
UNIT 13 ACCOUNTING CONCEPTS AND APPLICATION

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13.0 OBJECTIVES

After going through this unit you should be able to:

- describe the process of accounting;
- explain the objectives of financial reporting;
- explain and apply the basic concepts of accounting in your health system; and
- distinguish between the types of accounts and their applications.

13.1 INTRODUCTION

It is somewhat unusual to begin a text on Financial Management with a discussion of Accounting principles and concepts and one may ask “Why do so here?” The answer quite simply, is that if hospital managers are to understand the value of financial management for improved hospital operations and feel comfortable in its use, they must have a full understanding of the financial workings of the hospital. The best way to obtain such an understanding is to begin with a review of the definition of Accounting, the objectives of financial reporting and the related Accounting concepts and

conventions. An understanding of these is critical to the knowledgeable use of financial data, for they determine the nature and character of the financial information that hospital managers receive. Therefore, if managers are to be able to understand, evaluate property and utilise financial data. They must first understand the objectives that guide the collection and presentation of these data.

13.2 WHAT IS ACCOUNTING?

Accounting is often called the language of business. The basic function of any language is to serve as a means of communication. In this context, the purpose of Accounting is to communicate or report the results of business operations and its various aspects. Accounting has been variously defined and one commonly accepted definition is “Accounting is the art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which are in part at least, of financial. character and interpreting the results thereof.”

Another less restrictive definition is “Accounting is the process of identifying, measuring and communicating economic information to permit informed judgments and decisions by the uses of information.”

13.3 ACCOUNTING PROCESS

The process of Accounting involves the following steps:

- a) Data creation and collection which provide the raw material for Accounting. The data collected is ‘historic’ in the sense that it refers to events that have already taken place.
- b) Recording of data, which is done in accordance with the laid down concepts and conventions of Accounting as stated later in this unit. A large number of transactions or events have to be entered in the books of original entry (journals and ledgers.) The recording and processing of information usually accounts for a substantial part of total accounting work. The processing methods employed for recording may be manual, mechanical or electronic computer are generally taking to the primary method of recording and processing.
- c) Data evaluation is regarded as the most important activity in Accounting these days. Evaluation of data includes controlling the hospital activities with the help of budgets and standard costs, analysing the flow of funds and analysing the accounting information for decision making purposes by choosing among alternative courses of action. The analytical and interpretation work of Accounting may be for internal or external use and may range from snap answers to elaborate reports. Data evaluation has another dimension and can be known as auditor work which focuses on verification of transactions as entered in the books of Account and authentication of financial statements. Auditing will be discussed separately as a different unit in this block.
- d) Data reporting consists of two parts-external and internal. External reporting refers to the communication of financial information viz.

earnings financial and funds position about the hospital to outside parties i.e. trustees, Government agencies and regulatory bodies. Internal reporting is concerned with the communication of results of financial analysis and evaluation to hospital management committee for decision making purposes.

13.4 OBJECTIVES OF FINANCIAL REPORTING

The objectives of financial reporting are as follows:

- a) It should provide information that is useful to present and potential investors, creditors, and other users in making national investment credit and similar decision.
- b) It should provide information about the economic resources of an enterprise, the claims to those resources and the effects of transactions, events and circumstances that change resources.
- c) It should provide information about an enterprise's financial performance during a period.
- d) It should provide information about how an enterprise obtains and spends cash, about its borrowing and repayments, about its capital transactions and about other factors that may affect its liquidity or solvency.
- e) It should provide information that is useful to managers and directors in making decision in the interest of the enterprise and the owners.

The emphasis of these objectives is on the information needs of external users common to for profit publicly held enterprise or corporate sectors. However, you may substitute the terms hospital for enterprise and community for owners and the objectives are equally applicable.

13.5 ACCOUNTING CONCEPTS

Any activity that you perform is facilitated if you have a set of rules to guide your efforts. When you are driving your vehicle you keep to the left, you are in fact following a standard traffic rule. Without the drivers of vehicles following this rule, there would be chaos on the roads. Similarly without general rule or guides for the recording of business activities and the preparation of accounts, it would be impossible for the accounting information to be understandable and useful to various parties. There would be no common basis for recording transactions. Similar transactions if accounting records are to be understood, must agree at least in terms of Accounting records, similar results. If this end is to be attained certain basic concepts must be used in preparing accounting records. Accounting practices have developed over a long period of years. During the time accountants have accepted and adopted several basic concepts as fundamental guides that define the manner in which accounts should be kept.

Presented below are basic accounting principles or concepts, with which hospital managers should be familiar and that they should understand if they are to be able to use accounting data and reports. It should be pointed out that accounting is not a static art, these principles are continually being questioned and reviewed and in time will be modified. However, they are

currently the accepted guidelines, and while the reader may question the propriety of some, he or she should at this point accept and attempt to understand these principles so as to be able to utilise accounting data and financial reports knowledgeably.

Earlier, we had described accounting as the language of business. As with language, accounting has many dialects. There are differences in terminology. In dealing with the framework of accounting theory, one is confronted with a serious problem arising from differences in terminology. A number of words and terms have been used by different writers to express and explain the same idea or notion. Thus, confusion abounds in the literature in so far as the theoretical framework is concerned. The various terms used for describing the basic ideas are: concepts, postulates, propositions, basic assumptions, underlying principles, fundamentals, conventions, doctrines, rules, etc. Although each of these terms is capable of precise definition, general usage by the profession of accounting has served to give them loose and overlapping meanings. The same idea has been described by one author as a concept and by another as a convention. To take another instance, the idea implied in Conservatism has been labelled by one author as a (modifying) convention, by another as a principle and yet by another as a doctrine. The wide diversity in terminology to express the basic framework can only serve to confuse the learner.

Without falling into the trap of this terminological maze, we are explaining below some widely recognised ideas and we call all of these concepts. We do feel, however, that some of these ideas have a better claim to be called 'concepts', while the rest should be called 'conventions'. Fundamental accounting concepts are broad general assumptions with underlie the periodic financial accounts of business enterprises. The reason why some of these ideas should be called concepts is that they are basic assumptions and have a direct bearing on the quality of financial accounting information. The alteration of any of the basic concepts (or postulates) would change the entire nature of financial accounting.

Business Entity Concept

In accounting we make a distinction between business and the owner. All the records are kept from the viewpoint of the business rather than from that of the owner. An enterprise is an economic unit separate and apart from the owner or owners. As such, transactions of the business and those of the owners should be accounted for and reported separately. In recording a transaction the important question is how does it affect the business? For example, if the owner of a shop were to take cash from the cash box for meeting certain personal expenditure, the accounts would show that cash had been reduced even though it does not make any difference to the owner himself. Similarly, if the owner puts cash into the business, he has a claim against the business for capital brought in.

This distinction can be easily maintained in the case of a limited company because a company has a legal entity (or personality) of its own. Like a natural person it can engage itself in economic activities of producing, owning, managing, storing, transferring, lending, borrowing and consuming commodities and services. Distinction, however, is difficult in the case of

partnership, and even more so in the case of one-man business, accounting still maintains separation of business and owner. This implies that owner's personal and household expenses or obligations (e.g., expenditure on food, clothing, entertainment, debts, mortgages, etc.) will not appear in the books of account. It may be clarified that it is only for accounting purposes that partnerships and sole proprietorships are treated as separate and apart from the owners though law does not make such distinction. A creditor would be justified in looking to both the business assets and the private estate of the owner for satisfaction of his claim. One reason for this distinction is to make it possible for the owners to have an account of the performance from those who manage the enterprise. The managers are entrusted with funds supplied by owners, banks and others; they are responsible for the proper use of the funds. The financial accounting reports are designed to show how well this responsibility has been discharged.

