MGT101 PPT Slides (Module) 1 To 09 Complete

Chapter - 1
Basics of Financial Accounting

Video number 1-11 are mandatory part of this module

MGT 101
Financial Accounting

By
Mian Ahmad Farhan, FCA

Contents

Basics of Financial Accounting

Definition of Accounting and Financial Information

Accounting

Is accounting:

- process
- activity
- system
- subject

Source of images: Google

Accounting is a Language

Language is a medium that is used to

1. **communicate**
2. **understand**

some

- ideas
- policies
- plans
- information

Source of images: Google

Definition of Accounting

Accounting is a <u>language</u>
that is used to
1. communicate and
2. understand

the
- financial ideas
- financial policies
- financial plans
- financial information

Source of images: Google

Branches of Accounting

Financial Accounting
- financial information

Management Accounting
- financial ideas
- financial policies
- financial plans

Source of images: Google

Financial information

An information that is
1. measurable in terms of money, and
2. causing a change in financial position

of an entity

Source of images: Google

Important Tips To Remember - ITTR

1. Accounting is a language
2. Financial information is measurable in terms of money and belongs to the past

Basics of Financial Accounting

Sources of Financial Information

Sources of Financial Information

There are three sources of financial information

i. Transactions
ii. Events
iii. Conditions

also known as <u>accounting phenomena</u>

Transaction

Transaction occurs when two persons deal with each other.

<u>Social motives dealings</u>
Social transaction

birthday gift etc.

<u>**Economic benefits dealing**</u>
Accounting transaction

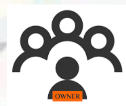
monetary dealing between the entity and other person



Source of images: Google

Accounting Transaction

Dealing between entity and other persons:



1. entity with owner/s
2. entity with any person other than the owner/s

There are two *criteria* to identify an accounting transaction:

1. Measurability in terms of money
2. Dealing of the entity with other person


Source of images: Google

Practice 1.1

Keeping in view the criteria, identify which of the following information is accounting transaction:

1. Payment of staff salaries made by cheque.
2. Appointing a production manager on contract.
3. Having a conversation with foreign supplier for import of raw material.
4. Placing an order for purchase of production machine.
5. Purchasing motor vehicle and paying cash for the price.

Practice 1.2

Identify accounting transactions:

1. Up-keeping expenses of building paid by cheque.
2. Collection of dues from customers.
3. Negotiating with bank for taking loan.
4. Receiving cash against loan from bank.
5. Payment of personal expenses of the owner in cash.

Event

Event means anything that happens. There are two types of events:

1. Monetary
2. Non-Monetary

Monetary Event

Examples include:

- *Loss by fire*
- *Loss by accident*
- *Foreign exchange (gain/loss)*

Non-Monetary Event

Examples include:

- *Winning or losing a game that does not carry financial impacts*

Condition

Condition covers certain adjustments in already recorded transactions and events.

Examples include:

- **Provision to be created against expected doubtful recovery from customer**
- **Fixed Assets to be depreciated according to their expected useful life**

Source of images: Google

Practice 1.3

Which of the the following information is **Transaction**, **Event** or **Condition**:

1. Stock in godown lost by fire
2. Giving away gifts to employees of the entity
3. Training to employees through external trainers
4. Organizing a dinner for entity's valued customers
5. Recognizing depreciation of machinery
6. Insurance claim recovered from insurance company against stock lost by fire
7. Cash paid as charity to a hospital

Answer:

1.Event
2.Transaction
3.Transaction
4.Transaction
5.Condition
6.Transaction
7.Transaction

Important Tips To Remember - ITTR

1. Three sources of financial information
2. Transaction results from a deal
3. First party is the entity itself dealing with others
4. Each accounting information is measurable in money

Basics of Financial Accounting

Money Measurement and Financial Position

Money measurement

Money measurement means to assign a value in reporting currency to an accounting phenomena.

Source of images: Google

Measurement parameters

Measuring its weight	10.0 Kg
Measuring its length	3.0 Feet
Measuring its width	1.5 Feet
Measuring its height	2.0 Feet

Rs. 15,000 its *money measurement in reporting currency.*

Source of images: Google

Practice 1.4

Which of the following information is carrying money measurement?

1. Bought 30 numbers of computers. No
2. Bought 10 fans @ Rs. 1,500 each, cash paid immediately. Yes
3. Scrap dumped, weighted 150 Kg. No
4. 5 workers are working on plant in double shift. No
5. Bought raw material worth Rs. 50,000, cash is not yet paid. Yes

Financial position

Financial position means; an entity's status of Resources & Sources.

1. **Resources** are the assets
2. **Sources** are the means of finances that include liability and owners' equity

Assets = Liability + Equity

ASSETS	Rs.	LIABILITIES	Rs.
Furniture	80,000	Bank loan	35,000
Computers	10,000	Other payable	15,000
		EQUITY	
		Owner's Capital	40,000
TOTAL	90,000	TOTAL	90,000

Source of images: Google

Important Tips To Remember - ITTR

1. Measurement in reporting currency
2. Financial position means financial status
3. Resources are equal to sources

Basics of Financial Accounting

Functions of Financial Accounting

Functions of financial accounting

Financial accounting is required to:

1. *Classify*
2. *Record*
3. *Summarize*
4. *Report*
5. *Analyze*

These are the five functions of Financial Accounting that are covered in

Accounting Cycle

Accounting cycle

Source of images: Google

Important Tips To Remember - ITTR

1. Financial accounting is about past information
2. Accounting Cycle starts from source documents and ends at analysis of past information

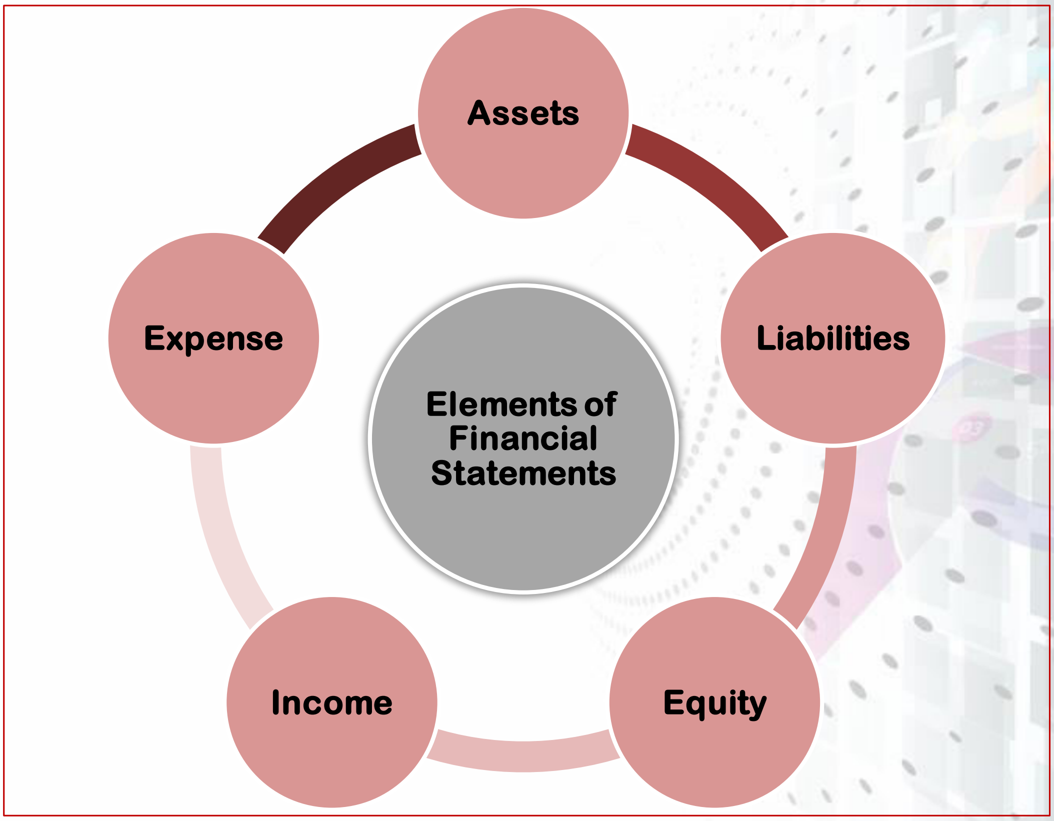
Basics of Financial Accounting

Elements of Financial Statements

Classifying financial information

Financial information are classified into five main heads, these are also known as elements of financial statements

Elements of financial statements



Elements of financial statements

Assets:
Assets are the resources in control

Liabilities:
Liabilities are the present obligations

Owners' Equity:
Owners' equity is the source of finance that represents owners' stake

Incomes:
Incomes are earnings

Expenses:
Expenses are the costs that expire

Sub-classification of Main Heads

Main Heads	Assets	Liabilities	Owners' Equity	Incomes	Expenses
Accounting Heads	Land	Bank loan	Capital	Sales	Purchases
	Building	Bank overdraft	Drawings	Service Fee	Salaries
	Machinery	Creditors	Profits	Commission	Electricity
	Furniture	Payable	etc.	etc.	Repair
	Motor Van	etc.			Advertisement
	Computer				Telephone
	Stocks				Traveling
	Receivables				Freight
	Cash Balance				Rent
	Bank Balance				Stationery
	etc.				etc.

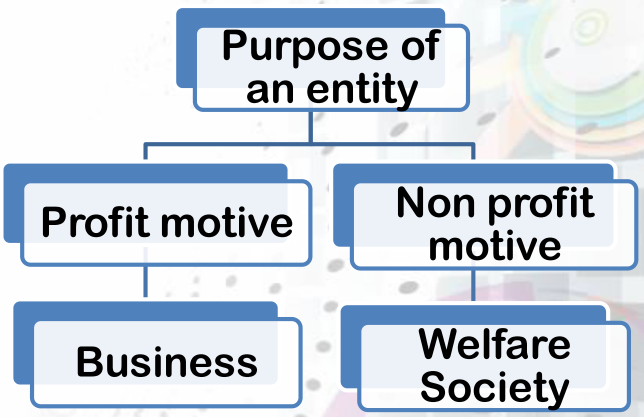
Important Tips To Remember - ITTR

1. There are five main heads
2. Assets are resources in control of entity
3. Liabilities are present obligation
4. Present obligation means – obligation at the end of reporting period
5. Accounting heads are sub-heads

Basics of Financial Accounting

Entity and Separate Entity Concept

Entity



Financial information is involved in both *profit motive* and *non-profit motive* entities. Therefore, financial accounting is a need for a business as well as a welfare society.

Separate Entity Concept

A business entity and its owner are two different persons.

For accounting purposes, business has separate entity/identity apart from its owner.

Source of images: Google

Practice 1.5

Based on the business entity concept, which of the following information would be accounted for in the accounting books of an entity/business?

1. Cash invested as capital of the business by the owner.
2. Owner bought motor car for his personal use out of his personal bank account.
3. Owner used a part of his residential building for the business godown for which he was paid rent out of business bank account.
4. Owner took loan for his daughters' marriage from a friend.
5. Goods bought by business for trading were consumed by the owner for his personal consumption.

Answers (1, 3, 5)

Important Tips To Remember - ITTR

1. Accounting is a requirement of each entity
2. Business has separate entity apart from its owner
3. Accounting entity concept is different from the legal entity concept

Basics of Financial Accounting

Users of Financial Information

Users of Financial Information

a) <u>Investor/Shareholders/owners</u> How well the management is performing

b) <u>Trade contacts</u> Suppliers and customers

c) <u>Lenders</u> providers of finance are lenders

d) <u>Taxation authorities</u> assess the tax payable by the entity, including sales taxes etc.

Source of images: Google

Users of Financial Information

e) **<u>Manager and Employees</u>** To enable them to manage the business

e) **<u>Financial consultants and advisers</u>** For their clients

g) **<u>Government</u>** Interested in the allocation of resources

h) **<u>Public</u>** Entity may make a substantial contribution to a local economy

Source of images: Google

Practice 1.6

Which of the following statements is true or false:

1. Debt burden of the company is the information mostly required by income tax authorities. False
2. Dividend declaration is the information needed by shareholders. True
3. Financial ratios are most likely required by financial consultants True
4. Bonus to employees is the information that is needed by Government False
5. Cost of sales information is usable for managers. True
6. Welfare society is always interested in green policies cost of company. True

Answers: (1-false 2-true 3-true 4-False 5-true 6-True)

Important Tips To Remember - ITTR

1. Financial accounting produces general purpose financial statements
2. Users are internal and external

Basics of Financial Accounting

Underlying Assumption

Going Concern

Underlying Assumption

Going Concern

Assumption that a business entity will remain in existence for the foreseeable future

Going concern

Examples include:

- Significant trading losses being incurred for several years
- Deteriorating liquidity position
- High financial risk arising from increased debts level
- Aggressive growth strategy not backed by sufficient finance
- Serious litigations
- Inability of a company to develop a new range of commercially successful products.
- Bankruptcy of major customer

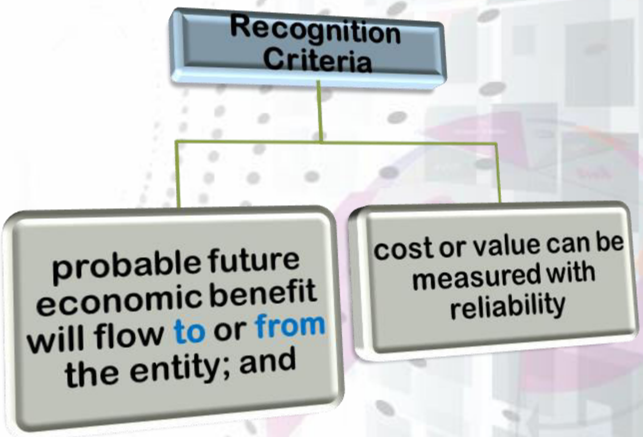
Important Tips To Remember - ITTR

1. Accounting principles cannot be applied if entity is not a going concern
2. Reporting requirements would be different if entity is not a going concern

Basics of Financial Accounting

Recognition of the elements of financial statements

Recognition of Financial Information



Recognition Criteria

Asset

1. probable inflow of future economic benefits, and
2. cost or value can be measured reliably.

Liability

1. probable outflow of resources embodying economic benefits will result from the settlement of a present obligation and
2. amount at which the settlement will take place can be measured reliably.

Recognition Criteria

Income

1. an increase in future economic benefits related to an increase in an asset or a decrease of a liability has arisen, and
2. amount can be measured reliably.

Expense

1. a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen, and
2. amount can be measured reliably.

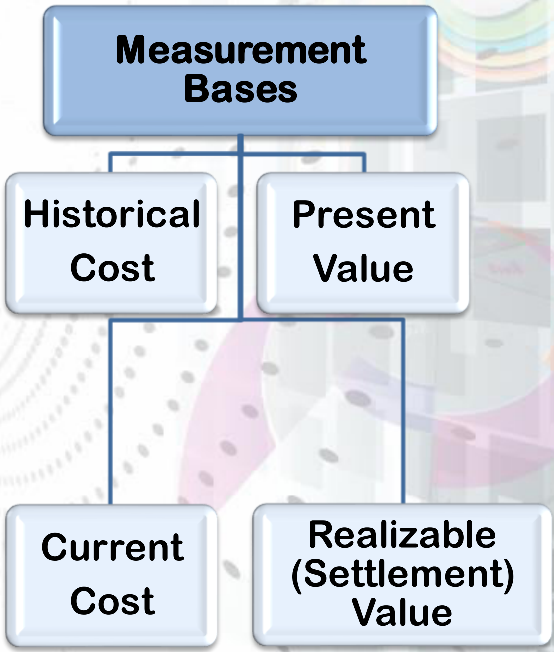
Important Tips To Remember - ITTR

1. Recognition means to identify correct main head
2. Recognition is done at classifying stage in accounting cycle

Basics of Financial Accounting

Measurement of the elements of financial statements

Measurement of Financial Information



Measurement Bases

1. Historical cost
2. Current cost
3. Net realisable (settlement) value
4. Present value (discounted cash flows)

Historical cost is the most commonly used measurement basis, it is usually combined with other measurement bases.

Important Tips To Remember - ITTR

1. Initial measurement is done at recognition
2. Subsequent measurement is needful at the end of reporting period and in certain cases at the time of de-recognition

Basics of Financial Accounting

Qualitative characteristics of useful financial information

Qualitative characteristics

- Relevance
  - *Materiality*
- Faithful representation

Fundamental

- Comparative
- Verifiability
- Timeliness
- Understandability

Enhancing

Cost constraint on useful financial reporting

Fundamental Qualitative Characteristics

Relevance

- Confirmatory Value
- Predictive Value; or
- Both

Materiality is an entity specific aspect of **Relevance** based on:
- Nature
- Magnitude; or
- Both

Faithful representation

- Complete
- Neutral
- Free from error

Enhancing Qualitative Characteristics

Comparability	• Consistency
Verifiability	• Direct • Indirect
Timeliness	• Timely Report • Reliable Information
Understandability	• Reasonable Knowledge • Disclosures

Important Tips To Remember - ITTR

1. Qualitative financial information produce qualitative financial statements
2. Information is material if its non-disclosure changes the decision of the user of financial statement

Thank you very much
for being attentive

Chapter - 2

Recording Financial Information
Double Entry Bookkeeping

Video number 12-16 are mandatory part of this module

MGT 101
Financial Accounting

By
Mian Ahmad Farhan, FCA

Contents

Recording Financial Information

Types of Transactions Cash and Credit

Sources of financial information

There are three sources of financial information:

- Transactions
- Events
- Conditions

A special concentration to identify and analyze "Transactions"

Types of transactions

There are two types of transactions

Cash Transactions

Credit Transactions

Source of images: Google

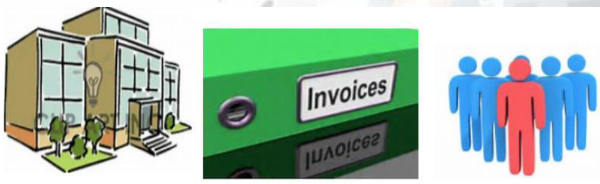
Cash transaction

Examples:
1. Cash received from customers
2. Cash paid to supplier
3. Staff salaries paid
4. Payments made by cash/cheques/standing order/direct debit/debit card/demand draft etc.
5. Collections received in cash/cheques/credit transfer in the bank etc.

Source of images: Google

Credit transaction

In which payment or receipt in terms of cash or any other financial instrument is deferred for some future period.



Examples include:
1. Sales of goods on credit
2. Purchase of goods on credit
3. Return of goods from customers
4. Return of goods to suppliers

Source of images: Google

Important Tips To Remember - ITTR

1. Cash transaction is about cash inflow and cash outflow
2. Credit transaction is about deferment of cash flows

Recording Financial Information

Identifying Debtors and Creditors

Identifying Debtors and Creditors

Each **credit transaction** either creates accounts receivable also known as **debtor**, or accounts payable also known as **creditor**.

Examples:

An entity buys goods from supplier without making cash payment.

OR

An entity sells goods to its customer without receiving cash.

Debtors (Accounts Receivables)

Customers to whom goods/services are sold on credit terms

Examples:

- Goods sold to Yasmin on credit terms.
- Cash received from Yasmin after 1 month of sales.

Here, **Yasmin** is accounts receivable (debtor) – Asset

Source of images: Google

Creditors (Accounts Payable)

Suppliers from whom the goods/services are purchased on credit term

Examples:

- ➢ Goods purchased from Maryam.
- ➢ Paid cash to Maryam After one month of purchase.

Here, Maryam is accounts payable (creditor) - Liability

Source of images: Google

Practice 2.1

Identify which of the followings is a cash or credit transaction, **also** identify the personal account as Debtor or Creditor from the following transactions.

a) Purchased goods from Hanan on credit.
- Credit transaction
- Cash transaction
- Hanan is Debtor – Accounts Receivable
- Hanan is Creditor – Accounts Payable

b) Paid cash to Maria on account.
- Cash transaction
- Credit transaction
- Maria is Debtor – Accounts Receivable
- Maria is Creditor – Accounts Payable

c) Received cash from Star Brothers on account.
- Cash transaction
- Credit transaction
- Star Brothers is Debtor – Accounts Receivable
- Star Brothers is Creditor – Accounts Payable

Practice 2.1

d) <u>Paid cash to Donald on account.</u>
- Cash transaction
- Credit transaction
- Donald is Debtor – Accounts Receivable
- Donald is Creditor – Accounts Payable

e) <u>Sold goods to John Smith on credit.</u>
- Cash transaction
- Credit transaction
- Smith is Debtor – Accounts Receivable
- Smith is Creditor – Accounts Payable

f) <u>Purchased goods from Michael & Co.</u>
- Cash transaction
- Credit transaction
- Michael & Co is Debtor – Accounts Receivable
- Michael & Co is Creditor – Accounts Payable

Practice 2. 2

Identify which of the followings is a cash or credit transaction, **also** identify personal account as a Debtor or Creditor in the following transactions.

1. Bought motor car for cash.
2. Paid creditor Donald by cash.
3. Paid cash to Meera on account.
4. Sold motor car for cash to Dawood.
5. Bought furniture on credit from Henry.
6. Received cash from Star Brothers on account.
7. Owner Hamesh introduced further cash into the business.
8. Loan in cash received from Jasmin.
9. Paid Richard by cheque on account.
10. Sold goods on credit to Nelson.
11. Received Loan from Commercial **Bank**

Important Tips To Remember - ITTR

1. Debtors are the receivables against sale of goods or services
2. Creditors are the payables against purchase of goods or services
3. Loan receivable is not Debtor
4. Loan payable is not Creditor
5. Payment or receipt in cash or cheque is cash transactions
6. Buying or selling on account is credit transaction

Recording Financial Information

Accounting Equation Concepts

Accounting Equation

Basic accounting equation:

(Resources = Sources)

(Assets = Owner's Equity + Liabilities)

Initially: (0 = 0)

Subsequently:

a) increase in left side and also increase in right side

(+ = +)

b) decrease in both sides

(- = -)

c) increase and decrease in the same side

($\pm$ = 0) or (0 = $\pm$)

Profit: a Source of finance

Two heads i.e., expenses and incomes are missing in the basic equation.

These two heads constitute profit for the entity.

Incomes – Expenses = Profit/Loss

Source of images: Google

Owner's Equity

Resources are financed by

1. External sources (Owners and Lenders)
2. Internal sources (profits)

Profit = Incomes – Expenses

Profits/Losses are included in Owners' Equity

Owner's Equity = Capital + Profit (– loss) – Drawings

Important Tips To Remember - ITTR

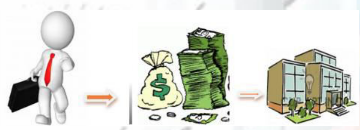
1. Resources = Sources
2. Initial equation "0 = 0"
3. Owner brings personal resources in the business as source of finance
4. Sources are invested by external investors as well as generated through internal profits

Recording Financial Information

Accounting Equation
Worked Example

Accounting Equation

Transaction 1: Henry started business, Micro Logics, by introducing capital Rs. 45,000 in cash.



Assets							Owner's Equity		Liabilities	
Sr #	Cash	Furniture	Computer	Stock	Debtors	=	Henry Capital	Profit	Bills payable	Creditors
1	45,000						45,000			

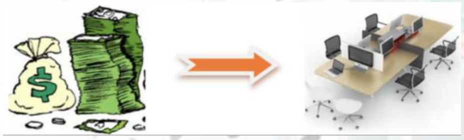
Henry is the sole owner of the business, Micro Logics is a sole proprietorship business.

Above accounting equation relates only to the business "Micro Logics". Under the business entity concept.

Source of images: Google

Accounting Equation

Transaction 2: Micro-Logics purchased furniture by paying cash Rs. 20,000.

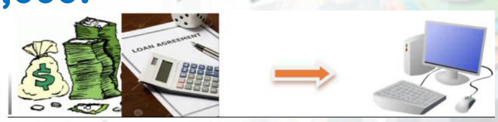


Assets						=	Owner's Equity		Liabilities	
Sr#	Cash	Furniture	Computer	Stock	Debtors	=	Henry's Capital	Profit	Bills payable	Creditors
1.	45,000						45,000			
2.	-20,000	20,000								
	25,000	20,000					45,000			

Source of images: Google

Accounting Equation

Transaction 3: Micro Logics purchased a computer for Rs. 28,000 by paying Rs. 8,000 in cash and signing a promissory note agreement with with supplier for Rs. 20,000.



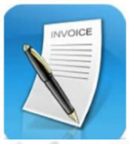
Assets						=	Owner's Equity		Liabilities	
Sr#	Cash	Furniture	Computer	Stock	Debtors	=	Henry's Capital	Profit	Bills payable	Creditors
1.	45,000						45,000			
2.	-20,000	20,000								
3.	-8,000		28,000						20,000	
	17,000	20,000	28,000				45,000		20,000	

Source of images: Google

Accounting Equation

Transaction 4: Micro Logics entered into a transaction of buying stocks/inventory of Rs. 1,350 and agreed to pay the supplier in near future.





Assets							Owner's Equity		Liabilities	
Sr #	Cash	Furniture	Computer	Stock	Debtors	=	Henry's Capital	Profit	Bills payable	Creditors
1.	45,000						45,000			
2.	-20,000	20,000								
3.	-8,000		28,000						20,000	
4.				1,350						1,350
	17,000	20,000	28,000	1,350			45,000		20,000	1,350

Source of images: Google

Accounting Equation

Transaction 5: During its first month of operations, Micro Logics provided services to customers, earning fee of Rs. 7,500 and receiving the amount in cash.


