Book-Keeping & Accountancy

Art is the technique which help us to achieve our desired objectives. Accounting is an art of recording, classifying and summarising financial transactions. It helps us in knowing the profitability and financial position of the business.

Science:- Any organised/systematised body of knowledge based on certain basic principles having universal application is a science. Accounting is also a science as it is an organised knowledge based on certain principles.

Goods:- Commodity or Article in which the business deals in or trade are known as Goods.

Expenditure:- It is the amount spent or incurred for acquiring assets, goods, or services.

Assets: Property of any type owned and possessed by a person/business is known as an asset. Example are Land, Building Motor Vehicle, Computers etc.

Current Assets: Current Assets are the assets which are held by the business with the purpose of converting them into cash within a short period that is one year.

Fictitious Assets: They are imaginary assets and generally do not have any realisable value.

Fixed Liabilities:- Fixed Liabilities are payable only after period of more than a year. Fixed Liabilities constitutes long term sources of finance. Ex: Long term loans.

Net Worth:- The excess of Assets over Liabilities of the business is known as Net Worth

Net Worth= Market Value of Total Assets Minus Liabilities

Contingent Liability:- Contingent Liability is a liability which may have to be paid at a future date, depending upon the happening or non-happening of a certain event. As it is not confirmed or perfect liability it does not affect the financial position of the business and therefore it is not shown on the liability side of the Balance Sheet but it is shown by way of foot note to Balance Sheet simply as information.

Liabilities: Amount payable by the business to others is known as liability. Ex: Loan taken, Creditors, Bank overdraft, Outstanding expenses.

Types of Liabilities:-

A) **Fixed Liabilities:-** It is that liability which is payable after a period of more than a year. Ex:- Long term long, Debentures etc. Fixed liability constitutes long term source of finance.

B) **Current Liabilities:-** Liabilities which are payable within a year are called Current Liabilities. Ex:- Creditors, Outstanding expenses.

Net Worth:- Worth means value or price. Net worth refers to the net value of the business enterprise in terms of its assets and liabilities. It is always equal to

Net Worth= Assets – Liabilities

Contingent Liability:- Contingent Liability is a liability which may have to be paid at a future date, depending upon the happening or non-happening of a uncertain event. As it is not confirmed or perfect liability it does not affect the financial position of the business and therefore it is not shown on the liability side of the Balance Sheet but it is shown by way of foot note to Balance Sheet simply as information.

Accounting Year:- It is a period of 12 months for which the accounts are maintained and closed by the proprietor. Earlier the proprietors were allowed to follow any accounting year i.e. Calendar year, or financial year or any other year as per tradition. But now for income tax purpose an accounting year starts on 1st April and ends on 31st March.

Expenditure:- Expenditure is the amount spent or liability incurred for acquiring assets, goods or services. Expenditure may be categorised into:

1) **Capital Expenditure**:- It is an expenditure incurred to acquire assets or improving the existing assets which will increase the earning capacity of the business. It will give benefit to business for a long period of time (more than one accounting year) and is non-recurring in nature ex:- purchase of Machinery, Computers, Furniture to carry on business.
2) **Revenue Expenditure**:- Revenue Expenditure is the Expenditure incurred, the benefit of which is consumed or exhausted within the accounting period. These are normal day to day operating expenses of the business organisation. Ex:- Rent, Electricity exp, salaries etc.

3) **Deferred Revenue Expenditure**:- An expenditure which is basically revenue in nature but benefit of which is not exhausted within one year is called Deferred Revenue Expenditure. Such expenditure is written off (charged) in more than one accounting period. For example, large advertising expenditure that will give benefit for more than one accounting period is a Deferred Revenue Expenditure.

Solvent:- Solvent is a person or enterprise which is in a position to pay its debts. If a person's assets are more than his liabilities or equal to his liabilities he is called as a solvent person

Insolvent:- Insolvent is a person or enterprise which is not in a position to pay its debts. Such person's liabilities are more than his assets.

Trading Concern:- A business concern established with an object of earning profit by selling goods is known as Trading Concern.

Not For Profit Concerns:- It is an organisation established not for making profit but for rendering services to the society. An organisation may be formed for promoting a useful object like art, science, sports, culture, charity, profession etc. Ex:- School, Hospital, sports club etc.

Goodwill:- Goodwill means reputation of the business valued in terms of money. Goodwill does not have actual physical existence. It is an Intangible asset for the business.

Income:- It is the revenue arising as result of business transactions. Ex: amount received from sale of goods or providing services to customers. It also includes other items of revenues common to many business like: receipt of rent, interest , commission, dividend etc.

