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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
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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



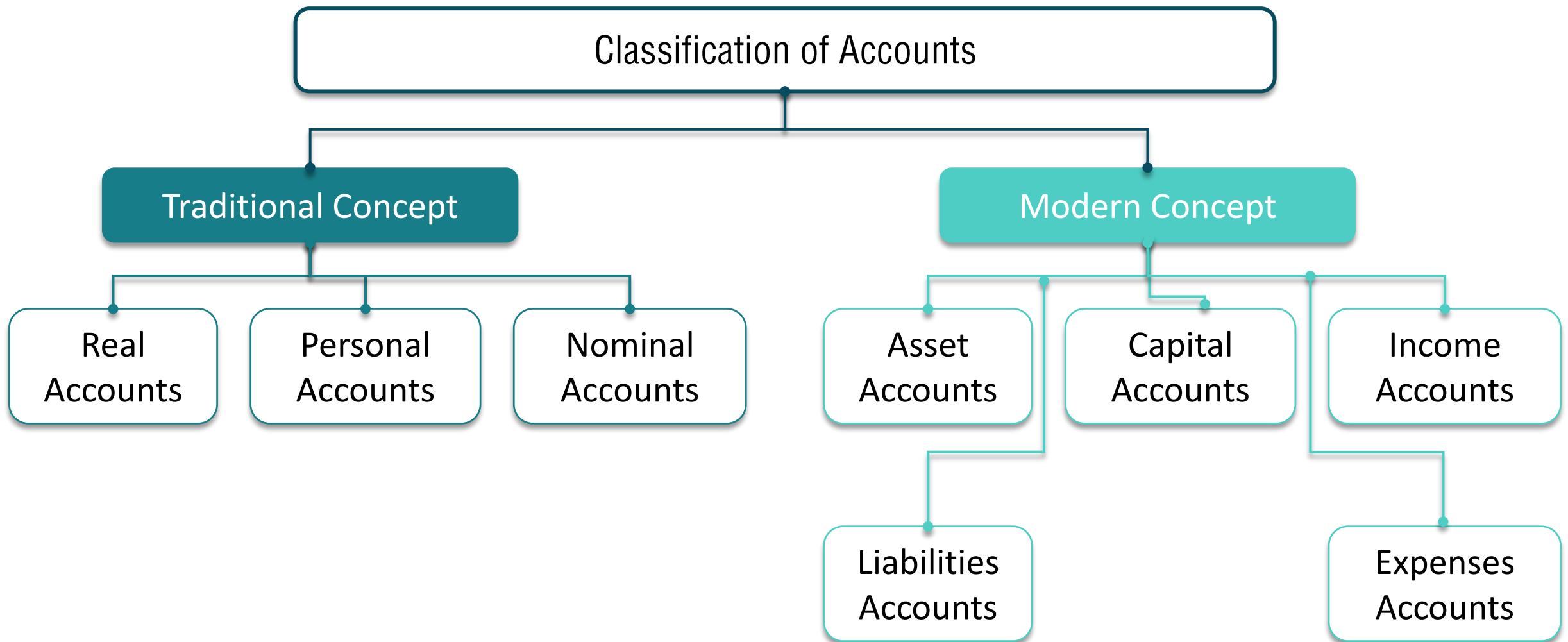
