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Course Financial Reporting & Statement Analysis

Segment 2 Accounting Process-Part 1

Faculty Ujwal M S



Webinar 1: Financial Reporting



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ONLINE EDUCATION
(A unit of Manipal Academy of Higher Education, Manipal)

Recap

1

Basic Introduction of accounting

2

The Accounting base for Financial reporting

3

A brief introduction to Financial statements

4

Users of Financial Information



Webinar 2: Accounting Process-Part 1



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Overview of Topics

1

Double entry system of bookkeeping

2

Classification of accounts

3

Important terms in Accounting

4

Concept of Journal, Ledger & Trial balance



Accounting Process-Part 1

Learning Objectives

At the end of this session, you will be able to:

Understand Double entry system of bookkeeping

Classify the types of accounts

Understand Important terms in Accounting

Demonstrate Concept of Journal, Ledger & Trial balance



DOUBLE ENTRY SYSTEM OF BOOK-KEEPING

"Book-keeping is the science and art of correctly recording in the books of accounts, all those business transactions that results in transfer of money's worth." - R.N. Carter

FUNCTIONS/STEPS OF BOOK KEEPING

1. Identifying Accounting Transactions (*in terms of money*)
2. Initial record of Business Transaction (*journal*)
3. Preparation of Ledger Account
4. Balancing Ledger Account (*subsidiary books*)
5. Preparation of Trial Balance





DOUBLE ENTRY SYSTEM OF BOOK-KEEPING

The double entry system of bookkeeping can be defined as “the system of recording transactions having two fundamental aspects - one involving the receiving of a benefit and the other giving the benefit - in the same set of books”.

Double-entry system works on the principle that, for every debit aspect, there is a corresponding credit. This is to keep the accounting equation in balance.

Under the double entry system, both the aspects of giving and receiving are recorded in terms of accounts.

It is the ultimate result of this system that every debit must have corresponding credit and vice versa thus, on any particular day the total of the debit entries and the credit entries on the various accounts must be equal.



DOUBLE ENTRY SYSTEM OF BOOK-KEEPING

What Is the Accounting Equation?

The accounting equation is considered to be the foundation of the double-entry accounting system. On a company's balance sheet, it shows that a company's total assets are equal to the sum of the company's liabilities and shareholders' equity.

Accounting Equation ➔

$$\text{TOTAL ASSETS} = \text{CAPITAL (SHAREHOLDERS EQUITY)} + \text{LIABILITIES}$$