Money Measurement Concepts

In accounting, only those facts which can be expressed in terms of money are recorded. As money is accepted not only as a medium of exchange but also as a store of value, it has a very important advantage since a number of widely different assets and equities can be expressed in terms of a common denominator. Without these adding heterogeneous factors like five buildings, ten machines, six trucks will not have much meaning.

While money is probably the only practical common denominator and a yardstick, we must realise that this concept imposes two severe limitations. In the first place, there are several facts which, though vital to the business, cannot be recorded in the books of account because they cannot be expressed in money terms. For example, the state of health of the Managing Director of a company who has been the key contributor to the success of business is not recorded in the books. Similarly, the fact that the Production Manager and the Chief Internal Auditor are not on speaking terms, or that a strike is about to begin because labour is dissatisfied with the poor working conditions in the factory, or that a competitor has recently taken over the best customer, or that it has developed a better product and so on will not be recorded even though all these events are of great concern to the business.

From this standpoint, one could say that accounting does not give a complete account of the happenings in the business. You will appreciate that all these have a bearing on the future profitability of the company.

Secondly, use of money implies that a rupee today is of equal value to a rupee ten years back or ten years later. In other words, we assume stable or constant value of rupee. In the accounts, money is expressed in terms of its value at the time an event is recorded. Subsequent changes in the purchasing power of money do not affect this amount. You are perhaps aware that most economies today are in inflationary conditions with rising prices. The value of a rupee of 1980's has depreciated to an unbelievably low level in the 90s. Most accountants know fully well that purchasing power of rupee does change but very few recognise this fact in accounting books and make allowance for changing price level. This is so despite the fact that accounting profession has devoted considerable attention to this problem and numerous suggestions have been made to account for the effects

of changes in the purchasing power of money. In fact, one of the major problems of accounting today is to find means of solving the measurement problem, that is, how to extend the quality and the coverage of meaningful information. It will be desirable to present in a supplementary analysis the effect of price level changes on the reported income of the business and the financial position.

Continuity Concept

Accounting assumes that the business (an accounting entity) will continue to operate for a long time in the future unless there is good evidence to the contrary. The enterprise is viewed as a **going concern**, that is, as continuing in operation, at least in the foreseeable future. The owners have no intention nor have they the necessity to windup or liquidate its operations.

This assumption is of considerable importance for it means that the business is viewed as a mechanism for adding value to resources it uses. The success of the business can be measured by the difference between output values (sales or revenues) and input values (expenses). Therefore, all unused resources can be reported at cost rather than at market values.

The assumption that the business is not expected to be liquidated in the foreseeable future, in fact, establishes the basis for many of the valuations and allocations in accounting. For example, depreciation (or amortisation) procedures rest upon this concept. It is this assumption which underlies the decision of investors to commit capital to enterprise. The concept holds that continuity of business activity is the reasonable expectation for the business unit for which the accounting function is being performed. Only on the basis of this assumption can the accounting process remain stable and achieve the objective of correctly recording and reporting on the capital invested, the efficiency of management, and the position of the enterprise as a going concern. Under this assumption neither higher current market values nor liquidation values are of particular importance in accounting. This assumption provides a basis for the application of **cost** in accounting for assets.

However, if the accountant has good reasons to believe that the business, or some part of it, is going to be liquidated or that it will cease to operate (say within a year or two), then the resources could be reported at their current values (or liquidation values).

Cost Concept

The resources (land, buildings, machinery, property rights, etc.) that a business owns are called assets. The money values that are assigned to assets are derived from the cost concept. This concept states that an asset is worth the price paid for or cost incurred to acquire it. Thus, assets are recorded at their original purchase price and this cost is the basis for all subsequent accounting for the assets. The assets shown on the financial statements do not necessarily indicate their present market worth (or market values). This is contrary to what is often believed by an uninformed person reading the statement or report. The term 'book value' is used for amount shown in the accounting records.

In case of certain assets the accounting values and market values may be similar; cash is an obvious example. In general, the longer an asset has been

owned by the company the lesser, are the chances that the accounting value will correspond to the market value.

The cost concept does not mean that all assets remain on the accounting records at their original cost for all time to come. The cost of an asset that has a long but limited life is systematically reduced during its life by a process called 'depreciation' which will be discussed at some length in a subsequent unit. Suffice it to say at this point that depreciation is a process by which the cost of the asset is gradually reduced (or written off) by allocating a part of it to expense in each accounting period. This will have the effect of reducing the profit of each period. In charging depreciation the intention is not to change depreciation equal to the fall in the market value of the asset. As such, there is no relationship between depreciation and changes in market value of the assets. The purpose of depreciation is to allocate the cost of an asset over its useful life and not to adjust its cost so as to bring it closer to the market value.

You must be wondering as to why assets are shown at cost even when there are wide differences between their costs and market values. The main argument is that the cost concept meets all the three basic criteria of **relevance, objectivity and feasibility**.

Accrual Concept

The accrual concept makes a distinction between the receipt of cash and the right to receive it, and the payment of cash and the legal obligation to pay it. In actual business operations, the obligation to pay and the actual movement of cash may not coincide. The accrual concept recognises this distinction. In connection with the sale of goods, revenue may be received

- (i) before the right to receive arises, or
- (ii) after the right to receive has been created.

The accrual concept provides a guideline to the accountant as to how he should treat the cash receipt and the rights related thereto. In the former case the receipt will not be recognised as the revenue of the period for the reason that the right to receive the same has not yet arisen. In the latter case the revenue will be recognised even though the amount is received in the subsequent period.

Similar treatment would be given to expenses incurred by the firm. Cash payments for expenses may be made before or after they are due for payment. Only those sums which are due and payable would be treated as expenses. If a payment is made in advance (i.e. it does not belong to the accounting period in question) it will not be treated as an expense, and the person who received the cash will be treated as a debtor until his right to receive the cash has matured. Where an expense has been incurred during the accounting period but no payment has been made, the expense must be recorded and the person to whom the payment should have been made is shown as a creditor.

Concept of Conservatism

The concept of conservatism, also known as the concept of prudence, is often stated as "anticipate no profit, provide for all possible losses". This

means an accountant should follow a cautious approach. He should record lowest possible value for assets and revenues, and the highest possible value for liabilities and expenses. According to this concept, revenues or gains should be recognised only when they are realised in the form of cash or assets (usually legally enforceable debts) the ultimate cash realisation of which can be assessed with reasonable certainty. Further, provision must be made for all known liabilities, expenses and losses whether the amount of these is known with certainty or is at best an estimate in the light of the information available. Probable losses in respect of all contingencies should also be provided for. A contingency is a condition or a situation, the ultimate outcome of which –gain or loss–cannot be determined accurately at present. It will be known only after the event has occurred (or has not occurred). For example, a customer has filed a suit for damage against the company in a court of law. Whether the judgment will be favourable or unfavourable to the company cannot be determined for sure. Hence, it will be prudent to provide for likely loss in the financial statements. As a consequence of the application of this concept, net assets are more likely to be understated than overstated, and income is more likely to be overstated than understated. Based on this concept is the widely advocated practice of valuing inventory (stock of goods left unsold) at cost or market price whichever is lower? You will note that this convention, in a way, modifies the earlier cost concept. It should be stated that the logic of this convention has been under stress recently; it has been challenged by many writers on the ground that it stands in the way of fair determination of profit and the disclosure of true ad fair financial position of the business enterprise. The concept is not applied as strongly today as it used to be in the past. In any case, conservatism must be applied rational Y as over-conservatism may result in misrepresentation.

