

STUDY MATERIAL

EXECUTIVE PROGRAMME

**CORPORATE
ACCOUNTING
&
FINANCIAL
MANAGEMENT**

**GROUP 1
PAPER 4**



**THE INSTITUTE OF
Company Secretaries of India**

भारतीय कम्पनी सचिव संस्थान

IN PURSUIT OF PROFESSIONAL EXCELLENCE

Statutory body under an Act of Parliament

(Under the jurisdiction of Ministry of Corporate Affairs)

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Timing of Headquarters :

Monday to Friday
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Public Dealing Timings :

Without financial transactions – 9.30 A.M. to 5.00 P.M.
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Laser Typesetting by :

AArushi Graphics, Prashant Vihar, New Delhi

EXECUTIVE PROGRAMME

CORPORATE ACCOUNTING & FINANCIAL MANAGEMENT

In today's business world accounting is considered as 'the universal language of all business', because it is the medium for reporting financial information about a business entity to users, such as shareholders, banks and managers. A proper accounting system is essential to any business, whether big or small, in order to manage its daily functions and run it successfully. The main obligation of any business is to maximize profits, minimize losses and at the same time maintain its position as a responsible entity within the society.

So, in the current business world, everybody should have the knowledge of accounting discipline irrespective of the job one is doing. Due to the rapid advancement in business activities due to industrialization and globalization, the need for people having knowledge of accounts have increased manifold. It is impossible to survive in today's advanced business environment without adequate knowledge of basic accountancy.

Especially all business students should have some background in accounting to understand, interpret and present the results of business. Keeping this objective in alignment, this study material is prepared to augment the basic as well as advanced understanding of students in the related aspects of Corporate Accounting and Financial Management.

The Study Material which is divided in two parts covers in the details the concepts of Corporate Accounting in Part – I and discusses Financial Management in detail under Part-II.

The legislative changes made upto November 30, 2025 have been incorporated in the study material. The students are advised to refer to the updations at the Regulator's website, Supplements relevant for the subject issued by ICSI and ICSI Journal Chartered Secretary and Other publications. Specifically, students are advised to read "**Student Company Secretary**" e-Journal which covers regulatory and other relevant developments relating to the subject. In the event of any doubt, students may contact the Directorate of Academics at academics@icsi.edu.

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EXECUTIVE PROGRAMME

Group 1

Paper 4

CORPORATE ACCOUNTING & FINANCIAL MANAGEMENT

SYLLABUS

OBJECTIVES:

Part I: To provide knowledge and understanding of the concepts, principles and practices in Company Accounts, Interpretation of Financial Statements.

Part II: To provide conceptual clarity and practical aspects of financial management so as to develop skills in taking financial and investment decisions and in business strategies.

Level of Knowledge: Working Knowledge

PART I – CORPORATE ACCOUNTING (60 MARKS)

- 1. Introduction to Accounting:** Book Keeping • Accounting Cycle • Single / Double entry system • Accounting Principles • Accounting Concept & Convention • Types of Account • Journal • Ledger • Trial Balance • Final Accounts
- 2. Introduction to Corporate Accounting:** Records of accounts to be maintained by a company • Preparation and Presentation of Financial Statements • Schedule III of the Companies Act, 2013 • Disclosure Requirement • True and Fair View of Financial Statements • XBRL
- 3. Accounting Standards (AS):** Applicability • Interpretation • Scope and Compliance • International Financial Reporting Standards • Overview of AS • AS vs. Ind AS vs. IFRS
- 4. Accounting for Share Capital :** Issue of Shares • Forfeiture and Reissue of Shares • Accounting Treatment of Premium • Buy-back of Shares • Redemption and Conversion • Capital Redemption Reserve • Bonus Shares • Rights Issue • ESOPs • ESPS • Sweat Equity Shares and Underwriting • Book Building
- 5. Accounting for Debentures:** Accounting Treatment • Debenture Redemption Reserve • Redemption of Debentures and Conversion of Debentures into Shares
- 6. Related Aspects of Company Accounts:** Accounting for ESOP • Buy-back • Equity Shares with differential rights • Underwriting and Debentures
- 7. Consolidation of Accounts:** Standalone and Consolidated Financial Statements • Holding Company • Subsidiary Company • Associate Companies and Joint Venture • Accounting Treatment and disclosures
- 8. Financial Statement Analysis:** Introduction • Characteristics of good financial statements and its relevancy for better reporting • Requirements of Financial Reporting and Recent trends • Best Practices

applicable to all companies • Usage and features of ratios analysis • liquidity ratios • turnover ratio • leverage ratios • Insolvency ratio and profitability ratio • DuPont Analysis • Reading and Interpretation of Financial Statements

9. **Cash Flows:** Understanding the Statement of Cash Flows • Identify the purpose of the statement of Cash Flows • structure and interpretation of operating • investing and financing activities in Cash Flow statement • Analyze information in the statement of Cash Flows to determine whether the firm is in its life cycle • Examine additional uses of Cash Flow information
10. **Forecasting Financial Statements:** Build forecasts of future Balance Sheets • Income Statements and Statements of Cash Flows.

PART II – FINANCIAL MANAGEMENT (40 MARKS)

11. **Introduction :** Nature • Scope & Objectives of Financial Management • Profit Maximization vs. Wealth Maximization
12. **Time Value of Money:** Introduction • Concept of Time Value of Money – The power of compounding • Significance and application of Time Value of money • Concept of Annuity • Understanding and application of Table used in Time value of money
13. **Capital Budgeting:** Compounding and Discounting techniques - Capital Budgeting Process • Techniques of Capital Budgeting - Discounted and Non- Discounted Cash Flow Methods • NPV • Payback • Profitability Index • IRR • Economic Value Added (EVA) • Capital Rationing • Risk Evaluation and Sensitivity Analysis
14. **Cost of Capital:** Sources • Meaning • Factors Affecting Cost of Capital • Methods for Calculating Cost of Capital • Weighted Average Cost of Capital (WACC) • Marginal Cost of Capital
15. **Capital Structure:** Introduction • Significance of Capital Structure • Determinants of Capital Structure • Capital structure planning and designing of optimum capital structure • Capital Structure Theories • EBIT- EPS Analysis • Breakeven - EBIT Analysis • Under / Over Capitalisation
16. **Dividend Decisions:** Factors determining dividend policy • Dividend Models- Relevant/ Irrelevant Theories - Walter's Model, Gordon's Model, M-M Model • Forms of Dividend – Cash Dividend, Stock Dividend, Stock Splits, Share repurchase
17. **Working Capital Management:** Meaning • Types • Determinants and Assessment of Working Capital Requirements • Negative Working Capital • Operating Cycle Concept and Applications of Quantitative Techniques • Management of Working Capital – Cash Receivables Inventories • Financing of Working Capital • Banking Norms and Macro Aspects • Factoring and Forfaiting
18. **Security Analysis:** Measuring of Systematic and Unsystematic Risk • Fundamental Analysis (Economic, Industry and Company) • Technical Analysis and Efficient Market Hypothesis
19. **Operational Approach to Financial Decision:** An Overview of Costing • Key Concepts • Basics Principles of Costing • Marginal Costing – Breakeven Point, Margin of Safety

ARRANGEMENT OF STUDY LESSONS

CORPORATE ACCOUNTING & FINANCIAL MANAGEMENT

GROUP 1 • PAPER 4

PART I : CORPORATE ACCOUNTING (60 MARKS)

Sl. No.	Lesson Title
1.	Introduction to Accounting
2.	Introduction to Corporate Accounting
3.	Accounting Standards (AS)
4.	Accounting for Share Capital
5.	Accounting for Debentures
6.	Related Aspects of Company Accounts
7.	Consolidation of Accounts
8.	Financial Statement Analysis
9.	Cash Flows
10.	Forecasting Financial Statements

PART II : FINANCIAL MANAGEMENT (40 MARKS)

11.	Introduction
12.	Time Value of Money
13.	Capital Budgeting
14.	Cost of Capital
15.	Capital Structure
16.	Dividend Decisions
17.	Working Capital Management
18.	Security Analysis
19.	Operational Approach to Financial Decision

LESSON WISE SUMMARY

CORPORATE ACCOUNTING & FINANCIAL MANAGEMENT

PART I : CORPORATE ACCOUNTING (60 MARKS)

Lesson 1 – Introduction to Accounting

Accounting is a very old concept – as old as money. A description of proper keeping of accounts is also found in ‘Arthashastra’ written by Kautilya. However, it has developed with the passage of time to meet the requirements and challenges of ever – growing society. The modern-day accounting concept based on double entry system was originated by Luca Pacioli in Italy. Though the act of accounting is very old, in recent times it has acquired special significance because of rapidly growing economy, cut-throat competition, expanding markets and increasing production and changes in technology.

In this lesson, we will throw light on the basic concepts of accounting, types of accounts, accounting principles, conventions, accounting concepts, meaning of double entry system and the rules of debit & credit on which the entire concept of accounting is based.

Accounting process involves identification and analysis of financial transactions. These transactions are recorded, classified and summarised in a systematic manner to give useful information. Thus, accounting process starts with the recording of business transactions in monetary terms, in the primary books of accounts. For recording business transactions, it is necessary that these transactions are evidenced by proper source documents like cash memos, purchase bills, sales bills, counterfoils of cheques issued, salary slips etc. From these source documents, transactions are recorded in the books of accounts which are the first and major step in accounting. It is the basis of accounting as entire future process would depend upon this recording of transactions. In this lesson, we will know about recording transactions in primary books like Journal and other subsidiary books, posting in ledger and then preparation of trial balance.

Lesson 2 – Introduction to Corporate Accounting

There is no legal obligation for sole proprietorship and partnership firm to prepare final accounts, but companies have statutory obligations to keep proper books of account and to prepare its final accounts every year in the manner as prescribed in the Companies Act. Chapter IX, Sections 128 to 138 of the Companies Act, 2013 deals with the legal provisions relating to the Accounts of Companies. Final accounts of a company consist of balance sheet as at the end of the accounting period and profit and loss account for that period. Section 129 of the Companies Act, 2013 prescribes the form and contents of balance sheet and profit and loss account of a company. Balance sheet of a company shall be prepared according to Schedule III of the Companies Act, 2013. The Schedule III sets out the minimum requirements for disclosure on the face of the Balance Sheet, and the Statement of Profit and Loss (hereinafter referred to as “Financial Statements”) and Notes. Statement of Profit & Loss of a company shall be prepared according to Part II of Schedule III of the Companies Act, 2013. Section 129(1) of the Companies Act 2013, states that the financial statements shall give a true and fair view of the state of affairs of the company or companies, comply with the accounting standards notified under section 133 and shall be in the form provided for different class or classes of companies in Schedule III.

