Unit 2

Mechanics of Accounting

The mechanics of accounting refer to the processes and procedures involved in recording, classifying, summarizing, and interpreting financial transactions within an organization. These processes are crucial for generating accurate financial statements and reports that provide insights into the financial health and performance of a business. Here are the key mechanics involved in accounting:

1. **Recording Transactions:** The first step in accounting involves systematically recording all financial transactions, such as sales, purchases, and expenses, in appropriate books of accounts.
2. **Double-Entry Bookkeeping:** The double-entry system is used to record each transaction with at least two entries: a debit and a credit, ensuring that the accounting equation (Assets = Liabilities + Equity) remains balanced.
3. **Journals and Ledgers:** Transactions are initially recorded in a journal and then posted to respective ledger accounts. Journals provide a chronological record of transactions, while ledgers provide a summary of transactions related to specific accounts.
4. **Trial Balance:** A trial balance is prepared to ensure that the total debits equal the total credits, thus verifying the accuracy of the recorded transactions before preparing the financial statements.
5. **Financial Statements:** The final step involves preparing financial statements, including the income statement, balance sheet, and cash flow statement. These statements provide an overview of the organization's financial performance, position, and cash flows.
6. **Closing Entries:** At the end of an accounting period, temporary accounts such as revenues and expenses are closed to the retained earnings account to prepare for the next accounting period.
7. **Adjusting Entries:** Adjusting entries are made to ensure that the revenue recognition and matching principles are followed, and to account for any accrued revenues or expenses that have not been recorded.
8. **Financial Analysis:** Financial analysis is performed to interpret the data from financial statements, which helps in assessing the organization's financial performance, profitability, liquidity, and solvency.

Accounting Standards

Accounting Standards (ASs) provide framework and standard accounting policies for treatment of transactions and events so that the financial statements of different enterprises become comparable. Accounting standards are written policy documents issued by the expert accounting body or by the government or other regulatory body covering the aspects of recognition, measurement, presentation and disclosure of accounting transactions and events in the financial statements. The ostensible purpose of the standard setting bodies is to promote the dissemination of timely and useful financial information to investors and certain other parties having an interest in the company's economic performance. The accounting standards deal with the issues of -

i. recognition of events and transactions in the financial statements;
ii. measurement of these transactions and events;
iii. presentation of these transactions and events in the financial statements in a manner that is meaningful and understandable to the reader; and
iv. the disclosure requirements which should be there to enable the public at large and the stakeholders and the potential investors in particular, to get an insight into what these financial statements are trying to reflect and thereby facilitating them to take prudent and informed business decisions.

Objectives of Accounting Standards

The whole idea of accounting standards is centred around harmonisation of accounting policies and practices followed by different business entities so that the diverse accounting practices adopted for various aspects of accounting can be standardised. Accounting Standards standardise diverse accounting policies with a view to:

i. eliminate the non-comparability of financial statements and thereby improving the reliability of financial statements; and
ii. provide a set of standard accounting policies, valuation norms and disclosure requirements.

Accounting standards reduce the accounting alternatives in the preparation of financial statements within the bounds of rationality, thereby ensuring comparability of financial statements of different enterprises.

Benefits and Limitations of Accounting Standards

Accounting standards seek to describe the accounting principles, the valuation techniques and the methods of applying the accounting principles in the preparation and presentation of financial statements so that they may give a true and fair view. By setting the accounting standards, the accountant has following benefits:

i. Standards reduce to a reasonable extent or eliminate altogether confusing variations in the accounting treatments used to prepare financial statements.
ii. There are certain areas where important information are not statutorily required to be disclosed. Standards may call for disclosure beyond that required by law.
iii. The application of accounting standards would, to a limited extent, facilitate comparison of financial statements of companies situated in different parts of the world and also of different companies situated in the same country. However, it should be noted in this respect that differences in the institutions, traditions and legal systems from one country to another give rise to differences in accounting standards adopted in different countries.

However, there are some limitations of accounting standards:

i. ***Difficulties in making choice between different treatments:*** Alternative solutions to certain accounting problems may each have arguments to recommend them.

Therefore, the choice between different alternative accounting treatments may become difficult.

ii. ***Restricted scope:*** Accounting standards cannot override the statute. The standards are required to be framed within the ambit of prevailing statutes.

List of Accounting Standards in India

S. No.	Number of Accounting Standards (AS)	Title of the Accounting Standard
1.	AS 1	Disclosure of Accounting Policies
2.	AS 2 (Revised)	Valuation of Inventories
3.	AS 3 (Revised)	Cash Flow Statements
4.	AS 4 (Revised)	Contingencies and Events Occurring after the Balance Sheet Date
5.	AS 5 (Revised)	Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies
6.	AS 7 (Revised)	Accounting for Construction Contracts
7.	AS 9	Revenue Recognition
8.	AS 10	Property, Plant and Equipment
9.	AS 11 (Revised)	The Effects of Changes in Foreign Exchange Rates
10.	AS 12	Accounting for Government Grants
11.	AS 13	Accounting for Investments
12.	AS 14	Accounting for Amalgamations
13.	AS 15 (Revised)	Employee Benefits
14.	AS 16	Borrowing Costs
15.	AS 17	Segment Reporting
16.	AS 18	Related Party Disclosures
17.	AS 19	Leases
18.	AS 20	Earnings Per Share
19.	AS 21	Consolidated Financial Statements
20.	AS 22	Accounting for Taxes on Income
21.	AS 23	Accounting for Investments in Associates in Consolidated Financial Statements
22.	AS 24	Discontinuing Operations
23.	AS 25	Interim Financial Reporting
24.	AS 26	Intangible Assets
25.	AS 27	Financial Reporting of Interests in Joint Ventures
26.	AS 28	Impairment of Assets
27.	AS 29	Provisions, Contingent Liabilities & Contingent Assets

