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**VIRTUAL COACHING CLASSES
ORGANISED BY BOS, ICAI**

**FOUNDATION LEVEL
PAPER 1: PRINCIPLES AND PRATICE OF
ACCOUNTING**

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CHAPTER 2- ACCOUNTING PROCESS

- There are 6 units in total for this chapter
- This chapter mainly deals with the basics to the recording, classifying and summarizing steps of accounting.
- **Recording-** As discussed earlier, this is the first step to record the transactions as and when it happens in a separate book called the JOURNAL.
- The process of recording the transaction as a first hand information is termed as- Passing an ENTRY.
- In an entry- there are 2 sides to the entry which is termed as credit and the other to be debit.
- The two sides are termed using the words- Accounts (A/c).
- In general parlance, the term credit and debit means either (+) or (-)



Unit 1- Basic accounting procedures- Journal

- Accounting works Based on the double entry system of book keeping meaning for every transaction , there will be two accounts identified. One of them will debited and the other will be credited.
- Double entry system of Book keeping has been given out by a famous mathematician Luca Pacioli which means that every debit has a corresponding credit.
- To identify which has to be debited and which account to be credited we need to go for classification of the accounts.
- The accounts- (i.e) identifying from the transaction- for each transaction there will be 2 accounts- the **classification of the accounts** is important to understand whether an account to be debited or credited. Classification of accounts can be of two types
 - Traditional approach
 - Modern or Accounting equation approach
- What ever is the method that is followed the answer will remain the same.

Unit 1- Basic accounting procedures- Journal

- TRADITIONAL APPROACH
 - PERSONAL ACCOUNTS- Natural persons, Artificial persons, Representative legal persons
 - IMPERSONAL ACCOUNTS- Real accounts and nominal accounts.
- Accounts which start with the name of the persons is classified as a **personal account**.
- **Natural persons** refer to the names of *debtors, creditors, owner- who are all real people*
- **Artificial persons** refer to the name of the *companies which are separate entities and not real people*.
- **Representative legal persons** refers to the name of the persons to whom something specific payable or receivable- *Outstanding, Prepaid, Accrued or advance received*.
- *Examples – Rent outstanding, Commission receivable, Bank account, Bank FD, Creditors, Debtors*
- GOLDEN RULE OF ACCOUNTING- PERSONAL ACCOUNTS-
 - **DEBIT THE RECEIVER AND CREDIT THE GIVER**

Unit 1- Basic accounting procedures- Journal

- **Real Accounts** refers to those accounts or assets which can be seen, felt and touched. Since they do not involve the name of persons- they are classified under *impersonal accounts*
- *Examples are- Land and building, Plant and machinery, Cash, Inventory.*
- GOLDEN RULE OF ACCOUNTING- PERSONAL ACCOUNTS-
 - **DEBIT WHAT COMES IN AND CREDIT WHAT GOES OUT**
- **Nominal Accounts** refers to expenses/losses and incomes/gains which are taken in to the Profit and loss accounts. Since they do not involve the name of persons- they are classified under *impersonal accounts*
- *Examples are- Rent, electricity, profit on sale of assets.*
- GOLDEN RULE OF ACCOUNTING- PERSONAL ACCOUNTS-
 - **DEBIT ALL EXPENSES AND LOSSES AND CREDIT ALL INCOMES AND GAINS**

Unit 1- Basic accounting procedures- Journal

- Accounting equation approach- Under this approach the entire items in the accounting are classified into the following-
 - Assets- Which will bring in an economic benefit to the business.
 - Liabilities- which involves an outflow of money from the business
 - Capital- refers to the amount contributed by the owner in to the business and it is considered as internal liability of the business towards its owners.
 - Expenses- Refers to the day to day payments made to maintain the business.
 - Incomes- Refers to the regular receipt from the sale of goods/services
- Basic accounting equation is – **ASSETS (Dr)= LIABILITIES (Cr) + CAPITAL (Cr)**
- Generally – the above mentioned accounts have some normal balances which reflects the nature of the account. It is ***based on the normal balance, we need to decide whether it will be debited or credited under this approach.***

Unit 1- Basic accounting procedures- Journal

- It is important for the students to understand this approach and the normal balances to be clearly understood since further levels of accounts, will need this practical understanding method. Hence, the normal balances is the key. If you have to increase an account- go as per the normal balance , to decrease the account- reverse of the normal balance.

