

JOURNAL ENTRIES



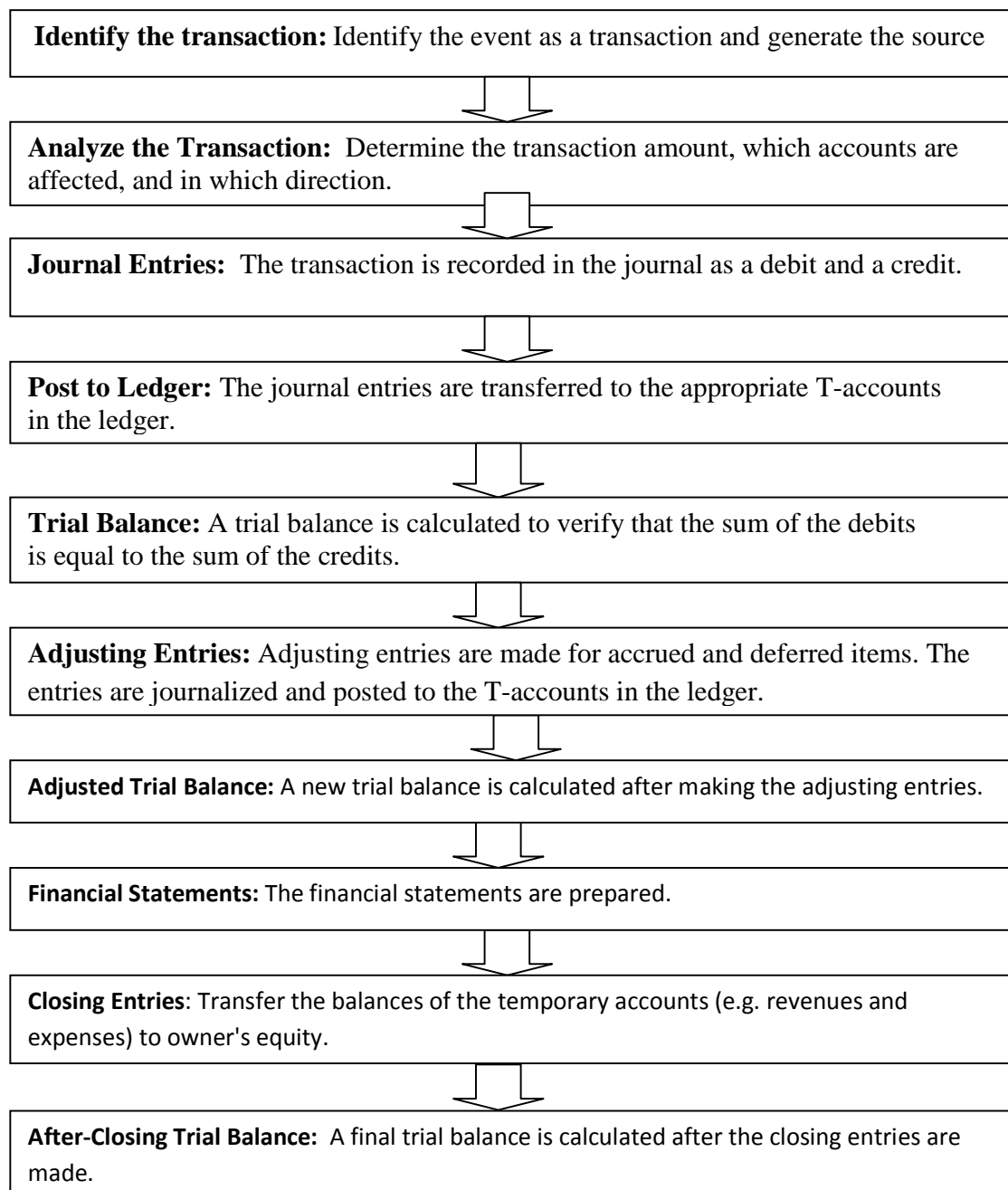
Odeny Okelo

Why is it important to pass the journal entries before extracting the ledgers? Your guess may be good as mine!