Profit:- Excess of income over the expenses during the accounting year is called profit. Ex: If the goods are sold for Rs: 2,00,000 and all expenses during the period amounts to Rs: 75,000. Then the profit is Rs: 1,25,000.

Loss:- Excess of expenses over the income is called loss. Ex: If the goods are sold for Rs: 1,20,000 and all expenses during the period amount to Rs: 2,00,000 then the loss will be Rs: 80,000.

Discount :- Discount is basically a concession or allowance given by the seller to the buyer. When the customers are allowed a reduction in the prices of goods by the business, it is known as Discount. There are two types of Discounts:-

1) **Trade Discount:-** It is the amount deducted by the seller from the list price or marked price of goods at the time of sale. It helps a retailer to sell the goods at printed price and yet make the profit. Therefore it is not required to be recorded in the books of accounts. Sales are recorded at net value, i.e., Sales minus Trade Discount, similarly purchases are recorded at net value, i.e., Purchases minus Trade discount.
2) **Cash Discount**:- Cash Discount is the rebate allowed for timely payment of due amount. It is the concession encouraging prompt. It is an expense for the party allowing the discount and income for the party receiving Cash discount. Cash Discount is calculated after deducting Trade Discount, since it the loss to the seller and gain to the buyer Cash discount appears in the books of account.

Account:- An account is a summarised record of transactions at one place relating to a particular head.

Operating Profit:- It arises as result of carrying out operation activities. Operating activities are the principal revenue producing activities of the organization

Non-Operating Profit:- It arises as a result of carrying out non-operating activities. The excess of non-operating revenues over non-operating expenses is called as non-operating Profit.

Normal Profit:- During the normal course of production if quantity of output is increased, it is referred to as normal gain. Normal gain arises if wastages are controlled.

Abnormal Gain:- When goods under production are transferred from one process to another, it is possible that quantity may increase to much more than expectation which is called as Abnormal Gain. Abnormal gain arises due to rise in the efficiency of the production department.

Book-Keeping, Accounting & Accountancy

Book-Keeping and Accounting are often considered as same. But it is not so. The two terms are distinct from each other. Accounting is a wider concept and includes Book-Keeping.

Meaning of Book-Keeping:- Book-Keeping is a part of accounting being a process recording of financial transactions and events in the books of accounts. Thus Book-Keeping involves:

1) Identifying financial transactions and events.
2) Measuring them in terms of money
3) Recording the identified financial transactions and events In the books of accounts and
4) Classifying recorded transactions and events (i.e., posting them into Ledger accounts)(Classification is the process of collecting similar transactions at one place by opening accounts in the ledger)

Accounting:- Accounting is related to recording, classifying, summarising, analysing and interpreting the financial data.

Accountancy:- Accountancy is the systematic knowledge of accounting. It explains how to deal with various aspects of accounting. It educates us how to maintain the books of accounts and how to summarise the accounting information and communicate it to the users. In the words of Kohler, Accountancy refers to the entire body of the theory and practice of accounting.

Accounting and Accountancy:- Accountancy is an area of knowledge whereas accounting is the action or process used in the area. Accounting depends on rules and principles framed by accountancy but accountancy does not depend upon accounting. Thus it can be said that that accountancy is the knowledge of accounting and accounting is the application of accountancy.

Classifying:- it is the process of collecting similar transactions at one place.

Analysis : Detailed examination of the elements or structure of something.

Relationship of Book-Keeping, Accounting and Accountancy can be depicted in the following chart as:-

Basis of Accounting:- There are mainly three basis or method of accounting in common usage, namely

1) Cash Basis 2) Accrual Basis 3) Mixed or Hybrid Basis

Cash Basis:- Under this system income is recorded as and when cash is actually received and expenses are recorded when they are actually paid in cash or by cheque.

Accrual Basis:- Under accrual basis system incomes are recorded as and when they accrues or earned and expenses are recorded as and when they are due or become payable. This system records incomes and expenses in the books of accounts as and when they are earned and incurred and not when they are actually received and paid. This system is also called Mercantile basis of accounting.

Mixed or Hybrid Basis:- It is the combination of Cash and Accrual Basis of accounting. Under mix basis of accounting both cash basis and accrual basis are followed. Revenue and assets are generally recorded on cash basis whereas expenses are generally taken on accrual basis.

