5

BASIC ACCOUNTING PRINCIPLES

5.0 INTRODUCTION

We have studied economic activities which have been converted into business activities. In business activity a lot of "give & take" exist which is known as transaction. Transaction involves transfer of money or money's worth. Thus exchange of money, goods & services between the parties is known to have resulted in a transaction. It is necessary to record all these transactions very systematically & scientifically so that the financial relationship of a business with other persons may be properly understood, profit & loss and financial position of the business may be worked out at a particular date. The procedure to record all these transactions is known as "Book-keeping".

In other words the book keeping may be defined as an activity concerned with the recording of financial data relating to business operations in an orderly manner. Book keeping is the recording phase of accounting. Accounting is based on an efficient system of book keeping.

Accounting is the analysis & interpretation of book keeping records. It includes not only the maintenance of accounting records but also the preparation of financial & economic information which involves the measurement of transactions & other events relating to entry.

There are various terminology used in the Accounting which are being explained as under: -

1) **Assets:** An asset may be defined as anything of use in the future operations of the enterprise & belonging to

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the enterprise. E.g., land, building, machinery, cash etc.

2) **Equity:** In broader sense, the term equity refers to total claims against the enterprise. It is further divided into two categories.

   i. Owner Claim - Capital

   ii. Outsider's Claim – Liability

   Capital: The excess of assets over liabilities of the enterprise. **It is the difference between the total assets & the total liabilities of the enterprise.** e.g.,: if on a particular date the assets of the business amount to Rs. 1.00 lakhs & liabilities to Rs. 30,000 then the capital on that date would be Rs.70,000/-.

   Liability: Amount owed by the enterprise to the outsiders i.e. to all others except the owner. e.g.,: trade creditor, bank overdraft, loan etc.

3) **Revenue:** It is a monetary value of the products or services sold to the customers during the period. It results from sales, services & sources like interest, dividend & commission.

4) **Expense/Cost:** Expenditure incurred by the enterprise to earn revenue is termed as expense or cost. The difference between expense & asset is that the benefit of the former is consumed by the business in the present whereas in the latter case benefit will be available for future activities of the business. e.g., Raw material, consumables & salaries etc.

5) **Drawings:** Money or value of goods belonging to business used by the proprietor for his personal use.

6) **Owner:** The person who invests his money or money's worth & bears the risk of the business.

7) **Sundry Debtors:** A person from whom amounts are due for goods sold or services rendered or in respect of a contractual obligation. It is also known as debtor, trade debtor, accounts receivable.

8) **Sundry Creditors:** It is an amount owed by the enterprise on account of goods purchased or services rendered or in respect of contractual obligations. e.g., trade creditor, accounts payable.

5.1 OBJECTIVES

At the end of this lesson you will be able

- To maintain the books of accounts
- To prepare the annual accounts

5.2 ACCOUNTING CYCLE

After taking decisions such as selecting a business, selecting the form of organisation of business, making decision about the amount of capital to be invested, selectingsuitable site, acquiring equipment & supplies, selecting staff, getting customers & selling the goods etc. a business man finally resorts to record keeping.

For all types of business organisations, transactions such as purchases, sales, manufacturing & selling expenses, collection from customers & payments to suppliers do take place. These business transactions are recorded in a set of ruled books such as journal, ledger, cash book etc. Unless these transactions are recorded properly he will not be in a position to know where exactly he stands.

The following is the complete cycle of Accounting

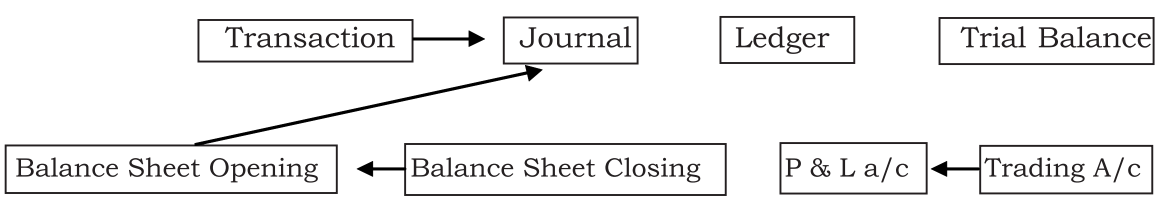
a) The opening balances of accounts from the balance sheet & day to day business transaction of the accounting year are first recorded in a book known as **journal.**

b) Periodically these transactions are transferred to concerned accounts known as **ledger** accounts.

c) At the end of every accounting year these accounts are balanced & the **trial balance** is prepared.

d) Then the final accounts such as **trading & profit & loss** accounts are prepared.

e) Finally, a **balance sheet** is made which gives the financial position of the business at the end of the period.



