Financial Accounting
Dr. Puran Singh
School of Humanities and Social Science
Indian Institute of Technology, Mandi

Lecture -28
2.9 Journalizing complex transactions

Hi, now is the time to go for some more complex transactions. When we say complex transactions, I do not mean difficult; it is just that the number of accounts involved are going to be more than two. So, three or four accounts can be involved in some of the transactions and we may need to write a combined journal entry. In this video, we are going to look at a bunch of such transactions, wherein multiple accounts will be involved.

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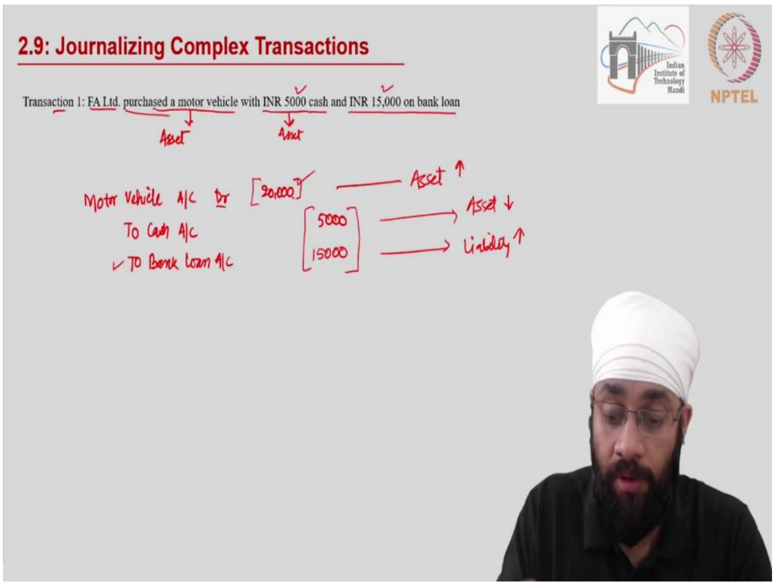

Let us get started. The first transaction says FA limited, Financial Accounting Limited, I have created a new company for you, FA limited purchased a motor vehicle 5000 cash and 15000 on bank loan. So, you know that you do a down payment for purchase of an asset and then, there is some loan which is taken from a financial institution. How do we write such journal entries? And have you noticed that I have removed that step-by-step template from the slide now. So, I am just going to jump on to how to write the journal entry and of course, we will do a discussion on how all of that was worked out. So, you are purchasing a motor vehicle. Motor vehicle is an asset. An asset is coming into the business, so debit what comes in. So, in my journal entry the motor vehicle account is debit. Now, the total value of the motor vehicle is 5000 plus 15000, so 20000. The value of the motor vehicle is 20000. I paid for it in cash, so cash is going out. Again, an asset is going out. Debit what comes in, credit what goes out. So, I am going to write To Cash A/c and the amount is 5000. Now, there is a balance of 15000. All debits have equal credits. So, debit was 20000, credit has to be 20000. So, the remaining 15000 is my bank loan. I am going to write To Bank Loan A/c; bank loan account or bank loan is a liability. The liability is getting created here, claims of business are going down which is shown as a credit here. Alternatively, bank is a personal account. Bank loan is a liability, hence a personal account. Bank loan represents bank’s claim on the business. The bank in this case is a giver of the loan to the business; debit the receiver, credit the giver and this is how we write a complex journal entry. We did look at a couple of journal entries in the tutorial video 29th and 30th journal entry, where we had discount allowed and discount received. But this is slightly different from that, in the sense that now you are purchasing a vehicle, you are doing with partial payments and so on. So, you have to think about such transactions. Again, summarizing this transaction motor vehicle is being purchased and two sources are being created here; motor vehicle gives rise to a new asset being generated, this is an asset that is going out, going down, going up and this is a new liability which is going up, liability has been created. Debits have equal credits. So, the total amount is equal on both sides.

