchase Returns book from the following information

2006 April 1 Returned goods to Vinod Rs.200

April 5 Sent debit note to Jayanth for an overcharge by him Rs.100

Purchases Returns Book

Date	Particulars	Debit note No.	Ledger Folio	Amount
2006				Rs.
April 1	Vinod			200
April 5	Jayanth			100
April 10	Rajan			300
Total purchases Returns				600

Rajan Rs.300

4.9 Sales return book

Sales returns book is intended for recording only returns of goods sold on credit and allowances granted in connection with goods sold on credit.

4.9.1 Credit Note

Whenever goods are taken back from a customer or an allowance is granted to a customer, a statement is known as the **◆ Credit Note ◆ is prepared by the trader.**

This statement is known as the credit note, because it informs the customer that his account has been credited for the goods returned by customer or for the allowance granted to customer.

Self assessment questions

8. What is credit note?

Difference Between Debit Note And Credit Note

DEBIT NOTE	CREDIT NOTE
A debit note is prepared by the person who returns goods to supplier and is sent to the seller of goods	A credit note is prepared by the person who receives the goods returned by the customer and is sent to the buyer of the goods

Sales return book

Date	Particulars	Credit note No.	Ledger Folio	Amount

Date column is used for recording the date on which the credit note sent.

Particulars column is used for Recording the name of the purchaser or the buyer of goods.

Credit Note No. Column is used for recording the serial number of Credit Note No.

Ledger folio column is used for recording the page no of ledger where the account of customer is maintained

Amount column is used for recording value of goods returned by the customer.

4.9.3 Illustrations as to sales return book

Problem 1. Enter the following transactions in the sales return book.

2007 Feb 1 Divya Bangalore, returned goods worth Rs.100

Feb 5 Ramesh and company returned goods worth Rs.500

Sales return book

Date	Particulars	Credit note No.	Ledger Folio	Amount
2007				Rs.
Feb 1	Divya Bangalore			100
Feb 5	Ramesh and company			500
Feb 25	Raviraj and Co, Udupi			150
Total Sales return				750

raj and Co, Udupi for breakage Rs.150.

Note : In ledger accounts of Divya Bangalore, Ramesh and Company and Raviaraj & Co is to be credited with respective amounts on respective dates.

Similarly Sales Return a/c would be maintained in the ledger but only one entry for Rs.750 would be debited for total Sales Returns of February 2006.

Problem 2. Prepare sales return book from the following transactions. 2007 Jan 1 allowance granted to Ram Kumar Rs.350

Jan 5 sent credit note to Gireesh Rs.100

Date	Particulars	Credit note No.	Ledger Folio	Amount
2007				Rs.
Jan 1	Ram Kumar			350
Jan 5	Gireesh			100
Jan 27	Mahesh			600
Total Sales return				1,050

by Mahesh worth Rs.600

4.10 Illustrations as to all subsidiary books

Problem1: Enter the following transactions in the proper subsidiary books. 2004

Jan 1 Purchased goods from Mahesh of the list price of Rs.40,000 less 10% trade discount.

5 Sold goods to Suresh for Rs.10,000

6 Returned goods to Mahesh, list price being Rs.5,000

7 Naresh sent us goods for Rs.30,000

8 Sold goods to Ravish for Rs.12,000

19 Sent goods to Suresh for Rs.6,000

27 Sent goods to Ravish for Rs.8,000

30 Bought goods from Veeresh Rs.3,500

Purchases Book

Date	Particulars	Inward invoice No.	Ledger Folio	Details	Amount
2004 Jan 1	Mahesh			40,000	Rs.
	Less: Trade discount 10%			4,000	
Jan 7	Naresh				30,000
Jan 30	Veeresh				3,500
Total credit purchases					69,500

19	Suresh			6,000
27	Ravish			8,000
Total credit sales				36,000

Purchase Returns Book				
Date	Particulars	D.N.O.	L.F.	Amt.
2004 Jan 6	Mahesh (5,000 - 100 Trade discount)			Rs 4,500
Total purchase returns				4,500

Note: While Purchasing from Mahesh we have been give a discount of 10%. Now we are returning goods whose list price is Rs.5,000. But we have received this goods at Rs.4,500 after 10% Trade discount. Hence the amount due to Mahesh on account of these goods are only Rs.4,500. Hence this amount is debited to his account as these goods are returned to him

Problem 2. Enter the following transactions in the proper subsidiary books of Essar Bakers.

2001 Jan. 1 Sold to Ramesh 5,250

1 Bought from Ram 7,800

2 Ramesh returned goods 750

2 Sold to Dina Nath 5,500

2 Purchased goods from Mangal 7,000

4 Returned goods to Mangal 1,000

4 Bought of Devi Lal 3,250

4 Sold to Zakir Hussain 3,500

5 Zakir Hussain returned goods 40

6 Sold to Ram Saran 5,000

6 Sold to Ghanshyam 3,000

7 Ram saran returned goods 500

8 Returned goods to Devilal 250

9 Purchased goods from Raghunath

subject to a Trade discount of 10% 1,000

10 Sold to Raja Ram goods subject to discount at 5% Rs.5,000

5%				
			Total credit sales	27,000

Sales return book

Date	Particulars	Credit note No.	Ledger Folio	Amount
2006				Rs.
Jan 2	Ramesh			750
Jan 5	Zameer Hussain			40
Jan 7	Ram saran			500
			Total sales returns	1,290

Problem 3. Enter the following transactions of P.C.Lal Ice cream Parlor in Sales book, Sales returns book; Purchases book and purchases returns book.

2005

**July 5. Sold on credit to Sethi and co
5 units of Butter Scotch @ Rs.25
each 5 units of Vanilla @ Rs 15 each**

8. Purchased on credit from Kwaliti ice-cream

25 units of Dilkush @Rs.40

100 units of strawberry @ Rs.20

10. Purchased for cash from Mohan and co

10 units of chocolate ice-cream at Rs.30

15. Sold to Gopal Bros. on credit

10 units of Dilkush @ Rs. 50

5 units of strawberry at Rs.25

Purchases Book

Date	Particulars	Inward Invoice No.	L.F	Details	Amount
					Rs.
2006 July 5	Quality ice-cream 25 units of Dilkush @Rs 40 100 units of Strawberry @ Rs 20			1,000 2,000	3,000
July 20	Joy ice creams 100 units Raspberry @ Rs 20 100 units Custard @ Rs 20			2,000 2,000	4,000
Total credit purchases					8,000

Note: Transaction on 10th July is a cash transaction so, should not be entered in the purchases book.

Purchase Returns Book

Date	Particulars	Debit note No.	Ledger Folio	Amount
July 10	Quality ice-cream 5 units of Dilkush at Rs 40 each			Rs 200
Total purchase returns				200

5 units of Dilkush being spoiled.

15

Sales Book

Date	Particulars	Outward Invoice No.	Ledger Folio	Details	Amount
2006 July 5	Seth and Co 5 units of Butter Scotch @ Rs 20 each 5 units of Vanilla @ Rs 15 each			125 75	200
July 11	Opal Bites 12 units of Dilkush @ Rs 80 5 units of Strawberry @ Rs 20			960 125	1,085
Total credit sales					1,285

Sales return book

Date	Particulars	Credit note No.	Ledger Folio	Amount
2006 July 20	Opal Bites 1 unit of Dilkush at Rs 12			Rs 12
Total sales returns				12

Dilkush as the same was spoiled

4.11 Summary

Subsidiary books or special journals are the various books of original entry maintained under the modern or practical system of accounting for recording directly various business transactions, of similar nature as and when they take place. Subsidiary books reduce the work of accountants, provide useful information promptly and enable delegation of work to different specialists.

Very important subsidiary books are as follows:

Subsidiary books	Nature of transactions
-------------------------	-------------------------------

	Recorded
1. The Purchases book	1. Credit purchases of goods.

2. The Sales book	2. Credit sales of goods.
3. The Purchases Returns book	3. Goods returned to suppliers
4. The Sales returns book	4. Goods returned by customer
5. Cash Book	5. Cash receipts and payments

4.12 Terminal questions

1. **Record the following transactions in the sales book of Green hotels Ltd.**

2006 Jan 1 Sold to Jason

5 **units of Dilkush at Rs.50 each**

10 **units of strawberry at Rs.25**

Jan 5 Purchased from Naveen

100 **bags of rice at Rs.250 per bag**

30 **bags of ragi at Rs.200 per bag**

Jan 24 Returned one bag of rice to Naveen.

Jan 25 Purchased from Davidson and co

50 bags of sugar at Rs.200 per bag subject to trade discount at 10%

Jan 28 Sold to Kiran for cash 2 plates of north Indian meals at Rs.100 each. Jan 29

Purchased furniture on credit for Rs.1,000 from Modern Furniture & Co. Ltd.

2. Prepare purchases return book from the following transactions

2000 Nov.1 Returned goods to Chandan and Co

10 bags of rice at Rs.500 each

20 bags of wheat at Rs.400 each

**Nov. 5 Returned goods to Sudha and
Co 5 bags of sugar at Rs.200 each**

**5 bags of Ragi at Rs. 1000each
Less trade discount at 5%**

**3. Find out the total credit purchases, total credit sales, total purchase returns
and total sales returns from the following transactions.**

1999

January -1 Purchased goods from Mahendra of the list

Price of Rs.40,000 less 10% trade discount.

January -5 Sold goods Surendra for Rs.10,000

January -6 Returned goods to Mahendra list price being

Rs.5,000

January -7 Narendra sent us goods for Rs.30,000

January-8 Sold goods to Ravindra for Rs.12,000

January -19 Sent goods to Surendra for Rs.6,000

January-27 Sold goods to Ravindra for Rs.8,000

January-30 Bought goods from veerendra

Rs.3,500 4.13 Answers

Self assessment questions

- 1. Subsidiary books or special journals are the various books of original entry maintained under the modern system of accounting for recording directly the various business transactions, as and when they take place.**

2. Advantages of subsidiary books

- **Creation of useful information**

- **Division of work and simplification of work**

- **Minimum errors and frauds**

- **Time saving**

3. Very important subsidiary books are as follows

Subsidiary books	Nature of transactions Recorded
1. The Purchases book	1. Credit purchases of goods.
2. The Sales book	2. Credit sales of goods.
3. The Purchases Returns book	3. Goods returned to suppliers
4. The Sales returns book	4. Goods returned by customer
	5. Cash receipts and payments

4. **Invoice or Bill is a statement, which gives the particulars of the quantity, quality and price of goods.**

5. **Invoice received by the purchaser is called Inward Invoice.**

6. **Trade discount is an allowance or deduction made from the invoice price, or list price of goods sold. The manufacturer or distributor allows it to the purchaser.**

7. **Whenever goods are returned to a supplier or an allowance is claimed from a supplier, a statement is prepared by a trader known as ♦Debit note♦. This**

statement is known as debit note because it informs the supplier that his account has been debited for the goods returned or for the allowance claimed.

8. **Whenever goods are taken back from a customer or an allowance is granted to a customer, a statement is known as the trader prepares the ♦Credit Note♦.**

This statement is known as the credit note, because it informs the customer that his account has been credited for the goods returned by him or for the allowance granted to him

Less: trade discount 10%		1,000	9,000
		Total credit purchases	94,000

Purchase Returns Book

Date	Particulars	Debit note No.	Ledger Folio	Amount
2006 Jan 24	100/100000 bag of rice at Rs. 250 each			250
				Total purchase returns 250

Sales Book

Date	Particulars	Outward Invoice No.	Ledger Folio	Details	Amount
2006 Jan 1	Jason				Rs
	5 units of Orikush at Rs 50 each			250	
	10 units of strawberry at Rs 25			250	500
					Total credit sales 500

Note:

1. **Purchase of furniture should not be entered in the purchases book, because furniture is a fixed asset not goods.**

2. **Cash Sales should not be entered in the sales book, that should be entered in cash book. Hence transaction of Jan.28th is omitted from Sales Book.**

Date	Particulars	Debit note No.	Ledger Folio	Details	Amount
2000 Nov 1	Chander and Co 10 bags of rice at Rs.500 each 20 bags of wheat at Rs.400 each			5,000 8,000	13,000
Nov 2	Sinha and Co 5 bags of sugar at Rs.200 each 5 bags of Raji at Rs.1000 each Less trade discount at 5%			1,000 5,000 200	5,700
Total purchase returns					18,700

o transactions relating to sales return, so, we unt.

3. **Total credit purchases Rs.69,500**

Total credit sales Rs.36,000

Total purchase returns Rs.4,500

Total sales returns Rs.Nil

UNIT 5

5.1 Introduction

In every business entity, there will be a number of transactions relating to cash. We have studied subsidiary books are used to directly enter special or common types of transactions in these books. Therefore, it is necessary to maintain a separate book for cash transactions i.e. for all cash receipts and payments of cash.

Objectives

After studying this unit, you will be able to understand

- ◆ **Meaning of cash book**

- ◆ **Features of cash book**

- ◆ **Advantages of cash book**

- ◆ **Types of cash book**

- ◆ **Preparation of cash book**

5.2 Meaning of Cash Book

Cash book is also one of special journal or subsidiary book which is used for recording special transactions i.e. only transactions relating to cash.

According to Andrew Munro, ◆ Cash book is used for recording the receipts and payments of money, whether in coins, notes, cheque, postal orders, bank draft etc.◆

So, cash book is a book of original entry where all cash receipts and cash payments are recorded as and when they take place. It is a book of prime or first

entry as well as final entry. It plays the double role of journal as well as ledger. This is because not only the cash transactions are directly entered in cashbook, like in the case of journal, the cash balance on day-to-day basis is found out in cash book and hence it acts like cash account in a ledger. Hence, when cash book is maintained there is no need to have separate cash account in the ledger. All transactions relating to cash such as cash purchases, cash sales, cash received from debtors, cash paid to creditors, cash paid for different expenses, cash received from different sources etc. are recorded in the cash book.

Self Assessment Questions

- 1. What is Cash Book?**

5.3 Features of cash book

- 1. It is a book of primary or original entry or principal book.**
- 2. Only cash transactions are recorded in the cash book.**
- 3. It is subsidiary book or special journal as it records only special transactions relating to cash.**
- 4. It is a book of original as well as final entry as it serves purposes of both journal as well as ledger.**

5. All cash receipts are recorded on the debit side of the cash book and all cash payments are recorded on the credit side of the cash book.

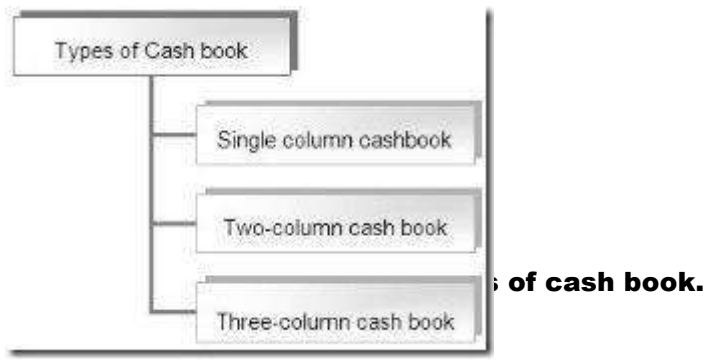
Self Assessment questions

2. State any two features of Cash Book.

5.4 Advantages of cash book

The advantages of cash book are as follows.

- 1. It is useful for recording all cash receipts and cash payments during a given period.**
- 2. It helps to know the cash balance in hand and at bank at any time.**
- 3. It saves time and labour.**
- 4. It simplifies the recording of cash transactions.**
- 5. It helps in detecting mistakes or errors easily.**
- 6. It helps to avoid fraud and misappropriation of cash.**



Self Assessment Questions

3. What are the types of cash book?

5.6 Simple cash book

A simple cash book is also called as single column cash book or cash book with cash column only. Simple cash book is a cash book which contains only one amount column. That means amount column is used only for cash. It is just like an ordinary cash account. Generally, the small business concerns

maintain the simple cash book.

