Decision making using financial accounting

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Lecture - 14

Journal - 1

Welcome back and I think we were finished about 3 weeks, and continuing from where we left in the last session. What we were actually doing in the last session was, we were trying to go back, go beyond, what is called as your P and L and balance sheet is you sort of talked about. We talked about in the earlier classes week 1 and week 2.

And in the last class we were trying to see how does that recording process take place. Finally, it ends up in what you call it as a P and L and balance sheet, but to get into the P and L and balance sheet, what are the process, what is the basic, what you call it is the typically when we say we bookkeeping, etcetera. Recording of the transaction in the transaction happens or when the transaction takes place how is the transaction recorded, number 1 and number 2 is after that how is it converted or how does it become a P and L and a balance sheet that is what basically we looked at in the last class.

We just give you bird's eye view of the whole thing. Today what will try and do is we will try and take up a series of transactions out there. I have given you series of transactions out there which you can see that is for week 4, please use this.

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For Week - 4

From the following transactions of Nadkarni and Co. you are required to pass the necessary journal entries, post them to a ledger, prepare the Profit & Loss account and Balance Sheet. All figures are in INR.

1- Nadkarni commenced business with capital of	10,000
2- Deposited in the bank	3,000
3- Bought goods from E engineer	2,000
4- Sold goods to V Ragavan for cash	700
5- Sold goods to Vijay Merchant	700
6- Received cash from Vijay Merchant	680
7- Allowed discount to Vijay Merchant	20
8- Sold goods to Jayshima	600
9- Received cheque from Jayshima on account	500
10- Paid E engineer on account	1000
11- Received discount on payment to E engineer	30
12- Bought goods from Subramaniam	900
13- Sold goods for cash to Pattnaik	900
14- Sold goods to Chandrashekar on credit	400
15- Jayasimha returned goods	20
16- Returned goods to E engineer	100
17- Cash purchases	200
18- Cash sales	375
19- Withdrew from bank for office use	1000
20- Provided loan to Amarnath	200
21- Bought goods from Savlega	300
22- Sold goods to Thankad for cash	400
23- Paid for office rent	150
24- Paid for office salaries	250
25- Paid for general expenses	25
26- Purchased goods from Abdali	100
27- Withdrew from bank for personal use	500
28- Bought stationary for cash	25

Now, we look at a series of transactions. We will take these transactions and what we will do and try and do is we will go the typical accountant's way. When I said typical accountants way, we will start recording each of this transaction as I said in the last class, in a book or journal. Then it moves to the next consolidation of these accounts that is what we call it as a typically the ledger and then we move into preparing what is called as a profit and loss statement and a balance sheet out there. We will take you through the entire process for this small list of transaction what I have taken.

I thing we have got about 25 to 30 transactions out there. We have got roughly about 27 transactions out there and we will take this 27 transactions and go through you go through it in a sequential form. Now, first and foremost what we will do is we will take each of this transaction and let us pass the journal entry as if. Now, once you finish the journal entry for all this transactions then let us get into what is called as preparing the ledger account and so on and so forth as we go along. Now, let us do the journal entry. Let me start with that.

Let us read the first transaction out here if we look at, it says from the following transactions of x y z Nadkarni and Co. You are required to pass the what you call it as the necessary journal entries, for prepare the ledger account, prepare the P and L and the balance sheet and then all the figures are given in this INR that is Indian rupee out there. Let us check the first transaction.

It says that Nadkarni commenced the business with the capital of 10,000 dollar, 10,000s INR, 10,000s rupees. Now, when we talked about, I said talked about accounting itself there are 3 basic principles which we used for accounting normally for every transaction that is we classified this transaction into 3 basic aspects.

