

RECORDING OF TRANSACTIONS

(JOURNAL ENTRIES, LEDGER AND TRIAL BALANCE)

Source Document :

A document which provides evidence of the transactions is called the Source Document such as Cash memo, Invoice etc. At times, there may be no documentary proof for certain items in such case voucher may be prepared showing the necessary details and it must be approved by appropriate authority. All recording in books of account is done on the basis of Voucher.

Classification of Accounting Vouchers :

Vouchers	Further classification	Purpose
Cash Vouchers	Debit Vouchers	To show Cash Payments
	Credit Vouchers	To show Cash Receipts
Non Cash Vouchers	Transfer Vouchers	To show Transactions not involving cash

Debit Voucher :

This voucher is prepared for all the cash payments made by the business e.g. Payment of Salary, Purchases of Goods and services, Payment made to any Creditor etc.

Credit Voucher :

This voucher is prepared by the business in case of cash receipt from any source such as Sale of goods for Cash, Payment received from any of Debtors, Income received etc

Transfer Voucher / Non-Cash Voucher :

This type of vouchers are prepared in those transactions where cash is not involved. e.g.as Credit Sales, Credit Purchases, Bad Debts, Depreciation etc.

Accounting Equation :

An accounting equation is based on the dual concept of accounting. According to this concept every transaction has two aspects - Debit and Credit.

Assets = Capital + Liabilities

A transaction may affect either both sides of the equation by the same amount or one side of the equation only, by both increasing or decreasing it by equal amount. It can be said “Accounting equation holds good under all circumstances.”

RULES OF DEBIT AND CREDIT :

TRADITIONAL APPROACH :

Under this approach, all ledger accounts are mainly classified into two categories:

A. Personal accounts :

It includes all those accounts which are related to any person i.e. individuals, firms, companies, Banks etc. This can further be classified into three categories :

1. **Natural persons :** All accounts of human beings/persons are included such as Ram’s a/c, Shyam’s a/c etc.
2. **Artificial persons :** This includes all accounts related to organizations which are treated as persons in the eyes of law and having all the legal rights as a natural person have such as buying/selling assets in its name, suing and be sued etc. Some of the examples are Reliance industries ltd. Punjab National Bank etc.
3. **Representative persons :** In this category, accounts which represents some person are included e.g. Capital a/c (representing Owner), Outstanding salary (representing the employee to whom salary is due) etc.

B. Impersonal accounts :

all ledger accounts which are not related to persons are included in this category. This can be classified as :

1. **Real accounts :** under this category, mainly assets (excluding debtors) are included. These assets can be **tangible** (which can be touched, seen and measured such as furniture, cash, stock etc.) and **intangible** (which can’t be seen, touched or measured but still have monetary value such as patents, trademark etc.)
2. **Nominal accounts :** all this, all accounts which are related to income/gain and expenses/losses are included e.g. Salary paid, Commission received etc

JOURNAL :

Journal is a book in which transactions are originally recorded in a chronological order (as per the occurrence) after analyzing the transaction and applying the rules of debit and credit.

PROCESS OF RECORDING :

- (1) Identification of financial transactions
- (2) Analysis of transactions
- (3) Application of rules of debit and credit
- (4) Recording in Journal

CLASSIFICATION OF JOURNAL ENTRIES :

- | | | |
|---|---|---|
| <input type="checkbox"/> SIMPLE ENTRIES | <input type="checkbox"/> COMPOUND ENTRIES | <input type="checkbox"/> OPENING ENTRIES |
| <input type="checkbox"/> TRANSFER ENTRIES | <input type="checkbox"/> CLOSING ENTRIES | <input type="checkbox"/> RECTIFYING ENTRIES |

Simple Entries : The entries in which only two accounts are affected, one a/c is debited and other one is credited. All entries in the above illustration 3 are this nature.

Compound Entries : The entries in which there are at least two accounts are debited and at least one account is credited or vice versa.

SPECIAL TRANSACTIONS RELATED TO GOODS :

1. Withdrawal of goods by owner for personal use.

Drawings a/c Dr.

To Purchases a/c

2. Goods given as charity.

Charity a/c Dr.

To Purchases a/c

3. Goods distributed as free samples

Advertisement a/c Dr.

To Purchases a/c

4. Goods lost by fire/ flood/theft etc.

Loss by fire/theft a/c Dr.

To Purchases a/c

Note : Purchases a/c is credited in the above entries because the goods are going out of our business on cost and it is not a sale hence, deducted from the purchases a/c.

TRANSACTIONS RELATED BANKS:

1. Cash deposited into the bank

Bank a/c Dr.

To Cash a/c

2. Cash withdrawn for office use.

Cash a/c Dr.

To Bank a/c

3. When cheque is received from customer and deposited into bank same day.

Bank a/c Dr.

To Customer's personal a/c

4. When cheque is received from customer and not deposited into bank same day.

Cash a/c Dr.

To Customer's personal a/c

5. When above cheque (Point 4) is deposited later into bank.

Bank a/c Dr.

To Cash a/c

6. When payment is made through cheque.

Personal a/c Dr.

To Bank a/c

7. When expenses is paid through cheque.

Expense a/c Dr.

To Bank a/c

8. When interest is allowed by the bank.

Bank a/c Dr.

To Interest a/c

9. When Bank charges for the services provided.

Bank Charges a/c Dr.

To Bank a/c

Some special entries :

1. Bad Debts (when customer is declared insolvent and amount is irrecoverable from him)

Cash a/c Dr. (If partial amount is recovered)

Bad Debts a/c Dr. (the irrecoverable part)

To Personal a/c (the due amount)

2. Bad debts recovered earlier written off as bad debts.

Cash a/c Dr.

