INTRODUCTION TO ACCOUNTING

Introduction

The main aim of a business is to earn profit. For earning profit, the businessman will either purchase the goods in one market at a certain price and sell it in another market at higher price or will convert the raw materials into finished products or sell it to the different customers at a price which will give him some percentage of profit on cost of production. However he will be anxious at the end of the year to find out whether his goods taken together have been sold at a profit or at a loss and what is the financial position on a particular date. Moreover in big business information is required for planning, control, evaluation of performance and decision making. This information can be provided only when business transactions are recorded, classified and summarized properly.

In order to achieve the above purposes it would be necessary to record business transactions according to well devised system. Book-keeping (in elementary stage) and accounting (in advanced stage) is the name given to such a system.

Meaning of BOOK-KEEPING

Bookkeeping is the recording of financial transactions. Transactions include sales, purchases, income, receipts and payments by an individual or organization. Bookkeeping is usually performed by a bookkeeper. The purpose of bookkeeping is to keep the management and the owners informed about the financial health of the company. **Book-keeping, in this way, may be defined as the science and art of identifying and recording accounting transactions systematically in the proper books of accounts.**

"Book- keeping is the art of recording business transactions in a systematic manner." A.H. Rosenkamph.

"Book- keeping is 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." R.N.Carter

"Book-keeping is the art of recording in the books of accounts the monetary aspect of commercial or financial transactions." North Cott

Objectives of Book- keeping:

- Book- keeping provides a permanent record of each transactions.
- Soundness of a firm can be assessed from the records of assets and abilities on a particular date.
- Entries related to incomes and expenditures of a concern facilitate to know the profit and loss for a given period.

- It enables to prepare a list of customers and suppliers to ascertain the amount to be received or paid.
- It is a method gives opportunities to review the business policies in the light of the past records.
- Amendment of business laws, provision of licenses, assessment of taxes etc are based on records.

Meaning of ACCOUNTING

The systematic recording, reporting, and analysis of financial transactions of a business. The person in charge of accounting is known as an accountant, and this individual is typically required to follow a set of rules and regulations, such as the Generally Accepted Accounting Principles. Accounting allows a company to analyze the financial of the business, and look at statistics such as net profit. Thus accounting is a wider term and
includes the recording, classifying and summarising of business transactions in term of money, the preparation of financial reports, the analysis and interpretation of these reports for the information and guidance of management.

The main purpose of accounting is to ascertain profit or loss during a specified period, to show financial position of the business on a particular date and to have control over the firm‘s property. Accounting is a discipline which records, classifies, summarises and interprets financial information about the activities of a concern so that intelligent decisions can be made about the concern.

The American Accounting Association defines accounting as: "the process of identifying, measuring and communicating economic information to permit informed judgments and decisions by users of the information!

The American Institute of Certified Public Accountants (AICPA) has defined the Financial Accounting as "the art of recording, classifying and summarizing in a significant manner in terms of money transactions and events which in part, at least of a financial character and interpreting the results thereof."

In the words of Smith and Ashburne, "accounting is a means of measuring and reporting the results of economic activities."

In the opinion of Bierman and Derbin, "Accounting may be defined as the identifying, measuring, recording and communicating of financial information."

From the above the following attributes of accounting emerge:

a) It is the art of recording business transactions.
b) It is the art of classifying business transactions.
c) The transactions or events of a business must be recorded in monetary terms.

d) It is the art of summarising financial transactions.

i. It is the art of analysis and interpretation of these transactions.

ii. The results of such analysis must be communicated to the persons who are to make decisions or form judgements.

Objectives of ACCOUNTING

Accounting is an information system that measures business activities, processes information into reports and communicates the reports to decision makers. A key product of this information system is a set of financial statements—the documents that report financial information about an entity to decision makers. The main objects of accounting are:

1. To ascertain whether the business operations have been profitable or not - Accounting helps is ascertaining the net profit earned or loss suffered on account of carrying the business. This is done by keeping a proper record of revenues and expenses of a particular period. The profit and loss account is prepared at the end of a period and if the amount of revenue for the period is more than the expenditure incurred in earning that revenue, there is said to be a profit. In case the expenditure exceeds the revenue, there is said to be a loss.
2. To ascertain the financial position of the business - The profit and loss account gives the amount of profit or loss made by the business during a particular period. However, it is not enough. The businessman must know about his financial position i.e., where he stands; what he owes and what he owns? This objective is served by the balance sheet or position statement.

