UNIVERSAL CONVENT SR. SEC. SCHOOL KALADHUNGI

ACCOUNTANCY-11TH

CHAPTER 1
Introduction

According to American Institute of Certified Public Accountants, "Accounting is the art of recording, classifying and summarising the economic information in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character, and interpreting the results thereof."
Accounting Principles Board (APB) of AICPA (U.S.A) defined accounting as "Accounting is a service activity. Its function is to provide quantitative information, primarily financial in nature, about economic entities that is intended to be useful in making economic decisions."
In Simple words, accounting is the process of collecting, recording, classifying, summarising and communicating financial information to the users for judgment and decision-making.

Objectives of Accounting
1. To keep systematic and complete records of financial transactions in the books of accounts according to specified principles and rules to avoid the possibility of omission and fraud.
2. To ascertain the profit earned or loss incurred during a particular accounting period which further help in knowing the financial performance of a business.

3. To ascertain the financial position of the business by the means of financial statement i.e. balance sheet which shows assets on one side and Capital & Liabilities on the other side.
4. To provide useful accounting information to users like owners, investors, creditors, banks, employees and government authorities etc who analyze them as per their requirements.
5. To provide financial information to the management which help in decision making, budgeting and forecasting.
6. To prevent frauds by maintaining regular and systematic accounting records

Advantages of Accounting
1. It provides information which is useful to management for making economic decisions.
2. It help owners to compare one year's results with those of other years to locate the factors which leads to changes.
3. It provide information about the financial position of the business by means of balance sheet which shows assets on one side and Capital & Liabilities on the other side.
4. It help in keeping systematic and complete records of business transactions in the books of accounts according to specified principles and rules, which is accepted by the Courts as evidence.
5. It help a firm in the assessment of its correct tax Liabilities such as income tax, sales tax, VAT, excise duty etc.
6. Properly maintained accounts help a business entity in determining its proper purchase price.

Limitations of Accounting
1. It is historical in nature; it does not reflect the current worth of a business. Moreover, the figures given in financial statements ignore the effects of changes in price level.
2. It contains only those informations which can be expressed in terms of money. It ignores qualitative elements such as efficiency of management, quality of staff, customers satisfactions etc.
3. It may be affected by window dressing i.e. manipulation in accounts to present a more favorable position of a business firm than its actual position.
4. It is not free from personal bias and personal judgment of the people dealing with it. For example different people have different opinions regarding life of asset for calculating depreciation, provision for doubtful debts etc.
5. It is based on various concepts and conventions which may hamper the disclosure of realistic financial position of a business firm. For example assets in balance sheet are shown at their cost and not at their market value which could be realised on their sale.

Book Keeping - The Basis of Accounting
Book keeping is the record-making phase of accounting which is concerned with the recording of financial transactions and events relating to business in a significant and orderly manner.
Book Keeping should not be confused with accounting.Book keeping is the recording phase while accounting is concerned with the summarizing phase of an accounting system. The distinction between the two are as under.

Book keeping Accounting
1. It is the recording phase of an accounting system.
1. It is the summarizing phase of an accounting system.
2. It is a primary stage and basis for accounting.
2. It is a Secondary Stage which begins where the Book keeping process ends.
3. It is routine in nature and does not require any special skill or knowledge
3. It is analytical in nature and required special skill or knowledge.
4. It is done by junior staff called book-keepers
4. It is done by senior staff called accountants.
5. It does not give the complete picture of the financial conditions of the business unit.
5. It gives the complete picture of the financial conditions of the business unit.

Types of accounting information
Accounting information can be categorized into following:
1. Information relating to profit or loss i.e. income statement, shows the net profit of business operations of a firm during a particular accounting period.
2. Information relating to Financial position i.e. Balance Sheet. It shows assets on one side and Capital & Liabilities on the other side.
3. Schedules and notes forming part of balance sheet and income statement to give details of various items shown in both of them.
Subfields/Branches of Accounting
1. **Financial Accounting:-** It is that subfield/Branch of accounting which is concerned with recording of business transactions of financial nature in a systematic manner, to

ascertain the profit or loss of the accounting period and to present the financial position of the business.

