PRINCIPLES OF ACCOUNTANCY
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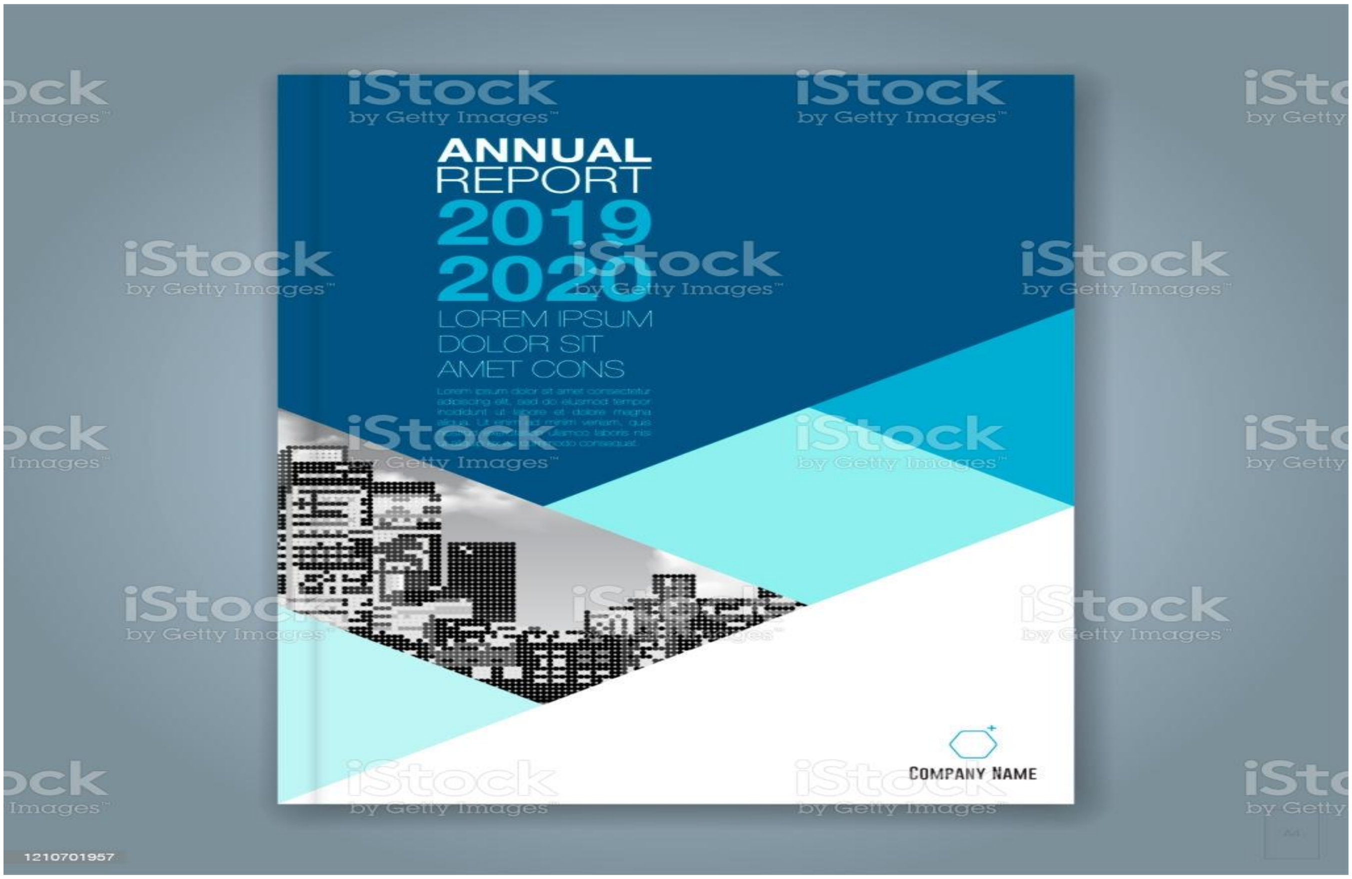

STUDY MATERIAL PREPARED BY

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Principles of accountancy 2 marks

