UNIT – I

Accounting principles: Concepts func tions, book keeping, Double entry system, accounting standards, functions of accounting standards, journal, ledger, posting, rules regarding posting, trail balance, final accounts – Trading accounts, profit and loss accounts, balance sheet, adjustments. (Problems & Cases)

INTRODUCTION

Every person performs some kind of economic activity. A worker daily works and get wages and he spends to buy goods, cloths and some part of earnings saves for future. A business man purchases goods and sales it and incurred various expenses like salaries, rent etc. A partner in firm contributes towards capital in the firm which carries on business may be trading in goods.

Governments are also carries on some financial activities. All are carrying some kind of economic activities. Such economic activities are performed through transactions and / or events. Thus the business transactions include purchase, sale of goods, rendering various services, receipts and payments for such transactions. In a business concerns the transactions are numerous. The details of all transactions cannot be remembered by the business man. Therefore it is necessary to keep written records of all such transactions. The records of written transaction will help business to settle disputes and also possible to provide valuable information to the owner of business.

“Accounting is as old as money itself”. Since in early ages all commercial activities were based on **barter system only**, recording keeping was not a necessity. The **Industrial Revolution of 19th century along** with rapid rise in population, paved way for the development of commercial activities, mass production and credit terms. Thus recording of business transaction has become an important feature. In recent years with the change of technologies and marketing along with stiff competition, accounting system has undergone remarkable changes.

MEANING OF ACCOUNTING

Accounting, as an information system is the process of **identifying, measuring and communicating the economic information of an organization to its users** who need the information for decision making. It identifies transactions and events of a specific entity. A transaction is **an exchange in which each** participant receives or sacrifices value (e.g. purchase of raw material). An event i.e. results from the transactions (whether internal or external) is a happening of consequence to an entity (e.g. use of raw material for production). An entity means an economic unit that performs economic activities

DEFINITION

Accounting as “the process of **identifying, measuring and communicating** economic information to permit informed judgments and decision by users of the information”.

American Accounting Association (AAA)

Accounting as “the art of **recording**, **classifying, summarizing in a significantmanner** and in terms of **money transactions** and events, which are, in part at least, of afinancial character and **interpreting** the results there off”.

American Institute of Certified Public Accountants (AICPA)

KEY SUMMARY OF DEFINITION

(1)Recording: Recording all the transactions in journal/subsidiary books for purpose of future record or reference. It is referred to as "Journal."
(2) Classifying: All recorded transactions in subsidiary books are classified and posted to the main book of accounts. It is known as "Ledger."
(3) Summarizing: All recorded transactions in main books will be summarized for the preparation of Trail Balance, Profit and Loss Account and Balance Sheet.
(4) Interpreting: Interpreting refers to the explanation of the meaning and significance of the result of final accounts and balance sheet so that parties concerned with business can determine the future earnings, ability to pay interest, liquidity and profitability of a sound dividend policy.

FINANCIAL ACCOUNTING AND MANAGEMENT ACCOUNTING

Accounting information can be classified broadly between financial accounting and management accounting.

Financial accounting is the day-to-day recording of an organization's financial transactions and the summarizing of those transactions to satisfy the information needs of the user groups. It is sometimes referred to as meeting the *external* accounting needs of the organization, and as such is subject to many rules and regulations (a **regulatory framework)** imposed by company legislation and accounting standards.

Management accounting is sometimes referred to as meeting the *internal* accounting needs of the organization, as it is designed to help managers with decision making and planning. As such it often involves estimates and forecasts, and is not subject to the same regulatory framework as financial accounting.

NEED AND IMPORTANCE OF ACCOUNTING

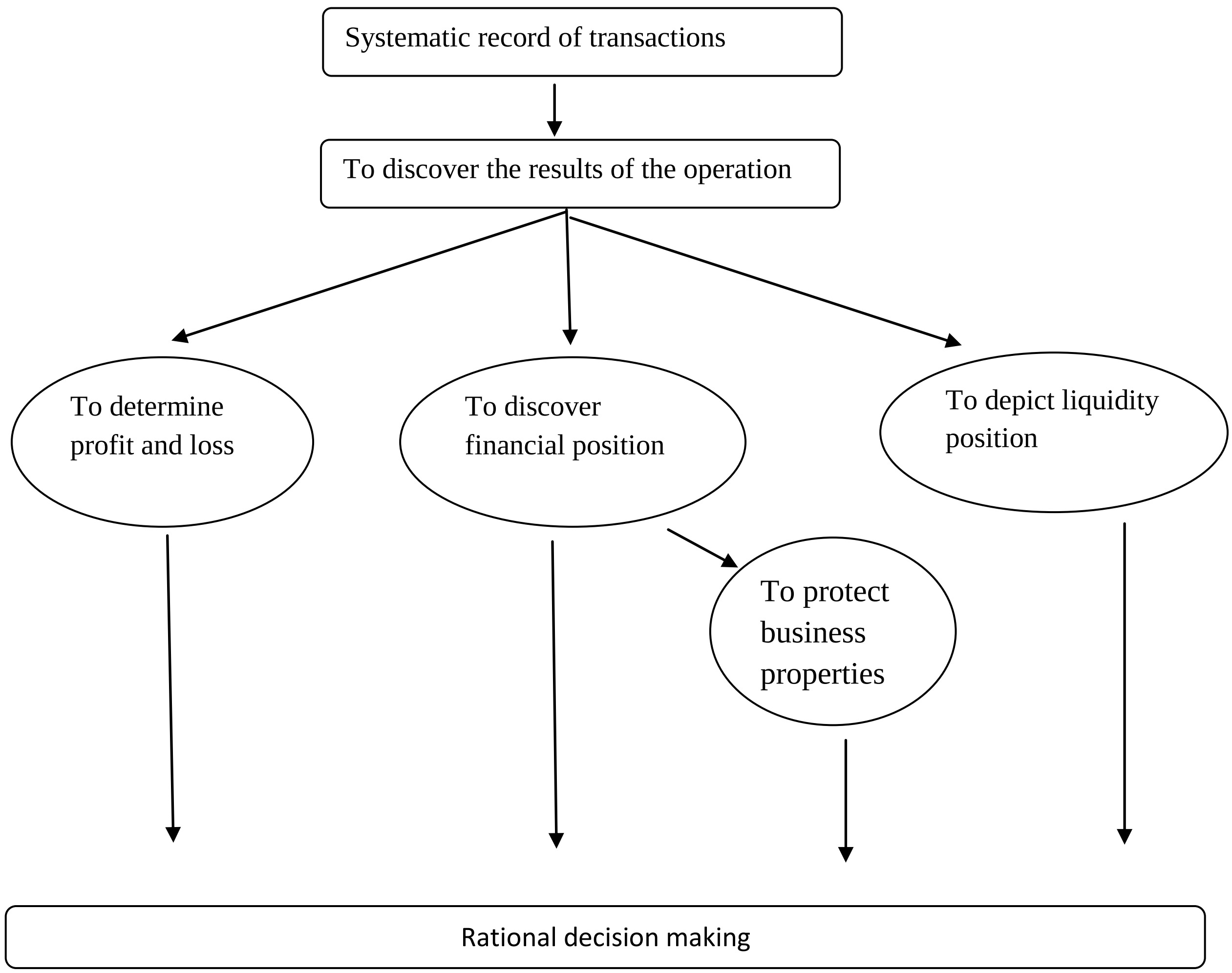
When a person starts a business or firm, whether large or small, his main aim is to earn profit. He receives money from definite sources like sale of goods, interest on bank deposits etc. He has to spend money on certain items like purchase of goods, salary, rent, etc. These activities take place during the normal course of his business. He would naturally be anxious at the year end, to know the progress of his business. **Business transactions are numerous, that it is not possible to recall his memory as to how the money had been earned and spent.** At the same time, if he had noted down his incomes and expenditures, he can readily get the required information. Hence, the details of the business transactions have to be recorded in a clear and systematic manner to get answers easily and accurately for the following questions at any time he likes.

i. What has happened to his investment?
ii. What is the result of the business transactions?
iii. What are the earnings and expenses?
iv. How much amount is receivable from customers to whom goods have been sold on credit?
v. How much amount is payable to suppliers on account of credit purchases?
vi. What are the nature and value of assets possessed by the business concern?
vii. What are the nature and value of liabilities of the business concern?

These and several other questions are answered with the help of accounting. The need for recording business transactions in a clear and systematic manner is the basis which gives rise to Book-keeping.

OBJECTIVE OF ACCOUNTING

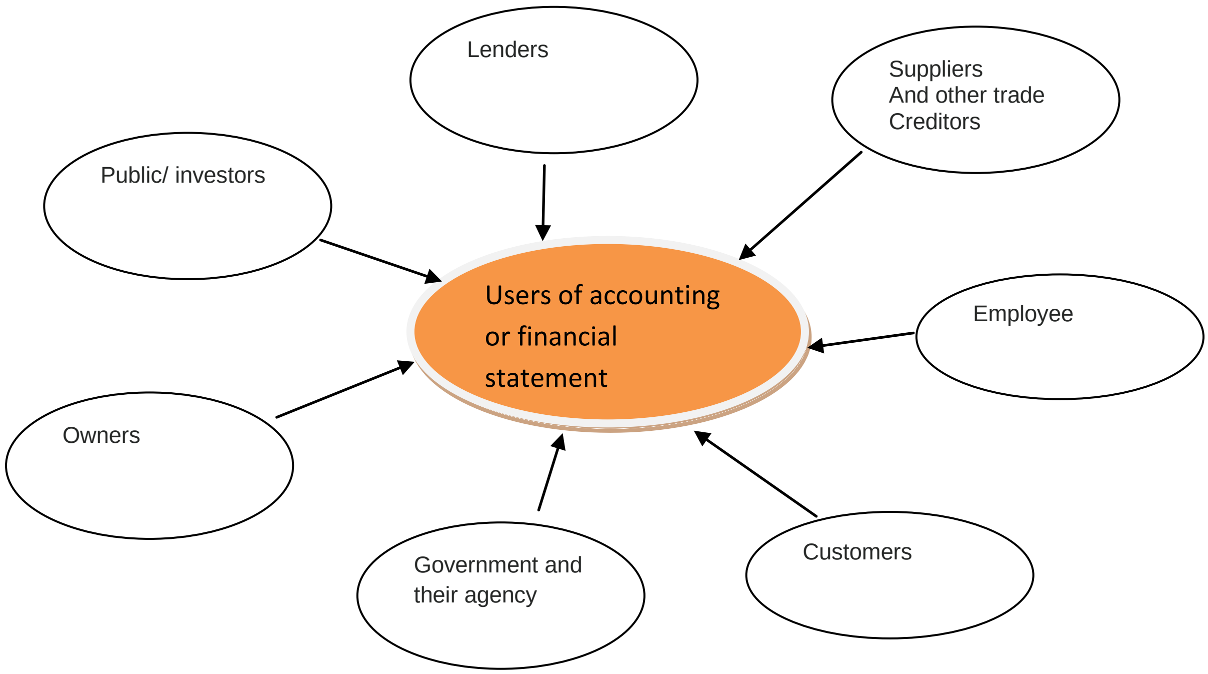
Objective of accounting may differ from business to business depending upon their specific requirements. However, the following are the general objectives of accounting.



To keeping systematic record	It is very **difficult to remember all the business transactions** that take place. Accounting serves this purpose of record keeping by promptly recording all the business transactions in the books of account.
To ascertain the results of the operation	Accounting helps in ascertaining result i.e., **profit earned or loss suffered in business during a particular Period**. For this purpose, a business entity prepares either a **Trading and Profit and Loss account or an Income and Expenditure account which shows the profit or loss** of the business by matching the items of revenue and expenditure of the same period.
To ascertain the financial position of the business	In addition to profit, a businessman must know his financial position i.e., **availability of cash, position of assets and liabilities etc.** This helps the businessman to know his financial strength. Financial statements are barometers of health of a business entity.
To depict the liquidity position:	Financial reporting should provide information about **how an enterprise obtains and spends cash, about its borrowing and repayment of borrowing,** about its capital transactions, cash dividends and other distributions of resources by the enterprise to owners and about other factors that may affect an enterprise's liquidity and solvency.
To protect business properties	Accounting provides up to date **information about the various assets that the firm possesses and the liabilities the firm owes,** so that nobody can claim a payment which is not due to him.
To facilitate rational decision – making	Accounting records and financial statements provide financial information which help the **business in making Rational decisions** about the steps to be taken in respect of various aspects of business.

1.4 USES OF ACCOUNTING or IMPORTANTS OF ACCOUNTING

In 2001 the IASB adopted a *Framework for the Preparation and Presentation of Financial Statements* which set out certain concepts that underlie the preparation and presentation of financial Statements. The Framework identifies the following seven groups of users together with the information which they need from the financial statements:



USERS GROUP	*INFORMATION NEEDS*
Owners	The owners provide funds or capital for the organization. They possess **curiosity in knowing whether the business is being conducted on sound lines or not and whether the capital** is being employed properly or not. Owners, being businessmen, always keep an eye on the returns from the investment. Comparing the accounts of various years helps in getting good pieces of information.
Employees:	Payment of **bonus depends upon the size of profit earned by the firm.** The more important point is that the workers expect regular income for the bread. The demand for wage rise, bonus, better working conditions etc. depend upon the profitability of the firm and in turn depends upon financial position.
Investors:	The prospective investors who **want to invest their money in a firm of course wish to see the progress and prosperity of the firm, before investing their amount**, by going through the financial statements of the firm. This is to safeguard the investment
Government	Government keeps a close watch on the firms which yield good amount of profits. The state and central Governments are **interested in the financial statements to know the earnings for**

	the purpose of taxation. To compile national accounting is essential
Consumers	These groups are interested in getting the goods at reduced price. Therefore, they wish to know the establishment of a proper accounting control, which in turn will reduce to cost of production, in turn fewer prices to be paid by the customers. Researchers are also interested in accounting for interpretation.
Creditors	Profit and Loss Account and Balance Sheet are nerve centers to know the soundness of the firm. **Creditors are the persons who supply goods on credit, or bankers or lenders of money**. It is usual that these groups are interested to know the financial soundness before granting credit.
Management:	The management of the business is greatly interested in **knowing the position of the firm**. The accounts are the basis, the management can study the merits and demerits of the business activity. The financial accounting is the **"eyes and ears of management and facilitates in drawing future course of action, further expansion etc."**

1.5 BOOK KEEPING

Every day business transactions may be around hundreds/thousands. Can a businessman remember all these transactions in every respect? Not at all. So it becomes necessary to record these business transactions in details and in a systematic manner**. Recording of business transactions in a systematic manner in the books of account is called book-keeping.** Book-Keeping is concerned with recording of financial data. It is important to note that only those transactions related to business which can be expressed in terms of money are recorded. The activities of book-keeping include recording in the journal, posting to the ledger and balancing of accounts.

DEFINITION

"Book-keeping is the science and art of correctly recording in the books of account all those business transactions that result in the transfer of money or money's worth".

R.N. Carter

"The art of keeping a permanent record of business transactions is book keeping".

A.H.Rosenkamph.

OBJECTIVES

i. to have permanent record of all the business transactions.
ii. To keep records of income and expenses in such a way that the net profit or net loss may be calculated.
iii. To keep records of assets and liabilities in such a way that the financial position of the business may be ascertained.
iv. To keep control on expenses with a view to minimize the same in order to maximize profit.
v. To know the names of the customers and the amount due from them.
vi. To know the names of suppliers and the amount due to them.
vii. To have important information for legal and tax purposes.

1.6 BOOK KEEPING VS ACCOUNTING

BASIS OF DISTINCTION	**BOOK-KEEPING**	**ACCOUNTING**
Nature	It is concerned with identifying financial transactions, measuring them in monetary terms**; recording and classifying them.**	It is concerned with **summarizing the recorded transactions, interpreting them** and communicating the results.
Scope	**Recording and maintenance** of books of accounts.	It is not only recording and maintenance of books of accounts but also includes **analysis, interpreting and communicating** the information.
Responsibility	A book-keeper is responsible for **recording business transactions.**	An accountant is also responsible for the **work of a book-keeper.**
Objective	It is to maintain **systematic records of financial transactions**	It aims at ascertaining **business income and financial position** by maintaining records of business transactions
Function	It is to **record business transactions**.So its scope is limited.	It is the **recoding, classifying, summarizing, interpreting business transactions and communicating the results**. Thus its scope is quite wide.
Stage	Primary stage.	Secondary stage.
Basis	**Vouchers and other supporting documents** are necessary as evidence to record the business transactions.	Book-keeping works as the **basis for accounting information**
Level of knowledge	It is enough to have **elementary Knowledge of accounting** to do book keeping.	For accounting, **advanced and in-depth knowledge and understanding** is required.
Relation	Book-keeping is the **first step to accounting.**	**Accounting begins where bookkeeping ends**
Staff involved	Work is done by the **junior involved staff of the organization.**	**Senior staff performs** the accounting work.

ACCOUNTANCY, ACCOUNTING AND BOOK-KEEPING

Accountancy refers to a systematic knowledge of accounting. It explains **"why to do" and "how to do" of various aspects of accounting**. It tells us why and how to prepare the books of accounts and how to summarize the accounting information and communicate it to the interested parties.

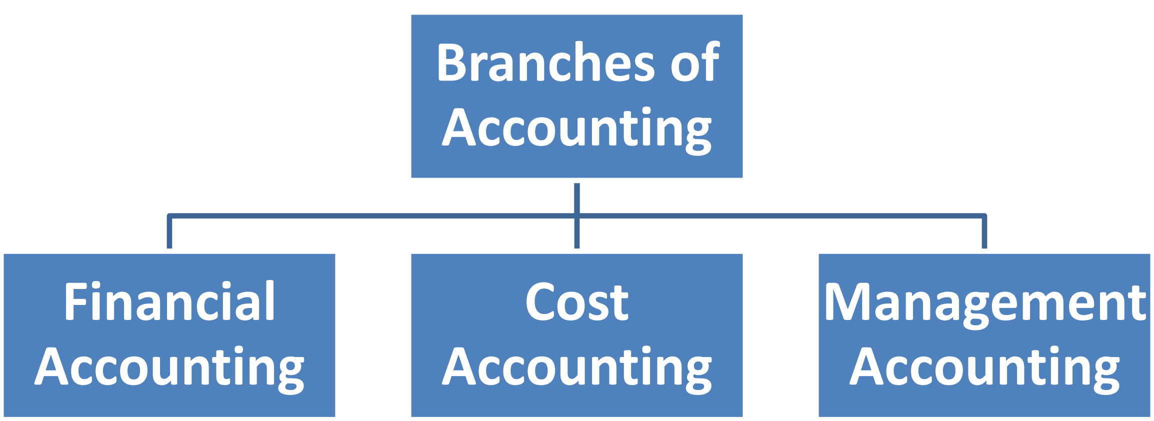
Accounting refers to the actual process of preparing and presenting the accounts. In other words, it is the **art of putting the academic knowledge of accountancy into practice**

Book-keeping is a part of accounting and is concerned with record keeping or maintenance of books of accounts. It is often **routine and clerical in nature**.

Book-keeping provides the basis for accounting and it is complementary to accounting process. Accounting begins where book-keeping ends. Accountancy includes accounting and book-keeping. The terms Accounting and Accountancy are used synonymously.

BRANCHES OF ACCOUNTING

Increased scale of business operations has made the management function more complex. This has given rise to specialized branches in accounting. The main branches of accounting are Financial Accounting, Cost Accounting and Management Accounting.

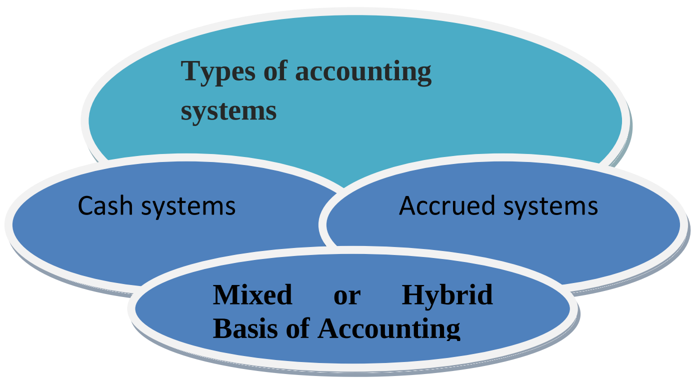


Financial Accounting
It is concerned with recording of business transactions in the books of accounts in such a way that operating result of a particular period and financial position on a particular date can be known.

Cost Accounting
It relates to collection, classification and ascertainment of the cost of production or job undertaken by the firm.

Management Accounting
It relates to the use of accounting data collected with the help of financial accounting and cost accounting for the purpose of policy formulation, planning, control and decision making by the management.

1.7 ACCOUNTING SYSTEMS

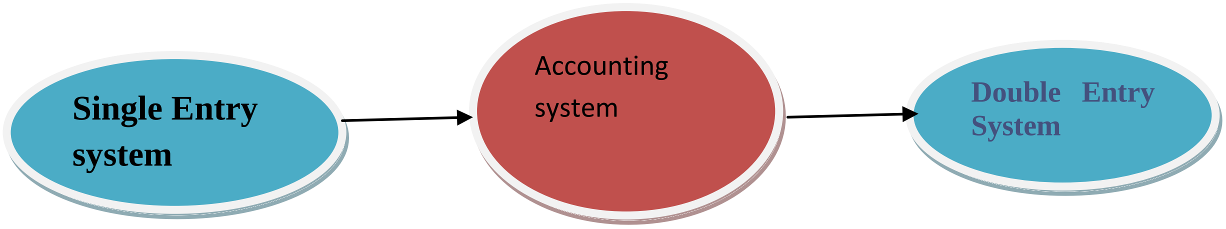


Cash system of accounting:
It is a system in which accounting entries are made only when cash is received or paid.no entry is made when a payment or receipts is merely due. Government system of accounting is mostly on the cash systems.

Accrued system mercantile system of accounting
It is a system in which accounting entries are made on the basis of amount become due for payment or receipts. These systems recognize the facts that if a transaction or event has occurred.

Mixed or Hybrid Basis of Accounting
When certain items of revenue or expenditure are recorded in the books of account on cash basis and certain items on mercantile basis, the basis of accounting so employed is called ‘hybrid basis of accounting’. For example, a company may follow mercantile system of accounting in respect of its export business. However, government subsidies and duty drawbacks on exports to be received from government are recorded only when they are actually received.

1.7 ACCOUNTING SYSTEMS



1.7.1SINGLE ENTRY:

It is incomplete system of recording business transactions. The business organization maintains only cash book and personal accounts of debtors and creditors. So the complete recording of transactions cannot be made and trail balance cannot be prepared.

1.7.2 DOUBLE ENTRY SYSTEM:

There are numerous transactions in a business concern. Each transaction, when closely analyzed, reveals two aspects. One aspect will be "receiving aspect" or "incoming aspect" or "expenses/loss aspect". This is termed as the "Debit aspect". The other aspect will be "giving aspect" or "outgoing aspect" or "income/gain aspect". This is termed as the "Credit aspect". These two aspects namely "Debit aspect" and "Credit aspect" forms the basis of Double Entry System.

The double entry system is so named since it records both the aspects of a transaction .In short, the basic principle of this system is, for every debit, there must be a corresponding credit of equal amount and for every credit, there must be a corresponding debit of equal amount.

FEATURES

i. Every business transaction affects two accounts.
ii. Each transaction has two aspects, i.e., debit and credit.
iii. It is based upon accounting assumptions concepts and principles.
iv. Helps in preparing trial balance which is a test of arithmetical accuracy in accounting.
v. Preparation of final accounts with the help of trial balance.

MEANING OF DEBIT AND CREDIT:

The term 'debit' is supposed to have derived from 'debit' and the term 'credit' from 'creditable'. For convenience 'Dr' is used for debit and 'Cr' is used for credit. Recording of transactions require a thorough understanding of the rules of debit and credit relating to accounts. Both debit and credit may represent either increase or decrease, depending upon the nature of account.