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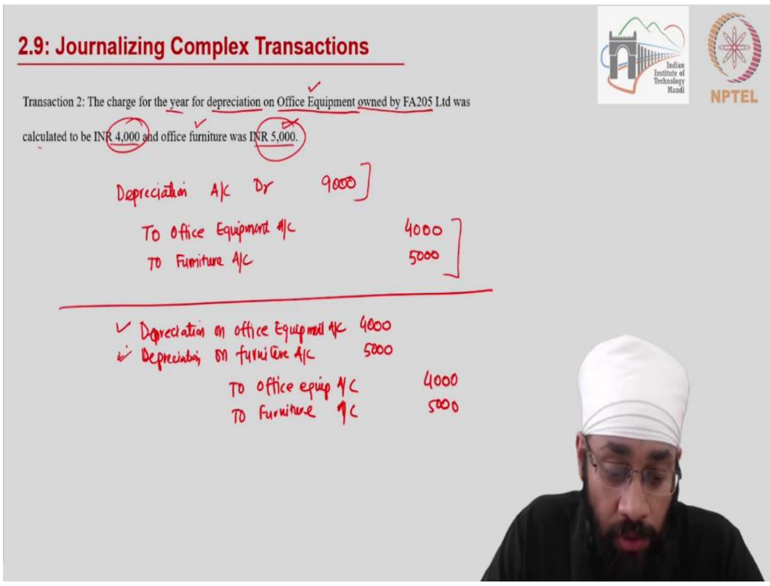

Let us look at another transaction. The charge for depreciation on office equipment owned by FA limited was calculated to be 4000 and office furniture 5000, for the year. So, there are a couple of asset items given to you. There is office equipment and office furniture and depreciation is being charged on both the assets. We know the journal entry for depreciation. The journal entry is Depreciation A/c (Dr.) and depreciation is charged on the asset. So, the asset name has to be written as well: office equipment account and the other asset is furniture, so, furniture account here. The total depreciation being charged is 5000 plus 4000 which is equal to 9000. 5000 depreciation is charged on office furniture and 4000 is being charged on office equipment. Again, depreciation is being charged on multiple assets and a single account is being created for depreciation. You could also segregate the depreciation in the following way. Let me give you an alternative to have depreciation. Depreciation on office equipment and you can have depreciation on office furniture and you could write them separately. So, office equipment has 4000 and you have 5000 for furniture; To Office Equipment A/c and To Furniture A/c. It is another way of keeping separate records. If you want to look at what is the total depreciation on one of the assets, then what do you do? You create a separate account for depreciation on each of the assets and you can write them together, rather writing two separate journal entries which consumes more space, you can write a combined journal entry which is called Complex journal entry as well and this is how you write it and I am not going through why I debited some accounts and why credited others because all of that should be pretty clear to you by now.

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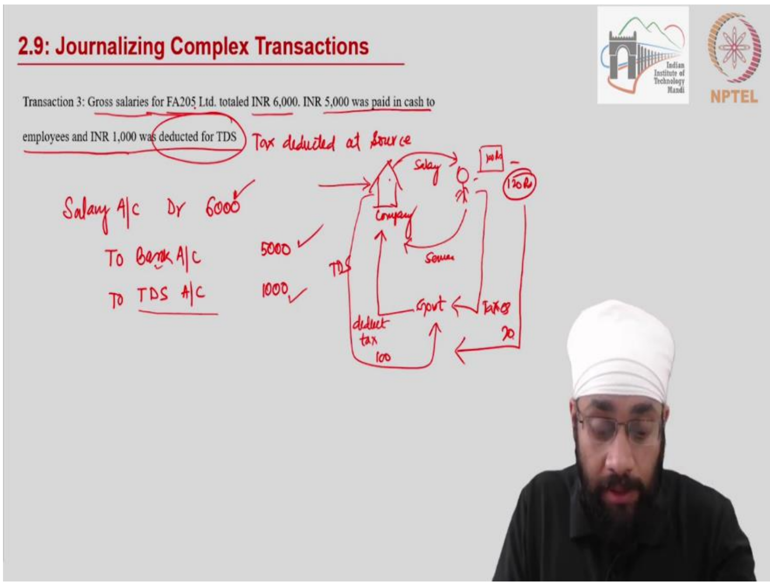

