- Source Document and Rules of Debit and Credit
- Accounting Equation
- Rules of Debit and Credit
- Journal

Source Document and Rules of Debit and Credit

Concept Explanation:

Business transactions involve the exchange of economic consideration between parties and have two-fold effects recorded in two or more accounts. These transactions are usually supported by appropriate documents such as cash memos, invoices, sales bills, pay-in-slips, cheques, salary slips, etc. A document that provides evidence of a transaction and on the basis of which entries are made in subsidiary books is called a **Source Document** or **Voucher**. These are also known as supporting documents.

Key Definitions / Features:

- **Source/Supporting Vouchers:** Documents evidencing transactions, e.g., cash memo, invoice, receipt voucher, pay-in-slip, cheque, debit note, credit note.
- **Accounting Vouchers:** Documents prepared by accountants to record debit and credit accounts before making entries in books of accounts, e.g., cash voucher, non-cash/transfer voucher.

Examples of Source Documents:

- **Cash Memo:** Prepared by the seller when goods are sold for cash, containing date, items, quantity, rate, total amount, and terms.
- **Invoice/Bill:** Prepared when goods are sold on credit, containing party details, date, items, quantity, rate, total amount, and terms.
- **Receipt Voucher:** Prepared to record receipt of cash or cheque, usually in duplicate.
- **Pay-in-Slip:** Document used for depositing cash or cheque into the bank.
- **Cheque:** Negotiable instrument payable on demand drawn upon a bank.

- **Debit Note:** Prepared when a party's account is to be debited due to overvaluation or returns.
- **Credit Note:** Prepared when a party's account is to be credited due to undervaluation, returns, or discounts.

Accounting Vouchers Types:

- **Cash Voucher:** Prepared at receipt or payment of cash; debit voucher when cash is paid, credit voucher when cash is received.
- **Non-cash/Transfer Voucher:** Prepared for non-cash transactions like credit sales, purchases, or rectifications. Simple transactions have one debit and one credit; complex transactions have multiple debits and credits (also called journal vouchers).

Practice Set:

- *Level 1 – Easy:* Identify the source document for a cash sale of goods.
- *Level 2 – Moderate:* Differentiate between a debit note and a credit note with examples.
- *Level 3 – Challenging:* Prepare accounting vouchers for a complex transaction involving multiple debits and credits.

Answer Key:

- Level 1: Cash Memo is the source document for a cash sale.
- Level 2: Debit Note is issued when goods are returned or overvalued; Credit Note is issued when goods are undervalued or discounts are given.
- Level 3: Accounting vouchers must list all accounts debited and credited with amounts and narration, following double-entry principles.

Quick Reference:

- Source Document = Evidence of transaction
- Cash Memo = Cash sale
- Invoice = Credit sale
- Receipt Voucher = Receipt of cash/cheque
- Pay-in-Slip = Bank deposit
- Debit Note = Debit party account
- Credit Note = Credit party account

Glossary:

- **Voucher:** Document supporting a transaction.
- **Cash Memo:** Document evidencing cash sale.
- **Invoice:** Document evidencing credit sale.
- **Debit Note:** Document to debit a party's account.

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- **Credit Note:** Document to credit a party's account.

Accounting Equation

Concept Explanation:
The accounting equation expresses the relationship between assets, liabilities, and owner's equity (capital) of a business. It states that the total assets of a business are always equal to the sum of its liabilities and capital.

Key Definitions / Features:

The accounting equation is represented as:

A = L + C

Where:
A = Assets
L = Liabilities
C = Capital (Owner's Equity)

Under the double-entry system, every transaction affects at least two accounts, keeping the accounting equation balanced. This equation is also known as the Balance Sheet Equation.

Examples:

- If a business takes a loan of ₹50,000, assets (cash) increase by ₹50,000 and liabilities (loan) increase by ₹50,000.
- If the owner invests ₹1,00,000 in the business, assets (cash) increase by ₹1,00,000 and capital increases by ₹1,00,000.

Practice Set:

- *Level 1 – Easy:* State the accounting equation and explain its components.
- *Level 2 – Moderate:* Show the effect on the accounting equation when the business purchases machinery for cash.
- *Level 3 – Challenging:* Analyze a transaction where the business takes a loan and purchases inventory on credit, and show the impact on the accounting equation.

Answer Key:

- Level 1: A = L + C; Assets are resources owned, Liabilities are obligations, Capital is owner's investment.
- Level 2: Purchase machinery for cash decreases cash (asset) and increases machinery (asset); total assets remain unchanged.

