Unit 3: Accounting Process 8 LHs

- Accounting events of business: concept and types
- Accounting equation for analyzing the transactions
- Debit and credit and their rules
- Recording process of accounting events: journal, ledger, and trial balance.
- Opening and closing entries: concept and types of closing entries
- Adjusting entries: concept and types of adjusting entries
- Prepaid and outstanding items
- Adjusted trial balance.

Accounting Process

- Accounting events of business: concept and types

An accounting event is a transaction that is recognized in the financial statement of an accounting entity. An accounting event is any business event that impacts the account balances of a company's financial statements. The recording of these events must follow the accounting equation, which specifies that assets must equal liabilities plus shareholder equity.

Types of Accounting Events

1.External Events

An external accounting event is when a company engages in a transaction with an outside party or there is a change in the company's finances due to an external cause. For example, if a company purchases from a supplier the raw materials needed for the manufacturing of its goods, this would be categorized as an external event. When a company receives payment from a customer, this would also be an external event that it would need to record in its financial statements.

2. Internal Events

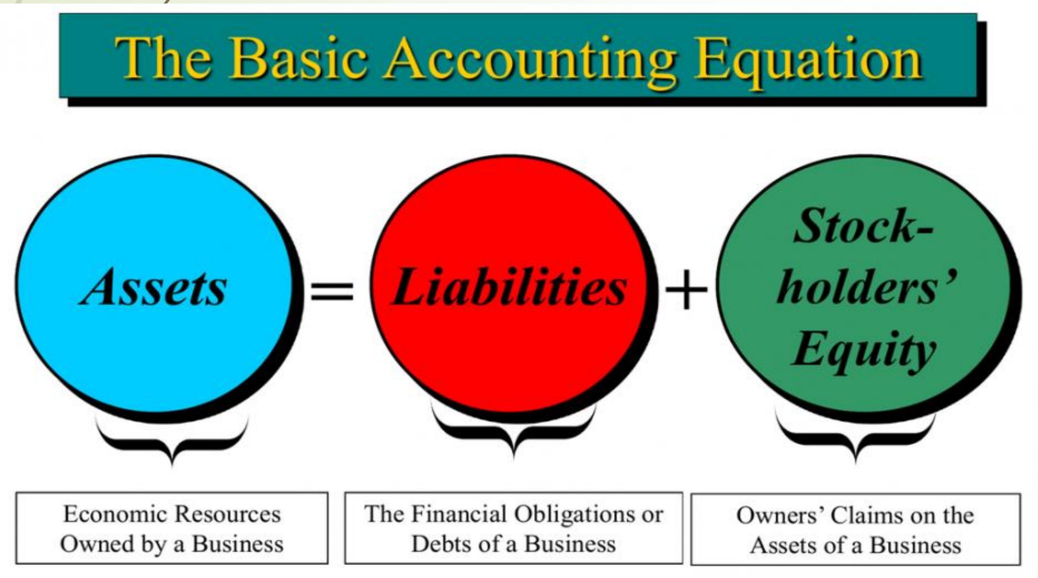
An internal event involves other changes that need to be reflected in the accounting entity's records that affect its financial position. These may include the "purchase" of goods such as supplies from one department by another department within the company. The recording of depreciation expenses is another type of internal accounting event.

❖ ACCOUNTING EQUATION

➢ Concept of Accounting Equation:

The relationship of different assets, capital and liabilities of a business expressed mathematically in equation form is called the accounting equation. The accounting equation shows that the total of assets always equal to the total of capital and liabilities. The economic resources refer to the total assets, the total of capital refers to the amount of money brought into the business by the proprietor and the amount of profit earned or loss incurred during a given period of time. Similarly, the liabilities refer to the total amount payable by a business. It can be expressed as under:

Assets = Capital or shareholder equity+ Liabilities.



Assets=Liabilities +Shareholder equity(Capital)

Common stock + Retained Earning

Revenue - Expenses & losses - Dividend
+ Gain / profit

Principles of Accounting Equation

Accounting equation is totally based on the dual aspect concept of accounting. Following table shows the effects of changes in the different components of accounting equation:

Condition	Possible effects
• If a component of asset increases.	• Capital increases. • Liabilities increases. • Other component of asset decreases.
• If a component of asset decreases.	• Capital decreases. • Liabilities decreases. • Other component of asset increases.
• If a component of liability increases.	• Assets increases. • Capital decreases. • Other component of liabilities decreases.
• If a component of liability decreases.	• Assets decreases. • Capital increases. • Other component of liability increases.
• If capital increases.	• Assets increases.
• If capital decreases.	• Assets decreases.
• If there is revenues, income /gains.	• Assets increases. • Capital increases.
• If there is an expenses and losses.	• Assets decreases. • Capital decreases.

Effects of Transactions on Accounting Equation

Every financial transaction of a business organization would have certain effect on the various components of accounting equation. The following table will help to understand the effect of changes on the various components of accounting equation:

S.No.	Transactions	Assets	=	Capital	+	Liabilities
1.	When the business is started with cash or anything else.	+		+		0
2.	When the goods/ assets are purchased and the payment made either in cash or by issuing cheque.	+ −		0		0
3.	When the goods/assets are purchased on credit.	+		0		+
4.	When the goods/assets are purchased and the payment made partially.	+ −		0		+
5.	When the goods/assets are sold and the payment received either in cash or through bank.	+ −		0		0
6.	When the goods/assets are sold on credit.	+ −		0		0
7.	When the goods/assets are sold and the payment received partially.	+ −		0		0
8.	When the loan is taken by the business.	+		0		+
9.	When the loan is repaid.	−		0		−
10.	When there are expenses/losses.	−		−		0
11.	When there is a gain/income.	+		+		0
12.	When there are some prepaid expenses.	+ −		0		0
13.	When there are some outstanding expenses.	0		−		+
14.	When the i.e. is some income receivable /accrued income.	+		+		0
15.	When there is some advance income received.	+		0		+
16.	When there is some drawing from business for private use.	−		−		0
17.	When the amount is withdrawn from bank for office use.	+ −		0		0
18.	When there is interest on capital /drawing.	0		+ −		0

Preparation of Statement of Accounting Equation

To show the effect of different financial transactions on accounting equation, the following type of specimen is frequently used in practice:

Statement of accounting equation (Non expanded form)

Date	Assets	=	Shareholder Equity	+	Liabilities
Final balance	*****	=	*****	+	*****

Illustration 1:

Consider the following information:

a) Started business with cash Rs. 1,00,000.
b) Purchased machinery of Rs 20,000 and made partial payment Rs. 8,000.
c) Cash deposited in to bank Rs. 15,000.
d) Purchase goods for cash Rs. 20,000 and credit Rs 10,000.

