Introduction to Accounting

Definition of Accounting Definition by the American Institute of Certified Public Accountants (Year 1961): "Accounting is the art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character, and interpreting the result thereof".

Definition by the American Accounting Association (Year 1966): "The process of identifying, measuring and communicating economic information to permit informed judgments and decisions by the users of accounting".

Accountancy is the process of communicating financial information about a business entity to users such as shareholders and managers (Elliot, Barry & Elliot, Jamie: Financial accounting and reporting).

Accounting has been defined 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 financial character, and interpreting the results thereof. (AICPA)

Objectives of Accounting

(i) Providing Information to the Users for Rational Decision-making: The primary objective of accounting is to provide useful information for decision-making to stakeholders such as owners, management, creditors, investors, etc. Various outcomes of business activities such as costs, prices, sales volume, value under ownership, return of investment, etc. are measured in the accounting process. All these accounting measurements are used by stakeholders (owners, investors, creditors/bankers, etc.) in course of business operation. Hence, accounting is identified as 'language of business'.
(ii) Systematic Recording of Transactions: To ensure reliability and precision for the accounting measurements, it is necessary to keep a systematic record of all financial transactions of a business enterprise which is ensured by bookkeeping. These financial records are classified, summarized and reposted in the form of accounting measurements to the users of accounting information i.e., stakeholder.
(iii) Ascertainment of Results: 'Profit/loss' is a core accounting measurement. It is measured by preparing profit and loss account for a particular period. Various other accounting measurements such as different types of revenue expenses and revenue incomes are considered for preparing this profit and loss account. Difference between these revenue incomes and revenue expenses is known as result of business transactions identified as profit/loss. As this measure is used very frequently by stockholders for rational decision making, it has become the objective of accounting. For example, Income Tax Act requires that every business should have an accounting system that can measure taxable income of business and also explain nature and source of every item reported in Income Tax Return.
(iv) Ascertain the Financial Position of Business: 'Financial position' is another core accounting measurement. Financial position is identified by preparing a statement of ownership i.e., Assets and Owings i.e., liabilities of the business as on a certain date. This statement is popularly known as balance sheet. Various other accounting measurements such as different types of assets and different types of liabilities as existed at a particular date are considered for preparing the balance sheet. This statement may be used by various stakeholders for financing and investment decision.

(v) To Know the Solvency Position: Balance sheet and profit and loss account prepared as above give useful information to stockholders regarding concerns potential to meet its obligations in the short run as well as in the long run.

Functions of Accounting

The main functions of accounting are as follows:

(a) Measurement: Accounting measures past performance of the business entity and depicts its current financial position.

(b) Forecasting: Accounting helps in forecasting future performance and financial position of the enterprise using past data.

(c) Decision-making: Accounting provides relevant information to the users of accounts to aid rational decision-making.

(d) Comparison & Evaluation: Accounting assesses performance achieved in relation to targets and discloses information regarding accounting policies and contingent liabilities which play an important role in predicting, comparing and evaluating the financial results.

(e) Control: Accounting also identifies weaknesses of the operational system and provides feedbacks regarding effectiveness of measures adopted to check such weaknesses.

(f) Government Regulation and Taxation: Accounting provides necessary information to the government to exercise control on die entity as well as in collection of tax revenues.

Briefly explain the users and their need for accounting information.

Users of Accounting Information - Internal & External

Accounting information helps users to make better financial decisions. Users of financial information may be both internal and external to the organization.

Internal users (Primary Users) of accounting information include the following:

- Management: for analyzing the organization's performance and position and taking appropriate measures to improve the company results.
- Employees: for assessing company's profitability and its consequence on their future remuneration and job security.
- Owners: for analyzing the viability and profitability of their investment and determining any future course of action.
- Accounting information is presented to internal users usually in the form of management accounts, budgets, forecasts and financial statements.

External users (Secondary Users) of accounting information include the following:

- Creditors: for determining the credit worthiness of the organization. Terms of credit are set by creditors according to the assessment of their customers' financial health. Creditors include suppliers as well as lenders of finance such as banks.
- Tax Authorities: for determining the credibility of the tax returns filed on behalf of the company.
- Investors: for analyzing the feasibility of investing in the company. Investors want to make sure they can earn a reasonable return on their investment before they commit any financial resources to the company.
- Customers: for assessing the financial position of its suppliers which is necessary for them to maintain a stable source of supply in the long term.

- Regulatory Authorities: for ensuring that the company's disclosure of accounting information is in accordance with the rules and regulations set in order to protect the interests of the stakeholders who rely on such information in forming their decisions.

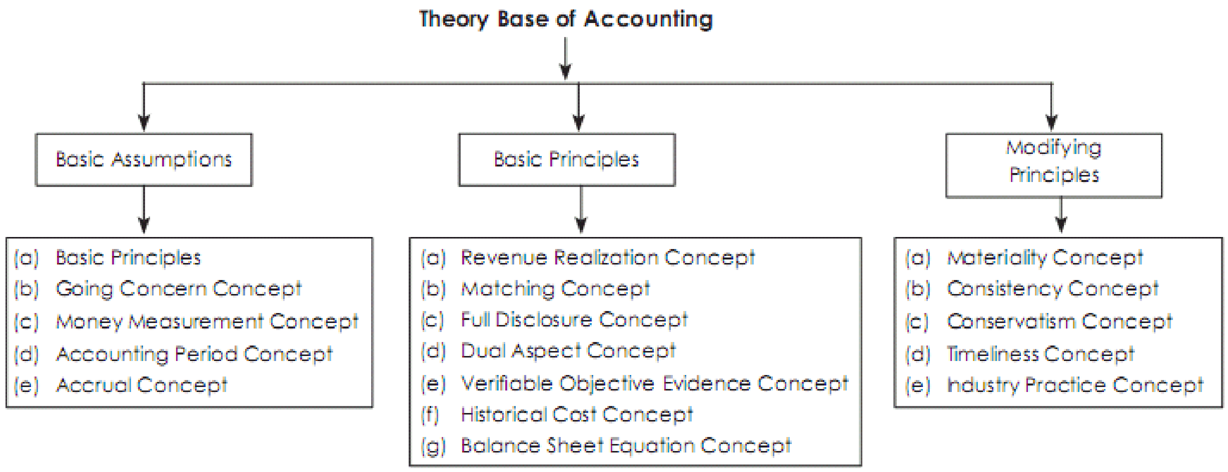
Distinction between Book-keeping and Accounting

	Book-Keeping		Accounting
1.	Output of book-keeping is an input for accounting.	1.	Output of accounting permit informed judgments and decisions by the user of accounting information.
2.	Purpose of book-keeping is to keep systematic record of transactions and events of financial character in order of its occurrence.	2.	Purpose of accounting is to find results of operating activity of business and to report financial strength of business.
3.	Book-keeping is a foundation of accounting.	3.	Accounting is considered as a language of business.
4.	Book-keeping is carried out by junior staff.	4.	Accounting is done by senior staff with skill of analysis and interpretation.
5.	Objects of book-keeping is to summarize the cumulative effect of all economic transactions of business for a given period by maintaining permanent record of each business transaction with its evidence and financial effects on accounting variable.	5.	Object of accounting is not only bookkeeping but also analyzing and interpreting reported financial information for informed decisions.

GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

A widely accepted set of rules, conventions, standards, and procedures for reporting financial information, as established by the Financial Accounting Standards Board are called Generally Accepted Accounting Principles (GAAP). These are the common set of accounting principles, standards and procedures that companies use to compile their financial statements. GAAP are a combination of standards (set by policy boards) and simply the commonly accepted ways of recording and reporting accounting information.

GAAP is to be followed by companies so that investors have a optimum level of consistency in the financial statements they use when analyzing companies for investment purposes. GAAP cover such aspects like revenue recognition, balance sheet item classification and outstanding share measurements.



1. **Business Entity Concepts**: According to these concepts, a business is treated as separate Entity distinct from its owner. This means that in accounting the business and owner must be treated separately. Thus, when one person invests amount in to the business, it will be deemed to the liability of the business. The concept of separate entity is applicable to all form of business.

2. **Going concern concepts: A**ccording to this, it is assumed that business will exist for a long time. There is no intention t o liquidate the business in the immediate future.

3. Money measurement concepts: Accounting records only those transactions which are expressed in monetary terms. Transactions which cannot be expressed in money do not find place in the books of accounts.

4. Cost Concepts: According to this concept, all transactions are recorded in the books of accounts at actual price involved.

5. Dual aspect Concepts: according to this concept, every transaction has two aspects. These two aspects are receiving aspect and giving aspect. These two aspects have to be recorded. The basis of this principle is that for every debit, there is an equal and corresponding credit.

6. Realization Concept: According to this principle revenue is said to be realized when goods or services are sold to be a customer. It emphasizes the fact that the mere receipt of an order for goods or services cannot be taken for the realization of revenue. So advanced payment received from a customer cannot be considered as revenue earned.

7. Matching Concept: According to this concept, cost of a business of a particular period is compared with the revenue of that period in order to ascertain net profit or net loss.

8. Accounting period Concept: According to this assumption, the life of a business is divided in to different periods for preparing financial statements. Generally business concern adopt twelve months period for measuring the income of the concern. This time interval is known as accounting period.

Accounting conventions: Accounting conventions are the customs and traditions which guide the accountant while preparing accounting statements. Some of the accounting conventions are:-

(1) **Convention of consistency**: - This convention follows that the basis followed in several accounting periods should be consistent. This means the methods adopted in one accounting year should not be changed in another year. Then only comparison of results is possible.