JOURNAL ENTRIES AND LEDGER ACCOUNT

The Accounting Cycle

The sequence of activities beginning with the occurrence of a transaction is known as the accounting cycle. This process is shown in the following diagram:



The Source Document

When a business transaction occurs, a document known as the source document captures the key data of the transaction. The source document describes the basic facts of the transaction such as its date, purpose, and amount. Some examples of source documents:

- Cash receipt
- cancelled cheques
- Invoice sent or received
- Credit memo for a customer refund
- Employee time sheet

The source document is the initial input to the accounting process and serves as objective evidence of the transaction, serving as part of the audit trail should the firm need to prove that a transaction occurred. To facilitate referencing, each source document should have a unique identifier, usually a number or alphanumeric code. Prenumbering of commonly-used forms helps to enforce numbering, to classify transactions, and to identify and locate missing source documents. A well-designed source document form can minimize errors and improve the efficiency of transaction recording.

The source document may be created in either paper or electronic format. For example, automated accounting systems may generate the source document electronically or allow paper source documents to be scanned and converted into electronic images. The source document is an early document in the accounting cycle. It provides the information required to analyze and classify the transaction and to create the journal entries.

Double Entry Bookkeeping

A business transaction involves an exchange between two accounts. For example, for every asset there exists a claim on that asset, either by those who own the business or those who loan money to the business. Similarly, the sale of a product affects both the amount of cash (or cash receivable) held by the business and the inventory held.

Two notable characteristics of double-entry systems are:

- ✓ Each transaction is recorded in two accounts
- ✓ Each account has two columns.

In a double-entry system, two entries are made for each transaction - one entry as a debit in one account and the other entry as a credit in another account. The two entries keep the accounting equation in balance so that:

$$\text{Assets} = \text{Liabilities} + \text{Owners' Equity}$$

To illustrate, consider a repair shop with a transaction involving repair service performed on Jan 4 for a cash payment of Kshs 275.00.

Date	Accounts	Dr	Cr
Jan 4	Cash	275.00	
	Revenue		275.00

Example I

Date Transaction

Sep 1 Owner contributes Kshs7500 in cash to capitalize the business.

Sep 8 purchased kshs 2500 in bike parts on account, payable in 30 days.

Sep 15 Paid first month's shop rent of kshs 1000.

Sep 17 Repaired bikes for kshs 1100; collected kshs 400 cash; billed customers for the kshs 700 balance.

Sep 18 kshs 275 in bike parts were used.

Sep 25 collected kshs 425 from customer accounts

Sep 28 Paid kshs500 to suppliers for parts purchased earlier in the month.

Journal Entries

After a transaction occurs and a source document is generated, the transaction is analyzed and entries are made in the general journal. A journal is a chronological listing of the firm's transactions, including the amounts, accounts that are affected, and

in which direction the accounts are affected. Because the journal is where the information from the source document first enters the accounting system, it is known as the book of original entry. A journal entry takes the following format: (Format of a General Journal Entry)

Date	Accounts	Dr	Cr
	Account to be debited	xxxx	
	Account to be credited		xxx
	Narration [a short notation that describes the transaction]		

Special Journals

The general journal is the main journal for a wide range of transactions. Of these, a business usually finds itself performing some types much more frequently than others. By grouping specific types of transactions into their own special journal, the efficiency and organization of the accounting system can be improved.

Some commonly-used special journals:

- Sales journal
- Purchases journal
- Cash receipts journal
- Cash disbursements journal

While a special journal may be organized differently from the general journal, it still provides the core transaction information such as date, debits and credits, and the relevant accounts.

Example one

Company A was incorporated on January 1, 2010 with an initial capital of 5,000 shares of kshs 20 par value common stock. During the first month of its operations, the company engaged in following transactions:

Date	Transaction
Jan 2	An amount of kshs 36,000 was paid as advance rent for three months.
Jan 3	Paid kshs 60,000 cash on the purchase of equipment costing kshs 80,000. The remaining amount was recognized as a one year note payable with interest rate of 9%.
Jan 4	Purchased office supplies costing kshs 17,600 on account.
Jan 13	Provided services to its customers and received kshs 28,500 in cash.
Jan 13	Paid the accounts payable on the office supplies purchased on January 4.
Jan 14	Paid wages to its employees for first two weeks of January, aggregating kshs 19,100.
Jan 18	Provided kshs 54,100 worth of services to its customers. They paid kshs 32,900 and promised to pay the remaining amount.
Jan 23	Received kshs 9,300 from customers for the services provided on January 18.
Jan 25	Received kshs 4,000 as an advance payment from customers.
Jan 26	Purchased office supplies costing kshs 5,200 on account.
Jan 28	Paid wages to its employees for the third and fourth week of January: kshs 19,100.
Jan 31	Paid kshs 5,000 as dividends.
Jan 31	Received electricity bill of kshs 2,470.
Jan 31	Received telephone bill of kshs 1,494.
Jan 31	Miscellaneous expenses paid during the month totaled kshs 3,470

The following table shows the journal entries for the above events.

