CHAPTER-2

ACCOUNTING PROCESS

UNIT-1

BASIC ACCOUNTING PROCEDURES

JOURNAL ENTRIES

DOUBLE ENTRY SYSTEM:

- ⇒ More than 500 years old.
- ⇒ Luca Pacioli, an Italian friar & mathematician published the first book Summa de Arithmetica, Geometria, Proportioni, et Proportionalita.
- ⇒ Scientific system of accounting.
- ⇒ Every transactions has two-fold aspects - debit and credit.
- ⇒ Systematic and has great use for recording the financial affairs for all institutions requiring use of money.

ADVANTAGES:

* Accuracy of accounting through trial balance.
* Profit or loss suffered can be ascertained
* Financial position through balance sheet.

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* Affords significant information.
* Helps in comparison.
* Used extensively in all countries.

ACCOUNT:

* Summary of transactions relating to a particular item grouped at a particular place.
* Account is in 'T' form.
* Accounts are classified into:
  - i) PERSONAL ACCOUNT:
    - a) Natural Personal Accounts.
    - b) Artificial Personal Accounts.
    - c) Representative Personal Accounts.
  - ii) IMPERSONAL ACCOUNT:
    - a) Real account.
    - b) Nominal account.

i) PERSONAL ACCOUNT:

a) NATURAL PERSONAL ACCOUNT:

* Relates to transactions of human beings.

Eg: Ram a/c, Sita a/c ....

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b) ARTIFICIAL (LEGAL) PERSONAL ACCOUNT:

* Organisations formed by persons.
* Recognised as persons in the eye of law.

Eg: Bank, club, ...

c) REPRESENTATIVE PERSONAL ACCOUNT:

* Represented as personal account and behind that there must be a person.
* Should be asset or liability.

Eg: Outstanding or prepaid account, capital a/c, drawing a/c, receivables or payables a/c, bank loan, PBDD, fixed deposit, ...

ii) IMPERSONAL ACCOUNT:

a) REAL ACCOUNTS:

* Relate to assets of the firm.

Eg: Tangible - land, cash, stock ...
Intangible - trademark, goodwill ...

b) NOMINAL ACCOUNTS:

* Relate to expenses, revenues, losses or gains.
* Temporary account.

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* The net results of all the nominal accounts is reflected as P/L which is transferred to capital a/c

Eg: salary a/c, interest paid a/c, insurance a/c, telephone expenses a/c ...

DEBIT AND CREDIT:

* The terms debit and credit does not mean favourable or unfavourable thing.
* They merely describe the two sides of account

TRANSACTIONS:

* Recorded in the books of accounts.
* Type of event which is external in nature & determined in terms of money.
* They are analyzed, recorded, classified & summarised.
* It is a two way process in which value is transferred from one party to another.
* Supported by source documents like voucher, debit note, credit note, passbook, purchasing invoices, bills, pay-slips, cash-memos ....

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JOURNAL:

* Transactions are first entered in journal
* Also called as subsidiary book.
* It is the book of original entry in which transactions are entered on a daily basis in a chronological order.

JOURNALISING:

* Recording of transaction in journal is called as journalising.

TYPES OF JOURNAL:

* General journal
* Specialised journal.

ADVANTAGES OF JOURNAL:

* Helps to get complete information about the business transactions
* Narration helps in understanding the entry and to know the correctness of the entry.
* Basis for posting the entries in the ledger.
* Helps to reduce the chances of error.

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METHODS OF RECORDING THE TRANSACTIONS:

* Accounting equation approach.
* Traditional approach
    - i) Golden rules of accounting.
    - ii) Modern rules of accounting.

ACCOUNTING EQUATION APPROACH:

* The relationship of assets with that of liabilities and owner's equity in the equation form is called accounting equation.
* Accounting equation holds good at all points of time and for any number of transactions and event except when there are errors in accounting process.

EQUITY + LIABILITIES = ASSETS

EQUITY + LONG TERM LIABILITIES + SHORT TERM LIABILITIES = FIXED ASSETS + CURRENT ASSETS.

ASSETS → What business owns.

CAPITAL & LIABILITIES → What business owes.

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CAPITAL → Contribution by owner.

LOANS OR LIABILITIES → Borrowings.

SHORT TERM LOANS → Repayable within 1 year.

LONG TERM LOANS → Repayable after 4 or 5 years.

FIXED ASSETS → Lasts more than 1 year.

CURRENT ASSETS → Will not remain fixed for long.

EQUITY → Owner's claim or fund.

OWNER'S CLAIM → Capital invested plus profit minus loss.

ASSET = LIABILITIES + CAPITAL / EQUITY.

ASSET = LIABILITIES + CONTRIBUTED CAPITAL + BEGINNING RETAINED EARNINGS + REVENUE − EXPENSE − DIVIDENDS.

CONTRIBUTED CAPITAL → Original capital introduced by the owner.

BEGINNING RETAINED EARNINGS → Previous earings not distributed to the shareholders.