Dr.					Cr.				
1	2	3	4	5	6	7	8	9	10
Date	Particular	R.No.	L.F	Amount	Date	Particular	V.No.	L.F	Amount
				Rs.					Rs.

The simple cash book has two sides, viz. 1) Left hand side or debit side 2) Right hand side or credit side. The debit side is used for recording cash receipts, and the credit side used for recording cash payments. Each side of the simple cash book has 5 columns.

- 1. First column, Date column on the debit side is used for recording date of cash received.**
- 2. Second column, Particular column on the debit side is used for recording name of the person from whom cash is received or the name of the thing for which cash is received or the name of the income for which cash is received.**
- 3. Third column on the debit side, ♦Receipts Number or R.No.♦ is used for recording the serial number of the receipt which is issued at the time of receipts of cash.**
- 4. Fourth column, ♦Ledger Folio♦ or L.F on the debit side is used for**

recording page number of the ledger to which a particular item from the cash book is

posted.

5. Fifth column, Amount column on the debit side is used for recording amount of the cash received.

6. Sixth column, Date column on the credit side is used for recording date of cash paid.

7. Seventh column, Particular column on the credit side is used for recording name of the person from whom cash is paid or the name of the thing for which

cash is paid or the name of the expense for which cash paid.

8. Eighth column on the credit side, Voucher Number or V.No. is used for recording the serial number of the Voucher which is received at the time of

payments of cash.

9. Ninth column, Ledger Folio or L.F on the credit side is used for recording page number of the ledger to which a particular item from the cash book is

posted.

10. Tenth column, Amount column on the credit side is used for recoding amount of cash paid.

Points to be noted while preparing simple cash book:

1. If there is any opening cash balance, that should be entered on debit side of the cash book as **◆ To balance b/d ◆**.

2. Every receipt of cash has to be entered on the debit side of the cash book. If receipt is from a person on account, then, it has to be entered as **◆ To concerned person ◆s account ◆**. If the receipt is for the sale of goods, then, it has to be entered as **◆ To sales Account ◆**. If the receipt is for the sale of assets, then, it has to be entered as **◆ To concerned asset Account ◆**. If the receipt is for an income, then, it has to be entered as **◆ To concerned income Account ◆**.

3. Every payment of cash has to be entered on the credit side of the cash book. If payment made to a person on account, then, it has to be entered as **◆ By concerned person ◆s account ◆**. If the payment is for the purchase of goods, then, it has to be entered as **◆ By purchase Account ◆**. If the payment is for the purchase of assets, then, it has to be entered as **◆ By concerned asset Account ◆**. If the payment is for an expense, then, it has to be entered as **◆ By concerned income Account ◆**.

4. Cheques received and deposited into bank and cheques issued to others have to be recorded in cash book as well as bank account opened in the ledger. But usually, a business firm which maintains simple cash book may not have a bank account.

5. If firm allowed any discount or received discount, can not be entered in simple cash book, as there is no discount column in the cash book.

6. After recording all cash transactions, it has to be balanced at the end of given period. At the time of balancing of simple cash book, it should be noted that the total of the debit side should always more than the total of credit side, because

cash payments cannot be more than cash receipts. Balance amount should be written before closing the cash book as **By balance c/d**.

Illustration 1:

Enter the following in simple cash book

2006 January 1 Balance of cash in hand Rs.3,500

2 Purchased goods for cash Rs.300

5 Sold goods for Rs.400 for cash

15 Received commission Rs.50

19 Paid rent Rs.200

25 Paid to Ram Rs.1,000

28 Received from Kumar Rs.500

Cash Book									
Dr.					Cr.				
1	2	3	4	5	1	2	3	4	5
Date	Particulars	V.No.	L.F.	Rs.	Date	Particulars	V.No.	L.F.	Rs.
2008				Rs.	2008				Rs.
Jan 1	To Balance b/d			3,500	Jan 2	By Purchase Ac			300
5	By Sales Ac			400	10	By Rent Ac			200
15	By Commission Ac			50	25	By Ram Ac			1,000
25	By Kumar's Ac			500	29	By Furniture Ac			500
					31	By Salary Ac			1,000
					31	By Balance c/d			1,450
				4,450					4,450
Foot	To Balance b/d			1,450					

cash Rs.500

office staff

5.7 Two column cash book

Two column cash book is also called as double column cash book or cash book with discount and cash column.

Before we discuss the two column cash book, let us know something about cash discount, which is required to be entered in the two column cash book.

Cash Discount:

To encourage the prompt payment or quick payment the trader allows discount to his debtor. So, cash discount is an allowance or deduction made from the amount due. The creditor allows this to the debtor. The trader receives discount from his creditors, when he pays their dues promptly. The discount received from his creditor is called cash discount received. Similarly, the trader allows discount to his debtors, when they pay their dues promptly. The discount allowed is called cash discount allowed. The main object of cash discount is to induce the debtor to make quick payment.

Treatment of cash discount in the books of account

Generally, cash discount is not paid or received actually in cash. It is only an adjustment made in the account of a debtor or a creditor. When cash discount is allowed to a debtor for his prompt payment, discount allowed account is debited and the debtor's account is credited. Similarly, when cash discount received from the creditor for the prompt payment made to him, the creditors account is debited and the discount-received account is credited. Cash discount arises only when cash is received or paid. Since cash received and paid is recorded in

the cash book, it will be convenient to record the discount allowed and received in the cash book itself. So, the cash book is having discount columns on each side for recording cash discount received and cash discount allowed. The cashbook, which contains an additional column for discount on each side, is known as Cash book with discount and cash columns or Two-column cashbook or Double column cash book.

Difference between cash discount and trade discount

Trade Discount	Cash Discount
1. It is a reduction in the invoice price	1. It is a reduction in the amount due from the debtor
2. It is allowed by the seller to the buyer	2. It is allowed by the creditor to the debtor
3. It does not appear in the books of accounts of both the parties	3. It appears in the books of accounts of both the parties
4. It helps the trader to earn a reasonable profit	4. It encourages the debtor to make prompt payment

Format of Two-column cash book

The format of two-column cash book is same as single column cash book, but only difference is one more additional discount column is added on each side.

as follows:

Cashbook											
1	2	3	4	5	6	7	8	9	10	11	12
Side	Particular	R.No	L.F	Disco-ant	Cash	Date	Particular	V.No	L.F	Disco-ant	Cash
					Rs.						Rs.

1. **First column, ◆Date◆ column on the debit side is used for recording date of cash received.**

2. **Second column, ◆Particular◆ column on the debit side is used for recording name of the person from whom cash is received or the name of the thing for**

which cash is received or the name of the income for which cash received.

3. **Third column on the debit side, ◆Receipts Number or R.No.◆ is used for recording the serial number of the receipt which is issued at the time of receipts**

of cash.

4. **Fourth column, Ledger Folio or L.F on the debit side is used for recording page number of the ledger to which a particular item from the cash book is**

posted.

5. **Fifth column, Discount column is used for recording amount of discount allowed at the time of receipt of cash.**

6. **Sixth column Cash column on the debit side is used for recording amount of the cash received.**

7. **seventh column, Date column on the credit side is used for recording date of cash paid.**

8. **Eighth column, Particular column on the credit side is used for recording name of the person from whom cash is paid or the name of the thing for which cash is paid or the name of the income for which cash paid.**

9. **Ninth column on the credit side, Voucher Number or V.No. is used for recording the serial number of the Voucher which is received at the time of payments of cash.**

10. **Tenth column, Ledger Folio or L.F on the credit side is used for recording page number of the ledger to which a particular item from the cash book is**

posted.

11. Eleventh column, **Discount** column is used for recording amount of discount received at the time of payment of cash.

12. Twelfth column, **Cash** column on the credit side is used for recording amount of the cash paid.

Points to be noted while preparing two-column cashbook:

1. In the case of a two-column cash book, it is necessary to maintain separate bank account in the ledger for recording all banking transactions, such as deposits into bank and withdrawals from the bank, payment made by cheques etc.

2. Opening cash balance should be entered on debit side of the cash book as **To balance b/d**.

3. Every receipt of cash has to be entered on the debit side of the cash book. If

receipt is from a person on account, then, it has to be entered with concerned person's name as **To concerned person's account**. If the receipt is for the sale of goods, then, it has to be entered as **To sales Account**. If the receipt is for the sale of assets, then, it has to be entered as **To concerned asset Account**. If the receipt is for an income, then, it has to be entered as **To**

concerned income Account. Amount of cash received should be written in cash column.

4. Every payment of cash has to be entered on the credit side of the cash book. If payment made to a person on account, then, it has to be entered as **By concerned person's account**. If the payment is for the purchase of goods, then, it has to be entered as **By purchases Account**. If the payment is for the sale of assets, then, it has to be entered as **By concerned asset Account**. If the payment is for an income, then, it has to be entered as **By concerned expense Account**. Amount of cash paid should be written in cash column.

5. **If any cheque, draft or postal order received and not deposited into bank on**

the same day should be treated as cash received. As and when it is deposited in the bank, the entry should be made in the credit side as By Bank account

6. **If any cheque, draft or postal order received and banked on the same day,**

then, it should be treated as two transactions, first, as to receipt of cash from some account , say, Mr.A's a/c which should be entered on the debit side of cash book as To Mr.A's a/c and secondly, as to depositing the cheque etc into bank which should be entered on the credit side of cash book as By Bank account

7. **Cheque which was received on a previous date, if it is deposited into bank the**

same has to be treated as cash deposited into bank. The entry should be made in the credit side as **By Bank account** as already mentioned in Point 5

8. Any payment made by cheque should be treated two transactions, first, as withdrawal of cash from bank which should be entered on the debit side as **To Bank account** and secondly, as to payment of cash on some account which should be entered on the credit side as **By concerned person's account** (for payment made to any other person) or **By concerned expense account** (for expense paid by cheque) or **concerned assets account** (for purchase of asset

and payment by cheque)

9. Cheque drawn by the owner for personal use has to be treated as two

transactions, first, as to withdrawal of cash from bank and entered on the debit side as **To Bank account** and secondly, as to payment of cash to owner and entered on the credit side as **By owner's drawings account**

10. Bank charges charged by the bank has to be treated as two transactions, first, as withdrawal of cash and entered on the debit side as **To Bank account** secondly, payment of cash for bank charges and entered on the credit side as **By Bank Charges account**.

11. **When interest is credited by the bank on deposits it has to be treated as two transactions, first, receipt of cash and entered on the debit side as To Bank Interest account for bank interest received and secondly, for the interest amount being deposited into bank entered on the credit side as To Bank account.**

12. **When cheque issued is dishonored (returned unpaid or bounced), the original**

entry made when cheque was issued as mentioned in Point 8 is to be reversed. Thus the concerned person's account is written on debit side (even in the case

of payment for expenses or assets as some person was to receive the amount even in these cases) and Bank account is mentioned in credit side of cash book.

13. **For the cash discount allowed to a customer, while receiving cash from him,**

the discount will be entered in the discount column on the debit side of the cash book and against the concerned party's name , the cash amount received is

entered in the cash column of debit side of cash book.

14. **The cash discount received from a supplier, while paying cash to him, will be**

entered in the discount column on the credit side of the cash book against the concerned party's name and the amount of cash paid is entered in the cash

column of the credit side of the cash book.

15. After recording all cash transactions, it has to be balanced at the end of given period. At the time of balancing of two column cash book, it should be noted that the total of the debit side should always more than the total of credit

side, because cash payments cannot be more than cash receipts. Balance amount should be written before closing the cash book as \diamond By balance c/d \diamond . (It

may be noted that discount column should not be balanced, but it should be totaled up both the sides and the both total should be written on respective total row, total of discount column on debit side represents total discount allowed and total of discount column on credit side represents total discount received).

Problems on Two-column cash book

Problem 1: Prepare cash book with discount and cash columns.

2006

Illustration 2:

Prepare two column cash book from the following transactions and also prepare bank account.

2006 April 1 Cash in hand Rs.3,000 and at bank Rs.4,000 April 2 Goods sold for cash Rs.5,500

**April 4 Furniture sold for Rs.400
April 5 Cash sales Rs.4,000**

April 8 Purchased goods for Rs.3,000 on credit from Vishnu. April 9 Purchased goods worth Rs.1,000 from Sunil for cash April 10 paid interest Rs.100

April 15 Rent paid by cheque Rs.1,000 April 16 Paid postage Rs.50

April 17 Received cheque from Prasad for Rs.2,000 and allowed him discount of Rs.200.

Cash Book											
Dr						Cr					
Date	Particular	R.No.	L.F.	Debit	Credit	Date	Particular	R.No.	L.F.	Debit	Credit
2008						2008					
April	To Balance b/d			3,000		April	By Purchase (C)				3,000
1	By Opening Balance				8,500		By Purchase (S)				100
2	By Cash					10	By Interest Acc				100
4	By Furniture (A)			400		15	By Rent paid				3,000
5	By Cash (A)			4,000		18	By Postage Acc				50
8	By Cash (A)			5,000		20	By Bank Acc				2,000
17	By Present Acc			200	2,000	25	By Cheque Deposited				4,000
	By Reserve (Share)			4,000		28	By Savings Acc				3,000
25	By Bank Acc			9,000		30	By Balance b/d				13,750
26	By Bank Acc			2,000							
30	By Bank Acc			2,000							
				200	22,500						22,500
May 1	To Balance b/d			13,750							

ed from Prasad. into bank

.4,000

k for personal use Rs.1,000

Bank A/c							
Dr				Cr			
Date	Particular	J.F.	Amount	Date	Particular	J.F.	Amount
2008				2008			
April 1	To Balance b/d		4,000	April 15	By Cash A/c		1,000
April 23	By Cash A/c		2,000	28	By Cash A/c		4,000
April 30	By Balance b/d		2,000	30	By Cash A/c		1,000
			8,000	30	By Cash A/c		2,000
				May 1	By Balance b/d		2,000

k for office use 2,000.

Note: April 8, Purchased goods for Rs.3,000 on credit from Vishnu is a credit transaction, should not be entered in cash book and this should be entered in purchases book.

Illustration 3:

Enter the following transaction in a cash book with discount and cash columns and show the balance.

2004

January 1 cash in hand Rs.250 and at bank Rs.10,650

January 1 Sold goods for cash Rs.5,700

January 2 Received a cheque from Mr. Govind for Rs.750 in full settlement of his account for Rs.775

January 3 Sent Govind's cheque to bank for collection.