Qualitative charactertics of accounting information:- While recording information in the books of accounts we must observe the following qualitative charactertics of accounting:-

1) **Reliability of accounting information:-**Accounting information must be reliable. Reliability of information means it is verifiable, free from material error and bias.
2) **Relevance:-** Accounting information must be relevant to the user. Information is relevant if it meets the needs of the users in decision-making.
3) **Understandability:-** Understandability means that the information provided through the financial statements must be presented in a manner that the users are able to understand it.
4) **Comparability:-** Comparability means that the users should be able to compare the accounting information of an enterprise of the period either with that of other periods, known as intra-firm comparison or with the accounting information of other enterprises, known as inter-firm comparison.

Accounting Concepts, Conventions

Accounting concept refers to the basic assumptions and rules and principles which work as the basis of recording of business transactions and preparing **accounts**.

1)Business Entity Concept:- Business is treated as a separate entity distinct from its owners. According to this concept only business transactions are recorded in the books of accounts. Personal transactions of the owners are not recorded. But his transactions with the business are recorded in the books of accounts.

2)**Money Measurement Concept**:-Transactions and events that can be expressed in money or in money terms are recorded in the books of accounts.

3)**Cost Concept:-** The underlying principle of cost concept is that the asset be recorded at its cost price, which is the cost of acquisition less depreciation.

4)**Consistency Concept**:- Any policy adopted for accounting should be continuous or consistent throughout the business and it need not be changed generally unless and until circumstances demand.

5) **Conservatism:**- Do not anticipate profits but provide for all possible losses.

6) **Going Concern Concept**:- The business will continue for an indefinite period and there is no intention to close the business or downsize its operations significantly.

7) **Realization:**- Revenue are recorded only when sale are effected or the services are rendered.

8) **Accrual:**- Income is recorded when it accrues (earned) and expenses are recorded when they accrue (become payable)

9) **Dual Aspect:-**According to this concept every transaction or event has two aspects i.e., dual effect. This is the basis of the entire system of double entry book-keeping.

10) **Full Disclosure Principle:-** According to this convention, financial statements should be prepared and to that end, full disclosure of all significant information should be made.

11) **Materiality:**- Items or events having a significant effect should be disclosed.

12) **Matching Concept**:- Cost incurred during a particular period should be set out against the revenue of that period to ascertain profits.

Double Entry Book-Keeping

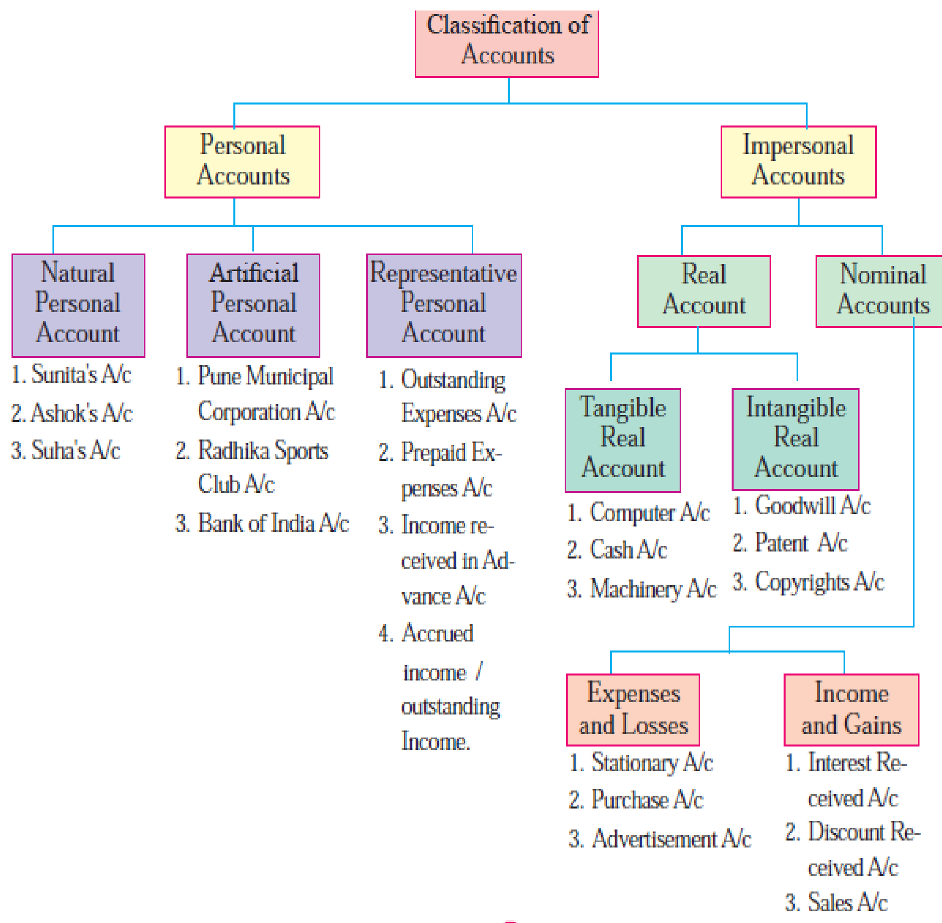
This system of Book-Keeping is based on the fact that there are two aspects of every business transactions. Every business transactions involves two persons or accounts or parties where in one is the receiver of the benefit and other is the giver of the benefit. If something comes into the business, something goes out from the business. Recording of the two aspects of monetary transactions in the Books of Accounts in term of Debit (Dr) and Credit (Cr) is called as Double Entry System of Book-Keeping.
Every debit has an equal and corresponding credit of the same amount is the basic principle of Double Entry System.

