

**SYLLABUS****Class – BBA I Year****Subject – Fundamental of Accounting (Elective)**

<b>UNIT NO.</b>	<b>TOPICS</b>
1	Accounts- History, Definition, Development, Objective, Basic Concept, Principals, Assumption and Convention of Accounting.
2	Principles of Double Entry System, Preparation of Journal, Subsidiary Books, Preparation of Ledgers.
3	Preparation of Trial Balance, Rectification of Errors.
4	Depreciation Accounting :- Definition, Reasons governing the existence of depreciation Method, Objectives of providing of Depreciation, Factors Determining the Amount of Depreciation, Methods of Charging Depreciation. Practical Question of Depreciation Accounting: - Fixed and Written down value method only. Bank Reconciliation.
5	Accounts of Non Profit Organisation and Professionals



## Unit I & II

### FUNDAMENTAL PRINCIPLES OF FINANCIAL ACCOUNTING

According to American Institution of Certified Public Accountant Committee:-

“Accounting as 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 results thereof”.

From the above definition, it can be said that “Accounting is science of recording and classifying trading transaction of financial nature and is an art in which financial results are summarized and interpreted.”

#### Characteristics of Accounting

- 1) Accounting is science as well as an art.
- 2) The transaction and events relating to financial nature are recorded in it.
- 3) All transaction and events are recorded in monetary terms.
- 4) It maintain complete, accurate, permanent and legible records of all transaction in a systematic manner.
- 5) It analyses the results of all the transaction in detail.

#### Objectives of Accounting

##### **1. To Maintain a Systematic Record**

Accounting is done to maintain a systematic record of the monetary transactions of the firm which is the initial step leading to the creation of the financial statements. Once the recording is complete, the records are classified and summarized to depict the financial performance of the enterprise.

##### **2. To Ascertain the Performance of the Business**

The income statement also known as the profit and loss account is prepared to reflect the profits earned or losses incurred. All the expenses incurred in the course of conducting the business are aggregated and deducted from the total revenues to arrive at the profit earned or loss suffered during the relevant period.

##### **3. To Protect the properties of the Business**

The information about the assets and liabilities with the help of accountancy, provides control over the resources of the firm, because accounting gives information about how much the business has to pay to others ? And how much the business has to recover from others?

##### **4. To Facilitate Financial Reporting**

Accounting is the precursor to finance reporting. The vital liquidity/solvency position is comprehended through the Cash and Funds Flow Statement elucidating the capital transactions.

##### **5. To Facilitate Decision making**

Accounting facilitates in decision making. The American Accounting Association has explained this while defining the term accounting, it says accounting is, the process of identifying measuring and communicating economic information to permit informed judgments and decisions by users of the information.

#### **Accounting As Science and Art**

Accounting is both a science and an art. Science as well we know is the systematical body of knowledge establishing relationship between causes and their effects. In other words, science has its own concepts, assumptions and principles which are universal and verifiable. Accounting as discipline has also its own assumptions, concepts and principles, which have got universal application. Accounts have systematically and scientifically developed accounting equation and rules of debit and credit. It makes



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accounting, Science.



Art is the practical application of the knowledge. Accounting as discipline is used in the maintenance of books of accounts practically in the real life situations and day-to day affairs of the business, so it is an art also. It can now be safely concluded that Accounting is both science and an art.

### BOOK-KEEPING

Book-Keeping is the proper and systematic keeping or maintenance of the books of accounts. Book-Keeping starts from the identification of business transactions. These transactions must be supported by the documents and they must be financial in nature. For example, selling goods for cash in an accounting transaction, because cash is received and goods are going outside the business. The transaction will increase cash and reduce goods.

Book-Keeping involves the following process:

1. Identifying accounting transactions
2. Initial record of accounting transactions
3. Preparation of ledger accounts
4. Balance Ledger accounts
5. Preparation of trial balance

### DIFFERENCE BETWEEN BOOK-KEEPING AND ACCOUNTING

S.No	Basis of Difference	Book-Keeping	Accounting
1	Transaction	Trading transactions are recorded in primary books.	Entries written in primary books are checked and verified.
2	Posting	Entries are posted in ledger from journal and subsidiary books	Posting are checked whether correctly posted or not.
3	Total and Balance	It includes totaling of journal and finding of balances of ledger.	On the basis of balances of ledger final accounts are prepared
4	Objects	The object of Book-keeping is to write all trading transactions in a reasonable manner.	The object of accounting is to analyse the transactions written in the books.
5	Adjustments and Rectification of errors	In Book-keeping entries of adjustments and rectification of errors are not included.	Accounting includes entries of adjustments and rectification of errors.
6	Scope	Scope of Book keeping is narrow.	Scope of Accounting is wide.
7	Final Accounts	Final Account is not prepared in Book-Keeping.	Final account preparation is must.

### Accounting Concepts

**Meaning and Significance:** - Accounting concepts are those basic assumptions or conditions upon which the accounting system is based. Some of the important accounting concepts are as follows :

**1) Business Entity Concept :** As per this concept, business is treated as a separate entity or unit distinct from that of the proprietor. The significance of this concept is that without such a distinction the affairs of the business will be mixed up with the private affairs of the proprietor and the true picture of the business will not be available. The transactions between the proprietor and the business will be recorded in the business books separately and shown separately under the heading capital account. For example, if when the proprietor invests Rs. 50000 in this business, it will be assumed that the owner has given that much money to the business and will be shown as a liability for the business. When he withdraws, say Rs. 10000 from the business it will be charged to his capital account and the net amount due to him will be only Rs. 40000.

**2) Going Concern Concept :** As per this concept it is assumed that a business unit has a perpetual succession or continued existence and transactions are recorded from this point of view. Hence, while valuing the business assets, the accountant does not take into account the realizable or market values of



the assets. Assets are valued at cost at which they were originally purchased less depreciations till date, which is calculated on the basis of the original cost only.

The concept presumes that the business will continue in operation long enough to charge the cost of fixed assets over their useful life against the business income. It is only on the basis of this concept that a distinction is made between capital expenditure and revenue expenditure. If it is expected that the business will exist only for a limited period, the accounting records will be kept accordingly.

**3) Dual Aspect Concept** : Each business transaction has two aspects, i.e., the receiving of a benefit [debit] and giving of a benefit [credit]. For example, if a business purchases furniture, it must have given up cash or have incurred an obligation to pay for it in future. Technically speaking, for every debit, there is a credit this concept is the core of accountancy and upon this the whole superstructure of Double entry system of book keeping has been raised. As each transaction has giving account and receiving account equally, the total assets of a business firm will always be equal to its total equities [i.e. liabilities]. That is

External liabilities + Capital = Total Assets

Total Liabilities = Total Assets

This is called the Accounting or Balance Sheet equation.

**4) Historical Cost Concept** : This concept is based on the going concern concept According to this concept, assets purchased are normally entered in the accounting books at the cost at which they are purchased and this cost is the basis for all subsequent accounting for asset. The market value is immaterial for accounting purpose since the business is not going to be liquidated but is to be continued for a long time to come. This concept also prevents arbitrary values being used for recording purposes, mainly those resulting in the acquisition of assets.

**5) Money Measurement Concept** : According to this concept, accounting records only those transactions, which can be expressed in terms of money. Events or transactions, which cannot be expressed in terms of money cannot find place in the books, however important they may be. Qualitative or non monetary transactions are either omitted or recorded separately. For example a strained relationship between production manager and sales manager, which may affect directly the operating results of the business, does not find place in accounting records.

**6) Realization Concept** : According to this concept, the revenue is recognized only when the sale is made. But the sale is a gradual process, which starts with the purchase of raw materials for production and ends with the sale. If no sale is effected, no revenue is recognized. This is important to stop business firms from inflating their profits. However, there are certain exceptions to this concept like hire purchase sale, or contract etc.

**7) Accrual Concept** : This concept is based on the economic that all transactions are settled in cash but even if cash settlement has not yet taken place, it is proper to bring the transaction or event concerned into the books. Expenditure incurred during the year but not paid and Income earned but not received is called as accrued items. According to this concept these items will be taken into consideration while arriving at profit or loss. This concept enables to define income and expense.

**8) Matching Concept** : The matching concept provides the guidelines as to how the expense be matched with revenues. In other words, costs are reported as expenses in the period in which the associated revenue is reported. Note that costs are matched with, revenues, not the other way round. The expense shown in an income statement must refer to the same accounting period, production units, division or department of business unit to which revenue refers.