Assets							Owner's Equity		Liabilities	
Sr #	Cash	Furniture	Computer	Stock	Debtors	=	Henry's Capital	Profit	Bills payable	Creditors
1.	45,000						45,000			
2.	-20,000	20,000								
3.	-8,000		28,000						20,000	
4.				1,350						1,350
5.	7,500							7,500		
	24,500	20,000	28,000	1,350			45,000	7,500	20,000	1,350

Source of images: Google

Accounting Equation

Transaction 6: For Micro Logics, the expenses paid during the month were as follows:

Wages	Rs. 2,125
Rent	Rs. 800
Utilities	Rs. 450
Miscellaneous	Rs. 275

Assets							Owner's Equity		Liabilities	
Sr #	Cash	Furniture	Computer	Stock	Debtors	=	Henry's Capital	Profit	Bills payable	Creditors
1.	45,000						45,000			
2.	-20,000	20,000								
3.	-8,000		28,000						20,000	
4.				1,350						1,350
5.	7,500							7,500		
6.	-3,650							-2,125 -800 -450 -275		
	20,850	20,000	28,000	1,350			45,000	3,850	20,000	1,350

Source of images: Google

Accounting Equation

Transaction 7: Micro Logics paid Rs. 950 to its creditors during the month.

Assets							Owner's Equity		Liabilities	
Sr #	Cash	Furniture	Computer	Stock	Debtors	=	Henry's Capital	Profit	Bills payable	Creditors
1	45,000						45,000			
2	-20,000	20,000								
3	-8,000		28,000						20,000	
4				1,350						1,350
5	7,500							7,500		
6	-3,650							-2,125 -800 -450 -275		
7	-950									-950
	19,900	20,000	28,000	1,350	1,200		45,000	3,850	20,000	400

Source of images: Google

Accounting Equation

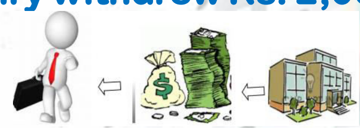
Transaction 8: During the month Micro Logics sold out stock costing Rs. 800 for Rs. 1,200 on credit terms, earning a profit of Rs. 400.

	Assets						Owner's Equity		Liabilities	
Sr. #	Cash	Furniture	Computer	Stock	Debtors	=	Henry's Capital	Profit	Bills payable	Creditors
1.	45,000						45,000			
2.	-20,000	20,000								
3.	-8,000		28,000						20,000	
4.				1,350						1,350
5.	7,500							7,500		
6.	-3,650							-2,125		
								-800		
								-450		
								-275		
7.	-950									-950
8.				-800	1,200			400		
	19,900	20,000	28,000	550	1,200		45,000	4,250	20,000	400

Source of images: Google

Accounting Equation

Transaction 9: At the end of month, Henry withdrew Rs. 2,000 cash from the business for personal use.



	Assets						Owner's Equity		Liabilities	
Sr. #	Cash	Furniture	Computer	Stock	Debtors	=	Henry's Capital	Profit	Bills payable	Creditors
1.	45,000						45,000			
2.	-20,000	20,000								
3.	-8,000		28,000						20,000	
4.				1,350						1,350
5.	7,500							7,500		
6.	-3,650							-2,125		
								-800		
								-450		
								-275		
7.	950									-950
8.				-800	1,200			400		
9.	-2,000							-2,000*		
	17,900	20,000	28,000	550	1,200		45,000	2,250	20,000	400

*Solved example presented two columns for owner equity head i.e., capital and profit. Drawing is not the expense and it should not be treated to reduce the income because drawing is not a contra account of income/revenue. Drawing is basically treated as appropriation/distribution of profit and reduces the amount of profit. Profit becomes the part of owners' equity; ultimately the drawing indirectly reduces the owner equity. You can directly reduce the amount of drawing from owner's equity/capital if use one column of capital to solve the questions of accounting equation. Please note that Drawings account is a contra account of capital.

Source of images: Google

Important Tips To Remember - ITTR

1. Each transaction brings a change in accounting equation
2. Incomes earned cause increase in Owner's Equity
3. Expenses incurred cause decrease in Owner's Equity
4. Increase in resources may result because of increase in sources or decrease in another resource

Recording Financial Information

Accounting Equation Practice

Practice 2.3

Choose the possible effects of following transactions on accounting equation.

1. Goods purchased on credit
   - increase asset
   - decrease asset
   - increase liability
   - decrease liability
   - increase equity
   - decrease equity
2. Paid utility bills
   - increase asset
   - decrease asset
   - increase liability
   - decrease liability
   - increase equity
   - decrease equity

Practice 2.3

3. Sold goods on profit of Rs.200
   - increase asset
   - decrease asset
   - increase liability
   - decrease liability
   - increase equity
   - decrease equity
4. Paid to trade creditors
   - increase asset
   - decrease asset
   - increase liability
   - decrease liability
   - increase equity
   - decrease equity
5. Cash invested by owner
   - increase asset
   - decrease asset
   - increase liability
   - decrease liability
   - increase equity
   - decrease equity

Practice 2.3

6. Owner buys a new car from personal resources
   - increase asset
   - decrease asset
   - increase liability
   - decrease liability
   - increase equity
   - decrease equity

no effect

7. Goods lost in fire
   - increase asset
   - decrease asset
   - increase liability
   - decrease liability
   - increase equity
   - decrease equity

Practice 2.3

8. Drawing of goods by owner
   - increase asset
   - decrease asset
   - increase liability
   - decrease liability
   - increase equity
   - decrease equity
9. Loan taken from bank
   - increase asset
   - decrease asset
   - increase liability
   - decrease liability
   - increase equity
   - decrease equity
10. Received commission
    - increase asset
    - decrease asset
    - increase liability
    - decrease liability
    - increase equity
    - decrease equity

Thank you very much
for being attentive

Chapter - 3

Rules of Debit and Credit
Preparation of voucher with supporting documents
Video number 17-27 are mandatory part of this module

MGT 101
Financial Accounting

By
Mian Ahmad Farhan, FCA

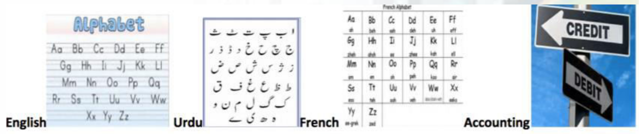
Contents

Sr. No	Course Outline Topics
1	Concept of Debit and Credit (Dr. and Cr.)
2	Types of Account - Elements of Financial Statements
3	Analyzing Dr. & Cr.
4	Practice - Identifying accounting heads
5	Double entry bookkeeping
6	Double entry accounting system - Practice
7	Concept of Voucher
8	Concept of Source Documents
9	Different types of books of accounts
10	Accounting systems - Cash Basis Vs. Accrual Basis
11	Single entry accounting Vs Double entry accounting

Double Entry Bookkeeping System

Concept of Dr. & Cr.

Alphabets of Accounting Language



Accounting carries unique alphabets these are two in count.

1. **Debit – Debere in Latin – Dr.**
2. **Credit – Credere in Latin – Cr.**

Alphabets of all the languages do not carry any meaning.
Dr. and Cr. are also termed as tools of accounting.

Source of images: Google

Debit Group

Debit Group *consists of*

1. Assets
2. Expenses

Assets

Expenses

Source of images: Google

Credit Group

Credit Group
consists of

1. Owner's Equity
2. Liabilities
3. Incomes

O. Equity

Liabilities

Incomes

Source of images: Google

Important Tips To Remember - ITTR

1. Dr. and Cr. are two alphabets of Accounting Language
2. Debit nature for Assets and Expenses
3. Credit nature for Owner's equity, Liabilities and Incomes

Double Entry Bookkeeping System

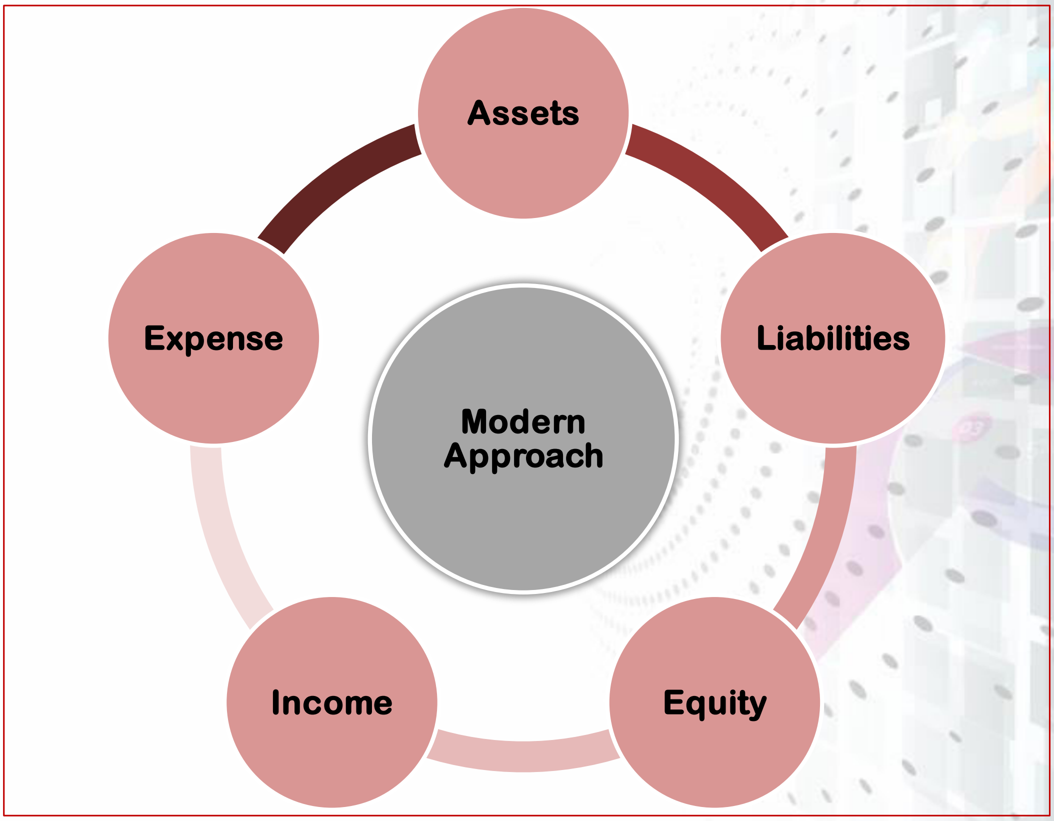
Types of Accounts
Elements of
Financial Statements

Identifying correct types of Account

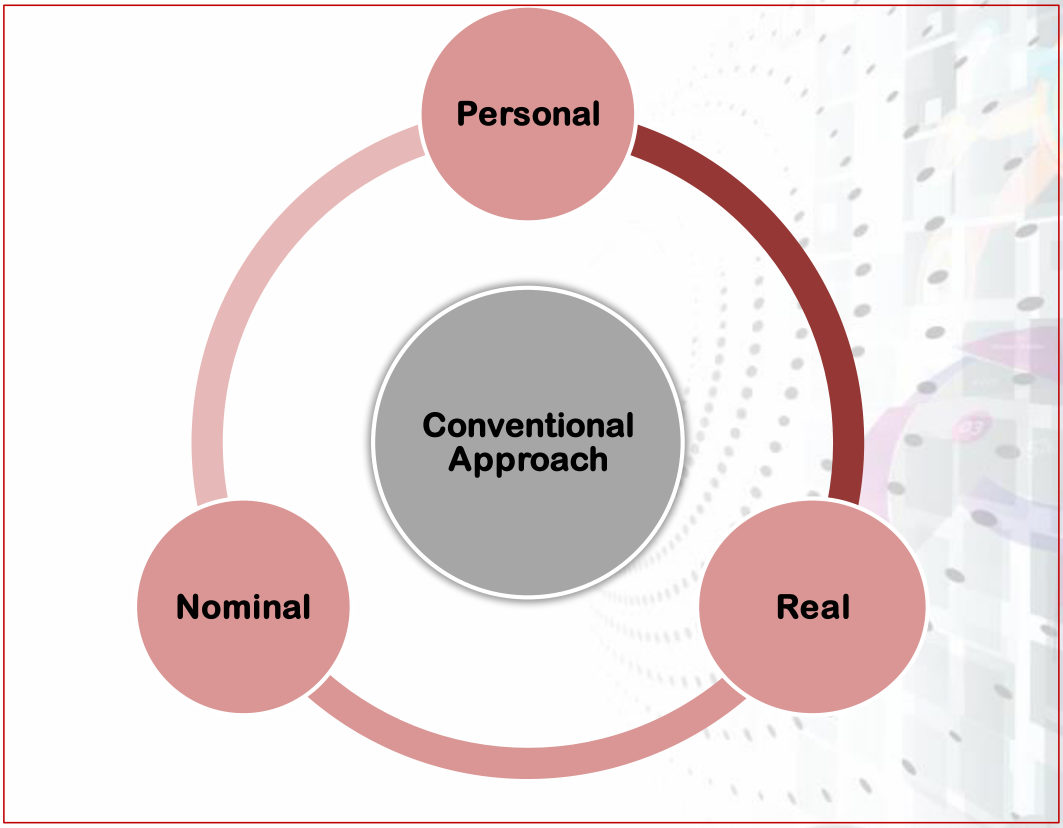
While recording financial information we have to identify the correct type of "account"

to be recognized as Dr. or Cr.

Types of Account – Modern approach



Types of Account – Conventional approach



Important Tips To Remember - ITTR

1. Modern approach discusses five types of accounts
2. Conventional approach discusses three types of accounts
3. Modern approach is easy to understand Dr. and Cr.

Double Entry Bookkeeping System

Analyzing Dr. & Cr.

Analyzing "Debit and Credit"

Increase in Dr. group "Dr"
Decrease in Dr. group "Cr"
Increase in Cr. group "Cr"
Decrease in Cr. group "Dr"

Increase in Assets & Expenses Dr.
Decrease in Assets & Expenses Cr.
Increase in Equity, Liabilities & Income Cr.
Decrease in Equity, Liabilities & Income Dr.

Debit	Credit
⇑ Assets	⇓ Assets
⇑ Expenses	⇓ Expenses
⇓ O Equity	⇑ O Equity
⇓ Liabilities	⇑ Liabilities
⇓ Incomes	⇑ Incomes

Approach to recognize Dr. & Cr.

- Financial impact on accounting equation is translated into accounting language using its alphabets *"Dr"* & *"Cr"*.
- Each transaction causes a change in two **accounting heads:**
  - one is analyzed as *Dr.*
  - second is analyzed as *Cr.*

Main Head –Vs – Accounting Head

"Main Heads" are not the "Accounting Heads".

Main Heads	Assets	Expenses	Owners' Equity	Liabilities	Incomes
Accounting Heads	Land	Purchases	Capital	Bank Loan	Sales
	Building	Salaries	Drawings	Bank Overdraft	Interest
	Machinery	Electric Bill	Profits	Creditors	Commission
	Furniture	Repair		Accounts Payable	
	Motor Van	Advertisement			
	Computer	Commission			
	Stocks	Traveling			
	Debtors	Freight			
	Cash Balance	Rent			
	Bank Balance	Stationery			

Important Tips To Remember - ITTR

1. "Dr" or "Cr" does not carry literal meanings
2. Each account involved in financial information is analyzed for recognizing Dr. and Cr.

Double Entry Bookkeeping System

Practice Identifying accounting heads

Practice 3.1

Identify two accounting heads from each transaction and place it under the appropriate main head.

Transaction 1: Bought a building for cash.
a) Bought b) Building c) Cash d) Expense

Transaction 2: Paid salaries to staff in cash.
a) Paid b) Staff c) Cash d) Salary

Transaction 3: Goods sold on credit to Dar Brothers.
a) Creditor b) Sales c) Cash d) Debtor

Transaction 4: Cash introduced by the owner as a capital.
a) Investment b) Cash c) Capital d) Owner

Transaction 5: Commission received in cash
a) Receiving b) Cash c) Equity d) Commission

Transaction 6: Purchase goods for cash.
a) Stock b) Cash c) Purchases d) goods

Transaction 7: Cash withdrew by the owner for personal use.
a) Drawings b) Cash c) Owner d) Goods

Transaction 8: Rent paid by cheque.
a) Rent b) Cash c) Bank d) Goods

(Greens are correct)

Practice 3.1 – Answer

Transaction	Assets	Expenses	Owner's Equity	Liabilities	Incomes
1	b) Building c) Cash				
2	c) Cash	d) Salary			
3	d) Debtors				b) Sales
4	b) Cash		c) Capital		
5	b) Cash				d) Commission
6	b) Cash	c) Purchases			
7	b) Cash		a) Drawings		
8	c) Bank	a) Rent			

Important Tips To Remember - ITTR

1. Always identify two accounting heads in an accounting phenomena
2. Both accounting heads may belong to one main head or two different main heads

Double Entry Bookkeeping System

Double Entry Bookkeeping

Double Entry Bookkeeping

Described in Italy in 1494

Each transaction causes increase or decrease in two accounting heads.

Increase or decrease caused by a transaction in two accounting heads is recorded in terms of Dr and Cr.

Source of images: Google

Practice 3.2

From the following transactions, identify relevant accounting heads along with their respective main heads and also show increase or decrease in the main heads to make decision for Dr and Cr effects.

1. Capital introduced in the business Rs.10,000.
2. Purchase furniture for cash Rs.4,000.
3. Purchase goods for cash Rs. 2,000.
4. Sold goods for cash Rs.3,000.
5. Rent paid in cash Rs.2,000.
6. Owner withdrew cash for personal use Rs.500.
7. Salaries paid in cash Rs.200.
8. Bought goods from John Smith on credit Rs.6,000.
9. Sold goods on credit to Henry for Rs.8,000.
10. Received cash from Donald Rs.2,500.

Practice 3.2 – Answer

No.	Accounting Head	Main Head	Group	+/–	Dr./Cr.
1	Cash	Asset	Dr.	Inc. +	Dr.
	Capital	Own. Equity	Cr.	Inc. +	Cr.
2	Cash	Asset	Dr.	Dec. –	Cr.
	Furniture	Asset	Dr.	Inc. +	Dr.
3	Purchases	Expense	Dr.	Inc. +	Dr.
	Cash	Asset	Dr.	Dec. –	Cr.
4	Cash	Asset	Dr.	Inc. +	Dr.
	Sales	Income	Cr.	Inc. +	Cr.
5	Rent	Expense	Dr.	Inc. +	Dr.
	Cash	Assets	Dr.	Dec. –	Cr.
6	Drawings	Own. Equity	Cr.	Dec. –	Dr.
	Cash	Assets	Dr.	Dec. –	Cr.
7	Cash	Asset	Dr.	Dec. –	Cr.
	Salaries	Expense	Dr.	Inc. +	Dr.
8	Purchases	Expense	Dr.	Inc. +	Dr.
	Creditors (John Smith)	Liability	Cr.	Inc. +	Cr.
9	Sales	Income	Cr.	Inc. +	Cr.
	Debtor (Henry)	Asset	Dr.	Inc. +	Dr.
10	Cash	Asset	Dr.	Inc. +	Dr.
	Debtor (Donald)	Asset	Dr.	Dec. –	Cr.

Important Tips To Remember - ITTR

1. Σ Dr = Σ Cr
2. For purchase of goods; use “Purchases” as Dr accounting head
3. For sales of goods; use “Sales” as Cr accounting head
4. For personal use of owner; use “Drawings” as Dr accounting head
5. For investments introduced by owner; use “Capital” as Cr accounting head

Double Entry Bookkeeping System

Practice Double Entry Bookkeeping

Practice 3.3

Identify relevant accounting heads, respective main heads, show increase or decrease in the main heads and then make decision for Dr and Cr effects.

1. Started business with Rs. 10,000 in the bank.
2. Paid insurance by cheque Rs.600.
3. Owner withdrew goods for personal use Rs. 2,000.
4. Machinery purchased from Maria & Co. on credit Rs.2,000.
5. Loan taken from friend Rs.200 in cash.
6. Machinery returned to Maria & Co. Rs. 2,000.
7. Goods returned to Kashmiri Rs.100.
8. Goods returned by Harris Rs. 200.
9. Free sampling of goods Rs. 50.
10. Friend's loan was repaid Rs. 200.

Practice 3.3 – Answer

No.	Accounting Head	Main Head	Group	+/–	Dr./Cr.
1	Bank	Asset	Dr.	Inc. +	Dr.
	Capital	Own. Equity	Cr.	Inc. +	Cr.
2	Bank	Asset	Dr.	Dec. –	Cr.
	Insurance	Expense	Dr.	Inc. +	Dr.
3	Drawings	Own. Equity	Cr.	Dec. –	Dr.
	Purchases	Expense	Dr.	Dec. –	Cr.
4	Machinery	Asset	Dr.	Inc. +	Dr.
	Creditors (Maria & Co.)	Liability	Cr.	Inc. +	Cr.
5	Cash	Asset	Dr.	Inc. +	Dr.
	Loan from friend	Liability	Cr.	Inc. +	Cr.
6	Machinery	Asset	Dr.	Dec. –	Cr.
	Creditor (Maria & Co.)	Liability	Cr.	Dec. –	Dr.
7	Purchases Return	Expense	Dr.	Dec. –	Cr.
	Creditor (Kashmiri)	Liability	Cr.	Dec. –	Dr.
8	Sales Return	Income	Cr.	Dec. –	Dr.
	Debtor (Harris)	Asset	Dr.	Dec. –	Cr.
9	Free Sampling	Expense	Dr.	Inc. +	Dr.
	Purchases	Expense	Dr.	Dec. –	Cr.
10	Cash	Asset	Dr.	Dec. –	Cr.
	Loan from friend	Liability	Cr.	Dec. –	Dr.

Practice 3.4

Choose correct answer

1. Goods purchased from John smith
   - a) - cash + stock
   - b) + stock + cash
   - **c) + creditors + stock**
   - d) b & c both
2. Commission paid to agent Jordan
   - a) - commission - cash
   - **b) + commission - cash**
   - c) + Jordan - cash
   - d) + capital - cash
3. Goods sold for Rs.5,000 that cost 4500
   - **a) + cash 5,000 + sales 5,000**
   - b) - cash 4,500 - stock 4,500
   - c) + cash 5,000 - stock 5,000
   - d) +cash 4,500 - sales 4,500
4. Goods returned from Debtors
   - **a) - debtors + sales return**
   - b) - creditors + stock
   - c) + debtors - owner's
   - d) none of the above
5. Cash received from debtor on account
   - a) + cash + sales
   - b) + cash + capital
   - **c) + cash - debtor**
   - d) + cash - drawings
6. Loan repaid to Hassan
   - a) - o equity + cash
   - **b) - liability - cash**
   - c) + cash - liability
   - d) + Hassan – cash
7. Cash withdraw by owner
   - a) + o equity - cash
   - b) - o equity + cash
   - **c) - o equity - cash**
   - d) - o equity - stock
8. Machinery purchased from Caterpillar on credit
   - a) + machinery - cash
   - b) + machinery + cash
   - **c) + machinery + Liability**
   - d) - machinery + cash

Answer:
(1-c, 2-b, 3-a, 4-a, 5-c, 6-b, 7-c, 8-c)

Important Tips To Remember - ITTR

1. For payment through cheque; use "Bank" as Cr accounting head
2. For decrease in purchased goods or stocks, other than because of sales and purchase return transactions; use "Purchase" as Cr accounting head
3. For goods returned to supplier; use "Purchases Return" as Cr accounting head
4. For goods returned by customers; use "Sales Return" as Dr accounting head

Double Entry Bookkeeping System

Concept of Voucher

Voucher

- Two accounting heads along with their values are recognized on voucher.
- It is an internal document to witness that the transaction is complete and verified.
- It is supported by needful documents and authorized by appropriate signatories.


Journal Voucher

Month: Year: Number:

Reference	Description	Account Code	Debit	Credit

Total

Reason:

Prepared by: Date:

Authorized by: Posted by:

APPROVED

Source of images: Google

Types of vouchers

- Journal Voucher
- Petty Cash Voucher
- Cash Receipt/Payment Voucher
- Bank Receipt/Payment Voucher
- Gift Voucher

Practice - 3.8

1. Who is responsible to prepare journal voucher?
   a) supplier b) manager **c) bookkeeper** d) accountant
2. Journal voucher is used to record transaction in?
   a) general journal b) general ledger c) trial balance d) balance sheet
3. Which voucher is used as a proof that significant cash transaction has occurred between two persons?
   a) petty cash voucher **b) cash payment voucher** c) journal voucher d) gift voucher
4. Which voucher is given by seller to customer that gives right of free shopping or discounts?
   a) petty cash voucher **b) gift voucher** c) cash payment voucher d) bank payment voucher
5. Which voucher is prepared in support to transaction of collecting money in the bank from customer?
   a) bank receipt voucher b) bank payment voucher c) deposit slip d) bank statement

Important Tips To Remember - ITTR

1. Voucher is the first document, which is prepared by the accounts department of an entity to start accounting process
2. Voucher is a documentary evidence that transaction is complete and verified

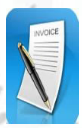
Double Entry Bookkeeping System

Concept of Source Documents

Source Documents

No.	Transaction	Source Documents
1	Sales	Invoice (issued) against sales of goods or services on account
2	Purchases	Invoice (received) against purchases of goods or services on account
3	Sales Return	Credit Note (issued) upon accepting the goods returned by customer
4	Purchases Return	Debit Note (issued) / Credit Note (received) upon returning goods to supplier
5	Cash received	Cash Memo/receipt (issued) upon receiving cash
6	Cash paid	Cash Memo/receipt (received) upon making cash payment
7	Leases (Rental)	Agreements signed by the parties to a lease or any other contract
8	Staff Salaries	Payroll sheet upon transferring salaries and wages to the staff
9	Utility Bills	Metered Bills/Invoices against obtaining economic benefits of the utilities

Invoice

Seller ⇨  ⇨ Buyer

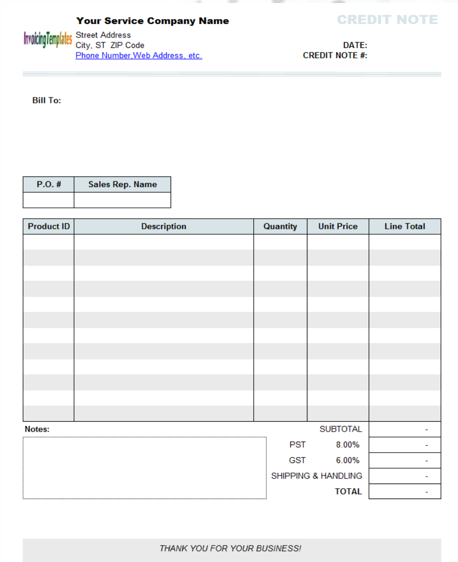
INVOICE (extract)	
Goods total	£575.00
Trade discount @ 10%	£57.50
Net total	£517.50
VAT @ 20%	£99.36
Total payable	£616.86

Terms: 4% settlement discount for payment within 14 days

Source of images: Google

Credit Note

Seller →  → Buyer



Your Service Company Name
Street Address
City, ST ZIP Code
Phone Number,Web Address, etc.