Lesson 3 – Accounting Standards (AS)

Accounting Standards (AS) are written policy documents by expert accounting body or by government or other regulatory body covering the aspects of recognition, measurement, presentation and disclosure of accounting

transactions in the financial statements. The ostensible purpose of the standard setting bodies is to promote the dissemination of timely and useful financial information to investors and certain other parties having an interest in the company's economic performance. Accounting standards reduce the accounting alternatives in the presentation of financial statements within the bounds of rationality, thereby ensuring comparability of financial statements of different enterprises. This lesson covers the brief about the Accounting Standard, the International Financial Reporting Standard and also list out the difference between Accounting Standard and IFRS.

Lesson 4 – Accounting for Share Capital

The most striking feature of a company is its ownership structure. The capital in a company is divided into small shares of fixed value. The shares of a company may be equity shares or preference shares. The objective of this lesson is to make students aware about accounting of different aspects of share capital. After studying this lesson, students will be able to:

- Understand the share capital structure in the balance sheet of a company.
- Understand the methods and accounting procedure of issue of shares.
- Specify the accounting treatment when shares are issued at par, premium and at discount.
- Explain the meaning and accounting treatment of forfeiture of shares and reissue thereof.
- Understand the accounting procedure of buy-back of shares.
- Enumerate the steps for redemption of preference shares.
- Appreciate the purpose of issuing Right shares & Bonus shares.
- Understand the meaning of underwriting.
- Familiarize with various types of underwriting.
- Distinguish between marked application and unmarked applications.
- Determine the liability of underwriters.

Lesson 5 – Accounting for Debentures

Equity sources of financing are however not always sufficient to meet the ever growing needs of the corporate expansion and growth. Hence, corporates turn to debt financing through financial institutions, commercial banks or by issuing debt instruments either through the route of private placement or by offering the same for public subscription. Owing tax shield provided by debt instruments, the debt financing not only helps in reducing the cost of capital but also helps in designing appropriate capital structure of the company. This lesson deals with the accounting treatment of different aspects of debenture and bond especially with issue, redemption including conversion of debenture.

Lesson 6 – Related Aspects of Company Accounts

The objective of this lesson is to make students aware about accounting of different aspects of share capital and deals with the accounting treatment of different aspects of debenture and bond especially with issue, redemption including conversion of debenture. Understand the share capital structure in the balance sheet of a company. Discuss the methods and accounting procedure of issue of shares. Understand the accounting procedure of buy- back of shares. Understand the accounting treatment for ESOPs and ESPS. Understand the

meaning of underwriting Familiarize with various types of underwriting. Distinguish between marked application and unmarked applications. Determine the liability of underwriters. State the meaning of debenture and bonds; Describe the methods for the issue of debenture for cash and for consideration other than cash; Explain the issue of debenture as a collateral security; Explain the sources and record transaction relating to redemption of debenture; Discuss the methods of redemption of debenture; Record the Sinking Fund Investment transactions; Deal with cum-interest and ex-interest, open market operations.

Lesson 7 – Consolidation of Accounts

A holding company is one which acquires all or a majority of the equity shares of any other company called subsidiary company in order to have control over the subsidiary company. In order to understand the financial position of holding company, consolidations of accounts become very vital. After studying this lesson, students will be able to:

- Understand the concept of holding company and subsidiary company.
- Familiarize the legal requirements for preparation of final accounts of holding company.
- Prepare consolidated balance sheet and statement of profit and loss.
- Make appropriate accounting adjustments required for the preparation of consolidated balance sheet.
- Understand the concept of minority interest in consolidation of accounts.
- Appreciate the treatment of pre-acquisition profits and losses of the subsidiary company. Make adjustment regarding profit and loss on revaluation of assets of subsidiary company.
- Understand the calculation of goodwill or cost of control.
- Make adjustment for inter-company unrealized profits and inter-company transactions.
- Understand the treatment of bonus issue on consolidation of accounts.
- Make adjustment on dividend received from subsidiary company.

Lesson 8 – Financial Statement Analysis

Financial statements are compilation of financial data, collected and classified in a systematic manner according to the accounting principles, to assess the financial position of an enterprise as regards to its profitability, operational efficiency, long and short – term solvency and growth potential.

Financial statements are basic and formal means through which management of an enterprise make public communication of financial information along with select quantitative details. They are structured financial representation of the financial position, performance and cash flows of an enterprise. Many users rely on the general purpose financial statements as the major source of financial information and therefore, financial statements should be prepared and presented in accordance with their requirement. That does not undermine the dependence of the general users on the information contents of the financial statements.

Lesson 9 – Cash Flows

Cash flow statement is additional information to user of financial statement. This statement exhibits the flow of incoming and outgoing cash and cash equivalent. It assesses the ability of the enterprise to generate cash and utilize cash. Cash Flow Statement is one of the tools for assessing the liquidity and solvency of the enterprise.

Cash Flow Statement is considered to be a summarized statement showing sources of Cash Inflows and application of cash outflows of an enterprise during a particular period of time. It is prepared on the basis of the published data as disclosed by the Financial Statement of two different financial periods. It is an essential tool

for managerial decision-making. Cash Flow reports the management Net Cash Flow (i.e. cash inflow less cash outflow or vice versa) from each activity of the enterprise as well as of the overall business of the enterprise. The management of the enterprise gets a picture of movement of cash resources from the Cash Flow Statement and can assess the stronger and weaker area of movement of cash for different activities of the business for drawing up the future planning.

Lesson 10 – Forecasting Financial Statements

According to section 2(40) of Companies Act, 2013 defines “financial statement” in relation to a company, includes

- Balance Sheet as at the end of the financial year,
- Profit and Loss account, or (In the case of a company carrying on any activity not for profit, an income and expenditure account for the financial year),
- Cash Flow Statement for the financial year,
- Statement of Changes in Equity, if applicable, and
- Any explanatory note annexed to, or forming part of, any document.

Financial Statements shall be considered as horoscope if one knows how to read and analyze it then probably by addressing the various early warning signal available in statements would have helped to great extent.

Financial Forecasting is a process of estimating or predicting a company’s financial future by examining historical performance of data like revenue, cash flow, expenses, or sales. It is at the heart of driving business performance and stakeholder’s confidence. This lesson covers the Forecasting of Balance Sheet, Profit and Loss A/c , Cash Flows.

PART II : FINANCIAL MANAGEMENT (40 MARKS)

Lesson 11 – Introduction

This lesson covers the nature, scope and objectives of financial management, risk-return and value of the firm, objective of the firm: profit maximisation vs. wealth maximisation and emerging role of finance managers. Financial Management deals with procurement of funds and its effective utilizations in the business. It is concerned with investment, financing and dividend decisions in relation to objectives of the company. Financial management is very important for an organisation as it brings economic growth and development through investment, financing, dividend and risk management decision which help companies to undertake better projects. Lack of financial management in business will lead to losses and closure of business.

Lesson 12 – Time Value of Money

Time value of money is the quintessence in the formulation of financial decisions, especially in case of capital expenditure and long-term investments related decisions. Compounding and discounting are two pillars of time value of money. Now, depending upon the scenarios, cash inflows and outflows may take different forms, such as cash outflow in lump-sum at present and inflow in lump-sum in future, cash outflow and inflow in the form of annuities in the future etc.

In view of the mentioned facts, this lesson elucidated the concepts of time value of money, the power of compounding, concept of annuity, application of the various tables, i.e., Present Value Interest Factor, Future Value Interest Factor, Present Value Interest Factor of Annuity, Future Value of an Annuity and other pertinent concepts.

Lesson 13 – Capital Budgeting

This lesson covers capital budgeting process, its need and importance, kinds of capital budgeting decisions, capital expenditure control, capital rationing, various methods of capital budgeting- non discounted and discounted cash flow techniques, risk evaluation and sensitivity analysis, simulation for risk evaluation and some case studies on capital budgeting. Capital budgeting refers to long-term planning for proposed capital outlays and their financing. Thus, it includes both raising of long-term funds as well as their utilisation. It may, thus, be defined as the firm's formal process for acquisition and investment of capital. Capital budgeting requires use of various methods including statistical techniques which have been discussed in the chapter.

Lesson 14 – Cost of Capital

A business requires funds to purchase fixed assets like land and building, plant and machinery, furniture etc. These assets may be regarded as the foundation of a business. The cost of capital is the required rate of return that a firm must achieve in order to cover the cost of generating funds in the marketplace. It is used as a discount rate in determining the present value of future cash flows associated with capital projects. In this lesson we will study Sources of Long Term Finance, cost of capital, factors affecting the cost of capital, calculation of cost of capital of for different sources of finance, calculation of weighted cost of capital and marginal cost of capital.

Lesson 15 – Capital Structure

Capital Structure of a firm is a reflection of the overall investment and financing strategy of the firm. It shows how much reliance is being placed by the firm on external sources of finance and how much internal accruals are being used to finance expansions. Optimal capital structure means arrangement of various components of the structure in tune with both the long-term and short term objectives of the firm. This lesson comprises of nature, scope and significance of capital structure, factors affecting capital structure, capital structure vis a vis financial structure, planning and designing of capital structure, optimal capital structure, capital structure & valuation, theories of capital structure, types of leverage – operating leverage, financial leverage, combined leverage, EBIT-EPS analysis and effect of leverages on return on equity.

Lesson 16 – Dividend Decisions

Dividend policy determines what portion of earnings will be paid out to stock holders and what portion will be retained in the business to finance long-term growth. Dividend decision is one of the crucial parts of the financial manager, as it determines the amount available for financing the organization long term growth and it plays very important part in the financial management. This lesson includes types of dividend policies, determinants and constraints of dividend policy, type/ forms of dividend, different dividend theories – Walter's Model, Gordon's Model, Modigliani-Miller Hypothesis of Dividend Irrelevance Policy etc.

Lesson 17 – Working Capital Management

The capital which is required to finance current assets is called working capital. It is the capital of a business which is used to carry out day-to-day business operations of a firm. Working capital is vital for the proper and smooth functioning of an organisation. Therefore, it is very necessary for a corporate professional to know about management of different constituents of working capital. In this lesson we will study the meaning, types, determinants and assessment of working capital requirements, concept of negative working capital, operating cycle concept and applications of quantitative techniques, financing of working capital etc.

Lesson 18 - Security Analysis

Investment may be defined as a conscious act on the part of a person that involves deployment of money in securities issued by firms with a view to obtain a target rate of return over a specified period of time. Securities

are the instruments issued by seekers of funds in the investment market to the providers of funds in lieu of funds. Security analysis is about valuing the securities using publicly available information. In this lesson we will cover the concept of investment and security analysis, investment vs. speculation, risks and its types, approaches to valuation of a security, fundamental analysis, technical analysis and efficient market theory.

Lesson 19 – Operational Approach to Financial Decision

Financial decisions are largely influenced by the scale of operations of a business organization, which in turn are influenced by various forms of costs incurred on operations, like cost incurred on procurement of raw materials, employment of human capital, manufacturing process, sales and distribution etc., and in this regard different costing techniques plays a pivotal role in formulation of robust financial decisions.

