CHAPTER

3

Double Entry Principles and Journal

3.1 INTRODUCTION

Dual aspect is the basic concept of accounting. According to this concept, for every debit, there has to be a corresponding credit. In other words, when a transaction is recorded, debit amount has to be equal to the credit amount. This is also known as 'Double Entry Principle'. The basic principle of double entry system is that each business transaction affects two accounts in the books of a businessman. No transaction is complete without double aspect. The same amount is entered on the debit side as well as credit side of different accounts.

This system recognises the fundamental fact that a business transaction is a double-sided affair.

> **In the words of J.R. Batliboy "Every business transaction has two fold effect and it affects two accounts. In order to keep a complete record of transactions, one account is bound to be debited and the other account is bound to be credited. Recording this two fold account of each transaction is called Double Entry System".**

3.2 DOUBLE ENTRY SYSTEM

There are two aspects in every business transaction. They are receiving aspect and the other giving aspect. Under this system, every transaction is recorded twice, one on the debit side i.e. the receiving aspect and the other – credit side i.e. giving aspect. Let us illustrate. When a business man buys goods, he receives goods on one side and on the other side, money is given towards the value of goods. When he hires the services of employees, services are received on one side, while payment is made for the services rendered.

The features of double entry can be summarised as under:

- It records two aspects of every transaction.
- One aspect is debited and the other aspect is credited.
- Total of debits are equal to total of credits.

The double entry system can be well explained by the Accounting equation.

Accounting Equation

An accounting equation is a statement of equality. Here, the resources are equal to the sources. The owner or proprietor and outsiders provide the sources for acquiring resources. The resources are known as 'Assets'. As owners and outsiders have provided the funds to the business and business is independent from these persons, due to business entity concept, these persons have a claim against the assets of the business. These claims are known as 'Equities'. Equities are of two types. They are owner's equity and outsider's equity. Owner's equity (or capital) is the claim of owners against the assets of the business. Outsider's equity (or liabilities) is the claim of the outsiders such as creditors, loan providers and debenture-holders against the assets of the company.

Resources (Assets) = Sources of Finance (Capital + Liabilities)

Someone, either owner or outsider, has claim against the assets of the business. So, the total value of the assets is equal to the total value of capital and liabilities. The owner's share is what is left out of the assets, after paying off all the liabilities of the outsiders.

We can say

$$\text{Assets} = \text{Equity (Total claims)}$$

$$\text{Assets} = \text{Owner's claim} + \text{Outsiders' claim}$$

$$\text{Assets} = \text{Capital} + \text{Liabilities}$$

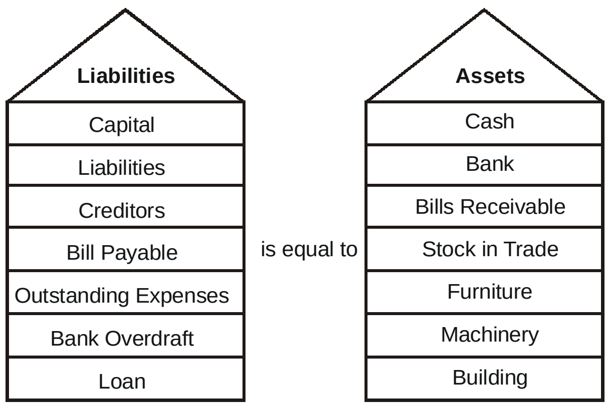
The above is known as the accounting equation or balance sheet equation.

> **The term 'Assets' denotes the resources owned by the business, while the term 'Equities' denotes the various claims of the parties against those Assets.**

At any point of time, the assets are equal to the sum of owner's claim and outsiders' claims. Therefore

$$\text{Capital} = \text{Total Assets} - \text{Outside Liabilities}$$

Accounting equation can be presented as under:



Accounting Equation

When any one of them (owner or outsiders) provides funds, the assets increase. Similarly, the assets decrease when payment is made to them. In other words, when the assets are sold, new assets can be bought in their place, alternatively the amount can be utilised for payment of liabilities. In other words, a change in an asset results in change of other asset/liability.

The double entry principle is explained with the following example:

1. Suppose, Cherry & Co starts a business with Rs. 1,00,000 as capital. The accounting equation would be as follows:

$$\text{Assets} = \text{Capital} + \text{Liabilities}$$

$$\text{Cash } (1{,}00{,}000) = \text{Capital } (1{,}00{,}000) + \text{Liabilities } (0)$$

$$1{,}00{,}000 = 1{,}00{,}000$$

2. The business purchases furniture for Rs. 10,000. In place of cash, furniture has come into the business. The accounting equation would appear as follows:

   Cash (90,000) + Furniture (10,000) = Capital (1,00,000) + Liabilities (0)

   1,00,000 = 1,00,000

3. At this stage, firm makes a cash purchase of stock Rs. 20,000 for carrying on the business. The equation will be as follows:

   Cash (70,000)+ Furniture (10,000) + Goods (20,000) = Capital (1,00,000) + Liabilities (0)

   1,00,000 = 1,00,000

4. To add stock to the business, a credit purchase of goods is made for Rs. 30,000 from Dimpy & Co, who would be a creditor as he has supplied goods on credit. The equation, now, would be:

   Cash (70,000) + Furniture (10,000) + Goods (50,000) = Capital (1,00,000) + Creditors (30,000)

   1,30,000 = 1,30,000

   As and when a change is taking place, for the same amount, change is taking place somewhere else. It would be observed that a change has taken place on both the sides. However, the total on both the sides remains the same.

5. Goods are sold on credit for Rs. 5,000. The cost of the goods is Rs. 4,000. So, stock of goods decreases by Rs. 4,000 and debtors increase by Rs. 5,000. Here, the transaction has resulted in a profit of Rs. 1,000. This profit increases capital as the profit belongs to the proprietor as he has assumed the risk of commencing the business. So, the capital increases by Rs. 1,000. In other words, profit or loss is transferred to capital account. Profit increases capital account while loss or drawings reduce the balance in capital account.

   Cash (70,000) + Furniture (10,000) +

   Goods (46,000) + Debtors (5,000) = Capital (1,01,000) + Creditors (30,000)

   1,31,000 = 1,31,000

6. The business pays Rs. 200 for rent and Rs. 600 for salaries. Cash balance would be reduced by Rs. 800. So, these expenses reduce the profit and inconsequence, balance in capital account. Hence, the position would be as under:

   Cash (69,200) + Furniture (10,000) +

   Goods (46,000) + Debtors (5,000) = Capital (1,00,200) + Creditors (30,000)

   1,30,200 = 1,30,200

There is a two-way effect for every transaction.

