Business Accounting
UNIT - I

INTRODUCTION TO ACCOUNTING

Introduction :

The word "money" is so important to survive in the human society just like as blood in the human structure. It is well said that "Nothing is impossible when money is available and nothing is possible when the money is not available". The source of money is created by way of undertaking a job, engaging in agriculture, business or profession etc. The availability of money is depend upon the manner in which money is expended. This means if a person or business concern is careless in spending money; the day may come when he or it does not have a single rupee.

In other words, the availability of money is not merely depend upon the earning of income but very much depend upon the manner in which the earned income is expended. Thus the proper management of income and expenditures is quite important to survive as well as to grow. It requires preparing and maintaining proper records and books in the systematic manner. For this purpose, a technique or tool named as "accounting" has been in the use since the ancient period.

Meaning of Accounting:

Accounting is an art of recording transactions according to size, nature and type of business transactions – cash transactions, credit transactions, frequent transactions etc. When the recording in journal or subsidiary books is done, they are to be classified by grouping the transactions or entries of one nature at place.

Accounting and Book keeping:

Book keeping may be defined as the art and science of correctly and systematically recording in the books of account the business transactions of an individual or a concern in a way to show clearly the monetary effect of each such transactions. The work of book-keeping is usually entrusted to junior employees, who maintain various books of accounts, journal, subsidiary books, ledgers etc, can be called as book Keepers.

Need for Accounting:

It is common experience of all of us that money must be spent carefully. A firm receives money from certain sources like sale of goods, interest on bank deposits. It has to spend money on a number of items like salary, rent, electricity, water, advertisement.

Definition:

Accounting is defined as "the art of recording, classifying and summarising in terms of money transactions and events of a financial character and interpreting the results thereof."

Steps in Accounting :

Following are the various steps involved in accounting:

i. Recording : Each and every transaction is recorded as and when it occurs in chronological order. Every entry recorded has to be supported by reliable documentary evidence. The method of recording is adjusted according to the size, and nature of business and the type of transactions.

ii. Classification : The classification takes the form of accounts in a separate book called as Ledger. Separate ledger accounts are opened for each expenses, income, property and liability. It useful for the segregation of numerous business transactions into identifiable groups.

iii. Summarizing : Summarizing takes place in the form of trial balance, trading account, profit & loss account and balance sheet which are discussed in detail in the following chapters.

iv. Interpretation: It is usually done through flow statements. They are useful in evaluating past performance and providing guidance for future plans and activities.

Objectives of Accounting:

Following are the objectives for which accounting is aimed at:

i. To provides the permanent record.

ii. To provides the most effective way to the management for fixing of objectives of the business.

iii. To provides the most vital information to the management to preparing budgets.

iv. To facilitates the business concern to know the profit or loss for a given period.

v. To facilitates to know the soundness of a business concern by providing balance sheet.

vi. To enables to prepare a list of customers and suppliers to ascertain amount to be received or paid.

vii. To gives opportunities to review the business policies in the light of the past records.

viii. To comply with provisions of Companies Act 1956, it is necessary to maintain accounting records.

ix. To be useful for business loss, provision of licenses, assessment of taxes etc.,

Types of Accounting:

There are two systems of accounting namely Single Entry System and Double Entry System.

Single Entry System: The single entry system is not a really a system because in some cases record may be one – sided; and in some other cases no record is maintained at all. Thus, the system is incomplete, inaccurate and unscientific system of recording business transactions.

Double Entry System: The modern system of accounting is based on what is Known as double entry principle. It refers to that system of book keeping where each transaction is recorded in both of its aspects. viz.i. receiving of the benefit of the transaction and ii. Giving away of the benefit of the transaction. For a complete record of transactions, it should be presented in both the accounts. Thus, every transaction involves two accounts, one which gives the benefit of the transactions and another which receives the same.

CONCEPTS AND CONVENTIONS OF ACCOUNTING

Meaning of Accounting Concepts :

Accounting concepts can be described as something which signifies a general notion regarding accounting principle. The assumptions, so made, are most natural and are not forced ones. A concept is self-evident proposition i.e., something taken for granted. There is no authoritative list of these concepts.

1.Business Entity Concept :

Business is treated as separate from the proprietor. This concept is important and implies that a business is separate and distinct from the persons who supplied capital to the firm. All transactions of the business are recorded in the books of the firm. It is important to note that transactions of the business affairs and private affairs are separated for recording only and in law, no such distinction is recognized except for an incorporated company.

