UNIT: 01
INTRODUCTION TO ACCOUNTING

Structure

1.1 Introduction

In our routine life we make many transactions like borrowing some ones pen, paying various bills like groceries bill, electricity bills etc, and going with someone for picnic so on and so forth. In all our daily transaction several involve financial elements. All the financial transactions should be recorded so that there is no confusion in future. The methods and procedures of recording financial transaction is the area of accounting.

1.2 Objective

After reading this unit the learner will be able to:

- To Familiarize the meaning, definitions & branches of accounting
- To understand the terms of Financial Accounting
- Familiarize with the Objectives & Importance of accounting
- To get insight on Accounting Terminologies
- To Explain the applicability of Accounting norms in hotel operations
- Understanding the Functions of accounting
- Review of Accounting Cycle
- Insight on Guest Accounting Cycle
- Understanding Accounting Principles
- Advantages & Limitations of Accounting

1.3 Meaning of Accounting

- An accounting system shows detailed information regarding each of the account categories, and it governs recording, reporting, and preparation of financial statement
- Accounting is concerned with the recording of financial transactions and analyzing the effect of such transactions; which will assist in the development of business decisions.
- Hospitality Accounting is concerned with providing specialized internal data to operational managers of the core departments of Hotel & Hospitality Industry.
- Executives from Food Production Department can direct stores for specific orders based on current & foreseen data of Hotel Occupancy. Duty Roasters can be altered across all core departments to enhance operational efficiency with available data.

1.3.1 Definitions of Accounting

The committee of the ***American Institute of Certified Public Accountants*** has defined Accounting as:

> *"Accounting is the art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events, which are, in part at least of financial character and interpreting the results thereof".*

Further, According to ***American Accounting Association***, Accounting is defined as –

> *"The process of identifying, measuring and communicating economic information to permit informed judgments and decisions by users of the information".*

1.3.2 Branches of Accounting

The changing business scenario over the centuries gave rise to specialized branches of accounting which could cater to the changing requirements. The branches of accounting are:

- Financial accounting;
- Cost accounting; and
- Management accounting.

1.3.2.1 Financial Accounting

The accounting system concerned with the financial state of affairs and financial results of operations is known as Financial Accounting. It is the original form of accounting. It is mainly concerned with the preparation of financial statements for the use of outsiders like creditors, debenture holders, investors and financial institutions. The financial statements i.e., the profit and loss account and the balance sheet, show them the manner in which operations of the business have been conducted during a specified period.

1.3.2.2 Cost Accounting

It is that branch of accounting which is concerned with the accumulation and assignment of historical costs to units of product and department. Cost Accounting has been primarily being use for the purpose of valuation of stock and measurement of profits. It also seeks to ascertain the cost of unit produced and sold or the services rendered by a business entity. Cost Accounting is mostly related to the future aspects of the business. The process of cost accounting is based on the data provided by the financial accounting.

1.3.2.3 Management Accounting

It is an accounting for the management i.e., accounting which provides necessary information to the management for discharging its functions. According to the Anglo-American Council on productivity, "Management accounting is the presentation of accounting information is such a way as to assist management in the creation of policy and the day-to-day operation of an undertaking." It covers all arrangements and combinations or adjustments of the orthodox information to provide the Chief Executive with the information from which he can control the business e.g. Information about funds, costs, profits etc. Management accounting covers the area of accounting beyond the perspectives of cost accounting. These areas can be capital expenditure decisions, capital structure decisions, and dividend decisions.

1.4 Methods of Accounting

Business transactions are mostly recorded in two different ways.

- **Single Entry**
- **Double Entry**

1.4.1 Single Entry

It is the incomplete system of recording business transactions. The business organization maintains only cash book and personal accounts of debtors and creditors. Henceforth, the complete recording of transactions cannot be made. Further, Trail Balance – a important constituent of Accounting cannot be prepared in this system.

1.4.2 Double Entry

It this system every business transaction is having a twofold effect of benefits giving and benefit receiving aspects. The recording is made on the basis of both these aspects. Double Entry is an accounting system that records the effects of transactions and other events in at least two accounts with equal debits and credits.

CHECK YOUR PROGRESS-I

1. Define accounting? List the various branches of accounting.

2. Explain the various methods of accounting.

1.5 Business Transaction

The details of the business transactions have to be recorded in a clear and systematic manner to get answers easily and accurately for the following questions like

i. What has happened to his investment?
ii. What is the result of the business transactions?
iii. What are the earnings and expenses?
iv. How much amount is receivable from customers to whom goods have been sold on credit?
v. How much amount is payable to suppliers on account of credit purchases?
vi. What are the nature and value of assets possessed by the business concern?
vii. What are the nature and value of liabilities of the business concern?

All of the above questions can be answered only when we have proper books of accounts that maintain all business transaction's – recorded &updated. Henceforth, we can conclude that:

- Business transactions gives an insight for appropriate decisions for each cyclical sales or revenue pattern
- Hotel & Hospitality operations tend to be highly departmentalized with separate operating divisions – like Room Division Department, Food & Beverage Department.
- The major direct costs in Hotel Operations include - Cost of sales, Salary & wages& specific operating supplies.

- The variable cost like Cost of sales, Labour costs require unique planning procedures that will assist in budget forecasting.
- Indirect costs are not easily traceable to a department or division.
    - **CASH BASIS OF ACCOUNTING** – Cash Basis of accounting recognizes sales revenue and operating expenses only when cash changes hand. In other, terms – Cash Basis ofaccounting recognizes sales revenue inflow when cash is received and operational expenses outflows to generate. The cash basis can be computed as :

$$\textbf{Beginning Cash} + \textbf{Cash Sales Revenue} - \textbf{Cash Payments} = \textbf{Ending Cash}$$

    - **ACCURAL BASIS OF ACCOUNTING**–It recognizes the inflow of sales revenue when earned & operating expenses outflow to produce sales revenue when incurred. It doesn’t matter – when actual cash is received or paid.

1.6 Objectives of Accounting

The main objectives of accounting are: -

1. **To keeping systematic record**: Accounting serves the purpose of record keeping by promptly recording all the business transactions in the books of account.

2. **To ascertain the results of the operation**: Accounting helps in ascertaining result of a business entity i.e., profit earned or loss suffered in business during a financial year or Accounting period. For this very purpose, a business entity prepares either a Trading and Profit and Loss account or an Income and Expenditure account which shows the profit or loss of the business. The entities are matched on both revenue and expenditure to derive the results of operation modulus for the already specified financial year or Accounting period.

3. **To ascertain the financial position of the business**: Besides, the prime motive of profit, a businessman must have the knowledge of his financial position i.e., availability of cash, position of assets and liabilities etc. This helps the businessman to know his financial strength in his business entity.

4. **To portray the liquidity position**: Financial reporting provides critical information of an enterprise spending, borrowing, repayment of borrowing, capital transactions, cash dividends and other distributions of resources by the enterprise to owners. Besides, the above data’s; other factors that may affect an enterprise’s liquidity and solvency is highlighted in these reporting.

5. **To protect business properties**: Accounting provides up to date information about the various assets and the liabilities reflected in the books of Accounts of the business entity.

6. **To facilitate rational decision – making**: Accounting records and financial statements provide financial information to the business entity. These information’s assist the business in making rational decisions about interpreting data for future planning in form of Forecasting &Budgeting.

7. **To satisfy the requirements of law**: Entities such as companies, societies, public trusts are compulsorily required to maintain accounts as per the law governing their operations such as the Companies Act, Societies Act, and Public Trust Act etc. Maintenance of accounts is also mandatory under the Sales Tax Act and Income Tax Act.

8. **Assisting in Strategic Decision Making**: -Accounting assists proprietor's in making informed decisions on Mergers& optimum utilization of Resources.

1.7 Importance of Accounting

The importance of accounting is as under:

a. ***Owners****:* The owners provide funds in forms of capital infusion for the organization. They possess curiosity in knowing whether the business is being conducted on sound lines or not and whether the capital is being employed properly or not. Owners, being also the businessmen, always keep a tab on the returns from their investments. Comparing the accounts of various years helps in strategizing their funds or reallocation of portfolio for future actions.

b. ***Management****:* The management of the business is greatly interested in knowing the financial position of the organization. The accounts form the basis for the management to study the merits and demerits of the business activity. Henceforth, the financial accounting is the "eyes and ears of management and facilitates in drawing future course of action, further expansion etc."

c. ***Creditors****:* Creditors are the persons who supply goods on credit, or bankers or lenders of money. It is these groups that are interested to know the financial soundness before granting credit. The progress and prosperity of the firm, two which credits are extended, are largely watched by creditors from the point of view of security and further credit. Profit and Loss Account and Balance Sheet are nerve centers to know the soundness of the firm.

d. ***Employees****:* Payment of bonus depends upon the size of profit earned by the firm. The more important point is that the workers expect regular income for the bread. The demand for wage rise, bonus, better working conditions etc. depend upon the profitability of the firm and in turn depends upon financial position. For these reasons, this group has its interest in accounting.

e. ***Investors****:* The prospective investors, who strategically want to invest their hard-earned money in a firm, wishes to see the progress and prosperity of the firm. He / she before investing their amount will go through the financial statements of the firm. This is to safeguard the investment. For this, this group is eager to go through the accounting which enables them to know the safety of investment.

f. ***Government****:* Government keeps a close watch on the firms which yield good amount of profits. The state and central Governments are interested in the financial statements to know the earnings for the purpose of taxation. To compile national accounting is essential.

g. ***Consumers:*** These groups are interested in getting the goods at reduced price. Therefore, they wish to know the establishment of a proper accounting control, which in turn will reduce to cost of production, in turn fewer prices to be paid by the consumers. Researchers are also interested in accounting for interpretation.

h. ***Research Scholars:*** Accounting information, being a mirror of the financial performance of a business organization, has been of immense value to the research scholar. These scholars want to make a study into the financial operations of a particular firm. To make a study into the financial operations of a particular firm, the research scholar needs detailed accounting information relating to purchases, sales, expenses, cost of materials used, current assets, current liabilities, fixed assets, long-term liabilities and share-holders funds which is available in the accounting record maintained by the firm.

i. ***Stock Market:*** - Both Primary & Secondary Stock Market keep a close tab on financial performance of top 50 Companies in each sector. For Example: - The BSE Sensex & NSE Nifty is churned with changing times, but all computed on Financial Performance as per accounting norms.

CHECK YOUR PROGRESS-II

1. List the objectives of accounting.

2. Explain the importance of accounting.

1.8 Basic Terminology

The basic terminology of accounting is as under:

- **Account**: - Account is a summary of relevant business transactions at one place relating to a person, asset, expense or revenue named in the heading. An account is a brief history of financial transactions of a particular person or item. An account has two sides called debit side and credit side.

- **Accounting Equation**: The total assets of a business are always equal to the aggregate of its Capital &Liabilities.
    - Total Assets =Capital + Total liabilities

- **Allowance Journal**: -A Journal is used to recoup allowance vouchers when a sale is discounted

- **Assets**: -Assets are the properties of every description belonging to the business. Cash in hand, plant and machinery, furniture and fittings, bank balance, debtors, bills receivable, stock of goods, investments, Goodwill are examples for assets. Assets can be classified into tangible and intangible.

    - **Tangible Assets**: These assets are those having physical existence. It can be seen and touched. For example, plant & machinery, cash, etc.

    - **Intangible Assets**: Intangible assets are those assets having no physical existence but their possession gives rise to some rights and benefits to the owner. For Example, Goodwill, patents, trademarks are some of the examples.

- **Auditing**: - It is the branch of accounting, which examines a firm's financial statement & internal controls. In Hotel Industry, it is popularly known as Night Auditing.

- **Business**: - Business is an economic activity. It is defined as "The regular production or purchase and sale of goods undertaken with object of earning profit through the satisfaction of human wants".

- **Capital**: -It is the amount invested by a person in his business.This amount is increased by the amount of profits earned and the amount of additional capital introduced. It is decreased by the amount of losses incurred and the amounts withdrawn. For example, if Mr. Anand starts business with Rs.5,00,000, his capital would be Rs.5,00,000. It also includes the profit earned in the business.
    - Capital =Assets - Liabilities

- **Cash Purchase**: - Goods purchased by cash are called as Cash Purchase

- **Cash sales**: - When the sale of Goods is in Cash to the customer

- **City Ledger**: - A subsidiary ledger which is prepared at the end of accounting period to close the temporary proprietorship accounts into permanent one.

- **Closing Stock**: -Goods that are lying unsold on a particular date is known as closing stock.

- **Creditors**: - A person who gives a benefit without receiving money or money's worth immediately but to claim in future, is a creditor. The creditors are shown as a liability in the balance sheet. In the above example Mr. Babe is a creditor to Mr. Arul till he receives the value of the goods. It is abbreviated as 'Cr'.

- **Credit Purchase**: - Goods that are purchased without payment at that particular time is known as credit purchase.

- **Credit sales**: - When the sale of Goods is in the form of credit transaction to the customer.

- **Current Assets**: -Assets which are meant to be converted into cash within a period of time or during the normal operating cycle.

- **Current Liabilities**: -Obligations in Money or Money worth which are to be paid within a stipulated period of time.Example: - Short TermLoans, Bank Overdraft

- **Debtors**: -debtors A person (individual or firm) who receives a benefit without giving money or money's worth immediately, but liable to pay in future or in due course of time is a debtor. The debtors are shown as an asset in the balance sheet. For example, Mr. Arul bought goods on credit from Mr. Babu for Rs. 10,000. Mr. Arul is a debtor to Mr. Babu till he pays the value of the goods. It is abbreviated as 'Dr'.

- **Discount**: -It is when a businessman allows any type of concession in the price of goods to its customers.

- **Drawings**: - It is the cash or Goods withdrawn from the business by the proprietor for his personal use. It is deducted from the capital.

- **Expenses**: - It is the amount spent in order to produce and sell the goods and services. For example, purchase of raw materials, payment of salaries, wages, etc.

- **Fixed Assets**: -An asset which are required only for use & not for resale are known as fixed assets.

- **Income**: - Income is the difference between revenue and expense

- **Insolvent**: - A person's whose liabilities exceed the assets is known as insolvent

- **Intangible Assets**: -These are assets that are attached to the business & are not in physical forms.Example: -Goodwill, Patents Etc.

- **Invoice**: - Invoice is a business document which is prepared when one sell goods to another. The statement is prepared by the seller of goods. It contains the information relating to name and address of the seller and the buyer, the date of sale and the clear description of goods with quantity and price.

- **Liabilities**: -These refer to the financial obligations of a business. These denote the amounts which a business owes to others, e.g., loans from banks or other persons, creditors for goods supplied, bills payable, outstanding expenses, bank overdraft etc.

- **Net worth**: - It is the excess of Assets over the Liabilities of business to the outsider's. It can also be the amount payable from the owners to the business.

- **Owner**: -One who own's the business.

- **Profession**: - It is the practice of the intellectual skill by a person in a defined field of operations

- **Proprietor**: - A person who owns a business is called its proprietor. He contributes capital to the business with the intention of earning profit

- **Purchase Return or returns Outward**: -Goods when returned to the suppliers due to defective quality or not as per the terms of purchase, it is called as purchases return. To find net purchases, purchases return is deducted from the total purchases.

- **Purchases**: -Purchases refers to the amount of goods bought by a business for resale or for use in the production. Goods purchased for cash are called cash purchases. If it is purchased on credit, it is called as credit purchases. Total purchases include both cash and credit purchases.

- **Receipt**: - Receipt is an acknowledgement for cash received. It is issued to the party paying cash. Receipts form the basis for entries in cash book.

- **Revenue**: -Revenue means the amount receivable or realized from sale of goods and earnings from interest, dividend, commission, etc.

- **Sales return or returns inward**: - When goods are returned from the customers due to defective quality or not as per the terms of sale, it is called sales return or returns inward. To find out net sales, sales return is deducted from total sales.

- **Sales**: -Sales refers to the amount of goods sold that are already bought or manufactured by the business. When goods are sold for cash, they are **cash sales,**but if goods are sold and payment is not received at the time of sale, it is **credit sales**. Total sales include both cash and credit sales.

- **Solvent**: - When a person's assets exceeds or equals his liabilities

- **Stock**: - Stock includes goods unsold on a particular date. Stock may be opening and closing stock. The term opening stock means goods unsold in the beginning of the accounting period. Whereas the term closing stock includes goods unsold at the end of the accounting period. For example, if 4,000 units purchased @ Rs. 20 per unit remain unsold, the closing stock is Rs. 80,000. This will be opening stock of the subsequent year.

- **Tangible assets**: -These are assets that are in Physical forms attached to the Business. Example: -Land, Building Etc.
    - **Transactions**: - Transactions are those activities of a business, which involve transfer of money or goods or services between two persons or two accounts. For example, purchase of goods, sale of goods, borrowing from bank, lending of money, salaries paid, rent paid, commission received and dividend received. Transactions are of two types, namely, cash and credit transactions.

    - **Cash Transaction** is one where cash receipt or payment is involved in the transaction. For example, When Ram buys goods from Kannan paying the price of goods by cash immediately, it is a cash transaction.

    - **Credit Transaction** is one where cash is not involved immediately but will be paid or received later. In the above example, if Ram, does not pay cash immediately but promises to pay later, it is credit transaction.

- **Voucher**: -It is a written document in support of a transaction. It is a proof that a particular transaction has taken place for the value stated in the voucher. It may be in the form of cash receipt, invoice, cash memo, bank pay-in-slip etc. Voucher is necessary to audit the accounts.

1.9 Need to Study Accounting

The need to study accounting is listed below:

- A Firm communicates with the outside world through accounting statements

- Through the firm's financial statements, one can understand the affairs of the business

- It is a discipline that record's ,classify, summarizes and interprets financial information of a business in order to make informed & intelligent decisions

1.9.1 Users of Accounting Information

The basic objective of accounting is to provide information which is useful for persons and groups inside and outside the organizations.

a. **Internal Users**: Internal users are those individuals or groups who are within the organizations like owners, management, employees and trade.

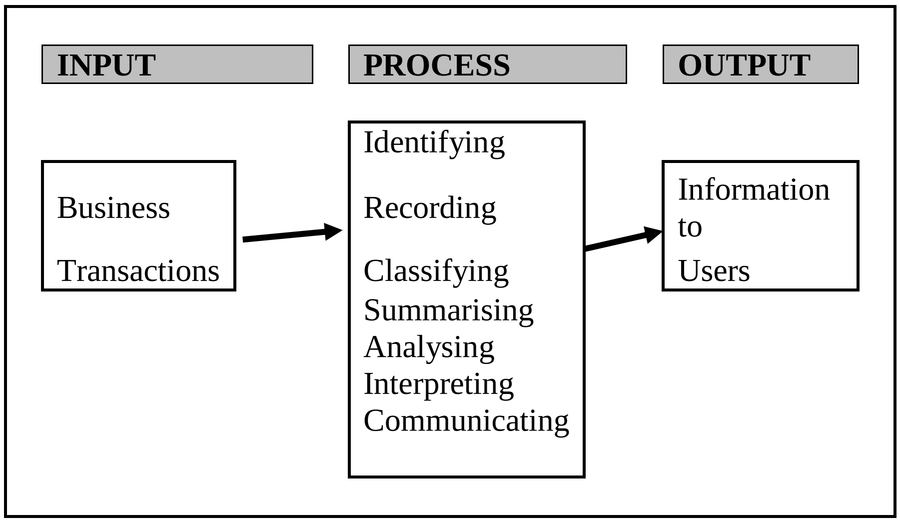
b. **External Users**: External users are those individuals or groups who are outside the organizations like creditors, investors, banks and other lending institutions, present and potential investors, Government, tax authorities, regulatory agencies and researchers.

Users		Need for Information
INTERNAL		
I.	Owners	To know the profitability & financial stability of the business
II.	Management	To Take prompt decisions to manage the business efficiently
III.	Employees & Trade Unions	To form judgement about the earning capacity of the business. This determines their remuneration and bonus.
EXTERNAL		
I.	Creditors, Banks & other lending institutions	To determine the repayment capacity of the principal and the interest thereof in due time frame.
II.	Present Investors	To know the position, progress and prosperity of the business. This is done to ensure the safety of their investments.
III.	Potential Investors	Decision making to invest in the business or not.
IV.	Government & Tax authorities	To know the earnings in order to assess the tax liabilities of the business
V.	Regulatory Agencies	To evaluate the business operation under the regulatory legislation

VI.	Researchers	To use their research work

1.10 Accounting Functions

- The Business Transactions can be summarized by the following accounting process: -



In order to accomplish its main objective of communicating information to the users, accounting embraces the following functions. The Function of Accounting are as follows:

1. **Identifying**: Identifying the business transactions from the source documents.

2. **Recording**: It ensures that all business transactions are recorded& maintained as per Accounting norms.

3. **Classifying**: This is concerned with the classification of the recorded business transactions so as to group the transactions of similar type at one place. i.e., in ledger accounts. In order to verify the arithmetical accuracy of the accounts, trial balance is prepared.

4. **Summarising**: Summarising involves presenting the data in a manner which is understandable and useful for both internal & external users. Example: - Income Statement, Balance sheet.

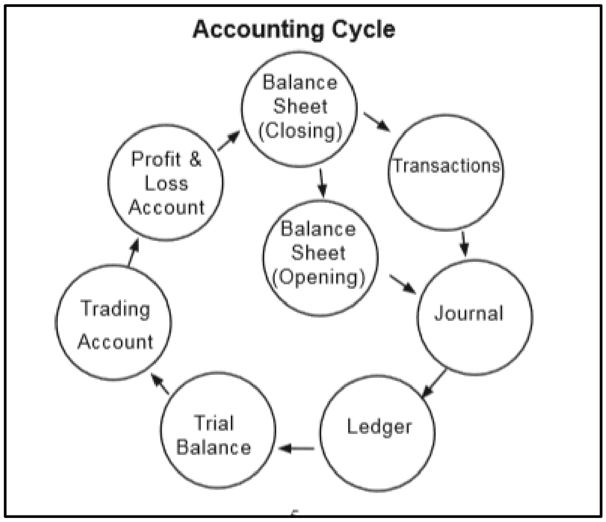
5. **Analysing**: It establishes the relationship between the items of the profit and loss account and the balance sheet. The purpose of Analysing is to identify the financial strength and weakness of the business. It provides the basis for interpretation.

6. **Interpreting**: The accountant interprets the data in a useful way for both internal & external users.

7. **Communicating**: In this last step, the accountant uses the Income statement & Balance sheet for interpreting Accounting ratio's, funds flow statement & comparison graphs.

1.11 Meaning of Accounting Cycle

An accounting cycle is a complete sequence of accounting process, that begins with the recording of business transactions and ends with the preparation of final accounts.



Accounting Cycle in an Organization:

Stage 1 – Creation & Maintenance of Primary Books of Accounts

When a businessman starts his business activities, he records the day-today transactions in the Journal. From the journal the transactions move further to the ledger where accounts are written up. Here, the combined effect of debit and credit pertaining to each account is arrived at in the form of balances. To prove the accuracy of the work done, these balances are transferred to a statement called trial balance.

Stage 2 – Preparation of Trading and Profit & Loss Accounts

Preparation of trading and profit and loss account is the next step. The balancing of profit and loss account gives the net result of the business transactions.

Stage 3 – Preparation of Balance Sheet

To know the financial position of the business concern balance sheet is prepared at the end. These transactions which have completed the current accounting year, once again come to the starting point – the journal – and they move with new transactions of the next year. Thus, this cyclic movement of the transactions through the books of accounts (accounting cycle) is a continuous process.

1.11.1 Guest Accounting Cycle in Hotel Operations

Guest Accounts are Bradly classified in three stages of Guest Accounting cycle: -

Stage 1 – **Creation of Guest Accounts**

Stage 2 – **Maintenance of Guest Accounts**&
Stage 3 – **Settlement of Guest Accounts**

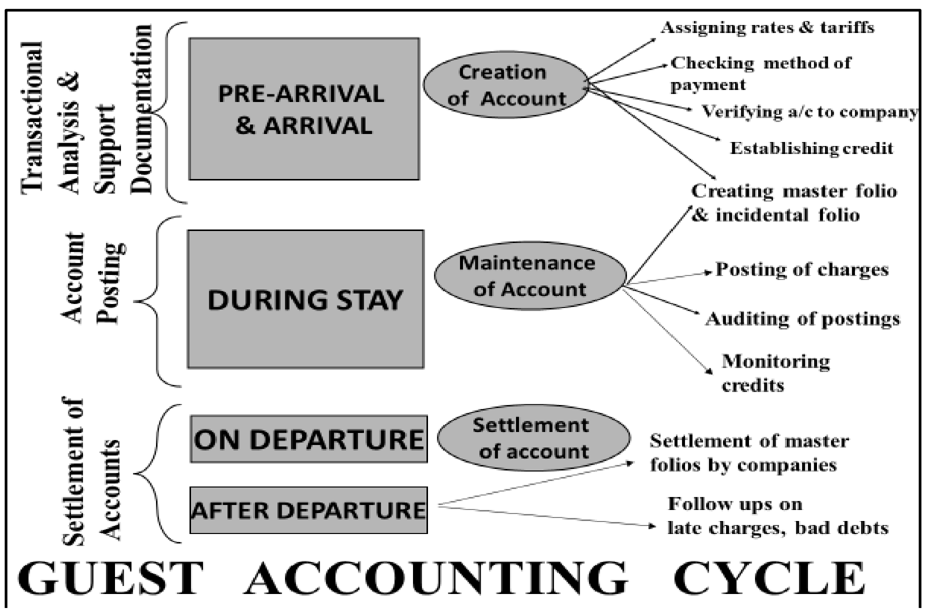
Stage 1 Creation of Accounts - Creating and maintaining an accurate accounting record for each guest or non-guest in the hotel
Stage 2 Maintenance of Accounts - Tracking all financial transactions throughout the guest cycle. It also ensures internal control over cash and non-cash transactions

Stage 3 Settlement of Accounts - Recording settlement for all goods & services provided.

The formula for calculating the outstanding balance is:

$$\text{Opening Balance} + \text{Debit Entries} - \text{Credit Entries} = \text{Net Outsatanding Balance}$$

The guest may have debit or credit balance during his stay in the Hotel. At the time of departure, the final bill of the guest is prepared and settled in such a way that the outstanding balance is brought to zero.



1.12 Purpose of Accounting Records

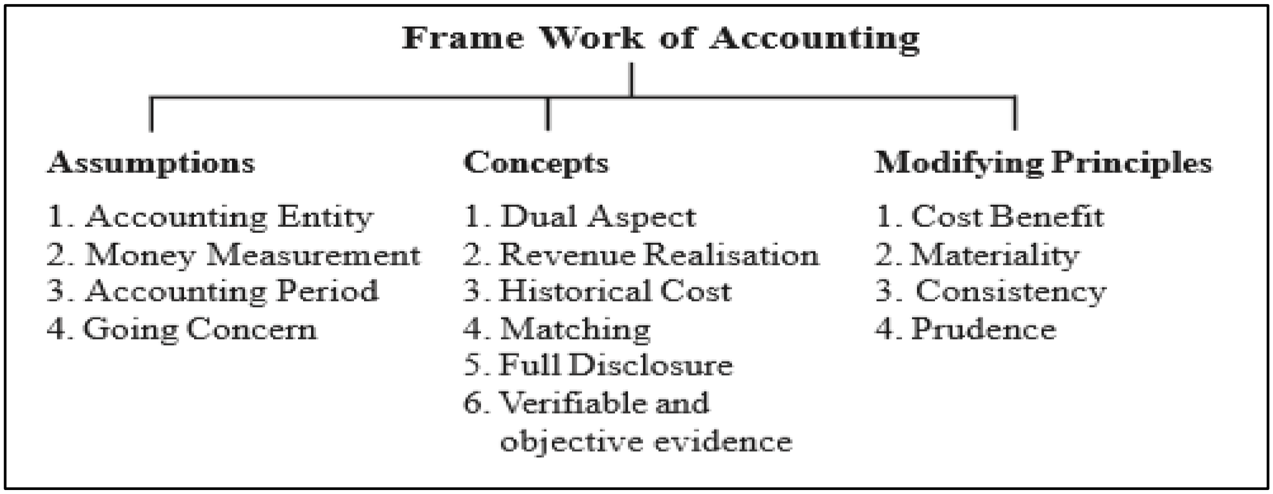
- **Utilization by Managers**: - Accounting is used to report an organization's money and other valuable properties.

- **Utilization by Owner's in Hospitality Industry**: - The owners of Hotel or restaurant will want to monitor their business financial conditions.

- **Utilization by Banker's**: - Banks will want to know the proposed business estimates in regards to financial performance, before they decide to lend money.

- **Utilization by Investor's**: - Investor's in the hospitality industry will want to put their money in hotel or restaurant businesses that will conserve or increase their wealth.

1.13 Accounting Principles – Concepts &Conventions



1.13.1 Assumptions

The basic assumptions of accounting are like the foundation pillars on which the structure of accounting is based. The four basic assumptions are as follows:

1.13.1.1 Accounting entity

According to this assumption, business is treated as a unit or entity apart from its owners, creditors and others. In other words, the proprietor of a business concern is always considered to be separate and distinct from the business which he controls. All the business transactions are recorded in the books of accounts from the view point of the business. Even the proprietor is treated as a creditor to the extent of his capital.

1.13.1.2 Money Measurement

In accounting, only those business transactions and events which are of financial nature are recorded. For example, when Sales Manager is not on good terms with Production Manager, the business is bound to suffer. This fact will not be recorded, because it cannot be measured in terms of money.

1.13.1.3 Accounting Period

The users of financial statements need periodical reports to know the operational result and the financial position of the business concern. Hence it becomes necessary to close the accounts at regular intervals. Usually a period of 365 days or 52 weeks or 1 year is considered as the accounting period.

1.13.1.4 Going Concern

As per this assumption, the business will exist for a long period and transactions are recorded from this point of view. There is neither the intention nor the necessity to wind up the business in the foreseeable future.

1.13.2 Modifying Principles

To make the accounting information useful to various interested parties, the basic assumptions and concepts discussed earlier have been modified. These modifying principles are as under.

1.13.2.1 Cost Benefit

This modifying principle states that the cost of applying a principle should not be more than the benefit derived from it. If the cost is more than the benefit then that principle should be modified.

1.13.2.2 Materiality

The materiality principle requires all relatively relevant information should be disclosed in the financial statements. Unimportant and immaterial information are either left out or merged with other items.

1.13.2.3 Consistency

The aim of consistency principle is to preserve the comparability of financial statements. The rules, practices, concepts and principles used in accounting should be continuously observed and applied year after year. Comparisons of financial results of the business among different accounting period can be significant and meaningful only when consistent practices were followed in ascertaining them. For example, depreciation of assets can be provided under different methods, whichever method is followed, it should be followed regularly.

1.13.2.4 Prudence Conservatism

Prudence principle takes into consideration all prospective losses but leaves all prospective profits. The essence of this principle is "anticipate no profit and provide for all possible losses". For example, while valuing stock in trade, market price or cost price whichever is less is considered.

1.13.3 Accounting Concepts

The term accounting concept is used to mean the necessary accounting assumptions upon which the accounting is based on.

1. **Business Entity Concept**: -Accounting assumes that a business is separate and distinct from the person who owns it. All the transactions of the business are recorded in the books of accounts from the sole view of business & not with the point of view of owner.

2. **Money Measurement Concept**: -Accounting records only those all transactions and events that can be expressed in terms of money.

3. **Going Concern concept**–In this concept, The Accounting assumes that the business will continue to operate for an indefinitely long period in the future. This will lead to clear distinction between assets &expenses.

4. **Cost Concept**–According to this concept asset is recorded as its actual cost. This cost of assets is the basis of all subsequent accounting norms.

5. **Dual Aspect Concept**–In this concept, every transaction entered into by a firm will have two aspects. In the business, the resources earned are assets and the claims of different parties against these assets are called equities. Accordingly, based on this concept, Total assets must be equal to equal to the claims of different parties against these assets.Thus,

   Assets = Equities
   Assets = Capital + Liabilities
   Capital = Assets - Liabilities

6. **Realisation Concept**–This concept is also known as Revenue concept.According to this concept, Revenue is deemed to be realized when the goods have been transferred or the service has been rendered to a customer.

7. **Accounting Period Concept** – In this concept,the business entity sets a time frame (generally one year) for determining the profit and loss of the business. Such time interval is known as Accounting period.

8. **Matching Concept**–According to this concept, all expenses that are incurred in an accounting period should be matched with revenue realized in that period.

9. **Accrual Concept**–In this concept, a recorded transaction will affect the assets &liabilities of the business entity. Further, this concept requires all events and transactions, both cash & credit transactions to be taken into account.

1.13.4 Accounting Standards

To promote world-wide uniformity in published accounts, the international Accounting Standards Committee (IASC) has been set up in June 1973 with nine nations as founder members.

IASC exist to reduce the differences between different countries' accounting practices. This process of harmonization will make it easier for the users and preparers of financial statement to operate across international boundaries.

In our country, the institute of Chartered Accountants of India has constituted Accounting Standard Board (ASB) in 1977. The ASB has been empowered to formulate and issue accounting standards, that should be followed by all business concerns in India.

1.13.5 Accounting Conventions

These are traditions, which are generally used as a guide in the preparation of accounting reports and statements. Accounting conventions are as follows:

1. **Consistency**: - In this convention, the different accounting practices should remain unchanged from one period to another.

2. **Convention of Conservatism**: - The essence of this convention is to anticipate no profit, but provisions for all losses.

3. **Disclosure**: - The full disclosure convention specifies that there must be complete and understandable reporting on the economic affairs of the entity.

1.14 Advantages of Accounting

The following are the advantages of accounting to a business:

1. **Permanent and Reliable Record**: Book-keeping provides permanent and reliable record for all business transactions.

2. **Arithmetical Accuracy of the Accounts**: With the help of book keeping trial balance can be easily prepared. This is used to check the arithmetical accuracy of primary books of accounts.

3. **Net Result of Business Operations**: The result (Profit or Loss) of business can be correctly calculated through Trading and Profit & Loss Account.

4. **Ascertainment of Financial Position**: Through the development of Balance sheet; the proprietor of a business entity besides the profit or loss; gets a firsthand information and the full picture of his financial position.This helps him/ her in introspecting the business processes for future corrective or improvement actions

5. **Ascertainment of the Progress of Business**: When a proprietor prepares financial statements every year, he will be in a position to compare the statements. This will enable him to ascertain the growth of his business. Thus, book keeping enables a long-range planning of business activities besides satisfying the short-term objective of calculation of annual profits or losses.

6. **Calculation of Dues**: For certain transactions payments may be made later. Therefore, the businessman has to know how much he has to pay others.

7. **Control over Assets**: In the course of business operations, the proprietor acquires various assets like building, machines, furniture's, etc. He has to keep a check over them and find out their values year after year.

8. **Control over Borrowings**: Businessmen borrow from banks and other sources. These loans are repayable. Just as he must have a control over assets, he should have control over liabilities.

9. **Identifying Do's and Don'ts**: Book keeping enables the proprietor to take an informed decision for the different aspects of the business such as purchases, sales, expenditures and incomes. From such analysis, it will be possible to focus his attention on what should be done and what should not be done to enhance his profit earning capacity.

