ACCOUNTING – I

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PREFACE

This Text-Book of **Accounting – I** is specially prepared for the B.Com & B.B.A. Students. It is prepared in accordance with the syllabus given in this book.

I do not claim any originality in the subject-matter of this book. I have drawn immense material from many standard books on this subject. Yet, this book is original in the exposition and presentation of the subject-matter. The subject-matter has been dealt with exhaustively and in very simple language.

I express my profound gratitude to my well-wishers for their encouragement in the preparation of this book. We am also thankful to **United Publishers, Mangalore,** for bringing out this book.

I shall consider my efforts amply rewarded if this book is found useful by the teachers and the students.

Suggestions for improvement of this book will be gratefully accepted.

Mangalore,
2022 **Late B.S. Raman**

SYLLABUS

ACCOUNTING – I

MODULE I : **Introduction -** Origin and Development of Accounting Thought, Book-Keeping, Accounting, Accountancy – Meaning and Objectives of Accounting – Functions of Accounting; Accounting Principles – Concepts and Conventions; Accounting Standards - Meaning - Objectives - Indian Accounting Standards - List of Indian Accounting Standards (List only), IFRS (Meaning only) - Basis of Accounting – Cash System, Mercantile System and Hybrid System; Systems of Accounting – Single Entry System (Meaning and features only) - Recent development in Accounting - COmputerized Accounting - SAP, TALLY and ERP (Meaning only). **12 hrs.**

MODULE II : Recording of transactions under Doulbe Entry System - Journal - Journalising, preparation of Ledger Accounts. Subsidiary Books Purchases Book, Sales Book, Purchases Returns Book. Sales Returns Book, BIlls Receivable Book and Bills Payable Book (Meaning and format only). **12 hrs.**

MODULE III: Cash Book - Simple Cash Book and Three Column Cash Book, Peety Cash Book (under Imprest System), Bank Reconciliation Statement - Meaning - Causes of different between Cash Book Balance and Balance as per Bank Pass Book - Need for Bank Reconciliation Statement; Procedure for preparation of Bank Reconciliation Statement. **12 hrs.**

MODULE IV: **Depreciation Accounting** - Meaning and definition - Causes, Methods of Charging depreciation - Original Cost Method, Written - Down - Value Method and Annuity Method (Excluding change of methods); Trial Balance - Meaning, Methods of Preparation.

Errors and their rectification -Meaning- types oferrors - rectification of errors - Errors located before the preparation of Trial Balance - Errors located after the preparation of Trial Balance and before the preparation of final accounts - Suspence Account. **12 hrs.**

MODULE V: Accounting for Special Transactions - Bills of Exchange and Promissory Notes - Meaning - Features - Parties to Bill of Exchange - Noting and Protest - Discounting - Endorsement- Dishonor of Bills, Renewels of Bills (Excluding accommodation bill). **12 hrs.**

MODULE VI: **Preparation of Final Accounts of a Sole Trader –** Meaning of Final Accounts - Trading Account, Profit and Loss Account and Balance Sheet. **12 hrs.**

Total Hours : 72

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MODULE – I INTRODUCTION

ORIGIN AND DEVELOPMENT OF ACCOUNTING THOUGHT

Introduction :

Accounting had emerged not by chance, but in response to the economic and social developments in developed countries of the world. This is clear from the fact that, in developed countries like the U.K., Germany, France, Switzerland, U.S.A., etc., where there were remarkable economic and social developments, there was a major revolution in accounting theory and practice during the past sixty years, while in developing and under-developed countries, where the economic and social developments were not significant, there was not much development in accounting theory and practice.

It is gratifying to note that, of late, even in developing countries, there have been some developments in accounting theory and practice.

HISTORY OF ACCOUNTING THOUGHT

Accounting thought (i.e., the theory and practice of accounting) had developed over several centuries. So, let us discuss the history of accounting thought under various stages.

FIRST STAGE : EARLY HISTORY OF ACCOUNTING THOUGHT

(I.E., ACCOUNTING THOUGHT DURING THE PERIOD UPTO 1450)

Accounting had been in existence since the beginning of human civilisation.

The Chinese were the originators of accounting practice. In China, sophisticated forms of Government accounting existed as early as in 2000 BC.

The development of banking and the growth of commercial activities led to the introduction of accounting in ancient Greece.

There were evidences of accounting practice (i.e., the maintenance of accounts) in ancient Rome.

The economic development of the middle ages and the large-scale growth of banking and commercial activities contributed to the introduction and development of accounting in other European countries like Germany, France, Switzerland, etc.

There were also adequate evidences to suggest that accounting was practised even in India in the ancient period. In the book **'Arthashastra',** written by **Kautilya, the minister of Chandra Gupta Maurya,** around 4th century B.C., there was a specific reference to account-keeping.

However, in the ancient period, accounting was not developed as it is at present, because, in those days, business was conducted on a very small scale, and so, the need for a well-developed accounting system was not felt.

