CHAPTER 3

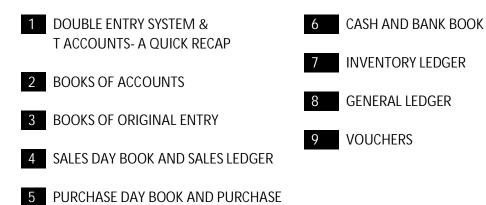## WHERE ARE ACCOUNTING TRANSACTIONS RECORDED?

10 DOUBLE ENTRY & T ACCOUNTS – A QUICK RECAP

By now, you will have familiarized yourself with Double Entry System and T Accounts. These two concepts will be repeatedly used in this Chapter. Double Entry system is the backbone of Accounting and is closely linked to the use of T Accounts.

11 BOOKS OF ACCOUNTS

Books of Accounts refers to registers, papers and documents which are usually maintained by Businesses, in one form or another, for the purpose of recording financial transactions. The number and format of Books of Accounts can vary between Businesses but the purpose and information contained in these Books remains same.

Typically, following Books of Accounts are used to record Accounting transactions:

- Sales Day Book & Sales Ledger.
- Purchase Day Book & Purchase Ledger.
- Cash & Bank Book.
- Inventory Ledger.
- General Ledger.

Deciding whether some or all of these Books of Accounts are required really depends on the size of the Business and the complexity of accounting & reporting requirements. However, these five Books will be more than sufficient to cater for all Accounting requirements that an SME is expected to have.

12 BOOKS OF ORIGINAL ENTRY

Before we discuss Books of Accounts in more detail, it is pertinent to introduce the concept of Books of Original Entry which refers to:

- Sales Day Book.
- Purchase Day Book.
- Cash & Bank Book.

Books of Original Entry are so called because these are the "first" books where an Accounting transaction gets recorded. These three Books also comprise of what is called the "Single Entry System", so called because financial transactions are recorded in these Books as either a "debit" or as a "credit" and not as a "debit" and a "credit" for each transaction as is required under Double Entry System of Accounting.

While Single Entry System of Accounting is simple and easy to follow, accounts can not be prepared from these Books. To understand this better, consider the following:

- Sales will be recorded but this System will not reflect how much is yet to be received from customers.
- Purchases and expenses will be recorded but this System will not reflect how much

is still payable to suppliers.

- Bank & Cash Book will show the balance in hand and in account but this System will not reflect how much has been spent in expenses, paid to suppliers, received from customers etc.

Because of these issues, Single Entry System has limitations with respect to being able to generate Accounts from them. However, this System is still in use because of its simplicity but is not a recommended method of Accounting for all external and internal purposes.

A word of caution here:

Sales Ledger, Purchase Ledger and Inventory Ledger are not part of the Double Entry System of Accounting. The purpose of these Ledgers is to give individual customer-wise, vendor-wise and inventory-wise balances by showing all "Debit" and "Credit" transactions against each account opened in the respective Ledgers.

In Accounting language, these are called Memorandum records. What this means is that while Double Entry Accounting is done using Day Books and General Ledger, transactions are also recorded in these Ledgers but only to update each individual customer, vendor and inventory account. By recording each transaction in the Day Book, General Ledger and the respective Ledgers, each entry will get recorded three times – this is not what a Double Entry System does. For this reason, the respective Ledgers are called "Memorandum Records" and are outside the purview of Double Entry System.

In General Ledger, as a mirror-image of each Ledger, Control Accounts are opened, e.g., Sales Ledger is represented in the General Ledger as Customers Control Account, Purchase Ledger as Suppliers Control Account and Inventory Ledger as Inventory Control Account. Every transaction which affects a customer, vendor or an inventory item is recorded in the General Ledger in the respective Control Account while it is also recorded in the respective Ledgers. Consequently, the balance on each Control Account should always equal the sum of balances on all accounts in each Ledger.