**9) Accounting Period concept** : - It is also known as periodicity concepts or time period assumption. According to this assumption, the economic life of an enterprise is artificially split into periodic intervals which are known as accounting periods, at the end of which financial position. The use of this assumption further requires the allocation of expenses between capital and revenue. That portion of capital expenditure which is consumed during the current period is charged as an expense to income statement and the unconsumed during the current period is charged as an expense to income statement and the unconsumed portion is shown in the balance sheet as an asset for future



consumption. Truly speaking, measuring since, actual income can be determined only on the liquidation of the enterprise. It may be noted that the custom of using twelve month period applied only for external reporting. For internal reporting, accounts can be prepared even for shorter periods, say monthly, quarterly or half yearly.

**10) Verifiable Objective Concept:-** according to this principle, the accounting data should be definite, verifiable and free from personal bias of the accountant. In other words, this principle requires that each recorded transaction/event in the books of accounts should have an adequate evidence to support it. In historical cost

accounting, the accounting data are verifiable since, the transactions are recorded on the basis of source documents such as vouchers, receipts, cash memos, invoices, and the like. The supporting documents form the basis for their verification by auditors afterwards.

### **Accounting Conventions**

**Meaning and Significance :-** Accounting conventions, are those customs, usage and traditions that are being followed by the accountant for a long time while preparing the accounting statements.

**1) Convention of Conservatism :** According to this convention, financial statements are usually drawn up on a conservative basis. While preparing accounts and statements, the accountants are expected not to take into account anticipated profits but to provide for all possible anticipated losses. It is only on the basis of this convention, the inventory is valued at cost or market price whichever is lower. Similarly provision for bad and doubtful debts is made in the books before ascertaining profits.

**2) Convention of Consistency :** According to this convention, accounting practices should remain unchanged for a fairly long time. And they should not be changed unless it becomes absolutely essential to change them. For example, if a particular method of charging depreciation on a particular asset is followed, it should be followed consistently. However, consistency does not prevent the introduction of new improved accounting methods or techniques. If any change is required, such change and its effects should be stated clearly. The aim of this convention is to provide for continuity in accounting practices and methods and enable meaningful comparison of accounting statements over a period or between different firms.

**3) Convention of Material Disclosure :** Apart from the legal requirements, good accounting practice demands that all vital information should be disclosed. For example, in addition to asset values, the mode of valuation should also be disclosed. The practice of giving footnotes, references, and parentheses in the statements is in accordance with this convention only. Accountants should report only material information and ignore insignificant details while preparing the accounting statements. What is material depends upon the circumstances and the discretion of the accountant.

### **ACCOUNTING SYSTEMS**

The main systems of Financial Accounting are as under:

**(1) Cash system -** In this system, only cash entries are recorded in the accounts. All credit entries are written in a handbook and are entered in Cash Book only when they are paid or received. This system is kept by small trades, professional persons or non-trading institutions where most of the transactions are in cash.

**(2) Mahajani system -** It is the oldest method of keeping accounts in India. Long Bahis are used for recording transactions and entries can be made in Mudia, Urdu, Sarafi, Hindi and any regional language. This system is completely scientific system as it is based on certain principles.

**(3) Single entry system -** Under it, some transactions are recorded at one place, some other transactions at two places and some transactions are recorded at all. Cash book and personal accounts are kept in it. It is an incomplete and unscientific system. Hence it is rarely used.

**(4) Double entry system -** Under it, every entry is recorded at two sides of the account so that the effect on each side of the account may remain equal. There are debit and credit side in it. This system was originated in Italy. Being a complete and scientific method, it is widely used and is more popular.



### **CONCEPT OF DOUBLE ENTRY SYSTEM**

There are many systems of presenting business transactions in accounting books e.g., Mahajani system, Cash system, Double entry system etc. The use of these systems depends upon the size and type of business and nature of transactions. But in modern business world, double entry system of book-keeping is more popular and widely used.

The focus of the double entry system is that every business transaction has two aspects, i.e., when we receive something, we give something else in return. This approach of writing both the aspects of the transactions is known double entry system of accounting. Of the two accounts one account is given debit while the other is given credit with an equal amount. Thus, on any date the debits must be equal to the credits.

#### **Evolution of Double Entry system:**

The double entry system was originated in Italy in 15<sup>th</sup> century. First of all in 1494 Lucas Pacioli, the famous mathematician of Venice of Venice city of Italy wrote his first book "De Computis et Scripturis" and mentioned method of accounting in one of its part. Emphasis was given on division and utility of waste book, Journal, Ledger etc. In 1543 Hugué Old Castle translated it in English and after that many learned persons showed their views and gave it a new shape.

The following are the three distinct stages of a complete system of double entry :

- a) Recording the transactions in the journal.
- b) Classifying the transactions in the journal by posting them to the appropriate ledger accounts and then preparing a trial balance.
- c) Closing the books and preparing the final accounts

#### **Merits of Double Entry System**

1. Full description: Every financial transaction is recorded in two related accounts separately in which full particulars are given for each transaction.
2. Knowledge of some important information regarding business: In Double entry system, real and nominal accounts are also maintained together with personal accounts. The information about capital employed, assets and liabilities can be obtained easily.
3. Testing of Mathematical Accuracy: Under this system, each debit entry has a credit entry due to which arithmetical accuracy can be checked with the help of trial balance.
4. Less chances of fraud: Under this system, double entry of each transaction reduces the possibility of forgery and fraud. Fraud can be avoided and traced easily.
5. Information of Profit and Loss: under this system, profit and loss account is prepared at the end of the certain period to find profit and loss.
6. Knowledge of Economic Status: With the help of balance sheet, the economic and financial status of the business can be obtained easily.
7. Comparatively Study and useful results: Trading, profit and loss account and balance sheet of current year can be compared with trading, profit & loss account and balance sheet of previous year to obtain useful analysis and conclusions.

#### **Demerits and Limitations of Double Entry system**

1. it is difficult to follow the rules of debit and credit in this system.
2. Though this system is fully scientific even then there are chances of errors and mistakes.
3. It is necessary to follow the principles and even a small mistake may give erroneous results.
4. It is an expensive system for small traders.
5. In order to get full efficiency in the system, it is necessary to have education, training and practical knowledge of accounts.



## CLASSIFICATION OF ACCOUNTS

### 1) PERSONAL ACCOUNTS

a) Natural Personal Account : The term Natural persons means persons who are created by the almighty. For example : Shyam's Account, Gopals's Account etc.

b) Artificial Personal Account : These accounts include accounts of institutions or companies which are recognized as persons in business dealings. For example, the account of a Club, the account of an Insurance Company, Banking Company.

c) Representative Personal Account : These are accounts which represent a certain person or group of persons. For example, if the rent is due to the landlord, an account for the outstanding amount will be opened. Likewise for salaries due to the employees (not paid) an outstanding salaries account will be opened. The outstanding rent account represents the account of the landlord to whom the rent is to be paid while the outstanding salaries account represents the account of the person to whom the salaries have to be paid therefore such accounts are called as representative personal accountant.

### 2) REAL ACCOUNTS

- a. Intangible Assets : These accounts represent things which cannot be touched. However, they can be measured in terms of money, for example goodwill account, patents accounts.
- b. Tangible Accounts : Tangible accounts are those which relate to things which can be touched, felt, measured etc. Examples of such accounts are furniture account, stock account, building account etc.

### 3) Nominal Accounts :-

Accounts related to income and gain or expenditure and loss are known as Nominal Accounts, e.g. Rent A/c, Interest A/c, Salary A/c, discount A/c, etc.

Nominal Accounts are divided into two parts as:

- i. Revenue Account: - Such as rent received, interest received, commission paid, salary paid, discount allowed, etc.
- ii. Expenditure Account: - Such as rent paid, interest paid, commission paid, salary paid, discount received, etc.

At the end of each financial year, the balances of nominal accounts are transferred to Trading A/c or Profit & Loss A/c

## RULES OF DOUBLE ENTRY SYSTEM

The rules related to debit and credit of any account in double entry system are as under:

<b>Personal accounts</b>	<b>:-</b>	<b>Debit the receiver, and credit the giver.</b>
<b>Real accounts</b>	<b>:-</b>	<b>Debit what comes in, and credit what goes out</b>
<b>Nominal accounts</b>	<b>:-</b>	<b>Debit all expenses and losses and credit all incomes and gains.</b>
		<b>Capital and revenue</b>

### **Classification of capital and revenue**

The Going Concern Assumption allows the accountant to classify the expenditure and receipts as Capital expenditure, Revenue expenditure, Deferred Revenue expenditure, Capital Receipts, Revenue Receipts. The expenditure and receipts may be classified as follows:

**Capital Expenditure:** Capital Expenditure is that expenditure which is incurred (a) for acquiring or bringing into existence an asset or advantage of an enduring benefit or (b) for extending or improving a fixed asset an asset or advantage of an enduring benefit or (b) for extending or improving a fixed asset or (c) for substantial replacement of an existing fixed asset. An asset of advantage of an enduring nature does not mean that it should last forever, it should not at the same time be so transitory and ephemeral





that it can be terminated at any time. Basically, the capital expenditure is incurred with a view to bringing in improvement in productivity or earning capacity. The examples of capital expenditure include cost of land and building, plant and machinery, furniture and fixtures etc. Such expenditure normally yields benefits which extended beyond the current accounting period.

