Introduction to Financial Accounting

Meaning & Scope of Accounting

Everyone performs some economic activity i.e. there are some receipts and there are some payments. Receipts are the income that one earns on periodical/daily basis. Expenditure are the expenses that one incurs on daily basis. The net amount after adjusting the Income & Expenses is called surplus or deficit. If the income is more than expenses, it is called surplus and vice versa is deficit. The economic activity is performed through a transaction or series of transactions and events. Such economic activity performed are recorded. Accounting measures the economic activity through various means & methods which are useful in decision making process.

The growth in accounting is associated with the expansion of commerce across the globe. Accounting involves recording & communication of financial information for decision making. Hence the Accounting refers the Language of Business.

Accounting Definition by American Institute of Certified public Accountant – Accounting is defined as an art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character, and interpreting the result thereof."

Detailed Accounting Definition:

Components of Accounting	Meaning
Recording	This is a basic function of Accounting. All business transactions are evidence by some document. Based on the document, the recording is done by passing a Journal entry
Classification	Grouping of transactions of same nature under single head. The book containing classified information is called as Ledger.
Summarizing	Summarizing means preparation and presentation of classified data in a manner which are useful for internal & external users. This process leads to preparation of Trail Balance, Profit & Loss Account, Balance sheet and cash flow statements
Analysis	By looking the Financial Statements, one may be able to identify the financial data. Analysing involves comparing two financial periods or two financial data.
Interpreting	This is a final function of Accounting. Interpreting is explaining the meaning and significance of the relationship as established by the analysis of Accounting Data. The financial information should explain not only historical information but also expected future events & its financial impact.
Communicating	It is concerned with transmission of summarized, analysed and interpreted information to the end users to enable them to make decisions

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Hence from the above, we can conclude that, the Accounting involves

a) Systematic recording of transactions,
b) Ascertainment of results of the above recorded transaction,
c) Ascertainment of financial position of the Business and
d) Providing informant to the users for the rational decision making.

Functions of Accounting:

- Measurement of past information to depict its current position
- Forecasting of future performance & financial position
- Decision making

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- Comparison & Evaluation
- Control

Types/fields of Accounting:

Types of Accounting	Description
Financial Accounting	Preparation and interpretation of financial statements.
Management Accounting	Internal reporting for planning & Decision making.
Cost Accounting	Ascertainment & Controlling of cost.
Social Responsibility Accounting	Accounting for social costs and social benefits created.
Human resource accounting	Quantifying the investment made in Human resource.

Users of accounting information:

- Investors
- Employees
- Lenders
- Suppliers & Creditors
- Customers
- Government
- Public
- Management

Accounting Concept, Principles and Conventions

- The Financial Statements prepared by different organization should be prepared on uniform basis.
- There should be consistency over a period of time in preparation of the financial statements.
- Hence to bring uniformity in Accounting, Generally Accepted Accounting Principles (GAAP) are applied.
- These principles are rules which define the parameters & constraints within which accounting reports are generated.
- In addition to these principles, an accountant is also required to use Accounting standards issued by regulatory authorities.
- The Accounting concept define certain assumptions on the basis of which financial statements of a business entity are prepared.

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Accounting concepts:

Basic Concepts

1. Entity concept:

- It distinguishes Business from owners. Accounting is done separately.
- The practice of distinguishing the affairs of the business from the personal affairs of the owners originated only in early days of double entry book-keeping.
- The basic concept is applied across all type of organization (Sole proprietor, partnership or corporate entities).
- The Business entity is liable to the owner for capital investment made by the owner. Since the owner invested capital, which is called risk capital, he/she has claim on the profit of the enterprise.

2. Money measurement concept:

- The transactions which can be measured in terms of monetary terms are recorded.
- Transaction and events that cannot be measured in terms of money are not recorded in the business books even if they affect the results of the business materially.

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- The transactions are to be recorded in uniform monetary units. For Eg: in case of sale of goods outside India, it has to be converted into Indian value & reported.

Valuation criteria

1. Going concern concept:

- The Financial statements are prepared on the assumption that an enterprise is a going concern and will continue in operations for foreseeable future.
- Hence it is assumed that the enterprise has neither intention nor need to liquidate or curtail materially the scale of operations.

2. Cost concept:

- Under this concept, the value of asset is determined based on historical cost i.e. acquisition cost.
- However, there are limitations attached to this cost concept. In an inflationary condition, when price of goods go up, the acquisition cost loses its relevance.
- So, if accountant makes valuation of asset at historical cost, the accounts will not reflect the true position.

3. Realization concept:

- Any change in value of asset is to be recorded only when business realizes it.
- When an asset is recorded at its historical cost and even when its current costs increases, such change is not counted unless there is a certainty that such change is material.
- The revaluation of assets has become widely accepted practice when the concept change in value is of permanent nature.
- For example, a firm purchases a land for Rs. 50,000 and it records the same amount, in future even if the value of the asset is increases, as per cost concept same value is maintained, unless it is sold, when the asset is sold, the true value is recorded in the books as per realization concept.

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Time Related Concepts

1. Periodicity concept:

- As per going concern concept, an indefinite life of the entity is assumed. It is not desirable to measure the performance of business entity at end of its life.
- Hence small workable fraction out of indefinite cycle of the business entity is chosen for measuring financial performance & position. As per this concept
- Accounts to be prepared after every period and not at end of life of the entity. We follow 1st April to 31st March as Accounting year.
- The concepts make the accounting system workable and the term accrual meaningful.
- The periodicity concepts facilitate comparison of financial statements of two different periods, uniform & consistent Accounting treatment for ascertaining profit & loss and assets of the business and matching period revenues with expenses for getting correct results of the business operations.

2. Accrual concept

- The effect of transactions and other events are recorded as and when they occur and not as cash or cash equivalent is received or paid.
- The financial statements are prepared on accrual basis to inform the users of financial statements to know the past events involving

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receipts of cash & payments but also obligation to pay cash in future and resource that represent cash to be received in the future.

- Accrual means recognition of revenue and costs as they are earned or incurred and not as money is received or paid.
- The accrual concept relates to measurement of income, identifying assets and liabilities.
- For example, the goods are sold on credit, though cash is not received but it is recorded.

Core Concepts

1. Matching concept:

- All expenses matched with the revenue of that period should be taken into consideration.
- If any revenue is recognized, then expenses related to earn that revenue should also recognized.
- However, it is not necessary that every expense identify every income. Some expenses are directly related to the revenue and some are time bound.
- For example, selling expenses are directly related to sales and expenses like rent, salaries are accrued in the books for a particular accounting period.
- Periodicity concept is followed while applying matching concept.

2. Dual aspect concept:

- This concept is core of double entry system. Every transaction has two aspects.

Other Concepts

1. Conservatism Concept:

- Conservatism is a concept where all possible losses are provided for and the income is recognized only when there is a certainty.
- Conservatism approach requires characteristics of i) Prudence, ii) Neutrality – unbiased outlook to identify and record all possible losses and to exclude uncertain gains and iii) Faithful representation of alternative values.

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2. Consistency:

- For comparability between two periods, the accounting policies are followed consistently from one period to another. Any change in Accounting policies is made only in exceptional circumstances.
- An enterprise should change its accounting policies in any of the following circumstances:
  - To comply accounting standards
  - To comply provisions of law
  - When the proposed policy reflects even more true and fair view.

3. Materiality:

- This principle is an exception to full disclosure principle. According to materiality principle all items which have significant economic effect on business of the enterprise should be disclosed in the financial statements and any insignificant item which is not relevant to the users need should not disclosed.
- The term materiality is a subjective term. It is on judgment, common sense and discretion of the accountant that which item is material, and which is not.

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Accounting Terms:

The understand the subject, it is important to know the meaning of some basic accounting terms, which are briefly explained below.

Transactions

Transactions are those activities of a business, which involve transfer of money or goods or services between two persons or two accounts.
For example, purchase of goods, sale of goods, borrowing from bank, lending of money, salaries paid, rent paid, commission received, and dividend received. Transactions are of two types, namely, cash and credit transactions.

a. Cash Transaction is one where cash receipt or payment is involved in the transaction. *For example*, When Ram buys goods from Kannan paying the price of goods by cash immediately, it is a cash transaction.

b. Credit Transaction is one where cash is not involved immediately but will be paid or received later. In the above example, if Ram, does not pay cash immediately but promises to pay later, it is credit transaction.

