UNIT I

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.

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. The firm should manage its affairs in such a way as will enable it to receive more than it spends. Otherwise, it will have to meet expenses from the original amount invested by the owner for starting the business.

Accounting

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

Definition of Accounting:

According to the American Institute of Certified Public Accountants (AICPA)
“Accounting is the art of recording, classifying and summarizing in a significant manner and in terms of money transactions and events which are of a financial character and interpreting the results thereof”.

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.,

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. Summarising :

Summarising 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.

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. It is more

appropriate to call it an incomplete system of recording transactions. Double effect of every transaction is ignored and only the accounts relating to suppliers and customers an cash account are found. Thus, the system is incomplete, inaccurate and unscientific system of recording business transactions.

Double Entry System:

The modern system of accounting is based on double entry principle. It refers to that system of book keeping where each transaction is recorded in both of its aspects. Vix 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.

Book keeping

Book-keeping is concerned with the recording of business transactions in a systematic manner. The transactions that are related with business which can be expressed in terms of money are recorded.

Book keeping is a part of accounting and is concerned with record keeping or maintenance of books of accounts. It s often routine and clerical in nature.

Book keeping is responsible for recording business transactions of financial nature in the books of original entry.

Book keeping provides the basis for accounting and it is complementary to accounting process. Accounting begins where book keeping ends.

Difference between Book keeping and Accounting

1. Scope
2. Stage
3. Objective
4. Nature
5. Responsibility
6. Supervision
7. Staff invoved

Advantages and Limitations of Accounting

Advantages of Accounting:

1. Systematic records
2. Preparation of financial statements
3. Assessment of progress
4. Aid to decisions making
5. Statutory requirements

6. Information to interested groups
7. Evidence in courts
8. Taxation problems
9. Merger of firms

Limitations of Accounting

Methods of Accounting:

i. Cash Basis of Accounting:

Under this method, all incomes are considered to be earned when they are actually received in cash. Similarly, expenses are deemed to be incurred only when they are actually paid in cash.

ii. Accrual Basis or Mercantile Basis of Accounting:

This method is commonly adopted by business concerns. Incomes are recorded or credited to the period in which they are earned irrespective of the fact whether the same has actually been received or not.

iii. Hybrid or Mixed Basis of Accounting:

Under this method, both cash basis and accrual basis are followed. Incomes are recorded on cash basis whereas expenses are taken on accrual basis. The net income is ascertained by matching expenses on accrual basis with income on cash basis.

Branches of Accounting:

i. Financial Accounting:

The main purpose of this type of accounting is to record business transactions in the books of accounts in such a way that operating results for a particular period and financial condition on a particular date can be known for the information of the various persons.

ii. Cost Accounting :

It relates to the collection, classification, ascertainment of cost and its accounting and cost control relating to the various elements of cost, that is, materials, labour and overheads.

iii. Management Accounting:

It relates to the use of accounting data collected with the help of financial accounting and cost accounting for the purpose of policy formulation, planning, control and decision-making by the management. The accounting which is prepared exclusively for the use of management is called management accounting.

Accounting terms

1. Account: A clear record of transactions affecting a person or an asset or profit or loss.
2. Book Keeping: Recording of financial transactions in a systematic manner.
3. Transaction: Transfer of money’s worth from one account to another account

