<u>Financial Accounting & Cost Control</u>

Financial accounting is a specific branch of accounting involving a process of recording, summarizing, classifying and analysing the transactions resulting from business operations over a period of time. These transactions are summarized in the preparation of financial statements, including the balance sheet, income statement and cash flow statement that record the company's operating performance over a specified period.

OR

Financial accounting is a specialized branch of accounting that keeps track of a company's financial transactions. Using standardized guidelines, the transactions are recorded, summarized, and presented in a financial report or financial statement such as an income statement or a balance sheet.

OR

Financial accounting is the process of preparing financial statements that companies' use to show their financial performance and position to people outside the company, Including investors, creditors, suppliers, and customers.

Companies issue financial statements on a routine schedule. The statements are considered *external* because they are given to people outside of the company, with the primary recipients being owners/stockholders, as well as certain lenders. If a corporation's stock is publicly traded, however, its financial statements (and other financial reportings) tend to be widely circulated, and information will likely reach secondary recipients such as competitors, customers, employees, labor organizations, and investment analysts.

It's important to point out that the purpose of financial accounting is not to report the value of a company. Rather, its purpose is to provide enough information for others to assess the value of a company for themselves

Financial Statements

Most companies put together quarterly and annual financial statements, which they make available to shareholders and the investing public. There are four basic financial statements used in the corporate world to show a company's financial performance:

1. The **income statement** (also called the profit and loss statement) reports a company's profitability during a specified period of time. The period of time could be one year, one month, three months, 13 weeks, or any other time interval chosen by the company.

   The main components of the income statement are revenues, expenses, gains, and losses. Revenues include such things as sales, service revenues, and interest revenue. Expenses include the cost of goods sold, operating expenses (such as salaries, rent, utilities, advertising), and nonoperating expenses (such as interest expense). If a corporation's stock is publicly traded, the earnings per share of its common stock are reported on the income statement.

On an income statement, Revenues - Expenses = Net Income.

In accordance with the Generally Accepted Accounting Principals (GAAP), revenue is always recorded in the period of the sale of the goods and services, which may not be the same period when cash is actually received.

2. The **balance sheet** is a statement of assets and liabilities at the end of an accounting period. In other words, the balance sheet is a financial snapshot at a specific point in time.

   The balance sheet is organized into three parts: (1) assets, (2) liabilities, and (3) stockholders' equity at a specified date (typically, this date is the last day of an accounting period).

   The first section of the balance sheet reports the company's *assets* and includes such things as cash, accounts receivable, inventory, prepaid insurance, buildings, and equipment. The next section reports the company's *liabilities*; these are obligations that are due at the date of the balance sheet and often include the word "payable" in their title (Notes Payable, Accounts Payable, Wages Payable, and Interest Payable). The final section is *stockholders' equity,* defined as the difference between the amount of assets and the amount of liabilities.

   On a balance sheet, Assets = Liabilities + Stockholders' Equity.

Stockholders' equity is the amount of financing provided by operations (retained earnings not distributed to stockholders) and by stockholders who reinvest through contributed capital.

3. The **cash flow statement** shows the actual flow of cash into and out of a company over a specific period of time, in contrast to the net income on the income statement, which is a non-cash number.

A cash flow statement shows cash flows from operating activities, investing activities, and financing activities.

The *operating activities* section explains how a company's cash (and cash equivalents) have changed due to operations. *Investing activities* refer to amounts spent or received in transactions involving long-term assets. The *financing activities* section reports such things as cash received through the issuance of long-term debt, the issuance of stock, or money spent to retire long-term liabilities.

4. The **statement of retained earnings** covers a specific period of time and shows the dividends paid from earnings to shareholders and the earnings kept by the company.

Notes to financial statements provide additional information about the financial condition of a company. The three types of notes describe accounting rules used to produce the statements, give more detail about an item on the financial statements, and supply more information about an item not on the statements.

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Double-entry system of book – keeping

Double entry system of bookkeeping is a method of recording business transactions based on a set of rules formulated for recording financial transactions. In this methodical system, every transaction has two impacts i.e. Debit and Credit. And the rule states that “for every debit, there is credit and for every credit, there is debit”. It is based on the formula “Assets = Liabilities + Equity (Capital)” or conversely on the formula “Equity= Assets – Liabilities”

The **double-entry system of accounting** or **bookkeeping** means that for every business transaction, amounts must be recorded in a minimum of two accounts. The **double-entry system** also requires that for all transactions, the amounts entered as debits must be equal to the amounts entered as credits.

Example of a Double-Entry System

To illustrate double entry, let's assume that a company borrows $10,000 from its bank. The company's Cash account must be increased by $10,000 and a liability account must be increased by $10,000. To increase an asset, a debit entry is required. To increase a liability, a credit entry is required. Hence, the account Cash will be debited for $10,000 and the liability Loans Payable will be credited for $10,000.

How is it different from single-entry?

Single-entry accounting involves writing down all of your business’s transactions (revenues, expenses, payroll, etc.) in a single ledger. If you’re a freelancer or sole proprietor, you might already be using this system right now. It’s quick and easy—and that’s pretty much where the benefits of single-entry end.

Single-entry doesn’t track assets or liabilities, is prone to mistakes, doesn’t tell you much about the state or health of your business, and is the accounting equivalent of carrying around a velcro wallet—fine when you’re a kid, but not very secure, or reputable, when you’re older.

Noting these flaws, a group of accountants—in 12th century Genoa, 13th century Venice, or 11th century Korea, depending on who you ask—came up with a new kind of system called double-entry accounting.

Unlike single-entry, the double-entry system provided accountants with enough information to create all of the major financial statements, including income statements, balance sheets, statements of cash flows, and statements of retained earnings.