Materiality Concept

There are many events in business which are trivial or insignificant in nature. The cost of recording and reporting such events will not be justified by the usefulness of the information derived. Materiality concept holds that items of small significance need not be given strict theoretically correct treatment. For example, a paper stapler costing Rs. 30 may last for three years. However, the effort involved in allocating its cost over the three-year period is not worth the benefit than can be derived from this operation. Since the item obviously is immaterial when related to overall operations, the cost incurred on it may be treated as the expense of the period in which it is acquired. Some of the stationery purchased for office use in any accounting period may remain unused at the end of that period. In accounting, the amount spent on entire stationery would be treated as expense of the period in which the stationery was purchased, notwithstanding the fact that a small part of it still lies in stock. The value (or cost) of the stationery lying in stock would not be treated as an asset and carried forward as a resource to the next period. The accountant would regard the stock lying unused as immaterial. Hence, the entire amount spent on stationery would be taken as the expense of the period in which such expense was incurred.

Where to draw the line between material and immaterial events is a matter of judgment and common sense. There are no hard and fast rules in this respect. Whether a particular item or occurrence is material or not,

should be determined by considering its relationship to other items and the surrounding circumstances. It is desirable to establish and follow uniform policies governing such matters.

Consistency Concept

In practice, there are several ways to record an event or a transaction in the books of account. For example, the trade discount on raw material purchased may be deducted from the cost of goods and net amount entered in the books, or alternatively trade discount maybe shown as the income with full cost of raw material purchased entered in the books. Similarly, there are several methods to charge depreciation (which is a decrease in the value of assets caused by wear and tear, and passage of time) on an asset or of valuing inventory. The consistency concept requires that once a company has decided on one method and has used it for some time, it should continue to follow the same method or procedure for all subsequent events of the same character unless it has a sound reason to do otherwise. If for valid reasons the company makes any departure from the method it has been following so far, then the effect of the change must be clearly stated in the financial statements in the year of change.

You will appreciate that much of the utility of accounting information lies in the fact that one could draw valid conclusions from the comparison of data drawn from financial statements of one year with data of the other year. Compar ability is essential so that trends or differences may be identified and evaluated. Inconsistency in the application of accounting methods might significantly affect the reported profit and the financial position. Further, inconsistency also opens the door for manipulation of reported income and assets. The comparability of financial information depends largely upon the consistency with which a given class of events are handled in accounting records year after year.

Periodicity Concept

Although the results of operations of a specific enterprise can be known precisely only after the business has ceased to operate, its assets have been sold off and liabilities paid off, the knowledge of the results periodically is also necessary. Those who are interested in the operating results of business obviously cannot wait till the end. The requirements of these parties therefore force the accountant to report for the changes in the wealth of a firm for short time periods. These time periods in actual, practice vary, though a year is the most common interval as a result of established business practice, tradition and government requirements. Some firms adopt calendar year, some others financial year of the government. But more and more firms are changing to the 'natural' business year the end of which is marked by relatively lower or lowest volume of business activity in the twelve-month period. The custom of using twelve-month period is applied only for external reporting. The firms usually adopt a shorter span of interval, say one month or three months, for internal reporting purposes.

The allocation of long-term costs and the difficulties associated with this process directly stem from this concept. While matching the earnings and the cost of those earnings for any accounting period, all the revenues and all the costs relating to the year in question have to be taken into account

irrespective of whether or not they have been received in cash or paid cash. Despite the difficulties that arise in locations and adjustments, short-term reports (i.e., yearly reports) are of such importance to owners, management, creditors, and other interested parties that the accountant has no option but to resolve such difficulties. Obviously, the utility of the periodic financial statements outweighs the difficulties.

While going through all these concepts, probably you have developed a feeling that they come in conflict with each other. You are right. We illustrate this by considering some of these concepts in the context of valuation of business properties. Suppose, a firm acquired a piece of land in 2017 for a price of Rs.6,00,000. Factory premises were constructed in 2018 and operations commenced in 2019. The firm has been successful in achieving desired profit for the past year. The Balance Sheet (a statement of assets and liabilities) for the year 2019 is being prepared and 'Land' is required to be valued. The estimated current market price of this land is Rs. 60,00,000.

Should you recommend that the land be valued at Rs. 60 lakhs? The answer is 'no' obviously. Land would be carried on the Balance Sheet at its original cost of Rs.6,00,000 only. This decision is supported by several of the concepts discussed in this section. In the first place, the stability of purchasing power of money implied in the **money measurement concept** prevents us from recognising accretion in values as a result of changing price levels. Then, the **realisation concept** will not allow unrealised profits to be included as long as land is held by the company and not sold away. You may note that the **continuity** or **going concern** concept makes any possible market value of land irrelevant for balance sheet because the firm has to continue in business and land will be needed by it for its own use. In this connection, it could be argued that if land were shown on the balance sheet at its estimated current market value, the owner might decide to discontinue the business, sell the land and retire. The principle of **objectivity** is now introduced into the argument. It can be easily seen that in a situation like this the cost of acquisition of land at Rs.6,00,000 in 2000 is the objective fact because it is based on a transaction that actually took place and this objective evidence is capable of being verified. In contrast, the estimate of current market value figure may be suspect. It raises many questions. Do you have a market quotation for an identical plot of land? Has a similar plot of land been sold recently and can we pick it up as verifiable evidence of the current market price? It may be said that even if market price for an identical plot of land is not available, estimates by an accredited valuer may be accepted as verifiable evidence of the market price. Further complications may be noticed if buildings and facilities have been erected on the plot of land. Is it possible to estimate the value of land without factory buildings and other facilities constructed on it? The answer is a flat 'no' and the conservatism concept will then deter you from accepting an estimate of market value since it cannot be ascertained with reasonable accuracy.

Check your progress-1

- i. Define accounting.
- ii. Enumerate the steps involved in the process of Accounting.
- iii. List the objectives of financial reporting
- iv. Enumerate the basic Accounting Principles

13.6 CRITICAL APPRAISAL OF THE CONCEPTS AND CONVENTIONS

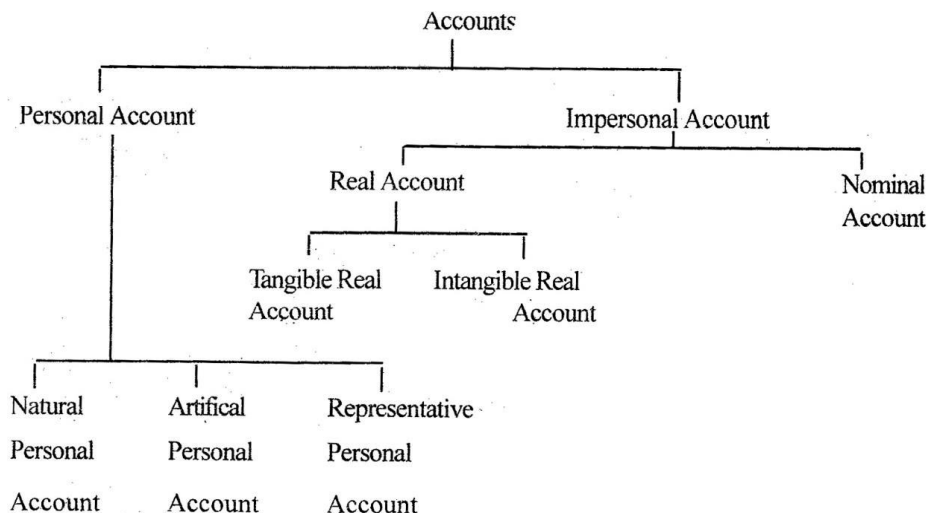
While going through all these concepts, probably you have developed a feeling that they come in conflict with each other. You are right. We illustrate this by considering some of these concepts in the content of valuation of hospital properties. Suppose a hospital acquired a piece of land in 1985 for a price of Rs. 6,00,000. Hospital premises were constructed in 1986 and the hospital operations commences in 1987. The hospital has been a great success with a profit profile for the past 12 years. The Balance Sheet for the year 1999 is being prepared and 'Land' is required to be valued. The estimated current market price of the land i.e. 60,00,000.