Proprietor

A person who owns a business is called its proprietor. He contributes capital to the business with the intention of earning profit.

Capital

It is the amount invested by the proprietor/s in the business. This amount is increased by the amount of profits earned and the amount of additional capital introduced. It is decreased by the amount of losses incurred and the amounts withdrawn. *For example*, if Mr.Anand starts business with Rs.5,00,000, his capital would be Rs.5,00,000.

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Assets:

An asset is a resource with economic value that a business owns or controls with the expectation that it will provide a future benefit. For example, cash, Property, Plant, and Equipment (PPE), stocks, debtor – one who owes money to the business etc.

Assets:

Event	Transaction
Increase in one asset and decrease in another asset	A new asset is purchased by paying cash. Here an asset increases and cash decreases
Increase in asset & increase in liability	A new asset is purchased for credit i.e payable at later date. Here an asset is increased with consequently there is also increase in liability (payables)
Decrease in asset & decrease in liability	Cash is paid to repay bank Loan. In this case cash is an asset gets reduced and by repaying the bank loan there is decrease in liability.
Decrease in asset and increase in another asset	A new asset is purchased by paying cash. Here an asset increases and cash decreases.

Liabilities:

Liabilities refer to the financial obligations of a business. These denote the amounts which a business owes to others, e.g., loans from banks or other persons, creditors for goods supplied, bills payable, outstanding expenses, bank overdraft etc.

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Liabilities:

Event	Transaction
Increase in one liability, decreases another Liability	Increase in Bank Loan and decrease in other loan
Increase in liability, increase in assets	Purchasing assets at credit will increase the assets and increase the liability (payables)
Decrease in liability, increase in other liability	Increase in Bank Loan and decrease in other loan
Decrease in liability, decrease in assets	Cash is paid to repay bank Loan

Drawings
It is the amount of cash or value of goods withdrawn from the business by the proprietor for his personal use. It is deducted from the capital.

Debtors
A person (individual or firm) who receives a benefit without giving money or money is worth immediately, but liable to pay in future or in due course of time is a debtor. The debtors are shown as an asset in the balance sheet. *For example*, Mr. Ibrahim bought goods on credit from Mr. Ali for Rs.10,000. Mr. Ibrahim is a debtor to Mr. Ali till he pays the value of the goods.

Creditors
A person who gives a benefit without receiving money or money is worth immediately but to claim in future, is a creditor. The creditors are shown as a liability in the balance sheet. In the above example Mr. Ali is a creditor to Mr. Ibrahim till he receives the value of the goods.

Purchases
Purchases refers to the amount of goods bought by a business for resale or for use in the production. Goods purchased for cash are called cash purchases. If it is purchased on credit, it is called as credit purchases. Total purchases include both cash and credit purchases.

Purchases Return or Returns Outward
When goods are returned to the suppliers due to defective quality or not as per the terms of purchase, it is called as purchases return. To find net purchases, purchases return is deducted from the total purchases.

Sales
Sales refers to the amount of goods sold that are already bought or manufactured by the business. When goods are sold for cash, they are cash sales but if goods are sold and payment is not received at the time of sale, it is credit sales. Total sales include both cash and credit sales.
Sales Return or Returns Inward: When goods are returned from the customers due to defective quality or not as per the terms of sale, it is called sales return or returns inward. To find out net sales, sales return is deducted from total sales.

Stock
Stock includes goods unsold on a date. Stock may be opening and closing stock. The term opening stock means goods unsold in the beginning of the accounting period. Whereas the term closing stock includes goods unsold at the end of the accounting period. For example, if 4,000 units purchased @ Rs. 20 per unit remain unsold, the closing stock is Rs.80,000. This will be opening stock of the subsequent year.

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Revenue

Revenue means the amount receivable or realised from sale of goods and earnings from interest, dividend, commission, etc.

Expense

It is the amount spent in order to produce and sell the goods and services. For example, purchase of raw materials, payment of salaries, wages, etc.

Voucher

It is a written document in support of a transaction. It is a proof that a particular transaction has taken place for the value stated in the voucher. It may be in the form of cash receipt, invoice, cash memo, bank pay-in-slip etc. Voucher is necessary to audit the accounts.

Invoice

Invoice is a business document which is prepared when one sell goods to another. The statement is prepared by the seller of goods. It contains the information relating to name and address of the seller and the buyer, the date of sale and the clear description of goods with quantity and price.

Receipt

Receipt is an acknowledgement for cash received. It is issued to the party paying cash. Receipts form the basis for entries in cash book.

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Fundamental assumptions

1. Going concern
2. Consistency
3. Accrual

Capital and Revenue Expenditure

As discussed in earlier topic that the Accounting involves recording, classifying and summarizing and interpreting the result thereof. Hence to record the transactions one must know whether a transaction is of revenue or capital in nature.

Note: The transaction whether revenue or capital in nature has two aspect viz. receipts & payments.

Revenue Expenditure:

Revenue expenditure refers to those expenditures which are incurred during normal business operation by the business.

Benefit of which will be received in the same accounting period. For example, rent, utility expenses, salary, insurance, commission, manufacturing expenses, legal charges, postage and printing expenses, etc.

Capital Expenditure

Capital Expenditure generates enduring benefits and helps in revenue generation over more than one accounting period.

For example, the purchase of a building that would provide a benefit of more than 1 year and would be deemed a capital expenditure.

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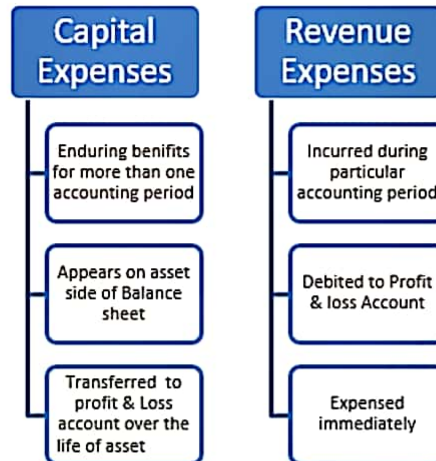
Need for distinction of Revenue and Capital Expenditure

- The distinction of transaction into revenue and capital is done for the purpose of placing them in profit and loss account and in the Balance sheet. (*About which will be dealt in next chapter*).
- The revenue expenses are charged to profit & loss account and capital expenditure appear on the assets side of the balance sheet.
- The benefits arising out of capital expenditure which pertains to particular accounting year are transferred to profit & loss account.
- Hence both revenue & capital are ultimately transferred to Profit & loss account.
- Once capitalized, the value of the asset is slowly reduced over time (i.e., expensed) via depreciation expense.



How to identify whether revenue or capital expenditure?

1. Nature of Business:

- Purchasing goods on the course of trade or business is treated as revenue in nature.
- For example, for trader dealing with sale of Air conditioner, purchasing AC will be considered as revenue in nature and for other businesses the same AC purchase are capital expenditure.

2. Recurring nature: Recurring expenditure are revenue nature. Non-recurring expenditure are capital nature.

3. Purpose of expense: Expenses incurred for repairs & maintenance on day to day basis will be revenue expenses. Expenses incurred for major repair which increases productive capacity is of a capital nature

4. Revenue generating capacity:

- Expenses which help in generating income for the current accounting period will be considered as revenue in nature for example, manpower cost.
- Expenses which help in generating revenue for more than one accounting period will be of capital nature. For example, Plant & Equipment, technology etc.

<u>Capital receipts and Revenue receipts:</u>

Receipts obtained in course of normal business activities are revenue receipts. For example, revenue earned from sale of goods or services of company from day to day operations.

Capital receipts are a non-recurring incoming cash flow into business, which leads to the creation of a liability for example, borrowing loan from bank or decrease in assets for example, receipt from sale of asset such as land and building.