In the case of Cash & Bank Book, the status is different – Cash & Bank Book itself can be part of General Ledger (in which case, it is part of Double Entry System of Accounting) or can also act as a Memorandum record in which a Cash Control Account and a Bank Control Account will be separately maintained in the General Ledger. Both ways are correct.

The approach that we have taken in subsequent Chapters is as follows:

Sales Transactions

Double Entry: Sales Day Book & Customers Control Account

Memorandum Record: Sales Ledger

Purchase Transactions

Double Entry: Purchase Day Book, Purchase & Inventory Control Accounts

Memorandum Record: Purchase   Ledger&   Inventory   Ledger,   Cash   &   Bank

Transactions

Double Entry: Cash & Bank Book

Memorandum Record: None

13 SALES DAY BOOK & SALES LEDGER

Probably one of the most critical functions of a Business is the correct recording of sales and then monitoring its recovery. This is achieved by effective utilization of Sales Day Book & Sales Ledger.

13.1 SALES DAY BOOK

Sales Day Book is used to record all sales. The basis of an entry in the Sales Day Book is a Sales Invoice which a Business will normally raise in favor of another Business or individual, called "Customers".

Sales Day Book contains date-wise record of all sales, separate for each month, made by a Business to its customers, and usually contains information extracted from each sales invoice.

An example of a typical Sales Day Book is as follows:

SALES DAY BOOK					
Date	Customer Name	Description	Invoice No	Folio	Amount(Rs.)
Date of the transaction	Name of customer involved in transaction	Brief description of items which have been sold	Number of invoice which has been issued to customer	Page number in Sales Ledger where the transaction is recorded	The amount of transaction

An example of entries in Sales Day Book is as follows:

EXAMPLE # 3.1
Sales Day Book Transactions

Hussain Khaddar & Looms (Pvt) Limited had the following sale transactions:
1. On 2/9/05, sold 50 meters of Dyed Khaddar @ Rs. 210 per meter to M/s ABC & Co.
2. On 9/9/05, sold 75 meters of Greige Khaddar @ Rs. 100 per meter to Jhangeer Khan
3. On 13/9/05, sold 45 meters of White Khaddar @ Rs. 1,500 per meter to Jhangeer Khan

SALES DAY BOOK				Page No 50	
Date	Customer Name	Description	Invoice No	Folio	Amount (Rs.)
2/9/05	M/s ABC & Co	50 meters of Dyed Khaddar @ Rs. 210 per meter	50214	SL-1	10,500
9/9/05	Jhangeer Khan	75 meters of Greige Khaddar @ Rs. 100 per meter	50215	SL-2	7,500
13/9/05	Jhangeer Khan	45 meters of White Khaddar @ Rs. 1,500 per meter	50216	SL-2	67,500
	Sales for the month				85,500

13.2   SALES LEDGER

In the Sales Ledger, transactions originating from Sales Day Book and from Cash & Bank Book are recorded. Each customer's own account is opened in the Sales Ledger and all transactions with that customer are recorded in that Account so that, at any point of time, the balance on this Account will show how much money is to be received from that customer. The format of a typical account in Sales Ledger will be as follows.

SALES LEDGER					
	Account Name				Page No
Date	Ref No.	Description	Amount (Rs.) Debit	Credit	Balance (Rs.)
Date of the transaction	Page number of Day Book where the transaction is recorded	Brief description of transaction			

Continuing with Example # 3.1 above, the Sales Ledger account for the two customers would appear as follows:

SALES LEDGER					
	M/s ABC & CO				SL-1
Date	Ref No.	Description	Amount (Rs.) Debit	Credit	Balance (Rs.)
2/9/05	50	50 meters of Dyed Khaddar	10,500		10,500

SALES LEDGER					
	JHANGEER KHAN ACCOUNT			SL-2	
Date	Ref No.	Description	Amount (Rs.) Debit	Credit	Balance (Rs.)
9/9/05	50	75 meters of Greige Khaddar	7,500		7,500
13/9/05	50	45 meters of White Khaddar	67,500		75,000

14 PURCHASE DAY BOOK & PURCHASE LEDGER

Purchase of materials, incurring expenses and calculating amounts owed to suppliers usually involve a large number of transactions. Keeping a record of how much is owed and to whom is critical for smooth and efficient running of a Business.