This lesson makes an endeavour to throw light on the pertinent cost dimensions that affects the operations of an enterprise, such as an overview of costing, key concepts, basics principles of costing, marginal costing etc.

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Introduction to Accounting

Lesson

1

KEY CONCEPTS

■ Accounting ■ Book-Keeping ■ Debit ■ Credit ■ Personal Account ■ Real Account ■ Nominal Account
■ Single Entry System ■ Double Entry System ■ Journal ■ Subsidiary Books ■ Ledger ■ Trial Balance ■ Final Accounts

Learning Objectives

To understand:

- Basic Concepts of Accounting
- Attributes and Objectives of Accounting
- Book-Keeping & Accounting Cycle
- Accounting Concept
- Golden Rules of Accounting
- Types of Accounts i.e. Personal , Real , Nominal
- Single and Double Entry System
- Journal, Subsidiary Books, Ledger, Trail Balance
- Final Accounts (Trading , Profit and Loss & Balance Sheet)

Lesson Outline

- Introduction
- Book-Keeping
- Accounting Cycle
- Single Entry System
- Double Entry System
- Accounting Concept
- Types of Accounts
- Journal
- Ledger
- Trial Balance
- Final Accounts
- Lesson Round-Up
- Glossary
- Test Yourself
- List of Further Readings

INTRODUCTION

Business is the activity of making one's living or making money by producing or buying and selling products (such as goods and services). It is also "any activity or enterprise entered into with the motive of earning profits and maximization of the wealth for owners. No business can run in isolation. Largely, the business activity is carried out by people coming together with a purpose to serve a common cause. This term is often referred to as an organization, which could be in different forms such as sole proprietorship, partnership, corporate body, etc.

- **Sole proprietorship:** A sole proprietorship, also known as a sole trader, is owned by one person and operates for their benefit. All assets of the business belong to a sole proprietor, including, for example, a computer infrastructure, any inventory, manufacturing equipment, or retail fixtures, as well as any real property owned by the sole proprietor.
- **Partnership:** A partnership is a business owned by two or more people. In most forms of partnerships, each partner has unlimited liability for the debts incurred by the business. The three most prevalent types of for-profit partnerships are general partnerships, limited partnerships, and limited liability partnerships.
- **Corporation:** The owners of a corporation have limited liability and the business has a separate legal personality from its owners. Corporations can be either government-owned or privately owned, and they can organize either for profit or as nonprofit organizations.
- **Co-operative:** Often referred to as a "co-op", a co-operative is a limited-liability business that can organize as for-profit or not-for-profit. A cooperative differs from a corporation in that it has members, not shareholders, and they share decision-making authority.
- **Franchises:** A franchise is a system in which entrepreneurs purchase the rights to open and run a business from a larger corporation. Franchising in the United States is widespread and is a major economic powerhouse.
- **A company limited by guarantee:** Commonly used where companies are formed for non-commercial purposes, such as clubs or charities. The members guarantee the payment of certain (usually nominal) amounts if the company goes into insolvent liquidation, but otherwise, they have no economic rights in relation to the company. A company limited by guarantee may be with or without having share capital.
- **A company limited by shares:** The most common form of the company used for business ventures. Specifically, a limited company is a "company in which the liability of each shareholder is limited to the amount individually invested" with corporations being "the most common example of a limited company."
- **A company limited by guarantee with a share capital:** A hybrid entity, usually used where the company is formed for non-commercial purposes, but the activities of the company are partly funded by investors who expect a return.
- **An unlimited company with or without a share capital:** A hybrid entity, a company where the liability of members or shareholders for the debts (if any) of the company are not limited. In this case, the doctrine of a veil of incorporation does not apply.

The business activities require resources (which are limited and have multiple uses) primarily in terms of material, labour, technology etc. The success of a business depends on how efficiently and effectively these resources are managed. Therefore, there is a need to ensure that the businessman tracks the use of these resources. The resources are not free, and thus one must be careful to keep an eye on the cost of acquiring them as well. As the basic purpose of business is to make profit, one must keep an ongoing track of the activities undertaken in the course of business. Two basic questions would have to be answered:

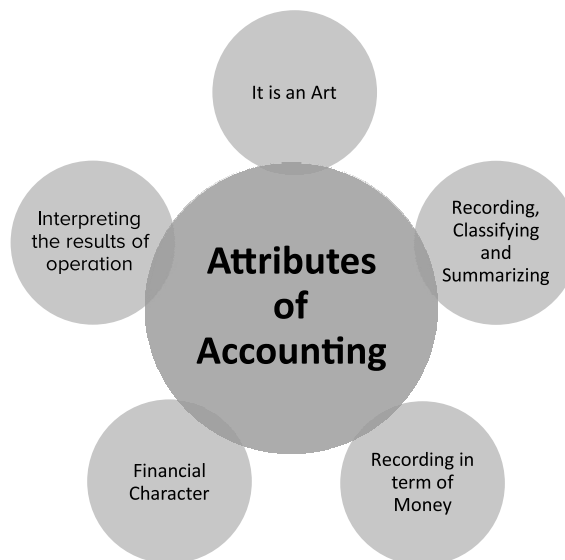
- (a) What is the result of any business operations? i.e. whether it has made profit or loss?
- (b) What is the position of the resources acquired and used for business purposes? How are these resources financed and where do the funds come from?

The answers to these questions can be found through recording all the business activities / transaction / event. Recording of business activities has to be done in a scientific manner so that they reveal the correct outcome.

Accounting, also known as accountancy, is the measurement, processing, and communication of financial and non financial information about economic entities such as businesses and corporations. Accounting, which has been called the “language of business”, measures the results of an organization’s economic activities and conveys this information to a variety of stakeholders, including investors, creditors, management, and regulators. Practitioners of accounting are known as accountants. The terms “accounting” and “financial reporting” are often used as synonyms.

“Accounting is “the art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character and interpreting the results thereof”. - American Institute of Certified Public Accountants (‘AICPA’)

Attributes of Accounting



- (i) **Accounting is an Art** - Accounting is classified as an art, as it helps us in attaining our aim of ascertaining the financial results, that is, operating profit and financial position through analysis and interpretation of financial data which requires special knowledge, experience and judgment.
- (ii) **It involves recording, classifying and summarizing** - Recording means systematically writing down the transactions and events in account books soon after their occurrence. Classifying is the process of grouping transactions or entries of the same type at one place. This is done by opening accounts in a book called ledger. Summarizing involves the preparation of reports and statements from the classified data (ledger), understandable and useful to management and other interested parties. This involves preparation of final accounts namely profit and loss account and balance sheet.
- (iii) **It records transactions in terms of money** - All transactions are recorded in terms of common measure, i.e., money which increases the understanding of the state of affairs of the business.
- (iv) **It records only those transactions and events which are of financial character** - If an event has no financial character then it will not be capable of being measured in terms of money; it will not be, therefore, recorded.

- (v) **It is the art of interpreting the results of operations** - to determine the financial position of the enterprise, the progress it has made and how well it is getting along.

Objectives of Accounting

Providing Information to the Users for Rational Decision making	Accounting provides useful information for decision-making to stakeholders such as owners, management, creditors and investors and other stake holders. Various outcomes of business activities such as costs, prices, sales volume, value under ownership and return on investment are measured in the accounting process. All these accounting measurements are used by stakeholders in decision making process. Hence, accounting is identified as the language of a business.
Systematic Recording of Transactions	To ensure reliability and precision for the accounting measurements, it is necessary to keep a systematic record of all financial transactions of a business enterprise which is ensured by book-keeping. These financial records are classified, summarized and reposted in the form of accounting measurements to the users of accounting information i.e., stakeholders.
Ascertainment the results of above Transactions	Profit/Loss is a core accounting measurement done and measured by preparing a Profit and Loss Account for a particular period. Difference between these revenue incomes and revenue expenses is known as the result of business transactions identified as profit/loss. As this measure is used very frequently by stake-holders for rational decision making, it has become the objective of accounting. For example, Income Tax Act requires that every business should have an accounting system that can measure taxable income of the business and also explain nature and source of every item reported in Income Tax Return.
Ascertain the Financial Position of Business	Financial position is identified by preparing a statement of ownership meaning Assets, and owing meaning Liabilities of the business as on a certain date. This statement is popularly known as Balance Sheet. This statement may be used by various stakeholders for taking financing and investment decisions.
To Know the Solvency Position	Balance Sheet and Profit and Loss Account provide useful information to stockholders regarding potential of the entity to meet their obligations in the short as well as in the long run.

BOOK-KEEPING

As defined by Carter, “Book-Keeping is a science as well as art of correctly recording in books of accounts all those business transactions that result in transfer of money or money’s worth”.

Book-keeping is an activity concerned with recording and classifying financial data related to business operations in order of occurrence.

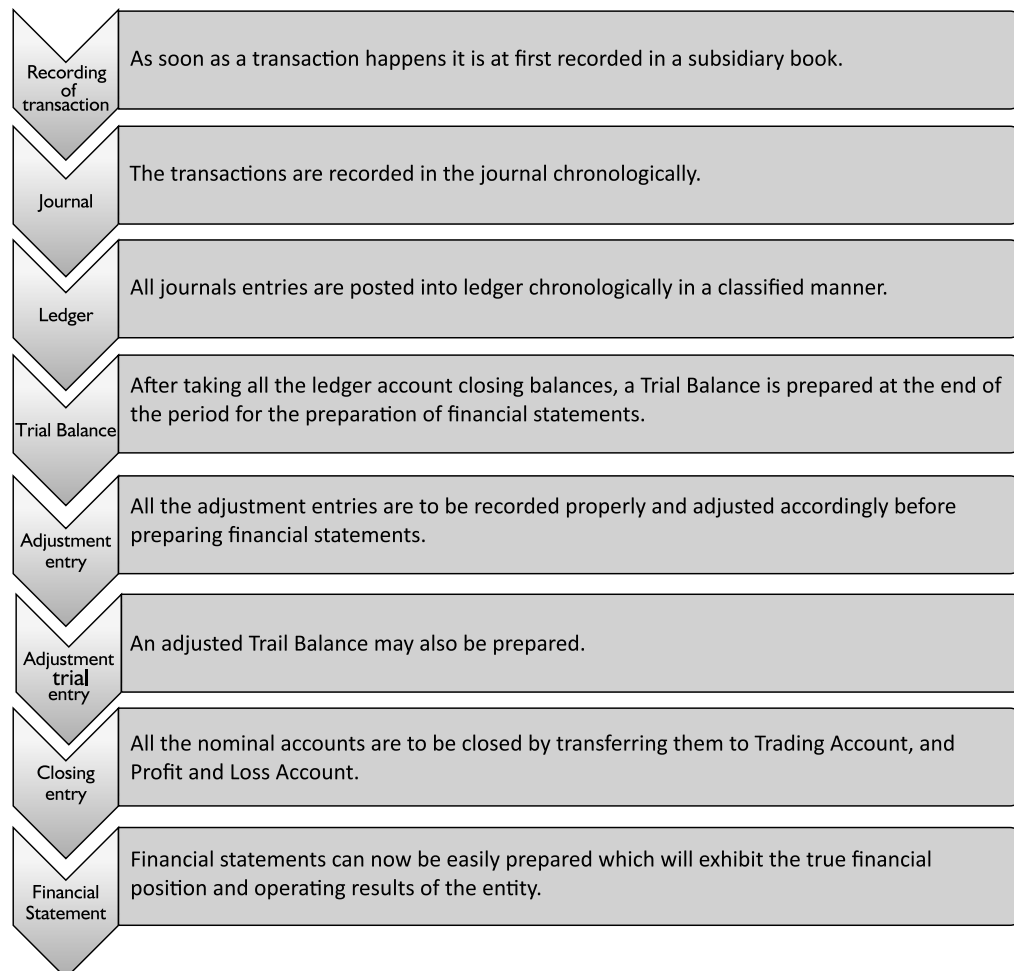
Book-keeping involves:

- Collection of basic financial information
- Identification of events and transactions with financial character, i.e., economic transactions
- Measurement of economic transactions in terms of money
- Recording of financial effects of economic transactions in order of its occurrence
- Classifying effects of economic transactions
- Preparing organized statement known as Trial Balance

Distinction between Book-Keeping and Accounting

Book-Keeping	Accounting
Output of book-keeping is an input for accounting.	Output of accounting permits informed judgments and decisions by the user (stakeholders) of accounting information.
Purpose of book-keeping is to keep systematic record of transactions and events of financial character in order of occurrence.	Purpose of accounting is to find results of operating activity of a business and to report its financial strength.
Book-keeping is the foundation of accounting.	Accounting is considered as a language of business.
Book-keeping is carried out by the junior staff.	Accounting is done by the senior staff who have skills of analysis and interpretation.
Objective of book-keeping is to summarize the cumulative effect of all economic transactions of business for a given period by maintaining permanent record of each business transaction with its evidence and financial effects on accounting variable.	Object of accounting is not only book-keeping but also analyzing and interpreting reported financial information for informed decisions by the stake-holders or user of financial statement.

ACCOUNTING CYCLE



The accounting cycle is a basic, eight-step process for completing a company's book-keeping tasks. It provides a clear guide for the recording, analysis, and final reporting of a business's financial activities.

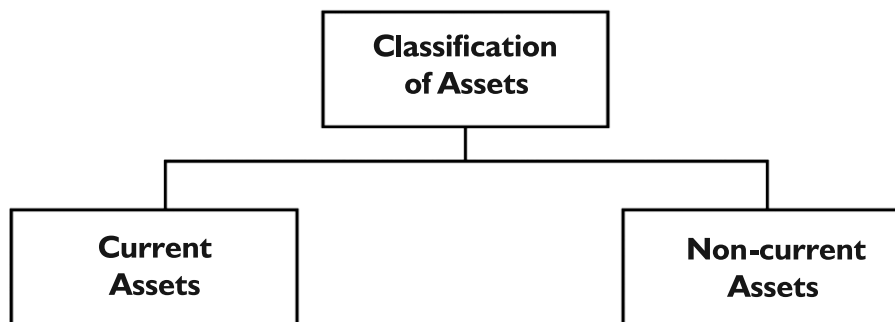
The steps or phases of accounting cycle can be developed as under:

Basic Accounting Terms

In order to understand the Accounting clearly, one must grasp the following common expressions used in business accounting. The aim here is to enable the student to understand these often used concepts before we embark on accounting procedures and rules.

- **Transaction:** It means an event or a business activity which involves exchange of money or money's worth between parties. The event can be measured in terms of money and changes the financial position of a entity e.g., purchase of goods would involve receiving material and making payment or creating an obligation to pay to the supplier at a future date. Transaction could be a cash transaction or credit transaction. When the parties settle the transaction immediately by making payment in cash or by cheque, it is called a cash transaction. On the other hand, in credit transactions, the payment is settled at a future date as per agreement between the parties.
- **Event:** An event may be described as any incidence that occurs as a result of something. In an accounting sense, an event can be understood as the final outcome of a business activity that can affect the account balances of the company if it is financial in nature. Whenever there is an increase or decrease in the company's assets or liabilities, an accounting event takes place. Therefore, it can change the fundamental accounting equation and can be expressed monetarily.
- **Goods/Services:** These are tangible article or commodities in which a business deals. These articles or commodities are either bought and sold or produced and sold. At times, what may be classified as goods to one business firm may not be goods to the other firm, e.g., for a machine manufacturing company, the machines are goods as they are frequently made and sold. But for the buying firm, it is not goods as the intention is to use it as a long-term resource and not sell it. The services are intangible in nature and are rendered with or without the object of earning profits.
- **Capital Expenditure:** This represents expenditure incurred for the purpose of acquiring a fixed asset which is intended to be used over long term for earning profits there from, e.g., amount paid to buy a computer for office use is a capital expenditure. At times expenditure may be incurred for enhancing the production capacity of the machine. This will also be a capital expenditure. Capital expenditure forms a part of the Balance Sheet.
- **Revenue Expenditure:** This represents expenditure incurred to earn revenue of the current period. The benefits of revenue expenses get exhausted in the year of the incurrence. For example repairs, insurance, salary and wages to employees, travel, etc. The revenue expenditure results in the reduction in profit or surplus. It becomes part of the Income statement.
- **Profit and Loss Account or Income Statement:** This account shows the revenue earned by the business and the expenses incurred by it to earn that revenue. This is prepared usually for a particular accounting period, which could be a month, quarter, half a year or a year. The net result of the Profit and Loss Account shows profit earned or loss suffered by the business entity.
- **Profit:** The excess of revenue over expenses is called profit.
- **Loss:** The excess of expense over income is called loss.

- **Trade Discount:** It is the discount usually allowed by the wholesaler to the retailer computed on the list price or invoice price. For example, the list price of a TV set could be Rs. 15,000. The wholesaler may allow 20% discount thereof to the retailer. This means the retailer will get it for Rs.12,000 and is expected to sell it finally to a customer at the list price. Thus, the trade discount enables the retailer to make profit by selling at the list price. Trade discount is not recorded in the books of accounts. The transactions are recorded at net values only. In the above example, the transaction will be recorded at Rs. 12,000 only.
- **Cash Discount:** It is allowed to encourage prompt payment by the debtor. It has to be recorded in the books of accounts. It is calculated after deducting the trade discount, like if list price is Rs. 15,000 on which a trade discount of 20% and cash discount of 2% apply, the first trade discount of Rs.3,000 (20% of Rs. 15,000) will be deducted and the cash discount of 2% will be calculated on Rs.12,000 (Rs.15,000 – Rs.3,000). Hence, the cash discount will be Rs.240 (2% of Rs. 12,000) and net payment will be Rs. 11,760 (Rs. 12,000 - Rs. 240)
- **Balance Sheet:** It is the statement of the financial position of the business entity on a particular date. It lists all assets, liabilities and capital. It is important to note that this statement exhibits the state of affairs of the business as on a particular date only. It describes what the business owns and what it owes to outsiders (this denotes liabilities), and to the owners (this denotes capital). It is prepared after incorporating the resulting Profit/Loss or Income Statement.
- **Asset:** Asset is a resource owned by a business with the purpose of using it for generating future profits. Assets can be tangible and intangible.
- **Tangible Assets** are the capital assets which have some physical existence. These can, therefore, be seen, touched and felt, e.g., plant and machinery, furniture and fittings, land and buildings, books, computers and vehicles.
- **Intangible Assets:** The capital assets which have no physical existence and whose value is limited by the rights and anticipated benefits that possession confers upon the owner are known as intangible assets. These cannot be seen or felt although these help to generate revenue in future, e.g., goodwill, patents, trade-marks, copyrights, brand equity, designs and intellectual property, etc.
- **Classification of Assets:** Assets can also be classified as Current Assets and Non-Current Assets.



- **Current Assets** – An asset can be classified as Current if it satisfies any of the following:
 - i. It is expected to be realized in, or is intended for sale or consumption in the company's normal Operating cycle;
 - ii. It is held primarily for the purpose of being traded;

- iii. It is due to be realized within 12 months after the Reporting Date; or
 - iv. It is Cash or Cash Equivalent unless it is restricted from being exchanged or used to settle a liability for at least 12 months after the Reporting Date.
- **Non-Current Assets** – Other than Current Assets, all other assets are classified as Non-Current Assets, e.g., Machinery held for Long-term, etc.
 - **Current Investments:** Current investments are investments that are by their nature readily realizable and are intended to be held for not more than one year from the date on which such investment is made. 11-months Commercial Paper is an example of current investment.
 - **Non-Current Investments:** Non-Current Investments are investments which are held beyond the current period for sale or disposal, like a Fixed Deposit for 5 years.
 - **Debtor:** The sum total or aggregate of the amounts which the customer owes to the business for the purchase of goods on credit or services rendered or in respect of other contractual obligations, is known as Sundry Debtors or Trade Debtors, or Trade Payable, or Book-Debts or Debtors. These debtors may again be classified as under:
 - (a) **Good Debts:** The debts which are sure to be realized are called good debts.
 - (b) **Doubtful Debts:** The debts which may or may not be realized are called doubtful debts.
 - (c) **Bad Debts:** The debts which cannot be realized at all are called bad debts.
 - **Fictitious Assets:** Fictitious assets are not assets at all since they are not represented by any tangible possession. They appear on the asset side simply because of a debit balance in a particular account not yet written off, e.g., provision for discount to creditors, discount on issue of shares, etc.
 - **Wasting Assets:** Such assets as mines, quarries, etc., that become exhausted or reduce in value by their workings are called wasting assets.
 - **Liability:** It is an obligation of financial nature to be settled at a future date. It represents amount of money that the business owes to the other parties. For instance, when goods are bought on credit, the firm will create an obligation to pay to the supplier, the price of goods on an agreed future date, or when a loan is taken from bank, an obligation to pay the interest and principal amount is created. Depending upon the period of holding, these obligations could be further classified into long term or Non-current liabilities, and short term or current liabilities.
 - **Current Liabilities** – A liability is classified as current when it satisfies any of the following:
 - i. It is expected to be settled in the company's normal Operating Cycle;
 - ii. It is held primarily for the purpose of being traded;
 - iii. It is due to be settled within 12 months after the Reporting Date; or
 - iv. The company does not have an unconditional right to defer settlement of the liability for at least 12 months after the reporting date.
 - **Non-Current Liabilities** – Other than Current Liabilities, all other liabilities shall be classified as Non-Current Liabilities. For example loan taken for 5 years, Debentures issued etc.
 - **Contingent Liability:** It represents a potential obligation that could be created depending on the outcome of an event. For example, if a supplier of a business files a legal suit, it will not be treated as a

liability because no obligation is created immediately. If the verdict of the case is given in favour of the supplier then only the obligation is created. Till that time it is treated as a contingent liability. Please note that contingent liability is not recorded in books of account, but disclosed through a note in the financial statements.