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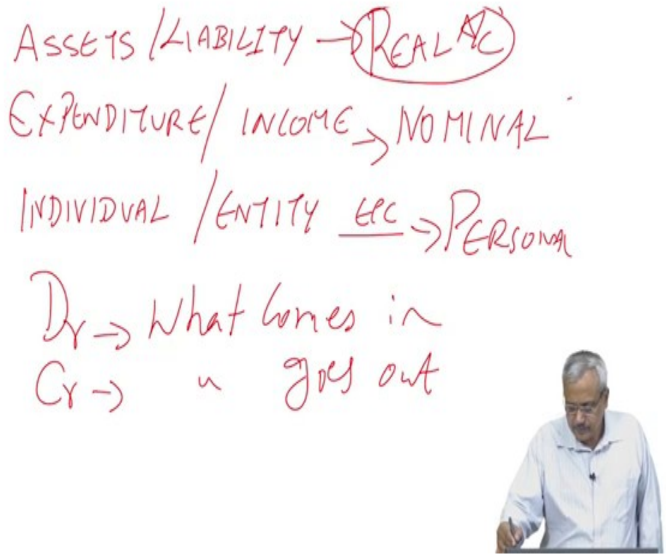

First of the basic aspect is what we typically call it as what we say we say is it either an asset or a liability. The second thing, if second aspect what we call it as we call a we try we classify it as whether it is a expenditure or an income. Third basic aspect how we classify is basically when we say it is on what is called as related to an individual, entity, etcetera. These 3 now what they, so they is this what we call it as we apply what is called as a typical accountants, we will apply what is called as a real account principle out here.

For this they look at what is called as your basically for the income, expenditure, etcetera out there they will apply what is called as a nominal account principle. Now, for an individual entity they apply what is called as a personal account principle. Now, what does it say? It says that whenever it pertains to any of these that is whenever it pertains to an aspect it in real account that is an asset or liability, we always say, we always say debit what comes in, we always say credit what goes out. That is if an asset is coming into the firm company we debit it. If something is asset is going outer the company what you have do we credit it out there.

Let us look at continue this. For if I is a cut what you call it as a next aspect what a said in this particular case, if I see that it is related to income and expenditure. When it is related to income and expenditure, what happens? It says that debit all incomes debit, debit all expenditure and losses and basically what we says credit all income and gains. We normally say that debit all expenditure and or losses and credit all income and or gains.

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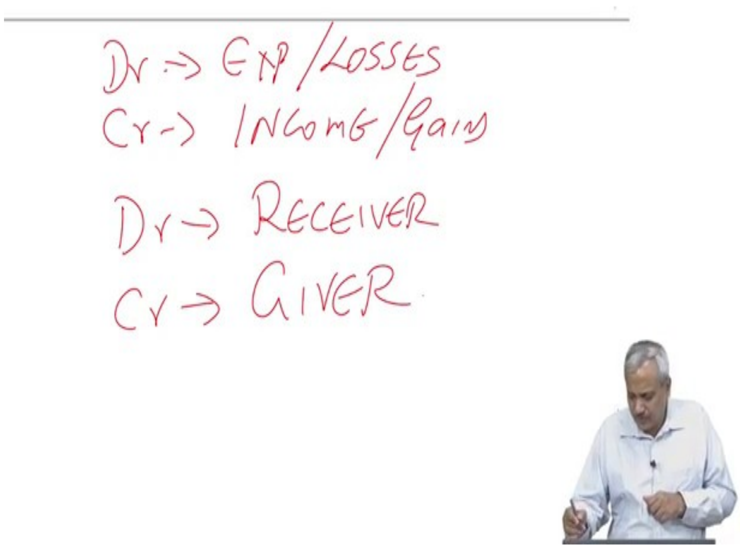

The third basic aspect in this particular, in this particular whatever recording of the transaction what we follow is a personal account principle, what you call it as, it is related to individual or an entity we say debit the we will say again debit and credit out. Here when we talk about, we will normally say that debit the receiver, credit the giver. The person who is giving, the person who is giving that particular in the transaction who is the giver in the transaction credit the giver and debit the receiver. Let us keep these principles in mind, and let us see try and see if we can journalize these transactions first and foremost. Then let us look at the ledger and so on and so forth out here.

