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Bachelor of Business Administration (BBA) | Fifth Semester | UK5DSCMGT302

Basics of Financial Accounting

Course Code: UK5DSCMGT302 • Module 2 Notes

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Module 2: Recording of Business Transactions

Basics of Financial Accounting • Course Code: UK5DSCMGT302

Chapter 1: The Journal: The Primary Book of Original Entry

1.1 Meaning, Concept, and Structural Format of the Journal

The **Journal** is the primary book of original entry in which business transactions are first recorded in chronological order (date-wise) as and when they occur, following the double-entry bookkeeping system. The word *Journal* is derived from the French word *Jour*, meaning "day." Thus, a journal is literally a daily financial record of commercial happenings. The process of recording transactions in a journal is termed **Journalizing**, and each individual transaction recorded therein is designated as a **Journal Entry**.

Every standard journal page features five mandatory vertical columns:

Date	Particulars	L.F.	Debit (Rs)	Credit (Rs)
Column 1	*Column 2*	*Column 3*	*Column 4*	*Column 5*

- **1. Date Column:** Records the calendar year, month, and day on which the commercial event took place. Strict chronological sequencing ensures historical integrity and legal auditability.
- **2. Particulars Column:** Specifies the names of the two or more accounts affected by the transaction. The account to be debited is written on the first line adjacent to the left margin, terminated with the abbreviation **"Dr."** The account to be credited is written on the subsequent line, indented slightly to the right, preceded by the preposition **"To"**. Below the entry, a concise explanatory note describing the transaction, enclosed in brackets and termed the **Narration** (prefixed by "Being..."), is mandatorily recorded to provide context for future audits.
- **3. Ledger Folio (L.F.) Column:** Records the specific page number (folio) of the Ledger where the corresponding account resides and where this entry has been posted. This establishes a cross-reference linking the journal directly with the ledger.
- **4. Debit Amount Column:** Records the exact monetary value to be debited to the receiving or asset/expense account.
- **5. Credit Amount Column:** Records the exact monetary value to be credited to the giving or liability/revenue account. Due to the double-entry principle, the sum of debits must mathematically equal the sum of credits.

1.2 Simple versus Compound Journal Entries

Depending on the number of accounts involved in a single commercial transaction, journal entries are categorized as:

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- *Simple Journal Entries:* An entry that contains exactly one debit account and one credit account (e.g., purchasing furniture for cash: Debit Furniture A/c, Credit Cash A/c).
- *Compound (Combined) Journal Entries:* An entry that involves multiple debits, multiple credits, or both, recording two or more related transactions occurring on the same date. For example, when opening business accounts or receiving cash from a customer alongside allowing a cash discount: Debit Cash A/c (amount received), Debit Discount Allowed A/c (loss), and Credit Customer's A/c (total gross debt extinguished). Compound entries conserve space and enhance clarity.
- *Opening Entries:* A specialized compound entry recorded on the first day of every new financial year to transfer the closing balances of assets (debited) and liabilities/capital (credited) from the previous year's balance sheet into the new year's ledger.
- *Closing Entries:* Entries passed on the final day of the financial year to transfer balances of all nominal accounts (purchases, sales, expenses, incomes) to the Trading and Profit & Loss Account, resetting them to zero for the upcoming year.

1.3 Comprehensive Worked Demonstration of Journalizing

To illustrate the practical execution of double-entry journalizing across diverse business scenarios (including capital introduction, banking, credit purchases, trade discounts, cash discounts, credit sales, bad debts, drawings, and expense accruals), consider the transactions of Bharat Commercial Enterprises during April 2024:

Date	Particulars	L.F.	Debit (Rs)	Credit (Rs)
2024 Apr 1	Cash A/c ..... Dr. Bank A/c ..... Dr. To Capital A/c *(Being business commenced with cash Rs 1,00,000 and bank balance Rs 4,00,000)*	1 2 3	1,00,000 4,00,000	5,00,000
Apr 4	Purchases A/c ..... Dr. To Raman & Sons A/c *(Being goods of list price Rs 1,00,000 purchased on credit at 10% trade discount; trade discount Rs 10,000 is not recorded in books)*	4 5	90,000	90,000
Apr 8	Raman & Sons A/c ..... Dr. To Purchases Returns A/c *(Being defective goods returned to supplier Raman & Sons, list price Rs 10,000 less 10% trade discount)*	5 6	9,000	9,000