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TRADITIONAL APPROACH:

i) GOLDEN RULES OF ACCOUNTING:

TYPES OF ACCOUNT	ACCOUNT TO BE DEBITED	ACCOUNT TO BE CREDITED
PERSONAL ACCOUNT	Receiver	Giver.
REAL ACCOUNT	What comes in	What goes out.
NOMINAL ACCOUNT	Expenses & losses	Incomes & gains

ii) MODERN RULES OF ACCOUNTING:

TYPES OF ACCOUNT	ACCOUNT TO BE DEBITED WHEN THERE IS:	ACCOUNT TO BE CREDITED WHEN THERE IS
ASSETS	Increase	Decrease
LIABILITIES	Decrease	Increase
CAPITAL	Decrease	Increase
REVENUE	Decrease	Increase
EXPENDITURE	Increase	Decrease
WITHDRAW	Increase	Decrease.

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FORMAT OF JOURNAL :

DATE	PARTICULARS	L.F	Dr. AMOUNT	Cr. AMOUNT

NOTE :

* Journal entries can be single entry (i.e. one debit and one credit) or compound entry (i.e. one debit & two or more credits / two or more debits & one credit / two or more debits & credits). In such cases, it is important to check that the total of both debits & credits are equal.
* If journal entries are recorded in several pages, then both the amount column of each page should be totalled & the balance should be written at the end of that page with the words 'carried forward' and also that the same total should be written the begining of the next page with the words 'brought forward'.

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* When journal entry for two or more transactions are combined, it is called composite journal entry.
* Purchase/sales a/c is a real account as they represents 'flow of goods'.
* Adjusted purchase/sales a/c is a nominal account as they are closed by transferring to 'Trading & profit or loss a/c'.
* Discount, bad debts, bad debts recovered, depreciation, drawings are temporary capital.
* In a transaction, if only the name of the debtor or creditor is given without mentioning whether it is cash/credit purchase/sales, then, the transaction should be treated as credit purchase/sales.
* Trade discount should not be entered in the books of accounts.
* In journal, amounts should be entered in cost price.
* Adjusted purchase is an expense & purchase is an asset.
* Free samples - Advertisement expenses account.

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UNIT - 2

LEDGERS

LEDGER:

* After recording the transactions in the journal, recorded entries are classified and grouped into by preparation of accounts.
* The book which contains all set of accounts is known as Ledger.
* It is known as principal books of account.

FORMAT OF LEDGER ACCOUNT:

Dr.			ACCOUNT				Cr.
DATE	PARTICULARS	J.F	AMOUNT (₹)	DATE	PARTICULARS	J.F	AMOUNT (₹)

POSTING:

* The process of transferring the debit & credit items from journal to classified accounts in the ledger is known as posting.

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* The concerned account debited in the journal should also be debited in the ledger but reference should be of the respective credit account.

BALANCING AN ACCOUNT :

* If the credit side is bigger than the debit side, it is a credit balance.
* If the debit side is bigger than the credit side, it is a debit balance.
* Only real & personal accounts are balanced.
* Nominal accounts are not balanced. The balance in the end are transferred to the profit & loss account.

NOTE :

* Ledger records transactions in analytical order.

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UNIT - 3

TRIAL BALANCE

TRIAL BALANCE:

* Contains various ledger balances on a particular date.
* Basis for preparing final accounts
* Checks arithmetical accuracy of the books.
* Third phase of the accounting process.
* If the trial balance tallies, the accounting work is free from clerical errors.
* Though, errors of principle and compensating errors may still remain.
* Trial balance is statement and not an account.
* Though a trial balance can be prepared any time, it is preferable to prepare it at the end of the year.

OBJECTIVES OF PREPARING THE TRIAL BALANCE:

* Helps to establish arithmetical accuracy of the books.

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* Helps in preparation of financial statements.
* Serves as a summary of what is contained in the ledger.

LIMITATIONS OF TRIAL BALANCE:

* Transaction has not been entered at all in the journal.
* An entry has not at all been mentioned in the journal.
* A wrong amount has been written in both columns of the journal.
* A wrong account has been mentioned in the ledger.
* Entry is posted twice in the ledger.

Even though trial balance is prepared to check the arithmetical accuracy of the books, these errors may still remain.

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FORMAT OF TRIAL BALANCE:

TRIAL BALANCE AS AT ....

S.NO	LEDGER ACCOUNTS	L.F	Dr. AMOUNT (Total or balance) ₹	Cr. AMOUNT (Total or balance) ₹

METHODS OF PREPARATION OF TRIAL BALANCE:

1) TOTAL METHOD:

* Every ledger account is totalled and that total amount of both debit & credit side is transferred to trial balance.
* This method is not commonly used as it cannot help in the preparation of the financial statements.

2) BALANCE METHOD:

* Every ledger account is balanced and those balances are only carried forward to the trial balance

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* This method is commonly used as it helps in preparing the financial statements.

3. TOTAL AND BALANCE METHOD:

* Under this method the above two methods are combined and statement of trial balance contains seven columns instead of five columns.

ADJUSTED TRIAL BALANCE:

* If the trial balance does not agree after transferring all the ledger balances and errors are not located timely, then the difference of debit & credit side is transferred to an account known as suspense account.
* This is a temporary account opened to prepare financial statements timely.

