UNIT-1

Concept of Accounting

Definition of Accounting

Definition by the American Institute of Certified Public Accountants (Year 1961):

“Accounting is the art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character, and interpreting the result thereof”.

Definition by the American Accounting Association (Year 1966):

“The process of identifying, measuring and communicating economic information to permit informed judgments and decisions by the users of accounting”.

(a) Objectives of Accounting

(i) Providing Information to the Users for Rational Decision-making

The primary objective of accounting is to provide useful information for decision-making to

stakeholders such as owners, management, creditors, investors, etc. Various outcomes of business activities such as costs, prices, sales volume, value under ownership, return of investment, etc. are measured in the accounting process. All these accounting measurements are used by stakeholders (owners, investors, creditors/bankers, etc.) in course of business operation. Hence, accounting is identified as ‘language of business’.

(ii) Systematic Recording of Transactions

To ensure reliability and precision for the accounting measurements, it is necessary to keep a

systematic record of all financial transactions of a business enterprise which is ensured by bookkeeping.

These financial records are classified, summarized and reposted in the form of accounting

measurements to the users of accounting information i.e., stakeholder.

(iii) Ascertainment of Results of above Transactions

‘Profit/loss’ is a core accounting measurement. It is measured by preparing profit and loss account for a particular period. Various other accounting measurements such as different types of revenue expenses and revenue incomes are considered for preparing this profit and loss account. Difference between these revenue incomes and revenue expenses is known as result of business transactions identified as profit/loss. As this measure is used very frequently by stockholders for rational decision making, it has become the objective of accounting.

For example, Income Tax Act requires that every business should have an accounting system that can measure taxable income of business and also explain nature and source of every item reported in Income Tax Return.

(iv) Ascertain the Financial Position of Business

'Financial position' is another core accounting measurement. Financial position is identified by preparing a statement of ownership i.e., Assets and Owings i.e., liabilities of the business as on a certain date. This statement is popularly known as balance sheet. Various other accounting measurements such as different types of assets and different types of liabilities as existed at a particular date are considered for preparing the balance sheet. This statement may be used by various stakeholders for financing and investment decision.

(v) To Know the Solvency Position

Balance sheet and profit and loss account prepared as above give useful information to stockholders regarding concerns potential to meet its obligations in the short run as well as in the long run.

Scope of accounting

1. Accounting is concerned with financial transactions and events which bring' about a change in the resources (or wealth) position of the business firm. Such transactions have to be identified first, as and when they occur. It is not difficult because. there will be proof in the form of a bill or receipt (called vouchers). With the help of these bills and receipts identification of a transaction is easy. For example, when you purchase something you get a bill, when you make payment you get a receipt.

2. These transactions are to be measured or expressed in terms of money, if not done already. Generally, this problem will not arise, because the statement of proof expresses the transaction in terms of money. For example, if ten books are purchased at the rate of Rs. 20 each, then the bill is prepared for Rs. 200. But, if an event cannot be expressed in monetary terms, it will not come under the scope of accounting.

3. The transactions which are identified and measured are to be recorded in a book called journal or in one of its sub-divisions.

4. The recorded transactions are to be classified with a view to group transactions of similar nature at one place. The work of classification is done in a separate book called ledger. In the ledger, a separate account is opened for each item so that all transactions relating to it can be brought to one place. For example, all payments of salaries are brought to salaries account.

5. The recording and classification of many transactions will result in a mass of financial data. It is, therefore, necessary to summarise such data periodically (at least once a year), in a significant and meaningful form. The summarisation is done in the form of profit and loss account which reveals the profit made or loss incurred, and the balance sheet which reveals the financial position.

6 The summary results will have to be analysed, interpreted (critically explained) and communicated to interested parties. Accounting information is generally communicated in the form of a 'report'. Big organisations generally present printed reports, called published account.

Basic accounting terminologies

(i) **Transaction:** It means an event or a business activity which involves exchange of money or money's worth between parties. The event can be measured in terms of money and changes the financial position of a person e.g. purchase of goods would involve receiving material and making payment or creating an obligation to pay to the supplier at a future date. Transaction could be a cash transaction or credit transaction. When the parties settle the transaction immediately by making payment in cash or by cheque, it is called a cash transaction. In credit transaction, the payment is settled at a future date as per agreement between the parties.

(ii) **Goods/Services :** These are tangible article or commodity in which a business deals. These articles or commodities are either bought and sold or produced and sold. At times, what may be classified as 'goods' to one business firm may not be 'goods' to the other firm. e.g. for a machine manufacturing company, the machines are 'goods' as they are frequently made and sold. But for the buying firm, it is not 'goods' as the intention is to use it as a long term resource and not sell it. Services are intangible in nature which are rendered with or without the object of earning profits.

(iii) **Profit:** The excess of Revenue Income over expense is called profit. It could be calculated for each transaction or for business as a whole.

(iv) **Loss:** The excess of expense over income is called loss. It could be calculated for each transaction or for business as a whole.

(v) **Asset:** Asset is a resource owned by the business with the purpose of using it for generating future profits. Assets can be Tangible and Intangible. Tangible Assets are the Capital assets which have some physical existence. They can, therefore, be seen, touched and felt, e.g. Plant and Machinery, Furniture and Fittings, Land and Buildings, Books, Computers, Vehicles, etc. The capital assets which have no physical existence and whose value is limited by the rights and anticipated benefits that possession confers upon the owner are known as Intangible Assets. They cannot be seen or felt although they help to generate revenue in future, e.g. Goodwill, Patents, Trade-marks, Copyrights, Brand Equity, Designs, Intellectual Property, etc.

Assets can also be classified into Current Assets and Non-Current Assets.

Current Assets – An asset shall be classified as Current when it satisfies any of the following :

(a) It is expected to be realised in, or is intended for sale or consumption in the Company's normal

Operating Cycle,

(b) It is held primarily for the purpose of being traded ,

(c) It is due to be realised within 12 months after the Reporting Date, or

(d) It is Cash or Cash Equivalent unless it is restricted from being exchanged or used to settle a

Liability for at least 12 months after the Reporting Date.

Non-Current Assets – All other Assets shall be classified as Non-Current Assets. e.g. Machinery held for long term etc.

(vi) **Liability:** It is an obligation of financial nature to be settled at a future date. It represents amount of money that the business owes to the other parties. E.g. when goods are bought on credit, the firm will create an obligation to pay to the supplier the price of goods on an agreed future date or when a loan is taken from bank, an obligation to pay interest and principal amount is created.

Depending upon the period of holding, these obligations could be further classified into Long Term on non-current liabilities and Short Term or current liabilities.

Current Liabilities – A liability shall be classified as Current when it satisfies any of the following :

(a) It is expected to be settled in the Company's normal Operating Cycle,

(b) It is held primarily for the purpose of being traded,

(c) It is due to be settled within 12 months after the Reporting Date, or

(d) The Company does not have an unconditional right to defer settlement of the liability for at least 12 months after the reporting date (Terms of a Liability that could, at the option of the counterparty, result in its settlement by the issue of Equity Instruments do not affect its

classification)

Non-Current Liabilities – All other Liabilities shall be classified as Non-Current Liabilities. E.g. Loan taken for 5 years, Debentures issued etc.

(vii) **Internal Liability :** These represent proprietor's equity, i.e. all those amount which are entitled to the proprietor, e.g., Capital, Reserves, Undistributed Profits, etc.