IFRS

The International Financial Reporting Standards (IFRS) are a set of accounting standards developed by the International Accounting Standards Board (IASB) to establish a common global language for business affairs. These standards are designed to provide a comprehensive framework for the preparation, presentation, and disclosure of financial statements. They are intended to enhance transparency, comparability, and quality of financial information across different countries and industries. Some key features of IFRS include:

1. **Global Applicability:** IFRS are designed to be globally applicable, making it easier for multinational companies to present their financial statements in a consistent manner across different jurisdictions.
2. **Principles-Based Approach:** IFRS are principles-based rather than rules-based, providing a conceptual framework that allows for more interpretation and judgment in their application. This flexibility enables companies to adapt the standards to their specific circumstances while still ensuring transparency and comparability.
3. **Comprehensive Coverage:** IFRS cover a wide range of accounting topics, including financial instruments, revenue recognition, leasing, and business combinations. They provide guidance on how to recognize, measure, present, and disclose various financial transactions and events.
4. **Disclosure Requirements:** IFRS emphasize the importance of providing relevant and comprehensive information in financial statements. Companies are required to disclose significant accounting policies, key assumptions, and other pertinent information that could impact users' understanding of the financial statements.
5. **Consistency and Comparability:** By promoting consistency and comparability in financial reporting, IFRS facilitate better decision-making for investors, creditors, regulators, and other stakeholders. They help improve the transparency and reliability of financial information, thereby enhancing investor confidence and reducing information asymmetry.
6. **Convergence Efforts:** Many countries have adopted or converged their national accounting standards with IFRS, contributing to the global harmonization of accounting practices. This convergence aims to facilitate cross-border investments, mergers, and acquisitions, as well as promote international trade and economic development.

International Accounting Principles and Standards

International accounting principles and standards refer to a set of guidelines and rules that are recognized and utilized globally to ensure uniformity and comparability in financial reporting across countries and jurisdictions. These standards are crucial for enhancing transparency, facilitating cross-border transactions, and promoting confidence in the global financial system.

The primary international accounting principles and standards include:

1. **International Financial Reporting Standards (IFRS):** Developed by the International Accounting Standards Board (IASB), IFRS are a set of globally accepted accounting standards designed to provide a common framework for preparing financial statements. They are principles-based and intended for use by public companies in various countries around the world.
2. **Generally Accepted Accounting Principles (GAAP):** GAAP is a set of accounting standards, principles, and procedures that are widely used in the United States. While

not fully convergent with IFRS, efforts have been made to align the two systems to promote global consistency in financial reporting.

3. **International Public Sector Accounting Standards (IPSAS):** IPSAS are a set of accounting standards for use by governments and other public sector entities. They provide guidance on various aspects of accounting, including financial reporting, budgeting, and disclosure requirements.

4. **International Standards on Auditing (ISA):** ISA are a set of standards and guidelines for conducting quality audits of financial information. They provide guidance to auditors on the conduct of an audit and the preparation of audit reports to ensure the credibility and reliability of financial statements.

5. **International Accounting Education Standards Board (IAESB):** The IAESB develops education standards and guidance for the development and assessment of professional knowledge, skills, and competence of accountants. These standards ensure that accountants are equipped with the necessary expertise to apply international accounting principles effectively.

Matching of Indian Accounting Standards with International Accounting Standards

India has made significant efforts to align its accounting standards with international accounting standards to improve transparency and comparability in financial reporting. The adoption of International Financial Reporting Standards (IFRS) in India has been facilitated through the issuance of Indian Accounting Standards (Ind AS), which are largely converged with IFRS.

The matching of Indian Accounting Standards with International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS) includes several key areas:

1. **Convergence with IFRS:** The Indian accounting standards have been gradually aligned with IFRS to ensure consistency and comparability with global accounting practices. The convergence process aims to bridge the gap between Indian accounting standards and international standards, enabling Indian companies to prepare financial statements that are more in line with international norms.

2. **Adoption of Ind AS:** The Ministry of Corporate Affairs (MCA) in India mandated the adoption of Ind AS for certain classes of companies, including listed companies and unlisted companies meeting specific financial thresholds. Ind AS adoption has helped Indian companies improve the quality and transparency of financial reporting and has made it easier for them to raise funds internationally.

3. **Disclosure Requirements:** Indian accounting standards have been modified to align with the disclosure requirements of IFRS. This ensures that Indian companies provide comprehensive and transparent financial information, enhancing the understanding of their financial performance and position by domestic and international stakeholders.

4. **Revisions and Updates:** The Accounting Standards Board (ASB) in India periodically revises and updates the Indian Accounting Standards to ensure continued convergence with IFRS and international best practices. This ongoing process helps Indian companies stay up to date with global accounting standards and practices.

5. **Training and Education:** Efforts have been made to provide training and education to accounting professionals in India to facilitate the smooth transition to Ind AS and enhance their understanding of international accounting standards and their application in the Indian context.

Dual Aspect of Accounting

This is the basic principle of accounting. As per this principle every financial transaction of the business has dual effect and recorded at two places. Therefore, it is called double entry system. On the basis of this principle, it is said that every debit must have an equivalent credit and every credit must have an equivalent debit because every transaction of the business has two aspects. For instance, if Mr. Aditya Raj started a business for cash 2,00,000 there will be two aspects of this transaction. In one aspect cash is coming into business while in the other aspect the business has to pay this amount to Mr. Aditya Raj. Because Mr. Aditya Raj has given the amount to the business. For this transaction the following journal entry will be passed:

Cash A/c Dr.

To Mr. Aditya Raj

Or

To Capital A/c

This transaction can be expressed in the following equation:

Capital = Assets (Cash)

₹2,00,000 = ₹2,00,000

Here cash (assets) is the resource of the business and capital is the claim of the proprietor as business has to return this amount to the proprietor.