(2) **Convention of conservatism**: - This is a convention of playing safe, which is followed while preparing the financial statements. The idea of this convention is to consider all possible losses and to ignore all probable profits.
(3) **Convention of Materiality**: - Materiality means relevance or importance or significance. It is generally accepted in the accounting circle that the accounting statements and records must reveal all material facts.

Accounting's Importance to Business

So why do we need accounting? Asking that question of an accountant is like asking a farmer why we need rain. We need accounting because it's the only way for business to grow and flourish. Accounting is the backbone of the business financial world. After all, accounting was created in response to the development of trade and commerce during the medieval times.

Italy is our first recorded source for accounting entries, and the first published accounting work in 1494 was by a Venetian monk. So you see accounting as an organized method for record-keeping has been around almost as long as the trade and business industries. Another interesting fact is the knowledge and principles upon which the first accounting practices were established, have changed very little in the many hundreds of years that accounting has been in use. The concepts of assets, liabilities, and income and the need to reconcile these areas is still the basis for all accounting functions today.

The process for recording those transactions, and the many reports generated by the compilation of that information has evolved over the last two hundred years. Thanks to the creation of computers, many of the bookkeeping functions that are vital to accounting, but somewhat repetitive are performed by data entry clerks, and the reports generated come from the IS Department. The end result is still the same: accounting gives us the financial snapshot we need in order to make solid business decisions about the current status or projected future health of our businesses.

There are two basic categories of accounting: financial accounting and managerial accounting. Financial accounting is comprised of information that companies make available to the general public: stockholders, creditors, customers, suppliers, and regulatory commissions. Managerial accounting deals with information that is not made public. Information such as salary costs, Cost of goods produced, profit targets, and material control information. The knowledge supplied by managerial accounting is for the use of department heads, division managers, and supervisors to help them make better decisions about the day-to-day operations of the business.

Now, what about the "accountability" part of the accounting process? Why do we need that and how do we enforce it? Businesses need to be held accountable for the methods they use to run a business because the potential for greed, theft, and dishonesty exist in every business. You have only to read the current events section of the newspaper to realize how rampant corporate abuse is in business today. We have Enron, HealthSouth, and Martha Stewart examples to show us just how extensive the problem has become. There are specialized areas of accounting, that when correctly enforced, eliminate the possibility for fraud. Auditing and income taxation, when used correctly, force business to account for all business income, transactions, and transfers, and then to pay their fair share of the tax burden. The catch here is that the principles must be correctly enforced.

Accounting is the conscious of the business world. When handled with care and with respect, it performs as expected. When abuse occurs, and the system is circumvented or overridden because of dishonesty and greed, it doesn't work correctly. Accounting is much like all other systems in place, they are only as good as the people using them.

NATURE AND MEANING OF ACCOUNTING PRINCIPLES

What is an accounting principle or concept or convention or standard? Do they mean the same thing? Or does each one have its own meaning? These are all questions for which there is no definite answer because there is ample confusion and controversy as to the meaning and nature of accounting principles. We do not want to enter into this controversial discussion because the reader may fall a prey to the controversies and confusions and lose the spirit of the subject.

The rules and conventions of accounting are commonly referred to as principles. The American Institute of Certified Public Accountants have defined the accounting principle as, "a general law or rule adopted or professed as a guide to action; a settled ground or basis of conduct or practice". It may be noted that the definition describes the accounting principle as a general law or rule that is to be used as a guide to action. The Canadian Institute of Chartered Accountants has defined accounting principles as, "the body of doctrines commonly associated with the theory and procedure of accounting, serving as explanation of current practices and as a guide for the selection of conventions or procedures where alternatives exist". This definition also makes it clear that accounting principles serve as a guide to action. The peculiar nature of accounting principles is that they are manmade. Unlike the principles of physics, chemistry etc. they were not deducted from basic axiom. Instead they have evolved. This has been clearly brought out by the Canadian Institute of Chartered Accountants in the second part of their definition on accounting principles: "Rules governing the foundation of accounting actions and the principles derived from them have arisen from common experiences, historical precedent, statements by individuals and professional bodies and regulation of governmental agencies". Since the accounting principles are manmade they cannot be static and are bound to change in response to the changing needs of the society. It may be stated that accounting principles are changing but the change in them is permanent.

Accounting principles are judged on their general acceptability to the makers and users of financial statements and reports. They present a generally accepted and uniform view of the accounting profession in relation to good accounting practice and procedures. Hence the name generally accepted accounting principles.

Accounting principles, rules of conduct and action are described by various terms such as concepts, conventions, doctrines, tenets, assumptions, axioms, postulates, etc. But for our purpose we shall use all these terms synonymously except for a little difference between the two terms – concepts and conventions. The term "concept" is used to connote accounting postulates i.e. necessary assumptions or conditions upon which accounting is based. The term convention is used to signify customs or traditions as a guide to the preparation of accounting statements.

ACCOUNTING CONCEPTS

The important accounting concepts are discussed hereunder:

Business Entity Concept: It is generally accepted that the moment a business enterprise is started it attains a separate entity as distinct from the persons who own it. In recording the transactions of the business the important question is:

How do these transactions affect the business enterprise? The question as to how these transactions affect the proprietors is quite irrelevant. This concept is extremely useful in keeping business affairs strictly free from the effect of private affairs of the proprietors. In the absence of this concept the private affairs and business affairs are mingled together in such a way that the true profit or loss of the business enterprise cannot be ascertained nor its financial position. To quote an example, if the proprietor has taken Rs.5000/- from the business for paying house tax for his residence, the amount should be deducted from the capital contributed by him. Instead if it is added to the other business expenses then the profit will be reduced by Rs.5000/- and also his capital more by the same amount. This affects the results of the business and also its financial position. Not only this, since the profit is lowered, the consequential tax payment also will be less which is against the provisions of the Income-tax Act.

Going Concern Concept: This concept assumes that the business enterprise will continue to operate for a fairly long period in the future. The significance of this concept is that the accountant while valuing the assets of the enterprise does not take into account their current resale values as there is no immediate expectation of selling it. Moreover, depreciation on fixed assets is charged on the basis of their expected life rather than on their market values. When there is conclusive evidence that the business enterprise has a limited life the accounting procedures should be appropriate to the expected terminal date of the enterprise. In such cases, the financial statements could clearly disclose the limited life of the enterprise and should be prepared from the `quitting concern' point of view rather than from a `going concern' point of view.

Money Measurement Concept: Accounting records only those transactions which can be expressed in monetary terms. This feature is well emphasized in the two definitions on accounting as given by the American Institute of Certified Public Accountants and the American Accounting Principles Board. The importance of this concept is that money provides a common denomination by means of which heterogeneous facts about a business enterprise can be expressed and measured in a much better way. For e.g. when it is stated that a business owns Rs.1,00,000 cash, 500 tons of raw material, 10 machinery items, 3000 square meters of land and building etc., these amounts cannot be added together to produce a meaningful total of what the business owns. However, by expressing these items in monetary terms Rs.1,00,000 cash, Rs.5,00,000 worth of raw materials, Rs,10,00,000 worth of machinery items and Rs.30,00,000 worth of land and building – such an addition is possible.

A serious limitation of this concept is that accounting does not take into account pertinent non-monetary items which may significantly affect the enterprise. For instance, accounting does not give information about the poor health of the Chairman, serious misunderstanding between the production and sales manager etc., which have serious bearing on the prospects of the enterprise. Another limitation of this concept is that money is expressed in terms of its value at the time a transaction is recorded in the accounts. Subsequent changes in the purchasing power of moneys are not taken into account.

Cost Concept: This concept is yet another fundamental concept of accounting which is closely related to the going-concern concept. As per this concept: (i) an asset is ordinarily entered in the accounting records at the price paid to acquire it i.e., at its cost and (ii) this cost is the basis for all subsequent accounting for the asset.

The implication of this concept is that the purchase of an asset is recorded in the books at the price actually paid for it irrespective of its market value. For e.g. if a business buys a building for Rs.3,00,000, the asset would be recorded in the books at Rs.3,00,000 even if its market value at that time happens to be Rs.4,00,000. However, this concept does not mean that the asset will always be shown at cost. This cost becomes the basis for all future accounting for the asset. It means that the asset may systematically be reduced in its value by changing depreciation. The significant advantage of this concept is that it brings in objectivity in the preparations and presentation of financial statements. But like the money measurement concept this concept also does not take into account subsequent changes in the purchasing power of money due to inflationary pressures. This is the reason for the growing importance of inflation accounting.

Dual Aspect Concept (Double Entry System): This concept is the core of accounting. According to this concept every business transaction has a dual aspect. This concept is explained in detail below: The properties owned by a business enterprise are referred to as assets and the rights or claims to the various parties against the assets are referred to as equities. The relationship between the two may be expressed in the form of an equation as follows:

Equities = Assets

Equities may be subdivided into two principal types: the rights of creditors and the rights of owners. The rights of creditors represent debts of the business and are called liabilities. The rights of the owners are called capital. Expansion of the equation to give recognition to the two types of equities results in the following which is known as the accounting equation:

Liabilities + Capital = Assets

It is customary to place `liabilities' before `capital' because creditorshave priority in the repayment of their claims as compared to that of owners.

Sometimes greater emphasis is given to the residual claim of the owners by transferring liabilities to the other side of the equation as:

Capital = Assets – Liabilities

All business transactions, however simple or complex they are, result in a change in the three basic elements of the equation. This is well explained with the help of the following series of examples:

(i) Mr.Prasad commenced business with a capital of Rs.3,000: The result of this transaction is that the business, being a separate entity, gets cash-asset of Rs.30,000 and has to pay to Mr.Prasad Rs.30,000 his capital. This transaction can be expressed in the form of the equation as follows:

Capital = Assets
Prasad Cash
30,000 30,000

(ii) Purchased furniture for Rs.5,000: The effect of this transaction is that cash is reduced by Rs.5,000 and a new asset viz. furniture worth Rs.5,000 comes in thereby rendering no change in the total assets of the business. The equation after this transaction will be:

Capital = Assets
Prasad Cash + Furniture
30,000 25,000 5,000

(iii) Borrowed Rs.20,000 from Mr.Gopal: As a result of this transaction both the sides of the equation increase by Rs.20,000; cash balance is increased and a liability to Mr.Gopal is created.