**Revenue Expenditure:** Revenue Expenditure is that expenditure which is incurred for maintaining productivity or earning capacity of a business. Such expenditure yields benefits in the current accounting period. The examples of revenues expenditure include Office and Administrative expenses such as Salaries, Rent, Insurance, Telephone Exp., Electricity Charges, etc. Selling and Distribution Expenses such as Advertising, Travelling expenses, Commission to Salesman, Sales Promotion Expenses etc. Non-operating expenses and losses such as interest on loan taken, loss by theft etc.

**Deferred Revenue Expenditure:** Deferred Revenue Expenditure is that expenditure which yields benefits which extend beyond a current accounting period, but to relatively a short period as compared to the period for which a capital expenditure is expected to yield benefits. Such expenditure should normally be written-off over a period of 3 to 5 years. The examples of such, expenditure include heavy Advertising Campaign, Research and Development Expenditure.

**Capital Receipts Vs Revenue Receipts** There is no specific test to draw a clear cut demarcation between a capital receipt and a revenue receipt. In order to determine whether a receipt is capital or revenue in nature, one has to look into its true nature and substance over the form in the hands of its receipts. For example, sale proceeds of a land in the hands of a dealer in real estate is revenue receipt whereas the same in the hands of a dealer in cars is a capital receipt.

The examples of capital receipts include sale of fixed assts, capital contribution, loaned receipts, and the examples of revenue receipts include sale of stock-in-trade, revenue from services rendered in the normal course of business, revenue from permitting other to use the assets of the enterprise, such as interest, rent royalty.

### **ACCOUNTING STANDARDS**

Accounting as a 'language of 'business' communicates the financial performance and position of an enterprise to various interested parties by means by financial statements which have to exhibit a 'true and fair' view of financial results and its state of affairs. As a result a wide variety of accounting methods were used by different companies. It was, then, felt that there should be some standardized set of rules and accounting principles to reduce or eliminate confusing variation in the methods used to prepare financial statements. However, such accounting rules should have a reasonable degree of flexibility in view of specific circumstances of an enterprise and also in line with the changes in the economic environment, social needs, legal requirements and technological developments. The setting of accounting standards is a social decision. Standards place restrictions on behaviour and therefore they must be accepted by affected parties.

### **ACCOUNTING STANDARDS ISSUED BY THE ICAI**

The Institute of Chartered Accountants of India has thus far issued the following standard effective from the date noted against them.

(i)	AS-1	Disclosure of Accounting Policies	(1-4-1991)
(ii)	AS-2	Valuation of Inventories	(1-4-1991)(Revised)
(iii)	AS-3	Cash Flow Statement	(1-6-1991)(Revised)
(iv)	AS-4	Contingencies and events occurring after the Balance Sheet Date	(1-4-1995)
(v)	AS-5	Net Profit or Loss for the period, prior items and changes in Accounting Policies	(1-4-1996)
(vi)	AS-6	Depreciation Accounting	(1-4-1995)
(vii)	AS-7	Accounting for Construction contracts	(1-4-1991)



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(viii)	AS-8	Accounting for Research and Development	(1-4-1991)
(ix)	AS-9	Revenue Recognition	(1-4-1991)
(x)	AS-10	Accounting for Fixed Assets	(1-4-1991)
(xi)	AS-11	Accounting for the effects of changes in Foreign Exchange Rates	(1-4-1995)
(xii)	AS-12	Accounting for Government Grants	(1-4-1994)
(xiii)	AS-13	Accounting for Investments	(1-4-1995)



(xiv)	AS-14	Accounting for Amalgamation	(1-4-1995)
(xv)	AS-15	Accounting for retirement benefits in the financial statements of employers	(1-4-1995)
(xvi)	AS-16	Borrowing Costs	(1-4-2000)
(xvii)	AS-17	Segment Reporting	(1-4-2001)
(xviii)	AS-18	Related Party Disclosures	(1-4-2001)
(xix)	AS-19	Leases	(1-4-2001)
(xx)	AS-20	Earning per share	(1-4-2001)
(xxi)	AS-21	Consolidated Financial Statements	(1-4-2001)
(xxii)	AS-22	accounting for Taxes on Income	(1-4-2002)
(xxiii)	AS-23	Accounting for Investments in Associates in consolidated Financial Statements	(1-4-2002)
(xxiv)	AS-24	Discontinuing Operations	(1-4-2002)
(xxv)	AS-25	Interim financial Reporting	(1-4-2002)
(xxvi)	AS-26	Intangible Assets	(1-4-2003)
(xxvii)	AS-27	Financial Reporting of Interest in Joint Ventures	(1-4-2002)
(xxviii)	AS-28	Impairment of Assets	(1-4-2004)
(xxix)	AS-29	Provisions, Contingent Liabilities and Contingent Assets	(1-4-2004)

**JOURNAL**

**It is the fundamental book of account which is necessarily used by each organization whether it is a small or large institution. It can be known as foundation stone of accounting palace.**

A journal may be defined as the book of original entry containing a chronological record of the transactions. The process of recording the transactions in a journal is called Journalizing.

Date	Particulars	L/F	Debit amount	Credit Amount
2009 July,25	.....A/c      Dr To..... A/c (.....)			

**COMPOUND JOURNAL ENTRY**

If two or more transactions of the same nature occur on the same day and either debit account and/or credit account are common in them, instead of passing a separate entry for each such transaction, one combined entry may be passed. Such type of entry is known as compound journal entry.

Example:

Postage a/c			Dr.
Stationary a/c			Dr.
Cartage a/c			Dr.
	To Cash	a/c	



**DISCOUNT**

**Types of Discount :-**

- 1) **Trade discount:** is allowed at the time of purchase or sale of goods by one trader another in order to promote sales. For example, a manufacturer may allow discount on sale goods to wholesaler or wholesaler may allow discount to a retailer. It is always allowed a certain percentage on sale price i.e., invoice price. The trade discount is not normally record in the books of account. In other words, only the net amount of purchase or sale i.e., invoice price minus trade discount is recorded in the journal.
- 2) **Cash discount:** is a discount allowed at the time of making payments or receipts of cash. It is allowed as certain percentage the amounts due. It is allowed to a debtor by a creditor in order to induce hirt pay on time. As the cash discount is calculated on the amounts already recorded in the books, it is shown in the book. Cash discount allowed to a debtor is a loss and it should be debited to discount a/c. Cash discount received from a creditor is a gain and it should be credited to discount a/c.

**DISTINCTIONS BETWEEN TRADE DISCOUNT AND CASH DISCOUNT**

S.No.	Trade Discount	Cash Discount
1.	It is allowed at the time of making purchases or sales.	It is allowed at the time of making payments or receipts of cash.
2	It is calculated as certain percentage on the invoice price of goods purchased or sold.	It is calculated as certain percentage on the amounts due to creditors or amounts due from debtors.
3	It is not shown in the books of accounts. Only the net amount of purchase or sale is recorded in the books.	It is shown in the books : discount allowed as debit entry and discount received as a credit entry.
4	It is allowed in order to promote more sales of purchases	It is allowed in order to encourage parties to make payments on time.

**Cash Book**

**Meaning of Cash Book**

Cash book may be defined as the record of transactions concerning cash receipts and cash receipts and cash payments. In other words in Cash Book, all transactions (i.e., receipts and payments of cash) are recorded as soon as they take place.

Cash Book is in the form of an account and actually it serves the purpose of Cash Account also. It has two sides-debit and credit side. On the debit side, all receipts of cash are recorded while on the credit side, all the payments of cash are recorded. Items on the debit side of the cash book are posted on the credit side of the ledger accounts and items on the credit side are posted on the debit side of the ledger accounts.

**Features of cash book:**

- a. Only cash transactions are recorded in the cash book.
- b. It performs the functions of both journal and ledger at the same time.
- c. All cash receipts are recorded in the debit side and all cash payments are recorded in the credit side.
- d. It records only one aspect of transactions i.e. cash.
- e. All cash transactions are recorded chronologically in the cash book.

