



**CBSE XI**



- Depreciation •
- Accounting Equation •
- Final Accounts •
- Trial Balance •

**Thukral Brothers**

**2014-15**

# ACCOUNTANCY

**Exam Cracker**



**CA. Sunil Thukral**

Chartered Accountant, B.Com (H)

*"Nothing is beyond your limit"*

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2014-15

# ACCOUNTANCY

## Exam Cracker

THUKRAL BROTHERS  
  
Best Coaching Institute  
9210473733

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# CA. SUNIL THUKRAL

- ☞ Mr. Sunil Thukral is an Associate Member of "The Institute of Chartered Accountants of India".
- ☞ Possesses a vast experience (more than 12 Years) in teaching Accountancy, Costing and Financial Management.
- ☞ Topper of Sant Nirankari School.
- ☞ First Class Commerce Graduate from prestigious Delhi University in B.Com (Hons).
- ☞ Topped Delhi University twice by scoring 68% in B.Com (H) 2nd Year and 72% in Final Year.
- ☞ Has been teaching Students of 11TH to B.Com (P/H) Final Year and also guiding Students of M.Com, CA, CS, CMA (CWA).
- ☞ Himself secured 91 marks in Accounts, 92 marks in Costing, 82 marks in Financial Management and 94 marks in Mathematics in B.Com (H).
- ☞ Is in All India Topper List of CA Final by securing 81 marks in Accountancy and 84 marks in Financial Management.
- ☞ Mentor of many teachers. Many students of CA. SUNIL THUKRAL teaching in various fields of study.

## ACADEMIC JOURNEY

10 <sup>TH</sup>	2001-02
12 <sup>TH</sup>	2003-04
B.COM (H) 1 <sup>ST</sup> YEAR	2004-05
B.COM (H) 2 <sup>ND</sup> YEAR	2005-06
B.COM (H) FINAL YEAR	2006-07

### STARTED CA AFTER GRADUATION

CA-FOUNDATION (CPT)	Nov-2006	ARTICLESHIP (TRAINING)
CA-INTERMEDIATE (PCC)	Nov-2008	ARTICLESHIP (TRAINING)
CA-FINAL	May-2011	

***If You Like My Teaching Style, Raise Your Hands.  
If You Do Not Understand My Teaching Style, You Need to Raise Your Standard.***  
(अपना Level बढ़ाओ)  
**CA. Sunil Thukral**

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# 12TH Students' Desk

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## Kamakshi (95 marks)

Mr. Sunil Thukral is a fabulous teacher. His knowledge regarding the subject is ultimate. His way of teaching is very friendly and we can ask any number of doubts in the class without any hesitation. He is always ready to help students at **any time** either face to face or on mobile. He takes doubts on the spot. He never postpone doubts to next day.

## Ravit Thukral (95 marks)

Mr. Sunil Thukral is an excellent teacher. He gives you the best guidance and study material. He always tries to understand the demand and requirements of his students, their suggestions and makes all efforts to clear their concepts as far as possible. **Finally, it is upto the students to make the best use of him and his study material for a bright success.**

## Dheeraj Joshi (93 marks)

Sunil Bhaiya teaches us Accountancy. He tells us things again and again until we all are able to understand properly. He teaches us every topic in a very clear way which we all can understand very easily and quickly. He possesses all the qualities of an ideal teacher. He gives his 100% to his students.

## Rakesh Pandit (92 marks)

Sir is giving excellent knowledge in the field of Accountancy. He is a brilliant teacher. I have not missed any of his class. Well I would say that one should attend his class regularly, have faith in sir, follow his notes and nobody can stop you from getting good marks.

## Rakesh Sharma (Lucky) (91 marks)

Sunil Sir is a very good teacher. He is always ready to solve the problems. He is cooperative person. There is no comparison with the sir. He teaches each and every concept in logical and simplified manner. He always focuses on concepts. He also helped me in Business Study and I secured 89 marks. Just because of Sunil Sir I am able to Pass CA-CPT with good marks and without coaching. Now i have understood Sunil Sir's dialogue --- आखिर कब तक रद्दा लगाओगे..??

## Kajal Jha (91 marks)

I had a really good experience. Sunil sir is fab and supportive teacher. He is always there to guide you and help you no matter what day or time it is. Plus he creates a whole friendly atmosphere which attracts you like magnet to sit and study for hours.



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### **Neeraj Bhatt (90 Marks)**

One should not waste his/her time in looking for other teachers in the area if they want CA, CS and CMA (CWA) as his future career. I just want to say that the knowledge of Sir is Superb and the book given up is also quite good which is covering all concepts. He does not waste class time in talking about himself like other teachers do in the class. He just focuses on teaching. Moreover, I want to say that when I secured 90 marks, no students of other teachers except one or two students got above 90. Even, at that time (2010) paper was very hard but just because of Sunil Sir's concepts I got 90 marks.

### **AMIT PANDEY (89 marks)/BHISHAN TIWARI (82 marks)**

Teacher is a person who always helps everybody to get the knowledge and always stands beside the students when they have problems. Thanks for being my teacher.

### **GURINDER (88 marks)**

Sunil Sir is highly qualified and experienced teacher of accountancy. You must join Sunil Sir's classes to feel the difference from other teachers. He always encourages and motivates the students. Currently I have got admission in Khalsa College in B.Com Hons. with the support of Sunil Sir. Finally I would say..... Remember all words he says, words to make you social, words to make you special. **He is our Teacher, He is our Guide. Lets make him feel Pride.....**

### **Tanuj Joshi (85 marks)**

Sunil Sir is very motivating and class notes given by him in classes are very good and knowledgeable for the exam purpose. Thank you sir for teaching me. Your teaching has made ACCOUNTANCY a favourite subject of mine.

### **AASHIV (84 marks)**

Mr. Sunil Thukral is one of those teachers who can make a dull student take keen interest in his subject. He made accountancy a game which every student would love to play instead of wasting his precious time.

### **Amit (84 Marks)**

Sunil Sir's teaching style is different from other teacher. Firstly he focuses on concepts, cover all adjustments and important point then start doing questions. After reading concepts you can easily solve all questions of book. Actually in Accountancy exam only concepts help. Even I joined Sunil Sir's Classes 2 months before of Board Exam but just because of his concepts register i got 84 marks. I tell you one more thing, I used to ask doubts from other books too, he solved the questions easily. Actually he does not teach from T.S. Grewal only like other teacher do. He uses T.S. Grewal, D.K. Goel, S.C. Sharma, V. Wason, P. C. Tulsian, S.A. Siddiqui, Balbir Singh, NCERT, Together etc.

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### Abhishek (84 Marks)

I was a student of Government School. I had never expected that I would be able to get 84 marks in Accountancy. Even I had not studied from Sunil Sir in Class 11<sup>TH</sup>. My base was not so much strong. He motivated me and helped in improving my base. Now just because of him I got such good marks.

### TWINKLE (83 marks)

I would like to say about Sunil Bhaiya that he is a excellent teacher of accountancy. He always finds new-new techniques to understand and learn the concepts easily. He always clears the doubts of the students anytime. He always motivates and teaches when exam come with his popular dialoge "**Question** से प्यार मत करना और **Question** से लड़ाई मत करना" Because of Bhaiya's teaching techniques I have got 83% marks in Accountancy.

### Neha Bansal (83 Marks)

I joined late but got 83 marks just because of full support and efforts of Sunil Sir. I want to share one more thing that one of my friend studying from other teacher got 95 marks, has come for taking doubts of his CS Foundation from Sunil Sir. I would not take name of that teacher.

### Jitender (83 Marks)

I must say to any one that 11<sup>TH</sup> Accountancy is a base. You must join Sunil Sir's classes for strong base. I have joined in Class 11<sup>TH</sup>. Now you are seeing my result. Scoring 90 plus only is not enough. Good marks with strong base help in future. So for your bright future join Sunil Sir.

**Advice :- Sir you must provide coaching for CA also.**

### Amit (82 Marks)

He believes in 'KARMA'. He does not speak unnecessarily about himself in the class. Ya one of his dialogue is "फर्क पड़ता है आखिर पढ़ किसके पास रहे हो" His efforts, support, style of teaching, friendly behaviour speaks much more about him. According to him "ACTION SPEAKS LOUDER THAN WORDS".

### Neeraj Kumar (79 Marks)

Sunil Sir is a perfect teacher. He will motivate you. He will give you complete knowledge regarding Accountancy. He treats me as his younger brother. He is always ready to support students for further studies. He took doubts of every subject in my CA Journey so far. Just because of him I am in CA-Final before B.Com Final. He gives logic of each formula & Debit-Credit which strongly helped me in passing CA-CPT, CA-IPCC. Currently I am also teaching to many students. He always encourage me in teaching and studying. With Sunil Sir's Blessings I will be CA very soon. Finally I would say - "**NO** रट्टे, चक दे फट्टे".

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### Anjali (79 Marks)

Sunil Sir is a Doctor of Accountancy. Sir's Accountancy knowledge is no wonder very deep and he takes up queries excellently. He has been helpful as a teacher. If you call him '**Accountancy Guru**' then you are not wrong.

### Rohit Parihar (70 Marks)

Even I got less marks in 12<sup>TH</sup> Accountancy. Currently I have appeared for CA-CPT. But just because of logical concepts of Sunil Sir, I did not find any difficulty in Accountancy subject of CA-CPT. He focuses on every word, every formula, every adjustment which helped me in CA-CPT. I think in this area only students of Sunil Sir dare to go for CA, CS, CMA (CWA) just because of strong base.

### Pinki (87 Marks)

I wanna tell you all famous dialogue of Sunil Sir

- (a) आओ जी आओ।
- (b) जाओ जी लो अपनी जिंदगी।
- (c) Question से प्यार मत करना और Question से लड़ाई मत करना।
- (d) Full Marks लाओ, Smart Phone पाओ।
- (e) Shunty भाई में भी दम है, Shunty भाई किसी से कम है।
- (e) ठाकूर जी (भगवान जी) Pass लो नहीं करवाएंगे, Thukral ji Pass करवाएंगे।

**"IF YOU WANT TO KNOW THE REAL LOGIC BEHIND EVERY DEBIT AND CREDIT, JOIN CA. SUNIL THUKRAL CLASSES. "**

**"ONLY FOR THOSE STUDENTS WHO BELIEVE IN UNDERSTANDING THE CONCEPTS, NOT CRAMMING THE CONCEPTS."**





## लहरों से डर कर नौका पार नहीं होती



लहरों से डर कर नौका पार नहीं होती,  
कोशिश करने वालों की हार नहीं होती,  
नन्हीं चींटी जब दाना लेकर चलती है,  
चढ़ती दीवारों पर, सौ बार फिसलती है,  
मन का विश्वास रगों में साहस भरता है,  
चढ़कर गिरना, गिरकर चढ़ना न अखरता है,  
आखिर उसकी मेहनत बेकार नहीं होती.  
कोशिश करने वालों की हार नहीं होती,  
डुबकियां सिंधु में गोताखोर लगाता है,  
जा जा कर खाली हाथ लौटकर आता है,  
मिलते नहीं सहज ही मोती गहरे पानी में,  
बढ़ता दूना उत्साह इसी हैरानी में,  
मुट्ठी उसकी खाली हर बार नहीं होती,  
कोशिश करने वालों की हार नहीं होती,  
असफलता एक चुनौती है, स्वीकार करो,  
क्या कमी रह गई, देखो और सुधार करो,  
जब तक न सफल हो, नींद चैन को त्यागो तुम,  
संघर्ष का मैदान छोड़ मत भागो तुम,  
कुछ किये बिना ही जय जय कार नहीं होती,  
कोशिश करने वालों की हार नहीं होती ।

## हार्दिक शुभकामनाओं के साथ

Your's Economics And Accounts Teacher

CA. Anil Thukral

9250232779

CA. Sunil Thukral

9210473733





आज आप TIME को बर्बाद कर रहे हो।  
कल TIME आपको बर्बाद कर देगा।



**NO PHONE, NO FACEBOOK,  
NO MESSAGE, TIMELY STUDY  
AND MOST IMPORTANT IS  
CONCEPTUAL KNOWLEDGE FROM  
THUKRAL BROTHERS TO KNOW  
SUCCESS**

“NO रट्टे, चक दे फट्टे”  
आखिर कब तक रट्टा लगाओगे..??

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# INTRODUCTION TO ACCOUNTING

**CHAPTER - 1****Outline :**

- ☞ Meaning and Definition of Accounting
- ☞ Attributes, Objectives, Advantages, Systems of Accounting
- ☞ Functions, Limitations of Accounting
- ☞ Users of Accounting Information
- ☞ Systems of Accounting
- ☞ Book-Keeping, Accounting and Accountancy

**Q.1. What is meant by "Accounting" ?**

**Ans.** Accounting means a process of identifying, measuring, recording and communicating the required information relating to the financial transactions of an organisation to the different users to enable them to make decisions.

**Q.2. Why is Accounting called an Information system ?**

**Ans.** Accounting is called an information system because it collects data and communicates economic information about the organisation to a wide variety of users.

**Q.3. What type of Events or Transactions are recorded in Accounting Books ?**

**Ans.** Economic or Financial.

**Q.4. What is meant by "Economic Events or Financial Transaction" ?**

**Ans.** Economic events or financial transactions are the events or transactions, which are **measurable** in the **monetary terms**.

**Q.5. Give any two examples of financial transactions or economic events.**

**Ans.** (a) Purchase of Raw - Materials.  
(b) Payment of Salaries.

**Q.6. Give any two examples of transactions which are not recorded in accounting reports and books.**

**Ans.** (a) Value of Human Resources.  
(b) Policy of Management.  
(c) Labour-Management Relations.  
(d) Good Industrial Relations.  
(e) Customer Loyalty.

**Q.7. Mention any two "Internal Users of Accounting Information".**

**Ans.** (a) Owners.  
(b) Management (Chief Executive, Financial Manager).

**Q.8. Mention any two "External Users of Accounting Information".**

**Ans.** (a) Shareholders.  
(b) Creditors.



- Q.9. **Give two areas of interest for Owners/Shareholders while using accounting information.**  
Ans. (a) Return on their investment.  
(b) Financial health of the company.
- Q.10. **Give two areas of interest for Management (Directors/Managers) while using accounting information.**  
Ans. (a) Performance of the company.  
(b) Return on their investment.
- Q.11. **Give the area of interest for the Creditors while using accounting information.**  
Ans. Ability to pay its debts as they become due.
- Q.12. **Give the area of interest for the Prospective Investors while using accounting information.**  
Ans. Whether to invest or not to invest their money in the company.
- Q.13. **Give the area of interest for the Government and Regulatory Agencies.**  
Ans. Whether the company has satisfied the legal obligations imposed by the various laws.
- Q.14. **Give the area of interest for the Stock Exchanges.**  
Ans. Stock Exchanges are interested in financial statement to see that financial statements have been prepared to safeguard the interests of investors.
- Q.15. **What is the basic Objective of Accounting ?**  
Ans. To provide useful information to the interested group of users.
- Q.16. **Mention the Branches/Sub-Disciplines of Accounting.**  
Ans. (a) Financial Accounting.  
(b) Cost Accounting.  
(c) Management Accounting.
- Q.17. **Which branch of accounting serves the stewardship (Main/Looking After) function ?**  
Ans. Financial Accounting.
- Q.18. **Explain the Qualitative Characteristics of Accounting Information.**  
Ans. Following are the Qualitative Characteristics of Accounting Information :  
(a) **Understandability** :- An accounting system should be readily understandable by the different users. Accounting information should be presented in simple terms and form.  
(b) **Relevance** :- An accounting information should be relevant for decision making. To be relevant, information must be made available in time and must help in prediction and feedback.  
(c) **Reliability** :- An accounting information should be reliable in the sense that it should be free from error and bias and should represent what it should represent. An accounting information should be objective i.e., solidly supported by the facts.  
(d) **Comparability** :- An accounting information will be useful and beneficial to the different users only when it is comparable over time and with other enterprises. For this, there should be consistency i.e., use of common unit of measurement, common format of reporting and common accounting policies.



- Q.19. Which qualitative characteristic of accounting information is reflected when accounting information is clearly presented ?  
Ans. Understandability.
- Q.20. Which qualitative characteristic of accounting information requires the use of common unit of measurement and common format of reporting ?  
Ans. Comparability.
- Q.21. Which qualitative characteristic of accounting requires the audit of accounts ?  
Ans. Reliability.
- Q.22. Which qualitative characteristic of accounting requires that information should be made available in time ?  
Ans. Relevance.
- Q.23. Nitin, a businessman, has paid the school fee of his son from the business. Is it a business transaction ?  
Ans. Yes.
- Q.24. Ajay, a businessman, has paid the school fee of his daughter from his personal bank account. Is it a business transaction ?  
Ans. No.
- Q.25. State the meaning of "Entity".  
Ans. Entity means a thing that has a **definite individual existence**.
- Q.26. State the meaning of "Transaction".  
Ans. Transaction means an event involving some value between two or more entities. A business transaction is an economic activity of the business that changes its financial position. Whenever any business transaction takes place, **it results in a change in the value of some of the assets, liabilities or capital.**
- Q.27. What is an Accounting Cycle ?  
Ans. An Accounting Cycle is a complete sequence beginning with the recording of the transactions and ending with the preparation of Final Accounts, interpreting and communicating them to the users.
- Q.28. Who are the Users (Parties) of an Accounting Information ? Why do they need Accounting Informations ?  
Ans. Financial statements are useful to the following parties who are interested in the affairs of the undertaking :  
Internal Users :  
(a) **Owners or Shareholders** :- Owners or shareholders rely on the financial statements for ascertaining the profitability and growth potential of the company.  
(b) **Management** :- Management is answerable to the Owners. The responsibility of the management is to operate the business efficiently. Management needs accounting information  
(c) **Employees and Workers** :- Employees and Workers are entitled to Bonus at the year end which is linked to the profit earned by the enterprise.  
Financial Statements also show whether the enterprise has deposited its dues into provident fund and employees state insurance, etc., or not.



**External Users :**

(d) **Banks and Financial Institutions** :- Banks and Financial Institutions are an essential part of any business as they provide loans to the businesses. They rely on financial statements to know the capacity of the business enterprise to pay their claims in time. Financial statements give an idea of liquidity and solvency of the company.

(e) **Investors and Prospective (Future) Investors** :- Investors invest their money in the business. They need accounting information to know the safety of their investments. Financial statements provide prospective investors various information about the past performance and future prospects of the company.

(f) **Creditors** :- Creditors are those parties who supply goods or services on credit. Before granting credit, creditors want to be satisfied about the creditworthiness of the business enterprise by assessing financial capability of the business enterprise.

(g) **Government and Regulatory Authorities** :- The Government is interested in the financial statements of a business on account of assessment of Income Tax, Sales Tax, Excise Duty etc. Financial statements also provide basic input to the Government and regulatory authorities to frame fiscal policies.

(h) **Researchers** :- Researchers need accounting information to study the financial operations of a particular firm or company.

(i) **Consumers** :- Consumers need accounting information to create public opinion against those firms who exploit (शोषण) the consumers.

(j) **Public** :- The Business Enterprises affects the public in a variety of ways, For example, public might be interested in knowing the trend of employment opportunities provided by the enterprises and the measures adopted to control the level of pollution.

Such type of information is available from the Annual Reports of the enterprise.

(k) **Stock Exchanges** :- Stock exchanges are interested in financial statements to see that financial statements have been prepared to safeguard the interest of investors.

(l) **Trade Association** :- Trade association analyse financial statements to provide service and protection to their members.



	Parties	Area of Interest
<b>Internal Users :</b>		
(1)	<b>Owners</b>	(i) Profitability, (ii) Financial Position, (iii) Future Prospects.
(2)	<b>Management</b>	(i) Profitability in relation to Investment, (ii) Managerial Decisions, (iii) Liquidity of the Concern.
(3)	<b>Employees</b>	(i) Profitability.
<b>External Users :</b>		
(4)	<b>Banks and Financial Institution</b>	(i) Performance, (ii) Profitability, (iii) Financial Position.
(5)	<b>Investors and Potential Investors</b>	(i) Earning Capacity, (ii) Safety.
(6)	<b>Creditors</b>	(i) Profitability, (ii) Financial Position.
(7)	<b>Government and its Authorities</b>	(i) Profitability, (ii) Financial Position, (iii) Tax Liability.
(8)	<b>Researchers</b>	(i) Accounting Theory, (ii) Business Practices, (iii) Future Profitability.
(9)	<b>Consumers</b>	(i) Pricing.
(10)	<b>Public</b>	(i) Protecting Environment, (ii) Indirect Contribution for Betterment.
(11)	<b>Stock Exchanges</b>	(i) Safeguard the Interests of Investors.
(12)	<b>Trade Associations</b>	(i) Provide Services and Protection to their members.

Q.29. **What are the Steps involved in the "Process of Accounting" ?**

Ans. (a) Identifying Financial Transactions.  
 (b) Recording in the Books of Accounts.  
 (c) Classifying the Recorded Entries.  
 (d) Preparation of Trial Balance.  
 (e) Preparation of Final Accounts; and  
 (f) Communicating to the Users.

Q.30. **What is the Traditional Function of Accounting ?**

Ans. Recording Financial Transactions.

Q.31. **What is the role of accountant now-a-days ?**

Ans. Providing relevant information to the Decision Making System.

Q.32. **What are the Attributes (Features/Characteristics) of Accounting ?**

Ans. Followings are the attributes of Accounting :

(a) **Accounting is an Art as well as Science :-** Accounting is an art of recording, classifying and summarising business (financial) transactions with a view to ascertain (find) Profitability and Financial Position of the Business Enterprise.

Accounting is also science since it is also an organised body of knowledge based on certain basic principles and accounting standards.

(b) **Recording of Financial Transactions and Events :-** Only those transactions and events are recorded in the accounting which can be measured in terms of money i.e. are of financial character.



It is a serious limitation of the accounting. There are so many transactions which are very important for the business but which cannot be measured and expressed in terms of money and hence such transactions will not be recorded.

**Though these events affect the earning of the business adversely (बुरी तरह से) but as no one can measure the effect of such events in terms of money, these will not be recorded in the books of the business.** These events are :

- (i) Quarrel (लड़ाई) between Production Manager and the Sales Manager.
- (ii) Resignation by an able and experienced manager.
- (iii) Strike by Employees.
- (iv) Starting of a new business by the other competitor etc.