Now, if I have to say that if I have to continue on this, in the first what you call it as if you see the first transaction out here it says Nadkarni commenced a business with the capital of rupees 10,000. You can add multiple 0s, these all these 0s are in 1000s out here, you can actually do that.

Now, in this if I look at in this particular case what happens? Nadkarni commenced a business. Now, what happens in this transaction? Now, there is something there are two things out here that is one is as for a look at it only from the point of view of the business, do not look at it from any other point, look at it from the point of view of the business because you are preparing the financial statements for the business out here.

When you are preparing the financial statements for a business you have to look at it from the business point of view, if you look at it from the business point of view let us say you take it like this. He has commenced business with a cash of by what you call it as commenced business with the capital of 10,000; that means, as for as a business is concerned you go back to your asset and liability principle there is something which is something coming inside the business. What is coming inside the business? There is cash that is coming inside the business.

The second aspect of it, what is happening because of that? There is cash that is coming inside the business that is very good, but at the same time you also owe that money to Nadkarni that is the company as such is a separated entity, go back to the entity concept what we talked about. The entity also owes that money back to the person who has contributed at the time of dissolution. Now, what is cash? Cash is coming into the company. What is cash? Cash as we know is basically nothing, but what you call it as an asset out there. When it is an asset what happens? Debit what comes in, that is real account principle in the process.

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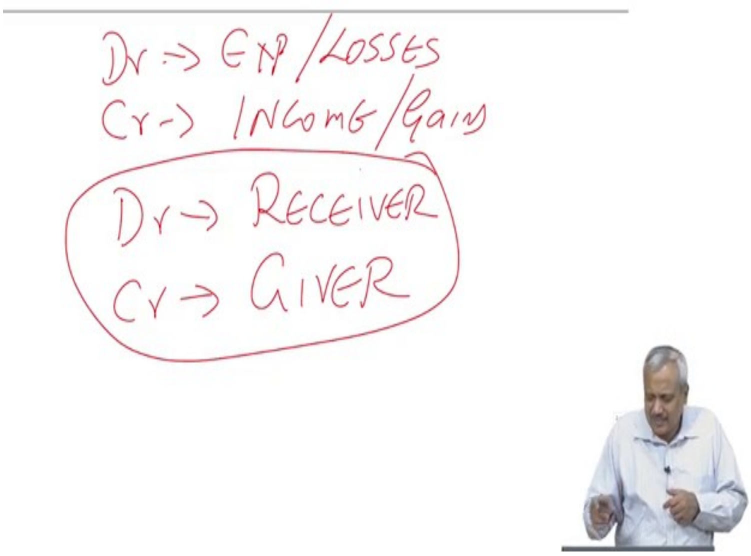

What do I do out here, I will say cash account debited rupees 10,000 out here. And then what happens? Is capital, if a capital is not when I say somebody as given you capital there is an asset, there is something is when who has contributed that capital. In this particular, case cash is come in perfectly alright. Now, who has given this cash? Nadkarni has given this cash. Now, when Nadkarni has given this cash what happens? The what is the principle you will apply? You apply what is called as this personal account principle out here. When I apply the personal account principle what happens? Debit the receiver credit the giver. Who is giving that cash? Nadkarni is giving that cash.