Required: Accounting equation.

Solution:

Accounting equation

Date .	**Assets**	**=**	**Capital**	**+**	**Liabilities**
a)	1,00,000	=	1,00,000	+	0
balance	1,00,000	=	1,00,000	+	0
b)	20,000				
	(8,000)	=	0	+	12,000
balance	112,000	=	1,00,000	+	12,000
c)	(15,000)				
	15,000	=	0	+	0
balance	1,12,000	=	1,00,000	+	12,000
d)	30,000				
	(20,000)	=	0	+	10,000
Final balance	**1,22,000**	**=**	**1,00,000**	**+**	**22,000**

Illustration 2:

Prepare accounting equation from the following transactions:

a. Gaurav invested cash of Rs. 1,00,000 in the business.
b. Purchased goods from Shyam and paid by cash Rs 40,000.
c. Cash of Rs. 30,000 were received providing services.
d. Purchase goods from Dipendra on credit Rs 10,000.
e. Sold goods to Nisha on credit Rs 15,000.
f. Sold goods for Rs 20,000 by making profit of Rs 5,000.
g. Sold goods (cost price 10,000) Rs 8,000
h. Cash received from Nisha Rs 10,000.
i. Paid to Dipendra Rs 10,000
j. Cash deposited into Bank Rs 15,000.

Solution:

Accounting equation

Date.	Assets	=	shareholders equity)	+	Liabilities
a	100,000 (Cash)	=	100,000		0
balance b	100,000 40,000 (goods) (40,000) (Cash)	=	100,000 0		0 0
balance c	100,000 30,000 (Cash)	=	100,000 30,000 (Income)		0 0
balance d	1,30,000 10,000 (Goods)	=	1,30,000 0		0 10,000 (A/P)
balance e	1,40,000 15,000 (A/R) (15,000) (Goods)	=	1,30,000 0		10,000 0
balance f.	1,40,000 20,000 (Cash) (15,000) (goods)	=	1,30,000 5,000 (profit)		10,000 0
balance g.	1,45,000 8,000 (cash) (10,000) (goods)	=	1,35,000 (2,000) (Loss)		10,000 0
balance h.	1,43,000 10,000 (cash) (10,000) (A/R)	=	1,33,000 0		10,000 0
balance i.	1,43,000 (10,000) (cash)	=	1,33,000 0		10,000 (10,000) (A/P)
balance j.	1,33,000 15,000 (Bank) (15,000) (Cash)	=	1,33,000 0		0 0
final balance	**1,33,000**	**=**	**1,33,000**		**0**

Illustration 3:

Global College of Applies Business opened a software design service on January 20, 2007. During January the following transaction occurred:

Jan 20: Rs. 50,000 was invested as a capital

Jan 21: Purchased office supplies on credit, Rs. 8,000

Jan 21: Purchased office equipment on credit, Rs. 18,000

Jan 22: Invested office equipment, valued of Rs. 20,000 in the firm.

Jan 23: Paid rent of Rs. 1,000 for the month and Rs. 4,000 for the next month.

Jan 24: Received cash for service performed Rs 21000.

Jan 26:paid half of the liability of equipment purchase in jan.21.

Jan 27: Paid full amount for office supplies that were purchased in January 21.

Required: Record each of these transactions in an expanded balance sheet equation .

Solution:

Accounting Equation (Expanded Form) tabular

SN	Assets				=	Liabilities	+	Stockholders' Equity	
	Cash	**Supplies**	**Equipment**	**Prepaid expenses**		**Account payable**		**Common stock**	**Retained earnings**
Jan.20	50,000							50,000	
Balance 21	50,000	 8,000				 8,000		50,000	
Balance 21	50,000	8,000	 18,000			8,000 18,000		50,000	
Balance 22	50,000	8,000	18,000 20,000			26,000		50,000 20,000	
Balance 23	50,000 (1,000) (4,000)	8,000	38,000	 4,000		26,000		70,000	 (1,000)
Balance 24	45,000 21,000	8,000	38,000	4,000		26,000		70,000	(1000) 21,000
Balance 26	66,000 (9,000)	8,000	38,000	4,000		26,000 (9,000)		70,000	20,000
Balance 27	57,000 (8000)	8,000	38,000	4,000		17,000 (8,000)		70,000	20,000
Total	**49,000**	**8000**	**38,000**	**4,000**	=	**9,000**	+	**70,000**	**20,000**
Assets = 99,000						**Liability +equity = 99,000**			

- **Types of Accounts, Rules for Debit and Credit**

Types of Accounts

The accounts are classified on the basis of two approaches.

1.Traditional approach:

Under this approach, an account is classified into three types or categories according to their nature. They are **personal account, real account and nominal account.**

a. Personal Accounts: The accounts which are the transactions relating to natural persons, artificial persons or legal persons and person's representation are called 'personal accounts. For example: Ramesh a/c, Sita a/c, Rabin a/c etc. The accounts which are relating to companies, partnership firms, institutions, clubs etc. are called artificial person's personal account. For e.g. ABC Company's a/c, Everest Florida College a/c etc. Similarly, the accounts which record transaction relating to advance and outstanding income and expenditure are representative personal account. For example: Outstanding wages, prepaid rent, accrued income, advance income etc.

b. Real Accounts: The accounts which are related to property are called real accounts. These things which can be seen, touched, purchased and sold are known as tangible things. Cash a/c, Machinery a/c, Land and building a/c, Furniture a/c etc. are examples of tangible real accounts. In other words, these things which can not be seen and touched but can be measured in terms of monetary value are known as intangible real accounts. Goodwill a/c, Trademark a/c, Patent a/c and Copyright a/c etc. are the examples of intangible real accounts.

c. Nominal Accounts: The accounts which are related to expenses, losses, incomes and gains are called nominal accounts. Salary a/c, Rent a/c, wages a/c, interest a/c, and commission a/c are examples of nominal account. Nominal accounts are also known revenue and expenditure account and fictitious account.

