UNIT 3 BASIC ACCOUNTING PROCESS: PREPARATION OF JOURNAL, LEDGER AND TRIAL BALANCE

Structure **Page Nos.**

3.0 INTRODUCTION

The Double Entry System was developed in the 15th century in Italy by Luca Pocioli. The Double Entry System is the basic framework of present day accounting. Every transaction has two aspects and according to this system, both the aspects are recorded. For example, if a business requires something then either it must have been given by someone or it must have been acquired by giving up something. On purchase of furniture, either the cash balance will be reduced, or a liability to the supplier will arise. This has been made clear already. The Double Entry System is so named since it records both the aspects of a transaction. This system has proved to be systematic, and has been found of great use for recording the financial affairs for all institutions requiring the use of money.

3.1 OBJECTIVES

After studying this unit, you should be able to:

- understand what is Double Entry System,
- understand how debit and credit are determined for business transactions,
- see classification of account as Personal and Impersonal accounts,
- learn the definitions of journal and ledger,
- learn the journalizing process,
- become familiar with the technique of ledger posting and how to balance an account, and

- identify the techniques to prepare Trial Balance and familiarize about accounting cycle.

3.2 ACCOUNTING EQUATION

The whole structure of the Double Entry system is based on the Accounting Equation which explains the equal relationship between total claims and the total assets of the firm. The accounting equation states that a company's total assets are equal to the sum of its liabilities and its shareholders' equity. Total claims include the claims of outsiders and of the proprietors. We can express the same as:

Assets = Total Claims

Assets = Liabilities + Capital

If there is any change in the amount of assets, or of the liability, the owner's claim or the capital is bound to change correspondingly. It is totally based on Double Entry System principles.

The effect of transactions on Accounting Equation

1. Start business with Rs. 5000 as capital

Assets	=	Liabilities	+	Capital
5000	=	0	+	5000
5000	=	5000		

2. Purchase furniture for Rs. 2000 cash

Assets Cash + Furniture	=	Liabilities	+	Capital
3000 + 2000	=	0	+	5000
5000	=	5000		

Note: On the purchase of furniture, the cash is reduced but another asset, furniture, is increased by the same value.

3. Purchase goods for Rs. 3000 on credit

Assets Cash + Furniture + Goods	=	Liabilities	+	Capital
3000 + 2000 + 3000	=	3000 (Creditor)	+	5000
8000	=	8000		

Note: On purchase of goods on credit worth Rs. 3000, goods (another asset) worth Rs. 3000 has come in the business and liability of same value has been increased in the form of creditors

4. Paid Rs. 1000 for rent

Assets Cash + Furniture + Goods	=	Liabilities	+	Capital
3000 + 2000 + 3000 -1000 (Rent Paid)	=	3000	+	5000 -1000 (Rent)
2000 + 2000 + 3000	=	3000	+	4000
7000	=	7000		

Note: Rent as an expense will be charged from capital, because all expenses and incomes are to be finally 'owned' by the proprietors as well as deducted from the cash that a firm has.

5. Sold goods of Rs.3000 on credit for Rs. 4000

Assets Cash + Furniture + Goods+ Debtors	=	Liabilities	+	Capital
2000 + 2000 + (3000 –3000) + 4000	=	3000	+	4000 + 1000
2000 + 2000 + 4000	=	3000	+	5000
8000	=	8000		

Note: The net increase in assets (4000–3000 = 1000) will be added to the capital as a profit.
Whatever we have done above is suitable only if the number of transactions is small. But, if the number is large, a different procedure – putting increases and decreases in different columns – will be required, and be useful for yielding significant information.

The procedure for large number is followed for a form, which is called the T form. In this form, the two sides are put together. The left-hand side is called the Debit-side and the right-hand side is called the Credit-side. It is called an account. When in an account a record is made on the debit, or left hand side, one says the one has debited that account; similarly to record an amount on the right side is to credit it.

The proper form of an account is as follows:

Dr. **Cr.**

Date	Particulars	Ref.*	Amount Rs.	Date	Particulars	Ref.*	Amount Rs.

*Ref. indicates the sources where information about the entry is available.

To put the entries in 'T' form account, we have to follow some standard rules of debit and credit:

1. When there is an increase in the amount of **assets**, its account is debited; and when there is a decrease in the amount of an asset, its account is credited. For example, on the purchase of furniture, the assets have increased and the furniture account will be debited. But if cash is paid for the purchase, the asset has decreased and the cash account will be credited.