CREDIT NOTE

DATE:
CREDIT NOTE #:

Bill To:

P.O. #	Sales Rep. Name

Product ID	Description	Quantity	Unit Price	Line Total

Notes:

SUBTOTAL		-
PST	8.00%	-
GST	6.00%	-
SHIPPING & HANDLING		-
TOTAL		-

THANK YOU FOR YOUR BUSINESS!

Source of images: Google

Important Tips To Remember - ITTR

1. Invoice, credit note and cash memo are prepared and issued by seller
2. Debit note is prepared by the buyer, it is issued at the time of returning goods to seller as a request to make adjustment in the account. Seller issues credit note in response, if the goods returned are accepted.

Double Entry Bookkeeping System

Different Types of Books of Accounts

Recording in the books of accounts

Computerized bookkeeping

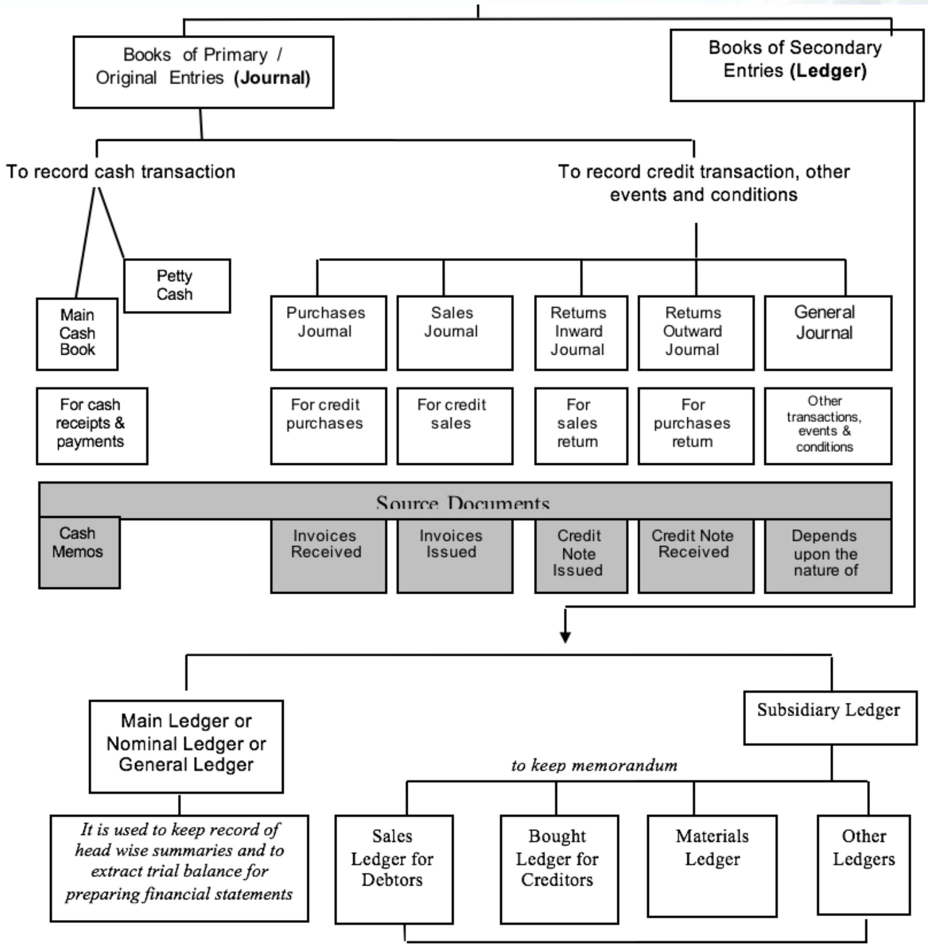
Manual bookkeeping

There are two types of books of accounts:

1. Books of original entries
2. Books of secondary entries

Source of images: Google

Books of Accounts



Important Tips To Remember - ITTR

1. Separate journals are maintained for cash and non-cash transactions
2. Balances of subsidiary ledgers are not shown in financial statements, these are kept as memorandum

Double Entry Bookkeeping System

Accounting systems
Cash Vs. Accrual

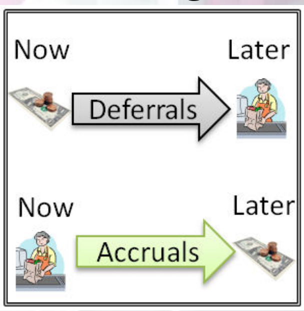
Cash Based Accounting

Transactions are recorded only when cash is received or paid.

Example:

During the year 20X9

1. **Office rental paid for 15 months at the rate of Rs. 10,000 per month. Rs.150,000 shall be recognized as rent expense for the year 20X9**
2. **Cleaning agent received Rs.180,000 against office cleaning for 18 months. Rs.180,000 shall be recognized as his income.**



Source of images: Google

Accrual Based Accounting

Transactions are recorded on the basis that expenses and incomes belong to the reporting period, regardless the condition that settlement in terms of cash has happened or not.

Example:

During the year 20X9

1. **Office rental paid for 15 months at the rate of Rs. 10,000 per month. Rs.150,000 shall be recognized as rent expense for the year 20X9**
2. **Cleaning agent received Rs.180,000 against office cleaning for 18 months. Rs.180,000 shall be recognized as his income.**

Examples – Accrual based accounting

Example – 1

Electricity bill for the last quarter (October – December) was not paid until the end of reporting period 31st December 20X9.

Under the cash-based accounting; the unpaid utility bill will not be recognized as expense in the accounting year 20X9. It will be recognized as expense for the year 20Y0 upon payment.

Under the accrual-based accounting; the unpaid utility expense will be recognized as expense in the accounting year 20X9 along with a liability that will be paid in 20Y0.

Example – 2

Insurance paid in advance for the year 20X9 on 1st November 20X8

Under the cash-based accounting; **the** payment will be recorded as expense as soon as cash is paid to insurance company on 1st November 20X8

Under the accrual-based accounting; the payment of insurance will be recorded in the year 20X8 as "prepayment or paid in advance" which shall be recognized as asset and then in the year 20X9 it will be recorded as expense, to which it belongs to.

Important Tips To Remember - ITTR

1. Cash based accounting is the system, which reports income when received and expenses when paid
2. Accrual based accounting is the system, which reports income when earned and expenses when incurred

Double Entry Bookkeeping System

Single Entry Vs. Double Entry

Single Entry Approach

- It is a simplest form of **bookkeeping**
- Single effect of each financial information is **entered** in the books of accounts
- It does not require background or training in accounting
- Entities using single entry approach are effectively limited to reporting on a cash basis only

Adequacy of single entry system

Small entities may in fact prefer single-entry accounting over a double-entry system when all or most of the following conditions apply:

- Entity uses cash based accounting, not accrual accounting
- There are few financial transactions per day
- Entity does not sell on its own credit
- Customers must pay at the time of the sale
- There are very few employees
- Entity is privately held or operates as a sole proprietorship or partnership

Important Tips To Remember - ITTR

1. Any system that falls short of complete double entry approach is single entry system
2. It is a defective double entry system

Thank you very much

for being attentive

Chapter - 4

Journalizing – Books of Original Entries

Topic Videos 28-46 are mandatory part of this module

MGT 101
Financial Accounting

By
Mian Ahmad Farhan, FCA

Contents

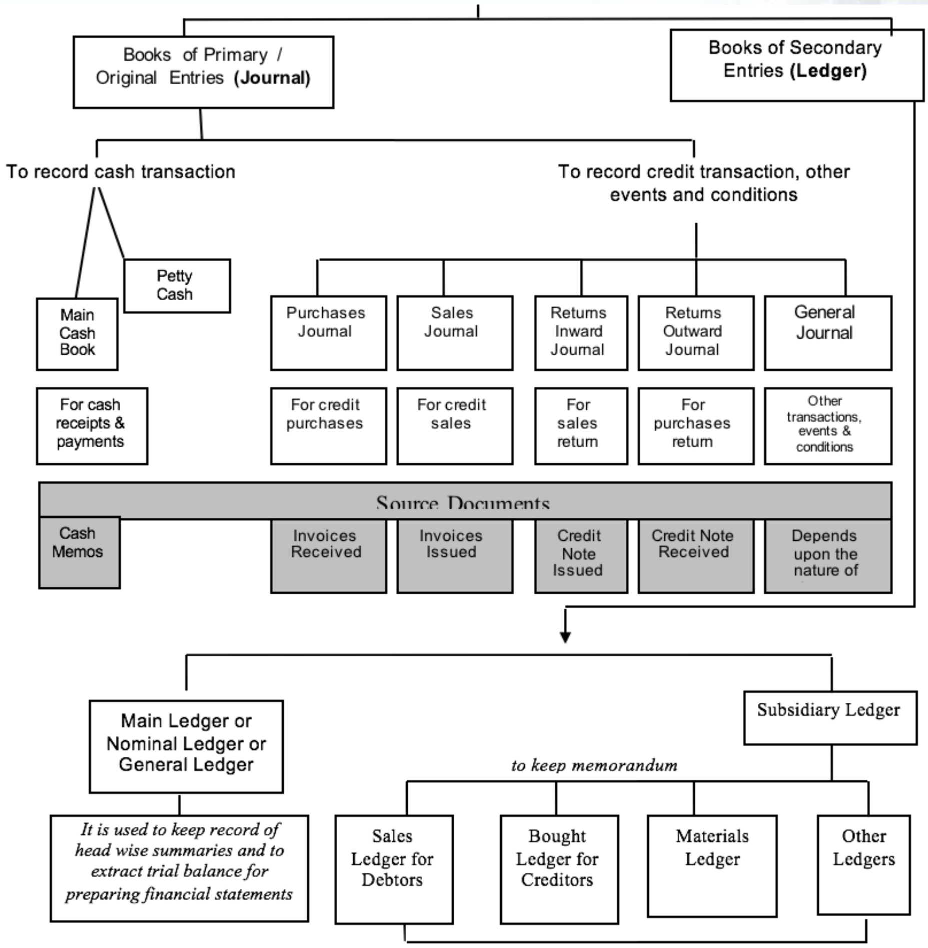
Journal – Books of Original Entries

Journalizing Transactions

Recapitulation – Analyzing Dr & Cr

Main Heads	Nature	Increase	Decrease
Assets	Dr	Dr	Cr
Expenses	Dr	Dr	Cr
Owners' Equity	Cr	Cr	Dr
Liabilities	Cr	Cr	Dr
Incomes	Cr	Cr	Dr

Recapitulation – Books of Accounts



Journal

- First book in accounting cycle
- Maintained chronologically
- Prepared systematically
- For small entities, a general-purpose journal is quite sufficient

Source of images: Google

Journal Entry

Information recorded in general journal is known as *journal entry or accounting entry or entry*.

Parts of a Journal Entry

There are six parts of an entry in Accounting language:

1) Date
2) Particulars
3) Post reference
4) Debit amount
5) Credit amount
6) Narration

Format of Journal & Journal Entry

<u>Sample Transaction</u>

1st Jan 20X9, Cash paid for staff salaries Rs.50,000

1 2 3 4 5

Date 20X9	Particulars/Description	Post Ref.	Debit (Rs)	Credit (Rs)
Jan. 1	Salaries Account (Debit) Cash Account (Credit) (Staff salaries paid in cash)	39 10	50,000	 50,000

6

Source of images: Google

Important Tips To Remember - ITTR

1. Journal is a book of original / primary entry
2. Journal is maintained in chronological sequence
3. Narration is an integral part of Journal entry

Journal – Books of Original Entries

Practice Journal Entry

Practice 4.1

Pass journal entries for the following transactions:

20X9

Jan. 2 Goods bought for cash Rs.20.000.

Jan. 5 Goods sold for cash Rs.35,000.

Jan. 7 Loan taken from friend in cash Rs.50,000.

Source of images: Google

Practice 4.1 – Answer

Date 20X9	Particulars/Description		Post Ref.	Debit (Rs)	Credit (Rs)
Jan. 2	Purchases Account	(Debit)	?	20,000	
	Cash Account	(Credit)	?		**20,000**
	(Bought goods for cash)				
Jan. 5	Cash Account	(Debit)	?	35,000	
	Sales Account	(Credit)	?		**35,000**
	(Sold goods for cash)				
Jan. 7	Cash Account	(Debit)	?	50,000	
	Loan from friend	(Credit)	?		**50,000**
	(Loan taken in cash from friend)				

Important Tips To Remember - ITTR

1. Debit account comes first and its amount is written in the left column
2. Credit account is written under the debit account by indenting few space and its amount is written in the right side column
3. Don't put "To" as a prefix to the credit accounting head

Journal – Books of Original Entries

Compound Entry

Compound Entry

The single journal entry, which combines multiple journal entries in which same accounting head is repeating

Example – Compound Entry

5 Jan 20X9:

Cash Rs.7,000 was paid for salaries and

Cash Rs.1,000 was paid for purchase of stationery

Date 20X9	Particulars/Description	Post Ref.	Debit (Rs)	Credit (Rs)
Jan. 5	Salaries account Cash account (Salaries paid in cash)	? ?	7,000	 7,000
Jan. 5	Stationery account Cash account (Stationery purchased for cash.)	? ?	1,000	 1,000

Source of images: Google

Example – Compound Entry

5 Jan 20X9:

Cash Rs.7,000 was paid for salaries and

Cash Rs.1,000 was paid for purchase of stationery.

Date 20X9	Particulars/Description	Post Ref.	Debit (Rs)	Credit (Rs)
Jan. 5	Salaries account Stationery account Cash account (Salaries paid & Stationery purchased for cash)	? ? ?	7,000 1,000	 8,000

Source of images: Google

Important Tips To Remember - ITTR

1. Compound entry combines two journal entries in which one accounting head is common
2. Sum of Dr. should always remain equal to sum of Cr.
3. Narration should be simple and understandable

Journal – Books of Original Entries

Practice General Journal

Practice 4.2

Prepare a journal for the following transactions

Jan 1: Capital introduced in the business Rs.10,000 in cash and Rs.20,000 as machinery.
Jan 2: Purchase land for cash Rs.4,000.
Jan 3: Purchase goods for cash Rs.2,000 and on credit from Giant Store Rs.7,000.
Jan 4: Sold goods for cash Rs.3,000.
Jan 5: Rent paid in cash Rs.2,000.
Jan 6: Owner withdrew cash for personal use Rs.500 **OR** Paid Rs.500 to owner for his personal use.
Jan 7: Salaries paid in cash Rs.200.
Jan 8 Bought goods from Moon Light on credit Rs.6,000.
Jan 9 Sold goods on credit to Falcon for Rs.8,000 and for cash Rs.4,000.
Jan10: Received cash from Falcons 2,500 on his account.

Practice 4.2 – Answer

Date 20X9	Particulars	Post Ref.	Debit (Rs)	Credit (Rs)
Jan. 1	Cash Account	?	10,000	
	Machinery Account	?	20,000	30,000
	Capital Account			
	(Cash & machinery introduced as capital)			
Jan. 2	Land Account	?	4,000	
	Cash Account	?		4,000
	(Purchased land for cash)			
Jan. 3	Purchases Account	?	9,000	
	Cash Account	?		2,000
	Creditor (Giant Store)			7,000
	(Goods purchased for cash & on credit from Giant Store)			
Jan. 4	Cash Account	?	3,000	
	Sales Account	?		3,000
	(Sold goods for cash)			
Jan. 5	Rent Account	?	2,000	
	Cash Account	?		2,000
	(Rent paid in cash)			

Practice 4.2 – Answer

Date 20X9	Particulars	Post Ref.	Debit (Rs)	Credit (Rs)
Jan. 6	Drawings Account Cash Account (Cash withdrew by the owner for personal use).	? ?	500	 500
Jan. 7	Salaries Account Cash Account (Salaries paid in cash).	? ?	200	 200
Jan. 8	Purchased Account Creditors (Moon Light) Account (Purchase goods on credit from Moon Light).	? ?	6,000	 6,000
Jan. 9	Debtors (Falcon) Account Cash Account Sales Account (Sold goods on credit to Falcons and goods sold for cash)	? ? ?	8,000 4,000	 12,000
Jan. 10	Cash Account Debtors (Falcons) Account (Received cash from Falcons on account).	? ?	2,500	 2,500

Important Tips To Remember - ITTR

1. It is not compulsory to write "Account" or along with the accounting head appearing in journal entry
2. "Account" can be abbreviated as "a/c" or "A/C"
3. Identify the name of debtor and creditor in journal entry

Journal – Books of Original Entries

Discounts

Discounts

A trader often allows its customers two types of discounts

1. Trade discount
2. Settlement discount

Source of images: Google

Trade Discount

Offered by a seller to its customers before entering into transaction based on some policy

Examples – Trade Discount

1. Bulk purchase discounts
2. Regular customer discounts
3. Season end discounts

Trade discounts are never recorded in the books of either party (Seller or Buyer)

Working – Trade Discount

List price of a product is Rs.220 and retail seller offers 10% discount to its customers.

220 – (220 x 10%)

220 – 22

Rs.198

	Rs.	Rs.
Purchases Account	198	
Cash Account		198

Settlement Discount

Offered by a seller to its customers based on cash settlement terms for early payment of the invoice.

Also known as cash discount.

Working – Settlement Discount

Invoice	Rs.2,000
Terms	5/10, n/30

Settlement discount
(2,000 x 5%) = Rs.100

- it is recorded in the books of Seller and Buyer
- for seller it is "*discount allowed*"
- for buyer it is "*discount received*"

Important Tips To Remember - ITTR

1. Trade discount is never recorded in journal entry
2. Settlement discount is recorded as "discount allowed" or "discount received"
3. Settlement discount reflects settlement terms

Journal – Books of Original Entries

Journalizing Settlement Discounts

Scenario – Settlement discount

Scenario (i)

Cash received from debtor Rs.114 in full settlement of his account of Rs.120.

	Rs.	Rs.
Cash Account	**114**	
Debtor Account		**114**
Discount Allowed	**6**	
Debtor Account		**6**

Combining the two entries

Cash account	**114**	
Discount Allowed	**6**	
Debtors Account		**120**

Scenario – Settlement discount

Scenario (ii)

Cash paid to creditors Rs.95 after deducting a discount of Rs.5.

	Rs.	Rs.
Creditor Account	**95**	
Cash Account		**95**
Creditor Account	**5**	
Discount Received		**5**

Combining the two entries

Creditor's Account	**95**	
Cash Account		**90**
Discount Received		**5**

Settlement terms – Sample invoice

Invoice# 123456 Date: 19/12/20X9	Business Name and Address John Smith Traders Customer's Name and Address Star Traders			
Description		Qty	Rate Rs.	Amount Rs.
1. Fans		5	2,000	10,000
2. Air conditioner		2	25,000	50,000
3. Room Coolers		3	10,000	30,000
Sub Total				90,000
Trade discount 10%				(9,000)
Net amount of invoice				81,000
Settlement term: 2/10, n/30				

Accounting entries – Sample invoice

In the Books of Seller (John Smith Traders)

Date	Particulars	Rs.	Rs.
Dec. 19	Debtors A/c.	81,000	
	Sales A/c.		81,000
	If settled before		
Dec. 29	Cash A/c.	79,380	
	Discount allowed A/c.		1,620
	Debtors A/c.		81,000
	If settled after		
Dec. 29	Cash A/c.	81,000	
	Debtors A/c.		81,000

Accounting entries – Sample invoice

In the Books of Buyer/Customer (Star Traders)

Date	Particulars	Rs.	Rs.
Dec. 19	Purchases A/c.	81,000	
	Creditors A/c.		81,000
	If settled before		
Dec. 29	Creditors A/c.	81,000	
	Cash A/c.		79,380
	Discount received A/c.		1,620
	If settled after		
Dec. 29	Creditors A/c.	81,000	
	Cash A/c.		81,000

Important Tips To Remember - ITTR

1. Discount allowed is expense
2. Discount received is income
3. Amount in front of “cash account” should always be net of discount

Journal – Books of Original Entries

Practice Journalizing Complex Transactions

Practice 4.4 – Journalizing

Dec 1: Business started with cash Rs.100,000 and furniture worth Rs.35,000 as capital

Dec 2: Machinery purchased from Jordan on credit Rs.20,000

Dec 4: Loan taken from bank Rs.200,000

	Particulars	PR	Dr. Rs. 000	Cr. Rs. 000
1	Cash Account Furniture Account Capital Account (Cash and Furniture introduced as capital)	? ? ?	100 35	 135
2	Machinery Account Creditors (Jordan)Account (Machinery purchased on credit from Jordan)	? ?	20	 20
4	Bank Account Bank Loan Account (Loan taken from Bank)	? ?	200	 200

Practice 4.4

Dec 6: Machinery returned to Jordan Rs.20,000

Dec 8: Bought goods on credit from Pearl Traders Rs.60,000

Dec 10: Bought goods on credit from Giant Store for Rs.100,000 subject to a 5% trade discount.

	Particulars	PR	Dr. Rs. 000	Cr. Rs. 000
1	Creditors (Jordan) Machinery Account (Machinery returned to Jordan).	? ?	20	 20
2	Purchase Account Creditors (Pearl Traders) Account (Bought goods on credit from Pearl Traders)	? ?	60	 60
4	Purchases Account Creditors (Giant Store) Account (Goods purchased on trade discount of 5%) (100,000 X 95%)	? ?	95	 95

Practice 4.4

Dec 11: Goods sold for Rs.20,000 to Falcon on settlement terms 5/10, n/30.

Dec 12: Sold goods on credit to John Smith for Rs.80,000.

Dec 16: Goods returned to Pearl Traders Rs.10,000.

	Particulars	PR	Dr. Rs. 000	Cr. Rs. 000
11	Debtor (Falcon) Account	?	20	
	Sales Account	?		20
	(Goods sold on credit on settlement term 5/10, n/30)			
12	Debtors (John Smith) Account	?	80	
	Sales Account	?		80
	(Goods sold on credit)			
16	Creditors (Pearl Traders) Account	?	10	
	Purchases Return Account	?		10
	(Goods returned to Pearl Traders).			

Practice 4.4

Dec 17: Falcon settled his account in full.

Dec 18: Cash paid to Pearl Traders Rs.48,000 in full settlement of his account.

Dec 20: Goods returned by John smithRs.20,000.

	Particulars	PR	Dr. Rs. 000	Cr. Rs. 000
17	Cash Account	?	19	
	Discount Account	?	1	
	Debtor (Falcon) Account			20
	(Cash received & discount allowed 5%)			
18	Creditor (Pearl Trader) Account	?	50	
	Cash Account	?		48
	Discount Received	?		2
	(Final settlement to Pearl Trader 60-10=50			
16	Sales return Account	?	20	
	Debtors (John Smith) Account	?		20
	(Goods returned by John Smith).			

Practice 4.4

Dec 22: Charity paid in cash Rs.2,000.

Dec 23: Goods worth Rs.5,000, Cash Rs.10,000 were taken away by the proprietor for personal use.

Dec 26: Goods distributed as free sample Rs.13,000 and given away as charity worth Rs.2,000.

	Particulars	P R	Dr. Rs. 000	Cr. Rs. 000
22	Charity Account	?	2	
	Cash Account			2
	(Charity paid in cash).			
23	Drawings Account	?	15	
	Cash Account	?		10
	Purchases Account	?		5
	(Owner withdrew cash & goods for personal use).			
26	Free Sample Account	?	13	
	Charity Account		2	
	Purchases Account	?		15
	(Goods distributed as free sampling & given away as charity).			

