PART – B

Chapter 2

Accounting Equation:

In a particular time, the total asset of an organization should be equal to the sum of owner's equity and external liabilities. The equation that represents this fundamental concept is known as **Accounting Equation**.

$$A = L + E$$

Here,

A= Assets

L= Liabilities

E= Equity

Asset: Asset means the economic resources that belong to a business that is invested for making profit. For example, furniture, buildings, machineries of a business.

Liability: Liability means the financial rigidity that has to be paid up after a certain period of time. That is it is the claim of the third party over the total assets of the business.

Owner's Equity: If the claim of the third party is deducted from the total assets of the business the rest will be known as owner's equity. That is the claim of the owner over the entire assets of the business is known as owner's equity. Four elements affect owner's equity.

These are:

- Investment of owner
- Income
- Drawings
- Expense

Extending Accounting Equation, we get –

Assets = Liabilities + Capital + Revenue - Expenses - Drawings

Means, $A = L + (C + R – E – D)$

Where,

A=Assets ; L=Liabilities ; C=Capital ; R=Revenue ; E=Expenses ; D=Drawings.

Identifying transaction:

Which events are transactions and which are not is explained by the following examples-

In the business of Mr. Sohail, the following events took place-

1. Mr. Sohail started business with tk.50,000.
2. He purchased goods with cash tk.15,000.
3. He has paid one of his creditors tk.10,000.
4. He has placed an order for purchasing goods worth tk.8,000.
5. Made an expense for advertisement worth tk.2,000.
6. Mr. Mamun has appointed as manager in business for a monthly salary tk.7,000.
7. Withdrawn from business for his personal use tk.3,000.
8. Tk.500 has stolen from his personal fund.
9. Agreed to purchase goods from Hashem Brother's worth tk.10,000 per month.
10. Sold goods to Hanif on account tk.10,000.

Whether these events are transaction or not explained with reason-

Solution:

No.	Whether Transaction or Not	Explanation with reason
1.	Transaction	Since cash brought in as capital it has brought a financial change and includes two parties involved in it- one the capital of the owner and the other is the cash.
2.	Transaction	Value of product is measurable in terms of money. Purchase of goods is an expense to the business, while the payment has decreased the cash amount.
3.	Transaction	Payment to the creditor has decreased both the liability as well as the cash of the business, so financial condition has been affected.
4.	Not a Transaction	Placing order for the purchase of goods does not mean actual purchase. The buying and selling of the goods have not been taken place, so it is not a transaction.
5.	Transaction	The business has taken a benefit by placing advertisement and the value paid for it has brought a financial change.
6.	Not a Transaction	Giving appointment letter to any person has not brought any financial change to the business ad it does not include any cash flow either.
7.	Transaction	The owner has taken a benefit by withdrawing amount from the business, so the cash of the business has been affected.
8.	Not a Transaction	Loss of personal savings is not related to the business; the loss belongs to the owner alone. So the cash of the business is not affected.
9.	Not a Transaction	Has been agreed to purchase but actual purchase has not been taken place and the payment of which is neither made. So no financial changes occur in the business
10.	Transaction	By selling goods on credit to Hanif, the business has given him a benefit, which is an income to the business. It has brought a financial change.

Transaction : Exchange of money or money's worth any event or service that reflects on the financial condition of a firm will be treated as transaction. Apparently if any exchange of product or service that brings a financial change will be known as transaction. Every transaction is an event; every event is not a transaction.

Features / nature of transaction:

So far, we have learnt that every transaction is an event but not every event is a transaction. By analyzing the concept of a transaction, we will get the following features of it:

i. **Measurable in terms of money :** One of the important features of a transaction is that it has to be measurable in terms of money or else it could not be treated as transaction. For example, the death of manager of a firm is loss to the firm but is not measurable in terms of money. However, goods destroyed by fire worth 20,000 taka are a loss to the firm and will be treated as a transaction.

ii. **Changes of financial condition :** If any event brings any financial changes of a firm, it will be treated as a transaction. For example: Bought furniture with cash 5000 taka Here the furniture of the business has been increased by 5000 taka at the same time cash 5000 taka has also been decreased. Since this event has brought about a change in the financial position of the business, it will be treated as a transaction. Again, if an order of buying furniture worth 5000tk is placed; it will not be treated as a transaction as it has not brought any financial changes in the business.

iii. **Dual entity :** Every transaction must include two parties. That is one party will receive benefits while the other will ensure the same. For example – salaries paid to the workers taka 5000. Here one party is the salary expense account while the other one is cash account.

iv. **Complete and independent:** Another important feature of transaction is that each transaction is completely separate and independent from the others. For example – goods sold on credit taka 10,000 and the payment of which is received after 7 day. Here goods sold on credit are a transaction while 7 days later the payment received is a separate account.

