INTRODUCTION TO ACCOUNTING

Meaning & Definition of Accounting

Accounting is an information system which receives data inputs, process the same and give its output in the form of information which is useful for decision making. Accounting is also called the language of business.

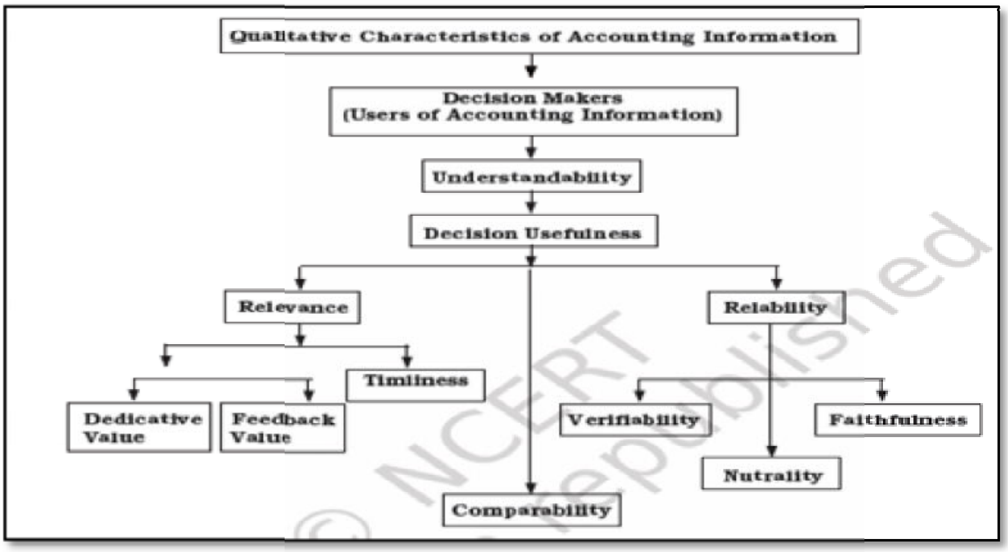
Father of Accounting: Luca Pacioli (Italian Mathematician)

American Institute of Certified Public Accountants (AICPA) defines "accounting is an art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which are in part, at least, of a financial character and interpreting results thereof."

Thus, **accounting is the art of recording, classifying, summarizing, analyzing and interpreting the financial transactions and communicating the results to the interested persons.**

Qualitative characteristics of accounting information – In order to ensure the objectivity in reporting and validity in the system, accounting information must possess certain qualitative characteristics as shown below:-

1. **Reliability –** Accounting information is considered to be reliable if it is free from bias and faithfully represents the facts.
2. **Relevance –** The information to be relevant, it must be available in time.
3. **Understandability –** It must be understood by those to whom it is communicated.
4. **Comparability –** It means that the accounting reports should be comparable with other firms to identify similarities or differences. To achieve this, the period, the format, unit of measurement etc. should be the same.

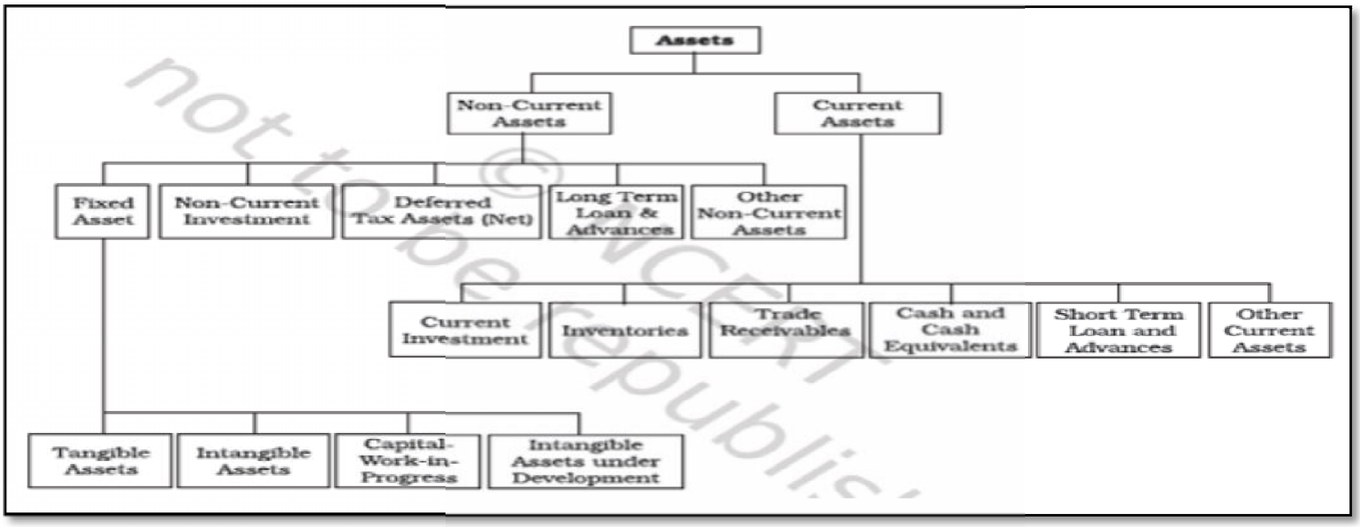


Objectives of Accounting

1. **To maintain business records –** Business managers cannot remember every transaction or event that has taken place in their business, hence it is to be recorded, which will be helpful in taking decisions and to find out errors if any in future.
2. **Calculation of profit or loss –** Accounting helps in ascertaining profit or loss to the enterprise by preparing a profit and loss account.
3. **Ascertainment of financial position –** It implied the financial strength of the business in term of assets and liabilities and it is revealed by preparing a balance sheet.
4. **Providing information to users –** The accounting information obtained from records should be communicated to interested parties like owners, creditors, bankers, government, employees etc.

