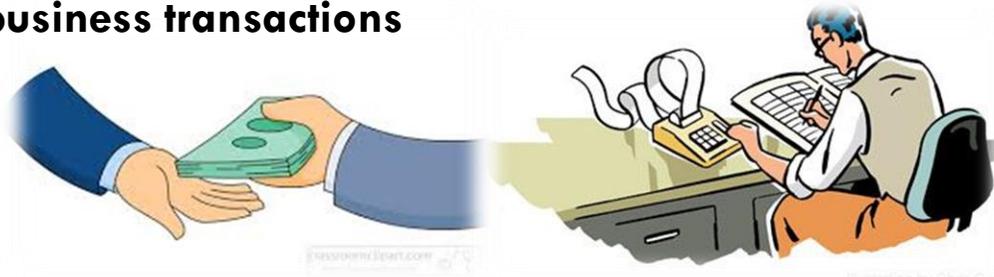


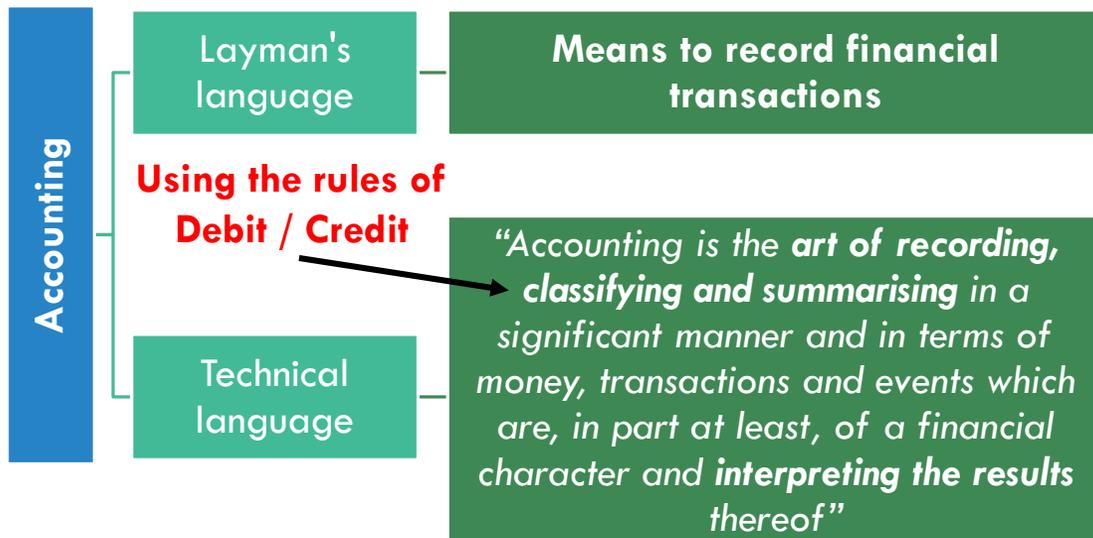
# Topic 1 Introduction to Financial Accounting

## ACCOUNTING

In layman's language Accounting means to record business transactions



“Aaasaan bhasha me, Accounting ka matalb hai Hisab-Kitab rakhna”



## FUNCTIONS OF ACCOUNTING

1. Measurement
2. Forecasting
3. Decision-Making
4. Comparison & Evaluation
5. Control
6. Government Regulation & Taxation

### Need for Accounting

1. To maintain **systematic accounting records**. (Recording)
2. To ascertain the **financial position**. (Balance Sheet)
3. To ascertain the **financial performance**. (P&L Account)
4. To **communicate information** to users. (Reporting)

### Other reasons for accounting: To Know..

1. the **amount receivable** from the various persons
2. the **amount payable** to the various persons
3. the **expenses** incurred during the year
4. the **income** earned during the year, *etc.*

# BOOK-KEEPING

As per **Carter**: “Book-Keeping is a science as well as art of correctly recording in books of accounts all those business transactions that result in transfer of money or money’s worth”

**Book-keeping is a mechanical task which involves:**

1. Collection of basic financial information
2. Identification of events and transactions with financial character, i.e., economic transactions
3. Measurement of economic transactions in terms of money
4. Recording of financial effects of economic transactions in order of its occurrence
5. Classifying effects of economic transactions
6. Preparing organized statement known as Trial Balance