The equation will appear as follows:

Liabilities + Capital =Assets
Creditiors + Prasad Cash + Furniture
20,000 30,000 45,000 5,000

(iv) Purchased goods for cash Rs.30,000: This transaction does not affect the liabilities side total nor the asset side total. Only the composition of the total assets changes i.e. cash is reduced by Rs.30,000 and a new asset viz. stock worth Rs.30,000 comes in.

The equation after this transaction will be as follows:

Liabilities + Capital =Asset

Creditors Prasad Cash + Stock + Furniture

20,000 30,000 15,000 30,000 5,000

(v) Goods worth Rs.10,000 are sold on credit to Ganesh for Rs.12,000. The result is that stock is reduced by Rs.10,000 a new asset namely debtor (Mr.Ganesh) for Rs.12,000 comes into picture and the capital of Mr.Prasad increases by Rs.2,000 as the profit on the sale of goods belongs to the owner. Now the accounting equation will look as under:

Liabilities + Capital =Asset

Creditors Prasad Cash +Debtors+Stock+ Furnitures

20,000 32,000 15,000 12,000 20,000 5,000

(vi) Paid electricity charges Rs.300: This transaction reduces both the cash balance and Mr.Prasad's capital by Rs.300. This is so because the expenditure reduces the business profit which in turn reduces the equity. The equation after this will be:

Liabilities + Capital =Asset

Creditors + Prasad Cash +Debtors+Stock+ Furnitures

20,000 31,700 14,700 12,000 20,000 5,000

Thus it may be seen that whatever is the nature of transaction, the accounting equation always tallies and should tally.

The system of recording transactions based on this concept is called double entry system.

Account Period Concept: In accordance with the going concern concept it is usually assumed that the life of a business is indefinitely long. But owners and other interested parties cannot wait until the business has been wound up for obtaining information about its results and financial position. For e.g. if for ten years no accounts have been prepared and if the business has been consistently incurring losses, there may not be any capital at all at the end of the tenth year which will be known only at that time. This would result in the compulsory winding up of the business. But if at frequent intervals information are made available as to how things are going, then corrective measures may be suggested and remedial action may be taken. That is why, Pacioli wrote as early as in

1494: `Frequent accounting makes for only friendship'. This need leads to the accounting period concept.

According to this concept accounting measures activities for a specified interval of time called the accounting period. For the purpose of reporting to various interested parties one year is the usual accounting period. Though Pacioli wrote that books should be closed each year especially in a partnership, it applies to all types of business organisations.

Periodic Matching of Costs and Revenues: This concept is based on the accounting period concept. It is widely accepted that desire of making profit is the most important motivation to keep the proprietors engaged in business activities. Hence a major share of attention of the accountant is being devoted towards evolving appropriate techniques of measuring profits. One such technique is periodic matching of costs and revenues.

In order to ascertain the profits made by the business during a period, the accountant should match the revenues of the period with the costs of that period. By `matching' we mean appropriate association of related revenues and expenses pertaining to a particular accounting period. To put it in other words, profits made by a business in a particular accounting period can be ascertained only when the revenues earned during that period are compared with the expenses incurred for earning that revenue. The question as to when the payment was actually received or made is irrelevant. For e.g. in a business enterprise which adopts calendar year as accounting year, if rent for December 1989 was paid in January 1990, the rent so paid should be taken as the expenditure of the year 1989, revenues of that year should be matched with the costs incurred for earning that revenue including the rent for December 1989, though paid in January 1990. It is on account of this concept that adjustments are made for outstanding expenses, accrued incomes, prepaid expenses etc. while preparing financial statements at the end of the accounting period.

The system of accounting which follows this concept is called as mercantile system. In contrast to this there is another system of accounting called as cash system of accounting where entries are made only when cash is received or paid, no entry being made when a payment or receipt is merely due.

Realisation Concept: Realisation refers to inflows of cash or claims to cash like bills receivables, debtors etc. arising from the sale of assets or rendering of services. According to Realisation concept, revenues are usually recognized in the period in which goods were sold to customers or in which services were rendered. Sale is considered to be made at the point when the property in goods passes to the buyer and he becomes legally liable to pay. To illustrate this point, let us consider the case of A, a manufacturer who produces goods on receipt of orders. When an order is received from B, A starts the process of production and delivers the goods to B when the production is complete. B makes payment on receipt of goods. In this example, the sale will be presumed to have been made not at the time when goods are delivered to B. A second aspect of the Realisation concept is that the amount recognized as revenue is the amount that is reasonably certain to be realized. However, lot of reasoning has to be applied to ascertain as to how certain `reasonably certain' is … Yet, one thing is clear, that is, the amount of revenue to be recorded may be less than the sales value of the goods sold and services rendered. For e.g. when goods are sold at a discount, revenue is recorded not at the list price but at the amount at which sale is made.

Similarly, it is on account of this aspects of the concept that when sales are made on credit though entry is made for the full amount of sales, the estimated amount of bad debts is treated as an expense and the effect on net income is the same as if the revenue were reported as the amount of sales minus the estimated amount of bad debts.

ACCOUNTING CONVENTIONS

Convention of Conservation: It is a world of uncertainty. So it is always better to pursue the policy of playing safe. This is the principle behind the convention of conservatism. According to this convention the accountant must be very careful while recognising increases in an enterprise's profits rather than recognising decreases in profits. For this the accountants have to follow the rule, anticipate no profit, provide for all possible losses, while recording business transactions. It is on account of this convention that the inventory is valued `at cost or market price whichever is less', i.e. when the market price of the inventories has fallen below its cost price it is shown at market price i.e. the possible loss is provided and when it is above the cost price it is shown at cost price i.e. the anticipated profit is not recorded. It is for the same reason that provision for bad and doubtful debts, provision for fluctuation in investments, etc., are created. This concept affects principally the current assets.

Convention of full disclosure: The emergence of joint stock company form of business organisation resulted in the divorce between ownership and management. This necessitated the full disclosure of accounting information about the enterprise to the owners and various other interested parties. Thus the convention of full disclosure became important. By this convention it is implied that accounts must be honestly prepared and all material information must be adequately disclosed therein. But it does not mean that all information that someone desires are to be disclosed in the financial statements. It only implies that there should be adequate disclosure of information which is of considerable value to owners, investors, creditors, Government, etc. In Sachar Committee Report (1978) it has been emphasised that openness in company affairs is the best way to secure responsible behaviour. It is in accordance with this convention that Companies Act, Banking Companies Regulation Act, Insurance Act etc., have prescribed proforma of financial statements to enable the concerned companies to disclose sufficient information. The practice of appending notes relating to various facts on items which do not find place in financial statements is also in pursuance to this convention. The following are some examples:

(a) Contingent liabilities appearing as a note

(b) Market value of investments appearing as a note

(c) Schedule of advances in case of banking companies

Convention of Consistency: According to this concept it is essential that accounting procedures, practices and method should remain unchanged from one accounting period to another. This enables comparison of performance in one accounting period with that in the past. For e.g. if material issues are priced on the basis of FIFO method the same basis should be followed year after year.

Similarly, if depreciation is charged on fixed assets according to diminishing balance method it should be done in subsequent year also. But consistency never implies inflexibility as not to permit the introduction of improved techniques of accounting. However if introduction of a new technique results in inflating or deflating the figures of profit as compared to the previous methods, the fact should be well disclosed in the financial statement.

Convention of Materiality: The implication of this convention is that accountant should attach importance to material details and ignore insignificant ones. In the absence of this distinction accounting will unnecessarily be overburdened with minute details. The question as to what is a material detail and what is not is left to the discretion of individual accountant. Further an item should be regarded as material if there is reason to believe that knowledge of it would influence the decision of informed investor. Some examples of material financial information are: fall in the value of stock, loss of markets due to competition, change in the demand pattern due to change in government regulations, etc. Examples of insignificant financial information are: rounding of income to nearest ten for tax purposes etc. Sometimes if it is felt that an immaterial item must be disclosed, the same may be shown as footnote or in parenthesis according to its relative importance.

ACCOUNTING STANDARDS

The information revealed by the published financial statements is of considerable importance to shareholders, creditors and other interested parties. Hence it is the responsibility of the accounting profession to ensure that the required information is properly presented.

If the accountants present the financial information using their own discretion and in their own way, the information may not be valid and hence may not serve the purpose. There is, therefore, the urgent need that certain standard should be followed for drawing up the financial statements so that there is the minimum possible ambiguity and uncertainty about the information contained in them. The International Accounting Standards Committee (IASC) has undertaken this task of drawing up the standards.

The IASC was established in 1973. It has its headquarters at London. At present, the IASC has two classes of membership:

(a) Founder members, being the professional accounting bodies of the following nine countries:

1. Australia
2. Mexico
3. Canada
4. Netherlands
5. France
6. U.K. and Ireland
7. Germany
8. U.S.A.
9. Japan

Journal Entry

Que1

Journalise the following transactions in the books of Shankar & Co.