From the above, two things are clear. At any stage, the total of assets will be equal to total of liabilities and capital. An increase in an asset can result in a corresponding decrease in another asset or corresponding increase of liability. Similarly, a decrease in an asset can result in increase of another asset or decrease of liability. Every transaction has a corresponding effect.

The last equation stated above can also be presented in the form of a statement called the Balance sheet. It is given below:

Balance Sheet of Cherry & Co as on ....

Rs.

Liabilities		Assets	
Creditors	30,000	Cash	69,200
Capital	1,00,200	Furniture	10,000
		Goods	46,000
		Debtors	5,000
	1,30,200		1,30,200

Any change in an Asset/Liability and impact of Profit/Loss can be summed up as under:

Change	Results in
1. Increase in an asset	Increase in liability Decrease in another asset
2. Decrease in an asset	Decrease in liability Increase in another asset
3. Increase in liability	Increase in asset Decrease in another liability
4. Decrease in liability	Increase in liability Decrease in asset
5. Profit	Increase in asset/s Decrease in liability/liabilities
6. Loss	Decrease in asset/s Increase in liability/liabilities

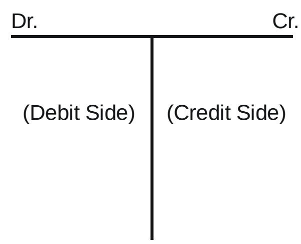
When the business incurs loss, the impact is on the reduction of assets. In the event of closing or winding up business, first we pay the outsiders' claims and balance is left to the owner.

3.3 RULES OF DEBIT AND CREDIT

Under the double entry system of accounting, each account has two sides—debit side and credit side. The left hand of an account is called debit side and the right hand side is called credit side. If an amount is to be debited, it is to be entered on the left hand side of the account, while the credit amount is to be entered on the right side of the account.

The term 'Account' denotes the date-wise record of all dealings or transactions relating to a person, body of persons, corporate, property, liability, expense and income according to certain principles.

The form of an account is in "T" form, which is as under:

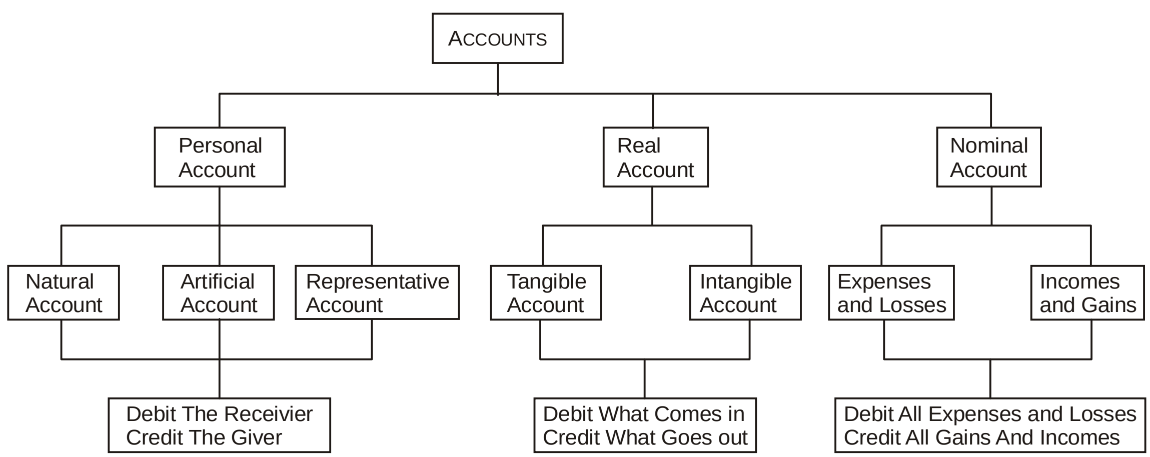


Form of Account – "T" Form

Wherever possible, prepare Account in "T" form to avoid mistakes and ensure arithmetical accuracy.

For the purpose of recording business transactions, accounts are classified into three categories:

Classification & Rules of Accounts



(A) Personal Accounts

They are the accounts of persons with whom the business deals. They can be divided into three categories.

The rule is:

DEBIT THE RECEIVER
CREDIT THE GIVER

(i) Natural Personal Accounts: They are persons who are created by God. For example, Suresh's account, Apeksha's Account and Kuhu's Account etc.

(ii) Artificial Personal Accounts: These are artificial persons i.e. any limited company, bank, insurance company, partnership firm, government body, co-operative society or a club.

(iii) Representative Personal Accounts: These accounts represent a certain person or group of persons. For example, if rent is due to the landlord, the amount is credited to an outstanding rent account, not to the landlord account. Similarly, if salary is due (amount not paid) to the employees and, in the meanwhile, books of accounts are closed, the amount due would be credited to outstanding salaries account. Only one account is opened for all the employees, 'outstanding salaries account'. If individual employees accounts are to be opened, there would be many, resulting in unnecessary workload, as the purpose of the account is temporary to show a liability till the amount is paid. It is immaterial to whom the amount is payable as the nature of the account shows the total amount due to the employees for services rendered. The amount represents salary payable. All such accounts are termed as 'Representative Personal Accounts'

(B) Real Accounts

The Rule is:

DEBIT WHAT COMES IN
CREDIT WHAT GOES OUT

Real accounts relate to the business property and such things, which can be touched. Real accounts are further divided into two categories:

(i) Tangible Real Accounts: Examples of such accounts are cash account, furniture account, building, stock account etc. It is important to note that bank account is a personal account, not real account. Many think cash and bank represent property and purpose of holding is same so they think bank account is also a real account. Balance lying in Bank of India is to be distinguished from the balance in Andhra Bank. Bank balance is related to the institution where it is kept.

Cash is real account, while a bank account is a personal account.

(ii) Intangible Real Accounts: These accounts represent such things, which cannot be touched, though they can be measured in terms of money. Examples are Goodwill, Patents and Trademarks etc.

(iii) Fictitious Assets: Fictitious assets are expenditure on some activity, considered as capital expenditure as the benefits of the expenditure lasts over a long period. Total amount is not charged to profit and loss account, in one year, as the benefit is expected to spread over a period.

The expenditure is debited to profit and loss account, in installments, over a period during which the benefit is expected to last. Till the expenditure is written off, the amount appears on the assets side of the balance sheet.

