

***SIMPLE SECRETS BEHIND
DIFFICULT
ACCOUNTING-CONCEPTS
(from scratch to balance sheet)
Volume – 1***

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Just for information, spellings that conform to British English have been used.

Regret, I am not computer-savvy. Kindly excuse errors in formatting.

Knowledge says, "I know so much."
Wisdom says, "I know only so much."
Ego says, "What is there for me to learn from others?"
Humility says, "Let us all learn from one another."
— *Author not known*

PREFACE

These secrets are a result of umpteen mistakes I have committed in the course of more than 43 years of accounts-writing, including preparation of more than 700 real-life balance-sheets and over 150 real-life project-reports, all manually, an indication that the analytical capabilities have not been handed over to the computer.

Add to this, over two decades of teaching accounts and related subjects and conducting programmes for many schools and colleges.

No need to memorise entries. No need to use any tricks to remember concepts. These secrets, deep-rooted in logic and common sense, are explained in an easy-to-understand step-by-step method.

These secrets, apart from becoming a life-long asset, would not only help the learner in understanding advanced chapters quite easily but also make classroom instructions, video and YouTube lectures, tuition sessions and self-study efforts more comprehensible.

Prior knowledge of accounts is not necessary.

Accounts is no rocket science. If this book is studied methodically as suggested, the simple secrets of accounting (from scratch to preparation of balance sheet from raw data) (all the volumes) can be learnt in about two weeks, without any assistance.

If I am not mistaken to be having a high opinion of myself, I can confidently state that the above compilation stands many notches above existing text books, reference materials, internet downloads, etc. of even the leading professors, authors and practicing accountants because the above compilation is not just bookish knowledge, but practical understanding born out of more than 43 years of roller-coaster ride of ups and downs in real-life accounting-career.

This compilation would help the students in not only acquiring knowledge and scoring high, but also simultaneously getting prepared to start an accounting career.

This compilation can help freshers, applying for an accounting job, to brush up their knowledge before getting ready for an interview.

Non-finance businesspersons, with the help of this compilation, can stop signing blindly on the dotted line as asked for by their auditors and be able to ask questions before confidently attesting the papers.

Irrespective of the level of accounting knowledge a learner has, with the help of this compilation (all the volumes), he / she needs a maximum of 15 days of self-study to understand the basic nuances of accounting and be able to prepare balance sheet from raw data.

Well! What are you waiting for?

Go ahead!

***Knowledge, without wisdom, is like water in the sand.
—Guinean proverb***

SUGGESTED METHOD OF STUDY

Optimise your learning of the accounting-secrets by making a workable schedule depending on your other commitments.

There are 16 sections (from scratch to preparation of balance sheet) spread over eight mini-volumes.

Volume – I

01. Basics
02. How a financial statement takes shape – I

Volume – II

03. How a financial statement takes shape – II, III and IV
04. Journal entries

Volume – III

05. Expenses and incomes (cash)
06. Expenses and incomes (credit)

Volume – IV

07. Depreciation

Volume – V

08. Closing stock

Volume – VI

09. Outstanding expenses
10. Prepaid expenses
11. Incomes to be received
12. Incomes received in advance

Volume – VII

13. Bad debts

14. Reserve for doubtful debts

Volume – VIII

15. Final accounts - 1

16. Final accounts - 2

It is recommended that, irrespective of the level of knowledge a learner has about accounts, he / she should first study Volumes I, II and III compulsorily as the basics are discussed in detail in these volumes. Only after having completed with these volumes, the learner may proceed to other volumes. Also, the last volume may be taken up only at the end.

While the first section (Basics) may take up to 2 hours, other sections require much-less time. So, plan for a time table of 15 days. It wouldn't be surprising if you complete the book (all the volumes) in much less time.

After studying each section, attempt problems on the same from various text books, references, internet downloads and so on. Compare your answers to those given in the respective sources. You will be surprised that you are almost always bang on target.