Should you recommend that the land be valued at Rs. 60 lakh. The answer is 'No' obviously. Land would be carried on the Balance sheet at its original costs of Rs. 6 lakh only. This decision is supported by several of the concepts discusses in this unit. In the first place, the stability of purchasing power of money implies in the *cost valuation concept* prevents us from recognising accretion in values as in result of changing price levels. The *accrual concept* will not allow unrealised profits to be included as long as the land is held by the hospital and not sold away. You may note that the continuity and the *ongoing concern concept* makes any possible market value of land for balance sheet because the hospital has to continue in business and land will be needed by it for its own use. In this connection, it could be argued that if land were shown on the balance sheet at its estimated current market value, the owner might decide to discontinue the hospital sell the land and retire, the principle of objectivity is now introduced into the argument. It can be easily seen that in a situation like this the cost of acquisition of land at Rs. 6 lakh in 1985 is the objective fact because it is based on the transaction that actually took place and this objective evidence is capable of being verified in contrast the estimate of the current market value to give may be suspect. It raises many questions. Do you have a market quotation for an identical plot of land. Has a similar plot of land been sold recently and can we pick it up as a verifiable evidence of the current market price? Further complications may be noticed if buildings and facilities have been erected on the plot of land. Is it possible to estimate the value of land without factory building and other facilities constructed on it. The answer is a flat 'no' and the *conservation concept* will deter you from accepting an estimate of market value since it cannot be ascertained with reasonable accuracy.

13.7 TYPES OF ACCOUNTS AND THEIR APPLICATIONS

Accounts are divided into two groups: personal and impersonal account. The detailed classification is given below.

13.7.1 Classification of Accounts



(I) Personal Accounts: Accounts which are related with accounts of individuals, firms, companies are known as personal accounts. The personal accounts may further be classified into three categories:

- (i) **Natural Personal Accounts:** Accounts of individuals relating to natural persons such as Akhil'sA/c, Rajesh'sA/c, Sohan'sA/care natural personal accounts.
- (ii) **Artificial Personal Accounts:** Accounts of companies, institutions such as Reliance Industries Ltd; Lions Club, M/s Sham & Sons, National College account are artificial personal accounts. These exist only in the eyes of law.
- (iii) **Representative Personal Accounts:** The accounts which represent some person such as wage outstanding account, prepaid insurance account, and accrued interest account are considered as representative personal accounts.

(II) Real Accounts: Real accounts are the accounts related to assets/properties. These may be classified into tangible real account and intangible real account. The accounts relating to tangible assets such as building, plant, machinery, cash, furniture etc are classified as tangible real accounts. Intangible real accounts are the accounts related to intangible assets such as goodwill, trademarks, copyrights, franchisees, Patents etc.

(III) Nominal Accounts: The accounts relating to income, expenses, losses and gains are classified as nominal accounts. For example Wages Account, Rent Account, Interest Account, Salary Account, Bad Debts Accounts.

RULES FOR DEBIT AND CREDIT

Type of Accounts	Rules for Debit	Rules for Credit
(a) Personal Account	Debit the receiver	Credit the giver
(b) Real Account	Debit what comes in	Credit what goes out
(c) Nominal Account	Debit all the expenses and losses	Credit all the incomes and gains

Learners who are studying accounting for the first time would find it difficult to classify the accounts on the basis explained above. You would be able to classify the account on the basis of asset, liabilities, expense and income if you understand the Dual aspect concept and accounting equation approach given below.

13.7.2 Dual Aspect Concept

Let us take a step further in the previous example: suppose Mr. Raghav purchased some goods (raw material) worth Rs. 10,000 in cash. This transaction will have a dual impact on the balance sheet of RT Ltd. First, the inventory will increase by Rs. 10,000 and second, the cash balance will decrease by Rs. 10,000. Similarly, if the goods were purchased by Mr. Raghav on credit for Rs. 10,000, the inventory (asset) will go up by Rs. 10,000 whereas, the creditors will also increase by Rs. 10,000. This brings us to a fundamental accounting concept known as **dual-aspect** in accounting. This concept explains that each transaction made by a business entity impacts the business in two different aspects which are equal and opposite in nature. It means that every business transaction will affect at least two accounts which imply that for every debit there is an equivalent credit and vice versa. For example, if your company borrows money from the bank, the company's asset Cash is increased (debited) and the company's liability Notes Payable is also increased (credited). It is because of this feature that both sides (assets and liabilities) of the balance sheet will always be equal. This concept forms the basis of double-entry accounting and is used by all accounting frameworks for generating accurate and reliable financial statements. The dual aspect concept is also explained in the fundamental accounting equation:

$$ASSETS = LIABILITIES + OWNERS EQUITY$$

The above accounting equation indicates that an entity's assets have to be equal to the sum of its liabilities and owner's equity. This equation is considered to be the foundation of double entry system of accounting. It ensures that every entry made on the debit side has a corresponding entry made on the credit side and vice versa. Hence, the double entry made will automatically balance the accounting equation.

To sum it up,

- An increase in assets is followed by an increase in liabilities and/or equity and vice versa.
- A decrease in assets is followed by a decrease in liabilities and/or equity and vice versa.
- An increase in an asset is followed by a decrease in another asset and vice versa.
- An increase in a liability is followed by a decrease in another liability and vice versa.

Let's consider the following series of examples to explain this concept further:

- (i) Mr. Raghav further invested cash worth of Rs. 4,00,000 into his business RT Ltd. The effect of this transaction will be as follows:

- Capital will increase by Rs. 4,00,000. (*Liabilities side*)
 - Cash will also increase by Rs. 4,00,000. (*Assets side*)
- (ii) Also, Mr. Raghav repaid the loan in cash, he took from bank for his office building worth Rs. 3,50,000. This transaction will have the following effect:
- Loan from Bank will reduce by Rs. 3,50,000. (*Liabilities side*)
 - Cash will also reduce by Rs. 3,50,000. (*Assets side*)
- (iii) Lastly, Mr. Raghav sold the investments he made in government bonds for Rs. 2,00,000 cash. In this transaction, RT Ltd. made a profit of Rs. 20,000 (as the gold bonds were purchased for Rs. 1,80,000 initially). The effect of this transaction will be shown as follows:
- Investment in Government Bonds will reduce by Rs. 1,80,000. (*Assets side*)
 - Cash will increase by Rs. 2,00,000. (*Assets side*)
 - Profits of Rs. 20,000 will be shown by an increase in Capital. (*Liabilities side*)

Hence, a balance sheet will always balance its two sides. The effect on one account will be compensated by an equal and opposite effect on another account.

13.7.3 Accounting Equation Approach

The basic accounting equation is

$$\text{Assets} = \text{Liabilities} + \text{Capital}$$

In this equation Assets refer to the resources owned by the business enterprise (of resources owned by the owner/s of business enterprise). These resources are expected to generate future cash flows and earnings for the business. Liabilities are the claim of the others on the assets of the business or in simple terms it is the debt outstanding expenses payable to various stakeholders.

Capital means the amount which is payable by the business enterprise to the owners of the business. In brief the assets are the resources which business enterprise owns and capital and liabilities are what business enterprise owns to others.