Owners' Equity

+



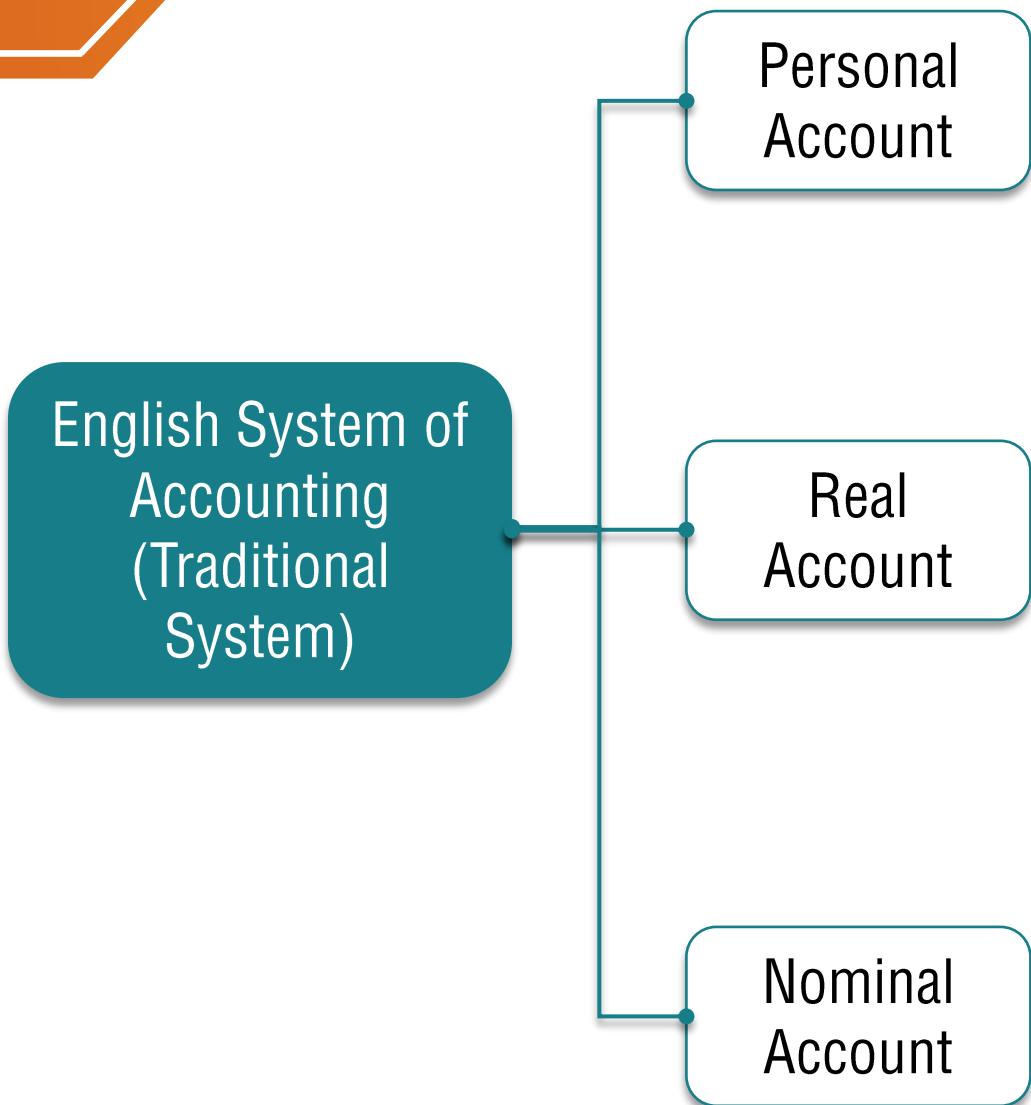
Liabilities

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.

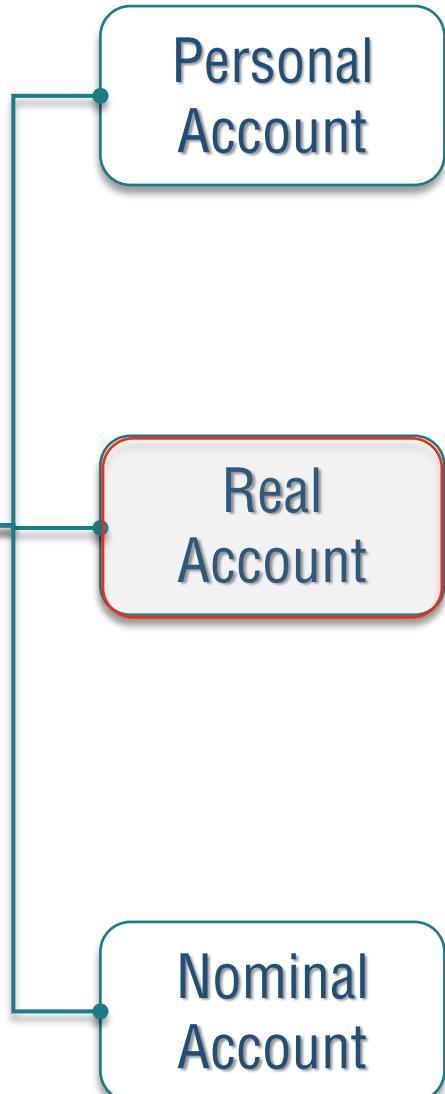
Example

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)