10. **Fixing the Selling Price**: In fixing the selling price, the businessmen may have to consider many aspects of accounting information such as cost of production, cost of

purchases and other expenses. Accounting information is essential in determining selling prices.

11. **Taxation**: Businessmen pay sales tax, income tax, etc. The tax authorities require them to submit their accounts. For this purpose, they have to maintain a record of all their business transactions.

12. **Management Decision-making**: Planning, reviewing, revising, controlling and decision-making functions of the management are well aided by book-keeping records and reports.

13. **Legal Requirements**: Claims against and for the firm in relation to outsiders can be confirmed and established by producing the records as evidence in the court.

1.15 Limitations of Accounting

- **Accounting is historical in nature**: It does not reflect the current financial position or worth of a business.

- Transactions of non-monetary mature do not find place in accounting. Accounting is limited to monetary transactions only. It excludes qualitative elements like management, reputation, employee morale, labour strike etc.

- Facts recorded in financial statements are greatly influenced by accounting conventions and personal judgments of the Accountant or Management. Valuation of inventory, provision for doubtful debts and assumption about useful life of an asset may, therefore, differ from one business house to another.

- Accounting principles are not static or unchanging-alternative accounting procedures are often equally acceptable. Therefore, accounting statements do not always present comparable data

- Cost concept is found in accounting. Price changes are not considered. Money value is bound to change often from time to time. This is a strong limitation of accounting. vi) Accounting statements do not show the impact of inflation.

- The accounting statements do not reflect those increase in net asset values that are not considered realized.

CHECK YOUR PROGRESS-III

1. What are the advantages of accounting?

____
____
____
____
____

2. List the limitations of accounting.

1.16 Summary

Accounting plays a vital role in the field of commerce and business. One should know the basic purpose of accounting, its merits, and kinds of accounting and rules of accounting. By studying this lesson, one can understand the above said things and need of double entry system.

1.17 Glossary

Account: **-** Account is a summary of relevant business transactions at one place relating to a person, asset, expense or revenue named in the heading. An account is a brief history of financial transactions of a particular person or item. An account has two sides called debit side and credit side.

Accounting Equation: The total assets of a business are always equal to the aggregate of its Capital &Liabilities.
Total Assets =Capital + Total liabilities

Allowance Journal: -A Journal is used to recoup allowance vouchers when a sale is discounted

Assets: -Assets are the properties of every description belonging to the business. Cash in hand, plant and machinery, furniture and fittings, bank balance, debtors, bills receivable, stock of goods, investments, Goodwill are examples for assets. Assets can be classified into tangible and intangible.

Tangible Assets: These assets are those having physical existence. It can be seen and touched. For example, plant & machinery, cash, etc.

Intangible Assets: Intangible assets are those assets having no physical existence but their possession gives rise to some rights and benefits to the owner. For Example, Goodwill, patents, trademarks are some of the examples.

Auditing: - It is the branch of accounting, which examines a firm's financial statement & internal controls. In Hotel Industry, it is popularly known as Night Auditing.

Business: - Business is an economic activity. It is defined as "The regular production or purchase and sale of goods undertaken with object of earning profit through the satisfaction of human wants".

Capital: -It is the amount invested by a person in his business.This amount is increased by the amount of profits earned and the amount of additional capital introduced. It is decreased by the amount of losses incurred and the amounts withdrawn. For example, if Mr. Anand starts business with Rs.5,00,000, his capital would be Rs.5,00,000. It also includes the profit earned in the business.
Capital =Assets - Liabilities

Cash Purchase: - Goods purchased by cash are called as Cash Purchase

Cash sales: - When the sale of Goods is in Cash to the customer

City Ledger: - A subsidiary ledger which is prepared at the end of accounting period to close the temporary proprietorship accounts into permanent one.

Closing Stock: -Goods that are lying unsold on a particular date is known as closing stock.

Creditors: - A person who gives a benefit without receiving money or money's worth immediately but to claim in future, is a creditor. The creditors are shown as a liability in the balance sheet. In the above example Mr. Babe is a creditor to Mr. Arul till he receives the value of the goods. It is abbreviated as 'Cr'.

Credit Purchase: - Goods that are purchased without payment at that particular time is known as credit purchase.

Credit sales: - When the sale of Goods is in the form of credit transaction to the customer.

Current Assets: -Assets which are meant to be converted into cash within a period of time or during the normal operating cycle.

Current Liabilities: -Obligations in Money or Money worth which are to be paid within a stipulated period of time.Example: - Short TermLoans, Bank Overdraft

Debtors: -debtors A person (individual or firm) who receives a benefit without giving money or money's worth immediately, but liable to pay in future or in due course of time is a debtor. The debtors are shown as an asset in the balance sheet. For example, Mr. Arul bought goods on credit from Mr. Babu for Rs. 10,000. Mr. Arul is a debtor to Mr. Babu till he pays the value of the goods. It is abbreviated as 'Dr'.

Discount: -It is when a businessman allows any type of concession in the price of goods to its customer's.

Drawings: - It is the cash or Goods withdrawn from the business by the proprietor for his personal use. It is deducted from the capital.

Expenses: - It is the amount spent in order to produce and sell the goods and services. For example, purchase of raw materials, payment of salaries, wages, etc.

Fixed Assets: -An asset which are required only for use & not for resale are known as fixed assets.

Income: - Income is the difference between revenue and expense

Insolvent: - A person's whose liabilities exceed the assets is known as insolvent

Intangible Assets: -These are assets that are attached to the business & are not in physical forms.Example: -Goodwill, Patents Etc.

Invoice: - Invoice is a business document which is prepared when one sell goods to another. The statement is prepared by the seller of goods. It contains the information relating to name and address of the seller and the buyer, the date of sale and the clear description of goods with quantity and price.

Liabilities: -These refer to the financial obligations of a business. These denote the amounts which a business owes to others, e.g., loans from banks or other persons, creditors for goods supplied, bills payable, outstanding expenses, bank overdraft etc.

Net worth: - It is the excess of Assets over the Liabilities of business to the outsider's. It can also be the amount payable from the owners to the business.

Owner: -One who own's the business.

Profession: - It is the practice of the intellectual skill by a person in a defined field of operations

Proprietor: - A person who owns a business is called its proprietor. He contributes capital to the business with the intention of earning profit

Purchase Return or returns Outward: -Goods when returned to the suppliers due to defective quality or not as per the terms of purchase, it is called as purchases return. To find net purchases, purchases return is deducted from the total purchases.

Purchases: -Purchases refers to the amount of goods bought by a business for resale or for use in the production. Goods purchased for cash are called cash purchases. If it is purchased on credit, it is called as credit purchases. Total purchases include both cash and credit purchases.

Receipt: - Receipt is an acknowledgement for cash received. It is issued to the party paying cash. Receipts form the basis for entries in cash book.

Revenue: -Revenue means the amount receivable or realized from sale of goods and earnings from interest, dividend, commission, etc.

Sales return or returns inward: When goods are returned from the customers due to defective quality or not as per the terms of sale, it is called sales return or returns inward. To find out net sales, sales return is deducted from total sales.

Sales: -Sales refers to the amount of goods sold that are already bought or manufactured by the business. When goods are sold for cash, they are **cash sales,**but if goods are sold and payment is not received at the time of sale, it is **credit sales**. Total sales include both cash and credit sales.

Solvent: - When a person's assets exceeds or equals his liabilities

Stock: - Stock includes goods unsold on a particular date. Stock may be opening and closing stock. The term opening stock means goods unsold in the beginning of the accounting period. Whereas the term closing stock includes goods unsold at the end of the accounting period. For example, if 4,000 units purchased @ Rs. 20 per unit remain unsold, the closing stock is Rs. 80,000. This will be opening stock of the subsequent year.

Tangible assets: -These are assets that are in Physical forms attached to the Business.Example: - Land, Building Etc.

Transactions: - Transactions are those activities of a business, which involve transfer of money or goods or services between two persons or two accounts. For example, purchase of goods, sale of goods, borrowing from bank, lending of money, salaries paid, rent paid, commission received and dividend received. Transactions are of two types, namely, cash and credit transactions.

Cash Transaction is one where cash receipt or payment is involved in the transaction. For example, When Ram buys goods from Kannan paying the price of goods by cash immediately, it is a cash transaction.

Credit Transaction is one where cash is not involved immediately but will be paid or received later. In the above example, if Ram, does not pay cash immediately but promises to pay later, it is credit transaction.

Voucher: It is a written document in support of a transaction. It is a proof that a particular transaction has taken place for the value stated in the voucher. It may be in the form of cash receipt, invoice, cash memo, bank pay-in-slip etc. Voucher is necessary to audit the accounts.

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1.19 Suggested Reading

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- Hotel Accounting Earnest B. Horwath & Luis Toth
- Accounting for Management, S K Bhattacharya, Vikas Publishing House
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- Introduction to Accountancy, T.S. Grewal

1.20 Terminal Questions

Multiple Choice Questions:

1. The debts owing to others by the business is known as
   a) Liabilities b) expenses c) debtors

2. Assets minus liabilities is
   a) Drawings b) capital c) credit

3. A written document in support of a transaction is called
   a) receipt b) credit note c) voucher

4. Business transactions may be classified into
   a) three b) two c) one

5. Purchases return means goods returned to the supplier due to
   a) good quality b) defective quality c) super quality

6. Amount spent in order to produce and sell the goods and services is called
   a) expense b) income c) revenue

Fill in the blanks:

1. The amount which the proprietor has invested in the business is__________.
2. Book-keeping is an art of recording ____________ in the book of accounts.
3. ____________ is a written document in support of a transaction.
4. Accounting begins where ________ ends.
5. Liabilities refer to the ____________ obligations of a business.
6. Owner of the business is called ___________.

7. An account is a _________ of relevant business transactions at one place relating to a person, assets, expense or revenue named in the heading.
8. Receipt is an acknowledgement for __________.
9. Income is the difference between revenue and ________.

Long Answer Questions:

1. Define Accounting.
2. Explain the primary objectives of accounting?
3. Explain the different methods of accounting.
4. Explain the various types of accounts.
5. Explain the accounting rules.
6. What is accounting process?
7. Briefly explain the users and their need for accounting information.
8. What are the branches of accounting?
9. Write short notes on:
   a) Debtors b) Creditors c) Stock
10. Briefly explain the following terms
    a) Voucher b) Invoice c) Account
11. Write short note on
    a) Revenue b) Purchase c) Assets

UNIT: 02
ACCOUNTING RECORDS

2.1 Introduction

In the first unit the basic concepts of accounting have been introduced. In this unit the learner will learn the basic principles of double entry, journal entries, ledger and recording transaction in ledger, various subsidiary books and their maintenance and bank reconciliation statement.

2.2 Objectives

After reading this unit learner will be able:

- To understand the Meaning, Features and Advantages of Double Entry System
- To Understand the Approaches of Recording
- To Explain the Classification of Account Transactions.
- To understand journal entries
- To understand how to make entries in ledger
- To maintain subsidiary books of accounts
- To maintain cash book
- To maintain sales book
- To maintain bank reconciliation statement

2.3 Double Entry System

The system of recording business transactions in a systematic manner had originated in Italy. Over the years, it was perfected in England and other European countries. The Modern Accounting practices developed after the Industrial Revolution in the 18th century. Since, then many countries have adopted this system.

2.3.1 Definition

According to Jr. Batliboi,

"*Every business transaction has a two-fold effect and that it affects two accounts in opposite directions and if a complete record were to be made of each such transaction, it would be necessary to debit one account and credit another account. It is this recording of the two-fold effect of every transaction that has given rise to the term Double Entry System*".

2.3.2 Approaches of Recording

There are two approaches for recording a transaction:

- Accounting Equation Approach
- Traditional Approach

Accounting equation Approach: Under this approach , transactions are recorded based on the accounting equation, i.e.,

Assets = Liabilities + Capital

Traditional Approach: Recording of business transactions under this approach are formed on the basis of the existence of two aspects (debit and credit) in each of the transactions. All the business transactions are recorded in the books of accounts under the 'Double Entry System'. All the accounts are classified into the following five categories in the accounting equation approach:

1. Assets Accounts
2. Capital Account
3. Liabilities Accounts
4. Revenues or Incomes Accounts
5. Expenses or Losses Accounts

Accordingly, the following rules of debit and credit in respect of the various categories of accounts can be summarized as below:

Elements of Accounting Equation	Debit (Dr.)	Credit (Cr.)
Assets	Increases	Decreases
Liabilities	Decreases	Increases
Capital	Decreases	Increases
Revenue	Decreases	Increases
Expenses	Increases	Decreases

2.3.3 Dual Aspect of Account

The basic principle of this system is, for every debit, there must be a corresponding credit of equal amount and for every credit, there must be a corresponding debit of equal amount.

2.3.4 Double Entry System

In Account's, every transaction has two aspects and each aspect has an account. One aspect will be "receiving aspect" or "incoming aspect" or "expenses/loss aspect". This is termed as the "**debit aspect**". The other aspect will be "giving aspect" or "outgoing aspect" or "income/gain aspect". This is termed as the "**Credit aspect**". These two aspects - "Debit aspect" and "Credit aspect" form the basis of Double Entry System.

2.3.5 Classification of Account Transactions

All the accounts are classified into the following three types:

1. Personal Accounts
2. Real Accounts
3. Nominal Accounts

1. **Personal Accounts**: The accounts which relate to persons. Personal accounts include the following.
    i. **Natural Persons**: Accounts that relate to individuals. Example :- Ganesh's A/c

    ii. **Artificial persons**: Accounts which relates to a group of persons or firms or institutions. Example: - Canara Bank, LIC, India etc.

    iii. **Representative Persons**: Accounts which represent a particular person or group of persons. Example: - outstanding salary account, prepaid insurance account, etc.

The business entity keeps business relations with all the above personal accounts, because of either of the following:

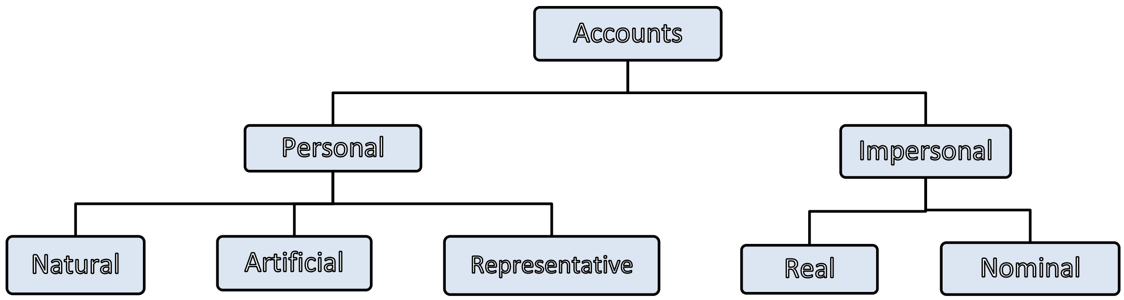
- Buying goods from them or
- Selling goods to them or
- Borrowing from them or
- Lending to them.
- The proprietor being an individual his capital account is personal accounts.
- Further, the proprietor drawings account is also personal accounts.

Henceforth, they become either Debtors or Creditors.

2. **Real Accounts**: Accounts relating to properties and assets which are owned by the business concern. Real accounts include tangible and intangible accounts. Example: Land, Building, Goodwill etc.

3. **Nominal Accounts**: These accounts do not have any existence, form or shape. They relate to incomes and expenses and gains and losses of a business concern. Example: Salary Account, Dividend Account, etc.

The classification may be illustrated as under:



Golden rules of Accounting: All the business transactions are recorded on the basis of the following rules.

S. No	Name of The Account	Debit Aspect	Credit Aspect
1.	Personal	The Receiver	The Giver
2.	Real	What Comes In	What Goes Out
3.	Nominal	All Expenses and Losses	All Income and Gains

Illustration: 1

Classify the following items into Personal, Real and Nominal Accounts.

1. Capital 2. Sales 3. Drawings 4. Outstanding salary 5. Cash
6. Rent 7. Interest paid 8. Indian Bank 9. Discount received 10. Building
11. Somnath Lending Library

Solution:

1. Personal account 2. Real account 3. Personal account
4. Personal (Representative) account 5. Real account 6. Nominal account
7. Nominal account 8. Personal (Legal Body) account
9. Nominal account 10. Real account 11. Personal account

Rules for debiting and Crediting In actual practice: The place wherein a record of individual transactions of similar nature being recorded, added and or subtracted , maintained is termed as an '**Account**'. All accounts are divided into two sides. The left-hand side of an account is called **Debit side** and the right-hand side of an account is called **Credit side**. In the abbreviated form Debit is written as Dr. and Credit is written as Cr.

Debit (Dr.)	**Cash Account**	**Credit (Cr)**

2.3.6Accounting Equation

Accounting equation emphasizes on the fact that every transaction has a two-sided effect i.e., on the assets and claims on assets. Also , the total claims (those of outsiders and of the proprietors) will be equal to the total assets of the business concern. The claims are also known as equities, are of two types:

i.) Owners' equity (Capital);
ii.) Outsiders' equity (Liabilities).

Assets	**=**	**Equities**	
Assets	**=**	**Capital + Liabilities**	**(A = C + L)**
Capital	**=**	**Assets – Liabilities**	**(C = A – L)**
Liabilities	**=**	**Assets – Capital**	**(L = A – C)**

Effect of Transactions on accounting equation:

Illustration 1 : If the capital of a business is Rs.3,00,000 and other liabilities are Rs.2,00,000 . Calculate the total assets of the business.

Solution: -

Assets	= Capital	+	Liabilities	
Capital	+	Liabilities	=	Assets
Rs. 3,00,000	+	Rs.2,00,000	=	Rs.5,00,000

Illustration 2 : If the total assets of a business are Rs.3,60,000 and capital is Rs.2,00,000, calculate liabilities.

Solution: -

Assets	= Capital	+	Liabilities
Liabilities	= Assets	–	Capital
Assets –	Capital	= Liabilities	
Rs. 3,60,000 –	Rs. 2,00,000	= Rs. 1,60,000	

Illustration 3 : If the total assets of a business are Rs.4,50,000 and outside liabilities are Rs.2,50,000, calculate the capital.

Solution:

Capital	= Assets	– Liabilities
Assets	– Liabilities	= Capital
Rs. 4,50,000	– Rs. 2,50,000	= Rs.2,00,000

Illustration - 4 : *Transaction 1*: Rajesh started business with Rs. 50,000 as capital.

The business unit has received assets totaling Rs. 50,000 in the form of cash and the claims against the firm are also Rs. 50,000 in the form of capital. The transaction can be expressed in the form of an accounting equation as follows:

Assets	= Capital	+ Liabilities
Cash	= Capital	+ Liabilities
Rs. 50,000	= Rs. 50,000	+ 0

Transaction 2: Mr. Rajesh purchased furniture for cash Rs. 5,000.

The cash is reduced by Rs, 5,000 but a new asset (furniture) of the same amount has been acquired. This transaction decreases one asset (cash) and at the same time increases the other asset (furniture) with the same amount, leaving the total of the assets of the business unchanged. The accounting equation now is as follows:

		Assets	= Capital	+ Liabilities
	Cash	+ Furniture	= Capital	+ Liabilities
Transaction 1	50,000	+ 0	= 50,000	+ 0
Transaction 2	(-) 5000	+ 5000	= 0	+ 0
Equation	**45,000**	**+ 5,000**	**= 50,000**	**+ 0**

Transaction 3: Mr. Rajesh has purchased goods for cash Rs. 30,000.

As a result, cash balance is reduced by the goods purchased, leaving the total of the assets unchanged.

			Assets	= Capital	+ Liabilities
	Cash	+ Furniture	+ Stock	= Capital	+ Liabilities
Transaction 1&2	45,000	+ 5000	+ 0	= 50,000	+ 0
Transaction 3	(-) 30000	+ 0	+30000	= 50000	+ 0
Equation	**15,000**	**+ 5,000**	**+30000**	**= 50,000**	**+ 0**

Transaction 4: He then, purchased goods on credit for Rs.20,000.

The above transaction will increase the value of stock on the assets side and will create a liability in the form of creditors.

			Assets	=	Capital	+ Liabilities
	Cash	+ Furniture	+ Stock	=	Capital	+ Liabilities
Transaction 1-3	15,000	+ 5000	+ 30000	=	50,000	+ 0
Transaction 4	0	+ 0	+20000	=	50000	+ 0
Equation	**15,000**	**+ 5,000**	**+50000**	**=**	**50,000**	**+ 20000**

Transaction 5: Mr. Rajesh purchased Goods costing Rs. 25,000 &sold them on credit for Rs. 35,000.

The above transaction will give rise to a new asset in the form of Debtors to the extent of Rs. 35,000. But the stock of goods will be reduced by Rs. 25,000 i.e., the cost of goods sold. The net increase of Rs. 10,000 is the amount of revenue which will be added to the capital.

				Assets	=	Capital	+ Liabilities
	Cash	+ Furniture	+ Stock	+Debtor	=	Capital	+ Liabilities
Transaction 1-4	15,000	+ 5000	+ 50000	+0	=	50,000	+ 20000
Transaction 5	0	+ 0	+(-)25000	+35,000	=	10000	+ 0
Equation	**15,000**	**+ 5,000**	**+25000**	**+35,000**	**=**	**60,000**	**+ 20000**

Transaction 6: Now , Mr. Rajesh has paid Rent of Rs.3,000.

It reduces cash and the rent is an expense, it results in a loss which decreases the capital.

				Assets	=	Capital	+ Liabilities
	Cash	+ Furniture	+ Stock	+Debtor	=	Capital	+ Creditors
Transaction 1-5	15,000	+ 5000	+ 25000	+35000	=	60,000	+ 20000
Transaction 6	3000	+ 0	+0	+0	=	(-)3000	+ 0
Equation	**12,000**	**+ 5,000**	**+25000**	**+35,000**	**=**	**57,000**	**+ 20000**
				77000	**=**	**77000**	

2.3.7Advantages Accounting Equation

The advantages of this system are as follows:

- ✓ **Scientific system**: This is the only scientific system of recording business transactions.
- ✓ **Complete record of transactions**: This system maintains a complete record of all business transactions.
- ✓ **Check on the accuracy of accounts**: By the use of this system the accuracy of the accounting work can be established with the preparation of trial balance.

- ✓ **Ascertain the profit or loss**: The profit earned or loss incurred during accounting period can be ascertained by the preparation of profit and loss account.

- ✓ **Knowledge of the financial position**: The financial position of the business entity can be determined at the end of each period through the preparation of balance sheet.

- ✓ **Full details for control**: This system permits accounts to be kept in a very detailed form, and henceforth provides sufficient information's for the purpose of control.

- ✓ **Comparative study**: The results of one year are compared with those of previous years and the reasons for change are established.

- ✓ **Helps in decision making**: The management obtains sufficient information for making decisions. The concept of SWOT (Strength, Weakness, Opportunities and Threats) can be applied.

- ✓ **Detection of fraud**: The systematic and scientific recording of business transactions on the basis of this system minimizes the chances of fraud.

2.4 Journal Entries

The books in which a transaction is recorded for the first time from a source document are called **Books of Original Entry** or **Prime Entry**.

2.4.1 Journal

Journal is one of the books of original entry in which transactions are originally recorded in a chronological order according to the principles of Double Entry System.
It is also called a 'Day Book'.

The process of recording a transaction in the journal is called 'Journalising' and the entries made in this book-are called 'Journal entries '.

2.4.2 Format- Journal

The format of journal is as under:

Date	**Particulars**		**L.F.**	**Debit Rs.**	**Credit Rs.**
1	**2**		**3**	**4**	**5**

The journal has five columns, viz.

(1) Date (2) Particulars with "Narration"
(3) Ledger Folio (4) Amount (Debit)
(5) Amount (Credit)

Explanation: The columns of journal are as under:

1. **Date**: In each page of the journal at the top of the date column, the year is written and in the next line, month and date of the first entry are written.

2. **Particulars**: In this column, the details regarding account titles and description are recorded.

3. **Ledger Folio**: The page number of the ledger in which the accounts are appearing is indicated in this column.

4. **Amount (Debit)**: The amount to be debited along with its unit of measurement at the top of this column on each page is written against the Account that is debited.

5. **Amount (Credit)**: The amount to be credited along with its unit of measurement at the top of this column on each page is written against the Account that is credited.

2.4.3 Steps in Journalizing

The process of Analysing the business transactions & recording them in the Journal is called **Journalising**. The steps in Journalising are:

- ✓ ***Step 1*** → To determine the two accounts involved in the transaction.

- ✓ ***Step 2*** → Classifying the ~~above~~ two accounts under Personal, Real or Nominal.

- ✓ ***Step 3*** → Finding out the rules of debit and credit for the accounts.
- ✓ ***Step 4*** → To identify which account is to be debited and credited.

- ✓ ***Step 5*** → Recording the date of transaction in the date column. The sequence of the dates and months should be strictly maintained.

- ✓ ***Step 6*** → Enter the name of the account to be debited in the particulars column very close to the left-hand side of the particulars column followed by the abbreviation '**Dr.**' in the same line. The amount to be debited is written in the debit amount column in the same line.

- ✓ ***Step 7*** → Enter the name of the account to be credited in the second line starts with the word '**To**' a few spaces away from the margin in the particulars column. The amount to be credited is written in the credit amount column in the same line.

- ✓ ***Step 8*** → Write the narration within brackets in the next line in the particulars column.

- ✓ ***Step 9*** → Draw a line across the entire particulars column to separate one journal entry from the other.

Transactions Relating to Discount: There are two types of discounts allowed to customers. They are :

- ✓ Trade discount, and

✓ Cash discount,

Trade discount: - Trade discount is a reduction in selling price allowed at the time of sale. The buyer pays only the net price and the recording in books is made for the net amount only.

Cash discount: - Cash discount is a reduction in the net amount due. It is allowed only if the customer makes payment before the due date. Cash discount must be recorded in the books of account.

Example 1: January 1, 2004 – Saravanan started business with Rs. 1,00,000.

Solution:

Analysis of Transaction			
Step 1	Determine the two accounts involved in the transactions	Cash Account	Capital Account
Step 2	Classify the accounts under personal, real or nominal	Real Account	Personal Account
Step 3	Find out the rules of debit and credit	2(a) Debit what comes in	1(b) Credit the Giver
Step 4	Identify which account is to be debited and credited	Cash A/c is Debited	Capital A/c is Credited

Journal

Date	**Particulars**	**L.F**	**Debit**		**Credit**	
			Rs.	**P**	**Rs.**	**P**
2004 Jan 1	Cash A/c. Dr. To Capital A/c. (Amount invested in the business)	12 45	100,000		 100,000	

The Ledger Folio column indicates 12 against Cash Account which means that Cash Account is found in page 12 in the ledger. Similarly, 45 against Capital A/c indicates the page number in which Capital account is found.

Example 2: Jan. 3, 2004: Received cash from Balan Rs. 25,000

Solution:

Step 1	Determine the two accounts involved in the transactions	Cash Account	Balan Account
Step 2	Classify the accounts under personal, real or nominal	Real Account	Personal Account
Step 3	Find out the rules of debit and credit	2(a) Debit what comes in	1(b) Credit the Giver
Step 4	Identify which account is to be debited and credited	Cash A/c is Debited	Balan A/c is Credited

Journal

Date	Particulars	L.F	Debit		Credit	
			Rs.	P	Rs.	P
2004 Jan 3	Cash A/c. Dr. To Balan's A/c. (Cash Received from Balan)	12 81	25,000		 25,000	

The Ledger Folio column indicates 12 against Cash Account which means that Cash Account is found in page 12 in the ledger. Similarly, 81 against Balan A/c indicates the page number in which Balan Account is found.

Example 3: July 7, 2004 – Paid cash to Perusal Rs. 37,000.

Solution: -

Analysis of Transaction			
Step 1	Determine the two accounts involved in the transactions	Perusal Account	Cash Account
Step 2	Classify the accounts under personal, real or nominal	Personal Account	Real Account
Step 3	Find out the rules of debit and credit	1(a) Debit the Receiver	2(b) Credit - What goes out
Step 4	Identify which account is to be debited and credited	Perumal A/c is Debited	Cash A/c is Credited

Journal

Date	Particulars	L.F	Debit		Credit	
			Rs.	P	Rs.	P
2004 July 7	Perumal A/c. Dr. To Cash A/c. (Cash paid to Perumal)	95 12	37,000		 37,000	

Example 4: Feb. 7, 2004 – Bought goods for cash Rs. 80,000.

Solution: -

Analysis of Transaction			
Step 1	Determine the two accounts involved in the transactions	Purchase Account	Cash Account
Step 2	Classify the accounts under personal, real or nominal	Real Account	Real Account
Step 3	Find out the rules of debit and credit	2(a) Debit what comes in	2(b) Credit - What goes out
Step 4	Identify which account is to be debited and credited	Purchase A/c is Debited	Cash A/c is Credited

Journal

Date	Particulars	L.F	Debit		Credit	
			Rs.	P	Rs.	P
2004 Feb 7	Purchases A/c. Dr.	48	80,000			
	To Cash A/c.	12			80,000	
	(Cash purchase of goods)					

Example 5: March 10, 2004 – Cash sales Rs. 90,000.

Solution: -

Analysis of Transaction			
Step 1	Determine the two accounts involved in the transactions	Cash Account	Sales Account
Step 2	Classify the accounts under personal, real or nominal	Real Account	Real Account
Step 3	Find out the rules of debit and credit	2(a) Debit what comes in	2(b) Credit - What goes out
Step 4	Identify which account is to be debited and credited	Cash A/c is Debited	Sales A/c is Credited

Journal

Date	Particulars	L.F	Debit		Credit	
			Rs.	P	Rs.	P
2004 Mar 10	Cash A/c. Dr.		90,000			
	To Sales A/c.				90,000	
	(Cash Sales)					

Example 6: March 15 ,2004 – Sold goods to Jaleel on credit Rs. 1,00,000

Solution: -

Analysis of Transaction			
Step 1	Determine the two accounts involved in the transactions	Jaleel Account	Sales Account
Step 2	Classify the accounts under personal, real or nominal	Personal Account	Real Account
Step 3	Find out the rules of debit and credit	1(a) Debit the Receiver	2(b) Credit - What goes out
Step 4	Identify which account is to be debited and credited	Jaleel A/c is Debited	Sales A/c is Credited

Journal

Date	**Particulars**	**L.F**	**Debit**		**Credit**	
			Rs.	**P**	**Rs.**	**P**
2004 Mar 15	Jaleel A/c. Dr. To Sales A/c. (Credit Sales)		100,000		100,000	

Example 7: March 18, 2004 – Purchased goods from James on credit Rs.1,50,000.

Solution: -

Analysis of Transaction			
Step 1	Determine the two accounts involved in the transactions	Purchases Account	James Account
Step 2	Classify the accounts under personal, real or nominal	Real Account	Personal Account
Step 3	Find out the rules of debit and credit	2(a) Debit what comes in	1(b) Credit the Giver
Step 4	Identify which account is to be debited and credited	Purchases A/c is Debited	James A/c is Credited

Journal

Date	**Particulars**	**L.F**	**Debit**		**Credit**	
			Rs.	**P**	**Rs.**	**P**
2004 Mar 18	Purchases A/c. Dr. To James A/c. (Credit Purchases)		150,000		150,000	

Example 8 : March 25, 2004 – Paid salaries in cash Rs. 6,000.

Solution: -

Analysis of Transaction			
Step 1	Determine the two accounts involved in the transactions	Salaries Account	Cash Account
Step 2	Classify the accounts under personal, real or nominal	Nominal Account	Real Account
Step 3	Find out the rules of debit and credit	3(a) Debit all Expenses & Losses	2(b) Credit - What goes out
Step 4	Identify which account is to be debited and credited	Salaries A/c is Debited	Cash A/c is Credited

Journal

Date	Particulars	L.F	Debit		Credit	
			Rs.	P	Rs.	P
2004 Mar 25	Salaries A/c. Dr. To Cash A/c. (Salaries Paid)		6,000		6,000	

Example 9 : April 14, 2004 – Commission received Rs. 5,000.

Solution: -

Analysis of Transaction			
Step 1	Determine the two accounts involved in the transactions	Cash Account	Commission Account
Step 2	Classify the accounts under personal, real or nominal	Real Account	Nominal Account
Step 3	Find out the rules of debit and credit	2(a) Debit What comes in	3(b) Credit - all Incomes & gains
Step 4	Identify which account is to be debited and credited	Cash A/c is Debited	Commission A/c is Credited

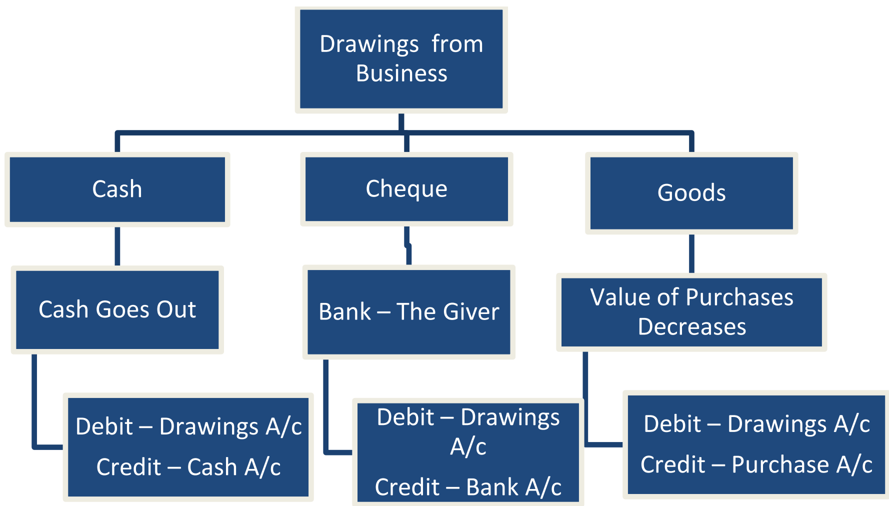
Journal

Date	Particulars	L.F	Debit		Credit	
			Rs.	P	Rs.	P
2004 April 14	Cash A/c. Dr. To Commission A/c. (Commission Received)		5,000		5,000	

Capital and Drawings

- The amount with which a trader starts the business is known as Capital.

- The proprietor when withdraws certain amounts from the business to meet personal expenses or goods for personal use. It is called **Drawings**



Example 10: January 31, 2004 – Saravanan withdrew for personal use Rs. 20,000

Solution: -

Analysis of Transaction			
Step 1	Determine the two accounts involved in the transactions	Drawings Account	Cash Account
Step 2	Classify the accounts under personal, real or nominal	Personal Account	Real Account
Step 3	Find out the rules of debit and credit	1(a) Debit - The Receiver	2(b) Credit - What goes Out
Step 4	Identify which account is to be debited and credited	Drawings A/c is Debited	Cash A/c is Credited

Journal

Date	**Particulars**	**L.F**	**Debit**		**Credit**	
			Rs.	**P**	**Rs.**	**P**
2004 Jan 31	Drawings A/c. Dr. To Cash A/c. (Amount Withdrawn for personal use)		20,000		20,000	

BANK TRANSACTIONS: Bank transactions that occur in the business concerns are:

- cash paid into bank,

- cheque and bills received from customers that are paid into bank for collection,
- payment of cheque for expenses and
- cheque issued to suppliers or creditors.

