Chapter - 1 Basics of Financial Accounting

Definition of Accounting

Accounting is a language that is used to communicate and understand the financial ideas, financial expressions, financial thoughts and financial information.

Accounting is a Language

Language is a medium that is used to communicate and understand some ideas, feelings, expressions or information.

Financial information

Any information that is measurable in terms of money and causes a change in financial position of an entity is known as financial information.

Sources of Financial Information

There are three sources of financial information, which are also known as accounting phenomena.

i. Transactions
   Transactions are the outcome of dealings made.
ii. Events
   Events are the outcome of incidents happened.
iii. Conditions
   Conditions are the adjustments in recorded information.

Transaction (source of financial information)

Transaction occurs when two persons deal with each other Monetary and Non-Monetary events

Monetary Event

It is an outcome of happening or occurrence of incident that can be measured in terms of money and can cause a change in financial position (financial status) of an entity.

Examples include: Loss by fire, Loss by accident, Foreign exchange (gain/loss)

Condition (source of financial information)

Condition is the third source of financial information. It requires certain adjustments to be made in already recorded transactions and events.

Examples include: • Fixed Assets to be depreciated according to their expected useful life

Money measurement

Money measurement means to assign a value in reporting currency to accounting phenomena.

Financial position

Financial position means; an entity's status of Resources & Sources.

1. Resources are the assets
2. Sources are the means of finances that include liability and owners' equity

Functions of financial accounting (Accounting cycle)

Financial accounting is a subject that is about financial information Financial accounting is used to:

1. Classify,
2. Record,
3. Summarize,
4. Report, and
5. Analyze

So, there are five functions of Financial Accounting.



Classifying

All types of financial information are classified into five main heads:

i. Assets
ii. Liabilities
iii. Incomes
iv. Expenses
v. Owners' Equity.

These main heads are further sub-classified into accounting heads, which are then used for recording accounting transactions in the books of accounts.

Recording

Financial information are recorded in the books of accounts according to the prescribed rules

Summarizing

Recorded financial information is summarized in another book of account. These summaries are prepared for each accounting head that are named as ledger accounts

Reporting

The results of summaries of each accounting head are reported to the users of financial information by preparing financial statements

Analyzing

Finally the facts reported are analyzed for certain decision making purposes

Elements of Financial Statements

Assets:

Assets are the resources in control

Liabilities:

Liabilities are the present obligations

Owners' Equity:

Owners' equity is the source of finance that represents owners' stake

Incomes:

Incomes are earnings

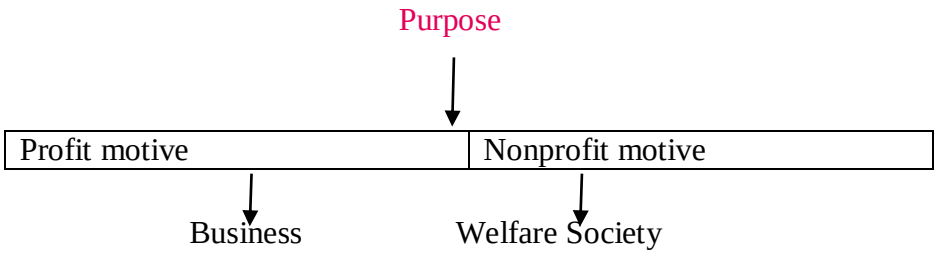
Expenses:

Expenses are the costs that expire

Entity and Separate Entity Concept

Entity

It is an activity that is undertaken by individuals or group of people for some purpose (profit or nonprofit).



It is an economic activity, which is undertaken to earn profits. It is initially financed by owners and all of its risks and rewards also belong to its owners.	It is a welfare organization, which is undertaken by some volunteers and its motive is to help the other beings.

Separate Entity Concept

A business entity and its owner are two different persons. For accounting purposes, business has separate entity/identity apart from its owner.

Users of Financial Information

a) Investor/Shareholders/owners How well the management is performing

b) Trade contacts Suppliers and customers

c) Lenders providers of finance are lenders

d) Taxation authorities assess the tax payable by the entity, including sales taxes etc.

e) Manager and Employees To enable them to manage the business

f) Financial consultants and advisers For their clients

g) Government Interested in the allocation of resources

h) Public Entity may make a substantial contribution to a local economy

Underlying Assumption

Assumption that a business entity will remain in existence for the foreseeable future

Examples include:

- Significant trading losses being incurred for several years
- Deteriorating liquidity position
- High financial risk arising from increased debts level
- Aggressive growth strategy not backed by sufficient finance

Defiance between Asset and Liability

Asset

1. probable inflow of future economic benefits, and
2. Cost or value can be measured reliably.

Liability

1. probable outflow of resources embodying economic benefits will result from the settlement of a present obligation and
2. Amount at which the settlement will take place can be measured reliably.

Defiance between Income and Expense

Income

1. an increase in future economic benefits related to an increase in an asset or a decrease of a liability has arisen, and
2. Amount can be measured reliably.

Expense

1. a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen, and
2. Amount can be measured reliably.

Measurement of the elements of financial statements

There are four measurement attributes for elements of traditional financial statements:

- historical cost,
- Current cost
- Fair Value (realizable value / settlement value)
- Present value (discounted cash flows)

Historical cost is the price paid to acquire an asset or the amount received pursuant to the incurrence of a liability in an actual exchange transaction.

Qualitative characteristics of useful financial information

Fundamental qualitative characteristics

Relevance

According to the framework, qualitative characteristics are the attributes that meet the decision usefulness of financial information. The framework listed these attributes as; relevance, faithful representation, comparability, understandability, verifiability and timeliness.