January 6 Bought goods, and paid by cheque Rs.5,000

January-10 Paid rent for the month of November by cheque Rs.500

Dr.						Cr.					
Cash book											
1	2	3	4	5	6	7	8	9	10	11	12
Date	Particular	K.No	L.F	De	Cash	Date	Particular	V.No	L.F	Cr.	Cash
2004						2004					
Jan 1	To Balance b/d				200	Jan 1	By Sale Ac				700
	Opening balance brought over						Sale Ac				
1	By Sale Ac				6,700	8	Purchase Ac				6,000
	Cash sales						Goods purchased				
2	To Cash Ac			28	700	10	By Sale Ac				800
	Received cheque from Mr. Kalidas						Sale Ac				
8	By Sale Ac				8,000	15	By Sale Ac				800
	Received cheque from Mr. Kalidas						Sale Ac				
10	By Sale Ac				800	22	Postage Ac				80
	Received cheque from Mr. Kalidas						Postage Ac				
15	By Commission Ac				900	31	Balance c/d				8,900
	Cheque received from Mr. Kalidas						Balance c/d				
				28	12,800						12,800
					8,800						
	To Balance b/d										

commission earned from Mr. Kalidas of Dharwar
 Section Rs.600

Rs Rs.50

Illustration 4:

From the following particulars prepare a two-column cash book for December

- Commenced business with cash Rs.10,000**

2. **Opened a current with bank Rs.5,000**

4. **Received for cash sales Rs.13,500**

5. **Paid cash to Bank Rs.5,000**

8. **Received from Mr. Karan a cheque for Rs.2,000, in full settlement of Rs.2,025**
9. **Mr. Karan's cheque of Rs.2,000, deposited into Bank**

15. **Received Arun's cheque of Rs.3,000 and paid directly into Bank**

18. **Purchased furniture and paid by cheque Rs.2,000**

24. **Paid Wages Rs.200**

26. **Drew cheque for private expenses Rs.2,800**

27. **Paid to Jayant by cheque for commission Rs.200**

31. **Paid cash in excess of Rs.2,000 to Bank.**

Also prepare a Bank Account

Solution

30	Bank A/c		2,000	24	Wages A/c		200
	Chas. Comm.				Freights		
27	Bank A/c		2,000	25	Drawings by		2,000
	Drawings		200		Widow's share by		
				27	Commission A/c		
					Prof. Commission		200
				31	Bank A/c		11,300
					Drawings by cash		2,000
				31	Balance c/d		2,000
			11,300				11,300
Jan 1	To Balance b/d		2,000				

Note : the amount of Rs.11,300 paid into bank is arrived by totaling the debit side and deducting all the amounts on credit side , including the balance c/d of

Dr.				Bank A/c				Cr.			
Date	Particular	J.F.	Amount	Date	Particular	J.F.	Amount				
Dec 2	To Cash A/c		5,000	Dec 18	By Cash A/c		2,000				
5	To Cash A/c		5,000	20	By Cash A/c		2,000				
9	To Cash A/c		2,000	27	By Cash A/c		200				
15	To Cash A/c		3,000	31	By Balance c/d		21,300				
30	To Cash A/c		11,300								
			26,300				26,300				
Jan 1	To Balance b/d		21,300								

.2,000 as the Illustration mentions that the is to be paid into bank, meaning the cash

Self Assessment Question

4. **What is cash discount?**

5. **State any two differences between cash discount and trade discount.**

5.8 Three column cash book

Usually, businessman opens a current account with bank and deposits his excess money in the bank. When an owner of the business with a bank opens a current account, he can deposit his excess money or surplus money and can withdraw whatever amount he requires from time to time. When a concern opens a current account with a bank, it has to maintain a record of its dealings with bank in its cashbook. The concern can maintain a record of its banking transaction through a two-column cash book or through a three column cash book.

When bank transactions are recorded in two-column cash book, whenever a payment made by cheque, three entries have to be made for recording the transaction. Two entries in the cash book and third in the separately maintained

bank account in the ledger. We have seen how cumbersome this method of cash book in the above illustrations. As a result, maintaining two column cash book becomes highly difficult. In order to overcome this problem, the cash book itself may be provided with an additional bank column on either side. The cash book that contains bank column in addition to discount and cash column is called three column cash book or cash book with discount, cash and bank columns or triple column cash book.

The advantage of three-column cash book is that, whenever payment is made by a cheque, the entry can be made directly in the bank column on the credit side of the cash book.

However in three column cash book also confusion might arise while we have to enter transactions involving only cash and bank. These are done through contra entries.

Contra Entries:

The term \diamond Contra \diamond is a Latin word, and it means the other side or opposite or against. In accounting, this term means the both the sides of any account. With regard to Three-column cash book this term means opposite or both the side of the cash book.

The entries made on both the sides of cash book, one in the cash column and the other in the bank column, for a transaction which affects both cash and bank are called as Contra Entries.

Basically there are some transactions which are treated as contra entry:

1. If cash, cheque, bank draft or postal order is deposited into the bank, two

entries have to be made in the three-column cash book. First an entry has to be made in the cash column on the credit side as **By Bank account as cash goes**

into bank, secondly , an entry has to be made in the bank column on the debit side as **To Cash account since this amount comes into bank. Then, the letter **C** has to be written in the ledger folio column on each side against**

these entries, which indicates that these are actually part of one journal entry involving cash and bank transactions.

2. If cash is drawn for office use two entries have to be made in the cash book. Firstly, an entry is made on debit side as **To Bank account for receipt of cash from bank and secondly, another entry is made on the credit side as **By cash account** for withdrawal of the amount from bank. Then, the letter **C** has to be**

written in the ledger folio column on each side against these entries which indicates that these are actually part of one journal entry involving cash and bank transactions

Cash book											
Debit						Credit					
1	2	3	4	5	6	7	8	9	10	11	12
Date	Particulars	R.No.	L.F	Dr.	Cr.	Date	Particulars	R.No.	L.F	Dr.	Cr.

1. **First column, Date column on the debit side is used for recording date of cash received.**

2. **Second column, Particular column on the debit side is used for recording name of the person from whom cash,cheque etc is received or the name of the account for which cash, cheque is received or the name of the income account towards which cash, cheque received.**

3. **Third column on the debit side, Receipts Number or R.No. is used for recording the serial number of the receipt which is issued at the time of receipts of cash or cheque etc.**

4. **Fourth column, Ledger Folio or L.F on the debit side is used for recording**

page number of the ledger to which a particular item from the cash book is posted.It is also used for writing C to indicate contra entries.

5. **Fifth column, Discount column is used for recording amount of discount allowed at the time of receipt of cash/cheque.**

6. **Sixth column \diamond Cash \diamond column on the debit side is used for recoding amount of the cash received including that is withdrawn from bank.**

7. **Seventh column \diamond Bank \diamond column is used for recording amounts deposited by way of cash, cheques etc into bank.**

8. **Eighth column, Date column on the credit side is used for recording date of cash paid.**

9. **Ninth column, Particular column on the credit side is used for recording name of the person from whom cash/cheque is paid or the name of the account for which cash/cheque is paid or the name of the income account towards which cash/ cheque is paid.**

10. **Tenth column on the credit side, Voucher Number or V.No. is used for recording the serial number of the Voucher which is received at the time of payments of cash/cheque etc.**

11. **Eleventh column, \diamond Ledger Folio \diamond or L.F on the credit side is used for recording page number of the ledger to which a particular item from the cash**

book is posted.

12. Twelfth column, **Discount** column is used for recording amount of discount received at the time of payment of cash/cheque.

13. Thirteenth column, **Cash** column on the credit side is used for recording amount of the cash paid.

14. Fourteenth column, **Bank** column on the credit side is used for recording amount paid through cheque /DD etc or the amount withdrawn for office use.

Points to be noted while preparing three column cash book:

1. Opening cash balance and bank balance should be entered on debit side of the cash book as **To Balance b/d**. Cash balance should be written in the cash

column and bank balance should be written in the bank column. If there is any

credit balance of bank account, that should be written on credit side of the cash book in the bank column as **By Balance b/d** (credit balance in bank account is

possible because banks allow customers overdrafts whereby you can issue cheques or withdraw amounts which is in excess of your deposits in a bank account)

2. Every receipt of cash has to be entered on the debit side of the cash book. If

receipt is from a person on account, then, it has to be entered in the concerned person's name as To concerned person's account. If the receipt is for the sale of goods, then, it has to be entered as To sales Account. If the receipt is for the sale of assets, then, it has to be entered as To concerned asset Account. If the receipt is for an income, then, it has to be entered as To concerned income Account. Amount of cash received should be written in

cash column.

3. Cheque received and not deposited into bank on the same day has to be treated as cash received and entered in the cash column on the debit side of the cashbook.

4. Cheque received and deposited into bank on the same day has to be entered in the bank column on the receipts side of the cashbook.

5. Cheque received on any previous day and deposited into bank will be treated as cash paid into bank. This involves a contra entry. Hence in the debit side bank column and in the credit side cash column should contain the amount of cheque deposited.

6. Every payment of cash has to be entered on the credit side of the cash book. If payment made to a person on account, then, it has to be entered as By concerned person's account. If the payment is for the purchase of goods, then, it has to be entered as By purchase Account. If the payment is for the sale of

assets, then, it has to be entered as **By concerned asset Account**. If the payment is for an income, then, it has to be entered as **By concerned expense Account**. Amount of cash paid should be written in cash column.

7. **If payment is made by cheque, draft or postal order that amount should be written directly in the bank column on the credit side of the cash book.**

8. **The cash discount allowed to a customer, while receiving cash from him, will**

be entered in the discount column on the debit side of the cash book against the concerned party's name. The amount of cash received is entered in the cash

column of the debit side of the cash book. Similar entries will be made in case of discount allowed while receiving cheque from a customer, only difference being the amount of cheque received is written in the bank column in the debit side of the cash book.

9. **The cash discount received from a supplier, while paying cash to him, will be**

entered in the discount column on the credit side of the cash book against the concerned party's name. The amount of cash paid is entered in the cash

column of the credit side of the cash book. Similar entries will be made in case of discount received while making payment through cheque to a customer, only difference being the amount of cheque paid is written in the bank column in the credit side of the cash book.

10. **Cheque issued by us if dishonored has to be entered in the bank column on the receipts/debit side of cash book. If customer's cheques received by us is**

dishonoured ,the entry should be made on the bank column in the credit side of cash book.

11. **Cheque drawn by the owner for personal use has to be entered on the credit side as By Owner's drawings account in the bank column Bank charges charged by the bank has to be entered on the credit side as By Bank Charges account in the bank column.**

12. **When interest is credited by the bank on deposits entered on the debit side as To Bank Interest account in the bank column.**

13. **After recording all cash transactions, it has to be balanced at the end of given period. At the time of balancing of cash book, it should be noted that the total of cash column on the debit side should always more than the total of credit side, because cash payments cannot be more than cash receipts. But bank column may show debit balance or credit balance due to overdraft allowed by bank. Balance amount whether cash or bank should be written before closing the cash book. As in two column cash book discounts column are totaled on**

both sides , debit side indicating discounts allowed and credit side indicating discount received.

Illustrations on Three column cash book:

Illustrations1. Enter the following transaction of a merchant in a three column cash book.

2005 JAN. 1 Commence business with Rs.10,000

2 Paid into bank Rs.8,000

7. Purchased goods by cheque Rs.3,000

10. Paid rent Rs.150

11. Purchased furniture by cheque Rs.3,000

15 Cash sales Rs.650

16. Gave to Gopal a cheque of Rs.970 (allowed discount Rs.30)

17. Received from Narayana a cheque of Rs.1,500

been allowed by bank. In such cases, by observation, the students should find out that credit side of bank column is more and should total the credit side of bank column first, so that balance on the debit side can be easily arrived.

28. **Bought Postage Stamps Rs.50**

29. **Bank charges Rs.100**

Problem 3:

Prepare a Triple Column cash book from the following information of M/s Krishna Hotels. Give narrations.

Jan. 1 Balance of cash in hand Rs.400 and Overdraft at bank Rs.1,600

Jan. 3 Paid to J. Jones by cheque Rs.950 in full settlement of

Rs.1,000 Jan. 5 Bought goods for cash Rs.80 and for cheque Rs.300

Jan. 6 Drew cash from Bank for office use Rs.300

Paid wages in cash Rs.250

Paid woods and Co. Rs.120 by cheque.

Jan. 8 Sold Goods for cash Rs. 8,000

Jan 8 Received cheque from J. Robinson Rs.320 in full settlement on account of Rs.340

Jan. 9 Deposited the cheque received from J Robinson into the bank. Jan. 9 Paid Rs.920 into Bank.

Jan. 10 Received cheque from Williams Rs.4,200 on account and sent to the bank on the same day.

Jan. 11 Paid John Rs.4,750 in full settlement of his account of Rs.5,000.

Jan. 11 Received cheque from C.Stevenson Rs.600 in full settlement of his account of Rs.615.

Dr.		Cash book												Cr.	
1	2	3	4	5	6	7	8	9	10	11	12	13	14		
Day	Particulars	A	L	Dr	Cr	Dr	Cr	Particulars	A	L	Dr	Cr	Dr	Cr	
1	To Balance b/d							By Balance b/d							100
1	To Robinson's (Cheque)					40		By Robinson's (Cheque)							100
1	To Bank A/c (Cheque)					30		By J. Robinson's (Cheque)							90
1	To Bank A/c (Cheque)					600		By Robinson's (Cheque)							30
1	To Bank A/c (Cheque)					20		By Cash A/c							20
1	To Bank A/c (Cheque)					30		By Cash A/c							30
1	To Bank A/c (Cheque)					20		By Cash A/c							20
1	To Bank A/c (Cheque)					100		By Cash A/c							100
1	To Bank A/c (Cheque)					420		By Cash A/c							20
1	To Bank A/c (Cheque)					600		By Cash A/c							60
1	To Bank A/c (Cheque)					80		By Cash A/c							80
1	To Bank A/c (Cheque)					4750		By Cash A/c							4750
1	To Bank A/c (Cheque)					20		By Cash A/c							20
1	To Bank A/c (Cheque)					2750		By Cash A/c							2750
1	To Bank A/c (Cheque)					240		By Cash A/c							240
				20	100	4390							100	100	4340
1	To Balance b/d					2750	240								

Robinson was the cash book.

Illustration 4

Prepare the cash book with discount and bank columns from the following transactions.

2004 Jan 1 Commenced business with cash Rs.20,000

2 Paid for cash purchases Rs.4,000

4 Sold goods for cash Rs.6,000

5 Received cheque from Amar Rs.2,000 and allowed him

Self Assessment questions:

6. **What is a contra entry?**

7. **Give one example for contra entry.**

5.9 Summary

Cash book is a book of original entry where all cash receipts and cash payments are recorded as and when they take place. It is a book of prime or first entry as well as final entry.

A simple cash book is also called as single column cash book or cash book with cash column only. Simple cash book is cash book which contains only

one amount column.

Two column cash Book is as cash book which contains discount and cash column.

Three column Cash book is a cash book which contains discount, cash and bank column use for recording cash receipts and cash payments as well as banking transactions.

Cash discount is an allowance or deduction made form the amount due.

The entries made on both the sides of cash book, one in the cash column and the other in the bank column, for a transaction which affects both cash and bank are called as Contra Entries.

5.10 Terminal questions

1. From the following information prepare simple cash book.

2006 Feb 1 Balance of cash in hand Rs.7,000

◆ 2 Purchased goods for cash Rs.600

◆ 5 Sold goods for Rs.800 for cash

◆ 15 Received commission Rs.100

◆ 19 Paid rent Rs.200

◆ 25 Paid to Ram Rs.2,000

◆ 28 Received from Kusuma Rs.1,000

2. **Prepare a cash book with discount, cash and bank columns2004**

Jan 1. Cash in hand Rs.250 and at Bank Rs.10,650

5 **Sold goods for cash and Banked the proceeds Rs.5,700**

6 **Received a cheque from Mr. Govind for Rs.775 in full settlement for Rs.800**

10. **Sent Govind's cheque to bank for collection.**

16. **Bought goods and paid by cheque Rs.5,000**

20. **Paid Rent by cheque Rs.500**

25. **Received a cheque for commission earned from Mr. Pramod**

and sent the same to bank for collection Rs.600

30. **Bought Postage Stamps Rs.5**

31 **Bank charges Rs.10**

3. **Prepare two column cash book from the following transactions.**

2006

**April 1 Cash in hand Rs.3,000 and at bank
Rs.4,000 April 2 Goods sold for cash Rs.5,500**

**April 4 Furniture sold for Rs.400
April 5 Cash sales Rs.4,000**

**April 8 Purchased goods for Rs.3,000 on credit from
Vishnu. April 9 Purchased goods worth Rs.1,000 from Sunil
for cash April 10 paid interest Rs.100**

**April 15 Rent paid by cheque
Rs.1,000 April 16 Paid postage Rs.50**

**April 17 Received cheque from Prasad for Rs.2,000 and allowed him discount of
Rs.100.**

**April 20 Deposited cheque into bank received from
Prasad. April 26 Salary paid by cheque Rs.4,000**

**April 28 Withdrew cash from bank for personal use Rs.1,000
April 30 Withdrew cash from bank for office use 2,000.**

5.11 Answers

Self assessment questions

1. **According to Andrew Munro, Cash book is used for recording the receipts**

and payments of money, whether in coins, notes, cheque, postal orders, bank draft etc.

2. **Features of cash book**

It is book of primary or original entry or principal book.

Only cash transactions are recorded in the cash book.

It is subsidiary book or special journal as it records only special transactions relating to cash.

