FUNDAMENTALS OF ACCOUNTING – MODULE I
OVERVIEW OF ACCOUNTING CONCEPTS

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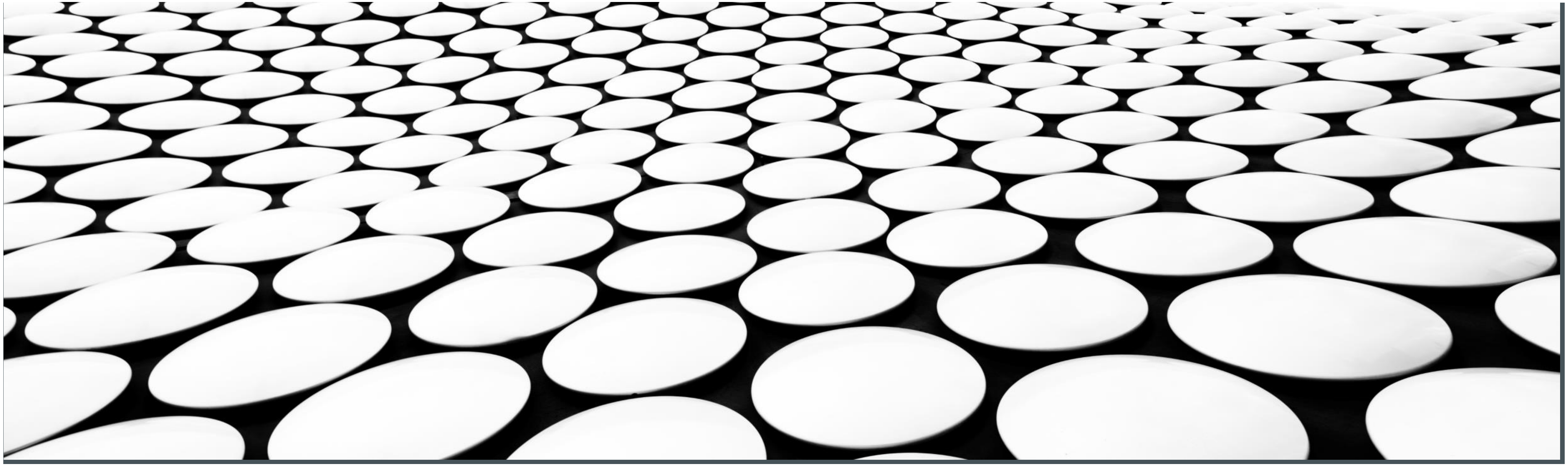


Definition of Accounting
Function of Accounting
Classification of Accounting
Bank Reconciliation Statement
Rectification of Errors

Definition of Accounting

DEFINITION OF ACCOUNTING

- Recording
- Classifying
- Summarizing
- Analysing
- Interpreting
- Communicating
- Transaction & Events in Monetary Terms

DEFINITION OF ACCOUNTING

Accounting can be defined as a process of reporting, recording, interpreting and summarizing economic data. The introduction of accounting helps the decision-makers of a company to make effective choices, by providing information on the financial status of the business.

Today, accounting is used by everyone and a good understanding of it is beneficial to all. Accountancy act as a language of finance. To understand accounting efficiently, it is important to understand the aspects of accounting.

Economic Events- It is a consequence of a company has to undergo when the number of monetary transactions is involved. Such as purchasing new machinery, transportation, machine installation on-site, etc.

Identification, Measurement, Recording, and Communication- The accounting system should be outlined in such a way that the right data is identified, measured, recorded and communicated to the right individual and at the right time.

Organization-In refers to the size of activities and level of a business operation.

Interested Users of Information- It is about communicating important financial information to the customers, according to which they will make the correct decision.

EXAMPLES OF EVENTS/TRANSACTIONS

- Received Loan from X of Rs.8,00,000 through Cheque.
- Opened Bank Account & deposited Cheque.
- Purchased Land for Rs.4,00,000
- Given Advance for purchase of Go down Building Rs.75,000.
- Bought a Motorcycle for Rs.50000.
- Given loan to Y Rs.1,00,000.
- Started small business by investing Rs.50000 for Tables/ Chairs/Furniture.
- Purchased Goods for Rs.1,00,000.
- Sold 80% of those Goods for Rs.1,20,000.
- Y repaid Rs.75,000 out of loan given by you within 1 month.
- Paid Income Tax on Profit made during period.
- Received Advance amount of Rs.50,000 from Customers to whom you promised to supply after 1 month.

