CBSE CLASSS 11 ACCOUNTANCY

FINANCIAL ACCOUNTING PART-1

REVISION NOTES

CHAPTER-3

RECORDING OF TRANSACTIONS-1

- **Accounting Equation**

  An Accounting equation is based on the dual concept of accounting, according to which, every transaction has two aspects namely Debit and Credit. It means that every transaction in accounting affects both Debit (Dr.) and Credit (Cr.) side equally. Total assets of the business firm are financed through the funds raised from either the outsiders (which generally consist of Creditors and lenders) or the Owners (which is called Capital).

  According to Business entity concept, Business is a legal entity separate from its owners and thus the amount invested by the owner in the business (called Captial) is a liability for the business.

  Accounting equation thus refers to an equation in which total assets are always equal to the total Liabilities (i.e. Capital + Liabilities).

  Total Assets = Total Liabilities Or

  Total Assets = Internal Liabilities + External Liabilities Or

  Total Assets = Capital + Liabilities

- **Analysis of Business Transactions**

  Business transactions may affect either both sides of the equation or one side of the equation but the ultimate effect must be equal on both the sides. All the effects are as follows:

  1. Transaction affecting both sides of the equation:

A. Commenced business with cash Rs 3,00,000

Assets		=	**Capital + Liabilities**
	Cash		Capital
Transactions	3,00,000	=	3,00,000

Explanation: As Cash is invested by the owner, it should be shown as the Capital (anything which is brought in by the owner is termed as Capital) & the business is receiving an asset in the form of cash, so it is to be shown on the Assets side as Cash.

B. Bought goods from Ram Rs. 30,000

Assets		=	**Capital + Liabilities**
	Cash + Goods		Capital + Creditors
Old Equation	3,00,000	=	3,00,000
Transactions	+30,000	=	0 +30,000
N.E.	3,00,000+30,000	=	3,00,000+30,000

Explanation: As goods have been purchased on credit, one effect is that it should be shown on the assets side as goods & the other effect is that since goods have been purchased on credit, so it is to be shown in Liabilities as Creditors.

C. Sold goods (costing Rs. 10000) for cash at Rs. 13000 Effect

Assets		=	**Capital + Liabilities**
	Cash + Goods		Capital + Creditors
Old Equation	3,00,000+30,000	=	3,00,000+30,000
Transactions	+13000-10,000	=	+3000 +0
N.E.	3,13,000+20,000	=	3,03,000+30,000

Explanation: The transaction will affect both the sides. As cash has been received, so Rs 13,000 is to be added to cash & Goods are to be reduced by Rs 10,000 as goods have been sold. Also profit of Rs. 3,000 is to be added to Capital. Net effect will remain same for both sides.

D. Paid to creditors Rs. 20,000

Assets		=	**Capital + Liabilities**
	Cash + Goods		Capital + Creditors
Old Equation	3,13,000+20,000	=	3,03,000+30,000
Transactions	-20000 +0	=	+0 -20,000
N.E	2,93,000+20,000	=	3,03,000+10,000

Explanation: The transaction will affect both the sides. As cash has been paid, so it is to be deducted from cash and also from the creditors as the payment has been made to them.

Transaction related to Expenses

All the expenses and Losses are to be borne by the owner. Although business is a legal entity separate from its owners but He/She is the person who has taken the risk to do business.

E. Rent paid Rs. 5,000

Assets		=	**Capital + Liabilities**
	Cash + Goods		Capital + Creditors
Old Equation	2,93,000 + 20,000	=	3,03,000 +10,000
Transactions	-5,000 + 0	=	-5000 + 0
N.E.	2,88,000 + 20,000	=	2,98,000 +10,000

Explanation: The transaction will affect both the sides. As cash has been paid, so it is to be reduced and also the capital is to be reduced because the expense is to be borne by the owner.

Transaction related to Income

Income or Profit is the reward for taking risk. As the risk is taken by the owner, so the income or profit is to be added to the Capital.