“It was just a whole revolution in the way of thinking about business and trade,” writes Jane Gleeson-White of the popularization of double-entry accounting in her book *Double Entry*.

“You could itemize the profits in each account, so you knew which products you were doing well in and which you weren’t. Then you could start to think about how you would change your business activities.”

In a nutshell, the double-entry method lets you do modern accounting.

Types of bookkeeping accounts for a small business:

- **Cash**. It doesn't get more basic than this. All your business transactions pass through the Cash account, which is so important that often bookkeepers actually use two journals, Cash Receipts and Cash Disbursements, to track the activity.
- **Accounts Receivable**. If your company sells products or services and doesn't collect payment immediately, you have "receivables," or money due from customers. You must track Accounts Receivable and keep it up to date so that you send timely and accurate bills or invoices.
- **Inventory**. Unsold products are like money sitting on a shelf and must be carefully accounted for and tracked. The numbers in your books should be periodically tested by doing physical counts of inventory on hand.
- **Accounts Payable**. No one likes to send money out of the business, but a clear view of everything via your Accounts Payable makes it a little less painful. Concise bookkeeping helps assure timely payments and avoid paying someone twice! Paying bills *early* can also qualify your business for discounts.
- **Loans Payable**. If you've borrowed money to buy equipment, vehicles, furniture or other items for your business, this account tracks payments and due dates.
- **Sales**. The Sales account tracks all incoming revenue from what you sell. Recording sales in a timely and accurate manner is critical to knowing where your business stands.
- **Purchases**. The Purchases Account tracks any raw materials or finished goods that you buy for your business. It's a key component of calculating "Cost of Goods Sold" (COGS), which you subtract from Sales to find your company's gross profit.
- **Payroll Expenses.** For many businesses, payroll expenses can be the biggest cost of all. Keeping this account accurate and up to date is essential for meeting tax and other government reporting requirements. Shirking those responsibilities will put you in serious hot water.
- **Owners Equity.** This account has a nice ring to it. Basically, it tracks the amount an owner (or owners) puts into the business. Also referred to as net assets, owners equity reflects the amount of money an owner has once liabilities are subtracted from assets.
- **Retained Earnings.** The Retained Earnings account tracks any company profits that are reinvested in the business and are not paid out to the owners. Retained earnings are cumulative, which means they appear as a running total of money that has been retained since the company started. Managing this account doesn't take a lot of time and is important to investors and lenders who want to track how the company has performed over time.

Advantages/merits of double entry system

The major advantages of employing a double entry system of accounting are given below:

1. Under double entry system of accounting, the two aspects of each transaction are recorded (i.e., for every debit there must be a credit and vice versa). It creates an equilibrium within the records which helps in detecting errors, omissions and frauds.

2. Under this system, a trial balance can be prepared to check arithmetical accuracy of all accounting entries. The trial balance can be further used for finding out operating results by preparing income statement and determining the financial position of the business by preparing a balance sheet.
3. Double entry system is the most advanced and useful form of maintaining accounting records and is extensively used by companies worldwide. Without this system, a company would not be able to compare its financial statements with that of other companies.
4. Double entry system is highly systematic that follows certain rules and principles so it is easy to find information about a particular transaction or account quickly when needed by owners, management, accountants or other employees.
5. Almost all accounting standards and laws in the world require the use of double entry system of accounting. If a company fails to comply with this requirement, the auditors will not accept the financial statements of that company.
6. The financial reports and results generated by double entry system is reliable to great extent for decision making purpose.

Types of Account

There are mainly three types of accounts in accounting: **Real, Personal and Nominal accounts**

1. Personal Account

As the name suggests, Personal Accounts are the ones that are related with individuals, companies, firms, group of associations etc. These persons could include natural persons, artificial persons or representative persons.

Type of Personal Accounts

a. Natural Persons

These accounts relate to natural persons such as Veer's A/c, Ayan's A/c, Karen's A/c etc.

b. Artificial Accounts

These accounts relate to companies and institutions such as Kapoor Pvt Ltd A/c, Booker's Club A/c etc. Thus, companies and institutions are the entities that exist in the eyes of law.

c. Representative Accounts

Accounts that are a representative of some person are called as representative accounts. These include Outstanding Interest A/c, Outstanding Wages A/c, Prepaid Expense A/c etc.

Golden Rule Related To The Personal Account

Debit the Receiver, Credit the Giver

Illustration

Karan purchased a machinery from M/s Sharma worth Rs 10,00,000 on credit. So, this transaction involves two accounts: a Personal Account of M/s Sharma and Machinery Account. Thus, purchasing a machinery worth Rs 10,00,000 on credit means that M/s Sharma is providing the Machinery to Karan for his business. The Golden Rule of Personal Account says, “Debit the Receiver, Credit the Giver”.

Since M/s Sharma is the Giver in this transaction, his Personal Account will be credited with Rs 10,00,000. Whereas, Machinery A/c would be debited with the same amount.

Thus, this transaction will be recorded in the respective accounts as follows:

Machinery Account

Particulars (Dr)	**Amount (in Rs)**	**Particulars (Cr)**	**Amount (in Rs)**
To M/s Sharma	10,00,000		

M/s Sharma Account

Particulars (Dr)	**Amount (in Rs)**	**Particulars (Cr)**	**Amount (in Rs)**
		By Machinery	10,00,000

2. Real Account

Real Accounts are the ones that are related with properties, assets or possessions. These properties can be both physically existing as well as non physical in nature. Thus, Real Accounts can be of two types: Tangible Real Accounts and Intangible Real accounts.

a. Tangible Real Accounts

Tangible Real Accounts are accounts which have physical existence. In other words, such assets can be seen, felt or touched. For example Machinery A/c, Vehicle A/c, Building A/c etc.

a. Intangible Real Accounts

These are the assets or possessions that do not have physical existence but can be measured in terms of money. This means that such assets have some value attached to them.