Let us go on to the next transaction. Transaction 3, gross salaries for the company totalled 6000, 5000 was paid in cash to the employees and 1000 was deducted as TDS. Now, some of you may be familiar with the concept of TDS. TDS is Tax Deducted at Source. Think of your companies, if you are working. When you work for an organization, this is the employee, this is the company. The employee provides services to the company and the company provides salary to the employee. Now, in this picture there is government. Let me bring in the government here. The government has a rule which says all the employers, all the companies who have employees and who pay salaries to the employees, are liable. The government has a regulation to deduct the tax. You should deduct the tax at source. What is the source? Source is the company. Company is the source of salary to the individual; the individual is then supposed to pay taxes to the government. Now, individuals will pay taxes to the government later on, but the government says if a company is paying salary to the individual, to the employee, then it is obvious that there will be some tax liability, some tax that the individual will have to pay at the end of the year. Now, the government does not want to let all taxes be pending and paid at the end of the year. So, the government says everybody has to pay the taxes as and when they get the salary. Enforcing that on individuals is difficult. So, they created a rule, where they said the company will pay tax, when they pay salary to the individual. They will not pay them the full salary; they will deduct a percentage typically 10 percent or depending upon what tax bracket you come in. They deduct a 10 percent, let us say, salary of yours and that salary through a direct channel goes into government treasury, this is TDS. This is called tax deducted at source by a company and then, at the end of the financial year, the individual is given a report that the company has deposited 100 rupees as tax already on your behalf. And then, you go to the website, where the tax is calculated, you go to the income tax website or you go to your chartered accountant and figure out what is the actual tax liability according to the taxation rates. It turns out that you have to pay 120 rupees as the tax, when 100 has already been paid. So, you only pay the remaining taxes which is; 20. So, the government benefited in the way that they already received this 100, they did not have to wait for the end of the year. So, the government gets revenue in that way and also, the employee does not have to worry about the end of financial year to pay 120 as tax: you only have to pay 20 because rest has been taken care of. Anyways, that was the concept of TDS. Now, this means that in this process, the TDS deducted by the company has to be paid to the government. So, it is kind of a liability for the company. The amount of TDS that the company keeps with itself has to be given to the government at a certain point in time. Till that time, this is a liability on the company. So, let us go to the transactions and try to journalize it. So, salaries are being paid. We know when you pay the salary, you say salary account debit. Now, the total salary to be paid is 6000. So, that is the gross salary. This is the company's expense and this will be paid through the bank account. So, you will write bank account 5000. All debits must have equal credit. Where is the remaining 1000? The remaining 1000 is the liability of the business of FA limited. So, you are going to write the name of the liability which is TDS account. This TDS is due to be paid to the government. Now, for the business, the salary expense is equal to 6000. The business can pay 6000 to the employee directly and only write To bank account, but the government rule says only pay 5000 to the employees and pay 1000 to the government by way of TDS. So, right now, TDS is not being paid; it was deducted, meaning the company has kept it in a separate bank account to be paid to the government. When it is paid to the government, you can write another journal entry which is separate. So, this is how you write another complex transaction in the books of accounts.

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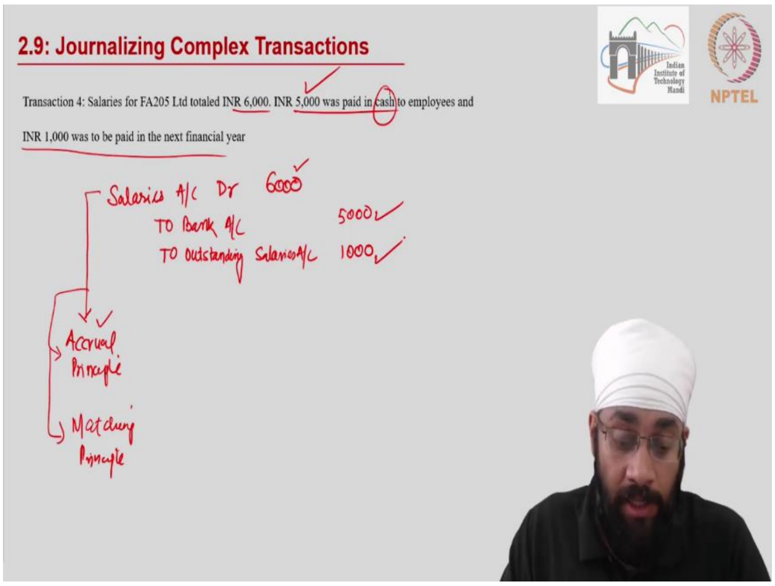

Let us look at other transaction salaries; salaries worth 6000; 5000 paid and 1000 to be paid in the next year. For a moment I thought, it is the same transaction that is why I paused. So, let us write the journal entry. You have salaries account debit total amount of 6000, this is the expense for the year. You have paid 5000 in cash. So, To Bank A/c, oh it says cash, but I am assuming money goes through a bank account; so, just following that understanding. You paid 5000 and 1000 will be paid in the next year. In the next year, 1000 is the balance, you will pay it later. This becomes outstanding, it is a liability; outstanding salaries account, what is happening here is that we are following accrual principle here. Accrual principle says you used the services of the people in this year and you produced whatever goods and services and you generated revenue. According to the accrual principle whether or not you paid this money, you have to recognize it as an expense. I am also invoking the other principle which is matching principle which says you have to match, you have to match the expenses of current year to the incomes of current year and the accrual principle says that; the expenses of current year are not only the expenses paid in cash, but even if not paid, even if they are due, you have to consider them as an expense. So, that is why we are showing 6000 as our total expense for the year or for the duration and you are actually paying 5000 and remaining 1000 becomes a liability.