v. **Visibility :** Transactions can be both visible and invisible. For example – furniture purchased worth 10,000 taka. It is a visible transaction. Again, the depreciation of furniture worth 1000 taka is an invisible transaction.

vi. **Historical event:** The financial matters that have taken place previously are known as historical transactions. Again, some events that may take in future are also known as transaction. If any future events change the financial position of the business, it will also be treated as transaction. For example – reserve for bad debts, reserve for discount etc.

vii. **Impact over accounting equation :** Each transaction leaves a direct impact over the accounting equation. The items of transactions are affected by accounting equation. "Asset= Liabilities+ owner's Equity" this accounting equation. Therefore, any event is justified through accounting equation whether it is a transaction or not.

The impact of transactions over accounting equation is shown in the chart –

Mr. Dipok started his legal practitioner business on January 1, 2012. The transactions of the first month were as follows:

Jan 1   Invested tk.50,000 in his business.

Jan 2   Paid the rent for the month of January tk.3000

Jan 7   Machine purchase on credit worth tk.15,000

Jan 10   Legal services given to the clients for cash tk.6,000

Jan 15   Paid salary to the office staff tk.2,000

Jan 20   Loan taken from the bank tk.20,000.

Jan 24   Legal services provided to the clients on credit tk.7,000.

Jan 29   Dues for machine purchase paid tk.10,000.

Mr. Depok's

Effects of transactions over the elements of Accounting Equation is mentioned below for January 2012 -

Date	Related Accounts	Effects on Accounting Equation (A=L+E)
January 1	Cash Account	A Increase
	Capital Account	E Increase
January 2	Rent Expense Account	E Decrease
	Cash Account	A Decrease
January 7	Machinery Account	A Increase
	Supplier Account/ Accounts Payable	L Increase
January 10	Cash Account	A Increase
	Service Revenue Account	E Increase
January 15	Salaries Expense Account	E Decrease
	Cash Account	A Decrease
January 20	Cash Account	A Increase
	Bank Account	L Increase
January 24	Accounts Receivable	A Increase
	Service Revenue Account	E Increase
January 29	Supplier Account/ Accounts Payable	L Decrease
	Cash Account	A Decrease

Mr. Depok's

Effects of transactions over the elements of Accounting Equation is Shown for January 2012 -

Date		Assets			=	Liabilities + Equity			Remarks
		Cash	Debtors/ Accounts Receivable	Machinery	=	Loan	Creditors/ Accounts Payable	Capital	
2012		50,000			=			50,000	Capital Invested
Jan: 1	Balance	50,000			=			50,000	
Jan: 2		-3,000			=			-3,000	Expense
	Balance	47,000			=			47,000	
Jan: 7				15,000	=		15,000		
	Balance	47,000		15,000	=		15,000	47,000	
Jan: 10		6,000			=			6,000	Revenue
	Balance	53,000		15,000	=		15,000	53,000	
Jan: 15		-2,000			=			-2,000	Expense
	Balance	51,000		15,000	=		15,000	51,000	
Jan: 20		20,000			=	20,000			
	Balance	71,000		15,000	=	20,000	15,000	51,000	
Jan: 24			7,000		=			7,000	Revenue
	Balance	71,000	7,000	15,000	=	20,000	15,000	58,000	
Jan: 29		-10,000			=		-10,000		
	Balance	61,000	7,000	15,000	=	20,000	5,000	58,000	
	Total		83,000		=		83,000		

Chapter 1

Accounting : Accounting is such a subject by studying which the various financial activities of a person or an institution i.e. expenses paid, receive income, purchase and sale of assets, buying and selling of goods, receive from debtors and pay to creditors etc. are correctly recorded in different books of accounts and determine their actual result after a certain period. In accounting the economic transactions of a business are recorded, classified, and summarized.

Objectives and necessity of accounting :

1. Without proper recording of transactions, it is not possible to know the financial condition of a firm. Therefore, the foremost objective of accounting is to record the transactions properly into the books of accounts.
2. One of the main objectives of accounting is to ascertain financial condition and result. It is possible to locate the motion of a business through identifying the profit and loss. Recording all the incomes and expenses properly the profit and loss of a firm can be obtained.
3. The pen picture of financial condition can be seen by calculation the assets, liabilities, and owners equity of a firm.
4. Reducing cost can optimize the objective of a business. Accounting helps to record the expenses properly and thus helps reducing cost.
5. Accounting has no alternatives in controlling the fraud and forgery of a business firm. With proper recording of accounts, we can resist and control fraud and forgery.
6. Helps in informing financial condition to interested group and thus takes correct decision.
7. Financial information of the previous year helps in taking proper steps by making comparative study.
8. Determines the source of internal and external flow of money of various services oriented nonprofit organizations like schools, colleges, hospitals, clubs and societies and ascertain their accounts balance.
9. Govt. accumulates through collecting VAT, duties and taxes and contributes to different regular and development areas. The role of accounting is great in managing smooth functions of govt. Besides, the books of accounts and related documents are useful to a firm in many ways i.e. for bank or taking loan from money lending organization, fixing the sales price of a product, identifying future activities etc. The necessity of accounting is very much essential for keeping a fine, disciplined and a thrifty/frugal life. Without keeping accounts properly, the pros and cons of an organization can never be identified. Keeping records properly ensures cost control and wastage of a firm and thus attain financial solvency.

