DegreeLive

Bachelor of Business Administration (BBA) | Fifth Semester | UK5DSCMGT302

Basics of Financial Accounting

Course Code: UK5DSCMGT302 • Module 1 Notes

degreelive.in

Module 1: Introduction to Financial Accounting

Basics of Financial Accounting • Course Code: UK5DSCMGT302

Chapter 1: Conceptual Framework and Evolution of Financial Accounting

1.1 Nature, Scope, and Definitional Evolution of Accounting

Accounting is universally recognized as the language of commercial enterprise. In modern economic society, business organizations engage in thousands of complex transactions daily involving purchases, sales, debt obligations, employee compensation, and tax remittances. Without a disciplined, standardized system of record-keeping, measuring enterprise financial performance or communicating economic reality to external stakeholders would be impossible.

The definitive conceptual definition formulated by the American Institute of Certified Public Accountants (AICPA) defines **Accounting** as: *"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 a financial character, and interpreting the results thereof."* In contemporary accounting theory, the American Accounting Association (AAA) broadens this perspective, defining accounting as: *"The process of identifying, measuring, and communicating economic information to permit informed judgments and decisions by users of the information."*

Accounting is both a science and an art. It is an **Art** because it requires skilled human judgment, professional skepticism, and practical acumen to classify complex economic events, establish depreciation schedules, and interpret financial ratios. It is a **Science** because it is governed by an organized, universal body of knowledge structured around the double-entry equation, standardized principles (GAAP), and statutory standards (Ind AS and IFRS).

The Core Functions of Accounting:

- *Systematic Record-Keeping:* Creating a chronological, tamper-evident financial history of all business transactions in journals and ledgers, replacing fragile human memory.
- *Ascertainment of Operational Results:* Computing the net profit or loss generated by operating activities over a specific financial year through the preparation of the Trading and Profit & Loss Account.
- *Ascertainment of Financial Position:* Constructing the Balance Sheet on the final day of the financial year to provide a true and fair view of enterprise assets, liabilities, and owners' equity.
- *Facilitating Managerial Decision Making:* Supplying internal executives with cost data, cash flow analyses, and budget variances to guide pricing, capital investments, and cost control.
- *Meeting Statutory and Legal Requirements:* Ensuring transparent compliance with the Companies Act 2013, the Income Tax Act 1961, Goods and Services Tax (GST) statutes, and regulatory listing requirements.
- *Stewardship and Accountability:* Enabling company directors to report objectively to external shareholders regarding how corporate capital has been managed.

DegreeLive

1.2 Distinct Branches of Accounting

As business organizations expanded in size and complexity, specialized branches of accounting evolved to address distinct information requirements of varied user groups:

Accounting Branch	Core Purpose & Primary User Orientation	Regulatory Framework & Focus
1. Financial Accounting	Recording monetary transactions and preparing general-purpose financial statements (P&L, Balance Sheet) primarily for **external stakeholders** (investors, creditors, banks, tax authorities).	Mandatory statutory compliance; strictly governed by Indian Accounting Standards (Ind AS), Companies Act 2013, and IFRS. Historical orientation.
2. Cost Accounting	Ascertaining and controlling the unit cost of manufacturing goods or delivering services. Assists **internal management** in product pricing and cost reduction.	Internal management discipline; governed by Cost Accounting Standards (CAS) issued by ICMAI. Focuses on materials, direct labour, and overhead allocation.
3. Management Accounting	Synthesizing financial and cost accounting data to assist **internal executives** in strategic planning, budgeting, performance evaluation, and decision-making.	Purely optional and customized to internal needs; zero statutory constraints. Forward-looking; utilizes standard costing, marginal costing, and variance analysis.
4. Tax Accounting	Calculating tax liabilities (Direct Income Tax and Indirect GST), preparing tax returns, and executing legitimate tax planning strategies.	Governed strictly by national taxation statutes (Income Tax Act 1961 and CGST/SGST Acts). Reconciles accounting profit with taxable income.
5. Forensic Accounting	Investigating financial fraud, embezzlement, corporate asset diversion, and white-collar crime for presentation in courts of law.	Integrates accounting, auditing, and investigative legal skills; used in corporate bankruptcy proceedings and judicial litigation.
6. Social & Environmental Accounting	Measuring the ecological and societal impact of corporate operations (carbon footprint, resource depletion, community welfare CSR).	Emerging non-financial reporting framework; aligned with Business Responsibility and Sustainability Reporting (BRSR) mandates by SEBI.