3. Top generate information - Accounting these days has taken upon itself the task of collection, analysis and reporting of information at the required points of time to the required levels of authority in order to facilitate rational decision making.

Functions of ACCOUNTING

The main functions of accounting are:

1. Systematic record of business transactions - The primary function of accounting is to keep a systematic record of financial transaction - journalisation, posting and preparation of final statements. The purpose of this function is to report regularly to the interested parties by means of financial statements.

2. Protecting the property of the business - The second function of accounting is to protect the property of business from unjustified and unwanted use. The accountant thus has to design such a system of accounting which protect its assets from an

unjustified and unwanted use.

3. Communicating results to interested parties - Accounting is the language of business. Various transactions are communicated through accounting. There are many parties - owners, creditors, government, employees etc, who are interested in knowing the results of the firm. The fourth function of accounting is to communicate the results to interested parties. The accounting shows a real and true position of the firm of the business.

4. Compliance with legal requirements - The another function of accounting is to devise such a system as will meet the legal requirements. Under the provision of law, a business man has to file various statements e.g., income tax returns, returns for sales tax purpose etc. Accounting system aims at fulfilling the requirements of law. Accounting is a base, with the help of which various returns, documents, statements etc., are prepared.

Branches of ACCOUNTING

1. **General Accounting or Financial Accounting** - is concerned with the recording of transactions for a business or other economic unit and the periodic preparation of statements from these records.

2. **Cost Accounting** - emphasizes the determination and the control of costs particularly the costs of manufacturing processes and of the manufactured products.

Management Accounting

3. **Management Accounting** - concerned with the application of appropriate techniques and concepts in processing the historical and projected economic data of an entity, to assist management in setting up reasonable economic objectives and in making rational decisions towards the attainment of these objectives.

DISTINCTION BETWEEN BOOK-KEEPING AND ACCOUNTING

Book-keeping is 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. A book-keeper may be responsible for keeping all the financial records of a business or only a minor segment such as maintenance of the customer‘s accounts in a departmental store.

On the other hand, Accounting is primarily concerned with the design of the system of records, the preparation of reports based on the recorded data, the interpretation of the reports and finally communicating the results of the interpretation to persons who are interested in such results.

The main difference between Book-keeping and Accounting are as follows:

Bookkeeping	Accounting
Bookkeeping is routine work and is largely concerned with development and maintenance of accounting records. It is the "how" of accounting.	Accounting is abstract and theoretical. It is concerned with the "why", in other words the reason or justification for any action that's implemented.
Bookkeeping is a part of accounting. It is mainly a mechanical aspect of recording, classifying and summarising transactions.	Accounting is a four-stage process of recording, classifying, summarizing and the interpretation of the financial statements.
The process of bookkeeping does not require any analysis.	Accounting uses bookkeeping information to interpret the data and then compiles it into reports to present to management.
It records incoming transactions (received payments from customers, etc.) and outgoing transactions (paying for specific bills on the correct time, etc).	They usually deliver the business results in the form of reports. Management can see whether the company is successful or not and with the help of the analysis they can see where the problems come from in case of negative results.
There are two basic kinds of bookkeeping: single entry bookkeeping and double entry bookkeeping.	The accounting department also does preparations of a Company's budgets and plans loan proposals.

Advantages of ACCOUNTING

The following are the main advantages of accounting:

- **Assistance to management:** Accounting provides information to the management to enable it to do its work properly. Such information helps in the Planning, Decision making and controlling.

- **Comparative study:** A systematic record enables a business to compare one year's results with those of other years and locate significant factors leading to the change if any.
- **Evidence in the court:** Systematic record of transactions is often treated by the courts as good evidence.
- **Replacement of memory:** it provides records which will furnish information as and when desired and thus it replaces human memory.
- **Settlement of taxation liability:** if accounts are properly maintained it will be of great assistance to the businessman in settling the income tax and sale tax liability.
- **Sale of business:** accounts help in ascertaining the proper purchase price in case the businessman is interested to sell his business.