**(c) Recording in terms of Money :-** Each transaction is recorded in the books in terms of money. For example, a business, on a particular day has ₹ 20,000 in cash, 5,000 kilograms of raw materials, 5 machines, 100 chairs. All these things cannot be added up unless expressed in terms of money. In order to make a record of these items, these will have to be expressed in monetary items such as cash ₹ 20,000; raw material ₹ 25,000; machines ₹ 2,00,000; chairs ₹ 5,000.

As such, to make accounting records relevant, simple, understandable and homogeneous (same), they are expressed in a common unit of measurement, i.e., **Money**.

**(d) Functions of Accounting :-**

- (i) **Identification :-** Financial Transactions are identified as only those transactions are recorded in the books of accounts that are **financial in nature**.
- (ii) **Measuring :-** Financial Transactions and Events are measured in money terms are recorded in the books of accounts.
- (iii) **Recording :-** Accounting is the process of recording business transactions of financial nature in the books of accounts.

They are recorded in the books of original entry i.e., **Journal**.

This book may be further sub-divided into various subsidiary books such as :

Cash Journal :- For recording Cash Transactions,

Purchases Journal :- For recording Credit Purchases of Goods,

Sales Journal :- For recording Credit Sales of Goods.

- (iv) **Classifying :-** Classification is the process of grouping financial transactions or entries of one nature at one place.

The transactions recorded in the Journal or the Subsidiary Books are classified and posted to the main book of account known as the **Ledger**.

- (v) **Summarising :-** Summarising involves presenting the classified data in a manner which is understandable and useful to the end-users of accounting statements.

This process leads to the preparation of :

(i) Trial Balance, (ii) Trading and Profit & Loss Account and (iii) Balance Sheet.

- (vi) **Analysis and Interpretation :-** In Accounting, the results of the business are presented in such a manner that the parties interested in the business such as proprietors, managers, banks, creditors, employees etc. can have full information about the **profitability** and **financial position** of the business.



- (vii) **Communicating** :- Accounting functions also include the communication of financial data to the users who analyse them as per their individual requirements.

(d) **Service Activity** :- Accounting is a service activity. It is designed to produce relevant information of an organisation to be used for decision-making.

Q.33. **List any two Functions of Accounting.**

Ans. Two Functions of Accounting are :

- (a) Identifying Financial Transactions; and
- (b) Recording them in the Books of Accounts.

Q.34. **What are the Branches/Sub-Disciplines of Accounting ?**

Ans. The branches of the Accounting are :

(a) **Financial Accounting** :- The main purpose of this branch of accounting is to record business transactions in a systematic manner, **to ascertain the profit or loss** of the accounting period by preparing a **Profit & Loss Account** and to **present the financial position** of the business by preparing a **Balance Sheet**.

(b) **Cost Accounting** :- The main purpose of cost accounting is to ascertain (find) the **total cost** and **per unit cost of goods produced and services rendered** by a business.

It also estimates the cost in advance and helps the management in exercising strict control over cost.

(c) **Management Accounting** :- The main purpose of management accounting is to present the accounting information in such a way as to assist (help) the management in planning and controlling the operations of the business.

The Management Accountant uses various techniques and concepts to make the accounting data more useful for managerial decision making.

**These techniques includes ratio analysis, budgetary control, fund flow statement, cash flow statement etc.**

Q.35. **What are the Objectives or Utilities of Accounting ?**

Ans. The following are the main objectives or utilities of Accounting :

(a) **To Keep Systematic Record of Business Transactions** :- The main objective of accounting is to **keep complete record of business transactions** according to specified rules.

Complete records of business transactions **helps to avoid the possibility of omission and fraud**. For this purpose, all the business transactions are first of all recorded in Journal or Subsidiary Books and then posted into Ledger.

(b) **To Calculate Profit or Loss** :- Another objective of accounting is to ascertain **profit earned or loss incurred** by the business during the accounting period.

For this purpose, a statement called an **Income Statement** or the **Trading and Profit & Loss Account** is prepared.

(c) **To Show Financial Position** :- Accounting provides necessary information about the financial position i.e., Assets, Liabilities and Capital of the Owner.

For this purpose, a statement called **Balance Sheet** is prepared.

(d) **To Assist (Help) the Management** :- The management often requires financial information for decision-making, effective control, budgeting and forecasting.

Accounting provides financial information to assist the management in discharging this function.



(e) **To Communicate Accounting Informations to Users :-** Another objective of accounting is to provide accounting information to users who analyse them as per their individual

(f) **To Prevent Frauds :-** Maintaining regular and systematic accounting records helps in preventing possible frauds.

Q.36. **What are the Advantages or Uses of Accounting ?**

Ans. The Advantages of Accounting are :

(a) **Financial Information about Business :-** Financial Performance during the accounting period, i.e., **Profit or Loss** and also the **Financial Position** at the end of accounting period is known through Accounting.

(b) **Helpful in Management of Business :-** The management makes business plans, takes actions and exercises control over affairs on the basis of accounting information.

(c) **Provides Complete and Systematic Records and Replaces Memory :-** Business transactions have grown in size and complexity and it is not possible to remember each and every transactions. Accounting keeps a systematic records of all transactions.

(d) **Enables Comparative Study :-** By keeping a systematic records Accounting helps the owners to compare one year's cost, expenses, sales and profit etc. with those of other years. Such a comparison provides the useful informations on the basis of which important decision can be taken.

(e) **Helpful in Settlement of Tax Liabilities :-** Properly maintained accounting record immensely helps settlement of Income Tax, Sales Tax, VAT and Excise Duty Liabilities since it is good evidence of the correctness of the transactions.

(f) **Helpful in Raising (Taking) Loans :-** Accounting Information is of great help while raising loans from Banks or other Financial Institutions. Such institutions before sanctioning loan screen (check) various financial statements of the firm such as Final Accounts, Fund Flow Statement, Cash Flow Statement etc.

(g) **Evidence in Court :-** Systematic record of transactions is often accepted by the Courts as good evidence.

(h) **Facilitates Sale of Business :-** If someone desires to sell his business, the accounts maintained by him will enable the **determination of the proper Purchase Price**.

Q.37. **What are the Limitations/Disadvantages of Accounting ?**

Ans. The Limitations of Accounting are :

(a) **Accounting is not Fully Exact :-** Although most of the transactions are recorded on the basis of evidence such as sale or purchase or receipt of cash, **yet some estimates are also made for ascertaining profit or loss**.

Examples of this are providing depreciation of an asset, possible bad debts, the probable market price of the stock of goods, etc.

**Thus Profit cannot be treated as exact because different estimates drawn by different peoples lead to different amount of profit or loss.**

(b) **Accounting ignores the Qualitative Elements :-** Since Accounting is confined (limited) to monetary matters only, Qualitative elements like quality of staff, industrial relations and public relations are ignored.



(c) **Accounting is based on Historical Cost i.e. ignores the Effect of Price Level Changes :-** Since Assets are recorded at their original cost when purchased and not at their market prices. Hence, Financial Statements fail to show real worth of the business.

(d) **Accounting is not a Good Tool for Management :-** Financial Accounts are only a record of Past Events which do not help the management for forecasting or decision making in the present era where continuous changes takes place in the demand of the product, the position of the competition etc.

(e) **Accounting is Influenced by Personal Judgements :-** Adoption of various accounting policies depends on the personal judgement of the accountant. Like method of valuation of inventory and making provision for Doubtful Debts. As a result, Financial Statements may not be objective and comparable.

(f) **Accounting may lead to Window Dressing :-** Window Dressing refer to the practice of **Manipulating (हेर-फेर) Accounts**, so that the Financial Statements may disclose (show) a Favourable Position than the Actual Position.

Q.38. **What is meant by the term "Accountancy" and "Accounting" ?**

Ans. Accountancy refers to a Systematic Knowledge of Accounting. It explains how to deal with various aspects of Accounting. It educates us why and how to maintain the books of accounts and how to summarise the accounting information and communicate the users.

*In words of Kohler, Accounting refer to the entire body of the theory and practice of accounting.*

Accounting starts where book-keeping ends. It includes the decision making function also on the basis of information provided by book-keeping and Accounting.

Q.39. **What is the meaning of Book-Keeping ? What is the Functions of Book-Keeping ?**

Ans. Book-Keeping is an art of recording in books of accounts the monetary aspect of commercial or financial transactions.

It is mainly concerned with **Record Keeping or Maintenance of Books of Accounts.**

Thus Book-Keeping is concerned with:

- (a) Identifying financial transactions and events,
- (b) Measuring them in terms of money,
- (c) Recording the identified financial transactions and events in the books of original entry and
- (d) Classifying them into Ledger.

Q.40. **Distinguish between Book-Keeping and Accounting.**

Ans.

Points of Difference	Book-Keeping	Accounting
1. Scope	Book-Keeping is concerned with identifying financial transactions; measuring them in a money terms; recording them in books of accounts and classifying them.	Accounting is concerned with summarising the recorded transactions, interpreting them and communicating the results.
2. Stage	It is a <b>Primary Stage</b> .	It is a <b>Secondary Stage</b> . Accounting starts where Book-Keeping ends.



<b>3. Objective</b>	The objective of Book-Keeping is to maintain systematic records of financial transaction.	The objective of Accounting is to ascertain Net Results of operations and financial position and to communicate information to the interested parties.
<b>4. Nature of Job</b>	The job is <b>Routine</b> in nature.	The job is <b>Analytical and Dynamic</b> in nature.
<b>5. Performance</b>	<b>Junior Staff</b> performs this function.	<b>Senior Staff</b> performs this function.
<b>6. Relation</b>	Book-Keeping is the <b>Basis</b> for Accounting.	Accounting <b>starts</b> where Book-Keeping <b>ends</b> .
<b>7. Special Skills</b>	The Book-Keeper is not required to possess special skills.	The Accountant is required to possess special skills.

Q.41. Distinguish between Accounting and Accountancy.

Ans.

Points of Difference	Accounting	Accountancy
<b>1. Meaning</b>	It is concerned with recording, classifying and summarising of transactions.	It is a body of knowledge prescribing certain rules or principles to be observed while recording, classifying and summarising of transactions.
<b>2. Scope</b>	It is <b>narrow</b> in scope. <b>Accounting starts where Book-Keeping ends.</b>	It is much <b>wider</b> in scope and includes Book-Keeping as well as Accounting.
<b>3. Relation</b>	It depends on Book-Keeping.	It depends both on Book-Keeping and Accounting.
<b>4. Function</b>	Its main function is to ascertain the net results and financial position of the business and to communicate them to interested parties.	It includes the decision making function also on the basis of information provided by Book-Keeping and Accounting.

Q.42. Name the Branch of Commerce, which keeps a record of monetary transactions in a set of books.

Ans. Book-Keeping.

Q.43. Is the basic objective of Book-Keeping to maintain systematic records or to ascertain net results of operation of financial transactions.

Ans. The basic objective of Book-Keeping is to maintain Systematic Records of Financial Transactions.

Q.44. Book-Keeping is not a part of Accounting. Do you agree with the statement ?

Ans. No Book-Keeping is a part of Accounting. Two processes of Accounting, i.e., Collecting and Recording of Financial Transactions and Events are the processes of Book-Keeping.

Q.45. What is the Role of the Accounting ?

or

"The Role of Accounting has changed over the period of time" - Do you agree ?



Ans. Role of Accounting has been changing with the changes in business environment and increasing social demands. Over the centuries, the role of accounting was confined (limited) to the Record Keeping of Financial Transactions only.

But Today's rapidly (fastly) changing business environment has changed the role of accounting and at present the Accounting plays the following different roles :

(a) **Role of a Language** :- Accounting is viewed as a Language of Business because it prepares **Reports and Statements which communicate information regarding the business enterprise.**

(b) **Role of Historical Record** :- Accounting is viewed as Systematic Record of all financial transactions in the books of accounts according to specified rules.

(c) **Role of Determining the Net Profit** :- It is also regarded as a means of determining True Profit or Loss of a Business Enterprise.

(d) **Role of Information System** :- Accounting as an Information System communicates economic information to various interested groups such as Management, Investors, Creditors, Employees etc. for taking appropriate decisions.

(e) **Role of Service Provider** :- Accounting is regarded as Service Activity because it provides quantitative financial information which is helpful to the users in different ways.

(f) **Role of Commodity** :- Accounting reports the activities of the enterprise affecting society which are important for social environment.

Q.46. **What are the two Systems of Accounting ? Which system of accounting is more widely used ?**

Ans. (a) Double Entry System and  
(b) Single Entry System.

*Double Entry System is most widely used.*

Q.47. **Write short note on "Double Entry System".**

Ans. All business transactions are recorded in the books of account on the basis of **Double Entry System**. The system is based upon the fact that there are two aspects of every transactions. Each business transaction involves at least two persons, parties or accounts.

Double Entry does not mean that a transaction is recorded twice. It means at least two accounts are affected by a transaction.

As per traditional **English Approach** if there is receiver of goods or cash, there must be giver of goods or cash also. If there is loss for someone, it will definitely be gain for someone else.

**Therefore, recording dual aspects of business transaction in terms of 'Debit and Credit' is Double Entry System.**

For Example : If Machinery is purchased for ₹ 10,000, it involves two accounts - Machinery Account and Cash Account. Since Machinery is coming into the business it will be debited and Cash Account will be credited as it is going out.

Q.48. **What are the Features of the Double Entry System ?**

Ans. (a) It maintains a complete record of each transaction.  
(b) It recognises the two fold aspect of every transaction.  
(c) In this system, one aspect is Debited and other aspect is credited following the rules of Debit and Credit.

Since, one aspect of a transaction is debited and other is credited, the total of all debits is always equal to total of all credits. It helps in establishing arithmetical accuracy by preparing a Trial Balance.



Q.49. **What are the Advantages of the Double Entry System ?**

Ans. The main advantages of Double Entry System are :

(a) **Scientific System** :- Double Entry System is the only scientific system of recording business transactions as compared to other systems of Book-Keeping. It helps to attain (प्राप्त करना) the objectives of Accounting.

(b) **Complete Record of Transactions** :- Under the system both sides of a transaction are recorded. It is a complete record as it results in depicting (showing) correct income or loss, assets and liabilities.

(c) **A Check on the Accuracy of Accounts** :- By the use of this system the accuracy of the accounting work can be established through Trial Balance.

(d) **Ascertainment of Profit or Loss** :- The profit earned or loss incurred during a period can be ascertained by preparing Profit and Loss Account.

(e) **Knowledge of Financial Position** :- The financial position of the firm can be ascertained at the end of each period by preparing the Balance Sheet.

(f) **Full Details for purposes of Control** :- Under this system accounts are maintained in as much detail as necessary and, therefore, provides significant information for purposes of control, etc.

(g) **Comparative Study is possible** :- Results of one year may be compared with those of previous years and reasons for the change may be ascertained.

(h) **Helps Management in Decision Making** :- The management may be able to obtain good information for making Timely Decisions.

(i) **No Scope of Fraud** :- The firm is saved from Frauds and Misappropriations (हेर-फेर) since full information about all Assets and Liabilities is available.

It is because of these advantages that the Double Entry System has been used widely in all countries.

Q.50. **What are the Disadvantages of the Double Entry System ?**

Ans. The disadvantages of Double Entry System are :

(a) **Sound (Good) Knowledge of Book-Keeping** :- Maintenance of books of accounts requires sound knowledge of principles of accounting and the procedure for maintaining them.

(b) **Complicated Method** :- The system involves recording both the aspects of transaction. It also involves application of principles of accounting. The process thus, becomes complicated and lengthy for a normal person.

(c) **Costly** :- Maintaining the books of accounts involved specialised knowledge. It thus, requires trained and experienced staff. Such a staff are hired at higher salaries which makes Book-Keeping under the Double Entry System Costly.

(d) **Not suitable for Small Business** :- Double Entry System of Book-Keeping is not suitable for small businesses with very few transactions as it is costly and complicated method.

Q.51. **Write short note on "Single Entry System".**

Ans. Under Single Entry system, both aspects of a transactions are not recorded. In fact, for some transactions two aspects, for some others one aspect and yet for other no aspect at all are recorded. Under this system, only **Personal Accounts** and **Cash Book** are maintained. Hence it remains an incomplete record of Accounts.

The accounts maintained under this system are incomplete and unsystematic and therefore, **not reliable**.

The Single Entry System is also known as **Accounts from Incomplete Records**.

Since all transactions are not recorded under Double Entry Principle, it is not possible to prepare Trial Balance. As a result, the Profit & Loss Account and the Balance Sheet can not be prepared.



The accounts maintained under this system are incomplete and unsystematic and therefore, **not reliable**.

The Single Entry System is also known as **Accounts from Incomplete Records**.

Since all transactions are not recorded under Double Entry Principle, it is not possible to prepare Trial Balance. As a result, the Profit & Loss Account and the Balance Sheet can not be prepared.

Q.52. **Briefly appreciate the exact nature of Accounting.**

Ans. In order to appreciate the exact nature of Accounting, we must understand the following aspects of Accounting.

(a) **Economic Events** :- Accounting records only economic events. An economic event is a transaction which can be measured and expressed in terms of money.

(b) **Identification, Measurement, Recording and Communication** :-

**Identification** :- It means determining what transactions are to be recorded.

It involves observing activities and selecting those events that are of financial characters and relate to organisation.

**Measurement** :- It means quantification of business transactions into financial terms by using monetary units.

**Recording** :- Accounting is the art of recording business transactions according to some specified rules and in chronological order.

**Communication** :- The recorded events are communicated to management and other internal and external users regularly through accounting reports.

(c) **Organisation** :- It refers to a business enterprise which can be Sole-Proprietary Concern, Partnership Firm, Company or any other Association of Persons.

(d) **Interested Users of Information** :- They may be internal users and external users. Internal users include Chief Executive, Financial Officer, Vice President, Plant Managers, Stores Managers etc. External users include Owners, Potential Investors, Creditors, Lenders, Labour Unions, Tax Authorities, Customers etc.

Q.53. **Explain the factors which necessitated Systematic Accounting.**

Ans. Main purpose of Accounting is to provide information to a variety of users for taking various decisions. Hence the information should have the quality of **reliability, understandability and comparability** which is possible only if the accounting is carried out systematically i.e. based on principles and rules of accounting.

Further, the role of accounting has been changing with the changes in economic development and increasing social demands, which requires analyses of accounting data and preparation of reports.

Systematic recording is also needed for assessment of various taxes such as Value Added Tax (VAT), Income Tax, Customs and Excise Duties etc.

Q.54. **"Accounting Information should be Comparable." Do you agree with this statement ? Give two reasons.**

Ans. Yes, Accounting Information should be comparable, because

(a) Comparability is needed to make inter-firm comparisons, i.e. to find out how a firm has performed as compared to the other firms, and

(b) Comparability is needed to make inter-period comparisons, i.e. to find out how it has performed as compared to the previous years.

Q.55. **Discuss briefly the types of Accounting Information.**

Ans. Accounting Information refers to the financial statements generated through the process of Book-Keeping, use of which enables the users to arrive at the correct decision.

The financial statements so generated are the Income Statement, i.e., Profit and Loss Account and the Position Statement i.e., Balance Sheet.

The information made available by these statements can be categorised into the following :

- (a) Information relating to Profit or Surplus;
- (b) Information relating to Financial Position; and
- (c) Information about Cash Flow.





# BASIC ACCOUNTING TERMS

## CHAPTER - 2

### Outline :

- ☞ Asset, Liability, Expense, Income, Capital
- ☞ Profit, Loss, Gain, Debit, Credit, Discount
- ☞ Cost, Cost of Goods Sold, Goods, Stock
- ☞ Proprietor, Solvent, Insolvent, Entity
- ☞ Depreciation, Balance Sheet, Drawings, Vouchers
- ☞ Purchases, Sales, Purchases Return, Sales Return

- (1) **Assets :-** Assets are the economic resources that is owned or/and used by an individual or business enterprise in its operations which can be valued in terms of money. It may be in tangible (physical) form or intangible form.

**Fixed Assets & Currents Assets** are the **two types** of Assets.

Assets can be classified into :

**Fixed Assets or Long Term Assets :-** Fixed Assets are assets which are **held** on a **long-term basis**. Fixed assets are of **durable nature**. Fixed Assets are not meant for resale in the normal course of business but with the purpose to increase the earning capacity of the business by employing them. For example - Land, Building, Machinery, Furniture etc.

**Current Assets or Short Term Assets :-** Current Assets are assets which are **held** in the business for a **short period of time**. Current assets can be realised to discharge liabilities. For example - Cash, Debtors, Stock, Prepaid Expenses etc.

**Tangible Assets :-** Tangible Assets are those assets which **have physical existence**, i.e., they **can be seen and touched**. For example - Land, Building, Machinery, Computer, Furniture, Goods etc.

**Intangible Assets :-** Intangible Assets are those assets which **do not have physical existence**, i.e., they **can not be seen and touched**. For example - Patents, Goodwill, Trademark etc.

**Fictitious Assets/Nominal Assets :-** Fictitious Assets are those assets which are neither tangible assets nor intangible assets.

It represents **loss or expenses yet to be written off**. For Example - Debit balance of Profit & Loss Account and Deferred Revenue Expenditure etc.

**Liquid Assets :-** Liquid Assets are those assets which are either in the form of Cash or can be converted into cash within a very short period. For example - Cash, Bill Receivables and Debtors etc.

**Wasting Assets :-** Wasting Assets are those assets which are natural resources extracted and consumed as raw material or otherwise. For example - Mines, Quarries (from where stones or minerals are extracted by digging, drilling), Oil Wells etc.

- (2) **Liabilities :-** Liabilities are **obligations or debts** that an enterprises has to pay at some time in future. It is the amount which the business owes to outsiders that is, excepting the proprietors.



*Internal Liabilities :-* Capital invested by the proprietors is internal liability.

*External Liabilities :-* External liability is a liability that is payable to outsiders, i.e., other than the owners, i.e., proprietors. For Example - Creditors, Bank Overdraft, Bills Payable etc.

**Non-Current Liabilities & Current Liabilities** are the **two types** of Liabilities.

*Non Current or Long Term Liabilities or Fixed Liabilities:-* Long Term Liabilities are the obligations payable **after a long period, normally after one year**. For example, Loan from Financial Institution, Debentures etc.