Example: Share issue expenses, Discount on issue of shares, Preliminary expenses, under writing commission etc.

Fictitious assets are not assets like machinery, building, computer etc. Goodwill, patents cannot be called as fictitious assets as these are Intangible assets.

(C) Nominal Accounts

Nominal accounts include all expenses, losses, incomes and gains. Examples of such accounts are rent, rates, lighting, insurance, salaries and dividends etc.

The rule is

DEBIT ALL EXPENSES AND LOSSES
CREDIT ALL GAINS AND INCOMES

Note: When prefix or suffix is added to a nominal account, it becomes personal account. The following explains how a nominal account becomes a personal account.

Nominal Account	Personal Account
1. Interest account (expense)	Outstanding interest account, pre-paid interest account.
2. Rent account	Outstanding rent account, rent pre-paid account.
3. Salary account	Outstanding salaries account, pre-paid salaries account
4. Interest account (income)	Accrued income account, interest received in advance account.
5. Insurance account	Outstanding insurance account, pre-paid insurance account.

3.4 ADVANTAGES OF DOUBLE ENTRY BOOK-KEEPING

The primary advantage of Double Entry Book-keeping is to establish arithmetical accuracy of accounts. Once, trial balance is tallied, it means that the transactions are recorded on the debit and credit sides, with the same amount. Double Entry Book-keeping does not indicate or guarantee the correctness of the entry. Instead of debiting one account, a wrong account may be debited and similar is the case with the credit aspect. As for every debit, there is a corresponding credit, so books of accounts balance. Arithmetical accuracy is there, but financial correctness may not be there.

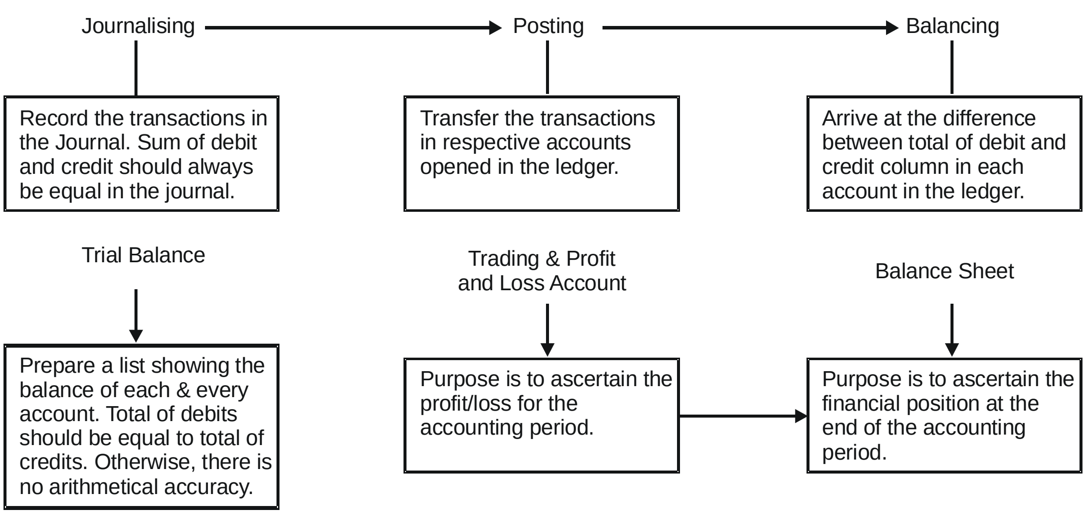
Example: Cash paid towards repairs Rs.100. Instead of debiting repairs account, Radha's account may be debited. Yet, the trial balance tallies.

Accounts are arithmetically correct, but they are not financially correct as repairs account does not show the total amount of repairs incurred.

Double Entry Book-keeping ensures arithmetical accuracy alone, does not guarantee financial correctness.

3.5 ACCOUNTING CYCLE

An accounting cycle is a complete sequence of transactions, beginning with the journal, later recording in a ledger, arriving at the balance in the ledger, moving to prepare trial balance and finally preparation of financial statements — Trading and Profit and Loss Account (Income Statement) and Balance Sheet (Position Statement).



Sequential Steps in an Accounting Cycle

3.6 RULES OF JOURNALISING OR PROCESS OF JOURNALISING

A journal is a book in which transactions are recorded in the order in which they occur. Journal is a book of daily record.

> **A journal is called a book of original entry (prime entry) because all business transactions are first recorded in the journal.**

An entry made in the journal is called a 'Journal Entry'. In every business, accountant enters the business transactions date-wise in a chronological order on the debit and credit side, along with the narration according to the principles of double entry. The process of recording transactions in the journal is called 'Journalising'.

To record transactions, the first step is to record in a journal. The proforma of journal is as under:

Date	Particulars	Ledger Folio	Dr. Amount		Cr. Amount	
			Rs.	P.	Rs.	P.

Proforma of Journal

Thus, Journal contains five columns—

1. **Date:** In the column, the date on which the transaction takes place or occurs is entered.
2. **Particulars:** The names of the two accounts affected by the transaction are recorded. In the first line, the name of the account which is debited is written, added with the word 'Dr.' In the second line, the name of the account, which is credited is written after leaving some space, commencing with the words 'To'. 'Dr' indicates that the relevant account is to be debited and the word 'To' shows that the concerned account, written against, is to be credited.

   Below these lines, a short description of the transaction is made, which is called 'narration'. The narration explains why the account is debited and credited. Thereafter, a line is drawn which signifies that the transaction is complete.
3. **Ledger Folio or L.F.:** L.F. stands for ledger folio. Every entry in the journal is to be posted in the ledger. After posting in the ledger, the folio number of the ledger is mentioned in the journal. Similarly, in the ledger, the folio of the journal is mentioned for cross-referencing to facilitate easy identification and verification.
4. **Amount (Dr.):** This column shows the amount, which is to be debited to the account shown against.
5. **Amount (Cr.):** This column shows the amount, which is to be credited to the account shown against.

   The totals of debit and credit columns are to be made on every page to confirm the correctness of the arithmetical accuracy as the principle is 'for every debit, there has to be a corresponding credit'. If the total of debit and credit do not agree, it is an indication that the amounts have not been entered, correctly, in the journal. Adequate care is needed as the subsequent accounting work is dependent upon the correctness of the entries made in the journal.

3.7 TIPS FOR JOURNALISING

(A) Clarity of Fundamentals

To pass the correct journal entries, we must ascertain answers to the following questions:

1. Which accounts would be affected by the transaction?
2. What is the nature (Real, Personal or Nominal) of those affected accounts?
3. Which account will be debited or credited and why?