2. When there is an increase in the amount of **liability**, its account will be credited; and when there is a decrease in the amount of liability, its account will be debited. For example, if we borrow some money from "A"; A's account will be credited. But if we pay the money back to "A", A's account will be debited since the liability no longer exists.

3. When there is an increase in the **owner's capital**; the capital account will be credited, and when there is a decrease in owner's capital, it will be debited. For example, if a proprietor introduces additional capital, the capital account will be credited. But, if the owner withdraws some money, the capital account will be debited.

4. Profit leads to an increase in the capital, and a loss leads to reduction. Since the impact of **profit or loss** can directly be seen on the capital, it is clear that the rule of capital will be applicable on profit / loss also. Profits may be directly credited, and losses may be similarly debited.

These rules can be summaries as below:

1. Increase in assets are debits; decrease in credits
2. Increase in liabilities are credits; decrease in debits
3. Increase in owner's capital are credits; decrease in debits

4. Increase in expenses/losses are debits; decrease in credits
5. Increase in revenue/income are credits; decrease in debits.

It should be noted that an increase in assets is favourable to the firm, but an increase in expenses is not so, even though, in both cases, the increase will be recorded on the debit side. Similarly, an increase in liabilities is not favourable, but an increase in revenue is, even though both will be recorded on the credit side.

Thus the terms debit and credit should not be taken to mean, respectively, favourable and unfavourable things, they merely describe the two side of an account.
The system of recording into debits and credits is based on a very important accounting concept – the Dual Aspect Concept. As per this concept, every transaction is viewed as one that has a dual aspect, that is, one aspect of transaction has an impact on the debit side, and another on the credit side. For example, if a firm purchases machinery of Rs.20,000 for cash, this transaction has a dual aspect – one that affects the debit side of the Machinery Account (assets have increased), and another affects the credit side of the Cash Account (assets have decreased). The implication of the dual aspect concept is that the total of all debits are always equal to the total of credits.

☞ Check Your Progress 1

1. Fill in the blanks with the words debits or credits.

   a. Decrease in liability are ……………………
   b. Increase in assets are ……………………….
   c. Decrease in revenue are…………………….
   d. Increase in expenses are…………………….

2. What is the Accounting Equation? Also, explain its working.

   ……………………………………………………………………………………
   ……………………………………………………………………………………
   ……………………………………………………………………………………

3. What is the Dual Aspect Concept?

   ……………………………………………………………………………………
   ……………………………………………………………………………………
   ……………………………………………………………………………………

4. What is the rule for debit and credit in respect of Owner's capital?

   ……………………………………………………………………………………
   …………………………………………………………………………………..
   ……………………………………………………………………………………

3.3 CLASSIFICATION OF ACCOUNTS

As per the accounting equation, the broad categories of the account are:

1. **Assets:** Includes all the resources which the firm has.

2. **Liabilities:** Amounts that the firm owes to outsiders.

3. **Capital:** Amounts that the firm owes to the owners and proprietor who have invested in the firm.

4. **Expenses:** Amounts that have been spent, or even lost, in carrying on operations.

5. **Incomes:** Amounts earned by the firm.

Accounts may be classified in another manner:

1. **Personal Account :** Personal accounts relate to personal, debtors, or creditors. Example ABC & Co., Ram Account, etc.

2. **Real Account :** Accounts which relate to assets of the firm. For example, Machinery, Furniture, Cash, Plant, Land etc.
3. **Nominal Account :** Accounts, which related to expenses, losses, gains, revenue etc. like wages, salary, interest, commission etc. The net result of all the nominal accounts is reflected as profit or loss which is transferred to the capital account. Nominal accounts are, therefore, temporary.

On the basis of the above, three classifications of accounts, three basic rules about recording transactions are:

1. Personal account

   Debit the receiver and credit the giver

2. Real Account

   Debit what comes in and credit what goes out

3. Nominal Account

   Debit all expenses/losses and credit all income/gains

Hence, a Debit denotes

1. In case of a person, that s/he has received some benefit against which s/he has already rendered some service, or will render service in future. When a person becomes liable to do something in favour of the firm, the fact is recorded by debiting that person's account.
2. In case of goods or properties, that the stock and value of such goods or properties has increased; and

3. In case of other accounts like salary or rent, that the firm has enjoyed some benefit, or has lost money.

A Credit denotes

1. In the case of a person, that some benefit has been received from him, entitling him to claim from the firm, a return or a benefit in the form of cash, or goods, or services. In other words, when a person becomes entitled to money, or money's worth, for any reason, the fact is recorded by crediting him/her;

2. In the case of goods or proprieties, that the stock and value of such goods, or properties has diminished; and

3. In the case of other accounts like commission, that the firm has made a gain.

Illustration 1

1. Ram started business with Rs.15,000
2. He purchased furniture for Rs.3,000
3. Salary paid for Rs.1000
4. Received interest Rs.2500.