2. Accounting Equation base Approach:

Under this approach, all financial transaction of the business are grouped into five categories of accounts and analyzed on the principles of accounting equation. These five categories of account are as follows:

(a) Assets Account i.e. plant a/c, cash a/c, goodwill a/c etc.
(b) Liabilities Account i.e. creditors a/c, bank loan a/c etc.
(c) Stockholders' equity Account/Common Stock Account i.e. capital a/c
(d) Incomes and Gains Account i.e. sales a/c, interest received a/c
(e) Expenses and Losses Account i.e. salaries a/c, rent a/c

While recording of financial transaction of the business, we have to identify whether the transactions are related to assets, liabilities, capital, expenses or loss and incomes and gains.

➢ Rules for Debit and Credit

The debiting and crediting of the accounts are done on the basis of certain approaches. There are two approaches can be used as the rules of debit and credit.

1. *On the basis of types of accounts i.e. traditional approach:*

a. Personal Account:

The company and person receiving benefit from business is receiver 'debit' and the person or company giving benefit to business is giver 'credit'.

Debit ⟶ The receiver

Credit ⟶ The giver

Some examples for debiting and crediting of the personal accounts are as follows:

Transactions	Personal a/c	Reason	Debit	Credit
(a) Ram started business with cash	Ram's capital A/C or capital A/C	Ram is the giver	–	Ram's capital A/C or Capital A/C
(b) Goods purchase from XYZ company	XYZ Company A/C	XYZ Company is giver	_	XYZ Company
(c) Goods sold to Ram	Ram's A/C	Ram is receiver	Ram's A/C	_
(d) Goods returned to XYZ Company	XYZ Company A/C	XYZ Company is receiver	XYZ Company	_
(e) Loan given to Hari	Hari's A/C	Hari is receiver	Hari A/C	_

b. Real Accounts: According to nature of transactions, if assets (things) come into business then the account of such assets or things should be debited and if the assets(things) go out from business, such assets or things account should be credited.

Debit $\longrightarrow$ **What comes in**

Credit $\longrightarrow$ **What goes out**

Some examples of debiting and crediting of the real accounts are as follows:

Transactions	Related to Real a/c	what comes in What goes out	Debit	Credit
(a) Ram started business with cash	Cash A/C	Cash comes in	Cash A/C	–
(b) Machinery purchased on cash	Machinery a/c Cash A/C	Machinery comes in Cash goes out	Machinery A/C	Cash A/C
(c) Goods purchase from Ram	Goods A/C	Goods comes in	Goods A/C	
(d) Loan taken from Bank	Cash A/C	Cash comes in	Cash A/C	
(e) Loan repayment to XYZ	Cash A/C	Cash goes out		Cash A/C

c. Nominal Accounts: According to nature of transaction, all expenses or losses are debited and all incomes and gains are credited.

Debit ⟶ All expenses and losses

Credit ⟶ All incomes and gains

Some examples for debiting and crediting of the Nominal accounts are as follows:

Transactions	Related to Nominal a/c	Reason	Debit	Credit
(a) Salary paid to staff	salary A/C	Expenses	salary A/C	–
(b) Sales of goods	Sales A/c	Income	-	Sales A /C

2.On the Basis of Accounting Equation (Change in Assets, Liabilities and Capital Transaction)Approach:

- ❖ If assets increases, the *increase is debited* and if assets decreases, the decrease is credited.
- ❖ If common stock(capital) and liabilities increases, the increase is credited and if common stock(capital) and liabilities decreases, the decrease is debited.
- ❖ If the incomes and gains increase, the increase is credited and if the incomes and gains decrease, the decrease is debited.
- ❖ If expenses and losses increase, the increase is debited and if expenses and losses decrease, the decrease should be credited.

Particular	Increase/Decrease	Debit/Credit
(a) Assets	Increase	Debit
	Decrease	Credit
(b) Liabilities	Increase	Credit
	Decrease	Debit
(c) Capital	Increase	Credit
	Decrease	Debit
(d) Income and gains	Increase	Credit
	Decrease	Debit
(e) Expenses and losses	Increase	Debit
	Decrease	Credit

Some examples of debit and credit on the basis of change in assets, liabilities and capital are as follows:

Transaction	Increase or Decrease	Debit a/c	Credit a/c
(a) Business started with cash	Increase in cash	Cash a/c	–
	Increase in capital	–	Capital a/c
(b) Furniture purchase on cash	Increase in furniture	Furniture a/c	
	Decrease in cash		Cash a/c
(c) Loan taken from Arjun	Increase in cash(assets)	Cash a/c	
	Increase in loan(liability)		Loan a/c
(d) Interest received on investment	Increase in cash	Cash a/c	
	Increase in income		Interest a/c
(e) Salary paid to staff	Increase in expenses	Salary a/c	
	Decrease in cash		Cash a/c

➢ Meaning of Journal:

The book in which all the financial transaction of a business are recorded for the first time in chronological order is known as journal or book of original entry. In journal, all the financial transaction of a business are recorded with their dates, amounts and brief explanations. Brief explanation is called narration. All transaction are recorded with two sided (dual) aspects one is debit and another is credit with equal amounts. The act of recording of transactions into journal is called journalizing and the record of the transactions is called journal entry.

"Journal is originally used, as a book of prime entry in which transactions are copied in order of date from memorandum or waste book. The entries as they are copied are classified into debits and credits, so as to facilitate them being correctly posted, afterwards in the ledger." ☞ **Professor Carter**

➢ OBJECTIVES OF JOURNAL

- To keep a systematic and date wise records of all business transactions
- To show financial transactions in chronological order
- To provide the necessary information about all financial transactions
- To help to prepare the various ledger
- To use as legal evidence of all financial transactions

➢ Preparation of Journal

Following format is used to journalize the monetary transactions.