Principles of Double Entry Book-Keeping System:-

1) In every business transaction there must be minimum two effects i.e. debit and credit.
2) Two accounts means one is the Receiver of benefit and other is the Giver of the benefit.
3) If one account is debited other account must be credited.
4) Every debit has a equal and corresponding credit of the same amount.

Classification of Accounts :-

Meaning of Account: An account is a summarized record of transaction relating to a particular person, asset, liability, particular head of expense or income recorded at one place.



Each type of account is explained below with examples:-

1) **Personal Accounts**:- These account represents a person and group of persons with whom the business deals. These accounts are classified into following three categories:-

a) **Natural Personal Account**:- The term Natural Person means persons who are creations of God. For example, Ram's Account; Asha's Account etc.

b) **Artificial Personal Account**:- Artificial Persons includes account of organisations, association which are created by law for Ex: Bank of India, Reliance Ltd, Cipla Ltd etc.

c) **Representative Personal Account:-** These accounts represent a certain person or group of persons in business dealing. For example, if rent is due to the landlord, an outstanding Rent Account will be opened in the

books. The Outstanding Rent Account represents the amount of rent payable to the landlord.

2) **Impersonal Account:-** Impersonal Accounts are classified into following two categories:-

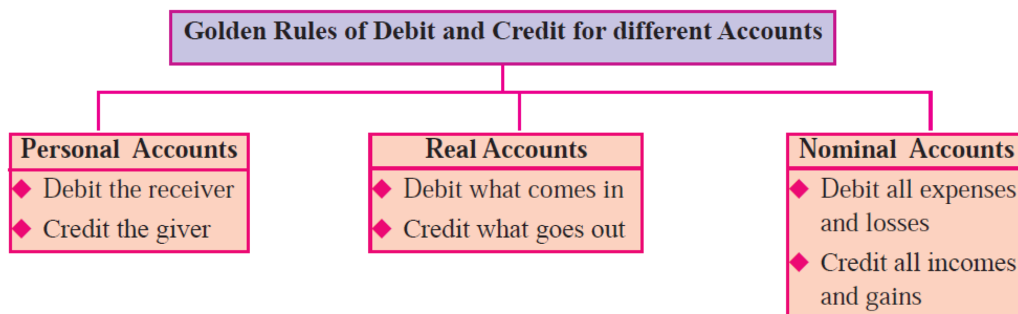
1) **Real Accounts**:-This accounts represents assets (excluding debtors) and properties owned by business. The following are the two types of Real Account.

   a) **Tangible Real Accounts**:- Tangible real account means Assets and Properties which can be seen, touched and felt e.g. Machinery a/c, Motor Car, Stock of Goods etc.

   b) **Intangible Real Account**:-Intangible real account means assets which cannot be seen, touched or felt but they can be measured in terms of money e.g. Goodwill a/c, Patent a/c, Trademark a/c, Copyright a/c etc.