*Current or Short Term Liabilities :-* Short Term of Current Liabilities are the liabilities that are payable **within a period of one year**. For example, Creditors, Bank Overdraft etc.

*Contingent Liabilities :-* Contingent Liabilities are the liabilities which **come into existence on the happening of some uncertain events**. Contingent Liabilities are **possible future liabilities**. Since contingent liabilities are **not actual liabilities** on the date of Balance Sheet, they are **not included in the total liabilities**. However, contingent liabilities are shown as **footnote** to the Balance Sheet. For Example - Discounting of Bills Receivable, Disputed Excise Duty Claim etc.

- (3) **Capital :-** Capital means the amount invested by the owner (Proprietor/Businessman) in the firm. It may be in the form of money or assets having money value. Capital is also known as **Owner's Equity** or **Net Worth**.

$$\text{Capital} = \text{Assets} - \text{External Liabilities}$$

- (4) **Drawings :-** Drawings means the cash or value of goods withdrawn by the owner from the business for his **Personal Use (Private/Domestic/Household Use/Own Consumption)**.
- (5) **Goods or Merchandise :-** 'Goods' refer to product in which the business enterprise is dealing i.e. product which is meant for resale.

- (6) **Stock or Inventory :-** Stock refers to the amount of goods which remain unsold or unused on a particular date.

*Opening Stock :-* Opening Stock means stock of goods on the first day of the year.

*Closing Stock :-* Closing Stock means stock of goods on the last day of the year.

Stock may be of the following kinds :

*Stock of Raw Material :-* It includes stock of raw materials purchased for using them in the products manufactured but still lying unused. For Example - the value of cotton in case of cloth mills in the stock of raw material.

*Stock of Work-in-progress :-* It is also termed as **stock of partly finished goods**. It means goods in semi-finished form. Such goods need further processing for converting into finished products. For the valuation of work in progress, the value of raw materials used in it, the cost of labour, power, fuel and other expenses on proportionate basis are included. In case of cloth mills the value of threads and the unfinished cloth will be the stock of work-in-progress.

*Stock of Finished Goods :-* It includes the stock of those goods which have been completely processed and are ready for sale but are lying unsold at the end of the accounting period. In case of cloth mills the value of finished cloth will be the value of finished goods.

- **Calculation of Closing Stock :-** To ascertain (find) the value of the closing stock, a complete list of all items in the godown together with their quantities is prepared.



Also the separate lists should be prepared for raw materials, semi-finished goods and finished goods in the stores. **Preparation of such lists is called 'STOCK TAKING'.**

Care should be taken that the following goods are not included in the list of the stock :-

- (a) Goods which have been sold but remain undelivered.
- (b) Goods purchased and received but which have not been recorded in the purchase book.

Following goods should be included in the list of stocks :-

- (a) Goods sent to customers on sale or return basis.
- (b) Goods sent to agents (consignee) for sale but remain lying with them as unsold.

It should always be kept in the mind that stock is valued at **Lower of Cost Price or Market Value (Realisable Value).**

- (7) **Purchases :-** The term 'Purchases' is used only for the purchase of **Goods in which the business deals.**

Goods are those things which are purchased for resale or acquiring raw materials for the purpose of producing the finished goods and then sale.

*Cash Purchases :-* Goods purchased for cash are called Cash Purchases.

*Credit Purchases :-* Goods purchased on credit are called Credit Purchases.

*Purchases Return/Returns Outward :-* Goods purchased may be returned due to any reason, say, they are not as per specifications or are defective. Goods returned are known as Purchases Return.

- (8) **Sales :-** The term 'Sales' is used only for the Sales of those **Goods which are purchased for resale purposes.**

It also includes revenue from services provided to customers. The term 'Sales' is never used for the sales of assets.

*Cash Sales :-* Goods Sold for **Cash** are called Cash Sales.

*Credit Sales :-* Goods Sold on **Credit** are called Credit Sales.

*Sales Return/Returns Inward :-* Goods sold when returned by the purchaser are termed as Sales Return/Returns Inward.

- (9) **Debtors or Book Debt :-** The term 'Debtors' represents those persons or firms to whom Goods have been sold or services rendered (provided) on credit and payment has not been received from them.

*Trade Receivables :-* Amount due from Debtors and Bills Receivables is jointly termed as 'Trade Receivables' or 'Receivables' or 'Accounts Receivables'.

- (10) **Creditors :-** The term 'Creditors' represents those persons or firms from whom Goods have been purchased or services procured (taken) on credit and payment has not been made to them.

*Trade Payables :-* Amount due to Creditors and for Bills Payables is jointly termed as 'Trade Payables' or 'Payables' or 'Accounts Payables'.

- (11) **Bills Receivable :-** Bills Receivable is a Bill of Exchange in the hand of a person who is entitled to receive the amount due from him. It is Drawn by Creditors.



(12) **Bills Payable :-** Bills Payable is a Bill of Exchange for a person who is liable to pay it on its maturity. It is accepted by Debtors.

(13) **Expenses :-** Expenses is a value which expired during the Accounting Period. It may be

- (a) Cash Payment such as Salaries, Wages, Rent etc.
- (b) Writing off a part of Fixed Assets (Depreciation).
- (c) An Amount written off out of a current asset (e.g. Bad Debts).
- (d) Decline in the value of Assets (e.g. Investment)
- (e) Cost of Goods Sold.

An expense is Charged (Debited) to Profit & Loss Account.

(14) **Revenue :-** Revenue in accounting means the income of a recurring (regular) nature from any source. Revenue is related with the day-to-day affairs of the business.

It consists of the amount received from sale of goods and from service provided to customers. It also includes receipt of Rent, Commission, Dividend, Interest etc.

(15) **Income or Profit :-** Income is the profit earned during a period of time.

In other words, the difference between Revenue and Expenses is termed as Income.

$$\text{Income} = \text{Revenue} - \text{Expenses}$$

(16) **Expenditure :-** Expenditure is the amount spent or liability incurred for acquiring (purchasing) Assets, Goods or Services. Expenditure may be categorised into :

- (a) Capital Expenditure
- (b) Revenue Expenditure
- (c) Deferred Revenue Expenditure

**Capital Expenditure :-** Capital Expenditure is the amount spent by an Enterprise on **Purchase of Fixed Assets** that are used in the business to **Earn Income and not intended for Resale**. **Fixed Asset** purchased may be **Tangible or Intangible**.

**Revenue Expenditure :-** Revenue Expenditure is the amount spent on **Running a Business**. The benefit of Revenue Expenditure is Exhausted (Achieved) in the accounting period in which it is incurred.

**Deferred Revenue Expenditure :-** Deferred Revenue Expenditure may be defined as a **Heavy Expenditure of Revenue Nature** incurred for getting **Benefit over a number of years**. For Example - Large Expenditure incurred on advertising to introduce new product in the market.

(17) **Receipts :-** Receipts is the amount received or receivable for **Selling Assets, Goods or Rendering (Providing) Services**.

- (a) Capital Receipts
- (b) Revenue Receipts

**Capital Receipts :-** Capital Receipts are the Receipts which **do not arise** out of an ordinary Operations of the Business but out of some **Casual or Non-Recurring Transactions**. They are not Revenue for the business. Examples are Sale of Fixed Assets, Loan received by the business etc.

**Revenue Receipts :-** Revenue Receipts are the Receipts which **arise out of Normal Operations** of the **Business**. Revenue Receipts are the amount received by the business in the regular course of business say Sale of Goods or Rendering of Services. Examples are Sale of Goods, Interest Received etc.



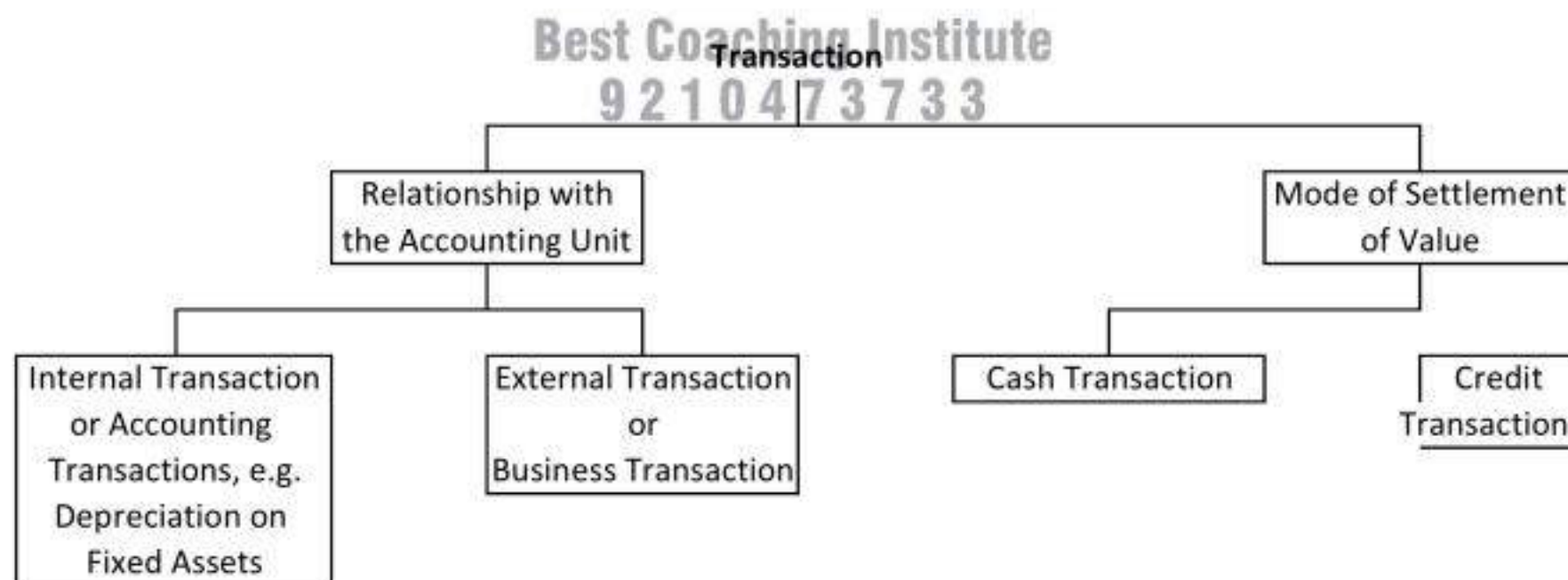
- (18) **Loss :-** Loss means the result of the business for a period when **total expenses exceed the total revenue**.  
It also refers to money or money's worth lost against which the firm receives no benefits, e.g. Cash or Goods Lost in Theft.
- (19) **Profit :-** It is the surplus of Revenue of a Business over its Costs. Profit is normally categorised into Gross Profit and Net Profit.  
*Gross Profit/Trading Profit :-* Gross Profit is the difference between Sales Revenue or the Proceeds of Goods Sold and/or Services rendered over its direct cost.  
*Net Profit :-* Net Profit is the profit made after allowing all expenses.  
**In Case Expenses are more than the Revenue, it is Net Loss.**
- (20) **Gain :-** Gain is a Profit of Irregular or Non-Recurrent Nature. e.g. Profit on Sale of Fixed Assets.
- (21) **Cost :-** It is the amount of expenditure incurred on or attributable to a specified Article, Product or Activity.
- (22) **Cost of Goods Sold :-** Cost of Goods Sold is the Direct Costs of the Goods Sold or Services Rendered.  
Where Cost Of Goods Sold =  
 (a) Net Sale - Gross Profit  
 (b) Net Sale + Gross Loss  
 (c) Opening Stock + Net Purchases + Direct Expenses - Closing Stock
- (23) **Proprietor/Businessman/Owner :-** The person who makes the investment and bears all the risks connected with the business.
- (24) **Discount :-** When Customers are allowed any type of reduction in the prices of Goods by the business, it is called a Discount.  
*Trade Discount :-* When some Discount is allowed in the Prices of Goods **on the basis of Sales**, it is called Trade Discount.  
**It is not recorded in the books of accounts as it is deducted in the Gross Value of Goods.**  
*Cash Discount :-* When Debtors are allowed some Discount in Prices of Goods **for timely payment**, it is called Cash Discount.
- (25) **Bad Debts :-** Bad Debts is the amount that has become **irrecoverable**. It is a business loss and is debited to Profit & Loss Account.
- (26) **Voucher :-** A Voucher means a **written evidence of a transaction** that has taken place. Examples are Cash Memo, Bill, Receipts, Debit Note, Credit Note etc.
- (27) **Depreciation :-** Depreciation is a **Fall in the Value of an Asset** because of its **usage** or **with Efflux of Time** or **Due to Obsolescence** or **Accident**.
- (28) **Trial Balance :-** Trial Balance is a **Statement of Accounts** which appears in the Ledger showing either the balances or the total amount of debit and credit items.  
The agreement of Trial balance ensures arithmetical accuracy and not accounting accuracy.



- (29) **Balance Sheet or Position Statement** :- Balance Sheet is a statement of **Financial Position** of an individual or an enterprise as at a given date, which exhibits (shows) its Assets, Liabilities, Capital, Reserves and other account balances at their respective book values.
- (30) **Prepaid Expenses** :- Prepaid Expenses are the expenses that have been paid but they **do not relate** to the **Current Accounting Period** but **relate to Next Year**. It is an expenses that has been paid in advance and the benefit of which will be available in following year(s).
- (31) **Outstanding Expenses** :- Outstanding Expenses means the **Expenses incurred but not yet paid**. It is an expense that has to be paid but the benefit thereof has already been availed.
- (32) **Unearned Incomes** :- Unearned Incomes means Income that has been **Received in Advance** against which **Services are yet to be Rendered (Provided)** or **Goods are yet to be Sold**.
- (33) **Accrued Income** :- Accrued Income means the **Incomes earned but not yet received**. It is an income that has to be received but the benefit thereof has already been provided.
- (34) **Business Transaction** :- A business transaction means an exchange of economic consideration between two parties.  
Examples are : Sale of Goods, Receipts from Debtors, Payment made to Creditors, Purchase or Sale of Fixed Assets, Payment of Dividend etc.

#### Characteristics of a Transactions :

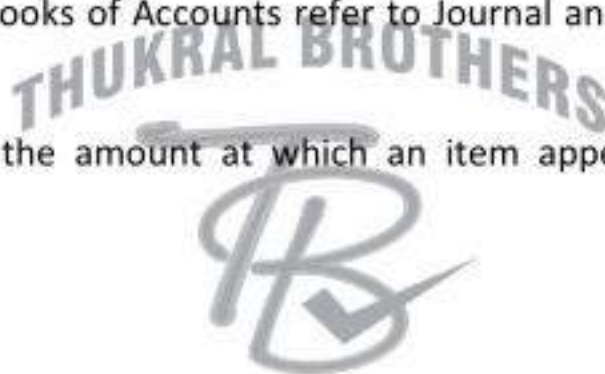
- (a) It is concerned with Money or Money's worth of Goods or Services.  
(b) It arises out of the Transfer or Exchange of Goods or Services.  
(c) It brings about a change in the Financial Position (Assets and Liabilities) of a Concern.  
(d) It has an effect on the Accounting Equation of any Business Firm.  
(e) It has dual aspects (sides) - 'Receiving' (Debit) and 'Giving' (Credit) of the benefit.



- (35) **Cash Transactions** :- Cash Transactions is a Financial Transactions or Event that has been settled in Cash.
- (36) **Credit Transactions** :- Credit Transactions is a Financial Transactions or Event that has not been settled in Cash i.e., is agreed to be settled later.
- (37) **Insolvent/Bankrupt** :- Insolvent is a person or enterprise which is not in a position to pay its debts.



- (38) **Solvent** :- Solvent is a person or enterprise which is in a position to pay its debts.
- (39) **Entity** :- An Entity means an Economic Unit which performs Economic Activities. e.g. Reliance Industries, Bajaj Auto, Maruti.
- (40) **Entry** :- A transaction and event when recorded in the Books of Accounts is known as an Entry.
- (41) **Debit** :- An Account has two parts, i.e. Debit and Credit. The Left Side is the Debit Side while the Right Side is the Credit Side. If an Account is to be Debited, then the entry is posted to the Debit side of the account. In such an event, it is said that the account is debited. It has been derived from an Italian word '**Debito**'.
- (42) **Credit** :- Credit is the Right Side of an Account. If an Account is to be Credited, then the entry is posted to the Credit side of the account. In such an event, it is said that the account is credited. It has been derived from an Italian word '**Credito**'.
- (43) **Account** :- Account is a Summarised record of relevant transactions at one place relating to a particular head. It records not only the amount of transactions but also their effect and direction.
- (44) **Books of Accounts** :- Books of Accounts refer to Journal and Ledger in which transactions are recorded.
- (45) **Book Value** :- This is the amount at which an item appears in the Books of Accounts or Financial Statements.



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# THEORY BASE OF ACCOUNTING : ACCOUNTING STANDARDS AND IFRS

## CHAPTER - 3

### Outline :

- ☞ Meaning and Nature of Accounting Principles
- ☞ Necessity of Accounting Principles
- ☞ Accounting Principles and Concepts
- ☞ Accounting Standards

**Q.1. What is meant by "Generally Accepted Accounting Principles" ? What is the need and role of "GAAP" ?**

**Ans.** Generally Accepted Accounting Principles refer to the rules or guide-lines adopted for recording and reporting of business transactions.

GAAP are needed to make accounting information consistent, comparable and free from personal bias of the accountants.

The role of GAAP is to bring uniformity and consistency to the process of accounting.

### Features of Accounting Principles :

- (a) Accounting Principles are man-made.
- (b) Accounting Principles are flexible.
- (c) Accounting Principles are generally accepted.

**Accounting Principles can be classified into two categories :**

(a) Accounting Concepts; (b) Accounting Concepts.

**Q.2. What is meant by "Postulates" ?.**

**Ans.** Postulates are the basic assumptions on which financial statements are prepared. Postulates includes going concern postulates, money measurement postulate, realisation postulate.

**Q.3. "Accounting Principles are not man made; they have been evolved gradually." Discuss.**

**Ans.** Changes in Business Environment influences to develop such accounting techniques which should be based on some accepted principles and can be applied uniformly as guiding principles for financial reporting of a business enterprise.

Due to Modern Business Environment it becomes important to develop certain rules and principles that can be accepted by all persons involved in accounting.

*Interestingly, these rules are known by different terms such as principles, concepts, conventions, postulates, assumptions, modifying principles etc.*

**Precisely there is no difference between the terms such as postulates, concepts, principles etc. However, there are conflicting opinions on the usage of these terms.**



An Assumption or Postulate is that which does not require any proof as they are self evident truths in accounting. These are the basic foundations in accounting process and without considering certain assumptions in accounting, financial statements can not be prepared.

Concepts are ideas about the desirability and applicability of a particular method.

Conventions are customs, based on the generally accepted practices. Conventions are also known as modifying principles.

Concepts and Conventions when combined together become principles. Thus, accounting principles have been evolved gradually, through an evolutionary process of combining concepts and conventions together.

**Though these principles are not universal truths yet they are found to be pervasive in business entities.**

Q.4. **What do you mean by "Fundamental Accounting Assumption (Concepts)".**

Ans. Fundamental Accounting Assumptions or Concepts are the assumption which are presumed to have been followed in preparing the annual accounts. **The entities which do not follow any of the fundamental accounting assumptions should disclose which of these assumptions have not been followed and the reasons for not following them.**

The Fundamental Accounting Assumptions are :-

- (a) Going Concern Assumption;
- (b) Consistency Assumption;
- (c) Accrual Assumption.

(a) **Going Concern Assumption** :- The business will continue for an indefinite period and there is no intention to close the business or downsize its operations significantly.

This concept assumes that a business will not be sold or liquidated in the near future.

Without this concept, the classification of current and fixed assets and short and long term liabilities cannot be made and such classification would difficult to justify.

On the basis of this concept, fixed assets are recorded at their **original cost** and depreciated in a systematic manner **without reference to their market value**.

For example, a machine purchased is expected to last 5 years. The cost of the machinery is spread on a suitable basis over the next 5 years for ascertaining the profit or loss for each year. **The total cost of the machine is not treated as an expense in the year of purchase itself.**

(b) **Consistency Assumption** :- Consistency Concept means that accounting policies and practices should remain consistent over the period of time.

According to consistency Assumption, accounting practices once selected and adopted, should be applied consistently year after year.

Consistency Assumption makes the financial statements **meaningful and comparable**.

For instance, if the **stock is valued at cost** in one year and it is valued at **market price** in the following year, the two results would not be comparable. However if the change is essential, the reason for the same should be clearly stated.



For example, two methods of charging depreciation, Written Down Value Method and Straight Line Method, are equally acceptable. Under the convention, method once chosen and applied should be applied consistently year after year. **But, it does not mean that practice once adopted cannot be changed.**

The accounting practice may be changed if the law or Accounting Standard requires it or the change will result in more meaningful presentation. If an enterprise desires to adopt an alternative practice, it must disclose the change and its impact on the profit or loss.

(c) **Accrual Assumption** :- According to the Accrual Concept, a transaction is recorded in the books of accounts at the time **when it is entered into and not when the settlement takes place.**

Accrual concept applies equally to revenue and expenses. In accrual concept revenue is recorded when sales are made or services are rendered and **it is immaterial whether cash is received or not.**

For example, sales made on credit will be recorded in the books of accounts on the date of sales, not when the amount is received.

Similarly, according to this concept, expenses are recorded in the accounting period in which they assist in earning the revenues **whether the cash is paid or not.**

For example, if the factory rent of the company is outstanding, it will be recorded in the books of account.

**Accrual concept is often described as matching concept.**

Under the accrual basis of accounting, **outstanding** and **Prepaid** expenses are adjusted. Similarly, **Accrued Income** and **Income Received in Advance** are recognised for ascertaining correct profit or loss for the accounting period.

Q.5. **What do you mean by "Accounting Principles".**

Ans. Most of the accounting principles are in the form of basic accounting concepts. Basic accounting concepts may be defined as the fundamental ideas or assumptions underlying the theory and practice of accounting.

The Accounting Principles are :-

- (a) Accounting Entity or Business Entity Principle;
- (b) Money Measurement Principle;
- (c) Accounting Period Principle;
- (d) Full Disclosure Principle;
- (e) Materiality Principle;
- (f) Prudence or Conservatism Principle;
- (g) Cost Concept or Historical Cost Principle;
- (h) Matching Concept or Matching Principle;
- (i) Dual Aspect or Duality Principle;
- (j) Revenue Recognition Concept or Realisation Concept;
- (k) Verifiable Objective Concept.

