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B.Com Honours

Semester I

Calicut University

Fundamentals of Financial Accounting

Course Code: COM1MN103 • Module 3 Notes

1. Recording Transactions: Double Entry and Rules of Debit & Credit

The foundation of modern accounting rests on the double-entry bookkeeping system, first codified by Luca Pacioli in 1494. This system recognizes that every business transaction has a dual effect—affecting at least two accounts. This module covers the rules for debit and credit under traditional and modern approaches, recording transactions in primary and subsidiary books, and the preparation of a Bank Reconciliation Statement (BRS).

Double Entry Bookkeeping

The double-entry system is based on the principle that for every debit, there must be a corresponding and equal credit. This maintains the accounting equation balance: **Assets = Liabilities + Owner's Equity**.

Traditional Approach (The Three Golden Rules)

Under the traditional approach, accounts are classified into Personal and Impersonal (Real and Nominal) accounts:

Account Classification	Nature of Account	Golden Rule of Debit and Credit	Typical Examples
Personal Accounts	Relates to individuals, firms, companies, or representative accounts.	Debit the Receiver, Credit the Giver	Ramu's account, ABC Ltd, Capital A/c, Bank A/c.
Real Accounts	Relates to tangible or intangible assets/properties of the business.	Debit What Comes In, Credit What Goes Out	Cash A/c, Machinery A/c, Land & Building, Patents.
Nominal Accounts	Relates to expenses, losses, revenues, or gains.	Debit All Expenses & Losses, Credit All Incomes & Gains	Rent A/c, Salaries A/c, Commission Received, Bad Debts.

Modern Approach (Accounting Equation Classification)

The modern approach groups accounts into five categories, applying debit and credit rules based on increases or decreases:

Assets & Expenses

Any increase in an Asset or an Expense account is debited. Any decrease is credited. (Debit balance is normal).

Liabilities & Capital

Any increase in a Liability or Capital account is credited. Any decrease is debited. (Credit balance is normal).

Revenues / Incomes

Any increase in Revenue is credited. Any decrease is debited. (Credit balance is normal).

Primary Books: Journal and Ledger

- **Journal (Book of Original Entry):** Chronological record of transactions. Each entry contains date, account debited, account credited, amount, and a brief explanation (narration).
- **Ledger (Principal Book of Accounts):** The collection of all accounts. Ledger posting is the transfer of debits and credits from the journal to their respective ledger T-accounts. Balancing an account involves finding the difference between debit and credit columns.

2. Subsidiary Books: Specialized Journals

In large businesses, recording all transactions in a single journal is inefficient. Instead, the journal is sub-divided into specialized subsidiary books:

Cash Book (Special Book)

Records all cash and bank receipts and payments. It acts as both a primary book and a ledger account. Types:

- **Single Column:** Records cash transactions only.
- **Double Column:** Records cash and discount transactions.
- **Triple Column:** Records cash, bank, and discount transactions. It handles Contra Entries (transfer between cash and bank).
- **Petty Cash Book:** Records small daily expenses, operated under the Imprest System (replenishing spent funds to a fixed balance).

Specialized Day Books

- **Purchase Book:** Records credit purchases of goods only. (Cash purchases are in the Cash Book; asset purchases in Journal Proper).
- **Sales Book:** Records credit sales of goods only.
- **Purchase Return Book (Journal):** Records goods returned to suppliers.
- **Sales Return Book (Journal):** Records goods returned by customers.
- **Journal Proper:** Records transactions that cannot fit elsewhere (e.g., opening entries, depreciation, adjustments, rectifications).

3. Bank Reconciliation Statement (BRS)

A Bank Reconciliation Statement is a report prepared to reconcile the difference between the bank balance shown in the company's Cash Book (bank column) and the balance shown in the bank's Pass Book (bank statement) on a specific date.

Causes of Discrepancies

Discrepancies arise due to two main reasons:

- **Timing Differences:**
 - *Cheques issued but not presented:* Recorded as payment in the Cash Book, but bank balance does not decrease until the creditor presents the cheque. (Cash Book < Pass Book).
 - *Cheques deposited but not cleared:* Recorded as receipt in Cash Book, but bank does not credit the account until funds clear. (Cash Book > Pass Book).
- **Transactions Recorded Only by the Bank:**
 - Bank charges or interest on overdraft debited by bank. (Cash Book > Pass Book).

- Interest or dividend collected and credited directly by bank. (Cash Book < Pass Book).
- Direct deposit into bank by a customer. (Cash Book < Pass Book).
- Dishonor of bills or cheques deposited but not notified. (Cash Book > Pass Book).

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