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ACCOUNTING AND FINANCIAL MANAGEMENT

SYLLABUS

UNIT I

Accounting Basic Concepts: Principles of financial accounting. Relationship with cost and management accounting. Principles of Double entry book keeping – Difference between entry and double entry. Preparation of Journal – Ledger – Trial balance and financial accounts with adjustments – including company final accounts – Problems and solutions. Costing – Cost accounting concepts – costs classification – Methods of costing – Preparation of cost sheet – Problems and solutions.

UNIT II

Depreciation – Meaning, types problems and solutions. Financial statements – Analysis purpose procedures for interpretation – Tool of analysis. Ratio analysis. Classification of Ratios – Applications of ratios, problems and solutions.

UNIT III

Funds flow and cash flow statements – Uses – Preparations – Difference between FFS/CFS – Problems and solutions. Working capital analysis – Forecasting methods problems and solutions. Marginal costing – Break even analysis – Uses-application of marginal costing in managerial decisions making – Problems and solutions.

UNIT IV

Butgeting, Budgetary control – Classification and preparation of budgets – Uses of budgets – Capital budgeting different methods-objectives – Uses-difference between standard costing and budgetary control – Problems and solutions.

UNIT V

Computer Accounting and Algorithms: Introduction to Computer accounting – Coding – Master Files – Transaction files – Documents used for data collection – Processing of different files – Outputs obtained – Reports – Types and uses of report.

UNIT I

LESSON

1

PRINCIPALS OF FINANCIAL ACCOUNTING

CONTENTS

- 1.0 Aims and Objectives
- 1.1 Introduction
- 1.2 Process of Accounting
 - 1.2.1 What is Cash System?
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 - 1.2.3 Value at which it is to be Recorded?
- 1.3 Utility of Financial Statements
- 1.4 Forms of Business Organisations
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- 1.12 Keywords
- 1.13 Questions for Discussion
- 1.14 Suggested Readings

1.0 AIMS AND OBJECTIVES

After studying this lesson, you will be able to:

- Analyze process of accounting and accounting concepts
- Understand accounting conventions
- Know different business organisations
- Explain way of recording transactions and classifying it

1.1 INTRODUCTION

Accounting is a business language which elucidates the various kinds of transactions during the given period of time. Accounting is defined as either recording or recounting the information of the business enterprise, transpired during the specific period in the summarized form.

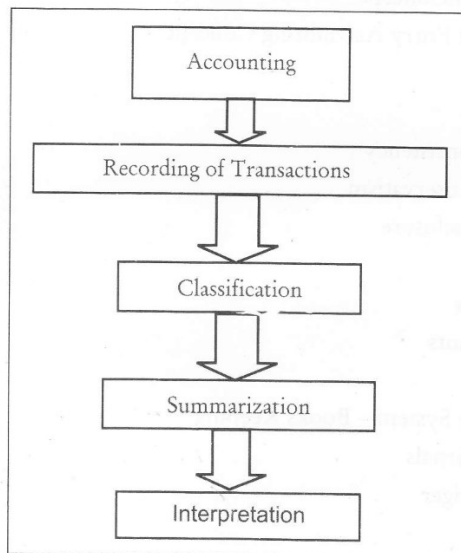
What is meant by accounting?

Accounting is broadly classified into three different functions viz.

Recording	}	Transactions of Financial Nature
Classifying and		
Summarizing		

Is accounting an equivalent function to book keeping?

No, accounting is broader in scope than the book keeping, the earlier cannot be equated to the later. Accounting is a combination of various functions viz.

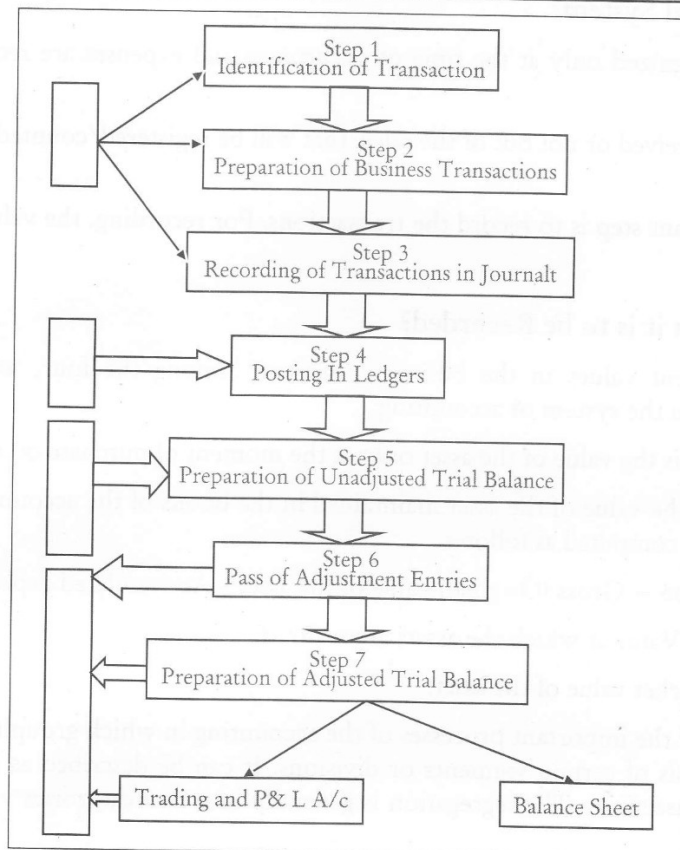


American Institute of Certified Public Accountants Association defines the term accounting as follows "Accounting is the process of recording, classifying, summarizing in a significant manner of transactions which are in financial character and finally results are interpreted."