SECOND STAGE: DEVELOPMENT OF ACCOUNTING AFTER THE YEAR 1450 UPTO 1494

The real development of accounting, i.e., the modern system of accounting based on double-entry principles, took place only after the year 1450. The increase in the volume of trade and commerce contributed to the development of the modern accounting system. The modern accounting system owes its development to **Luca Pacioli,** a monk in Venice in Italy. Luca Pacioli wrote a book on mathematics, popularly called **'Summa'** in Italian language in 1494. This book on mathematics contained a section on **double-entry principles of accounting called De Computi et Scripturies.** As this book contributed largely to the development of modern accounting, **Luca Pacioli came to be regarded as the founder or father of modern**

accounting. This book on double-entry system of accounting became very popular in a short period of time due to its simple approach. So, it was translated into English by **Hugh Old Castle** in 1544.

(In this context, it may be noted that some authorities are of the opinion that Luca Pacioli is not the inventor or founder of the double entry system of book-keeping. He had just put together the different aspects of double entry book-keeping in a comprehensive tract.)

A decade later, **James Pule** wrote a book on **"how to keep a perfect accounts of debtors and creditors".** This book also contributed to the development of accounting. Other European Professors like **Simmon Stevon** and **Arthur Cayley** also contributed to the development of Accounting thought and ideas. **Arthur Cayley, a Professor of Mathematics at Cambridge University of England,** wrote a book which contained the **Principles of Double-entry Book-keeping.**

THIRD STAGE: AGE OF STAGNATION OF ACCOUNTING DURING THE PERIOD FROM 1494 UPTO THE YEAR 1775

For centuries after the development of the double-entry system of accounting, practically, there were no significant developments in accounting upto the year 1775. During this period, the owners of business firms did not give much importance to accounting. They did not consider it necessary to give importance to the preparation of financial statements like the profit and loss account and the balance sheet.

However, during this period, the **concept of capital as the difference between assets and liabilities,** and **the concept of net profit as the change in capital between two dates,** viz., the beginning of the accounting period and the end of the accounting period, were established.

FOURTH STAGE : PERIOD OF GROWTH OF ACCOUNTING KNOWLEDGE (I.E., THE PERIOD AFTER 1775 TO THE PRESENT DAY)

The period after 1775 to the present day is regarded as the period of growth of accounting knowledge, because, during this period, accounting knowledge (i.e., accounting principles and practices) has grown remarkably.

The development of accounting during the period of growth may be studied under the following stages :

(a) During the Period between 1775 and 1850 :

During the period after 1775 till 1850, business enterprises were mostly proprietary concerns (i.e., sole trading concerns). They were more interested in knowing their net worth or own capital (i.e., the assets minus the liabilities). So, they laid greater emphasis on the preparation of only the **balance sheet.**

It may be noted that it was during this period, i.e., in 1785, **Edward Jones,** after incorporating many changes in the double-entry book-keeping, wrote and published **a complete book on the double-entry system of book-keeping,** named **"English System of Book-Keeping".** It was in this book that **the use of many subsidiary books or special journals, instead of a single general journal, and the preparation of trial balance were discussed.**

(b) During the Period between 1850 and 1900 :

During the period between 1850 and 1900, though the sole proprietorships and partnerships continued to grow, there appeared a large number of big joint stock companies in the business field thanks to the Industrial Revolution. A joint stock company was regarded as a separate entity distinct from the shareholders who owned the company. This separate entity concept led to the introduction of separate business entity concept in accounting. As per the separate business entity concept, a joint stock company was regarded as a separate entity not only in law but also for the purpose of accounting.

The shareholders (i.e., the owners of capital) of a joint stock company were interested in their investments in the company. Further, as the shareholders did not directly participate in the management of the joint stock company, a need was felt to present the shareholders periodically with the report of the use of their wealth and the rate of return on their investments. This led to a change in emphasis in financial statements from the balance sheet to the income statement. The change in emphasis from balance sheet to income statement contributed to the introduction of **accounting concept of income and the accounting period concept. The going concern concept (i.e., a company would continue for a long period of time) was also developed during this period. The cost concept,** under which fixed assets were valued at their original cost less depreciation, was also developed during this period.

Since ownership is separated from management in the case of joint stock companies, it became necessary for joint stock companies to get their annual accounts audited by independent outside agencies. This led to the evolution of **financial auditing.** Many institutes of chartered accountants were established in several countries to perform the function of financial auditing.

Above all, several basic accounting principles or operating guidelines were developed during this period. **The revenue principle, the cost principle and the matching principle** were developed and applied in the preparation of income statement. To ensure the authenticity of financial statements, **the principle of verifiability** was developed and applied. The **principle of historical cost** was applied in the valuation of inventories. As the joint stock companies used not only their owned funds but also funds borrowed from outsiders, to protect the interests of the outside lenders, the **principle of conservatism** was applied in the preparation and presentation of financial statements. Thus, it was during this period that there was a move from relatively simple book-keeping towards a full-fledged accounting with methodology or accounting theory.

(c) During the Period between 1900 and 1950 :

During the period between 1900 and 1950, there was a major revolution in accounting theory and practice.