## Book Keeping

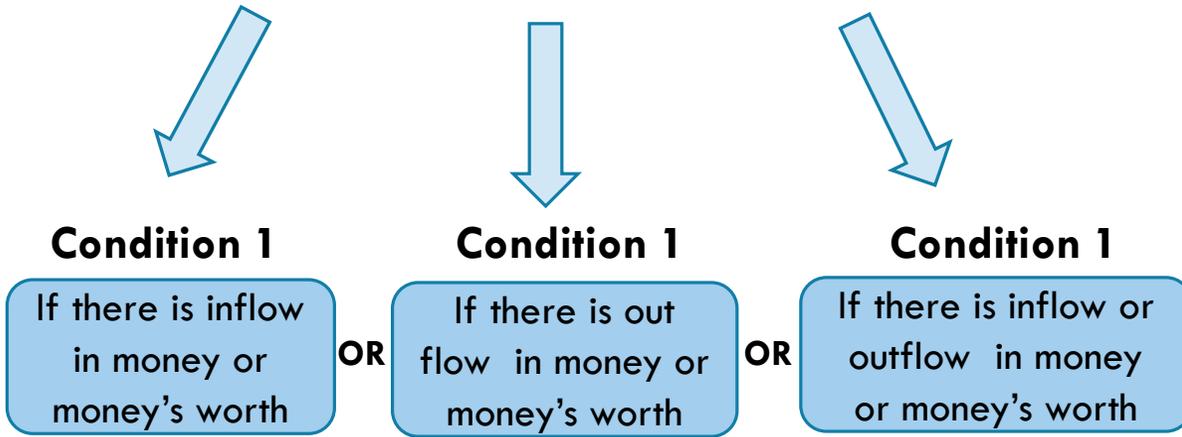
- Recording transactions
- Work mainly routine and clerical in nature
- Book-keeping constitute the base for accounting.
- To follow Basic accounting concepts and conventions.
- Financial statements not form part of book-keeping
- Financial position of the business cannot be ascertained

## Accounting

- Summarizing of the recorded transactions.
- Reqd. higher level of knowledge
- Language of business.
- The methods and procedures for accounting may vary from firm to firm.
- Financial statements are prepared from the bookkeeping records.
- To ascertained Financial position of the business

# Basic Accounting Terms

## Financial Transaction

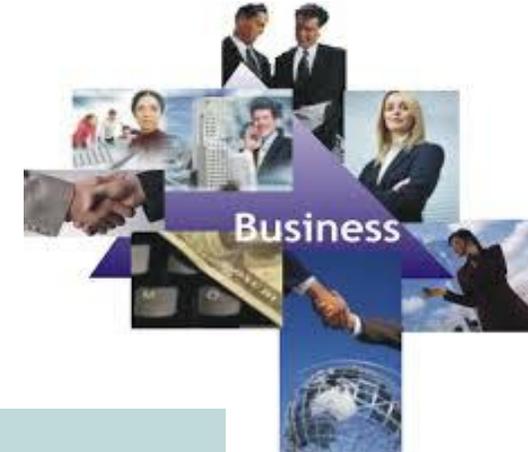


If any of the above conditions are satisfied then transaction shall deemed be a Financial transaction

Transactions are those activities of a business, which involve transfer of money or goods or services **between two persons or two accounts.**

## Business:

- ✓ Is the set of activities for earning profit (Profit Motive)
- ✓ Regularly carried on by a person or an organization
- ✓ Business may be: Manufacturing; Trading or Service



## Goods

- ✓ **Products / Articles / Items** which are **regularly traded** by the businessman are called "Goods".



## Assets

### •In Technical Language:

- ✓ Resource controlled by the enterprise
- ✓ as a result of past events and
- ✓ from which future economic benefits are expected to flow to the enterprise.

### •In General Language:

- ✓ Properties of the business
- ✓ Amounts receivable from others by the business
- ✓ Eg. Stock, Land, Building, Debtors, Receivables, etc

Property of every  
description of business,  
which gives future economic  
benefit

## Drawing

Cash / Goods / Assets **drawn** by the owner for his **personal purpose** is called as Drawing. It decreases the capital.

## Debtors

Persons from whom the business has to receive money, due to credit sales made to them.

## Expenses

Amount spent for benefits for an accounting period. For eg. Rent paid for the benefit of Business.

## Losses

Amount spent but no benefits is derived / amount not recoverable from debtors. For eg. Bad Debt, Stocks lost due to earthquake, etc.

## Liabilities

Amounts Payable by the business to outsiders and includes capital. For eg. Bank loans, Expenses not yet paid

## Capital

Amount (in money / money's worth) Invested by the owner into the business

## Creditors

Persons to whom the business has to pay money due to **credit Purchase** made from them.

## Incomes

Any amount received or receivable arising out of the regular operations (eg. Sales) of the business. For eg. Interest, commission due or received, etc.

## Purchase (from purchaser's point of view)

**Buying of goods / raw materials** for consideration. Sale for one person is the purchase for another person.

## Sales

sales" refers to Transfer of **ownership in goods** from one person to another for a consideration"

### 3 Conditions for sale:

- (a) Transfer of **ownership**
- (b) Ownership must be in **goods**
- (c) Consideration – some money or money's worth must be given by one person to another.

