UNIT 2

FINANCIAL ACCOUNTING PROCESS

JOURNAL

A **journal** is a chronological (arranged in order of time) record of business transactions.

JOURNAL ENTRY

A journal entry is the recording of a business transaction in the journal. A journal entry shows all the effects of a business transaction as expressed in debit(s) and credit(s) and may include an explanation of the transaction.

A transaction is entered in a journal before it is entered in ledger accounts. Because each transaction is initially recorded in a journal rather than directly in the ledger, a journal is called a book of original entry.

FEATURES OF JOURNAL ENTRY

The Chief features of journal may be stated as under:

1. Journal is a book in which the transactions are recorded first of all, as and when they take place. ...
2. Journal is only a book of primary (Original) entry.
3. A Journal is a daily accounting record.
4. It records both debit and credit aspect of a transaction.
5. Each entry in the journal is followed by Narration.
6. It may be single journal entry or compound journal entry.

FORMAT OF JOURNAL ENTRY

Journal entry in the books of………………

DATE	PARTICULARS	LF	DEBIT Rs.	CREDIT Rs.
	(Being…………………………)			

July 1, 2004 – Ajay contributed capital – Cash Rs. 90,000, Furniture Rs. 20,000
Vijay contributed capital – Cash Rs. 50,000, Stock Rs. 70,000

Journal

Date	Particulars		L.F	Debit Rs.	Debit P.	Credit Rs.	Credit P.
2004 July 1	Cash A/c	Dr.		1,40,000	–		
	Stock A/c	Dr.		70,000	–		
	Furniture A/c	Dr.		20,000	–		
	To Ajay's Capital A/c					1,10,000	–
	To Vijay's Capital A/c					1,20,000	–
	(Capital introduced by Ajai & Vijay)						

LEDGER

A **ledger** (general ledger) is the complete collection of all the accounts and transactions of a company.

Features of Ledger

Some important characteristics of Ledger has been explained below

1. Books of Secondary Entry

Ledger is also known as books of secondary entry, because second step of processing of financial transaction is performed in ledger.

2. Ledger Keep the Accounts

Ledger keeps the account of all heads. Therefore ledger is also described as ledger accounts. Thus we can say that ledger is a book which contains the accounts.

3. Classification of Transaction

Ledger is used to classify the financial transactions.

4. Related & Relevant information.

Ledger account gathers all related information on a subject matter in one place. Thus ledger provides the detailed activity in a particular head of account. Accountant used ledger account to analyze the detailed activity in particular account.

5. Closing balance information

Ledger provides closing balance information. This information is not only used for payment and receipt, but trial balance is also prepared from the closing balances of general ledger accounts.

6. Facilitates Reporting

Ledger facilitates reporting. It is technically impossible to prepared financial reports directly from the journal. Thus ledger is an important book for preparing the financial statements.

7. List of Characteristics of ledger

Some important characteristics of ledger are listed below

a. Ledger is used to classify information.
b. Ledger keeps all related information at one place.
c. Ledger facilitates reporting.
d. Ledger facilitates timely payment & receipt.

FORMAT OF LEDGER ACCOUNT

FORMAT OF LEDGER ACCOUNT

Dr. Cr.

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)

SUBSIDIARY BOOK

Also known as special purpose books, special purpose subsidiary books, and subsidiary books of account are various books recording financial transactions of similar nature. They are sub-division of the **journal**.

During the lifecycle of a business, the volume of transactions in a business may rise to an extent that a single journal may no longer be adequate to keep the books. This is when special purpose books or subsidiary books may be required for more efficient **bookkeeping**.

TYPES OF SUBSIDARY BOOKS

Subsidiary Books			
Cash Book	Sales Returns Book	Sales Book	Bills Receivable Book
Purchase Book	Journal Proper	Purchase Returns Book	Bills Payable Book

Types of Subsidiary Books

1. **Cash Book** – A cash book is a book of prime entry which records all transactions made by a business in both cash and a bank instrument.