1.3 Historical Origin: Luca Pacioli and the Birth of Double-Entry

While rudimentary tracking of agricultural surpluses and temple tributes existed in ancient Mesopotamia, Egypt, and India (as codified in Kautilya's *Arthashastra* around 300 BCE), modern double-entry bookkeeping was formally codified in Renaissance Italy. In 1494, Franciscan friar and mathematician **Fra Luca Bartolomeo de Pacioli** published his masterwork, *Summa de*

Arithmetica, Geometria, Proportioni et Proportionalita. Within this volume, a dedicated treatise entitled *Particularis de Computis et Scripturis* (Particulars of Reckonings and Writings) documented the Venetian merchants' double-entry system.

Pacioli introduced the three foundational accounting books that remain universal today: the **Memoriale** (memorandum log of raw transactions), the **Giornale** (the Journal, recording debits and credits in chronological sequence), and the **Quaderno** (the Ledger, containing indexed accounts). Pacioli declared that a merchant cannot sleep peacefully until their debits equal their credits, establishing the enduring principle of mathematical balance.

2.3 Cash Basis versus Accrual Basis of Accounting: Comprehensive Comparison

The timing of revenue and expense recognition fundamentally dictates the measurement of enterprise profitability. Accounting theory contrasts two operational methodologies:

Comparative Dimension	Cash Basis of Accounting	Accrual (Mercantile) Basis of Accounting
Revenue Recognition	Recorded strictly when cash is physically received in hand or bank.	Recorded when earned (goods delivered or services rendered), regardless of cash timing.
Expense Recognition	Recorded strictly when cash is physically disbursed.	Recorded when incurred (liability created or resource consumed), regardless of cash disbursement.
Matching Principle	Violates the matching principle; revenues and related expenses fall into disparate periods.	Strictly satisfies the matching principle, providing a true and fair view of operating profit.
Statutory Recognition	Prohibited by the Companies Act 2013 for corporate entities; allowed only for small professionals.	Mandatory under the Companies Act 2013, Indian Accounting Standards (Ind AS), and IFRS.

Worked Numerical Demonstration (Cash vs Accrual Basis): In its first year of operations, Apex Consulting Services generated total service billings of Rs 12,00,000, of which Rs 8,00,000 was collected in cash and Rs 4,00,000 remained outstanding as debtors on March 31. Operating expenses incurred during the year totaled Rs 6,50,000, of which Rs 4,50,000 was paid in cash and Rs 2,00,000 remained outstanding as accrued salaries. The firm also received an advance of Rs 50,000 for consulting services to be delivered next year.

Profit Calculation under Both Systems:

1. Under Cash Basis:
Total Cash Inflows = Rs 8,00,000 (collections) + Rs 50,00,000 (advance) = Rs 8,50,000.
Total Cash Outflows = Rs 4,50,000.
Net Cash Basis Profit = Rs 8,50,000 - Rs 4,50,000 = Rs 4,00,000.

2. Under Accrual Basis:
Earned Revenue = Rs 12,00,000 (Rs 8,00,000 collected + Rs 4,00,000 accrued debtors; the Rs 50,000 unearned advance is credited to a liability account on the balance sheet).
Incurred Expenses = Rs 6,50,000 (Rs 4,50,000 paid + Rs 2,00,000 accrued expenses).
True Net Operating Profit = Rs 12,00,000 - Rs 6,50,000 = Rs 5,50,000.
Managerial Insight: The cash basis distorted true enterprise profitability by Rs 1,50,000, masking Rs 4,00,000 of earned assets and including unearned advance liabilities as income.