1. **What is book-keeping?**
Book-keeping is the branch of knowledge which tells us how to keep a record of business transactions. It is clerical in nature. It is important to note that only those transactions related to business which can be expressed in terms of money are recorded. The activities of book-keeping include recording in the journal, posting to the ledger and balancing of accounts.
2. **What do you mean by accounting?**
Accounting is concerned with summarizing the recorded transactions, interpreting them and communicating the results to the interested parties.
3. **Define Accounting.**
Accounting is the process of collecting, recording, classifying, summarizing and communicating financial information to the users.
4. **Define Accountancy.**
Accountancy is a systematic knowledge of accounting. It explains how to deal with various aspects of accounting. It educates us how to maintain the books of accounts and how to summarize the accounting information and communicate it to the users. In other words of Kohler, accountancy refers to the entire body of the theory and practice of accounting.
5. **What is single entry system?**
Single entry system of recording transactions in the books of accounts may be defined as an incomplete Double Entry System. In this system, all transactions are not recorded on double entry basis. The single entry system is also known as Accounts from Incomplete Records.
6. **Define Business Transaction .**
The term 'Business Transaction' means a financial transaction or event entered into between
two parties and recorded in the books of accounts.
7. **Define capital .**
Capital is the amount invested by the proprietor or partner in the business.
Capital=Assets-
Liabilities
8. **What is Drawings ?**
It is the amount withdrawn or goods taken by the proprietor for his personal use. Goods so taken by the proprietor are valued at purchase cost. Drawings reduce the investment (or capital) of the owners.

9. **What is Liability ?**

Liability means amount owed (payable) by the business. Liability towards the owners (proprietor) of the business is termed as internal liability. On the other hand, liability towards the outsiders, i.e., other than the owners (proprietor) is termed as external liability .

10. **Define asset.** Asset is a property or legal rights owned by a business to which money value can be attached. **Assets can be classified in to (i) Non-current Assets, and (ii) Current Assets: (i) Non- current Assets:** Non- current Assets are those assets which are held by a business from a long-term point of view. They are not held with a purpose to resell but are held either as investment or to facilitate business operations.

    (a) Tangible Assets: Tangible Assets are those assets which have physical existence, i.e., they can be seen and touched. Examples of Tangible Assets are land, building, machinery, computer, goods etc. **(b) Intangible Assets:** Intangible Assets are those assets which do not have physical existence, i.e., they cannot be seen and touched. Examples of Intangible Assets are land, building, machinery, computer etc. **(ii) Current Assets:** Current Assets are those assets which are held by the business with the purpose of converting them into cash within a short period, i.e., one year. For example, goods are purchased with a purpose to resell and earn profit, debtors exist to convert them into cash, i.e., receive the amount from them, bills receivable exist again for receiving cash against it, etc. **(iii) Fictitious Assets:** Fictitious Assets which are neither tangible assets nor intangible assets. They are losses written off not in the year in which they are incurred but in more than one accounting period.

11. What is Expense?

Expense is the cost incurred for generating revenue. It is the value which has expired during the accounting period. It may be

- **(i)** Cash payment such as salaries, wages, rent, etc (depreciation).
- **(ii)** An amount written off out of current assets (say bad debts).
- **(iii)** Decline in the value of assets (say investment.
- **(iv)** Cost of goods sold.
- **(v)** **Prepaid Expenses**: It is an expense that has been paid in advance and the benefit of which will be available in the following year or years.
- **(vi)** **Outstanding Expenses:** It is an expense that has been incurred but has not been paid.

12. **Define the term Purchases.**

    The term ‘Purchases’ is associated with or used for purchases of goods. Goods are articles purchased for resale or for producing the finished products which are also to be sold.

13. **Define purchases return.**

Goods purchased may be returned to the seller for any reason, say, they are not as per the specifications or are defective. Goods returned are known as Purchases Return or Return Outward.

14. **Define the term sales.**
    The term 'Sales' is associated with or used for sale of goods that is dealt with by the firm. The term 'sales' includes both cash and credit sales. When goods are sold for cash, they are termed as Cash Sales and when sold on credit, they are termed as Credit Sales.
15. **Purchases Book** Purchases book also known as **Bought Day Book** is used to record all credit purchases of goods which are meant for resale in the business. **Cash purchases of goods, cash and credit purchases of assets are not entered in this book**.
16. **Trade Discount Trade discount** is an allowance or concession granted by the seller to the buyer, if the customer purchases goods above a certain quantity or above a certain amount. Trade discount is not recorded in the books. They are used for determining the net price.
17. **Define the term Stock.**
    Stock is tangible asset held by an enterprise for the purpose of sale in the ordinary course of business or for the purpose of using it in the production of goods meant for sale. Stock may be: (i) Opening Stock or (ii) Closing Stock. Opening Stock is the stock-in-hand in the beginning of the accounting year. In other words, it is stock-in-hand at the end of the previous accounting year. Closing Stock is the stock-in-hand at the end of the accounting year.
18. **Define Debtor.**
    Debtor is a person who owes amount to the enterprise against credit sales of goods or services. For examples, when goods are sold to a person on credit that person is called a Debtor because he owes the amount to the enterprise. The amount due is known as debt.
19. **Define creditor**
    Creditor is a person to whom an enterprise owes amount against credit purchases of goods or services taken. For example, Mohan is a creditor of a firm when goods are purchase d from him on credit.
20. **Define Voucher.**
    Voucher is an evidence of a business transaction. Explain of voucher are Cash Memo, Invoice or Bill, Receipt, Debit/Credit Notes, etc.
21. **Define Discount.** When customers are allowed a reduction in th e prices of goods by the business, it is known as a Discount.