Example 11: January 18, 2004 – Opened a current account with Indian Overseas Bank Rs. 10,000.

Solution: -

Analysis of Transaction			
Step 1	Determine the two accounts involved in the transactions	Bank Account	Cash Account
Step 2	Classify the accounts under personal, real or nominal	Personal Account	Real Account
Step 3	Find out the rules of debit and credit	1(a) Debit - The Receiver	2(b) Credit - What goes Out
Step 4	Identify which account is to be debited and credited	Bank A/c is Debited	Cash A/c is Credited

Journal

Date	**Particulars**	**L.F**	**Debit**		**Credit**	
			Rs.	**P**	**Rs.**	**P**
2004 Jan 18	Indian Overseas Bank A/c. Dr. To Cash A/c. (Opened a Current A/c.)		10,000		10,000	

Example 12: Feb 3, 2004 – Rent paid by cheque Rs. 5,000.

Solution: -

Analysis of Transaction			
Step 1	Determine the two accounts involved in the transactions	Rent Account	Bank Account
Step 2	Classify the accounts under personal, real or nominal	Nominal Account	Personal Account
Step 3	Find out the rules of debit and credit	3(a) Debit all Expenses & Losses	1(b) Credit the Giver
Step 4	Identify which account is to be debited and credited	Rent A/c is Debited	Bank A/c is Credited

Journal

Date	Particulars	L.F	Debit		Credit	
			Rs.	P	Rs.	P
2004 Feb 3	Rent A/c. Dr. To Bank A/c. (Rent paid by Cheque)		5,000		5,000	

Example 13: March 5, 2004 – Received cheque from Elavarasan Rs. 20,000

Solution:

Analysis of Transaction			
Step 1	Determine the two accounts involved in the transactions	Cash Account	Elavarasan Account
Step 2	Classify the accounts under personal, real or nominal	Real Account	Personal Account
Step 3	Find out the rules of debit and credit	2(a) Debit What comes in	1(b) Credit the Giver
Step 4	Identify which account is to be debited and credited	Cash A/c is Debited	Elavarasan A/c is Credited

Journal

Date	Particulars	L.F	Debit		Credit	
			Rs.	P	Rs.	P
2004 Mar 5	Cash A/c. Dr. To Elavarasan A/c. (Cheque received but not paid into Bank)		20,000		20,000	

Example 14: March 15, 2004 – Cheque received from Santhosh Rs. 30,000 and immediately banked

Solution: -

Analysis of Transaction			
Step 1	Determine the two accounts involved in the transactions	Bank Account	Santhosh Account
Step 2	Classify the accounts under personal, real or nominal	Personal Account	Personal Account
Step 3	Find out the rules of debit and credit	1(a) Debit - The Receiver	1(b) Credit the Giver
Step 4	Identify which account is to be debited and credited	Bank A/c is Debited	Santhosh A/c is Credited

Journal

Date	Particulars	L.F	Debit		Credit	
			Rs.	P	Rs.	P
2004 Mar 15	Bank A/c. Dr. To Santhosh A/c. (Cheque Received and deposited in Bank)		30,000		30,000	

COMPOUND JOURNAL ENTRY

- When two or more transactions of similar nature take place on the same date, such transactions can be entered in the journal by means of a combined journal entry is called **Compound Journal entry**.
- The only precaution is that the total debits should be equal to total credits.

Example 15: July 1, 2004 – Ajay contributed capital – Cash Rs. 90,000 Furniture Rs. 20,000

Vijay contributed capital – Cash Rs. 50,000 Stock Rs. 70,000

Solution: -

Journal

Date	Particulars	L.F	Debit		Credit	
			Rs.	P	Rs.	P
2004 July 1	Cash A/c. Dr.		140,000			
	Stock A/c. Dr.		70,000			
	Furniture A/c. Dr.		20,000			
	To Ajay's Capital A/c.				110,000	
	To Vijay's Capital A/c.				120,000	
	(Capital invested by Ajay and Vijay)					

Example 16: July 13, 2003 – Received cash Rs. 24,700 from Shanthi in full settlement of her account of Rs. 25,000. Here cash received is Rs. 24,700 in full settlement of Rs. 25,000 so the difference Rs.300 is discount allowed.

Solution:

Journal

Date	Particulars	L.F	Debit		Credit	
			Rs.	P	Rs.	P
2003 July 13	Cash A/c. Dr.		24,700			
	Discount Allowed A/c. Dr.		300			
	To Shanthi's A/c.				25,000	
	(Shanthi Settled her Account)					

Example 17:

July 14, 2003 – Paid cash to Thamnophis Rs. 14,500, in full settlement of her account of Rs. 15,000. Here cash paid Rs. 14,500 in settlement of Rs. 15,000 so the difference Rs. 500 is discount received.

Solution:

Journal

Date	Particulars	L.F	Debit		Credit	
			Rs.	P	Rs.	P
2003 July 14	Thamnophis A/c. Dr.		15,000			
	To Cash A/c.				14,500	
	To Discount Received A/c.				500	
	(Settled Thenmozhi's Account)					

Bad debts

When the goods are sold to a customer on credit and if the amount becomes irrecoverable due to his insolvency or for some other reason, the amount not recovered is called ***bad debts***. For recording it, the bad debts account is debited because the unrealised amount is a loss to the business and the customer's account is credited. Bad debts that was previously written off are now recovered; then in such case, cash account is debited and bad debts recovered account is credited because the amount so received is a gain to the business.

Example 18 : Jamuna who owed us Rs. 10,000 is declared insolvent and 25 pauses in a rupee is received from her on 15th July, 2003.

Solution:

Journal

Date	Particulars	L.F	Debit Rs.	Debit P	Credit Rs.	Credit P
2003	Cash A/c. Dr.		2,500			
July 15	Bad Debts A/c. Dr.		7,500			
	To Jamuna A/c.				10,000	
	(Received 25 paise in a Rupee on Jamuna's Insolvency)					

Example 19 : Received cash for a Bad debt written off last year Rs. 7,500 on 18th January, 2004.

Solution:

Journal

Date	Particulars	L.F	Debit Rs.	Debit P	Credit Rs.	Credit P
2004	Cash A/c. Dr.		7,500			
Jan 18	To Bad debts recovered A/c.				7,500	
	(Bad Debts Recovered)					

Opening entry: Opening Entry is an entry which the closing balance of assets and liabilities of the previous year is passed on to the beginning of each current year of record.

In this entry, Asset accounts are debited and Liabilities and Capital account are credited.

Example 20: The following balances appeared in the books of Malakai as on 1st January 2004 – Cash Rs. 7,000, Bank Rs. 70,000, Stock Rs. 80,000, Furniture Rs. 10,000, Computer Rs. 50,000, Debtors Rs. 33,000 and Creditors Rs. 90,000.

Solution: -The opening entry is

Journal

Date	Particulars	L.F	Debit Rs.	Debit P	Credit Rs.	Credit P
2004	Cash A/c. Dr.		7,000			
Jan 1	Bank A/c. Dr.		70,000			
	Stock A/c. Dr.		80,000			
	Debtors A/c. Dr.		33,000			
	Furniture A/c. Dr.		10,000			
	Computer A/c. Dr.		50,000			
	To Creditor's A/c.				90,000	
	To Capital A/c. (Balancing Figure)				160,000	
	(Assets and Liabilities are brought forward)					

Solved Problems:

Problem No. 01 Journalese the following in transactions in Uma Maheswari's Journal.

1994,			Rs.
Sept.	1	Tat. Uma Maheswari started business with	50,000
	3	Opened a current account with Indian Overseas Bank	15,000
	10	Bought goods from Tmt. Latha Baskar	40,000
	15	Paid to Tmt. Latha Baskar	25,000
	18	Sold goods to Tmt. Kanniga	36,000
	25	Tmt. Kanniga settled her account	

Solution:

Journal of Tmt. Uma Maheswari

Date	**Particulars**		**L.F**	**Debit Rs.**	**Credit Rs.**
1994	Cash A/c.	Dr.		50,000	
Sept 1	To Capital A/c.				50,000
	(Capital invested in the business)				
3	Bank A/c.	Dr.		15,000	
	To Cash A/c.				15,000
	(Cash deposited in bank)				
10	Purchases A/c.	Dr.		40,000	
	To Tmt. Latha Baskar A/c.				40,000
	(Credit purchases made by Latha Baskar)				
15	Tmt. Latha Baskar A/c.	Dr.		25,000	
	To Cash A/c.				25,000
	(Cash paid to Latha Baskar)				
18	Tmt. Kanniga A/c.	Dr.		36,000	
	To Sales A/c.				36,000
	(Credit Sales made to Kanniga)				
25	Cash A/c.	Dr.		36,000	
	To Tmt. Kanniga A/c.				36,000
	(Settlement by Kanniga)				

Problem No. 02 Journalese the following transactions in Thiru. Narayanaswamy's books.

1994,			Rs.
Aug.	5	Sold goods to Maharajan on Credit	6,500
	9	Brought goods for cash from Chengalvarayan	7,500
	12	Met Travelling expenses	1,500
	15	Received Rs. 10000 from Sukumar as loan	
	17	Returned damaged goods to Mohan	800
	21	Paid wages to workers	2,000

Solution : **Journal of Thiru. Narayanaswamy**

Date	Particulars	L. F	Debit Rs.	Credit Rs.
1994 Aug 5	Maharajan A/c. Dr. To Sales A/c. (Credit sales to Maharajan)		6,500	 6,500
9	Purchase A/c. Dr. To Cash A/c. (Cash purchases made to Chengalvarayan)		7,500	 7,500
12	Travelling exp. A/c. Dr. To Cash A/c. (Paid for Travelling expenses)		1,500	 1,500
15	Cash A/c. Dr. To Sukumar A/c. (Payment on Behalf of Sukumar)		10,000	 10,000
17	Mohan A/c. Dr. To Purchases Returns A/c. (Damaged goods returned to supplier - Mohan)		800	 800
21	Wages A/c. Dr. To Cash A/c. (Wages paid to Worker's)		2,000	 2,000

2.4.4 Hotel Industry Operations

The hotel industry implication is discussed as under:

2.4.4.1 Receiving of Advance / Deposit

Advance or deposit is collected under three occasions.

1. At the time of booking (making reservation for a room) or for a bulk / group booking to guarantee the booking.
2. In the case of unknown Walk-ins or a guest with reservation who looks suspicious or with scanty baggage, it is a practice to take advance depending on the stay of the guest duration.
3. During the stay of the guest too pays advance / deposit, when his bill amount reaches or exceeds the Floor limit (set by Hotel) or House-Limit (Set by Banker card or Credit Card).

Proforma of Advance / Deposit Receipt

Advance Deposit Receipt

Hotel ABCD

Receipt No.________ **Date __________**

Received with thanks Rs. ____________ (Rupees ____) toward deposit / advance from Mr. / Ms. __________________________________ vide Reservation Reference No. / Guest Registration No. _______________

Cashier / Front Office Assistant

2.4.4.2 Guest Billing

All the registered guests accounts are maintained and continuously posted and updated.

1. There are different computerized **Points of Sale (POS)** outlets. Henceforth, all recorded guest's account is consolidated into guest's bill.
2. The Guest bill is made and presented mostly at his Check-Out day & time.

A guest may also request for making the bill in different ways -

- **a. Vertical split**, when the room and charges are shared by two guests, who would like to have their bill split into two identical halves.
- **b. Horizontal split**, when certain charges are paid by the company or agency and the rest are to be borne by the guest himself, the split is made on the basis of charges

Example 1: 1 Following registration particulars are of a guest that has checked in into Room No.1002

1 Following are the registration particulars of Guest Mr. Ramesh who has checked In at Room No. 1002

G. Regna. No	29134	Plan	CP
Name of Guest	Mr. Ramesh Chauhan	Room Rate	Rs. 2500
Arr. Date	20- April - 2005	Dep. Date	22-Apr-05
Room No.	1002	Dep. Time:	09:00 A.M (Expected Dep. Time)
		Pax	2

Following transactions took place during his stay.

20-Apr-05

Breakfast for two extra persons

One Lunch

Advance received Rs. 5000

One Dinner

21-Apr-05

Breakfast for one extra persons

Two Lunch

Two Dinner

Coffee Pot

Bill from Coffee Shop Rs. 150

News Stand Bill Rs. 200

Telephones Rs. 75

Laundry Bill Rs. 125

VPO Rs. 250

22-Apr-05

Pot Coffee

Telephones Rs. 150

Three Lunch

Guest Checked out at 4 p.m. after settling the bill

Instructions: Make a bill for the above keeping the following in mind.

Pot Coffee Rs. 75

Breakfast Rs. 150

Lunch / Dinner Rs. 250

Extra- Bed Rs. 250

Checkout time 12 Noon

VAT on Room Rent & Extra Bed @7 %

Service Charges on Room Rent @ 10 %

Working:

<u>GUEST WEEKLY BILL</u> **<u>BILL No. 303</u>**

G. Regn . No	**29134**	*Dep. Date*	**22 - April - 2005**
Name :-	**Mr. Ramesh Chauhan**	*Dep. Time*	**04:00 P.M**
Arr. Date	**20- April - 2005**	*Plan*	**CP**
Arr. Time	**10:00 A.M**	*Room Rate*	**Rs. 2500**
Room No.	**1002**	*Pax*	**2**

Day / Date	(1) 20/4	(2) 21/4	(3) 22/4	(4) 23/4	(5) 24/4	(6) 25/4	(7) 26/4
Op. Balance Dr. / (Cr.)		-1275	3675	7575			
<u>DEBIT ENTRIES</u>							
Apartments	2500	2500	2500	2500			
Guest Charges							
Breakfast	300	150					
Lunch	250	500	750				
Dinner	250	500					
Coffee / Tea / Milk		75	75				
Room Service							
Restaurant							
Bar							
Coffee Shop		150					
News Stand		200					
Telephones		75	150				
Laundry		125					
Other Charges							
Visitors Paid Out		250					
Luxury Tax							
VAT	175	175	175	175			
Service Charge	250	250	250	250			
Total :- Op. Balance + Debit Charges	3725	3675	7575	10500			
<u>CREDIT ENTRIES</u>							

Allowance / Discount							
Advance / Deposit	5000						
Transfer to Guest A/c							
Transfer to City Ledger							
CLOSING BALANCE : Total - Credit Entries	-1275	3675	7575	10500			

When payment is received from the guest a receipt is issued as a proof of having received the amount.

Proforma of Receipt
Receipt

Hotel ABCD

Receipt No.________ **Date __________**

Received with thanks Rs.____________(Rupees ______________________________) toward part settlement / settlement of bills No. __________dated _____________ From Mr. / Ms. ___________________ Guest Registration No. _________ in cash / _____________ Bank Cheque No. _____________Dated __________ (Cheque subject to Realisation)

Cashier / Front Office Assistant

2.4.4.3 Vouchers

A. Visitors Paid Outs (VPO): A guest during his hotel stay at times request's for services, which the hotel does not provide. The front office personnel will arrange and pay for these services and notify the cashier or reception of the charge to be added to the guest's bill. These charges are termed as Visitors **Paid Outs (VPO)**. The amount is paid from the Front office Petty cash. The procedure in VPO is:

- To raise a voucher against the services
- Get it signed by the guest
- Post the amount on the debit side of the guest's account.

It is also used at the time of settlement of guest bill / account, if the guest account showed a credit balance.

Proforma of VPO: Proforma is on next page.

Hotel ABCD

VPO. No.________ **Date __________**

I acknowledge receipt of Rs. ____________________(Rupees ____________________) for payment made on my behalf / towards ______________________________ against Bill / Receipt No. _________________ dated _________ Guest Registration No. _________/Room No. ___________________

Guest's Signature

b. Allowance or discount: An allowance is a type of credit posting which is given to a guest during his stay or at the time of his departure.

This can be either:

- An over-age i.e. excess charges, or
- As a form of compensation when improper service was rendered or
- Quality of service provided was deplorable.

Proforma of Allowance / Discount Voucher

Hotel ABCD

Allowance/Discount Voucher

Date: _____________

Credit the account of Mr./Mrs.________________ guest registration No. ____________ Rs. __________ (Rs. ____) towards________________

Explanation/Remarks:

____

____

Authorized Signatory **Cashier / Front Office Assistant**

2.4.5 Advantages

The main advantages of the Journal are:

1. It reduces the possibility of errors.
2. It provides an explanation of the transaction.
3. It provides a chronological record of all transactions.

2.4.6 Limitations

The limitations of the Journal are:

1. It will be too long if all transactions are recorded here.
2. It is difficult to ascertain the balance of each account.

CHECK YOUR PROGRESS-I

1. Define double entry system of accounting.

2. What is Visitor's Paid-out? Draw the neat format of the same.

2.5 Ledger

In order to ascertain the net effect of all the transactions relating to a particular account are collected at one place in the Ledger. A Ledger is a book which contains all the accounts whether personal, real or nominal, which are first entered in journal or special purpose subsidiary books.

2.5.1 Format of Ledger

Name of the Account

Dr. Cr.

Date	Particulars	J.F	Amount. Rs.	Date	Particular	J.F	Amount. Rs.
Year Month Date	To (Name of the Credit Account in Journal)			Year Month Date	By (Name of the Debit Account in Journal)		

Explanation:

i. Each ledger account is divided into two parts. The left hand side is known as the debit side and the right hand side is known as the credit side. The words 'Dr.' and 'Cr.' are used to denote Debit and Credit.

ii. The name of the account is mentioned in the top (middle) of the account.

iii. The date of the transaction is recorded in the date column.

iv. The word 'To' is used before the accounts which appear on the debit side of an account in the particulars column. Similarly, the word 'By' is used before the accounts which appear on the credit side of an account in the particulars column.

v. The name of the other account which is affected by the transaction is written either in the debit side or credit side in the particulars column.

vi. The page number of the Journal or Subsidiary Book from where that particular entry is transferred, is entered in the Journal Folio (J.F) column.

vii. The amount pertaining to this account is entered in the amount column

Personal Accounts

Santhosh Account

Dr.	Cr.
Debit Santhosh when he receives goods , money or value from the business	Credit Santhosh when he gives goods , money or value to the business

Real Accounts

Computer Account

Dr.	Cr.
Debit Purchase of Asset	Credit Sale of asset

Nominal Accounts

Salaries Account

Dr.	Cr.
Debit - Expenses or Losses	

Commission Received Account

Dr.	Cr.
	Credit - Income or Gains

2.5.2 Procedure of Posting

The procedure of posting is given as follows:

i. ***Procedure of posting for an Account which has been debited in the journal entry***.

Step 1 → Locate in the ledger, the account to be debited and enter the date of the transaction in the date column on the debit side.

Step 2 → Record the name of the account credited in the Journal in the particulars column on the debit side as "To..... (name of the account credited)".

Step 3 → Record the page number of the Journal in the J.F column on the debit side and in the Journal, write the page number of the ledger on which a particular account appears in the L.F. column.

Step 4 → Enter the relevant amount in the amount column on the debit side.

ii. ***Procedure of posting for an Account which has been credited in the journal entry***.

Step 1 → Locate in the ledger the account to be credited and enter the date of the transaction in the date column on the credit side.

Step 2 → Record the name of the account debited in the Journal in the particulars column on the credit side as "By...... (name of the account debited)"

Step 3 → Record the page number of the Journal in the J.F column on the credit side and in the Journal, write the page number of the ledger on which a particular account appears in the L.F. column.

Step 4 → Enter the relevant amount in the amount column on the credit side.

Illustration 1 : Mr. Ram started business with cash Rs. 5,00,000 on 1st June 2003. The above transaction will appear in Journal and Ledger as under.

Solution :

In the Books of Ram
Journal

Date	Particulars	L.F	Debit		Credit	
			Rs.	P	Rs.	P
2003	Cash A/c. Dr.		500,000			
June 1	To Ram's Capital A/c.				500,000	
	(Amount invested By Ram in the business)					

Note : Here two Accounts are involved . Cash Account and Ram's Capital Account . We are allocating the Ledger a page for each of these Accounts .

Ledger

Cash Account

Dr. Cr.

Date	Particulars	J.F	Amount. Rs.	Date	Particular	J.F	Amount. Rs.
2003							
June 1	To Ram's Capital A/c		500000				

Ram's Capital Account

Dr.							Cr.
Date	**Particulars**	**J.F**	**Amount. Rs.**	**Date**	**Particular**	**J.F**	**Amount. Rs.**
				2003			
				June 1	By Cash A/c.		500000

Illustration 2: Journalise the following transactions in the books of Amar and post them in the Ledger:

2004

March	1	Bought goods for cash Rs. 25,000
	2	Sold goods for cash Rs. 50,000
	3	Bought goods for credit from Gopi Rs.19,000
	5	Sold goods on credit to Robert Rs.8,000
	7	Received from Robert Rs. 6,000
	9	Paid to Gopi Rs.5,000
	20	Bought furniture for cash Rs. 7,000

Journal of Amar

Date	**Particulars**	**L.F**	**Debit Rs.**	**Credit Rs.**
2004	Purchases A/c. Dr.		25,000	
Mar 1	To Cash A/c.			25,000
	(Cash Purchases)			
2	Cash A/c. Dr.		50,000	
	To Sales A/c.			50,000
	(Cash Sales)			
3	Purchases A/c. Dr.		19,000	
	To Gopi A/c.			19,000
	(Credit purchases)			
5	Robert A/c. Dr.		8,000	
	To Sales A/c.			8,000
	(Credit Sales)			
7	Cash A/c. Dr.		6,000	
	To Robert A/c.			6,000

	(Cash Received)			
9	Gopi A/c. Dr.		5,000	
	To Cash A/c.			5,000
	(Cash paid)			
20	Furniture A/c. Dr.		7,000	
	To Cash A/c.			7,000
	(Furniture purchased)			

Explanation : There are six accounts involved: Cash, Purchases, Sales, Furniture, Gopi & Robert, so six accounts are to be opened in the ledger.

Solution :-

Ledger of Amar

Cash Account

Dr. Cr.

Date	Particulars	J.F	Amount. Rs.	Date	Particular	J.F	Amount. Rs.
2004				2004			
Mar 5	To Sales A/c		50000	Mar 1	By Purchases A/c		25000
7	To Robert A/c		6000	9	By Gopi A/c		5000
				20	By Furntiure A/c		7000

Purchases Account

Dr. Cr.

Date	Particulars	J.F	Amount. Rs.	Date	Particular	J.F	Amount. Rs.
2004							
Mar 1	To Cash A/c		25000				
3	To Gopi A/c		19000				

Sales Account

Dr. Cr.

Date	Particulars	J.F	Amount. Rs.	Date	Particular	J.F	Amount. Rs.
				2004			
				Mar 2	By Cash A/c		50000
				5	By Robert A/c		6000

Furniture Account

Dr. Cr.

Date	Particulars	J.F	Amount. Rs.	Date	Particular	J.F	Amount. Rs.
2004 Mar 20	To Cash A/c		7000				

Gopi Account

Dr. Cr.

Date	Particulars	J.F	Amount. Rs.	Date	Particular	J.F	Amount. Rs.
2004 Mar 9	To Cash A/c		6000	2004 Mar 3	By Purchase A/c		19000

Robert Account

Dr. Cr.

Date	Particulars	J.F	Amount. Rs.	Date	Particular	J.F	Amount. Rs.
2004 Mar 6	To Sales A/c		6000	2004 Mar 7	By Cash A/c		6000

2.5.3 Posting of Compound Journal entries

Compound or Combined Journal Entry is one where more than one transactions are recorded by passing only one journal entry instead of passing several journal entries. Special care must be taken in posting the compound journal entry, where there may be only one debit aspect but many corresponding credit aspects of equal value or vise versa.

Illustration 3 : Jan. 12, 2003, Cash sales Rs.10,000, Cash received from Kannan Rs.5,000 and commission earned Rs.2,500.

Journal

Date	Particulars	L.F	Debit		Credit	
			Rs.	P	Rs.	P
2003	Cash A/c. Dr.		17,500			
Jan 12	To Sales A/c.				10,000	
	To Kannan's A/c.				5,000	
	To Commission A/c.				2,500	
	(Received cash for sale from Kannan and as commission)					

Ledger

Cash Account

Dr. Cr.

Date	Particulars	J.F	Amount. Rs.	Date	Particular	J.F	Amount. Rs.
2003							
Jan 12	To Sales A/c		10000				
	To Kannan's A/c		5000				
	To Commission A/c		2500				

Sales Account

Dr. Cr.

Date	Particulars	J.F	Amount. Rs.	Date	Particular	J.F	Amount. Rs.
				2003			
				Jan 12	By Cash A/c.		10000

Kannan's Account

Dr. Cr.

Date	Particulars	J.F	Amount. Rs.	Date	Particular	J.F	Amount. Rs.
				2003			
				Jan 12	By Cash A/c.		5000

Commission Account

Dr. Cr.

Date	Particulars	J.F	Amount. Rs.	Date	Particular	J.F	Amount. Rs.
				2003			
				Jan 12	By Cash A/c.		2500

Note: In the above transactions, there is only one debit aspect namely cash account and three credit aspects. Therefore, while posting in the cash account, the names of three credit aspects are entered in the cash account on the debit side, thus having a total of Rs.17,500 which is equal to the amount in the debit column of the journal. The cash account is written on the credit side of the three accounts, namely, Sales, Kannan and Commission received, as it acts as an opposite and corresponding accounts for Sales Rs.10,000, Kannan Rs.5,000 and Commission Rs.2,500 respectively which are equal to the amount in the credit column of the journal.

2.5.4 Posting the Opening entry

The opening entry is passed to open the books of accounts for the new financial year. The debit or credit balance of an account what we get at the end of the accounting period is known as closing balance of that account. **This closing balance becomes the opening balance in the next accounting year**.

The procedure of posting an opening entry is same as in the case of an ordinary journal entry. An account which has a **debit balance**, the words **' To balance b/d'** are recorded on the debit side in the particulars column. An account which has a **credit balance**, the words "**By balance b/d**" are recorded in the particulars column on the credit side.

Illustration 4 : Post the opening entry into the ledger of Rajan as on 1st April 2003, cash in hand Rs. 10,000; Loan Rs. 1,00,000.

In the Books of Rajan

Cash Account

Dr. Cr.

Date	Particulars	J.F	Amount. Rs.	Date	Particular	J.F	Amount. Rs.
2003 Apr 1	To Balance b/d		10000				

Loan Account

Dr. Cr.

Date	Particulars	J.F	Amount. Rs.	Date	Particular	J.F	Amount. Rs.
				2003 Apr 1	By Balance b/d		100000

2.5.5 Balancing an Accounts

Balance is the difference between the total debits and the total credits of an account. When posting is done, many accounts may have entries on their debit side as well as credit side. The net result of such debits and credits in an account is the balance.

Balancing means the writing of the difference between the amount columns of the two sides in the lighter (smaller total) side, so that the grand totals of the two sides become equal.

2.5.5.1 Significance of balancing

There are three possibilities while balancing an account during a given period. It may be a debit balance or a credit balance or a nil balance depending upon the debit total and the credit total.

j. **debit Balance** : The excess of debit total over the credit total is called the debit balance. When there is only debit entries in an account, the amount itself is the balance of that account, Then it is entered on the debit side, below the total, as the first item for the next period.

Cash Account

Dr. Cr.

Date	Particulars	J.F	Amount. Rs.	Date	Particular	J.F	Amount. Rs.
2003				2003			
Mar 2	To Ram's Capital A/c		15000	Mar 15	By Purchases A/c		8000
12	To Ram's Capital A/c		4000	28	By Salary A/c		2500
				31	By Balance c/d		8500
			19000				19000
Apr 1	To Balance b/d		8500				

ii. **Credit Balance** : The excess of credit total over the debit total is called the credit balance. When there is only credit entries in an account, the amount itself is the balance of that account i.e., the credit balance. It is first written in the debit side, as the last item, above the total. Then it is recorded on the credit side, below the total, as the first item for the next period.

Capital Account

Dr. Cr.

Date	Particulars	J.F	Amount. Rs.	Date	Particular	J.F	Amount. Rs.
2003 Mar 31	To Balance c/d		50000	2003 Mar 1	By Cash A/c.		50000
			50000				50000
				Apr 1	By Balance b/d		50000

iii. **Nil Balance** : When the total of debits and credits are equal, it is closed by merely writing the total on both the sides. It indicates the equality of benefits received and given by that account

Shankar Account

Dr. Cr.

Date	Particulars	J.F	Amount. Rs.	Date	Particular	J.F	Amount. Rs.
2003 Mar 20	To Sales A/c		6000	2003 Mar 25	By Cash A/c.		6000
			6000				6000

2.5.5.2 Balancing of different accounts

Balancing is done periodically depending on the requirements of the business.

i. **Personal Accounts** : These accounts are balanced regularly to know the amounts due to the persons (creditors) or due from the persons (debtors).

ii. **Real Accounts** : These accounts are balanced at the end of the financial year, when final accounts are being prepared. When, cash account is frequently balanced to know the cash on hand. A debit balance in an asset account indicated the value of the asset owned by the business. Assets accounts always show debit balances.

iii. **Nominal Accounts** : These accounts are not to be balanced as they are to be closed by transfer to final accounts. A debit balance in a nominal account indicates that it is an expense or loss. A credit balance in a nominal account indicates that it is an income or gain.

All such balances in personal and real accounts are shown in the Balance Sheet and the balances in nominal accounts are taken to the Profit and Loss Account.

2.5.5.3 Procedure for Balancing

While balancing an account, the following steps are involved:

Step 1 → Total the amount column of the debit side and the credit side separately and then ascertain the difference of both the columns.

Step 2 → If the debit side total exceeds the credit side total, put such difference on the amount column of the credit side, write the date on which balancing is being done in the date column and the words "By Balance c/d" (c/d means carried down) in the particulars columnOR

If the credit side total exceeds the debit side total, put such difference on the amount column of the debit side, write the date on which balancing is being done in the date column and the words "To Balance c/d" in the particulars column.

Step 3 → Total again both the amount columns, put the total on both the sides and draw a line above and a line below the totals.

Step 4 → Enter the date of the beginning of the next period in the date column and bring down the debit balance on the debit side along with the words "To Balance b/d" (b/d means brought down) in the particulars column and the credit balance on the credit side along with the words "By balance b/d" in the particulars column.

Note: In the place of c/d and b/d, the words c/f or c/o (carried forward or carried over) and b/f or b/o (brought forward or brought over) may also be used. When the balance is carried down in the same page, the words c/d and b/d are used, while balance is carried over to the next page, the term c/o and b/o are used. When balance is carried forward to some other page either in same book or some other book, the abbreviations c/f (carried forward) and b/f (brought forward) are used.

Illustration 5 : Balance the following Ledger Account as on 31st March 2003.

Siva's Account

Dr. Cr.

Date	Particulars	J.F	Amount. Rs.	Date	Particular	J.F	Amount. Rs.
2003				2003			
Mar 5	To Sales A/c		150000	Mar 8	By Sales Returns A/c.		10000
21	To Sales A/c		10000	12	By Cash A/c.		25000
				20	By Bank A/c.		50000

Explanation : The steps involved in balancing Siva's Account

Step 1	Total the amount column of the debit side	Rs.	160000
Step 2	Total the amount column of the credit side	Rs.	85000

Step 3	Balance / Difference	Rs.	75000

Explanation : The steps involved in balancing Siva's Account.

Step 1 → Total the amount column of the debit side Rs. 1,60,000 Total the amount column of the credit side Rs. 85,000 Balance / Difference Rs.75,000 . Since the total of debit amount column exceeds the total of credit amount column, the difference is Debit balance.

Step 2 → Enter the date of balancing, which is normally the last date of the accounting period (i.e., 31st March 2003) in the date column, "By Balance c/d" in the particulars column, and the difference in the amount column on the credit side.

Step 3 → Total both the amount columns and draw a line above and a line below the totals.

Step 4 → Enter the date of the beginning of the next period in the date column (i.e., 1st April 2003) , 'To Balance b/d' in the particulars column and enter the balance amount in the amount column on the debit side. After taking into consideration of the above steps, Siva's Account will appear as follows:

Siva's Account

Dr. Cr.

Date	**Particulars**	**J.F**	**Amount. Rs.**	**Date**	**Particular**	**J.F**	**Amount. Rs.**
2003				2003			
Mar 5	To Sales A/c		150000	Mar 8	By Sales Returns A/c.		10000
21	To Sales A/c		10000	12	By Cash A/c.		25000
				20	By Bank A/c.		50000
				31	By Balance c/d		75000
			160000				160000
April 1	To Balance b/d		75000				

Illustration 6 : Balance the ledger accounts for Illustration 2.

Cash Account

Dr. Cr.

Date	**Particulars**	**J.F**	**Amount. Rs.**	**Date**	**Particular**	**J.F**	**Amount. Rs.**
2004				2004			
Mar 5	To Sales A/c		50000	Mar 1	By Purchases A/c.		25000
7	To Robert A/c		6000	9	By Gopi A/c		5000
				20	By Furniture A/c		7000
				31	By Balance c/d		19000
			56000				56000
April 1	To Balance b/d		19000				

Purchases Account

Dr. Cr.

Date	Particulars	J.F	Amount. Rs.	Date	Particular	J.F	Amount. Rs.
2004				2004			
Mar 1	To Cash A/c		25000	Mar 1	By Balance c/d		44000
7	To Gopi A/c		19000				
			44000				44000
April 1	To Balance b/d		44000				

Sales Account

Dr. Cr.

Date	Particulars	J.F	Amount. Rs.	Date	Particular	J.F	Amount. Rs.
2004				2004			
Mar 31	To Balance c/d		58000	Mar 1	By Cash A/c.		50000
				9	By Robert A/c		8000
			58000				58000
				April 1	By Balance b/d		58000

Furniture Account

Dr. Cr.

Date	Particulars	J.F	Amount. Rs.	Date	Particular	J.F	Amount. Rs.
2004				2004			
Mar 5	To Cash A/c		7000	Mar 31	By Balance c/d		7000
			7000				7000
April 1	To Balance b/d		7000				

Gopi Account

Dr. Cr.

Date	Particulars	J.F	Amount. Rs.	Date	Particular	J.F	Amount. Rs.
2004				2004			
Mar 19	To Cash A/c		5000	Mar 3	By Purchases A/c		19000
31	To Balance c/d		14000				
			19000				19000
				April 1	By Balance b/d		14000

Robert Account

Dr. Cr.

Date	Particulars	J.F	Amount. Rs.	Date	Particular	J.F	Amount. Rs.
2004				2004			
Mar 5	To Sales A/c		8000	Mar 7	By Cash A/c.		6000
				9	By Balance c/d		2000
			8000				8000
April 1	To Balance b/d		2000				

PROBLEM No. 1

Journalese the following in Tat. Uma Maheswari's Journal.