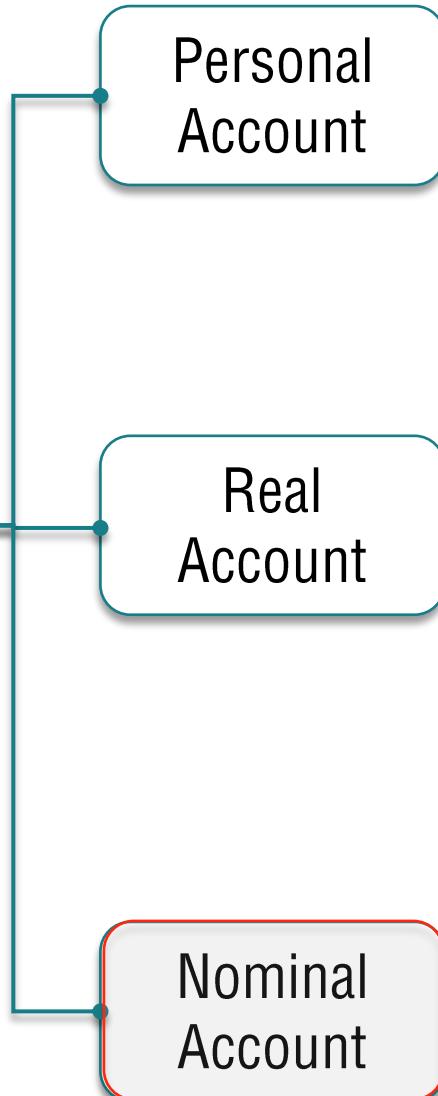
These accounts represent the property of the business – in other words, things owned by businesses.

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

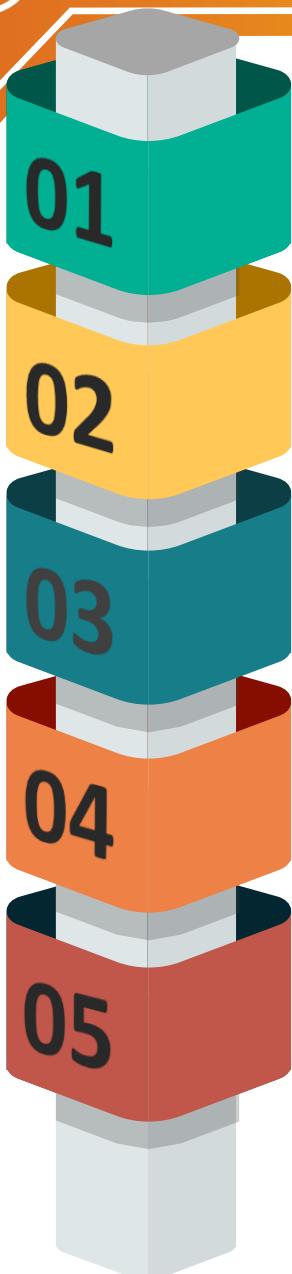
- Debit all expenses and losses
- Credit all incomes and gains

Personal Account

- Debit the receiver
- Credit the giver



American System of Accounting (Modern System)