Assets



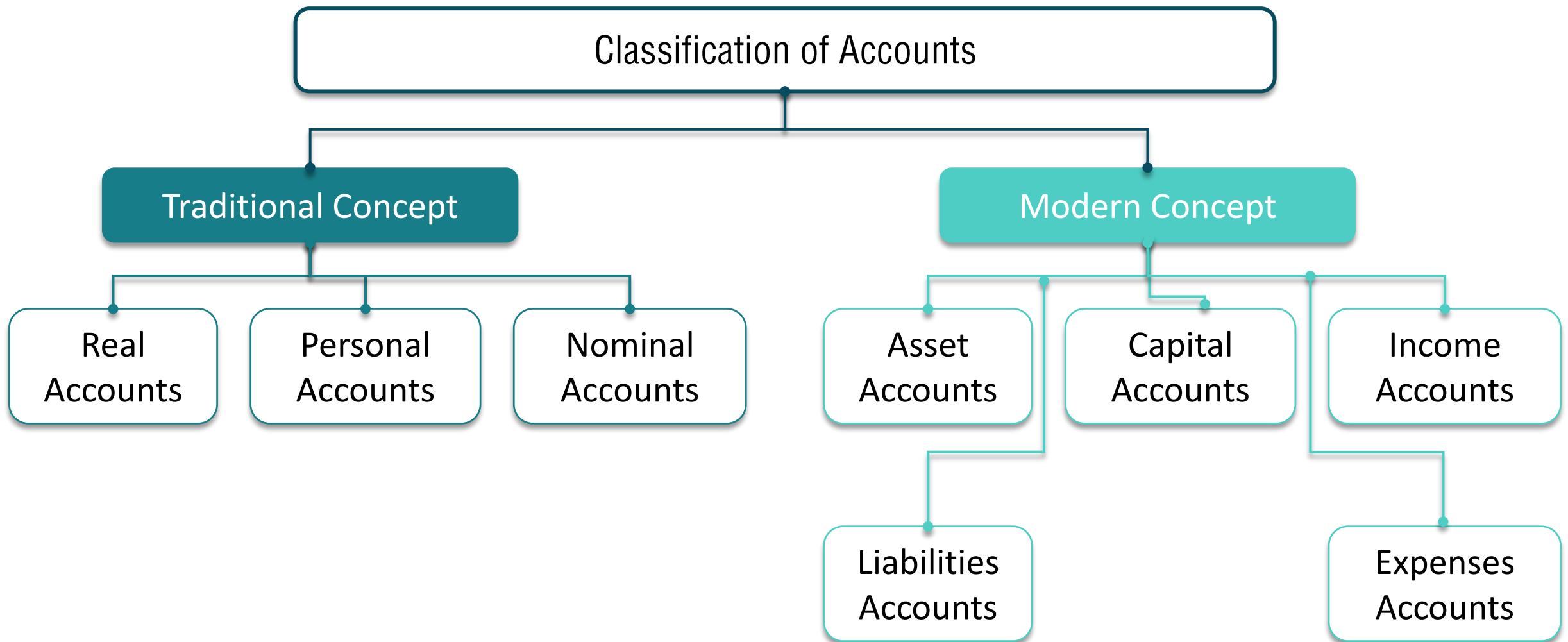
Owners' Equity

+



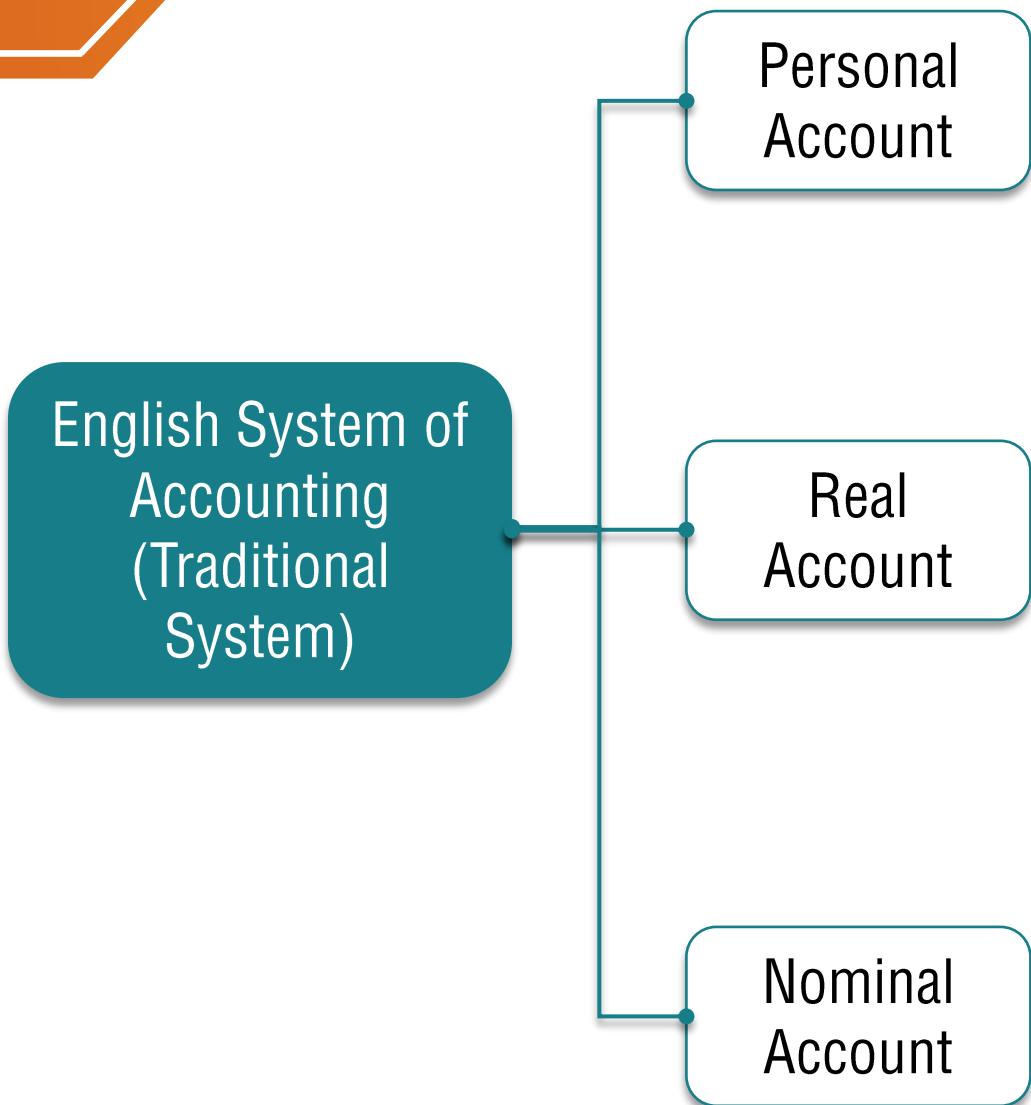
Liabilities

Classification of Accounts (Types/Kinds)





Classification of Accounts (Types/Kinds)





Classification of Accounts (Types/Kinds)

English System of
Accounting
(Traditional
System)

Personal
Account

Real
Account

Nominal