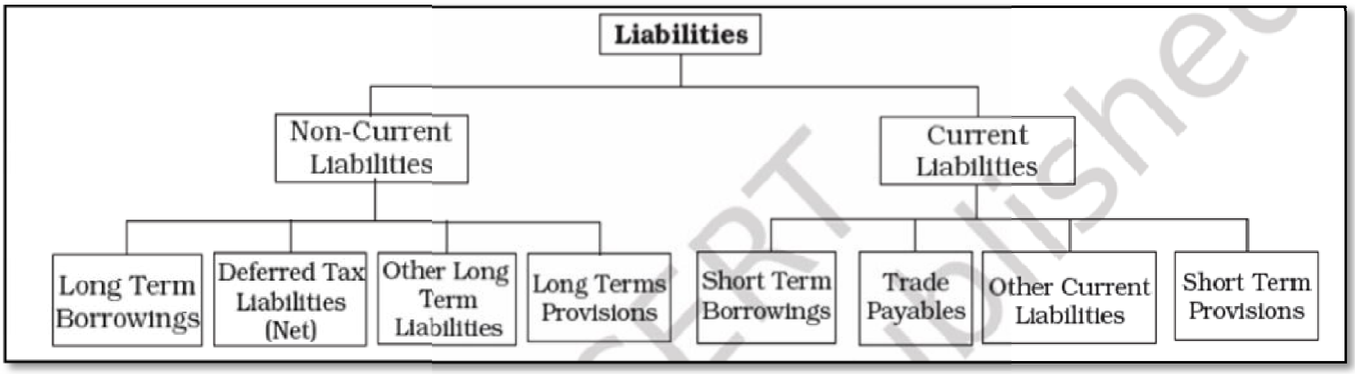
Basic Accounting Terms

1. **Entity –** Entity means a reality that has a definite individual existence. Business entity means a specifically identifiable business enterprise like Super Bazaar, Jewellers, ITC Limited, etc. An accounting system is always devised for a specific business entity (also called accounting entity).
2. **Transaction –** The dealing of a businessman with an external party which can be expressed in monetary terms is called business transactions. In other words, all economic events in a business organization is known as transactions.
3. **Assets –** These are the economic resources or material things or properties of the business including the amounts due from others which can be expressed in monetary terms. It can be broadly classified into two, current assets and non-current assets.



4. **Liabilities –** Liabilities are the obligations which an enterprise owes. It represents the amount payable by the business in future. Liabilities are classified as current and non-current. Eg: Creditors, Bank Loan etc.

Distinction between current and non-current items:
1. Current assets or liabilities are involved in operating cycle.
2. Current assets or liabilities are realised/settled within 12 months.
3. Current items are primarily for trading.
4. Current items are cash or cash equivalent.



5. **Capital –** It is the investment made by the owners for use in the business. It is also called owner's equity.
6. **Sales –** It represents total revenue earned by a business through sale of goods or services to customers. It includes cash sales and credit sales.
7. **Revenues (Income) –** It represents the amount a business earns through the sale of its products or providing services to customers. It also includes earnings like interest received, dividend received, rent received, commission received, discount received etc.
8. **Expenses –** It represents the amount spent to earn revenue. Eg; rent, wages, salaries etc.
1.
9. **Expenditure –** Spending money or incurring a liability for some benefit, service or property received is called expenditure. Purchase of goods, purchase of machinery, purchase of furniture, etc. are examples of expenditure. If the benefit of expenditure is exhausted within a year, it is treated as an expense (also called revenue expenditure). On the other hand, the benefit of expenditure lasts for more than a year; it is treated as an asset (also called capital expenditure) such as purchase of machinery, furniture, etc.
10. **Profit –** It is the excess of revenue over expenses in an accounting year and represents increase in capital.
11. **Gain -** A profit that arises from events or transactions which are incidental to business such as sale of fixed assets, winning a court case, appreciation in the value of an asset etc.
12. **Loss –** It is the excess of expenses over revenue in an accounting year and represents reduction in owners' equity or capital investment.
13. **Discount –** Discount is the deduction in the price of the goods sold. It may be of two types; trade discount and cash discount. Trade discount is the deduction of price at the time of selling goods, whereas cash discount means a deduction in the amount payable by a debtor within a stipulated period.
14. **Voucher –** The documentary evidence in support of a transaction is known as voucher. For example, if we buy goods for cash, we get cash memo, if we buy on credit, we get an invoice; when we make a payment we get a receipt and so on.
15. **Goods –** It refers to commodities, products, articles or things in which a trader deals. They refer to commodities which are purchased and are meant for resale. For stationary merchant, stationary articles like pen, pencil books etc. are his goods but for other business, it is an expense. Likewise, for a furniture dealer, furniture items like tables, chairs etc. are his goods, but for others it is an asset. They also include commodities purchased for manufacture and sale. In accounting they are called by different name, such as purchases, sales, purchases returns, sales returns and stock.

16. **Drawings –** It represents the amount of cash or other assets withdrawn by the owner for his personal use.
17. **Purchases –** It is an expense incurred for procurement of **goods** in a business. It includes both cash purchase and credit purchase.
18. **Stock –** It represents the unsold goods at the end of accounting year. It includes unsold goods, raw materials, semi finished goods etc. Stock is also called **inventory**. Inventory at the end of the accounting year is called **closing stock**, while the same at the beginning of the year is called **opening stock**.
19. **Debtors / Accounts receivable –** A **debtor** is a person who owes money to the business as he has received some benefit from the business. The amounts due from different persons are totaled on the close of the accounting period and are shown under the heading **Sundry Debtors or Accounts Receivable** on the asset side of the balance sheet.
20. **Creditors / Accounts payable –** A **creditor** is a person to whom the business owes money as he has given some benefit to the business. The amounts due to various persons are totaled on the close of the accounting period and are shown under the head **Sundry Creditors or Accounts Payable** on the liability side of the balance sheet.

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Chapter – 2

THEORY BASE OF ACCOUNTING

As we know, every discipline can be developed only with a sound theoretical base. The theory base of accounting consists of principles, concepts, rules and guidelines developed to bring uniformity and consistency to the process of accounting. Apart from these, the Institute of Chartered Accountants of India, (ICAI), which is the regulatory body for standardisation of accounting policies in the country, has issued Accounting Standards which are expected to be uniformly adhered to, in order to bring consistency in the accounting practices.

GAAP – In order to ensure uniformity in accounting procedures and methods, certain accounting principles have been accepted by accountants all over the world. The rules and guidelines used in preparing accounting reports are termed as Generally Accepted Accounting Principles (GAAP).

These principles are also referred as concepts and conventions. The term *concept* refers to the necessary assumptions and ideas which are fundamental to accounting practice, and the term *convention* connotes customs or traditions as a guide to the preparation of accounting statements.

