



Module-B

Principles of Bookkeeping & Accountancy

JAIIB

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JAIIB/DBF Paper 2- Accounting & Finance for Bankers

Module B- Principles of Bookkeeping & Accountancy

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Unit 1- Definition, Scope and Accounting Standards

Accounting

Accounting often is called the language of business. The basic function of any language is to serve as a means of communication. In this, context, the purpose of accounting is to communicate or report the results of business operations and the financial health of the organization.

Features of Accounting



- Accounting is an art of recording, classifying and summarising business transactions: it not only records the business transaction but also records them in an orderly manner. It also classifies business transactions according to their nature, before recording them in the books of account.
- **Accounting also summarises the data, recorded in books of account, and presents them in a systematic way, in the form of:**
 1. Trial Balance
 2. Profit and loss account and
 3. Balance sheet
- **Accounting records the transactions in terms of money:** Accounting records business transactions by expressing them in terms of money. This makes the recorded data more meaningful. Events that cannot be expressed in money terms, are not recorded in the books of account.
- Accounting records only the transactions of a financial character
- Accounting also interprets the financial data

Purpose and Objectives of Accounting

- To Keep a systematic record
- To Ascertain the result of the operations
- To ascertain the financial position of the business
- To facilitate rational decision-making
- To satisfy the requirements of law (**Companies Act, Societies Act, Public Trust Act etc and also compulsory under the Sales Tax Act and Income Tax Act**)

Types of Accounting:

- Financial Accounting
- Cost Accounting
- Management Accounting
- Social Responsibility Accounting
- Human Resource Accounting
- Inflation Accounting

Accounting Standards in India and Its Definition and Scope



The Institute of Chartered Accountants of India (ICAI), recognising the need to harmonise the diverse accounting policies and practices, constituted an '**Accounting Standards Board**' (ASB) on **21st April, 1977**. The main function of the ASB is to formulate accounting standards so that the council of ICAI may mandate such standards.

- ASB shall determine the broad areas in which accounting standards need to be formulated and the priority about the selection thereof.
- In the preparation of the accounting standards, the ASB will be assisted by study groups constituted to consider specific subjects. It will also hold a dialogue with the representatives of the government, public and private sector industries and other organisations, for ascertaining their views.
- Based in the above, an exposure draft of the proposed standard will be prepared and issued to its members for comments and the public at large.
- After taking into consideration the comments received, the exposure draft will be finalised by the ASB for submission to the council of ICAI.

A mandatory accounting standard, if not followed, requires the auditors, who are members of ICAI, to qualify their audit reports, failing which they will be guilty of professional misconduct. Both the SEBI and Companies Act 2013 require auditors to qualify the audit reports that do not conform to mandatory accounting standards. **Section 134(5) of the Companies Act 2013** also casts a responsibility on the board of directors to comply with mandatory accounting standards.

Under the Section 129(5) of the Companies Act 2013, where the financial statements do not comply with the accounting standards, such companies shall disclose the following:

- The deviation from the accounting standards
- The reasons for such a deviation
- The Financial effects, of any arising out of such a deviation.

Accountancy Standards

The Institute of Chartered Accountants of India (ICAI) has so far issued twenty-nine standards:

- (AS 1) Disclosure of Accounting Policies
- (AS 2) Valuation of Inventories
- (AS 3) Cash Flow Statements
- (AS 4) Contingencies and Events Occurring after the Balance Sheet Date



- (AS 5) Net Profit or Loss for the period, Prior Period and Extraordinary Items and Changes in less Accounting Policies
- (AS 6) Depreciation Accounting
- (AS 7) Accounting for Construction Contracts
- (AS 8) Accounting for Research and Development (deleted w.e.f. 1/4/2003)
- (AS 9) Revenue Recognition
- (AS 10) Accounting for Fixed Assets
- (AS 11) Accounting for the Effects of Changes in Foreign Exchange Rates
- (AS 12) Accounting for Government Grants
- (AS 13) Accounting for Investments
- (AS 14) Accounting for Amalgamations
- (AS 15) Accounting for Retirement Benefits in the Financial Statements of Employers
- (AS 16) Borrowing Costs
- (AS 17) Segment Reporting
- (AS 18) Related Party Disclosures
- (AS 19) Leases
- (AS 20) Earnings per Share
- (AS 21) Consolidated Financial Statements
- (AS 22) Accounting for Taxes on Income
- (AS 23) Accounting for Investments in Associates in Consolidated Financial Statements
- (AS 24) Discontinuing Operations
- (AS 25) Interim Financial Reporting
- (AS 26) Intangible Assets
- (AS 27) Financial Reporting of Interest in Joint Ventures
- (AS 28) Impairment of Assets
- (AS 29) Provisions, Contingent Liabilities and Contingent Assets



Apart from these, there are 3 not mandatory Accounting Standards:

- (AS 30) Financial Instruments; Recognition and Measurement
- (AS 31) Financial Instruments; Presentation
- (AS 32) Financial Instruments; Disclosures

Generally Accepted Accounting Principles of USA (US GAAP)

Generally accepted accounting principles, or GAAP, are a set of rules that encompass the details, complexities, and legalities of business and corporate accounting. The Financial Accounting Standards Board (FASB) uses GAAP as the foundation for its comprehensive set of approved accounting methods and practices.

U.S. law requires businesses that release financial statements to the public and companies that are publicly traded on stock exchanges and indices to follow GAAP guidelines, which incorporate 10 key concepts:

- **Principle of regularity:** GAAP-compliant accountants strictly adhere to established rules and regulations.
- **Principle of consistency:** Consistent standards are applied throughout the financial reporting process.
- **Principle of sincerity:** GAAP-compliant accountants are committed to accuracy and impartiality.
- **Principle of permanence of methods:** Consistent procedures are used in the preparation of all financial reports.
- **Principle of non-compensation:** All aspects of an organization's performance, whether positive or negative, are fully reported with no prospect of debt compensation.
- **Principle of prudence:** Speculation does not influence the reporting of financial data.
- **Principle of continuity:** Asset valuations assume the organization's operations will continue.
- **Principle of periodicity:** Reporting of revenues is divided by standard accounting time periods, such as fiscal quarters or fiscal years.
- **Principle of materiality:** Financial reports fully disclose the organization's monetary situation.
- **Principle of utmost good faith:** All involved parties are assumed to be acting honestly.



GAAP compliance makes the financial reporting process transparent and standardizes assumptions, terminology, definitions, and methods. External parties can easily compare financial statements issued by GAAP-compliant entities and safely assume consistency, which allows for quick and accurate cross-company comparisons.

Because GAAP standards deliver transparency and continuity, they enable investors and stakeholders to make sound, evidence-based decisions. The consistency of GAAP compliance also allows companies to more easily evaluate strategic business options.

These three rules are:

Basic accounting principles and guidelines: These 10 guidelines separate an organization's transactions from the personal transactions of its owners, standardize currency units used in reports, and explicitly disclose the time periods covered by specific reports. They also draw on established best practices governing cost, disclosure, going concern, matching, revenue recognition, professional judgment, and conservatism.

Rules and standards issued by the FASB and its predecessor, the Accounting Principles Board (APB): The FASB issues an officially endorsed, regularly updated compendium of principles known as the *FASB Accounting Standards Codification*. The compendium includes standards based on the best practices previously established by the APB. These organizations are rooted in historic regulations governing financial reporting, which were implemented by the federal government following the 1929 stock market crash that triggered the Great Depression.

