Chapter Introduction

The ledger accounts of a business are the main source of information used to prepare the financial statements. However, if a business were to update their ledger each time a transaction occurred, the ledger account would quickly become cluttered and errors might be made. This would also be a very time consuming process.

To avoid this complication, all transactions are initially recorded in a book of prime entry. This is the simple note of the transaction, the relevant customer/supplier and the amount of the transaction. It is, in essence, a long list of daily transactions. Books of original entry are also known as either 'journals' or 'daybooks'. The term 'day book' is, perhaps, more commonly used, as it more clearly indicates the nature of these books of original entry - entries are made to them every day.

Several books of prime entry exist, each recording a different type of transaction:

<table>
<thead>
<tr>
<th>Book of prime entry</th>
<th>Transaction type</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales day book</td>
<td>Credit sales</td>
</tr>
<tr>
<td>Purchases day book</td>
<td>Credit purchases</td>
</tr>
<tr>
<td>Sales returns day book</td>
<td>Returns of goods sold on credit</td>
</tr>
<tr>
<td>Purchases returns day book</td>
<td>Returns of goods bought on credit</td>
</tr>
<tr>
<td>Cash book</td>
<td>All bank transactions</td>
</tr>
<tr>
<td>Petty cash book</td>
<td>All small cash transactions</td>
</tr>
<tr>
<td>The journal</td>
<td>All transactions not recorded elsewhere</td>
</tr>
</tbody>
</table>
At the end of each topic you should be able to;

- Explain the main forms of business transaction and documentation
- Identify, explain and understand the main forms of accounting record, including:
  - Day books
  - The cash book
  - The journal
In every business a number of transactions and events will take place every day. The role of financial reporting is to effectively measure the effect of those transactions and events records the effects on the business and summarize those transactions and their consequences in a format that is useful to the users of the financial statements.

The main transactions that take place include sales, purchases and payroll related transactions. All of these transactions must be adequately captured by the financial reporting system.

With most transactions supporting document will be created to confirm the transaction has taken place, when the transaction took place and the associated value of the transaction. This documentation is vital to the financial accountant, who uses the information on the document as a data source to initiate the measurement and recording of the transactions.

The table below summarizes the main types of business documentation and sources of data for an accounting system, together with their content and purpose.

<table>
<thead>
<tr>
<th>Contents</th>
<th>Purpose</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quotation</td>
<td>Contents: Quantity/ description/details of goods required.</td>
</tr>
<tr>
<td>Purchase order</td>
<td>Contents: Details of supplier. E.g. name, address. Quantity/ description/ details of goods required and price. Terms and conditions of delivery, payments, etc.</td>
</tr>
<tr>
<td>Sales Orders</td>
<td>Contents: Quantity/ description/ details of goods required and price.</td>
</tr>
<tr>
<td>Goods dispatched note (GDN)</td>
<td>Contents: Details of supplier, e.g. name and address. Quantity and description of goods.</td>
</tr>
<tr>
<td>Invoice</td>
<td>Contents: Name and address of customer and supplier; details of goods, e.g. quantity, price, value, sales, tax, terms of credit, etc.</td>
</tr>
<tr>
<td>Statement</td>
<td>Contents: Details of supplier, e.g. name and address. Has details of date, invoice numbers and values, payments made, refunds, amount owing.</td>
</tr>
</tbody>
</table>
Once the relevant document/data source has been received by the financial accountant they have to make a record of it in an appropriate place in the accounting system. However, transactions cannot simply be entered into the financial statements for the shareholders; there is an accounting process that has to take place before the results for the year can be summarized.

The flow of information from the initial transaction to the financial statements is illustrated as follows:

<table>
<thead>
<tr>
<th>Data Source</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trail Balance</td>
</tr>
<tr>
<td>Books of Prime Entry</td>
</tr>
<tr>
<td>Ledger Accounts</td>
</tr>
<tr>
<td>Financial Statements</td>
</tr>
</tbody>
</table>

Sent by the firm to customers who have returned the goods. Checked with documents regarding goods returned.