- **Capital:** Capital is the amount invested in a business by its owners. It may be in the form of cash, goods, or any other asset which the proprietor or partners of business invest in the business.
- **Drawings:** It represents the amount of cash, goods or any other assets which the owner withdraws from business for his or her personal use, e.g., the life insurance premium of the proprietor or a partner of the firm is paid from the business, it is called drawings. Drawings will result in a reduction in the owners' capital. The concept of drawing is not applicable to the corporate bodies like limited companies.
- **Net worth:** It represents the excess of total assets over total liabilities of a business. Technically, this amount is made available to be distributed to the owners in the event of closure of the business after payment of all liabilities.
- **Creditor:** A creditor is a person to whom the business owes money or money's worth. For example, money payable to the supplier of goods or provider of service. Creditors are generally classified as Current Liabilities.

SINGLE ENTRY SYSTEM

Single-entry bookkeeping, also known as, single-entry accounting, is a method of bookkeeping that relies on a one-sided accounting entry to maintain financial information. In case of double entry system of bookkeeping both the aspects of every transaction are recorded. In this system, the first entry is made to the debit of an account, and the second entry to the credit of second account. However, in case of single entry system, the business houses for their convenience and more practical approach ignore the strict rules of double entry system. The users of this system maintain only the essential records. In other words, it is a system which may not keep some books of subsidiary records, and some ledger accounts too which otherwise are kept in case of double entry system.

According to a Dictionary of Accountancy by Kohler, "A system of book-keeping in which as a rule only records of cash and of personal accounts are maintained, it is always incomplete double entry varying with the circumstances." Thus, under the so-called single entry system both the aspects of business transactions and events are not recorded. Under the single entry system usually a cash book and personal accounts are maintained.

DOUBLE ENTRY SYSTEM

Double-entry bookkeeping, also known as double-entry accounting, is a method of bookkeeping that relies on a two-sided accounting entry to maintain financial information. Every entry to an account requires a corresponding and opposite entry to a different account. The double-entry system has two equal and corresponding sides known as debit and credit.

It was in 1494 that Luca Pacioli, the Italian mathematician, first published his comprehensive treatise on the principles of Double Entry System. The use of principles of double entry system made it possible to record not only cash but also all sorts of mercantile transactions. It had created a profound impact on auditing too, because it enhanced the duties of an auditor to a considerable extent.

Features of Double Entry System

- (a) Every transaction has two-fold aspects, i.e., one party giving the benefit and the other receiving the benefit.
- (b) Every transaction is divided into two aspects, debit and credit. One account is to be debited and the other account is to be credited.
- (c) Every debit must have its corresponding and equal credit.

Advantages of Double Entry System

- (a) Since personal and impersonal accounts are maintained under the double entry system, both the effects of the transactions are recorded.
- (b) It ensures arithmetical accuracy of the books of accounts, for every debit, there is a corresponding and equal credit. This is ascertained by preparing a trial balance periodically, or at the end of the financial year.
- (c) It prevents and minimizes error. Moreover frauds can be detected early.
- (d) Errors can be checked and rectified easily.
- (e) The balances of receivables and payables are determined easily, since the personal accounts are maintained.
- (f) The businessman can compare the financial position of the current year with that of the past years.
- (g) The businessman can justify the standing of his business in comparison with the previous year purchase, sales, and stocks, incomes and expenses with that of the current year figures.
- (h) Helps in decision-making.
- (i) The net operating results can be calculated by preparing the Trading and Profit and Loss A/c for the year ended and the financial position can be ascertained by the preparation of the Balance Sheet.
- (j) It helps the Government to decide sickness of business units and extend help accordingly.
- (k) The other stakeholders, like suppliers and banks can take a proper decision regarding grant of credit or loans.

Limitations of Double Entry System

- (a) The system does not disclose all the errors committed in the books of accounts.
- (b) The Trial Balance prepared under this system does not disclose certain types of errors i.e. compensating error.
- (c) It is costly as it involves maintenance of numbers of books of accounts.

ACCOUNTING CONCEPT

Accounting concepts are the generally accepted rules and assumptions that assist accountants in preparing financial statements. In layman's terms, they are the fundamental building blocks of the transactions of the business. The following are the some Accounting Concepts that's need to be kept in mind while recording the transaction in books of accounts.

1. **Accruals Concept:** An accrual is a journal entry that is used to recognize revenues and expenses that have been earned or consumed, respectively, and for which the related cash amounts have not yet been received or paid out. Accruals are needed to ensure that all revenues and expenses are recognized within the correct reporting period, irrespective of the timing of the related cash flows.
2. **Conservatism Concept:** Revenue is only recognized when there is a reasonable certainty that it will be realized, whereas expenses are recognized sooner, when there is a reasonable possibility that they will be incurred. This concept tends to result in more conservative financial statements.
3. **Consistency Concept:** Once a business chooses to use a specific accounting method, it should continue using it on a go-forward basis. By doing so, financial statements prepared in multiple periods can be reliably compared.
4. **Economic Entity Concept:** The transactions of a business are to be kept separate from those of its owners. By doing so, there is no intermingling of personal and business transactions in a company's financial statements.
5. **Going Concern Concept:** Financial statements are prepared on the assumption that the business will remain in operation in future periods. Under this assumption, revenue and expense recognition may be deferred to a future period, when the company is still operating. Otherwise, all expense recognition in particular would be accelerated into the current period.
6. **Matching Concept:** The expenses related to revenue should be recognized in the same period in which the revenue was recognized. By doing this, there is no deferral of expense recognition into later reporting periods, so that someone viewing a company's financial statements can be assured that all aspects of a transaction have been recorded at the same time.
7. **Materiality Concept:** Materiality is an accounting principle which states that all items that are reasonably likely to impact investors' decision-making must be recorded or reported in detail in a business's financial statements using GAAP standards. Materiality is a concept that defines why and how certain issues are important for a company or a business sector. A material issue can have a major impact on the financial, economic, reputational, and legal aspects of a company, as well as on the system of internal and external stakeholders of that company. Items or events which have significant effect in decision based on Financial Statement must be clearly disclosed. Both nature and volume of a transaction is capable to make it material.

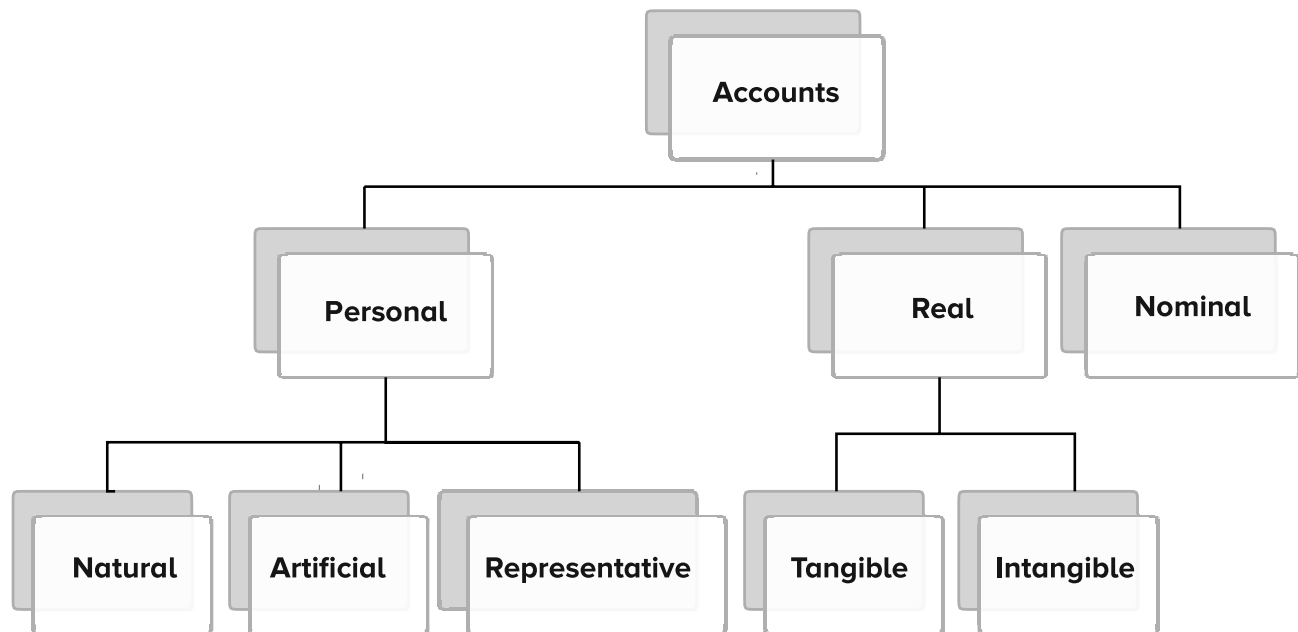
TYPES OF ACCOUNTS

An account is defined as a summarized record of transactions related to a person or a thing, e.g., when the business deals with customers and suppliers, the customer and supplier will each be a separate account.

The account is also related to things – both tangible and intangible, like, land, building, equipment, brand value and trademarks are some of the things. When a business transaction happens, one has to identify the account that will be affected by it and then apply the rules to decide its accounting treatment.

Typically, an account is expressed as a statement in the form of English letter 'T'. It has two sides. The left hand side is called as the Debit side, and the right hand side is called as the Credit side. The debit is denoted as 'Dr' and the credit as 'Cr'. The convention is to write the Dr. and Cr. labels on both sides as shown below.