(viii) **Working Capital :** In order to maintain flows of revenue from operation, every firm needs certain amount of current assets. For example, cash is required either to pay for expenses or to meet obligation for service received or goods purchased, etc. by a firm. On identical reason, inventories are required to provide the link between production and sale. Similarly, Accounts Receivable generate when goods are sold on credit. Cash, Bank, Debtors, Bills Receivable, Closing Stock, Prepayments etc. represent current assets of firm. The whole of these current assets form the working capital of a firm which is termed as Gross Working Capital.

Gross Working capital = Total Current Assets = Long term internal liabilities plus long term debts plus the current liabilities minus the amount blocked in the fixed assets. There is another concept of working capital. Working capital is the excess of current assets over current liabilities. That is the amount of current assets that remain in a firm if all its current liabilities are paid. This concept of working capital is known as Net Working Capital which is a more realistic concept.

Working Capital (Net) = Current Assets – Currents Liabilities.

(ix) **Contingent Liability :** It represents a potential obligation that could be created depending on the outcome of an event. E.g. if supplier of the business files a legal suit, it will not be treated as a liability because no obligation is created immediately. If the verdict of the case is given in favour of the supplier then only the obligation is created. Till that it is treated as a contingent liability. Please note that contingent liability is not recorded in books of account, but disclosed by way of a note to the financial statements.

(x) Capital : It is amount invested in the business by its owners. It may be in the form of cash, goods, or any other asset which the proprietor or partners of business invest in the business activity. From business point of view, capital of owners is a liability which is to be settled only in the event of closure or transfer of the business. Hence, it is not classified as a normal liability. For corporate bodies, capital is normally represented as share capital.

(xi) Drawings : It represents an amount of cash, goods or any other assets which the owner withdraws from business for his or her personal use. e.g. if the life insurance premium of proprietor or a partner of business is paid from the business cash, it is called drawings. Drawings will result in reduction in the owners' capital. The concept of drawing is not applicable to the corporate bodies like limited companies.

(xii) Net worth : It represents excess of total assets over total liabilities of the business. Technically, this amount is available to be distributed to owners in the event of closure of the business after payment of all liabilities. That is why it is also termed as Owner's equity. A profit making business will result in increase in the owner's equity whereas losses will reduce it.

(xiii) Non-current Investments : Non-current Investments are investments which are held beyond the current period as to sale or disposal. e. g. Fixed Deposit for 5 years.

(xiv) Current Investments : Current investments are investments that are by their nature readily realizable and are intended to be held for not more than one year from the date on which such investment is made. e. g. 11 months Commercial Paper.

(xv) Debtor : The sum total or aggregate of the amounts which the customer owe to the business for purchasing goods on credit or services rendered or in respect of other contractual obligations, is known as Sundry Debtors or Trade Debtors, or Trade Payable, or Book-Debts or Debtors. In other words, Debtors are those persons from whom a business has to recover money on account of goods sold or service rendered on credit. These debtors may again be classified as under:

(i) Good debts : The debts which are sure to be realized are called good debts.

(ii) Doubtful Debts : The debts which may or may not be realized are called doubtful debts.

(iii) Bad debts : The debts which cannot be realized at all are called bad debts.

It must be remembered that while ascertaining the debtors balance at the end of the period certain adjustments may have to be made e.g. Bad Debts, Discount Allowed, Returns Inwards, etc.

(xvi) Creditor : A creditor is a person to whom the business owes money or money's worth. e.g. money

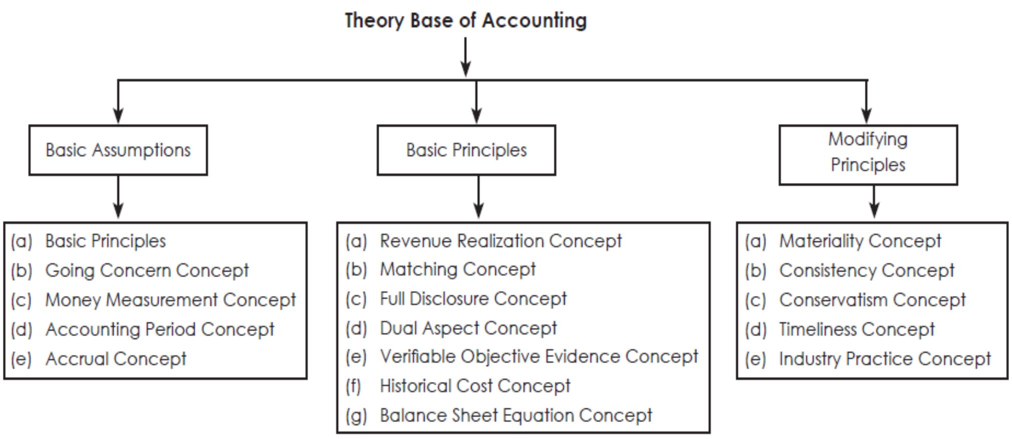
payable to supplier of goods or provider of service. Creditors are generally classified as Current Liabilities.

(xvii) Capital Expenditure : This represents expenditure incurred for the purpose of acquiring a fixed asset which is intended to be used over long term for earning profits there from. e. g. amount paid to buy a computer for office use is a capital expenditure. At times expenditure may be incurred for enhancing the production capacity of the machine. This also will be a capital expenditure. Capital expenditure forms part of the Balance Sheet.

(xviii) Revenue expenditure : This represents expenditure incurred to earn revenue of the current period. The benefits of revenue expenses get exhausted in the year of the incurrence. e.g. repairs, insurance, salary & wages to employees, travel etc. The revenue expenditure results in reduction in profit or surplus. It forms part of the Income statement.

(xix) Balance Sheet : It is the statement of financial position of the business entity on a particular date. It lists all assets, liabilities and capital. It is important to note that this statement exhibits the state of affairs of the business as on a particular date only. It describes what the business owns and what the business owes to outsiders (this denotes liabilities) and to the owners (this denotes capital). It is prepared after incorporating the resulting profit/losses of Income statement.

Accounting Concepts



A. BASIC ASSUMPTIONS

(a) Business Entity Concept

This concept explains that the business is distinct from the proprietor. Thus, the transactions of business only are to be recorded in the books of business.

(b) Going Concern Concept

This concept assumes that the business has a perpetual succession or continued existence.

(c) Money Measurement Concept

According to this concept only those transactions which are expressed in money terms are to be recorded in accounting books.

(d) The Accounting Period Concept

Businesses are living, continuous organisms. The splitting of the continuous stream of business events into time periods is thus somewhat arbitrary. There is no significant change just because one accounting period ends and a new one begins. This results into the most difficult problem of accounting of how to measure the net income for an accounting period. One has to be careful in recognizing revenue and expenses for a particular accounting period. Subsequent section on accounting procedures will explain how one goes about it in practice.

(e) The Accrual Concept

The accrual concept is based on recognition of both cash and credit transactions. In case of a cash transaction, owner's equity is instantly affected as cash either is received or paid. In a credit transaction, however, a mere obligation towards or by the business is created. When credit transactions exist (which is generally the case), revenues are not the same as cash receipts and expenses are not same as cash paid during the period.

Today's accounting systems based on accrual concept are called as Accrual system or mercantile system of accounting.

BASIC PRINCIPLES

(a) Realization Concept

This concept speaks about recording of only those transactions which are actually realized. For example Sale or Profit on sales will be taken into account only when money is realized i.e. either cash is received or legal ownership is transferred.