Date	Particulars	L.F.	Debit (Rs)	Credit (Rs)
Apr 12	Deepak Traders A/c ..... Dr. To Sales A/c *(Being goods sold on credit to Deepak Traders at list price Rs 60,000 less 5% trade discount Rs 3,000)*	7 8	57,000	57,000
Apr 16	Cash A/c ..... Dr. Discount Allowed A/c ..... Dr. To Deepak Traders A/c *(Being cash received from Deepak Traders in full settlement of Rs 57,000 account, allowing Rs 2,000 cash discount)*	1 9 7	55,000 2,000	57,000

Apr 20	Raman & Sons A/c ..... Dr.
	  To Bank A/c
	  To Discount Received A/c
	(Being balance due of Rs 81,000 settled by cheque Rs 78,500, receiving cash discount of Rs 2,500)
		5
		2
		10
			81,000	78,500
				2,500

Apr 24	Drawings A/c ..... Dr.
	  To Cash A/c
	  To Purchases A/c
	(Being proprietor withdrew Rs 10,000 cash and Rs 5,000 goods at cost for personal domestic use)
		11
		1
		4
			15,000	10,000
				5,000

Apr 28	Bad Debts A/c ..... Dr. To Suresh Kumar A/c *(Being debt of Rs 8,000 owed by insolvent debtor Suresh Kumar written off as completely irrecoverable)*	12 13	8,000	8,000

Apr 30	Salaries A/c ..... Dr.
	  To Bank A/c
	  To Outstanding Salaries A/c
	(Being monthly staff salaries of Rs 40,000 recorded: Rs 30,000 paid by bank transfer, Rs 10,000 accrued outstanding)
		14
		2
		15
			40,000	30,000
				10,000

Total	**Journal Debit and Credit Grand Totals**	-	**Rs 8,46,000**	**Rs 8,46,000**

1.4 Trade Discount versus Cash Discount: Dual Accounting Demonstration

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To demonstrate the exact bookkeeping differentiation between Trade Discounts and Cash Discounts across both seller and buyer ledgers, consider the following commercial transaction: On May 10, Sharda Furnishings sold 50 executive office chairs to Modern Tech Solutions. The catalogue list price is Rs 4,000 per chair (Total List Price = Rs 2,00,000). Sharda allowed a **Trade Discount of 15%**. Payment terms stated: *"2% Cash Discount if settled within 10 days; Net 30 days."* Modern Tech Solutions paid the entire account by cheque on May 18 (within the 10-day cash discount window).

Step-by-Step Computational Breakdown:
Gross Catalogue List Price = 50 chairs × Rs 4,000 = Rs 2,00,000.
Less: Trade Discount @ 15% = (Rs 30,000).
Net Invoice Value (Recorded in Books): Rs 1,70,000. (Trade discount is completely ignored in ledger accounts).
Payment on May 18 (Cash Discount applied on Net Invoice Value):
Cash Discount @ 2% of Rs 1,70,000 = Rs 3,400.
Net Amount Paid by Cheque = Rs 1,70,000 - Rs 3,400 = **Rs 1,66,600**.