The above mentioned equation forms the basis of double entry system of book keeping. Every transaction recorded under this method has dual effect viz. it affects two accounts simultaneously. For example Furniture worth Rs. 5000/- is purchased is cash / credit. Now when the furniture is purchased in cash two accounts are affected. Cash which is an asset decreases by Rs. 5000/- and Furniture A/C which is an asset increases by Rs. 5000/-. In second case when furniture is bought on credit again two accounts are affected. First, Furniture A/C increased by Rs. 5000/- and a new liability of Rs. 5000/- is created, thus the increase in liability of Rs. 5000/-. Thus in nutshell every business transaction will have a twofold effect if there is an increase in a particular asset the counterpart of that transaction would be decrease in some other asset or creation of decrease in some other asset or creation of new liability. This is also known as Dual Aspect Concept.

From the above example it is clear that effect on one account will be compensated by an equal and opposite effect on another account/s.

When we use accounting equation approach for recording business transactions all accounts are divided into three categories namely:

- Asset Account
- Liability Account
- Capital Account

Now let us understand the basic rules used for recording changes in assets liabilities and capital

Rule no. 1: For recording changes in assets

Increase in assets is debited and decrease in assets is credited

Rule no. 2: for recording changes in liabilities and capital Increase in Liabilities and Capital is Credited and Decrease in Liabilities and Capital is debited

To understand this let us assume that you have started a business on 01/04/2021 with Rs. 5,00,000/- in cash through your firm M/S Myself. This transaction is analysed and recorded as follows:

Transaction	Analysis	Nature of account	Rule	Entry
Introduction of Rs. 5,00,000/- in the cash by the owner in the business	Increase of cash balance by Rs. 5,00,000/-	Asset	Debit increase in assets	Debit cash account
	Increase of liabilities (Capital) by Rs. 5,00,000/-	Capital	Credit increase in capital	Credit capital account

The Journal entry for this is going to be

Date	Particulars	L.F	Dr (Rs.)	Cr. (Rs.)
01/04/2021	Cash A/C		5,00,000/-	
	To Capital A/c			5,00,000/-

Now you are able to understand how to record transactions for change in assets and liabilities. Now we are going to discuss how to analyse and record changes in capital account.

The capital account increases due to introduction of new capita, revenue and income earned. It decreases due to with drawl of goods, cash and other assets for personal use and expenses incurred.

Recording all these transactions directly into capital account will make it cumbersome and unwieldy. In practice all the revenue and expenses are taken to profit & loss account and the net effect is transferred to capital account. In the same way cumulative effect of drawings is recorded in capital account at the end of the accounting period.

For recording the items of revenue and expenditure temporary capital accounts are created.

The reason behind calling these accounts as temporary capital account is that each of these accounts starts with a zero balance at the beginning of the accounting period and at the end of the accounting period these accounts are closed and their balance are transferred to profit and loss account and the net balance (net profit / net loss) is transferred to capital account. The temporary capital accounts include:

- (i) Revenue Account (including other income and gains)
- (ii) Expense Account (including losses)
- (iii) Drawing Account

Increase in revenue leads to increase in capital therefore revenue earned is credited to revenue account.

For example Sales of Rs. 10,000/- in cash, in this case cash account would be debited by Rs. 10,000/- and Sales A/c would be credited by Rs. 10,000/-.

Expenses decrease capital and decrease in capital is debited therefore expenses incurred are debited to expense account.

For example Purchase of Rs. 9,000/- in cash, in this case Purchase A/c would be debited by Rs. 9,000/- and cash account would be credited by Rs. 9,000/-.

In nutshell if

	Asset	Liability	Capital	Drawings	Expense	Revenue
Increase	Dr	Cr	Cr	Dr	Dr	Cr
Decrease	Cr	Dr	Dr	Cr	Cr	Dr

Illustration 1: Analyse transactions of M/s. Sunil & Co. for the month of March, 2021 on the basis of double entry system by adopting the following approaches:

- A) Accounting Equation Approach
- B) Traditional Approach

Transactions for the month of March, 2021 were follows:

1. Sunil introduced cash Rs. 40,000.
2. Cash deposited in the City bank Rs. 20,000.
3. Cash loan of Rs. 5,000 taken from Mr. Y.
4. Salaries paid for the month of March, 2021 Rs. 3,000 and Rs. 1,000 are still payable for the month of March, 2021.
5. Furniture purchased Rs. 5000.

What conclusions one can draw from the above analysis?

(A) Analysis of Business Transaction: Accounting Equation Approach

Accounting concepts and application

Transaction	Analysis	Account Affected & Nature of Account	Rule	Entry
Introduction of Rs. 40,000 cash by the Proprietor	Cash received	Cash –Asset	Debit increase in asset	Debit Cash
	Investment by owner	Capital-Capital	Credit increase in capital	Credit Capital
Cash deposited in bank Rs. 20,000	Bank balance increases	Bank-Asset	Debit increase in asset	Debit Bank
	Cash balance decreases	Cash-Asset	Decrease in asset	Credit Cash
Loan from Y Rs. 5,000	Cash balance increases	Cash- Asset	Debit increase in assets	Debit Cash
	Creates an obligation to repay Y	Y’s Loan-Liability	Credit increase in liabilities	Credit Y’s Loan
Salaries paid Rs. 3,000 and outstanding Rs. 1,000	Salaries for services received Rs. 4,000	Salary-Temporary capital (Expense)	Debit increase in expenses	Debit Salary (Rs. 4,000)
	Paid Rs. 3,000 Obligation to pay Rs. 1,000	Cash-Asset Salaries outstanding-Liability	Credit decrease in asset Credit increase in liabilities	Credit Cash (Rs. 3,000) Credit Salaries Outstanding (Rs. 1,000)
Furniture purchased Rs. 5,000	Increases furniture owned	Furniture-Asset	Debit increase in asset	Debit Furniture
	Cash decreases	Cash-Asset	Credit decrease in asset	Credit Cash

B) Analysis of Business Transaction: Tradition approach

Transaction	Analysis	Account Affected & Nature of Account	Rule	Entry
Introduction of Rs. 40,000 cash by the Proprietor	Cash is received by business	Cash – Real	Debit what comes in	Debit Cash
	Owner has given cash	Capital-Personal	Credit the giver	Credit Capital
Cash deposited in bank Rs. 20,000	Bank receives cash	Bank-Personal	Debit the receiver	Debit Bank
	Cash goes out of business	Cash- Real	Credit what goes out	Credit Cash

Loan from Y Rs. 5,000	Business gets cash Y pays cash	Cash-Real Y's loan- Personal	Debit what comes in Credit the giver	Debit Cash Credit Y's Loan
Salaries paid Rs. 3,000 and still payable Rs. 1,000	Cost of services used Rs. 4,000 Cash goes out Rs. 3,000 Still payable or Outstanding for services received Rs. 1,000	Salary- Nominal Cash- Real Salary Outstanding- Personal	Debit all expenses Credit what goes out Credit the giver	Debit Salary (Rs. 4,000) Credit Cash (Rs. 3,000) Credit Salaries Outstanding (Rs. 1,000)
Furniture purchased Rs. 5,000	Furniture is purchased Cash is paid	Furniture – Real Cash- Real	Debit-what comes in Credit-what goes out	Debit Furniture Credit Cash

Illustration 2: Show the classification of the following Accounts under traditional and accounting equation approach:

(a) Building; (b) Purchases; (c) Sales; (d) Bank Deposit; (e) Rent; (f) Rent Outstanding; (g) Cash; (h) Adjusted Purchases; (i) Closing Stock; (j) Investments; (k) Debtors; (l) Sales Tax Payable; (m) Discount Allowed; (n) Bad Debts; (o) Capital; (p) Drawings; (q) Provision for depreciation account; (r) Interest Receivable account; (s) Rent received in advance account; (t) Prepaid salary account; (u) Provision for Bad & doubtful debts account; (y) Stock reserve account; (z) Provision for discount on creditors account.