## Revenue Expenditure

<b>Meaning</b>	Revenue Expenditure is an expenditure which is incurred  (a) To maintain productivity or earning capacity of business.  (b) To carry out operating activity in normal course of business.
<b>Accounting</b>	debited to Trading / P&L Account
<b>Examples</b>	Expenses for replacement of worn out part of machine, Repairs of an existing machine.

## Gain

Benefit received without hard work is gain

## Discount

**Discount** is an allowance or concession in price. **Discount** is given so that the buyer is induced (lured) to place an order and later to make payment in time.

## Inventory

Inventory is technical term for “stock”(Unsold Goods/ Unused raw material).

It includes Raw Material stock, work in progress and finished goods stock

## Capital Expenditure

### Meaning

An expenditure which is incurred –  
To acquire an asset or  
To acquire or bring into existence an advantage of enduring nature, or  
To increase productivity or earning capacity

### Accounting

Capital Expenditure is debited to Respective Asset Account

### Examples

Expenses incurred before the asset is put to use, Repairs of a newly purchased old machine, Purchase of new machine.

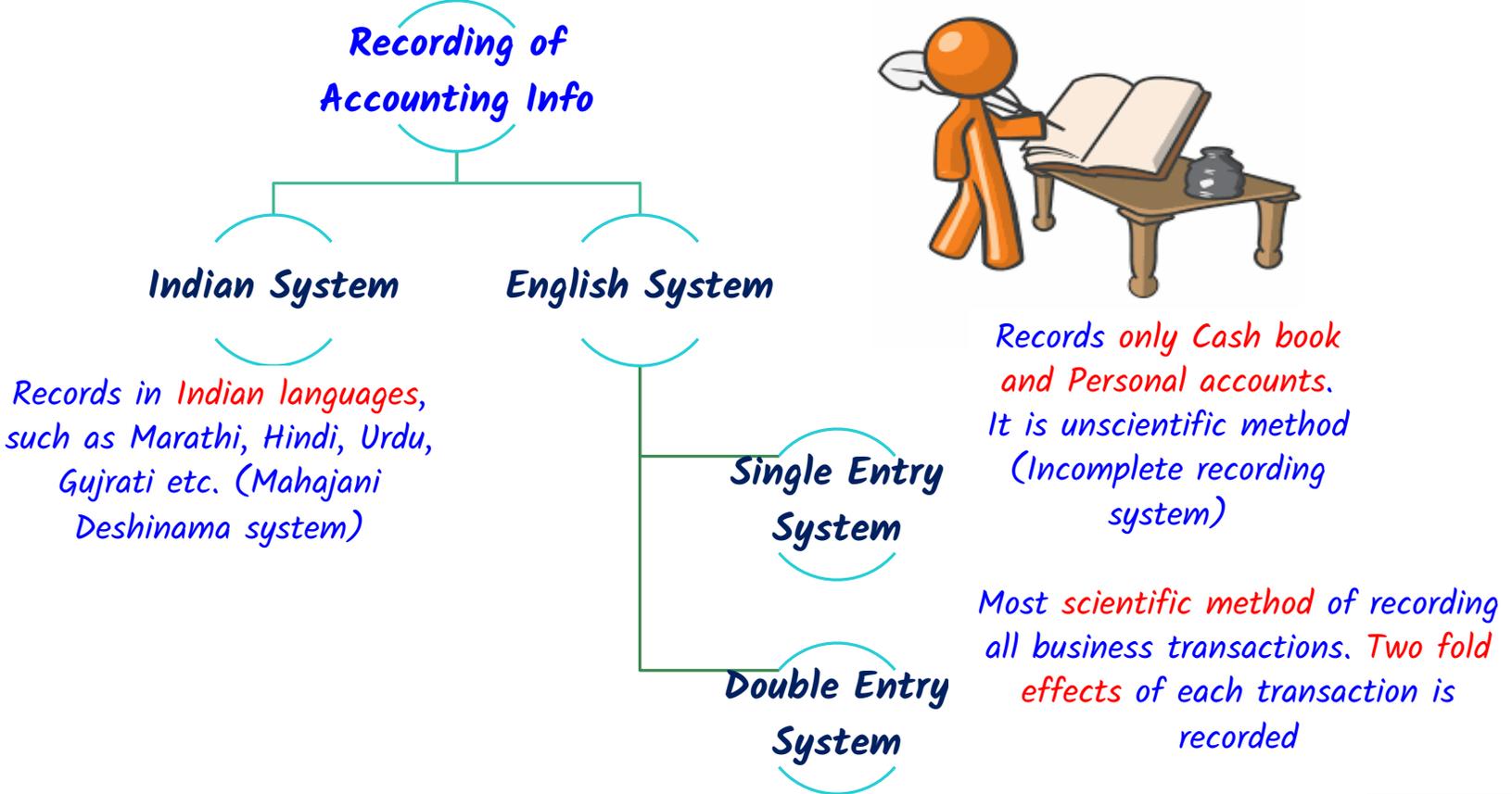
- Fictitious Assets
- Wasting Assets
- Trade Discount
- Cash Discount
- Contingent Liability
- Internal Liability
- Good Debts
- Doubtful Debts
- Bad Debts

'Double Entry System is most scientific method of recording all monetary transactions.

