

BRANCHES OF ACCOUNTING

The changing business scenario over the centuries gave rise to specialized branches of accounting which could cater to the changing requirements. The branches of accounting are;

- i) Financial accounting;
- ii) Cost accounting; and
- iii) Management accounting.

Financial Accounting

Financial accounting may be defined as the science and art of recording and classifying business transactions and preparing summaries of the same for determining year and profit and loss and the financial position of the concern.

Functions of Financial Accounting

1. Recording information
2. Classification of data
3. Making Summaries
4. Dealing with financial transaction
5. Interpreting financial information
6. Communicating results

7. Making Information more reliable

Limitations of Financial Accounting

1. Historical Nature
2. Provides information about the concern as a whole
3. Not helpful in price fixation
4. Cost control not possible
5. Appraisal of Policies not possible
6. Only actual costs recorded
7. Not helpful in taking strategic decision
8. Changes of manipulations

Cost Accounting

Cost Accounting is the classifying, recording and appropriate allocation of expenditure for the determination of the cost of products or services and for the presentation of suitably arranged data for purpose of control and guidance management

Scope of cost accounting

Cost Ascertainment
Cost Accounting

Cost Control

Advantages of Cost Accounting

1. Profitable and unprofitable activities are disclosed.
2. It enables a concern to measure the efficiency and then to maintain and improve it.
3. It provides information upon which estimates and tenders are based.
4. It guides future production policies
5. It helps in increasing profits
6. It enables a periodical determination of Profit and loss.
7. Helpful to the government
8. Helpful to consumers
9. Efficiency of public enterprises

Financial Accounting Vs Cost Accounting

- Purpose
- Formsofaccounting (CompaniesAct.)
- Recording(Natureofexp.)
- Control
- Periodicityofreporting
- Analysisofprofits
- Reportingofcosts
- Natureoftransaction(commercialtransaction)
- Information(Monetary&Nonmonetary)
- Fixationofsellingprice
- Figures(Actual&Estimateddata)
- Reference(Companylawboard)
- RelativeEfficiency

ManagementAccounting

Itisstudyaboutmanagerialaspectofaccounting“Managementaccountingisconcernedwiththe accountinginformationthat isusefultomanagement”

Characteristics–ManagementAccounting

1. ProvidingAccountingInformation
2. CauseandeffectAnalysis
3. Useofspecialtechniquesandconcepts
4. Takingimportantdecision
5. Achievingofobjectives
6. Nofixednormsfollowed
7. Increaseinefficiency
8. Supplies informationarenotdecision
9. Concernedwithforecasting

Objectives–ManagementAccounting

1. Planningandpolicyformulation
2. Helpfulincontrollingperformance
3. Helpfulinorganizing

4. Helpful in interpretation of financial statements
5. Motivating employees
6. Helps in making decisions
7. Helpful in co-ordination
8. Report to management
9. Tax Administration

Management Accounting Vs Financial Accounting

- Object
- Nature (Historical)
- Subject Matter (Whole business)
- Compulsion
- Precision (figures)
- Reporting (outsiders)
- Description (Monetary & non-monetary)
- Quickness
- Accounting principles
- Period
- Publication
- Audit **ACCOUNTING**

JOURNAL AND LEDGER INTRODUCTION

When the business transactions take place, the first step is to record the same in the books of original entry or subsidiary books or books of prime or journal. Thus journal is a simple book of accounts in which all the business transactions are originally recorded in chronological order and from which they are posted to the ledger accounts at any convenient time. Journalising refers to the act of recording each transaction in the journal and the form in which it is recorded, is known as a journal entry.

ADVANTAGES OF JOURNAL

The following are the inherent advantages of using journal, though the transactions can also be directly recorded in the respective ledger accounts;

1. As all the transactions are entered in the journal chronologically, a date wise record can easily be maintained;
2. All the necessary information and the required explanations regarding all transactions can be obtained from the journal; and
3. Errors can be easily located and prevented by the use of journal or book of prime entry.

The specimen journal is as follows:

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
1	2	3	4	5
			-	-

The journal has five columns, viz. (1) Date; (2) Particulars; (3) Ledger Folio; (4) Amount (Debit); and (5) Amount (Credit) and a brief explanation of the transaction by way of narration is given after passing the journal entry.