RECORDING

- The process of Identifying and recording the financial transactions in the books.
- Below are the few examples of recording:

- *Cash Book/Bank Book*
- *Purchase and Sales Book*
- *Bills receivables and Bills Payables book.*
- *Purchase and Sales return books.*
- *Journal Book.*

CLASSIFYING

- Process where transactions or entries of one or similar nature are grouped.
- The book containing classified information is called “Ledger”.
- For Example, there may be separate account heads for Sales, Purchases, GST, Salaries, Rent, Office Expenses, Taxes Paid, Advertisement expenditure etc.

SUMMARIZING

- Summarizing involves preparation and presentation of the classified data in a way which is useful to internal and external Users.
- It paves the way to the preparation of following financial statements
  - Trial Balance
  - Profit and Loss Account
  - Balance Sheet
  - Cash Flow-Statement

ANALYSIS & INTERPRETATION

- Includes analyzing and then interpreting the financial data to make a meaningful judgement of the profitability and financial position of the business.
- The financial statement should explain not only

➢ –"what had happened" but also

➢ – "why it happened" and

➢ – "what is likely to happen" under specified condition.

COMMUNICATING

- This concerns communication of financial data like financial statements to the users who analyze them as per individual requirements.
- This includes preparation and distribution of accounting statements/Annual Reports

USERS OF FINANCIAL INFORMATION

INTERNAL USERS

Board of Directors

Partners

Managers

Officers

Employees

EXTERNAL USERS

- Investors
- Lenders
- Suppliers
- Government
- Customers

Functions of Accounting

FUNCTIONS OF ACCOUNTING

❑Identification of Financial Transaction and events

- Only those transactions and events are recorded in the accounts which are financial in nature.
- Thus, the events or the transactions are to be identified at first.

❑Measurement of Transactions

- Accounting measures the entity in terms of money and depicts its current financial position

❑Forecasting

- Helps in forecasting future performance and financial position of the enterprise using past data

❑Decision Making

- Provides relevant information to the users of accounts to aid rational decision making.

Functions of Accounting

❑ Comparison & Evaluation

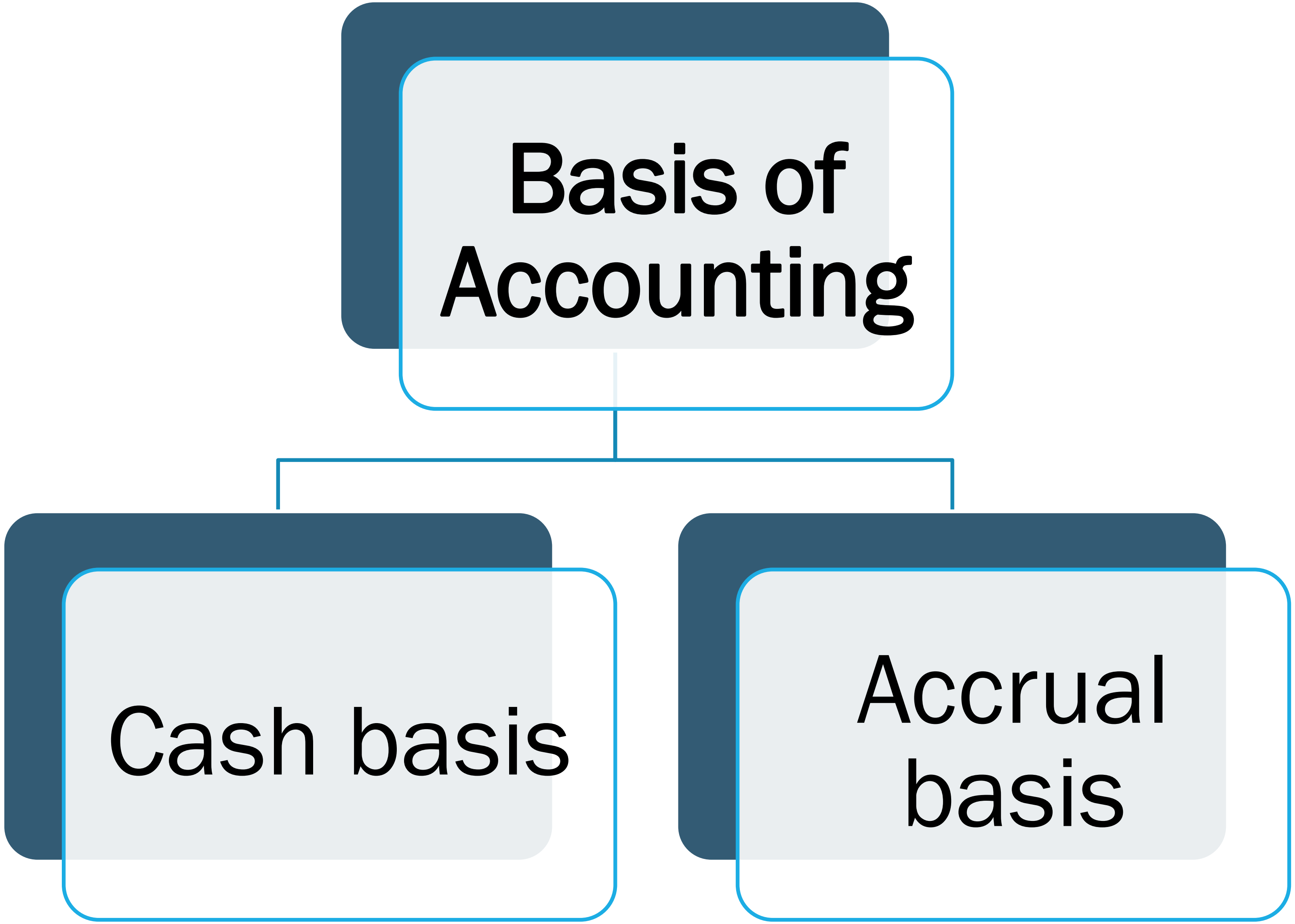
- Assesses performance achieved in relation to targets which is important for predicting, comparing and evaluating the financial results

