Bachelor of Commerce
(B.Com.)

Financial Accounting
(OBCMCO101T24)

Self-Learning Material
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Financial Accounting

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Course Introduction

Financial Accounting is assigned 5 credits and contains 15 units. Its objective is to help the students to become intelligent users of accounting information and use the basic accounting and financial terminology.

Each unit is divided into sections and sub-sections. Each unit begins with statement of objectives to indicate what we expect you to achieve through the unit.

Course Outcomes

After studying this course, a student will be able to:

1. Identify the nature and purpose of financial statements in relationship to decision making.
2. Summarize the ability to use a basic accounting system to create (record, classify, and summarize) the data needed to solve a variety of business problems
3. Subdivide the higher concepts of branch and departmental accounting and comprehend it
4. Instil the knowledge about accounting procedures, methods and techniques.
5. Evaluate the fundamental of company accounts –issue of shares and debentures its entries and balance sheet.
6. Analyse the financial performance of the firm and company.
7. Prepare financial reports of the firm to use in decision making.

We hope you will enjoy the course.

Acknowledgement

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Unit 1

Accounting (As an Information System)

Objective:

1. Know what Accountancy means.
2. Understand the meaning of the Financial Accounting (as an Information System.)
3. Explain Functions, advantages, and limitations of Accounting
4. Understand the Qualitative characteristics of Accounting Information

Structure

1.1 Introduction

1.2 Accounting as the Language of Business and an Information System

1.3 Financial Accounting Information the (Needs & User)

1.4 Qualitative features

1.5 Functions, advantages, and limitations.

1.6 Summary

1.7 Self-Assessment Questions

1.8 References

1.1 Introduction

When it comes to running a business, what is the first thing that comes to your mind? Finances, right? No matter the size, running a business smoothly requires optimal cash flow and the right flow of reports and information across channels. This system disseminates information related to the company to their respective stakeholders. This is very important for faster decision making.

One of the key responsibilities of the accountant is to work closely with the AIS to ensure complete accuracy in the company's financial transactions and record keeping. Additionally, this information should be readily available and accessible to those who need to refer to it as needed.

Advantages of Accounting Information Systems

Accounting information systems provide a seamless flow of important and relevant data throughout an organization and have several benefits that help companies better manage their operations. Let's take a look at these advantages.

1. **Improving cross-departmental communication**

The robust AIS paves the way for proper information flow across different departments within an organization. Let's say the sales department has uploaded a sales budget. This information is essential for inventory departments to improve inventory planning and inventory management. Once inventory is purchased based on sales input and analysis, this information is shared with accounts payable whenever new inventory is purchased for invoicing purposes. In a nutshell, AIS gives you complete visibility into your company's transactions within its various functions for better business planning and forecasting.

2. **Data access control**

The AIS allows users to define different security configurations based on their requirements. It's clear that not every department needs information about everything that's going on within their organization, right? Well, that's what AIS does. By providing controlled data access, we ensure that only relevant information is distributed to specific users. There are varying levels of security privileges that require authorization to access information, and AIS limits information based on the privileges granted by primary privileges.

What are the functions of AIS?

Accounting information systems help different departments within a company work together. The three basic functions of AIS are:

Types of Accounting Information Systems:

There are three types of accounting information systems: manual, legacy, and modern/integrated systems.

1. Manual systems are primarily used by smaller organizations where the entire system is manual and lacks technical integration. Due to the size of the business, AIS doesn't have to be very complicated and all records can be maintained manually. However,

manual systems require source documents, general ledgers, general Journals, special Journals or sub-Journals for more accurate bookkeeping.

2. Legacy systems were prevalent before high-end technology came along. While it certainly has the benefits and ease of use of having historical data for your company, it definitely lacks the flexibility and reliability that modern technology can offer.
3. A modern/integrated system is a Windows-based technology that is considered much more user-friendly than traditional accounting systems. They are generally less expensive, faster to implement, and less buggy than traditional systems.

How are Accounting Information Systems (AIS) used?

An accounting information system is the broad structure of an organization that deals with the collection, storage, and processing of financial and accounting data for use by decision makers. It forms a centralized system where financial information is stored by authorized personnel and this information is distributed to various stakeholders within the organization. Sensitive data such as earnings, purchases, employees, customers and taxes are stored in AIS.

Accounting information systems have database structures for storing information. This database structure is usually programmed with a query language that allows manipulation of tables and data. Due to the large number of required input fields in AIS (old and new), it is important that security be very strong to prevent malicious virus attacks.

Accounting software such as Tally Prime can handle multiple verticals of business. It not only stores your data, it gives you the freedom to generate your most important financial reports, manage your inventory, and comply with tax laws seamlessly.

1.2 Accounting as the Language of Business

“Accounting is often referred to as "language of business". It is the means of communicating information regarding a business. Its responsibility is to apply accounting theory, a thorough knowledge of generally accepted accounting principles, to the practical field of business to ensure a fair representation of income and financial position.”

Accounting is the analysis and interpretation of bookkeeping records.

To run your business profitably and maintain your solvency, you need to measure your business profitability and solvency on a regular basis. To that end, it is imperative to know if the business is making enough profit, is suffering losses, and has enough money to pay off its

debts. Accounting provides all this information and enables management to guide the business on a profitable solvent course.

After properly analyzing the information provided by the financial report, the user makes decisions about future activities. Accounting provides the necessary information, so in practice it is used to represent the economic position of an entity while performing a service function. Therefore, it becomes clear that maintaining an account is not the primary purpose of any person or entity.

On the contrary, the main purpose is to make decisions based on the financial facts presented by the financial statements. Therefore, account understanding is not the primary objective. They just serve a specific purpose.

We express ourselves through language. Similarly, the results of activities are expressed through accounting with the help of financial statements. Financial accounting measures the performance of a business - profitability and financial position. In this way, the language of accounting expresses the overall picture of the business through various processes of accounting. Company progress can be easily compared and checked with the help of various accounting data.

"Accounting, the language of business, has a lot in common with other languages," says Yuji Ijiri, as was reported in the financial statements using accounting terms.

1.3 The users of Financial Accounting Information and their needs

"Another definition of the American Institute of Certified Public Accountants (AICPA) is: Interpret the result. "

"Accounting includes recording, classifying, and summarizing business transactions. This is the process of identifying, measuring, and communicating economic information, including four interrelated phases." They are outlined here:

First, the first phase is intended to record economic events or transactions called Journals- recording them in chronological books in chronological order as they occur. This process is known as journaling. Next is ledger posting phase. This is the process by which all transactions are synthesized for each account and the cumulative balance for each of those accounts can be determined. The ledger posting process is very important because it helps you see the net effect of various transactions over a particular time period.

The next step is to prepare a Trial Balance that includes aggregating all ledger accounts into debit and credit balances. This activity allows you to see if the total of debit is equal to the total of credit. Finally, there is the stage of preparing financial statements. This phase aims to close the account by measuring the profit and loss account at the end of the accounting period and creating a balance sheet.

Accounting information has different users, who can be inside or outside your organization. Accounting information is economic information because it relates to the financial or economic activity of a corporate organization. Because numerous people use accounting information for many diverse purposes, the aim of monetary statements is the needs of users who may lead them to form better financial decisions. Is to respond to. Users can be categorized as internal users and external users.

The internal or primary users of accounting information are:

1. **Management-**Accounting information is very useful for managing planning, management, and decision-making processes. In addition, management needs accounting information to assess an organization's performance and status and can take the necessary steps to improve performance. What's more, accounting information helps managers make their jobs better.
2. **Employees-**Employees use accounting information to study the financial position, sales, and profitability of their business to determine employment stability, future compensation potential, severance pay, and employment opportunities.
3. **Owner** – The owner uses accounting information to analyze the feasibility and profitability of an investment. Accounting information allows owners to assess the ability of a business organization to pay dividends. It also guides you in deciding on a future course of action.

The external or secondary users of accounting information are:

1. **Creditors** – Creditors are paying attention in accounting information because they can determine the credit worthiness of their business. Credit terms and standards are set based on the financial position of the business, which helps you analyze with accurate information. Creditors include financial suppliers and lenders such as banks. Trade creditors are generally more interested in accounting information in a shorter period of time than lenders.

2. **Investor** – We need information because we are interested in the risks and returns inherent in our investment. It is important to assess the feasibility of investing in a company and should be analyzed before funding the company.
3. **Customers** – Customers are involved in accounting information to consider the financial position of business. This is because you can maintain a stable business source, especially if you are involved in the long term.
4. **Regulators** – Accounting information is needed to ensure that it complies with rules and regulations and protects the interests of stakeholders who depend on such information.

Some of the ways in which external users use accounting information are as follows:

a. Shareholders investments
b. Federal and state
c. Banks or lending institutions
d. Investors

1.4 Qualitative characteristics of Accounting

The qualitative characteristics or quality required for information play a major supporting role in the usefulness of decision making in Accounting theory, the approach of decision-making models. A qualitative feature is a compliment that makes the information provided in the financial statements very useful to the user.

The Accounting Information reported to facilitate financial decisions must have certain characteristics or normative standards. Table 1 shows the quality of information recognized in FASB (US) Concept No. 2 “Quality Characteristics of Accounting Information”.

Qualitative Features

Relevance is directly associated with concept of useful accounting information. Relevance means that you need to report all information items that may help users make decisions and forecasts. In general, the more important information in decision making is more relevant.

In particular, it is the capability of information to make a difference that identifies it as relevant to decision making. The Commission, which prepares a statement on the basic accounting theory of the American Accounting Society, describes relevance as "a primary

standard and influences actions designed to facilitate information or outcomes that are desired to be generated. Or need to be usefully associated. "

1. **Reliability:**

Confidence is described as one of the two main qualities (relevance and credibility) that make accounting information very useful for decision making. Reliable information is needed to make decisions regarding a company's profitability and financial position. Reliability varies from item to item.

Some of the information contained in the annual report is more reliable than the others. For example, information about plants and machinery may be less reliable than certain information about current assets due to differences in realization uncertainty. Reliability is the quality that allows users of data to rely on it with confidence as a representative of what the data is trying to represent.

The FASB Concept No. 2 concludes that:

To be useful information, it can only be trusted. There must be no relevance. You need to be aware of the degree of reliability. There are few black or white issues, but it is a high or low reliability issue. Reliability is verified by accounting explanations or measurements. It is possible, expressively faithful and dependent to some extent. Information neutrality too interacts with these two elements of reliability and affects the helpfulness of information. "

2. **Intelligibility:**

Intelligibility is the eminence of information that enables users to recognize its importance. You can increase the benefits of information by making it easier to understand and helping more users.

Presenting information that only sophisticated users can understand and others cannot understand creates a bias that contradicts proper disclosure standards. The presentation of information should not only facilitate understanding, but as well avoid misinterpretation of financial statements. Therefore, easy-to-understand financial accounting information presents data that is understandable to the user of the information and is expressed in a format and terminology that fits the user's understanding.

3. Comparability:

To make an economic decision, you need to choose from a possible course of action. When making a decision, the decision maker makes a comparison between the alternatives. This is facilitated by financial information. Comparability means that they are reported in the same way and in different ways.

“FASB (USA) Concept No. 2 defines comparability as follows: Obviously, a valid comparison is only possible if the measurements (quantities or ratios) used are certain to represent the characteristics to be compared.”

The information, when comparable, helps decision makers determine relative financial strengths and weaknesses, as well as future prospects, between two or more companies, or between periods of one company.

4. Consistency:

Consistency of the process over a period of time is a valuable quality that makes accounting numbers more useful.

If the investor knows which system is being followed and it is guaranteed that it is being followed consistently each year, then what exact rules and practices are used by the investor to report their earnings. It doesn't really matter if you adopt. Inconsistency creates a lack of comparability. The value of business-to-business comparisons is significantly reduced if significant differences in revenue are caused by fluctuations in accounting practices.

5. Neutrality:

Neutrality is furthermore known as "freedom from prejudice" or the quality of objectivity. Neutrality means that the main concern in developing or implementing a standard should be the relevance and credibility of the resulting information, not the impact of the new rules on a particular interest or user. Means neutral choices between accounting options are not biased towards given results. The purpose of (general purpose) financial reporting serves many different information users with different interests, and one given result may not fit the interests and purposes of all users.

Therefore, accounting facts and practices should be fairly determined and reported without the purpose of intentionally biasing users or groups of users. If there is no bias in the choice

of reported accounting information, then one set of profits cannot be said to have an advantage over another. In fact, it may support a particular interest, because the information points to it that way.

6. **Importance:**

The concept of materiality pervades the whole field of accounting and auditing. The concept of materiality means that all financial information needs to or should not be communicated in accounting reports-only important information should be reported. Information that is not important may be omitted and should probably be omitted. Information that may affect your financial decisions should be disclosed in your annual report. Information that meets this requirement is important.

1.5 Functions, Advantages, and Limitations of Accounting.

Accounting Definition

According to AW Johnson; "Accounting collects, edits, systematically records, prepares financial reports, analyses and interprets these reports, and uses these reports for management information and guidance." It may be defined as,

"A technique for recording, classifying, and summarizing the terms of money, transactions, and events in a critical way, at least in part, of a monetary nature, and as a result. Interpretation is called Accounting. "American Institute of Certified Public Accountants" [AICPA];"

"A process of identifying, measuring, and communicating economic information that allows users of information to make informed decisions is known as Accounting." American Accounting Association [AAA]"

In light of the discussion above and the definition of accounting, we can thus give a comprehensive and meaningful definition of accounting.

Accounting is a field with the technology and methods to properly and systematically record, classify, and summarize all types of transactions that are measurable in terms of money or monetary value. This helps to present and explain income, expenses, loss of profits, and assets and liabilities for a particular period of time, and to provide management and investors with the information and statements they need.

So, we can say that Accounting is the art and science of tracking financial events.

a. Accounting systematically records business transactions from a financial perspective.
b. The accounting process produces financial reports and examines them to facilitate decision making.
c. Accounting is an ongoing process for providing information to interested users.
d. Accounting is just a tool for measuring the financial position of any entity involved in economic activity. Accounting helps management.
e. It is a system that keeps a record of financial events, analyzes them, and presents a report of financial results and the location of economic agents.
f. The accounting process provides the governing body with the information it needs to make decisions. This information is needed by stakeholders. Inside and outside the organization.
g. The information that accounting provides is very important to do that. For this reason, accounting is also known as the "business language."

Accounting as a Business Language

Language is a medium of communication process that conveys one person to another, one person to another business, and one business to another, and takes several different forms, such as verbal, written, and non-verbal.

It identifies, records, and communicates the financial events of a business organization to those users who are interested.

"Accounting is as old as money itself. As a child, commercial activities were based on barter systems, so record keeping was not necessary. The Industrial Revolution of the 19th century paved the way for commercial activity, mass production, and the development of credit terms, along with the rapid population growth. Therefore, **the record of commerce has become an important function."**

1. **Applicability**

Accounting principles are expected to be feasible, predictable and applicable. It should be easy to apply to accounting systems and easy for anyone to implement.

For example, if you see fixed assets on your balance sheet, replacement costs are difficult, and fluctuations and people can cause fluctuations and market prices. It doesn't change from person to person, but it shouldn't.

2. **Recording**

Accounting has the unique function of recording all financial transactions. It provides provisions for recording transactions in a detailed way that companies can use. Recording is systematic and can be done by anyone familiar with the basics of accounting and the law.

Recording is done by similar grouping entries under a single title so that all financial transactions can be easily categorized.

3. **Classification**

Accounting provides the ability to categorize all financial transactions into different categories. These categories are grouped in one place according to their similarity. For example, all payments and receipts received will be reflected in your cashbook or memo book.

This helps to classify all similar transactions into one heading, which helps to find them and makes it easier. A book that has completed the process of opening an account is called a ledger.

4. **Usefulness**

Accounting principles have been found to be useful and provide important information to anyone trying to find them in an easy way. With different categories and headings that categorize different transactions, the finder can easily find a particular transaction.

These entries help determine and identify the nature of the transaction and analyze its impact on the overall balance sheet.

5. Objectivity

Principals are relevant when there are numbers and facts. Factual accounting principles that support numbers make it very relevant. There is no prejudice, as it is guaranteed that personal whims and prejudices are not included in the accounting case.

This is why accounting is said to be objective.

6. Summary

Accounting is known to provide a summary of the relevant complex financial statements. Cash flow, fund flow and balance sheet statements are briefly summarized and presented to investors and the general public.

These statements help investors make investment decisions. The abstract also provides a test of the organization's overall financial position without spending a lot of time.

Income statements, balance sheets, etc. are mirrors of the company, and summaries are considered to be very important statements.

7. Verification

All statements generated by a Certified Treasury Auditor or Bookkeeper can be audited and verified for their validity. All entries in the accounting system are related to a company's financial transactions. Therefore, financial statements give a glimpse of the mirror of the organization.

All of these entries can be validated and verified to test the validity of the statement.

8. Interpretation

Financial statement summaries can be read and interpreted by anyone with knowledge. The interpretation is universal and there is no difference from person to person or from auditor to auditor. It remains constant regardless of who interprets it, which gives it a characteristic of universality.

9. Reproducibility

Accounting is characterized by reproducibility due to established procedures and formulas. Accounting steps are calculated based on a fixed formula. For example, ratio analysis uses different formulas to determine different aspects of a stock. This is convenient for investors.

The results obtained from these analyses are repeatable due to the universality of the formula and are not individual dependent or change over time.

The necessity and importance of Accounting

1) Records management

The basic role of the accounting department of an organization is to keep a systematic record of all financial transactions. Systematic records management ensures an appropriate level of analysis to reach the financial position of the organization.

It makes systematic record keeping an absolute purpose of accounting. This is a great help for systematic and accurate decision analysis. Proper recording is one of the key factors and must form the backbone of an organization before it can achieve other purposes or other sections of accounting.

2) Analysis and confirmation of financial results

If you are in business, you will want to determine the exact state of your company's financial position at the end of a particular period. Companies typically prefer quarterly closing of operating finance.

The accounting department creates the profit and loss details of the organization based on the income statement generated using the records held during that period. This is a continuous process and will continue regardless of the specified time period.

3) Analysis of financial condition

Accounting also aims to check the financial status of an organization. This includes liabilities, liabilities, assets, and assets. The accounting section should be able to keep up to date with the financial status of the company.

This is ideally achieved through the creation of a balance sheet. This gives you a glimpse of your organization's financial position over a specific period of time. The balance sheet helps you analyze your company's financial position and make future decisions and goals.

4) Decision-making

Decision-making accounting has a broader purpose of supporting the decision-making of business owners and business owners. Systematic accounting is an important factor in making business decisions and setting goals for future growth and realistic goals for planning.

Here are some examples of decisions that accounting can support:

1. Product pricing to achieve maximum profit. Accounting can reach operational and other costs associated with manufacturing a product, so you can reach realistic and accurate pricing without ambiguity.
2. Make decisions when you're short on money to maximize your profits and improve your status.
3. Helps make decisions when an organization needs to obtain additional funding. This is also true for new product launches and diversification into new businesses.
4. Accounting can also help you determine poorly performing products and services.
5. Decisions regarding credit lending to customers.
6. In essence, these decisions can often be made without the help of accounting. However, accounting provides a reasonable basis for these decisions.

5) Liquidity status

A complete understanding of an organization's liquidity status is also an important goal that accounting must fulfill. Lack of proper accounting often leads to financial mismanagement of the organization and can lead to major problems such as lockouts and business closures.

Appropriate accounting should help management and business owners see how much cash and other resources they have at their disposal to pay their financial commitments. Must be.

6) Ensuring positioning

One of main purposes of accounting is to support the positioning of an organization. Accounting provides a large amount of financial statements to help you reach this goal. The financial position of an organization would ideally be of great help in promoting the financial position of the company.

Financial statements that help you check your organization's financial position include,

1. The amount of capital raised by the organization to do business.

2. Amount of funds from this capital used for business activities
3. The organizations complete balance sheet showing cumulative profits or losses.
4. Organizational responsibility. This refers to the amount the company should pay to others
5. The sum of cash, inventory, machinery, assets, and other assets owned by the organization.

7) Accountability

One of the most important goals of accounting perfection is to maximize the accountability of the company. It is the accounting department of an organization that provides a solid foundation for assessing the actual performance of an organization over a period of time.

This also helps to promote organizational accountability in the long run and through multiple layers of the organizational hierarchy. Financial statements in the accounting department also help to give shareholders sufficient trust. In poor performance, the same financial statements help shareholders hold the company's directors and promoters accountable. This is also useful if you are planning to fund a new project. A reliable and accountable financial position helps to secure financing through loans or from investors.

8) Legal purpose

Accounting also serves as legal support to support an organization's financial position. Therefore, one of the key objectives that accounting needs to meet, is to deal with the legal requirements of the organization.

Accounting is a legal requirement in accordance with laws around the world. In accordance with the law, all companies are required to maintain and maintain financial records of transactions for a specified period of time and share this information with shareholders, promoters and regulators. In addition, proper accounting helps an organization to positively reach the right financial rights, obligations, and liabilities.

9) Fraud detection and prevention

Financial mismanagement and fraud are one of the main reasons that can cause business closures or losses. One of the main purposes of accounting is to record actual transactions to prevent fraud and mismanagement.

If the records are correct and genuine, you can prevent employees of your organization from indulging in fraudulent financial activities. Accounting provides the coveted transparency of company-wide transactions and thus ensures that fraud is reduced to near zero.

Conclusion

In essence, the main purpose of accounting is to manage and maintain good records of each financial transaction in a systematic way and analyze these records to reach the proper financial position of the organization. Once you start achieving this goal, rest on the goals outlined above.

Overview:

Accounting principles are built on some basic concepts. These concepts are so basic that most financial statement authors do not consciously consider them. As mentioned earlier, they are considered trivial. Some accounting researchers and theorists argue that some of the current accounting concepts are wrong and need to be changed.

Nevertheless, in command to understand the accounting that currently exists, it is compulsory to understand basic concepts currently in use. The basic accounting concepts described here may not be the same as those listed by other authors or groups. However, these are widely accepted and practical concepts used by financial statement authors and auditors to review financial statements.

Objects and functions of Accounting

1 – Compliance with statutory requirements

One of the objectives is to ensure compliance with local laws related to taxation, corporate law, and other statutory requirements related to the country of business. This ensures that the business complies with such laws and that relevant provisions are complied with during the course of the business.

2 – Protecting the interests of various stakeholders

It provides relevant stakeholders, including shareholders, future investors, finance personnel, clients and creditors, with relevant and relevant information related to their business operations. They are suitable not only for those who have an existing business relationship, but also for those who are interested in collaborating with future businesses by providing

meaningful information about the business. Further financial accounting standards ensure control of corporate accounting policies to protect the interests of investors.

3 – Useful for measuring business profits and losses

It measures the profitability of a business over a specific phase of time and discloses the net profit or loss of the entire business. It also shows the assets and liabilities of the business.

4 – Presenting historical records

Unlike other accounting, it focuses on displaying past records rather than forecasting the future. The main reason for creating financial accounting is the confirmation of profits or losses incurred by the business during the period.

5 – Focus on external business transactions

It focuses on the transactions that a business conducts with external parties such as customers and suppliers, and based on these transactions, quantifies the business, the costs incurred, and the resulting profits or losses. An account will be created for you.

Limitations

1. Accounting information is expressed in terms of money. Non-monetary events or transactions, however important they may be, are completely omitted.
2. Fixed assets are recorded in the accounting records at the original cost, that is, the actual amount spent on them plus, of course, any incidental charges. In this way the effect of inflation (or deflation) is not taken into consideration. The direct result of this practice is that the balance sheet does not stand for the true financial situation of the business.
3. Accounting information is from time to time based on estimates; estimates are often may be inaccurate. For example, it is not possible to predict with any degree of accuracy the actual useful life of an asset for the rationale of depreciation expense.
4. Accounting information cannot be used as only a test of managerial performance on the basis of more profits. Profits of a period of one year can readily be manipulated by omitting such costs of advertisement, research and development, depreciation and so on.

5. Accounting information is not neutral or unbiased. Accountants calculate income as excess of revenue over expenses. But they only consider selected revenues and expenses. For example, include cost of such items as water or air pollution, employee's injuries etc.
6. Accounting like any other discipline has to follow certain principles which in certain cases are contradictory. For example: current assets (e.g., stock of goods) are esteemed on the basis of cost or market price whichever is less following the principle of conservatism. Accordingly, the current assets may be valued on a cost basis in some years and at market price in other years. In this manner, the rule of consistency is not followed regularly.

1.6 Summary

- Accounting may be a necessary function for deciding, cost planning, and economic performance measurement, no matter the dimensions of the business.
- Bookkeepers can handle basic accounting needs, but Certified Accountants (CPA) should utilize them for larger or more advanced accounting tasks.
- Two important sorts of corporate accounting are management accounting and costing. Management accounting helps management teams make business decisions, and costing helps business owners determine the value of a product.
- Main financial statements are the earnings report, the record, and therefore the income statement.
- Two important types of corporate accounting are management accounting and costing. Management accounting helps management teams make business decisions, while costing helps business owners determine the cost of a product.
- Users of monetary accounting.
- Well-known departments or accounting types include financial accounting, management accounting, accountancy, auditing, taxation, AIS, base accounting, and forensic accounting.
- Accounting may be a necessary function for deciding, cost planning, and economic performance measurement, no matter the dimensions of the business.
- Bookkeepers can handle basic accounting needs, but Certified Accountants (CPA) should utilize them for larger or more advanced accounting tasks.

1.7 Self-Assessment Questions

1. Discuss the difference between internal and external user information and the needs and demands of users for information systems.
2. Distinguish between Accounting Information Systems (AIS) and Management Information Systems (MIS)
3. Discuss the importance of accounting independence in accounting information systems. Please tell me where this concept is important.
4. Why should auditors be involved in the system design process?
5. Unlike systems that occur naturally, accounting information systems must be created." Describe five characteristics of a successful system and how to achieve each characteristic.
6. What are the three main activities in accounting information systems?
7. What are the basic Accounting questions?

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Unit 2

Accounting Process

Learning Objective:

After studying this unit, students will be able to understand:

- Know what Cash Basis and Accrual Basis means.
- Understand the concept of Branches of accounting
- Describe the meaning of Accounting Equation.
- Understand the Basics of the Accounting Process.

Structure

2.1 Branches of Accounting.

2.2 Basis of Accounting: Cash Basis and Accrual Basis.

2.3 The nature of Financial Accounting Principles – Basic concepts and conventions

2.4 Summary

2.5 Self-Assessment Questions

2.6 References

2.1 Branches of Accounting.

When companies want to know their financial health, analyze their cash flow, determine the health of their operations, or understand their competition, they usually turn to a particular accounting department. Small businesses may use the services of the one professional accountant, while large corporations and government agencies may work with accounting firms that can handle different areas of accounting.

Accounting departments use various types of analysis and data to inform management and enable the organization to make informed and forward-looking decisions about the company's present and future.

What is an Accounting Branch?

Accounting departments are responsible for measuring, processing, and disseminating both financial and non-financial data that impacts an entity or a company's economic interests. Accounting departments are used by the majority of firms and businesses to gauge the financial performance of their enterprise. Accounting departments gather data and communicate findings to management, investors, creditors, regulators, and tax authorities using a range of techniques. The growth of international trade along with the enlargement of tax rules and regulations has led to the branching out of accounting and the creation of specialties within particular financial domains.

Different areas of accounting

The world of accounting has expanded to several branches that specialize in specific areas of law or focus on specific aspects of the business.

1. Financial Accounting

Financial accounting includes the preparation and presentation of financial statements, as well as the recording and clarification of commercial transactions. Financial accounting follows GAAP principles with a heavy focus on historical data.

For example, a financial accountant may analyze last quarter's financial records and recommend changes for the next quarter.

Financial Accounting analyzes a company's balance sheet and produces an income statement that advises management or stakeholders regarding financing, investments, or acquisitions.

Financial Accounting provides important economic business information on:

a. A creditor
b. Bank or financial institution
c. Regulator
d. Supplier
e. Tax expert

2. Management Accounting

Management accounting provides information to the internal structure of the company, namely management. Unlike financial accounting, management accountants monitor the use

of money, not the amount of money. Management accounting focuses on the needs of managers and does not necessarily follow her GAAP accounting rules. The Institute of Chartered Management Accountants has developed a set of accounting principles known as the Global Management Accounting Principles (GMAP) that are directly related to this area.

3. Costing

Cost accounting, considered a subset of management accounting, focuses on the evaluation of costs. This branch considers all manufacturing factors to accurately determine the cost of a project or venture. Cost accounting analyzes manufacturing costs and creates and presents reports that inform decision makers on how to reduce costs or when to increase costs. Monitor project waste and cost control. Costing involves the periodic analysis of actual costs over budget to determine future financial behavior.

4. Audit

Auditing is a branch of accounting that is typically done internally and externally. Auditors examine and monitor the business for accurate reporting, compliance with tax laws and regulations, and financial integrity. He has two specialties.

a. External auditor

A state or federal audit is conducted by an independent external auditor who examines the company's financial statements for accuracy. The audit complies with her GAAP and assesses the adequacy of the company's internal controls. External auditors may test the effectiveness and completeness of the company's segregation of duties, policies, authorities, and other administrative controls.

b. Internal auditor

Internal audits identify and prevent tax issues or prepare for external audits. Auditors in this division are typically elected by shareholders, so their role does not create conflicts of interest and ensures objectivity.

5. Project accounting

Some industries, such as construction and engineering, are working on large projects that require dedicated accountants. Project accounting falls under the umbrella of project management. This accounting process analyzes costs and produces regular reports to track

the financial status of projects. Provides historical data to inform future project decisions, such as cost-cutting measures and budget adjustments

6. Fund Accounting

Fund Accounting works with non-profit organizations (NPOs) to ensure accurate and accurate allocation of funds. Fund accountants ensure that NPO funds are used as intended by segregating and distributing funds according to company policy or laws governing the NPO.

Fund Accounting is frequently used for:

a. Charity
b. Church
c. Educational institution
d. Hospital
e. Government agency
f. Club

7. International Accounting

As global business grows, so does the need for international markets and international accounting. This accounting department will help you learn the laws and regulations of other countries in order to conduct business honestly and fairly. International accountants are internationally savvy in addition to following GAAP Financial Reporting Standards (IFRS), the accounting standards adopted by most global economies.

2.2 Bases of Accounting: Cash Basis and Accrual Basis

Difference between cash and anticipation

The difference between cash accounting and accrual accounting lies in the timing at which sales and purchases are recorded in your account. Cash accounting recognizes revenues and expenses only when money changes, while accrual accounting recognizes revenues when revenues are earned and expenses when billed (but pays).

Cash Basis Accounting

Accounting cash basis recognizes revenue when you receive cash and costs when you pay. Accounts receivable and accounts payable are not recognized this way.

Many small businesses choose to use an accounting cash basis because it is easy to maintain. You can easily determine when a transaction occurred (whether the money is in or out of the bank) and you don't need to track receivables or payables.

The cash method is also beneficial in that it tracks the amount of cash the business actually has at a given point in time. You can look at your bank balance and understand the exact resources you have at your disposal.

Also, since transactions are not recorded until you receive or pay cash, your company's income is not taxed until you enter the bank.

Accrual Accounting

Accrual accounting is an accounting method that records when income and expenses are earned, regardless of when the money is actually received or paid. For example, record revenue when a project is completed, not when you receive payment.

The advantage is that accrual accounting provides a more realistic idea of income and expenses over a period of time, thus providing a long-term picture of the business that cash accounting cannot provide.

The downside is that accrual accounting cannot recognize cash flows. Even though you actually have an empty bank account, your business can seem very profitable.

What does "record a transaction" mean?

So far, we've covered a lot about recording transactions in books and how cash and accruals decide when to do it.

What is the recording of a transaction?

Every company needs to record all financial transactions in its ledger. This is also known as bookkeeping. If you request a tax credit at the end of the year, you need to do this. And you need one central place to sum up all your income and expenses (you'll need this information to file your taxes). If you want someone else to do the bookkeeping, check out the bench.