If the business purchases furniture of 20,000 on credit, the above equation will change as follows:

Capital + Creditors = Cash + Furniture

2,00,000 + 20,000 = 2,00,000 + 20,000

Capital + Liabilities = Assets

Thus, we find that in the above equations the total of assets is always equal to the liabilities. Technically we can say that for every debit there is an equivalent credit. This relationship of assets and liabilities is also called accounting equation.

Account

An account is a statement in which the date wise details regarding the business transactions as persons, companies, representatives, assets, liabilities, income and expenditures and profit & loss are given.

Kinds of Accounts

For the purpose of ruling of debit and credit, under double entry system the accounts are classified on the basis of two approaches. These are:

1. American Approach
2. English Approach

1. ***American Approach:*** As per this approach the accounts relating to financial transactions are classified as follows:

a) *Assets Accounts:* Under this heading those transactions are kept which are relating to the business assets as plant, machinery, land, building, etc.
b) *Liabilities Account:* Under this heading those accounts are kept which are relating to the credit purchases and outstanding expenses, loans, capital, etc.
c) *Capital Account:* Capital account is an account stating the amount of fund and assets invested by the owners in the business.
d) *Revenue Accounts:* Revenue accounts include the transactions relating to income, commission, interest, dividend, sales, etc.
e) *Expenses Accounts:* These include those accounts which are relating to the expenses of business as repairs, rent, maintenance, insurance, and lighting, etc.

2. English Approach: Under this approach accounts are classified into following three categories:

a) *Personal Account:* Here those accounts are included which are relating to persons, firms, companies, representatives and organizations as Shiam Lal & Company's Account, etc.
b) *Real Account:* Accounts which are relating to the assets and properties of the business are counted under this heading. Assets can be real or intangible. Real assets are as land & buildings, plant & machinery, cash and stock, etc. While intangible assets may be as goodwill, patents and trademarks, etc.
c) *Nominal Account:* Accounts which are relating to the revenues, incomes, expenses and losses of the business are called nominal accounts. For example, rent, commission, interest, dividend, etc.

Preparation of Journal

Journal

Journal is a book of accounts in which all day-to-day business transactions are recorded in a chronological order i.e., in the order of their occurrence. Transactions when recorded in a Journal are known as entries. It is the book in which transactions are recorded for the first time. Journal is also known as 'Book of Original Record' or 'Book of Primary Entry'.

The accounting process does not stop here. The transactions are recorded in number of books in chronological order. Such recording of business transactions serves little purpose of accounting. Items of same title in different books of accounts need to be brought at one place under one head called an account. There are numerous account titles of items/persons or accounts. All the accounts, if brought in one account book, will be more informative and useful. The account book so maintained is called Ledger.

'Journal' word is derived from French word '*Jour*' which means a daybook. Journal is a primary book of original entries for accounting data. In the Journal the business transactions are recorded chronologically that is called Journalising. Thus, the accounting data are recorded first time in this book. In the words of Carter, "A Journal, as originally used, is a book of primary entry in which transactions are copied in the order of date from a memorandum or waste book. The entries are then copied and classified into debts and credits, so far to facilitate their being correctly posted afterwards in the ledger". The proforma of a Journal is given here under:

Pro forma of a Journal

Date	Particulars	L.F.	Amount Dr. (₹)	Amount Cr. (₹)

As per the above pro forma of Journal the first column is kept for date means date of transaction is recorded, second wide column for particulars of business transactions in which the related accounts are showed along with their narrations. Third column is for ledger folio number where the journal entry is posted in ledger. The fourth and fifth columns are kept for debit amount and credit amount.

What is meant by the journal entry?

It is an entry systematically recorded to the tune of golden rules of accounting in the journal book is known as journal entries.

Rules of Debiting and Crediting in Journal

In the Journal the business transactions of the financial nature are recorded on the basis of debit and credit. The accounts are debited and credited on the basis of following rules. These rules are based on the English classification of accounts.

1. ***Personal Account:*** If in a transaction, a person receives something in cash or goods, it is debited and if that person gives, that is credited. Debit account is denoted by 'Dr.' while credit account is denoted by 'Cr.' In brief, the rule of personal account is.

Receiver is debited (Dr.)

Giver is credited (Cr.)

2. ***Real Account:*** If in a transaction, the assets are coming into business, they are debited and if those are going outside from business, they are credited. Thus, these rules are as below:

'What comes in' is debited.

'What goes out' is credited.

3. ***Nominal Account:*** The rules of debiting and crediting of nominal account are – the expenses and losses of the business are debited, and the gains and profit of the business are credited. In brief the rules are:

Expenses and Losses are debited.

Incomes and Gains are credited.

At the time of Journalising of the transactions, when an account is debited, it is denoted by 'Dr.' and crediting of an account by 'To'. When a transaction is recorded first of all its two aspects (accounts) are identified, those may of the same group (same type of account) or different groups (different types of accounts). Then the rules of debiting and crediting are applied. On the completion of a page of the Journal it is totalled, and the balance is carried forward to the next page.

Illustration: Journalise the following transactions in the books of Mr. Ram Krishna:

2007		**(₹)**
July 1	Mr. Ram Krishna Started business with cash	2,00,000
July 4	Goods purchased in cash	20,000
July 5	He deposited in Bank	40,000
July 7	Goods sold	15,000
July 10	Goods purchased from Mr. Kamlesh on credit	25,000
July 11	Furniture purchased	18,000
July 12	Wages paid	4,000
July 20	Interest received	500
July 25	Cash paid to Mr. Kamlesh	25,000
July 30	Additional capital brought by Mr. Ram Krishna	50,000

Solution:

Journal of Mr. Ram Krishna

Date	Particulars	L.F.	Amount Dr. (₹)	Amount Cr. (₹)
2007 July 1	Cash A/c Dr. To Capital A/c (Being start of business by Mr. Ram Krishna)		2,00,000	2,00,000
July 4	Purchase A/c Dr. To Cash A/c (Being purchase of goods in cash)		20,000	20,000
July 5	Bank A/c Dr. To Cash A/c (Being deposit of cash into Bank)		40,000	40,000
July 7	Cash A/c Dr. To Sales A/c (Being sale of goods in cash)		15,000	15,000
July 10	Purchase A/c Dr. To Mr. Kamlesh (Being purchase on credit from Mr. Kamlesh)		25,000	25,000
July 11	Furniture A/c Dr. To Cash A/c (Being purchase of furniture)		18,000	18,000
July 12	Wage A/c Dr. To Cash A/c (Being payment of wages in cash)		8,000	8,000

July 20	Cash A/c Dr. To Interest A/c (Being receipt of interest)		500	500
July 25	Mr. Kamlesh Dr. To Cash A/c (Being payment of credit purchases)		25,000	25,000
July 30	Cash A/c Dr. To Capital A/c (Being introduction of additional capital in business)		50,000	50,000
	Total		3,97,500	3,97,500

Compound Journal Entry

When two or more transactions take place in the business relating to a same account on the same date, in the place of passing many entries for the same account a single journal entry is pass which is called a compound journal entry. Compound entry can be of following three types:

a) Single debit account and more than one credit account
b) Single credit account and more than one debit accounts
c) More than one debit account and more than one credit account

For example, if a debtor is allowed cash discount and he makes the payment. Then the accounts involved are three, i.e., (1) Cash A/c (2) Discount A/c and (3) The Debtors A/c.

The following compound entry is to be passed:

Date	Particulars	L.F.	(₹)	(₹)
	Cash A/c Dr. Discount A/c Dr. To Debtors A/c (Debtor paid & discount allowed)			

Opening Journal Entry

The closing balances of accounts of one year are transferred to the next year. In the next year these balances become the opening balances. After recording the opening balances, the transactions of the year are recorded. To record the opening balances a Journal entry is passed which is called opening entry. Suppose in a business there are closing balances of cash of 10,000, plant 90,000 and capital of 1,00,000, and then opening Journal entry will be as follows:

Assets Account Dr.	90,000	
Cash Account Dr.	10,000	
To Capital Account		1,00,000

Illustration: Pass the necessary opening entry on 1st January 2006 in the books of Gopinath.

Cash in hand	3,000
Cash at Bank	16,000

Stock in trade	30,000
Furniture & Fittings	5,000
Sundry Debtors	21,000
Sundry Creditors	18,000
Loan from Ganesh & Co.	9,000

Solution:

Opening Journal Entries

Date	Particulars		L.F.	(₹)	(₹)
1.1.2006	Cash in hand A/c	Dr.		3,000	
	Cash at bank A/c	Dr.		16,000	
	Stock in trade A/c	Dr.		30,000	
	Furniture's Fittings A/c	Dr.		5,000	
	Sundry debtors A/c	Dr.		21,000	
	To Sundry creditors A/c				18,000
	To Ganesh & Co. A/c				9,000
	To Capital A/c				48,000
	(Opening entry in respect of assets and liabilities. Difference between Assets and liabilities is equal to capital)				

Ledger

Journal of a business is very useful, but it does not reply to the different queries as how much amount is due from debtors, how much is to be paid to creditors and what is the balance of a particular account etc. For the reply of all these queries the ledger is prepared from the Journal entries. Ledger is the set of accounts in which all types of account (personal, real or nominal) are kept. There can be two forms of ledger:

a) Bound Ledger
b) Loose Leaf Ledger

A ledger in traditional way, is normally kept in the form of bound notebooks. In bigger business enterprises, it is not easy to maintain a large and variety of transaction in a single book. To overcome this difficulty, loose leaf shuts take the place of bound books.

Under loose leaf ledger, appropriate sheets are introduced. Additional pages may be added to any extent, completed account may be removed to reduced volume, any account may be rearranged so as to suit the needs of the enterprises. This mode of maintaining ledger in the form of loose sheets is called loose leaf ledger.

Posting

The process of transferring the entries from Journal to Ledger accounts is called posting. In other words, account wise selection of debit or credit items and recording them into the relevant side of the relevant account is called posting. The process of posting is done after a period as week, fortnight, or a month. For example, if rent as an expense is shown in the debit in Journal, this will be posted in the debit side of the Rent (Expenses) A/c in the Journal. The proforma of a Ledger account is given below:

Proforma of an Account

Name of Account………

Date	Particulars	L.F.	Amount (Dr.) (₹)	Date	Particulars	L.F.	Amount (Cr.) (₹)

In the above proforma of an account, there are two sides of an account. Left hand side is debit side and right-hand side is credit side. In both the sides, the first column is for date and second column for details, third column for the Journal folio number and in the last column the amount of the transaction is recorded.

Rules of Posting in Ledger Account

At the time of posting of transactions from Journal to ledger the following points/rules should be kept in mind:

1. In the debit side of a ledger account, the word 'To' is used while in the credit side word 'By' is used.
2. All those accounts are opened in the Ledger which are given in the Journal.
3. All the debit items of an account given in Journal are posted in the debit side of the respective account. And all the credit items of an account given in Journal are posted in the credit side of the respective account in ledger.
4. The name of the account, in which posting is being made, is not written. But the posting is done by the name of other account given in the opposite side of that entry in the Journal.
5. At the time of posting if the page is full and account is not complete, its total is carried to the next page and then remaining posting is done.

Balancing

There can be several transactions relating to a particular account in the different places in the Journal. Such transactions are collected and recorded in the concerned account. At the end of the accounting period, the businessman becomes interested to know the position of these accounts. The position of an account is determined by calculating the net balance of the account for which debit and credit sides of the account are totalled separately. If total of debit side is greater than the total of credit side, difference is written in the credit side of the account and that is carried to next year. And if the total of credit side is greater than the total of debit side, difference is written in debit side and carried to next year. Thus, totals of both the sides become equal and account is closed.