Generally accepted industry practices: There is no universal GAAP model followed by all organizations across every industry. Rather, particular businesses follow industry-specific best practices designed to reflect the nuances and complexities of different areas of business. For example, banks operate using a different set of accounting and financial reporting methods than those used by retail businesses.

International Financial Reporting Standard (IFRS)

The **International Financial Reporting Standards (IFRS)** are accounting standards that are issued by the **International Accounting Standards Board (IASB)** with the objective of providing a common accounting language to increase transparency in the presentation of financial information.

What is IASB?

The International Accounting Standards Board (IASB), is an independent body formed in 2001 with the sole responsibility of establishing the International Financial Reporting Standards (IFRS). It succeeded the International Accounting Standards Committee (IASC), which was earlier given the responsibility of establishing the international accounting standards. IASB is based in London. It has also provided the



'Conceptual Framework for Financial Reporting' issued in September 2010 which provides a conceptual understanding and the basis of the accounting practices under IFRS.

The Principal Objective of the IFRS Foundation are:

To Develop a single set of high quality, understandable, enforceable and globally accepted International Financial Reporting Standards (IFRSs) through its standard-setting body, the International Accounting Standard Board (IASB);

To promote the use and rigorous applications of those standard;

To take account of the financial reporting needs of emerging economics and small and medium-sized entities (SMEs); and

To promote and facilitate adoption of IFRSs, being the standards and interpretations issued by the IASB, through the convergence of national accounting standards and IFRSs.

List of International Financial Reporting Standards (IFRS)

Standard No. -Standard Title

IFRS 1- First-time Adoption of International Financial Reporting Standards

IFRS 2- Share-based Payment

IFRS 3- Business Combinations

IFRS 4- Insurance Contracts

IFRS 5- Non-current Assets Held for Sale and Discontinue Operations

IFRS 6- Exploration and Evaluation of Mineral Resources

IFRS 7- Financial Instruments: Disclosures

IFRS 8- Operating Segments

IFRS 9- Financial Instruments

IFRS 10- Consolidated Financial Statements

IFRS 11- Joint Arrangements

IFRS 12- Disclosure of Interests in Other Entities

IFRS 13- Fair Value Measurement

IFRS 14- Regulatory Deferral Accounts

IFRS 15- Revenue from Contracts with Customers

IFRS 16- Leases



IFRS 17- Insurance Contracts

IAS 1- Presentation of Financial Statements

IAS 2- Inventories

IAS 7- Statement of Cash Flows

IAS 8- Accounting Policies, Changes in Accounting Estimates and Errors

IAS 10- Events after the Reporting Period

IAS 11- Construction Contracts

IAS 12- Income Taxes

IAS 16- Property, Plant, and Equipment

IAS 17- Leases

IAS 18- Revenue

IAS 19- Employee Benefits

IAS 20- Accounting for Government Grants and Disclosure of Government Assistance

IAS 21- The Effects of Changes in Foreign Exchange Rates

IAS 23- Borrowing Costs

IAS 24- Related Party Disclosures

IAS 26- Accounting and Reporting by Retirement Benefit Plans

IAS 27- Separate Financial Statements

IAS 28- Investments in Associates and Joint Ventures

IAS 29- Financial Reporting in Hyperinflationary Economies

IAS 32- Financial Instruments: Presentation

IAS 33- Earnings per Share

IAS 34- Interim Financial Reporting

IAS 36- Impairment of Assets

IAS 37- Provisions, Contingent Liabilities, and Contingent Assets

IAS 38- Intangible Assets

IAS 39- Financial Instruments: Recognition and Measurement

IAS 40- Investment Property



IAS 41- Agriculture

Differences between US GAAP and IFRS

Differences between IFRS and U.S. GAAP		
Issue	IFRS	U.S. GAAP
Documents included in the financial statements	Balance sheet Income statement Changes in equity Cash flow statement Footnotes	Balance sheet Income statement <u>Statement of comprehensive income</u> Changes in equity Cash flow statement Footnotes
Balance sheet	Requires split-up of current and noncurrent assets and liabilities	Commends separation of current and noncurrent assets and liabilities
Deferred taxes	Shown as distinct line items on the balance sheet	Contained within with assets and liabilities
Minority interests (usually ownership positions by significant but not majority investors)	Encompassed in equity as a separate line item	Included in liabilities as a distinct line item
Extraordinary items (events that don't occur on a regular basis)	Prohibited	Allowed if they're uncommon and infrequent
Bank overdrafts	May be involved in cash if used in cash management	Charged as a financing activity

Transfer Pricing

Transfer pricing is the method used to sell a product from one subsidiary to another within a company. This approach is used when the subsidiaries of a parent company are measured as separate profit centers. Transfer pricing impacts the purchasing behavior of the subsidiaries, and may have income tax implications for the company as a whole. **Here are the key issues:**

- Revenue basis
- Preferred customers
- Preferred suppliers



Traditional Methods

- **Market rate transfer price.** The simplest and most elegant transfer price is to use the market price. By doing so, the upstream subsidiary can sell either internally or externally and earn the same profit with either option. It can also earn the highest possible profit, rather than being subject to the odd profit vagaries that can occur under mandated pricing schemes.
- **Adjusted market rate transfer price.** If it is not possible to use the market pricing technique just noted, then consider using the general concept, but incorporating some adjustments to the price. For example, you can reduce the market price to account for the presumed absence of bad debts, since corporate management will likely intervene and force a payment if there is a risk of non-payment.
- **Negotiated transfer pricing.** It may be necessary to negotiate a transfer price between subsidiaries, without using any market price as a baseline. This situation arises when there is no discernible market price because the market is very small or the goods are highly customized. This results in prices that are based on the relative negotiating skills of the parties.
- **Contribution margin transfer pricing.** If there is no market price at all from which to derive a transfer price, then an alternative is to create a price based on a component's contribution margin.
- **Resale Price Methods:** The Resale Price (RP) while similar to the Cost plus method, is found by working backwards from the transactions taking place at the next stage in the supply chain and is determined by subtracting an appropriate gross mark-up from the sale price, to an unrelated third party, with the appropriate gross margin being determined by examining the conditions, under which, the goods or services are sold and comparing the said transaction to other third party Transactions.
- **Cost-plus transfer pricing.** If there is no market price at all on which to base a transfer price, you could consider using a system that creates a transfer price based on the cost of the components being transferred. The best way to do this is to add a margin onto the cost, where you compile the standard cost of a



component, add a standard profit margin, and use the result as the transfer price.

- **Cost-based transfer pricing.** Have each subsidiary transfer its products to other subsidiaries at cost, after which successive subsidiaries add their costs to the product. This means that the final subsidiary that sells the completed goods to a third party will recognize the entire profit associated with the product.

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Unit 2- Basic Accountancy Procedures

Concepts of Accountancy

Accounting is often called the language of business through which a business house normally communicates with the outside world. In order to make this language intelligible and commonly understood by all, it is necessary that it is based on certain uniform scientifically laid down standards. These standards are termed as accounting principles.

Concepts

There following are the main accounting concepts

Cost Concepts: Every business transaction is recorded in the books of accounts at cost price, e.g. the machinery is recorded in the books by that amount which is paid to the supplier plus the expenses of bringing and installing the machinery which are necessary to put it in working order.

Applications

- Fixed assets are kept at the cost of purchase and not their market value.
- Every transaction is recorded with the present value and not any future value.
- Unrealised gains are ignored.
- An item, that has no cost, is not taken in books

Money measurement concept: Every transaction that is recorded in books of accounts must be measured in terms of money. All the transactions are converted into a common form, which is money. Example, quarterly production, sales, wages, etc, all are converted in terms of money.