1998			Rs.
June	1	Started business with a capital of	60,000
June	2	Paid into bank	30,000
June	4	Purchased goods from Kamal on credit	10,000
June	6	Paid to Shiram	4,920
June	6	Discount allowed by him	80
June	8	Cash Sales	20,000
June	12	Sold to Hameed	5,000
June	15	Purchased goods from Bharat on credit	7,500
June	18	Paid Salaries	4,000
June	20	Received from Prem	2,480
June	20	Allowed him discount	20
June	25	Withdrew from bank for office use	5,000
June	28	Withdraw for personal use	1,000
June	30	Paid Hanif by cheque	3,000

Solution

Date		Particulars		L.F.	Dr. Rs.	Cr. Rs.
1998 June	1	Cash A/c To Capital A/c (Capital brought into the business)	Dr.		60,000	60,000
June	2	Bank A/c To Capital A/c (Cash paid into bank)			30,000	30,000
June	4	Purchases A/c To Kamal's A/c (Purchased goods from Kamal on credit)			10,000	10,000
June	6	Shriram's A/c To Cash A/c (Cash paid to Shriram)	Dr.		4,920	4,920
June	6	Shriram's A/c To Cash A/c (Cash allowed by Shriram)	Dr.		80	80
June	8	Cash A/c To Sales A/c (Cash sales effected)	Dr.		20,000	20,000
June	12	Hameed's A/c To Sales A/c (Goods sold to Hameed)	Dr.		5,000	5,000

June	15	Purchases A/c To Bharat's A/c (Purchased goods from Bharat)	Dr.		7,500	7,500
June	18	Salaries A/c To Cash A/c (salaries paid)	Dr.		4,000	4,000
June	20	Cash A/c To Prem's A/c (Cash received from Prem)	Dr.		2,480	2,480
June	20	Discount A/c To Prem's A/c (Discount allowed to Prem)	Dr.		20	20
June	25	Cash A/c To Bank A/c (Cash withdrawn from bank)	Dr.		5,000	5,000
June	28	Drawings A/c To Cash A/c (Cash withdrawn from bank for personal use	Dr.		1,000	1,000
June	30	Hanif's A/c To Bank A/c (Paid to Hanif by cheques)	Dr.		3,000	3,000

Que2. Journalise the following transactions in the books of Mr. Roy April, 2013

1 He started business with a capital of – Plant Rs. 10,000, Bank Rs. 8,000, Stock Rs. 12,000
2 bought furniture for resale Rs. 5,000 Bought furniture for Office decoration Rs. 3,000
3 Paid rent out of personal cash for Rs. 2,000
8 Sold furniture out of those for resale Rs. 6,000
12 Paid Salary to Mr. X for Rs. 1,200
15 Purchased goods from Mr. Mukherjee for cash Rs. 3,000
18 Sold goods to Mr. Sen on credit for Rs. 8,000
20 Mr. Sen returned goods valued Rs. 1,000
22 Received cash from Mr. Sen of Rs. 6,500 in full settlement
28 Bought goods from Mr. Bose on credit for Rs. 5,000
30 Returned goods to Mr. Bose of Rs. 500 and paid to Mr. Bose Rs. 4,000 in full settlement.

Date	Particulars		L. F.	Debit (₹)	Credit (₹)
April, 2013					
1	Plant A/c	Dr.		10,000	
	Bank A/c	Dr.		8,000	
	Stock A/c	Dr.		12,000	
	To, Capital A/c				30,000
	[Being Plant, Bank, Stock introduced to the business]				
2	Purchase A/c	Dr.		5,000	
	To, Bank A/c				5,000
	[Being furniture purchased for resale]				
	Furniture A/c	Dr.		3,000	
	To, Bank A/c				3,000
	[Being furniture purchased for office decoration]				
3	Rent A/c	Dr.		2,000	
	To, Capital A/c				2,000
	[Being rent paid out of personal cash]				
8	Cash A/c	Dr.		6,000	
	To, Sales A/c				6,000
	[Being furniture out of those meant for resale are sold]				
12	Salary A/c	Dr.		1,200	
	To, Bank A/c				1,200
	[Being salary paid to Mr. X]				
April, 2013					
15	Purchase A/c	Dr.		3,000	
	To, Cash A/c				3,000
	[Being goods purchased]				
18	Mr. Sen A/c	Dr.		8,000	
	To, Sales A/c				8,000
	[Being goods sold on credit to Mr. Sen]				
20	Returns Inward A/c	Dr.		1,000	
	To, Mr. Sen A/c				1,000
	[Being goods returned from Mr. Sen]				
22	Cash A/c	Dr.		6,500	
	Discount Allowed A/c	Dr.		500	
	To, Mr. Sen A/c				7,000
	[Being cash received from Mr. Sen in full settlement]				
28	Purchase A/c	Dr.		5,000	
	To, Mr. Bose A/c				5,000
	[Being goods purchased from Mr. Bose on credit]				
30	Mr. Bose A/c	Dr.		5,000	
	To, Cash A/c				4,000
	To, Returns Outward A/c				500
	To, Discount Received A/c				500
	[Being goods returned to Mr. Bose and paid cash in full settlement]				

Que3:

Journalise the following transactions:

1998

June 1 Purchased goods worth Rs.300 from Vimal and Rs.500 from Kamal on credit.
June 3 Sale of goods worth Rs.1,000 to Balram and Rs.700 to Dhanram.
June 5 Cash of Rs.900 received from Ramasamy and Rs.800 from Krishnasmy.
June 7 Paid Rs.800 to Pradeep and Rs.500 to kuldeep.
June 9 Withdrawn from bank Rs.600 for office use and Rs.300 for personal use.

Solution:

Journal

Date		Particulars		L.F.	Dr. Rs.	Cr. Rs.
1998						
June	1	Purchases A/c	Dr.		800	
June	3	Balram's A/c	Dr.		1,000	
		Dhanram A/c	Dr.		700	
		To Sales A/c				1,700
		(Sales of goods to Balram and Dhanram)				
June	5	Cash A/c	Dr.		1,700	
		To Ramasamy's A/c				900
		To Krishnasamy's A/c				800
		(Cash received from Ramasamy and Krishnasamy)				
June	7	Pradeep's A/c	Dr.		800	
		Kuldeep's A/c	Dr.		500	
		To Cash A/c				1,300
		(Paid Pradeep and Kuldeep)				
June	9	Cash A/c	Dr.		600	
		Drawings A/c	Dr.		300	
		To Bank A/c				900

Cash Book

In every business house there are cash transactions as well as credit transactions. All credit transactions will become cash transactions when payments are made to creditors or cash received from debtors. Since, cash transactions will be numerous, it is better to keep a separate book to record only the cash transactions.

Features

A cash book is a special journal which is used to record all cash receipts and cash payments. The cash book is a book of original entry or prime entry since transactions are recorded for the first time from the source documents. The cash book is a ledger in the sense that it is designed in the form of a cash account and records cash receipts on the debit side and cash payments on the credit side. **Thus, the cash book is both a journal and a ledger** . **Cash Book will always show debit balance** , as cash payments can never exceed cash available. In short, cash book is a special journal which is used for recording all cash receipts and cash payments.

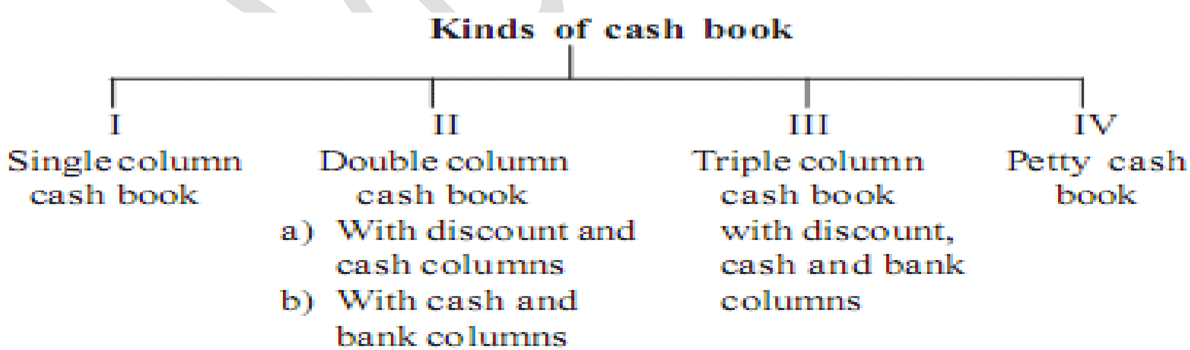
Advantages 1. **Saves time and labour:** When cash transactions are recorded in the journal a lot of time and labour will be involved. To avoid this all cash transactions are straight away recorded in the cash book which is in the form of a ledger.

2. **To know cash and bank balance:** It helps the proprietor to know the cash and bank balance at any point of time.

3. **Mistakes and frauds can be prevented:** Regular balancing of cash book reveals the balance of cash in hand. In case the cash book is maintained by business concern, it can avoid frauds. Discrepancies if any, can be identified and rectified.

4. **Effective cash management:** Cash book provides all information regarding total receipts and payments of the business concern at a particular period. So that, effective policy of cash management can be formulated.

Kinds of Cash Book The various kinds of cash book from the point of view of uses may be as follow:



Que 1.

Enter the following transactions in a single column cash book of Mr. Kumaran.

2004 Jan	1	Started business with cash	...	Rs.	1,000
	3	Purchased goods for cash	...	Rs.	500
	4	Sold goods	...	Rs.	1,700
	5	Cash received from Siva	...	Rs.	200
	12	Paid Balan	...	Rs.	150
	14	Bought furniture	...	Rs.	200
	15	Purchased goods from Kala on credit	...	Rs.	2,000
	20	Paid electric charges	...	Rs.	225
	24	Paid salaries	...	Rs.	250
	28	Received commission	...	Rs.	75

Solution:

Cash Book
of Mr. Kumaran

Dr. Cr.