Account

An account in the name of a person from whom value in terms of money is receivable or to whom value in terms of money is payable.

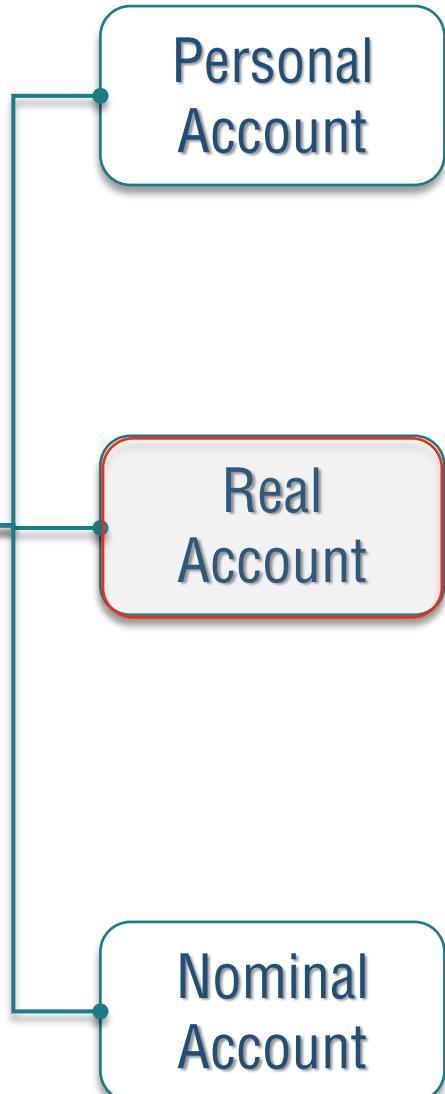
Example

Ujwal's a/c, Canara Bank a/c, Reliance Co. Ltd. a/c, and so on



Classification of Accounts (Types/Kinds)

English System of Accounting (Traditional System)