22. **Define Depreciation.**
    Depreciation is a fall in the value of an asset because of usage or with afflux of time or obsolescence or accident. It is an allocation of cost of fixed asset in each accounting year during its expected useful life.
23. **Define Bad Debts.**

Bad Debts is the amount owed to the business that is written off because it has become irrecoverable. It is a loss for the business and is, thus, debited to Profit and Loss Account .

24. **What is a Balance Sheet?**

 It is a statement of the financial position of an individual or enterprise at a given date, which exhibits its assets, liabilities, capital, reserves and other account balances at their respective book values.

25. **What is the meaning and nature of Accounting Standards?**

 The Accounting Standards are set of guidelines, i.e., Generally Accepted Accounting Principles, issued by the accounting body of the country such as The Institute of Chartered Accountants of India, that are followed for preparation and presentation of Financial Statements.

26. **What are Outstanding Expenses?**

 They are those expenses which have been incurred during the accounting period but have not yet been paid during the year. In the Balance Sheet, they are shown as liability.

27. **What are prepaid expenses?**

 They are those expenses which have been paid in advance. In the Balance Sheet, they are shown as an asset.

28. **What is Accrued Income?**

 It is an income which has been earned du ring the accounting period but has not yet become due for payment and, therefore, has not been received. In the Balance Sheet, it is shown as an asset.

29. **What is Income Received in Advance?**

 It is an income which has been received before it has been earned, i.e., goods have been sold or services have been rendered. In the Balance Sheet, it is shown as a liability.

30. **What is Source Documents?**

 "A Source Document is a written document containing details of the transaction".

31. **Define Cash Memo.**

 Cash Memo is prepared by the seller when goods are sold against cash.

32. **What is Invoice or Bill?**

 An Invoice or Bill is prepared by the seller when the goods are sold on credit.

33. **Define Receipt.**

 When cash or Cheque is received from a customer, a receipt for the amount received is issued.

34. **What is Pay-in-Slip ?**

 It is a source document used for depositing cash or cheques into bank. A Pay -in-Slip is a form available from a bank.

35. **Define Cheque.** A Cheque is a document in writing, drawn upon the bank with which the account is held and is payable on demand.

36. **What is Debit Note?**

Debit Note is made out evidencing that a debit has been made to the account of the party named in the debit note.

37. **What is Credit Note?**

A Credit Note is made out evidencing that credit has been granted to a debtor. For example, if a customer returns goods previously invoiced, or the customer is allowed further discount, a credit not is issued.

38. **What is journal?**

It is the primary book of accounts in which transactions are first recorded in a chronological order.

39. **Define Trial Balance.**

It is a statement in which the balance is in the accounts is written. The total of amount in the two columns should be same and is a proof of arithmetical accuracy transactions recorded in the books of accounts.

40. **What is Special Purpose Books or Subsidiary Books?**

The sub-division for the Journal into various books recording transactions of similar nature is called subsidiary books.

41. **Define Cash Book.**

Cash Book is a Special Purpose Subsidiary Book or Journal in which cash receipts and cash payments are recorded.

42. **What are the Kinds of Cash Book?**

The kinds of cash book are: **(i) Simple Cash Book:** It is a cash book in which only cash transactions are recorded. It has only one column on each side of the cash book. **(ii)Double-column or Two-column Cash Book:** It is a cash book which has two columns on each side of the cash book to record cash receipts and payments besides cash discount allowed and received. **(iii) Triple-column or three-column Cash Book:** It is a cash book which has three columns on each side of the cash book. One column to record cash transactions, one column to record bank transactions and one column to record cash discount allowed and received. **(iv)Pretty Cash Book:** It is a cash book in which payment of small amount is recorded.