3. **Types of cash book**

1. **Simple cash book**

2. **Two column cash book**

3. **Three column cash book**

4. **Cash discount is an allowance or deduction made form the amount due. This is allowed by the creditor to the debtor.**

5. **Difference between trade discount and cash discount**

Trade Discount	Cash Discount
1.It is a reduction in the invoice price	1.It is a reduction in the amount due from the debtor
2.It is allowed by the seller to the buyer	2.It is allowed by the creditor to the debtor

6. **The entries made on both the sides of cash book, one in the cash column and the other in the bank column, for a transaction which affects both cash and bank are called as Contra Entries.**

7. **Example for contra entry:**

1. **Cash paid into bank.**

2. **Cash withdrawal from bank for office use.**

Terminal q

Cash Book									
Dr.					Cr.				
1	2	3	4	5	1	2	3	4	5
Date	Panicular	R.No	L.F	Amount	Date	Panicular	V.No	L.F	Amount
2005				Rs. 2000					Rs.
Feb 1	To Balance b/d			7,000	Feb 2	By Purchase A/c			400
5	" Bank A/c			800	15	" Rent A/c			200
15	" Commission A/c			100	25	" Rent A/c			2,000
28	" Purchase A/c			1,000		To Balance b/d			5,100
				8,900					8,900
March 1	To Balance b/d			5,100					

Cash book														
1	2	3	4	5	6	7	8	9	10	11	12	13	14	
Dec	Faktura	A.No	L.P	Da	Ca	Be	Dec	Faktura	V. No	L.P	Da	Ca	Be	
Jan	To Balance				350	11.050	Jan	By Bank A/c				775		
4	Bank A/c					8.700	10	By Purchase A/c					8.000	
2	Goods A/c			25	775		20	By Bank A/c					500	
10	Debit A/c					775	30	By Purchase A/c				5		
20	Commission A/c					500	31	By Charges A/c				245	11	
							31	By Balance					12.210	
				25	1.025	17.725						-	1.025	17.725
Jan	To Balance				345	12.210								

Solution 3:

27	Bank AC Bank of America New York	100	2,000	28	Bank AC Bank of America New York	4,000
28	Bank AC Bank of America New York		4,000	29	Bank AC Bank of America New York	1,000
29	Bank AC Bank of America New York		1,000	30	Bank AC Bank of America New York	13,750
30	Bank AC Bank of America New York		2,000			
		100	22,500			- 22,500
Net	To Balance		13,750			

UNIT 6

6.1 Introduction

In the previous unit we have studied about how a two column cash book with bank account or three column cash book with bank column is maintained. We also know how to balance the cash book or ledger accounts. It is possible that the balance of bank account or bank column of cash book need not be identical to the balance shown as per Bank Statement issued by our bank due to many reasons.

In this unit we study how a business deals with any differences between the balance of the bank account in the cash book and the closing balance of the bank account shown by the bank statement or pass book for the same period. These differences are explained by a statement known as a bank reconciliation statement. This statement lists:

- ◆ Items which are recorded in the cash book but not on the bank statement**

- ◆ Items which are recorded on the bank statement but not in the cash book**

This process enables the business to update its cash book and also helps to prove the accuracy of the bookkeeping of the business and of the bank.

Objectives:

After studying this unit, you will be able to understand:

- ◆ **Need for Bank Reconciliation statement**
- ◆ **Meaning of Bank Reconciliation statement**
- ◆ **Advantages of Bank Reconciliation statement**
- ◆ **Reasons for difference in balances of cash book and pass book**
- ◆ **Steps in preparing Bank Reconciliation statement**

6.2 Need for Bank Reconciliation statement

Most organisations keep a record of their cash and bank transactions in a cash book usually with three columns. This type of cash book contains a record of both the cash account and the bank account and shows the balance in each account at the end of a period.

When a business firm opens a current account with a bank, the bank also keep a record of all the banking transactions of the business firm. The bank records all transactions made by the business firm or trader with the bank in the particular customer's account opened in its ledger. The bank copies down the entries and the balance in the customer's current account in its ledger in a small bound note book called the bank pass book or in a sheet called Bank statement and hands over the same to the customer for his verification.

So, Pass book or Bank statement is just a copy of the customer's account in the ledger of banker. The same transactions are recorded in both the books. But the transactions are recorded in opposite directions or sides. The items recorded on the debit side of the cash book are recorded on the credit side of the pass book, and the items recorded on the credit side of the cash book are recorded on the debit side of the pass book. This is because any payment made by us to bank is receipt to bank and vice versa.

Both the cash book and the pass book contain the same banking transactions. As the same banking transactions are recorded in the cash book and in the pass book, it is natural to expect that the bank balance shown by the cash book and the bank balance as shown by the pass book should be same on any particular day.

For example, consider bank column in your cash book appears as follows.

Cash Book(only bank column)

Date	Particulars	Amount	Date	Particulars	Amount

		(bank)			(bank)
1-1-07	To bal b/d	10000			
2-1-07	To cash	5000			
			3-1-07	By cash	3000
			31-1-07	By bal c/d	12000
	Total	15000		Total	15000

The same transactions in your bank pass book or bank statement appear as follows.

Pass Book or Bank Statement

Date	Particulars	Amount (bank)	Date	Particulars	Amount (bank)
			1-1-07	By bal b/d	10000
			2-1-07	By cash	5000
3-1-07	To cash	3000			
31-1-07	Toy bal c/d	12000			
	Total	15000		Total	15000

Often, when a comparison is made between the bank balances as shown in the firm's cash book with that shown on the bank statement, the two balances might be will be different. For example, in the above case if the bank balance as per pass book is say , Rs.15,000 there would be difference

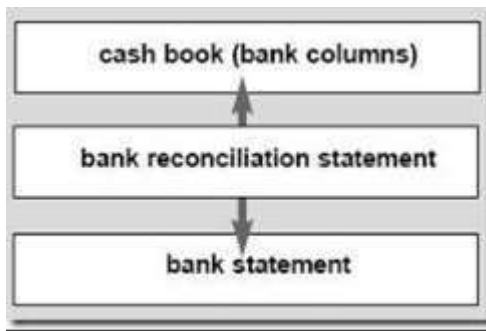
between pass book and cash book balances. It is for this reason that a bank reconciliation statement is prepared to reconcile (tally up) the two balances or in other words, to find the cause of difference.

Self assessment questions:

- 1. What is pass book?**
- 2. Why a bank reconciliation statement is prepared ?**

6.3 Meaning of Bank Reconciliation Statement

Bank reconciliation statement is a statement prepared to reconcile the bank balance as per the cash book with the bank balance as per the bank statement or the pass book. In other words, it is statement prepared to reconcile the cash



balance after analyzing the causes for the
able adjustment for removing the causes of

Fig 6.1 The figure showing the status of Bank Reconciliation Statement

6.4 Advantages of Bank Reconciliation Statement:

It helps in detection of errors of omission of entries or wrong entries made either by the bank or by the business firm(customer of bank).

It helps the customer to know the causes for difference between cash book balance (bank column) and pass book balance.

It helps the customer to know the balance that is really available in his bank account.

It makes the customer to keep his cash book up-to-date.

It helps in reducing the frauds or misappropriation of bank balances by comparing cash book balance(bank column) and pass book balance.

6.5 Reasons or causes for disagreement between bank balance as per the cash book and bank balance as per passbook

1. Cheque issued but not presented for payment:

Customer of the bank issues cheque to any other party which may not have been presented for payment on a particular day. As such, if the cash book balance and pass book balance is compared on a particular day, the both will not agree with each other. Because cheque issued is recorded only in the cash book but not in the pass book where it would be recorded only on presentation.

2. Cheque deposited but not collected:

When we receive cheque from any other party and deposits the same into the bank, we immediately record the same on the debit side of the cash book in the bank column . But the bank will make corresponding entry only when cheque is

collected from the other party. As such, if the cash book balance and the pass book balance is compared in the meantime, they will not agree with each other.

3. Cheque received and entered on the debit side of the cash book but not deposited into bank for collection:

Sometimes, the customer might have received cheque from any other party and entered in the cash book but not sent to the bank. As such, no entry will be there in the pass book. If both the balance is compared in the meantime, they will not agree with each other.

4. Cheque deposited dishonoured:

Sometimes, cheque deposited into bank dishonoured. It has the same effect as a cheque deposited but not collected.

5. Interest allowed and entered on the credit side of pass book:

Sometimes, Interest on deposits is recorded in the pass book but not in the cash book. We come to know of interest only when we receive pass book. Hence difference would exist on a particular day.

6. Collection of interest on securities and dividend:

Interest and dividend collected by the bank and entered only in the pass book

is one of the cause for difference in cash book balance and pass book balance as the customer would not be having knowledge of these collections.

7. Interest, bank charges and commission etc., charged by the bank:

Bank charges interest or other charges for overdrafts or other facilities provided by it. These entries made only in the pass book. Corresponding entries would not be there in the cash book which may be cause for difference between the two books.

8. Errors or wrong entries made in the cash book or pass book or both:

Errors made by the customer in the cash book or by the banker in the pass book is one of the cause for disagreement of balances of both the book.

9. Omissions:

If certain entries omitted by the banker or by the customer the same may be a cause for the difference.

6.6 Steps in preparation Bank Reconciliation Statement(BRS)

1. Take the cashbook or passbook balance as starting point. The following points have to be noted while taking the starting balance

- ❖ **Debit balance as per cashbook indicates positive or favorable balance.**

- ❖ **Credit balance as per cashbook means overdraft or negative or unfavorable balance.**

- ❖ **Debit balance as per passbook means overdraft or negative or unfavorable balance.**

- ❖ **Credit balance as per passbook means favourable or positive balance.**

If the starting point denotes a favourable balance take it as positive figure. However, if the starting point denotes negative unfavourable balance, take it as negative figure.

2. Make additions or deletion to the starting point amount as per the information provided.

3. When once the BRS is complete, the balance as per in the other book is obtained For example cashbook balance is obtained if the starting point is passbook balance and vice versa. If the final balance is positive, it denotes favourable balance (debit balance as per cashbook or credit balance as per the passbook). However, if the final balance is negative, it denotes the unfavourable balance or overdraft. (Credit balance as per cashbook or debit balance as per passbook).

The following table summarises the impact of various differences and errors on the starting balance.

Case 1: If the starting balance is cash at bank or debit balance as per cash book

Bank Reconciliation statement		
Items	Rs	Rs.
Bank balance as per cash book		XXXX
Add:		
A) Items credited only in cash book but not in the pass book		
1. Cheque issued but not presented	XXXX	
2. Cheque issued and entered in the cash book but dishonoured etc.	XXXX	
B) Items credited only in pass book		
1. Direct payment made by customer	XXXX	
2. Amount collected by the bank on behalf of the business firm (rent, dividend, interest on investment etc.)	XXXX	
3. Cheque deposited but omitted to be record in cash book	XXXX	
C) Wrong entry made on the credit side of pass book only.	XXXX	XXXX
D) Wrong entry made on the credit side of cash book only		XXXX
Less:		
A) Items debited only in the cash book but not in the pass book		
1. Cheque deposited into bank and entered in the cash book but not collected by the bank	XXXX	
Cheque paid into the bank but dishonoured etc.	XXXX	
B) Items debited only in the pass book but not in the cash book		
1. Bank charges and interest charges charged by the bank	XXXX	
2. Payments made by the bank on behalf of business firm	XXXX	
3. Cheque issued and omitted in the cashbook but recorded in the pass book etc.	XXXX	
C) Wrong debit made in the pass book only		XXXX
D) Wrong debit made in the cash book only		XXXX
Bank balance as per pass book		XXXX

**Case 2: If the starting balance is cash at bank or credit balance as per pass book
The above procedure (i.e. procedure followed for case 1) has to be reversed.**

That means instead of adding the items deduct those items from balance as per cash book and instead of deducting the items add those items

Case 3: If the starting balance is bank overdraft or credit balance as per cash book

The above procedure (i.e. procedure followed for case 2) has to be reversed.

It means Case 1 is to be followed

Case 4: If the starting balance is bank overdraft or debit balance as per pass book

The above procedure (i.e. procedure followed for case 3) has to be reversed

6.7 Summary

Bank reconciliation statement is a statement prepared to reconcile the bank balance as per the cash book with the bank balance as per the bank statement or the pass book. In other words, it is statement prepared to reconcile the cash book balance and pass book balance after analyzing the causes for the disagreement and making suitable adjustment for removing the causes of disagreement.

6.8 Terminal Questions

1. What do you mean by Bank reconciliation statement?

2. State any two reasons for difference in the Bank balance in cashbook and pass book.

6.9 Answers

Self Assessment Question

1. Pass book or Bank statement is just a copy of the customer's account in the ledger of banker.

2. To explain the causes for difference between the balances of cash book and pass book, the bank reconciliation statement is prepared.

Terminal Questions

1. Bank reconciliation statement is a statement prepared to reconcile the bank balance as per the cash book with the bank balance as per the bank statement or the pass book. In other words, it is statement prepared to reconcile the cash book balance and pass book balance after analyzing the causes for the

disagreement and making suitable adjustment for removing the causes of disagreement.

2. Reasons or causes for disagreement between bank balance as per the cash book and bank balance as per passbook

- 1. Cheque issued but not presented for payment:**

- 2. Cheque deposited but not collected:**

- 3. Cheque received and entered on the debit side of the cash book but not deposited into bank for collection:**

UNIT 7

7.1 Introduction

We already discussed major functions of accounting i.e. journalizing the business transactions, classification and posting entries from journal to ledger and transferring all balances of ledger accounts to the trail balance. In this unit we will discuss the most important functions of accounting i.e. summarizing and interpreting the results of the business by preparing financial statements.

Objectives:

After studying this unit, you will be able to understand.

- ◆ **Meaning of financial statements**

- ◆ **Objectives of financial statements**

- ◆ **Trading account**

- ◆ **Profit and loss account**

- ◆ **Balance sheet**

- ◆ **Preparation of Final accounts**

7.2 Meaning of final accounts

Final accounts are the summaries of ledger accounts organized in such a manner as to show the profit or loss of the business for the accounting year and financial position of the business at the end of the accounting year. Though accounting year can be any period consisting 12 months most of the business units adopt financial year i.e April to March as the accounting year.

The final accounts help the management to ascertain the progress made by the business from one period to another period. Final accounts provide correct and concise picture of profitability and financial position of the business. Final accounts are the end products of accounting process. Final accounts provide complete accounting information to all end users like owner, employees, creditors and bankers etc through which decisions can be taken by these users.

The final accounts are also called as financial statements

The important final accounts or financial statements are:

1. **Trading account**

2. **Profit and loss account**

3. **Balance sheet**

Trading account gives trading profit or trading loss of the business, profit and loss account gives net profit or net loss of the business and balance sheet shows the list of assets and list of liabilities and net worth of a business.

Self assessment questions

1. **What are final accounts?**

7.3 Trading Account

Meaning:

The trading account is an account which shows merely the result of Trading which may be gross profit or gross loss. It is the account which shows the result of buying and selling of goods without taking into account administration, selling and distribution expenses incurred in conducting the business.

Gross profit or loss is difference between net sales and the cost of goods sold. Cost of goods sold is calculated by adding opening stock, purchases, direct expenses in purchasing or manufacturing the goods and deducting closing stock from the total.

Preparation of Trading Account:

The trading account is prepared from only those transactions which are directly connected with the goods. Such transactions are:

- 1. Opening stock i.e. stock of goods at the beginning of the trading period.**
- 2. Purchase of goods i.e. raw materials or finished products purchased for manufacturing or selling the final product.**

3. **Purchases returns i.e. goods returned to the supplier.**

4. **Direct expenses incurred on the purchase of goods and on production or for making the goods ready for sale. Such as :**
 - i) **Carriage inward** ♦ **Expenses incurred for bringing the goods purchased to the premises of a business firm. For eg. Carriage, cartage, freight etc. paid for transportation of goods.**

 - ii) **Import duty and Clearing charges incurred on the purchase of goods.**

 - iii) **Wages** ♦ **Wages paid to the workers or labourers who are directly engaged in the manufacture of goods.**

 - iv) **Power and light which are the direct expense incurred for the manufacture of goods.**

 - v) **Other direct expenses such as factory expenses, factory rent, factory insurance, salary to works manager and materials for special packing of goods etc.**

5. **Sale of goods** ♦ **Finished goods sold to customer.**

6. **Sales returns- Finished goods returned by the customer.**

7. **Closing stock** \blacklozenge **Stock of goods at the end of the trading period.**

Opening stock, net purchases (i.e. Purchase amount after deducting purchase returns from the purchases) and direct expenses are recorded on debit side of the trading account and net sales (i.e. after deducting sales return from the sales) and closing stock are recorded on credit side of the trading account.