Materiality (entity specific aspect of relevance)

Materiality is an aspect of relevance which is entity-specific. It means that what is material to one entity may not be material to another. Materiality is affected by the nature and magnitude (or size) of the item. Faithful Representation is the second Fundamental Qualitative Characteristic.

Faithful representation

There are three characteristics of faithful representation:

1. Completeness (adequate or full disclosure of all necessary information),
2. Neutrality (fairness and freedom from bias).
3. Free from error (no inaccuracies and omissions).

Chapter – 2 Recording Financial Information Double Entry Bookkeeping Systems – Accounting Equation

Sources of financial information

As discussed earlier financial information means the information that can be measured in terms of money.

There are three sources of financial information:

1. **Transactions**
2. **Events**
3. **Conditions**

Transactions

A financial transaction is an agreement, or communication, carried out between a buyer and a seller to exchange an asset for payment. It involves a change in the status of the finances of two or more businesses or individuals.

Types of transactions

There are two types of transactions

1. **Cash Transactions**
2. **Credit Transactions**

Cash transaction

A cash transaction refers to a transaction which involves an immediate outflow of cash towards the purchase of any goods, services, or assets. A cash transaction stands in contrast to other modes of payment, such as credit transactions in a business involving bills receivable.

Credit Transactions

Credit transaction means any transaction by the terms of which the repayment of money loaned or loan commitment made, or payment for goods, services, or properties sold or leased, is to be made at a future date or dates.

Identifying Debtors and Creditors

- **Each cash transaction causes an increase or decrease in the cash balance / bank balance**
- **Each credit transaction either creates accounts receivable also known as debtor, or accounts payable also known as creditor.**

Examples: An entity buys goods from supplier without making cash payment.

Debtors (Accounts Receivables) – ASSETS

Customers to whom goods/services are sold on credit terms

Examples include:

- **Goods sold to Yasmin on credit terms. (credit transaction)**
- **Cash received from Yasmin after 1 month of sales. (cash transaction)**

Creditors (Accounts Payable) – LIABILITIES

Suppliers from whom the goods/services are purchased on credit term

Examples:

- **Goods purchased from Maryam.**
- **Paid cash to Maryam After one month of purchase.**

Here, Maryam is accounts payable (creditor) - Liability

Accounting Equation

Basic accounting equation: (Resources = Sources)

(Assets = Owner's Equity + Liabilities)

Initially: (0 = 0)

Subsequently:

a) **increase in left side and also increase in right side (+ = +)**

b) **decrease in both sides (- = -)**

c) **increase and decrease in the same side**

(± = 0) or (0 = ±)

Profit in a Source of finance

Two heads expenses and incomes are missing in the basic equation. These two heads constitute profit for the entity.

Incomes – Expenses = Profit/Loss

Owner's Equity

Resources are financed by

1. **External sources (Owners and Lenders)**
2. **Internal sources (profits)**

Profit = Incomes – Expenses

Profits/Losses are included in Owners' Equity

Owner's Equity = Capital + Profit (– loss) – Drawings

Accounting Equation Worked Example

Transaction 1: Henry started business, Micro Logics, by introducing capital Rs. 45,000 in cash.



Assets							Owner's Equity		Liabilities	
Sr #	Cash	Furniture	Computer	Stock	Debtors	=	Henry Capital	Profit	Bills payable	Creditors
1	45,000						45,000			

Henry is the sole owner of the business; Micro Logics is a sole proprietorship business.

Transaction 2: Micro-Logics purchased furniture by paying cash Rs. 20,000.



Assets							Owner's Equity		Liabilities	
Sr #	Cash	Furniture	Computer	Stock	Debtors	=	Henry's Capital	Profit	Bills payable	Creditors
1.	45,000						45,000			
2.	-20,000	20,000								
	25,000	20,000					45,000			

Transaction 3: Micro Logics purchased a computer for Rs. 28,000 by paying Rs. 8,000 in cash and signing a promissory note agreement with with supplier for Rs. 20,000.



Assets							Owner's Equity		Liabilities	
Sr #	Cash	Furniture	Computer	Stock	Debtors	=	Henry's Capital	Profit	Bills payable	Creditors
1.	45,000						45,000			
2.	-20,000	20,000								
3.	-8,000		28,000						20,000	
	17,000	20,000	28,000				45,000		20,000	

Transaction 4: Micro Logics entered into a transaction of buying stocks/inventory of Rs. 1,350 and agreed to pay the supplier in near future.



Assets							Owner's Equity		Liabilities	
Sr #	Cash	Furniture	Computer	Stock	Debtors	=	Henry's Capital	Profit	Bills payable	Creditors
1.	45,000						45,000			
2.	-20,000	20,000								
3.	-8,000		28,000						20,000	
4.				1,350						1,350
	17,000	20,000	28,000	1,350			45,000		20,000	1,350

Transaction 5: **During its first month of operations, Micro Logics provided services to customers, earning fee of Rs. 7,500 and receiving the amount in cash.**



Assets							Owner's Equity		Liabilities	
Sr #	Cash	Furniture	Computer	Stock	Debtors	=	Henry's Capital	Profit	Bills payable	Creditors
1.	45,000						45,000			
2.	-20,000	20,000								
3.	-8,000		28,000						20,000	
4.				1,350						1,350
5.	7,500							7,500		
	24,500	20,000	28,000	1,350			45,000	7,500	20,000	1,350

Transaction 6: **For Micro Logics, the expenses paid during the month were as follows:**

Wages **Rs. 2,125**
Rent **Rs. 800**
Utilities **Rs. 450**
Miscellaneous **Rs. 275**