**Types of Cash Book**

The various types of cash book from the point of view of uses may be as follows:

**Types of Cash Books**



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**Single Column  
Book**

**Cash Book with  
discount**

**Cash Book with  
Bank &**

**Petty Cash Book**

**1 Single Cash Book**

Single Column Book has one amount column on each side. All cash receipts are recorded on the debit side and all cash payments on the credit side. In fact, this book is nothing but a Cash Account. Hence, there is no need to open this account in the ledger.

Format of Single Column Cash Book:



Dr. Single Column Cash Book				Cr.			
Date	Particulars	L.F.	Amount Rs	Date	Particulars	L.F.	Amount Rs

### 2 Cash Book with Discount Column

Cash book with discount Column has two amount columns (one for cash and another for discount) as each side. All cash receipts and cash discount allowed are recorded on the debit side and all cash payments and cash discount received are recorded on the credit side.

#### Format of Cash Book with Discount Column:

Dr. Cash Book with Discount Column					Cr.				
Date	Particulars	L.F.	Dis.	Cash	Date	Particulars	L.F.	Dis.	Cash

### 3. Three Column Cash Book

Three Column Book has three amount columns (one for cash, one for Bank, and one for Discount) on each side. All cash receipts, deposits into bank and discount allowed are recorded on debit side and all cash payments, withdrawals from bank and discount received are recorded on the credit side. In fact, a three-column cash book serves the purposes of Cash Account and Bank Account. Hence, there is no open these two accounts in the ledger.

#### Contra Entries

#### Format of Cash Book with Discount Column

#### Dr. Three Column Cash Book

#### Cr.

Date	Particulars	L.F.	Dis.	Cash Rs	Bank Rs	Date	Particulars	L.F.	Dis.	Cash Rs	Bank Rs

### 4. Petty Cash Book (Imprest system)

Petty Cash Book is the book which is used for the purposes of recording the payment of petty cash expenses.

#### Meaning of Petty Cashier

Petty Cashier is the person who is authorized to make payments of petty cash expenses and to record them in petty cash book.

#### Features of Petty Cash Book

1. The amount of cash received from the main cashier is recorded on the left hand side column.
2. The payments of petty cash expenses are recorded on the right hand side in the respective columns.
3. It can never show a credit balance the cash payments can never exceed the cash receipts.
4. Its balance represents unspent petty cash in hand.



- Recording is done on the basis of internal as well as external vouchers.
- All the column of expenses are totaled periodically and such periodic totals are individually posted.
- Petty Cash Book is both a book of original entry as well as a book of final entry.

Receipts				Payment								
Date	Particular	Cash Book Folio	Total Rs.	Date	Particular	Voucher No.	Postage Rs.	Conveyance Rs.	Cartage Rs.	Printing & Stationery Rs.	Misc. items Rs.	Total Rs.

### Advantages of Petty Cash Book

- Economy of time: The time of chief cashier is saved when petty expenses are recorded in petty cash book.
- Saving of labour in posting : There is saving in labour in posting because :
  - Limited number of accounts are opened for heads of petty expenses only,
  - Periodical totals (say monthly) of each column of expenses are posted to the debit of the respective ledger accounts.
- Lesser chance of mistakes: The chances of mistakes are reduced since the chief cashier regularly examines the petty cash book.
- Control over petty expenses: Petty expenses are kept within the limits of imprest since the petty cashier can never spend more than the available petty cash.
- Control over fraud: Misappropriation if any, is always kept within the limits of imprest.
- Benefits of specialization: The benefits of specialization are available since recording of cash transactions is divided between main cash book and petty cash book.

### Posting of Petty Cash Book in ledger

- Petty Cash Book as a part of Journal or Double Entry system
- Petty Cash Book as a Memorandum book.

### Imprest vs. Non-Imprest System of Petty Cash Book

The amount which the main cashier hands over to the petty cashier in order to meet the petty cash expenses of a given period is known as 'Imprest' or 'Float'.

Petty cash book may be maintained on imprest system or non-imprest system.

### Features of imprest system of petty cash

- Estimation by chief cashier: The Chief Cashier estimates the total petty cash expenses for a particular fixed period.
- Advances by chief cashier: The Chief Cashier advance the estimated amount to the petty cashier in the beginning of the period.
- Submission of petty cash book by petty cashier: The Petty Cashier submits the petty cash book along with supporting vouchers to the chief cashier at the end of the period.
- Examination of petty cash bank by chief cashier: The Chief Cashier examines the petty cash book.
- Reimbursement of amount spent: The Chief Cashier makes the reimbursement of the amount spent by the Petty Cashier.



6. Availability of same amount of petty cash: The Petty Cashier again has the same amount of petty cash in the beginning of new period.

### Ledger

Ledger is the principal book or final book under double entry system of accounting in which the transactions recorded in subsidiary books are classified in various accounts chronologically with a view to knowing the position of business account-wise in a particular period.

### Characteristics of Ledger

1. Major or principal book of accounts.
2. Index- The initial pages of ledger are left for indexing. These pages are not numbered. With the help of index one can find on which page of ledger a particular account is opened.
3. Pages booked- For every account one separate page or pages called folio is engaged in ledger.
4. One debit one credit- For every transaction one account is debited and other account is credited.
5. Books of final entry- Ledger is the last stage of daily accounting or book keeping.
6. Classification of transactions- While journal a bunch of various accounts, ledger is the classification of these accounts.

### Utility or importance or Advantages of Ledger

1. Knowledge of account
2. Details of income and expenditure
3. Assessment of financial position
4. Text of accuracy
5. Knowledge of profit and loss
6. Economy of time
7. Knowledge of assets
8. Knowledge of liabilities
9. Assessment of overall position of business
10. Evidence in business disputes-

### Difference between journal and Ledger

S. No.	Basic of Differences	Journal	Ledger
1	Nature of book	It is the book of first or original entry	It is the book of final entry
2	Record	It is the book for chronological record	It is the book of analytical record
3	Weight in legal evidence	It is the book of source entry and has a greater weight as legal evidence	It has a lesser weight as legal evidence as it is based on journal
4	Unit of classification of data	The unit of classification of data within the journal is transaction	The unit of classification of data within the ledger is account
5	Process of recording	The process of recording in the journal is called 'journaling'	The process of recording in the ledger is called 'posting'
6	Place	More than one transactions regarding one account are written at different places date-wise	More than one transaction regarding one account are written at one place

### Posting

When the transactions entered in journal are recorded in the ledger, it is called posting. In other words, posting is the process of transferring the debits and credits of journal entries to the ledger account. The subject of such posting is to have a fixed classified record of various transactions pertaining to each account.





**Balancing of ledger Accounts**

Assets, liabilities and capital accounts have certain closing balance of the end of accounting period, so their values are to be carried forward to the next accounting period. This is why they are closed as "By Balance b/d" or "To Balance c/d. The balance of those accounts carried forward to the next accounting period, because the firm has to carry on its business with these assets, liabilities and capital in hand. While closing these accounts we write the 'Balance c/d' to show the closing balance of the account.

While closing nominal accounts or those accounts which are either an expense or revenue. we do not use the word balance c/d because the balance of these accounts need be carried forward to the next period. Whatever has been paid on account of expenses has been paid once and forever. This is the expense of the business. so it should be directly posted to the debit side of the profit and loss account or trading account. In the same way, account relating to income or gain or revenues are also closed by transfer to profit and loss account. Receipts i.e. rent, interest and discount are revenue of the business, so while closing these accounts their balance will be transferred to profit and loss account.

**Subsidiary Book**

**Preparation of Purchase Day Book**

This book is maintained mainly to record credit purchases of goods. The term goods refers to all such commodities and services in which we deal.

Date	Particulars (Names of suppliers)	Invoice No.	L.F.	Amount Rs.	Net Amount Rs

Posting : Each suppliers personal account is credited in the ledger with its respective amount with the words " By purchases a/c". The monthly total of this book is debited to purchases a/c in the ledger with the words "To sundries as per Purchases Book"

**Preparation of Sales Book**

This book is maintained mainly to record credit sales of goods. Hence the cash sales of goods and assets sold are not entered in this book. Entries in this book are made from the outward invoice of credit sales.

Date	Particulars (Names of Customer /Party)	Invoice No.	L.F.	Amount Rs.	Net Amount Rs

Postings : Each Customer's personal account is debited in the ledger with its respective amount with the words "to Sales a/c". The periodical total of this book is credited to sales a/c with the words " By sundries as per sales book".

**Preparation of Returns Outward of Purchase Return Book**

This book is maintained to record the return of goods purchased earlier from the suppliers on credit. When goods are returned a debit note is made out and sent to the supplier to whom goods are returned.

Date	Particulars	Debit Note No.	I.F.	Amount Rs.