(B) Open Purchase/Sales Account, Instead of Goods Account

Goods are purchased as well as sold. If we debit and credit goods account, how do we know the amount of purchases and sales, separately? A consolidated goods account does not give totals of purchases and sales, separately. For this reason, goods account is not opened, but purchases and sales accounts (of goods) are to be opened, separately, to know the amount of purchases and sales. Similar is the case with purchase returns and sales returns. Accounts are to be, separately, maintained to get the totals and details, separately.

(C) Which Account is Relevant for Passing the Journal Entry?

Often, students stand in a dilemma which account is to be debited or credited. Some of the situations are explained, here:

Treatment of cash/credit transactions

(i) Sold goods for Rs.5,000 cash.

(ii) Sold goods to Dheera for Rs.5,000 cash.

(iii) Sold goods for Rs.5,000.

(iv) Sold goods for Rs.5,000 on credit to Dheera.

In transactions, (i) and (ii), goods are sold for cash. It is immaterial to whom the goods are sold, when it is for cash. The reason is it is a cash transaction. The transactions are cash sales and sale proceeds have been received, already, in cash. Students do not have a problem in debiting cash account but they often face the problem in identifying the account for crediting. Which account is to be credited, whether sales or Dheera's account? If Dheera's account is credited, we have to pay the amount to her as she stands as our creditor in our accounting books. Dheera is not to be paid any amount. So, there is no need, at all, to credit her account. So, sales account is to be credited.

In the transaction (iii), it is silent whether goods have been sold for cash or credit. Needless to say, it is a cash sale. Reason is if it is a credit sale, party's name would have been given for recording recovery, to debit her account. In transaction (iv), no such confusion exists as it is a credit sale. So, in this case, Dheera's account is to be debited and sales account is to be credited. Only when a credit sale is made, question of recovering the amount comes up.

Similar is the case with purchases. When cash purchase is made, it is immaterial for us to know the person from whom the purchase has been made. But, when credit purchase is made, the name of the party is required to credit the party's account. If the transaction does not mention, whether it is for cash or credit purchase and party's name is not given, treat the transaction as cash purchase.

(D) Treatment of Payment/Expenses

When payment is made to a person, check whether the payment is made to him for any services, already, rendered. In such a case, the amount is to be debited to the concerned expense account. If the amount has been paid, in advance, the amount would be recovered, later, in case, the assured service is not received. So, the person to whom the payment is made is to be debited. Let us explain.

(i) Salary paid to Rakesh Rs.1,000

(ii) Payment made to Kalyan Rs.2,000 as advance for repairs

In the first case, we debit salary account, not Rakesh account. For the services rendered by Rakesh, payment is made and so Rakesh does not repay the amount, later. So, Rakesh account is not to be debited, but only salary account.

In the second case, Kalyan has not rendered any service at the time payment. So, repairs account is not to be debited, but Kalyan's account is to be debited. If Kalyan does not undertake repairs, as agreed, we have to recover the amount from him. Till such time, he stands as a debtor in our accounting books. Once Kalyan repairs and submits the bill for Rs.2,200 then the following entry is passed:

Repairs account …….. Dr	2,200	
To Kalyan		2,200

(Being repairs incurred as per bill No. ….. dated …. submitted by Kalyan)

So, the advance is adjusted and balance of Rs.200 would be the credit balance lying in his account. This shows that an amount of Rs.200 is payable to him, towards the balance for services rendered.

(E) Treatment of Income/Receipt

When any amount is received, check whether the amount received is for the services rendered. If the amount is for the services rendered to that extent, credit the amount to the service account say commission account. If amount is received, without providing any service, the amount is to be credited to the party who has paid the amount as the amount is refundable/adjustable, depending on the extent of service rendered. Let us explain:

(i) Commission received from Suresh Ltd Rs.1,000

(ii) Advance for Commission received from Rao Rs.5,000

In the first case, Commission has been received and the situation indicates that services have been, already, provided. So, credit commission account.

In the second case, services have not, yet, been provided, but advance has been received. If we do not provide services, we have to refund the advance amount. If services provided are not to the extent of advance, even then balance is to be refunded. So, here, we credit Rao's account with Rs.5,000 for the advance received. If we render commission services for Rs. 4,000 and submit the bill, then we debit Rao account and credit commission account with Rs. 4,000. Then Rao's account shows a credit balance of Rs.1,000, indicating the balance amount payable to him.

(F) Treatment of Trade Discount

When seller gives a deduction on the list price, it is known as trade discount. Normally, trade discount is given to encourage higher quantum of purchases. Suppose, the list price is Rs.1,000 and a trade discount of 10% is offered, then the Net amount = List price –Trade discount, Rs.900 would be paid.

Suppose, goods are sold on credit to Kishore for Rs.10, 000 with a trade discount of 10%, sale is recorded with the net price, in the books of the seller:

Kishore Account …………..Dr	9,000	
To Sales Account		9,000

(Being goods sold to Kishore, on credit, after allowing a trade discount of 10% as per the invoice no. … dated …)

(G) Treatment of Cash Discount (Full Settlement)

To make prompt payment, cash discount is normally allowed. At times, some reduction in the form of discount is allowed to receive the full and final settlement. To the person who allows the discount, it is expenditure. Discount is an income to the person getting it.

Radhi has to pay Rs.10,000 to Dheera. The amount is pending for a long period. To encourage Radhi to make the full payment in one go, Dheera offers her Rs.500 as cash discount and Radhi makes the payment by cheque to take advantage of the discount. In the books of Radhi, the journal entry will be shown as under:

Dheera Account …………….. Dr. 10,000		
To Discount received account	500	
Bank		9,500

(Being cheque issued to Dheera, after deducting cash discount)

(H) Treatment of Personal Expenses of the Owner

Sometimes, proprietor/partner withdraws cash from the business for his personal use, which is known as drawings. Some of the articles dealt in the business may also be consumed, which is to be recorded as drawings, in kind. If the transaction is not recorded, there would be shortage in stock and at the same time, profits would not be correct to the extent of the drawings made. When daughters of a garment owner take the clothes they like, they are to be recorded. They would be treated as sales, but at cost price as goods are sold to the owner.