For example, trademarks, patents, goodwill, copyrights etc.

Golden Rule Related To The Personal Account

Debit What Comes In, Credit What Goes Out

Illustration

Karan purchased a vehicle for his business worth Rs 5,00,000 in cash. So, this transaction involves two real accounts: Vehicle Account and Cash Account.

Thus, purchasing a Vehicle worth Rs 5,00,000 in cash means Vehicle is coming into the business. Whereas, Cash is going out of the business. The Golden Rule of Real Account says, “Debit What Comes in, Credit What Goes Out”.

Both Vehicle and Cash being Real Accounts, therefore, Vehicle A/c will be debited with Rs 5,00,000. Whereas, Cash A/c will be credited with the same amount.

Thus, this transaction will be recorded in the respective accounts as follows:

Vehicle Account

Particulars (Dr)	**Amount (in Rs)**	**Particulars (Cr)**	**Amount (in Rs)**
To Cash	5,00,000		

Cash Account

Particulars (Dr)	**Amount (in Rs)**	**Particulars (Cr)**	**Amount (in Rs)**
		By Vehicle	5,00,000

3. Nominal Account

Nominal Accounts relate to income, expenses, losses or gains. These include Wages A/c, Salary A/c, Rent A/c etc.

Golden Rule Related To The Personal Account

Debit All Expenses and Losses, Credit All Incomes and Gains

Illustration

Karan paid wages worth Rs 1,00,000 in cash. So, this transaction involves two accounts: Nominal Account of Wages and Real Account of Cash.

Thus, paying wages worth Rs 1,00,000 in cash means wages are an expense to the business. And Cash is paid towards such an expense. Now Golden Rules pertaining to two accounts would apply in such a case. The Golden Rule of Nominal Account says, “Debit All Expenses and

Losses, Credit All Incomes and Gains".Whereas, Golden Rule of Real Account says, "Debit What Comes In, Credit What Goes Out".

Thus, Wages A/c will be debited with Rs 1,00,000. Whereas, Cash A/c will be credited with the same amount.

Thus, this transaction will be recorded in the respective accounts as follows:

Wages Account			
Particulars (Dr)	**Amount (in Rs)**	**Particulars (Cr)**	**Amount (in Rs)**
To Cash	1,00,000		
Cash Account			
Particulars (Dr)	**Amount (in Rs)**	**Particulars (Cr)**	**Amount (in Rs)**
		By Wages	1,00,000

Journal

An accounting journal is a detailed account of all the financial transactions of a business. It's also known as the book of original entry as it's the first place where transactions are recorded. The entries in an accounting journal are used to create the general ledger which is then used to create the financial statements of a business.

Before computerized bookkeeping and accounting, the transactions were entered manually into a journal and then posted to the general ledger. Apart from the general journal, accountants maintained various other journals including purchases and sales journal, cash receipts journal and cash disbursements journal. With accounting software, today you're likely to find only a general journal in which adjusting entries and unique financial transactions are entered.

To create an accounting journal, record the information about your financial transactions. The details of financial transactions can be derived from invoices, purchase orders, receipts, cash register tapes and other data sources.

Once you've analyzed the transactions, the information is documented in a chronological order in the journal. Each transaction that is listed in the journal is known as a journal entry. This information is then recorded in the ledgers.

The journal entries are usually recorded using the double entry method of bookkeeping. Each transaction is recorded in two columns, debit and credit.

For example, if you purchase a piece of equipment with cash, the two transactions are recorded in a journal entry. You will have to decrease the cash account and the increase the asset account.

Date	Account Title and Description	Debit	Credit
4-12-18	Office Equipment	8,000	
	Cash		8,000

Following are the three steps for completing journal entries of a business:

1. Identify the financial transactions that affect your business
2. Analyze how the transaction changed the accounting equation, whether it has increased or decreased and by how much
3. Use debits and credits to record the changes in the general journal. Ideally, the debited accounts are listed before credited accounts and every journal entry is accompanied by the transaction title, date and description.

While it's rarely used, the single-entry bookkeeping method can also be used for journal entries. In this method, there is only a single account used for each journal entry which is a running total of cash inflows and cash outflows.

What Is the Difference Between a Journal and a Ledger?

Journals and ledgers are where the financial transactions are recorded. The journal, also known as the book of first entry, records transactions in chronological order. It's prepared from the current transactions and does not start with an opening balance. The detailed information of the individual transactions is entered in the journal.

On the other hand, the ledger, also known as the principal book, is a set of accounts in which the financial information in the journals is summarized and posted.

Here are the differences between a journal and ledger:

Basis for Comparison	Journal	Ledger
Meaning	The book in which all financial transactions of a business are recorded	The ledger holds financial information needed to make the financial statements
Known as	Book of original entry	Book of secondary entry
Purpose	Used in preparation of ledger	It is used for making the trial balance and final accounts
Transactions recorded	Journal entries are made in chronological order	Posted account-wise
Debit and credit	Columns	A ledger has two sides. The left side is called debit and the right side is known as credit in the "T" format
Narration	Required	Not necessary
Balancing	Balancing is not done	All accounts are balanced

The journal is the primary and basic book for recording daily transactions. Recording accurate entries into the journal show the correct financial status of the business to not only people internally but also to external users.