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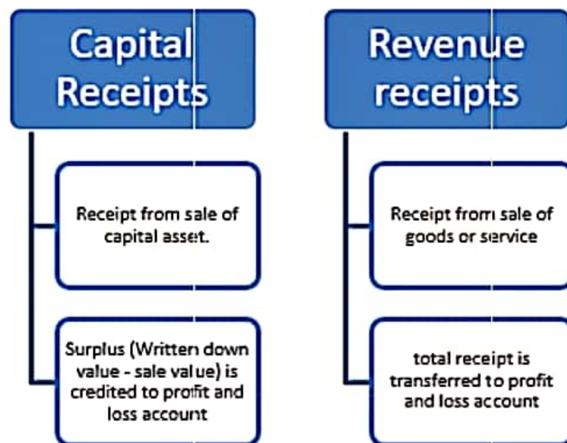
The net surplus or deficit arising out of capital receipt is credited to profit & loss account.



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Practice Questions:

Q. Ascertainment & Controlling of cost is related to which type of Accounting?
A. Social Accounting
B. Management Accounting
C. Cost Accounting
D. Financial Accountig

Q. The amount of cash or value of goods withdrawn from the business by the proprietor for his/her personal use is known as,
A. Salary
B. Drawings
C. Intrest on Capital
D. Commission

Q. Who among the following is not an user of accounting information?
A. Investors
B. Employees
C. Government
D. None of the above

Ans – C, B, D

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Accounting equation and Journal

Accounting Equation

The accounting equation is considered to be the foundation of the double-entry accounting system.

Accounting Equation Accounting equation signifies that the assets of a business are always equal to the total of its liabilities and capital (owner's equity).

The equation reads as follows: **A = L + C**

Where, A = Assets; L = Liabilities; and C = Capital/ Owner's equity

Assets:

Assets are economic resources of an enterprise that can be usefully expressed in monetary terms. Assets are items of value used by the business in its operations.

Liabilities:

Liabilities are obligations or debts that an enterprise has to pay at some time in the future. They represent creditors' claims on the firm's assets

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Capital:

Amount invested by the owner in the firm is known as capital. It may be brought in the form of cash or assets by the owner for the business entity capital is an obligation and a claim on the assets of business

The accounting equation depicts the fundamental relationship among the components of the balance sheet, hence it is **also known as the Balance Sheet Equation.**

At any point of time resources of the business entity must be equal to the claims of those who have financed these resources. The proprietors and outsiders provide the resources of the business. The claim of the proprietors is called capital and that of the outsides is known as liabilities. Each element of the equation is the part of balance sheet, which states the financial position of the business on a particular date.

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Journal

- Transactions are first entered in this book to show which accounts should be debited and which credited.
- Journal is also called as Subsidiary book. Recording of transactions in journal is termed as journalizing the entries.
- It is the book of original entry in which transactions are entered on a daily basis in chronological order.
- As stated earlier there are two aspects to a journal viz. debit and credit. Whenever a transaction is affected, one account is debited, and another account is credited.

Principles for Journal:

1) Journal entries can have one debit and one credit (single entry) or one debit and two or more credits (compounding entry).
2) Debit and credit must be equal. There must not be any mismatch. If there is a mismatch, the same shall be identified and rectification entries shall be passed.
3) If journal runs for many pages, the total balance in one page must be carried forwarded at the beginning of the page.

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Let us understand with an example:

Mr. Khan starts a business, with capital of Rs. 50,000 cash on 1st March 2020, by March 31st, 2020, he carried out following transactions.

1. On 1st March, he purchases furniture for Rs. 30,000 by cash.

2. On 2nd March, he purchased goods for Rs. 20,000 from Mr. Ram on credit.

3. On 5th March, he purchased goods worth Rs. 10,000 by cash.

4. On 10th March, Sold part of the goods to Mr. Victor on credit for Rs. 30,000.

5. On 20th March, he sold remaining goods for Rs. 20,000 by cash.

6. On 31st March, he paid rent of Rs. 3,000 and salary of Rs. 7,000.

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Journal Entries for the above transactions:

Sl. No	Date 2020	Particulars	L.F.	Debit Amount (Rs.)	Credit Amount (Rs.)
1	**March** 1	Cash A/c To Capital A/c (Being the amount invested by Mr. Khan in business as capital)	1 7	50,000	 Rs. 50,000
2	1	Furniture A/c To Cash A/c (Being furniture purchased for cash)	2 1	30,000	 Rs.30,000
3	2	Purchase A/c To Mr. Ram A/c (Being goods purchased on credit)	3 8	20,000	 20,000
4	5	Purchase A/c To cash A/c (Being goods purchased for cash)	3 1	10,000	 10,000
5	10	Mr. Victor A/c To Sales A/c (Being goods sold on credit)	9 4	30,000	 30,000
6	20	Cash A/c To Sales A/c (Being goods sold for Cash)	1 4	20,000	 20,000
7	31	Rent A/c To Cash A/c (Being rent paid for March 2020)	5 1	3000	 3000
8	31	Salary A/c To Cash A/c (Being salary paid for March 2020)	6 1	7000	 7000

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Here you can see every transaction has two effects, one account is debited, and another account is credited, this is how double entry system works.

L.F. – Ledger folio is a column in journal, which shows the reference to the page numbering the ledger, where that transaction can be verified from.

The description in the bracket of each transaction is narration which is a short explanation of every transaction.

Description of the transactions:

1. Mr. Khan starts a business, with capital of Rs. 50,000 cash. In the first journal entry, the capital account is credited, as Mr. Khan bring in cash and cash account is debited.

Balances:

Cash A/c (Dr.): 50,000

Capital A/c (Cr.): 50,000

Accounting Rule: Cash account is Real Account: Debit what comes in and credit what goes out. Capital A/c is personal account: Debit the receiver and credit the giver.

2. Furniture worth Rs. 30,000 is purchased, so in second journal entry, furniture account is debited with Rs. 30,000 and cash account is credited with Rs. 30,000.

Balances:

Cash A/c (Dr.): 20,000 (50,000-30,000)

Furniture A/c (Dr.): 30,000

Accounting Rule: Both are Real Account: Debit what comes in and credit what goes out.

3. Goods worth Rs. 20,000 was purchased from Mr. Ram but on credit, so in the 3rd transaction, Purchase Account is debited with Rs. 20,000 and Mr. Ram's Account is credited with Rs. 20,000.

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Balances:

Purchase A/c (Dr.): 20,000

Mr. Ram's A/c (Cr.): 20,000

Accounting Rule: For Mr. Ram's A/c, it is a Personal Account: Debit the receiver and credit the giver. For Purchase A/c, it is a Nominal A/c: Debit all expenses and losses, credit all incomes and gains.

4. Again goods worth Rs. 10,000 is purchased by paying cash, so in the 4th transaction, Purchase account is debited with Rs. 10,000 and Cash Account is credited with Rs. 10,000.

Balances:

Purchase A/c (Dr.): 30,000 (20,000+10,000)

Cash A/c (Dr.): 10,000 (20,000-10,000).

Accounting Rule: For Cash A/c, it is a Real Account: Debit what comes in and credit what goes out. For Purchase A/c, it is a Nominal A/c: Debit all expenses and losses, credit all incomes and gains.

5. Part of Goods was sold for Rs. 30,000 to Mr. Victor on credit. So, in the 5th transaction, the sales account is credited, and Mr. Victor's account is debited.

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Balances:

Sales A/c (Cr.): 30,000

Mr. Victor's (Dr.): 30,000

Accounting Rules: For Sales A/c, it is a Nominal A/c: Debit all expenses and losses, credit all incomes and gains. Mr. Victors A/c is personal account: Debit the receiver and credit the giver.

6. In 6th transaction, goods are sold for Rs. 20,000 by cash, so Cash account is debited, and Sales account is credited.

Balances:

Cash A/c (Dr.): 30,000 (10,000+20,000)

Sales A/c (Cr.): 50,000 (30,000+20,000)

Accounting Rules: Cash A/c is real account and Sales account is nominal account.

7. In the 7th transaction, rent is paid by cash. So, the cash account is credited and rent account is debited by Rs. 3,000.

Balances:

Cash A/c (Dr.): 27,000 (30,000-3,000).

Rent A/c: (Dr.): 3,000.

Accounting Rules: Cash A/c is real account and Rent account is nominal account.

