

Financial Accounting
Dr. Puran Singh
School of Humanities and Social Sciences
Indian Institute of Technology, Mandi

Lecture – 17
2.2 Tutorial - Types of Accounts (Part II)

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2.2 Tutorial – Types of Accounts

Name of Account	Type of Account
Creditors A/c XYZ Ltds A/c	Personal A/c

Justification:

① Vendors/Suppliers
 ② ABC Ltd
 XYZ Ltd

1000 } Creditors
 1000

Business → Vendor
 Vendor → Business
 Liability Creditors

Personal A/c: Liability ✓ Real A/c: Assets Nominal A/c: Exp/Incomes

This is a continuation of the previous video. There are three four more accounts that we need to look at and then we will summarize.

The account that we now have is the creditors account. The creditors are the vendors or the suppliers of the business. The idea is that the business is based upon the growing concern principle. You expect the business to continue for a long period of time and therefore, your vendors and suppliers supply goods to you and you can pay them after a lag of a certain period of time. So, when that happens, a new account is created, it is called a creditors account. The creditors may have a name. For example, the vendors could be ABC limited, another could be XYZ limited and you owe them different amounts. Collectively these vendors are going to be called creditors. There can be one creditor or there can be tens of creditors. Let us understand the nature of creditors account. Now, let us say there are two businesses. This is your business and this is your vendor. The vendor is going to supply goods to the business and the business is either going to pay in cash, or let us assume, the business does not pay in cash right now. Therefore, there is going to be a new liability which is going to get created, the business has to

now pay this vendor at some point after 2 months. So, a new liability is created and the name of the liability is creditors. Now, this is a liability and the rule for liabilities is that all the liabilities are categorized as personal accounts. Now, you could have the name of the creditor here as well, it could be called XYZ limited's account. But then you will have to ask who is XYZ: is this our supplier? Is this our buyer? You need more information to decide which type of account it should be. Therefore, for simplicity we have said creditors. But, in assignment questions or otherwise, if you have been given a name then you have to figure out whether this is a supplier or this is a vendor. If it is a vendor then whether it is a liability for the business or not and if it is a liability then it should be a personal account.

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2.2 Tutorial – Types of Accounts

Name of Account	Type of Account
Outstanding expenses <i>Handwritten: 'Overdue', Salaries, Rent, Tele, elec.</i>	<u>Personal A/c</u>

Justification:

Timeline: 2020 (Apr) to 2021 (Apr Today)

- 6 months (2020): 100 x 6 = 600 paid
- 6 months (2021): 100 x 6 = 600 unpaid

Summary: Total = 1200 Expense Paid = 600 Outstanding = 600 Expense

Diagram: Services → Outstanding Liability

Account Types: Personal A/c: Liability, Real A/c: Assets, Nominal A/c: Expenses

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Then, you have outstanding expenses. What are outstanding expenses? In one of the earlier slides, I talked about the financial year 2020-2021. So, this is March. In the earlier slides I talked about expenses for a given year. You may pay for 6 months, let us say this is the first 6 months, and this is the second 6 months and you assume any expense. Let us say these are salaries; outstanding expenses and expenses could be salaries, rent, telephone bill, electricity- any expense for that matter as long as it is outstanding and I am trying to explain to you what outstanding means.

So, for 6 months let us say this is salaries. Salaries, let us say 100 into 6; 600 has been paid and 100 into 6; remaining 600 is unpaid. And, right now you are standing here in April 2021. The next financial year has already begun and you have paid half of the salaries for the past year

and half of the salaries have not been paid for the past year. This is what is called outstanding. Outstanding as against, general English language meaning which is you are an outstanding student for example, that has a different meaning; but another connotation in English language itself is that of something which needs to be paid by the business. So, in the language of accounting, the word outstanding is used to refer to the expenses which are overdue. Let me write overdue here; it is outstanding, and can be thought of as overdue. The last date has gone by and you have received these services. So, again let me write about it. You have received the benefit or the services against this expense, but you did not pay for it. Now, salaries are to be paid to staff who have rendered their services to the business, they can go to the court of law, sue the company and demand the payment of salaries. So, that is the idea. The company has a liability. So, if we want to again look at this infographic, the employees provide services to the business and in return the company has to pay salaries. When salaries are not paid, then salaries are outstanding and when salaries are outstanding, they represent a liability. The liability that the business has towards the employees and when it is a liability, it is a personal account.