<u>Users of accounting information :</u>

Accounting is known as an information system. Thinking about the internal and external users of accounting reports and records of transactions are kept and statements are published.

- ❖ **Internal Users :**
  1. **Owners and managers:** Accountants prepare books of accounts and other necessary documents. The owner as well as manager tries to identify profit and loss and financial condition from this statement. So, future course of action can be realized.
- ❖ **External Users :**
  1. **Loan/ credit providers:** Before granting loans to the recipient organization, the credit providers analyze its financial conditions whether it might be able to pay back the loan or not.
  2. **Govt.:** Authority concerned of the govt. might look into the accounts and check whether organizations pay its rates, taxes, and VAT and for taking necessary measures.
  3. **Creditors:** Before allowing credit sales, the creditors always want to ensure that the recipients are in a financial state of paying back the due amount. This can only be possible by seeing the records of accounts.
  4. **Workers and officers:** Workers and officers of organizations take the assistance of the financial statements to know and have their benefits from the profit of the organization. Besides auditors, investors, consumers and other concerned also use accounting information.
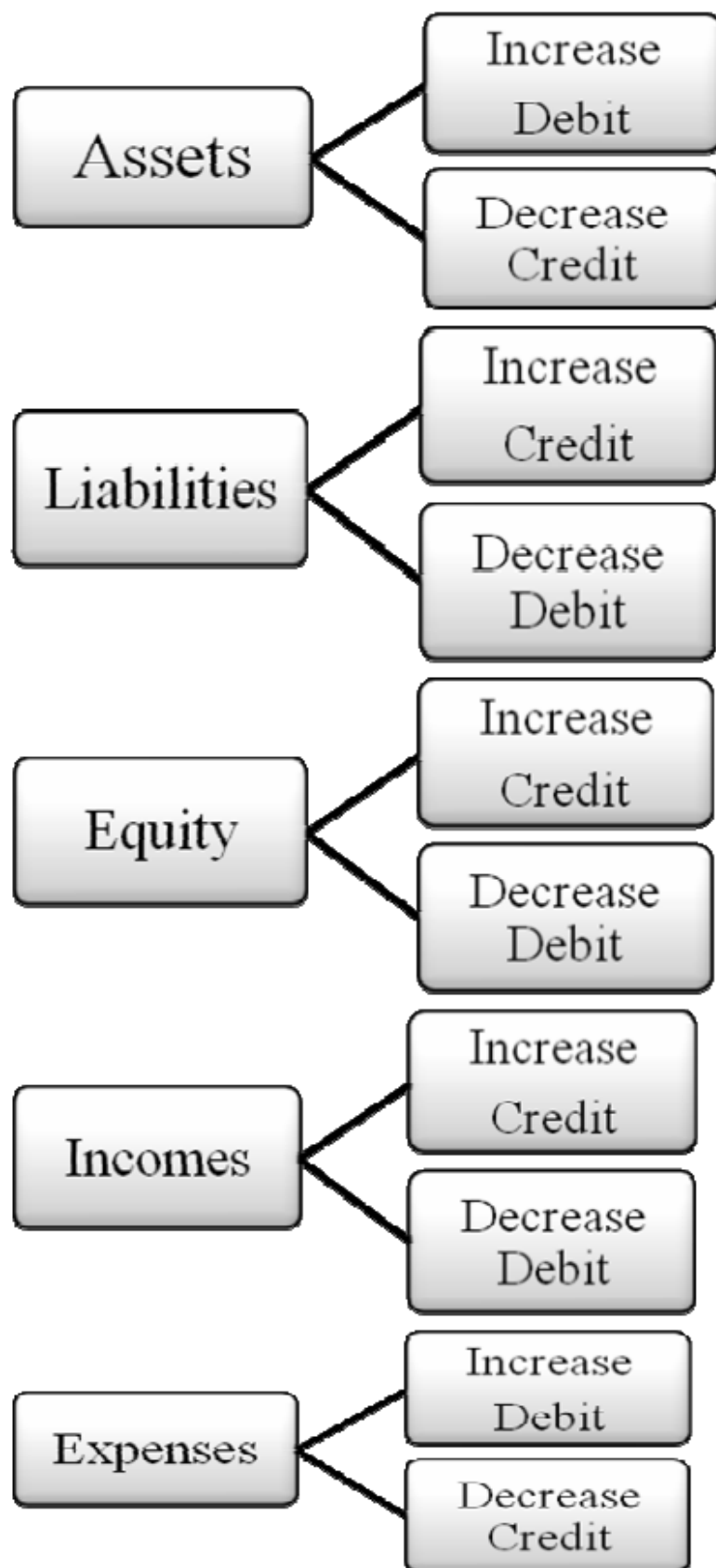
<u>Chapter 3</u>