Date	Particulars	R. N.	L. F.	Amount Rs.	Date	Particulars	V. N.	L. F.	Amount Rs.
2004					2004				
Jan 1	To Capital A/c			1,000	Jan 3	By Purchases A/c			500
4	To Sales A/c			1,700	12	,, Balan A/c			150
5	To Siva A/c			200	14	,, Furniture A/c			200
28	To Commission A/c			75	20	,, Electric charges A/c			225
					24	,, Salaries A/c			250
					31	,, Balance c/d			1,650
				2,975					2,975
2004									
Feb 1	To Balance b/d			1,650					

Note : The transaction dated January 15th will not be recorded in the cash book as it is a credit transaction.

Que2.

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

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

Solution:

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

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

Que 3

Let us see an illustration for the following cash and bank transactions in the books of Mr. Abhishek

January 1	Opening cash balance was ₹ 3,800 and bank balance was ₹ 27,500
January 4	Wages paid in cash ₹ 1,500
January 5	received cheque of ₹ 19,800 from KBK enterprises after allowing discount of ₹ 200
January 7	Paid to consultancy charges by cheque for ₹ 7,500
January 10	Cash of ₹ 2,500 withdrawn from bank
January 12	Received a cheque for ₹ 4,500 in full settlement of the account of Mr. X at a discount of 10% and deposited the same into the Bank.
January 15	X's cheque returned dishonoured by the Bank

Solution:

In the Books of Mr. Abhishek

Dr. Cash Book Cr.

Receipts						Payments					
Date	Particulars	L.F.	Cash (₹)	Bank (₹)	Discount Allowed (₹)	Date	Particulars	L.F.	Cash (₹)	Bank (₹)	Discount received (₹)
1-Jan	Opening Balance		3,800	27,500		4-Jan	Wages paid		1,500		
5-Jan	Recd from KBK			19,800	200	7-Jan	Consultancy fees			7,500	
10-Jan	Cash withdrawn		2,500			10-Jan	Cash withdrawn			2,500	
12-Jan	Mr. X			4,500	500	15-Jan	Mr. X			4,500	500
							Closing balance		4,800	37,300	
			6,300	51,800	700				6,300	51,800	500

Please note that the balance of discount columns is not taken and these are posted directly to the respective ledger account separately. The balance of cash and bank columns are posted into cash and bank accounts periodically. The posting into ledger is explained later in this chapter.

Bank Reconciliation Statement

When an individual or a firm deposits any money into a bank or withdraw money by issuing a cheque from a bank, he/it records the transaction in the debit-side of the bank columns of the Cash Book for such deposits and credit side of the bank column of the Cash book for such withdrawals.

On the other hand, bank also records such transactions in its book i.e. credit such account for deposits and debit such account for any withdrawals. The Bank issues a book to the account holder after recording such transactions. The book which is prepared by the bank for accountholder is known as Pass Book.

In case of Current Account, the bank issues Statements and not a Pass Book. The statement is known as Bank Statement.

Definition

A statement which is prepared to reconcile the causes of difference between Bank Balance as per Cash Book and Bank Balance as per Pass Book/ Bank Statement is known as a Bank Reconciliation Statement.

Features of a Bank Reconciliation statement

1. It is a statement.
2. It is not a part of the process of Accounts.
3. It is prepared to reconcile the causes of difference between the Bank balance as per Cash Book and the Bank balance as per Pass Book.
4. It can be prepared at any time during the financial year, as and when it is required.
5. Since it is prepared on a particular date, it is written as Bank Reconciliation statement as at/as on ....

It is necessary for a beginner to understand the mechanism of how to prepare the Bank Reconciliation statement. The first milestone on this journey is to understand the various reasons for differences between the two records.

Reasons for Differences between Cash Book and Pass Book

The differences are basically of two types:

(A) Items appear in Cash Book but not appearing in Pass Book and

(B) Items appear in Pass Book but not appearing in the Cash Book

(A) Items not appearing in Bank Pass Book

(1) Cheques issued by business entity not debited by the Bank – This may be because they might not have been Banked by the payee or it may still be under clearance. The entry in Cash Book will be made immediately when the cheque is issued thereby reducing the Bank balance in the books of entity's books of A/cs. Here, Bank balance as per Cash Book will be less, but as per Bank Pass Book it will be more. This is also termed as unpresented cheques.

(2) Cheques deposited but not credited by the Bank – The business entity may receive cheques or draft which is deposited into the Bank for collecting the payment. Again entry in Cash Book will be instant thereby increasing the balance. Here, Bank balance as per Cash Book will be more than the balance as per Bank passbook. This is also called as outstanding cheques.

(3) Errors – The Bank may by mistake miss out entering the debit or credit which results in the difference.

(4) Standing Instructions – The entity may give standing instruction to the Bank for certain regular payments like loan repayment installment, transfer of funds etc. This may get entered in the Cash Book immediately, but Pass Book entry may be delayed.

(B) Items not appearing in the Cash Book

(1) Bank interest, Bank charges etc. – The Bank will charge interest on overdraft or also charges for services, issue of demand draft, pay orders etc. Here, being the source of transaction, the Bank will record in the Pass Book immediately and send the debit advice slips to the business entity. The entry in the Cash Book may be delayed. Similarly the Bank could credit interest on fixed deposits, which may get entered in business books at a later date.

(2) Direct deposits in Bank account – Sometimes customers or others may directly deposit an amount in the Bank for goods or services rendered. The Bank will enter it immediately, but entry in Cash Book will appear later.

(3) Bills for collection – The Business Entity may send bills of exchange for collection. The Bank will collect the payment and credit the same in the passbook. The entry in Cash Book will be made only after receipt of information from the Bank.

(4) Errors – The records may be missed out by the book-keeper of the Business Entity.

Need of Bank Reconciliation Statement

1. It helps to understand the actual Bank balance.
2. It helps to identify the mistakes in the Cash Book and the Pass Book.
3. It helps to detect and prevent frauds and errors in recording the Banking transactions.
4. It helps to incorporate certain expenditures/income debited/credited by Bank in the books of accounts.

Steps in Preparing Bank Reconciliation Statement

One has to have a systematic approach towards preparation of the reconciliation. To avoid a lengthy reconciliation, one must ensure that the entries in the Cash Book are absolutely online. One also must obtain the Bank statements at regular intervals. Once this checking is done, Bank reconciliation could be done by following these steps:

(a) Identify the balances and the character thereof. Remember, a debit balance in Cash Book means asset where as a credit balance means a Bank overdraft. In Bank passbook, it's reverse. A debit balance in Pass Book means overdraft and a credit balance is a favourable balance. This must be carefully understood.

(b) Based on the above, start with the balance (or overdraft) as per one book and arrive at the balance (or overdraft) as per the other book. The items of differences will be added to or deducted from the balance (or overdraft) with which the reconciliation is started.

(c) The end result should be the balance (or overdraft) as per the other book e. g. if you start with balance as per Cash Book, then after adding or deducting items of differences, you should arrive at the balance (or overdraft) as per the Pass Book.

(d) One has to make sure that all the items of differences from Cash Book as well as Bank book are taken into account in the reconciliation statement.

(e) Whether the items of differences should be added or deducted will depend on the sequence you follow. This is shown in following table:

When reconciliation is started with →	Bal. as per CB	OD as per CB	Bal. as per CB	OD as per CB
Cheques deposited in Bank, but not cleared	Less	Add	Add	Less
Cheques issued, but not presented in Bank	Add	Less	Less	Add
Bank charges debited in PB only	Less	Add	Add	Less
Interest debited in PB only	Less	Add	Add	Less
Payments by Bank debited in PB only	Less	Add	Add	Less
Direct payment by customer in PB only	Add	Less	Less	Add
Bills discounted & dishonoured in PB only	Less	Add	Add	Less
Cheques deposited, dishonoured in PB only	Less	Add	Add	Less
Interest, Dividend, Commission collected by Bank not recorded in the Cash Book	Add	Less	Less	Add
Overcasting of payment side of Cash Book or Undercasting of Receipt side of Cash Book	Add	Less	Less	Add
Undercasting of Payment side of Cash Book or overcasting of Receipts side of Cash Book	Less	Add	Add	Less
Deposits recorded twice in the Cash Book or excess amount recorded in the Cash Book	Less	Add	Add	Less
Undercasting of credit side of the Pass Book or overcasting of the debit side of the Pass Book	Less	Add	Add	Less
Cheques deposited into Bank and credited without recording in the Cash Book	Add	Less	Less	Add
Wrong debit in the Pass Book for issue of cheque, Bank charges, etc.	Less	Add	Add	Less
Wrong credit in the Pass Book for deposit of cheque, interest, etc.	Add	Less	Less	Add
Cheques drawn but not actually issued to the suppliers/ creditors	Add	Less	Less	Add
Bank charges recorded twice in the Cash Book	Add	Less	Less	Add
Amount withdrawn from Bank not recorded in the Cash Book	Less	Add	Add	Less

Que1.

On 31.12.13, P. Roy's Bank Balance as shown by the Cash Book was ₹ 75,000. On receipt of Bank Statement it was found that :-

(i) Three cheques of ₹3,000, ₹4,000 and ₹1,500 drawn in favour of suppliers respectively on 28th, 29th and 30th December, 2013 had been debited in the Bank Statement on 2nd January 2014.

(ii) The Bank had credited ₹8,000 on 30th December, 2013, in respect of collection made by Bank directly from a customer, the intimation not having yet been received.

(iii) Two cheques of ₹5,000 and ₹6,000 were deposited into Bank on 30th December, 2013 had been credited in the Bank statement on 4th January, 2014.