Use a long ruled-book and don't forget to number the pages for ease of reference. Use a scale to draw lines. Highlight important points. Write neatly and legibly even if it takes some extra time. Don't scribble. Remember, well-begun is half-done. Ill-begun is never done.

At the most, study three sections at one go. Practice the same before you move on to the next section. Study the sections in the order given.

There is a reason to the order that makes difficulty level to go up gradually.

BON STUDIES!

“Knowledge that is not being used for winning of further knowledge does not even remain, it decays and disappears.”

— J D Bernal, me

BASICS

To start with, just know these 10 points.

01.CONCEPT AND CONVENTION

Every country has its own traffic rules. But, all have one common ingredient, that is, the traffic has to move in an orderly way, stop at junctions to make way for pedestrians and give way to cross-traffic, etc. This is known as CONCEPT.

Maybe, in some countries, it is left-side-driving and in some others, it may be right-side-driving. In some countries, 3 minutes are earmarked for halting-traffic at junctions, in some other countries, it may be more or less. This is called CONVENTION.

Concept and convention, together, make for TRAFFIC RULES.

Let us take another example. The education department of a local government makes it a rule that schools shall introduce a common dress-code (known as uniform) for all students so that the students belonging to various economic-groups don't discriminate against one another. This is one of the CONCEPTS of education.

Different schools prefer different dress-types to maintain an identity. Some may prefer white shirt and blue trousers, some, checks and stripes, and so on. This is the CONVENTION (regarding dress).

Put together, concept and convention are the DRESS CODE of the school.

Coming to a more practical example. It is well-known and well-established that the sum of 2 and 2 is 4. Whether a nursery child does the calculation, a scientist does, a shopkeeper, a housewife, whosoever, for that matter, does, every one of them gets 4 as the answer. This is CONCEPT.

One may choose to write it as $2 + 2 = 4$ or *sum of 2 and 2 is 4* or 2

$$\begin{array}{r} +2 \\ \hline 4 \end{array}$$

This is CONVENTION.

Put together, it is MATHEMATICAL PRINCIPLE.

Same is the case with accounts. We have ACCOUNTING CONCEPTS and ACCOUNTING CONVENTIONS which, together, make for ACCOUNTING PRINCIPLES.

For example, amount spent on travelling has to be considered as TRAVELLING AND CONVEYANCE ACCOUNT. This is the CONCEPT.

Some firms consider it as TRAVELLING ACCOUNT. Some, as TRAVELLING AND CONVEYANCE ACCOUNT. Some others, as CONVEYANCE ACCOUNT. Yet, some others, as TRANSPORT ACCOUNT. And so on and so forth. These are all CONVENTIONS.

Put together, they make for ACCOUNTING PRINCIPLES.

You shouldn't, but may go wrong in CONVENTIONS. For instance, instead of writing "TRAVELLING ACCOUNT" you may have written it as "TRANSPORT ACCOUNT". Later on, while finalising, they can be grouped under a name conventionally used by the firm as all these names have similar meanings.

But never go wrong in CONCEPT. Don't write the total of 2 and 2 as 5, 6, etc. The answer has to be only 4. Don't write money spent on, say, conveyance as "RENT ACCOUNT". Don't enter 25 bucks as 250 bucks. These are all mistakes in CONCEPTS.

02. DIRECTLY- AND INVERSELY-PROPORTIONAL EQUATIONS

In mathematics, we have two of the very common concepts. They are directly-proportional and inversely-proportional equations. These equations would be of great help when you are studying advanced chapters like shares, ratio analysis, etc.

Now, let us elaborate on these concepts.