Asset Account

Liabilities Account

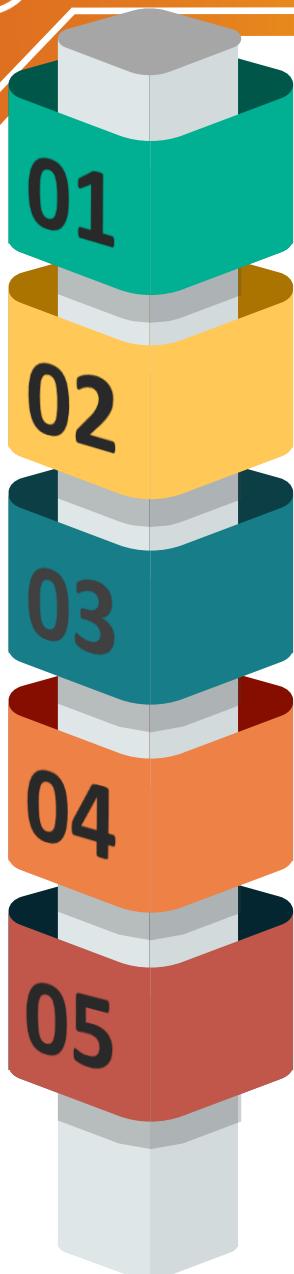
Capital Account

Income Account

Expense Account



American System of Accounting (Modern System)



Debit increases in asset



Credit decreases in asset

Liabilities Account

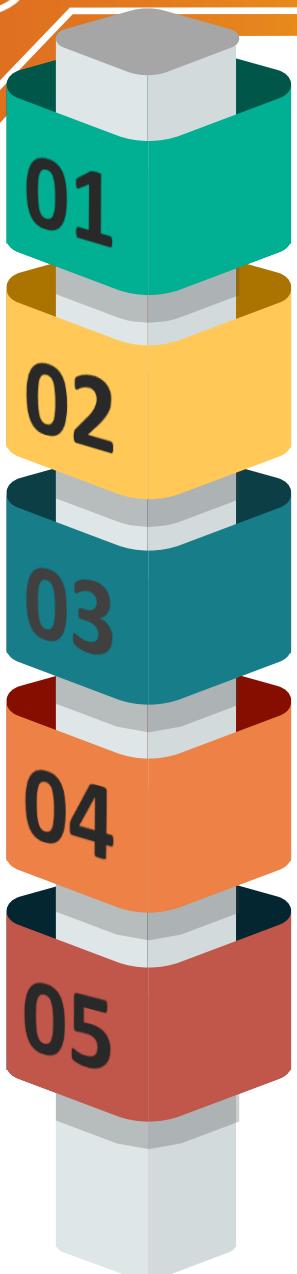
Capital Account

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

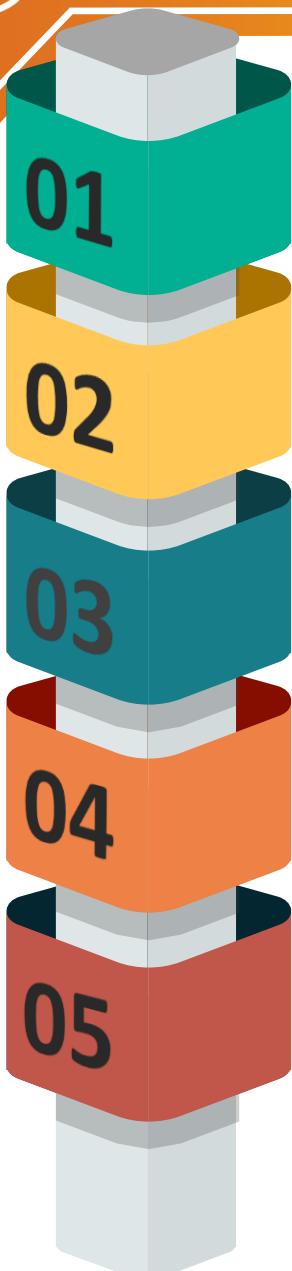
Expense Account



American System of Accounting (Modern System)