1.7.3 SINGLE ENTRYSYSTEM vs. DOUBLE ENTRY SYSTEM:

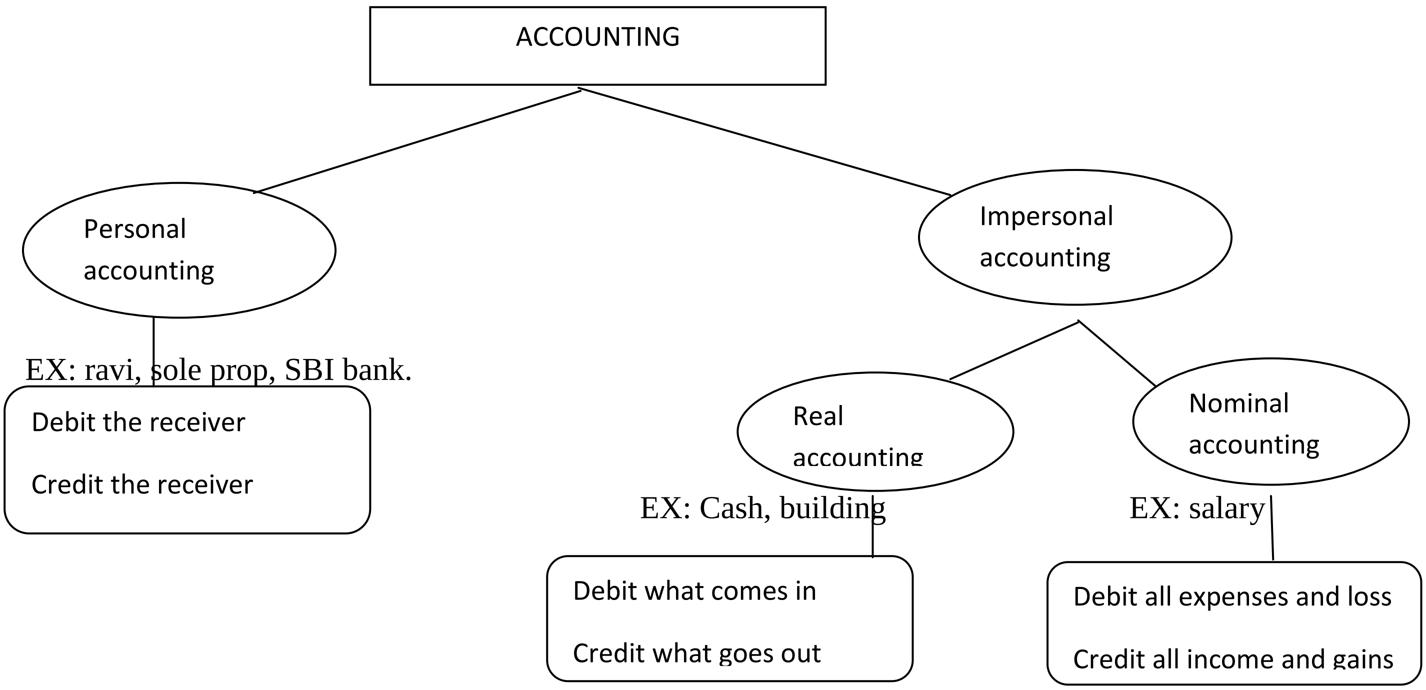
Nature	Single Entry system	Double Entry system
Meaning	Single entry system is an incomplete system of recording financial transactions	Double entry system is a complete system of recording and reporting financial transactions
Accounts	Single entry system maintains only personal accounts of debtors and creditors and cash book.	Double entry system all personal, real and nominal accounts.
Trial Balance	Single entry system cannot prepare a trial balance and hence, arithmetical accuracy of books of accounts cannot be checked.	Double entry system prepares trial balance and hence, arithmetical accuracy of the books of accounts can be checked.
Profit Or Loss	Single entry system cannot ascertain the true amount of profit or loss of the business as it does not maintain nominal accounts.	Double entry system ascertains true profit or loss of the business as it maintains all nominal accounts.
Financial Position	Single entry system cannot ascertain the true financial position of the business because it does not maintain real accounts except cash book.	Double entry system ascertains financial position of the business as it maintains all personal and real accounting
Suitability	Single entry system is suitable to a small business where only limited number of transactions are performed.	Double entry system is suitable for a large business.
Tax Purpose	Single entry system is not acceptable for the purpose of assessment of tax	Double entry system is acceptable for the purpose of assessment of tax.

1.8 TYPES OF ACCOUNTS

The transactions are recorded in the books under a unique account. Each account is assigned a separate name to distinguish it from other accounts. While making an entry in the books, first we should see, to which category of accounts it belongs. There are mainly three types of accounts.

(i) Transactions relating to persons.
(ii) Transactions relating to properties and assets
(iii) Transactions relating to incomes and expenses.

The accounts falling under the first heading are known as **‘personal Accounts’**. The accounts falling under the second heading are known as **‘Real Accounts’**, the accounts falling under the third heading are called **‘Nominal Accounts’**. The accounts can also be classified as personal and impersonal. The following chart will show the various types of accounts



1. Personal Accounts.

Accounts related to **persons (living ornon-living) are called** personal accounts. In business we have to deal with a number of persons. Some are living like us and some are artificial which do not have a living existence but have a separate legal existence.Thus in accountancy we classify persons into

Natural Persons

Artificial Person.

Natural persons are the persons **who are living e.g. Rahul, Mohan, Sam, Peter etc.**

Artificial persons are **all the firms, companies, institutions with whom you deal**. In accounts business is a separate legal entity which has an existence of its own. Similarly the other companies, firm or organizations are regarded as separate legal entities.These are regarded as artificial persons... Examples of artificial persons are ABC Ltd, Wipro Ltd, Hindustan Lever, X and Co, Ahuja & sons etc.

Debit the Receiver **Credit the Giver**

2. Real Accounts

Accounts **related to assets** (tangible or intangible) come under the category of real accounts e.g. land, furniture, machinery, goodwill, patents etc. are real accounts. Some of the assets of the business are such which you can touch, see and feel. **Tangible assetshave physical existence**.g.cash, inventories, debtors, securities, land, building, machinery, furniture, equipment's, vehicles etc. assets which can be seen, touched and felt. These assets are called tangible assets.

In business it's not necessary that all assets must have a physical existence. Some assets are such **which cannot be touched, seen or felt but still they have an economic value**. The example of such assets are Goodwill, patents, trademarks, brand value, human intelligence. These assets are called **intangible assets**. These assets just like tangible assets can be sold and bought in the market and these appear on the balance sheet of the company together with other assets.

Debit what comes in
Credit what goes out

3. Nominal Accounts

These are the accounts **related to incomes and expenditures of a business entity**. Expenditure or expenses are **the amount paid or payable which has given its benefit to the business in the fiscal year.**e.g. Salaries, wages, carriage, transportation, rent, electricity, stationary, taxes, commissions paid, interest paid etc. Incomes are the **receipts which increase the profits of the business**. Examples of incomes are rent received, commission received, interest received, dividend received etc.

Debit all the expenses and losses
Credit all incomes and gains

FUNCTIONS OF ACCOUNTING

A. **Record Keeping Function:**

The primary function of accounting relates to recording, classification and summary of financial transactions-journalism, posting, and preparation of final statements. These facilitate to know operating results and financial positions. The purpose of this function is to report regularly to the interested parties by means of financial statements. Thus accounting performs historical function i.e., attention on the past performance of a business; and this facilitates decision making programmed for future activities.

B. **Managerial Function:**

Decision making programmed is greatly assisted by accounting. The managerial function and decision making programmers, without accounting, may mislead...

C. **Legal Requirement function:**

Auditing is compulsory in case of registered firms. Auditing is not possible without accounting. Thus accounting becomes compulsory to comply with legal requirements. Accounting is a base and with its help various returns, documents, statements etc., are prepared.

D. **Language of Business:**

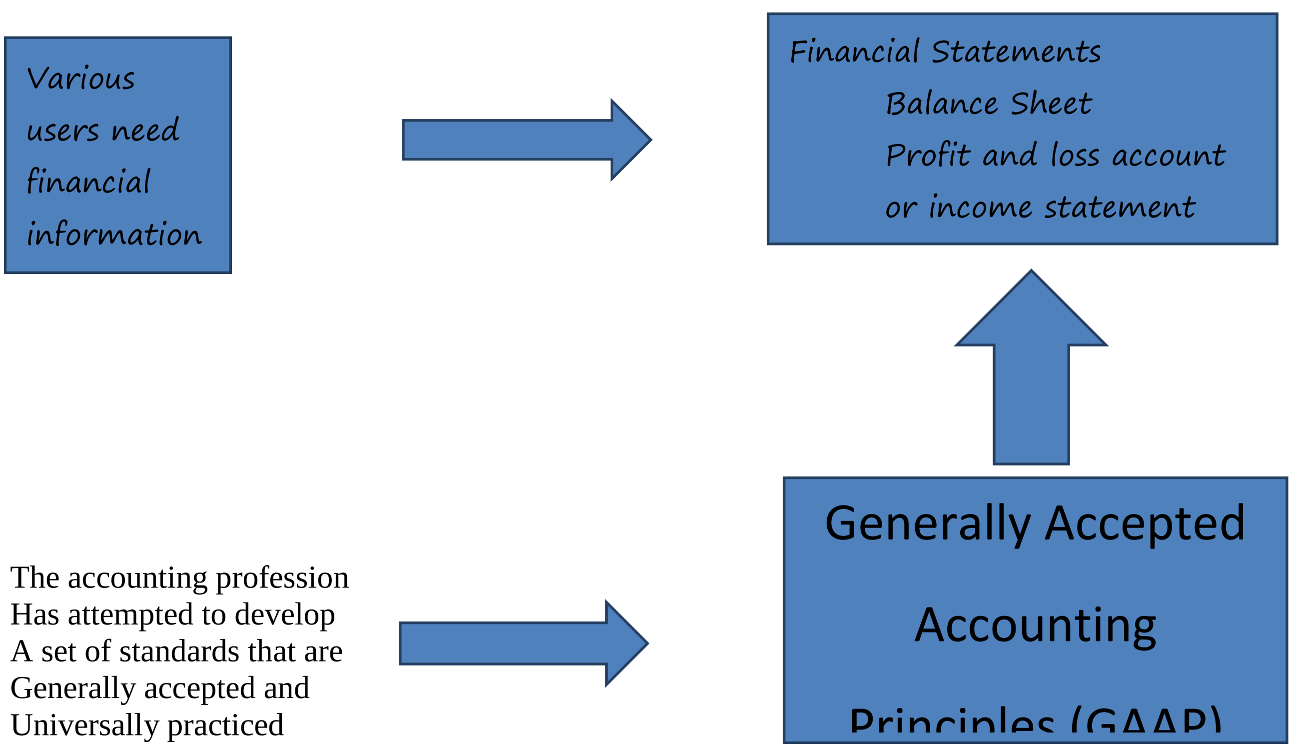
Accounting is the language of business. Various transactions are communicated through accounting. There are many parties-owners, creditors, government, employees etc., who are interested in knowing the results of the firm and this can be communicated only through accounting. The accounting shows a real and true position of the firm or the business.

GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

A set of rules and practices, having substantial authoritative support that the accounting profession recognizes as a general guide for financial reporting purposes.

Standard-setting bodies:

- ► Securities and Exchange Commission **(SEC)**
- ► Financial Accounting Standards Board **(FASB)**
- ► International Accounting Standards Board **(IASB)**



MEANING ACCOUNTING CONCEPT

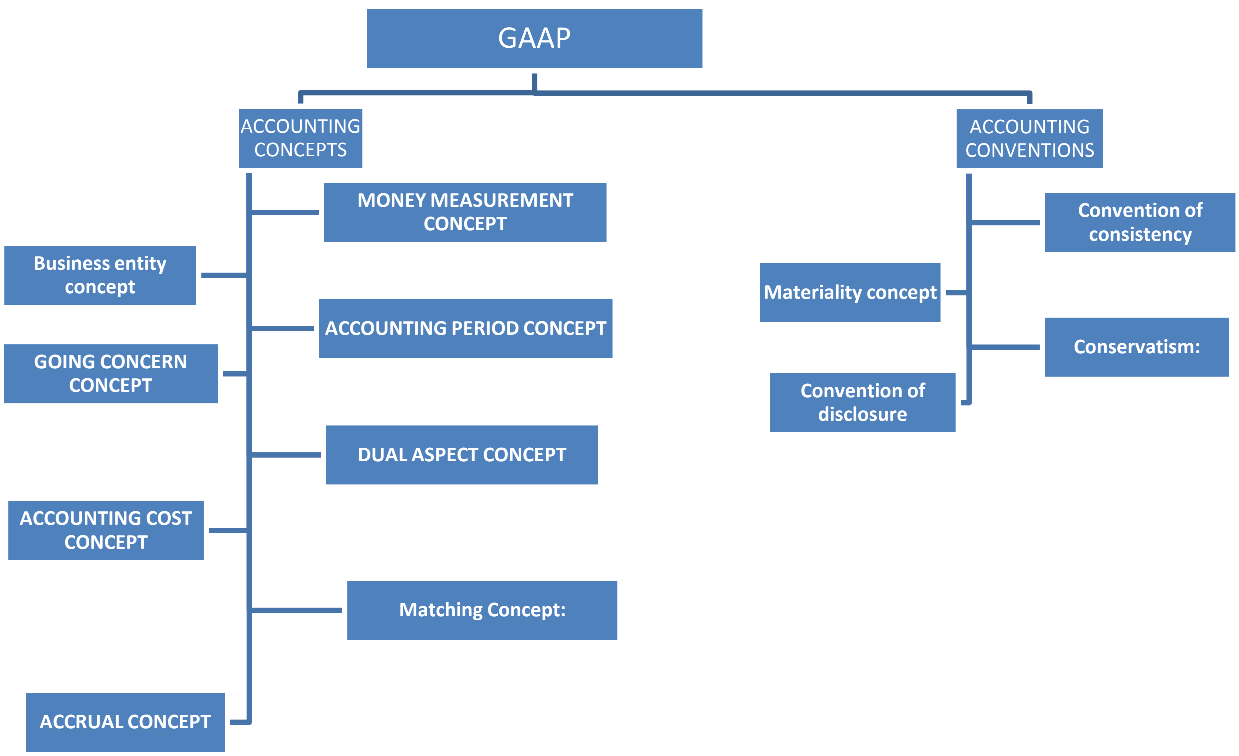
Let us take an example. In India there is a basic rule to be followed by everyone that one should walk or drive on his/her left hand side of the road. It helps in the smooth flow of traffic. Similarly, there are certain rules that an accountant should follow while recording business transactions and preparing accounts. These may be termed as accounting concept.

Accounting concept refers to the basic assumptions and rules and principles which work as the basis of recording of business transactions and preparing accounts.

1. **BUSINESS ENTITY CONCEPT**

This concept assumes that, for accounting purposes, the business enterprise and its owners are two separate independent entities. Thus, the business and personal transactions of its owner are separate. For example, when the owner invests money in the business, it is recorded as liability of the business to the owner. Similarly, when the owner takes away from the business cash/goods for his/her personal use, it is not treated as business expense. Thus, the accounting records are made in the books of accounts from the point of view of the business unit and not the person owning the Business. This concept is the very basis of accounting.

Let us take an example. Suppose Mr. Sahoo started business investing Rs100000. He purchased goods for Rs40000, Furniture for Rs20000 and plant and machinery of Rs30000. Rs10000 remains in hand. These are the assets of the business and not of the owner. According to the business entity concept Rs100000 will be treated by business as capital i.e. a liability of business towards the owner of the business.



Now suppose, he takes away Rs5000 cash or goods worth Rs5000 for his domestic purposes. This withdrawal of cash/goods by the owner from the business is his private expense and not an expense of the business. It is termed as Drawings. Thus, the business entity concept states that business and the owner are two separate/distinct persons. Accordingly, any expenses incurred by owner for he or his family from business will be considered as expenses and it will be shown as drawings.

2. **MONEY MEASUREMENT CONCEPT**

This concept assumes that all business transactions must be in terms of money that is in the currency of a country. In our country such transactions are in terms of rupees.Thus, as per the money measurement concept, transactions which can be expressed in terms of money are recorded in the books of accounts.For example, sincerity, loyalty, honesty of employees are not recorded in books of accounts because these cannot be measured in terms of money although they do affect the profits and losses of the business concern.

For example,

At the end of the year 2006, an organization may have

	physical units	monetary unit
land	10 acres	12 core
office building containing	50 rooms,	10 core
personal computers	**50**	10 lakhs
office chairs and tables	**50**	2 lakhs
raw materials	**100 k.g**	Rs.30 lakhs

Therefore, the transactions which can be expressed in terms of money are recorded in the accounts books, that too in terms of money and not in terms of the quantity.

3. **GOING CONCERN CONCEPT**

This concept states that a business firm will continue to carry on its activitiesfor an indefinite period of time. Simply stated, it means that every businessentity has continuity of life. Thus, it will not be dissolved in the near future. This is an important assumption of accounting, as it provides a basis for Showing the value of assets in the balance sheet.For example, a company purchases a plant and machinery of Rs.100000 and its life span is 10 years.

According to this concept every year some amount will be shown as expenses and the balance amount as an asset.

4. **ACCOUNTING PERIOD CONCEPT**

Under this concept, the life of the business is segmented into different periods and accordingly the result of each period is ascertained. Though the business is assumed to be continuing in future (as per going concern concept), the measurement of income and studying the financial position of the business for a shorter and definite period will help in taking corrective steps at the appropriate time. Each segmented period is called “accounting period” and the same is normally a year.

Ex: Year that begins from 1st of January and ends on 31st of December, is known as Calendar Year. The year that begins from 1st of April and ends on 31st of March of the following year, is known as financialYear.

5. **ACCOUNTING COST CONCEPT**

Accounting cost concept states that all assets are recorded in the books of accounts at their purchase price, which includes cost of acquisition, transportation and installation and not at its market price. It means that fixed assets like building, plant and machinery, furniture, etc. are recorded in the
Books of accounts at a price paid for them.

For example, a machine was purchased by XYZ Limited for Rs.500000, for manufacturing shoes. An
Amount of Rs.1, 000 were spent on transporting the machine to the factory site. In addition, Rs.2000 were spent on its installation. The total amount at which the machine will be recorded in the books of accounts would be the sum of all these items i.e. Rs.503000. This cost is also known as historical cost.

6. **DUAL ASPECT CONCEPT**

Dual aspect is the foundation or basic principle of accounting. It provides the very basis of recording business transactions in the books of accounts. This concept assumes that every transaction has a dual effect, i.e. it affects two accounts in their respective opposite sides. Therefore, the transaction should be recorded at two places. It means, both the aspects of the transaction must be recorded in the books of accounts. For example, goods purchased for cash has two aspects which are (i) Giving of cash (ii) Receiving of goods. These two aspects are to be recorded. Thus, the duality concept is commonly expressed in terms of fundamental accounting equation:

Assets = Liabilities + Capital

The above accounting equation states that the assets of a business are always equal to the claims of owner/owners and the outsiders. This claim is also termed as capital or owners' equity and that of outsiders, as liabilities or creditors' equity.

7. **MATCHING CONCEPT:**

The essence of the matching concept lies in the view\ that all costs which are associated to a particular period should be compared with therevenues associated to the same period to obtain the net income of the business.Under this concept, the accounting period concept is relevant and it is this concept
(matching concept) which necessitated the provisions of different adjustments for recording outstanding expenses, prepaid expenses, outstanding incomes, incomes received in advance, etc., during the course of preparing the financial statements at the end of the accounting period.

Ex: expenses have been matched with revenue i.e.(Revenue Rs.3150-Expenses Rs.2900) this comparison has resulted in profit of Rs.250. If the revenue is more than the expenses, it is called profit. If the expenses are more than revenue it is called loss. This is what exactly has been done by applying the matching concept.

8. **ACCRUAL CONCEPT**

The meaning of accrual is something that becomes due especially anamountof money that is yet to be paid or received at the end of the accounting period. It means that revenues are recognized when they become receivable. Though cash is received or not received and the expenses are recognized when they become payable though cash is paid or not paid. Both transactions will be recorded in the accounting period to which they relate.

The accrual concept under accounting assumes that revenue is realized atthe time of sale of goods or services irrespective of the fact when the cash is received. For example, a firm sells goods for Rs 55000 on 25th March 2005 and the payment is not received until 10th April 2005, the amount is due and payable to the firm on the date of sale i.e. 25th March 2005. It must be included in the revenue for the year ending 31st March 2005. Similarly, expenses are recognized at the time services provided, irrespective of the fact when actual payment for these services is made. For example, if the firm received goods costing Rs.20000 on 29th March 2005 but the payment is made on 2nd April 2005 the accrual concept requires that expenses must be recorded for the year ending 31st March 2005 although no payment has been made until 31st March 2005 through the service hasbeen received and the person to whom the payment should have been madeIs shown as creditor.

ACCOUNTING CONVENTIONS

Accounting conventions are bearing the practical considerations in recording the transactions of the business enterprise in systematic manner.

1. **CONVENTION OF CONSISTENCY**

The nature of recording the transactions should not be changed at any cause or moment. It should be maintained throughout the life period of the firm. If a firm follows the straight line method of charging the depreciation since its inception should be followed without any change. The firm should not alter the method of charging the depreciation from one method to another. The change cannot be entertained. If any change has to be incorporated, the valid reason for change should be emphasized.

2. **CONSERVATISM:**

In the prevailing present day uncertainties, the convention of conservatism has its own importance. This convention follows the policy of caution or playing safe. It takes into account all possible losses but not the possible profits or gains. A view opposed to this convention is that there is the possibility of creation of secret reserves when conservatism is excessively applied, which is directly opposed to the convention of full disclosure. Thus, the convention of conservatism should be applied very cautiously.

3. **MATERIALITY CONCEPT**

Materiality refers to the *significance* of information contained within financial statements. It is considered significant if its inclusion could influence the economic decisions of the users.

4. **CONVENTION OF DISCLOSURE**

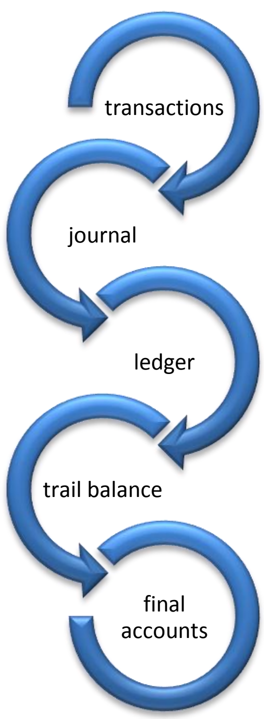
According to this convention, the entire status of the firm should be highlighted / presentedin detail without hiding anything; which has to furnish the required information to various parties involved in the process of the firm.

1. ACCOUNTING PROCESS

Book keeping began with the entry of all transactions into one book which recorded the details of transactions. This book was called a book of prime entry or Journal. The transactions were copied from Waste Books or Memorandum Book into the Journal in a chronological order.

This work of entering every transaction into the Journal first and then posting to ledger, however, was soon found to be tedious and cumbersome as well as lacking facilities for ready and easy reference. With the result the Journal was sub-divided into various subsidiary journals to record accounting transactions of similar nature date-wise. First of all the cash transactions were separated and used to be dealt with in another book. Then the transactions relating to credit purchases and credit sales were separated and started to be recorded separately.

A sequence of activities involving the recording of how cash is received and paid out in a company or organization. The accounting process in business is based on four accounting methods, which are: the accrual method, the consistency method, the carefulness method and the going concern method.



JOURNAL

Journal is a historical record of business transaction or events. The word journal comes from the French word “Jour” meaning “day”. It is a book of original or prime entry. Journal is a primary book for recording the day to day transactions in a chronological order i.e. the order in which they occur. The journal is a form of diary for business transactions. This is called the book of first entry since every transaction is recorded firstly in the journal.

Journal Entry

Journal entry means recording the business transactions in the journal. For each transaction, a separate entry is recorded. Before recording, the transaction is analyzed to determine which account is to be debited and which account is to be credited.

The Performa of journal is shown as follows:

Date (1)	Particulars (2)	L.F. (3)	Debit (Amount) (4)	Credit (Amount) (5)

Column 1 (Date): The date of the transaction on which it takes pale is written in this column.

Column 2 (Particulars): In this column, the name of the accounts to the debited is written first, and then the names of the accounts to be credited and lastly, the narration (i.e. a brief explanation of transaction) are entered.

Column 3 (L.F.): L.F. stands for ledger folio which means page of the ledger. In this column are entered the page numbers on which the various accounts appear in the ledger.

Column 4 (Dr. Amount): In this column, the amount to be debited against the ‘Dr.’ Account is written along with the nature of currency.

Column 5 (Cr. Amount): In this column the amount to be credited against the ‘Cr.’ Account is written along with the nature of currency.

LEDGER

Ledger is a principal book of accounts of the enterprise. It is rightly called as the 'King of Books'. Ledger is a set of accounts. Ledger contains the various personal, real and nominal accounts in which all business transactions of the entity are recorded. The main function of the ledger is to classify and summaries all the items appearing in Journal and other books of original entry under appropriate head/set of accounts so that at the end of the accounting period, each account contains the complete information of all transaction relating to it. A ledger therefore is a collection of accounts and may be defined as a summary statement of all the transactions relating to a person, asset, expense or incomewhich have taken place during a given period of time and shows their net effect.

Utility of a Ledger

The main utilities of a ledger are summarized as under:

(a) It provides complete information about all accounts in one book.

(b) It enables the ascertainment of the main items of revenues and expenses

(c) It enables the ascertainment of the value of assets and liabilities.

(d) It facilitates the preparation of Final Accounts.

Dr Name of the account…….. cr

Date	Particulars	J.F	Amount	Date	Particulars	J.F	amount

Posting

Posting refers to the process of transferring debit and credit amounts from the Journal or subsidiary books to the respective heads of accounts in the ledger. Journal will have at a minimum of one debit and one credit for each transaction. The ledger will have either a debit or a credit for each account used in the Journal. Posting may be done daily, weekly fort nightly or monthly according to the convenience and requirements of the business, but care should be taken to complete it before the preparation of annual financial statements.

5. TRIAL BALANCE:

Trial balance is a statement prepared with the balances or total of debits and credits of all the accounts in the ledger to test the arithmetical accuracy of the ledger accounts. As the name indicates it is prepared to check the ledger balances. If the total of the debit and credit amount columns of the trail balance are equal, it is assumed that the posting to the ledger in terms of debit and credit amounts is accurate.

DEFINITION

According to M.S. Gosav "Trail balance is a statement containing the balances of all ledger accounts, as at any given date, arranged in the form of debit and credit columns placed side by side and prepared with the object of checking the arithmetical accuracy of ledger postings".

OBJECTIVES OF PREPARING A TRAIL BALANCE

(i) It gives the balances of all the accounts of the ledger. The balance of any account can be found from a glance from the trail balance without going through the pages of the ledger.
(ii) It is a check on the accuracy of posting. If the trail balance agrees, it proves:
(a) That both the aspects of each transaction are recorded and
(b) That the books are arithmetically accurate.
(iii) It facilitates the preparation of profit and loss account and the balance sheet.
(iv) Important conclusions can be derived by comparing the balances of two or more than two years with the help of trail balances of those years.

NAME OF THE ACCOUNT	DEBIT	CREDIT

CAPITAL EXPENDITURES:

An expenditure which results in the acquisition of permanent asset which is intended to be permanently used in the business for the purpose of earning revenue is known as capital expenditure. These expenditures are 'non-recurring' by nature. Assets acquired by incurring these expenditures are utilized by the business for a long time and thereby they earn revenue.