Solution as per debit/ credit rules of accounting equation

Explanation	Accounts involved	Nature of accounts	How effected	Dr.	Cr.
Rs.15,000 cash invested in business by Ram	Cash Capital	Assets Liabilities	Increased Increased	15,000	 15,000
Purchased furniture for Rs. 3,000	Furniture Cash	Assets Assets	Increased Decreased	3,000	 3,000
Paid Rs.1000 for salary	Salary Cash	Expense Assets	Increased Decreased	1000	 1000
Received interest Rs.2500	Cash Interest	Assets Income	Increased Increased	2500	 2500

Solution as per three basic rules of classification of accounts

Explanation	Accounts involved	Classification of accounts	How effected	Dr.	Cr.
Rs.15,000 cash invested in business by Ram	Cash Capital	Real Personal	Comes in Giver	15,000	 15,000
Purchased furniture for Rs.3,000	Furniture Cash	Real Real	Comes in Goes out	3,000	 3,000
Paid Rs.1000 for salary	Salary Cash	Nominal Real	Expenses Goes out	1000	 1000
Received interest Rs.2500	Cash Interest	Real Nominal	Comes in Income/gain	2500	 2500

3.4 DEFINITIONS OF JOURNAL AND LEDGER

Journal: Transactions are first entered in this book to show which account should be debited, and which should be credited. Journal is also called primary book, as it is a book of first entry. Transactions are recorded in it in chronological order.

Ledger: Accounts are prepared on the basis of entries made in the journal. The book that contains the accounts is called a 'ledger'. A ledger is also called secondary book, as the entries in the ledger are made subsequent to the journal.

3.4.1 The Journalizing Process

Transactions are either written as they occur in the various documents, or papers, are filed, in the order in which transactions occur (chronological). On the basis of these records, first, one writes out which accounts are to be credited, and which accounts are to be debited. This is done in the Journal, the format of which is given below:

JOURNAL

Date (1)	Particulars (2)	L.F. (3)	Dr. Amount (4)	Cr. Amount (5)

A B

Note: The columns have been numbered for reference only.

1. In the first column, the date of the transaction is entered. The year is written at the top, then the month and in the narrow part of the column the date is entered.

2. In the second column, the name of the account to be debited is written first, and it is written close to the line marked (A). The word "Dr." is written near the line marked (B). In the next line the name of the account to be credited is written preceded by the word "To". This is written a few spaces away from the line (A). There must be an explanation of the entry and this should be recorded. This is known as narration. Narration records the facts leading to the entry and facilitates quick understanding.

3. In the third column, the number of the page in the ledger on which the account is written up is entered.
4. In the fourth column, the amounts to be debited to the various accounts concerned are entered. The amount is written in the extreme right hand side of the column.

5. In the fifth column, the amount to be credited to various accounts is entered in the extreme right hand side of the column.

Before one can journalize transactions, one must think from the basis of the rules, either from the five accounting equation rule, or from the three basic classifications of accounts rules given above. In accordance with the rules/effects, the accounts to be debited, or credited will be determined. Then, the entry will be made in the journal as indicated above.

Illustration 2

Mohan's transactions for the month of April 05 are given below. Journalize them.

2021		Rs.
April 1	Mohan started business with cash	5000
,, 2	Deposit in the bank	500
,, 3	Furniture purchased for cash	200
,, 5	Purchased goods for cash	400
,, 8	Purchased goods from M/s Ram Narain on credit	1000
,, 16	Goods sold to M/s Ram & Co. for cash	600
,, 24	Goods sold on credit to Ramesh	300
,, 28	Received cash from Ramesh	300
,, 30	Paid Rent	100
,, 30	Paid Salary	200

