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INTRODUCTION TO FINANCIAL ACCOUNTING

THIS CHAPTER INCLUDES

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| <ul style="list-style-type: none">• Introduction• Objectives of Accounting• Function of Accounting• Book-Keeping• Accounting Cycle• Steps/Phases of Accounting Cycle• Basic Accounting Terms• Double Entry Systems• Concept of Account• Types of Accounts• Accounting Process• Accounting Equation | <ul style="list-style-type: none">• Functions of Journal• Advantages of Journal• Compound Journal• Cash Book• Types of Cash Book• Purchase Day Book• Sales Day Book• Journal Proper• Ledger Posting• Trial Balance• Method of Preparation |
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CHAPTER AT A GLANCE

Sr. No.	Topic	Important Highlight
1.	Objectives of Accounting	<ul style="list-style-type: none">• Providing information to the users for rational Decision-making• Systematic recording of Transactions• Ascertainment of results of Above Transactions• Ascertain the Financial Position of Business• To know the Solvency Position
2.	Function of Accounting	The main functions of accounting are as follows: <ul style="list-style-type: none">• Measurement: Accounting measures past performance of a business entity and depicts its current financial position.• Forecasting:

		<p>Accounting helps in forecasting future performance and financial position of an enterprise using past data.</p> <ul style="list-style-type: none"> • Decision-Making: Accounting provides relevant information to the users of accounts to aid rational decision-making. • Control: Accounting also identifies weak-nesses of the operational system and provides feedbacks regarding effectiveness of measures adopted to check such weaknesses. • Government Regulation and Taxation: Accounting provides necessary information to the government to exercise control on the entity as well as in collection of tax revenues.
3.	Book-Keeping	<p>Book-keeping is a mechanical task which involving:</p> <ul style="list-style-type: none"> • Collection of basic financial information • Identification of events and transactions with financial character, i.e., economic transactions • Measurement of economic transactions in terms of money • Recording of financial effects of economic transactions in order of its occurrence • Classifying effects of economic transactions • Preparing organized statement known as Trial Balance
4.	Phases of Accounting Cycle	<p>The steps or phases of accounting cycle can be developed as under:</p> <ul style="list-style-type: none"> • Recording of Transaction: As soon as a transaction happens it is at first recorded in subsidiary book. • Journal: The transactions are recorded in the journal

		<p>chronologically.</p> <ul style="list-style-type: none"> • Ledger: All journals are posted into ledger chronologically in a classified manner. • Trial Balance: After taking all the ledger account closing balances, a trial Balance is prepared at the end of the period for the preparations of financial statements. • Adjustment Entries: All the adjustments entries are to be recorded properly and adjusted accordingly before preparing financial statements. • Adjusted Trial Balance: An adjusted Trail Balance may also be prepared. • Closing Entries: All the nominal accounts are to be closed by transferring them to Trading Account, and Profit and Loss Account.
5.	Double Entry System	<p>Features of Double entry System</p> <ol style="list-style-type: none"> (a) Every transaction has twofold aspects, i.e., one party giving the benefit and the other receiving the benefit. (b) Every transaction is divided into two aspects, debit and credit. one account is to be debited and the other account is to be credited. (c) Every debit must have its corresponding and equal credit.

6.	Accounting Equation	<p>The whole Financial Accounting depends on Accounting Equation which is also known as Balance Sheet equation. the basic accounting equation is:</p> <p>Assets = Liabilities + Owner's Equity or $A = L + P$ or $P = A - L$ Where A = Assets, L = Liabilities, P = Capital or $L = A - P$</p> <p>While trying to do this correlation, please note that income or gains will increase owner's equity and expenses or losses will reduce it.</p>
7.	Subsidiary Books	<p>Subsidiary Books refers to books meant for specific transactions of similar nature. They Books are also known as Special journals or day books. To overcome shortcoming of the use of the journal only as a book of original entry, the journal is subdivided into specific journals or subsidiary books.</p>
8.	Cash Book	<p>A Cash Book is a special journal which is used for recording all cash receipts and cash payments. Cash Book is a book of original entry since transactions are recorded for the first time from the source documents. The Cash Book is larger in the sense that it is designed in the form of a Cash Account and records cash receipts on the debit side and cash payments on the credit side. Thus, the Cash Book is both a journal and a ledger.</p>
9.	Types of cash Book	<p>There are different types of Cash Book as follows :</p> <ul style="list-style-type: none"> (a) Single column cash Book (b) Double column cash Book- (c) Triple column cash Book- (d) The Multicolumn cash Book (e) The Petty Cash Book