(iv) The Bank had debited ₹30 as incidental charges on 30th December, 2013 but not entered in the Cash Book.

Show the reconciliation of the Bank Balance as per Cash Book with the Bank Balance as per Bank Statement as on 31st December, 2013.

Solutions:

Bank Reconciliation Statement of Mr. P. Roy as on 31st December, 2013.

Particulars	Amount (₹)	Amount (₹)
Bank Balance as per Cash Book (Dr.)		75,000
Add: (i) Cheques issued but not presented for payment ₹3,000, ₹4,000 & ₹1500 respectively.	8,500	
(ii) Collection by Bank from a Customer not recorded in the Cash Book	8,000	16,500
		91,500
Less: (i) Cheques deposited but not credited in the Pass Book on 31.12.13 ₹5,000 + ₹6,000 respectively.	11,000	
(ii) Bank charges not recorded in the C.B.	30	11,030
Balance as per Pass Book (Cr.)		80,470

Que 2.

The Bank statement of Mr. J. White dated 31.12.2013 showed a balance with his Bank of ₹ 924, when checked with his Cash Book the following were noted :

(a) During December, the Bank had paid ₹200 for a yearly contribution of Mr. White, made to a local charity, as per his standing order. This amount appeared in the Bank statement but not in the Cash Book.

(b) The Bank had credited his account with ₹28 interest and had collected on his behalf ₹ 230 as dividends. No corresponding entries were made in the Cash Book.

(c) A cheque of ₹ 65 deposited into the Bank on 28.12.2013 was not cleared by the Bank till after 31.12.2013.

(d) A cheque of ₹150 deposited into and cleared by the Bank before 31.12.2013 was not entered in the Cash Book, through an oversight.

(e) Cheques drawn by and posted to parties by Mr. White on 31.12.2013 for ₹73, ₹119 and ₹ 46 were presented for payment to the Bank only on 3.1.2014.

Solution:

Bank Reconciliation Statement as on 31st December, 2013

Particulars	Amount (₹)	Amount (₹)
Bank balance as per Pass Book (Cr.)		924
Add: (i) Payment of contribution by the Bank not entered in the Cash Book	200	
(ii) Cheque deposited but not cleared	65	265
		1,189
Less: (i) Interest and dividend collected by the Bank not entered in the Cash Book - Interest	28	
- Dividend	230	
(ii) Cheque deposited and cleared but not entered in the Cash Book	150	
(iii) Cheques issued but not presented ₹ (73+119+46)	238	646
Bank balance as per Cash Book (Dr.)		543

Que 3

Mr. Suresh request you to ascertain the Bank balance as per the Pass Book for January 2013, as his cash clerk reported a figure of ₹11,515 (credit) as on 31.1.2013. Scrutiny revealed the following discrepancies :

(i) Cheques issued and deposited by the cash clerk in January 2013, were ₹ 15,000 and ₹ 7,000 respectively. However, against the above, the Bank had paid out and debited cheques worth ₹9,000 only and cleared and credited cheques worth ₹ 4,000 only, by 31.1.2013.

(ii) A customer had paid in ₹ 6,400 directly into Suresh's Bank account, the effect of which was missing in the Cash Book.

(iii) Bank commission of ₹ 45 charged and interest earned ₹ 1,400 on investments of Mr. Suresh, where only recorded in the Pass Book.

(iv) Total cash withdrawals of ₹ 3,000 by self and bearer cheques for office use, were recorded erroneously as ₹ 5,000 in the Cash Book.

Solution:

Mr. Suresh

Bank Reconciliation Statement as on 31st January, 2013

Particulars			Amount (₹)	Amount (₹)
	Overdraft as per Cash Book			11,515
Add:	(i)	Cheques deposited but not cleared (7,000 - 4,000)	3,000	
	(ii)	Bank commission charged by the Bank	45	3,045
				14,560
Less:	(i)	Cheques issued but not presented for payment (15,000 - 9,000)	6,000	
	(ii)	Direct deposit by a customer	6,400	
	(iii)	Interest on investment credited in the Pass Book only	1,400	
	(iv)	Withdrawals of ₹ 3,000 recorded in the Cash Book as ₹ 5,000	2,000	15,800
		Bank balance as per Pass Book (Cr.)		1,240

Que 4.

The Bank Pass Book of Mr. Anil showed an overdraft of ₹ 6,000 on 31.12.2013. Prepare the Bank Reconciliation Statement based on the following details:

(a) Cheques issued but not presented upto 31.12.2013, ₹ 5,500

(b) Cheques deposited but not credited upto 31.12.2013, ₹ 9,000

(c) Bank commission ₹ 30 was entered only in the Pass Book.

(d) A cheque for ₹ 6,500 issued in settlement of a debt was encashed on 28.12.2013 but entered in the Cash Book as ₹ 8,500.

Solution:

Mr. Anil

Bank Reconcilliation Statement as on 31st December, 2013

Particulars	Amount (₹)	Amount (₹)
Overdraft as per Pass Book		6,000
Add: (i) Cheques issued but not presented for payment	5,500	
(ii) Cheque for ₹ 6,500 issued and encashed but entered in the Cash Book at ₹ 8,500 (8,500 - 6,500)	2,000	7,500
		13,500
Less: (i) Cheques deposited but not credited	9,000	
(ii) Bank commission entered in the Pass Book only	30	9,030
Overdraft as per Cash Book		4,470

Que 5.

From the following particulars of M/s Suresh enterprises, prepare a Bank reconciliation statement:

(1) Bank overdraft as per Pass Book as on 31st March 2013 was ₹ 8,800

(2) Cheques deposited in Bank for ₹ 5,800 but only ₹ 2,000 were cleared till 31st March

(3) Cheques issued were ₹ 2,500, ₹ 3,800 and ₹ 2,000 during the month. The cheque of ₹ 5,800 is still with supplier.

(4) Dividend collected by Bank ₹ 1,250 was wrongly entered as ₹ 1,520 in Cash Book.

(5) Amount transferred from fixed deposit A/c into the current A/c ₹ 2,000 appeared only in Pass Book

(6) Interest on overdraft ₹ 930 was debited by Bank in Pass Book and the information was received only on 3rd April 2013.

(7) Direct deposit by M/s Rajesh Traders ₹ 400 not entered in Cash Book.

(8) Corporation tax ₹ 1,200 paid by Bank as per standing instruction appears in PB only.

Solution:

Bank Reconciliation Statement as on 31st March, 2013

Particulars	Amount (₹)	Amount (₹)
Overdraft as per Pass Book		8,800
Add: (i) Cheques issued but not presented till 31st March	5,800	
(ii) Transfer from fixed deposit	2,000	
(iii) Direct deposit by M/s Rajesh Traders	400	8,200
		17,000
Less: (i) Cheques deposited but not cleared (5,800 - 2,000)	3,800	
(ii) Dividend collected excess recorded in CB (1,520 - 1,250)	270	
(iii) Interest on overdraft debited in PB only	930	
(iv) Corporation tax paid appeared in PB only	1,200	6,200
Overdraft as per Cash Book		10,800

Que 6.

The Bank column of the Cash Book showed an overdraft of ₹ 5,000 on 31-03-2013, whereas as per Bank statement the overdraft is ₹ 4,200. The following differences were noticed between the two records:

(a) Cheques of ₹ 2,400 issued but not encashed by customers

(b) Cheques deposited but not cleared ₹ 1,200

(c) Collection charges debited by Bank not recorded in CB ₹ 100

(d) Bank interest charged by the Bank not recorded in CB ₹ 300

(e) Cheques dishonoured debited by Bank not in CB ₹ 400

(f) Interest directly received by Bank not entered in CB ₹ 400

Prepare Bank reconciliation statement after amending the CB.

Solution:

Here, please note that amended CB is asked. What it actually means is to record all revenue (expense or income) items of differences and those items that are recorded in PB only must first be recorded in the CB and then the reconciliation statement should be prepared by taking the revised balance as per CB. Here is the amended CB.

Dr. **Cash Book (Bank column only)** **Cr.**

Particulars	Amount ₹	Particulars	Amount ₹
To Interest received	400	By Balance b/d (OD)	5,000
		By collection charges	100
		By Bank interest	300
To Balance c/d (OD)	5,400	By customer (chq dishonoured)	400
	5,800		5,800

Bank reconciliation statement as on 31-03-2013	₹
Bank OD as per CB	5,400
Add: Cheques deposited, but not cleared	1,200
Less: cheques issued but not encashed	(2,400)
Bank OD as per PB	4,200

Rectification of Errors

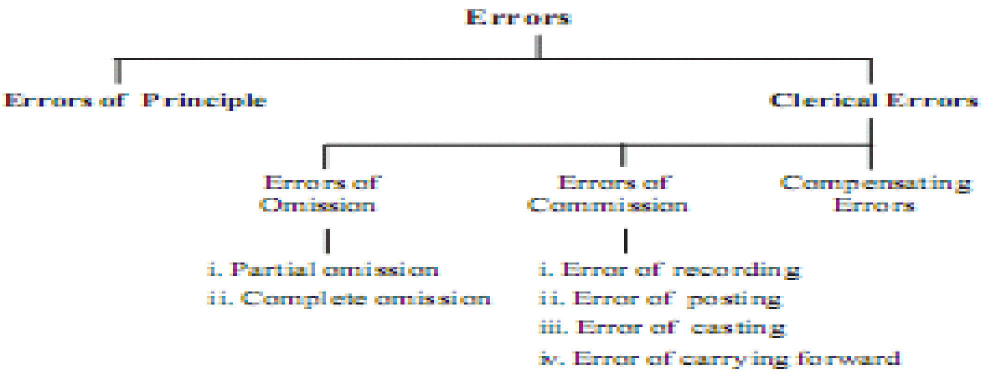
10.8.1. Kinds of Errors

Keeping in view the nature of errors, all the errors committed in the accounting process can be classified into two.

i. Errors of Principle and

ii. Clerical Errors

Kinds of Errors



Que1

Rectify the following errors:

i. Purchases from Bagavathi for Rs.4,500 has been posted to the debit side of her account.

ii. Sales to Vijay for Rs.1,520 has been posted to his credit as Rs.1,250.

iii. Purchases from Shakila for Rs.750 has been omitted to be posted to the personal A/c.

iv. Sales to Khader for Rs.780 has been posted to his account as Rs.870.