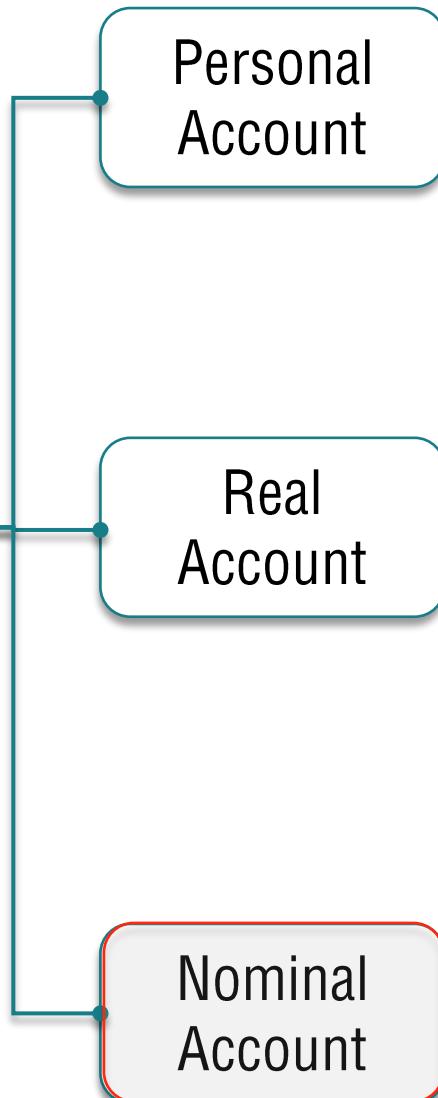
These accounts represent the property of the business – in other words, things owned by businesses.

Example

Cash a/c, Furniture a/c, Machinery a/c, and so on



English System of Accounting (Traditional System)



- These accounts represent expenses and losses, incomes and gains of a business.
- Such accounts do not exist and are not visible.
- They exist only in name – also called **fictitious accounts**.

Example

Salary a/c, Interest a/c, Discount a/c, Commission a/c

Real Account

- Debit what comes in
- Credit what goes out

Nominal Account

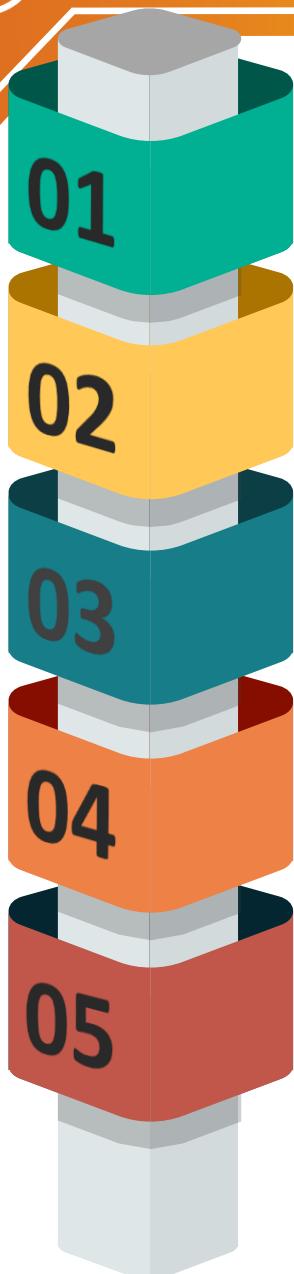
- Debit all expenses and losses
- Credit all incomes and gains

Personal Account

- Debit the receiver
- Credit the giver



American System of Accounting (Modern System)



Asset Account

Liabilities Account

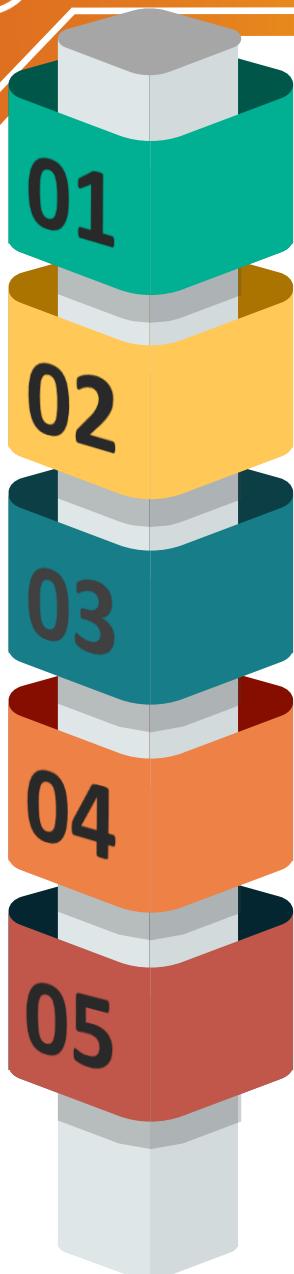
Capital Account

Income Account

Expense Account



American System of Accounting (Modern System)