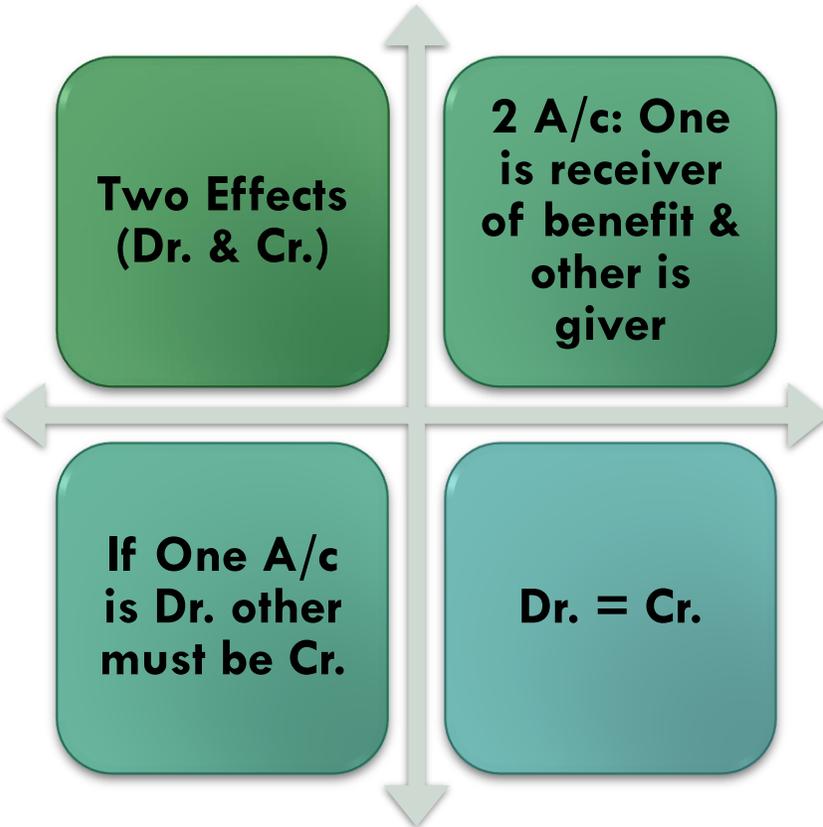
Owes its origin to Italian Merchant "LUCA D. BARGO PACIOLI" on 10th November 1494 and this day is celebrated as International Accounting Day

There are two aspects of every business transactions.

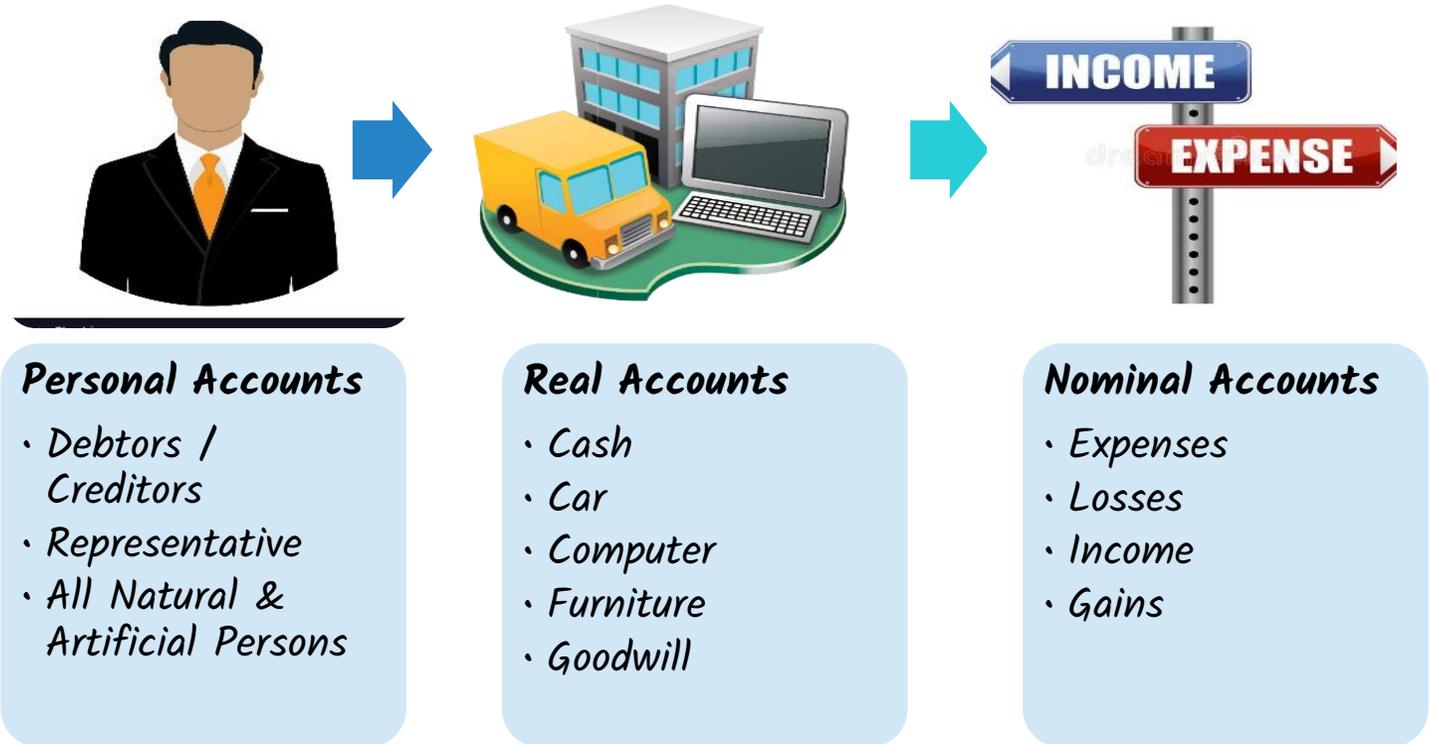
Recording of two aspects of monetary transactions in the Books of Account in terms of Debit (Dr.) and Credit (Cr.) is called as "Double Entry" System of Book-keeping.