Disadvantages of ACCOUNTING

- **Financial accounting is of historical nature**: Net effect of transactions is recorded in financial accounting which has happened in past. These accounts is just postmortem of all events of business in past .These record does not help for future planning and other managerial decisions.

- **Financial accounting deals with overall profitability:** Accounts of business are made by a way which shows only overall profitability .It does not shows net profit per product , or per department or according to job.

- **Absence of full disclosure of facts**: In financial accounting we record only those activities and transactions which we can show or describe in money. There are many other facts of business which are non financial and non monetary like efficient management, demand of products of firm , good relations in industry , good working environments which can not be known by financial accounting .

- **Financial reports are interim report of business**: Financial statements made by financial accounting is the interim report of firm's all business work but financial position and profitability which are shown in it is not fully true . Due to adopting cost concept, all transactions are recorded on it real cost but by changing in the time; it is the need of time to adjust cost of assets and liabilities according to inflation of market.

- **Incomplete knowledge of costs**: From cost point of view, financial accounting is incomplete. In financial accounting, accountant does not calculate each and every product's total cost. So, financial accounting does not help to determine the price of product of business.

- **No provision of cost control**: Financial accounting does not help business organization for controlling the cost. Because, there is no provision of controlling cost in it. In financial accounting, we write cost, if we paid any expenses. Thus there is no provision of improvement in financial accounting. Except this, there is no any other

way to inspect all expenses.

- **Financial statements are affected from personal judgment**: Many events of financial statements are affected from personal judgment of accountant. Method of calculating depreciation, rate of provision of doubtful debts and stock valuation method are decided by accountant. Thus, financial statements do not show true and fair view of business.

Basic Accounting Terms:

i. **Business Transactions:** It is an economic event that relates to a business entity. It can be a purchase of goods, collection of money, payment to creditors for goods and expenses. An event must be capable of being measured in monetary terms and related to business enterprise in terms of economic consequence.

ii. Assets: These are economic resources of an enterprise that can be usefully expressed in monetary terms. Assets are things of value used by the business in its operations. For example, Departmental Store owns a fleet of trucks, which is used by it for delivering food stuff; the trucks, thus, provides economic benefits to the enterprise.

iii. Capital: Investment by the owners for the use in the firm is known as capital. Owner‘s equity is the

ownership claim on total assets. It is equal to total assets minus total external liabilities: **E=A-L** this is also called residual interest. Owner's equity is equal to capital.

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

v. **Revenues:** These are the amounts the business earns by selling it products or providing services to customers. These are called 'sales revenues'. Other items and sources of revenues common to many businesses are: sales, fees, commission, interest, dividends, royalties, rent received, etc.

vi. **Expenses:** These are costs incurred by a business in the process of earning revenues. Generally, expenses are measured by the cost of assets consumed or services used during an accounting period. The usual items of expenses are: depreciation, rent, wages, salary, interest, costs of heat, light and water, telephone, etc.

vii. **Expenditure:** Expenditure is the amount of resources consumed. Usually, it is of long term in nature. Therefore, its benefit is to be derived in future. *For example*: capital expenditure.

viii. **Loss:** Loss is the gross decreases in the assets or gross increases in the liabilities. It is the excess of expenses over revenues. It represents reduction in owners' equity due to inability of the firm to recover the assets used in the business. For example, a firm spends Rs. 70,000 and generates revenue of Rs. 60,000 there is a loss of Rs. 10,000 which represents non-recovery of assets consumed in doing business.

ix. **Income**: Income is the increase in the net worth of the organization either from business activity or other activities. Income is a comprehensive term, which includes profit also. In accounting income is the positive change in the wealth of the firm over a period of time.

x. **Profit:** Profit is the excess of revenues over expenses during an accounting year. It increases the owner's equity.

xi. **Gains**: Gain is the change in the equity (net worth) arising from change in the form and place of goods and holding of assets over a period of time whether realized or unrealized. It may either be of capital nature or revenue nature or both.

xii. **Drawings:** It is the amount of cash or other assets withdrawn by the owner for his personal use.

