

***The Chapter Covers :***

- MEANING OF ACCOUNTING
- OBJECTIVES OF ACCOUNTING
- IMPORTANT TERMS
- ACCOUNTING EQUATION
- RULES OF DEBIT AND CREDIT- JOURNAL & LEDGER
- JOURNAL
- LEDGER
- CASH BOOK
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## MEANING OF ACCOUNTING

Accounting is a process-oriented task that follows a prescribed series of steps in order to keep track of, and record, the balances of the various accounts. Accounting is the method in which financial information is gathered, processed, and summarized into financial statements and reports.

When a business makes a transaction, the effect of that transaction is recorded in the accounting system. Accounting is the process of keeping track of the changes, which are brought about by the new transactions, recording and then reporting them.

### **ACCOUNTING: a detailed report of the financial state or transactions of a firm.**

The theory and system of setting up, maintaining, and auditing the books of a firm; art of analyzing the financial position and operating results of a business house from a study of its sales, purchases, overhead, etc. is accounting.

It is not easy to provide a concise definition of accounting since the word has a broad application within businesses and applications.

It is said that accounting is the language of the business, So in order to understand the affairs of a firm financial statements should be very accurate.

In the words of the committee on terminology of the American Institute of Certified Public Accountants:

*“Accounting is the art of recording, classifying and summarising in terms of money transactions and events of financial character and interpreting the result thereof.”*

— AICPA Committee

## OBJECTIVES OF ACCOUNTING

The following are the main objectives of accounting:

1. **Maintaining Systematic Business Records.** Accounting enables business firms to maintain systematic records of all financial transactions. It includes proper recording of transactions, classifying them under appropriate accounts and summarising them into financial statements.
2. **Depiction of Financial position.** Maintenance of proper records is necessary to show firm's possessions and the amount the firm owes to others at the end of a particular period. A businessman would be interested in knowing at periodical intervals the net result of business operations i.e. how much profit or loss has been incurred.

Such information is useful for the management, lenders, investors etc. The management can know whether the policies adopted by it were fruitful or not, lenders can know whether the firm is likely to earn profits in future or not. Investors can decide on this basis whether they should keep their money invested in the firm.

3. **Availability of information to interested parties.** Apart from proprietors and owners various other parties are interested in the accounting information. These are creditors, tax authorities, potential customers, employees, etc. They want to assess the profitability and the financial soundness of the firm. They get this information from the annual reports and statements.
4. **Ascertainment of working results.** The working of business ultimately results into profit or loss. To measure the real working performance of an enterprise, profit and loss account must be prepared which help in ascer-

taining the current costs and current revenues during a particular accounting period. A systematic record of incomes and expenses facilitates the preparation of the income statements.

Accounting

## Subsidiary Objectives of Accounting

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Accounting systems are designed mainly to provide information that managers and outsiders can use in decision making. Some of its subsidiary objects are as follows :

- (1) They also serve other purposes: to produce operating documents, to protect the company's assets, to provide data for company tax returns, and, in some cases, to provide the basis for reimbursement of costs by clients or customers.
- (2) The Accounting organization is responsible for preparing documents that contain instructions for a variety of tasks, such as payment of customer bills or preparing employee payrolls. It also must prepare documents that serve what might be called private information purposes, such as the employees' own records of their salaries and wages.
- (3) Accounting systems must provide means of reducing the chance of losses of assets due to carelessness or dishonesty on the part of employees, suppliers, and customers. Asset protection devices are often very simple; for example, many restaurants use numbered meal checks so that waiters will not be able to submit one check to the customer and another, with a lower total, to the cashier.
- (4) The accounting system must also provide data for use in the completion of the company's tax returns.
- (5) Accounting systems in some companies must provide cost data in the forms required for submission to customers who have agreed to reimburse the companies for the costs they have incurred on the customers' behalf.
- (6) Making decision concerning the use of limited resources including identification of crucial decision areas and determination of objectives & goals.
- (7) Effectively directing the controlling of an organisation's human and material resources.
- (8) Maintaining and reporting on the custodianship of resources.

## ADVANTAGES OF ACCOUNTING

The advantages of accounting can be enumerated as follows:

1. *Maintenance of business records.* All financial transactions are recorded in a systematic manner in books of accounts. It is not possible to remember all the daily operations of business. The records provide the necessary information as and when required.
2. *Preparation of financial statements.* Records enable the preparation of financial statements to calculate profit or loss during a particular period and that of balance sheet to state the financial position of the business on a particular date.
3. *Assessment of results.* Profit of one year is compared with those of earlier years to know the significant facts about the changes.

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4. *Decision making.* Management is faced at times with a number of problems requiring an appropriate decision. For making such decisions, only accounting can provide the relevant information.
5. *Evidence in courts.* Records of business transactions are treated as satisfactory evidence in the courts of law.
6. *Planning and controlling operations.* Planning of operations like sales, production, cash requirements for next accounting periods is achieved. Management is also interested in observing that the operations in the business are going on according to plan and all departments are spending within the specified limit.
7. *Provides information to interested groups.* Parties like owners, creditors, management, employees, government, consumers and creditors are interested in accounting information related to sales, profits, production, etc.
8. *Taxation problems.* In settlement of taxation matters, systematic records are of great help.
9. *Valuation of business.* Accounting records kept in a proper way enable a business unit to determine the purchase or sale price.
10. *Assistance to an Insolvent person.* An insolvent person is able to explain the past transactions if proper records are maintained.

## IMPORTANT TERMS

1. **Business.** Any trade, business, manufacture or some work of enterprise which is meant to earn profit.
2. **Transaction.** The act of exchanging goods/services for a valuable consideration.
3. **Goods.** These are the commodities which are used in business transaction. They may be raw material, manufactured goods or services.
4. **Discount.** Discount is the amount deducted by a businessman to increase the sale of a product. Discount is of two types :
  - (a) **Trade discount** – The discount allowed by a seller to its customers at a fixed percentage on the listed price of goods is termed as Trade discount.
  - (b) **Cash discount** – This discount is allowed to the customers for making prompt payment within a fixed period
5. **Bad debts.** Person to whom goods have been sold on credit are known as 'Debtors'. Sometimes due to dishonesty, death and insolvency of a Debtor, full amount will not be recovered which is known as 'Bad debts'.
6. **Liability.** Those items that the concerns owes to the outside world are known as liability. Liabilities are debts and are amount owned to creditors. It can be expressed as :

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

Examples of liabilities are Loans, Creditors, Bills payable, Debentures etc. Liabilities may be classified into two parts :

- (i) **Long-term/fixed liabilities** – These refer to those liabilities which are due for payment in a relatively long period (normally after more than one year). For example : Debentures, Long term, loans etc.

- (ii) **Current Liabilities** – These refer to those liabilities which are to be paid in near future (normally within one year). For example : Bills payable Creditors, Bank Overdrafts, Outstanding expenses & short term loans etc.
7. **Assets.** Any thing which is in the possession or is the property of business enterprise including the amount due to it from others, is called an asset. In other words, anything which will enable a business enterprise to get cash or a benefit in future is an asset. For example : Building, Land, Furniture, Debtors, Goodwill etc. Assets can be classified in following category :
- (a) **Fixed Asset** : The assets which are purchased for long-term use in business or production are known as fixed assets. Generally, such assets are not purchased for the purpose of sale. Such assets are not valued at market price. Example-Machinery, Land, Furniture etc.
  - (b) **Floating/Current/Active Assets** : Those assets which are meant for sale or which the management want to convert in cash within one year. Such assets are Debtors, Stock, Bill receivable etc.
  - (c) **Wasting Assets** : Those assets which are consumed through being worked or used, such as mines. As soon as all the minerals have been extracted the mine becomes valueless. Other examples are Oil-wells, Patents, Trademarks, Leasehold properties etc.
  - (d) **Nominal or Fictitious Asset** : The assets which are not material assets but are mentioned in the assets side of balance-sheet are known as fictitious assets. Examples- Goodwill, Prepaid expenses etc.
8. **Debtors.** A person who owes money to the firm generally on account of credit sales of goods is called a debtor. A debtor pays the price of goods he purchases in future. He is called a debtor because he owes the money to the firm.
9. **Stock.** The term 'stock' includes goods lying unsold on a particular date. To ascertain the value of closing stock, it is necessary to make a complete list of all the items in the store together with quantities. The stock may be opening and closing stock. The term 'opening stock' means goods lying unsold in the beginning of the accounting year whereas the term 'closing stock' includes goods lying unsold at the end of the accounting year.
10. **Receivables.** The amount that is receivable by the firm, other than the amount due from the debtors.
11. **Creditors.** A person to whom the firm owes money is called a creditor.
12. **Payables.** The term payables is used for the amount payable by the firm, other than the amount due to creditors.
13. **Losses.** Loss means something against which the firm receives no benefit like theft.
14. **Proprietor.** The person who makes the investment and bears all the risks connected with the business is called the proprietor.
15. **Drawings.** It is the amount of money or the value of goods which the proprietor takes for his domestic or personal use.
16. **Revenue.** Revenue means the amount which, as a result of operations, is added to the capital. Revenue is an inflow of assets which results in an increase in the owner's equity.