4.4 Comprehensive Numerical Demonstration of the Accounting Equation

To demonstrate the perpetual mathematical equilibrium of the accounting equation (Assets = Liabilities + Capital), consider the following sequence of business transactions executed by entrepreneur Smt. Ananya upon launching Ananya Trading Enterprises:

Txn No.	Transaction Description	Equation Impact (Rs)	Resulting Balance Sheet Equation
1	Ananya commenced business with cash Rs 5,00,000.	Assets: Cash +5,00,000 Capital: +5,00,000	Assets (5,00,000) = Liab (0) + Cap (5,00,000)
2	Opened commercial bank account with SBI depositing Rs 3,00,000 cash.	Assets: Cash -3,00,000 Assets: Bank +3,00,000	Assets (Cash 2L + Bank 3L = 5,00,000) = Liab (0) + Cap (5,00,000)
3	Purchased display furniture by cheque Rs 50,000.	Assets: Furniture +50,000 Assets: Bank -50,000	Assets (Cash 2L + Bank 2.5L + Furn 50K = 5L) = Liab (0) + Cap (5L)
4	Purchased merchandise on credit from Bharat Ltd Rs 1,50,000.	Assets: Stock +1,50,000 Liabilities: Creditors +1,50,000	Assets (6,50,000) = Liab (1,50,000) + Cap (5,00,000)
5	Sold goods costing Rs 80,000 for Rs 1,20,000 on credit to Vikas.	Assets: Stock -80,000 Assets: Debtors +1,20,000 Capital (Profit): +40,000	Assets (6,90,000) = Liab (1,50,000) + Cap (5,40,000)
6	Paid office rent by cash Rs 20,000.	Assets: Cash -20,000 Capital (Expense): -20,000	Assets (6,70,000) = Liab (1,50,000) + Cap (5,20,000)
7	Paid Bharat Ltd in full settlement Rs 1,45,000 by cheque (discount Rs 5,000).	Liabilities: Creditors -1,50,000 Assets: Bank -1,45,000 Capital (Discount Gain): +5,000	Assets (5,25,000) = Liab (0) + Cap (5,25,000)
8	Withdrew cash for personal household use Rs 15,000.	Assets: Cash -15,000 Capital (Drawings):	Assets (5,10,000) = Liab (0) + Cap (5,10,000)

Txn No.	Transaction Description	Equation Impact (Rs)	Resulting Balance Sheet Equation
		-15,000	

Final Equation Equilibrium:
Total Assets: Cash (Rs 1,65,000) + Bank (Rs 55,000) + Furniture (Rs 50,000) + Stock (Rs 70,000) + Debtors (Rs 1,20,000) = **Rs 5,10,000**.
Total Liabilities: Creditors = **Rs 0**.
Total Capital: Initial (Rs 5,00,000) + Net Profit (Rs 40,000) + Discount Received (Rs 5,000) - Rent (Rs 20,000) - Drawings (Rs 15,000) = **Rs 5,10,000**.
Assets (Rs 5,10,000) = Liabilities (Rs 0) + Capital (Rs 5,10,000). The accounting equation holds in perfect mathematical harmony!

Chapter 2: Generally Accepted Accounting Principles (GAAP), Concepts, and Conventions

2.1 Accounting Concepts (Foundational Assumptions)

Generally Accepted Accounting Principles (GAAP) comprise the standardized rules, theoretical concepts, conventions, and regulatory doctrines that ensure financial statements remain consistent, transparent, and comparable across corporate enterprises. **Accounting Concepts** represent the fundamental theoretical assumptions upon which the entire structure of financial accounting is constructed:

1. Business Entity Concept: The business enterprise is treated as a separate, distinct legal and economic personage entirely divorced from its individual owners, partners, or shareholders. Personal assets, domestic expenditures, and private liabilities of owners must never be commingled with enterprise financial accounts. When an owner invests capital in the firm, the business records it as an internal liability owed by the enterprise to the owner.

