Financial Accounting
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Lecture - 35
3.3 Balancing the Accounts

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In this video, we are going to talk about balancing the ledger accounts. After having posted the journal entries in the ledger accounts, what is next? You need to figure out the balances in these accounts. What is the amount to be paid or to be recovered? We had some discussion over it, but there is a little bit more that we need to formally discuss about balancing the accounts.

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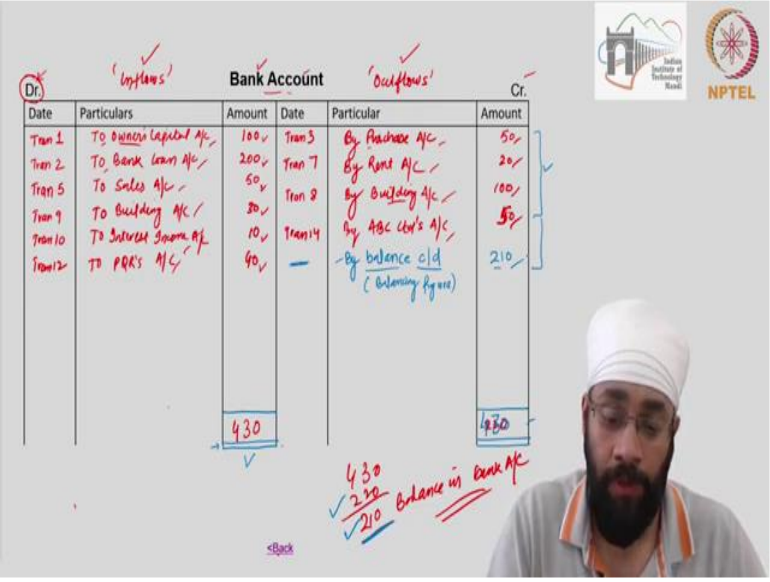

Let me quickly get another colour of ink, because already there is some text on the slide. Let me take a blue colour. So, there are some conventions that we need to understand. In the bank account, we did a total on the debit side and we closed the account. The process is called '*closing this account'* by placing you know one line on the top and two lines on the bottom of the total: this is a convention. 430 is the total on the debit side, and I am going to write the same total on the other side. So, I write 430 and I close this as well. However, we know the total on the credit side is only 220 and there is a 210-balance left. We are going to write that balance here, 210, and now when you sum this up it will be 430. And, we are going to write here By Balance c/d; c/d stands for carried down. It simply refers to the process that we have taken the total on the debit side and we have deducted the total of the credit side and finally we carry 210 down. We are going to carry the balance of 2010 to the next period after the 14 transactions. So, we are carrying this balance down after the 14 transactions. So, c/d stands for that, but necessarily what we are saying is that 210 is the balancing figure. This does not come out of any transaction. This is the result of all the transactions.

After you have done all of these, you put the date here, as we do not have a transaction number for this transaction and this is not necessarily a transaction here. So, you just put the last date of the financial year or the month whenever you are closing this account and you write 210. So, this is the balance in the bank account. This is the formal process of closing an account and figuring out what balance is left in this bank account.

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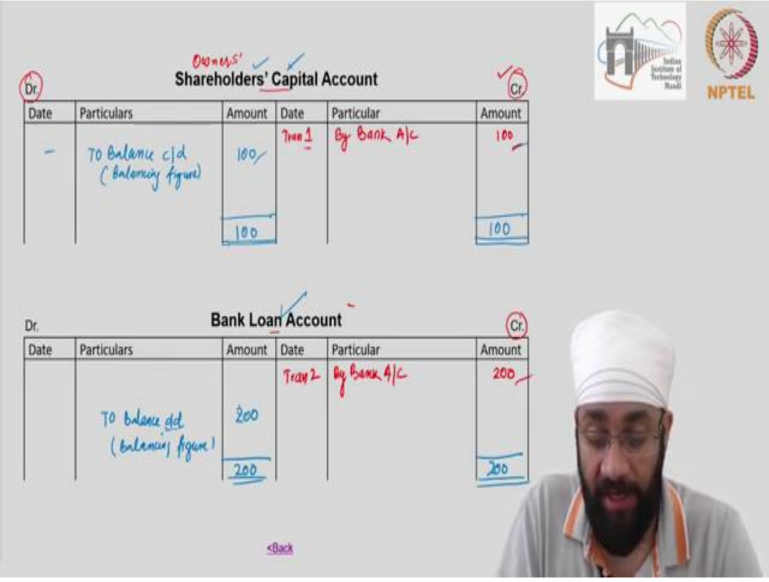