Postings : Each suppliers account mentioned in the purchased earlier from the suppliers on credit. When goods are returned a debit note is made out and sent to the supplier to whom goods are returned

**Preparation of Return inward or Sales Return Book**

This Book is maintained mainly the returns of goods sold to customers on credit. On receipt of the goods the firm prepares a Credit Note in the name of the customer and sends its original copy to the



customer. Entries are made from credit note book into the sales returns books.

Date	Particulars	Credit Note No.	I.F.	Amount Rs.
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Posting: Each customer's personal account {as given in the sales returns book} is credited with the amount of goods returned by him with the words "By Sales a/c". The sales return A/c in the ledger gets the debit with the periodical total of Sales Returns Book with the words "To sundries as per Sales returns Book"

### Preparation of Bills Receivables Book

This books is maintained to keep a detailed record of the bills receivable received by the firm. This book provides a medium for posting bills receivable transactions. The ruling of this book is given below:

Date When received	Drawer	Acceptor	Where Payable	Date of bill	Term	Due date	I.F.	Amount Rs.	Remark

Posting: - The personal account of the person from whom the bill is received is credit with the amount of that bill and the periodical total of the Bills Receivable Book is debit to Bills Receivable a/c in the ledger.

### Preparation of Bills Payable Book

This book is maintained to keep a detailed record of all bills payable accepted by firm.

Date of Acceptance	To whom given	Payee	Where payable	Date of bill	Term	Due date	L/F	Amount Rs.	Remark

Posting: The person account of the person whose bill as accepted is debited with the amount of that bill and the periodical total of the Bills Payables Book is credited to Bills Payables in the ledger.



## UNIT - 3

### TRIAL BALANCE

#### Meaning

When all the accounts of a concern are balanced off they are put in a list, debit balances on one side and credit balances on the other side. The list so prepared is called trial balance. The total of the debit side of the trial balance must be equal to that of its credit side. This is based on the principle that in double entry system. For every debit there must be a corresponding credit. The preparation of a trial balance is an essential part of the process because if totals of both the sides are the same then it is proved that book are at least arithmetically correct.

#### Main Characteristics and uses of a Trial Balance

Following are the main characteristics of a trial balance :

1. It is a statement prepared in a tabular form. It has two columns- one for debit balance and another for credit balances.
2. Closing balance, i.e., balance at the end of the period as shown by ledger accounts, are shown in the statement.
3. Trial balance is not an account. It is only a statement of balance.
4. It can be prepared on any date provided accounts are balanced.
5. It is a consolidated list of all ledger balances at the end of a period at one place.
6. It is a method of verifying the arithmetical accuracy of entries made in the ledger. The agreement of the trial balance means that the total of the debit column agrees with the total of the credit column of the trial balance.
7. It is a big help in preparation of Trading A/c, Profit and Loss A/c and Balance Sheet at the end of the period which exhibit the financial position of the firm.

#### Objects of preparing a Trial Balance

The following are the important objects or purposes of preparing a trial balance :

1. If the two sides of the trial balance are equal, it is proved that the book are at least arithmetically correct.
2. Error in casting the books of subsidiary records is immediately known.
3. Error in posting from the books of subsidiary records to ledger is found out.
4. Error in balancing the ledger accounts is found out.
5. Schedules of debtors and creditors are verified to be correct.

#### Limitations of a Trial Balance

A trial balance is not a conclusive proof of the absolute accuracy of the accounts books. If the trial balance agrees, it does not mean that now there are absolutely no errors in books. Even if trial balance agrees, some errors may remain undetected and will not be disclosed by the trial balance. This is the limitation of a trial balance. The errors which are not disclosed by a trial balance are as under :

**Errors of Omission:** - If an entry has not been recorded in the original or subsidiary book at all, then both the aspects of the transaction will be omitted and the trial balance will not be affected.

1. **Errors of Commission:** - Posting an item on the correct side but to the wrong account.
2. **Error in subsidiary books-** Wrong amount entered in the subsidiary book.
3. **Compensating errors-** These are errors arising from the excess-debits on under debits of accounts being neutralized by excess credit or under credit to the same extent of some other accounts.
4. **Error of principle-** Whenever any amount is not properly allocated between capital and



revenue or some double entry principles are violated the error so made is known as error of principle.

- 5. **Compensatory Errors-** Under it, the errors on one side of the ledger account are compensated by errors of the same amounts on the other side or on the same side.

**Methods of Preparation of Trial Balance -**

- 1. **Total Method** - Under this method debit and credit total of each account of ledger are recorded in trial balance.

**Trial Balance**  
(As on.....)

<b>Title of Accounts</b>	<b>L.F.</b>	<b>Debit Total Rs.</b>	<b>Credit Total Rs.</b>
<b>Total</b>			

- 2. **Balance Method-** Under this method only balance of each account of ledger is recorded in trial balance.

**Trial Balance**  
(As on.....)

<b>Title of Accounts</b>	<b>L.F.</b>	<b>Debit Balance Rs.</b>	<b>Credit Balance Rs.</b>
<b>Total</b>			



3. **Total Cum Balance Method-** This method is a combination of Total method and Balances method.

**Trial Balance**  
(As on.....)

Title of Accounts	L.F.	Debit Total Rs.	Credit Total Rs.	Debit Balance Rs.	Credit Balance Rs.
<b>Total</b>					



## UNIT - 4

### 'Depreciation Accounting'

On the basis of accounting concept of going concern, assets are classified as fixed assets and current assets. Fixed assets are used in the business to derive benefits for more than one accounting period. Periodic profit is measured by charging cost against periodic revenue. Since fixed assets are used to generate periodic revenue, an appropriate proportion of the cost of fixed assets which is believed to be used or expired for generation of periodic revenue needs to be charged as cost. Such an appropriate proportion of the cost of fixed assets is termed as 'Depreciation'.

#### Meaning

Depreciation means a fall in the value of an asset because of usage or efflux of time due to obsolescence or accident. It is the permanent and continuing diminution in the quality, quantity of value of an asset.

#### Definition

1. **According to Spicer & Pegler**, "Depreciation is the measure of the exhaustion of the effective life of an asset from any cause during a given period."

Thus, depreciation may be defined as continuing and gradual shrinkage in the value of fixed assets. It has a significant impact in presenting the financial position and result of operations of a business enterprise. It is charged in every accounting period as an expense/ loss to the extent of shrinkage in the value of fixed assets so that cost of production can be determined properly.

#### Features or Characteristics of Depreciation

1. Depreciation is charged on fixed assets except land.
2. Depreciation is calculated on the book value (as shown in the books after charging of depreciation) and not on market value of assets.
3. Depreciation is charged on permanent basis. Once the depreciation is charged, it reduces the value of the asset permanently.
4. Depreciation is charged on a continuous basis. Once the depreciation is charged, it must be charged on regular basis in the succeeding period also.
5. The charge of depreciation will decrease the value of asset gradually. In other words, it must reduce the value of assets slowly and steadily.
6. The process of computation of depreciation implies allocation of cost of an asset over the effective and useful life of the assets.

#### Causes of Depreciation

The principal causes of depreciation are as follows:

1. **By Constant use:** Wear and tear of an asset due to its constant use is a cause of decline in the value of an asset. A fixed asset begins to lose its value when it is used in the business e.g. plant & machinery, building, furniture etc.
2. **By expiry of time:** Certain assets get decreased in their value with the expiry of time whether they are used in the business or no. this is true in case of assets like leasehold properties, patents or copyrights etc. For example, if a lease is obtained for 25 years for Rs. 1,00,000, it will lose 1/25<sup>th</sup> i.e. Rs. 4,000 of its value every year whether it is used in the business or not. So at the end of 25<sup>th</sup> year, its value will be reduced to zero.
3. **By Obsolescence:** Some assets are discarded before they are worn out because of changed conditions. For example, an old machine which is still workable may have to be replaced by a new machine because of the later being more efficient and economical. Such a loss on account of new inventions or changed fashions is termed as loss on account of obsolescence.
4. **By Depletion:** Some assets like mineral mines, oil wells etc. get exhausted or depleted through working. On account of continuous extraction of minerals or oil, a stage comes when the mine or oil gets completely exhausted and nothing is left.



5. **By Accidents:** An asset may meet an accident and therefore, it may get depreciated in its value.
6. **By Permanent fall in market price:** Though the fall in the market value of fixed assets is not recorded because such assets are not resale for use in the business. Sometimes, the fall in the value of certain fixed assets is treated as depreciation e.g. permanent fall in the value of investment.
7. **Changes in economic environment:** There may be instances when slackening of demand for the services of an asset may bring about a fall in its value. Such a change in conditions arises due to a number of factors e.g. technological changes within an industry, changes in tastes and habits of consumers, changes in availability of natural resources and so on.