Balancing of Different types of Accounts

Assets: All asset accounts are balanced. These accounts always have a debit balance.

Liabilities: All Liability accounts are balanced. All these accounts have a credit balance.

Capital: This account is always balanced and usually has a credit balance.

Expense and Revenues: These Accounts are not balanced but are simply totalled up. The debit total of Expense/Loss will show the expense/Loss. In the same manner, credit total of Revenue/Income will show increase in income. At the time of preparing the Trial Balance, the totals of these are taken to the Trial Balance.

Example: Record the following transactions in the Journal and post them into Ledger of Mr. Aditya Raj:

2008		**(₹)**
March 1	Purchase of Goods from Ramautar	3,20,000
March 10	Paid Rent for the month	2,000
March 11	Purchase of Plant	1,00,000
March 12	Paid Salaries	12,000
March 15	Paid Ramautar	1,00,000
March 20	Sold Goods to Shyam	20,000
March 25	Received from Shyam	30,000
March 31	Reserved Cash from Cash Sales	2,50,000
March 31	Wages Paid	5,000

Solution:

Journal of Mr. Aditya Raj

Date	Particulars	L.F.	Amount (Dr.) (₹)	Amount (Cr.) (₹)
2008 March 1	Purchase A/c Dr. To Ramautar (Being purchase of goods on credit)		3,20,000	 3,20,000
March 10	Rent Account Dr. To Cash Account (Being payment of rent)		2,000	 2,000
March 11	Plant Account Dr. To Cash Account (Being purchase of plant)		1,00,000	 1,00,000
March 12	Salaries Account Dr. To Cash Account (Being payment of salaries)		12,000	 12,000
March 15	Ramautar Dr. To Cash Account (Being payment to Ramautar)		1,00,000	 1,00,000
March 20	Shyam Dr. To Sales Account (Being goods sold on credit)		20,000	 20,000
March 25	Cash Account Dr. To Shyam (Being receipts of cash)		30,000	 30,000
March 31	Cash Account Dr. To Sales Account (Being goods sold in cash)		2,50,000	 2,50,000

March 31	Wages Account Dr. To Cash Account (Being payment of wages)		5,000	5,000
	Total		8,39,000	8,39,000

Ledger

Cash Account

Date	Particulars	L.F.	Debit (₹)	Date	Particulars	L.F.	Credit (₹)
2008				2008			
March 25	To Shyam		30,000	March 10	By Rent A/c		2,000
March 31	To Sales A/c		2,50,000	March 11	By Plant A/c		1,00,000
				March 12	By Salaries A/c		12,000
				March 15	By Ramautar		1,00,000
				March 31	By Wages		5,000
				March 31	By Balance c/d		61,000
			2,80,000				2,80,000
April 1	To Balance b/d		61,000				

Purchase Account

Date	Particulars	L.F.	Debit (₹)	Date	Particulars	L.F.	Credit (₹)
2008				2008			
March 1	To Ramautar		3,20,000	March 31	By Balance c/d		3,20,000
			3,20,000				3,20,000
April 1	To Balance b/d		3,20,000				

Ramautar’s Account

Date	Particulars	L.F.	Debit (₹)	Date	Particulars	L.F.	Credit (₹)
2008				2008			
March 15	To Ramautar		1,00,000	March 1	By Purchase c/d		3,20,000
March 31	To Balance c/d		2,20,000				
			3,20,000				3,20,000
				April 1	To Balance b/d		2,20,000

Rent Account

Date	Particulars	L.F.	Debit (₹)	Date	Particulars	L.F.	Credit (₹)
2008				2008			
March 10	To Cash A/c		2,000	March 31	By Balance c/d		2,000
			2,000				2,000
April 1	To Balance b/d		2,000				

Plant Account

Date	Particulars	L.F.	Debit (₹)	Date	Particulars	L.F.	Credit (₹)
2008				2008			
March 11	To Cash A/c		1,00,000	March 31	By Balance c/d		1,00,000
			1,00,000				1,00,000
April 1	To Balance b/d		1,00,000				

Salaries Account

Date	Particulars	L.F.	Debit (₹)	Date	Particulars	L.F.	Credit (₹)
2008				2008			
March 12	To Cash A/c		12,000	March 31	By Balance c/d		12,000
			12,000				12,000
April 1	To Balance b/d		12,000				

Shyam's Account

Date	Particulars	L.F.	Debit (₹)	Date	Particulars	L.F.	Credit (₹)
2008				2008			
March 20	To Sales A/c		20,000	March 31	By Cash A/c		30,000
March			10,000				
			30,000				30,000
				April 1	To Balance b/d		10,000

Sales Account

Date	Particulars	L.F.	Debit (₹)	Date	Particulars	L.F.	Credit (₹)
2008				2008			
March 1	To Balance c/d		2,70,000	March 20	By Shyam		20,000
				March 31	By Cash A/c		2,50,000
			2,70,000				2,70,000
				April 1	To Balance b/d		2,70,000

Wages Account

Date	Particulars	L.F.	Debit (₹)	Date	Particulars	L.F.	Credit (₹)
2008				2008			
March 1	To Cash A/c		5,000	March 31	By Balance c/d		5,000
			5,000				5,000
April 1	To Balance b/d		5,000				

Question: Journalise the following transactions and post them in the ledger.

2011		**(₹)**
January 1	Commenced business with cash	50,000
January 3	Paid into bank	25,000
January 5	Purchased furniture for cash	5,000
January 8	Purchased goods and paid by cheque	15,000
January 8	Paid for carriage	500
January 14	Purchased goods from K. Murthy	35,000
January 18	Cash sales	32,000
January 20	Sold goods to Ashok on credit	28,000
January 25	Paid cash to K. Murthy in full settlement	34,200
January 28	Cash received from Ashok	20,000
January 31	Paid rent for the month	2,000
January 31	Withdrew from bank for private use	2,500

Trial Balance

Trial balance is a list in which all the balances of the accounts of Ledger are showed to test the arithmetical accuracy of the posting in ledger. It is prepared after the end of a particular period – year, half year or quarter. Trial balance prepares a base for the preparation of final accounts. After the completion of trial balance, the financial accounts - P&L Account and Balance Sheet are prepared to disclose the overall results of the business after a period. The proforma of a trial balance is given hereunder:

Proforma of Trial Balance

S. No.	Particulars	Amount Dr. (₹)	Amount Cr. (₹)

Generally, three columns are made in the trial balance. The first wide column is kept for the particulars of accounts and the two columns for debit amount and credit amount are made.