(1) **Date:** In each page of the journal at the top of the date column, the year is written and in the next line, month and date of the first entry are written. The year and month need not be repeated until a new page is begun or the month or the year changes. Thus, in this column, the date on which the transaction takes place is alone written.

(2) **Particulars:** In this column, the details regarding account titles and description are recorded. The name of the account to be debited is entered first at the extreme left of the particulars column next to the date and the abbreviation 'Dr.' is written at the right extreme of the same column in the same line. The name of the account to be credited is entered in the next line preceded by the word "To" leaving a few spaces away from the extreme left of the particulars column. In the next line immediately to the account credited, a short about the transaction is given which is known as "Narration". "Narration" may include particulars required to identify and understand the transaction and should be adequate enough to explain the transaction. It usually starts with the word "Being" which means what it is and is written within parentheses. The use of the word "Being" is completely dispense with, in modern parlance. To indicate the completion of the entry for a transaction, a line is usually drawn all through the

particulars column.

(3) **Ledger Folio:** This column is meant to record the reference of the main book, i.e., ledger and is not filled in when the transactions are recorded in the journal. The page number of the ledger in which the accounts are appearing is indicated in this column, while the debits and credits are posted to the ledger accounts.

(4) **Amount (Debit):** The amount to be debited along with its unit of measurement at the top of this column on each page is written against the account debited.

(5) **Amount (Credit):** The amount to be credited along with its unit of measurement at the top of this column on each page is written against the account credited.

SUB-DIVISION OF JOURNAL

When innumerable number of transactions takes place, the journal, as the sole book of the original entry becomes inadequate. Thus, the number and the number and type of journals required are determined by the nature of operations and the volume of transactions in a particular business. There are many types of journals and the following are the important ones:

1. Sales Day Book - to record all credit sales.
2. Purchases Day Book - to record all credit purchases.
3. Cash Book - to record all cash transactions of receipts as well as payments.
4. Sales Returns Day Book - to record the return of goods sold to customers on credit.
5. Purchases Returns Day Book - to record the return of goods purchased from suppliers on credit.
6. Bills Receivable Book - to record the details of all the bills received.
7. Bills Payable Book - to record the details of all the bills accepted.
8. Journal Proper -

to record all residual transactions which do not find place in any of the aforementioned books of original entry.

LEDGER

Ledger is a main book of account in which various accounts of personal, real and nominal nature, are opened and maintained. In journal, as all the business transactions are recorded chronologically, it is very difficult to obtain all the transactions pertaining to one head of account together at one place. But, the preparation of different ledger accounts helps to get a consolidated picture of the transactions pertaining to one ledger account at a time. Thus, a ledger account may be defined as a summary statement of all the transactions relating to a person, asset,

expense, or income or gain or loss which have taken place during a specified period and show their net effect ultimately. From the above definition, it is clear that when transactions take place, they are first entered in the journal and subsequently posted to the concerned accounts in the ledger. Posting refers to the process of entering in the ledger the information given in the journal. In the past, the ledgers were kept in bound books. But with the passage of time, they became loose-leaf ones and the advantages of these are in the removal of completed accounts, insertion of new accounts and arrangement of accounts in any required manner.

Ruling of ledger account

The ruling of a ledger account is as follows:

Type- 1

Date	Particulars	J.F.	Dr. Rs.	Cr. Rs.	Dr./Cr.	Balance Rs.
	To name of the account to be credited				By name of the account to be debited	

Type- 2

Dr. Cr.

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
	To name of the account to be credited				By name of the account to be debited		

Ledger Account Type 1 is followed in almost all the business concerns, whereas Type 2 is followed only in banking institutions to save space, time and clerical work involved.

Sub-division of ledger

In a big business, the number of accounts is numerous and it is found necessary to maintain a separate ledger for customers, suppliers and for others. Usually, the following three types of ledgers are maintained in such big business concerns.

(i) Debtors' Ledger: It contains accounts of all customers to whom goods have been sold on credit. From the Sales Day Book, Sales Returns Book and Cash Book, the entries are made in this ledger. This ledger is also known as sales ledger.

(ii) Creditors' Ledger: It contains accounts of all suppliers from whom goods have been bought on credit. From the Purchases Day Book, Purchases Returns Book and Cash Book, the

entries are made in this ledger. This ledger is also known as Purchase Ledger.