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17. **Expense.** It is the cost relating to the operations of an accounting period or to the revenue earned during the period or the benefits of which do not extend beyond that period.
18. **Income.** Income is the profit earned during a period of time. In other words the difference between revenue and expense is called income.
19. **Gain.** It is the term used to describe profit of an irregular nature, for example capital gains.
20. **Purchases.** The amount of goods purchased by a business for selling purposes or sale or consumption is called purchases. Purchases may be on cash or credit basis. In the latter case the payment is made at a future date.
21. **Sales.** These are goods sold out by the business. Sales may be cash sales or credit sales. In the latter case, the customers do not pay cash immediately but promise to pay in future.
22. **Gross Profit.** It is the difference between the sales revenue or the proceeds of goods sold and/or services rendered over its direct cost.
23. **Net Profit.** It is the profit made after allowing for all expenses. In case, expenses are more than the revenue, it is net loss.
24. **Cost of goods sold.** It is the direct costs of the goods or services sold.
25. **Equity:** The net worth of your company. Also called owner's equity or capital. Equity comes from investment in the business by the owners, plus accumulated net profits of the business that have not been paid out to the owners.
26. **Inventory :** Inventory consists of raw materials and other items available for sale or in the process of being made ready for sale. Inventory is a current assets as it is converted into cash on sale. Kinds of Inventory - Raw Material, Finished goods.
27. **Vouchers :** Written proof of Transaction is called voucher.  
**Types :**
  - (i) **Invoice or Bill :** Invoice voucher is used for credit transaction and related to record Inventory.
  - (ii) **Cash Memo & Receipt :** Cash memo & Receipt is used to record cash transactions.

## ACCOUNTING EQUATION

All transactions of a business have a dual aspect. According to this basic concept, every business transaction has a two-fold effect i.e., every receiver is also a giver and every giver is also a receiver.

The resources controlled by a business are referred to as its assets. For a new business, those assets originate from two possible sources:

- Investors who buy ownership in the business
- Creditors who extend loans to the business

Those who contribute assets to a business have legal claims on those assets. Since the total assets of the business are equal to the sum of the assets contributed by investors and the assets contributed by creditors, the following relationship holds and is referred to as the **accounting equation**.

Total claims will equal the total assets of the firm. The claims are owner's capital and liabilities or amount due to outsiders.

$$\begin{array}{lcl} \text{Assets} & = & \text{Liabilities} + \text{Owner's Equity} \\ \text{Resources} & = & \text{Claims on the resources} \end{array}$$

Initially, owner equity is affected by capital contributions such as the issuance of stock. Once business operations commence, there will be income (revenues minus expenses, and gains minus losses) and perhaps additional capital contributions and withdrawals such as dividends. At the end of the reporting period, these items will impact the owner's equity as follows:

<b>Assets</b>	=	<b>Liabilities</b>	+	<b>Owner's Equity</b>
			+	<i>Revenues</i>
			-	<i>Expenses</i>
			+	<i>Gains</i>
			-	<i>Losses</i>
			+	<i>Contributions</i>
			-	<i>Withdrawals</i>

The accounting equation holds at all times over the life of the business. When a transaction occurs, the total assets of the business may change, but the equation will remain in balance. The accounting equation serves as the basis for the balance sheet.

**Assets :** It is an expenditure for acquiring valuable resources which benefit the future activities of the concern. Land, building, debtors, cash in hand, etc. are some of the assets.

**Capital :** The proprietor of the business brings capital into the business out of which the business purchases assets for its use. The amount of assets of the business is equal to the owner's capital.

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

**Creditors :** when the capital contributed by the proprietor is insufficient, the business takes to borrowings from other sources.

$$\text{Capital} + \text{liabilities (Equities)} = \text{Assets}$$

The term 'equities' denotes the claims of various parties against the assets. Equities are of two types: Owner's equity and outsider's equity. Owner's equity is called the capital of the business which is the claim of the owners against the assets of the business. Payments which have to be made to the outsiders are called liabilities.

The equality of total assets and total liabilities is called Accounting equation.

## Owners' equity

This is the difference between assets and liabilities. If it's positive-assets exceed liabilities and we have a positive owners' equity. In this section we'll put in things like

- Partners' capital accounts
- Retained earnings
- Stock

Capital is what remains to the owner when all outside claims have been settled from the assets of the firm.

<b>Capital</b>	+	<b>Liabilities</b>	=	<b>Assets</b>
		(Loans, Bank Overdraft,		(Buildings, land,
		Creditors, Bills Payable,		Machinery, Furniture,
		Outstanding Expenses, Bank		Stock-in-trade,
		overdraft.)		Debtors, Cash,
				Bills receivable, Bank)

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Any change in the amount of assets or the liabilities will bring corresponding change in owner's capital. If asset increases and liabilities do not, the capital will increase; a reduction in the amount of asset or an increase in the amount of liabilities means reduction in the amount of capital.

**We shall follow the following procedure to work out an accounting equation.**

- (i) Transactions are analysed in terms of variables as assets, liabilities, capital, revenues and expenses.
- (ii) Effect of transactions is decided in terms of increase or decrease on variables, then
- (iii) Effect on the relevant side of equation is recorded.

**Example 1.** Suppose (1) The owner A commences business with Rs. 30,000.

It means that the firm has an asset of Rs. 30,000 in the form of capital and the claims against the firm are also Rs. 30,000 in the form of capital.

$$\begin{array}{rclclcl} \text{Assets} & = & \text{Liabilities} & + & \text{Capital} \\ 30,000 & = & 0 & + & 30,000 \end{array}$$

- (2) The business purchases a table for Rs. 400 in cash. This will reduce the cash by Rs. 400 but a new asset has been acquired so the total of the assets remain unchanged.

	Cash	+	Assets furniture(table)	=	Liabilities	+	Capital
Old balance	30,000	+	0	=	0	+	30,000
New transaction	-400	+	400	=	-	+	-
New balance	29,600	+	400	=	0	+	30,000

- (3) Business purchases raw material of Rs. 2,000 in cash, we see that the cash balance will be lowered by 2,000 and another asset, i.e., raw material has come into existence, but the total of assets remain unchanged. The equation will be as follows:

	Cash	+	Assets furniture	+	raw material	=	Liabilities	+	Capital
Old balance	29,600	+	400	+	0	=	0	+	30,000
New transaction	-2,000	+	0	+	2,000	=	0	+	0
New balance	27,600	+	400	+	2,000	=	0	+	30,000

- (4) The business purchases raw material of Rs. 4000 on credit. It will increase raw material by Rs. 4,000 making the total asset to Rs. 34,000. Now, Rs.4,000 is due to be paid to the supplier of the raw material.

	Cash	+	Assets furniture	+	raw material	=	Liabilities	+	Capital
Old balance	27,600	+	400	+	2,000	=	0	+	30,000
New transaction	0	+	0	+	4,000	=	4,000	+	0
New balance	27,600	+	400	+	6,000	=	4,000	+	30,000

- (5) The business sells goods on credit for Rs. 4,000; the cost of goods is Rs. 3,000.

On account of this credit transaction, the accounting equation is maintained, i.e., debtors, has come into existence to the extent of Rs. 4,000. But the raw material will be reduced only by Rs. 3,000, being the cost of goods sold. The net increase in assets, Rs.1, 000 i.e., Rs. 4,000 – Rs. 3,000; will be added to the capital.

	Assets				=	Liabilities +	Capital
	Cash +	furniture +	Raw M +	Debtors =		Creditors +	As
Old balance	27,600 +	400 +	6,000 +	0 =		4,000 +	30,000
New transaction	0 +	0 -	3,000 +	4,000 =		0 +	1,000
New balance	27,600 +	400 +	3,000 +	4,000 =		4,000 +	31,000

NOTES

The total of assets will be equal to the total of liab

## RULES OF DEBIT AND CREDIT- JOURNAL & LEDGER

### *Double entry system*

A business transaction involves an exchange between two accounts. Each transaction is recorded in its two-fold aspects. For example, for every asset there exists a claim on that asset, either by those who own the business or by those who loan money to the business. Similarly, the sale of a product affects both the amount of cash held by the business and the inventory held. The fundamental principle is that every transaction has two aspects, one who receives is a debtor (Dr.) and one who gives is a creditor (Cr.). Under the double-entry system, both these aspects, receiving and giving, are recorded in terms of account. The account which receives the benefit is credited.

**Double-entry accounting** : Debits must always equal credits. Because debits equal credits, double-entry accounting prevents some common book-keeping errors. Errors that do occur are easier to find. In double-entry accounting, every transaction in business affects at least two accounts, since there is at least one debit and one credit for each transaction. Entries that are not made to a balance sheet account are made to an income or expense account. Income and expenses affect the net profit of the business, which ultimately affects owner's equity.

Thus, *it can be seen that under double entry system, the total of the debit entries and credit entries on the various accounts must be equal.* Each debit entry has a corresponding credit and each credit has a corresponding debit entry.

Under the double entry system, both the aspects of all the transactions are recorded and thus, complete and reliable records of all the transactions is provided, based on which a management is in a position to take proper decisions. A trial balance are drawn to check accuracy of the books of accounts. Profit and loss account indicates correct profit or loss made during a particular time period, while the balance sheet represents the true financial position of the business on a particular date.

### **Advantages of double entry system.**

- Accurate calculation of profit and loss in complex organizations.
- Inclusion of assets and liabilities in the book-keeping accounts.
- Preparation of financial statements directly from the accounts.
- Easier detection of errors and frauds.
- Complete and reliable records of all business transactions since it records both the aspects of a transaction.
- A trial balance can be prepared and arithmetical accuracy can easily be verified.
- The balance sheet of the business can be prepared to ascertain the financial position of a firm.

## NOTES

**Single entry system** does not record the two fold effect of each and every transaction. The accounts are prepared in a defective and unscientific manner and thus are not so reliable. It is suited for small sized concerns which are personally supervised by the owners. In single entry system trial balance cannot be extracted and arithmetical accuracy cannot be checked.

### Double entry system and single entry system of book keeping-Distinction

- Under the double entry system both the aspects, i.e., debit and credit, of all the transactions are recorded. Under single entry system, some transactions are recorded only in one of their aspects whereas some other transactions are recorded in both of their aspects.
- Under double entry system, various subsidiary books like sales book, purchases book, etc. are maintained. Under single entry system, no subsidiary books except cash book, which is also considered as a part of ledger, is maintained.
- Under double entry system there is a ledger which contains personal, real and nominal accounts. But under single entry system, the ledger contains some personal accounts only.