Nature of Account

S.No.	Title of Account	Traditional Approach	Accounting Equation Approach
a	Building	Real	Asset
b	Purchases	Real	Asset
c	Sales	Nominal (Revenue)	Temporary Capital (Revenue)
d	Bank Deposit	Personal	Asset
e	Rent	Nominal (Expense)	Temporary Capital (Expense)
f	Rent Outstanding	Personal	Liability
g	Cash	Real	Asset
h	Adjusted Purchases	Nominal (Expense)	Temporary Capital (Expense)
i	Closing Stock	Real	Asset
j	Investment	Real	Asset

k	Debtors	Personal	Asset
l	Sales Tax Payable	Personal	Liability
m	Discount Allowed	Nominal (Expense)	Temporary Capital (Expense)
n	Bad Debts	Nominal (Expense)	Temporary Capital (Expense)
o	Capital	Personal	Capital
p	Drawings	Personal	Temporary Capital (Drawings)
q	Provision for depreciation	Valuation (Real)	Asset
r	Interest receivable	Personal	Asset
s	Rent received in advance	Personal	Liability
t	Prepaid salary	Personal	Valuation (Asset)
u	Provision for bad & doubtful debts	Valuation (Personal)	Valuation (Asset)
v	Bad debts recovered	Nominal (Gain)	Temporary capital (Gain)
w	Depreciation	Nominal (Expense)	Temporary capital (Expense)
x	Personal Income Tax	Personal (Drawing)	Temporary capital (Drawings)
y	Stock reserve	Valuation (Real)	Valuation (Asset)
z	Provision for discount on creditors	Valuation (Personal)	Valuation (Liability)

Check your progress-2

- i. List different types of accounts.
- ii. Describe the concept of dual-aspect in accounting.
- iii. What is basic accounting equation?

13.8 ACCOUNTING BOOKS

The objectives of keeping the Accounting books are to enable the hospital manager to ascertain easily and conveniently the following at a glance.

- a) The financial position of the hospital
- b) The assets and liabilities of the hospital
- c) Profit earned or loss incurred for a given period
- d) The amount owed by others to the hospital and by the hospital to others
- e) The financial requirement of the hospital

In a hospital thousands of transaction may take place every day. They are generally of a repetitive nature like pools purchase etc. They are reflected on vouchers that could be any of the following.

- a) The document which serves as evidence of the disbursement or receipt of cash e.g., Cash receipt of the hospital or cash memo for purchase note etc. or an approved invoice from supplier.
- b) The form or a voucher to which bills receipts and other evidence of purchases are often attached sharing the authority for payment, the terms for settlement etc.

These vouchers are often listed out in various books, a few of items are briefly described in succeeding paragraphs.

13.8.1 Journal

Journal is a historical record of business transaction or events. The word journal comes from the French word “Jour” meaning “day”. It is a book of original or prime entry. Journal is a primary book for recording the day-to-day transactions in a chronological order i.e., the order in which they occur. The journal is a form of diary for business transactions. This is called the book of first entry since every transaction is recorded firstly in the journal.

Journal Entry

JOURNAL

Date	Particulare	L.F.	Debit (Amount)	Credit (Amount)
(1)	(2)	(3)	(4)	(5)

Journal entry means recording the business transactions in the journal. For each transaction, a separate entry is recorded. Before recording, the transaction is analysed to determine which account is to be debited and which account is to be credited.

The Performa of journal is shown as follows:

Column1 (Date):The date of the transaction on which it takes place is written in this column.

Column2 (Particulars): In this column, the name of the accounts to the debited is written first, then the names of the accounts to be credited and lastly, the narration (i.e., a brief explanation of transaction) are entered.

Column3(L.F.): L.F stands for ledger folio which means page of the ledger. In this column are entered the page numbers on which the various accounts appear in the ledger.

Column4 (Dr. Amount): In this column, the amount to be debited against the 'Dr.' Account is written along with the nature of currency.

Column5(Cr. Amount):In this column the amount to be credited against the 'Cr.' Account is written along with the nature of currency.

Advantages of Using Journal

Journal is used because of the following advantages:

- A journal contains a permanent record of all the business transactions.
- The journal provides a complete chronological (in order of the time of occurrence) history of all business transactions and the task of later tracing of some transactions is facilitated.
- Complete information relating to one single business transaction is available in one place with all its aspects.
- The transaction is provided with an explanation technically called a narration.
- Use of the journal reduces the possibility of an error when transactions are first recorded in this book.
- The journal establishes the quality of debits and credits for a transaction and reconciles any problems. If a business purchases a bicycle, it is necessary to decide whether the bicycle represents ordinary goods or machinery. Further any amount paid is debited to bicycle account and credited to cash account.
- The use of journals avoids omission or duplication of transactions or parts of transaction. Without the journal the accountant would be forced to go to the individual account to enter debits and credits. Therefore, it is possible for accountant to miss part of a transaction, duplicate all or part of a transaction or incorrectly record debits and credits. Even with the Journal, it is still possible to omit transactions and make other errors. However, the Journal reduces these problems.
- Once a transaction is recorded in the journal, it is not necessary to post it immediately in the ledger accounts. In this, way, the journal allows the delayed posting.
- In connection with the journal, the following points are to be remembered:
 - For each transaction, the exact accounts should be debited and credited. For that, the two accounts involved must be identified to pass a proper journal entry.
 - Sometimes, a journal entry may have more than one debit or more than one credit. This type of journal entry is called compound journal entry. Regardless of how many debits or credits are contained in a compound journal entry, all the debits are entered before any credits are entered. The aggregate amount of debits should be equal to the aggregate amount of credits.
 - For a business, journal entries generally extend to several pages. Therefore, the total are cast at the end of each page, against the debit and credit columns, the following words and written in the particular

column, which indicates, carried forward (of the amount on the next page) “Total c/f”.

The debits and credits totals of the page are then written on the next page in the amount columns; and opposite to that on the left, the following words are written in the particulars column to indicate brought forward (of the amount of the previous page) “Total b/f”. This process is repeated on every page and on the last page, “Grand Total” is cast.

Journalizing

Journalizing is the process of recording journal entries in the Journal. It is a systematic act of entering the transaction in a day book in order of their occurrence i.e., date-wise or event-wise. After analysing the business transactions, the following steps in journalising are followed:

- i) Find out what accounts are involved in business transaction.
- ii) Ascertain what is the nature of accounts involved?
- iii) Ascertain the golden rule of debit and credit is applicable for each of the accounts involved.
- iv) Find out what account is to be debited which is to be credited.
- v) Record the date of transaction in the “Date Column”.
- vi) Write the name of the account to be debited very near to the left-hand side in the ‘Particulars Column’ along with the word ‘Dr’ on the same line against the name of the account in the ‘Particulars Column’ and the amount to be debited in the ‘Debit Amount column against the name of the account.
- vii) Record the name of the account to be credited in the next line preceded by the word ‘To’ at a few spaces towards right in the ‘Particulars Column’ and the amount to be credited in the ‘Credit Amount Column’ in front of the name of the account.
- viii) Record narration (i.e., a brief explanation of the transaction) within brackets in the following line in Particulars Column’.
- ix) A thin line is drawn all through the particulars column to separate one Journal entry from the other and it shows that the entry of a transaction has been completed.

Goods Account

Generally, the term goods include every type of property such as Land, Building, Machinery, Furniture, Cloth etc. However, in accountancy its meaning is restricted to only those articles which are purchased by a businessman with an intention to sell it. For example, if a businessman purchased typewriter, it will be goods for him if he deals in typewriter but if he deals in other business say clothes then typewriter will be asset for him and clothes will be goods.