Assets							Owner's Equity		Liabilities	
Sr #	Cash	Furniture	Computer	Stock	Debtors	=	Henry's Capital	Profit	Bills payable	Creditors
1.	45,000						45,000			
2.	-20,000	20,000								
3.	-8,000		28,000						20,000	
4.				1,350						1,350
5.	7,500							7,500		
6.	-3,650							-2,125		
								-800		
								-450		
								-275		
	20,850	20,000	28,000	1,350			45,000	3,850	20,000	1,350

Transaction 7: **Micro Logics paid Rs. 950 to its creditors during the month.**





Assets							Owner's Equity		Liabilities	
Sr #	Cash	Furniture	Computer	Stock	Debtors	=	Henry's Capital	Profit	Bills payable	Creditors
1	45,000						45,000			
2	-20,000	20,000								
3	-8,000		28,000						20,000	
4				1,350						1,350
5	7,500							7,500		
6	-3,650							-2,125		
								-800		
								-450		
								-275		
7	-950									-950
	19,900	20,000	28,000	1,350	1,200		45,000	3,850	20,000	400

Transaction 8: **During the month Micro Logics sold out stock costing Rs. 800 for Rs. 1,200 on credit terms, earning a profit of Rs. 400.**



Assets							Owner's Equity		Liabilities	
Sr. #	Cash	Furniture	Computer	Stock	Debtors	=	Henry's Capital	Profit	Bills payable	Creditors
1.	45,000						45,000			
2.	-20,000	20,000								
3.	-8,000		28,000						20,000	
4.				1,350						1,350
5.	7,500							7,500		
6.	-3,650							-2,125		
								-800		
								-450		
								-275		
7.	-950									-950
8.				-800	1,200			400		
	19,900	20,000	28,000	550	1,200		45,000	4,250	20,000	400

Transaction 9: **At the end of month, Henry withdrew Rs. 2,000 cash from the business for personal use.**



Assets							Owner's Equity		Liabilities	
Sr. #	Cash	Furniture	Computer	Stock	Debtors	=	Henry's Capital	Profit	Bills payable	Creditors
1.	45,000						45,000			
2.	-20,000	20,000								
3.	-8,000		28,000						20,000	
4.				1,350						1,350
5.	7,500							7,500		
6.	-3,650							-2,125		
								-800		
								-450		
								-275		
7.	950									-950
8.				-800	1,200			400		
9.	-2,000							-2,000*		
	17,900	20,000	28,000	550	1,200		45,000	2,250	20,000	400

Thank you very much for being attentive

Chapter – 3 Rules of Debit and Credit

Concept of Debit and Credit – (Dr. and Cr.)

Accounting carries unique alphabets these are two in count.

1. **Debit – Debere in Latin – Dr.**
2. **Credit – Credere in Latin – Cr.**

Alphabets of all the languages do not carry any meaning.

Dr. and Cr. are also termed as tools of accounting.

Debit Group

1. Assets
2. Expenses

Credit Group

1. Owner's Equity
2. Liabilities
3. Incomes

Types of Accounts Elements of Financial Statements

While recording financial information we have to identify the correct type of "account" to be recognized as Dr. or Cr.

Conventionally accounts were divided into three types; personal, real, nominal.

1. **Personal Account**
   Accounts which are related to persons or institutions dealing with the entity,
   for example; debtors, creditors or banks

2. **Real account**
   Accounts which are related to properties or possessions related to the entity,
   for example; furniture, buildings, cash.

3. **Nominal Account**
   Accounts which are related to expenses, income, losses and gains of the entity,
   for example; sales, purchases, salary, utility bills etc

Analyzing Dr. & Cr.

Increase (+) in the items of Debit group is brought in through "Dr"

Decrease (-) in the items of Debit group is brought in through "Cr"

Increase (+) in the items of Credit group is brought in through "Cr"

Decrease (-) in the items of Credit group is brought in through "Dr"

Increase in Assets & Expenses Dr.

Decrease in Assets & Expenses Cr.

Increase in Equity, Liabilities & Income Cr.

Decrease in Equity, Liabilities & Income Dr.

Debit	Credit
⇑ Assets	⇓ Assets
⇑ Expenses	⇓ Expenses
⇓ O Equity	⇑ O Equity
⇓ Liabilities	⇑ Liabilities
⇓ Incomes	⇑ Incomes

Approach to recognize Dr. & Cr.

- **Financial impact on accounting equation is translated into accounting language using its alphabets "Dr" & "Cr".**
- **Each transaction causes a change in two accounting heads:**
  - **one is analyzed as Dr.**
  - **Second is analyzed as Cr.**

Main Heads	Assets	Expenses	Owners' Equity	Liabilities	Incomes
Accounting Heads	Land	Purchases	Capital	Bank Loan	Sales
	Building	Salaries	Drawings	Bank Overdraft	Interest
	Machinery	Electric Bill	Profits	Creditors	Commission
	Furniture	Repair		Accounts Payable	
	Motor Van	Advertisement			
	Computer	Commission			
	Stocks	Traveling			
	Debtors	Freight			
	Cash Balance	Rent			
	Bank Balance	Stationery			

Double Entry Bookkeeping

Described in Italy in 1494Each transaction causes increase or decrease in two accounting heads. Increase or decrease caused by a transaction in two accounting heads is recorded in terms of Dr and Cr.

Concept of Voucher and Supporting Documents

Two accounting heads along with their values are recognized on voucher. It is an internal document to witness that the transaction is complete and verified. It is supported by needful documents and authorized by appropriate signatories.

Types of vouchers

- Journal Voucher
- Petty Cash Voucher
- Cash Receipt/Payment Voucher
- Bank Receipt/Payment Voucher
- Gift Voucher

Journal Vouchers

A written authorization prepared for each non-cash financial information, or for every transaction that meets defined requirements.