Qualities of Accounting

- In accounting, transactions which are non- financial in character can not be recorded.
- Transactions are recorded either individually or collectively according to their groups.
- Users should be able to make use of information.

1.2 PROCESS OF ACCOUNTING



Financial Accounting is described as origin for the creation of information and the continuous utility of information.

After the creation of information, the developed information should be appropriately recorded. Are there any scales/guides available for the recording of information? Yes, what are they?

They are as follows:

- **What to record:** Financial Transaction is only to be recorded.
- **When to record:** Time relevance of the transaction at the moment of recording.
- **How to record:** Methodology of recording - It contains two different systems of accounting viz. cash system and accrual system.

1.2.1 What is Cash System?

The revenues are recognized only at the moment of realization but the expenses are recognized at the moment of payment. For e.g. sale of goods will be considered under this method, only at the moment of receipt of cash out of sale of goods. The charges which were paid only will be taken into consideration but the outstanding, not yet paid will not be considered. For e.g. Rent paid only will be considered but not the outstanding of rent charges.

1.2.2 What is Accrual System?

The revenues are recognized only at the time of occurrence and expenses are recognized only at the moment of incurring.

Whether the cash is received or not out of the sales, that will be registered/counted as total value of the sales.

The next most important step is to record the transactions. For recording, the value of the transaction is inevitable.

1.2.3 Value at which it is to be Recorded?

There are four different values in the business practices. Among the four, which one should be followed or recorded in the system of accounting:

1. **Original Value:** It is the value of the asset only at the moment of purchase or acquisition.
2. **Book Value:** It is the value of the asset maintained in the books of the account. The book value of the asset could be computed as follows.

$$\text{Book Value} = \text{Gross (Original) value of the asset} - \text{Accumulated depreciation.}$$

3. **Realizable Value:** Value at which the assets are realized.
4. **Present Value:** Market value of the asset.

Classifying: It is one of the important processes of the accounting in which grouping of transactions are carried out on the basis of certain segments or divisions. It can be described as a method of rational segregation of the transactions. The segregation is generally into two categories viz. cash and non-cash transactions.

The preparation of the ledger accounts and Subsidiary books is done on the basis of rational segregation of accounting transactions. For example the preparation of cash book is involved in the unification of cash transactions.

Summarizing: The ledger books are appropriately balanced and listed one after another. The list of the name of the various ledger book accounts and their accounting balances is known as the Trial Balance. The trial balance is summary of all unadjusted name of the accounts and their balances.

Preparation: After preparing the summary of various unadjusted accounts, we are required to adjust to the tune of adjustment entries which were not taken into consideration at the time of preparing the trial balance. Immediately after the incorporation of adjustments, the final statement is available for interpretations.

Purposes of preparing financial statements:

- Financial accounting provides necessary information for decisions to be taken initially and it facilitates the enterprise to pave way for the implementation of actions
- It exhibits the financial track path and the position of the organization
- As the organisation does business in a dynamic environment, it is required to face the ever changing environment. In order to meet the needs of the ever changing environment, the policies are to be formulated for the smooth conduct of the business
- It equips the management to discharge the obligations at every moment
- Obligations to customers, investors, employees, to renovate/restructure and so on.

1.3 UTILITY OF FINANCIAL STATEMENTS

The financial statements are found to be more useful to users after presentation only, in order to study the financial status of the enterprise in the angle of their own objectives.

To Management

The financial statements are most inevitable for the management to take rational decisions to maintain the sustainability in the business environment among the other competitors.

To Shareholders, Security Analysts and Investors

The information extracted from the financial statements are processed by the above mentioned people to identify not only the financial status but also to determine the qualities of getting appropriate rate of return out of the prospective investment.

To Lenders

The lenders do study the business enterprise through the available information of its financial statements normally before lending. The aim of the study is to analyse the status of the firm for the worthiness of lending with reference to the payment of interest periodically and the repayment of the principal.

To Suppliers

The suppliers are in need of information about the business prospects before sale of goods on credit. The suppliers are very cautious in supplying the goods to the business houses based on their capacity. The most important capacity required as well as expected from the buyer firms is that of prompt repayment of dues of the credit purchase from the suppliers. This quality of prompt payment could be known through the balance sheet.

It mainly plays a pivotal role in answering the status inquiries about the buyer.

To Customers

The legal relationship of the transferability of ownership of the products is obviously understood through financial information available in the statements. The agreement of warranty and guarantee is tested through the financial status of the enterprise.

To Govt. and Regulatory Authorities

The taxes to be paid to the central and state governments on the revenues only through presentation of information.

To Promote Research and Development

For research and development, the amount of investment required is voluminous, which has to be mobilized from either internally or externally for the requirement of the future prospects of the enterprise.

The following questions should be answered one after the other in meeting the needs of the research and development

- How much to be raised?
- When the required amount is to be raised?
- How to raise the required resources?

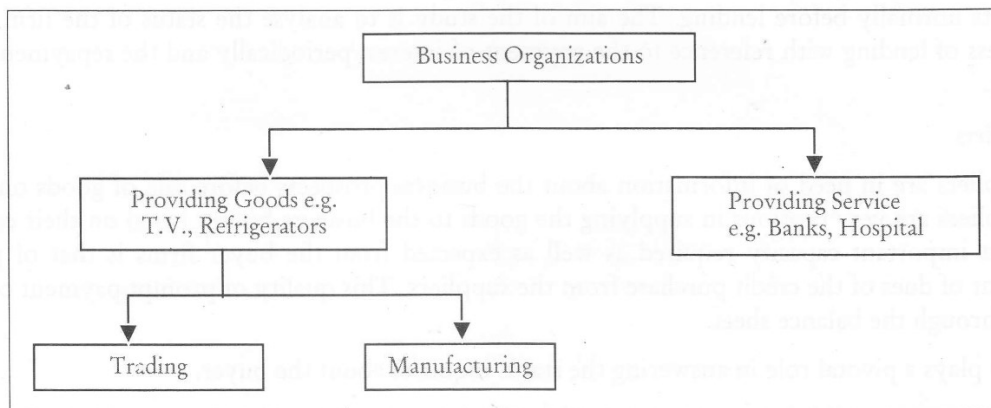
The above questions could be answered through immense financial planning exercise by way of extracting and utilizing the financial information from the Accounting statements of the enterprise.