Basic Accounting Concepts – The basic accounting concepts are referred to as the fundamental ideas or basic assumptions underlying the theory and practice of financial accounting which are developed by the accounting profession. From the practicability view point, it is observed that the various terms such as principles, conventions, modifying principles, assumptions, etc. have been used interchangeably and are referred to as *Basic Accounting Concepts.*

The important concepts are:

1. Business entity
2. Money measurement
3. Going concern
4. Accounting period
5. Dual Aspect
6. Matching
7. Conservatism
8. Cost
9. Revenue recognition (Realisation)
10. Full disclosure
11. Consistency
12. Materiality
13. Objectivity

(Only the first 7 items of the above are included in Focus Area)

1. **Business Entity Concept** – This concept assumes that the entity of business is different from its owners. For accounting purpose, the business is treated as a unit or entity separate from the person who controls it. Based on this concept when a person brings in some money as capital into his business, it is treated as a liability of the business to the owner.
2. **Money Measurement Concept –** According to this concept, transactions that can be measured in terms of money only are recorded in the books of accounts. For example, an organization is having a factory building in 2 acres of land, 100 boxes of finished goods etc. cannot be accounted, but it should stated in monetary terms such as Land and Building Rs. 50 lakhs, Stock of goods Rs. 50000 etc.
3. **Going Concern Concept –** According to this concept, it is assumed that the business will last for a long time. Based on this concept we are charging depreciation on fixed assets every year till the end of its life, that the cost of asset which has been used during a period should be charged from the revenue of that period itself.
4. **Accounting period –** The period of interval for which accounts are prepared to know the profit or loss and what exactly the financial position of the business is called accounting period. For this purpose "Profit and Loss account and Balance sheet is prepared at the end of the accounting period. Usually it is one year starting from April 1^{st} and ends at March 31^{st} every year.
5. **Dual aspect principle –** This is the basic principle of accounting. According to this concept every transaction has two aspects; they are receiving aspect and giving aspect. In other words, at least two accounts are involved in recording a transaction. Eg: Capital introduced: Cash A/c and Capital A/c, Machinery purchased: Machinery A/c and Cash A/c. The receiving aspect is called debit aspect and giving aspect is called credit aspect. Thus <u>for every debit there is a corresponding credit</u>. The system of recording transactions with dual aspect concepts is called **double entry system of accounting.**
6. **Matching Concept** - It states that expenses incurred in an accounting period should be matched with revenues during that period. An expense is recognized not when cash is paid but when an asset or service has been used to generate revenue. For example, expenses such as salaries, rent, insurance etc. are recognized on the basis of period to which they relate and not when these are paid. Similarly, costs like depreciation of fixed asset are divided over the periods during which the asset is used. The matching concept, thus, implies that all revenues earned during an accounting year, whether received during that year, or not and all costs incurred, whether paid during the year, or not should be taken into account while ascertaining profit or loss for that year. **(Profit = Revenue – Expenses).**

While ascertaining the profit or loss of an accounting year, we should not take the cost of all the goods produced or purchased during that period but consider only the cost of goods that have been sold during that year. For this purpose, the cost of unsold goods should be deducted from the cost of the goods produced or purchased.

7. **Conservatism Concept –** This principle is also called **prudence**, which states that anticipated profits are not to be considered but only possible losses, while recording business transactions. This is the policy of 'playing safe'. Eg: Inventory is valued at 'cost or market price, whichever is lower'; creating provision for doubtful debt, discount on debtors etc.

Accounting Concepts – Some Examples

No.	Description	Accounting Concept
1	Anticipate no profit and provide for all possible losses	Conservatism
2	Provision for doubtful debt	Conservatism
3	Capital is treated as liability of the business	Business Entity
4	Method of charging depreciation should not be changed year after year	Consistency
5	Policy of playing safe	Conservatism
6	Increase / Decrease in the market value of an asset is not accounted	Cost concept
7	A business owns 2 buildings, it cannot be accounted	Money measurement
8	There must be a source document for every transaction	Objectivity / Verifiability
9	Rent outstanding is added to Rent A/c	Matching
10	Stock of stationery items are not treated as asset, but it is an expense	Materiality
11	Businessman and the firm are separate entities	Business Entity
12	For every debit there is a corresponding credit	Dual Aspect
13	Transactions which are measurable in terms of money only be recorded	Money Measurement
14	Business will last for a long period	Going Concern
15	Stock is valued at cost price or market price (net realizable value) whichever is lower	Conservatism
16	Provision should be given for all possible losses	Conservatism
17	100 Kg rice @ Rs.20 purchased by a grocery shop, recorded it as Rs.2000	Money Measurement
18	Transaction between owner and business are recorded separately	Business Entity
19	Charging depreciation on fixed assets every year till the end of its life.	Going Concern & Matching Concept
20	Depreciation of fixed debited in P/L Acccount	Matching Concept
21	Depreciation deducted from concerned asset in the Balance Sheet every year	Going Concern
22	Profit and Loss account and Balance sheet is prepared at the end of every year.	Accounting Period
23	A machinery purchased for Rs.5000, transportation charges Rs.1000 and installation cost Rs.2000. The amount of transaction recorded is Rs.8000	Cost Concept
24	Every transaction has two aspects	Dual Aspect
25	In case of a contract work the profit is calculated on the basis of work certified for each year.	Revenue Recognition
26	Revenue is earned or recognized at the point of sale	Revenue Recognition
27	Sales is recorded when the title of goods passes from the seller to the buyer (cash or credit).	Revenue Recognition
28	In case of hire purchase system, sales are assumed to the extent of installments due, whether paid or not.	Revenue Recognition

29	Profit = Revenue – Expenses	Matching Concept
30	Accounting statements should contain all relevant material information and their accompanying footnotes	Full Disclosure
31	Assets = Liabilities + Capital	Dual Aspect
32	Total Debits = Total Credits	Dual Aspect
33	Sales revenue is recorded when goods are delivered to the customers	Revenue Recognition
34	Paise column is eliminated in the books of accounts	Materiality
35	Contingent liabilities are shown as a footnote in Balance Sheet	Full Disclosure
36	Expenses are incurred for earning revenue	Matching
37	Owner is treated as a creditor to the business	Business Entity
38	The owner of a business cannot wait till the closure of the business to know the financial position	Accounting Period
39	Account books should not be overloaded with irrelevant facts	Materiality
40	Vouchers are the basis for recording a transaction	Objectivity
41	Personal transactions of the owner should not be included in the books of accounts of the business	Business Entity
42	All business events may not be recorded in books of accounts	Money Measurement
43	Accounting information should be free from bias	Objectivity
44	Qualities of a manager cannot be accounted	Money Measurement
45	Business has indefinite life	Going Concern
46	Following same accounting practices year after year	Consistency
47	Compare expenses with revenues of an accounting period	Matching
48	ABC Ltd. sold goods to XYZ Ltd on credit assuming that they can realize the amount in future	Going Concern
49	Closing stock is credited to Trading A/c	Matching Concept
50	Assets and Liabilities shown in Balance sheet	Full Disclosure

Chapter – 3

RECORDING OF TRANSACTIONS - I

Accounting equation – It is a statement of equality between the assets and liabilities including capital. Therefore,

Assets = Equities

Equities include both owner's equity or **capital** and creditor's equity or **liabilities**. Therefore, the accounting equation may be as follows:

A = C + L   **C = A - L**   **L = A - C**   **A – C – L = 0**

A – Assets
C – Capital
L - Liabilities

The accounting equation is also called as the Balance Sheet equation as it gives the fundamental relationship among the components of a Balance sheet ie: assets, liabilities and capital.