(a) **Accounting Entity Principle or Business Entity Principle** :- According to the Accounting Entity Principle, business is considered to be separate and distinct from its owners.



Therefore, Business transactions are recorded in the books of accounts from the **business point of view and not from the point of view of owners.**

Owners being considered separate and distinct from business they are considered creditors of the business to the extent of their capital.

The effect of Accounting Entity Principle is that "Personal transactions of the owner are not recorded in the books of the business unless it involves inflow or outflow of business funds.

Due to Accounting Entity Principle, personal expenses of proprietor or partners should be **debited to Drawing Account. Capital Account is credited** when proprietor introduces his capital.

(b) **Money Measurement Principle :-** Money Measurement Concepts means that only those transactions or events or facts **which can be expressed in money or in money terms** are recorded in the books of accounts.

The following transactions are not recorded in accounting books because they cannot be measured and expressed in monetary terms :

- (i) Value of Human Resources.
- (ii) Policy of Management.
- (iii) Labour-Management Relations.
- (iv) Good Industrial Relations.
- (v) Customer Loyalty.

It should be remembered that money is only measurement which enables various things of diverse nature to be added up together and dealt with.

For example, a business, on a particular day has ₹ 20,000 in cash, 5,000 kilograms of raw materials, 5 machines, 100 chairs. All these things cannot be added up unless expressed in terms of money. In order to make a record of these items, these will have to be expressed in monetary items such as cash ₹ 20,000; raw material ₹ 25,000; machines ₹ 2,00,000; chairs ₹ 5,000.

As such, to make accounting records relevant, simple, understandable and homogeneous (same), they are expressed in a common unit of measurement, i.e., **Money.**

(c) **Accounting Period Principle :-** Accounting Period Concept means that during the life time of an entity, financial statement of an entity should be prepared at regular intervals **normally after a period of one year** for the purpose of measuring income of the enterprise.

According to this principle the whole indefinite life of an enterprise is divided into parts known as accounting period.

But the accounts of an enterprise are maintained following the **Going Concern Concept**, meaning the enterprise shall continue its activities in the foreseeable future.

The proprietor of the business cannot wait for such a long period to determine income at the end of the life of the business because they have invested money and have to ensure its safety and returns. Moreover, it will be too late to take corrective steps at that time, if it is disclosed that the business had all the time been running at a loss on account of certain reasons or business had not been using its full capacity to make more profits.



Therefore, accountants choose some shorter and convenient time for the measurement of income. **Twelve months** period is normally adopted for this purpose. **This time interval is called Accounting Period.** The one year period is recognized by various laws viz., Companies Act, Income Tax Act, Sales Tax Act etc.

(d) **Full Disclosure Principle :-** The principle of full disclosure means that financial statements should disclose **all significant information relating to the economic affairs of the firm.** The significance of this principle is that there is a sufficient disclosure of information which is of material interest to proprietors, creditors, investors etc.

Apart from legal requirements, good accounting practices requires all material and significant information should be disclosed. Whether an information should be disclosed or not **always depends on the materiality of the information.**

Disclosure of material information will result in better understanding. For example, the reasons for low turnover should be disclosed.

For this purpose, facts or items which do not find place in financial statements are shown as **footnotes, schedules** etc. Examples are :

- (i) Contingent liabilities appearing as a footnote.
- (ii) Market Value of Investments appearing as a footnote.

(e) **Materiality Principle :-** Materiality concepts means that all material facts relating to business should be provided in the financial statements.

Material fact is a fact which may influence the decision of the informed user of financial statements.

Whether an item is material or not shall depend on its nature and/or amount. Thus it means that it is a matter of exercising judgement to decide which item is material and which is not.

The concept of materiality is **relative**. What is material for a small company, may not be material for a big company.

For Example, Cost of loose tools may be material for a small repair workshop but may not be material for **Maruti Udyog**.

Company purchased stationery (pencils) of ₹ 50. These had all been issued from stock and were still in use at the end of the year, **but the amount and nature is not material.** Therefore, it is debited to Stationery Account.

Amount spent on repairs of building ₹ 2,50,000 is material for an enterprise having a turnover of ₹ 1,50,000 but it is not material for an enterprise having a turnover of ₹ 15,00,00,000.

(f) **Prudence or Conservatism Principle :-** The Prudence Principle is many a times described using the phrase "**Do not anticipate a profit, but provide for all possible losses.**"

This is the policy of "**Playing Safe.**"

In other words, all prospective losses must be taken into account and all anticipated profits should be ignored.

Conservatism concept means that profits should not be recorded until realised but all losses including remote losses should be provided for in the books.



It has a drawback as it may be used to create secret reserve (e.g., by creating excess provision for doubtful debts, depreciation, etc.) and thus financial statements may not depict(show) a true and fair view of the state of affairs of the business. **Conservatism concept leads to underestimation of profits and value of assets.**

The application of this concept ensures that the financial statements present a realistic picture of the state of affairs of the enterprise and **do not paint a better picture than what actually is.**

Following are some examples of conservatism :

- (i) Making the provision for doubtful debts and discount on debtors.
- (ii) Valuing the stock in trade at market price or cost price, whichever is less.
- (iii) Creating provision against fluctuation in the price of investments.
- (iv) Charging of small capital items to revenue like crockery.
- (v) Adopting written down value method of depreciation.
- (vi) amortization of intangible assets like goodwill.
- (vii) Showing Joint Life Policy at surrender value as against the amount paid.
- (viii) Not providing for discount on creditors.

(g) **Cost Concept or Historical Cost Principle** :- Historical Cost concept is closely related to Going Concern Concept.

According to this concept, **assets are recorded in the accounting records at the price paid to acquire them** and the cost will be the basis for all subsequent accounting for the asset.

If a businessman buys a plot of land for ₹ 50,000, the assets would be recorded in the books at ₹ 50,000 even if market value at that time happens to be ₹ 60,000. In case, a year later the market value of this asset comes down to ₹ 40,000, it will ordinarily continue to be shown at ₹ 50,000 and not at ₹ 40,000.

Historical Cost Concept does not mean that the assets will always be shown at cost. It means that asset is recorded at cost at the time of its purchase but it may systematically be reduced in its value by charging depreciation.

Historical Cost Concept has the advantage of bringing **objectivity** in the preparation and presentation of financial statements. In the absence of this concept, the figures shown in the accounting records would have depended on the subjective views of a person.

The drawbacks of the historical cost concept are :

(i) **Assets for which nothing is paid will not be recorded.** Thus a favourable location, brand name and reputation of the business, knowledge and technological skill built inside the enterprise will remain unrecorded though these are valuable assets.

**Note for students :- Don't relate it with credit purchase.**

(ii) During periods of inflation, the figure of net profit disclosed by profit & loss account will be seriously distorted because depreciation based on historical costs will be charged against revenue at current prices.

(iii) Information based upon historical cost may not be useful to management, investors, creditors etc.



(h) **Matching Concept or Matching Principle :-** Matching Concept means that **expenses should be matched with the revenue generated in the relevant period.**

Matching Concept means that revenue and expenses that relate to same transactions should be recognised together. The central idea of matching concept is that all costs applicable to the revenue of a particular period should be charged against revenue so that net income of the business may be ascertained correctly.

The Matching Concept operates as follows :

(i) If an amount of revenue is received during the year but against it service is to be rendered or goods are to be sold in the next year, the amount received is treated as **revenue in the next year** after the service has been rendered or the goods have been sold. **This year it is shown as liability.**

e.g. One month fee is ₹ 500 per month. If a teacher has received fee for 15 months ( $15 \times 500 = ₹ 7,500$ ) then ₹ 6,000 ( $12 \times 500$ ) will be treated as revenue in this year and ₹ 1,500 ( $3 \times 500$ ) will be treated as liability in this year. This ₹ 1,500 will be treated as revenue in the next year.

(ii) When an item of revenue is included in the profit & loss account, all expenses incurred on it, whether paid or not, should be shown as expenses in the profit & loss account. **On the basis of this principle, outstanding expenses, though not paid in cash are shown in the profit & loss account.**

e.g. One month Salary is ₹ 1,000 per month. If an employer has paid salary for 11 months ( $11 \times 1,000 = ₹ 11,000$ ) then ₹ 12,000 ( $11,000 + 1,000$ ) will be treated as expense in this year and ₹ 1,000 ( $1 \times 1,000$ ) will be treated as liability in this year.

(iii) When some expense, say insurance premium is paid partly for the next year also, **the part relating to next year will be shown as expense only next year and not this year.** This means that, that part of the insurance premium against which benefit will be derived or revenue will be earned in future should be shown in the balance sheet as an asset and the rest is treated as an expense during the current year.

e.g. Current Financial Year is from 1<sup>st</sup> April, 2010 to 31<sup>st</sup> March, 2011. Proprietor has paid an annual insurance premium of ₹ 12,000 on 1<sup>st</sup> July, 2010 then insurance of ₹ 9,000 ( $9 \times 1,000$  (from 1<sup>st</sup> July, 2010 to 31<sup>st</sup> March, 2011)) will be treated as an expense in this year and insurance of ₹ 3,000 ( $3 \times 1,000$  (from 1<sup>st</sup> April, 2011 to 30<sup>th</sup> June, 2011)) will be treated as an asset this year. This ₹ 3,000 will be treated as an expense in the next year.

(iv) Similarly, income receivable must be added in revenues and incomes received in advance must be deducted from revenues.

(v) Machinery of ₹ 1,00,000 purchased and life of it is 10 years. Then only one-tenth of the cost i.e. ₹ 10,000 is treated as an expense (**Depreciation**) and remaining (₹ 90,000) is carried forward to the balance sheet.

(i) **Dual Aspect or Duality Principle :-** According to the Dual Aspect Concept, every transaction entered into by an enterprise has two aspects: one aspect of transaction is debited while the other is credited.



Simply stated, for every debit there is a credit of equal amount in one or more accounts. It is also vice versa.

For example, Ram starts business with a cash of ₹ 1,00,000. There are two aspects to the transaction. On one hand, the business has an asset of ₹ 1,00,000 (cash) while on the other hand, it has a liability towards Ram of ₹ 1,00,000 (capital of Ram). Thus we can say

$$\text{Capital} = \text{Cash (Assets)}$$

We may state that because any transaction has a two sided effect, it will affect the accounts in any of the following manner :

- (i) It Increases an Asset and Decreases another Asset.
- (ii) It Increases an Asset and also Increases a Liability.
- (iii) It Decreases an Asset and also Decreases a Liability.
- (iv) It Increases a Liability and also Decreases another Liability.
- (v) It Increases a Liability and also Increases an Asset.
- (vi) It Decreases a Liability and also Decreases an Asset.

(j) **Revenue Recognition Concept or Realisation Concept:-** Revenue Recognition or Realisation Concept means that revenue is considered to be earned by the business enterprise only when revenue is realised.

Revenue is considered to be realised when either cash has been received or a legal obligation to pay has been assumed by the customer. This is possible only when the property in goods is transferred to the purchaser.

**It means that receipt of a mere order from a customer cannot be recognised as revenue unless the goods are dispatched to the customer.** It implies that revenue should be recognised only when sale is made.

For example, an enterprise sells goods in February 2011 and receives the amount in April 2011. Revenue of this sales should be recognised in February 2011, i.e., when the goods are sold. It is so because legal obligation has been established (upon sales) in February 2011.

Suppose an enterprise has received an advance in February 2011 for the sales to be made in May 2011, revenue shall be recognised in May 2011, upon sales having been made because the legal obligation to receive the amount has been established in May 2011.

Besides Sales, following may be the criteria for revenue-recognition :

- (i) **Asset Received :-** In some cases, revenue is recognised only when sale is made.
- (ii) **Completed Production :-** In agriculture and extractive industries like oil, gold, silver and other metal, production is considered to be the basis of revenue recognition.
- (iii) **Prior to Production Completion :-** In long-term contracts, like construction contracts, revenue is recognised even before the completion of contract on the basis of work completed.
- (iv) **Revenues in case of incomes such as rent, interest, commission etc. is recognised on Time Basis.**



For example, rent for the month of March 2011, even if received in April 2011 will be treated as revenue of the financial year ending 31<sup>ST</sup> March, 2011. Similarly if commission for April 2011 is received in March 2011, it will be treated as revenue of the financial year commencing on April 2011.

(k) **Verifiable Objective Concept :-** According to this concept, all accounting must be based on objective evidence. i.e., transactions recorded in the books of accounts should be supported by verifiable documents.

The evidence supporting the business transactions should be objective i.e. **free from the bias of the accountant and others.**

This concept emphasises that business transactions should be based on **original documents such as vouchers, invoices, cash-memos etc.**

This concept make accounts fair to all the users of accounting information.

Q.6. **Explain Accounting Standards briefly.**

Ans. Accounting Standards are a set of Guidelines, i.e., Generally Accepted Accounting Principles, issued by the **Accounting Body of the country such as "The Institute of Chartered Accountants"**. Accounting Standards are followed for Preparation and Presentation of Financial Statements.

Q.7. **What are the Objectives (Utility) of having Accounting Standards ?**

Ans. The Objectives of having Accounting Standards are as follows :

- (a) To Ensure Uniformity in the Preparation and Presentation of Financial Standards.
- (b) To Harmonise (Match) the Different and Diverse Accounting Policies and Practices to make the Financial Statements meaningful.
- (c) Accounting Standards provide the norms on the basis of which Financial Statements should be prepared.

Q.8. **Briefly explain your understanding of International Financial Reporting Standards (IFRS).**

Ans. IFRS are the accounting standards issued by International Accounting Standards Board (IASB), recommended to be used by the enterprises globally to produce financial statements following a single set of accounting standards.

IFRS are **principle based accounting standards** in comparison to **rule based** Indian Accounting Standards. Also IFRS are based on **Fair Value Concept** while Indian Accounting Standards are based on **Historical Value**.

**Objectives** of IFRS is to develop a single set of high-quality, understandable global accounting standards in public interest that requires high-quality, transparent and comparable information in financial informations to help users of the informations to make economic decisions.



**CHAPTER SUMMARY****Fundamental Accounting Assumptions :**

- (a) **Going Concern Assumption** : The business will continue for an indefinite period and there is no intention to close the business or downsize its operations significantly.
- (b) **Consistency Assumption** : Accounting Practices once selected and adopted should be applied consistently year after year.
- (c) **Accrual Assumption** : Transactions are recorded when they have been entered into and not when the settlement takes place.

**Accounting Principles :**

- (a) **Accounting Entity or Business Entity Principle** : Business is treated as a Separate Entity distinct from its owners.
- (b) **Money Measurement Principle** : Transactions and Events that can be expressed in money or in money terms are recorded in the books of accounts.
- (c) **Accounting Period Principle** : Life of an enterprise is divided into time intervals which are known as accounting periods, at the end of which an Income Statement and Position Statement are prepared to show the performance and financial position.
- (d) **Full Disclosure Principle** : According to this convention, financial statements should be prepared and to that end, full disclosure of all significant information should be made.
- (e) **Materiality Principle** : Items or Events having a significant effect should be disclosed.
- (f) **Prudence or Conservatism Principle** : Do not anticipate profits but provide for all possible losses.
- (g) **Cost Principle** : The underlying principle of cost concept is that the asset be recorded at its cost price, which is the **Cost of Acquisition Less Depreciation**.
- (h) **Matching Concept** : Cost incurred during a particular period should be set out against the revenue of that period to ascertain profits.
- (i) **Dual Aspect Concept** : Every transaction has two aspects : one aspect of a transaction is Debited while other is Credited.
- (j) **Revenue Recognition Concept** : Revenue is recognised in the period in which it is earned irrespective of the fact whether it is received or not during that period.
- (k) **Verifiable Objective Concept** : There must be objective evidence of transactions which are capable of verification.



**HIGH ORDER THINKING SKILLS (HOTS) QUESTIONS**

- Q.1.** Rahul, the proprietor of M/s. R.K. & Co. purchased an Air-Conditioner and installed it at his residence. The payment was made by issuing a cheque from the account of M/s. R.K. & Co. The Accountant debited to the Drawings Account with the amount whereas Rahul is of the view that it should be debited to the Fixed Assets (Non Current Assets). In your view who is correct and why ?
- Ans.** The Accountant is correct because according to the Business Entity Concept business is separate and distinct from the owners. Since, the air-conditioner has been installed at the residence, i.e., for the personal use of the proprietor, it is Drawings by the owner.
- Q.2.** Which Accounting Principle requires that personal expenses of proprietor or partners should be debited to Drawings Account ?
- Ans.** Accounting Entity or Business Entity Principle.
- Q.3.** Production at a factory had to stop for a week due to a labour strike. The owner estimated the loss of production and the likely loss of profit arising out of the situation. He directed the accountant to record the loss in the books of accounts. Is the owner correct in recording the likely loss ? Give reasons.
- Ans.** No, the owner is not correct because transactions and events are recorded in the books of account if they can be measured in money terms and on the basis of evidences. In the present case, evidence to the effect of loss or profit does not exist on the basis of which the owner can measure the loss in money terms.
- Q.4.** Under which accounting principle, Quality of Manpower, Caliber or Quality of Management is not recorded in the books of accounts ?
- Ans.** Money Measurement Principle.
- Q.5.** The Assets of Standard Sugar Co. were acquired by the Government on 1<sup>st</sup> April, 2000 and the company received a compensation of ₹ 10 crores. The company did not have any other business as on the date of acquisition and has also not ventured into any other business after acquisition of assets. The company placed the amount so received in a fixed deposit with a bank, which is lying deposited with the bank as on date also. It has also filed a case in the Court seeking higher compensation. Is the company a going concern ?
- Ans.** The company is not a going concern because it has not commenced any business post acquisition. The company is only seeking higher compensation and not quashing (मना करना) the acquisition order of the Government. It has also invested the compensation received in the fixed deposit which remains deposited as on date also. Thus, the company does not have intentions to conduct the business.
- Q.6.** Which concept (principle) assumes that a business enterprise will not be liquidated in the near future ?
- Ans.** Going Concern Concept.
- Q.7.** An Infrastructure Company building highways has a contract to construct road of 25 Kms. The project is likely to be completed in 4 years. It has approached a bank seeking finance. The bank has requested them to prepare projected yearly accounts whereas the company has argued that since the project shall be completed in 4 years, projected accounts should be prepared for the end of the project. Is the company correct in its view ? Give reasons.
- Ans.** No, the company is not correct because the bank requires year-wise projected accounts firstly, to assess the time when the funds shall be required and how much funds shall be required; and secondly it shall be in a position to monitor the progress of the project at regular intervals.



- Q.8. **X Limited gets a Contract of ₹ 100 crores to build a Shopping-Mal to be completed in 3 years. The management of the company wants to ascertain profit or loss on this contract only when the contract is completed. Is the management justified ?**
- Ans. No, the management is not justified. Although the true profit or loss can be ascertained only after the completion of the contract, it will be divided into time intervals of twelve months for the ascertainment of profit as per Accounting Period Principle.
- Q.9. **A customer of X Limited has discontinued his business. He used to purchase 30% of the total goods produced by X Limited. Is it a relevant information in your opinion and should be disclosed by X Limited ?**
- Ans. Yes. The information is of material interest to the users of financial statements and must be disclosed as per the principle of full disclosure.
- Q.10. **Proprietor of the Business is treated as Creditor to the extent of his Capital under which Principle ?**
- Ans. Business Entity Principle.
- Q.11. **Which Accounting Principle states that all anticipated losses should be recorded but all anticipated profits should be ignored ?**
- Ans. Principle of Prudence.
- Q.12. **According to which concept, Depreciation is to be charged as per one particular method year after year ?**
- Ans. Concept of Consistency.
- Q.13. **A Company has been charging depreciation @ 10% p.a. on Original Cost Method. It now wants to change the method from Original Cost to Diminishing Balance Method, the rate of depreciation being 15% p.a. Can it do so ?**
- Ans. Yes. The method and the rate of depreciation can be changed but the change in method will be treated as a change in accounting policy and the company should disclose the change in its financial statements along with its impact on profit or loss.
- Q.14. **Why should a business follow the Consistency Principle ?**
- Ans. One of the qualitative characteristic of accounting information is comparability i.e., the financial statements must be comparable from year to year. It is possible only when accounting principles are not changed and followed consistently year after year.
- Q.15. **On 25<sup>th</sup> March, 2013, a fire broke out in the premises of Kamal Limited and destroyed a part of its Plant and Machinery. On account of this, a sharp decline in production for the next six months is expected. The company did not disclose this fact in its annual report for the year ended 31<sup>st</sup> March, 2013. What is your opinion about this omission ?**
- Ans. The Company has violated the Principle of Full Disclosure. Loss of Plant and Machinery is a material information and should have been disclosed.
- Q.16. **How does the Matching Principle apply to Depreciation ?**
- Ans. According to the Matching Principle, the expenses for an accounting period are matched against related revenues for the determination of profit. On account of this principle, the purchase price of the fixed asset is not taken but only depreciation on fixed asset related to the accounting period is taken.



Q.17. **"Capital is a liability for the business." Explain this statement with the Principle applied.**

Ans. According to Accounting Entity or Business Entity Principle capital is a liability for the business. This principle requires that for accounting purpose, a distinction should be made between business affairs and personal affairs and in the accounting books of the business only business transactions be recorded. The amount invested by the owner is recorded in his Capital Account and the amount withdrawn by the owner from the business for his personal use is recorded in Drawings Account. The amount in the credit of the Capital Account is a liability of the business towards the owner.

Q.18. **"Closing Stock is valued at lower of Cost or Market Price." Which concept of Accounting is applied here ?**

Ans. Prudence Concept or Concept of Conservatism.

Q.19. **An Investment Company has been valuing its inventory of Land at lower of market price or cost. It now wants to value its inventory at the current market price which is higher than the cost. Which accounting concept will be violated ?**

Ans. Prudence Concept.

Q.20. **An Investment Company has securities as current assets having market value substantially lower than the cost price. The company continues to show them at cost. Do you think the concept of prudence is being followed ?**

Ans. No, the company is not following the concept of Prudence. It should bring down the value of current assets to its market value because the financial statements will otherwise show a better picture than what is actually is.

Q.21. **Under which Accounting Concept Asset is recorded at cost, even if the market price is less or more ?**

Ans. Cost Concept.