❑ Control

- Defines weaknesses of the operational system and provides feedbacks regarding effectiveness of measures adopted to check such weaknesses.

❑ Govt. Regulation and Taxation

- Provides necessary information to the government to exercise control on the entity as well as in collection of tax revenues


Basis of Accounting
Cash basis
Accrual basis

Cash Basis

- Recognizes revenues when cash is received and expenses when they are paid.
- Does not recognize accounts receivable or accounts payable.
- Beneficial in terms of tracking how much cash the business has at any given time.
- Since the transactions are not recorded until the cash is received or paid, the business's income is not taxed until it is in the bank.

Accrual Basis

- Revenues and expenses are recorded when the are earned or Due, regardless of when the money is received or paid •
- Gives a more realistic idea of income and expenses during a period, therefore providing a long-term picture of the business that cash accounting can not provide.
- Most widely followed method, mandatory for Companies etc.,

DOUBLE ENTRY SYSTEM

- This is the system of Keeping the Books of Accounts worldwide and now India is also following the same
- It is based on the principle that “every business transaction has two accounts in opposite directions and if a complete record is to be made of each such transaction, it would be necessary to Debit one account and Credit one Account.”
- So “every Debit has corresponded Credit and every Credit has corresponding
- a fundamental concept underlying present-day bookkeeping and accounting, states that every financial transaction has equal and opposite effects in at least two different accounts. It is used to satisfy the accounting equation:

- **Assets = Liabilities + Equity**

Classification of Accounts

Classification of Accounts

- Personal
- Real
- Nominal

Golden Rule of Accounts

Personal Account	Real Account	Nominal Account
Debit the "Receiver" **Credit the "Giver"**	**Debit-What comes in** **Credit-What goes out**	**Debit- Expenses & Losses** **Credit- Income & Gains**

PERSONAL ACCOUNTS

- Natural personal accounts: The elements or accounts which represent persons. E.g., Ram's A/c, Shyam's A/c etc.
- Artificial personal accounts: Personal accounts which are created artificially by law, such as corporate bodies and institutions, are called Artificial personal accounts. Ex. Private Ltd Companies, LLPs, Clubs, Societies/Schools etc.
- Representative personal accounts: Accounts which represent a certain person or a group directly or indirectly. E.g., Outstanding expense A/c, Prepaid expense A/c

EXAMPLE:

- Paid Mr. Banerjee Rs.30,000 by cheque.