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UNIT-4

SUBSIDIARY BOOKS

SUBSIDIARY BOOKS:

* A separate register to record cash receipts and payments, sale of goods and their purchases is called subsidiary book.
* It is a book of original entry or of prime entry.
* For transactions recorded in such books there will be no journal entry.
* The system by which transactions of a class are first recorded in the book, specially meant for it and on the basis of which ledger accounts are then prepared is known as the Practical System of Book-Keeping or even the English System.
* There is no departure from the rules of the double entry system.

ADVANTAGES OF SUBSIDIARY BOOKS:

* Division of work.
* Specialization & efficiency.
* Saving of the time.

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* Availability of information.
* Facility in checking.

DIFFERENCE BETWEEN SUBSIDIARY BOOKS & PRINCIPAL BOOKS :

* The books in which transactions are first recorded to enable processing are called subsidiary books.
* The books which furnish information for preparation of the trial balance and financial statements are called principal books.

PURCHASE BOOK :

* Only credit purchase of goods are recorded.
* The particulars column is meant to record the name of the supplier and name of the articles purchased and the respective quantities.
* The details column is meant to enter the amount in respect of each article.
* The amount column is meant to enter amount of single purchase including amount for packing, or other charges is added and the amount for trade discount is deducted.

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FORMAT OF PURCHASE BOOK:

PURCHASE DAY BOOK

DATE	PARTICULARS	INVOICE NO.	L.F	DETAILS ₹	AMOUNT ₹

SALES BOOK:

* Only credit sale of goods are recorded.
* The particulars column will record the name of the customers concerned together with particulars and quantities of the goods sold.
* The details column is meant to enter the amount in respect of each sale.
* The amount column is meant to enter total amount for one sale; Charges for packing, etc., are added and the trade discount, if any is deducted.

FORMAT OF SALES BOOK:

* Same format as like the purchase day book.

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PURCHASE RETURN BOOK:

* Shows the total Purchase returns made.
* When goods are returned to suppliers, the firm returning goods will issue a debit note to the supplier, indicating the amount for which the supplier is liable on account of the return.

FORMAT OF PURCHASE RETURN BOOK:

PURCHASE RETURN BOOK

DATE	PARTICULARS	DEBIT NOTE NO.	L.F	DETAILS (₹)	AMOUNT (₹)

SALES RETURN BOOK:

* Shows total sales return made.
* When goods are returned by customers, credit note is issued to the customers concerned, indicating the amount to be credited to the customer's account.

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FORMAT OF SALES RETURN BOOK:

SALES RETURN BOOK.

DATE	PARTICULARS	CREDIT NOTE NO	L.F	DETAILS (₹)	AMOUNT (₹)

BILLS RECEIVABLE BOOK:

* If the firm usually receives a number of promissory notes or hundies, it would be convenient to record the transaction in a separate book called the Bills Receivable Book.

BILLS PAYABLE BOOK:

* If promisory notes or hundies are frequently issued, the Bills Payable Book will be convenient

JOURNAL PROPER:

* Opening entries.
* Closing entries

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* Rectification entries.
* Transfer entries.
* Adjusting entries.
* Entries on dishonour of bills
* Miscellaneous entries.

FORMAT OF BILLS RECEIVABLE BOOK:

BILLS RECEIVABLE BOOK (FOLIO NO...)

DATE OF RECEIPT	V. No.	PARTY FROM WHOM RECEIVED	ACCEPTOR	DATE OF BILL	DUE DATE	PLACE OF PAYMENT	Amt.	L.F	MODE OF DISPOSAL

FORMAT OF BILLS PAYABLE BOOK:

BILLS PAYABLE BOOK (FOLIO NO...)

DATE OF ACCEPTANCE	DRAWER	PAYEE	DATE OF BILL	DUE DATE	PLACE OF PAYMENT	Amt.	L.F.	MODE OF DISPOSAL

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UNIT-5

CASH BOOK

CASH BOOK:

* Cash book is a subsidiary book as cash transactions are straightaway recorded in the cash book &, on the basis of such a record, ledger accounts are prepared.
* Cash book is a principal book as the cash book itself serves as the cash account & bank account.
* Thus, cash book is both a subsidiary book and a principal book.

KINDS OF CASH BOOK:

* MAIN CASH BOOK:
  - i> Simple cash book.
  - ii> Two-column cash book.
  - iii> Three-column cash book.
* SUBSIDIARY BOOK:
  - i> Petty cash book.

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SIMPLE CASH BOOK:

* Only cash receipts and cash payments are recorded.
* Always shows debit balance, i.e., the total of debit side is always greater than the total of credit side since the payment cannot exceed the available cash.
* It is like an ordinary cash account.

FORMAT OF SIMPLE CASH BOOK:

Dr. CASH BOOK Cr.

DATE	RECEIPTS	L.F	AMOUNT (₹)	DATE	PAYMENTS	L.F	AMOUNT (₹)

TWO-COLUMN CASH BOOK:

* Along with amount column to record cash receipts & payments, amount column to record discount allowed & received or to record bank receipts & payments is added.

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* Discount columns in the cash book are not balanced. They are only totalled.
* Their totals are entered in the discount received / paid account in the ledger.