Important Tips To Remember - ITTR

1. Discount to Debtor is always "Expense". It doesn't mean cash payment
2. Discount from Creditor is always "Income". It doesn't mean cash received
3. Practice this exercise at least three times

Journal – Books of Original Entries

Practice Journalizing Complex Transactions

Practice 4.5 – Journalizing

Dec 2: Machinery purchased from Jordan on credit Rs.40,000

Dec 4: Machinery lost in fire accident Rs.20,000

	Particulars	PR	Dr. Rs.	Cr. Rs.
2	Machinery Account Creditors (Jordan)Account (Machinery purchased on credit from Jordan).	?	40,000	 40,000
4	Loss by Fire Account Machinery Account (Machinery lost in fire)	? ?	20,000	 20,000

Practice 4.5 – Journalizing

Dec 8: Cash withdrawal from bank Rs.5,000 for office use
Dec 10: Cash stolen from Business Rs.3,000

	Particulars	PR	Dr. Rs.	Cr. Rs.
2	Cash Account Bank Account (Cash withdrawn from bank).	?	5,000	 5,000
23	Loss by theft Account Cash Account (cash stolen)	? ?	3,000	 3,000

Practice 4.5 – Journalizing

Dec 11: Owner sold his saving bonds of value Rs.30,000 and invested that money in business
Dec 12: Profit earned on Bank Deposits Rs.12,000

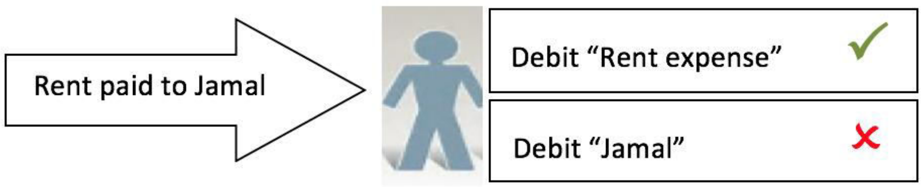
	Particulars	PR	Dr. Rs.	Cr. Rs.
11	Cash Account Capital Account (Fresh capital introduced by owner)	?	30,000	 30,000
12	Bank Account Profit on bank Account (Profit earned on bank deposits)	? ?	12,000	 12,000

Practice 4.5 – Journalizing

Dec 16: Received commission from a client Rs.10,000

Dec 17: Rent paid to Jamal by cheque Rs.20,000

	Particulars	PR	Dr. Rs.	Cr. Rs.
2	Cash Account Commission Account (Commission received)	?	10,000	 10,000
23	Rent Account Bank Account (Rent paid by cheque)	? ?	20,000	 20,000



Important Tips To Remember - ITTR

While analyzing "Expenses" & "Incomes" for Dr or Cr, never use "*personal account"* like name of the person to whom expense is being paid or from whom income is being received. Use "*nominal accounts*" as Dr. account or Cr. account.

For example:

1. Salaries paid to John, Steve and Zara; here personal account "*the names*" shall not be debited rather <u>salaries</u> as an expense account will be debited.
2. Received commission from David, Nasar, and Rajab; here personal account "*the names*" shall not be credited rather <u>commission</u> as an income account will be credited.

Important Tips To Remember - ITTR

1. Any event of loss belongs to "Expense"
2. Profits and gains belong to "Income"
3. Consider the difference between "withdrawal for office use" and "withdrawal for personal use"
4. Dealing in cheque affects "Bank a/c"

Journal – Books of Original Entries

Subdivision of Journal

Subdivision of Journal

Journal is sub-divided because of large size of business. Subdivision of journal is required because:

- frequent cash transactions
- large number of credit purchases and credit sales are creating numerous Debtors and Creditors

Types of Journal

1. Sales journal
2. Purchase journal
3. Sale return journal
4. purchase return journal
5. Cash book or cash journal or cash register
6. General journal

Important Tips To Remember - ITTR

1. Journal is also termed as “Day Book”
2. Broadly speaking there are three types of Journal or Day Book
   a) for credit transactions
   b) for cash transactions
   c) for other events and conditions

Journal – Books of Original Entries

Sales Journal

Sales Journal

✓ Credit sales
× Cash sales

- **Need for Sales Journal**
- **Recording transactions in Sales Journal**

Practice 4.5

Record following transactions in a Sales Journal.

Feb 1: Credit sales to Nelson Rs.3,875
Feb 3: Credit sales to John Smith Rs.1,667
Feb 6: Credit sales to Moon Light Rs.1,285
Feb 10: Credit sales to Super Mart Rs.550
Feb 17: Credit sales to Moon Light Rs.9,280
Feb 19: Credit sales to Popular Traders Rs.2,880
Feb 27: Credit sales to Pearl Traders Rs.8,250
Feb 28: Credit sales to Royal Club Rs.4,244

Date 20X9	Name of Debtors	Invoice no.	Post Ref.	Amount Rs.
Feb 1	Nelson			3,875
Feb 3	John Smith			1,667
Feb 6	Moon Light			1,285
Feb 10	Super Mart			550
Feb 17	Moon Light			9,280
Feb 19	Popular traders			2,880
Feb 27	Pearl Traders			8,250
Feb 28	Royal club			4,244
Feb 28	Total			32,031

Important Tips To Remember - ITTR

1. Only and only credit transactions for sales are recorded in sales journal
2. Single effect is recorded in sales journal
3. Sales journal is totaled after a regular interval

Journal – Books of Original Entries

Purchase Journal

Purchase Journal

✓ Credit purchases
× Cash purchases

- Need for Purchase Journal
- Recording transactions in Purchase Journal

Practice 4.6

Record following transactions in a Purchase Journal.

Feb 1: Credit Purchase from Shahla Rs.2,875
Feb 3: Credit Purchase from Samrana Rs.667
Feb 6: Credit Purchase from Amara Rs.285
Feb 10: Credit Purchase from Fareeha Rs.550
Feb 17: Credit Purchase from Saima Rs.8,280
Feb 19: Credit Purchase from Arooj Rs.1,880
Feb 27: Credit Purchase from Naila Rs.7,250
Feb 28: Credit Purchase from Shumaila Rs.3,244

Date 20X9	Name of Creditor	Invoice no.	Post Ref.	Amount Rs.
Feb 1	Shahla			2,875
Feb 3	Samrana			667
Feb 6	Amara			285
Feb 10	Fareeha			550
Feb 17	Saima			8,280
Feb 19	Arooj			1,880
Feb 27	Naila			7,250
Feb 28	Shumaila			3,244
Feb 28	Total			25,031

Important Tips To Remember - ITTR

1. Only and only credit transactions for purchases are recorded in purchases journal
2. Single effect is recorded in purchase journal
3. purchase journal is totaled after a regular interval

Journal – Books of Original Entries

Sales Return Journal

Sales Return Journal

Goods sold on credit - returned by customers

- **Need for Sales Return Journal**
- **Recording transactions in Sales Return Journal**

Practice 4.7

Record following transactions in a Sales Return Journal

Feb. 1: Goods returned by Madinah Stores Rs.200
Feb. 9: Goods returned by John SmithRs.100
Feb. 10: Goods returned by Giant Store Rs.300
Feb. 11: Goods returned by Falcons Rs.400
Feb. 16: Goods returned by Pearl Traders Rs.50
Feb. 19: Goods returned by Nelson Rs.150
Feb. 23: Goods returned by Mega Mart Rs.500
Feb. 28: Return inwards by Giant store Rs.600

Date 20X9	Name of Debtors	Credit note no.	Post Ref.	Amount Rs.
Feb. 1	Madinah Stores			200
Feb. 9	John Smith			100
Feb. 10	Giant Store			300
Feb. 11	Falcons			400
Feb. 16	Pearl Traders			50
Feb. 19	Nelson			150
Feb. 23	Mega Mart			500
Feb. 28	Giant Store			600
Feb 28	Total			2,300

Important Tips To Remember - ITTR

1. Only and only credit transactions for sales return are recorded in sales return journal
2. Single effect is recorded in sales return journal
3. Sales return journal is totaled after a regular interval

Journal – Books of Original Entries

Purchase Return Journal

Purchase Return Journal

Goods purchased on credit - returned to suppliers

- **Need for Purchase Return Journal**
- **Recording transactions in Purchase Return Journal**

Practice 4.8

Record following transactions in a Purchase Return Journal
Feb. 1: Goods returned to Mega Mart Rs.200
Feb. 3: Goods returned to Royal club Rs.600
Feb. 7: Goods returned to Super Mart Rs.120
Feb. 9: Goods returned to Moon Light Rs.300
Feb. 11: Goods returned to Star Gold Rs.500
Feb. 19: Goods returned to Dunhill mart Rs.600
Feb. 23: Return outwards to Falcon Rs.800

Date 20X9	Name of Creditors	Credit Note No.	Post Ref.	Amount Rs.
Feb. 1	Mega Mart			200
Feb.3	Royal Club			600
Feb. 7	Super Mart			120
Feb. 9	Moon Light			300
Feb. 11	Star Gold			500
Feb. 19	Dunhill mart			600
Feb. 23	Falcon			800
Feb. 28	Total			3,670

Important Tips To Remember - ITTR

1. Only and only credit transactions for purchase return are recorded in purchase return journal
2. Single effect is recorded in purchase return journal
3. Purchase return journal is totaled after a regular interval

Journal – Books of Original Entries

Practice Subdivided Journals

Practice 4.9

Record transactions in the appropriate journals

Dec 2: Credit sales to Nelson Rs.600, John smithRs.200, Hills Bros. Rs.500
Dec 4: Credit purchases from Giant store Rs.450, Star Gold Rs.300, Moon Light Rs.250
Dec 5: Credit sales to Madinah Stores Rs.630, John smithRs.500, Falcon Rs.420
Dec 6: Credit purchase from Falcon Rs.1,000
Dec 10: Goods returned by Nelson Rs.100, John smithRs.50
Dec 12: Goods returned to Star Gold Rs.80, Giant store Rs.30
Dec 18: Credit sales to Super Mart Rs.650
Dec 24: Return outwards to Falcon Rs.200
Dec 28: Return inwards from Super Mart Rs.150

Practice 4.9 – Answer

Sales Journal

Date	Name of Debtors	Invoice No.	Post. Ref.	Amount Rs.
Dec 2	Nelson			600
	John Smith			200
	Hills Bros.			500
Dec 5	Madinah stores			630
	John Smith			500
	Falcon			420
Dec 18	Super Mart			650

Sales Return Journal

Date	Name of Debtors	Credit Note No.	Post Ref.	Amount Rs.
Dec. 10	Nelson			100
	John Smith			50
Dec. 28	Super Mart			150

Practice 4.9 – Answer

Purchase Journal

Date	Name of Creditors	Invoice No.	Post. Ref.	Amount Rs.
Dec 4	Giant Store			450
	Star Gold			300
	Moon Light			250
Dec 6	Falcon			1,000

Purchase Return Journal

Date	Name of Creditors	Credit Note No.	Post Ref.	Amount Rs.
Dec. 12	Star Gold			80
	Giant store			30
Dec. 24	Falcon			200

Important Tips To Remember - ITTR

1. Return outwards is “purchase return”
2. Return inwards is “sales return”

Journal – Books of Original Entries

Cash Journal
Cash Book

Cash Book

- **Need for Cash Book**
- **Recording transactions in Cash Book**
- **Types of Cash Book**
  1. Single column cash-book
  2. Two column cash-book
  3. Three column cash-book
  4. Petty cash book

Cash book - Format

Cash Book (Single Column)

Date	RECEIPTS Particulars	Post Ref.	Amount Rs.	Date	PAYMENTS Particulars	Post Ref.	Amount Rs.

Cash Book (Two Column)

Date	RECEIPTS Particulars	P/R	Cash Rs.	Bank Rs.	Date	PAYMENTS Particulars	P/R	Cash Rs.	Bank Rs.

Cash Book (Three Column)

Date	RECEIPTS Particulars	Disc allowed	Cash Rs.	Bank Rs.	Date	PAYMENTS Particulars	Disc Received	Cash Rs.	Bank Rs.

Cash Book (Petty Expenses)

Date	Receipts Rs.	Particulars	Total Payments Rs.	Enter-tainment Rs.	Photo copy Rs.	Repair Rs.	Travelling Rs.	Postage Rs.	Misc. Rs.

Important Tips To Remember - ITTR

1. Only and only cash transactions are recorded in cash book
2. Bank is cash equivalent
3. Discounts are associated to cash receipts and cash payments

Journal – Books of Original Entries

Single Column Cash Book

Practice 4.10

Record following transactions in a cash book with single cash column and find closing balance to carry forward.

		Rs.
Mar. 1:	Balance brought forward (b/f)	4,000
Mar. 3:	Sold goods for cash	40,000
Mar. 7:	Sold goods on credit to Alpha	75,000
Mar. 10:	Bought goods for cash	28,000
Mar. 15:	Bought goods on credit from Beta	42,000
Mar. 18:	Received cash from Debtor (Alpha)	75,000
Mar. 19:	Made part payment in cash to Creditor (Beta)	15,000
Mar. 20:	Paid staff salaries	20,000
Mar. 26:	Bought furniture for cash	25,000
Mar. 30	Paid Electricity bill	5,000

Practice 4.10 - Answer

Cash Book

Date 20X9	RECEIPTS Particulars	Post Ref.	Rs.	Date 20X9	PAYMENTS Particulars	Post Ref.	Rs.
Mar.1	Balance b/f		4,000	Mar. 10	Purchases		28,000
3	Sales		40,000	19	Creditor (Beta)		15,000
18	Debtor (Alpha)		75,000	20	Staff salaries		20,000
				26	Furniture		25,000
				30	Electricity bill		5,000
				31	Balance c/f		26,000
			119,000				119,000

Important Tips To Remember - ITTR

1. Cash is "Asset", its opening balance will always be placed in Dr. side (Receipt side)
2. Closing balance of cash is excess of receipts over payments
3. Closing balance of Cash is always placed in Cr. side to balance the both sides

Journal – Books of Original Entries

Two Column Cash Book

Practice 4.11

Record following transactions into a cash book with cash and bank columns, also find closing balance for both columns to carry forward.

20X9

Mar. 1	Balances brought forward cash Rs.7,000; bank Rs.25,000
Mar. 2	Sold goods for cash Rs.40,000, the amount was deposited into bank on the same date.
Mar. 5	Bought stationary for cash Rs.2,000
Mar. 9	Bought furniture, payment made by cheque Rs.10,000
Mar. 15	Received Rs.15,000 in cash from Debtor Sagheer
Mar. 16	Received a cheque of Rs.20,000 from Debtor Kabeer and deposited into bank
Mar. 20	Made payment to a creditor Abeer through cheque Rs.18,000
Mar. 22	Cash withdrawn from bank for office use Rs.25,000
Mar. 25	Cash withdrawn from Bank from owner's personal use Rs.8,000
Mar. 28	Cash received from sale of old machine Rs.60,000
Mar. 30	Cash deposited into bank Rs.75,000 and paid salaries in cash Rs.20,000

Practice 4.11 - Answer

Cash Book

Date 20X9	RECEIPTS Particulars	PR	Cash Rs.	Bank Rs.	Date 20X9	PAYMENTS Particulars	PR	Cash Rs.	Bank Rs.
Mar. 1	Balance b/f		7,000	25,000	Mar. 05	Stationery		2,000	
2	Sales			40,000	09	Furniture			10,000
15	Debtor - Sagheer		15,000		20	Creditor - Abeer			18,000
16	Debtor - Kabeer			20,000	22	Cash	C		25,000
22	Bank	C	25,000		25	Drawings			8,000
28	Machine Disposal		60,000		30	Bank	C	75,000	
30	Cash	C		75,000	30	Salaries		20,000	
					31	Balance c/f		10,000	99,000
			107,000	160,000				107,000	160,000

Important Tips To Remember - ITTR

1. In "Contra Entry", "cash account" reciprocates with "bank account"
2. Contra entries:
   a) Cash deposited into bank
   b) Cash withdrawn from bank for office use

Journal – Books of Original Entries

Three Column Cash Book

Practice 4.12

Record following transactions into three column cash-book; with cash, bank, and discount columns, also find closing balances to carry forward.

20X9

Mar. 1	**Balance brought forward: Cash Rs.3,000; Bank overdraft Rs.10,000**
Mar. 5	**Cash received from debtor Burhan in full settlement of his account balance Rs.50,000, after subtracting 8% cash discount.**
Mar. 10	**Received a cheque of Rs.70,000 from debtor Hanan in full settlement of his account after subtracting cash discount Rs.5,000.**
Mar. 15	**Goods sold on credit to debtor Zain worth Rs.80,000 subject to settlement terms 5/10, n/30 and a trade discount of Rs.4,000. (credit transaction – no effect in cash book)**
Mar. 20	**Paid Rs.40,000 through cheque to creditor Rehan after subtracting cash discount Rs.4,000.**
Mar. 25	**Paid to Bilal his account balance due Rs.25,000 in cash after subtracting cash discount Rs.2,000.**
Mar. 30	**Received cheque from debtor Athar against sales made on March 15th and deposited into bank.**
Mar. 31	**Cash in excess of Rs.6,000 is to be deposited into bank. (Rs.6,000 should remain in cash balance c/f)**

Practice 4.12 - Answer

Cash Book

Date 20X9	Receipts Particulars	PR	Cash Rs.	Bank Rs.	Disc. Allow Rs.	Date 20X9	Payments Particulars	PR	Cash Rs.	Bank Rs.	Disc. Rec Rs.
Mar. 1	Balance b/f		3,000			Mar. 1	Balance b/f			10,000	
5	Debtor - Burhan		46,000		4,000	20	Creditor - Rehan			40,000	4,000
10	Debtor - Hanan			70,000	5,000	25	Creditor - Bilal		23,000		2,000
30	Debtor - Athar			76,000		31	Bank	C	20,000		
31	Cash	C		20,000		31	Balance c/f		6,000	116,000	
			49,000	166,000	9,000				49,000	166,000	6,000

Important Tips To Remember - ITTR

1. Bank is not always “Asset”. It is “Liability” if cash is overdrawn from bank upon facility
2. Opening balance of bank over draft is placed in the payment side

Journal – Books of Original Entries

Petty
Cash Book

Petty Cash Book

Accountants separately recognize cash at bank, cash in hand and petty cash:

1. Main Cash (significant)
2. Petty Cash (insignificant)

Mechanism to maintain Petty Cash Book

1. Petty Cash System
2. Imprest System

Petty Cash System

Petty cashier receives a fixed amount at the start of each week to meet petty expenses during that week.

Example

In the first week of business setup the petty cashier receives Rs.1,000 and spends Rs.970 for different petty expenses and left with a balance of Rs.30 in petty cash box. In the start of second week; the petty cashier once again receives Rs.1,000 from the main cash and keeps it in the petty cash box that increases the balance of petty cash box, on that day, to Rs.1,030. During the second week the petty cashier spends Rs.990. Now the balance in petty cash box, at the end of second week, is Rs.40. In the start of third week the petty cashier once again receives Rs.1,000 from the main cash book and keeps it in the petty cash box that increases the balance in petty cash box to Rs.1,040.

Imprest System

An imprest amount is fixed and provided to petty cashier that is subsequently topped-up exactly equal to the amount spent during the previous period for petty expenses.

Example

a petty cashier receives Rs.1,000 at the start of first week to meet petty expenses during that week on imprest system. The petty cashier spends Rs.970 for different petty expenses and left with a balance of Rs.30 in petty cash box. In the start of second week; the petty cashier receives Rs.970 from the main cash in order to top-up petty cash box balance up to Rs.1,000. During the second week the petty cashier spends Rs.990. Now the balance in petty cash box, at the end of second week, is Rs.10 and the amount for top-up is Rs.990 to make the balance in petty cash box equal to Rs.1,000.

Practice 4.13

Record following transactions in petty cash book on imprest system. Imprest limit is Rs.1,000.

Date	Transactions	Rs.
Jan 01	Funds transferred from main cash for petty expenses	1,000
Jan 01	Paid for tea bags	150
Jan 02	Paid for cycle repair	200
Jan 03	Paid for photocopies	50
Jan 03	Paid for cycle stand at bank	10
Jan 03	Paid for postage	60
Jan 05	Paid for sugar and tea biscuits	220
Jan 06	Paid for stove repair	180
Jan 07	Paid for stationery	120

Practice 4.13 - Answer

Petty Cash Book

Date	Receipt Rs.	Particulars	Total Payment Rs.	Enter-tainment Rs.	Photo copy Rs.	Repair Rs.	Travelling Rs.	Postage Rs.	Stationery Rs.
Jan 01	1,000	Imprest from Main Cash							
Jan 01		Tea bags	150	150					
Jan 02		Cycle repair	200			200			
Jan 03		Photocopy	50		50				
Jan 03		Cycle stand	10				10		
Jan 03		Postage	60					60	
Jan 05		Sugar etc.	220	220					
Jan 06		Stove repair	180			180			
Jan 07		Stationery	120						120
		Balance c/f	10						
	1,000	Total	1,000	370	50	380	10	60	120
Jan 08	10	Balance b/f							
Jan 08	990	Imprest from Main Cash							

Important Tips To Remember - ITTR

1. Petty cash book is prepared for insignificant payments
2. Receipt side has single column, payment side is divided into multiple columns
3. Imprest is topped up with actual spending in the previous period

Practice 4.14

Choose correct answer

1.Goods purchased from John smith Rs.500 are debited to _____

a)John smith account

b)Goods Account

c)Cash Account

d)Purchases Account

2.Commission paid to agent Jordan Rs.1,000 will be debited to _____

a)Commission account

b)Cash Account

c)Jordan Account

d)None of above

3.Goods purchased for Rs.5,000 subject to 10% trade discount, amount to be debited to purchases account will be _____

a)5,000

b)5,500

c)4,500

d)None of the above

Practice 4.14

4.Goods returned from debtors will be recorded in which book of account?

a)Return inward journal
b)Return outward journal
c)Purchase journal
d)General journal

5.Payment received from Star Brothers Rs.4,800 in full settlement of Rs.5,000 will be debited to _____

a)Cash Account
b)Discount allowed Account
c)Star Brothers Account
d)Both a. and b.

6.Loan repaid to Hassan Brothers will be debited to _____

a)Hassan Brothers
b)Hassan Brothers' Loan Account
c)Cash Account
d)None of above

Practice 4.14

7.Goods purchased for cash will be recorded in which book of account?

a) Purchase journal
b) Cash book
c) General journal
d) a and b both

8.Machinery purchased from on credit from Caterpillar will be recorded in which book of account?

a) Assets journal
b) Purchases journal
c) General journal
d) Machinery journal

Practice 4.14

9. Stock lost in fire will be credited to _____
   a) Stock account
   b) Goods Account
   c) purchases Account
   d) Loss by fire Account

10. Short explanation written below the accounting entry is called _____
   a) Explanation
   b) Narration
   c) Compound entry
   d) None of above

Answer: (1-d, 2-a, 3-c, 4-a, 5-d, 6-b, 7-b, 8-c, 9-c, 10-b)

Chapter - 5

Main Ledger / General Ledger / Nominal Ledger

(Book of secondary entries)

and

Trial Balance

Topic Videos 47-57 are mandatory part of this module

MGT 101

Financial Accounting

By

Mian Ahmad Farhan, FCA

Contents

Sr. No	Course outline Topics
1	Need for ledger
2	Chart of Accounts
3	Format of ledger account
4	Posting from General Journal into Main Ledger
5	Posting of Compound Entries into Main Ledger
6	Practice – Posting Process
7	Balancing the ledger accounts
8	Balancing the ledger accounts - Practice
9	Trial Balance
10	Posting from subdivided journal into main ledger
11	Posting from cash book into main ledger

Ledger and Trial Balance

Need for Ledger

Main Ledger / General Ledger

We need balances of the elements of financial statements for reporting purposes.

Journals do not produce final balances of all accounting heads

Ledger is maintained to extract balances

Important Tips To Remember - ITTR

1. Main ledger is a book of account
2. Ledger account is a summary of similar transactions of an accounting head already recorded in journal
3. Each ledger account gives a balance at the end of reporting period

Ledger and Trial Balance

Chart of Accounts

Chart of accounts

Chart of accounts is a list of the names of **accounts**

Chart of Account – Example

1. Assets

11 Cash

12 Accounts Receivable

14 Stocks

15 Prepaid Insurance

17 Land

18 Office Equipment

2. Liabilities

21 Accounts payable

23 Rent Payable (accrued)

3. Owner's equity

31 Owner's capital

32 Owner's drawings

4. Incomes

41 Sales

42 Sales return

5. Expenses

51 Wages

52 Rent

54 Utilities

55 Stationery

59 Office maintenance

Important Tips To Remember - ITTR

1. Chart of accounts is a list of accounting heads
2. Each chart of account is assigned a unique code
3. Accounting software identifies code assigned to each chart of account

Ledger and Trial Balance

Format of
Ledger Account

Format of ledger accounts

A ledger account, in its T form, has three parts

- Title, the name of accounting head
- Debit side, which is its left-hand side
- Credit side, which is its right-hand side.

Title	
Debit Side	Credit Side

Detailed format of a ledger account

A ledger account with full details is prepared in two styles:

a) T account style

Date	Particulars	Post Ref.	Rs.	Date	Particulars	Post Ref.	Rs.

b) Running balance style

Date	Particulars	Post Ref.	Debit Rs.	Credit Rs.	Dr/ Cr	Balance Rs.

Important Tips To Remember - ITTR

1. For beginners; T account style is easy to understand
2. Practically; Running balance style is used
3. Running balance style gives balance after each posting

Ledger and Trial Balance

Posting from
General Journal
into
Main Ledger

Posting from General Journal

The process of picking up amount from journal and placing into the debit or credit side of relevant ledger account is known as *posting*.