Comparative Journal Entries in Both Parties' Books:

In the Books of Seller (Sharda Furnishings)	In the Books of Buyer (Modern Tech Solutions)
1. On May 10 (Sale of Goods): Modern Tech Solutions A/c ..... Dr. 1,70,000 To Sales A/c ..... 1,70,000 *(Being goods sold at 15% trade discount)*	**1. On May 10 (Purchase of Goods):** Purchases A/c ..... Dr. 1,70,000 To Sharda Furnishings A/c ..... 1,70,000 *(Being goods purchased at 15% trade discount)*
2. On May 18 (Receipt of Payment): Bank A/c ..... Dr. 1,66,600 Discount Allowed A/c ..... Dr. 3,400 To Modern Tech Solutions A/c ..... 1,70,000 *(Being payment received, allowing 2% cash discount)*	**2. On May 18 (Execution of Payment):** Sharda Furnishings A/c ..... Dr. 1,70,000 To Bank A/c ..... 1,66,600 To Discount Received A/c ..... 3,400 *(Being debt settled, receiving 2% cash discount)*

Chapter 2: The Ledger: The Principal Book of Accounts

2.1 Concept, Structure, and Posting Mechanics

While the journal is the book of primary chronological entry, the **Ledger** is the principal book of accounts in which all financial transactions recorded in the journal and subsidiary books are classified, organized, and permanently summarized under separate thematic accounts. The process of transferring debits and credits from the journal into the respective accounts in the ledger is known as **Posting**.

Every ledger account is traditionally rendered in a "T-Shape" divided into two symmetrical halves: the left-hand side is designated as the **Debit Side (Dr.)**, and the right-hand side is designated as the **Credit Side (Cr.)**:

DEBIT (Dr.) SIDE				CREDIT (Cr.) SIDE			
Date	**Particulars**	**J.F.**	**Amount**	**Date**	**Particulars**	**J.F.**	**Amount**
Date	To [Opposite Account Name]	*Page*	*Rs*	*Date*	By [Opposite Account Name]	*Page*	*Rs*

Standard Posting Protocols:

- When an account is debited in a journal entry, the posting is entered on the **Debit Side** of that ledger account. In the Particulars column, the entry is prefixed by the preposition **"To"**, followed by the name of the corresponding credited account.
- When an account is credited in a journal entry, the posting is entered on the **Credit Side** of that ledger account. In the Particulars column, the entry is prefixed by the preposition **"By"**, followed by the name of the corresponding debited account.
- The *Journal Folio (J.F.)* column records the exact page number of the journal from which the entry was transcribed, ensuring complete audit cross-referencing.

2.2 The Mechanics of Balancing Ledger Accounts

At the close of an accounting month or financial year, every ledger account must be **Balanced** to determine its net financial position:

1. Total the Debit column and Credit column on scratch paper to identify which side has the larger monetary sum.
2. Enter the larger sum in the total box at the foot of both the Debit and Credit columns on the exact same horizontal line.
3. Compute the difference between the two columns. If the Debit side exceeds the Credit side, the account has a **Debit Balance**. Enter this difference on the Credit side as *"By Balance c/d"* (carried down).
4. If the Credit side exceeds the Debit side, the account has a **Credit Balance**. Enter this difference on the Debit side as *"To Balance c/d"*.
5. On the first day of the subsequent accounting period, bring the balance forward to the opposite side as *"To Balance b/d"* (brought down) on the Debit side, or *"By Balance b/d"* on the Credit side.
6. **Nominal Accounts Exception:** Unlike Personal and Real accounts, Nominal accounts (expenses and revenues) are not carried down with balances. Instead, their balances are transferred directly to the Trading Account or Profit and Loss Account at year-end.

2.3 Complete Ledger Postings and Account Balances

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To demonstrate the mechanical process of posting from the journal to the ledger and balancing accounts, the ledger accounts resulting from Bharat Commercial Enterprises' April 2024 journal entries are fully drafted below:

Dr. CASH ACCOUNT (A/c No. 1) Cr.

Date	Particulars	J.F.	Rs	Date	Particulars	J.F.	Rs
2024 Apr 1	To Capital A/c	1	1,00,000	2024 Apr 24	By Drawings A/c	1	10,000
Apr 16	To Deepak Traders A/c	1	55,000	Apr 30	By Balance c/d	-	1,45,000
Total	-	-	**1,55,000**	**Total**	-	-	**1,55,000**

Dr. CAPITAL ACCOUNT (A/c No. 3) Cr.