(iii) General Ledger: It contains all the residual accounts of real and nominal nature. It is also known as Nominal Ledger.

Distinction between journal and ledger

- (i) Journal is a book of prime entry, whereas ledger is a book of final entry.
- (ii) Transactions are recorded daily in the journal, whereas posting in the ledger is made periodically.
- (iii) In the journal, information about a particular account is not found at one place, whereas in the ledger information about a particular account is found at one place only.
- (iv) Recording of transactions in the journal is called journalizing and recording of transactions in the ledger is called posting.
- (v) A journal entry shows both the aspects debit as well as credit but each entry in the ledger shows only one aspect.
- (vi) Narration is written after each entry in the journal but no narration is given in the ledger.
- (vii) Vouchers, receipts, debit notes, credit notes etc., from the basic documents form journal entry, whereas journal constitutes basic record for ledger entries.

DISCOUNTS

Trade discount

When a customer buys goods regularly or buys large quantity or buys for a large amount, the seller is usually inclined to allow a concession in price. He will calculate the total price according to the list or catalogue. But after the total is arrived at, he will make a deduction 5% or 10% depending upon his business policy. This deduction is known as Trade discount.

Cash Discount

An amount which is allowed for the prompt settlement of debt arising out of a sale within a specified time and calculated on a percentage basis is known as cash discount, i.e., it is always associated with actual payment.

Difference between Trade Discount and Cash Discount Trade discount

- i. It is given by the manufacturer or the wholesaler to a retailer and not to others.
- ii. It is allowed on a certain quantity being purchased.

- iii. It is a reduction in the catalogue price of an article.
- iv. It is not usually accounted for in the books since the net amount (i.e. after deducting discount) is shown.
- v. It is allowed only when there is a sale either cash or credit.
- vi. It is usually given at the same rate which is applicable to all customers.
- vii. It is allowed or not allowed according to sales policy followed by a business concern.

Cash discount

- i. It may be allowed by seller to any debtor.
- ii. It is allowed on payment being made before a certain date.
- iii. It is a reduction in the amount due by a debtor.
- iv. This discount must have to be accounted for in the books since it is deducted from the gross selling price.
- v. It is allowed only when there is cash receipt or cash payment including cheques.
- vi. It varies from customer to customer depending on the time and period of payment.
- vii. It is allowed only on condition. The dues should be paid within the stipulated time. If not, the debtor is not eligible for cash discount.

TRIAL

BALANCE INTRODUCTION

ION

According to the dual aspect concept, the total of debit balance must be equal to the credit balance. It is a must that the correctness of posting to the ledger accounts and their balances be verified. This is done by preparing a trail balance.

MEANING AND DEFINITION

Meaning

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 amounts

of the trial balance are equal, it is assumed that the posting to the ledger in terms of debit and credit amounts is accurate. The agreement of a trail balance ensures

arithmetical accuracy only, a concern can prepare trail balance at any time, but its preparation as on the closing date of an accounting year is compulsory.

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.

FEATURES OF TRAIL BALANCES

The following are the important features of a trail balance:

- (i) A trail balance is prepared as on a specified date.
- (ii) It contains a list of all ledger accounts including cash account.
- (iii) It may be prepared with the balances or total of ledger accounts.
- (iv) Total of the debit and credit amount columns of the trail balance must tally.
- (v) If the debit and credit amounts are equal, we assume that ledger accounts are arithmetically accurate.
- (vi) Difference in the debit and credit columns points out that some mistakes have been committed.
- (vii) Tallying of trail balance is not a conclusive proof of accuracy of accounts.

LIMITATIONS OF TRAIL BALANCE

The following are the important limitations of trail balances:

- (i) The trail balance can be prepared only in those concerns where double entry system of

book-keeping is adopted. This system is too costly.

- (ii) A trail balance is not a conclusive proof of the arithmetical accuracy of the books of account. If the trail balance agrees, it does not mean that now there are absolutely no errors in books. On the other hand, some errors are not disclosed by the trail balance.
- (iii) If the trail balance is wrong, the subsequent preparation of Trading, P&L Account and Balance Sheet will not reflect the true picture of the concern.