Solution:

i. Purchases from Bagavathi should have been posted to the credit of Bagavathi's A/c., but it has been debited. Hence, Credit Bagavathi's A/c with double the amount i.e, Rs.9,000.

ii. Sales to Vijay has to be debited in Vijay's account but his account is credited with Rs.1,250. Hence, Debit Vijay's A/c with Rs.1,250 + Rs.1,520 i.e, Rs.2,770.

iii. This is an error of omission. Posting must be to the credit of Shakila's A/c. Hence, post Rs.750 to the credit of Shakila's A/c.

iv. Here Khader's A/c has been debited with a wrong amount i.e., with excess amount. To rectify this error, the excess amount must be credited to his account. Hence, credit Khader's A/c with Rs.90.

Que2

The following errors were found in the books of Prabhu. Give the necessary entries to correct them:

i) Salary of Rs.10,000 paid to Murali has been debited to his personal account.

ii) Rs.3,500 paid for a typewriter was charged to office expenses account.

iii) Rs.8,000 paid for furniture purchased has been charged to purchases account.

iv) Repairs made were debited to building account for Rs.500.

v) An amount of Rs.5,000 withdrawn by the proprietor for his personal use has been debited to trade expenses account.

vi) Rs.2,000 received from Shanthi & Co. has been wrongly entered as from Shakila & Co.

Rectifying Journal Entries

Errors	Particulars	L.F	Debit Rs.	Credit Rs.
i.	Salaries A/c Dr. To Murali A/c. [Correction of wrong debit to Murali's personal A/c for salaries paid]		10,000	10,000
ii.	Typewriter A/c Dr. To Office expenses A/c [Correction of wrong debit to office expenses A/c for purchase of typewriter]		3,500	3,500
iii.	Furniture A/c Dr. To Purchases A/c [Correction of wrong debit to purchases account for furniture purchased]		8,000	8,000
iv.	Repairs A/c Dr. To Building A/c [Correction of wrong debit to building Account for repairs made]		500	500
v.	Drawings A/c Dr. To Trade expenses A/c [Correction of wrong debit to Trade Expenses A/c. for cash withdrawn by the proprietor for his personal use]		5,000	5,000
vi.	Shakila & Co. A/c. Dr. To Shanthy & Co. A/c [Correction of wrong credit to Shakila & Co. instead of Shanthi & Co.]		2,000	2,000

Que3

Give journal entries to rectify the following errors:

i. Purchase of goods from Devi amounting to Rs.25,000 has been wrongly passed through the sales book.

ii. Credit sale of goods Rs.30,000 to Rajan has been wrongly passed through the purchases book.

iii. Sold old furniture for Rs.3,500 passed through the sales book.

iv. Paid wages for the construction of Building debited to wages account Rs. 1,00,000.

v. Paid Rs.10,000 for the installation of Machinery debited to wages account.

vi. On 31st Dec. 2003 goods worth Rs.5,000 were returned by Manjula and were taken into stock on the same date, but no entry was passed in the books.

Rectifying Journal Entries

Errors	Particulars		L.F	Debit Rs.	Credit Rs.
i.	Purchases A/c	Dr.		25,000	
	Sales A/c	Dr.		25,000	
	To Devi A/c				50,000
	[Correction of wrong entry in sales book for a credit purchase from Devi]				
ii.	Rajan A/c	Dr.		60,000	
	To Purchases A/c				30,000
	To Sales A/c				30,000
	[Correction of wrong entry in purchases book for credit sale to Rajan]				
iii.	Sales A/c	Dr.		3,500	
	To Furniture A/c				3,500
	[Correction of wrong credit to sales account for sale of old furniture]				
iv.	Building A/c	Dr.		1,00,000	
	To Wages A/c				1,00,000
	[Correction of wrong debit to wages account for wages paid for construction of building]				
v.	Machinery A/c	Dr.		10,000	
	To Wages A/c				10,000
	[Correction of wrong debit to wages account for wages paid for installation of machinery]				
vi.	Sales Return A/c	Dr.		5,000	
	To Manjula A/c				5,000
	[Entry for goods returned and taken into stock]				

Que 4

Pass journal entries necessary to rectify the following errors :

1. An amount of Rs. 2,000 withdrawn by the proprietor for his personal use has been debited to Trade Expenses Account.
2. A purchase of goods from Nathan amounting to Rs. 3,000 has been wrongly entered through the Sales Book.
3. A credit sale of Rs. 1,000 to Santhanam has been wrongly passed through the Purchases Book.
4. Rs. 1,500 received from Malhotra have been credited to Mehrotra.
5. Rs. 3,750 paid on account of salary to the cashier Dhawan stands debited to his personal account.
6. A contractor's bill for extension of premises amounting to Rs. 27,500 been debited to Building Repairs Account.
7. On 25th June, goods of the value of Rs. 5,000 were returned by Akash Deep and were taken into stock but the return's were entered in the Books under date 3rd July, i.e.; after the expiration of the financial year on 30th June.
8. A bill of Rs. 2,000 for old office furniture sold to Sethi were entered in the Sales Day Book.
9. An amount of Rs. 800 received on account of interest was credited to Commission Account.

Solution:

				Rs.	*Rs.*
1.		Proprietor's Drawing Account	Dr.	2,000	
		To Trade Expenses			2,000
		(For the amount withdrawn for personal use wrongly charged to the latter account)			

				Rs.	*Rs.*
2.	(a)	Sales Account	Dr.	3,000	
		To Nathan			3,000
		(Being the cancellation of the entry passed through the Sales Book)			
	(b)	Purchases Account	Dr.	3,000	
		To N'athan			3,000
		(To record the credit purchases from Nathan)			

Alternativel y: One combined entry can also be passed as under:

		Rs.	*Rs.*
Sales Account	Dr.	3,000	
Purchases Account	Dr.	3,000	
To Nathan			6,000
(For cancellation of entry passed through the Sales Book and record the credit purchases from Nathan)			

			Rs.	Rs.
3.	Santhanam	Dr.	2,000	
	To Purchases Account			1,000
	To Sales Account			1,000
	(Rectification of the mistake caused by entering Rs. 1,000 to Santhanam in the Purchases Book) *Note* : Apply the reasons given in entry No. 2)			
4.	Mehrotra	Dr.	1,500	
	To Malhotra			1,500
	(Being the rectification of wrong credit given to the former account)			
5.	Salaries Account	Dr.	3,750	
	To Dhawan			3,750
	(Being the adjustment of salary wrongly debited to the Personal Account of the cashier)			
			Rs.	*Rs.*
6.	Building Account	Dr.	27,500	
	To Building Repairs Account			27,500
	(Being the adjustment of amount wrongly debited to the latter account)			
7.	Return Inwards Account	Dr.	5,000	
	To Akash Deep			5,000
	(Being the entry necessay to record the return inwards within the financial year) Note: The entry passed to record the above returns made in 3rd July will have to be cancelled by passing a reverse entry under the same date i.e.:			
	Akash Deep	Dr.	5,000	
	To Return Inwards Account			5,000
8.	Sales Account	Dr.	2,000	
	To Office Furniture Account			2,000
	(Being the sale of old office Furniture wrongly passed through the Sales Book, error of principle)			
9.	Commission Account	Dr.	800	
	To Interest Account			800
	(Being the adjustment of amount wrongly credited to the former account)			

Que5

Pass journal entries to rectify the following errors assuming the existence of the necessary Suspense Account:

(i) Goods bought from Mukesh amounting to Rs. 5,500 was posted to the credit of his account as Rs. 5,000.

(ii) Sales book was overcast by Rs. 10,000.

(iii) While carrying forward the total of one page of the Purchases Book to the next, the amount of Rs. 12,350 was written as Rs. 13,250.

(iv) Cartage Rs. 780 paid on machinery newly acquired was debited to carriage inward account.

(v) Purchases return to Shivalker Bros. Rs. 3,100 were not recorded in purchases returns book but the account of Shivalker Bros. was duly debited for the amount.

(vi) Drawings of goods costing 300 were not recorded in the books of account.

(vii) Whitewashing expenses, Rs. 670 were posted from cash book to the nominal account as Rs. 760.

Also prepare Suspense Account starting it with debit balance of Rs. 320. Have you any comments to offer on Suspense Account?

Journal

Date		*Particulars*		*LF*	*Dr. Amount*	*Cr. Amount*
					Rs.	*Rs.*
	(i)	Suspense Account	Dr.		500	
		To Mukesh				500
		(For rectification of short credit to Mukesh)				

Date		*Particulars*		*LF*	*Dr. Amount*	*Cr. Amount*
					Rs.	*Rs.*
	(ii)	Sales Account	Dr.		10,000	
		To Suspense Account				10,000
		(For rectification of wrong total of Sales Book)				
	(iii)	Suspense Account	Dr.		900	
		To Purchases Account				900
		(For rectification of wrong carry forward of total from one page to another in the Purchases Book)				
	(iv)	Machinery Account	Dr.		780	
		To Carriage Inwards A/c				780
		(For rectification of wrong debit to carriage inwards for cartage paid on newly acquired machinery)				
	(v)	Suspense Account	Dr.		3,100	
		To Purchases Returns Account				3,100
		(For rectification of omission of credit to Purchases Returns Account for goods returned to Shivalkar Bros.)				