Date	Account	Debit	Credit
Jan 1	Cash	100,000	
	Common Stock		100,000
Jan 2	Prepaid Rent	36,000	
	Cash		36,000
Jan 3	Equipment	80,000	
	Cash		60,000
	Notes Payable		20,000
Jan 4	Office Supplies	17,600	
	Accounts Payable		17,600
Jan 13	Cash	28,500	
	Service Revenue		28,500

Jan 13	Accounts Payable	17,600	
	Cash		17,600
Jan 14	Wages Expense	19,100	
	Cash		19,100
Jan 18	Cash	32,900	
	Accounts Receivable	21,200	
	Service Revenue		54,100
Jan 23	Cash	15,300	
	Accounts Receivable		15,300
Jan 25	Cash	4,000	
	Unearned Revenue		4,000
Jan 26	Office Supplies	5,200	
	Accounts Payable		5,200
Jan 28	Wages Expense	19,100	
	Cash		19,100
Jan 31	Dividends	5,000	
	Cash		5,000
Jan 31	Electricity Expense	2,470	
	Utilities Payable		2,470
Jan 31	Telephone Expense	1,494	
	Utilities Payable		1,494
Jan 31	Miscellaneous Expense	3,470	
	Cash		3,470

Example two

Following are transactions extracted from the books of XYZ Ltd (figures in Kshs)

1. Cash brought in by proprietor as capital. 30000

Journal Entry

Cash Account Debit 30, 000

Proprietor's capital Account Credit 30,000

2. Goods purchased on credit from Madan 5,000

inventory account debit 5000

Madan account (ac payable) credit 5000

3. Furniture purchased for cash 10000

Furniture Account Debit 10,000

Cash Account Credit 10,000

4. Goods sold on credit to Dev 1600

Dev Account (ac receivable) Debit 1600

Sale Account Credit 1600

5. Goods purchased for cash 4500

inventory account debit 4500

Cash account credit 4500

6. Goods sold for cash 2100

Cash account debit 2100

Sale account credit 2100

7. Rent paid for shop to landlord 3000

Rent Account Debit 3000

Cash Account Credit 3000

8. Commission received in cash 2000

Cash Account Debit 2000

Commission Account Credit 2000

9. Cash deposited into bank 5000

Bank Account Debit 5000

Cash Account Credit 5000

10. Cash withdrawn from bank for office use 2000

Cash Account Debit 2000

Bank Account Credit 2000

11. Cash drawn by proprietor from business for personal use 3000

Drawing Account Debit 3000

Cash Account Credit 3000

12. Goods given as charity 1000

Charity Account Debit 1000

inventory Account Credit 1000

13. Bad Debts written off 500

Bad Debt Account Debit 500

Debtor Account Credit 500

14. Bad debts recovered in cash 300

Cash Account Debit 300

Bad Debts Recovered Account Credit 300

15. Carriage paid on machinery- (part of cost of machinery, so machinery account will be debited) **Rs. 1000**

Machinery Account Debit 1000

Cash Account Credit 1000

16. Depreciation on fixed assets 500

Depreciation Account Debit 500

Fixed Asset Account Credit 500

Example Three

Journalize the following transactions and post them to the ledger accounts concerned:

1991

Jan. 1	Purchased goods for cash	2,000
Jan. 3	Sold goods to Karim	500
Jan. 10	Received from Karim	500
Jan. 15	Purchased machinery for cash	1,000
Jan. 20	Cash sales	300
Jan. 25	Sold goods to Rahim & Sons	600
Jan. 28	Received from Rahim & Sons	590
	Discount allowed	10
Jan. 30	Paid Rent	50
Jan. 31	Paid Salaries	100

Solution:

Date	Particulars	L.F.	Debit	Credit
Jan. 1	Purchases Account	12	2,000	
	To Cash Account	13		2,000
	(Goods purchased for cash)			
<hr/>				
Jan. 3	Karim	14	500	
	To Sales Account	15		500
	(Goods sold on credit)			
<hr/>				