Types of Journal in Accounting

1. Purchase journal
2. Sales journal
3. Cash receipts journal
4. Cash payment/disbursement journal
5. Purchase return journal
6. Sales return journal
7. Journal proper/General journal

Here it should be mentioned that most of the business organizations of our country are of small or medium size. These organizations **maintain cash book for recording daily cash receipts and cash payments** instead of maintaining cash receipt journal and cash payment journal separately.

But where cash receipts journal and cash payments journal are maintained cash book is not needed.

Purchase Journal

The special journal used for recording the credit purchase of merchandise is called a purchase journal.

In purchase journal transactions of merchandise purchased on credit for sale are recorded. An asset purchased on the account is not recorded in the purchase journal.

But many are of the opinion to record all credit transactions in the multi-column purchase journal.

For instance, Pyle and Larson have shown credit purchase of assets and supplies, etc. in a purchase journal under a separate column – debiting asset or office supplies and crediting accounts payable.

Since purchase journal is meant for recording merchandise purchased on credit purchase of assets and other things on credit should not be recorded in the purchase journal rather a recording of these in general journal is more acceptable.

The format of the purchase journal:

Single-column purchase journal:

Purchase Journal

Date	Accounts credited	Terms	Reference	Purchase/Inventory Dr. Accounts Payable Cr.

A single-column purchase journal is used only for recording credit purchase of merchandise. In this respect, the format of the purchase journal under periodic and perpetual systems is the same.

But in the case of periodic system purchase account and in the case of the perpetual system merchandise inventory accounts are debited and account payable is credited in both the cases:

Multi-column purchase journal

Purchase Journal
(Multi-column)

Date	Accounts credited	Terms	Ref.	Accounts Payable Cr.	Purchase / Inventory Dr.	Supplies Dr.	Other Accounts Dr.

Some organizations use a multi-column purchase journal wherein credit purchase of merchandise, assets and other things are recorded. Organizations concerned use columns of the journal according to their needs.

Trade discount

At the time of sale, the value which is exempted from catalog price as per terms by the seller to the purchaser is called trade discount.

The trade discount is allowed in order to give benefit to the buyer of goods so that he can earn a definite amount of profit by selling goods. For example, at the time of price fixing the price of a commodity is fixed at $100 including a 5% trade discount.

At the time of selling the seller can sell this commodity granting a 5% trade discount i.e. the buyer gets the benefit to sell the commodity at $95. Trade discount is not recorded in the books of account because it does not bring any financial change of seller or buyer.

Only in the invoice, the trade discount is shown by way of deduction from the invoice price. In purchase and sale books/journals the net purchase or sale value after deducting trade discount from the total value of goods is shown.

In both, cases i.e. in cash sale or credit sale trade discount is generally allowed.

Posting in Ledger

The purchase journal is not written in **accordance with a double-entry system** i.e., it is not written **determining the debit account and credit account**.

So, at **the time of posting in the ledger**, its dual aspects are to be completed. It is not mandatory to show the journal entry which is submitted at the end of the purchase journal.

For convenient postings in the ledger, these journals have been given. Opening purchase account in the ledger the weekly or monthly purchase is to be debited from the miscellaneous account in its debit side.

Opening an individual account in the name of creditor or creditors recorded in the purchase journal respective receivable amounts are credited to the credit side.

Balancing ledger accounts is not generally determined or shown until the end of the year, because posting in these accounts may be needed throughout the whole year.

Sales Journal

Sales journal is used for recording the credit sale of merchandise only.

Cash sale of merchandise is recorded in the cash receipt journal. A credit sale of an asset is recorded in general journal.

Cash Receipts Journal

The special journal used for recording all types of cash receipts is called the cash receipts journal.

In modem age, the introduction of cash receipts journal is in practice in medium and large size business organizations.

All kinds, of cash receipts, are recorded in this journal. The main sources of cash receipts are two; Cash from cash sale and cash from accounts receivable.

There might have other sources of cash receipts. For example, taking a loan from a bank, interest receipts, the cash sale of assets, etc.

Since the cash book does not contain a separate required column for recording cash receipts, it fails to provide information regarding various cash receipts and cash flow.

To overcome these entire limitations multi-column cash receipts journal is required.

Generally in the cash receipts journal to debit columns for cash receipts and cash discount and three credit columns for accounts receivable, sales and other accounts are there. Cash received from various sources other than cash sales and account receivables are recorded in other accounts column.

If the perpetual inventory system is followed in recording merchandise inventory, a separate journal entry is passed along with a sale journal where the cost of goods sold is debited and merchandise inventory is credited.

It may be mentioned that under the periodic inventory system this additional journal entry is not required.

Periodic Inventory System: Under periodic inventory system the format of cash receipt journal is as follows:

Cash Receipt Journal

Date	Accounts credited	Ref.	Cash Dr.	Sales Discount Dr.	Accounts receivable Cr.	Sales Cr.	Other accounts Cr.

Perpetual Inventory System: Under the perpetual inventory system the format of cash receipt journal is as follows:

Cash Receipt Journal

Date	Accounts credited	Ref.	Cash Dr.	Sales Discount Dr.	Accounts receivable Cr.	Sales Cr.	Other acco-unts Cr.	Cost of goods sold Dr Merchandise Inventory Cr.

Cash Payment Journal

The; special journal used for recording various transactions relating to cash payment is called a cash payment journal. Business concerns usually pay debts by cheques.

Payment by cheque is treated as a cash payment.

For the acceptability of cash payment, business organizations pay bills by cheques. The cash payment journal contains many money columns as cash payments are made under many heads.

Payment to accounts payable is an important item among the cash payment items and for this account payable provision for a separate debit, the money column is made in cash payment journal.