Objects and Functions of Trial Balance

The main objectives of preparing a trial balance are to check the arithmetical accuracy of all transactions. In every trial balance, the total of debit balances must agree with the total of credit balances. It is a proof of arithmetical accuracy of postings, but it is not conclusive evidence of correctness of the books of accounts. The other objects and functions of a trial balance are as under:

7.2 Methods of Preparation of Trial Balance

A trial balance is prepared by the following three methods:

1. Balance Method
2. Total Method
3. Balance and Total Method or Combined Method

Among the above methods the balance method is the most popular and statutory method to prepare the Trial Balance. Under this method the balances of all the accounts are recorded. If an account shows a debit balance in the ledger, this balance is recorded in the debit side of the trial balance and if it has a credit balance, in the credit side of it is written. If any account has no balance means its total of debit side is equal to the total of credit side, it is not recorded in the Trial Balance. After recording the balances of all accounts of the Ledger, the amounts of both the sides are totalled to check the arithmetical accuracy of the ledger. If the total of debit side agrees with the total of credit side, it proves that books are at least arithmetically correct. However, the trial balance is not the sole proof of accuracy of the books of Ledger.

Total Method instead of taking balance of each account, the total of both the side of each account is taken. Combined method is both the above explained method i.e., balance as well as total method are used. This method is not in use because of wastage of time and labour.

Illustration: Prepare ledger accounts and also a trial balance from the following transactions:

2011		**(₹)**
July 1	Ram commenced business with cash	10,000
July 3	Paid into bank	8,000
July 3	Bought goods for cash	500
July 5	Bought office furniture	400
July 10	Drew from bank for office	100
July 13	Goods sold to Shyam	600
July 15	Bought goods from Krishan	410
July 18	Trade Expenses paid	100
July 19	Received cash from Shyam	590
	Allowed him discount	10
July 25	Wages paid	50
July 29	Krishan paid off in full settlement of his account	400
July 31	Rent paid	100
July 31	Interest due on capital	500

Solution:

Capital A/c

Dr. Cr.

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
2011				2011			
July 31	To Balance c/d		10,500	July 1	By Cash		10,000
				July 31	By Int. on capital		500
			10,500				10,500
				Aug 1	By Balance b/d		10,500

Cash A/c

Dr. Cr.

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
2011				2011			
July 1	To Capital A/c		10,000	July 3	By Bank A/c		8,000
July 10	To Bank A/c		1,000	July 3	By Purchases A/c		500
July 19	To Shyam		590	July 5	By Office furniture A/c		400
				July 18	By Trade Exp. A/c		100
				July 25	By Wages A/c		50
				July 29	By Krishan		400
				July 31	By Rent A/c		100
				July 31	Balance c/d		2040
			11,590				11,590
Aug. 1	To Balance b/d		2,040				

Bank A/c

Dr. Cr.

Date	Particulars	L.F.	Amount (₹)	Date	Particulars	L.F.	Amount (₹)
2011				2011			
July 3	To Cash A/c		8,000	July 10	By Cash A/c		1,000
				July 31	Balance c/d		7,000
			8,000				8,000
Aug. 1	To Balance b/d		7,000				

Purchases A/c

Dr. Cr.

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
2011				2011			
July 3	To Cash A/c		500	July 31	By Balance c/d		910
July 15	To Krishan		410				
			910				910
Aug. 1	To Balance b/d		910				

Sales A/c

Dr. Cr.

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
2011				2011			
July 31	To Balance c/d		600	July 13	By Shyam		600
				Aug. 1	By Balance b/d		600

Office Furniture A/c

Dr. Cr.

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
2011				2011			
July 3	To Cash A/c		400	July 31	By Balance c/d		400
Aug. 1	To Balance b/d		400				

Shyam A/c

Dr. Cr.

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
2011				2011	By Cash A/c		590
July 13	To Sales A/c		600	July 19	By Discount A/c		10
			600				600

Krishan A/c

Dr. Cr.

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
2011				2011			
July 29	To Cash A/c		400	July 15	By Purchases A/c		410
July 29	Discount A/c		10				
			410				410

Trade Expenses A/c

Dr. Cr.

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
2011				2011			
July 18	To Cash A/c		100	July 31	By Balance c/d		100
Aug. 1	To Balance b/d		100				

Wages A/c

Dr. Cr.

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
2011				2011			
July 25	To Cash A/c		50	July 31	By Balance c/d		50
Aug. 1	To Balance b/d		50				

Rent A/c

Dr. Cr.

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
2011				2011			
July 31	To Cash A/c		100	July 31	By Balance c/d		100
Aug. 1	To Balance b/d		100				

Interest on Capital A/c

Dr. Cr.

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
2011				2011			
July 31	To Capital A/c		500	July 31	By Balance c/d		500
Aug. 1	To Balance b/d		500				

Discount A/c

Dr. Cr.

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
2011				2011			
July 19	To Shyam		10	July 29	By Krishan		10
	To Balance c/d		10	July 31	By Balance c/d		10
			20				20
Aug. 1	To Balance b/d		10	Aug. 1	By Balance b/d		10

Notes: No balance is ascertained practically but the total of both the sides of discount A/c is brought down in the trial balance.