Issued by the company receiving the goods. Cross referred to the credit note issued by the supplier.

Sent to supplier with, or as notification of payment.

Issued by the selling company indicating the payment received.
Books of Prime entry are the books in which we first record transactions. These are not accounts; they are simply books that record the details of a transaction, almost like a diary. The firm will have a separate book for each kind of transaction. The type of the transaction will affect which book it is entered into. Sales will be entered in one book, purchases in another book, cash in another book, and so on. The books of prime entry are used to record the following:

- The date on which each transaction took place - the transactions should be shown in date order;
- Details relating to the transactions are entered in a 'details' column; e.g. name of customer/supplier
- A folio column entry is made cross-referencing back to the original 'source document', e.g. the invoice;
- The monetary amounts are entered in columns included in the books of original entry for that purpose.

Advantages of keeping books of original entry

- Accounts can be found more easily by the use of the cross referencing nature of the books of original entry being kept.
- If records are lost then the ledgers and the books of original entry acts as a backup for each other.
- Acts as a 'listing device' for posting totals to various accounts, thereby saving labour.
- The commonly used books of original entry together with source document it used to record transactions are:

<table>
<thead>
<tr>
<th>Books of Prime Entry</th>
<th>Transaction Type</th>
<th>Source Document</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales daybook (or Sales journal)</td>
<td>for credit sales</td>
<td>Sales invoice</td>
</tr>
<tr>
<td>Purchases daybook (or Purchases journal)</td>
<td>for credit purchases</td>
<td>Purchase invoice</td>
</tr>
<tr>
<td>Sales returns day book/Returns inwards daybook (or Returns inwards journal)</td>
<td>for returns inwards</td>
<td>Credit notes</td>
</tr>
<tr>
<td>Purchases returns day book/Returns outwards daybook (or Returns outwards journal)</td>
<td>for returns outwards</td>
<td>Debit notes</td>
</tr>
<tr>
<td>Cashbook</td>
<td>for receipts and payments of</td>
<td>Cheque counterfoils (From the chequebook to show cheques paid out), paying in slips (Evidence of money paid into bank accounts), till rolls (Evidence of cash being received)</td>
</tr>
<tr>
<td>Petty cashbook</td>
<td>All small cash transactions</td>
<td>Petty cash vouchers</td>
</tr>
<tr>
<td>General journal</td>
<td>All transactions not recorded else where</td>
<td>Everything else not covered by above</td>
</tr>
</tbody>
</table>
2.1 Sales Day Book

A book in which non-cash sales are recorded with details of customer, invoice, amount and date; these details are later posted to each customer's account in the sales ledger.

A sales book is also known as sales day book is a book of prime entry in which are recorded the details of credit sales made by a businessman. Total of sales book shows the total credit sales of goods during the period concerned. Usually the sales book is totaled every month. The sales day book is written up daily from the copies of invoices sent out.

In many businesses most of the sales will be made on credit rather than for immediate settlement of the amount. For some businesses all sales will consist entirely of credit sales, while for some other firms, all will be for cash settlement. It is realistic to expect most firms to have some cash and some credit sales. All credit sales should be entered into the sales daybook.

The source document for the sales daybook is the sales invoice. A sales invoice is simply a business document containing all the details of the sale made. The business will keep a copy and will send another copy of the invoice to the customer. Details contained on the invoice would include:

- Name of customer
- Address of customer
- Date of sale
- Value of sales
- Any trade discount
- Any cash discount - and details of the conditions
- Invoice number

The sales book summarizes the daily sales made on credit terms (i.e. the goods are sold and payment is collected at a later date).