At the time of recording transactions, the test of equality is always kept in mind. That means, every transaction is expressed in terms of accounting equation i.e. Assets = Capital + Liabilities.

Rules for Debit and Credit – Every transaction has a dual aspect – the receiving aspect is called Debit and the giving aspect is called Credit. In order to record transactions in the books of original entry, it is necessary to identify the debit and credit aspects of each transaction. This is done in accordance with the rules of debit and credit applicable to different types of accounts. According to modern approach, business transactions are divided into five categories, they are Assets, Liabilities, Capital, Income (Revenue) and Expenses.

The rules for debit and credit in respect of various categories are given below:

Type of Account	If Debited	If Credited
1. Assets	Increase	Decrease
2. Capital	Decrease	Increase
3. Liability	Decrease	Increase
4. Income	Decrease	Increase
5. Expense	Increase	Decrease

Account – An account is a formal record of all transactions relating to changes in a particular item'. It brings together transaction of similar nature at one place in a book called the **ledger**. Traditionally ledger account is prepared in "**T**" format having two equal sides. The left side is called Debit side and the right side is called Credit side. The process of transferring entries recorded in the journal to the ledger is called **Posting**.

Format of an account

…………… Account

Dr Cr

Date	Particulars	Folio	Amount Rs.	Date	Particulars	Folio	Amount Rs.

Folio = Page number

Double entry book keeping – The recording of debit aspect and the credit aspect of a transaction in the books of accounts is called double entry book keeping. In this system every transaction affects at least two accounts or each and every transaction has at least two aspects – a receiving aspect and a giving aspect (debit and credit).

Book keeping here means, keeping the books of accounts in a systematic manner.

Accounting under double entry system is divided into two stages –

1. Preparation of Journal.
2. Preparation of Ledger.

Journal – It is the prime book or **book of original entry** or book of prime entry in which transactions are recorded in the order in which they occur. It is the book of accounting transaction in a chronological order.

The process of recording transaction in a journal is termed as **journalizing** and the transactions entered in the journal are called **journal entry**. It is also known as the day book because it records daily transactions in the order in which they took place.

Format of a Journal

Date	Particulars	L/F	Debit Amount Rs.	Credit Amount Rs.

L/F = Ledger Folio (page number in ledger)

Compound entry – When there are two or more transactions of similar nature occurring on the same day and the entry for the same have more than one debit or credit, it is called compound entry. For example, Salary paid Rs. 2000 and rent paid Rs.1000 on 1-1-2014:

Salary Ac/	Dr	2000	
Rent A/c	Dr	1000	
To Cash A/c			3000
(Salary and Rent paid)			

Ledger – A ledger is a collection of accounts. It is the main or principal book of account of a business. It is a book where transactions of similar nature are grouped together in one place in the form of an account. As all the transactions are finally entered in this book, it is also called **book of final entry** or secondary entry whereas journal is a book original entry.

Classification of ledger accounts – Ledger accounts are put into five categories namely, assets, liabilities, capital, revenues/gains and expenses/losses. All these may further be put into two groups, i.e. permanent accounts and temporary accounts. All permanent accounts are balanced and carried forward to the next accounting period. The temporary accounts are closed at the end of the accounting period by transferring them to the trading and profit and loss account. All permanent accounts appear in the balance sheet. Thus all assets, liabilities and capital accounts are permanent accounts and all revenues and expense accounts are temporary accounts.

Differences between Journal and ledger

Journal	Ledger
1. It is a book of first entry as all transactions are recorded first in the journal.	It is a book of final entry as all transactions are recorded finally in the ledger.
2. Transactions are recorded in a chronological order	Transactions are recorded in an analytical manner
3. Transactions are recorded on the basis of source documents	Posting is done on the basis of journal (book of original entry)
4. Balancing is not done	All ledger accounts are balanced
5. The process of recording entries in the books of original entry is called journalizing	The process of recording entries in the ledger is called posting

Posting – The process of transferring the entries recorded in the journal into appropriate accounts in the ledger is called posting.

Example: Cash Received from Abhijith Rs.1000

Journal entry:	Cash A/c	Dr	1000
	To Abhijith		1000

The above entry will be posted to both the cash account and Abhijith account as follows:

Cash Account

Date	**Particulars**	**J.F**	**Amount**	**Date**	**Particulars**	**J.F**	**Amount**
	To Abhijith A/c		1000				

Abhijith Account

Date	**Particulars**	**J.F**	**Amount**	**Date**	**Particulars**	**J.F**	**Amount**
					By Cash A/c		1000

Balancing an account – The process of ascertaining the balance of each and every account in the ledger at the end of accounting period (at the end of each month or any time if required) is called balancing. The difference between the two sides of an account is known as account balance. If the debit side is heavier than the credit side, it shows a debit balance. If the credit side is heavier than the debit side, it means a credit balance.

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Chapter – 4

RECORDING OF TRANSACTIONS – II

Special purpose books / subdivisions of journal / day books – When the size of business and transactions are large, recording of transactions in one journal will not be convenient and cause delay in collecting information. Many of the transactions are repetitive in nature. If separate journals are kept for recording transactions of similar nature, journalizing and posting will be easier. Therefore, the journal is subdivided into many subsidiary books called special journals or day books. The journal in which transactions of a similar nature are recorded is known as special journal or day book.

Cash book – All cash transactions are recorded in this subsidiary book. Cash means notes, coins, bank drafts and cheques. It also serves the purpose of a ledger account, because it is written in the form of an account with debit and credit sides. Therefore, it is not necessary to open a separate cash account in the ledger. Thus cash book is both a journal and a ledger.