8. In 8th transaction, salary is paid by cash. So, the cash account is credited, and salary account is debited by Rs. 7,000.

Balances:

Cash A/c (Dr.): 20,000 (27,000-7,000).

Salary A/c (Dr): 7,000.

Accounting Rules: Cash A/c is real account and Salary account is nominal account.

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Practice Questions

Q.1 Accounting Equation is also known as:

A. Equation of Financial Statement
B. Profit and Loss Equation
C. Balance Sheet Equation
D. Equation of Business

Q.2 Mr. A started a business, with capital of Rs. 65,000. Which of the following account will be debited in this case?

A. Capital Account
B. Cash Account
C. Mr. A's Account
D. Either A or C

Q.3 Recording of transactions in journal is termed as ____________.

A. Journal Posting
B. Record Keeping
C. Primary Process

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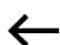

Voucher Approach in Accounting

Business transactions are usually evidenced by an appropriate document such as Cash memo, Invoice, Sales bill, Pay-in-slip, Cheque, Salary slip, etc. A document which provides evidence of the transactions is called a Voucher. Essentially it is a document that shows goods purchased or services rendered, authorizing the payment and indicating in the ledger account in which these transactions must be recorded.

At times, there may be no documentary for certain items as in case of petty expenses. In such case voucher may be prepared showing the necessary details and got approved by appropriate authority within the firm.

All such documents (vouchers) are arranged in chronological order and are serially numbered and kept in a separate file. All recording in books of account is done on the basis of vouchers.

Voucher is also known as the Source Document.

Benefits of Voucher

I. Vouchers are useful for maintaining a higher level of control over the payables process.

II. Several invoices can be paid at once (reducing the number of checks).

III. It can be pre-numbered, which simplifies the audit trail for payables.

IV. Invoice approval is separated from invoice payment, it makes easier to schedule both to maximize efficiency.

V. Payment of the invoices is done by the cashier, who reports to the treasurer.

Preparation of Accounting Voucher

Now a days, accounting is computerised and the necessary accounting vouchers showing the code number and name of the accounts to be debited and credited are prepared for the purpose of necessary recording of transactions.

A transaction with one debit and one credit is a simple transaction and the accounting vouchers prepared for such transaction is known as **Transaction Voucher.**

Voucher which records a transaction that entails multiple debits/credits and one credit/debit is called **compound voucher**.

Compound voucher may be: (a) Debit Voucher or (b) Credit Voucher;

Transactions with multiple debits and multiple credits are called complex transactions and the accounting voucher prepared for such transaction is known as **Complex Voucher/ Journal Voucher.**

Vouchers must be preserved in any case till the audit of the accounts and tax assessments for the relevant period are completed.

The design of the accounting vouchers depends upon the nature, requirement and convenience of the business. There is no set format of an accounting voucher. To distinguish various vouchers, different colour papers and different fonts of printing are used. Some of the specimen of the accounting vouchers are given in the earlier pages. An accounting voucher must contain the following essential elements:

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I. It is written on a good quality paper;

II. Name of the firm must be printed on the top;

III. Date of transaction is filled up against the date and not the date of recording of transaction is to be mentioned;

IV. The number of the voucher is to be in a serial order;

V. Name of the account to be debited or credited is mentioned

VI. Debit and credit amount is to be written in figures against the amount;

VII. Description of the transaction is to be given account wise;

VIII. The person who prepares the voucher must mention his name along with signature; and

IX. The name and signature of the authorised person are mentioned on the voucher.

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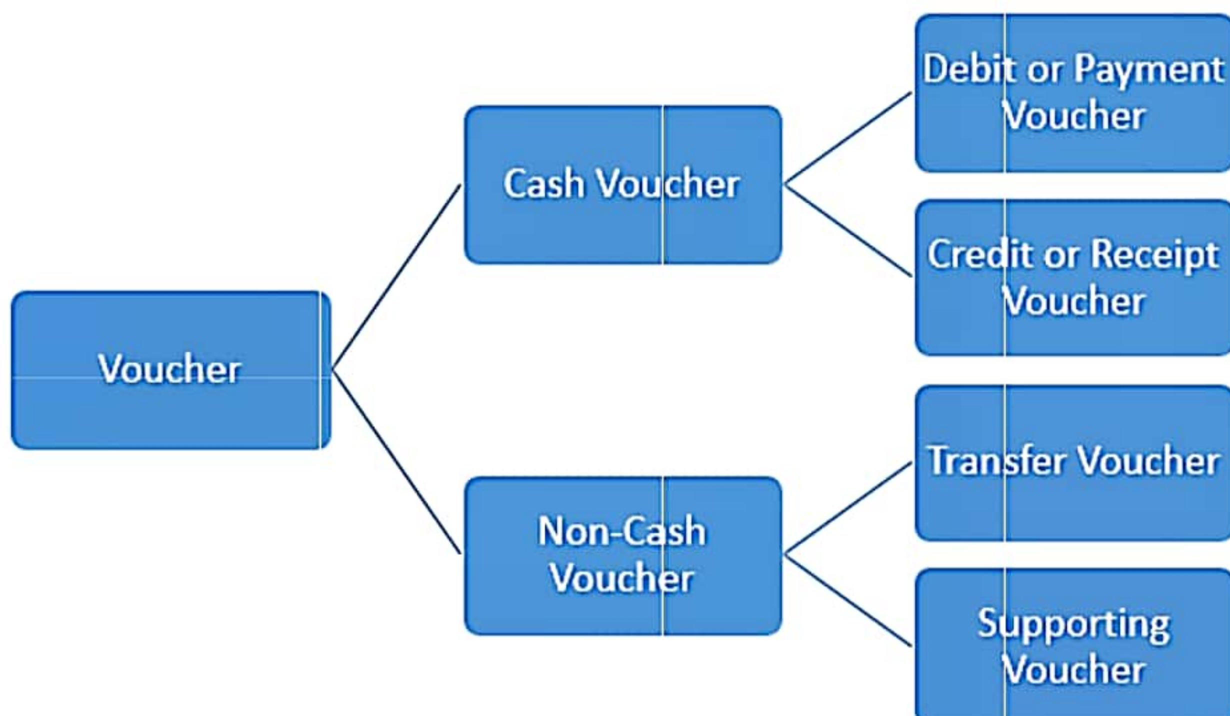
Types of Vouchers in Accounting:



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I. Cash Voucher:

1. Debit or Payment Voucher: A Payment voucher is used to record a payment of cash or cheque. In this case, the cash/bank will be credited and there will be an outflow of funds.

Proforma of Payment Voucher:

Payment Voucher

Ref No: ______________

Amount:		Date:
Method of Payment		
Cash:		Check#:
To:		
The Sum of:		
Being:		Payee:
Approved By:	Paid By:	Signature

2. Credit or Receipt Voucher: A Receipt voucher is used to record cash or bank receipt. Here there is an inflow of funds. Receipt Vouchers are of two types:

a. Cash receipt voucher: It represents receipt of cash in hand

b. Bank receipt voucher: It indicates receipt of a cheque or demand draft i.e. money is not received in the form of cash in hand.

II. Non-Cash Voucher:

1. Transfer Voucher:

Non-cash vouchers are used for non-cash transactions. They are basically used as documentary evidence. e.g., Goods sold on a credit basis.

2. Supporting Voucher:

Supporting voucher serves as documentary evidence of the transactions happened in the past.

For example, Attaching the bill of an expense along with the original voucher just to further support the primary voucher such as Petrol Bills attached to the conveyance vouchers as Supporting Voucher.

Practice Questions

Q.1 Accounting voucher prepared for transactions with multiple debits and multiple credits are called:

A. Compound Vouchers

B. Journal Vouchers

C. Payment Vouchers

D. High Level Vouchers

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Bank Reconciliation Statement.

What is Bank Reconciliation Statement?

Reconciliation means finding out the difference between two and eliminating the difference. In a business environment, cash and bank transactions are common, it is recorded at two places viz. Bank column of the cash book and Bank statement.

The cash book is maintained by the owner and the bank statement is prepared by Bank. Therefore, the balance in both should be equal and opposite in nature.