Applications

- Health of a proprietor or manager is not taken into the books although it may have a great impact on the overall business.
- We do not include any inflation or deflation or depreciation in the value of any asset.



Business entity Concept: This concept separates the entity of the proprietor from the business transactions. The capital contributed by the owner is a liability for the business because business, which is an artificial person, is different from owner.

Applications

- Any money withdrawn by the proprietor is treated separately as drawings.
- Profit is a liability while loss is an asset.

Realisation concept: This concept tells us when is the revenue treated as realized or earned. It is treated as realized or earned on that date when the property in the goods pass to the buyer and he becomes legally liable to pay.

Applications

- No future income is considered.
- Goods sold on approval will not be included in sales but taken at cost only.
- The rules of revenue recognition determines that the earning process should be either complete or near completion.

Historical records Concept: In accounts, The historical cost principle states that businesses must record and account for most assets and liabilities at their purchase or acquisition price. In other words, businesses have to record an asset on their balance sheet for the amount paid for the asset.

Going concern concept: This concept indicates that the business is a going concern and the transactions are recorded accordingly. If an expense is incurred and its utility is consumed during the year, then it is treated as an expense, otherwise it is recorded as an asset.

Applications

- The fixed assets are valued at cost and not at market value.
- Current assets are valued at cost or the market value whichever is less.
- Depreciation is provided based on the total number of years of life of asset. Balances of one year are carried forward to the next year.
- Reserves and provisions are created for any future liability.

Matching concept: This concept explains that we have to match the income of a certain period with expenses of that period only. The term matching refers to the close relationship that exists between certain expired cost and revenues realized as a result of incurring those costs. The justification of the matching concept arises from accounting period concept.



Applications

- All adjustments regarding prepaid expenses, outstanding expenses are made in the final accounts.
- Deferred revenue expenditure concept arises due to this.

Accounting period concept: An accounting period is the span of time covered by a set of financial statements. This period defines the time range over which business transactions are accumulated into financial statements, and is needed by investors so that they can compare the results of successive time periods.

Main Conventions of Accounting

Accounting of full disclosure: Entries are made in such a way, that they provide honestly all information relating to the activities of the business. The records should not conceal anything from outsider. Secret reserves should not be maintained as per this convention.

Convention of materiality: All material information, must be recorded. What is material depends upon the value of the item involved and circumstances of individual case of business. Exp: Paisa is not recorded.

Convention of conservatism: While recording transactions, all possible losses must be taken into consideration, while all anticipated profits should be ignored. This is also called the principle of prudence.

Convention of consistency: If a method is selected for recording purposes, it must be regularly followed in the future also. Whenever it is necessary to change, the impact of such change must be given separately.

Going Concern Entity

The going concern concept of accounting implies that the business entity will continue its operations in the future and will not liquidate or be forced to discontinue operations due to any reason. A company is a going concern if no evidence is available to believe that it will or will have to cease its operations in foreseeable future.

An example of the application of going concern concept of accounting is the computation of depreciation on the basis of expected economic life of fixed assets rather than their current market value. Companies assume that their business will continue for an indefinite period of time and the assets will be used in the business until fully depreciated. Another example of the going concern assumption is the prepayment and accrual of expenses. Companies prepay and accrue expenses because they believe that they will continue operations in future.

System of Keeping Recording



Single entry system: A single entry system records each accounting transaction with a single entry to the accounting records, rather than the vastly more widespread double entry system. The single entry system is centered on the results of a business that are reported in the income statement.

Double entry system: The double-entry system of accounting or bookkeeping means that for every business transaction, amounts must be recorded in a minimum of two accounts. The double-entry system also requires that for all transactions, the amounts entered as debits must be equal to the amounts entered as credits.

Principles of Double Entry system

The following are main principles of double entry system:

- For every transaction, two parties must be interested
- Every business transaction has two aspects, one of receiving the benefit and the other of giving it. In simple words, “Double entry” system means “every debit has a corresponding credit”.
- Both the aspects, are recorded in the books of account.
- The two-fold effect of a business transaction is recorded by debiting one account and crediting the other account at the same time.

Principle of Conservatism

The conservatism principle is the general concept of recognizing expenses and liabilities as soon as possible when there is uncertainty about the outcome, but to only recognize revenues and assets when they are assured of being received. Thus, when given a choice between several outcomes where the probabilities of occurrence are equally likely, you should recognize that transaction resulting in the **lower amount of profit, or at least the deferral of a profit**. Similarly, if a choice of outcomes with similar probabilities of occurrence will impact the value of an asset, recognize the transaction resulting in a lower recorded asset valuation.

Under the conservatism principle, if there is uncertainty about incurring **a loss, you should tend toward recording the loss**. Conversely, if there is uncertainty about recording a gain, you should not record the gain.

The conservatism principle can also be applied to recognizing estimates. **For example**, if the collections staff believes that a cluster of receivables will have a 2% bad debt percentage because of historical trend lines, but the sales staff is leaning towards a higher 5% figure because of a sudden drop in industry sales, use the 5% figure when creating an allowance for doubtful accounts, unless there is strong evidence to the contrary.

Accrual Concept



The accrual concept makes a distinction the receipt of cash and right to receive, it and the payment of cash and the legal obligation to pay it. In actual business operations, the obligation to pay and the actual movement of cash may not coincide. The accrual recognises this distinction. In connection with the sale of goods, revenue may be received.

- Before the right to receive arise, or
- After the right to receive has been created.

Unit 3- Maintenance of Cash/ Subsidiary Books and Ledger

Record Keeping Basics

Journal

The form of a journal contains a column Ledger folio. Journal records each transaction. However, if anyone wants to find out transactions affecting a personal account or an expense account, he will have to turn over pages of journal, add all debits and credits and then find out the balance of a particular account.

Cash Book

The Book that keeps records of all cash transactions, i.e. cash receipts and cash payments is called a cash book. Its ruling is like a ledger account and is divided into two sides, viz, debit and credit. All receipts are recorded on the debit side whereas all payment are recorded on the credit side. Since it serves the function of cash account, there is no need for opening cash account in the ledger.

Accounting cycle includes the following:

Recording: In the first instance, all transactions should be recorded in the journal or the subsidiary books as and when they take place.

Classifying: All entries in the journal or subsidiary books are posted to the appropriate ledger account to find out at a glance the total effect of all such transactions in a particular account.

Summarising: The last stage is to prepare the trial balance and final accounts with view to ascertain the profit or loss made during a particular period and the financial position of the business on a particular date.

Ledger

The Ledger is the principal book of accounts where similar transactions relating to a particular person or property or revenue or expense are recorded. In other words, it



is a set of accounts. It contains all accounts of the business enterprise whether real, nominal or personal. **The main function** of a ledger is to classify or sort out all the items appearing in the journal or the other subsidiary books under their appropriate accounts, so that at the end of the accounting period each account will contain the entire information of all the transactions relating to it in a summarized or condensed form.

Relationship Between 'Journal' and 'Ledger'

BASIS FOR COMPARISON	JOURNAL	LEDGER
Meaning	The book in which all the transactions are recorded, as and when they arise is known as Journal.	The book which enables to transfer all the transactions into separate accounts is known as Ledger.
What is it?	It is a subsidiary book.	It is a principal book.
Also known as	Book of original entry.	Book of second entry.
Record	Chronological record	Analytical record
Process	The process of recording transactions into Journal is known as Journalizing.	The process of transferring entries from the journal to ledger is known as Posting.
How transactions are recorded?	Sequentially	Account-wise
Debit and Credit	Columns	Sides
Narration	Must	Not necessary.
Balancing	Need not to be balanced.	Must be balanced.