### Account

*An account is a summarized record of relevant transactions at one place relating to a particular head.*

All the transactions that lead to an increase are recorded in one column and those that reduce the cash balance in another column; then the net result can be ascertained. If to the opening balance of cash we add all increases and then deduct the total of all decreases, closing balance can be ascertained.

The name of the account is shown clearly as a central heading. Account or its short form 'a/c' is added to the name of account. For Example: if the account is in respect of furniture, it is written as "Furniture Account" or Furniture a/c.

### T-Accounts

Dr.		Cr.	
Asset Accounts		Liability or Equity Accounts	
Furniture A/c		Furniture A/c	
Increase	Decrease	Increase	Decrease
Debit	Credit	Debit	Credit
Left side or debit side of Account	Right side or Credit side of Account	Left side or debit side of Account	Right side or Credit side of Account

#### NAME OF THE ACCOUNT

Dr.					Cr.

Increases of cash are recorded on the left side and decreases on the right-hand side. It can also be said that the account which involves receiving aspect is debited and the account which involves giving aspect is credited.

T-Accounts are used as a tool to illustrate business transactions, debits and credits, double entry book-keeping, and the purpose of accounts. It is called this because it has the form of the letter T. On the top of the horizontal bar there is the account title (name). Increases and Decreases are placed on the side of the vertical bar, depending on whether the account type is an asset, liability or equity account. The left side of the T-account is called Debit, and the right side is called Credit. These terms are often abbreviated as Dr. and Cr.

The difference between the debit and the credit side of an account (total increases less total decreases) is called the account balance.

### Example 2 :

Open 'T' shape account for furniture and write the following on the proper side.

1. Furniture purchased for Rs 20,000
2. Furniture sold costing Rs. 5,000
3. Furniture again purchased for Rs. 8,000
4. Old furniture discarded for Rs. 2,500
5. Value of furniture was reduced by Rs. 2,000

### Solution :

Dr.		Furniture Account		Cr.	
Recorded Increase in furniture				Recorded decrease in furniture	
	1.	20,000		2.	5,000
	3.	8,000		4.	2,500
				5.	2,000
	Total	28,000		Total	9,500
				Balance	18,500
		<u>28,000</u>			<u>28,000</u>

## CLASSIFICATION OF ACCOUNTS

Transactions of a business can be classified into the following three categories:

- Transactions relating to persons or individuals – Personal accounts;
- Transactions relating to property, assets or possessions – Real accounts;
- Transactions relating to incomes and expenses- Nominal accounts;

Real and nominal accounts are categorized as impersonal accounts.

### PERSONAL ACCOUNT

Personal accounts record the dealings of a *trader* with persons or firms. A separate account is opened for each such person or firm for recording transactions. The account of each person or firm is debited when it receives any benefit and is credited with any benefit such person or firm imparts.

For Example, Proprietor's account, Suppliers' accounts, Receivers' accounts (like Mohan's A/c), bank account, any firm's account, any government's account, any institution's account, Unexpired insurance account, Rent prepaid account, etc.

### Check Your Progress

1. What do you mean by Accounting.
2. What are the main objectives of Accounting.
3. What do you understand by Assets.

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## REAL ACCOUNTS

The real accounts represent items which are more or less permanent. It deals with property, assets and possessions. A separate account is kept for each class of property such as furniture, cash, equipment, machinery etc. so that by recording particulars of each asset received or given away, the businessman can find value of each asset on hand on any particular date. For example, Accounts of things which can be touched, felt, measured, purchased, sold etc. like land account, building account, furniture account etc and also accounts of things which are difficult to touch in the physical sense but can be measured, like: Goodwill, Trademarks and patent rights.

## NOMINAL ACCOUNTS

They are used to define the nature of transactions i.e., expenses and gains of traders. For example, if in a factory the manager gets salary, the commission agents get commission, the worker gets wages, in fact they all get cash. Cash is the real thing which exists and salary, commission, wages etc., are only ways of describing the nature of heads for which cash has been paid.

Thus, a separate account is opened for each head of expenditure or income such as rent, salaries, commission, etc. Each such account is debited when an expense or loss is incurred and is credited when there is any gain.

### Names of Different Types of Accounts

Personal Accounts	Real Accounts	Nominal Accounts
Capital A/c	Purchase A/c	Interest A/c
Drawings A/c	Sales A/c	Discount A/c
Ram A/c	Stock A/c	Salary A/c
Rotary club A/c	Purchase Return A/c	Repairs A/c
HDFC Bank A/c	Cash A/c	Insurance A/c
Makhan Lal Chaturvedi A/c	Land A/c	Advertisement A/c
University A/c	Goodwill A/c	Commission A/c
Prepaid Rent A/c	Machinery A/c	Trade Exp. A/c
Outstanding Salary A/c	Oil wells A/c	Charity A/c
Unexpired Insurance A/c	Mines A/c	Sales Tax A/c
	Patents A/c	Depreciation A/c

## RULES OF DEBIT AND CREDIT

Each transaction has two aspects; one aspect is the receiving or the 'debit' aspect. Another aspect is giving or the 'credit' aspect. Debit and credit aspects of a transaction form the basis of double entry system.

Rules of double entry are framed on the basis of these two aspects in each of the business transactions.

The two sides are put together in "T" form, the left side is called the 'debit' side and the right side is called the 'credit' side. Rules can be obtained as –

Since, incomes and gains increase capital, the rule is to credit all gains and incomes and since expenses and losses decrease capital, the rule is to debit all expenses and losses in the accounts concerned. If there is a reduction in any income or gain, the account concerned will be debited; similarly for any reduction in an expense or loss, the concerned account will be credited.

## Debit and Credit Rules

Accounting

Account Type	Debit	Credit	Normal Account Balance
Assets	Increase	Decrease	Debit Balance
Liabilities	Decrease	Increase	Credit Balance
Owner's Equity	Decrease	Increase	Credit Balance
Revenue	Decrease	Increase	Credit Balance
Expense	Increase	Decrease	Debit Balance

NOTES

### How To Use and Apply The Debit and Credit Rules:

- (1) Determine the type of account(s) the transactions affect-asset, liability, revenue, or expense account.
- (2) Determine if the transaction increases or decreases the account's balance.
- (3) Apply the debit and credit rules based on the type of account and whether the balance of the account will increase or decrease.

We can understand these rules in another manner:

1. **Debit the receiver and credit the giver.** One who receives should be debited and one who gives credited.
2. **Debit what comes in and credit what goes out.** This rule is mainly applicable to asset accounts like furniture etc. When cash comes in Cash account should be debited; on payments this account will be credited.
3. **Debit all losses (and expenses) and credit all gains (and profits).** Whenever money is paid because of an expense, the debit should be to an account showing the nature of the expense and not to the personal account of the receiver. Similarly, when cash is received on account of an income or gain, the credit should be to an account indicating the fact.

The three rules can be stated as:

1. **Debit the receiver and credit the giver in case of personal account.**
2. **Debit what comes in and credit what goes out in case of Real Account.**
3. **Debit all expenses and losses and credit all gains and profits in case of Nominal account.**
  - (i) **Rule for personal accounts.** Debit that person's account who receives something from the business and credit that person's account who gives something to the business.
  - (ii) **Rule for real account.** Debit what comes into the business and credit what goes out of the business.
  - (iii) **Rule for nominal account.** Debit all expenses and losses and credit all gains and incomes.

## SIGNIFICANCE OF DEBIT AND CREDIT IN ACCOUNTS

- (i) **Personal accounts.** Whenever the business sells goods on credit to a customer, the account of the customer is debited. Debit in personal

## NOTES

accounts means that the person whose account is being debited becomes a debtor or that he owes a certain sum to the business. Whenever the business purchases goods on credit from suppliers the account of the suppliers is credited. A further credit in the account of supplier implies increase on the credit side. If the account of a debtor is credited, it implies decreases in the debt of customers.

- (ii) **Real accounts.** Debit in a real account implies purchase of an asset. Any further debit in real account means more acquisitions of the asset and this will increase the value. Any credit in real account implies that some part or whole of the asset has been sold off.
- (iii) **Nominal accounts.** Debit implies that expenditure has been incurred or some loss has taken place. When any expenditure on account of salary, rent, interest, commission is incurred, these nominal accounts will be debited. Credit in a nominal account signifies that income or profit has taken place or some expenditure or loss has decreased by the amount of credit.

### EXAMPLE 3 :

State the nature of account (nominal, real or personal) and show which account will be debited and which account will be credited:

- |                          |                         |
|--------------------------|-------------------------|
| (i) Rent paid            | (ii) Interest received  |
| (iii) Building purchased | (iv) Machinery sold     |
| (v) Discount allowed     | (vi) Capital introduced |

Account	Nature of account	Debited/ Credited
Rent paid account	Nominal	Debited
Interest received account	Nominal	Credited
Building account	Real	Debited
Machinery account	Real	Credited
Discount allowed account	Nominal	Debited
Capital account	Personal	Credited

**JOURNAL** The Journal is called the book of original entry and the process of recording transactions in the journal is called journalising. It is a book of original entry wherein transactions are recorded chronologically, showing date, amounts and accounts to be debited and credited and an explanation. With the growth in the business activities several journals are required for recording the large number of activities e.g., sales journal etc. These journals are called *special journals*.

According to Cortez– “The Journal, or ‘Daily Record’ as originally used was a book of primary entry in which transactions were copied in order of date, from a Memorandum or waste Book. The entries as they were copied, were classified into debits and credits so as to facilitate their being correctly posted afterwards in the ledger.

### Object / Importance of Journal

- (1) One can have a clear picture of the business by a study of its journal book.
- (2) A journal makes the postings of transactions in ledger very easy.
- (3) It shows us all effects of a transaction.

- (4) It plays an important role in solving business disputes.
- (5) Journal reduces the possibility of errors. The two sides can be compared easily and it can be seen whether they are equal or not.
- (6) It provides an explanation to the transaction.
- (7) It provides a chronological record of all transactions.