5.3 ACCOUNTING ASSUMPTIONS

In the modern world no business can afford to remain secretive because various parties such as creditors, employees, Government, investors & public are interested to know about the affairs of the business. The affairs of the business can be studied mainly by consulting final accounts and the balance sheet of the particular business. Final accounts & the balance sheet are the end products of book keeping. Because of the importance of these statements it became necessary for the accountants to develop some principles, concepts and conventions which may be regarded as fundamentals of accounting. The need for generally accepted accounting principles arises from two reasons:

1) to be logical & consistent in recording the transaction

2) to conform to the established practices & procedures

The International Accounting Standards Committee (IASC) as well as the Institute of Chartered Accountants of India (ICAI) treat (vide IAS-I & AS-I) the following as the fundamental assumptions:

1. **Going Concern:** In the ordinary course accounting assumes that the business will continue to exist & carry on its operations for an indefinite period in the future. The entity is assumed to remain in operation sufficiently long to carry out its objects and plans. The values attached to the assets will be on the basis of its current worth. The assumption is that the fixed assets are not intended for re-sale. Therefore, it may be contended that a balance sheet which is prepared on the basis of record of facts on historical costs cannot show the true or real worth of the concern at a particular date. The underlying principle there is that the earning power and not the cost is the basis for valuing a continuing business. The business is to continue indefinitely and the financial and accounting policies are followed to maintain the continuity of the business unit.

2. **Consistency:** There should be uniformity in accounting processes and policies from one period to another. Material changes, if any, should be disclosed even though there is improvement in technique. Only when the accounting procedures are adhered to consistently from year to year

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the results disclosed in the financial statements will be uniform and comparable.

3. **Accrual:** Accounting attempts to recognize non-cash events and circumstances as they occur. Accrual is concerned with expected future cash receipts and payments. It is the accounting process of recognizing assets, liabilities or income amounts expected to be received or paid in future. Common examples of accruals include purchases and sales of goods or services on credit, interest, rent (unpaid), wages and salaries, taxes. Thus, we make record of all expenses and incomes relating to the accounting period whether actual cash has been disbursed or received or not.

   In order to keep a complete record of the entire transactions of any business it is necessary to keep the following accounts:

a) **Assets Accounts:** These accounts relate to tangible and intangible assets. e.g., Land a/c, building a/c, cash a/c, goodwill, patents etc.

b) **Liabilities Accounts:** These accounts relate to the financial obligations of an enterprise towards outsiders. e.g., trade creditors, outstanding expenses, bank overdraft, long-term loans.

c) **Capital Accounts:** These accounts relate to the owners of an enterprise. e.g., Capital a/c, drawing a/c.

d) **Revenue Accounts:** These accounts relate to the amount charged for goods sold or services rendered or permitting others to use enterprise's resources yielding interest, royalty or dividend. e.g., Sales a/c, discount received a/c, dividend received a/c, interest received a/c.

e) **Expenses Account:** These accounts relate to the amount spent or lost in the process of earning revenue. e.g., Purchases a/c, discount allowed a/c, royalty paid a/c, interest payable a/c, loss by fire a/c.

5.4 SYSTEMS OF RECORDING

There are three methods of recording of entries which are explained as under:

Single Entry System: This system ignores the two fold aspect of each transaction as considered in double entry system.

Under single entry system, merely personal aspects of transaction i.e. personal accounts are recorded. This method takes no note of the impersonal aspects of the transactions other than cash. It offers no check on the accuracy of the posting and no safeguard against fraud and because it does not provide any check over the recording of cash transactions , it is called as "imperfect accounting".

Double entry system: The double entry system was first evolved by Luca Pacioli, who was a Franciscan Monk of Italy. With the passage of time, the system has gone through lot of developmental stages. It is the only method fulfilling all the objectives of systematic accounting. It recognizes the two fold aspect of every business transaction.