Format of Journal

Journal entry in the books of ……………

Date (1)	**Account Titles and Explanation (2)**	**PR (3)**	**Debit (Rs) (4)**	**Credit (Rs) (5)**
	Name of the account to be debited ………………..……. Dr. To Name of the account to be credited (For…………………………………………………..)		xxx	 xxx
	Total		xxx	xxx

➢ Posting Reference(PR) number

Journal entries:

The Journal entries may be divided in to the following two categories:

A.Simple Journal Entries

There are two or more than two accounts involved in every business transaction. But that business transaction which has only two accounts is called simple transaction and recording of such simple transaction in journal is known as simple journal entries. Some journal and explanation of simple business transaction are given below:

Transaction 1: On March 1st Bishal started of business with cash Rs 50,000.

Journal entry

Date	Particular	PR	Debit (Rs)	Credit (Rs)
March 1	Cash a/c Dr. To Capital/common stocks a/c (for business started with cash)		50,000	50,000

- ✓ As per the rules of debit and credit, The increase of assets (cash a/c)will be debited and increase of stockholders' equity (capital a/c)will be credited.

Transaction 2: On March 6th purchase of machinery on credited Rs. 1,00,000.

Journal entry

Date	Particular	PR	Debit (Rs)	Credit (Rs)
March 6	Machinery a/c Dr. To Accounts payable (Creditors) a/c (for machinery purchase on credit.)		1,00,000	1,00,000

- ✓ The increase of assets (machinery)will be debited and increase of liability (account payable)will be credited.

Transaction 3: On March 7th purchased goods on cash of Rs. 30,000

Journal entry

Date	Particular	PR	Debit (Rs)	Credit (Rs)
March 7	Purchase(goods/stock) a/c Dr. To cash a/c (for good purchased on cash)		30,000	 30,000

- ✓ The increase of expenses /assets (Purchase/stock a/c)will be debited and decreased of assets (Cash a/c)will be credited.

Transaction 4: On March 10th paid for salary to the staff of Rs. 20,000.

Journal entry

Date	Particular	PR	Debit (Rs)	Credit (Rs)
March 7	Salary a/c Dr. To cash a/c (for Salary paid to staff)		20,000	 20,000

- ✓ The increase of expenses (Salary a/c)will be debited and decreased of assets (Cash a/c)will be credited.

Transaction 5: On march 15 Goods sold to Hari on account for Rs. 20,000.

Journal entry

Date	Particular	PR	Debit (Rs)	Credit (Rs)
March 7	Account receivable/Debtors a/c Dr. To Sales a/c (for goods sold on credit)		20,000	 20,000

- ✓ The increase of assets (Account receivable a/c)will be debited and Increase of income (Sales a/c)will be credited.

etc….

B. Compound Journal Entry

The transaction which has two or more than two accounts involved then it is called compound entry. In other words, two or more than two accounts are involved with same date and time that is called compound entry. Some journal and their are given below:

Transaction 1: On July 1st Started business with cash of Rs. 50,000 , bank balance Rs. 1,00,000 and computer Rs. 60,000.

Date	Particulars	PR	Debit (Rs)	Credit (Rs)
July 1	Cash a/c Dr.		50,000	
	Bank a/c Dr.		100,000	
	Computer a/c Dr.		60,000	
	To capital a/c			2,10,000
	(For business started with cash, bank balance and computer.)			

Explanation:
When business is started with cash and other assets, the head of cash and other assets account will be debited as it increases assets and capital account will be credited as it increases capital' .

Transaction 2: On July 5th Goods purchased Rs. 20,000 and paid Rs. 12,000 partially.

Journal entry

Date	Particulars	PR	Debit (Rs)	Credit (Rs)
July 5	Purchase a/c Dr.		20,000	
	To Cash a/c			12,000
	To Accounts payable a/c			8,000
	(for Goods purchase and made payment partially)			

Explanation:
The increase of expenses Purchase a/c will be debited ,decreased of assets Cash a/c and increase in liability Account payable a/c will be credited.

Transaction 3: On July 7th Goods sold Rs. 15,000 on cash and Rs. 20,000 on credit.

Journal entry

Date	Particulars	PR	Debit (Rs)	Credit (Rs)
July 7	Cash a/c Dr. Account Receivable a/c Dr. To Sales a/c (For Goods sold on partial cash and credit)		15,000 20,000	 35,000

Explanation:
The increase of Assets, cash and account receivable a/c will be debited And increase in income so sales a/c will be credited.

Transaction 4: On July 10th payment to account payable (creditor)Rs.7500 and received discount Rs.500 .

Journal entry

Date	Particulars	PR	Debit (Rs)	Credit (Rs)
July 7	Account payable a/c Dr. To Cash a/c To Discount Received a/c (For payment to creditors and received discount)		8000	 7500 500

Explanation:
The Decrease of liability, So Account payable a/c will be debited And Decreased in Assets and increase in income so Cash a/c & Discount received a/c will be credited.
etc……

➢ Meaning of Ledger :

We have already discussed that first of all the financial transactions of a business are recorded in the books of original entry i.e. journal. After recording a transaction in journal, the next step is the transfer of transactions in the respective accounts opened in the ledger. It is the classification of financial transaction. All the transaction of like nature are recorded in the same heading and at the end balancing will be done. For example, all the transaction relating to sales are recorded in sales account, all the transaction related to machinery are recorded in machinery account and so on. Recording of financial transactions of like nature in the same heading is called posting.

A ledger is a principle book which contains all the accounts (assets accounts, liabilities account, capital account, incomes and expenses account) to which the all the financial transactions recorded in journal are transferred. It is also called "Book of Final Entry" .

➢ OBJECTIVES OF LEDGER:

1. **To classify the financial transactions:**

   The ledger is prepared to classify the all the financial transactions into different group and sub-group.

2. **To check on arithmetic accuracy:**

   It helps to check arithmetic accuracy by preparing trail balance from the balance of ledgers.