2. **Purchase Book** – A purchase book is one of the special purpose books where all the credit purchases are recorded by a business.

3. **Sales Book** – A sales book is one of the subsidiary books where all the credit sales are recorded by a business.

4. **Purchase Returns Book** – Also known as returns outward book, a purchase returns book is prepared to record goods returned by a business to its suppliers.

5. **Sales Return Book** – Also known as returns inward book, a sales return book is prepared to record goods returned to a business by the customers.

6. **Journal Proper** – It is a book in which all miscellaneous transactions which are not recorded in any other subsidiary book is called a journal proper.

7. **Bills Receivable Book** – is a book that records all bills receivable to a business, the total of bills receivable book is posted on the debit side of the B/R account.

8. **Bills Payable Book** – is one of the subsidiary books that records all bills payable by a business, the total of bills payable book is posted on the credit side of the B/P account.

FORMAT OF PURCHASE BOOK

Purchase Book				
Date	Particulars	Inward Invoice No.	L.F.	Amount
(1)	(2)	(3)	(4)	(5)

FORMAT OF SALES BOOK

Sales Book				
Date	Particulars	Outward Invoice No.	L.F.	Amount
(1)	(2)	(3)	(4)	(5)

FORMAT OF PURCHASE RETURNS BOOK

Purchase Return Book				
Date	Particulars	Debit Note No.	L.F.	Amount

FORMAT OF SALES RETURNS BOOK

Sales Return Book				
Date	Particulars	Credit Note No.	L.F.	Amount Rs.

BASIS FOR COMPARISON	DEBIT NOTE	CREDIT NOTE
Meaning	Debit Note is a document which reflects that a debit is made to the other party's account. It is a articulated form of purchase returns to the seller intimating the reason behind it.	Credit Note is an instrument used to inform that the other party's account is credited in his books. It is articulated form of sales return and informing that the purchase return is accepted.

BASIS FOR COMPARISON	DEBIT NOTE	CREDIT NOTE
Issued by	Purchaser	Seller
Which book is updated on the basis of note?	Purchase Return Book	Sales Return Book
Effect	Minimization in account receivables.	Minimization in account payables.
Exchanged for	Credit Note	Debit Note
Accounting entry	In the books of purchaser, suppliers account is debited and purchase returns account is credited	In the books of the seller, purchasers account is credited and sales returns account is debited.

1. Cash Book:

In Cash book, we will record the all-cash transaction of the business. This book keeps all cash payment and cash receipts. It is the book of original entries because first of all, we record the all-cash transaction in this book and then posted these transactions into the various ledger accounts.

Types of Cash Book

1. Single Column cash book

2. Double Column cash book

3. Three Column cash book

1. Single Column Cash Book

This type of cash book is very simple because it is similar to the cash account. It has only one column on both sides. Debit side of cash book shows the all receipt and credit side shows all the payment made.

Dr.				Cash Book					Cr.
Receipts					Payment				
Date	Particulars	V No.	L. F.	Amount (Rs)	Date	Particulars	V. No.	L. F.	Amount (Rs)

2. Double Column Cash Book

Double Column Cashbook has a two account column on both sides of the cash book.

3. Three Column Cash Book

It is a cash book with three columns on both sides of the cash book.

TRIAL BALANCE

A **trial balance** is a listing of all accounts (in this order: asset, liability, equity, revenue, expense) with the ending account balance. It is called a trial balance because the information on the form must balance.

FORMAT OF TRIAL BALANCE

Trial balance as on...........

1	2	3	4	5
Serial No.	Name of the account	Ledger Folio	Debit Balance (Rs.)	Credit Balance (Rs.)

FEATURES OF TALLY

1. A trial balance can be prepared anytime during the accounting period.

2. It is prepared to check the arithmetical accuracy of posting of entries from journal to ledger, in other words it is an instrument for carrying out the job of checking and testing.

3. It is not a part of the double entry system of book keeping but only for checking the accuracy of posting. However, it does not reveal all errors.