Impact of Cash and Accrual Accounting

It's significant to be aware of the difference between cash accounting and accrual accounting, but it's also necessary to look at the direct effects of each method and put this in context.

Let's look at an example of how cash and accrual accounting affect revenue differently.

Suppose you want to execute the following transaction in a month's business – Invoiced for a web design project completed this month for $5,000, Received a $1,000 invoice for developer fees for work done this month and paid a $75 fee for the bill received last month. Received $1,000 from a client for a project billed last month

Impact on cash flow

a. Using the cash-based method, this month's profit is $925 ($1,000 in income minus $75 in commission).
b. Using accrual accounting, this month's profit is $4,000 ($5,000 in revenue minus $1,000 in developer fees).

This example shows how the flow of revenue and the appearance of cash flows are affected by the accounting process used.

Tax impact

Now imagine that the above example happened between November and December 2017. One of the differences between cash accounting and accrual accounting is that it affects which tax year is recorded in profit or loss.

In cash-basis accounting, income is recorded when it is received, whereas in accrual accounting, income is recorded when it is received.

Following the example above, if you use accrual accounting to charge your client $5,000 in December 2017, you will record the transaction as part of your 2017 income, even if you receive a payment (thus I will pay the tax). January 2018.

Do SMEs Need to Use Cash or Accrual Accounting?

a. If your business is a company with an average total revenue of over $25 million over the last three years (excluding S corporations), the IRS requires you to use accrual accounting.
b. If your business does not meet these criteria, you can use the cash method.
c. That said, the cash method is usually suitable for small businesses that do not have inventory. For high-inventory businesses, accountants probably recommend accrual accounting.

d. To change the accounting method, you must submit Form 3115 for approval from the IRS.

Differences:

Basis for Comparison	Cash Accounting	Accrual Accounting
Meaning	In cash accounting, incomes and expenses are only recognized through cash.	In Accrual Accounting, incomes and expenses are recognized when they are done (on the mercantile basis).
Includes	Only cash expenses, cash incomes.	All expenses and all incomes;
Nature	Simple and easy to understand.	Complex and difficult to understand.
Recognized by	Not recognized by Companies Act.	Recognized by Companies Act.
How is accounting done?	When cash is received or paid;	When revenue is earned, or loss is incurred.
Focus	Liquidity.	Revenue/Expense/Profit/Loss.
Why is it useful?	We can quickly get how much cash the business generated (i.e., net cash flow).	We can understand how much profit or loss a business has made during a particular period.
Holistic in approach	No, because it only talks about cash.	Yes, because it includes all of the transactions.
Which one is more accurate?	Accuracy of cash accounting is doubtful since it doesn't take every transaction into accounting.	It is a more accurate method of accounting.

Now let's look at some important differences –

Business size: The size of the business you own is very important. If you own a micro-sized business and are making a small amount of cash flow from it (that is, if you want to handle minimal transactions), cash accounting is the best way to use it. **However, for SMEs and large companies, it is wise to adopt accrual accounting.**

a. **Simplicity:** Accounting accrual accounting has the ability to handle complex types of transactions. However, cash accounting only handles simple transactions. That's why business owners prefer cash accounting when they start a business.
b. **Tax Benefits:** If you run a small business, we recommend that you use the cash accounting method. This is because you can get tax incentives by using the cash accounting method. However, for large companies, tax incentives are only available by using accrual accounting methods.
c. **Trading Hours:** In accrual accounting, trading hours are very important. According to accrual accounting methods, accountants record transactions when they occur (rather than when they receive money). However, the cash accounting method is completely the opposite. The cash accounting method records transactions when you receive or spend cash. In this case, accounting accrual accounting has its disadvantages. The downside is that the company has to pay taxes even if the company hasn't received any income yet (a good example of this is selling in credit).
d. **Double-entry bookkeeping** – Cash accounting follows single-entry bookkeeping. Accrual accounting follows double-entry bookkeeping.
e. **Accuracy** – Cash accounting is not very accurate because the focus is on cash only. Accrual accounting is relatively accurate.
f. **Holistic** – Cash accounting is not a holistic accounting method. However, accrual accounting is the overall accounting method.

Conclusion

Both are important in their respective fields. Sole proprietorships , that are just starting out ,need to follow cash accounting, because they are easy to maintain and initially have few financial transactions. On the other hand, for large cap companies, accrual accounting is best because cash accounting cannot handle hundreds or thousands of financial transactions per day.

In other words, you need to understand which corporate accounting is applicable. Sure, accrual accounting has always been a more advanced accounting method, but without employee support, it's almost impossible to maintain.

2.3 The nature of Financial Accounting Principles – Basic concepts and conventions

Overview:

Accounting principles are built on some basic concepts. These concepts are so basic that most financial statement authors do not consciously consider them. As mentioned earlier, they are considered trivial. Some accounting researchers and theorists argue that some of the current accounting concepts are wrong and need to be changed.

Nevertheless, in order to be aware of accounting that currently exists, it is compulsory to understand the basic concepts currently in use. The basic accounting concepts described here may not be the same as those listed by other authors or groups. However, these are widely accepted and practical concepts used by financial statement authors and auditors to review financial statements.

The Basic Accounting Concept is as follows:

1. **Separate Entity Concept:** According to this concept business is treated as a separate unit from its owner. In other word the owner of a business always separate from the business. We have to record business transaction from firm's point of view not from the point view of the owner. The owners invest money to start business is called capital and the capital is treated as liability for business because it is assumed that the firm has borrowed fund from its own proprietor instead of borrowing it from outsiders. For this reason interest on capital given by the business to business owner similarly the any cash or goods withdrawn by the owner for personal use from business are called drawing and it is reduce from capital and on drawings business charge interest to owner. Because of separate entity concept the owner's personal transactions are kept from the accounts of business entity.

Going Concern Concept: In light of this, it is anticipated that the company will last for a very long time. Assuming that the business is an ongoing entity, the transactions are entered into the company's accounts. This idea states that fixed assets should be recorded at their original cost and that depreciation should be applied to them without taking into account their

market value. For instance, if a machine is purchased with a ten-year lifespan, its cost will be allocated over the following ten years in order to determine the profit and loss for each year. The entire cost of the machine would not be recognized as an expense for the year of purchase due to the going concern concept.

2. **Money measurement concept:** According to this concept only those transaction are recorded in books of accounts which are expressed in terms of money. For example accounting does not recorded a quarrel between the production and sales manager, 200 unit purchases, 100 chairs, and 10 fans. All these things cannot be expressed in terms of money.
3. **Accounting period concept:**

Financial accounting provides information about a company's economic activity over a specific period of time that is shorter than the company's lifespan. The periods are usually the same length for ease of comparison.

The period is specified in the financial statements. The period is usually 12 months. Quarterly or semi-annual statements may also be issued. These are considered provisional and differ from the annual report. Statements that cover shorter periods of time, such as months or weeks, may also be created for administrative use.

4. **Cost concept**: According to this concept the value of an asset is to be recorded in Books of account on cost price not on market price for example, if a Building Purchases for Rs 500000, it would be recorded in the books at this figure. If increase and decrease in the market value of building would not be recorded in the books of accounts. If two year later the market value of building move up to Rs 10, 00,000, the increased value will not be recorded in the books of accounts. But cost concept does not mean that assets will continuously show at their purchases price. So their cost is reduced from year to year by charging depreciation and assets are shown in balance sheet at cost less deprecation
5. **Dual aspect concept:** According to this concept every financial transaction of a business having at least two aspects in other word s, every transaction affects at least two account. And if one account is debited and other account must be credited. And both the debit and credit are always equal. On the basis of this concept accounting equation is developed.

Assets= Capital + Liability

Whenever a transaction is to be recorded it has to be recorded two or more accounts to balance the equation. If a transaction affects one side of equation it will also affect the other side of equation.

6. **The concept of accrual accounting:**

"According to the Financial Accounting Standards Board (USA)":

"Accrual accounting is the financial impact of transactions and other events and situations that affect a corporation on cash, not only during the amount during which it had been received, but also during the amount during which those transactions, events and situations occur. Accrual accounting is paid to the corporation as more (or perhaps less) cash spent on resources and activities, also because of the start and end of the method. It's associated with the method of being returned. We recognize that purchases, production, sales, other operations, and other events that affect a company's performance during a period often do not match the receipt or payment of cash for that period. "

Realization and matching concepts are central to accrual accounting. "Accrual accounting measures revenue for a period of time as the difference between the revenues recognized during that period and the costs that match those incomes. In accrual accounting, the period revenue is usually not the same as the period cash receipt from the customer, and the period cost is usually not the same as the period cash payment."

7. **Conservatism concept:** According to this convention all future losses should be recorded in the books of accounts, but all the future profit ignore in other word conservatism means playing safe. Provision is made for all the future liability, expenses and losses.
8. Examples

    Closing stock is valued at cost or market price whichever is less.
    Provision for doubtful debts
    Join life insurance policy
    Any Provision

9. **Matching concept**: This concept is very important for calculate correct profit and loss. According to this Concept to calculate the true profit and loss and financial position of the Company for An Account period all the expenses related to the accounting period is

recorded in the books Of account in related year whether paid or not and all the Income related to the accounting Period is Recorded in the books of account in related year whether received or not.

10. **Realization or Cognitive concept:** To calculate the true profit and loss and financial position of the Company for an account period all the Income related to the accounting period is Recorded in the books of account in related year weather Receive or not. Because the revenue is to be realize when the ownership of the goods has been transferred to the purchaser not on receiving revenue.

11. **Convention of consistency**: This convention states that accounting principle and methods should remain consistent from one year to another. These should not be changed from year to year .if a company use different accounting principle and method in two accounting period then the profit of one year cannot be compare with another year profit. But the convention of consistency should not mean that a firm does not change the method of accounting in its life time. No it is not right a company can change the methods of accounting if it is necessary to change.

12. **Convention of Materiality:** This convention is an exception of the convention of full disclosure. According to this Convention only those transaction are recorded in books of accounts which are important for business or affect the profit and loss and financial position of the company and left out unimportant transaction. Example stock of 1 all pin.

8. **Full disclosure concept: The** concept of full disclosure requires companies to make available each and every relevant information to external users for the reason of strong economic decisions. This concept means to information that is substantive or interest to the regular investor is not omitted or hidden from a company's financial statements.

2.4 Summary

- Accounting may be a necessary function for deciding, cost planning, and economic performance measurement, no matter the dimensions of the industry.
- The chief purpose of monetary accounting is to accurately prepare the financial accounting of a corporation for a specific period of your time. This is often also referred to as financial statements.

- The three main financial statements are the earnings report, the record, and therefore the income statement.
- Two important types of corporate accounting are management accounting and costing. Management accounting helps management teams make business decisions, while costing helps business owners determine the cost of a product.
- Well-known departments or accounting types include financial accounting, management accounting, accountancy, auditing, taxation, AIS, base accounting, and forensic accounting.
- Cash-basis accounting is easier, but accrual accounting includes accounts payable and accounts receivable to better describe the health of the company.
- Accrual accounting is the most commonly used method, especially by listed companies, because it equalizes revenue over time.
- Both are important in their respective fields. Sole proprietorships that are just starting out need to follow cash accounting because they are easy to maintain and initially have few financial transactions.
- Accounting rules are guidelines that help companies determine how to record business transactions that are not yet fully covered by accounting standards.
- Accounting rules no longer apply if the supervisory body has guidelines that address the same topics as accounting rules.
- There are four widely recognized accounting rules. Conservatism, consistency, full disclosure, and importance.
- Accounting policies are the procedures that a company uses to prepare financial statements. Unlike accounting principles, which are rules, accounting policies are the basis for following those rules.
- The choice of a company in its accounting policy indicates whether management is willing or conservative in reporting its revenue

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2.5 Self-Assessment Questions

1. Explain the meaning and importance of the concept of going concern.
2. What is meant by the concept of a business entity?
3. Describe the meaning and importance of money measurement concepts.
4. What do you mean by accounting concepts? Explain four accounting concepts.
5. Give an example to illustrate the consistency rules.
6. Explain conservative accounting practices with examples.

7. Explain the conventions of materiality.
8. Please state the meaning and importance of the dual aspect concept.
9. Queries various entities to list various accounting periods where these entities do not follow the same accounting practices

2.6 References

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Unit 3

Basic Accounting Procedures-Accounting Equation

Learning Objective:

After studying the unit, students will be able to:

- Clarify the meaning of Accounting Equation.
- Understand the importance of Accounting Equation.
- Point out the impact of each aspect of the transaction on the Accounting Equation.
- Establishes that assets equal liabilities and equity;
- Create Accounting Equation from specific transactions

Structure

3.1 Meaning of Accounting Equation

3.2 Effect of Transactions on Accounting Equation

3.3 Combinations of the Equation

3.4 Summary

3.5 Self-Assessment Questions

3.6 References

3.1 Meaning of Accounting Equation

The recording of business dealings in books is based on basic equations is called accounting equations. A business owned in the form of an asset is funded by the owner or an outsider. This equation represents the equality of assets on one side and the claims of outsiders (liabilities) and owners or owners (equity) on the other side.

Every time an asset is introduced into a business, there is also a corresponding liability. Business has no volume of its own. So, you can say:

A business owns nothing and owes nothing (in simple terms, no business has any responsibilities or assets of its own on any given date)

What does it own and what does it owe?

Let's see how commerce affects the accounting equation. These transactions increase or decrease assets, liabilities, or equity. Every business has certain assets.

All business concerns typically borrow money from outsiders to continue their activities. In other words, every business concern owes money to an outsider. The assets are funded by funds contributed by owners and outsiders. Money borrowed from outside is called debt.

Double entry system of accounting deals with two aspects of every business transaction. In other words, every business transaction has both effects. For example, a person buys a cold drink from a shop and in return pays the money to the shopkeeper for the cold drink. This transaction has two effects in terms of both buyer and seller. Buyer cash balance will decrease by the cost of purchase. On the other side, he will obtain a cold drink. Seller will have one drink short but his cash balance will increase.

Accounting attempts to record both effects of transactions in the financial statement. This refers to the double entry concept. Under this every transaction involves two parties, one party gives the benefit and the other party receives it. It is also called a dual entity of transaction.

Accounting records the two effects which are identified as Debit (Dr) and Credit (Cr). Accounting structure is based on the duality principle that for each and all Debit entry, there will always be an equal Credit entry.

Debit entries are ones that account for the follow effects:

1. Increase in assets
2. Increase in expense
3. Decrease in liability
4. Decrease in equity
5. Decrease in income

Credit entries are ones that account for the following effects:

1. Decrease in assets
2. Decrease in expense
3. Increase in liability
4. Increase in equity
5. Increase in income

Accounting equation recorded in double entry are,

Assets – Liabilities = Capital

Increase in expense (Dr) will be offset by a decrease in assets (Cr) or increase in liability or equity (Cr) and vice-versa. The accounting equation will still be in balance or symmetry.

Examples

1. Purchase of machine by cash

Machine account debited (increase in assets)

Cash account credited (decrease in assets)

2. Payment of utility bills

Utility expenses account debited (increase in expenses)

Cash account credited (decrease in assets)

3. Receipt of bank loans

Cash account credited (increase in assets)

Bank loan account credited (increase in liability)

Characteristic of Double Entry System

1. **Two parties** – every business transaction involves two parties – debit and credit. According to the duality principle that for each and every Debit entry, there will always be an equal Credit entry.

2. **Giver and receiver** – every transaction must have a giver and receiver. For example, when purchasing a car, the buyer purchases a car from the seller in return for cash – hence the buyer is the receiver and seller is the giver. When the seller receives the cash for the purchase made by the buyer – the seller is the receiver of cash and buyer is the giver.

3. **Exchange of equal amount** – the amount of money of a transaction the party gives is equal to the amount the party receives.

4. **Separate entity** - the business enterprise and its owner or business man are two separate independent entities. Thus, the business and businessman personal transactions are separate.

5. **Dual aspects** – every transaction has two aspects – debit and credit. Debit is always left side of the account or ledger and credit always is on the right side of the account or ledger.

6. **Result –** under the double entry system, the total of debit side is equal to the total of credit side.

7. **Complete accounting system:** Double entry system is a scientific and complete accounting system.

The process of keeping accounts under the Double-Entry System;

1. **Journal** - It is called as daily book because transaction are recorded on day to day basis as and when takes place

2. **Ledger** - Ledger is the principal or primary book of accounts. The transactions are classified under appropriate heads, called accounts

3. **Trial Balance** - Trial Balance is a statement, arranged with debit and credit balances of ledger or accounts to test the arithmetical accuracy of the business books.

4. **Financial statement** - The final accounts are prepared for ascertaining the operational results and financial position of the business. These are prepared with the help of trial balance.

Advantages of Double Entry System

1. Through the trial balance, the system increases the accuracy of the accounting
2. Profit and loss during the year can be calculated in detail
3. The company keep accounting records which helps in controlling
4. Using double entry system of accounting, current year can be compared with previous year to formulate the future course of action
5. Under double entry system, the total amount of assets and liabilities can be ascertained
6. under the double-entry system, the accounts are maintained systematically thus it become easier to fix the price of the commodity
7. The balance sheet ascertains the financial position of the business.

Account classification

Transactions can be divided into three categories.

I. Transactions related to individuals and businesses

ii. Transactions related to real estate, goods or cash

iii. Transactions related to costs or losses and income or profits.

Therefore, accounts be able to also be categorized as personal, genuine, or nominal. **The classification can be explained as follows.**

I. Personal Account: An account related to an individual. Personal accounts include:

a. **Natural person:** An account related to an individual.
b. **Artificial person:** An account associated with an individual or a set of businesses or institutions. For example, TATA Ltd., Indian Bank, LIC, any club.
c. **Representative:** An account that represents a particular individual or group of individuals. For example, unpaid payroll accounts, prepaid insurance accounts, and so on.

A business concern may be to maintain business relationships with all of the above personal accounts in order to purchase, sell, rent, or rent goods from them. Therefore, they are either debtors or creditors.

The capital and drawing accounts of the individual owner are also personal accounts.

II. Non-personal accounts: All accounts that are not related personal accounts. This can be further divided into two categories, real accounts and nominal accounts.

a. **Actual account:** Assets owned by business parties and accounts related to the assets. Real accounts contain tangible and intangible accounts. For example, buildings, land, goodwill, purchases, etc.
b. **Nominal Accounts:** These accounts have no existence, form, or shape. They are related to income and expenses, and profits and losses of business concerns. For example, payroll accounts, dividend accounts, and so on.

1.Personal Accounts	–	Debit the receiver Credit the giver
2.Real Accounts	–	Debit what comes in Credit what goes out
3.Nominal Accounts	–	Debit all expenses and losses Credit all incomes and gains

3.2 Effect of Transactions on Accounting Equation

Assets, liabilities and equity are the three basic elements of all business transactions and their relationship is always expressed in the shape of equal accounting equations, individual assets have variations, liabilities or equity, but accounting both sides of the equation always remain equal. Let's examine this fact with a few more transactions.

Suppose Rajni starts a business and the following transactions occur.

1. She started her business by introducing Rs. 5,00,000 cash as her capital.

The deal means Rs. 5,00,000 has been introduced by her Rajni in cash. This is a business fund. So, on the one hand, assets (cash) have been created up to 5,00,000 or so.

Assets (cash) = Liabilities +Capital

Effect of the

Transaction = 5,00,000 + 0 = `5,00,000

Assets Cash	+ Furniture	=	Capital	+	Liabilities
Old equation 5,00,000	+ 0	=	5,00,000	+	0
Effect of the					
transaction (-) 50,000	+ 50,000	=	0	-	0
New equation 4,50,000	+ 50,000	=	5,00,000	+	0

2. She bought her furniture with her Rs. 50,000 worth of cash.

This transaction only affects assets because one asset is purchased for another asset. Furniture is purchased for cash in this transaction. Furniture and cash are assets. So furniture will increase her by 50,000 and cash will decrease her by 50,000.

3. She bought the item for Rs. 10,000 in cash.

	Cash	Assets + Furniture	+ Goods	= =	Capital	+ +	Liabilities
Old equation	4,50,000	+ 50,000	+ 0	=	5,00,000	+	0
Effect of the transaction	- 10,000	+ 0	+ 10,000	=	0	+	0
New equation	4,40,000	+ 50,000	+ 10,000	=	5,00,000	+	0

Goods purchased are assets, and cash paid in return is also an asset.
Therefore, in this transaction, one asset (goods) is increased and the other asset (cash) is decreased by 10,000, leaving equity and liabilities unchanged.

3.3 Combinations of the Equation

The interrelationships between assets, liabilities and equity can be expressed in many different ways. You can create 9 combinations.

An increase or decrease in one corresponds to an increase or decrease in itself or the other.

Let's look at the nine combinations with an example.

1. An increase in assets with a corresponding increase in capital;

Example: You started your business with cash.

2. An increase in assets with a corresponding increase in liabilities;

Example: Items purchased on credit.

3. Decrease in assets and corresponding decrease in capital;

Example: Cash withdrawn from a business by management for personal use.

4. A decrease in assets with a corresponding decrease in liabilities;

Example: cash paid to creditors.

5. Increase or decrease in assets;

Examples: Furniture purchased with cash, goods purchased with cash, etc.

6. Increase or decrease in liabilities;

Example: Taking a loan from a bank and paying it to a creditor.

7. Increase or decrease in capital;

Example: Capital Interest

8. An increase in debt and a decrease in equity;

Examples: unpaid wages, unpaid salaries

9. An increase in equity and a decrease in debt;

Example: Conversion of loan (provided by the owner) to equity.

Let's consider another diagram and examine the accounting equation again.

Formula Rules

1. Capital: It is credited (+) when the capital is increased and debited (-) when part of the capital is withdrawn (that is, the drawing is made).
2. Earnings: The owner's equity (capital) increases by the amount of earnings.
3. Expenses: The owner's equity (capital) is reduced by the amount of the expense.

4. Outsider's Equity: As the debt increases, the outsider's debt is credited (+).
5. Assets: If assets increase, the increase is debited to the assets account (+). A decrease in the credit (-) of the asset account if the asset decreases.
6. Impact of accrued expenses: increase in debt and decrease in equity.
7. Accrued Income: Increase in Assets and Increase in Capital.
8. Unearned income: increase in assets (as cash) and increase in liabilities.
9. Interest on capital is the cost of the business, so the profit is reduced by that amount, and interest on capital is added to the capital, because it is the income of the owner. Therefore, the net equity impact of this transaction is zero.
10. Assets and liabilities are not subject to interest on capital and interest on drawings.

The data below shows the impact of the following transactions on the Accounting Equation.

1. Shashi started doing business with the following companies: `
    a) Cash 2,00,000
    b) Goods 1,20,000
    c) Machine 80,000
2. He bought the goods for 50,000 cash
3. He sold the goods (which cost Rs 20,000) 25,000
4. Purchase items from Rabbi for 70,000
5. He paid Ravi cash in full settlement of 69,000
6. He sold goods to Vikas (which cost Rs54,000) 60,000

Assets										= Liabilities +						
S.No. Transaction	Cash	+	Goods	+	Machine	+	Debtors	+	Prepaid expense	=	Creditors	+	Outstanding expense	+	Capital
1. Started business with Cash `2,00,000 Goods `1,20,000 Machine `80,000	2,00,000	+	1,20,000	+	80,000	+	0	+	0	=	0	+	0	+	4,00,000
2. Goods purchased for `50,000	-50,000	+	50,000	+	0	+	0	+	0	=	0	+	0	+	0
New Equation	1,50,000	+	1,70,000	+	80,000	+	0	+	0	=	0	+	0	+	4,00,000
3. Sold goods (Cost															
`20,000) for `25,000	25,000	-	20,000	+	0	+	0	+	0	=	0	+	0	+	5,000
New Equation	1,75,000	+	1,50,000	+	80,000	+	0	+	0	=	0	+	0	+	4,05,000
4. Purchased goods from Ravi `70,000	0	+	70,000	+	0	+	0	+	0	=	70,000	+	0	+	0
New Equation	1,75,000	+	2,20,000	+	80,000	+	0	+	0	=	70,000	+	0	+	4,05,000
5. Payment made to	-69,000	+	0	+	0	+	0	+	0	=	-70,000	+	0	+	1,000
Ravi in full															
settlement `69,000															
New Equation	1,06,000	+	2,20,000	+	80,000	+	0	+	0	=	0	+	0	+	4,06,000
6. Goods of `54,000 Sold for `60,000	0	-	54,000	+	0	+	60,000	+	0	=	0	+	0	+	6,000
New Equation	1,06,000	+	1,66,000	+	80,000	+	60,000	+	0	=	0	+	0	+	4,12,000

3.4 Summary

- Business Transactions means the exchange of goods and/or services of value and other financial activities conducted in the course of business.
- All business transactions are recorded according to accounting equations.

- An accounting equation is a statement of equality between assets on the one hand and equity and liabilities on the other.
- Assets = Equity + Liabilities (A = C + L)
- All business transactions affect the accounting equation.
- A business owns nothing and owes nothing. What does it own and what else does it owe the business?
- The equality of the accounting equations does not change under any circumstances.
- Expense and income impacts are always reflected in the capital account. Expenses reduce capital, income increases it.
- All business transactions satisfy the Dual Aspect Concept.

3.5 Self-Assessment Questions

1. Contact various business organizations to list various ways to maintain records of transactions.
2. Write down any 10 business transactions, prepare Accounting Equations for them and make sure they are equal at every step.
3. If a company borrowed a lot of money, what effect would it have on the accounting equation?
4. Give two examples. One shows the effect on assets only and the other shows the effect on liabilities only.
5. How will pre-received income appear in the accounting equation?
6. For commodities `. 8,000 sells for 8,500, how is capital affected?
7. What is the Dual Aspect of Accounting?
8. How are income and expenses treated in the accounting equation?
9. "The accounting equation holds true under all circumstances."
10. Define Accounting Equation in your own words with examples.

3.6 References

1. Basic Financial Accounting for Management- Paresh Shah -Oxford University Press
2. An Introduction to Accounting S N Maheswari and S K Maheswari, Vikas
3. Modern Accountancy Volume-1- A Mukherjee and M Hanif-TMH

Unit 4

Basic Accounting Procedures – Journals

Learning Objective:

After studying the unit, students will be able to:

- Know what Journals means.
- Understand the Performa of a Journal.
- Understand the Journalizing steps.

Structure

4.1 Meaning of Journals

4.2Proforma of a Journal

4.3 Journalizing steps

4.4 Summary

4.5 Self-Assessment Questions

4.6 References

4.1 Meaning of Journals

An accounting journal or ledger is an official record that provides all business financial transactions in chronological order. Accounting Journals are used by accountants, bookkeepers, and auditors to track and analyze an organization's financial health. If you plan to work in the financial and accounting industry, knowing when and how to use accounting Journals will help you file your taxes on time and analyze your organization's financial health.

"What is an Accounting Journal?"

An accounting journal is a chronological record of business and financial transactions, which records commercial transactions within the company's finance and accounting departments. Accounting Journals show the effect of business transactions in terms of credits and debits and explain the transactions. The journal displays detailed accounts of all financial transactions, reconciles accounts and transfers accounting information to other accounting records. Typically, companies maintain accounting Journals in the form of books.

As their use of technology increases, they use accounting software and other forms such as spreadsheets to record all their business transactions. Common accounting entries include entries and information such as how an organization pays expenses and records transactions as revenue. Most businesses use a double-entry bookkeeping system to accurately balance their books.

Types of Accounting Journals

Accountants and book-keepers use different accounting Journals to record specific transactions,

1. **Cash Receipt Journal (CRJ):** Record all cash your company receives in the Cash Receipt Journal. This includes cash received from sources such as cash from cash sales and accounts receivable. Other sources of funding include receiving interest, bank loans, or selling assets for cash.
2. **Cash Disbursement Journal (CPJ**): The cash disbursement journal records all transactions for which a company disburses cash, such as expense Cheque and accounts payable payments. Accounting treats check payments as cash payments.
3. **Journal:** This journal records the goods or assets purchased on credit. Assets or goods purchased on your account are not part of your purchase journal.
4. **Sales Journal:** The sales journal records only credit sales of goods and assets. We don't record income received in cash in the sales journal because the income goes into the CRJ.
5. **Purchase Return Journal (PRJ):** The purchase return journal records all returns of inventory purchased on credit by the company. This includes credit purchases where the customer returns the supplier to the supplier for defective or non-conforming products.
6. **General Journal:** The general journal records all transactions except those recorded in cash payments, cash receipts, purchase Journals, and sales Journals. Record transactions such as asset purchases on credit, account reconciliations, year-end inventory, and correction errors.
7. **Sales Return Journal (SRJ):** The sales return journal records all credit sales returned to your company from customers and clients.

Benefits of Accounting Journals

The benefits of Accounting Journals are:

1. **Track records chronologically:** Accounting Journals record transactions as they occur. This gives you detailed day-to-day information about your business transactions.
2. **Reduce the chance of error:** Because Journals contain both the debit and credit aspects of financial transactions, the chance of error is minimized. It helps accountants and auditors track irregularities in a company's finances and spot budgeting errors.
3. **Provide details for all transactions:** Journals are recorded only after you confirm the related invoices. The accountant writes a journal entry narration under every entry so that auditors can audit the company's financial records.
4. **Avoiding overspending:** Accounting Journals can prevent businesses from overspending in some areas and underspending in others. Avoid over drafting funds and help financial professionals spot fraud before it escalates.

Accounting Journal Elements

An accounting journal consists of the following elements:

1. Account number and name.
2. Header for writing entry date.
3. A reference number or journal entry number to retrieve the journal entry if required.
4. Footer journal description.
5. Debit and credit amounts.

4.2 Performa of a Journal

Original Entry Book

The book in which the transaction is recorded for the first time from the source document is called the Books of Original Entry or primary Entry. The journal is one of the original entry books in which transactions were originally recorded in chronological order (daily) according to the principle of double-entry bookkeeping.

Journal

The journal is a dated record of all transactions, including debited and credited account details and the amount of each transaction.

Proforma of a Journal

			Dr.	Cr.
Date / S.no	**Particulars**	**Ledger Folio**	**Amount**	**Amount**
(I)	**(II)**	**(III)**	**(IV)**	**(V)**

Description:

1. Date: The date of the business transaction is entered in the first column. The year and month are in print only once until they change. The date and month order must be severely maintained.

2. Details: Each business transaction affect two accounts, one of which is debited and another of which is credited. The name of the account is to be debited is first written in the immediate vicinity of the row of details column, Dr. Is also written at the end of a particular column. On the second line, the name of the credited account begins with the word "To", a few spaces away from the margins of the detail column to distinguish it from a debit account.

3. Narration: After recording each entry, a brief description of the business transaction required details are displayed in a detail column in parentheses called narration. The words "For" or "Being" are used before you start writing the narration. Currently, you don't have to use the word "For" or "Being".

4. Ledger Folio (L.F.): All entries in the journal are later posted to the ledger account. The ledger page numbers or folio numbers posted from the journal are recorded in the L.F. column of the journal. Until such time, column remains blank.

5. Debit Amount: This column contains the amount of the account to be debited.

6. Credit Amount: This column will contain the amount of the account to be credited.

4.3 Journalizing Steps

The process of analyzing and journalizing business transactions under the head of debits and credits is called journalizing. The entries created in the journal are called "**Journal Entries".**

Step 1: - decide the two accounts involved in the transaction.

Step 2: - categorize the above two accounts by personal, real, or nominal.

Step 3: - check debit and credit rules for the both accounts above.

Step 4: - recognize which account to debit and which account to credit.

Step 5: - Record the trading date in date column. The year and month are written only once until they change. The date and month order must be strictly maintained.

Step 6: - Write the name of the account you want to debit in the detail's column very close to the left of the detail's column, followed by the abbreviation Dr. in the same row. In contrast, the amount debited is written in the debit amount column on the same row.

Step 7: - Enter the name of the account to be credited on the second row, starting with the word "To", a few spaces away from the margins in the "Details" column. In contrast, the amount to be credited is written to the credit amount column in the same row.

Step 8: - Write the narration in parentheses in the next row of the detail column.

Step 9: - Draw a line across the detail column to separate one journal entry from the other.