3. **To help ascertaining profit or loss:**

   It provides closing balance of all expenses and incomes which helps to prepare profit and loss account to determine amount of profit or loss.

4. To help reveal the financial position:

Ledgers are also prepared for different types of account such as asset account, liabilities account and capital account which help to know financial position of the business.

➢ PREPARATION OF LEDGER:

The ledger can be prepared by using any one of the following two methods. There are as below:

1. General ledger/Standard formats of ledger:

a. T-shaped ledger

b. Continuous/running balancing ledger

2. Simplified T-Account

1. General ledger/Standard formats of ledger

a. T-shaped Ledger: This is simple and most popular format of ledger account. Its basic form is same as the English alphabet 'T' having two sides, one is left-side and another is right side, which are commonly known as debit side and credit side respectively. Each side of ledger account has same column of date, particulars, journal folio and amount. A format of a 'T' shaped ledger account is as follows:

In the books of . . .

Dr. **Name of ledger (assets a/c)** **Cr.**

Date	Particulars	PR	Amount	Date	Particulars	PR	Amount
….	To……….a/c		xxx xxx	….. ….	By……….a/c By balance c/d		xxx xxx
	To balance b/d		xxx				

Example 1: The following transactions are taken from book of business:

Jan.1 Received contribution of Rs. 40,000 from each of the two owner for commenced the business.

5 Purchased a office equipment for cash Rs. 20,000

11 Cash paid to Rs. 3,000 to the advertising agency for advertisement.

16 Billed the client Rs. 10,000 for service rendered by export.

19 An amount of Rs. 5,000 distributed as dividend to the stock holders.

21 Paid Rs. 20,000 for rent and salaries for the month of Jan.

26 Cash received from client Rs.5,000 and allowed discount Rs. 1,000.

29 Signed a three years promissory note at Siddhartha Bank Ltd. and received cash of Rs. 5,000

31 Purchase office supplies amounting to Rs. 5,000. The company should pay the amount within 25 days of purchase.

Required: (i) Journal entry (ii) Ledger account

Solution

(i) Journal entries in the books ......

Date	Particulars	PR	Debit (Rs)	Credit (Rs)
1-1	Cash a/c Dr.		80,000	
	To Capital a/c			80,000
	(for cash received for commenced the business)			
1-5	Office equipment a/c Dr.		20,000	
	To Cash a/c			20,000
	(for service equipment purchase)			
1-11	Advertisement expenses a/c Dr.		3,000	
	To Cash a/c			3,000
	(forpayment for advertisement expenses)			
1-16	Account receivable a/c Dr.		10,000	
	To Service revenue a/c			10,000
	(Being service revenue receivable)			
1-19	Dividend a/c Dr.		5,000	
	To Cash a/c			5,000
	(for payment of dividend)			
1-21	Rent and salary a/c Dr.		20,000	
	To Cash a/c			20,000
	(for payment of Rent and salary)			
1-26	Cash a/c Dr.		5,000	
	Discount a/c Dr.		1,000	
	To Account Receivable a/c			6,000
	(for cash received from client and Discount allowed)			
1-29	Cash a/c Dr.		5,000	
	To Notes payable a/c			5,000
	(forsigned of promissory note and received cash)			
1-31	Office supplies a/c Dr.		5,000	
	To Account payable a/c			5,000
	(for purchase of office supplies on account)			

(ii) Ledger account

Dr. **Cash a/c** **Cr.**

Date	Particulars	PR	Amount	Date	Particular	PR	Amount
Jan.-1	To Capital a/c		80,000	Jan.-5	By office equipment a/c		20,000
-26	To Account receivable a/c		5,000				
-29	To Notes payable		5,000	-11	By Advertisement expenses a/c		3,000
				-19	By Dividend a/c		5,000
				-21	By Rent and salary a/c		20,000
				-31	By balance c/d		42,000
			90,000				90,000
Feb.-1	To balance b/d		42,000				

Dr. **Capital Account** **Cr.**

Date	Particulars	PR	Amount	Date	Particulars	PR	Amount
Jan.31	To Balance c/d		80000	Jan. 1	By Cash a/c		80,000
			80,000				80,000
				Feb. 1	By Balance b/d		80,000

Dr. **Equipment Account** Cr.

Date	Particulars	PR	Amount	Date	Particulars	PR	Amount
Jan. 5	To Cash a/c		20,000	Jan. 31	By Balance c/d		20,000
			20,000				20,000
Feb. 1	To Balance b/d		20,000				

Dr. **Advertisement expanses Account** Cr.

Date	Particulars	PR	Amount	Date	Particulars	PR	Amount
Jan. 11	To Cash a/c		3,000	Jan. 31	By Balance c/d		3,000
			3,000				3,000
Feb. 1	To Balance b/d		3,000				

Dr. **Account Receivable Account** Cr.

Date	Particulars	PR	Amount	Date	Particulars	PR	Amount
Jan. 16	To Service Revenue a/c		10,000	Jan.26	By Cash a/c		5,000
				“	By Discount allowed a/c		1,000
				Jan. 31	By Balance c/d		4,000
			10,000				10,000
Feb. 1	To Balance b/d		4,000				

Dr. **Service Revenue Account** **Cr.**

Date	Particulars	PR	Amount	Date	Particulars	PR	Amount
Jan.31	To Balance c/d		10000	Jan.16	By Account Receivable a/c		10,000
			10,000				10,000
				Feb. 1	By Balance b/d		10,000

Dr. **Dividend Account** **Cr.**

Date	Particulars	PR	Amount	Date	Particulars	PR	Amount
Jan. 19	To Cash a/c		5,000	Jan. 31	By Balance c/d		5,000
			5,000				5,000
Feb. 1	To Balance b/d		5,000				

Dr. **Rent and Salary Account** **Cr.**

Date	Particulars	PR	Amount	Date	Particulars	PR	Amount
Jan. 21	To Cash a/c		20,000	Jan. 31	By Balance c/d		20,000
			20,000				20,000
Feb. 1	To Balance b/d		20,000				

Dr. **Discount allowed Account** Cr.