Debit increases in asset



Credit decreases in asset

Liabilities Account

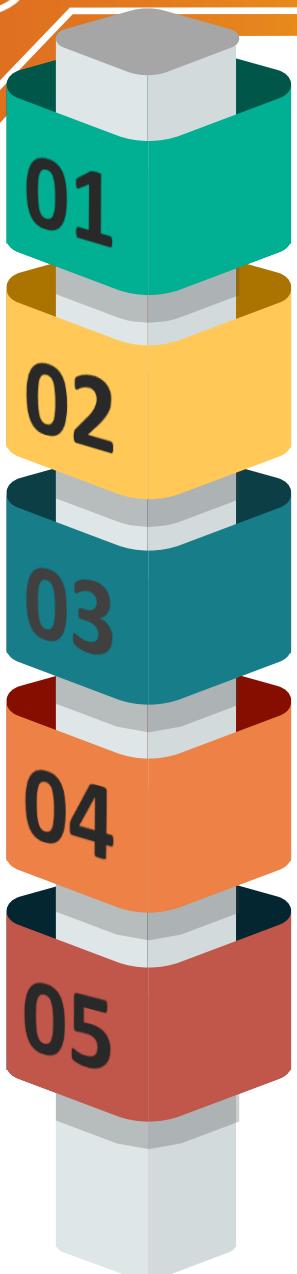
Capital Account

Income Account

Expense Account



American System of Accounting (Modern System)



Asset Account



Debit decreases in liabilities

Liabilities Account



Credit increases in liabilities

Capital Account

04

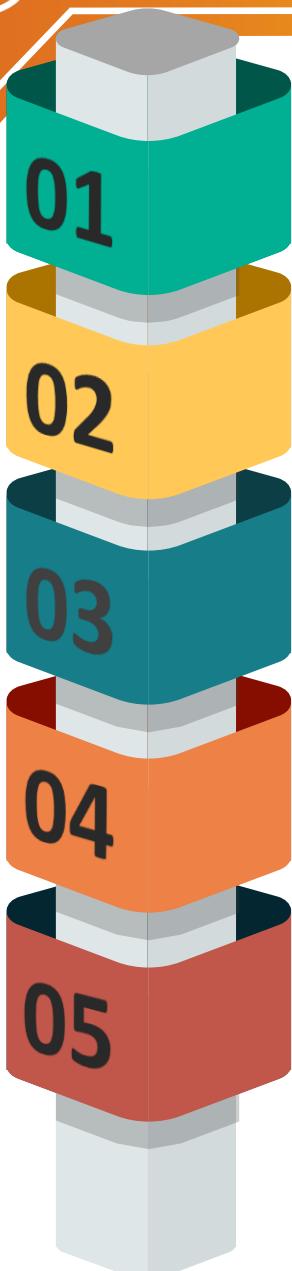
Income Account

05

Expense Account



American System of Accounting (Modern System)



Asset Account

02

Liabilities Account

03

Capital Account

04

Income Account

05

Expense Account



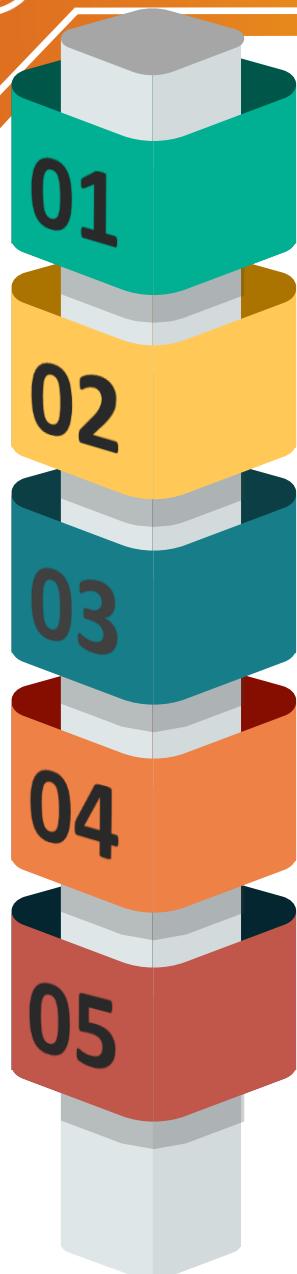
Debit decreases in capital



Credit increases in capital



American System of Accounting (Modern System)