- Level 3: Loan increases liabilities and cash (assets); purchase on credit increases inventory (assets) and creditors (liabilities); equation remains balanced.

Quick Reference:

- Assets = Liabilities + Capital
- Every transaction affects at least two accounts
- Equation must always balance

Glossary:

- **Assets:** Resources owned by the business.
- **Liabilities:** Amounts owed to outsiders.
- **Capital:** Owner's investment in the business.

Rules of Debit and Credit

Concept Explanation:
To record transactions in the books of accounts, it is essential to determine which accounts are to be debited and which are to be credited. Two approaches guide this process: the Traditional Approach and the Modern Approach.

Traditional Approach

Accounts are classified into:

- **Personal Accounts:** Related to persons (natural, artificial/legal, representative).
- **Impersonal Accounts:** Includes real accounts (assets) and nominal accounts (expenses, losses, incomes, gains).

Golden Rules of Accounting (Traditional Method):

- **Personal Account:** Debit the receiver, credit the giver.
- **Real Account:** Debit what comes in, credit what goes out.
- **Nominal Account:** Debit all expenses and losses, credit all incomes and gains.

Modern Approach

Accounts are classified into five categories:

- **Assets:** Accounts of resources owned; debit balance.
- **Liabilities:** Amounts owed to outsiders; credit balance.
- **Capital:** Owner's investment; credit balance.
- **Revenue:** Incomes and gains; credit balance.
- **Expenses:** Amounts spent or losses; debit balance.

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Fundamental Rules for Recording Changes:

- **Assets/Expenses:** Increase is debited, decrease is credited.
- **Liabilities/Capital/Revenue:** Increase is credited, decrease is debited.

Practice Set:

- *Level 1 – Easy:* State the golden rule for personal accounts.
- *Level 2 – Moderate:* Classify accounts into assets, liabilities, capital, revenue, and expenses.
- *Level 3 – Challenging:* Analyze a transaction and determine which accounts to debit and credit using the modern approach.

Answer Key:

- Level 1: Debit the receiver, credit the giver.
- Level 2: Assets (machinery, cash), Liabilities (creditors, loans), Capital (owner's investment), Revenue (sales), Expenses (salary).
- Level 3: For purchase of goods on credit, debit purchases (expense), credit creditors (liability).

Quick Reference:

- Personal Account: Debit receiver, credit giver
- Real Account: Debit what comes in, credit what goes out
- Nominal Account: Debit expenses/losses, credit incomes/gains
- Assets/Expenses: Increase debit, decrease credit
- Liabilities/Capital/Revenue: Increase credit, decrease debit

Glossary:

- **Debit:** Left side of an account; increase in assets/expenses.
- **Credit:** Right side of an account; increase in liabilities/capital/revenue.
- **Personal Account:** Account related to persons.
- **Real Account:** Account related to assets.
- **Nominal Account:** Account related to expenses and incomes.

Journal

Concept Explanation:
The journal is the book of original entry where business transactions are first recorded in chronological order. The process of recording transactions in the journal is called **journalising**, and each entry is called a **journal entry**.

Types of Journal Entries:

- **Simple Journal Entry:** Involves one debit and one credit of the same amount.
- **Compound Journal Entry:** Involves one debit and two or more credits or vice versa.

Functions of Journal:

- Analyzes transactions to determine debit and credit accounts.
- Records transactions with brief narration starting with 'Being...' or 'For...'.
- Maintains chronological record for future reference.

Advantages of Journal:

- Provides timely information about business transactions.
- Narration helps understand the nature of transactions.
- Minimizes errors by recording both debit and credit aspects.
- Forms the basis for posting to ledger accounts.

Opening Entry:
An opening entry records the opening balances of various accounts transferred from the previous year. Assets are debited and liabilities are credited as per their balances in the previous year's balance sheet.

Practice Set:

- *Level 1 – Easy:* Define journal and journal entry.
- *Level 2 – Moderate:* Differentiate between simple and compound journal entries with examples.
- *Level 3 – Challenging:* Prepare journal entries for given complex transactions including opening entries.

Answer Key:

- Level 1: Journal is the book of original entry; journal entry records a transaction.
- Level 2: Simple entry has one debit and one credit; compound entry has multiple debits or credits.
- Level 3: Entries must show date, accounts debited and credited, amounts, and narration.

Quick Reference:

- Journal records transactions chronologically.
- Entries include debit and credit accounts with narration.
- Opening entry records opening balances.

Glossary:

- **Journalising:** Process of recording transactions in the journal.
- **Journal Entry:** Record of a transaction in the journal.
- **Opening Entry:** Entry to record opening balances.

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