Let us assume that 10 mangoes cost 50 bucks
Then, one mango costs $(50 / 10)$ bucks ie., 5 bucks
3 mangoes would cost (3×5) bucks ie., 15 bucks

In other words, 3mangoes would cost. $(50 / 10 \times 3)$ bucks ie., 15 bucks

It may be observed that to find out for one unit, we have to divide. To find out for anything other than one unit, ie., more or less than one, we have to multiply. Here, if one variable (mango) goes up, the other variable (value), too, goes up. If one comes down, the other,

too, comes down. This is the DIRECTLY-PROPORTIONAL EQUATION.

Let us now discuss the INVERSELY-PROPORTIONAL EQUATION. In this case, if one variable goes up, the other comes down and vice versa.

For example,

If 10 persons can construct a road in one day

One person would require (1×10) days to do the job

5 persons would require $(1 \times 10 / 5)$ days, ie., 2 days to complete the job

Here, to find out for one unit, we multiply and to find out for anything other than one, ie., more or less than one, we have to divide. To repeat, the above two equations would help you when studying the advanced chapters.

03. FIRM AND THE OWNER

Let us assume there is a guy named A. He starts a firm called A & Co. For all practical purposes, he is the owner of the firm.

He can do anything he wants with the firm. He can work hard and make it prosper. He can laze around and run into losses. He can invite friends and waste time chit-chatting. He can even close the firm and go on a vacation. No one can question him.

But for accounting purposes, A (the owner) is different from A & Co (the firm). For accounting purposes, A & Co (the firm) is more important than A (the owner).

While reading a balance sheet or other accounts-related documents, we should assume that the firm has hands, mouth, lips, etc. like us and it, too, can talk. Hence, if you want any information about the firm, pretend talking to the firm. It shall give replies including information about the owner.

There is no need to talk to the owner, proprietor, partner, director, etc. This concept, like the earlier ones, would make reading of the financial statements like profit and loss account and balance sheet very much easier. As you go along, you will understand the importance of this concept.

ALWAYS IMAGINE THAT THE FIRM (NOT THE OWNER) IS TALKING TO YOU

04. ASSETS = LIABILITIES

Let us assume that our friend A loves cars. He has identified a car (which costs a thousand bucks) that he wants to buy. But he does not have money to buy that. He goes to a moneylender, borrows one thousand bucks and buys his dream car.

He is driving around town when we happen to meet him at a junction. He gets down to greet us and proudly shows off his new possession. We congratulate him, “Oh! What a nice car!” He is happy and says, “This is my asset. It cost me one thousand bucks.” (One of the meanings of ‘asset’ is ‘property’).

Then we ask him discreetly, “Do you have any liabilities?” (‘Liability’ means ‘what we owe others’). He replies, “Yes, I owe moneylender one thousand bucks. He lent me the money to buy this car.” A draws a matrix to explain his financial position.

<u>LIABILITIES</u> (in bucks)	<u>A</u>		<u>ASSETS</u> (in bucks)
Moneylender	1,000	Car	1,000
Total	1,000	Total	1,000

He elaborates, “My asset (car) is one thousand bucks. My liability (the moneylender) is also one thousand bucks. In other words, my asset is equal to my liability. In case, the moneylender insists on being paid immediately, I will have to sell the car and give him the proceeds of the sale. Or, I will have to surrender the car to him. Alternatively, I will have to borrow from moneylender – 2 and pay moneylender – 1. Then, moneylender – 2 will become my liability. Whatever be the case, my asset is equal to my liability.”

From the above, we can understand that whosoever’s financial position we may try to compile, it is that ASSETS are always equal to LIABILITIES. Be it an unborn baby or a dead person, infant or an adult, a petty shop or a big corporate-entity, an animal or a statue, be it anyone or anything, for that matter, the financial position always indicates that ASSETS = LIABILITIES. This concept becomes clearer as we go along.

It may be noted that in most of the text books and other reference-materials, it would be given as ASSETS = CAPITAL + LIABILITIES.