Examples are:

(a): machinery was purchased for $50,000 from Karachi. We paid carriage $1,000, octroi duty $500 to bring the machinery from Karachi to Lahore. Then we paid wages $1,000 for its installation in the factory. For all these expenditures, we should debit machinery account instead of debiting carriage A/c, octroi A/c and wages A/c.

(b): Fees paid to a lawyer for drawing up the purchase deed of land,

(c): Overhaul expenses of second-hand machinery etc.

(d): Interest paid on loans raised to acquire a fixed asset etc.

REVENUE EXPENDITURE:

All the expenditures which are incurred in the day to day conduct and administration of a business and the effect-of which is completely exhausted within the current accounting year are known as **"revenue expenditures"**. These expenditures are recurring by nature i.e. which are incurred for meeting day today requirements of a business and the effect of these expenditures is always short-lived.

Examples are:

1. Wages paid to factory workers.
2. Power required running machine or motor.
3. Expenditure incurred in the ordinary conduct and administration of business, i.e. rent, , carriage on saleable goods, salaries, wages manufacturing expenses, commission, legal expenses, insurance, advertisement, free samples, postage, printing charges etc.
4. Repair and maintenance expenses incurred on fixed assets.

CAPITAL RECEIPT:

Receipts which are non-recurring (not received again and again) by nature and whose benefit is enjoyed over a long period are called "Capital Receipts", e.g. money brought into the business by the owner (capital invested), loan from bank, sale proceeds of fixed assets etc. Capital receipt is shown on the liabilities side of the Balance Sheet.

REVENUE RECEIPT:

Receipts which are recurring (received again and again) by nature and which are available for meeting all day to day expenses (revenue expenditure) of a business concern are known as "Revenue receipts", e.g. sale proceeds of goods, interest received, commission received, rent received, dividend received etc.

6. FINAL ACCOUNTS

The basic objective of every business concern maintaining the book of accounts is to find out the profit or loss in their business at the end of the year. Every businessman want to know his financial position of business firm as a whole during the particular period. In order to satisfy the objectives for the firm, it is necessary to prepare final accounts.

The term 'Final Accounts' is a broader term. The three following financial statements are prepared for the preparation of final accounts:

Trading account:
It shows gross profit/loss of the business.
Profit & loss account:
It shows the net profit/loss of the business. **FINAL ACCOUNTS'**
Balance sheet
It shows the financial position of the business.

WHY THIS NAME – FINAL ACCOUNTS?

Every businessman is, ultimately, interested to know the final result of the business. These are called final accounts because they are the last accounts, prepared at the end of the year. They serve the ultimate purpose of keeping accounts. Their purpose is to analyze the effect of various incomes and expenses during the year and the resultant profit or loss.

Trading, profit & loss account and balance sheet, all these three together, are called as final accounts. Final result of trading is known through Profit and Loss Account. Financial position is reflected by Balance Sheet. These are, usually, prepared at the close of the year hence known as final accounts.

7. PREPARATION OF FINAL ACCOUNTS

Final accounts have to be prepared, every year, in every business firm. Trading and profit & loss accounts are prepared, after all the accounts have been completely written and trial balance is extracted. Before preparing final accounts, it becomes necessary to examine whether all the expenses and incomes for the year for which accounts are prepared have been duly provided for and included in the accounts. Circumstances and items are common where adjustments, at the end of the accounting period, are to be made. In such items, no cash is involved hence no record has been kept till year-end.

7.1 TRADING ACCOUNT:

Trading Account and Profit and Loss Account are the two important parts of income statements. Trading Account is the first stage in the final account which is prepared to know the trading results of gross profit or loss during a particular period. In other words, it is a summary of the purchases, and sale of a business or production cost of goods sold and the value of sales. The difference between the elements establishes the gross profit or loss which is then carried forward to the profit or loss account for calculation of net profit or net loss.

Accordingly, if the sales revenue is higher than the cost of goods sold the difference is known as 'Gross Profit,' similarly, if the sales revenue is less than the cost of goods sold the difference is known as 'Gross Loss.'

The following Specimen Reformat of a Trading Account which is widely used in practice:

Specimen Preform of trading Account

TRADING ACCOUNT

Dr **For the year ended 31.1 ....** **Cr**

Particulars	*Amount Rs.*	*Particulars*	*Amount Rs.*

To Opening Stock	****	By Gross Sales ****	
To Purchases * * *		*Less* " Sales Return ****	****
Less,' Purchase Return * * *	****	Net Sales	****
To Direct Expenses:	****	By Closing Stock	****
Carriage Inward	****		
Wages (Transferred to Freight Freight P & LAIc)	****	By Gross Loss c/d (balance figure)	****
Custom Duty	****		
Fuel and Power	****		
Factory Expenses	****		
Royalty on Production	****		
Other Direct Expenses	****		
To Gross Profit c/d (Transferred to P & LAIc)(balance figure)	****		
	*****		*****

Balancing figure will be either Gross Profit or Gross Loss

Elements of trading Account *(Debit Side)*

(1) Opening Stock.
(2) Purchases and Purchase Returns.
(3) Direct Expenses.
(4) Gross Profit is the excess value of sales over the cost of Sales.

Elements of Trading Account *(Credit Side)*

(1) Sales: The term sales refer to the total of sales of goods which include both cash sales and credit sales during the particular period.
(2) Sales Return: If any goods returned from the customers will be deducted from the total sales.
(3) Closing Stock: Closing Stock refers to the goods remaining unsold at the end of the particular period. The closing stock may be raw materials, work-in-progress and finished goods. Generally closing stock does not appear in the Trial Balance. Therefore, the closing stock is not brought into the books of accounts but it is credited to Trading Account and also recorded in the assets side of the Balance Sheet.

Equation of Trading Account

The purpose of preparing the Trading Account is to calculate the Gross Profit or Gross Loss of a concern during a particular period. The following equations are highly useful for determination of Gross Profit or Gross Loss:

Calculation of Gross Profit or Loss

$$GrossProfit = \text{Sales - Cost of Sales}$$

$$sales = \text{Cost of Sales} + \text{Gross Profit}$$

Or

$sales =$ Stock in the beginning + Purchases + Direct Expenses- Stock at the end + Gross Profit

7.2 PROFIT AND LOSS ACCOUNT

The determination of Gross Profit or Gross Loss is done by preparation of Trading Account. But it does not reveal the Net Profit or Net Loss of a concern during the particular period. This is the second part of the income statement and is called as Profit and Loss Account. The purpose of preparing the profit and loss account to calculate the Net Profit or Net Loss of a concern. Net profit refers to the surplus which remains after deducting related trading expenses from the Gross Profit. The trading expenses refer to inclusive of office and administrative expenses, selling and distribution expenses.

In other words, alloperating expenses such as office and administrative expenses, selling and distribution expenses and non-operatingexpenses are shown on the debit side and all operating and non-operating gains and incomes are shown on the credit side of the Profit and Loss Account. The difference of two sides is either Net Profit or Net Loss. Accordingly, when total of all operating and non-operating expenses is more than the Gross Profit and other non-operating incomes, the difference is the Net Profit and in the reverse case it is known as Net Loss. This Net Profit or Net Loss is transferred to the Capital Account of Balance Sheet.

The following Specimen Preformatted which is used for preparation of Trading, Profit and Loss Account.

Dr **Specimen Preformatted of a Profit and Loss Account** **Cr**

Particulars	*Amount Rs.*	*Particulars*	*Amount Rs.*
To Opening Stock	****	By Gross Sales ****	
To Purchases ***		*Less* " Sales Return ****	****
	****	Net Sales	****
Less,' Purchase Return ***	****	By Closing Stock	****
To Direct Expenses:	****		
To Carriage Inward	****	By Gross Loss c/d (balance figure)	****
To Wages (Transferred to Freight Freight P & LAIc)	****		
To Gross Profit c/d (Transferred to P & LAIc)(balance figure)			
	*****		*****
		By Non-Operating Incomes:	
To Office & Administrative Expenses:	****	Interest Received	****
To Office Salaries	****	Discount Received	****
To Office Rent and Rates	****	Dividend Received	****
To Printing and Stationery	****	Income from Investment	****
To Telephone Charges	****	Interest on Debenture	****
To Legal Charges	****	Any other incomes	****
To Audit fees	****	By Net Loss *c/d* (Transferred to Capital	****

To General Expenses **To Selling Expenses:** To Advertisement To Discount Allowed To Commission Paid To Salesmen Salaries To Godown Rent To Carriage Outward To Agent Commission To Traveling Expenses **To Distribution Expenses**: Depreciation on Vehicle Upkeep of Motor Van Travelers' Salaries Repairs and Maintenance **To Non-Operating Expenses:** Discount on Issue of Shares Preliminary Expenses To Net Profit *c/d* } • • • (Transferred to Capital *Nc)*	**** **** **** **** **** **** **** **** **** **** **** **** **** **** **** **** **** ****	Account)	*****

Components appearing on Debit Side of the P & L Alc

Those expenses incurred during the manufacturing process of conversion of raw materials into finished goods will be treated as direct expenses which are recorded in the debit side of Trading Account. Any expenditure incurred subsequent to that will be known as indirect expenses to be shown in the debit side of the Profit and Loss Account. The indirect expenses may be classified into:

(1) Operating Expenses

(2) Non-Operating Expenses.

(1) Operating Expenses: It refers to those expenses as the day-to-day expenses of operating a business include office & administrative expenses, selling and distribution expenses

(2) **Non-Operating Expenses:** Those expenses incurred other than operating expenses. Cooperating expenses which are related to a financial nature. For example, interest payment on loans and overdrafts, loss on sale of fixed assets, writing off fictitious assets such as preliminary expenses, under writing commission etc.

Components appearing on Credit Side of P&L Alc

The following are the components as shown on the Credit Side:

(1) **Gross Profit** brought down from Trading Account

(2) **Operating Income:** It refers to income earned from the operation of the business excluding Gross Profit and Non-Operating incomes.

(3) **Non-Operating Income:** Non-Operating incomes refer to other than operating income. For example, interest on investment of outside business, profit on sale of fixed assets and dividend received etc.

7.3BALANCE SHEET

The Balance Sheet is also described as a statement showing the sources of funds and application of capital or funds. In other words, liability side shows the sources from where the funds for the business were obtained and the assets side shows how the funds or capital were utilized in the business.

Accordingly, it describes that all the assets owned by the concern and all the liabilities and claims it owes to owners and outsiders. The purpose of preparing balance sheet is to know the true and fair view of the status of the business as a going concern during a particular period. The balance sheet is oneof the important statement which is used to owners or investors to measure the financial soundness of the concern as a whole.

A statement is prepared to show the list of liabilities and capital of credit balances of the business on the left hand side and list of assets and other debit balances are recorded on the right hand side is known as "Balance

(1) Fixed Assets:

These classes of assets include those of a tangible nature having a specific value and which are not consumed during the normal course of business and trade but provide the means for producing saleable goods or providing services.

(2) Current Assets or Floating Assets :

The assets of a business of a transitory nature which are used for resale or conversion into cash during the course of business operation. In other words, those assets which are easily converted into cash in normal course of business during the shorter period say, less than one year are treated as current or floating assets.

(3) Fictitious Assets :

Fictitious Assets refer to any deferred charges. They are really not assets. Preliminary expenses, Share issue expenses, discount on issue of shares and debentures, and debit balance of profit and loss account etc. are the important components of fictitious assets.

(1) Non-Current Liabilities:

Non-Current Liabilities otherwise known as Long-Term Liabilities. Liabilities which are become due for payment beyond a period of one year say, five to ten years, are treated as Long-Term Liabilities

(2) Capital:

Capital refers to the value of assets owned by a business and which are used during the course of business operations to generate additional Capital or Wealth. It is also known as Owner's Equity or Net Worth. When a business first comes into existence the initial capital may be provided by the proprietor. The initial influx of capital will normally be in the form of cash which need to be converted into plant and machinery, building and stock of materials prior to commencing operations. Thus, capital is equal to the total assets.

(3) **Current Liabilities**:

Any amount owing by the business which are currently due for payment are referred to as current liabilities. In other words, these liabilities which are paid within one year are treated as current liabilities.

Specimen Form of Balance Sheet

Liabilities	*Amount*	*Assets*	*Amount*
Current Liabilities :		***Current Assets :***	
Sundry Creditors	*****	*Cash in Hand*	*****
Bills Payable	*****	*Cash at Bank*	*****
Bank Overdraft	*****	*Sundry Debtors*	*****
Outstanding Expenses	*****	*Short Term Investments*	*****
		** * * Stock in Trade*	*****
Long-Term Liabilities :		*Bills Receivable*	*****
Loan from Bank	*****	*Prepaid Expenses*	*****
Loan from Mortgage	*****	*Accrued Incomes*	*****
Debenture	*****		
Any other Long Term	*****	***Fixed Assets :***	
		Plant and Machinery	*****
Total Liabilities	*****	*Furniture & Fixtures*	*****
Net worth		*Buildings*	*****
Capital Account : * **		*Loose Tools*	*****
*Add: Net Profit * * **		*Motor Cars*	*****
*Add : Interest on Capital * * **		***Intangible Assets :***	
*Less : Drawings * * **	*****	*Goodwill*	*****
Reserves and Surplus :		*Patents*	*****
General Reserve	*****	*Copy Rights*	*****
Reserve for Contingency	*****	*Trade Marks*	*****
Reserve for Sinking Fund	*****	***Fictitious Assets :***	
		Preliminary Expenses	*****
		Advertisement Misc. Expenses	*****
	******		******

8. ADJUSTMENTS IN FINAL ACCOUNTS

Transactions omitted relate to the current year must be entered in books. If a transaction entered is not related to the current year, fully or partly, that portion of income or expense must be excluded. This process is made through adjustment entries in the books of accounts. If we ignore to make the necessary adjustments, the trading, profit & loss accounts do not show the true profit or loss and in consequence balance sheet fails to depict true financial position of the business. This situation defeats the very purpose of final accounts. Hence, adjustment entries play an important role in presenting correct picture of accounts.

(1). CLOSING STOCK:

The term Closing Stock refers to stock of raw materials, work in progress and finished goods at the end of the year valued at cost price or market price whichever is less. The following adjustment entry is

Closing Stock A/c … Dr *****
To Trading Account *****

The two-fold effect of this entry will be:

(i) Closing stock will be shown on the credit side of the Trading Account.

(ii) Stock will have a debit balance. Being a real account, it will be shown on the assetsside of the Balance Sheet.

Dr Trading Account for the year ending... Cr

Particulars	Amounts	Particulars	Amounts
		By closing stock	******

BALANCE SHEET as on ……….

Liabilities	Amounts	Assets	amounts
		closing stock	******

(2). OUTSTANDING EXPENSES

There are certain expenses, which have been incurred but not paid. These expenses are called outstanding expenses.

Salary Account …..Dr. *****
To Outstanding Salary A/c. *****

The two fold effect of this entry will be:

(i) Outstanding salary will be added to salary, if any, on the debit side of Profit & Loss Account.

(ii) Outstanding Salary Account, being personal and having credit balance, will be shown on the liabilities side of the Balance Sheet

Dr. PROFIT & LOSS Account for the year ending… Cr.

Particulars	Amounts	Particulars	Amounts
To salary	*****		

BALANCE SHEET as on ……….

Liabilities	Amounts	Assets	amounts
Outstanding salary	*****		

(3) PREPAID EXPENSES:

Prepaid expenses are also known as unexpired expenses. Those expenses which are incurred and paid in advance. Such expenses are actually related to a future period. In order to ascertain the correct picture of the profit and loss accounts the following adjustment entry is required for adjusting such prepaid expenses.

Prepaid Expenses Account …..Dr. *****
To Expenses Account *****

The double effect of this adjusting entry will be:
(i) Prepaid insurance will be deducted from the insurance premium on the debit side of the Profit & Loss Account.
(ii) Prepaid insurance, being personal account and having debit balance, will be shown on the assets side of the Balance Sheet.

Dr. PROFIT & LOSS Account for the year ending… Cr.

Particulars	Amounts	Particulars	Amounts
To insurance premium *****			
Less prepaid ****	*****		

BALANCE SHEET as on ……….

Liabilities	Amounts	Assets	amounts
		Prepaid insurance	****

(4) ACCRUED INCOME

Accrued Income otherwise known as Outstanding Income. Such incomes are accrued during the accounting period but not actually received in cash during that period. The adjustment entry will be as follows:

Accrued Income Account …..Dr. *****
To Concerned Income Account *****

The two fold effect of this entry will be:
(i) Interest on Investment account (accrued interest) will be added to the interest account on the credit side of the profit & loss account.
(ii) Accrued interest, being personal account and having debit balance, will be shown on the debit side of the Balance Sheet.

Dr. PROFIT & LOSS Account for the year ending… Cr.

Particulars	Amounts	Particulars	Amounts
		By interest *****	
		Add interest accrued ****	*****

BALANCE SHEET as on ……….

Liabilities	Amounts	Assets	amounts
		Accrued interest	****

(5) INCOME RECEIVED IN ADVANCE

Any income received in advance which is not earned during theaccounting period. Therefore, if any income received in advance, it should be treated as income for the subsequent year. The adjustment entry will be:

Income Account …..Dr.	*****	
To Income Received in Advance Account		*****

The two fold effect of this entry will be:
(i).the income actually earned alone will appear on the credit side of Profit and Loss Account.
(ii) It shown on the liability side of the balance sheet.The Income Received in Advance is treated as a liability because an amount due to the party

Dr. PROFIT & LOSS Account for the year ending… Cr.

Particulars	Amounts	Particulars	Amounts
		By interest *****	
		less interest Received in Advance ****	*****

BALANCE SHEET as on ……….

Liabilities	Amounts	Assets	amounts
interest Received in Advance	****		

(6) DEPRECIATION:

The term depreciation refers to loss on account of reduced value of assets due towear and tear, obsolescence, efflux ion of time or accident. Depreciation is treated as the cost or loss raisedwhen the asset is used in the normal course of time. In order to ascertain the correct value of the assets in the balance sheet, it is essential to make to following adjustment entry as:

Depreciation Account …..Dr. *****
To Fixed Assets Account *****

The two fold effect of this entry will be:
(i).the amount of depreciation is charged to debit side of the profit and loss account
(ii) It is deductedfrom the respected assets shown on the asset side of the balance sheet.

Dr. PROFIT & LOSS Account for the year ending… Cr.

Particulars	Amounts	Particulars	Amounts
To depreciation	*****		

BALANCE SHEET as on ……….

Liabilities	Amounts	Assets	amounts
		Machinery ***** Less depreciation ****	*****

(7) INTEREST ON CAPITAL

In order to ascertain true profitability of the business concern, it is essentialthat profit is determined after deducting interest on the capital provided by proprietor. Interest on capital is included in the capital expenditure and thus the adjustment entry will be:

Interest on Capital Account …..Dr. *****
To Capital Account *****

The two fold effect of this entry will be:
(i).The Interest on Capital is an expenditure charged to debit side of profit and loss account
(ii) It is added to capital shown on the liability side of the balance sheet.

Dr PROFIT & LOSS Account for the year ending… Cr.

Particulars	Amounts	Particulars	Amounts
To interest on capital	*****		

BALANCE SHEET as on ……….

Liabilities	Amounts	Assets	amounts
Capital Account : * * * *Add : Interest on Capital* * * *	*****		

(8) INTEREST ON DRAWINGS

It is like an interest on capital provided by the proprietor. Any amount charged as interest on drawings made by the proprietors for his personal use during the particular period is treated as interest on drawings. Interest on drawings should be taken as an income for ascertaining the true profit for a period. The adjustment entry will be:

Capital Account …..Dr. *****
To Interest on Drawings Account *****

The two fold effect of this entry will be:
(i).Interest on drawings is charged on the credit side of the profit and loss account
(ii) It is deducted from the capital account shown on the liability side of the Balance Sheet.

Dr PROFIT & LOSS Account for the year ending… Cr.

Particulars	Amounts	Particulars	Amounts
		By interest on drawings	*****

BALANCE SHEET as on ……….

Liabilities	Amounts	Assets	amounts
Capital Account : * * * *Add : Interest on drawing* * * *	*****		

(9) BAD DEBTS:

The term bad debts refer to any amount which are definitely irrecoverable are termed asBad Debts. It may be treated as actual loss of the business. Any amount irrecoverable due to inability of the debtors, it should be written off from the accounts of debtors. The necessary adjustment entry will be:

Bad Debts Account …..Dr. *****
To Debtor's Personal Account *****

The two fold effect of this entry will be:
(i).Being bad debts are treated as expenses is charged to debit side of profit and loss account.
(ii)Theamount deducted from debtors account shown on the assets side of the balance sheet

Dr PROFIT & LOSS Account for the year ending… Cr.

Particulars	Amounts	Particulars	Amounts
To bad debts	*****		

BALANCE SHEET as on ……….

Liabilities	Amounts	Assets	amounts
		Debtors **** Less bad debts ***	*****

(10) PROVISION FOR DOUBTFUL DEBTS

It is like a bad debt but recovery is doubtful. Thus doubtful debts should not be written off from the books of accounts. Doubtful debts are treated as anticipated loss therefore making suitable provisions required to be made in the books of accounts. In order to ascertain the correct picture of the debtor's balance, it is essential to make an adjustment entry:

Profit and Loss Account …..Dr. *****
To Provision for Doubtful Account *****

The two fold effect of this entry will be:
(i).the provision for doubtful debts is an anticipated expenses charged to the debit side of the profit and
Loss account
(ii)It is deducted from the debtor's account shown on the asset side of the balance sheet.

Dr PROFIT & LOSS Account for the year ending… Cr.

Particulars	Amounts	Particulars	Amounts
To bad debts	*****		

BALANCE SHEET as on ……….

Liabilities	Amounts	Assets	amounts

		Debtors **** Less bad debts ***	*****

11.PROVISION FOR DISCOUNT ON DEBTORS

Sometimes the goods are sold on credit to customers in one accounting period whereas the payment of the same is received in the next accounting period and discount is to be allowed.

Profit and Loss A/c Dr. *****

To Provision for discount on debtors A/c *****

The two fold effect of this entry will be:
(i).Provision for Discount onDebtors is an anticipated expenses charged to the debit side of the profit and
Loss account
(ii)It is deducted from the debtor's account shown on the asset side of the balance sheet.

Dr PROFIT & LOSS Account for the year ending… Cr.

Particulars	Amounts	Particulars	Amounts
To Provision fordiscount on debtors	*****		

BALANCE SHEET as on ……….

Liabilities	Amounts	Assets	amounts
		Debtors **** (-) Bad debts *** (-) Provision for double debts **** (-) Discount on debtors ****	*****

Assignment I – Journal
Q.1 Journalize the following relating to April 2009:

Particulars	*Rs.*
1. R. started business with	1, 00,000
2. He purchased furniture for	20,000
3. Paid salary to his clerk	1,000
4. Paid rent	5,000
5. Received interest	2,000

Date	Particulars	Ledger Folio	Debit Amount (Rs)	Credit Amount (Rs)
1	Cash A/c Dr To Capital A/c		100,000	 100,000
2	Furniture A/c Dr To Cash A/c		20,000	 20,000
3	Salary A/c Dr To Cash A/c		1,000	 1,000
4	Rent A/c Dr To Cash A/c		5,000	 5,000
5	Cash A/c Dr To Interest A/c		2,000	 2,000

Assignment II – Journal

Q.2 Journalize the following relating to April 2009:

Date	Transactions	Rs.
2009		
Jan.1	Started business with cash	50,000
Jan.3	Sold Goods to Rohan	40,000
Jan .7	Goods purchased from Sohan	20,000
Jan.20	Paid Rent	500
Jan.25	Commission Received	200
Jan.30	Machinery purchased	10,000
Jan.30	Purchased Furniture	5000
Jan.30	Goods purchased	6000
Jan.30	Cash Sales	8000

Date	Particulars	Debit (Rs.)	Credit (Rs.)
2009 Jan.1	Cash A/c Dr. To Capital A/c (Being the business started with cash)	50,000	 50,000
Jan.3	Rohan Dr. To Sales A/c (Being the goods sold to Rohan)	40,000	 40,000
Jan.7	Purchase A/c Dr. To Sohan (Being the goods purchased from Sohan)	20,000	 20,000
Jan.20	Rent A/c Dr. To Cash A/c (Being the rent paid)	500	 500
Jan. 25	Cash A/c Dr. To Commission Received A/c (Being the commission received)	200	 200
Jan.30	Machinary A/c Dr. To Cash A/c (Being the machinery purchased)	10,000	 10,000
Jan.30	Furniture A/c Dr. To Cash A/c (Being the machinery purchased)	5000	 5000
Jan.30	Purchases A/c dr. To cash a/c	6000	 6000

Jan.30	Cash a/c dr To sales	8000	 8000

Assignment IV – Journal

Q.4 Journalize the following relating to December2008:

December 1, 2008, Ajit started-business with cash Rs. 4,00,000.
2: December 3, paid into the bank Rs. 20,000.
3. December 5, purchased goods for cash Rs. 1,50,000.
4. December 8, sold goods for cash Rs. 60,000.
5. December 10, purchased furniture and paid by cheque Rs. 50,000.
6. December 12, sold goods to Arvind Rs. 40,000.
7. December 14, purchased goods from Amrit Rs. 1,00,000.
8. December 15, returned goods to Amrit Rs. 50,000.
9. December 16, received from Arvind Rs. 39,600 in full settlement.
10. December 18, withdrew goods for personal use Rs. 10,000.
11. December 20, withdrew cash from business for personal use Rs. 20,000.
12. December 24,paid telephone charges Rs. 10,000.
13. December 26, cash paid to Amrit in full settlement Rs. 49,000.
14. December 31, paid for stationery Rs. 2,000, rent Rs. 5,000 and salaries to staff Rs. 20,000.
15. December 31, goods distributed by way of free samples Rs. 10,000.
16. December 31, wages paid for erection of Machinery Rs. 80,000.
17. Personal income tax liability of X of Rs. 17,000 was paid out of petty cash of business.
18. Purchase of goods from Naveen of the list price of Rs. 20,000. He allowed 10% trade discount, Rs. 500 cash discount was also allowed for quick payment.