2. Money Measurement Concept: Financial accounting records exclusively those economic transactions, events, and states that can be reliably quantified and expressed in terms of a common monetary currency (e.g., Indian Rupees). Intangible yet immensely valuable organizational realities—such as the genius of an executive team, employee morale, technological patents pending discovery, or customer goodwill—cannot be recorded directly in financial ledgers due to the absence of objective monetary measurement.

3. Going Concern Concept: It is assumed that the business enterprise will continue operating indefinitely into the foreseeable future and has neither the intention nor the necessity of entering liquidation or curtailing operations. This critical assumption justifies valuing fixed assets (plant, machinery, real estate) at historical acquisition cost minus accumulated depreciation rather than at immediate forced-liquidation market values.

DegreeLive

4. Accounting Period Concept: Although the true economic profit of an enterprise can only be determined with absolute precision when it is ultimately liquidated, management, investors, and tax authorities require regular periodic performance updates. Consequently, the infinite operating lifespan of the enterprise is partitioned into standardized, artificial temporal intervals termed *Financial Years* (in India, April 1 to March 31). This concept mandates the preparation of annual financial accounts.

5. Cost Concept (Historical Cost Principle): Assets acquired by an enterprise are initially recorded in accounting ledgers at their original purchase price (including all shipping, customs duty, installation, and commissioning costs incurred to make the asset operational). This historical value remains the objective foundation for balance sheet reporting and future depreciation computations, protecting financial statements against subjective speculative revaluations.

6. Dual Aspect Concept: The bedrock foundation of double-entry bookkeeping. Every commercial transaction exerts a dual, simultaneous impact on financial accounts. For every debit, there must exist an equal and corresponding credit. This is expressed in the fundamental **Accounting Equation**:

> `Assets = Liabilities + Owner's Equity (Capital)`
>
> Every business transaction alters the composition of assets, liabilities, or equity while keeping the equation in perfect mathematical balance.

7. Accrual Concept: Revenue is recognized and recorded in financial ledgers when it is earned (goods delivered or services rendered), and expenses are recognized when they are incurred (services consumed or obligations created), regardless of when cash is physically received or paid. This distinguishes accrual accounting sharply from simplistic cash accounting.

8. Matching Concept: To determine true net profit or loss for an accounting period, all operating expenses incurred to generate the revenues of that specific period must be matched against those revenues. If goods sold during a year were manufactured using raw materials purchased in that year or prior years, the cost of those goods must be deducted from the sales revenue of that exact operating period.

9. Realization Concept: Revenue is recognized only when the legal right to receive cash has been established—typically at the exact point of sale when physical goods are transferred to the buyer and invoices are accepted, rather than when sales contracts are negotiated or cash is subsequently collected.

2.2 Accounting Conventions (Pragmatic Guidelines)

While concepts represent foundational theoretical assumptions, **Accounting Conventions** emerge from longstanding practical traditions, customs, and professional usage:

- **1. Convention of Prudence (Conservatism):** The classical doctrine of accounting prudence: *"Anticipate no profits, but provide for all possible losses."* When evaluating assets and transactions under uncertainty, accountants must choose the valuation option that is least likely to overstate assets and income. Practical applications include: valuing closing inventory at *cost or net realizable value (NRV), whichever is lower*; creating provisions for doubtful debts; and creating

provisions for pending litigation liabilities. Speculative future gains are never recorded until fully realized.