### Example

<table>
<thead>
<tr>
<th>Date</th>
<th>Invoice</th>
<th>Customer</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>30.4.14</td>
<td>1</td>
<td>Ruwan</td>
<td>4,900</td>
</tr>
<tr>
<td>30.4.14</td>
<td>2</td>
<td>Nuwan</td>
<td>3,800</td>
</tr>
<tr>
<td>30.4.14</td>
<td>3</td>
<td>Kamal</td>
<td>2,700</td>
</tr>
<tr>
<td>30.4.14</td>
<td>4</td>
<td>Sunil</td>
<td>10,500</td>
</tr>
<tr>
<td>30.4.14</td>
<td>5</td>
<td>Amal</td>
<td>2,500</td>
</tr>
</tbody>
</table>

Total for 30.4.14 24,400

The total sales for the day of Rs.24,400 will be entered into the accounting ledgers in double entry format.
2.2 Purchases day book

Purchases book or purchases day book is a book of original entry maintained to record credit purchases. You must note that cash purchases will not be entered in purchases day book because entries in respect of cash purchases must have been entered in the cash book. At the end of each month, the purchases book is totaled. The total shows the total amount of goods purchased on credit. Purchases book is written up daily from the invoices received. The invoices are consecutively numbered. The invoice of each number is noted in the purchases book.

The purchase day book summarizes the daily purchases made on credit terms (i.e. the goods are purchased and payment is made at a later date)

<table>
<thead>
<tr>
<th>Date</th>
<th>Invoice</th>
<th>Customer</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>30.4.14</td>
<td>34</td>
<td>Henry</td>
<td>2,750</td>
</tr>
<tr>
<td>30.4.14</td>
<td>11</td>
<td>Roshni</td>
<td>1,450</td>
</tr>
<tr>
<td>30.4.14</td>
<td>5609</td>
<td>Herath</td>
<td>4,875</td>
</tr>
<tr>
<td>30.4.14</td>
<td>2</td>
<td>Nuwan</td>
<td>7,550</td>
</tr>
<tr>
<td>30.4.14</td>
<td>577</td>
<td>Diluka</td>
<td>3,445</td>
</tr>
</tbody>
</table>

Total for 30.4.14

The total purchases for the day of Rs.20,070 will be entered into the accounting ledgers in double entry format.

2.3 Sales returns book

Sales returns book is also called returns inwards book. It is used for recording goods returned to us by our customers. The ruling of this book is exactly as for sales day book.

Credit Note:

Customers who return goods should be sent a credit note. It is a statement sent by a business to another person showing the amount credited to the account of the later. Credit notes are serially numbered and are similar in form to the invoices. These are usually printed in red ink. Credit notes issued to customers are vouchers for the entries appearing in the sales returns book.

The sales returns book summarizes the daily return of goods sold on credit terms

<table>
<thead>
<tr>
<th>Date</th>
<th>Invoice</th>
<th>Customer</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>30.4.14</td>
<td>1</td>
<td>Amal</td>
<td>500</td>
</tr>
<tr>
<td>30.4.14</td>
<td>2</td>
<td>Roshan</td>
<td>4,500</td>
</tr>
<tr>
<td>30.4.14</td>
<td>3</td>
<td>Damith</td>
<td>3,900</td>
</tr>
<tr>
<td>30.4.14</td>
<td>4</td>
<td>Sam</td>
<td>6,700</td>
</tr>
<tr>
<td>30.4.14</td>
<td>5</td>
<td>Sunil</td>
<td>2,300</td>
</tr>
</tbody>
</table>

Total for 30.4.14

17,900
The total sales returns for the day of Rs.17,900 will be entered into the accounting ledgers in double entry format.

2.4 Purchases returns book

Purchases returns book is a book in which the goods returned to suppliers are recorded. It is also called returns outward book or purchases returns day book. Goods may be returned because they are of the wrong kind or not up to sample or because they are damaged etc. The ruling of this book is absolutely the same as of purchases day book. The book and entries are made therein just the same as those made in the purchases day book.