F. Commission received Rs. 8,000

Assets		=	**Capital + Liabilities**
	Cash + Goods		Capital + Creditors
Old Equation	2,88,000 + 20,000	=	2,98,000 + 10,000
Transactions	+ 8,000 + 0	=	+ 8000 + 0
N.E.	2,96,000 + 20,000	=	3,06,000 + 10,000

Explanation: The transaction will affect both the sides. As cash has been received, so it is to be added to cash and also to the capital because it is an income

Transaction related to Accrued Income/Income due but not received.

Income is to be added to the capital but as it has not been received, it should be shown on the Assets Side as accrued Income because it is meant to be received in the current financial year.

A. Accrued Interest Rs. 10,000

Assets		=	**Capital + Liabilities**
	Cash + Goods + Accured		Capital + Creditors
	Income		
Old Equation	2,88,000+20,000	=	3,06,000 + 10,000
Transactions	+8,000+0 +10,000	=	+10,000+0
N.E	2,96,000+20,000+10,000	=	3,16,000+10,000

Explanation: The transaction will affect both the sides as the Accrued Income is to be added to the capital but as it has not been received, it is to be shown on the assets side.

Transaction related to Income received in Advance

As the Income has been received in advance, it does not belong to the current financial year and thus it cannot be added to the Capital. It as an amount which has been received by the business firm for an activity to be performed in the future. Till the time that activity is not performed, it is a liability for the business.

Rent received in advance Rs. 5000

Assets		=	**Capital + Liabilities**
	Cash + Goods + Accrued Income		Capital + Creditors + Advance Rent
Old Equation	2,96,000+20,000+10,000	=	3,16,000+10,000
Transactions	+5,000+0+0	=	+0+0+5,000
N.E.	3,01,000+20,000+10,000	=	3,16,000+10,000+5,000

Explanation: The transaction will affect both the sides as the advance Income is a Liability and should be shown on the Liabilities side. The Cash received by the business should be added to the Cash column on the assets side.

2. Transaction affecting one side of the equation:

(I) Transaction affecting Assets side of the equation:

Transaction related to Prepaid expenses or expenses paid in advance.

As the expense has been paid in advance, it does not belong to the current financial year and thus it cannot be deducted from the Capital. It as an amount which has been paid by the business firm for a service/benefit to be availed/received in the future. Till the time that service/benefit is not availed/received, it is an Asset for the business.

A. Prepaid insurance Rs. 4,000

Assets	=	**Capital + Liabilities**

	Cash + Goods + Accured + Prepaid Income Insurance		Capital + Creditors + Advance Rent
Old Equation	3,01,000+20,000+10,000	=	3,16,000+10,000+5,000
Transactions	-4,000+0+0+4,000	=	+0+0+0
N.E.	2,97,000+20,000+10,000+4,000	=	3,16,000+10,000+5,000

Explanation: The transaction will affect only one side as the prepaid expense is an Asset and should be shown on the Assets side & the Cash paid by the business should be deducted from the Cash column on the assets side.

B. Purchased Machinery for Cash Rs. 80,000

Assets		=	**Capital + Liabilities**
	Cash + Goods + Accrued+ Prepaid + Machinery Income Insurance		Capital + Creditors + Advance Rent
Old Equation	2,97,000+20,000+10,000+4,000	=	3,16,000+10,000+5,000
Transactions	-80,000+0+0+0+80,000	=	+0+0+0
N.E.	2,17,000+20,000+10,000+4,000+80,000	=	3,16,000+10,000+5,000

Explanation: The transaction will affect only one side as cash has been paid for the machinery which is a fixed asset, so it is shown separately on the assets side and also the cash has been reduced.

(II) Transaction affecting Liability side of the equation:

Transaction related to outstanding Expense or expense due but not paid The expense has not been paid yet but it relates to the current financial year, so it is deducted from the capital & since the business will have to pay it in the future, it is a liability for the firm.