Most of the times, there arises a difference in the cash book and bank statement/passbook. The process of eliminating the difference and bringing the two statements in line with each other is known as Reconciliation and the statement which reconciles the bank balance as per cash book with bank balance as per pass book by showing differences is called Bank reconciliation statement.

Reverse Balances

- When the entries in the bank statement are compared with the cash book, it will be found that the accounting treatment is reverse in the cash book.
- This is because the cash book is prepared from the point of view of business, whereas the bank statement is prepared from the bank's point of view.
- The credit balance in the bank passbook represents the debit balance as per the cash book and vice-versa.
- This is because, bank is a debtor for the business and business unit is a creditor for the bank when there is a favorable balance in the bank.

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Let us understand with an illustration:
Ms. Asha opens a bank account and deposits Rs. 1,000 on January 1.
Next day she withdraws Rs. 500. It will have following effect:
In Ms. Asha's Cash book (with bank column):

Dr. Cr.

		Bank A/c (₹)							
Date	Particulars	JF	Cash	Bank	Date	Particulars	JF	Cash	Bank
Jan 1	To balance b/d		1,000		Jan 1	By Bank		1,000	
Jan 1	To Cash			1,000	Jan 1	By Cash			500
Jan 2	To Bank		500		Jan 31	By Balance		500	500
	Total		**1,500**	**1,000**		**Total**		**1,500**	**1,000**

In Bank Passbook:

Date	Particulars	Dr. (Withdrawn)	Cr. (Deposited)	Balance
Jan 1	Cash Deposit		1,000	1,000 (Cr.)
Jan 2	Cash Withdrawal	500		500 (Cr.)

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- Here, as per Ms. Asha's books, she has debit balance of Rs.500, while in Bank passbook it is credit balance of Rs.500
- Because, when money is deposited by the business into the bank, customers account is credited in the bank's book, as this is the amount owed by the bank to its customer.
- Similarly, when the money is withdrawn or taken out of the bank by the business, customer's account is debited as this decreases the amount owed by the bank to the customer.
- As a result of this, favorable balance, as per bank statement (bank passbook), will appear as a credit balance and overdrawn balance as a debit balance.

Bank overdraft:

It is not possible to have unfavorable cash balance in the cash book. But it is possible to have unfavorable balance in the bank account. When the business is not having sufficient money in its bank account, it can borrow money from the bank. As a result of this, amount is overdrawn from bank.

Balance: Bank V/s Cash book

- ✓ Bank statement: Debit Balance /overdraft (Negative), Credit balance (positive balance)
- ✓ Cash book: Debit balance (positive), Credit balance/overdraft (negative balance)

Reasons for difference in Bank passbook and cash book:

1. Timing difference: Sometimes a transaction is recorded at two different cash book and passbook.

2. Transactions: There are various transactions which banks carried out by itself without intimating the customers but reflected in the passbooks. Such as interest credited by bank or banks charges debited, customer comes to know about it, usually at later stage.

3. Errors in recording – Difference arising due to errors in recording the entries.

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Time Differences	
Cheque issued but not yet presented for payment	1. Upon issuing cheque by the business, it is immediately entered in credit side of cash book. 2. But this may not be entered on the same day in the bank statement. 3. It will be entered in the bank statement only after it is presented with Bank.
Cheque deposited into bank but not yet credited.	1. When the cheques are deposited into bank, the amount is debited in the cash book on the same day. 2. But these may not be shown in the bank passbook on the same day because these will be entered in the bank statement only after the collection of the cheques.
Transactions	

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	Transactions
Bank charges and interest on loans and overdraft	1. The bank has to cover the cost of running the customer's account. 2. So, debit is given to the account of the business towards bank charges. 3. If the business had taken any loan or overdrawn, interest has to be paid by the business. 4. These entries for bank charges and interest are made in the bank statement. 5. But the entry is made in the cash book only when the bank statement is received by the business. Till then, the cash book shows more balance than bank statement.
Interest and dividends collected by bank	1. The bank may collect dividends on its customer's investment in shares and interest on any investment. 2. The entry for this will be made in the bank statement on the date of collection. 3. But the entry is made in the cash book only when the bank statement is received by the customer. 4. Till then, the cash book shows less balance than the bank statement.
Dishonor of cheques and bills	1. When the cheque is received from outside parties, it is deposited with the bank and debited in the cash book. 2. If the cheque is dishonored, the bank cannot collect the amount of such cheque from outside parties' bank. 3. It is not credited in the bank statement. As a result of this, the two records would differ.
Amount paid by parties directly into bank account	1. Debtors or the customers of the business may directly deposit the money into bank account of the business. 2. It may be done by directly visiting the branch of the bank by paying cash (including NEFT, RTGS) or swiping debit or credit or business card or depositing the money in cash deposit machine or transfer through online banking facility. 3. This will be credited in the banker's book. But

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Amount paid by parties directly into bank account	1. Debtors or the customers of the business may directly deposit the money into bank account of the business. 2. It may be done by directly visiting the branch of the bank by paying cash (including NEFT, RTGS) or swiping debit or credit or business card or depositing the money in cash deposit machine or transfer through online banking facility. 3. This will be credited in the banker's book. But the entry is made in the cash book only when the bank statement is received by the customer. Until then, the cash book shows less balance than bank statement.
Payment made directly by banks to others	1. The bank may be instructed to make payments such as, insurance premium, instalment of loan, etc., as an agent of the customer on behalf of its customer. In all such cases, debit is made in bank statement. 2. But the entry is made in the cash book only when the bank statement is received by the customer. Till then, the cash book shows more balance than bank statement.
Bills collected by the bank on behalf of its customer	1. When goods are sold by the business, the documents may be sent through the bank. 2. When the bank collects the amount, it is credited in bank records. 3. But, the entry is made in the cash book only when the bank statement is received by the business. 4. Till then, the bank statement shows more balance than cash book.
Errors in Recording	
Errors in recording transaction in cash book	1. Omission or wrong recording of transaction relating to cheques deposited or issued, wrong balancing, etc. 2. In these cases there will be differences between bank balance as per bank statement and bank balance as per cash book.
Errors in recording transactions in bank book.	1. Omission or wrong recording of transaction relating to cheques deposited and wrong balancing. 2. In these cases, there will be differences between bank balance as per bank statement and bank balance as per cash book.

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Preparation of Bank Reconciliation Statement (BRS):

In any of such cases, a BRS is prepared using Bank Passbook (Statement) and Bank Column of Cash Book and necessary entries are passed in journal and ledger to match the balance between cash book and bank passbook.

Bank Reconciliation statement format while taking cash book as starting point:

Particulars	Amount	Amount
Balance as per cash book (favorable balance)	XXX	XXX
Add:		
Cheques issued but not presented	XXX	XXX
Credits in the passbook only	XXX	XXX
Interest credited in Bank statement	XXX	XXX
Dividend and other income	XXX	XXX
Direct deposit by a party	XXX	XXX
Any error in cash book/ bank statement which has the effect of increasing the balance as per bank statement	XXX	XXX
Less:		
Cheques deposited but not credited	XXX	XXX
Cheques dishonored but not entered in cash book	XXX	XXX
Debits in bank statement only	XXX	XXX
Interest debited	XXX	XXX
Insurance premium, loan instalment, etc., paid as per standing instructions	XXX	XXX
Direct payment by banker	XXX	XXX
Any error in cash book/bank statement which has the effect of decreasing the balance as per bank statement.	XXX	XXX
Balance as per bank statement	XXX	XXX

In Case of Unfavorable Balance (Negative Balance)

- If unfavorable balance as per cash book is the starting point, then reverse is the procedure for preparing bank reconciliation statement.
- It means, items that are added to be subtracted and items that are subtracted are to be added.