2. **Cost Accounting**:- It is that Subfield/Branch of accounting which is concerned with ascertainment of total cost and per unit cost of goods or services produced/ provided by a business firm.

3. **Management Accounting**:- It is that subfield/Branch of accounting which is concerned with presenting the accounting information in such a manner that help the management in planning and controlling the operations of a business and in better decision making.

Interested users/parties of Accountings information's and their Needs

There arenumber of users interested in knowing about the financial soundness and the profitability of the business.

Qualitative Characteristics of Accounting Information

Accounting information is useful for interested users only if it posses the following characteristics:

1. **Reliability**: Means the information must be based on facts and be verified through source documents by anyone. It must be free from bias and errors.
2. **Relevance**: To be relevant, information must be available in time and must influence the decisions of users by helping them to form prediction about the outcomes.
3. **Understandability**: The information should be presented in such a manner that users can understand it well.
4. **Comparability**: The information should be disclosed in such a manner that it can be compared with previous year's figures of business itself and other firm's data.

Basic accounting terms/Business Transaction

An Economic activity that affects financial position of the business and can be measured in terms of money e.g., purchase of goods for use in business.

Account: Account refers to a summarized record of relevant transactions of particular head at one place. All accounts are divided into two sides. The left side of an account is called debit side and the right side of an account is called credit side.

Capital: Amount invested by the owner in the firm is known as capital. It may be brought in the form of cash or assets by the owner.

Drawings: The money or goods or both withdrawn by owner from business for personal use, is known as drawings. Example: Purchase of car for wife by withdrawing money from business.

Assets: Assets are valuable and economic resources of an enterprise useful in its operations. Assets can be broadly classified as:

1. **Current Assets**: Current Assets are those assets which are held for short period and can be converted into cash within one year. For example: Debtors, stock etc.
2. **Non-Current Assets**: Non-Current Assets are those assets which are hold for long period and used for normal business operation. For example: Land, Building, Machinery etc.

They are further classified into:

a. **Tangible Assets**: Tangible Assets are those assets which have physical existence and can be seen and touched. For Example: Furniture, Machinery etc.

b. **Intangible Assets**: Intangible Assets are those assets which have no physical existence and can be felt by operation. For example: Goodwill, Patent, Trade mark etc.

Liabilities: Liabilities are obligations or debts that an enterprise has to pay after some time

in the future.

Liabilities can be classified as:

1. **Current Liabilities**: Current Liabilities are obligations or debts that are payable within a period of one year. For Example: Creditors, Bill Payable etc.
2. **Non-Current Liabilities**: Non-Current Liabilities are those obligations or debts that are payable after a period of one year. Example: Bank Loan, Debentures etc.

Receipts

1. **Revenue Receipts**: Revenue Receipts are those receipts which are occurred by normal operation of business like money received by sale of business products.
2. **Capital Receipts**: Capital Receipts are those receipts which are occurred by other than business operations like money received by sale of fixed assets.

Expenses: Costs incurred by a business for earning revenue are known as expenses. For example: Rent, Wages, Salaries, Interest etc.

Expenditure: Spending money or incurring a liability for acquiring assets, goods or services is called expenditure. The expenditure is classified as :

1. **Revenue Expenditure**: If the benefit of expenditure is received within a year, it is called revenue expenditure. For Example: rent, Interest etc.
2. **Capital Expenditure**: If benefit of expenditure is received for more than one year, it is called capital expenditure. Example: Purchase of Machinery.
3. **Deferred Revenue Expenditure**: There are certain expenditures which are revenue in nature but benefit of which is derived over number of years. For Example: Huge Advertisement Expenditure.

Profit: The excess of revenues over its related expenses during an accounting year is profit.
Profit = Revenue - Expenses

Gain: A non-recurring profit from events or transactions incidental to business such as sale of fixed assets, appreciation in the value of an asset etc.

Loss: The excess of expenses of a period over its related revenues is termed as loss.
Loss = Expenses - Revenue

Goods: The products in which the business deal in. The items that are purchased for the purpose of resale and not for use in the business are called goods.

Purchases: The term purchases is used only for the goods procured by a business for resale. In case of trading concerns it is purchase of final goods and in manufacturing concern it is purchase of raw materials. Purchases may be cash purchases or credit purchases.