If the total of credit side is more than the total of debit side, the difference is called as Gross Profit and if the total debit side is more than the total of credit side, the difference is called as Gross Loss.

Form of Trading Account:

Dr.		Trading Account for the year ended				Cr.	
Particular	Amount	Amount	Particular	Amount	Amount		
To Opening stock of provisions, liquor etc.	XXX	XXX	By Restaurant sales	XXX			
Restaurant Purchases	XXX	XXX	Less Sales Return	XXX	XXX		
less Purchase return			To Closing stock of provisions, liquor etc.			XXX	
Direct Expenses	XXX		Gross loss or gross loss transferred to P & L account)			XXX	
Carriage inward	XXX						
Cartage	XXX						
Freight inward	XXX						
Import duty	XXX						
Cleaning charges	XXX						
Wages	XXX						
Power, fuel gas	XXX	XXX					
Other direct expenses		XXX					
To Gross profit or (balancing figure transferred to P & L A/c)		XXX					
		XXX				XXX	

Note: Gross profit is the difference between credit side and debit side of trading account. Or in other words if credit balance exists in trading account it is called as Gross Profit ,

On the other hand if debit balance exists in Trading account it is called Gross Loss.

Both Gross Profit and Gross Loss do not exist together in a Trading A/c

Closing entries for the trading account are:

All the accounts, except the Closing Stock , that appear in Trading account

1. Trading A/c	Dr.
To Opening Stock A/c	
To Net purchases A/c	
To Direct Expenses A/c	

balance. Trial balance, as we know is a list of
ring in a ledger. Thus the accounts with balances
transferred to trading account. Such closing of
ring to Trading Account is called closing entries.
of a Trading A/c are

2. Net Sales A/c	Dr
Closing Stock A/c	Dr
To Trading A/c	

appear with debit balances in ledger. Now they are by giving debit to Trading A/c

3. a) For Gross profit

Trading A/c	Dr
To Gross Profit A/c	

As already mentioned, if credit side is more than debit side there would be Gross Profit.

b) For gross loss

Gross loss A/c	Dr
To Trading A/c	

not appearing in trail balance is decided
 closing stock account is to be debited as it is an
 n to Trading Account.

If debit side is more than credit side there would be Gross Loss

Self assessment questions

2. What is closing stock?

7.4 Profit and Loss Account

Meaning

The second important final account of a business is Profit and loss account. Profit and loss Account is an account, which shows the net profit or net loss. The net profit or loss is the profit earned or loss suffered after charging all business expenses. It is final profit or loss of a business.

Preparation of Profit And Loss Account:

For preparation of Profit And Loss Account, Gross profit or gross loss, as shown by the trading account, is to be transferred to the profit and loss account. If there is gross profit, it is entered on the credit side of profit and loss account. If there is gross loss, it is entered on the debit side of the profit and loss account.

All indirect expenses and losses are entered on debit side of the profit and loss account and all indirect incomes and gains are entered on credit side of the profit and loss account.

Indirect expenses are as follows:

- i) **Selling and distribution expenses** ♦ **The expenses incurred to improve the sales or to attract the customers are taken as selling and distribution expenses.**

For eg: advertisement expenses, carriage or freight outwards, export expenses, selling expenses, agents and travelers commission and their expenses, trade expenses, samples, upkeep of motor vehicles etc.

ii) Management expenses ♦ **The expenses incurred to run organization smoothly called management expenses. For e.g. Rent, rates and taxes, postage and**

telegrams, office salaries, printing and stationery, legal charges, audit fee, general expenses, insurance etc.

iii) Maintenance expenses ♦ **The expenses incurred for maintaining the fixed assets of the business. For e.g. repairs and renewals, depreciation etc.**

Depreciation is the decrease in the value of an asset due to wear and tear, lapse of time, exhaustion and accident.

iv) Financial Expenses ♦ **The expenses incurred to meet the financial needs of the business. For e.g. Interest on loan, interest on capital, discount allowed etc.**

v) Miscellaneous expenses ♦ **Other expenses such as charity given, donation given, loss of goods, and other assets by fire, theft etc. and all other expenses**

which are not included in the above four categories.

Indirect Incomes are incomes other than sales such as commission received, discount received, interest received, surplus on the sale of fixed assets etc.

Net Profit is the excess of credit side total over debit side total of Profit and loss account and the same is transferred to (added to) capital account appearing in Balance Sheet. This is because the profit belongs to the owner and his investment in the business (capital) increases to that extent. Hence in Profit and Loss Account, this credit balance is written as **Net Profit transferred to Capital Account**

Dr		Rs.	Particular	Rs.
	To Gross Profit B/D	XXX	By Gross Profit B/D	XXX
	To Office Expenses		By Indirect Incomes	XXX
	Salaries	XXX	Rent Received	XXX
	Office Rent	XXX	Interest Received	XXX
	Printing And Stationery	XXX	Commission Received	XXX
	Postage And Telegram	XXX	Bad Debt Recovered	XXX
	Office Insurance	XXX	Interest On Drawings	XXX
	Office Lighting And Heating	XXX	Income From Investment	XXX
	Audit Fees	XXX	By Net Loss (Gaining) Figure	XXX
	General Expenses	XXX	Transferred To Capital Account in	XXX
	To Maintenance Expenses		Balance Sheet	
	Repairs And Renewals	XXX		
	Depreciation Etc.	XXX		
	To Selling And Distribution			
	Expenses			
	Commission Paid	XXX		
	Traveling Expenses	XXX		
	Printing Charges	XXX		
	Carriage Outward	XXX		
	Rent And Insurance	XXX		
	Bad Debt B/D	XXX		
	To Financial Expenses			
	Interest Paid	XXX		
	Bank Discount Allowed	XXX		
	Discount On Bills Discounted Etc.	XXX		
	To Net Profit (Gaining) Figure	XXX		
	Transferred To Capital Account in			
	Balance Sheet			
		XXXX		XXXX

expenses) in Profit and Loss Account are more than (direct incomes) it indicates that there was a Net Loss. If the credit side total is less than the debit side total, it is transferred to Capital Account as the owner has to bear the loss in the Capital account in the Balance Sheet, as the owner's investment is reduced to that extent.

Profit:

Combined Trading and Profit and loss account:

For convenience, trading and profit and loss account is combined together and is known as trading and profit and loss A/c. First part is prepared to know the gross profit or gross loss and second part is prepared to know the net profit or net loss.

The combined format of Trading and Profit and Loss Account is as follows.

Particular	Amount	Amount	Particular	Amount	Amount
To Opening stock		100000	By Sales	1000000	1000000
* Purchases	300000		Less: Return inwards	300000	1000000
Less: Return outwards	30000	300000	By Closing stock		300000
* Wages		300000			
* Gross Profit cd		300000			
		100000			1000000
To Salaries		100000	By Gross profit bd		300000
* Rent and Taxes		100000			
* Insurance		100000			
* Printing and stationery		100000			
* Net profit transferred to capital account		100000			300000
		100000			300000

Self assessment questions

3. Give any two examples for indirect expenses.

7.5 Balance Sheet

Meaning:

We have studied about the Accounting Equation ie Owner's Capital + Liabilities

= Assets.

We have studied the meaning of these terms Capital, Liabilities and Assets. We know that any transaction can be ultimately represented in the form of above accounting equation. Thus the ultimate effect of any set of transaction

would be shown by way of aforesaid equation. The aforesaid equation when presented in the form of a statement is called Balance Sheet.

The trading and profit and loss account shows only the net profit or net loss of the business for a certain period. But an owner of the business is usually interested to know not only the net profit or net loss of his business for a certain trading period, but also the financial position of his business at the end of the trading period. For example, in restaurant you are not only interest in knowing how much profit you made, you are also interested in find out how much money has to come to you or how much is due from you to others or what happened to your investment in the business. For this purpose you have to prepare a statement of assets and liabilities as on the closing date of the trading period. This statement of assets and liabilities is called as Balance Sheet. The balance sheet is a major financial statement prepared at the end of Balance Sheet. The balance sheet is also called as statement of financial position.

Definition:

It the words of Freeman \diamond a balance sheet is an item wise list of assets, liabilities and proprietorship of a business at a certain date \diamond .

According to J.R. Botliboi \diamond a balance sheet is a statement prepared with a view to measure the exact financial position of a business on a particular date \diamond .

From the above definition it is clear that, balance sheet shows financial position of the business prepared at end of trading period.

Advantages of balance sheet:

- 1. Balance sheet helps in ascertaining the financial position of a concern as on a particular date.**
- 2. Balance sheet gives information about various assets.**
- 3. Balance sheet gives information about various liabilities and capital**
- 4. Balance sheet helps in ascertaining solvency of the business.**
- 5. Balance sheet helps to management in solving financial problems.**

Classification of assets and liabilities

Assets:

Asset refers to resources acquired by the business either from the funds made available by the owner or the creditors of the business. In other words, assets are properties owned by the business for carrying the business. All the assets of the business can be classified into the following types:

◆ **Fixed assets:** Fixed Assets are those, which are permanent in nature used in the business and intended not for sale. The purpose of purchasing these assets

is not for re-sale but retain them in the business. In other words, fixed assets are

those assets with a useful life greater than one year. Generally, fixed assets are Kitchen equipment, building, furniture◆s and fittings, production plants and

property, Land etc. Fixed assets are valued at cost less depreciation.

◆ **Current assets:** Current assets are assets that are usually converted to cash within one year easily. These assets are also called as floating assets as their

value goes on changing many times even in a day. Examples for current assets are cash, bank balance, stock, debtors, bills receivable short term investment, prepaid expenses, outstanding incomes etc. Current assets are valued at cost or market price whichever is less.

Assets can also be classified as follows:

◆ **Intangible assets:** Intangible assets are those, which can◆t be seen or touched. These assets are non-physical assets such as copy rights, patents,

trade marks, good will etc.

◆ **Tangible assets:** Tangible assets are those assets, which can be seen or touched. Examples of such assets are plant and machinery, furniture◆s and

fixtures, land and building etc. which have some physical existence.

❖ **Wasting assets:** Wasting assets are those assets which are exhausted gradually in the process of their use. Examples for wasting assets are mines,

patents, lease hold premises, oil wells, quarries etc.

❖ **Fictitious assets:** These assets are mere debit balances i.e. expenses and losses, carried forward one accounting year to another. These assets do not

have a real value. These assets also called as nominal assets. Examples for fictitious assets are discount on issue of shares or debentures, debit balance of profit and loss account, deferred revenue expenditure etc.

Liabilities:

Liabilities are obligations or responsibilities of a business owes to outside parties. In other words, liability may either be a debt or loan or the amount which the business firm owes to the outsiders. Liabilities can be classified into the following categories.

- **Fixed liabilities or long term liabilities:** Fixed liabilities are those liabilities which are repayable at least after one year or more. Examples

for fixed liabilities are loans, debentures, mortgages, public deposits etc.

- **Current liabilities or short-term liabilities:** Current liabilities are those which are to be repaid within a year of the date of balance sheet.

Examples for current liabilities are bank overdraft, creditors, bills payable, outstanding expenses, income received in advance etc.

Owner's capital:

Owner's capital or shareholder's equity is the value of a business to its owners after all of its obligations have been met. Owner's capital together with Net profit is called Net worth. It is possible that the owner might have drawn part of his net worth by way of drawings for his personal purposes. Hence Net worth is $\text{Owner's Capital} + \text{Net Profit (or minus Net Loss)} - \text{Drawings}$. The net worth belongs to owners.

Arranging of assets and liabilities in the balance sheet:

Assets and liabilities are arranged in the balance sheet in two ways-

- 1. In order of liquidity**
 - 2. In order of permanence**
-
- 1. In the order of liquidity**

In this method, an asset which is most easily convertible into cash is written first and it is followed by those assets which are comparatively not very easily convertible, so that the least liquid asset will be shown at last. In the same way, the liabilities are arranged in order of urgency of payment.

2. In order of permanence

This method is totally reverse of above liquidity order. Assets which are permanent in nature are written first and which are most liquid are written last. In the same way, those liabilities which are to be repaid last will be

Balance sheet as on

Liabilities		Rs.	Assets		Rs.
1. Current liabilities.			1. Current Assets		
Bank over draft		XXX	Cash in hand		XXX
Bills Payable		XXX	Cash at bank		XXX
Sundry Creditors		XXX	BS Payable		XXX
Outstanding Expenses		XXX	Sundry Debtors		XXX
Income received in advance		XXX	Closing stock		XXX
2. Fixed liabilities.		XXX	Prepaid expenses		XXX
Long term loans			Outstanding incomes		XXX
3. Capital			7. Long term investments		XXX
Capital		XXX	8. Fixed Assets		
Add: Net profit	XXX		Loose tools		XXX
Inc. on capital	XXX		Furniture and fixtures		XXX
		XXX	Vehicles		XXX
Less: Drawings	XXX		Plant and machinery		XXX
Interest on drawings	XXX	XXX	Land and Buildings		XXX
			Goodwill etc.		XXX
		XXX			XXX

and funds are recorded first of all, then long liabilities.

of liquidity

Balance sheet as on					
Liabilities		Rs.	Assets		Rs.
1. Capital			1. Fixed Assets		
Capital	1000	1000	Loose tools	1000	
Add: Ret profit	1000	1000	Furniture and fixtures	1000	
Int. on capital	1000	1000	Vehicles	1000	
	1000	1000	Plant and machinery	1000	
Less: Drawings	1000	1000	Land and Buildings	1000	
Interest on drawings	1000	1000	Goodwill etc.	1000	
	1000	1000		1000	
2. Fixed Liabilities			2. Long term investments		
Long term Loans			3. Current Assets		
2. Current liabilities			Cash in hand	1000	
Bank over draft			Cash at bank	1000	
Bills Payable			Bills Receivable	1000	
Sundry Creditors			Sundry Debtors	1000	
Outstanding Expenses			Closing stock	1000	
Income received in advance			Prepaid expenses	1000	
		1000	Outstanding incomes	1000	
		1000		1000	

of Permanence:

Self assessment questions

4. Define balance sheet.

7.6 Adjustments in Final Accounts

Adjustments are additional information which are not accounted while drawing the trial balance properly. For example, you might have paid salary to your cook for only 11 months of the year. One month's salary might be due to him. While

preparing Trading and Profit and Loss Account you have to arrive at correct

profit. If you assume only 11 months salary is to be considered then the profit shown by your firm would be incorrect .Because as on the date of preparation of financial statement you know that all 12 months salary is an expense for you though 12th months salary is yet to be paid. Hence while preparing Profit and loss account you have adjust the Salary figure.

Thus in many other cases Adjustment by account might be required.

Adjustments given in the problem are always adjusted two times, first in the trading or profit & loss account and secondly in the balance sheet.

Following table shows some common adjustments and their treatment in the Trading or profit & loss account and in the balance sheet.