Example:

March 18, 2004 – Purchased from James with credit Rs.1,50,000.

Date	Particulars	L.F	Debit Rs.		Credit Rs.	
2004 March 18	Purchases A/c Dr. To James A/c (Credit purchases)		1,50,000	–	1,50,000	–

Some Important Points:

1. We write books of accounts of business.
2. Owner and business are considered as separate persons, hence there can be transactions between them.

3. Our own name cannot appear in our books of accounts (i.e. the name of the business cannot appear in the books of accounts of business).
4. Look at all the transactions from the point of view of business only.
5. Owner giver - Capital A/c Credit.
6. Owner receiver - Drawings A/c Debit.

Hence Capital A/c and Drawing A/c represents the owner, hence these two are personal a/c's.

7. **Capital:** Amount invested by the owner into the business.
8. **Drawings:** Amount withdrawn by owner from the business for personal use.
9. **Goods:** Items bought for resale and to make profit.
10. **Assets**: Items bought for use in the business.
11.
    a) **Cash purchase:** Goods are purchased and cash is paid on the spot.
    b) **Credit purchase:** Goods are purchased and cash will be paid in future.
    c) **Creditor:** Party to whom cash will be paid in the future is known as Creditor OR Supplier.
12.
    (a) **Cash sales:** Goods are sold and cash is received on the spot.
    (b) **Credit sales:** Goods are sold and cash will be received in the future.
    (c) **Debtor:** Party from whom cash will be received in the future is known as Debtor or Customer.

13. **Stock A/c Dr.** Only When owner introduces goods to start the business.
14. (a) **Cash received** - Cash A/c Debit
    (b) **Cheque received** - Bank A/c Debit (because bank is the receiver of money).
15. (a) **Cash paid** - Cash A/c Credit.
    (b) **Cheque issued** - Bank A/c credit (because bank is the giver of money).
16. If Nominal A/c is our income we should write the word **'Received'.**

For e.g.

(a) If Rent is our expense Rent A/c **Debit**

(b) If Rent is our Income Rent Received A/c **Credit**

17. (a) When the Party's name is given and nothing is specified, consider it to be a credit transaction.

For e.g. Goods purchased from Amit Rs. 1,000, means goods are purchased on credit.

(b) When the Party's name is not given and nothing is specified, consider it to be a cash transaction.

For e.g., Goods purchased for Rs. 2,000, means goods are purchased for cash.

18. a) Any expense paid at the time of buying the Asset or making the asset should be debited to **Asset** A/C.

(b) Any routine or repair charges paid during the lifetime of the asset should be debited to the **Expense** A/C.

19. **Outgoing of goods at cost**

- Purchase A/c CREDIT

e.g., Goods distributed as free samples, Goods lost by theft, Goods destroyed by fire, Goods given as donation.

20. (a) **Carriage Inward:** Transportation charges paid at the time of purchase of goods.

(b) **Carriage Outward:** Transportation charges paid at the time of sale of goods

Note: both are expenses and should be debited.

21. (a) **Our expenses paid by us:**

Expense A/c Dr.

To Cash A/c

(b) **We pay the expenses of Mr. X:** (It is as good as paying cash to Mr. X).

Mr. X. A/c Dr.

To Cash A/c.

(c) **Mr. Y pays our expense:** (It means Mr. Y is the giver of money for our expenses)

Expenses A/c Dr.

To Mr. Y. A/c.

22. (a) Paid cash to Mr. X on advice of Mr. Y (It is as good as paying cash to Mr. Y).

Mr. Y. A/c Dr.

To Cash A/c

(b) Mr. X paid cash to Mr. Y on our behalf. (It is as good as: Cash received from Mr. X and then cash paid to Mr. Y)

23. **Different ways of recording Personal A/cs.**

Owner - Capital A/c / Drawings A/c

Party for goods - Party A/c

Party for borrowings - Loan A/c / Advances A/c

Party for Deposits - Deposit A/c

24.

Trade Discount (T.D.)	Cash Discount (C.D.)
1. T.D. is allowed on sale of goods in large quantities.	1. C.D. is allowed on prompt payment.
2. T.D. is allowed for cash as well as credit transactions of buying / selling of goods.	2. C.D. is allowed only for cash transactions.
3. % of T.D. is applied on GROSS PRICE (Original price of goods) (G.P.).	3. % of C.D. is applied on NET PRICE (N.P.).
4. G.P. – T.D. = N.P.	4. N.P. – C.D. = Cash received / paid
5. T.D. is never recorded in the books of accounts.	5. C.D. is recorded in the books of accounts.
6. Goods A/C and party A/C will be recorded at net price.	

25. (a) **Bad debts:** Amount which cannot be recovered from the party. (Insolvent).

(b) **Solvent:** Person whose Assets > Liabilities.

(c) **Insolvent:** Person whose Liabilities > Assets.

26. (a) Insurance premium paid - Expense of business.

(b) Life Insurance premium paid - Personal expense of the owner.

(c) Income tax paid - Personal expense of the owner.

27. (a) **Goods distributed (given) as free samples for advertisement**

Advertisement A/c Dr. (AT COST)

To Purchase A/c

(b) **Goods received as free samples**

No Entry - because for us the cost is ZERO

(c) **Free Samples sold:**

Cash A/c Dr (AT S.P.)

To Sundry Income A/c

28. **Bad debts Recovery:** Amount recorded as bad debts in the past now received. It is our income, hence Bad Debts Recovery A/c is a nominal A/c.

Other Important Points of Journal:

(1)	Expenses paid by Business: (a) If it is of Business Expenses A/ c Dr. To Cash A/c To Bank A/c (lf paid by cheque)
	(b) **If it is Owner:** Drawings A/ c Dr. To Cash A/c
	(c) **lf it is of Customer:** Customer A/c Dr. To Cash A/c
	(d) **lf it is in relation to Purchase of Asset:** Asset A/ c Dr. To Cash A/c
	(e) **Paid in Advance (Prepaid):** Prepaid Expenses A/c Dr. To Cash A/c

	(Note: Party A/c should not be debited)
(2)	**Expenses of business paid by other party:** Expenses A/c Dr. To Party A/c (who paid the expenses)
(3)	**Expenses due but not paid (payable)** Expenses A/c Dr. To Party A/c (To whom payable) To Outstanding Expenses, A/c (lf name of party is not given) (**Note**: In case of o/s Salary & Wages, ignore the party A/c)
(4)	**Income Received:** Cash A/c Dr. To Income A/c
(5)	**Income due from Party (Receivable):** Party A/c (From whom Receivable) Dr. Income Receivable A/c (lf name of party not given) Dr. To Income A/ c
(6)	lf in the transaction of purchase or sale It is not given clearly whether it is for cash or on credit, then (a) lf the name of the party is given then It is a credit transaction (ignore % of C.D. given in the transaction). (b) lf the name of the party is not given then it is a cash transaction.
(7)	ln case of purchase and sale of goods party on cash and on credit with cash discount.

	(a) If Goods A/c debited then all other A/c's will be credited. **(b) lf Goods A/c is credited then all other A/c's will be debited.**
(8)	**Entries are not passed for the following:** (a) Placing and receiving of order. (b) Giving Change (c) Appointing a person » (d) Deciding for buying and selling of any asset etc.
(9)	Entry is passed on the day on which order is executed. (Completed)
(10)	Any amount brought in business by Owner is credited to capital A/c. (a) Private (Personal) Car sold any money invested in the business or for business purposes. (b) Gift received or Lottery price received and invested in business etc.
(11)	Whenever goods are sold, entry should be passed with the selling price of goods. Profit or sale of goods not recorded separately. **E.g.:** Goods costing Rs. 10,000 sold at a loss of Rs. 1,000., Entry: **Cash A/c Dr. 9,000** **To Sales A/c - 9,000**
(12)	Cash discount is calculated only for cash transactions and not on credit transactions. Cash transaction means **cash and cheque received or given.**

(13)	**Bad debts recovered:** **E.g.**: Received Rs. 3,000 cash from Amar which was earlier written off as bad. Entry: **Cash A/c Dr. 3,000** **To Bad Debts recovered A/c - 3,000** **Note: Amar A/c is not credited because bad debts recovered is gain (Profit). It is an income.**

4.4 Summary

- A journal is a detailed record of all transactions made by a business.
- Reconciliation of accounts and transfer of information to other accounting records is done using the information recorded in the journal.
- When transactions are recorded in a company's journal, they are usually recorded using double-entry bookkeeping, but can also be recorded using single-entry bookkeeping.
- Double-entry bookkeeping reflects changes in two accounts after a transaction has occurred. One increase and corresponding decrease in accounts.
- Single-entry bookkeeping is rarely used and only records changes to one account.
- Journal is also used in the financial world to refer to a trading journal detailing trades made by an investor and why.

4.5 Self-Assessment Questions

1. What is a Journal of Accounting?
2. Should Journal entries be balanced?
3. What to do with accounting entries?
4. What are the types of accounting Journals?
5. List the benefits of Journaling.
6. Create Journal entries for the following transactions (Rs. = Rupees = Indian currency).

a. Harish started his business with cash Rs. 10000
b. He purchased the item from Manohar Rs. 5000
c. Purchase fittings for cash Rs. 800
d. He sold the goods to Charanjeet Rs. 1600
e. He paid Manohar Rs. 3000
f. Sale Vadva Ram Rs. 2000
g. Receive from Charanjeet Rs. 1540 and allowed him a discount of Rs. 60
h. Wages Paid Rs. 80
i. Purchased goods with cash Rs. 600
j. He sold the goods to Ramesh Rs. 3400

7. What is a Compound Journal Entry?
8. What does L.F. mean? How do you fill in this column?

4.6 References

1. Basic Financial Accounting for Management- Paresh Shah -Oxford University Press
2. An Introduction to Accounting S N Maheswari and S K Maheswari, Vikas
3. Modern Accountancy Volume-1- A Mukherjee and M Hanif-TMH

Unit 5

Basic Accounting Procedures-Ledgers

Learning Objective:

After studying the unit, students will be able to:

1. Know what Ledgers means.
2. Understand the Proforma of a Ledgers
3. Explain the Posting Procedure

Structure

5.1 Meaning of Ledgers

5.2 Proforma of a Ledgers

5.3 Posting Procedure

5.4 Summary

5.5 Self-Assessment Questions

5.6 References

5.1 Meaning of Ledgers

In the journal, each transaction is processed individually. Therefore, the ultimate results of many transactions can't be seen at a glance. Therefore, it's collected in one place in your ledger to ascertain the internet effect of all transactions associated with a specific account

A ledger may be a book that contains all the accounts that are initially entered into the journal or special purpose auxiliary books, whether personal, genuine, or nominal. consistent with L.C., Cropper, "A book that contains a categorized and protracted record of all transactions during a business is named a ledger."

The foremost commonly used ledger for many business concerns is bound notebooks. It is often stored for an extended time. As a result, the page is numbered. Each ledger account should open on a divide page, if possible. When one page is complete, your account will proceed to the subsequent page or another page. But with greater concern, keeping the ledger as a bound notebook is impractical. The loose-leaf ledger has replaced the bound notebook.

The loose-leaf ledger introduces an appropriate cardboard border sheet and secures it with the assistance of a binder. You'll delete the finished accounts and relocate and relocate the accounts in any order, whenever the specified additional pages could also be inserted.

Utility

A utility ledger may be a most important or main ledger that contains all accounts to which business transactions recorded within the original entry's books are transferred. Ledgers in addition are referred to as "final entry books" or "secondary entry books" because transactions are eventually incorporated into the ledger.The benefits of the ledger are:

a) **Complete information at a glance:**

All business transactions associated with your account which is collected in one place in your ledger. By watching balance of that account, you'll see at a look the collective effect of all such transactions.

b) **Arithmetic Accuracy**

With the assistance of your ledger balance, you'll prepare an attempt balance to understand the arithmetic accuracy of your account.

c) **Business Performance**

This makes it easy to make a final accounting to know business performance and therefore the financial position of the business.

d) **Accounting Information**

Data provided by various ledger accounts is summarized, analyzed, and interpreted to get various accounting information.

Description

e) Each ledger account is split into two parts. The left side is named accounting and therefore the right side is named credit. The words "Dr." and "Cr." Are wont to describe debits and credits.
f) The name of your account is often found at the highest (center) of your account.
g) The date of the transaction is recorded within the date column.

h) The word "destination" is employed before the account that appears on the accounting of the account within the detail column. Similarly, the word "By" is employed before the account that appears on the accounting of the account within the detail column.

i) The names of the opposite accounts suffering from the transaction are written to either the accounting or the accounting of the detail column.

j) The pagination of the journal or auxiliary workbook to which that specific entry is transferred is entered within the Journal Folio (J.F) column.

k) The quantity related to this account is going to be entered within the Amount column. The method of transferring entries recorded during a posting journal or auxiliary book to every account opened within the ledger is named posting.

In other words, posting means grouping all transactions associated with a specific account in one place. All journals must be posted to different accounts in your ledger because postings assist you understand the internet impact of various transactions over a specific period on a specific account.

5.2 Performa of a Ledger

Dr. **Ledger A/c** **Cr.**

Date	Particulars	J. F	Rs.	Date	Particulars	J.F.	Rs.
	To				By		

5.3 Posting Procedure

I. **The posting procedure is as follows: Procedure for posting a debited account in journal entry.**

Step 1

Find the account you would like to debit in your ledger and enter the date of the transaction within the debit date column.

Step 2

Record the name of the account credited within the journal as a "destination" within the debit details column. (The name of the credited account) ".

Step 3

Record the pagination of the journal within the debit J.F column and write the pagination of the ledger during which the actual account appears within the journal within the L.F. column.

Step 4

Enter the quantity related to the accounting amount column.

II. **Procedure for posting an account credited to a journal.**

Step 1

Find the account to be credited in your ledger and enter the date of the transaction within the credit date column.

Step 2

Record the name of the debited account within the journal as "By (the name of the debited account)" within the detail's column on the accounting.

Step 3

Record the journal page number in column J.F on the credit side and enter the page number of the ledger for which a particular account appears in the journal.

L.F. column.

Step 4

Enter the amount associated with the amount column on the credit side.

Ledger: A book in which all accounts are kept is called a ledger. In other words, a ledger is a set of all the different types of accounts. It is a bound book of all the transactions. It includes all the different accounts of persons, assets, liability, incomes, expenses, etc. Transactions cannot be directly recorded in a ledger. Every entry in the ledger accounts comes from the books of prime entry.

Important points:

1. Journal is the first book or original book of entry. Ledger is the main book or principal book of entry.
2. In Journal transactions are recorded date wise in Ledger transactions are recorded Account date wise.
3. For each Account give a separate page in Ledger.
4. Process of transferring Journal entry into the ledger Account is known as posting.
5. Posting Rule:

(a) Name of opposite Account.

(b) Amount of the same Account.

6. Ledger accounts are closed and reopened at regular intervals, mostly after every month.
7. Balance at the end - Closing balance (Balance c/d)

Balance at the beginning - Opening balance (Balance b/d)

8. In an Account:

If Dr. Side is heavy - A/c shows Dr. Balance

If Cr. Side is heavy - A/c shows Cr. Balance

9. Closing balance - Recorded on opposite side. Opening balance – recorded on the same side.
10. Personal Accounts:

Dr. Balance	Cr. Balance
(Debtor)	(Creditor)
(Amount receivable from)	(Amount payable to)
(Amount due from)	(Amount due to)
(Amount owing from)	(Amount owing to)

11. Real A/c's - Always Dr. balance.
12. Nominal A/c's

Expenses	Incomes
Dr. Balance	Cr. Balance

13.

a) Cash A/c - Always Dr. Balance
b) Bank A/c - Normally- Dr. Balance
   - Overdraft- Cr. balance

14.

a) Capital A/c - Cr. Balance.
b) Drawings A/c - Dr. Balance.

15.

a. Purchase A/c Dr. Balance
b. Sales A/c Cr. Balance
c. Purchase Return A/c Cr. Balance
d. Sales Return A/c Dr. Balance

Difference between accounting journal and accounting ledger

Accounting journal and ledger are two different accounting terms. Below are two comparisons.

1. **Importance:** Journals are more important than ledgers because they represent the original record of business transactions. The accountant's journal entries form the basis for creating an accounting ledger.
2. **Records:** In journal accounting, accountants write entries in chronological order. But in the ledger, these experts sort the entries by their accounts.
3. **Purpose:** The purpose of the journal is to create the company's ledger, and the purpose of the ledger is to create the company's Trial Balance and financial statements. Ledgers often contain the information needed to prepare financial statements.
4. **Requirement:** In a journal, a narration or description of transactions is essential as it helps financial professionals understand the type of entry. Book accounts, by comparison, do not require narration.
5. **Balancing:** It is imperative to balance the transactions in the ledger. However, although balancing is not a requirement for journal entry, many professionals choose journal reconciliation to ensure the accuracy of their entries.

5.4 Summary

- A general ledger is the foundation of a company's double-entry bookkeeping system.
- General ledger accounts contain all transactional data required to produce income statements, balance sheets, and other financial reports.
- A general ledger transaction is a summary of transactions created as journal entries to sub ledger accounts.
- A Trial Balance is a report that lists all general ledger accounts and their balances, making it easier to review reconciliations and spot errors.
- Ledger balances are calculated by banks at the end of each business day and include all debits and credits.
- It is the opening balance in your bank account the next morning and remains the same throughout the day.
- Ledger Balance is different from Customer's Available Balance which is the total funds available for withdrawal at any given time.

5.5 Self-Assessment Questions

1. What is a ledger?
2. Describe the utility of the ledger.
3. What is a loose-leaf ledger?
4. What is posting?
5. What is the submission process?
6. Explain what it means to balance accounts.
7. Describe the balancing procedure.
8. What is a debit and Credit Balance?
9. Explain the importance of debit and credit balances for different types of accounts.
10. Please indicate the nature of your regular balances in the following accounts.
    a) Cash
    b) Debtor
    c) Creditors
    d) Purchase

e) Operating
f) Equity
g) Furniture
h) Salaries Paid
i) Commission receipt
j) Computer

11. Please provide an example of posting a double-entry journal entry.
12. Distinguish between ledgers and journals.

5.6 References

1. Basic Financial Accounting for Management- Paresh Shah -Oxford University Press
2. An Introduction to Accounting S N Maheswari and S K Maheswari, Vikas
3. Modern Accountancy Volume-1- A Mukherjee and M Hanif-TMH

Unit 6

Basic Accounting Procedures-Trial Balance

Learning Objective:

After studying the unit, students will be able to:

- Know what Trial Balance means.
- Understand the Performa of a Trial Balance.

Structure

6.1 Meaning of Trial Balance

6.2Proforma of a Trial Balance

6.3 Summary

6.4 Self-Assessment Questions

6.5 References

6.1 Meaning of Trial Balance

A Trial Balance is a statement that shows the debit and credit balances of all accounts in your ledger. The sum of the debit and credit balances must match, because every debit must have a corresponding credit according to the rules of the double-entry bookkeeping system. If there is a difference, you will need to verify the accuracy of the balances carried forward from each account. Trial balances can be created at any time as long as your account balance is reconciled.

"A Trial Balance is a statement prepared using the debit and credit balances of ledger accounts to test the arithmetical correctness of the books." – J.R. Batliboi.

Purpose

The purpose of preparing a Trial Balance is to:

1. To check the arithmetic accuracy of accounts.
2. Find the error;

3. To facilitate the preparation of final accounts;

Advantages

The advantage of the Trial Balance is

1. It helps to check the arithmetic accuracy of the bookkeeping work done during the period.
2. It provides a quick reference of all the balances of the ledger accounts in one place.
3. Any errors found in the preparation of the Trial Balance may be corrected prior to the preparation of the Financial Statements.
4. This forms the basis for preparing financial statements.

Methods

You can create a Trial Balance in the following ways:

1. **Totalling Method:** According to this method, the total amount of debits for an account and the total amount of credits for an account are recorded.
2. **Balance Method:** With this method, only the balance of an account, either debit or credit, as the case may be, is recorded against the respective account. The balance method is more widely used as it provides better figures for preparing final accounts.

How does Trial Balance work?

The Trial Balance is the statement of all debits and credits. Business men prepare Trial Balance at the end of the reporting period regularly to ensure that the entries are mathematically correct in the books of account. The total of Trial Balance should be equal. In case the debit and credit does not match it means there is an error. For example, the accountant may have recorded an account or classified a transaction incorrectly

6.2 Performa of a Trial Balance

1. Before starting the Trial Balance all the ledger accounts should be closed. The ledger balance is provided by the difference between the sum of all the debit entries and the sum of all the credit entries

2. Prepare Trial Balance worksheet. The column headers should be for the account number, account name and the corresponding columns for debit and credit balances.
3. Every ledger account is transferred to the Trial Balance worksheet. The account name and number along with the account balance in the appropriate debit or credit column
4. Add up the debit and credit column. In an error free Trial Balance, the total should be the same. Trial Balance are closed when the total is same
5. Accountants have to locate and rectify the errors, if there is a difference,

A Trial Balance looks like

All the account titles are the closing balance of ledger account

ABC LTD - Trial Balance as at 31 December 2021		
	Debit	Credit
Account Title	Rs	Rs
Share Capital	-	15,000
Furniture & Fixture	5,000	-
Building	10,000	-
Creditor	-	5,000
Debtors	3,000	-
Cash	2,000	-

Sales	-	10,000
Cost of sales	8,000	-
General and Administrative Expense	2,000	-
Total	30,000	30,000

6.3 Summary

- A Trial Balance is a worksheet with two columns, one for debits and one for credits, to ensure that your company's bookkeeping is mathematically correct.
- Debits and credits include all business transactions of a company over a period of time, including totals for accounts such as assets, expenses, liabilities, and income.
- Trial Balance debits and credits must be aggregated to ensure that there are no mathematical errors, but there can still be mistakes and errors in the accounting system.
- The accounting cycle is a process designed by business owners to facilitate financial accounting of their business activities.
- The end of the accounting cycle provides business owners with a comprehensive financial performance report used to analyze their business.
- The eight steps of the accounting cycle are identifying transactions, recording transactions in journals, posting, unadjusted trial balances, worksheets, adjusting journal entries, financial statements, and closing books.

6.4 Self-Assessment Questions

1. What is a Trial Balance?
2. What is the purpose of creating a Trial Balance?
3. What are the benefits of Trial Balance?

4. Why is it said that the Trial Balance is not conclusive proof of the accuracy of the books?
5. Describe the principles underlying the Trial Balance arrangement.
6. What errors did the Trial Balance reveal?
7. What are the undisclosed errors in the Trial Balance?
8. How Does Trial Balance Work?
9. What is the Trial Balance used for?
10. What does the Trial Balance include?

6.5 References

1. Basic Financial Accounting for Management- Paresh Shah -Oxford University Press
2. An Introduction to Accounting S N Maheswari and S K Maheswari, Vikas
3. Modern Accountancy Volume-1- A Mukherjee and M Hanif-TMH

Case Study

Ram and Shyam are two friends who have both just attended their first accounting class. Friends were intrigued by the different areas of accounting and their wide application. Ram personally likes the accounting department where cash flow statements and budget controls are used. That department helps you plan and manage your operations. As the concept of accounting was further explored, they began discussing different users of accounting. Lam said it's interesting that even employees request information about the business. Even competitors want information about the relative strengths and weaknesses of the companies, Shyam said, finding the fact of making comparisons more interesting, saying that even accounting can help owners determine the annual cost, saying it helps compare costs, and sales to those of other years. However, they were quite shocked that the accounting did not consider labor relations. On the other hand, Ram and Shyam quarrelled at the end of their discussion. Ram said accounting was an art, Shyam said accounting was a science. Their teacher came over and said something to them that made them stop arguing.

Questions:

1. What did their teacher say to settle their argument?
    a. Ram, please understand, Shetty is right in this situation
    b. Shyam, please understand, Ram is right in this situation.
    c. Both are correct
    d. There is no correct answer
2. What type of accounting users did Shyam talk about?
    a. Internal users
    b. External users
    c. Both (a) and (b)
    d. Neither of these;
3. Which accounting limit are they talking about?
    a. Influence of personal judgment;
    b. Omission of qualitative information.
    c. Incomplete information;
    d. Based on historical costs
4. Which are the accounting benefits that Shyam is talking about in the last part of the first paragraph?
    a. Provision of information on profit and loss;
    b. Provide complete and systematic records;
    c. Comparative study is possible
    d. Evidence in legal matters;
5. What is Ram's favourite accounting department?
    a. Financial Accounting;
    b. Costing
    c. Management Accounting
    d. Tax Accounting

Unit 7

Cash Book

Learning Objective:

After studying the unit, students will be able to:

1. Know what Cash Book means.
2. Understand the Different types of Cash Book
3. Understand what the Contra Entry means

Structure

7.1 Introduction of Cash Book

7.2 Single Column Cash Book

7.3 Double Column Cash book

7.4 Triple Column Cash book

7.5 Summary

7.6 Self-Assessment Questions

7.7 References

7.1 Introduction of Cash book

Cash is an essential medium for conducting transactions conducted in a business and must be recorded in order to maintain proper bookkeeping of transactions. Cash is a liquid asset and examples of cash transactions are bank overdrafts, money orders and demand deposits.

This creates the need to keep all cash transactions in one place for your business and necessitates the use of a cash book.

Cash Book Definition

A cash book is a special kind of book concerned only with recording an organization's cash transactions. It acts as both a journal and ledger for all cash transactions that take place in a business organization.

A cash book records all cash receipts on the debit side and all cash payments for an organization on the credit side.

Features of Cash Book

Cashbook has the following features:

1. It acts as both a journal and a ledger.
2. It can be used as an alternative to cash accounts for recording transactions.
3. This follows the dual-entry system of accounting (that is, debits and credits in the cash book).
4. The debit side must be the same as the credit side.
5. A cash book always requires a debit balance.

Types of Cash Book

There are four types of cash books used for accounting purposes. Let's take a look at the types of deposit passbooks.

1. Single Column Cash Book
2. Double Column Cash Book
3. Triple Column Cash Book
4. Petty Cash Book

1. **Single-Column Cash Book:** A single-column cash book is also called a simple cash book. You will see entries for cash received (receipts) on the left or debit side and entries for cash payments on the right or credit side.

In a single-column cash book, bank transactions and discounts applied to transactions appear in separate ledger accounts.

Some business companies update their cash books daily. The most notable feature of a cash book is its inability to keep a credit balance. You should always display the debit balance.

2. **Double Column Cash Book**: The dual column cash book has an additional column reserved for discounts. Thus, in a two-column cash book, also called a two-column cash book, his receipts and transactions of cash are recorded in one column, and the discounts received and offered are recorded in a second column increase.

Discounts are nominal accounts, with discounts offered placed on the debit side of the cash book and discounts received placed on the credit side of the cash book.

At the end of the accounting period, the balances in both columns are adjusted and the closing balance is transferred appropriately.

3. **Triple Column Book**: In a triple column cash book, the two columns are similar to a double column cash book. Additional columns are for banking transactions.

With advances in the banking industry, most businesses now deal with Cheque, so having a bank column in your cash book helps you get your transactions right.

4. **Petty Cash Book:** The petty cash book is, as the name suggests, for very small transactions within an organization. Transactions like this can occur in a single day, and because they are repetitive in nature, they can overwhelm the general cash book. For this reason, they are managed separately.

Examples of such transactions include stationery, postage, and food expenses.

Advantages of Cash Book

Cashbooks have the following advantages:

1. By checking the balance of the cash book and cash deposits, it becomes easier to check cash and helps to find input errors.
2. Helps create regular records by trading day for the convenience of the accountant.
3. Cash payments and transactions can be tracked correctly in the cash book as they are maintained by date.
4. Help detect cash fraud within your organization.
5. Helps reduce workload and save time and effort

7.2 Single Column Cash Book

A single-column cash book (simple cash book) has one amount column on each side. All cash receipts are recorded on the debit side and all cash payments are recorded on the credit side. In fact, the book is nothing more than a cash account. Therefore, there is no need to open a cash account on the ledger. A one-column cash book resembles a T-shaped cash account in almost every way. The pages of this book are divided vertically into two halves. Receipts are entered on the left side (debit). Payments are entered on the right (credit) side.

A one-column cash book has only one money column for debits and credits to record cash transactions. This is why it is called a single-row cash book (or simple cash book).

Explanation

A single-column cash book records only cash receipts and payments.

A cash book in this format has only one He Amount column on each of the debit and credit sides of the cash book. All cash receipts are entered on the debit side and cash payments are entered on the credit side.

In essence, a single column cash book is nothing more than a cash account. A cash account cannot show a credit balance on the principle that you can't pay what you don't have. This means that cash accounts always show a debit or zero balance.

The format for a Single-Column Cash Book is shown below.

Format

Single Column Cash Book of ....

Debit Side   Credit Side

Date	Particulars	R. N.	L. F	Amount Rs.	Date	Particulars	V. N.	L. F	Amount Rs.

Explanation:

1. **Date:** This column is displayed as both a debit and a credit. Record the dates when cash is received on the debit side and paid on the credit side.
2. **Details:** This column is used for both debits and credits. The names of the party receiving the payment (personal account), the head (nominal account) and the item (real account) are recorded.
3. **Receipt Number (R.N):** This refers to the serial number of the cash receipt.
4. **Voucher Number (V.N):** This refers to the serial number of the voucher on which payment is made.
5. **Ledger Folio (L.F):** This column is used for both debits and credits in the cash book.

A ledger page (folio) for all accounts in the cash book is recorded against it.

6. **Amount**: This column appears on both sides of the cash book. The actual amount of cash received is recorded on the debit side. The actual payment is entered as a credit.

Balance:

The cash book is balanced like any other account. The total of the receipt (debit) column is always greater than the total of the payment (credit) column. The difference will appear on the credit side as "By Balance c/d". To show the cash on hand at the beginning of the next period, record the remaining amount as 'Balance b/d' on the debit side.

7.3 Double Column Cash Book

A Two-Column Cash Book has two columns on each side. One is used to record cash transactions and the other is used to record bank transactions or discounts. If the trader has a bank account, he / she must record the amount deposited at the bank and the amount withdrawn from the bank.

The most common two-column cash book is

1. Cash book with discounts and cash columns
2. A cash book with columns for cash and banks.
3. Cash book with discounts and cash columns

Another column is added to either side of the single-column cash book to record the discounts allowed and the discounts received. The format is as follows.

Format-Double Column Cash Book

(Cash book with Discount and Cash Column)

Debit .... Credit

Date	Particulars	R. N.	L. F	Discount Allowed Rs.	Amount Rs.	Date	Particulars	V. N.	L. F	Discount Received Rs.	Amount Rs.

If you have a large number of bank transactions, it is recommended that you open the cash book by recording the bank transactions with separate columns on either side of the cash book.

In such cases, the two columns of the cashbook serve the purpose of a cash account and a bank account, respectively, so there is no need to open separate bank accounts in the ledger. A combination of a cash account and a bank account. The format of this cash book is:

The debit has two amount columns, one for cash receipts and the other for bank deposits (that is, payments to bank accounts). Similarly, there are two amount columns on the credit side, one for cash payments and the other for check payments.

Cash Book with Cash and Discount columns is one in which an additional amount column of ‘Cash Discount’ on each side is provided.

Cash Discount is a deduction from the amount paid or received. Such a cash discount can either be ‘discount allowed’ or ‘discount received’. It will be ‘discount received' if the trader pays his account promptly or within the period of credit. It will be ‘discount allowed’ if he receives the payment from his own customers promptly. Since discount is received or allowed at the time of receipt or payment of Cash, it is necessary to record this fact at the same place and time where and when cash transaction is recorded. This is why the Cash Book usually contains two additional amount columns, one on each side. Discount columns on the debit side records

Cash discount allowed by a businessman whereas the discount column on the credit side records discount received by him.

Cash discount should, however, be distinguished from trade discount. Cash discount is allowed or received for prompt settlement of account or for settlement of account within the period of credit. The trade discount on the other hand, is an allowance made by a whole-seller to a retailer on the catalogue or invoice price. The object of the trade discount may be either to encourage large-scale buying by the retailer or to enable the retailer to sell the goods at the price mentioned in the catalogue or Price List issued by the wholesaler. The trade discount is deducted from the invoice itself and the entry in the books is made with the net amount, i.e., after deducting the trade discount.