## PRINCIPLES OF DOUBLE ENTRY BOOK-KEEPING SYSTEM:



## TYPES OF ACCOUNTS (TRADITIONAL APPROACH):



## GOLDEN RULES OF DEBIT AND CREDIT (TRADITIONAL APPROACH):

Personal A/c	Real A/c	Nominal A/c
<ul style="list-style-type: none"> <li>• Debit the Receiver</li> <li>• Credit the Giver</li> </ul>	<ul style="list-style-type: none"> <li>• Debit what comes in</li> <li>• Credit what goes out</li> </ul>	<ul style="list-style-type: none"> <li>• Debit Exp. &amp; Losses</li> <li>• Credit Income &amp; Gains</li> </ul>

## Advantages of Double Entry System

Complete Records (Both Effects)

Arithmetical Accuracy

Business Results

Common Acceptance

Minimize Frauds

Receivable & Payable Balances can determined easily

Decision Making

Easy Tax Calculation

## Limitations of Double Entry System

Not Disclose all errors

Trial Balance does not disclose all the errors

It costly (Required to maintain no. of a/c)

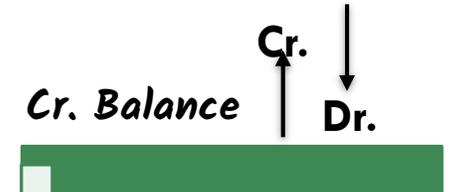
## ACCOUNTING EQUATION



## CLASSIFICATION OF ACCOUNTS (MODERN APPROACH)



- Assets
- Drawing
- Debtors
- Expenses
- Losses



- Liabilities
- Capital
- Creditors
- Incomes
- Gains

Properties of every description of the Business. (Resources having some future economic benefit to business.)

Cash / Goods / Assets drawn by the owner for his personal purpose

Persons from whom the business has to receive money, due to credit sales made them.

Amount spent for benefits for an accounting period

Amount spent but no benefits is derived / amount not recoverable from debtors

ALL ASSETS, DRAWING, DEBTORS, EXPENSES & LOSSES –

Dr. Balance

Dr.

Cr.

ALL LIABILITIES, CAPITAL, CREDITORS, INCOMES & GAINS –

Cr. Balance

Cr.

Dr.