Date	**Particulars**	**Ledger Folio**	**Debit Amount (Rs)**	**Credit Amount (Rs)**
1-Dec-08	Cash A/c Dr To Capital A/c		400,000	 400,000
3-Dec-08	Bank A/c Dr To Cash A/c		20,000	20,000
5-Dec-08	Purchase A/c Dr To Cash A/c		150,000	 150,000
8-Dec-08	Cash A/c Dr To Sales A/c		60,000	 60,000
10-Dec-08	Furniture A/c Dr To Bank A/c		50,000	 50,000
12-Dec-08	Arvind A/c Dr To Sales A/c		40,000	 40,000
14-Dec-08	Purchase A/c Dr To Amrit A/c		100,000	 100,000
15-Dec-	Amrit A/c Dr		50,000	

08	To Purchase Returns A/c			50,000
16-Dec-08	Cash A/c Dr Discount A/c Dr To Arvind A/c		39,600 400	 40,000
18-Dec-08	Drawings Dr To Purchase A/c		10,000	 10,000
20-Dec-08	Drawings Dr To Cash A/c		20,000	 20,000
24-Dec-08	Telephone A/c Dr To Cash A/c		10,000	 10,000
26-Dec-08	Amrit A/c Dr To Cash A/c To Discount A/c		50,000	 49,000 1,000
31-Dec-08	Stationery A/c Dr Rent A/c Dr Salary A/c Dr To Cash A/c		2,000 5,000 20,000	 27,000
31-Dec-08	Advertising A/c Dr To Purchase A/c		10,000	 10,000
31-Dec-08	Machinery A/c Dr To Cash A/c		80,000	 80,000
31-Dec-08	Drawings Dr To Petty Cash A/c		17,000	 17,000
31-Dec-08	Purchase A/c Dr Discount A/c Dr To Cash A/c		18,000	 500 17,500

Assignment VII – final account

Q.7

From the following informations of Jansons Ltd. on 31[st] March, 2003 you are required to prepare the Trading, Profit and Loss A/c and Balance Sheet:

	Rs.		Rs.
Opening Stock	5,000	Capital	89,500
Bills Receivable	22,500	Commission (Cr.)	2,000
Purchases	1,95,000	Return Outward	2,500
Wages	14,000	Trade Expenses	1,000
Insurance	5,500	Office Fixtures	5,000
Sundry Debtors	1,50,000	Cash in Hand	2,500
Carriage Inward	4,000	Cash at Bank	23,750
Commission (Dr.)	4,000	Rent & Rates	5,500
Interest on Capital	3,500	Carriage Outward	7,250
Stationery	2,250	Sales	2,50,000
Return Inward	6,500	Bills Payable	15,000
		Creditors	98,250
		Closing Stock	12,500

Solution:

Dr. Trading, Profit & Loss A/c of Jansons Ltd. for the year ending 31st March, 2003 Cr.

Particulars		*Amount Rs.*	*Particulars*		*Amount Rs.*
To Opening Stock		5,000	By Sales	2,50,000	
To Purchase	1,95,000		*Less :* Sales Return	6,600	2,43,500
Less: Purchase Return	2,500	1,92,500	By Closing Stock		1,25,000
To Wages		14,000			
To Carriage Inward		4,000			
To Gross Profit c/d		1,53,000			
		3,68,500			3,68,500
To Insurance		5,500	By Gross Profit b/d		1,53,000
To Commission		4,000	By Commission		2,000
To Interest on Capital		3,500			
To Stationery		2,250			
To Trade Expenses		1,000			
To Rent & Taxes		5,500			
To Carriage Outward		7,250			
To Net Profit c/d		1,26,000			
		1,55,000			1,55,000

Balance Sheet of Jansons Ltd.

Liabilities		*Amount Rs.*	*Assets*	*Amount Rs.*
Creditors		98,250	Cash in Hand	2,500
Bills Payable		15,000	Cast at Bank	23,750
Capital	89,000		Bills Receivable	22,500
Add : Net Profit	1,26,000	2,15,500	Stock	1,25,000
			Sundry Debtors	1,50,000
			Office Fixtures	5,000
		3,28,750		3,28,750

Assignment VIII– final accounts

Q.8: From the following Trial Balance of Mr. y as on31st March, 2006, prepare Trading Account, Profit and Loss Account andBalance Sheet.

Debit Balance	Rs.	Credit Balance	Rs.
Stock on 1st April, 2005	500	Capital	2,000
Purchases	1,500	Sales	3,500
Land and Building	2,000	Sunday Creditors	750
Bills Receivable	300	Commission	50
Wages	300	Bills payable	300
Machinery	800	Loan	600
Carriage Inward	100		

Carriage Outward 100	100		
Power	150		
Salaries	200		
Discount Allowed	30		
Drawings	100		
Insurance Premium	20		
Cash at Bank	500		
Cash in Hand	100		
Investments	500		
Total	7200	Total	7200

Adjustments

1. Stock as on 31st March 2006 is valued at Rs. 200.
2. Provide depreciation @ 10% on Machinery and @ 5% on Land and Building.
3. Outstanding salaries amounted to Rs.50.
4. Insurance premium is paid in advance to the extent of Rs.10.
5. Allow interest on Capital @ 6% per annum.
6. Interest on loan @ 12% per annum is due for one year.

Solution

Dr TRADING & PROFIT AND LOSS A/C FOR THE YEAR ENDED 31ST MARCH, 2006 Cr

Particulars	Rs.	Particulars	Rs.
To Opening stock	500	By Sales	3500
To Purchases	1500	By Closing Stock	200
To Wages	300		
To Carriage Inward	100		
To Power	150		
To Gross Profit c/d	1,150		
	3,700		3,700
To Salaries 200 Add Outstanding Salaries 50	250	By Gross profit b/d	1,150
To Carriage Inward	100	By Commission	50
To Insurance Premium 20 *Less* prepaid Ins. 10	10		
To Discount allowed	30		
To Depreciation on: Machinery 80 Land and Building 100	180		
To Interest on Loan	72		
To Interest on Capital	120		

To Net Profit (Transferred to capital account)	438		
	1200		1200

BALANCE SHEET AS ON 31ST MARCH 2006

Liabilities	Rs.	Assets	Rs.
Capital 2,000		Land and Building 2,000	
Add Interest on Capital 120		Less Dep. 100	1900
Add Net profit 438		Machinery 800	
2558		Less Dep. 80	720
Less Drawings Loan 100	2458	Investments	500
		Closing stock	200
Loan 600		Bills Receivable	300
Add Interest O/S 72	672	Cash at Bank	500
Sundry Creditors	750	Cash in Hand	100
Bills payable	300	Prepaid Insurance	10
Outstanding Salaries	50		
	4230		4230

Accounting equation: the formula representing the relationship between a business's assets, liabilities and capital, usually expressed as A - L = C or, when extended to include revenue and expenses,

A + E = L + C + R.

Liabilities: Present obligations of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

Income statement :a financial summary showing revenue and expenses for the financial period.

Cash book : The book containing the bank account and cash account. Part of the general (impersonal) ledger.

Closing off : Balancing accounts at the end of a financial period.

General ledger The impersonal ledger containing accounts for capital and types of assets, expenses, liabilities and revenue. Also known as the nominal ledger.

Impersonal ledger The general (or nominal) ledger.

Imprest system A method of controlling petty cash by keeping a 'float' which is topped up at intervals.

Journal A book of prime entry used to record the correction of errors and other adjustments between ledger accounts.

Ledger A collection of individual records known as accounts.

Nominal ledger Another name for the general ledger.

Payable A supplier of goods or services who is owed money by the business. Also known as a creditor.

Personal ledgers The Receivables (Debtors) and Payables (Creditors) ledgers, containing the individual accounts of customers and suppliers who trade on credit terms.

Petty cash Small items of expenditure, usually shown in a separate book.

Posting A word used to describe the entering of information in the double-entry system.

Purchases The name of an account in the general ledger which records goods bought for resale.
Receivable A customer or client who owes an amount to the business. Also Knownas a debtor.
T account Simple representation of the layout of a ledger account.
Trial balance A list of all the account balances, divided between debit and credit balances at a specific time. If the total debit balances equal the total credit balances, the trial balance is said to 'agree' and shows that the arithmetic of all the entries is correct. It is not a perfect check of overall accuracy.
Appropriation account An additional part of the income statement, inserted after the net profit or loss, showing,
for a partnership, the financial implications of the partnership agreement or, for a limited company, tax and dividend deductions and reserve transfers.
Auditor An independent accountant who reports on whether the financial summaries reflect a true
and fair view of a business's affairs.
Columnar layout *See* Vertical layout.
Cost of manufacturing The first part of a manufacturing company's income statement, showing all the costs,
direct and indirect, of producing the goods manufactured in the period.
Direct costs Costs which can be readily identified with the items being produced, for example sugar in
a biscuit factory.
Final accounts A name given to the income statement and balance sheet when prepared at the end of a
financial period.
Horizontal layout A traditional account format used for the income statement and balance sheet by many
mainland European and other countries. Nowadays, it is very unusual in the UK.
Indirect costs All manufacturing costs other than direct costs, e.g. the rent of a biscuit factory.
M.B.A

What is Marketable securities: Surplus cash can be invested in short term instruments in order to earn interest.

Trade Credit: It represents credit granted by suppliers of goods, in the normal course of business.

Funds flow statement: It is the statement deals with the financial resources for running business activities. It explains how the funds obtained and how they used.

Cost accounting: It is thus concerned with recording, classifying, and summarizing costs for determination of costs of products or services planning, controlling and reducing such costs and furnishing of information management for decision making.

Marginal costing: it is a technique of costing in which allocation of expenditure to production is restricted to those expenses which arise as a result of production, i.e., materials, labour, direct expenses and variable overheads.

Mark to market: In future market, at the end of the each trading day, the margin a/c is adjusted to reflect the investors' gains or loss depending upon the futures selling price. This is called mark to market.

. Meaning of ratio: Ratios are relationships expressed in mathematical terms between figures which are connected with each other in same manner.

. Return on share holders' funds: it indicates measures earning power of equity capital.

Formula:

Profits available for Equity shareholders
--X 100
Average Equity Shareholders Funds

Define the term accrual: Recognition of revenues and costs as they are earned or incurred. it includes recognition of transaction relating to assets and liabilities as they occur irrespective of the actual receipts or payments.

Define the term preliminary expenses: Expenditure relating to the formation of an enterprise. There include legal accounting and share issue expenses incurred for formation of the enterprise.

b.com

. Principles of accounting:

A. Personal a/c: Debit the receiver
Credit the giver

B. Real a/c: Debit what comes in
Credit what goes out

C. Nominal a/c: Debit all expenses and losses
Credit all gains and incomes

. Credit note: The customer when returns the goods get credit for the value of the goods returned. A credit note is sent to him intimating that his a/c has been credited with the value of the goods returned.

Bank reconciliation statement: It is a statement reconciling the balance as shown by the bank passbook and the balance as shown by the Cash Book. Obj: to know the difference & pass necessary correcting, adjusting entries in the books.

Amortization: The process of writing of intangible assets is term as amortization

Capital employed: The term capital employed means sum of total long term funds employed in the business. i.e.

(Share capital+ reserves & surplus +long term loans – (non business assets + fictitious assets)

Factoring: It is an arrangement under which a firm (called borrower) receives advances against its receivables, from financial institutions (called factor)

Capital receipts: Capital receipts may be defined as "non-recurring receipts from the owner of the business or lender of the money crating a liability to either of them.

Glossary

Accounting: It is the maintenance of daily record of All financial transactions in such a manner that it would help in the preparation of suitable information regarding the financial affairs of a business or an individual.

Financial Accounting needed: The need for recording financial transactions arises because the individual or business wants to know theperformance of the business and to assist the person in making decisions related to the business.

Transactions: In accounting or business terms, any dealing between two persons involving money or a valuable thing is called **transaction**

Cash transaction: When the money value of an item being purchased is paid at the same time the item is exchanged the transaction is said to be a cash transaction

Record Keeping: We can maintain a diary of transactions and note the daily transactions like sale, purchase etc. in it.

Credit transaction: it is an agreement between a buyer and seller for deferred payment on goods and services

Purchases: This term is used for goods to be dealt-in i.e. goods are purchased for resaleor for producing the finished products which are meant for sale.

Sales: Sales are total revenues from goods or services provided to customers. Sales may be in cash or in credit.

Assets A resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.

Capital The value of the investment of the owner or owners in the business, found by deducting all of the organization's liabilities from all of the organization's assets. Also known as 'equity'.

Expenses Expenditure made by a business related to the revenue generated within the same financial period. **It** includes goods bought for resale, and overheads such as light and heat, wages and salaries.

Financial accounting: theday-to-day recording of an organization's financial transactions and the summarizing of those transactions to satisfy the information needs of various user groups in accordance with the regulatory framework.

Management accounting theinternal accounting needs of an organization, involving planning, forecasting andbudgeting for decision-making purposes.

Revenue The revenue generated by the business by selling its goods or services, plus sundry incomesuch as interest received.

Bookkeeping The process of recording financial transactions.

Single entry accounting/Cash accounting. This system records only cash movement of transactions and that too up to the extent of recording oneaspect of the transactions.This means that only receipt or payment of cash is recorded and no separate record is maintained (aboutthe source of receipt and payment) as to from whom the cash was received or to whom it was paid.

Double entry book keeping/Commercial accounting.

Double entry or commercial accounting system records both aspects of transaction i.e. receipt or payment and source of receipt or payment. It also records credit transactions i.e. recording of Electricity Bill or accruals of Salary payment etc.

Expenses: Costs incurred by a business in the process of earning revenue are calledexpenses.

Credit: The right-hand side of a ledger account. Liability, capital and income accounts have credit balances. Abbreviated to Cr.

Debit The left-hand side of a ledger account. Asset and expenses accounts have debit balances. Abbreviated to Dr.

B.COM

1. What is the difference between accounts and finance?
2. Assets are shown on the balance sheet at cost less depreciation. If the market value of the asset is higher, is this not a misrepresentation? What accounting concept is involved in this?
3. What is costing?
4. Make a profit and loss account and a balance sheet.
5. What is the difference between finance and accounts, shares and debentures?
6. What is SLR? CRR? What is the difference between the two?
7.What is Working capital turnover ratio?

It is also known as Working Capital Leverage Ratio. This ratio indicates whether or not working capital has been effectively utilized in making sales.

Formula: $$\frac{\text{Net Sales}}{\text{Working Capital}}$$

8.What is Floating Change?

Assume change on some or all assets of an enterprise which are not attached to specific assets and are given as security against debt.

9.What are the important things to be remembered while preparing a bank reconciliation statement?

Cheques issued but not presented for payment
Amount credited in Passbook but not in Cash book
Deposits made in the bank directly
Wrong credits given by bank
Interest credited in the Passbook.

10. What is Accrual System of Accounting?

This system of accounting is considered to be ideal but it may result into unrealized profits which might reflect in the books of the accounts on which the organization have to pay taxes too.

M.B.A

1. **Cost of production:** In office and administration overheads are added to factory cost, office cost is arrived at.
2. **Fictitious assets:** These are assets not represented by tangible possession or property. Examples of preliminary expenses, discount on issue of shares, debit balance in the profit And loss account when shown on the assets side in the balance sheet.
3. **Provision:** provision usually means any amount written off or retained by way of providing depreciation, renewals or diminutions in the value of assets or retained by way of providing for any known liability of which the amount cannot be determined with substantial accuracy.
4. **Optimum capital structure:** Capital structure is optimum when the firm has a combination of equity and debt so that the wealth of the firm is maximum.
5. **Time value of money:** The time value of money means that worth of a rupee received today is different from the worth of a rupee to be received in future.

6. **Capital budgeting:** Capital budgeting involves the process of decision making with regard to investment in fixed assets. Or decision making with regard to investment of money in long-term projects
7. **Bridge finance:** It refers to the loans taken by the company normally from commercial banks for a short period pending disbursement of loans sanctioned by the financial institutions.
8. **Certificate of deposits:** The CD is a document of title similar to a fixed deposit receipt issued by banks there is no prescribed interest rate on such CDs it is based on the prevailing market conditions.
9. **GDR (Global depository receipts):** A depository receipt is basically a negotiable certificate, dominated in us dollars that represents a non-US company publicly traded in local currency equity shares.
10. **Master budget:** A summary of budget schedules in container form made for the purpose of presenting in one report the highlights of the budget forecast.

Accounting Career Opportunities

Public Accounting
Careers in auditing, taxation, And management consulting Serving the general public.

Private Accounting Careers in industry working in cost accounting, budgeting, accounting information systems, and taxation.

Government
Careers with the IRS, the FBI, the SEC, and in public Colleges and universities.

Forensic Accounting
Uses accounting, auditing, and investigative skills to conduct investigations into theft and fraud.

Accounting manager

Accounting Manager Role Responsibilities & Duties

- Obtain and maintain a thorough understanding of the financial reporting and general ledger structure.
- Ensure an accurate and timely monthly, quarterly and year end close.
- Ensure the timely reporting of all monthly financial information.
- Assist the Controller in the daily banking requirements.
- Ensure the accurate and timely processing of positive pay transactions.
- Ensure the monthly and quarterly Bank Compliance activities are performed in a timely and accurate manner.

Accounting Manager Skills and Qualifications:

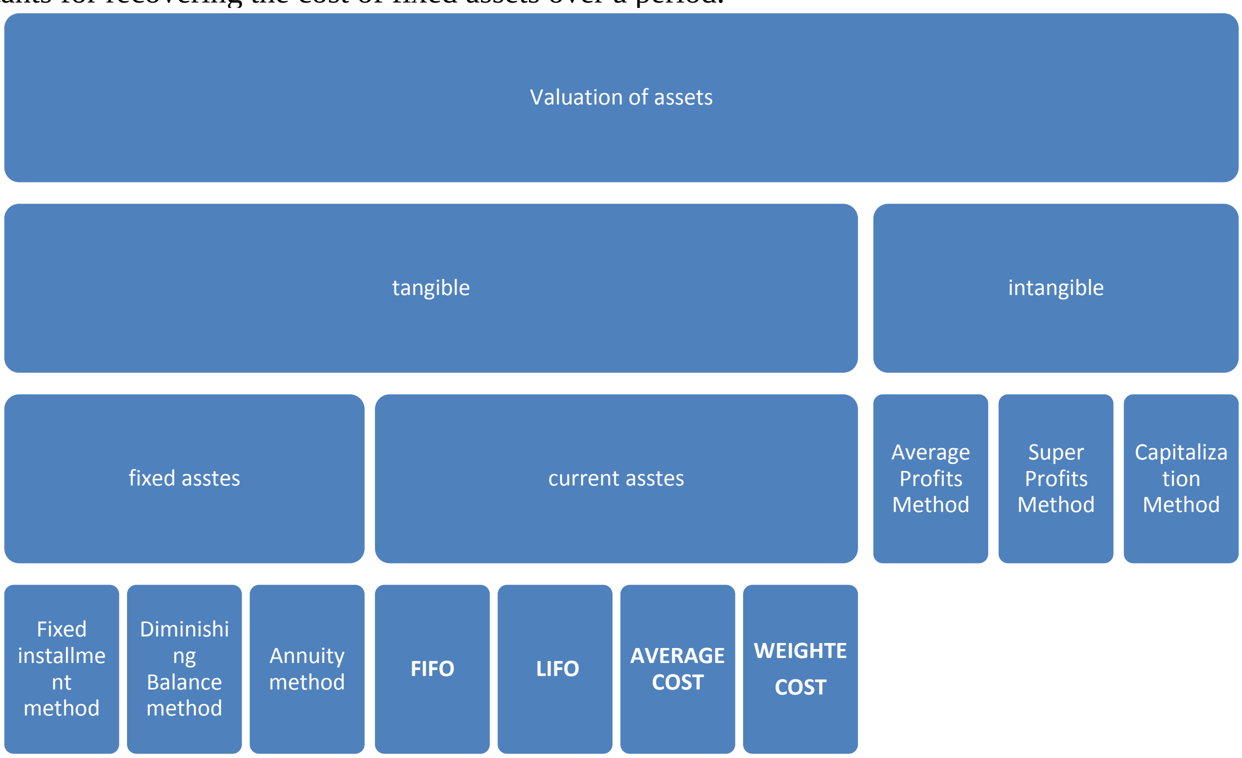
- Advanced computer skills on MS Office, accounting software and databases
- Ability to manipulate large amounts of data
- Developing Budgets, Legal Compliance, Tracking Budget Expenses, SFAS Rules, Accounting, Managing Processes, Reporting Research Results

UNIT II

Depreciation Accounting: concept of depreciation, causes of depreciation, depreciation accounting, fixation of depreciation amount, methods of depreciation – depletion method, machine hour-rate method, written down value method, accelerated method, sinking fund method. (Problems & Cases)

INTRODUCTION

The term depreciation refers to the reduction in or loss of quality or value of a fixed asset through wear or tears in or tears, in use, effusion of time, obsolescence through technology and market changes or from any other cause. Depreciation takes place in case of all fixed assets with certain possible exceptions e.g. land and antiques etc, although the process may be invisible or gradual. Depreciation does take place irrespective of regular repairs and proper maintenance of assets. The word 'depreciation' is closely related to the concept of business income. Unless it is charged against revenues, we cannot say that the business income has been ascertained properly. This is because of the fact that the use of long term assets tend to consume their economic value and at some point of time these assets become useless. The economic value so consumed must be recovered from the revenue of the firm to have a proper measure of its income. Hence, the reader's must understand that\ the process of charging depreciation is the technique used by accountants for recovering the cost of fixed assets over a period.



1.1 FIXED ASSETS VS INTANGIBLE ASSETS

Both tangible and intangible assets represent an opportunity for future economic benefits. Tangible assets are generally defined as those physical assets which are used for the purpose of producing and distributing goods, and sometimes services. Tangible assets are usually fixed and have a physical existence (real estate, equipment, cash, and accounts receivable). These assets have no physical existence (for the most part).

Intangible assets can be measured by consideration of their costs but are generally valued based on the expected economic income to be generated by the asset over a period of time. Usually businesses with a *low* percentage of tangible assets (such as service companies and professional practices) have a *large* percentage of intangible net worth.

1.2 MEANING OF DEPRECIATION

Generally, the term depreciation is used to denote decrease in value but in accounting, this term is used to denote decrease in the book value of fixed asset. Depreciation is the permanent and continuous decrease in the book value of a fixed asset due to use, afflux ion of time, obsolescence, expiration of legal rights or any other cause.In simple words to understand the terminology depreciation is the permanent decrease in the value of the fixed assets.

"Depreciation is the permanent and continuous diminution in the quality /quantity / value of the asset."

Dickens

"Depreciation represents that part of the cost of a fixed asset to its owner which is not recoverable when the asset is finally out of use by him. Provision against this loss of capital is an integral cost of conducting the business during the effective commercial life of the asset and is not dependent on the amount of profit earned".

According to the Institute of Chartered Accountants

An analysis of the definition given above highlights the characteristics of depreciation as follows:

(a) It is related to fixed assets only.
(b) It is a fall in the book value of an asset.
(c) The fall in the book value of an asset is due to the use of the asset in business operations, efflux ion of time, obsolescence, and expiration of legal rights or any other cause.
(d) It is a permanent decrease in the book value of an asset.
(e) It is a continuous decrease in the book value of an asset.

1.3 AIMS OF CHARGING DEPRECIATION

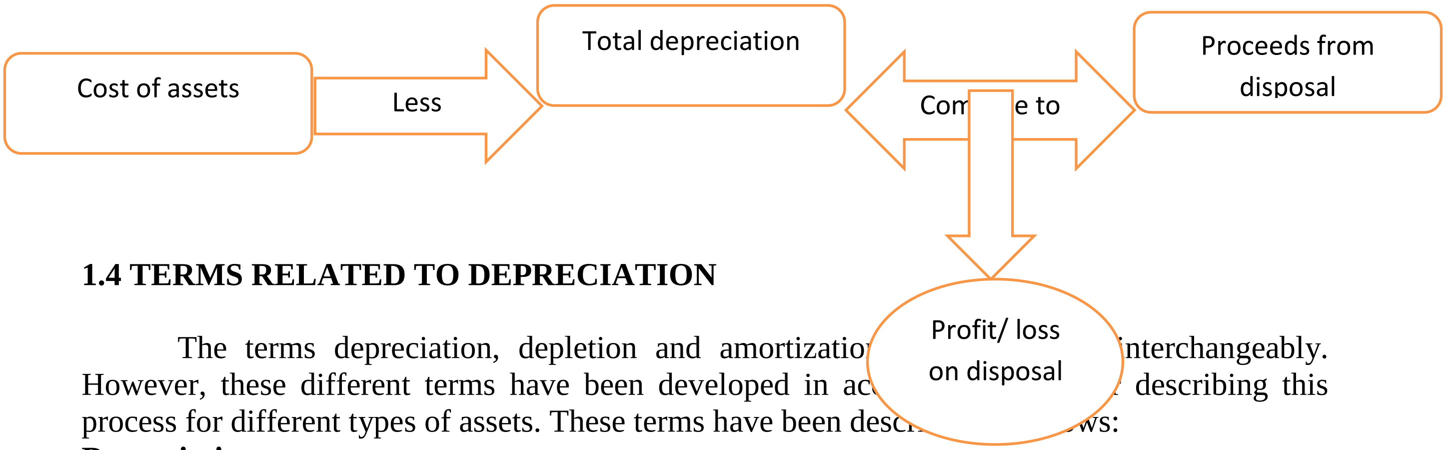
To recover the cost: The depreciation charge is a mean to recover the cost of operations of the enterprise. More specifically to recover the cost of asset procured which is in usage.