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Asset Account

02

Liabilities Account

03

Capital Account

04

Income Account

05

Expense Account



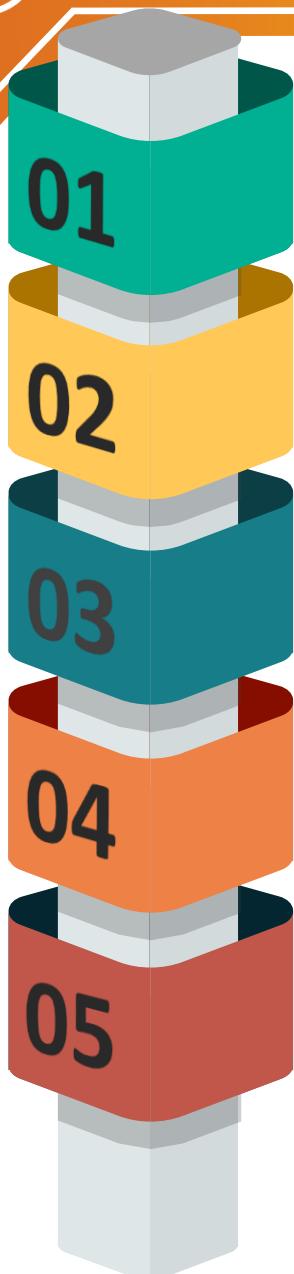
Debit decreases in capital



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



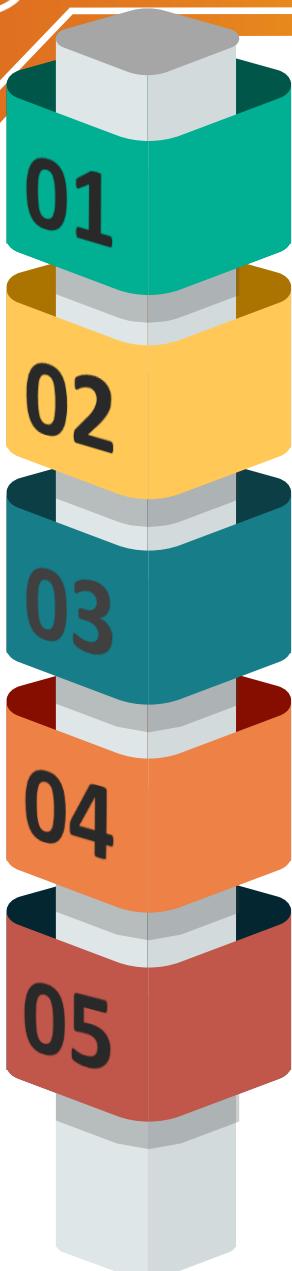
Credit increases in income



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

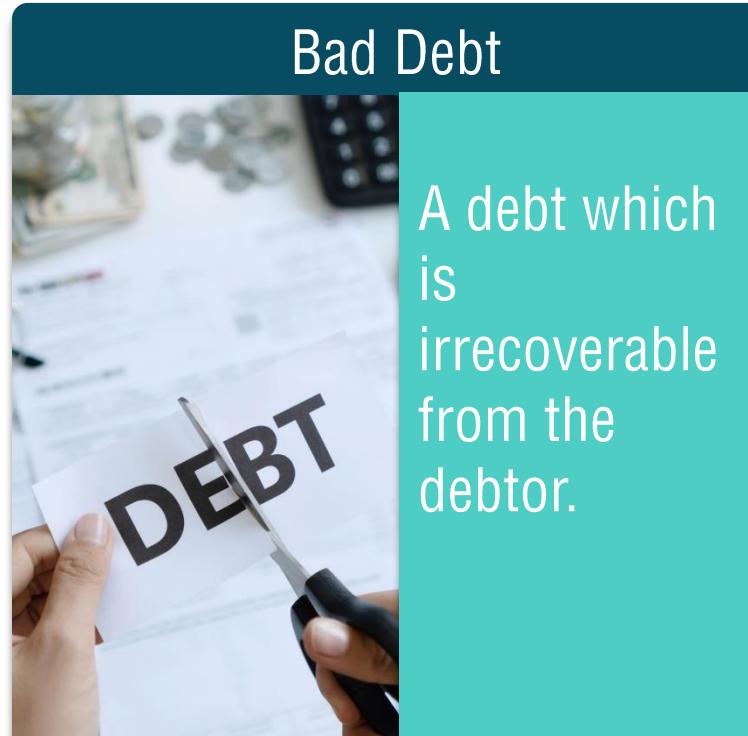


Important Terms Used in Accounting

Debtors

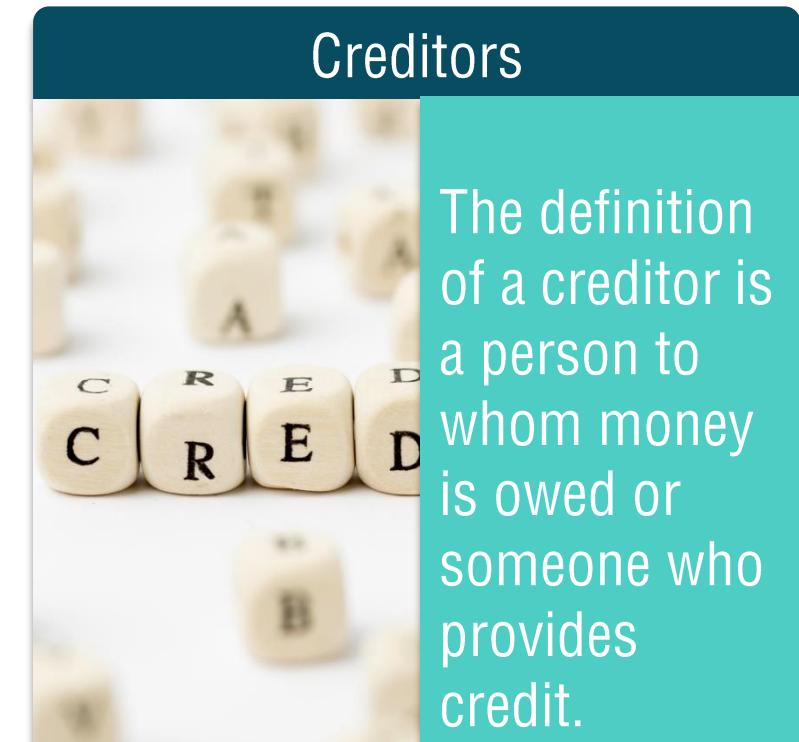


A debtor is a company or individual who owes money.



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



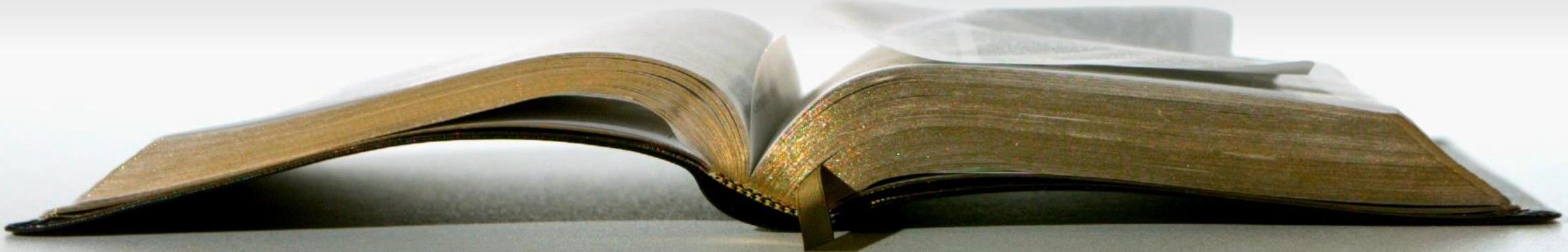
Solvent

➤ 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.

JOURNAL





JOURNAL

MEANING

- The word journal is derived from the French word '**'JOUR'**', which means a day. Therefore it is a book in which day to day transactions are recorded
- A Journal is the book of original entry or prime entry in which transactions are recorded in the books of accounts from the source documents. The transactions are recorded in a chronological order, i.e. as and when they take place. The transactions are recorded following the double-entry system of accounting.



JOURNAL

Terms / Expression Used For Journal

- ☛ **Journalising** : The process of recording transactions in the book of original entry is known as Journalising. The transactions are recorded in the form of a Journal entry. Recording is made following the double-entry system of accounting. Thus, it records the two-fold effect of every transaction.