## STEPS FOR JOURNALISING

The following are the steps for journalising transactions:

- The year is recorded at the top of the page and the month and the date are recorded on the first line in the first column of the date section. This information is repeated for every new journal page.
- The name of the account(s) to be debited is entered in the particulars column and the amount of the debit is recorded in the Debit column. When more than two accounts are involved in the transaction the entry is called a compound entry.
- The name of the account(s) to be credited is entered on the next line and indented. The amount of the credit is recorded in the Credit column.
- An explanation of the transaction is included in the particulars column on the line below the credit entry.

*Format of journal.*

### JOURNAL

Date	Particulars	L.F.	Debit	Credit
(1)	(2)	(3)	(4)	(5)

- (1) **Date :** The date on which transaction has taken place is written in this column.
- (2) **Particulars :** Every transaction has two effects-Debit & Credit, which are recorded in it. This is accomplished by a debit description of the deal known as Narration and a line is drawn at the end.
- (3) **L.F./Ledger Folio :** This column contains the folio number of ledger where the account is opened.
- (4) **Amount :** This column is divided into two parts : (a) Debit, (b) Credit. In these two columns debit & credit amounts are recorded respectively.

### Important points to be kept in mind at the time of Journalising

- (1) Before recording a Journal entry, it is essential to analyse a transaction in order to determine the two accounts which are affected. Then, on the basis of the rules of journalising it must be debited or credited.
- (2) The name of the account to be debited is written first and the word 'Dr.' is also written towards the end of the column.
- (3) The credit account starts with the word of 'To', a few space away from the margin to make it distinct from the debit account.
- (4) It is necessary to write the narration after each entry and should be short, complete and clear.

NOTES

- (5) After every Journal entry, a line should be drawn in particulars column, so that each entry is separated from the preceding one.
- (6) Two words 'For'/'Being' are customarily used before starting to write down narration.
- (7) It is not necessary to use the word 'Account' or A/C after the personal accounts.
- (8) At the end of each page, both the Dr. and Cr. columns are totalled up just in front of each other.

These totals must be equal because the amount debited in each entry equals the amount credited. These totals are carried forward to the next page progressively upto the end of accounting period.

### RULES OF JOURNALISING

- (1) **Personal Accounts** : "Debit the receiver and credit the giver" for e.g. : a cash of Rs. 2000 is given to Gopal.

Gopal	Dr.	2,000	
To cash a/c			2,000
(cash paid to Gopal)			

(Here Gopal is debited as he is the one who received cash)

- (2) **Real Accounts** : "Debit what comes in and credit what goes out". In the above e.g. cash goes out to Gopal. So cash is credited. Again if machinery is bought for Rs. 10,000 then Machinery came to business and cash went out of business.

Machinery a/c	Dr.	10,000	
To cash a/c			10,000
(Machinery purchased by cash)			

- (3) **Nominal Account** : "Debit all expenses losses and credit all Incomes & gains" for e.g. : Paid salary of Rs. 2,000 and received rent of Rs. 5,000. Here Salary is an expense, so debited where as rent is an income thus credited.

Salary a/c	Dr.	2,000	
To cash a/c			2,000
(For Salary paid)			
Cash a/c	Dr.	5,000	
To Rent a/c			5,000
(For Rent received)			

**Example 4.** Transactions of Shyam for the month of June are given below. Journalize them.

2003	Rs.	
June 1	Shyam started business with cash	1,00,000
June 2	Cash deposited in bank	25,000
June 3	Bought raw material for cash	5000
June 4	Withdrew cash from bank for office	1000
June 13	Sold to Ram goods on credit	1500
June 20	Bought from Mohan raw material on credit	225

June 24	Received cash from Ram	1500
June 28	Paid cash to Mohan and discount allowed	215 10
June 30	Paid rent	50
June 30	Cash sales for the month	800
June 30	Paid salary to Ashok	100

Accounting

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No.	Transactions	Affected A/C	Types of A/C	Dr.	Cr.
2003 June 1	Commenced Business (Owner brings capital, cash comes in)	Cash A/C & Capital A/C	Real Personal	Cash A/C	Capital A/C
2	Deposited in bank (Bank is receiver & cash goes out)	Bank A/C & Cash A/C	Personal Real	Bank A/C	Cash A/C
3.	Goods purchased for cash (Goods comes in & cash goes out)	Purchase A/C & Cash A/C	Real Real	Purchase A/C	Cash A/C
4.	Withdrawn cash from bank (cash comes in & bank is giver)	Bank A/C & Cash A/C	Personal Real	Cash A/C	Bank A/C
13	Sold goods to Ram on credit [Ram is receiver & goods goes out]	Ram & Goods	Personal Real	Ram	Sales A/C
20	Purchase Material from Mohan on Credit [Mohan is giver goods comes in]	Mohan Goods	Personal Real	Purchase A/C	Mohan
24	Cash paid by Ram [cash comes in, Ram is giver]	Ram Cash A/C	Personal Real	Cash A/C	Ram
28	Cash paid to Mohan [cash goes out, Mohan is receiver and discount profit is given]	Mohan Cash A/C Discount A/C	Personal Real Nominal	Mohan	Cash A/C Discount A/C
30	Rent paid in cash [Rent (expenses) paid, cash goes out]	Rent A/C Cash A/C	Nominal Real	Rent A/C	Cash A/C
30	Goods sold for cash [Goods goes out, cash comes in]	Goods A/C Cash A/C	Real Real	Cash A/C	Sales A/C
30	Salary paid [expenses paid, cash goes out]	Salary A/C Cash A/C	Nominal Real	Salary A/C	Cash A/C

## JOURNAL ENTRIES (In the books of Shyam)

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
2003				
June 1	Cash A/c .....Dr. To Capital A/c (Being the amount invested by Shyam in the business as capital)		1,00,000	1,00,000

## NOTES

June 2	Bank A/c .....Dr. To Cash A/c (Being the amount deposited in bank)		25,000	25,000
June 3	Purchases A/c.....Dr. To Cash A/c (Being raw material purchased for cash)		5,000	5,000
June 4	Cash A/c .....Dr. To Bank A/c (Being cash withdrawn from bank)		1,000	1,000
June 13	Ram .....Dr. To Sales A/c (Being goods sold to Ram on credit)		1,500	1,500
June 20	Purchases A/c .....Dr. To Mohan (Being goods bought from Mohan on credit)		225	225
June 24	Cash A/c .....Dr. To Ram (Being cash received from Ram)		1,500	1,500
June 28	Mohan .....Dr. To Cash A/c To Discount A/c (Being cash paid to Mohan and discount received)		225	215 10
June 30	Cash A/c .....Dr. To Sales A/c (Being goods sold for cash)		800	800
June 30	Rent A/c .....Dr. Salaries A/c .....Dr. To Cash A/c (Being amount paid for rent and salary)		50 100	150
	Total		1,35,400	1,35,400

## LEDGER

**Meaning of Ledger.** The book which contains accounts is known as the ledger. It is defined as a “book or register which contains, in a summarized and classified form, a permanent record of all the transactions.” It is the most important book of accounts, since final position pertaining to the financial status of a business emerges only from them. Hence, the ledger is called the Principal Book.

Their sources of information are the books of original entry, called journals. When a customer purchases goods from a firm on different dates, his transactions are recorded on different pages in the journal. It is not possible to know at a glance what amount is owed by a customer unless all the entries relating to his account are brought together in the form of an account. Ledger is kept keeping in view of this objective.

A General Ledger is just a formal set of T-Accounts. Each account that is to be tracked and kept up with has a separate page or pages maintained in a

record book called the General Ledger. The general ledger's major sections are Assets, Liabilities, Owner's Equity, Revenues, Expenses, and Drawings.

For each item (account) in General Ledger, the increases and decreases for a period (usually a month) are measured and its ending balance is calculated. The ending balance of the account is easily determined by adding the increases and subtracting the decreases from the account's beginning period balance.

### Ending Account Balance = Beginning Balance + Increases - Decreases

Simply stated a General Ledger is just a book containing the summarized financial transactions and balances of the accounts for all of a business's assets, liabilities, equity, revenue, and expense accounts

**Utility of ledger.** Ledger is the most important book of account. *It is the principal book of account which contains all the information regarding business.* It will be very difficult to prepare final accounts in the absence of ledger. Ledger provides necessary information regarding various accounts. Personal accounts in ledger show how much money the firm owes to his creditors and the amounts it can recover from its debtors. The real accounts show the values of properties and also the value of stock. Nominal accounts reflect the sources of income and also the amount spent on various items. The financial position of the business concern can be ascertained easily at any time with the help of ledger.

**EXAMPLE 1:** Journalise the following transactions and post them to ledger, also balance the accounts.

#### 2007

- Dec 11 Ram commences business with Rs. 2,00,000 in cash.
- 12 He buys goods of Rs. 1,50,000 from Darshan on credit.
- 15 He buys machinery for Rs. 50,000 from Nathan on credit.
- 18 He pays Nathan Rs. 25,000
- 20 He pays Darshan Rs. 50,000.
- 22 Cash sales Rs. 1,00,000.
- 31 He sells goods to Rakesh on credit Rs. 7,000.