As purchase discount arises with various payments a separate purchase discount credit money column is kept in it. A cash credit column is provided for cash payment and cheque payment.

Another debit column for office supplies is also contained in the cash payment journal. Besides, for showing other payment there contains another accounts-debit column. A format of the multi-column cash payments journal is shown below:

Cash Payment Journal

Date	Accounts debited	Ref.	Other accounts Dr.	Accounts payable Dr.	Purch-ase Dr.	Purchase discount Cr.	Cash Cr.

Purchase Return Journal

The special journal, where purchase returns of credit purchase are recorded, is called a purchase return journal.

In the case of isolation of purchase agreement or in the case of defective goods the purchaser returns the- goods to the seller. While returning goods to the seller a slip containing reasons for the return of goods is sent along with goods.

This is called a debit note. The seller also sends a note to the purchaser as a reply which is called a credit note. It may be mentioned that goods purchased on cash if returned are not recorded in the purchase return journal.

A format of purchase return journal is shown below:

Purchase Return Journal

Date	Accounts debited	Terms	Ref.	Debit note	Accounts payable Dr Purchase return Cr

Sales Return Journal

The special journal, where the credit sale returns are recorded, is called a sales return journal. The sales return journal is prepared from debit notes sent by the buyer with returned goods. In reply, the seller sends a credit note.

The format of sales return is similar to that of sales journal excepting challan/invoice column where credit note is written.

It may be mentioned that where the sales return transactions are large in number this sales return journal is maintained.

But where such return transactions are very few in number, these are recorded in the general journal.

Objects and Advantages of Journal

- Detail descriptions of transactions are available in the journal,
- It is the primary and basic book for recording transactions.
- It is the daily book of transactions.
- From various subsidiary journals, necessary information can be known easily.
- Increases efficiency in accounting tasks.
- It helps the distribution of recounting tasks among the employees according to their efficiency.
- Helps to minimize errors.
- As various subsidiary journals are maintained, they become smaller in size and can be handled easily.
- The possibility of omission of transactions – recording is removed.
- It is used as future reference.
- Ledger can be kept brief and in a neat and clean manner.
- It helps rectification ‘of errors.

Ledger

A **ledger** is the principal book or computer file for recording and totaling economic transactions measured in terms of a monetary unit of account by account type, with debits and credits in separate columns and a beginning monetary balance and ending monetary balance for each account.

1. Sales Ledger or Debtors' Ledger

First among different types of ledgers is "Sales or Debtors' ledger". It is a grouping of all accounts related to customers to whom goods have been sold on credit (Credit Sales). Sum of all the money owed to a business by their customers is shown here and is termed as **Accounts Receivable**, **Trade Debtors** or **Sundry Debtors**.

The accounts are mostly arranged in an alphabetical order, however, nowadays all the ledger accounts are maintained with the help of accounting ERPs.

2. Purchase Ledger or Creditors' Ledger

It is a grouping of all accounts related to sellers from whom goods have been purchased on credit (Credit Purchases). Sum of all the money owed by a business to their sellers is shown here and is termed as **Accounts Payable, Trade Creditors** or **Sundry Creditors**.

Total monetary amount inside the purchase ledger is shown in the **trial balance** and the balance sheet at its appropriate place.

Cash Sales and Cash Purchases are booked into the Cash Book.

3. General Ledger

Companies usually make a single general ledger which includes 2 additional subtypes of ledgers i.e. **nominal ledger** and **private ledger.** These two may or may not be included in the list for different types of ledgers in accounting.

A general ledger or GL is a centralized compilation for all the ledger accounts of a business. It contains all types of accounts which can be found in an organization such as **assets, liabilities, capital or equity, revenues, expenses, etc.**

As per traditional or UK style accounting, GL consists of all nominal & real accounts necessary to prepare financials for a company. E.g. Building, Office equipment, Furniture and so on.

Nominal Ledger – As the name suggests it **contains all nominal accounts** i.e. expense, losses, incomes and gains. Examples – Salaries, Sales, Purchases, Returns Inward/Outward, Rent, Stationery, Insurance, Depreciation, etc.

Private Ledger – Private ledger consists of accounts which are **confidential** in nature such as capital, drawings, salaries, etc. These accounts are only accessible by selected individuals.

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.

- A cash book is a subsidiary to the general ledger in which all cash transactions during a period are recorded.
- The cash book is recorded in chronological order, and the balance is updated and verified on a continuous basis.
- There are three common types of cash books: single column, double column, and triple column.

A cash book is set up as a subsidiary to the general ledger in which all cash transactions made during an accounting period are recorded in chronological order. Larger organizations usually divide the cash book into two parts: the cash disbursement journal which records all cash payments, and the cash receipts journal, which records all cash received into the business.

Types of cash book

- A single **column cash book** to record only cash transactions.
- A double/two **column cash book** to record cash as well as bank transactions.
- A triple/three **column cash book** to record cash, bank and purchase discount and sales discount.
- A **petty cash book** to record small day to day cash expenditures.

1. The **single column cash book** (also known as **simple cash book**) is a cash book that is used to record only cash transactions of a business. It is very identical to a traditional cash account in which all cash receipts are recorded on left hand (debit) side and all cash payments are recorded on right hand (credit) side in a chronological order.

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Dr. (Receipts) CASH BOOK Cr. (Payments)

Date	Description	VN	PR	Amount	Date	Description	VN	PR	Amount
2016					2016				

2. The **double column cash book** (also known as **two column cash book**) has two money columns on both debit and credit sides – one to record cash transactions and one to record bank transactions. In other words, we can say that if we add a bank column to both sides of a single column cash book, it would become a double column cash book. The cash column is used to record all cash transactions and works as a cash account whereas bank column is used to record all receipts and payments made by checks and works as a bank account. Both the columns are totaled and balanced like a traditional T-account at the end of an appropriate period which is usually one month.