- ☛ **Narration** : The narration is a brief explanation of the transaction together with the necessary details that are provided with the Journal entry.

- ☛ **Simple entry** : An entry in which one account is debited and another account is credited, is termed as simple entry. It involves only two accounts, i.e. one is debited and other is credited

- ☛ **Compound/ Combined entry** : The Journal entries in which more than one account is to be debited or credited are known as compound or combined journal entries.



FEATURES OF JOURNAL ENTRIES

- ☛ **Chronological**
- ☛ **Double Entry System**
- ☛ **Daybook**
- ☛ **Compound Entry Possible**
- ☛ **Assistant to Ledger**
- ☛ **Transaction Identity**
- ☛ **Original Entry**
- ☛ **Includes Brief Explanation**



FORMAT OF JOURNAL

Journal Entries in The Books Of.....

DATE	PARTICULARS	LF	DEBIT (Rs.)	CREDIT (Rs.)
1	<i>Cash / Bank a/c</i> <i>To Fast's Capital a/c</i> (being capital & goodwill brought in by new partner)	<i>Dr.</i>	52000	52000
2	<i>Fast's Capital a/c</i> <i>To Quick's Capital a/c</i> <i>To Slow's Capital a/c</i> (being goodwill amount distributed between old partners in their sacrifice ratio)	<i>Dr.</i>	12000 6000 6000	



FORMAT OF JOURNAL

- ☛ **Date:** The date on which the transaction has taken place is recorded here.
- ☛ **Particulars:** The two aspects of a transaction are recorded in this column i.e. However, mostly there are no sub-column and year, month and date in one column of Date. the accounts which have to be debited and credited. The name of the account(s) to be debited is entered at the extreme left of the particulars column next to the date column.
- ☛ **L.F. (Ledger Folio):** This column records the page number of the ledger in which the accounts in the particulars column are posted.
- ☛ **Debit Amount (Debit):** The debit amount is recorded in the debit amount column opposite to the title of the account being debited.
- ☛ **Credit Amount (Credit):** The credit amount is recorded in the credit amount column opposite to the title of the account being credited

LEGDER



LEGDER

MEANING:

A ledger is a book containing accounts in which the classified and summarized information from the journals is posted as *Debits & Credits*.

It is also called the *Second book* or *Final book* of entry & 'T' account.

The ledger contains the information that is required to prepare financial statements. It includes accounts for *Assets, Liabilities, Capital, Revenues and Expenses*.



FEATURES OF LEDGER ACCOUNT:

- Ledger book is an accounts book to which various transactions of an enterprise are posted under different accounts.
- It follows the double-entry system.
- It is also known as the Principal book of account as it is the book of final entry of transactions after the journal or all-purpose books.
- In the ledger, all the types of accounts relating to assets, liabilities, capital and revenue are maintained.
- It is the only record of the business transaction classified into relevant accounts.
- It facilitates the preparation of financial statements in future.



FORMAT OF LEDGER ACCOUNT:

Each ledger account is divided into two equal parts.

- Left Hand Side → Debit side (Dr.)
- Right Hand Side → Credit side (Cr.)

LEDGER ACCOUNT							
Date	Particulars	J. F	Amount (Rs.)	Date	Particulars	J. F	Amount (Rs.)
	To.... To.... To bal c/d (bf)		xxxxx xxxxx xxxx		By..... By..... By bal c/d (bf)		xxxxx xxxxx xxxxx
			xxxxx				xxxxx
	To bal b/d				By bal b/d		xxx



FORMAT OF LEDGER ACCOUNT:

Following are the details contained in the various columns in the ledger:

- ☛ **Date** : Date of the transaction is recorded in this column.

- ☛ **Particulars** : The account debited or credited is recorded in this column. On the debit side, the entries are made starting with 'To' and on the credit side, entries are made starting with 'By'.

- ☛ **Journal Folio (J.F.)**: In this column, the page number of the journal from which the entry has been posted to the ledger is noted

- ☛ **Amount** : The amount of the transaction is recorded in this column.



