THE NEW COLLEGE (AUTONOMOUS) CHENNAI

DEPATMENT OF BANK MANAGEMENT

PRINCIPLES OF FINANCIAL ACCOUNTING

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WHAT IS ACCOUNTING?

According to the American Institute of Public Accountants (AICPA), " Accounting is the art of recording, classifying and summarizing in a significant manner and in terms of money transactions and events which are of a financial character and interpreting the results thereof ".

NEED FOR ACCOUNTING

Effective management of business requires control over expenses to reduce the cost of operations and make the business profitable. In practice, it is impossible for any businessmen to memorize and recollect all his business dealings. To relieve them of questions like *what he owns, *what he owes, *profit earned etc. accounting was developed.

OBJECTIVES OF ACCOUNTING

1. MAINTENANCE OF ACCOUNTING RECORDS : Accounting records are the basis for accounting works. The records have to be maintained systematically. While maintaining the accounting records, the generally accepted accounting conventions and concepts have to be followed.
2. ASSECERTAINMENT OF PROFIT OR LOSS : Accounting is expected to ascertain and reveal the net results of the operations of a business. While finalizing the accounts, objective approach is essential, combined with consistency and conservatism.
3. DEPICTION OF FINANCIAL POSITION : A true fair view of the financial position should e presented. The properties and assets possessed by the business should be shown at appropriate values as per prevailing practices. All the material information must be clearly disclosed.
4. PROVIDING INFORMATION : In the recent years, providing information has become the most important objective of accounting. The American Accounting Association (AAA) has listed out purposes for which accounting should be disclosed such as at the time of maintenance and reporting of custodianship of resources and facilitating social functions & control.

METHODS OF ACCOUNTING

1. SINGLE ENTRY SYSTEM : The term 'single entry' is vaguely used to define the method of accounting which do not conform to strict principles of double entry. It is wrong to define it as a system. Under this system; only the personal accounts of debtors, creditors and cashbook of the trader is maintained. Impersonal accounts such as sales account, purchase accounts etc. are ignored. The absence of two fold effect of transaction make it impossible to prepare a trial balance and checking of arithmetical accuracy of the books. Absence of purchase account & sale accounts result in inconvenience to prepare trading account and balance sheet. Hence, single entry is incomplete as well as final results are not reliable.
2. DOUBLE ENTRY SYSTEM : This system was invented by and Italian named luco Pacioli and has spread all over the world. According to this system, every transaction has two aspects, namely incoming aspect (debit) and outgoing aspect (credit). For every transaction, one account si to be debited and the other is to be credited in order to have a complete record of the transaction. Therefore, every transaction affects two accounts in the opposite direction. Hence, the basic principle under this system is that for every debit, there must be a corresponding and equal credit, and vice versa.

STEPS IN ACCOUNTING

- IDENTIDY (What is the product)
- MEASURE (Value of product)
- RECORD (Journal entry)
- CALSSIFY (Allocate to ledger)
- SUMMARIZE (Allocate to trial balance)
- ANALYZE (Verification of info. by experts)
- INTERPRET(Better course of action to choose in future)
- COMMUNICATE (Provide info. to people associated with the firm)

GODLEN RULES OF ACCOUNTING

- DEBIT THE RECEIVER, CREDIT THE GIVER
- DEBIT WHAT COMES IN, CREDIT WHAT GOES OUT
- DEBIT ALL EXPENSES & LOSS, CREDIT ALL INCOME & GAIN

ACCOUNTING CONCEPTS & CONVENTIONS

Accounting concepts, are the assumptions or postulates or ideas which are essential to the practice of accounting and preparation of financial statements. The following is a generally accepted list of basic accounting concepts;

(1) The Entity Concept
(2) The Money Measurement Concept
(3) Going Concern Concept
(4) Dual Aspect Concept
(5) Accounting Period Concept
(6) Cost Concept
(7) Revenue recognition concept
(8) Matching Concept
(9) Accrual Concept
(10) Objective Evidence Concept

Accounting conventions are the established traditions, customs, methods and practices which usually act as guidelines for preparation and presentation of accounts. Accounting community has accepted their utility and importance in making the financial statements more realistic and useful to the end users. The following ae the generally accepted accounting conventions;

(1) Convention of Full Disclosure
(2) Convention of Consistency
(3) Convention of Materiality
(4) Convention of Conservatism

ACCOUNTING TERMS

- Capital
- Liability
- Assets
- Revenue
- Expense
- Debtor
- Creditor
- Tangible Asset
- Fictitious Asset
- Wasting Asset
- Fixed Asset
- Current Asset

- Drawings
- Invoice
- Voucher
- Goods
- Current Liability
- Long Term Liability
- Solvent
- Insolvent
- Stock
- Losses
- Purchase
- Sales

- Bills Payable
- Bills Receivable
- Opening Stock
- Closing Stock
- Depreciation
- Equity
- Inventory
- Overdraft
- Variable Cost

ACCOUNTING EQUATION

ASSETS = LIABILITIES + CAPITAL

JOURNAL

Journal is a book of 'primary entry'. All the transactions are initially recorded in the Journal. The ruling of the journal is such that any business transaction can be analyzed under the heads of debit and credit. A thorough understanding of the principles of debit and credit which are the basis of journal is essential for every student of accountancy to get the grasp of the subject.

LEDGER

Ledger is the second most important stage in the accounting cycle. In this stage, all recorded business transactions are grouped on a predetermined basis. Such classification takes the form of account in a book called Ledger. It is the main book of accounts in a business. The accounts it contains is the core of accounting process. The accounts in ledger provide identifiable grouping to the numerous transactions.

TRIAL BALANCE

All business transaction are initially recorded in Journal and then transferred to Ledger by posting relevant accounts. Later a statement is prepared to show the debit and credit balances separately. Such a statement is known as Trial Balance. It is not an account, it is a statement in which the debit and credit balances of all the accounts in the ledger are shown to test the arithmetical accuracy of the books of accounts. The fundamental principle of double entry system of book keeping is that every debit has a corresponding credit and vice versa. Therefore the total of the debit balances must be equal in aggregate to the total of the credit balances when the accounts are balanced.

Thus to find out the arithmetical correctness of the book keeping work, we prepare a summary of balances as they appear in the ledger at some particular date. This summary of balances is known as TRIAL BALANCE.

According to M.S. Gosav, " Trial Balance is a statement containing the balances of all ledger accounts, as at any given date, arranged in the form of debit and credit columns placed side by side and prepared with the object of checking the arithmetical accuracy of ledger postings" .

FINAL ACCOUNTS

The primary function of accounting is to accumulate accounting data in a manner that the amount of profit made or loss suffered during a period can be determined. The manner in which the profit or loss has been arrived at is disclosed in the statement of accounts, prepared at the end of the accounting year. The various items of income and expenditure which arose during the accounting period are detailed out therein, grouped under significant heads. It is also accompanied by a balance sheet, exhibiting assets and liabilities of the business as at the close of the period. In addition for showing the nature of economic activity to which the account pertains, the revenue account as well as different sections in which it is set up are invariably headed as manufacturing trading and profit and loss account or simply P&L account. These two statements of Trading and Profit and Loss account and Balance Sheet are prepared to give the final results of the business. That is why both are collectively called FINAL ACCOUNTS.