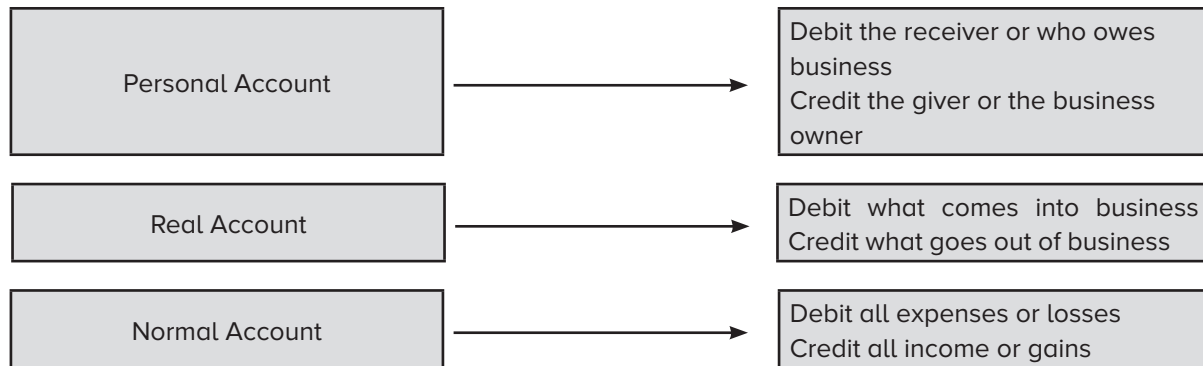
	Debit side (Dr.)	Credit side (Cr.)
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1. **Personal Account:** As the name suggests these are accounts related to persons.
 - (a) These persons could be natural persons, like Suresh's A/c, Anil's A/c and Rani's A/c.
 - (b) The persons could also be artificial persons like companies, bodies corporate or association of persons or partnerships. Accordingly, we could have Videocon Industries A/c, Infosys Technologies A/c, Charitable Trust A/c, Ali and Sons Trading A/c and ABC Bank A/c.
 - (c) There could be representative personal accounts as well. Although the individual identity of persons related to these is known, the convention is to reflect them as collective accounts, e.g., when salary is payable to employees, we know how much is payable to each of them, but collectively the account is called as Salary Payable A/c.
2. **Real Accounts:** These are accounts related to assets or properties or possessions Depending on their physical existence or otherwise, they are further classified as follows:
 - (a) *Tangible Real Account* – Assets that have physical existence and can be seen and touched, under this as Machinery A/c, Stock A/c, Cash A/c, Vehicle A/c, and the like.
 - (b) *Intangible Real Account* – These represent possession of properties that have no physical existence but can be measured in terms of money and have value attached to them like Goodwill A/c, Trade Mark A/c, Patents & Copy Rights A/c and Intellectual Property Rights A/c.
3. **Nominal Account:** These accounts are related to expenses or losses and incomes or gains e.g. Salary and Wages A/c, Rent and Rates A/c, Travelling Expenses A/c, Commission received A/c and Loss by fire A/c.

Golden Rules of Accounting

When one identifies the account that is getting affected by a transaction and type of that account, the next step is to apply the rules to decide whether the accounting treatment is to be debited or credited from that account. The Golden Rules will guide whether the account is to be debited or credited. These rules are shown below:



JOURNAL

A journal is often referred to the Book of Prime Entry or Book of Original Entry. In this book transactions are recorded in their chronological order. The process of recording transaction in a journal is called 'Journalization'. The entry made in this book is called 'journal entry'.

Advantages of Journal

The following are the advantages of a journal:

- Chronological Record:** It records transactions as and when it happens. So it is possible to get detailed day-to-day information.
- Minimizing the possibility of errors:** The nature of transaction and its effect on the financial position of the business is determined by recording and analyzing into both debit and credit aspects.
- Narration:** It means explanation of the recorded transactions.
- Helps to finalize the accounts:** Journal is the basis of ledger posting and the ultimate Trial Balance.

The Trial Balance helps to prepare the final accounts.

Specimen of a Journal Book

Journal Entries in the Books of xxx

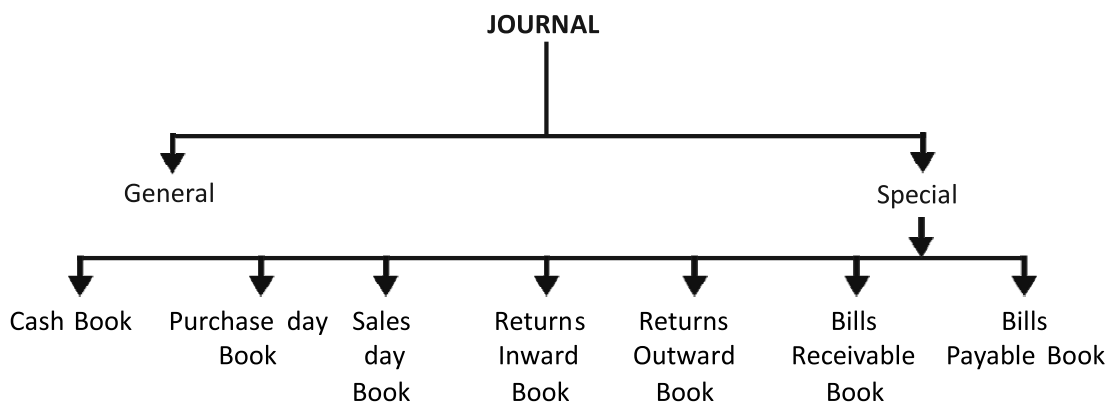
Date	Particulars	Voucher Number	Ledger folio	Debit amount (Rs.)	Credit Amount (Rs.)
dd-mm-yy	Name of A/c from which to be debited Name of A/c to be credited (narration describing the transaction)	-----	Reference of page number of the A/c in ledger	-----	-----

- Date Column:** This column contains the date of the transaction.
- Particulars:** This column contains which account is to be debited and which account is to be credited. It is also supported by an explanation called narration.
- Voucher Number:** This column contains the number written on the voucher of the respective transaction.

- (d) **Ledger Folio (L.F.):** This column contains the folio (i.e., page no.) of the ledger, where the transaction is posted.
- (e) **Dr. Amount and Cr. Amount:** This column shows the financial value of each transaction. The amount is recorded in both the columns, since for every debit there is a corresponding and equal credit.

Sub-division of Journals

Journal is divided into two types -(i) General Journal and (ii) Special Journal.



(i) General Journal

- (a) This book contains chronological record of transactions.
- (b) This book records those transactions which occur so infrequently that they do not warrant the setting up of special journals.

Examples of such entries: (i) opening entries (ii) closing entries (iii) rectification of errors. The form of this general journal, is as under:

JOURNAL

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. Amount</i>	<i>Cr. Amount</i>

Recording of transactions in this book is called journalizing and the record of transactions is known as journal entry.

(ii) Special Journal

It is sub-divided into Cash Book, Purchase Day Book, Sales Day Book, Returns Inward Book, Returns Outward Book, Bills Receivable Book and Bills Payable Book. These books are called subsidiary books.

Subsidiary Books

Subsidiary Books refer to books meant for specific transactions of similar nature. These books are also known as special journals or day books. To overcome shortcoming of the use of the journal only as a book of original entry, the journal is sub-divided into specific journals or subsidiary books.

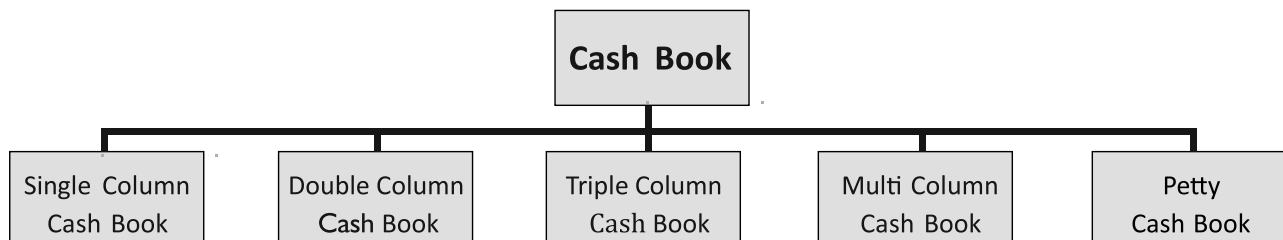
The sub-division of journal is done as follows:

Transaction	Subsidiary Book
All cash and bank transactions	Cash Book has columns for cash, bank and cash discount
All credit purchase of goods – only those goods that are purchased for resale are covered here	Purchase Day Book or Purchase Register
All credit sale of goods	Sales Day Book or Sales Register
All purchase returns – i.e., return of goods back to suppliers due to defects	Purchase Return Book or Return Outward Book
All sales returns – i.e., return of goods back from Customers	Sales Return Book or Return Inward Book
All bill receivables – these are bills accepted by Customers to be honored at an agreed date	Bills Receivable Book
All bills payable - these are bills accepted by the business to be honored by paying to suppliers at an agreed date	Bills Payable Book
For all other transactions not covered in any of the above categories – i.e., purchase or sale of assets, expense accruals, rectification entries, adjusting entries, opening entries and closing entries	Journal Proper

Cash Book

A Cash Book is a special journal which is used for recording all cash receipts and cash payments. Cash Book is a book of original entry since transactions are recorded for the first time from the source documents. The Cash Book is larger in the sense that it is designed in the form of a Cash Account and records cash receipts on the debit side and cash payments on the credit side. Thus, the Cash Book is both a journal and a ledger.

Types of Cash Book



- (a) **Single Column Cash Book-** Single Column Cash book has one amount column on each side. All cash receipts are recorded on the debit side and all cash payments on the payment side; this book is nothing but a Cash Account and there is no need to open separate cash account in the ledger.

Dr. Specimen of Single Column Cash Book Cr.

Receipts				Payments			
Date	Particulars	L.F.	Cash	Date	Particulars	L.F.	Cash

- (b) **Double Column Cash Book-** The Double Column Cash Book has two amounts columns on each side as under:

- (a) Cash and discount columns
- (b) Cash and bank columns
- (c) Bank and discount columns

Dr. Specimen of Double Column Cash Book Cr.

Receipts					Payments				
Date	Particulars	L.F.	Cash	Disc. Allowed	Date	Particulars	L.F.	Cash	Disc. Received

- (c) **Triple Column Cash Book-** Triple Column Cash Book has three amount columns, one for cash, one for bank and one for discount on each side. All cash receipts, deposits into book and discounts allowed are recorded on the debit side and all cash payments, withdrawals from bank and discounts received are recorded on the credit side. In fact, a triple-column cash book serves the purpose of both Cash Account and Bank Account. Thus, there is no need to create these two accounts in the ledger.

Dr. Specimen of Triple Column Cash Book Cr.

Receipts						Payments				
Date	Particulars	L.F.	Cash	Bank	Discount Allowed	Date	Particulars	L.F.	Bank	Discount Received

- (d) **The multi-column cash book** has multiple columns on both the sides of the cash book.
- (e) The petty cash book.

Is the Cash Book a Journal or a Ledger?

Cash Book is a book of original entry since transactions are recorded for the first time from the source documents. It is a ledger in the sense that it is designed in the form of a Cash Account and records cash receipts on the debit side and cash payments on the credit side. Thus, the cash book is both a journal and a ledger.

Purchase Day Book

The purchase day book records the transactions related to credit purchase of goods only. Any cash purchase or purchase of things other than goods is not recorded in the purchase day book. Periodically, the totals of purchase day book are posted to purchase account in the ledger. A specimen of purchase day book is given below:

In the Books of _____ Purchase Day Book

<i>Date</i>	<i>Name of the Suppliers and details of Goods purchased</i>	<i>Invoice reference</i>	<i>L. F.</i>	<i>Amount (Rs.)</i>	<i>Remarks</i>
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The format for Purchase Return Book is exactly the same; hence separate illustration is not given.

