

## Basics of Accounting. Unit V

Accounting is as old as civilization. It was the key to important phases of history & the most important professions such as economics & business.

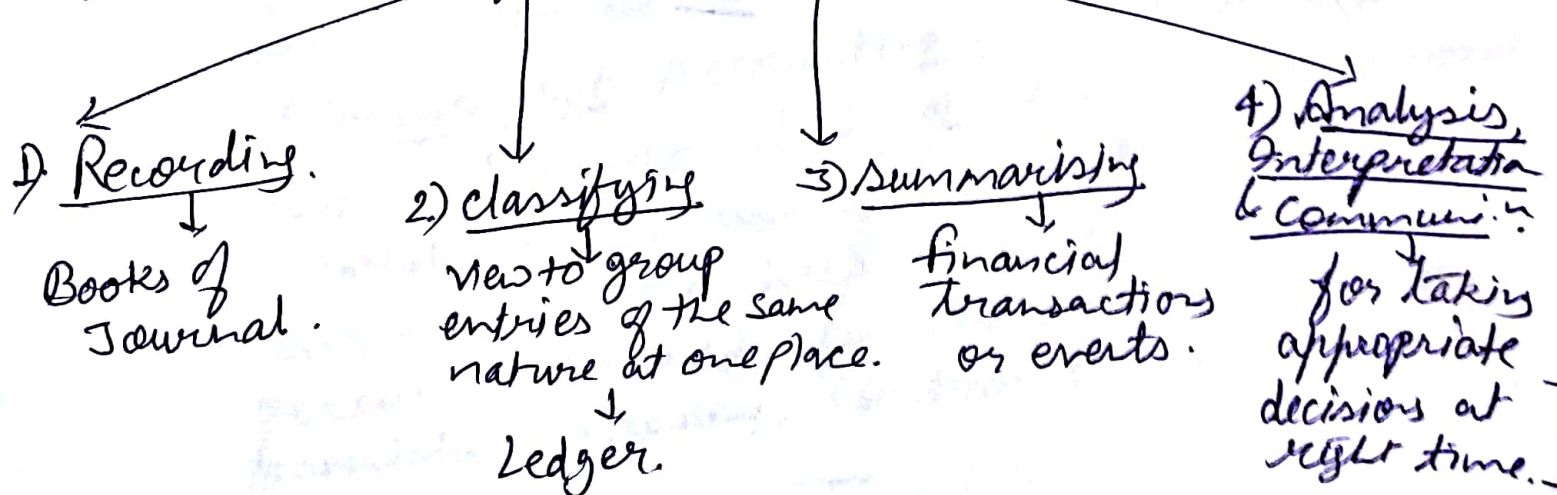
In 1494, Luca Pacioli, an Italian mathematician, published the book "Summa de Arithmetica, Geometrica, Proportioni et Proportionalitate". This book was the first complete description of double entry bookkeeping & details of Accounting & recording. It became the most widely read book in Italy on mathematics & firmly established Pacioli as the "father of Accounting".

⇒ Definition:

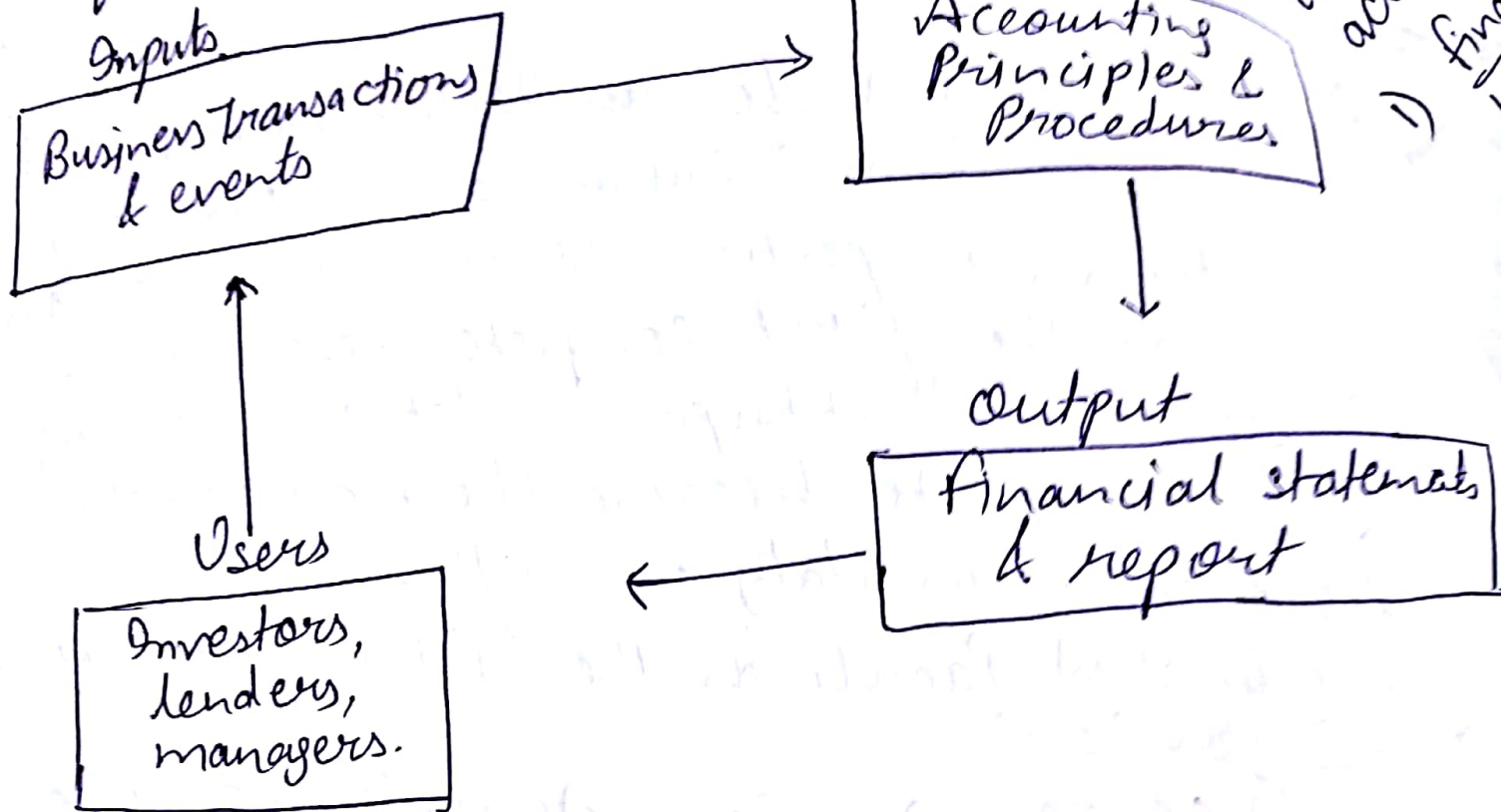
In 1966, The American Accounting Association (AAA) defined Accounting as:

"The Process of identifying, measuring and communicating economic information to permit informed judgements & decisions by users of the information".

⇒ Functions of Accounting:



⇒ Accounting as a language of business  
Accounting is the language of information system.



⇒ Objectives of Accounting :-

- 1) To keep systematic records.
- 2) To protect business properties.
- 3) To ascertain profit or loss.
- 4) To ascertain financial position of the bus.
- 5) To facilitate rational decision-making.



Branches of Accounting ÷ In order to satisfy the needs of the different people interested in accounting information, various branches of accounting have developed. They are as follows:-

- 1) Financial Accounting ÷ This is the original form of accounting. The main purpose of this form of accounting is to record transactions in the books of accounts in such a way that the financial statements can be prepared, & the profit for the period and position of the firm on a particular date can be analysed & interpreted by those who are interested to know the financial results of the firm.
- 2) Cost Accounting ÷ It has developed on a/c of the factory system and due to complexities of modern business. This process starts with recording of expenditure and ends with preparation of statistical data. With the help of this system, the cost of products or services can be ascertained & controlled.
- 3) Management Accounting ÷ This is the recent origin. It is the study of managerial aspects. It relates to the use of accounting data collected with the help of financial and cost accounting methods for the purpose of policy formulation, planning, control & decision making.