xiii. **Purchases:** Purchases are total amounts of goods procured by a business on credit and for cash, for use or sale. In a trading concern, purchases are made of merchandise for resale with or without processing. In a manufacturing concern, raw materials are purchased, processed further into finished goods and then sold. Purchases may be cash purchases or credit purchases.

xiv. **Stock:** Stock (inventory) is a measure of something on hand-goods, spares and other items-in a business. It is called stock on hand. In a manufacturing company, closing stock comprises raw materials, semi-finished goods and finished goods on hand on the closing date. Similarly, opening stock (beginning inventory) is the amount of stock at the beginning of the accounting year.

xv. **Debtors/Accounts Receivable**: Debtors (accounts receivable) are persons and/or other entities who owe to an enterprise an amount for receiving goods and services on the credit.

xvi. **Creditors/Accounts Payable:** Creditors (accounts payable) are persons and/or other entities who have to be paid by an enterprise an amount for providing the enterprise goods and/ or services on credit.

ACCOUNTING PRINCIPLES

There are general rules and concepts that govern the field of accounting. These general rules—referred to as basic accounting principles and guidelines—form the groundwork on which more detailed, complicated, and legalistic accounting rules are based. For example, the Financial Accounting Standards Board (FASB) uses the basic accounting principles and guidelines as a basis for their own detailed and comprehensive set of accounting rules and standards.

The phrase "generally accepted accounting principles" (or "GAAP") consists of three important sets of rules: (1) the basic accounting principles and guidelines, (2) the detailed rules and standards issued by FASB and its predecessor the Accounting Principles Board (APB), and (3) the generally accepted industry practices.

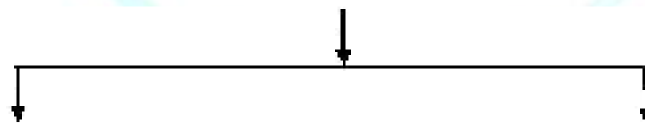
GAAP is exceedingly useful because it attempts to standardize and regulate accounting definitions, assumptions, and methods. Because of generally accepted accounting principles we are able to assume that there is consistency from year to year in the methods used to prepare a company's financial statements. And although variations may exist, we can make reasonably confident conclusions when comparing one company to another, or comparing one company's financial statistics to the statistics for its industry. Over the years the generally accepted accounting principles have become more complex because financial transactions have become more complex.

Accounting Principles can be classified into two categories:

I. Accounting concepts,

II. Accounting conventions.

ACCOUNTING PRINCIPLES



ACCOUNTING CONCEPTS

i. Business entity
ii. Money measurement
iii. Going concern
iv. Cost
v. Dual aspect
vi. Accounting period

ACCOUNTING CONVENTIONS

i. Consistency
ii. Full Disclosure
iii. Conservation
iv. Materiality

vii. Matching
viii. Realization
ix. Objective evidence

ACCOUNTING CONCEPTS

i. **Business Entity Concept:** The accountant keeps all of the business transactions of a sole proprietorship separate from the business owner's personal transactions. For legal purposes, a sole proprietorship and its owner are considered to be one entity, but for accounting purposes they are considered to be two separate entities.

ii. **Monetary measurement:** Money is the only practical unit of measurement that cane be employed to achieve homogeneity of financial data, so accounting records only those transactions which can be expressed in terms of money.

iii. **Going concern:** This accounting principle assumes that a company will continue to exist long enough to carry out its objectives and commitments and will not liquidate in the foreseeable future. If the company's financial situation is such that the accountant believes the company will not be able to continue on, the accountant is required to disclose this assessment. The going concern principle allows the company to defer some of its prepaid expenses until future accounting periods.

iv. **Cost Concern:** From an accountant's point of view, the term "cost" refers to the amount spent when an item was *originally* obtained, whether that purchase happened last year or thirty years ago. For this reason, the amounts shown on financial statements are referred to as *historical* cost amounts. Because of this accounting principle asset amounts are *not* adjusted upward for inflation. In fact, as a general rule, asset amounts are not adjusted to reflect *any* type of increase in value. Hence, an asset amount does not reflect the amount of money a company would receive if it were to sell the asset at today's market value.