Sales Day Book

The sales day book records transactions of credit sale of goods to customers. Sale of other things, even on credit, will not be entered in the sales day book, but is entered in Journal. If goods are sold for cash, it is entered in the cash book. Total of sales day book is periodically posted to the sales account in the ledger. A specimen of a sales day book is given below.

In the Books of Sales Day Book

<i>Date</i>	<i>Particulars</i>	<i>Invoice reference</i>	<i>L. F.</i>	<i>Amount (Rs.)</i>	<i>Remarks</i>
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The format of sales return book is exactly the same; hence a separate illustration is not given.

Other Subsidiary Books – Returns Inward, Return Outward, Bills Receivable, Bills Payable

- i) **Return Inward Book-** The transactions relating to goods which are returned by the customers for various reasons (may be for the reason that the goods are not according to sample, or not up to the mark) are recorded in return inward book. It is also known as Sales Return Book. Generally, when a customer returns goods to suppliers, he issues a Debit Note for the value of the goods returned by him. Similarly, the supplier who receives those goods issues a Credit Note.

Returns Inward Day Book

<i>Date</i>	<i>Particulars</i>	<i>Outward Invoice</i>	<i>L. F.</i>	<i>Details</i>	<i>Totals</i>	<i>Remarks</i>
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- ii) **Return Outward Book-** This book records the transactions relating to goods that are returned by us to our creditors, e.g., goods broken in transit, or not matching with the sample, etc. It is also known as Purchase Return Book.

Return Outward Day Book

<i>Date</i>	<i>Particulars</i>	<i>Debit Note</i>	<i>L. F.</i>	<i>Details</i>	<i>Totals</i>	<i>Remarks</i>
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- iii) **Bills Receivable Book-** It is a book where all bills received are recorded and therefrom posted directly to the credit of the respective customer's account. The total amounts of the bills so received during the period (either at the end of the week or month) is to be posted in one sum to the debit of Bills Receivable A/c.

Bills Receivable Day Book

No. of Bills	Date of Receipt of Bill	From whom	Name of the Receiver	Name of Drawer	Name of Acceptor	Date of Bill	Due Date	L.F.	Amount of Bill	How disposed off
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- iv) **Bills Payable Book-** Here all the particulars relating to bills accepted are recorded and therefrom posted directly to the debit of the respective creditor's account. The total amounts of the bills so accepted during the period (either at the end of the week or month) is posted in one sum to the credit of Bills Payable Account.

Bills Payable Day Book

No. of Bills	Date of Acceptance	To whom given	Name of Drawer	Name of Payee	Name of Payable	Date of Bill	Term	Due Date	L.F.	Amount of Bill How disposed off
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Journal Proper

Credit transactions that cannot be entered in any other subsidiary book are entered in journal proper. It will cover purchase or sale of assets, expense accruals, rectification entries, adjusting entries, opening entries and closing entries. The format of journal proper is same as the Journal.

LEDGER ACCOUNTS

The book which contains accounts is known as the ledger. Since finding information pertaining to the financial position of a business emerges only from the accounts, the ledger is also called the Principal Book. As a result, all the necessary information relating to any account is available from the ledger. This is the most important book of the business and hence is rightly called the "King of All Books".

*Dr.***Specimen of Ledger Account***Cr.*

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
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Ledger Posting

As and when the transaction takes place, it is recorded in the journal in the form of journal entry. This entry is posted again in the respective ledger accounts under double entry principle from the journal. This is called ledger posting.

The rules for writing up accounts of various types are as follows:

Assets: Increases on the debit side and decreases on the credit side.

Liabilities: Increases on the credit side and decreases on the debit side.

Capitals: Increases on the credit side and decreases on the debit side.

Expenses: Increases on the debit side and decreases on the credit side.

Incomes or Gain: Increases on the credit side and decreases on the debit side.

To summarize:

Dr.	Assets	Cr.	Dr.	Expenses or Loses	Cr.
Increase		Decrease	Increase		Decrease
Dr.	Liabilities & Capital	Cr.	Dr.	Income or Gains	Cr.
Decrease		Increase	Decrease		Increase

Posting to Ledger Accounts from Subsidiary Books

In the above section, we have explained how posting is done to ledger accounts directly on the basis of journal entries. In practice, however, we know that use of subsidiary books is in vogue. Let us see how the posting to ledger accounts is done based on these records. For each of the subsidiary books, there is a ledger account, e.g., for purchase book, there is Purchase Account, for sales book there is Sales A/c, for cash book there is Cash A/c as well as Bank A/c and so on. In case of balance various ledger accounts, some accounts show debit balance, while the others show credit balance. Is there any relationship between the type of account (whether it is the account of asset, liability, capital, owner's equity, income or gain, expenses or losses) and the kind of balance (debit or credit).

The answer is generally 'Yes'. You may test to find the following are typical relationships.

Type of Account	Type of balance
All asset accounts	Debit balance
All liability accounts	Credit balance
Capital & Owner's equity account	Credit balance
Expenses or loss accounts	Debit balance
Income or gain accounts	Credit balance

Let us test these possibilities for confirmation. How does one go about testing this? Consider 'Cash A/c'.

Whenever business receives cash we debit it, and whenever it pays we credit it. Is it possible to see a situation where credits to cash are more than debits? In other words could we have negative cash in hand? No. Cash account will therefore always show a debit balance. So is true for all real asset accounts.

After solving problems, if the contrary is observed, there is every chance that an error has been made while passing the accounting entries.

Closing Balance and Opening Balance

The debit or credit balance of an account that we get at the end of the accounting period is known as closing balance of that account.

The "balance of the nominal accounts" is closed by transferring to trading account, and the profit and loss account which shows the net operating results – net profit or net loss.

The “balance of the personal accounts and real accounts” representing assets, liabilities, owner’s equity are reflected in the Balance Sheet, which shows the financial position of a business on a particular date. These balances are transported as opening balance in the succeeding accounting period.

Some terms used:

Casting — totaling

Balancing — to find the difference between debit side total and credit side total of an account.

C/d -Carried down B/d -Brought down

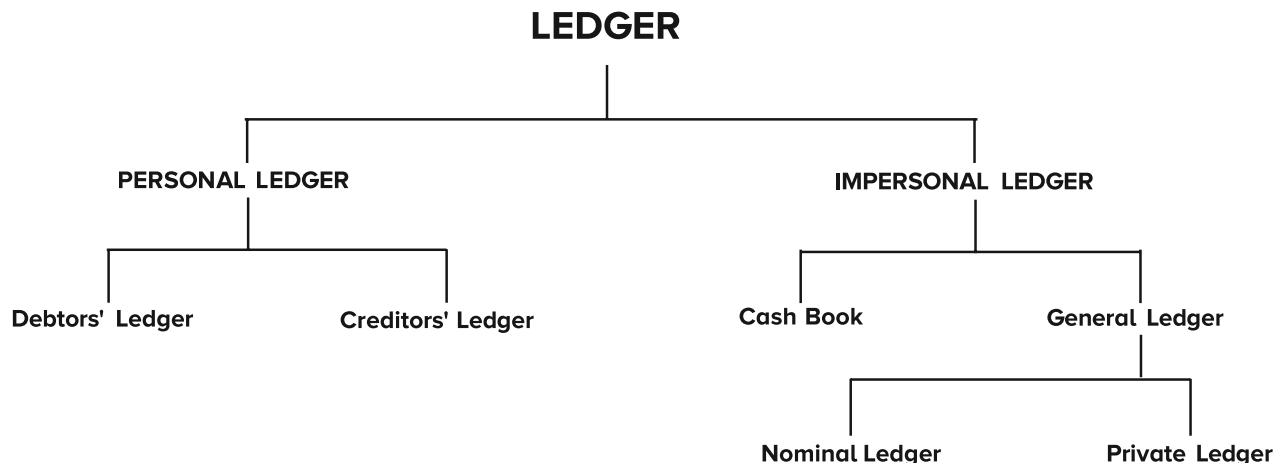
C/o - Carried over B/o - Brought over

C/f - Carried forward B/f - Brought forward

Sub-divisions of Ledger

Practically, the Ledger may be divided into two groups - Personal Ledger and Impersonal Ledger.

They are again sub-divided as:



Personal Ledger: The ledger where the details of all transactions about persons who are related to the accounting unit are recorded is called Personal Ledger.

Again, Personal Ledger may be divided into two groups: viz. (a) Debtors’ Ledger, and (b) Creditors’ Ledger.

- i) **Debtors’ Ledger:** The ledger where the details of transactions about the persons to whom goods are sold, cash is received, etc., are recorded is called Debtors’ Ledger.
- ii) **Creditors’ Ledger:** The ledger where the details of transactions about the persons from whom goods are purchased on credit, cash paid to them, etc., are recorded, is called Creditors’ Ledger.

Impersonal Ledger: The ledger where details of all transactions about assets, income & expenses, etc., are recorded is called Impersonal Ledger.

Impersonal Ledger may, again be divided into two group, viz., (a) Cash Book; and (b) General Ledger.

- i) **Cash Book:** The book wherein all cash & bank transactions are recorded is called Cash Book.
- ii) **General Ledger:** The ledger where all transactions relating to real accounts, nominal accounts are recorded is called General Ledger.

General Ledger may again be divided into two groups, viz., Nominal Ledger & Private Ledger.

- a) **Nominal Ledger:** The ledger where all transactions relating to income and expenses are recorded is called Nominal Ledger.
- b) **Private Ledger:** The Ledger where all transactions relating to assets and liabilities are recorded is called Private Ledger.

TRIAL BALANCE

Trial Balance may be defined as a statement or a list of all ledger account balances taken from various ledger books on a particular date to check the arithmetical accuracy.

Trial Balance is defined as “a list or abstract of the balances or of total debits and total credits of the accounts in a ledger, the purpose being to determine the equality of posted debits and credits and to establish a basic summary for financial statements”. According to Rolland, “The final list of balances, totaled and combined, is called Trial Balance”. – **By Eric. L. Kohler**

As this is merely a listing of balances, it will always be on a particular date. Further, it must be understood that Trial Balance does not form part of Books of Account, but it is a report prepared by extracting balances of accounts maintained in the books of accounts.

When this list with tallied debit and credit balances is drawn up, the arithmetical accuracy of basic entries, ledger posting and balancing is ensured. However, it does not guarantee that the entries are correct in all respect.

It can be seen that the respective total of debit and credit balances is exactly matching. This is the result of double entry book-keeping wherein every debit has equal corresponding credit.