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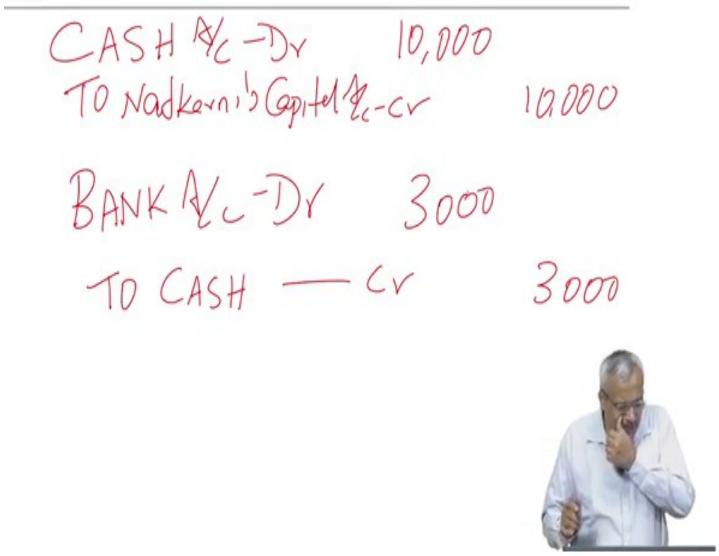

So, basically what I do is in this particular case, in this particular, case I will say to Nadkarnis capital account, credited 10,000 rupees. Again take this transaction, let me specify. It says that Nadkarni commence business with the capital of 10,000. Yes, company is incorporated, business, as for as the business is concerned what is happened cash has come into the business. Go back to what we did, in the initial class when we sort of recorded the P and L and balance sheet.

What happened? Moment cash comes into the business the asset increases. Now, when asset increases what is the a, what is in cash? Cash is basically an asset out there. When there is an asset that is increasing now what is a, what is a principle under which this basic asset falls. In the principle under which the basic asset falls is real account principle which has basically which says that debit what comes in. What is coming in? Cash is coming in. So, what I have done? Cash account debited 10,000.

And then then what happens? Now, question is debit comes in debit, debit what comes in, credit what goes out. Is there is anything going out? Nothing, ok. What is the next aspect? Is there anything going out? There is nothing going out there. What is the next aspect out here? Now, here somebody can say personal account principle. Debit, all expenditure in losses, is there any expenditure in a loss? There is no expenditure loss. Credit, all income on gain, is there an income or a gain? No, he has contributed capital it is not profit, it is not gain, so it has nothing.

Then what is the other one, nominal account principle. What is nominal account principle say? Debit the receiver. Is there somebody receiving it? No. What is it? Somebody is basically giving that cash to you, when somebody is basically giving that cash to you what happens in this particular case is you will say who is giving that particular cash to you. Nadkarni is giving that cash to you. So, there the in the first one in the first part of this particular transaction is debit what comes in, cash has come in, I have debited. Second part of the transaction pertains to personal parts of it that is somebody is giving me that cash. So, credit the giver out there that is what basically I have done out there.

Now, let us look at the second transaction if there is a question we will come back again. So, if I have to look at the second transaction out here, it says deposited money in the bank, deposited in the bank, deposited in the bank the 3,000 rupees out there. Now, what happens? When you deposit money in the bank that is your own bank, it is in this particular case let me even qualify this particular statement, it says deposited money in your own account in the bank. It is not somebody else's account, you are depositing money in your own account, that is some extension of that which is missed out. You can record it as deposited money in the company's account, you can write it as deposited money in the company's account rupees 3,000 perfectly, all right.

Now, how does how will that statement read out here? If I have to look at, moment you deposit money what is happening to your cash? Cash is going out of the business. Yes or a no? So, what is happening to your asset? Asset is reducing. Yes or a no? Yes, when asset is reducing cash is going out of the business. What is happening? What is the principle that comes in debit what comes in credit what goes out. What is going out? Cash is going out. I will say cash account is basically credited rupees 3,000.

Now, it now the next aspect out here is debit what comes in; what cash is going out perfectly all right. Is an anything coming in? Yes. What is coming in? Your money is getting deposited in your account in the bank and what is called as another asset is coming to you that is cash is an asset which is going out, another asset which is coming in is in the form of a bank account, the bank balance is yours, you own it. The bank account is coming in cash is going out. So, one asset is going out, another asset is coming in. Debit what comes in. What is coming in? Bank account is coming in, cash account cash is going out there and then this transaction is basically complete out there. Am I with you on this?