1.4 FORMS OF BUSINESS ORGANISATIONS

Business organizations are those which provide either goods or services with the basic objective of profit earning. There are of two types of goods providing organizations:

1. Trading organizations and
2. Manufacturing organizations.

Manufacturing business organizations process the raw materials into finished goods. However trading organizations purchase the goods and sell the same.

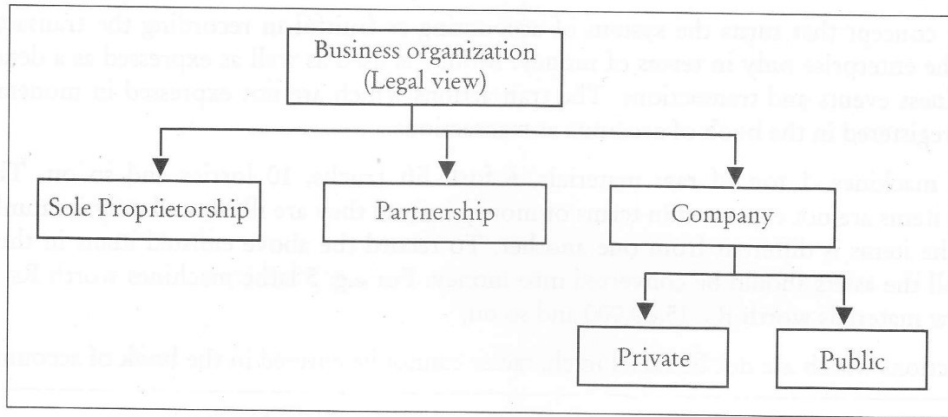


Service organizations are those which purely provide services, do not deal with any goods.

From legal point of view business can be classified into different forms, these are:

1. ***Sole Proprietorship***: This form of business is taken care of by a single individual. This form is generally small also.

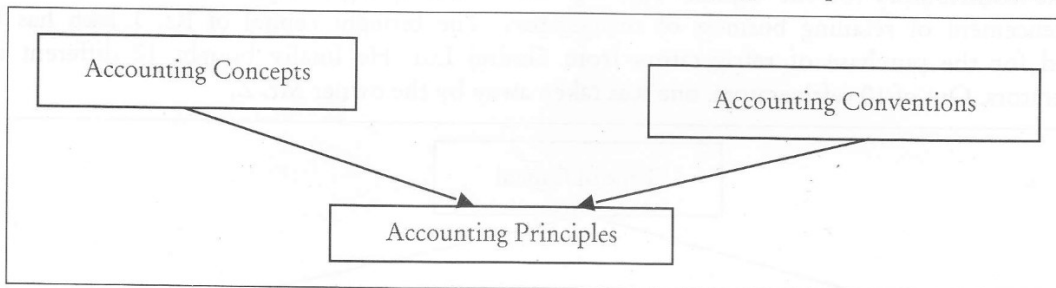
2. **Partnership:** This form of business is run by 2 to 20 persons known as partners on profit/loss sharing basis. Generally size of this type of business is small to medium.
3. **Company:** This form of business comes through a legal process. Company can be classified under two categories, i.e. private co. and public co.



1.5 ACCOUNTING PRINCIPLES

The transactions of a business enterprise are recorded in the business language, which is routed through accounting. The entire accounting system is governed by the practice of accountancy. The accountancy is being practiced through the universal principles which are wholly led by the concepts and conventions.

The entire principles of accounting are on the constructive accounting concepts and conventions.



1.6 ACCOUNTING CONCEPTS

The following are the most important concepts of accounting:

- Money Measurement concept
- Business Entity concept
- Going Concern concept
- Matching concept
- Accounting Period concept

- Duality or Double Entry concept
- Cost concept

1.6.1 Money Measurement Concept

This is the concept that turns the system of accounting as fruitful in recording the transactions and events of the enterprise only in terms of money. Money is used as well as expressed as a denominator of the business events and transactions. The transactions which are not expressed in monetary terms cannot be registered in the book of accounts as transactions.

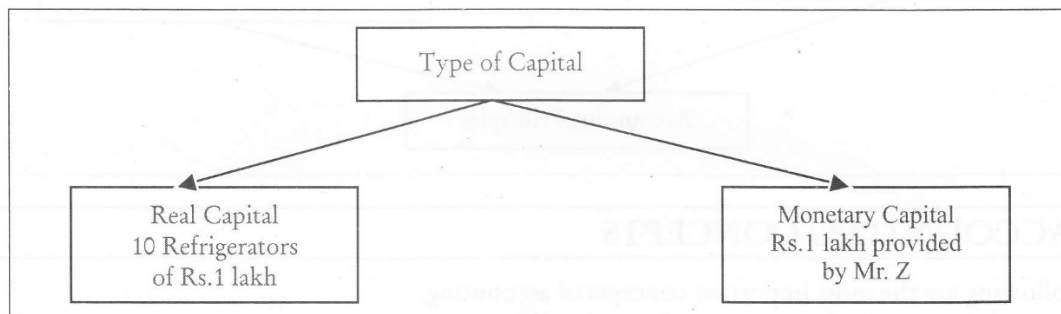
For e.g. 5 machines, 1 ton of raw materials, 6 fork lift trucks, 10 lorries and so on. The earlier mentioned items are not expressed in terms of money instead they are illustrated only in numbers. The worth of the items is different from one another. To record the above enlisted items in the book of accounts, all the assets should be converted into money. For e.g. 5 lathe machines worth Rs 1,00,000 ; 1 ton of raw materials worth Rs. 15,00,000 and so on.