A. Salary outstanding Rs. 8,000

Assets	=	**Capital + Liabilities**

	Cash + Goods + Accured + Prepaid + Machinery Income Insurance		Capital + Creditors + Advance + Outstanding Rent Exp
Old Equation	**2,17,000+20,000+10,000+4,000+80,000**	**=**	**3,16,000+10,000+5,000**
Transactions	**-0+0+0+0+0**	**=**	**-8,000+0+0+8,000**
N.E.	**2,17,000+20,000+10,000+4,000+80,000**	**=**	**3,08,000+10,000+5,000+8,000**

Explanation: The transaction will affect only one side. Outstanding expense is a Liability and should be shown on the Liabilities side & the expense should be deducted from the capital because it relates to the current financial year.

Transaction related to Interest on Capital

As interest on capital is an expense for the business, it should be deducted from the capital. Also, interest on capital is the amount which is to be paid to the owner as the capital has been invested by him, therefore it is to be added back to the capital.

A. Interest on Capital Rs. 10,000

Assets		=	**Capital + Liabilities**
	Cash + Goods + Accrued + Prepaid + Machinery Income Insurance		Capital + Creditors + Advance + Outstanding Rent Exp.
Old Equation	2,17,000+20,000+10,000+4,000+80,000	=	3,08,000+10,000+5,000+8,000
Transactions	+0+0+0+0+0	=	-10,000+10,000+0+0+0
N.E.	2,17,000+20,000+10,000+4,000+80,000	=	3,08,000+10,000+5,000+8,000

Explanation: The transaction will affect only one side. The Interest on Capital should be added to as well as deducted from the capital resulting in no impact on the previous accounting equation.

Transaction related to interest on drawings

As interest on drawings is an income for the business, it should be added to the capital. Also the interest on drawings is the amount which is to be paid by the owner to the business, so it is treated as drawings and deducted from the capital.

A. Interest on drawings Rs. 1,000

Assets		=	**Capital + Liabilities**
	Cash + Goods + Accrued + Prepaid + Machinery Income Insurance		Capital + Creditors + Advance + Outstanding
Old Equation	2,17,000+20,000+10,000+4,000+80,000	=	3,08,000+10,000+5,000+8,000
Transactions	-0+0+0+0+0	=	-1,000
N.E.	2,17,000 + 20,000 + 10,000 + 4,000 + 80,000	=	3,08,000 + 10,000 + 5,000 + 8,000

Explanation: The transaction will affect only the liabilities side. Interest on drawings should be added to as well as deducted from the capital as both of them belong to the owner

Transaction related to drawings

As drawings is the amount withdrawn by the owner from the business, so it is to be deducted from the capital & also from the asset which has been withdrawn.

A. Owner withdrew cash Rs. 10,000

Assets	=	**Capital + Liabilities**

	Cash + Goods + Accrued + Prepaid + Machinery Income Insurance		Capital + Creditors +Advance + Outstanding Rent Exp.
Old Equation	2,17,000+20,000+10,000+4,000+80,000	=	3,08,000+10,000+5,000+8,000
Transactions	-10,000+0+0+0+0	=	-10,000+0+0+0
N.E	2,07,000+20,000+10,000+4,000+80,000	=	2,98,000+10,000+5,000+8,000

Explanation: The transaction will affect both the sides as drawings should be deducted from the capital & also from the cash.

- **Rules of Debit and Credit**

(I) Traditional or English Approach: This approach is based on the main principle of double entry system i.e. every debit has a credit and every credit has a debit. According to this system we should record both the aspects of a transaction whereas one aspect of a transaction will be debited and other aspect of a transaction will be credited.

(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 and losses credit all incomes and gains.

(2) Modern or American Approach: This approach is based on the accounting equation or balance sheet. In this approach accounts are debited or credited according to the nature of an account. In a summarised way the five rules of modern approach is as follows:

1. Increase in asset will be debited and decrease will be credited.

2. Increase in the liabilities will be credited and decrease will be debited.

3. Increase in the capital will be credited and decrease will be debited.

4. Increase in the revenue or income will be credited and decrease will be debited.

5. Increase in expenses and losses will be debited and decrease will be credited.

- **Journal**

  This is the basic book of original entry. In this book, transactions are recorded in the chronological order, as and when they take place. Afterwards, transactions from this book are posted to the respective accounts. Each transaction is separately recorded after determining the particular account to be debited or credited.