Asset Account

02

Liabilities Account

03

Capital Account

04

Income Account

05

Expense Account



Debit decreases in income



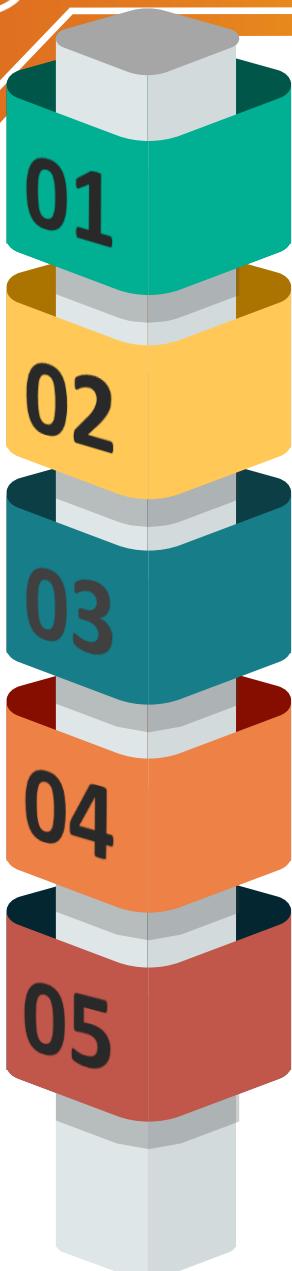
Credit increases in income



American System of Accounting (Modern System)



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Asset Account

02

Liabilities Account

03

Capital Account

04

Income Account

05

Expense Account



Debit increases in expenses



Credit decreases in expenses



Rules of Debit and Credit



Commenced Business With ₹10,000

Cash a/c

Increases

Debit ₹10,000

Capital a/c

Increases

Credit ₹10,000

Asset Account



Debit increases in asset



Credit decreases in asset

Capital Account



Debit decreases in capital



Credit increases in capital



Rules of Debit and Credit



Paid Cash ₹800 to Mr. C

Cash a/c

Decreases

Credit ₹800

Mr. C's a/c

Decreases

Debit ₹800

Asset Account



Debit increases in asset



Credit decreases in asset

Liabilities Account



Debit decreases in liabilities



Credit increases in liabilities



Rules of Debit and Credit



Sold Goods to Mr. B for Cash ₹500

Sales a/c

Increases

Credit ₹500

Cash a/c

Increases

Debit ₹500



Debit increases in asset



Credit decreases in asset



Debit decreases in income



Credit increases in income

Asset Account

Income Account



Rules of Debit and Credit



Paid Salary ₹7,000

Salary a/c

Increases

Debit ₹7,000

Cash a/c / Bank a/c

Decreases

Credit ₹7,000

Asset Account



Debit increases in asset



Credit decreases in asset

Expense Account



Debit increases in expenses



Credit decreases in expenses



Assets



An asset is a resource/properties owned by the business, an individual, corporation, or country with the expectation that it will provide a future benefit (earning income through constant use).

Assets are classified into

Fixed Assets

Current Assets



Liabilities

 A liability is something a person or company owes, usually a sum of money.

Classification of Liabilities

Long-Term

Current



Important Terms Used in Accounting

Capital

- Money or money's worth introduced by the owner into the business, which is used to create wealth.



Important Terms Used in Accounting

Goods

The things which are bought and sold by business.

In accounting

When goods are **purchased**



It is written as **Purchases**

Purchase, Purchase Return

When goods are **sold**



It is written as **Sales**

Sales, Sales Return

If goods **remain unsold** at the **end of the year**



It is written as a **Stock**

Opening Stock, Closing Stock



Stock

- Stock is the items that your business has bought with the intention of reselling to customers.
- Stock may include raw materials, work in progress, and finished goods.
- The items may be resold without change, or they could be combined into a new product.