14.1 PURCHASE DAY BOOK

Purchase Day Book is used to record all purchases i.e. those purchases, whether for material, stores, spares, equipment against which money is payable by the Business. The basis of an entry in the Purchase Day Book is a Purchase Invoice which a Business will normally receive from its suppliers.

A typical sample of a Purchase Day Book is as follows:

PURCHASE DAY BOOK					
Date	Supplier Name	Description	Invoice No	Folio	Amount(Rs.)
Date of the transaction	Name of Supplier	Brief description of the transaction	The invoice number as shown on invoice	Page number of purchase ledger where the transaction is recorded	The amount of transaction

An example of entries in a typical Purchase Day Book is as follows:

EXAMPLE # 3.2
Purchase Day Book Transactions
Hussain Khaddar & Looms (Pvt) Limited entered into the following purchase transactions: 1. On 2/1/06, 5 bales of Cotton @ Rs. 5,000 per bale are purchased from M/s GNJ & Co. 2. On 9/1/06, 250 Meter Cloth @ Rs. 50 per meter is purchased from M/s Shaheen Fabrics 3. On 23/1/06, 15 bales of Cotton @ Rs. 4,500 per bale are purchased from M/s GNJ & Co.

PURCHASE DAY BOOK				Page No 90	
date	Supplier Name	Description	Invoice No.	Folio	Amount (Rs.)
2/1/06	M/s GNJ & Co.	5 bales of Cotton @ Rs. 5,000 per bale	A-1028	PL-1	25,000
9/1/06	M/s Shaheen Fabrics	250 Meters of Cloth @ Rs. 50 per meter	SH-669	PL-2	12,500
23/1/06	M/s GNJ & Co.	15 bales of Cotton @ Rs. 4,500 per bale	9935	PL-1	67,500
`	Purchases for the month				105,000

14.2   PURCHASE LEDGER

Purchase Ledger records all transactions with each supplier so that at any point in time each supplier's account in Purchase Ledger will show the amounts owed by a Business. The source of transactions in Purchase Ledger is the Purchase Day Book and the Cash & Bank Book.

The format of a typical account in Purchase Ledger is as follows:

PURCHASE LEDGER					
Account Name				Page No	
Date	Ref No.	Description	Amount (Rs.)		Balance (Rs.)
			Debit	Credit	
Date of the transaction	Page number of Day Book where the transaction is recorded	Brief description of the transaction			

Continuing from Example # 3.2 above, the Purchase Ledger accounts for the two suppliers will appear as under.

PURCHASE LEDGER					
GNJ & Co.				PL-4	
Date	Ref No.	Description	Amount (Rs.) Debit	Credit	Balance (Rs.)
2/1/06	90	5 Bales of Cotton		25,000	25,000
23/1/06	90	15 Bales of Cotton		67,500	92,500

PURCHASE LEDGER					
SHAHEEN FABRICS				PL-5	
Date	Ref No.	Description	Amount (Rs.) Debit	Credit	Balance (Rs.)
9/1/06	90	250 meters of Cloth		12,500	12,500

15 CASH & BANK BOOK

Cash & Bank Book, as name implies, carries a record of all transactions carried out in cash or through a Business's bank account. Cash transactions are those which are paid for through petty cash, while Bank transactions are those which are directly dealt with through the bank account.

Considered as one of the most important Books of Accounts, accurate and complete maintenance of Cash & Bank Book is very important, and a prerequisite to preparing Accounts for any Business. Cash & Bank Book has wide applications as this Book may get used whether it is an entry for Sales, Purchases, or Expenses. Since the Cash & Bank Book is so frequently used, it becomes an important part of the Accounts of any Business. If a Business prepares Accounts in the absence of a Cash & Bank Book, or even where such a Book is not properly maintained, the Accounts will not be of any use.