Jan. 10	Cash Account	13	500	
	To Karim Account	14		500
	(Cash received)			
<hr/>				
Jan. 15	Machinery Account	16	1,000	
	To Cash Account	13		1,000
	(Machinery purchased)			
<hr/>				
Jan. 20	Cash Account	13	300	
	To Sales Account	15		300
	(Goods sold for cash)			
<hr/>				
Jan. 25	Rahim & Sons	17	600	
	To Sales Account	15		600
	(Goods sold on credit)			
<hr/>				
Jan. 28	Cash Account	13	590	
	Discount Allowed	18	10	
	To Rahim & Sons	17		600
	(Cash received, discount allowed)			
<hr/>				
Jan. 30	Rent Account	19	50	
	To Cash Account	13		50
	(Rent paid)			
<hr/>				
Jan. 31	Salaries Account	20	100	
	To Cash Account	13		100
	(salaries paid)			
<hr/>				
	Total		5,650	5,650

LEDGER ACCOUNT

When all the transactions of a given period have been journalized, the next thing is to classify them according to the accounts affected. All similar transactions must be brought together. For instance, all transactions relating to cash must be put in one place. The book in which this classification is done is called the **ledger**.

The *ledger* is a book which contains a condensed and classified record of all the financial transactions of the business generally brought, transferred or posted from the books of original entry.

Ledger is called the king of all books of accounts because all entries from the books of original entry must be posted to the various accounts in the ledger.

Features of Ledger:

The following are the features of ledger.

1. It has two identical sides - left hand side and right hand side. The left hand side is called debit side and right hand side is called credit side.
2. Debit aspects of all the concerned transactions is recorded on the debit side, while credit aspect on credit side according to date.
3. The difference of the total of the two sides represents balance. The excess of debit side over credit side indicates debit balance, while excess of credit side over debit side indicates credit balance. If the total of the two sides are equal there will be no balance.
4. Usually balance is drawn at the year end and recorded on the deficit side to make the two sides equal. This balance is known as closing balance.
5. The closing balance of the current year will be the opening balance of the next year

Main advantages of ledger

1. It is the ledger through which successful application of double entry system of bookkeeping is ensured. Each and every transaction is divided into two parts - receiver

and giver - and recorded in the two concerned accounts in ledger.

2. Transactions relating to different persons or concerns are recorded in the account of each person or concern separately. As a result, complete and reliable information is available in respect of each and every account.
3. Different types of income and expenses are recorded in different accounts separately. So, it is possible to ascertain the amount of income and expenditure under each head and the overall result at the year end through trading and profit and loss account.
4. Separate account is opened for each item of assets and liabilities. It is, therefore, possible to ascertain the value of different assets and liabilities and the true financial position at the year end through balance sheet.
5. Transactions being recorded primarily in journal and thereafter finally in ledger, the possibility of errors are remote.
6. Valuable information and statistics are collected from ledger and supplied to the management to enable them to run the concern efficiently.

Inventory Account

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
1991. Jan.1	To Cash a/c	30	2,000				

Cash Account

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
1991. Jan.10	To Karim	30	500	1991. Jan.1	By Purchases a/c	30	2,000
Jan.20	To Sales a/c	30	300		By Machinery a/c	30	1,000
Jan.28	To Rahim & Sons	30	590		By Rent a/c	30	50
					By Salaries a/c	30	100

Karim Account

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
1991. Jan.1	To Sales a/c	30	500	1991. Jan.10	By Cash a/c	30	500

Sales Account

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
				1991. Jan.3	By Karim	30	500
					By Cash a/c	30	300
					By Rahim & Sons	30	600

Machinery Account

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
1991. Jan.15	To Cash Account	30	1,000				

Rahim & Sons Account

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
1991. Jan.25	To Sales a/c	30	600	1991. Jan.28	By Cash a/c		590
					By Discount a/c		10

Discount Account

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
1991. Jan.28	To Rahim & Sons	30	10				

Rent Account

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
1991. Jan.30	To Cash a/c	30	50				

Salaries Account

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
1991. Jan.31	To Cash a/c	30	2,000				

Trial Balance / Accuracy of Ledger

A trial balance is a statement prepared by taking out the debit and credit balances of all accounts appearing in the ledger.

Objectives and Advantages of Preparing a Trial Balance:

The following are the main objectives of preparing a trial balance.

1. Trial balance helps in knowing the arithmetical accuracy of the accounting entries. Trial balance represents a summary of all ledger balances and, therefore, if the two sides of the trial balance tally, it is an indication of this fact that the books of accounts are arithmetically accurate.
2. Trial balance forms the basis for preparing financial statements such as income statement / Trading and profit and loss account and balance sheet. In case, the trial balance is not prepared, it will be almost impossible to prepare the financial statements.
3. The entire ledger is summarized in the form of a trial balance. Thus the position of a particular account can be judged simply by looking at the trial balance.