TRIAL BALANCE

MEANING OF TRIAL BALANCE:

- ▶ Trial Balance is a statement of debit and credit balances taken out from all ledger accounts including cash book. The golden rules that “*Accounting equation remains balanced all the time*” and “*For every business transaction there is an equal debit and credit*” shall always prevail in the whole accounting theory. Therefore, total of all debits balances must be equal to total of all credit balances.
- ▶ To verify this, a schedule known as Trial Balance is prepared. Balances of debits and credits are to be extracted from all ledger accounts, including cash book and shown in this schedule. This schedule is prepared to assure the management about arithmetical accuracy of books of accounts.

Trial Balance may be defined as a statement which contains balances of all ledger accounts on a particular date.



OBJECTIVES OF PREPARING A TRIAL BALANCE

To Check Arithmetical Accuracy : Arithmetical accuracy in ledger posting means writing correct amount, in the correct account and on its correct side while posting transactions from various original books of accounts, such as Cash Book, Purchases Book, Sales Book, etc.

To Help in Preparing Financial Statements : The ultimate objective of the accounting is to prepare financial statements i.e. Trading and Profit and Loss Account, and Balance sheet of a business enterprise at the end of an accounting year.

Helps in Locating Errors: If total of two columns of the trial balance agrees it is a proof of arithmetical accuracy in the ledger posting.

Helps in Comparison: Comparison of ledger account balances of one year with the corresponding balances with the previous year helps the management taking some important decisions. This is possible by using the Trial Balances of the two years.



PREPARATION OF TRIAL BALANCE:

Trial Balance is not an account. It is only a list or schedule of balances of ledger accounts including cash and bank balances. It is prepared on a particular date. The accounts having a debit balance are entered in the debit amount column and credit balance accounts are entered in the credit amount column. The sum of each column should be equal. It is known as preparation of trial balance by “Balance Method”



PREPARATION OF TRIAL BALANCE:

Trial Balance of..... As at..... (Closing date)

S.No.	Heads of Accounts	L.F.	Debit (₹)	Credit (₹)
	• Capital		---	xxx
	• Land and Buildings		xxx	---
	• Plant and Machinery		xxx	---
	• Equipment		xxx	---
	• Furniture and Fixtures		xxx	---
	• Cash in Hand		xxx	---
	• Cash at Bank		xxx	---
	• Debtors		xxx	---
	• Bills Receivable		xxx	---
	• Stock of Raw Materials		xxx	---
	• Stock of Finished Goods		xxx	---
	• Purchases		xxx	---
	• Carriage Inwards		xxx	---
	• Carriage Outwards		xxx	---
	• Sales		---	xxx
	• Sales Return		xxx	---
	• Purchases Return		---	xxx
	• Interest Paid		xxx	---
	• Commission/Discount Received		---	xxx
	• Salaries		xxx	---
	• Long Term Loan		---	xxx
	• Bills Payable		---	xxx
	• Creditors		---	xxx
	• Advances from Customers		---	xxx
	• Drawings		xxx	---
	Total		xxx	xxx



PREPARATION OF TRIAL BALANCE:

Steps to prepare Trial Balance:

- The name of the business firm is written on the top of the statement with Trial Balance.
- Under this we write the date on which Trial Balance is prepared.
- Trial Balance has four columns: Name of the Ledger Account (*heads of account*), Ledger folio, Debit Amount and Credit Amount.
- In the heads of account column we write the name of the account.
- In the Debit amount column we write the amount of debit balance of the account (or the total of the debit side of the account).
- Similarly in the credit amount column we write the amount of credit balance of the account (or the total of the credit side of the account).
- Finally, columnar total is done and compared.



Summary

Key points discussed in this session:

- *How Double entry system of book keeping is implemented in Accounts*
- *The Rules of debit & credit based on Traditional & Modern approach*
- *The Importance of process involved in Journalising business transaction, transferring them to respective ledger & preparing trial balance.*



Accounting Process-Part 1

Important Questions

Question 1: *Components in the Accounting Equation*

Question 2: *Problem on Accounting Equation*

Question 3: *Problem on Journal*



References

E - Book References:

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

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