10.	Ledger Accounts	The book which contains accounts is known as the ledger. Since finding information pertaining to the financial position of a business emerges only from the accounts, the ledger is also called the Principal Book. As a result, all the necessary information relating to any account is available from the ledger. This is the most important book of the business and hence is rightly called the “King of All Books”. Also Known as Book of Final entry.
11.	Trial Balance	Trial balance may be defined as a statement or a list of all ledger account balances taken from various ledger books on a particular date to check the arithmetical accuracy. According to the Dictionary for Accountants by Eric. L. Kohler, Trial Balance is defined as “a list or abstract of the balances or of total debits and total credits of the accounts in a ledger, the purpose being to determine the equality of posted debits and credits and to establish a basic summary for financial statements”. According to Rolland, “The final list of balances, totaled and combined, is called Trial Balance”.
12.	Purpose of a Trial Balance	It serves the following purposes: (i) To check the arithmetical accuracy of the recorded transactions. (ii) To ascertain the balance of any ledger account. (iii) To serve as an evidence of the fact that the double entry has been completed in respect of every transaction. (iv) To facilitate the preparation of final accounts promptly.

DESCRIPTIVE QUESTIONS

2008 - Dec [2] (b) Define Contingent Liabilities. **(3 marks)[CMAF]**

Answer :

It represents a potential obligation that could be created depending on the outcome of an event. E.g. if any supplier files a legal suit it will not be accepted as admitted liability till the verdict of the court of law is received. From the date of legal suit till the date of final verdict, this claim is shown as contingent liabilities, which is not recorded in the books of accounts, but disclosed by way of foot note under the liabilities side of the Balance Sheet.

Some of examples are :

- (i) Claims against the company not acknowledged as debt.
- (ii) Uncalled liabilities on shares partly paid.
- (iii) Arrears of fixed cumulative dividend.
- (iv) Other money for which the company is contingently liable.

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2010 - Dec [2] (b) State the basic object of :

- (ii) Preparing the Trial Balance.

(1 mark) [CMAF]

Answer :

Trial Balance: This is a statement of Debit and Credit balances derived from ledger amounts in ledger and is expected to tally on a particular date. It facilitates the accountant to prepare the financial statements, viz., Profit and Loss account and Balance Sheet of any business entity. A trial balance may not tally on account of commissions, omissions and offsetting mistakes.

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2012 - June [3] (c) Recognize the accounting concept in the following :

- (i) The transactions are recorded at their original cost.
- (ii) The business will run for an indefinite period.
- (iii) Every transaction has two effects to be recorded in the books of accounts.
- (iv) Accounting treatment once decided should be followed period after period.

(1 × 4 = 4 marks)[CMAF]

Answer :

Accounting Concept:

- (i) Historical Cost concept
- (ii) Going Concern concept
- (iii) Dual aspect concept
- (iv) Consistency concept

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PRACTICAL QUESTIONS

2010 - June [4] (a) Journalise the following transactions in the books of Ramesh:

- (i) Started business with ₹ 10,00,000/-, out of which ₹ 1,00,000 was borrowed from ICICI as loan.
- (ii) Machinery purchased for ₹ 4,00,000/- on credit and Furniture purchased for ₹ 1,50,000 on cash.
- (iii) Deposited cash in Vijaya Bank Current A/c 2,50,000/-

(1 × 3 = 3 marks)[CMAF]

Answer :

In the Book of Ramesh

(i) Cash A/c	Dr.	10,00,000	
To Capital			9,00,000
To Loan from ICICI			10,00,000
(ii) Machinery A/c	Dr.	4,00,000	
To Supplier A/c			4,00,000
Furniture A/c	Dr.	1,50,000	
To Cash A/c			1,50,000
(iii) Vijaya Bank A/c	Dr.	2,50,000	
To Cash			2,50,000

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2010 - Dec [3] (a) Show the Accounting equation for the following transactions of Rakesh Bihari Mittal:

- (i) Sold goods costing ₹ 30,000 for ₹ 50,000 to Shyam.
- (ii) Purchased household goods for ₹ 15,000 giving ₹ 5,000 in cash and the balance through a loan.
- (iii) Received ₹ 49,500 from Shyam in full settlement of an account of ₹ 50,000.
- (iv) Paid Salary ₹ 500 and Salary still outstanding ₹ 100.
- (v) Paid Rent-in advance ₹ 200.
- (vi) Withdrew goods for personal use (Cost ₹ 500, Sale Price ₹ 600).