4. It is prepared on a specific date.

5. It is not a part of double entry and not an account.

6. It is a statement of balance of all accounts.

7. Total of the debit and credit columns of the trial balance must tally.

8. If the debit and credit columns are equal it is presumed that accounts are arithmetically accurate.

8. Difference in the debit and credit columns indicate that some mistakes have been committed

9. Tallying of trial balance is not a conclusive proof of accuracy of books of accounts; it serves to prove only the arithmetical accuracy of books.

The following are the objectives of preparing Trial Balance

1. To ascertain the arithmetical accuracy of the ledger accounts

It provides useful check up of ledger posting. If trial balance tallies it means ledger posting is correct.

2. To help in locating errors

If trial balance does not tally it means some error has occur in preparing trial balance.

3. To help in the preparation of final accounts

Trial contains all ledger accounts therefore it is basis for all preparation of final accounts.

4. It helps to obtain summary of ledger account

It contains all ledger account and show picture of all assets, liabilities, income and expenses of the company.

BANK RECONCILIATION STATEMENT

This statement indicates the differences between the passbook and cash book of the entity. By reconciling the differences that exist between the two, a Bank

Reconciliation Statement helps in arriving at the exact value of the amount of bank balance held on a particular date.

1. Cheques issued by the bank but not yet presented for payment

When cheques are issued by the firm to suppliers or creditors of the firm, these are immediately entered on the credit side of the cash book. However, the receiving party may not present the cheque to the bank for payment immediately. The bank will debit the firm's account only when these cheques are actually paid by the bank. Hence, there is a time lag between the issue of a cheque and its presentation to the bank which may cause the difference between the two balances.

2. Cheques paid into the bank but not yet collected

Firm receives cheques from its customers (debtors), they are immediately recorded in the debit side of the cash book. This increases the bank balance as per the cash book. However, the bank credits the customer account only when the amount of cheques are actually realised. The clearing of cheques generally takes few days especially in case of outstation cheques or when the cheques are paid-in at a bank branch other than the one at which the account of the firm is maintained. This leads to a cause of difference between the bank balance shown by the cash book and the balance shown by the bank passbook.

3. Direct debits made by the bank on behalf of the customer

Sometimes, the bank deducts amount for various services from the account without the firm's knowledge. The firm comes to know about it only when the bank statement arrives. Examples of such deductions include: cheque collection charges, incidental charges, interest on overdraft, unpaid cheques deducted by the bank – i.e. stopped or bounced, etc. As a result, the balance as per passbook will be less than the balance as per cash book

4. Amounts directly deposited in the bank account

There are instances when debtors (customers) directly deposits money into firm's bank account. But, the firm does not receive the intimation from any source till it receives the bank statement. In this case, the bank records the receipts in the firm's account at the bank but the same is not recorded in the firm's cash book. As a result, the balance shown in the bank passbook will be more than the balance shown in the firm's cash book.

5. Interest and dividends collected by the bank

When the bank collects interest and dividend on behalf of the customer, then these are immediately credited to the customer's account. But the firm will know about these transactions and record the same in the cash book only when it receives a bank statement. Till then the balances as per the cash book and passbook will differ.

6. Direct payments made by the bank on behalf of the customers

Sometimes the customers give standing instructions to the bank to make some payment regularly on stated days to the third parties. For example, telephone bills, insurance premium, rent, taxes, etc. are directly paid by the bank on behalf of the customer and debited to the account. As a result, the balance as per the bank passbook would be less than the one shown in the cash book.