43. **What is Imprest System of Petty Cash?**

It is a system whereby an estimate of expenditure is made and the estimated amount is given to the Petty Cashier. Thereafter he submits the statement of expenses at the end of the designated period. This is reimbursed to him to make the petty cash equal to the original petty cash amount.

44. **What is a contra entry?**

It means a transaction involving both cash and bank. Such transactions though recorded in the cash book are not posted into the ledger. In the folio for ledger letter ‘C’ is written to indicate that it is a contra entry.

5 MARKS

1. Distinction between Book-keeping and Accounting

S.NO	BASIS	BOOK KEEPING	ACCOUNTING
1	**Scope**	Recording and maintenance of books of accounts	It is not only recording and maintenance of books of accounts but also includes analysis, interpreting and communicating the information.
2	**Stage**	Primary stage	Secondary stage
3	**Objective**	To maintain systematic records of business transactions**.**	To ascertain the net result of the business operation.
4	**Nature**	Often routine and clerical in nature.	Analytical and executive in nature.
5	**Responsibility**	A book-keeper is responsible for recording business transactions**.**	An accountant is also responsible for the work of a book-keeper.
6	**Supervision**	The book-keeper does not supervise and check the work of an Accountant.	An accountant supervises and checks the work of the book-keeper.
7	**Staff involved**	Work is done by the junior staff of the organization.	Senior staff performs the accounting work.

Users of Accounting Information

I. Internal users: Internal users are those individuals or groups who are within the organization like owners (profitability), management(prompt decisions), employees and trade unions(remuneration and bonus).

II. External users: External users are those individuals or groups who are outside the organization like creditors(credit worthiness), investors, banks and other lending institutions, present and potential investors(safety of investment), Government, tax authorities(to know the earnings), regulatory agencies(evaluation) and researchers.

2. Basic Concepts of Accounting

- **Dual Aspect Concept**

Dual aspect principle is the basis for Double Entry System of book-keeping. All business transactions recorded in accounts have two aspects - receiving benefit and giving benefit. For example, when a business acquires an asset (receiving of benefit) it must pay cash (giving of benefit).

- **Revenue Realization Concept**

According to this concept, revenue is considered as the income earned on the date when it is realized. Unearned or unrealized revenue should not be taken into account. The realization concept is vital for determining income pertaining to an accounting period.

❖ **Historical Cost Concept**

Under this concept, assets are recorded at the price paid to acquire them and this cost is the basis for all subsequent accounting for the asset. For example, if a piece of land is purchased for Rs.5,00,000 and its market value is Rs.8,00,000 at the time of preparing final accounts the land value is recorded only for Rs.5,00,000.

❖ **Full Disclosure Concept**

Accounting statements should disclose fully and completely all the significant information. Based on this, decisions can be taken by various interested parties. It involves proper classification and explanations of accounting information which are published in the financial statements.

❖ **Verifiable and Objective Evidence Concept**

This principle requires that each recorded business transactions in the books of accounts should have an adequate evidence to support it. For example, cash receipt for payments made. The documentary evidence of transactions should be free from any bias. As accounting records are based on documentary evidence which are capable of verification, it is universally acceptable.

❖ **Double Entry System**

Each transaction, when closely analyzed, reveals two aspects. One aspect will be "receiving aspect" or "expenses/loss aspect". This is termed as the **"Debit aspect".** The other aspect will be "giving aspect" or "income/gain aspect". This is termed as the **"Credit aspect.** In short, the basic principle of this system is, for every debit, there must be a corresponding credit of equal amount and for every credit, there must be a corresponding debit of equal amount.

3. Classification of Accounts

Transactions can be divided into three categories.

i. Transactions relating **to individuals and firms**

ii. Transactions relating **to properties, goods or cash**

iii. Transactions relating **to expenses or losses and incomes or gains.**

Therefore, accounts can also be classified into

Personal, Real and Nominal.

I. **Personal Accounts**: The accounts which relate to persons. Personal accounts include the following.

i. **Natural Persons**: Accounts which relate to individuals. For example, Mohan's A/c, Shyam's A/c etc.

ii. **Artificial persons**:: Accounts which relate to a group of persons or firms or institutions. For example, HMT Ltd., Indian Overseas Bank, Life Insurance Corporation of India, Cosmopolitan club etc.

iii. **Representative Persons:** Accounts which represent a particular person or group of persons. For example, outstanding salary account, prepaid insurance account, etc.

The business concern may keep business relations with all the above personal accounts, because of buying goods from them or selling goods to them or borrowing from them or lending to them. Thus they become either **Debtors or Creditors.**

The proprietor being an individual his capital account and his drawings account are also personal accounts.