(b) Matching Concept

It is referred to as matching of expenses against incomes. It means that all incomes and expenses relating to the financial period to which the accounts relate should be taken in to account without regard to the date of receipts or payment.

(c) Full Disclosure Concept

As per this concept, all significant information must be disclosed. Accounting data should properly be clarified, summarized, aggregated and explained for the purpose of presenting the financial statements which are useful for the users of accounting information. Practically, this principle emphasizes on the materiality, objectivity and consistency of accounting data which should disclose the true and fair view of the state of affairs of a firm.

(d) Duality Concept

According to this concept every transaction has two aspects i.e. the benefit receiving aspect and benefit giving aspect. These two aspects are to be recorded in the books of accounts.

(e) Verifiable Objective Evidence Concept

Under this principle, accounting data must be verified. In other words, documentary evidence of transactions must be made which are capable of verification by an independent respect. In the absence of such verification, the data which will be available will neither be reliable nor be dependable, i.e., these should be biased data. Verifiability and objectivity express dependability, reliability and trustworthiness that are very useful for the purpose of displaying the accounting data and information to the users.

(f) Historical Cost Concept

Business transactions are always recorded at the actual cost at which they are actually undertaken. The basic advantage is that it avoids an arbitrary value being attached to the transactions. Whenever an asset is bought, it is recorded at its actual cost and the same is used as the basis for all subsequent accounting purposes such as charging depreciation on the use of asset, e.g. if a production equipment is bought for ` 1.50 crores, the asset will be shown at the same value in all future periods when disclosing the original cost. It will obviously be reduced by the amount of depreciation, which will be calculated with reference to the actual cost. The actual value of the equipment may rise or fall subsequent to the purchase, but that is considered irrelevant for accounting purpose as per the historical cost concept.

The limitation of this concept is that the balance sheet does not show the market value of the assets owned by the business and accordingly the owner’s equity will not reflect the real value. However, on an ongoing basis, the assets are shown at their historical costs as reduced by depreciation.

(g) Balance Sheet Equation Concept

Under this principle, all which has been received by us must be equal to that has been given by us and needless to say that receipts are clarified as debits and giving is clarified as credits. The basic equation,

appears as :- Debit = Credit

Naturally every debit must have a corresponding credit and vice-e-versa. So, we can write the above in the following form –

Expenses + Losses + Assets = Revenues + Gains + Liabilities

And if expenses and losses, and incomes and gains are set off, the equation takes the following form

– Asset = Liabilities

or, Asset = Equity + External Liabilities

i.e., the Accounting Equation

MODIFYING PRINCIPLES

(a) The Concept of Materiality

The materiality could be related to information, amount, procedure and nature. Error in description of an asset or wrong classification between capital and revenue would lead to materiality of information. Say, If postal stamps of ` 500 remain unused at the end of accounting period, the same may not be considered for recognizing as inventory on account of materiality of amount. Certain accounting treatments depend upon procedures laid down by accounting standards. Some transactions are by nature material irrespective of the amount involved. e.g. audit fees, loan to directors.

(b) Consistency Concept

This Concept says that the Accounting practices should not change or must remain unchanged over a period of several years.

(c) Conservatism Concept

Conservatism concept states that when alternative valuations are possible, One should select the alternative which fairly represents economic substance of transactions but when such choice is not clear select the alternative that is least likely to overstate net assets and net income. It provides for all known expenses and losses by best estimates if amount is not known with certainty, but does not recognizes revenues and gains on the basis of anticipation.

(d) Timeliness Concept

Under this principle, every transaction must be recorded in proper time. Normally, when the transaction is made, the same must be recorded in the proper books of accounts. In short, transaction should be recorded date-wise in the books. Delay in recording such transaction may lead to manipulation, misplacement of vouchers, misappropriation etc. of cash and goods. This principle is followed particularly while verifying day to day cash balance. Principle of timeliness is also followed by banks, i.e. every bank verifies the cash balance with their cash book and within the day, the same must be completed.

(e) Industry Practice

As that are different types of industries, each industry has its own characteristics and features. There may be seasonal industries also. Every industry follows the principles and assumption of accounting to perform their own activities. Some of them follow the principles, concepts and conventions in a modified way. The accounting practice which has always prevailed in the industry is followed by it. e.g Electric supply companies, Insurance companies maintain their accounts in a specific manner. Insurance companies prepare Revenue Account just to ascertain the profit/loss of the company and not Profit and Loss Account. Similarly, non trading organizations prepare Income and Expenditure Account to find out Surplus or Deficit.

Accounting Standards

To keep uniformity and consistency in the accounts some rules and regulations have to be followed. We call these principles of accounting. Every accounting body has their own such rules, standards, principles etc. These are regarded and accepted by the accounting professionals. Here we will look at a few such principles – AS, GAAP and IFRS.

Accounting standards are the rules, regulations, directives etc that are issued by accounting and governing bodies of the world. The intention is to make sure all companies and organizations follow the same rules for accounting and have the same format for their financial statements.These accounting standards are implemented in the whole country. So this means the entire national economy can implement the same standards and can adopt similar accounting terminology. So all organizations and business units have a uniform, precise and correct financial statements and records.

Indian Accounting Standards (IAS) are issued by the Institute Of Chartered Accountants of India (ICAI). These Accounting Standards are named as well as numbered similarly to the IFRS.

- Disclosure of accounting policies.
- Valuation Of Inventories.
- Cash Flow Statements.
- Contingencies and events Occurring after the Balance sheet Date
- Net Profit or loss For the period, Prior period items and Changes in accounting Policies.
- Depreciation accounting.
- Construction Contracts.
- Revenue Recognition.
- Accounting For Fixed Assets.
- The Effect of Changes In Foreign Exchange Rates.
- Accounting For Government Grants.
- Accounting For Investments.
- Accounting For Amalgamation.
- Employee Benefits.
- Borrowing Cost.
- Segment Reporting.
- Related Party Disclosures.
- Accounting For Leases.
- Earning Per Share.
- Consolidated Financial Statement.
- Accounting For Taxes on Income.

• Accounting for Investment in associates in • Consolidated Financial Statement.

• Discontinuing Operation.

• Interim Financial Reporting.

• Intangible assets.

• Financial Reporting on Interest in joint Ventures.

• Impairment Of assets.

• Provisions, Contingent, liabilities and Contingent assets.

• Financial instrument.

• Financial Instrument: presentation.

• Financial Instruments, Disclosures and • Limited revision to accounting standards.

Journal

A journal is often referred to as Book of Prime Entry or the book of original entry. In this book transactions are recorded in their chronological order. The process of recording transaction in a journal is called as 'Journalisation'. The entry made in this book is called a 'journal entry.

Functions of Journal

(i) Analytical Function : Each transaction is analysed into the debit aspect and the credit aspect. This helps to find out how each transaction will financially affect the business.

(ii) Recording Function : Accountancy is a business language which helps to record the transactions based on the principles. Each such recording entry is supported by a narration, which explain, the transaction in simple language. Narration means to narrate – i.e. to explain. It starts with the word – Being …

(iii) Historical Function : It contains a chronological record of the transactions for future references.

Advantages of Journal

The following are the advantages of a journal :

(i) Chronological Record : It records transactions as and when it happens. So it is possible to get a detailed day-to-day information.