METHODS OF PREPARING TRAIL BALANCE

A trail balance refers to a list of the ledger balances as on a particular date. It can be prepared in the following manner:

Total Method

According to this method, debit total and credit total of each account of ledger are recorded in the trail balance.

Balance Method

According to this method, only balance of each account of ledger is recorded in trail balance. Some accounts may have debit balance and the other may have credit balance. All these debit and credit balances are recorded in it. This method is widely used.

Ruling of a trail balance:

The following is the form of a trail balance Method I: Total Method

Books Trail Balance as on.....

S.No.	Name of Account	L.F	Debit Total Amount Rs.	Credit Total Account Rs.

Method II: Balance Method:

Books Trail Balance as on

S.No.	Name of Account	L.F	Debit balance Rs.	Credit balance Rs.

Note: Accounts of all assets, expenses, losses and drawings are debit balances. Accounts of

incomes, gains, liabilities and capital are credit balances.

Trial balance discloses some of the errors and does not disclose some other errors.

This is given below.

- A) Trial Balance disclosed by the Errors
 - i) Wrong totaling of subsidiary books
 - ii) Posting of an amount on the wrong side
 - iii) Omission to post an amount into ledger
 - iv) Double posting or omission of posting
 - v) Posting wrong amount
 - vi) Error in balancing
- B) Trial Balance not disclosed by the Errors
 - i) Error of principle
 - ii) Error of omission
 - iii) Error of Commission
 - iv) Recording wrong amount in the books for original entry
 - v) Compensating errors

TRADING ACCOUNT

INTRODUCTION

Trading account is prepared for an accounting period to find the trading results or gross margin of the business i.e., the amount of gross profit the concern has made from buying and selling during the accounting period. The difference between the sales and cost of sales is gross profit. For the purpose of computing cost of sales, value of opening stock of finished goods, purchases, direct expenses on purchasing and manufacturing are added up and closing stock of finished goods is reduced. The balance of this account shows gross profit or loss which is transferred to the profit and loss account.

PREPARATION OF TRADING ACCOUNT

Trading account is a ledger account. It has to be prepared in conformity with double entry principles of debit and credit.

Items shown in trading account:

(A) Debit side

i) **Opening stock:** The stock at the beginning of an accounting period is called opening stock. This is the closing stock as per the last balance sheet. It includes stock of raw materials, work in progress, (where manufacturing account is not separately prepared) and finished goods. Trading account starts with opening stock on the debit side.

ii) **Purchases:** The total value of goods purchased after deducting purchase returns is debited to trading a/c. Purchases comprise of cash purchases and credit purchases.

iii) **Direct expenses:** Direct expenses are incurred to make the goods sale able. They include wages, carriage and freight on purchases, import duty, customs duty, clearing and forwarding charges manufacturing expenses or factor. Expenses (where manufacturing account is not separately prepared). All direct expenses are extracted from trial balance.

Items shown in trading account:

(B) Credit side:

i) **Sales:** It includes both credit and cash sales. Sales returns are reduced from sales and net sales are shown on the credit side of trading account. The sales and returns are extracted from the trial balance.

ii) **Closing stock:** Closing stock is the value of goods remaining at the end of the accounting period. It includes closing stock of raw materials, work progress (where manufacturing account is not separately prepared) and finished stock. The opening stock is ascertained from trial balance but closing stock is not a part of ledger. It is separately valued and given as an adjustment. If it is given in trial balance, it is after adjustment of opening and closing stocks in purchases. If closing stock is given in trial balance it is shown only as current asset in balance sheet. If closing stock is given outside trial balance, it is shown on credit side of trading account and also as current asset in the balance sheet

CLOSING ENTRIES RELATING TO TRADING ACCOUNT

The Journal entries given below are passed to transfer the relevant ledger account balances to trading account.

(i) For opening stock, purchases and direct expenses.

Trading A/c	Dr	xxx	
To Opening Stock A/c			xxx
			xxxxxx

To Purchases (Net) A/c To Direct expenses

A/c

[Being transfer of trading a/c debits side items]

(ii) For transfer of sales (after reducing sales returns)

Sales (net) A/c Dr Xxx

To Trading A/c xxx

[Being transfer of sales to Trading A/c]

(iii) For transferring gross profit

Trading A/c Dr xxx

To Profit & Loss A/c xxx

[Being transfer of gross profit to P&LA/c]

(iv) For Gross Loss

Profit & Loss A/c Dr xxx

To Trading A/c xxx

[Being transfer of gross loss to P&LA/c]

Note: Closing stock is taken into account by an adjustment journal entry along with other adjustments.