Q.22. **Gurpreet purchased 1,000 Sq. Yards land to build a factory and paid ₹ 15 lakhs towards its cost including registration charges. At the end of the financial year, the value of the land came down to ₹ 13 lakhs. Gurpreet recorded the land at ₹ 13 lakhs and booked a loss of ₹ 2 lakhs. Is he correct in treating the fall in value as a loss ?**

Ans. No, Gurpreet is not correct because he has purchased a **Fixed Asset** by paying ₹ 15 lakhs. The Cost Concept of Accounting holds that an asset should be recorded in the books at the price paid.

Q.23. **Why Fixed Assets are not shown in the books at market value ?**

Ans. Fixed Assets are not shown in the books at market value because :

- (a) as per Historical Cost Concept, we record Fixed Assets at **Original Cost**, and
- (b) as per Going Concern Concept, the assets are not going to be sold in near future. Hence, the market value is irrelevant.

**Fixed Asset** को हमेशा **Cost** पर दिखाते हैं। Current Assets को हमेशा **Lower of Cost or Market Price** पर दिखाते हैं।

Q.24. **Under which concept Provision is made for doubtful debts ?**

Ans. Prudence Concept.



- Q.25. A firm received a large order to supply goods. Will it be recorded in the books of accounts of the firm ?
- Ans. No. Mere order from a customer cannot be recognised as revenue unless the goods are dispatched to the customer. It implies that revenue should be recognised only when sale is made.
- Q.26. Under which concept if Advance is received against Sale of Goods, the advance received is recorded as "Advance Against Sale" and Not Sales. Which Accounting Concept requires so ?
- Ans. Revenue Recognition Concept.
- Q.27. Mohan, the owner of a business receives an order for supply of goods worth ₹ 2,00,000. He has also received ₹ 25,000 against this order. Mohan wants to record it as a Sale. Is Mohan correct in doing so ?
- Ans. No, he will not be correct in recording it as sales because the goods have not been delivered as yet and hence the sale is not completed.  
Mohan has not earned the revenue so far.
- Q.28. An Enterprise prepares its accounts under the accrual basis. Salaries amounting to ₹ 10,000 for the month of March, 2013 were not paid. The owner did not want to account it in the books of accounts on the ground that the amount was not paid. The Enterprise closes its books of accounts on 31<sup>st</sup> March every year. Is he correct ?
- Ans. No, the owner is not correct because under the Accrual Concept, expenses should be accounted at the time when it is incurred and not when it is paid. Salaries for March 2013 have become due on 31<sup>st</sup> March, 2013 and therefore should be accounted in the books of accounts for the year ended 31<sup>st</sup> March, 2013.
- Q.29. Rent for the month of March, 2012 is not paid. Under which Accounting Concept it should be recorded as expense for the year ended 31<sup>st</sup> March, 2012.
- Ans. Accrual Concept.
- Q.30. If one aspect of a transaction is not recorded, which Accounting Concept is not followed ?
- Ans. Dual Aspect Concept.
- Q.31. State clearly what Accounting Conventions or Principles are followed or violated in each of the following cases. State in each case as to what would be correct procedure to be followed :
- (a) A Company incurs a heavy amount of ₹ 15,00,000 on publicity through T.V. and Radio. It wishes to spread expenditure over a period of five years.
- (b) A Company wishes to decrease the rate of depreciation from 15% to 10% in view of the inadequate profits in the current year.
- (c) A Company with a heavy turnover purchases a desk calculator for ₹ 4,000. As its life is for 5 years, it wishes to charge depreciation of ₹ 800 in the current year.
- (d) A Company commissions the making of a very special machine useful for a number of years. As the machine is very special and has no resale value in the event of liquidation, it wishes to provide 100% depreciation in the current year itself.
- Ans. (a) Violates Principle of Matching unless the benefits are expected over a 5 years period.  
(b) Both Consistency and Conservatism Principles are violated.  
(c) Materiality is violated.  
(d) Going Concern Concept is violated.



# BASES OF ACCOUNTING

## CHAPTER - 4

**Outline :**

- ☞ Cash Basis of Accounting
- ☞ Accrual Basis of Accounting

Q.1. **What are the Bases of Accounting ?**

Ans. One of the main objective of accounting is to ascertain (find) the Profit or Loss of a Business Enterprise at the end of the Accounting Period. There are two Bases of Accounting Profit or Loss, namely  
(a) Cash Basis and  
(b) Accrual (Due/Mercantile) Basis.

Q.2. **What do you understand by "Cash Basis of Accounting" ?**

Ans. Cash Basis of Accounting means that the **Entry is recorded on Receipt or Payment of Cash**. The System **does not distinguish** between Capital and Revenue items. It also **does not recognise** Prepaid Expenses and Outstanding Expenses, Prereceived Incomes and Accrued Incomes.

Q.3. **What are the Advantages of Cash Basis of Accounting ?**

Ans. Advantages of Cash Basis of Accounting are :  
(a) It is a **Simple System** as (because) Adjustments are not required.  
(b) It is more objective as **Very few Estimates and Judgements** are made.  
(c) It is **suitable** for those enterprises where **most of the transactions are on Cash Basis**.

Q.4. **What are the Disadvantages of Cash Basis of Accounting ?**

Ans. Disadvantages of Cash Basis of Accounting are :  
(a) It **does not give a True & Fair View of Profit or Loss** and the **Financial Position**.  
(b) It **does not follow the Matching Concept**.  
(c) Since Capital and Revenue items are not distinguish in Cash Basis, there is no consistency in the Profits of different years.

Q.5. **What do you understand by "Accrual Basis of Accounting" ?**

Ans. Accrual Basis of Accounting means the transactions is recorded at the time when it is entered into and not when the settlement takes place. In other words, under Accrual Basis of Accounting System, Accounting Entries are recorded **when Incomes are Earned and Expenses are Incurred irrespective of Cash Received or Paid**.

Q.6. **What are the Advantages of Accrual Basis of Accounting ?**

Ans. Advantages of Accrual Basis of Accounting are :  
(a) It **gives a True & Fair View of Profit or Loss** and the **Financial Position**.  
(b) It shows complete picture of financial transactions as it accounts prepaid and outstanding expenses, earned and unearned incomes, assets and liabilities.  
(c) It **follows the Matching Principle of Accounting**.  
(d) There is consistency in the computation of Profits of different years in Accrual Basis because it makes a distinction between Capital and Revenue Expenditure.



Q.7. What are the Disadvantages of Accrual Basis of Accounting ?

Ans. Disadvantages of Accrual Basis of Accounting are :

- (a) The Accounting Process is **more Elaborate**.
- (b) It is not as simple as Cash Basis of Accounting. It is **more Complicated** than Cash Basis of Accounting and requires adequate Skills.
- (c) It requires the Use of Estimates and Personal Judgements.

Q.8. Distinguish between Accrual Basis of Accounting and Cash Basis of Accounting.

Ans.

Points of Difference	Accrual Basis of Accounting	Cash Basis of Accounting
1. Recording of Transactions	Both Cash and Credit Transactions are recorded. Income : It is recorded when it is earned whether received or not. Expenses : It is recorded when it is incurred whether paid or not.	Cash transactions are recorded. Income : It is recorded when cash has been received. Expenses : It is recorded when cash is paid.
2. Outstanding/ Prepaid Expenses Accrued/Income Received in Advance	Prepaid and Outstanding Expenses are accounted in the Profit & Loss Account. Accrued and Income Received in Advance are also accounted and shown in the Balance Sheet.	Prepaid and Outstanding Expenses are not accounted. Similarly Accrued and Income Received in Advance are not accounted.
3. Capital and Revenue	Capital and Revenue items are distinguished and recorded accordingly.	Capital and Revenue items are not distinguished.
4. Profit or Loss	Correct Profit or Loss is ascertained because it records both Cash and Credit transactions and also it distinguishes between Capital and Revenue items.	Correct Profit or Loss is not ascertained because it records only Cash and also it does not distinguish between Capital and Revenue items.
5. Suitability	This basis is adopted by Business Enterprises with Profit Motive.	This basis is suitable for Professional People like Chartered Accounts, Lawyers, Doctors etc.
6. Legal Position	This basis is recognised under the Companies Act, 1956.	This basis is not recognised under the Companies Act, 1956.
7. Acceptability and Reliability	It is more Acceptable & Reliable.	It is less Acceptable & Reliable.

#### HIGH ORDER THINKING SKILLS (HOTS) QUESTIONS

Q.1. During the Financial Year 2012-13, Ashok had Cash Sales of ₹ 3,90,000 and Credit Sales of ₹ 1,60,000. His expenses for the year were 2,70,000 out of which 80,000 is still to be paid.

- (a) Find out Ashok's income for 2012-13 according to Cash Basis of Accounting.
- (b) Find out Ashok's income for 2012-13 according to Accrual Basis of Accounting.

Ans.

(a)	Revenues (Inflow of Cash, i.e., Cash Sales)	₹ 3,90,000
	Less : Expenses (Outflow of Cash) (2,70,000 - 80,000)	1,90,000
	<b>Net Income</b>	<b><u>2,00,000</u></b>



Note : Credit Sales and Outstanding Expenses will not be considered under Cash Basis of Accounting.

(b)	Total Sales = Cash Sales + Credit Sales (3,90,000 + 1,60,000)	5,50,000
	Less : Total Expenses for the year	2,70,000
	<b>Net Income</b>	<b><u>2,80,000</u></b>

Note : ₹ 80,000 expenses still to be paid belong to this year and hence are to be charged to the revenue of this year. Similarly, Credit Sales of ₹ 1,60,000 are taken in the year in which sales transactions is done.

Q.2. Dr. Arvind Kishore, a homeopathic doctor in practice has been advised by his Accountant to maintain his accounts on Accrual Basis instead of presently followed Cash Basis of Accounting. Do you agree with the advice of the Accountant ? Give reasons.

Ans. No, I do not agree. Cash Basis of Accounting is more appropriate for Dr. Arvind Kishore because a medical practitioner receives his fee immediately after giving Consultancy.

Q.3. M/s. Kalra Bros., a dealer in Computer Hardware, has received an order for 10 computers along with an advance of ₹ 50,000. The firm maintains its accounts on Accrual Basis of Accounting. Should the amount received, i.e., ₹ 50,000 be credited to Sales Account or the Advance Received Account ? Give reasons for your answer.

Ans. It should be credited to Advance Received Account and later transferred to the account of purchaser on affecting sales.

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# ACCOUNTING EQUATION

## CHAPTER - 5

### Outline :

- ☞ Meaning of an Accounting Equation
- ☞ Effect of Transactions on an Accounting Equation

Q.1. ☹ "Accounting Equation always holds good under all circumstances" Explain with examples.  
or

**Briefly Explain the Accounting Equation.**

- ☺ The Accounting Equation is a Mathematical Equation which shows that the Assets and Liabilities of a Firm are equal, i.e., **Assets = Liabilities + Capital.**

*It is based on Dual Aspect Concept of Accounting.*

**A transaction can change the Accounting Equation but cannot break it.**

For example, Ram starts business with a cash of ₹ 1,00,000. There are two aspects to the transaction. On one hand, the business has an asset of ₹ 1,00,000 (Cash) while on the other hand, it has a liability towards Ram of ₹ 1,00,000 (Capital of Ram).

Paid Salary of ₹ 10,000. Cash and Capital will decrease by ₹ 10,000. Thus we can say

$$\text{Assets} = \text{Liabilities} + \text{Capital}$$

Q.2. **Give an Example for each of the following types of Transactions :**

- ☹ **Increase in One Asset, Decrease in Another Asset.**
- ☺ Purchase of Furniture for Cash → Increase in Furniture and Decrease in Cash.
- ☺ Cash Received from Debtors → Increase in Cash and Decrease in Cash.
- ☹ **Increase in One Liability, Decrease in Another Liability.**
- ☺ Bill Payable Accepted → Increase in Bills Payable and Decrease in Creditors.
- ☺ Repayment of Bank Loan by taking Loan from Another Bank → Increase in Liability and Decrease in Liability.
- ☹ **Increase in Owner's Capital, Decrease in Owner's Capital.**
- ☺ Interest on Capital Provided → Increase in Capital and Decrease in Capital.
- ☺ Interest on Drawing Charged → Increase in Capital and Decrease in Capital.
- ☹ **Increase in Asset, Increase in Liability.**
- ☺ Purchase of Machinery on Credit → Increase in Machinery and Increase in Liability.
- ☺ Loan Taken from Bank → Increase in Cash and Increase in Liability.
- ☹ **Decrease in Asset, Decrease in Liability.**
- ☺ Payment to Creditor → Decrease in Cash and Decrease in Creditors.
- ☺ Repayment of Loan → Decrease in Cash and Decrease in Liability.
- ☹ **Increase in Asset, Increase in Owner's Capital.**
- ☺ Capital Introduced by Proprietor → Increase in Cash and Increase in Capital.
- ☺ Interest Received → Increase in Cash and Increase in Capital.



- ☹ **Decrease in Asset, Decrease in Owner's Capital.**
- 😊 Cash Withdrawn by Proprietor → Decrease in Cash and Decrease in Capital.
- 😊 Salary Paid → Decrease in Cash and Decrease in Capital.
- ☹ **Increase in Liabilities, Decrease in Owner's Capital.**
- 😊 Outstanding Expenses Provided → Increase in Creditors for Outstanding Expenses and Decrease in Capital.
- 😊 Interest on Loan Provided → Increase in Liability and Decrease in Capital.
- ☹ **Decrease in Liabilities, Increase in Owner's Capital.**
- 😊 Discount Received from Creditors → Increase in Capital and Decrease in Creditors.
- 😊 Creditors Written Back → Increase in Capital and Decrease in Creditors.
- 😊 Conversion of Partner's Loan into Capital → Increase in Capital and Decrease in Loan.
- Q.3. ☹ **Following are the Assets and Liabilities of Mr. Lallu Lal. Calculate the Capital :**  
**Cash ₹ 50,000, Bank ₹ 1,00,000, Debtors ₹ 40,000, Plant & Machinery ₹ 1,50,000, Furniture ₹ 50,000, Land ₹ 4,00,000, Creditors ₹ 45,000, Bills Payable ₹ 48,000, Bills Receivable ₹ 1,20,000, Bank Loan ₹ 17,000.**
- 😊 Capital = Assets + Liabilities
- Capital = Cash + Bank + Debtors + Plant & Machinery + Furniture + Land + Bills Receivables - Creditors - Bills Payables - Bank Loan
- Capital = 50,000 + 1,00,000 + 40,000 + 1,50,000 + 50,000 + 4,00,000 + 1,20,000 - 45,000 - 48,000 - 17,000 = ₹ 8,00,000
- Q.4. ☹ **What is the Owner's Equity ?**
- 😊 Owner's Equity means balance standing to the Credit of Capital Account of the Proprietor.
- Q.5. ☹ **Indicate how Accounting Equation is affected if Machinery is purchased for Cash ?**
- 😊 It will result in Cash being reduced and Machinery Account being increased.
- Q.6. ☹ **Indicate how Accounting Equation is affected if Payment is made to Creditor ?**
- 😊 Cash Decreases and so does the Liability (Creditor).
- Q.7. ☹ **Indicate how Accounting Equation is affected if Cash is received against services rendered ?**
- 😊 Cash Increases and so does the Capital.



# ACCOUNTING PROCEDURES - RULES OF DEBIT AND CREDIT

## CHAPTER - 6

**Outline :**

- ☞ Meaning of an Account
- ☞ Meaning of Debit and Credit
- ☞ Rules of Debit and Credit
- ☞ Classification of Accounts
- ☞ Significance of Various Balances

Q.1. **What is an "Account" ?**

Ans. An Account is Summarised Record of Transactions at one place relating to a particular head.

Q.2. **What is the Objective of preparing an Account ?**

Ans. The objective of preparing an Account is to summarise all transactions relating to a particular head in one account. Balances of All Accounts leads to preparation of Trial Balance.

Q.3. **What are the Two Sides of an Account called ?**

Ans. The Two Sides of an Account are Debit and Credit.

Q.4. **What are the Three Classes of Accounts ?**

- Ans.
- (a) Personal Accounts.
  - (b) Real Accounts.
  - (c) Nominal Accounts.

Q.5. **What is a "Personal Account" ? What is the Rule for Personal Account ? Give Two Examples of Personal Account.**

Ans. Personal Accounts are the accounts which relates to persons, i.e., Individuals, Firms, Companies, etc.

Rule for Personal Account is '**Debit the Receiver, Credit the Giver**'.

Two Examples of Personal Accounts are :

- (a) Capital Account.
- (b) Creditor's Account.

Q.6. **What is a "Real Account" ? What is the Rule for Real Account ? Give Two Examples of Real Account.**

Ans. Real Accounts is the account which relates to Tangible or Intangible Asset.

Rule for Real Account is '**Debit What Comes in, Credit What Goes out**'.

Two Examples of Real Accounts are :

- (a) Land Account.
- (b) Computer's Account.



Q.7. **What is a "Nominal Account" ? What is the Rule for Nominal Account ? Give Two Examples of Nominal Account.**

Ans. Nominal Accounts is the account which relates to Expenses, Losses, Gains, Revenues etc.

Rule for Nominal Account is '**Debit All Expenses and Losses, Credit All Incomes and Gains**'.

Two Examples of Nominal Accounts are :

(a) Salary Account.

(b) Commission Received Account.

Q.8. **What is signified by a Debit Cash Balance ?**

Ans. A Debit Cash Balance signifies Cash in Hand. Cash Account can never have a Credit Balance.

Q.9. **What is signified by a Debit Bank Balance ?**

Ans. A Debit Bank Balance signifies Balance lying Deposited into Bank.

Q.10. **What is signified by a Credit Bank Balance (Bank Overdraft) ?**

Ans. A Credit Bank Balance signifies amount payable to Bank by the Firm.

Q.11. **What does a Debit in Personal Account signify ?**

Ans. A Debit in Personal Account means the amount **receivable from the person**.

Q.12. **What does a Credit in Personal Account signify ?**

Ans. A Credit in Personal Account means the amount **Payable to the person**.

Q.13. **What does a Debit in Asset Account signify ?**

Ans. A Debit in Asset Account means further Asset Purchased by the Firm.

Q.14. **What does a Credit in Asset Account signify ?**

Ans. A Credit in Asset Account means the Asset Sold or Discarded by the Firm.

Q.15. **What does a Debit in Nominal Account (Expense Account) signify ?**

Ans. A Debit in Nominal Account means the amount of expense incurred by the Firm.

Q.16. **What does a Credit in Nominal Account (Income Account) signify ?**

Ans. A Credit in Nominal Account means the amount of income earned by the Firm.

Q.17. **Is Capital a Personal Account ? If yes, Why ?**

Ans. Capital Account is a Personal Account because it is the amount due to the Proprietor by the Firm.

Q.18. **When is a Capital Account Debited ?**

Ans. Capital Account is Debited when the Proprietor **makes a Drawings and with the amount of Loss**.

Q.19. **When is a Capital Account Credited ?**

Ans. Capital Account is Credited when

(a) the Proprietor introduces further Capital and

(b) with the amount of profit.

Q.20. **When an Account is said to have a Debit Balance ?**

Ans. An Account is said to have a Debit Balance if the Total of its Debit Side is more than the Total of its Credit Side.



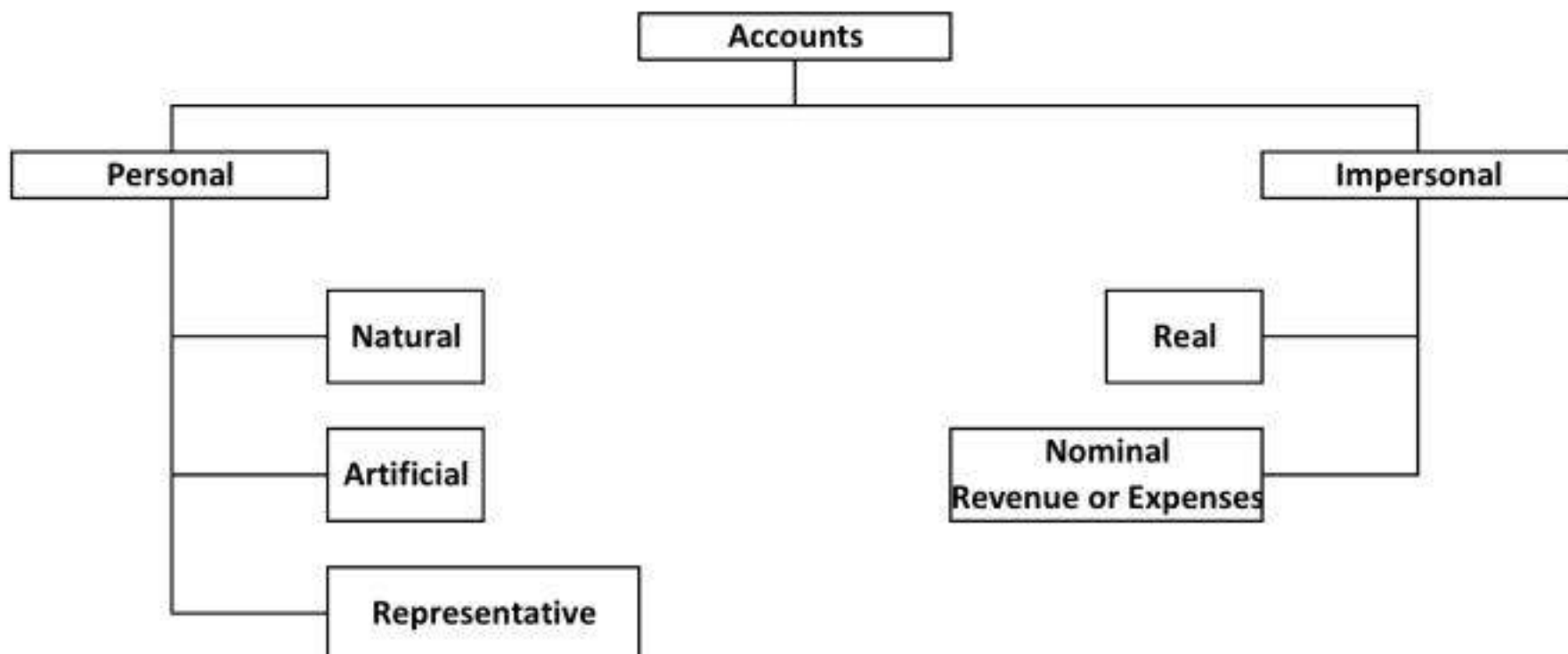
- Q.21. **When an Account is said to have a Credit Balance ?**  
Ans. An Account is said to have a Credit Balance if the Total of its Credit Side is more than the Total of its Debit Side.
- Q.22. **Why are the Rules of Debit and Credit same for Liability and Capital ?**  
Ans. Because both are of the Same Nature and Move in Same Direction.
- Q.23. **Which Account should be Debited, if Wages are paid for Installation of a Machine ?**  
Ans. For Wages paid for installation of machinery, Machinery Account should be Debited.
- Q.24. **What are "Natural Personal Accounts" ? Give one example.**  
Ans. Accounts of "Natural Persons" means the accounts of Human Beings. For Example, Mohan's Account.
- Q.25. **What are "Artificial Personal Accounts" ? Give one example.**  
Ans. These accounts do not have Physical Existence as human beings but they work as personal accounts. For Example, any Firm's Account.
- Q.26. **What are "Representative Personal Accounts" ? Give one example.**  
Ans. When an account represents a particular person or group of persons, it is termed as a Representative Personal Account. For Example, 'Outstanding Rent' Account.