To facilitate the induction of new asset: To replace the old one, the new asset has to be purchased only with the help of depreciation charge

To find out the correct P&L accounting balance

To know the original position of the enterprise through proper adjustments on the fixed assets

Profit or loss on the disposal of a non-current asset.



1.4 TERMS RELATED TO DEPRECIATION

The terms depreciation, depletion and amortizatio ... interchangeably. However, these different terms have been developed in ac ... describing this process for different types of assets. These terms have been desc ... ws:

Depreciation

Depreciation is concerned with charging the cost of man-made fixed assets to operation (and not with determination of asset value for the balance sheet). In other words, the term 'depreciation' is used when expired utility of physical asset (building, machinery, or equipment) is to be recorded.

Depletion

This term is applied to the process of removing an available but irreplaceable resource such as extracting coal from a coal miner or oil out of an oil well. Depletion differs from depreciation in that the former implies removal of a natural resource, while the latter implies a reduction in the service capacity of an asset.

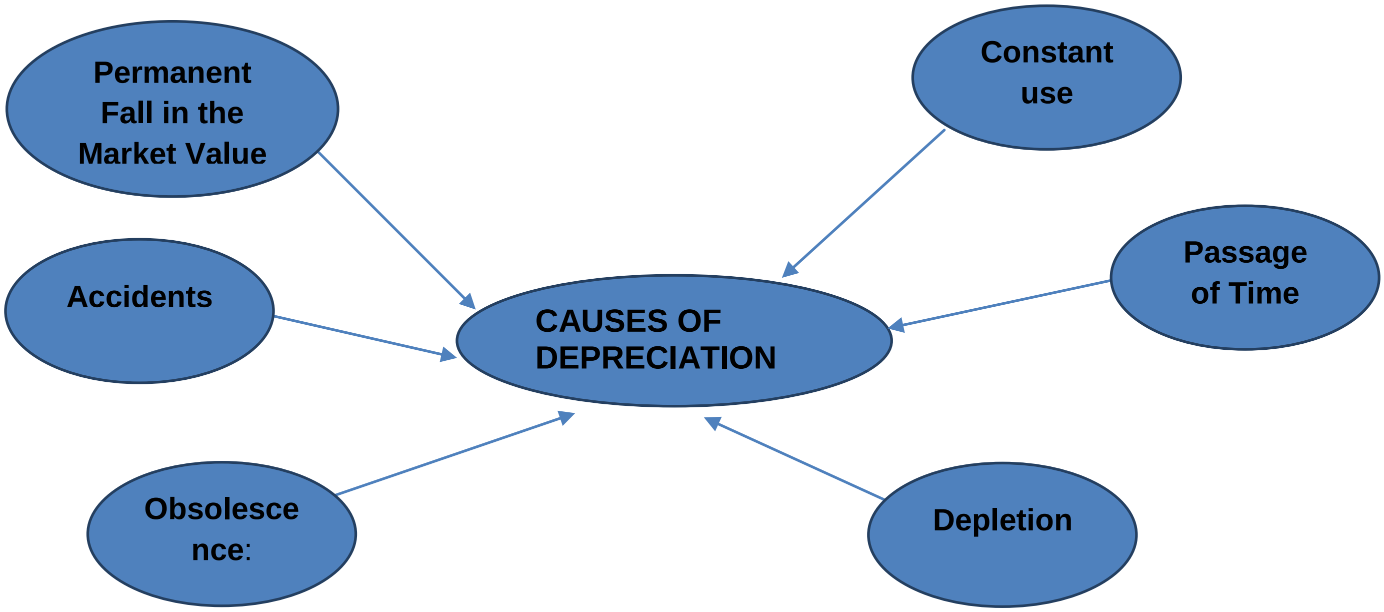
Amortizations

The process of writing off intangible assets is termed as amortization. The intangible assets like patents, copyrights, leaseholds and goodwill are recorded at cost in the books of account; many of these assets have a limited useful life and are, therefore, written off.

Obsolescence

It refers to the decline in the useful life of an asset because of factors like (i) technological advancements, (ii) changes in the market demand of the product, (iii) legal or other restrictions, or (iv) improvement in production process

1.5 CAUSES OF DEPRECIATION



1. Constant use: The constant use of assets results into their wear and tear, which in turn reduces their working capacity. Hence, a decrease in the value of assets may be seen due to reduced capacity. The value of assets like, machinery, furniture, etc., declines with the constant use of them.

2. Passage of Time: Many fixed assets lose their value with the passage of time. This holds true in case of intangible fixed assets such as patents, copy rights, lease hold properties, etc. The term "amortisation" is generally used to indicate the reduction in the value of such assets.

3. Depletion: Depletion also causes decline in the value of certain assets. This is true in case of wasting assets such as mines, oil wells and forest-stands. On account of continuous extraction of minerals or oils, these assets go on declining in their value and finally they get completely exhausted.

4. Obsolescence: There may not be any physical deterioration in the asset itself. Despite of this there may be reduction in the utility of an asset that results from the development of a better method, machine or process. For example, an old machine which is still in good working condition may have to be replaced by a new machine because of the later being more economical as well as efficient. In fact, new inventions, developments in production processes, changes in demand for product or services, etc. make the asset out of date.

5. Accidents: An asset may get reduction in its value if it meets an accident.

6. Permanent Fall in the Market Value: Certain assets may get permanent fall in their value and this decline in their value is treated as depreciation. For example, a permanent decline in the market value of securities and investment may be assumed as depreciation.

1.6 BASIC ELEMENTS OF DEPRECIATION

Cost of the asset: The knowledge about the cost of the asset is very essential for determining the amount of depreciation to be charged to the profit and loss account. The cost of the asset includes the invoice price of the asset less any trade discount plus all costs essential to make the asset usable. Cost of transportation and transit insurance are included in acquisition cost.
Estimated life of the asset: Estimated life generally means that for how many years or hours an asset could be used in business with ordinary repairs for generating revenues. For estimating useful life of an asset one must begin with the consideration of its physical life and the modifications, if any, made, factors of obsolescence and experience with similar assets.
Scrap Value of the Asset: The salvage value of the asset is that value which is estimated to be realised on account of the sale of the asset at the end of its useful life. This value should be calculated after deducting the disposal costs from the sale value of the asset. If the scrap value is considered as insignificant, it is normally regarded as nil

1.7 NEED FOR PROVIDING DEPRECIATION

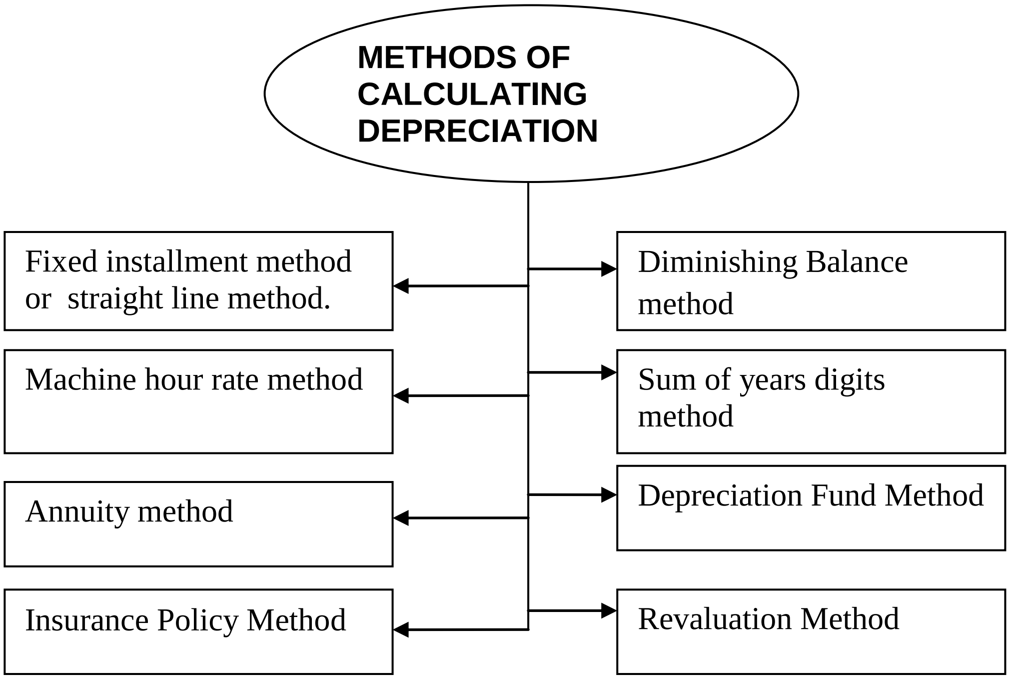
To Ascertain the Profits or Losses: The true profits or losses could be ascertained when all costs of earning revenues have been properly charged against them. Fixed assets like building, plant and machinery, furniture, motor vehicles etc are important tool in earning business income. But the cost of the fixed asset is not charged to profit and loss of the accounting period in which the asset is purchased.

To show the Asset as its Reasonable Value: The assets get decrease in their value over a period of time on account of various such as passage of time, constant use, accidents, etc. Therefore, if the depreciation is not charged then the asset will appear in the balance sheet at the over stated value. This practice is unfair as the balance sheet fail to present the true financial position.

Replacement of assets: Business assets become useless at the expiry of their life and, therefore, need replacement. The cash resources of the concern are saved from being distributed by way of dividend by providing for depreciation. The resources so saved, if set aside in each year, may be adequate to replace it at the end of life of the asset.

To Reduce Income Tax: If tax is paid on the business income without providing for depreciation then it will be in excess to the actual income tax. This is a loss to the business man. Thus, for calculating tax, depreciation should be deducted be from income similar to the other expenses.

2. METHODS OF CALCULATING DEPRECIATION



Among the above mentioned methods, Straight line method and Diminishing balance or written down method are more important methods. These two methods are preferable and renowned methods among the industrialists in charging the depreciation on the fixed assets.

1. FIXED INSTALLMENT METHOD OR STRAIGHT LINE METHOD

This is also known as fixed instalment method. Under this method the depreciation is charged on the uniform basis year after year. When the amount of depreciation charged yearly under this method is plotted on a graph paper, we shall get a straight line. Thus, the straight line method assumes that depreciations is a function, of time rather than use in the sense that each accounting period received the same benefit from using the asset as every other period.

The depreciation is calculated by dividing the cost of the asset minus scrap value by the effective life of the asset. The amount of depreciation remains fixed over the whole life of the asset. This method is simple and works well when an asset has a fixed life as in the case of lease etc.

The following formula or equation is used to calculate depreciation under this method:

Annual Depreciation = [(Cost of Assets - Scrap Value)/Estimated Life of Machinery]

The journal entries that will have to be made under this method are very simple. The journal entries will be as under:

Depreciation account
To Asset account
(Being the depreciation of the asset)

Profit and loss account
To Depreciation account
(Being the amount of depreciation charged to Profit and Loss account)

These entries will be passed at the end of each year so long as the asset lasts. In the last year, the scrap will be sold and with the amount that realized by the sale the following entry will be passed:

Cash account
To Asset account
(Being the sale price of scrap realized.)

Advantages:

1. Fixed installment method of depreciation is simple and easy to work out
2. The book value of the asset can be reduced to zero.

Disadvantages:

1. This method, in spite of its being simplest is not very popular because of the fact that Where as each year's depreciation charge is equal, the charge for repairs and renewals goes on increasing as the asset becomes older. The result is that the profit and loss account has to bear a light burden in the initial years of the asset but later on this burden becomes heavier.
2. Interest on money is locked up in the asset is not taken into account as is done in some other methods.
3. No provision for the replacement of the asset is made.
4. Difficulty is faced in calculation of depreciation on additions made during the year.

2. DIMINISHING BALANCE METHOD

This is also known as Written down value method [WDV]. Under the diminishing balance method depreciation is charged at fixed rate on the reducing balance (i.e., cost less depreciation) every year. Thus, the amount of depreciation goes on decreasing every year. Under this method also the amount of depreciation is transferred to profit and loss account
in each of the year and in the balance sheet the asset is shown at book value after reducing depreciation from it.

For example, if an asset is purchased for Rs. 10,000 and depreciation is to be charged at 20% p.a. on reducing balance system then the depreciation for the first year will be Rs. 2000. In the second year, it will Rs. 1600 (i.e. 20% of 8000), in the third year Rs. 1280 (i.e. 20% of 6400) and so on. The rate of depreciation under this method can be computed by using the following formula:

Depreciation rate = –1√net scrap value/acquisition cost

Merits of Diminishing Balance Method

(i) It is very easy to understand and calculate the amount of depreciation despite the early variation in the book value after depreciation

(ii) This method put an equal burden for use of the asset on each subsequent year since the amount of depreciation goes on decreasing for each subsequent year while the charge for repairs goes on increasing for each subsequent year.

(iii) This method has also been approved by the income tax act applicable in India

(iv) Asset is never reduced to zero because if the rate of depreciation is (say) 20%. Then even when asset is reduced to very small value, there must remain the 80% of that small value as on written off balance.

Demerit

(i) It ignores the interest on the capital committed to purchase that asset.

(ii) It does not provide adequately for replacing the asset at the end of its life.

(iii) The calculation of rate of depreciation is not so simple.

(iv) The formula for calculating the rate of depreciation can be applied only when there is some residual of the asset.

3. MACHINE HOUR RATE METHOD

Under this method, total cost of the machine is divided by the total number of hours of the life of the machine to arrive at the hourly rate of the machine. In order to calculate the depreciation amount, the actual number of hours in a particular year is multiplied with the hourly rate.

In case of this method, the running time of the asset is taken into account for the purpose of calculating the amount of depreciation. It is suitable for charging depreciation on plant and machinery, air-crafts, gliders, etc. The amount of depreciation is calculated as follows:

= **Acquisition cost of the assets – Scrap value/ Life of the Asset in hours**

4. SUM OF YEARS DIGITS (SYD) METHOD

Under this method also the amount of depreciation goes on diministing in the future years similar to that under diminishing Balance method. For calculating the amount of depreciation to be charged to the profit and loss account this method takes into account cost, scrape value, and life of the asset. The following formula is used for determining depreciation:

$$\frac{\text{Remaining life of the Assets at the end of the year} + 1}{\text{Sum of the digits representing the life of the asset}} * \text{Acquisition Cost}$$

For example, an asset having an effective life of 5 years is purchased at a cost of Rs. 20,000. It is estimated that its scrap value at the end of its effective life will be Rs. 2000. The depreciation on this asset, if SYD method is followed, will be calculated as follows from one to five years:

Year	Depreciation Amount		
1 =	5/15*18000	=	6000
2=	4/15*18000	=	4800
3=	3/15*18000	=	3600
4=	2/15*18000	=	2400
5	1/15*18000	=	1200

5. **ANNUITY METHOD**

This method charges depreciation on the assumption that fixed rate of interest is charged on the asset, treating the fixed asset as an investment. The first two methods — Straight Line Method and Diminishing Balance Method — ignore interest aspect. The annuity method takes into account the interest lost on the acquisition of an asset. The amount to be written off as depreciation is calculated from the annuity table. The depreciation will be different according to the rate of interest and according to the period over which the asset is to be written off. The annuity table is used to help in the determination of the amount of depreciation. A specimen of Annuity Table is as follows:

Year	3%	4%	5%	6%
4	0.269027	0.275490	0.282012	0.288591
5	0.218335	0.224627	0.230975	0.237376
6	0.184598	0.190762	0.197012	0.203363
7.	0.160506	0.166610	0.172820	0.179135
8.	0.142456	0.148528	0.154722	0.161036
9.	0.128434	0.134493	0.140690	0.147022
10.	0.117231	0.12391	0.129505	0.135868

In case depreciation is charged according to this method, the following accounting entries are passed:

(i) Purchase of an asset

Asset Account Dr.
To Bank

(ii) For charging interest

Asset Account Dr.
To Interest Account

(iii) For charging depreciation:

Depreciation Account Dr.
To Asset Account

Merits

(i) This method keep into account interest on money spent on the purchase of the asset.

(ii) The value of the asset becomes zero at the end of life.

Demerits

(i) This method is comparatively more difficult than the methods discussed so far.
(ii) It makes no arrangement of money to replace the old asset with the new one at the expiry of its life.
(iii) Under this method the burden on the profit and loss account is no similar in each year because the depreciation remains constant year after year but the interest goes on decreasing.

6. **REVALUATION METHOD**

This method is used in case of small items like cattle (livestock) and loose tools, where it is difficult to maintain account for every single item. The amount of depreciation is to be calculated by comparing the value at the end of the year (valuation is done by a person, who has knowledge of those assets) with the value in the beginning and assets purchased during the year.

7. **DEPRECIATION FUND METHOD**

Funds are needed for replacement of the fixed asset. As and when the fixed asset is required to be replaced with a new asset, all the above three methods do not provide ready funds for replacing the asset. Non-availability of ready funds is the greatest handicap in respect of all the above methods. Depreciation Fund Method provides the advantage of ready funds for replacing the asset, as and when needed. **Depreciation Fund Method is also known as 'Sinking Fund Method'.**

8. **INSURANCE POLICY METHOD**

Insurance policy method is a slight modification of the depreciation fund method or sinking fund method. Under this method the amount represented by the depreciation fund, instead of being used to buy securities, is paid to an insurance company as premium. The insurance company issues a policy promising to pay a lump sum at the end of the working life of the asset for its replacement.

The advantage of insurance policy method is that risk of loss on the sale of investment and the trouble and expense of buying investment are avoided, while disadvantage lies that the interest received on the premiums paid is comparatively very low. When insurance policy method is employed the policy account will take the place of the depreciation fund investment account and no interest will be received at the end of each year, but the total interest on the premiums will be received when the policy matures.
Every year's two entries will be made:

1. in the beginning:

Depreciation insurance policy account
  To Cash account
(Being the payment of premium on depreciation policy)

2. at the end of the year:

Profit and loss account
  To Depreciation fund account

(Being the amount of depreciation charged to profit and loss account)
When the policy will mature i.e., to say the amount of the policy will be received. The entry is:

Cash account
To Depreciation insurance policy account
(Being the policy amount realized)

The depreciation insurance policy account will show some profit. This will be transferred to depreciation fund account, the entry being.

Depreciation insurance policy account
To Depreciation fund account
(Being the policy amount realized)

The asset account will have been shown throughout at its original cost. It now is written off by transfer to depreciation fund account. The entry is:

Depreciation fund account
To Asset account

Difference between Straight Line Method And Diminishing Balance Method

Points of difference	**Straight Line Method**	**Diminishing Balance Method**
Computation Method	The depreciation is charged at a fixed rate on the original cost of the asset.	The depreciation is charged at a fixed rate on the original cost in the first year and on the written down value (cost minus total depreciation) in the subsequent years
Recognition	Not accepted by Income tax law.	Recognized under Income Tax Act
Calculation	It is easy to calculate the rate of depreciation.	It requires the use of mathematical tables.
Book Value	The book value of the asset becomes zero or equal to scrap value.	The book value never becomes zero.
Amount of Statement	The amount of depreciation remains the same in all the years of useful life of the asset.	The amount of depreciation goes on decreasing year after year

UNIT – III

Budgets and Budgeting control: Objectives, characteristics and essentials of budgetary control, classification of budgets – production budget, sales budget, cash budget, flexible budget, and master budget. (Problems & Cases)

INTRODUCTION:

A budget is an accounting plan. It is a formal plan of action expressed in monetary terms. It could be seen as a statement of expected income and expenses under certain anticipated operating conditions. It is a quantified plan for future activities – quantitative blue print for action.

Every organization achieves its purposes by coordinating different activities. For the execution of goals efficient planning of these activities is very important and that is why the management has a crucial role to play in drawing out the plans for its business. Various activities within a company should be synchronized by the preparation of plans of actions for future periods. These comprehensive plans are usually referred to as budgets. Budgeting is a management device used for short-term planning and control. It is not just accounting exercise.

MEANING AND DEFINITION:

Budget:

According to CIMA (Chartered Institute of Management Accountants) UK, a budget is "A plan quantified in monetary terms prepared and approved prior to a defined period of time, usually showing planned income to be generated and, expenditure to be incurred during the period and the capital to be employed to attain a given objective."

In a view of Keller & Ferrara, "a budget is a plan of action to achieve stated objectives based on predetermined series of related assumptions."

A budget is a financial plan for a business, prepared in advance. A budget may be set in money terms, eg a sales budget of £500,000, or it can be expressed in terms of units, eg a purchases budget of 5,000 units to be bought. Budgets can be **income** budgets for money received, eg a sales budget, or **expenditure** budgets for money spent, eg a purchases budget.

The budget we shall be focusing on in this chapter is the **cash budget**, which combines both income and expenditure, estimating what will happen to the bank balance during the time period of the budget.

BUDGETARY CONTROL

Budgetary Control is the process of establishment of budgets relating to various activities and comparing the budgeted figures with the actual performance for arriving at deviations, if any. Accordingly, there cannot be budgetary control without budgets. Budgetary Control is a system which uses budgets as a means of planning and controlling.

According to I.C.M.A. England Budgetary control is defined by Terminology as the establishment of budgets relating to the responsibilities of executives to the requirements of a policy and the continuous comparison of actual with the budgeted results, either to secure by individual actions the objectives of that policy or to provide a basis for its revision.

Brown and Howard defines budgetary control is "a system of controlling costs which includes the preparation of budgets, co-ordinating the department and establishing responsibilities, comparing actual performance with the budgeted and acting upon results to achieve maximum profitability."

The above definitions reveal the following essentials of budgetary control:

(1) Establishment of objectives for each function and section of the organization.

(2) Comparison of actual performance with budget.

(3) Ascertainment of the causes for such deviations of actual from the budgeted performance.

(4) Taking suitable corrective action from different available alternatives to achieve the desired Objectives.

BUDGETARY CONTROL

Budgetary Control is planned to assist the management for policy formulation, planning, controlling and co-ordinating the general objectives of budgetary control and can be stated in the following ways:

(1) Planning: A budget is a plan of action. Budgeting ensures a detailed plan of action for a business over a period of time.

(2) Co-ordination: Budgetary control co-ordinates the various activities of the entity or organization and secure co-operation of all concerned towards the common goal.

(3) Control: Control is necessary to ensure that plans and objectives are being achieved. Control follows planning and co-ordination. No control performance is possible without predetermined standards. Thus, budgetary control makes control possible by continuous measures against predetermined targets. If there is any variation between the budgeted performance and the actual performance, the same is subject to analysis and corrective action.

PREPARATION OF BUDGET

Definition of objectives:

A budget being a plan for the achievement of certain operational objectives, it is desirable that the same are defined precisely. The objectives should be written out; the areas of control demarcated; and items of revenue and expenditure to be covered by the budget stated. This will give a clear understanding of the plan and its scope to all those who must cooperate to make it a success.

Location of the key (or budget) factor:

There is usually one factor (sometimes there may be more than one) which sets a limit to the total activity. For instance, in India today sometimes non-availability of power does not allow production to increase inspite of heavy demand. Similarly, lack of demand may limit production. Such a factor is known as key factor. For proper budgeting, it must be located and estimated properly.

Appointment of controller:

Formulation of a budget usually required whole time services of a senior executive; he must be assisted in this work by a Budget Committee, consisting of all the heads of department along with the Managing Director as the Chairman. The Controller is responsible for coordinating and development of budget programmes and preparing the manual of instruction, known as Budget manual.

Budget Manual:

Effective budgetary planning relies on the provision of adequate information to the individuals involved in the planning process. Many of these information needs are contained in the budget manual. A budget manual is a collection of documents that contains key information for those involved in the planning process.

Budget period:

The period covered by a budget is known as budget period. There is no general rule governing the selection of the budget period. In practice the Budget Committee determines the length of the budget period suitable for the business. Normally, a calendar year or a period co-terminus with the financial year is adopted. The budget period is then sub-divided into shorter periods; it may be months or quarters or such periods as coincide with period of trading activity.

Standard of activity or output:

For preparing budgets for the future, past statistics cannot be completely relied upon, for the past usually represents a combination of good and bad factors. Therefore, though results of the past should be studied but these should only be applied when there is a likelihood of similar conditions repeating in the future. Also, while setting the targets for the future, it must be remembered that in a progressive business, the achievement of a year must exceed those of earlier years. Therefore, what was good in the past is only fair for the current year.

CHARACTERISTICS OF BUDGET

The main characteristics of budget are as follows:

A budget is concerned for a definite future period.

A budget is a writtendocument.

A budget is a detailed plan of all the economic activities of a business.

All the departments of a business unit co-operate for the preparation of a business budget.

Budget is a mean to achieve business and it is not an end in itself.

Budget needs to be updated, corrected and controlled every time when circumstances change. Therefore, it is a continuous process.

Budget helps in planning, coordination and control.

Different types of budgets are prepared by industries according to business requirements.

A budget acts a business barometer.

Budget is usually prepared in the light of past experiences.

Budget is a constant endeavour of the Management.

ADVANTAGES OF BUDGETARY CONTROL:

	Points	Description
1.	**Efficiency**	The use of budgetary control system enables the management of a business concern to conduct its business activities in the efficient manner.
2.	**Control on expenditure**	It is a powerful instrument used by business houses for the control of their expenditure. It in fact provide1`s a yardstick for measuring and evaluating the performance of individuals and their departments.
3.	**Finding deviations**	It reveals the deviations to management, from the budgeted figures after making a comparison with actual figures.
4.	**Effective utilisation of resources**	Effective utilisation of various resources like—men, material, machinery and money—is made possible, as the production is planned after taking them into account.
5.	**Revision of plans**	It helps in the review of current trends and framing of future policies.
6.	**Implementation of Standard Costing system**	It creates suitable conditions for the implementation of standard costing system in a business organisation.
7.	**Cost Consciousness**	Budgets are studied by outside fund providers also such as banking and financial institutions, realising that management encourages cost consciousness and maximum utilisation of available resources.
8.	**Credit Rating**	Management which have developed a well ordered budget plans and which operate accordingly, receive greater favour from credit agencies.