Date	Particulars	PR	Amount	Date	Particulars	PR	Amount
Jan. 26	To Account Receivable a/c		1,000	Jan. 31	By Balance c/d		1,000
			1,000				1,000
Feb. 1	To Balance b/d		1,000				

Dr. **Nots Payable Account** Cr.

Date	Particulars	PR	Amount	Date	Particulars	PR	Amount
Jan.31	To Balance c/d		5,000	Jan.29	By Cash a/c		5,000
			5,000				5,000
				Feb. 1	By Balance b/d		5,000

Dr. **Office supplies Account** Cr.

Date	Particulars	PR	Amount	Date	Particulars	PR	Amount
Jan. 31	To Account Payable a/c		5,000	Jan. 31	By Balance c/d		5,000
			5,000				5,000
Feb. 1	To Balance b/d		5,000				

Dr.		Account Payable Account					Cr.
Date	**Particulars**	**PR**	**Amount**	**Date**	**Particulars**	**PR**	**Amount**
Jan.31	To Balance c/d		5,000	Jan.31	By office supplies a/c		5,000
			5,000				5,000
				Feb. 1	By Balance b/d		5,000

b. Continuous/running balancing ledger

This is alternative form of a ledger account. In this form, Dr. or Cr. balance can be readily ascertained after entry of every transaction. This types of ledger is most commonly used by banks and different other financial institutions.

Format of Balance Ledger:

Date	Particulars	PR	Debit (Rs)	Credit (Rs.)	Dr./Cr.	Balance

Some Ledger account of Example 1 are solved under continuous balancing ledger as follows:

Ledger account

Cash Account

Date	Particulars	PR	Debit Rs.	Credit Rs.	Dr./Cr.	Balance
1-1	Capital a/c		80,000	-	Dr.	80,000
1-5	office equipment a/c		-	20,000	Dr.	60,000
1-11	Advertisement expenses a/c		-	3,000	Dr.	57,000
1-19	Dividend a/c		-	5,000	Dr.	52,000
1-21	Rent and salary a/c		-	20,000	Dr.	32,000
1-26	Account Receivable a/c		5,000	-	Dr.	37,000
1-29	Notes payable		5,000	-	Dr.	42,000

Capital Account

Date	Particulars	PR	Debit Rs.	Credit Rs.	Dr./Cr.	Balance
1-1	Cash a/c		-	80,000	Cr.	80,000

Equipment Account

Date	Particulars	PR	Debit Rs.	Credit Rs.	Dr./Cr.	Balance
1-5	Cash a/c		20,000	-	Dr.	20,000

Account Receivable Account

Date	Particulars	PR	Debit Rs.	Credit Rs.	Dr./Cr.	Balance
1-16	Service revenue a/c		10,000	-	Dr.	10,000
1-26	Cash a/c		-	5,000	Dr.	5,000
‘’	Discount a/c		-	1,000	Dr.	4,000

Service Revenue Account

Date	Particulars	PR	Debit Rs.	Credit Rs.	Dr./Cr.	Balance
1-16	Account receivable a/c		–	10,000	Cr.	10,000

etc.

Simplified T-Account:

T-Account is the graphical representation of a general ledger that records a business transactions. It shapes exactly likely English alphabet capital letter T. It is simple and it takes few time to prepare but the result at the end of the accounting period is the same with that of ledger accounts. It includes debit items on the left side and credit item on its right side. The Example of the T-account is shown as below:

Cash

(1) 80,000	20,000(1-5)
(26) 5,000	3,000(1-11)
(29) 5,000	5,000(19)
	20,000(21)
bal 42,000	

Equipment

(5) 20,000	
Bal 20,000	

Account receivable

(16) 10,000	5,000 (26)
	1,000 (26)
Bal 4,000	

Share capital

	80,000 (1)
	80,000 bal

Service Revenue

	10,000(16)
	10,000 bal

etc.

Example 2: The closing balance of Bhandari Pvt. Ltd. as on July 31, 2020 is as follows:
Cash Rs.50,000,Bank Rs 25,000, Office equipment Rs. 20,000,Account receivable Rs.10,000 and Account payable Rs. 5,000.

During August, the company completed the following transactions:

Aug 5	Purchase goods on credit Rs.20,000.
Aug 7	Paid for advertisement Rs. 3,000 by cheque.
Aug 10	Paid rent for August Rs. 5,000.
Aug 15	Goods sold Rs.15,000 on cash and Rs.10,000 on credit.
Aug 20	Paid to creditors Rs.17,100 by cheque after deduction 5% discount.
Aug 28	Paid salary for August Rs. 2,000
Aug 30	Cheque received from debtors Rs 14,500 in full settlement Rs.15,000.
Aug 31	Paid electricity bill for August, Rs. 500

Required: Prepare journal entries for August transactions and post them into Ledger .

Solution:

Journal entries in the books of Bhandari Pvt.Ltd.

Date	Particular	PR	Debit Rs.	Credit Rs.
Aug 1	Cash a/c Dr.		50,000	
	Bank a/c Dr.		25,000	
	Office Equipment a/c Dr.		20,000	
	Account Receivable a/c Dr.		10,000	
	To Account payable a/c			5,000
	To capital a/c(balancing fig.)			100,000
	(for opening balance of Assets ,Liability and capital)			
5	Purchase a/c Dr.		20,000	
	To Account payable a/c			20,000
	(for goods purchase on credid)			
7	Advertisement A/c Dr.		3000	
	To bank a/c			3,000
	(Being Advertisement paid by cheque)			
10	Rent a/c Dr.		5,000	
	To cash a/c			5,000
	(for rent paid)			
15	Cash a/c Dr.		15,000	
	Account Receivable a/c Dr.		10,000	
	To Sales a/c			25,000
	(for goods sold on cash and credit)			

Cont,,,,

20	Account payable a/c Dr. To bank a/c To Discount received a/c (for paid to creditors by cheque after deduct discount)		18,000	 17,100 900
28	Salaries a/c Dr. To Cash a/c (Being salaries paid)		2,000	 2,000
30	Bank a/c Dr. Discount a/c Dr. To Account Receivable (forcheque received from customer and discount allowed)		14,500 500	 15,000
31	Electricity expenses a/c Dr. To Cash a/c (for electricity expenses paid)		500	 500

In the books of Bhandari Pvt. Ltd.