7. Cheques deposited/bills discounted dishonoured

If a cheque deposited by the firm is dishonoured or a bill of exchange drawn by the business firm is discounted with the bank is dishonoured on the date of maturity, the same is debited to customer's account by the bank. As this information is not available to the firm immediately, there will be no entry in the firm's cash book regarding the above items. This will be known to the firm when it receives a statement from the bank. As a result, the balance as per the passbook would be less than the cash book balance

FORMAT

	Details	Amt Rs.
Debit Balance as per Cash Book **ADD** Cheques issued or drawn but not yet presented for payment Interest allowed by bank not recorded in Cash Book amount directly deposited by the customer in Bank Account Interest and dividends collected by bank Cheques paid into bank but omitted to be entered in Cash book Any wrong credit given by bank in the Bank Statement		
LESS Cheques paid into bank for collections but dishonoured by the bank Standing instructions given to bank e.g. payment of insurance premium Bank Charges Cheques issued but omitted to be recorded in Cash Book Any wrong debit given by bank in the Bank Statement Credit		
Balance as per Bank Statement		

FINANCIAL ACCOUNTING AND MANAGEMENT

UNIT 1: INTRODUCTION TO ACCOUNTING

BOOK KEEPING

It is the art of recording the business transactions in a set of books systematically.

The two systems in book-keeping are

1. Single entry system of book-keeping and

2. Double entry system of book-keeping

The set of books are

1. Journal

2. Subsidiary books

3. Ledger

4. Trial Balance and

5. Final Accounts.

ACCOUNTING

Accounting may be defined as the art of recording, classifying and consolidating business transactions that are financial in nature for audit and tax purposes.

ACCOUNTANCY

Accountancy is the theory and principles of accounting.

OBJECTIVES OF ACCOUNTING

1. To provide information about the business activities to the owners, stake holders or investors and creditors facilitating them to take decisions on investment and lending.

2. To effectively manage the material resources available.

3. To facilitate social functions and control.

4. To provide information regarding accounting policies.

ACCOUNTING CONCEPTS

1. Business entity concept

The transactions of a business are to be kept separate from those of its owners. By doing so, there is no intermingling of personal and business transactions in a company's financial statements.

2. Going concern concept

Financial statements are prepared on the assumption that the business will remain in operation in future periods.

3. Consistency concept

Once a business chooses to use a specific accounting method, it should continue using it on a go-forward basis. By doing so, the financial statements prepared in multiple periods can be reliably compared.

4. Money Measurement Concept

Business transactions can only be recorded in terms of their monetary value.

5. Conservatism concept

Revenues are only recognized when there is a reasonable certainty that they will be realized, whereas expenses are recognized sooner, when there is a reasonable possibility that they will be incurred. This concept tends to result in more conservative financial statements.

6. Dual Aspect Concept

Each transaction has two aspects. When a business acquires an asset, it has to pay money. Acquiring an asset and paying money are two sides of the coin. Similarly, if the asset is acquired through credit, there arises a liability to that extent. Thus if there is an increase in asset, there will be increase in liability also.

Capital = Assets-Liabilities

7. Cost Concept

The transactions are recorded keeping in mind the actual cost involved and this concept does not consider the projected value or appreciation.

8. Matching concept

The expenses related to revenue should be recognized in the same period in which the revenue was recognized. By doing this, there is no deferral of expense recognition into later reporting periods, so that someone viewing a company's financial statements can be assured that all aspects of a transaction have been recorded at the same time.

ACCOUNTING CONVENTIONS

1. Convention of Disclosure

This convention requires that accounting statements should be honestly prepared and all significant information should be disclosed therein. That is, while making accountancy records, care should be taken to disclose all material information. Here the emphasis is only on material information and not on immaterial information.

2. Convention of Consistency

Rules and practices of accounting should be continuously observed and applied. In order to enable the management to draw conclusions about the operation of a company over a number of years, it is essential that the practices and methods of accounting remain unchanged from one period to another.

3. Conservatism

According to this convention, accounts follow the rule "anticipate no profit but provide for all possible losses", while recording business transactions.

4. Materiality

The term materiality refers to the relative importance of an item or an event. An item is "material" if knowledge of the item might reasonably influence the decisions of users of financial statements. Accountants must be sure that all material items are properly reported in the financial statement.

BRANCHES OF ACCOUNTING

1. Financial Accounting

The main purpose is to record the business transactions in the books of accounts enabling businessmen to know the results. In general, the term accounting refers to financial accounting only.