Certain important points in connection with the cash discount be noted:

(1) The Discount columns are not to be balanced. This is so because the total of the debit side discount columns represents the total discount allowed whereas the total of the credit side discount column represents the total discount received.

(2) Discount columns do not serve the purpose of Discount Account because they are only the memorandum columns. A discount account will be opened in the ledger and the total of these columns will be posted therein.

(3) The rules for recording discounts allowed and received in the personal accounts are:

   (a) Debit the creditor's account with the amount of discount received while debiting his account with the amount of cash paid, and

   (b) Credit the debtor's account with the amount of discount allowed together with cash received from him.

(4) The total of the discount column appearing in the debit side of the Cash Book will be posted on the debit side of the Discount Allowed Account and the total of the discount column appearing on the credit side of the Cash Book will be posted on the credit side of the Discount Received Account in the ledger.

This at first sight appears to be incorrect. How can a debit total be transferred to the debit of an account? Here one must look at the entries for discounts in the personal account. Discounts allowed have been entered in the credit of the individual personal accounts. The entry of the total in the expense account of discount allowed must, therefore, be on the debit side to preserve double entry balancing. The converse applies to discounts received.

The sides on which the two types of discounts are entered in the discount accounts in the ledger can be easily reconciled if discounts allowed are seen as an expense of attracting money. As an expense they will be found as a debit in the discount allowed account. Similarly, discounts received may be seen as income received for prompt payment of account, and as income will, therefore, appear on the credit side in the discounts received account.

(5) Discount account being a nominal account, the following rule should be applied while recording discounts.

   Debit all losses and expenses (Discount allowed) Credit all gains and incomes (Discount Received)

7.4 Triple Column Cash Book

In this type of Cash Book, three amount columns are provided on either side. Three columns are for (a) Discounts (b) Cash (c) Bank. Triple column cash Book is generally used by big business houses which have numerous bank transactions. No bank account needs to be opened because the bank columns themselves represent debit and credit sides of the Bank Account. The businessmen are thus able to save their time in posting.

The method of recording in this type of Cash Book is similar to the one adopted in case of the columnar Cash Book. But contra entries involving Cash and Bank deserve special attention. When cash is deposited into the bank or cash is withdrawn from the bank, the transaction is to be recorded in the cash column on one side and the bank column on the other side. If cash is withdrawn from the bank, the amount will be debited in the cash column and will be credited in the bank column.

Similarly, when we deposit the cash in the bank, an entry will be made on the credit side of the cash book in the bank column; and the corresponding entry will be made on the credit side of the cash book in the ledger column.

Such entries are known as contra entries. A small letter (c) is written in the ledger folio column to indicate that this is a contra entry. No further posting of contra entries is required in the ledger as both the aspects, Debit and Credit, are recorded in the Cash Book itself.

Important Points:

1. Cash Book is one of the subsidiary books.
2. Cash Book is a Journal - Cum - Ledger: Cash Book is a journal because it is a subsidiary book, prepared instead of a journal. Cash Book is a Ledger because after preparing a cash book. We don’t have to prepare Cash A/c and Bank A/c.
3. Incoming of Money in Cash Box or Bank A/c - RECEIPTS. (Dr.) Outgoing Money from Cash Box or Bank A/c - PAYMENTS. (Cr.).
4. Different types of Bank A/c :
    a. Current A/c - Bank A/c of business.
    b. Savings A/c - Personal and private Bank A/c of owner.
    c. Deposit A/c - Bank A/c either of business or owner but where deposits and withdrawal cannot be frequent or day to day.

NOTE: Normally when we say Bank A/c, we refer to the current A/of Bank.

5. **CONTRA ENTRY:**

Transaction where (i) Cash A/c Dr. and Bank A/c Cr. **OR**

(ii) Bank A/c Dr. and Cash A/c Cr.

is known as Contra entry. It is recorded on both sides of Cash Book.

6. (a) Cheque received and deposited on the same Day:

Bank A/c Dr.

(b) Cheque received and deposited later on:

* On the date of receiving the cheque:

Cash a/c Dr.

* On the date of depositing the cheque:

Bank A/C Dr. and Cash A/C Cr.

(c) Cheque received and endorsed:

* On receiving the cheque:

Cash a/c Dr.

* On endorsing the cheque:

CASH A/c Cr.

(d) Bearer cheque received:

Cash a/c Dr.

(e) Bearer cheque received and deposited into Bank :

Bank a/c Dr.

7. Cheque Issue: Always Bank A/c - Cr.
8. Dishonour of cheques: Reverse the above effects.
9. Closing of Cash Book:

(a) Cash and Bank Columns are closed like Ledgers A/cs.

(b) Discount columns of both sides are just to be totalled, which are posted to Discount allowed A/c (Dr. side) and Discount received A/c (Cr. side)

Format:

Dr. **Cash Book** **Cr.**

Date	Receipts	R .No.	L F	Discount	Cash	Bank	Date	Payments	V. No.	L F	Discount	Cash	Bank

7.5 Summary

- Cash Book is a subsidiary of General Ledger that records all cash transactions during the period.
- Cash books are recorded in chronological order and balances are continuously updated and validated.
- Large organizations typically split the cash book into two parts. Cash payment journal and cash receipt journal.
- A cash account differs from a cash account in that it is a separate ledger in which cash transactions are recorded, but a cash account is an account in the general ledger.
- There are three common types of cash books: 1-column, 2-column, and 3-column.

7.6 Self-Assessment Questions

1. What is a cash book? What are its characteristics?
2. What are the advantages of cash on delivery?
3. What is a Single Column Cash Book?
4. What is a double Column Cash book?
5. What is a three-stage cash register?
6. Write a note in the "Contra Entries".
7. Please provide a sample of the "three-level cash book".
8. How the cashbook works

9. What are the rules for making entries in a dual-column cash book with cash and bank columns?
10. How are postings from the cash book done?

7.7 References

1. Basic Financial Accounting for Management- Paresh Shah -Oxford University Press
2. An Introduction to Accounting S N Maheswari and S K Maheswari, Vikas
3. Modern Accountancy Volume-1- A Mukherjee and M Hanif-TMH

Unit 8

Preparation of Bank Reconciliation Statement

Learning Objective:

After studying the unit, students will be able to:

1. Know what Bank Reconciliation Statement means.
2. Understand the importance and necessity of Bank Reconciliations.
3. Understand why your Cashbook and Passbook balances do not match.
4. How to create a Bank Reconciliation.

Structure

8.1 Introduction of Bank Reconciliation Statement
8.2 Performa
8.3 Summary
8.4 Self-Assessment Questions
8.5 References

8.1 Introduction of Bank Reconciliation Statement

A cash book with cash and bank columns was discussed in the previous chapter. On the debit side of the cash book, the bank column represents:

1. A check deposited in a bank for collection.
2. Cash deposited in the bank and
3. Some entries are made only after receiving information from the bank.
    a) Amounts collected on our behalf by banks pursuant to ongoing instructions. For example, interest earned on an investment.
    b) interest charged by bankers on balances held by us in our bank accounts;
    c) Amounts paid by you directly to our bank account.

On the other hand, cash book credits represent:

a) A check issued for payment.
b) Cash withdrawn from banks for office and personal use.

c) Also, some entries are made after receiving information from the bank.

1. Amounts paid by banks on our behalf under standing orders, such as insurance premium payments.
2. Interest charged by the bank on the amount withdrawn in addition to the actual balance held in the bank account.
3. Bank charges paid for agency and utility services provided by banks;

Bank Passbook

A Bank Passbook (passbook) is just a copy of your account in the bank book. It shows all deposits, withdrawals, and balances available in the customer's account.

Format

Bank Pass Book

Date	Particulars	Dr. Withdrawals Rs.	Cr. Deposits Rs.	Balance Dr / Cr Rs.	Initials

The date column records the date of the transaction. Detail columns record withdrawals and deposits. The balance after each transaction is recorded in the next column and the bank official signs the last column.

Following the principles of double-entry bookkeeping, bankers deposit all amounts received from customers into their accounts on their behalf. Similarly, the banker deducts from the customer's account all withdrawals and amounts paid to others on behalf of the customer.

The main point to remember is that entries are made only after receipt or payment of cash, except in the case of interest and bank charges. Interest and bank charges are just book adjustments, they have no cash receipts or cash payments

Bank Reconciliation Statement- Meaning

The balance in the bank column of a two- or three-column cash book represents the customer's cash balance at the bank. It should be the same as shown in his bank passbook on a particular day. If there is a corresponding entry in the passbook (maintained by the banker) or vice versa, the bank balance will be the same in both books for every entry made in the cash book.

However, he must be aware that the cash book and passbook are managed by two different parties, so entries in one book do not always have corresponding entries in the other. Generally, cash book entries should be aggregated (matched) with passbook entries, and the balance displayed in both books should be the same. But in practice the balance is generally different. If the bank book and passbook balances do not match, you will need to create a bank account reconciliation statement.

Definition

"A bank reconciliation is a list showing the various items that contribute to the difference between the bank balances in your cash book and passbook on a particular date."

Necessity and Importance

1. After tracking various discrepancies, a bank reconciliation statement is created. Below are the benefits based on their importance.
2. Any errors that may have occurred in the cash book related to banking transactions can be easily spotted.
3. Fraud can be prevented by creating bank reconciliation statements on a regular basis.
4. It indirectly imposes a moral check on accounting staff.
5. By creating bank reconciliation statements, you can detect unpaid Cheque and take action toward collection.

Reasons why the cash book balance and bank book balance do not match

I. A cheque that has been credited to the bank but not yet collected

Cheques are paid to the bank for collection, but are not credited to the customer's account.

a) It has not been collected or credited until that date.
b) Collected but the banker forgot to fill it out.

c) Collected but credited to the wrong account.
d) Dishonorable.
e) Credited to account number 1, but credited to her account number 2 of the same customer.

As soon as the check is sent to the bank, an entry is made on the debit side (bank column) of the cash book. However, banks typically only credit a customer's account when they receive payment from the bank involved, i.e., when the check is collected. Therefore, there is a time lag between the deposit of the check and its collection by the bank.

For example, Bharat Company Limited deposited a cheque on March 28, 2003totaling Rs 3,000. The check was collected on April 4, 2003. If the bank sent his account statement up to March 31, 2003, the difference is Rs 3,000 between the balance shown in the cash book and passbook.

II. Cheque issued but not yet presented for payment

A cheque has been issued but has not been credited to the customer's account because the cheque was

a) Not cashed till date.
b) Not presented to date.
c) Was presented, but has been dishonored for any reason;
d) Lost by the party to which the check was issued.
e) Cashed out from account number 1, but was mistakenly debited to her account number 2 for the same customer.

In all the above cases, entries in the cash book are made as soon as the check is issued, but, of course, entries are made by the bank only when the check is presented for payment. increase. Therefore, there is a gap of several days between entering the cash book for check issuance and entering the payment in the passbook.

For example, Bharat Company Limited issued a check in his favor to Mr. Krishna on March 28, 2003 in the sum of Rs.5,000. This check will be presented for bank payment on April 4, 2003.

The difference between the Cash Book Balance and The Passbook Balance Rs.5,000.

S. No.	Basis of Distinction	Cash Book (Bank Column)	Pass Book
1.	Maintained by	Cashier	Banker
2.	Deposits of Cash	Entered on the debit side of the cash book.	Entered on the credit column of the pass book.
3.	Withdrawals of Cash	Entered on the credit side of the cash book.	Entered on the debit column of the pass book.
4.	Cheques deposited for collection	Entered on the debit side of the cash book on the date of depositing the cheques into the bank.	Entered in the pass book only on the date of the Realisation of the check.
5.	Cheques issued	Entered on the credit side of the cash book on the date of issuing the cheque to the creditors.	Entered on the debit column of the pass book only on the date on which they are presented and paid.
6.	Collections and payments as per customers standing instructions	Entered in the Cash book after seeing the pass book.	Entered in the Pass book first.

7.	Signature	It is not signed by the cashier	It is signed by the Bank official after each transaction.
8.	Balancing	It is balanced at the end of a specified period.	It is balanced after each transaction

III. **Amount deposited into the passbook by a bank employee without the customer's knowledge**

Below are some examples of the statements above.

a) Banks may have collected rents, dividends, bills of exchange, interest, etc. due to customers in accordance with standing instructions.
b) Some debtors may have paid directly to the bank.
c) The bank will credit interest on the credit balance of the customer's account.
d) A bank employee mistakenly credited this account instead of another account.

In any of the above cases, it is first entered in the passbook. The customer will only know this after confirming the passbook entry. Therefore, there may be a time lag of several days before the information entered by the customer is reflected in the passbook.

For example, the bank said he credited her Rs.500 interest to her Bharat Company Limited account on March 31, 2003. The bank prepared and sent him a statement on March 31, 2003. If the customer receives her account statement on April 4th, 2003, he will have a difference of 500 rupees between the cash book balance and the passbook balance.

IV. The amount deducted from the passbook by the banker, which the customer does not immediately know.

Here are some examples:

a) Bankers keep track of bank charges, interest on overdrafts, and more.
b) Bank employees paid insurance premiums, subscriptions to periodicals, etc.; On behalf of the customer, according to the permanent instructions.
c) The banker mistakenly debited from this account instead of another account.
d) The banker paid the customer's bills payable according to the standing instructions.

e) Dishonored Deposit Cheque and Discounted Bills Receivables

In any of the above cases, the entry in the customer's passbook is first. Customers only know when they see their passbook or account statement entries. Therefore, there may be a time lag of several days before the contents entered by the customer are reflected in the passbook.

For example, the bank deducted a fee equivalent to Rs from her Bharat Company Limited account. 250 on March 31, 2003. If the bank sends her account statement up to March 31, 2003, he will have a difference of Rs.250 between the balance in the passbook and the balance in the passbook.

For example, a cheque for Rs.5,000 that was dishonored on March 28, 2003. If the bank sent his account statement up to March 31, 2003, there would be a difference of Rs.5,000 from the balance shown in the cash book. The balance displayed in the passbook.

After going through the various items of difference, a bank's reconciliation is created, starting with the balance represented by either of the two books. In practice, however, the bank reconciliation statement is created by the customer, starting with the bankbook-based balance, to ensure that the bankbook-based balance is reached.

Bank Overdraft

A bank overdraft is an amount withdrawn in excess of the actual balance held in your bank account. This feature is only available to current account holders. Interest is charged on the overdraft or overdrawn amount. Your cash book shows your credit balance, or unfavorable balance. The debit balance will be displayed in the passbook.

An overview of the trading and adjustment procedures is provided in the table below.

Procedure for preparing Bank Reconciliation

S. No	Transactions	Entries by customer in the cash book	Entries by Bank in the pass book	Effect	Procedure to ascertain the balance as per pass book from cash book

		(Bank column)			Favorable balance	Unfavou -table balance (over- -draft)
1.	When cash is deposited	Customer enters in the debit side	Bank enters in the credit column	Cash book =Pass book	_	_
2.	When cash is withdrawn	Customer enters in the credit side	Bank enters in debit column	Cash book =Pass book	_	_
3.	Issue of cheque	Customer enters in the credit side immediately	Bank enters in the debit column only on the date when presented for payment	Cash book <Pass book	Add	Less
4.	Cheque received and entered in cash book and sent to bank for collection	Customer debits cash book	Only after collection, the amount will be entered in the credit column of the pass book because the process takes some time	Cash book >Pass book	Less	Add
5.	Bank charges for services rendered by bank	No entry can be found in the cash book till the pass book is verified.	Entered in the debit column of the passbook immediately.	Cash book >Pass book	Less	Add

6.	Interest, dividend etc collected by bank on behalf of customer	No entry can be found in cash book till the pass book is verified.	These are entered in the credit column of the passbook immediately after receiving the amount	Cash book <Pass book	Add	Less
7.	Interest allowed by bank	No entry is made unless the pass book is verified.	Entered in the credit column of the pass book first.	Cash book <Pass book	Add	Less
8.	Amount directly remitted into bank	No entry is found in the cash book till the pass book is verified.	Entered in the credit column of the passbook on the same day of receipt.	Cash book <Pass book	Add	Less
9.	Subscription, premium etc paid by the banker as per the standing instructions of the customer	Entry is made only after the pass book is verified.	Entered in the debit column of the passbook on the same day of payment	Cash book >Pass book	Less	Add
10.	Dishonor of bills receivable or cheques paid into bank	No entry in the cash book till the customer is intimated by the banker	Entered in the debit column of the pass book immediately	Cash book >Pass book	Less	Add

11.	Dishonor of bills payable or cheques issued	No entry in the cash book till the customer is intimated by the banker	Entered in the credit column of the pass book immediately	Cash book <Pass book	Add	Less
12.	Wrong credit in the pass book	No entry is found in the cash book unless it is verified with the pass book.	Entered (wrongly) in the credit column in the pass book	Cash book <Pass book	Add	Less
13.	Wrong debit in the pass book	No entry is found in the cash book unless it is verified.	Entered (wrongly) in the debit column in the pass book	Cash book >Pass book	Less	Add

8.2 Performa

The format of the Bank Reconciliation table when starting from the bank balance of the cash book.

Bank Reconciliation of ……………………

	Particulars	Amount Rs.	Amount Rs.
A	Balance as per Cash Book		* *
B	Add: Cheques issued but not presented for payment	* *	
	Interest credited by bank but not recorded in cash book	* *	
		* *	

	Debtors directly paid into bank but not recorded in cash book	* *	
	Wrong credit by banker	* *	
	Collections by banker as per customer standing instructions		**
			* *
	Total (B) (Total A + B)	* *	
	Less: Cheques deposited but not credited by the bank	* *	
	Dishonored cheques appeared in the pass book but	* *	
	not entered in the cash book	* *	
C	Bank charges as per pass book Wrong debit by banker	* *	
D	Payments as per standing instructions		* *
	Total (D) Balance as per Pass Book (C- D)		* *

To resolve Bank Reconciliation issues, please note the following:

a) The heading is given as "Bank Reconciliation Statement as on"

b) All added items are grouped and displayed in the inner column, and the sum is displayed in the outer column for summation (B).

c) All deductible items are grouped in inner columns and totals are shown in outer columns for deductions. (D).

d) A favorable balance means that you have a debit balance in your bankbook and a credit balance in your passbook.

e) A bank overdraft or unfavorable balance means that you have a credit balance on your cash book and a debit balance on your passbook.

For easy reference, the following table will help.

Book	Favorable Balance	Unfavorable Balance (overdraft)
Cash	Debit	Credit
Pass	Credit	Debit

8.3 Summary

- A Bank Reconciliation Statement summarizes bank and business activities and reconciles a company's bank accounts with its financial records.
- A Bank Reconciliation Statement confirms that the payment has been processed and the cash collection has been credited to your bank account.
- Any fees your bank charges to your account must be accounted for in your reconciliation statement.
- After all adjustments, the balance on your Bank Reconciliation Statement should equal the final balance of your bank account.

8.4 Self-Assessment Questions

1. What is a Passbook?
2. What is Bank Reconciliation?
3. When will the Bank Reconciliation be ready?
4. Who prepares Bank Statements?
5. Why is it necessary to prepare Bank Reconciliations?
6. Name five items that will help increase your Cash Book Balance.
7. List 5 things that can help reduce your Bankbook Balance.
8. Name two reasons why the Cash Book and Pass Book balances do not match.
9. Please prepare Mr. Uday Kumar’s bank reconciliation statement from the items below.
   a) Balance of Rs.1,500 per cash book.
   b) Cheque credited but not cleared Rs.100.
   c) A cheque issued for payment of Rs.150.
   d) Interest Rs.20 as permitted by the bank.

10. On March 31, 2004, Fashion World's Cash Book showed his balance of Rs.1,500 as Bank Cash, while his Bank Passbook on that day showed Rs.185, Rs. 175, and was shown missing a cheque for Rs.100 presented for payment. Also, a cheque for 410 rupees paid to the bank was not cleared. Check the balance in your Passbook for the day.

8.5 References

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Unit 9

Capital and Revenue Expenditures and Receipts

Learning Objective:

After studying the unit, students will be able to:

- Know what Capital Expenditures means.
- Understand the meaning of Revenue Expenditure

Structure

9.1 Definition and Description Expenditures-Capital and Revenue

9.2 Definition and Description Receipts -Capital and Revenue

9.3 Summary

9.4 Self-Assessment Questions

9.5 References

9.1 Definition and Description Expenditures- Capital and Revenue

Preface

Accounting is intended to confirm and present the results of the business during the accounting period. To see regular performance, the nature of the transaction needs to be analyzed whether they are the nature of capital or the nature of earnings. Revenue and expense are related to the operation of the business during the accounting period, or the income or expense items earned during that period, and the profits do not extend beyond that period. Capital investment, on the other hand, produces lasting profits and helps generate revenue over multiple accounting periods. Revenue costs must be associated with the physical activity of the entity. Therefore, while production and sales generate revenue in the revenue process, the use of goods and services that support these features is costly. Expenses are recognized in the income statement through a matching principle that informs you when and how much the expense will be charged to your revenue. Part of the expenditure can only be capitalized if the definable flow of future benefits can be traced directly.

The distinction between revenue and equity of a transaction is made for the purpose of placing them in the income statement or balance sheet. Example: Revenue and expenditure appear in the income statement because the profit is for one accounting period. That is, capital expenditures are placed on the asset side of the balance sheet because profits are generated over multiple accounting periods. It is a period and is transferred to the income statement for that year based on the use of that profit in a particular fiscal year. Therefore, both capital expenditures and revenue expenditures are ultimately transferred to the P & L account.

Income and expenditure are transferred to the profit and loss account of the year of expenditure, and capital expenditure is transferred to the profit and loss account of the year in which the profit is used. Therefore, we can conclude that the main determinant for transferring expenses to the income statement is the time factor. Expenses are also recognized in the income statement through a matching concept that indicates when and how much expense is charged against revenue. However, the distinction between capital and income creates considerable difficulty. Often the border between the two is very thin.

Things to consider when checking Capital and Revenue Expenditure

Here are some basic considerations when distinguishing between capital and revenue expenditures:

(A) Nature of business: For furniture traders, the purchase of furniture is a revenue expense, but in other transactions, the purchase of furniture is treated as a capital expense and appears on the balance sheet as an asset. Therefore, the nature of the business is a very important criterion in separating spending between capital and income.

(B) Repetitive nature of spending: If the frequency of spending is very frequent in a fiscal year, it is said to be spending of the nature of income, but non-recurring spending is inherently rare and It does not occur frequently in the fiscal year. Monthly salaries and rents are examples of monthly income and expenditures, but asset purchases are not regular transactions and are classified as capital expenditures unless defined as income and expenditures by materiality criteria.

(C) Purpose of costs: Machine repair costs may be incurred during the normal maintenance process of the asset. Such costs are essentially income. On the other hand, the expenditure incurred to repair assets on a large scale to increase capacity is essentially capital. However,

in contrast to the costs that need to be capitalized, determining the costs of maintenance and regular repairs that need to be costly is not always easy.

(D) Impact on the revenue-generating capacity of the business: Revenues / costs that help generate revenues for the period are essentially revenues and must be matched to revenues for the period. On the other hand, when spending helps generate revenue over multiple accounting periods, it is commonly referred to as capital spending.

If expenses are made to improve and repair fixed assets and the expected future profits from fixed assets do not change, the income statement must be charged, and if expected, the book value of fixed assets. Included in future profits from the asset will increase.

(E) Importance of the amount involved: The relative proportion of the amount involved is another important consideration in distinguishing between income and equity.

Capital and Revenue Expenditures

Definition and Description of Capital Expenditures:

If the profit of the expenditure spans several trading years, the expenditure is capital expenditure. **Capital expenditures may include the following expenditures:**

1. Expenditures required to acquire fixed assets (tangible or intangible) related to the business for the purpose of profit, not resale of land and buildings, plants and machines, furniture and fixtures, goodwill, patents and copyrights, etc.
2. Fixed asset costs include all expenses required before the asset becomes available. For example, the cost of every building you purchase includes the price paid to the seller, legal costs, and broker fees. Similarly, machine costs include purchase prices, freight charges, import taxes, wagons, octroi taxes, construction and installation costs.
3. Expenditures to increase the profitability of a business. For example, the expenses incurred to move a business beyond a specific area and the goodwill (the right to use the established name of the originating company) to attract customers of the old company and increase sales and profits. Money.
4. Money spent converting, for example, from manual machines to powered machines, to extend the life of existing assets or reduce production costs.
5. The cost of expanding and adding existing fixed assets. For example, the cost of adding to buildings, furniture, machinery, cars, etc.

6. All expenses incurred to raise capital for a business, such as commissions and intermediaries paid to agents to arrange long-term loans, discounts on the issuance of stocks and bonds.
7. Capital investment appears as an asset on the balance sheet.

Example of Capital Investment

The most important items of Capital Investment are as follows:

1. Purchase of factories and buildings.
2. Purchase of machinery, furniture, automobiles, office equipment, etc.
3. Goodwill, trademarks, patents, copyrights, patterns, design costs.
4. Costs for installing plants and machinery and other office equipment.
5. Add or extend existing fixed assets.
6. Structural improvements or changes that improve the life or profitability of fixed assets.
7. Reserve fund of limited company.
8. Issuance costs for stocks and corporate bonds.
9. Legal costs for loans and mortgages.
10. Interest on capital during the construction period.
11. Development costs for mines and plantations.

Revenue Expenditure

Definition and Description of Income and Expenditure:

Expenditure items for which benefits expire within the year are revenue expenditures. Income and expenditure do not increase the efficiency of the company.

Expenditures incurred for the following purposes are treated as revenue expenditures.

1. Liquid assets, that is, expenses incurred for resale assets such as commodities, raw materials, and store costs required for the manufacturing process.
2. All establishment and other day-to-day expenses related to the implementation and management of the business, including salaries, rent, taxes, postage, stationery, bank charges, insurance and advertising costs.
3. Expenditures incurred to keep fixed assets in good working condition, such as repairing, replacing, or renewing buildings, furniture, machinery, etc.

Examples Of Revenue Expenditure

The following are important items of Revenue Expenditure.

1. Rent, salary, wages, manufacturing costs, shipping costs, fees, statutory costs, insurance and advertising, free samples, salaries, shipping costs, and all other costs incurred in normal operations.
2. The costs incurred by repairs, renewals, and replacements to keep the business's existing fixed assets healthy.
3. The cost of the item purchased for resale.
4. Raw materials purchased during the manufacturing process and store costs.
5. Wages paid to manufacture products for sale.
6. Depreciation of assets used in the business.
7. Interest on a loan borrowed for a business.
8. Fares and carts paid for purchased items.
9. The cost of oil to lubricate the machine.
10. Service to the vehicle.
11. Expenditures of all kinds incurred to defend proceedings in the sale of goods.

As mentioned earlier, capital investment contributes to the profitability of a business over multiple accounting periods, but revenue costs are incurred to generate revenue for a particular accounting period. Revenue costs are directly related to revenue or are related to accounting periods such as cost of goods sold, salary, and rent. Cost of goods sold is directly related to revenue, while rent is related to a particular accounting period. Therefore, the profits from capital expenditures last for multiple accounting periods, while the profits from revenues and expenses expire in the same accounting period.

Comparison Chart

Basis for comparison	Capital expenditure	Revenue expenditure
Meaning	The expenditure incurred in acquiring a capital asset or improving the capacity of an existing one, resulting in the extension in its	Expenses incurred in regulating day to day activities of the business.

	life years.	
Term	Long Term	Short Term
Capitalization	Yes	No
Shown in	Income Statement & Balance Sheet	Income Statement
Outlay	Non-recurring	Recurring
Benefit	More than one year	Only in current accounting year
Earning capacity	Seeks to improve earning capacity	Maintain earning capacity
Matching concept	Not matched with capital receipts	Matched with revenue receipts

The Main Differences between Capital Spending and Revenue Spending

1. Capital investment will generate future economic benefits, but revenue expenditures will only generate profits this year.
2. The main difference between the two is that the capital investment is a one-time investment. On the contrary, revenue spending is frequent.
3. Capital expenditures appear on the balance sheet, on the asset side, and on the income statement (depreciation), but revenue expenditures only appear on the income statement.
4. Capitalized expenditures are capitalized as opposed to uncapitalized revenue expenditures.
5. Capital investment is a long-term expenditure. Revenue spending, on the other hand, is short-term spending.
6. Capital spending seeks to improve a company's earning power. On the contrary, revenue spending is aimed at maintaining the profitability of the company.
7. Capital expenditure does not match capital income. It is different from income expenditure that matches income.

Illustration 1

Please state whether the following statement is "true" or "false" with a reason.

(1) The overhaul cost of the used machine purchased is income expenditure.

(2) The money spent to reduce labor costs is revenue expenditure.

(3) The statutory cost for acquiring real estate is capital expenditure.

(4) The amount spent as attorney's fees to defend a lawsuit alleging that the company's factory premises belong to the plaintiff's land is capital expenditure.

(5) The amount spent on replacing worn parts of the machine is capital expenditure.

(6) The cost of repairing or whitening for the first time when purchasing an old building is income.

(7) The costs associated with obtaining a license to operate a movie theatre are capital expenditures.

(8) The amount of money needed to build the Cinema House and spent on the construction of the temporary hut that was demolished when the Cinema House was ready is capital expenditure.

Solution:

(1) Incorrect: Overhaul costs are incurred in order to bring used machines into operation and generate lasting long-term profits. Therefore, it must be capitalized.

(2) Wrong: The money spent to reduce revenue spending may be reasonably presumed to have brought long-term profits to the enterprise. If it is in the form of technical know-how, it will be part of the property, plant and equipment, and if it is in the form of an additional exchange of any of the existing property, plant and equipment, it will be part of the property, plant and equipment. So this is a capital investment.

(3) Correct: The legal costs paid to acquire an asset are part of the cost of that asset. Ownership of property and thus capital expenditures occur.

(4) Error: The legal cost incurred to defend a lawsuit alleging that the company's factory premises belong to the plaintiff is the maintenance cost of the asset. This cost does not give

you a lasting benefit in the future, in addition to what is currently available, and does not increase the capacity of your assets. Maintenance costs associated with assets are income expenditures.

(5) Error: The amount of money spent on replacing worn parts of the machine is a profit cost because it is part of the maintenance cost.

(6) Wrong: For the first time, the cost of repairing and whitening the old building will be incurred to make the old building usable. These are part of the build cost. Therefore, these are capital investments.

(7) Correct: Cinema Hall could not be started without a license. The cost incurred to obtain a license is capitalized preoperative costs. Such costs are amortized over a period of time.

(8) True: The construction cost of the temporary hut required for the construction of the movie theatre is a part of the construction cost of the movie theater. Therefore, such costs are capitalized.

Illustration 2

Please state whether the following is capital expenditure or revenue expenditure, along with the reason.

(1) Costs incurred in connection with the acquisition of a license to start the Rs factory. 10,000.

(2) Rs. 1,000 was paid for the removal of inventory to the new site.

- (3) The engine ring and piston were replaced at the cost of Rs. 5,000 to improve fuel economy.

(4) Money paid to Mahan agar Telephone Nigam Ltd. (MTNL) Rs. 8,000 for installing a phone in the office.

(5) The factory hut was built at the cost of Rs. 1,00,000. Total of Rs. 5,000 people were involved in the construction of a temporary hut to store building materials.

Solution:

(1) Rupees paid. 10,000 to get a license to set up a factory is capital expenditure. This is an expense item incurred to acquire the right to continue business.

(2) Rupees 1,000 paid for removing inventory to a new site is revenue expenditure. It does not bring lasting benefits or increase the value of the asset.

(3) Rupees 5,000 spent to replace engine rings and pistons for fuel efficiency is a capital investment. This is an expense to improve fixed assets. As a result, cost savings improve the profitability of your business.

(4) Money deposited in MTNL for installation of Office phones is not an expense. It is treated as an asset and is adjusted over a period of time to the actual telephone charges.