Types of cash book

1. Single column cash book or simple cash book
2. Double column cash book or cash book with cash and bank columns.
3. Triple column cash book or cash book with cash, bank and discount columns.

4. Petty cash book.

Single column cash book – It contains only one column for amount on both sides, the format of this cash book is similar to a ledger account. The debit side is meant for receipts and credit side for payments.

Format of single column cash book

Dr. Cr.

Date	Particulars	R.N	LF	Amount Rs.	Date	Particulars	V.N	LF	Amount Rs.
	(Receipts)					(Payments)			

R.N – Receipt Number, V.N – Voucher Number

Payment by cheques – Payment by cheques though does not affect the cash balance in the business, must be recorded in the cash books as it is the book of original entry for showing bank transactions also. Such payments are assumed to have been made from the business after withdrawing the amount from the bank. Therefore, cash book is first debited for such amounts and then credited with the same. By doing so, it will have no effect in the cash balance, i.e.,

Cash A/c Dr
To Bank A/c
(Cash withdrawn from bank)
Rajan A/c Dr
To Cash A/c
(Cash paid to Rajan)

Direct deposits by customers – Direct payments into bank by the customers must also be treated as if it were received from them into the business and then deposited into bank by us. Hence, cash book is first debited and then credited with the same amount, which will also show no effect on the cash balance, i.e.,

Cash A/c Dr
To Mr. Tom
(Cash received from Tom)
Bank A/c Dr
To Cash A/c
(Cash paid into bank)

When cash is withdrawn from bank for personal use, the same treatment is followed. i.e;

1. Cash A/c Dr
To Bank A/c

2. Drawings A/c
    To Cash A/c

The following points are to be kept in mind while preparing a single column cash book:

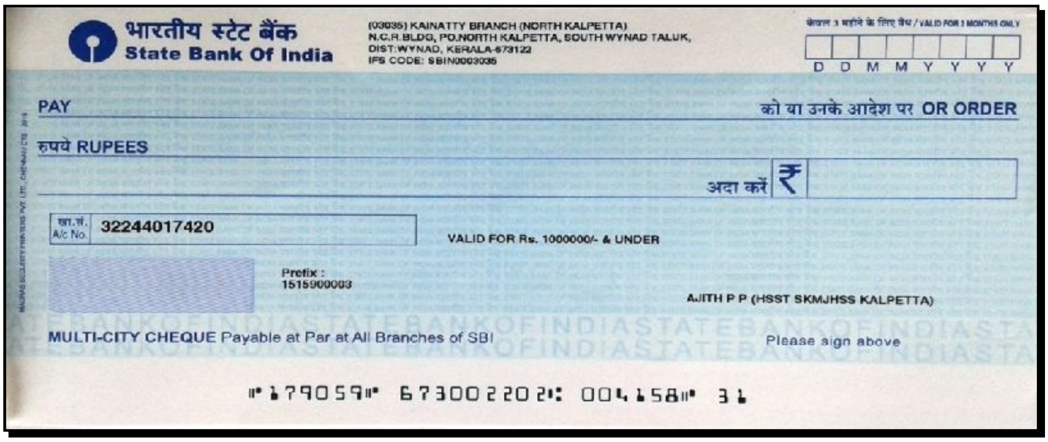
1. Cash book is just like a cash account.
2. The opening balance of cash is to be entered on the debit side as “Balance b/d”
3. The receipt side (debit side) will always be more than or equal to the payment side (credit side), but never be less than the credit side, because no one can spend more than they receive.
4. The difference between debit side and credit side totals will be written on the credit side as “Balance c/d”.

Double column cash book – A cash book with two amount columns such as cash and bank on both sides is called Double column cash book. A businessman generally opens a current account with a bank when the number of bank transactions is very large. As such one more column called Bank column is added on both the sides of the cash book to record the bank transactions.

The opening balance of cash column in the cash book always shows a ‘debit balance’, but the bank column of the cash book may show either a debit balance or credit balance. A credit balance is shown when the bank allows a customer to withdraw more than what is deposited into the bank. Such facility is provided by the bank is called as “overdraft”.

For depositing cash/cheques in the bank account, a form has to be filled, which is called a **pay-in-slip**. It contains a counterfoil also which is returned to the customer with the signature of the cashier as a receipt.

The bank issues blank cheque forms to the account holders for withdrawing money. The depositor writes the name of the party to whom payment is to be made or to his order.



Contra entry – It is a transaction in between cash and bank**.** When a transaction is recorded on both the sides of cash book but in different columns, such entry is called "Contra Entry". It is more likely to occur in a double column cash book as it is a combination of cash account and bank account. To indicate that the entry is a contra entry, the alphabet "C" should be written in the LF column on both sides.

When cash is deposited into bank	When cash is withdrawn from bank for office use
Bank A/c Dr 1000 To Cash A/c 1000	Cash A/c Dr 2000 To Bank A/c 2000

The above will be shown in the double column cash book as follows:

Receipts Payments

Date	Particulars	LF	Cash Rs.	Bank Rs.	Date	Particulars	LF	Cash Rs.	Bank Rs.
	Cash	C		1000		Bank	C	1000	
	Bank	C	2000			Cash	C		2000

Petty cash book - A number of small payments, like telephone bills, taxi fares, postage, cartage etc. have to be made by every organization. In this case a petty cashier is appointed to make all the small payments and record the same in a separate cash book called 'petty cash book'.

Imprest system of petty cash book – The term imprest means advance. Under this system of petty cash, a fixed amount is advanced to the petty cahier at the beginning of a period. The amount advanced to him by the main cashier is called "imprest" and hence this system is called as imprest system of petty cash.

It may be maintained in two ways:-

a. **Simple petty cash book –** It is maintained just like a simple cash book. The amount received from the main cashier is entered on the debit side and all the payments are recorded on the credit side.
b. **Analytical / columnar petty cash book –** Under this method a number of columns for the amount on the payment side besides the first total amount column. The other amount columns are provided for items of repetitive nature. One last column is designated as 'miscellaneous' followed by a 'remarks' column in order to record the payments for which there is no separate column. The nature of payment is entered in the remarks column. At the end, all the amount columns will be totaled and the total amount column will show the total amount spent and to be reimbursed.