(ii) Minimising the possibility of errors : The nature of transaction and its effect on the financial position of the business is determined by recording and analyzing into debit and credit aspect.

(iii) Narration : It means explanation of the recorded transactions.

(iv) Helps to finalise the accounts : Journal is the basis of ledger posting and the ultimate Trial Balance. The Trial balance helps to prepare the final accounts.

The specimen of a journal book is shown below.

Date	Particulars	Voucher number	Ledger folio	Debit amount (₹)	Credit amount (₹)
dd-mm-yy	Name of A/c to be debited Name of A/c to be credited (narration describing the transaction)	-----------	Reference of page number of the A/c in ledger	-----------	-----------

Explanation of Journal

(i) Date Column : This column contains the date of the transaction.

(ii) Particulars : This column contains which account is to be debited and which account is to be credited. It is also supported by an explanation called narration.

(iii) Voucher Number : This Column contains the number written on the voucher of the respective transaction.

(iv) Ledger Folio (L.F.) : This column contains the folio (i.e. page no.) of the ledger, where the transaction is posted.

(v) Dr. Amount and Cr. Amount : This column shows the financial value of each transaction. The amount is recorded in both the columns, since for every debit there is a corresponding and equal credit.

All the columns are filled in at the time of entering the transaction except for the column of ledger folio. This is filled at the time of posting of the transaction to 'ledger'.

Example: As per voucher no. 31 of Roy Brothers, on 10.05.2013 goods of Rs 50000 were purchased. Cash was paid immediately. Ledger Folios of the Purchase A/c and Cash A/c are 5 and 17 respectively. Journal entry of the above transaction is given bellow:

In the books of Roy Brothers
Journal Entries

Date	Particulars		Voucher No.	Ledger Folio	Dr. Amount (₹)	Cr. Amount (₹)
10.05.2013	Purchase A/c	Dr.	31	5	50,000	
	To, Cash A/c			17		50,000
	(Being goods purchased for Cash)					

Solved Example

Let us illustrate the journal entries for the following transactions:

2013

April

1 Mr. Vikas and Mrs. Vaibhavi who are husband and wife start consulting business by bringing in their personal cash of `Rs 5,00,000 and Rs 2,50,000 respectively.

10 Bought office furniture of Rs 25,000 for cash. Bill No. - 2013/F/3

11 Opened a current account with Punjab National Bank by depositing `Rs 1,00,000

15 Paid office rent of `Rs 15,000 for the month by cheque to M/s Realtors Properties. Voucher No. 3

20 Bought a motor car worth Rs 4,50,000 from Millennium Motors by making a down payment of 50,000 by cheque and the balance by taking a loan from HDFC Bank. Voucher No. M/13/7

25 Vikas and Vaibhavi carried out a consulting assignment for Avon Pharmaceuticals and raise a bill for `Rs10,00,000 as consultancy fees. Bill No. B13/4/1 raised. Avon Pharmaceuticals have immediately settled Rs 2,50,000 by way of cheque and the balance will be paid after 30 days. The cheque received is deposited into Bank.

30 Salary of one receptionist @ Rs 5,000 per month and one officer @ ` 10,000 per month. The salary for the current month is payable to them.

Journal Entries **Journal Folio-1**

Date	Particulars	Voucher number	L.F	Dr. Amount (₹)	Cr. Amount (₹)
01-04-2013	Cash A/c Dr. To Vikas's Capital A/c To Vaibhavi's capital A/c (Being capital brought in by the partners)		1 2 3	7,50,000	 5,00,000 2,50,000
10-04-2013	Furniture A/c Dr. To Cash A/c (Being furniture purchased in cash)	2013/F/3	4 1	25,000	 25,000
11-04-2013	Punjab National Bank A/c Dr. To Cash A/c (Being current account opened with Punjab National Bank by depositing cash)		5 1	1,00,000	 1,00,000
15-04-2013	Rent A/c Dr. To Punjab National Bank A/c (being rent paid to Realtors Properties for the month)	3	6 5	15,000	 15,000
20-04-2013	Motor Car A/c Dr. To Punjab National Bank A/c To Loan from HDFC Bank A/c (Being car purchased from Millennium Motors by paying down payment and loan arrangement)	M/13/7	7 5 8	4,50,000	 50,000 4,00,000
25-04-2013	Punjab National Bank A/c Dr. Avon Pharma A/c Dr. To Consultancy Fees A/c (Being amount received and revenue recognized for fees charged)	B13/4/1	5 9 10	2,50,000 7,50,000	 10,00,000
30-04-2013	Salary A/c Dr. To Salary payable A/c (Being the entry to record salary obligation for the month)		11 12	15,000	 15,000

Cash Book

A Cash Book is a special journal which is used for recording all cash receipts and all cash payments.

Cash Book is a book of original entry since transactions are recorded for the first time from the source documents. The Cash Book is larger in the sense that it is designed in the form of a Cash Account and records cash receipts on the debit side and cash payments on the credit side. Thus, the Cash Book is both a journal and a ledger.

Example

Write up a Cash Book of Mr. Y for the month of April 2013, which serves as the only book of original entry

April 2013	
1.	Balance in hand ₹5,000
4.	Sold goods to Mr. Z on credit ₹3,000
6.	Sold goods for Cash ₹1,000
8.	Purchased goods on credit from Mr. P for ₹3,000
12.	Paid to Mr. P for ₹2,000 and Received Discount ₹200
15.	Returned goods to Mr. P for ₹800
20.	Goods Returned by Mr. Z for ₹300
25.	Z settled his account for ₹2,500
26.	Paid salary by cheque for ₹1,000
30.	Received interest for ₹1,000

Solution:

In the books of Mr. Y Cash Book (as the only Book of Single Entry)

Date	Particulars	L/F	Amount ₹	Date	Particulars	L/F	Amount ₹
2013				2013			
Apr.1	To Balance b/d		5,000	Apr. 4	By Z A/c (Goods sold on credit)		3,000
4	,, Sales A/c (Goods sold to Mr. Z)		3,000	8	,, Purchase A/c (Goods purchased on credit)		3,000
6	,, Sales A/c (Goods sold for cash)		1,000	12	,, P A/c (Paid to P)		2,000
8	,, P A/c (Goods purchased on credit)		3,000		,, P A/c (Discount Received)		200
12	,, Discount Received A/c		200	15	P A/c (Goods returned)		800
15	,, Returns Outwards A/c (Goods Returned)		800	20	,, Returns Inwards A/c (Goods returned by Mr. Z)		300
20	,, Z A/c (Goods returned by Z)		300		,, Discount Allowed A/c		200
25	,, Z A/c (Received from Z)		2,500	26	,, Salary A/c (Paid Salary)		1,000
	,, Z A/c (Discount Allowed)		200		,, Balance c/d		7,500
26	,, Bank A/c (Withdrawn by cheque)		1,000				
30	`` Interest A/c (Interest Received)		1,000				
			18,000				18,000
May. 1	To Balance b/d		7,500				

LEDGER

A ledger is a group of accounts. Most of us have probably seen a bound book with the word 'ledger' printed on the cover. All the accounts of a small business/industry could be entered in a ledger in concerned accounts in a summarised and classified form.