In the book of Mohan
JOURNAL ENTRIES

Date	Particulars	L.F.	Dr. Amount	Cr. Amount
2021				
April 1	Cash Account		5000	
	Dr.			5000
	To Capital Account			
	(Being the amount invested by Mohan in the business as capital)			
,, 2	Bank Account		500	
	Dr.			500
	To Cash Account			
	(Being the amount paid into bank)			
,, 3	Furniture Account		200	
	Dr.			200
	To Cash Account			
	(Being furniture purchased for cash)			
,, 5	Purchases Account		400	
	Dr.			400
	To Cash Account			
	(Being goods purchased for cash)			
,, 8	Purchases Account		1000	
	Dr.			1000
	To M/s Ram Narain			
	(Being goods purchased for cash)			
,, 16	Cash Account		600	
	Dr.			600
	To Sales Account			
	(Being goods sold for cash)			
,, 24	Ramesh		300	300
	Dr.			
	To Sales Account			
	(Being goods sold to Ramesh on credit)			
,, 28	Cash Account		300	
	Dr.			300
	To Ramesh			
	(Being cash received from Ramesh)			
,, 30	*Rent Account		100	
	Dr.		200	
	*Salary Account			300
	Dr.			
	To Cash Account			
	(Being Rent and salary paid)			

* When transactions of similar nature take place on the same date, they may be combined while they are journalized.

Detailed discussion of the above solution:

April 1: Mohan started business with Rs.5,000
Firm received cash Rs.5,000 – Assets increases – Debited
Firm owes Rs.5,000 to proprietor – Capital increases – Credited

April 2: Rs.500 is deposited in the bank
Bank balance increased – Assets increased – Debited
Cash balance reduced – Assets decreased – Credited

April 3: Furniture is purchased for cash Rs.200
Furniture purchased – Assets increased – debited
Cash paid – Assets decreased – Credited

April 5: Purchased goods for cash Rs.400
Goods purchased – Assets increased – debited
Cash paid – Assets decreased – Credited

April 8: Purchased goods on credit for Rs.1,000 from M/s Ram Narain
Goods purchased – Assets increased – debited
Firm owes Rs.1,000 to M/s. Ram Narain – Liability increases – Credited

April 16: Goods sold to M/s. Ram & Co. for cash
Cash received – Assets increased – Debited
Sale to merchandise is revenue item so it is to be Credited or
On Sale stock decreases – assets decreases - Credited

April 24: Sold goods to Ramesh on credit for Rs.300
Ramesh owes – Assets increases – Debited
Sale to merchandise is revenue item so it is to be Credited or
On Sale stock decreases – assets decreases - Credited

April 28: Received cash from Ramesh Rs.300
Amount of cash increases- Assets increases – Debited
Ramesh is no longer owes to firm – Assets decreases – Credited

April 30: Paid rent and salary
Services enjoyed – Expenses increases – Debited
Cash decreased – Assets decreased – Credited

3.4.2 Ledger Posting

The ledger is the most important book of accounts. It is the principal book of accounts and contains all the information regarding business. It is very difficult to prepare a final account in the absence of the ledger. The ledger provides the necessary information regarding various accounts. The personal account in the ledger shows how much money the firm owes to debtors, and how much money creditors owe to the firm. The real account shows the value of asset and the value of stock. Nominal accounts reflect the sources of income, and amount spent on various items.

Till now, with the help of journal entries, we are able to ascertain how the accounts are to be debited and credited and also the amounts involved. Through ledger posting we will learn how to prepare a summarized and classified form of all the accounts.

Consider the following entry

April 8	Furniture Account	Dr.	500	
	To ABC Furniture & Co.			500

From the above journal entry, we will prepare two ledger accounts: the Furniture Account, and the ABC Furniture & Co.

While posting entries from journal to ledger, we have to remember the following:

- Nowhere in a given account, will the name of that account will appear. For example, if we are in a journal entry, then its ledger account will be credited with the name of the debited account of journal entry.

Using the above rules, the posting of the given journal entry into the furniture account is done as follows:

Dr. FURNITURE ACCOUNT Cr.

Date	Particulars	Amount	Date	Particulars	Amount
2021 April 8	To ABC Furniture & Co	500			

Since the furniture account is debited in the journal entry, the furniture account is debited, but by writing the name of ABC Furniture & Co. , appearing as credit item in journal entry. This ledger posting will be read as – The Furniture Account is debited by ABC Furniture & Co. just, as ABC Furniture & Co. Account is credited in the journal entry, the same will find an entry in its ledger account on credit side but with the name of Furniture Account; and it is shown below:

Dr. ABC FURNITURE & Co. Cr.

Date	Particulars	Amount	Date	Particulars	Amount
			2021 April 8	By Furniture Account	500

The above ledger posting will be read as: The ABC Furniture & Co. is credited by Furniture account.
The transactions, which have been journalized in illustration 2, are posted below.