Page No___

Dr. (Receipts) CASH BOOK Cr. (Payments)

Date	Description	VN	PR	Cash	Bank	Date	Description	VN	PR	Cash	Bank

3. The **triple column cash book** (also referred to as **three column cash book**) is the most exhaustive form of cash book which has three money columns on both receipt (Dr) and payment (Cr) sides to record transactions involving cash, bank and discounts. A triple column cash book is usually maintained by large firms which make and receive payments in cash as well as by bank and which frequently receive and allow cash discounts.

Page No:___

Dr. (Receipts) CASH BOOK Cr. (Payments)

Date	Description	VN	PR	Disc	Cash	Bank	Date	Description	VN	PR	Disc	Cash	Bank

4. Petty cash book is a type of cash book that is used to record minor regular expenditures such as office teas, bus fares, fuel, newspapers, cleaning, pins, and causal labor etc. These small expenditures are usually paid using coins and currency notes rather than checks. The person responsible for spending petty cash and recording it in a petty cash book is known as *petty cashier*.

-COMPANY-

Dr. PETTY CASH BOOK Cr.

Receipt	Date	Details	VN	Total	expense 1	Expense 2	Expense 3	Expense 4

Trial Balance

A trial balance is a bookkeeping worksheet in which the balance of all ledgers are compiled into debit and credit account column totals that are equal. A company prepares a trial balance periodically, usually at the end of every reporting period. The general purpose of producing a trial balance is to ensure the entries in a company's bookkeeping system are mathematically correct.

- A trial balance is a worksheet with two columns, one for debits and one for credits, that ensures a company's bookkeeping is mathematically correct.
- The debits and credits include all business transactions for a company over a certain period, including the sum of such accounts as assets, expenses, liabilities, and revenues.
- Debits and credits of a trial balance being equal ensure there are no mathematical errors, but there could still be mistakes or errors in the accounting systems.

Concept of Trial Balance

Let's say you record all your activities in a diary. At month end you summarize your diary and classify it into various categories. Now you make a sheet and divide the categories into productive / non productive. That's exactly what businesses do.

- Recording of transaction is a Journal entry.
- Summarizing them and categorizing them are Ledgers.
- Creating a worksheet and classifying the ledgers is a Trial Balance.

A trial balance is a sheet recording all the ledger balances categorized into debit and credit. A typical trial balance will have name of ledger and the balances. This is prepared as at a particular date which can be financial year end or calendar year.

Advantages of Trial Balance

 Arithmetical accuracy

Given the nature of double entry system, every transaction will result in two entries of equal and opposite nature. Hence at any point in time all debit ledger totals will match to credit ledger totals. Since Trial Balance lists all the accounts as on a particular date, the debit total of a trial balance must match to the credit total.

Therefore a Trial Balance is an indicator of the Arithmetical accuracy of the books of accounts.

With softwares being used for accounting, the above advantage of the trial balance is not very relevant. As data entry systems does not allow entries to be posted if there is a difference in the debit and credit amount hence leaving no room for error.

- **Bird's-eye view**

A trial balance is a summary sheet listing all ledges and balances. Hence it provides a bird eye view of the accounting transactions of an organization.

- **Prerequisite for preparation of Financial statements**

An organization needs to know profit or loss and financial position at year end. And thus to prepare financial statements, Trial Balance is prerequisite. All stakeholders also need this information. It is the first step towards closure of accounts for a particular period.

Uses of Trial Balance

- **Ease of posting adjustments**

A tallied Trial Balance offers significant comfort regarding accuracy and hence post TB adjustments can be affected.

- **Aids in Audit**

Trial Balance gives a list of all ledgers with balances. For the purpose of audit the trial balance is analyzed. For example if the nature of an account is debit, but it holds a credit balance, then the entire ledger will be scrutinized. So trial balance is also an important tool for auditors.

- **Defines credibility**

Trial Balance is also used by Banks and lending agencies to understand the borrowing capacity of the business and credibility.

Despite the numerous benefits of a Trial balance, it is imperative to understand that a tallied Trial Balance does not ensure zero errors. If there are offsetting errors, the Trial Balance will tally despite the error.

Also if some transactions have not been recorded,there will be no impact on the ledgers and hence the tallied Trial Balance will pose a wrong picture.

With softwares being used for preparation of accounts, today the Trial Balance from ERP system has automated a lot of processes. It includes ledger codes, ledger names, type of account, balance for the current period, balance for the previous period. Also for large organizations the trial balance can be extracted for any particular period.

Looking at all the pros and cons, it is very clear that preparation of Trial Balance has lot of benefits and hence it preparation has become mandatory for closure of books of accounts. Even today the Trial Balance provides an excellent base for preparation of financial statements and analysis of business.

Components of Final Account

Final Accounts are the accounts, which are prepared at the end of a fiscal year. It gives a precise idea of the financial position of the business/organization to the owners, management, or other interested parties. Financial statements are primarily recorded in a journal; then transferred to a ledger; and thereafter, the final account is prepared.

Usually, a final account includes the following components −

- Trading Account
- Profit and Loss Account
- Balance Sheet

Now, let us discuss each of them in detail −

Trading Account

Trading accounts represents the Gross Profit/Gross Loss of the concern out of sale and purchase for the particular accounting period.