Petty Cash Receipt Voucher

A statement of spending from petty cash fund for which bill/invoice was not received. Petty cash fund is maintained to provide fast access to small amounts of cash for no routine expenses. Petty cash vouchers are used to maintain financial control of petty cash account, preventing abuse or mismanagement of the funds.

Cash Payment Voucher

A document, which is used as proof that a cash payment transaction has occurred between two parties. In business, a payment voucher can be used for a variety of purposes, sometimes taking the place of cash in a transaction, acting as a receipt, or indicating that an invoice has been approved for payment.

Bank Receipt & Payment Voucher

A bank receipt voucher contains detailed information about transactions involving bank deposits, collection from customers who make payments on account, credit card based sales and other similar types of transactions. Bank payment voucher is a document that is used as a proof of payments made through cheques, pay order, direct debits, standing instructions etc.

Gift Voucher

Gift voucher is used to give rights to the customers for buying goods for free or to avail discount as a special offer.

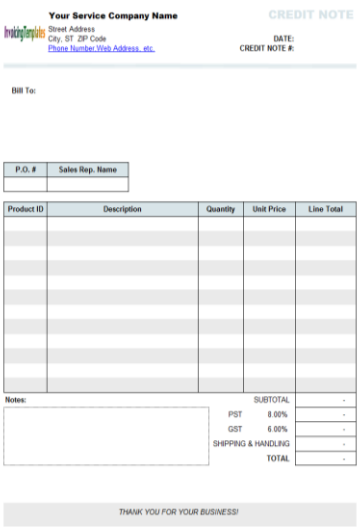
Source Documents

No.	Transaction	Source Documents
1	Sales	Invoice (issued) against sales of goods or services on account
2	Purchases	Invoice (received) against purchases of goods or services on account
3	Sales Return	Credit Note (issued) upon accepting the goods returned by customer
4	Purchases Return	Debit Note (issued) / Credit Note (received) upon returning goods to supplier
5	Cash received	Cash Memo/receipt (issued) upon receiving cash
6	Cash paid	Cash Memo/receipt (received) upon making cash payment
7	Leases (Rental)	Agreements signed by the parties to a lease or any other contract
8	Staff Salaries	Payroll sheet upon transferring salaries and wages to the staff
9	Utility Bills	Metered Bills/Invoices against obtaining economic benefits of the utilities

Invoice

An invoice is a document that is prepared by seller and sent to the buyer, it specifies description and amount of products or services provided by the seller.

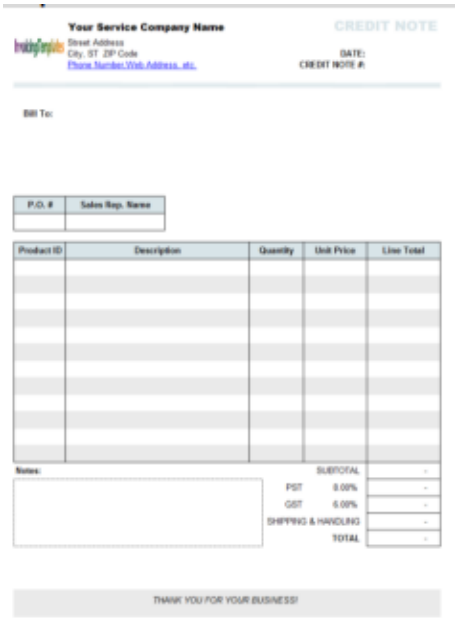
Sample invoice



Credit Note

Credit note is a document that is prepared by a seller and sent to the buyer to correct mistake in the original invoice or to reduce the balance due on the buyer for any other reason including the return of goods by buyer to seller.