($\frac{1}{2} \times 6 = 3$ marks)[CMAF]

(b) Journalize the following transactions in the books of Anju Mittal:

- (i) Received ₹ 975 from Shyam on his account of ₹ 1,000.
- (ii) Sold goods costing ₹ 40,000 to Anil at a profit of 20% on sales less 20% trade discount and charged 10% Value Added Tax.
- (iii) Vishal Pandey paid ₹ 975 towards a debt of ₹ 1,000 which was written off as bad in the previous year. **(1 × 3 = 3 marks)[CMAF]**

Answer :

(a)

Transaction	Assets =	Liabilities +	Capital
(i)	+ 50,000 - 30,000	0	+ 20,000
(ii)	- 5,000	+ 10,000	- 15,000
(iii)	+ 49,500 - 50,000	0	- 500
(iv)	- 500	+ 100	- 600
(v)	- 200 + 200	0	0
(vi)	- 500	0	- 500

(b)

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
(a)	Cash A/c Dr. To Shyam (Being the cash received from Shyam on account)		975	975
(b)	Anil Dr. To Sales A/c To Value Added Tax A/c (Being the goods sold to Anil on Credit) Cost 40,000 Add : Profit @ 25% on cost 10,000 List price 50,000 Less : Trade discount @ 20% 10,000 Invoice Value 40,000 Add : Vat @ 10% 4,000 44,000		44,000	40,000 4,000
(c)	Cash A/c Dr. To Bad Debts Recovered A/c (Being the Bad Debts already w/o, now recovered)		975	975

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2011 - June [2] (c) Journalise the following transactions in the books of a trader :

2011

- April 1 Goods costing ₹ 600 (sale price ₹ 800) withdrawn for personal use.
- " 5 Goods costing ₹ 2,000 (sales price ₹ 2,500) distributed as free samples.
- " 8 Goods stolen in transit ₹ 2,000 (cost ₹ 1,500).

5.10**Scanner CSEP M-II Paper 5 (2017 Syllabus)**

- " 10 Goods worth ₹ 1,500 stolen by an employee cost of which was ₹ 1,000.
- " 15 Goods used in making of furniture (cost ₹ 2,000 selling price ₹ 2,400). **(2 marks)[CMAF]**

Answer :**Journal**

Date	Particulars	(₹)	(₹)
2011 April, 1	Drawings A/c Dr. To Purchases A/c	600	600
April, 5	Free Sample A/c Dr. To Purchases A/c	2,000	2,000
April, 8	Loss in Transit A/c Dr. To Purchases A/c	1,500	1,500
April, 10	Loss by embezzlement A/c Dr. To Purchases A/c	1,000	1,000
April, 15	Furniture A/c Dr. To Purchases A/c	2,000	2,000

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2011 - June [3] (b) Pass Journal Entries :

- (1) Started Business with cash ₹ 2,00,000, furniture 80,000 and stock ₹ 20,000.
- (2) Deposited ₹ 1,00,000 in the Bank.
- (3) Paid wages ₹ 20,000 through cheques. **(3 marks)[CMAF]**

Answer :**Journal**

	Particulars	(₹)	(₹)
1	Cash A/c Dr. Furniture A/c Dr. Stock A/c Dr. To Cash A/c	2,00,000 80,000 20,000	3,00,000

2	SBI Bank A/c To Cash A/c	Dr.	1,00,000	1,00,000
3	Wages A/c To Bank A/c	Dr.	20,000	20,000

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2011 - Dec [2] (a) Journalise the following transactions in the books of a trader:

2011

Nov. 1 Mr. Dutta was declared insolvent and a sum of ₹ 5,600 would be received instead of ₹ 8,000.

Nov. 4 An old machinery was sold to Rakesh for ₹ 15,000.

