Traditional Approach of Financial Accounting

Classification of Accounts:

1. Personal accounts
2. Impersonal accounts

Personal Accounts

These are the accounts of human beings, natural persons and artificial persons. Hence, Personal accounts are further classified as:

1. Natural persons
2. Artificial persons and
3. Representative persons

1] Natural Persons

Natural persons are human beings. Here, we include accounts belonging to humans. Thus, Debtor's A/c., Creditor's A/c., Proprietor's A/c., Proprietor's Capital A/c., Proprietor's Drawings A/c. etc. fall under this category.

2] Artificial Persons

These are those persons who are not human beings but can act and work like humans. They possess a separate identity in the eyes of law. So, they can enter into agreements. They qualify to be penalized too.

These, therefore, include Hindu undivided families, partnership firms, co-operative societies, an association of persons, companies, municipal corporations, hospitals, banks, government bodies, etc.

3] Representative Persons

As the name suggests, these accounts represent the accounts of the persons. These persons may be natural or artificial. Most importantly, when the nominal accounts i.e., those of expenses and incomes become outstanding, pre-paid, accrued or unearned, they fall under this category. Hence, Wages Outstanding A/c, Pre-paid Rent A/c, Accrued Interest A/c, Unearned Commission A/c, etc. fall under this category.

Impersonal Accounts

Impersonal Accounts are the accounts other than the Personal Accounts. Hence, these are further classified as:

1. Real accounts
2. Nominal accounts

1. Real Accounts

These accounts are the accounts of all the assets and liabilities of the business. Therefore, these accounts are not closed at the end of the accounting year. Thus, they continue to appear in the Balance Sheet. The balances of these accounts are carried forward to the next accounting year. So, these are permanent accounts and have the following categories:

(a) Tangible Real Account:

It comprises of those assets, properties or possessions that one can touch, see and measure. For example, Building A/c, Furniture A/c, Cash A/c, etc.

(b) Intangible Real Account:

It comprises of those assets or possessions that one cannot touch, see or measure. But these possess a monetary value. Thus, they can be bought and sold also. For example, Goodwill, Patents, Copyrights, Trademark, etc.

2. Nominal Accounts

Nominal accounts are the accounts related to the expenses, losses, incomes, and gains. These accounts are temporary accounts. Therefore, the balances of these are transferred to Trading and Profit and Loss A/c at the end of the accounting year. Hence, these accounts have no balance to carry forward next year.

Rules for Debit and Credit under the Traditional Approach

Personal Account	Debit the Receiver; Credit the Giver
Real Account	Debit what comes in; Credit what goes out
Nominal Account	Debit all expenses/losses; Credit all income/gains

Modern Approach of Financial Accounting

Under the Modern Approach the accounts can be classified as follows:

I. Assets Accounts

Assets are the properties, possessions or economic resources of a business. They help in business operations and help in earning revenues. They can be measured in terms of money.

Assets can be tangible or intangible. Also, assets can be classified as Fixed Assets and Current Assets. Fixed Assets are held for the long-term.

They help in carrying out the normal operations of the business. For example, land, building, furniture, machinery, vehicles, etc. Current Assets are held for short-term. They are realizable within a year usually. For example, debtors, bills receivable, bank balance, cash, stock, etc.

II. Liabilities Accounts

Liabilities are the amounts that an entity owes to the outsiders. These are the obligations or the debts payable by the business. Liabilities can also be classified as Long-term and Current.

Long-term Liabilities are payable after a period of one year. For example, debentures, bank loans, etc. Current liabilities are payable within one year. For example, creditors, bills payable, rent outstanding, bank overdraft, etc.

III. Capital Accounts

The money brought into the business by the owner is called Capital or Owner’s Equity. The Capital can be brought in cash or assets by the owner.

Capital is an obligation of the business that has to be paid back to the owner. Because business is a separate entity from its owner.

Therefore, the Capital is shown on the liabilities side of the Balance Sheet. The capital account is shown after deducting the Drawings by the owner. Drawings are the amount of cash, goods or assets taken by the owner for personal use from the business.

IV. Revenue Accounts

Revenue is the amount earned by the business by selling goods or rendering of services. Also, it includes other incomes such as rent received, the commission received, interest received, dividend earned, etc. All items of revenue are also clubbed together under the Modern Approach.

V. Expenses Accounts

All costs incurred or money spent by a business in order to earn revenues is called expenses. It is noteworthy here that when the benefits of the money spent are exhausted within a period of one year, it is called an Expense. While in case the benefit lasts for more than a year it is called Expenditure.

Therefore, the purchase of goods is expenditure while the cost of goods sold is an expense. For example, rent paid, salary paid, electricity charges, interest paid, etc. are expenses. While the purchase of assets, purchase of short-term investments, etc. fall under the category of expenditure.

Rules of Debit and Credit under the Modern Approach

Asset Accounts	Debit the increase; Credit the decrease
Liabilities Accounts	Credit the Increase; Debit the decrease
Capital Accounts	Credit the Increase; Debit the decrease
Revenue Accounts	Credit the Increase; Debit the decrease
Expense Accounts	Debit the increase; Credit the decrease

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