Thus, depreciation applies to fixed assets, depletion to wasting assets, amortization to intangible assets and damage due to dilapidations of building or other property during tenancy.

Need or Objects or Significance of Providing Depreciation

**The following are the objectives of providing depreciation:**

1. **Ascertainment of true profit or loss:** Depreciation being a loss, will certainly affect the business profits. Therefore, to arrive at the true profit or loss, depreciation must be provided for and records in the books of accounts.
2. **Presentation of true financial position:** In a balance sheet, assets must be shown at their true values. This is not possible unless depreciation is provided and deducted from the values of these assets.
3. **Replacement of assets:** Some assets used in the business need replacement after the expiry of their service life. By providing depreciation, a part of the profit of the business is kept in the business which can be used for purchase of new assets when the old fixed assets become useless.
4. **Calculation of correct cost of production:** Correct cost of production cannot be calculated unless depreciation is properly provided and accounted for an item of cost of production.
5. **Prevention to withdrawal of capital:** Capital of a business remains invested in different assets. If no depreciation is charged, assets and capital are shown at enhanced figures due to such misrepresentation; capital itself may be withdrawn in the guise of imaginary profit.
6. **Excess payment of income tax:** Depreciation accounting is required for correct computation of profit for tax purposes and for computation of tax liability, otherwise more income tax will be paid on account of excess profit.
7. **To prevent distribution of profit out of capital:** If no depreciation is charged, it will result in showing more profit. Such excess profit may either be withdrawn by the owner or may be distributed among shareholders of the company as dividend. This will mean payment out of capital to the shareholders.
8. **Other objectives:** The workers may demand an increase in the wages or salary or in the payment of bonus as more profit will be shown if depreciation is not provided.

### Factors Affecting Depreciation

Calculation of depreciation is a difficult work. Following three basic factors are of utmost importance in the calculation of depreciation:

1. **Total cost of the assets:** The cost of the asset includes the invoice price of the asset, less any trade discount plus all costs essential to bring the asset to a useable condition. In other words, cost includes all expenses upto the installation of the assets e.g. freight, carriage, installation charges etc.
2. **Estimated useful life of an asset:** This is represented by the number of years of the estimated serviceable life span of an asset. Thus, if an asset is expected to last for 15 years before completely losing its usefulness for business operations, its life is taken to be 15 years. If a machine can work for 15 years but it is likely to become obsolete in 10 years due to availability of better type of machine, its useful life will be considered as 10 years.
3. **Estimates scrap value of an asset:** The term scrap value means the residual or break up or



salvage value which is estimated to be realized on account of the sale of the asset at the end of its useful life. An important part in this connection is that an asset may not necessarily have a scrap value e.g., leasehold property.

Example: if a machine is bought for Rs. 50,000; Rs. 3,000 are spent on its freight, Rs. 2,000 for its installation, it is estimated by the expert that its working life will be 10 years and at that time residual value will be Rs. 2,500. In such case, depreciation will be calculated as follows:

Cost of the asset = Rs. 50,000 + Rs. 3,000 + Rs. 2,000 = Rs. 55,000

Working life of the asset = 10 years

Scrap value of asset Rs. 2,500

It means Rs. 52,500 (Rs. 55,000 – Rs. 2,500) will be written off in the time span of 10 year i.e. Rs. 5,250 every year as depreciation.

**Depreciation and other Related Concepts**

- i. **Depreciation and Depletion:** Depreciation refers to a reduction in the value of all kinds of fixed assets arising from then wear and tear. Depletion is used in respect of the extraction of natural resources like quarries, mines, etc. that reduces the availability of the quantity of material or asset.
ii. **Depreciation and Obsolescence:** Obsolescence refers to decrease in usefulness caused on account of the asset becoming out of date, old fashioned, etc, and it is one of the causes of depreciation. Depreciation is the loss in the value of an asset on account of wear and tear.
iii. **Depreciation and Amortization:** Amortization refers to writing off of the proportionate value of the intangibles such as goodwill patents, copyrights while depreciation refers to writing off of the expired cost of the tangible assets like machinery, building, etc.
iv. **Depreciation and Fluctuation :** The points of difference are as follows :

Table with 2 columns: Depreciation and Fluctuation. It lists four points of difference between the two concepts.

Use of word per annum for calculation of amount of depreciation

In case the word "per annum" is given with the rate of depreciation than the amount of depreciation is calculated for the number of months the asset is used in business. When sale or purchase of asset takes place in between the year the depreciation is calculated for the period for which the asset was used.

In case per annum word is not given than the concept of number of months for which asset is used is over looked and depreciation is charged for whole year irrespective of asset being purchased in between the year and in case of sale of asset in between the year no depreciation is charged in selling year.

**Methods of Charging Depreciation:**

**1. Fixed Installment Method/ Original Cost Method:**

In fixed installment method, a fixed part of the original cost of the asset is transferred to P & L A/c every year as depreciation. The amount transferred as depreciation is fixed or the same. In this method when the asset becomes useless, its value becomes zero.

i. When the asset has no residual value:

Original cost of asset

Each year's Dep. = Number of years of estimated life of the asset

ii. When the asset has residual value:

Original cost of the asset – Its estimated resident value

Each years Dep. = Number of years of estimated life of the asset





**2. Diminishing Balance Method/ Reducing balance method/ Written down value method:**

In this method, depreciation is charged on the residual balance of the asset by a fixed rate of percentage. Thus, as the value of asset keeps going down year by year, depreciation also goes down in proportion. In this method the amount of depreciation is decreased every year.

Rate of depreciation is fixed in this method, but depreciation at this rate is calculated on the balance of the asset standing in the books on the first day of each year.

This method is suitable in case of those assets whose repair charges increase as they become old, e.g., Machinery. Also known as Reducing Balance method and written down value method.

**Difference between Fixed Installment and Reducing Balance Method**

Basis of different	Fixed Installment Method	Reducing Balance Method
1. Calculation of Depreciation	Depreciation is calculated on the original cost.	Depreciation is calculated on the remaining balance or opening book value of the asset.
2. Variation in dep. amount	Amount of annual depreciation remains same.	Amount of annual depreciation keeps decreasing.
3. Balance at the end of life	Under this method, balance of asset account is either equal to zero or is equal to scrap value at the end of life of an asset.	According to this method balance of the asset can never be equal to zero.
4. Rate of Depreciation	Rate of depreciation is not kept high.	Rate of depreciation is normally kept high.
5. Burden on Profit & Loss	Burden of repairs and depreciation is not equitable under this method.	Burden to total cost of running the asset is almost equitable.
6. Applicability	This method is adopted on the assets which are of less value and shorter life.	This method is more suitable for those assets which lose their utility gradually and heavy repair cost is incurred on them.
7. Validity	This method is not approved by income tax laws.	This method is approved by tax laws and tax rebate is given on depreciation calculated by this method.
8. Practicability	Same depreciation is charged even when the asset is of less value.	As the utility of the asset reduces, the amount of depreciation keeps on decreasing.

**Journal entries in case of Depreciation**

**1. On asset purchase**

Asset A/c           Dr  
                          To cash/ Bank

**2. On depreciation charged**

Depreciation on asset A/c       Dr  
  To asset A/c

**3. On Transfer of depreciation to P&L A/c**

P&L A/c           Dr  
                          To depreciation

**4. On sale of asset at profit**

Cash/ Bank A/c       Dr  
                          To P&L A/c



- To asset A/c  
5. **On sale of asset at loss**  
Cash/ Bank a/c Dr  
P&L A/c Dr  
To asset A/c

**Journal entries for Depreciation when provision of Depreciation is made**

1. **For providing depreciation**  
Depreciation a/c Dr  
To provision For Depreciation A/c
2. **For transfer of depreciation to P&L A/c**  
P&L A/c Dr  
To Depreciation A/c
3. **On sale of asset**
  - a. Provision for Depreciation A/c Dr  
To Assets A/c
  - b. In case of profit or loss on sale of asset

**If Profit:** Asset A/c Dr  
To P&L A/c

**If Loss:** P&L A/c Dr  
To asset A/c

Alternately, on sale asset, an asset disposal account may be opened.

**Change of Method:**

- i. In case of change of method of charging depreciation from straight line method to diminishing balance method, the depreciation is charged on the reduced balance of asset on the date when change is applicable.
- ii. In case of change of method of charging depreciation from diminishing balance to straight line method, the depreciation is charged on the original cost of asset when change is applicable.