v. **Dual aspect:** according to this concept, every financial transaction involves a two-fold aspect, (a) yielding of a benefit and (b) the giving of that benefit. For example: if a business has acquired some asset, it must have given up some other asset such as cash or the obligation to pay for it in future.

vi. **Accounting period concept:** This accounting principle assumes that a company will continue to exist long enough to carry out its objectives and commitments and will not liquidate in the foreseeable future. If the company's financial situation is such that the accountant believes the company will *not* be able to continue on, the accountant is required to disclose this assessment. The going concern principle allows the company to defer some of its prepaid expenses until future accounting periods.

vii. **Matching concept:** This accounting principle requires companies to use the accrual basis of accounting. The matching principle requires that expenses be matched with revenues. For example, sales commissions�' expense should be reported in the period when the sales were made (and not reported in the period when the commissions were paid). Wages to employees are reported as an expense in the week when the employees worked and not in the week when the employees are paid.

viii. **Realization concept:** Under the accrual basis of accounting, **revenues** are recognized as soon as a product has been sold or a service has been performed, regardless of when the money is actually received. Under this basic accounting principle, a company could earn and report $20,000 of revenue in its first month of operation but receive $0 in actual cash in that month. For example, if ABC Consulting completes its service at an agreed price of $1,000, ABC should recognize $1,000 of revenue as soon as its work is done—it does not matter whether the client pays the $1,000 immediately or in 30 days.

ix. **Objective evidence concept:** Objectivity cannotes reliability, trustworthiness and verifiability, which means that there is some evidence in ascertaining the correctness of the information reported. Evidence should be such which will minimize the possibility of error and intentional bias or fraud.

ACCOUNTING CONVENTIONS

I. **Convention of Consistency**: Accountants are expected to be consistent when applying accounting principles, procedures, and practices. Same accounting principles, rules and conventions should be used i.e. these should not change from one year to another. The results of different years will be comparable only when accounting rules are continuously adhered to from year to year.

II. **Convention of full Disclosure**: according to this convention, all accounting statements should be honestly prepared and to that end full disclosure of all significant information should be made. All information which is of material interest to proprietors, creditors and investors should be disclosed in accounting statements.

III. **Convention of Conservatism**: it is a policy of caution or playing safe and had its origin as a safeguard

against possible losses in the world of uncertainty. It compels the businessman to wear a ―risk-proof‖ jacket, for the working rule is: *"anticipate no profits, but provide for all possible losses."*

IV. Convention of Materiality: Whether something should be disclosed or not in the financial statements will depend on whether it is material or not. Materiality depends on the amount involved in the transaction**.**

ACCOUNTING EQUATION

The whole of the financial accounting is based on the accounting equation. This can be stated to be that for a firm to operate resources are required and that these resources are to be supplied to the firm by someone. The equation that is the foundation of double entry accounting. The accounting equation displays that all assets are either financed by borrowing money or paying with the money of the company's shareholders.

Thus, the accounting equation is: Assets = Liabilities + Shareholder Equity (capital).

The balance sheet is a complex display of this equation, showing that the total assets of a company are equal to the total of liabilities and shareholder equity. Any purchase or sale by an accounting equity has an equal effect on both sides of the equation, or offsetting effects on the same side of the equation. The accounting equation is also written as:

Liabilities = Assets – Shareholder Equity and Shareholder Equity = Assets – Liabilities.

Rules of Accounting Equation

1. **Regarding Assets**
   Increases in assets are debits and decreases in assets are credits.

2. **Regarding Liabilities**
   Increases in liabilities are credits and decreases in liabilitites are debits.

3. **Regarding Capital**
   Increases in capital are credits and decreases in capital are debits.

4. **Regarding Expenses**
   Increases in expenses are debits and decreases in expenses are credits.

5. Regarding Incomes or Profits
   Increases in Income or Profits are credits and decreases in Incomes or Profits are debits.

DOUBLE ENTRY SYSTEM

The double entry system is based on " Dual concept " which states "for ebery debit ,there is a credit". Every transaction has two sided effects to the same extent and both the effects are recorded under double entry system.
Double Entry system seeks to record every transaction in money or money's worth in its double aspect – the receipt of a benefit by one account and the surrender of alike benefit by another account, the former entry being to the debit of the account receiving the later to the credit of the account surrendering.