From the journal a trader cannot know his total cash, purchases, amount spent under each head of expense and amount earned under each head of income. The journal will not tell him what he owes to his creditors and what his customers owe to him. Such classified information can be got only by opening ledger accounts for every kind of transaction. Every ledger has two sides namely debit and credit. Left hand side is debit and right hand side is credit. Each side of the ledger has columns on date, particulars, journal folio and amount- In the particulars column of the debit side the name of the account from which benefit is received is recorded and on the credit side, the name of the account to which benefit is given is recorded. The words 'To' and 'By' are affixed to the name of the amount entered on debit and credit sides respectively.

If a business is not able to accommodate all its accounts in one ledger it can have more than one ledgers. Business may have an 'accounts receivable ledger' an 'accounts payable ledger' and a 'general ledger' each containing the group of accounts suggested by the title. The ledger is not necessarily a bound book, it may consist of a set of loose leaf pages, a set of punched cards, or if computerised a set of impulses on a magnetic tape. No matter what its form may be, the essential character of the account and the rules for making entries to it remain exactly the same.

(i) Ledger Posting:

Transferring the entries from the journal or a subsidiary book to the ledger is known as posting. Posting the ledger from journal is easy as the transactions in the journal are already classified into debit and credit. However, the following points must be noted while posting the ledger.

– For the same person or expense only one account should be opened.

– Cash and credit sales should be posted to Sales Account and cash and credit purchases to Purchase Account.

– The word Debit as Dr. and Credit as Cr. should not be omitted.

– Date and folio columns should not be left blank.

(ii) Balancing of Ledger Accounts :

At periodic intervals, the debit and credit sides of individual ledger accounts are totalled and balance of each account indicated. If the total of the debit side of any account is more than the credit side, there will be a debit balance and, if the credit side is more than the debit side there will be credit balance.

With the help of the illustration which we took for recording journal entries, let us see how the ledger postings and balancing will be done.

Based on the illustration the following accounts need to be opened in ledger.

Dr. **Capital A/c** **Cr.**

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
	To balance c/d		20,000/-		By Cash		20,000/-
			20,000/-				20,000/-
				Feb.1	By balance b/f		20,000/-

Dr. **Cash A/c** **Cr.**

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
1997	To capital		20,000	1997	By purchase		6,000
Jan.1	To sales		2,000	Jan.3	By S		2,000
Jan.7	To B		4,000	Jan.12	By wages		100
Jan.17				Jan.23	By interest		200
				Jan.28	By salaries		200
				Jan.31	By bal. c/d		200
				Jan.31			17,500
			26,000				26,000
Feb1	To bal. b/f		17,500				

Dr. **Purchase A/c** **Cr.**

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
1997				1997			
Jan.3	To cash		6,000	Jan 31	By balance c/d		10,000
Jan.5	To S		4,000				10,000
			10,000				
Feb.1	To bal. b/f		10,000				

Dr. **Sales A/c** **Cr.**

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
1997				1997			
Jan.31	To balance		8,000	Jan.7	By cash		2,000
			8,000	Jan.10	By B		6,000
							8,000
				Feb.1	By bal. b/f		8,000

Dr. **S's A/c** **Cr.**

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
1997				1997			
Jan.12	To cash		2,000	Jan.5	By Purchase		4,000
Jan.31	To bal. c/d		2,000				
			4,000				4,000
				Feb.1	By bal. b/f		2,000

Trial balance

A trial balance is a statement showing the balances, or total of debits and credits, of all the accounts in the ledger with a view to verify the arithmetical accuracy of posting into the ledger accounts. Trial balance is an important statement in the accounting process as it shows the final position of all accounts and helps in preparing the final statements. The task of preparing the statements is simplified because the accountant can take the balances of all accounts from the trial balance instead of going through the whole ledger. It may be noted that the trial balance is usually prepared with the balances of accounts.

It is normally prepared at the end of an accounting year. However, an organisation may prepare a trial balance at the end of any chosen period, which may be monthly, quarterly, half yearly or annually depending upon its requirements.

In order to prepare a trial balance following steps are taken:

• Ascertain the balances of each account in the ledger.

• List each account and place its balance in the debit or credit column, as

the case may be. (If an account has a zero balance, it may be included in

the trial balance with zero in the column for its normal balance).

• Compute the total of debit balances column.

• Compute the total of the credit balances column.

• Verify that the sum of the debit balances equal the sum of credit balances. If they do not tally, it indicate that there are some errors. So one must check the correctness of the balances of all accounts. It may be noted that all assets expenses and receivables account shall have debit balances whereas all liabilities, revenues and payables accounts shall have credit balances.

Objectives of Preparing the Trial Balance

The trial balance is prepared to fulfill the following objectives :

1. To ascertain the arithmetical accuracy of the ledger accounts.

2. To help in locating errors.

3. To help in the preparation of the financial statements. (Profit & Loss account

and Balance Sheet).

Preparation of Trial Balance:

1. It may be prepared on a loose sheet of paper.

2. The ledger accounts are balanced at first. They will have either “debit-balance” or “credit balance” or “nil-balance”.

3. The accounts having debit-balance is written on the debit column and those having credit-balance are written on the credit column. The sum total of both the balances must be equal, for “Every debit has its corresponding and equal credit”.

Me1. Total Method or Gross Trial Balance.

2. Balance Method or Net Trial Balance.

3. Compound Method.

These are explained as under :-

1. Total Method or Gross Trial Balance : Under this method, two sides of the accounts are totalled. The total of the debit side is called the “debit total” and the total of the credit side is called the“credit total”. Debit totals are entered on the debit side of the Trial Balance while the credit total is entered on the credit side of the Trial Balance.

If a particular account has total in one side, it will be entered either in the debit column or the credit column as the case may be.

Advantages : (a) It facilitates arithmetical accuracy of the accounts.

(b) Extraction of ledger balances is not required at the time of preparation of Trial Balance.

Disadvantages : Preparation of final accounts is not possible.

2. Balance Method or Net Trial Balance : Under this method, all the ledger accounts are balanced. The balances may be either “debit-balance” or “credit balance”.

Advantages : (a) It helps in the easy preparation of final accounts.

(b) It saves time and labour in constructing a Trial Balance.

Disadvantages : Errors may remain undisclosed irrespective of the agreement of Trial Balance.

3. Compound Method : Under this method, totals of both the sides of the accounts are written in the separate columns. Along with this, the balances are also written in the separate columns. Debit balances are written in the debit column and credit balances are written in the credit column of the Trial Balance.

Advantages : It offers the advantage of both the methods.

Disadvantages : Lengthy process and more time consumed in the preparation of a Trial Balance.

Trial Balance – Utility and Interpretation

The utility of Trial balance could be found in the following:

(1) It forms the basis for preparation of Financial statements i.e. Profit and Loss Account and Balance sheet.

(2) A tallied trial balance ensures the arithmetical accuracy of the entries made. If the trial balance does not tally, the errors can be found out, rectified and then financial statements can be prepared.

(3) It acts as a quick reference. One can easily find out the balance in any ledger account without actually referring to the ledger.

(4) If the listing of ledger accounts is systematically done in the trial balance, one can do quick time analysis. Hence, listing is usually done in the sequence of Asset accounts, Liability accounts, Capital accounts, Owner's equity accounts, Income or gain accounts and Expenses or losses accounts in that order.

There are certain type of errors that will not affect tallying of the T.B. i.e. it will tally but still there will be errors. These are as follows:

(a) Error of omission: if any entry is totally missed, the T.B. will tally but will be incorrect and incomplete.

(b) Compensating error: if there are two errors that are compensating each other, still the T.B. will tally but not accurate.