Cash & Bank Book is also important because it controls, calculates and tells the liquidity, i.e. the cash position of a Business. As you will learn in more detail in Chapter 15, liquidity or cash position of Business is as important as profitability if not more – just the fact that a Business is making profits does not mean that the Business also has cash.

There have been many instances in history where profitable Businesses have been closed down only because these Businesses didn't have cash.

Back to the Cash & Bank Book for now - a typical example of a Cash & Bank Book is given below. It is also pertinent to mention here that a Business can have separate Cash & Bank Books but where these Books are maintained separately, the format must be same as if these Books were maintained together as one.

An example of a typical Cash & Bank Book is as follows:

GENERAL LEDGER									
CASH & BANK ACCOUNT								Page No	
Debit					Credit				
Date	Folio	Description	Cash (Rs.)	Bank (Rs.)	Date	Folio	Description	Cash (Rs.)	Bank (Rs.)

This is the example of a combined Cash & Bank Book in which there are separate columns for recording of both Cash and Bank related transactions. A Business may choose to have separate Books for both Cash as well as Bank related transactions, which is also acceptable. In subsequent Chapters, we have used separate Cash and Bank Books.

We will now consider the following example to show how transactions are recorded in a combined Cash & Bank Book.

EXAMPLE # 3.3

Cash & Bank Book

Hanif Auto had the following transactions in August '05:

On 1/8/05, Rs. 800,000 was deposited in Bank as advance from a customer
On 9/8/05, a vehicle was purchased in cash for Rs. 500,000
On 9/8/05, raw material was purchased in cash for Rs. 25,000
On 20/8/05, bank loan of Rs. 100,000 was repaid through cheque
On 29/8/05, a cheque for Rs. 25,000 was received for sale of an item

These transactions will be recorded in the Cash & Bank Book in the following manner:

GENERAL LEDGER

CASH & BANK ACCOUNT   GL-25

Debit   Credit

Date	Folio	Description	Cash (Rs.)	Bank (Rs.)	Date	Folio	Description	Cash (Rs.)	Bank (Rs.)
1/8/05	GL-1	Capital Account	800,000		9/8/05	GL-5	Vehicle Account	500,000	
29/8/05	GL-16	Sales Account		25,000	9/8/05	GL-6	Stock Account	25,000	
					20/8/05	GL-17	Loan Account		100,000

16 INVENTORY LEDGER

Inventory Ledger is the platform where all inventory related transactions e.g. purchases and sales get recorded. Inventory is used in broad context which includes raw material, finished goods, goods held for resale (trading), stores, spares & tools.

Separate accounts are opened for each inventory item in the Inventory Ledger and each account contains quantitative and numeric information on each inventory item. Locally, "Bin Cards" is a very popular term used in many Businesses, and each Bin Card can be considered as an individual account in the Inventory Ledger. A typical Bin card is shown on the next page.

BIN CARD					
Commodity:					
Date	Reference (GRN)	Receipt (Quantity)	Issue (Quantity)	Balance (Quantity)	Signatures

On the other hand, a typical Inventory Ledger is shown below:

INVENTORY LEDGER										
FULL DESCRIPTION OF ITEM										
Date	Ref No.	Receipt			Issue			Balance		
		Quantity	Rate (Rs.)	Amount (Rs.)	Qty	Rate (Rs.)	Amount (Rs.)	Qty	Rate (Rs.)	Amount (Rs.)

The basic difference between a Bin Card and the Inventory Ledger is that the latter also contains a 'rate' column.

17 GENERAL LEDGER

General Ledger is the back bone and foundation of all Accounting. All entries originating from Day Books and Cash & Bank Books get consolidated in the General Ledger. Various types of accounts are opened in the General Ledger whether it is for Assets, Liabilities, Income and Expense.

Within each category, further accounts can also be opened when needed of, e.g. within the category Expenses, the following further accounts may be opened:

- Telephone expense.
- Rent expense.
- Salaries expense.
- Utilities expense.