**Solution:**

**Ram**

#### JOURNAL

Date	V. No.	Particulars	L.F.	Amount Dr.	Amount Cr.
2007 Dec 11		Cash Dr. To Ram's capital account (Being the capital invested in cash)		2,00,000	2,00,000
12		Purchases account Dr. To Darshan (Being goods purchased on credit)		1,50,000	1,50,000

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15	Machinery account To Nathan (Being machinery purchased on credit)	Dr.	50,000	50,000
18	Nathan To Cash (Being cash paid to Nathan)	Dr.	25,000	25,000
20	Darshan To Cash (Being cash paid to Darshan)	Dr.	50,000	50,000
22	Cash To Sales account (Being goods sold for cash)	Dr.	1,00,000	1,00,000
31	Rakesh To Sales account (Being goods sold on credit to Rakesh)	Dr.	7,000	7,000

LEDGER  
CASH ACCOUNT

Dr.					Cr.				
Date	V. No.	Particulars	L.F.	Amount	Date	V. No.	Particulars	L.F.	Amount
2007 Dec 11		To Ram's Capital		2,00,000	2007 Dec 18		By Nathan		25,000
Dec 22		To Sales Account		1,00,000	Dec 20		By Darshan		50,000
					Dec 31		By Balance c/d		2,25,000
				3,00,000					3,00,000
2008 Jan 1		To Balance b/d		2,25,000					

RAM'S CAPITAL ACCOUNT

Dr.				Cr.			
Date	Particulars	L.F.	Amount	Date	Particulars	L.F.	Amount
2007 Dec 31	To Balance c/d		2,00,000	2007 Dec 11	By Cash		2,00,000
				2008 Jan 1	By Balance b/d		2,00,000

PURCHASES ACCOUNT

Dr.				Cr.			
Date	Particulars	L.F.	Amount	Date	Particulars	L.F.	Amount
2007 Dec 12	To Darshan		1,50,000	2007 Dec 31	By Balance c/d		1,50,000
2008 Jan 1	To Balance b/d		1,50,000				

# MACHINERY ACCOUNT

Dr.				Cr.			
Date	Particulars	L.F.	Amount	Date	Particulars	L.F.	Amount
2007 Dec 15	To Nathan		50,000	2007 Dec 31	By balance c/d		50,000
2008 Jan 1	To Balance b/d		50,000				

# NATHAN A/C

Dr.				Cr.			
Date	Particulars	L.F.	Amount	Date	Particulars	L.F.	Amount
2007 Dec 18	To Cash		25,000	2007 Dec 15	By Machinery A/c		50,000
Dec 31	To Balance c/d		25,000				
			50,000	2008 Jan 1	By Balance b/d		25,000

# DARSHAN A/C

Dr.				Cr.			
Date	Particulars	L.F.	Amount	Date	Particulars	L.F.	Amount
2007 Dec 20	To Cash		50,000	2007 Dec 12	By Purchases A/c		1,50,000
Dec 31	To Balance c/d		1,00,000				
			1,50,000	2008 Jan 1	By Balance b/d		1,00,000

# RAKESH A/C

Dr.				Cr.			
Date	Particulars	L.F.	Amount	Date	Particulars	L.F.	Amount
2007 Dec 31	To Sales A/c		7,000	2007 Dec 31	By Balance c/d		7,000
			7,000				
2008 Jan 1	To Balance b/d		7,000				

# SALES ACCOUNT

Dr.				Cr.			
Date	Particulars	L.F.	Amount	Date	Particulars	L.F.	Amount
2007 Dec 31	To Balance c/d		1,07,000	2007 Dec 22	By Cash		1,00,000
				Dec 31	By Rakesh		7,000
			1,07,000				
				2008 Jan 1	By Balance b/d		1,07,000

Accounting

NOTES

## CASH BOOK

Cash book may be defined as the record of transactions concerning cash receipts and cash payments. It is essential for a business to know the flow of cash or bank balance on hand. For this purpose and for recording the cash transactions, cash book is maintained. The number of cash transactions in a firm is generally large and, therefore, it becomes convenient to have a separate cash book, to record such transactions. Cash Book is a special journal.

Cash transactions are straightaway recorded in the cash book and, on the basis of such a record, ledger accounts are prepared. Therefore, the cash book is a subsidiary book. But, the cash book itself serves as the cash account and the bank account. As a matter of fact, the balances are entered in the Trial balance directly.

## TYPES OF CASH BOOK

The main cash book may be of three types:

- (1) *Single-column cash book*, (2) *Two-column cash book*, and
- (3) *Three-column cash book*

## SPECIAL JOURNALS

### Meaning

If the size of the business is large the system of book-keeping should be easy and simple to follow, and should be such as to allow division and sub-division of duties and speedy working. If the size of the business is a small one, then it is possible to enter each and every transaction in the journal, commonly known as books of original record or primary record. But when size of the business grows, it is no longer possible to record all the transactions in one general journal, but the main journal is split into a number of separate journals or Day Books. A separate Day Book is used for each type of transaction. These transactions are usually numerous. These journals are prepared almost everyday and are of specialized character as they include transactions relating to one type of transactions. They are, therefore, known as special journals. They may also be called **special purpose subsidiary books**. **Subsidiary Books** may be defined as books where transactions are entered first for the purpose of record. In a large business, the subsidiary books generally used are:

- (1) Purchase Journal or Purchases Book,
- (2) Sales Journal or Sales Book,
- (3) Purchase Returns journal or Purchases Returns Book,
- (4) Sales Returns Journal or Sales Returns Book.
- (5) Bills Payable Book
- (6) Bills Rceivable Book
- (7) Journal Proper

## TRIAL BALANCE

**Meaning.** A basic rule of double-entry accounting is that for every credit there must be an equal debit amount. Trial Balance is a statement of accounts which appeared in the ledger showing either the balances or total amounts of debit and credit items. The trial balance is prepared after posting the journal entries into the ledger and balancing the accounts. All the debit entries are written on one side and all the credit entries on the other side. The total of the debit side of trial balance must be equal to that of the credit side. If debits do not equal credits, then an error has been made. The Trial Balance is a tool for detecting such errors.

The trial balance is calculated by summing the balances of all the ledger accounts. The account balances are used because the balance summarizes the net effect of all of the debits and credits in an account.

The preparation of a Trial balance is an essential part of the process because if totals of both the sides are the same then it is proved that books are at least arithmetically correct.

The trial balance is a worksheet where all general ledger accounts and their debit or credit balance appear. It is a tool that is used to detect errors in the books. The total debits must equal the total credits. At the end of the accounting period three trial balances are prepared:

- A preliminary trial balance is prepared using general ledger account balances before making adjusting entries.
- An adjusted trial balance is done after preparing adjusting entries and posting them to general ledger. This will help ensure that the books used to prepare financial statements are in balance.
- A post-closing trial balance is done after preparing and posting closing entries. This trial balance, which should contain only balance sheet accounts, will guarantee that the books are in balance for the beginning of the new accounting period.

Financial statements refer to such statements which reports the profitability and the financial position of the business at the end of accounting period. The term financial statements includes at least two basic statements which are as under :

- (i) Income Statements (or Trading and Profit & Loss Account)
- (ii) Statement of Financial Position (or Balance Sheet)

These two financial statements are also termed as 'Final Accounts'.

In the words of John. N. Myer- "The financial statements provide a summary of the accounts of a business enterprise, the balance sheet reflecting the assets, liabilities and capital as on a certain date and the income statement showing the results of operations during a certain period."

## USERS OF FINANCIAL STATEMENTS

- (1) **Management** : It helps the management in assessing the profitability of various activities and departments. Management can review the progress of the business and take decisions for controlling the non-profitable activities.
- (2) **Employees** : They can judge as to how much bonus and increase in their wages are possible from the profits of the enterprise.
- (3) **Investors** : They can assess the short term & long term soundness by studying the future growth of enterprise.
- (4) **Government** : To study the profit margin of various industries to introduce or withdraw various concessions and to increase or decrease the excise duty.
- (5) **Taxation Authorities** : They use the financial statements for the purpose of assessment of income tax, sales tax etc.
- (6) **Other Users** : Such as creditors, researchers, trade associations, consumer agencies etc.

## INCOME STATEMENTS

It is divided into two parts :

- (i) Trading Account
- (ii) Profit & Loss Account

## NOTES

- (i) **Trading Account** : Trading Account is prepared for calculating the gross profit or gross loss arising or incurred as a result of the trading activities of a business. In other words, it records the amount of purchases of goods and also the expenses which are incurred in bringing that commodity to a saleable state. All expenses related to purchase of material or manufacturing of goods (Direct Expenses) are recorded in the Trading Account.

According to Carter “Trading Account is the account which is prepared to determine gross profit or gross loss.”

According to J.R. Batliboi - “The Trading Account shows the results of buying and selling of goods. In preparing the accounts, the general charges are ignored and only the transactions in goods are included.:

### Objects / Importance of Trading Account :

- (1) To find out Gross Profit or Gross Loss.
- (2) To compare last year's items with this year's.
- (3) To scrutinise the reasons for increase or decrease in sales.
- (4) To find out the percentage of Gross Profit or Gross Loss on sales.
- (5) To fine out the expenses incurred on purchase of goods.
- (6) To simplify the method of valuation of closing stock.

### SPECIMEN OF TRADING ACCOUNT

(for the year ending .....)

Dr.		Cr.	
Particulars	Amount	Particulars	Amount
To Opening Stock	.....	By Sales	.....
To Purchases	.....	Less : Sales Return or	.....
Less : Purchase Return or		Return Inward	.....
Return outward	.....	By Closing stock	.....
To wages	.....	By Gross Loss	.....
To wages & Salaries	.....	(if any) transferred to	
To carriage	or	Profit and Loss A/C	
To carriage Inward	or	(Balancing figure)	
To carriage on purchase	.....		
To Direct Expenses	.....		
To Freight, Octroi and cartage	.....		
To Gas, Fuels & Power	.....		
To Manufacturing Expenses	.....		
or productive Expenses	.....		
To Factory Expenses, such as			
Factory lighting	.....		
Factory Rent etc.	.....		
To Dock charges and clearing charges	.....		
To Import Duty or Custom Duty	.....		
To Excise Duty	.....		
To Royalty	.....		
To Gross Profit	.....		
transferred to P&L A/C	.....		
(Balancing figure)	.....		.....