Nov. 8 Goods costing ₹ 2,500 (sale price ₹ 3,000) withdrawn from business for personal use.

Nov. 12 Purchased furniture from Vikas for shop ₹ 25,000.

Nov. 15 Deposited ₹ 80,000 in SBI account. **(1 × 5 = 5 marks) [CMAF]**

Answer:

In the Books of a Trader

Date	Particulars		Amount (₹)	Amount (₹)
2011 Nov. 1	Cash A/c Bad Debts A/c To Mr. Dutta's A/c	Dr. Dr.	5,600 2,400	8,000
Nov. 4	Rakesh's A/c To Machinery A/c	Dr.	15,000	15,000
Nov. 8	Drawings A/c To Purchase A/c	Dr.	2,500	2,500
Nov. 12	Furniture A/c To Vikas's A/c	Dr.	25,000	25,000
Nov. 15	Bank Account To Cash A/c	Dr.	80,000	80,000

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5.12**Scanner CSEP M-II Paper 5 (2017 Syllabus)**

2012 - June [2] (a) Journalize the following transactions in the books of a trader :

- (i) 1st March 2012, paid quarterly interest on borrowed amount of ₹ 20,000 at 12% p.a.
- (ii) 10th March 2012, Goods destroyed by fire for ₹ 6,000, for which there is no insurance coverage.
- (iii) 15th March 2012, Received commission for ₹ 5,000.
- (iv) 21st March 2012, paid transportation charges for machinery of ₹ 1,000 and installation charges for ₹ 1,500. **(1 × 4 = 4 marks) [CMAF]**

Answer :

		<i>Dr.</i>	<i>Cr.</i>	
Date	Particulars	L.F.	Amount (₹)	Amount (₹)
(i) 1.3.12	Interest Account Dr. To Cash Account (Being the amount paid as quarterly interest on borrowed Amount of ₹ 20,000 @ 12% p.a.)		600	600
(ii) 10.3.12	Loss By Fire Account Dr. To Purchase Account (Being the goods not insured lost by fire)		6,000	6,000
(iii) 15.3.12	Cash Account Dr. To Commission Account (Being the commission received)		5,000	5,000
(iv) 21.3.12	Machinery Account Dr. To Cash Account (Being the transportation and installation charges on Machinery paid in cash)		2,500	2,500

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2012 - Dec [2] (a) Find out the accounting equation from the following assets and liabilities of Bholu as on 31st March, 2012:

Land and Building	₹ 21,00,000	:	Plant and Machinery	₹ 3,60,000
Investment	₹ 1,00,000	:	Prepaid Insurance	₹ 4,000
Stock	₹ 70,000	:	Debtors	₹ 1,50,000
Creditors	₹ 1,30,000	:	Bank loan	₹ 4,50,000
Cash in hand	₹ 30,000	:	Bills payable	₹ 36,000
Outstanding Salary	₹ 10,000			

(3 marks)[CMAF]

(b) Pass necessary adjustment entries for the following at the end of the accounting year on 31st March, 2012.

- Fire insurance of building paid ₹ 1,500 on 10.1.2012 for the year 2012.
- During the year 2011-12, office rent paid ₹ 19,000 for 10 months.
- Bank loan taken on 1st May, 2011 for ₹ 3,00,000 @ 15 percent interest per annum. Including interest it was unpaid on 31st March, 2012
- On 1st October, 2011 ₹ 50,000 deposited in SBI 5 years fixed deposit scheme, on which interest would be received on maturity @ 9.5 percent per annum.

(4 marks)[CMAF]

Answer:

(a) As per Accounting Equation —

Capital + Liabilities = Assets or, Capital = Assets – Liabilities	
Assets: Land & Building	21,00,000
Plant & Machinery	3,60,000
Investment	1,00,000
Stock	70,000
Debtors	1,50,000
Prepaid Insurance	4,000
Cash in hand	<u>30,000</u>
Total Assets	28,14,000

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Less: Liabilities :

Bank Loan	4,50,000	
Creditors	1,30,000	
Bills Payable	36,000	
Outstanding Salary	<u>10,000</u>	
Total Liability		<u>6,26,000</u>
Capital		<u>21,88,000</u>

Hence, Accounting Equation

Capital ₹ 21,88,000 + Liabilities ₹ 6,26,000 = Assets ₹ 28,14,000

(b)