Value of goods on closing day of a year

Closing Stock

Value of goods on opening day of a year

Opening Stock

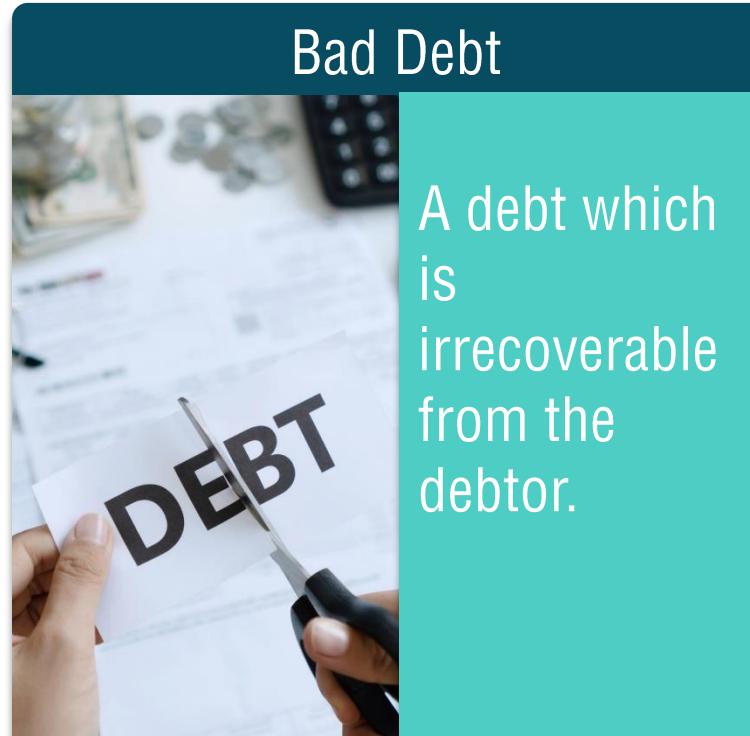


Important Terms Used in Accounting

Debtors

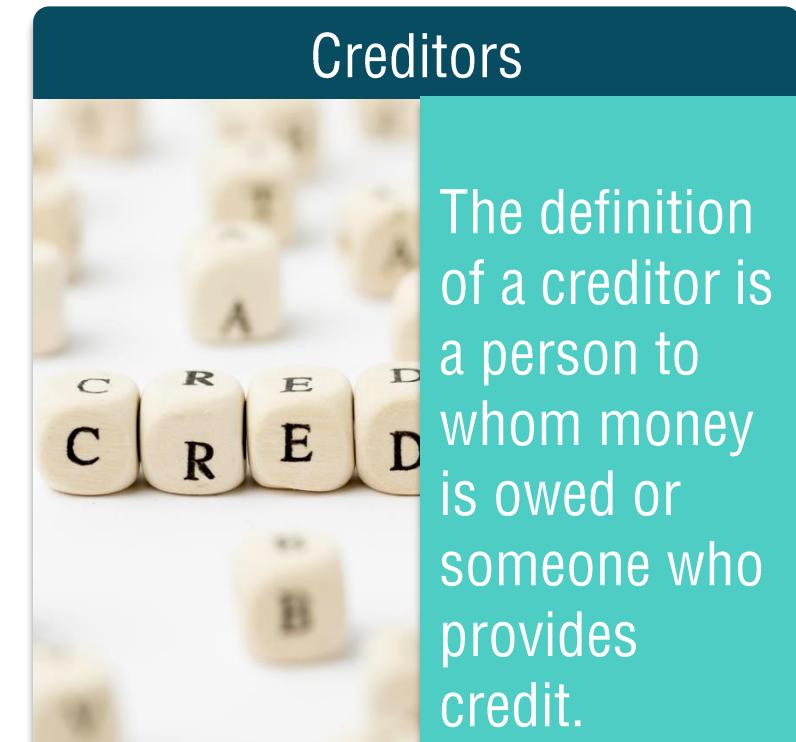


A debtor is a company or individual who owes money.



Bad Debt

A debt which is irrecoverable from the debtor.