Example for analytical cash book:

Receipts Rs.	Date	V. No.	Particulars	Total Amt	TA	Cartage	Stationary	Misc.	Remarks
	2001								
200	Feb		Cash						
	1		TA	10	10				
	13		Stationary	20			20		
	15		Cartage	10		10			
	28								
			TOTAL	40	10	10	20		
200			Balance c/d	160					
				200					
	2001								
160	March 1		Balance b/d						
40			Cash received						

Purchase day book or Purchase journal – This book is used for recording only credit purchases of goods made by the businessman. Cash purchases and purchases of assets are not recorded in it. The purchase invoices from the suppliers of goods are the source documents for recording entries in this book.

Sales day book or Sales journal – All credit sales of goods are recorded in this book. Cash sales and sale of assets are not recorded in the sales day book. The sales invoice or bill acts as the source document for recording entries in this book.

Format of a Purchase day book

Date	Particulars	Inv. No.	L/F	Details Rs.	Amt Rs.
2014	Bangalore Cycles Ltd				
Jan 1	(Supplier)				
	2 Cycles @ Rs. 1500			3000	
	3 Cycles @ Rs. 2000			4000	
	Total			7000	
	Less Trade discount @ 3%			210	6790

Format of a Sales day book

Date	Particulars	Inv. No.	L/F	Details Rs.	Amt Rs.
2014	Swaraj Co Ltd. (Customer)				
Jan 1	1 Cycle @ Rs. 1800			1800	
	2 Cycles @ Rs. 2500			5000	
	Total			6800	
	Less Trade discount @ 2%			136	6664

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Bank Reconciliation Statement

It is a statement prepared by the depositor (customer) for the purpose of making agree (reconcile) the cash book balance with the pass book balance on a certain date by making suitable adjustments.

Preparation of BRS – A bank reconciliation statement can be prepared in two ways:

1. Take the balance as per cash book as the starting point, adjust the effect of each item causing the differences and arrive at the balance as per pass book.

   Cash book → Pass book

2. Take the balance as per pass book as the starting point, adjust the effect of each item causing the differences and arrive at the balance as per cash book.

   Pass book → Cash book

Causes of differences between cash book balance and pass book balance

The differences between the cash book and the bank passbook are caused by:

- *Timing differences on* recording of the transactions.
- *Errors* made by the business or by the bank.

There are certain valid reasons for disagreement between the balances of cash book and pass book, they are as follows:

1. **Cheque issued but not presented for payment –** When a trader issues cheque to a third person, he immediately enters in the cash book whereas, it will be entered by the bank only when the cheques are presented to the bank for payment.
2. **Cheque paid in but not credited by bank –** Cheque received from customers might have been paid into bank and entered on the debit side of the cash book by the trader. But the bank will credit the same only after realization of the cheque.
3. **Interest etc. credited by bank –** Interest allowed on bank balance, dividends etc. collected by the bank will be credited in the pass book. But the trader may not enter the same in his cash book on the same day.
4. **Bank charges etc. debited in pass book –** Bank charges, interest on overdraft, commission for collection of cheques, bills, etc. will be debited by the bank in pass book as and when they occure. But it will be entered by the trader only on a later date in his cash book as he may not be aware about them on the same day.
5. **Cheques credited but dishonoured –** When cheque is discounted, bank will credit it in pass book and customer debit it in cash book, hence both the balances will be increased. Later on if this cheque is dishonoured, the bank will debit the customers account (pass book) but it may not be entered by the trader in his cash book at that time.
6. **Direct payment into the bank by trader's customers –** The customers of a trader might have deposited money into the trader's bank account directly. But it may not be intimated to the trader soon, hence it will not be recorded in the cash book.

7. **Payment made by bank on behalf of the customer –** The bank might have made some payments on behalf of the customer under 'standing instructions' and debited the customer's account. But the customer may not have entered the same in his cash book.
8. **Dishonour of a bill discounted with the bank –** Sometimes the customer discounts bills of exchange before maturity for urgent cash. If on the date of maturity, such a bill is dishonoured, the bank will debit the customer's account. The customer will make this entry in his book only after getting information from the bank.

Items to be added with cash book balance

1. Cheques issued but not yet presented.
2. Interest allowed by the bank.
3. Interest, dividend, commission etc. collected by the bank but not recorded in the cash book.
4. Direct deposit made by the customer in firm's bank account.

Items to be deducted from the cash book balance

1. Cheques deposited into bank but not yet collected.
2. Bank charges debited by the bank in the pass book.
3. Interest on overdraft charged by the bank.
4. Payment made by bank on customer's behalf.
5. Cheques dishonored, but not recorded in cash book.

Note: If we are starting with the pass book balance, all the items added with cash book balance must be deducted and all the items deducted from the cash book balance must be added with the pass book balance.

In case the cash book and pass book shows an overdraft balance, the adjustment should be made in opposite direction of starting with deposit balance.

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Chapter – 6

TRIAL BALANCE AND RECTIFICATION OF ERRORS

Meaning – Trial balance is a statement prepared with the balances or totals of debits and credits of all accounts in the ledger to test the arithmetical accuracy of ledger account. It may be prepared annually, half yearly, quarterly or even monthly. It provides a basis for the preparation of final accounts in a reliable manner.

Objectives of trial balance

1. **To verify the arithmetical accuracy of ledger accounts** – If the total of debit and credit balances are found equal, we can assume that posting have been made on the correct side of account and balances taken correctly.
2. **To locate errors** – If the trial balance total does not agree, it means that there exist some errors due to posting of wrong amount, wrong totaling, posting on wrong side, omission to post an amount etc. As soon as it is identified, it can be rectified.

3. **To help in preparation of final accounts –** Final accounts or financial statements consists of Trading and Profit and Loss account and the balance sheet. The financial statements are prepared with the balances of ledger accounts, therefore, an accountant should make it sure that all the accounts are correctly prepared. An agreed trial balance thus, becomes an essential tool for preparing final accounts.

Format of a Trial Balance

Account Code	Name of accounts	Amount Rs. (Debit)	Amount Rs. (Credit)
TOTAL			

Methods of preparing trial balance

1. **Totals method –** In this method, the debit side total and credit side total of all accounts are entered in the respective column of trial balance. Finally, these columns are totaled.
2. **Balances method –** Under this method the balances of ledger accounts are shown in the respective column of the trial balance.
3. **Totals - cum - balances method –** This is a combination of the above two methods in which 4 amount columns are prepared. 2 columns for writing the debit and credit totals of all accounts and the other 2 columns for entering its balances.

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Chapter – 9

FINANCIAL STATEMENTS – I

Introduction

A trader is anxious to know the operating results in terms of profit or loss during a specified period of time and his financial position on a particular date. For this purpose, he prepares a summary of statements of accounting data at the end of the period. This summary is prepared in the form of a Trading and Profit and Loss A/c (Income Statement) and a Balance Sheet (Position Statement). These two statements are financial statements or final accounts.