Journalise the following transactions and post them in their respective ledger accounts.

2016		Rs.
May 2	Paid interest to Loan	4,000
May 3	Ramesh who owed Rs.3,000 has become insolvent. He pays 50 paise in rupee in full settlement.	



May 4	A cheque received from Ranjan deposited into bank was returned dishonored.	6,300
May 5	Wood used for making office furniture.	5,000
May 21	Due from Rama are bad debts.	600
May 25	Purchased building and issued cheque.	4,300

Journal Entry

Date	Particulars	L.F.	Dr. Rs.	Cr. Rs.
2016 May 2	Interest to Loan A/c To Cash A/c (Being interest payment made on loan)	Dr.	4,000	4,000
May 3	Cash A/c Bad Debts A/c To Ramesh A/c (Being 50 paise in rupee received from Ramesh out of the debt of Rs.3,000 in full settlement)	Dr. Dr.	1,500 1,500	3,000
May 4	Ranjan A/c To Bank A/c (Being the cheque deposited into bank dishonoured)	Dr.	6,300	6,300
May 5	Furniture A/c To Purchases A/c (Being the wood used in making office furniture)	Dr.	5,000	5,000
May 21	Bad Debts A/c To Rama A/c (Being the bad debts written off)	Dr.	600	600
May 25	Building A/c To Bank A/c (Being the goods purchased and payment made through cheque)	Dr.	4,300	4,300

Account Categories

Classification of Accounts: Accounts are broadly classified into two classes:

- Personal Accounts and



- Impersonal Accounts

The Letter is further sub-divided into:

- Real Accounts
- Nominal Accounts

Personal Accounts

These accounts show the transactions with customers, suppliers, moneylenders, banks and the owner.

Personal accounts can take the following forms:

- **Natural Personal accounts:** The term natural person means persons who are the creation of God. For example, proprietor's account, supplier's account, receiver's account (Abhinav a/c, Alpa A/c).
- **Artificial personal accounts:** These accounts include the accounts of corporate bodies or institutions that are recognised as persons in business dealings. Example: firm's a/c , club a/c.
- **Representative personal account:** These are accounts that represent a certain person or group of person. Example: Salary outstanding, Rent prepaid etc.

There following list indicates, some more of the usual accounts coming under each category: (Personal accounts)

- Bank (an artificial Person)
- Tata Iron & Steel Co. (a Company)
- Alpa (an Individual)
- Capital (Abhinav –owner)
- Bank loan (an artificial person)
- Rent outstanding (representative personal account)

Impersonal Accounts

Real Accounts

Real accounts may be of the following types:



Tangible real accounts: These are accounts of such things that are tangible, i.e, which can be seen, touched, physically. Example: Land, building, cash etc.

Intangible real accounts: These account represent such things that cannot be touched. Example: Trademarks, Patent right etc.

There following list indicates, some more of the usual accounts coming under each category: (Real accounts)

- Plant and machinery
- Investment
- Land and building
- Stock in hand
- Bill receivable
- Trademarks
- Cash

Nominal Accounts

Nominal accounts are opened in the books to explain the nature of the transactions. Example: Salary is paid to the employees, rent is paid to the property owner etc.

There following list indicates, some more of the usual accounts coming under each category: (Nominal accounts)

- Interest
- Salaries
- Rent
- Carriage
- Commission received
- Insurance
- Discount received
- Wages
- Credit and Debit Concepp

Accounting and columnar accounting mechanics



Cash book may be defined as the record of transactions concerning cash receipts and cash payments. In other words, in cash book, all transactions (i.e receipts and payment of cash) are recorded as soon as they take place. Cash book is in the form of an account and actually it serves the purpose of a 'Cash Account'.

Cash book thus serves the purpose of a book of original entry as well as that of a ledger account. A cash book has the following features:

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

Types of Cash book

Simple (Single column) cash book: This cash book will only record cash transactions. The cash coming in (receipts) will be on the left and the cash payments will be on the right. And since we will record all cash transactions here there is no need for a cash ledger account.

Date	Particulars	L.F	Receipt No.	Amount	Date	Particulars	L.F.	Vr. No.	Amount

Date: The date on which cash is received or paid is entered in this column.

Particulars: The name of the account in respect of which the amount is received or paid is shown.

LF (Ledger folio): The column shows page number of the ledger where the entry has been posted.

Two Column Cash Books

Here instead of one column, we have an additional column for discounts. So along with the cash transactions, we will also record the discounts in the same cash book. So both discounts received and the discount that is given is recorded here. If any organization is in a general practice of giving or receiving discounts this is the preferable option.

Discount is a nominal account – so the discount is given (loss) is on the debit side and discount received (profit) is on the credit side. At the end of the period, we balance both columns and transfer the closing balances.



Prepare a two column cash book from the following entries

Cash in Hand – 15000

Received from ABC – 4800; Discount – 200

Goods bought for cash 1500

Cash paid to LMN – 2400; Discount – 100

Cash Book

Sr No	Particulars	Cash	Discount	Sr No	Particulars	Cash	Discount	Sr No
1	To Bal b/d	15000		1	By Goods Purchase A/c	1500		
2	To ABC A/c	4800	200	2	LMN A/c	24000	1000	
					By Bal c/d	5700		
		19800	200			25500	1000	
	To Bal b/d	5700						

Three Column Cash Books

This cash book has the cash, the discount and additionally the bank columns in it. Since the development of banking most firms, these days prefer to deal in cheques or other such bills of exchange. And so having a bank column in your cash book makes things concise and simpler to understand.

So when you receive a cheque and you deposit it in the bank the same day you make the entry in the bank column (the debit side in this case). But say you send the cheque later (not the same day) then this will be a contra entry. A contra entry is transactions that



happen between a cash account and a bank account. Ultimately your Cash & Bank balance remains the same, the money just moves around.

Petty Cash Book

In a firm, there are usually cash transactions happening in all the departments. These we will record in one of the above formats of cash books. But there are many cash transactions happening for very small amounts. Sometimes there are dozens of such transactions that occur in just one day. These are known as petty transactions. Examples are expenses for postage, stationery, traveling, food bills, etc.

So since the number of such transactions tends to be very high we maintain a separate cash book for them – the petty cash book. Such a cash book is maintained by the petty cashier (who in most cases also handles the petty cash).

Two types of petty cash book:

- Simple petty cash Book
- Columnar Petty cash Book

Journalising

Journalising refers to recording business transactions systematically and in a summarised form in the journal. It means a process of entering the twofold effects of transactions in the form of debit and credit in the journal.

Date	Particulars	L.F	Debit Amount	Credit Amount
(i)	(ii)	(iii)	(iv)	(v)

Date: In the first column the date of the transaction is entered, the year is most probably written on the top of the column than to repeat it every day.

Particulars: Here the accounting entry is written in a summarised form of debit and credit. The names of the accounts involved in the transaction are written in the journal entry.

On the first line, the account is debited, the word “Dr.” is written at the right end of the same line of account debited.

On the second line, the account credited is written with a prefix “To” after leaving a little space towards the start.

Immediately below the entry, a small explanation of the transaction called ‘narration’ is written. The narration begins with the word “Being”.



Ledger Folio No. (L.F.): In this column, the page number of the Ledger in which the journal entry is posted, is recorded. This also helps in easy cross verification and reference in the future.

Debit Amount: The amounts to be debited to the accounts concerned or involved are written.