(c) Wrong Account head: if entry for insurance paid is wrongly debited to Commission A/c, tallying of T.B. will not be affected.

(d) Error of duplication: if a transaction is recorded twice, again the T.B. will match.

(e) Error of principle: if interest received is wrongly entered as debit to interest and credit to cash, there won't be any mismatch in the T.B.

Procedure to locate Errors:

If the Trial Balance does not agree, the following procedure should carefully be followed :

(i) At first, check all ledger account balance one by one.

(ii) Addition of both the columns (Debit and Credit) should be checked.

(iii) If any difference comes divide the same by 2 and see whether the said figure appear on the correct side or not.

(iv) Additions of the subsidiary books, and ledger accounts to be checked up.

(vi) Posting from subsidiary books to the ledger to be checked up.

Example: From the following ledger account balances, prepare a Trial Balance of Mr. Sen for the year ended 31st March,2013.

Capital ` 80,000 ; Sales `10,00,000; Adjusted Purchase ` 8,00,000; Current A/c(cr) ` 10,000; Petty Cash` 10,000; Sales Ledger Balance ` 1,20,000; Purchase Ledger Balance ` 60,000; Salaries `24,000; Carriage Inwards ` 4,000; Carriage Outward ` 6,000; Discount Allowed ` 10,000; Building ` 80,000; Outstanding Expenses ` 10,000; Prepaid Insurance ` 2,000 ; Depreciation ` 4,000 ; Cash at Bank ` 80,000 ; Loan A/c (cr) ` 66,000; Profit & Loss A/c(cr) `

20,000; Bad Debts Recovered ` 2,000 ; Stock at 31.03.2013` 1,20,000; Interest Received ` 10,000; Accrued Interest ` 4,000; Investment ` 20,000; Provision for BadDebts (01.04.2012) ` 6,000 ; General Reserve ` 20,000. (All figures in Rs).

Solution.

Trial Balance of Mr. Sen

Dr. as on 31st March, 2013 Cr.

Heads of Accounts	Amount (₹)	Heads of Accounts	Amount (₹)
Adjusted Purchase	8,00,000	Capital	80,000
Petty Cash	10,000	Sales	10,00,000
Sales Ledger Balance	1,20,000	Current A/c	10,000
Salaries	24,000	Purchase Ledger Balance	60,000
Carriage Inward	4,000	Outstanding Expenses	10,000
Discount Allowed	10,000	Loan A/c	66,000
Building	80,000	Profit & Loss A/c(cr)	20,000
Prepaid Insurance	2,000	Bad Debts Recovered	2,000
Depreciation	4,000	Interest Received	10,000
Cash at Bank	80,000	Provision for Bad debts	6,000
Stock (31.03.2013)	1,20,000	General Reserve	20,000
Accrued Interest	4,000		
Investment	20,000		
Carriage outward	**12,84,000**		**12,84,000**

Depreciation

When the business uses its assets to earn income, there is wear and tear of the asset life. Assets will have limited life and as we go on using it, the value diminishes. Again the question to be asked is – at what value should the asset be shown in the balance sheet? Consider a machine was bought on 1st April 2011 for ` 200000. It's used for production activity throughout the year. When the final accounts are being prepared, at what value should it be shown in balance sheet as on 31st March 2012Well, according to cost principle initial entry for purchase of machine is shown at cost paid for it e.g. `200000 in this case. But the fact that the machine is used must be recognized in financials. Hence the value in the balance sheet must be brought down to the extent of its use. This is called as Depreciation. How is it calculated? While there are different methods of calculating depreciation (explained in subsequently), the simple idea is to spread it over the useful life of the asset, so that at the end of its life the value is zero. In our example, if useful life of the machine is taken as 10 years, the depreciation will be simply ` 200000 ÷ 10 i.e. ` 20000 every year. So a depreciation of ` 20000 will be charged to the profit of every year and value of asset will be brought down by the same value.

Students are advised to refer to Accounting Standard 6 issued by ICAI to get thorough knowledge on

Depreciation accounting.

The entry passed for this is:

Depreciation A/c Dr

To Fixed Asset A/c

The effect given is one – include in the P & L A/c as expense for the period and two – reduce from asset value in the balance sheet.

Accrued Expenses or Outstanding Expenses

There may be expenses incurred for the current accounting period, but not actually paid for. The matching concept, however, necessitates that this expense must be recognized as expense for the current year and should not be deferred till its actual payment. Typically, we know salary for the month is normally paid in the 1st week of the next month. Imagine the accounting period close on 31st March.

The salary for the month of March is not paid till 31st March. But is it is related to this month, it must be booked as expense for the current month and also as a liability payable in the next month (which is in next accounting period). This can be shown as follows:

March salary paid in April

Mar 2013 Apr 2013

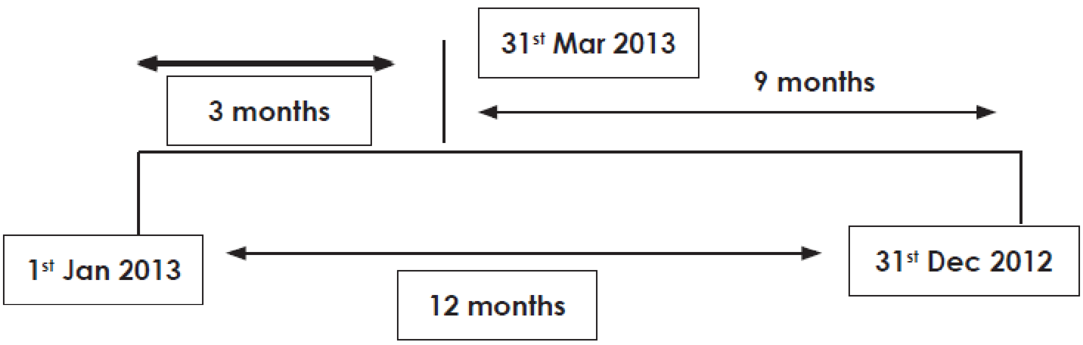
The entry for this is:

Expense A/c Dr

To Outstanding Expense A/c or Expense payable A/c

The two effects when preparing the final accounts are:One – add in respective expense in P & L A/c and two – show as a liability in the balance sheet. Prepaid Expenses At times we may pay for certain expenses which are period related. For example, the business has taken an insurance policy against fire on which the annual premium payable is ` 75000. The policy is taken on 1st January 2013 valid till 31st December 2013. But the company's accounting period ends on 31st March 2013. When considering the insurance expense for the accounting year, what amount should be considered? See the following.

As can be seen, out of the total premium period of 12 months, only 3 months are related to the current accounting period and the remaining 9 months' premium is related to the next accounting period. Hence only 3 months' premium is to be considered as expense for the current year i.e. ` 18750 (75000 ÷ 4).