This is technically wrong. Capital is one of the liabilities for the firm. So, it should be

ASSETS = LIABILITIES or ASSETS = CAPITAL + **OTHER**
LIABILITIES

05. ACCOUNTS IS NOTHING BUT SIMPLE ARITHMETIC AND LOGIC

Accounts is nothing but simple arithmetic and logic. To put it bluntly, accounts is just a combination of + (addition), - (subtraction), x (multiplication) and \div (division), the basic mathematical operations and sheer common sense.

Take for example, a pavement vendor. He would have hardly attended primary school or not even that. But, he would reel out statistics about his business. He may say, “This product fetches 70% of my revenue. This item is just to attract customers. I had 500 bucks in the morning. I got 1000 bucks from the money lender. I gave interest of 150 bucks.... ..”

He, with no educational background, is already a 50% accountant. We, with an education, must be at least 75% accountants. It is the 25% in us that is in a confused state. This study material’s humble effort is to bring out this 25% in us and merge with the 75% to make us 100% accountants.

So, anyone can become an accountant. There is nothing to worry about.

06. TYPES OF ACCOUNT

In accountancy, there are three types of accounts. They are:

- Real account
- Personal account
- Nominal account

Real account is that which we can see, touch and feel. There are certain exceptions which we shall take up at a later stage. Examples of real account are car account, building account, computer account, furniture account, etc.

Personal account is the name of a person or an organisation. For example, we have Smith's account, Ram's account, Siemens's account, etc.

Just check whether an account is a real account. If not, try to fit it into the personal-account category. If it doesn't fit in even there, just dump it in the nominal-account category.

For example, you go in an auto, enjoy the ride, reach your destination and pay as per the meter. You have experienced the ride but cannot see it or touch it.

Similarly, you pay rent for a particular month. You enjoyed the shelter the house provided but cannot see it. These (rent account, travelling account, etc.) are nominal accounts.

Each of the above three types of accounts has to be dealt with in a particular way.

In case of real accounts, it is DEBIT WHAT COMES IN and CREDIT WHAT GOES OUT.

In case of personal accounts, it is DEBIT THE RECEIVER and CREDIT THE GIVER.

In case of nominal accounts, it is DEBIT ALL EXPENSES AND LOSSES and CREDIT ALL INCOMES AND GAINS.

Combined, they are known as GOLDEN RULES.

Indeed, they are golden in characteristics. But, many a time, the learner gets confused with these rules. Hence, in a later volume of this book, a simpler method of identifying the treatment of these accounts has been given. Now and then, the learner may refer to the golden rules to make sure the answers are correct.

07. WORDS AND ABBREVIATIONS USED IN ACCOUNTING

Words and abbreviations used in accounting have different meanings according to the context in which they are used.

For example,

‘DR’ can mean ‘debtor’, ‘debit’ or ‘debited’.

‘CR’ can mean ‘creditor’, ‘credit’ or ‘credited’.

‘Loan’ can mean loan given to others or loan received from others.

‘Deposit’ can mean deposit given to others or deposit received from others.

‘A/C’, ‘A/c’ or ‘a / c’ means account.

As the study progresses, you will be able to make out the context in which abbreviations and words like the above are used.

08. REALISTIC VALUES HAVE TO BE CONSIDERED

Let us assume it is 25/12/2012. A sells 10,000 bucks worth of pens to B on the condition that B pays A later.

On 31/12/2012, A sits down to prepare his financial statements. He finds that B owes him 10,000 bucks. He thinks of collecting that amount and closing his (B’s) account. So, he approaches B and requests for payment. B replies, “Sorry friend. I need some time to pay you. I haven’t sold a single pen that you have given me.”

A understands the position of B. He agrees, “Yes, I understand your position. I, too, am a businessman like you. I will come next week. Please arrange for 10,000 bucks.”

B appears slightly annoyed, “Who says “10,000 bucks? I owe you only 9,000 bucks.”

A is shocked, “But I sold you 10,000 bucks worth of pens.”

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