1994,			Rs.
Sept.	1	Tat. Uma Maheswari started business with	50,000
	3	Opened a current account with Indian Overseas Bank	15,000
	10	Bought goods from Tmt. Latha Baskar	40,000
	15	Paid to Tmt. Latha Baskar	25,000
	18	Sold goods to Tmt. Kanniga	36,000
	25	Tmt. Kanniga settled her account	

post them in the ledger

Solution :-

Ledger Accounts

In the books of Tmt. Uma Maheswari

Cash Account

Dr. Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particular	J.F	Amount. Rs.
1994				1994			
Sept 1	To Capital A/c		50000	Sept 15	By Tmt. Latha Baskar A/c		25000
25	To Tmt. Kanniga A/c		36000				
				Sept 30	By Balance. c/d		61000
			86000				86000
Oct 1	To Balance b/d		61000				

Capital Account

Dr. Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particular	J.F	Amount. Rs.
1994				1994			
Sept 30	To Balance. c/d		65000	Sept 1	By Cash A/c		50000
				3	By Bank A/c		15000
			65000				65000
				Oct 1	By Balance. b/d		65000

Bank Account

Dr. Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particular	J.F	Amount. Rs.
1994				1994			
Sept 3	To Cash A/c		15000	Sept 30	By Balance. c/d		15000
			15000				15000
Oct 1	To Balance b/d		15000				

Purchase Account

Dr. Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particular	J.F	Amount. Rs.
1994				1994			
Sept 10	To Tmt. Latha Baskar A/c.		40000	Sept 30	By Balance. c/d		40000
			40000				40000
Oct 1	To Balance b/d		40000				

Tmt. Latha Baskar Account

Dr. Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particular	J.F	Amount. Rs.
1994				1994			
Sept 15	To Cash A/c		25000	Sept 10	By Purchase A/c		40000
30	To Balance. c/d		15000				
			40000				40000
				Oct 1	By Balance. b/d		15000

Sales Account

Dr. Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particular	J.F	Amount. Rs.
1994				1994			
Sept 30	To Balance. c/d		36000	Sept 18	By Tmt. Kanniga A/c		36000
			36000				36000

				Oct 1	By Balance. b/d		36000

Tmt. Kanniga Account

Dr. Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particular	J.F	Amount. Rs.
1994				1994			
Sept 18	To Sales A/c		36000	Sept 25	By Cash A/c		36000
			36000				36000

PROBLEM No. 2

Journalese the following transactions in Thiru. Narayanaswamy's books.

1994, Aug.			Rs.
	5	Sold goods to Maharajan on Credit	6,500
	9	Brought goods for cash from Chengalvarayan	7,500
	12	Met Travelling expenses	1,500
	15	Received Rs. 10000 from Sukumar as loan	
	17	Returned damaged goods to Mohan	800
	21	Paid wages to workers	2,000

post them in the ledger

Solution :-

Ledger Accounts

In the books of Thiru . Narayanaswamy

Cash Account

Dr. Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particular	J.F	Amount. Rs.
1994				1994			
Aug 5	To Sales A/c		6500	Aug 9	By Purchases A/c		7500
15	To Sukumar A/c		10000	12	By Travelling Expenses A/c		1500
	To Bank A/c			21	By Wages A/c		2000
				31	By Balance. c/d		5500
			16500				16500
Sept 1	To Balance b/d		5500				

Maharajan Account

Dr. Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particular	J.F	Amount. Rs.
1994				1994			
Aug 31	To Balance. c/d		6500	Aug 5	By Sales A/c		6500
			6500				6500
				Sept 1	By Balance. c/d		6500

Travelling Expenses Account

Dr. Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particular	J.F	Amount. Rs.
1994				1994			
Aug 12	To Cash A/c		1500	Aug 31	By Balance. c/d		1500
			1500				1500
Sept 1	To Balance b/d		1500				

Purchase Account

Dr. Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particular	J.F	Amount. Rs.
1994				1994			
Aug 9	To Cash A/c		7500	Aug 31	By Balance. c/d		7500
			7500				7500
Sept 1	To Balance b/d		7500				

Sukumar Account

Dr. Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particular	J.F	Amount. Rs.
1994				1994			
Aug 31	To Balance. c/d		10000	Aug 15	By Cash A/c		10000
			10000				10000
				Sept 1	By Balance. c/d		10000

Mohan Account

Dr. Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particular	J.F	Amount. Rs.
1994 Aug 17	To Purchases Returns A/c		800	1994 Aug 31	By Balance. c/d		800
			800				800
Sept 1	To Balance b/d		800				

Purchases Return Account

Dr. Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particular	J.F	Amount. Rs.
1994 Aug 31	To Balance. c/d		800	1994 Aug 17	By Mohan A/c		800
			800				800
				Sept 1	By Balance. c/d		800

Wages Account

Dr. Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particular	J.F	Amount. Rs.
1994 Aug 21	To Cash A/c		2000	1994 Aug 31	By Balance. c/d		2000
			2000				2000
Sept 1	To Balance b/d		2000				

2.5.6 Distinction between Journal and Ledger

Basis of distinction	Journal	Ledger
1. Book	It is the book for prime entry	It is the main book for Account
2. Stage	Recording of entries in this books is the first stage of transaction process	Recording of entries in Ledger is the second stage of transaction process

3. Process	The process of recording entries in this books is known as "Journalising "	The process of recording entries in Ledger is known as "Posting "
4. Transactions	Transactions relating to a particular Account are spread over	Transactions relating to a particular Account are found together on a particular page
5. Net effect	The Final position of an account cannot be ascertained	The Final position of an account can be ascertained with a glance
6. Next Stage	Entries get transferred to Ledger	Entries get transferred to first the Trail Balance & then Final Accounts are prepared
7. Tax authorities	Do not rely on this Book	Rely on Ledger for the assessment purposes .

2.5.7 Hotel Ledgers

A Ledger is a collection of the same type of accounts . The front office ledger has a collection of folios . There are two ledgers maintained by the front office . One , of them is **Guest Ledger** , containing all folios entries of resident guests ; the other contains the folio entries of non-resident guest accounts and is known as **city ledger** .

2.5.7.1 Guest Ledger or Visitors' Tabular Ledger

A guest ledger contains the details of all financial transactions between a resident guest and the hotel , including charge purchases and the payments received from the guest . It has two parts – Debit & Credit . By taking the look at the guest ledger , one can find the credit or debit balance of an individual guest as well as the total credit or debit balance on date . In a manual system , the financial transactions are recorded in a tabular ledger , or tab ledger , which is of two types :

- Horizontal Tabular Ledger
- Vertical tabular Ledger

VISITORS' TABULAR LEDGER **Date : 21 - APR - 2019**

G. Regn . No	**2999**					
Name :-	**Mr. xyz**					
Arr. Date	**20- April - 2019**					
Arr. Time	**10:00 A.M**					
Dep. Date	**21 - April - 2019**					
Dep. Time	**04:00 P.M**					
Plan ! PAX	**CP ! 2**					2
Room Rate	**Rs. 2500**					
Room No.	102	103	104	201	202	
Op. Balance Dr. / (Cr.)	-1275					-1275

DEBIT ENTRIES						
Apartments	2500					2500
Guest Charges						
Breakfast	150					150
Lunch	500					500
Dinner	500					500
Coffee / Tea / Milk	75					75
Room Service						
Restaurant						
Bar						
Coffee Shop	150					150
News Stand	200					200
Telephones	75					75
Laundry	125					125
Other Charges						
Visitors Paid Out	250					250
Luxury Tax						
VAT	175					175
Service Charge	250					250
Total :- Op. Balance + Debit Charges	3675					3675
CREDIT ENTRIES						
Allowance / Discount						
Advance / Deposit						
Transfer to Guest A/c						
Transfer to City Ledger						
CLOSING BALANCE : Total -Credit Entries	3675					3675

Types of postings: There are two basic types of transactions that are posted to a guest account: debit entries and credit entries. The most common debit items include: Room charges Restaurant / coffee shop / bar Telephone Laundry Use of hotel facilities (viz. health center, business center and transportation) Credit entries: Prepayments Payments for part of the bill during stay Payments for final settlement Amendments to the bill. The posting resembles that of the guest bill. Only difference is different guest's accounts are posted column wise on the same sheet. Each day a separate sheet is used to create a VTL, taking the previous day's closing balances of all existing guests at that time as opening balances.

2.5.7.2 City Ledger

The city ledger is also called the non-guest ledger. It is the collection of non-guest accounts. If a guest account is not settled in full by cash payment at checkout, the guest's folio balance is transferred from the guest ledger in the front office to the city ledge in the accounting division for collection. At the time of account transfer, the responsibility for account collection shifts from the front office to the accounting division.

Creation Of City Ledger: These could include accounts held by:

- Local business people who are not resident in the hotel but who use the hotel facilities and services for entertainment or business meetings.
- Guests who walk out of the hotel without settling the outstanding balance. Walkouts are no longer resident so their account is transferred to the city ledger, till the account is settled or closed by writing off as bad debt, if the amount is over due and not forthcoming for a long period.
- Guests who have sent prepayments to guarantee their bookings, but have not arrived or checked in. This amount is recorded in the city ledger and the account needs to be closed as per the terms of the reservation.
- Even a skipper's outstanding balance is transferred to city ledger with a hope that the amount may come through.

Bad Debt :- Eventually if there was no trace of the guest the amount will be written off as a Bad Debt.

2.5.8 Advantages of ledger

i. **Complete information at a glance**: All the transactions pertaining to an account are collected at one place in the ledger.

ii. **Arithmetical Accuracy**: With the help of ledger balances, Trial balance can be prepared to know the arithmetical accuracy of accounts.

iii. **Result of Business Operations**: It facilitates the preparation of final accounts for ascertaining the operating result and the financial position of the business concern.

iv. **Accounting information**: The data supplied by various ledger accounts are summarised, analysed and interpreted for obtaining various accounting information.

CHECK YOUR PROGRESS-II

1. What is ledger? Explain the procedure of posting in ledger.

2. Distinguish between journal and ledger.

2.6 Subsidiary Books

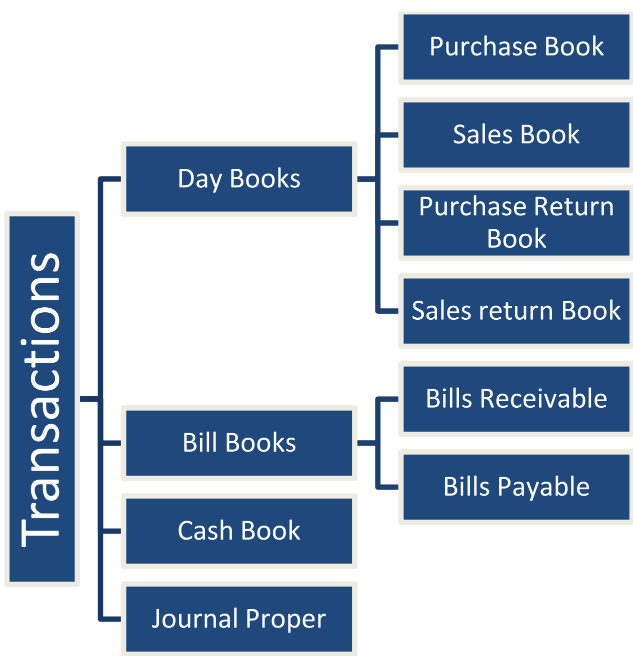
Transactions are classified and grouped according to their nature. Transactions are of two types: **Cash** and **Credit**.

Cash transactions are grouped in one category – ***Cash Book***

credit transactions are sub-grouped in separate book is used for each category or group of transactions which are repetitive and sufficiently large in number. – ***Purchases Book***&***Sales Book***

2.6.1 Kinds of Subsidiary Books

The following are the special purpose subsidiary books



2.6.2 Purpose of Subsidiary Books

I. **Purchases Book** records only credit purchases of goods by the trader.
II. **Sales Book** is meant for entering only credit sales of goods by the trader.
III. **Purchases return Book** records the goods returned by the trader to suppliers.
IV. **Sales return Book** deals with goods returned (out of previous sales) by the customers.
V. **Bills receivable Book** records the receipts of bills (Bills Receivable).
VI. **Bills Payable Book** records the issue of bills (Bills Payable).
VII. **Cash Book** is used for recording only cash transactions i.e., receipts and payments of cash.
VIII. **Journal Proper** is the journal which records the entries which cannot be entered in any of the above listed subsidiary books.

2.6.3 Advantages of Subsidiary Books

The advantages of maintaining subsidiary books are :

i. **Division of Labour** : The division of journal, resulting in division of work, ensures more clerks working independently in recording original entries in the subsidiary books.

ii. **Efficiency** : The division of labour also helps the reduction in work load, saving in time and stationery.

iii. **Prevents errors and Frauds** : The accounting work can be divided in such a manner that the work of one person is automatically checked by another person.

iv. **Easy reference** : It facilitates easy references to any particular item. Example :- Total credit sales for a month can be easily obtained from the Sales Book.

v. **Easy Postings** : Posting from the subsidiary books are made at convenient intervals depending upon the nature of the business.

2.6.4 Cash Book

Cash transactions are numerous transaction in a business entity ; it becomes easier to maintain all these in a separate book of records . This book that upkeep's only the cash transactions is the **Cash Book** .

The cash book is both a journal and a ledger. Cash Book will always show debit balance, as cash payments can never exceed cash available.

2.6.4.1 Advantages of using Cash Book

1. ***Saves time and labour***: All cash transactions are straight away recorded in the cash book which is in the form of a ledger.

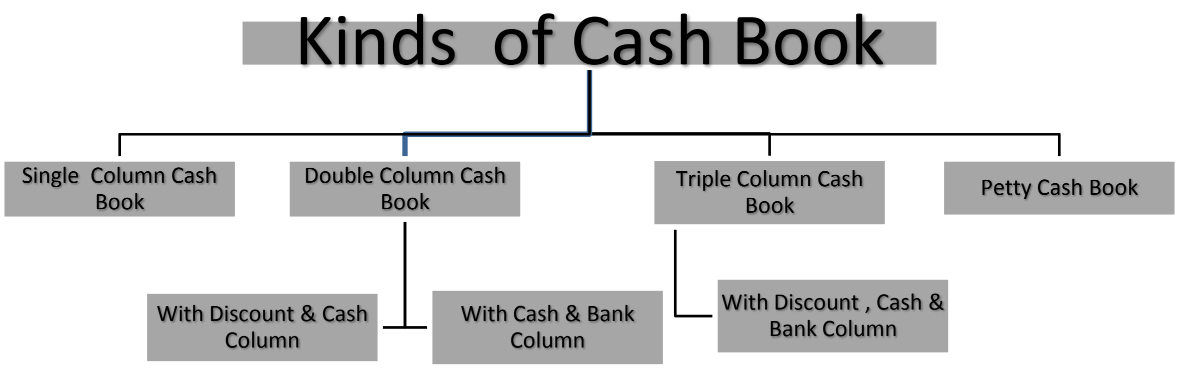
2. ***To know cash and bank balance***: It benefits the proprietor to know the cash and bank balance at any point of time.

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

4. ***Effective cash management***: Cash book provides all information regarding total receipts and payments of the business concern at a particular period.

2.6.4.2 Kinds of Cash Book

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



2.6.4.3 Single Column Cash Book

Single column cash book has one amount column in each side. All cash receipts are recorded on the debit side and all cash payments on the credit side. The format of a single column cash book is given below.

Format

Single Column Cash Book of ……………………

Debit Side | Credit Side

Date	Particulars	R.N	L.F	Amount Rs.	Date	Particulars	V.N	L.F	Amount Rs.

Explanation :

i. **Date** : This column appears in both the debit and credit side. It records the date of receiving cash at debit side and paying cash at credit side.

ii. **Particulars** : This column is used at both debit and credit side. It records the names of parties (personal account), heads (nominal account) and items (real account) from whom payment has been received and to whom payment has been made.

iii. **Receipt Number (R.N)**: This column refers to the serial number of the cash receipt.

iv. **Voucher Number (V.N)** : The column refers to the serial number of the voucher for which payment is made.

v. **Ledger Folio (L.F)** : This column is used in both the debit and credit side of cash book. The ledger page (folio) of every account in the cash book is recorded against it.

vi. **Amount** : This column appears in both sides of the cash book. The actual amount of cash receipt is recorded on the debit side. The actual payments are entered on the credit side.

Balancing : - The total of the receipt (debit side) column will always be greater than the total of the payment column (credit side). The difference will be written on the credit side as "By Balance c/d". In the beginning of the next period, to show the cash balance in hand, the balance amount is recorded in the debit side as "To balance b/d".

Illustration 1 : Enter the following transactions in a single column cash book of Mr.Kumaran.

2004

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

Solution:

Cash Book
of Mr. Kumaran

Dr Cr.

Date	Particulars	R.N	L.F	Amount Rs.	Date	Particulars	V.N	L.F	Amount Rs.
2004					2004				
Jan 1	To Capital A/c			1000	Jan 3	By Purchases A/c			500
4	To Sales A/c			1700	12	By Balan A/c			150
25	To Siva A/c			200	14	By Furniture A/c			200
	To Commission			75	20	By Electric Charges A/c			225

	A/c								
					24	By Salaries A/c			250
					31	By Balance c/d			1650
				2975					2975
Feb 1	To Balance b/d			1650					

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

2.6.4.4 Double Column Cash Book

The most common double column cash books are

i. Cash book with discount and cash columns
ii. Cash book with cash and bank columns.

Cash book with cash and bank columns

Cash Book with discount and cash columns On either side of the single column cash book, another column is added to record discount allowed and discount received. The format is given below.

Double Column Cash Book
(Cash book with Cash and Bank Column)

Dr Cr.

Date	Particulars	R.N	L.F	Cash Rs.	Bank Rs.	Date	Particulars	V.N	L.F	Cash Rs.	Bank Rs.

The discount column on each side is totaled. The total of the discount column on the debit side shows the total discount allowed to customers and is debited to Discount Allowed Account. The total of the discount column on the credit side shows total discount received and is credited to Discount Received Account.

Illustration 2: Prepare a Double Column Cash Book from the following transactions of Mr.Gopalan:

			Rs.
2004			
Jan.	1	Cash in hand	4,000
	6	Cash Purchases	2,000
	10	Wages paid	40
	11	Cash Sales	6,000
	12	Cash received from Suresh and	1,980

	allowed him discount		20
19	Cash paid to Meena	2,470	
	and discount received		30
27	Cash paid to Radha	400	
28	Purchased goods for cash	2,070	

Solution :-

Double Column Cash Book of Mr. Goplalan
(Cash book with Discount Column)

Dr Cr.

Date	Particulars	R. N	L. F	Discount Allowed	Amount Rs.	Date	Particulars	V. N	L. F	Discount Allowed	Amount Rs.
2004						2004					
Jan 1	To Balance b/d				4000	Jan 6	By Purchases A/c				2000
11	To Sales A/c				6000	10	By Wages A/c				40
12	To Suresh A/c			20	1980	19	By Meena A/c			30	2470
						27	By Radha A/c				400
						28	By Purchases A/c				2070
						31	By Balance c/d				5000
				20	11980					30	11980
Feb 1	To Balance b/d				5000						

2.6.4.5Cash book with cash and bank columns

It is a cash book ~~by~~ providing a separate column on either side of the cash book to record the bank transactions therein. The two columns in the cash book serve the purpose of Cash Account and Bank Account respectively. It is a combination of Cash Account and Bank Account. The format of this cash book is given below.

Double Column Cash Book
(Cash book with Cash and Bank Column)

Dr Cr.

Date	Particulars	R.N	L.F	Cash Rs.	Bank Rs.	Date	Particulars	V.N	L.F	Cash Rs.	Bank Rs.

There are two amount columns on debit side one for cash receipts and the other for bank deposits. Also, there are two amount columns on the credit side, one for payments in cash and the other for payments by Cheques respectively.

Contra entry: When an entry affect both cash and bank accounts it is called a contra entry. In contra entries both the debit and credit aspects of a transaction are recorded in the cash book itself.

Example 1: Cash paid into bank

This is a contra entry. As the cash book with cash and bank columns is a combined cash and bank account, both the aspects of the transaction will be entered in the same book. In the debit side 'To Cash A/c' will be entered in the particulars column and the amount will be entered in the bank column. In thecredit side 'By Bank A/c' will be entered in the particulars column and the amount will be entered in the cash column. Such contra entries are denoted by writing the letter 'C' in the L.F. column, on both sides of the cash book. They indicate that no posting in respect thereof is necessary in the ledger.

Example 2: Cash withdrawn from bank for office use.

This is also a contra entry. In the debit side 'To Bank A/c' will be entered in the particulars column and the amount will be entered in the cash column. In the credit side 'By Cash A/c' will be entered in the particulars column and the amount will be entered in the bank column. Such contra entries are denoted by writing the letter 'C' in the L.F. column, on both sides of the cash book. They indicate that no posting in respect thereof is necessary in the ledger.

Illustration 3 : Enter the following transactions in the double column cash book of Mr.Rajesh and balance it.

2003

Aug.	1	Opening Balance :
		Cash in Hand Rs.4,250
		Cash at Bank Rs.13,750
	2	Paid to petty cashier Rs.2,500
	2	Cash sales Rs.1,750
	3	Paid to Arun by cheque Rs.3,750
	3	Received a cheque from Mr.RamBabu Rs.4,500 paid into bank.
	5	Received cheque from Mr.Jayaraman Rs.6,000 paid into bank
	8	Cash purchases Rs.2,500
	8	Paid rent by cheque Rs. 2,500
	9	Cash withdrawn from bank for office use Rs.2,500
	10	Cash sales Rs.3,750
	14	Stationery purchased Rs.1,000
	20	Cash sales Rs.6750
	21	Paid into bank Rs.10,000
	23	Withdrew cash for personal use Rs.1,000
	25	Salaries paid by cheque Rs.9000.

Solution :-

Double Column Cash Book of Mr. Rajesh

(Cash book with Cash and Bank Column)

Dr Cr.

Date	Particulars	R.N	L.F	Cash Rs.	Bank Rs.	Date	Particulars	V.N	L.F	Cash Rs.	Bank Rs.
2003 Aug 1	To Balance b/d			4250	13750	2003 Aug 2	By Petty Cash A/c			2500	

2	To Sales A/c			1750		3	By Arun's A/c				3750
3	To Ram Babu's A/c				4500	8	By Purchases A/c			2500	
5	To Jayaramans A/c				6000	8	By Rent A/c				2500
9	To Bank A/c		C	2500		9	By Cash A/c		C		2500
10	To Sales A/c			3750		14	By Stationery A/c			1000	
20	To Sales A/c			6750		21	By Bank A/c		C	10000	
21	To Cash A/c		C		10000	23	By Drawing's A/c				1000
						25	By Salary A/c				9000
						31	By Balance c/d			3000	15500
				19000	34250					19000	34250
Sept 1	To Balance b/d			3000	15500						

2.6.4.6 Triple Column Cash Book

When cash discount is a regular feature in a business entity ; then , a Triple Column Cash Book with three amount columns (cash, bankand discount) on each side is the most appropriate primary book . All cash receipts, deposits into bank and discount allowed are recorded on debit side and all cash payments, withdrawals from bank and discount received are recorded on credit side.

Format :

Triple Column Cash Book of Mr. ……………………………………..

(Cash book with Discount , Cash and Bank Columns)

Dr													Cr.
Date	**Particulars**	**R. N**	**L. F**	**Dis. Allowed Rs.**	**Cash Rs.**	**Bank Rs.**	**Date**	**Particulars**	**V. N**	**L. F**	**Dis. Received Rs.**	**Cash Rs.**	**Bank Rs.**

2.6.4.7 Postings from cash book to ledger accounts

1. Opening (Cash and Bank) balance appearing in the cash book is not posted to any account in the ledger.

2. Contra entries are not posted to any account.

3. Each item of discount allowed appearing on the debit side of the cash book will be posted to the credit of respective personal account. Total of discount allowed column should be posted to the debit side of discount allowed account with the words “To Sundry Accounts”.

4. Each item of discount received appearing on the credit side of the cash book will be posted to the debit of respective personal account. Total of discount received column should be posted to the credit of discount received account with the words “By Sundry Accounts”.

5. The other transactions recorded on the debit side of the cash book are posted to the credit of the respective accounts in the ledger. 6. The other transaction recorded on the credit side of the cash book are posted to the debit of the respective accounts in the ledger.

Illustration 4 : Compile three column cash book of Mr.Sundar from the following transactions

2002

Aug	1	Sundar started business with cash Rs.2,00,000
	2	Deposited into Bank Rs.50,000.
	4	Cash purchases Rs.5,000.
	5	Purchases by cheque Rs.6,000.
	6	Goods sold to Nathan on credit Rs. 5,000.
	8	Received cheque from Mano Rs.490, Discount allowed Rs.10.
	10	Paid carriage Rs.1,000. 12 Withdrew from Bank for office use Rs.10,000.
	15	Paid to Sundari Rs.4,960, Discount allowed by her Rs.40.
	20	Received a cheque for Rs.4950 from Nathan in full settlement of his account, which is deposited into Bank.

Solution :-

Triple Column Cash Book of Mr. Sundar

Dr Cr.

Date	**Particulars**	**R.N**	**L.F**	**Dis. Allowed Rs.**	**Cash Rs.**	**Bank Rs.**	**Date**	**Particulars**	**V.N**	**L.F**	**Dis. Received Rs.**	**Cash Rs.**	**Bank Rs.**
2002							2002						
Aug 1	To Capital A/c				200000		Aug 2	By Bank A/c		C		50000	
2	To Cash A/c		C			50000	4	By Purchases A/c				5000	
8	To Mano's A/c			10	490		5	By Purchases A/c					6000
12	To Bank A/c		C		10000		10	By Carriage A/c				1000	
20	To Nathan's A/c			50		4950	12	By Cash A/c		C			10000
							15	By Sundari's A/c			40	4960	
							31	By Balance c/d				149530	38950
				60	210490	54950					40	210490	54950
Sep 1	To Balance b/d				149530	38950							

Note : Transaction dated 6th August will not appear in the cash book as it is a credit transaction

Illustration 5 : Enter the following transactions in three column cash book of Mr.Muthu and balance the same.

2003

Aug	1	Cash in hand Rs.75,000
		Cash at bank Rs.40,000
	4	Paid into bank Rs.20,000.
	6	Purchased machinery by cheque Rs.10,000.
	8	Received from Mohan Rs.2,560 Discount allowed Rs. 40.
	10	Paid to Somu by cheque Rs.3,970 in full settlement of his account Rs.4,000.

11 Withdrew cash from Bank for personal use Rs.5,000.
15 Received cheque from Balan Rs.4,900. Allowed him discount Rs.100.
19 Balan's cheque deposited into Bank
24 Anandan our customer has paid directly into our bank account Rs.10,000.
27 Rent paid by cheque Rs.3,000.

Solution :

Triple Column Cash Book of Mr. Muthu

Dr Cr.

Date	Particulars	R. N	L. F	Dis. Allowed Rs.	Cash Rs.	Bank Rs.	Date	Particulars	V. N	L. F	Dis. Received Rs.	Cash Rs.	Bank Rs.
2003 Aug 1	To Balance b/d				75000	40000	2003 Aug 4	By Bank A/c		C		20000	
4	To Cash A/c		C			20000	6	By Machinery A/c					10000
8	To Mohan's A/c			40	2560		10	By Somu's A/c			30		3970
15	To Balan's A/c		C	100	4900		11	By Drawings A/c					5000
19	To Cash A/c					4900	19	By Bank A/c		C		4900	
24	To Anandan's A/c					10000	27	By Rent A/c					3000
							31	By Balance c/d				57560	52930
				140	82460	74900					30	82460	74900
Sep 1	To Balance b/d				57560	52930							

2.6.5 Purchases Book

Purchases book is used to record all credit purchases of goods which are meant for resale in the business.

Trade Discount: Trade discount is an allowance or concession granted by the seller to the buyer, if the customer purchases goods above a certain quantity or above a certain amount. The amount of the purchase made, is always arrived at after deducting the trade discount .

Cash Discount : This discount is given In order to encourage customer's to make the payment before the expiry of the credit period a deduction is offered. The deduction so made is known as cash discount.

Distinction between cash discount and trade discount: Trade discount differs from cash discount in the following respects.

S. No	Basis of Distinction	Trade Discount	Cash Discount
1	Parties	It is a reduction granted by the manufacturer / Supplier	It is a reduction granted by the whole-saler (Creditor) to the buyer (debtor)
2	Purpose	This encourages retailer to earn some profit	This to encourage prompt payment within a stipulated time period .
3	Time when allowed	It is allowed on the purchase of goods	It is allowed when payments is made within the specified period
4	Variation	It is normally given at the same rate , that is applicable to customer's . It varies with the quantity purchased	It greatly varies from customer to customer . The variance is on the basis of time & period of payments
5	Disclosure	It is shown as a deduction in the invoice itself	It is not shown in the invoice
6	Ledger Account	A separate Account is not opened in the Ledger	A separate Account is not opened in the Ledger for discount received and discount allowed

Format – Purchase Book

Purchases Book

Date	Particulars	Inward Invoice No.	L.F	Amount		Remarks
				Details Rs.	Total Rs.	

1. **Date Column** – Represents the date on which the transaction took place.
2. **Particulars Column** – This column has the name of the seller and the particulars of goods purchased.
3. **Inward Invoice No. Column** – It reveals the serial number of the inward invoice.
4. **LF. Column** – This column shows the page number of the suppliers account in the ledger accounts.
5. **Details Column** – It reveals the amount of goods purchased and the amount of trade discount.

6. **Total Column** – This column represents the net price of the goods.

7. **Remarks Column** – Contains any extra information.

2.6.5.1 Posting and Balancing

Once transactions are properly recorded in purchases journal, they are posted into the ledger. The procedure for posting is as follows :-

Step 1 → Entries will be posted to the credit side of the respective creditors (supplier) account in the ledger by writing "By Purchases A/c" in the particulars column.
Step 2 → Periodic total is posted to the debit of purchases account by writing "To sundries as per purchases book" in the particulars column.

Illustration 1: From the following transactions of Ram for July, 2003 prepare the Purchases Book and ledger accounts connected with this book.

2003
July 5 Purchased on credit from Kannan & Co.
50 Iron boxes @ Rs. 500
10 Grinders @ Rs. 3,000
6 Purchased for cash from Siva & Bros.
25 Fans @ Rs. 1,250
10 Purchased from Balan & Sons on credit
20 Grinders @ Rs. 2,500
10 Mixie @ Rs. 3,000
20 Purchased, on credit, one Computer from Kumar for Rs. 35,000.

Solution :-

Ledger Accounts

Purchases Account

Dr. Cr.

Date	**Particulars**	**J.F**	**Amount. Rs.**	**Date**	**Particular**	**J.F**	**Amount. Rs.**
2003 July 31	To Sundries as per Purchases Book		135000				

Kannan & Co. Account

Dr. Cr.

Date	**Particulars**	**J.F**	**Amount. Rs.**	**Date**	**Particular**	**J.F**	**Amount. Rs.**
				2003 July 5	By Purchases A/c.		55000

Balan & Co. Account

Dr. Cr.

Date	Particulars	J.F	Amount. Rs.	Date	Particular	J.F	Amount. Rs.
				2003 July 10	By Purchases A/c.		80000

Note : July 6th transaction is a cash transaction and July 20th transaction is purchase of an asset, so both will not be recorded in the purchases book.

2.6.6 Sales Book

The sales book is used to record all credit sales of goods dealt with by the trader in his business. The entries in the sales book are on the basis of the invoices issued to the customers with the net amount of sale.

2.6.6.1 Format – Sales Book

The format of sales book is shown below:

Sales Book

Date	Particulars	Outward Invoice No.	L.F	Amount		Remarks
				Details Rs.	Total Rs.	

1. **Date Column** – It represents the date on which the transaction took place.
2. **Particulars Column** – This column includes the name of purchasers and the particulars of goods sold.
3. **Outward Invoice No. Column** – It reveals the serial number of the outward invoice.
4. **L.F. Column** – The page number of the customers accounts in the Ledger is recorded.
5. **Details Column** – This contains the amount of goods sold and the mount of trade discount if any.
6. **Total Column** – This column shows the net amount which s receivable from the customers.
7. **Remarks Column** – Any other extra information will be recorded.

2.6.6.2 Posting and Balancing

At the end of the month the individual entries and the total of the sales book column are posted into the ledgers as under.

Step 1 → Individual amounts are daily posted to the debit of Customers' Accounts by writing "To Sales A/c" in the particulars column.

Step 2 → Grand total of the sales book is posted to the credit of sales account by writing "By Sundries as per Sales Book" in the particulars column.

Illustration 2

From the transactions given below prepare the Sales Book of Ram for July 2003.

2003		
July 5	Sold on credit to S.S. Traders	
	10 Chairs @ Rs. 250	Less 10%
	10 Tables @ Rs. 850	Discount
8	Sold to Raja for cash	
	15 Chairs @ Rs. 250	
20	Sold to Mohan & Co.	
	5 Almirah @ Rs. 2,200	
	10 Tables @ Rs. 850	
23	Sold on credit to Narayanan old computer for Rs. 5,000	
28	Sold to Kumaran for cash 15 Chairs @ Rs. 250	

Solution :-

In the books of Ram
Sales Book

Date	Particulars	Outward Invoice No.	L.F	Amount Details Rs.	Amount Total Rs.	Remarks
2003 July						
5	S.S. Trader & Co.					
	10 Chairs @ Rs. 250			2500		
	10 Tables @ Rs. 850			8500		
				11000		
	Less : 10 % Discount			1100		
					9900	
	Sales as per S.S. Traders & Co. Invoice no…… dated ……….					
20	Mohan & Co.					

	5 Almirah @ Rs. 2200			11000		
	10 Tables @ Rs. 850			8500		
					19500	
	Sales as per Mohan & Co Invoice no…… dated ……….					
	Total				29400	

Ledger Accounts

Sales Account

Dr. Cr.

Date	**Particulars**	**J.F**	**Amount. Rs.**	**Date**	**Particular**	**J.F**	**Amount. Rs.**
				2003 July 31	By Sundries as per sales Book		29400

S.S. Trader's Account

Dr. Cr.

Date	**Particulars**	**J.F**	**Amount. Rs.**	**Date**	**Particular**	**J.F**	**Amount. Rs.**
2003 July 5	To Sales A/c.		9900				

Mohan & Co. Account

Dr. Cr.

Date	**Particulars**	**J.F**	**Amount. Rs.**	**Date**	**Particular**	**J.F**	**Amount. Rs.**
2003 July 5	To Sales A/c.		19500				

2.6.7 Returns Books

Returns Books are those books in which the goods returned to the suppliers and goods returned by the customers are recorded.

The reasons for the return of goods are

i. not according to the order placed.
ii. not upto the samples quality which were already shown.
iii. due to damaged condition.
iv. due to difference in the prices charged.

v. Undue delay in the delivery of the goods.

2.6.7.1 Kinds of returns Books

The following are the kinds of Returns Books;

i. Purchases return or returns outward book
ii. Sales return or returns inward book

2.6.8 Purchases return book

It is also known as returns outward book

When the business concern returns a part of the goods purchased on credit, the returns fall under the category Purchases return or returns Outward.

2.6.8.1 Format - Purchases return book

Purchases Return Book

Date	Particulars	Debit Note No.	L.F	Amount		Remarks
				Details Rs.	Total Rs.	