Indian (Deshi Nama) system: This is the Indian system. It differs from region to region; community to community and from business to business. Under this system books are written in regional languages such as Muriya, Sarafi etc. Books are called "Bahis". It is older than double entry system and is complete in itself.

5.5 BASIS OF ACCOUNTING SYSTEM

Cash or receipt basis is the method of recording transactions under which revenues and costs and assets and liabilities are reflected in accounts in the period in which actual receipts or actual payments are made. "Receipts and payments account" in case of clubs, societies, hospitals etc., is the example of cash basis of accounting.

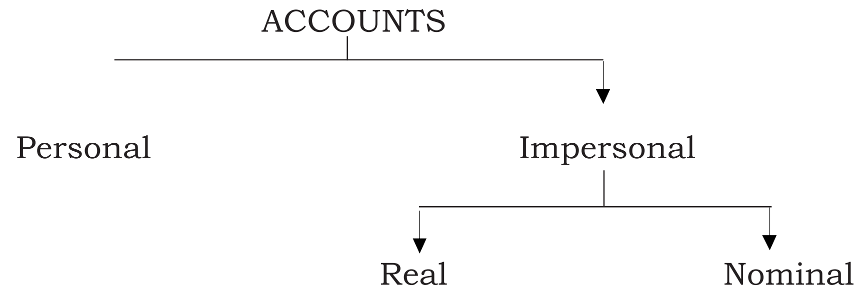
Accrual or mercantile basis is the method of recording transactions by which revenues, costs, assets and liabilities are reflected in accounts in the period in which they accrue. This basis includes considerations relating to outstanding; prepaid, accrued due and received in advance.

Hybrid or mixed basis is the combination of both the basis i.e. cash as well as mercantile basis. Income is recorded on cash basis but expenses are recorded on mercantile basis.

5.6 CLASSIFICATION OF ACCOUNTS

The classification of accounts and rules of debit and credit based on such classification are given below:

Classification of accounts



Personal Accounts:

Accounts recording transactions relating to individuals or firms or company are known as personal accounts. Personal accounts may further be classified as:

(i) **Natural Person's personal accounts:** The accounts recording transactions relating to individual human beings e.g., Anand's a/c, Ramesh's a/c, Pankaj a/c are classified as natural persons' personal accounts.

(ii) **Artificial Persons' Personal accounts:** The accounts recording transactions relating to limited companies, bank, firm, institution, club, etc., Delhi Cloth Mill; M/s Sahoo & Sahoo; Hans Raj College; Gymkhana Club are classified as artificial persons' personal accounts.

(iii) **Representative Personal Accounts:** The accounts recording transactions relating to the expenses and incomes are classified as nominal accounts. But in certain cases (due to the matching concept of accounting) the amount, on a particular date, is payable to the individuals or recoverable from individuals. Such amount (i) relates to the particular head of expenditure or income and (ii) represent persons to whom it is payable or from whom it is recoverable. Such accounts are classified as representative personal accounts e.g., "wages outstanding account", pre-paid Insurance account, etc.

Real Accounts: The accounts recording transactions relating to tangible things (which can be touched, purchased and sold) such as goods, cash, building, machinery etc., are classified as tangible real accounts.

Whereas the accounts recording transactions relating to intangible things (which do not have physical shape) such as

goodwill, patents and copy rights, trade marks etc., are classified as intangible real accounts.

Nominal Accounts: The accounts recording transactions relating to the losses, gains, expenses and incomes e.g. Rent, salaries, wages, commission, interest, bad debts etc., are classified as nominal accounts.

Rules of debit and credit (classification based)

1.	Personal accounts	:	Debit the receiver Credit the giver (supplier)
2.	Real accounts	:	Debit what comes in Credit what goes out
3.	Nominal accounts	:	Debit expenses and losses Credit incomes and gains

Let us consider the following example to illustrate how the rules of debit and credit are applied in practice:

Illustration 1.