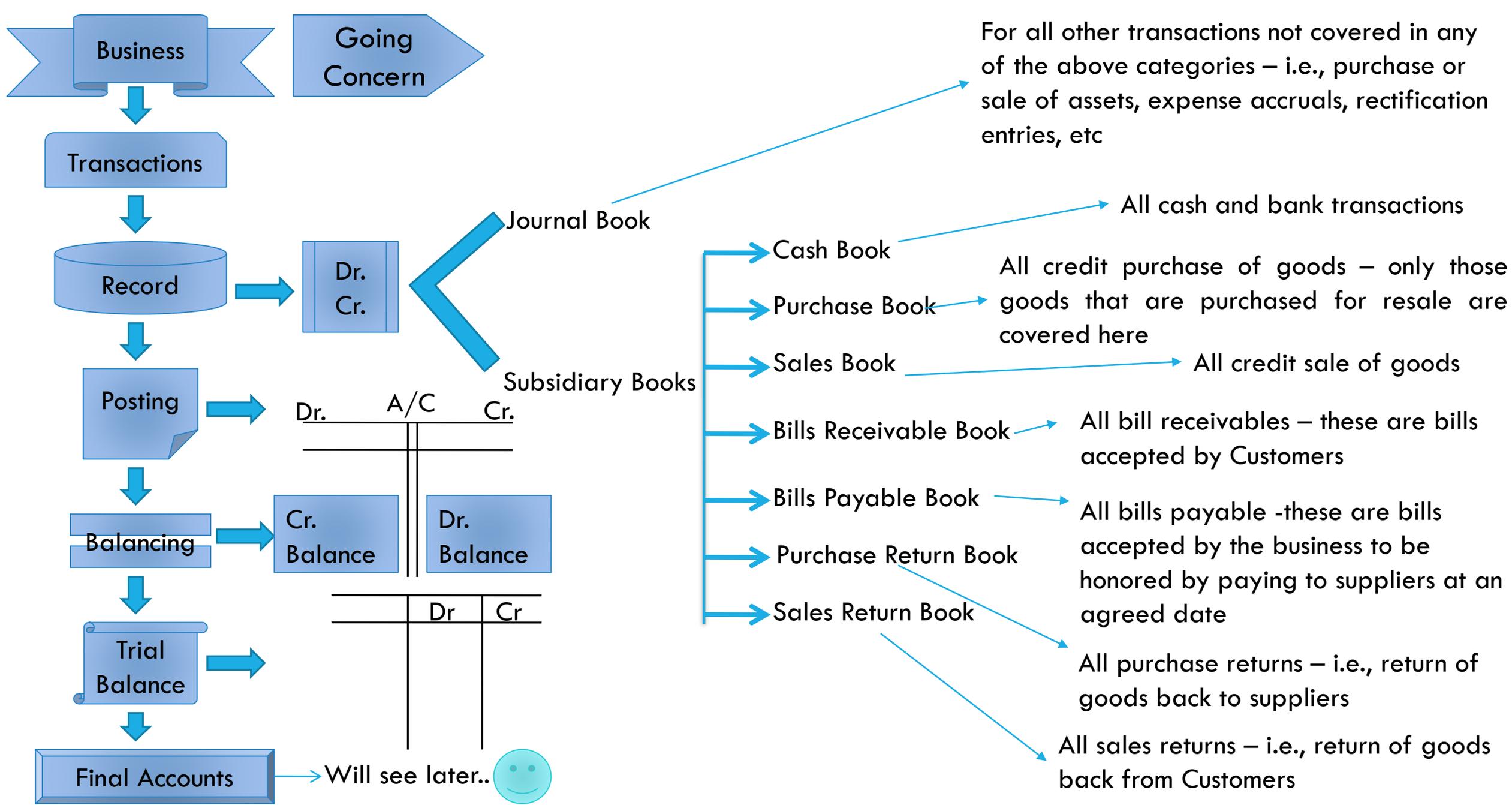
Amounts Payable by the business to outsiders and includes capital. For eg. Bank loans, Expenses not yet paid

Amount Invested by the owner into the business

Persons to whom the business has to pay money due

amount received or receivable arising out of the regular operations of the business

amount received or receivable arising out of the operations for which no hard work has done



❑ **Example: Journalise the following transactions in the books of Akashay Kumar**

1. **Akashay Kumar commenced business with Cash Rs. 95,000. Furniture Rs. 5,000, Machinery Rs. 80,000. Of the Cash Rs. 8,000 was borrowed from sumit personally by owner**

First Step (Identification of A/C)	Second Step (Classification)	Third Step (Apply the RULE)
Cash A/c	Dr. Balance	Dr. 95,000
Furniture A/c	Dr. Balance	Dr. 5,000
Machinery A/c	Dr. Balance	Dr. 80,000
Capital A/c	Cr. Balance	Cr. 1,80,000

2. **Purchased Machinery from kent and Co, for Rs. 18,000 and paid Rs. 800 as freight on our account.**

First Step (Identification of A/C)	Second Step (Classification)	Third Step (Apply the RULE)
Machinery A/c	Dr. Balance	Dr. 18,800
Kent & Co. A/c	Cr. Balance	Cr. 18,000
Cash A/c	Dr. Balance	Cr. 800

3. **Paid Wages on Erection of Machinery Rs. 2,000.**

First Step (Identification of A/C)	Second Step (Classification)	Third Step (Apply the RULE)
Machinery A/c	Dr. Balance	Dr. 2,000
Cash A/c	Dr. Balance	Cr. 2,000