Example: Sandhya & Co runs a garment shop and her daughters Radhi and Dheera takes clothes for their use worth Rs. 20,000. Normal profit is 20% on sales. The transaction is to be recorded as under:

Drawings account ....Dr.	16,000	
To Sales		16,000

(Being the withdrawal of goods at cost price)

Note to Students: For every transaction, there are two persons. For example, when a sale occurs, there is a purchaser and seller. While recording transactions, it is important to understand in whose books, the transactions are recorded. In the books of the buyer, the same transaction is a purchase, while it is a sale in the books of the seller.

Illustration No. 1

State under what heading (Personal, Real or Nominal) would you classify each of the following accounts, with suitable explanation:

(i) Rent a/c. (ii) Bank a/c.

(iii) Furniture a/c. (iv) Goodwill a/c.

(v) Proprietor's a/c.

Solution:

(i) Rent is a nominal account. Nominal accounts are expenditure and income. Rent is expenditure, hence it is a nominal account.

(ii) Bank is a personal account. Bank account may be with Bank of India or Bank of America. In personal account, the rule is debit the receiver and credit the giver.

(iii) Furniture is a real account. Furniture is an asset. In the real account, the rule is debit what comes in and credit what goes out.

(iv) Goodwill is a real account. Goodwill is an intangible asset. The rule is debit what comes in and credit what goes out.

(v) Proprietor's account is a personal account. In personal account, the rule is debit the receiver and credit the giver.

Illustration No. 2

Enter the following transactions in the journal of Kalyan & Co.

2008 Jan		Rs.
1	Commenced business investing in cash	70,000
2	Purchased land for cash	20,000
3	Purchased goods for cash	30,000
4	Purchase goods from Suresh on credit	10,000

5	Sold goods for cash	20,000
6	Sold goods to Arun on credit	6,000
7	Paid freight	300
8	Donated to charities	1,000
9	Paid salaries to Ramesh	1,200
10	Deposited cash into bank	16,000
11	Withdrawn from bank for office use	4,000
12	Withdrawn from bank for private use	6,000
13	Charged interest on capital	1,000
14	Rent received	2,000
15	Loan from bank	20,000

Solution: We shall prepare a chart to understand why a particular account is to be debited/ credited. This chart is only for the purpose of explaining only. The chart is not required to be prepared, while recording the transactions in the journal.

Date of Transaction	Account to be debited	Account to be credited	Nature of Account	Reasons for debit/ credit
2008 Jan 1	Cash	Capital	Real account Personal account	Cash has come in. Capital has been given by the proprietor.
2	Land	Cash	Real account Real account	Land, an asset has come into our books/business. Cash has gone out.
3	Purchases (Goods) account	Cash	Real account Real account	Goods have come in. Cash has gone out.
4	Purchases (Goods) account	Suresh account	Real account Personal account	Goods have come in. Goods have been purchased from Suresh and amount is due to him.
5	Cash	Sales (Goods) account	Real account Real account	Cash has come in. Goods have gone out.
6	Arun	Sales (Goods) account	Personal account Real account	Arun is receiver. Goods have gone out.
7	Freight	Cash	Nominal account Real account	Expenditure incurred. Cash has gone out.

8	Charity	Cash	Nominal account Real account	Expenditure incurred. Cash has gone out.
9	Salaries	Cash	Nominal account Real account	Expenditure incurred. Cash has gone out. (Ramesh account is not to be debited as he has rendered services and would not repay amount received)
10	Bank	Cash	Personal account Real account	Bank is receiver. Cash has gone out.
11	Cash	Bank	Real account Personal account	Cash has come in. Bank is giver.
12	Drawings	Bank	Personal account Personal account	Debit receiver (in a partnership firm, there are more than one partners, it is necessary to identify the person) Bank is giver.
13	Interest	Capital	Nominal account Personal account	Expenditure incurred. Amount payable to him.
14	Cash	Rent	Real account Nominal account	Cash has come in. Income received.
15	Cash	Bank loan	Real account Personal account	Cash has come in. Bank is giver.

Date	Particulars	L.F.	Amount [Dr.] Rs.	Amount [Cr.] Rs.
2008 Jan1	Cash a/c To Capital a/c [Being cash brought in as capital]	Dr.	70,000	70,000
2	Land a/c To Cash a/c [Being land bought for cash]	Dr.	20,000	20,000
3	Purchases (Goods) a/c To Cash a/c [Being cash purchases]	Dr.	30,000	30,000
4	Purchases (Goods) a/c To Suresh a/c [Being credit purchases]	Dr.	10,000	10,000

5	Cash a/c Dr. To Sales (Goods) a/c [Being cash sales]		20,000	 20,000
6	Arun a/c Dr. To Sales (Goods) a/c [Being credit sales]		6,000	 6,000
7	Freight a/c Dr. To Cash a/c [Being freight paid]		300	 300
8	Donation a/c Dr. To Cash a/c [Being donation paid]		1,000	 1,000
9	Salary a/c Dr. To Cash a/c [Being salaries paid]		1,200	 1,200
10	Bank a/c Dr. To Cash a/c [Being cash deposit into bank]		16,000	 16,000
11	Cash a/c Dr. To Bank a/c [Being withdrawal from bank for office use]		4,000	 4,000
12	Drawings a/c Dr. To Bank a/c [Being withdrawal from bank for private use]		6,000	 6,000
13	Interest a/c Dr. To Capital a/c [Being interest charged (paid) on capital]		1,000	 1,000
14	Cash a/c Dr. To Rent a/c [Being rent received]		2,000	 2,000
15	Cash a/c Dr. To Bank Loan a/c [Being loan taken from bank]		20,000	 20,000

Illustration No. 3

Journalise the following transactions:

2008

April 2 Started business with Rs.60,000 paid into Bank Rs.30,000

3 Bought furniture for cash Rs.10,000
5 Bought goods for Rs.30,000
6 Sold goods for cash Rs.6,000
10 Bought typewriters for Rs.18,000 from the Remington Rand Inc. on credit
13 Sold goods to M/s. Radhi & Co. for Rs.10,000 on credit
15 Bought goods from M/s. Mohindra & Co. for Rs.20,000 on credit
18 Paid telephone rent Rs.2,400 for one year
22 Paid Rs.1,000 for advertisement
26 Sold goods to Dheera & Co. for Rs.8,000 for cash
30 Paid salaries Rs.2,000
30 Paid rent Rs. 1,000
30 Withdrawal of cash for personal use Rs.3,000 from Bank
30 Bought one delivery van for Rs.3,00,000 from the Maruti Motors Ltd. Payment to be made by monthly installments of Rs.20,000 each. First installment paid by cheque.