Entry A

On January 1, 20X9 owner introduced cash Rs.25,000 as capital into the business

Journal **Page 01**

Date 2009	Particulars	Post Ref	Rs.	Rs.
Jan.1	Cash account Capital account (Cash introduced as capital in the business)	L61 L08	25,000	 25,000

Cash Account **Page 61**

Date 20X9	Particulars	Post Ref.	Rs	Date 2009	Particulars	Post Ref.	Rs
Jan 1	Capital account	J01	25,000				

Owner's Capital Account **Page 08**

Date 2009	Particulars	Post Ref.	Rs	Date 2009	Particulars	Post Ref.	Rs
				Jan 1	Cash account	J01	25,000

Entry B

On January 5, the owner bought Computer for Rs.8,000 by paying cash

Journal **Page 2**

Date 20X9	Particulars	Post Ref.	Rs.	Rs.
Jan.5	Computer account Cash account (Purchase computer for business)	L10 L61	8,000	 8,000

Cash Account **Page 61**

Date	Particulars	Post Ref.	Rs	Date 20X9	Particulars	Post Ref.	Rs
				Jan 5	Computer account	J02	8,000

Computer Account **Page 10**

Date 20X9	Particulars	Post Ref.	Rs	Date	Particulars	Post Ref.	Rs
Jan5	Cash account	J02	8,000				

Entry C

On January 10, the owner purchased goods on credit from Pasha worth Rs.1,500

Journal — **Page 03**

Date 20X9	**Particulars**	**Post Ref.**	**Rs.**	**Rs.**
Jan.10	Purchases account	L13	1,500	
	Creditor (Pasha) account	L42		1,500
	(Purchased goods on credit)			

Purchases Account — **Page 13**

Date	Particulars	Post Ref.	Rs	Date	Particulars	Post Ref.	Rs
Jan 10	Creditors account	J03	1,500				

Creditors (Pasha) Account

Date	Particulars	Post Ref.	Rs	Date	Particulars	Post Ref.	Rs
				Jan 10	Purchases account	J03	1,500

Entry D

On January 18, received cash of Rs.2,500 from customers for sale of goods

Page 04

Date 20X9	**Particulars**	**Post Ref.**	**Rs.**	**Rs.**
Jan.18	Cash account	L61	2,500	
	Sales account	L24		2,500
	(sold goods for cash)			

Cash Account — **Page 61**

Date 20X9	Particulars	Post Ref.	Rs	Date	Particulars	Post Ref.	Rs
Jan 18	Sales account	J04	2,500				

Sales Account — **Page 24**

Date	Particulars	Post Ref.	Rs	Date 20X9	Particulars	Post Ref.	Rs
				Jan 18	Cash account	J04	2,500

Entry E

On January 30, the owner paid creditors on account, Rs.1,000

Page 05

Date 20X9	Particulars	Post Ref.	Rs.	Rs.
Jan.30	Creditors Cash (Paid creditors on account)	L42 L61	1,000	 1,000

The posting of this entry is shown in the relevant ledger account as follows:

Cash Account **Page 61**

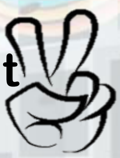
Date	Particulars	Post Ref.	Rs	Date 2009	Particulars	Post Ref.	Rs
				Jan 30	Creditors	J05	1,000

Creditors Account **Page 42**

Date 2009	Particulars	Post Ref.	Rs	Date	Particulars	Post Ref.	Rs
Jan 30	Cash account	J05	1,000				

Important Tips To Remember - ITTR

1. Each journal entry is posted twice in the ledger
2. First, in the debit side of a ledger account and second in the credit side of another ledger account with the same amount.
3. This is because of double entry book keeping system



Ledger and Trial Balance

Posting of Compound Entry into Main Ledger

Entry F (Compound entry)

On January 1, 20X9 owner introduced cash Rs.25,000 and a computer worth Rs.10,000 into the business as capital.

Journal **Page 01**

Date 20x9	Particulars	Post Ref	Rs.	Rs.
Jan.1	Cash account Computer account Capital account (Cash and computer introduced as capital in the business)	L61 L12 L08	25,000 10,000	 35,000

Cash Account **Page 61**

Date 20X9	Particulars	Post Ref.	Rs.	Date	Particulars	Post Ref.	Rs.
Jan 1	Capital account	J01	25,000				

Computer Account **Page 12**

Date 20X9	Particulars	Post Ref.	Rs.	Date	Particulars	Post Ref.	Rs.
Jan 1	Capital account	J01	10,000				

Owners Capital Account **Page 08**

Date	Particulars	Post Ref.	Rs.	Date 20X9	Particulars	Post Ref.	Rs.
				Jan 1	Cash account	J01	25,000
				Jan 1	Computer account	J01	10,000

Post Reference

In journal the post reference column is also named as 'ledger folio (LF)' and in ledger the post reference column is also named as 'journal folio (JF)'.

Journal **Page 01**

Date 2009	**Particulars**	**Post Ref**	**Rs.**	**Rs.**
Jan.1	Cash account Capital account (Cash introduced as capital in the business)	L61 L08	25,000	 25,000

Cash Account **Page 61**

Date 20X9	Particulars	Post Ref.	Rs	Date 2009	Particulars	Post Ref.	Rs
Jan 1	Capital account	J01	25,000				

Owner's Capital Account **Page 08**

Date 2009	Particulars	Post Ref.	Rs	Date 2009	Particulars	Post Ref.	Rs
				Jan 1	Cash account	J01	25,000

Important Tips To Remember - ITTR

1. Sum of Dr. is equal to Sum of Cr.
2. Post reference is page number of journal and ledger
3. Particular column in ledger account shows reason for being debited or credited

Ledger and Trial Balance

Practice
Posting Process

Practice 5.1

Journalize the transactions and prepare ledger accounts

Jan 1	Started business with Rs.200,000 in the bank and Rs.40,000 in cash
Jan 1	Bought shop fittings Rs.40,000 and a van Rs.60,000. Both paid by cheque.
Jan 2	Paid rent expense by cheque Rs.5,000.
Jan 3	Bought goods, for reselling, on credit from Jordan & Co. Rs.50,000
Jan 5	Cash sales Rs.5,000.
Jan 8	Paid wages of assistant in cash Rs.1,000.
Jan 10	Paid insurance expense by cheque Rs.500.
Jan 12	Cash sales Rs.8,000.
Jan 15	Paid wages of assistant in cash Rs.1,000.
Jan 17	Paid Jordan & Co. Rs.30,000 by cheque and goods returned to Jordan & Co.Rs.6,000..
Jan 19	Bought goods, for reselling, on credit from Dunhill & Co. Rs.25,000.
Jan 19	Cash sales Rs.7,000.
Jan 22	Paid wages of assistant in cash Rs.1,000.
Jan 24	Bought stationery and paid in cash Rs.500.
Jan 25	Cash sales Rs.15,000.
Jan 27	Paid Dunhill & Co. Rs.14,000 by cheque.
Jan 29	Paid wages of an assistant in cash Rs.1,000.
Jan 31	Deposited cash Rs.20,000 into the bank.

Practice 5.1 - Answer

Date 20X9	Particulars	Post Ref.	Debit (Rs)	Credit (Rs)
Jan. 1	Bank Account	?	200,000	
	Cash Account	?	40,000	
	Capital Account	?		240,000
	(Capital introduced by the owner)			
Jan. 1	Furniture & Fittings Account	?	40,000	
	Van Account	?	60,000	
	Bank Account			100,000
	(Purchase of furniture & fittings and van for the business)			
Jan. 2	Rent Account	?	5,000	
	Bank Account	?		5,000
	(Rent paid by cheque)			
Jan. 3	Purchases Account	?	50,000	
	Creditors (Jordan & Co.)	?		50,000
	(Purchase goods on credit)			

Practice 5.1 - Answer

Date 20X9	Particulars	Post Ref.	Debit (Rs)	Credit (Rs)
Jan. 5	Cash Account	?	5,000	
	Sales Account	?		5,000
	(Goods sold for cash)			
Jan. 8	Wages Account	?	1,000	
	Cash Account	?		1,000
	(Wages paid in cash)			
Jan. 10	Insurance Account	?	500	
	Bank Account	?		500
	(Insurance paid by cheque)			
Jan. 12	Cash Account	?	8,000	
	Sales Account	?		8,000
	(Goods sold for cash)			
Jan. 15	Wages Account	?	1,000	
	Cash Account	?		1,000
	(Wages paid in cash)			

Practice 5.1 - Answer

Date 20X9	Particulars	Post Ref.	Debit (Rs)	Credit (Rs)
Jan. 17	Creditor (Jordan & Co.) Account	?	36,000	
	Bank Account	?		30,000
	Purchases return Account	?		6,000
	(Paid Jordan & Co. by cheque and returned goods to Jordan & Co.)			
Jan. 19	Purchases Account	?	25,000	
	Creditor(Dunhill) Account	?		25,000
	(Bought goods on credit)			
Jan. 19	Cash Account	?	7,000	
	Sales Account	?		7,000
	(Sold goods for cash)			
Jan. 22	Wages Account	?	1,000	
	Cash Account	?		1,000
	(Paid wages for cash)			

Practice 5.1 - Answer

Date 20X9	Particulars	Post Ref.	Debit (Rs)	Credit (Rs)
Jan. 24	Stationery Account	?	500	
	Cash Account	?		500
	(Stationery purchased for cash)			
Jan. 25	Cash Account	?	15,000	
	Sales Account	?		15,000
	(Goods sold for cash)			
Jan. 27	Creditor (Dunhill & Co) Account	?	14,000	
	Bank Account	?		14,000
	(Paid to creditors by cheque)			
Jan. 29	Wages Account	?	1,000	
	Cash Account	?		1,000
	(Wages paid in cash)			
Jan. 31	Bank Account	?	20,000	
	Cash Account	?		20,000
	(Cash paid into bank)			

Chart of Accounts

Following is the chart of accounts for above journal:

1. Bank account
2. Cash account
3. Capital account
4. Furniture & fittings account
5. Van account
6. Rent account
7. Purchases account
8. Creditor (Jordan & Co) account
9. Sales account
10. Wages account
11. Insurance account
12. Purchases Return account
13. Creditor (Dunhill & Co) account
14. Stationery account

Ledger Accounts

Bank Account

Date 2009	Particulars	Post Ref.	Rs	Date 2009	Particulars	Post Ref.	Rs
Jan 1	Capital Account		200,000	Jan 1	Furniture & Fittings A/c		40,000
Jan 31	Cash Account		20,000	Jan1	Van Account		60,000
				Jan2	Rent Account		5,000
				Jan 10	Insurance Account		500
				Jan 17	Jordan & co. Account		30,000
				Jan 27	Dunhill & Co. Account		14,000

Cash Account

Date	Particulars	Post Ref.	Rs	Date	Particulars	Post Ref.	Rs
Jan.1	Capital Account		40,000	Jan.8	Wages Account		1,000
Jan.5	Sales Account		5,000	Jan.15	Wages Account		1,000
Jan.12	Sales Account		8,000	Jan.22	Wages Account		1,000
Jan.19	Sales Account		7,000	Jan.24	Stationery Account		500
Jan.25	Sales Account		15,000	Jan.29	Wages Account		1,000
				Jan.31	Bank Account		20,000

Ledger Accounts

Capital Account

Date	Particulars	Post Ref.	Rs	Date	Particulars	Post Ref.	Rs
				Jan. 1	Bank Account		200,000
				Jan. 1	Cash Account		40,000

Furniture & Fittings Account

Date	Particulars	Post Ref.	Rs	Date	Particulars	Post Ref.	Rs
Jan 1	Bank Account		40,000				

Ledger Accounts

Van Account

Date	Particulars	Post Ref.	Rs	Date	Particulars	Post Ref.	Rs
Jan 1	Bank Account		60,000				

Rent Account

Date	Particulars	Post Ref.	Rs	Date	Particulars	Post Ref.	Rs
Jan 2	Bank Accounts		5,000				

Ledger Accounts

Purchases Account

Date	Particulars	Post Ref.	Rs	Date	Particulars	Post Ref.	Rs
Jan 3	Jordan & co. Account		50,000				
Jan. 19	Dunhill & Co. Account		25,000				

Creditor (Jordan & co) Account

Date	Particulars	Post Ref.	Rs	Date	Particulars	Post Ref.	Rs
Jan 17	Return outwards A/c		6,000	Jan 31	Purchases A/c		50,000
Jan 17	Bank Account		30,000				

Ledger Accounts

Sales Account

Date	Particulars	Post Ref.	Rs	Date	Particulars	Post Ref.	Rs
				Jan 5	Cash Account		5,000
				Jan 12	Cash Account		8,000
				Jan 19	Cash Account		7,000
				Jan 25	Cash Account		15,000

Wages Account

Date	Particulars	Post Ref.	Rs	Date	Particulars	Post Ref.	Rs
Jan 8	Cash Account		1,000				
Jan 15	Cash Account		1,000				
Jan 22	Cash Account		1,000				
Jan 29	Cash Account		1,000				

Insurance Account

Date	Particulars	Post Ref.	Rs	Date	Particulars	Post Ref.	Rs
Jan 10	Bank Account		500				

Ledger Accounts

Purchases Return Account

Date	Particulars	Post Ref.	Rs	Date	Particulars	Post Ref.	Rs
				Jan 17	Jordan & co. A/c		6,000

Creditor (Dunhill & Co) Account

Date	Particulars	Post Ref.	Rs	Date	Particulars	Post Ref.	Rs
Jan 27	Bank Account		14,000	Jan 19	Purchases A/c		25,000

Stationery Account

Date	Particulars	Post Ref.	Rs	Date	Particulars	Post Ref.	Rs
Jan 18	Cash Account		500				

Important Tips To Remember - ITTR

1. Always develop a chart of account prior to posting process
2. Ledger account of an accounting head summarized all related journal entries recorded in the journal

Ledger and Trial Balance

Balancing the Ledger Accounts

Balancing the ledger accounts

In the above **practice 5.1**, the ledger accounts are not producing final balances, which can be reported in the financial statements.

Balancing figure is an amount that equalizes both sides of a ledger account.

Balancing a Sample accounts

Sample Account

Date	Particulars	Post Ref.	Rs	Date	Particulars	Post Ref.	Rs
Jan 18	Cash Account		5,000	Jan 25	Cash		9,000
Jan 20	Cash Account		7,000				
Jan 30	Cash Account		3,000		Balancing figure	ß	6,000
Total			**15,000**		**Total**		**15,000**

Total Debit	**Rs.15,000**
Total Credit	**Rs. 9,000**
Debit Balance	**Rs. 6,000**

Identifying the Balance

- A balancing figure appearing in the credit side of a ledger account is known as a *Debit Balance* and
- A balancing figure appearing in the debit side of a ledger account is known as *Credit Balance*.

Balancing the ledger accounts

Balance of "Bank account" in the practice 5.1
Step 1. Total of Debit side Rs.220,000.
Step 2. Total of Credit side Rs.149,500.
Step 3. Deduct the sum of lower side out of the sum of higher side; the Balance is Rs.70,500.

Bank Account

Date 1997	Particulars	Post Ref.	Rs	Date	Particulars	Post Ref.	Rs
Jan 1	Capital Account		200,000	Jan 1	Furniture & Fittings A/c		40,000
Jan 31	Cash Account		20,000	Jan1	Van Account		60,000
				Jan2	Rent Account		5,000
				Jan 10	Insurance Account		500
				Jan 17	Jordan & co. Account		30,000
				Jan 27	Dunhill & Co. Account		14,000
				Jan 31	*Balance*	ß	*70,500*
	Total		**220,000**		**Total**		**220,000**

Mechanism of Balancing Ledger

1. Identify "natural side" of the accounting head.
2. Make total of the "natural side" (being greater).
3. Place this sum at the bottom of both sides (Dr. and Cr.) of the ledger account.
4. Deduct, one by one, the amounts of lower side (opposite to the natural side) from the total of the "natural side" (that has already been placed at the bottom).
5. Place the balancing figure in the lower side, so that the sum of both sides remains same.

Contra nature of accounts

There is an exception to the above criterion for contra nature of accounts e.g. sales return account and purchases return account etc.

Because the natural side (greater side) of contra accounts would always be opposite to the group's nature.

Contra Accounts

Original Accounts	Contra Accounts	Main Head
Purchases	Purchases Return	Expense
Sales	Sales Return	Income
Capital	Drawings	Owner's Equity
Fixed Assets	Provision for Depreciation	Asset
Debtors	Provision for Doubtful Debts	Asset

Balance of contra account is always opposite to the balance of its original accounts.

Important Tips To Remember - ITTR

1. Balance appearing in the Cr. side is Dr. balance
2. Balance appearing in the Dr. Side is Cr. balance
3. Balance reflects the nature of the accounting head in terms of Dr. and Cr.

Ledger and Trial Balance

Practice Balancing the Ledger Accounts

Balancing ledger – Practice 5.1

Bank Account

Date 1997	Particulars	Post Ref.	Rs	Date	Particulars	Post Ref.	Rs
Jan 1	Capital Account		200,000	Jan 1	Furniture & Fittings A/c		40,000
Jan 31	Cash Account		20,000	Jan 1	Van Account		60,000
				Jan 2	Rent Account		5,000
				Jan 10	Insurance Account		500
				Jan 17	Jordan & co. Account		30,000
				Jan 27	Dunhill & Co. Account		14,000
				Jan 31	*Balance*	ß	*70,500*
			220,000				**220,000**

Cash Account

Date	Particulars	Post Ref.	Rs	Date	Particulars	Post Ref.	Rs
Jan 1	Capital Account		40,000	Jan 8	Wages Account		1,000
Jan 5	Sales Account		5,000	Jan 15	Wages Account		1,000
Jan 12	Sales Account		8,000	Jan 22	Wages Account		1,000
Jan 19	Sales Account		7,000	Jan 24	Stationery Account		500
Jan 25	Sales Account		15,000	Jan 29	Wages Account		1,000
				Jan 31	Bank Account		20,000
				Jan 31	*Balance*	ß	*50,500*
			75,000				**75,000**

Balancing ledger – Practice 5.1

Capital Account

Date	Particulars	Post Ref.	Rs	Date	Particulars	Post Ref.	Rs
Jan 18	*Balance*	ß	*240,000*	Jan 1	Bank Account		200,000
				Jan 1	Cash Account		40,000
			240,000				**240,000**

Furniture & Fittings Account

Date	Particulars	Post Ref.	Rs	Date	Particulars	Post Ref.	Rs
Jan 1	Bank Account		40,000	Jan 31	*Balance*	ß	*40,000*
			40,000				**40,000**

Van Account

Date	Particulars	Post Ref.	Rs	Date	Particulars	Post Ref.	Rs
Jan 1	Bank Account		60,000		*Balance*	ß	*60,000*
			60,000				**60,000**

Balancing ledger – Practice 5.1

Rent Account

Date	Particulars	Post Ref.	Rs	Date	Particulars	Post Ref.	Rs
Jan 2	Bank Accounts		5,000	Jan 31	*Balance*	ß	*5,000*
			5,000				**5,000**

Purchases Account

Date	Particulars	Post Ref.	Rs	Date	Particulars	Post Ref.	Rs
Jan 3	Jordan & co. A/c		50,000	Jan 31	*Balance*	ß	*75,000*
Jan 19	Dunhill & Co. A/c		25,000				
			75,000				**75,000**

Creditor (Jordan & Co.) Account

Date	Particulars	Post Ref.	Rs	Date	Particulars	Post Ref.	Rs
Jan 17	Purchases Return A/c		6,000	Jan 31	Purchases A/c		50,000
Jan 17	Bank Account		30,000				
Jan 31	*Balance*	ß	*14,000*				
			50,000				**50,000**

Balancing ledger – Practice 5.1

Sales Account

Date	Particulars	Post Ref.	Rs	Date	Particulars	Post Ref.	Rs
Jan 31	*Balance*	ß	*35,000*	Jan 5	Cash Account		5,000
				Jan 12	Cash Account		8,000
				Jan 19	Cash Account		7,000
				Jan 25	Cash Account		15,000
			35,000				**35,000**

Wages Account

Date	Particulars	Post Ref.	Rs	Date	Particulars	Post Ref.	Rs
Jan 8	Cash Account		1,000	Jan 31	*Balance*	ß	*4,000*
Jan 15	Cash Account		1,000				
Jan 22	Cash Account		1,000				
Jan 29	Cash Account		1,000				
			4,000				**4,000**

Insurance Account

Date	Particulars	Post Ref.	Rs	Date	Particulars	Post Ref.	Rs
Jan 10	Bank Account		500	Jan 31	*Balance*	ß	*500*
			500				**500**

Balancing ledger – Practice 5.1

Purchases Return Account

Date	Particulars	Post Ref.	Rs	Date	Particulars	Post Ref.	Rs
Jan 31	*Balance*	ß	*6,000*	Jan 17	Jordan & Co. A/c		6,000
			6,000				**6,000**

(Dunhill & Co.) Account

Date	Particulars	Post Ref.	Rs	Date	Particulars	Post Ref.	Rs
Jan 27	Bank Account		14,000	Jan 19	Purchases A/c		25,000
Jan 31	*Balance*	ß	*11,000*				
			25,000				**25,000**

Stationery Account

Date	Particulars	Post Ref.	Rs	Date	Particulars	Post Ref.	Rs
Jan 18	Cash Account		500	Jan 31	*Balance*	ß	*500*
			500				**500**

Important Tips To Remember - ITTR

1. The side matching with nature of the relevant ledger account would always be heavier
2. Never put c/d or c/f with balances of the nominal accounts i.e., income and expense

Ledger and Trial Balance

Trial Balance

Trial Balance

Trial balance is merely a list of balances extracted from the ledger containing final balance of each ledger account.

In a trial balance; all accounting heads having debit balances are listed in the left-hand side (Dr-side) and likewise all accounting heads having credit balances are listed in the right-hand side (Cr-side).

Trial Balance – Practice 5.1

Sr. No.	Accounting Heads	Debit Rs.	Credit Rs.
1	Bank account	70,500	
2	Cash account	50,500	
3	Capital account		240,000
4	Furniture & fittings account	40,000	
5	Van account	60,000	
6	Rent account	5,000	
7	Purchases account	75,000	
8	Creditor Jordan & Co. account		14,000
9	Sales account		35,000
10	Wages account	4,000	
11	Insurance account	500	
12	Purchases Return account		6,000
13	Creditor Dunhill & Co. account		11,000
14	Stationery account	500	
	Total	306,000	306,000

Important Tips To Remember - ITTR

1. Trial balance is neither a book of account nor it is a financial statement
2. Trial balance confirms arithmetic accuracy of bookkeeping
3. Sum of Dr. is equal to Sum of Cr.

Ledger and Trial Balance

Posting from
Subdivided
Journal
into
Main Ledger

Posting from sub-divided journals

The mechanism of posting process from subdivided journals into the relevant ledger accounts is somewhat different from the posting process discussed earlier; from general journal into ledger.

Posting from Purchase Journal

PURCHASE JOURNAL

Date 2009	Name of Creditor	Inv. No.	Post. Ref.	Amount Rs.
Feb 1	Mian			2,875
Feb 3	Malik			667
Feb 6	Butt			285
Feb 10	Jutt			550
Feb 17	Buttar			8,280
Feb 19	Mughal			1,880
Feb 27	Kashmiri			7,250
Feb 28	Meer			3,244
Feb 28	**Total**			**25,031**

Sundry/Total Creditors Account

Date	Particulars	Post Ref.	Rs.	Date	Particulars	Post Ref.	Rs.
Feb 28				Feb 28	Purchases Account		25,031

Purchases Account

Date	Particulars	Post Ref.	Rs.	Date	Particulars	Post Ref.	Rs.
Feb 28	Creditors Account		25,031	Feb 28			

Posting from Sales Journal

SALES JOURNAL

Date 2009	Name of Debtors	Invoice No.	Post. Ref.	Amount Rs.
Mar2	Tiwana			5,425
Mar6	Kumboh			928
Mar10	Dar			728
Mar14	Tiwana			1,872
Mar18	Bhatti			5,427
Mar22	Kumboh			271
Mar28	Sial			9,494
Mar30	Rajpoot			899
Mar31	**Total**			**25,044**

Sales Account

Date	Particulars	Post Ref.	Rs.	Date	Particulars	Post Ref.	Rs.
				Mar 31	Debtors Account		25,044

Sundry/Total Debtors Account

Date	Particulars	Post Ref.	Rs.	Date	Particulars	Post Ref.	Rs.
	Sales Account		25,044				

Important Tips To Remember - ITTR

1. Sum of Purchase Journal is posted into Purchases a/c and Creditors a/c
2. Sum of Sales Journal is posted into Sales a/c and Debtors a/c

Ledger and Trial Balance

Posting from Cash Book into Main Ledger

Posting from cash book

Cash Book

Date	Receipts	Post Ref.	Rs.	Date	Payments	Post Ref.	Rs.
	Capital A/c		20,000		Rent A/c		500
	Debtors A/c		5,000		Creditors A/c		4,000
	Commission A/c		2,000		Stationery A/c		1,000
	Sales A/c		10,000		Purchases a/c		8,000
					Balance	ß	23,500
			37,000				37,000

Capital Account

Date	Particulars	Post Ref.	Rs.	Date	Particulars	Post Ref.	Rs.
	Balance	ß	20,000		Cash A/c		20,000

Sundry Debtors Account

Date	Particulars	Post Ref.	Rs.	Date	Particulars	Post Ref.	Rs.
	Sales journal		25,044		Cash A/c		5,000
					Balance	ß	20,044

Commission Account

Date	Particulars	Post Ref.	Rs.	Date	Particulars	Post Ref.	Rs.
	Balance	ß	2,000		Cash A/c		2,000

Sales Account

Date	Particulars	Post Ref.	Rs.	Date	Particulars	Post Ref.	Rs.
					Cash A/c		10,000
	Balance	ß	35,044		Sales journal		25,044

Rent Account

Date	Particulars	Post Ref.	Rs.	Date	Particulars	Post Ref.	Rs.
	Cash A/c		500		Balance	ß	500

Sundry Creditors Account

Date	Particulars	Post Ref.	Rs.	Date	Particulars	Post Ref.	Rs.
	Cash A/c		4,000		Purchase journal		25,031
	Balance	ß	21,031				

Stationery Account

Date	Particulars	Post Ref.	Rs.	Date	Particulars	Post Ref.	Rs.
	Cash A/c		1,000		Balance	ß	1,000

Purchases Account

Date	Particulars	Post Ref.	Rs.	Date	Particulars	Post Ref.	Rs.
	Cash A/c		8,000				
	Purchase journal		25,031		Balance	ß	33,031

Important Tips To Remember - ITTR

1. Cash book is considered as a ledger account for cash
2. Considering first effect of has already been posted, the second effects cash receipts and payments are posted into relevant ledger accounts

Practice 5.6

State whether each of following statements is True or False

1. Ledger keeps transactions in chronological order. False
2. Posting is done in Ledger. True
3. Ledger is a source for preparing Trial Balance. True
4. An account will show a Dr. balance if its Cr. side is greater than its Dr. side. False
5. First of all, the transactions are recorded in ledger. False
6. Cash Account always shows a debit balance. True
7. Debit side of expenses is always greater than its credit side. True
8. While posting from general journal to ledger; the opposite account will be used to show as a reason in particulars column of ledger account. True

Important Tips To Remember - ITTR

Accounting Cycle
1. Voucher / Source document
2. Journal
3. Ledger
4. Trial Balance
5. Financial Statements
6. Analysis

Chapter - 6

Preparation of Financial Statements

Topic videos 58-61 are mandatory part of this module

MGT 101
Financial Accounting

By
Mian Ahmad Farhan, FCA

Contents

Sr. No	Course Outline Topics
1	Components of Financial Statements and Accounting Equations
2	Proper format of Income Statement
3	Proper format of Balance Sheet
4	Practice

Preparation of Financial Statements

Components of Financial Statements and Accounting Equations

Need for financial statements

- To know financial position
- To know financial performance
- To know cash flows
- To know changes in equity
- To know significant accounting policies and disclosures

Components of financial statements

Main components

1. Income statement
   (profit or loss and other comprehensive income)
2. Balance sheet
   (financial position)

(IAS 1) five components of financial statements:

1) Statement of Financial Position
2) Statement of Profit or Loss and Other Comprehensive Income
3) Statement of Cash Flows
4) Statement of Changes in equity and
5) Notes to the Financial Statements

Accounting Equation

Income statement

<u>Incomes – Expenses = Profit</u>

Balance sheet

<u>Assets = Owners equity + Liabilities</u>

Practice 6.1

Prepare income statement and balance sheet with the help of following trail balance.