(5) Building construction costs, including temporary hut costs, are capital expenditures. Buildings are fixed assets that bring lasting benefits to your business over multiple accounting periods. The construction of the temporary hut is incidental to this construction. Such costs are also included in construction costs.

9.2 Definition and Description Receipts - Capital and Revenue

What is a Capital Receipt?

A capital receipt is a receipt that creates a liability or reduces an asset. As mentioned above, receipts for capital are inherently non-recurring. And this kind of receipt is not sometimes received either.

From the above definition, it is clear that a receipt can be called a capital receipt if it complies with at least one of the following conditions:

It must create responsibility. For example, when a company gets a loan from a bank or financial institution, it incurs debt. That's why it's essentially a receipt for capital. However, if one company receives a fee for using the expertise to manufacture a special kind of product for another company, it is not liable and is not called a capital receipt.

It needs to reduce the company's assets. For example, if a company sells its stock to the public, it can help reduce assets and generate more money in the future. In other words, it should be treated as a receipt for capital.

Receiving capital and receiving income are both very important elements of accounting. It is important to distinguish between the two correctly. The classification of these transactions is reflected in the company's final report. Learn more about them.

Receipt of Capital Receipts

A capital receipt is a receipt for a business that has nothing to do with the company's day-to-day business activities. They occur occasionally and benefit over the long term.

Types of Capital

Receipts of Capital can be divided into **three types:**

1. **Borrow money**

When a company receives a loan from a bank or financial institution, it is called a loan. Borrowing funds from a financial institution is one of three forms of receiving capital.

2. **Loan collection**

In many cases, a company needs to secure a portion of its assets in order to recover the loan, which reduces the value of the assets. This is the second type of capital income.

3. **Receipt of Other Capital**

There is a third type of receipt called "Other Capital Receipts". Below this, we include investment cuts and small savings. Withdrawal from investment means selling part of the business. Stopping an investment is called receiving capital because it has reduced the company's assets. Small savings are called capital receipts because they bring debt to the business.

Receiving capital usually appears on the company's **balance sheet at realization and usually occurs as a result of the following events:**

1. Sale of fixed assets
2. Issuance of capital in the form of shares
3. Issuance of debt certificates

Suppose the QRS complex's annual shareholders meeting approves the issuance of rights shares at a rate of $ 8 per share. QRS allocated shares proportionally to all existing members

of the company and received cash in return. The cash received by QRS was a receipt for capital. The company debited from the bank account and credited the stock account to the books.

Other common examples of receiving capital

1. Cash received from the sale of fixed assets.
2. The amount of loan the company received from the bank.
3. Capital invested in the business by a new partner.
4. The consideration received by a company by selling a license to manufacture a well-sold drug to another company.

What is a Receipt for Income?

Income receipts are receipts that do not reduce a company's assets or generate liabilities. They are essentially always repetitive and are acquired in the normal course of business.

By definition, it is clear that any type of receipt must meet **two conditions called income receipts –**

First, don't reduce your company's assets.

Second, it must not cause any liability to the company.

Income Receipt

Revenue receipts are receipts that occur on a regular basis. They are realized by the day-to-day business activities of companies and are needed for every company to survive and strive. Receipts of revenue are usually received through the sale of shares and the provision of services to customers in the normal course of business. The effect of income is usually only visible on the company's income statement.

Suppose the CDE Company manufactures baby diapers and sells them in bulk to wholesalers and retailers. CDE charges the customer when they receive the item and maintains an average collection period of 30 days. CDE records sales / revenue when a customer receives an item. The sales revenue received by the CDE company is a receipt for the revenue.

General Example of Income

1. Revenue received from selling goods to customers.

2. Revenue from providing services to clients
3. Income received as interest on a savings account.
4. Dividend income received from stocks of various companies.
5. Rental income received by the company.
6. Bad debts collected by the company
7. Cash discount received from the vendor.
8. Commission income received by the company.

Summary and Conclusions

The receipt of capital is the influx of economic resources into the company and is essentially non-recurring. Those effects are only communicated to the company's balance sheet

Receiving income is an influx of economic resources into the company and is essentially repetitive. They are essential to keep the company running. Their effects are only shown in the company's income statement.

Do not confuse a receipt for capital with a receipt for income. It can lead to classification errors and incorrect financial summary reports.

Income Characteristics

Income receipts appear to be the opposite of capital receipts, so look at the various features of income receipts so that you can understand the meaning of income receipts and compare them to the characteristics of capital receipts. That makes perfect sense.

Let's see:

Means to Survive: Companies start their businesses because they expect to receive money as a result of servicing their customers. They can sell a lot of products or provide services. No matter what they do, without a receipt for income, they cannot survive long because the receipt for income is collected from the direct operation of the business.

Short-term application: Income receipts are money received in a short period of time. The benefits of receiving revenue can only be enjoyed for one fiscal year and no more.

Periodic: Revenue receipts need to be regular, as revenue receipts bring profits in a short period of time. If the revenue receipt is not repeated, the business can't last long.

Affect Profit / Loss: Receiving revenue has a direct impact on your business's profit / loss. When you receive revenue, you either increase your profits or decrease your losses.

Small Volume: The number of income receipts is usually small compared to capital receipts. That doesn't mean that all income is low. For example, if a company sells one million products in a particular year, the income can be huge, more than the annual capital income.

Capital Receipts V/s. Revenue Receipts (Comparison Table)

Basis for Comparison – Capital Receipts vs. Revenue Receipts	Capital Receipts	Revenue Receipts
1. Inherent meaning	Capital Receipts are receipts that don't affect the profit or loss of business.	Revenue Receipts are receipts that affect the profit or loss of business.
2. Source	Capital Receipts stem from non-operational sources.	Revenue Receipts stem from operational sources.
3. Nature	Capital Receipts are non-recurring.	Revenue Receipts are recurring in nature.
4. Reserve funds	Capital Receipts can't be saved for creating reserve funds.	Revenue Receipts can be saved for creating reserve funds.
5. Distribution	Not available for distribution of profits.	Available for distribution of profits.
6. Loans – Capital Receipts vs. Revenue Receipts	Capital Receipts can be loans raised from banks/financial institutions.	Revenue Receipts are not loans, but the amount received from operations.
7. Found in	**Balance Sheet**.	Income Statement.

8. **Example** – Capital Receipts vs. Revenue Receipts	Sales of **fixed assets**.	Sale of products of the business;

Capital Receipts and Revenue Receipts-Main Differences

There are many differences between receipts of capital and receipts of income. **Let's take a look at the most famous ones –**

1. Receiving capital is inherently non-recurring. Income receipts, on the other hand, are inherently repetitive.
2. Without a receipt for capital, the business can survive, but without a receipt for income, the business cannot last.
3. Receipts of capital cannot be used as a profit share. Income receipts can be distributed after deducting the costs incurred to earn income.
4. Receipts of capital can be found on the balance sheet. The receipt of income can be found on the income statement.
5. Receiving capital reduces the company's assets or creates company responsibility. Income receipts are the opposite. They do not hold the company accountable or reduce the company's assets.
6. Receipts of capital are atypical. Income receipts are routine.
7. Capital receipts are sources from non-operational sources. Income receipts, on the other hand, come from operational sources.

Conclusion

A receipt for capital and a receipt for income are the opposite, even if they are both receipts.

Investors need to understand the difference between receiving capital and receiving income so that they can carefully determine when a transaction will occur.

Understanding these two concepts also helps investors make careful choices about whether to invest in a company. If your company has low income and high capital, you need to think twice before investing. And if the company has high income and low capital income

(generated rather than generated), the company is above the level of survival and can take risks.

Just as you would like to form a transparent distinction between capital expenditures and revenue expenditures, you would like to differentiate between capital income and revenue income.

Receipts obtained within the course of normal business activities are income receipts (e.g., receipts from the sale of products and services, interest income, etc.). Receipts that aren't essentially income, on the opposite hand, are receipts for capital (for example, receipts from the sale of fixed assets or investments, secured or unsecured loans, owner donations, etc.). Revenue and receipt of capital are recognized on an accounting as soon because the entitlement is established. The income receipt shouldn't be an equivalent because the actual cash receipt. Revenue receipts are credited to the P & L account.

Capital receipts, on the opposite hand, aren't credited on to the earnings report. for instance, if a hard and fast asset is sold for rupees. 92,000 (cost Rs. 90,000), capital income Rs. 92,000 won't be credited to the earnings report. Gains and losses on sales of fixed assets are calculated and credited to **the P & L account as follows:**

Sale price Rs. 92,000

Less: Cost rupee. 90,000

Profit Rs. 2,000

Illustration 3

Good Pictures Co., Ltd. will build a cinema house within the first year until March 31, 2016 and can bear the subsequent costs.

1. Used furniture like rupees. 9,000 are purchased. Rs are going to be applied to repaint the furniture. 1,000. The furniture was installed by their workers, the wage for this is often rupees. 200.

2. Expenses associated with obtaining a license to work in movies are like rupees. 20,000. During the year, the movie company was fined Rs. 1,000 for violating rules. Renewal fee Rs. I paid 2,000 next year.

3. Insurance, Rs. On October 1, 2015, 1,000 were purchased in one year.

4. The temporary hut was built at the value of Rs. 1,200. They were needed to create a movie. They were demolished when the cinema was ready.

Mention the way to classify the above items.

Solution:

1. The entire cost of furniture should be treated to capitalize 10,200, that is, all the amounts listed, because you cannot use furniture without such spending. For Rs 1,000, 200 debited to the repair and wage accounts, respectively, and these accounts are credited to the furniture account.

2. You would like a license to run a cinema house, so you would like to capitalize the value. But fine of Rs 1,000 is revenue expenditure. A subsequent year's renewal fee is additionally a revenue expense, but it's associated with subsequent years. Therefore, it's a prepaid cost.

3. Half the premium is said to the year starting April 1, 2016. Therefore, such amounts should be treated as prepaid expenses. The remaining amount is the revenue and expenses for the present year.

4. The development required a short-lived hut, which must be capitalized additionally to the value of the cinema.

Illustration 4

Please explain why you'd wish to classify the subsequent spending items.

1. Rupee overhaul cost 25,000 for car engines to urge better fuel efficiency.

2. Rupee inauguration fee 250,000 was incurred when opening a replacement manufacturing unit in an existing business.

3. Workers who chose to retire voluntarily were paid Rs. 250 million as compensation.

Solution:

1. Car engine overhaul costs are going to be incurred to enhance fuel economy. These costs reduce future running costs; therefore, the benefits are within the sort of lasting long-term benefits. Therefore, this expenditure must be capitalized.

2. The opening costs incurred when opening a replacement unit may help to succeed in more customers. This expenditure has the character of revenue expenditure because it's going to not bring lasting benefits to the business over multiple accounting periods.

3. The amount paid to workers for voluntary retirement has the character of revenue expenditure. The quantity of paying is so important that it's going to be better to postpone it within the future.

Illustration 5

Classify the subsequent expenditures and receipts as capital or income.

(i) Rs. 10,000 was spent on travel expenses for directors traveling abroad to get capital assets.

(ii) The quantity received from assets during the year.

(iii) The quantity of cash spent on the demolition of a building to create an outsized building on an equivalent site.

(iv) Claims received for a machine damaged by a fireplace.

Solution:

(i) Capital investment.

(ii) Receipt of income.

(iii) Capital investment.

(iv) Receipt of capital.

Illustration 6

Is the next spending essentially capital?

(i) M / s ABC & Co. Runs a restaurant. They refurbish a number of the old cabins. This refurbishment freed up some space and increased the number of cabins from 10 to 13. The entire expenditure was rupees. 20,000.

(ii) M / s New Delhi Financing Co. Certain products were sold on an installment basis. Five customers didn't pay in installments. The corporation spent rupees to recover such unpaid installments. 10,000 for statutory costs.

(iii) M / s Ballav & Co in Delhi. Is Ahmedabad's M / s Shah & Co. I bought a machine from. M / s Ballav & Co. is Rs. 40,000 for the transportation of such machines. The top of the year is New Year's Eve, 2015.

Solution:

(i) The number of cabins has increased thanks to the renovation of the cabins. This may affect your business's ability to get revenue within the future. Therefore, refurbishment costs are essentially capital investments.

(ii) The prices incurred to gather installments from customers don't improve future revenue-generating capabilities. This is often the traditional recurring cost of a business. Therefore, the legal costs incurred during this case are essentially revenue expenditures.

(iii) The prices incurred for the transportation of fixed assets are essentially capital expenditures.

9.3 Summary

- Capital expenditures (CapEx) are payments for goods or services recorded or capitalized on the record, instead of being spent on the earnings report.
- Capital investment is vital for companies to take care of their existing assets and equipment and invest in new technologies and other assets for growth.
- If an item features a useful lifetime of but one year, you ought to calculate the value within the earnings report rather than capitalizing it (that is, it's not considered a capital investment).
- Sales, often mentioned as sales, are the income generated from normal business operations and other business activities.
- Operating income is income from normal business operations, like the sale of products and services.
- Non-operating income is rare or non-recurring income from secondary sources of income (such as proceedings in proceedings).
- Capital investment (CAPEX) is the funds that a corporation uses to accumulate, upgrade, and maintain physical assets like equipment.
- Capital investment is typically a one-time, large-scale purchase of fixed assets that won't generate long-term revenue.

- Income and expenditure are continuous operating expenses, short-term expenses used for daily business operations.
- Cost of goods sold is directly related to revenue, while rent is related to a particular accounting period.
- A capital receipt is a receipt that creates a liability or reduces an asset. As mentioned above, receipts for capital are inherently non-recurring.
- For example, if a company sells its stock to the public, it can help reduce assets and generate more money in the future.
- A capital receipt is a receipt for a business that has nothing to do with the company's day-to-day business activities.
- Income receipts are receipts that do not reduce a company's assets or generate liabilities. Revenue receipts are receipts that occur on a regular basis.
- They are realized by the day-to-day business activities of companies and are needed for every company to survive and strive.
- The receipt of capital is the influx of economic resources into the company and is essentially non-recurring.
- Income receipts appear to be the opposite of capital receipts, so look at the various features of income receipts so that you can understand the meaning of income receipts and compare them to the characteristics of capital receipts.
- Receipts obtained within the course of normal business activities are income receipts (e.g., receipts from the sale of products and services, interest income, etc.).

9.4 Self-Assessment Questions

1. Please state if the following is a capital expenditure or a revenue expenditure, with reasons.
    a. The new machine was purchased by him for Rs.60,000 and he paid Rs.800 for transportation and Rs.1,500 for installation.
    b. A total of Rs.10,000 was spent on painting the new factory.
    c. 5,000 rupees he paid for the assembly of new machinery;
    d. He spent Rs 2,000 on repairs before using a recently purchased second-hand generator.
    e. Rs.1,500 was spent on repairing the machinery.

f. Brokerage commission for the issue of shares was Rs.10,000 and other issue costs were Rs.25,000.

2. The basic considerations in distinguishing between capital expenditures and revenue expenditures are: (a) the nature of the business; (b) the recurring nature of the expenditure; (c) Purpose of Costs. (d) impact on the revenue-generating ability of the business; (e) the materiality of the amounts involved.
3. Receipts obtained in the ordinary course of business are receipts of income (eg, receipts from sales of goods or services, interest income, etc.). Income receipts should not be equated with actual cash receipts. Income receipts are credited to the income statement
4. Define income receipts and give examples. How are these receipts handled?
5. What are the basic considerations when distinguishing between capital expenditures and revenue expenditures?
6. Are the following expenditures capital in nature?
    a. M/s ABC & Co. operates restaurants. They are renovating some of the old cabins. The renovation freed up some space and increased the number of cabins from 10 to 13. Total expenditure was £20,000.
    b. M/s New Delhi Financing Co. sold certain goods on an installment basis; 5 customers have not paid in installments. The company spent £10,000 in litigation costs to recover such outstanding payments.
    c. M/s Ballav & Co. of Delhi purchased the machine from M/s Shah & Co. of Ahmedabad. M/s Ballav & Co. cost him £40,000 to transport such a machine. The fiscal year ends on December 31, 2015
7. State whether the following expenditures are capital, income, or deferred income. Give your reasons:
    a. Furniture with a book value of Rs.10,000 was sold for Rs.2,500 and new furniture with a value of Rs.6,000 was purchased for Rs.50.
    b. the property purchased for INR 20,00,000 and his INR 1,50,000 paid for its registration and attorney's fees;
    c. replacement of the old Machine by a new Machine;
    d. Compensation for damages paid by the transportation company to passengers who were injured in the accident.
    e. Construction of huts for vehicle parking at a cost of Rs.10.

8. Categorize the following into expenditures of capital, income and deferred income and indicate the reasons in each case.
   (a) A total of INR 32,000 was expended on the machine as follows: (i) INR 20,000 for additional expenses for doubling the output, (ii) for repairs necessitated by negligence. (iii) INR 7,000 parts for replacement of worn parts.
   (b) Total expenditure on cinema building for one year was Rs.2,00,000, of which 20% related to repairs and 80% related to improvements and additions.
9. Please state the reasons for whether the following receipts are treated as capital or income: -
   a. ₹ 5,000 received from a customer whose account was previously canceled as bad;
   b. 20,000 rupees he received from the sale of old machinery;
   c. Rs.2,60,000 received from sale of trading shares.
   d. 5,00,000 rupees are donated as funds by the partner
10. Write a note about the deferred revenue expenditure.

9.5 References

1. Basic Financial Accounting for Management- Paresh Shah -Oxford University Press
2. An Introduction to Accounting S N Maheswari and S K Maheswari, Vikas
3. Modern Accountancy Volume-1- A Mukherjee and M Hanif-TMH

Case Study

Sam and Jay started with 10,000 Cash and 1,00,000 Machinery. They decided to set up a production line for PPE kits. Protection from Covid 19 virus. As demand increased, they decided to purchase another machine. In the same way, they took bank overdrafts and bought machines. The quality of the company's products was so high that it was able to develop its reputation in the market and its business was thriving. After 1.5 years, the old machine became obsolete and I decided to sell the same. They sold it and got some cash income. To further increase the brand's presence among its stakeholders, they decided to advertise from the cash proceeds of the machines sold. As more and more customers requested our products, we decided to launch discounts for bulk purchases. The discount was not recorded in the books of accounts. The campaign was a success and they benefited a lot from the same.

Questions

1. Which type of discount is discussed in the last part of this article?
    a. Transaction discounts;
    b. Cash discount
    c. Both (a) and (b)
    d. Unable to determine
2. Which asset is described in the row "The company's product quality was very high, and therefore it was able to develop its reputation in the market and its business was thriving"?
    a. Tangible;
    b. Intangible asset
    c. current.
    d. Both (a) and (c)
3. Which type of liability is described in this passage?
    a. Non-current
    b. Present
    c. Both (a) and (b)
    d. Unable to determine
4. How much capital did you initially invest?
    a. 10,000
    b. 1,00,000
    c. 1,10,000
    d. Unable to determine
5. This passage includes the receipt of capital (separate from the initial investment capital).
    a. True
    b. Error

Unit 10

Preparation of Financial Statements of Sole Trade Business with Adjustments

Learning Objective:

After studying the unit, students will be able to:

- Know the meaning, purpose, content, form, Income Statement and Balance Sheet of Transactions.
- Understand the difference between Trial Balance and Balance Sheet.
- Preparation for final settlement

Structure

10.1 Meaning of Final Account

10.2 Format of Trading, P/L and Balance Sheet

10.3 Types of adjustment entry for the Final Account

10.4 Summary

10.5 Self-Assessment Questions

10.6 References

10.1 Meaning of Final Account

The final account is the account prepared by the Joint Stock Company at the end of the fiscal year. The purpose of creating a final account is to provide a clear picture of the financial situation of the organization to its management, owners or other users of such accounting information.

Final account preparation involves preparing a set of accounts and statements at the end of the fiscal year.

1. **Trading and profit and loss accounts**
2. **Balance sheet**
3. **Profit and Loss Appropriation Account**
4. **Purpose of Final Account preparation**

The final account is prepared for the following purposes:

1. To determine the profit and loss incurred by the company within a certain financial period
2. To determine the financial status of the company
3. To serve as a source of information to inform users of accounting information (owners, creditors, investors and other stakeholders) about the solvency of the company.

Trading Account

The results of the purchase and sale of goods are known as the trading account. This sheet is provided to show the difference between the sales price and the cost price. It is prepared to show the trading results of the business i.e. The total profit or total loss maintained by the business. It records the direct costs of the business company.

J.R. according to Batlibboi,

The trading account shows the results of buying and selling goods. When we prepare this account, the general establishment costs are not taken into account and only the transaction of goods is included."

Profit and loss accounts

This account is prepared to check the net profit/loss and fiscal year expenses of the business during the fiscal year. It records the indirect expenses of the business company like rent, salary, and advertising expenses. Profit and loss A/C includes expenses and losses and gains and losses incurred in business other than the production of goods and services.

Balance Sheet

The balance statement shows the financial status of the business at a specific date. The financial status of a business is discovered by aggregating its assets and liabilities on a specific date. The excess of assets over liabilities represents the capital sunk into the business and reflects the financial health of the enterprise.

Now it is known as a statement of the financial status of the company.

1. **Trading Account**

Trade and manufacturing operating companies deal with the sale and purchase of goods. Therefore, only the manufacturing and trading entities prepare the trading account. Service providers do not prepare for this.

Advantages of preparing a trading account format

- It is a very important statement from the point of view of the cost of goods. By preparing a trading account, an entity may take a decision to continue or discontinue a particular product, which helps to obtain maximum profit or reduce losses.
- With the help of a trading account, the sales tax authority can, in accordance with the sales tax declaration filed by the business, It also helps the excise duty authorities to assess the excise duty of a business enterprise.
- The management, having in mind the market competition, determines the price of the product with the help of a trading account.

Items in trading account format

The trading account contains the following details:

1. Details of raw materials, semi-finished goods and finished products, opening stock.
2. Close inventory details of raw materials, semi-finished products, and finished products.
3. Total purchase of goods less purchase return.
4. Total sales of goods less sales return.
5. All direct costs associated with the purchase or sale or manufacture of goods.

Item of income (Cr. Side)

- Less sales return than total sales of goods
- Close the stock of the product.
- Expenditure item (Doctor) side

Item of expenditure (Dr. Side)

- Opening stock
- Total purchase of goods less purchase return
- All the direct costs like carriage interior & freight cost, rent, electricity and power cost, wages for godown or factory, packing cost, etc. for workers and supervisors.

Notes

- The trial count will not be displayed on the close. But, firstly, we need to show the amount of closing shares on the income side of the trading account, and secondly, on the balance sheet under current assets.

- We value closing inventory at either lower cost or market price.
- On the day of preparation of the trading account, we value the physically available closed shares.
- However, the trading account can also be prepared in horizontal form, but the content remains the same.

10.2 Format of Trading, P/L and Balance Sheet

Trading Account Format

Particulars	Amount	Particulars	Amount
To opening stock	xxx	By sales	xxx
To purchase	xxx	Less: Returns	xxx
Less: returns	xxx	By Closing stock	xxx
To direct expenses:	xxx	**By Gross loss c/d**	
Freight & carriage	xxx		
Custom & insurance	xxx		
Wages	xxx		
Gas, water & fuel	xxx		
Factory expenses	xxx		
Royalty on production	xxx		
To Gross profit c/d	xxx		

2. **Profit and loss A/C**

All companies generally prepare profit and loss accounts/statements at the end of the year to gain visibility of income, revenue, expenses, and losses incurred in a certain range of periods. It is important to prepare a profit and loss statement because this information helps organizations make the right business decisions, such as where to cut costs, from where the business can generate more profit, and which parts of the business are suffering from losses.

1. **Profit and loss accounts / statements**
2. **Types of profit and loss**
3. **Gross profit/gross loss**
4. **Profit / loss**

Trading account is prepared to check gross profit/loss while a profit and loss account is created to check profit and loss/net loss.

Profit and loss accounts are made to check the annual profit or loss of a business. This account only shows overhead. All items of income and expenses, whether cash or non-cash, are considered in this account.

Only revenue or expenses related to the current period are debited or credited to the profit and loss account. The profit and loss account starts with gross profit on the credit side and, if there is a total loss, appears on the debit side. Items not displayed in the profit and loss account format

Drawing: the drawing is not the company's expense. Therefore, we debit it to capital a/c, and not to profit and loss a/c.

Income tax: for a company, income tax is an expense, but for a sole proprietor, it is his personal expense. Therefore, we debit it to the capital A/C.

Discounts: as we know, discounts are of two types–trade discounts and cash discounts. We deduct the trade discount from the amount charged and therefore do not show it in the account books. On the other hand, if the customer pays the amount on a certain date, a cash discount will be possible. We view cash discounts in account books. Therefore, we debit it to the profit and loss account.

Bad debt: it is because of the customer and the amount he does not pay it. We debit this amount to profit and loss a/c in the event that preparations have already been made for a bet that is worse than it is initially written off from it. When bad loans are recovered, it is again. Now it is not credited to the account of the party, but recovered account should be credited to the bad debt and is written on the credit side of the profit and loss account

Profit and Loss Account Format

Particulars	Amount	Particulars	Amount
To Gross loss b/d	xxx	**To Gross profit b/d**	xxx
Management expenses:	xxx	Income:	xxx
To salaries	xxx	By Discount received	xxx
To office rent, rates, and taxes	xxx	By Commission received	xxx
To printing and stationery	xxx	Non-trading income:	xxx
To Telephone charges	xxx	By Bank interest	xxx
To Insurance	xxx	By Rent received	xxx
To Audit fees	xxx	By Dividend received	xxx
To Legal charges	xxx	By Bad debts recovered	xxx
To Electricity charges	xxx	Abnormal gains:	xxx
To Maintenance expenses	xxx	By Profit on sale of machinery	xxx
To Repairs and renewals	xxx	By Profit on sale of investments	xxx
To Depreciation	xxx	By Net Loss(transferred to Capital A/c)	xxx

Selling distribution expenses:			
To Salaries	xxx		
To Advertisement	xxx		
To Godown	xxx		
To Carriage outward	xxx		
To Bad debts	xxx		
To Provision for bad debts	xxx		
To Selling commission	xxx		
Financial expenses:			
To Bank charges	xxx		
To Interest on loan	xxx		
To Discount allowed	xxx		
Abnormal losses:	xxx		
To Loss on sale of machinery	xxx		
To Loss on sale of investments	xxx		
To Loss by fire	xxx		
To Net Profit(transferred to capital a/c)	xxx		
TOTAL		TOTAL	

3. Balance Sheet

A balance sheet (**also known as a financial statement**) is a financial statement that shows the Assets, Liabilities and ownership interests of a business at a specific date. The main purpose of drawing up a balance sheet is to disclose the financial status of the enterprise at a certain date. The balance sheet can be prepared at any time, but it is prepared mainly at the end of the accounting period.

Most of the information about Assets, Liabilities and owner's equity items is taken from the company's adjusted trial balance. Retained earnings are the part of the owner's equity section which is provided by the retained earnings statement.

Section of the balance sheet

To be widely considered about the balance sheet of the division part of assets part of liabilities main capital. For each department:

Assets section

In the balance sheet, assets with similar characteristics are grouped. The mainly adopted approach is to divide assets into current and noncurrent assets. Liquid assets include cash and all assets that can be converted into cash or expected to be consumed in a short period of time– usually one year. Examples of current assets include cash, cash equivalents, accounts receivable, prepayment costs or prepayment, short-term investments and inventories.

All assets that aren't listed as current assets are grouped as non-current assets. A common feature of such assets is that they continue to provide profit for a long time-usually more than one year. Examples of such assets include long-term investments, equipment, plants and machinery, land and buildings, and intangible assets.

Debt Division

A debt is an obligation to a party other than the owner of the business. They are grouped as current and long-term liabilities in the balance sheet. Current liabilities are obligations that are expected to be met within a one-year period by using current assets of the business or by providing goods or services.

Owner's equity division

The owner's interest is the obligation of the business to its owner. The term owner's equity is mainly used in the balance sheet of a business in the form of a sole proprietor and partnership.

In the balance sheet of the company the term “ownership interest “is often replaced by the term "shareholder interest".

When the balance sheet is created, the liabilities section appears first, and the owner's equity section appears later.

Balance sheet format: There are two formats on the balance sheet that present Assets, Liabilities and owner's equity–the account format and the report format.

In the account form, the balance sheet is divided into the left and right, like the t-account. Both liabilities and the owner's capital are listed on the right side of the balance sheet, while assets are listed on the left. If all the elements of the balance sheet are listed correctly, then the sum on the asset side (that is, on the left) is equal to the sum on the debt and the capital side of the owner (that is, on the right)

Business Consulting Company

Balance Sheet as at December 31, 2022

Assets	$	Liabilities & Stockholders equity	$
Current Assets :		Liabilities:	
Cash	85,550	Notes payable	5,000
Account receivable	4,700	Accounts payable	1,600
Prepaid building rent	1,500	Salaries payable	2,000
Unexpired insurance	3,600	Income tax payable	3,000
Supplies	250	Unearned service revenue	4,400
Total current assets	95.600	Total liabilities	16,000
Non-current assets:		Stockholders equity:	
Equipment 9,000		Capital stock 50,000	
Acc. dep. –Equipment 3,600	5,400	Retained earnings 35.000	85,000
	101,200		101,000
Total assets		Total liabilities & stockholder’s equity	

In reporting format the balance table element is displayed vertically, the asset section is displayed at the highest, and therefore the liabilities and owner's equity sections are displayed below the asset section.

The example below shows both formats.

Assets	Rs
Current assets:	
	85,500
Cash	4,700
Account receivable	1,500
Prepaid building rent	3,600
Unexpired insurance	250
Supplies	
	95,600
Total current assets	
Non-current assets:	
Equipment 9000	
Acc. Dep- Equipment 3600	5,400
	101,000
Total assets	
Liabilities & Stockholders Equity	
Liabilities	5,000
Notes payable	1,600
Accounts payable	2000
Salaries payable	3000
Income tax payable	4,400

Unearned service revenue Total liabilities	
	16,000
<u>Stockholders equity:</u> Capital stock Retained earning	 50,000 35,000
Total stockholder's equity	85,000
Total liabilities and stockholder's equity	101,00

10.3 Types of adjustment entry for the Final Account

1. **Closing stocks:**

The value of the closing stock is checked at the end of the fiscal year, so it is displayed as an adjustment. It must be credited to the transaction a/c and displayed on the asset side of b/S.

The adjustment entry is:

Closing stock a/c ------ Dr.

To trade A / c

Trading account and balance sheet

Rs	
	By Sales
	By Trading Stock

Balance Sheet

Liabilities	Rs	Assets	Rs
		Closing Stock	

2. Depreciation of Assets:

Depreciation implies a decrease or decrease in the value of an asset due to its constant use. It may also occur due to wear and tear, the passage of time and obsolescence. It's a loss to business.

It is usually calculated at a certain percentage to the value of the asset, and so the amount obtained is shown first on the debit side of the P & L A/C, and then subtracted from the original value of the asset of B/s.

For example, a business has furniture worth Rs. At the end of the year 50, 000 it is depreciated by 5%.

Adjusting entries:

Depreciation A / c Dr Rs. 2,500

To Furniture A / c to Rs. 2,500

[5% Rs 50,000 = 2,500]

Profit and Loss Account

	Rs.	
To Depreciation a/c Furniture	2,500	

Balance Sheet

Liabilities	Rs	Assets		Rs
		Furniture Less: Depreciation	50,000 2,500	 47,500

3. Unpaid expenses:

These are expenses incurred in the fiscal year, but no payments have been made. Any unpaid or unpaid expenses will be added to such expense a/c in P&L a/c and will be displayed as current liability in b/S.

For example, monthly rent in May 2002 Rs. 1,000 remains unpaid. A calendar year is an accounting year.

Adjusting entries:
Rent account Dr. Rs.1000
To Outstanding Rent a/c Rs. 1,000

Profit and loss accounts

			Rs
TO Rent Account Add: Outstanding	[11 month rent] [December]	11,000 1,000	 12,000

Balance Sheet as on 31st December 2002

Liabilities	Rs	Assets	
Outstanding Expenses: Rent	 1,000		

Income received in advance:

These are the income received during the current year, but part of the amount received is related to the following year. Such amounts must be deducted from the total amount received in P & L A / C and displayed on the debt side of B / S, which represents the amount that the business is obliged to return.