## ⇒ Accounting mechanics - I

(i) The Journal → The first step in bookkeeping is the recording of transactions. All transactions are first recorded in the journal which is called the "Book of Prime entry" or "Book of original entry". The word 'journal' was originally derived from the French word 'jour' which means 'day'. It is also known as the day book, because it records the daily transactions in the order in which they take place. This process is known as "journalising".

### Journal format

Date	Particulars	L.F.	Amount Dr.	Amount Cr.

Accounts can be mainly classified into -

Personal A/c

Impersonal A/c

Real A/c

Nominal A/c



books  
1. Personal  
2. Real  
3. Nominal

## Rules for Debit & Credit -

### Personal A/c ÷ Types

1) Natural Personal A/c

↓  
ex. Mohan's A/c  
Ram's A/c

2) Artificial Personal A/c

↓  
ex. LIC A/c  
SBI A/c

3) Representative Personal A/c.

↓  
ex. Landlord,  
employee etc.

### The rule for Personal A/c -

Debit the Receiver  
Credit the giver.

### 2) Real Account ÷ Types

1) Tangible real a/c

↓  
ex. Cash A/c, land,  
building, etc.

2) Intangible Real A/c.

↓  
ex. goodwill, Patent,  
copyright etc.

### The rule for Real A/c -

Debit what comes in  
Credit what goes out.

3) Nominal A/c - Nominal a/c are opened in the books to simply explain the nature of the transactions. They do not really exist. ex. expenses, losses, income & gains etc.

## The Rule for Nominal A/c -

Debit all the expenses & losses.  
Credit all the incomes & gains.

Ex. Journalise the following transactions in the books of Alan Jones:

2007

May 1. Alan Jones started business with cash Rs. 25,000/-

May 2. Bought furniture for Rs 2100/-

May 6. Purchased goods from Salil Traders, Rs. 2850/-

May 9. Cash sales Rs. 3500/-

May 14 Sold goods on credit to Quaiser Rs. 2500/-

May 15 Paid for office stationery Rs. 25/-

May 21 Quaiser remitted Rs 1,000 on account.

May 25 Interest on investments received Rs. 150/-

May 26 Paid rent to landlord Rs. 550/-

Insurance Premium Rs. 200/-

Ans.

### Journal Entries.

Date	Particulars	L.F.	Amount Dr.	Amount Cr.
2003 May 1.	Cash A/c Dr. To, Alan's Capital A/c (Being Amt. invested in the business)		25000	25000
May 2.	Furniture A/c Dr. To cash A/c (Being furniture purchased for cash)		2100	2100

## ⇒ Final Accounts

(9)

It means -

- 1) Trading A/c
- 2) Profit & Loss A/c &
- 3) Balance-sheet.

For Preparation of final A/c's generally a Trial Balance is given. Every item of Trial Balance will be shown at one place only.

### Format of Trading A/c

Dr.		Cr.	
Particulars	Amount	Particulars	Amount
To opening stock	xxx	By sales	xxx
To Purchases		less: sales Return	
less: Pur. Returns		or Return inwards	xxx
or Returns outwards	xxx	By closing stock	xxx
To Direct expenditure		By Gross loss (B/P)	xxx
To Carriage / carriage inwards	xxx		
To Wages	xxx		
To Coal, gas, fuel, Power	xxx		
To Gross Profit (B/P)	xxx		
	xxx		xxx



# Profit & loss A/c

(10)

Particulars	Amt	Particular	Amt
To Salaries	xxx	By Gross Profit	xxx
To Carriage outward	xxx	By Interest receive	xxx
To Depreciation	xxx	By Dividend receive	xxx
To Bad debts	xxx	By Commis. Received	xxx
To Rent	xxx	By Bad debts recovered	xxx
To Electricity	xxx	By Insu. Claims	xxx
To Commission	xxx	By Profit on sale of Investment/Assets	xxx
To General exp.	xxx	By Net loss (B/F)	xxx
To Postage	xxx		
To Telephone charges	xxx		
To Maintenance exp	xxx		
To Audit fees	xxx		
To legal charges	xxx		
To Discount	xxx		
To Interest Paid	xxx		
To Net Profit (B/F)	xxx		
	xxx		xxx

P.T.O.