Dr. CASH ACCOUNT Cr.

Date	Particulars	Amt.	Date	Particulars	Amt.
2021			2021		
April 1	To Mohan's Capital a/c	5000	April 2	By Bank Account	500
,, 16	To Sales Account	600	,, 3	By Furniture Account	200
,, 28	To Ramesh Account	300	,, 5	By Purchase Account	400
			,, 30	By Rent Account	100
			,, 30	By Salary Account	200
			,, 30	By Balance c/d	4500
		900			5900
May 1	To Balance b/d	4500			

Dr. CAPITAL ACCOUNT Cr.

Date	Particulars	Amount	Date	Particulars	Amount
			2021 April 1	By Cash Account	5,000

Dr. BANK ACCOUNT Cr.

Date	Particulars	Amount	Date	Particulars	Amount
2021			2021		
April 2	To Cash Account	500			
			April 30	By Balance c/d	500
May 1		500			500
	To Balance b/d	500			

Dr. PURCHASE ACCOUNT Cr.

Date	Particulars	Amount	Date	Particulars	Amount
2021					
April 5	To Cash Account	400			
April 8	To M/s Ram Narain	1,000			

Dr. SALES ACCOUNT Cr.

Date	Particulars	Amount	Date	Particulars	Amount
			2021		
			April 16	By Cash Account	600
			April 24	By Ramesh	300

Dr. FURNITURE ACCOUNT Cr.

Date	Particulars	Amount	Date	Particulars	Amount
2021			2021		
April 3	To Cash Account	200			
			April 30	By Balance c/d	200
May 1		200			200
	To Balance b/d	200			

Dr. M/S RAM NARAIN Cr.

Date	Particulars	Amount	Date	Particulars	Amount
			2021		
			April 8	By Purchase Account	1,000
April 30	To Balance c/d	1,000			
1,000					
1,000			May 1		1,000
				By Balance b/d	

Dr. RAMESH Cr.

Date	Particulars	Amount	Date	Particulars	Amount
2021			2021		
April 24	To Sales Account	300	April 28	By Cash Account	300
		300			300

Dr. RENT ACCOUNT Cr.

Date	Particulars	Amount	Date	Particulars	Amount
2021					
April 30	To Cash Account	100			

Dr SALARY ACCOUNT Cr.

Date	Particulars	Amount	Date	Particulars	Amount
2021					
April 30	To Cash Account	200			

3.4.3 Balancing an Account

At the end of the each month, or year, or any particular day it may be necessary to ascertain the balance in an account. The difference between the total of two sides is said to be balancing figure. Balancing of an account is to total both debit and credit sides of an account and putting the difference on that side which is shorter For instance, if the total of the debit side is Rs.1,000, and the total of credit is Rs.850, then the balancing figure is Rs.150 only. As the total of the debit side is greater than the total of credit side, the balancing figure is called the debit balance. The debit balance is written on the credit side as "By Balance C/d". C/d means carried down. By doing this, the two side will be balance. Then, this balance is written on the debit side as "To Balance B/d" (i.e., brought down). This is the opening balance for the new period. The similar, but reverse procedure is applied for credit balance. It should be noted that Nominal Accounts (such as rent, salary, etc.) are not balanced. The balance at the end of the accounting year is transferred to the profit and loss account. Only Personal and Real Accounts show balances.

☞ Check Your Progress 2

1. Differentiate Between Real, Personal and Nominal Account.
2. Identify Personal, Real and Nominal Accounts.
   a. Cash Account
   b. Sales Account
   c. Capital Account
   d. Purchase Account
   e. Discount Account
3. Give the narration of the following journal entries
   a. Salary A/c Dr
      To Cash A/c
   b. Ram A/c Dr
      To Cash A/c
      To Discount A/c
   c. Purchase A/c Dr
      To Anil
   d. Cash A/c Dr
      To Capital A/c
   e. Machinery A/ c Dr.
      To Cash A/c
4. Record the following transactions in general journal and post them to ledger.
   a. Commenced business with cash of Rs.50,000
   b. Purchased goods for cash Rs.16,000.
   c. Paid rent for the month, Rs.2,000.
   d. Purchased equipments for cash, Rs.6,000.
   e. Paid miscellaneous expenses, Rs.2,600.
   f. Paid creditors, Rs. 11,000.
   g. Received Rs. 4,200 as commission.
   h. Received from cash sales, Rs.12,000.
5. On April 1, 2021, Sanjeev established an enterprise under the name DP Sons. Transactions completed during the months were as follows:
   a. Started business with cash Rs.60,000.

b. Opened a business bank account with a deposit of Rs.20,000.
c. Purchased sundry equipment for Rs.22,000, paying cash of Rs.15,000, and the balance on account.
d. Purchased supplies for the office for cash, Rs.1,500.
e. Paid creditors on account, Rs.3,000.
f. Paid office rent for the month, Rs.1,150.
g. Earned commission (in cash), Rs.9,000.
h. Paid miscellaneous expenses, Rs.25.
i. Withdrew cash Rs.2,700 from bank.