2. Cost Accounting

Cost accounting is the process of recording, classifying, analyzing, summarizing, and allocating costs associated with a process, and then developing various courses of action to control the costs.

3. Management Accounting

Both financial and cost accounting methods and results contribute to management accounting where the data is interpreted mainly for arriving at optimal managerial decisions.

ACCOUNTING TERMS

CAPITAL: Capital refers to investment made by owners of a business enterprise in the form of cash or kind.

DRAWINGS: Drawings refers the money or any other item used or withdrawn by owners for personal purposes.

GOODS: Goods refers to articles, commodities, things with which business deals. Example: stationery, books pens, pencils, table, cupboards.

PURCHASES: Purchase refers to goods purchased by the business.

PURCHASE RETURNS: When goods purchased are returned to the supplier of goods on account of damage or defect.

USERS OF ACCOUNTING INFORMATION

Examples of internal users are owners, managers, and employees.

External users are people outside the business entity (organization) who use accounting information. Examples of external users are suppliers, banks, customers, investors, potential investors, and tax authorities.

ADVANTAGES OF ACCOUNTING

1. Maintenance of business records-

Accounting helps to maintain the business records in a systematic manner.

2. Preparation of financial Statements-

It helps in the preparation of financial statements.

3. Useful in comparing the results-

Accounting information is also used to compare the result of current year with the previous year to analyze the changes.

4. Decision Making-

It helps the managers in the decision making process.

5. Information to users-

It provides information to other interested parties such as shareholders, creditors, investors, customers, government, employees, regulatory bodies etc.

6. Information to Concerned Authorities-

It provides information to authorities like Income Tax Department etc

7. Source of Evidence

Accounting information can be produced as evidence in the legal matter.

8. It helps in valuation of business.

DISADVANTAGES OF ACCOUNTING

1. Monetary transactions are recorded

The items expressed in monetary terms are recorded in the accountings where as the items which are nonmonetary nature not recorded.

2. Based on estimates

Sometimes accounting data are recorded on the basis of estimates and which could be inaccurate.

3. Recorded at Cost Price

Fixed assets are recorded as the original cost.

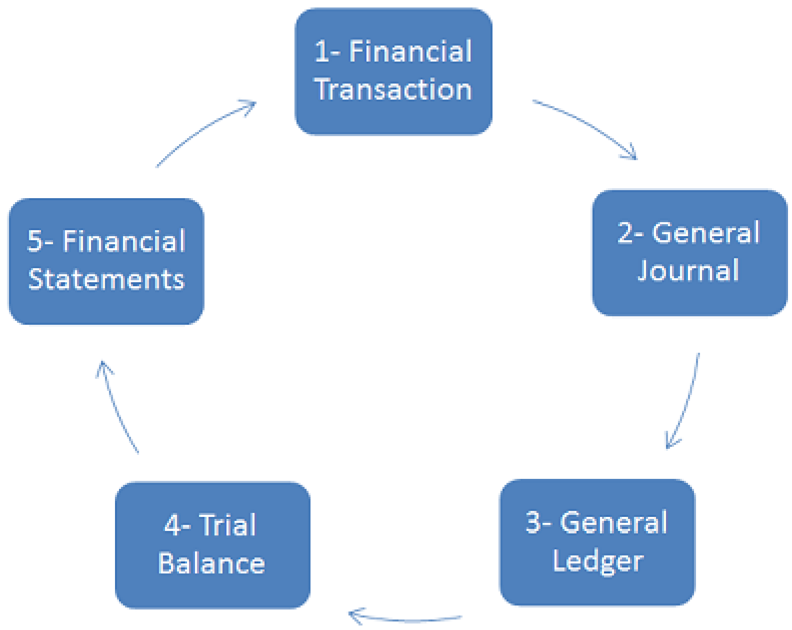
4. Doesn’t show true financial statements

Value of money does not remain stable so accounting value does not show true financial results.