The transactions which are not financial in character cannot be entered in the book of accounts.

Recording of transactions is only in terms of money in this process

1.6.2 Business Entity Concept

This concept treats the owner as a totally different entity from the business. To put in a nutshell "Owner is different and Business is different". The money which is brought inside the firm by the owner, at the commencement of the firm is known as capital. The amount of the capital, which was initially invested should be returned to the owner considered as due to the owner; who was nothing but the contributory of the capital. For e.g. Mr Z has brought capital of Rs.1 lakh for the commencement of retailing business of refrigerators. The brought capital of Rs. 1 lakh has been utilized for the purchase of refrigerators from Godrej Ltd. He finally bought 10 different sized refrigerators. Out of 10 refrigerators, one was taken away by the owner Mr. Z.



From the Angle of the Firm

The amount of the capital Rs.1 lakh has to be returned to the owner Mr. Z, which is considered to be as due. Among the 10 newly bought refrigerators for trading, one was taken away by the owner for his personal use. The one refrigerator drawn by the owner for his personal use led the firm to sell only 9 refrigerators. It means that Rs. 90,000 out of Rs. 1 Lakh is the volume of real capital and the Rs.10,000 worth of the refrigerator considered to be as drawings; which illustrates that the capital owed by the firm is only Rs. 90,000 not Rs. 1 lakh.

From the Angle of the Owner

The refrigerator drawn worth of Rs.10,000 is nothing but Rs.10,000 worth of real capital of the firm which was taken for personal use. As drawings reduced the total volume of the capital of the firm from Rs.1 lakh to Rs. 90,000, the firm is to return the capital due amounting to Rs. 90,000.

Owner and business organizations are two separate entities

1.6.3 Going Concern Concept

The concept deals with the quality of long lasting status of the business enterprise irrespective of the owners' status, whether he is alive or not. This concept is known as concept of long-term assets. The fixed assets are bought in with the intention to earn profits during the business season. The assets which are idle during the slack season of the business are retained for future use. Those assets that are frequently sold out by the firm immediately after the utility means that those assets are not fixed assets but tradable assets. The fixed assets are retained by the firm even after the usage is only due to the principle of long lastingness of the business enterprise. If the business disposes the assets immediately after the current usage by not considering the future utility of the assets in the firm which will not distinguish in between the long-term assets and short-term assets known as tradable in categories.

Accounting concept for long lastingness of the business enterprise

1.6.4 Matching Concept

This concept only makes the entire accounting system as meaningful to determine the volume of earnings or losses of the firm at every level of transaction; which is an outcome of matching in between the revenues and expenses.

The worth of the transaction is identified through matching of revenues which are mainly generated from the sales volume and the expenses of the firm at every level. For example, the cost of goods sold and selling price of the pen of ABC Ltd are Rs. 5 and Rs. 10 respectively. The firm produced 100 ball pens during the first shift and out of 100 pens manufactured 20 pens are considered to be damage which cannot be supplied to the customers, rejected by the quality circle department. There was an order from the firm XYZ Ltd., which amounted 80 pens to be supplied immediately.

The worth of the transaction of the firm at every level of the transaction is being studied only through the matching of revenues with the expenses.

At first instance, the firm produced 100 pens which incurred the total cost of Rs 500 required to match with the expected revenues of Rs 1,000; illustrated the level of profit how much would it accrue if the entire level of production is sold out?

If the entire production capacity is sold out in the market the profit level would be Rs 500.

Out of the 100 pens manufactured 20 were identified not ideal for supply as damages, the remaining 80 pens were supplied to the individual retailer The retailer has been dispatched 80 pens amounted Rs 400 which equated to Rs 800 of the expected sales At the moment of dispatching, the firm expected to earn a profit of Rs 400 at the level of 80 pens supplied. After the dispatch, the retailer found that 50 pens are in accordance with the order placement but the remaining are to the tune of the retailers'

specifications. Finally, the retailer has agreed to make the payment of the bill only in accordance with the order placed which amounted Rs 500 out of the expenses of the manufacturer Rs 250.

This concept facilitates to identify the worth of the transaction at every moment.

Concept of fusion in between the expenses and revenues

1.6.5 Accounting Period Concept

Though the life period of the business is longer in span, which is classified into the operating periods which are smaller in duration. The accounting period may be either calendar year of Jan-Dec or fiscal year of April-Mar. The operating periods are not equivalent among the trading firms, which means that the operating period of one firm may be shorter than the other one. The ultimate aim of the concept is to nullify the deviations of the operating periods of various traders in the trading practice. According to the Companies Act, 1956, the accounting period should not exceed more than 15 months.

Concept of uniform accounting horizon among the firms to evade deviations

1.6.6 Duality or Double Entry Accounting Concept

It is the only concept which portrays the two sides of a single transaction. The law of entire business revolves around only on mutual agreement sharing policy among the players. How mutual agreement is taking place?