In case of Income, some examples of further accounts may be:

- Local sale of yarn.
- Export of cloth.
- Interest received from Bank.
- Sale of scrap.

In case of Assets, some examples of further accounts may be:

- Plant & machinery.

- Inventory.
- Accounts receivable.
- Stores & spare parts.
- Advance for purchases.

In case of Liabilities, some examples of further accounts may be:

- Bank loan.
- Accounts payable.
- Interest payable.
- Salaries payable.

After transactions have been recorded, balances are then derived from these accounts and presented in a certain manner which then become Accounts for the Business. How balances are derived from accounts will be discussed in more detail in Chapter 14.

You will recall the concept of "Control Accounts" and how these Control Accounts relate to individual Ledgers, i.e. Sales, Purchase and Inventory Ledgers. You will also recall that Control Accounts form part of the Double Entry System while Ledgers are only maintained as Memorandum records.

We will now illustrate this difference by showing Sales transactions in the following example:

EXAMPLE # 3.4

Control Accounts & Sales Ledger

Continuing from Example # 3.1 above, the transactions will be recorded in the following manner.

Sales are recorded in the Sales Day Book.

SALES DAY BOOK				Page No 50	
Date	Customer Name	Description	Invoice No	Folio	Amount (Rs.)
2/9/05	M/s ABC & Co	50 meters of Dyed Khaddar @ Rs. 210 per meter	50214	SL-1	10,500
9/9/05	Jhangeer Khan	75 meters of Greige Khaddar @ Rs. 100 per meter	50215	SL-2	7,500
13/9/05	Jhangeer Khan	45 meters of White Khaddar @ Rs. 1,500 per meter	50216	SL-2	67,500
	Sales for the month				85,500

The Double Entry is recorded in the Books of Accounts:

GENERAL LEDGER							
CUSTOMERS CONTROL ACCOUNT							GL-15
Debit				Credit			
Date	Folio	Description	Amount (Rs.)	Date	Folio	Description	Amount (Rs.)
30/9/05	GL-27	Sales Account	85,500				

GENERAL LEDGER							
SALES ACCOUNT						GL-27	
Debit				Credit			
Date	Folio	Description	Amount (Rs.)	Date	Folio	Description	Amount (Rs.)
				30/9/05	GL-15	Customers Control Account	85,500

The Memorandum Sales Ledger accounts for both the customers are updated.

SALES LEDGER							
			ABC & CO				SL-1
Debit				Credit			
Date	Folio	Description	Amount (Rs.)	Date	Folio	Description	Amount (Rs.)
2/9/05	GL-27	Sales Account	10,500				

SALES LEDGER							
			JHANGEER KHAN				SL-2
Debit				Credit			
Date	Folio	Description	Amount (Rs.)	Date	Folio	Description	Amount (Rs.)
9/9/05	GL-27	Sales Account	7,500				
13/9/05	GL-27	Sales Account	67,500				

If these were the only transactions for a Business, the balance on Customers Control Account will stand at Rs. 85,500 while the sum total of balances due from each customer in the Sales Ledger also stands at Rs. 85,500. Also, you will note that the Control Account only gives the total balance while the Sales Ledger gives the breakup of this balance between each individual customer. And, this is the main reason why individual Ledgers are maintained despite the fact that these Ledgers do not form part of the Double Entry System.

18 VOUCHERS

Vouchers are documents used by Businesses to record Accounting entries in the Books of Accounts. The purpose served by these Vouchers is to:

- Document the Accounting entries.
- Show the debit and credit of each transaction.
- Show the account name and number where the transaction is being recorded.
- Show and facilitate approval process to ensure that Accounting is correct.
- Names of Vouchers, their format and the information included therein vary between Businesses. Two of the commonly used Vouchers are Cash & Bank Payment Voucher (Appendix 03-01) and Journal Voucher (Appendix 03-02).

Where an Accounting entry is to be recorded which has not originated from any Day Book, it is recorded through a Journal Voucher.

Besides the Vouchers named above, a Business can also choose to have a Purchase Journal Voucher or a Sales Journal Voucher to record sale and purchase related transactions in the General Ledger.