Accounting heads	Debit Rs.	Credit Rs.
Bad debts	305	
Advertisement	1,506	
Telephone Bill	1,615	
Stationery	500	
Repairs	600	
Sales Revenue		40,600
Purchases Expense	28,500	
Salaries and wages	4,850	
Machinery	12,500	
Creditor		5,250
Debtors	7,810	
Furniture	5,600	
Land	28,000	
Drawings	7,218	
Rent Income		1,000
Capital		52,154
Total	**99,004**	**99,004**

Closing stock is valued at Rs. 9,960

Practice 6.1 - Answer

Income Statement for the reporting period…

Income		-	Expense		=	Net Profit
Sales Revenue	40,600		Purchases Expense	28,500		
Rent income	1,000		Less: closing Stock*	(9,960)		
			Cost of goods sold	18,540		
			Bad debts	305		
			Advertisement	1,506		
			Telephone bill	1,615		
			Stationery	500		
			Repairs	600		
			Salaries & wages	4,850		
	41,600	-		27,916	=	13,684

Balance Sheet as on the reporting date…

Assets		=	Owner's equity		+	liabilities	
Debtor	7,810		Capital	52,154		Creditors	5,250
Stock closing*	9,960		Add Net profit	13,684			
Furniture	5,600		Less Drawings	(7,218)			
Machinery	12,500						
Land	28,000						
				58,620	+		5,250
	63,870	=				63,870	

*The cost that expires during the reporting year is reported as expense. Cost of closing stock is un-expired cost.

Important Tips To Remember - ITTR

1. Income Statement and Balance Sheet are the two most important components of FS
2. Accounting Equations correspond to these components of FS

Preparation of Financial Statements

Format of Income Statement

Format of Income Statement

Entity's Name
Income Statement
For the year ended 31 December 20X9

	Rs.	Rs.
Sales Revenue		***
Cost of Goods Sold *(Note 1)*		
Opening stock	***	
Purchases	***	
Closing stock	(***)	(***)
Gross Profit *(Note 2)*		***
Operating Expenses *(Note 3)*		(***)
Operating Profit		***
Other Income *(Note 4)*		***
Net Profit *(Note 5)*		***

Notes

1. Cost of Goods Sold

Although the purchases account is an accounting head that belongs to the main head EXPENSES but all the goods purchased are rarely sold out in the year of purchase. It is adjusted with opening and closing stock.

2. Gross Profit

Gross profit shows potential of the entity to meet operating expenses during the period.

Notes

3. **Operating Expenses**

These include:

1. Administrative
2. Selling and marketing

These are subtracted from the gross profit to ascertain operating profit of the business.

3.1 Administrative

These are incurred to run the administrative affairs.

3.2 Selling and Marketing

These expenses are incurred to promote the sales.

Notes

4. **Other Incomes**

These are the non-operating incomes.

5. **Net Profit**

It is the profit that management of the entity wants to know through income statement in order to take certain economic decisions.

Important Tips To Remember - ITTR

1. Matching principle is the base of preparing Income Statement
2. Cost that expires is expense

Preparation of Financial Statements

Format of Balance Sheet

Format of Balance Sheet

Entity's Name
Balance Sheet
As at 31 December 20X9

			Rs.	Rs.
Assets				
	Fixed Assets (Note 6)			
		Land	***	
		Building	***	
		Machinery	***	
		Furniture	***	***
	Current Assets (Note 7)			
		Stock / Inventory	***	
		Debtors	***	
		Bank balance	***	
		Cash in hand	***	***
				***
Owner's Equity *(Note 8)*				
	Capital		***	
Add:	Net profit		***	
Less:	Drawings		(***)	***
Liabilities:				
	Long term loans *(Note 9)*			
		Loan from bank	***	
		Finance lease liability	***	***
	Current liabilities *(Note 10)*			
		Creditors	***	
		Bank overdraft	***	
		Short term loans	***	***
				***

Notes

6. Fixed Assets

These are the assets that are held; for use in production of goods/services or delivery of goods/services, for renting to others and for administration purpose.

7. Current Assets

These are the assets that are held for trading purposes (means stock for selling purpose) and/or are expected to be recovered in cash in next twelve months (debtor), and/or are cash in hand and cash at bank.

Notes

8. **Owners' Equity**

It includes the amount of capital and also the net profit earned/generated by the entity. The amount of drawings is subtracted from it.

9. **Long-Term Loan**

It is an obligation on the entity that is expected to be settled after more than one accounting year.

10. **Current Liabilities**

These are obligations on the entity that are payable within next twelve months.

Important Tips To Remember - ITTR

1. Distinguishing between fixed assets and current assets is must
2. Liabilities should also be distinguished between long-term and short-term obligations
3. Short-term obligations are current liabilities

Preparation of Financial Statements

Practice
Income Statement
Balance Sheet

Practice 6.1 – Answer

Entity's Name
Income Statement
For the year ended 31st December 20X9

	Rs.	Rs.
Sale		40,600
Cost of Goods Sold ***(Note 1)***		
Opening stock	-	
Purchases	28,500	
Closing stock	(9,960)	(18,540)
Gross Profit		22,060
Operating Expenses:		
Bad Debts	305	
Advertisement	1,506	
Telephone Bill	1,615	
Stationary	500	
Repairs	600	
Salaries & Wages	4,850	9,376
Operating Profit/Income		12,684
Other Income		
Add: Rent Income		1,000
Net Profit/Income		**13,684**

Practice 6.1 – Answer

Entity's Name
Balance Sheet
As at 31 December 20X9

	Rs.	Rs.
Assets		
Fixed Assets		
Land	28,000	
Machinery	12,500	
Furniture	5,600	46,100
Current Assets		
Stock	9,960	
Debtors	7,810	17,770
		63,870
Owner's Equity		
Capital	52,154	
Add: Net Profit	13,684	
Loss: Drawings	(7,218)	58,620
Liabilities		
Current liabilities		
Creditors		5,250
		63,870

Important Tips To Remember - ITTR

1. Expenses are classified in accordance to their functions
2. Grouping of Balance Sheet items is mostly based on the order of permanency

Chapter - 7

Bank Reconciliation Statements

MGT 101
Financial Accounting

By
Mian Ahmad Farhan, FCA

Contents

Bank Reconciliation Statement

Basic Concept of Bank Reconciliation Statement

Basic Concept of Bank Reconciliation

- Cash book balance in conformity with the bank statement balance
- Accountant of the business prepares a bank reconciliation statement on a specific date
- BRS presents reasons causing difference among the ***balance as per cash book*** and ***balance as per bank statement***
- There arise two types of difference
  - Adjusting difference
  - Reconciling difference

Important Tips To Remember - ITTR

1. Business accountant prepares cash book
2. Bankers prepare bank statement
3. Business accountant prepares BRS

Bank Reconciliation Statement

Nature and Behaviour of Balances

Nature and Behaviour of Balances

It is important to know the nature and behavior of two balances before unfolding the possible reasons of difference among the two balances.

Balances as per: **Favorable or Unfavorable Balance**	**Deposit account (Favorable for the entity/business)**	**Overdraft account (Unfavorable for the entity/business)**
Business Record _ Cash Book (Bank Column) _ Bank a/c _ Bank Book	Dr. Entity's Asset	Cr. Entity's Liability
Bank Record _ Bank Statement _Pass Book	Cr. Bank's Liability	Dr. Bank's Asset

Important Tips To Remember - ITTR

1. There are two types of deposit account:
   a) Fixed/Time Deposit
   b) Demand Deposit
2. BRS is prepared for demand deposit accounts only. These may be:
   a) Current Account
   b) Profit and Loss Sharing Account, also known as Saving Account
3. Transactions take place frequently in demand deposit accounts
4. Further deposits and withdrawals are not made in time deposit account till its maturity

Bank Reconciliation Statement

Possible Reasons of Differences

“Those need adjustments in Cash Book”

Possible Reasons of Difference

1. Adjusting items
2. Reconciling items

Adjusting Items

<u>Those need adjustments in cash book</u>

	Effect in Cash Book	
a) Not yet recorded in cash book		
• Credit transfers	(collections)	**Dr**
• Direct debits	(payments)	**Cr**
• Standing orders	(payments)	**Cr**
• Bank charges	(deductions)	**Cr**
• Interest on overdrawn balance	(deductions)	**Cr**
• Deposited cheque returned	(deductions)	**Cr**
b) Mistakes committed in cash book		
• Receipts side mistakenly overstated		**Cr**
• Receipts side mistakenly understated		**Dr**
• Payments side mistakenly overstated		**Dr**
• Payments side mistakenly understated		**Cr**
• Issued cheque returned but in replacement a new cheque was issued immediately		**(No effect)**

Important Tips To Remember - ITTR

1. Business accountant amends cash book for the mistakes or unrecorded financial information
2. Cash book balance after the adjustments is presented in balance sheet

Bank Reconciliation Statement

Possible Reasons of Differences

"Those need to be presented in BRS"

Possible Reasons of Difference

1. Adjusting items
2. Reconciling items

Reconciling Items

<u>Those need to be presented in BRS</u>

a) **Not yet recorded in the bank statement** — **Effect in BRS**
- A cheque from a customer recorded in cash book and also deposited but not yet collected by the bank — **Cr**
- Cheques paid to suppliers recorded in cash book but not yet presented to the bank for payment — **Dr**

b) **Mistakes committed in bank statement**
- Wrongly debited/charged by the bank — **Cr**
- Wrongly credited by the bank — **Dr**

Important Tips To Remember - ITTR

1. Uncollected cheques are also named as:
   a) uncleared cheque
   b) uncredited cheques
   c) uncleared lodgments
   d) deposits in transit and
   e) outstanding lodgments
2. Unpresented cheques are also named as:
   a) outstanding cheques
   b) uncashed cheques
   c) unpaid cheques

Bank Reconciliation Statement

Practice:
Given – Both Balances

Practice 7.1

The balance as per Yasin Trader's cash book (bank column) Rs.4,500 does not agree with the balance as per bank statement Rs.7,700 on December 31, 20X9.

An investigation reveals following facts:

1. Cheques from customers of Rs.2,000 have been paid into the bank but have not yet been processed/cleared.
2. Cheques paid to suppliers of Rs.6,200 have not yet been presented to the bank for payment
3. The bank statement shows Rs.700 as bank charges that are yet to be recorded in the cash book.
4. A cheque for Rs.300 received from a customer has been returned dishonoured and could not be rectified in the cash book.

Practice 7.1 – Answer

Adjusted Cash Book (Bank Column)

Date	Receipts	Amount Rs.	Date	Payments	Amount Rs.
2009 Dec.31	Balance b/f (re-opened)	4,500	2009 Dec.31	Bank charges	700
				Cheques Dishonored	300
				Balance c/f	3,500
		4,500			**4,500**

Bank Reconciliation Statement
As on December 31, 20X9

		Rs.
Balance as per Bank Statement (favorable)	Cr	7,700
Un-collected Cheques	Cr	2,000
Un-presented Cheques	Dr	6,200
Corrected Balance	**Cr**	**3,500**
Balance as per adjusted cash book (bank column)	**Dr**	**3,500**

Important Tips To Remember - ITTR

1. When both balances are given in a question then prepare BRS starting with balance as per bank statement
2. Never mix up adjusting and reconciling items in one statement, always prepare adjusted cash book and BRS separately.
3. Practice Dr. and Cr. for preparing BRS

Bank Reconciliation Statement

Practice:
Given – Previous BRS, current cash book and current bank statement

Practice 7.2

Following information relates to the bank balance of Sethi Industries for the month of June 20X9.

Bank Reconciliation Statement
As on May 31, 20X9

		Rs.	Rs.
Balance as per Bank Statement			Cr. 5,000
Unpresented Cheques			
	Rashid Kamal	1,700	
	Asad Ali	1,300	Dr. 3,000
Uncollected Cheques			
	Nauman Zikria	2,800	
	Munir Ishaq	1,200	Cr. 4,000
			Cr. 6,000
Balance as per Cash Book			**Dr. 6,000**

Cash Book (Bank column)

Jun 20X9		Rs.	June 20X9		Rs.
1	Balance b/f	6,000	6	Fareed ud Din	800
2	Abbass Elahi	950	18	Rent	1,500
3	Bilal Mushtaq	450	20	Ghulam Abbas	1,400
10	Chiragh Din	2,000	27	Haider Ali	1,600
19	Dilnawaz khan	1,250	30	Ismail Rana	1,200
29	Elahi Buksh	850	30	Balance b/f	5,000
		11,500			**11,500**

Practice 7.2

Bank Statement
June 1, 20X9 to June 30, 20X9

Jun 20X9		Dr. Rs.	Cr. Rs.	Balance Rs.
1	Balance b/f			Cr. 5,000
2	Nauman Zikria		2,800	7,800
3	Abbas Elahi		950	8,750
3	Munir Ishaq		1,200	9,950
5	Bilal Mushtaq		450	10,400
7	Fareed ud Din	800		9,600
13	Chiragh Din		2,000	11,600
13	Bank charges	20		11,580
19	Rent	1,500		10,080
22	Chamber of Commerce Subscription (Standing order)	3,000		7,080
25	Asad Ali	1,300		5,780
28	Credit transfer (Bad Debts recovered)		120	5,900
30	Electricity Bill (Direct Debit)	900		Cr. 5,000

Required:

1 Prepare adjusted Cash Book for June, 20X9

2 Prepare Bank Reconciliation Statement as on June 30, 20X9.

3 Pass adjusting entries in Journal of Sethi Industries.

Practice 7.2 – Answer

Adjusted Cash Book

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
20X9			**20X9**		
June30	Balance b/f	5,000	June 30	Bank Charges	20
	Credit transfer	120		Subscription chamber of Commerce (standing order)	3,000
				Electricity Bill (Direct debit)	900
				Balance c/f	1,200
		5,120			5,120

Practice 7.2 – Answer

Bank Reconciliation Statement
As on June 30, 20X9

	Rs.	Rs.
Balance as per Bank Statement		Cr. 5,000
Uncollected Cheques:		
Dilnawaz Khan	1,250	
Elahi Buksh	850	Cr. 2,100
Unpresented Cheques:		
Rashid Kamal (May)	1,700	
Ghulam Abbas	1,400	
Haider Ali	1,600	
Ismail Rana	1,200	Dr. 5,900
		Cr. 1,200
Balance as per Adjusted Cash Book		Dr. 1,200

Practice 7.2 – Answer

Journal Entries

		Rs.	Rs.
1	Bank Charges A/c.	20	
	Bank A/c.		20
2	Trade subscription A/c.	3,000	
	Bank A/c.		3,000
3	Electricity Bill A/c.	900	
	Bank A/c.		900
4	Bank A/c.	120	
	Bad Debts recovered A/c.		120

Important Tips To Remember - ITTR

1. Items appearing in the Dr. side of Cash Book should appear in Cr. side of the Bank Statement and vice versa
2. Accounting entry is passed for each adjusting item

Bank Reconciliation Statement

Practice:
Given – Previous cash book and current bank statement

Practice 7.3

Books of Mehran Bros.
Cash Book (Bank Column)

Dr. **Cr.**

Dec. 20X8		Rs.	Dec. 20X8		Rs.
1	Balance b/f	760	3	Drawings	400
7	Warda	840	11	Fateh Din	2,380
15	Danish	2,000	15	Cheque Book	20
19	Faiqa	2,620	24	Pervaiz	1,040
29	Bashir	600	26	Haris	760
31	Ghazal	360	29	Ghazanfar	220
			29	Commission	20
			29	Wages & Salaries	800
			31	Balance c/f	1,540
		7,180			**7,180**

Practice 7.3

Bank Statement
Mehran Bros. in Current Account with Bank

Dr. **Cr.**

Jan. 20X9		Rs.	Jan. 20X9		Rs.
2	Pervaiz	1,040	1	Balance b/f	1,840
4	Humaira	80	3	Bashir	600
5	Bashir (Cheque dishonored)	600	4	Steel Co.	1,230
6	Dilbar	450	5	Ghazal	360
8	Babar	150	9	Dilawar	750
9	Ghazanfar	220			

Prepare a bank reconciliation statement as on December 31, 20X8 and compare the pattern of this question with the pattern of Practice 7.2.

Practice 7.3 – Answer

Bank Reconciliation Statement
As on December 31, 20X8

	Rs.	Rs.
Balance as per Bank Statement on December 31, 20X8		Cr. 1,840
Uncollected Cheques:		
Bashir	600	
Ghazal	360	Cr. 960
Unpresented Cheques:		
Pervaiz	1,040	
Ghazanfar	220	Dr. 1,260
		Cr. 1,540
Balance as per Cash Book on December 31, 20X8		Dr. 1,540

Important Tips To Remember - ITTR

1. When only the balance as per bank statement is given; first prepare BRS to find out the balance as per adjusted cash book, place this balance in adjusted cash book as a closing balance and then find out the opening balance of cash book (through reverse working) that would be a balancing figure.
2. When only the balance as per cash book is given in the question then first prepare adjusted cash book and then prepare BRS starting with the balance as per adjusted cash book.

Bank Reconciliation Statement

BRS
Accounting Entries

BRS – Accounting Entries

Transactions	Entries
Credit transfers	Dr Bank Cr Income/Receivable
Direct debits	Dr Expense/Creditor Cr Bank
Standing order	Dr Expense/Creditor Cr Bank
Bank charges	Dr Bank Charges Cr Bank
Interest charges	Dr Interest expense Cr Bank
Deposited cheque returned dishonoured	Dr Debtors Cr Bank

BRS – Accounting Entries

Mistakes committed in cash book

Receipts side mistakenly overstated
Dr Suspense A/c
Cr Bank A/c

Receipts side mistakenly understated
Dr Bank A/c
Cr Suspense A/c

Payments side mistakenly overstated
Dr Bank A/c
Cr suspense A/c

Payments side mistakenly understated
Dr Suspense A/c
Cr Bank A/c

Issued cheque returned dishonored but in replacement a new cheque was re-issued immediately

(No effect in the book of accounts)

Important Tips To Remember - ITTR

1. Practice
2. Practice
3. Practice

Chapter - 8

Accrual Accounting

MGT 101
Financial Accounting

By
Mian Ahmad Farhan, FCA

Contents

Accrual Accounting

Basic Concept of Accrual Based Accounting

Cash Basis of Accounting

Two bases to present financial performance of an entity:

1) Cash basis and
2) Accrual basis

Conventionally, small business entities prepare financial statements on *"Cash Basis"*

- Very easy to handle
- Less costly
- No complex accounting system is required to be developed and implemented

Accrual Basis of Accounting

Entities of considerable size follow *"Accrual Basis"*

- Little complex
- More cost and efforts are required to report financial performance
- It establishes control over trade receivables and payables through a designed system

Examples – Accrual based accounting

Example – 1

Electricity bill for the last quarter (October – December) was not paid until the end of reporting period 31st December 20X9.

Under the cash-based accounting; the unpaid utility bill will not be recognized as expense in the accounting year 20X9. It will be recognized as expense for the year 20Y0 upon payment.

Under the accrual-based accounting; the unpaid utility expense will be recognized as expense in the accounting year 20X9 along with a liability that will be paid in 20Y0.

Example – 2

Insurance paid in advance for the year 20X9 on 1st November 20X8

Under the cash-based accounting; the payment will be recorded as expense as soon as cash is paid to insurance company on 1st November 20X8

Under the accrual-based accounting; the payment of insurance will be recorded in the year 20X8 as "prepayment or paid in advance" which shall be recognized as asset and then in the year 20X9 it will be recorded as expense, to which it belongs to.

Important Tips To Remember - ITTR

1. Accrual concept gives basis to measure incomes and expenses for an accounting period
2. Accrued concept cover
   a. Accrued income
   b. Unearned income
   c. Accrued expense
   d. Unexpired expense

Accrual Accounting

Technique/Formula for calculating expense for the year

Technique/Formula for Expenses

<u>Expenses with closing balances of: accrued expense due and advance payment / prepayment</u>

Expenses paid in cash	Cash Book
Add Closing accrued/due	Liability
Less Closing advance/prepayment	Asset
Expenses for the year	Income Statement

<u>Expenses with opening and closing balances of: accrued expense due and advance payment / prepayment</u>

Expenses paid in cash	Cash Book
Add Closing accrued/due	Liability
Less Opening accrued/due	Previous Liability
Less Closing advance/prepayment	Asset
Add Opening advance/prepayment	Previous Asset
Expenses for the year	Income Statement

Practice 8.1

Cash paid for rent expense during the year Rs.7,000, opening balance of expense due was Rs.250 and opening balance of prepaid expenses was Rs.400, on closing date expense still due is Rs.300 and prepaid expense is Rs.700

Prepare:

1. Rent Expense a/c
2. Accrued expense a/c
3. Prepaid expense a/c

Answer – Practice 8.1

Expense account

Particular	Debit Rs.	Particulars	Credit Rs.
Op. Advance	400	Op. Owing	250
Cash Paid	7,000	Cl. Advance	700
Cl. Owing	300	Profit & Loss (balancing figure)	**6,750**
	7,700		7,700

Accrued (Due) Expenses account

Particular	Rs.	Particulars	Rs.
Op Bal transferred to Exp. A/c	250	Balance b/f	250
Balance c/f	300	Cl owing charged to Exp. a/c	300
	550		550

Prepaid (Advance) Expenses account

Particular	Rs.	Particulars	Rs.
Balance b/f	400	Op Balance Charged to Exp. a/c	400
Cl Adv transferred from Exp. a/c	700	Balance c/f	700
	1100		1100

Important Tips To Remember - ITTR

1. Cash paid during the year is different from Expense for the year
2. Expense is measured based on its belongingness to the reporting period
3. + Closing Due – Opening Due
4. + Opening prepaid – Closing prepaid

Accrual Accounting

Technique/Formula for calculating Income for the year

Technique/Formula for Incomes

<u>Incomes with closing balances of: accrued income due and advance recieved / unearned</u>

Income received in cash	Cash Book
Add Closing accrued/due	Asset
Less Closing advance/unearned	Liability
Incomes for the year	Income Statement

<u>Incomes with opening and closing balances of: accrued income due and advance received / unearned</u>

Income received in cash	Cash Book
Add Closing accrued/due	Asset
Less Opening accrued/due	Previous Asset
Less Closing advance/unearned	Liability
Add Opening advance/unearned	Previous Liability
Income for the year	Income Statement

Practice 8.2

Rent Income received during the year Rs.3,000, opening balance of income due was Rs.150 and opening balance of unearned income was Rs.500, on closing date income still due is Rs.70 and unearned income on closing date is Rs.50.