ESSENTIALS OF A BUDGET

An analysis of the above said definitions reveal the following essentials of a budget:

(1) It is prepared for a definite future period.

(2) It is a statement prepared prior to a defined period of time.

(3) The Budget is monetary and *I* or quantitative statement of policy.

(4) The Budget is a predetermined statement and its purpose is to attain a given objective.

(5)A budget, therefore, be taken as a document which is closely related to both the managerial as well as accounting functions of an organization

(6) Establishment of budgets for each purpose of the business.

(7) Revision of budget in view of changes in conditions.

(8)Comparison of actual performances with the budget on a continuous basis.

(9)Taking suitable remedial action, wherever necessary.

(10)Analysis of variations of actual performance from that of the budgeted performance to know the reasons thereof.

OBJECTIVES OF BUDGETARY CONTROL:

Budgeting is a forward planning. It serves basically as a tool for management control; it is rather a pivot of any effective scheme of control. The objectives of budgeting may be summarized as follows:

1. **Planning:** Planning has been defined as the design of a desired future position for an entity and it rests on the belief that the future position can be attained by uninterrupted management action. Detailed plans relating to production, sales, raw-material requirements, labour needs, capital additions, etc. are drawn out. By planning many problems estimated long before they arise and solution can be thought of through careful study. In short, budgeting forces the management to think ahead, to foresee and prepare for the anticipated conditions. Planning is a constant process since it requires constant revision with changing conditions.

2. **Co-ordination:** Budgeting plays a significant role in establishing and maintaining coordination. Budgeting assists managers in coordinating their efforts so that problems of the business are solved in harmony with the objectives of its divisions. Efficient planning and business contribute a lot in achieving the targets. Lack of co-ordination in an organization is observed when a department head is permitted to enlarge the department on the specific needs of that department only, although such development may negatively affect other departments and alter their performances. Thus, co-ordination is required at all vertical as well as horizontal levels.

3. **Measurement of Success:** Budgets present a useful means of informing managers how well they are performing in meeting targets they have previously helped to set. In many companies, there is a practice of rewarding employees on the basis of their accomplished low budget targets or promotion of a manager is linked to his budget success record. Success is determined by comparing the past performance with previous period's performance.

4. **Motivation:** Budget is always considered a useful tool for encouraging managers to complete things in line with the business objectives. If individuals have intensely participated in the preparation of budgets, it acts as a strong motivating force to achieve the goals.

5. **Communication:** A budget serves as a means of communicating information within a firm. The standard budget copies are distributed to all management people provide not only sufficient understanding and knowledge of the programmes and guidelines to be followed but also give knowledge about the restrictions to be adhered to.

6. **Control:** Control is essential to make sure that plans and objectives laid down in the budget are being achieved. Control, when applied to budgeting, as a systematized effort is to keep the management informed of whether planned performance is being achieved or not.

Limitations of Budgetary Control System

Points	Description
Based on Estimates	Budgets are based on series of estimates which are based on the conditions prevailed or expected at the time budget is established. It requires revision in plan if conditions change.
Time factor	Budgets cannot be executed automatically. Some preliminary steps are required to be accomplished before budgets are implemented.It requires proper attention and time of management. Management must not expect too much during the developmentperiod.
Co-operation Required	Staffco-operationisusuallynotavailableduringbudgetary controlexercise.In a decentralised organisation each unit has its own objective and these units enjoy some degree of discretion. In this type of organisation structure coordination among different units are required. The success of the budgetary control depends upon willing co-operation and teamwork,
Expensive	Its implementation is quite expensive. For successful implementation of the budgetary control proper organisation structure with responsibility is prerequisite. Budgeting process start from the collection of requirements to budget and performance analysis. It consumes valuable resources for these purpose, hence, it is an expensive process.
Not a substitute for management	Budget is only a managerial tool and must be applied correctly for managementtogetbenefited.Budgetsarenot a substitute for management.
Rigid document	Budgets are considered as rigid document. But in reality, an organisation is exposed to various uncertain internal and external factors. Budget should be flexible enough to incorporate ongoing developments in the internal and external factors affecting the very purpose of the budget.

REQUISITES FOR EFFECTIVE BUDGETARY CONTROL

The following are the requisites for effective budgetary control :

(1) Clear cut objectives and goals should be well defined.

(2) The ultimate objective of realising maximum benefits should always be kept uppermost.

(3) There should be a budget manual which contains all details regarding plan and procedures for its execution. It should also specify the time table for budget preparation for approval, details about responsibility, cost centers etc.

(4) Budget committee should be set up for budget preparation and efficient execution of the plan.

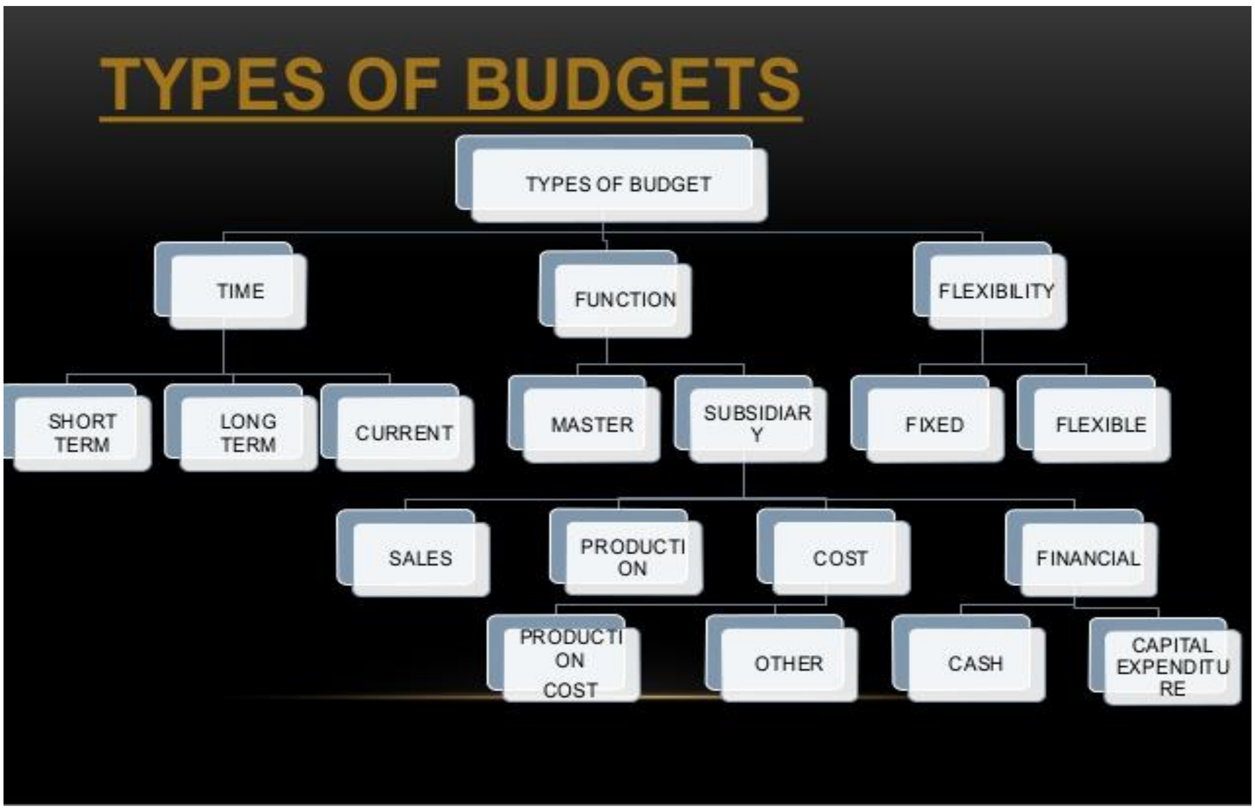
(5) A budget should always be related to a specified time period.

(6) Support of top management is necessary in order to get the full support and co-operation of the system of budgetary control.

(7) To make budgetary control successful, there should be a proper delegation of authority and responsibility.
(8) Adequate accounting system is essential to make the budgeting successful.
(9) The employees should be properly educated about the benefits of budgeting system.
(10) The budgeting system should not cost more to operate than it is worth.
(11) Key factor or limiting factor, if any, should consider before preparation of budget.
(12) For budgetary control to be effective, proper periodic reporting system should be introduced.

TYPES OF BUDGETS

As budgets serve different purposes, different types of budgets have been developed. The following are the different classification of budgets developed on the basis of time, functions, and flexibility or capacity.



1.Long-Term Budgets: Long-term budgets are prepared for a longer period varies between five to ten years. It is usually developed by the top level management. These budgets summarise the general plan of operations and its expected consequences. Long-Term Budgets are prepared for important activities like composition of its capital expenditure, new product development and research, long-term finance etc.

2**. Short-Term Budgets**: These budgets are usually prepared for a period of one year. Sometimes they may be prepared for shorter period as for quarterly or half yearly. The scope of budgeting activity may vary considerably among different organization.

3. **Current Budgets:** Current budgets are prepared for the current operations of the business. The planning period of a budget generally in months or weeks. As per ICMA London, "Current budget is a budget which is established for use over a short period of time and related to current conditions."

MASTER BUDGET –

It is defined as summary budget which includes different functional budgets and which is finally approved adopted and employed. It is defined as a budget which summarises all functional budgets when all functional budgets are prepared they are summarized to produce.

i. Profit & Loss Account and Profit & Loss Appropriation Account.
ii. Balance Sheet. Master Budget takes the form of budged Profit & Loss Account and Balance Sheet.

It is overall business plan and familiar to financial statements. The only difference is that the accountant here deals with expected future data rather than historical data. The budget committee will prepare the master budget based on the functional budget. Once it is approved by the committee it becomes the target for the firm during the budget period.

FUNCTIONAL BUDGET

SALES BUDGET

The sales budget is an estimate of total sales which may be articulated in financial or quantitative terms. It is normally forms the fundamental basis on which all other budgets are constructed. In practice, quantitative budget is prepared first then it is translated into economic terms. While preparing the Sales Budget, the Quantitative Budget is generally the starting point in the operation of budgetary control because sales become, more often than not, the principal budget factor. The factor to be consider in forecasting sales are as follows:

 Study of past sales to determine trends in the market.
 Estimates made by salesman various markets of company products.
 Changes of business policy and method.
 Government policy, controls, rules and Guidelines etc.
 Potential market and availability of material and supply.

PRODUCTION BUDGET

The production budget is prepared on the basis of estimated production for budget period. Usually, the production budget is based on the sales budget. At the time of preparing the budget, the production manager will consider the physical facilities like plant, power, factory space, materials and labour, available for the period. Production budget envisages the production program for achieving the sales target. The budget may be expressed in terms of quantities or money or both. Production may be computed as follows: Units to be produced = Desired closing stock of finished goods + Budgeted sales – Beginning stock of finished goods.

PURCHASE BUDGET

Strategic planning of purchases offers one of the most important areas of reduction cost in many concerns. This will consist of direct and indirect material and services. The purchasing budget may be expressed in terms of quantity or money. The main purposes of this budget are:

 It designates cash requirement in respect of purchase to be made during budget period; and
 It is facilitates the purchasing department to plan its operations in time in respect of purchases so that long term forward contract may be organized.

COST OF PRODUCTION BUDGET

After Preparation of production budget, this budget is prepared. Production Cost Budgets show the cost of the production determined in the production budget. Cost of Production Budget is grouped in to Material Cost Budget, Labour Cost Budget and Overhead Cost Budget. Because it breaks up the cost of each product into three main elements material, labour and overheads. Overheads may be further subdivided in to fixed, variable and semi-fixed overheads. Therefore separate budgets required for each item

CASH BUDGET –

A Cash Budget is a projected cash transaction in future that is utilized in controlling actual receipts and payments by mending for the variances. It starts with a given 'Cash Balance' which may be either big or small. But the said balance is, in any case, desired to be 'the optimum balance'. The sign of optimality for a given cash balance is obviously its ability to produce the highest rate of return for the minimum cost for mainly the said cash balance.

The main aim of Cash Budget is to ascertain whether there is excess or deficit of cash. It involves different steps.

i. The First element is selection of time period to be covered which is known as planning horizon. This coverage will differ from firm to firm depending upon its nature and degree of accuracy.

ii. The Second element is the factors affecting the cash flows. Non cash items such as, depreciation are excluded from Cash Budget. The cash flow is affected by two factors operating and financial. The operating category includes cash flow generated by operations of the firm and are known as operating cash flows. The other category is known as financial cash flow.

a) Operating Cash Flow contains the following.

INFLOW	**OUTFLOW**
1. Cash Sales	1. Cash Purchases
2. Collection from Debtors	2. Payment to Creditors
3. Sale of Assets	3. Purchase of Assets.
	4. Operating Expenses Paid

b) Financial Cash Flow contains the following.

INFLOW	**OUTFLOW**
1. Loans taken	1. Repayment of Loan
2. Sale of Investments	2. Purchase of Investment
3. Issue of Shares	3. Redemption of Shares
4. Interest, Divided, Rent Received.	4. Interest, Dividend, Rent Paid

METHODS OF PREPARATION OF CASH BUDGET

Methods used for cash forecasting – There are two recognized ways of preparing a cash forecasting.

1 The Receipt & Payment Method.

2 The Income Statement Cash Flow Method (Adjusted Profit & Loss method)

1 THE RECEIPT AND PAYMENT METHOD –

Under this method, all expected cash receipts and payments during the period; under consideration are taken into account. The expected cash balance of a week or month will be equivalent to the difference between total expected Cash Receipts including opening balance, if any, and total expected Cash Payment during that period. The budget is generally prepared from various plans.

i. Cash Receipts from Customers, based on sales forecast, the term of sale, lag in payment etc. are generally taken into consideration.
ii. Cash Receipts from other sources, such as dividend on trade investments, rent, issue of capital, sale of; investment and fixed assets etc.
iii. Cash requirements for materials, wages and salaries and overhead expenses based on purchasing, personnel and overhead budgets. The policy of the business with regard to the payment of supplier's accounts, the term of cash discount, the lag in payment of wages etc. are given due consideration.
iv. Cash requirements for capital expenditure as per capital expenditure budget.
v. Cash requirement for other purposes, such as payment of dividend, income tax, fines, penalties etc.

ADJUSTED PROFIT AND LOSS ACCOUNT:

This method is based on cash and non-cash transactions. This method estimates closing cash balance by converting profit into cash. The hypothesis of this method is that the earning of profit brings equal amount of cash into the business. The net profit shown by profit and loss account does not signify the actual cash flow into the business. This also leads to another assumption, that is the business will remain static, i.e. there will be no wearing out or increase of assets and changes of working capital so that the total cash on hand for the business would be equal to the profit earned.

Model of Cash Budget

Particular	January	February	March
Opening Balance	-	-	-
Add: Receipts:			
Cash Sales	-	-	-
Receipts from Debtors	-	-	-
Interest and Dividend	-	-	-
Sale of fixed assets	-	-	-
Sale of Investments	-	-	-
Bank Loan	-	-	-
Issue Shares & Debenture	-	-	-
Others	-	-	-
Total Receipts (A)	-	-	-
Less: Payments			
Cash Purchases	-	-	-
Payment to creditors	-	-	-
Salaries & wages	-	-	-
Administrative expenses	-	-	-
Selling expenses	-	-	-
Dividend payable	-	-	-
Purchase of Fixed Assets	-	-	-
Repayment of Loan	-	-	-
Payment of taxes	-	-	-
Total Payments (B)	-	-	-
Closing Balance (A - B)	-	-	-

FIXED AND FLEXIBLE BUDGET:

1. FIXED BUDGET:

A fixed budget is prepared for one level of output and one set of condition. This is a budget in which targets are tightly fixed. It is known as a static budget. It is firm and prepared with the assumption that there will be no change in the budgeted level of motion. Thus, it does not provide room for any modification in expenditure due to the change in the projected conditions and activity. Fixed budgets are prepared well in advance. This budget is not useful because:

- The conditions go on the changing and cannot be expected to be firm.
- The management will not be in a position to assess, the performance of different heads on the basis of budgets prepared by them because to the budgeted level of activity.
- It is hardly of any use as a mechanism of budgetary control because it does not make any difference between fixed, semi-variable and variable costs
- It does not provide any space for alteration in the budgeted figures as a result of change in cost due to change in the level of activity.

Merits	Demerits

1. Very simple to understand 2. Less timeconsuming	1. It is misleading. A poor performance may remain undetected and a good performance may go unrealised. 2. It is not suitable for long period. 3. It is also found unsuitable particularly when the business conditions are changing constantly. 4. Accurate estimates are not possible.

2. FLEXIBLE BUDGET:

This is a dynamic budget. In comparison with a fixed budget, a flexible budget is one "which is designed to change in relation to the level of activity attained." An equally accurate use of the flexible budgets is for the purposes of control.

Flexible budgeting has been developed with the objective of changing the budget figures so that they may correspond with the actual output achieved. It is more sensible and practical, because changes expected at different levels of activity are given due consideration. Thus a budget might be prepared for various levels of activity in accord with capacity utilization.

Flexible budget may prove more useful in the following conditions:

- Where the level of activity varies from period to period.
- Where the business is new and as such it is difficult to forecast the demand.
- Where the organization is suffering from the shortage of any factor of production. For example, material, labour, etc. as the level of activity depends upon the availability of such a factor.
- Where the nature of business is such that sales go on changing.
- Where the changes in fashion or trend affects the production and sales.
- Where the organization introduces the new products or changes the patterns and designs of its products frequently.
- Where a large part of output is intended for the export.

Merits	Demerits
1. With the help of flexible budget, the sales, costs and profit may be calculated easily by the business at various levels of production capacity.	1. The formulation of flexible budget is possible only when there is proper accounting system maintained, perfect knowledge about the factors of production and various business circumstances is available.
2. In flexible budget, adjustment is very simple according to change in business conditions.	2. Flexible Budget also requires the system of standard costing in business.

3. It also helps in determination of production level as it shows budgeted costs with classification at various levels of activity along with sales. Hence the management can easily select the level of production which shows the profit predetermined by the owners of the business.	3. It is very expensive and labour oriented.
4. It also shows the quantity of product to be produced to earn determined profit.	

Model of Flexible Budget

Particulars	Capacity Utilization		
	60%	80%	100%
1. Prime Cost:			
- Direct Material	-	-	-
- Direct Labour	-	-	-
- Direct expenses (if any)	-	-	-
Total (A)	-	-	-
2. Variable overheads:			
- Maintenance & repairs	-	-	-
- Indirect Labour	-	-	-
- Indirect Material	-	-	-
- Factory overheads	-	-	-
- Administrative Overheads	-	-	-
- Selling & distribution O/H	-	-	-
Total (B)	-	-	-
3. Marginal Cost (A + B)	-	-	-
4. Sales	-	-	-
5. Contribution (Sales - MC)	-	-	-
6. Fixed cost			
- Factory overheads	-	-	-
- Administrative Overheads	-	-	-
- Selling & distribution O/H	-	-	-
Total (C)	-	-	-
7. Profit or Loss (C- FC)	-	-	-

Difference between Fixed and Flexible Budgets:

Sl. no.	Fixed Budget	Flexible Budget
1.	It does not change with actual volume of activity achieved. Thus it is known as rigid or inflexible budget	It can be re-casted on the basis of activity level to be achieved. Thus it is not rigid.
2.	It operates on one level of activity andunder one setof conditions. It assumes that there will be no change in the prevailing conditions, which is unrealistic.	It consists of various budgets for different levels of activity
3.	Here as all costs like - fixed, variable and semi-variable are related to only one level of activity so variance analysis does not give useful information.	Here analysis of variance provides useful information as each cost is analysed according to its behaviour.
4.	If the budgeted and actual activity levels differ significantly, then the aspects like cost ascertainment and price fixation do not give a correct picture.	Flexible budg¬eting at different levels of activity facilitates the ascertainment of cost, fixation of selling price and tendering of quotations.
5.	Comparison of actual performance with budgeted targets will be meaningless specially when there is a difference between the two activity levels.	It provides a meaningful basis of comparison of the actual performance with the budgetedtargets.

UNIT- IV

Computer applications in business: Role of computer in accounting, accounting information systems, software package for accounting, tally. (Theory and Lab) (No Problem)

ROLE OF COMPUTER IN ACCOUNTING

Now a day's computer is everywhere and it playing important role in our daily life. Over the past two decades the way accounting data is entered, stored and processed has changed considerably. This is due to the introduction of computerized accounting software. Due to use of Computerized accounting system it is no longer necessary for large business unit to have large store room full of ledgers and records. Since all information can be stored in computer hard discs. Computerized Accounting System software gives many advantages over manual systems for example. Ledger entries are not recorded in multiple ledgers separately. A single entry is made and the software will update all the appropriate accounts automatically.

Concept of computerized account system:

A computerized accounting system is an accounting information system that processes the financial transaction and events as per Generally Accepted Accounting Principles to produce report as per user's requirements.

Every account system, manual or computerized, has two aspects are as follows:

A) It has to work under a set of Well-defined concepts called accounting principles.

B) There is a user-defined Framework for maintenance of record and generation of records.

Definition:

It can be defined as "A computerized account system is a system used by businesses for recording their financial information."

Accounting is a financial method used by Business to collect, organize, process and summarize data for reports and statements. Accounting is used to keep track of business Trends and to keep report a relevant fact within the business. Computer and business software allow more efficient processing and organization of data.

Elements of computerized account system:

Following are the elements of Computerized Accounting System:

1. Preparation of Accounting Documents:

Computer helps in preparing accounting documents like Cash Memo, Bills and invoices etc., and preparing accounting vouchers.

2) Recording of transactions:

Everyday business transaction is recorded with the help of computer software. Logical scheme is implied for codification of account and transaction. Every account and transaction is assigned a unique code. The grouping of accounts is done for from the first stage. This process simplifies the work of recording transactions.

3) Preparation of trial balance and financial statements:

After recording of transaction, the data is transferred to ledger account automatically by the computer. Vouchers are prepared by the help of accounting vouchers, the computer can be programmed to prepare trading, profit and loss account and balance sheet. For example. Contra, payment, receipt etc.

Features of Computerized accounting system:

1) Accuracy, Speed:

Computerized Accounting System has user-definable templates. Which provides, fast and accurate data entry of the transactions. All documents and reports can be generated automatically, at the press of button.

2) Simple, fast and powerful and integrated data:

Computerized account system is this is designed to automate and integrate all the business operations, such as Purchase, Sales, finance, inventory and manufacturing. With computerized accounting, accurate, up-to-date business information is literally at the fingertips.

3) Enhanced User experience:

Computerized account system allows the company to enter data in various ways in which makes work a pleasure by adapting to the specific business/organization.

4) Complete visibility:

Computerized Accounting System gives the company sufficient time to plan, increase the customer base, and enhance customer satisfaction. With computerized accounting system the company will have greater transparency to the day-to-day business operations and access to vital information.

5) Grouping of accounts:

Groups are collection of ledgers of the same nature. Account groups are maintained to determine the hierarchy of ledger accounts which is helpful in determining and presenting meaningful and compliant reports.

Limitations of Computerized Accounting System:

1) Human errors:

Human errors can occur at all levels within a system, from programming to user errors. A system could be set up incorrectly, with an account reporting in the wrong report. A user could also enter enormous numbers or employ wrong accounts. Because of human errors, a new system implementation should undergo a rigorous testing before it goes live. And comprehensive training should be provided to users to minimize errors.

2) Security:

System Security concern can pose limitations on accounting software. Besides worrying about viruses and worms, small-business owner also should be concerned with unauthorized access of Computerized Accounting data. User ID and Passwords are common minimum security measures business can use to protect the accounting software against intrusion, but they may not be enough. Hacking is very common with small business however, only one in five small firms antivirus software and over half don't use wireless connections.

3) Cost:

According to system costs have decreased substantially, but they still can be costly, not only to purchase, but to maintain them as well. Extra costs for training new employees in the system should be considered along with ongoing customer service. Charges for customizing reports and other processes can pose limitations on small and medium-sized business that cannot afford these services. Other program costs to be considered include new version upgrades and even hardware that may be required as Technology progresses. If business can't afford these costs they will be left behind.

4) Other considerations:

When dealing with accounting programs, you should consider Electrical power as a major limitation of the system. Without electricity, most small-business accounting systems are useless.... because no data can be inserted or reports generated. Any electrical fluctuations can have a negative impact on accounting data, deleting information and creating confusion. Another consideration that limits the usage of accounting system is a network where the program may reside...if the computer network is not properly set up the software cannot be accessed and cannot be utilized.

Computer is an important part of an accounting system. Computerized accounting systems are important to business in various ways. Computers helps businesses by making their staff efficient , productive and also save their valuable time. It helps to maintain business and all financial information for the business is well-organized.

1) Time and cost savings :

Using a computerized accounting system saves companies time and money. The use of computer makes inputting accounting information simple. Business transaction are entered into the system and the system posts transactions accordingly.

2) Organization :

A computerized accounting system help business to stay organised. When information is entered into the system. it makes finding the information easy. Employees can see any financial information whenever it is needed.

3) Storage :

Storing information is vital to a business. In Computerized System data cam be stored quickly. after information is entered into the system the information is stored indefinitely. Companies perform backups on the system regularly to avoid losing any information.

4) Distribution :

Computerized accounting systems Allow companies to distribute Financial information easily. Financial statements are printed directly from the system and are distributed internally and externally to those needing the information.

5) Management reports :

Data within the computerized accounting system is accurate and up-to-date. Management can request online report in real-time and that makes management decisions more reliable and timely.

6) Regulatory Compliance :

Reports are required on a regular basis from various government Agencies. a computer system can organize their data and reports to comply with this statutory requirements savings time.