5. Manipulation

Accounting can be manipulated and biased

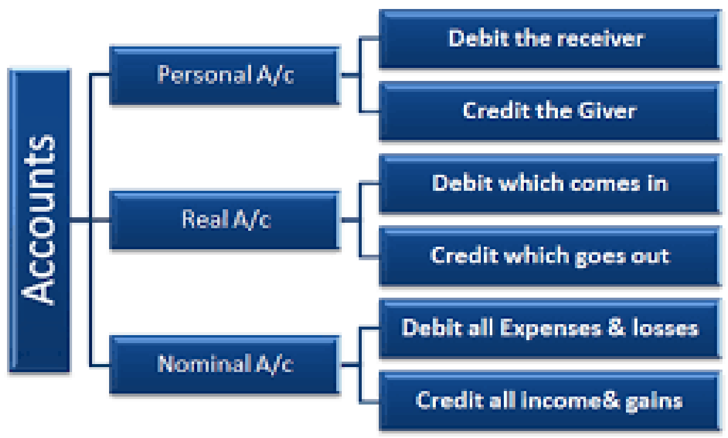
ACCOUNTING CYCLE



ACCOUNTING PRINCIPLES

Accounting principles are the rules and guidelines that companies must follow when reporting financial data.

RULES OF ACCOUNTING



ACCOUNTING STANDARDS

An accounting standard is a common set of principles, standards and procedures that define the basis of financial accounting policies and practices.

List of Indian Accounting Standards

Ind AS No.	Name of Indian Accounting Standard
Ind AS 101	First-time adoption of Ind AS
Ind AS 102	Share Based payments
Ind AS 103	Business Combination
Ind AS 104	Insurance Contracts

Ind AS 105	Non-Current Assets Held for Sale and Discontinued Operations
Ind AS 106	Exploration for and Evaluation of Mineral Resources
Ind AS 107	Financial Instruments: Disclosures
Ind AS 108	Operating Segments
Ind AS 109	Financial Instruments
Ind AS 110	Consolidated Financial Statements
Ind AS 111	Joint Arrangements
Ind AS 112	Disclosure of Interests in Other Entities
Ind AS 113	Fair Value Measurement
Ind AS 114	Regulatory Deferral Accounts
Ind AS 115	Revenue from Contracts with Customers
Ind AS 1	Presentation of Financial Statements
Ind AS 2	Inventories Accounting
Ind AS 7 & in only AS 3	Statement of Cash Flows
Ind AS 8	Accounting Policies, Changes in Accounting Estimates and Errors
Ind AS 10	Events after Reporting Period
Ind AS 11	Construction Contracts
Ind AS 12	Income Taxes
Ind AS 16	Property, Plant and Equipment
Ind AS 17	Leases
Ind AS 18	Revenue
Ind AS 19	Employee Benefits
Ind AS 20	Accounting for Government Grants and Disclosure of Government Assistance
Ind AS 21	The Effects of Changes in Foreign Exchange Rates
Ind AS 23	Borrowing Costs
Ind AS 24	Related Party Disclosures
Ind AS 27	Separate Financial Statements
Ind AS 28	Investments in Associates and Joint Ventures
Ind AS 29	Financial Reporting in Hyper inflationary Economies
Ind AS 32	Financial Instruments: Presentation
Ind AS 33	Earnings per Share
Ind AS 34	Interim Financial Reporting
Ind AS 36	Impairment of Assets
Ind AS 37	Provisions, Contingent Liabilities and Contingent Assets
Ind AS 38	Intangible Assets
Ind AS 40	Investment Property
Ind AS 41	Agriculture

ADVANTAGES / IMPORTANCE OF ACCOUNTING STANDARDS

1. Accounting standards help investors in judging for company.

2. Accounting standards helps the chartered accountants to deal with their clients by providing rules and regulations

3. Accounting standards helps in reporting financial statements

4. Accounting standards helps the tax authorities and government officials.

5. Accounting standards helps in reliable documents for the purpose of analysis and interpretation of data