Now, let me sort of move to the third basic transaction out there. Any doubt? Again, I will sort of look at, I will do one thing I will quickly do a recap of this. Now, that I have done two transaction, so let me quickly do a recap of this. Where to do a quick recap of this it says that we classify all our transactions into 3 broad categories. First broad category is related to your assets and liabilities and we call it as the real account principle. Anything that comes under that is what we call it as a real account principle.

The second broad category is related to only your income and expenditures, income losses, expenditure and gains all these 4 put together. We classify that under a group what is called as nominal. Third classification is related to what is called as non living entities or living entities that is individual's enterprises, etcetera, etcetera. So, we classify that basically as what you call it as group of personal account group out there and each of it has a basic principle.

The basic principle is if I look at real account what happens in this case asset and liability? We say debit what comes in, credit what goes out. We will say when we talk about income expenditure and losses debit all expenditures and losses, credit all incomes and gains. The third basic aspect in this particular case if you look at in out here is another personal, personal account principle out here we say debit the receiver, fellow who is receiving debit him, credit what is called as the giver of that particular benefit to you.

So, in the same principle out there we look at what you call it as this particular transaction, e in this particular transaction out here, when you look at this particular transaction we said that first he started business with the capital, as for as the business is concerned. Please note I am doing there is only from the point of view of an enterprise, not from any other point of view, only from the point of view of an enterprise.

If I have to look at it from the point of view of an enterprise as for as the enterprises is concerned what is happened in the first thing? When somebody contributes money and form of capital, business is concerned, cash is coming into the business. When cash comes into the business, what is cash? Cash is an asset. What happens? What is the principle? Real account principle. What is the real account principle? Debit what comes in. I have debited cash over.

Then, there is somebody who is giving me cash, who is that guy who is giving me cash? There is Nadkarni who is giving his who is giving the cash in the form of capital perfectly, all right. So, what happen? Nadkarni, moment the word Nadkarni comes in it basically is related to be an individual that is personal account principle. Moment we look at personal account principle then what happens?

Nadkarni that is debit the receiver, credit the giver. Who is giving the credit? Nadkarni is giving the credit. So, Nadkarnis capital account is basically credited in the process. As I said every transaction will have two basic aspects minimum, two accounts and two basic aspects. What I said in class one, what I said in class one continues. So, here are the two basic aspects out here.

Now, how does this translate to my P and L? We will look at it as we go along. You can even visualize right now, based on the initial classes what happened. What we did you could be visualize, that is you would visualize that it will go into the balance sheet cash as an asset 10,000 and then in the liability plus capital, Nadkarni's capital of 10,000. And then what happens? Your balance sheet is, basically balance there is no effect on your P and L as if now in the process.

Let us look at the second transaction. It says that deposited money in the bank to the extent of about 3,000 dollars. When you are deposited money in the bank to a extent of 3,000 dollars what happens? You are deposited money in your own account. There is a cash which has gone out of the business debit what comes in, credit what goes out. I credited cash because cash has gone out of the business.

The next aspect debit what comes in, what is coming in? Your bank passbook is coming in. Means what is called as an entry, which says you have deposited 3,000 and you own that 3,000. So, what I have a done? Bank account debited out there in the process, debit what comes in. This is entire thing of this transaction is both related to an asset rest only within what you call it as the real account.

Now, visualize in the balance sheet and P and L. What happens? The cash which has 10,000 gets splits into cash 7000 and the next aspect in that balance sheet on the asset side will be bank 3,000 your balance sheet is still balanced in the process out there. Am I with you on this? Shall we go along? Shall we go to the third transaction out here? If I have to see the third transaction out here, bought goods from E engineer, I have just arbitrary given out there bought goods from E engineer rupees 2,000, you can add multiple 0s to it, that is till 2,000 all these on the multiple 0s out there.