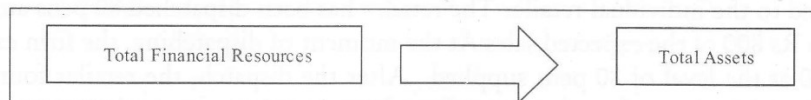
The entire principle of business is mainly conducted on mutual agreement among the parties from one occasion to another. The payment of wages is only made by the firm out of the services of labourers. What kind of mutual agreement in sharing the benefits is taking place? The services of the labourers are availed by the firm through the payment of wages. Like-wise, the labourers are regularly getting wages for their services in the firm.

Payment of Wages = Labourers' service

From the angle of accounting aspects of a firm, the labourer's service is availed through the payment of wages; it is nothing but the mutual sharing of benefits. Availing of services or taking the services of the labourers only through the cash payment whatever you make at the end i.e., giving wages.

This is being denominated into two different facets of accounting viz. Debit and Credit. Every debit transaction is appropriately equated with the transaction of credit.

The entire above sample of transactions are being carried out by the firm through the raising of financial resources. The resources raised were finally deployed in terms of assets. It means that the total funds raised by the firm are equated to the total investments. From the table illustration below, it is clearly evidenced that the entire raising of financial resources are applied in the form of asset applications. It means that the total liabilities are equivalent to the total assets of the firm.



Liabilities	Assets
Share capital	Plant and Machinery
Preference Share Capital	Land and Buildings
Debentures/Long Term Borrowings	Fixtures and Tools
Retained Earnings	Delivery vehicles
Commercial Paper	Furniture - Industry and office
Public Deposits	Office administrative devices
Bank Loan	Marketable securities
Overdraft	Short-term investments
Pre received Income	Closing stock
Outstanding Expenses	Prepaid expenses
Sundry Creditors	Outstanding Income
Bills Payable	Sundry debtors
Provision for Taxation	Bill Receivable
	Cash at Bank
	Cash in Hand

Concept of mutual agreement and sharing of benefits

1.6.7 Cost Concept

It is the concept closely related with the going concern concept. Under this concept, the transactions are recorded only in terms of cost rather than in market value. Fixed assets are only entered in terms of the purchase price which is original cost of the asset at the moment of purchase. The depreciation is deducted from the original value which is the initial purchase price of the asset. This will give us the book value of the asset at the end of the accounting period. The marketing value of the asset should not be taken into consideration. Why? The main reason is that the market value of the asset is subject to fluctuations due to demand and supply forces. The entry of market value of the asset will require the frequent update of information to the tune of changes in the market. Will it be possible to record the changes taking place in the market then and there? This is not only possible as regular updating of information also leads to lot of consequences. Though the firm is ready to register the market value; which market value has to be taken into consideration? The market value can be bifurcated into two categories viz. Realizable value and Replacement value.

Realizable value is the value of the asset at the moment of sale or realization. Replacement value is the other value which is considered at the moment of replacing the old asset with the new one. These two cannot be the same at a single point of time and the wear and tear of the asset will play a pivotal role in fixing the realization value which has the demarcation over the latter.

Relationship with Cost and Management Accounting

Cost accounting, financial accounting and managerial accounting are all associated with the organization. Cost accounting is used to determine cost of business operations, financial accounting depicts the financial position of that organization either strong or weak, managerial accounting used by internal parties (management) to know regarding their organization and to make shareholders interested in it.

1.7 ACCOUNTING CONVENTIONS

Accounting conventions are bearing the practical considerations in recording the transactions of the business enterprise in systematic manner.

- Convention of consistency
- Convention of conservatism
- Convention of disclosure

1.7.1 Convention of Consistency

The nature of recording the transactions should not be changed at any cause or moment. It should be maintained throughout the life period of the firm. If a firm follows the straight line method of charging the depreciation since its inception should be followed without any change. The firm should not alter the method of charging the depreciation from one method to another. The change cannot be entertained. If any change has to be incorporated, the valid reason for change should be emphasized.

1.7.2 Convention of Conservatism

The conservatism won't give any emphasis on the anticipation of the firm; instead it gives paramount importance to all possible uneventualities of the firm without considering the future profits.

The most important of the rule of guidance at the moment of valuing the stock is as follows:

Stock Valuations: "Stock of the goods should be valued either at market price or cost whichever is lower".

To anticipate the future losses due to default in the payments of the customers; Provision is created for bad and doubtful debts of the firm in order to meet the losses expected out of the defaulters.

1.7.3 Convention of Disclosure

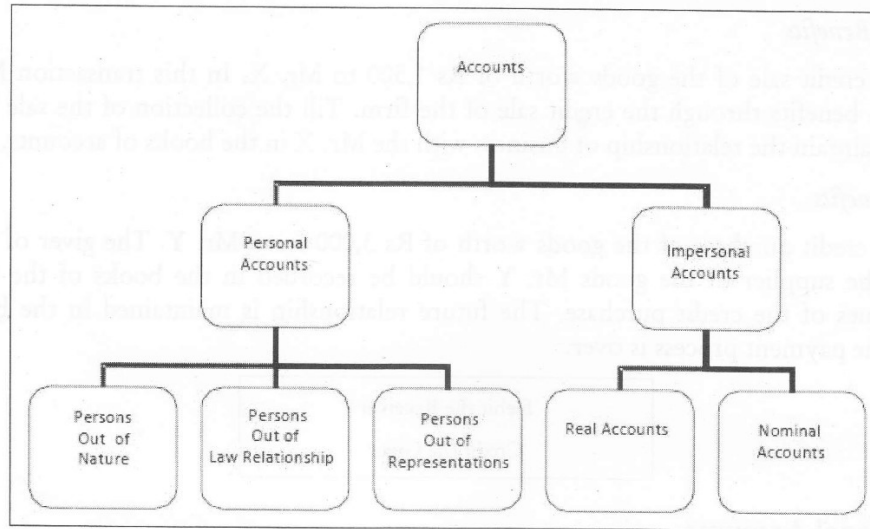
According to this convention, the entire status of the firm should be highlighted / presented in detail without hiding anything; which has to furnish the required information to various parties involved in the process of the firm.