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Ready Reference for preparation of Bank Reconciliation Statement:

Cause of difference	Favorable Balance (Dr.) as per cash book	Unfavorable balance as per cash book	Favorable balance (Cr.) as per bank statement	Unfavorable balance (Dr.) as per bank statement
Cheque issued but not presented to bank	Add	Subtract	Subtract	Add
Cheque directly deposited in bank by a customer	Add	Subtract	Subtract	Add
Income directly received by bank	Add	Subtract	Subtract	Add
Wrong credit in the cash book	Add	Subtract	Subtract	Add
Under casting of debit side of bank column of the cashbook.	Add	Subtract	Subtract	Add
Over casting of credit side of bank column of the cash book.	Add	Subtract	Subtract	Add
Bill receivable collected directly by bank.	Add	Subtract	Subtract	Add
Cheque deposited but not cleared	Subtract	Add	Add	Subtract
Expenses directly paid by bank on standing instructions.	Subtract	Add	Add	Subtract
Bank charges	Subtract	Add	Add	Subtract

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instructions.				
Bank charges levied by bank	Subtract	Add	Add	Subtract
Locker rent levied by bank.	Subtract	Add	Add	Subtract
Wrong debit in the cash book.	Subtract	Add	Add	Subtract
Wrong debit in the bank statement.	Subtract	Add	Add	Subtract
Over casting of debit side of bank column of the cash book.	Subtract	Add	Add	Subtract
Under casting of credit side of bank column of the cash book.	Subtract	Add	Add	Subtract
Interest on bank overdraft charged.	Subtract	Add	Add	Subtract
Final Balance	If answer is positive, then favorable balance (Cr.) as per bank statement and If, negative then unfavorable balance (Dr.) as per bank statement.	If answer is positive, then unfavorable balance (Dr.) as per bank statement and If, negative then favorable balance (Cr.) as per bank statement.	If answer is positive, then favorable balance (Dr.) as per cash book and If, negative then unfavorable balance (Cr.) as per cash book.	If answer is positive, then unfavorable balance (Cr.) as per cash book and If, negative then favorable balance (Dr.) as per cash book.

Here the final balance is as per the other book. I.e. the final balance is the cash book column is the balance as per bank column and vice versa.

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Financial Management and Audit

In this chapter we will deal with the concept of Financial management, Financial statement pertaining to Cash flow statement and Ratio Analysis and Financial Audit.

Financial Management

Financial Management is defined as dealing with and analyzing money and investments for a person or a business to help make business decisions.

Financial Management includes planning, organizing, directing and controlling the financial activities such as procurement and utilization of funds of the enterprise. It means applying general management principles to financial resources of the enterprise.

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Objectives of Financial Management:

1. Profit Maximization:
The Primary aim for employing financial management in the organization is the maximization of Profits. The gain can be in the short or long term.

2. Maximization of Shareholders' wealth

Another objective is to maximize the value of a share of a firm for benefitting its shareholders.

3. Proper Mobilization of Finance
It is essential for an entity to maintain a proper balance between the money it has, and the amount borrowed by it. It can be achieved by an entity by proper deployment of various tools of Financial Management.

4. The Company's Survival
For any entity long term survival is the foremost objective and it can only be achieved if the entity is financially sound. It is one of the prime objectives of financial management to ensure the same.

5. Lowers Cost of Capital
Financial management helps in reducing the cost of the capital and functioning of the business to achieve the objective of maximization of the profits.

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6. Proper Coordination
Financial Management helps the companies to understand and corporate among themselves for smooth functioning of the business.

Now lets study and understand the basic components of Financial Management:

Cost of Capital

Cost of capital is also known as Minimum Rate of Return/ Cut-off Rate / Hurdle Rate, is the return expected by the providers of capital i.e., shareholders, lenders and the debt holders to the business as a compensation for their contribution to the total capital.

Suppose you lend Rs. 1,00,000 to a Company named ABC Ltd. You would expect return over and above Rs 1,00,000 from the Company unless it is a gift or donations.
Now Suppose, the company gave you 10% p.a. as an interest for the borrowings made by it. So, This additional money of Rs. 10,000 paid by the company to you is the cost for using the capital of Rs. 1,00,000 and this is called the cost of capital.

This cost of capital expressed in rate is used to discount the cash flow. The concept of Cash flow will be discussed later in this chapter.

Cost of Capital is used as a benchmark for framing debt policy of a firm and taking capital budgeting decisions.

Significance of Cost of Capital

The cost of capital is important to arrive at correct amount and helps the management or an investor to take an appropriate decision. The correct cost of capital helps in the following decision making:

i. **Evaluation of investment options:** The estimated benefits from available investment opportunities whether business or project are converted into the present value of benefits by discounting them with the relevant cost of capital.

ii. **Financing Decision:** An entity can simply compare their cost and choose the source which has lower cost.

iii. **Designing of optimum credit policy:** While appraising the credit period to be allowed to the customers, the cost of allowing credit period is compared against the benefit/ profit earned by providing credit to customer of segment of customers.

How to Calculate Cost of Capital?
To calculate cost first of all we should identify various cash flows like:
1. Inflow of amount received at the beginning
2. Outflows of payment of interest, dividend, redemption amount etc.
3. Inflow of tax benefit on interest or outflow of payment of dividend tax.

Thereafter we can use trial & error method to arrive at a rate where present value of outflows is equal to present value of inflows. That rate is basically Internal Rate of Return (IRR). In investment decisions IRR indicates income, because there we have initial outflow followed by series of inflows. IRR can be calculated by following formulae:

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$$IRR = \frac{\text{Cash flows}}{(1+r)^i} - \text{Initial Investment}$$

Where r = discount rate and
i = Time Period

We will also see this concept in Capital Budgeting under discounted cash flow techniques.

Capital Budgeting

Capital Budgeting is a process in which decisions related to the allocation of funds to different long-term assets are evaluated.

Broadly speaking, the capital budgeting decision denotes a decision situation where a lump sum funds are invested in the initial stages of a project and returns are expected over a long period.

Remember you gave an amount of Rs. 1,00,000 to ABC Ltd company and for which the company gave you Rs. 10,000. Now suppose from that amount the company bought a Machinery or started a program related to research and development. ABC Ltd. will expect returns over a long period of time (period involving more than a year) and this investment and expected returns for a long span of time is known as Capital Budgeting.

Objective of Capital Budgeting

It is to select those long-term investments projects that are expected to make maximum contribution to the wealth of the shareholder.

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Features and Significance

1. Long Term Effects

These decisions have a long-term effect on the risk and return composition of the firm. They affect the future position of the firm to a considerable extent.

2. Substantial Commitments

Capital Budgeting involves large commitment of funds and as a result substantial portion of capital funds are blocked in these decisions. Therefore, more attention is required for towards them.

3. Irreversible Decisions

Most of the decisions are Irreversible. Once taken, the firm may not be in a position to revert them unless it is ready to absorb heavy losses which may result due to abandoning a project in midway.

4. Affect the capacity and strength to compete

These decisions affect the capacity and strength of a firm to face the competition. A firm may lose competitiveness if the decision to modernize is delayed or not rightly taken.

Capital Budgeting: Techniques of evaluation

Capital budgeting decisions process involves three steps i.e.

1. Estimation of costs and benefits of a proposal.
2. Estimation of required rate of return
3. Evaluation of different proposals in order to select one

There are two types of capital budgeting techniques, namely,

1. Traditional or Non-Discounting
2. Time-Adjusted or Discounted cash flows

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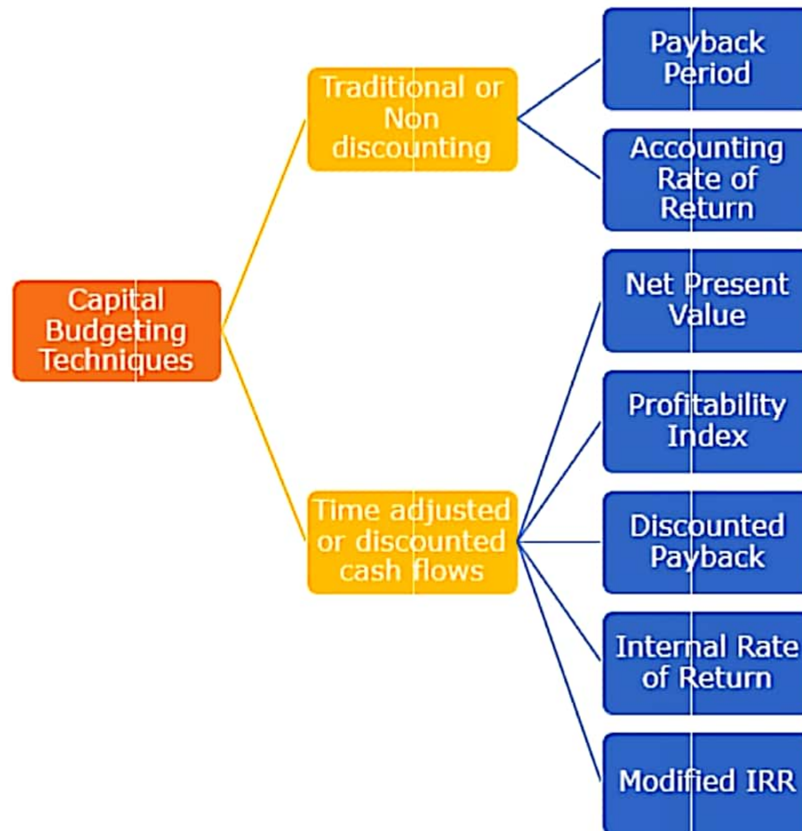
The diagram stated below helps us in the classification of Capital Budgeting Techniques.