We can follow the similar process for all the accounts. So, for the shareholder capital account we have the amount on the credit side: I am going to sum this. As per the convention, two lines at the bottom of 100, this account, and then I write the total on the opposite side whichever side it may be. It is not necessary that you total the debit side always, you total whichever side's amount is higher. So, in the shareholder capital accounts case we have the amount on the credit side only. Now, we write it here and sum up the debit side which is 0. Then we deduct it from 100. So, you have 100 here as balance carried down. Again, the carried down has the same meaning. After all the 14 transactions that were done, we are carrying a balance of 100 in the capital account. Now, this is not a bank account to say that there is 100 money, but we are saying there is a balance of 100 in the capital account and capital is a liability for the business. So, business is carrying a liability equal to 100. The liability is towards the shareholders that is what it means. And here you put the last date of the financial year or the month or whenever you are closing this account. There you go this is how you close the shareholders capital account and this again is a balancing figure. This did not come out of any transaction. We followed the process of closing the ledger accounts and that is how we got to this number.

Let us go to the next, bank loan account, which has 200 on the credit side. So, I am just going to sum this up here 200 and I am going to total the debit side which is equal to nil. So, the balance is 200 and I am going to write To Balance c/d. This is also a balancing figure. A balancing figure means that you know this did not come from any transaction, but after the process of closing down this account. So, this means that the business, after the 14 transactions business, is still carrying a liability of 200.

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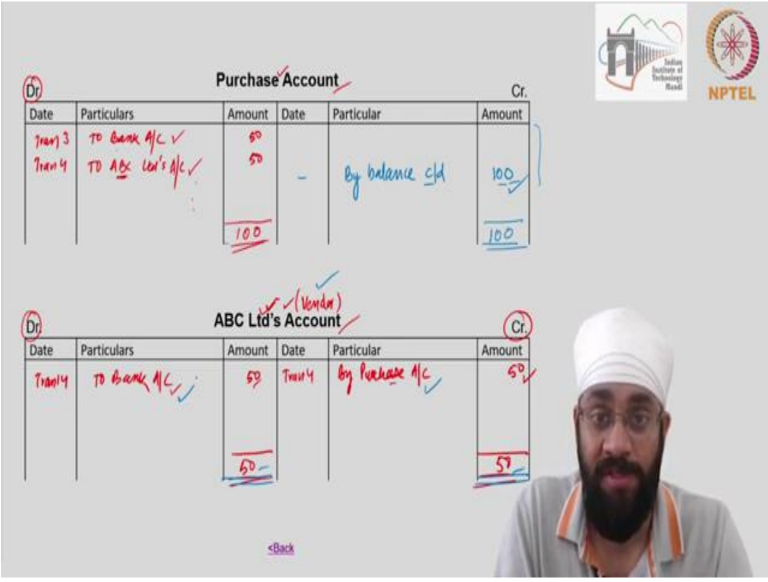

Follow the same process for purchase account. In this case, we have 100 total on the debit side. So, we just write it on the credit side. Then we figure out the total of the credit side which is 0, and find out the balance which is 100, of course. We write By Balance c/d and you put the last date or the date on which you are doing this. So, if you have a balance of 100 in the purchase account, that means that during the year or during the 14 transactions, whatever is the period, total purchases of 100 rupees have been made. Some of those can be cash or credit, it does not matter as accounting is done on an accrual basis. So, all the purchases are equal to 100. When you have to figure out your profit you have to deduct your expenses from incomes; you look at purchase expenses and you look at this account and you say 100. That is it, you do not need to worry about the hundreds of journal entries in the journal.

Alright let us go to ABC's account. ABC's account interestingly has 50 on the both sides already and I have closed the account in the previous video already. There is no balance. ABC was a vendor, you purchased from him 50, you paid him 50. There is no balance to be carried down. The business does not carry any liability towards ABC Limited that is what this account is indicating. There is no balance in this account.