**Change of method from previous date (Retrospective effect)**

The change of method from straight line to diminishing balance and from diminishing to straight line can be made effective from the original/ previous date. In such a case there might be extra depreciation already charged or to be charged as change is to be made effective from previous date. The treatment of this extra of less depreciation is to be made. Such change of method is known as change of method from previous date i.e. retrospective effect. As per AS-6 when any change of method of depreciation is recommended, then the change is to be made effective from retrospective effect and not immediate effects.

3. **Annuity Method:** In annuity method the amount invested in an asset is considered as an investment and interest is calculated on such amount. Every year the amount of interest is calculated and same is transferred to debit side of the asset A/c and depreciation A/c is credited. Thus the effect of depreciation and interest keeps increasing on the P & L A/c because every year the P & L A/c is debited with the amount of depreciation and credited with the interest.

Under this method amount of depreciation is found out from annuity table. When an asset is purchased, the purchaser not only loses the amount spent in purchasing the asset but he also loses the expected amount of interest which he would have earned had he invested this amount elsewhere instead of purchasing this asset. Under this method amount of depreciation includes some portion of the asset and some portion of this expected amount of interest also.



- 4. **Depreciation Fund Method:** In this method, Govt. Investments are purchased every year by the amount of depreciation. More securities are purchased by the return on previous securities. Thus the depreciation is invested in securities. Compound interest is received on such securities. Investments are not made in the last year; instead all securities are sold out and the return is used for renewal. Amount of depreciation is not deducted from the value of the asset; instead it is transferred to the credit side of Depreciation Fund A/c. Asset is shown on the original cost every year.
- 5. **Depreciation Repairs & Renewals Fund Method:** In this method, the life of the asset, depreciation thereon, scrap value at the end of its life and repairing expenses of the asset are estimated in advance. Such estimated amount is transferred to the P & L A/c in equal parts. In this method a Depreciation Repairs and Renewals Fund a/c is opened. In this account, the estimated installment calculated in the above mentioned manner is transferred to the P & L A/c every year. When the life of the asset is over, it is disposed of. The balance of Fund A/c is transferred to the asset A/c and both accounts are closed. If some balance remains in the Asset A/c it is transferred to the P & L A/c.
- 6. **Insurance Policy Method:** In Insurance Policy Method the amount of depreciation is not invested in external securities. Instead, an insurance policy is taken for renewal of the asset. Every year a fixed amount is paid as premium of the policy and after a certain period the insurance company pays back in lump sum, which is used for renewal.
- 7. **Revaluation Method:** In this method at the end of each year the asset is revalued by an expert before the preparation of final accounts and any reduction in the value of the asset is assumed as depreciation and is duly charged. If there is an appreciation in the value of such asset, it is overlooked. When the asset is revalued at a lower price, the amount by which it is reduced is assumed as depreciation. The Depreciation A/c is debited with this amount and asset A/c is credited with the same.
- 8. **Sum of the year digits method:** First of all the estimated cost of assets is calculated by deducting scrap value from original cost. The total of digits of the assets is made in an order. If the life of a company is five years - 5 + 4 + 3 + 2 + 1 = 15 will be sum of the digits. For calculation of depreciation assets of first year will be assumed to be equal in use of the asset throughout its life. In the following years the period will gradually be reduced. The following formula is used to calculate depreciation:

$\text{First year} = \frac{\text{Estimated value of the asset} \times \text{Total life of asset}}{\text{Total of all years}}$
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- In second and following years one year respectively will be reduced from the total number of years.
- 9. **Machine hour rate method:** In this method the life of machinery is estimated in hours and the whole loss on the machinery (Cost - Scrap Value) is divided by such hours. Thus the depreciation is calculated on per hour use of the machinery.
  - 10. **Depletion Method :** In this method, an estimate of the profits which the assets is supposed to yield in the future is made and the amount invested in the asset is divided in such profit and depreciation per unit is calculated.

**Difference between Reserves & Provisions**

S. No	Basis of Difference	Reserve	Provision
1	Meaning	A reserve is meant for meeting an unanticipated situation.	A provision is created for some specific object
2	Mode of creation	A reserve is created only out of profit. If there is no sufficient profit, a reserve cannot be created.	A provision is a charge against profit. It is created even though there is no profit.



**BBA I YEAR**

**FUNDAMENTAL OF ACCOUNTING**

3	Time of creation	A reserve is created after ascertaining the profit	A provision is created before ascertaining the profit or loss of a business.
4	Object	The object of creating such reserves is to strengthen the financial position of the business and to increase the working	The object of making provisions is arrangement made to provide funds for known liability.



		capital.	
5	Utilization	Reserve can be used in the payment of any liability or loss.	Provision can be utilized only for the purpose for which it is meant.
6	Distribution	General reserve are always available for distribution of profits e.g. as dividend.	A provision cannot be utilized for the distribution of profit e.g. as dividend.
7	Place in accounting	Reserves show excess of assets over liabilities.	A provision is not shown as excess of asset over liabilities but it is helpful for determining the real valuation of assets.
8	Presenting in balance sheet	Reserves are always on the liabilities side in the balance sheet.	A provision is shown as an item of deduction from its related asset or shown on liability side.



## **Bank Reconciliation**

### **Meaning**

Bank reconciliation is a critical financial process that involves comparing the transactions and balances on a bank statement with the corresponding records in a company's accounting books. This procedure is essential for identifying discrepancies between the two sets of records, ensuring the accuracy of financial statements, and maintaining the integrity of a company's financial health.

At its core, bank reconciliation aims to verify that every transaction recorded in an organization's cash account matches those listed on the bank statement. This includes deposits, withdrawals, bank fees, and other financial transactions. Discrepancies can arise due to timing differences in recording transactions, errors by the bank or the company, or unauthorized transactions. By reconciling these differences, companies can correct errors, detect potential fraudulent activities early, and accurately report their financial position.

### **Causes of Difference in Bank Reconciliation Statement**

Reconciliation statement is a record book which lists the changes that appear in either book (cashbook or passbook). Two broad terms cover up major challenges due to which differences may appear:

#### **Errors committed by Firm**

Wrong totaling of notes while depositing, omission or wrong recording of amounts of cheques issued, etc. are some major drawbacks. The reconciliation addresses this major issue and resolves it.

#### **Errors committed by Bank**

Wrong recording of transactions related to cheque while posting it or wrong totaling results in a difference in cashbook and passbook.

#### **Time Difference in Recording Entry**

When a bank cross checks bank statement and business cash book, there are innumerable errors present due to the time gap. The factors affecting this time gap are as follows:

#### **Cheque issued by the bank but not yet presented for payment**

The bank works in advance to provide faster services. It adds money to the beneficiary's account as it encounters a cheque. Afterward, it looks for the credited amount in the supplier's account. If it is unable to find the balance amount, it deducts from the beneficiary's account and returns the cheque with fault charges.

The bank statement excludes it but the cash book might have recorded it. Therefore, it becomes a time discrepancy.

#### **Cheque deposited but not collected by the bank**

When a firm receives a cheque, the cash book posts the entry for the business firm. Whereas a bank takes 3 to 4 days to clear a cheque and the entry then finds a place in the bank statement.

#### **Direct debits made by Bank**

The services provided by bank require a nominal fee. The bank deducts money from the firm's



account without them knowing it. The firm gets to know this directly through the bank statement.

For example, interest on overdraft, cheque bounced or stopped charges, incidental charges, etc. As a result, the balance in passbook will be less than the balance in cash book.

### **Amount directly deposited in the bank**

There may be a situation where a debtor submits an amount to a firm's account and the firm receives no message regarding the same. In this situation, the passbook balance rises and the cashbook balance doesn't.

### **Interests collected by the bank**

The bank directly adds interest to a firm's account and the only medium of its knowledge is bank statement. The firm jots down the interest after issuing the bank statement. They are noted in the final balance additions in the cash book.

## **Branch Accounting**

### **MEANING**

Branch accounting is a bookkeeping system. It separates accounts into different branches, each of which is maintained separately. This is a system that is typically found in corporations that are geographically dispersed, as well as chain operators. It allows for greater transparency when it comes to transactions and calculating cash flow, as well as helping accountants track the overall performance and financial position of each branch.

Branch Accounting is defined as a bookkeeping system of accounting that allows a business with multiple locations or branches to keep track of financial transactions at each branch individually, while also consolidating them at the main or head office. This helps in monitoring the performance and financial position of each branch separately. These branches are divided by geographical location, and each department has its profit and cost centers. In this accounting system, separate Trial Balance, Profit and Loss Statements, and Balance Sheets are prepared by each branch. Branches operate independently in terms of day-to-day transactions but still are part of the larger organizational structure, so the financial results of each branch are consolidated at the head office to prepare overall financial statements for the entire organization.