Trial Balance
(As on July, 31, 2011)

S. No.	Particulars	Amount (Dr.) (₹)	Amount (Cr.) (₹)
	Capital A/c	----	10,500
	Cash A/c	2,040	---
	Bank A/c	7,000	---
	Purchases A/c	910	---
	Sales A/c	----	600
	Office Furniture A/c	400	----
	Trade Expenses A/c	100	----
	Wages A/c	50	----
	Rent A/c	100	----
	Interest on Capital A/c	500	----
	Discount A/c	10	10
	Total	11,110	11,110

Preparation of Trial Balance with the Help of Balances

Following rules should be kept in mind while preparing a Trial Balance:

1. The balances of all the assets accounts and drawing accounts are recorded in the debit side of the Trial Balance.
2. The balances of all the liabilities and capital accounts are recorded in the credit side of the Trial Balance.
3. The balances of all expenses and losses of the business are showed in the debit side of the Trial Balance.
4. The balances of all incomes and gains are disclosed in the credit side of the Trial Balance.
5. The balances of sales and sale returns are disclosed in the credit side and debit side of Trial Balance respectively.
6. The balances of purchases and purchase returns are disclosed in the debit side and credit side of the Trial Balance respectively.

Illustration: Mr. Akshey Kumar furnishes the following balances as on 31st March 2008. You have to prepare a Trial Balance with the following information:

Particulars	(₹)	Particulars	(₹)
Interest on capital	24,000	Salaries	1,28,000
Creditors	6,00,000	Capital	8,00,000
Discount received	23,000	Drawings	2,46,000
Loan	1,74,000	Machinery	3,00,000
Purchase returns	40,000	Bills Payable	20,000
Sales returns	6,000	Furniture	6,00,000
Advertisement	1,63,000	Debtors	5,00,000
Commission received	20,000	Bank loan	2,00,000
Rent	10,000	Patents	60,000
Purchases	19,00,000	Sales	32,60,000
Opening stock	12,00,000		

Solution:

Trial Balance

(as on 31st March 2008)

Particulars	Amount Dr. (₹)	Amount Cr. (₹)
Interest on capital	24,000	-
Creditors	-	6,00,000
Discount Received	-	23,000
Loan	-	1,74,000
Purchase returns	-	40,000
Sale returns	6,000	-
Advertisements	1,63,000	-
Commission received	-	20,000
Rent	10,000	-
Purchases	19,00,000	-
Sales	-	32,60,000
Opening stock	12,00,000	-
Salaries	1,28,000	-
Capital	-	8,00,000
Drawings	2,46,000	-
Machinery	3,00,000	-
Bills payable	-	20,000
Furniture	6,00,000	-
Debtors	5,00,000	-
Bank loan	-	2,00,000
Patents	60,000	-
Total	**51,37,000**	**51,37,000**

Types of Errors

There are two types of errors:

Errors which cannot be located by Trial Balance

The following errors cannot be detected by the trial balance means in spite of agreeing the totals of debit side and credit side, these errors occur in the accounts.

1. ***Error of Omission:*** These errors occur when any business transaction is completely omitted from the recording in the books of original records.

Example: As goods, sold of 10,000 to Mr. Ram, is entered nowhere in the original books then its effect will also not come on the ledger and trial balance. Thus, such type of errors cannot be located by trial balance.

2. ***Error of Commission:*** Such types of errors are found when one account is debited or credited in the place of another account.

Example: As cash received from Shyam 1,000 has been credited in the name of Ram. Such type of errors does not affect the agreement of the totals of the debit and credit side of the trial balance, but they affect the result of the business.

3. ***Error of Principle:*** These errors occur when there is wrong classification between the capital and revenue nature incomes or expenditures.

Example: As the purchases of furniture of 20,000 are entered in the book of purchases while it should be in furniture account. Such errors cannot be located by trial balance.

4. ***Compensating Error:*** When two errors of the same account occur and the effect of one error is compensated by the effect of other error it is called compensating error.

Example: If purchase of 10,000 from Ajay is credited only by 1,000 while the purchases from Vijay for 1,000 is credited by 10,000. Thus, such type of errors does not effect on the agreement of the Trial Balance.

Errors which can be located by Trial Balance

The error which affects the agreement of the totals of the Trial balance can be located easily. These errors may be relating to:

1. Totals of the subsidiary books or ledger accounts.
2. Balancing of an account of the ledger.
3. Wrong posting of any amount in any account.
4. Posting of any account may be in the wrong side of the account.
5. Balance of any account may be omitted in writing in the Trial Balance.
6. Wrong total of the Trial Balance.
7. Partially omitted means omission may be the part of the transaction. If it is a part of the transaction, then it would affect trial balance and can be located by trial balance.

Thus, we see that errors are of two types:

1. Error of Principle

2. Clerical errors which are of the following types:

a) Error of Omission.
b) Error of Commission.
c) Compensatory errors.

Steps to point out errors: If the trial balance does not agree, the following steps can be taken in order to point out the errors. These are based on hit and trial method.

1. To see whether the total of both the columns agree or does not agree. In order to see it, it must be again totalled.
2. It is also necessary to see whether the balances of all the accounts including cash and bank have been properly recorded or not.
3. Difference of both the sides must be checked carefully and if possible, see whether any such item is there which is exactly of the same amount being omitted/left out. If it is not, then have half of the difference and again compare it with the amount of any item of the same amount which is being left out or wrongly put.
4. Subsidiary books must also be checked again, so that if any error has taken place could be rectified.
5. Still, if there is any error, thorough and complete checking of all ledger accounts is required.

Rectification of Errors: Errors are/can be rectified if the correcting entries are passed in the books of account. For this, care and alertness are exercised to see whether error is in both the accounts or is in one account only. If the error affects both the accounts, then a fresh entry is to be passed and if it affects only one account, the rectification is done by recording in one account only.