Purchase Return: When purchased goods are returned to the suppliers, these are known as purchase return.

Sales: Sales are total revenues from goods sold or services provided to customers. Sales may be cash sales or credit sales.

Sales Return: When sold goods are returned from customer due to any reason is known as sales return.

Debtors: Debtors are persons and/or other entities to whom business has sold goods and services on credit and amount has not received yet. These are assets of the business.

Creditors: If the business buys goods/services on credit and amount is still to be paid to the persons and/or other entities, these are called creditors. These are liabilities for the business.

Bill Receivable: Bill Receivable is an accounting term of Bill of Exchange. A Bill of Exchange is Bill Receivable for seller at time of credit sale.

Bill Payable: Bill Payable is also an accounting term of Bill of Exchange. A Bill of Exchange is Bill Payable for purchaser at time of credit purchase.

Discount: Discount is the rebate given by the seller to the buyer. It can be classified as :
1. **Trade Discount**: The purpose of this discount is to persuade the buyer to buy more goods. It is offered at an agreed percentage of list price at the time of selling goods. This discount is not recorded in the accounting books as it is deducted in the invoice/cash memo.
2. **Cash Discount**: The objective of providing cash discount is to encourage the debtors to pay the dues promptly. This discount is recorded in the accounting books.
Account : Account refers to a summarised record of relevant transaction of particular head at one place.
Income: Income is a wider term, which includes profit also. Income means increase in the wealth of the enterprise over a period of time.
Stock : The goods available with the business for sale on a particular date is known as stock.
Cost : Cost refers to expenditures incurred in acquiring manufacturing and processing goods to make it saleable.
Voucher: The documentary evidence in support of a transaction is known as voucher. For example, if we buy goods for cash we get cash memo, if we buy goods on credit, we get an invoice, when we make a payment we get a receipt.
Goods and Service Tax (GST) : GST is an indirect tax which is levied on the supply of goods and service.

Chapter-2 Theory Base of Accounting

Fundamental Accounting Assumptions

1. **Going Concern Assumption:** This concept assumes that an enterprise has an indefinitelife or existence. It is assumed that the business does not have an intention to liquidate or to scale down its operations significantly.

2. **Consistency Assumption:** According to this assumption, accounting practices once selected and adopted, should be applied consistently year after year. This will ensure a meaningful study of the performance of the business for a number of years. Consistency assumption does not mean that particular practices, once adopted, cannot be changed. The only requirement is that when a change is desirable, it should be fully disclosed in the financial statements along with its effect on income statement and Balance Sheet. Any accounting practice may be changed if the law or Accounting standard requires so, to make the financial information more meaningful and transparent.

Relevance: It helps the management in decision-making as they can compare the financial information of current year with that or previous years.

3. **Accrual Assumption:** As per Accrual assumption, all revenue
s and costs are recognized when they are earned or incurred.It is immaterial, whether the cash is received or paid at the time of transaction or on a later date e.g., if a credit sale (Credit for two months) for Rs. 15,000 is made on 15th Feb.
2016, then the revenue earned is to be recorded on 15th Feb. 2016, not on the date when cash is realized, i.e., after two months. In case of Expenses, if at the end of the year, salary for two months is due but not paid, then the expenses of salary will be recorded in the current year in which the salary is due, not in the next year when it will be paid.

Relevance: Earning of revenue and consumption of a resource (expenses) can beaccurately matched to a particular accounting period.

Accounting Principles

1. **Accounting Entity :** An entity has a separate existence from its owner. According to this principle, business is treated as an entity, which is separate and distinct from its owner. Therefore, transactions are recorded and analyzed, and the financial statements are prepared from the point of view of business and not the owner.
The owner is treated as a creditor (Internal liability) for his investment in the business, i.e. to the extent of capital invested by him. Interest on capital is treated as an expense like any other business expense. His private expenses are treated as drawings leading to reductions in capital.

2. **Money Measurement Principle:** According to this principle, only those transactions that are measured in money or can be expressed in terms of money are recorded in the books of accounts of the enterprise. Non-monetary events like death of any employee/Manager, strikes, disputes etc., are not recorded at all, even though these also affect the business operations significantly.