Treatments of usual adjustments in final accounts are given below in the table:

Adjustments	Meaning	Treatment in the Trading or profit and loss account	Treatment in the Balance Sheet
1. Closing stock	Stock of goods at the end of the trading period.	To be entered on the credit side of the trading a/c	To be shown on the Assets side of the balance sheet
2. Outstanding Expenses or accrued expenses	Expenses incurred but not paid. Or expenses payable. For	To be added to the respective expenses on the debit side of the	To be shown as outstanding liabilities on the liabilities side of

	example outstanding rent, Outstanding salaries.	Trading Account or profit and loss account	the Balance sheet
3. Prepaid Expenses	Expenses paid in advance. For example Rent paid in advance etc.	To be deducted from the respective expenses on the debit side of the Trading account or profit and loss a/c	To be shown as prepaid expenses on the Assets side of the Balance sheet.
4.Outstanding incomes	Income earned but not received. Or incomes receivable. For	To be added to the respective incomes on the credit side of the trading account	To be shown as outstanding incomes on the Assets side of

example	or profit and loss the Balance

	commission not yet received.	a/c	sheet.
5. Incomes received in advance	Income received during the current period relating to the next period. Or income pre-received.	To be deducted from the respective incomes on the credit side of the Trading account or profit and loss a/c.	To be shown as incomes received in advanced on the liabilities side of the Balance sheet.
6. Bad debts	Irrecoverable debt. If your customer does not pay his dues to you , it is a loss to you and it is called Bad Debt.	To be shown on the debit side of the profit and loss a/c.	To be deducted from sundry Debtors on the assets side of the balance sheet
7. New Reserve or provision for doubtful debts	The reserve or provision made out of profit for doubtful debt. Or in other words keeping aside a part of money from your profits assuming that there would be loss due to one of your customer might not pay his due to you.	To be added to bad debt during the year on the debit side of the profit and loss account.	To be deducted from Debtors on the assets side of the balance sheet.
8. Depreciation	Decrease in the value of an asset. the	To be entered on the debit side of	To be deducted from concerned

This is a non-cash expense.

Profit and loss a/c.
Decrease in the value of asset might happen due

assets on the assets side of the Balance sheet

	to use of asset, passage of time, change of fashion or technology etc. Though you cannot find out exactly what was the reduction in value of a asset , you can make an estimate which is called depreciation.		
9.Appreciation	Increase in the value of an asset.	To be entered on the credit side of the Profit and loss a/c.	To be added to concerned assets on the assets side of the Balance sheet
10. Interest on capital	Interest allowed on capital invested by the owner. This is an expense to the business	To be entered on the debit side of the profit and loss a/c.	To be added to capital on the Liabilities side of the balance sheet
11.Interest on drawings	Interest charged on owner's drawings from the business. This is an income to the business.	To be entered on the credit side of profit and loss a/c	To be deducted from capital on the liabilities side of B/S

Points to be noted regarding provision for doubtful debt

1. In case of any requirement of fresh or further provision for doubtful debts given in the adjustments the following procedure is to be followed, The fresh provision is called new provision or reserve and is recorded at two places. It is

added to bad debt on the debit side of profit and loss account, another it is deducted from debtors on the assets side of the balance sheet.

To Bad debt	XXX
Add: New provision	XXX
	XXX
Less: Old Provision	XXX
	XXX

**reserve for doubtful debts is given in the trial
for previous year's provision of doubtful debts and
deducted from the total of bad debt and new
profit and loss account as follows:**

3. When Bad debts (i.e. further bad debts) are given in the adjustments also the same should be added to the bad debt shown in Profit & Loss Account and deducted from the debtors on the assets side of the balance sheet.

4. In case the amount of old provision is less than the total of bad debt and new provision, the details will be shown on the debit side of profit and loss account as:

To Bad debt	XXX
Add: New provision	XXX
	XXX
Less: Old Provision	XXX
	XXX

5. _____

By Old provision	XXX
Less: Bad debt	XXX
Additional bad debt	XXX
New Provision	XXX
	XXX

provision is more than the total of bad debt and is shown on the credit side of profit and loss

7. _____

8. In the balance sheet only additional and new provision for doubtful debt is deducted from the debtors on the assets side

Self assessment questions:

5. How do you treat the depreciation in the balance sheet?

7.7 Problems on final accounts

Problem 1. From the following trail balance of Kumar as on 31-12-2006 prepare Trading and Profit and Loss Account for the year ending 31-12-2006

Sl.no	Particular	Dr	Cr.
		Rs.	Rs.
1	Kumar's Capital	20,000	1,00,000
2	Kumar's Drawings	50,000	3,25,000
3	Opening stock	10,000	7,000
4	Bills receivable	5,000	24,000
5	Sales	2,07,000	12,000
6	Returns inwards	30,000	
7	Purchases	25,000	
8	Returns outwards	18,000	
9	Sundry debtors	60,000	
10	Sundry creditors	10,000	
11	Bills payable	8,000	
12	Salaries	2,000	
13	Wages	3,000	

14	Machinery	1,000
15	Furniture	11,000
16	Rent and taxes	
17	Insurance	
18	Printing and stationery	
19	Cash in hand	
20	Cash at bank	

2,34,000 2,34,000

The stock as on 31-12-2006 was valued at 36,000

Trading and profit and loss A/C
For the year ending 31st December 2006

Dr.		Cr.			
Particular	Amount	Amount	Particular	Amount	Amount
To Opening stock		50,000	By Sales	3,25,000	
↳ Purchases	2,07,000		Less: Return Inwards	5,000	3,20,000
Less: Return outwards	2,000	2,00,000	By Closing stock		36,000
↳ Wages		18,000			
↳ Gross Profit		88,000			
		3,55,000			3,55,000
To Salaries		25,000	By Gross profit		88,000
↳ Rent and Taxes		8,000			
↳ Insurance		2,000			
↳ Printing and stationery		3,000			
↳ Net profit transferred to capital account		80,000			
		88,000			88,000

and loss account

Note: Other items in trial balance are either assets or liabilities and hence do not appear in Profit and Loss Account. These appear in Balance Sheet. Similarly the Net profit of Rs.50,000 will be added to Capital Account in the Balance Sheet

Capital		20,000
Stock 1 st Jan 1999	1,700	
Cash	6,200	
Sundry Debtors	9,100	
Purchases	61,300	
Sales		93,600
Returns Outwards		1,800
Returns Inwards	500	
Freight Inwards	3,700	
Freight outwards	7,200	
Salaries	10,500	
Rent	6,000	
Sundry Creditors		4,000
Miscellaneous receipts		100
Drawings account	6,300	
Furniture and fittings	10,800	
Depreciation of furniture fittings	1,200	
Bills payable		5,000
	1,24,500	1,24,500

and profit and loss accounts of Surya hotel for the following.

Closing stock valued at Rs.15,000

To Opening Stock			To Sales	93,500
To Purchases	61,200		Less: Returns	500
Less: Returns	1,800	59,400	To Closing Stock	19,000
To Freight Inwards	3,700			
To Gross Profit (old)		43,200		
		43,200		
To Freight Outwards	7,500			
To Salaries	10,100			
To Rent	8,000			
To Depreciation of Furniture (Wage)	3,200			
Total Profit transferred to Balance Sheet	19,400			
	43,200			43,200

Liabilities	Rs	Rs	Assets	Rs	Rs
Current Liabilities			Current Assets		
Sundry Creditors		4,000	Cash		6,300
Bills payable		5,000	Sundry Debtors		9,100
Fixed Liabilities	20,000		Closing Stock		19,000
Capital	12,400		Long term Investment		Nil
Add: Net Profit	19,400		Fixed Assets		
Less: Drawings	6,300	25,100	Furniture		10,800
		41,100			41,100

Note:

- Closing Stock appears both in credit side of trading account and Asset side of Balance Sheet.**

2. **Sundry Debtors are amount due from your customers and hence an asset.**

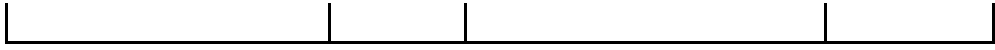
3. **Sundry creditors are amount due from you to your suppliers and hence a liability.**

4. **Net profit is added to capital account as it belongs to the owner , while drawings are deducted as he is taking away from business part of his investments. Hence Rs.32,100 represents his Net Worth in the business.**

5. **Observe that totals both the sides of Balance Sheet tally. This is because of accounting equation. If they do not tally, it indicates that there has been an error while preparing Profit & Loss Account or Balance Sheet.**

Problem 3. Prepare trading and profit and loss account for the year ending 31st March 2006 and also balance sheet as on that date from the following Trail balance.

Debit balance	Rs.	Credit balance	Rs.
Purchases	20,000	Capital	15,000
Sales return	1,000	Sales	25,000



Wages	400	Creditors	5,000
Salaries	1,000	Commission	1,050
Machine	5,000	Provision for bad debts	500
Rent	350		
Opening stock	3,500		
Cash	1,000		
Debtors	5,000		
Bad debts	300		
Building	9,000		

Adjustments:

- Closing stock Rs.10,000**
- outstanding wages and salaries Rs.200 and Rs.300 respectively**
- Further bad debts Rs.250**
- Create reserve for bad debt at 5% on debtor**

Dr.				Cr.	
Particular	Amount	Amount	Particular	Amount	Amount
To Opening stock		3,500	By Sales	25,000	
To Purchases		20,000	Less: Returns	1,000	24,000
To Wages	400		To Closing Stock		10,000
Add: Outstanding	200	600			
Gross Profit (old)		9,500			
		34,000			34,000
To Salaries	1,000		By Gross profit (old)		9,500
Add: Outstanding	300	1,300	By commission	1,050	
To Rent		350	Add: outstanding	450	1,500
To Bad debt	300				
Add: Further bad debt	250				
Add: New reserve	238				
	788				
Less: Old reserve	500	288			
To Dep. On machine (eg Rs 5,000 X 10%)		500			
To Net profit transferred to Capital A/c		3,962			
		11,400			11,400

ceived Rs.450

machine

by

10%

p.a

.

Note1: Calculation of New provision for bad debt on debtors

For calculation of new provision for bad debt, Amount of Debtor should be considered after deducting further bad debt given in the adjustment. This is because , you create a provision for those debtors who might not pay your dues. You do not create provision for those debtors who have already become bad ie

did not pay you. In the given case out of the debtors amounting to Rs5000 , the debtors amounting to Rs250 did not pay you and the same is bad debt and a loss to you. Out of the remaining debtors worth Rs4750 , you estimate that 5% of them may turn out to be bad and hence create a provision equal to 5% of this amount as follows.

New provision @ 5% on Debtors = (5,000 - 250) X 5% = 237.5 is rounded off

Liabilities		Assets	
	Rs.		Rs.
Current Liabilities		Current assets	
Debtors	5,000	Cash	1,000
Out standing expenses		Debtors	5,000
Wages	200	Less: Futherbad debt	250
Salary	300	Less: New provision	237.5
Fixed liabilities		Deeeng stock	10,000
Capital	15,000	Outstanding commission	450
Add: Net profit	2,982	Long term investment	Full
		Fixed Assets	
		Machne	6,000
		Less: Depreciation	400
		Building	9,000
	23,482		23,482

Note:

- Outstanding expenses are liabilities because you have to pay them in subsequent years**

2. **Outstanding commission is income to be received in future and hence an asset**

3. **Debtor is not reduced by bad debts of Rs.300 appearing in Trial balance because the debtor of Rs.5,000 is arrived after reducing the said Rs.300. This is because the entry passed at the time of recording this Bad debt is**

Bad debts a/c Dr 300

To Debtor a/c 300

4. **However further bad debts of Rs.250 is reduced from debtors as the same has been given in the adjustment(and not in trial balance) . Or in other words, the entry similar to aforesaid entry in 3 above should be passed for Rs.250 which reduces the debtors and increases the bad debts. Hence we reduce debtor by Rs.250 in Balance Sheet and add Rs.250 to bad debts in Profit and Loss a/c**

5. **The amount of depreciation of Rs.500 is reduced from Machine because the value of machine has gone down to that extent. This loss called depreciation is shown in profit and loss account debit side.**

Problem 4. From the following trail balance taken from the books of Mohan hotels, prepare trading and profit and loss A/c for the year ending

31-12-2005 and also prepare balance sheet as on that date, after taking into adjustments given.

Debit balance	Rs.	Credit balance	Rs.
Printing and Stationery	325	Capital	35,000
	150	Sales	84,870
Bad debt	50,600	Sundry creditors	15,300
Purchases	1,875	Bank overdraft	5,760
Sales tax	24,200	Commission	360
Sundry debtors	7,965		
Stock (1st January 2005)	190		
	1,650		
Trade expenses	400		
Rent	180		
Insurance	1,200		
Cash in hand	2,400		
Computer	8,200		
Drawings	19,600		
Bills receivable	1,200		
Plant and machinery	11,600		
Advertising	160		
Wages	340		
Discount allowed	930		
Freight on purchases	375		

Return inwards			
	7,500		
Furniture			
	250		
Salaries			
Rates and taxes			

Adjustment

1. Depreciation is to be charged as follows:

Plant and machinery 5% and Computer 10%

2. **Commission earned but not received Rs.140**

3. **Outstanding items are: Printing Rs.75 and rent Rs.150**

4. **Charge interest on capital @ 5%**

Trading and profit and loss A/c					
For the year ending 31st December 2005					
Dr	Particular	Amount	Particular	Amount	Cr
	To Opening stock	7500	By Sales	34,970	
	To purchase	82,000	Less: Return inward	900	83,070
	To freight and purchase	340	By Closing stock		12,666
	To wages	11,800			
	To Gross profit c/d	26,104			
		86,074			86,074
	To salaries	7,600	By Gross profit b/d		26,104
	To advertising	1,200	By commission	360	
	To discount	740	Add outstanding	140	500
	To Rent and taxes	280			
	To Sales tax	1,876			
	To Printing and stationery	320			
	Add Out standing	75			
		421			
	Less: Prepaid	84			
	To Bad debt	360			
	To Trade expenses	360			
	To Rent	1,800			
	Add outstanding	150			
	To Insurance	1,800			
	To Depreciation on	400			
	Plant and machinery	180			
	Computer	220			
	To interest on capital	1,300			
	(36,000 x 5%)	1,790			
	To Net profit transferred to Balance sheet	8,874			
		28,914			28,914

Net profit for 2005 was valued at Rs.12,666

Note: 1. Interest on capital is calculated on Rs.35,000 @5% p.a

Balance sheet as on 31 st December 2005					
Liabilities		Rs.	Rs.	Assets	
				Rs.	Rs.
Current Liabilities				Current assets	
Sundry Creditors			15,500	Cash	180
Out standing expenses				Debtors	24,200
Printing	75			Bills Receivable	8,200
Rent	150		225	Closing stock	12,600
Bank Overdraft			5,700	Prepaid stationery	80
Fixed Liabilities				Outstanding commission	140
Capital	35,000			Long term investment	Nil
Add: Interest on capital	1,750			Fixed assets	
Net profits	2,675			Plant and Machinery	19,800
Less: Drawings	2,400		44,225	Less: Depreciation	980
					18,820
				Computer	1,200
				Less: Depreciation	120
				Furniture	375
					65,511
					65,511

of Rs.75 as to Printing as well as stationery. First item is added and accordingly from printing and stationery

Note: 1. Interest on capital amount is added to Capital account as the same belongs to the owner and the same is due to him. The journal entry passed in this regard is

Interest on capital a/c Dr 1,750

Particular	Dr	Cr
Capital and Drawings A/c	10,000	1,08,090
Bank loan		20,000
Cash in hand	360	
Cash at bank	8,200	
Investment	5,000	
Bank deposits	30,000	
Creditors and Debtors	24,000	14,800
Furniture & fittings	1,800	
Stock in trade	46,800	
Sales & Sales Returns	8,600	2,89,600
Purchases & purchase returns	2,43,100	5,800
Freight & Carriage	18,600	
Rent Rates & taxes	5,700	
Salaries and Wages	9,300	
Bank Interest	1,000	
Printing & advertising	14,600	
Income from investment		250
Discount received and allowed	7,340	3,790
General Expenses	3,610	
Audit fees	500	
Insurance	800	
Traveling Expenses	2,130	
Postage & Telegrams	870	
Total	4,42,330	4,42,330

Prepare a Trial balance of Annapoorna Hotels. Prepare a Profit and Loss account for the year ending 31st March, 2004 and Balance Sheet as on that date, after considering the adjustments given

Other adjustments

1. **Closing stock was Rs.78,600**

2. **Depreciate furniture and fittings by 10 percent.**

3. **Create 5 percent reserve on debtors**

4. **Insurance prepaid amounts to Rs.200**

5. **Salaries outstanding Rs.600**

6. **Outstanding interest on bank deposit Rs.1,500**

Solution: Preparation of trading and profit and loss account

To Discount Allowed		650		
To General Expenses	900	200		
To Audit fees	200			
To Insurance		600		
Less: Freight		2,100		
To Traveling Expenses		870		
To Postage & Telegrams		1,200		
To Reserve on Debtors (1% on 24,000)		180		
To Depreciation on Furniture and fittings (1,000 x 10%)		14,850		
Transfer from Balance Sheet				
Balance Sheet				
		62,440		62,440

Note:

1. In this problem two items like sales and sales returns are simultaneously given in trial balance. By applying our knowledge of different types of account we should arrive at the correct amount applicable to correct item. For example in case of sales we know that it is a revenue account and usually shows credit balance, hence the sales amount is Rs.2,89,600.