For example, business concerns have received a three-year apprenticeship premium equivalent to Rs.6, 000. Rs in this amount.2, 000 IE, 1/3 of Rs.6, 000 is for the current year and must be credited to P&L a/c as income. And balance Rs. As a business is obliged to return 4, 000 represents responsibility.

Adjusting entries:

Apprentice premium A / c Dr Rs. 4000

To Apprentice premium received in advance Rs. 4000

Profit and Loss Account

		Rs	**Rs**
	By Apprentice Premium Less: Received in advance	6,000 4,000	 2,000

Balance Sheet

Liabilities	Rs	Assets	Rs
Apprentice Premium received in advance	4,500		

4. Prepaid Expenses

These are the costs paid, but part of the amount paid extends to the next year. It is also called" expiring expenses". The prepaid amount paid should be deducted from such expenses and displayed as current assets in the B/S.

For example, Rs premium for a total of 2,400 people was paid on July 1, 2002. A calendar year is an accounting year. The annual premium is paid for 1 month, so the 6-month premium concerns half of the current year and the other half the following year.

Hence Rs. 1,200 must be treated as an upfront payment, deducted from the premium paid and displayed as an asset on b/S.

Adjusting entries:

Prepaid insurance A/c Dr Rs. 1, 200

To Premium A/c Rs. 1, 200

Profit and Loss Account

	Rs	Rs	
To Insurance Premium A/c Less: Prepaid insurance	2,400 1,200	1,200	

Balance Sheet

Liabilities	Rs	Assets	Rs
		Prepaid Insurance	1,200

Accrued income:

It is an income that has already been earned [i.e. the service has already been rendered], but no money has been received. For example, interest on investments accrued Rs. 1,200.

Interest in the current year is due to the end of the year. That amount can actually be received in the next year. Currently, it represents income, which has become accounts receivable or accrued. Therefore, P&L is credited to a/c, IS accounts receivable and appears as an asset in b/S.

Adjusting entries:

Accrued interest A/c Dr. Rs. 1,200

To be interested in A/c Rs. 1,200

Profit and Loss Account

	By Interest on investment Add: Interest accrued	…… 1,200	

Balance Sheet

Liabilities	Rs	Assets	Rs
		Interest accrued	1,200

5. Dividend:

Dividends may be defined as a share of the profits paid to each shareholder of a company. The Companies Act stipulates that dividends can only be paid from profits and prohibits the payment of dividends from capital. In addition, dividends are to be paid in cash only.

Companies can pay dividends from any or all of the following three sources:

a. Profit for the current year
b. Undistributed profit from previous years
c. Money provided by the central or state governments to pay dividends under guarantees given by the relevant governments.

Directors generally recommend the percentage of dividends paid on shares. Shareholders at the Annual General Meeting of Shareholders may pass a resolution to adopt the recommendation or reduce the percentage of the recommendation. Shareholders do not have the authority to increase the dividends recommended by the Board of Directors. The percentages adopted should only apply to paid-in capital.

For example, a director of Sunshine Limited proposes to shareholders a dividend of 15% adopted by shareholders. The company's capital is rupees. At 50,00,000, there are overdue calls in the Rs range. 40,000.

The dividend paid in this example is calculated as (15/100) x (50,00,000 – 40,000) = Rs. 7, 44,000. Recently, companies have begun to declare dividends as a percentage of after-tax profit.

Dividends recommended by Directors are referred to as "proposed dividends" until they are adopted at the Annual General Meeting of Shareholders. The entry for recording the proposed dividend is

P & L A /c Dr
To Propose dividends A / c

The proposed dividend is classified as a provision and appears on the liabilities side of the balance sheet. Dividends determined by shareholders at the Annual General Meeting of Shareholders as the final dividend payable are called "declared dividends."

Declared dividends must be paid within 42 days from the date of declaration. Therefore, the declared dividend must be classified as a current liability on the company's balance sheet.

Dividends can only be declared by shareholder resolution, but if the company's provisions permit, directors may declare interim dividends between the two annual shareholders' meetings. When the interim dividend is paid, the entry for recording the payment is

Interim dividend A / c Dr.
To bank A / c
Interim dividends paid during the year will be displayed in our trial balance as the last day of the accounting period and will be debited to profit and loss appropriation a / c as they are appropriation items. Profit.

Dividends are usually paid by posting a dividend warrant to shareholders. The dividend warrant must then be presented to the bank of the paying company. In some cases, the fact that a particular shareholder has not claimed such dividends may leave some of the declared dividends unpaid.

Unpaid or unclaimed dividends are current liabilities and appear on the liability side of the balance sheet. The company must transfer the unpaid dividend to a special bank account within 49 days of the declaration date of the dividend.

If dividends are not charged for three years from the date of transfer to the special bank account, the unclaimed amount must be transferred from the company to the central government's general revenue account. After such a transfer, shareholders who are eligible to claim such dividends may claim it from the Government.

6. Income tax allowance:

This provision is made from profit. This is below the row entry. Taxable income arrives after adjusting the required items from gross profit (for example, depreciation recorded in the books and depreciation allowed according to income tax rules). For that taxable income, it is necessary to reserve income tax at the general income tax rate.

Prepaid income tax:

Income tax law requires you to pay prepaid income tax. This is displayed on the Assets and Assets side in parentheses under Other Assets on the balance sheet.

Collectable / Receivable TDS:

Generally, some taxes are withheld from income such as interest and fees to generate net income. To simplify the case where the interest received is Rs.9000 /-and the TDS deducted from it is Rs.1000 /-, the total income is Rs.10000 /.

The amount of TDS recoverable is also indicated by prepaid income tax on the "Real Estate and Assets" side of the balance sheet.

In general, the sum of TDS and prepaid income tax exceeds the income tax allowance.

However, the tax calculated on returns must be the same as the tax allowance. If not, you will need to pass an entry for the difference.

If the allowance is less than the tax calculated in return, you need to make an additional allowance

[1] If our return is accepted without permission and without request:

<u>Accounting entry will be as under:</u>

Provision for Income Tax A/c Dr.

To Advance Income Tax Paid

To TDS recoverable

[2] When short-term tax demand arises and is accepted due to non-permissible expenses, non-permissible records, miscalculations, non-permissible depreciation, non-reflecting deducted TDS in 26AS, etc.

In addition to the entries shown in [1]

When paying taxes by cheque

Accounting entry will be as under:

Income tax paid for earlier years Dr (profit & loss a/c)

To bank a/c

If adjusted from other refund for another A.Y.,

Accounting entry will be as under:

Income tax paid for earlier years Dr (profit & loss a/c)

To Advance Income Tax Paid

[3] When receiving a refund with interest (interest on refund is taxable income)

Expected Refund = Prepaid Income Tax + Recoverable TDS – Income Tax Reserve

Accounting entry will be as under:

Bank A/c Dr (if received by cheque = tax refund + int. on refund)

Advance Income tax Paid A/c Dr (if adjusted with another year's demand)

Provision for Income Tax Dr

Provision for Income Tax for Earlier years Dr (Profit & loss A/c-for additional provision))

To Advance Income Tax Paid

To TDS recoverable

To Interest on Income Tax refund a/c

If you receive less refund than expected

Accounting entry will be as under:

Bank A/c Dr (if received by cheque = tax refund + int. on refund)

Advance Income tax Paid A/c Dr (if adjusted with another year's demand)

Provision for Income Tax Dr

To Advance Income Tax Paid

To TDS recoverable

To Income Tax refund a/c (additional amt than expected-P/L a/c)

To Interest on Income Tax refund a/c (P/L a/c)

7. Bill of exchange (Endorsement, Honour, Dishonour)

8. Capital Expenditure included in Revenue expenditure and vice versa eg- purchase of furniture included in purchases

Deferred appropriations: A huge expenditure of the nature of the revenue generated at the initial stage of a business enterprise with the belief that it derives profit from such expenditure during subsequent years is considered a deferred revenue expenditure if the charge of such expenses is spread over the number of years in which the profit is expected to be derived.

Part of such expenditure is charged as revenue for each year, and the rest is capitalized on the basis of the matching concept. For example, huge expenditures on "advertising" occur in the first year of the business and derive profits over an estimated period of ten years. Then one-tenth of that expenditure each year is charged to income over a decade period. The Important point here is that the expenditure that is not charged to the revenue is capitalized and appears as a fictitious asset on the balance sheet.

Revenue Expenditure included in Capital Expenditure	Trading A/c /Profit & Loss A/c – Debit side (Add to that particular Revenue Expenditure)	Balance Sheet – Asset side (Deduct from that particular asset)
Capital Expenditure included in Revenue Expenditure	Trading A/c /Profit & Loss A/c Debit side (Deduct from that particular Revenue Expenditure)	Balance Sheet – Asset side (Add to that particular asset)

9. Unrecorded Sales and Purchases

Unrecorded Purchases	Trading A/c – Debit side (Add to Purchases)	Balance Sheet – Liability side (Add to Creditors)
Unrecorded Sales	Trading A/c – Credit side (Add to Sales)	Balance Sheet – Asset side (Add to Debtors)

10. Good sold on sale or return basis

11. Managerial remuneration on Net Profit before tax

Manager is allowed commission at a certain % on Net Profit a. If commission eg.10% is quoted on "Net Profit before charging such commission": Commission amount = Profit before commission * 10/100 b. If commission eg.10% is quoted on "Net Profit after charging such commission": Commission amount = Profit before commission * 10/110	Profit & Loss A/c – Debit side (Manager's Commission)	Balance Sheet – Liability side (Outstanding Manager's Commission), OR Balance Sheet – Asset side (Reduce from Cash/Bank)

12. Transfer to Reserves

Creation of reserve funds: To strengthen the financial situation of the enterprise, a part of the net profit can be transferred to the reserve account by appropriation. The entries for creating a reserve fund are –

Particulars		Dr ₹	Cr ₹
Profit and Loss Appropriation A/c To Reserve Fund A/c	Dr	****	****

Note:

(i) Reserve fund will appear on the liabilities side of the balance sheet.

(ii) In the case of sole trading and partnership organizations, it is customary to charge this directly to profit and loss account instead of profit and loss appropriation account.

13. Bad debts

Debt represents money from the debtor [i.e., the uncollected portion of the credit sale]. When a debt becomes irretrievable, it becomes a bad debt and is treated as a loss. The amount of non-performing loans is debited to P&L a/c and deducted from the various debtors of B/S.

For example, a trader's ledger balance on sundry debtors shows Rs with 20,000. 1,000 are estimated to be unrecoverable.

Adjusting entries:

Bad debts A/c Dr Rs. 1,000

To Sundry debtor A/c to Rs. 1,000

a) Provision for bad and doubtful debt:

Every business has a lot of trading through margin trading. This gives rise to a significant amount of book debts or debtors. But 100% of these debts are rarely recovered.

Therefore, it would be necessary to bring down the balance of the debtor to its true position. The usual practice is to calculate such a bad debt at a certain rate, based on the past experience of the debtor. It is called reserves or reserves for doubtful debts.

However, the allowance for bad loans and bad debt is calculated on good debt, that is, after deducting previously unadjusted bad loans.

For example:

At the end of the year the sundries of debtors of traders stood at Rs.21, 000. It is estimated to be Rs. 1,000 is written off as bad loans and a 5% allowance is created for bad debt.

Adjusting entries:

Bad Debts a/c Dr. Rs. 1,000

To Sundry Debtors a/c Rs. 1,000

To Profit and Loss a/c Dr. Rs. 2,000

To Bad Debts a/c Rs. 1,000

To Provision for Doubtful Debts 1,000

Profit and Loss Account

	Rs	
TO Bad Debts To Reserve for doubtful Debts	**1,000** **1,000**	

If there is an old provision for doubtful debts, it should be adjusted [deducted] against the new provision.

Balance Sheet

Liabilities	Rs	Assets	Rs	
		Sundry Debtors Less: Bad Debts	21,000 1,000	
			20,000	
		Less: Provision for Doubtful Debts	1,000	19,000

b) Provision for discounts to debtors:

Cash discounts are allowed to debtors to prompt quick payments. After providing bad loans and bad debts, the debtor's balance represents the debt from a healthy party.

They may pay their dues on time and try to take advantage of the acceptable cash discounts themselves. Therefore, this discount should be expected and offered. It is, therefore, the usual practice in business is to offer debtors discounts at a certain percentage on good debt.

For example:

Suppose a trader has various debtors equivalent to rs.20, 000 and he estimates that a provision for a discount of 5% is desirable, after a provision of 2% for bad debts. Then about healthy debt, i e a provision of 19,000 at 2% has been made as a reserve for debtors ' discounts.

Adjusting entries:

Profit and Loss a/c Dr. Rs.380

To Reserve for Discount on Debtors a/c Rs.380

Profit and Loss Account

	Rs	
Tobad Debts To Reserve for Doubtful Debts To Reserve for Discount on Debtors	 1,000 380	

Balance Sheet

Liabilities	Rs	Assets		Rs
		Sundry Debtors Less: Provision for Doubtful on Debts Less: Provision for Doubtful Debts	20,000 1,000 19,000 380	 18,620

14. Calls in Arrears

The company issues shares in the market and the general public buys the shares. The company can make full or partial "phone" calls. The company demands money from shareholders when

needed within a certain period of time. If shareholders are unable to make an allotment or make a payment by phone before the payment deadline or by a specific date, the payment will be deferred.

Balance Sheet

When the company confirms the allocation of shares to a person, it becomes a valid contract and that person becomes a shareholder. He is obliged to pay the full amount of shares. If the shareholder fails to pay the call amount within the allotment deadline, the unpaid amount will be an overdue call. The amount of such delinquent calls is displayed on the liabilities side of the balance sheet by deducting it from the capital called. If the shares are confiscated, they will be deducted from the confiscated account.

Advance phone call on balance sheet

The company may require partial payments rather than one-time payments over the phone, subject to the terms of the issue of shares. If the company accepts an amount for a call that has not yet been made, the amount received in advance is called an "advance call". On the balance sheet, down payments are shown under the subheadings and other current liabilities under current liabilities.

Calling overdue journal entries

If shareholders fail to pay, the due date will be displayed as an overdue call. This amount is displayed in the journal by opening another account called the "Calls Overdue" account, and 5% p.a for all such calls overdue. Interest will be charged. Until the amount is repaid. Finally, the total (call for delinquent entry) appears on the balance sheet as a deduction from the called capital.

Calling pre-journal entries

Companies that are well-licensed by the text can receive advance phone calls from shareholders, but journal entries cannot capitalize on advance phone calls.

Call in the example of overdue

When a shareholder calls to request funding, they will be debited from their respective accounts. Some shareholders may not be able to pay the dues by allocation and / or telephone within the specified time. The amount not paid by the defaulting shareholder is called a

delinquent call and indicates the debit balance. Opening a "delinquent account" supports the creation of a balance sheet because it is deducted from the capital that was called.

15. Loss by fire (Partly and fully insured goods)

If the stock is destroyed by fire, the losses incurred will be treated differently under the following three possible circumstances:

A. if the stock is not insured-the entire value of the stock destroyed by fire is treated as a loss, at the entry –

Particulars	Dr. Rs.	Cr. Rs.
Profit and Loss A/c Dr To Trading A/c	***	 ***

(i) Destroyed stock value is credited to trading account as 'stock destroyed' (it would have appeared in closing stock if it was not destroyed)

(ii) Entire amount shown in profit & loss A/c as loss since the whole value of the stock is considered as destroyed.

B. If the stock is fully insured-when the fully insured stock is destroyed, the company has a claim to the insurance company for the recovery of losses due to the goods destroyed by fire. Therefore, the claim takes precedence in the entry –

Particulars	Dr. Rs.	Cr. Rs.
Insurance Co. A/c Dr To Trading A/c	***	 ***

In practice, claims against the insurance company are treated as "debtors" and are indicated on the asset side of the balance sheet as payments from the insurance company.

If the insurance company settled the dues, the entry would be

In fact, the account of the insurance company does not appear on the balance sheet, since the cash/bank balance on the balance sheet increases with the settled claims.

C. if the shares are partially insured-in this case, the total value of the destroyed shares will be credited to the trading account, that portion of the claim settled by the insurance company will be debited to the insurance company account, and the difference between the destroyed shares and the accepted insurance claim will be debited to the profit and loss account as a loss. The entries are as follows –

Particulars	Dr. Rs.	Cr. Rs.
Insurance Co. A/c Dr (amount of claim accepted) Profit and loss A/c (unrecoverable loss) To Trading A/c	***	***

16. Goods distributed as free samples.

To promote the products, free samples are supplied to experts in the field. For example, I distributed a free sample of a book to a professor, a free sample of medicine to a doctor, etc. Since it is a promotional activity, the cost of such a sample should be treated as promotional costs, for example, advertising. Free sample distribution is equivalent to a decrease in purchase or sale without a monetary return.

Thus, the adjusted entry is:

Particulars	Dr. Rs.	Cr. Rs.
Advertising A/c Dr To Purchases A/c or To Trading A/c	***	***

Particulars	Dr. Rs.	Cr. Rs.
Profit and Loss A/c Dr To Advertisement A/c	***	***

The net effect will be the reduction of purchases as promotional costs and the charge to the profit and loss account

Goods sold or sold on an approval basis: sometimes goods are sold on an approval basis in order to gain the trust of customers about the quality of the goods. If the customer approves it, it becomes a sale. If the customer does not approve it, the sale is not completed and therefore cannot be treated as a sale. Suppose that at the end of the fiscal year, you have a specific product with the customer that was sent on an approval basis, and you need to pass the necessary entries for reconciliation.

The adjustment entry is as follows: the treatment is as follows:

Particulars	Dr. Rs.	Cr. Rs.
Sales A/c Dr To Debtors A/c (at goods sales price)	***	***

Particulars	Dr. Rs.	Cr. Rs.
Stock A/c Dr To Trading A/c (at goods cost price)	***	***

(A) As a deduction from sales at the selling price on the credit side of the trading account, and in addition to closing the shares at the cost price.

(h) As a deduction from debtors on the asset side, and as the total inventory displayed at the cost on the asset side of the balance sheet (cost+finished stock in stock with authorized customers).

3. About shipping of products by consignment sale:

Since consignment transactions are not sales transactions, they do not directly affect transactions and profit and loss accounts. Another consignment account is opened, and the goods sent to the consignment are debited to the consignment account. When an account sale is

received, it is treated as a consignment sale, credited to the consignment account and debited to the consignment account.

The consignment inventory remaining at the consignment is deposited into the consignment account, and after invoicing the consignment cost, the consignment fee, etc., the consignment profit is confirmed. However, the closing stock of the deposit is displayed on the asset side of the balance sheet, and the profit and loss of the deposit is credited to the profit and loss account (if there is a loss of the deposit, it is cancelled).

The transfer input of consignment profit and loss is as follows:

(a) In case of profit

Particulars	Dr. Rs.	Cr. Rs.
Consignment A/c Dr To profit and loss A/c	***	 ***

(b) In case of loss

Particulars	Dr. Rs.	Cr. Rs.
Profit and loss A/c Dr To Consignment A/c	***	 ***

17. Any other adjustments as per the prevailing accounting standard.

1. **Provision for discounts to creditors:**

The creditor represents the amount paid by the business to the supplier of goods on credit. A healthy business concern is the creditor's goodwill and the practice of settling accounts with creditors in time to get the discounts allowed by them.

In that case, the liability for various creditors can be reduced to the extent of the expected discount. Based on past practice, a certain percentage of the balance of receivables is calculated as a reserve for discounts and subtracted from the balance of receivables of B/S, and the same amount is calculated as the gain of P&L A/C.

For example:

Traders had various creditors at Rs. 10,000on31th December2002. It is desirable to *provide 3% for this amount for discounts.

Adjusting entries:

Discounts on creditors for Reserve a /c Dr Rs. 300

To Profit and loss a / c Rs. 300

Profit and Loss Account

	Rs		Rs
		By Reserve for Discount on Creditors	300

Balance Sheet

Liabilities	**Rs**			
Sundry Debtors Less: Reserve for Discount	10,000 300	 9,700		

2. **Interest on capital:**

Often, interest at the usual rate is allowed to the owner's capital, which is adopted in the business. This is necessary in order to assess the efficiency of the business. Otherwise, the profit will include interest and will be displayed at a higher rate.

So the interest charged is a loss to the business and a profit to the owner. Thus, it is debited to profit and loss a/c and added to the capital of the balance sheet.

Adjusting entries:

a) Interest on Capital a/c Dr.

To Capital a/c

b) Profit and Loss a/c Dr.
   To Interest on Capital a/c

3. Interest in Drawing:

The drawing is the money that the owner has withdrawn from the capital. It charges interest on the drawing so that it allows business interest on capital. It's a profit to the business and a loss to the owner. Thus, it is credited to profit and loss a/c and deducted from the capital on the balance sheet.

Profit and Loss Account

	Rs		Rs
To Interest on Capital		By Interest on Drawings	

Balance Sheet

Capital Add: Interest on Capital Less: Drawings Interest on Drawings			

4. Committee of managers:

Business companies sometimes offer profit incentives to managers in the form of commissions to motivate people to increase business profits. This fee is given as a percentage of net profit. There are two ways to provide this percentage of net profit.

(a) The percentage of the commission against net profit before charging such fees;

(b) The percentage of fees to net income after invoicing such fees;

5. Specific hidden tweaks:

The adjustments are not given explicitly under the array of adjustments, but they need to be placed and adjusted. For example, the balance displays the subsequent items alongside other items at the top of Dec 31, 2009:

DR Cr		
10% loan January 1, 2009	-	-
Interest on loan	3,000	-
(Paid during the year)		

If we carefully observe loans are obtained in March 1, 2009 at a rate of interest of 10%. That is, the interest paid on a one-year loan on December 31, 2009 (Rs.50, 000×10/100) rupees.5, 000. But the interest paid is only Rs.3, 000 as shown in the trial balance. This indicates that interest is not paid (Rs.5, 000-3,000-2,000. Therefore, this should be considered as an adjustment. The entry is –

Profit and Loss A/c	Dr	2,000
TO Interest payable A/c		2,000

Here, the total interest charged to the profit and loss account is Rs. Will you be given 3,000 trial balances plus interest expense? 2,000, which is completely equivalent to Rs.5,000. Interest expense Rs.2,000 will appear as liabilities on the balance sheet.

Please note that there are many adjustments to different types of courses and preparations for the final. Their treatment is explained when they appear.

Worksheet

When all the necessary information for financial reporting is ready (that is, information on the trial balance and adjustment, officially aggregated without errors), the accountant prefers to draft a worksheet. The worksheet is a rough work and is not part of the financial statements.

The worksheet is provided for convenience to ensure that the financial statements prepared in the debit and credit columns representing the trial balance, adjusted, adjusted trial balance, trading account, profit and loss account and balance sheet are in order.

10.4 Summary

- Financial accounting follows either the accrual basis of accounting or the cash basis.
- Non-profits, companies, and small businesses use financial accountants.
- Financial reporting is done by using financial statements in five different areas. Accounting records are all documents involved in the preparation of financial statements of the company.
- Certain regulatory bodies require companies to keep accounting records for several years if they need to be reviewed.
- Accounting records can be used for audits, compliance checks, or other business-related necessities.
- Accounting record types include transactions, general ledgers, trial balances, journals, and financial statements.

10.5 Self-Assessment Questions

1. Describe the need for a Trading Account.
2. What is a Trading Account? What is its use?
3. What are the debits and credits displayed on my trading account?
4. What are the benefits of the income statement?
5. What are direct and indirect costs?
6. Write the difference between trial balance and balance sheet.
7. What do liquid assets mean?
8. Explain the term debt.
9. Draw the vertical balance sheet format.
10. What do you mean by assets? Categorize assets using a good example.

10.6 References

1. Basic Financial Accounting for Management- Paresh Shah -Oxford University Press
2. An Introduction to Accounting S N Maheswari and S K Maheswari, Vikas
3. Modern Accountancy Volume-1- A Mukherjee and M Hanif-TMH

Unit 11

Preparation of Financial Statements of Partnership Business with Adjustments

Learning Objective:

After studying the unit, students will be able to:

1. Know what a Financial Statement means.
2. Understand the meaning of Trading, P/L and Balance Sheet
3. Explain the adjustments related to expenses, income n etc.

Structure

11.1 Meaning of Final Account
11.2 Partnership Statement of Financial Position
11.3 Summary
11.4 Self-Assessment Questions
11.5 References

11.1Meaning of Final Account

We have already taken into account closing inventory, unpaid / prepaid expenses / income, depreciation, interest on capital on partners, interest on withdrawals from partners, salaries on partners, adjustment of reserves, goodwill, and partnerships. We have already studied how final accounting is prepared; about partner admission / retirement / death. This was when the partner entered / retired at the end of the fiscal year. In this unit, you will learn how to prepare for final accounting if your partner enrols / retires during the fiscal year.

The Final Account of the Partnership is prepared in the same way as the sole proprietorship account. They include Trading A / C, Income statement, and Balance Sheet.

The Final Account will be prepared for the following purposes:

I. To know the gross profit or loss of the period

ii. How to find out the profit or loss for that period

iii. To know the financial position of a business on a particular date

iv. To prepare various statements for future planning

v. To know how much the company's debtors and creditors are

vi. Know the source of funds (liabilities) and the use of funds (assets)

vii. To calculate different ratios for analysis

viii. To provide the bank with audited financial statements and other documents to obtain a loan

ix. To evaluate the good intentions of the company when a partner joins, leaves, dies, or dissolves the company

X. Find out the amount of tax to be paid and pay the prepaid tax.

Preparation For Final Accounting

The final closing of a partnership company is similar to that of a sole proprietor. The only difference is that in a sole proprietorship, the profit is added to the business owner's capital, whereas the profit is distributed among the partners. First, prepare a trial balance from all debit and credit balances for all ledger accounts. This will generate a trading account and a profit and loss account. Finally, a balance sheet is created that reflects your position at the end of the period. The trading account shows gross profit or total loss, and the profit and loss account reflect the net position.

I. Manufacturing Account

This is provided only for manufacturing concerns. The production cost is displayed.

II. Trading Account

The trading account is prepared for the transaction and is part of the income statement. Record all transactions related to goods and direct costs. If the credit side is larger than the debit side, the gross profit thus obtained is

It will be credited to the income statement. On the other hand, if the debit is greater than the gross loss

It will be debited on the income statement.

a. Debit side of trading account

1. Opening stock
2. Purchases after deducting the amount of burnt items, partner withdrawn items, and items

Distributed as a free sample

Direct costs mean costs that are directly related to the production or purchase of goods, such as wages.

Manufacturing costs for inward freight, factory rent, octroi, import taxes, tariffs, electricity, etc.

b. Credit side of Trading Account

1. Sale of goods
2. Closed stock
3. Items that have been burnt down, items that have been withdrawn by a partner, items that have been distributed as free samples, etc. may appear here instead of being deducted from your purchase.

Partnership-style business organizations are very similar to sole proprietorship-style businesses, but there are certain exceptions to this form of business organization that must be taken into account when preparing a partnership company account.

These exceptions, called special aspects of partnership accounts, are:

1. Maintaining a partner's capital account
2. Distribution of profit and loss between partners.
3. Adjustment of misappropriation of profits
4. Reorganization of partnership firm
5. Dissolution of partnership firm

Maintaining a partner's capital account

In partnership operations, capital accounts are maintained in two different ways: (a) fixed capital and (b) variable capital.

The fixed capital method maintains two accounts, the capital account and the current account, while the variable capital method maintains only the capital account.

Distribution of profit and loss between partners

Since multiple individuals are involved in the partnership business, care must be taken in the distribution of profit and loss. A profit and loss account is provided for this purpose.

Adjustment of misappropriation of profits

One of the special aspects of partnership is to coordinate your partnership account whenever you need to adjust or modify past events. In the past, the profit-sharing ratio between partners may have been incorrect, in which case the company will make adjustments to correct the error.

Reorganization of partnership firm

Restructuring is referred to as changes that occur with respect to partnerships or in partnership actions that lead to the creation of new terms and conditions between partners.

The following situations lead to the restructuring of the partnership company.

a. Admission of a new partner
b. Partner Retirement / Partner Death
c. Dissolution of partner

11.2 Partnership Statement of Financial Position

There is an equity account and a recurring account for each partner

A partner's equity account may be aggregated together with the original contribution or separated as in this example.

In this example, each partner has his 3 current accounts showing the total received from the business.

The three capital accounts show how much each partner contributed.

ABC LLP Statement of Financial Position as at 31 December 2015			
Current assets			**$**
Cash on hand		2600	
Cash in bank		80 000	82 600
Non-current assets			
Office building		200 000	
Office furniture		14 000	
Less Accumulated depreciation		1000	13 000
Total assets			$ 295 600
Current liabilities			
Accounts payable		4.000	
Non-current liabilities			
Bank loan		5 000	
Total liabilities			9 000
Net assets			
Partners' equity Capital			
Capital	A	50000	
	B	200000	
	C	30000	286 600
Current	A	1179	
	B	4714	
	C	707	6600
			$ 286 600

Partnership income statement/income statement

Partnership Statement

a. Profits and losses are divided according to the original contribution or according to the agreement
b. Profits and losses are minus salaries owed to partners (partners are normally paid if they are active in the business or agreed in the partnership agreement)
c. Tax not shown

The difference between partnerships and sole proprietorships lies in the distribution of profits

1. If you are a sole proprietor, everything goes to the owner.
2. In the case of a partnership, the distribution of profits (losses) is subject to the partnership agreement.

ABC LLP Statement of Financial Position as at 31 December 2015			
Sales			$20 000
Expenses			
Administration expenses		1 200	
Rent		2000	
Finance expenses		200	
Depreciation of office furniture		1000	4.400
Profit			$15 600
Distributions to partners			
Salary	A	4000	
	B	2000	
	C	3000	9000
Distribution of remaining profit to current a/c			
A(50 000/280 000 x 6600)		1 179	
B(200 000/280 000 x 6600)		4714	
C(30 000/280000 x 6600)		707	6600
			$15 600

Balance Sheet

An account style balance sheet shows assets on the left and liabilities and owner's equity on the right. In this chapter, we use the account form balance sheet to show the balance sheet changes resulting from the withdrawal of a partner, the addition of a partner, or the closure of a partnership. The balance sheet in report form was used in the previous chapter. Below are examples of the various possible changes in the composition of the partnership.

Withdrawing or adding new partners

A partnership is based on a contractual agreement between individuals and ends when a partner leaves the company or a new partner is added. However, business may continue with new partnership agreements. Partners may withdraw by selling their stake or shares for cash or other assets. If all partners agree, the new partner may purchase the current partner's stake, contribute additional assets equal to the shares he or she has acquired, or have more or less than the shares he or she has acquired. You can join the company by investing. Or she will receive.

The partnership agreement should outline the procedures for managing partners who wish to exit the business. A withdrawal may occur if a partner wishes to retire or does not wish to continue under the current business arrangement. For example, her Abdullah, who has $40,000 in stock, wants to retire. The partnership agreement stipulates that an audit will be conducted that

includes evaluating all assets to determine market value. Additionally, all responsibilities of the partnership must be determined. If an audit reveals that the assets and liabilities differ from those reflected in the partnership's books, the records will be adjusted to determine the true equity of the partners. Once this is accomplished, the contract may provide for the distribution of assets to the retiring partner, so long as it does not jeopardize the future profitability of the remaining partner.

Saar, Loretto, and Abdullah,
Accountants Balance Sheet

December 31, 20XX

Assets									Liabilities and Owners' Equity																
									Liabilities																
Cash					0				Accounts Payable													0			
Other Assets			0		0																				
									Owners' Equity																
									Saar, Capital																
									Loretto, Capital			0		0											
									Abdullah, Capital			0		0											
									Total Liabilities and																

Total Assets			0		0				Owner's Equity																

Suppose M. Saar wants to sell her ownership to her B. Knight. The balance sheet before the sale is as follows.