Date	Particulars	J.F.	Rs
2024 Apr 24	By Drawings A/c	1	10,000
Apr 30	By Balance c/d	-	1,45,000
Total	-	-	**1,55,000**

Dr. BANK ACCOUNT (A/c No. 2) Cr.

Date	Particulars	J.F.	Rs
2024 Apr 1	To Capital A/c	1	4,00,000
Total	-	-	**4,00,000**
2024 Apr 4	To Raman & Sons	1	90,000
Total	-	-	**90,000**

Dr. PURCHASES ACCOUNT (A/c No. 4) Cr.

Date	Particulars	J.F.	Rs
2024 Apr 20	By Raman & Sons	1	78,500
Apr 30	By Salaries A/c	1	30,000
Apr 30	By Balance c/d	-	2,91,500
Total	-	-	**4,00,000**
2024 Apr 24	By Drawings A/c	1	5,000
Apr 30	By Trading A/c (transfer)	-	85,000
Total	-	-	**90,000**

3.4 Practical Formulation of the Purchases and Sales Books

To demonstrate the mechanics of specialized subsidiary registers, consider the recording of transactions in the Purchases Book and Sales Book of an electronics trading concern:

1. Purchases Book Format (Recording Credit Merchandise Purchases):

Date	Invoice No.	Name of Supplier (Particulars)	L.F.	Net Amount (Rs)
2024 May 4	Inv-402	**Sony India Pvt Ltd** 10 LED Monitors @ Rs 8,000 = Rs 80,000 Less: 10% Trade Discount = (Rs 8,000)	14	72,000
May 15	Inv-881	**Samsung Electronics Ltd** 5 Commercial Tablets @ Rs 12,000 = Rs 60,000 Less: 5% Trade Discount = (Rs 3,000)	18	57,000
May 28	Inv-105	**LG Electronics India** 4 Smart Displays @ Rs 15,000 = Rs 60,000 Less: 10% Trade Discount = (Rs 6,000)	22	54,000
May 31	-	**Purchases Account Dr. (Monthly Total transferred to Ledger)**	-	**Rs 1,83,000**

2. Sales Book Format (Recording Credit Merchandise Sales):

Date	Invoice No.	Name of Customer (Particulars)	L.F.	Net Amount (Rs)
2024 May 8	Out-101	**Horizon Infotech** 4 LED Monitors @ Rs 11,000 = Rs 44,000 Less: 5% Trade Discount = (Rs 2,200)	31	41,800
May 20	Out-102	**Zenith Solutions** 2 Smart Displays @ Rs 20,000 = Rs 40,000 Less: 10% Trade Discount = (Rs 4,000)	35	36,000
May 31	-	**Sales Account Cr. (Monthly Total transferred to Ledger)**	-	**Rs 77,800**

Posting Rule from Subsidiary Books: Individual suppliers (Sony, Samsung, LG) are credited in the creditors' ledger on the date of transaction. At the end of the month, the Purchases Book grand total of Rs 1,83,000 is posted as a debit to the *Purchases Account* in the general ledger. Conversely, individual debtors (Horizon, Zenith) are debited on the transaction date, and the Sales Book monthly total of Rs 77,800 is credited to the *Sales Account*.

Chapter 3: Subsidiary Books (Specialized Journals)

3.1 Sub-division of the Journal: Operational Rationale

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In large-scale commercial organizations executing hundreds or thousands of transactions daily, recording every single event in one solitary journal creates catastrophic operational bottlenecks. A single bookkeeper cannot cope with the sheer volume; furthermore, locating specific credit purchase invoices or sales returns requires tedious manual searching through thousands of pages.