When you are bought goods from E engineer unless and normally in accounting, I have already I also indicated to you guys that unless, until, otherwise, specified, I repeat unless, until, otherwise, specified. All transactions will always be on credit. Unless, until, otherwise, specified transactions will always be on credit, it will not be on cash. If it is on cash there will be a specific mention saying that the transaction is based on cash out there.

In this case what does happened? Bought goods from E engineer. When you buy goods what is happening? There is what is called as a purchase that is happening. When you as a purchase that is happening, what is happening? Goods are coming into your factory. When goods are coming into your factory, what is happening? There is an enhancement of an asset, there is an asset which is increasing, an asset is coming in. So, when asset is coming in what happen? Debit what comes in.

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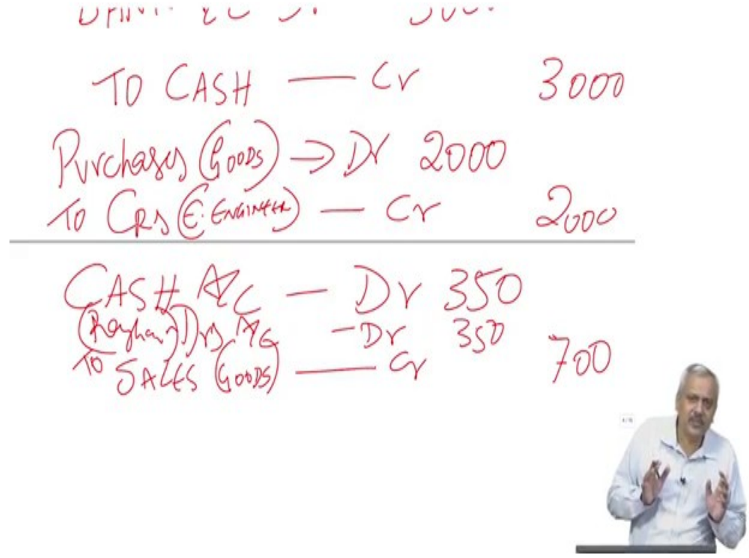

So, what is coming in? There is goods that is coming in, normally we will say purchases account debited. What is the amount? Amount in this particular case is 2,000 dollars, 2,000 INR, 2,000 rupees. Is there anything going out? There is nothing going out. But is there an expenditure, so that is real account is over. Is there is there an expenditure, income, loss, gain? No, there is only a purchase. There is no gain, as is there is no profit as of now.

Now, next, personal account, debit the receiver. Is there anybody giving this? There is no cash that has gone out, please note. Is there anybody giving it? Yes, E engineer is giving it to you. E engineer is giving it to you, that is he giving the goods to you, he is giving it on credit, debit the receiver, credit the giver. Who is giving it? E engineer is giving it, that is normally we will say creditors in this particular bracket I will write E engineer.

I repeat. If if we look at it in this particular case we see thus what is happened? There is a there is a purchase that has happened. When there is a purchase that has happened what is happening? Goods are coming in. Goods are coming in means, asset is increasing. Moment asset is increasing, what is the principle? Debit what comes in, that is what I have done here.

Second, there is there a cash have you paid cash? No, you are not paid cash. There is somebody who has sold it on credit. Who is that fellow who is sold it on credit? Entity or an individual. Moment entity or an individual, then it goes to personal account principle.

Personal account principle what it says? Debit the receiver, credit the giver. Who is giving the credit? E engineer is giving the credit. Normally, they all called as creditors, as we said, so it is 2,000.

Visualize it back in the balance sheet, what happens? Moment I do this transaction, on the asset side my asset will increase that is stock in trade are what is called as opening stock or purchaser, that is basically stock will increase by 2,000. On the credit side what will happen, by creditors will also increase by 2,000. Am I with you on this? Asset and liability increasing, their balance sheet will automatically will be balancing out in the process. Am I with you on this?