- **2. Convention of Consistency:** Accounting policies, valuation methods, and reporting formats once adopted must be applied consistently year after year. For example, if a firm selects the Straight-Line Method of depreciation or the FIFO inventory valuation method, it must not alternate arbitrarily between Straight-Line and Written Down Value (WDV) methods across consecutive years. Consistency ensures meaningful historical comparison of financial performance over time. Any deliberate change in policy must be disclosed in financial footnotes alongside its monetary impact.
- **3. Convention of Materiality:** Accounting must record and disclose all significant financial facts that could reasonably influence the economic decisions of informed users. Trivial, insignificant expenditures (e.g., purchasing a Rs 50 stapler that technically lasts five years) need not be capitalized and depreciated over five years; they are expensed immediately as office stationery to prevent financial statements from becoming cluttered with trivial accounting minutiae.
- **4. Convention of Full Disclosure:** Financial statements must disclose all material economic facts completely, honestly, and transparently. Financial statements must include comprehensive statutory footnotes detailing contingent liabilities (e.g., pending tax claims disputed in court), market valuation of investments, changes in accounting estimates, and related-party corporate transactions.

Chapter 3: Indian Accounting Standards (Ind AS) and Convergence with IFRS

3.1 The Need for Global Accounting Harmonization

With the rapid globalization of capital markets, multinational corporate investments, and cross-border mergers and acquisitions, the existence of disparate national accounting standards created severe friction. Foreign investors struggled to compare financial statements prepared under US GAAP, Indian GAAP, UK GAAP, or Japanese GAAP. This friction led to the formation of the International Accounting Standards Board (IASB), which promulgated **International Financial Reporting Standards (IFRS)** as the universal global accounting benchmark.

3.2 Indian Accounting Standards (Ind AS) Framework

India made the strategic decision not to adopt IFRS verbatim, but rather to **converge** with IFRS by formulating **Indian Accounting Standards (Ind AS)**. Ind AS are converged standards notified by the Ministry of Corporate Affairs (MCA) under Section 133 of the Companies Act 2013, formulated by the Institute of Chartered Accountants of India (ICAI) and vetted by the National Financial Reporting Authority (NFRA).

Where the unique Indian economic, legal, or regulatory environment required departures from IFRS, ICAI introduced specific modifications termed **Carve-Outs** (deviations from IFRS) and **Carve-Ins** (additional options allowed under Ind AS):

Standard No.	Standard Title	Core Mandate & Financial Impact
Ind AS 1	Presentation of Financial Statements	Governs structure, minimum disclosures, classification of current/non-current assets, and Statement of Changes in Equity.
Ind AS 2	Inventories	Requires inventory valuation at the lower of historical cost and net realizable value (NRV). Prohibits the LIFO cost formula.
Ind AS 16	Property, Plant and Equipment (PPE)	Governs recognition, component depreciation, derecognition, and subsequent measurement (Cost model vs Revaluation model).
Ind AS 115	Revenue from Contracts with Customers	Establishes the universal 5-step model for revenue recognition based on the transfer of control rather than risks and rewards.
Ind AS 116	Leases	Eliminates operating lease classification for lessees, mandating balance sheet recognition of a Right-of-Use (ROU) Asset and Lease Liability.

3.3 Qualitative Characteristics of Useful Financial Information

According to the Conceptual Framework for Financial Reporting issued by the IASB and adopted by ICAI, financial statements must exhibit specific qualitative characteristics to ensure utility for investors, lenders, and creditors:

Qualitative Characteristic	Category Hierarchy	Operational Accounting Mandate
1. Relevance	Fundamental Characteristic	Financial information must be capable of making a difference in user decisions by having predictive value, confirmatory value, or both. Governed strictly by Materiality.
2. Faithful Representation	Fundamental Characteristic	Financial statements must represent economic phenomena in words and numbers faithfully: complete, neutral (free from managerial bias), and free from material error. Substance over form prevails.
3. Comparability	Enhancing Characteristic	Enables users to identify and understand similarities and differences across corporate entities and across different financial years for the

Qualitative Characteristic	Category Hierarchy	Operational Accounting Mandate
		same enterprise. Requires consistent accounting policies.
4. Verifiability	Enhancing Characteristic	Different knowledgeable and independent observers can reach consensus that a particular depiction represents economic reality faithfully (supported by objective audit trails and third-party invoices).
5. Timeliness	Enhancing Characteristic	Having financial information available to decision-makers in time to be capable of influencing their decisions (quarterly filings published within 45 days).
6. Understandability	Enhancing Characteristic	Classifying, characterizing, and presenting information clearly and concisely for users who possess reasonable knowledge of business and economic activities.