FORMAT OF TWO-COLUMN CASH BOOK:

Dr. TWO - COLUMN CASH BOOK Cr.

DATE	RECEIPTS	L.F	BANK/ DISCOUNT (₹)	AMOUNT (₹)	DATE	PAYMENTS	L.F	BANK/ DISCOUNT (₹)	AMOUNT (₹)

THREE - COLUMN CASH BOOK:

* There are three amount columns, namely cash receipts & payments, discount received & allowed, bank receipts & payments.
* While commencing a new business, the amount is written in the cash column if cash is introduced and in the bank column if it is directly put into the bank with the description "To capital Account".

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* If a new cash book is being started for an existing business, the opening balances are written as : "To balance b/d".
* When cash is deposited in bank, the amount is recorded in the bank column on the receipt side and in the cash column on the payment side.
* Likewise, when cash is withdrawn from the bank, the amount is recorded in the cash column on the receipt side and in the bank column on the payment side.
* These are called contra entries and against such entries, the letter "C" should be written in the L.F column, to indicate that these are contra transaction & no further posting is required for them.
* In three-column cash book, discount columns are not balanced but totalled.
* Cash & bank column are balanced in the same manner as cash account.

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FORMAT OF THREE - COLUMN CASH BOOK :

Dr. THREE - COLUMN CASH BOOK Cr.

DATE	RECEIPTS	L.F	DISCOUNT	CASH	BANK	DATE	PAYMENTS	L.F	DISCOUNT	CASH	BANK
			(₹)	(₹)	(₹)				(₹)	(₹)	(₹)

PETTY CASH BOOK :

* For small payments, petty cash book is maintained separately recording the particulars of payment and its amount.
* The fixed amount is given to the petty cashier for making small payments in the begining of the period.
* The amount spent is replenished so that he will have again the fixed sum in the begining of the next period.
* This system is known as imprest system of petty cash book.
* This system is very useful specially if an analytical petty cash book is used.

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* The petty cashier should not be allowed to receive any cash except for reimbursement.

POSTING THE PETTY CASH BOOK:

* From the petty cash book the total of the various columns may be directly debited to the concerned accounts ; or
* A journal entry may first be prepared on the basis of the petty cash book, debiting the accounts shown by the various analysis columns, and crediting the total of the payment of the petty cash account.

ADVANTAGES OF PETTY CASH BOOK:

* Saving of time of the chief cashier.
* Saving in labour in writing up the cashbook and posting into the ledger.
* Control over small payments.

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FORMAT OF PETTY CASH BOOK:

PETTY CASH BOOK

RECEIPTS (₹)	DATE	V.NO	PARTICULARS	TOTAL (₹)	CONVEYANCE (₹)	CARTAGE (₹)	STATIONERY (₹)	POSTAGE (₹)	WAGES (₹)	SUNDRIES (₹)

ENTRIES FOR SALE THROUGH DEBIT & CREDIT CARDS:

* Generally bank charges annual subscription fees from the credit card holder. No fee is charged in case of Debit Card, though some banks charge a nominal fee on Debit card.
* When the card holder intends to buy some goods or services through credit or debit card, the seller fills in a form, generally in triplicate, the details of the goods with the amount of sales and uses the embossed card with the help of the credit card machine to print the data on that form. Also customer has to countersign the form. One carbon copy of the form is given to the customer for the record.

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* The bank issuing the card, charges commission for each such transaction, which varies between 1% to 4% and is immediately debited to seller's bank account.

ENTRY:

1. Bank a/c Dr.

    To sales a/c

    [sales made through credit/debit card]

2. Commission a/c Dr.

    To Bank a/c

    [Commission charged by bank]

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UNIT-6

RECTIFICATION OF ERRORS.

STAGES OF ERRORS:

1, AT THE STAGE OF RECORDING THE TRANSACTIONS IN JOURNAL:

* Errors of principle.
* Errors of omission.
* Errors of commission.

2, AT THE STAGE OF POSTING THE ERRORS:

* Errors of omission
  a, Partial omission.
  b, Complete omission.
* Errors of commission.
  a, Posting to wrong account.
  b, Posting on the wrong side.
  c, Posting of wrong amount.

3, AT THE STAGE OF BALANCING THE LEDGER ACCOUNTS:

* Wrong totalling of accounts
* Wrong balancing of accounts.

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4, AT THE STAGE OF PREPARING THE TRIAL BALANCE:

* Errors of omission.
* Errors of commission.
  a, Taking wrong account.
  b, Taking wrong amount.
  c, Taking to the wrong side.

TYPES OF ERRORS:

* Errors of principle.
* Clerical errors.
  a, Errors of omission.
  b, Errors of commission.
  c, Compensating errors.

TYPES OF ERRORS FROM ANOTHER POINT OF VIEW:

* Errors affecting the trial balance
* Errors does not affecting the trial balance.

RECTIFICATION OF ERROR:

* If the errors are located after some time, the correction Should be made by making another suitable entry, called rectification entry.

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* It is better to begin the checking with the nominal accounts.
* The rectification of an error depends on at which stage it is detected.
* An error can be detected at any one of the following stages.
  i) Before preparation of trial balance.
  ii) After trial balance but before the final accounts are drawn.
  iii) After final accounts, i.e., in the next accounting period.