### Profit & Loss Account

A businessman has to incur a number of expenses which are not taken to trading account. Hence a business man is more interested in knowing the profit earned or net loss incurred during the year. As such, a Profit & Loss Account prepared

which contains all the items of losses and gains pertaining to the accounting period. This account is prepared from Nominal accounts and its balance is transferred to capital account.

According to Prof. Carter – “A Profit & Loss Account is an account into which all gains and losses are collected, in order to ascertain the excess of gains over the losses or vice-versa.”

### Objects/Importance of Profit & Loss Account

- (1) To ascertain the Net Profit or Net Loss
- (2) To Compare current year and previous year profits
- (3) To ascertain whether business is being conducted efficiently or not.
- (4) Helps in taking concrete steps for controlling expenses.
- (5) Helpful in the preparation of Balance-sheet

#### Specimen of Profit & Loss Account (for the year ending .....)

Particulars	Amount	Particulars	Amount
To Gross Loss b/d	.....	By Gross Profit b/d	.....
To Salaries	.....	By Rent (Cr.)	.....
To Salaries & wages	.....	By Discount (Cr.)	.....
To Rent, Rates & taxes	.....	By Commission received	.....
To Printing & Stationery	.....	By interest on investments	.....
To Postage & Telegram	.....	Investments	.....
To Insurance Premium	.....	By Bad-debts Recovered	.....
To Telephone Charges	.....	By Apprentice Premium	.....
To Legal Charges	.....	By Profit on sale	.....
To Audit fees	.....	of Assets	.....
To Traveling expenses	.....	By Discount on purchases	.....
To Establishment Expenses	.....	By Rent of subletting	.....
To Trade Expenses	.....	By income from	.....
To General Expenses	.....	other sources	.....
To Carriage outward or	.....	By Net loss (if any)	.....
Carriage on sale	.....	transferred to	.....
To Unproductive wages	.....	capital A/c	.....
To Advertisement	.....		
To Commission	.....		
To Brokerage	.....		
To Bad-debts	.....		
To Packing charges	.....		
To Delivery van expenses	.....		
To Stable Expenses	.....		
To Discount	.....		
To Sales tax			
To Repairs			
To Depreciation			
To Interest (Dr.)			
To Bank Charges			
To charity & Donation			
To entertainment Expenses			
To Conveyance Expenses			
To Loss on sale of Asset			
To Net Profit			
transferred to Capital A/c			
	.....		.....

NOTES

## BALANCE-SHEET

The Trading and Profit & Loss account show only the net profit or net Loss of a business for a certain trading period. But the businessman likes to know the financial position of the business at the end of the trading period. For this purpose, he prepares a statement of his assets and liabilities as on the closing date of the trading period. This statement is known as Balance-sheet. A Balance-Sheet is a sheet containing the balances of real and personal accounts of a business. The name, balance-sheet is derived from the fact that these accounts must always be in balance i.e. Assets must equal the sum of liabilities.

According to J.R. Batliboi – “A Balance-sheet is a statement with a view to measure the exact financial position of a business on a certain fixed date.”

### Need and Importance of Balance-Sheet

- (1) To ascertain the true financial position of the business at a particular point of time.
- (2) To ascertain the nature and cost of various assets of the business.
- (3) To determine the nature and amount of various liabilities of business.
- (4) To provide information about the exact amount of capital at the end of year and the addition/deduction in the current year.
- (5) To find out whether the firm is solvent or not.
- (6) To help in preparing the opening entries at the beginning of the next year.

### BALANCE-SHEET

Liabilities	Amount	Assets	Amount
<b>Current Liabilities</b>	.....	<b>Current Assets</b>	.....
Bank Overdraft	.....	Cash in hand	.....
Bills Payable	.....	Cash at Bank	.....
Sundry Creditors	.....	Bills Receivable	.....
Outstanding Expenses	.....	Short term Investment	.....
Bank Loan (Short-term)	.....	Sundry Debtors	.....
Unearned Income	.....	Closing Stock	.....
<b>Fixed Liabilities</b>	.....	Prepaid Expenses	.....
Long term loan	.....	Accrued Income	.....
Reserves	.....	<b>Fixed Assets -</b>	.....
Capital	.....	Furniture	.....
(+) Net Profit .....	.....	Motor Vehicles	.....
(-) Net Loss .....	.....	Long term Investment	.....
(-) Drawings .....	.....	Plant & Machinery	.....
(-) Income Tax & LIP ....	.....	Land & Building	.....
	.....	Patents	.....
	.....	Goodwill	.....
	.....		.....

## ADJUSTMENT ENTRIES

In order to ascertain the true profit or loss of a business for a particular year, it is necessary that all expenses and incomes relating to that year are taken into consideration. For example, if we want to ascertain the net profit for the year

## NOTES

### NEED OF ADJUSTMENTS :

1. To ascertain the true net profit or loss of the business.
2. To ascertain the true financial position of the business.
3. To make a record of the transaction omitted from the books.
4. To rectify the errors committed in the books of accounts.
5. To make a record of such expenses or incomes which have accrued but have not been paid.
6. To provide for depreciation and other provision.

While preparing final accounts it must be detected whether there is a transaction :

- (1) which has been omitted to be recorded in the books, or
- (2) which has wrongly been recorded in the books, or
- (3) of which only one aspect has been recorded in the books. Entries passed for such transactions are called '**adjustment entries**'.
- (1) **Closing stock** – The amount of goods unsold at the end of the year is called closing stock. It is valued at cost price or market price, whichever is less. The entry will be :

(for closing stock transferred to Trading A/c)

**Effect** – It will be shown at two places, i.e., on the credit side of the Trading A/c and on the Assets side of the Balance-sheet.

- (2) Outstanding expenses or expenses due but not paid** – These are the expenses which have been incurred during the year but have been left unpaid on the date of preparation of final accounts. For example, a firm pays rent @ 5000 per month. If during the accounting year ending on 31 Dec., only 11 months rent amounting to Rs. 55,000 has been paid, rent for one month of Rs. 5,000 will remain outstanding at the end of the year. The entry will be :

Rent A/c	Dr.	5000	
To Outstanding Rent			5000
(for outstanding rent of one month)			

**Effect :** Added to the concerned expenses on the debit side of Trading or Profit & Loss. Account and on the other hand, will also be shown on the Liabilities side of the Balance-Sheet.

NOTES

- (3) **Prepaid Expenses or Unexpired Expenses or Expenses paid in advance** – These are the expenses which have been paid in advance for the next year during the current year itself. In other words, the benefit of such payments will be available in the next accounting year. Prepaid insurance amounted to Rs. 1000.

Prepaid Insurance A/c	Dr.	1000
To Insurance A/c		1000
(for Prepaid Insurance is to Insurance A/C)		

**Effect :** It will be deducted from the concerned expenses on the debit side of Trading or Profit and Loss Account and on the other hand, will also be shown on the Asset side of the Balance-sheet.

- (4) **Depreciation** – Depreciation is the loss on fall in value of fixed assets due to their constant use and expiry of time. For example : Machinery of Rs. 60,000 is to be depreciated @ 10% p.a. Entry will be :

Depreciation A/c	Dr.	6,000
To Machinery A/c		6,000
(for Depreciation charged)		

**Effect :** It will be shown on the debit side of the Profit & Loss A/C and will be deducted from the value of the concerned asset on the Asset side of Balance Sheet.

- (5) **Accrued Income or Income Receivable** – Income earned during the current year but have not been actually received by the end of the current year. Such incomes are known as 'Accrued Incomes' or 'Earned Incomes'. For example, commission earned in December (at the end of year) and received in January of Rs. 300 then commission accrued is Rs. 300.

Accrued commission A/c	Dr.	300
To Commission A/c		300
(for commission receivable)		

**Effect :** Such incomes will be shown on the credit side of the Profit & Loss Account and on the other hand, will be shown on the Asset side of the Balance-sheet.

- (6) **Unearned Income or Income Received in Advance** – Certain Income is received in the current year but the whole amount of it does not belong to the current year. Such Income is known as 'Unearned Income' or 'Income Receivable'. For e.g. – Rent received on 1<sup>st</sup> April, 2006 Rs. 28,000 @ Rs. 2000 P.M. This rent is from 1<sup>st</sup> April, 2006 to 30 May, 2007. Accounting year is from 1<sup>st</sup> April, 2006 to 31<sup>st</sup> March, 2007. In such case, 2 months, rent (April 07 & May 07) is advance income, entry will be.

Rent a/c	Dr.	4000
To Rent received in Advance a/c		4000
(For adjustment of unearned Rent)		

**Effect :** It will be deducted from the concerned, income on the credit side of Profit & Loss Account and also be shown on the liabilities side of the Balance-sheet.

- (7) **Interest on Capital** – Capital invested by the proprietor is treated as a loan to the business earning interest at a fixed rate. If this amount had not been

invested in the capital, it would even then have earned some interest outside. As such the proprietor wants interest for his capital and profit for the risk undertaken by him, for example, if 5% interest is to be allowed on the capital of Rs. 1,00,000, the entry will be :

Interest on capital A/c Dr.	5,000	
To Capital A/c		5,000
(for Interest allowed on capital)		

**Effect :** Interest on capital is shown on the debit side of Profit & Loss Account and added to capital in Balance-sheet.

- (8) **Interest on Drawings** – The proprietor draws cash or goods for his personal use. Such withdrawals are termed as Drawings. If the firm pays interest on Capital, it is fully justified that it should also charge interest on drawings. For example : Proprietor has drawn 10,000 for personal use and interest is @ 3%. Its entry will be :

Drawings A/c Dr.	300	
To Interest on Drawings		300
(for Interest charged on Drawings)		

**Effects :** Interest on drawing is shown on the credit side of Profit & Loss Account & deducted from capital in Balance-Sheet.

- (9) **Interest on Loan** – Loan is a liability of the firm and interest on such loan will be an expense. If up-to-date interest has not been paid on the loan, the unpaid interest will have to be calculated and will be treated just like outstanding expenses i.e. For example, Interest on loan is charged @ 10% & the amount of loan is 200000.