	Rs.
1. Mr. A commenced business with cash	70,000
2. Purchased goods on credit from Mr. B	14,000
3. Paid wages	500
4. Paid to Mr. B	10,000
5. Purchased furniture	1,000
6. Goods stolen by the Store-keeper	200
7. Received commission	100

(a) S. No.	(b) Explanation	(c) Account Involved	(d) Equation based analysis Group	Effect	Rule I	(e) Classification based analysis Group	Effect
1.	Business commenced with cash Rs.70,000	Cash & Capital	Assets Personal	Increase Increase	1 3	Real Personal	Comes in Giver
2.	Purchased goods on credit from Rs. 14,000	Goods & Mr. B	Assets Liability	Increase Increase	1 2	Real Personal	Comes in Giver
3.	Paid wages Rs. 500	Wages & Cash	Expenses Asset	Increase Decrease	4 1	Nominal Personal	Expenses go out
4.	Paid to Mr. B Rs.10,000	Mr. B & Cash	Liability Asset	Decrease Decrease	2 1	Personal Real	Receiver Goes out
5.	Purchased furniture for cash Rs.1,000	Furniture & Cash	Assets Assets	Increase Decrease	1 1	Real Real	Comes in Goes out
6.	Goods stolen by store-keeper Rs.200	Loss of Goods & Goods	Loss Asset	Increase Decrease	4 1	Nominal Real	Loss Goes out
7.	Received commission Rs.100	Cash & Commis-sion	Assets Income	Increase Increase	1 5	Real Nominal	Comes in Income

5.7 JOURNAL

Journal is a book which lists accounting transactions of a business other than cash, before posting them to ledgers. The journal is currently only used to a limited extent to cover item outside the scope of other accounting books. Let us understand the mechanism of recording business transaction in a journal.

Example:

Business transactions of Mr.A for the month of Jan.1997.

1^{st} January, 1997	A started business with cash	Rs.20,000/-
3^{rd} January, 1997	Goods purchased for cash	Rs.6,000/-
5^{th} January, 1997	Goods purchased from S	Rs.4,000/-
7^{th} January,1997	Goods sold for cash	Rs.2,000/-
10^{th} January, 1997	Goods sold to B	Rs.6,000/-
12^{th} January, 1997	Cash paid to S	Rs.2,000/-

17th January, 1997	Cash received from B	Rs.4,000/-
23rd January, 1997	Paid wages	Rs.100/-
25th January, 1997	Furniture purchased from R	Rs.400/-
28th January, 1997	Paid for interest	Rs.200/-
31st January, 1997	Paid salaries	Rs.200/-

Journal Entries

Date	*Particulars Ledger Folio*	*Dr. Amount (Rs.)*	*Cr. Amount (Rs.)*
1997	Cash A/c Dr.	20,000/-	
Jan. 1	To Capital A/c		20,000-
	(Being cash introduced by A)		
Jan.3	Purchase A/c Dr.	6,000/-	
	To Cash A/c		6,000/-
	(Being cash purchases)		
Jan.5	Purchase A.c Dr.	4,000/-	
	To S's A/c		4,000/-
	(Being credit purchase from S)		
Jan.7	Cash A/c Dr.	2,000/-	
	To sales A/c		2,000/-
	(Being cash sales)		
Jan.10	B's A/c Dr.	6,000/-	
	To Sales A/c		6,000/-
	(Being the amount of credit sales)		
Jan.12	S's A/c Dr.	2,000/-	
	To Cash A/c		2,000/-
	(Being the amount of credit sales)		
Jan.17	Cash A/c Dr.	4,000/-	
	To B's A/c		4,000/-
	(Being receipt of cash from B)		
Jan.23	Wages A/c Dr.	100/-	
	To Cash A/c		100/-
	(Being payment of wages in cash)		
Jan.25	Furniture A/c Dr.	400/-	
	To R's A/c		400/-
	(Being purchase of furniture on credit from R)		
Jan.28	Interest A/c Dr.	200/-	
	To Cash A/c		200/-
	(Being payment of interest by cash)		
Jan.31	Salaries A/c Dr.	200/-	
	To Cash a/c		200/-
	(Being payment of salaries by cash)		

5.8 CASH BOOK

All business dealings ultimately resolve themselves into cash transactions, therefore, recording of cash transactions in a separate book becomes necessary. To keep record of all receipts and payments of money in business, cash book is maintained. Cash book with regard to the nature of business and the manner in which the cash is dealt with. Money receipts are entered on debit side and payments are shown on the credit side.

There are three distinct types of Cash Book, and each business could get its cash book ruled in a manner as would suit its own requirements. Thus the Cash Book may be ruled so as to possess.

- Cash and Discount columns only on both sides or
- Cash, Bank and Discount columns on both sides or
- Bank and Discount columns only on both sides.