Creditors

The definition of a creditor is a person to whom money is owed or someone who provides credit.



Important Terms Used in Accounting



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Owners/Proprietors



- Individual or group of people who invests funds into the business and bears the risk of the business.
- Profit earned by them is called as owners' reward for undertaking the risk.

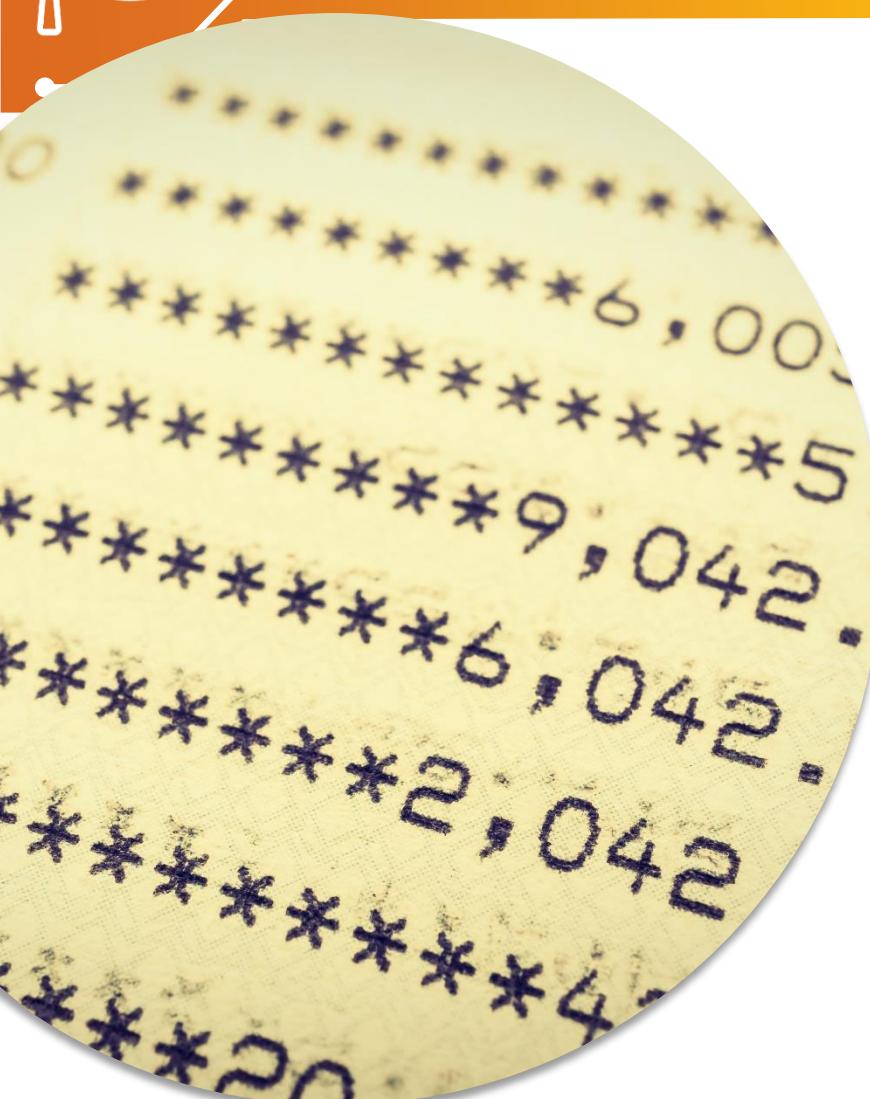


Drawings

- Any amount the owner withdraws from the business for personal use

Entity

- An organisation established through laws or accounting principles that separates it from its owners, other organisations, and individuals
- If owner introduces capital, then it is taken as loan given to the business



Solvent

➤ Solvency is the ability of a company to meet its long-term debts and financial obligations.

Insolvent

➤ Insolvency is the state that companies or individuals enter when they are not able to repay their debts.



References

E - Book References:

- ❖ <https://open.umn.edu/opentextbooks/textbooks/financial-accounting>

- ❖ <https://open.umn.edu/opentextbooks/textbooks/principles-of-financial-accounting>