Credit Amount: The amounts to be credited to the accounts concerned or involved are written.

Rules for Journalising Transactions: (Golden rules of Accountancy)

Personal Account: It relates to persons (natural or legal) with whom a business keeps dealings.

Rule: Debit the receiver and Credit the giver.

E.g. Goods worth Rs. 5000/- sold to Alpa. Here, because Alpa is the receiver of goods so it is to be debited.

Real Account: It relates to property or goods which may come or go from the business.

Rule: Debit what comes in and Credit what goes out.

E.g. Goods worth Rs. 7000/- sold on cash. Here, cash a/c is to be debited because cash flows out.

Nominal Account: It relates to business expenses, losses, incomes, and gains.

Rule: Debit all the expenses or losses and Credit all the incomes, gains or profits.

E.g. Paid Rs. 2000/- as commission to the agent. Here, commission a/c is debited because it is a business expense.

Solved Example for You

Question: Journalise the following transactions in the Journal of Mr. Abhinav for the year 2018

- January 1 – Paid rent Rs. 4000/-
- January 2 – Sold goods to Harsh for Rs. 10,000/-

Answer:

In the Journal of Mr. Abhinav



Date	Particulars	Debit Amount	Credit Amount
2018 01/01	Rent A/c Dr. To Cash A/c (Being rent paid)	4000	4000
02/01	Harsh A/c Dr. To Goods A/c (Being goods sold to Harsh on credit)	10,000	10,000
Total		14,000	14,000

Unit 4- Bank Reconciliation Statement

Recording Transactions in cash Book

Record the following transactions in a bank column cash book for December 2019:

		₹
01	Started business with cash	80,000
04	Deposited in bank	50,000
10	Received cash from Abhinav	1,000
15	Bought goods for cash	8,000
22	Bought goods by cheque	10,000
25	Paid to Alpa by cash	20,000



		₹
30	Drew from Bank for office use	2,000
31	Rent paid by cheque	1,000

Cash book									
Dr.					Cr.				
Date	Receipts	L.F.	Cash ₹	Bank ₹	Date	Payments	L.F.	Cash ₹	Bank ₹
2019					2019				
01 Dec	Capital		80,000		04 Dec	Bank	C		50,000
04 Dec	Cash	C		50,000	15 Dec	Purchases		8,000	
10 Dec	Abhinav		1,000		22 Dec	Purchases			10,000
30 Dec	Bank	C	2,000		25 Dec	Alpa		20,000	
					30 Dec	Cash	C		2,000
					31 Dec	Rent			1,000
					31 Dec	Balance c/d		5,000	37,000
			83,000	50,000				83,000	50,000

Cash Book and Passbook

BASIS FOR COMPARISON	CASH BOOK	PASSBOOK
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Meaning	A book that keeps a record of cash transactions is known as cash book.	A book issued by the bank to the account holder that records the deposits and withdrawals is known as passbook.
Prepared by	Firms	Bank
Side affected	Receipts will be shown in the debit side while payments are entered in credit side.	Deposits will be shown in credit side while withdrawals are shown in debit side.
Preparation	Discretionary	Compulsory
Recording of cheque deposited for collection	Date of deposit	Date on which the amount is actually collected from the debtor's bank
Recording of cheque issued to the creditor	Date of issue.	When the amount is paid by the bank to the creditor.
What do the balances reflect?	Debit balance shows cash at bank while the credit balance shows overdraft.	Debit balance shows overdraft while the credit balance shows cash at bank.

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Understanding Reconciliation

The Bank statement is received periodically, say every month. We check it for clerical and if any errors are found, we obtain a revised statement containing no errors. ***The balance is this statement gives us a firm starting point to proceed for:***

- Finding out entries which do not requires change in cashbook (these entries are present in the cashbook but not in the bank statement). These entries give us the 'Adjusted bank balance'.
- Finding out clerical mistake in our cashbook and rectifying them.
- Finding out entries which require change in our cashbook (these entries are present in the statement but not in the cashbook).

Preparing Reconciliation Statement

Based on these 3 steps, we can prepare a statement called "Bank Reconciliation". It is pertinent to note that step 1 gives the adjusted bank balance which is a national figure and not the actual balance in the account with in bank while step 2 and 3 result in actually changing the balance in the cashbook by correction of errors and posting of missing entries.



This cash book balance should be equal to the adjusted bank balance as arrived in step 1. This is balance which goes to the trial balance and balance sheet.

Bank Reconciliation Statement as in_____

Closing balance in bank statement	Rs.....
Adjustments to the balance in the bank statement	Rs
(a)Add: cheque deposited but not yet credited	Rs
(b)Subtract: Cheque issued but not presented to the bank for payment	
Adjusted balance in the bank statement	Rs A

Balance as per cashbook	Rs.....
Adjustment made to cashbook	Rs.
(a)Add or subtract: clerical errors	
(b) Add: Credit entries shown in the bank statement but not appearing in cash book	Rs.....
(c)Subtract: Debit entries shown in the bank statement but not appearing in cashbook	Rs.
Adjusted (corrected) cashbook balance	Rs.B

Need for Preparing a Bank Reconciliation Statement

- Accuracy
- Check on the Entries
- Rectifying Incorrect Entries
- Updated Cash Book
- Detection of Delays
- Check on the Dishonest Behavior of Employees

Example:



The cash book of Mr Abhinav shows Rs 8364 as the balance at the bank as on 31 December 2018, but you find this does not agree with the balance as per the bank pass book, which shows a balance of Rs 15534.

On scrutiny, you find the following discrepancies:

- On 1st December, the payment side of the cash book was undercast by Rs100
- A cheque of Rs 131 issued on 25th December, was not taken in the bank column.
- One deposit of Rs 150 was recorded in the cash book as if there is no bank column therein.
- On 18th December, the debit balance of Rs 1526 as on the previous day, was brought forward as credit balance.
- Of the total cheque, amounting to Rs 11,514 drawn in the last week of December, cheques aggregating to Rs 7815 were encashed in December.
- Dividend of Rs 250, collected by bank and, subscription of Rs 100, paid by it, were not recorded in the cash book
- One out-going cheque of Rs 350 was recorded twice in the cash book.

Rough working: Correction of cash book for errors

Item	Debit	Credit
Deposit entry (shown in cash column)	150	
Wrong carry forward of balance	3052	
Outgoing cheque recorded twice	350	
Undercasting payment side		100
Cheque issued		131
Total	3552	231

The bank reconciliation statement will be as under:



Closing balance in bank statement	Rs 15534	
Adjustments to the balance in the bank statement		
(a) Add: cheque deposited but not yet credited		
(b) Subtract: Cheque issued but not presented to the bank for payment	Rs 3699	
Adjusted balance in the bank statement	Rs 11835	A

Balance as per cashbook	Rs 8364	
Adjustment made to cashbook		
(a) Add or subtract: clerical errors	Rs. 3321	
(b) Add: Credit entries shown in the bank statement but not appearing in cash book	Rs. 250	
(c) Subtract: Debit entries shown in the bank statement but not appearing in cashbook	Rs. 100	
Adjusted (corrected) cashbook balance	Rs. 11835	.B

How to prepare a Bank Reconciliation statement when extracts of cash Book and Pass Book are given

When the cash book and pass book abstracts are given, the following points should be noted.

- Find out the period for which both the abstracts are given
- Compare the cash book debit side with the pass book credit side and the cash book credit side with the pass book debit side.
- When the period for which both the abstracts are given is common, i.e. the cash book abstract relates to January and the pass book abstract is also given for January, take into account only uncommon entries.