Note : The reason for goods returned is recorded in Remarks column.

2.6.8.1 Posting and Balancing

The individual entries and the periodic total of the Purchase Return Book are posted into the Ledger as :

Step 1 → Individual amounts are daily posted to the debit of supplier accounts by writing "To Purchases Return A/c" in the particulars column.

Step 2 → Periodic total is posted to the credit of purchases return account by writing "By Sundries as per Purchases Return Book" in the particulars column.

Illustration 3

Enter the following transactions in the purchases return book of Hari and post them into the ledger.
2003
Jan 5 Returned goods to Anand
5 chairs @ Rs.200 each, not in accordance with order.
14 Returned goods to Chandran
4 chairs @ Rs.200 each and
10 tables @ Rs.350 each, due to inferior quality.

Solution :-

In the books of Hari
Purchases Return Book

Date	Particulars	Debit	L.F	Amount	Remarks

		Note No.		Details Rs.	Total Rs.	
2003 Jan 5	Anand 5 Chairs @ Rs. 200				1000	Not in accordance with order
14	Chandran 4 Chairs @ Rs. 200 10 Tables @ Rs. 350			800 3500	4300	Due to inferior quality
	Total				5300	

Ledger Accounts

Purchases Return Account

Dr. Cr.

Date	Particulars	J.F	Amount. Rs.	Date	Particular	J.F	Amount. Rs.
				2003 Jan 31	By Sundries as per Purchases return Book		5300

Anand Account

Dr. Cr.

Date	Particulars	J.F	Amount. Rs.	Date	Particular	J.F	Amount. Rs.
2003 Jan 5	To Purchases Return A/c.		1000				

Chandran Account

Dr. Cr.

Date	Particulars	J.F	Amount. Rs.	Date	Particular	J.F	Amount. Rs.
2003 Jan 14	To Purchases Return A/c.		4300				

2.6.9 Sales return Book

This book is used to record all returns of goods to the business by the customers. The entries in the sales return book are usually on the basis of credit notes issued to the customers or debit notes issued by the customers.

2.6.9.1 Format - Sales return Book

Format - Sales return Book

Sales Returns Book

Date	Particulars	Credit Note No.	L.F	Amount		Remarks
				Details Rs.	Total Rs.	

Note : Remarks column is meant to record the reason for return of goods.

2.6.9.1 Posting and Balancing

The individual entries and the periodic total of sales return book are posted into the ledger as under.

Step 1 → Individual amounts are daily posted to the credit of customers account by writing "By Sales return A/c" in the particulars column.

Step 2 → Periodic total is posted to the debit of sales return account by writing "To Sundries as per sales return book " in the particulars column.

Illustration 4 : Enter the following transactions in Returns Inward Book:

2003

April 6 Returned by Shankar 30 shirts each costing Rs.150, due to inferior quality.

8 Amar Tailors returned 10 Baba suits, each costing Rs.100, on account of being not in accordance with their order.

21 T.N. Stores returned 12 Salwar sets each costing Rs.200, being not in accordance with order.

Solution:

Sales Returns Book

Date	Particulars	Credit Note No.	L.F	Amount		Remarks
				Details Rs.	Total Rs.	
2003						
April 6	Shankar 30 shirts @ Rs. 150			4500		Due to inferior quality
8	Amar Tailors 10 baby			1000		Not in

	Suits @ Rs. 100					accordance with order
21	T.N. Stores 12 Salwar sets @ Rs. 200			2400	7900	Not in accordance with order
	Total				7900	

Shankar Account

Dr. Cr.

Date	Particulars	J.F	Amount. Rs.	Date	Particular	J.F	Amount. Rs.
				2003 April 6	By Sales Return A/c.		4500

Amar Tailors Account

Dr. Cr.

Date	Particulars	J.F	Amount. Rs.	Date	Particular	J.F	Amount. Rs.
				2003 April 8	By Sales Return A/c.		1000

T .N. Stores Account

Dr. Cr.

Date	Particulars	J.F	Amount. Rs.	Date	Particular	J.F	Amount. Rs.
				2003 April 21	By Sales Return A/c.		2400

2.7 Bank Reconciliation Statement

The balance of the bank column in the double or triple column cash book represents the customers cash balance at bank. It should be the same as shown by his bank pass book on any particular day. In case of disagreement in the balance of the cash book and the pass book, the need for preparing Bank Reconciliation Statement arises.

Definition - Bank reconciliation Statement: 'Bank reconciliation statement is a list in which the various items that cause a difference between bank balance as per cash book and pass book on any given date are indicated'.

Causes of Disagreement

It is between the balance shown by the cash book and the balance shown by the pass book

1. Cheques paid into bank but not yet collected

   The cheque paid into bank for collection but not credited into the account of the customer, because the cheque is

   i. not collected and credited till that date.
   ii. collected but the bank staff has forgotten to make entry.
   iii. collected but credited to wrong account.
   iv. dishonoured.
   v. collected for No.I account but credited to No.II account of the same customer.

2. Cheques issued but not yet presented for payment

The cheques issued but not debited customers account may be because the cheque is

   i. not cashed till date.
   ii. not presented till date.
   iii. presented but dishonoured for some reasons or other.
   iv. lost by the party to whom the cheque was issued.
   v. cashed out of No.I account but wrongly debited to No.II account of the same customer.

Amount credited by the banker in the pass book without the immediate knowledge of the customer

3. Amounts debited by the banker in the pass book without the immediate knowledge of the customer

Bank Pass Book

Bank Pass Book (statement of account) is a copy of the customer's account in the books of a bank. It shows all the deposits, withdrawals and the balance available in the customers account.

Difference between Cash Book and Pass Book

S. No	**Basis of Distinction**	**Cash Book (Bank Column)**	**Pass Book**
1	Maintenance Personnel	Cashier	Banker
2	Deposits of Cash	Entry on the debit side of the cash book	Entry on the credit side of the pass book
3	Withdrawal of cash	Entry on the credit side of the cash book	Entry on the debit side of the pass book

4	Cheque deposited for collection	Entry on the debit side of the cash book on date of depositing cheque	Entry on the pass book after realisation of cheque
5	Cheque issued	Entry on the credit side of the cash book on date of issuing cheque	Entry on the debit side of the pass book on date of cheque is presented and paid
6	Collections and payments as per customers standing instructions	Entry in to cash book after seeing pass book	Entry into Pass book first
7	Balancing	It is balanced at the end of a specified period	It is balanced at the end of each transaction

Format - Bank Reconciliation Statement

The format of Bank Reconciliation Statement when bank balance as per cash book is taken as the starting point

Bank Reconciliation Statement as on ……………………

Particulars			**Amount Rs.**	**Amount Rs.**
A		Balance as per Cash Book		……..
B	Add:	Cheque issued , but not presented for payment	…….	
		Interest allowed by bank but not recorded in cash book	…….	
		Debtors directly paid into bank , but not recorded in cash book	…….	
		Wrong credit by banker	…….	
		Collections by banker as per customer's standing instructions	…….	
		Total (B)		……..
C		Total (A + B)		……..
D	Less	Cheque deposited but not credited by the bank	…….	
		Dishonoured cheque appeared in the pass book , but not entered in the cash book	…….	
		Bank charges as per pass book	…….	
		Wrong debit by banker	…….	
		Payments as per standing instructions	…….	
		Total (D)		…….

E	Balance as per pass book (C - D)		…….

For easy reference the table given below will be useful.

Book	**Favourable Balance**	**Unfavorable Balance (Overdraft)**
Cash	Debit	Credit
Pass	Credit	Debit

Procedure for Preparing Bank reconciliation Statement

A summary of the transactions and the reconciliation procedure is given in the table below.

S. No	**Transactions**	**Entries by customer in the cash book (Bank Column)**	**Entries by Bank in the pass book**	**Effect**	**Ascertain the balance reflected as per pass book from cheque book**	
					Favourable Balance	**un-Favourable Balance (over-draft)**
1	When cash is deposited	Customer entries on the debit side	Bank entries on the credit side	Cash book - Pass book		
2	When cash is withdrawn	Customer entries on the credit side	Bank entries on the debit side	Cash book - Pass book		
3	Issue of cheque	Customer entries on the credit side - immediately	Bank entries on the debit side - on the presentation date of payment	Cash book < Pass book	Add	Less
4	Interest allowed by bank	No entry is made unless pass book is verified	Bank entries on the credit side – first	Cash book - Pass book	Add	Less
5	Amount directly remitted into bank	No entry is made unless pass book is verified	Bank entries on the credit side - on the same day of receipt	Cash book - Pass book	Add	Less

6	Wrong credit in the pass book	No entry is made unless pass book is verified	Entry (Wrongly) in the credit column of the pass book	Cash book < Pass book	Add	Less
7	Wrong debit in the pass book	No entry is made unless pass book is verified	Entry (Wrongly) in the debit column of the pass book	Cash book > Pass book	Less	Add

Illustration 1:

When balance as per cash book is favourable. From the following details, make out a bank reconciliation statement for M/s.Elavarasan& Company as on December 31, 2003

Rs.

1. Cheque deposited but not yet collected by the bank 1500
2. Cheque issued to Mr. raju , it has not yet been presented for payment 2500
3. Bank charges debited in the pass book 200
4. Interest allowed by bank 100
5. Insurance premium directly paid by the bank as per standing instructions 500
6. Balance as per cash book 200

Solution :-

Bank Reconciliation Statement as on December 31 , 2003

Particulars			**Amount Rs.**	**Amount Rs.**
A		Balance as per Cash Book		200
B	Add:	Cheque issued to Mr. Raju , but not presented for payment	2500	
		Interest allowed by bank but not recorded in cash book	100	
				2600
				2800
C	Less :	Cheque deposited but not credited by the bank	1500	
		Bank has paid insurance premium as per standing instructions	500	
		Bank charges as per pass book	200	
				2200
D		Balance as per Pass Book		600

Illustration 2: When balance as per pass book (favourable) is given Mrs.Jame's pass book showed a balance of Rs 25,000 on June 30, 2003. Her cash book shows a different balance. On examination, it is found that

1. No record has been made in the cash book for a dishonour of a cheque for Rs.250
2. Cheques paid into bank amounting to Rs. 3,500 were paid into the bank on June 28, 2003 and the same had not been entered in the pass book.
3. Bank charges of Rs. 300 have not been entered in the cash book.
4. Cheques amounting to Rs. 9,000 issued to Ms.Devi has not been presented for payment still.
5. Mr. Balu who owed Rs. 3,000 has directly paid the sum into the bank account.

You are required to prepare a Bank reconciliation statement and ascertain the balance as per cash book.

Solution

Bank Reconciliation Statement as on June 30 , 2003

Particulars			**Amount Rs.**	**Amount Rs.**
A		Balance as per Cash Book		25000
B	Add:	Dishonour of cheque not recorded in Cash Book	250	
		Cheque paid into bank , not collected	3500	
		Bank Charges as per pass book , not entered in the Cash Book	300	
				4050
				29050
C	Less :	Cheque issued but not presented for payment	9000	
		Amount directly paid by Mr. Balu into the bank	3000	
				12000
D		Balance as per Pass Book		17050

Illustration 3: When overdraft as per cash book is given Prepare a Bank Reconciliation Statement as at June 30, 2003 for M/s.Jothi Sales Private Limited from the information given below

	Rs.	
1. Bank overdraft as per cash book	1,10,450	
2. Cheque issued on June 20, 2003 but not yet presented for payment		15,000
3. Cheque deposited but not yet credited by bank	22,750	
4. Bills receivable directly collected by bank		47,200
5. Interest on overdraft debited by bank	12,115	
6. Amount wrongly debited by bank		2,400

Solution :-

Bank Reconciliation Statement as on June 30 , 2003

Particulars			Amount Rs.	Amount Rs.
A		Overdraft balance as per cash book		110450
B	Add:	Cheque deposited , but not yet credited	22750	
		Interest on overdraft debited by bank	12115	
		Wrong debit by bank	2400	
				37265
				147715
C	Less :	Cheque issued but not presented for payment	15000	
		Bills receivable collected by bank	47200	
				62200
D		Overdraft balance as per Pass Book		85515

2.8 Summary

The system of recording business transactions in a systematic manner had originated in Italy. Over the years, it was perfected in England and other European countries. The Modern Accounting practices developed after the Industrial Revolution in the 18th century. Since, then many countries have adopted this system. All the accounts are classified into the following three types they are Personal Accounts, Real Accounts and Nominal Accounts. The books in which a transaction is recorded for the first time from a source document are called Books of Original Entry or Prime Entry. Journal is one of the books of original entry in which transactions are originally recorded in a chronological order according to the principles of Double Entry System. It is also called a 'Day Book'. In order to ascertain the net effect of all the transactions relating to a particular account are collected at one place in the Ledger. A Ledger is a book which contains all the accounts whether personal, real or nominal, which are first entered in journal or special purpose subsidiary books. The opening entry is passed to open the books of accounts for the new financial year. The debit or credit balance of an account what we get at the end of the accounting period is known as closing balance of that account. This closing balance becomes the opening balance in the next accounting year.

The procedure of posting an opening entry is same as in the case of an ordinary journal entry. An account which has a debit balance, the words ' To balance b/d‟ are recorded on the debit side in the particulars column. An account which has a credit balance, the words "By balance b/d" are recorded in the particulars column on the credit side. Transactions are classified and grouped according to their nature. Transactions are of two types: Cash and Credit. Cash transactions are grouped in one category – *Cash Book.* Credit transactions are sub-grouped in separate book is used for each category or group of transactions which are repetitive and sufficiently large in number. – *Purchases Book&Sales Book.* The balance of the bank column in the double or triple column cash book represents the customers cash balance at bank. It should be the same as shown by his bank pass book on any particular day. In case of disagreement in the balance of the cash book and the pass book, the need for preparing Bank Reconciliation Statement arises. Bank reconciliation statement is a list in which the various items that cause a difference between bank balance as per cash book and pass book on any given date are indicated.

CHECK YOUR PROGRESS-III

1. What is the purpose of subsidiary books of accounts?

2. What are the advantages of subsidiary books of accounts?

3. What do you mean by bank reconciliation statement?

4. Describe three column cash book with neat format.

2.9 Glossary

Journal is one of the books of original entry in which transactions are originally recorded in a chronological order.

Utility Ledger - It is a principal or main book which contains all the accounts in which the transactions recorded in the books of original entry are transferred. Ledger is also called the ‘Book of Final entry’ or ‘Book of Secondary entry’.

Guest Ledger :- A guest ledger contains the details of all financial transactions between a resident guest and the hotel ,

Cash book - It is a special journal which is used to record all cash receipts and cash payments.

Triple Column Cash Book - All cash receipts, deposits into bank and discount allowed are recorded on debit side and all cash payments, withdrawals from bank and discount received are recorded on credit side.

Trade discount - Trade discount is an allowance or concession granted by the seller to the buyer, if the customer purchases goods above a certain quantity or above a certain amount. The amount of the purchase made, is always arrived at after deducting the trade discount.

Cash discount - This discount is given In order to encourage customer’s to make the payment before the expiry of the credit period a deduction is offered. The deduction so made is known as cash discount.

Bank reconciliation Statement - The balance of the bank column in the double or triple column cash book represents the customers cash balance at bank.

Bank Pass Book - Bank Pass Book (statement of account) is a copy of the customer’s account in the books of a bank.

2.10 References and Bibliography

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2.11 Suggested Readings

- Hospitality Management Accounting, Michael M Coltman
- Hotel Accountancy & Finance – S.P. Jain & K.L. Narang, Kalyani Publisher Ludhiana
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- Accounting for Management, S K Bhattacharya, Vikas Publishing House

- Hospitality Financial Accounting By Jerry JWeygandt, Publisher Wiley & sons
- Accounting in Hotel & Catering Industry – Richard Kotas- International Textbook Company
- Comprehensive Accountancy, SA Siddiqui
- A complete Course in Accounting Volume – I, N.D. Kappor
- Double – Entry Book- Keeping, Rc. Chawla & C. Juneja
- Introduction to Accountancy, T.S. Grewal

2.12 Terminal Questions

Fill in the Blanks

1. Every business transaction reveals __________ aspects.
2. The incoming aspect of a transaction is called _________ and the outgoing aspect of a transaction is called _________.

3. Traditional approach of accounting is also called as _________ approach.

4. The American approach is otherwise known as _________ approach.

5. Impersonal accounts are classified into _________ types.

6. Plant and machinery is an example of _________ account.

7. Capital account is an example of _________ account.

8. Commission received will be classified under _________ account.

9. The source document gives information about the nature of the _________.

10. The accounting equation is a statement of _________ between the debits and credits.

11. The journal is a book of _________.

12. Recording of transaction in the journal is called _________.

13. The _________ column of journal represents the place of posting of an entry in the ledger account.

14. Ledger is the _________ book of account.

15. The process of transferring entries from Journal to the Ledger is called ________.

16. c/d means _________ and b/d means _________.

17. Debiting an account signifies recording the transactions on the _________ side.

18. Discount allowed column appears in _______ side of the cash book.

19. In the triple column cash book, when a cheque is received the amount is entered in the _______ column.

20. Discount received column appears in _____ side of the cash book.

21. Sub division of the journals into various books for recording transactions of similar nature are called ________.

22. The total of the ________ book is posted to the debit of purchases account.

23. The person who prepares a bill is called the ________.

24. ________ balance in pass book shows bank overdraft.

25. For the purposes of reconciliation only the ________ column of the cash book are to be considered.

Choose the correct answer:

1. The receiving aspect in a transaction is called as
   a) debit aspect b) credit aspect c) neither of the two

2. The giving aspect in a transaction is called as
   a) debit aspect b) credit aspect c) neither of the two

3. Murali account is an example for
   a) personal A/c b) real A/c c) nominal A/c

4. Capital account is classified under
   a) personal A/c b) real A/c c) nominal A/c

5. Goodwill is an example of
   a) tangible real A/c b) intangible real A/c c) nominal A/c

6. Commission received is an example of
   a) real A/c b) personal A/c c) nominal A/c

7. Outstanding rent A/c is an example for
   a) nominal account b) personal account c) representative personal account

8. Nominal Account is classified under
   a) personal A/c b) impersonal A/c c) neither of the two

9. Drawings account is classified under
   a) real A/c. b) personal A/c. c) nominal A/c.

10. The origin of a transaction is derived from the
    a) Source document b) Journal c) Accounting equation

11. Which of the following is correct?
    a) Capital = Assets + Liabilities b) Capital = Assets – Liabilities
    c) Assets = Liabilities – Capital

12. Amount owned by the proprietor is called
    a) Assets b) Liabilities c) Capital

13. The Accounting Equation is connected with
    a) Assets only b) Liabilities only c) Assets, Liabilities and capital

14. The origin of a transaction is derived from the
    a) Source document b) Journal c) Accounting equation

15. Which of the following is correct?
    a) Capital = Assets + Liabilities b) Capital = Assets – Liabilities
    c) Assets = Liabilities – Capital

16. Amount owned by the proprietor is called
    a) Assets b) Liabilities c) Capital

17. The Accounting Equation is connected with
    a) Assets only b) Liabilities only c) Assets, Liabilities and capital

18. Goods sold to Srinivasan should be debited to
    a) Cash A/c b) Srinivasan A/c. c) Sales A/c.

19. Withdrawals of cash from bank by the proprietor for office use should be credited to
    a) Drawings A/c b) Bank A/c c) Cash A/c

20. Ledger is a book of :
    a. original entry b. final entry c. all cash transactions.

21. Personal and real accounts are:
    a. closed b. balanced c. closed and transferred

22. The column of ledger which links the entry with journal is
    a. L.F column b. J.F column c. Particulars column

23. Posting on the credit side of an account is written as
    a. To b. By c. Being

24. Nominal account having credit balance represents
    a. income / gain b. expenses / losses c. assets

25. The cash book records
    a) all cash payments b) all cash receipts c) all cash receipts & payments

26. When goods are purchased for cash, the entry will be recorded in the
    a) cash book b) purchases book c) journal

27. The balance of cash book indicates
    a) net income b) cash in hand c) difference between debtors and creditors

28. Purchase of machinery is recorded in
    a) sales book b) journal proper c) purchases book

29. Purchases book is kept to record
    a) all purchases b) only cash purchases c) only credit purchases

30. Credit sales are recorded in
    a) sales book b) cash book c) journal proper

31. Bank Reconciliation statement is prepared by the
    a) bank b) creditor of a business c) customer of a bank

32. Debit balance in the Cash Book means
    a) overdraft as per Pass Book b) credit balance as per Pass Book
    c) overdraft as per Cash Book

33. When balance as per Cash Book is the starting point, to ascertain balance as per pass book interest allowed by Bank is
    a) subtracted b) added c) not adjusted

34. When balance as per Cash Book is the starting point, to ascertain the balance as per pass book interest charged by Bank is:
    a) added b) subtracted c) not adjusted

35. When the balance as per Cash Book is the starting point to ascertain balance as per pass book, direct deposits by customers are:
    a) added b) subtracted c) not adjusted

Long Answer Questions

1. Define Double Entry System. ? What are the advantages of Double Entry System?
2. Classify the following items into real, personal and nominal accounts with appropriate justification for each items
    a. Capital
    b. Purchases
    c. Goodwill
    d. Copyright
    e. Ms. Gayathri
    f. Bank of Baroda
    g. Electricity Charges
    h. Dividend
    i. Mr. Rohan
    j. Outstanding rent
3. Mention the five categories of Accounts.
4. Explain the rules & Steps for Journalising.
5. What is debit balance&credit balance? Explain this significance in various types of accounts.
6. Explain the posting of a compound journal entry with an example.
7. What is triple column cash book? Write notes on ‘contra entry’.

8. Define subsidiary books ? What are the various types of subsidiary books?
9. What are the differences between Trade Discount and Cash Discount?
10. List the five items having the effect of higher balance in the Cash Book & lower balance in the Pass Book ?

Practical – Problems

1. Journalese the following transactions in the books of Tmt.Amutha

2004,		Rs.	
Jan. 1	Tmt.Amutha commenced business with cash		50,000
2	Purchased goods for cash	10,000	
5	Purchased goods from Mohan on credit	6,000	
7	Paid into Bank		5,000
10	Purchased furniture	2,000	
20	Sold goods to Suresh on credit		5,000
25	Cash sales	3,500	
26	Paid to Mohan on account	3,000	
31	Paid salaries	2,800	

2. Journalese the following transactions of Mrs.Rama

2004,		Rs.	
Jan 1	Mrs.Rama commenced business with cash	30,000	
2	Paid into bank		21,000
3	Purchased goods by cheque	15,000	
7	Drew cash from bank for office use	3,000	
15	Purchased goods from Siva	15,000	
20	Cash sales	30,000	
25	Paid to Siva	14,750	
	Discount Received	250	
31	Paid rent	500	
	Paid Salaries	2,000	

3. Journalise the following transactions of Mr.Ravi and post them in the ledger and balance the same. 2004,

June	1	Ravi invested Rs.5,00,000 cash in the business
	3	Paid into Bank Rs.80,000
	5	Purchased building for Rs.3,00,000
	7	Purchased goods for Rs.70,000
	10	Sold goods for Rs.80,000
	15	With drew cash from bank Rs.10,000
	25	Paid electric charges Rs.3,000
	30	Paid Salary Rs. 15,000

4. Enter the following transactions into the VTL of 4th July,2005.

Opening balances:

G.Regn. No.	3576	3558	3567
Name:	Mr.Sumanth	Mr.Fonda	Mr.Richard
Arr. Date:	3-Jul-05	1-Jul-05	2-Jul-05
Arr. Time:	6.00 P.M.	10:00 A.M.	8:00 A.M.
Dep. Date:	4-Jul-05	7-Jul-05	6-Jul-05
Dep. Time:	1:30 P.M.	10:00 A.M.	7:00 A.M.
Plan	| PAX AP	| 1 CP	| 2 EP |
Rate	Rs.2, 500	Rs.2,500	Rs.2,200
Room No.	102	107	109
Op.bal. Dr./(Cr.)	3200	14,200	-2200

6 A.M.	Mr. Rakesh checked in into 103 with registration no.3589 on CP.
6.30 A.M.	All occupants were served pot coffee.
7.00 A.M.	Breakfast was served to all occupants.
8.00 A.M.	Laundry bills for room 109 Rs.225; 107 Rs.175.
8:30 A.M.	Telephone bill for Room No.107 was Rs.350.
8.30 A.M.	Room No.107 checked out after settling the bill.
10.00 A.M.	Ms.Zeenath and her child checked in into 106 with registration no.3590 on EP.
11.00 A.M.	Restaurant bill for Rs.1250 to Room no.109.
12:00 noon	Lunch was served to all rooms. There was an extra lunch served at Room No.106.
4:00 P.M.	Laundry bill for 102 Rs.200.
5:00 P.M.	Pot tea was served to all occupants.
6:00 P.M.	Snacks were served to Room 102 bill was Rs.250.
7:00 P.M.	Advance received from Room 109 - Rs.10,000.
7:30 P.M.	Bill from Health club Rs.250 for Room.103.
8:30 P.M.	VPO for Room 106 Rs.1250 towards air tickets.
10:00 P.M.	Dinner was served to all rooms.
10:30 P.M.	An allowance voucher to Room 106 was raised for Rs.50
11:30 P.M.	Telephone bills for room 102 - Rs.160; 109 - Rs.70; 106 - Rs.150.

Instructions: Checkout time 24 hours. , Pot coffee/tea/milk Rs.40. , Breakfast Rs.150 , Lunch / Dinner Rs.300 , Extra bed charges Rs.175.

5 . From the following particulars, prepare single column cash book of Ms.Kokila.

2002

Mar.	1	Cash in hand Rs.20,000.
	4	Cash purchases Rs.4,000.
	7	Cash sales Rs.8,000.
	8	Paid to Balan Rs. 5,000
	9	Received cash from Cheran Rs.10,000.
	13	Paid into bank Rs.10,000.
	14	Cash withdrawn from bank Rs.4,000.
	18	Paid salaries Rs.1,000.

20 Bought furniture Rs.3,000.
28 Rent paid Rs. 1,000.

6. Enter the following transactions in the Purchase Book of M/s.Subhashree

2003
March 1 Purchased 100 Kg. of coffee seeds from Suresh @ Rs.40 per Kg.
5 Purchased 80 Kg. of tea dust from Hari @ Rs.20 per Kg.
12 Bought from Rekha Sugars, Trichy 1,200 Kg.of Sugar @ Rs.8 per Kg.
18 Bought from Perumal Sweets, Chennai, 40 tins of Sweets @ Rs.200 per tin.
20. Purchased from Govinda Biscuit Company, Chennai 20 tins of biscuits @ Rs.400 per tin.

7. From the following particulars prepare the sales book of Modern Furniture Mart

2003
June 5 Sold on credit to Arvind & Co.
20 tables @ Rs.600 per table
20 chairs @ Rs.300 per chair
7 Cash sales to Anand & Co.,
10 tables @ Rs.300 per table
20 chairs @ Rs.150 per chair
10 Sold to Baskar & Co., on credit
10 almirahs @ Rs.3,000 per almirah
10 tables @ Rs.200 per table
15 Sold old typewriter for Rs.1,000 to Madan on credit
20. Sold to Gopinath on credit.
10 tables @ Rs.1,000 per table
2 revolving chairs @ Rs.1,200 per chair

8. Enter the following transactions in proper subsidiary books.

2003
March 1 Purchased goods from Balaraman Rs.2000
2 Sold goods to Senthil Rs.1,000
3 Goods purchased from Durai Rs.1,000
5 Sold goods to Saravanan Rs.700
8 Sold goods to Senthil Rs.500
10 Purchased goods from Elangovan Rs.600
14 Purchased goods from Parthiban Rs.300
20 Sold goods to Sukumar Rs.600

9. Make a bank reconciliation statement of Mr.Udayakumar from the following particulars.
a) Balance as per cash book Rs.1,500.
b) Cheques deposited but not cleared Rs.100.
c) Cheques issued but not presented for payment Rs.150.

d) Interest allowed by bank Rs.20.

10. Prepare a bank reconciliation statement of Mr.Goutham from the following data as on 31.12.2003.

		Rs.
a) Balance as per cash book		12,500
b) Cheque issued but not presented for payment	900	
c) Cheque deposited in bank but not collected	1,200	
d) Bank paid insurance premium		500
e) Direct deposit by a customer		800
f) Interest on investment collected by bank		200
g) Bank charges		100

UNIT: 03
FINANCIAL STATEMENTS

Structure

3.1 Introduction

A financial statement is the combination of the three major reports on a business. It will contain the cash flow statement, the income statement and the balance sheet of the business. The objective of financial statements is to provide information about the financial position, performance and changes in financial position of an enterprise that is useful to a wide range of users in making economic decisions. Financial statements should be understandable, relevant, reliable and comparable. Reported assets, liabilities, equity, income and expenses are directly related to an organization's financial position.

3.2 Objectives

After reading this unit learner will be able:

- To understand the meaning, definition of Basic Financial Statements
- To understand Trial Balance
- To prepare Trial Balance
- Understand Format of Trial Balance
- Understand Sundry Debtors and Sundry Creditors
- To make Front Office Trial Balance
- Understand limitations of Trail Balance
- To know about Final Accounts
- To know about Parts of Final Accounts
- To know about Trading Account
- To know about Profit and Loss Account
- To know about Classification of Assets and Liabilities
- To know about Format of Balance Sheet

3.3 Basic Financial Statements

In the Hotel Industry, we see that at the end of each accounting period, the cycle is completed by the preparation of financial statements. The financial statements primarily constitute a statement of Income and & Balance Sheet. A Statement of income is prepared for the period with the year to date. Further, Financial statements (as stated above) can be two different statements or combined into one statement using two columns. With The use of computer technology in form of Hotel Information system (HIS) or Property Management System (PMS) have simplified the basic recording steps in Hotel accounting in form of Accounting Modules. Hotel operations, in this module, besides the traditional Income statement & Balance sheet, have the following inclusive in Financial statement: -

- Individual department schedules
- Operating schedules – Rooms Division
- Operating schedules – Food & Beverage
- Operating schedules – Rental & other incomes
- Overhead schedules – Administrative & General
- Overhead schedules – Sales & Marketing
- Overhead schedules – Hotel Operations & Maintenance
- Relevant Statistics for Financial Interpretations

Illustration 1: Prepare the Financial statement from the following Trial Balance

In the books of Hotel ABCD

Trail Balance as on 30th April 1980

S. No.	**Name of the Account**	**L.F**	**Debit Rs.**	**Credit Rs.**
1	Cash		27,090	
2	Accounts Receivable		9,220	
3	Inventory - Food		17,080	
4	Inventory - Beverage		1,760	
5	Land		520,000	
6	Building		2,100,000	
7	Furniture & Equipment		397,120	
8	Accumulated depreciation			327,400
9	Accounts Payable			13,820
10	Mortgage Payable			1,580,000
11	Capital			1,132,270
12	Room & Banquet sales			282,100
13	Other food sales			27,100
14	Beverage sales			12,600
15	Miscellaneous Revenue			4,120
16	Cost of Food		112,060	
17	Cost of Beverage		3,630	
18	Payroll Expenses		27,600	
19	Cleaning Supplies		8,200	
20	Other Supplies		7,620	
21	Linen Service		18,200	
22	Heating Expenses		47,050	
23	Electricity		32,080	
24	Depreciation Expenses		11,200	
25	Interest Expenses		39,500	
	TOTAL		3,379,410	3,379,410

Solution: Figure – A

Hotel ABCD
Income Statement as on 30th April 1980

Month of April	*Revenue*	*4 Months to April 30, 1980*
	Room & Banquet sales	282,100
	Other food sales	27,100
	Beverage sales	12,600
	Miscellaneous Revenue	4,120
	Total Revenue	325,920
	Expenditure	
	Cost of Food	112,060
	Cost of Beverage	3,630
	Payroll Expenses	27,600
	Cleaning Supplies	8,200
	Other Supplies	7,620
	Linen Service	18,200
	Heating Expenses	47,050
	Electricity	32,080
	Depreciation Expenses	11,200
	Interest Expenses	39,500
	Total Expenditure	307,140
	Net Income	18,780

Interpretation of Data: -(Figure – A): The income statement as described in above format is for 4 months in Figure - A. The left-hand side column has empty space for April amounts. The statement incorporates all the revenue and expenses amounts for the 4 months.

Figure – B

Hotel ABCD
Balance sheet as on 30th April 1980

Assets		
Cash		27,090
Accounts Receivable		9,220
Inventory - Food		17,080
Inventory - Beverage		1,760
Land	520,000	
Building	2,100,000	
Furniture & Equipment	397,120	
	3,017,120	
Accumulated depreciation	327,400	
		2,689,720

		Rs.	**2,744,870**
Liabilities			
	Accounts Payable		13,820
	Mortgage Payable		1,580,000
	Capital	1,132,270	
	Net Income (as per Income Statement)	18780	
			1,151,050
		Rs.	**2,744,870**

Interpretation of Data: -(Figure – B): The net result is incorporated into the end of the period Balance sheet as reflected in Figure B

3.3.1 Current Ratio

It is also known as working capital ratio or solvency ratio.The current ratio basically measures the relationship between current assets to current liabilities.

- **Current Assets** include – Cash,stock,debtors, bills of exchange & Investments (held by business for immediate cash conversion).
- **Current Assets** are the one which will be converted within a year or within the two dates of the balance sheets
- **Current Liabilities** include – Sundry creditors, bills payable, provision for taxation, outstanding expenses

Formula: -

$$\text{Current ratio} = \frac{\text{Current Assets}}{\text{Current liabilities}}$$

In order to obtain Current ratio,the current assets are divided by current liabilities.Normally, the ratio should be 2:1.

Example: -

Current Assets	Rs. 150000
Current Liabilities	Rs. 50000
Working Capital	Rs. 100000

Then,

$$\text{Current ratio} = \frac{\text{Current Assets}}{\text{Current liabilities}}$$

$$= \frac{\text{Current Assets (Rs.150000)}}{\text{Current Liabilities (Rs.50000)}}$$

$$= \frac{3}{1}$$

$$= 3:1$$

Explanation: - The result shows that for paying a liability of Re.1, The Hotel Assets are Rs. 3. This signifies the hotel's capability to meet the current obligation.

3.3.2 Quick Ratio (Liquidity Ratio)

This ratio is also known as Acid Test Ratio.

Formula: - $Quick\ Ratio = \frac{\text{Current assets} - \text{inventory}}{\text{current liabilities}}$

In computing the numerator of the quick ratios; we use selective which are relatively liquid or quickly convertible expenses**.**

Example: -

The current assets of a hotel are of the value Rs. 1,47,888 and its inventory is Rs. 24,192. Its current liabilities are RS 1,23,750 then,

Quick ratio = $\frac{\text{Current assets} - \text{Inventory}}{\text{Current liabilities}}$

= $\frac{\text{Rs}.1,47,888 - \text{Rs}.24,192}{\text{Rs}.1,23,750}$

= 1.0 rounded

It shows that there is Rs. 1 in quick assets for every Rs. 1 of the current liabilities.

3.3.3 Gross Profit Ratio

It is also known as 'Turn Over Ratio '.