BEFORE THE PREPARATION OF TRIAL BALANCE:

* Errors that are detected before the preparation of trial balance can be rectified without opening suspense account either through rectification statements or through rectification entries.

AFTER THE PREPARATION OF TRIAL BALANCE:

* Opening balance in the suspense account will be equal to the difference in trial balance.

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* If the question is silent as to whether a suspense account has been opened, we have to make a assumption that it is stated clearly & then proceed.

AFTER THE PREPARATION OF FINAL ACCOUNTS:

* Correction of all amounts concerning nominal accounts, i.e., expenses & incomes should be through a special account styled as "Prior period items" or "profit & loss adjustment account".
* "Prior period items" are material income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial Statements of one or more period.

BASIS	BEFORE TRIAL BALANCE	AFTER TRIAL BALANCE	AFTER FINAL ACCOUNTS
RULE:	Perfect journal entry is not needed.	There must be a perfect journal entry.	Expenses/income = Profit/loss adjustment a/c.

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1, Purchase day book undercast by ₹100.	Purchase a/c Dr ₹100.	Purchase a/c Dr 100 To suspense a/c 100	P/L adj a/c Dr 100 To suspense a/c 100
2, wages paid for the errection of the machinery ₹100 wrongly debited to wages a/c.	Machinery a/c Dr 100 To wages a/c 100	Machinery a/c Dr 100 To wages a/c 100	Machinery a/c Dr 100 To wages a/c 100

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CHAPTER - 3

BANK RECONCILIATION STATEMENT

BANK RECONCILIATION STATEMENT:

* To reconcile means to identify or find out the difference between two different sources and eliminating that difference.
* Whenever we deposited or withdraws money from banks, it is always recorded at two places:
  i) Bank column of the cash book (in customer books)
  ii) Bank statement (passbook, i.e., in the banks books)
* The process of eliminating the difference between the cashbook & passbook and bringing the two statements in line with each other is known as "Reconciliation".
* The statement which reconciles the bank balance as per cash book with the balance as per the pass book by showing all the causes of difference is known as "Bank Reconciliation Statement".

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SERVICES RENDERED BY BANKS:

* Receives deposits.
* Handles cash transactions.
* Discounts promissory notes or hundies.
* Allows overdraft to its good customers.
* Gives loans as financial assistance.
* Collects the amount of dividend or interest,...
* Makes payments of insurance premium, rent,...
* Sells & purchases shares, debentures or govt. securities.
* Helps in remittance of money to another place or persons.
* Furnishes security or guarantee to its good customers.
* Issues letter of credit or traveller's cheque.

IMPORTANCE / FEATURES OF BANK RECONCILIATION STATEMENT:

* Important tool / mechanism for internal control of cash flows
* Bring out the errors committed either in cash book or pass book.

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* Undue delay in the clearance of cheque will be shown up.
* Discourages the accountant of the bank from embezzlement.
* Helps in finding the true or actual position of the bank balance.

CAUSES OF DIFFERENCE:

i) TIMING:

* Cheques deposited
* Cheques issued

ii) TRANSACTIONS:

* Interest received
* Bank charges

iii) ERRORS:

* Errors made either by bank or by customer.
* For this reason, rectification of errors is required to be done in both the statements before preparing any BRS.
* Commission of entry, recording of an incorrect amount, recording of entry on the

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wrong side of the book, wrong totalling of the account or wrong balancing of the book and recording of transactions of other party are some of the errors.

POINTS TO REMEMBER -1 :

* Balance as per cash book (Cr) / unfavourable balance as per cash book / Overdraft balance as per cash book are same.
* Balance as per passbook (Dr) / unfavourable balance as per pass book / overdraft balance as per pass book are same.

POINTS TO REMEMBER -2 :

* In favourable balance, we have to add or deduct according to the changes in ending point.
* In unfavourable balance, we have to add or deduct according to the changes in starting point.

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POINTS TO REMEMBER - 3

* While preparing BRS, only bank column of the cash book is ~~only~~ relevant.
* Bank column of the cash book is also called as bank book / bank account / SBI account in the books of KS.

POINTS TO REMEMBER - 4:

* Business enterprise treats the bank as a debtor / trade receivables.
* Bank treats the business enterprise as a creditor / trade payables.

DIFFERENCE BETWEEN TIME OF RECORDING IN CASH BOOK & PASS BOOK:

TRANSACTION	TIME OF RECORDING IN CASH BOOK	TIME OF RECORDING IN PASS BOOK
Payment done by the account holder through issuing a cheque.	• At the time of issuing the cheque.	• At the time of presenting the cheque to the bank for payment or clearing of funds.

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Receipt by the account holder through a cheque.	• At the time of depositing the cheque into the bank comes into notice.	• At the time of collection of amount from the account of the issuing party.
Collection of bills/cheque directly on behalf of the account holder.	• When the entry posted in the pass book comes into notice.	• When the amount is collected by the bank.
Direct payment to the third party on behalf of the account holder.	• When the entry posted in the pass comes into notice.	• When the amount is paid by the bank.
Dishonour of cheque/bills receivable.	• When the entry posted in the pass book comes into notice.	• When the cheque is dishonoured.