2.Money Measurement Concept :

Only those transactions, which can be expressed in monetary terms, are recorded in accounting though their quantitative records may also be kept. All business transactions should be expressed only in money.

3.Going Concern Concept:

This concept relates with the long life of the business. A business is intended to continue for an indefinitely long period. For all practical purposes, a business firm comes under going concern concept, when there is no evidence to the contrary. All firms that continue to operate on a profitable footing are treated as going concerns.

4.Accounting Period Concept:

Accounting is a continuous process in any business undertaking. Every businessman wants to know the result of his investment and efforts at frequent intervals. Accountants choose some shorter period to measure the result. Therefore, one year has been, generally, accepted as the accounting period. It may be 3 months or 2 years also. This period is called accounting period. One year accounting period is recognised by law and the taxation is assessed annually. Reports to the outsiders are provided on this accounting period.

5.Accrual Concept:

According to this concept the revenue is recognised on its realisation and not on its actual receipt. Similary, the costs are recognised when they are incurred and not when payment is made. This assumption makes it necessary to give certain adjustments in the preparation of income statement regarding revenues and costs.

6.Cost Concept:

Under this concept, fixed assets are recorded in the account books at the price at which they are acquired. This price paid to acquire the assets is termed as cost and this cost is the basis for all the subsequent accounting for the asset.

7. **Reliasation Concept :**

According to realisation concept, which is also known as the "revenue recognition concept", revenue is considered as being earned on the date on which is realised i.e., the date on which goods and services are transferred to customers either for cash or for credit. The realisation concept is important in ascertaining the exact profit earned during a period in business concern. This concept is very important as it prevents firms from inflating profits by recording sales and incomes that are likely to accrue.

8.Dual Aspect Concept :

This concept signifies that every business transaction involves a two-fold aspect a. the yielding of benefit and b. the giving of the benefit. For an exchange of value, two parties are required-a giver and a receiver, the assets of a business entity will always be equal to its liabilities i.e.,

Total Assets = Total Liabilities

Total Assets = Capital + Outsiders' liabilities

Capital = Total Assets - Outsiders' liabilities.

9.Matching Concept :

According to this concept, it is necessary to match the expenses incurred during the accounting period with the revenues recognised during the same period. Since profit is an excess of revenue over expenses, it becomes necessary to bring together all revenues and expenses pertaining to a particular period. In other words, expenses incurred in an accounting year should be matched with the revenues recognised in that year.

10.Objectivity Concept:

This concept implies that all accounting transactions should be evidenced and supported by business documents i.e., invoices, vouchers etc.

Meaning of Accounting Convention:

An accounting convention is a common practice which is universally followed in recording and presenting accounting informations of business. They are like customs that are followed in a society. Conventions help in comparison of accounting data of different business units or of the same unit for different periods. The object is to make accounting data more useful. Following are the accounting conventions in the use:

1.Convention of Disclosure:

The convention requires that accounting statements should be honesty prepared and all significant information should be disclosed therein. That is, while making accountancy records, care should be taken to disclose all material information. Here the emphasis is only on material information and not on immaterial information. In short, full disclosure of all relevant facts in accounts is a necessity in order to make accounting record useful. Therefore, full disclosure is a very healthy convention, and is important.

2.Convention of Conservatism :

"Anticipate no profit and provide for all possible losses" is the essence of this convention. Future is uncertain. Fluctuations and uncertainties are not uncommon. Conservatism refers to the policy of choosing the procedure the leads to under-statement as against overstatement of resources and income.

3.Convention of Materiality :

American Accounting Association defines the term materiality as "an item should be regarded as material if there is reason to believe that knowledge of it would influence the decision of informed investor." In short, all material information should be disclosed that it is necessary to make the financial statements clear and understandable.

4.Convention of Consistency :

Rules and practices of accounting should be continuously observed and applied. In order to enable the management to draw conclusions about the operation of a company over a number of years, it is essential that the practices and methods of accounting remain unchanged from one period to another. Comparisons are possible only if a consistent policy of accounting is followed.

ACCOUNTING PROCEDURE

Introduction :

In the previous two chapters we have discussed basic elements, concepts and conventions of accounting . In the present chapter we are going to discuss the various procedures involved in the process of accounting starting with journal and ending with trial balance .