Understand the difference between the first 600 that has been paid. The first 600 which has been paid in cash is your expense, the remaining 600 which has not been paid in cash which is overdue becomes your liability going forward. However, one important point which you must notice is that according to matching principle and according to accrual principle, while calculating the profit for a given year you have to match the expenses of a year to the incomes of a year. So, the total expense in this financial year; let me write it here, total expense is 1200 regardless, of whether you have paid it or not, it has become due. Total expense for the year is 1200; actually, the expense which was paid is 600 and the outstanding expense is the remaining 600. This remaining 600 becomes a liability, this 1200 becomes the total expense that you show in the income statement while calculating the profit, and this paid 600 reduces the cash balance that you have.



More on that, when we get into these topics a little bit more, but I am also using this tutorial to introduce you to various dynamics of these transactions, these accounts and how to think about these as we move along.

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2.2 Tutorial – Types of Accounts

Name of Account	Type of Account
<p style="text-align: center; margin: 0;">Interest earned on deposits</p> <p style="text-align: center; margin: 0;"><u>Income</u> <u>Bank</u></p> <p style="margin: 5px 0 0 0;">Justification:</p> <p style="margin: 0 0 0 20px;">① Interest \neq Operating Income</p> <p style="margin: 0 0 0 20px;">② Non operating Income</p> <div style="margin: 10px 0 0 20px;"> <p style="text-align: center; margin: 0;"><u>Furniture Trading Corp</u></p> <p style="margin: 0 0 0 20px;">↑ ↑</p> <p style="margin: 0 0 0 20px;">Business Bank</p> <p style="margin: 0 0 0 40px;">↙ ↘</p> <p style="margin: 0 0 0 40px;">Interest 10</p> <p style="margin: 0 0 0 40px;">Non operating Income</p> </div>	<p style="text-align: center; margin: 0;"><u>Nominal A/c</u></p> <p style="margin: 10px 0 0 20px;">Only operating income = sales of G or S</p> <p style="margin: 0 0 0 20px;"><u>SBI Bank Corp</u></p> <p style="margin: 0 0 0 20px;">Take deposits – Int</p> <p style="margin: 0 0 0 20px;">Lend Money – Int</p> <p style="margin: 0 0 0 20px;">Operating Income</p>

Personal A/c: Liability
Real A/c: Assets
Nominal A/c: Expenses

Let us move on. You have interest earned on deposits. So, this is business depositing money in the bank. So, deposit is let us say in the bank and you have earned clearly this is an income. Now, interest that you earn, interest is not an operating income. The only operating income that a business has is from the sale of goods and services. The only operating income is from the sales of either goods or services. G and S are not standard short forms, but for lack of space I just wrote it here. Interest, therefore, clearly is a non-operating income. Regardless of whether it is an operating income or non-operating income: it is a nominal account.

Now, another discussion on this, the treatment of an item depends upon the nature of business. Take for example a furniture trading business. The furniture trading corporation has additional cash, let me say this is a bank, this is business. So, the business has extra cash, they deposit this in the bank and the bank pays an interest of 10. This is a furniture trading corporation and you have an income which is non-operating in nature because your primary activity was manufacturing, trading the furniture, buying and selling the furniture.

However, if you are talking about a bank, take for example SBI. So, what is SBI's main business? Main business is to take deposits right and lend money; loans, right. So, it does not produce any other goods. The services that are lent: you take a deposit and you pay interest on it; you lend money to people and you earn interest on it. So, for a bank the interest that is earned on the loans is actually operating income because that is the primary activity. It is not a finance cost, it is operating income.



Again I am emphasizing that you should look at the purpose of the business, you should look at what the business is doing on a day to day basis, what are the primary activities in order to decide whether an item or an account should be operating or non-operating in nature.

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2.2 Summary

Account	Type	Category
Cash	Real -	Asset
Bank Balance	Real ✓	Asset
Office equipment	Real ✓	Asset
Stock of goods	Real ✓	Asset
Rent for building	Nominal	Expense
Electricity bills	Nominal	Expense
Capital	Personal	Liability
Purchase of goods	Nominal	Expense
Sales	Nominal	Income
Carriage	Nominal	Expense
Duty on purchase	Nominal	Expense
Motor Van	Real ✓	Asset
Furniture	Real ✓	Asset
Land	Real ✓	Asset
Salary	Nominal	Expense
Interest	Nominal	Expense
Loan from bank	Personal	Liability
Loss by fire/theft	Nominal	Loss
Loss on sale of building	Nominal	Loss
Creditors	Personal	Liability
Outstanding Expenses	Personal	Liability
Interest earned on deposits	Nominal	Income

All assets are Real Accounts!