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Bank charges levied by the bank	• When the entry posted in the pass book comes into notice.	• When charges are levied by the bank.
Interest & dividend credited by the bank.	• When the entry posted in the pass book comes into notice.	• When interest or dividend is allowed or collected by the bank.
Interest debited by the bank.	• When the entry is posted in the pass book comes into notice.	• When the interest is charged by the bank.

ADJUSTED CASH BOOK :

* When the balance in the cash book is first adjusted for certain adjustments before taking it to the bank reconciliation statement, then it is known as adjusted cash book balance.

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* Adjusting the cashbook balance before preparing the bank reconciliation statement is completely optional, if reconciliation is done during different months.
* But if the reconciliation is done at the end of the accounting year or financial year, the cash-book must be adjusted so as to reflect the correct bank balance in the balance sheet.
* In BRS, particularly, only 3 items can be come. They are:
  i) Cheques deposited but not credited in passbook.
  ii) Cheques issued but not debited in passbook.
  iii) Errors in passbook.
* Other than these three transactions, all the other transactions will be adjusted in cash book.

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CHAPTER - 4.

INVENTORIES

INVENTORY:

IN CASE OF MANUFACTURING CONCERNS:

* Raw materials.
* Work-in-progress.
* Finished goods.
* Stores & spares.
* Packing material.
* Stock of consumables.
* Maintanence supplies.
* Loose tools.

IN CASE OF TRADING CONCERN:

* Traded goods [Stock in trade]

INVENTORY VALUATION:

1) DETERMINATION OF INCOME:

* The effect of misstatement of inventory figure on the net income is always through cost of goods sold.

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* Thus, proper calculation of cost of goods sold and for that matter, proper valuation of inventory is necessary for determination of correct income.

2, ASCERTAINMENT OF FINANCIAL POSITION:

* Inventories are classified as current assets.
* The value of inventory on the date of balance sheet is required to determine the financial position of the business.

3, LIQUIDITY ANALYSIS:

* Current ratio which studies the relationship between current assets & current liabilities is significantly affected by the value of inventory.

4, STATUTORY COMPLIANCE:

i, SCHEDULE III TO THE COMPANIES ACT, 2013:

* Requires valuation of each class of goods i.e., raw material, work-in-progress and finished goods under broad head to be disclosed in the financial statements.

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ii) ACCOUNTING STANDARDS:

* The accounting policies adopted in measuring inventories, including the cost formula used.

* The total carrying amount of inventories and its classification appropriate to the enterprise.

BASIS OF INVENTORY VALUATION:

* Inventories should be valued at the lower of cost or net realisable value.

* This principle is governed by "Principle of conservative Accounting"

COST:

As per Accounting Standards, Cost of inventories should comprise:

* all cost of purchase.

* cost of conversion (primarily for finished goods and work - in progress)

* other costs incurred in bringing the inventories to their present location and condition.

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COST OF PURCHASE :

* Includes any amount paid to the seller such as duties & taxes, freight inwards reduced by any discounts, rebate, duty drawbacks given by the seller.
* Similarly, any duties paid to the supplier will be part of cost of the inventory unless the enterprises can recover these taxes duties from the authorities.

COST OF CONVERSION :

* Includes costs directly related to the units of production, such as direct labour.
* They also include a systematic allocation of fixed and variable overheads.

OTHER COSTS :

* Administrative overheads incurred to bring the inventory into present location and condition.
* Interest & other borrowing costs only if the production process is longer. e.g: wine, rice & timber.

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EXCLUSIONS FROM COST OF INVENTORIES:

* Administrative overheads.
* Interest of other finance expenses.
* Selling & distribution expenses.
* Storage expenses after production.
* Abnormal loss of goods.

NET REALIZABLE VALUE:

* Market price per unit less estimated expense to complete the product and estimated expenses to make sale.
* FINISHED GOODS: Selling price less selling & distribution expenses.
* WORK-IN-PROGRESS: Selling price less expenses and overheads required to be incurred to convert work-in-progress into finished goods and making it ready for sale.
* RAW MATERIALS: Replacement cost.

INVENTORY RECORD SYSTEMS:

PERIODIC INVENTORY SYSTEM:

* Method of ascertaining inventory by taking an actual physical count at a particular date.

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* It is also called physical inventory system.
* Used by small enterprises.

OPENING INVENTORY (KNOWN) + PURCHASES (KNOWN) - CLOSING INVENTORY (PHYSICALLY COUNTED) = COST OF GOODS SOLD.

ADVANTAGES:

* Simple
* Less expensive.

DISADVANTAGES:

* It requires closure of normal operations of business.
* Not possible to identify loss of goods as COGS is taken as residual figure.
* Inventory control is not possible.
* Difficult to plan operations such as how much or when to order / manufacture as books of accounts does not reflect inventory in hand and its value.

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* Physical inventory taking is required more than once a year for preparation of quarterly or half yearly financial statements thereby making this system more expensive.

PERPETUAL INVENTORY SYSTEM:

* System of recording inventory balances after each receipt and issue.

