

INTRODUCTION

The need for a system by which man might keep a record of his business transactions with his fellowmen was felt early in the history of civilization. Many and varied methods were used to record the transactions. But book-keeping had its beginning at a comparatively recent date and it has passed through many phases since its institution. With the development of commerce it has attained a position of great importance and today the whole fabric of modern commerce rests on book-keeping.)

Definition of book-keeping: The word book of books mean books of accounts and keeping implies maintaining in proper form and order. Thus book-keeping may be defined as the art of recording business transactions in books in a regular and systematic manner. It has been defined by different experts as :—

1. "The science and art of correctly recording in books of account all those business transactions that result in the transfer of money's worth."
2. "The art and science of recording business transactions in such a systematic way as a trader may know the result of his trade at the end of a certain period and may also prove the accuracy of such record."
3. "The science and art of correctly recording business dealings in a set of books with a view to having a permanent record of transactions and the financial result thereof."

It should be noted from the above definitions that Book-keeping primarily deals in the art of recording transactions in books.

Some Important Terms

Before attempting to learn the art or science of Book-keeping it will be better to clarify some of the terms that will have to be used again and again.

Transaction: Any dealing between two persons or things is a transaction. It may relate to purchase and sale of goods, receipt and payment of cash and rendering of service by one party to another. Transaction is of two kinds — Cash Transaction and Credit Transaction. When cash is paid or received as a result of an exchange, the transaction is said to be a cash transaction. When the payment or receipt of cash is postponed for a future date, this transaction is said to be credit-transaction.

Business: It includes any activity undertaken for the purpose of earning profit e.g., banking business, an insurance business, a merchandise business etc., etc.

Proprietor: He is the owner of a business. He invests capital in it, gives his time and attention to it. He is entitled to receive the profit or bear loss arising out of it.

Capital: The amount with which the trader starts his business or the amount which is actually invested in the business at any given time is known as capital. This is the owner's financial interest or holding in the business and is represented by the value of net assets.

Drawings: The cash or goods taken away by the proprietor from the business for his personal use are called his drawings.

Purchases: Goods purchased are called purchases. When the goods are purchased for cash they are called cash purchases but if they are purchased for which payment will have to be made at some future date it is known as credit purchases.

Purchases Returns: If goods purchased are found defective or unsatisfactory, they are sometimes returned to the persons from whom they were purchased or to suppliers are called purchases returns or returns outwards.

Sales: Goods sold are called sales. When goods are sold for cash they are called cash sales, but when they are sold without having received payment, they are credit sales.

Sales Returns: If a person to whom goods have been sold finds that they are defective or unsatisfactory and returns them, are called sales returns or returns inwards.

Trade Discount: It is a rebate or allowance from the scheduled price granted by the seller to the buyer. Trade discount is usually granted in the following circumstances:—

- (a) When selling to a fellow trader.
- (b) When the buyer is an old customer.
- (c) When sales are made in bulk.
- (d) As a custom of trade.

Cash Discount: It is deduction or allowance allowed by a creditor to a debtor. If a person pays his debit before the due date of payment the recipient may grant him an allowance for doing so. This allowance is known as cash discount.

Commission: It is a form of remuneration for services rendered by one person to another.

Expenditure: An expenditure takes place when assets or service is acquired.

Expense: It means an expenditure whose benefit is finished or enjoyed immediately such as salaries, rent etc. Distinction between expense and expenditure is that the benefit

Summary *note*

of the former is consumed by the business in present whereas in latter case benefit will be available for future activities of the business

Account: A summarised record of transactions relating to a person or thing is called an account.

Debtor (Account Receivable): A person who owes money to another is a debtor. When we say that we owe Mr. Rahim Rs. 200, we mean that we have received from Mr. Rahim Rs. 200 which we have to repay. We stand as debtor to Mr. Rahim for Rs. 200. It is also termed as Account Receivable.

Creditor (Account Payable): A person who pays-out-something or to whom money is owing is a creditor. It is also termed as Account Payable.

Assets: These are the things of value possessed by a trader such as building, land, machinery, furniture, etc.

Liabilities: They are the debts due by a business to its proprietor and others.

✓ **Voucher:** Any written evidence in support of a business transaction is called a voucher. When a ream of paper is bought from a stationer, he gives a Cash Memo. The Cash memo is a voucher for the payment. when wages for the month are paid to the peon, a receipt is taken from him. The receipt serves as a voucher for the payment.