Solution:

JOURNAL

Date 2008 April	Particulars	L.F.	Dr. Amount Rs.	P.	Cr. Amount Rs.	P.
2	Cash Account ….. Dr. To Capital Account (Cash brought in to start business)		60,000	—	60,000	—
2	Bank Account ….. Dr. To Cash Account (Cash deposited with bank)		30,000	—	30,000	—
3	Furniture Account ….. Dr. To Cash Account (Furniture bought for cash)		10,000	—	10,000	—
5	Purchases (Goods) Account….. Dr. To Cash Account (Goods bought for cash)		30,000	—	30,000	—
6	Cash Account ….. Dr. To Sales (Goods) Account (Goods sold for cash)		6,000	—	6,000	—
10	Typewriters Account ….. Dr. To Reminton Rand Inc. (Typewriters bought on credit)		18,000	—	18,000	—
13	M/s. Radhi & Co. ….. Dr. To Sales (Goods) Account (Sale of goods on credit to Radhi & Co.)		10,000	—	10,000	—

15	Purchases (Goods) Account Dr. To M/s. Mohindra & Co. (Goods bought on credit as per bill no.........date ....)		20,000	—	20,000	—
18	Telephone Charges Account ..... Dr. To Cash Account (Telephone rent paid for one year)		2,400	—	2,400	—
22	Advertisement Account ..... Dr. To Cash Account (Amount paid for advertisement)		1,000	—	1,000	—
26	Cash Account ..... Dr. To Sales (Goods) Account (Goods sold for cash)		8,000	—	8,000	—
30	Salaries Account ..... Dr Rent Account ...... Dr. To Cash Account (Salaries and rent for the month of April paid in cash)		2,000 1,000	—	3,000	—
30	Capital Account (or Drawings Account) .... Dr. To Bank Account (Amount withdrawn from bank for private use)		3,000	—	3,000	—
30	Motor Van Account ..... Dr. To Maruti Motors Ltd. (Motor van no......... bought on the installment system as per agreement no............. dated.................)		3,00,000	—	3,00,000	—
30	Maruti Motors Ltd. ..... Dr. To Bank Account (Amount paid to Maruti Motors & Co., through cheque no.......... dated ....in pursuance of agreement)		20,000	—	20,000	—
		Rs.	5,21400	—	5,21,400	—

Illustration No. 4

One of the accounts involved in the following transactions is given; state the rest.

			Debit	**Credit**
(a)	Commenced business with cash	(e.g.)	Cash	Capital
(b)	Paid into bank		Bank	—
(c)	Purchased goods for cash		—	Cash

(d)	Paid cash for furniture	—	Cash
(e)	Sold to Vasu goods on credit	—	Sales (Goods)
(f)	Received from Vasu on account	—	Vasu
(g)	Sold to Varshney & Co. goods for cash	Cash	—
(h)	Received cash from Vasu	—	Vasu
	Allowed discount		Vasu
(i)	Bought goods for cash from Kalyan	Purchases	—
		(Goods)	
(j)	Paid Mohan by cheque	Mohan	—
(k)	Received rent from a sub-tenant	Cash	—
(l)	Rent due to landlord	Rent	—
(m)	Paid wages by cheque	Wages	—

Solution:

[(b) Cash (c) Purchases (Goods) (d) Furniture (e) Vasu (f) Cash (g) Sales (Goods) (h) Cash, Discount (i) Cash (j) Bank (k) Rent Received (l) Landlord (m) Bank].

Illustration No. 5

The following journal entries have been made by a student. You are required to pass correct entries, wherever you think them to be wrong.

(a) Brought capital into business:

Capital A/c Dr.

To Cash A/c

(b) Purchased furniture for cash:

Purchase A/c Dr.

To Furniture

(c) Cash purchases from Ravi & Co:

Ravi & Co A/c Dr.

To Cash A/c

(d) Paid carriage for cash purchases:

Purchase A/c Dr.

To Cash

(e) Paid carriage:

Carriage A/c Dr.

To Cash A/c

(f) Salaries due to clerk:

Salaries A/c Dr.

To Cash A/c

Solution:

[(a) should be reverse; (b) Debit Furniture, Cr. Cash; (c) Purchases (Goods) account should be debited, not Ravi & Co; (d) Carriage account is to be debited, not Purchase account (e) correct; (f) Credit Unpaid Salary A/c)]

Illustration No. 6

What do the following journal entries mean:

(a) Salary A/c Dr.
    To Bank A/c

(b) Furniture A/c Dr.
    To Ram Mart

(c) Ram Dr.
    To Cash A/c
    To Discount A/c

(d) Drawings A/c Dr.
    To Bank A/c

Solution:

[(a) Salary paid by cheque; (b) Furniture purchased on credit; (c) Paid to Ram and Discount received; Two transactions - receipt of cash as well as discount are combined, and one entry is passed; (d) Drew cash for private use from bank.]

Illustration No. 7

What do the following journal entries mean:

(a) Depreciation A/c Dr.
    To Car A/c

(b) Rent A/c Dr.
    To Landlord

(c) Gopal Rao Dr.
    To Discount A/c

(d) Bank A/c Dr.
    To Cash A/c

Solution:

[(a) Depreciation charged on car; (b) Rent due to Landlord; (c) discount has been allowed by Gopal Rao; (d) Cash deposited into bank.]

Illustration No. 8

On 1st April, 2007, Vasant & Co commenced business with a capital of Rs.60,000 and his transactions for the month are given below:

2007		Rs.
April 1	Purchased goods for cash	15,000
April 2	Purchased furniture for cash	1,000
	Purchased a typewriter for cash	2,000
April 5	Cash sales	5,000
April 6	Sold goods to Vikas on credit	8,000
April 10	Purchased goods from Prafulla	10,000
April 12	Returned goods to Prafulla	2,000
April 15	Goods returned by Vikas	1,000
April 20	Sold goods to Mukesh for cash	5,000
April 25	Withdrew goods for personal use	500

Solution:

Journal Entries in the Books of Vasant & Co

Date	Particulars	L.F.	Dr. Amt. Rs.	Cr. Amt. Rs.
2007 April 1	Purchases A/c .... Dr. To Cash A/c (goods purchased for cash)............		15,000	 15,000
2007 April 2	Furniture A/c................................. Dr. Typewriter A/c .... Dr. To Cash A/c (furniture and typewriter bought for cash)		1,000 2,000	 3,000
2007 April 5	Cash A/c .... Dr. To Sales A/c (goods sold for cash)......................		5,000	 5,000
2007 April 6	Vikas A/c .... Dr. To Sales A/c (goods sold on credit).....................		8,000	 8,000
2007 April 10	Purchases A/c .... Dr. To Prafulla A/c (goods purchased from Prafulla)		10,000	 10,000
2007 April 12	Prafulla A/c .... Dr. To Purchases Returns A/c (goods returned by Prafulla)		2,000	 2,000

2007 April 15	Sales Returns A/c .... Dr. To Vikas A/c (goods returned by Vikas)		1,000	 1,000
2007 April 20	Cash A/c .... Dr. To Sales A/c (goods sold for cash)		5,000	 5,000
2007 April 25	Drawings A/c .... Dr. To Sales A/c (goods withdrawn for personal use)		500	 500
	Grand Total Rs.		**49,500**	**49,500**

Illustration No. 9

Point out what is wrong in the following journal entries and give correct entries on the basis of your explanation.