11.3 Summary

- For example, if walking partners adds partners to provide receivables and equipment from an existing business, the partnership assesses the collectability of the receivables and records them at net realizable value.
- Existing valuation reserve accounts (commonly referred to as allowance for doubtful accounts) are not transferred to the partnership because the partnership establishes its own reserve account.
- Similarly, the existing accumulated depreciation account will not be taken over by the partnership.
- The partnership establishes and records the equipment at its current fair market value and begins depreciation of the equipment over its useful life.
- Partnership accounting is the same as sole proprietorship accounting, except for the number of partner stock accounts.
- Each partner has a separate capital account for their share of investment and net profit or net loss, and a separate withdrawal account.

11.4 Self-Assessment Questions

1. What are difference between trial balance and balance sheet?
2. What is role of account opening in partnership business?
3. How is the balance sheet created?
4. What are the benefits of the income statement?
5. What are direct and indirect costs?
6. What do you mean by liquid assets?

11.5 References

1. Basic Financial Accounting for Management- Paresh Shah -Oxford University Press
2. An Introduction to Accounting S N Maheswari and S K Maheswari, Vikas
3. Modern Accountancy Volume-1- A Mukherjee and M Hanif-TMH

Unit 12

Opening and Closing Journal Entries

Learning Objective:

After studying the unit, students will be able to:

1. Know what the Adjustment Entry means.
2. Understand the meaning of opening Entry
3. Explain the meaning of closing Entry

Structure

12.1 Meaning and Necessity of Adjustment Entry
12.2 Opening Entry
12.3 Closing Entry
12.4 Summary
12.5 Self-Assessment Questions
12.6 References

12.1 Meaning and Necessity of Adjustment Entry

After creating the trial balance and before creating the final account, you may find that some commercial transactions are recorded completely or partially omitted or entered incorrectly. In addition to this, there are some income or expenses associated to the following year, but inward or paid throughout the year. You must make adjustments to these accounts before you can create trading and profit and loss accounts.

Final Account Adjustment

The final account is usually prepared for the entire accounting period. It should be kept in mind that the costs and income of the appropriate accounting period will be occupied when preparing the final accounting. If expenses are incurred but not paid during the period, you will need to create a liability for the unpaid amount before you can review the performance and financial position of concern. In order to create the final account of the commercial

accounting system, all expenses and income related to the period, whether incurred or received, must be booked. To do this, you need to be concerned about passing assured entries at the end of the year to adjust various items of income and expenses. These types of entries are called reconciliation entries.

Accounting: Transactions and profit and loss and balance sheets are collectively referred to as final accounts. Items that appear in the trial balance are either debited or credited and appear only once in the final account. The reconciliation entry requires two postings of the same amount, debit and credit. The important point is that students need to post (debit and credit) to the relevant accounts at the same time. Care must be taken to ensure that the total amount of debits and credits will be same.

The following is a summary of important adjustments that are typically made at the end of the accounting period.

Sr. No	Adjustment	Effect 1	Effect 2
1	Closing Stock- Raw Materials	Less from RC- MFG A/c	BS- Asset Side
	Closing Stock- Work in Progress	MFG A/c- Cr Side	BS- Asset Side
	Closing Stock- Finished Goods	Trading A/c- Cr Side	BS- Asset Side
2	Outstanding Expenses or Payable	Add to Expense	BS- Liability Side
3	Prepaid Expense	Less from Expenses	BS- Asset Side
4	Outstanding Income or Receivable	Add to Income	BS- Asset Side
5	Income received in Advance	Less from Income	BS- Liability Side
6	Depreciation on Assets used in MFG	Less from Asset in BS	MFG A/c Dr Side
7	Depreciation on Office Assets	Less from Asset in BS	P/L A/c Dr Side
8	Interest on Capital	P & L A/c Dr Side	Add to Capital in BS

9	Interest on Drawings	P & L A/c Cr Side	Less from Capital in BS
9	Bad or Doubtful Debts	P & L Dr Side (Formula)	Less From Debtors
10	Provision/Reserve for Doubtful Debts (RDD)	P & L Dr Side (Formula)	Less From Debtors
11	Provision for Discount on Debtors	Add to Discount (P & L Dr Side)	Less From Debtors
12	Provision for Discount on Creditors	Add to Discount (P & L Cr Side)	Less From Creditors
13	Unrecorded Sales	Add to Debtors	Add to Sales
14	Unrecorded Purchases	Add to Creditors	Add to Purchases
15	Uninsured Goods lost by Fire/theft	P & L Dr Side	Trading A/c Cr Side
16	Insured Goods lost by Fire/theft	P & L Dr Side- Actual Loss Amount BS Asset Side - Insurance Claim Receivable	Trading A/c Cr Side- Amount of Goods Lost
17	Goods Distributed as Free Samples	P & L Dr Side	Trading A/c Cr Side
18	Goods taken for Personal use by proprietor	Add to Drawings	Trading A/c Cr Side
19	Bills Receivable Dishonored	Less from Bills Receivable	Add to Debtors
20	Bills Payable Dishonored	Less from Bills Payable	Add to Creditors
21	Interest on Loan Payable	Add to Loan Liability Side	P & L Dr Side

22	Interest on Investment Receivable	Add to Investment Asset Side	P & L Cr Side

12.2 Opening Entry

What is the opening entry?

The starting entry is called the first entry recorded or carried over from the previous accounting period to the new accounting period.

For ongoing operations, closing balance of the earlier period serves as the opening balance of the existing period.

Starting entries vary by business, and starting entries can be either debits or credits.

In business matters, at the beginning of an accounting period, accountants hand over journal entries containing the opening balances of all assets and liabilities, including equity.

Assets have a debit balance, so they are debited at the opening entry, but liabilities have a credit balance, so they are credited at the opening entry.

One sample journal entry can be represented as:

Assets A/c Dr.

Debt A/c

Capital A/c

If assets exceed all liabilities, the excess amount is taken as the value of equity and appears as a credit on the opening entry, whereas if liabilities exceed the value of assets, it is debited on the opening entry. .

Example of opening entry

A business start entry can be represented as:

Particulars	Dr. Rs.	Cr. Rs.
Assets A/c Dr	***	

To Liabilities A/c To Capital A/c (Bring forward assets and liabilities)		*** ***

12.3 Closing Entries

"Closing entry" is indispensable to confirm the correct operation result. In order to determine operating income, we will settle expenses and profits. Therefore, the balances of the expense and profit and loss accounts must be transferred to the manufacturing, trading, and profit and loss accounts. The process of closing expense and revenue accounts is done by closing the entry.

Tips if the Balance Sheet is not calculated

"I made all the adjustments correctly, but the balance sheet isn't aggregated." –

How to avoid such a situation.

1. The entries displayed in the trial balance search for a location in only one place, debit or credit.
2. While reading the trial balance, provide special identification information for entries that need adjustment (see the adjustment number in question). You will not forget to make adjustments as symbol will remind you to make adjustments! This is also "time management".
3. All adjustment entries must be finished in two places for the same amount. Students will be able to enter at their own convenience. This is the wrong approach. After debiting, credit the same amount at the same time.
4. After making adjustments, double-check that the same number of adjustments have been made in both locations before moving on to the next entry.
5. Remember to make sure that the debit and credit amounts are the same.

With great care, the balance sheet is always aggregated.

To facilitate the preparation of trading and profit & loss accounts, all nominal account balances must be closed on the last day of the accounting or financial year. This is done by passing the required closing entries to the appropriate journals. Purchases have a debit

balance and purchase returns have a credit balance. At the end of the fiscal year, the balance of the Return Goods Account is closed by transferring it to the Purchase Account.

Similarly, a sales account has a credit balance and a sales return has a debit balance. At the end of the fiscal year, close the sales returns account by transferring the balance to the sales account. Here are the various closing entries:

1. **Closing your purchase return account**

Particulars	Dr. Rs.	Cr. Rs.
Purchase Return A/c Dr	***	
To Purchases A/c		***
(Purchase returns account may be closed by transferring to purchases account)		***

2. **Closing the return account**

Particulars	Dr. Rs.	Cr. Rs.
Sales A/c Dr	***	
To Sales Return A/c		***
(By transferring to Sales account we may close the sales returns account)		***

3. **Settlement of opening price inventory and direct costs, such as items appearing on the debit side of a trading account**

Particulars	Dr. Rs.	Cr. Rs.
Trading A/c Dr	***	
To Opening Stock A/c		***
To Purchases A/c		***
To carriage inward A/c		***
To wages A/c		***
To other direct expenses A/c		***
(By transferring all the items to trading account various items may be closed)		

4. **In the case of closing price, closing price inventory displayed on the credit side of the trading account**

Particulars	Dr. Rs.	Cr. Rs.
Sales A/c Dr Closing Stock A/c Dr To Trading A/c (Various items may be closed by transferring to trading account)	***	 *** ***

5. **For the transfer of gross profit or loss to the income statement**

(a) Gross Profit

Particulars	Dr. Rs.	Cr. Rs.
Trading A/c Dr To Profit and loss A/c (Gross Profit to be transferred to Profit and loss account)	***	 ***

(b) For Gross Loss;

Particulars	Dr. Rs.	Cr. Rs.
Profit and loss A/c Dr To Trading A/c (Gross loss to be transferred to Profit and loss account)	***	 ***

6. **To close indirect costs and losses, items that appear on the debit side of the income statement**

Particulars	Dr. Rs.	Cr. Rs.
Profit and Loss A/c Dr To depreciation A/c To provision A/c	***	 *** ***

To financial expenses A/c To salary A/c To distribution A/c To selling and administration expenses A/c To office expenses A/c To other indirect expenses and loss A/c (By transferring all the items to profit and loss account various items may be closed)		*** *** *** *** *** ***

7. **To close indirect income, i.e. items appearing on the income statement credit side**

Particulars	Dr. Rs.	Cr. Rs.
Commission earned A/c Dr Discount earned A/c Dr Other indirect incomes A/c Dr To profit and loss A/c (By transferring all the items to profit and loss account various items may be closed)	*** *** ***	 ***

8. **For the transfer of net profit or net loss to the capital account**

(a) For Net Profit;

Particulars	Dr. Rs.	Cr. Rs.
Profit and loss A/c Dr To Capital A/c (Net Profit to be transferred to Capital account)	***	 ***

(b) Net loss

Particulars	Dr. Rs.	Cr. Rs.
Capital A/c Dr To Profit and loss A/c (Net loss to be transferred to Capital account)	***	***

12.4 Summary

- The process of closing expense and revenue accounts is done by closing the entry.
- Closing entry" is indispensable to confirm the correct operation result. In order to determine operating income, we will settle expenses and profits.
- After creating the trial balance and before creating the final account, you may find that some commercial transactions are recorded completely or partially omitted or entered incorrectly.
- The final account is usually prepared for the entire period. It should be kept in mind that the costs and income of the relevant accounting period will be taken when preparing the final accounting.
- Transactions are recorded in profit & loss account and, balance sheets are collectively referred to as final accounts.

12.5 Self-Assessment Questions

1. What is Closing Entry?
2. What is the order of the four final entries?
3. What is the purpose of closing your account?
4. Which accounts do you open and close?
5. What is the opening entry?
6. What are the four basic closing entries?
7. What are the 5 types of journal entries?
8. How do you open a journal entry entry?
9. Why is the opening entry passing?
10. Is the opening balance a debit or a credit?

12.6 References

1. Basic Financial Accounting for Management- Paresh Shah -Oxford University Press
2. An Introduction to Accounting S N Maheswari and S K Maheswari, Vikas
3. Modern Accountancy Volume-1- A Mukherjee and M Hanif-TMH

Case Study

GHI Ltd suffered a loss in a company-wide fire in February 2020. We have a valid insurance policy to cover this accident. In April 2020, we filed an insurance claim for the loss caused by the fire. The claim was approved by the insurer in May 2020 (before the Board BOD approves the financial statements). The fair value of real estate based on an independent valuation just before a natural disaster was 50 rupees.

a. Will the accounting change if the claim is filed in March 2020 and approved in May 2020?
b. Where insurance would be shown in a Financial Statement?

Unit 13

Accounting Standard AS-3

Learning Objective:

After studying the unit, students will be able to:

1. identify what Cash Flow means.
2. Different ways how Cash flow are prepared
3. Understand the meaning of Companies Annual reports

Structure

13.1 Cash Flow Statement-Introduction

13.2 Summary

13.3 Self-Assessment Questions

13.4 References

13.1 Cash Flow Statement-Introduction

Cash flow: overview

There are generally four types of financial statements in accounting: balance sheet, income statement, Cash flow statement. Let's take a closer look at the last two.

In financial accounting, a Cash flow statement refers to the change in a company's cash and equivalents from one period to the next. However, the flow of money has two different implications. One is for accounting purposes and the other is for investment purposes.

Cash flow

Cash flows are recorded on the company's cash flow statement. This statement (one of the company's key statements) shows the actual inflows and outflows of cash (or cash-like assets) from its investment activities. This is a mandatory report under generally accepted accounting principles (gaap)

This is different from the income statement, which records data and transactions that may not be fully realized, such as uncollected income and unpaid income. On the other hand, this

information is already entered in the cash flow statement, which gives you a more accurate picture of how much cash your company is generating.

The cash flow statement allows you to classify cash flow sources into three different categories:

1. **Cash flow from operating activities:** cash generated from the general or core business of the business is listed in this category.
2. **Cash flows from investing activities**: this section describes the cash flows spent on investments such as new equipment.
3. **Cash flows from financing activities:** this category includes all transactions involving the debtor, such as income from new debt and dividends paid to investors.

Specimen of cash flow

Cash flow statement for xyzbusiness

For the year ended 31st december 2020

Cash flow from operating activities

a. Cash receipts from customer
b. Cash paid to supplier
c. Cash paid to employees
d. Cash paid for other operating expenses
e. Cash generated from operations
f. Dividend received *
g. Interest received
h. Interest paid
i. Tax paid

Net cash flow from operating activities

Cash flow from investing activities

a. Proceeds from capital contributed
b. Proceeds from loan
c. Payment of loan
d. Net cash flow from financing activities

e. Cash flow from financing activities
f. Proceeds from capital contributed
g. Proceeds from loan
h. Payment of loan

Net cash flow from financing activities

a. Net increase/decrease in cash
b. Cash at the beginning of the period
c. Cash at the end of period

Net Increase/Decrease in Cash
Cash at the beginning of the period
Cash at the end of period

A company receives an inflow of cash income from selling goods, providing services, selling assets, earning interest on investments, renting, acquiring loans, or issuing new shares. Cash outflows can result from purchases, loan repayments, business expansions, payroll payments, or dividend distributions.

Investors and lenders have liquidity and cash on hand because the securities and exchange commission (sec) requires all listed companies to use accrual accounting and largely ignores the actual balance of cash on hand. It relies on cash flow statements to evaluate flow management. It's a more reliable tool than the metrics companies use to dress up their earnings, such as interest, taxes, depreciation, and earned before interest.

How to prepare Cash Flow Statement with reference to Accounting Standard No 3. (Indirect method only)

Cash flow as per accounting standards:

1. **Applicability of AS3 income Statement**

The applicability of the income statement is defined under the businesses Act 2013. **As defined by the law, financial statements include:**

I. record
ii. Profit and Loss Account / Balance Account
iii. Income statement

iv. Statement of changes in shareholders' equity, etc.

v. Annotation

Therefore, the income statement must be prepared by all companies, but the law also specifies certain categories of companies that are exempt from an equivalent.

For e.g.: One Person Company (OPC), Small Company, and Dormant Company.

- OPC means a corporation with just one member.
- SMEs are private companies with a maximum paid-up capital of Rupees. The utmost sales are 500,000 rupees. 2 rolls.
- A dormant company is an inactive company that's established for future projects or simply to carry assets and has no significant transactions.

2. Cash and cash equivalents

Cash equivalents are held by a corporation to satisfy its short-term cash commitment on behalf of an investment or other such purpose. **For investments that qualify as cash equivalents:**

1. The investment must be easily convertible to cash
2. Must be exposed to a really low level of risk regarding changes in its value

Therefore, an investment is taken into account as a debt instrument as long as such investment features a short maturity within 3 months from the date of acquisition.

The AS 3 income statement states that movements between items that form a part of cash or cash equivalents should be excluded because they are part of a company's cash management, not business, financing, and investment activities. Cash management consists of investing surplus and taking advantage of cash equivalents.

3. View income

The income statement must represent the cash flows within the amount during which they're categorized as follows:

A. Sales activities

B. Investment

C. Financing activities

Companies have to prepare and present cash flows from operations, financing, and investment activities in a way that suits their business.
Grouping activities provides information that permits users to measure the impact of such activities on the company's overall financial position and to assess the worth of money and cash equivalents.

A. Sales activities

Cash flow from operating activities comes primarily from activities that generate the company's main revenue. **For example:**

- Cash received from the sale of products and services
- Cash received in fees, royalties, commissions, and various other sorts of revenue
- Cash paid to suppliers of products and services

B. Investment activities

Cash flows from investing activities represent outflows for cash flows and resources aimed toward generating future income. **For example:**

- Cash purchased the acquisition of fixed assets
- Cash received from the disposal of fixed assets (including intangible assets)
- Cash paid to accumulate shares, warrants or debt certificates of other companies and equity interests in joint ventures

C. Financing activities

Financing activities are activities that change the composition and size of the owner's capital and therefore the company's debt. **For example:**

- Cash received from the issuance of shares or other similar securities
- Cash received from the issuance of loans, corporate bonds, bonds, bills, and other short-term or long-term debt
- Repayment of debt

4. **Income from operating activities**

Companies must report on Cash flows from operating activities using:

1. Direct method-if all the majority important classes of money receipt and payment are presented. Or

2. Indirect method – If net or loss is adjusted as follows:

a) Impact of non-cash transactions like depreciation, deferred taxes and provisions.

b) Income or deferral of future or past operating cash income or payments

c) Expenses or income related to income financing or investment

5. **Income from investment and financing activities**

In an organization must independently record all major classes of money receipts and payments resulting from financial and investment activities, except people who have to be reported on a net basis.

A. **Net-based income**

Cash flows from any of the subsequent operating, financing or investing activities could also be reported in net form.

- Cash income and payments on behalf of the client if the cash flows reflect the activities of such clients instead of the activities of the corporate itself.
- Revenue and cash payments for products with large amounts, fast sales and short maturities

Cash flows from each of the subsequent activities of a financial company could also be reported in net form.

a. Cash income and payments for receipt and refund of fixed-maturity deposits
b. Placement and withdrawal of deposits from other financial companies
c. Loans and cash advance payments are provided to Customer / Customer and repayment of such loans and advance payments.

B. **Foreign currency cash flow**

Cash flows from business transactions in foreign currencies must be recorded in the company's reporting currency using the following methods:

Foreign currency amount * FX rates the exchange rate between the cash flow date report and the foreign currency.

If the result is similar to using the cash flow date rate, you can use a rate that is close to the actual rate.

The impact of exchange rate fluctuations on cash and cash equivalents held in foreign currencies must be reported as a separate and separate part of the adjustment of changes in cash and cash equivalents during the accounting period.

6. Special items, dividends and profits

Cash flows related to special items must be categorized as originating from operating, financing, or investing activities, as appropriate and clearly disclosed.

Cash flows from receiving and paying dividends and interest must be disclosed separately. For financial companies, cash flows from receiving and paying dividends and interest must be categorized as cash flows from operating activities.

For other companies, cash flows from interest expense should be categorized as cash flows from financing activities, while dividends and interest received should be categorized as cash flows from investing activities.

7. Tax on income

Income tax cash flows have to be disclosed separately and reported as cash flows from operating activities unless they may be explicitly related to investment and financing activities.

8. Acquisition and disposal of business divisions including subsidiaries

Total cash flows from acquisitions and disposals of business units, including subsidiaries, must be viewed as investment activity and reported separately.

An entity must provide a complete of the subsequent for both acquisitions and disposals of other business units, including subsidiaries, within the subsequent accounting period:

(A) Total purchase or disposal

(B) Purchase or disposal price discharged as cash and cash equivalents

9. **Non-cash transaction**

Financing and investment transactions that do not necessitate cash or cash equivalents should not be included in cash flow statement. These transactions must be presented elsewhere in the financial statements in a way that provides relevant information regarding such financing and investment activities.

10. **Disclosure**

An entity must disclose the amount of substantial unusable cash and cash equivalents it holds, along with management commentary.

Commitments that may result from discounted bills of exchange and other parallel obligations undertaken by an entity are usually disclosed in the financial statements by note, even if the likelihood of loss is low.

13.2 Summary

- The main reason for creating a cash flow statement is that a company's income statement is always accrued and profits may appear on the income statement, but the cash received from these profits runs the business. Because there is less possibility to do so. Or vice versa.
- The Cash flow statement must report Cash flows over the time categorized by operating, investing, and financing activities.
- Cash flows related to special items must be categorized as originating from operating, investing or financing activities as appropriate and disclosed separately.
- The company's cash flow and cash flow statements reflect two different variables over a particular period of time.
- Cash flow records the inflows and outflows of a company's actual cash (cash and cash equivalents).
- The flow of money records the movement of cash in and out of the company.
- Both help provide investors and markets with snapshots of how the company does it on a regular basis.
- The cash flow statement is great for measuring a company's liquidity profile, while the fund flow statement is great for long-term financial planning.

13.3 Self-Assessment Questions

1. Define Cash flow.
2. Classify cash flow statement
3. Draw the specimen of Cash flow
4. Define Cash and cash equivalents
5. What are Investment activities? Give some examples.
6. Explain Income from investment and financing activities.
7. Write short note on Acquisition and disposal of business divisions including subsidiaries
8. From the overview of the Cash Account of x INC., we have finished using the 31st March2007 direct method of preparing the cash flow statement of the year according to AS-3. We have no cash equivalents.

Summary (cash account) 31.3.2007

	Rs		Rs
To balance b/d 1.4.2006	50	By payment to supplier	2,000
To equity shares	300	By purchase of fixed asset	200
To receipt from customer	2,800	By overhead expenses	200
To sale of fixed asset	100	By wages & salaries	100
		By taxation	250
		By dividend	50
		By repayment of loan	300
		By balance c/d	150
	3,250		3,250

9. Create a cash flow statement for Suryan Corporation. From: additional information:

Balance sheet

Liabilities	1.1.06 Rs	31.12.06 Rs	assets	1.1.06 Rs	31.12.06 Rs
Share capital	1,00,000	4,00,000	Goodwill	-	20,000
8% debenture	-	2,00,000	Machinery	1,25,000	4,75,000
Retained earnings	60,000	90,000	Stock	20,000	80,000
Creditors	40,000	1,00,000	Debtor	30,000	1,00,000
Bills payable	20,000	40,000	Cash at bank	50,000	1,50,000
Provision for tax	30,000	40,000	Cash in hand	25,000	45,000
	2,50,000	8,70,000		2,50,000	8,70,000

Other information:

(a) During 2006, the sole trader's business was purchased by issuing shares of Rs. 2, 00,000. The assets acquired from him were: goodwill Rs. 20,000, machine Rs. 1, 00,000, 50,000 and debtors Rs. 30,000.

(b) The provision for the tax imposed in 2006 was Rs. 35,000.

(c) Corporate bonds were issued at a 5% premium included in retained earnings.

(d) The depreciation levied on the machine was Rs. 30,000.

10. Make-out cash flow statement from the following balance sheet of Executive Corporation:

Liabilities	2003 Rs	2004 Rs	Assets	2003 Rs	2004 Rs
Equity share capital	3,00,000	4,00,000	Goodwill	1,15,000	90,000
8% redeemable preference share capital	1,50,000	1,00,000	Land & building	2,00,000	1,70,000
General reserve	40,000	70,000	Plant	80,000	2,00,000
Profit & loss	30,000	48,000	Debtors	1,60,000	2,00,000

Proposed dividend	42,000	50,000	Stock	77,000	1,09,000
Creditors	55,000	83,000	Bills receivable	20,000	30,000
Bills payable	20,000	16,000	Cash in hand	15,000	10,000
Provision for taxation	40,000	50,000	Cash at bank	10,000	8,000
	6,77,000	8,17,000		6,77,000	8,17,000

Other information:

(A) Depreciation of Rs. 10,000 and Rs. 20,000 were filled with plants and land and buildings in 2004.

(B) Interim dividend of Rs. 20,000 was paid in 2004.

(C) Rs. 35,000 income tax paid between 2004

13.4 References

1. Basic Financial Accounting for Management- Paresh Shah -Oxford University Press
2. An Introduction to Accounting S N Maheswari and S K Maheswari, Vikas
3. Modern Accountancy Volume-1- A Mukherjee and M Hanif-TMH

Unit 14
Income Statement

Learning Objective:

After studying the unit, students will be able to:

1. Identify what Financial Statements as Per the Companies Act, 2013 means.
2. Understand how Part 1- Format of Balance Sheet is prepared
3. Describe the components of the income statement and alternative presentation formats of that statement
4. Understand how Part 2- Format of Statement of Profit or Loss is prepared

Structure

14.1 Rules of Financial Statements (Companies Act, 2013)

14.2 Part 1- Format of Balance Sheet

14.3 Part 2- Profit or Loss (Format)

14.4 Part of Balance Sheet & Profit & Loss Account

14.5 Summary

14.6 Self-Assessment Questions

14.7 References

14.1 Rules of Financial Statements (Companies Act, 2013)

Section 129 of the Companies Act 2013 given for the preparation of financial statements.

1. "2.2 (40) includes Balance Sheet, Income Statement, Cash Flow Statement, Statement of changes in Shareholders' Equity, and the description attach above".
2. "Section 129 related to the current section 210. The financial statements shall grant a true and fair picture of company's position and shall meet the terms with the accounting standards notified in new Section 133".

3. “It is also predetermined that the Financial Statements will be ready in the format precise in the new Schedule III of the Companies Act 2013”.
4. “New Schedule III provides Balance Sheet preparation and income statement with provisions in the same row as current Schedule VI”.
5. “In addition, the new Schedule III compulsory the consolidation of subsidiary books accounts in Section 129, which provide detailed information on the preparation of consolidated financial statements”.
6. “Note that for the initial time in new section 129 (3), a provision was shaped that if a company has one or more subsidiaries companies, the consolidated financial statements of the holding company and all of its subsidiaries necessity to be prepared. In format provided in the new Schedule III of the Companies Act 2013”.
7. “The company be required to also attack its Financial Statements, beside with other financial statements that be full of the salient features of the subsidiary's finances in a manner as explain in the rule’s”
8. “In addition, if a company which is interested in an affiliated company or joint venture business activity, the accounting for company and the joint venture should be incorporated”
9. “Affiliates are defined in new Section 2 (6) for purpose of company has an significant influence. Manages almost 20% of the company's total equity share capital, or contractual business decisions.”
10. “The Central Government of India has the main authority to excused companies from complying with any of requirements created under mention section”.

General Instruction designed for Preparation of Balance Sheet and Statement of Profit and Loss of a Company (Section 129)	
General instructions	(1) “ where compliance with the needs of the act as well as **Accounting Standards** as applicable to the companies require any alteration in treatment or disclosure including addition, amendment, substitution or deletion in the head or sub-head or any modification, in financial statements or statements forming part thereof, the similar

	shall be finished and the requirements of this schedule shall stand modified accordingly.” (2) ‘Disclosure requirements particular in this schedule are in totting up to and not in substitution of the disclosure requirements specified in basic accounting standards prescribed under the companies act, 2013. Other related disclosures specified in the accounting standards shall be made in the notes to accounts or by mode of supplementary statement unless required to be disclosed on the face of the financial statements. Similarly, all other disclosures as required by the companies’ act shall be made in the notes to accounts in addition to the requirements set out in this schedule”. (3) (i) “notes to accounts shall enclose information in adding together to that accessible in the financial statements and shall make available where required” A) “Narrative descriptions or disaggregation’s of matter recognized in those statements” and B) “Information about objects that do not meet the requirements for recognition in those statements”. (ii) “Each and every article on the face of the balance sheet with statement of profit and loss shall be cross-referenced to several associated information in the notes to accounts. In preparing the financial statements including the notes to accounts, a minimum balance shall be maintained among providing excessive detail that may not assist users of financial statements and not providing important information as a result of too much aggregation” (4) (i) “the situation depending upon the overall sale or revenue of the company, the statistics appearing in the financial statements may be rounded off as given below”: —

<table>
<tr>
<td></td>
<td>
<table>
<tr><td>Turnover</td><td>Rounding off</td></tr>
<tr><td>(a) less than one hundred’ crore rupees</td><td>To the nearest hundreds, thousands, lakhs or millions, or decimals thereof</td></tr>
<tr><td>(b) one hundred crore rupees or more</td><td>To the nearest lakhs, millions or crores, or decimals thereof.</td></tr>
<tr><td></td><td></td></tr>
</table>
(ii) Once a unit of dimension is used, it shall be used consistently in the financial statements. (5) Excepting in the situation of the first financial statements laid ahead of the company (after its incorporation) the consequent amounts for without delay preceding reporting period for each and every items shown in the financial statements including notes shall also be given below.

(6) The purpose of this agenda, the stipulations used herein shall be as per the applicable
</td>
</tr>
<tr>
<td>Accounting Standards</td>
<td>Note: This section of schedule ready out the basic requirements for the balance sheet, and statement of profit & loss and their notes. main matter, sub-line matter and sub-totals shall be presented as an adding up or substitution on the features of the financial statements as soon as such presentation is appropriate to an considerate of the company's financial position or financial performance or to supply to industry/sector-specific confession requirements or when required for compliance with the amendments to the companies act or the Accounting Standards.</td>
</tr>
</table>

Format of the Balance Sheet

NAME OF THE COMPANY

Balance Sheet as at

	Notes	Current Year (In Rs.)	Previous Year (In Rs.)
Equity and Liabilities			
Shareholders fund			
Share Capital	1		
Reserves & surplus	2		

Money received against warrants			
Share application money pending allotment			
Non-current liabilities			
Long term borrowings	3		
Deferred tax liabilities (net)	4		
Other long term liabilities	5		
Long term provisions	6		
Current liabilities			
Short term borrowings	7		
Trade payables	8		
Other current liabilities	9		
Short term provisions	10		
Total			
Assets			
Non-current assets			
Fixed assets	11		
Tangible assets			
Intangible assets			
Capital work-in-progress			
Intangible assets under development			
Non-current investments	12		
Deferred tax assets (net)			
Long term loans & advances	13		
Other non-current assets	14		
Current assets			
Current investments	15		
Inventories	16		
Trade receivables	17		
Cash and cash equivalents	18		
Short term loans & advances	19		
Other current assets	20		
Total			

General instructions for Preparation of Balance Sheet

	Particulars		
1.	**When an asset shall be classified as current?**	If it satisfies any of the given criteria	(a) it is expected to be realised, or is intended for sale or consumption, in the company's normal operating cycle; or (b) it is held primarily for the purpose of being traded; or (c) it is expected to be realised within twelve months after the reporting date; or (d) it is cash or cash equivalent unless it is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting date.
2.	**When an asset shall be classified as non-current ?**		Asset other than current asset shall be classified as non-current
	Operating cycle	Time between the acquisition of assets for processing and Their realisation in cash or cash equivalents	Where the normal operating cycle cannot be identified: it is assumed to have a duration of 12 months
	When liability shall be classified as current?	If it satisfies any of the given criteria	(a) it is expected to be settled in the company normal operating cycle; or (b) it is held primarily for the purpose

			of being traded; or (c) it is due to be settled within twelve months after the reporting date; or (d)the company does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting cm terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments that do not affect its classification.
	When a liability shall be classified as non-current?		Liability other than current liability shall be classified as non-current.
	When receivable shall be classified as a “trade receivable”?	If it is in respect of the amount due on account of goods sold or services rendered	In the normal course of business
	When payable shall be classified as a “trade payable”?	If it is in respect of the amount due on account of goods purchased or services received	In the normal course of business

1	**Share capital**	**For each class of share capital (different classes of preference shares to be treated separately)**	A. The number and amount of shares authorized. B. The number of shares issued, subscribed and fully paid, and subscribed

			but not fully paid. C. Par value per share. D. A reconciliation of the number of shares outstanding at the beginning and at the end of the reporting period. E. The rights, preferences and restrictions attaching to each class of shares including restrictions on the distribution of dividends and the repayment of capital. F. Shares in respect of each class in the company held by its holding company or its ultimate holding company including shares held by or by subsidiaries or associates of the holding company or the ultimate holding company in aggregate. G. Shares in the company held by each shareholder holding more than 5 per cent, shares specifying the number of shares held. H. Shares reserved for issue under options and contracts/commitments for the sale of shares/disinvestment, including the terms and amounts. I. For the period of five years immediately preceding the date at which the balance sheet is prepared. I. Aggregate number and class of shares allotted as fully paid-up pursuant to contract(s) without payment being received in cash. Ii. Aggregate number and class of shares allotted as fully paid-up by way of bonus

			shares. Iii. Aggregate number and class of shares bought back. J. Terms of any securities convertible into equity/preference shares issued along with the earliest date of conversion in descending order starting from the farthest such date. K. Calls unpaid (showing aggregate value of calls unpaid by directors and officers). L. Forfeited shares (amount originally paid-up).
2	**Reserves and surplus**	**Shall be classified as**	1) capital reserves; 2) capital redemption reserve; 3) securities premium reserve; 4) debenture redemption reserve; 5) revaluation reserve; 6) share options outstanding account; 7) other reserves(specify the nature and purpose of each reserve and the amount in respect thereof); 8) surplus i.e., balance in statement of profit and loss disclosing allocations and appropriations such as dividend, bonus snares and transfer to/from reserves, etc.; (additions and deductions since last balance sheet to be shown under each of the

			specified heads);
		Reserve specifically represented	By earmarked investments shall be termed as a "fund".
		Debit balance of statement of profit and loss	Shall be shown as a negative figure under the head "surplus". Similarly, the balance of "reserves and surplus", after adjusting the negative balance of surplus, if any, shall be shown under the heading "reserves and surplus" even if the resulting figure is in the negative.
3.	**Long-term borrowings**	**Shall be classified as**	1) bonds/debentures; 2) term loans: (i) From banks. (ii) from other parties 3) deferred payment liabilities; 4) deposits; 5) loans and advances from related parties; 6) long term maturities of finance lease obligations; 7) other loans and advances (specify nature)
		Shall be further sub-classified as	**Secured and unsecured** (nature of security shall be specified separately in each case)
		Where loans have been guaranteed by directors or others	The aggregate amount of such loans under each head shall be disclosed.