4. **Received an order from M/s Pushpalata for goods Rs. 8,000.**

First Step (Identification of A/C)	Second Step (Classification)	Third Step (Apply the RULE)
<b>No entry will be recorded for this event</b>		

5. **Cash of Rs. 200 was stolen by the cashier who is absconding.**

First Step (Identification of A/C)	Second Step (Classification)	Third Step (Apply the RULE)
Loss by theft A/c	Dr. Balance	Dr. 200
Cash A/c	Dr. Balance	Cr. 200

6. Executed pushpalata's order and paid transport charges on her account Rs. 100.

First Step (Identification of A/C)	Second Step (Classification)	Third Step (Apply the RULE)
Pushpalata A/c	Dr. Balance	Dr. 8,100
Sales A/c	Cr. Balance	Cr. 8,000
Cash A/c	Dr. Balance	Cr. 100

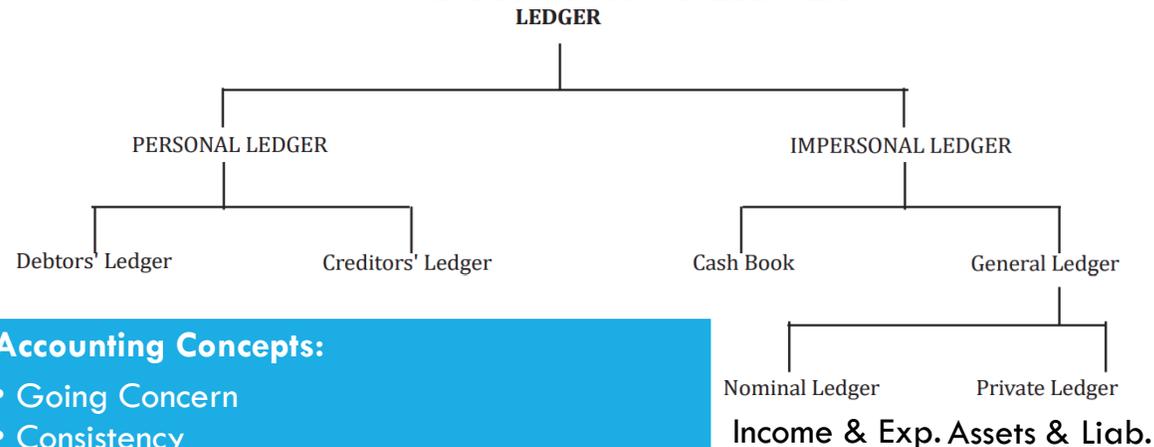
7. Purchased 20 shares of Rs. 100 each at Rs. 90 by paying 2% brokerage.

First Step (Identification of A/C)	Second Step (Classification)	Third Step (Apply the RULE)
Investment in shares A/c	Dr. Balance	Dr. 1,800
Brokerage A/c	Dr. Balance	Dr. 36
Cash / Bank A/c	Dr. Balance	Cr. 1,836

8. Goods worth Rs. 100 were distributed as free samples.

First Step (Identification of A/C)	Second Step (Classification)	Third Step (Apply the RULE)
Advertisement A/c	Dr. Balance	Dr. 100
Purchase A/c	Dr. Balance	Cr. 1`00

## SUB-DIVISION OF LEDGER



### Accounting Concepts:

- Going Concern
- Consistency
- Accrual
- Cost Concept
- Conservatism
- Revenue Matching
- Dual Aspect
- Prudence
- Substance over form

### Closing Balance and Opening Balance:

The debit or credit balance that we get at end of the accounting period is known as closing balance of that account.

“Balance of the nominal accounts” is closed by transferring to trading account, & profit & loss account which shows the net operating results – net profit or net loss.

“Balance of personal accounts & real accounts” representing assets, liabilities, owner's equity are reflected in Balance Sheet, which shows financial position of a business on a particular date.

These balances are transported as opening balance in the succeeding accounting period.

**Trial Balance:** statement or a list of all ledger account balances taken from various ledger books on a particular date to check the arithmetical accuracy

**Features of a Trial Balance:**

- list of debit and credit balances
- does not prove arithmetical accuracy
- is not an account. It is only a statement
- not a part of the final statements
- Usually prepared at the end of the accounting year but it can also be prepared any time
- link between the Books of Accounts, Profit and Loss Account and Balance sheet

**Purpose of a Trial Balance:**

- To check the arithmetical accuracy of recorded transactions
- To ascertain the balance of any ledger account
- To serve as an evidence of the fact that the double entry has been completed
- To facilitate the preparation of final accounts

**Trial Balance – Utility and Interpretation**

- It forms the basis for the preparation of financial statements,
- ensures the arithmetical accuracy of the entries made
- can easily find out the balance in any ledger account without actually referring to the ledger
- can do a quick time analysis. Hence, listing is usually done in the sequence of Asset accounts, Liability accounts, Capital accounts, Owner's equity accounts, Income or gain accounts and Expenses or Losses accounts in that order