In the books of
Journal Entries

Date	Particulars	L.F.	Dr.	Cr.
			(₹)	(₹)
2012 March, 31				
(i)	Prepaid Fire Insurance A/c Dr. To Fire Insurance A/c (Being the Fire Insurance paid in advance for 9 months, now adjusted)		1,125	1,125
(ii)	Office Rent A/c Dr. To Outstanding Rent A/c (Being the Office Rent outstanding for 2 months, now adjusted)		3,800	3,800
(iii)	Interest on Bank Loan A/c Dr. To Outstanding Interest on Bank Loan A/c (Being the Interest on Bank Loan is Outstanding for 11 months, now adjusted)		41,250	41,250

(iv)	Accrued Interest A/c To Interest A/c (Being the Interest on deposit are accrued for 6 months, now adjusted)	Dr.		2,375	2,375
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2012 - Dec [4] (a) Journalise the following transactions in the books of Mahi: 2012

- November 1 : Ashok was declared insolvent and a sum of ₹ 5,600 received instead of ₹ 8,000
 „ 12 : An old machinery was sold to Mukesh for ₹ 15,000
 „ 13 : Goods withdrawn from business for personal use ₹ 2,500
 „ 20 : Purchased furniture from Jatin for shop ₹ 25,000
 „ 26 : Goods worth ₹ 15,000 burnt by fire
 „ 29 : Insurance company accepted the fire insurance claim of ₹ 14,000.

(6 marks) [CMAF]

Answer:

**In the books of Mahi
Journal Entries**

Date	Particulars	L.F.	Dr.	Cr.
			(₹)	(₹)
2012 Nov, 1	Cash A/c Bad Debt A/c To Ashok's A/c (Being the Ashok was insolvent and received a sum of ₹ 5,600)		5,600 2,400	8,000
Nov, 12	Mukesh's A/c To Machinery A/c (Being the old machinery sold to Mukesh)		15,000	15,000

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Nov, 13	Drawings A/c To Purchase A/c (Being the goods withdrawn from business for personal use)	Dr.	2,500	2,500
Nov, 20	Furniture A/c To Jatin's A/c (Being the Furniture purchased from Jatin)	Dr.	25,000	25,000
Nov, 26	Loss by fire A/c To Purchase A/c (Being the goods burnt by fire)	Dr.	15,000	15,000
Nov, 29	Insurance Company A/c Profit & Loss A/c To Loss by fire A/c (Being the Insurance Company accepted the fire insurance claim and loss adjusted to P/L Account)	Dr. Dr.	14,000 1,000	15,000

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2016 - Dec [3] Journalise the following transactions:

- Mr. X paid ₹ 2,000 on account and returned goods worth ₹ 500.
- Paid transportation charges of ₹ 1,000 and installation charges for ₹ 1,500 for a new Machine.
- At the end of the accounting year, closing stock has been valued at ₹ 2,65,000. **(2 × 3 = 6 marks)**

Answer:

- | | | | |
|--------------------|-----|-------|-------|
| Return Inwards A/c | Dr. | 500 | |
| Cash A/c | Dr. | 2,000 | |
| To Mr. X A/c | | | 2,500 |

(Being goods returned and amount received on account)
- | | | | |
|-------------|-----|-------|-------|
| Machine A/c | Dr. | 2,500 | |
| To Cash A/c | | | 2,500 |

(Being transportation and installation charges paid for new machine)

(iii) Closing Stock A/c	Dr. 2,65,000	
To Trading A/c		2,65,000
(Being closing stock valued at year end)		

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TOPICS NOT YET ASKED BUT EQUALLY IMPORTANT FOR EXAMINATION**SHORT NOTES**

Q1. Write short note on Book Keeping.

Answer :

As defined by Carter, Book-Keeping is a science as well as art of correctly recording in books of accounts all those business transactions that result in transfer of money or money's worth'.

Book-keeping is a mechanical task which involving:

- Collection of basic financial information
- Identification of events and transactions with financial character, i.e., economic transactions
- Measurement of economic transactions in terms of money
- Recording of financial effects of economic transactions in order of its occurrence
- Classifying effects of economic transactions
- Preparing organized statement known as Trial Balance

— Space to write important points for revision —

Q2. Write short note on Single Entry.