Debit Note:

When the goods are returned to the suppliers, intimation is sent to them through what is known as a debit note. These debit notes serve as vouchers for these entries. A debit note is a statement sent by a businessman to another person, showing the amount debited to the account of the later. Debit notes are usually serially numbered and are prepared in the same

The purchases returns book summarizes the daily return of goods bought on credit terms

<table>
<thead>
<tr>
<th>Date</th>
<th>Invoice</th>
<th>Customer</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>30.4.14</td>
<td>112</td>
<td>Henry</td>
<td>1,600</td>
</tr>
<tr>
<td>30.4.14</td>
<td>56</td>
<td>Saman</td>
<td>750</td>
</tr>
<tr>
<td>30.4.14</td>
<td>7</td>
<td>Kamal</td>
<td>800</td>
</tr>
<tr>
<td>30.4.14</td>
<td>890</td>
<td>Nuwan</td>
<td>500</td>
</tr>
<tr>
<td>30.4.14</td>
<td>12</td>
<td>Diluka</td>
<td>1000</td>
</tr>
</tbody>
</table>

Total for 30.4.14        4,650

The total purchases returns for the day of Rs.4,650 will be entered into the accounting ledgers in double entry format.

2.5 Cash Book

Deals with both credit and debit transactions using cash. These transactions are totaled on a regular basis to be posted to the ledger, either directly or through the journal.

Single column cash book

Single column cash book records only cash receipts and payments. It has only one money column on each of the debit and credit sides of the cash book. All the cash receipts are entered on the debit side and the cash payments on the credit side.

A double column cash book

A double column cash book or two column cash book is one which consists of two separate columns on the debit side as well as credit side for recording cash and discount. In many concerns it is customary for the trader to allow or to receive small allowance off or against the dues.
These allowances are made for prompt settlement of accounts. In certain business almost all receipts or payments are accompanied by such discounts and in order to avoid unnecessary postings separate columns in the cash book are introduced to record the discounts received or allowed. These discount columns are memorandum columns only. They do not form the discount account. The discount column on the debit side of the cash book will record discounts allowed and that on the credit side discounts received.

A three column cash book

A three column cash book or treble column cash book is one in which there are three columns on each side - debit and credit side. One is used to record cash transactions, the second is used to record bank transactions and third is used to record discount received and paid.

When a trader keeps a bank account it becomes necessary to record the amounts deposited into bank and withdrawals from it. For this purpose one additional column is added on each side of the cash book. One of the main advantages of a three column cash book is that it is very helpful to businessmen, since it reveals the cash and bank deposits at a glance.

Writing a Three column Cash Book:

Opening Balance:
Put the opening balance (if any) on cash in hand and cash at bank on the debit side in the cash book and bank columns. If the opening balance is credit balance (overdraft) then it will be put in the credit side of the cash book in the bank column.

Cheque/Check or Cash Received:
If a cheque is received from any person and is paid into the bank on the same date it will appear on the debit side of the cash book as “To a Person”. The amount will be shown in the bank column. If the cheque received is not deposited into the bank on the same date then the amount will appear in the cash column. Cash received will be recorded in the usual manner in the cash column.

Payment By Cheque/Check or Cash:
When we make payment by cheque, this will appear on the credit side “By a person” and the amount in the bank column. If the payment is made in cash it will be recorded in usual manner in the cash column.

Contra Entries:
If an amount is entered on the debit side of the cash book, and the exact amount is again entered on the credit side of the same account, it is called “contra entry”. Similarly an amount entered on the credit side of an account also may have a contra entry on the debit side of the same account.

Contra entries are passed when:
Cash is deposited into bank by office: It is payment from cash and receipt in bank. Therefore, enter on credit side, cash column “By Bank” and on debit side bank column “To Cash”. The reason for making two entries is to comply with the principle of double entry which in such transactions is completed and therefore, no posting of these items is necessary. Such entries are marked in the cash book with the letter “C” in the folio column.