Ledger Accounts

Dr. **Cash a/c** **Cr.**

Date	Particulars	PR	Amount	Date	Particulars	PR	Amount
Aug 1	To balance b/d		50,000	Aug 10	By rent a/c		5,000
15	To sales a/c		15,000	28	By salaries a/c		2,000
				31	By electricity expenses a/c		500
				31	By balance c/d		57,500
			65,000				65,000
Sept 1	Balance b/d		57,500				

Dr. **Bank a/c** **Cr.**

Date	Particulars	PR	Amount	Date	Particulars	PR	Amount
Aug 1	To balance b/d		25,000	Aug 7	By advertisement a/c		5,000
30	To account receivable		14,500	20	By account payable a/c		17,100
				31	By balance c/d		17400
			39,500				39,500,
Sept 1	Balance b/d		17,500				

Dr. **Office equipment a/c** **Cr.**

Date	Particulars	PR	Amount	Date	Particulars	PR	Amount
Aug 1	To balance b/d		20,000	Aug 31	By balance c/d		20,000
			20,000				20,000,
Sept 1	Balance b/d		20,000				

Dr. **Account Receivable a/c** **Cr.**

Date	Particulars	PR	Amount	Date	Particulars	PR	Amount
Aug 1	To balance b/d		10,000	Aug 30	By Bank a/c		14,500
15	To sales a/c		10,000	“	By Discount a/c		500
				31	By balance c/d		5,000
			20,000				20,000,
Sept 1	Balance b/d		5,000				

Dr. **Capital a/c** **Cr.**

Date	Particulars	PR	Amount	Date	Particulars	PR	Amount
Aug 31	To balance c/d		100,000	Aug 1	By balance b/d		100,000
			100,000				100,000,
				Sept 1	Balance b/d		100,000

Dr. **Account payable a/c** **Cr.**

Date	Particulars	PR	Amount	Date	Particulars	PR	Amount
Aug 20	To bank a/c		17,100	Aug 1	By balance b/d		5,000
"	To discount received a/c		900	5	By purchase a/c		20,000
31	To balance c/d		7,000				
			25,000				25,000,
				Sept 1	Balance b/d		7,000

Dr. **Purchase a/c** **Cr.**

Date	Particulars	PR	Amount	Date	Particulars	PR	Amount
Aug 5	To Account payable a/c		20,000	Aug 31	By balance c/d		20,000
			20,000				20,000,
Sept 1	Balance b/d		20,000				

Dr. **Advertisement exp. a/c** **Cr.**

Date	Particulars	PR	Amount	Date	Particulars	PR	Amount
Aug 7	To bank a/c		3,000	Aug 31	By balance c/d		3,000
			3,000				3,000,
Sept 1	Balance b/d		3,000				

etc.

Trial Balance

Meaning of Trial balance:

The trial balance is prepared after closing all the ledger accounts. It is a statement which is prepared at the end of a financial period using the debit and credit totals or balances of all ledger account with a view to ascertain(check) the arithmetical accuracy of recordings the business transaction. It can also be used to prepare the final accounts of the business.

R.N. Carter: "Trial balance is a list of debit and credit balances, taken out from ledger; it also includes the balances of cash and bank taken from cash book."

William Pickles: "The statement prepared with the help of ledger balances, at the end of financial year to find out whether debit total agrees with credit total is called trial balance."

Objectives or importance of preparing trial balance :

1.To check the arithmetical accuracy:
2. To help locate accounting errors:
3. To summarize the financial transactions:
4.To provide the basis for preparing final accounts:

<u>Preparation of Trial Balance:</u>

There are two primary methods of preparing the trial balance.

a) Total Method

The debit side and credit side of ledger accounts are added up. The total of the debit side is placed in the debit column and the total of the credit side in the credit column of the trial balance. The total of the debit column and credit column should be the same.

b) Balance Method

Under balance method, only the balances of all the ledger accounts are shown in the trial balance

1. <u>Debit items of Trail balance</u>

a) Opening stock

b) Purchases

c) Sales return / Return inward / Return from customers

d) <u>Assets :-</u> Cash, bank, Debtors, furniture, land, building, machinery, goodwill patent, trademark, copyright, premises (group of assets), equipment, loose tools, accrued income etc.

e) <u>Expenses :-</u> Rent, salary, wages, carriage, printing, discount, bad debts, interest on loan, audit fee, depreciation, distribution expenses selling expenses, insurance, commission, stationery fuel & power, freight , import duty etc.

2) **<u>Credit items of trial balance</u>**

a) Sales / revenue

b) Purchase return / return outward / Return to suppliers

c) General reserve / Reserve fund/ surplus and reserve

d) <u>Liabilities :-</u> creditors, account payable, bills payable, bank overdraft, outstanding expenses, advance income, bank loan etc.

e) Provision for bad debts.

f) <u>Income :-</u> Bad debt recovered, interest on investment, discount received, commission received, discount on purchases, dividend received, profit on sale of assets etc.

g) Share Capital etc

Trial balance of …….
for the year ended……

S.N.	Particular	Debit (Rs)	Credit (Rs)
	Opening stock	xxx	
	Purchases	xxx	
	Discount allowed	xxx	
	Interest on loan	xxx	
	Salary	xxx	
	Rent	xxx	
	Other expenses etc	xxx	
	Cash	xxx	
	Bank	xxx	
	Debtors	xxx	
	Furniture	Xxx	
	Other assets etc.	xxx	
	Capital		Xxx
	Creditors		Xxx
	10% Bank loan		Xxx
	Other liabilities etc		Xxx
	Sales		Xxx
	Discount received		Xxx
	Other incomes etc.		xxx
		xxx	xxx

Opening Entries

All the assets and liabilities of the previous year are required to be carried forward to the current year by passing necessary entries. Such type of entries are called opening entries. These are passed through journal proper. While doing so, all the assets are debited and liabilities are credited. The excess of assets over liabilities obtained in this way is credited to capital account.