Branch accounting method split in two categories:

- Dependent branch
- Independent branch

## **Methods of Branch Accounting**

### **Debtor system**

#### **Stock and debtor system**

#### **Final accounts system**

#### **Wholesale branches system**

### **Debtor System**

In the debtor system, a branch account is debited in the head office's books with the goods supplied by the head office. The branch account will then be credited with all of the returns and remittances. This can be used to find out the profit or loss of each branch.

### **Stock and Debtors System**

This system is ideal for smaller branches. It is where goods are shipped to the branch at the sale



price. The branch doesn't have the authorization to vary that selling price.

### Final Accounts System

In this method, trading and profit and loss accounts are prepared. This is for calculating the gross profit or gross loss, alongside the net loss or net profit. Opening goods and stock that are sent to the branch are debited in the trading account. Any closing stock, goods, and sales that are returned by the branch are credited to the trading account.

### Wholesale Branches System

For this system, the invoicing of goods is done at the wholesale price. This is to a retail branch. The opening and closing stock of the branch in question is shown at the wholesale price. Plus any unrealized profits in the closing stock are debited as a stock reserve. This is to the profit and loss account of the corporate headquarters. A stock reserve of opening stock is also then credited to the same account.

### Objectives of branch accounting:-

- To know the profit or loss of each branch separately.
- To ascertain the financial position of each branch separately on a particular date .
- To know the cash & goods requirements of the various branches.
- To calculate commission for payment to the managers.
- To give concrete suggestions for the improvement in the working of the various branches .
- To meet the requirements of specific enactments as all branches of a company must keep the accounts for audit purpose
- To evaluate the progress and performances of each branch .

### Accounting Entries:

Transactions Journal Entries

1. Goods sent to branch by head office Or any other branch

Branch A/c

To Goods sent to branch A/c

(Being value of goods sent to the branch)

2. Goods returned by branch to head Office or to any other branch

Goods sent to branch A/c

To Branch A/c

(Being value of goods returned by branch)

3. Cash remitted to branch or paid to others

Branch A/c

To Cash/Bank A/c

(Being amount sent to branch for payment /exp)

4. Expenses in respect of branch paid by Head office

Branch A/c

To Cash/Bank A/c

(Being payment for expenses relating to branch)

5. Provision for expenses relating to Branch

Branch A/c

To outstanding Exp. A/c

(Being provision of unpaid expenses)

6. Charging depreciation on assets used at branch not included in branch

Account

Branch A/c

To asset A/c

(Being dep. on asset used at branch provided)





7. Cash remitted by branch to head Office

Cash/Bank A/c

To Branch A/c

(Being amount remitted by branch)

8. Amount received from customer & other sundry income of branch by Head office

Cash/Bank A/c

To Branch A/c

(Being amount received from third party in respect of branch sales/income.

9. Goods received from customer of branch by head office

Goods sent to branch A/c

To Branch A/c

(Being goods sold by branch returned by customer directly)

10. Goods sent to branch account transferred to trading account at the end of accounting year

Goods sent to branch A/c

To Purchase or (Trading) A/c

(Being value of goods sent to branch transferred to trading)

11. Profit or loss at branch (balancing figure in branch account)

Branch A/c

To Profit & Loss A/c

(Being Profit/loss for the year at the branch) (for loss entry will be reversed)

12. Assets at the end of the accounting year

Branch Assets A/c

To Branch A/c

13. Liabilities at the end of the accounting year

Branch A/c

To Branch liabilities A/c



## UNIT - 5

### Accounts of non-profit organizations and professionals

In many countries, besides profit making organization, there are many such organizations whose main motto is not to earn profit but to serve for the benefit of the society or for entertaining its members or to safeguard the interest of the society. Such type of organizations are known as 'non-profit organizations'. For example, club, education institutions, schools, trade unions, consumer co-operatives, political associations, automobile association, hospital etc.

Need for maintaining accounts of non-profit organizations and professional:

- 1) For the information
- 2) Balancing the expenditure
- 3) Calculation of surplus or deficit
- 4) To find the financial position
- 5) Information regarding assets
- 6) Calculation of tax

Final Accounts

- a) Receipts and payments accounts
- b) Income and expenditure accounts
- c) Balance sheet

Difference between receipts & payments account and cash book –

S.No.	Basis of difference	Receipts & payments accounts	Cash Book
1	Datewise	Receipts and payments are not recorded datewise.	Receipts and payments are recorded date wise.
2	Fixed date	It is prepared on some fixed date in a year.	The transaction goes on for the full year.
3	Base	Cash book is the base for the payments a/c.	It is prepared on the basis of cash transactions.
4	Form	It is a brief statement of cash book.	It is the detailed record of cash transactions.
5	Items	Analysis of each receipts & payments are made item wise & the it is written.	Each item is differently written in the book.
6	Nature	It is a memorandum book.	It is a main and most important book.

Following points are taken into consideration while preparing income & expenditure account and balance sheet of non-profit organization –

- 1) Life membership fees** – Instead of paying membership fees annually, some members deposit a lump sum membership fees i.e. deposit the life time membership fees. This fees are not related to one year but it is related to life time of the member.
- 2) Entrance fees** – At the time of admission of members entrance fees is taken from them. It is taken only once from the members. After that normal annual membership fees are taken



from members. Since it is paid once for ever by a member, it is not of recurring nature hence it should be considered as capital receipts and will appear on the liability side of balance sheet.

- 3) **Endowment Fund** – Some people donate a huge amount for some religious or for some social purpose or donate some valuable fixed assets. Such a huge amount forms a base for the working of organizations. Since it is not a recurring amount it is treated as of capital nature and hence taken into balance sheet.
- 4) **Donation** – Gift received from any person, firm, company etc. is known as donation. It depends upon type of donation whether to credit in income & expenditure account or to treat it as capital income & take it to balance sheet. For this, following points should be kept in mind.
  - a) **Specific donation** – If organization receives donation for some specific purpose then it is treated as capital income & written on the liability side of balance sheet. For example, donation for library, sports ground, building etc.
  - b) **General donation** – When donation is not received for some specific purpose then it is known as general donation. If huge amount is received then it should be taken to the liability side of balance sheet as there are small changes of its recurring. But if the amount received is small then it should be credited to income & expenditure account because there are more changes of its recurring every year. Whether the amount is smaller or higher is decided by comparing this item with other items in the question or by some related circumstances.
- 5) **Legacy** – Legacy received by organization is such type of donation which is rarely received, hence it is treated as capital income and written on the liability side of balance sheet. But if the amount received is smaller in size then it is treated as revenue income and credited to income and expenditure account.
- 6) **Income or expenses from specific fund** – To fulfil certain specific object, non-profit organizations open specific funds. Like match fund, sports fund, tournament fund, prize fund, charity fund, etc. If any income is earned from such fund, then it is written on liability side of balance sheet and if any expenditure is related to it then it should be deducted.
- 7) **Subscription** – Main source of income of non-profit organization is from subscription. Total subscriptions of previous year is treated as revenue and written on the credit side of income & expenditure account.
- 8) **Sale of old assets** – Amount received on sale of old asset is debited to receipts and payments account. If there is profit on sale of assets, it should be credited and if there is a loss then it should be debited to income & expenditure account. Book value of sold asset should be deducted from the assets.
- 9) **Sale of sports equipment** – Sale of sports equipment is usually made by club. Hence it should be property accounted for.
- 10) **Sale of old newspaper** – It is an income which can occur frequently, hence it is credited to income and expenditure a/c.
- 11) **Subsidies from government and other institution** – If non-profit organization received some subsidy from government or other institution then it should be credited to income expenditure account. If it is of capital nature it should be recorded on liabilities side.

**Difference between receipts & payments account and income & expenditure account**

S.No.	Basis of Difference	Receipt & Payment A/c	Income & Expenditure A/c
1	Nature	It is a cash account of a non-trading concern.	It is like a profit & loss account of a non-trading concern.
2	Account	It is a real account.	It is a nominal account.
3	Side	Receipts are debited and payments are credited to this account.	Expense are debited and income are credited to his account.
4	Capital & revenue	It records receipts & payments of both capital & revenue nature.	It records income & expenditure of only revenue nature.
5	Period of income & expenses	It shows the receipts & payments made during the year whether they belong to past, current or subsequent year.	It shows incomes & expenditure of the current year only whether received or not received/paid.
6	Opening Balance	Balance in the beginning represents cash in hand in the beginning.	There is no balance in the beginning.
7	Closing Balance	Balance at the end represents cash in hand at the end.	Balance at the end represents excess of income over the expenditure or <i>vice versa</i> .
8	Adjustment	There is no place for adjustment.	Here adjustments are made.
9	Balance sheet	It is not essential that balance sheet should accompany this account.	Balance sheet must accompany this account.