To Bad debts recovered a/c

3. Outstanding Expenses (expenses due but not paid yet).

Expenses a/c Dr.

To Outstanding Expenses a/c

4. Prepaid Expenses (Expenses not due but paid in advance).

Prepaid expenses a/c Dr.

To Expenses a/c

5. Accrued income (income due but not received yet).

Accrued Income a/c Dr.

To Income a/c

6. Unearned Income (Income not due but received in advance).

Income a/c Dr.

To Unearned Income a/c

7. Depreciation provided on fixed assets.

Depreciation a/c Dr.

To Related asset's a/c

8. Interest on Capital provided.

Interest on capital a/c Dr.

To Capital a/c

9. Interest on Drawings charged.

Drawings a/c Dr.

To Interest on Drawings a/c

BOOKS OF ORIGINAL ENTRY/SPECIAL PURPOSE BOOKS :

As size of the business grows and number of transactions increases, it becomes necessary for the business to divide the recording work. The books maintained are illustrated below :

Transactions	Further classification	Subsidiary Books Maintained
Cash and Bank related transactions	Only Cash Transaction	Simple Cash Book
	Cash & Bank Transactions	Double Column Cash Book
	Cash payment of small Amount	Petty Cash Book
Transactions other than cash and Bank	Credit Sales	Sales Book
	Credit Purchase	Purchases Book
	Sales Return	Sales Return Book
	Purchase Return	Purchase Return Book
	Transactions of Bills Receivable	Bills Receivable Book
	Transactions of Bills Payable	Bills Payable Book
	Any Other Transactions	Journal Proper

LEDGER:

Meaning :

After recording the business transaction in the Journal or special purpose Subsidiary Books, the next step is to transfer the entries to the respective accounts in the Ledger. **Ledger is a book where all the transactions related to a particular account are collected at one place.**

Definition :

The Ledger is the main or Principal book of accounts in which all the business transactions would ultimately find their place under various accounts in a duly classified form.

Importance :

Main point is To know the collective effect of all the transaction pertaining to one particular A/c By this classification / collective effect we are able to know the following–

1. How much amount is due from each customer and how much amount the firm has to pay to each supplier/ creditor.
2. The amount of Purchase and Sales during a particular period.
3. Amount paid or received on account of various items.
4. Ultimate position of Assets and Capital.
5. For the preparation of Trial Balance which helps in ascertaining the Arithmetic Accuracy of the Accounts.

Important:

Ledger is also called the Principal Book of Accounts
Performa for Ledger

Each ledger account is divided into two equal parts.

Left Hand Side Debit side (Dr)

Right Hand Side Credit side (Cr)

TRIAL BALANCE :

1. **Meaning** – When posting of all the transactions into the Ledger is completed and accounts are balanced off, then the balance of each account is put on a list called Trial Balance.

2. **Definition** – Trial Balance is the list of debit and credit balances taken out from ledger. “It also includes the balances of Cash and bank taken from the Cash Book”.

3. **Preparation** – Steps (Only Balance Method)
 2. Ledger A/cs which shows a debit balance is put on the Debit side of the trial balance.
 3. The A/c Showing credit balance is put on the Credit side of Trial Balance.
 4. Accounts which shows no balance i.e. whose Debit and Credit totals are equal are not entered in Trial Balance.
 5. Then the two sides of the Trial Balance are totalled. If they are equal it is assumed that there is at least no arithmetical error in the posting and balancing of Ledger A/cs.

Objectives or Functions of Trial Balance :

1. It helps in ascertaining the arithmetic accuracy of ledger accounts.
2. Helps in locating errors.
3. Provides the summary of Ledger A/cs.
4. Helps in the preparation of Final A/cs.

Posting of opening Entries :

1. First of all opening Journal Entry is done in the Journal proper.

2. All Assets A/cs are Debited and Liabilities A/cs are Credited. Difference between the totals of the two sides is the Capital.

Important :

Besides opening Journal entries, any transaction which is not covered under any of the Subsidiary Book is done in Journal proper.

Suspense Account :

When Trial Balance does not agree, then first of all we try to locate the errors. Sometimes, in inspite of the best efforts, all the errors are not located and the Trial Balance does not tally. Then in order **to avoid delay in the preparation of final accounts, a new account is opened which is known "Suspense Account"**

Difference in Trial Balance is posted to this Account :

1. If there is Excess Debit Difference is posted in the Trial Balance to the Credit side of Suspense A/c
2. If there is Excess Credit Difference is posted in the Trial Balance to the Debit side of Suspense Account.

Closing of Suspense A/c :

The errors which led to the difference still remains to have to be located. These errors will be rectified through Suspense A/c (One sided errors) which will be explained in the topic Rectification of Errors.

When all the errors are rectified, this Account closes down automatically. If the difference in Trial Balance persist, it is shown in the Balance Sheet.

1. **Debit Balance of Suspense A/c** is shown in the **Asset Side of the B/Sheet.**
2. **Credit Balance of Suspense A/c** is shown in the **Liability Side of the Balance Sheet.**

CONTACT : SAURABH SARDANA : 9811507560, DEEPALI SARDANA : 9899663603, VAIBHAV ARORA : 9654587567

Milestone : B-118, Basement, Kalkaji, New Delhi-110019

: 2932, Sant Nagar, Rani Bagh, Opp. Aggarwal Prestige Mall, Near M2K, Pitam Pura, New Delhi-34

: C-73, First Floor, Pushpanjali Enclave, Pitam Pura, New Delhi-110034

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