Date	Particulars	L.F.	Dr. Amt. Rs.	Cr. Amt. Rs.
(a)	Bhima ....Dr. To Purchases A/c (for goods purchased from Bhima on credit)		600	 600
(b)	Purchase A/c ....Dr. To Vikas Varshney & Co. (for furniture purchased from Vikas Varshney & Co.)		250	 250
(c)	Kishore ....Dr. To Cash A/c (for Salary paid to Kishore, a computer executive)		2550	 2550
(d)	Examination Fees A/c ....Dr. To Cash A/c (for examination fees of proprietor's son paid)		50	 50
(e)	Sales A/c ....Dr. To Cash A/c (for goods sold for cash)		300	 300
(f)	Cash A/c ....Dr. To Sales A/c (for old machinery sold)		800	 800
(g)	Purchase Returns A/c ....Dr. To Sandhya (for goods purchased from Sandhya on credit)		400	 400

Solution:

Date	Particulars	L.F.	Dr. Amt. Rs.	Cr. Amt. Rs.
(a)	Purchase A/c ….Dr. To Bhima A/c (for goods purchased from Bhima on credit)		600	600
(b)	Furniture A/c ....Dr. To Vikas Varshney & Co. (for furniture purchased from Vikas Varshney & Co.)		250	250
(c)	Salary A/c ....Dr. To Cash A/c (for Salary paid to Kishore, a computer executive)		2,550	2,550
(d)	Drawings A/c ....Dr. To Cash A/c (for examination fees of proprietor's son paid)		50	50
(e)	Cash A/c ....Dr. To Sales A/c (for goods sold for cash)		300	300
(f)	Cash A/c ....Dr. To Machinery A/c (for old machinery sold)		800	800
(g)	Purchase A/c ....Dr. To Sandhya (for goods purchased from Sandhya on credit)		400	400

Illustration No. 10

Journalise the following transactions:

Date	Transactions
02.04.2008	Purchased goods from Srikant at the list price of Rs.2,000. He allowed 10% Trade Discount.
03.04.2008	Sold goods to Govind at the list price of Rs.1,000 and allowed him 5% Trade Discount.
08.04.2008	Received a cheque from Govind for Rs.930 in full settlement.
11.04.2008	Sent to Srikant in full settlement a cheque for Rs.1,750.
13.04.2008	Raghav is declared insolvent. Received from his Official Receiver, a first and final dividend of 60 Paise in the rupee on a debt of Rs.2,500 .
14.04.2008	Recovered from Sudha an old amount written off as bad debt Rs.100.
15.04.2008	Received a V.P.P. for Rs.680, sent a peon to take delivery of it and he paid Rs.5 for cartage.

20.04.2008	Goods distributed as free samples (Sales Price Rs.1,200 Cost Price Rs.1000).
22.04.2008	Goods destroyed by fire (Sale Price Rs.1,000, Cost Price Rs.800).

Solution:

Journal

Date	Particulars		L.F.	Dr. Amt. Rs.	Cr. Amt. Rs.
02.04.08	Purchases A/c To Srikant (Being the goods purchased from Srikant for Rs.2,000 at a discount of 10%)	Dr.		1,800	 1,800
03.04.08	Govind To Sales A/c (Being the goods sold to Govind for Rs.1,000 at discount of 5%)	Dr.		950	 950
08.04.08	Bank A/c Discount Allowed A/c To Govind (Being a cheque received from Govind in full settlement)	Dr. Dr.		930 20	 950
11.04.08	Srikant To Bank A/c To Discount Received A/c (Being a cheque for Rs.1,750 sent to Srikant in full settlement)	Dr.		1,800	 1,750 50
13.04.08	Cash A/c Bad Debts A/c To Raghav (Being 60 Paise in the rupee received from Raghav in full and final settlement)	Dr. Dr.		1,500 1,000	 2,500
14.04.08	Cash A/c To Bad Debt Recovered A/c (Being and old amount written off as bad debt, recovered)	Dr.		100	 100
15.04.08	Purchases A/c Cartage Inward A/c To Cash A/c (Being a V.P.P. received for Rs. 680 and paid Rs. 5 for cartage)	Dr. Dr.		680 5	 685

20.04.08*	Sales Promotion A/c Dr. To Purchases A/c (Being the goods distributed as free samples)		1,000	1,000
22.04.08*	Loss by Fire A/c Dr. To Purchases A/c (Being the goods destroyed by fire)		800	800

*** These transactions are recorded at cost price as they are not real sales, so profit cannot be expected.**

Descriptive Questions

1. " Each transaction has a double aspect." Explain this statement giving suitable examples. (3.1 and 3.2)
2. What do you mean by 'Double Entry System'? Explain with a suitable illustration. (3.1 and 3.2)
3. Explain the different types of accounts and the rules for recording in books of accounts. (3.3)

Check Your Understanding

(A) State whether the following statements are True or False:

1. Both cash and bank accounts are real accounts.
2. Assets are equal to equities.
3. Equities are equal to the total value of capital and liabilities.
4. There is no difference between trade discount and cash discount.
5. Drawings in cash are recorded in books of accounts while drawings in kind are not recorded.
6. Cash purchase and credit purchase are treated in a similar manner so far as debit entry is concerned.
7. For every debit, there is a corresponding credit for the same amount.
8. Journal is a book of prime entry.
9. Loss results in increase of asset or reduction of liability.
10. Profit or loss is finally transferred to capital account.
11. In an accounting equation, assets are equal to capital and liabilities.
12. When sales returns are made, sales returns account is credited.
13. When entertainment expenditure is incurred and payment is not made, entertainment expenditure account is credited.
14. Dividend received is a personal account.
15. Double Entry Book-keeping ensures arithmetical accuracy alone, would not guarantee financial correctness.
16. Cash book is a journal as well as a ledger.
17. It is necessary to record all non-cash transactions, first, in the journal before posting is made into the concerned accounts in the ledger.