## Balance - sheet

(11)

Liabilities		Amt.	Assets	Amt.
Capital	xxx		Land, Building	xxx
(+) Net Profit	xxx		Plant & machinery	xxx
(-) Drawings	xxx	xxx	furniture & fittings	xxx
Creditors		xxx	Car/Typewriter/	
Bills Payable		xxx	Computer	xxx
Bank overdraft		xxx	Good will / Trademark	xxx
Expenses outstanding			Patent / copyright	
(wages, salary etc.)		xxx	stock / closing stock	xxx
Income received in advance			Debtors	xxx
Reserves		xxx	Bills receivables	xxx
Bank loan		xxx	Cash / Bank Balances	xxx
			Prepaid expenditure	xxx
			Income outstanding	xxx
		xxx		xxx

### Adjustment Entries.

Transactions not recorded before preparing Trial-Balance. or

~~Errors~~ Errors (Rectify)

⇒ Every adjustment is shown at two places.

## ⇒ Some common Adjustments.

(12)

1) Closing stock — (When it is given outside the trial balance).

Entry =      Stock A/c      Dr.  
                                    To Trading A/c/Purchase A/c.

\* Balance sheet - Assets side

\* Trading A/c - cr. side

Note:- Stock is to be shown at lower of cost or Net realisable value.

2) Expenses outstanding - Expenses are incurred but Payment not yet made.

Entry -      Expenses A/c      Dr.  
                                    To Expenses outstanding

\* Exp. (Add)

\* B/s - liabilities side.

3) Prepaid expenses - Expenses not yet incurred but still Payment has been made.

Entry -      Prepaid exp. A/c      Dr.  
                                    To expenses A/c

\* Expenses (less)

\* B/s - Assets side

P.T.O.



Depreciation - Dep.<sup>n</sup> means decrease in the value of fixed Assets. (12)

Two methods

i) Without Provisions

entry - Depreciation A/c Dr.  
To Assets A/c

P&L (Dr.)

B/s (- Assets Value)

ii) with provisions

entry = Dep.<sup>n</sup> A/c Dr.  
To Prov for Dep.<sup>n</sup>

P&L A/c (Dr.)

Add with  
Prov for Dep.<sup>n</sup>  
↓  
B/s Assets  
(- Prov.)

5) Bad Debts Recovered -

entry - Cash A/c Dr.  
To Bad debts Recovered.

In ques<sup>n</sup> → Bad debts recovered was wrongly credited to Debtors A/c. (wrong) → case of Rectification.

Correct

~~Cash A/c Dr.~~  
To B/d Recd

wrong

~~Cash A/c Dr.~~  
To Debtors A/c

Rectification

Debtors A/c Dr.  
To B/d Recovered.

(+) Debtors  
P&L A/c (cr)

P.T.O.

# Bad debts & Provision for Doubtful debts (A)

→ Trial Balance  
→ Addi. Inf<sup>n</sup>

→ Trial Balance (old)  
→ Additional Inf<sup>n</sup> (New Prov)

Ex.

## Trial - Balance (Extract) (A part)

Debtors  
Bad debts  
Prov. for D/debts

xxx

xxx

xxx

## Additional Inf<sup>n</sup> -

- (dH) i) make Prov<sup>n</sup> for D/debts at %  
Is debts (-) ii) Additional / further Bad debts Amounted = -

## P & L A/c

## Balance sheet

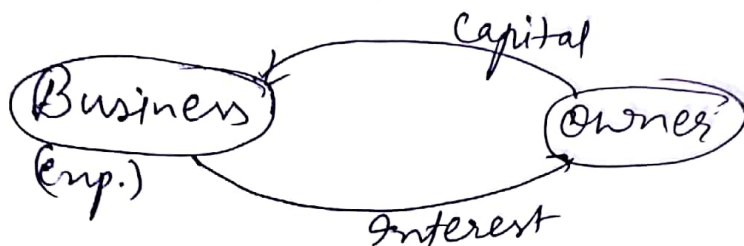
Dr.		Cr	Liabi	Assets -
Bad debts	xxx			Debtors xxx
(+) further B/d	xxx			(-) further B/d xxx
(+) New Prov <sup>n</sup>	xxx			(make all other adj) (except discount) xxx
(-) Old Prov <sup>n</sup>	xxx			xxx
	<u>xxx</u>			<u>xxx</u>
				- New Prov <sup>n</sup> (%)

Note:- Before calculation of amount of Prov<sup>n</sup> for doubtful debts, all adjustments relating to debtors must be made except provision for discount on debtors.



provisions for Discount on Debtors (15)  
 (same treatment except Provi. for Discount must be adjusted after the adjustment of Bad debts.).