To establish division of labour, speed, and internal control, the Journal is subdivided into specialized primary registers termed **Subsidiary Books (Special Journals)**:

Subsidiary Register	Permissible Transactions Recorded	Explicit Transaction Prohibitions
1. Purchases Book	Exclusively records **credit purchases of trading merchandise** (goods bought for resale or manufacturing).	Cash purchases of goods (recorded in Cash Book) and credit purchases of fixed capital assets (recorded in Journal Proper).
2. Sales Book	Exclusively records **credit sales of trading merchandise** to customers.	Cash sales of goods (recorded in Cash Book) and credit sales of obsolete fixed assets (recorded in Journal Proper).
3. Purchases Returns Book	Records goods returned by the enterprise to suppliers due to defects, damages, or non-conformance. Accompanied by a **Debit Note**.	Returns of cash-purchased goods where immediate cash refunds are received (recorded in Cash Book).
4. Sales Returns Book	Records goods returned by customers to the enterprise. Accompanied by a **Credit Note** issued to the customer.	Returns of goods sold for immediate cash where cash is refunded immediately across the counter.
5. Bills Receivable Book	Records formal promissory notes and bills of exchange accepted by debtors and payable to the enterprise.	Informal verbal credit promises or open account trade credit without negotiable bills.
6. Bills Payable Book	Records formal bills of exchange drawn by creditors and formally accepted by the enterprise for payment.	Standard trade credit payables without executed negotiable instruments.
7. Cash Book	Records all cash and bank receipts and cash and bank disbursements without exception.	All non-cash credit transactions.
8. Journal Proper	Residual book of original entry recording miscellaneous	Routine cash, banking, credit purchases, and credit sales transactions.

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Subsidiary Register	Permissible Transactions Recorded	Explicit Transaction Prohibitions
	transactions that cannot fit into any specialized subsidiary book.	

3.2 Debit Notes versus Credit Notes

The mechanics of returns in subsidiary books rely on two crucial commercial source documents:

- **Debit Note:** A formal business document dispatched by a buyer to a seller notifying that the seller's account has been debited in the buyer's books. A debit note is issued when goods are returned due to transit damages, when an overcharge occurred in the original invoice, or when discounts were omitted.
- **Credit Note:** A formal business document dispatched by a seller to a buyer acknowledging that the buyer's account has been credited in the seller's books. A credit note confirms that returned goods have been accepted, or that an overbilling error has been rectified, reducing the debtor's outstanding balance.

3.3 The Role and Transactions Recorded in Journal Proper

The **Journal Proper** serves as the indispensable residual journal, capturing essential non-cash accounting entries that cannot be accommodated in any other subsidiary book:

- *1. Opening Entries:* Transferring asset, liability, and capital balances at the start of a financial year.
- *2. Closing Entries:* Transferring nominal accounts to Trading and Profit & Loss accounts at year-end.
- *3. Adjusting Entries:* Year-end adjustments for prepaid expenses, accrued incomes, depreciation, and bad debt provisions.
- *4. Rectification Entries:* Correcting bookkeeping errors made during journalizing, posting, or balancing.
- *5. Transfer Entries:* Moving balances between accounts (e.g., transferring drawings to capital, or transferring profit to general reserve).
- *6. Miscellaneous Sourcing Entries:* Credit purchase of fixed capital assets (e.g., purchasing computer equipment on credit from Dell Technologies); endorsement of bills of exchange; and writing off bad debts.

3.5 Returns Registers: Purchases Returns and Sales Returns Books

Returns of merchandise represent a frequent commercial occurrence arising from goods arriving damaged in transit, defective manufacturing tolerances, incorrect specifications dispatched, or late delivery. Dedicated subsidiary books track these physical and financial reversals:

1. Purchases Returns Book (Return Outwards Book): Accompanied by a *Debit Note* dispatched to the vendor:

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Date	Debit Note No.	Name of Supplier (Particulars)	L.F.	Net Amount (Rs)
2024 May 12	DN-101	**Sony India Pvt Ltd** 1 LED Monitor returned damaged @ Rs 8,000 Less: 10% Trade Discount = (Rs 800)	14	7,200
May 22	DN-102	**Samsung Electronics Ltd** 1 Commercial Tablet returned defective @ Rs 12,000 Less: 5% Trade Discount = (Rs 600)	18	11,400
May 31	-	**Purchases Returns Account Cr. (Monthly Total transferred to Ledger)**	-	**Rs 18,600**