Prepare:

1. Rent Income a/c
2. Accrued income a/c
3. Unearned income a/c

Answer – Practice 8.2

Income Account

Particular	Debit Rs.	Particulars	Credit Rs.
Opening Owing	150	Opening Advance	500
Closing Advance	50	Cash Received	3,000
Profit & Loss (balancing figure)	**3,370**	Closing Owing	70
	3,570		3,570

Accrued (Due) Income Account

Particular	Rs.	Particulars	Rs.
Balance b/f	150	Op Bal transferred to Income a/c	150
Cl Bal transferred from Income a/c	70	Balance c/f	70
	220		220

Unearned (Advance) Income Account

Particular	Rs.	Particulars	Rs.
Op Bal transferred to Income A/c.	500	Balance b/f	500
Balance c/f	50	Cl Bal transferred from Income a/c	50
	550		550

Important Tips To Remember - ITTR

1. Cash received during the year for an income is different from Income for the year
2. Income is measured based on its belongingness to the reporting period
3. + Closing Due – Opening Due
4. + Opening prepaid – Closing prepaid

Accrual Accounting

Accrued Expense
Outstanding Expense
Expense in Arrear
Expense Due
Expense Owing
Expense Not Yet Paid
Expense Payable

One Account Method for Expenses

Only one ledger account is prepared for measuring expense and for its reciprocal payable

Practice 8.3

Rent is paid quarterly in arrear
Reporting Period is 12 months (Jan 1, 20X8 to Dec 31,20X8)

Payment Date	Payment Period	Amount (Rs.)
Jan 31, 20X8	Nov X7, Dec X7, Jan X8	9,000
Apr 30, 20X8	Feb X8, March X8, Apr X8	9,500
July 31, 20X8	May X8, June X8, July X8	10,000
Oct 31, 20X8	Aug X8, Sep X8, Oct X8	10,000
Jan 31, 20X9	Nov X8, Dec X8, Jan X9	10,500

Answer - Practice 8.3

		Rs.
Cash paid during the year	(W-3) – 1st Jan X8 to 31st Dec X8	38,500
Less: Opening Accrual	(W - 1) – Nov X7 and Dec X7	(6,000)
Add: Closing Accruals	(W - 2) – Nov X8 and Dec X8	7,000
Expense for the year		**39,500**

W – 1: Opening Accruals = $9{,}000 \times \frac{2}{3} = 6{,}000$

W – 2: Closing Accruals = $10{,}500 \times \frac{2}{3} = 7{,}000$

W – 3: Cash paid = $9{,}000 + 9{,}500 + 10{,}000 + 10{,}000 = 38{,}500$

Answer - Practice 8.3

One Account Method:

Rent Payable A/c.

	Rs.		Rs.
Cash paid	38,500	Opening rent payable balance b/f	6,000
Closing rent payable balance c/f	7,000	Profit & Loss (balancing figure)	**39,500**
	45,500		45,500

Accounting Entries

Particulars	**Debit Rs.**	**Credit Rs.**
Rent Payable A/c.	38,500	
Cash A/c.		38,500
(Rent paid in cash)		
Profit & Loss A/c.	39,500	
Rent Payable A/c.		39,500
(Closing entry for rent expense – Closed into Income Statement)		

Two Account Method for Expenses

Two ledger accounts are prepared for measuring expense and for its reciprocal payable

Practice 8.4

Rent is paid quarterly **in arrear**
Reporting Period is 12 months **(Jan 1, 20X8 to Dec 31,20X8)**

Payment Date	Payment Period	Amount (Rs.)
Jan 31, 20X8	Nov X7, Dec X7, Jan X8	9,000
Apr 30, 20X8	Feb X8, March X8, Apr X8	9,500
July 31, 20X8	May X8, June X8, July X8	10,000
Oct 31, 20X8	Aug X8, Sep X8, Oct X8	10,000
Jan 31, 20X9	Nov X8, Dec X8, Jan X9	10,500

Answer - Practice 8.4

		Rs.
Cash paid during the year	(W-3) – 1st Jan X8 to 31st Dec X8	38,500
Less: Opening Accrual	(W - 1) – Nov X7 and Dec X7	(6,000)
Add: Closing Accruals	(W - 2) – Nov X8 and Dec X8	7,000
Expense for the year		**39,500**

W – 1: Opening Accruals = $9{,}000 \text{ X } \frac{2}{3} = 6{,}000$

W – 2: Closing Accruals = $10{,}500 \text{ X } \frac{2}{3} = 7{,}000$

W – 3: Cash paid = 9,000 + 9,500 + 10,000 + 10,000 = 38,500

Answer - Practice 8.4

Two Account Method

Rent Payable A/c.

	Rs.		Rs.
Rent expense	6,000	Opening rent payable balance b/f	6,000
Closing rent payable balance c/f	7,000	Rent expense	7,000
	13,000		13,000

Rent Expense A/c.

	Rs.		Rs.
Cash paid	38,500	Rent Payable (Opening balance)	6,000
Rent Payable (Closing balance)	7,000	**Profit & Loss (balancing figure)**	**39,500**
	45,500		45,500

Answer - Practice 8.4

Accounting Entries

Particulars	Debit Rs.	Credit Rs.
Rent Expense A/c.	38,500	
Cash A/c.		38,500
(Rent paid in cash)		
Rent Payable A/c.	6,000	
Rent Expense A/c.		6,000
(Opening balance rent due transferred)		
Rent expense A/c.	7,000	
Rent Payable A/c.		7,000
(Rent of current year is still due.)		
Profit & Loss A/c.	39,500	
Rent Expense A/c.		39,500
(Closing entry for rent expense – Closed into Income Statement)		

Important Tips To Remember - ITTR

One Account Method

1. Separate ledger account for expense is not maintained
2. Balancing figure is closed to Income Statement
3. Closing balance is presented in Balance Sheet

Important Tips To Remember - ITTR

Two Account Method

1. Opening balance b/f and Closing balance c/f appears in payable account
2. Expense account is closed into Income Statement

Accrual Accounting

Advance Expense

Prepaid Expense

Unexpired Expense

One Account Method for Expenses

Only one ledger account is prepared for measuring expense and for its reciprocal asset

Practice 8.5

Rent is paid quarterly **in advance**
Reporting Period is 12 months **(Jan 1, 20X9 to Dec 31,20X9)**

Payment Date	Payment Period	Amount (Rs.)
Nov. 1, 20X8	Nov X8, Dec X8, Jan X9	9,000
Feb. 1, 20X9	Feb X9, Mar X9, Apr X9	9,500
May 1, 20X9	May X9, June X9, Jul X9	10,000
Aug. 1, 20X9	Aug X9, Sep X9, Oct X9	10,000
Nov. 1, 20X9	Nov X9, Dec X9, Jan Y0	10,500

Answer - Practice 8.5

		Rs.
Cash paid during the year	(W-3) – 1ST Jan 20X9 to 31st Dec 20X9	40,000
Add: Opening Advance	(W - 1) – Jan 20X9	3,000
Less: Closing Advance	(W - 2) – Jan 20Y0	(3,500)
Expense for the year		39,500

W – 1: Opening Advance = $9{,}000 \times \frac{1}{3} = 3{,}000$

W – 2: Closing Advance = $10{,}500 \times \frac{1}{3} = 3{,}500$

W – 3: Cash paid = $9{,}500 + 10{,}000 + 10{,}000 + 10{,}500 = 40{,}000$

Answer - Practice 8.5

One Account Method:

Prepaid (Advance) Rent A/c.

	Rs.		Rs.
Opening prepaid rent balance b/f	3,000	Profit & Loss (balancing figure)	39,500
Cash paid	40,000	Closing prepaid rent balance c/f	3,500
	43,000		43,000

Particulars	Debit Rs.	Credit Rs.
Prepaid (Advance) Rent A/c.	40,000	
Cash A/c.		40,000
(Rent paid in cash)		
Profit & Loss A/c.	39,500	
Prepaid (Advance) Rent A/c.		39,500
(Closing entry for rent expense – Closed into Income Statement)		

Important Tips To Remember - ITTR

1. Separate ledger account for expense is not maintained
2. Balancing figure is closed to Income Statement
3. Closing balance is presented in Balance Sheet

Two Account Method for Expenses

Two ledger accounts are prepared for measuring expense and for its reciprocal asset

Practice 8.6

Rent is paid quarterly in advance
Reporting Period is 12 months (Jan 1, 20X9 to Dec 31,20X9)

Payment Date	Payment Period	Amount (Rs.)
Nov. 1, 20X8	Nov X8, Dec X8, Jan X9	9,000
Feb. 1, 20X9	Feb X9, Mar X9, Apr X9	9,500
May 1, 20X9	May X9, June X9, Jul X9	10,000
Aug. 1, 20X9	Aug X9, Sep X9, Oct X9	10,000
Nov. 1, 20X9	Nov X9, Dec X9, Jan Y0	10,500

Answer - Practice 8.6

		Rs.
Cash paid during the year	(W-3) – 1ST Jan 20X9 to 31st Dec 20X9	40,000
Add: Opening Advance	(W - 1) – Jan 20X9	3,000
Less: Closing Advance	(W - 2) – Jan 20Y0	(3,500)
Expense for the year		39,500

W – 1: Opening Advance $= 9{,}000 \times \frac{1}{3} = 3{,}000$

W – 2: Closing Advance $= 10{,}500 \times \frac{1}{3} = 3{,}500$

W – 3: Cash paid $= 9{,}500 + 10{,}000 + 10{,}000 + 10{,}500 = 40{,}000$

Answer - Practice 8.6

Two Account Method

Advance Rent A/c.

	Rs		Rs.
Balance b/f	3,000	Rent Expense	3,000
Rent Expense	3,500	Balance c/f	3,500
	6,500		6,500

Rent Expense A/c.

	Rs		Rs.
Opening advance rent	3,000	Closing advance rent	3,500
Cash paid	40,000	Income statement	39,500
	43,000		43,000

Answer - Practice 8.6

Accounting Entries

Particulars	Debit Rs.	Credit Rs.
Rent Expense A/c. Cash A/c. (Rent paid in cash.)	40,000	40,000
Rent Expense A/c. Advance Rent A/c. (Opening balance of advance rent transferred)	3,000	3,000
Advance Rent A/c. Rent Expense A/c. (Rent paid in advance transferred from rent Expense)	3,500	3,500
Income Statement A/c. Rent Expense A/c. (Closing entry for rent expense.)	39,500	39,500

Important Tips To Remember - ITTR

1. Opening balance b/f and Closing balance c/f appears in prepaid account.
2. Expense account is closed into Income Statement

Accrual Accounting

Accrued Income
Outstanding Income
Income in Arrear
Income Due
Income Owing
Income Not Yet Received
Income Receivable

One Account Method for Income

Only one ledger account is prepared for measuring income and for its reciprocal receivable

Practice 8.5

Rent is received quarterly **in arrear**
Reporting Period is 12 months **(Jan 1, 20X8 to Dec 31,20X8)**

Receipt Date	Receipt Period	Amount (Rs.)
Jan 31, 20X8	Nov X7, Dec X7, Jan X8	9,000
Apr 30, 20X8	Feb X8, March X8, Apr X8	9,500
July 31, 20X8	May X8, June X8, July X8	10,000
Oct 31, 20X8	Aug X8, Sep X8, Oct X8	10,000
Jan 31, 20X9	Nov X8, Dec X8, Jan X9	10,500

Answer - Practice 8.5

		Rs.
Cash received during the year	(W-3) – 1st Jan X8 to 31st Dec X8	38,500
Less: Opening Accrual	(W - 1) – Nov X7 and Dec X7	(6,000)
Add: Closing Accrual	(W - 2) – Nov X8 and Dec X8	7,000
Income for the year		**39,500**

W – 1: Opening Accruals $= 9{,}000 \times \frac{2}{3} = 6{,}000$

W – 2: Closing Accruals $= 10{,}500 \times \frac{2}{3} = 7{,}000$

W – 3: Cash paid $= 9{,}000 + 9{,}500 + 10{,}000 + 10{,}000 = 38{,}500$

Answer - Practice 8.5

One Account Method:

Rent Receivable A/c.

	Rs.		Rs.
Opening rent receivable balance b/f	6,000	Cash received	38,500
Profit & Loss (balancing figure)	**39,500**	Closing rent receivable balance c/f	7,000
	45,500		45,500

Accounting Entries

Particulars	**Debit Rs.**	**Credit Rs.**
Cash A/c. Rent receivable A/c. (Rent received in cash)	38,500	38,500
Rent receivable A/c. Profit & Loss A/c. (Closing entry for rent income – Closed into Income Statement)	39,500	39,500

Two Account Method for Incomes

Two ledger accounts are prepared for measuring income and for its reciprocal receivable

Practice 8.6

Rent is received quarterly **in arrear**
Reporting Period is 12 months **(Jan 1, 20X8 to Dec 31,20X8)**

Receipt Date	Receipt Period	Amount (Rs.)
Jan 31, 20X8	Nov X7, Dec X7, Jan X8	9,000
Apr 30, 20X8	Feb X8, March X8, Apr X8	9,500
July 31, 20X8	May X8, June X8, July X8	10,000
Oct 31, 20X8	Aug X8, Sep X8, Oct X8	10,000
Jan 31, 20X9	Nov X8, Dec X8, Jan X9	10,500

Answer - Practice 8.6

		Rs.
Cash received during the year	(W-3) – 1st Jan X8 to 31st Dec X8	38,500
Less: Opening Accrual	(W - 1) – Nov X7 and Dec X7	(6,000)
Add: Closing Accrual	(W - 2) – Nov X8 and Dec X8	7,000
Income for the year		**39,500**

W – 1: Opening Accruals = $9{,}000 \times \frac{2}{3} = 6{,}000$

W – 2: Closing Accruals = $10{,}500 \times \frac{2}{3} = 7{,}000$

W – 3: Cash paid = 9,000 + 9,500 + 10,000 + 10,000 = 38,500

Answer - Practice 8.6

Two Account Method

Rent Receivable A/c.

	Rs.		Rs.
Opening rent receivable balance b/f	6,000	Rent income	6,000
Rent income	7,000	Closing rent receivable balance c/f	7,000
	13,000		13,000

Rent Income A/c.

	Rs.		Rs.
Rent receivable opening	6,000	Cash received	38,500
Profit & Loss (balancing figure)	39,500	Rent receivable closing	**39,500**
	45,500		45,500

Answer - Practice 8.6

Accounting Entries

Particulars	Debit Rs.	Credit Rs.
Cash A/c. Rent income A/c. (Rent received in cash)	38,500	38,500
Rent Income A/c. Rent Receivable A/c. (Opening balance rent due transferred)	6,000	6,000
Rent Receivable A/c. Rent Income A/c. (Rent of current year is still due.)	7,000	7,000
Rent Income A/c. Profit & Loss A/c. (Closing entry for rent income – Closed into Income Statement)	39,500	39,500

Important Tips To Remember - ITTR

One Account Method

1. Separate ledger account for income is not maintained
2. Balancing figure is closed to Income Statement
3. Closing balance is presented in Balance Sheet

Important Tips To Remember - ITTR

Two Account Method

1. Opening balance b/f and Closing balance c/f appears in receivable account
2. Income account is closed into Income Statement

Accrual Accounting

Advance Income

Unearned Income

One Account Method for Income

Only one ledger account is prepared for measuring income and for its reciprocal liability

Practice 8.7

Rent is received quarterly **in advance**
Reporting Period is 12 months **(Jan 1, 20X9 to Dec 31,20X9)**

Receipt Date	Receipt Period	Amount (Rs.)
Nov. 1, 20X8	Nov X8, Dec X8, Jan X9	9,000
Feb. 1, 20X9	Feb X9, Mar X9, Apr X9	9,500
May 1, 20X9	May X9, June X9, Jul X9	10,000
Aug. 1, 20X9	Aug X9, Sep X9, Oct X9	10,000
Nov. 1, 20X9	Nov X9, Dec X9, Jan Y0	10,500

Answer - Practice 8.7

		Rs.
Cash received during the year	(W-3) – 1ST Jan 20X9 to 31st Dec 20X9	40,000
Add: Opening Advance	(W - 1) – Jan 20X9	3,000
Less: Closing Advance	(W - 2) – Jan 20Y0	(3,500)
Income for the year		39,500

W – 1: Opening Advance = $9{,}000 \text{ X } \frac{1}{3} = 3{,}000$

W – 2: Closing Advance = $10{,}500 \text{ X } \frac{1}{3} = 3{,}500$

W – 3: Cash Received = $9{,}500 + 10{,}000 + 10{,}000 + 10{,}500 = 40{,}000$

Answer - Practice 8.7

One Account Method:

Unearned (Advance) Rent A/c.

	Rs.		Rs.
Profit & Loss (balancing figure)	39,500	Opening advance rent b/f	3,000
Closing Advance rent c/f	3,500	Cash Received	40,000
	43,000		43,000

Particulars	Debit Rs.	Credit Rs.
Cash A/c.	40,000	
Unearned (Advance) Rent A/c.		40,000
(Rent received in cash)		
Unearned (Advance) Rent A/c.	39,500	
Profit & Loss A/c.		39,500
(Closing entry for rent income – Closed into Income Statement)		

Two Account Method for Incomes

Two ledger accounts are prepared for measuring income and for its reciprocal liability

Practice 8.8

Rent is received quarterly **in advance**
Reporting Period is 12 months **(Jan 1, 20X9 to Dec 31,20X9)**

Receipt Date	Receipt Period	Amount (Rs.)
Nov. 1, 20X8	Nov X8, Dec X8, Jan X9	9,000
Feb. 1, 20X9	Feb X9, Mar X9, Apr X9	9,500
May 1, 20X9	May X9, June X9, Jul X9	10,000
Aug. 1, 20X9	Aug X9, Sep X9, Oct X9	10,000
Nov. 1, 20X9	Nov X9, Dec X9, Jan Y0	10,500

Answer - Practice 8.8

		Rs.
Cash received during the year	(W-3) – 1ST Jan 20X9 to 31st Dec 20X9	40,000
Add: Opening Advance	(W - 1) – Jan 20X9	3,000
Less: Closing Advance	(W - 2) – Jan 20Y0	(3,500)
Income for the year		39,500

W – 1: Opening Advance = $9{,}000 \times \frac{1}{3} = 3{,}000$

W – 2: Closing Advance = $10{,}500 \times \frac{1}{3} = 3{,}500$

W – 3: Cash Received = $9{,}500 + 10{,}000 + 10{,}000 + 10{,}500 = 40{,}000$

Answer - Practice 8.8

Two Account Method

Advance Rent A/c.

	Rs		Rs.
Rent Income A/c	3,000	Balance b/f	3,000
Balance c/f	3,500	Rent Income A/c	3,500
	6,500		6,500

Rent Income A/c.

	Rs		Rs.
Advance Rent Closing	3,500	Advance Rent Opening	3,000
Profit & Loss (B)	39,500	Cash Received	40,000
	43,000		43,000

Answer - Practice 8.8

Accounting Entries

Particulars	Debit Rs.	Credit Rs.
Cash A/c.	40,000	
Rent Income A/c.		40,000
(Rent income received in cash)		
Advance Rent A/c.	3,000	
Rent Income A/c.		3,000
(Opening balance of advance rent transferred)		
Rent Income A/c.	3,500	
Advance Rent A/c.		3,500
(Rent received in advance transferred from rent Income)		
Rent Income A/c.	39,500	
Profit & Loss A/c.		39,500
(Closing entry for rent income)		

Important Tips To Remember - ITTR

One Account Method

1. Separate ledger account for income is not maintained
2. Balancing figure is closed to Income Statement
3. Closing balance is presented in Balance Sheet

Important Tips To Remember - ITTR

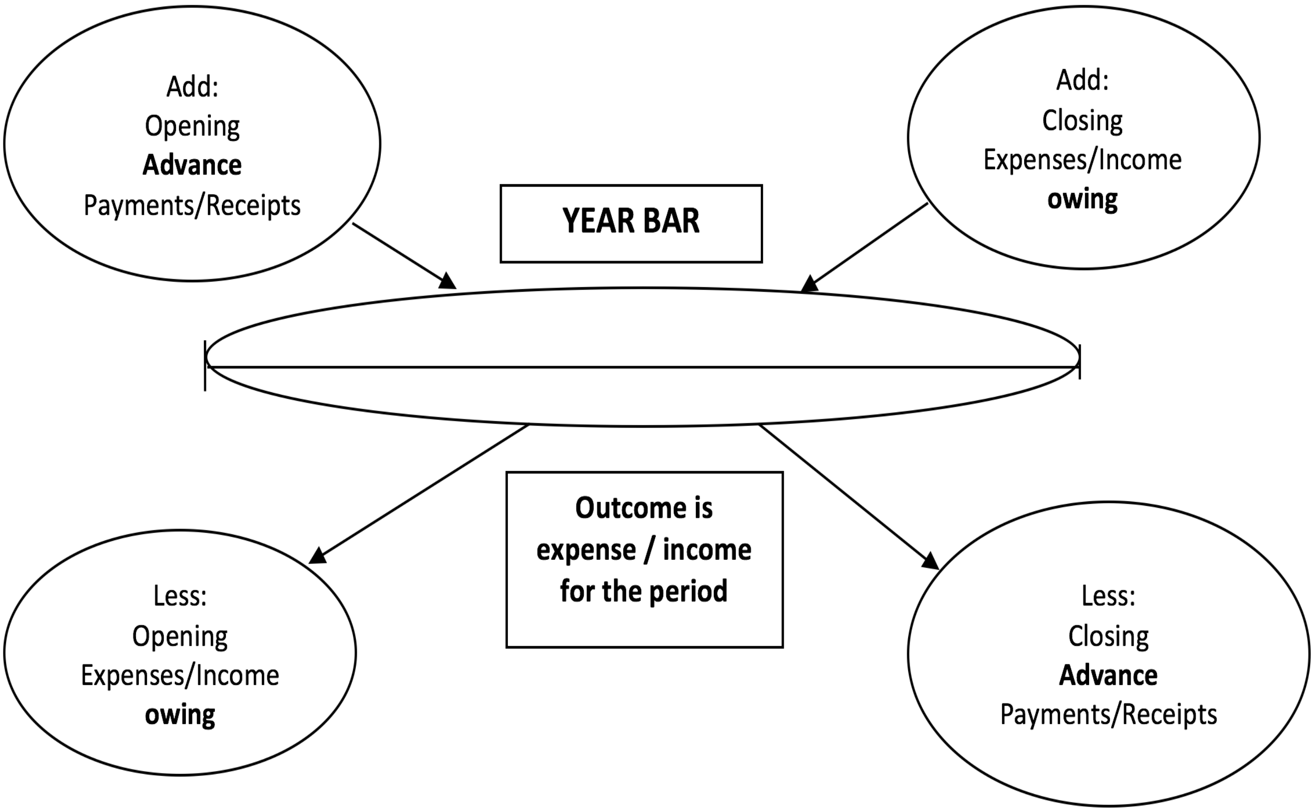
Two Account Method

1. Opening balance b/f and Closing balance c/f appears in Advance Rent account.
2. Income account is closed into Income Statement

Accrual Accounting

Diagrammatic Understanding of Accrual Concept

Diagrammatic Presentation

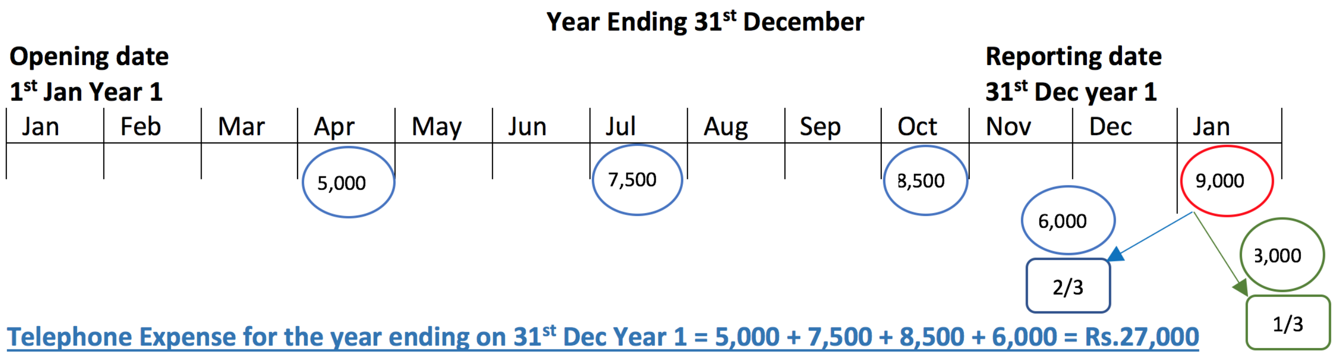


Practice 8.9

YEAR 1

- Yasin sets up a business on 1st January year 1 with 31st December as end of reporting period
- He acquires a telephone connection on 1st February and agrees to pay bill quarterly (3 months) in arrear
- Year 1 invoices are paid as follows:
  - 3 months ending 30th April year 1 — Rs.5,000
  - 3 months ending 31st July year 1 — Rs.7,500
  - 3 months ending 31st October year 1 — Rs.8,500
- The invoice for 31st January year 2 — Rs.9,000

Practice 8.9



Rs.9,000 will be paid in next year out of which Rs.6,000 relates to the current reporting period and is accrued/due on reporting date 31st Dec Year 1.