Sample credit note

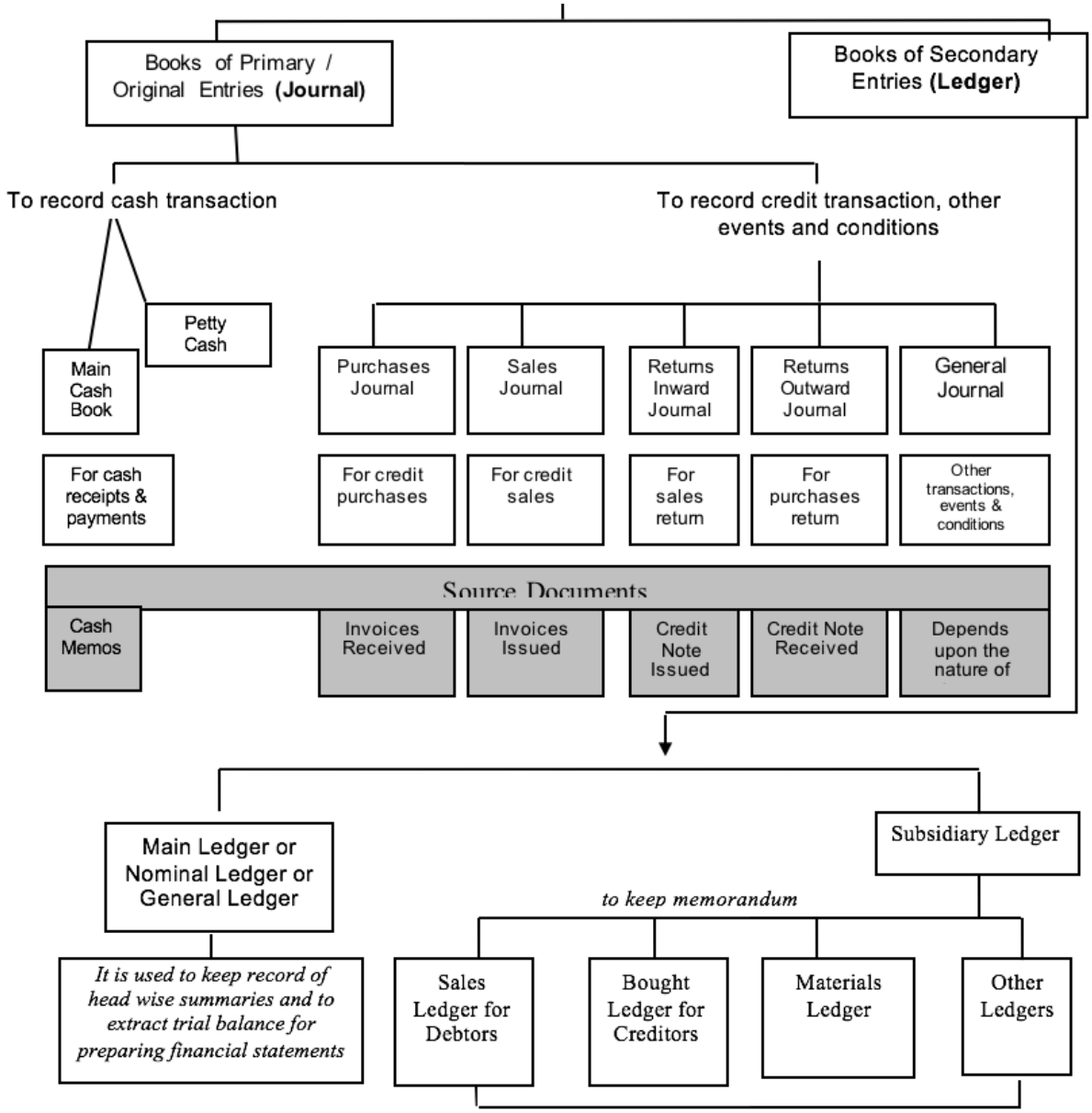


Different Types of Books of Accounts

There are two types of books of accounts:

1. Books of original entries

2. Books of secondary entries



Accounting systems Cash Vs. Accrual

Transactions are recorded only when cash is received or paid.

Example:

During the year 20X9

1. Office rental paid for 15 months at the rate of Rs. 10,000 per month. Rs.150,000 shall be recognized as rent expense for the year 20X9
2. Cleaning agent received Rs.180,000 against office cleaning for 18 months. Rs.180,000 shall be recognized as his income.

Single Entry Vs. Double Entry

- It is a simplest form of **bookkeeping**
- Single effect of each financial information is **entered** in the books of accounts
- It does not require background or training in accounting
- Entities using single entry approach are effectively limited to reporting on a cash basis only

Adequacy of single entry accounting system

Small entities may in fact prefer single-entry accounting over a double-entry system when all or most of the following conditions apply:

Entity uses cash based accounting, not accrual accounting. There are few financial transactions per day. Entity does not sell on its own credit. Customers must pay at the time of the sale. There are very few employees. Entity is privately held or operates as a sole proprietorship or partnership.