Formula: -

Gross Profit Ratio = $\frac{\boldsymbol{Gross\ Profit}}{\boldsymbol{Net\ Sales}}$

Percentage of Gross Profit Ratio = $\frac{\boldsymbol{Gross\ Profit}}{\boldsymbol{Net\ Sales}}$ *X 100*

This ratio is obtained by comparing the gross profit with the net sales.

3.3.4 Net Profit Ratio

Formula: -

Net Profit Ratio = $\frac{\boldsymbol{Net\ Profit}}{\boldsymbol{Net\ Sales}}$

Percentage of Net Profit Ratio = $\frac{\boldsymbol{Net\ Profit}}{\boldsymbol{Net\ Sales}}$ *X 100*

This ratio is obtained by comparing the net profit with the net sales

3.3.5 Inventory Turnover Ratio

It is also known as stock Turn Over Ratio.

Formula: -

$$\text{Inventory Turnover Ratio} = \frac{\text{Cost of Goods}}{\text{Average Stock}}$$

$$\text{Cost of Goods} = \text{Opening stock} + \text{Purchases} - \text{Closing Stock}$$

$$\text{The average stock} = \frac{\text{Opening Stock} + \text{Closing Stock}}{2}$$

It is calculated to measure the speed with which the stock moves through the business cycle during a particular period. It is calculated by dividing the cost of the goods sold by average stock.

Example: -

Cost of Goods sold = Rs. 4,80,000
Average Stock = Rs. 40000

$$\text{Inventory Turnover Ratio} = \frac{\text{Cost of Goods}}{\text{Average Stock}}$$

$$= \frac{4,80,000}{40,000}$$

= 12 times

The ratio discloses the excessive stock accumulated duringoperations.Inventory turnover indicates the quantity of stock to be maintained to cope up with corresponding sales.

3.3.6 Operating Ratios: - (Hotel Specific)

Ratios help in diagnosing the functional aspects of the hotel.Further, it alsohelps in predicting future possibilities in the hotel operations. The information used for ratios can be obtained from VTL and guest registration cards.

With the advent of computerization of major hotel operations, the ratios are computed on a daily basis and maintained in a columnar format for Analysing periodically.

Operating Ratios Useful to Hotel Industry is:

- Average Food Check
- Food Cost Percentage
- Beverage Cost Percentage
- labor cost percentage
- Average Room Rate
- Occupancy Percentage
- Seat Turnover

3.3.6.1 Average Food Check

The average food check reveals how much, on average, arestaurant guest is spending. The formula is:

$$\frac{\textit{Food Revenue}}{\textit{Number of Covers}}$$

3.3.6.2 Food Cost Percentage

The food cost percentage shows the relationship of food cost to food sales. The formula is**:**

$$\frac{\textit{Cost of Food Sales}}{\textit{Food Revenue}} \; X\; 100$$

3.3.6.3 Beverage Cost Percentage

The beverage cost percentage ratio is computed similar to the food cost percentage. The formula is:

$$\frac{\textit{Cost of Beverage Sales}}{\textit{Beverage Revenue}} \; X\; 100$$

3.3.6.4 Labor Cost Percentage

Labor cost includes payroll and related expenses.

The formula for calculating labor cost percentage is:

$$\frac{\textit{Payroll and Related}}{\textit{Revenue}} \; X\; 100$$

3.3.6.5 Average Room Rate

The average room rate (ARR) is an average selling price of all the paid rooms occupied.

The formula is as follows:

$$\frac{\textit{Rooms Revenue}}{\textit{Paid Rooms Occupied}}$$

3.3.6.6 Occupancy Percentage

The occupancy percentage measures actual room sales revenue in relationship to the hotel's room sales potential.

The formula is:

$$\frac{\textit{Paid Rooms Occupied}}{\textit{Rooms Available}} \; X\; 100$$

3.3.6.7 Seat Turnover

The seat turnover measures the Number of guests served to the number of seats available in that particular Food& beverage outlet.

$$\textit{Seat Turnover} = \frac{\textit{Number of Guests Served}}{\textit{Number of Available Seats}}$$

Solved Examples

Example 1

The following is the trading account of M/s. Shaw & Co. You are required to calculate stock turnover ratio.

To Opening Stock	7960	
To Purchases	19500	
Carriage Inwards	500	
Gross Profit	18240	
By Sales		39000
By Closing Stock		7200
Grand Total of Profit & Loss Account & Trading Account		46200

Solution: -

STEP 1

Cost of Goods Sold = Opening Stock + Purchases OR (Purchases + Carriage inward) - Closing stock
= 7960 + (19500 + 500) - 7200
= 20760
[OR]
Cost of Goods Sold = Sales - Gross Profit
= 39000 - 18240
= 20760

STEP 2

Average Stock = (Opening Stock + Closing Stock) / 2
= (7960 + 7200) / 2
= 15160 / 2
= 7580

STEP 3

Stock turnover Ratio = Cost of goods sold / Average Stock
Stock turnover Ratio = 20760 / 7580
= 2.74

Example 2:

From the following details calculate the current ratio and liquidity ratio.

Particulars	Amount	Amount
	Rs.	Rs.
Current Assets		
Loans & Advances		
(I) Stock in trade	77500	
(ii) Sundry debtors	46800	
(iii) Cash in Hand	6300	
(iv) Loans & Advances [Short Term]	13700	
(v) Prepaid Taxes	700	

145000

Current Liabilities	
(I) Sundry Creditors	23300
(ii) Acceptances	7560
(iii) Interest approved (Outstanding)	1900
(iv) Dividend warrants issued but not encashed	190
(v) Provision for Taxation	10150

Solution: -

Current Assets = Assets - Advances (prepaid Taxes)
= 145000 - 700
= 144300

Current Liabilities = 43100

Current Ratio = Current Assets / Current Liabilities
= 144300 / 43100
= 3.35 **Answer**

Liquid assets = Current assets - Stock - Prepaid Expenses
= 144300 - 77500 - 0
= 66800

Liquid Ratio = Liquid assets / Current Liabilities
= 66800 / 43100
= 1.55 **Answer**

Example 3:

From the following particulars you are required to compute
1)current Ratio 2) Net profit ratio 3) Gross profit ratio

Stock	50000
Debtors	40000
Bills Receivable	10000
Advances recoverable in cash or kind)	4000
Cash in hand	30000
Creditors	60000
Bills payable	40000
Bank over draft	4000
Sales(net)	700000
Gross profit	50000
Net profit	30000

Solution: -

1) Current ratio	=	Current asset / current liabilities
	=	134000 / 104000
	=	1.29
2) Net profit ratio	=	[Net profit / Net sales] x 100
	=	[30000 / 70000] x 100
	=	4.29%
3) Gross profit ratio	=	[Gross profit/Net sales] x 100
	=	[50000 / 70000] x 100
	=	7.14%

3.4 Trial Balance

Trial balance is a statement prepared with the balances or total of debits and credits of all the accounts in the ledger to test the arithmetical accuracy of the ledger accounts.

Step 1 - After recording and classifying the transactions in the various accounts along with balancing thereof.

Step 2 - Then the next step in the accounting process is to prepare a statement to check the arithmetical accuracy of the transactions recorded so for. This statement is called 'Trial Balance'.

A business entity prepares a trail balance on the closing date of an accounting year.

Definition - Trial Balance

"Trial balance is a statement, prepared with the debit and credit balances of ledger accounts to test the arithmetical accuracy of the books" – J.r. Batliboi.

3.4.1 Objectives of Preparing the Trial Balance

A trial balance can be prepared in the following methods.

i. **The Total Method**: According to this method, the total amount of the debit side of the ledger accounts and the total amount of the credit side of the ledger accounts are recorded.
ii. **The Balance Method**: In this method, only the balances of an account either debit or credit, as the case may be, are recorded against their respective accounts.

3.4.2 Methods of Preparing Trial Balance

A trial balance can be prepared in the following methods.

i. **The Total Method**: According to this method, the total amount of the debit side of the ledger accounts and the total amount of the credit side of the ledger accounts are recorded.

ii. **The Balance Method**: In this method, only the balances of an account either debit or credit, as the case may be, are recorded against their respective accounts.

3.4.3 Format of Trial Balance

Trail Balance of ABC Ltd.
as on ……………………………

Sl. No	Name of the Account	L.F.	Debit Rs.	Credit Rs.
1	Capital Account			XXXX
2	Sales Account			XXXX
3	Purchase Return Account			XXXX
4	Bills Payable			XXXX
5	Creditors			XXXX
6	Commission Account (Received)			XXXX
7	Discount (Received)			XXXX
8	Reserve fund			XXXX
9	Bank Overdraft			XXXX
10	Loans from ABCD			XXXX
11	Reserve for Doubtful debt			XXXX
12	Outstanding Salaries			XXXX
13	Purchase Account		XXXX	
14	Sales Return Account		XXXX	
15	Debtors		XXXX	
16	Cash in Hand		XXXX	
17	Cash at Bank		XXXX	
18	Bills Receivable		XXXX	
19	Commission Account (Paid / Allowed)		XXXX	
20	Wages		XXXX	
21	Plant & Machinery		XXXX	
22	Telephone Charges		XXXX	
23	Miscellaneous Charges		XXXX	
24	Drawing Account		XXXX	
25	Insurance Account		XXXX	
26	Carriage inward		XXXX	
27	Carriage Outward		XXXX	
28	Stock		XXXX	
29	Bad Debt		XXXX	
30	Prepaid Insurance		XXXX	

3.4.4 Sundry Debtors and Sundry Creditors

A list of names with the debit balances is prepared, which is known as 'Sundry debtors' (Sundry means 'many'). Similarly, a list of names with the credit balances is prepared. This list is known as 'Sundry Creditors'.

Illustration 2: The following balances were extracted from the ledger of Mr. Rohan on 31st March, 2004. Prepare a trial balance as on that date in the proper form

	Rs.		Rs.
Salaries	36320	Purchases	144670
Sales	173500	Sundry Debtors	1430
Plant & Machinery	34300	Travelling Expenses	2630
Commission Paid	1880	Carriage Inward	240
Stock as on 1.4.2003	1100	Sundry Creditors	14260
Repairs	1670	Capital as on 1.4.2003	62500
Sundry Expenses	460	Drawings	3500
Returns Inward	1000	Cash at Bank	1090
Discount Allowed	1150	Returns Outward	400
Rent and Rates	3220	Investments	6000

Solution: -

Trail Balance of Mr. Rohan
as on 31st March, 2004

S. No.	Name of the Account	L.F	Debit Rs.	Credit Rs.	Nature of Balance (Why Debit or Credit)
1	Salaries		36320		Nominal A/c - Expenses
2	Sales			173500	Real A/c - Goods
3	Plant & Machinery		34300		Real A/c - Asset
4	Commission Paid		1880		Nominal A/c - Expenses
5	Stock as on 1.4.2003		11100		Real A/c - Goods
6	Repairs		1670		Nominal A/c - Expenses
7	Sundry Expenses		460		Nominal A/c - Expenses
8	Returns Inward		1000		Real A/c - Goods
9	Discount Allowed		1150		Nominal A/c - Loss
10	Rent and Rates		3220		Nominal A/c - Expenses
11	Purchases		144670		Real A/c - Goods
12	Sundry Debtors		1430		Personal A/c - Customers
13	Travelling Expenses		2630		Nominal A/c - Expenses
14	Carriage Inward		240		Nominal A/c - Expenses
15	Sundry Creditors			14260	Personal A/c - Suppliers
16	Capital as on 1.4.2003			62500	Personal A/c - Owner

17	Drawings		3500		Personal A/c - Owner
18	Cash at Bank		1090		Real A/c - Asset
19	Returns Outward			400	Real A/c - Goods
20	Investments		6000		Real A/c - Asset
	TOTAL		250660	250660	

3.4.5 Hotel Front office Trial Balance

The following steps are followed in Front Office Trail Balance: -

- Opening balances of City Ledger and VTL must be taken depending on the total balance position.
- Advances / Deposits collected: include
  - (I). Advance with bookings made;
  - (ii). Advance at the time of check in with reservation and walk-ins;
  - (iii). Advance from long staying in-house guest.
- Bills cleared on the day: include
  - (I). Current guests who have settled their weekly bills or bills on credit limit that were presented for payment;
  - (ii). Guests checked out on the day;
  - (iii). City Ledger payments.
- Goods & Service (GST)Tax,Service Charge &Surcharge are applied
- VTL charges: total of all charges entered in the guest's accounts as total revenue for the day should be taken as Debit amount.
- Credit balances refunded or advances refunded must be taken on the Debit side.
- Discounts and allowances given to guests are taken on the credit side.
- Closing balances of City Ledger and VTL must be taken depending on the total balance position.

3.8.4.1 PROFORMA FOR A 3 STAR HOTEL

Front Office Trial Balance as on ___________________

DEBIT PARTICULARS		AMOUNT Rs.	CREDIT PARTICULARS		AMOUNT Rs.
Opening Balance of Visitors Tabular Ledger (VTL)		92000	Opening Balance of Advances		200000
Opening Balance of City Ledger		145000	Advances / Deposits Collected		125000
VTL Charges: -					
Rooms / Apartments	567500		Bills Cleared on the Day		1693656
Guest Charges	75000		Discount & Allowances		95000
Room Services	68000				
Restaurant	125000				
Bar	220000				
Coffee Shop	95000				
News Stand					
Telephones					
banquets	408000				
Wellness & Spa	204000				
Guest Laundry	64500				

Other Charges	7500			
Visitors Paid Out	140000			
		1974500		
GST - Rooms / Apartment		102150		
GST - Food & Beverage		109920		
GST - Wellness & Spa		24480		
Service Charges		192546		
Refund of Advance		45000	Closing Balance of City Ledger	326000
Closing Balance of Advance		123000	Closing Balance of Visitors Tabular Ledger	368940
		2808596		**2808596**

Note: -	**GST Tax Slab Range**
GST - Apartment @18 %	Room Tariff - above 2499 & Below 7500
GST Food & Beverage @12 %	Food & Beverage Bills - Above 999 & Below 2499
GST Wellness & Spa @12 %	Wellness Spa Bills - Above 999 & Below 2500
Service Charge @10.99 %	Room Tariff, Food&beverage, Wellness& Spa Bills,Guest Laundry

3.4.6 Limitations of Trail Balance

The following are the important limitations of trail balances:

- The trail balance can be prepared only in those concerns where double entry system of book- keeping is adopted.
- This system is too costly.
- If the trail balance is wrong, the subsequent preparation of Trading, P&L Account and Balance Sheet will not reflect the true picture of the concern.

SOLVEDPROBLEMS: -

Problem No. 1

From 2.13.1.1 PROBLEM No. 1,
Continued in 2.20.1 Solved Problems
Now, Continued in this problem

Prepare Ledger & Trail balance from the Journals of the booksof
Tmt. Uma Maheswari's

1994,			Rs.
Sept.	1	Tmt. Uma Maheshwari started business with	50,000
	3	Opened a current account with Indian Overseas Bank	15,000
	10	Bought goods from Tmt. Latha Baskar	40,000
	15	Paid to Tmt. Latha Baskar	25,000
	18	Sold goods to Tmt. Kanniga	36,000
	25	Tmt. Kanniga settled her account	

Solution: -

Trail Balanceof Tmt. Uma Maheswari
as on Oct 1, 1994

S. No	Name of the Account	L.F	Debit Rs.	Credit Rs.
1	Cash Account		61000	
2	Capital Account			65000
3	Bank Account		15000	
4	Purchase Account		40000	
5	Tmt. Latha Baskar Account			15000
6	Sales Account			36000
7	Tmt. Kanniga Account			
			116000	116000

Problem No. 2

From**2.13.1.2 PROBLEM No. 2**,
Continued in 2.20.2 Solved Problems
Now, Continued in this problem

1 Prepare Ledger & Trail balance from the Journals of the books of Thiru. Narayanaswamy's books.

1994,			Rs.
Aug.	5	Sold goods to Maharajan on Credit	6,500
	9	Brought goods for cash from Chengalvarayan	7,500
	12	Met Travelling expenses	1,500
	15	Received Rs. 10000 from Sukumar as loan	
	17	Returned damaged goods to Mohan	800
	21	Paid wages to workers	2,000

Solution: -

Trail Balance of Thiru. Narayanaswamy
as on Sept 1, 1994

S. No	Name of the Account	L.F	Debit Rs.	Credit Rs.
1	Cash Account		5500	
2	Maharajan Account			6500
3	Travelling Expenses Account		1500	
4	Purchase Account		7500	
5	Sukumar Account			10000
6	Mohan Account		800	
7	Purchases Return Account			800
8	Wages Account		2000	
			17300	17300

PROBLEM - No. 3

Journalise, then prepare Ledger & Trail Balance the following
1 transactions in the journal of Tmt. Manjula.

1995,			Rs.
Feb.	3	Bought goods for cash	14,500
	7	Sold goods to Lakshmi on credit	5,000
	9	Received commission	300
	10	Cash Sales	9,000
	12	Bought goods from Meenakshi	6,000
	15	Received five chairs from Saravana & Co. at Rs.300 each	
	20	Paid Saravanan & Co. cash for five chairs.	
	28	Paid Salaries Paid Rent	1000 500

Solution: -

Journal of Tmt. Manjula

Date	**Particulars**	**L.F**	**Debit Rs.**	**Credit Rs.**
1995 Feb 3	Purchases A/c. Dr. To Cash A/c. (Cash purchases of Goods)		14,500	 14,500
7	Lakshmi A/c. Dr. To Sales A/c. (Credit Sales toLakshmi)		5,000	 5,000
9	Cash A/c. Dr. To Commission A/c. (Commissionreceived)		300	 300
10	Cash A/c. Dr. To Sales A/c. (CashSales)		9,000	 9,000
12	Purchases A/c. Dr. To Meenakshi A/c. (Credit purchases from Meenakshi)		6,000	 6,000
15	Furniture A/c. Dr. To Saravana & Co. A/c. (Credit Purchase of Chairs from Saravana& Co.)		1,500	 1,500

20	Saravana & Co. A/c. Dr.			1,400	
	To Cash A/c.				1,400
	(Payment to Saravana & Co.)				
28	Salaries A/c. Dr.			1,000	
	Rent A/c. Dr.			500	
	To Cash A/c.				1,500
	(Rent& Salaries are paid)				

Ledger Accounts

In the books of Tmt. Manjula

Cash Account

Dr. Cr.

Date	Particulars	J. F	Amount Rs.	Date	Particular	J. F	Amount. Rs.
1995				1995			
Feb.9	To Commission A/c		300	Feb.3	By Purchase A/c		14500
10	To Sales A/c		9000	20	By Saravana& Co. A/c		1400
				28	By Salaries A/c		1000
				28	By Rent A/c		500
28	To Balance c/d		8100				
			17400				17400
				March 1	By Balance. b/d		8100

Salaries Account

Dr. Cr.

Date	Particulars	J. F	Amount Rs.	Date	Particular	J. F	Amount. Rs.
1995				1995			
Feb.28	To Cash A/c		1000	Feb.3	By Balance. c/d		1000
			1000				1000
March 1	To Balance b/d		1000				

Purchase Account

Dr. Cr.

Date	Particulars	J. F	Amount Rs.	Date	Particular	J. F	Amount. Rs.
1995				1995			
Feb.3	To Cash A/c		14500	Feb.28	By Balance. c/d		20500
12	To Meenakshi A/c		6000				
			20500				20500
March 1	To Balance b/d		20500				

Commission. Account

Dr. Cr.

Date	Particulars	J. F	Amount Rs.	Date	Particular	J. F	Amount. Rs.
1995 Feb.28	To Balance c/d		300	1995 Feb.9	By Cash A/c		300
			300				300
				March 1	By Balance. b/d		300

Sales Account

Dr. Cr.

Date	Particulars	J. F	Amount Rs.	Date	Particular	J. F	Amount. Rs.
1995 Feb.28	To Balance c/d		14000	1995 Feb.7	By Lakshmi A/c		5000
				10	By Cash A/c		9000
			14000				14000
				March 1	By Balance. b/d		14000

Lakshmi A/c.

Dr. Cr.

Date	Particulars	J. F	Amount Rs.	Date	Particular	J. F	Amount. Rs.
1995 Feb.7	To Sales A/c		5000	1995 Feb.28	By Balance. c/d		5000
			5000				5000
March 1	To Balance b/d		5000				

Meenakshi A/c.

Dr. Cr.

Date	Particulars	J. F	Amount Rs.	Date	Particular	J. F	Amount. Rs.
1995 Feb.28	To Balance c/d		6000	1995 Feb.12	By Purchases A/c		6000
			6000				6000
				March 1	By Balance. b/d		6000

Furniture A/c.

Dr. Cr.

Date	Particulars	J. F	Amount Rs.	Date	Particular	J. F	Amount. Rs.
1995 Feb.15	To Saravana& Co. A/c		1500	1995 Feb.28	By Balance. c/d		1500

			1500				1500
March 1	To Balance b/d		1500				

Saravana& Co. A/c.

Dr. Cr.

Date	Particulars	J. F	Amount Rs.	Date	Particular	J. F	Amount. Rs.
1995				1995			
Feb.20	To Cash A/c		1400	Feb.15	By Furniture A/c		1500
28	To Balance c/d		100				
			1500				1500
				March 1	By Balance. b/d		100

Rent A/c.

Dr. Cr.

Date	Particulars	J. F	Amount Rs.	Date	Particular	J. F	Amount. Rs.
1995 Feb.28	To Cash A/c		500	1995 Feb.28	By Balance. c/d		500
			500				500
March 1	To Balance b/d		500				

Trail Balanceof Tmt. Manjula
as on March 1, 1995

S. No	Name of the Account	L.F	Debit Rs.	Credit Rs.
1	Cash Account			8100
2	Salaries Account		1000	
3	Purchase Account		20500	
4	Commission Account			300
5	Sales Account			14000
6	Lakshmi Account		5000	
7	Meenakshi Account			6000
8	Furniture Account		1500	
9	Saravana& Co. Account			100
10	Rent Account		500	
			28500	28500

CHECK YOUR PROGRESS-I

1. What do you mean by term 'Basic Financial Statements'?

2. What are the objectives of preparing trial balance?

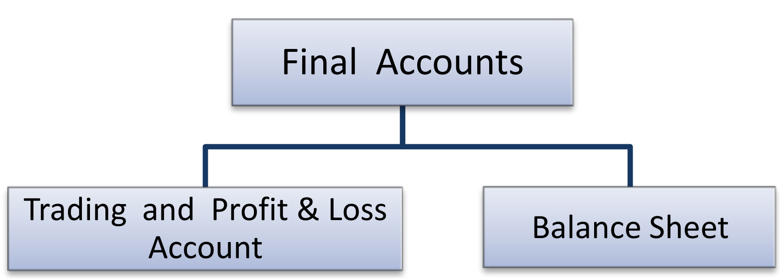
3.5 Final Accounts

As the name suggests final accounts are the accounts which are prepared at the last stage of an accounting cycle. Final accounts show both financial position of a business along with the profitability; they are used by external and internal parties for various purposes. Final accounts are a bookkeeping term that refers to the final trial balance at the end of an accounting period from which the financial statements are derived. This final trial balance includes all of the journal entries used to close the books, such as: Wage and payroll tax accruals etc.

3.5.1 Parts of Final Accounts

The final accounts of business concern generally include two parts.

The first part is Trading and Profit and Loss Account. This is prepared to find out the net result of the business. **The second part** is Balance Sheet which is prepared to know the financial position of the business.



3.5.2 Trading Account

Trading account is prepared for an accounting period to find the gross margin of the business. The balance of this account shows gross profit or loss which is transferred to the profit and loss account.

3.5.2.1 Items Shown in Trading Account: (A) Debit Side

- **Opening stock**: The stock at the beginning of an accounting period is called opening stock. This is the closing stock as per the last balance sheet.
- **Purchases**: The total value of goods purchased after deducting purchase returns is debited to trading a/c.
- **Direct expenses**: Direct expenses are incurred to make the goods saleable.

3.5.2.2 Items Shown in Trading Account :(B) Credit Side

- **Sales**: - It includes both credit and cash sales.
- **Closing stock**: - Closing stock is the value of goods remaining at the end of the accounting period.

3.5.2.3 A Specimen of Trading Account Is Shown Below

FORMAT

Trading Account for the year ending ___________________

Dr. Cr.

	Particulars	Rs.	Rs.			Particulars	Rs.	Rs.
To	Opening Stock		XXX		By	Sales	XXX	
To	Purchases	XXX			Less	Returns Inward	XXX	XXX
Less	Return Outward	XXX	XXX					
To	**Direct expenses:**				By	Closing Stock		XXX
To	Wages		XXX		By	Gross Loss C/d (Transferred to P&L A/c)		XXX XXX
To	Fuel & Power		XXX					
To	Freight		XXX					
To	Carriage Inwards		XXX					
To	Clearing Charges		XXX					
To	Packing Charges		XXX					
To	Royalty on production		XXX					
To	Dock dues		XXX					
To	Power (Factory)		XXX					
To	Octroi Duty		XXX					
To	Import duty		XXX					
To	Factory expenses		XXX					

To	Gross Profit C/d (Transferred to P&L A/c)		XXX			

3.5.2.4 Balancing of Trading Account

The difference between the two sides of the Trading Account, indicates either Gross Profit or Gross Loss. If the credit side total is more, the difference represents Gross Profit. Also, if the total of the debit side is more, the difference represents Gross Loss. Then, the Gross Profit or Gross Loss is transferred to Profit & Loss Account.

Illustration 1: From the following information, prepare a Trading Account for the year ended 31.12.2003.

2003 Jan 1 Opening stock Rs. 15,000 2 2003 Dec 31 Purchases Rs. 16,500
Sales Rs. 30,600 Closing stock Rs. 13,500

Solution :-

Trading Account for the year ending 31st December 2003

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Opening Stock	15,000	By Sales	30,600
To Purchases	16,500	By Closing Stock	13,500
To Gross Profit C/d (Transferred to P& L A/c)	12,600		
	44,100		44,100

Illustration 2: Prepare Trading Account for the year ending 31st March 2002 from the following information.

Opening stock	Rs. 1,70,000	Purchases return	Rs. 10,000
Sales	Rs.2,50,000	Wages	Rs. 50,000
Sales return	Rs. 20,000	Purchases	Rs. 1,00,000
Carriage inward	Rs. 20,000	Closing stock	Rs. 1,60,000

Solution: -

Trading Account for the year ending 31st March 2002

Dr Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Opening Stock		170,000	By Sales	250,000	
To Purchases	100,000		Less Returns Inward	20,000	
Less Return Outward	10,000				230,000

			90,000	By	Closing Stock		160,000
To	Wages		50,000				
To	Carriage Inwards		20,000				
To	Gross Profit C/d		60,000				
	(Transferred to P&L A/c)		390,000				390,000

Illustration 3: Prepare trading account of Sirica for the year ending 31-3-2001.

	Rs.
Opening Stock	400,000
Purchases	4,300,000
Carriage Inwards	260,000
Wages	120,000
Credit Sales	7,200,000
Cash sales	1,800,000
Sales returns	1,580,000
Purchase returns	50,000
Closing Stock	500,000

Solution:

Trading Account of Sirica for the year ending 31st March 2001

Dr Cr.

Particulars		Rs.	Rs.	Particulars		Rs.	Rs.
To	Opening Stock		400,000	By	Sales		
To	Purchases	4,300,000			Cash Sales	1,800,000	
Less:	Return Outward	50,000			Credit Sales	7,200,000	
			4,250,000			9,000,000	
To	Wages		120,000	Less:	Sales returns	1,580,000	
To	Carriage Inwards		260,000				7,420,000
To	Gross Profit C/d		2,890,000	By	Closing Stock		500,000
	(Transferred to P&L A/c)		7,920,000				7,920,000

Illustration 4: Prepare Trading Account of Lakshmi for the year ending 31-12-96 from the following information:

	Rs.		Rs.
Opening Stock	80,000	Purchases	8,60,000
Freight Inward	52,000	Wages	24,000
Sales	14,40,000	Purchase Returns	10,000
Sales Returns	3,16,000	Closing Stock	1,00,000
Import duty	30,000		

Solution: -

Trading Account of Lakshmi for the year ending 31st December 1996

Dr Cr.

	Particulars	Rs.	Rs.			Particulars	Rs.	Rs.
To	Opening Stock		80,000		By	Sales	1,440,000	
To	Purchases	860,000			Less	Sales returns	316,000	
Less	Purchase Return	10,000						1,124,000
			850,000		By	Closing Stock		100,000
To	Freight Inward		52,000					
To	Wages		24,000					
To	Import duty		30,000					
To	Gross Profit C/d (Transferred to P&L A/c)		188,000					
			1,224,000					1,224,000

3.5.3 Profit and Loss Account

In the words of Prof. Carter "Profit and 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."

3.5.3.1 Preparation of Profit and Loss Account

Step 1 - Profit and loss account starts with gross profit brought down from trading account on the credit side. (If gross loss, on the debit side).

Step 2: - All the indirect expenses are debited and all the revenue incomes are credited to the profit and loss account and then net profit or loss is calculated.

Step 3: - If incomes or credit is more, than the expenses or debit, the difference is net profit. On the other hand, if the expenses or debit side is more, the difference is net loss.

3.5.3.1.1 Items Appearing in The Debit Side (Profit and Loss Account)

Those expenses which are chargeable to the normal activities of the business are recorded in the debit side of profit and loss account. They are termed as indirect expenses.

i. Office and Administrative expenses
ii. Repairs and Maintenance expenses
iii. Financial expenses
iv. Selling and distribution expenses

3.5.3.1.2 Items Appearing in the Credit Side (Profit and Loss Account)

The following are some of the incomes and gains.

i. Interest received on investment & fixed deposits.

ii. Discount earned.
iii. Commission earned.

3.5.3.2 The Specimen of Profit and Loss Account Is Shown Below

Profit & Loss Account
for the year ending ___________________

Dr Cr.

Particulars		Rs.	Particulars		Rs.
To	Gross Loss B/d	XXX	By	Gross profit B/d	XXX
			By	Dividends received	XXX
To	**Administration expenses:**		By	Interest received	XXX
To	Salaries	XXX	By	Discount received	XXX
To	Rent rates & taxes	XXX	By	Commission received	XXX
To	Printing & Stationery	XXX	By	Rent received	XXX
To	Postage and Telegrams	XXX	By	Profit on Sale of assets	XXX
To	Telephone Charges	XXX	By	Sundry revenue receipts	XXX
To	Legal Charges	XXX	By	Net loss transferred to Capital A/c	XXX
To	Insurance	XXX			
To	Audit Fees	XXX			
To	Director Fees	XXX			
To	General Expenses	XXX			
To	**Selling &Distribution expenses:**				
To	Showroom Expenses	XXX			
To	Advertising	XXX			
To	Commission paid to salesman	XXX			
To	Bad debts	XXX			
To	Provision for doubtful debts	XXX			
To	Go down Rent	XXX			
To	Carriage outward	XXX			
To	Upkeep of delivery vans	XXX			
To	**Depreciation and Maintenance**				
To	Depreciation	XXX			
To	Repairs	XXX			
To	**Financial Expenses**				
To	Interest on borrowings	XXX			
To	Discount allowed	XXX			
To	**Abnormal Expenses**				
To	Loss on Sale of assets	XXX			
To	Net profit (transferred to Capital A/c)	XXX			
		XXX			XXX

* Balancing figure will be either net profit or loss in P &L A/c.

3.5.3.3 Balancing of Profit & Loss Account

The difference between the two sides of profit and loss account indicates either net profit or net loss. If the total on the credit side is more the difference is called net profit. Also, if the total of debit side is more the difference represents net loss. The net profit or net loss is transferred to capital account.

Illustration – 5: From the following Trial balance of Mr. Gandhi prepare profit and loss account for the year ended 31-3-2001.

S. No	Particulars	Debit Rs.	Credit Rs.
1	Gross Profit		950,000
2	Commission received		5,000
3	Sundry income		7,000
4	Depreciation	10,000	
5	Salaries	15,000	
6	Discount (Dr.)	8,000	
7	Discount (Cr.)		12,000
8	Bank charges	4,000	
9	Audit fees	2,000	
10	Stationery	400	

Solution: -

Profit & Loss Account of Mr. Gandhi
for the year ending 31-3-2001

Dr Cr.

Particulars		Rs.	Particulars		Rs.
To	Depreciation	10,000	By	Gross profit B/d	950,000
To	Salaries	15,000	By	Commission received	5,000
To	Discount	8,000	By	Interest received	4,000
To	Bank charges	4,000	By	Sundry Income	7,000
To	Audit Fees	2,000	By	Discount	12,000
To	Stationery	400			
To	Net profit transferred to Capital A/c	938,600			
		978,000			978,000

Illustration – 6: The Extracts from balance sheet of M/s. Diviya Ltd are as follows: -

G.P for the year	125,000	Discount allowed	7,000
Commission received	11,000	Interest received	4,000
Interest paid	5,000	Other office expenses	1,200
Commission paid	6,000	Sundry income	15,000
Advertisement	5,000	Prov. For doubtful debts	2,000
Printing & stationery	11,500	Traveling	5,000
Postage & telegram	7,500	Bad debts	1,500
Rent & rates	1,500	Depreciation	10,000

Medical Fees 3,000
Salary & wages 8,000
Prepare Profit & Loss Account for M/s. Diviya Ltd. For the year ending 31.12.2003

Solution: -

Profit & Loss Account of M/s Diviya Ltd
for the year ending 31.12.2003

Dr Cr.

Particulars		Rs.	Particulars		Rs.
To	Salary & wages	8,000	By	Gross profit B/d	125,000
To	Interest paid	5,000	By	Commission	11,000
To	Commission	6,000	By	Interest	4,000
To	Advertisement	5,000	By	Sundry income	15,000
To	Discount	7,000	By	Prov. For doubtful debts	2,000
To	Traveling expenses	5,000			
To	Bad debts	1,500			
To	Depreciation	10,000			
To	Printing & Stationery	11,500			
To	Postage & rates	7,500			
To	Rent & rates	1,500			
To	Medical Fees	3,000			
To	Other office expenses	1,200			
To	Net profit	84,800			
		157,000			157,000

Illustration – 7: Prepare Profit and Loss Account, from the following balances of Mr. Kandan for the year ending 31.12.2003.

Office rent	Rs. 30,000	Salaries	Rs. 80,000
Printing expenses	Rs. 2,000	Stationeries	Rs. 3,000
Tax, Insurance	Rs. 4,000	Discount allowed	Rs. 6,000
Advertisement	Rs. 36,000	Travelling expenses	Rs. 26,000
Gross Profit	Rs.2,50,000	Discount received	Rs. 4,000

Solution: -Profit & Loss Account of Mr. Kandan
for the year ending 31.12.2003

Dr Cr.

Particulars		Rs.	Particulars		Rs.
To	Office rent	30,000	By	Gross profit (transferred from the Trading A/c.)	250,000
To	Salaries	80,000	By	Discount received	4,000
To	Stationaries	3,000			
To	Printing expenses	2,000			
To	Tax. Insurance	4,000			
To	Discount allowed	6,000			
To	Travelling expenses	26,000			
To	Advertisement	36,000			
To	Net profit (transferred to Capital A/c)	67,000			
		254,000			254,000

Illustration -8: Prepare Trading and Profit Loss Account for the year ending 31st March 2002 from the books of Mr. Siva Subramanian.