The most scientific and reliable method of accounting is the Double Entry System. One must have a clear conception of the nature of the transaction to understand the double-entry system. Every transaction involves two parties or accounts – one account gives the benefit and the other receives it.
It is called a dual entity of transaction.
In every transaction, the account receiving a benefit is debited and the account giving benefit is credited.
The process of keeping account accepting this dual entity i.e. debiting one account for a definite amount of money and crediting the other account for the same amount is called a double-entry system.
Every transaction affects the accounting equation of a business. Dual change may take place between two assets.
For example, machinery purchase in cash.
Here machinery account receives the benefit and the cash account gives the benefit or the amount of decrease in cash will give an increase of machinery for the same amount.
Again this change may take place between two liabilities.
For example; to meet up the claim of a creditor taking a long-term loan.
Here long-term liability is credited abolishing the short term liability of creditor. Besides, this change may take place between assets and liabilities.
For example; furniture purchased on credit.
Here asset is debited for a particular amount and at the same time, an equal amount of liability is also credited.
Since every transaction brings changes in assets for an equal sum of money or asset and liability or liabilities, the transactions are to be recorded according to a double-entry system to know the accurate, position of assets and liabilities of a business concern.
If accounts are maintained under a double-entry system two accounts are affected.
One is debited and another is credited. This is the main principle of the double-entry system.
Mr. Angel invested cash Rs20,000 in his business as capital. This transaction involves two accounts – Cash Account and Capital Account – Angel. For this transaction asset-cash increases for rs.20,000 on one side and on the other side liability increases for Rs.20,000 as capital which is the claim of the owner.
This transaction is to be recorded debiting cash and crediting capital accounts. If the transactions are not recorded in two accounts proper results are not reflected.
Furniture purchased for Rs. 2,000. This transaction involves two accounts – a furniture account

and a cash account.
For this transaction cash decreases for Rs. 2,000 and furniture increases by $2,000. Here, the furniture account is debited and the cash account is credited for Rs2,000 cash.
In another way, the transaction changes only. An element of accounting equation i.e., A = L + P.
It is clear from the above discussion that every transaction is to be recorded in two accounts – one is debited and the other is credited.
The main principle of double-entry system is that for every debit there is a corresponding credit for an equal amount of money and for every credit there is a corresponding debit for an equal amount of money; i.e. for every transaction one account is debited for the amount of transaction and the other account is credited for the equal amount of money.
Therefore, it can be said that the system under which every transaction is accounted in two accounts for the equal amount of money debiting one and crediting the other ignoring no account is called a double-entry system.
Every debit must have a corresponding credit and Vice – Versa. Double-entry Book-Keeping is a system by which every debit entry is balanced by an equal credit entry.

A double-entry bookkeeping system is a set of rules for recording financial information in a financial accounting system in which every transaction or event changes at least two different nominal ledger accounts. It was first codified in the 15th century by Luca Pacioli. In deciding which account has to be debited and which account has to be credited, the golden rules of accounting are used.

This is also accomplished using the accounting equation: Equity= Assets − Liabilities.

The accounting equation serves as an error detection tool. If at any point the sum of debits for all accounts does not equal the corresponding sum of credits for all accounts, an error has occurred. It follows that the sum of debits and the sum of the credits must be equal in value.