Accounts Involved	Debit/Credit	Rule Applied
• Mr. Banerjee • To Bank A/c	• Debit • Credit	<u>Personal Account</u> <u>Golden rule</u>: • Debit the Receiver • Credit the Giver

REAL ACCOUNTS

- All assets of a firm, which are tangible or intangible, fall under the category “Real Accounts“.
- Tangible real accounts are related to things that can be touched and felt physically. Few examples of tangible real accounts are Building, Machinery, Stock, Land etc.
- Intangible real accounts are related to things that can’t be touched and felt physically. Few examples of such real accounts are Goodwill, Patents (invention), Trademarks (Brand Name such as Nike, Adidas, Titan etc.)

EXAMPLE:

- Purchased Furniture for Rs.10,000 in cash.

Accounts Involved	Debit/Credit	Rule Applied
• Furniture A/c • To Cash A/c	• Debit • Credit	Real Account Golden rule: • Debit what comes in. • Credit what goes out.

NOMINAL ACCOUNTS

- Accounts which are related to expenses, losses, incomes or gains are called Nominal accounts.
- Nominal accounts do not really exist in physical form, but behind every nominal account money is involved. E.g., Purchase A/c, Salary A/c, Sales A/c, Commission paid A/c, Commission received A/c.
- The result of all nominal accounts is either profit or loss which is then transferred to the capital account.

EXAMPLE:

- Paid salaries of Rs.50,000 in cash.

Accounts Involved	Debit/Credit	Rule Applied
• Salaries A/c • To Cash A/c	• Debit • Credit	<u>Nominal Account Golden rule</u>: • Expenses and losses are debit. • Income and Gains are credit.

Bank Reconciliation Statement

Bank Reconciliation Statement

A bank reconciliation statement is a summary of banking and business activity prepared by a company or individual to reconcile the balance in their own cash records with their bank account balance. This statement shows reasons for any discrepancies between the two. A company can prepare a bank reconciliation statement any time during its financial periods.

When an individual or a firm deposits any money into a bank or withdraw money by issuing a cheque from a bank, he/it records the transaction in the debit-side of the bank columns of the Cash Book for such deposits and credit side of the bank column of the Cash book for such withdrawals.

On the other hand, bank also records such transactions in its book i.e. credit such account for deposits and debit such account for any withdrawals. The Bank issues a book to the account holder after recording such transactions. The book which is prepared by the bank for accountholder is known as Pass Book.

EXAMPLES OF PASSBOOK

State Bank of India

Rash Behari Avenue

Account No: 0003478564

Name: Mr. Abhijit Mukherjee

Savings Bank Account

Pass Book

Date	Details	Transaction Reference No.	Dr.	Cr.	Balance	Initials
15.03.2023	Payment to Swiggy	WF035DC	560.00		1,560.00	
17.03.2023	Received Money from Suresh	XC145VF		780	2,340.00	
17.03.2023	Payment to NewsPaper	VB4856X	199		2,141.00	
21.03.2023	Internet Recharge	CV879XS	239		1,902.00	
22.03.2023	Medicines Purchased	CV891BV	230		1,672.00	
29.03.2023	EMI Loan	WS189CX	1500		172.00	
01.04.2023	Salary Received	SIM546X		22000	22,172.00	

FEATURES OF BANK RECONCILIATION STATEMENT

- It is a statement.
- It is not a part of the process of Accounts.
- It is prepared to reconcile the causes of difference between the Bank balance as per Cash Book and the Bank balance as per Pass Book.
- It can be prepared at any time during the financial year, as and when it is required.
- Since it is prepared on a particular date, it is written as Bank Reconciliation statement as at/as on

NECESSITIES OF BANK RECONCILIATION STATEMENT

- It helps to understand the actual Bank balance.
- It helps to identify the mistakes in the Cash Book and the Pass Book.
- It helps to detect and prevent frauds and errors in recording the Banking transactions.
- It helps to incorporate certain expenditures/income debited/credited by Bank in the books of accounts. Methods of preparation of Bank Reconciliation Statement

STEPS IN PREPARING BANK RECONCILIATION STATEMENT

- One has to have a systematic approach towards preparation of the reconciliation. To avoid a lengthy reconciliation, one must ensure that the entries in the Cash Book are absolutely online. One also must obtain the Bank statements at regular intervals. Once this checking is done, Bank reconciliation could be done by following these steps:
- Identify the balances and the character thereof. Remember, a debit balance in Cash Book means asset where as a credit balance means a Bank overdraft. In Bank passbook, it’s reverse. A debit balance in Pass Book means overdraft and a credit balance is a favorable balance. This must be carefully understood.
- Based on the above, start with the balance (or overdraft) as per one book and arrive at the balance (or overdraft) as per the other book. The items of differences will be added to or deducted from the balance (or overdraft) with which the reconciliation is started.
- The end result should be the balance (or overdraft) as per the other book e. g. if you start with balance as per Cash Book, then after adding or deducting items of differences, you should arrive at the balance (or overdraft) as per the Pass Book.
- One has to make sure that all the items of differences from Cash Book as well as Bank book are taken into account in the reconciliation statement.
- Whether the items of differences should be added or deducted will depend on the sequence you follow. This is shown in following table:

Example :

On 31.12.13, P. Roy's Bank Balance as shown by the Cash Book was ` 75,000. On receipt of Bank Statement it was found that :-

(i) Three cheques of `3,000, `4,000 and `1,500 drawn in favor of suppliers respectively on 28th, 29th and 30th December, 2013 had been debited in the Bank Statement on 2nd January 2014.

(ii) The Bank had credited `8,000 on 30th December, 2013, in respect of collection made by Bank directly from a customer, the intimation not having yet been received.

(iii) Two cheques of `5,000 and `6,000 were deposited into Bank on 30th December, 2013 had been credited in the Bank statement on 4th January, 2014.

(iv) The Bank had debited `30 as incidental charges on 30th December, 2013 but not entered in the Cash Book. Show the reconciliation of the Bank Balance as per Cash Book with the Bank Balance as per Bank Statement as on 31st December, 2013.

Bank Reconciliation Statement of Mr S. Banerjee as on 31st December 2022		
Particulars	Amount	Amount
Bank Balance as Per Cash book		50,000
Add:		
i) Cheques issued but not presented for payment 3000,4000, & 1000 Respectively	8,000	
ii) Collection by Bank from a Customer not recorded in the Cash Book	4,000	
		12,000
Less:		
i) Cheques deposited but not credited in the Pass Book on 31.12.23 `3,000 + `4,000 respectively	(7,000)	
ii) Bank charges not recorded in the C.B.	(250)	
		(7,250)
Balance as per Pass Book		**69,250**

Rectification of Errors

Rectification of Errors

- Errors are mistakes that we commit while giving accounting treatment either knowingly or unknowingly. An error may be clerical or Error of principle.

- There are various stages at which an accountant and bookkeeper may commit errors. Rectification of error is very important to know the true financial position of an entity at the close of the financial year.

- These mistakes can occur while posting the journal entries to the ledger accounts, classifying these accounts, and carrying the balance forward, etc.

- We will learn in-depth about the types of these errors in our following section.

Types of Rectification of Errors

- **Errors of omission**: These errors occur in cases like when the entire transaction has been omitted from the books of accounts. From the word ‘omitted’ this error got the name ‘Errors of Omission’. This normally happens when the transaction is not recorded in the books of the original entry.

- **Errors of commission**: These errors happen due to any wrong committed by the accountant. Again, from the word ‘commission’ the error got its name as ‘Errors of Commission’. This might happen due to the wrong balances in an account, wrong posting of other accounts, the wrong carryforwards, wrong totaling, etc.

Types of Rectification of Errors

- **Errors of principle:** Errors of principle are committed in those cases where a distinction between the revenue and the capital item is not differentiated. This is the error of principle when the accountant denies accepting the principle of common accounting practices.

- **Compensating errors**: As indicated by the name, compensating errors are those errors which naturally compensate each other.

Suspense Account

- For the one-sided errors in the books, the trial balance refuses totally, then an accountant puts the difference between the debit and credit side of the trial balance on the shorter side as the Suspense A/c.

- After locating and rectifying the errors, the balance in the Suspense A/c reduces and consequently ends up becoming zero. Thus, the Suspense A/C cannot be categorized.

- This is a temporary account that can have a debit or credit balance depending upon the situation.

Suspense Account

An accountant uses the Suspense A/c to rectify the one-sided errors, he needs to follow the following steps:

- Identify the account with the error.
- Ascertaining the excess debit or credit.
- In case of a shorter debit or an excess credit in an account, the concerned account is thus debited. In case of short credit or an excess debit in an account, we need to credit the similar affected account.
- Then pass the necessary journal entry by debiting or crediting the Suspense A/c.

Example :

Depreciation written off on machinery ₹4000 not recorded in Machinery account
Suspense A/c Dr. 4000
To Machinery A/c 4000
(Being rectification towards omission of posting in machinery account)

THANK YOU!