5.9 PRINCIPAL BOOK: LEDGER

A ledger is a group of accounts. Most of us have probably seen a bound book with the word 'ledger' printed on the cover. All the accounts of a small business/industry could be entered in a ledger in concerned accounts in a summarised and classified form.

From the journal a trader cannot know his total cash, purchases, amount spent under each head of expense and amount earned under each head of income. The journal will not tell him what he owes to his creditors and what his customers owe to him. Such classified information can be got only by opening ledger accounts for every kind of transaction.

Every ledger has two sides namely debit and credit. Left hand side is debit and right hand side is credit. Each side of the ledger has columns on date, particulars, journal folio and amount- In the particulars column of the debit side the name of the account from which benefit is received is recorded and on the credit side, the name of the account to which benefit is given is recorded. The words 'To' and 'By' are affixed to the name of the amount entered on debit and credit sides respectively.

If a business is not able to accommodate all its accounts in one ledger it can have more than one ledgers. Business may have an 'accounts receivable ledger' an 'accounts payable ledger' and a 'general ledger' each containing the group of accounts suggested by the title. The ledger is not necessarily a bound book, it may consist of a set of loose leaf pages, a set of punched cards, or if computerised a set of impulses on a magnetic tape. No matter what its form may be, the essential character of the account and the rules for making entries to it remain exactly the same.

(i) Ledger Posting:

Transferring the entries from the journal or a subsidiary book to the ledger is known as posting. Posting the ledger from journal is easy as the transactions in the journal are already classified into debit and credit. However, the following points must be noted while posting the ledger.

- For the same person or expense only one account should be opened.
- Cash and credit sales should be posted to Sales Account and cash and credit purchases to Purchase Account.
- The word Debit as Dr. and Credit as Cr. should not be omitted.
- Date and folio columns should not be left blank.

(ii) Balancing of Ledger Accounts :

At periodic intervals, the debit and credit sides of individual ledger accounts are totalled and balance of each account indicated. If the total of the debit side of any account is more than the credit side, there will be a debit balance and, if the credit side is more than the debit side there will be credit balance.

With the help of the illustration which we took for recording journal entries, let us see how the ledger postings and balancing will be done.

Based on the illustration the following accounts need to be opened in ledger.

Dr. **Capital A/c** **Cr.**

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
	To balance c/d		20,000/-		By Cash		20,000/-
			20,000/-				20,000/-
				Feb.1	By balance b/f		20,000/-

Dr. **Cash A/c** **Cr.**

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
1997	To capital		20,000	1997	By purchase		6,000
Jan.1	To sales		2,000	Jan.3	By S		2,000
Jan.7	To B		4,000	Jan.12	By wages		100
Jan.17				Jan.23	By interest		200
				Jan.28	By salaries		200
				Jan.31	By bal. c/d		200
				Jan.31			17,500
			26,000				26,000
Feb1	To bal. b/f		17,500				

Dr. **Purchase A/c** **Cr.**

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
1997				1997			
Jan.3	To cash		6,000	Jan 31	By balance c/d		10,000
Jan.5	To S		4,000				10,000
			10,000				
Feb.1	To bal. b/f		10,000				

Dr. **Sales A/c** **Cr.**

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
1997				1997			
Jan.31	To balance		8,000	Jan.7	By cash		2,000
			8,000	Jan.10	By B		6,000
							8,000
				Feb.1	By bal. b/f		8,000

Dr. **S's A/c** **Cr.**

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
1997				1997			
Jan.12	To cash		2,000	Jan.5	By Purchase		4,000
Jan.31	To bal. c/d		2,000				
			4,000				4,000
				Feb.1	By bal. b/f		2,000

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Dr. **B's A/c** **Cr.**

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
1997				1997			
Jan.10	To sales		6,000	Jan.17	By cash		4,000
				Jan.31	By bal. c/d		2,000
			6,000				6,000
Feb.1	To bal. b/f		2,000				

Dr. **Wages A/c** **Cr.**

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
1997				1997			
Jan.23	To cash		100	Jan.31	By bal. c/d		100
			100				100
Feb.1	To bal. b/f		100				

Dr. **Furniture A/c** **Cr.**

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
1997				1997			
Jan.25	To R		400	Jan.31	By bal. c/d		400
			400				400
Feb.1	To bal. b/f		400				