CHAPTER HIGHLIGHTS

What have we covered?

1. There are five Books of Accounts split between Ledgers and Day Books.

2. Sales Day Book and Sales Ledger are used to record sales related transactions.

3. Purchase Day Book and Purchase Ledger are used to record purchase related transactions.

4. Cash & Bank Book is used to record receipt and payment transactions.

5. General Ledger is mandatory for all Businesses who may also choose to have other Books of Accounts.

6. Inventory Ledger records inventory related transactions.

7. The Ledgers do not form part of Double Entry System of Accounting – these are only memorandum records.

8. Control accounts are opened in General Ledger to represent each Ledger – these control accounts are part of Double Entry System.

9. Vouchers are forms on which journal entries are documented.

APPENDIX 03-01   CASH PAYMENT/ BANK PAYMENT VOUCHER

BUSINESS NAME

☐ Cash OR Bank Payment

Voucher No:

Date:

Pay to Mr./Ms

Account #	Description	Debit (Rs.)	Credit (Rs.)
	Total		

The Sum of Rupees

Prepared By   Approved By   Received By

APPENDIX 03-02   JOURNAL VOUCHER

BUSINESS'S NAME

| | | JV. No | |
| | | JV Date | |

Account #	Explanation	Debit (Rs.)	Credit (Rs.)
	Total		

Prepared By		Approved By	
Signature		Signature	
Title		Title	

19 CASE STUDIES

So far, we have learnt the basic principles of Accounting. In subsequent Chapters, we shall apply these principles to see how Accounting is done and how Accounts are prepared from a typical set of Books of Accounts. We have prepared two Case Studies which will be used to show and explain how Accounting gets done in various circumstances during a Business's life cycle.

CASE STUDY # 1

HUSSAIN KHADDAR & LOOMS (PVT) LIMITED

Hussain Ahmed and his wife originally started this Business way back in 1981. They started off with 2 looms in 2 small rented rooms with only two karigars. Over the last 20 years, the Business has done well and now has 20 looms, 18 more were purchased in 1986, 1989 and 1992. The factory is now located on 2 kanals of land bought in 1985 at a cost of Rs. 250,000/- per kanal.

Hussain Ahmed's two sons have now completed their education and are interested in joining their father's family business. They have proposed that the family should form a Company under the name of Hussain Khaddar & Looms (Pvt) Limited in which all the existing business will get transferred. Since the family has been in this Business for more than two decades, they have established a good name for reliable quality products. Sons have proposed that the family should expand the Business by doubling the number of looms: some funds can be arranged by Hussain from his savings while for the remaining expenditure, they will have to seek a Bank's assistance. In line with the expansion plans, increased factory space and land will be required.

Khaddar is mostly sold on credit through agents in Faisalabad and Lahore for which the Company will have to pay commission to agents at 1%. Yarn will be purchased from "soot mandi" mostly on cash while some spinning mills will also offer credit.

CASE STUDY # 2

HANIF AUTO ENGINEERING

Hanif Mahmood and Nabeel Mansoor, two friends from school days, have 10 years' experience with a very large car dealership cum workshop in Lahore. In 2005, Hanif and Nabeel decided to leave their jobs to start their own similar Business. They decided to form a partnership under the name of Hanif Auto Engineering.

Hanif's residence is in central Lahore where he has two large size empty sheds in the backyard and these will be converted into workshop cum spare parts sale shop. Equipment and other items of machinery will be purchased from the local market. Both Nabeel and Hanif have some savings of their own, however, they feel that some long term facility may also be required. On the other hand, the Business will definitely need some working capital which has already been arranged for by Hanif through a local Bank.

Hanif Auto Engineering plans to employ two mechanics, one electrician, one painter and five helpers. Spare parts will be purchased from Karachi both in cash and on credit terms from distributors while some specialized parts will be purchased directly from manufacturers. Sales will normally be in cash but some corporate customers may ask for credit which will be given on a case to case basis.