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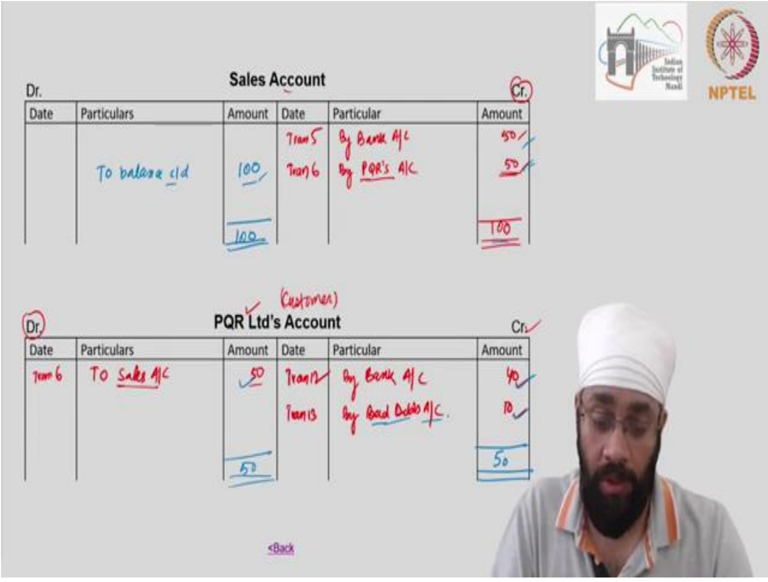

Next step you have a sales account. You write 100 here, because that is the total here and then you sum up the debit side which is 0 and you write the balance here which is 100. You write To Balance c/d. This means after the 14 transactions, after this period, the business conducted a total sale of 100. It can be cash or credit, it does not matter. What you are interested in is the total sale during the year, according to the matching principle, according to the accrual principle. So, the accrual principle says if you have transferred the goods and services and you have a legal right on obtaining the money from the customer you can consider this money as sale. You may not recover it in the future, then it can become a bad debt that is, but you have the legal right. So, you can consider credit sales as well. So, the total sale during the year 100, account closed.

PQR's account again interestingly has 50 on both sides. You sold goods worth 50 to PQR and then he paid you 40 and the remaining 10, as I said, have turned bad debts. So, you have given up hopes of recovering this 10, and you have considered this remaining balance. Instead of writing this as a balance carried down we have written this as bad debts. You cannot carry this balance, because it is highly improbable that you will recover this amount. So, it is considered a loss. No more money to be recovered from PQR, account has been closed.

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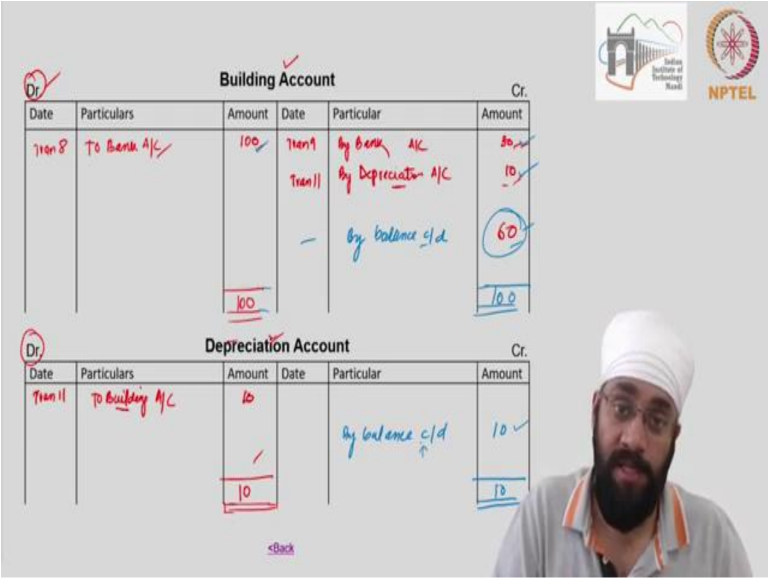

Building account: you have 100 total on the debit side, you can write this 100 here and in the previous video we have written 60 here as the balance. We write By Balance c/d. What does this mean? This means that the business is carrying a balance of 60 in the building. This is the book value of the building after the 14 transactions. There was 100 rupees worth of building that you bought, but you sold a building worth 30 and the value of the building has gone down because of wear and tear usage etc. by an amount of 10. So, the value left in the building account is only 60, you write the date here.