**Method of Preparation**

- Total Method or Gross Trial Balance.
- Balance Method or Net Trial Balance.
- Compound Method

**Cash Book**

- Single Column Cash Book
- Double Column Cash Book
- Triple Column Cash Book
- Multi Column Cash Book
- Petty Cash Book
- Contra Transactions

1. ₹3,50,000 cash paid to creditors for settlement of credit purchases will be recorded in –

- (a) Sales Book (b) Purchase Book  
(c) Journal Proper (General Journal) (d) **Cash Book**

2. Expenses whose benefit expires within year of expenditure & which incurred to maintain earning capacity of existing asset are called as

- (a) Capital expenditure (b) **Revenue expenditure**  
(c) Deferred revenue expenditure (d) None of the above

3. Fee paid to a lawyer for checking whether all the papers are in order before land is purchased is \_\_\_\_\_. But if later a suit is filed against the purchaser, the legal costs will be\_\_\_\_\_

- (a) **Capital expenditure, Revenue expenditure**  
(b) Revenue expenditure, Revenue expenditure  
(c) Deferred revenue expenditure, Revenue expenditure  
(d) Revenue expenditure, Capital expenditure

4. The following is not an advantage of Double entry system:

- (a) It prevents and minimizes frauds  
(b) Helps in decision making  
(c) **The trial balance doesn't disclose certain types of errors**  
(d) It becomes easy for the Government to calculate the tax

5. Mines as asset is an example of:

- (a) Current Asset (b) Wasting Asset  
(c) Fictitious Asset (d) **Intangible Asset**

6. Current Assets are those assets:

- (a) Which can be converted into cash within 12 mon  
(b) Which can be converted into cash within a period normally not exceeding 12 months  
(c) Which can be converted into cash within an operating cycle which does not exceed 12 mon  
(d) **Which are held for their conversion into cash within an operating cycle or a period of 12 mon**

7. A person who owes money to the business is a

- (a) **Debtor** (b) Creditor  
(c) Investor (d) Promoter

8. Provision is:

- (a) an unknown liability but its amount and due date are determinate  
(b) an unknown liability and its amount and due date are indeterminate  
(c) a known liability and its amount and due date are determinate  
(d) **a known liability but its amount and due date are indeterminate**

9. Preliminary expense is a .. asset.

- (a) Current (b) Fixed  
(c) Tangible (d) **Fictitious**

10. The words 'To Balance b/f' or 'By Balance b/f' are recorded in the 'Particulars Column' at the time of posting of:

- (a) all compound entries (b) **an opening entry**  
(c) a closing entry (d) an adjusting entry

11. Doctors, lawyers, firms of chartered accountants/Company Secretaries generally follows \_\_\_\_\_ of accounting

- (a) Accrual system of accounting      (b) **Cash basis of accounting**  
(c) Hybrid system of accounting      (d) None of the above

12. Which of the following would be considered as external users of accounting information's?

- (a) Board of Directors      (b) **Shareholders**  
(c) Finance manager      (d) Sales manager

13. Which of the following is characteristic of accounting information? P. Relevance Q. Reliability R. Comparability Select the correct answer from the options given below –

- (a) P      (b) Q  
(c) R      (d) **All of the above**

14. When a change in accounting policy is justified?

- (a) To comply with accounting standard  
(b) To ensure more appropriate presentation of the financial statement of the enterprise  
(c) To comply with law  
(d) **All of the above**

15. The determination of the amount of bad debts is an accounting –

- (a) Policy      (b) **Estimate**      (c) Parameter      (d) None of the above

16. All accounts are classified into –

- (a) Personal      (b) Real  
(c) Nominal accounts      (d) **Any of the above**

17. Outstanding wages is a –

- (a) Real Accounts      (b) **Personal Accounts**  
(c) Nominal Accounts      (d) None of above

18. As per the provisions of the Companies Act, 2013, companies must maintain their accounts under –

- (a) Double account system      (b) Single entry system  
(c) **Double entry system**      (d) Duplicate account system

19. According to which concept, the owner of an enterprise pays the 'interest on drawings'?

- (a) **Conservatism concept**      (b) Dual aspect concept  
(c) Entity concept      (d) Accrual concept

20. Opening, closing and adjustment entries are recorded in –

- (a) Purchase Book      (b) Sales Book  
(c) Petty Cash Book      (d) **Journal Proper**

21. Which of the following is/are not example of capital expenditure

- (a) Money spent to reduce working expenses like conversion of hand driven machinery to power-driven machinery  
(b) Money paid for goodwill (like the right to use the established name of an outgoing firm)  
(c) **Expenditure which does not result in an increase in capacity or in reduction of day-to-day expenses**  
(d) All of the above