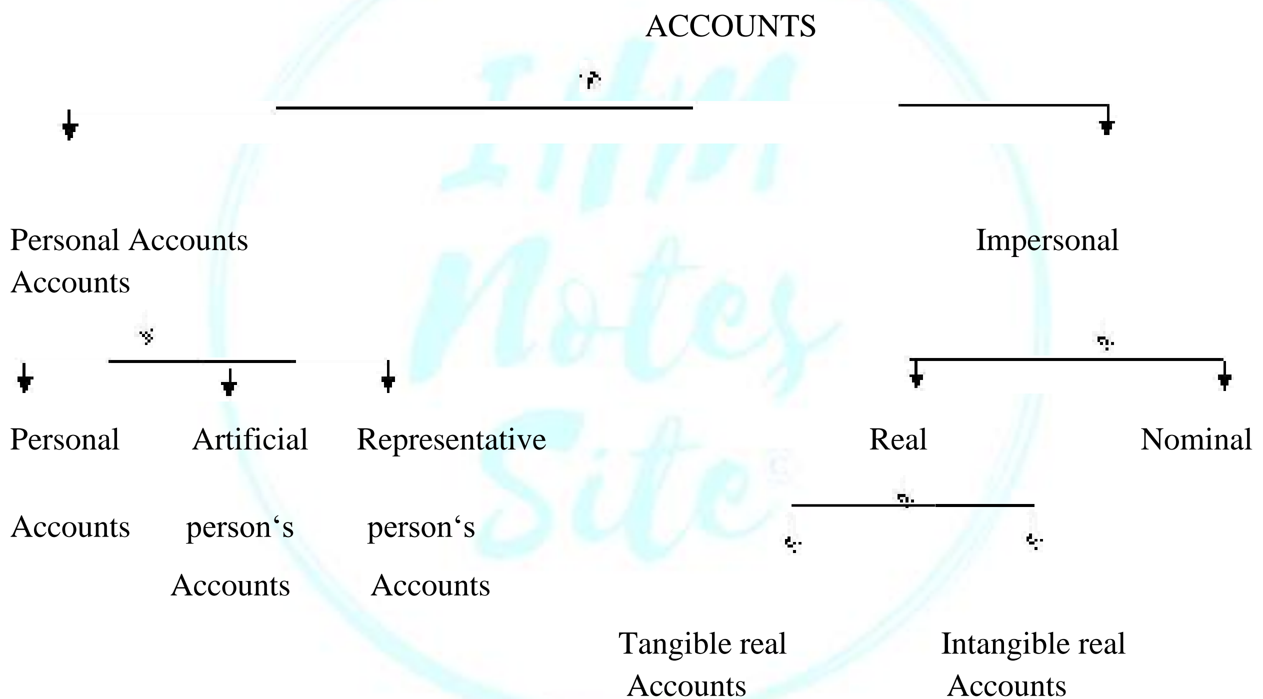
Characteristics of double-entry system are stated below;

Two parties: Every transaction involves two parties – debit and credit. According to the main principles of this system, every debit of some amount creates corresponding credit or every credit creates the corresponding debit for the same amount.
Giver and receiver: Every transaction must have one giver and one receiver.
Exchange of equal amount: The amount of money of a transaction the party gives is equal to the amount the party receives.
Separate entity: Under this system business is treated as a separate entity from the owner. Here the business is considered as a separate entity.
Dual aspects: Every transaction is divided into two aspects. The left side of the transaction debit and the right side is credit.
Results: Under double entry system totality of debit is equal to the totality of credit. In it ascertainment of the result is easy.
Complete accounting system: Double entry system is a scientific and complete accounting

system.
Through this system, the account is kept completely and no party is ignored. In fine it can be said that every transaction must possess these characteristics.
If there is an exception to this complete information will not be available in the books of accounting. As a result, the main objective of accounting will be frustrated.

Types of Accounts

Every business transaction has two aspects i.e., when we receive something and when we give something else in return. For e.g. when we purchase goods for cash, we receive goods and give cash in return. This method of writing every transaction in two accounts is known as Double entry system of accounting. Of the two accounts one account is given debit while the other account if given credit with an equal amount.



- **Personal Account: -** When a transaction is involved with a person or firm it is known as Personal account such as Mr. Roy, Bose & sons, ABC Ltd.co. etc.

  Natural Person's account: Human Beings/Name of the persons are natural persons like Ram, Shyam, Hira lal etc.

  Legal or artificial person : A person created by law is called legal person or artificial person. The name of companies like Reliance Industries Ltd, Ram Lal and sons, Hira lal and brothers are examples of Legal Persons.

  Representative personal account : Outstanding payment to persons are termed as representative personal e.g. outstanding salary to Ram ,Outstanding rent to landlord.

- **Nominal Account: -** All recurring expenses/incomes are known as Nominal Account, such as salary, Rent, Interest etc.