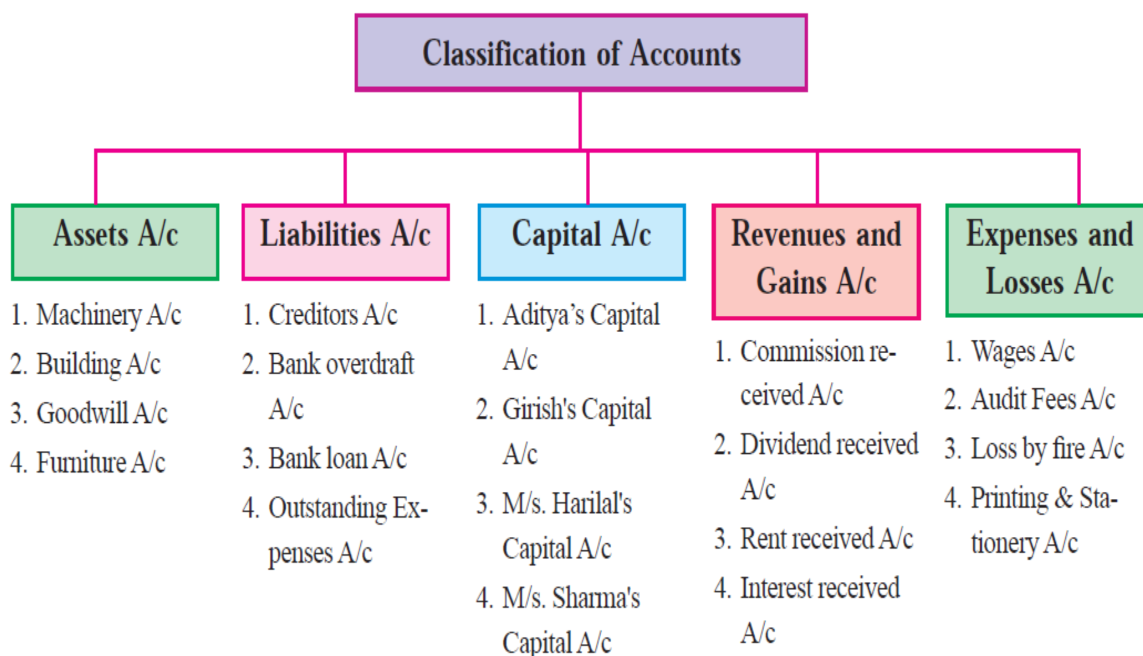
2) **Nominal Accounts**:- Accounts which relate to expenses, losses, gains, revenue, etc are termed as Nominal Accounts. These are Salary Account, Purchases Account, Interest Paid Account, Sales Account and Commission Received Account etc.

2.5 Golden Rules of Debit and Credit (Traditional Approach):



S. No	Types of Account	Account to be debited	Account to be credited
1	Personal	*Receiver*	*Giver*
2	Real a/c	*What comes in*	*What goes out*
3	Nominal a/c	*Expenses and Loss*	*Income and Gain*

2.6 Classifictation of Accounts (Modern approach)



As per Modern Approach in the given chart all accounts are divided into five categories for the purpose of recording the transactions. Namely:-

1) Assets 2) Liabilities 3) Capital 4) Expenses/Losses 5)Revenue/Gains

1) **Assets Accounts**:- These accounts are accounts of assets and properties such as Land & Building, Plant & Machinery, Furniture, Patents, Inventory etc.
2)**Liabilities Accounts**:- These accounts are that of lenders, creditors for goods, outstanding for expenses etc.
3**) Capital Accounts :-** They refer to the accounts of the proprietor/partners who invested into the business. Ex: Capital account of the owner, Capital account of the partners, drawings account, current account of the partners.
4**) Revenue Accounts:-** These are the accounts of Incomes and Gains. Examples are sales, discount received, interest received, bad debts recovered, etc.
5) **Expense Accounts**:- These are accounts which show the amount spent or even lost in carrying on business operations, Examples are Purchases, wages paid, depreciation, rent, discount allowed etc.

Two Fundamental Rules to be followed to record the changes in these accounts:-

1) **For Recording changes in Assets / Expenses / Losses.**
   a) Increase in the Asset is debited and decrease in the Asset is Credited.
   b) Increase in the Expenses/Losses is debited and decrease in the Expenses/Losses is credited.

2) **For Recording changes in Liabilities, Capital and Revenues / Gains.**
   a) Increase in the Liabilities is Credited and Decrease in the Liabilities is Debited.
   b) Increase in the Capital is Credited and Decrease in Revenue/Gains is Debited.
   c) Increase in the Revenue / Gains is Credited and Decrease in Revenue / Gains is Debited.

S. No	Types of Account	Account to be Debited	Account to be Credited
1	Assets a/c	Increase	Decrease
2	Liabilities a/c	Decrease	Increase
3	Capital a/c	Decrease	Increase
4	Revenue a/c	Decrease	Increase
5	Expenses a/c	Increase	Decrease

Accounting Equation:- Accounting equation signifies that assets of the business are always equal to the total of its liabilities and capital. The accounting equation is expressed as follows:-

Assets = Liabilities + Capital

The fundamental accounting equation gives the foundation to the Double Entry Book-Keeping System.

Following are the Equations:-

Capital = Total Assets – Outsider Liabilities

Assets = Capital + Outsiders Liabilities