Opening entries in the books of…………

Date	Particulars	PR	Dr. Amount	Cr. Amount
	Assets a/c(Individual) Dr.		XXX	
	To Liabilities a/c(individual)			xxx
	To Capital a/c (balancing figure)			xxx
	(Being opening balances of assets, liabilities and capital ascertain by deducting liabilities from assets.			
	Total		xxx	XXX

Illustration 1:

From the following account balance, you are advised to pass opening entry:

Particulars	Amount
Plant & machinery	80,000
Land & building	1,30,000
Sundry debtors	40,000
Sundry creditors	50,000
Outstanding expenses	10,000

Solution:

Opening entries in the books of…………

Date	Particulars	LF	Dr. Amount	Cr. Amount
	Plant and machinery a/c .... Dr.		80000	
	Land and building a/c.. Dr.		130000	
	Sundry debtors a/c .... Dr.		40000	
	To Sundry creditors a/c			50,000
	To Outstanding expenses a/c			10,000
	To Capital a/c (balancing figure)			1,90,000
	(Being opening balances of assets, liabilities and capital ascertain by deducting liabilities from assets.			
	Total		**250000**	**250000**

Closing Entries

The entries which are prepared for closing different ledger of Revenue and Expenses accounts at the time of preparing Financial statement, are called closing entries. While preparing such type of entries, all the expenses and income related items are transferred to income summary(income statement) or trading and profit and loss account. Following entries are passed for closing the temporary accounts.

Types of Closing Entries:

1.Closing Entries of revenue Account:

Sales / service revenue A/c …………………… ….Dr.

Interest revenue A/C ……………………….Dr.

Other revenue A/C…………………………..Dr.

To income summary A/c

(for closing the revenue account by income summary)

2.Closing Entries of expenses Account:

Income summary A/c …………… ….Dr.

To Salaries A/c

To Insurance expenses A/c

To rent A/c

To other expenses A/c

(for closing the expenses account by income summary)

3.Closing Entries of Income Summary:

a. If Credit column is greater than debit column in the income summary account the difference is considered as net income.

Income summary A/c …………………… ….Dr.

To Retained earnings or Capital stock A/c

(for closing the income summary account by Retained earnings account)

b. If Credit column is less than debit column in the income summary account the difference is considered as net loss.

Retained earnings or Capital stock A/c …………………… ….Dr.

To Income summary A/c

(for closing the income summary account by Retained earnings account)

4.Closing Entries of dividends Account

Retained earnings A/c …………………… ….Dr.

To dividend A/c

(for closing the dividend account by the Retained earnings account)

Adjusting Entries

Some income and expense related items may occur after closing of related ledger accounts. They may appear in the form of adjustments. Such incomes and expenses should be adjusted either in trading account or profit and loss account(Income statement) or balance sheet according to their nature. The entries passed for all such adjustments are called the adjusting entries.

Types of Adjusting Entries:

- Deferrals (Pre-receipts and Pre-payment):
  Following are the example of Deferrals adjustment:
  -Prepaid expense or unexpired expenses
  -Unearned revenue or advance revenue
  -Depreciation,
  -Stock of supplies/merchandise goods etc.

- Accruals (Outstanding Receipts and Outstanding payments):
  Following are the example of Accruals adjustments:
  - Accruals Revenues
  - Accruals Expenses

The following entries are made for different some adjustments:

Adjustments	Date	Particulars	PR	Dr. Amount	Cr. Amount
A. <u>Adjustment for Deferrals items:</u> 1. Prepaid expenses expired:		Related expenses a/c....... Dr. To Prepaid expenses a/c (For expire of prepaid expenses)		xxx	 xxx
2. Cost of good sold(Under periodic inventory system)		COGS or Cost of sales a/c .... Dr. To Purchase a/c To Opening stock a/c (For the cost of good sold from purchase and opening stock)		xxx	 xxx xxx
3. Closing stock:		Closing stock a/c............. Dr. To COGS or Cost of sales a/c (For the closing stock recorded)		xxx	 xxx
4..Advance/Unearned Income earned:		Advance income a/c....... Dr. To Related income a/c (For Unearned Income earned)		xxx	 xxx
5. Depreciation		Depreciation a/c............ Dr. To Fixed assets or Acc. Dep. a/c (For depreciation expenses foe the period)		xxx	 xxx

6.Supplies Expenses:		Supplies expenses a/c...............Dr. To Supplies a/c (For Supplies used for the period)		xxx	xxx
7. Bad debt		Bad debt a/c................ Dr. To Sundry debtors/ Acc. receivable a/c (For bad debt expenses made)		xxx	xxx
B. <u>Adjustment for Accruals Items:</u> 1. Outstanding/Accrued/payable expenses		Related expenses a/c.............. Dr. To Outstanding expenses a/c (For outstanding expenses record)		xxx	xxx
2. Accrued income/Accrued Revenue		Accrued income/income receivable a/c...... Dr. To Related income/Revenue a/c (For accrued revenue recorded)		xxx	xxx

Note : Treatment of Supplies:

Supplies expenses= Opening stock of supplies+ Purchase of supplies – Closing stock of supplies

Adjusted Trial Balance

Meaning: An adjusted trial balance represents a listing of all the account balance after posting of all the necessary adjusting entries in ledger accounts. It is not a financial statement, but the adjusted account balances will be reported on the financial statements. The adjust trial balance must have the total amount of the debit balances equal to the total amount of the credit balances.

Preparation of Adjusted Trial Balance

Adjusted trial balance is such type of trial balance which is prepared by considering different adjustments. Its specimen can be given as below:

Adjusted trial balance in the books of ....

As on ……………………..

S.N.	Particulars	Unadjusted trial balance		Adjustments		Adjusted trial balance	
		Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
1.	Revenues / Incomes		xx		.		Xx
2.	Expenses / Losses	xx				xx	
3.	Capital		xx				xx
4.	Assets	xx				xx	
5.	Liabilities		xx				xx
	Adjustments :						
a)	………………..						
b)	……………….						
c)	… ……………						
	Total	**xxx**	**xxx**	**xxx**	**xxx**	**xxx**	**xxx**