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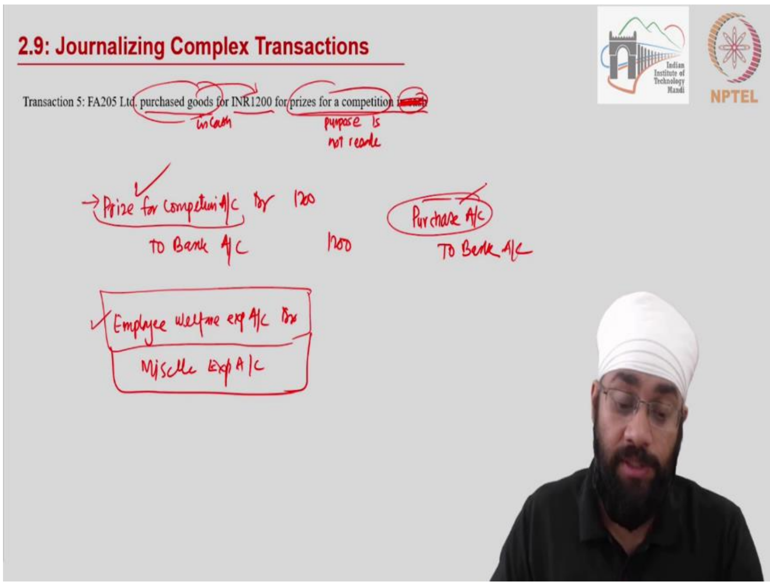

Let us go on to another transaction. Purchased goods 1200 for prizes for competition and you have paid for these goods in cash. The language of this transaction 5 is not very clear. What is happening here is that you purchase goods 1200; the intention, the purpose is not resale. Purpose is not a resale, the purpose is to give them away as prizes for some competition that you have and let me remove this and you say purchase goods in cash, you have purchased goods and you have paid for it in cash is what this means. So, how do we journalize this? Typically, you would do, and let me write it here, Purchase A/c (Dr.) because I am purchasing goods, To Bank A/c because I am paying for it. It says cash, but again we are assuming everything is happening through bank account. However, the purpose is not resale. If the purpose is not resale, what is the purpose? The purpose is prizes in the competition. Therefore, instead of purchase, we have an expense. We have prizes for competition, Prizes for competition A/c (Dr.) and you pay for it through your bank account; 1200, 1200. Well, this was not a combined journal entry, but a different kind of an entry, where the purchase of goods is being done with another intention. So, you should not confuse it with the regular purchase account in which the goods to be resold are written. So, those are prizes for competition. Now again, the right name of this account depends upon the business, you could give it an appropriate name. And what we have seen in case of the prescribed format of the financial statements, you have an item called employee welfare expenses. So, you could say employee welfare account expenses debit. I am assuming that these prizes are being given away in an annual staff competition of sorts, co-curricular activities, fun activities in the office or office parties. The idea is to incentivize staff to raise their morale and so on. So, you could club them under employee welfare expenses or it could go into miscellaneous expenses account as well, whatever is the company's policy. But the idea is that the name of the expense should be written instead of the purchase account.

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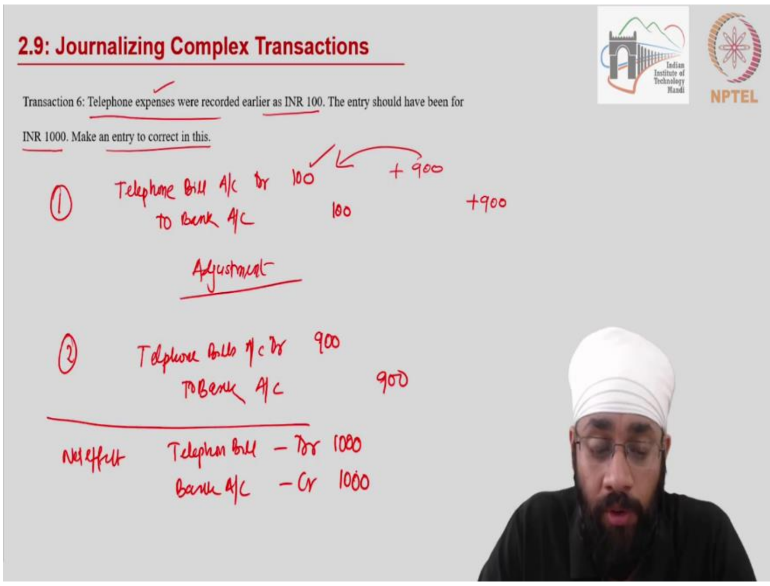