Dr. **Interest A/c** **Cr.**

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
1997				1997			
Jan.28	To Cash		200	Jan.31	By bal. c/d		200
			200				200
Feb.1	To bal. b/f		200				

Dr. **R's A/c** **Cr.**

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
1997				1997			
Jan.31	To bal. c/d		400	Jan.25	By furniture		400
			400				400
				Feb.1	By bal. b/f		400

Dr. **Salaries A/c** **Cr.**

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
1997				1997			
Jan.31	To Cash		200	Jan.31	By bal. c/d		200
			200				200
Feb.1	To bal. b/f		200				

5.10 FINAL ACCOUNTS

The final accounts of a business consists of :

(i) Manufacturing Account

(ii) Trading Account

(iii) Profit and Loss Account

(iv) Balance Sheet.

Before we look into the process of preparing final accounts we must understand the meaning and importance of Trial Balance.

The Trial Balance

The trial balance is simply a list of names of the accounts, and the balances in each account as at a given moment of time, with debit balances in one column and credit balances in another column. The preparation of trial balance serves two principal purposes (i) it shows whether the equality of debits and credits has been maintained and (ii) it provides a convenient transcript of the ledger record as a basis for making adjustments and closing entries for preparation of final accounts.

When the total debits equal total credits, it does not mean that there has been no error in recording the transactions. Entries may have been omitted entirely; they may have been posted to the wrong accounts; off-setting errors may have been made; or the transactions may have been analysed incorrectly. For example when a debit for purchase of a truck is made incorrectly to an expense account, rather than correctly to a fixed assets account, the total of the trial balance is not affected. Nevertheless, errors that result in unequal debits and credits are common, and the existence of such errors is revealed when a trial balance does not balance, that is when the debit column does not add to the same total as the credit column.

A trial balance may be prepared at any time. A pre-adjustment trial balance is one prepared after the original entries for the period have been posted, but prior to the adjusting and closing process. A post closing trial balance is prepared after the closing process.

(i) Manufacturing Account :

When a concern is engaged in both production and selling activities it will have to open a manufacturing account in the general ledger. The manufacturing account is prepared in the following manner.

Manufacturing Account of M/s ______________ for the period from __________ to __________ .

Dr. Cr.

Particulars		Amount Rs.	Particulars	Amount Rs.
To Opening stock of materials		———	By Closing stock of work in progress	———
To Opening stock of work in progress		———		
To Purchases	———		By Cost of manufacturing (B/F)	
Less Purchases returns	———	———		———
To Carriage inward		———		
To Manufacturing wages		———		
To Factory rent		———		
To Power		———		
To Fuel		———		
To Coal		———		
To Water		———		
To Factory insurance		———		
		———		———

Manufacturing Account is balanced by adding debit side and finding the excess of debit over credit. The excess of debit over credit will indicate the cost of manufacturing of the finished goods. This balancing figure will be inserted in the credit side of the Manufacturing Account preceded by the word 'By cost of manufacturing' during the period transferred to Trading Account and the same figure will also be written on the debit side of a 'Trading Account' to be opened in General Ledger. In the Trading Account this figure will be preceded by the word 'To cost of production transferred from the Manufacturing Account'. Thus Manufacturing Account is closed and the cost of production of finished goods during the period is transferred to the Trading Account. The debit balance of (a) opening stock of finished goods, (b) purchase less returns, (c) nominal accounts representing cost incurred in connection with purchase of materials/goods, like carriage inward on such

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purchase etc. will then be cleared by crediting these accounts and debiting the Trading Account.

(ii) Trading Account

When a concern is engaged in trading activities only, there will be no Manufacturing Account. The Trading Account on its debit side will show certain entries regarding opening stock (of saleable goods), purchase less returns and expenses relating to purchase viz. freight, duty, carriage inward etc.

The credit balance of sales account (less the debit balance of sales return accounts) will then be transferred to Trading Account by debiting the former account and crediting the latter account.

The excess of credit total of trading account over the debit total is called the gross profit. This amount is computed and an entry is passed by debiting this amount to Trading Account (preceded by the word 'To Gross Profit transferred to Profit and Loss Account') and crediting the Profit and Loss Account (preceded by the word 'By Gross Profit, brought over from Trading Account'). The Trading Account .thus indicates the gross result from selling of the goods.