Objectives of preparing financial statements

1. To present a true and fair view of the financial performance of the business.
2. To present a true and fair view of the financial position of the business.

For this purpose, the firm usually prepares “Trading and Profit and Loss Account” and “Balance Sheet”.
Trading Account – It is an account which is prepared to ascertain the trading result of a business. Profit arising out trading alone is called gross profit. Gross profit is the excess of net sales over the cost of goods sold and if the value of net sales is below the cost of goods sold the result will be gross loss.
Calculation of gross profit

Gross Profit = Net sales – cost of goods sold
Net Sales = Sales – Sales returns
Cost of goods sold = (Opening stock + Net Purchases + Direct Expenses) – Closing stock
Net Purchase = Purchase – Purchase returns
Gross Loss = Cost of goods sold – Net sales

Proforma of a Trading Account

Particulars		Amount Rs.	Particulars	Amount Rs.
Opening Stock			Sales	
Purchases	XXXX		XXXX	XXX
Less: Purchase returns	XXX	XXX	Less: Sales returns	XXX
Direct Expenses:			XXX	XXX
Carriage		XXX	Closing stock	
Wages		XXX	Profit & Loss a/c (**Gross loss** transferred to P&L a/c)	
Fuel		XXX		
Royalty		XXX		
Consumable stores		XXX		
Other manufacturing expenses		XXX		
Import duty		XXX		
Excise duty		XXX		
Octroi		XXX		
Clearing charges		XXX		
Dock dues		XXX		
Primary Packing Materials		XXX		
Profit & Loss a/c (**Gross Profit** transferred to P&L a/c)		XXX		
		XXXX		XXXX

Relevant terms/items in Trading Account

ON THE DEBIT SIDE

1. **Opening Stock –** It is the balance of stock brought forward from the previous year. It consists of raw materials, semi finished goods and finished goods. It is the first item on the debit side of the trading a/c because it forms part of the cost of sales.
2. **Purchases –** It refers to goods purchased for resale in business. It is shown on the debit side of trading a/c as it is a major expense. Net purchase = Purchase – Purchase returns.
3. **Direct expenses –** All expenses incurred for purchasing or manufacturing the goods and making them ready for sale are called direct expense. It must be debited to trading account.

a. Wages – paid to the workers who are directly engaged in production.
b. Carriage/Cartage/Freight – incurred for bringing the goods to the place of production or sales.
c. Fuel/Power/Gas/Water – incurred for production.
d. Royalty – It is the amount paid to the owner of an asset for using his right, Royalty paid on use of coal mines, quarries etc. (If royalty is based on sales, as on book publishing it is to be treated as indirect expenses and hence not debited to Trading account).
e. Consumable stores – It includes lubricating oil, grease, cotton waste etc. are used in the process of production.
f. Customs duty/Excise duty/ Octroi – These expenses are related to purchase of goods which are debited to trading account.
g. Primary packing materials – Packing materials and packing charges necessary to make the goods in saleable conditions have to be treated as direct expense.
h. Dock dues and clearing charges – they are incurred in connection with purchase of goods.

ON THE CREDIT SIDE

1. **Sales –** Sales less returns (net sales) is the direct income for any business and is credited to trading account.
2. **Closing stock –** It is the value of goods unsold at the end of accounting year. It is shown on the credit side of trading account as it reduces the cost of sales.

Profit and Loss Account – This account is prepared to find out the net profit earned or net loss incurred by a business during an accounting period. It is debited with all revenue expanses and losses which are not taken in the trading account and credited with all revenue incomes and gains. If the incomes credited in the account exceed the expenses on the debit side, it shows a net profit, otherwise, it shows a net loss.

Relevant items in Profit and Loss Account

1. **Salaries –** paid to the employees in administrative, selling and distribution sections fall under this category. It is debited to P&L A/c as it is having an indirect nature.
2. **Rent, Rates and Taxes –** These include office and godown rent, municipal rates and taxes. While, factory rent, rates and taxes will be debited to trading account.
3. **Interest –** Interest paid on loans, overdraft, renewal of bills of exchange etc. are indirect expenses, hence debited to P&L Account.
4. **Repairs –** All repairs and small renewal charges other than factory repairs are of indirect nature and hence debited to this account.
5. **Depreciation –** Any decline in the value of fixed assets duet to wear and tear or other reasons is called depreciation. It is an indirect expense and debited to this account.
6. **Miscellaneous expenses –** All other expenses having different nature will be grouped under this head and debited to P&L A/c.

Proforma of Profit and Loss Account

Profit and Loss account of ……….. (Name of the firm) for the year ended …….. (Date)

Particulars	**Amount Rs.**	**Particulars**	**Amount Rs.**
Gross loss B/F (Gross loss transferred from Trading a/c, if any)		Gross Profit B/F (Transferred from Trading account, if any)	XXX
Operating expenses:	XXX	Other incomes	XXX
Administration expenses			
Selling expenses	XXX		
Distribution expenses	XXX		
Operating Profit C/d	XXX		
	XXX	*Operating Loss C/d*	*XXX*
	~~XXX~~		XXX
Operating Loss B/F			
Non Operating expenses:	*XXX*	*Operating Profit B/f*	*XXX*
Interest		**Non Operating incomes:**	XXX
Tax	XXX		
Loss on sale of fixed assets	XXX		
Loss on sale of investment	XXX		
Net Profit transferred to Capital a/c	XXX		
	~~*XXX*~~	*Net Loss transferred to Capital a/*c	*XXX*
	~~XXXX~~		XXXX

Proforma of a Balance Sheet in the order of liquidity

Balance Sheet as on …………. (date)

LIABILITIES	Rs.	ASSETS	Rs.
Bank overdraft		Cash in hand	
Bills payable		Cash at bank	
Outstanding expenses		Short term investments	
Sundry creditors		Sundry Debtors	
Income received in advance		Bills Receivable	
Loan		Stock of goods	
Capital:		Machinery	
Opening balance		Furniture	
Add: Net Profit (less: N/p)		Buildings	
Less: Drawings		Patents	
		Copyrights	
		Goodwill	

Proforma of Balance Sheet in the order of permanence

Balance Sheet as on …………. (date)

LIABILITIES	Rs.	ASSETS	Rs.
Capital:		Goodwill	
Opening balance		Copyrights	
Add: Net Profit (less: N/p)		Patents	
Less: Drawings		Buildings	
Loan		Furniture	
Income received in advance		Machinery	
Sundry creditors		Stock of goods	
Outstanding expenses		Bills receivable	
Bills payable		Sundry Debtors	
Bank overdraft		Short term investments	
		Cash at bank	
		Cash in hand	

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Chapter – 10

FINANCIAL STATEMENTS - II

Final accounts with adjustments – It is quite usual that some of the expenses paid or incomes received during the accounting period may relate to the previous year or to the subsequent year. If these items are not adjusted into the accounts, the summary presented in the form of final accounts will not give a true picture. All items which need alteration or which are to be brought into records at the time of preparation of final accounts are called adjustments.

