

- (i) **Recording of Transaction:** As soon as a transaction happens it is at first recorded in subsidiary book.
- (ii) **Journal:** The transactions are recorded in Journal chronologically.
- (iii) **Ledger:** All journals are posted into ledger chronologically and in a classified manner.
- (iv) **Trial Balance:** After taking all the ledger account closing balances, a Trial Balance is prepared at the end of the period for the preparations of financial statements.
- (v) **Adjustment Entries:** All the adjustments entries are to be recorded properly and adjusted accordingly before preparing financial statements.
- (vi) **Adjusted Trial Balance:** An adjusted Trail Balance may also be prepared.
- (vii) **Closing Entries:** All the nominal accounts are to be closed by the transferring to Trading Account and Profit and Loss Account.
- (viii) **Financial Statements:** Financial statement can now be easily prepared which will exhibit the true financial position and operating results.

ACCOUNTING – CLASSIFICATION

The various sub-fields of the accounting are:



1.	Financial Accounting	Determining the financial results for the period and the state of affairs on the last day the accounting period.	Stewardship Accounting
2.	Cost Accounting	Information generation for Controlling operations with a view to maximizing efficiency and profit.	Control Accounting
3.	Management Accounting	Accounting to assist management in planning and decision making.	Decision Accounting

(a) Financial Accounting

It is commonly termed as Accounting. The American Institute of Certified Public Accountants defines Accounting as "an art of recoding, 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 the results thereof."

(b) Cost Accounting

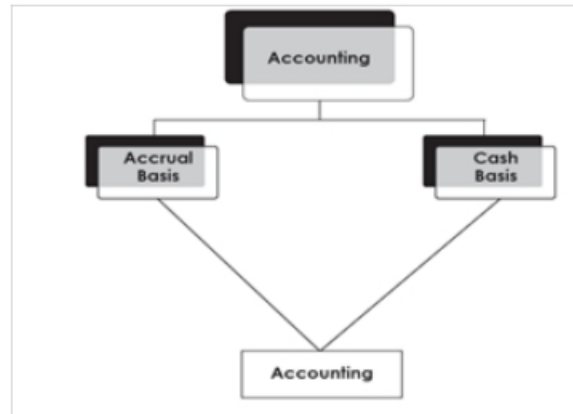
According to the Chartered Institute of Management Accountants (CIMA), Cost Accountancy is defined as "application of costing and cost accounting principles, methods and techniques to the science, art and practice of cost control and the ascertainment of profitability as well as the presentation of information for the purpose of managerial decision-making."

(c) Management Accounting

Management Accounting is concerned with the use of Financial and Cost Accounting information to managers within organizations, to provide them with the basis in making informed business decisions that would allow them to be better equipped in their management and control functions.

BASIS OF ACCOUNTING

ACCRUAL BASIS AND CASH BASIS OF ACCOUNTING



(I) Accrual Basis of Accounting

Accrual Basis of Accounting is a method of recording transactions by which revenue, costs, assets and liabilities are reflected in the accounts for the period in which they accrue. This basis includes consideration relating to deferrals, allocations, depreciation and amortization. This basis is also referred to as mercantile basis of accounting.

(I) Cash Basis of Accounting

Cash Basis of Accounting is a method of recording transactions by which revenues, costs, assets and liabilities are reflected in the accounts for the period in which actual receipts or actual payments are made.

Distinction between Accrual Basis of Accounting and Cash Basis of Accounting

Basis of Distinction	Accrual Basis of Accounting	Cash Basis of Accounting
1. Prepaid/Outstanding Expenses / accrued/ unaccrued Income in Balance Sheet.	Under this, there may be prepaid/ outstanding expenses and accrued/ unaccrued incomes in the Balance Sheet.	Under this, there is no prepaid / outstanding expenses or accrued / unaccrued incomes.
2. Higher/lower Income in case of prepaid expenses and accrued income	Income Statement will show a relatively higher income	Income Statement will show lower income.
3. Higher/lower income in case of outstanding expenses and unaccrued income	Income Statement will show a relatively lower income.	Income Statement will show higher income.
4. Availability of options to an accountant to manipulate the accounts by way of choosing the most suitable method out of several alternative methods of accounting e.g. FIFO/LIFO/SLM/WDV	Under this, an accountant has options.	Under this an accountant has no option to make a choice as such.

Hybrid or Mixed Basis

Under the hybrid system of accounting, incomes are recognised as in Cash Basis Accounting i.e. when they are received in cash and expenses are recognised on accrual basis i.e. during the accounting period in which they arise irrespective of when they are paid.