OPENING INVENTORY (KNOWN) + PURCHASES (KNOWN) - COST OF GOODS SOLD (KNOWN) = CLOSING INVENTORY (BALANCING FIGURE)

ADVANTAGES:

* Helps to overcome the limitations of periodic system.

DISADVANTAGES:

* Costlier method.
* As inventory is taken as residual figure, it includes loss of goods.

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DIFFERENCE BETWEEN PERIODIC INVENTORY SYSTEM AND PERPETUAL INVENTORY SYSTEM:

* Periodic inventory system & perputual inventory - both are not mutually exclusive & complementary in nature.

PERIODIC INVENTORY SYSTEM	PERPETUAL INVENTORY SYSTEM
* Based on physical verification.	* Based on book records.
* Provides information about inventory & cost of goods sold at a particular date.	* Provides continuous information about inventory & cost of sales.
* Determines inventory & takes cost of goods sold as residual figure	* Determines cost of goods sold directly & computes inventory as balancing figure.
* Simple & less expensive.	* Costlier method.

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* Cost of goods sold includes loss of goods as goods not in inventory are assumed to be sold.	* Closing inventory includes loss of goods as all unsold goods are assumed to be in the inventory.
* Inventory control is not possible.	* Inventory control can be exercised.
* Requires closure of business for counting of inventory.	* Does not require closure of business for counting of inventory.

METHODS TO DETERMINE THE COST OF INVENTORY:

1, HISTORICAL COST METHOD:

a, SPECIFIC IDENTIFICATION METHOD:

* Price is based on actual physical flow.
* This method is used to ascertain the cost of inventories of items that are not ordinarily interchangeable &, their value is high like expensive medical equipment.

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b) FIFO:

* It is used in case of perishable goods & items with frequent technological changes.

c) LIFO:

* It is based on the principles of matching current cost with current revenue as cost of recently purchased or produced goods are charged to cost against each sale.

d) SIMPLE AVERAGE PRICE METHOD:

* All the different prices are added together and then divided by the number of prices.
* It is used by entities using periodic inventory method as it is very simple.

e) WEIGHTED AVERAGE METHOD:

* As simple average price does not consider quantities purchased in various lots, weighted average price is computed using the quantities purchased in a lot as weights.

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FORMAT:

DATE	RECEIPTS			ISSUES			BALANCE INENTORY		
	Qty	Rate	Amount	Qty	Rate	Amount	Qty	Rate	Amount

POINTS TO REMEMBER:

* For the above methods, there will be difference in cost of goods sold & value of closing inventory between periodic inventory System & perpetual inventory system.
* FIFO & weighted average price method are popular among business entities & are permitted by Accounting Standards.
* LIFO method is not permitted by Accounting Standards.

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2) NON-HISTORICAL COST METHOD:

a) ADJUSTED SELLING PRICE METHOD:

* Also called as retail inventory method.
* Used widely in retail business or in business where the inventory comprises of items, the individual costs of which are not readily ascertainable.
* Cost price of inventory = Selling price of inventory - profit margin.
* Gross profit margin = $\frac{\text{Gross profit} \times 100}{\text{Selling price of goods available for sale}}$
* Selling price of goods available for sale = sales + selling price of closing stock.

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CHAPTER - 5

CONCEPT AND ACCOUNTING OF DEPRECIATION.

DEPRECIATION:

* The value of portion of property, plant and equipment utilized for generating revenue during an accounting year is called depreciation.
* As per schedule II under the companies Act, 2013, depreciation is the systematic allocation of the depreciable amount of an asset over its useful life.
* The depreciable amount of an asset is the cost of an asset or other amount substituted for cost, less its residual value.
* The useful life of an asset is the period over which an asset is expected to be available for use by an entity, or the number of production or similar units expected to be obtained from the asset by the entity.

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IMPORTANT FACTORS FOR COMPUTING DEPRECIATION:

* Estimated useful life of the asset.
* Cost of the asset.
* Residual value of the asset at the end of its estimated useful life.

CAUSES OF DEPRECIATION:

* Wear and tear due to its use in business.
* Efflux of time even when it is not being used.
* Obsolescence due to technological or other changes.
* Decrease in market value.
* Depletion mainly in case of mines and other natural reserves.

POINTS TO REMEMBER:

* Depreciation of an asset begins when it is available for use, i.e., when it is in the location and condition necessary for it to be capable of operating in the manner intended by management.
* Thus it is not necessary that an asset must be used to be depreciated.

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* Depreciation is allocated so as to change a fair proportion of the depreciable amount in each accounting period during the expected useful life of the asset.
* Depreciation for a period helps to charge that portion of the cost of the asset against the revenues earned, which is expired for that period and hence follows matching principle.
* In other words total cost of the asset is reflected in form of a, Expired cost (depreciation) and b, unexpired cost which shall be the written down value of the asset being reflected in balance sheet.
* Also charging depreciation every year reduces the distributable profits & hence ensuring the availability of funds whenever the replacement is required.
* Accounting standards as well as the Companies Act, 2013 requires depreciation to be charged on a component basis.

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* Each part of an item of Property, Plant and Equipment with a cost that is significant in relation to the total cost of the item should be depreciated separately.
* Depreciation is a non-cash expense and does not result in any cash outflow.