Now, shall we move on? We will move ahead, we will move ahead, we will move head to the next transaction out there. Then next transaction if I had to look at it says that sold goods to V Raghavan for cash rupees 700. Moment there is a sale what is happening? There is a goods which is leaving your company. That is there is an asset which is getting out of your company. Am I with you on this?

Yes. Moment an asset which is leaving the company what is the principle? Debit what comes in credit what goes out. What is going out? Goods are going out of your company when goods are going out of your company let me say that is what is called as I will have to credit the basic goods out here goods are going out of the company. Normally, what happens is we will write sales basically in this particular case goods are going out of your company, that is I credit the amount basically in this particular case is 700.

Now, what is happening? Your sold goods goods have gone, your credit debit what comes in, credit what goes out. What is, is there anything coming in? Yes, there is something coming in. Cash is coming in. Somebody can argue, it is not the cash, it is the giver. Who is giving? That is Raghavan, Raghavan should be credited or Raghavan's account should be credited. Now, moment you have received cash from Raghavan, are you worried about whether Raghavan has given cash or somebody else has given cash. As for as your sold goods you have got the money, you are not bothered about who is the customer to whom you have sold.

When is that you bother to whom you are sold? You are bothered to whom you have sold only when that fellow has to pay you the money, that is where, that is why he that is where he is giving that is where you are basically giving the what is called a credit to him, that is unless he has he has to pay you are not bothered. If he has paid you are not bothered to whom you are given the money.

So, once you have collected the cash, what is there are two aspects in this transaction what is happening? Goods going out an one side, cash coming in an one side. From whom it has come? I do not care. You might have given the cheque, I might have got the cash from the bank, anything. Cash has come in, goods has gone out. One asset has gone out another asset has come in.

Debit what comes in what comes in in this particular case, the what aspect the asset that has coming in this case is basically cash account that has come in in this particular case, so cash has come in. Debit what comes in, credit what goes out in this particular case. So, I have debited what is come in, credited what has gone out in this particular case.

It says, you might say Raghavan Raghavan Raghavan out there because the question says Raghavan. I am not worried, once he has paid. You just imagine a situation. You go to a shop normal a Kirana store and buy some whatever your basic daily need. You pay cash and buy it. Is a customer is the owner of the shop really bothered to whom is he selling? As long has he received the cash it is does not even worry about it. For him transaction is a done deal.

Suppose, you say I stay round the street he knows you and are you say down the street and you are buying it and credit, then what he will be do? Madam, tell me or sir please tell me your name and then he will have a register he will enter your name only then he is bother, otherwise he is not there the transaction is not complete. Here transaction is complete in the process that, is they deal is over after that he is not worried. So, debit what is coming in, credit what is going out. In this case, I have debited what is called as cash. In this case, I credited what is called as sales in this particular thing.

One can argue. Sir, supposing he had not paid me completely in cash, he had paid 50 percent in cash, then what happens? Well, that is a good question. Then, what happens? If he has paid 50 percent in cash then I would say what is the cash you have got in? Cash I have got in in this particular case is basically only about 350. In this particular case, if I have cash received cash half of cash then I have received only 350 dollars in cash. Then what happens, the other 50 percent? Other 50 percent is still owes me. Debit the receiver, credit the giver out there. Who is receiving the credit from me? Raghavan is receiving the credit from me, that is that is what is called a debit the receiver. Who is receiving? I am giving; please look at it from your company's point of view.

From your company's point of view you are giving that basically credit to him, debit the receiver. Who is receiving the benefit of that credit? The benefit of that credit is received by Raghavan, that is what we call it as in accountants accountings we call it as debtors out there, debtors account debited another 350. Yours credit account remains exactly the same, that does not change. Because basically, why it does not change? Because that is the amount of goods to which, that is the amount to extent to which goods have basically gone out of your company out there. Am I with you one this.