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1. **Traditional or Non-Discounting Technique**

These techniques do not discount the cash flows to find out their present worth. There are two such techniques available i.e. the payback period method and the accounting rate of return.

a. Payback period

It is defined as the number of years required for the proposal's cumulative cash inflows to be equal to its cash outflows, e.g., you have invested Rs. 10,00,000 into a machinery and it generates Rs. 2,00,000 every year, here you will be able to receive your invested amount in 5 years. This period of 5 years is known as the Payback Period.

It is quite a possibility that the machinery will generate unequal amount of cash for say, 3,00,000 in the 1st year, 2,50,000 in the 2nd year, 2,50,000 in the 3rd year, 2,00,000 in the 4th year. Here the Payback period would be 4 years.

b. Accounting Rate of Return/Average Rate of Return (ARR)

ARR is the annualized net income earned on the average funds invested in a project. It is based on the accounting concept of return on investment. For example, a project costing Rs. 10,00,000 is expected to generate after tax profit of 1,50,000 every year. The ARR for the proposal would be 15% (i.e. Rs.1,50,000/ Rs.10,00,000 X 100).

2. **Discounted Cash Flows/ Time-Adjusted Techniques/ Present Value Techniques**

It based upon the fact that Money has time value, the cash flows occurring at different point of time are not having same economic worth. To make these cash flows equal in economic worth, these must be discounted with reference to the time gap between different cash flows and a pre-determined discount rate.

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different cash flows and a pre-determined discount rate.

Why Time Adjusted Techniques over Traditional Techniques?

Time Adjusted techniques involve the time value of money and thus it more accurately reflects the true economic trade-off and returns.

a. Net Present Value (NPV) Method

It is the sum of the present values of all the cash inflows less the sum of present values of all the cash outflows associated with a proposal.

A rate of discount i.e., the rate of return which the investor normally enjoys from investments of similar nature and risk must be specified and applied to both inflows and outflows in order to find out their present values.

b. Profitability Index (PI) / Benefit-cost ratio / Present Value index

It is defined as the benefits per rupee invested in the proposal. This technique which is a variant of the NPV technique. It is ascertained by dividing the present value of the future cash inflows with the present value of the future cash outflows.

c. Discounted Payback Period

It is a combination of the original payback method and the discounted cash flow technique. The cash flows of the project are discounted to find their present values.

Since, it is a variant of the original payback period method, the discounted payback period method is also calculated in the same way as the payback period, except that the future cash inflows are first discounted and then the payback is calculated.

d. Internal Rate of Return (IRR)

The IRR of a proposal is defined as the discount rate which produces a zero Net Present Value. In the IRR technique, the time-schedule of occurrence of the future cash flows is known but the rate of discount is not rather this discount rate is ascertained by the trial and error procedure.

e. Modified Internal Rate of Return

The basic shortcoming of the IRR technique is the implied reinvestment rate assumption. In case of MIRR, the assumption is that all intervening cash inflows over the life of the project are reinvested at a rate equal to the reinvestment rate for the remaining life of the project. This total cumulative value of all cash inflows is then discounted back to be to the present value of all cash outflows.

CONCEPT OF LEVERAGE

Leverage refers to a relationship between two interrelated variables e.g., costs, output, sales revenue, Earnings Per Share etc., the leverage reflects the responsiveness or influence of one financial variable over some other financial variable.

Leverage = % Change in Dependent Variable / % Change in Independent Variable.

For example, a firm increased its sales promotion expenses from Rs. 5,000 to Rs. 6,000 i.e., an increase of 20 %. This resulted in the increase in number of unit sold from 200 to 300 i.e., an increase of 50 %. The leverage between the promotional expenses and the number of units sold may be defined as:

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Leverage = % Change in units sold / % Change in Sales Promotion Expenses
.50/ .20 = 2.5

Please Note: The two variables, for which the relationship is to be established and measured, should be interrelated otherwise it will not serve any purpose.

Types of Leverage

There are three commonly used measures of leverage in financial analysis. These are as follows:

1. **Operating Leverage**

   It is the employment of an asset with a fixed cost so that enough revenue can be generated to cover all the fixed and variable costs. Operating leverage is a function of three factors:

   i. Amount of fixed cost
   ii. Variable contribution margin, and
   iii. Volume of sales.

   Degree of Operating Leverage may be defined as percentage change in Earnings before interest and taxes (EBIT) with respect to percentage change in sales quantity.

2. **Financial Leverage**

   It is the use of funds with a fixed cost in order to increase earnings per share. In other words, it is the use of company funds on which it pays a limited return.

   Degree of financial leverage is the ratio of the percentage increase in earnings per share (EPS) to the percentage increase in earnings before interest and taxes (EBIT).

3. **Combined Leverage**

   It is defined as the potential use of fixed costs, both operating and financial, which magnifies the effect of sales volume change on the earning per share of the firm.

   Degree of combined leverage (DCL) is the ratio of percentage change in earning per share to the percentage change in sales.

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Working Capital Management

Working Capital is the difference between current assets and current liabilities.
A positive working capital indicates the company's ability to pay its short-term liabilities.
On the other hand, a negative working capital shows inability of an entity to meet its short-term liabilities.

Current Assets: An asset is classified as current when:

1. It is expected to be realized or intends to be sold or consumed in normal operating cycle of the entity.
2. The asset is held primarily for the purpose of trading.
3. It is expected to be realized within twelve months after the reporting period.
4. It is non- restricted cash or cash equivalent. For example, Inventory, Receivables, Cash or cash equivalents etc.

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Similarly, **Current Liabilities: A liability is classified as current when**:

1. It is expected to be settled in normal operating cycle of the entity.
2. The liability is held primarily for the purpose of trading.
3. It is expected to be settled within twelve months after the reporting period For example, Outstanding payments, Payables etc.

<u>Importance of Adequate Working Capital</u>

- Firm should have adequate working capital to run its business operations.
- Sufficient liquidity must be maintained in order to ensure the survival of the business in the long-term.

Please Note: Both excessive as well as inadequate working capital positions are dangerous.

Factors considered while planning for working capital requirement:
Cash, Price Level Changes, Operating Efficiency, Technology and Manufacturing Policies, Nature of Business, Market and Demand Conditions, Short-term Financing Options, Receivables.

Financial Statements

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Financial statements are the basic and formal annual reports through which the corporate management communicates financial information to its owners and various other external parties which include– investors, tax authorities, government, employees, etc.

There are three major components of Financial Statements i.e., Balance Sheet, Income Statement and Cash Flow Statement.

We have already familiar with the two of them i.e., Balance Sheet and Income Statement as we have learned about them in the chapter of Final Accounts.

Now, let us get ourselves familiar with the third important component, namely the Cash Flow Statement.

<u>Cash flow statement</u>
Cash flow statements shows inflows and outflows of the cash and cash equivalents of an entity over a period of time.

Revised Accounting Standard-3 deals with the preparation and presentation of Cash flow statement.