Journal

Date	Particulars	L.F	Debit Amount Rs.	Credit Amount Rs.
2017 Dec.24	Purchases A/c Dr. 30,000 Dr, To Govind Traders A/c (Purchase of goods- in-trade from Govind Traders)		30000	30000

Illustration

Prove that the accounting equation is satisfied in all the following transactions of Sita Ram house by preparing the analysis table. Also record the transactions in Journal.

(i) Business commenced with a capital of Rs. 6,00,000.

(ii) Rs. 4,50,000 deposited in a bank account.

(iii) Rs. 2,30,000 Plant and Machinery Purchased by paying Rs. 30,000 cash immediately.

(iv) Purchased goods worth Rs. 40,000 for cash and Rs. 45,000 on account.

(v) Paid a cheque of Rs. 2, 00,000 to the supplier for Plant and Machinery.

(vi) Rs. 70,000 cash sales (of goods costing Rs. 50,000).

(vii) Withdrawn by the proprietor Rs. 35,000 cash for personal use.

(viii) Insurance paid by cheque of Rs. 2,500.

(ix) Salary of Rs. 5,500 outstanding.

(x) Furniture of Rs. 30,000 purchased in cash.

Solution

Journal

Date	**Particulars**	**L.F**	**Debit Amount Rs**	**Credit Amount Rs.**
1.	Cash A/c Dr.		6,00,000	
	To Capital A/c			6,00,000
	(Business started with cash)			
2.	Bank A/c Dr.		4,50,000	
	To Cash A/c			4,50,000
	(Cash deposited into the bank)			
	Total c/f		10,50,000	10,50,000
3.	Plant and Machinery A/c Dr.		2.30,000	
	To Cash A/c			30,000
	To Creditors A/c			2,00,000
	(Purchase of plant and machinery by paying Rs. 30,000 cash and balance on a later date)			
4.	Purchases A/c Dr.		85,000	
	To Cash A/c			40,000
	To Creditors A/c			45,000
	(Bought goods for cash as well as on credit)			
5.	Creditor's A/c Dr.		2,00,000	
	To Bank A/c			2,00,000
	(Payment made to the supplier of plant and machinery			
6.	Cash A/c Dr.		70,000	
	To Sales A/c			70,000

	(Sold goods on profit)			
7.	Drawings A/c Dr. To Cash A/c (Withdrew cash for personal use)		35,000	35,000
8.	Insurance A/c Dr. To Bank A/c (Paid insurance by cheque)		2,500	2,500
9.	Salary A/c Dr. To Outstanding salary A/c (Salary outstanding)		5,500	5,500
10.	Furniture A/c Dr. To Cash A/c (Furniture purchased for cash)		30,000	30,000
	Total		17,08,000	17,08,000

- **Ledger Account**

The ledger is the principal book of accounting system. It contains different accounts where transactions relating to that account are recorded. A ledger is the collection of all the accounts, debited or credited, in the journal proper and various special journal. In the ledger, each account is opened preferably on separate page or card.

Name of the Account

Dr. **Cr.**

Date	Particulars	J.F.	Amount Rs.	Date	Particulars	J.F.	Amount Rs.