Let us move forward. We are done with all the various different types of accounts that I want to look at. You see a list of the accounts that we have gone through in the first column and then you have the type and then the category.



The point I want to drive home is as follows: all the assets are categorized as a real account. I mean empirically we are now proving it by looking at various items- all the assets in the real account.

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2.2 Summary

Account	Type	Category
Cash	Real	Asset
Bank Balance	Real	Asset
Office equipment	Real	Asset
Stock of goods	Real	Asset
Rent for building	Nominal	Expense ✓
Electricity bills	Nominal	Expense ✓
Capital	Personal	Liability
Purchase of goods	Nominal	Expense
Sales	Nominal	Income ✓
Carriage	Nominal	Expense
Duty on purchase	Nominal	Expense
Motor Van	Real	Asset
Furniture	Real	Asset
Land	Real	Asset
Salary	Nominal	Expense ✓
Interest	Nominal	Expense ✓
Loan from bank	Personal	Liability
Loss by fire/theft	Nominal	Loss ✓
Loss on sale of building	Nominal	Loss ✓
Creditors	Personal	Liability
Outstanding Expenses	Personal	Liability
Interest earned on deposits	Nominal	Income ✓

All expenses/losses and incomes/gains are nominal Accounts!



Next, you see all the expenses and incomes and losses here: all the expenses and losses and incomes and gains are nominal accounts.

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2.2 Summary

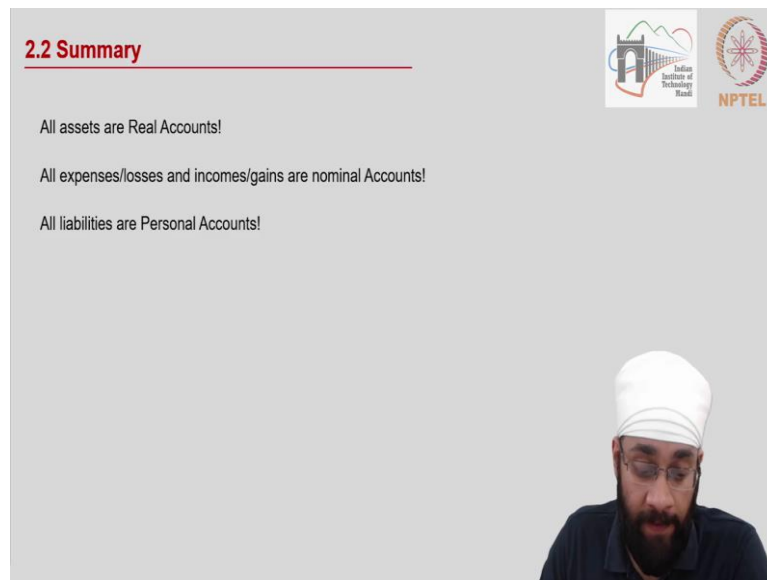
Account	Type	Category
Cash	Real	Asset
Bank Balance	Real	Asset
Office equipment	Real	Asset
Stock of goods	Real	Asset
Rent for building	Nominal	Expense
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Capital	Personal	Liability
Purchase of goods	Nominal	Expense
Sales	Nominal	Income
Carriage	Nominal	Expense
Duty on purchase	Nominal	Expense
Motor Van	Real	Asset
Furniture	Real	Asset
Land	Real	Asset
Salary	Nominal	Expense
Interest	Nominal	Expense
Loan from bank	Personal	Liability
Loss by fire/theft	Nominal	Loss
Loss on sale of building	Nominal	Loss
Creditors	Personal	Liability
Outstanding Expenses	Personal	Liability
Interest earned on deposits	Nominal	Income

All liabilities are Personal Accounts!

And, the third category is liabilities. All liabilities are personal account, there could be further categorization of personal accounts such as representative personal account. Regardless, if it is a liability it is going to be a personal account.

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2.2 Summary

- All assets are Real Accounts!
- All expenses/losses and incomes/gains are nominal Accounts!
- All liabilities are Personal Accounts!

The slide also features logos for the Indian Institute of Technology Madras and NPTEL in the top right corner. In the bottom right corner, there is a video feed of a man with a beard and glasses wearing a white turban.

Alright. So, this is the learning from this video and the video before this. These 3 rules are going to help us. These are the building blocks for us to understand the double entry system which we will learn in the following videos. Using this categorization, we will be able to write the transactions in the first book of entry called journal. More on that in the following videos. I see you in the next video.