Similarly in case of discount received and paid, the discount received being income shows credit balance and hence the amount of discount received is Rs.3.790

Balance sheet as on 31st March 2004

Liabilities		Assets	
Rs.	Rs.	Rs.	Rs.
Current Liabilities		Current assets	
Sundry Creditors	14,800	Cash in hand	380
Out standing expenses	800	Cash in bank	8,000
Salaries		Closing stock	78,800
Fixed liabilities	20,000	Debtors	24,000
Bank Loan		Less: New reserve	1,200
Capital		Prepaid insurance	200
Add: Net profit	1,08,000	Outstanding interest on bank deposit	1,500
	1,32,800	Long term investment	
Less: Drawings	95,000	Investment	5,000
	37,800	Bank deposits	30,000
	1,48,800	Fixed assets	
		Furniture and fittings	1,800
		Less: Depreciation	180
			1,620
			1,48,800

st received appears in Trial Balance , but we outstanding of Rs.1,500 .This means that the have to add outstanding interest of Rs1,500 be credited to Profit and Loss Account . The e is also shown in Balance sheet as an asset

1. In case of creditors and debtors , we should know that creditors show credit balance and the amount of creditors therefore is Rs14800.

7.8 Summary

Final accounts are the summaries of ledger accounts organized in such a manner as to show the profit or loss of the business for the accounting year and financial position of the business at the end of the accounting year.

The important final accounts are:

1. **Trading account**
2. **Profit and loss account**
3. **Balance sheet**

The trading account is an account, which shows merely the result of Trading by way of gross profit or gross loss. It is the account, which shows the result of buying and selling of goods without taking into taking account administration, selling and distribution expenses incurred in conducting the business.

Profit and loss Account is an account which shows the net profit or net loss after considering all the expenses of a business.

Both the trading and profit and loss account are shown in a combined manner usually.

Balance Sheet is an item wise list of assets, liabilities and proprietor's capital in a business at a certain date. Balance Sheet is a statement expressing the accounting equation.

7.9 Terminal questions

- 1. What is Gross Profit?**
- 2. What is Net Profit?**
- 3. Give four examples for direct expenses?**
- 4. What is treatment for new reserve for bad debt in the balance sheet?**
- 5. From the following particulars given below, prepare trading account for the year ending 31stDecember, 2006**

Stock on 01-01-2006 Rs.5,000

Purchases Rs.60,000

Stock on 31-12-2006 Rs.5,000

Sales Rs.75,000

Wages Rs.5,000

Carriage inward Rs.2,000

Freight inward Rs.1,000

Freight outward Rs.1,000

Carriage outward Rs.500

Commission on sale Rs.50

6. **From the following particulars, prepare a profit and loss account**

Gross profit Rs.30,000

Salaries Rs.15,000

Rent Rs.2,000

Interest Received Rs.100

Discount allowed Rs.50

Discount Received Rs.100

Commission paid Rs.50

7. Prepare trading and profit and loss account for the year ending 31st March 2006 and also balance sheet as on that date from the following Trail balance.

Debit balance	Rs.	Credit balance	Rs.
Purchases	10,000	Capital	7,500
Sales return	500	Sales	12,500
Wages	200	Creditors	2,500
Salaries	500	Commission	525
Machine	2,500	Provision for bad debts	250
Rent	175		
Opening stock	1,750		
Cash	500		
Debtors	2,500		
Bad debts	150		
Building	4,500		

1. Closing stock Rs.5,000

2. **Outstanding wages and salaries Rs.100 and Rs.150 respectively**
3. **Further bad debts Rs.125**
4. **Create reserve for bad debt at 5% on debtor**
5. **Commission due but not received Rs.225**
6. **Depreciation machine by 10% p.a.**

7.10 Answers

Self Assessment questions:

1. The important final accounts are:

❖ **Trading account**

❖ **Profit and loss account**

❖ **Balance sheet**

2. **Stock of goods at the end of the trading period.**

3. **Indirect expenses are selling and distribution expenses, maintenance expenses, financial expenses, office expenses etc.**

4. **In the words of Freeman a balance sheet is an item wise list of assets, liabilities and proprietorship of a business at a certain date.**

5. **Depreciation should be deducted from the concerned assets.**

Terminal questions

1. **Gross profit or loss is difference between net sale and the cost of goods sold. Cost of goods sold is calculated by adding opening stock, purchases, direct expenses in purchasing or manufacturing the goods and deducting closing stock from the total.**

2. **The net profit is the profit earned after charged all business expenses. In other words Net profit is calculated after deducting all indirect expenses from gross profit and any other indirect income.**

3. **Direct Expenses**

Carriage inward

Cartage

Freight inward

Import duty

Clearing charges

Wages

Power and light

4. The amount of new reserve for bad debt should be deducted from the debtors on the assets side of the balance sheet.

Trading and profit and loss A/C					
For the year ending 31 st December 2006					
Dr:	Particular	Amount	Particular	Amount	Cr
	To Opening Stock	5,000	To Sales		75,000
	To Purchases	60,000	To Closing Stock		5,000
	To Wages	5,000			
	To Carriage Inward	2,000			
	To Freight Inward	1,000			
	To Gross profit c/d	7,000			
		80,000			80,000

6. Solution:

Profit and Loss Account For the year ended			
Dr.		Cr.	
Particular	Rs.	Particular	Rs.
To Salaries	15,000	By Gross profit b/d	30,000
To Rent	2,000	By Interest Received	100
To Discount allowed	80	By Discount Received	100
To Commission paid	80		
To Net Profit	13,100		
	30,000		30,000

Trading and profit and loss A/C For the year ending 31 st March 2008					
Dr.			Cr.		
Particular	Amount	Amount	Particular	Amount	Amount
To Opening stock		1,150	By Sales	12,600	
To Purchases		10,000	Less: Returns	500	12,000
To Wages	200		To Closing Stock		4,000
Add: Outstanding	100	300			
Gross Profit b/d		4,550			
		17,000			17,000
To Salaries	600		By Gross profit b/d		4,550
Add: Outstanding	150	650	By Commission	516	
To Rent		175	Add: outstanding	225	750
To Bad debt	150				
Add: Further bad debt	125				
Add: 119	119				
Add: 304	304	144			
Add: 282	282	280			
Less: Old reserve		280			
To Dep. On machine (5,000 X 10%)		481			
To Net profit transferred to Capital A/C					
		8,700			8,700

Note1: Calculation of New provision for bad debt on debtors

For calculation of new provision for bad debt, Debtor should be taken after

deducting further bad debt given in the adjustment.

New provision @ 5% on Debtors = (2,500 - 125) X 5% = 118.75 is rounded off

Rs.119

Balance sheet as on 31st March 2008

Liabilities		Assets	
Rs	Rs	Rs	Rs
Current Liabilities		Current assets	
Creditors	2,500	Cash	800
Out standing expenses		Debtors	2,400
Wages	100	Less: Furthered amt	225
Salary	150	Less: Tax provision	118
Fixed liabilities		Closing stock	5,000
Capital	7,800	Outstanding commission	325
Acc for profit	4,681	Long term investment	Nil
		Fixed assets	
		Machine	2,500
		Less: Depreciation	250
		Building	4,800
	14,731		14,731

UNIT 8

8.1 Introduction

In earlier units we discussed all the functions of accountant. In this Unit, we shall discuss theory of hotel accounting.

After studying this unit you will be to understand:

- ❖ **Meaning of and need for Uniform System of Accounts.**

- ◆ **Meaning and use Night Audit**

- ◆ **Types of Departments in a Hotels**

- ◆ **About Various Ledger Maintained By The Hotel**

- ◆ **Meaning and use of Operating Ratios in a hotel**

8.2 Uniform System of Accounting

Need for Uniform System of Accounting

Hotels having branches or one Management running a chain of hotels would like to compare the income, expenditure, profit or loss of one branch with other branches. The comparison is possible only when all the branches adopt a common system and a common classification of accounts. Therefore to-day large hotels adopt uniform system of accounting Uniform system provides uniform classification of accounts and standardized method of presenting the financial results.

Meaning

Uniform systems of accounts are standardized accounting systems prepared for hotel industry.

Uniform system of accounts in hotels provides uniform classification of income, expenditure, assets and liabilities for hotels and secondly it provides a standardized, uniform method of presenting financial results of operation.

A uniform system of accounts is a time-tested system. The Uniform System of Accounts for Hotels (USAH) was first prepared and implemented in 1925-26 by a designated group of accountants for the Hotel Association of New York City. This Committee prepared a common manual, both for large and small hotels, showing uniform classification of accounts and instructions for preparing of financial statements. Since then, the USAH has been revised many times by committees, in the beginning by New York City accountants and most recently, by accountants from across the United States. A subcommittee of the Financial Management Committee of the American Hotel and Motel Association prepared the ninth revised edition of the USAH now being called USALI. The American Hotel Association recommended this system of accounting to all hotels of America. Today it has been adopted by hotels of several countries.

Uniform System of Accounts are available for the following types of organizations or businesses

- 1. Uniform system of Accounts for the Lodging Industry(USALI)**
- 2. Uniform system of Financial Reporting for Clubs**
- 3. Uniform system of Accounts for Restaurant (USAR)**

USALI contains not only the basic financial statements, but also covers over 25 supplementary departmental operating statements Its sections cover budgeting and forecasting, discussion of compiling revenue by market source, forms of statements, breakeven analysis, and a uniform account numbering system.

The operations of lodging business differ from operations of a commercial food service operation (restaurant). Therefore, the financial information as presented in financial statements also differs.

The income statement recommended for restaurants is prescribed in the Uniform System of Accounts for Restaurant (USAR) published by the National Restaurant Association.

Benefits of Uniform System of Accounts:

- 1. The uniform system of accounting allows for a more reasonable comparison of the operational results of similar hospitality businesses.**
- 2. This manual of classification has been designed in such a way so that all large and small hotels can adopt this system. Each hotel can select the head of**

account according to its requirement and eliminate such items as are not needed by it.

3. A hotel, having branches, can prepare consolidated Profit & Loss Account and Balance Sheet of all the branches.

4. An employee may not find any difficulty in maintaining the accounts, if he is transferred to some other branch of the hotel or seeks a job-change in a hotel where also the Uniform System of Accounts is in practice.

Self Assessment Questions:

1. State any two benefits of Uniform system of accounts.

8.3 Night Audit

Meaning of audit, auditing and night audit:

In general, audit means verification of documents or checking of documents. Auditing is process of verification of documents. Auditing of books of accounts means verification of books of accounts as to checking the arithmetical accuracy of the books of accounts and to detect any fraud or error in them

Night audit is actually the audit process of taking inventory of the day's work.

In other words it is the activity of checking the correctness of the posting to the guest's accounts and the entries of the day's sales.

Night auditing is activity of verifying and confirming that whatever transactions have been done during the day is correct and complete. Any mistakes made during the day as to transaction posting are to be checked by the night auditor. The charging made to the guest accounts as to rooms, food and beverages, taxes, phones and other are to be checked based on the records collected from various other departments and each account is to be balanced.

Since hotel business is a round-the-clock business, in hotels day's sales and accounts are closed at 12 midnights. So, the auditing work starts after closing the all books of accounts, that means after 12 midnight and hence this audit is called night auditing.

The person who does the night auditing is called Night Auditor. In large hotels the staff of the control department works as Night Auditor but in most of the hotels the night-duty billing clerk has to perform the duty of Night Auditor also besides his normal duties. He is called Night Auditor because he audits the days- sales at night.

Functions of Night auditor:

Night Auditor will be responsible for auditing, balancing and consolidating departmental ledger accounts, preparing various hotel operating reports. He has general duties at Front Office Desk and would be acting as primary point of contact for all guest inquiries.

Essential duties and responsibilities include the following:

◆ **Posting daily activity (transaction) including allocating activity to proper accounts, entering new activity and settlements, balancing accounts,**

monitoring account codes, and writing correcting journal entries.

◆ **Reconciling daily records including sorting, organizing, and verifying activity records and identifying, researching, and correcting discrepancies.**

◆ **Preparing, proofing, and distributing daily audit reports by collecting and summarizing activity, settlement, and discrepancy data and trends, proofing**

and distributing reports.

◆ **Double-checking credit card balances before closing batches and sending totals to credit card provider.**

◆ **Maintaining computer system by monitoring system performance, troubleshooting breakdowns, calling for repairs, resetting system for next day.**

- ◆ **Posting all daily room and outstanding, Tax charges.**

- ◆ **Balancing all revenue totals of cash and credits against revenue report.**

- ◆ **Accepting revenue and floats from restaurant, ensuring that these are securely locked away.**

- ◆ **Accepting and locking away keys from various departments.**

- ◆ **Registering guests including obtaining or confirming room requirements, verifying preregistration, assigning rooms, obtaining information and signatures,**

issuing door cards, verifying credit cards or obtaining cash, providing directions to room, and assisting with all general inquiries.

- ◆ **Being conversant with the hotel's emergency procedures including responding to individual calls or alarms, operating the hotel's fire alarm system, dispatching emergency services, and notifying the Manager-on-Duty.**

- ◆ **Protecting assets by ensuring adherence to internal control policies and guidelines**

- ◆ **Preparing Night Audit Report**

Self assessment questions:

2. What is night audit?

8.4 Departments of Hotels

A Hotel provides many types of comforts, luxuries, professional services and other facilities to its guests under one roof. To provide above facilities the hotel has to open different departments. The number of departments depends upon the policy of management. Small hotels run a few departments but large hotels run more departments.

In general the departments of Hotel can be divided into two groups from the point of earning revenue:

- 1. Revenue Earning Departments**

- 2. Non-Revenue Earning Departments**

Revenue Earning Departments:

These are departments from where the hotel earns revenue. Generally the following departments produce revenue for a hotel

◆ Room ◆ Sales Department

◆ Food and Beverage Department

◆ **Other operating departments**

Room-Sales Department:

The very important function of a hotel is to provide accommodation to the guests. The rooms are sold by the front office to the guests according to their requirements. From the sale of rooms, a hotel earns major portion of its revenue.

Food and Beverage Department:

This department sells food and beverages to the guests. From the sale of food items, soft drinks and alcoholic beverages a hotel earns more revenue.

Food and Beverage department is sub-divided into following categories

◆ **Restaurant** ◆ A hotel may have one or more restaurants where food items are sold to 3 types of guest ◆ Residents, credit card holders and guest from general public for cash or on credit.

◆ **Dinning Hall** - Here the food is sold to residents of a hotel.

◆ **Coffee shop** ◆ Here the coffee, tea and snacks is sold to guests.

◆ **Room Service Department** ◆ This department sells food to the residents and makes supplies to the respective rooms where guests stay

❖ **Banquet Department** ❖ This department involved in cooking and serving to a large number of people on a special occasion such as wedding reception. Only

large hotels operate this department.

❖ **Bar** ❖ This sells alcoholic beverages to guests. From this hotel earns revenue.

Other operating departments ❖ They are departments from where hotel earns less revenue compared to Room-sales and Food and Beverage Departments. These include Guest Laundry, Telephone, News stand etc. Guest Landry operates only for guest. Guest Landry is different from house laundry.