ASPECIMEN OF TRADING ACCOUNT IS SHOWN BELOW Trading account for the year ended

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Opening stock		xxx	By Sales	Xxx	
To purchases	Xxx		Less: Returns inwards		
			(or)		
			Sales Returns	xxx	
Less: purchaser returns	Xxx	xxx			xxx
To Direct expenses:					
Wages		xxx	By closing stock		

Fuel&Power		xxx	ByGrossloss/d *		xxx
Carriage inwards		xxx	(transferredtoprofit		xxx
			andlossA/c)		
Royaltyonproduction		xxx			
Power		xxx			
Coalwater, Gas		xxx			
Importduty		xxx			
Consumablestores		xxx			
Factoryexpenses		xxx			
ToGrossprofit/d		xxx			
(transferredtoprofit and					
lossA/c)					
*BalancingfigurewillbeeithergrossprofitforlossinTradingA/c					

PROFITANDLOSSACCOUNTINTRO

DUCTIONS

Profit and loss account is prepared to ascertain the net profit of the business concern foranaccountingperiod

DEFINITION

In the words of Prof. Carter “Profit and loss account is an account into which all gainsandlossesarecollectedinordertoascertaintheexcessofgainsover thelossesor viceversa.”

PREPARATIONOFPROFITANDLOSSACCOUNT

Profit and loss account starts with gross profit brought down from trading account onthe credit side. (If gross loss, on the debit side). All the indirect expenses are debited and all therevenueincomesarecreditedto theprofitandlossaccountand thennetprofitfor lossiscalculated. If incomes or creditis more, than the expenses or debit, the difference is net profit. Ontheotherhandiftheexpensesordebitsideismore,thedifferenceisnetloss.

Debitside:

Expensesshownonthedebitsideofprofitandlossaccountareclassifiedintotwocategories

1. Operatingexpensesand
2. Nonoperatingexpenses

- (1) **Operating expenses:** These expenses are incurred to operate the business efficiently. They are incurred in running the organisation. Operating expenses include administration, selling, distribution, finance, depreciation and maintenance expenses.
- (2) **Nonoperating expenses:** These expenses are not directly associated with day-to-day operations of the business concern. They include losses on sale of assets, extraordinary losses, etc.

Creditside

Gross profit is the first item appearing on the credit side of profit and loss account. Other revenue incomes also appear on the credit side of profit and loss account. The other incomes are classified as operating incomes and nonoperating incomes.

(1) **Operating incomes:** These incomes are incidental to business and earned from usual business carried on by the concern. Examples: discount received, commission earned, interest received etc.

(2) **Non operating incomes:** These incomes are not related to the business carried on by the firm. Examples are profit on sale of fixed assets, refund of tax etc.

CLOSING ENTRIES FOR PROFIT AND LOSS ACCOUNT

1. For transferring expenses to profit and loss account:

Profit and Loss A/c	Dr	xxx	
To expenses A/c			xxx

[Being transfer of all P&L A/c debit side items]

2. For transfer of incomes to profit and loss account

Incomes A/c	Dr	xxx	
To Profit and Loss A/c			xxx

[Being transfer of Incomes to P&L A/c]

3. For net profit:

P&L A/c	Dr	xxx	
To Capital A/c			xxx

[Being net profit credited to capital]

4. For transfer of Net Loss

Capital A/c	Dr	xxx	
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To P&L A/c

xxx

[Being net loss transferred to capital]

Note: In case of partnership, the profit or loss is divided between partners in their profit sharing ratio and credited or debited to the individual partners. In case of limited companies, Net profit or loss is transferred to the P&L Appropriation A/c for disposal.