Let us go to another transaction. Telephone expenses were recorded earlier as 100, the entry should have been for 1000. Make an entry to correct. This again, is not a combined journal entry, but I am trying to get you to apply the concepts that you have learnt of debit and credit, increase in claim and so on. So, here, telephone expenses were recorded. When you recorded the telephone expenses you would have said Telephone Bill A/c (Dr.) 100 and you have paid for it through bank account, so To Bank A/c 100. However, the entry should have been for 1000 ,you made a mistake, how do you correct this mistake? One way is you delete this entry and then, you write a new entry. But without deleting this entry, how would you make an adjustment for it? So, we are trying to make an adjustment. The adjustment is going to be as follows. You have to increase it by 900, simple as that. In order to increase it by 900, what do you do? You have to increase the expenses; the expenses have to go up. You rewrite the journal entry, you say, Telephone Bill A/c (Dr.) and you write the remaining amount 900, To Bank A/c. What is the net effect? This is let us say part 1, part 2; the net effect is that the telephone bill has a debit of 1000 in total at the end of it and the bank account has a credit of 1000 in total which was what was expected to be done. So, just an application of how do you increase a debit in an account or decrease the debit in an account. That is what we wanted to do in this transaction.

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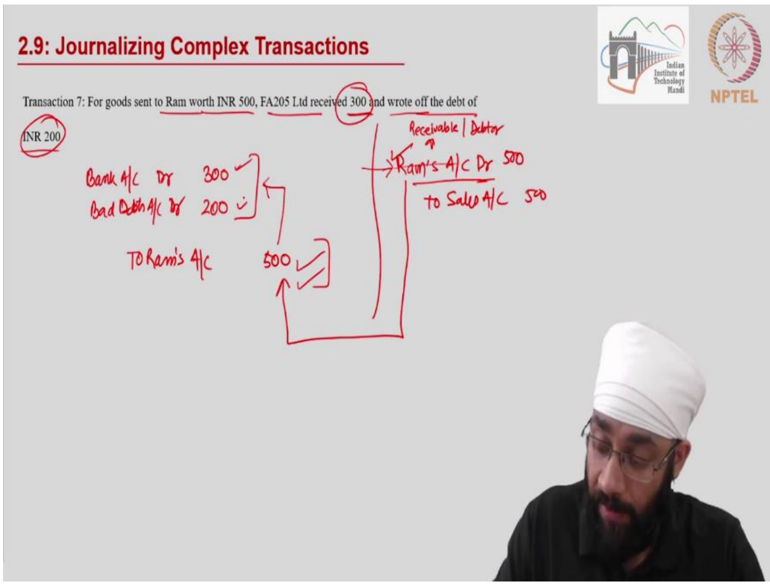

Transaction 7 for goods sent to Ram worth 500, the company received 300 and wrote off the bad debts of 200. So, this sounds like a customer; when you sold to this customer, the journal entry must have been Ram's account debit, To sales. So, this was 500 and this would have been done before. So, by giving a debit to Ram's account, you said we have a receivable. We have a receivable from Ram or this is a debtor, this is an asset 500 and now, you have received 300 from him. When you receive the money, you are going to say bank account debit; but only 300 and you are writing off the remaining 200 as a bad debt. You have new information which says he is not going to pay you. If he is not going to pay you, you have to first of all cancel the debit effect that you have, this asset is not going to be recovered. You have recovered part of it, but the remaining is not going to be recovered. So, you have to first of all cancel this. How do you cancel it? You cancel it by creating the opposite treatment, for debit 500 you create a credit 500. So, you are going to say To Ram's A/c 500. Now, there is no more recovery to be done from him. So, we have cancelled that. However, against this all debits must have equal credit. So, credit is 500, debits are less. So, remaining 200; 300 recovered, remaining 200 bad debt is a loss. All losses are debit, we are going to write bad debts account debit. Debits are 500, credits are 500. Ram's account has been adjusted because you no longer are going to recover this money from him or you have recovered a part of the money from him. In other way, as I said, assume that this has been cancelled and this has been converted into cash and a loss.