- When the period for which both the abstracts are given is uncommon, i.e, the cash book relates to January but the pass book relates to February, take into account only common entries.
- Where the period is same, uncommon entries will appear in the reconciliation statement.
- When the period is different, common entries will appear in the reconciliation statement.

Adjusting The Cash Book Balance

We have learnt that certain entries appear in the pass book first and then by comparing the pass book with the cashbook, these missing entries are incorporated in the cash book. The trader must know the correct bank balance at any time so that he can issue cheques only to the extent of the available bank balance. Therefore, preparing a bank reconciliation statement, the accountant makes the necessary corrections in the cash book and adjusts the cash book balance.

The items, which can usually be adjusted in the cash book are:

- Payment made by bank as per standing instructions.
- Bank charges, interest on bank overdraft debited by the bank.
- Collection of interest in securities and dividend on shares by bank.
- Debits for the dishonor of cheques in the pass book.
- Direct deposits made by customers of the trader.
- Errors committed in the cash book.

Advantages of Bank Reconciliation Statement

Following are the advantage of preparing the bank reconciliation statement:

- It helps the management to check the accuracy of the entries made in the cash book.
- It helps to detect errors and to take timely action for the correction of balances.
- It is a very important control technique for the management.
- It shows the correct bank balance at any particular time
- It reveals frauds committed by the staff handling cash and cheques and thus, helps the management to have effective control.

Unit 5- Trial Balance, Rectification of Errors and Adjusting & Closing Entries

Trial Balance



Multiple entries in various accounts will make a Ledger. Taking all the ledger balances and presenting them in a single worksheet as on a particular date is Trial Balance.

To understand a trial balance, we must first understand the following:

- **Double entry system** – Recording two entries for a single transaction that is equal and opposite in nature
- **Journal** – All transactions recorded in double entry system of bookkeeping
- **Ledger** – Summary of all journals of a similar nature.

Features and Purpose of a Trial Balance

- It is a list of debit and credit balance drawn from ledger.
- It includes cash and Bank balance.
- Its main purpose is to establish arithmetical accuracy of transactions recorded in the books of account.
- It is usually prepared at the end of the year but it can also be prepared any time, as and when required, e.g, monthly, quarterly or half yearly.\
- It enables the trader to know amounts receivable from customers and amounts payable to suppliers.
- It facilities preparation of final accounts.

Types of Trial Balance and Preparation of Trial Balance

There are two types of Trial balance:

- Gross Trial Balance
- Net Trial Balance

Gross Trial Balance

It is Prepared in the following stages:

- Take totals of debit and credit columns of each ledger account.
- Take totals of receipts and payments of cashbook showing separately cash, bank and discount columns.
- Write names of all accounts as per the ledger and cash, bank and discount accounts as per cash book onto a statement.
- Enter the debit and credit totals against each item.
- Finally take total of debit and credit columns.

Example:



On 31st March 2014, the totals of debit and credit sides of various ledger accounts and receipts and payments sides of cash and bank columns of cash book of Mr. Abhinav are as under:

Total of debit side (Rs.)	Name of the account	Total of credit side (Rs.)
10,000	Abhinav Capital	1,35,000
25,000	Drawings	-
15,000	Stock on 31 st March, 1996	-
1,90,000	Purchases	4,000
-	Purchases Returns	18,000
6,000	Sales	2,45,000
13,000	Sales Returns	--
12,000	Expenses	-
3,05,000	Customers	2,50,000
2,00,000	Suppliers	2,35,000
1,00,000	Car	-
2,81,000	Dena Bank	2,75,000
43,000	Cash	38,000

Solution

Gross Trial Balance as on 31st March 2014

Name of the Account	L.F	Debit (Rs.)	Credit (Rs.)
Abhinav Capital		10000	1,35,000
Drawings		25000	--
Stock on 31 st March, 2013		15000	--
Purchases		190000	4000
Purchases Returns		--	18000



Sales		6000	2,45,000
Sales Returns		13000	--
Expenses		12000	--
Customers		3,05,000	2,50,000
Suppliers		2,00,000	2,35,000
Car		1,00,000	--
Dena Bank		2,81,000	2,75,000
Cash		43,000	38,000
Total		12,00,000	12,00,000

Net Trial Balance

Under this trial Balance, net balance of each amount are drawn and shown in trial balance. If debit total of an account is more, it will show debit balance and of credit total of an account is more, it will show a credit balance.

Net Trial Balance as on 31st march 2014

Name of the Account	L.F	Debit (Rs.)	Credit (Rs.)
Abhinav Capital			1,25,000
Drawings		25000	--
Stock on 31 st March, 2013		15000	--
Purchases		186000	
Purchases Returns		--	18000
Sales			2,39,000
Sales Returns		13000	--
Expenses		12000	--
Customers		55000	--
Suppliers			35,000
Car		1,00,000	--



Dena Bank		6000	
Cash		5000	
Total		4,17,000	4,17,000

Disagreement of a Trial Balance

Disagreement of a trial balance may be caused by the wrong totaling or balancing of ledger accounts. While totaling the figure of subsidiary books there may arise some errors that will cause disagreement of trial balance. Omission to post a ledger balance also causes the disagreement of a trial balance.

Classification of Errors

Errors can be broadly divided into two type:

- Clerical Errors
- Principle Errors

Clerical Errors

- Errors of Omission,
- Errors of Commission, and
- Compensating errors.

Errors of Omission

The Errors of Omission will occur when a transaction is not recorded in the books of accounts or omitted by mistake. The Errors of Omission two types.

- Partial
- Complete

The partial errors may happen in relation to any subsidiary books. This is the result of when a transaction is entered in the subsidiary book but not posted to the ledger. For example, cash paid to the suppliers has been entered in the payment side of the cash book but it will not be entered in the debit side of the suppliers account.

The complete omission may happen the transaction is completely omitted from the books of accounts. For example, an accountant fails to enter a specific invoice from the sales day book.

Errors of Commission



When a transaction is entered in the books of accounts in wrongly, this may be entered as partially or incorrectly. This kind of errors are known as Errors of Commission. The Errors of Commission may happens because of ignorance or negligence of the accountant. This may be of different types, the main reasons are Errors relating to subsidiary books and Errors relating to ledger. **Following are some of the examples:**

- Posting of correct amount but on the wrong side
- Posting of a wrong amount but on the correct side
- Posting of a wrong amount amount on wrong side of an account

Compensating Errors

Compensating Errors are those errors which compensates themselves in the net results of the business. This means, if there are over debit in one account which will be compensated by the over credit in some account in the same extent of the business. Like that, if there is a wrong debit in one account which will be neutralized by some wrong credit in the same extent of the business.

Errors of Principles

This kind of errors are occurs when the entries are made against the principle of accounting. These Errors are made because of the following reasons:-

- Errors happens due to the inability to make a distinction between the revenue and capital items.
- Errors happens due to the inability to make a difference between the business expenses and personal expenses.
- Errors happens because of the inability to make a distinction between the productive expense and nonproductive expenses.

Rectification of Errors

One- sided Errors

These errors affect only one account. Thus, these are one-sided errors. We can rectify these errors by giving an explanatory note in the account or by passing a journal entry with the help of Suspense A/c. When we detect an error before posting to the ledger, we can correct it by simply crossing the wrong amount, writing the correct amount above it and initializing it. Similarly, we can also correct an error in the ledger account.