THE SPECIMEN OF PROFIT AND LOSS ACCOUNT IS SHOWN BELOW

Profit and Loss Account

For the year ended 31st March 2001

Particulars	Rs.	Particulars	Rs.
To Gross loss b/d	xxx	By Gross profit b/d	xxx
To Administration expenses		By Dividends received	xxx
Salaries	xxx	By Interest received	xxx
Rent rates & taxes	xxx	By Discount received	xxx
Printing & Stationery	xxx	By Commission received	xxx
Postage and Telegrams	xxx	By Rent received	xxx
Telephone expenses	xxx	By Profit on sale of assets	xxx
Legal charges	xxx	By Sundry revenue receipts	xxx
Insurance	xxx	By Net loss transferred to capital A/c (Bal. Fig)*	xxx
Audit fees	xxx		
Directors fees	xxx		
General expenses	xxx		
To Selling & Distribution Expenses			
Show room expenses	xxx		
Advertising	xxx		
Commission paid to salesmen	xxx		
Bad debts	xxx		
Provision for doubtful debts	xxx		
Godown rent	xxx		
Carriage outward	xxx		

Upkeep of delivery vans	xxx		
To Depreciation and maintenance			
Depreciation	xxx		
To Financial expenses			
Interest on borrowings	xxx		
Discount allowed	xxx		
To abnormal losses			
Loss on sale of assets	xxx		
To Net profit transferred to capital	xxx		
A/c (bal. fig)			
	xxx		xxx
Note: *Either net profit or net loss	ie balancing figure in P&L A/c		

The purpose and importance of preparing profit and loss account.

To determine the future line of action To know the net profit or loss of business To calculate different ratios. To compare the actual performance of the business with the desired one.

PRINCIPLES OF PREPARING PROFIT OF LOSS ACCOUNT

1. Only revenue receipts should be entered
2. Only revenue expenses together with losses should be taken into account.
3. Expenses and incomes relating only to the period for which the accounts are being prepared should be considered.
4. All expenses and income relating to the period concerned should be considered even if the expense has not yet been paid in cash or the income has not yet been received in cash.
5. All personal expenses of the proprietor and partners must be debited to the capital or drawings accounts and must not be debited to the profit and loss account. Similarly any income has been earned from the private asset of the proprietor which is received by firm; it must be credited to the capital or drawings account.

BALANCE SHEET

The Balance sheet comprises of lists of assets, liabilities and capital fund on a given date. It presents the financial position of a concern as revealed by the accounting records. It reflects the assets owned by the concern and the sources of funds used in the acquisition of those assets. In simple language it is prepared in such a way that true financial position is revealed in a form easily readable and more rapidly understood than would be possible from a view of the detailed information contained in the accounting records prepared during the currency of the accounting period. Balance sheet may be called a 'statement of equality' in which equality is established by representing values of assets on one side and values of liabilities and owners' funds on the other side.

TITLE

A balance sheet is called by different names probably due to lack of uniformity in accounting systems. Generally, the following titles are used in respect of balance sheet:

- (i) Balance sheet or General Balance sheet;
- (ii) Statement of Financial position or condition;
- (iii) Statement of assets and liabilities;
- (iv) Statement of assets and liabilities and owners' fund etc.

Of the above, the title 'Balance sheet' is mostly used. The use of this title implies that data presented in it have been taken from the balances of accounts,

DEFINITIONS OF BALANCE SHEET:

"Balance sheet is a 'Classified summary' of the ledger balances remaining after closing all revenue items into the profit and loss account." - Cropper.

"Balance sheet is a screen picture of the financial position of a going business concern at a certain moment" - Francis.

CLASSIFICATION OF ASSETS AND LIABILITIES

A clear and correct understanding of the basic divisions of the assets and liabilities and the meanings which they signify and the amounts which they represent is very essential for a proper perspective of financial position of a business concern. Assets and liabilities are classified under the following major headings.

Assets:

Assets are properties of business. They are classified on the basis of their nature.