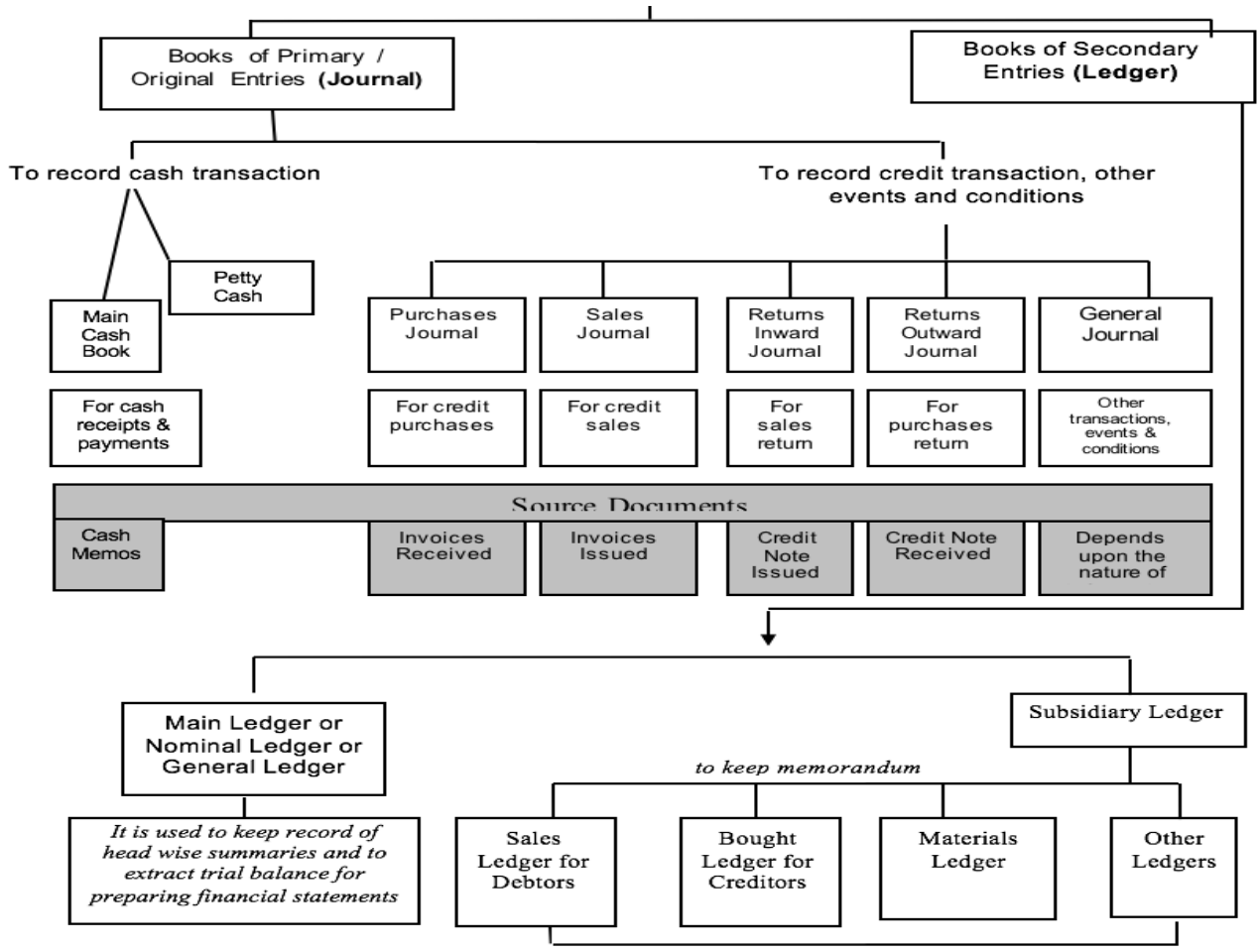
Lecture #4

Journalizing Transactions

Journalizing transactions is **the process of keeping a record of all your business transactions**, tracking them in chronological order, and generally includes the date, the account you're debiting or crediting and a brief description of the transaction that occurred.

Recapitulation – Analyzing Dr & Cr

Main Heads	Nature	Increase	Decrease
Assets	Dr	Dr	Cr
Expenses	Dr	Dr	Cr
Owners' Equity	Cr	Cr	Dr
Liabilities	Cr	Cr	Dr
Incomes	Cr	Cr	Dr



Journal

A general journal is a daybook or subsidiary journal in which transactions relating to adjustment entries, opening stock, depreciation, accounting errors etc. are recorded. The source documents for general journal entries may be journal vouchers, copies of management reports and invoices.

Journal Entry

Information recorded in general journal is known as journal entry or accounting entry or entry.

Parts of a Journal Entry

There are six parts of an entry in accounting language:

1) Date
2) Particulars
3) Post reference
4) Debit amount
5) Credit amount
6) Narration

Sample Transaction

1st Jan 20X9, Cash paid for staff salaries Rs.50,000





1 Date 20X9	2 Particulars/Description		3 Post Ref.	4 Debit (Rs)	5 Credit (Rs)
Jan. 1	Salaries Account	(Debit)	39	50,000	
	Cash Account	(Credit)	10		50,000
	(Staff salaries paid in cash)				

6

Compound Accounting Entry

The single journal entry, which combines multiple journal entries in which same accounting head is repeating

Example – Compound Entry

5 Jan 20X9:
Cash Rs.7,000 was paid for salaries and





Cash Rs.1,000 was paid for purchase of stationery





Date 20X9	Particulars/Description	Post Ref.	Debit (Rs)	Credit (Rs)
Jan. 5	Salaries account Cash account (Salaries paid in cash)	? ?	7,000	7,000
Jan. 5	Stationery account Cash account (Stationery purchased for cash.)	? ?	1,000	1,000

Discounts

A discount should not be confused with the discount rate, which is an interest rate used for computing the time value of money.

Types of discounts a trader often allows its customers two types of discounts

- Trade discount
- Settlement discount

Trade Discount

It is the discount offered by a seller to its customers before entering into transaction with them. Trade discount is always offered based on some policy.

Examples include:

1. Bulk purchase discounts.

Settlement Discount

It is the discount offered by a seller to its customers based on cash settlement terms for early payment of the invoice.

Settlement discount for seller is known as “discount allowed”; and for buyer is known as “discount received”

Subdivision of Journal

Journal is sub-divided because of large size of business.

Subdivision of journal is required because:

- frequent cash transactions
- large number of credit purchases and credit sales are creating numerous Debtors and Creditors

Types of Journal

1. **Sales journal**
2. **Purchase journal**
3. **Sale return journal**
4. **purchase return** journal
5. **Cash book or cash journal or cash register**
6. **General journal**

Sales Journal

A sales journal is a specialized accounting journal and it is also a prime entry book used in an accounting system to keep track of the sales of items that customers have purchased on account by charging a receivable on the debit side of an accounts receivable account and crediting revenue on the credit side.

Purchase journal

A purchase journal is a specialized accounting journal and it is also a prime entry book/daybook/main entry book which is used in an accounting system to keep track of the orders of items placed using accounts payable.

Sale return journal

Sales Return in terms of payroll journal entry can be defined as that the one which shall be used to account for the customer returns in the books of account or to account for when there is a return of goods sold by the customer due to defect goods sold, or misfit in requirement of the customer, etc.

Purchase return journal

A purchase returns journal is a prime entry book or a daybook which is used to record purchase returns. In other words, it is the journal which is used to record the goods which are returned to the suppliers.

Cash book or cash journal or cash register

A cash book is a separate ledger in which cash transactions are registered, while a cash account is a general ledger account. A cash book serves both journal and ledger purposes, while a cash account is organized like a ledger

General journal

A general journal is a daybook or subsidiary journal in which transactions relating to adjustment entries, opening stock, depreciation, accounting errors etc. are recorded. The source documents for general journal entries may be journal vouchers, copies of management reports and invoices.

Lecture No. 5

Need for Ledger

We need balances of the elements of financial statements for reporting purposes. Journals do not produce final balances of all accounting heads. Ledger is maintained to extract balances.