You are required to give entries in the general journal, and post them to ledger.

3.5 TRIAL BALANCE

A statement which is prepared to show the debit balances and credit balances separately for each account is known as the Trial Balance. It is prepared after posting the accounts in the ledger, and the balance of each account has been found. It is prepared by listing each and every account, and entering their balances into separate columns of the debit and credit. The totals of the debit and credit columns of a trial balance must be equal. An equality indicates that the trial balance does not contain an arithmetical error. This follows from the fact that under the Double Entry System, the amount written on the debit side of various accounts is always equal to the amounts entered on the credit side of other accounts, and vice-versa. Hence, the total of the debit side must be equal to the total of credit side. Also, the total of the debit side balances will be equal to the total of the credit side balances. Once this agreement is established, there is reasonable confidence that the accounting work is free from arithmetical errors, though it is not proof of cent per cent accuracy, because some other error (such as principle and compensating errors) may still remain.

Errors which are Undetectable by a Trial Balance

A trial balance can trace the mathematical inaccuracy of the general ledger. However, there are a number of errors that cannot be detected by the Trial balance: Let us discuss those errors in brief:

- **Error of complete omission:** The transaction was not entered into the system.
- **Error of original entry:** The double-entry transaction includes the wrong amounts on both sides.
- **Error of reversal:** When a double-entry transaction was entered with the correct amounts, but the account to be debited is credited and the account to be credited is debited
- **Error of Principle:** The entered transaction violates the fundamental principles of accounting. For example, the amount entered was correct and the appropriate side was chosen, but the type of an account was wrong (e.g., expense account instead of liability account).
- **Error of Commission:** The transaction amount is correct, but the account debited or credited is wrong. It is similar to the principle error described above, but commission error is usually a result of oversight, while principle error is a consequence of a lack of knowledge of accounting principles.

3.6 OBJECTIVES OF PREPARING TRIAL BALANCE

1. The trial balance enables one to establish whether the posting and other accounting processes have been carried out without committing arithmetical errors.
2. Financial statements are normally prepared on the basis of agreed trial balance, otherwise the work may be cumbersome.
3. The trial balance serves as a summary of what is contained in the ledger.
4. Trial balance helps in locating errors in book-keeping work.

The format of Trial Balance is as follow:

TRIAL BALANCE
As at…………..

S.No.	Name of Account	L.F.	Dr. Amount (Total /Balance)	Cr. Amount (Total /Balance)

3.6.1 The Total Method of Preparing the Trial Balance

In this, the total of each side of the account is entered respectively in the debit and credit columns of the Trial Balance. This is known as the Gross Trial Balance.

TRIAL BALANCE
As at April 30, 2021

S.No.	Name of Account	L.F.	Dr. Amount (Total)	Cr. Amount (Total)
1.	Cash Account		5900	
2.	Capital Account			1400
3.	Bank Account		500	5000
4.	Purchase Account		1400	
5.	Sales Account			900
6.	Furniture Account		200	
7.	M/s Ram Narain Account			1000
8.	Ramesh Account		300	300
9.	Rent Account		100	
10.	Salary Account		200	
			8600	8600

3.6.2 The Balance Method of Preparing the Trial Balance

In this, balances are entered separately in the debit and credit columns of the Trial Balance. This is known as the Net Trial Balance.

TRIAL BALANCE

As at April 30, 2021

S.No.	Name of Account	L.F.	Dr. Amount (Balance)	Cr. Amount (Balance)
1.	Cash Account		4500	
2.	Capital Account			5000
3.	Bank Account		500	
4.	Purchase Account		1400	
5.	Sales Account			900
6.	Furniture Account		200	
7.	M/s Ram Narain Account			1000
9.	Rent Account		100	
10.	Salary Account		200	
			6900	6900

3.6.3 The Limitations of Trial Balance

One should note that the agreement of trial balance is not conclusive proof of accuracy. In simple words, in spite of the agreement of the trial balance some errors may remain. These may be of the following types:

1. The transactions have not been entered at all in the journal.
2. An incorrect amount has been written in both column of the journal.
3. An incorrect account has been mentioned in the journal.
4. An entry has not been completely posted in the ledger.
5. Entry is posted twice in the ledger.