Interest on Loan A/c Dr.	20000	
To Outstanding Interest A/c		20000
(for interest charged on loan)		

**Effect :** It is an expense, write it towards debit side of P&L a/c and add to the loan from Bank.

- (10) **Bad Debts** – When it becomes certain that a particular amount will not be recovered from debtors, it is known as Bad debts. For examples written off Bad debts of Rs. 1000. Entry will be

Bad debts A/c Dr.	1000	
To Debtors A/c		1000
(for Bad debts deducted from debtors)		

**Effect :** It will come in debit side of the P&L a/c and the amount will be deducted from Debtors on the Asset side of the Balance-sheet.

- (11) **Provision for Bad and Doubtful Debts** – As the amount of actual loss on account of current year bad-debts would be known only in the next year when the amount is realized from Debtors, a provision is created to cover any possible loss on account of bad-debts likely to occur in future. Such a provision is created at a fixed percentage on Debtors every year and is called 'Provision for B.D.D.' For example : Debtors are of Rs. 60,000 and provision is made on it @ 5%. Its entry will be :

Profit & Loss A/c Dr.	3000	
To Provision for Bad and Doubtful Debts		3000
(for the creation of reserve @ 5% on Debtors)		

## NOTES

**Effect :** It will come on debit side of P&L a/c and amount is deducted from Debtors on the Asset side of Balance-Sheet.

**(12) Provision for discount on Creditors** – Many a time discount is received from the creditors. A reserve is created for possible discount in the future. For example, Creditors are of Rs. 20,000 and created provision@ 2% on its entry :

Provision for discount creditors A/c Dr.	400	
To Profit & Loss A/c		400
(for provision of discount on creditors)		

**Effect :** It will come towards the credit of Profit & Loss A/c & deduct from creditors from Balance-Sheet.

## BILL OF EXCHANGE

We know well that a transaction is either cash transaction or credit transaction. In credit transaction the payment and receipt of cash is not Included but in cash transaction cash or cheque is transfered between two parties. We can also make a transaction with bill of Exchange Transaction involving bill of exchange are governed by the provisions of the Negotiable Instruments Act 1881.

Bill of Exchange is an unconditional order to pay a certain sum of money only to or to the order of a certain person or to the bearer (payee) of the bill of exchange. Bill of exchange should be in writing and signed by the make and acceptor.

### Bill of Exchange (Specimen)

<div style="border: 1px solid black; padding: 5px; margin: 0 auto; width: 80%;"> Revenue Stamp </div>	Place & Date	
Rs : (In figure)  ( ..... Months) after the date pay to me or my order the sum of Rs. (amount in words) .....only for value Received.		
To, M/s ..... .....	<div style="display: flex; align-items: center;"> <div style="border-left: 1px solid black; border-right: 1px solid black; padding: 0 5px; text-align: center;"> Address of Drawee </div> <div style="margin-left: 10px;"> Accepted (Signature of) (Drawee) </div> </div>	Signature ..... Drawer

Drawer is a person who draw the bill of exchange drawee is a person who accepted the bill of exchange or on whom the bill is drawn. Payee is the person who receives the payment on maturity of the bill.

## DUTIES & TAXES

Accounting

### 1. VAT

The full form of VAT is Value added tax. It is an indirect tax. VAT is paid to the government and the amount of tax passed into the consumer. Input VAT is Tax paid on purchase & Output VAT is Tax charged on sale. VAT multipoint tax as against sales tax, which is a single point tax.

VAT has been introduced in India to ensure a fair and uniform system of taxation.

#### The Advantages :

- (i) Enhancement of Competitiveness by removal of the cascading effect to taxes.
- (ii) Simplifying the process of taxation.
- (iii) Self regulatory mechanism ensuring greater compliance.

### 2. Sale Tax

Central sale tax is governed by the central sales tax Act, 1956 which covers inter state transaction of sale of goods as well as transactions of import or export of goods.

Local sale tax is governed by the respective state sales tax Acts under which tax is levied on intra-state transactions.

## INVENTORY

"Inventory" means a physical stock of goods which is kept in hand for smooth and efficient running of future affairs of an organization at the minimum cost of fund blocked in inventories. Inventory is the aggregate of those items of tangible personal property which

- are held for sale in the ordinary course of business.
- are in the process of production for such sales, or
- are to be currently consumed in the production of goods or services or are to be available for sale.

Acc. to S.E. Bolton States – **"The term 'inventory' refers to the stockpile of the product of a firm is offering for sale and the components that make up the product."**

When the term 'inventory' is applied to a non-manufacturing concern, it includes goods owned by the business for sale to customers in the normal course of business, and when the term inventory is applied to a manufacturing concern, material used in production are also considered to be inventory. Since inventories are sold during a concern's normal operating cycle, usually a year such inventories are classified as 'current inventory', can be classified in following categories -

- work in progress
- Stores and spares i.e. loose tools etc.
- Finished goods or stock in trade.

Objectives of Inventory Management : The main objectives of inventory control is to avoid over-investment & under-investment as well as to provide right

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#### Check Your Progress

4. Define Cash Book.
5. What do you understand by Balancesheet.
6. Write some advantages of VAT.

quantity of goods of right quality at proper value and at proper time. The objectives are discussed as :

### OBJECTIVES OF INVENTORY MANAGEMENT

NOTES

Operating	Financial
(1) To make all types of material available	(1) To ascertain economy in purchasing raw materials.
(2) To minimize the wastage	(2) To have an optimum level of investments efficient use of capital
(3) To promote manufacturing efficiency	(3) To reduce cost of inventory.
(4) To provide better services to customers	
(5) To control production level	
(6) To maintain optimal level of inventories.	

### NEED OF HOLD INVENTORY

There are three main motives for holding inventory :

- (1) **Production and sales motive** – Smooth production can be ensured only when the raw material required is always available. In the same manner, sales can go well with sufficient production.
- (2) **Speculative motive** – It influences the decision to increase/decrease inventory level to take advantages of price fluctuation.
- (3) **Precautionary motive** – To guard against the risk of unpredictable changes in demand and supply force.

A consistent policy is maintained to decide how much inventory is to be kept in our business, because keeping little as well as keeping lots of inventory has its advantages and disadvantages

### How much stock should you keep?

Deciding how much stock to keep depends on the size and nature of your business, and the type of stock involved.

Keeping little or no Inventory

Advantages	Disadvantages
<b>Efficient and flexible. You only have what you need, when you need it.</b>	Meeting inventory needs can become complicated and expensive.
<b>Lower inventory and storage costs.</b>	You might run out of inventory if there's a hitch in the system.
<b>You can keep up-to-date and develop without wasting inventory.</b>	

This might suit your business if it's in a fast-moving environment where products develop rapidly, the inventory is expensive to store, the items are perishable or replenishing inventory is quick and easy.

Keeping lots of stock

Accounting

Advantages	Disadvantages
Easy to manage.	Higher inventory, storage and insurance costs.
Low management costs.	Certain goods might perish.
You never run out.	Inventory may become obsolete before it is used. Your capital is tied up.

NOTES

This might suit your business if sales are hard to predict (and it is hard to pin down how much inventory you need and when), you can store plenty of inventory cheaply, the product is unlikely to go through rapid developments or take a long time to re-order.

## Inventory levels depending on type of stock

### Raw materials and components

Ask yourself some key questions to help decide how much stock you should keep:

- How reliable is the supply?
- Are the components produced or delivered in batches?
- Can you predict demand?
- Is the price steady?
- Are there discounts if you buy in bulk?

### Work in progress -

Keeping inventory of unfinished goods can be a useful way to protect production if there are problems down the line with other supplies.

### Finished goods

You might keep inventory of finished goods when:

- demand is certain
- goods are produced in batches
- you are completing a large order

### Stores & Spares

For example, fuel loose tool sets. How much stock you keep will depend on factors such as:

- reliability of supply
- expectations of price rises
- how steady demand is
- discounts for buying in bulk

### Inventory Control

One of the principal functions of cost accounting is exercising effective control over materials i.e. inventory. Such control implies regulation of availability of right material in right quantity and on right time for smooth flow of production at minimum cost and investment material.

Inventory control is concerned with the acquisition storage, handling and uses of inventories so as to ensure the availability of inventory whenever

## NOTES

needed, providing economy and minimizing wastages. The main objectives of inventory control are –

- (1) To minimize the possibility of delay in production.
- (2) To avoid unnecessary capital being locked up in inventories.
- (3) To exercise economies in ordering and obtaining supplies and storage of materials.

Proper control of inventories increases the profitability of the business and causes substantial reduction in the working capital as well as solves the problem of liquidity.

The basic function of inventory is to insulate the production process from changes in the environment as shown below.

Note here that although we refer in this note to manufacturing, other industries also have stock e.g. the stock of money in a bank available to be distributed to customers, the stock of policemen in an area, etc).

One point to note from the above diagram is that most of the activities are a cost - it is only at the final point (sales of finished goods) that we get revenue to set against our costs and hopefully make a profit (= revenue - cost). Hence if we have cost associated with stock we need to deal with that stock in an **Effective, Efficient and Economic** manner (the **3E's** as I tend to term it).