(iii) Profit and Loss Account

At this stage Profit and Loss Account stands credited with gross profit. The Profit and Loss Account also stands adjusted with some of the adjustment entries like bad debts, depreciation, insurance, rent etc. All the debit and credit balances lying in different nominal accounts are then transferred to Profit and Loss Account. The debit balances are closed by entering the respective word 'By Profit and Loss Account'. The respective amounts are also entered on the debit side of the Profit and Loss Account preceded by the words To ………………. . The credit balance of nominal accounts are similarly closed by passing debit entries to the respective nominal accounts preceded by the word 'To Profit and Loss Account'. In the credit side of the "Profit and Loss Account" the corresponding credit entries are inserted preceded by the word 'By ……………….'.

Thus, the Profit and Loss Account on its credit shows Gross

Profit and items of miscellaneous incomes and on its debit shows Gross Loss and expenses incidental to carrying of the business and arising in course of running the business. The excess of credit side over the debit side is known as net profit and the excess of debit side over the credit side is known as net loss. The net profit or net loss is transferred to Capital Accounts) in case of proprietary or partnership business and to an account called Profit and Loss Appropriation Account in case of corporate business.

Proforma of Profit & Loss Account

Profit and Loss Account of M/s .... for the year ending ....

Dr. Cr.

Particulars	*Amount Rs.*	*Particulars*	*Amount Rs.*
To Trading A/c (Gross Loss)		By Trading A/c (Gross Profit)	
To Travelling exp.A/c		By Commission (Received)	
To Salaries & Wages A/c		By Interest A/c (Received)	
To Audit Fee A/c		By Discount A/c (Received)	
To printing charges A/c		By Rent A/c (Received)	
To Office establishment A/c		By Net Loss (trans-	
To Discount Paid A/c		ferred to Capital A/c	
To Advertisement A/c		or Profit & Loss	
To Insurance A/c		Appropriation A/c)	
To Carriage outward A/c			
To Dock dues outward A/c			
To Depreciation A/c			
To Bad debts A/c			
To Repair a/c			
To Office lighting A/c			
To Postage, Telegram A/c			
To Interest Paid			
To Legal charges A/c			
To Stationary A/c			
To Trade expenses A/c			
To Bank charges A/c			
Rates and taxes A/c			

Notes

To Brokerage A/c

To Sundry expenses A/c

To Rent A/c

To Duty on exported goods A/c

To Net Profit (transferred
to Capital A/c or Profit
& Loss Appropriation A/c)

(iv) The Balance Sheet

A balance sheet shows the financial position of an organisation as on a specified moment of time; in fact it is sometimes called a statement of financial position. It is therefore a status report, rather than a flow report.

After Trial Balance is prepared; adjustments entries passed, and revenue accounts drawn up, all the nominal accounts will stand closed. The accounts still remaining open in the general ledger will represent either personal accounts or real accounts. The balance remaining after the preparations of Trading and Profit and Loss Account in the Trial Balance represents either assets or liabilities existing on the date of the closing of the accounts. When they are arranged in a proper manner, the resultant statement is called 'Balance Sheet'. The balance sheet is a statement of position and strictly speaking not a part of double entry system of book keeping. No transfer of ledger accounts balances is therefore necessary. Only the relevant particulars are extracted from the general ledger. The balance sheet is prepared on a certain date and not for a period. Therefore, it is true only on the date of its preparation and not on any other day. Secondly, the total of liabilities including capital must be equal to total of assets, otherwise it means that the double entry system of book keeping has not been followed properly in respect of all the transactions.

A balance sheet represents the assets of the business, whether fixed or current or fictitious, on the right hand side and liabilities, whether owned or borrowed, on the left hand side. The balance sheet of an organisation can be prepared in the following format :

Notes

Proforma of Balance Sheet

Balance Sheet of M/s ....

as on ....