Depreciation account: again, you have only one single amount and you can just balance it by writing By Balance c/d 10. What does this mean? During the year total depreciation expense is equal to 10. The business is carrying or business has incurred an expense of 10 on depreciation.

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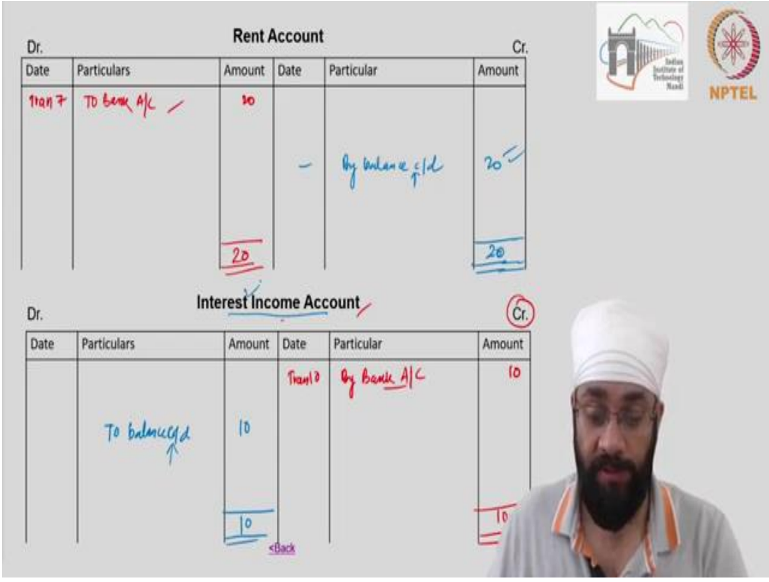

Rent account 20. This is the balance; I am going to write By Balance c/d and the last date of the financial year. Close this properly and this means the business is carrying a total rent expense of 20 during the 14 transactions. During a financial year, what is the amount of rent that has been paid by the business? How much rent expense should be shown in the income statement? 20, done.

Interest income account: again, I am just going to close this here 10, and you write To Balance c/d. This is the amount; this is the amount of income that business is carrying or the business has earned due to interest that is what it means.

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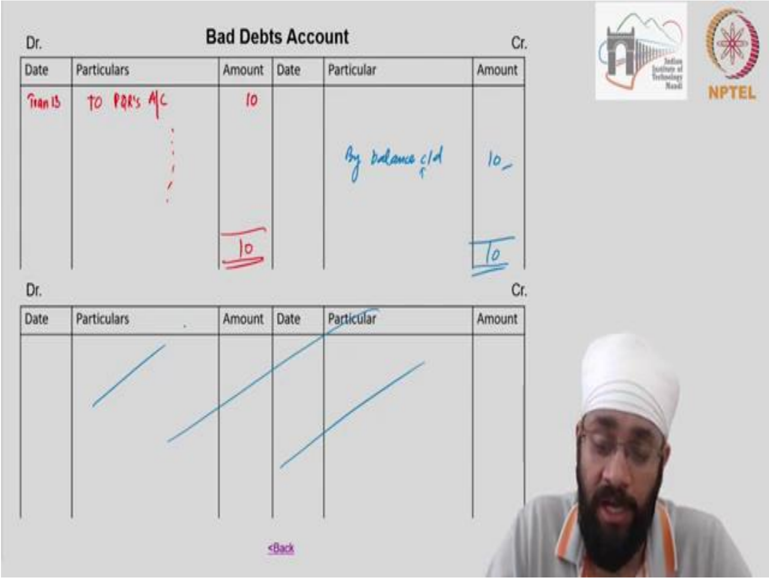

The last account is a bad debt account. You close this by writing By Balance c/d. The business is carrying a loss of 10 due to bad debts, that is what it means. This was an extra format. So, now we have completed the process of balancing.

We have learnt another thing about ledger posting. After you post it, you have to close the balances and you have to understand what these balances mean. So, now you should be familiar with how the accounts are closed and what this closing balance, the carried down balance indicates. I will continue this discussion in the next video.