Answer :

Single Entry System is an incomplete 'double entry system'. In case of double entry system of book-keeping both the aspects of every transaction are recorded. In this system, the first entry is made to the debit of an account, and the second entry to the credit of second account. However, in case of single entry system, the business houses for their convenience and

more practical approach ignore the strict rules of double entry system. The users of this system maintain only the essential records. In other words, it is a system which may not keep some books of subsidiary records, and some ledger accounts too which otherwise are kept in case of double entry system.

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DISTINGUISH BETWEEN

Q3. Distinguish between book keeping and accounting.

Answer :

Sr. No.	Book-keeping	Accounting
1.	Output of book-keeping is an input for accounting.	Output of accounting permit informed judgments and decisions by the user of accounting information.
2.	Purpose of book-keeping is to keep systematic record of transactions and events of financial character in order of its occurrence.	Purpose of accounting is to find results of operating activity of a business and to report its financial strength.
3.	Book-keeping is the foundation of accounting.	Accounting is considered as a language of business.
4.	Book-keeping is carried out by the junior staff.	Accounting is done by the senior staff who have skills of analysis and interpretation.

5.	Objects of book-keeping is to summarize the cumulative effect of all economic transactions of business for a given period by maintaining permanent record of each business transaction with its evidence and financial effects on accounting variable.	Object of accounting is not only book-keeping but also analyzing and interpreting reported financial information for informed decisions.
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DESCRIPTIVE QUESTIONS

Q4. What are the functions of Accounting?

Answer :

The main functions of accounting are as follows:

- **Measurement:** Accounting measures past performance of a business entity and depicts its current financial position.
- **Forecasting:** Accounting helps in forecasting future performance and financial position of an enterprise using past data.
- **Decision-Making:** Accounting provides relevant information to the users of accounts to aid rational decision-making.
- **Comparison and Evaluation:** Accounting assesses performance achieved in relation to targets and discloses information regarding accounting policies and contingent liabilities which play an important role in predicting, comparing and evaluating financial results.
- **Control:** Accounting also identifies weaknesses of the operational system and provides feedbacks regarding effectiveness of measures adopted to check such weaknesses.
- **Government Regulation and Taxation:** Accounting provides necessary information to the government to exercise control on the entity as well as in collection of tax revenues.

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Q5. Describe the advantages of double entry system.

Answer :

Advantages of Double entry System

- (a) Since personal and impersonal accounts are maintained under the double entry system, both the effects of the transactions are recorded.
- (b) It ensures arithmetical accuracy of the books of accounts, for every debit, there is a corresponding and equal credit. This is ascertained by preparing a trial balance periodically, or at the end of the financial year.
- (c) It prevents and minimizes frauds. Moreover frauds can be detected early.
- (d) Errors can be checked and rectified easily.
- (e) The balances of receivables and payables are determined easily, since the personal accounts are maintained.
- (f) The businessman can compare the financial position of the current year with that of the past years.
- (g) The businessman can justify the standing of his business in comparison with the previous year purchase, sales, and stocks, incomes and expenses with that of the current year figures.
- (h) Helps in decision-making.
- (i) The net operating results can be calculated by preparing the Trading and Profit and Loss A/c for the year ended and the financial position can be ascertained by the preparation of the Balance Sheet.
- (j) It becomes easy for the Government to calculate the tax.
- (k) It helps the Government to decide sickness of business units and extend help accordingly.
- (l) The other stakeholders, like suppliers and banks take a proper decision regarding grant of credit or loans.

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Q6. Discuss the features of a trial balance.

Answer :

Feature's of a Trial Balance

- (i) It is a list of debit and credit balances which are extracted from various ledger accounts.

- (ii) It is a statement of debit and credit balances.
- (iii) The purpose is to establish arithmetical accuracy of the transactions recorded in the Books of Accounts.
- (iv) It does not prove arithmetical accuracy which can be determined by audit.
- (v) It is not an account. It is only a statement of account.
- (vi) It is not a part of the final statements.
- (vii) It is usually prepared at the end of the accounting year but it can also be prepared anytime as and when required like weekly, monthly, quarterly or half-yearly.
- (viii) It is a link between the Books of Accounts, Profit and Loss Account and Balance sheet.

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