Errors of casting, errors of carrying forward the balances, errors of balancing the accounts, errors of posting the wrong amount in the correct account, error of posting in the correct



account on the wrong side, omitting to show an account in the trial balance, posting in wrong side with wrong amount are the examples of errors affecting the Trial Balance.

Two-sided Errors

These errors affect two or more accounts simultaneously. Thus, these are two-sided errors. We can rectify these by passing a journal entry giving the correct debit and credit to the accounts. In order to rectify an error, we need to cancel the effect of wrong debit or credit by reversing it and restore the effect of correct debit or credit.

When there is short debit or excess credit in an account we need to debit the concerned account. Whereas, when there is short credit or excess debit in an account we need to credit the concerned account.

Complete omission to record an entry in the journal or the subsidiary books, incorrect recording of transactions in the books, complete omission of posting and errors of principle are the examples of these errors.

Suspense Account

When the trial balance does not tally due to the one-sided errors in the books, an accountant puts the difference between the debit and credit side of the trial balance on the shorter side as the Suspense A/c. As and when we locate and rectify the errors, the balance in the Suspense A/c reduces and consequently becomes zero. Thus, we cannot categorize the Suspense A/c. It is a temporary account and can have debit or credit balance depending upon the situation.

While using the Suspense A/c to rectify the one-sided errors, the accountant needs to follow the following steps:

- Identification of the account with the error.
- Ascertainment of the excess debit or credit or short debit or credit in the above account.
- In case of short debit or excess credit in an account, we need to debit the concerned account. Whereas, in case of short credit or excess debit in an account we need to credit the concerned account.
- Pass the necessary journal entry by debiting or crediting the Suspense A/c

Example

Q: Trial Balance of M/s Srivastav Enterprises did not agree. It puts the difference to the Suspense A/c. Rectify the following errors and prepare the Suspense A/c to ascertain the original difference in the trial balance.

Amount paid for the installation of the machinery ₹10000 was posted to the Repairs and maintenance A/c.



Total of Purchases book ₹50000 was not posted to the ledger.

Goods returned to John ₹3000 were recorded in Sales Book.

Salary paid to Ram ₹6000 was debited to his personal account.

Depreciation written-off on furniture ₹500 was not posted to the furniture account.

Ans: In the books of M/s Srivastav Enterprises

Date	Particulars		Amount (Dr.)	Amount (Cr.)
1.	Machinery A/c	Dr.	10000	
	To Repairs and Maintenance A/c			10000
	(Being rectification of the wrong journal entry in the Repairs and maintenance A/c)			
2.	Purchases A/c	Dr.	50000	
	To Suspense A/c			50000
	(Being rectification of the omission to post the total of purchases book in the ledger)			
3.	Sales A/c	Dr.	3000	
	To Purchases Return A/c			3000
	(Being rectification of wrong recording of the purchases return in the sales book)			
4.	Salary A/c	Dr.	6000	



	To Ram's A/c			6000
	(Being rectification of wrong debit to the personal account of an employee)			
5.	Suspense A/c	Dr.	500	
	To Furniture A/c			500
	(Being rectification of omission of posting in the furniture account)			

Suspense A/c

Date	Particulars	Amount		Date	Particulars	Amount
	Difference as per Trial balance	49500		2.	By Purchases A/c	50000
5.	To Furniture A/c	500				
		<u>50000</u>				<u>50000</u>

Adjusting and Closing Entries

Adjusting Entries

Final Account are the accounts which are prepared at the end of the trading year. These accounts show the final results of the business carried out. Final accounts are prepared to find out profit earned or loss sustained by a concern.

At the end of the accounting year, all ledger accounts are balanced and then trial balance is prepared. From the trial balance, final accounts, i.e. trading, profit and loss account and balance sheet are drawn. While preparing trading and profit and loss account, all expenses



and incomes for the full period are to be taken into consideration. If expenses have been incurred but not paid or income is due but not received, necessary entries are required to be passed to show the correct picture of the business. These entries are called “Adjusting Entries”.

Closing Entries

At the end of cash year, all accounts of expenses and incomes must be closed. The balance of these accounts are transferred to trading account and profit and loss account. The entries passed to transfer these balances are called “Closing entries”.

Unit 6- Capital and Revenue Expenditure

Expenditure

Expenditure means spending on something. This can be a payment in cash or can also be the exchange of some valuable item in exchange for goods or services. It is the process of causing a liability by a commodity. Receipts and invoices keep the records of expenditures. An expense is a word very similar to expenditure but expense shows the deduction in the value of the asset while expenditure simply denotes the obtaining of assets. *Two types of expenditures are present on the basis of time durations, That is*

- Capital expenditures
- Revenue expenditures

Capital Expenditures

These are expenditures for high-value items that holds longer duration requirements. Capital expenditures are long-term expenditures. In other words, when the expenses are made for a particular asset but they do not get completely consumed in the specific time. Due to this the earning capacity increases, and in the meanwhile, the price of the assets decreases. **Example:** Cash money spent on business purposes, Purchasing of Plants and machinery items Etc.

Revenue Expenditures

In contrast to the capital expenditure, revenue expenditures are not the high-value items, instead, they are the routine expenditures that takes place in the normal business. In other words, this kind of expenditure maintains fixed assets.

Unlike capital expenditure, earnings do not increase but stay maintained in revenue expenditure. **The assets get consumed in an accounting year and no future benefits are available.**



Capital VS Expenditure

Capital Expenditure	Revenue Expenditure
Amount spent of usually large.	Amount spent is relatively small.
The purpose is to improve or enhance business or productive or earning capacity	The Benefit is short duration
The benefit of long duration	The benefit is short duration
It is non-recurring	It is recurring
It is shown in balance sheet	It is shown in profit and loss account.
Not matched with capital receipts	Matched with revenue receipts

Receipts

Capital Receipts

Capital Receipts are from issue of Equity/ Preference share/ Capital Instruments or from sale of Disposal of fixed Assets/Long Term investment or from Grants received from Government for Building of Capital Assets. Capital receipts are not routed through Profit & Loss account. However profit/loss, if any, arising from such transactions is recorded in the P & L account.

Revenue Receipts

Revenue Receipts are from day to day operation of the company or receipts where is no further obligation on the entry to perform certain actions. Revenue Receipts are routed through Profit and loss account.

Unit 7- Bills of Exchange

Types of Instruments of Credit

In a business, credit transactions play very important role. For manufacturing goods, manufacturer purchases raw materials, the majority of which will be on credit.

Credit may also be granted by a moneylender, a banker or financial institution. Credit is, generally, provided by obtaining, a written document called 'Instrument of Credit'. The serves as a proof of existence of credit.

- Bills of Exchange
- Promissory Notes



Bills of Exchange

- **Drawer:** A person who draws the bill.
- **Drawee:** A person on whom the bill is drawn
- **Payee:** A person who is going to receive money.

Features of Bills of Exchange

- A bill of exchange an instrument in writing.
- It is drawn and signed by the maker i.e. drawer of the bill.
- Contains an unconditional order to a person i.e. drawee.
- The specified amount is payable to the person whose name is mentioned in the bill or to his order or to the bearer.
- It specifies the date by which amount should be paid. (Section 5 of Negotiable Instrument Act).
- Payment of the bill must be in the legal currency of the country.
- It must be properly stamped.
- It must bear a revenue stamp.

Bills of Exchange Example

Mr. Abhinav srivastav draws a bill on Ms. Alpa jha for 3 months for ₹ 50,000, payable to Mr. Niraj kumar or his order on 15th April 2019.