(vi)	Drawings Account	Dr.	300	
	To Purchases Account			300
	(For rectification of omission of drawings of goods costing Rs. 300 by the proprietor)			
(vii)	Suspense Account	Dr.	90	
	To Whitewashing Account			90
	(For rectification of excess debit to whitewashing account)			

Suspense Account

		Rs.			Rs.
	To Balance b/d	320	(ii)	By Sales Account	10,000
(i)	To Mukesh	500			
(iii)	To Purchase Account	900			
(v)	To Purchases Returns	3,100			
(vii)	To Whitewashing A/c	90			
	To Balance c/d	5,090			
		10,000			10,000

Comment: As suspense account still shows a balance, it means all errors have not yet been rectified.

Que 6.

Pass necessary journal entries to rectify the following errors:

(a) An amount of ₹ 200 withdrawn by owner for personal use was debited to trade expenses.
(b) Purchase of goods of ₹ 300 from Nathan was wrongly entered in sales book.
(c) A credit sale of ₹ 100 to Santhanam was wrongly passed through purchase book.
(d) ₹ 150 received from Malhotra was credited to Mehrotra.
(e) ₹ 375 paid as salary to cashier Dhawan was debited to his personal A/c.
(f) A bill of ₹ 2,750 for extension of building was debited to building repairs A/c
(g) Goods of ₹ 500 returned by Akashdeep were taken into stock, but returns were not posted.
(h) Old furniture sold for ₹ 200 to Sethi was recorded in sales book.
(i) The period end total of sales book was under cast by ₹ 100
(j) Amount of ₹ 80 received as interest was credited to commission.

Solution:

Sl No.		Particulars		Debit (₹)	Credit (₹)
(a)	**Wrong Entry**	Trade Expenses	Dr	200	
		To Cash			200
	Correct entry	Drawings	Dr	200	
		To cash			200
	Rectification entry	Drawings	Dr	200	
		To Trade Expenses			200
(b)	**Wrong Entry**	Nathan	Dr	300	
		To Sales			300
	Correct entry	Purchases	Dr	300	
		To Nathan			300
	Rectification entry	Purchases	Dr	300	
		Sales	Dr	300	
		To Nathan			600
(c)	**Wrong Entry**	Purchases	Dr	100	
		To Santhanam			100
	Correct entry	Santhanam	Dr	100	
		To Sales			100
	Rectification entry	Santhanam	Dr	200	
		To Sales			100
		To Purchases			100
(d)	**Wrong Entry**	Cash	Dr	150	
		To Mehrotra			150
	Correct entry	Cash	Dr	150	
		To Malhotra			150
	Rectification entry	Mehrotra	Dr	150	
		To Malhotra			150
(e)	**Wrong Entry**	Dhawan	Dr	375	
		To cash			375
	Correct entry	Salary	Dr	375	
		To cash			375
	Rectification entry	Salary	Dr	375	
		To Dhawan			375
(f)	**Wrong Entry**	Building Repairs	Dr	2,750	
		To Cash			2,750
	Correct entry	Buildings	Dr	2,750	
		To Cash			2,750
	Rectification entry	Buildings	Dr	2,750	
		To Building Repairs			2,750
(g)	**Wrong Entry**	No entry passed			
	Correct entry	Sales Returns	Dr	500	
		To Akashdeep			500
	Rectification entry	Sales Returns	Dr	500	
		To Asashdeep			500
(h)	**Wrong Entry**	Sethi	Dr	200	
		To Sales			200
	Correct entry	Sethi	Dr	200	
		To Furniture			200
	Rectification entry	Sales	Dr	200	
		To Furniture			200
(i)	**Wrong Entry**	No entry passed			
	Correct entry	Suspense	Dr	100	
		To Sales			100
	Rectification entry	Suspense	Dr	100	
		To Sales			100
(j)	**Wrong Entry**	Cash	Dr	80	
		To Commission			80
	Correct entry	Cash	Dr	80	
		To Interest			80
	Rectification entry	Commission	Dr	80	
		To Interest			80

Que 7.

Rectify the following errors by passing necessary journal entries:

(i) Goods purchased for proprietor's use for Rs. 2,500 was debited to purchases account;

(ii) Rs. 2,750 received from Hari Chand was debited to his account;

(iii) Returns inward book was short totalled by Rs. 650.

(iv) Interest on deposit received Rs. 500 had been debited in the cash account, but had not been credited to interest account.

(v) Rs. 2,000 being purchases returned were posted to the debit of purchases account.

(vi) Interest on overdraft Rs. 1,200 was not posted to the ledger from the cash book.

(vii) A duplicate invoice for the purchase of machinery costing Rs. 10,000 was erroneously passed again and entered into the books.

Solution:

Rectifying Journal Entries

	Particulars		*Dr. (Rs.)*	*Cr. (Rs.)*
	(1)		*(2)*	*(3)*
(i)	Drawings A/c	Dr.	2,500	
	To Purchases A/c			2,500
	(Being goods purchased for personal use was wrongly debited to purchases account, now rectified)			
(ii)	Suspense A/c (2,750 X 2)	Dr.	5,500	
	To Hari Chand			5,500
	(Being cash received from Hari Chand of Rs. 2,750 was wrongly debited to his account, now rectified)			
(iii)	Returns Inward A/c	Dr.	650	
	To Suspense A/c			650
	(Being returns inward book was under cast by Rs. 650, now rectified)			
(iv)	Suspense A/c	Dr.	500	
	To Interest Received A/c			500
	(Being interest received had not been credited, now rectified)			

(v)	Suspense A/c	Dr.	4,000	
	To Purchases A/c			2,000
	To Purchases Returns A/c			2,000
	(Being purchases returns wrongly debited to purchases account, now rectified)			
(vi)	Interest A/c	Dr.	1,200	
	To Suspense A/c			1,200
	(Being interest on overdraft was not posted to the ledger from cash book, now rectified)			
(vii)	Supplier's A/c	Dr.	10,000	
	To Machinery A/c			10,000
	(Being duplicate invoice for purchase of machinery recorded in books twice, now reversed)			

Que 8.

The trial balance of M. Mukherjee did not tally as on 31.3.2007. The following errors were detected afterwards. Pass the necessary journal entries to rectify the errors and find out the difference in trial balance.

(i) Rs. 600 received from Mathur on 31.3.2007 was entered in the cash book on 2.4.2007.

(ii) Returns inward book was undercast by Rs. 300.

(iii) The purchase of typewriter for Rs. 5,000 was entered in the purchase day book.

(iv) Wages of workmen engaged in construction of building amounting Rs. 500 were debited to wages account.

(v) A purchase of Rs. 671 had been posted to the debit of supplier's account as Rs. 617.

(vi) Goods amounting to Rs. 1,000 had been returned by Raju and were taken into stock, but no entry was passed for the transaction.

(vii) Rs. 14,000 paid for purchase of T.V. for proprietors own use had been charged to miscellaneous expense account.

(viii) A sale of Rs. 600 to Sethi was credited to his account with Rs. 60.

(ix) A sale of Rs. 2,000 has been passed through purchase journal.

(x) Rs. 75 paid for repairs to furniture had been entered in the total column of petty cash book, but not entered in the appropriate analysis column, the total of which has been posted.

Solution:

Rectifying Journal Entries

			Dr. (Rs.)	*Cr. (Rs.)*
(i)	Cash A/c	Dr.	600	
	To Mathur			600
	(Being cash received was not entered in the cash book, now rectified)			
(ii)	Returns Inward A/c	Dr.	300	
	To Suspense A/c			300
	(Being returns inward book was undercast by Rs. 300, now rectified)			
(iii)	Typewriter A/c	Dr.	5,000	
	To Purchase A/c			5,000
	(Being typewriter purchased was wrongly passed through purchase day book, now rectified)			
(iv)	Building A/c	Dr.	500	
	To Wages A/c			500
	(Being wages paid for construction of building was wrongly debited to wages account, now rectified)			
(v)	Suspense A/c	Dr.	1,288	
	To Supplier's A/c			
	(Rs. 671 + Rs. 617)			1,288
	(Being purchase of Rs. 671 from supplier wrongly debited to his account by Rs. 617, now rectified)			
(vi)	Returns Inward A/c	Dr.	1,000	
	To Raju			1,000
	(Being goods returned by Raju had not been entered in the books of account now rectified)			
(vii)	Drawings A/c	Dr.	14,000	
	To Miscellaneous Expenses A/c			14,000
	(Being purchase of T.V. for owner had been charged to miscellaneous expenses account, now rectified)			
(viii)	Sethi (600 + 60)	Dr.	660	
	To Suspense A/c			660
	(Being goods of Rs. 600 sold to Sethi was wrongly credited to his account for Rs. 60, now rectified)			

(ix)	Suspense A/c	Dr.	4,000	
	To Purchases A/c			2,000
	To Sales A/c			2,000
	(Being a sale of Rs. 2,000 had been wrongly passed through purchase journal, now rectified)			
(x)	Repairs to Furniture Ae/c	Dr.	75	
	To Suspense A/c			75
	(Being repairs for furniture had not been posted in the general ledger from petty cash book, now rectified)			

Dr. **Suspense A/c** *Cr.*

Particulars	*Amount (Rs.)*	*Particulars*	*Amount (Rs.)*
To Supplier's A/c	1,288	By Returns Inward A/c	300
To Purchases A/c	2,000	By Sethi	660
To Sales A/c	2,000	By Repairs to Furniture A/c	75
	_____	By Balance c/d	4,253