Different types of assets are as under:

- (i) **Fixed assets:** Fixed assets are the assets which are acquired and held permanently and used in the business with the objective of making profits. Land and building, Plant and machinery, Furniture and Fixtures are examples of fixed assets.
- (ii) **Current assets:** The assets of the business in the form of cash, debtors bank balances, bill receivable and stock are called current assets as they can be realised within an operating cycle of one year to discharge liabilities.
- (iii) **Tangible assets:** Tangible assets have definite physical shape or identity and existence; they can be seen, felt and have volume such as land, cash, stock etc. Thus tangible assets can be both fixed assets and current assets.
- (iv) **Intangible assets:** The assets which have no physical shape which cannot be seen or felt but have value are called intangible assets. Goodwill, patents, trade marks and licences are examples of intangible assets. They are usually classified under fixed assets.
- (v) **Fictitious assets:** Fictitious assets are not real assets. Past accumulated losses or expenses which are capitalised for the time being, expenses for promotion of Organisations (preliminary expenses), discount on issue of shares, debit balance of profit and loss account etc. are the examples of fictitious assets.
- (vi) **Wasting assets:** These assets are also called depleting assets. Assets such as mines, Timber forests, quarries etc. which become exhausted in value by way of excavation of the minerals, cutting of wood etc. are known as wasting assets. Such assets are usually natural resources with physical limitations.
- (vii) **Contingent assets:** Contingent assets are assets, the existence, value or possession of which is based on happening or otherwise of specific events. For example, if a business firm has filed a suit for a particular property now in possession of other persons, the firm will get the property if the suit is decided in its favour. Till the suit is decided, it is a contingent asset.

Liabilities

A liability is an amount which a business firm is 'liable to pay' legally. All the amounts which are claims by outsiders on the asset of the business are known as liabilities. They are

credit balances in the ledger. Liabilities are reclassified into burcategories as given below.

- (1) **Owner's capital:** Capital is the amount contributed by the owners of the business. In addition to initial capital introduced, proprietors may introduce additional capital and withdraw some amounts from business over a period of time. Owner's capital is also called 'net worth. Net worth is the total fund of proprietors on a particular date. It consists of capital, profits and interest on capital subject to reduction of drawings and interest on drawings.

In case of limited companies, capital refers to capital subscribed by shareholders. Net worth refers to paid up equity capital plus reserves and profits, minus losses.

- (2) **Long term Liabilities:** Liabilities repayable after specific duration of long period of time are called long term liabilities. They do not become due for payment in the ordinary 'operating cycle' of business or within a short period of time. Examples are long term loans and debentures. Long term liabilities may be secured or unsecured, though usually they are secured.

- (3) **Current liabilities:** Liabilities which are repayable during the operating cycle of business, usually within a year, are called short term liabilities or current liabilities. They are paid out of current assets or by the creation of other current liabilities. Examples of current liabilities are trade creditors, bills payable, outstanding expenses, bank overdraft, taxes payable and dividends payable.

- (4) **Contingent liabilities:** Contingent liabilities will result into liabilities only if certain events happen. Examples are:

Bills discounted and endorsed which may be dishonoured, unpaid calls on investments.

PRFORMA OF BALANCE SHEET

Balance Sheet as on.....

Liabilities		Rs.	Assets	Rs.
Capital	xxx		Fixed assets	xxx
Add: Net profit	xxx		Goodwill	xxx
Add: Interest on capital	xxx		Land & Buildings	xxx
			Loose tools	xxx
Less: Drawing	xxx		Furniture & fixtures	xxx

Less: Int. on drawings	xxx		Vehicles	xxx
Less: Loss if any	xxx		Patents	xxx
		xxx	Trademarks	xxx
Long term liabilities			Long term loans (advances)	xxx
Loan on mortgage		xxx	Investments	Current assets
Bank loan		xxx	Closing stock	xxx
Current liabilities			Sundry debtors	xxx
Sundry creditors		xxx	Bills receivable	xxx
Bills payable		xxx	Prepaid expenses	xxx
Bank overdraft		xxx	Accrued incomes	xxx
Creditors for outstanding exp.		xxx	Cash at bank	xxx
Income received in advance		xxx	Cash in hand	Fictitious assets
			Preliminary expenses	Advertisement expenses
			Underwriting commission	Discount on issue of shares
			Discount on issue of debentures	
	xxx			xxx

Adjustments

1. Bad Debts

In order to display high amount of sales figures, goods are frequently sold out to known customers on credit. Some of these customers fail to pay their debts due to insolvency. These debts, which cannot be recovered, are called Bad Debts. It is a loss to the business and an adjustment is needed. The required entry will be:

Bad Debts A/c Dr

At first, calculate the amount of provision to be created at the end of the period in the same way as above. Now compare the provision with the provision appearing in the Trial Balance. There are two resultant options:

If the new provision exceeds the provision appearing in the Trial Balance, pass the following entry:

Profit & Loss Account

Dr.