Mr. Abhinav srivastav has ordered Ms. Alpa jha to pay ₹ 50,000 to Mr. Niraj kumar. If the order is acceptable to Ms. Alpa jha, he will write across the bill as follows:

Accepted

Ms. Alpa jha

Sector 56, Noida, UP

17th April 2019

When the drawee writes such acceptance on the bill, it becomes a bill of exchange. In the above example Mr. Abhinav srivastav is the drawer of the bill, Ms. Alpa jha is the acceptor and Mr. Niraj kumar is the Payee. Ms. Alpa jha will pay the amount to Mr. Niraj kumar.

Promissory Notes



A written undertaking by the buyer to make a payment on a specified date can take the form of a bill of exchange or a promissory note. We have seen earlier that a bill of exchange is drawn by the creditor and accepted by the debtor. A promissory notes, on the other hand, is written by the debtor (buyer) promising the creditor (seller) to pay a specified sum after a specified period. Thus, it can be defined as:

Features of Promissory Notes

- An instrument in writing
- Containing an unconditional undertaking
- Signed by the maker to pay a certain sum of money
- To or to the order of a certain person or the bearer of the instrument (section 4 of the Negotiable instrument Act)

In a case of Promissory notes, there are two parties:

- **Maker:** A person who makes the note and promises to make the payment.
- **Payee:** A person who is to receive money.

Or

- **The holder:** A holder is basically the person who holds the notes. He may be either the payee or some other person.

Essential Elements of a Promissory Note

- Written notes
- Express undertaking
- Unconditional promise
- Specific amount
- Legal tender

Example:



Promissory Note

Amount Date

Stamp

Term months after date, I promise to pay _____ or order, The sum of _____, for value received.

Signature
Name of Maker
Address of Maker

Difference between Bills of Exchange and Promissory Note

Bills of Exchange	Promissory Notes
It is an unconditional order to pay	It is an unconditional promise to pay.
It is made by a creditor.	It is made by a debtor.
Acceptance by debtor is necessary	No acceptance is required
On dishonor of a bill, it is usually noted by the notary Public.	Nothing is not necessary.

Cheque

Essential Features of cheque

- A cheque must have to fulfill all the essential elements of a bill of exchange.
- It must be payable to bearer or to order but in either case, it must be payable on demand.
- The banker named pays it when it is presented for payment.
- The signature must tally with the specimen sign of the drawer kept in the bank
- A cheque must be dated.



- A cheque drawn with a future is valid but the same is payable on or after such specified period.

Difference between Bills of Exchange and Cheque

Bills of Exchange	Cheque
A bill of exchange can be drawn upon any person including a bank.	A cheque can be drawn only upon a bank.
A bill of exchange requires acceptance.	A cheque does not requires any acceptance
The acceptor of a bill of exchange is allowed three days of grace after the date maturity of the bill.	A cheque is always payable on demand
Notice of dishonor is necessary	Notice does not requires any stamp.
A bill of exchange must be stamped	A cheque does not require any stamp.

Accommodation Bill

Accommodation Bills are drawn and accepted with no consideration passed or received. The Bill, which is drawn just to oblige a friend, who is in need of money, of course without any trading activities, with sole intention of raising funds required for ready cash is known as Accommodation Bill.

The accommodating party, i.e., the drawee accepts the Bill drawn by the accommodated party (drawer). That is the Drawer of the accommodation bill can be called accommodated party and drawee can be called accommodating party. After the Bill is accepted, the drawer discounts it with a bank and obtains the cash.

Before the due date of the Bill, Drawer provides funds to the Acceptor, who honours the Bill. Since the acceptance is given without consideration and to help the accommodated party to raise the funds, the accommodated party has to discharge the Bill by himself or provide funds to accommodating party.

Thus, there is always a mutual understanding between the parties and hence, **these bills are called Accommodation Bills.**

Example:

Mr. A accepted a bill for Rs 20,000 drawn by B to enable the latter to raise funds at three months on 1st October 2004. The bill was duly discounted by B at their Bank at 6% per



annum. On the due date B remitted the amount to the acceptor and the Bill was duly met. Pass journal entries in the books of both the parties.

SOLUTION

B's Journal				A's Journal				
			Rs	Rs		Rs	Rs	
2004 Oct. 1	Bills Receivable Account To A Account (Being Bill drawn on A for 3 months)	Dr.	20,000	20,000	B Account To Bills Payable Account (Being acceptance of Bill drawn by B)	Dr.	20,000	20,000
Oct. 2	Cash Account Discount on Bills Account To Bills Receivable (Being Bill discounted at 6% p.a.)	Dr.	19,700 300	20,000	NO ENTRY			
2005 Jan. 4	A Account To Cash Account (Being amount paid to A to meet the Bill on the due date)	Dr.	20,000	20,000	Cash Account To B Account (Being cash received from B to honour the Bill)	Dr.	20,000	20,000
Jan. 4	NO ENTRY				Bills Payable Account To Cash Account (Being bill honoured on maturity)	Dr.	20,000	20,000

Discount: $20,000 \times \frac{6}{100} \times \frac{3}{12} = \text{Rs } 300$

Two types of Bill Books

- Bills Receivable Book
- Bills Payable Book

Bills Receivable Book

Bills receivable book is a book where all the bills, which are received, are recorded and posted directly to the credit of respective customer's account from there. The total amount of bills so received during the period, either at the end of the week or month, is to be posted to, in one lump sum, to the debit of the bills receivable account. **The usual form of bills receivable book, with imaginary figures is shown below.**

N o.	Date of Receipt	From whom	Accept or	Date of bill	Term	Date due	Where payable	Amount	L. F	How Disposed off	Remarks
1	1/1/20	A	A	1/1/20	1 month	1/1/20	Delhi	4000	-	-	-



Bills Payable Book

This is a book where all particular relating to the bills accepted are recorded and , posted from there, directly to the debit of the respective creditor's account. The total amount of the bills so accepted during the period, either at end of the week or month, is to be posted in one lump sum to the credit of bills payable account. **The usual form of 'Bill payable book' with imaginary figures,**

No .	Date of Receipt	Drawn by	Payee	Date of bill	Term	Date due	Where payable	Amount	L. F	How Disposed off	Remarks
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Important Terms

Honouring of Bill: When the drawee pays the amount of the bill on due date, the bill is said to be 'Honoured Bills'.

Dishonour of Bill: When the drawee pays the amount of the bill on due date, the bill is said to be 'Honoured Bills'.

Discounting of Bills: The drawer may discount the bill with the bank before the due date. The bank charges discounting charges from the drawer at a certain rate.

Thus, at the time of discounting the bank deposits the net amount after charging such amount of discount in the account of the holder of the bill.

Discount = $\text{Amount of bill} \times \text{Rate of interest or discount} / 100 \times \text{Remaining period to maturity} / 12$

Endorsement of bills: Transfer of bill to same other person by the holder.

Retirement of bills: When a drawee pays the bill before its due date. It is called retirement of bill.

Renewal of bill: Renewal of bill of exchange is an act of cancellation of old bill before its maturity in return of a new bill, including interest, for an extended period. It is done by drawer on request of drawee.

Accommodation of bill: An accommodation bill is a bill of exchange signed for by a person (the accommodation party) acting as a guarantor. The accommodation party is liable for the bill should the acceptor fail to pay at maturity. Accommodation bills are sometimes also referred to as windbills or windmills.



Notary Public: A notary public of the common law is a public officer constituted by law to serve the public in non-contentious matters usually concerned with estates, deeds, powers-of-attorney, and foreign and international business.

Rebate: When a bill is paid by drawee before due date, same allowance is given to him. This allowance is called 'Rebate'.

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