Sub-Division of Goods Accounts

The goods account is not opened in accounting books and it is to be noted goods includes purchases, sales, sales returns, purchases return of goods. However, purchase account, sales account, sales return account and purchase return account are opened in the books of account.

Purchases Account: This is opened for goods purchased on cash and credit.

Sales Account: This account is opened for the goods sold on cash and credit

Purchase Returns Account or Return Outward Account: This account is opened for the goods returned to suppliers.

Sales Returns Account or Return Inward Account: This account is opened for the goods returned by customers.

Opening Entry: In case of going concern at the beginning of the new year, new books of accounts are opened and the balances relating to personal and real Accounts appearing in the books at the close of the previous year are brought forward in new books. The entry for this purpose in the books is called opening entry.

The opening entry is passed by debiting all assets and crediting all liabilities including capital. If the amount of capital is not given then this can be found out with the help of the accounting equation:

$$\text{Assets} = \text{Liabilities} + \text{Capital}$$

$$\text{Capital} = \text{Assets} - \text{Liabilities}$$

13.8.2 General Ledger

This is the main or basic book of accounting. It contains a record of all transactions for the accounting period analysed under various accounting heads each referring to a separate nature of transaction. The general ledger contains all accounts: Personal, Real and Normal.

13.8.3 Cash Book

In any business all the transactions that affect the cash are entered in a book called the cash book which is kept separate from the other book. When cash book is maintained the cash transactions are not journalised but entered directly in the cash book and then a corresponding entry is posted in the Ledger Receipts and Payments are generally written on the opposite side of the cash book. The number of columns provided for amount depend upon the number of bank accounts being maintained at a regular basis from the receipt books, the daily collection is analysed as under.

- a) Cheques and Cash
- b) Nature of Receipts such as patient bills, donations, deposits, grants etc.

In the main cash book individual entries are made for each cheque times. Summary totals are posted in respect of cash receipts.

Let us prepare simple cash book.

Example

01-04-99	Cash in hand	Rs.	1,00,000
02-04-99	Paid rent	Rs.	1,000
03-04-99	Purchased medicine for cash	Rs.	1,000
10-04-99	Car sold scrap for cash	Rs.	800
12-04-99	Received cash from patient A	Rs.	900
14-04-99	Purchased stationery	Rs.	750
20-04-99	Paid to daily wager	Rs.	50

24-04-99	Paid maintenance	Rs.	550
29-04-99	Paid electricity charges	Rs.	1,050
30-04-99	Paid salaries	Rs.	50,000

Cash Book

Receipts				Expenditure			
Date	Receipt	Folio	Amount Rs.	Date	Payment	Folio	Amount Rs.
01-04-99	To balance B/d		1,00,000	02-04-99	By Rent		1,000
10-04-99	Scrap taken		800	03-04-99	By Purchase		1,000
12-04-99	Patient		900	14-04-99	By Purchase		750
				20-04-99	By Daily wager		50
				24-04-99	By Maintenance		550
				29-04-99	By Electricity charges		1,050
				30-04-99	By Salaries		50,000
					By Balance C/d		46,300
	Total		1,00,700		Total		1,00,700

01-05-99 Balance B/d 46,300/-

13.8.4 Petty Cash Book

The popular system of controlling petty cash expenses is through imprest system. Under this system the petty cash is provided as a round sum in cash, turned as a float sufficient to cover the estimated petty cash expenditure from a week or a fortnight. Payments made by the cashier are entered into a petty cash book or register which has several analysis column. At periodic intervals written the cash balance with them is nearly exhausted, he prepares a petty cash voucher analysing the expenditure incurred under various head and the total expenditure incurred is down from the new cashier. This voucher is entered in the main cash book. Petty cash book is in effect a branch of the main cash book in the sense that the balance of small surgical entries are shown by it.

The format generally used for maintenance of petty cash book is as under:

Date	Particular	Cash Book Folio	Amount Received	Rate	Particular	Voucher Total	Petty Cash
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13.8.5 Subsidiary Book

Entries are not made directly into the General Ledger. Every entry in the Ledger should be based on an originating entry in a subsidiary book. The purpose of subsidiary book is to record the transactions as they occur and then to make the posting there from to the ledger.

They are a number of subsidiary books. These are briefly discussed below:

a) **Purchase Book**

In the purchase book only credit purchase are recorded and cash purchase are excluded. The monthly total is posted to the ledger under head purchaser A/c. The invoice number as given by the supplier is recorded in the purchase book.

Date	Particular	Invoice No.	LF	Amount
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Example

01 Apr. 99	Purchased medicines from Chugh Brothers			Rs. 7,000
10 Apr. 99	Purchased Stationery from Murthy Brothers			Rs. 8,000
15 Apr. 99	Purchased Surgical Glasses from Delhi Surgical			Rs. 10,000
30 Apr. 99	Brought Stationery from Sahu by cash			Rs. 600

Purchase Book

Date	Particular	Invoice No.	LF	Amount
April 01	Chugh Brothers			Rs. 7000.00
April 10	Murthy Brothers			Rs. 8000.00
April 15	Delhi Surgical			Rs. 10,000.00
				Rs. 25,000.00

It is important to note here that the stationery purchased from Sahu by cash is not included in purchased Book can you tell why?

b) **Sale Book (Income System)**

Income Register maintained by hospital are more in the nature of statistical record rather than an Accounting book which demands considerable accuracy. The Income Register provides for analysis of Income by department without any additional clerical effort. The patient bills are entered serially. Some of them are paid in cash some after the bills are raised (almost simultaneously) and some later. They are posted to the relevant parties' accounts in the patient ledger once entries are made. Changes, therefore, made through using of credit/debit note rather than by altering figures in original books. That is so because only credit sale entries are recorded in the sales book, but in the hospital context there are very few entries of credit sales.

c) **Purchase Return Book**

Here the goods returned to the suppliers are entered. A debit note stating the details prepared are intimated to the suppliers.

- d) The other subsidiary books like cash book and petty cash books have already been discussed earlier.
- e) General Journal to record transaction not falling in out of the above categories like depreciation charges entries. After having discussed, the principles of double entry and after being acquainted with the various Accounting Books, you must briefly acquaint yourselves with journalising the various transactions. Since journal is the primary step in the Accounting principle.

Example

Let us journalise the following transaction

01.01.99	Commenced a nursing home with cash	Rs. 10,00,000/-
15.03.99	Deposits made in State Bank	Rs. 5,00,000/-

Journal

Date	Particular	LF	Debit	Credit
01.01.99	Cash Account Dr To Capital (Being the cash introduced in hospital)		10,00,000	10,00,000
15.03.99	Credit Account Dr To Cash (Being the amount deposited in Bank)		5,00,000	5,00,000

Check your progress-3

- List the objectives of keeping the Accounting books.
- List the types of transactions.
- List various books for recording of the vouchers.

13.9 LET US SUM UP

In this unit you have learnt about the concepts of accounting. The foregoing concepts and conventions have been developed primarily for use by profit making enterprises. These guidelines, however are equally applicable to hospitals and hospital accounting. Hospitals though differing in orientation from commercial enterprises are still a form of business. Therefore, the principles of sound business management as mentioned in this unit are just as applicable to hospitals as to private business enterprises. The non profit operating philosophy of most hospital should neither constitute an excuse nor be used as a justification for irresponsible management or accounting practices. Hospital accounting practices should thus be based upon the above rules and conventions.