To Provision for Bad Debts

If the new provision is less than the provision appearing in the Trial Balance, pass the following entry:

Provision for Bad Debts

Dr. To Profit & Loss Account

Here, it should be noted that only new provision should be shown in the Balance Sheet as a deduction from Sundry Debtors.

3. Provision for Discount on Debtors

Many business organisations offer to give a cash discount to all those debtors who arrange to make their payment on or before the due date. It is clear that the real worth of debtors will be the gross figure of debtors minus the cash discount that they would be given. The figure of debtors should be accordingly adjusted.

The difficulty, however, is that nobody knows how many debtors will entertain cash discount and what the amount will be. Therefore, all that is possible is to make a rough estimate. Usually, it is made at a percentage of outstanding debtors who actually repay their obligation. Therefore, the estimate amount of bad debt should be deducted from the total of debtors and provision for discount on debtors should be made only on the balance.

Profit & Loss Account

Dr.

To Provision for discount on Debtors Account (To be shown in the Balance Sheet by way of deduction from Sundry debtors)

4. Reserve for discount on Creditors

If goods are purchased on credit and cash is paid to creditors in time, creditors allow cash discount. It is considered to be the income of the business. For this, following entries are passed:

Creditors Account

Dr.

To bank Account

To Discount Account

Discount

Received

Account Dr. To Profit & Loss Account

At the end of the accounting year, we may expect certain discount out of such creditors. However, that discount will be received in the next year though it is actually related to the current period. An adjustment is requested for the expected discount from creditors that should be reflected in the accounts at the year-end as follows:

Step 1

Calculate probable amount of discount to be received from creditors. Generally, it is calculated by applying a percentage on outstanding creditors.

Step 2

Pass the following entry to record it:

Reserve for Discount on Creditors Account Dr. Profit & Loss Account

unt

Step 3

To Assets Account (Being depreciation charged) Profit & Loss Account Dr.

To Depreciation Account (Being depreciation transferred to profit & Loss Account) When assets account is maintained at cost price:

Depreciation Account Dr.

To Provision for Depreciation Account (Being depreciation charged) Profit & Loss Account Dr.

To Depreciation Account (Being depreciation transferred to profit & Loss Account)

Total accumulated depreciation is shown in the Balance Sheet liability side. Alternatively, it can be shown by way of deduction from the original cost of assets side. Here, it should be noted that no adjustment is required for depreciation that already appears in the Trial Balance. Depreciation that already appears in the Trial Balance should only be debited to Profit & Loss Account.

6. Goods Distributed as Free samples:

This is one kind of advertisement. When goods are distributed to the prospective customers as free samples, an expense is incurred (known as advertisement expense) and there is a usual reduction from the stock of goods. The following entry is passed:

Advertisement Account Dr.

To Purchase Account (For trader)

7. Drawing Made by the Proprietors

Drawing made by the proprietor(s) may be in cash or in kind. Drawing relates to the resources of the business and the capital of the owner(s).

Drawings made in Cash: In this case, following entries are passed: Drawings Account Dr.

To Cash/Bank Account Capital Account Dr.

To Drawings Account

If the drawings made by the owner are incorporated in sales, we are to pass a reverse entry to cancel the original entry. For the drawings, the above two entries are to be passed:

8. Interest on Capital

Sometimes, it may be required to make a provision for interest on the capital contributed by the proprietor or the partner. Such interest is not a charge against profit but an appropriation of profit. In this connection, the following two entries have to be passed:

Profit & Loss Appropriation Account Dr.

To Interest on Capital Account (Being interest on capital payable)

Interest on Capital Account Dr.

To Capital/Current Account

(Being interest on capital transferred to Capital/Current Account)

9. Interest on Drawings

Sometimes, interest on drawing may be charged to restrict the frequent drawings by the partners. Such interest increases the divisible profit. The following two entries have to be passed:

Capital/Current Account

Dr.

To Interest on Drawing Account

(Being interest on drawing transferred to Capital/Current Account)

Interest on Drawings Account Dr.

To Profit and Loss Appropriation

Account (Being interest on drawings charged)