Accountancy Notes PDF

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Theory Base of Accounting

(Class – 11 / Chapter- 2)

Accounting aims at providing information about the financial performance of a firm to its various users. Accounting information must be reliable and comparable based on some consistent accounting policies, principles, and practices. This calls for developing a proper theory base of accounting.
The importance of accounting theory need not.be over-emphasized as no discipline can develop without a sound theoretical base. The theory base of accounting consists of principles, concepts, rules, and guidelines developed over a period of time to bring uniformity and consistency to the process of accounting and enhance its utility to different users of accounting information.

Generally Accepted Accounting Principles (GAAP)
Generally Accepted Accounting Principles refers to the rules or guidelines adopted for recording and reporting business transactions in order to bring uniformity in the preparation and presentation of financial statements. These principles are also referred to as concepts and conventions.

Systems Of Accounting

1. **Single entry system of accounting:** also known as the pure entry system of accounting, in the single entry system only a cash book is maintained by the business. All the cash related entries or transactions are recorded in the cash book. The system doesn't follow a double-entry system and no other ledgers are maintained. The transactions are personal in nature and are simply recorded in a rough book. A few other prominent features of the single input system are,

- As a single cash book is held, personal and business transactions will be recorded together.
- This system will disregard both real and nominal accounts.
- Profits and losses can be determined, but we cannot represent the financial state or position of the organization.
- As no trial balance is prepared, the arithmetic accuracy of the accounts may not be verified.

2. **Double-entry system of accounting:** this is the most followed, traditional and conventionally accepted system of accounting across the globe. In this accounting system, the financial transactions are recorded in the books of accounts and they always affect dual accounts i.e., debit and credit. It is also known as the debit and credit rule. Some features of the system are as follows:

- The three types of accounts are kept in this system – real accounts, nominal accounts and personal accounts.
- The mathematical correctness of the financial statements is verified by preparing the trial balance.
- The system does not involve a lot of changes.
- It prepares the balance sheet which will reflect the financial situation of the organization.
- Ease of detecting fraud and errors in this dual entry system.

Basis Of Accounting

1. Cash Basis of Accounting: Under the cash basis, entries in the book of accounts are made when cash is received or paid and not when the receipt or payment becomes due. This system is incompatible with the matching principle, which states that the revenue of a period is matched with the cost of the same period.

2. Accrual Basis of Accounting: Under the accrual basis, revenue and costs are recognized in the period in which they occur rather than when they are paid. A distinction is made between the receipt of cash and the right to receive cash and payment of cash and the legal obligation to pay cash. Thus, under this system, the monetary effect of a transaction is taken into account in the period in which they are earned rather than in the period in which cash is actually received or paid by the enterprise.

Difference between accrual basis of accounting and cash basis of accounting

Basis	Accrual Basis of Accounting	Cash Basis of Accounting
Recording of transactions	Both cash and credit transactions are recorded.	Only cash transactions are recorded.
Profit or Loss	Profit or Loss is ascertained correctly due to the complete record of transactions.	Correct profit/loss is not ascertained because it records only cash transactions.
Distinction between Capital and Revenue items	This method makes a distinction between capital and revenue items.	This method does not make a distinction between capital and revenue items.
Legal position	This basis is recognized under the Companies Act.	This basis is not recognized under the Companies Act.

Accounting-Standards (AS): The ICAI has issued the following standards:

- AS 1 Disclosure of Accounting Policies
- AS 2 Valuation of Inventories
- AS 3 Cash Flow Statements
- AS 4 Contingencies and Events Occurring after the Balance Sheet Date
- AS 5 Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies
- AS 6 Depreciation Accounting AS 7 Construction Contracts
- AS 8 Accounting for Research and Development
- AS 9 Revenue Recognition
- AS 10 Accounting for Fixed Assets
- AS 11 The Effects of Changes in Foreign Exchange Rates
- AS 12 Accounting for Government Grants

- AS 13 Accounting for Investments
- AS 14 Accounting for Amalgamations
- AS 15 Accounting for Retirement Benefits in the Financial Statements of Employers (recently revised and titled as Employee Benefits')
- AS 16 Borrowing Costs
- AS 17 Segment Reporting
- AS 18 Related Party Disclosures
- AS 19 Leases
- AS 20 Earnings Per Share
- AS 21 Consolidated Financial Statements
- AS 22 Accounting for Taxes on Income
- AS 23 Accounting for Investments in Associates in Consolidated Financial Statements
- AS 24 Discontinuing Operations
- AS 25 Interim Financial Reporting AS 26 Intangible Assets
- AS 27 Financial Reporting of Interests in Joint Ventures AS 28 Impairment of Assets
- AS 29 Provisions. Contingent Liabilities and Contingent Assets

IFRS International Financial Reporting Standards

This term refers to the financial standards issued by the International Accounting Standards Board (IASB). It is the process of improving financial reporting internationally to help the participants in the various capital markets of the world and other users.

IFRS Based financial Statements

Following financial statements are produced under IFRS:

1. Statement of financial position: The elements of this statement are
    1. Assets
    2. Liability
    3. Equity
2. Comprehensive Income statement: The elements of this statement are
    1. Revenue
    2. Expense
3. Statement of changes in Equity
4. Statement of Cash flow
5. Notes and significant accounting policies

Main difference between IFRS and IAS (Indian Accounting Standards)

1. IFRS are principle based while IAS are rule based.
2. IFRS are based on Fair Value while IAS are based on Historical Cost.

Classification Of Accounts/ Types Of Accounts

Business transactions are recorded under different accounts. Thus, an account is an individual and a formal record of a person, firm, assets, liabilities, goods, incomes, company and expenses. However, we need to classify accounts for better understanding and differentiation. Accounts can be classified as per the traditional approach as follows:

- Personal Accounts
  - Natural personal accounts: example- Capital A/c, Debtors A/c, Creditors A/c
  - Artificial personal accounts: example- Axis Bank, ICICI Bank, Maruti Suzuki Co., Shyam Enterprise Pvt. Ltd.
  - Representative personal accounts: Example- Outstanding Salary A/c, Pre-paid Rent A/c.
- Impersonal Accounts
  - Real Accounts
    - Tangible real accounts such as Plant A/c, Furniture and Fixtures A/c
    - Intangible real account such as Goodwill, patents, copyrights
  - Nominal Accounts: related to expenses, losses, incomes and gains.

Rules For Debit And Credit

There are certain rules which need to be followed for the process of debit and credit. They are mentioned below.

- **Personal Account**
  Debit the Reciever
  Credit the Giver
- **Real Account**
  Debit what Comes in
  Credit what Goes out
- **Nominal Account**
  Debit all Expenses and Losses
  Credit all Incomes and Gains
- **Representative Personal Account**
  Debit the Debtor
  Credit the Creditor

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CLASSES