II. **Impersonal Accounts:** All those accounts which are not personal accounts. This is further divided into two types viz. Real and Nominal accounts.

i. **Real Accounts**: Accounts relating to properties and assets which are owned by the business concern. Real accounts include tangible and intangible accounts. For example, Land, Building, Goodwill, Purchases, etc.

ii**. Nominal Accounts**: These accounts do not have any existence, form or shape. They relate to incomes and expenses and gains and losses of a business concern. For example, Salary Account, Dividend Account, etc.

4. Golden Rules of Accounting

All the business transactions are recorded on the basis of the following rules.

S.No.	Name of Account	Debit Aspect	Credit Aspect
1	**Personal**	The receiver	The giver
2	**Real**	What comes in	What goes out
3	**Nominal**	All expenses and losses	All incomes and gains

5. Meaning of ledger

The books in which a transaction is recorded for the first time from a source document are called Books of Original Entry or Prime Entry. Journal is one of the books of original entry in which transactions are originally recorded in a chronological (day-to-day) order according to the principles of Double Entry System.

Journal

Journal is a date-wise record of all the transactions with details of the accounts debited and credited and the amount of each transaction.

LEDGER

A Ledger is a book which contains all the accounts whether personal, real or nominal, which are first entered in journal or special purpose subsidiary books.

According to L.C. Cropper, ‘the book which contains a classified and permanent record of all the transactions of a business is called the Ledger’. In a loose-leaf ledger, appropriate ruled sheets of thick paper are introduced and fixed up with the help of a binder. Whenever necessary additional pages may be inserted, completed accounts can be removed and the accounts may be arranged and rearranged in the desired order. Therefore, this type of ledger is known as **Loose-leaf Ledger**.

Posting

The process of transferring the entries recorded in the journal or subsidiary books to the respective accounts opened in the ledger is called Posting. In other words, posting means grouping of all the transactions relating to a particular account at one place.

Distinction between Journal and Ledger:

Books of original entry (Journal) and Ledger can be distinguished as follows:

Basis of Distinction	**Journal**	**Ledger**
1. Book	It is the book of prime entry.	It is the main book of account.
2. Stage	Recording of entries in these books is the first stage.	Recording of entries in the ledger is the second stage.
3. Process	The process of recording entries in these books is called **"Journalizing".**	The process of recording entries in the ledger is called **"Posting".**
4.Transactions	Transactions relating to a person or property or expense are spread over.	Transactions relating to a particular account are found together on a particular page.
5. Net effect	The final position of a particular account cannot be found.	The final position of a particular account can be ascertained just at a glance.
6. Next Stage	Entries are transferred to the ledger.	From the Ledger, first the Trial Balance is drawn and then final accounts are prepared.
7. Tax authorities	Do not rely upon these books	Rely on the ledger for assessment purpose.

6. **Kinds of Subsidiary Books**

The number of subsidiary books may vary according to the requirements of each business. The following are the special purpose subsidiary books.

1. i. **Purchases Book** records only credit purchases of goods by the trader.
2. ii. **Sales Book** is meant for entering only credit sales of goods by the trader.
3. iii. **Purchases Return Book** records the goods returned by the trader to suppliers.
4. iv. **Sales Return Book** deals with goods returned (out of previous sales) by the customers.

5. v. **Bills Receivable Book** records the receipts of bills (Bills Receivable).
6. vi. **Bills Payable Book** records the issue of bills (Bills Payable).
7. vii. **Cash Book** is used for recording only cash transactions i.e., receipts and payments of cash.
8. viii. **Journal Proper** is the journal which records the entries which cannot be entered in any of the above listed subsidiary books.

7. Distinction between cash discount and trade discount

Basis of	**Trade Discount**	**Cash Discount**
Parties	It is a reduction granted by a manufacturer/ supplier	It is a reduction granted by a whole-saler (creditor) to the buyer (debtor).
Purpose	To help the retailer to earn some profit.	To encourage prompt payment within a stipulated period.
Time when allowed	It is allowed on the purchase of goods.	It is allowed when payment is made within the specified period.
Variation	It is usually given at the same rate which is applicable to all customers and will vary with the quantity purchased.	It varies from customer to customer depending on the time and period of payment.
Disclosure	It is shown by way of deduction in the invoice itself.	It is not shown in the invoice.
Ledger Account	A separate Account is not opened in the Ledger.	A separate Account is opened in the Ledger for discount received and discount allowed.