2. Sales Returns Book (Return Inwards Book): Accompanied by a *Credit Note* issued to the customer:

Date	Credit Note No.	Name of Customer (Particulars)	L.F.	Net Amount (Rs)
2024 May 16	CN-201	**Horizon Infotech** 1 LED Monitor returned not matching specs @ Rs 11,000 Less: 5% Trade Discount = (Rs 550)	31	10,450
May 31	-	**Sales Returns Account Dr. (Monthly Total transferred to Ledger)**	-	**Rs 10,450**

2.4 Modern Enterprise General Ledger Architecture in ERP Systems

In modern computer-based accounting and Enterprise Resource Planning (ERP) environments (such as SAP S/4HANA, Oracle Financials, and Tally Prime), physical paper ledgers are replaced by relational database tables. The general ledger architecture is organized into a hierarchical structure:

- **Chart of Accounts (COA):** A structured listing of all accounts available in the general ledger, organized using standardized alphanumeric account numbering schemes (e.g., 1000-1999 for Assets, 2000-2999 for Liabilities, 3000-3999 for Equity, 4000-4999 for Revenue, and 5000-5999 for Operating Expenses).
- **Control Accounts and Sub-Ledgers:** To prevent the general ledger from becoming cluttered with thousands of individual customer and vendor accounts, modern ERPs utilize *Sub-Ledgers (Subsidiary Ledgers)* for Accounts Receivable (debtors) and Accounts Payable (creditors). The general ledger maintains solitary *Control Accounts* (Accounts Receivable Control A/c and Accounts

Payable Control A/c) whose balances automatically synchronize with the grand total of the individual sub-ledger balances in real time.

- **Real-Time Posting and Audit Trails:** Unlike manual bookkeeping where transactions are posted periodically, ERP systems post journal entries simultaneously to all affected sub-ledgers and control accounts the moment a digital voucher is approved, generating immutable digital audit logs tracking user ID, timestamp, and machine IP address to ensure statutory compliance with MCA and Companies Act audit trail mandates.

3.6 Negotiable Instruments Registers: Bills Receivable and Bills Payable Books

When goods are sold on extended credit, parties frequently execute negotiable instruments governed by the Negotiable Instruments Act 1881:

- **Bills Receivable Book:** Records bills of exchange drawn by the enterprise on credit customers (debtors) and accepted by them, or promissory notes received from customers. Details include Date Received, Drawer, Drawee, Payee, Term/Tenure (e.g., 90 days), Due Date (including 3 days of grace), and Face Value.
- **Bills Payable Book:** Records bills drawn by suppliers (creditors) and accepted by the enterprise. Details track the drawer, due dates, and bank through which payment will be executed upon maturity.

3.3.1 Structured Typologies of Transactions in Journal Proper

Journal Proper Entry Type	Circumstance of Occurrence	Standard Bookkeeping Format
1. Opening Entry	Passed on first day of new financial year to open new books.	Debit all Assets A/c (Individually) To all Liabilities A/c (Individually) To Capital A/c (Balancing figure)
2. Credit Purchase of Fixed Assets	Acquiring machinery, equipment, or furniture on credit.	Debit Machinery / Asset A/c To Vendor / Supplier A/c
3. Rectification Entry	Correcting clerical or accounting errors discovered in books.	Debit Corrected A/c or Suspense A/c To Erroneous A/c or Suspense A/c
4. Adjusting Entry	Recording accrued expenses, prepayments, and depreciation at year-end.	Debit Depreciation A/c To Asset A/c
5. Closing Entry	Transferring nominal balances to Trading and P&L accounts.	Debit Trading A/c To Purchases A/c / Direct Expenses

3.4 Summary of Recording Invariants

The systematic recording of commercial transactions constitutes the primary operational phase of the accounting cycle. Mastering the chronological format of the journal and the rigorous application of

double-entry rules guarantees that every transaction is balanced. Posting to the ledger transforms raw chronological streams into classified thematic accounts, while balancing extracts net asset, liability, and equity positions. Subdividing the journal into specialized subsidiary books establishes division of labour and accelerates transaction processing, providing the verified empirical foundation for trial balance extraction and financial statement preparation.

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