## DETERMINATION OF STOCK LEVELS :

### Maximum level

It is the largest quantity of a particular material which should be stored at a given point of time. The limit should be fixed to avoid unnecessary investment in inventories, losses on account of deterioration and obsolescence of materials, extra overheads and other losses. The maximum limit should be decided after considering

1. Storage space
2. Amount to be invested on inventory
3. Availability of material
4. Rate of Consumption of material and time necessary to obtain new materials.
5. Government Rules for import or procurement.
6. Economic Order Quantity.
7. Cost of insurance, storage, interest on capital invested in stocks.

$$\text{Maximum level} = (\text{Re-Order level} + \text{Re-Order Quantity}) - (\text{Minimum Consumption} * \text{Minimum Re-Order Period})$$

### Minimum Level (Safety of Buffer Stock)

The minimum level is the lowest quantitative balance of materials in hand which must be maintained at all times so that the assembly line may not be stopped on account of non-availability of materials. Following factors should be kept in mind while deciding the limit:

1. Average rate of consumption of materials
2. Average time required to obtain delivery of fresh supplies

### Check Your Progress

7. What do you mean by Inventory.
8. What do you understand by ordering level (Re-order level).

### 3. Re-order level

*Minimum level = Re-order level - (normal consumption \* normal reordering period)*  
or

*Minimum level = Usage Rate per Day × Days of Safety*

NOTES

#### Ordering Level (Re-order level)

It is the point where further supplies must be ordered. The re-ordered level is fixed somewhere between the maximum and minimum level in a way that quantities of materials depicted by the difference between reordering level and the minimum level will be sufficient to meet the demands of production till the time fresh stock is received.

Re-order level mainly depends on:

1. Maximum consumption
2. Lead time i.e., the time gap between the date of issuing orders and receipt of materials.

*Re-order level = Maximum re-order period \* maximum usage.*

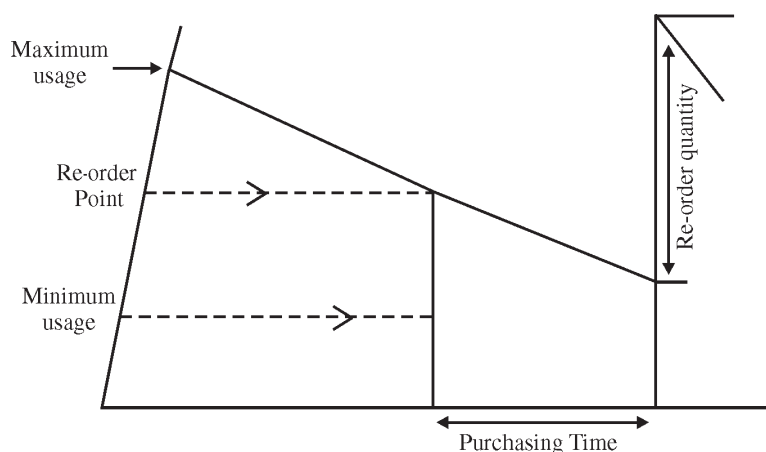
or *Re-order level = (Lead time × Usage Rate per Day) + Safety Stock*

#### Danger level

It is the level below which the material stock should not be allowed to fall in normal circumstances. This level is slightly below the minimum level. In some cases this limit is fixed above the minimum level but below the re-order level. Fixation of danger level below the minimum level is meant for taking corrective action while its fixation above the minimum level is indicator for preventive action.

*Danger level = Minimum Rate of Consumption × Minimum Re-order Period*

or *Normal Consumption × Max. delivery period during emergency purchases.*



**Example 6 :** Compute various levels of stock from the following data :

Normal Consumption	= 300 units per day.
Maximum Consumption	= 420 units per day
Minimum Consumption	= 240 units per day
Reordering quantity	= 3600 units
Reordering period	= 10 to 15 days
Normal reordering period	= 12 days

NOTES

**Solution :**

(i) Reorder Level = Maximum Consumption × Maximum re-ordering period  
 = 420 units × 15 days  
 = 6,300 units

(ii) Minimum Level = Reorder Level – (Normal consumption × Normal reordering period)  
 = 6300 – (300 × 12)  
 = 6,300 – 3,600  
 = 2,700 units

(iii) Maximum Level = (Reorder level + Reorder quantity) – (Minimum consumption × minimum Reordering Period)  
 = (6,300 + 3,600) – (240 × 10)  
 = 9,900 – 2,400  
 = 7,500 units

(iv) Average stock level =  $\frac{\text{Maximum level} + \text{Minimum level}}{2}$   
 =  $\frac{7,500 + 2,700}{2} = \frac{10,200}{2} = 5,100$  units

### Cost Centres

A Cost Centre is an organisational segment area of activity for which it is desirable to accumulate costs. It is the segment that is considered to accumulate costs, but not to generate revenues. A cost centre is charged, with all costs that relate to it. It may be a location, an area, an item of equipment, a person or a group of these. According to ICMA, England- "A cost centre is a location, person or item of equipment for which costs may be ascertained and used for the purpose of control."

### Cost Units

Cost unit is a step further which breaks up the cost into smaller sub-division and helps in ascertaining the cost of saleable products or services. A unit of quantity of product, service or time or a combination, in relation to which cost may be ascertained or expressed. The following are few examples of cost units :

Industry	Units
Paper	Per ream
Cable	Per metre
Bricks	1000 bricks
Automobile	number
Nuts & bolts	Gross, number
Shoes	Pair
Cotton or Jute	Bale
Power	Kilo-watt hour
Cloth	Per than (10-25 Metres)

### SUMMARY

- Accounting is the art of recording, classifying and summarizing in terms of money transactions and events of financial character and interpreting the result thereof.

- Objectives of Accounting are – Maintain Systematic Business Records, Depiction of Financial Position, Availability of information to interested parties and Ascertainment of working Results.
- Important terms related to accounting are Business, Transaction, Goods, Discount, Bad debts, Liability, Assets, Debtors, Stock, Creditors, Drawings, Expenses, revenues, Purchases, Sales, Inventory and vouchers.
- $\text{Assets} = \text{Liabilities} + \text{Owner's Equity}$ .
- Under double entry system, the total of the debit entries and credit entries on the various accounts must be equal.
- An Account is a summarized record of relevant transactions at one place relating to a particular head.
- Accounts of business are categorized as – Personal Account, Real Accounts and Nominal Accounts. Rules of these accounts are –
  - ⇒ Personal Account – Debit the receiver and credit the giver.
  - ⇒ Real Account – Debit what comes in and credit what goes out.
  - ⇒ Nominal Account – Debit all expenses/losses and credit all income/profits.
- Journal is a book of original entry wherein transactions are recorded chronologically showing date, amounts and amounts.
- Ledger is a book or register, which contains, in a summarized and classified form, a permanent record of all the transactions. The accounts balance is calculated as  $\text{Beginning Balance} + \text{Increase} - \text{Decrease}$ .
- Cash Book may be defined as the record of transactions concerning cash receipts and cash payments. There are three main types of cash book – Single Column, Two-Column and Three Column.
- Subsidiary books may be defined as books where transactions are entered first for the purpose of record.
- Trial balance is a worksheet where all general ledger accounts and their debit and credit balance appear. It is a tool that is used to detect error in the books. The total debits must equal to the total credits.
- Financial Statements refers to statements, which reports the profitability and the financial position of the business at the end of accounting period. They are Trading and Profit & Loss accounts, Balance – Sheet etc.
- Trading Account shows the results of buying and selling of goods, which is prepared to determine gross profit and gross loss.
- A Profit & Loss Account is an account into which all gains and losses are collected, in order to ascertain the excess of gains over the losses or vice-versa.
- A Balance-Sheet is a statement with a view to measure the exact financial position of a business on a certain fixed date.
- Bill of exchange is an unconditional order to pay a certain sum of money only to or to the order of, a certain person or to the bearer of the bill.
- The term 'Inventory' refers to the stockpile of the product a firm is offering for sale and the components that make up the product.
- Inventory control is concerned with the acquisition, storage, handling and uses of Inventories so as to ensure the availability of inventory whenever needed, providing sufficient protection for contingencies, maximizing economy and minimizing wastage and losses.

## NOTES

- The maximum stock level is that quantity of material, which the stock of any item should, not generally allowed going.
- Usually, it is seen that the ordering company does not get the required goods instantly. The company requires time to execute the order. This period is known as 'Lead Time' or 'Minimum stock level' or 'Safety stock'.
- Reorder level is the point at which the expected usage of an item of inventory would just exhaust the existing inventory during the time required in obtaining fresh delivery.

### Answer to Check Your Progress

1. Accounting is a process-oriented task that follows a prescribed series of steps in order to keep track of, and record, the balances of the various accounts.
2. The following are the main objectives of Accounting :
  - (a) Maintaining systematic business records.
  - (b) Depiction of Financial position.
  - (c) Availability of information to interested parties.
  - (d) Ascertainment of working results.
3. Any thing which is in the possession or is the property of business enterprise including the amount due to it from others, is called an asset. In other words, anything which will enable a business enterprise to get cash or a benefit in future is an asset. For example : Building, Land, furniture, debtors, goodwill etc.
4. Cash book may be defined as the record of transactions concerning cash receipts and cash payments. It is essential for a business to know the flow of cash or bank balance on hand. For this purpose and for recording the cash transactions, cash book is maintained.
5. A Balance-Sheet is a sheet containing the balances of real and personal accounts of a business. The name, balance-sheet is derived from the fact that these accounts must always be in balance i.e. Assets must equal the sum of liabilities.
6.
  - (i) Enhancement of Competitiveness by removal of the cascading effect to taxes.
  - (ii) Simplifying the process of taxation.
  - (iii) Self regulatory mechanism ensuring greater compliance.
7. "Inventory" means a physical stock of goods which is kept in hand for smooth and efficient running of future affairs of an organization at the minimum cost of fund blocked in inventories.
8. Reorder level is the point at which the expected usage of an item of inventory would just exhaust the existing inventory during the time required in obtaining fresh delivery.

### EXERCISE

1. Define following terms: -
  - ⇔ Stock
  - ⇔ Purchase
  - ⇔ Accounting Equation
  - ⇔ Minimum Level
  - ⇔ Maximum Level
  - ⇔ Reorder Level
  - ⇔ Trial Balance
  - ⇔ Financial Statements.
2. What is Accounting ? Give its Objects and Importance? Show what parties are interested in Accounting?