Next stage is to classify the accounts into various categories.

1.8 CLASSIFICATION OF ACCOUNTS

The entire process of accounting is brought under three major segments; which are broadly grouped into two categories.

The entire accounts of the enterprise are broadly classified into two categories viz. Personal Accounts and Impersonal Accounts. The Impersonal accounts are further classified into two categories viz. Real accounts and Nominal accounts.



1.8.1 Personal Accounts

It is an account which deals with a due balance either to or from these individuals on a particular period. It is an account that normally reveals the outstanding balance of the firm to individuals e.g. suppliers or outstanding balance from individuals e.g. customers. This is the only account which emphasizes the future relationship between the business firm and the individuals.

The personal accounts can be classified into three categories.

Persons of Nature

Natural persons e.g. Ram, Shyam etc.

Persons of Artificial Relationship

Persons who are made out of artificial relationship through legal structure e.g. organizations, corporate, partnership firm and so on. The companies and partnership firms are governed by the Companies Act 1956 and the partnership act. The relationship among the owners of the company or partners of the firm is totally structured through respective laws.

E.g.: LIC, SBI, Companies are most important illustrations governed by the artificial relationship among the members through LIC Act, SBI Act and the Companies Act 1956 and so on respectively.

Persons of Representations

This classification represents amount outstanding or prepaid in connection with the individual transactions. For example,

Outstanding of electricity charges: Electricity charges outstanding are with reference to the electricity board; Rent prepaid refers that the rent of the office is made as an advance payment for the forthcoming month to the owner of the building.

The personal account is the account of future relationship; to maintain the relationship of future in two different angles viz. Receiver of the benefits from the firm and giver of the benefits to the firm.

Receiver of the Benefits

For E.g.: The credit sale of the goods worth of Rs 1,500 to Mr. X. In this transaction Mr. X is the receiver of the benefits through the credit sale of the firm. Till the collection of the sale benefits, the firm should maintain the relationship of business with the Mr. X in the books of accounts.

Giver of the Benefits

For E.g.: The credit purchase of the goods worth of Rs 3,000 from Mr. Y. The giver of the goods is nothing but the supplier of the goods Mr. Y should be recorded in the books of the firm till the payment of dues of the credit purchase. The future relationship is maintained in the books of the accounts till the payment process is over.

Debit the Receiver Credit the Giver
--

1.8.2 Impersonal Accounts***Real Accounts***

It is a major classification which highlights the real worth of the assets. This is the account which especially deals with the movement of assets. It is an account that not only reveals the value and movement of the assets taking place in between the firm and also other parties due to any transactions.

The movement of the assets can be classified into two categories viz. the assets which are coming into the firm and the assets which are going out of the firm.

Whenever any movement of the assets takes place with reference to any transactions either coming into the firm or going out of the firm, it should be recorded in accordance with the set golden rules of this account.

Debit What comes in Credit What goes out

Nominal Accounts

This is an account that deals with the amount of expenses incurred or incomes earned. It includes all expenses and losses as well as incomes and gains of the enterprise. This nominal account records the expenses and incomes which are not carried forward to the near future.

Debit all the expenses and losses Credit all incomes and gains

The process of the accounting in normal practice as follows:

The practice starts with the journalizing of entries. After journalization, the entries passed in the journal will be passed into the ledger A/c. The immediate next stage is to prepare the trial balance.

1.9 JOURNALS

What is meant by the journal entry?

It is an entry systematically recorded to the tune of golden rules of accounting in the journal book is known as journal entries.

How the journal entries are entered?

The journal entries are recorded in the sequential order. The order of recording is conventionally done on the basis of date. The journal entry usually contains two different parts, which are nothing but two different accounts affecting the transactions.

Date	Particulars	Ledger Folio	Debit Rs	Credit Rs
Number of days in the month, Name of the month and Year in full	To Debit the Name of the account	Page number in the respective ledger		
	To credit the Name of the account			

Journalizing the entries is important as they are different, from one transaction to another. The difference is only due to nature and characteristics of the transactions. To journalize as easily as possible, a systematic approach has to be adopted to post the transactions without any ambiguity. Journalizing can be generally categorized into following various categories.

- Taking place within the same natured accounts
- Taking place between accounts of two different categories

First, we will discuss the journalizing of entries of the same natured accounts. This can be classified into various segments

- Transactions only between the personal accounts
- Transactions only between the real accounts

Under the category of transactions which affect only the personal accounts are as follows:

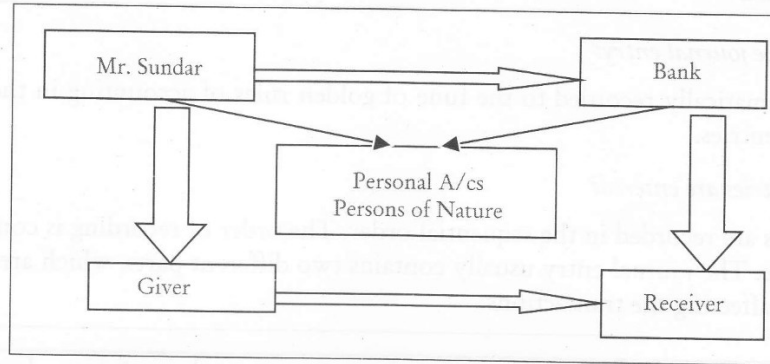
- Between the persons of the nature
- Between the persons of the artificial relationship
- Between the persons of Representations

What are the points to be observed at the moment of journalizing?