Illustration

Journalise the following transactions of M/s Mallika Fashion House and post the entries to the Ledger:

Date 2017	**Details**	**Amount Rs.**
June 05	Business started with cash	2,00,000
June 08	Opened a bank account with Syndicate Bank	80,000
June 12	Goods purchased on credit from M/s Gulmohar Fashion House	30,000
June 12	Purchase office machines, paid by cheque	20,000
June 18	Rent paid by cheque	5,000
June 20	Sale of goods on credit to M/s Mohit Bros	10,000
June 22	Cash sales	15,000
June 25	Cash paid to M/s Gulmohar Fashion House	30,000
June 28	Received a cheque from M/s Mohit Bros	10,000
June 30	Salary paid in cash	6,000

Solution

(I) Recording the transactions

Books of Mallika Fashion House

Journal

Date	**Particulars**	**L.F.**	**Debit Amount Rs.**	**Credit Amount Rs.**
June 05	Cash A/c Dr. To Capital A/c (Business started with cash)		2,00,000	 2,00,000
June 08	Bank A/c Dr. To Cash A/c (Opened a current account with syndicate bank)		80,000	 80,000
	Purchases A/c Dr.		30,000	

June 12	To Gulmohar Fashion House A/c (Goods purchased on credit)			30,000
June 12	Office Machines A/c Dr. To Bank A/c (Office machine purchased)		20,000	20,000
June 18	Rent A/c Dr. To Bank A/c (Rent paid)		5,000	5,000
June 20	Mohit Bros A/c Dr. To Sales A/c (Goods sold on credit)		10,000	10,000
June 22	Cash A/c Dr. To Sales A/c (Goods sold for cash)		15,000	15,000
June 25	Gulmohar Fashion House A/c Dr. To Cash A/c (Cash paid to Gulmohar Fashion House)		30,000	30,000
June 28	Bank A/c Dr. To Mohit Bros A/c (Payment received in full and final settlement)		10,000	10,000
June 30	Salary A/c Dr. To Cash A/c (Monthly salary paid)		6,000	6,000
	Total		4,06,000	4,06,000

(ii) Posting in the Ledger Book

Cash Account

Dr. **Cr.**

Date	Particulars	J.F.	Amount Rs.	Date	Particulars	J.F.	Amount Rs.
2017				2017			
June 5	Capital		2,00,000	June 8	Bank		80,000
June 22	Sales		15,000	June 25	Gulmohar Fashion House		30,000
				June 30	Salary		6,000

Capital Account

Dr. **Cr.**

Date	**Particulars**	**J.F**	**Amount Rs.**	**Date**	**Particulars**	**J.F**	Amount Rs.
				2017			
				June 5	Cash		2,00,000

Bank Account

Dr. **Cr.**

Date	**Particulars**	**J.F.**	**Amount Rs.**	**Date**	**Particulars**	**J.F.**	**Amount Rs.**
2017				**2017**			
June 08	Cash		80,000	June 12	Office Machines		30,000
June 28	Mohit Bros.			June 18	Rent		5,000

Purchases Account

Dr. **Cr.**

Date	Particulars	J.F.	Amount Rs.	Date	Particulars	J.F.	Amount Rs.
2017 June 12	Gulmohar FashionHouse		30,000	**2017**			

Gulmohar Fashion House Account

Dr. **Cr.**

Date	Particulars	J.F.	Amount Rs.	Date	Particulars	J.F.	Amount Rs.
2017 June 25	Cash		30,000	2017 June 12	Purchases		30,000

Office Machines Account

Dr. **Cr.**

Date	Particulars	J.F.	Amount Rs.	Date	Particulars	J.F.	Amount Rs.
2017 June 12	**Bank**		**20,000**	**2017**			

Rent Account

Dr. **Cr.**

Date	Particulars	J.F.	Amount Rs.	Date	Particulars	J.F.	Amount Rs.
2017 June 18	Bank		5,000	2017			

Mohit Bros. Account

Dr. **Cr.**

Date	Particulars	J.F.	Amount Rs.	Date	Particulars	J.F.	Amount Rs.
2017 June 20	Sales		10,000	2017 June 28	Cash		10,000

Sales Account

Dr. **Cr.**

Date	Particulars	J.F.	Amount Rs.	Date	Particulars	J.F.	Amount Rs.
2017 June 20				2017 June 20 June 22	Mohit Bros Cash		10,000 15,000

Salary Account

Dr. **Cr.**

Date	Particulars	J.F.	Amount Rs.	Date	Particulars	J.F.	Amount Rs.
2017 June 30	Cash		6,000	2017			