## ACCOUNTING PROCEDURES - RULES OF DEBIT AND CREDIT

### Traditional Classification of Accounts

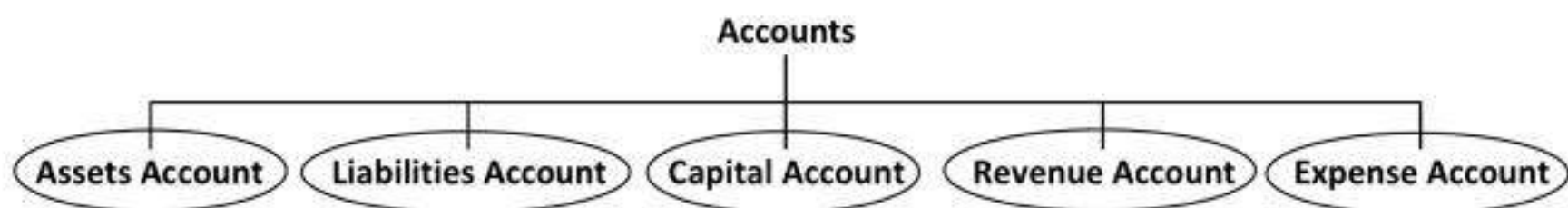


Rules for Debit and Credit When the Accounts are classified as Personal, Real and Nominal :

#### Golden Rules of Debit and Credit

	Types of Accounts	Rules for Debit	Rules for Credit
(a)	For Personal Account	Debit the Receiver.	Credit the Giver.
(b)	For Real Account	Debit What Comes in.	Credit What Goes out.
(c)	For Nominal Account	Debit All Expenses and Losses.	Credit All Incomes and Gains.

### Modern Classification of Accounts



Rules for Debit and Credit :

	Types of Accounts	Accounts to be Debited	Accounts to be Credited
(a)	Assets Account	Increase    ↑	Decrease    ↓
(b)	Liabilities Account	Decrease    ↓	Increase    ↑
(c)	Capital Account	Decrease    ↓	Increase    ↑
(d)	Revenue Account	Decrease    ↓	Increase    ↑
(e)	Expenses Account	Increase    ↑	Decrease    ↓



**Q.1. Classify the following under Personal, Real and Nominal Account :**

- |                                   |                          |                               |
|-----------------------------------|--------------------------|-------------------------------|
| (1) Capital Introduced            | (2) Drawings Account     | (3) Cash                      |
| (4) Interest Paid                 | (5) Discount Received    | (6) Bank Account              |
| (7) Bank Overdraft                | (8) Bad Debt Written Off | (9) Outstanding Salaries      |
| (10) Prepaid Rent                 | (11) Purchases Account   | (12) Sales Account            |
| (13) Carriage Inwards             | (14) Bad Debt Recovered  | (15) Interest Accrued Account |
| (16) Goodwill                     | (17) Kangali (Supplier)  | (18) Leasehold Property       |
| (19) Excise Duty                  | (20) Plant & Machinery   | (21) Land                     |
| (22) Return Inwards               | (23) Sohan (Creditor)    | (24) Return Outwards          |
| (25) Mohan (Debtor)               | (26) Monu (Proprietor)   | (27) Ram (Customer)           |
| (28) Bank Loan                    | (29) Unearned Income     | (30) Shyam (Purchaser)        |
| (31) Depreciation                 | (32) Loan                | (33) Petty Cash               |
| (34) Current Account of a Partner |                          |                               |

**Solution :-**

Personal Accounts	Real Accounts	Nominal Accounts
(1) Capital Introduced	(3) Cash	(4) Interest Paid
(2) Drawings Account	(16) Goodwill	(5) Discount Received
(6) Bank Account	(18) Leasehold Property	(8) Bad Debt Written Off
(7) Bank Overdraft	(20) Plant & Machinery	(11) Purchases Account
(9) Outstanding Salaries	(21) Land	(12) Sales Account
(10) Prepaid Rent	(33) Petty Cash	(13) Carriage Inwards
(15) Interest Accrued		(14) Bad Debt Recovered
(17) Kangali (Supplier)		(19) Excise Duty
(23) Sohan (Creditor)		(22) Return Inwards
(25) Mohan (Debtor)		(24) Return Outwards
(26) Monu (Proprietor)		(31) Depreciation
(27) Ram (Customer)		
(28) Bank Loan		
(29) Unearned Income		
(30) Shyam (Purchaser)		
(32) Loan		
(34) Current Account		

**Q.2. State the nature of Account (Personal, Real or Nominal) and show which will be Debited and which will be Credited :**

- |                        |                                  |                                 |
|------------------------|----------------------------------|---------------------------------|
| (1) Rent Paid          | (2) Prereceived Income           | (3) Interest Received           |
| (4) Machinery Purchase | (5) Building Sold                | (6) Goods Purchased             |
| (7) Discount Allowed   | (8) Capital Introduced           | (9) Goods Sold                  |
| (10) Rent Payable      | (11) Prepaid Salary              | (12) Accrued Interest           |
| (13) Return Inwards    | (14) Return Outwards             | (15) Bad Debt                   |
| (16) Doubtful Debts    | (17) Account Receivable (Debtor) | (18) Account Payable (Creditor) |



Solution :-

	Accounts	Nature of Accounts	Debited/Credited
(1)	Rent Paid A/c	Nominal	Debited
(2)	Prereceived Income A/c	Personal	Credited
(3)	Interest Received A/c	Nominal	Credited
(4)	Machinery Purchased A/c	Real	Debited
(5)	Building Sold A/c	Real	Credited
(6)	Purchases A/c	Nominal	Debited
(7)	Discount Allowed A/c	Nominal	Debited
(8)	Capital Introduced A/c	Personal	Credited
(9)	Sales A/c	Nominal	Credited
(10)	Rent Payable A/c	Personal	Credited
(11)	Prepaid Salary A/c	Personal	Debited
(12)	Accrued Interest A/c	Personal	Debited
(13)	Return Inwards A/c	Nominal	Debited
(14)	Return Outwards A/c	Nominal	Credited
(15)	Bad Debts A/c	Nominal	Debited
(16)	Doubtful Debts A/c	Personal	Credited
(17)	Account Payable (Creditors) A/c	Personal	Credited
(18)	Account Receivable (Debtors) A/c	Personal	Debited

**Q.3. From the following transactions, State the Nature of Accounts and state which Account will be Debited and which Account will be Credited on the Basis of Traditional Classification of Accounts.**

- Mr. Mohan Commenced Business with ₹ 5,00,000 in Cash.
- Purchased Goods for Cash ₹ 1,00,000.
- Sold Goods for Cash ₹ 1,50,000.
- Received Interest from Ram in Cash ₹ 500.
- Sold Goods to Ashok for ₹ 60,000.
- Purchased Furniture for Cash ₹ 50,000.
- Paid Wages ₹ 20,000.

Solution :-

**Analysis of Transactions**

	Transactions	Accounts Involved	Nature of Account	Debit ₹	Credit ₹	Reason
(1)	Mr. Mohan Commenced Business with ₹ 5,00,000 in Cash.	Cash Capital	Real Personal	5,00,000 -----	----- 5,00,000	Comes in Giver
(2)	Purchased Goods for Cash ₹ 1,00,000.	Purchase Cash	Nominal Real	1,00,000 -----	----- 1,00,000	Expenses Goes Out
(3)	Sold Goods for Cash ₹ 1,50,000.	Cash Sales	Real Nominal	1,50,000 -----	----- 1,50,000	Comes in Incomes
(4)	Received Interest from Ram in Cash ₹ 500	Cash Interest	Real Nominal	500 -----	----- 500	Comes in Incomes
(5)	Sold Goods to Ashok for ₹ 60,000.	Ashok Sales	Personal Nominal	60,000 -----	----- 60,000	Receiver Incomes
(6)	Purchased Furniture for Cash ₹ 50,000.	Furniture Cash	Real Real	50,000 -----	----- 50,000	Comes in Goes Out
(7)	Paid Wages ₹ 20,000.	Wages Cash	Nominal Real	20,000 -----	----- 20,000	Expenses Goes Out



**Q.4. Classify the following into Asset, Liabilities, Capital, Revenue, Expenses :**

(1) Rent	(2) Prereceived Income	(3) Interest Received
(4) Plant & Machinery	(5) Bank Loan	(6) Sales
(7) Discount Allowed	(8) Purchases	(9) Carriage Inward
(10) Rent Payable	(11) Prepaid Insurance	(12) Accrued Interest
(13) Account Payable	(14) Account Receivable	(15) Bad Debt
(16) Carriage Outward	(17) Wages	(18) Goodwill
(19) Bank Overdraft	(20) Capital	(21) Furniture & Fixtures
(22) Debtors	(23) Mohan (Proprietor)	(24) Shop Fittings/Office Fittings
(25) Creditors	(26) Ram (Customer)	(27) Commission Received
(28) Unsold Stock	(29) Shyam (Supplier)	(30) Trade Mark
(31) Bad Debt Recovered	(32) Discount on Purchase	(33) Drawings
(34) Provision for Depreciation	(35) Provision for Doubtful Debts	(36) Commission Received in Advance

**Solution :-**

Assets	Liabilities	Capital	Revenue	Expenses
Plant & Machinery	Prereceived Income	Capital	Interest Received	Rent
Prepaid Insurance	Bank Loan	Mohan (Proprietor)	Sales	Discount Allowed
Accrued Interest	Rent Payable (O/s)		Commission Received	Purchases
Account Receivable (Bills Receivable)	Account Payable		Bad Debt Recovered	Carriage Inward
Goodwill	Bank Overdraft		Discount on Purchase (Discount Received)	Bad Debts
Furniture & Fixtures	Creditors			Carriage Outward
Debtors	Shyam (Supplier)			Wages
Office Fittings	Provision for Doubtful Debts			
Ram (Customer)	Provision for Depreciation			
Unsold Stock	Commission Received in Advance			
Trade Mark				
Drawings				

**Q.5. On which Side the Increase in the following Accounts will be recorded ? Also, mention the Nature of Account :**

(1) Furniture A/c	(2) Mohan (Proprietor)	(3) Salary A/c
(4) Purchases A/c	(5) Sales A/c	(6) Cash
(7) Bank A/c	(8) Bank Overdraft A/c	(9) Sohan (Debtor)
(10) Ram (Creditor)	(11) Prepaid Insurance	(12) Accrued Interest
(13) Capital	(14) Account Receivable	(15) Account Payable
(16) Salary Outstanding	(17) Unearned Income	(18) Goodwill



Solution :-

	Accounts	Nature of Accounts	Debit / Credit
(1)	Furniture A/c	Assets	Debit
(2)	Mohan (Proprietor)	Capital	Credit
(3)	Salary A/c	Expenses	Debit
(4)	Purchases A/c	Expenses	Debit
(5)	Sales A/c	Revenue	Credit
(6)	Cash A/c	Assets	Debit
(7)	Bank A/c	Assets	Debit
(8)	Bank Overdraft A/c	Liabilities	Credit
(9)	Sohan (Debtor)	Assets	Debit
(10)	Ram (Creditor)	Liabilities	Credit
(11)	Prepaid Insurance A/c	Assets	Debit
(12)	Accrued Interest A/c	Assets	Debit
(13)	Capital A/c	Capital	Credit
(14)	Account Receivable A/c	Assets	Debit
(15)	Account Payable A/c	Liabilities	Credit
(16)	Salary Outstanding A/c	Liabilities	Credit
(17)	Unearned Income A/c	Liabilities	Credit
(18)	Goodwill A/c	Assets	Debit

**Q.6. On which Side the Decrease in the following Accounts will be recorded ? Also, mention the Nature of Account :**

(1) Furniture A/c	(2) Mohan (Proprietor)	(3) Salary A/c
(4) Purchases A/c	(5) Sales A/c	(6) Cash
(7) Bank A/c	(8) Bank Overdraft A/c	(9) Sohan (Debtor)
(10) Ram (Creditor)	(11) Prepaid Insurance	(12) Accrued Interest
(13) Capital	(14) Account Receivable	(15) Account Payable
(16) Salary Outstanding	(17) Unearned Income	(18) Goodwill

Solution :-

	Accounts	Nature of Accounts	Debit / Credit
(1)	Furniture A/c	Assets	Credit
(2)	Mohan (Proprietor)	Capital	Debit
(3)	Salary A/c	Expenses	Credit
(4)	Purchases A/c	Expenses	Credit
(5)	Sales A/c	Revenue	Debit
(6)	Cash A/c	Assets	Credit
(7)	Bank A/c	Assets	Credit
(8)	Bank Overdraft A/c	Liabilities	Debit
(9)	Sohan (Debtor)	Assets	Credit
(10)	Ram (Creditor)	Liabilities	Debit
(11)	Prepaid Insurance A/c	Assets	Credit
(12)	Accrued Interest A/c	Assets	Credit
(13)	Capital A/c	Capital	Debit
(14)	Account Receivable A/c	Assets	Credit



(15)	Account Payable A/c	Liabilities	Debit
(16)	Salary Outstanding A/c	Liabilities	Debit
(17)	Unearned Income A/c	Liabilities	Debit
(18)	Goodwill A/c	Assets	Credit

**Q.7. You are given a number of Accounts below, State which of them will normally show Debit Balance and which a Credit Balance :**

- |                                   |                                 |                          |
|-----------------------------------|---------------------------------|--------------------------|
| (1) Furniture A/c                 | (2) Capital                     | (3) Salary A/c           |
| (4) Purchases A/c                 | (5) Sales A/c                   | (6) Cash                 |
| (7) Repairs                       | (8) Bank Overdraft A/c          | (9) Sohan (Debtor)       |
| (10) Ram (Creditor)               | (11) Prepaid Insurance          | (12) Accrued Interest    |
| (13) General Reserve              | (14) Account Receivable         | (15) Account Payable     |
| (16) Salary Outstanding           | (17) Unearned Income            | (18) Goodwill            |
| (19) Merchandise (Goods)          | (20) Trade Mark                 | (21) Unsold Goods        |
| (22) Commission Received          | (23) Bad Debts                  | (24) Bad Debts Recovered |
| (25) Purchase Return              | (26) Sales Return               | (27) Depreciation        |
| (28) Provision for Doubtful Debts | (29) Provision for Depreciation | (30) Drawings            |

**Solution :-**

	Accounts	Logic	Debit Balance	Credit Balance
(1)	Furniture A/c	Assets	✓	
(2)	Capital A/c	Liability		✓
(3)	Salary A/c	Expenses	✓	
(4)	Purchases A/c	Expenses	✓	
(5)	Sales A/c	Income		✓
(6)	Cash A/c * <sup>1</sup>	Assets	✓	
(7)	Repairs A/c	Expenses	✓	
(8)	Bank Overdraft A/c	Liability		✓
(9)	Sohan (Debtor)	Assets	✓	
(10)	Ram (Creditor)	Liability		✓
(11)	Prepaid Insurance A/c	Assets	✓	
(12)	Accrued Interest A/c	Assets	✓	
(13)	General Reserve A/c	Liability		✓
(14)	Account Receivable A/c	Assets	✓	
(15)	Account Payable A/c	Liability		✓
(16)	Salary Outstanding A/c	Liability		✓
(17)	Unearned Income A/c	Liability		✓
(18)	Goodwill A/c	Assets	✓	
(19)	Merchandise (Goods)	Assets	✓	
(20)	Trade Mark	Assets	✓	
(21)	Unsold Goods	Assets	✓	
(22)	Commission Received	Income		✓
(23)	Bad Debts	Loss	✓	
(24)	Bad Debts Recovered	Income		✓
(25)	Purchase Return	Expenses ↓		✓
(26)	Sales Return	Income ↓	✓	
(27)	Depreciation	Expenses	✓	



(28)	Provision for Doubtful Debts	Liability		✓
(29)	Provision for Depreciation	Liability		✓
(30)	Drawings	Assets or Capital ↓	✓	

\*<sup>1</sup> Cash Account will always show **Debit Balance**.

Bank Account will have Debit or Credit Balance.

**Q.8. From the following transactions, State the Nature of Accounts and state which Account will be Debited and which Account will be Credited on the Basis of Modern Classification of Accounts.**

- (1) Mr. Mohan Commenced Business with ₹ 5,00,000 in Cash.
- (2) Purchased Goods for Cash ₹ 1,00,000.
- (3) Sold Goods for Cash ₹ 1,50,000.
- (4) Received Interest from Ram in Cash ₹ 500.
- (5) Sold Goods to Ashok for ₹ 60,000.
- (6) Purchased Furniture for Cash ₹ 50,000.
- (7) Paid Wages ₹ 20,000.

Solution :-

#### Analysis of Transactions

Transactions	Accounts Involved	Nature of Account	How Affected	Debit ₹	Credit ₹
(1) Mr. Mohan Commenced Business with ₹ 5,00,000 in Cash.	Cash Capital	Asset Capital	Increased Increased	5,00,000 -----	----- 5,00,000
(2) Purchased Goods for Cash ₹ 1,00,000.	Purchase Cash	Expenses Asset	Increased Decreased	1,00,000 -----	----- 1,00,000
(3) Sold Goods for Cash ₹ 1,50,000.	Cash Sales	Asset Revenue	Increased Increased	1,50,000 -----	----- 1,50,000
(4) Received Interest from Ram in Cash ₹ 500	Cash Interest	Asset Revenue	Increased Increased	500 -----	----- 500
(5) Sold Goods to Ashok for ₹ 60,000.	Ashok Sales	Asset Revenue	Increased Increased	60,000 -----	----- 60,000
(6) Purchased Furniture for Cash ₹ 50,000.	Furniture Cash	Asset Asset	Increased Decreased	50,000 -----	----- 50,000
(7) Paid Wages ₹ 20,000.	Wages Cash	Expenses Asset	Increased Decreased	20,000 -----	----- 20,000

**Q.9. Open a "T" Shape Account for Machinery and put the following transactions on the proper side :**

	₹
(1) Machinery Purchased	40,000
(2) Machinery Sold - Costing	10,000
(3) Machinery Purchased	8,000
(4) Machinery Discarded	14,000
(5) Depreciation on Machinery	1,000
(6) Machinery Destroyed	3,000



Solution :-

Dr.		Machinery Account		Cr.	
INCREASE (+)		₹	DECREASE (-)		₹
(1)	Cash (Purchase)	40,000	(2)	Cash (Sale)	10,000
(3)	Cash (Purchase)	8,000	(4)	Machinery Discarded	14,000
			(5)	Depreciation	1,000
			(6)	Profit & Loss	3,000
	Total	48,000	Total		28,000
			Balance		20,000
		48,000			48,000

Note :- Machinery Account has a Debit Balance of ₹ 20,000 which indicates Machinery in hand which will be shown in Balance Sheet as Asset.

Q.10. Open a "T" Shape Account of Creditor "Rakesh" and write the following transactions on the proper side :

	₹
(1) Goods Purchased from Rakesh on Credit	50,000
(2) Goods Returned to Rakesh for	5,000
(3) Paid to Rakesh	20,000
Discount Received from him	500
(4) Purchased Goods from Rakesh on Credit	10,000

Solution :-

Dr.		Rakesh (Creditor's Account)		Cr.
DECREASE (-)		₹	INCREASE (+)	₹
(2)	Return Outwards	5,000	(1) Purchases	50,000
(3)	Cash	20,000	(4) Purchases	10,000
(3)	Discount Received	500		
	Total	25,500	Total	60,000
	Balance	34,500		
		60,000		60,000

Note :- Rakesh (Creditor's Account) has a Credit Balance of ₹ 34,500 which indicates that the amount is due (payable) to him.

Q.11. Open a "T" Shape Account of Debtor "Brij" and write the following transactions on the proper side :

	₹
(1) Sold Goods to Brij on Credit	25,000
(2) Cash Received from Brij	10,000
Discount Allowed to him	500
(3) Goods Returned by Brij	5,000
(4) Sold Goods to Brij on Credit	15,000



Solution :-

Dr.		Brij (Debtor's Account)		Cr.	
INCREASE (+)		₹	DECREASE (-)	₹	
(1)	Sales	25,000	(2)	Cash	10,000
(4)	Sales	15,000	(2)	Discount Allowed	500
			(3)	Return Inward	5,000
	Total	40,000	Total		15,500
			Balance		24,500
		40,000			40,000

Note :- Brij (Debtor's Account) has a Debit Balance of ₹ 24,500 which indicates that the amount is due (receivable) from him.

Q.12. Open a "T" Shape Cash Account. Put the following transactions on the proper side and balance the account :

	₹
(1) Mohan Started Business with Cash	50,000
(2) Purchase Goods	10,000
(3) Sold Goods	5,000
(4) Paid Rent	1,000
(5) Received interest	500
(6) Drew for Personal Use	15,000
(7) Deposited into Bank	8,000
(8) Withdrawn from Bank	2,000

Solution :-

Dr.		Cash Account		Cr.	
INCREASE (+)		₹	DECREASE (-)		₹
(1)	Capital	50,000	(2)	Purchases	10,000
(3)	Sales	5,000	(4)	Rent	1,000
(5)	Interest	500	(6)	Drawings	15,000
(8)	Bank (Withdrawn)	2,000	(7)	Bank (Deposit)	8,000
	Total	57,500		Total	34,000
				Balance	23,500
		57,500			57,500

Note :- Cash Account has a Debit Balance of ₹ 23,500 which shows the Cash in Hand. Cash Account will never have a Credit Balance.