Accounting is the language of business and the process of Accounting involves data creation, collection, evaluation and data reporting. There are several concepts and conventions of Accounting which hospital management understand as the building of any hospital Accounting system. The entity concepts makes a distinction between the business and the owner and the ongoing concern of continuity concepts. You have also learnt about the cost evaluation concept, and need for recording the costs of assets at the price incurred to acquire it, and the double entity concept. You have also learnt that on the logic of the accrual concept the matching concept evolved to match the related items of revenue and expenditure. Apart from the accounting concepts there are certain accounting conventions like reliability, materiality, consistency, conservation which a manager should be familiar with to enable him to understand the basics of accounting practices.

There are basically three types of accounts viz. Personal, Real and Nominal Accounts. The personal accounts relate to individual or organisational account, real account relates to various aspects of organisational assets and the nominal account relates to income, expenses and losses.

Subsequently you learnt that there are a variety of Accounting books which are required to be maintained in any organisation including the hospital. The General Ledger is the main or the basic book of accounting in which a record of all transactions for the accounting are recorded. The general ledger is supported by various subordinate books like the cash book, petty cash book, the purchase and sale book, the purchase return book and the general journal.

13.10 ANSWERS TO CHECK YOUR PROGRESS

Check your progress-1

i. Define accounting.

“Accounting is the art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which are in part at least, of financial. character and interpreting the results thereof.”

“Accounting is the process of identifying, measuring and communicating economic information to permit informed judgments and decisions by the uses of information.”

ii. Enumerate the steps involved in the process of Accounting.

- Data creation and collection which provide the raw material for Accounting.
- Recording of data, which is done in accordance with the laid down concepts and conventions of Accounting.
- Data evaluation is regarded as the most important activity in Accounting these days. Evaluation of data includes controlling the activities with the help of budgets and standard costs, analysing the flow of funds and analysing the accounting information for decision making purposes by choosing among alternative courses of action.
- Data reporting consists of two parts-external and internal. External reporting refers to the communication of financial information viz. earnings financial and funds position about the hospital to outside parties i.e. trustees, Government agencies and regulatory bodies. Internal reporting is concerned with the communication of results of financial analysis and evaluation to hospital management committee for decision making purposes.

iii. List the objectives of financial reporting.

The objectives of financial reporting are as follows:

- It should provide information that is useful to present and potential investors, creditors, and other users in making national investment credit and similar decision.

- It should provide information about the economic resources of an enterprise, the claims to those resources and the effects of transactions, events and circumstances that change resources.
- It should provide information about an enterprise's financial performance during a period.
- It should provide information about how an enterprise obtains and spends cash, about its borrowing and repayments, about its capital transactions and about other factors that may affect its liquidity or solvency.
- It should provide information that is useful to managers and directors in making decision in the interest of the enterprise and the owners.

iv. Enumerate the basic Accounting Principles.

These are as follows:

- *Business Entity Concept*-In accounting we make a distinction between business and the owner. All the records are kept from the viewpoint of the business rather than from that of the owner. An enterprise is an economic unit separate and apart from the owner or owners.
- *Money Measurement Concepts*-In accounting, only those facts which can be expressed in terms of money are recorded. As money is accepted not only as a medium of exchange but also as a store of value, it has a very important advantage since a number of widely different assets and equities can be expressed in terms of a common denominator.
- *Continuity Concept*-Accounting assumes that the business (an accounting entity) will continue to operate for a long time in the future unless there is good evidence to the contrary. The enterprise is viewed as a going concern, that is, as continuing in operation, at least in the foreseeable future.
- *Cost Concept*-The resources (land, buildings, machinery, property rights, etc.) that a business owns are called assets. The money values that are assigned to assets are derived from the cost concept. This concept states that an asset is worth the price paid for or cost incurred to acquire it. Thus, assets are recorded at their original purchase price and this cost is the basis for all subsequent accounting for the assets
- *Accrual Concept*-The accrual concept makes a distinction between the receipt of cash and the right to receive it, and the payment of cash and the legal obligation to pay it. In actual business operations, the obligation to pay and the actual movement of cash may not coincide. The accrual concept recognises this distinction.
- *Concept of Conservatism*-The concept of conservatism, also known as the concept of prudence, is often stated as "anticipate no profit, provide for all possible losses". This means an accountant should follow a cautious approach.

- *Materiality Concept*-There are many events in business which are trivial or insignificant in nature. The cost of recording and reporting such events will not be justified by the usefulness of the information derived. Materiality concept holds that items of small significance need not be given strict theoretically correct treatment.
- *Consistency Concept*-In practice, there are several ways to record an event or a transaction in the books of account. The consistency concept requires that once a company has decided on one method and has used it for some time, it should continue to follow the same method or procedure for all subsequent events of the same character unless it has a sound reason to do otherwise.
- *Periodicity Concept*-Although the results of operations of a specific enterprise can be known precisely only after the business has ceased to operate, its assets have been sold off and liabilities paid off, the knowledge of the results periodically is also necessary. Some firms adopt calendar year, some others financial year of the government.

Check your progress-2

- List different types of accounts.

These are:

Personal Accounts: Accounts which are related with accounts of individuals, firms, companies are known as personal accounts.

Real Accounts: Real accounts are the accounts related to assets/properties. These may be classified into tangible real account and intangible real account.

Nominal Accounts: The accounts relating to income, expenses, losses and gains are classified as nominal accounts.

- Describe the concept of dual-aspect in accounting.

This concept explains that each transaction made by a business entity impacts the business in two different aspects which are equal and opposite in nature. It means that every business transaction will affect at least two accounts which imply that for every debit there is an equivalent credit and vice versa.

The dual aspect concept is also explained in the fundamental accounting equation:

$$ASSETS = LIABILITIES + OWNERS EQUITY$$

- What is basic accounting equation?

The basic accounting equation is: Assets = Liabilities + Capital

Check your progress-3

- List the objectives of keeping the Accounting books.

The objectives of keeping the Accounting books are to enable the hospital manager to ascertain easily and conveniently the following at a glance.

Financial Management

- The financial position of the hospital
 - The assets and liabilities of the hospital
 - Profit earned or loss incurred for a given period
 - The amount owed by others to the hospital and by the hospital to others
 - The financial requirement of the hospital
- ii. List the types of transactions.

They are reflected on vouchers that could be any of the following.

- The document which serves as evidence of the disbursement or receipt of cash e.g., Cash receipt of the hospital or cash memo for purchase note etc. or an approved invoice from supplier.
 - The form or a voucher to which bills receipts and other evidence of purchases are often attached sharing the authority for payment, the terms for settlement etc.
- iii. List various books for recording of the vouchers.

These vouchers are often listed out in various books such as:

- *Journal* - It is a historical record of business transaction or events. The word journal comes from the French word “Jour” meaning “day”. It is a book of original or prime entry. Journal is a primary book for recording the day-to-day transactions in a chronological order i.e., the order in which they occur.
- *General Ledger*-This is the main or basic book of accounting. It contains a record of all transactions for the accounting period analysed under various accounting heads each referring to a separate nature of transaction. The general ledger contains all accounts: Personal, Real and Normal.
- *Cash Book*-In any business all the transactions that affect the cash are entered in a book called the cash book which is kept separate from the other book.
- *Petty Cash Book*-The popular system of controlling petty cash expenses is through imprest system. Under this system the petty cash is provided as a round sum in cash, turned as a float sufficient to cover the estimated petty cash expenditure from a week or a fortnight. Payments made by the cashier are entered into a petty cash book or register which has several analysis column.
- *Subsidiary Book*-Entries are not made directly into the General Ledger. Every entry in the Ledger should be based on an originating entry in a subsidiary book. The purpose of subsidiary book is to record the transactions as they occur and then to make the posting there from to the ledger.