Features of a Trial Balance

- (i) It is a list of debit and credit balances which are extracted from various ledger accounts.
- (ii) It is a statement of debit and credit balances.
- (iii) The purpose is to establish arithmetical accuracy of the transactions recorded in the Books of Accounts.
- (iv) It is not an account. It is only a statement of account.
- (v) It is not a part of the financial statements.
- (vi) It is usually prepared at the end of the accounting year but it can also be prepared anytime as and when required like weekly, monthly, quarterly or half-yearly.
- (vii) It is a link between the Books of Accounts, Profit and Loss Account and Balance sheet.

Preparation of Trial Balance

- (i) The ledger accounts are balanced at first. They will have either “debit-balance” or “credit balance” or “nil- balance”.
- (ii) The accounts containing debit-balance are written on the debit column, and those with credit-balance are written on the credit column.
- (iii) The sum total of both the balances must be equal for “Every debit has its corresponding and equal credit”.

Purpose of a Trial Balance

It serves the following purposes:

- (i) To check the arithmetical accuracy of the recorded transactions.
- (ii) To ascertain the balance of any ledger account.
- (iii) To serve as an evidence of the fact that the double entry has been completed in respect of every transaction.
- (iv) To facilitate the preparation of final accounts promptly.

Is Trial Balance Indispensable?

It is a mere statement prepared by the accountants for their convenience, and if it agrees, it is assumed that at least arithmetical accuracy has been done, although there may be an errors.

Trial Balance is not a process of accounting, but its preparation helps us to finalize the accounts. Since it is prepared on a particular date, as at / as on is stated.

Specimen of Trial Balance as on

<i>Sl. No.</i>	<i>Name of the Account</i>	<i>L.F.</i>	<i>Debit Balance (Rs.)</i>	<i>Credit Balance</i>

Method of Preparation

- (a) Total Method or Gross Trial Balance.
- (b) Balance Method or Net Trial Balance.
- (c) Compound Method.

These are explained as hereunder:

- (a) Total Method or Gross Trial Balance :** Under this method, two sides of the accounts are totalled. The total of the debit side is called the “debit total”, and the total of the credit side is called the “credit total”. Debit totals are entered on the debit side of the trial balance while the credit total is entered on the credit side of the trial balance.

If a particular account has total in one side, it will be entered either in the debit column or the credit column as the case may be.

Advantages:

- (a) It facilitates arithmetical accuracy of the accounts.
- (b) Extraction of ledger balances is not required at the time of preparation of trial balance.

Disadvantages: Preparation of final accounts is not possible.

- (b) Balance Method or Net Trial Balance:** Under this method, all the ledger accounts are balanced. The balances may be either “debit-balance” or “credit balance”.

Advantages:

- (a) It helps in the easy preparation of final accounts.
- (b) It saves time and labour in preparing a trial balance.

Disadvantages: Errors may remain undisclosed irrespective of the agreement of trial balance.

- (c) **Compound Method:** Under this method, totals of both the sides of the accounts are written in separate columns. Along with this, the balances are also written in the separate columns. Debit balances are written in the debit column and credit balances are written in the credit column of the trial balance.

Advantages: It offers the advantage of both the methods.

Disadvantages: It is a lengthy process and more time is consumed in the preparation of a trial balance.

Summary of Rules

Debit Balance - All Assets, Drawings, Debtors, Expenses and Losses.

Credit Balance - All Liabilities, Capital, Creditors, Gains and Incomes.

FINAL ACCOUNTS

The primary function of accounting includes computing the net result of operations of the business for the current period. To meet out this purpose, Trading Accounts, Income statement and Balance sheet are prepared. These documents are popularly called as Final Accounts. It is the last phase of Accounting Process.

The components of final accounts depend upon the type of entity. In case of non-manufacturing entities, the business operations include purchase and sale of goods. That is why Trading Account is prepared to calculate Gross Profit. But a manufacturing entity is interested in computation of total cost of manufacturing the finished products. For this purpose, separate account is prepared as Manufacturing Account. The following table shows the components of final accounts for manufacturing and non-manufacturing firms:

Manufacturing firm		Non-Manufacturing Firm	
1	Manufacturing A/c	1	Trading A/c
2	Trading A/c	2	Profit and Loss A/c
3	Profit and Loss A/c	3	Balance Sheet
4	Balance Sheet		

The process of final accounts starts after preparation of trial balance. It is mainly divided into following two parts:

1. **Income Statement:** It is prepared to find out the net result of the operations. It is sub-divided into two parts:
 - a) Trading Account
 - b) Profit and Loss Account
2. **Position Statement:** It includes Balance Sheet showing the status of assets and liabilities as at a particular point of time.

Trading Account

A trading account shows the results of the buying and selling of goods. This sheet is prepared to demonstrate the difference between the selling price and the cost price. It shows the trading results of the business, example- gross profit earned or gross loss sustained by the business. It records the direct expenses of a business firm.

“The Trading Account shows the result of buying and selling goods. In preparing this account, the general establishment charges are ignored and only the transactions in goods are included.” - J. R. Batliboi

Profit and Loss Account

This account is prepared to ascertain the net profit/loss and expenses of a business during an accounting year. It records the indirect expenses of a business firm, like rent, salaries, and advertising expenses. Profit and loss a/c includes expenses and losses as well as income and gains, which have occurred in business other than the production of goods and services.

Balance Sheet

The balance statement demonstrates the financial position of a business on a specific date. The financial position of a business is found by tabulating its assets and liabilities on a particular date. The excess of assets over liabilities represents the capital sunk into the business and reflects the financial soundness of a company. Now it is known as the statement of financial position of the company.

[Note: The detail discussion with respect to preparation and presentation of Trading and Profit & Loss A/c as well as Balance Sheet is discussed in lesson No. 2.]

LESSON ROUND-UP

- Accounting information should be relevant, reliable, comparable, understandable, timely, neutral, verifiable and complete.
- Accounting can be based on cash or accrual system. In cash system, accounting entries are passed only when cash is received or paid, while in accrual system transactions are recorded on the basis of amounts having become due for payment or receipt.
- **Book-keeping** is different from accounting. Book-keeping is concerned with the permanent recording or maintaining of all transactions in a systematic manner to show their financial effects on the business.
- **Accounting** is concerned with the summarizing of the recorded transactions.
- **Accounting principles** are guidelines to establish standards for sound accounting practices and procedures in reporting the financial status of a business. These principles can be accounting concepts and accounting conventions.
- **Accounting concepts** are defined as basic assumptions on the basis of which financial statements of a business entity are prepared. While ‘**convention**’ denotes custom or tradition or practice based on general agreement between the accounting bodies which guide the accountant while preparing the financial statements.
- Some of the important accounting concepts are: going concern concept, accrual concept, accounting period concept, materiality concept etc.

- Two classes of accounts are personal accounts and impersonal accounts. Impersonal accounts can be further classified into real and nominal accounts.
- Accounting cycle includes identifying, recording, classifying and summarizing of the transactions.
- Every transaction is recorded in the journal before being posted into the ledger. It is the book of account in which transactions are recorded in a chronological order.
- Recording in the journal is done following the rules of debit and credit which is called Golden Rules of Accounting.
- Posting is the process of recording transactions in the ledger based on the entries in the journal.
- The main function of a ledger is to classify or sort out all the items appearing in the journal or other subsidiary books under their appropriate accounts so that at the end of the accounting period summary of each account is easily available.
- Balancing of ledger accounts involves equalization of both sides of the account by putting the difference on the side where the amount is short.
- Various subsidiary books are: purchases book; sales book; purchases returns book; sales returns book; bills receivable book; bills payable book and cash book.
- **General journal or journal proper** is maintained for recording those transactions for which there are no other appointed subsidiary book.
- **Trial balance** is prepared after posting and balancing the entries in ledger to verify the arithmetical accuracy of entries made in the ledger.
- **Final Accounts:** The primary function of accounting includes computing the net result of operations of the business for the current period. To meet out this purpose, Trading Accounts, Income statement and Balance sheet are prepared. These documents are popularly called as Final Accounts.

GLOSSARY

Accounting

Accounting is “the art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character and interpreting the results thereof.

Book-Keeping

Book-Keeping is a science as well as art of correctly recording in books of accounts all those business transactions that result in transfer of money or money’s worth.

Journal

A journal is often referred to the Book of Prime Entry or Book of Original Entry. In this book transactions are recorded in their chronological order.

Subsidiary Books

Subsidiary Books refer to books meant for specific transactions of similar nature. These books are also known as special journals or day books.

Ledger

The book which contains accounts is known as the ledger.

Trial Balance

Trial Balance is a statement or a list of all ledger account balances taken from various ledger books on a particular date to check the arithmetical accuracy.

TEST YOURSELF

(These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation)

1. What are the Golden Rules of Accounting?
2. Illustrate with examples the difference between “Event” and “Transaction”
3. “Debit what comes in” and “Credit what goes out” illustrate with examples?
4. “Debit the receiver a/c” and “Credit the given a/c” illustrate with examples?
5. “Debit all expenses and loss” and “Credit all Income and Gains” illustrate with examples?
6. Define Accounting and Book-keeping with examples.
7. Discuss the Double Entry System of Accounting with examples?
8. Explain important accounting concepts.
9. Even a small amount of the transaction can be considered as material transaction. Explain How?
7. Explain the basic rules of debit and credit in accounting.
8. Define the term ‘account’ and name the types of accounts? Also explain with examples.
9. Point out the accounts which will be debited and credited for each one of the following transactions:
 - Cash received from X and discount allowed to him.
 - Cash paid to Y and discount received from him.
 - Credit Sales to Z.
 - Cash Sales to A.
 - Purchases from B on credit.
 - Salary paid to clerk by means of cheque.
 - Payment of cash to landlord for rent.
 - Depreciation on furniture.

- Interest due but not yet paid.
- Interest provided on capital.

10. Give Journal Entries of the following transaction:

- Started business with cash Rs. 36,000
- Paid rent in advance Rs. 800– Purchased goods for cash Rs.10,000 and on credit Rs. 4,000
- Sold goods for cash Rs. 8,000
- Rent paid Rs. 2000 and rent outstanding Rs. 400
- Bought cycle for personal use Rs. 16,000
- Purchased equipments for cash Rs. 10,000
- Paid to creditors Rs. 1,200
- Some business expenses paid Rs. 1,800
- Depreciation on equipment Rs. 2,000.

LIST OF FURTHER READINGS

- **Advanced Accounts**
Author: M.C. Shukla, T.S. Grewal & S.C. Gupta
Publisher: S. Chand & Company Ltd.
 - **Corporate Accounting**
Author: Dr. S. N. Maheshwari & Dr. Suneel K Maheshwari
Publisher: Vikas Publishing House
 - **Fundamentals of Corporate Accounting**
Author: Bhushan Kumar Goyal
Publisher: Taxmann
 - **Treatise of Ind AS**
Author: CA. (Dr.) Alok K. Garg
Publisher: Bloomsbury
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