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Unit - 1

~~Introduction to Management~~

Introduction to Financial Accounting, Basic Concepts and Conventions

* Fundametal Accounting Assumptions:

- Going Concern: It is assumed that business shall continue for a foreseeable period and there is no intention to close the business or scale down its operations significantly. Due to this a distinction is made between capital and revenue expenditure, fixed assets are recorded at their original cost and depriciated systematically.

- Consistency: Accounting practices once selected and adopted should be applied consistently year after year which helps in better understanding, makes data comparable and eliminates personal bias.

- Accrual Assumption: A transaction is recorded in the books of account at the time when it is entered into and not when the settlement takes place. eg: Revenue is ~~realis~~ recognised when it is realised i.e. when sale is complete or services are rendered, it is immaterial whether cash is received or not.

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* Accounting Principles :

- **Business Entity :** Business is considered to be separate from its owners. Transactions are recorded in the books of account from the business point of view and not from that of the owners. Owners being regarded as separate from the business are considered as creditors of the business to the extent of their capital.

- **Money Measurement Principle :** Transactions and events that can be measured in money terms are recorded in the books of account of the enterprise.
  - Limitations : → events that cannot be measured in money terms are not recorded howsoever important they may be to the enterprise.

    → Value of money is considered to have static value.

- **Accounting Period :** The life of an enterprise is broken into smaller periods so that its performance is measured at regular interval. A business can opt for financial year or calander year as its accounting year/period

- Full Disclosure: There should be complete and understandable reporting on the financial statements of all significant information relating to the economic affairs of the entity. All material and significant information to be disclosed.

- Materiality: It refers to relative importance of an item or an event and only those items should be disclosed that have significant effect or are relevant to the user.

- Prudence/Conservatism: Do not anticipate profit but provide for all possible losses. It takes into consideration all prospective losses but not the prospective profits. It has a drawback as it may be used to ~~cr~~ create a Secret Reserve

- Dual Concept/Duality: Every transaction entered into by an enterprise has two aspects, a debit and a credit of equal amount.

* Some Terms:

- Liabilities: It means amount owed by the business liability towards the owners is internal whereas towards the outsiders is external.

- Non-Current: liability which is payable after a period of more than a year from the end of the accounting period.

- Current: liability which is payable within 12 months from the end of the accounting period.

- Assets: Properties owned by an entity or enterprise.

  - Non-Current: Assets which are held by an entity not with the purpose to resell but are held by the business either as investment or to facilitate business operations.

    - Fixed: Those non-current assets of an enterprise which are held not to resell but with the purpose to increase its earning capacity.

      - Tangible: Those assets which have physical existence.

      - Intangible: Those assets which do not have physical existence.

  - Current: Those assets which are held by an entity with the purpose of converting them into cash within a short period i.e one year

  - Fictitious: Those assets which are neither tangible nor intangible. They are losses not written off in the year in which they are incurred but in more than one accounting period.

- Receipts: Amount receivable or received for selling assets, goods or services.

- Revenue: Amount received or receivable against sale of goods or rendering of services or investment of business resources say in fixed deposit.

- Capital: Amount received or receivable against transactions which are not revenue in nature.

- Expenditure: Amount spent or liability incurred for acquiring assets, goods or services.

- Capital: expenditure incurred to acquire assets or improving the existing assets which will increase the earning capacity of the business

- Revenue: expenditure incurred, the benefit of which is consumed or exhausted within the accounting period.

- Deferred Revenue: Revenue expenditure in nature but is written off in more than one accounting period because it is estimated that benefit of such expenditure will accrue in more than one financial year.

- Revenue: Amount received or receivable by the enterprise from its operating activities

- Expense: Cost incurred for generating revenue.

- Accounting equation: mathematical expression which shows that the assets and liabilities of a firm are equal.

$$\text{Assets} = \text{Liabilities} + \text{Capital}$$

- IOC is an expense for business thus deducted from profit and income of owner, added to capital.

- IOD is profit for business added to profit and expense for owner, deducted from capital.

- IOC and IOD won't effect assets and liabilities

- Capital is increase/decreased by revenue/expense.

- Profit increases capital and loss decreases it.

$$\text{Income} = \text{Revenue} - \text{Expense}$$

- An increase in an asset, without a corresponding increase in liability or a corresponding decrease in another asset, means an increase in capital.

- Account: record of transactions under a particular head. It not only records the amount of transactions but also their effect and direction.

* Effect of Adjustment Transactions on Accounting Equation:

- Outstanding Expenses: subtract from capital and make a new column under liabilities.
- Prepaid Expenses: deduct from cash and make a new column under assets.
- Accrued Income: add in capital and make a new column under assets
- Unearned Income: add in cash and make a new column under liabilities

* Rules of Debit and Credit:

Classification of Accounts

- Personal
  - Natural
  - Artificial
  - Representative
- Impersonal
  - Real
  - Nominal

- Personal: Accounts which relate to persons i.e. individuals, firms, companies, debtors or creditors etc.