Journal :

Journal is the day-by-day of the business, wherein both the aspects of all business transaction are recorded in chronological order i.e. date – wise. The journal is, thus , a Book of Prime Entry. It is otherwise known as the Book of Original Entry. These entries are then posted from the journal into the ledger. As such, the ledger is known as the Principal Book or the Main Book. The journal merely helps the posting of entries from the journal into the ledger. Hence, journal is known as Subsidiary Record or Subsidiary Book. Journalising is an act of recording the debit and credit aspects of a business transaction in journal together with an explanation of the transaction, known as Narration.

Rules of Journals :

The act of recording the transaction in journal is called journalising. This recording is made according to certain rules and these rules, are called rules of journalising.

The business must enter into transactions with a number of persons or firms, possess some property, for example , cash, furniture, machinery etc., to carry on the business, pay certain expenses for example, rent salaries, wages etc., and receice certain incomes , for example, interest, commission etc. The following accounts are required to be maintained. Rules for Debit and Credit are

i. Personal Accounts

Debit the Receiver
Credit the Giver

ii. Real Accounts

Debit what comes in
Credit what goes out

iii. Nominal Accounts

Debit all losses and expenses
Credit all gains and incomes.

Steps in Journalising:

The following are the steps in journalising:

i) Determine the two accounts which are involved in the transactions.
ii) Clasify the above two accounts under Persaonal, Real or Nominal.
iii) Find out the rules of debit and credit for the above two accounts.
iv) Identify which accounts are to be debited and which account is to be credited.
v) Record the date of transaction in the date column.
vi) Enter the name of the account to be debited in the particulars column very close to the left hand side of the particulars column followed by the abbreviation Dr. in the same line against this, the amount to be debited is written in the debit amount, column in the same line.

vii) Write the name of the account to be credited in the second line starts with the word 'To'a few space away from the margin in the particulars column. Against this, the amount to be credited is written in the credit amount column in the same line.
viii) Write the narration within brackets in the next line in the particulars column.
ix). Draw a line across the entire particular column to separate one journal entry from the other.

Advantages: The main advantages of the journal are:
i.It reduces the possibility of errors
ii. It provides an explanation of the transactions iii. It provides a chronological record of all transactions.

Limitations: The limitations of the journal are:i. It will be too long if all transactions re recorded here ii. It is difficult to ascertain the balance of each account.

Ledger

As we know that first, all business transactions are recorded in the journal, separately and date-wise. The transactions relating to person, assets, expenses and income are journalized chronologically, i.e. date- wise. But one cannot find similar transactions at one place in the journal. Therefore, to have a consolidated view, we have to prepare different accounts in the ledger. Ledger is a register, having a number of pages, which are numbered consecutively. One page in the ledger is usually allotted to one account. An index to various accounts in the ledger is given at the beginning of the ledger for easy reference.

Subsidiary Books :

Maintaining a single ' journal book' in which journal entries are written for each transaction and posting them to ledger is practicable in small business where a single accountant can maintain accounts or the owner himself can do the accounts work.

1.Purchase Book :

Purchase book is also known as ' bought book' 'Purchase day book', invoice book'; and 'purchase journal'. All credit purchase of goods are recorded in this book. Periodical total of this book provided total credit purchase of goods made by the firm.

2.Purchase Return Book :

It is also called 'Returns outward book' and ' Purchase returns journal'. Goods returned to suppliers which were originally purchased on credit are recorded in this book. Periodically totals of this book provide data on purchase returns by the firm.

3.Sales Book :

Sales book is also known as 'Day book', Sales day book', ' Sold book', Sales journal', etc. All credit sales of goods are recorded in this book. Periodical totals of this book provide the total credit sales of goods by the firm.

4.Sales Returns Book :

This book is also called ' Returns Inward Book' and Sales Returns Journal'. Goods returned by customers which were originally sold on credit are recorded in this book. Monthly totals of this book provide data on sales returns. Credit notes sent to the customers after receiving the goods returned by them form the basis for entries in this book.

5.Cash Book :

One of the most important books maintained in any business concern is the cash book. The cash book records transactions connected with cash. The object of cash book is to keep a daily record of transactions relating to receipts and payments of cash. The following are the different types of cash book maintained in business firms :

i. Simple Cash Book
ii. Cash Book with Discount and Cash Columns.
iii. Cash Book with Discount, Cash and Bank Columns.
iv. Analytical Petty Cash Book.