Limitations:

1. It ignores the qualitative aspect e.g., efficient human resources (Assets), satisfied customers (Assets) and dishonest employees (liabilities).
2. Value of money (currency) is not stable.

To make accounting records simple, relevant, understandable and homogeneous, facts are expressed in a common unit of measurement-money, which is not stable.

3. **Accounting Period Principle:** According to this principle, the life of an enterprise is divided into smaller periods so that its peformance can be measured at regular intervals. These smaller periods are called accounting periods.
Accounting period is defined as the interval of time, at the end of which the profit and loss account and the balance sheet are prepared, so that the performance is measured at regular intervals and decisions can be taken at the appropriate time. Accounting period is usually a period of one year.

Relevance:

1. This Assumption requires the allocation of expenses between capital and revenue.
2. Portion of capital expenditure that is consumed during the current year is charged to the Income statement and the remaining portion i.e., the unconsumed portion is shown as an asset in the Balance Sheet.
3. As per the income tax law, tax on income is calculated on annual basis from 1st April to 31st March (Financial Year)

4. Timely decision for corrective measures can be taken by the Management by using these financial statements.

4. **Full Disclosure Principle:** According to this principle, apart from legal requirements, all significant and material information related to the economic affairs of the entity should be completely disclosed in its financial statements and the accompanying notes to accounts.

The financial statements should act as a means of conveying and not concealing the information. Disclosure of information will result in better understanding and the parties may be able to take sound decisions on the basis of the information provided.

E.g., footnotes such as :

1. Contingent liabilities in respect to a claim of a very big amount against the business are pending in a Court of Law.
2. Change in the method of providing depreciation.
3. Market value of investment.

5. **Materiality Principle:** Disclosure of all material facts is compulsory but it does not imply that even those figures which are irrelevant are to be included in the financial statements. According to this principle, only those items or information should be disclosed that have a material effect and are relevant to the users. So, an item having an insignificant effect or being irrelevant to user need not be disclosed separately, it may be merged with other item.

If the knowledge about any information is likely to affect the user's decision, it is termed as material information.

It should be noted that an item material for one enterprise may not be material for another enterprise, e.g., an expense of Rs. 50,000 is immaterial for an enterprise having a turnover of Rs. 100 crore but it is material for an enterprise having a turnover of Rs. 10,00,000.

6. **Prudence Principle:** According to this principle, prospective profit should not be recorded but all prospective losses should immediately be recorded. The objective of this principle is not to overstate the profit of the enterprise in any case and this concept ensures that a realistic picture of the company is portrayed. When different equally acceptable alternative methods are available, the method having the least favorable immediate effect on profit should be adopted, e.g.,

1. Valuation of stock at cost or realizable value, whichever is lower.
2. Provision for doubtful debts and provision for discount on debtors is made.

7. **Cost Principle :** According to this Principle, an asset is recorded in the books of accounts at its original cost comprising of the cost of acquisition and all the expenditure incurred for making the assets ready to use.

This cost becomes the basis of all subsequent accounting transactions for the asset, since the acquisition cost relates to the past, it is referred to as the Historical cost. Example: Machinery was purchased for Rs. 1,50,000 in cash and Rs. 20,000 was spent on the installation of machine, then Rs. 1,70,000 will be recorded as the cost of machine in the books and depreciation will be charged on this cost. If the market value of the machine goes up to Rs. 2,00,000 due to inflation, then the increased value will not be recorded. This cost is systematically reduced year after year by charging depreciation and the assets are shown in the balance sheet at book value (cost - depreciation).