OBJECTIVES FOR PROVIDING DEPRECIATION:

* Correct income measurement.
* True position statement.
* Funds for replacement.
* Ascertainment of true cost of production.

COST OF THE ASSET:

* Cost of the asset includes:
  i) Purchase price including non-refundable import duties and purchase taxes, after deducting trade discounts & rebate.
  ii) Any cost directly attributable to bring the asset to the location and condition necessary for it to be capable of operating in a manner intended by the enterprise.

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iii) the initial estimate of the costs of dismantling, removing, the item and restoring the site on which an asset is located.

* Cost of the asset does not include:

i) Inauguration costs

ii) Advertisement cost.

iii) Administation & other general overheads.

USEFUL LIFE OF ASSET:

* Period over which a depreciable asset is expected to be used by the enterprise.

* The number of production or similar units expected to be obtained from the use of the asset by the enterprise.

SCRAP / RESIDUAL VALUE:

* Estimated at the time of acquisition / installation, or at the time of subsequent revaluation of asset.

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$$DEPRECIATION = \frac{DEPRECIABLE\ AMOUNT}{ESTIMATED\ USEFUL\ LIFE}$$

Where,

Depreciable amount = Cost of asset - Scrap value.

METHODS FOR PROVIDING DEPRECIATION:

1, STRAIGHT LINE METHOD:

* Equal amount is written off every year.
* Simple to apply and gives accurate results especially in case of leases, and also in case of plant and machinery.
* Also known as Fixed Instalment Method.
* This method can be applied for assets which have insignificant repairs & maintenance expenditures.
* Under income tax rules depreciation is provided for full year if the asset was used for more than 180 days in a particular financial year.

$$Depreciation\ rate = \frac{Depreciation}{Cost\ of\ Asset} \times 100$$

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2. REDUCING BALANCE METHOD:

* Also known as diminishing balance method or written down value method.
* Commonly used for plants & fixtures.

$$\text{Depreciation rate} = \sqrt{\frac{\text{Residual value}}{\text{Cost of asset}}} \times 100$$

3. SUM OF YEARS OF DIGITS METHOD:

Total depreciation value

$$= (\text{cost of asset} - \text{scrap value}) \times \frac{\text{Sum of No. of years of remaining life of asset}}{n(n+1)/2}$$

Depreciation

$$= (\text{cost of asset} - \text{scrap value}) \times \frac{N}{\frac{n(n+1)}{2}}$$

Written down value

= Total cost of asset − Total depreciation value.

4. MACHINE HOUR METHOD:

* Where it is practicable to keep a record of the actual running hours of each machine, depreciation may be calculated using this method.

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* It is a slight variation of straight line method.

Annual depreciation

$$= \frac{\text{Effective hour}}{\text{Estimated total working hour}} \times (\text{Cost of the asset} - \text{scrap value})$$

5. PRODUCTION UNIT METHOD:

* Applicable to machines producing product of uniform specifications.

Annual depreciation

$$= \frac{\text{Production during the period}}{\text{Estimated total production}} \times (\text{cost of the asset} - \text{scrap value})$$

6. DEPLETION METHOD:

* Depletion is the allocation of the cost of wasting natural resources such as oil, gas, timber, and minerals to the production process.

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* Used in case of mines, quarries, etc., containing only a certain quantity of product.

Annual depreciation

$$= \frac{\text{Quantity extracted during the period}}{\text{Estimated quantity of product likely to be available to be extracted}} \times \text{cost of asset}.$$

Depreciation rate

$$= \frac{\text{Cost of asset}}{\text{Estimated quantity of product likely to be available to be extracted}}$$

JOURNAL ENTRIES:

1. Machinery purchased:

Machinery a/c Dr.
To bank a/c

2. Installation charges:

Machinery a/c Dr.
To bank a/c

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3, Depreciation :

Depreciation a/c Dr.

To machinery a/c

4, Depreciation transferred to P & L a/c :

Profit & loss a/c Dr.

To depreciation

5, Machinery sold :

Bank a/c Dr.

To machinery a/c

6, Profit on sale of machinery :

Machinery a/c Dr.

To profit & loss a/c

7, Loss on sale of machinery :

Profit & loss a/c Dr.

To Machinery a/c

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CHANGE IN THE METHOD OF DEPRECIATION:

* Whenever any change in depreciation method is made, such change in method is treated as change in accounting estimate as per Accounting Standards.
* Its effect needs to be quantified and disclosed separately.
* A change in an accounting estimate may affect the current period only or both the current period and future period.

REVISION OF THE ESTIMATED USEFUL LIFE OF PROPERTY, PLANT AND EQUIPMENT.

* The depreciation method, residual value & useful life applied to an asset should be reviewed at least at each financial year-end and, if there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, on account of the above, they should be changed to reflect the changed pattern.

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* Whenever there is a revision in the estimated useful life of the asset, the balance depreciable amount should be charged to the asset over the revised remaining estimated useful life of the asset.

REVALUATION OF PROPERTY, PLANT & EQUIPMENT:

* Whenever the depreciable asset is revalued, the depreciation should be charged on the revalued amount on the basis of the remaining estimated useful life of the asset.

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