	Rs.		Rs.
Stock (31.3.2001)	15,000	Carriage outwards	4,000
Purchases	1,65,000	Wages	30,000
Purchases return	10,000	Sales return	5,000
Postage	3,000	Salaries	20,000
Discount received	5,000	Stationeries	2,000
Bad debts	1,000	Interest	8,000
Sales	3,00,000	Insurance	4,000
Stock (31.3.2002)	80,000		

Solution: -

Trading and Profit & Loss A/c of Mr. Siva Subramanian
for the year ending 31st March 2002

Dr Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Opening Stock		15,000	By Sales	300,000	
To Purchases	165,000		Less Sales returns	5,000	
Less Purchase Return	10,000				295,000
		155,000	By Closing Stock		80,000
To Wages		30,000			
To Gross Profit C/d		175,000			
(Transferred to P&L A/c)		375,000			375,000
To Salaries		20,000	By Gross Profit (Transferred to Trading A/c)		175,000
To Postage		3,000			
To Bad debts		1,000	By Discount received		5,000
To Carriage outwards		4,000			
To Stationeries		2,000			
To Interest		8,000			
To Insurance		4,000			
To Net profit (Transferred to Capital A/c)		138,000			
		180,000			180,000

Illustration 9: From the following trial balance of Mr. John, prepare Trading, Profit and Loss Account for the year ending 31.12.2002.

Dr Cr.

Particulars	Debit Rs.	Particulars	Credit Rs.
Purchases	540,000	Sales	1,040,000
Salaries & wages	350,000	Returns outward	12,000
Office expenses	4,000	Discount received	6,000
Trading expenses	8,000	Interest received	3,000
Factory expenses	11,000	Capital	178,000
Carriage inwards	8,000		
Returns inward	12,000		

Discount allowed	4,000		
Commission	2,000		
Stock	60,000		
Income Tax	40,000		
Cash in hand	200,000		
	1,239,000		1,239,000

Closing stock is valued at Rs. 135000

Solution: -

Trading and Profit & Loss A/c of Mr. John
for the year ending 31.12.2002

Dr Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Opening Stock		60,000	By Sales	1,040,000	
To Purchases	540,000		Less Sales returns	12,000	
Less Purchase Return	12,000				1,028,000
		528,000	By Closing Stock		135,000
To Trading Expenses		8,000			
To Factory expenses		11,000			
To Carriage inwards		8,000			
To Gross Profit C/d		548,000			
(Transferred to P&L A/c)		1,163,000			1,163,000
To Salaries		350,000	By Gross Profit		548,000
To Office expenses		4,000	(Transferred to Trading A/c)		
To Discount allowed		4,000	By Discount received		6,000
To commission		2,000	By Interest received		3,000
To Net profit		197,000			
(Transferred to Capital A/c)					
		557,000			557,000

CHECK YOUR PROGRESS-II

1. What do you mean by trading account? Explain the procedure of balancing trading account.

2. What do you mean by profit and loss account? Explain the procedure of preparing profit & loss account.

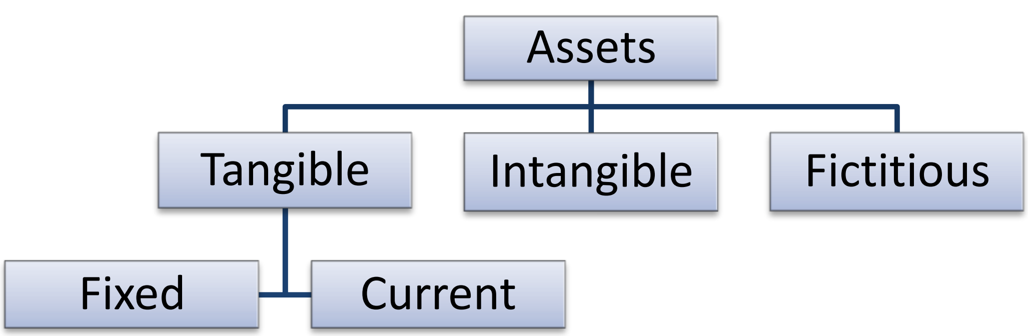
3.6 Preparation of Balance Sheet

Balance sheet is prepared by taking up all personal accounts and real accounts (assets and properties) together with the net result obtained from profit and loss account. On the left-hand side of the statement, the liabilities and capital are shown. On the right-hand side, all the assets are shown.

"Balance sheet is a 'Classified summary' of the ledger balances remaining after closing all revenue items into the profit and loss account." - Cropper.

3.6.1 Classification of Assets and Liabilities

Assets: Assets represents everything which a business owns and has money value. In other words, asset includes possessions and properties of the business.



3.6.1.1 Classification of Assets

- **Fixed assets**: Fixed assets are the assets which are acquired and held permanently and used in the business with the objective of making profits. Example: - Land and building, Plant and machinery, Furniture and Fixtures.

- **Current assets**: The assets of the business in the form of cash, debtors bank balances, bill receivable and stock are called current assets as they can be realized within an operating cycle of one year to discharge liabilities.

- **Tangible assets**: Tangible assets have definite physical shape or identity and existence.Example land, cash, stock etc.

- **Intangible assets**: The assets which have no physical shape but have value are called intangible assets. Example: - Goodwill, patents, trademarks.

- **Fictitious assets**: Fictitious assets are not real assets. Example: - Past accumulated losses or expenses which are capitalised for the time being, expenses for promotion of organisations.

3.6.1.2 Liabilities

A liability is an amount which a business firm is 'liable to pay' legally.

3.6.1.3 Classification of Liabilities

Liabilities are classified into bur categories as given below.

- **Owner's capital**: Capital is the amount contributed by the owners of the business.

- **Long term Liabilities**: They do not become due for payment in the ordinary 'operating cycle' of business or within a short period of lime. Examples are long term loans and debentures.

- **Current liabilities**: Liabilities which are repayable during the operating cycle of business, usually within a year, are called short term liabilities or current liabilities. Examples of current liabilities are trade creditors, bills payable, outstanding expenses, bank overdraft, taxes payable and dividends payable.

- **Contingent liabilities**: Contingent liabilities will result into liabilities only if certain events happen. Examples are: Bills discounted and endorsed which may be dishonoured, unpaid calls on investments.

3.6.2 Balance Sheet Equation

The liability to the owner - capital, is always made up of the difference between assets and liabilities.

Thus,

Assets = Liabilities + Capital or

Capital = Assets - Liabilities

3.6.3 Format of Balance Sheet

The Balance sheet of a business concern can be presented in the following two forms

i. Horizontal form or the Account form
ii. Vertical form or Report form

3.6.3.1 Horizontal Form of Balance Sheet

The right-hand side of the balance sheet is asset side and the left-hand side is liabilities side. All accounts having debit balance will appear in the asset side and all those having credit balance will appear in the liability side.

Proforma of balance sheet

Balance Sheet as on ___________________

Liabilities		Rs.	Rs.	Assets	Rs.	Rs.
Capital		XXX		**Fixed Assets**	XXX	
Add:	Net profit	XXX		Goodwill	XXX	XXX
Add:	Interest on capital	XXX		Land & Buildings		XXX
				Loose tools		XXX
Less:	Drawings	XXX		Furniture & fixtures		XXX
Less:	Int. on drawings	XXX		Vehicles		XXX
Less:	Loss if any	XXX		Patents		XXX
			XXX	Trade marks		XXX
Long term liabilities				Long term loans (Advances)		XXX
Loan on mortgage			XXX	**Investments**		
Bank loan			XXX	**Current Assets**		
				Closing stock		XXX
Current liabilities			XXX	Sundry debtors		XXX
sundry creditors			XXX	Bills receivable		XXX
Bills payable			XXX	Prepaid expenses		XXX
Bank overdraft			XXX	Accrued incomes		XXX
				cash at Bank		XXX
				Cash in hand		XXX
				Fictitious Assets		
				Preliminary expenses		XXX
				Advertisement expenses		XXX
				Underwriting commission		XXX
				Discount on issue of shares		XXX
			XXX			XXX

3.6.3.2 Vertical Form of Balance Sheet

In this, Balance Sheet is presented in a statement form. Balance Sheet as on ....

In this, Balance Sheet is presented in a statement form

Balance sheet as on _____________

Particulars	Rs.	Rs.
Current Assets: -		
Stock-in-trade	XXX	
Sundry Debtors	XXX	
Prepaid Expenses	XXX	
Accured income	XXX	
Bills Receivable	XXX	
Cash at Bank	XXX	
Cash in Hand	XXX	
Total Current Assets		XXX
Less: Current Liabilities:		
Sundry Debtors	XXX	
Bills Payable	XXX	
Bank Overdraft	XXX	XXX
Total Current Liabilities		XXX
Net Working Capital:		
Add:Fixed Assets		
Goodwill	XXX	
Land and Building	XXX	
Plant and Machinery	XXX	
Furniture	XXX	
Investment	XXX	
Total Fixed Assets		XXX
Capital Employed		XXX
(Both owner's and outsiders)		
Less: Long Term Liabilities:		
Debentures	XXX	
Loans	XXX	XXX
Net Assets		XXX
Represented by:		
Owner's Capital	XXX	
Reserves and Surplus	XXX	
Shareholder's Fund		XXX

Illustration 1: Prepare Balance Sheet from the Trail balance of M/s. Saravanan Traders

Trail Balance

Particulars	Debit Rs.	Credit Rs.
Capital		250,000
Cash in hand	40,000	
Cash at bank	30,000	
Closing stock	20,000	
Fixed assets less depreciation (Rs. 20000)	180,000	
Bills payable	21,000	
Sundry debtors		2,000
Sundry creditors	52,000	

Liabilities for expenses		25,000
Drawings		10,000
Investments	12,000	
P & L A/c.	15,000	
Bank overdraft		70,000
		13,000
TOTAL	370,000	370,000

Solution: -

Saravanan Traders
Balance Sheet as on 31st December 2004

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Capital	250,000		**Fixed Assets**	200,000	
Add: Net profit	70,000		Less: Depreciation	20,000	
					180,000
Less: Drawings	320,000				
	12,000		Investments		15,000
		308,000	Closing stock		20,000
			Sundry debtors		52,000
Bills payable		2,000	Bills receivable		21,000
Bank overdraft		13,000	Cash in hand		40,000
Sundry creditors		25,000	Cash at Bank		30,000
Liabilities for expenses		10,000			
		358,000			358,000

Illustration 2: From the following Trial Balance of M/s. Ram & Sons, prepare trading and profit and loss account for the year ending on 31st March 2002 and the balance sheet as on the date

Trail Balance as on 31st March 2002

Particulars	**Debit Rs.**	**Credit Rs.**
Opening stock (1.4.2001)	5,000	
Purchases	16,750	
Discount allowed	1,300	
Wages	6,500	
Sales		30,000
Salaries	2,000	
Travelling expenses	400	
Commission	425	
Carriage inward	275	
Administration expenses	105	
Trade expenses	600	
Interest	250	
Building	5,000	
Furniture	200	
Debtors	4,250	
Creditors		2,100
Capital		13,000

Cash	2,045	
TOTAL	45,100	45,100

Stock on 31st March 2002 was Rs. 6000

Solution:

Trading and Profit and Loss Account
for the year ending 31st March 2002

Dr

Particulars	Rs.	Particulars	Rs.
To Opening Stock	5,000	By Sales	30,000
To Purchases	16,750	By Closing Stock	6,000
To Wages	6,500		
To Carriage Inward	275		
To Gross Profit C/d (Transferred to P&L A/c)	7,475		
	36,000		36,000
To Discount	1,300	By Gross profit (Transferred from Trading A/c)	7,475
To Salaries	2,000		
To Travelling expenses	400		
To Commission	425		
To Administration expenses	105		
To Trade expenses	600		
To Interest	250		
To Net profit (Transferred to capital A/c.)	2,395		
	7,475		7,475

Saravanan Traders
Balance Sheet as on 31st March 2002

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Creditors		2,100	Cash		2,045
Capital	13,000		Debtors		4,250
Add: Net profit	2,395		Stock		6,000
		15,395	Furniture		200
			Building		5,000
		17,495			17,495

CHECK YOUR PROGRESS-III

1. Define balance sheet?

2. Explain term 'asset' and 'liability'.

3.7 Summary

After preparing the ledger account, in order to know the arithmetical accuracy trial balance will be prepared. Ledger accounts balances will be transferred and finally it should be totaled. The debit and credit balances should be equal. If it is equal our accounting is correct. If not, some mistake has been made. With the help of trial balance, we can find the arithmetical accuracy of accounts preparation. At the end of the accounting year the businessman prepares the final accounts with the help of a Trial Balance. The final accounts are divided into two sections

- Profit and Loss Account and
- Balance Sheet.

The first section called Trading Account reveals the gross profit or gross loss. The Profit and Loss Account is prepared for ascertaining the net profit/net loss of the business during the year. Gross profit is defined as the excess of sales revenue over the cost of goods sold which also includes the direct expenses. The net profit is worked out by crediting the Profit and Loss Account with the amount of gross profit and other incomes and debiting it with all indirect expenses and losses, the Balance Sheet is prepared for ascertaining its financial position as at the end of the year. The Balance Sheet shows all assets and liabilities of the business. The assets represent the debit balances of the real and personal accounts plus the unwritten off amounts of deferred revenue expenses. The liabilities, represents the credit balances of real and personal accounts including capital, the total assets should always be equal to the total of liabilities.

3.8 Glossary

Closing Stock: Goods remaining unsold at the end of the accounting year. Cost of Conversion: Expenses incurred in the factory (for converting raw materials into finished goods.) I Cost of Goods Sold: Difference between the cost of goods available for sale and the cost of goods in stock.

Cost of Production: It is the cost of goods produced what includes cost of raw materials consumed and all manufacturing expenses.

Current Assets: Assets which are likely to be realized within a period of one year or during the operating cycle. They are also called floating assets.

Current Liabilities: Liabilities which are likely to be paid within one year or during the operating cycle. They are also called short-term liabilities.

Direct Expenses: Expenses incurred on the goods purchased till they are brought to the place of business.

Fixed Assets: Assets acquired for use in the business for a long period. They are also called non-current assets.

Gross Profit: Excess of sales revenue over the cost of goods sold'.

Indirect Expenses: All expenses other than direct expense. These include expenses incurred in connection with general administration, financial matters and selling and distribution of goods.

Intangible Assets: Assets in the form of rights which cannot be seen or touched such as goodwill, patents, etc.

Net Profit: Excess of gross profit and other incomes over the indirect expenses and losses in the business.

Non-Current Liabilities: Liabilities payable after a long time. They are also called long-term liabilities.

Owner's Capital: Claim of owners against the assets of the business. It is also called owner's equity and is equal to excess of assets over outside liabilities.

Opening stock: Stock of goods as at the beginning of the accounting year,

Tangible Assets: Assets which have physical form and can be seen and touched such as buildings, machinery, Etc.

3.9 References and Bibliography

- Hospitality Management Accounting, Michael M Coltman
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- Accounting for Management, S K Bhattacharya, Vikas Publishing House
- Hospitality Financial Accounting By Jerry JWeygandt, Publisher Wiley & sons
- Accounting in Hotel & Catering Industry – Richard Kotas- International Textbook Company
- Comprehensive Accountancy, SA Siddiqui
- A complete Course in Accounting Volume – I, N.D. Kappor
- Double – Entry Book- Keeping, Rc. Chawla & C. Juneja
- Introduction to Accountancy, T.S. Grewal

3.10 Suggested Reading

- Hospitality Management Accounting, Michael M Coltman
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- Introduction to Accountancy, T.S. Grewal

3.11 Terminal Questions

Choose the correct answer

1. Trial balance is prepared to find out the
   a) profit or loss b) financial position c) arithmetical accuracy of the accounts

2. State which of the following errors will not be revealed by the Trial Balance.
   a) Errors of complete omission. b) Error of carrying forward.
   c) Wrong totaling of the purchases book.

3. Amount spent on servicing office Typewriter should be debited to:
   a) Miscellaneous Expenses Account b) Typewriter Account.
   c) Repairs Account.

4. Wages paid to workers for the installation of a new Machinery should be debited to:
   a) Wages Account b) Machinery Account c) Factory Expenses Account

5. Salary paid to Manager must be debited to
   a) Manager's Account b) Office Expenses Account c) Salary Account.

6. Goods taken by the proprietor for domestic use should be credited to
   a) Proprietor's Drawings Account. b) Sales Account. c) Purchases Account.

7. Cash received from Mani whose account was previously written off as a Bad Debt should be credited to:
   a) Mani's Account. b) Miscellaneous Income Account. c) Bad Debts Recovered Account.

8. Trading account is prepared to find out

   a) gross profit or loss b) net profit or loss c) financial position

9. Wages is an example of

   a) capital expenses b) indirect expenses c) direct expenses

10. Opening stock is

a) debited in trading account b) credited in trading account
c) credit in profit and loss account

11. Balance sheet is a

a) statement b) account c) ledger

12. Fixed assets have

a) short life b) long life c) no life

13. Cash in hand is an example of

a) current assets b) fixed assets c) current liability

14. Capital is a __________

a) income b) assets c) liability

15. Drawing must be deducted from

a) net profit b) capital c) gross profit

Fill in the Blanks

1. Trial Balance should be tallied by following the rules of _______.

2. If the total debits exceed the total credits of trial balance, suspense account will show _______ balance.

3. Suspense account having debit balance will be shown on the _______ side of balance sheet.

4. If the total debit balances of the trial balance exceed the total credit balances, the difference is transferred to the _______ side of the suspense account.

5. Suspense account having credit balance will be shown on the _______ side of the balance sheet.

6. Short credit of an account decreases the _______ column of the trial balance.

7. __________ account enables the trader to find out gross profit or loss.

8. By preparing profit and loss account __________ can be find out.

9. Closing stock is __________ in the trading account.

10. Direct expenses appears in the debit side of the __________ account.

11. Indirect expenses appears in the__________ side of the profit and loss account.

12. All incomes are__________ in the profit and loss account

13. Bad debt is a__________ expense.

14. Balance sheet shows the __________ of a business

Long Answer Questions

1) What is a Trial Balance?
2) What are the advantages of a Trial Balance?
3) Why is it said that the trial balance is not a conclusive proof of the accuracy of the account books?
4) Explain the principle on which the agreement of trial balance is based.
5) What is trading account? What are its uses?
6) What are the items appearing in the debit and credit side of trading account?
7) What are the merits of profit and loss account?
8) What do you mean by current assets. & liabilities.
9) Draw the format of vertical balance sheet.
10) What do you mean by Assets? Classify the assets with suitable examples?

Practical Problems

Problem 1 : Prepare Trial Balance as on 31.12.2000 from the following balances of Mr. Balan.

Capital	3,40,000	Purchases	94,000
Creditors	13,000	Sales Returns	3,400
Drawings	4,000	Purchases Return	2,400
Salaries	38,200	Carriage inwards	1,400
Bill Receivable	5,800	Printing & Stationery	5,000
Bills Payable	7,000	Stock	29,900
Debtors	16,000	Machinery	50,000
Sales	1,44,000	Wages	5,000
Insurance	2,200	Rent	1,600
Land	2,50,000	Interest received	1,700
Commission received	800	Electricity charges	2,400

Problem 2 : The following balances are extracted from the books of Mr. Senthil. Prepare Trial Balance as on 30.6.2004.

	Rs.		Rs.
Capital	4,70,200	Machinery	1,58,800

Cash in hand	6,000	Sundry Debtors	48,000
Building	3,20,000	Repairs	5,400
Stock	33,000	Insurance premium	3,300
Sundry creditors	26,000	Sales	2,90,000
Commission paid	750	Telephone charges	6,450
Rent & Taxes	6,300	Furniture	11,000
Purchases	1,65,000	Discount earned	1,100
Salaries	70,600	Loan from Mohammed	51,000
Discount allowed	650	Reserve funds	5,900
Drawings	5,000	Bills receivable	8,600
Bad debts	1,350	Bills payable	6,000

Problem 3 : Prepare a trading account of Mr. Vasu from the following figures: -

	Rs.
Opening Stock	500
Purchases	2,500
Sales	3,600
Closing Stock	300

Problem 4: Prepare a trading account of Mr. Devan for the year ended 31st December 2002

	Rs.
Opening Stock	5,700
Purchases	158,000
Purchases returns	800
Sales	262,000
Closing Stock	8,600

Problem 5 : The following are the extracts taken from the ledger of Mr. Sundaram as on 31.12.2002 . Prepare a trading account

S. No	Particulars	Debit Rs.	Credit Rs.
1	Stock as on 1.1.2000	12,500	
2	Purchases	100,000	
3	Sales Account		150,000
4	Returns outwards		5,000
5	Returns inwards	10,000	
6	Salaries	4,400	
7	Wages	7,500	
8	Carriage inwards	2,500	
9	Carriage outwards	750	
10	Power,coal, gas	1,000	

Stock as on 31.12.2000		14,000

Problem 6: Prepare Profit and Loss Account of Mrs. Nalini for the year ended 31st December 2001 from the following: -

	Rs.
Discount paid	600
Discount received	1,000
Interest paid	500
Interest received	700
Commission earned	2,000

Problem 7: From the following balance, ascertained from the books of M/s. Senthil and Bros. Prepare profit and Loss account.

	Particulars	**Rs.**	**Rs.**
1	Gross Profit		7,500
2	carriage outwards	2,000	
3	Interest received		4,000
4	Salaries	5,000	
5	Depreciation	7,000	
6	Audit fees	3,000	
7	Discount (Cr.)		8,000
8	Discount (Dr.)	6,000	
9	Insurance	2,000	
10	General expenses	10,000	
11	Advertisement	12,000	

Problem 8: From the following particulars, prepare a balance sheet of Mr. Venugopal as on 31.12.2003

	Rs.		Rs.
Capital	40,000	Drawings	4,400
Debtors	6,400	Creditors	4,200
Cash in hand	360	Cash at Bank	7,200
Furniture	3,700	Plant	10,000
Net profit	1,660	General reserve	1,000
Closing stock	14,800		

Problem 9: From the following information, prepare a balance sheet of Mrs. Nasreen Khan as on 31.12.2003

	Rs.		Rs.
Goodwill	10,000	Sundry debtors	25,000
Capital	90,000	Drawings	15,000
Cash in hand	10,000	Land & Buildings	30,000
Investment	500	Bank	10,000
Net Profit	46,900	Creditors	31,500
Bills receivable	6,500	Plant & Machinery	20,000
Bills payable	5,350	Closing Stock	40,000
Furniture	6,750		

Problem 10: Given below is the trial balance of shirt Hari Prakash. Prepare trading and profit and loss account for the year ended 31.03.2002

S. No	Particulars	Debit Rs.	Credit Rs.
1	Stock as on 1.4.2001	50,000	
2	Purchases	245,000	
3	Sales		290,000
4	Purchase returns		5,000
5	Sales Return	10,000	
7	Wages	12,000	
8	Carriage inwards	4,000	
9	Carriage outwards	6,000	

Problem 11: The following information is extracted from the books of M/s. Sudha Ltd. Prepare Final accounts as on 31.3.2002

S. No	Particulars	Debit Rs.	Credit Rs.
1	Opening stock	12,500	
2	Purchases	86,000	
3	Sales		189,000
4	Returns outwards		13,800
5	Sales return	14,000	
6	Depreciation	7,000	
7	Carriage inward	700	
8	Furniture	8,000	
9	Plant & Machinery	200,000	
10	Cash	8,900	
11	Salaries	7,500	
12	Debtors	19,000	
13	Bills receivable	17,000	
14	Wages	16,000	
15	Creditors		17,500
16	Carriage	500	

	outwards		
17	Commission		2,000
18	Capital		171,300
19	Bills payable		5,000
20	Discount	1,500	
	TOTAL	398,600	398,600

Closing stock as on 31.12.2002 is Rs. 45000

Problem 12: The following information is extracted from the books of Mrs. Mala. Prepare Final accounts as on 31.3.2003. The closing stock as on 31.3.2003 was Rs. 72500.

S. No	Particulars	Debit Rs.	Credit Rs.
1	Opening stock as on 1.4.2003	55,000	
2	Purchases	180,000	
3	Sales		375,000
4	Purchase Returns		3,000
5	Mrs. Mala's Capital		95,000
6	Plant & Machinery	37,000	
7	Repairs to Machinery	9,150	
8	Income Tax	750	
9	Land & building	111,750	
10	Cash and bank balances	3,000	
11	Salaries	6,000	
12	Interest	2,250	
13	Debtors	52,500	
14	Bills receivable	15,000	
15	Wages	42,000	
16	Creditors		40,650
17	Carriage outwards	500	
18	Commission (Cr.)		6,000
19	Bills payable		4,500
20	Suspense account		2,750
21	Drawings	12,000	
	TOTAL	526,900	526,900

UNIT: 04
DEPRECIATION RESERVES AND PROVISIONS

Structure

4.1 Introduction

In the process of preparing final accounts, allocation for depreciation on all fixed assets is done, in order to arrive at an appropriate amount of profit or loss for the accounting period.

Depreciation – Meaning: Depreciation is a method associated with tangible long-lived assets. It allows the recovery of the cost of a tangible asset over a period of time, commonly known as the asset's useful life.

Depreciation – Definition: Depreciation may be defined as the loss in value of assets or amount of expense arising out of physical deformation and other causes that has to deduct from profit.

According to Institute of Cost and Management Accounting, London (ICMA) terminology "The depreciation is the diminution in intrinsic value of the asset due to use and/or lapse of time."

Examples: -machines, plants, furniture's, buildings, computers, trucks, vans, equipment's, etc.

4.2 Objectives

After reading this unit the learner will be able to:

- Understand Causes of depreciation
- Understand methods for Providing Depreciation
- Understand computerized Accounting System
- Understand Ratios used in Room Division Department
- Understand Computerized Guest Accounting
- Understand Tools/Techniques/Methods of Financial Analysis

- Understand Hotel Accounting Terminology

4.3 Causes of Depreciation

The causes of depreciation are as follows:

1. **Wear and tear**: Wearing out of the asset is due to its constant use.

2. **Lapse of Time**:The depreciation is charged on time basis because with the passage of time causes reduction in the value of fixed assets.

3. **Obsolescence:** As the new machine performs the same operation more quickly and/or more economically than the existing machines.Then, the existing machines become out of date or obsolete. This causes a drastic reduction in the value of existing machinery

4. **Depreciation**: Due to continuitiesextraction of materials the natural resources get depleted. Depreciation, in case of such assets is oftencomputed on the basis of actual depletion of the resource material.

4.4 Features of Depreciation

The following are the features of depreciation:

1. It decline's in the book value of fixed assets.
2. It includes loss of value due to effluxion of time, usage or obsolescence.
3. It is a continuing process.
4. It is an expired cost

Example: - if profit before depreciation and tax is Rs. 50,000, and depreciation is Rs. 10,000; profit before tax will be:

Profit before depreciation & tax	Rs. 50000
(-) Depreciation	Rs. (10000)
	Rs. 40000

5. It is a non-cash expense.

4.5 Methods for Providing Depreciation

The depreciation amount to be charged for during an accounting year depends up on depreciable amount and the method of allocation. There are eight methods used for providing depreciation, which are: -

- Fixed Instalment Method
- Diminishing Balance Method
- Annuity Method
- Depreciation Fund Method

- Insurance Policy Method
- Revaluation Method
- Depletion Method
- Machine Hour Rate Method

4.5.1 Straight Line Method / fixed installment method

This method is based on the assumption of equal usage of the asset over its entire useful life. It is called straight line method or fixed installment method because the amount of depreciation remains constant from year to year over the useful life of the asset. It is also known as fixed percentage on original cost method because same percentage of the original cost (in fact depreciable cost) is written off as depreciation from year to year. The depreciation amount to be provided under this method is computed by using the following formula:

$$Depreciation = \frac{Cost\ of\ asset - Estimated\ net\ residential\ \ value}{Estimated\ uesful\ life\ \ of\ the\ asset}$$

4.5.1.1 Preparation of Accounts: - Straight Line Method (SLM)

It is done in the manner discussed below.

4.5.1.1.1 Rate of Depreciation

Rate of depreciation is calculated as follows:

$$Rate\ of\ Depreciation = \frac{Annual\ \ depreciation\ amount}{Acquisition\ Cost}\ X\ 100$$

Example 1 : the original cost of the asset is Rs. 2,50,000. The useful life of the asset is 10 years and net residual value is estimated to be Rs. 50,000. Now, the amount of depreciation to be charged every year will be computed as given below:

Annual Depreciation Amount $= \frac{Acquisitioncostofasset \quad - Estimatednetresidentialvalue}{Estimatedlifeofasset}$

$= \frac{Rs.\ 250000\ - Rs.50000}{10\ \ Years}$

= Rs. 20000 ……. (I)

Then,Rate of Depreciation = $\frac{Annualdepreciationamount}{AcquisitionCost} X\ 100$

From the point (I), the Annual depreciation amount is Rs. 20000.

Henceforth, Rate of Depreciation = $\frac{Rs.\ 20000}{Rs.\ 250000} X\ 100$ = 8 %

4.5.1.1.2 Journal Format

Journal Entries

Date	Particulars	Debit	Credit
Ist Year	Fixed Asset Account Dr.	XXXXX	
	To Cash / Bank Account		XXXXX
	(Being Fixed asset purchased)		
II	Depreciation Account Dr.	XXXXX	
	To Fixed Asset Account		XXXXX
	(Being depreciation provided)		
III	Profit & loss Account Dr.	XXXXX	
	To Depreciation Account		XXXXX
	(Being depreciation transferred to Profit & loss Account)		

[The above entries of II & III are to be passed at the end of every year.]

4.5.1.1.3 Format of asset Account or Plant account

FORMAT OFASSET ACCOUNTor PLANT ACCOUNT

Dr. Cr.

Date	Particulars	Amount	Date	Particulars	Amount
Ist Year	To Balance b/d	XXXX	Ist Year	By Depreciation	XXXX
	To Cash	XXXX		By balance c/d	XXXX
	[If the Asset is purchased during the year]				
		XXXX			XXXX
IInd Year	To Balance b/d	XXXX	IInd Year	By Depreciation	XXXX
				By balance c/d	XXXX
		XXXX			XXXX
IIIrd Year	To Balance b/d	XXXX	IIIrd Year	By Depreciation	XXXX
				By balance c/d	XXXX
		XXXX			XXXX
IVth Year	To Balance b/d	XXXX	IVth Year	By Depreciation	XXXX
				By balance c/d	XXXX
		XXXX			XXXX
Vth Year	To Balance b/d	XXXX	Vth Year	By Depreciation	XXXX
				By balance c/d	XXXX
		XXXX			XXXX

4.5.1.1.4 Format of Depreciation Account

FORMAT OF DEPRECIATION ACCOUNT

Dr. Cr.

Date	Particulars	Amount	Date	Particulars	Amount
Ist Year	To Fixed Asset	XXX	Ist Year	By Profit & Loss Account	XXX
		XXX			XXX
IInd Year	To Fixed Asset	XXX	IInd Year	By Profit & Loss Account	XXX
		XXX			XXX
IIIrd Year	To Fixed Asset	XXX	IIIrd Year	By Profit & Loss Account	XXX
		XXX			XXX

Illustration 1: From the Following particulars,Calculate Annual Depreciation & Rate of depreciation, under the straight-linemethod.

Cost of the Assets	Rs. 5000
Scrap Value	Rs. 500
Estimated Life	10 Years

Solution: -

Calculation ofdepreciation: -

Annual Depreciation Amount $= \frac{Acquisition cost of asset \quad - Estimated net residential value}{Estimated life of asset}$

$$= \frac{Rs. 5000 - Rs. 500}{10 \; Years}$$

$$= \frac{Rs. 4500}{10 \; Years}$$

$$\text{Annual Depreciation Amount} = \quad Rs. 450 \; everyyear$$

Then,Rate of Depreciation = $\frac{Annual depreciation amount}{Acquisition Cost} X \; 100$

$$Rate of Depreciation \quad = \quad \frac{Rs. 450}{Rs. 5000} X \; 100$$

$$Rate of Depreciation \quad = \quad \frac{1}{11} X \; 100$$

$$Rate of Depreciation \quad = \quad 9 \; \%$$

Illustration 2: Alpha Ltd company purchased on 1st January '91 a small plant for Rs. 10000. On 1st July in the same year. additional plant was purchased costing Rs.5000. On 1st October '93, the plant purchased on 1st January '91 having become absolute, was sold for Rs. 6750. Show the profit or loss of the sale of the plant. On the same date a fresh plant was purchased for Rs 12000. depreciation is provided at 10 % pea on the straight-line method. Pass journal entries, prepare plant account and Depreciation account for 3 years, assuming that theaccounts are closed on 31st December every year

Solution: -

Journal Entries of Alpha Ltd. Company

Date	Particulars	Debit	Credit
Jan1st 1991	Plant Account Dr. To Cash Account (Being Fixed asset purchased)	10000	 10000
July 1st 1991	Plant Account Dr. To Cash Account (Being Fixed asset purchased)	5000	 5000
Dec 31st 1991	Depreciation Account Dr. To Fixed Asset Account (Being depreciation provided)	1250	 1250
Dec 31st 1991	Profit & loss Account Dr. To Depreciation Account (Being depreciation transferred to Profit & loss Account)	1250	 1250
Dec 31st 1992	Depreciation Account Dr. To Fixed Asset Account (Being depreciation provided)	1500	 1500
Dec 31st 1992	Profit & loss Account Dr. To Depreciation Account (Being depreciation transferred to Profit & loss Account)	1500	 1500
October 1st 1993	Plant Account Dr. To Cash Account (Being Fixed asset purchased)	12000	 12000
October 1st 1993	Cash Account Dr. To Fixed Asset Account (Being Fixed asset sold)	6750	 6750
October 1st 1993	Profit & loss Account Dr. To Plant Account (Being Loss on sale of Fixed asset)	500	 500
Dec 31st 1993	Depreciation Account Dr. To Plant Account	1550	 1550

	(Being depreciation of Fixed assets)		
Dec 31st 1993	Profit & loss Account Dr. To Depreciation Account (Being depreciation transferred to Profit & loss Account)	1550	1550

Working Notes 1

As on Dec 31st 1991

Machinery 1

Purchase Cost of Plant	=	10000
Depreciation	=	10%
Depreciation Value	=	10000 * [10/100]
	=	1000

Machinery 2

Purchase Cost of Plant	=	5000
Depreciation	=	10 % (6Months)
Depreciation Value	=	5000 * [10/100] * [6/12]
	=	250

Total Depreciation

Machinery 1		1000
Machinery 2	+	250
	=	1250

Working Notes 2

Similarly, as on Dec 31st 1992

Machinery 1

Purchase Cost of Plant	=	10000
Depreciation	=	10%
Depreciation Value	=	10000 * [10/100]
	=	1000

Machinery 2

Purchase Cost of Plant	=	5000
Depreciation	=	10%
Depreciation Value	=	5000 * [10/100]
	=	500

Total Depreciation		
Machinery 1		1000
Machinery 2	+	500
	=	1500

Working Notes 3

Similarly, as on Dec 31st 1993

Machinery 1

Purchase Cost of Plant	=	10000
Depreciation	=	10%
Depreciation Value	=	10000 * [10/100] * [9/12]
	=	750

Machinery 2

Purchase Cost of Plant	=	5000
Depreciation	=	10%
Depreciation Value	=	5000 * [10/100]
	=	500

Machinery 3

Purchase Cost of Plant	=	10000
Depreciation	=	10%
Depreciation Value	=	5000 * [10/100] * [3/12]
	=	300

Total Depreciation		
Machinery 1		750
Machinery 2	+	500
Machinery 3	+	300
	=	1550

Working Notes 4

Calculation of profit orloss of sale of plant

Book Value on 1.1.91		10000
Less: Ist Year depreciation	1000	
Book Value on 1.1.92		9000
Less: IInd Year depreciation	1000	
Book Value on 1.1.93		8000
Less: IIIrd Year depreciation	750	
Book Value on Sale date		7250

Then,

Profit = Selling Price - Book Value

Profit = 6750 -7250

Profit = - 500

PLANT ACCOUNT

Dr.			Cr.		
Date	**Particulars**	**Amount**	**Date**	**Particulars**	**Amount**
Jan 1st 1991	To Cash	10000	Dec 31st 1992	By Depreciation	1250
July 1st 1991	To Cash	5000	Dec 31st 1992	By balance c/d	13750
		15000			15000
Jan1st 1992	To Balance b/d	13750	Dec 31st 1992	By Depreciation	1500
			Dec 31st 1992	By balance c/d	12250
		13750			13750
Jan1st 1993	To Balance b/d	12250	October 1st 1993	By Cash Account	6750
October 1st 1993	To Plant Account	12000	October 1st 1993	By Profit & Loss Account	500
			Dec 31st 1993	By Depreciation	1550
			Dec 31st 1993	By balance c/d	15450
		24250			24250

DEPRECIATION ACCOUNT

Dr.			Cr.		
Date	**Particulars**	**Amount**	**Date**	**Particulars**	**Amount**
Dec 31st 1991	To Plant Account	1250	Dec 31st 1991	By Profit & Loss Account	1250
		1250			1250
Dec 31st 1992	To Plant Account	1500	Dec 31st 1992	By Profit & Loss Account	1500
		1500			1500
Dec 31st 1993	To Plant Account	1550	Dec 31st 1993	By Profit & Loss Account	1550
		1550			1550

4.5.1.2 Merits of Straight Line Method

- It is simple & easy method of calculating depreciation
- The value of assets can be reduced to estimated scrap value or zero value
- This method is suitable for assets with fixed life cycle.
- Every year apportioned amount is being debited to Profit & Loss account

4.5.1.3 Demerits of Straight Line Method

- It does not take in to account the interest on capital invested in assets.