- Natural: persons who are creations of god.

- Artificial: accounts of corporate bodies or institutions which are recognised as persons in business dealings.

- Representative Personal : accounts which represent a certain person or a group of persons.

Debit the receiver, Credit the giver

- Impersonal : Accounts which are not personal i.e. machinery, cash etc.

- Real : accounts which relate to tangible or intangible assets excluding debtor

Debit what comes in, Credit what goes out

- Nominal : accounts which relate to expenses, losses, gains etc.

Debit all expenses and losses, Credit all incomes and gains.

* Journal : a book in which transactions are recorded in the order in which they are entered. Also called the book of original entry.

- In Expense A/c, even if the name of the party receiving or making payment is given, it is accounted as expense incurred in cash i.e. eg: salary paid to Mahesh

- Closing stock = Opening stock + purchases + Direct expenses - cost of goods sold.

Closing stock is valued at Cost or Market value whichever is less.

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* Discount and Rebate :

- Trade discount : discount allowed by the seller on purchase of goods in large quantity. It is not shown separately but directly deducted.

- Rebate : discount allowed for the reasons other than for which trade discount and cash discount are allowed.

- Cash discount : discount allowed to encourage early paymen

* Specific Entries

- Bad debts : Bad debts A/c Dr
  To Debtors A/c

- Bad debts recovered : Cash A/c Dr
  To Bad debts recovered

- Goods given as charity / donation : Charity / Donation A/c Dr
  To Purchases

- distribution of goods as samples : Samples A/c Dr
  To Purchases

- Loss of stock by theft / fire : Loss of stock by theft/fire A/c Dr
  To Purchases

- In case goods were insured and insurance claim is lodged:

Insurance Co. Dr
To Loss of stock by theft / fire

- when full amount of claim is received

Bank A/c Dr
To Insurance Co.

- when partial amount of claim is received:

Bank A/c Dr
loss of stock by theft or fire Dr
To Insurance Co.

- Expenditure on installation of machinery and on construction of building is added to the asset amount.

- Miscellaneous / sundry expenses:

Miscellaneous / sundry expenses A/c Dr
To Cash A/c

* **Adjustment Entries:**

- Closing stock: Closing Stock A/c Dr
To Trading A/c

- Outstanding Expenses: Expense A/c Dr
  To O/s Expense

- Prepaid Expense: Prepaid Expense A/c Dr
  To Expense A/c

- Accrued Income: Accrued Income A/c Dr
  To Income A/c

- Income received in advance: Income A/c Dr
  To Income received in advance

- Depriciation: Depriciation A/c Dr
  To Machinery

- IOC: IOC A/c Dr
  To Capital A/c

- IOD: Capital A/c Dr
  To IOD A/c

- Opening entry: first entry in journal to record closing balances of the previous year.

- Ledger: book which contains, in a summarised and classified form, a permanent record of all transactions. Also called the book of final entry.

- Compound journal entry: the entry in which two or more accounts are debited and one or more accounts are credited and vice versa.

- Format of ledger:

Ledger

------ A/c

Dr.							Cr.
Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹

- Opening entries are posted by writing balance b/d on the debit side for assets and credit side for liabilities.

- Trial Balance: statement which shows the balance in the accounts maintained in the ledger and cash book

- Format of Trial balance:

Trial Balance as on

Heads of Accounts	L.F.	Dr (₹)	Cr (₹)

- Closing stock does not appear in trial balance but given as adjustment and written on credit side of trial balance and posted as asset in balance sheet. If closing stock appears only in the debit column, then it will only be posted as asset in balance sheet.

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* GST : comprehensive indirect tax levied at the prescribed rate each time the sale is made.

- Intra - State Sale : CGST and SGST

- Inter - State sale : IGST (Integrate GST)

- GST is levied on net value i.e. after discounts.

- GST collected by the seller is output gst and gst paid by the buyer is input gst.

- Reverse Charge : GST is not charged by seller but directly paid by purchaser to the government.

- Goods and services that are subject to GST under Reverse charge are:
  - Purchasing from unregistered taxpayer
  - payment of fee to lawyers
  - payment of fee outside india
  - payment for use of copyright

- If input credit of GST paid is not allowed, it is treated as expense and is debited to expense or asset account.

Business Promotion Expense A/c Dr
To Cash A/c

- Reverse charge : Professional Fee A/c Dr
To Cash A/c

Input CGST A/c Dr
Input SGST A/c Dr
To Cash

- Depreciation: fall in the value of tangible fixed asset due to its usage or with efflux of time or due to obsolescence or accident.

- When rate of depreciation is given with the words per annum and:

  - date is given: depreciation is charged for the given period
  - date not given: depreciation is charged for full year

- when rate is given without words per annum, depreciation is charged for full year