Non-Revenue Earning Departments:

Non-Revenue Earning Departments means departments which do earn or produce any income. These departments help in producing revenue indirectly. **Non-Revenue earning departments are as follows:**

❖ **Property operation and Maintenance department**

❖ **Marketing departments**

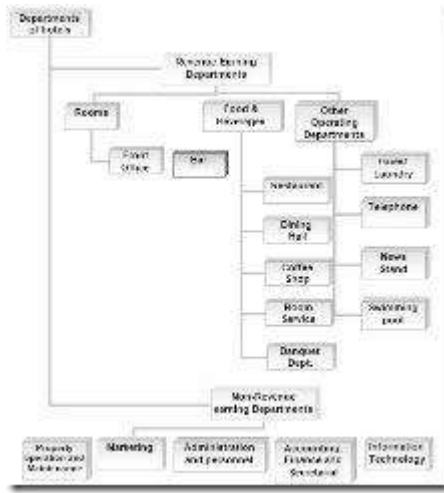
❖ **Administration and Personnel Department**

❖ **Accounting, Finance and Secretarial Department**

❖ **Information Technology Department**

◆ **Inventory Management Department or Stores**

The Departments of hotel are figuratively shown in Fig. 8.1



8.5 Various types of Ledgers maintained in Hotels

In small hotels only one type of ledger is maintained. In that ledger, all personal, real and nominal accounts are opened. In large hotels, where the transactions become voluminous, the ledger is subdivided into two types. They are:

1. Personal ledger ♦ **Personal ledger is kept in hotels for maintaining the personal accounts of guest or debtor and creditors. Personal Ledger can be divided into two groups** ♦ **one, Debtors Ledger and the other, Creditor ledger.**

♦ **Debtor ledger** ♦ **It is a ledger in which the accounts of debtors are kept.**

Debtors mean persons from whom the money is to be recovered by the hotel

either for services or for supply of food and beverages or rooms sales. The Debtors ledger can be divided into two Groups ♦ **one, Visitor Tabular Ledger and the other, City Ledger.**

♦ **Creditor Ledger** ♦ **It is a ledger in which the accounts of creditors are maintained. Creditor means person from whom the hotel purchases goods on credit and to whom the hotel has to pay the money.**

2. Impersonal ledger ♦ **It means ledger maintained for impersonal accounts like revenue and expenses, assets and liabilities. Impersonal ledger can be classified into two groups** ♦ **One, Trade Ledger and the other, General Ledger.**

♦ **Trade ledger is kept for maintaining all revenue and expenses account**

◆ **General Ledger is kept for maintaining all assets and liabilities accounts.**

Visitor Tabular Ledger:

In a hotel there are several rooms in which guest stay temporarily say for a day. Hence in a year a hotel might have thousands of guests. Maintaining each guests account in a ledger is difficult and redundant job for an accountant. Instead in hotels Visitors Tabular Ledger or Daily Guest Ledger is prepared. Visitors Tabular Ledger is prepared at the front office with whom guest usually interact. It is ledger maintained for keeping the accounts of the guest staying in the hotel. It is a ledger meant for keeping the record of registered guests in an analytical form. It serves the purpose of the Day Book on the one hand and registered guests' personal accounts on the other. It is maintained for keeping the record of all transactions relating to sales of rooms, food, goods and services to registered guests in a systematically analyzed and chronological order. There are two types of ledgers- one, horizontal Tabular ledger and the other, vertical Tabular ledger. Guests' transactions can be maintained horizontally (one row one guest or one room) or vertically (one column one guest or room) as per the requirements of the hotel. In vertical VTL for example, On one side of this ledger, one column is provided to each registered guest and rows are provided for each item of sale of food, beverages, services etc. As in

this ledger several columns are drawn to keep the records of guests on the one hand and several rows for the record of sales of different items to guests on the other, therefore, it is known as Visitors Tabular Ledger.

Visitors Tabular Ledger is maintained in loose-leaf form. A separate ledger is maintained for each day. The number of Tabular sheets used for the day depends upon the number of columns in the sheet and the number of rows for recording the rooms available for guests.

The Tabular sheet contains both Debit and Credit sides. Thus, Visitors Tabular Ledger records all aspects of both debit and credit transactions either on upper and lower sections or on the left and right sections. Such Visitors Tabular Ledger does not confine itself only to sales but it also includes all transactions that concern sales. This implies that amount paid by customer against outstanding debits, allowances and transfer to other ledgers are also recorded. Thus both debit and credit transactions relating to customers/guests are recorded in their respective columns. In such Tabular ledger if one extra column is provided for cash sales, then it can give the complete picture of total sales of the hotel (both cash and credit) of the day.

The completed Visitors Tabular Ledger gives the following information 

(a) The sale of each department and total sale of the hotel of a particular day. Not only this, the sale of each type of room, meal, beverages and services.

(b) The total debit balance of a departed guest transferred to ledger account or transferred to other guests account.

- (c) **Cash paid by guests during the day and allowances given to them.**

- (d) **The details of individual guests/customer's account and the total owed by resident guests at the close of the day.**

Advantages of Visitors Tabular Ledger

The advantages of Visitors Tabular Ledger can be summed up as under

1. **All personal accounts of registered guests are opened' in daily Visitors Tabular Ledger (sheets), so the names of all registered guests/customers and the number of rooms and room numbers occupied can be seen at one glance.**

2. **All personal accounts of registered guests are opened in daily Visitors Tabular Ledger and transactions relating to them for the day are recorded in their accounts in the Tabular Sheet, therefore, the day's detail of each personal**

account can be seen. It saves the necessity of opening personal accounts of registered guests in the debtor's ledger.

3. Each customer's personal account is debited directly with the help of vouchers known as "checks" without first entering the amount into the Journal

or book of prime entry, so there are less chances of mistakes.

4. The posting is done directly, so it takes less time.

5. Due to opening of customers' account in the Visitors Tabular Ledger the account of each guest is always complete up to the minute. Therefore, the bill can be prepared easily at the time of checking out of the guest.

6. Every department sends the original copy of check to the bill clerk for posting, so the original copy of checks are available with the bill clerk. In case of need they can be seen and verified.

7. The tabular sheet is prepared with original copy of the check and each department prepares a statement or summary of its day's sales or service with the help of duplicate copy so that control and checking of accounts can be done efficiently.

8. In Tabular Ledger the items of sales are recorded in an analytical form. It shows at a glance how much income has been derived from different departments such as Restaurant, Bar, Telephone, Tobacco, Laundry etc., etc.

9. **It serves as a guide for the minute-wise accumulation of debit item under each personal account. Any personal account showing abnormally high debit balance can be referred to the credit department which can control unwarranted credits to guests.**

10. **Allowances given to the customers are recorded in Visitors Tabular Ledger so it is easy to know the total allowance given to customers and whether it was approved and recorded in correct accounts.**

Disadvantages

The main disadvantages of Visitors Tabular Ledger are as follows:

- (1) **The Tabular Sheets which are used for guests accounts are unwieldy in dimension.**

- (2) **The columns are too many in the Tabular Sheet and they are close to each other. Therefore, there is every possibility of wrong posting.**

City Ledger:

It is a ledger in which accounts of the local customer (who is not a resident guest) of the city are opened, especially for restaurant charges and banquets, In city ledger accounts of large firms, who open accounts with hotels in various cities for the convenience of their representatives are usually maintained. This ledger may also contain many accounts of persons residing outside the city, who wish to use the facilities of the hotel.

Guest Folio:

When the guest is registered in the hotel, the cashier opens guest hotel credit bill normally known as Front office Guest Folio. An independent record of charges incurred for services availed of every resident guest is maintained in the form of Front Office Guest Folio.

8.6 Operating Ratios

Meaning of Ratio, ratio analysis and operating ratio:

Ratio means proportion which can be expressed in the form of a number, as percentage or as fraction. For example, if you say in your restaurant you have 50% profit you are expressing a ratio. Now this ratio arises due to relationship between two variables. For example when you express you have 50% profit you are associating two variables like profit and sales. What you are expressing is for every sales of Rs100 you are earning profit of Rs50. The sales and profits are variables because they need not remain same every day. Ratio analysis is thus calculating a ratio and then finding out reasons for any change in ratios. For example, your gross profit ratio may decrease from 50% to 40%. Hence you may have to find reasons for decline. Similarly you might compare your gross profit ratio with that your competitor. Most of the ratios are obtained through financial statements like Balance Sheet and Trading and Profit and Loss Account.

Ratio Analysis is thus the technique of the calculation of number of accounting ratios from the data or figures found in the financial statements, the comparison of the accounting ratio with those of the previous years or with those of other concerns engaged in similar line of activities or with those of standard or ideal ratios for an industry and the interpretation of the comparison.

In a hotel industry Operating ratios help management analyze the operations of a hotel business. Operating ratios relate expenses to revenue and are useful for control purposes. Operating ratios help in determining the causes for the variation between actual results and planned goals. Operating ratios can be used for solving the financial problems that exist. Operating ratios are calculated daily in hotels.

In this section we will discuss some common operating ratios.

1. Average Room Revenue (ARR): ARR is the relationship between Room revenue and rooms occupied. ARR is calculated daily, monthly or annual basis by dividing sales revenue by rooms occupied for the specific period. ARR is an indication of the quality of hotel's operation. Average Room Rate is also

referred as **Average Daily Rate (ADR)**.

Formula used for ARR is

$$\text{ARR} = \frac{\text{Room Revenue}}{\text{No. of Rooms Occupied}}$$

2. Revenue Per Available Room (RevPAR): RevPAR is the relationship between the room revenue and number rooms available. RevPAR is calculated by dividing Room sales or Room Revenue by Available Rooms for the specific period.

Formula used for RevPAR is

$$\text{RevPAR} = \frac{\text{Room Revenue}}{\text{No. of available rooms}}$$

OR

$$\text{RevPAR} = \text{Occupancy percentage} \times \text{ARR}$$

3. Occupancy Percentage: This ratio is calculated by dividing the rooms occupied by the total rooms available during the stated period.

Formula used for Occupancy Percentage is

$$\text{Occupancy \%} = \frac{\text{Room Occupied}}{\text{Rooms available}} \times 100$$

Occupancy Percentage: This ratio is calculated by dividing the rooms occupied by the total rooms available during the stated period.

Formula used for Occupancy Percentage is

$$\text{Occupancy \%} = \frac{\text{Room Occupied}}{\text{Rooms available}} \times 100$$

4. Average Food Service Check: The ratio is determined by dividing Total Food

Revenue by the number of food covers sold during the period.

Formula used for Average Food Service Check is

$$\text{Average Food Service Check} = \frac{\text{Total Food Revenue}}{\text{Number of Food Covers}}$$

5. Food Cost Percentage : The ratio is calculated by dividing total cost of food by the total food revenue. The most food service managers rely heavily on this ratio for determining whether food cost are reasonable.

Formula for Food cost Percentage is

$$\text{Food cost Percentage} = \frac{\text{Cost of Food sold}}{\text{Total Food Sales}} \times 100$$

6. Beverage Cost Percentage: The ratio is calculated by dividing cost of beverages sold by the total beverage revenue.

Formula for Beverage Cost Percentage is

$$\text{Beverage Cost Percentage} = \frac{\text{Cost of Beverages sold}}{\text{Total Beverage sale}} \times 100$$

7. Labour Cost Percentage: The ratio is calculated by dividing total labor cost by the total revenue. Total Revenue is the sum of Room Revenue, Food Revenue and Beverage Revenue.

Formula used for Labour Cost Percentage is

$$\text{Labour Cost Percentage} = \frac{\text{Total Labour cost}}{\text{Total Revenue}} \times 100$$

Illustrations on operating Ratio:

1. From the following information calculate ARR, RevPAR, Average Food service check, Food cost percentage, beverage cost percentage and labour cost percentage.

Number of Rooms Available 24,000

Paid Rooms occupied 20,000

No. of Covers 24,000

Rooms Revenue Rs. 6,00,000

Total Food sales Rs. 9,60,000

Cost of beverage Rs.3,00,000

Food cost Rs.2,84,000

Beverage Revenue Rs.4,30,000

Pay and Allowances Rs.5,00,000

Solution: Calculation of operating ratios

1. ARR

$$\text{ARR} = \frac{\text{Room Revenue}}{\text{No. of Rooms Occupied}}$$

$$= \frac{6,00,000}{20,000}$$

$$= \text{Rs.30}$$

2. RevPAR

$$\text{RevPAR} = \frac{\text{Room Revenue}}{\text{Rooms available}}$$

$$= \frac{6,00,000}{24,000}$$

= Rs.25

3. Average Food Service Check

$$\text{Average Food Service Check} = \frac{\text{Total Food Revenue}}{\text{Number of Food Covers}}$$

$$= \frac{9,60,000}{24,000}$$

= Rs.40

4. Food Cost Percentage

$$\text{Food cost percentage} = \frac{\text{Total Food Cost}}{\text{Total Food Sales}} \times 100$$

$$= \frac{2,84,000}{9,60,000} \times 100$$

= 29.58 %

5. Beverage Cost Percentage

$$\text{Beverage Cost Percentage} = \frac{\text{Cost of Beverage}}{\text{Beverage Revenue}} \times 100$$

$$= \frac{3,00,000}{4,30,000} \times 100$$

$$= 69,76\%$$

6. Labour Cost Percentage

$$\text{Labour Cost Percentage} = \frac{\text{Total Labour Cost}}{\text{Total Revenue}} \times 100$$

$$= \frac{5,00,000}{19,90,000} \times 100$$

$$5,00,000$$
$$= 25.12\%$$

Total Revenue = 9,60,000 + 4,30,000 + 6,00,000 = 19,90,000

8.7 Summary

Uniform systems of accounts are standardized accounting systems prepared for hotel industry.

Uniform system of accounts in hotels is provided in a Manual that provides uniform classification of income, expenditure, assets and liabilities for hotels and secondly provides standardized, uniform method of presenting financial results of operation.

Night auditing is activity of verifying and confirming that whatever transactions have been done during the day is correct and complete. Any mistakes made during the day of transaction posting and the charging to guest accounts such as to rooms, food and beverages, taxes, phones and others are verified from the records collected and each account is balanced.

The departments of Hotel can be divided into two groups from the point of view of earning revenue:

- 1. Revenue Earning Departments**

- 2. Non-Revenue Earning Departments**

Visitors Tabular Ledger is prepared at the front office. It is ledger maintained

for keeping the accounts of the guest staying in the hotel. It is a ledger meant for keeping the record of registered guests in an analytical form.

Operating ratios help management analyze the operations of a hotel business. Operating ratios relate expenses to revenue and are useful for control purposes.

8.8 Terminal Questions

1. **What is uniform system of account?**

2. **How do you calculate ARR?**

8.9 Answers

Self Assessment Question

1. a. The uniform system of account also allows for a more reasonable comparison of the operational results of similar hospitality businesses

b. This manual of classification has been designed in such a way so that all large and small hotels can adopt. Each hotel can select the head of account according to its requirement and eliminate such items as are not needed by it.

2. Night auditing is activity of verifying and confirming that whatever transactions have been done during the day is correct and complete. Any mistakes made during the day of transaction posting and as to the guest accounts such as rooms, food and beverages, taxes, phones and others are traced out through records collected and each account is balanced.

Terminal Questions

1. Uniform systems of accounts are standardized accounting systems prepared for hotel industry.

Uniform system of accounts in hotels is a manual that provides uniform classification of income, expenditure, assets and liabilities for hotels and secondly standardized, uniform method of presenting financial results of operation.

2. Average Room Revenue (ARR): ARR is the relationship between Room revenue and rooms occupied. ARR is calculated daily, monthly or annual basis by dividing sales revenue by rooms occupied for the specific period. ARR is an indication of the quality of its operation. Average Room Rate is also referred as Average Daily Rate (ADR).

Formula used for ARR is

$$\text{ARR} = \frac{\text{Room Revenue}}{\text{No. of Rooms Occupied}}$$