3.7 THE ACCOUNTING CYCLE

The accounting cycle is a process of identifying, analyzing, and recording the accounting transactions of a company. It has 7 to 8 steps in process that begins when a transaction occurs and ends with its inclusion in the financial statements. The following is a depiction of the steps in the accounting cycle. Let us discuss them in brief:

1. Financial transactions occur, such as selling inventory, buying raw materials, or making lease payments, for example.
2. Those transactions are noted in the appropriate financial journal, depending on what the money was spent on or originated from. Debits are used to indicate money spent and credits are used for money that is received.
3. The transactions are then posted to the account in the general ledger, which is the list of all the business' financial accounts that it impacts, such as rent or wages or marketing.
4. At the end of the accounting period, you run a trial balance to see if all the numbers balance.
5. The next step is trying to find the cause of the imbalance and correcting it.
6. At the end of the accounting period, adjustment entries must be posted to accounts for accruals and deferrals.
7. Once the accounts are balance, financial statements are prepared.

8. At the end of the period, the books are closed out and new revenue and expense accounts created with zero balances. These are used for the next accounting period.

Similar to information technology process (input – process – output), the accounting cycle accepts data input- monetary transactions– which is processed according to pre–defined accounting principles, and the output is in the form of final statements.

☞ Check Your Progress 3

1. From the following transactions of M/s Divya Sharma & Co., write up the journal in proper form, post the ledger, and take out a trial balance.

2021		Rs.
April 1	Started business with cash	1000
,, 2	Deposit in the bank	50
,, 3	Furniture purchased for cash	20
,, 5	Purchased goods for cash	40
,, 7	Old furniture sold for cash	80
,, 8	Purchased goods from M/s Sanjeev Tomar on credit	100
,, 9	Received cheque of money due to M/s Sanjeev Tomar	
,, 12	Deposited the cheque into bank	
,, 15	Paid taxes in cash	50
,, 16	Goods sold to M/s Ram & Co. for cash	560
,, 24	Goods sold on credit to Ramesh	210
,, 28	Received cash from Ramesh	310
,, 30	Bank interest credited	70
,, 30	Paid Rent	150
	Paid Salary	150
,, 30		

2. What is trial balance? What are the objectives of preparing it?

3. Point out the **errors** disclosed by trial balance:

   a) An item omitted from subsidiary records.

   b) An error in balancing an account

   c) Correct amount posted to correct account.

   d) An error in carry forward of a total of one page to another page.

4. Prepare the trial balance for question numbers 4 and 5 (Check Your Progress 2).

3.8 KEY WORDS

Accounting Equation explains the equal relationship between total claims, and total assets of the firm.

Double Entry System: Every transaction has two aspects and according to this system, both the aspects are recorded.

Journal: Transactions are first entered in this book to show which account should be debited, and which one should be credited. The journal is also called a subsidiary book.

Ledger: Accounts are prepared on the basis of entries made in the journal. The book, that contains the accounts is called a 'ledger'. The ledger is also called the principal book.

Total Claims = Liabilities + Capital

"T" Form Account:, Two sides are put together, and the left-hand side is called the "Debit-side", while the right-hand side is called the 'Credit-side".

Trial Balance is a statement which is prepared to show the debit and credit balances separately.

3.9 SUMMARY

The basic unit accounting procedure is a combination of various subunits. Double entry accounting system is a scientific system for recording transactions in which each transaction has its two effects– debit and credit. By this process the total of debit becomes equal to the total of credit. As per the accounting equation, transactions are: journalized on the basis of five elements (assets, liabilities, capital, expenses (loans), and revenue (profit)). Further, the accounts are classified by real and nominal account. Trial balance is prepared just to check the arithmetical accuracy of all the ledger accounts. It is drawn by taking the balances of all ledger accounts periodically, or at the end of the accounting period. In the accounting cycle, how transactions and events are recorded and processed to get final result is explained.

3.10 SOLUTIONS / ANSWERS TO CHEK YOUR PROGRESS

☞ **Check Your Progress 1**

1. a) Dr. b) Dr. c) Dr. d) Dr.