Liabilities	*Amount Rs.*	*Assests*	*Amount Rs.*
Capital —		Land	
+ Fresh Capital —		Building	
+ Profit —		(—) Less Depreciation	—
- Losses __		Plant & Machinery	
- Drawings __	____	(—) Less Dep.	—
Term Loan	—	Office Furniture	
Bank Over Draft	—	(—) Less Dep.	—
Creditors	—	Stock in Trade	
Bills Payables	—	Sundry Debtors	
Outstanding	—	(—) Less Reserve for	
Other Liabilities	—	Doubtful Debtors	—
		Bills Receivables	
		Prepaid Expenses	—
		Investments	—
		Cash at Bank	—
		Cash in Hand	—
Total	———	Total	———

5.11 APPLICATION OF COMPUTERS AND INFORMATION TECHNOLOGY TO ACCOUNTING AND FINANCIAL MANAGEMENT

Business Accounting and Financial Management are crucial management functions in every enterprise. Whether you manage a small department, a major division, big company, small company or your micro enterprise, you work with numbers every day. Numbers are the language of business and industrial enterprises. Use of computers in general and electronic spread sheet in particular can economically and effectively replace traditional tools of accounting like ledger pager, stubby pencils, worn-out erasers, desktop calculators etc. Use of computer and spread sheet in today's complex business can take you ahead in speed, accuracy and capability.

Computer application in accounting and financial management can help you in transaction recording, financial planning, analysis, and forecasting. Best of all, it gives you a method of examining the implications of endless "What if ?" situations - the tough alternatives you face in running your business profitably. Computer software developing companies have developed a large number of accounting and financial management softwares.

A brief account of some of the important soft wares available in India is given below. The basic function of these softwares is to enter the transactions and the rest of things i.e posting , balance calculation is done by these software. These software can prepare the trail balance, cash book, balance sheet and profit and loss account.

1. Tally
2. Easy
3. Visipak
4. Fact
5. Fast
6. Ex 3.0

5.12 SUMMARY OF ACCOUNTING PROCESS

(i) The first and the most important part of the accounting process is the analysis of transactions, i.e. the process of deciding which account or accounts should be debited, which should be credited, and in what amounts, in order to reflect events in the accounting records. This requires judgement.

(ii) Next comes the purely mechanical step of journalising original entries, that is, recording the result of the analysis.

(iii) Next to journalising is ledger posting. Posting is the process of recording transactions in the ledger accounts, exactly as specified by the journal entries. This is another purely mechanical step.

(iv) At the end of the accounting period Judgement is involved in deciding on the adjusting entries, and these are journalised and posted in the same way as original entries.

(v) The closing entries are journalised and posted. This is also a purely mechanical step.

(vi) Finally, the financial statements are required to be prepared. This requires judgement and knowledge. The accuracy of financial statements will depend upon the quality of judgement made as suggested in steps (i) and (ii)

5.13 TERMINAL QUESTIONS

1. Discuss the principles of accounting.

2. Pass the journal entries for the following transactions in the Books of Mr S.K.Jain

   a) He Sold old furniture for Rs 5000/-

   b) He received insurance commission of Rs 50000/-

   c) Rent paid by cheque Rs 2000/-

   d) He incurred traveling expenses of Rs 3900/-

3. Discuss the various financial statements prepared by any insurance broker.

5.14 OBJECTIVE TYPE QUESTIONS

1. Choose the correct option

   a. Accounting system is either on cash or receipt basis.

   b. Accounting system is either accrual or mercantile basis.

   c. Accounting system is either hybrid or mixed basis.

   d. All of the above

2. Statement A: Real accounts are maintained for tangible things

   Statement B: Real accounts are also maintained for intangible things.

   a. Only A is true b. Only B is true

   c. Both are true d. Neither of two

3. The final accounts of a business consists of

   a. Trading account b. Profit & loss Account

   c. Balance Sheet d. All of the above

4. Statement A: Balance sheet is summary of the financial position as on date.

   Statement B: Profit and loss account shows profit or loss for the year.

   a. Only A is true b. Only B is true

   c. Both are true d. Neither of two

5. Choose the correct options:

   a. Single entry system is a system of recording of transactions.

   b. Double entry system is a system of recording of transactions.

   c. Indian (desi nama) system is a system of recording of transactions

   d. All of the above

5.15 ANSWERS TO INTEXT QUESTIONS

5.1

1. Technical activities, Commercial activities, Financial activities, Security activities, Accounting activities, Managerial activities consisting of planning, organizing, commanding, co-ordaining and controlling.

2. Planning means looking ahead or to foresee. To foresee means “both to assess the future and make provision for it. To plan means to foresee and provide means for future.

5.16 ANSWERS TO OBJECTIVE TYPE QUESTIONS

1.d 2. c 3. d 4. c 5. d