3.4 Comparative Architecture: Indian GAAP (AS), Ind AS, and IFRS

The progression of corporate reporting in India reflects a deliberate migration from historical cost-centric accounting toward fair-value international standards:

- *Traditional Indian GAAP (Accounting Standards - AS):* Promulgated under the Companies (Accounting Standards) Rules 2006. Highly conservative, rule-based, reliant primarily on historical cost conventions, and restrictive on fair-value asset adjustments. Still applicable to non-corporate entities and small unlisted companies.
- *Indian Accounting Standards (Ind AS):* Mandatory for all listed companies and unlisted companies with net worth ≥ Rs 250 Crores, as well as their holding, subsidiary, joint venture, and associate entities. Converged with IFRS, Ind AS adopts principles-based guidance, mandatory discounting of long-term liabilities to present value, fair-value measurement of financial instruments, and comprehensive footnote disclosures.
- *Carve-Outs in Ind AS:* Notable deviations from IFRS include: **Ind AS 101** allowing companies to use Indian GAAP carrying values of property, plant, and equipment as deemed cost upon transition; and **Ind AS 21** permitting the continuation of amortizing long-term foreign currency monetary exchange differences over the remaining asset life.

Chapter 4: The Accounting Process, Types of Accounts, and Golden Rules

4.1 The Accounting Cycle

The **Accounting Cycle** is the continuous, standardized sequence of accounting procedures executed over each financial year to convert raw commercial transactions into audited financial statements:

1. **Identification of Transactions:** Gathering commercial source documents (cash receipts, vendor bills, tax invoices, bank statements).
2. **Journalizing:** Recording financial transactions chronologically in the primary book of original entry (the Journal) using the double-entry mechanism.
3. **Posting to Ledger:** Transferring debit and credit entries from the journal into individual thematic accounts in the Ledger.
4. **Balancing Accounts:** Totaling debit and credit columns of each ledger account at the end of the operating period to determine net balances.
5. **Preparation of Trial Balance:** Compiling an extraction schedule of all debit and credit ledger balances to mathematically verify arithmetical accuracy.
6. **Adjusting Entries:** Recording year-end adjustments for accruals, prepayments, depreciation, and doubtful debts.
7. **Preparation of Financial Statements:** Constructing the Trading Account, Profit and Loss Account, and Balance Sheet.
8. **Closing Entries:** Transferring temporary nominal accounts (revenues and expenses) to the Trading and P&L accounts to reset balances to zero for the new financial year.

4.2 Classification of Accounts and the Golden Rules of Accounting

Under the classical British approach to double-entry bookkeeping, all ledger accounts are categorized into three fundamental classes, each governed by its inviolable **Golden Rule of Debit and Credit**:

Account Classification	Definitional Scope & Sub-Types	Inviolable Golden Rule of Bookkeeping
1. Personal Accounts	Accounts representing individual human beings, corporate institutions, and representative entities with whom the firm conducts business. • *Natural Persons:* Rahul's A/c, Priya's A/c. • *Artificial Legal Persons:* State Bank of India A/c, Tata Motors Ltd A/c. • *Representative Personal:* Outstanding Rent A/c, Prepaid Insurance A/c.	**DEBIT THE RECEIVER** **CREDIT THE GIVER** *(Debit the party who receives economic benefit; credit the party who confers economic benefit).*
2. Real Accounts	Accounts representing physical and non-physical tangible and	**DEBIT WHAT COMES IN** **CREDIT WHAT GOES OUT**