Q.13. From the following particulars, Prepare the Account of D. Budhiraja, the Proprietor the Business :

	₹
(1) Commenced Business with Cash	25,000
(2) Drawings made by him	5,000
(3) Further Capital Introduced	10,000
(4) Profit for the period	20,000

Net Loss will be shown on the Debit Side of Capital Account



Solution :-

Dr.		D. Budhiraja's Capital Account		Cr.
DECREASE (-)		₹	INCREASE (+)	₹
(2)	Drawings	5,000	(1) Cash (Capital)	25,000
			(3) Cash (Capital)	10,000
			(4) Profit & Loss A/c	20,000
	Total	5,000	Total	55,000
	Balance	50,000		
		55,000		55,000

Note :- Proprietor's Capital Account has a Credit Balance of ₹ 50,000 which indicates that the business owes him this amount.

Q.14. From the following particulars, Prepare the Proprietor's Capital Account :

		₹
1 <sup>st</sup> April, 2010	Commenced Business with Cash	20,000
31 <sup>st</sup> March, 2011	Net Loss as per Profit & Loss Account	1,800
31 <sup>st</sup> March, 2011	Drawings during the period	1,500

Balance the same and explain what the Closing Balance indicates ?

Solution :-

Dr.		Proprietor's Capital Account		Cr.
DECREASE (-)		₹	INCREASE (+)	₹
2010			2010	
31 <sup>st</sup> March Profit & Loss A/c	1,800		1 <sup>st</sup> April Cash (Capital)	20,000
31 <sup>st</sup> March Drawings	1,500			
Total	3,300		Total	20,000
Balance	16,700			
	20,000			20,000

Note :- Proprietor's Capital Account has a Credit Balance of ₹ 16,700 which indicates that the business owes him this amount.

Q.15. Put the following transactions on the proper side of an Interest Account :

	₹
(1) Interest Earned	2,000
(2) Interest paid	1,000
(3) Interest Due	500

Solution :- {(1) Credit; (2) Debit; (3) Debit}



Q.16 (a). Put the following on the proper side of Cash Account, a Debtor's Account and a Creditor's Account :

	₹
(1) Sold Goods to Sanjay on Credit	50,000
(2) Sold Goods to Mohan for Cash	20,000
(3) Purchased Goods from Ram on Credit	25,000
(4) Cash Received from Sanjay	19,000
(5) Paid Rent	500
(6) Goods Returned by Sanjay	2,000
(7) Cash Paid to Ram	15,000
(8) Goods Returned to Ram	4,000
(9) Received Interest	5,000

Solution :- 16 (a) {Cash Account → Debit : (2), (4), (9); Credit : (5), (7); Sanjay → Debit : (1); Credit (4), (6); Ram → Debit : (7), (8); Credit : (3)}

Q.16 (b). Write the above transactions in Cash Account, a Debtor's Account and a Creditor's Account :

Solution :- 16 (b)

Cash Account			
Dr.			Cr.
INCREASE (+)	₹	DECREASE (-)	₹
(2) Sales	20,000	(5) Rent	500
(4) Sanjay	19,000	(7) Ram	15,000
(9) Interest	5,000		
Total	44,000	Total	15,500
		Balance	28,500
	44,000		44,000

Sanjay (Debtor's Account)			
Dr.			Cr.
INCREASE (+)	₹	DECREASE (-)	₹
(1) Sales	50,000	(4) Cash	19,000
		(6) Return Inward	2,000
Total	50,000	Total	21,000
		Balance	29,000
	50,000		50,000

Ram (Creditor's Account)			
Dr.			Cr.
DECREASE (-)	₹	INCREASE (+)	₹
(7) Cash	15,000	(3) Purchases	25,000
(8) Return Outwards	4,000		
Total	19,000	Total	25,000
Balance	6,000		
	25,000		25,000



# SOURCE DOCUMENT AND PREPARATION OF VOUCHERS

## CHAPTER - 7

### Outline :

- ☞ Source Documents
- ☞ Meaning of a Voucher
- ☞ Types of Voucher

Q.1. Define "Source Documents (Source Voucher/Supporting Voucher)".

Ans. "A Source Document is a written document containing details of the transactions prepared at the time it is entered into."

Source Documents may be defined as the documents which provide evidence of the transactions. They are also sometimes referred to as **Supporting Documents**.

Following are some examples of source documents.

- (a) Cash Memo
- (b) Invoice or Bill
- (c) Receipt
- (d) Pay-in-Slip
- (e) Cheque
- (f) Debit Note
- (g) Credit Note

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Let us now discuss the most common source documents.

(a) **Cash Memo** :- Cash Memo is prepared by the seller when he sells goods against cash. It has details of goods sold, quantity, rate of each item and the total amount received, the date of transaction and other terms and conditions, if any. It is an evidence for the purchaser for goods purchased against cash, and for the enterprise, it is an evidence of sales for cash.

(b) **Invoice or Bill** :- An Invoice or Bill is prepared by the seller when he sells goods on credit. It has details of the party to whom goods are sold, goods sold and the total sale amount.

The original copy of the sales invoice is sent to the purchaser and a duplicate copy is retained as an evidence of the sales for recording in the books of accounts and also for future reference. From the purchaser's point of view, purchases are evidenced by credit bills received from the supplier.

One prepares the an invoice but receives a bill, though the two terms are interchangeable and mean the same thing.



(c) **Receipt** :- When a trader receives cash from a customer, he issues a receipt containing the date, amount and the name of the customer. The receipt is prepared in duplicate. The original copy is handed over to the party tendering the payment and its duplicate copy is kept for making records in the books of accounts. In the same way, whenever we make payment we obtain a receipt from the party to whom we make payment.

(d) **Pay-in-Slip** :- It is a source document used for depositing cash or cheques into Bank. This is a form available from a bank. Each pay-in-slip has a counterfoil which is returned to the depositor duly stamped and signed by the cashier of the bank.

(e) **Cheque** :- A cheque is an order in writing drawn upon a bank to pay specified sum to the bearer or the person named in it. The bank supplies cheque forms. The name of the party to whom payment is to be made is written after the words 'Pay To'. Each cheque has a counterfoil in with the same details as entered in the cheque are filled. The counterfoil remains with the account holder for future reference.

(f) **Debit Note** :- When we return goods to a supplier, we prepare a debit note and send it to the supplier with the returned goods. Debit note is a document which indicates that supplier's account is being debited. It is a source document which contains the date of transaction, the name of the account which is debited, the amount and the reason for debit.

A duplicate copy or the counterfoil of 'Debit Note' is retained by us, on the basis of which, the supplier's account is debited in our books.

(g) **Credit Note** :- When goods are received back from a customer a credit note is sent to him indicating that customer's account has been credited in our books. A duplicate copy of the credit note is retained for record purpose.

Q.2. **What are the Features of Source Documents ?**

Ans. Following are the features of Source Documents :

- (a) It is a written document.
- (b) It contains complete details of the transaction.
- (c) It is a proof of a transactions having taken place.
- (d) It is generally for a business transactions.
- (e) It is signed by the maker.

Q.3. **What is meant by a "Voucher" ?**

Ans. A Voucher means a **written evidence of a transaction** that has taken place.

Whenever a transaction is entered into, an evidence to that effect is also established. Such evidences are Source Document. Examples of Source Documents are Cash Memo, Invoice or Bill, Receipt, Pay-in-Slip, Cheque and Debit and Credit Notes, etc.

On the basis of Source Documents, a voucher detailing the accounts that are debited and credited is prepared.

Q.4. **What is meant by a "Accounting Voucher" ?**

Ans. Accounting Voucher is a written document containing an Analysis of Business Transaction for Accounting and Recording purpose, prepared by the Accountant on the basis of source voucher and signed by the Authorised Person.



Before Recording in Books of Accounts, source voucher are analysed to determine which account or accounts are to be debited and credited. The decision is recorded on a document termed 'Accounting Voucher'.

Q.5. **What are the Features of Accounting Voucher ?**

Ans. Following are the features of Accounting Voucher :

- (a) It is a written document.
- (b) It is prepared on the basis of evidence of transactions.
- (c) It is an analysis of a transactions.
- (d) It is prepared and signed usually by an Accountant and Countersigned by the Authorised Signatory.
- (e) In the case of Cash/Bank Voucher, It is a receipt.

Q.6. **What are the Types of Accounting Voucher ?**

Ans. Accounting Vouchers are of two types, i.e.,

- (a) Cash Voucher; and
- (b) Non-Cash Voucher or Transfer Voucher.

(a) **Cash Voucher** :- Cash Voucher refers to the voucher prepared at the time of receipt or payment of cash and includes receipt and payment through cheque.

Cash Voucher can be of following two types namely

- (i) Credit Voucher; and
- (ii) Debit Voucher.

**Credit Voucher** :- Credit Voucher are prepared when cash is received. Cash may be received against

- (1) Sale of Goods.
- (2) Sale of Fixed Assets.
- (3) Sale of Investment.
- (4) Receipts from Debtors.
- (5) Withdrawal from Bank etc.

The Credit Voucher gives the following information :

- (1) Name and Address of the Organisation.
- (2) Date of Preparing the Voucher.
- (3) Accounting Voucher Number.
- (4) Title of the Account Credited.
- (5) Net Amount of the transaction.
- (6) Narration i.e., a brief description of the transaction.
- (7) Signature of the Person Preparing it.
- (8) Signature of the Authorised Signatory.
- (9) Supporting (Source) Voucher Number.



*Debit Voucher :-* Debit Voucher are prepared **when Payment is made**. Payment may be made against

- (1) Expenses.
- (2) Purchase of Goods.
- (3) Purchase of Fixed Assets.
- (4) Payment to Creditors.
- (5) Deposit into Bank.
- (6) Drawing etc.

The Debit Voucher gives the following information :

- (1) Name and Address of the Organisation.
- (2) Date of Preparing the Voucher.
- (3) Accounting Voucher Number.
- (4) Title of the Account Debited.
- (5) Net Amount of the transaction.
- (6) Narration i.e., a brief description of the transaction.
- (7) Signature of the Person Preparing it.
- (8) Signature of the Authorised Signatory.
- (9) Supporting (Source) Voucher Number.
- (10) A Document in lieu (instead) of the Supporting Voucher.

(b) **Non-Cash Voucher or Transfer Voucher :-** Non-Cash Voucher refer to vouchers prepared for transactions not involving cash. Examples are : Invoices or Bill, Debit and Credit Note etc.

Non-Cash Voucher are prepared for the transactions of Credit Sales, Credit Purchases, Goods Returned (both Inwards and Outwards), Rectifying the Mistakes, etc.

A Non-Cash Voucher gives the following information :

- (1) Name and Address of the Organisation.
- (2) Date of Preparing the Voucher.
- (3) Accounting Voucher Number.
- (4) Title of the Account Debited/Credited.
- (5) Net Amount of the transaction.
- (6) Narration i.e., a brief description of the transaction.
- (7) Signature of the Person Preparing it.
- (8) Signature of the Authorised Signatory.
- (9) Supporting (Source) Voucher Number.

**Q.7. What is meant by a "Compound Voucher" ?**

**Ans.** Voucher which records a transaction that entails multiple Debit and one Credit or multiple Credit and one Debit is called Compound Voucher.

Compound Voucher may be :

- (a) Debit Voucher or
- (b) Credit Voucher

*Debit Voucher :-* A document showing a transaction that contain multiple debits but one credit is called Debit Voucher.



*Credit Voucher :-* A document showing a transaction that contain multiple credits but one debit is called Credit Voucher.

**Q.8. Distinguish between Source Documents and Voucher.**

**Ans.**

	<i>Source Document</i>	<i>Voucher</i>
1.	It is a support to the Voucher.	It is supported by the Source Document.
2.	It is not prepared to record transactions.	It is prepared for the purpose of recording of transactions.
3.	It contains full details of a transaction.	It puts emphasis on which account is to be debited and which account is to be
4.	It is evidence of the transaction.	It is document of correct recording of a transaction.





# JOURNAL AND LEDGER

## CHAPTER - 8

### Outline :

- ☞ Meaning of Journal and Journalising
- ☞ Advantages of Journal
- ☞ Meaning and Utility of a Ledger
- ☞ Distinction between Journal and Ledger
- ☞ Compound Journal Entry
- ☞ Opening Journal Entry

Q.1. **What is a "Journal" ?**

Ans. Journal is a Primary Book of Account in which transactions are first recorded in a **Chronological Order** i.e. in the order in which they are occurred.

Q.2. **What is a "Special Journal" ?**

Ans. A Special Journal means a Journal meant for recording **all the transactions of a similar nature**. For Example Sales Journal is a special journal used to record the Credit Sales of Goods made by the Enterprise.

Q.3. **Why is the Journal called a Book of Original (Primary) Entry ?**

Ans. A Journal is called a Book of Original Entry because all transactions are entered first in this book.

Q.4. **What is a "Journalising" ?**

Ans. Journalising is a Process of recording a transactions in a Journal.

Q.5. **What are the Steps involved in Journalising ?**

- Ans.
- (a) Identify the Accounts involved in the transactions.
  - (b) Determine the Nature of Accounts, e.g. Real, Nominal or Personal.
  - (c) Apply the Rules for 'Debit' and 'Credit'.
  - (d) Draw Ruling of a Journal and record transactions.
  - (e) Record the date and month of the transactions in 'Date' Column.
  - (f) Record in the 'Particulars' Column the name of the account to be Debited.
  - (g) Record in the 'Particulars' Column the name of the account to be Credited.
  - (h) Record a brief description of transaction called 'Narration' in the 'Particulars' Column.
  - (i) Draw a line across the 'Particular' Column to separate one journal entry from another.

Q.6. **Give Advantages of a Journal.**

- Ans.
- (a) It reduces the Possibility of Errors.
  - (b) It provides an Explanation of transactions.
  - (c) It provides a Chronological records of transactions.
  - (d) It ensures arithmetical accuracy.



Q.7. **State Limitations of Journal.**

Ans. (a) Journal does not provide the required information on prompt basis.  
(b) Many transactions are repetitive in nature and if all transactions are recorded in journal, it will involve debiting and crediting the same accounts time and again. It will involve repetitive posting labour also.  
(c) When the number of transactions is large, it is not possible to record all transactions in Journal. It will become bulky and voluminous.

Q.8. **State Functions of a Journal.**

Ans. (a) To keep a Chronological (i.e., date-wise) Record of all transactions.  
(b) To analyse each transaction into Debit and Credit aspects by using Double Entry System of Book-Keeping.  
(c) To provide a basis for posting into Ledger.  
(d) To maintain the identity of each transaction by keeping a complete record of each transaction at one place on a permanent basis.

Q.9. **State Features or Characteristics of a Journal.**

Ans. (a) Journal is a book in which the transactions are recorded first of all, as and when they take place. For this reason it is called a book of original entry.  
(b) A Journal is a daily accounting record, i.e., each day's transactions are recorded in Journal on the same day.  
(c) In Journal, transactions are recorded in chronological order, i.e., in a date-wise order.  
(d) A Journal records both debit and credit aspects of a transaction according to the double entry system of book-keeping.

Q.10. **What is the meaning of "Ledger" ?**

Ans. Ledger is a **Principal Book** which contains a permanent record of all transactions in a summarised and classified form.  
Ledger is called a **Book of Second Entry**.

Q.11. **What is the Utility/Advantage of the Ledger ?**

Ans. Being the Principal Book of Account, a Ledger contains all the information regarding various accounts. It helps in preparing the Final Accounts.

Q.12. **What do you understand by "Posting" ?**

Ans. Posting means transferring the entries in the Journal to the Ledger Accounts.

Q.13. **What do you understand by the term "Casting" ?**

Ans. The term Casting means Totaling.

Q.14. **What do you understand by "Balancing an Account" ?**

Ans. Balancing an Account means totaling the two sides and striking the difference.  
The difference is written in the column with shorter balance and is carried forward as a balance in the next accounting period.

Q.15. **Name the Category of Accounts that are balanced.**

Ans. Real and Personal Accounts are balanced and are shown in the Balance Sheet.

Q.16. **Name the Category of Accounts that is not balanced.**

Ans. Nominal Account are not balanced. They are totaled and transferred to Profit & Loss Accounts i.e. are not shown in the Balance Sheet.



Q.17. **List the necessity of Balancing an Account.**

Ans. The necessity of Balancing an Account is as under :

- (a) To ascertain the Net Effect of transactions in an account.
- (b) To help in the preparation of Trial Balance.
- (c) To help in the preparation of Final Accounts.

Q.18. **Distinguish between Journal and Ledger.**

Ans.

Points of Difference	Journal	Ledger
1. Nature of Book	It is a Book of Primary Entry.	It is a Book of Final Entry.
2. Object	It is prepared to record all the transactions in a Chronological Order.	It is prepared to see the net effects of various transactions affecting a particular account.
3. Balancing	Journal is not balanced.	All Ledger Accounts (except Nominal Accounts) are balanced in the Ledger.
4. Process	The Process of recording in the Journal is called Journalising.	The Process of recording in the Ledger is called Posting.
5. Basis of Preparation of Final Accounts	Journal directly does not serve as a basis for the preparation of Final Accounts.	Ledger serves as a basis for the preparation of Final Accounts.
6. Stage of Recording	Recording in the Journal is <b>First Stage</b> .	Recording in the Ledger is <b>Second Stage</b> .
7. Basis for Preparation	Primary Documents (such as Vouchers, Receipts etc.) are the basis for recording transactions in the Journal.	Journal is the basis for recording transactions in the Ledger.
8. Format	Journal has five Columns : (a) Date (b) Particulars (c) Ledger Folio (d) Debit Amount (e) Credit Amount.	Ledger has four identical Columns on Debit and Credit side : (a) Date (b) Particulars (c) Folio (d) Amount.

Q.19. **What is Simple Journal Entry ?**

Ans. Simple Journal Entry means a Journal Entry in which One Account is Debited and One Account is Credited.

Q.20. **What is Compound Journal Entry ? Give One Example.**

Ans. Compound Journal Entry is the Entry in which **more than One Account is Debited or Credited**.

Electricity Expenses A/c	Dr.	2,500	
Stationery A/c	Dr.	500	
To Cash A/c			3,000

(Being the Expenses on Electricity and Stationery Paid)



**Q.21. What is Trade Discount ? What are the Advantages of allowing Trade Discount ? How is Trade Discount recorded in the Books of Accounts ?**

**Ans.** Trade Discount is generally allowed when the Goods are sold to purchaser for resale to the ultimate consumer or when the Goods are purchased in Large Quantity.

Advantages of Trade Discount are :

- (a) It improves sales because purchaser is encouraged to buy Large Quantity.
- (b) It reduces Purchase Cost of Purchaser and thus, improves Profit Margin.

Trade Discount is recorded in the Purchases Book and Sales Book **But it does not enter in the Ledger Accounts. In the Ledger, only Net Amount of Purchases and Sales are entered.**

**Q.22. What is Cash Discount ? What are the Advantages of allowing Cash Discount ? How is Cash Discount recorded in the Books of Accounts ?**

**Ans.** Cash Discount is the discount allowed to the Debtor for making Prompt (Fast/Early) Payment or for making payment before the Due Date.

Advantages of Cash Discount are :

- (a) Seller gets the due amount within the due date. Thus, his liquidity remains Good.
- (b) Purchaser gets Cash Discount, Thus, it increase the Profit.

Cash Discount Allowed is an Expense and Debited to Cash Discount Allowed Account. It is closed by transferring it to the Profit & Loss Account.

Similarly, Cash Discount Received is an Income and Credited to Cash Discount Received Account which is transferred to Profit & Loss Account.

**Q.23. Distinguish between Cash Discount and Trade Discount.**

**Ans.**

Points of Difference	Cash Discount	Trade Discount
<b>1. Nature</b>	It is allowed on payment being made on or before a certain date.	It is allowed on a certain quantity being purchased.
<b>2. Recording</b>	Cash Discount is recorded separately in the Books of Accounts.	Trade Discount is not separately recorded in the Books of Accounts.
<b>3. Deduction from Invoice</b>	It is not deducted from the Invoice.	The amount of Trade Discount is deducted from the Invoice.
<b>4. Nature of Transaction</b>	It is allowed only on Payment.	It is allowed both on Credit and Cash Transactions.
<b>5. Consideration</b>	The Consideration for Allowance is Payment.	The Consideration for Allowance is Purchases.
<b>6. Relation</b>	It is related to Payment.	It is related to Sales and Purchases of Goods.

**Q.24. Explain the meaning and purpose of Ledger Folio (L.F.) in Journal.**

**Ans.** Ledger Folio means a column in the books of the original entry in which the page numbers on which the various accounts appears in the ledger, are recorded. The purpose of Ledger Folio is to ascertain (find) on which page of ledger accounts have been posted in the ledger.

**Q.25. What is "Narration" ?**

**Ans.** After each entry, a brief explanation of the transactions together with necessary details is given. This explanation is called "Narration".



**Q.26. What is an Opening Entry ?**

Ans. Opening Entry is the Journal Entry through which the Closing Balances of the Previous Year are recorded in the Current Year's Books of Accounts.

## OPENING ENTRY

**Q.1. What is meant by "Opening Entry" ?**

Ans. With the beginning of New Accounting Year, a Business Enterprises has to record the accounts not closed during the last year in the new set of books. This is done with an entry which is known as **Opening Entry**.