		Bonds/debentures (along with the rate of interest and particulars of redemption or conversion, as the case maybe)	Shall be stated in descending order of maturity or conversion, starting from farthest redemption or conversion date, as the case may be. Where bonds/debentures are redeemable by instalments, the date of maturity for this purpose must be reckoned as the date on which the first instalment becomes due.
		Particulars of any redeemed bonds/debentures	Which the company has power to reissue shall be disclosed
		Shall state	Terms of repayment of term loans and other loans
		Shall specify	Period and amount of continuing default as on the balance sheet date in repayment of loans and interest(separately in each case)
4.	**Other long-term liabilities**	**Shall be classified as**	(1) trade payables; (2) others.
5.	**Long-term provisions**	**Shall be classified as**	1) provision for employee benefits; 2) others (specify nature).
6.	**Short-term borrowings**	**Shall be classified as**	1) loans repayable on demand; (i) from banks. (ii) from other parties. (2) loans and advances from related parties; (3) deposits;

			(4) other loans and advances (specify nature).
		Borrowings shall further be sub-classified as	Secured and unsecured(nature of security shall be specified separately in each case)
		Where loans have been guaranteed by directors or others	The aggregate amount of such loans under each head shall be disclosed.
		Shall specify	Period and amount of continuing default as on the balance sheet date in repayment of loans and interest (separately in each case)
7.	**Other current liabilities**	**Shall be classified as**	1) current maturities of long-term debt; 2) current maturities of finance lease obligations; 3) interest accrued but not due on borrowings; 4) interest accrued and due on borrowings; 5) income received in advance; 6) unpaid dividends; 7) application money received for allotment of securities and due for refund and interest accrued thereon. Share application money includes advances towards allotment of share capital. The terms and conditions including the number of shares proposed to be issued, the amount of premium, if any, and the period before which shares shall be allotted shall be disclosed. It shall also be disclosed whether the company has

			sufficient authorised capital to cover the share capital amount resulting from allotment of shares out of such share application money. Further, the period for which the share application money has been pending beyond the period for allotment as mentioned in the document inviting application for shares along with the reason for such share application money being pending shall be disclosed. Share application money not exceeding the issued capital and to the extent not refundable shall be shown under the head equity and share application money to the extent refundable, i.e., the amount in excess of subscription or in case the requirements of minimum subscription are not met, shall be separately shown under "other current liabilities"; 8) unpaid matured deposits and interest accrued thereon; 9) unpaid matured debentures and interest accrued thereon; 10) other payables (specify nature).
8	**Short-term provisions**	**Shall be classified as**	1) provision for employee benefits 2) others (specify nature).
9.	**Tangible assets**	**Classification shall be given as**	1) land; 2) buildings; 3) plant and equipment; 4) furniture and fixtures;

			5) vehicles; 6) office equipment; 7) others (specify nature).
		Under lease shall be separately specified	Under each class of asset
		A reconciliation of the gross and net carrying amounts of each class of assets at the beginning and end of the reporting period	Showing additions, disposals, acquisitions through business combinations and other adjustments and the related depreciation and impairment losses/reversals shall be disclosed separately.
		Where sums have been written-off on a reduction of capital or revaluation of assets or where sums have been added on revaluation of assets, every balance sheet subsequent to date of such write-off, or addition	Shall show the reduced or increased figures as applicable and shall by way of a note also show the amount of the reduction or increase as applicable together with the date thereof for the first five years subsequent to the date of such reduction or increase.
10	**Intangible assets**	**Classification shall be given as**	1) goodwill; 2) brands /trademarks; 3) computer software; 4) mastheads and publishing titles; 5) mining rights;

			6) copyrights, and patents and other intellectual property rights, services and operating rights; 7) recipes, formulae, models, designs and prototypes; 8) licences and franchise; 9) others (specify nature).
		A reconciliation of the gross and net carrying amounts of each class of assets at the beginning and end of the reporting period	Showing additions, disposals, acquisitions through business combinations and other adjustments and the related depreciation and impairment losses/reversals shall be disclosed separately.
		Where sums have been written-off on a reduction of capital or revaluation of assets or where sums have been added on revaluation of assets, every balance sheet subsequent to date of such write-off, or addition	Shall show the reduced or increased figures as applicable and shall by way of a note also show the amount of the reduction or increase as applicable together with the date thereof for the first five years subsequent to the date of such reduction or increase.
11.	**Non-current investments**	**Shall be classified as trade investments and other investments and further classified as**	1) investment property; 2) investments in equity instruments; 3) investments in preference shares; 4) investments in government or trust

			securities; 5) investments in debentures or bonds; 6) investments in mutual funds; 7) investments in partnership firms; 8) other non-current investments (specify nature). Under each classification, details shall be given of names of the bodies corporate indicating separately whether such bodies are (i) subsidiaries, (ii) associates, (iii) joint ventures, or (iv) controlled special purpose entities in whom investments have been made and the nature and extent of the investment so made in each such body corporate (showing separately investments which are partly-paid). In regard to investments in the capital of partnership firms, the names of the firms (with the names of all their partners, total capital and the shares of each partner) shall be given.
		Investments carried at other than at cost	Should be separately stated specifying the basis for valuation thereof;
		The following shall also be disclosed	1) aggregate amount of quoted investments and market value thereof; 2) aggregate amount of unquoted investments;

			3) aggregate provision for diminution in value of investments.
12.	**Long-term loans and advances**	**Loans and advances shall be classified as:**	1) capital advances; 2) security deposits; 3) loans and advances to related parties (giving details thereof); 4) other loans and advances (specify nature).
		The above shall also be separately sub-classified as:	1) secured, considered good; 2) unsecured, considered good; 3) doubtful.
		Allowance for bad and doubtful loans and advances	Shall be disclosed under the relevant heads separately.
		Loans and advances due by directors or other officers of the company or any of them either severally or jointly with any other persons or amounts due by firms or private companies respectively in which any director is a partner or a director or a member	Should be separately stated.
13.	**Other non-current assets**	**Shall be classified as**	1) long-term trade receivables (including trade receivables on deferred credit terms);

			2) others (specify nature); 3) long term trade receivables, shall be sub-classified as:
			(i) secured, considered good; (ii) unsecured, considered good; (iii) doubtful Allowance for bad and doubtful debts shall be disclosed under the relevant heads separately. Debts due by directors or other officers of the company or any of them either severally or jointly with any other person or debts due by firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.
14.	**Current investments**	**Shall be classified as**	1) investments in equity instruments; 2) investment in preference shares; 3) investments in government or trust securities: 4) investments in debentures or bonds; 5) investments in mutual funds; 6) investments in partnership firms; 7) other investments (specify nature).
		Under each classification	Details shall be given of names of the bodies corporate indicating separately whether such

			bodies are: (i) subsidiaries, (ii) associates, (iii) joint ventures, or (iv) controlled special purpose entities in whom investments have been made and the nature and extent of the investment so made in each such body corporate (showing separately investments which are partly paid). In regard to investments in the capital of partnership firms, the names of the firms (with the names of all their partners, total capital and the shares of each partner) shall be given.
		Following shall also be disclosed:	1) the basis of valuation of individual investments 2) aggregate amount of quoted investments and market value thereof; 3) aggregate amount of unquoted investments; 4) aggregate provision made for diminution in value of investments
15.	**Inventories**	**Inventories shall be classified as:**	1) raw materials; 2) work-in-progress; 3) finished goods; 4) stock-in-trade (in respect of goods acquired for trading);

			5) stores and spares; 6) loose tools; 7) others (specify nature)
		Goods-in-transit	Shall be disclosed under the relevant sub-head of inventories
		Mode of valuation	Shall be stated
16.	**Trade receivables**	**Shall separately state shall be sub-classified as**	Aggregate amount of trade receivables outstanding for a period exceeding six months from the date they are due for payment
			1) secured, considered good; 2) unsecured, considered good; 3) doubtful. Allowance for bad and doubtful debts shall be disclosed under the relevant heads separately. Debts due by directors or other officers of the company or any of them either severally or jointly with any other person or debts due by firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.
17.	**Cash and cash equivalents**	**Shall be classified as**	1) balances with banks; 2) cheques, drafts on hand;

			3) cash on hand; 4) others (specify nature)
		Earmarked balances with banks (for example, for unpaid dividend)	Shall be separately stated
		Balances with banks to the extent held as margin money or security against the borrowings, guarantees, other commitments	Shall be disclosed separately.
		Repatriation restrictions, if any, in respect of cash and bank balances	Shall be disclosed separately.
		Bank deposits with more than twelve months maturity	Shall be disclosed separately.
18.	**Short-term loans and advances**	**Shall be classified as:**	1) loans and advances to related parties (giving details thereof); 2) others (specify nature).
		Above shall also be sub-classified as	1) secured, considered good; 2) unsecured, considered good; 3) doubtful.
		Allowance for bad and doubtful loans and	Shall be disclosed under the relevant heads separately

		advances	
		Loans and advances due by directors or other officers of the company or any of them either severally or jointly with any other person or amounts due by firms or private companies respectively in which any director is a partner or a director or a member	Shall be separately stated
19.	**Other current assets (specify nature)**	**An all-inclusive heading**	Which incorporates current assets that do not fit into any other asset categories
20.	**Contingent liabilities (to the extent not**	**Shall be classified as**	1) claims against the company not acknowledged as debt;
	Provided for) commitments (to the extent not provided for)	**Shall be classified as**	2) guarantees; 3) other money for which the company is contingently liable. 1) estimated amount of contracts remaining to be executed on capital account and not provided for; 2) uncalled liability on shares and other investments partly paid; 3) other commitments (specify nature).

Unit 15

Balance Sheet as per Companies Act, 2013

Learning Objective:

After studying the unit, students will be able to:

1. Know what Financial Statements as Per the Companies Act, 2013 means.
2. Understand how Part 1- Format of Balance Sheet is prepared
3. Describe the components of the income statement and alternative presentation formats of that statement;
4. Understand how Part 2- Format of Statement of Profit or Loss is prepared

Structure

15.1 Part 2- Format of Statement of Profit or Loss

15.2 Schedules Forming a Part of Balance Sheet & Profit & Loss Account

15.3 Summary

15.4 Self-Assessment Questions

15.5 References

15.1 Part 2- Format of Statement of Profit or Loss

	Notes	**Current year**	**Previous year**
		(in rs.)	**(in rs.)**
<u>Continuing operations</u>			
-			
Revenue	**2**		
Revenue from operations			
Less : excise duty			
Revenue from operations (net)	**21**		

Other income	**22**		
Total revenue			
Expenses			
Cost of materials consumed	**23**		
Purchases of stock-in-trade	**24**		
(increase)/decrease in inventories of fg/wip/stock-in-trade	**25**		
Employee benefit expenses	**26**		
Finance cost	**27**		
Depreciation & amortisation expenses	**28**		
Other expenses	**29**		
Total expenses			
Profit before exceptional and extraordinary items & tax			
Exceptional income / expenses			
Profit before extraordinary items & tax			
Prior period items			
Extraordinary items			
Profit before tax			
Provision for taxation	**30**		

Profit/(loss) for the period from continuing operations			
Discontinuing operations	**-**		
-	**-**		
Profit/(loss) from discontinuing operations			
Tax expense of discontinuing operations			
Profit/(loss) from discontinuing operations after tax			
Profit/(loss) for the period			
Earnings per share	**3**		
Basic eps (in rs.)			
Diluted eps (in rs.)			

Details to be disclosed in the notes

a. Amount of "Revenue from operations" will be divided in –

i. Sale of products (including excise duty)

ii. Sale of services

iii. Other operating revenues

b. Finance cost will be distributed in –

i. Interest

ii. Dividend on redeemable preference shares

iii. Exchange Differences regarded as an adjustment to borrowing costs, and

iv. Other borrowing costs (if any)

c. Other Income will be distributed in –

i. Interest Income,

ii. Dividend Income, and

iii. Other non-operating income

d. Other Comprehensive Income shall be classified into –

i. Items that will not be reclassified to profit or loss

1. Changes in revaluation surplus

2. Remeasurements of the defined benefit plans

3. Equity Instruments through Other Comprehensive Income

4. Fair value changes relating to own credit risk of financial liabilities designated at fair value through profit or loss

5.Share of Other Comprehensive Income in Associates and Joint Ventures, to the extent not to be classified into profit or loss, and

6. Others

ii. Items that will be reclassified to profit or loss

1. Exchange differences in translating the financial statements of a foreign operation;

2. Debt instruments through Other Comprehensive Income;

3. The effective portion of gains and loss on hedging instruments in a cash flow hedge;

4. Share of other comprehensive income in Associates and Joint Ventures, to the extent to be classified into profit or loss; and

5. Others

e. Employees benefit expense

i. Salaries and wages,

ii. Contribution to provident and other funds,

iii. Share-based payments to employees

iv. staff welfare expenses

f. Depreciation and amortisation expense,

g. Interest Income,

h. Interest Expense,

i. Dividend Income,

j. Net gain or loss on sale of investments,

k. Net gain or loss on foreign currency transaction and translation (other than considered as finance cost),

l. Payment to the auditor as

i. Auditor

ii. For taxation matters

iii. For company law matters

iv. For other services

v. For reimbursement of expenses

m. Amount of expenses incurred on corporate social responsibility activities,

n. Details of items of exceptional nature

o. Any other expense or income which exceeds higher of Rs. 10,00,000 or 1% of revenue from operations.

15.2 Schedules Forming a Part of Balance Sheet & Profit & Loss Account

Particulars	Current Year	Previous Year
1. SHARE CAPITAL		
Authorised Share Capital :		
--- Equity Shares of Rs.—each		
Issued Subscribed and Paid Up Capital :		
--- Equity Shares of Rs.—each		
Less: Calls unpaid by Directors & Officers		
Less: Calls unpaid by Others		
Less: Shares Forfeited :		
Add: Forfeited Shares Reissued		
Total		
2. RESERVES & SURPLUS		
Capital Surplus		
As per last Balance Sheet		
Add : Additions during the year		
Less : Transfer / Adjustment during the year		
Profit & Loss Account		
As per last Balance Sheet		
Add : Transfer from General Reserves		
Add : Transfer from Capital Reserves		
Add : Transfer from Special Sources		
Add : Transfer from Other Reserves		

Add : Other Additions		
Less : Transfer to General Reserves		
Less : Transfer to Statutory Reserves		
Less : Transfer to Capital Reserves		
Less : Transfer to Capital Redemption Reserves		
Less : Transfer to Debenture Redemption Reserves		
Less : Transfer to Other Reserves		
Less : Appropriation for Interim Dividend		
Less : Appropriation for Final Dividend		
Less : Appropriation for Preference Dividend		
Less : Appropriation for Special Dividend		
Less : Appropriation for Dividend Distribution Tax on Equity Dividend		
Less : Appropriation for Dividend Distribution Tax on Preference Dividend		
Less : Other Deductions(Misc/Preliminary Exps not w/off)		
Surplus / (Deficit) during the year		
Total		
3. LONG TERM BORROWINGS		
Secured		
Bonds		
Debentures		
Loans from Banks		
Loans from Financial Institutions		
Loans from related parties		
Loans from Other		

Secured Deposits		
Loan from Subsidiaries		
Loan from Directors		
Loan from Managers		
Loan taken for Fixed Assets		
Hire Purchase Installment Payable		
Other Secured Borrowings		
<u>**Unsecured**</u>		
Bonds		
Debentures		
Loans from Banks		
Loans from Financial Institutions		
Loans from related parties		
Loans from Other		
Unsecured Deposits		
Loan from Subsidiaries		
Loan from Directors		
Loan from Managers		
Loan taken for Fixed Assets		
Hire Purchase Installment Payable		
Other Secured Borrowings		
Total		
4. DEFERRED TAX ASSET / LIABILITIES		
Deferred Tax Liabilities		

Branch Profit Tax		
Others		
Deferred Tax Assets		
Fixed Assets		
Others		
Total		
5. OTHER LONG TERM LIABILITIES		
Trade Payables		
Other Long Term Liabilities		
Total		
6. LONG TERM PROVISIONS		
Provision for Employee Related Liabilities		
Employee Health Insurance		
Other Long Term Provisions		
Others		
Total		
7. SHORT TERM BORROWINGS		
Secured		
Bonds		
Debentures		

Loans from Banks		
Loans from Financial Institutions		
Loans from related parties		
Loans from Other		
Secured Deposits		
Loan from Subsidiaries		
Loan from Directors		
Loan from Managers		
Loan taken for Fixed Assets		
Hire Purchase Installment Payable		
Other Secured Borrowings		
Unsecured		
Bonds		
Debentures		
Loans from Banks		
Loans from Financial Institutions		
Loans from related parties		
Loans from Other		
Unsecured Deposits		
Loan from Subsidiaries		
Loan from Directors		
Loan from Managers		
Loan taken for Fixed Assets		
Hire Purchase Installment Payable		
Other Secured Borrowings		
Total		

8. TRADE PAYABLES		
Creditors for Materials		
Creditors for Expenses		
Other Creditors		
Total		
9. OTHER CURRENT LIABILITIES		
Current Maturity of Long Term Debt		
Current Maturity of Finance Lease Obligation		
Interest Accrued but not Due		
Interest Accrued and Due		
Advances Received		
Unclaimed / Unpaid Amounts		
Share Application Money Refundable		
Other Payables		
Total		
10. SHORT TERM PROVISIONS		
Provision for Employee Related Liabilities		
Provision for Employees		
Provision for Dividend		
Provision for Dividend Distribution Tax		
Provision for Statutory Liabilities		

Other Short Term Provisions		
Total		
11. FIXED ASSETS		
<u>Tangible</u>		
Land & Building		
Add: Additions		
Less: Deductions		
Less: Depreciation		
Plant & Machinery		
Add: Additions		
Less: Deductions		
Less: Depreciation		
Furniture		
Add: Additions		
Less: Deductions		
Less: Depreciation		
Other Assets, etc		
Add: Additions		
Less: Deductions		
Less: Depreciation		
Intangible Assets		

Goodwill		
Brands / Trademarks		
Computer Software		
Mastheads and publishing titles		
Copyrights		
Patents		
Other intellectual property rights,		
Services & operating rights		
Less: Amortization		
Total Assets		
12. NON CURRENT INVESTMENTS		
A. Quoted Investments		
1. Trade Investments		
In Government Securities of Local Authorities		
In Debt Securities		
In Equity Securities		
In Preference Securities		
Other Investments		
2. Non-Trade Investments		
In Government Securities of Local Authorities		
In Debt Securities		
In Equity Securities		
In Preference Securities		
Other Investments		

3. Other Investments		
Investments in Associates		
Investments in Joint Venture		
Investments in Subsidiaries		
Investments in Controlled Special Purpose Entities		
B. Unquoted Investments		
1. Trade Investments		
In Government Securities of Local Authorities		
In Debt Securities		
In Equity Securities		
In Preference Securities		
In Mutual Funds		
In Property		
Other Investments		
2. Non-Trade Investments		
In Government Securities of Local Authorities		
In Debt Securities		
In Equity Securities		
In Preference Securities		
In Mutual Funds		
In Property		
Other Investments		
3. Other Investments		

Investments in Associates		
Investments in Joint Venture		
Investments in Subsidiaries		
Investments in Controlled Special Purpose Entities		
Investment in Capital of Partnership Firm		
Less : Provision for Diminution in Non-current Investments		
Total		
13. LONG TERM LOANS & ADVANCES		
Capital Advances		
Inter-Corporate Deposits		
Deposit with Statutory Authorities		
Other Security Deposits		
Given to Subsidiaries		
Given to Associates		
Given to Directors		
Given to Other Related Parties		
Given to Suppliers		
Given to Employees		
Other Long Term Loans & Advances		
Total		
14. OTHER NON-CURRENT ASSETS		
Long Term Trade Receivables		
Other Non-Current Assets		

Total		
15. CURRENT INVESTMENTS		
A. Quoted Investments		
1. Trade Investments		
In Government Securities of Local Authorities		
In Debt Securities		
In Equity Securities		
In Preference Securities		
Other Investments		
2. Non-Trade Investments		
In Government Securities of Local Authorities		
In Debt Securities		
In Equity Securities		
In Preference Securities		
Other Investments		
3. Other Investments		
Investments in Associates		
Investments in Joint Venture		
Investments in Subsidiaries		
Investments in Controlled Special Purpose Entities		
B. Unquoted Investments		
1. Trade Investments		
In Government Securities of Local Authorities		

In Debt Securities		
In Equity Securities		
In Preference Securities		
In Mutual Funds		
In Property		
Other Investments		
<u>2. Non-Trade Investments</u>		
In Government Securities of Local Authorities		
In Debt Securities		
In Equity Securities		
In Preference Securities		
In Mutual Funds		
In Property		
Other Investments		
<u>3. Other Investments</u>		
Investments in Associates		
Investments in Joint Venture		
Investments in Subsidiaries		
Investments in Controlled Special Purpose Entities		
Investment in Capital of Partnership Firm		
Less : Provision for Diminution in Non-current Investments		
Total		

16. INVENTORIES		
Raw materials		
Work in progress		
Finished goods		
Stock in trade (in respect of goods acquired for trading)		
Stores & Spares		
Loose Tools		
Others (Specify)		
Consumables		
Packing materials		
Total		
17. TRADE RECEIVABLES		
Secured - Considered Good		
Outstanding for more than six months		
Others		
Unsecured - Considered Good		
Outstanding for more than six months		
Others		
Unsecured - Considered Doubtful		
Outstanding for more than six months		
Others		
Other Trade Receivables		

Less : Provision for Doubtful Debts		
Total		
18. Cash & Cash Equivalents		
Cash in Hand		
Balance at Banks		
Total		
19. SHORT TERM LOANS & ADVANCES		
Given to Subsidiaries		
Given to Associates		
Given to Directors		
Given to Other Related Parties		
Given to Suppliers		
Given to Employees		
Other Long Term Loans & Advances		
Total		
20. OTHER CURRENT ASSETS		
Interest Accrued on Investments		
Unbilled Revenue		
Payment of Taxes		
Dividend Receivable		
Recoverable from government agencies		
Export Incentives Receivables		
Interest Income Accrued but Not Due		
Assets Held up Disposal		
Derivative Assets		

Prepaid Expenses		
Notes Receivable		
Claims Recoverable		
Other Receivables		
Total		
21. REVENUE FROM OPERATIONS		
Revenue from Sale of Products		
Export Sales		
Domestic Sales		
Revenue from Sale of Services		
Revenue from Contract		
Works Contract		
Revenue from Intangible Assets		
Patents Charges		
Revenue from Other Operations		
Other Income		
Total		
Less : Service Tax Collected		
Less : Other Duties & Taxes Collected		
Less : Inter Division Transfer		
Less : Brokerage Discounts & Rebates		
Less : Sales Return		
Less : Other Allowances & Deductions against Sales		
Total		

22. OTHER INCOME		
Rent Receipt		
Commission		
Dividend Income		
Interest Income		
Profit on sale of fixed assets		
Profit on sale of investment being securities chargeable to Securities Transaction Tax (STT)		
Profit on sale of other investment		
Profit on account of currency fluctuation		
Agriculture income		
Net gain / (loss) on sale of investment		
Other non operating income		
Other Income		
Total		
23. COST OF MATERIALS CONSUMED		
Raw Materials, Packing Materials, Stores & Spares		
Opening Stock		
Add: Purchases		
Add: Incidental Expenses on purchase		
Less: Purchase Returns		
Less: Closing Stock		
Total		

24. PURCHASE OF STOCK IN TRADE		
Traded Goods		
Finished Goods		
Total		
25. (INCREASE)/ DECREASE IN INVENTORIES		
Traded Goods		
Opening Stock		
Less: Closing Stock		
Finished Goods		
Opening Stock		
Less: Closing Stock		
Work in Progress		
Opening Stock		
Less: Closing Stock		
Total		
26. EMPLOYEE BENEFIT EXPENSES		
Salaries & Wages		
Overtime Wages		
Bonus		

Director's Remuneration		
Managerial Remuneration		
Reimbursement of Medical Exp		
Leave Encashment		
Leave Travel Benefits		
Contribution to approved Superannuation fund		
Contribution to recognized Provident fund		
Contribution to recognized Gratuity fund		
Contribution to any other fund/ESI		
Any other benefit to employees in respect of which expenditure has been incurred.		
Gratuity		
Performance Pay		
Profit Share		
Total		
27. FINANCE COSTS		
Interest Expenses		
Other borrowing cost		
Net Loss / (Gain) on foreign currency transaction		
Forward cancellation		
Bank charges/Bank Guarantee Charges		
Total		
28. DEPRECIATION & AMORTISATION EXPENSE		
Depreciation Expense		

Amortization Expense		
Total		
29. OTHER EXPENSES		
Manufacturing & Service Cost		
Transportation charges/Freight		
Consumption of stores and spare parts:		
Oil		
Packing Materials		
Stores		
Other consumables		
Tools, Jigs & fixtures		
Power and fuel. (Electricity/Generator Exp)		
Repairs to buildings.		
Repairs to machinery		
Research & Development Expenditure		
Installation S/W		
Payment to Auditors		
As auditors - statutory audit		
For taxation matters		
For company law matters		
For management services		
For other services		
Reimbursement of expenses		
Selling/Marketing Expenses		
Sales promotion including publicity (other than advertisement)		
Advertisement		

Commission Paid		
Other Expenses		
Duties and taxes in respect of goods and services purchased		
Custom duty		
Countervailing duty		
Special additional duty		
Union excise duty		
Service tax		
VAT/ Sales tax		
Any other tax		
Rents		
Insurance		
Medical Insurance		
Life Insurance		
Key-man Insurance		
Other Insurance including factory, office, car, goods, etc		
Workmen and staff welfare expenses		
Entertainment		
Hospitality		
Conference		
Hotel, Boarding and Lodging		
Travelling expenses including foreign travelling		
Conveyance Expenses		
Telephone Expenses		
Guest House Expenses		
Club expenses		
Festival celebration expenses		

Scholarships		
Gift		
Donation		
Rates and taxes, paid or payable to Government or any local body (excluding taxes on income)		
Union Excise Duty		
Service Tax		
VAT/Sales Tax		
Cess		
Any other rate, tax, duty or cess		
Other Expenses		
Bad debts		
Provision for bad & doubtful debts		
Other Provisions		
30. PROVISION FOR TAX		
Tax Expense		
Deferred Tax expense		
Total		

15.3 Summary

- The financial performance of a company for a specific accounting period is reported by the Income statement, along with a balance sheet and cash flow statement.
- It focuses on a company's profits, and losses, revenues and expenses for a specific accounting period.
- The statement also provides significant insight into a company's operations, operational efficiency, underperforming sectors, and performance in camparision to peers.

- Financial statements in five different areas are used for financial reporting. The documents used to prepare financial statements of the company are called accounting records.
- In order to facilitate review of a company's accounts regulatory bodies may require companies to keep accounting records for numerous years.
- Different types of accounting records are transactions, general ledgers, trial balances, journals, and financial statements.
- The income and expenses of the enterprise and profitability of a business organization for a specified period of time in the income statement reports of a company.
- The Balance Sheet statement includes Assets, Liabilities and capital (including amounts) of the enterprise organization at a specified period of time, which proves the accounting equation.

15.4 Self-Assessment Questions

1. Which Income Statement is prepared under the Companies Act 2013?
2. What is Section 134 of the Companies Act 2013?
3. Pursuant to Schedule III of Part I of the Companies Act 2013, list the items appearing under the heading "Current Liabilities".
4. What are the four key elements of an income statement?
5. What is the difference between operating revenue and non-operating revenue?
6. What Insights to Watch on the Income Statement?
7. Pursuant to Schedule III, Part 1 of the Companies Act 2013, which main subheading would place the following items on a company's balance sheet?
    a. Accrued income;
    b. Tool looseness;
    c. Welfare provisions;
    d. Accrued dividends;
    e. Short-term borrowings
    f. Long-term borrowing
8. In accordance with Schedule III of Part I of the Companies Act 2013, which subheading would place the following items on a company's balance sheet?
    a. Capital reserve
    b. Corporate bonds

c. Demand borrowings;
d. Vehicles
e. Goodwill;
f. Loose tools

9. Pursuant to Schedule III Part I of the Corporations Act 2013, the principal heading state where the following items appear on the company's balance sheet:
    a. Long-term borrowings
    b. Trade payables
    c. Tax provision
    d. Securities reserve
    e. Patents
    f. Accrued income
10. Pursuant to Schedule III, Part I of the Companies Act, 2013, we list the items that appear under the heading "Current Assets".

15.5 References

1. Basic Financial Accounting for Management- Paresh Shah -Oxford University Press
2. An Introduction to Accounting S N Maheswari and S K Maheswari, Vikas
3. Modern Accountancy Volume-1- A Mukherjee and M Hanif-TMH

Case Study

Mr. Sumit, Director of the Corporate Secretarial Department of Executive Limited, convened a meeting of the members of the Board of Directors on April 25, 2019 and notified them via email and registered on April 17, 2019. After posting, Mr. Ashok, one of the company's directors, contested the validity of the meeting on the following grounds:

(a) Mr Sumit was not authorized to call meetings;
(b) the notice was not sent on company letterhead;
(c) notice is not provided in accordance with legal requirements;
(d) Notices are not intended to inform you of any video conferencing features we offer.

Use this backdrop to answer the following questions.

1. Was Mr Sumit the person authorized to call the meeting? If so, please state why?
2. Is it mandatory to send meeting notices on company letterhead?
3. What are the statutory requirements for service of board notices by email and registered mail? Is the company required to provide video conferencing equipment?

Note:

COVID -19 Impact on Financial Reporting