Study of Debit side of Trading Account

- **Opening Stock** − Unsold closing stock of the last financial year is appeared in debit side of the Trading Account as "To Opening Stock" of the current financial year.
- **Purchases** − Total purchases (net of purchase return) including cash purchase and credit purchase of traded goods during the current financial year appeared as "To Purchases" in the debit side of Trading Account.
- **Direct Expenses** − Expenses incurred to bring traded goods at business premises/warehouse called direct expenses. Freight charges, cartage or carriage charges, custom and import duty in case of import, gas, electricity fuel, water, packing material, wages, and any other expenses incurred in this regards comes under the debit side of Trading Account and appeared as "To Particular Name of the Expenses".
- **Sales Account** − Total Sale of the traded goods including cash and credit sales will appear at outer column of the credit side of Trading Account as "By Sales." Sales should be on net releasable value excluding Central Sales Tax, Vat, Custom, and Excise Duty.
- **Closing Stock** − Total Value of unsold stock of the current financial year is called as closing stock and will appear at the credit side of Trading Account.

  closing Stock = Opening Stock + Net Purchases - Net Sale

- **Gross Profit** − Gross profit is the difference of revenue and the cost of providing services or making products. However, it is calculated **before** deducting payroll, taxation, overhead, and other interest payments. Gross Margin is used in the US English and carries same meaning as the Gross Profit.

Gross Profit = Sales - Cost of Goods Sold

- **Operating Profit** − Operating profit is the difference of revenue and the costs generated by ordinary operations. However, it is calculated **before** deducting taxes, interest payments, investment gains/losses, and many other non-recurring items.

  Operating Profit = Gross Profit - Total Operating Expenses

- **Net Profit** − Net profit is the difference of total revenue and the total expenses of the company. It is also known as net income or net earnings.

  Net Profit = Operating Profit - (Taxes + Interest)

Format of Trading Account

Trading Account of M/s ABC Limited (For the period ending 31-03-2014)			
Particulars	**Amount**	**Particulars**	**Amount**
To Opening Stock	XX	By Sales	XX
To Purchases	XX	By Closing Stock	XX
To Direct Expenses	XX	By Gross Loss c/d	XXX
To Gross Profit c/d	XXX		
Total	XXXX	**Total**	**XXXX**

Profit and Loss Account

Profit & Loss account represents the Gross profit as transferred from Trading Account on the credit side of it along with any other income received by the firm like interest, Commission, etc.

Debit side of profit and loss account is a summary of all the indirect expenses as incurred by the firm during that particular accounting year. For example, Administrative Expenses, Personal Expenses, Financial Expenses, Selling, and Distribution Expenses, Depreciation, Bad Debts, Interest, Discount, etc. Balancing figure of profit and loss accounts represents the true and net profit as earned at the end of the accounting period and transferred to the Balance Sheet.

Profit & Loss Account of M/s ……… (For the period ending ………..)			
Particulars	**Amount**	**Particulars**	**Amount**
To Salaries	XX	By Gross Profit b/d	XX
To Rent	XX		
To Office Expenses	XX	By Bank Interest received	XX
To Bank charges	XX	By Discount	XX
To Bank Interest	XX	By Commission Income	XX
To Electricity Expenses	XX	By Net Loss transfer to Balance sheet	XX
To Staff Welfare Expenses	XX		
To Audit Fees	XX		
To Repair & Renewal	XX		
To Commission	XX		
To Sundry Expenses	XX		
To Depreciation	XX		
To Net Profit transfer to Balance sheet	XX		
Total	**XXXX**	**Total**	**XXXX**

Balance Sheet

A balance sheet reflects the financial position of a business for the specific period of time. The balance sheet is prepared by tabulating the assets (fixed assets + current assets) and the liabilities (long term liability + current liability) on a specific date.

Assets

Assets are the economic resources for the businesses. It can be categorized as −

- **Fixed Assets** − Fixed assets are the purchased/constructed assets, used to earn profit not only in current year, but also in next coming years. However, it also depends upon the life and utility of the assets. Fixed assets may be tangible or intangible. Plant & machinery, land & building, furniture, and fixture are the examples of a few Fixed Assets.

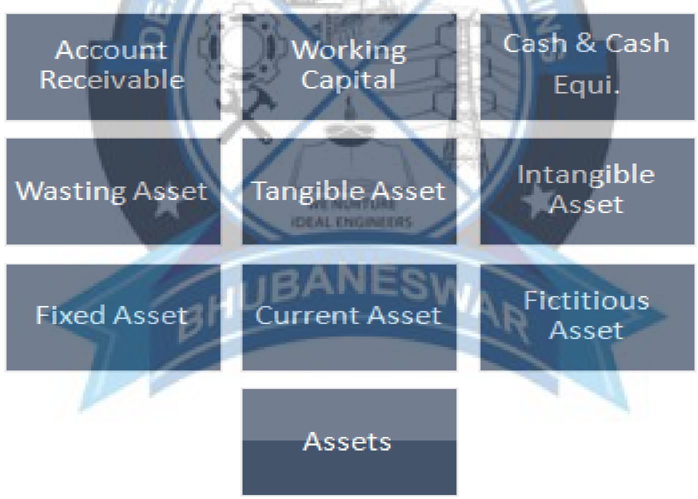
- **Current Assets** − The assets, which are easily available to discharge current liabilities of the firm called as Current Assets. Cash at bank, stock, and sundry debtors are the examples of current assets.

- **Fictitious Assets** − Accumulated losses and expenses, which are not actually any virtual assets called as Fictitious Assets. Discount on issue of shares, Profit & Loss account, and capitalized expenditure for time being are the main examples of fictitious assets.

- **Cash & Cash Equivalents** − Cash balance, cash at bank, and securities which are redeemable in next three months are called as Cash & Cash equivalents.