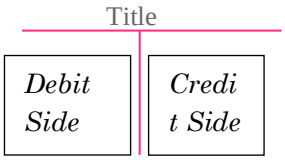
Chart of Accounts

A chart of accounts is a list of financial accounts set up, usually by an accountant, for an organization, and available for use by the bookkeeper for recording transactions in the organization's general ledger.

Format of Ledger Account

A ledger account, in its T form, has three parts

- Title, the name of accounting head
- Debit side, which is its left-hand side
- Credit side, which is its right-hand side.



Posting from General Journal into Main Ledger

The process of picking up amount from journal and placing into the debit or credit side of relevant ledger account is known as posting.

Balancing the Ledger Accounts

In short, **a ledger is an account wise summary of all monetary transactions**, whereas a trial balance is the debit and credit balance of such ledger accounts. Traditionally a ledger was prepared in a physical book with a separate page for each account and a trial balance was derived from these accounts.

Trial Balance

A trial balance is a list of all the general ledger accounts contained in the ledger of a business. This list will contain the name of each nominal ledger account and the value of that nominal ledger balance.

What is posting cash book?

A cash book is a financial journal that contains all cash receipts and disbursements, including bank deposits and withdrawals. Entries in the cash book are then posted into **the general ledger**.

Lecture No. 6

Components of financial statements

The components of Financial Statements are the building blocks that together form the Financial Statements and helps in understanding the financial health of the business and consist of Income Statement, Balance Sheet, Cash Flow Statement and Shareholders Equity Statement.

Components of financial statements

Main components

1. Income statement

(Profit or loss and other comprehensive income)

2. Balance sheet

(Financial position)

(IAS 1) five components of financial statements:

1) Statement of Financial Position
2) Statement of Profit or Loss and Other Comprehensive Income
3) Statement of Cash Flows
4) Statement of Changes in equity and
5) Notes to the Financial Statements

Accounting Equation

Income statement

Incomes – Expenses = Profit

Balance sheet

Assets = Owners equity +Liabilities Format of

Income Statement

An income statement is a financial statement that shows you the company's income and expenditures. It also shows whether a company is making profit or loss for a given period.

Format of balance sheet

Balance Sheet is the financial statement of a company which includes assets, liabilities, equity capital, total debt, etc. at a point in time.

1. Cost of goods sold

Cost of goods sold is the carrying value of goods sold during a particular period. Costs are associated with particular goods using one of the several formulas, including specific identification, first-in first-out, or average cost.

2. Gross profit

Gross profit is the profit a business makes after subtracting all the costs that are related to manufacturing and selling its products or services.

3. Operating Expenses

These are the expenses which are incurred to run/operate the entity. These include;

- Administrative expenses
- Selling, distribution and marketing expenses.

A business cannot even think to sell its goods or services without incurring operating expenses.

- Administration Expenses

Administrative expenses are expenses an organization incurs that are not directly tied to a specific core function such as manufacturing, production, or sales. These overhead expenses are related to the organization as a whole, as opposed to individual departments or business units.

- Selling, Distribution and Marketing Expenses

Selling expenses are the costs associated with distributing, marketing and selling a product or service. Selling expenses can include Distribution costs such as logistics, shipping and insurance costs. Marketing costs such as advertising, website maintenance and spending on social media.

4. Other Incomes

Other income is income that does not come from a company's main business, such as interest.

5. Net Profit

In business and accounting, net income is an entity's income minus cost of goods sold, expenses, depreciation and amortization, interest, and taxes for an accounting period.

6. Fixed Assets

Fixed assets are long-term assets that a company has purchased and is using for the production of its goods and services. Fixed assets include property, plant, and equipment (PP&E) and are recorded on the balance sheet. Fixed assets are also referred to as tangible assets, meaning they're physical assets.

7. Current Assets

Current assets are all the assets of a company that are expected to be sold or used as a result of standard business operations over the next year. Current assets include cash, cash equivalents, accounts receivable, stock inventory, marketable securities, pre-paid liabilities, and other liquid assets.

8. Owner's equity

Owner's equity is essentially the owner's rights to the assets of the business. It's what's left over for the owner after you've subtracted all the liabilities from the assets. If you look at your company's balance sheet, it follows a basic accounting equation:

Assets – Liabilities = Owner's Equity.

9. Long-Term Loan

A form of loan that is paid off over an extended period of time greater than 3 years is termed as a long-term loan. This time period can be anywhere between 3-30 years. These loans generally offer a hefty loan amount and are thus spread over a considerable period of repayment tenure.

10.current liabilities

In accounting, current liabilities are often understood as all liabilities of the business that are to be settled in cash within the fiscal year or the operating cycle of a given firm, whichever period is longer.

Lecture No. 7

Basic Concept of Bank Reconciliation Statement

A bank reconciliation statement summarizes banking and business activity, reconciling an entity's bank account with its financial records. Bank reconciliation statements confirm that payments have been processed and cash collections have been deposited into a bank account.

Nature and Behavior of Balances

It is important to know the nature and behavior of two balances before unfolding the possible reasons of difference among the two balances.

Balances as per: / Favorable or Unfavorable Balance	Deposit account (Favorable for the entity/business)	Overdraft account (Unfavorable for the entity/business)
Business Record _ Cash Book (Bank Column) _ Bank a/c _ Bank Book	Dr. Entity's Asset	Cr. Entity's Liability
Bank Record _ Bank Statement _Pass Book	Cr. Bank's Liability	Dr. Bank's Asset

Bank Reconciliation Statement

Possible reasons of difference among the "balance as per cash book" and "balance as per bank statement" can be subdivided into two:

1. Adjusting items
2. Reconciling items

Adjusting items

Adjusting entries fall into two broad classes: **accrued** (meaning to grow or accumulate) items and deferred (meaning to postpone or delay) items. The entries can be further divided into accrued revenue, accrued expenses, unearned revenue and prepaid expenses which will examine further in the next lessons.