Accounts	Normal balance	TO increase	To decrease
Assets	Debit	Debit	Credit
Liabilities	Credit	Credit	Debit
Capital	Credit	Credit	Debit
Expenses/losses	Debit	Debit	Credit
Incomes/gains	Credit	Credit	Debit
Drawings	Debit	Debit	Credit

Unit 1- Basic accounting procedures- Journal

- Steps to pass a journal entry-
 - First read the transaction to identify the two parts- For example- Payment of rent in cash Rs. 1000- involves “Rent” and “Cash”
 - The second step is to add Accounts as suffixes to the names of identified items– ***Rent A/c and Cash A/c.***
 - The third step is to select the method of classification of the accounts to pass the ***entry.***
 - If the above example is done using the ***traditional approach-*** Then ***Rent A/c*** is classified as ***Nominal account.*** So as per the **golden accounting rule- debit all the expenses and losses** since Rent is an expense for the business.
 - Coming to ***Cash A/c,*** it is a ***real account.*** And in this transaction – ***the cash goes out since payment is made*** and hence as per ***the golden accounting rule- credit what goes out, so cash A/c is credited.***
 - How to Pass an entry – final step– Debit account shall appear on the top and the credit account will be written in the second line.
 - There shall be 5 columns for the journal entry- Date | Particulars | Ledger folio(LF) | Debit (Rs) | Credit (Rs)

Unit 1- Basic accounting procedures- Journal

- Narration has to be written in one line after each entry- starting with the words- “Being”
- The words DR shall be written after the first account in the first line and the in second line the words “To” before the account to be written.
- The amounts also shall be recorded in the first line for Debit values and in the second line for the credit values.

Date	Particulars	LF	Debit (Rs)	Credit (Rs)
03/07	Rent A/c DR To Cash A/c (Being the rent paid in cash)		1000	1000

Unit 1- Basic accounting procedures- Journal

- Steps to pass a journal entry-
 - First read the transaction to identify the two parts- For example- Payment of rent in cash Rs. 1000- involves “Rent” and “Cash”
 - The second step is to add Accounts as suffixes to the names of identified items– **Rent A/c and Cash A/c.**
 - The third step is to select the method of classification of the accounts to pass the **entry.**
 - If the above example is done using the **accounting equation approach-** Then **Rent A/c** is classified under **expenses.** So as per the **normal balance of expenses, rent A/c will have a debit balance.** Rent is an expense for the business and thereby **payment of rent means recording it in books so it increases.** To increase a debit balance account- you need to **debit it once again. So Rent A/c is to be debited.**
 - Coming to **Cash A/c,** it is an **asset with debit balance.** And in this transaction – **the cash goes out since payment is made** and decreases. So to **decrease an account- do the opposite of the regular balance-** So **Cash A/c is credited** (Dr is normal balance).
 - Finally to pass an entry it is the same as in slide no 9. Please refer.

Unit 1- Basic accounting procedures- Journal

- Formulas that is included as part of this unit, very important from the examination perspective. Which can be used for reference perspective-
- Formula 1- $\text{Assets} = \text{Liabilities} + \text{Capital}$
- $\text{Assets} = \text{Fixed Assets}$ (Land and Building+ Plant and machinery)+ **Current Assets** (Inventory + Trade receivables+ cash in hand and at bank)
- $\text{Liabilities} = \text{Long term Liabilities}$ (Loan from Banks+ Debentures)+ **Current Liabilities** (Trade payables+ Bills payable)
- Capital means the capital brought into the business by the owner. There are two capitals- opening capital (beginning of the year), Closing capital (at the end of the year), additional capital (introduced during the year). Drawings is taking money for personal use. Hence it is deducted from Capital.
- $\text{Opening capital} + \text{profit (during the year)} + \text{Additional capital} - \text{drawings} = \text{Closing capital}$.
- $\text{Opening capital} - \text{loss (during the year)} + \text{Additional capital} - \text{drawings} = \text{Closing capital}$.

Unit 1- Basic accounting procedures- Journal

- Using the above formula- we need to solve Illustration 2 and 3 of the textbook. It is quite easy. Do try.
- Illustration 4 will be tried in the class. Illustration 5 & 7 to be tried once after the journal concepts is clear.
- Illustration 6 is very important which is based on the classification.
- from the Examination Perspective, this is to make you understand the first step of Recording- JOURNALISING IN THE BOOKS.
- There will a full question of some other chapter which will require you to pass entries. But this chapter as such will not have any weightage- it is for you to understand and get a hold.

Unit 2-Ledgers

- Second step in the process of accounting is to prepare the ledgers- or basically the T format accounts.
- This refers to the classification of the similar transactions under each account head.
- Now the process of transferring the journal entries into the ledger are termed as “POSTING”.
- As you all know there are Profit and loss account accounts and Balance sheet accounts.
- Once after the left hand side and right hand side balance is totaled, the difference will be called the balancing figure.

Unit 2-Ledgers

- The left hand side of the account is debit , the words Dr. are written on the left side top column and the words Cr. are written on the right hand side top column.
- Accounts on the debit side to start with letters “TO” and on the credit side with letters “BY”
- The closing balance which is the balancing figure is written as Balance C/f (carried forward) can be either a debit or credit balance.
- Always find the opening balance after closing the account, which is nothing but the opposite side of the closing balance figure written with the words Balance B/d (brought down)
- There are 3 illustrations- so can work out the same for practice. They are extension of the Journal entries.



THANK YOU