- In this method it is difficult to calculate the depreciation on additions made during the year

4.5.2 Written Down Value Method / reducing balance method

Under this method, the rate of depreciation is calculated on the **written down value** of the asset&is charged on the book value of the asset.This method involves the application of a pre-determined proportion/percentage of the book value of the asset at the beginning of every accounting period, so as to calculate the amount of depreciation. The amount of depreciation reduces year after year.

Example : The original cost of the asset is Rs. 2,00,000 and depreciation is charged @ 10% p.a. at written down value, then the amount of depreciation will be computed as follows:

(i)	Depreciation (1^{st}Year)	= Rs. 200000 X $\frac{10}{100}$ = Rs. 20,000
(ii)	Written down value (at the end of 1^{st}Year)	= Rs. 200000 – Rs. 20000 = Rs. 180000
(iii)	Depreciation (2^{nd}Year)	= Rs. 180000 X $\frac{10}{100}$ = Rs. 18,000
(iv)	Written down value (at the end of 2^{nd} Year)	= Rs. 180000 – Rs. 18000 = Rs. 162000
(v)	Depreciation (3^{rd} Year)	= Rs. 162000 X $\frac{10}{100}$ = Rs. 16,200
(vi)	Written down value (at the end of 3^{rd}Year)	= Rs. 162000 – Rs. 16,200 = Rs. 145800

Illustration : Sugan & Co. purchased on 1st January '92 a small machinery for Rs. 10000. On 1st July in the same year additional Machinery was purchased costing Rs. 5000. On 1st July '94, the machinery purchased on 1st January '92 having become absolute, was sold for Rs. 8000. depreciation is provided at 10 % per annum on the written down method. Pass the journal entries,prepare plant account and Depreciation account for 3 years, assuming that the accounts are closed on 31st December every year

Solution: -

Journal Entries of Sugan & Co.

Date	Particulars	Debit	Credit
Jan1st 1992	Machinery Account To Cash Account (Being Machinery purchased)	10000	 10000
July 1st 1992	Machinery Account To Cash Account (Being Additional Machinery purchased)	5000	 5000
Dec 31st 1992	Depreciation Account Dr. To Machinery Account (Being depreciation provided)	1250	 1250
Dec 31st 1992	Profit & loss Account Dr.	1250	

	To Depreciation Account (Being depreciation transferred to Profit & loss Account)		1250
Dec 31st 1993	Depreciation Account Dr.	1375	
	To Fixed Asset Account (Being depreciation provided)		1375
Dec 31st 1993	Profit & loss Account Dr.	1375	
	To Depreciation Account (Being depreciation transferred to Profit & loss Account)		1375
July 1st 1994	Cash Account Dr.	8000	
	To Machinery Account (Being Machinery sold)		8000
Dec 31st 1994	Depreciation Account Dr.	832	
	To Machinery Account (Being depreciation provided)		832
Dec 31st 1994	Profit & loss Account Dr.	832	
	To Depreciation Account (Being depreciation transferred to Profit & loss Account)		832
Dec 31st 1994	Machinery Account	305	
	To Profit& loss Account (Being Profit from sale of machinery)		305

Working Notes 1

As on Dec 31st 1992

Machinery 1

Purchase Cost of Plant	=	10000
Depreciation	=	10%
Depreciation Value	=	10000 * [10/100]
	=	1000

Machinery 2

Purchase Cost of Plant	=	5000 (6Months)
Depreciation	=	10%
Depreciation Value	=	5000 * [10/100] * [6/12]
	=	250

Total Depreciation

Machinery 1		1000
Machinery 2	+	250
	=	1250
Working Notes 2		
As on Dec 31st 1993		
Machinery 1		
Purchase Cost of Plant	=	9000
Depreciation	=	10%
Depreciation Value	=	9000 * [10/100]
	=	900
Machinery 2		
Purchase Cost of Plant	=	4750
Depreciation	=	10%
Depreciation Value	=	4750 * [10/100]
	=	475
Total Depreciation		
Machinery 1		900
Machinery 2	+	475
	=	1375
Working Notes 3		
As on Dec 31st 1994		
Machinery 1		
Purchase Cost of Plant	=	8100
Depreciation	=	10%
Depreciation Value	=	8100 * [10/100] *[6/12]
	=	405
Machinery 2		
Purchase Cost of Plant	=	4275
Depreciation	=	10%
Depreciation Value	=	4275 * [10/100]
	=	427
Total Depreciation		
Machinery 1		405
Machinery 2	+	427
	=	832
Working Notes 4		
Calculation of profit orloss of sale of Machinery 1		
Book Value on 1.1.92		10000
Less: Ist Year depreciation	1000	
Book Value on 1.1.93		9000
Less: IInd Year depreciation	900	

Book Value on 1.1.94	8100
Less: 'IIIrd Year depreciation	405
Book Value on Sale date	7695

Profit = Selling Price - Book Value
Profit = 8000 - 7695
Profit = 305

MACHINERY ACCOUNT

Dr.			Cr.		
Date	**Particulars**	**Amount**	**Date**	**Particulars**	**Amount**
Jan 1st 1992	To Cash	10000	Dec 31st 1992	By Depreciation	1250
July 1st 1992	To Cash	5000	Dec 31st 1992	By balance c/d	13750
		15000			15000
Jan1st 1993	To Balance b/d	13750	Dec 31st 1993	By Depreciation	1375
			Dec 31st 1993	By balance c/d	12375
		13750			13750
Jan1st 1994	To Balance b/d	12375	Dec 31st 1994	By Cash	8000
	To Profit & Loss A/C	305	Dec 31st 1994	By Depreciation	832
			Dec 31st 1994	By balance c/d	3848
		12680			12680
Jan1st 1995	To Balance b/d	3848			

DEPRECIATION ACCOUNT

Dr.			Cr.		
Date	**Particulars**	**Amount**	**Date**	**Particulars**	**Amount**
Dec 31st 1992	To Machinery	1250	Dec 31st 1992	By Profit & Loss Account	1250
		1250			1250
Dec 31st 1993	To Machinery	1375	Dec 31st 1993	By Profit & Loss Account	1375
		1375			1375
Dec 31st 1994	To Machinery	832	Dec 31st 1994	By Profit & Loss Account	832
		832			832

4.5.2.1 Rate of Depreciation

The formula generally used for Rate of Depreciation is as follow:

Rate of Depreciation $= \left(1 - n\sqrt{\frac{Scrap\ \ Value}{Cost\ of\ Asset}}\right)$ X 100

Illustration: The original cost of a mini truck is Rs. 18,00,000 and its net salvage value (ScrapValue) after 10 years of useful life is Rs. 1,00,000. Calculate the appropriate rate of depreciation?

Answer: -

Given,n = Expected useful life = 10 Years

Scrap Value = Rs. 100000

Cost of Asset = Rs. 1800000

Then,Applying the formula of Rate of Depreciation, we get

$$\text{Rate of Depreciation} = \left(1 - n\sqrt{\frac{Scrap\ \ Value}{Cost\ of\ Asset}}\right) \text{X } 100$$

$$= \left(1 - 16\sqrt{\frac{Rs.100000}{Rs.1800000}}\right) \text{X } 100$$

= (1- 0.834) X 100

= 16.6 %

4.5.2.2 Merits of Diminishing Balance Method

- In this method it is easy to calculate the depreciation on additions made during the year
- The income tax authorities in India, certify this method of depreciation.
- It ensures a fairly even charge to Profit and Loss Account on account of both depreciation and repairs

4.5.2.3 Demerits of Diminishing Balance Method

- the value of an asset cannot be brought down to zero
- This method also does not take into account the loss of interest on the money invested in the asset.
- The determination of a suitable rate of depreciation is also difficult under this method.

4.5.2.4 Straight Line Method and Written Down Method

Basis of Difference	Straight Line Method	Written Down Value Method
1. **Basis of Charging Depreciation**	Original Cost	Book Value (Original Cost – Depreciation till date)
2. **Annual Depreciation Charge**	Constant every year	Declines year after year
3. **Total charge against Profit & Loss A/c w.r.t depreciation**	Unequal year after year	Almost equal every year
4. **Recognition by Income Tax Law**	Not Recognised	Recognised

4.5.4 Annuity Method

The method by which the interest on advance is included in the amount of depreciation-is known, as Annuity Method.Asset account is debited with the amount of interest and credited with the amount of depreciation. The amount of depreciation is calculated from the Annuity table.

4.5.4.1 Merits of Annuity Method

- This method is referred as scientific method, as it treats the purchase of an asset as an investment in the business itself.
- This method is mainly used for lease in respect of which a lumpsum payment is made in advance
- The amount invested in an asset has an opportunity cost

4.5.4.2 Demerits of Annuity Method

- The chief demerits are that the amount of depreciation and repair put together does not remain fairly same from year to year.

4.5.5 Depreciation Fund Method

In this method, the security accumulates and when the lives of asset expire, the securities are sold and with the amount is released, new assets are purchased. As the securities always earn interest, it is not necessary to write off full amount of the cost of depreciation.

The sinking fund table gives the amount to be invested every year to have a given sum at the end of each year. This method is also known as sinking fund method.

4.6.6 Insurance Policy Method

In this method, the business entity takes an insurance policy for the required amount to replacement of assets. A fixed amount of premium is paid to the insurance company at the beginning of each year. At the end of a tenure period, the insurance company pays the agreed amount with which new assets can be purchased

This method is adopted at: -

1. The repair and maintenance cost are reducing over the life of the asset
2. The revenue and operating efficiency are uniform or increasing over the life of assets.

4.5.7 Revaluation Method

This method is also known as inventory method. At the end of accounting year, the value of asset is compared with its value at the beginning of the year. The difference in the two figures is treated as depreciation. This method is used in assets of large quantity, but with small value. Example: - Bottles, Corks, Loose Tools Etc.

4.5.8 Depletion Method

This method is used for wasting assets like – mines, quarries Etc. In this method, the amount of depreciation is calculated on the output during the year.

4.5.9 Machine Hour Rate Method

This method is also known as service hour method. This method is useful in case of machines. Under this method, the life of machinery is estimated in terms of hours.

4.6 Provisions

Provision represents an estimated amount to meet a loss or expenses in future. These amounts cannot be certain or fixed. If the amount of liability is ascertained; it will be treated as liability instead of provision.

‘Any amount written off or retained by the way of providing fordepreciation, renewals or diminution in value of assets, or retained by providing for any known liability of which the amount cannot be determined with substantial accuracy.‘(By Indian Companies Act)

4.7 Reserves

Reserve represents an amount set aside out of profits. It is an apportion out of profits to strengthen the financial position of the firm.

4.7.1 Introduction of Reserve & Reserve Fund

Reserve represents an amount set aside out of profits. It is an apportion out of profits to strengthen the financial position of the firm.

Example: - General reserves for expansion, reserves for equalization of dividends, reserve for increased costs for replacement Etc.

4.7.2 Importance of Reserve

- It helps in redemption of liabilities
- It is useful in meeting unforeseen contingencies.
- Reserves helps in making dividends uniform from year to year
- It helps in meeting legal requirements Example: - Investment reserve for income tax.

4.7.3 Types of Reserve

Reserves are of following types:

- Revenue Reserves
- Capital Reserve
- General Reserve
- Specific Reserve
- Secret Reserve

4.7.3.1 Revenue Reserves

Revenue reserves are created out of business profits, which is available for distribution of dividends. Example: - General Reserve, Staff welfare debenture redemption reserve.

4.7.3.2 Capital Reserve

These are reserves created out of capital profits. Capital reserves are not available for distribution as cash dividends

Example: - Profits on resale of fixed assets, Capital redemption reserve.

4.7.3.3 General Reserve

General reserve is that amount set aside out of profits which are not created for any specific purpose. It is available for any unforeseen contingency of business. These are also created to provide additional working capital.

4.7.3.4 Specific Reserve

It is that reserve, which is created for specific purpose and cannot be utilized for any other purpose. Example: - Workmen's compensation, debenture redemption fund.

4.7.3.5 Secret Reserve

A secret reserve is that reserve whose existence and the related amount does not appear on the face of the balance sheet. The chief objective of secret reserveis to reduce the disclosed profit; so as to have optimum utilization of same in bad period.

CHECK YOUR PROGRESS-I

1. Define depreciation? List the various methods of providing depreciation.

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2. Explain the various types of reserves.

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4.8 Introduction to Computerized Accounting System

The most important impact of computers has been on the manner in which data is stored and processed within an organization.

4.8.1 Features of Computerized Accounting System

- Online input and storage of accounting data.
- Printout of purchase and sales invoices.
- Logical scheme for codification of accounts and transactions. Every account and transaction are assigned a unique code.
- Instant reports for management **Example** – Aging Statement, Stock Statement, Trial Balance.

4.8.2 Accounting Packages

The accounting packages are classified into the following categories:

- **Ready to use** - Accounting software may be customized to meet the special requirement of the user.

- **Customized**: - Customized software is suited large and medium businesses and can be linked to the other information systems.

- **Tailored**: - The accounting software is tailored in large business organizations with multi users and geographically scattered locations.

4.8.3 Advantages of Computer System

Speed: The modern computers with a capacity of 100 million calculations per second can complete tasks much faster than human beings.

Accuracy: It is the degree of exactness with which computations are made and operations are performed.

Reliability: It is the ability with which the computers remain functional to serve the user which includes adapting & performing repetitive operations.

Storage: It is the amount of data a computer system can store and access.

Automated Document Production: The computerised accounting systems have standardized, user defined format of accounting reports that are generated automatically.
Example: -The accounting reports such as Cash book, Trial balance, Statement of accounts are obtained just by click of a mouse in a computerised accounting environment.

MIS Reports: The computerised accounting system facilitates the real time production of management information reports.

4.8.4 Limitations of a Computer System

Cost of Training: The sophisticated computerised accounting packages generally require specialised staff personnel. As a result, a huge training costs are incurred.

System Failure: The danger of the system crashing due to hardware failures and the subsequent loss of work is a serious limitation of computerised accounting system. No full proof solutions are available as of now to tackle the menace of attacks on software by viruses.

Breaches of Security: Computer related crimes are difficult to detect as any alteration of data may go unnoticed. Hacking of passwords or user rights may change the accounting records.

CHECK YOUR PROGRESS-II

1. What are the features of computerized accounting?.

2. List the limitations of computerized accounting.

4.9 Ratios used in Room Division Department

The common ratios used in financial interpretation of data in Room Division Department are:

1. **Current ratio:**

$$\text{Current ratio} = \frac{\text{Current Assets}}{\text{Current liabilities}}$$

2. **Quick Ratio (Liquidity Ratio): -**

$$\text{Quick ratio} = \frac{\text{Current assets} - \text{inventory}}{\text{current liabilities}}$$

3. **Gross Profit Ratio: -**

$$\textit{Gross Profit Ratio} = \frac{\textbf{Gross Profit}}{\textbf{Net Sales}}$$

$$\textit{Percentage of Gross Profit Ratio} = \frac{\textbf{Gross Profit}}{\textbf{Net Sales}} \textit{ X 100}$$

4. **Net Profit Ratio: -**

$$\textit{Net Profit Ratio} = \frac{\textbf{Net Profit}}{\textbf{Net Sales}}$$

$$\textit{Percentage of Net Profit Ratio} = \frac{\textbf{Net Profit}}{\textbf{Net Sales}} \textit{ X 100}$$

5. **Average Room Rate**

$$\textit{Average Room Rate} = \frac{\textbf{Rooms Revenue}}{\textbf{Paid Rooms Occupied}}$$

6. **Occupancy Percentage**

$$\textit{Occupancy Percentage} = \frac{\textbf{Paid Rooms Occupied}}{\textbf{Rooms Available}} \textbf{ X 100}$$

7. **RevPAR [Revenue Per Available Room]**

$$\text{RevPAR} = \frac{\text{Actual Room revenue (excluding taxes)}}{\text{Number of rooms available}}$$

$$\text{RevPAR} = \text{Occupancy \% X ADR}$$

4.10 Ratios used in Food & Beverage Department

The more common ratios used in financial interpretation of data in Food &Beverage Department are:

1. **Average Food Check**

$$\textit{Average Food Check} = \frac{\textbf{Food Revenue}}{\textbf{Number of Covers}}$$

2. **Food Cost Percentage**

$$\textit{Food Cost Percentage} = \frac{\textbf{Cost of Food Sales}}{\textbf{Food Revenue}} \; \boldsymbol{X\ 100}$$

3. **Beverage Cost Percentage**

$$\textit{Beverage Cost Percentage} = \frac{\textbf{Cost of Beverage Sales}}{\textbf{Beverage Revenue}} \; \boldsymbol{X\ 100}$$

4. **labour cost percentage**

$$\textit{Labour Cost Percentage} = \frac{\textbf{Payroll and Related}}{\textbf{Revenue}} \boldsymbol{X\ 100}$$

5. **Seat Turnover**

$$\textit{Seat Turnover} = \frac{\textbf{Number of Guests Served}}{\textbf{Number of Available Seats}}$$

6. **Inventory Turnover Ratio**

$$\textit{Inventory Turnover Ratio} = \frac{\textbf{Cost of Goods}}{\textbf{Average Stock}}$$

$$\textit{Cost of Goods} = \textit{Opening stock} + \textit{Purchases} - \textit{Closing Stock}$$

$$\textit{The average stock} = \frac{\textbf{Opening Stock} + \textbf{Closing Stock}}{\mathbf{2}}$$

4.11 Computerized Guest Accounting

In computerized hotel accounting, all postings are done at the point of sale (POS) by means of electronic input of data from the revenue outlet. The audit in hotels is done after arbitrary time line known as "***end of the day*** ". Most of the hotels set the end of the day after 11:00 p.m.or according to the policy or standard procedures set by management of the hotel.

4.12 Types of Account

The Hotel accounts are broadly classified as Guest Accounts and non-guest accounts (mostly referred as *Guest Folio*&*non-guestFolio*)

4.12.1 Assigning billing numbers for different accounts

The use of unique billing number alerts the guest accounting module to the type of account to be processed.
Example: - a 6-digit account number may signal a non-guest account.Similarly, a 4- digit number may signal an in-house guest account.

4.12.2 Folios

Folios in most of the accounting modules are: -

- **Individual (Guest) Folios**: assigned to in-house guest. The input involves the Room Number. The Room Number acts as the designated account number.
- Master Folios: - These apply for more than one guest or Room. These are created for billing service required by groups, corporate clients, Event managers & MICE Companies Etc.
- **Employee Folios**: - These folios offer charge privileges to hotel employee's. The transactions are processed in a manner similar to non-guest accounts
- **Control Folios**: -
    - These folios are used to track transactions that are posted to other folios (Individual guestfolio, Master folio, non-guest folio, or employee folio).
    - Control folio acts as a cross checking of all balances in all the electronic folios.
      Example: -
      Step 1: -When an in-house guest makes orders of a Screw Driver cocktail in the Bar, the amount is posted (debited) to the appropriate individual folio (Room Number being the reference point).
      Step 2: - The same amount is simultaneously posted (credited) as a deferred payment to the control folio of the Bar outlet.
      Tracking: - it also tracks allowances,discounts, or corrective vouchers prepared for the day [A correction voucher is a voucher that is used to rectify mistakes posted in a guest account on the same day. an Allowance voucher refers to the amount posted to a folio that cannot be rectified.]
    - It simplifies auditing function (because it serves as a powerful internal control document – in line with the principles of Double entry system)
- **Non-guest Folios**: -
  These folios are created for individuals who have in-house charge privileges but are not registered as guests in the hotel.
  Example: - Health Club members, corporate clients, local celebrity Etc.
  Non-guest account numbers are assigned at the time of creation pf accounts

4.12.3 Posting Entries to Accounts

Account entries can be made from terminals at the front desk or any remote Point of Sale (POS) terminal that interfaces with Property Management System (PMS) and Guest accounting Module.

Sequence of posting entries: -

Data entry requires the following sequence of posting: -

I. **Room Number** or **Account Number**
II. **Identification Code**(by placing first few letters of guest name)
III. **Reference Code**(by placing the serial number of the departmental source document)
IV. **Total Charges** (during this step – the software – compares the current folio balance with the predetermined credit limit (also known as house limit))

4.12.4 Guest Account Settlement

The settlement of guest bills is by cash, credit card, billing to company or signing the travel agent voucher. This is followed by Printing of itemized guest statements

4.12.5 'T' Form of Accounts

In theHotel Accounts, the most prominent is the 'T' Form of accounts. The left side of this form is the Debit entries & the right side is the Credit entries.

The most common debit entries in guest account include the following:

- **Room charges**
- **Food & beverage charges** (Restaurant / coffee shop / bar Etc.)
- **Visitors paid-out**

The Credit Entries in a guest account may include the following: -

- **Prepayment**
- **Payment for part of the bill during stay**
- **Payment for final settlement**

- The guest may have debit or credit balance during his stay in the Hotel.
- At the time of departure,the final bill of the guest is prepared and settled in such a way that the outstanding balance is brought to zero.
- The settlement of accounts means zeroing the balance in a guest folio.

FORMULA

The formula for calculating the outstanding balance is

Opening Balance + Debitentries - Credit Entries = Outstanding Balance

4.12.6 Resolving Guest disputes to Folios

Printing of itemized guest statements with reference to code details because this reduces disputes of guest with hoteliers on guest folio charges

Example: - The Hotel guest Mr. Stefan of #1004 at checkout has found a discrepancy in regards to Food bill in coffee shop outlet.

Standard Operating Procedure

I. The front office cashier will use the reference code to locate the specific food bill details from the coffee shop outlet.
II. The cashier will verify the detailed billing of food items with relevant charges to each of the transactions.
III. This will be followed by updates on posting taxes & guest signature on the credit voucher.

[All above steps are done at clicks of buttons or shortcut keys. – Henceforth, this procedure enables FO cashier to quickly, objectively & efficiently resolve disputes regarding amounts posted to guest folios]

4.12.7 Reports in Hotel Operations

Reports help the management review the profitability of the hotel operations and plan future goals. The night auditor prepares the following reports for the management:

I. High Balance Report

- A night auditor monitors the credit limit of the individual resident guest accounts as well as city accounts.
- The credit limit of a guest account depends upon the credibility of the guest and the floor limit of the guest credit card.
- The night auditor checks every account against the relevant credit limit of that account.
- A high balance report is made in case the account balance reaches or crosses the house limit
- This protects the hotel from the loss of revenue in case the guest leaves without settling her bills

II. Daily Operations Report

- The daily operations report, also known as the manager's report, daily report, and the daily revenue report,
- It provides a means of reconciling cash, bank accounts, revenue, and accounts receivable.

III. Occupancy Ratios:

- **Occupancy Percentage**. This indicates the proportion of rooms either sold or occupied to the number of rooms available during a specific period of time.

- **Multiple Occupancy Ratios**. Also called the double occupancy ratio, it is by determining the average number of guests per room sold or occupied (also called the occupancy multiplier or the multiple occupancy factor).

IV. Rooms Revenue Analysis

- **Average Guest per Room Sold** is calculated as a proportion of number of guests to the total number of rooms sold.
- **Average Daily Rate**. This indicates the proportion of total rooms revenue to the number of rooms sold. This is called the average house rate.
- **Average Rate per Guest**. This indicates the proportion of total rooms revenue to the total number of guests in the hotel.

V. Hotel Income Statement

- The hotel's income statement provides important financial information about the results of hotel operations for a given period of time.
- It is often called a consolidated income statement because it presents a composite picture of all the hotel's financial operations.

VI. Rooms Division Income Statement

- There are references to the departmental income statements prepared by each revenue centre, known as schedules.
- It provides information on total revenue earned by the division

4.13 Tools/Techniques/Methods of Financial Analysis

The following are the important tools which are commonly used for analyzing and interpreting financial statements:

- *Comparative Financial Statements/Horizontal Analysis*
- *Common-size Statements/Vertical Analysis/Cross-Sectional Analysis*
- *Trend Analysis*
- *Ratio Analysis*
- *Funds Flow Analysis*
- *Cash Flow Analysis*

4.14 Hotel Accounting Terminology

Allowances: -Allowances needs authorization from Managers to be implemented.Allowances are usually passed when

- the guest folio has been over charged (e.g. higher room rate),
- wrongly charged for the services not availed by the guests (e.g. coffee shop bill),
- guest denied charges,or
- as a compensation for not a very satisfied services like net connections from the room.

Account transfer: - It takes place incase the guest wishes to pay for another guest or relevant hotel debtor.Again,a proper authorization is needed for such transaction.

Late Charges: -If a Resident Hotel guest takes more than 6 hours from checkout time to vacate the Hotel Room, then he/ she can be charged late charges as per the hotel's policy.The policy of late charges may differ from one hotel to another. Factors like occupancy, profile of the guest in terms of social status, revenue generation,or any special reason like mishandled during the stay are to be considered before making these charges.

Half-Day Charges: -If a Resident Hotel guest takes more than 8 hours from checkout time to vacate the Hotel Room, Then, he/ she can be charged half day charges as per the hotel's policy.The policy of Half-day charges differs from one hotel to another.

Petty Cash:- Any cash purchase made by the hotel staff on behalf of the resident guest.

Cash float: -It is the amount of cash with the cashiers on shift and the amount is dependent on the policy of the hotel and is further dependent on smooth running of the operation and security. There is a cost of money involved as there is no interest on it.

CHECK YOUR PROGRESS-III

1. What is ARR?

2. What is RevPAR?

4.15 Summary

- Depreciation is a process of cost allocation.
- Through depreciation accounting the cost of a tangible asset less salvage value is distributed over the estimated useful life of the asset.
- Depreciation is to be accounted to know the true profit earned by the concern
- Depreciation is to provide funds for replacement of the asset when it is worn out.
- Three prominent methods of depreciation used across business entities are
    - Straight line method,
    - diminishing balance method and
    - annuity method is discussed.
- **Need of Computers in Accounting**: Every medium and large sized organisations require well-established information system in order to generate information required for
    - decision-making and
    - achieving the organisational objectives.
- **MIS:** A management information system provides information necessary to take decisions and manage an organisation effectively.
- **Accounting Information System**: Accounting information system identifies, collects, processes and communicates economic information about an entity to a wide variety of users.
- **Accounting Reports**: Information supplied to meet a particular need is called report. An accounting report must fulfil the following conditions: Relevance Timeliness, Accuracy Completeness & Summarisation

4.16 Glossary

Amortization:*amortization* is the process that allocates the cost of an intangible long-lived asset over its useful life.

Amortization Procedures: For intangible assets, the cost of the intangible asset is directly reduced to reflect its unamortized cost basis.

Book value – the result of the cost of the asset minus its accumulated depreciation.

Depreciation: Permanent and gradual diminution in value of a fixed asset.

Down Value: Book value of an asset after deducting depreciation from the. original cost. It is also called depreciated value.

Obsolescence: Becoming out of date, a cause for depreciation in value of asset.

Residual Value: Expected realizable amount, when the asset is sold out at the end of its useful life,

Salvage value – the estimated scrap or trade-in value of an asset at the end of its useful life

Written Useful life – the service life of an asset for its particular purpose as determined by the company.

Allowances: -Allowances needs authorization from Managers to be implemented.Allowances are usually passed when

- the guest folio has been over charged (e.g. higher room rate),
- wrongly charged for the services not availed by the guests (e.g. coffee shop bill),
- guest denied charges,or
- as a compensation for not a very satisfied services like net connections from the room.

Account transfer: - It takes place incase the guest wishes to pay for another guest or relevant hotel debtor.Again,a proper authorization is needed for such transaction.

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Cash float: -It is the amount of cash with the cashiers on shift and the amount is dependent on the policy of the hotel and is further dependent on smooth running of the operation and security. There is a cost of money involved as there is no interest on it.

Average Guest per Room Sold is calculated as a proportion of number of guests to the total number of rooms sold.

Average Daily Rate. This indicates the proportion of total rooms revenue to the number of rooms sold. This is called the average house rate.

Average Rate per Guest. This indicates the proportion of total rooms revenue to the total number of guests in the hotel.

Occupancy Percentage. This indicates the proportion of rooms either sold or occupied to the number of rooms available during a specific period of time.

Multiple Occupancy Ratios. Also called the double occupancy ratio, it is by determining the average number of guests per room sold or occupied (also called the occupancy multiplier or the multiple occupancy factor).

Individual (Guest) Folios: assigned to in-house guest. The input involves the Room Number. The Room Number acts as the designated account number.

Master Folios: - These apply for more than one guest or Room. These are created for billing service required by groups, corporate clients, Event managers & MICE Companies Etc.

Employee Folios: - These folios offer charge privileges to hotel employee's. The transactions are processed in a manner similar to non-guest accounts

4.17 References and Bibliography

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- A complete Course in Accounting Volume – I, N.D. Kappor
- Double – Entry Book- Keeping, Rc. Chawla & C. Juneja
- Introduction to Accountancy, T.S. Grewal

4.18 Suggested Readings

- Hospitality Management Accounting, Michael M Coltman
- Hotel Accountancy & Finance – S.P. Jain & K.L. Narang, Kalyani Publisher Ludhiana
- Hotel Accounting Earnest B. Horwath & Luis Toth
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4.19 Terminal Questions

Fill in the Blanks

a) …………………are usually passed when the guest folio has been overcharged orwrongly charged for the services not availed by the guests

b) If a Resident Hotel guest takes more than 6 hours from checkout time to vacate the Hotel Room, then he/ she can be charged ……………… as per the hotel's policy.

c) **……………..** is the amount of cash with the cashiers on shift?

State whether the following statements are True or False

a. Depreciation is charged also on current assets. ....

b. Profits will be overstated if depreciation is not charged …………….

c. expense's will-be understated if depreciation is not charged

d. If adequate maintenance expenditure is incurred, depreciation need not be charged

e. Depreciation is charged to reduce the value of asset to its market value

f. Depreciation is charged only on the original purchase price of the asset.

g. When market value of an asset is higher than book value, depreciation-is not charged.

h. The main cause of depreciation is wear and tear caused by its usage.

i. Depreciation is a temporary change in the value of an asset.

j. While calculating depreciation, the scrap value (salvage value) must be taken into account.

k. Under fixed installment reshod of providing depreciation the combined effect of repairs and depreciation is uniform over the year.

l. Under the diminishing balance method, it would be possible to reduce the value of an asset to zero.

m. The interest involved in the investment on assets purchased is ignored under both the fixed installment and the diminishing balance methods.

n. When a Provision for Depreciation Account is initiated, the asset is shown at the original cost in the Balance Sheet.

Long Answer Questions

1. Define depreciation. Distinguish it from depletion, amortization and obsolescence.
2. Explain the need and significance of depreciation. What factors should be considered for determining the amount of depreciation?
3. Explain the different methods of calculating depreciation? Discuss the advantages and disadvantages of fixed depreciation?
4. What are the merits and demerits of written down value method? Distinguish it from straight line method?

5. Describe the methods of recording depreciation in books of account: How is the balance of the Provisions for Depreciation Account shown in the Balance Sheet'?
6. What is Accounting Information System?
7. List the various limitations of computerized accounting systems.
8. Give two examples each of the organisations where ‘ready-to-use’, ‘customised’, and ‘tailored’ accounting packages respectively suitable to perform the accounting activity.
9. Describe the features of computerised accounting system?
10. Define (a) AIS (b) Accounting Packages
11. List the various advantages of computerized accounting systems.

Practical – Problems

1. A cold storage plant was purchased on July 1, 1980 for Rs. 1,00,000. Show the plant Account ruler (a) the Straight-Line Method and (b) the Written Down Value Method. Rate of depreciation charged is 20%. What is the balance of ' plant at the end of the third year?

2. Suresh purchased plant and Machinery for Rs. 50,000 on July 1, 1983. The asset was to be depreciated at the rate of 10 per cent per annum on written down value basis. The machinery was sold on January 1, 1987 for Rs. 32,000. Write up Machinery Account assuming accounting year to end on December 31 every year.

3. On 2-8-2018, a machine was purchased by a manufacturing concern for &. 60,000 and it spent for its overhaul and installation Ks. 10,000. Its effective life was estimated to be ten years and residual value at the end of its life time was estimated to be Rs. 10,000. Show Machine Account for the first three years assuming that the concern, decided to depreciate it under the fixed instalment method. The accounting year ends on December 31, 2018

4. Tofu Ltd. has bought machinery for Rs. 100000 including a boiler worth Rs. 10000. The Machinery Account has been credited for depreciation on the written down value method for the past four years at the rate of 10 %. During fifth year, the boiler became useless on account of damages on critical parts. the damaged boiler is sold for Rs. 5000. Write up the machinery account.