

CHAPTER- 1: INTRODUCTION OF ACCOUNTING

1. EVOLUTION OF ACCOUNTING: Accounting is a very old concept. It is used by traders from ancient time. The concept of accounting is also explained in VEDAS. According to some historians, the concept of accounting is noticed during barter age. But after evolution of currency, need for separate system of accounting system is felt. In 15th century, a mathematician, named **“FRA LUCAS PACIOLI”** has developed a concept for recording business transactions, which is now known as double entry system. He is recognised as the father of double entry system.

2. BOOK KEEPING: It is a process of recording transactions. Book keeping is an art of recording business transactions in a systematic order. It deals with:

- a) Identification of transactions and events.
- b) Monetary valuation of transactions.
- c) Proper recording of transactions.

3. ACCOUNTING: Accounting is an art of recording, classifying, summarising and interpretation of business transactions. It starts with the end of book keeping.

Objects: The objectives of Accounting are:

- a) Maintaining accounting records
- b) Determining profit or loss by preparing Income Statement.
- c) Determining financial position by preparing Balance Sheet.
- d) Communication of accounting information to its users.

Limitations:

- a) Non- monetary transactions cannot be recorded.
- b) It ignores inflation.
- c) Only historical cost of asset is shown.
- d) It leads to window dressing of balance sheet.

4. BOOK KEEPING VS ACCOUNTING:

BOOK KEEPING	ACCOUNTING
<ul style="list-style-type: none"> a) It is a process of recording transactions. b) It is a basis of accounting. c) It is a mechanical process and so skilled employees are not needed. d) It is a primary process. 	<ul style="list-style-type: none"> a) It is a process of classifying, summarizing and analyzing business transactions. b) It starts after the end of book keeping. c) It is an analytical process, so skilled employees are needed. d) It is a secondary process.

5. ACCOUNTANCY: Accountancy is a branch of study which provides different principles and procedures regarding accounting. It deals with, how to maintain books of accounts and how accounting information are communicated to its various users. It is a complete process which includes both book keeping and accounting.

6. IS ACCOUNTING A SCIENCE OR ART: Accounting is an art of recording, classifying, summarising and interpretation of financial transactions. It is also a science because it is based on some fundamental principles. Hence, accounting is both science and arts.

7. TRANSACTION & EVENT: Transactions means give something and take something in return. In each transaction, each transacting party will gain something and loose something. Event is an occurrence or happening of any incident, which may or may not bring any change in the financial position of a business. Events may or may not measurable in terms of money. Transactions are those events, which satisfy the following two conditions:

- a) It must be measured in terms of money.
- b) It must bring change in financial position.

If any event does not satisfy the above two conditions then it cannot be considered as transactions. It means all transactions are events but all events are not transactions. Events having monetary value is called transaction.

Example of Events:

- a) Stock valuation
- b) Death of manager
- c) Gift, sorry, thank you etc

Example of transactions:

- a) Purchases of goods
- b) Sales of goods
- c) Payment of expenses, etc.

8. TYPES OF TRANSACTIONS:

- **On the basis of currency:** Transactions are of two types:
 - a) **Cash transaction:** When a transaction is completed with the help of cash or cheque, then it is called a cash transaction. In cash transaction, the name of party is not important. Ex- goods sold for cash, wages paid etc.
 - b) **Credit transaction:** When a transaction is completed without immediate cash payment, then it is called a credit transaction. In credit transaction, payment is made on future date. In credit transaction, the name of party is important. Ex- goods sold to Ram on credit etc.
- **On the basis of parties:** Transactions are of two types:

- a) **External transaction:** When transactions takes place with outsiders then it is called an external transaction. Ex- goods sold to Ram for Rs 2,000. Here, Ram is an outsider. Hence, the transaction is called an external transaction.
- b) **Internal transaction:** When transactions takes place within the business concern then it is called an internal transaction. Ex- charging depreciation on assets, creating provision on asset etc.

9. RULES FOR ASCERTAINMENT OF CASH & CREDIT TRANSACTION:

RULE- 1: When the word, **PAID or RECEIVED** is used, then the transaction is called a cash transaction. Example:

- a) Wages paid
- b) Interest received

RULE-2: When the word, **CASH OR CHEQUE OR DRAFT OR BANK** is used, then the transaction is called a cash transaction. Example:

- a) Goods purchased for cash
- b) Sold goods and received cheque

RULE-3: When the word **CASH and NAME OF PARTY** both are given in a transaction, then the transaction is considered as a cash transaction. Example:

- a) Cash paid to Ram
- b) Received cheque from Shyam

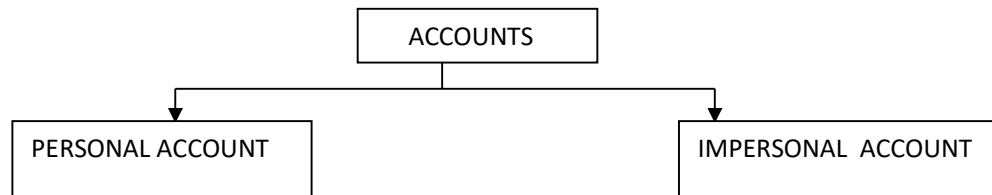
RULE-4: When the word **CASH and NAME OF PARTY** both are absent in a transaction, then the transaction is considered as a cash transaction. Example:

- a) Purchased machinery
- b) Sold goods

RULE-5: When the **NAME OF PARTY** is given but the word CASH is absent then the transaction is called credit transaction. Example:

- a) Goods purchased from Mohan
- b) Furniture purchased from Sohan.

10. MEANING OF DEBIT & CREDIT: Debit & Credit are two words which are used in double entry system. Debit is derived from a Latin word, "DEBERE" or from an Italian word 'Debito'. It is denoted by Dr. It indicates the left hand side of an account. Credit is derived from a Latin word, "CREDERE" or from an Italian word 'credito'. It is denoted by Cr. It indicates the right hand side of an account.

11. CLASSIFICATION OF ACCOUNTS:

Accounts are classified into two categories:

- a) Personal Account
- b) Impersonal Account

12. PERSONAL ACCOUNT: Accounts related to person, organisation, institution & shop are called personal account. Example- Ram, Shyam, Sita, ABC Ltd, School, College, Samsung Ltd, Pantaloon, Lion Club etc.

Personal accounts are classified as:

- a) Natural personal account
- b) Artificial personal account
- c) Representative personal account

According to some experts, personal accounts are classified as:

- a) Debtors
- b) Creditors

Explanations:

- a) **Natural personal account:** Persons come by birth are called natural personal person. It means accounts relating to human being are called natural personal account. Ex- Hari, Sonu etc.
- b) **Artificial personal account:** Artificial persons are those person which are created by human being. It means company, bank, school, hospital, club, shop etc are called are called artificial person. Accounts related to such artificial persons are called artificial personal account. Ex- Tata Ltd, Birla Ltd, St. Xavier college, MBSV school, Medical shop, Sweet Shop, SBI, Rotary club, SSKM hospital, Anandmela electronic shop etc.
- c) **Representative personal account:** Sometimes an account is used in place of a natural person, which is called representative personal account. Example- outstanding expenses, prepaid expenses, accrued income, advance income, capital & drawings.