4. Debit: An account which receives the benefit from a transaction.
5. Credit: An account which gives the benefit from a transaction.
6. Debit an a/c: A command to record a transaction on the left hand side of an account .
7. Credit an a/c: A command to record a transaction on the right hand side of an account.
8. Debtor: A person who owes money to the business.
9. Creditor: A person to whom the business owes money.
10. Journal: A date wise record of the transactions with details of the accounts debited and credited and the amount of each transactions.
11. Narration: A brief explanation of the transactions with necessary details written under each journal entry within brackets.
12. Ledger: A book containing all the accounts which are transferred from journal and subsidiary books.
13. Subsidiary books: The division of journal entries into various books on the basis of nature of transactions.
14. Personal a/c: An account containing details about the transactions with a living natural person.
15. Impersonal a/c: An account containing details about the transactions with any account other than
16. persons.
17. Real a/c: An account which contains details about real things owned by the business.
18. Nominal a/c: An account which contains details about expenses, losses, incomes and gains.
19. Capital: Amount invested by the proprietor in the business.
20. Drawings: Amount taken from the capital of the business for the personal purposes of the proprietor.
21. Capital Expenditure: Amount paid for the purchase of assets.
22. Revenue Expenditure: Amount paid for the purchase of goods.
23. Capital Receipts: Amount received from sale of assets etc.
24. Revenue Receipts: Amount received on account of sale of goods etc.
    Invoice: A business document prepared by seller on the occasion of credit sales of goods containing details about name, date, quantity and price.
25. Trial Balance: A two sided balanced statement contain all the account balances on a particular date.
26. Return Inwards: Sales returns 46. Return Outwards : Purchase returns
27. Carriage Inward: Transportation charges incurred on purchase of goods.
28. Carriage Outward: Transportation charges incurred on sale of goods.
29. Receipt: An acknowledgement for cash received from other persons for business dealings.
30. Voucher: An evidence document for the payment of cash to other party for business dealing.

CONCEPTS AND CONVENTIONS OF ACCOUNTING

Introduction:

The accounting principles used is called as Accounting concepts and conventions.
The accounting principles can be classified into two categories:
1. Accounting Concepts and
2. Conventions.

Meaning of Accounting Concepts :

Accounting concepts , the the assumptions or ideas which are essential to the practice of accounting and preparation of financial statements.

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. If business affairs and private affairs are mixed, the true picture of the business will not be available.

2. Money Measurment 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. 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. Accountants choose some shorter period to measure the result. Therefore, one year has been, generally, accepted as the accounting period. This period is called accounting period.

5. Accrual Concept:

According to this concept the revenue is recognized on its realisation and not on its actual receipt. Similarly, 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 cost is the basis for all the subsequent accounting for the asset. But the asset is shown in balance sheet year after year, at cost price minus depreciation. This value is called book value.

7. Reliasation Concept :

This concept revolves around the determination of the point of time when revenues are earned. 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. Credit transactions create debtors and the promise of debtors to make payment is sufficient for the purpose of realising revenue.

8. Dual Aspect Concept :

This concept signifies that every business transaction involves a two-fold aspect a. the yielding of beneift and b. the giving of the beneift. The principle of Double Entry is very simple but effective. “Double Entry book-keeping is a system of accounting by which receiving and giving aspects of each transaction are recorded at a time”.

9. Matching Concept :

Matcing of revenues and costs relevant to a specific period is called the matching concept. Matching of the costs with revenues has been done in two stages. That is Direct cost stage and indirect cost stage.

Meaning of Accounting Convention:

Accounting conventions are the established traditions, customs, methods and practices which usually act as guidelines for preparation and presentation of accounts.Following are the accounting conventions in the use:

1. Convention of Disclosure:

All accounting statement should be prepared honestly. This should be evident through the transparency of the statements. The statement should disclose fully all the significant informations.

2. Convention of Conservatism :

Conversatism refers to the policy of choosing the procedure the leads to under-statement as against overstatement of resources and income. The consequences of an error of understatement are likely to be less serious that of an error of overstatement.

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.” It refers to the relative importance of an item or event. Materiality of an item depends on its amount and its nature.

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. Comparison of accounting period with that in the past is possible only when the convention of consistency is adhered to.

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. 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.

Compound Journal :

When many transactions of the same nature occur on a particular day, such transactions can be entered in the journal by means of combined Composite. journal entries, known as Compound Journal Entry.

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

Ledger is a principal or main book which contains all the accounts which the transactions recorded in the books f original entry are transferred. Ledger is also called the '**Book of Final Entry'** or **'Book of Secondary Entry'**, because the transactions are finally incorporated in the Ledger.

Relationship between Journal and ledger:

i. Transactions are entered first in the journal and then these entries are posted to appropriate accounts
in the ledger.

ii. The journal is subsidiary book, while the ledger is the main book of accounts.

iii. The journal shows the transactions in chronological order, that is, journal is a daily record. Posting
from the journal is done periodically, may be weekly or fortnightly etc.,

iv. Entering the transactions in the journal is called journalising and the act of recording in the ledger is
called posting.
v. Journal is the book of prime entry, while ledger is the book of final entry.