- **Real Account:** - Such type of accounts relate to assets i.e. both tangible and intangible assets, such as Machinery, Furniture, building, goodwill, etc.
  Tangible Assets : the assets that can be touched and felt physically.few examples of Tangible Real accounts are ; Machinery, Furniture, Land and Building.
  Intangible Assets : The assets that cannot be touched or felf physically.Few examples of real accounts are goodwill, patent and trademark etc.

Rules of the Double Entry System

There are separate rules of the double entry system in respect of personal, real and nominal accounts which are discussed below:

- **In case of Personal Account** - Debit the receiver and Credit the giver.

- **In case of Nominal Account-** Debit all expenses and losses and Credit all income and liabilities.

- **In case of Real Accounts -** Debit what comes in and credit what goes out.

Advantages of Double entry system

The following are the main advantages of Double entry system.

- A complete record of the financial transactions is maintained.
- Gives accurate information
- Arithmetical accuracy of the account books can be tested
- Helpful in preventing frauds and errors
- Helpful in ascertaining profit or loss of a particular period
- Financial position can be ascertained
- Makes Helpful in filing accurate claim for loss of stock

Disadvantages of Double entry system

The following are the main disadvantages of this system:

- Number of books have to be maintained which is not suitable for small concerns
- System is very costly
- No guarantee of absolute accuracy of books
- Only qualified person can record the transaction.

Example 1.

1. Opened a bank account in State Bank of India with an amount of Rs. 4, 80,000.

Analysis of transaction: This transaction increases the cash at bank (assets) and decreases cash (asset) by Rs. 4, 80,000.

2. Bought furniture for Rs. 60,000 and cheque was issued on the same day.

Analysis of transaction: This transaction increases furniture e (assets) and decreases bank (assets) by Rs. 60,000.

3. Bought plant and machinery for the business for Rs. 1, 25,000 and an advance of Rs. 10,000 in cash is paid to M/s Ramjee Lal.

Analysis of transaction: This transaction incr eases plant and machinery (assets) by Rs. 1, 25,000, decreases cash by Rs. 10,000 and increases liabilities (M/s Ramjee lal as creditor) by Rs. 1, 15,000.

4. Goods purchased from M/s Sumit Traders for Rs. 55,000. Analysis of transaction: This transaction increases goods (assets) and increases liabilities (M/s Sumit Traders as creditors) by Rs. 55,000.

5. Goods costing Rs. 25,000 sold to Rajani Enterprises for Rs. 35,000. Analysis of transaction: This transaction decreases stock of goods (assets) by Rs. 25,000 and increases assets (Rajani Enterprises as debtors Rs. 35,000) and capital (with the profit of Rs. 10,000)

The final equation as per the above analysis table can be summarised in the form of a balance sheet as under:

Balance Sheet as at.....2015

Liabilities	*Amount Rs.*	*Assets*	*Amount Rs.*
Outsider's Claims (Creditors)	1,70,000	Cash	10,000
Capital	5,10,000	Bank	4,20,000
		Debtors	35,000
		Stock	30,000
		Furniture	60,000
		Plant & Machinery	1,25,000
	6,80,000		6,80,000

In terms of accounting equation

A = L + C

Rs. 6,80,000 = Rs. 1,70,000 + Rs. 5,10,000

In terms of accounting equation A = L + C

Rs. 6,80,000 = Rs. 1,70,000 + Rs. 5,10,00

Account Title	
(Left Side)	*(Right Side)*

Rules of Debit and Credit

All accounts are divided into five categories for the purposes of recording the transactions: (a) Asset (b) Liability (c) Capital (d) Expenses/Losses, and (e) Revenues/Gains.

Two fundamental rules are followed to record the changes in these accounts:

(1) For recording changes in Assets/Expenses (Losses):

I. *"Increase in asset is debited, and decrease in asset is credited."*
II. *"Increase in expenses/losses is debited, and decrease in expenses/ losses is credited."*

(2) For recording changes in Liabilities and Capital/Revenues (Gains):

I. *"Increase in liabilities is credited and decrease in liabilities is debited."*
II. *"Increase in capital is credited and decrease in capital is debited."*
III. *"Increase in revenue/gain is credited and decrease in revenue/gain is debited."*

The rules applicable to the different kinds of accounts have been summarized in the following chart