Goods(Merchandise): It includes all merchandise commodities which are purchased by the business for selling.

Stock (Inventory): Goods or merchandise on hand, that is goods remaining unsold, is called, stock, stack-in-trade or inventory.

✓ **Equity:** A claim which can be enforced against the assets of the firm is called equity. In other words, the rights to properties are called equities. Equities are of two types : the right of creditors and the right of owners. The equities of creditors represent debts of the business and are called liabilities. The equities of the owners is called capital, proprietorship or owner's equity.

OBJECTS OF BOOK-KEEPING

The main objects of book-keeping can be said to be the following :-

1. It must provide a permanent and systematic record of all business transactions.
2. The periodical results as to profits or loss should be readily and accurately ascertainable.
3. To enable financial data to be supplied for management of the business.
4. The entries and narrations should clearly show the nature and effect of each transaction and the combined result of all taken together.

DOUBLE ENTRY BOOK-KEEPING



The double entry system of book-keeping owes its origin to an Italian merchant named Lucas Pacioli who wrote the first book on double entry book-keeping entitled "De computis et Scripturis". It was published in Venice in 1544. All modern methods of accounting are simply adaptation of the system invented by that ancient pioneer.

The double Entry Theory of book-keeping can be defined as the system of recording transactions having two fundamental aspects—one involving the receiving of a benefit and the other to giving the benefit—in the same set of books.

In this theory, as the two fold aspects of each transaction are recorded, the name "Double Entry" has been given to this system.

Every transaction involves two fold aspects e.g., an aspect of receiving and an aspect of giving. One, who receives is a debtor (Dr) and one who gives is a creditor (Cr). Under the double entry system both the aspects of giving and receiving are recorded in terms of accounts. The account which receives the benefit is debited and the account which gives the benefit is credited. It is the ultimate result of this system that every debit must have a corresponding credit and vice versa and on any particular day the total of the debit entries and the credit entries on the various accounts must be equal.

Advantages of Double Entry System

The main advantages of Double Entry Theory of book-keeping are as follows:-

1. Trial Balance can be drawn up on any day to prove the arithmetical accuracy of record.
2. The nominal sides of the transactions being recorded; it is possible to prepare Trading and Profit and Loss Account from which the Gross Profit and Net Profit made by the business during a particular period can be easily ascertained.
3. As all personal accounts of debtors and creditors as well as real accounts are kept, it is possible to prepare a Balance Sheet.
4. The transactions being recorded in the most scientific and systematic way, it gives the most reliable information of business.
5. It prevents fraud by rendering any alteration in any account more difficult.
6. It enables the trader to compare the different items, such as sales, purchases, opening stock and closing stock of one period with similar items of preceding period and the trader may thus know whether his business is progressing or not.

Disadvantages of Double Entry System

The following are the main disadvantages of this system:

1. This system requires the maintenance of a number of books of accounts which is not practical in small concerns.

2. The system is costly because a number of records are to be maintained.
3. There is no guarantee of absolute accuracy of the books of account inspite of agreement of the trial balance.

SINGLE ENTRY vs. DOUBLE ENTRY

Single entry system is a system of book-keeping which does not follow the double entry system and as such, does not record or give effect to the two fold aspect of each and every transaction. Under this system of book-keeping, generally a Cash Book and books to record personal accounts are only maintained. It is not really a system because under this method there may be no record of some of the transactions and only partial record of some others. As such, Single Entry System of book-keeping is not perfect and frauds and mistakes can hardly be detected. We shall discuss the system in greater detail later, but suffice it to say here that proper results cannot be obtained by its use.

ADVANTAGES OVER THE SINGLE ENTRY SYSTEM

1. In Double Entry System of book-keeping as two fold aspect of each transaction is recorded in the books, a Trial Balance can be prepared to prove the arithmetical accuracy of the transactions. No Trial Balance can be prepared under Single Entry System and hence accuracy of books cannot be proved.
2. In Double Entry System the risk of fraud or its non discovery is less. But under Single Entry System chances of fraud or mistakes remaining undetected are very high.
3. In Double Entry System a Trading and Profit and Loss Account can be prepared very easily. The proprietor can know the profit earned or loss suffered by his business. Under Single Entry System no Trading and Profit and Loss Account can be prepared scientifically and, hence, the proprietor will have no firm idea of profit earned or loss suffered.
4. In Double Entry System a Balance Sheet can be prepared from the books of account. The correctness of Assets and Liabilities can be proved. The Balance Sheet, called statement of affairs in a Single Entry System is prepared in an unsatisfactory manner. The Assets and Liabilities are not proved from records. Hence the correctness of Assets and Liabilities cannot be relied upon.