Proof of Accuracy:

If the debit and credit totals of the trial balance are equal and also correspond with the total of journal, we may be satisfied that the posting have been properly made and are arithmetically accurate.

How to Prepare a Trial Balance (Balance Trial Balance Method)

The task of preparing a trial balance under balance - trial balance method is much simplified. There is well known axiom that if equals are subtracted from equals the remainders are equal. On this assumption, in place of writing against each account the debit as well as the credit total the balance alone is written. The difference between the two sides of an account is called the balance. If the debit side of an account is greater than the credit side, the balance falls on the

debit side and is known as "debit balance." If the credit side of an account is greater than the debit, the balance is on the credit side and is called "credit balance."

Rules of Balancing Accounts: Rules of balancing each account is as follows:

1. Add up both sides of the account
2. Find out the difference in a separate slip.
3. Put the difference on the lighter side.
4. Add up both sides again.
5. Rule off.

Trial Balance

Ledger Account	J.F	Dr. Balance	Cr. Balance
		\$	\$
Cash Account		4,017	--
Sundry Debtors Account		9,222	--
Sundry Creditors Account		--	7,644
Discount Account		--	120
Purchases Account		26,670	--
Sales Account		--	32,145
Machinery Account		10,000	--
Building Account		20,000	--
Capital Account		--	35,000
Rent Account		3,400	--
Wages Account		600	--
Salaries Account		1,000	--
		74,909	74,909

A trial balance only checks the sum of debits against the sum of credits. That is why it does not guarantee that there are no errors. The following are the main classes of error that are not detected by the trial balance:

- An **error of original entry** is when both sides of a transaction include the wrong amount. For example, if a purchase invoice for Kshs 21 is entered as Kshs 12, this will result in an incorrect debit entry (to purchases), and an incorrect credit entry (to the relevant creditor account), both for Kshs 9 less, so the total of both columns will be Kshs 9 less, and will thus balance.
- An **error of omission** is when a transaction is completely omitted from the accounting records. As the debits and credits for the transaction would balance, omitting it would still leave the totals balanced. A variation of this error is omitting one of the ledger account totals from the trial balance.
- An **error of reversal** is when entries are made to the correct amount, but with debits instead of credits, and vice versa. For example, if a cash sale for Kshs 100 is debited to the Sales account, and credited to the Cash account. Such an error will not affect the totals.
- An **error of commission** is when the entries are made at the correct amount, and the appropriate side (debit or credit), but one or more entries are made to the wrong account of the correct type. For example, if fuel costs are incorrectly debited to the postage account (both expense accounts). This will not affect the totals.
- An **error of principle** is when the entries are made to the correct amount, and the appropriate side (debit or credit), as with an error of commission, but the *wrong* type of account is used. For example, if fuel costs (an expense account), are debited to stock (an asset account). This will not affect the totals.
- **Compensating errors** are multiple unrelated errors that would individually lead to an imbalance, but together cancel each other out.
- A **Transposition Error** is an error caused by switching the position of two adjacent digits. Since the resulting error is always divisible by 9, accountants use this fact to locate the misentered number. For example, a total is off by 72, dividing it by 9 gives 8 which indicates that one of the switched digits is either more, or less, by 8 than the other digit. Hence the error was caused by switching the digits 8 and 0 or 1 and 9. This will also not affect the totals.

Errors disclosed by the Trial Balance:

A Trial Balance will not agree on account of the following errors:

- Wrong posting of entries i.e. A debit entry of Kshs. 1,000 for purchase of furniture wrongly posted as Kshs. 100 in the account.
- Omission of posting of debit or credit e.g. A debit entry of Kshs. 1,000 for purchase of furniture is not posted at all.
- Duplication of posting e.g. when debit entry of Kshs. 1000 for purchase of furniture has been posted twice in the account.
- Wrong side of posting e.g. when debit entry is posted on the credit side or credit entry is posted on the debit side, e.g. when a debit entry of Kshs. 1000 is posted on the credit side, i.e. when debit entry of Kshs. 1000 is posted on the credit side and vice versa.
- Errors in casting the totals of debit or credit side of the Trial Balance.
- Wrong transfer of balances in the Trial Balance.
- Omission of entering the balance of account in the Trial Balance.
- Balance of cash book omitted to be recorded in the Trial Balance.
- Wrong balancing of account.
- Errors in the total or posting or entries of subsidiary book.
- Wrong carry forward of balance in the various books