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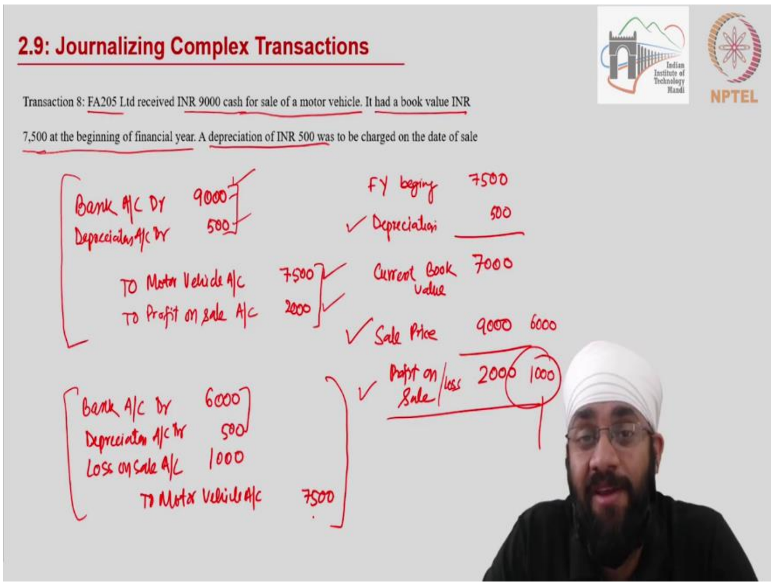

One last transaction, the company received 9000 cash for sale of the asset motor vehicle. The asset had a book value of 7500 at the beginning of the financial year. Now, we are talking about a financial year beginning and at this time the book value was 7500. A depreciation was charged. So, I am going to write about depreciation here; depreciation of 500 was charged which means the current book value of this motor vehicle is 7000 and it is being sold at the selling price of 9000. Sale price being higher than the book value means you are making a profit. So, profit on sale of an asset. We are making a profit here and we know profit is a gain and all incomes and gains are credit. Let me write the journal entry here. You are selling, so you are getting the money. How much money are you getting? You are getting 9000. Money is coming into your bank account, so you are going to write Bank A/c (Dr.) equal to 9000 which is being received. The asset is going out, the asset no longer exists, you do not have any claim on it. So, you have to cancel the debit that you would have given to the asset when you purchased it. You are going to write To motor vehicle A/c and the value of the motor vehicle was only 7500 at the beginning of the year, 7500. The vehicle goes out of the real account, asset goes out; debit what comes in, credit what goes out. So, credit to the motor vehicle. What else is happening is you are charging depreciation on the vehicle. When you charge depreciation, depreciation is considered an expense. So, all expenses are debit. I am going to write a depreciation account. Depreciation A/c (Dr.) 500. Now, debits and credits have to be equal. This is 9500, this is 7500, there is a 2000 which is missing. The 2000 is profit on sale. This is a gain. This is a nominal account; all incomes and gains are credit. So, you give a credit to the profit on the sale of the vehicle account and you are done. So, this is a complex journal entity. There are four accounts involved at the same time; the money is being received, there is depreciation charged, you have to write off the asset. When I say write off, I mean you have to cancel it because you have sold it and you have to show that you made a profit on its sale. There could also be a loss on sale and you know let us create that scenario as well. If instead of 9000, the selling price was 6000, then you would have made a loss of 1000. So, profit or it could be a loss; what would you do then? So, I am going to write that entry as well. Bank A/c (Dr.) instead of 9000, you get only 6000 here. Depreciation remains the same, it does not change. So, depreciation account debit 500 and the value of the motor vehicle remains the same. Motor vehicle account is credited 7500 alright. Now, debits must have equal credits. So, there is a balance of 1000 here. What is this 1000? This is a loss. All losses are debit; nominal account-debit expenses and losses. So, you write loss on the sale of motor vehicle account. Again, this is a complex journal entry and this is how you write it.

I have shown you both the cases where you make a profit on sale or loss on sale. It is possible that you sell the asset at the current book value and there is no profit or loss, that is also possible, I challenge you to do that transaction on your own. Alright, these were the transactions that I wanted you to go through, some complex transactions.

I will see you in the next video with some more journal entries.