## 7) Interest on Capital

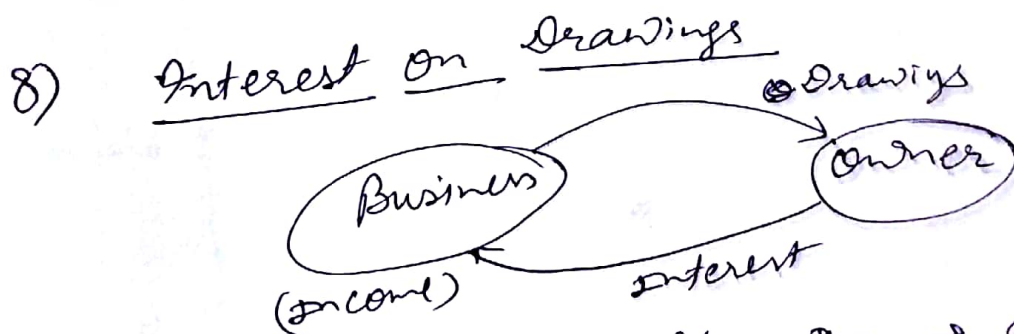


Entry - Interest on Capital A/c Dr  
 To Capital A/c

\* P&L A/c - Dr. side  
 \* Capital (+) in B/s.

Note :- Interest on capital is calculated on the amount of opening capital & additional capital with reference to time.

$$\text{Interest} = \frac{\text{Amount (op. capital / Additional capital)}}{1} \times \text{Rate} \times (\text{time})$$



entry - Capital / Drawings A/c Dr  $\rightarrow$  Capital (-)  
 To Int on Drawings A/c  $\rightarrow$  Profit & Loss A/c

P.T.O.

	Particulars	Dr Amount	Cr Amount
May 6.	Purchases A/c Dr. To Salil Traders A/c (Being Purchased goods on credit)	2850	2850
May 9.	Cash A/c Dr. To sales A/c (Being Goods sold for cash)	3500	3500
May 14	Quiser A/c Dr. To Sales A/c (Goods sold on credit to Quiser).	2500	2500
May 15	Stationery A/c Dr. To Cash A/c (Being Paid for stationery expenses)	25	25
May 21	Cash A/c Dr. To Quaiser's A/c (Cash received from Quaiser)	1000	1000
May 25.	Cash A/c Dr. To Interest A/c	150	150
May 26	Rent A/c Dr. To Cash (Rent Paid to landlord)	550	550
May 26.	Insurance Prem. A/c Dr. To Cash A/c (Insurance Prem. Paid)	210	210
	Total	-	-



## ⇒ Accounting mechanics - II

1) Ledger - The book in which various accounts lie, is known as ledger. After entering transactions in journal chronologically, these entries must be transferred to appropriate accounts in the ledger Periodically i.e. weekly, monthly, quarterly etc depending on the convenience and requirements of the business. This is done to know the exact position of each a/c on any particular date.

2) Trial Balance - It is a simple listing of Nominal accounts with the debit balances posted into the debit column and the credit balances posted into the credit column. Although it looks like an a/c, because it has a debit and a credit column, but it is not an a/c, it is merely a list of account balances.

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Drawings → Dates (not given) → (Int. half) (16)

Income Tax - is treated as personal nature item therefore it is treated like drawings.

10) Goods distributed as samples -

entry -  
Advertisement A/c Dr. → P&L (Dr)  
To Purchase A/c (at cost price)  
(-) Purchase

11) Goods lost by fire -

entry  
Loss by fire A/c Dr. P&L (Dr)  
To Purchase A/c (-) Purchase

12) Goods given as charity.

entry  
Charity/Donation A/c Dr (P&L Dr)  
To Purchase A/c (-) Purchase

13) Goods taken away by the Proprietor for personal use.

entry.  
Drawings A/c Dr (P&L Dr)  
To Purchase A/c (-) Purchase