Reconciling items

A reconciling item is a difference between balances from two sources that are being compared. These items are stated in account reconciliation, so that the balance from one source is adjusted by reconciling items to arrive at the balance from the other source.

Lecture No. 8

Basic Concept of Accrual Based Accounting

Two bases to present financial performance of an entity:

1) Cash basis and
2) Accrual basis

Conventionally, small business entities prepare financial statements on "Cash Basis"

- Very easy to handle
- Less costly
- No complex accounting system is required to be developed and implemented

Entities of considerable size follow "Accrual Basis"

- Little complex
- More cost and efforts are required to report financial performance
- It establishes control over trade receivables and payables through a designed system

Two Account Method

1. Opening balance b/f and Closing balance c/f appears in payable account
2. Expense account is closed into Income Statement

For Opening Expense Due

Dr Expense payable A/c.

Cr Expense a/c

For Closing Expense Due

Dr Expense a/c
Cr Expense payable a/c

For Opening Advance Payment

Dr Expense a/c
Cr Advance payment a/c

For Closing Advance payment

Dr Advance payment a/c
Cr Expense a/c

For Opening Income Due

Dr Income a/c
Cr Income receivable a/c

For Closing Income Due

Dr Income receivable a/c
Cr Income a/c

For Opening Advance Receipt

Dr Unearned income a/c
Cr Income a/c

For Closing Advance Receipt

Dr Income a/c
Cr Unearned income a/c

Lecture No. 9

Basic Concept of Bad and Doubtful Debts

Bad Debts are the accounts receivables (Debtors) that an entity will never be able to collect e.g. the customer has gone out of business. These are also known as irrecoverable debts.

Doubtful Debts are the accounts receivables (Debtors) where there is a high risk that it will not be recovered.

Accounting effects for "bad debts" and "doubtful debts" are different, although both are recognized as expense in the income statement but credit effect is different.

1. **Debtors written off as bad debts**

Bad Debts A/c. Dr

Debtors' A/c. Cr

2. **Creating provision for doubtful debts**

Bad Debts A/c. Dr

Provision for DD A/c. Cr

3. **Increase in provision for doubtful debts**

Bad Debts A/c. Dr

Provision for DD A/c. Cr

4. **Decrease in provision for doubtful debts**

Provision for DD A/c. Dr

Bad Debts A/c. Cr

5. **Bad debts recovered**

Bank A/c. Dr

Bad Debts Recovered A/c.Cr

6. **Discount allowed to Debtors.**

Discount Allowed A/c. Dr

Debtors' A/c. Cr

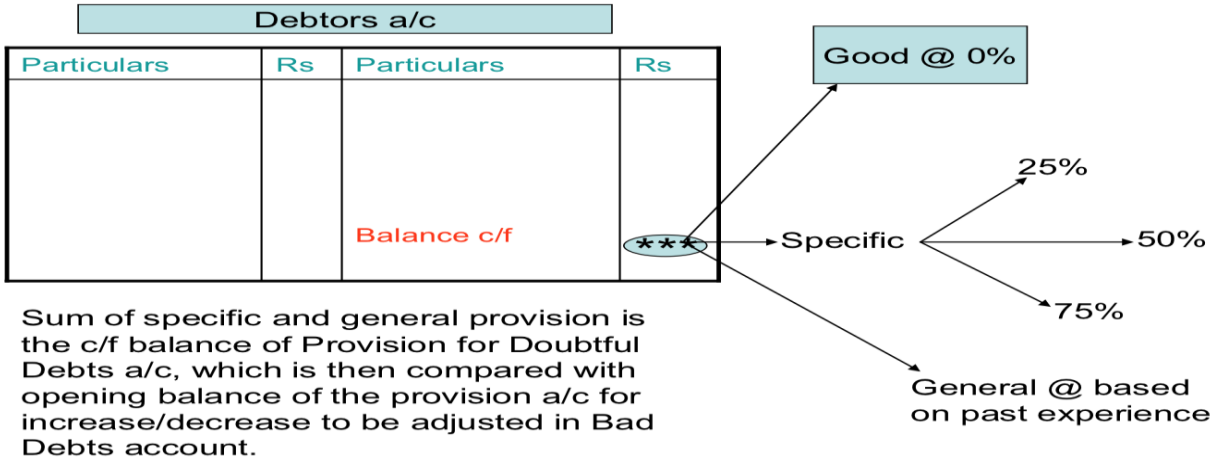
7. **Creating provision for discount on debts.**

Discount Allowed A/c. Dr

Provision for discount A/c.Cr

Measurement of Provision for Doubtful Debts

1. Specific and general provision based on Expected Credit Losses
2. Past due / age based analysis



Measurement of Provision for Doubtful Debts

1. Specific and general provision based on Expected Credit Losses
2. Past due / age based analysis

Aging Based Provision

1. Closing balance of debtors is analyzed in terms of age of each customer.
2. Recovery from older balances is considered more risky.

Accounting for Bad and Doubtful Debts

A business has Trade Receivables (Debtors) of Rs.75,000. Among the Debtors' balance, Mr A owes Rs.5,000 to the business who has recently been declared as bankrupt and should be written off.

Debtors / Receivables

	Rs.		Rs.
Bal b/f	75,000	Bad debts	5,000
		Bal c/f	70,000
	75,000		75,000

Bad Debts

	Rs.		Rs.
Debtors	5,000	Profit & Loss – Income Statement	5,000
	5,000		5,000

Debtors written off as bad debts

Bad Debts A/c.	Dr 5,000	
Debtors' A/c.		Cr 5,000