<u>Principles or Characteristics of Double Entry System:</u>

The most reliable, scientific, complete and self-sufficient system of accounting is Double Entry System.

Principles or Characteristics of Double Entry System are as follows:

1. **Dual Entity:** In every transaction, there are at least two accounts. While detecting debit and credit concerned accounts are to be identified first then their classification of account is settled. Then debit and credit is ascertained by double entry system.
2. **Debtor and creditor:** In every transaction, beneficent recipient is debtor and benefit giver acts as the creditor.
3. **Making Debit and credit:** The benefit recipient is made debit while the benefit giver is made credit.
4. **Exchanged equal amount:** In every transaction, the amount of debit and credit will be equal.
5. **Comprehensive result:** Since in every transaction the debit and credit are analyzed and recorded in equal amount, it is easy to detect the comprehensive result. The total of debit side should equal to the total of credit side.

Assets	Increase Debit	Decrease Credit
Liabilities	Increase Credit	Decrease Debit
Equity	Increase Credit	Decrease Debit
Incomes	Increase Credit	Decrease Debit
Expenses	Increase Debit	Decrease Credit

Effects of Double Entry System in Transactions described below with examples:

1. Mr. Hasan has started business bringing in Tk. 50,000 as Capital.
2. Furniture bought for business Tk. 5,000.
3. Employees salary paid off Tk. 6,000
4. Goods Purchase Tk. 20,000
5. Tk. 25,000is deposited into Bank.
6. Goods sold Tk. 18,000
7. Cheque paid for advertisement Tk. 7,000
8. Commission received Tk. 3,000.
9. Interest received from bank Tk. 1,200.
10. Goods sold on credit Tk. 15,000.
11. Cheque paid for rent Tk. 6,000
12. Tk. 8,000 has withdrawn from bank for business.

Solution:

No	Accounts Head		Taka	Effects of Double Entry System
1	Cash Account Capital Account	Debit Credit	50,000 50,000	As the cash (asset) increased in business, Cash A/c debited. Other side bringing cash to business by owner, owner's equity increased. So, Capital A/c credited
2	Furniture Account Cash Account	Debit Credit	5,000 5,000	For buying furniture, furniture named asset increased & cash decreased. Therefore, Furniture A/c debited & Cash A/c credited.
3	Salaries Account Cash Account	Debit Credit	6,000 6,000	For paying salary, expense of the business increased & cash decreased. So, Salary A/c debited & Cash A/c credited
4	Purchase Account Cash Account	Debit Credit	20,000 20,000	For buying goods, expense of the business increased & cash decreased. So, Purchase A/c debited & Cash A/c credited
5	Bank Account Cash Account	Debit Credit	25,000 25,000	For depositing cash into bank deposited amount in bank increased & cash in hand decreased. Therefore, Bank A/c debited & Cash A/c credited.
6	Cash Account Sales Account	Debit Credit	18,000 18,000	For selling goods in cash, both income & cash of the business increased. Therefore, Cash A/c debited & Sales A/c credited.
7	Advertisement A/c Bank Account	Debit Credit	7,000 7,000	For advertisement expense increased & for cheque issue Deposited amount in bank decreased. Therefore, Advertisement A/c debited & Bank A/c credited.
8	Cash Account Commission A/c	Debit Credit	3,000 3,000	For receiving commission income increased & cash increased. Therefore, Cash A/c debited & Commission A/c credited.
9	Bank Account Bank Interest A/c	Debit Credit	1,200 1,200	For interest allowing by bank deposited amount in bank increased & income also increased. So, Bank A/c debited & Bank interest A/c credited
10	Debtors Account Sales Account	Debit Credit	15,000 15,000	For selling goods on credit, business gets the rights to receive money from debtors and income increased. Therefore, Debtors A/c debited & Sales A/c credited.
11	Rent Account Bank Account	Debit Credit	6,000 6,000	For paying rent, expense increased & giving cheque bank deposit decreased. So, Rent A/c debited & Bank A/c Credited.
12	CashAccount Bank Account	Debit Credit	8,000 8,000	Taking out cash from bank, cash in hand increased & bank deposit decreased. Therefore, Cash A/c debited & Bank A/c credited.