As large-scale business enterprises became complex and competitive, new theories and practices of analysis of financial statements were evolved to help them face complexities and competition. For instance, **Cost accounting and management accounting were developed during this period.**

During this period, greater **emphasis was laid on envolving techniques and systems of accounting to make accounting more useful for decision-making.**

Tax accounting, tax advising and tax planning were developed during this period.

Auditing standards and guidelines were evolved during this period in several countries to rationalise auditing techniques.

Government accounting, which was traditionally linked to taxation and revenue control, was improved upon to make it more useful for planning, budgeting and control. Better techniques of recording and analysis of data were evolved during this period in the field of Government accounting.

(d) During the Period from 1950 to the Present Day :

During the period from 1950 to the present day, accounting has developed into a full-fledged information system. Today, accounting is not regarded just an art. It is regarded as a science like other social sciences.

Many new accounting concepts have been evolved and put into practice during this period.

Many accounting standards boards and committees have been set up in several countries to develop and issue accounting standards. International accounting has also been developed to harmonise accounting techniques and practices in member countries.

Information systems, management services and management audit are some of the developments during this period resulting from the application of new accounting techniques and systems.

There is also the development of the concept of social accounting or social responsibility accounting thanks to the realisation of their social responsibility by business enterprises, particularly by joint stock companies. In the area of social responsibility accounting, there is a shift in the emphasis from revenue and expense to cost-benefit.

More importance is also attached to **inflation accounting** and **human resource accounting during this period.**

The application of computers has revolutionised accounting systems and techniques during this period.

Conclusion :

Form the above discussion, it is clear that accounting has gone through several phases in its evolution and development, from simple double-entry book-keeping to full-fledged financial accounting.

BOOK-KEEPING

Introduction:

Book-keeping is a part of accounting. So, before we take up the study of accounting, it is necessary to have some idea about book keeping.

Definition and Meaning of Book-Keeping:

According to Northcot, "Book-Keeping" is the art of recording in the books of account the monetary aspect of commercial and financial transactions".

R.N. Carter defines book-keeping as "the science and art of correctly recording in books of account all those business transactions that result in the transfer of money or money's worth".

In the words of "A.J. Favell, "Book-keeping is the recording of the financial transactions of a business in a methodical manner so that information on any point in relation to them may be quickly obtained".

According to L.C. Cropper, "Book-keeping is the science of recording transactions in money or money's worth in such a manner that, at any subsequent date, their nature and effect may be clearly understood and, when required, a combined statement of their result may be prepared".

From the above definitions, it is clear that book-keeping is the process of recording business transactions in appropriate books of account in a systematic manner so as to ensure the availability of financial information on any point of the business, particularly about the profit or loss and the financial position of the business.

Essential Aspects or Features of Book-Keeping:

Book-keeping has certain essential features. They are:

(i) Book-keeping is the recording of only business transactions (i.e., only those activities of a business which, generally, result in transfer of money or money's worth between the business and the persons dealing with the business, and which affect the financial position of the business).

(ii) It is the recording of only the monetary or financial aspects of business transactions.

(iii) It is the recording of business transactions in terms of money.

(iv) It is the recording of business transactions in a set of books known as books of account or account books.

(v) It is the recording of business transactions in the books of account in a systematic manner in accordance with the principles or rules laid down by accountancy.

(vi) The recording of business transactions in the books of account is intended to ensure that financial information on any matter or point of the business, particularly about the profit or loss and the financial position of the business, is readily available.

(vii) **Book-keeping covers certain processes, viz., identifying the business transactions to be recorded, measuring those business transactions in terms of money, recording the identified and measured business transactions in the book or books of original entry, classifying, i.e., grouping of entries of like nature into appropriate heads or accounts periodically by posting the entries in the book or books of original entry to the book of final entry, called the ledger. This process also includes the balancing of ledger accounts and even the preparation of the trial balance from the ledger account balances at the end of the year.**

(viii) The scope of book-keeping is narrow, because it is concerned only with the recording of business transactions in the books of account, i.e., only with the maintenance of books of account.

(ix) In practice, book-keeping seems to be less important than accounting. But the importance of book-keeping cannot be denied. **Just as a finished product cannot be produced without raw-materials, accounting work of preparation of financial statements cannot be done without the necessary accounting information provided by book-keeping. That means, book-keeping is an important branch of accounting. In fact, book-keeping is regarded as the foundation of accounting.**

ACCOUNTING

Definition and Meaning of Accounting:

The American Institute of Certified Public Accountants (AICPA) has defined accounting as "the art of recording, classifying and summarising 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".

According to the American Accounting Association (AAA), "Accounting is the process of identifying, measuring and communicating economic information to permit informed judgements and decisions by users of the information".

In the words of Robert N. Anthony "Accounting system is a means of collecting, summarising, analysing and reporting in monetary terms information about the business.

In the words of Arnold W. Johnson, "Modern accounting has been called the language of business. Its responsibility is applying a thorough knowledge of the theory of accounting, i.e., generally accepted principles of accounting, to the practical field of