- **Wasting Assets** − The assets, which are reduce or exhausted in value because of their use are called as Wasting Assets. For example, mines, queries, etc.

- **Tangible Assets** − The assets, which can be touched, seen, and have volume such as cash, stock, building, etc. are called as Tangible Assets.



- **Intangible Assets** − The assets, which are valuable in nature, but cannot be seen, touched, and not have any volume such as patents, goodwill, and trademarks are the important examples of intangible assets.

- **Accounts Receivables** − The bills receivables and sundry debtors come under the category of Accounts Receivables.

- **Working Capital** − Difference between the Current Assets and the Current Liabilities are called as Working Capital.

Liability

A liability is the obligation of a business/firm/company arises because of the past transactions/events. Its settlement/repayments is expected to result in an outflow from the resources of respective firm.

There are two major types of Liability −

- **Current Liabilities** − The liabilities which are expected to be liquidated by the end of current year are called as Current Liabilities. For example, taxes, accounts payable, wages, partial payments of long term loans, etc.
- **Long-term Liabilities** − The liabilities which are expected to be liquidated in more than a year are called as Long-term Liabilities. For example, mortgages, long-term loan, long-term bonds, pension obligations, etc.

Break-Even Analysis

A break-even analysis is a financial tool which helps you to determine at what stage your company, or a new service or a product, will be profitable. In other words, it's a financial calculation for determining the number of products or services a company should sell to cover its costs (particularly fixed costs). Break-even is a situation where you are neither making money nor losing money, but all your costs have been covered.

Break-even analysis is useful in studying the relation between the variable cost, fixed cost and revenue. Generally, a company with low fixed costs will have a low break-even point of sale. For an example, a company has a fixed cost of Rs.0 (zero) will automatically have broken even upon the first sale of its product.

Contribution Margin
The concept of break-even analysis deals with the contribution margin of a product. The contribution margin is the excess between the selling price of the product and total variable costs

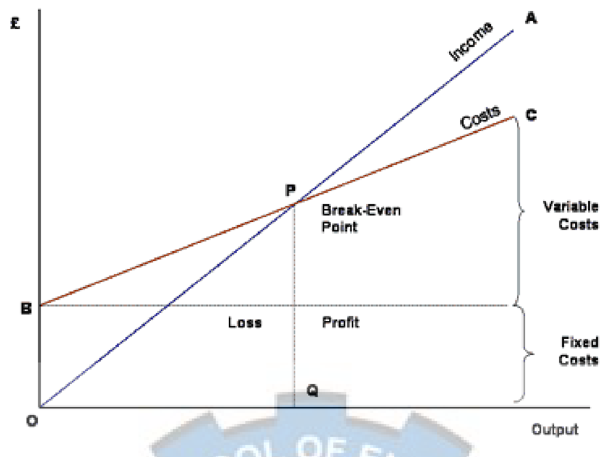
Formula for Break Even Analysis
The formula for break even analysis is as follows:

Break even quantity = Fixed costs / (Sales price per unit – Variable cost per unit)

where:

- **Fixed costs** are costs that do not change with varying output (e.g., salary, rent, building machinery).
- **Sales price per unit** is the selling price (unit selling price) per unit.
- **Variable cost per unit** is the variable costs incurred to create a unit.

The **break-even point** can be defined as a point where total costs (expenses) and total sales (revenue) are equal. Break-even point can be described as a point where there is no net profit or loss. .



In the diagram above, the line OA represents the variation of income at varying levels of production activity ("output"). OB represents the total fixed costs in the business. As output increases, variable costs are incurred, meaning that total costs (fixed + variable) also increase. At low levels of output, Costs are greater than Income. At the point of intersection, P, costs are exactly equal to income, and hence neither profit nor loss is made.

Fixed costs

Fixed costs are those business costs that are not directly related to the level of production or output. In other words, even if the business has a zero output or high output, the level of fixed costs will remain broadly the same. In the long term fixed costs can alter - perhaps as a result of investment in production capacity (e.g. adding a new factory unit) or through the growth in overheads required to support a larger, more complex business.

Examples are

- Rent and rates
- Depreciation
- Research and development
- Marketing costs (non- revenue related)
- Administration costs

Variable costs

Variable costs are those costs which vary directly with the level of output. They represent payment output-related inputs such as raw materials, direct labour, fuel and revenue-related costs such as commission.

Direct variable costs are those which can be directly attributable to the production of a particular product or service and allocated to a particular cost centre. Raw materials and the wages those working on the production line are good examples.

Indirect variable costs cannot be directly attributable to production but they do vary with output. These include depreciation (where it is calculated related to output - e.g. machine hours), maintenance and certain labour costs.

Semi – variable costs

Whilst the distinction between fixed and variable costs is a convenient way of categorising business costs, in reality there are some costs which are fixed in nature but which increase when output reaches certain levels. These are largely related to the overall "scale" and/or complexity of the business. For example, when a business has relatively low levels of output or sales, it may not require costs associated with functions such as human resource management or a fully-resourced finance department. However, as the scale of the business grows (e.g. output, number people employed, number and complexity of transactions) then more resources are required. If production rises suddenly then some short-term increase in warehousing and/or transport may be required. In these circumstances, we say that part of the cost is variable and part fixed.

Assignment Questions

1. What is cost? What are the different elements of cost? Prepare a cost sheet of ABC Ltd. With imaginary figures for a fan.
2. Differentiate between balance sheet and P and L A/C.
3. What is a cash book? Explain.
4. Define different components of balance sheet.
5. Define ledger.
6. What is trial balance?
7. Differentiate between fixed cost and variable cost.
8. Explain the break even pint.
9. State the significance of break-even analysis.