2. Assets = capital + liabilities

3. Every transaction has two aspects–The first is the debit and the other credit.

☞ **Check Your Progress 2**

1. Real accounts relate to assets of the firm where personal accounts relate to persons dealing with the firm, and nominal accounts related to expense, losses, gains and revenue etc.

2. a) Real b) Real c) Personal d) Real e) Nominal
3. a) Being salary paid in cash
   b) Being payment made to Ram and discount allowed.
   c) Being goods purchased on credit
   d) Being the capital invested in cash
   e) Being machinery purchased for cash.

4.

Date	Particulars	L.F.	Dr. Amount	Cr. Amount
	Cash Account Dr. To Capital Account (Being the amount invested by Mohan in the business as capital)		50,000	50,000
	Purchase Account Dr. To Cash Account (Being goods purchased for cash)		16,000	16,000
	Rent Account Dr. To Cash Account (Being Rent paid for cash)		2,000	2,000
	Equipment Account Dr. To Cash Account (Being equipment purchased for cash)		6,000	6,000
	Miscellaneous Expenses Account Dr. To Cash (Being Expenses paid for cash)		2,600	2,600
	Creditors Account Dr. To Cash Account (Being creditors paid on account)		11,000	11,000
	Cash Account Dr. To Commission Account (Being Commission received)		1,200	1,200
	Cash Account Dr. To Sales account (Being cash received from sales)		12,000	12,000

Dr. CASH ACCOUNT Cr.

Date	Particulars	Amt.	Date	Particulars	Amt.
2005			2005		
April 1	To Capital Account	50000	April 2	By Equipment	6000
,, 16	To Commission Account	1200	,, 3	Account	2600
,, 28	To Sales Account	12000	,, 5	By Misc.exp.	16000
			,, 30	Account	2000
			,, 30	By Purchase	11000
			,, 30	Account	25600
				By Rent Account	

May 1	To Balance b/d	63200 25600		By Creditors Account By Balance c/d	63200

Dr. CAPITAL ACCOUNT Cr.

Date	Particulars	Amount	Date	Particulars	Amount
	To Balance c/d	50,000		By Cash Account	50,000
				By Balance b/d	50,000

Dr. MISC. EXPENSES ACCOUNT Cr.

Date	Particulars	Amount	Date	Particulars	Amount
2005	To Cash Account	2600		By Balance c/d	2600
		2600			2600
	To Balance b/d	2600			

Dr. PURCHASE ACCOUNT Cr.

Date	Particulars	Amount	Date	Particulars	Amount
	To Cash Account	16000		By Balance c/d	16000
	To Balance b/d	16000			

Dr. SALES ACCOUNT Cr.

Date	Particulars	Amount	Date	Particulars	Amount
				By Cash Account	12000
	To Balance c/d	12000			
				By Balance b/d	12000

Dr. EQUIPMENT ACCOUNT Cr.

Date	Particulars	Amount	Date	Particulars	Amount
	To Cash Account	6000		By Balance c/d	6000
		6000			6000
	To Balance b/d	6000			

Dr. COMMISSION ACCOUNT Cr.

Date	Particulars	Amount	Date	Particulars	Amount
				By Cash Account	
	To Balance c/d	1200			1200
				By Balance b/d	1200

Dr. CREDITORS ACCOUNT Cr.

Date	Particulars	Amount	Date	Particulars	Amount
	To Cash Account	11000		By Balance c/d	11000
	To Balance b/d	11000			

Dr. RENT ACCOUNT Cr.

Date	Particulars	Amount	Date	Particulars	Amount
	To Cash Account	2000		By Balance c/d	2000
	To Balance b/d	2000			

5. (Similar to Question no. 4).

☞ Check Your Progress 3

1. Similar to Question no.4 (Ref. Check Your Progress 2).

2. The Trial Balance is a list of all the accounts and their balance.

3. a) True b) True c) False d) True.

4. TRIAL BALANCE
   As at April 30, 2021

S.No.	Name of Account	L.F.	Dr. Amount	Cr. Amount
			(Total)	(Total)
1.	Cash Account		25600	
2.	Capital Account			50000
3.	Misc. exp.		2600	
4.	Purchase Account		16000	
5.	Sales Account			12000
6.	Equipment Account		6000	
7.	Commission Account			1200
8.	Creditors Account		11000	
9.	Rent account		2000	
			63200	63200

3.11 FURTHER READINGS

Financial Accounting, Dr. R.K. Sharma and Dr. R.S. Popli, Kitab Mahal, 2021.

Basic Financial Accounting, J.R. Monga, Girish Ahuja, Mayur Paperbacks, 2021.