Cheque/Check is drawn for office use: It is payment by bank and receipt in cash. Therefore, enter on the debit side, cash column “To Bank” and on credit side, bank column “By Cash”.

Books of Prime Entry
Bank Charges and Bank Interest Allowed:

Bank charges appear on the credit side, bank column “Bank Charges.” Bank interest allowed appears on the debit side, bank column “To Interest”.

The main advantages of cash book are as follows:

- To have systematic and permanent record of all cash and banking transactions in a separate book.
- To obtain reliable and detailed information of all cash receipts and payments easily and immediately.
- To keep effective control over misappropriation of cash and banking transactions.
- To know the main sources and heads of payment of cash.
- To know cash and bank balances.
- To help to prepare cash budget and to avoid the possibility of having excess or shortage of cash.
- To make the cashier and other concerned officers accountable for all cash and banking transactions.

2.6 Petty cash book

In almost all businesses, it is found necessary to keep small sums of ready money with the cashier or petty cashier for the purpose of meeting small expenses such as postage, telegrams, stationary and office sundries etc. The sum of money so kept in hand generally termed as petty cash and book in which the petty cash expenditures are recorded is termed as petty cash book.

In large business houses, the cashier has to handle every day a large number of receipts and payments and if in addition to this he is further saddled with petty cash payments, his position becomes embarrassing. Besides, it is most common to find with large commercial establishments that all receipts and payments are made through bank. Since expenses like postage, telegrams, traveling etc, cannot be made by means of cheques, the maintenance of a small cash balance to meet these petty payments becomes all the more necessary.

A petty cash book is generally maintained on a columnar basis – a separate column being allotted for each type of expenditure. This is only one money column on the debit side and all sum received from time to time by the petty cashier from the chief cashier are entered in it. The credit side consists of several analysis columns. Every payment made by the petty cashier is entered on this side twice – Firstly it is recorded in the total column and then to the appropriate column to which the expense is concerned. The total of the “total column” will naturally agree with the total of all subsidiary columns. The difference between the total of the debit items and that of the “total column” on the credit side at any time will represent the balance of the petty cash in hand and this should tally with the petty cashier’s actual holding of cash.

The posting from the petty cash book to the respective accounts in the ledger are made directly in total at the end of every month or any other fixed period.

The Imprest System of petty cash:

The more scientific method of maintaining petty cash so for introduced into practice is the imprest system. Under this system a fixed sum of money is given to the petty cashier to cover the petty expenses for the month (Or even on weekly basis). At the end of a month the petty cashier submits his statement of petty expenses to the chief cashier. The chief cashier on the receipt of
such statement refunds to the petty cashier the exact amount spent by him during the month, thus making the imprest for the next month the same as it was at the beginning of the current month.

It is to be noted that the amount of cash in the hands of the petty cashier is a part of the cash balance; therefore it should be included in the cash balance when the latter is shown in the trial balance and the statement of financial position. It should also be kept in mind that petty cash book is not like the cash book. It is a branch of cash book.

The main advantages of imprest system of petty cash are as follows:

- As the petty cashier has to produce to the chief cashier the petty cash book for inspection, it acts as a healthy check on the petty cashier.
- As the petty cashier has to account for his expenses, before he can draw further sums, the petty cash book remains up to date.
- As the petty cashier cannot draw as and when he likes, it prevents unnecessary accumulation of cash in his hand thus the chances of defalcation of cash are minimized.
- Petty cash book maintains records of all petty payments systematically.
- Petty cash book supplies information regarding petty payments made on different heads more easily and quickly.
- Petty cash reduces the burden of head cashier as he is not required to handle petty transactions. Hence, the head cashier will have enough time to manage and control major cash transactions more effectively.
- Petty cash book saves time because each payment under particular head is not posted into the ledger separately. The posting is made with the periodical total at a time.