1. **Closing stock –** The adjustments regarding closing stoc
   a. It is credited to trading account.
   b. It is shown as an asset in the balance sheet.

Closing Stock a/c Dr
To Trading a/c

2. **Outstanding expenses –** Expenses which have been incurred and are due for payment, but have not yet been paid during the accounting period is called outstanding expenses. (**Due but not paid**) E.g., Rs.1000 per month is paid salary to an employee, but altogether only Rs.11000 has been paid during this year, here one month salary Rs.1000 is due but not paid and is called outstanding salary. In order to find the true

profit for the year this outstanding amount is to be brought into accounts. This is actually an expense for the year as well as a liability too. Adjustment entry regarding this item is as follows:

Concerned expenses a/c (Salary a/c) Dr
To Outstanding expenses a/c (O/s salary a/c)

The effect of the above adjustment will be:

a. Outstanding expenses will be debited to trading and profit and loss a/c by way of addition to the concerned expense.
b. Outstanding expenses will be shown on the liability side of the Balance Sheet.

3. **Prepaid expenses –** Those expenses which have been paid in advance, whose benefit will be available in future are called unexpired or prepaid expenses. (**Paid but not due**). E.g., Prepaid insurance, Prepaid rent etc.

Adjustment entry: Prepaid expense a/c Dr
To Concerned expense a/c

The effect of the above adjustment will be:

a. It will be deducted from the respective expense on the debit side of trading and profit and loss account.
b. It is shown as an asset in the Balance sheet

4. **Accrued Income or outstanding income –** Income which have become due during the accounting period but the same has not been received are called accrued income. (**Income due but not received**). E.g., Accrued Interest on bank deposit, Accrued commission etc.

Adjustment entry:

Accrued/Outstanding income a/c Dr
To Concerned income a/c

The effect of the above adjustment will be:

a. It will be shown on the credit side of the profit and loss a/c by way of addition to the income.
b. It will be shown on the asset side of the Balance Sheet as Accrued Income.

5. **Income received in advance –** A portion of the income received during the current year may relate to the future period is called Unearned income or income received in advance. (**Received but not due**). E.g., Rent received in advance, commission received in advance.

Adjustment entry:

Concerned Income a/c Dr
To Income received in advance a/c

The effect of the above adjustment will be:

a. It will be deducted from concerned income on the credit side of T&P/L a/c.
b. It is shown as a liability in the Balance Sheet.

6. **Depreciation –** Depreciation is the decrease in the value of an asset due to wear and tear, passage of time etc. This is an operating expense to the business. And to arrive at the correct profit or loss made by the business, it should be charged (debited) to profit and loss a/c.

Adjustment entry:

Depreciation a/c Dr
To Concerned Asset a/c

The effect of the above adjustment will be:

a. Depreciation is shown on the debit side of profit and loss account.
b. It is shown on the assets side of the Balance Sheet by way of deduction from the concerned asset.

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Chapter – 13

COMPUTERIZED ACCOUNTING SYSTEM

Concept of Computerized Accounting System

A computerized accounting system is an accounting information system that processes the financial transactions and events as per accounting principles (GAAP) to produce reports as per user requirements. In a computerized accounting system, the framework of storage and processing of data is called **operating environment** which consists of hardware and software in which the accounting system works.

Modern computerized accounting system is based on the concept of database. A database is implemented using a database management system, which is defined by a set of computer programs (software) that manage and organize data effectively.

Comparison between Manual Accounting and Computerised Accounting

Basis	Manual Accounting	Computerised Accounting
1. Identifying transactions	Based on Accounting Principles	Based on Accounting Principles
2. Recording	In the books of original entries	In an accounting database (software)
3. Classification	By posting into ledger accounts – results in duplication of accounting data	Automatic by the software – no duplication of data
4. Summarising	By balancing all the ledger accounts	No need to balance the ledger accounts, but it is automatic
5. Financial Statements	Preparation of Final Accounts presupposes the availability of trial balance	Not necessary to prepare the trial balance for the preparation of final accounts
6. Closing the Books	After the preparation of financial reports, accountants make preparation for the next accounting period. It is by passing opening journal entries	There is year-end processing for closing the books of accounts of current year and to open new accounts for the next accounting period.

Advantages of computerized accounting system

1. **Speed –** Accounting data is processed in a lightning speed when it is compared with the manual effort.
2. **Accuracy –** The possibility of error is eliminated because the primary accounting data is entered only once.
3. **Reliability –** Computers are highly reliable compared to human beings as they are free from tiredness, boredom or fatigue.
4. **Up-to-date information –** The accounting records in a computerized accounting system are updated automatically as and when the data is entered and stored and it will be reflected in all the reports within no time. Therefore, latest information is available without any additional effort.
5. **Real time user interface –** Most of the automated accounting system are inter-linked through network of computers, so that the information is available to various users at the same time on a real time basis.
6. **Automated Document Production –** The accounting reports such as cash book, trial balance, balance sheet etc. are obtained just by a mouse click.
7. **Legibility –** The reports and data displayed on a monitor or printout is more legible than handwritten words. So that the chances errors are minimized.
8. **Efficiency –** Computer accounting system ensures better use of resource and time.
9. **Quality reports –** The reports generated by this system are error free and highly objective and can be relied upon.
10. **MIS reports –** Computerized accounting system facilitates the real time production of management information reports, which will help the management to monitor and control the business effectively. E.g. Credit limit to a particular customer can be set.
11. **Storage and Retrieval –** Computer accounting system allows the users to store data in a manner that does not require a larger amount of physical space as in the case of manual accounting.
12. **Motivation and employee interest –** The computer system requires specialized training for staff which makes them feel highly motivated and develops interest on the job.

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Chapter 7, 8, 11 and 12 included in Un-focus Area
(25% Questions expected from un-focus area)

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