MEANING OF ACCOUNTING

Accounting is defined as "the art of recording, classifying and summarising in terms of money transactions and events of a financial character and interpreting the results thereof."

An analysis of the definition brings out the following functions of accounting.

1. **Recording:** This is the basic function of accounting. Recording means to put the transaction to writing in the books of accounts. It is essentially concerned with not only

ensuring that all business transactions of financial character are in fact recorded but also that they are recorded in an orderly manner. Recording is done in the book - "Journal". This book is further sub-divided in various subsidiary books such as cash journal, purchases journal, sales journal etc. The number of subsidiary books to be maintained will be according to the nature and size of the business.

2. **Classifying:** Classification is the process of grouping of transactions or entries of one nature at one place. The work of classification is done in the book termed as "Ledger".
3. **Summarising:** This involves presenting the classified data in a manner which is understandable and useful to management and other interested parties. This involves the preparation of at least two statements: (i) trading and profit and loss account and (ii) balance sheet.
4. **Deals with financial transactions:** Accounting records only those transactions and events in terms of money which are of financial character. Transactions which are not of a financial character are not recorded in the books of accounts. For example if a company has got a team of dedicated and efficient employees, it is of great use to the business but since it is not of a financial character and capable of being expressed in terms of money, it will not be recorded in the books of the business.
5. **Interprets:** This is final function of accounting. Accounting not only creates data through recording, classifying and summarising events but also uses them by interpreting. The recorded financial data is interpreted in a manner that the end users can make a meaningful judgment about the financial conditions and profitability of the business operations. The data is also used for preparing the future plans.

BRANCHES OF ACCOUNTING

Accounting has three main forms of branches, viz, Financial accounting, Cost accounting, and Management accounting. These forms of accounting have been developed to serve different types of objectives.

1. **Financial accounting:** It is the original form of accounting. It is mainly confined to the preparation of financial statements for the use of outsiders like creditors, banks and financial institutions etc. The chief purpose of financial accounting is to calculate profit or loss made by the business during the year and exhibit financial position of the business as on a particular date.
2. **Cost accounting:** Function of cost accounting is to ascertain the cost of a product and to help the management in the control of cost.
3. **Management accounting:** It is accounting for the management i.e., accounting which provides necessary information to the management for discharging its functions. It is the reproduction of financial accounts in such a way as will enable the management to take decisions and to control activities.

✓ FUNCTIONS OF ACCOUNTING

Accounting has the following functions:

1. **Record Keeping Function:** The primary function of accounting is to keep a record of financial transactions -- 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. **Protect Business Properties:** The second function of accounting is to protect property of the business from unjustified and unwarranted use. The accountant has to design such a system of accounting which will protect its assets from an unjustified and unwarranted use.
3. **Legal Requirement Function:** The third function of accounting is to devise a system as will meet the legal requirements. Under the provision of law, a business is required to file various statements e.g., income-tax returns, returns for sales-tax purposes. Accounting system aims at fulfilling the requirements of law. Accounting is a basis on the help of which various returns, documents, statements etc., are prepared.
4. **Communicating the results:** Accounting is the language of business transactions are communicated through accounting. There are many parties like creditors, government, employees etc, who are interested in knowing the results of business. The fourth function of accounting is to communicate the results to interested parties. Accounting shows a real and true position of the firm or the business.

✓ PARTIES INTERESTED IN ACCOUNTING INFORMATION

There are a number of parties who are interested in the accounting information relating to business. Accounting is the language employed to communicate the information of a concern to such parties. The following are the groups who like to receive the accounting information.