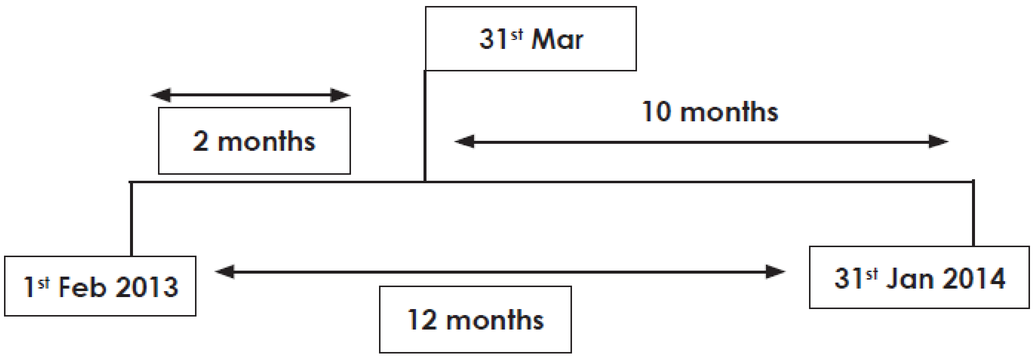
Prepaid Insurance A/c Dr.

To Insurance A/c

The two effects while preparing final accounts are:

One – Reduce from respective expense in P & L A/c and two – show as an asset in the balance sheet.

Accrued Incomes: Just as expenses accrue, there are instances of income getting accrued at the end of accounting period. The extent to which it accrues, it must be booked as income for the current accounting period .Consider, the business has put a One year fixed deposit of ` 100000 with Citi Bank at a fixed interest of 9 % p.a. on 1st February 2013 and the interest is credited by the bank on a semi-annual basis. Also, consider that the accounting period ends on 31st March 2013. The Citi bank will credit the 1st semi-annual interest on 31st July 2013 and the next on 31st January 2014. Now, consider the following :



It can be noticed that interest for the 2 months will be considered as accrued as on 31st of March 2012 and must be taken as income for the current accounting year.

The entry for this is:

Accrued Interest A/c Dr

To Interest A/c

The two effects while preparing final accounts are:

One – Show as income in the P & L A/c and two – show as an asset in the balance sheet.

Income Received in Advance

If an income is received which is not related to the current accounting period, it cannot be included in

the current year's P & L A/c. So, if it's already included as income it must be reduced. The entry for this is:

Respective Income A/c Dr

To Income received in advance A/c

The effects while preparing final account are:

One – Reduce from respective income and two – show it as liability in balance sheet

Accounting In Practice These are days of computerised accounting. Even smaller firms like sole proprietors use accounting packages like Tally 9.0 which are very strong. At this stage it is necessary to understand the practical aspects of how accounting is actually done by these packages. Based on years of experience, they come with a standard chart of account. The chart of account is nothing but master ledger accounts and they are numerically coded for quick and easy identification and reporting. There are customized screens made to enter different transactions. Hence, the user can not by mistake put a purchase transaction into sales book. The customers and vendors are also alpha-numerically coded for ease of identification. Once the basic documents are entered, the job of posting, balancing and trial balance is all automated. So actually, most of the potential errors can be avoided.

There is an increased feeling among students that when there are automated systems available, why should one go through the study of manual processes. This is absolutely essential for grasping basic concepts. Once, you thoroughly understand them, it will be easy to operate any computerised accounting package in practice.

Example: All figures in Rs

Journalize the following transactions in the books of Gaurav, post them into ledger and prepare trialbalance for June 2013 :

June 1: Gaurav started business with ` 10,00,000 of which 25% amount was borrowed from wife.

June 4: Purchased goods from Aniket worth ` 40,000 at 20% TD and 1/5th amount paid in cash.

June 7: Cash purchases ` 25,000.

June 10: Sold goods to Vishakha ` 30,000 at 30% TD and received 30% amount in cash.

June 12: Deposited cash into bank ` 20,000.

June 15: Uninsured goods destroyed by fire ` 5,500.

June 19: Received commission ` 3,500.

June 22: Paid to Aniket ` 25,500 in full settlement of A/c.

June 25: Cash stolen from cash box ` 1,000.

June 27: Received from Vishakha ` 14,500 and discount allowed ` 200.

June 30: Interest received ` 2,400 directly added in our bank account.

In the books of Gaurav
Journal

Date 2013	Particulars		L.F.	Dr. Amount (₹)	Cr. Amount (₹)
1-Jun	Cash A/c	Dr		1,000,000	
	To Capital A/c				750,000
	To Loan from Wife A/c				250,000
	(Being capital brought into business)				
4-Jun	Purchases A/c	Dr		32,000	
	To Cash A/c				6,400
	To Aniket's A/c				25,600
	(Being goods purchased at 20% TD & 1/5th amount paid in cash)				
7-Jun	Purchases A/c	Dr		25,000	
	To Cash A/c				25,000
	(Being cash purchases)				
10-Jun	Cash A/c	Dr		6,300	
	Vishakha's A/c	Dr		14,700	
	To Sales A/c				21,000
	(Being goods sold at 30% TD & 30% amount received in cash)				
12-Jun	Bank A/c	Dr		20,000	
	To Cash A/c				20,000
	(Being cash deposited in bank)				
15-Jun	Loss by Fire A/c	Dr		5,500	
	To Purchases A/c				5,500
	(Being uninsured goods lost by fire)				
19-Jun	Cash A/c	Dr		3,500	
	To Commission A/c				3,500
	(Being commission received)				
22-Jun	Aniket's A/c	Dr		25,600	
	To Cash A/c				25,500
	To Discount A/c				100
	(Being paid to Aniket in full settlement & discount received)				
25-Jun	Loss by Theft A/c	Dr		1,000	
	To Cash A/c				1,000
	(Being cash stolen)				
27-Jun	Cash A/c	Dr		14,500	
	Discount A/c			200	
	To Vishakha's A/c				
	(Being amount received from Vishakha & discount allowed)				14,700
30-Jun	Bank A/c			2,400	
	To Interest A/c				2,400
	(Being interest received directly added into bank account)				
				1,150,700	1,150,700

Cash account

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amont (₹)
1/6/13	To Capital A/c		7,50,000	4/6/13	By PurchasesA/c		6,400
1/6/13	To Loan from Wife A/c		2,50,000	7/6/13	By Purchases A/c		25,000
10/6/13	To Sales A/c		6,300	12/6/13	By Bank A/c		20,000
19/6/13	To Commission A/c		3,500	22/6/13	By Aniket's A/c		25,500
27/6/13	To Vishakha's A/c		14,500	25/6/13	By Loss by Theft A/c		1,000
				30/6/13	By Balance c/d		9,46,400
			10,24,300				10,24,300
1/7/13	To Balance b/d		9,46,400				

Dr.			Capital Account				Cr.
Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
30/6/13	To Balance c/d		7,50,000	1/6/13	By Cash A/c		7,50,000
			7,50,000				7,50,000
				1/7/13	By Balance b/d		7,50,000

Dr.			Loan from Wife Account				Cr.
Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amtoun (₹)
30/6/13	To Balance c/d		2,50,000	1/6/13	By Cash A/c		2,50,000
			2,50,000				2,50,000
				1/7/13	By Balance b/d		2,50,000

Dr.			Purchases Account				Cr.
Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
4/6/13	To Cash A/c		6,400	15/6/13	By loss by fire		5,500
4/6/13	To Aniket's A/c		25,600	30/6/13	By Bal c/d		51,500
7/6/13	To Cash A/c		25,000				
			57,000				57,000
1/7/13	To Balance b/d		51,500				

Dr.			Aniket's Account				Cr.
Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
22/6/13	To Cash A/c		25,500	4/6/13	By PurchasesA/c		25,600
22/6/13	To Discount A/c		100				
			25,600				25,600