- The nature of the accounts to be identified
- The accounts to be correlated to the golden rules
- Once the accounts are finalized, the next stage is to pass the entry through proper debiting and crediting of the accounts respectively.

The meaning of the transaction should be made explicit for easier understanding through brief and catchy narration to follow as well as evade the ambiguity in near future.

Mr. Sundar is a debtor who has paid Rs 1,500, in the bank A/c



- Transaction is identified which is between two different persons under the personal A/c, they are nothing but persons of nature.
- The benefits are shared between two persons viz. Mr. Sundar and Banker who are nothing but giver and receiver of the benefits respectively.
- It means that Sundar is the giver of Rs 1,500 to Banker who is the receiver of the same Rs. 1,500.

Debit the Receiver	Bank	Debit the Melvin A/c
Credit the Giver	Sundar	Credit the Sundar A/c

Final step is to pass the journal entry

Bank A/c	Dr	Rs. 1,500
To Sundar A/c		Rs. 1,500

(Being cash is paid by Sundar to Bank A/c)

Transactions between the Real A/c

Real A/c is an account to highlight the movement of the assets. If any simultaneous movement is taking place between two different assets of the enterprise it can be explained with the following example:

Purchase of a Plant and Machinery of Rs.15,000.

The purchase of a plant and machinery is only through cash payment to the vendor. What are the two different types of assets involved in the movement during the purchase? There are two different type of assets viz. Cash and Plant & Machinery.

To put in a nutshell, among the two assets, Cash is one of the current assets and the Plant & Machinery is one of the fixed assets. In general, these two are brought under the category of assets or applications of the firm.

If the assets are involved in the transaction, Real account should only be referred. How the movement of assets is taking place at the moment of purchase?

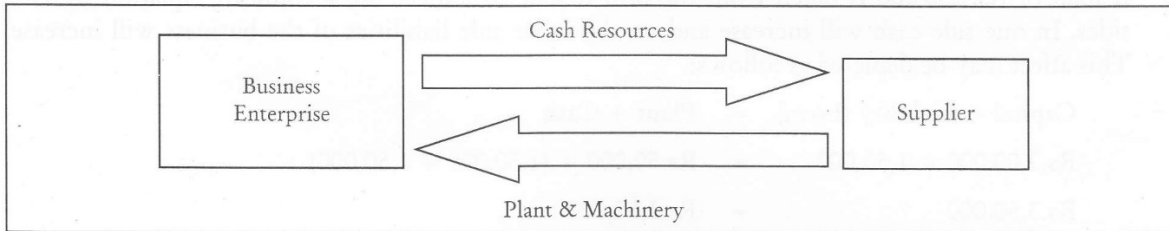
The movement of the assets classified into two segments viz. movement in and movement out.

What is Movement-in?

The movement-in is the movement of the assets to the business enterprise. With reference to above cited example which asset is coming into the business enterprise? Plant & Machinery is the asset which comes into the business enterprise only at the moment of purchase.

What is Movement-out?

The movement-out is the movement of the assets from the business enterprise. From the above illustrated example, which asset is going out of the firm during the purchase? Cash resources are going out of the firm in order to make the payment of the purchase to the supplier of the assets.



Next stage is to highlight the movement of the assets during the purchase

Movement-In	Plant & Machinery	Debit What Comes in
Movement-Out	Cash Resources	Credit What goes out

What is coming in?- Plant & Machinery

What is going out?- Cash Resources

Plant & Machinery A/c	Dr	Rs.15,000
To Cash resources A/c		Rs.15,000
(Being Plant & Machinery is purchased)		

What is the basic point to be registered?

During the purchase, the plant & machinery worth of Rs.15,000 is coming into the firm, in turn Rs.15,000 worth of cash resources are going out of the firm. During the cash purchase, the assets are moving from one entity to another viz. from business enterprise to supplier and vice versa.

1.10 PRINCIPLES OF DOUBLE ENTRY SYSTEM - BOOK KEEPING

As per the principles of the double entry system, each transaction of the business is recorded at the two places. In other words two entries are made for every financial transaction of the business. If someone is giving something in the business, it has two sides - one is giver and other is receiver. The system of double entry can be understood easily by an equation which is called accounting. Following are some transactions of the business to explain it.

1. Mr. Kamlesh started business with cash of Rs.2,00,000.

In this transaction one side cash is coming into business and in the other side capital is being brought by Mr. Kamlesh. Thus:

$$\begin{aligned} \text{Capital} &= \text{Assets (Cash)} \\ \text{Rs.2,00,000} &= \text{Rs.2,00,000} \end{aligned}$$

2. In the next transaction if a plant of Rs.50,000 is purchased in cash, this transaction will also leave two sides. In one side cash is going and in other side plant is coming. In this situation the accounting equation will be as follows:

$$\begin{aligned} \text{Capital} &= \text{Plant + Cash (Assets)} \\ \text{Rs.2,00,000} &= \text{Rs.50,000 + (Rs.2,00,000 - 50,000)} \end{aligned}$$

3. If loan of Rs.1,50,000 is taken from the SBI, it will also affect the accounting equation by two sides. In one side cash will increase and on the other side liabilities of the business will increase. This affect may be depicted as follows:

$$\begin{aligned} \text{Capital + Liability (Loan)} &= \text{Plant + Cash} \\ \text{Rs.2,00,000 + 1,50,000} &= \text{Rs.50,000 + (1,50,000 + 1,50,000)} \\ \text{Rs.3,50,000} &= \text{Rs.3,50,000} \end{aligned}$$