1. *Rectification of Errors when error affects only one account:* If it is so, no journal entry is required to pass; it is corrected by debiting or crediting the concerned account. For example, Sales book was overcasted by ₹250 [As the sales book was overcasted by ₹250], hence sale account is to be debited by ₹250 in order to rectify the error. This error affects only one account. Similarly, if the Purchases Day Book is undercasted by ₹100 then the error also affects only one account, and this can be corrected by debiting purchases account by ₹100. Likewise paid ₹20 as repairs were recorded ₹25 in Repairs account again the error is in one account i.e., repair account. It may be corrected by crediting repair A/c by ₹5 i.e., the difference (₹25 - ₹20).

2. *Rectification of Errors when it affects both the accounts:* If it is so, it is rectified by passing a journal entry. For example, received ₹150 from Shri Bhagwan were credited to sales account. This error affects both the accounts i.e., (i) Shri Bhagwan A/c and (ii) Sales A/c.

Journal entry for correction would be:

S. No.	Particulars	L.F.	(₹)	(₹)
1.	Sales A/c Dr. To Shri Bhagwan A/c (Error in Sales a/c and Shri Bhagwan a/c rectified)		150	 150

Similarly, if Building is purchased for 2 lacs is recorded in the Purchases Book, again the error affects both the accounts i.e. (1) Building A/c (2) Purchases A/c.

Though the error is of principle, in the above case Purchases A/c is unnecessarily debited and Building A/c is wrongly left out. In order to rectify the error, the following entry (correcting the error) is to be passed:

Journal Entry for Correction (Rectification)

S. No.	Particulars	L.F.	(₹)	(₹)

1.	Building A/c Dr. To Purchases A/c (Error in Building a/c and Purchases a/c rectified)		2,00,000	 2,00,000

Journal Entry already passed which was wrong entry.

S. No.	Particulars	L.F.	(₹)	(₹)
1.	Purchases A/c Dr. To Cash/Creditor A/c (Building Purchased)		2,00,000	 2,00,000

Correct entry required to pass.

S. No.	Particulars	L.F.	(₹)	(₹)
1.	Building A/c Dr. To Cash/Creditor A/c (Building Purchased)		2,00,000	 2,00,000

Thus, we see that if the error affects both the accounts, then it can be rectified by passing a journal entry as explained above.

What is suspense account?

Sometimes, it is not possible to point out errors easily, and then the difference is put to an account, known as suspense account. Suspense A/c is shown in the trial balance. As and when Errors are located, the same is debited or credited for rectifying the error and the other account which is credited or debited is the suspense account. Thus, the suspense account is automatically closed.

Illustration: Rectify the following Errors:

a) A sale of goods to Raja Ram for ₹2500 was passed through the Purchases book.
b) Salary ₹800 paid to Hari Babu was wrongly debited to his personal account.
c) Furniture purchased on credit from Mohan Singh for ₹1000 was entered in the Purchases book.
d) ₹5000 spent on the extension of building was debited to the buildings repairs account.
e) Goods returned by Mani Ram ₹1200 were entered in Returns outward book.

Solution:

Journal Entries to rectify the errors

S. No.	Particulars	L.F.	Amount (₹)	Amount (₹)
a)	Raja Ram Dr. To Purchases A/c To Sales A/c (A sale of goods to Raja Ram through the Purchases book is rectified.)		5,000	 2,500 2,500
b)	Salary A/c Dr. To Hari Babu		800	 800

	(Salary wrongly debited in his personal A/c is rectified.)			
c)	Furniture A/c Dr. To Purchases A/c (Furniture purchased was wrongly entered in the Purchases book is rectified.)		1,000	 1,000
d)	Buildings A/c Dr. To Buildings Repairs A/c (Sent on extension of building was wrongly debited to Building repairs A/c is rectified.)		5,000	 5,000
e)	Returns Inward A/c Dr. Returns Outward A/c Dr. To Mani Ram (Goods returned by Mani Ram were entered in returns outward book.)		1,200 1,200	 2,400

Question: Rectify the following errors:

a) Sales book was overcasted by 200.
b) 100 received as rent from the tenant was debited to rent account.
c) Received 500 from Sudan Mittal was credited to Sales book.
d) Paid 200 as salary but were debited 20 in Salary account.
e) Paid 20 as repairs were recorded 25 in Repairs account.

Question: Consider the following trial balance:

Trial Balance
(As on 31 March 2011)

S. No.	Particulars	L.F.	Amount (Dr.) (₹)	Amount (Cr.) (₹)
1.	Capital Account		-	5,00,000
2.	Sales Account		-	25,50,000
3.	Purchases Account		18,75,000	-
4.	Salaries Account		5,20,000	-
5.	Rent, rates & taxes		1,67,500	-
6.	Interest Income		-	1,25,000
7.	Interest expenses		1,76,000	-
8.	Bank loan		-	20,00,000
9.	Returns inward		32,000	-
10.	Returns outward		-	25,000
11.	Carriage inward		87,500	-
12.	Carriage outward		55,000	-
13.	Income tax paid		50,000	-
14.	Property, plant and equipment		18,00,000	-
15.	Debtors		3,55,000	-
16.	Creditors		-	1,75,000
17.	Cash and Bank Balances		1,76,000	-
18.	Suspense Account		81,000	-
			53,75,000	**53,75,000**

The accountant could not tally the trial balance and put the difference in suspense account.

Other Information: While inspecting the books of accounts, the accountant found the following errors:

a) Rent for the month of October 2010 of ₹10,000 was wrongly debited to salaries account.
b) Carriage outward of ₹7,500 was debited to carriage inward account.
c) Cash sales of ₹45,000 was debited in purchases account.
d) Cash paid to creditors ₹22,500 was debited to creditors account as ₹25,200.
e) Interest paid ₹5,350 was debited in interest income account.
f) Return inward of ₹25,350 was credited in return inward account.
g) Cash paid to creditors ₹61,500 was credited in creditors account.

Redraft the trial balance after rectifying the above errors.