Account Classification	Definitional Scope & Sub-Types	Inviolable Golden Rule of Bookkeeping
	intangible assets and property owned by the enterprise (excluding personal debts). • *Tangible Real Assets:* Cash A/c, Machinery A/c, Furniture A/c, Land A/c. • *Intangible Real Assets:* Patents A/c, Goodwill A/c, Trademarks A/c.	*(Debit an asset account when property enters the firm; credit an asset account when property departs).*
3. Nominal Accounts	Accounts representing expenses, operational losses, gains, and revenue streams incurred during business operations. • *Expenses & Losses:* Salaries A/c, Rent Paid A/c, Bad Debts A/c, Depreciation A/c. • *Revenues & Incomes:* Sales A/c, Commission Received A/c, Interest Earned A/c.	**DEBIT ALL EXPENSES AND LOSSES** **CREDIT ALL INCOMES AND GAINS** *(Debit when economic value is consumed; credit when economic surplus is realized).*

4.2.1 Tabular Application of the Golden Rules across Representative Transactions

Transaction Description	Accounts Involved	Account Classifications	Rule Applied & Decision
Started business with cash Rs 1,00,000	Cash A/c Capital A/c	Real Account Personal Account	Debit what comes in (Cash) Credit the giver (Capital)
Deposited cash into bank Rs 40,000	Bank A/c Cash A/c	Personal Account Real Account	Debit the receiver (Bank) Credit what goes out (Cash)
Purchased goods for cash Rs 25,000	Purchases A/c Cash A/c	Nominal Account Real Account	Debit all expenses (Purchases) Credit what goes out (Cash)
Sold goods on credit to Rohan Rs 18,000	Rohan's A/c Sales A/c	Personal Account Nominal Account	Debit the receiver (Rohan) Credit all incomes (Sales)
Paid office salary Rs 12,000	Salaries A/c Cash A/c	Nominal Account Real Account	Debit all expenses (Salaries) Credit what goes out (Cash)

DegreeLive

Transaction Description	Accounts Involved	Account Classifications	Rule Applied & Decision
Received interest on deposit Rs 3,500	Cash A/c Interest Received A/c	Real Account Nominal Account	Debit what comes in (Cash) Credit all incomes (Interest)

4.3 The Modern Accounting Equation Approach

Modern international accounting (the American Balance Sheet Approach) classifies accounts into five categories based directly on the accounting equation: **Assets, Liabilities, Capital (Equity), Revenues, and Expenses**:

- *Assets:* Increases are recorded on the **DEBIT** side; decreases are recorded on the **CREDIT** side. Normal balance is Debit.
- *Liabilities:* Increases are recorded on the **CREDIT** side; decreases are recorded on the **DEBIT** side. Normal balance is Credit.
- *Capital (Equity):* Increases are recorded on the **CREDIT** side; decreases (e.g., Drawings) are recorded on the **DEBIT** side. Normal balance is Credit.
- *Expenses & Losses:* Increases are recorded on the **DEBIT** side; decreases are recorded on the **CREDIT** side. Normal balance is Debit.
- *Revenues & Gains:* Increases are recorded on the **CREDIT** side; decreases are recorded on the **DEBIT** side. Normal balance is Credit.

4.4 Summary of Foundational Accounting Invariants

Financial accounting represents the bedrock infrastructure of modern corporate transparency and capital allocation. Anchored by the dual-aspect convention, the accounting equation ensures perpetual equilibrium across assets, liabilities, and equity. Understanding the distinction between concepts and conventions protects accountants from subjective distortion, while convergence with Ind AS aligns Indian enterprises with international corporate reporting standards. Mastering the classical Golden Rules of bookkeeping provides the essential foundation for journalizing, ledger posting, and constructing audited financial statements.

DegreeLive