Opening Entry is the **First Journal Entry** of the Accounting Year. Opening Entry is Passed on the basis of Balances shown in the Balance Sheet prepared at the end of Last Year. Entry is :

Sundry Assets A/c                      Dr.  
To Sundry Liabilities A/c  
To Capital A/c  
(Being Assets and Liabilities brought forward)

**Q.2. Pass the respective Opening Journal Entries in the following cases :**

(i) On 1<sup>st</sup> April, 2011, the following were Ledger Balances of M/s. Kishmish & Co. :

Cash in Hand	300
Cash at Bank	7,000
Bills Payable	1,000
Ramu (Dr.)	800
Stock	4,000
Kangali (Cr.)	2,000
Mottu (Dr.)	1,500
Punnu (Cr.)	900
Capital	9,700

**Solution :-**

## Journal

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2011	Cash A/c Dr.		300	
April 1	Bank A/c Dr.		7,000	
	Ramu Dr.		800	
	Stock A/c Dr.		4,000	
	Mottu Dr.		1,500	
	To Bills Payable A/c			1,000
	To Kangali			2,000
	To Punnu			900
	To Capital A/c			9,700
	(Being Assets and Liabilities brought forward)			



(ii) On 1<sup>st</sup> January, 2011, the following were Ledger Balances of M/s. Kishmish & Co. :

**Assets :-** Cash - ₹ 15,000; Bank Balance - ₹ 5,000; Stock - ₹ 40,000; Furniture - ₹ 3,600; Debtors - ₹ 24,000 (Chhotu - ₹ 6,000; Mottu - ₹ 8,000 and Pattlu - ₹ 10,000).

**Liabilities :-** Bank Loan - ₹ 10,000; Creditors - ₹ 12,500 (Kaju - ₹ 5,000; Badaam - ₹ 7,500).

Solution :-

**Journal**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2011	Cash A/c	Dr.	15,000	
Jan 1	Bank A/c	Dr.	5,000	
	Stock A/c	Dr.	40,000	
	Furniture A/c	Dr.	3,600	
	Chhotu	Dr.	6,000	
	Mottu	Dr.	8,000	
	Pattlu	Dr.	10,000	
	To Bank Loan A/c			10,000
	To Kaju			5,000
	To Badaam			7,500
	To Capital A/c <b>(Balancing Figure)</b>			<b>65,100</b>
	(Being Assets and Liabilities brought forward)			

(iii) On 1<sup>st</sup> April, 2010, the following Balances appeared in the books of Gopal :

Capital - ₹ 1,80,000; Debtors - ₹ 40,000; Stock - ₹ 5,000; Cash in Hand - ₹ 2,000; Cash at Bank - ₹ 5,000; Furniture - ₹ 4,500; Creditors - ₹ 12,000; Machinery - ₹ 1,30,000.

Solution :-

**Journal**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2010	Debtor A/c	Dr.	40,000	
April 1	Stock A/c	Dr.	5,000	
	Cash A/c	Dr.	2,000	
	Bank A/c	Dr.	5,000	
	Furniture A/c	Dr.	4,500	
	Machinery A/c	Dr.	1,30,000	
	Goodwill A/c <b>(Balancing Figure)</b>	Dr.	<b>5,500</b>	
	To Creditors A/c			12,000
	To Capital A/c			1,80,000
	(Being Recording of Assets, Liabilities and Capital at the beginning of the Accounting Period, the difference debited to Goodwill A/c)			



Q.1. What do the following Journal Entries mean ? Write down their narration in the space provided :

- |       |                           |     |
|-------|---------------------------|-----|
| (i)   | Cash A/c                  | Dr. |
|       | To Sales A/c / Goods A/c  |     |
|       | ( )                       |     |
| (ii)  | Purchases A/c / Goods A/c | Dr. |
|       | To Ram                    |     |
|       | ( )                       |     |
| (iii) | Bank A/c                  | Dr. |
|       | To Cash A/c               |     |
|       | ( )                       |     |
| (iv)  | Cash A/c                  | Dr. |
|       | To Shyam                  |     |
|       | ( )                       |     |

- (i) Sales of Goods for Cash.
- (ii) Purchases of Goods from Ram on Credit.
- (iii) Deposited Cash into Bank.
- (iv) Received Cash from Shyam.

**Q.2. Complete the following Journal Entries :**

- (i) ..... Dr. 921047373  
 To Capital A/c  
 (Businessman Started Business with Cash)

(ii) ..... Dr.  
 To Sales A/c  
 (Goods Sold to Mohan for Cash)

(iii) ..... Dr.  
 To Cash A/c  
 (Commission Paid in Cash)

(iv) Mottu Dr.  
 .....  
 (Goods Sold to Mottu on Credit)

(v) Sohan Dr. 5,000  
 To Cash A/c  
 .....  
 (Sohan's Account Settled, Cash Discount 3%)



Ans.

- (i) Cash A/c  
 (ii) Cash A/c  
 (iii) Commission A/c  
 (iv) Sales A/c  
 (v) Sohan Dr. 5,000  
     To Cash A/c 4,850  
     To Discount Received A/c 150

Q.3. Rectify the following Entries assuming that the narration in each case is correct:

- (i) Building A/c Dr. 5,00,000  
 Brokerage A/c Dr. 10,000  
     To Cash A/c 5,10,000  
 (Purchase of Building and Payment of Brokerage on its Purchase)
- (ii) Drawings A/c Dr. 12,000  
     To Sales A/c 12,000  
 (Goods taken away by the Proprietor for Personal Use)
- (iii) Filing Cabinet A/c Dr. 4,000  
 Electric Fan A/c Dr. 2,500  
     To Cash A/c 6,500  
 (Purchase of Filing Cabinet and an Electric Fan)
- (iv) Cash A/c Dr. 8,730  
     To Sales A/c 8,730  
 (Goods worth ₹ 10,000 sold at 10% Trade Discount and 3% Cash Discount)
- (v) Cash A/c Dr. 40,000  
     To Naresh 40,000  
 (Receipt of 25 paise per rupee from the Estate of Naresh who is declared insolvent)
- (vi) Bank Charges A/c Dr. 150  
     To Cash A/c 150  
 (Charges made by Bank for its services)

Ans.

- (i) Building A/c Dr. 5,10,000  
     To Cash A/c 5,10,000  
 (Purchase of Building and Payment of Brokerage on its Purchase)



(ii)	Drawings A/c	Dr.	12,000	
	To Purchases A/c			12,000
	(Goods taken away by the Proprietor for Personal Use)			
(iii)	Office Equipment A/c	Dr.	4,000	
	Fixtures A/c	Dr.	2,500	
	To Cash A/c			6,500
	(Purchase of Filing Cabinet and an Electric Fan)			
(iv)	Cash A/c	Dr.	8,730	
	Discount Allowed A/c	Dr.	270	
	To Sales A/c			9,000
	(Goods worth ₹ 10,000 sold at 10% Trade Discount and 3% Cash Discount)			
(v)	Cash A/c	Dr.	10,000	
	Bad Debts A/c	Dr.	30,000	
	To Naresh			40,000
	(Receipt of 25 paise per rupee from the Estate of Naresh who is declared insolvent)			
(vi)	Bank Charges A/c	Dr.	150	
	To Bank A/c			150
	(Charges made by Bank for its services)			

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# SPECIAL PURPOSE BOOKS I - CASH BOOK

## CHAPTER - 9

### Outline :

- ☞ Meaning of a Cash Book
- ☞ Kinds of Cash Book
- ☞ Similarities of Cash Book with Journal
- ☞ Similarities of Cash Book with Ledger
- ☞ Petty Cash Book
- ☞ Crossing of a Cheque

Q.1. **Why is Journal Book Sub-Divided ?**

Ans. The Journal Book is Sub-Divided because the transactions are numerous (more) and thus, it is difficult to record all of them in one book, i.e., Journal Book.

Therefore, Specialised Subsidiary Books are maintained to record particular class of transactions.

For Example, Cash Book is maintained to record Cash Transactions.

Q.2. **Name the Books of Original Entry as Sub-Divided Journal.**

Ans. Cash Book, Purchases Book, Sales Book, Purchases Return Book, Sales Return Book, Bills Receivable Books, Bills Payable Book and Journal Proper.

Q.3. **What do you understand by Cash Book ?**

Ans. Cash Book is a Subsidiary Book in which **all Cash Transactions, Receipts and Payments are recorded.**

**But the Cash Book by itself is the Cash Account and Bank Account.** It is both Subsidiary Book (Book of Original Entry) and a Principal Book. When a Cash Book is maintained, transactions are not recorded in Journal. As all transactions are recorded for the first time in the Cash Book, it is therefore a **Book of Original Entry**. But when Cash Book is prepared, Cash Account in the ledger is not prepared. In this way, Cash Book represents the Cash Account and hence, becomes the **Principal Book of Accounts**. As such, the Cash Book is a Subsidiary Book as well as Principal Book.

Q.4. **Why Cash Book is called a Book of Original Entry ?**

Ans. Since all cash transactions are recorded for the first time in the Cash Book, it is therefore called a book of original entry.

When a Cash Book is maintained, transactions of Cash and Bank are not recorded in Journal.

Q.5. **Is Cash Book a Journal or Ledger or Is Cash Book a Journalised Ledger or How does a Cash Book serve 'Dual Purpose' ?**

Ans. It is Journal as well as Ledger.

It is a **Journal** since Cash and Bank transactions are first recorded in it and



It is a **Ledger** since it serves the purpose of a Cash Account also. When a Cash Book is prepared, no Separate Cash Account is opened in the ledger.

Q.6. **What kind of transactions are recorded in Cash Book ?**

Ans. Cash and Bank Transactions are recorded.

Q.7. **Name the Types of Cash Book.**

Ans. Simple or Single Column Cash Book and Two Column Cash Book.

Q.8. **What do you understand by Simple Cash Book.**

Ans. Simple Cash Book is a Cash Book with one column on each side to record only **Cash Transactions**.

Q.9. **What do you understand by Two-Column Cash Book.**

Ans. Two-Column Cash Book is a Cash Book which has two columns on each side, one column each to record **Cash Transactions and Bank Transactions**.

Q.10. **Cash Column of Cash Book will always have a Debit Balance. Why ?**

Ans. It is because Cash Payments cannot be more than the Cash in Hand.

or

Q.10. **Cash Book cannot have a negative balance, i.e., payment cannot be more than Cash Balance in Hand. Why ?**

Ans. Yes, Cash Book can never have a negative balance. It is so because if the firm does not have cash it cannot make the payment.

Q.11. **Bank Column of Cash Book can either have Debit Balance or Credit Balance Why ?**

Ans. Bank Column in the Cash Book represents Bank Account. Bank Account will have a Credit Balance if it is overdrawn and will otherwise have a Debit Balance.

Q.12. **What do you understand by Bank Overdraft [Unfavourable Bank Balance or Bank(Cr.)] ?**

Ans. Bank Overdraft is the withdrawing out from a Bank Account of more than what has been deposited in it.

Q.13. **When Cash Account is a Real Account then why is Bank Account a Personal Account ?**

Ans. This is because Bank Account is maintained with an organisation.

Q.14. **Which Balance of the Bank Column in the Cash Book signifies Bank Overdraft ?**

Ans. Credit Balance.

Q.15. **To which side Transactions of Receipts posted in Cash Book ?**

Ans. Debit Side.

Q.16. **To which side of Ledger Accounts are the Transactions in the Receipts Side of the Cash Book posted ?**

Ans. Credit Side.

Q.17. **To which side Transactions of Payments posted in Cash Book ?**

Ans. Credit Side.

Q.18. **To which side of Ledger Accounts are the Transactions in the Payments Side of the Cash Book posted ?**

Ans. Debit Side.



Q.19. **What is Contra Entry ?**

Ans. Contra Entry means withdrawal of Cash from Bank for Office Use or Cash Deposited in the Bank. As both the Accounts are in the Cash Book it is signified by writing 'C' in the column of Ledger Folio.

Q.20. **Give one Advantage of maintaining a Cash Book.**

Ans. It is Journal as well as a Ledger. When a Cash Book is maintained, there is no need of opening a Separate Cash Account in the Ledger.

It gives information about daily receipts, payments and the closing cash and bank balance at the end of each day.

Q.21. **Write one difference between Cash Account and Cash Book.**

Ans. Cash Account is an account in the ledger whereas Cash Book is a separate book.

Q.22. **Briefly Explain the "Petty Cash Book" ?**

Ans. Petty Cash Book is maintained for recording Petty (Small) Payments or Expenses in cash.

Q.23. **Name Two Types of Petty Cash Book.**

Ans. Simple Petty Cash Book and Analytical Petty Cash Book.

Q.24. **What do you understand by Analytical Petty Cash Book ?**

Ans. Analytical Petty Cash Book has two sides, left side is used to record receipts or cash and the right side is used for recording payments. The payments side has columns for recording each type of expense.

Q.25. **What are the Advantages of Petty Cash Book.**

Ans. The Advantages of maintaining Cash Book are :

(a) **Time Saving** :- Saves the Chief Cashier's time.

(b) **Labour Saving** :- Saving of Labour in writing up the Cash Book and posting into Ledger.

(c) **Control** :- It provides control over small payments.

Q.26. **What do you understand by Imprest System of Petty Cash ?**

Ans. Under this system, certain amount is given to Petty Cashier for a particular period (say for a week, fortnight or month) to meet various petty expenses for the period.

At the end of the period, the amount actually spent by the Petty Cashier is reimbursed (repay) to him by the Head Cashier.

Q.27. **What are the Advantages of Imprest System of Petty Cash.**

Ans. The Advantages of Imprest System of Petty Cash are :

(a) It provides control over Mistakes by regular checking by the Cashier.

(b) It provides control over Petty Expense since the Petty Cashier can not spend more than the available petty cash.

(c) It provides control over Fraud since the Petty Cashier is not allowed to draw cash as and when he desires.

Q.28. **What are the Advantages of Subsidiary Books.**

Ans. The use of Subsidiary Books has the following Advantages :

(a) It facilitates Division of Work.

(b) It Leads to Specialisation and Efficiency.

(c) Saving of Time.



- (d) Availability of Information relating to each class at one place.
- (e) Facility in Checking.
- (f) Responsibility can be easily fixed.

Q.29. **State one Difference between Purchase Book and Purchase Account.**

Ans. Purchase Book is a part of Journal, whereas Purchase Account is the part of Ledger.

Q.30. **Which form is filled for depositing Cash or Cheque in the Bank.**

Ans. Pay-in-Slip.

Q.31. **What is a "Bearer Cheque" ?**

Ans. Payment of such a cheque is made on the counter of the Bank either to the person whose name has been written on the cheque or to the bearer of the cheque.

Q.32. **What is a "Order Cheque" ?**

Ans. In case the word 'bearer' is struck off, the cheque becomes an order cheque. In such a case Bank will make the payment to the person whose name is written on the cheque.

Q.33. **What is meant by "Crossing a Cheque" ?**

Ans. Cheques are usually crossed. A cheque is said to be crossed when two parallel lines are drawn across the cheque. Bank cannot make payment of a crossed cheque direct to the person on the counter of the bank.

**Its payment can be taken only by depositing it in a Bank Account.**

Q.34. **Name the book which is considered both Journal and Ledger.**

Ans. Cash Book.

Q.35. **Where will you record "Rent Unpaid" or "Goods/Assets Purchased on Credit" in the Cash Book ?**

Ans. No Entry.

Q.36. **Is the balance of Petty Cash Book an Asset or Income ?**

Ans. Asset.

Q.37. **What are the Similarities of Cash Book with Journal.**

Ans. (a) Just like a Journal, transactions in the Cash Book are recorded for the first time from source documents.

(b) Just like a Journal, transactions in the Cash Book are recorded date wise, i.e., in a chronological order, as and when they take place.

(c) Just like a Journal, transactions from Cash Book are posted to the relevant accounts (except Cash Account) in the ledger.

(d) Just like a Journal, a Cash Book also contains a Ledger Folio Column.

Q.38. **What are the Similarities of Cash Book with Ledger.**

Ans. (a) Form of Cash Book closely resembles (प्रतीत होना) to a ledger account. It has two equally divided sides having identical columns.

(b) Cash Book itself serves as a Cash Account also and as such when a Cash Book is maintained, Cash Account is not opened in the Ledger. The Cash Book, hence, is a part of Ledger also.

(c) Just like a ledger account, the words 'To' and 'By' are used in a Cash Book also.

(d) It is balanced just like a ledger account.



# SPECIAL PURPOSE BOOKS II - OTHER BOOKS

## CHAPTER - 10

### Outline :

- ☞ Purchases Book
- ☞ Sales Book
- ☞ Purchases Return Book
- ☞ Sales Return Book

## SPECIAL PURPOSE BOOKS (SUBSIDIARY BOOKS)

These books may be of following types :-

- (1) Purchases Book or Purchases Journal or Bought Book or Invoice Book;
- (2) Sales Book or Sales Journal or Day Book;
- (3) Purchases Return Book or Returns Outward Book or Purchases Return Journal;
- (4) Sales Return Book or Returns Inward Book or Sales Return Journal;
- (5) Cash Book or Cash Journal;
- (6) Bills Receivable Book;
- (7) Bills Payable Book;
- (8) Journal Proper or General Journal.

Dr.  
Cr.  
Cr.  
Dr.  
Dr.  
Dr.  
Cr.

### Purchases Book or Purchases Journal or Bought Book or Invoice Book

All **Credit Purchases of Goods** are recorded in the Purchases Book.

**Following transactions are not recorded in the Purchases Book.**

- (a) Cash Purchases.
- (b) Purchase of Asset or Purchases of those items in which trader does not deal. (cash or credit)  
e.g. If trader deals in stationery items then only credit purchases (not cash purchases) of stationery items will be recorded in Purchases Book and if he purchases furniture on cash/credit then it will not be recorded in Purchases Book.
- (c) Transactions related to other books; e.g. Sales, Purchase Return, Cash Book etc.

### Sales Book or Sales Journal or Day Book

All **Credit Sales of Goods** are recorded in the Sales Book.

**Following transactions are not recorded in the Sales Book.**

- (a) Cash Sales.
- (b) Sales of Asset or Sales of those items in which trader does not deal. (cash or credit)



e.g. If trader deals in garments items then only credit sales (not cash sales) of garments items will be recorded in Sales Book and if he sells old news paper/cement/stationery/furniture etc. on cash/credit then it will not be recorded in Sales Book.

(c) Transactions related to other books; e.g. Purchases, Purchases Return, Sales Return etc.

### Purchases Return Book or Returns Outward Book or Purchases Return Journal

This book is used to record the **Return of such Goods as were Purchased on Credit Basis**. Assets or other items in which trader does not deal, which were purchased on credit basis, their returns will not be recorded in Purchases Return Book, it will be recorded in Journal Proper.

### Sales Return Book or Returns Inward Book or Sales Return Journal

This book is used to record the **Return of such Goods as were Sold to the customers on Credit Basis**. Assets or other items in which trader does not deal, which were sold on credit basis, their returns will not be recorded in Sales Return Book, it will be recorded in Journal Proper.

### Cash Book or Cash Journal

All **Cash** transactions involving payments and receipts are recorded in this book. Payments and receipts through **cheques** are also recorded in this book.

e.g. Purchases (Sales) of Asset (Goods/Items in which trader does not deal) in cash or by cheque; Expenses paid or Income received in cash or by cheque; Paid to Mohan or Received from Shyam in cash or by cheque; Bad Debts Recovered etc.

### Bills Receivable Book

Bills transactions involving **Bills Receivables received from Debtors** are recorded in this book. Bill drawn by us or Bill accepted by Debtors (Customers).

### Bills Payable Book

**Bills Payable accepted from various Creditors** are recorded in this book. Bill drawn by Creditors (Suppliers) or Bill accepted by us.

### Journal Proper or General Journal

Any transactions which **cannot be recorded in any of the above mentioned book**, will be recorded in Journal Proper. Transactions like bad debts, depreciation, salaries payable etc. cannot be recorded in any of the above seven books. They will be recorded in this Journal in the same way as discussed in Chapter "Journal Entries".

**Generally it is meant for recording the following entries :-**

- (a) Opening Entries.
- (b) Closing Entries like Salary A/c is closed by transferring its balance to Profit & Loss A/c.



- (c) Transfer Entries like transfer of Gross Profit to Profit & Loss A/c; Net Profit is ₹ 36,000, out of which 10% is to be transferred to reserve.
- (d) Rectification Entries.
- (e) Adjusting Entries like bad debts, depreciation, prepaid, prereduced, outstanding, accrued and necessary provisions etc.
- (f) Other Items :
  - (i) Purchase or Sale of an Asset or other items on Credit.
  - (ii) Returns of Assets on credit
  - (iii) Endorsement, dishonour and Cancellation of Bills of Exchange (not discounted with Bank, honoured/payment/meeting of the bill).
  - (iv) Capital brought in kind.
  - (v) Goods taken by the proprietor for personal use.
  - (vi) Goods given away as Charity or Free Samples.
  - (vii) Abnormal Loss of Stock or Other Assets by Fire, Accident, theft etc.
  - (viii) Discount Allowed and Discount Received.
  - (ix) Credit Sale of Worn-Out or Obsolete Assets.
  - (x) Provide Interest on Liabilities and Charge Interest on Assets.

**Q.1. Name the Books of Original Entry where the following transactions will be recorded with reasons thereof :**

- (a) Goods purchased from Ram for ₹ 5,000 on Credit.
- (b) Provision for Doubtful Debts created @ 5% on Debtors with Book Value of ₹ 10,000.
- (c) Defective Goods sold to Charan on Credit worth ₹ 4,000 were returned by him.
- (d) Purchased Furniture on Credit from Sanjay for ₹ 15,000 for use in the business (shop).
- (e) Sales of Goods on Credit.
- (f) Goods returned by Debtors (Customers).
- (g) Purchases of Stock (Goods) on Credit.
- (h) Providing for Interest on Capital to Proprietor.
- (i) Goods Returned to Creditors (Suppliers).
- (j) Bad Debt Written Off.
- (k) Bill Accepted by Proprietor from Creditors.
- (l) Provide Depreciation on Furniture.
- (m) Bill Drawn by Proprietor.
- (n) Bad Debt Recovered from Ram.
- (o) Asset sold in Cash.
- (p) Payment made to Creditors.
- (q) A Debit Note of ₹ 500 issued by us to Supplier for Goods returned by us is to be accounted for in
- (r) A Credit Note of ₹ 500 issued by us to Customer for Goods returned by Customer is to be accounted for in

**Ans.** {(a) Purchases Book; (b) Journal Proper; (c) Sales Return Book; (d) Journal Proper; (e) Sales Book; (f) Sales Return Book; (g) Purchases Book; (h) Journal Proper; (i) Purchases Return Book; (j) Journal Proper; (k) Bills Payable Book; (l) Journal Proper; (m) Bills Receivable Book; (n) Cash Book; (o) Cash Book; (p) Cash Book; (q) Purchases Return Book; (r) Sales Return Book}