8. **Matching Principle:** According to this principle, all expenses incurred by an enterprise during an accounting period are matched with the revenues recognized during the same

period.
The matching principle facilitates the ascertainment of the amount of profit earned or loss incurred in a particular period by deducting the related expenses from the revenue recognized in that period.
The following treatment of expenses and revenues are done due to matching principle.:
1. Ascertainment of Prepaid Expenses.
2. Ascertainment of Income received in advance.
3. Accounting of closing stock.
4. Depreciation charged on fixed assets.
9. **Dual Aspect Principle:** According to this principle, every business transaction has two aspects - a debit and a credit of equal amount. In other words, for every debit there is a credit of equal amount in one or more accounts and vice-versa.
The system of recording transactions on the basis of this principle is known as “Double Entry System”.
Due to this principle, the two sides of the Balance Sheet are always equal and the following accounting equation will always hold good at any point of time.
Assets = Liabilities + Capital
Example : Ram started business with cash Rs. 1,00,000. It increases cash in assets side and capital in liabilities- side by Rs. 1,00,000.
Assets Rs. 1,00,000 = Liabilities + Capital Rs. 1,00,000
Bases of Accounting
There are two bases of ascertaining profit or loss, namely: (1) Cash Basis, and (2) Accrual Basis.
1. **Cash Basis of Accounting :** Under this system of accounting, transactions are recorded in the books of accounts only on the receipt/ payment of cash. The income is calculated as the excess of actual cash receipts (in respect of sale of goods, services, properties etc.) over actual cash payments (regarding purchase of goods, expenses, rent, electricity, salaries etc.)
Entry is not recorded when a payment or receipt is merely due i.e., outstanding expenses, accrued incomes are not treated.
This method is contradictory to the matching principle.
2. **Accrual Basis of Accounting:** Under this system of accounting, revenue and expenses are recorded when they are recognized i.e., Income is recorded as Income when it is accrued (when transaction takes place) irrespective of the fact whether cash is received or not. Similarly, expenses are recorded when they are incurred or become due and not when the cash is paid for them.
Under this system, expenses such as outstanding expenses, prepaid expenses, accrued income and income received in advance are identified and taken into account.
Under the Companies’ amendments Act 2013, all companies are required to maintain their accounts according to accrual basis of accounting.

Accounting Standards : Concept and Objections
The accounting principles or GAAP have been developed in the form of concepts and conventions to bring comparability and uniformity in the financial statements. But GAAP also allow a large number of alternative treatments for the same items. Different organizations may adopt different accounting policies for the same transaction or an organization may follow different accounting policies for the same item over different

accounting periods. As a result, the financial statements become inconsistence and incomparable.
So it was felt that certain minimum standards should be universally applicable, so that the accounting statements have the qualitative characteristics of reliability, relevance, understandability and comparability.
International Accounting Standard Committee (IASC) was set up in 1973. (Now renamed as International financial Reporting Committee IFRC). The Institute of Chartered Accountants of India (ICAI) and the Institute of Cost and Works Accountants of India (ICWAI) are members of this committee. ICAI set up the Accounting Standard Board (ASB) in 1977 to identify the areas in which uniformity in accounting is required. ASB prepares and submits a draft accounting standard to the Council of ICAI. The Council of ICAI issues the draft for the comments by the Govt., industry and professionals etc. After due consideration on the comments received, the Council of ICAI notifies it for its use in the financial statements.

Concept of Accounting Standards
Accounting standards are written statements, issued from time-to-time by institutions of accounting professionals, specifying uniform rules and practices for drawing the financial statements.

Objectives of Accounting Standards
1. **Accounting standards are required to bring uniformity** in accounting practices and policies by proposing standard treatment in preparation of financial statements.
2. **To improve reliability of the financial statements:** Statements prepared by using accounting standards are reliable for various users, because these standards create a sense of confidence among the users.
3. **To prevent frauds and manipulation** by codifying the accounting methods and practices.
4. **To help Auditors**: Accounting standards provide uniformity in accounting practices, so it helps auditors to audit the books of accounts.

IFRS International Financial Reporting Standards
This term refers to the financial standards issued by International Accounting Standards Board (IASB). It is the process of improving the financial reporting internationally to help the participants in the various capital markets of the world and other users.

IFRS Based financial Statements
Following financial statements are produced under IFRS:
1. Statement of financial position: The elements of this statement are
a. Assets
b. Liability
c. Equity
2. Comprehensive Income statement: The elements of this statement are
a. Revenue
b. Expense
3. Statement of changes in Equity
4. Statement of Cash flow
5. Notes and significant accounting policies

Main difference between IFRS and IAS (Indian Accounting Standards)

1. IFRS are principle based while IAS are rule based.
2. IFRS are based on Fair Value while IAS are based on Historical Cost.