Double Entry System

It was in 1494 that Luca Pacioli the Italian mathematician, first published his comprehensive treatise on the principles of Double Entry System. The use of principles of double entry system made it possible to record not only cash but also all sorts of Mercantile transactions. It had created a profound impact on auditing too, because it enhanced the duties of an auditor to a considerable extent.

Features of Double Entry System

- (i) Every transaction has two fold aspects, i.e., one party giving the benefit and the other receiving the benefit.
- (ii) Every transaction is divided into two aspects, Debit and Credit. One account is to be debited and the other account is to be credited.
- (iii) Every debit must have its corresponding and equal credit.

Advantages of Double Entry System

- (i) Since personal and impersonal accounts are maintained under the double entry system, both the effects of the transactions are recorded.
- (ii) It ensures arithmetical accuracy of the books of accounts, for every debit, there is a corresponding and equal credit. This is ascertained by preparing a trial balance periodically or at the end of the financial year.
- (iii) It prevents and minimizes frauds. Moreover frauds can be detected early.
- (iv) Errors can be checked and rectified easily.
- (v) The balances of receivables and payables are determined easily, since the personal accounts are maintained.
- (vi) The businessman can compare the financial position of the current year with that of the past years.
- (vii) The businessman can justify the standing of his business in comparison with the previous year purchase, sales, and stocks, incomes and expenses with that of the current year figures.
- (viii) Helps in decision making.
- (ix) The net operating results can be calculated by preparing the Trading and Profit and Loss A/c for the year ended and the financial position can be ascertained by the preparation of the Balance Sheet.
- (x) It becomes easy for the Government to decide the tax.
- (xi) It helps the Government to decide sickness of business units and extend help accordingly.
- (xii) The other stakeholders like suppliers, banks, etc take a proper decision regarding grant of credit or loans.

Limitations of Double Entry System

- (i) The system does not disclose all the errors committed in the books accounts.
- (ii) The trial balance prepared under this system does not disclose certain types of errors.
- (iii) It is costly as it involves maintenance of numbers of books of accounts.

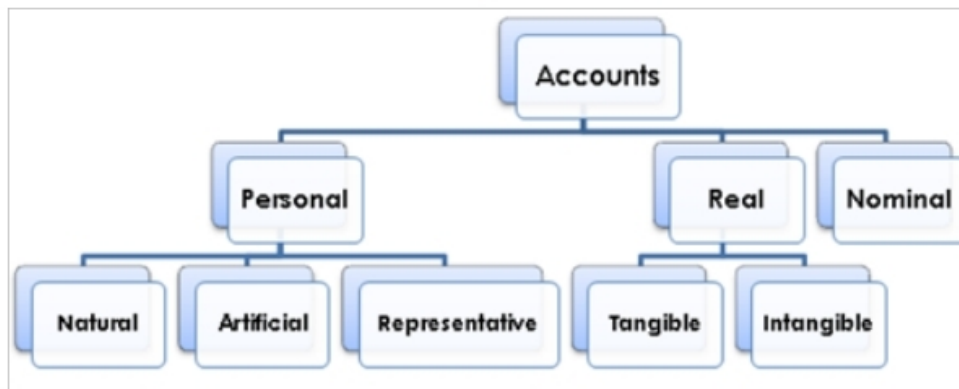
THE CONCEPTS OF 'ACCOUNT', 'DEBIT' AND 'CREDIT'

The concept of Account

- An account is defined as a summarized record of transactions related to a person or a thing e.g. when the business deals with customers and suppliers, each of the customers and supplier will be a separate account.
- The account is also related to things – both tangible and intangible. e.g. land, building, equipment, brand value, trademarks etc are some of the things. When a business transaction happens, one has to identify the 'account' that will be affected by it and then apply the rules to decide the accounting treatment.
- Typically, an account is expressed as a statement in form of English letter 'T'. It has two sides. The left hand side is called as "Debit" side and the right hand side is called as "Credit" side. The debit is denoted as 'Dr' and the credit by 'Cr'. The convention is to write the Dr and Cr labels on both sides as shown below. Please see the following example:

Dr.	Cash Account	Cr.
Debit side		Credit side

TYPES OF ACCOUNTS



Let us see what each type of account means:

- (1) **Personal Account:** As the name suggests these are accounts related to persons.
 - (a) These persons could be natural persons like Suresh's A/c, Anil's a/c, Rani's A/c etc.
 - (b) The persons could also be artificial persons like companies, bodies corporate or association of persons or partnerships etc. Accordingly, we could have Videocon Industries A/c, Infosys Technologies A/c, Charitable Trust A/c, Ali and Sons trading A/c, ABC Bank A/c, etc.
 - (c) There could be representative personal accounts as well. Although the individual identity of persons related to these is known, the convention is to reflect them as collective accounts. e.g. when salary is payable to employees, we know how much is payable to each of them, but collectively the account is called as 'Salary Payable A/c'. Similar examples are rent payable, Insurance prepaid, commission pre-received etc. The students should be careful to have clarity on this type and the chances of error are more here.
- (2) **Real Accounts:** These are accounts related to assets or properties or possessions. Depending on their physical existence or otherwise, they are further classified as follows:-
 - (a) Tangible Real Account – Assets that have physical existence and can be seen, and touched. e.g. Machinery A/c, Stock A/c, Cash A/c, Vehicle A/c, and the like.
 - (b) Intangible Real Account – These represent possession of properties that have no physical existence but can be measured in terms of money and have value attached to them. e.g. Goodwill A/c, Trade mark A/c, Patents & Copy Rights A/c, Intellectual Property Rights A/c and the like.
- (3) **Nominal Account:** These accounts are related to expenses or losses and incomes or gains e.g. Salary and Wages A/c, Rent of Rates A/c, Travelling Expenses A/c, Commission received A/c, Loss by fire A/c etc.

The concept of Debit and Credit

- In double entry book-keeping, debits and credits (abbreviated Dr and Cr, respectively) are entries made in account ledgers to record changes in value due to business transactions.
- Debit is derived from the latin word "debitum", which means 'what we will receive'. It is the destination, who enjoys the benefit.
- Credit is derived from the latin word "credre" which means 'what we will have to pay'. It is the source, who sacrifices for the benefit.
- The source account for the transaction is credited (an entry is made on the right side of the account's ledger) and the destination account is debited (an entry is made on the left).
- Each transaction's debit entries must equal its credit entries.
- The difference between the total debits and total credits in a single account is the account's balance. If debits exceed credits, the account has a debit balance; if credits exceed debits, the account has a credit balance.

ACCOUNTING EQUATION

Illustration: 3

Prepare an Accounting Equation from the following transactions in the books of Mr. X for January, 2015 :-

- 1 Invested Capital in the firm ₹ 20,000
- 2 Purchased goods on credit from Das & Co. for ₹ 2,000
- 4 Bought plant for cash ₹ 8,000
- 8 Purchased goods for cash ₹ 4,000
- 12 Sold goods for cash (Cost ₹ 4,000 + Profit ₹ 2,000) ₹ 6,000.
- 18 Paid to Das & Co. in cash ₹ 1,000
- 22 Received from B. Banerjee ₹ 300
- 25 Paid salary ₹ 6,000
- 30 Received interest ₹ 5,000
- 31 Paid wages ₹ 3,000

Solution:

Effect of transaction on Assets, Liabilities and Capital

Date	Transaction	Assets=	Liabilities+	Capital
2015 Jan. 1	Invested Capital in the firm ₹ 20,000	20,000	-	20,000
2	Purchased goods on credit from Das & Co. ₹2000	+2,000	+2,000	-
	Revised Equation	22,000=	2,000+	20,000
4	Bought Plant for cash ₹ 8,000	+8,000 -8,000	-	-
	Revised Equation	22,000=	2,000+	20,000
8	Purchased goods for cash ₹ 4,000	+4,000 -4,000	--	--
	Revised Equation	22,000=	2,000+	20,000
12	Sold Goods for cash (Cost ₹ 4,000 + Profit ₹ 2,000)	+6,000 -4,000		+2,000
	Revised Equation	24,000	2,000+	22,000
18	Paid to Das & Co. for ₹ 1,000	-1,000	-1,000	-
	Revised Equation	23,000=	1,000+	22,000
22	Received from B. Banerjee for ₹ 300	+300		

		-300		
	Revised Equation	23,000=	1,000+	22,000
25	Paid salary for ₹ 6,000	- 6,000		-6,000
	Revised Equation	17,000=	1,000+	16,000
30	Received Interest for ₹ 5,000	+5,000		+5,000
	Revised Equation	22,000=	1,000+	21,000
31	Paid Wages for ₹3,000	-3,000		-3,000
	Revised Equation	19,000=	1,000+	18,000