### 2.7 Journals

The journal is a book of prime entry which records transactions which are not routine (and not recorded in any other book of prime entry), for example:

- year-end adjustments
  - depreciation charge for the year
  - irrecoverable debt write-off
  - record the movement in the allowance for receivables
  - accruals and prepayments
  - closing inventory
- acquisitions and disposals of non-current assets
- opening balances for statement of financial position items
- correction of errors

The journal is a clear and comprehensible way of setting out a bookkeeping double entry that is to be made. Show if transactions are to be posted to the debtor or creditor side of the relevant ledger account.

**Presentation of a journal**

A journal should be laid out in the following way:

Dr Non-current asset \( \text{Rs.xxx} \)
Cr Payables \( \text{Rs.xxx} \)

A brief narrative should be given to explain the entry.
Transactions occur

Cash & Bank Transactions - Cash book
Small Cash Transactions - Petty cash
Credit Sales - Sales day book
Credit Purchases - Purchases day book
Credit sales returns - Sales returns day book
Credit purchase returns - Purchases returns day book

Dual Effect Records In Ledger Accounts
1. Mr. Mathew runs a business providing equipment for bakeries. Write up the following transactions arising in the two weeks of April 2014 into the relevant day books.

- 1st April Mrs. Sandra buys Rs. 5000 worth of cake tins.
- 1st April Mr. Mathew purchases Rs. 20,000 worth of equipment from Ceylon PLC.
- 3rd April Mr. Mathew returns goods costing Rs.3500 to another supplier, Cook PLC.
- 4th April Mr. Fernando buys Rs.12,000 worth of equipment.
- 5th April Mrs. Sandra returns Rs.1000 worth of goods supplied to her.
- 5th April Mr. Jeson buys a new oven for Rs.5000.
- 5th April Mr. Mathew purchases Rs.2500 worth of baking trays from Sandwich PLC.
- 9th April Mr. Mathew purchases ovens costing Rs. 10,000 from Hot PLC.
- 9th April Mr. Mathew returns equipment costing Rs.3000 to Ceylon PLC.
- 11th April Mrs. Sandra buys oven costing Rs.6000.

2. On April 1, 2014 Amali Stores cash book showed debit balance of cash Rs.1,55,000 and bank Rs.135,750. During the month of January following business was transacted.

2014

Apr.1  Purchased office computer for cash Rs.55000; cash sales Rs.31500
       Deposited cash Rs.5000
       4  Received from Ruwan a cheque for Rs.25.500 in part payment of his account
       6  Paid by cheque for merchandise purchased worth Rs.10,050
       8  Deposited into bank the cheque received from Ruwan.
       10 Received from Khan a cheque for Rs.7750 in full settlement of his account and allowed him discount Rs.1500.
       12 Sold merchandise to Kamal Bros. for Rs.1,5000 who paid by cheque which was deposited in the bank.
       16 Paid Saman Rs.9150 by cheque, discount received Rs.500
       27 Paid to Ahmad by cheque Rs.6500
       30 Paid salaries by cheque Rs.17500
       30 Deposited into bank the cheque of Khan.
       30 Drew from bank for office use Rs.2500.
Required: Record the transactions in three column cash book

3. Tom Smart started a small printing business on 1 June. The following is a list of transactions which occurred during his first week of trading. Following relate to the petty cash expenditure incurred during the first week.

2014

Jun. 1  established the petty cash fund in the amount of 10,000
Jun. 2  Issued Voucher No. 1 for Sundry accessories for shop display Rs.1850.
Jun. 2  Issued Voucher No. 2 for Cleaning cloths, soap and disinfectant Rs. 975
Jun. 3  Issued Voucher No. 3 for One dozen marker pens & one box of printer labels Rs. 1750
Jun. 4  Issued Voucher No. 4 for Postage stamps Rs. 250
Jun. 6  Issued Voucher No. 5 for Petrol for delivery van Rs. 2500
Jun. 7  Replenished the fund

Required: Record the transactions in petty cash book