Journal Proper :

There are certain transactions, which cannot be entered in through any subsidiary books and such transactions are entered in the form of journal, called Journal Proper. From this journal proper, further their postings are made as usual.

Examples of such transactions are:

i. Opening entries
ii. Transfer entries
iii. Adjusting entries
iv. Closing entries
v. Rectification journal entries.
vi. Credit Purchase or Sales of assets.
vii. Bad debts.
viii. Other entries not made in any other subsidiary books

Advantages of Subsidiary Books :

The advantages of maintaining subsidiary books are as follows :

i. Division of labour : The division of journal resulting in division of work, ensures more clerks working independently in recording original entries in the subsidiary books.

ii. Efficiency : the division of labour also helps the reduction in work load, saving in time and stationery. It also gives advantages of specialization leading to efficiency.

iii. Prevents Errors and Frauds : The accounting work can be divided in such a manner that the work of one person is automatically checked by another person. With the use of internal check, the possibility of occurrence of errors and frauds may be avoided.

iv. Easy References : It facilitates easy references to any particular item. For instance total credit sales for a month can be easily obtained from the sale book.

v. Easy Postings : Postings from the subsidiary books are made at convenient intervals depending upon the nature of the business.

Trial Balance :

Meaning : Books of accounts of a firm are closed at the end of the year, but they may be closed at any time according to the requirements of the proprietor. Thus, Trial Balance is a statement in which the debit and credit balances of all accounts are recorded with a view two ascertain the arithmetical accuracy of the books of accounts. The only condition is the accounts must be balance in order to draw a Trial Balance. Trial Balance is not a part of journal or ledger. It is only a list or statement.

Objectives/ Advantages :

The objects of the preparation of the Trial Balance are as follows:

i. A Trial Balance provides a good check on the accuracy of the work done in preparing ledger accounts. When the total of the debit balances agree with total of credit balances, it is quite a good proof that the ledger accounts have been correctly written up. If the Trial balance totals do not agree, then it shows that there are some errors which must be detected and rectified, before final accounts are prepared.

ii. It brings together the balances of all the accounts at one place and thus facilitates the preparing the trading accounts and profit and loose accounts, which is the results of the business; and the balance sheet to ascertain the financial position of the firm. In short, Trial Balance is the basic to prepare the final accounts.

iii. The balance of any accounts can be easily and continently known by the trail balance.

iv. It serves as a summary of what is contained in the ledger.

Rules for Preparation of Trial Balance :

From the available balances of various ledger accounts, the trial balance shall be prepared on the basis of following rules.

Debit All Expenses and Assets .

Credit All Incomes and Liabilities.

Fundamental Journal Entries:

Following are the Journal entries for the important transactions usually take place in a business. The students are advised to use these entries to familiar with passing of journal entries.

1 For Capital Introduced

Cash A/c Dr

To Capital A/c

2 For Drawings Made

Drawings A/c Dr

To Cash A/c

3 For Deposit into Bank

Bank A/c Dr

To Cash A/c

4 For Withdrawl from the Bank

Cash A/c Dr

To Bank A/c

5 For Income Received

Cash A/c Dr

To Income

6 For Expenses paid

Expenses A/c Dr

To Cash A/c

7 For Purchases of Asset for Cash

Asset A/c Dr

To Cash A/c

8 For Purchases of Asset on Credit

Asset A/c Dr

To Seller A/c

9 For Purchases of Goods for Cash
Purchases A/c Dr
To Cash A/c
10 Purchases of Goods on Credit
Purchases A/c Dr
To Creditor A/c
11 For Sale of Asset for Cash
Cash A/c Dr
To Asset A/c
12 For Sale of Asset on Credit
Buyer A/c Dr
To Asset A/c
13 For Sale of Goods for Cash
Cash A/c Dr
To Sales
14 For Sale of Goods on Credit
Debtors A/c Dr
To Sales A/c
15 For Collection from Debtors
Cash A/c Dr
To Debtors A/c
16 For Payment to Creditors
Creditors A/c Dr
To Cash A/c
17 For Purchase Returns
Creditors A/c Dr
To Purchase Returns A/c
18 For Sales Returns
Sales Returns A/c Dr
To Debtors