An accounting as an information system (AIS) is a system of collecting, storing and processing financial and accounting data that are used by decision makers. An accounting information system is generally a computer-based method for tracking accounting activity in conjunction with information technology resources. The resulting financial reports can be used internally by management or externally by other interested parties including investors, creditors and tax authorities. Accounting information systems are designed to support all accounting functions and activities including auditing, financial accounting & reporting, -managerial/ management accounting and tax. The most widely adopted accounting information systems are auditing and financial reporting modules.

CONCEPT OF COMPUTERISED ACCOUNTING SYSTEM

A computerised accounting system is an accounting information system that processes the financial transactions and events as per Generally Accepted Accounting Principles (GAAP) to produce reports as per user requirements. Every accounting system, manual or computerised, has two aspects. First, it has to work under a set of well-defined concepts called *accounting principles*. Another, that there is a user-defined framework for maintenance of records and generation of reports.

In a computerised accounting system, the framework of storage and processing of data is called *operating environment* that consists of hardware as well as software in which the accounting system, works. The type of the accounting system used determines the operating environment. Both hardware and software are interdependent. The type of software determines the structure of the hardware. Further, the selection of hardware is dependent upon various factors such as the number of users, level of secrecy and the nature of various activities of functional departments in an organisation.

Take the case of a club, for example, where the number of transactions and their variety is relatively small, a Personal Computer with standardized software may be sufficient. However, for a large business organisation with a number of geographically scattered factories and offices, more powerful computer systems supported by sophisticated networks are required to handle the voluminous data and the complex reporting requirements. In order to handle such requirements, multi-user operating systems such as UNIX, Linux, etc. are used.

Modern computerised accounting systems are based on the concept of *database*. A database is implemented using a database management system, which is define by a set of computer programmes (or software) that manage and organise data effectively and provide access to the stored data by the application programmes. The accounting database is well-organised with active interface that uses accounting application programs and reporting system.

Every computerised accounting system has two basic requirements;

• *Accounting Framework* : It consists a set of principles, coding and grouping structure of accounting.

• *Operating Procedure* : It is a well-defined operating procedure blended suitably with the operating environment of the organisation. The use of computers in any database oriented application has four basic requirements as mentioned below ;

• *Front-end Interface* : It is an interactive link or a dialog between the user and database-oriented software through which the user communicates to the back-end database. For example, a transaction relating to purchase of goods may be dealt with the accounting system through a purchase voucher, which appears on the computer's monitor of data entry operator and when entered into the system is stored in the database. The same data may be queried through reporting system say purchase analysis software programme.

• *Back-end Database* : It is the data storage system that is hidden from the user and responds to the requirement of the user to the extent the user is authorised to access.

• *Data Processing* : It is a sequence of actions that are taken to transform the data into decision useful information.

• *Reporting System*: It is an integrated set of objects that constitute the report. The computerised accounting is also one of the database-oriented applications wherein the transaction data is stored in well-organised database. The user operates on such database using the required and desired interface and also takes the desired reports by suitable transformations of stored data into information. Therefore, the fundamentals of computerised accounting embrace all the basic requirements of any database-oriented application in computers. Accordingly, the computerised accounting system has the above four additional requirements.

13.2 COMPARISON BETWEEN MANUAL AND COMPUTERISED ACCOUNTING

Accounting, by definition, is the process of identifying, recording, classifying and summarising financial transactions to produce the financial reports for their ultimate analysis. Let us understand these activities in the context of manual and computerised accounting system.

• *Identifying* : The identification of transactions, based on application of accounting principles is, common to both manual and computerized accounting system.

• *Recording* : The recording of financial transactions, in manual accounting system is through books of original entries while the data content of such transactions is stored in a well-designed accounting database in computerised accounting system.

• *Classification* : In a manual accounting system, transactions recorded in the books of original entry are further classified by posting into ledger accounts. This results in transaction data duplicity. In computerized accounting, no such data duplication is made to cause classification of transactions. In order to produce ledger accounts, the stored transaction data is processed to appear as classified so that the same is presented in the form of a report. Different forms of the same transaction data are made available for being presented in various reports.

• *Summarising* : The transactions are summarised to produce trial balance in manual accounting system by ascertaining the balances of various accounts. As a result, preparation of ledger accounts becomes a prerequisite for preparing the trial balance. However, in computerised accounting, the originally stored transactions data are processed to churn out the list of balances of various accounts to be finally shown in the trial balance report. The generation of ledger accounts is not a necessary condition for producing trial balance in a computerised accounting system.

• *Adjusting Entries* : In a manual accounting system, these entries are made to adhere to the principle of cost matching revenue. These entries are recorded to match the expenses of the accounting period with the revenues generated by them. Some other adjusting entries may be made as part of errors and rectification. However, in computerised accounting, Journal vouchers are prepared and stored to follow the principle of cost matching revenue, but there is nothing like passing adjusting entries for errors and rectification, except for rectifying an error of principle by having recorded a wrong voucher such as using payment voucher for a receipt transaction.

• *Financial Statements* : In a manual system of accounting, the preparation of financial statements pre-supposes the availability of trial balance. However, in computerised accounting, there is no such requirement. The generation of financial statements is independent of producing the trial balance because such statements can be prepared by direct processing of originally stored transaction data.

• *Closing the Books* : After the preparation of financial reports, the accountants make preparations for the next accounting period. This is achieved by posting of closing and reversing journal entries. In computerised accounting, there is year-end processing to create and store opening balances of accounts in database.

It may be observed that conceptually, the accounting process is identical regardless of the technology used.

13.3 ADVANTAGES OF COMPUTERISED ACCOUNTING SYSTEM

Computerised accounting offers several advantages vis-a-vis manual accounting, these are summarised as follows ;

• *Speed* : Accounting data is processed faster by using a computerized accounting system than it is achieved through manual efforts. This is because computers require far less time than human beings in performing a task.

• *Accuracy* : The possibility of error is eliminated in a computerized accounting system because the primary accounting data is entered once for all the subsequent usage and processes in preparing the accounting reports. Normally, accounting errors in a manual accounting system occur because of repeated posting of same set of original data by several times while preparing different types of accounting reports.

• *Reliability* : The computer system is well-adapted to performing repetitive operations. They are immune to tiredness, boredom or fatigue. As a result, computers are highly reliable compared to human beings. Since computerized accounting system relies heavily on computers, they are relatively more reliable than manual accounting systems.

• *Up-to-Date Information* : The accounting records, in a computerized accounting system are updated automatically as and when accounting data is entered and stored. Therefore, latest information pertaining to accounts get reflected when accounting reports are produced and printed. For example, when accounting data pertaining to a transaction regarding cash purchase of goods is entered and stored, the cash account, purchase account and also the financial statements (trading and profit and loss account) reflect the impact immediately.

• *Real Time User Interface* : Most of the automated accounting systems are inter-linked through a network of computers. This facilitates the availability of information to various users at the same time on a real time basis (that is spontaneously).

• *Automated Document Production* : Most of the computerised accounting systems have standardised, user defined format of accounting reports that are generated automatically. The accounting reports such as Cash book, Trial balance, Statement of accounts are obtained just by click of a mouse in a computerised accounting environment.

• *Scalability* : In a computerised accounting system, the requirement of additional manpower is confined to data entry operators for storing additional vouchers. The additional cost of processing additional transactions is almost negligible. As a result the computerised accounting systems are highly scalable.

• *Legibility* : The data displayed on computer monitor is legible. This is because the characters (alphabets, numerals, etc.) are type written using standard fonts. This helps in avoiding errors caused by untidy written figures in a manual accounting system.

• *Efficiency* : The computer based accounting systems ensure better use of resources and time. This brings about efficiency in generating decisions, useful informations and reports.

• *Quality Reports* : The inbuilt checks and untouchable features of data handling facilitate hygienic and true accounting reports that are highly objective and can be relied upon.

• *MIS Reports* : The computerised accounting system facilitates the real time production of management information reports, which will help management to monitor and control the business effectively. Debtors' analysis would indicate the possibilities of defaults (or bad debts) and also concentration of debt and its impact on the balance sheet. For example, if the company has a policy of restricting the credit sales by a fixed amount to a given party, the information is available on the computer system immediately when every voucher is entered through the data entry form. However, it takes time when it comes to a manual accounting system. Besides, the results may not be accurate.

• *Storage and Retrieval* : The computerised accounting system allows the users to store data in a manner that does not require a large amount of physical space. This is because the accounting data is stored in hard-disks, CD-ROMs, floppies that occupy a fraction of physical space compared to books of accounts in the form of ledger, journal and other accounting registers. Besides, the system permits fast and accurate retrieval of data and information.

• *Motivation and Employees Interest* : The computer system requires a specialised training of staff, which makes them feel more valued. This motivates them to develop interest in the job. However, it may also cause resistance when we switch over from a manual system to a computer system.

13.4 LIMITATIONS OF COMPUTERISED ACCOUNTING SYSTEM

The main limitations emerge out of the environment in which the computerized accounting system is made to operate. These limitations are as given below ;

• *Cost of Training* : The sophisticated computerised accounting packages generally require specialised staff personnel. As a result, a huge training costs are incurred to understand the use of hardware and software on a continuous basis because newer types of hardware and software are acquired to ensure efficient and effective use of computerised accounting systems.

• *Staff Opposition* : Whenever the accounting system is computerised, there is a significant degree of resistance from the existing accounting staff, partly because of the fear that they shall be made redundant and largely because of the perception that they shall be less important to the organisation.

• *Disruption:* The accounting processes suffer a significant loss of work time when an organisation switches over to the computerised accounting system. This is due to changes in the working environment that requires accounting staff to adapt to new systems and procedures.

• *System Failure* : The danger of the system crashing due to hardware failures and the subsequent loss of work is a serious limitation of computerized accounting system. However, providing for back-up arrangements can obviate this limitation. Software damage and failure may occur due to attacks by viruses. This is of particular relevance to accounting systems that extensively use Internet facility for their online operations. No fullproof solutions are available as of now to tackle the menace of attacks on

• *Inability to Check Unanticipated Errors* : Since the computers lack capability to judge, they cannot detect unanticipated errors as human beings commit. This is because the software to detect and check errors is a set of programmes for known and anticipated errors.

• *Breaches of Security* : Computer related crimes are difficult to detect as any alteration of data may go unnoticed. The alteration of records in a manual accounting system is easily detected by first sight. Fraud and embezzlement are usually committed on a computerised accounting system by alteration of data or programmes. Hacking of passwords or user rights may change the accounting records. This is achieved by tapping telecommunications lines, wire-tapping or decoding of programmes. Also, the people responsible for tampering of data cannot be located which in a manual system is relatively easier to detect.

• *Ill-effects on Health* : The extensive use of computers systems may lead to development of various health problems: bad backs, eyestrain, muscular pains, etc. This affects adversely the working efficiency of accounting staff on one hand and increased medical expenditure on such staff on the other.

13.5 SOURCING OF ACCOUNTING SOFTWARE

Accounting software is an integral part of the computerised accounting system. An important factor to be considered before acquiring accounting software is the accounting expertise of people responsible in organization for accounting work. People, not computers, are responsible for accounting.

The need for accounting software arises in two situations :

(a) when the computerised accounting system is implemented to replace the manual system or

(b) when the current computerised system needs to be replaced with a new one in view of changing needs.

ACCOUNTING SOFTWARE

Variety of accounting software is available in the market. The most popular software used in India are Tally and Ex. The basic features of all accounting software are same on a global basis. The legal reporting requirements in a given country and the business needs affect the software contents. The other popular softwares are Sage, Wings 2000, Best Books, Cash Manager, and Ace Pays, etc.

13.5.1 Accounting Packages

Every Computerised Accounting System is implemented to perform the accounting activity (recording and storing of accounting data) and generate reports as per the requirements of the user. From this perspective. The accounting packages are classified into the following categories :

(a) Ready to use

(b) Customized

(c) Tailored

Each of these categories offers distinctive features. However, the choice of the accounting software would depend upon the suitability to the organization especially in terms of accounting needs.

13.5.2 Ready-to-Use

Ready-to-Use accounting software is suited to organisations running small/ conventional business where the frequency or volume of accounting transactions is very low. This is because the cost of installation is generally low and number of users is limited. Ready-to-use software is relatively easier to learn and people (accountant) adaptability is very high. This also implies that level of secrecy is relatively low and the software is prone to data frauds.

The training needs are simple and sometimes the vendor (supplier of software) offers the training on the software free. However, these software offer little scope of linking to other information systems.

13.5.3 Customised

Accounting software may be customised to meet the special requirement of the user. Standardised accounting software available in the market may not suit or fulfil the user requirements. For example, standardised accounting software may contain the sales voucher and inventory status as separate options. However, when the user requires that inventory status to be updated immediately upon entry of sales voucher and report be printed, the software needs to be customised.

Customised software is suited for large and medium businesses and can be linked to the other information systems. The cost of installation and maintenance is relatively high because the high cost is to be paid to the vendor for customisation. The customisation includes modification and addition to the software contents, provision for the specified number of users and their authentication, etc. Secrecy of data and software can be better maintained in customised software. Since the need to train the software users is important, the training costs are therefore high.

13.5.4 Tailored

The accounting software is generally tailored in large business organizations with multi users and geographically scattered locations. These software requires specialised training to the users. The tailored software is designed to meet the specific requirements of the users and form an important part of the organizational MIS. The secrecy and authenticity checks are robust in such softwares and they offer high flexibility in terms of number of users.

To summarise, the following table represents the comparison between the various categories of accounting software :

Basis	*Ready to use*	*Customised*	*Tailored*
Nature of business	Small, conventional business	Large, medium business	Large, typical business
Cost of installation and maintenance	Low	Relatively high	High
Expected Level of secrecy (Software and Data)	Low	Relatively high	Relatively high
Number of users and their interface	Limited	As per specifications	Unlimited
Linkage to other information system	Restricted	yes	Yes
Adaptability	High	Relatively high	Specific
Training requirements	Low	Medium	High

13.6 Generic Considerations before Sourcing an Accounting Software

The following factors are usually taken in considerations before sourcing an accounting software.

13.6.1 Flexibility

An important consideration before sourcing an accounting software is flexibility, viz. data entry and the availability and design of various reports expected from it. Also, it should offer some flexibility between the users of the software, the switch over between the accountants (users), operating systems and the hardware. The user should be able to run the software on variety of platforms and machines, e.g. Windows 98/2000, Linux, etc.

13.6.2 Cost of Installation and Maintenance

The choice of the software obviously requires consideration of organisation ability to afford the hardware and software. A simple guideline to take such a decision is the cost benefit analysis of the available options and the financing opportunities available to the firm. Some times, certain software which appears cheap to buy, involve heavy maintenance and alteration costs, e.g. cost of addition of modules, training of staff, updating of versions, data failure/restoring costs. Conversely, the accounting software which appear initially expensive to buyers, may require least maintenance and free upgrading and negligible alteration costs.

13.6.3 Size of Organisation

The size of organisation and the volume of business transactions do affect the software choices. Small organisations, e.g. in non-profit organisations, where the number of accounting transactions is not so large, may opt for a simple, single user operated software. While, a large organisation may require sophisticated software to meet the multi-user requirements, geographically scattered and connected through complex networks.

13.6.4 Ease of Adaptation and Training needs Some accounting software is user friendly requiring a simple training to the users. However, some other complex software packages linked to other information systems require intensive training on a continuous basis. The software must be capable of attracting users and, if its requires simple training, should be able to motivate its potential users.

13.6.5 Utilities/MIS Reports

The MIS reports and the degree to which they are used in the organization also determine the acquisition of software. For example, software that requires simply producing the final accounts or cash flow/ratio analysis may be readyto- use software. However, the software, which is expected to produce cost records needs to be customised as per user requirements.

13.6.6 Expected Level of Secrecy (Software and Data)

Another consideration before buying accounting software is the security features, which prevent unauthorised personnel from accessing and/or manipulating data in the accounting system. In tailored software for large businesses, the user rights may be restricted to purchase vouchers for the purchase department, sales vouchers to the billing accountants and petty cash module access with the cashier. The operating system also matters. Unix environment allows multi-users compared to Windows. In Unix, the user cannot make the computer system functional unless the user clicks with a password, which is not a restriction in Windows.

13.6.7 Exporting/Importing Data Facility

The transfer of database to other systems or software is sometimes expected from the accounting software. Organisations may need to transfer information directly from the ledger into spreadsheet software such as Lotus or Excel for more flexible reporting. The software should allow the hygienic, untouched data transfer.

Accounting software may be required to be linked to MIS software in the organisation. In some ready to use accounting softwares, the exporting, importing facility is available but is limited to MS Office modules only, e.g. MS Word, MS Excel, etc. However, tailored softwares are designed in manner that they can interact and share information with the various sub components of the organisational MIS.

13.6.8 Vendors Reputation and Capability

Another important consideration is the reputation and capability of about the vendor. This depends upon how long has he been the vendor is in business of software development, whether there are other users of the software and extent of the availability of support mechanisms outside the premises of the vendor.

UNIT – V

Emerging concepts in accounting: Human resource accounting, inflation accounting, responsibility accounting and government accounting. IFRS. (No Problem)

INTRODUCTION:

Human Resource Accounting is the process of identifying and measuring data about Human Resources and communicating this information to the interested parties. It is an attempt to identify and report the Investments made in Human Resources of an organisation that are currently not accounted for in the Conventional Accounting Practices.

Thus, **Human Resource Accounting** is a term applied by the Accountancy Profession to quantify the cost and value of employees of their employing organisation.

MEANING:

Human resources are considered as important assets and are different from the physical assets. Physical assets do not have feelings and emotions, whereas human assets are subjected to various types of feelings and emotions. In the same way, unlike physical assets human assets never gets depreciated. Therefore, the valuations of human resources along with other assets are also required in order to find out the total cost of an organization. In 1960s, Rensis Likert along with other social researchers made an attempt to define the concept of human resource accounting (HRA).

DEFINITION:

1. The American Association of Accountants (AAA) defines HRA as follows: 'HRA is a process of identifying and measuring data about human resources and communicating this information to interested parties'.
2. Flamhoitz defines HRA as 'accounting for people as an organizational resource. It involves measuring the costs incurred by organizations to recruit, select, hire, train, and develop human assets. It also involves measuring the economic value of people to the organization'.
3. According to Stephen Knauf, ' HRA is the measurement and quantification of human organizational inputs such as recruiting, training, experience and commitment'.

NEED FOR HRA:

The need for human asset valuation arose as a result of growing concern for human relations management in the industry.

Behavioural scientists concerned with management of organizations pointed out the following reasons for HRA:

1. Under conventional accounting, no information is made available about the human resources employed in an organization, and without people the financial and physical resources cannot be operationally effective.
2. The expenses related to the human organization are charged to current revenue instead of being treated as investments, to be amortized over a period of time, with the result that magnitude of net income is significantly distorted. This makes the assessment of firm and inter-firm comparison difficult.
3. The productivity and profitability of a firm largely depends on the contribution of human assets. Two firms having identical physical assets and operating in the same market may have different returns due to differences in human assets. If the value of human assets is ignored, the

total valuation of the firm becomes difficult. Paper name: - Human Resource Management Stream:

4. If the value of human resources is not duly reported in profit and loss account and balance sheet, the important act of management on human assets cannot be perceived.
5. Expenses on recruitment, training, etc. are treated as expenses and written off against revenue under conventional accounting. All expenses on human resources are to be treated as investments, since the benefits are accrued over a period of time.

OBJECTIVES OF HRA:

1. Providing cost value information about acquiring, developing, allocating and maintaining human resources.
2. Enabling management to monitor the use of human resources.
3. Finding depreciation or appreciation among human resources.
4. Assisting in developing effective management practices.
5. Increasing managerial awareness of the value of human resources.
6. For better human resource planning.
7. For better decisions about people, based on improved information system.
8. Assisting in effective utilization of manpower.

IMPORTANCE OF HUMAN RESOURCE ACCOUNTING

The 21st Century has been referred to as the Century of the Service Sector. All major expansion scope seems to be happening in the service sector and the scope of expansion of the manufacturing sector is minimal.

But are the Accountants properly able to value this Service Sector and show this on the Company's Balance Sheet?

For any Company operating in the Manufacturing Sector, its core assets are its Machinery and Fixed Assets but for a Company operating in the Service Sector, its core assets are its employees which are Intangible Assets. For a Service Sector Company, the value of employees gains importance as earnings are based on the per-employee per hour billing model and profitability is linked to the value added by the workforce.

The Concept of Human Resource Accounting was established primarily for the service sector has now started gaining so much relevance that now Companies in all Sectors have applying HR Accounting and a good weightage is given to these reports when making any Company Analysis.

METHODS OF VALUATION OF HUMAN RESOURCES:

There are certain methods advocated for valuation of human resources. These methods include historical method, replacement cost method, present value method, opportunity cost method and standard cost method. All methods have certain benefits as well as limitations.

Methods of Human Resource Accounting

Quite a few Models have been suggested in the past for the Human Resource Accounting and these can be classified into 2 parts each having various Models. Some of the Important ones are:-

A. Cost Based Models

I. Capitalisation of Historical Costs Model

II. Replacement Costs Model

III. Opportunity Cost Model

B. Value Based Models

I. Present Value of Future Earnings Model/ Lev and Schwartz Model

II. Reward Valuation Model/ Flamholtz Model

III. Valuation on Group Basis

A. **COST BASED MODELS**

I. Capitalisation of Historical Costs

As per this Method of HR Accounting, the sum of all costs related to Human Resources (i.e. Recruitment, Acquisition, Formal Training, Informal Training, Informal Familiarisation, experience and development) is taken together to represent the value of the human resources.

The value is amortised annually over the expected length of the service of individual employees and the unamortised cost is shown as Investments in the Human Assets. If an employee leaves the firm (i.e. Human Assets expire) before the expected service life period, then the net value to that extent is charged to the Current Revenue.

Limitations

This Model of HR Accounting is simple and easy to understand and satisfies the basic principles of matching the costs and revenues.

1. As the historical costs are sunk costs and are irrelevant for decision making, this model was severely criticised as it failed to provide a reasonable value to the human resources.
2. This method of HR Accounting capitalises only the Training and Development Costs incurred on the employees and ignores the future expected costs to be incurred for their maintenance.
3. This Model of HR Accounting distorts the value of the highly skilled human resources as such employees require less training and therefore, according to this model, they will be valued at a lesser cost.

II. Replacement Costs

The Historical Cost Method was highly criticised as it only takes into account the Sunk Costs which are irrelevant for Decision Making. Thus, a new model for Human Resource Accounting was conceptualised which took into the account, the costs that would be incurred to replace its existing human resources by an identical one.

1. Individual Replacement Costs – which refers to the cost that would have to be incurred to replace an individual by a substitute who can provide the same set of services as that of the individual being replaced
2. Positional Replacement Costs – which refers to the cost of replacing the set of services referred by an incumbent in a defined position

Thus, the Positional Replacement Cost takes into account the position in the organisation currently held by the employee and also the future positions expected to be held by him.

Limitations

As per this method of HR Accounting, the determination of replacement cost of an employee is highly subjective and often impossible. Particularly at the management cadre, finding out an exact replacement is very difficult. The exit of a top management person may substantially change the human assets value.

III. Opportunity Cost Model

This model was advocated by Hekimian and Jones in the year 1967 and is also known as the Market Value Method.

This method of measuring Human Resources under this Model is based on the concept of opportunity cost i.e. the value of an employee in its alternative best use, as a basis of estimating the value of human resources. The opportunity cost value may be established by competitive bidding within the firm, so that in effect, managers bid for any scarce employee. A human asset therefore, will have a value only if it is a scarce resource, that is, when its employment in one division denies it to another division.

Limitations

One of the serious limitations of this method for Human Resource Accounting is that it excludes employees of the type which can be hired readily from outside the firm. Thus, this approach seems to be concerned with only one section of a firm's human resources, having special skills within the firm or in the labour market.

B. ECONOMIC VALUE MODELS

I. Present Value of Future Earnings Model

This Model of human resource accounting was developed by Lev and Schwartz in the year 1971 and involves determining the value of human resources as per the present value of estimated future earnings discounted by the rate of return on Investment (Cost of Capital).

As per this valuation model of Human Resource Accounting, the following expression is used for calculating the expected value of a person's human capital

Limitations

1. This Model of HR Accounting ignores the possibility and probability that an Individual may leave an organisation for reasons other than Death or Retirement.
2. This Model of HR Accounting also ignores the probability that people may make role changes during their careers. For example, an Assistant Engineer will not remain in the same position throughout the expected service life in the Organisation.

Despite the above limitations, this model is the most commonly used model across the Globe for the purpose of Human Resource Accounting.

II. Reward Valuation Model/ Flamholtz Model

Flamholtz advocated that an Individual's Value to an organisation is determined by the services he is expected to render. This model of Human Resource Accounting is an improvement to the "Present Value of Future Earnings Model" as it takes into account the probability that an individual is expected to move through a set of mutually exclusive organisational roles or service states during a time interval. Such movement can be estimated probabilistically by using the following model

Limitations

1. The major drawback of this model of Human Resource Accounting is that it is difficult to estimate the probabilities of likely service states of each employee.
2. Determining the monetary equivalent of service states is also very difficult and costly affair.
3. Since the analysis is restricted to Individuals, it ignores the value added element of Individuals working as groups.

III. Valuation on Group Basis

While applying the above models, the Accountants realised that proper Valuation as per Human Resources Accounting is not possible unless the contributions of the Individuals as a Group are taken into consideration.

An Individual's expected service tenure in the organisation is difficult to predict but on a group basis it is relatively easier to estimate the percentage of people in a group likely to leave the organisation in the future. This model of Human Resource Accounting attempted to calculate the present value of all existing employees in such in each rank. Such Present Value is ascertained with the help of the following steps:-

1. Ascertain the number of employees in each rank
2. Estimate the probability that an employee will be in his rank within the organisation or will be terminated in the next period. This probability will be estimated for a specified time period.
3. Ascertain the economic value of an employee in a specified rank during each time period.
4. The present value of existing employees in each rank is obtained by multiplying the above three factors and applying an appropriate discount rate.