1. **Owners:** The owners provide funds or capital for the organization. They want to know whether their funds are being properly used or not. They need accounting information to know the profitability and the financial position of the concern in which they have invested their funds. The financial statements prepared from time to time from accounting information tell them the profitability and the financial position.
2. **Management:** Management is the art of getting things done through other people. Management should ensure that the subordinates are doing work properly. Accounting information is an aid in this respect because it helps a manager in appraising the performance of the subordinates. Accounting information provides the eyes and ears to management.
3. **Creditors:** Creditors are the persons who supply goods on credit or bank lenders of money. They want to know the financial position of a concern before giving or granting credit. They want to be sure that the concern will not experience difficulties.

making their payment in time i.e., liquid position of the concern is satisfactory. To know the liquid position, they need accounting information.

4. **Employees:** Employees are interested in the financial position of a concern they serve particularly when payment of bonus depends upon the size of the profits earned. The demand for wage rise, bonus, better working conditions etc. depends upon the profitability of the concern and in turn depends upon financial position. For these reasons, this group is interested in accounting information.

5. **Investors:** The prospective investors who want to invest their money in a business, want to know the progress and prosperity of the business, before investing their amount. A study of the financial statements will help them in this respect. They can know the profitability and the financial position of the organization by making a study of the accounting information given in the financial statements of the organization.

6. **Government:** The Government is interested in the accounting information because it wants to know earnings or sales for a particular period for purpose of taxation. Government also needs accounting information for compiling statistics concerning business which in turn helps in compiling national accounts.

7. **Consumers:** Consumers need accounting information for establishing good accounting control so that cost of production may be reduced with the resultant reduction of the prices of goods they buy. Sometimes, prices for some goods are fixed by the Government, so it needs accounting information to fix reasonable prices so that consumers are not exploited.

SYSTEMS OF ACCOUNTING

There are basically two systems of accounting:

1. **Cash system of accounting:** It is a system in which accounting entries are made only when cash is received or paid. No entry is made when a payment or receipt is merely due. For example the rent for December 1985 has not been paid till January 10th 1986. Under cash basis, rent expense for the month of December will not be recorded as payment has not been made. Government system of accounting is mostly on the cash system.

2. **Accrual system of accounting:** It is a system in which accounting entries are made on the basis of amount having become due for payment or receipt. This system recognises the fact that if a transaction or an event has occurred, its consequences cannot be avoided and therefore, should be brought into book in order to present a meaningful picture of profit earned or loss suffered.

BOOK-KEEPING Vs. ACCOUNTING

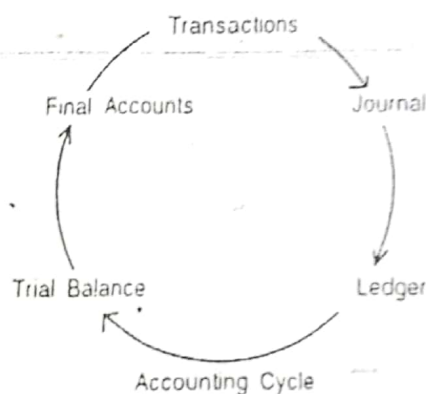
There is some confusion over the distinction between "book-keeping" and "accounting". This is due to the fact that two are related and there is no universal accepted line of demarcation between them.

In general, book-keeping is the recording of business data in the prescribed manner; this is the first phase. Much of the work of the book-keeper is clerical in nature. The sphere of accounting starts where the sphere of book-keeping ends. Accounting is primarily concerned with the design of the system of records, the preparation of reports, and the interpretation of the reports. Accountants often direct and review the work of book-keepers.

✓ Accounting Cycle

It refers to a complete sequence of accounting procedures which are required to be repeated in same order during each accounting period. Accounting cycle includes:

- (a) *Recording.* First, all transactions should be recorded in the Journal or Books of Original Entry known as subsidiary books as and when they take place.
- (b) *Classifying.* All entries in the Journal or Books of Original Entry should be posted to the appropriate ledger accounts to find out at a glance the total effect of all such transactions in a particular account.
- (c) *Summarising.* Last stage is to prepare the trial balance and final accounts with a view to ascertaining the profit or loss made during a trading period and the financial position of the business on a particular date.



All these successive stages will be discussed in detail one by one in the subsequent pages.

QUESTIONS

Theoretical:

1. What is the theory of double entry book-keeping?
2. Define book-keeping, what are its objects?
3. Give a short explanation of Double Entry book-keeping. Name three advantages which the system of book-keeping has.