Dr.			Vishakha's Account				Cr.
Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
10/6/13	To Sales A/c		14,700	27/6/13	By Cash A/c		14,500
				27/6/13	By Discount A/c		200
			14,700				14,700

Dr.			Sales Account				Cr.
Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
30/6/13	To Balance c/d		21,000	10/6/13	By Cash A/c		6,300
				10/6/13	By Vishakha's A/c		14,700
			21,000				21,000
				1/7/13	By Balance b/d		21,000

Dr.			Bank Account				Cr.
Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
12/6/13	To Cash A/c		20,000	30/6/13	By Balance c/d		22,400
30/6/13	To Interest A/c		2,400				
			22,400				22,400
1/7/13	To Balance b/d		22,400				

Dr.			Loss by Fire Account				Cr.
Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
15/6/13	To Purchases A/c		5,500	30/6/13	By Balance c/d		5,500
			5,500				5,500
1/7/13	To Balance b/d		5,500				

Dr.			Commission Account				Cr.
Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
30/6/13	To Balance c/d		3,500	19/6/13	By Cash A/c		3,500
			3,500				3,500
				1/7/13	By Balance b/d		3,500

Dr.			Discount Account				Cr.
Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
27/6/13	To Vishakha's A/c		200	22/6/13	By Aniket's A/c		100
				30/6/13	By Balance c/d		100
			200				200
1/7/13	To Balance b/d		100				

Dr.			Loss by Theft Account				Cr.
Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
25/6/13	To Cash A/c		1,000	30/6/13	By Balance c/d		1,000
			1,000				1,000
1/7/13	To Balance b/d		1,000				

Dr.			Interest Account				Cr.
Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
30/6/13	To Balance c/d		2,400	30/6/13	By Bank A/c		2,400
			2,400				2,400
				1/7/13	By Balance b/d		2,400

Trial Balance as on 30.6.13

	Dr.	Cr.
Name of Account	(₹)	(₹)
Cash A/c	9,46,400	-----
Capital A/c	-----	7,50,000
Loan from Wife A/c	-----	2,50,000
Purchases A/c	51,500	-----
Aniket's A/c	-----	-----
Vishakha's A/c	-----	-----
Sales A/c	-----	21000
Bank A/c	22,400	-----
Loss by Fire A/c	5,500	-----
Commission A/c	-----	3500
Discount A/c	100	-----
Loss by Theft A/c	1,000	-----
Interest A/c	-----	2,400
Total	10,26,900	10,26,900

Bank Reconciliation Statement (BRS)

To keep a record of business transactions, a Bank Reconciliation Statement (BRS) comes into play. Bank Reconciliation Statement is a statement which records differences between the bank statement and general ledger. The amount specified in the bank statement issued by the bank and the amount recorded in the organization's accounting book maintained by Chartered Accountant might differ. A BRS checks entries on a monthly basis to avoid any future discrepancy. A BRS means matching records for a cash account entries corresponding to the bank statement. BRS checks the dissimilarity found between the two and makes appropriate changes. In this article, we will discuss the bank reconciliation format and how to prepare it.

A bank reconciliation statement is a summary of business activity that reconciles financial details. It ensures that payments have been processed and money has been deposited on the same date. An accountant prepares the reconciliation statement once a month.

Bank Reconiliation Statement Format

PARTICULARS	AMOUNT (Rs)	
Balance as per Pass Book (Cr) (Positive) (Favourable)		10,000
Add: 2) Cheques deposited but not credited	2,000	
4) Bank charges unrecorded	10	2,010
		12,010
	5,000	
Less: 1) Cheque issued but not cleared		
	50	
3) Bank Interest received unrecorded in cash book		5,050
Calculate balance as per Cash Book (Dr) (Positive) (Favourable)		6,960

The bank prepares a bank statement including cash deposits and withdrawals for a month. Whereas, accounting record book records the same entries by the hands of the accountant. Due to the difference in publishing firms, errors might creep in. Bank reconciliation helps in substituting those differences. In simple words, to eradicate two different versions of the same document.

Difference Between Bank Reconciliation Statement and Company's Ledger

Cheque issued by the company not delivered for payment

Before the end of the month (i.e. time of BRS generation) if a company issues a cheque and it is not handed for payment, it would not be counted as debit amount. This might become a discrepancy.

Deposits entered in ledger but not stated in the bank statement

The depositor might submit some amount in his account. If the payment is not recorded in the bank statement, it will make a difference. Whereas a depositor will never forget to add an entry for the same.

Interest rates may differ

The interest rates differ from bank to bank. Ledger may contain entries with a slight difference in interest. Also, interests on some entries might out in ledger!

Service charges might not be applied properly

Banks provide various services to their users with applicable service charges. Like interest rates, service charges can be missed.

NSF Check might cause an error

NSF (Not Sufficient Funds) is a highlighted issue. Bank officials add money in beneficiary's account after receiving a cheque.If a sufficient amount is not present in payee's account, it deducts the amount from the beneficiary's account.The bank returns the cheque to the payee with NSF Check. The entry might be saved as an added amount and causes an error in the company's ledger.

Steps to Prepare Bank Reconciliation Statement

Initial Check

First of all, compare the records in the company's bank statement and ledger cash account. Check off records that match. Check whether all records in ledger clear the bank account statement. Reconciliation at this stage removes major faults.

Deposit Check

Once the initial check is complete, mark all items remained in the ledger. Add any transit deposits accounted in ledgers that might not appear in the bank statement. Hence, the case of transit deposits occurs due to transactions made just before bank holidays or non-working hours. Transit deposits are deposits that are currently in pending status and therefore, bank statement can't note them.

Interests earned

Add the interests earned noting accurate interest rates. It applies only to interest-bearing accounts.

Bank errors

After all, officials working in the bank are humans like us. They might mistakenly interchange entries for two different account statements. Or they might record wrong entries. Add or delete bank errors accordingly.

Outstanding Checks

Deduct outstanding checks from overall balance.

Check ledger errors

A bank provides facilities for which it charges. Like transfer charges, account maintenance charges, late payment charges, etc. Deduct bank service charges from the ledger.

Check Reconciliation

Ledger may contain posting a payment that didn't reach completion. Make necessary amendments. Check it carefully before adding in the bank statement.

Equate Final Balance

The overall balance must match to finalize reconciliation.

Journal Entries

As a part of this process, you might require to prepare some journal entries to correct errors. These errors are those which interrupt during bank statement and general ledger comparison.

Importance of Bank Reconciliation Statement

There's no point in saying that banks aren't trustworthy. But there is no harm in double-checking the bank statements with ledgers. After all, bank accounts hold our assets.Segregation of duties makes it possible to rectify errors at a better speed. Hence, the identification and correction of errors are necessary. Neither bank nor you would like to meet a loss. Reconciliation also assists in monitoring the flow of cash in a business.

When can we request a Reconciliation?

Usually, a general schedule suggests a monthly reconciliation. For example, you are handling a large scale business with transactions over 50 in a week. Cash accounts require some reconciliation schedule. A reconciliation can occur in 15 days or weekly.

Conclusion

BRS proves to be a useful tool in fixing irrelevant faults in bank statements. Bank statements are useful in huge transactions and in making Income Tax Return (ITR) statements. We can call it a basic medium of operation in banking. If basic is not justified, unidentified problems arise with further documents.Reconciliation makes the bank statement error-free and clears additional charges. Therefore, before closing the accounting chapter in the banking book, reconciliation checks whether the closing page hits green light i.e. ending is correct and safe