Practice 8.9

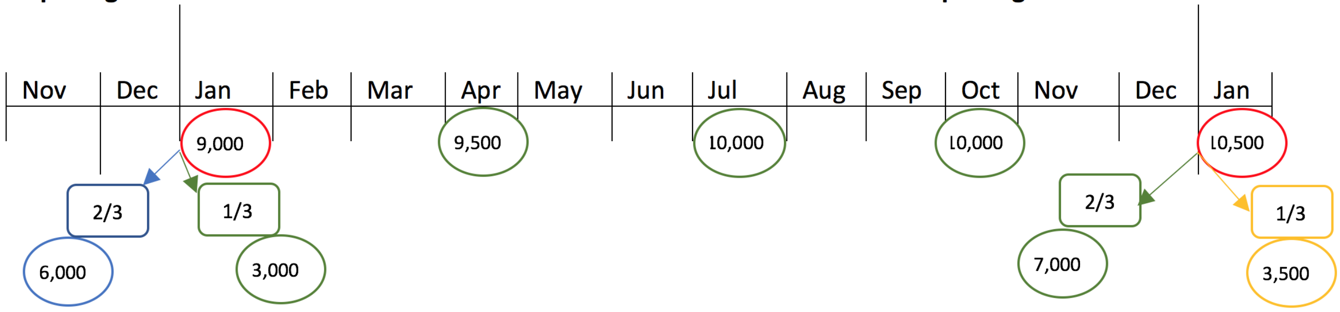
YEAR 2

- Year 2 invoices are paid as follows:
  - 3 months ending 31st January year 2 — Rs.9,000
  - 3 months ending 30th April year 2 — Rs.9,500
  - 3 months ending 31st July year 2 — Rs.10,000
  - 3 months ending 31st October year 2 — Rs.10,000
- The invoice for 31st January year 3 — Rs.10,500

Practice 8.9

Year Ending 31st December

Opening date 1st Jan Year 2 **Reporting date 31st Dec Year 2**



Telephone Expense for the year ending on 31st Dec. Year 2 = 3,000 + 9,500 + 10,000 + 10,000 + 7,000 = Rs.39,500

Rs.10,500 will be paid in next year out of which Rs.7,000 relates to the current reporting period and is accrued/due on reporting date 31st Dec Year 2.

Answer – Practice 8.9

One account method

YEAR 1

Telephone Payable Account

		Rs.		Rs.
Apr 30	Bank	5,000	Dec 31 **Profit & Loss (balancing figure)**	**27,000**
July 31	Bank	7,500		
Oct 30	Bank	8,500		
Dec 31	Closing due	6,000		
		27,000		27,000

Answer – Practice 8.9

One account method

YEAR 2

Telephone Payable Account

		Rs.			Rs.
Jan 31	Bank	9,000		Opening due	6,000
Apr 30	Bank	9,500	Dec 31	Profit & Loss	
July 31	Bank	10,000		(Balancing figure)	**39,500**
Oct 30	Bank	10,000			
Dec 31	Closing due	7,000			
		45,500			45,500

Answer – Practice 8.9

Two account method

YEAR 1

Telephone Expenses Account

		Rs.		Rs.	
Apr 30	Bank	5,000	Dec 31		
July 31	Bank	7,500	Profit & Loss	**27,000**	Expenses
Oct 30	Bank	8,500	(Balancing figure)		Year 1
Dec 31	Payable a/c	6,000			
		27,000		27,000	

Telephone Payable Account

		Rs.		Rs.	
Dec 31			Dec 31		
	Bal c/f	6,000	Telephone expenses	6,000	Liability
					Year 1
		6,000		6,000	

Answer – Practice 8.9

Two account method

YEAR 2

Telephone Expenses Account

		Rs.	Jan 1	**Rs.**	
Jan 31	Bank	9,000	Telephone payable	6,000	Reversal of the accrual
Apr 30	Bank	9,500	Dec 31		
Jul 31	Bank	10,000	**Profit & Loss**	**39,500**	Expenses year 2
Oct 30	Bank	10,000	**(Balancing figure)**		
Dec 31	Tel payable	7,000			
		46,000		45,500	

Telephone Payable Account

	Rs.		**Rs.**	
Telephone exp.	6,000	Balance b/f	6,000	
Balance c/f	7,000	Telephone exp.	7,000	Liability Year 2
	13,000		13,000	

Important Tips To Remember - ITTR

1. Cash receipt or payment happens during the reporting period/year (DTY)
2. Income or Expense is measured for the reporting period/year (FTY)

Accrual Accounting

Adjusting Entries

Closing Entries

Adjusting Entries

For Opening Expense Due

Dr Expense payable A/c.

Cr Expense a/c

For Closing Expense Due

Dr Expense a/c

Cr Expense payable a/c

For Opening Advance Payment

Dr Expense a/c

Cr Advance payment a/c

For Closing Advance payment

Dr Advance payment a/c

Cr Expense a/c

For Opening Income Due

Dr Income a/c

Cr Income receivable a/c

For Closing Income Due

Dr Income receivable a/c

Cr Income a/c

For Opening Advance Receipt

Dr Unearned income a/c

Cr Income a/c

For Closing Advance Receipt

Dr Income a/c

Cr Unearned income a/c

Closing Entries

For expenses

Dr Income Statement

Cr Expense (accounting head)

For incomes

Dr Income (accounting head)

Cr Income Statement

Important Tips To Remember - ITTR

1. Adjusting entries are passed on reporting (closing) date in order to complete the Income/Expense account with respect to the accruals and prepayments.
2. Closing entries are passed on reporting (closing) date, in order to close final balance of Income/Expense account into the Income Statement for the reporting period to which they relate.

Chapter - 9

Provision for Bad and Doubtful Debts

MGT 101
Financial Accounting

By
Mian Ahmad Farhan, FCA

Contents

Provision for Bad and Doubtful Debts

Basic Concept of Bad and Doubtful Debts

Bad and Doubtful Debts

Bad Debts / Irrecoverable Debts are the accounts receivables (Debtors) that an entity will never be able to collect

Doubtful Debts are the accounts receivables (Debtors) where there is a high risk that it will not be recovered

Accounting Effects

1. **Debtors written off as bad debts**

Bad Debts A/c. Dr
Debtors' A/c. Cr

2. **Creating provision for doubtful debts**

Bad Debts A/c. Dr
Provision for DD A/c. Cr

3. **Increase in provision for doubtful debts**

Bad Debts A/c. Dr
Provision for DD A/c. Cr

4. **Decrease in provision for doubtful debts**

Provision for DD A/c. Dr
Bad Debts A/c. Cr

5. **Bad debts recovered**

Bank A/c. Dr
Bad Debts Recovered A/c. Cr

6. **Discount allowed to Debtors.**

Discount Allowed A/c. Dr
Debtors' A/c. Cr

7. **Creating provision for discount on debts.**

Discount Allowed A/c. Dr
Provision for discount A/c. Cr

Important Tips To Remember - ITTR

1. Bad Debts and Discount Allowed are loss for the business entity, these belong to main head "Expense"
2. Provision for Doubtful Debts is contra to Asset, hence Cr. in nature
3. Bad Debts Recovered is not "Income". It is reduction in "Expense"

Provision for Bad and Doubtful Debts

Measurement of Provision for Doubtful Debts

(Specific & General Provision)

Measurement Bases

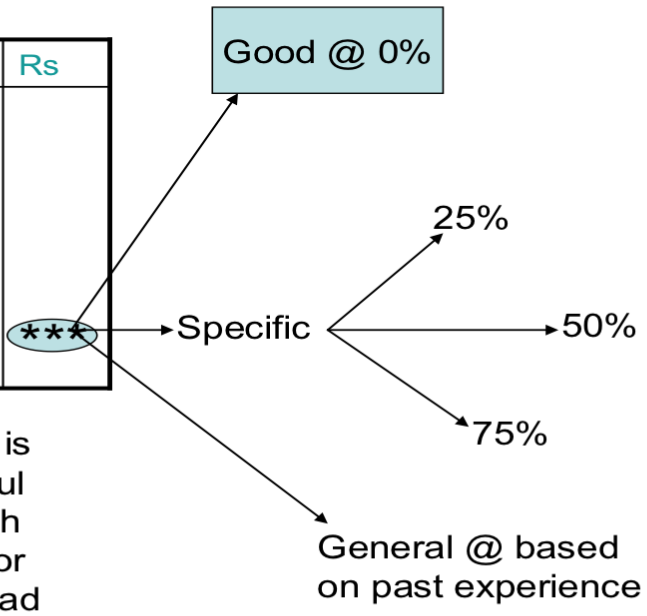
1. Specific and general provision based on Expected Credit Losses
2. Past due / age based analysis

Specific and General Provision

Provision for doubtful debts based on specifically doubtful debtors

Debtors a/c

Particulars	Rs	Particulars	Rs
		Balance c/f	***



Sum of specific and general provision is the c/f balance of Provision for Doubtful Debts a/c, which is then compared with opening balance of the provision a/c for increase/decrease to be adjusted in Bad Debts account.

Practice 9.1

Closing balance of Debtors is Rs.80,000 out of which:

- **One of the debtors Mr. Fill owing Rs.6,000 is also a creditor to whom entity owes Rs.7,500 (he is considered as a good debtor);**
- **One of the debtors Mr. Kill owing Rs.10,000 is specifically doubtful and 75% is expected recovery from his estate as final dividend;**
- **One of the debtors Miss Hill owing Rs.6,000 is expected to be doubtful at 50%;**
- **One of the debtors Mr. Bill owing Rs.8,000 is expected to be doubtful @ 75%;**
- **Generally, provision for doubtful debts is estimated @ 5% of the debtors' balance.**

Calculate provision for doubtful debts against debtors of Rs.80,000 and pass accounting entry for increase in provision assuming that opening balance for provision for doubtful debt at the beginning of reporting period was Rs.10,000.

Answer – Practice 9.1

	Rs.		Rs.
Good Debtor Mr. Fill	6,000 x 0%	=	zero
Specific Debtor			
Mr. Kill	10,000 x 25%	=	2,500
Miss. Hill	6,000 x 50%	=	3,000
Mr. Bill	8,000 x 75%	=	6,000
General Debtors	50,000 x 5%	=	2,500
(remaining balance; 80,000 – 30,000)			
Closing Balance of Debtors	**80,000**		**14,000**

Opening Balance of Provision for Doubtful Debts	**10,000**
Closing Balance of Provision for Doubtful Debts	**14,000**
Increase in Provision for Doubtful Debts	**4,000**

Bad Debts A/c.	Dr 4,000	
Provision for Doubtful Debts A/c.		Cr 4,000

Important Tips To Remember - ITTR

1. Subtract good debtors from c/f balance of debtors before calculating amount of provision
2. Sum of specific and general provision gives c/f balance of provision

Provision for Bad and Doubtful Debts

Measurement of Provision for Doubtful Debts

(Age Based Provision)

Measurement Bases

1. Specific and general provision based on Expected Credit Losses
2. Past due / age based analysis

Aging Based Provision

- Closing balance of debtors is analyzed in terms of age of each customer.
- Recovery from older balances is considered more risky.

Practice 9.2

Analysis of closing balance of Debtors shows following facts:

Balance Due:	**Rs.**	**Rate & Amount of Provision**	
For less than 30 days	90,000 x	0%	Rs. 0
For more than 30 days but less than 60 days	60,000 x	5%	Rs. 3,000
For more than 60 days but less than 90 days	50,000 x	7%	Rs. 3,500
For more than 90 days	20,000 x	10%	Rs. 2,000
Closing Balance Debtors and Provision	**Rs. 220,000**		**Rs. 8,500**

Practice 9.2

Opening Balance of Provision for Doubtful Debts	**Rs. 9,800**
Closing Balance of Provision for Doubtful Debts	**Rs. 8,500**
Decrease in Provision for Doubtful Debts	**Rs. 1,300**

Provision for doubtful debts A/c.	Dr 1,300	
Bad Debts A/c.		Cr 1,300

Important Tips To Remember - ITTR

1. Closing balance of debtors is classified on "past due" basis
2. Greater % is estimated for older debtors
3. Sum of all the estimated amounts is closing balance for provision

Provision for Bad and Doubtful Debts

Accounting for Bad and Doubtful Debts

Recognition of Bad Debts

A business has Trade Receivables (Debtors) of Rs.75,000. Among the Debtors' balance, Mr A owes Rs.5,000 to the business who has recently been declared as bankrupt and should be written off.

Movement in Ledger Accounts

Debtors / Receivables

	Rs.		Rs.
Bal b/f	75,000	Bad debts	5,000
		Bal c/f	70,000
	75,000		75,000

Bad Debts

	Rs.		Rs.
Debtors	5,000	Profit & Loss – Income Statement	5,000
	5,000		5,000

Debtors written off as bad debts

Bad Debts A/c.	Dr 5,000	
Debtors' A/c.		Cr 5,000

Recognition of Provision for DD

Year 1 (Start of Entity)

- Trade receivables of Rs.75,000
- Rs.5,000 is to be written off as 'Bad'

Provision for doubtful debts is to be maintained (for the first time) amounting to Rs.2,000

Movement in Ledger Accounts

Debtors / Receivables

	Rs.		Rs.
Bal b/f	75,000	Bad debts	5,000
		Bal c/f	70,000
	75,000		75,000

Bad Debts

	Rs.		Rs.
Receivables	5,000	Income Statement	7,000
Prov. for Doubtful Debts	2,000		
	7,000		7,000

Provision for doubtful debt

	Rs.		Rs.
Bal c/f	2,000	Bad debts	2,000
	2,000		2,000

Statement of Financial Position

Debtors	70,000
Provision for Doubtful Debts	(2,000)
	68,000

Income Statement

Bad debts expense	7,000

Accounting Entries

Debtors written off as bad debts

Bad Debts A/c. Dr 5,000

Debtors' A/c. Cr 5,000

Creating provision for doubtful debts

Bad Debts A/c. Dr 2,000

Provision for doubtful debts A/c. Cr 2,000

Important Tips To Remember - ITTR

1. Actual bad debts and estimated doubtful debts; both are debited to Bad Debts A/c.
2. Written off means permanent decrease in asset (receivable)
3. Provision balance is presented as contra against debtors balance

Provision for Bad and Doubtful Debts

Increase in Provision for Doubtful Debts

Recognition of Increase in Provision

Year 2

- Credit sales Rs.200,000
- Receipts from customers Rs.185,000
- Bad debts written off Rs.8,000
- The allowance for doubtful debts is to be increased from Rs.2,000 to Rs.6,000

Movement in Ledger Accounts

Debtors / Receivables

	Rs.		Rs.
Bal b/f	70,000	Bank	185,000
Sales	200,000	Bad debts	8,000
		Bal c/f	77,000
	270,000		270,000

Bad Debts

	Rs.		Rs.
Debtors	8,000	Income statement	12,000
Provision for Doubtful Debts	4,000		
	12,000		12,000

Provision for Doubtful debt

	Rs.		Rs.
		Bal b/f	2,000
Bal c/f	6,000	Bad debt	4,000
	6,000		6,000

Statement of Financial Position

Debtors	77,000
Provision for Doubtful Debts	(6,000)
	71,000

Income Statement

Bad debts expense	12,000

Accounting Entries

Debtors written off as bad debts

Bad Debts A/c.	Dr 8,000	
Debtors' A/c.		Cr 8,000

Increase in provision for doubtful debts

Bad Debts A/c.	Dr 4,000	
Provision for doubtful debts A/c.		Cr 4,000

Important Tips To Remember - ITTR

1. Provision carries Cr. nature, being contra against Debtors
2. Increase in Cr. should be Cr.
3. Reciprocal effect is loss; Dr. to Bad Debts.

Provision for Bad and Doubtful Debts

Decrease in Provision for Doubtful Debts

Recognition of Decrease in Provision

Year 3

- Credit sales Rs.200,000
- Receipts from customers Rs.185,000
- Bad debts written off Rs.8,000
- The allowance for doubtful debts is to be decreased from Rs.6,000 to Rs.5,000

Movement in Ledger Accounts

Debtors / Receivables

	Rs.		Rs.
Bal b/f	70,000	Bank	185,000
Sales	200,000	Bad debts	8,000
		Bal c/f	77,000
	270,000		270,000

Bad Debts

	Rs.		Rs.
Debtors	8,000	Provision for Doubtful Debts	1,000
		Income statement	7,000
	8,000		8,000

Provision for Doubtful debt

	Rs.		Rs.
Bad Debts	1,000	Bal b/f	6,000
Bal c/f	5,000		
	6,000		6,000

Statement of Financial Position

Debtors	77,000
Provision for Doubtful Debts	(5,000)
	72,000

Income Statement

Bad debts expense	7,000

Accounting Entries

Debtors written off as bad debts

Bad Debts A/c.	Dr 8,000	
Debtors' A/c.		Cr 8,000

Increase in provision for doubtful debts

Provision for Doubt Debts A/c.	Dr 1,000	
Bad Debts A/c.		Cr 1,000

Important Tips To Remember - ITTR

1. Provision carries Cr. nature, being contra against Debtors
2. Decrease in Cr. should be Dr.
3. Reciprocal effect is decrease in loss; Cr. to Bad Debts.

Provision for Bad and Doubtful Debts

Practice - Maintenance of Provision for Doubtful Debts

Different Scenarios

Practice 9.3

	Debit	Credit
Debtors (balance before adjustments)	Rs. 25,000	
Bad debts (written off during the year)	Rs.1,000	
Provision for doubtful debts (b/f)		Rs.480

Adjustment Scenario 1

Write off further bad debts Rs.500

Maintain/increase provision for doubtful debts at/up to Rs.600

Adjustment Scenario 2

Write off further bad debts Rs.500

Maintain/decrease provision for doubtful debts at/up to Rs.400

Adjustment Scenario 3

Write off further bad debts Rs. 500

Increase provision for doubtful debts by Rs.200

Answer – Scenario 1

Debtors account

Particulars	Rs.	Particulars	Rs.
From Trial Balance	25,000	Bad Debts (Adjustment)	500
		Balance c/f	24,500
	25,000		25,000

Bad Debts account

Particulars	Rs.	Particulars	Rs.
From Trial Balance	1,000	Income Statement	1,620
Debtors (Adjustment)	500		
Provision for doubtful debts	120		
	1,620		1,620

Provision for doubtful debts account

Particulars	Rs.	Particulars	Rs.
Balance c/f	600	From TB Balance b/f	480
		Bad debts (balancing figure) (Increase in Provision)	120
	600		600

Answer – Scenario 2

Debtors account

Particulars	Rs.	Particulars	Rs.
From Trial Balance b/f	25,000	Bad Debts (Adjustment)	500
		Balance c/f	24,500
	25,000		25,000

Bad Debts account

Particulars	Rs.	Particulars	Rs.
From Trial Balance	1,000	Provision for doubtful debts	80
Debtors (Adjustment)	500	Income Statement	1,420
	1,500		1,500

Provision for doubtful debts account

Particulars	Rs.	Particulars	Rs.
Bad debts (balancing figure) (decrease in provision)	80	From TB Balance b/f	480
Balance c/f	400		

Answer – Scenario 3

Debtors account

Particulars	Rs.	Particulars	Rs.
From Trial Balance b/f	25,000	Bad Debts (Adjustment)	500
		Balance c/f	24,500
	25,000		25,000

Bad Debts account

Particulars	Rs.	Particulars	Rs.
From Trial Balance	1,000	Income Statement	1,700
Debtors (Adjustment)	500		
Provision for doubtful debts	200		
	1,700		1,700

Provision for doubtful debts account

Particulars	Rs.	Particulars	Rs.
Balance c/f (balancing figure)	680	From TB Balance b/f	480
		Bad debts (Prov. increase by)	200
	680		680

Important Tips To Remember - ITTR

1. Bad Debts appearing in TB have already been written off DTY
2. Don't confuse because of difficult words, just focus on the movement in provision i.e., increase or decrease

Provision for Bad and Doubtful Debts

Practice:

Provision for Doubtful Debts

and

Provision for Discount Allowable

Practice 9.4

On 1-1-20X9 the Provision for Doubtful Debts Account in the books of S. Zahid stood at Rs.1,200 and the Provision for Discount Allowable Account at Rs.150.

On 31-12-20X9, the Sundry Debtors were Rs. 20,400 of which Rs. 400 were considered bad and required to be written off. The discount allowed to Debtors during 20X9 was Rs. 300 (already accounted for DTY).

On 31-12-20Y0, the Sundry Debtors were Rs. 10,100 of which Rs. 100 were considered bad and required to be written off. The discount allowed to debtors during 2010, was Rs. 50 (already accounted for).

On 31-12-20Y1 the Sundry Debtors were Rs.36,200 of which Rs. 200 were considered bad and required to be written off. The discount allowed to debtors during 2011 was Rs. 50 (already accounted for).

It is decided to maintain a provision for doubtful debts at 5% on Sundry Debtors and a provision for discount on debtors at 2% on Debtors.

Show how the provision for Doubtful Debts Account and the provision for Discount Allowable Account would appear in the ledger of S. Zahid for the year 20X9, 20Y0 and 20Y1.

Answer – Practice 9.4

Debtors A/c.

Date	Particular	Rs.	Date	Particulars	Rs.
20X9	Balance (Reopened)	20,400	20X9	Bad Debt	400
Dec.31			Dec 31	Balance c/f 5%	20,000
		20,400			20,400
20Y0	Balance (Reopened)	10,100	20Y0	Bad Debt	100
Dec.31			Dec.31	Balance. c/f 5%	10,000
		10,100			10,100
20Y1	Balance (Reopened)	36,200	20Y1	Bal Debt	200
Dec.31			Dec.31	Balance c/f 5%	36,000
		36,200			36,200

Answer – Practice 9.4

Provision for Doubtful Debts A/c.

Date	Particular	Rs.	Date	Particulars	Rs.
20X9	Bad Debt		20X9		
Dec.31	(decrease in provision)	200	Jan.1	Balance b/f	1,200
Dec.31	Balance c/f	1,000			
		1,200			1,200
	Bad debt	500	20Y0	Balance b/f	1,000
20Y0	(decrease in provision)		Jan.1		
Dec.31	Balance c/f	500			
		1,000	20Y1		1,000
20Y1			Dec.31	Balance b/f	50
					0
Dec 31	Balance c/f	1,800	Dec.31	Bad debt	1,300
				(Increase in provision)	
		1,800			1,800

Answer – Practice 9.4

Bad Debt A/c.

Date	Particular	Rs.	Date	Particulars	Rs.
20X9			**20X9**		
D.T.Y	Debtors	400	Dec. 31	Provision for Doubtful Debt	200
			Dec. 31	Income Statement	200
20Y0		400	20Y0		400
D.T.Y	Debtors	100	Dec. 31	Provision for Doubtful Debt	500
Dec. 31	Income Statement	400			
		500			500
20Y1					
D.T.Y	Debtors	200	20Y1		
Dec. 31	Provision for Doubtful Debt	1,300	Dec. 31	Income statement	1,500
		1,500			1,500

Answer – Practice 9.4

Provision for Discount Allowable A/c.

Date	Particular	Rs.	Date	Particulars	Rs.
20X9			20X9		
			Jan.1	Balance b/f	150
Dec.31	Balance c/f (Working*)	380	Dec.31	Discount allowed	230
				(increase in provision)	
		380			380
20Y0			20Y0		
Dec.31	Discount allowed	190	Jan.1	Balance b/f	380
	(decrease in provision)				
Dec.31	Balance c/f (Working*)	190			
		380			380
			20Y1	Balance b/f	190
	Balance c/f (Working*)	684		Discount allowed	494
				(Increase in provision)	
		684			684

***Workings:**

	Year 20X9	Year 20Y0	Year 20Y1
Debtors c/f	20,000	10,000	36,000
Provision for doubtful debts c/f	(1,000)	(500)	(1,800)
	19,000 x 2%	9,500x2%	34,200x2%
	= 380	= 190	= 684

Answer – Practice 9.4

Discount Allowed A/c.

Date	Particular	Rs.	Date	Particulars	Rs.
20X9					
D.T.Y	Debtor (already accounted for)	300	20X9		
Dec.31	Provision for discount allowed	230	Dec.31	Income statement	530
		530			530
20Y0			20Y0		
D.T.Y	Debtor (already accounted for)	50	Dec.31	Provision for discount allowed	190
Dec.31	Income statement	140			
		190			190
20Y1					
D.T.Y	Debtor (already accounted for)	50	20Y1		
Dec.31	Provision for discount allowed	494	Dec.31	Income statement	544
		544			544

Important Tips To Remember - ITTR

1. Provision for discount is calculated after subtracting credit balance of provision for doubtful debts from the debtors
2. Provision for discount is subtracted from the debtors after subtracting the closing balance of provision for doubtful debts.

Provision for Bad and Doubtful Debts

Recap

Very Important Tips To Remember

Important Tips To Remember - ITTR

1. Debtors are not written off with the amount of doubtful debts.
2. Doubtful debts are credited in an account:
   – known as a provision/allowances for doubtful debts
   – this provision is set off against the debtors' balance on the face of Statement of Financial Position (balance sheet).
   – credit balance of the provision account represents specifically doubtful receivables and/or general receivables. At the end of reporting period, there could be a valid reason to believe that there is no doubt with regards to recovery from specific debtors but based on past experience few unidentified debtors might become bad, for which provision is created for general debtors.

Important Tips To Remember - ITTR

3. Credit balance on provision account is re-measured at each reporting date (balance sheet date).
   – If the required (remeasured) balance is greater than the previous balance, then an additional expense is recognised as bad debts with the incremental amount.
   – If the required (remeasured) balance is lesser than the previous balance, then the amount of reduction in balance would also reduce the bad debts expense for the period.
4. Amount for the bad debts expense chargeable to the Income Statement is worked out as below:
   – Bad debts written-off during the reporting period
   – Add increase in Provision for doubtful debt or
   – Less decrease in Provision for doubtful debt
   – Less Bad debts recovered during the reporting period

Important Tips To Remember - ITTR

5. Amount for the discount allowed expense chargeable to the Income Statement is worked out as below:
   – Actual discount allowed during the reporting period
   – Add provision created for discounts allowable
6. Presentation in Statement of Financial Position / Balance Sheet
   – Debit balance of Debtors account and credit balance of Provision for Doubtful Debts account are set off in the Statement of Financial Position
   – Provision for discount allowable is calculated on remaining debtors balance after subtracting credit balance of provision for doubtful debts from the debtors' balance.
   – Provision for discount allowable is subtracted from the debtors after subtracting the closing balance of provision for doubtful debts.

Important Tips To Remember - ITTR

7. Bad debts appearing in Dr side of Trial Balance are not subtracted from Debtors balance appearing in Dr side of Trial Balance; because these have already been accounted for.