Answers

1. False 2. True 3. True 4. False 5. False 6. True 7. True 8. True 9. False 10. True 11. True 12. False 13. False 14. False 15. True 16. True 17. True

(B) Pick up the most appropriate answer

1. The term "double entry" in accounting refers to which of the following:
   (a) Keeping second set of books of accounts.
   (b) Accounting records reflect both cash and accrued income.
   (c) The fact that all transactions affect at least two accounts.
   (d) A type of embezzlement scheme.
2. At which of the following stages, income is typically be recognized under Generally Accepted Accounting Principles?
   (a) Product is manufactured and stored
   (b) Customer places the order
   (c) Product is delivered to the customer
   (d) Customer pays for the product, finally, after enjoying credit period allowed.
3. Which set of terms are synonymous in accounts?
   (a) Revenue, expense, income (b) Asset, resource, liability
   (c) Revenue, sales, loss (d) Earnings, profit, income
4. Purchase of land for cash will have what effect on total liabilities?
   (a) Increase (b) Decrease
   (c) No effect (d) Uncertain.
5. Liabilities appear on which of the following statements?
   (a) Statement of Cash Flows (b) Statement of Owner's Equity
   (c) Balance Sheet (d) Income Statement
6. Purchase of furniture on credit will have what effect on total assets?
   (a) Increase (b) Decrease.
   (c) No effect (d) Indeterminate.
7. The amount brought in by the proprietor is called
   (a) Drawings (b) Capital
   (c) Cash account (d) Credit account.
8. Return of goods purchased from a manufacturer should be credited to
   (a) Purchase returns (b) Sales returns
   (c) Purchases (d) Sales.
9. Amount of salary paid to Kishore should be debited to
   (a) Kishore account (b) Salary account
   (c) Salary outstanding account (d) Cash account.

10. Trade discount allowed by the supplier is to be debited to
    (a) Purchase account
    (b) No entry for trade discount, net purchase is debited
    (c) Supplier account
    (d) Discount is added to purchase amount.
11. Cash discount received from a customer should be credited to
    (a) Discount account
    (b) Customer account
    (c) Cash account
    (d) No entry.
12. In case of a debt becoming bad, amount of bad debts is credited to
    (a) Sales account
    (b) Debtor's account
    (c) Purchase account
    (d) Cash account.
13. In Double Entry system of Book-keeping, every business transaction affects
    (a) one account
    (b) two accounts
    (c) the same account on both debit and credit sides
    (d) the two sides of the same account on different dates.
14. What type of account is Prepaid Insurance?
    (a) Asset
    (b) Liability
    (c) Revenue
    (d) Expense.
15. The cost of earning the revenue of the current period is referred to as:
    (a) Liability
    (b) Expense
    (c) Net loss
    (d) Cash outflow.
16. Which financial statement provides information about a company's capital structure?
    (a) Profit and Loss Account
    (b) Balance Sheet
    (c) Funds flow statement
    (d) Cash flow statement.

Answers

1. (c) 2. (c) 3. (d) 4. (c) Land and cash are both assets. One asset is exchanged for another. So, total liabilities are unaffected. 5. (c), 6. (a) Purchase of Furniture on credit has created an asset as well as a liability, so total assets have increased. 7. (b) 8. (a) 9. (b) 10. (b) 11. (a) 12. (b) 13. (b) 14. (a) The prepayment creates an asset in the form of future insurance coverage. 15. (b) 16. (b) Capital structure deals with the way in which an entity has financed its assets. This information is provided by the liabilities side of the balance sheet.

Interview Questions

Q.1. What is "Accounting Equation"?

Ans. In every business, resources (assets) are provided by the owner as well as outsiders. These persons have a claim against those assets. Due to dual aspect of accounting, the assets are equal to the claims of the owners and outsiders. In simple words, the assets are equal to capital and liabilities, which is known as 'Accounting Equation'.

Q.2. What is meant by 'Dual aspect'?

Ans. Dual aspect means double entry system of book-keeping. Here, for every debit, there should be a corresponding credit for each transaction**.** Total debit should be equal to total credit.

Q.3. What is a fictitious asset? Quote three examples.

Ans. Fictitious assets are not real assets. Yet, they appear on the assets side of the balance sheet. Fictitious assets are expenditures/expenses whose benefit is not limited to one particular year. Therefore, the whole of these expenses cannot be charged to the profit and loss account of the year, in which the amount is incurred. Hence, they are deferred. These items are transferred in installments to P&L Account for some reasonable years. The expenditure is charged over the period the benefit is expected to be derived. Till they are fully written off, they appear on the assets side of the balance sheet.

Example: Share issue expenses, Discount on issue of shares, Preliminary expenses, Under writing commission etc.

Q.4. What is the difference between trade discount and cash discount?

Ans. Trade discount is allowed to encourage the customer to buy, in bulk. Normally, retailers buy their requirements as per demand of their customers. The wholesaler would offer a further reduction from the price list, if the retailers purchase a specific higher quantity. Suppose, the listed price on the item is Rs.100 and seller offers a trade discount of 5%, then the invoice shows the listed price as well as trade discount. However, the net price (Rs.95) is debited as purchase amount in the books of the buyer. In the books of the seller, the net price (Rs.95) is shown as sales. Trade discount does not appear in the books of the buyer and seller, separately.

Cash discount is allowed to encourage the customer to clear the dues, before the agreed due date. In other words, it is a reduction or inducement offered for early payment. Cash discount appears in the books of accounts, as expenditure to the person who allows it and income to the receiving person.

Q.5. What is the purpose of a 'Journal'?

Ans. Journal is a book of original entry. The purpose of a 'Journal' is to record the transactions in the same order as they happen. Once, an entry is made for the transaction, it would be known which account is to be debited and credited. As the journal contains narration, its reading would explain the nature of the transaction. It is also, immediately, known from the narration whether the entry made is correct or not.

Q.6. It is said that Double Entry Book-keeping does not guarantee financial correctness. Is it right and then what is its purpose?

Ans. It is correct that Double Entry Book-keeping does not guarantee financial correctness. The main purpose of double entry book-keeping is to establish arithmetical accuracy of recording business transactions. Double entry system ensures for every debit entry, there is a corresponding credit. It is an indication that all the entries recorded are, arithmetically, correct.

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