4. If some goods of Rs.20,000 are purchased on credit, it will also affect the accounting equation in two ways. In one side it increases the goods and in other side it increases the liability (creditors). Now the changed form of the above accounting equation will be as follows:

$$\begin{aligned} \text{Capital + Loan + Creditors} &= \text{Plant + Cash + Goods} \\ \text{Rs.2,00,000 + 1,50,000 + 20,000} &= \text{Rs.50,000 + 3,00,000 + 20,000} \\ \text{Rs.3,70,000} &= \text{Rs.3,70,000} \\ \text{Capital + Liabilities} &= \text{Assets} \end{aligned}$$

By observing the effect of above transactions on the accounting equation, we note that total of assets always remains equal to the total of capital and liabilities. Thus the principle of double entry system may be summarized as for every debit side there is an equivalent credit side and vice versa.

1.10.1 Preparation of Journal

Transactions are in between the Real A/c and Personal A/c: This type of the transaction is mainly governed by one important principle that future relationship. Its major focus is on the maintenance of future relationship among the parties involved, till the realization of the transaction is over.

Goods sold to Gopal Rs.15,000.

Meaning: The goods were sold on credit to Gopal amounted Rs.15,000. First, what are the various A/cs involved in the transaction?

There are two different A/cs viz. Real A/c and Personal A/c

How Real A/c and Personal A/c are considered for journalizing the entries?

During the sales, irrespective of nature, Goods are moving out of the firm, which finally will reach the individual Gopal. The goods, which are sold out to Gopal led to movement of goods out of the firm. Any movement of asset should be referred only to the tune of Real A/c. The goods which are going

out of the firm could be recorded as transaction under the Real A/c i.e. "Credit what goes out". While recording the transaction, it should not be entered as Goods A/c. Why? Instead of recording as Goods A/c, which are going out of the firm should be mentioned only with reason of going out. The reason for goods going out of the firm is only due to sales; it has to be registered in the books of accounts at the time of entering the journal entries.

The second account which gets affected is the personal A/c of representations. The goods sold out on credit led to register the receiver of goods who has not paid at the moment of sale. Gopal is the individual received the goods on credit during the sales expected to make the payment as per the terms of credit period. Till the maturity of the credit period agreed, the firm should wait and collect the amount from the individual who is nothing but the receiver of goods.

Movement-out-Real A/c	Goods are moving out of the firm	Credit what goes out Sales A/c
Receiver of benefits- Personal A/c	Receiver of the goods on credit with future relationship	Debit the receiver Gopal A/c

Next step is to record the journal entry

Gopal A/c	Dr	Rs.15,000
To Sales A/c		Rs.15,000

(Being goods sold on credit to Gopal)

Transaction between the Real A/c and Nominal A/c What are the two different accounts involved in the above illustrated transaction?

Office Rent paid Rs.10,000

First one is the Rent A/c and the other is Cash A/c only due to cash payment at the moment of making the payment of rent.

What is the nature of Rent A/c?

The Rent which is paid to the owner is an expense out of the benefits derived out of the asset during the previous month. In accordance with the Nominal A/c all the expenses are to be recorded, i.e. "Debit all the expenses and losses."

The second is in relevance with the cash payment which finally led to the movement of cash resources from the firm to the owner of the Asset. This mobility of the assets leads to movement - out which in connection with the Real A/c is the account for the assets.

Rent paid	Expense-Office Rent paid	Nominal A/c-Debit All expenses and losses
Movement- out	Cash - moving out of the firm Real A/c	Credit what goes out

Illustration 1

Pass the following various journal entries.

- (i) Jan 1, 2006 Mr. Sundar has started business with a capital of Rs 50,000
- (ii) Jan 2, 2006 Goods purchased Rs 10,000
- (iii) Jan 5, 2006 Goods sold Rs 5,000

- (iv) Jan 10, 2006 Goods purchased from Mittal & Co Rs 10,000
 (v) Jan 11, 2006 Goods sold to Ganesh & Co Rs 10,000
 (vi) Jan 12, 2006 Goods returned to Mittal & Co Rs 1,500
 (vii) Jan 20, 2006 Goods returned from Ganesh Rs 2,000
 (viii) Jan 31, 2006 Office Rent paid Rs 500
 (ix) Feb 2, 2006 Interim Cash Dividend paid Rs 3000
 (x) Feb 8, 2006 Cash withdrawn from bank Rs 2,000
 (i) Jan 1, 2006 Mr. Sundar has started business with a capital of Rs 50,000

			Rs	Rs
Jan 1, 2006	Cash A/c	Dr	50,000	
	To Sundar's capital A/c			50,000
Being capital brought by Sundar as cash				

- (ii) Jan 2, 2006 Goods purchased Rs 10,000

			Rs	Rs
Jan 2, 2006	Purchase A/c	Dr	10,000	
	To Cash A/c			10,000
Being cash purchase made				

- (iii) Jan 5, 2006 Goods sold Rs 5,000

			Rs	Rs
Jan 5, 2006	Cash A/c	Dr	5,000	
	To Sale A/c			5,000
Being cash sale made				

- (iv) Jan 10, 2006 Goods purchased from Mittal & Co Rs 10,000

			Rs	Rs
Jan 10, 2006	Purchase A/c	Dr	10,000	
	To Mittal A/c			10,000
Being credit purchase from Mittal				

- (v) Jan 11, 2006 Goods sold to Ganesh & Co Rs. 10,000

			Rs	Rs
Jan 11, 2006	Ganesh A/c	Dr	10,000	
	To Sale A/c			10,000
Being credit sale made to Ganesh				