Limitations

Although this process simplifies the process valuation of Human Resource Accounting by considering a group of employees as a valuation base, but this method ignores the exceptional qualities of certain skilled employees. Thus, the performance of a group may be seriously affected in the event of exit of a single individual.

BENEFITS OF HRA:

There are certain benefits for accounting of human resources, which are explained as follows:

1. The system of HRA discloses the value of human resources, which helps in proper interpretation of return on capital employed.
2. Managerial decision-making can be improved with the help of HRA.
3. The implementation of human resource accounting clearly identifies human resources as valuable assets, which helps in preventing misuse of human resources by the superiors as well as the management.

4. It helps in efficient utilization of human resources and understanding the evil effects of labour unrest on the quality of human resources.
5. This system can increase productivity because the human talent, devotion, and skills are considered valuable assets, which can boost the morale of the employees.
6. It can assist the management for implementing best methods of wages and salary administration. Paper name: - Human Resource Management Stream

LIMITATIONS OF HRA:

HRA is yet to gain momentum in India due to certain difficulties:

1. The valuation methods have certain disadvantages as well as advantages; therefore, there is always a bone of contention among the firms that which method is an ideal one.
2. There are no standardized procedures developed so far. So, firms are providing only as additional information.
3. Under conventional accounting, certain standards are accepted commonly, which is not possible under this method.
4. All the methods of accounting for human assets are based on certain assumptions, which can go wrong at any time. For example, it is assumed that all workers continue to work with the same organization till retirement, which is far from possible.
5. It is believed that human resources do not suffer depreciation, and in fact they always appreciate, which can also prove otherwise in certain firms.
6. The lifespan of human resources cannot be estimated. So, the valuation seems to be unrealistic.

INFLATION ACCOUNTING

INTRODUCTION :

The basic objective of Accounting is the preparation of financial statements is a way that they give a true and fair view of the operating results and the financial position or the business to its various users, namely investors, creditors, management Government, trade unions, research institutions etc. These financial statements are prepared based on certain accounting concepts and conventions. The money measurement concept is a basic attribute of accounting. The money measurement concept states that only those business transactions that are capable of being expressed in terms of money can be recovered in the books of account. It also assumes that the monetary unit used for recording the transaction is stable in nature.

However, this is not true in practice as many countries, developed as well as developing, have been experiencing inflation of high magnitude in recent times. Inflation refers to state of continuous rise in prices. It brings downward changes in the purchasing power of monetary unit. Thus, financial statements prepared without taking into account the change in purchasing power of the monetary unit lose their significance. There is a demand that business enterprises should prepare inflation adjusted financial statements. The different ways through which financial accounts can be adjusted for changing prices is studied under the subject "Inflation Accounting". Given that price changes can also be downward, it is more appropriately called "Accounting for price level changes".

HISTORY OF INFLATION ACCOUNTING :

Inflation accounting was practiced in the Us by the American Institute of Certified Public Accountants for over 50 years. During the period of Great Depression many companies reconstructed their financial reports recording the inflation in them. During those 50 years many companies were encouraged to record the price-level adjusted statements in place of cost-based financial statements. The FSAB or the Financial Accounting Standards Board raised a proposal of publishing the price-level adjustment statements which was withdrawn by them later due to certain problems.

MEANING OF INFLATION ACCOUNTING :

Inflation accounting is a term describing a range of accounting models designed to correct problems arising from historical cost accounting in the presence of high inflation and hyperinflation.Inflation accounting may be described as an attempt to portray financial performance of business enterprises on the basis of current prices. Special accounting techniques, which can be used during periods of high inflation. Inflation accounting requires statements to be adjusted according to price indexes, rather than rely solely on a cost accounting basis. Companies operating in countries experiencing hyperinflation may be required to update their statements periodically, in order to make them relevant to current economic and financial conditions.

OBJECTIVES OF INFLATION ACCOUNTING :

Inflation accounting aims at infusing the element of realism in the process of compilation of the financial statements, by making the necessary adjustments (in the figures of the historical costs) to the best possible extent, with a view to representing the currently prevailing prices of the various items in the market, caused by the effect of inflation. It reflects, in a true and fair manner, the financial position and performance, profitability and prospects, of the enterprise, during the respective accounting periods. In other words, it aims at convening the monetary units, having different purchasing powers, into one single monetary unit, whose purchasing power is uniform for various valuations and computations. The resultant effects of the inflation accounting adjustments are :

1. To enhance the meaning and measurement of the income and expenditure of the enterprise, keeping in view the ever-changing purchasing power of the momentary unit, the specific currency.
2. This, in turn makes the intra-firm comparison of the financial results of the company more realistic, rational and meaningful.
3. To highlight and specify the effect of inflation on different enterprises, depending upon their different nature of business as also the operating features.
4. To provide a meaningful and reliable database, facilitating a realistic and rational decision-making process in the organisation.

NEED FOR INFLATION ACCOUNTING :

Inflation, especially when it is prolonged and high, reduces considerably the meaningfulness and use of the corporate accounts because the various amounts in current rupee values may not signify proportionate real amounts, as the real worth of the rupee varies in different years. Moreover, arithmetical operations involving different amounts in rupees having different real worth become quite misleading. To make the accounts more meaningful, all items should be expressed in values relating to common year. This is attempted through inflation accounting, the following reasons usually being advanced in its favor.

1. It helps to correct the usually distorted picture of the financial operations and condition of a company presented by the conventional system of accounts.
2. It facilitates inter-company comparisons since inflation hits different firms in different degrees.
3. It also facilitates inter-period comparisons of the performance of firm.
4. Correct measurement of income is possible only with inflation accounting.
5. When some nominal value in the accounts forms the basis of government action, e.g., taxation based on profits, MRTP Act measures based on nominal value acting as proxy for relevant variables, determination of controlled price on the basis of nominal profits and so on, inflation may cause unfair decisions by the government, unless the relevant nominal value is adjusted for inflation.

ADVANTAGES OF INFLATION ACCOUNTING :

The approach offers following advantages :

- It enables the maintenance of capital intact which is essential in a limited liability business like companies.
- Profit/loss is determined by matching the cost and the revenue at current values which are comparable. This enables a realistic assessment of performance of the business.
- The assets are shown at real values uniformly instead of at distorted values as in historical rupee values.
- Trade unions, employees, shareholders and public are not misled by giving an exaggerated profit figure. "The profit earned is taken as a guide to prosperity by actual and potential investors and quite often trade unions base their wage claims on the assumption that a company can afford to pay higher wages because profits are higher."
- By showing the current values of fixed assets it enables the establishment of a realistic price for the company's shares.

DISADVANTAGES OF INFLATION ACCOUNTING :

The approach suffers from the following disadvantages too :

- Depreciation being the process of distribution on original cost over the effective life, charging anything in excess does not fit into the concept of depreciation.
- 'Replacement cost' is an indefinite figure colored by future technological developments and the time period at which the asset will be scrapped. Hence even the best estimate cannot give an accurate estimate of replacement costs.
- Charging depreciation on replacement cost basis will not be acceptable to income-tax authorities and hence there is no use of doing this exercise.
- The calculators are so involved that an average shareholder will not be able to understand the financial statements easily. Despite some obvious conceptual weaknesses and practical difficulties, the technique of inflation accounting is very useful. Due to rapid changes in price-levels, it has become rather a basic necessity to adjust accounts at current prices. How the various difficulties involved in it are resolved, is a challenge to the accountants.

EXPLAIN THE METHODS/TECHNIQUES OF INFLATION ACCOUNTING.

Number of techniques has been developed by professional institute and accountants to deal with inflationary conditions. The important among them are as follows.

METHODS/TECHNIQUES OF INFLATION ACCOUNTING :

1) Replacement Cost Method :

The replacement cost method, also called replacement value method, is based on the principle that sufficient provision should be made in the profit and loss account for the amount needed to meet the cost of replacement of all fixed assets as and when they wear out. Under this method, therefore, charges to profit and loss account would be made to provide for replacement cost instead of depreciation cost which is designed to amortise the cost of fixed assets over their useful life.

2) Writing-up of Fixed Assets :

Under this method, a portion of the value of fixed assets should be written off annually from the income statement of the company in addition to its normal depreciation charges. The amount to be written off will be determined on the basis of obsolescence in fixed assets as we do in the case of internal reconstruction of a company. The main problem in this method is this that the amount to be written off is a subjective decision; and secondly, this technique cannot be applied to all types of assets.

3) Replacement Cost Method Covering Fixed Assets and Inventories :

This method is an improvement over the first method as it includes inventory valuation problem too. The replacement cost of inventories consumed is kept in mind in the computation of the cost of goods sold. The replacement cost approach covers a number of variants (such as maintenance of real capital approach, anticipated cost approach, current cost approach and purchasing power approach), though all of them have one thing in common: they specifically allow for the effects of changes in prices and cost levels and relate depreciation, stock valuations and other cost computations to current replacement costs.

4) Present Value Accounting Method :

This method is also known as current value method. This method refers to a variety of valuation alternatives that focus on reflecting the current as opposed to past (or historical) values of financial statement items. By present value we simply mean the replacement cost as a concept of valuation. In respect of certain types of assets, we use the net realisable value as a basis of valuation (for the assets which are not essential to the continuance of the operations of the enterprise) on the other hand for comparatively permanent assets we use the discounted present value of the assets.

5) Continuously Contemporary Accounting Method :

This method also belongs to the family of replacement cost accounting. It involves the adjustment or modification of financial statements expressed in units of money so that relevant information is given in terms of existing purchasing power of money. Such general purchasing power adjustments can be applied under both historical cost and a current value system.

The method requires adjustment to every item in financial statements prepared on a historical cost basis. Each item is expressed in a single unit of purchasing power. The gain or loss on account of holding monetary items is determined and included in income measured on a purchasing power basis. These general purchasing power adjusted financial statements are proposed as supplementary information and they are presented in summarised form together with the historical cost statements. Obviously, the method involves more accounting work.

6) Current Purchasing Power Method :

This method is based on the assumption that capital should be maintain in terms of the same monetary purchasing power. The accounts are duly adjusted for changes in the price level by restating all items appearing in the financial statements in terms of a constant unit of money. The constant unit of money referred to above Is known as the general purchasing power. A general price index is used as a multiplier.

The reason underlying this is that the general price index is perhaps the best indicator of changes in the purchasing power of money. Under this method, the actual movements i.e. rise or fall in the price of a given item is ignored and only changes in the general purchasing power of money is considered. The proponents of this use the historical values and convert the same into the value of purchasing power as at the end of a specified period. In order to do so two index numbers are used one showing the general price level on the date of the transaction while the other portrays the general price level at the end of the period specified. The current purchasing power method of accounting for price level changes measures profit as the increase in the current purchasing power of equity i.e., net assets. The valuations of all items are made in terms of current purchasing power.

Definition of Responsibility Accounting

Responsibility accounting refers to the process of identifying and spotting the centers of responsibility accounting and their objectives; this helps the organization to analyze and draft a performance report of all the responsibility centers, additionally, these centers are also responsible for reporting revenues and expenses as per the responsibility areas.

Explanation

- Basically, responsibility accounting is defined and based on the defined centers like cost centers, profit centers, and investment centers.
- Responsibility accounting is a sort of management accounting that is responsible for internal accounting, budget related issues, and management concerns.
- The main and crucial objective is to support all the centers within the company and help them with costing and planning.
- The accounting we referred to above relates to the preparation of annual or monthly budget which is allocated or designed for any particular center.
- This accounting style also accounts for the revenue and cost of any company, where quarterly and annual reports are being accumulated and then reported to the manager for the review or feedback.
- In responsibility accounts, a specific person is a help responsible for looking into an assigned area of accounting and cost control of the same, so that it is convenient to hold the person responsible for any increase in cost.
- In this accounting, tasks and responsibilities are assigned based on the knowledge and skillset an individual possess, and proper authority might be given to that person so that he can autonomously take decision pertaining to that department.

History of Responsibility Accounting

- The responsibility accounting was introduced in the year 1920s with the intention to handle all the different levels of authority in any organization's management.
- During the 1950s and 1960s, the economic activities of the companies were significantly diversified significantly increasing the demand of responsibility accounting and decentralization.

Features of Responsibility Accounting

Some of the features are given below:

- The main feature of responsibility accounting is to define the cost centers at the initial stage which we earlier referred to as responsibility centers.
- For each center, there should be a fixed target which the department has to achieve in the defined deadline, so setting targets for the center is very crucial.
- Then, we must track the performance of each responsibility center and also compare the actual performance with the target performance.
- The variance between the actual performance and target performance is analyzed and post that the responsibility of each center should be fixed.

- Then corrective action has to be taken by the management and it should be individually communicated to the concerned person taking care of the responsibility center.

Example of Responsibility Accounting

Example of responsibility accounting is given below:

- Let us take an example from the cost center perspective, Amgen a renowned pharmaceutical company proposes to produce vaccinations for Polio in a batch of 100,000 in 3 phases. The company estimated the cost of $25 million for all three phases spanned out in 6 months.
- However, post the production of the vaccine the company ended up spending $26.5 million, so here the responsibility account manager must justify the increased cost to the management.
- There can be several reasons, increased cost of raw materials, increased per unit of electricity cost or any new government policy leading to an increase in the cost.

Types of Responsibility Accounting

There are various types, let us discuss them in detail below:

- **Cost Center:** As the name suggests the persons involved in this center are responsible for controlling cost for the company and they are not responsible for any other functions in the company. However, there are two types of costs namely controlled and uncontrolled, a person should be held responsible for the controlled costs, and the performance of each center is evaluated by comparing the actual vs estimated costs.
- **Revenue Center:** Revenue takes care of the revenue for the company and no other related responsibilities, mostly the sales related teams are accountable for this center.
- **Profit Center:** The performance of this center is measured in terms of revenue and cost and the team working in this center has to make sure to report accurate numbers. Generally, a factory can be considered as a profit center where the raw materials as input are a part of the cost center and sales of the finished goods are revenue center.
- **Investment Center:** We can say that this is a very important center to be on, as this team has to make sure that the assets of the company are properly utilized in the best manner so that the company effectively capitalize on the deployed capital and earn handsome revenues from the same.

Prerequisites of Responsibility Accounting

- As much as effective is responsibility accounting it is equally important to have some prerequisites as a company.
- The initial one is to have a well-defined organizational structure, where the levels of employees are clearly defined, and authorization is efficiently established within the firm.
- The measures which will help to analyze the performance and evaluate must be clearly established and explained to the entire team.

Advantages of Responsibility Accounting

Some of the advantages are:

- The most and the crucial advantage of responsibility accounting is that every accounted person knows the roles and responsibilities he has towards the company, this helps to maintain transparency in the firm.
- Since there are different departments accountable for different activities within the organization, chances of any information mishandling or misreporting are very slim.
- It surely enhances and improves the accuracy of managers working closely with different centers as they are liable for every action within that particular center.

Government accounting is a scientific procedure of collecting, classifying, recording, summarizing, and interpreting all the financial transactions including revenues and expenditures of all the government offices. It keeps the record of public funds.

Followings are the main objectives of the Government Accounting −

- **Information about Revenues** − One of the most important functions of the Government accounting is to maintain the transactions of generation and collection of revenues during the financial year (and maintain all the past years' financial data). Under the 'Right to Information Act,' if someone asks to have the information regarding the financial transactions of a government office, it is oblige to provide that.
- **Information about Expenditures** − One of the most important objectives of the Government accounting is to provide information about the expenditures incurred on various heads. It is checked by the Parliament in case of Central Government and state legislature in case of the State Government.
- **Information about Deposits and Loans** − Government has to provide information about the loan granted by the Government to others and repayment of the deposits.
- **Information about Availability of Cash** − It has to provide information about the present and the future cash availability.

DIFFERENCE BETWEEN GOVERNMENT AND COMMERCIAL ACCOUNTING

There are following notable differences between the Government accounting and the commercial accounting −

Headings	Govt. Accounting	Comm. Accounting
Objective	Administration and management of all the financial activities of the government.	Maintain the records of trading and manufacturing of goods or to provide services to calculate profits.
Date Entry System	It has single entry system — Govt. does not work to earn profit; so, it does not need cross-	Normally, it has double entry system — need to prepare

	check the accounting records.	Trading & Profit & Loss account and Balance Sheet at the end of the accounting period.
Basis of Accounting statements	Accounting statements are also prepared on the basis of single entry system. Most of the statements are merely statements of collections of revenue and expenditures done, except where the Government acts like a banker or lender or borrower.	Accounting statements are prepared on the basis of double entry system.

Important Terms and Expressions of Government Finance

Following are the important terms and expressions used in Government accounting −

- **Demand for Grant** − Without sanction from the Parliament, no expenditure can be incurred by any Government Authority. Public Authority can request for the grant of expenditure to the Government, this request is called "**Demand for Grant**".
- **Supplementary Grant** − Sometimes, grants are sanctioned before the end of the financial year, in case where annual budget might be inadequate. Supplementary demand can be made, if need arises to meet the expenditure. For example, amount granted for the Natural Disaster Relief fund, may be found inadequate due to extraordinary disaster by the flood; in such a condition, an additional grant may be asked by the concerned state or ministry.
- **Treasuries** − Treasuries are the units of fiscal system in India. Every Indian States and Union Territory is divided into different districts' headquarters and every district headquarters has one or more than one treasury. Treasuries are conducted by the State Bank of India as an agent of the Reserve Bank of India. Central Government and State Government keep their separate accounts and differences of Central and State Govt. are adjusted by the Reserve Bank of India.
- **Votable and Non-votable Items** − To incur some expenditures, Parliamentary approval is not required; so, these expenditures may be charged from the Consolidated fund or the Public account, these items are known as **Non-votable** items. Some items of expenditure require sanction of the Parliament and cannot be incurred without its grant. Thus, demand for grant for that expenditure may be placed to the government, such items are called as **Votable** Items.
- **Appropriation Act** − After the approval of the budget proposal in the Parliament or Legislature, an Appropriation Bill has to be introduced, when this Bill is passed, it becomes Appropriation Act. Now, money can be withdrawn from the Consolidated Fund of India or the concerned State to meet the grants.
- **Vote on Account** − In certain condition, when government has no time to place full budget in the Parliament, then it uses the special provision of 'Vote on Account.' Under this provision, government obtains the vote of the Parliament for the amount required to incur the expenditure of the items in demand. After sanction obtained in the Parliament, government obtains money from the Consolidated Fund of India.

- **Public Accounts Committee (PAC)** − Public Account Committee is formed by the Parliament and each Legislature to scrutinize the Appropriation account and Audit the report thereon. All the reports on financial statements those are to be submitted to the President of Indian and in the Parliament are examined by the Public Accounts Committee (PAC). Examination by the PAC is similar to post-mortem of the reports. Members of the PAC are appointed from the Opposition Parties of the Parliament. Member of the ruling party cannot be part of this committee, as this committee is working as a watchdog to look after the affairs of ruling party.
- **Local Government Accounting** − Accounting of the Local government is based on the concept of "fund accounting" and on the budget. Urban local government entities and rural local government entities are two types of local government entities. Accounting of the Local Government in India comprises budget, Receipt, and payment accounts.

Government Fund

Government of India has following three types of Funds for marinating the records of all sorts of financial transactions −

- Consolidated Funds of India
- Contingency Funds of India
- Public Account

Let's discuss each of them succinctly −

Consolidated Funds of India

As per the Clause 1 of the Article 266 of the Indian Constitution −

"All revenues received by the Government by way of taxes like Income Tax, Central Excise, Customs and other receipts flowing to the Government in connection with the conduct of Government business i.e. Non-Tax Revenues are credited into the Consolidated Fund constituted. Similarly, all loans raised by the Government by issue of Public notifications, treasury bills (internal debt) and loans obtained from foreign governments and international institutions (external debt) are credited into this fund. All expenditure of the government is incurred from this fund and no amount can be withdrawn from the Fund without authorization from the Parliament."

Contingency Funds of India

As per the Article 267 of the Indian Constitution −

"The Contingency Fund of India records the transactions connected with Contingency Fund set by the Government of India. The corpus of this fund is Rs. 50 crores. Advances from the fund are made for the purposes of meeting unforeseen expenditure which are resumed to the Fund to the full extent as soon as Parliament authorizes additional expenditure. Thus, this fund acts more or less like an imprest account of Government of India and is held on behalf of President by the Secretary to the Government of India, Ministry of Finance, and Department of Economic Affairs."

Public Account

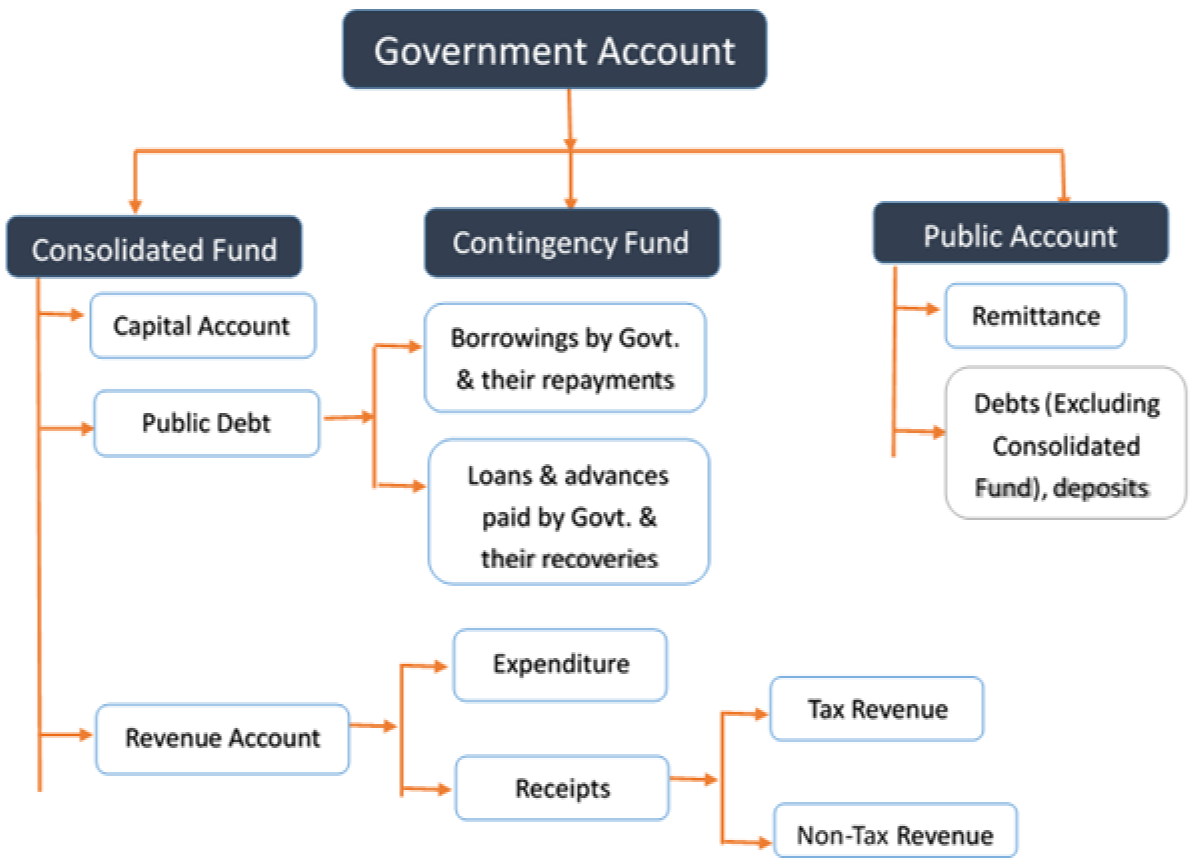
The Public Account is constituted under Clause 2 of Article 267 of the Indian Constitution, which says −

"The transactions relate to debt other than those included in the Consolidated Fund of India. The transactions under Debt, Deposits and Advances in this part are those in respect of which Government incurs a liability to repay the money received or has a claim to recover the amounts paid. The transactions relating to 'Remittance' and `Suspense' shall embrace all adjusting heads. The initial debits or credits to these heads will be cleared eventually by corresponding receipts or payments. The receipts under Public Account do not constitute normal receipts of Government. Parliamentary authorization for payments from the Public Account is therefore not required."

Similarly, all 29 states of India has the same structure as described above.

General Structure of Government Accounts

The general structure of the government accounts is illustrated below −



Compilation of Accounts

Treasury and other government departments, initially compile their receipt and payment accounts on monthly basis for central government and state government separately and then send to respective Accountant General of India.

Collection of revenue and disbursement are directly made by Railway, Defense, Post & Telegraphs, Forest, and public departments and lump sum payments are made by treasury through the departmental officers. Detail of accounts on monthly basis is maintained by the departmental Accounts officers.

Monthly accounts submitted by the treasury and account officer are compiled by the Accountant General, for the central government as a whole and for each state separately. The compiled report shows progressive figure of each month from 1st April to 31st March of every year. Complied accounts along with appropriation accounts are submitted by Comptroller and Auditor General of India to the President of India, to the Governor of each state, or to the Administrator of the Union Territory accordingly.

Principles of Government Accounting

- Charges or expenditure on a new project like constructions, new equipment, plant & machinery installation, maintenance, improvement, and service should be allocated to the capital account as per the rule made by competent authority.
- Working charges of the project should be allocated to the revenue account.
- In case of renewal and replacement and cost of the genuine replacement should be charged to capital account.
- In case of damage due to extraordinary calamities, charged should be debited from the capital account or revenue account or from both. However, it will be determined by the government according to the case and circumstances.
- Capital receipts during the new project should be credited to the capital account to reduce the capital expenditure of the project.