<u>Objective and benefits of cash flow statement:</u>

1. The cash flow statement reveals whether the company realized positive or negative cash from its transactions. **It records three types of activities: cash flow from operations, cash flow from investments and cash flow from financing activities**. This separation of different kinds of cash flow enables the analyst to determine if a company is generating a positive cash flow from its operations or is borrowing money to pay its bills.
2. Historical cash flow information **can be used as an indicator of the amount, timing and certainty of future cash flows.**
3. It **facilitates and enhances the comparison of operation**

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performance among different enterprises as it eliminates the effect of using different accounting treatments for the same transactions

What is Cash and Cash equivalents for the purpose of cash flow statement:

The term 'Cash' means cash in hand and demand deposits with banks. The term 'Cash equivalents' means short-term highly liquid investments which are readily convertible into Cash.

Please note: Cash flow statement excludes movements between items that constitute cash or cash equivalents. Thus, short-term investment which constitutes cash equivalents is not considered while preparing cash flow statement.

As mentioned earlier, the Cash Flow Statement is classified into three activities. Let us know dig deeper into them in order to understand the treatment of Cash Flow Statement.

I. Operating Activities:

These are the activities that constitute the primary or main activities of an enterprise.

The amount of cash from these activities indicate the internal solvency level of the company. In these activities no recourse to external source of financing is made by the organization.

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Cash Inflows from operating activities:

- Cash receipts from sale of goods and the rendering of services.
- Cash receipts from royalties, fees, commissions and other revenues.

Cash Outflows from operating activities:

- Cash payments to suppliers for goods and services.
- Cash payments to and on behalf of the employees.
- Cash payments to an insurance enterprise for premiums and claims, annuities, and other policy benefits.
- Cash payments of income taxes unless they can be specifically identified with financing and investing activities.

Cash flow from Operating Activities can be ascertained by two methods namely:

1. Direct Method: In this method major classes of gross cash receipts and payments are disclosed.

2. Indirect Method: In this method net profit or loss is duly adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past/future operating cash receipts, and items of income or expenses associated with investing or financing cash flows.

II Investing Activities:

They are related to purchase and sale of long-term or fixed assets such as machinery, furniture, land and building, etc. Transactions related to long-term investment are also investing activities.

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Cash Inflows from Investing Activities:

- Cash receipt from disposal of fixed assets including intangibles.
- Cash receipt from the repayment of advances or loans made to third parties (except in case of financial enterprise).
- Cash receipt from disposal of shares, warrants or debt instruments of other enterprises except those held for trading purposes.
- Interest received in cash from loans and advances.
- Dividend received from investments in other enterprises.

Cash Outflows from investing activities:

- Cash payments to acquire fixed assets including intangibles and capitalised research and development.
- Cash payments to acquire shares, warrants or debt instruments of other enterprises other than the instruments those held for trading purposes.
- Cash advances and loans made to third party (other than advances and loans made by a financial enterprise wherein it is operating activities).

III. Financing activities:

They are related to long-term funds or capital of an enterprise.
For example, cash proceeds from issue of equity shares, debentures, raising long-term bank loans, redemption of bank loan, etc.

Cash Inflows from financing activities:

- Cash proceeds from issuing shares (equity or/and preference).
- Cash proceeds from issuing debentures, loans, bonds and other short/ long-term borrowings.

Cash Outflows from financing activities:

- Cash repayments of amounts borrowed.
- Interest paid on debentures and long-term loans and advances.
- Dividends paid on equity and preference capital.

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Treatment of Some Peculiar Items

Extraordinary items are of non-recurring nature and should be classified and disclosed separately from the above stated three heads e.g. loss due to theft or earthquake or flood.

1. Interest and Dividend:
a. In case the main business of an enterprise is lending and borrowing:
Interest paid or received and dividend received are classified as operating activities while dividend paid is the financing activity.

b. In case the main business of an enterprise is not that of lending and borrowing:
Payment of interest and dividend paid are classified as financing activities whereas receipt of interest and dividends are classified as investing activities.

2. Taxes on Income and Gains
Cash flows arising from taxes on income should be separately disclosed and should be classified as cash flows from operating activities unless they can be specifically identified with financing and investing activities.

3. Non-cash Transactions are excluded from a cash flow statement

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Format of Cash Flow Statement:

Cash Flow Statement
(Main heads only)

(A)Cash flows from operating activities	**Xxx**
(B)Cash flows from investing activities	**Xxx**
(C)Cash flows from financing activities	**xxx**
	______
Net increase (decrease) in cash and cash equivalents (A + B + C)	**xxx**
+ Cash and cash equivalents at the beginning	**xxx**
	______
= Cash and cash equivalents at the end	**xxxx**
	______

Illustration:

From the following information, prepare a Cash Flow Statement for OB Limited.

Balance Sheet of OB Ltd. as on March 31, 2020

Liabilities	31st March, 2019	31st March, 2020	Assets	31st March, 2019	31st March, 2020
Equity Share	10,00,000	15,00,000	Land & Building	5,00,000	3,50,000
Debentures	2,00,000	Nil	Plant &Machinery	4,00,000	3,60,000
Bank Loan	Nil	100,000	Debtors	40,000	2,60,000
Creditors	60,000	70,000	Stock	60,000	70,000
			Cash	50,000	1,40,000
			Bank	1,50,000	4,50,000
			Goodwill	60,000	40,000
Total	**12,60,000**	**16,70,000**		**12,60,000**	**16,70,000**

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Additional Information:

1. Dividend of Rs.2,20,000 was proposed and paid during the year.
2. Income tax paid during the year is 80,000 and it includes Rs. 15,000 on account of Dividend Tax
3. Moreover, during the year, Land and Building worth Rs.1,50,000 was sold at a profit of 10%.
4. The rate of Depreciation on Plant and Machinery is 10%
5. Net Profit before Taxation and Extraordinary Items is Rs. 1,50,000.

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Solution

Cash Flow Statement

	Rupees
I. Cash Flow from Operating Activities	
Net Profit before Taxation and Extraordinary Items	1,50,000
(+) Depreciation	40,000
(+) Goodwill written-off	20,000
(+) Proposed Dividend	1,50,000
(-) Profit on Sale of Land and Building	(15,000)
= **Operating Profit before working capital charges**	3,45,000
(+) Increase in Creditors	10,000
(-) Increase in Debtors	(2,20,000)
(-) Increase in Stock	(10,000)
= **Cash generated from Operations**	125,000
(-) Income Tax Paid	(65,000)
A. Cash Inflows from Operating Activities	**60,000**
II. Cash flows from Investing Activities	
Proceeds from Sale of Land and Building	1,65,000
B. Cash Inflows from Investing Activities	**1,65,000**
III. Cash flows from Financing Activities	
(+) Proceeds from issue of Equity Share Capital	5,00,000
(-) Redemption of Debentures	(2,00,000)
(+) Proceeds from raising Bank Loan	1,00,000
(-) Dividend Paid	(2,20,000)
(-) Dividend Tax Paid	(15,000)
C. Cash flows from Financing Activities	**1,65,000**
Net Increase in cash and cash equivalents (A+B+C)	**3,90,000**
(+) Cash and Cash equivalents at the beginning	**2,00,000**
= **Cash and cash equivalents at the end**	**5,90,000**

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Ratio Analysis

It is the comparison of line items in the financial statements of a business. Ratio analysis is used to evaluate several issues with an organization, such as its liquidity, efficiency of operations, and profitability.

Objectives of Ratio Analysis Ratio:

1. To know the areas of the business which need more attention.
2. To know about the potential areas which can be improved with the effort in the desired direction.
3. To provide a deeper analysis of the profitability, liquidity, solvency and efficiency levels in the business.
4. To provide information for making cross sectional analysis by comparing the performance with the best industry standards.
5. To provide information derived from financial statements useful for making projections and estimates for the future.

Traditional Classification of Ratios:

1. **Income Statement Ratios**: A ratio of two variables from the income statement.
   For example, ratio of gross profit to sales known as gross profit ratio is calculated using both figures from the income statement.

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2. **Balance Sheet Ratios**: In this case both variables are from balance sheet.
   For example, ratio of current assets to current liabilities known as current ratio is calculated using both figures from balance sheet.

3. **Composite Ratios**: If a ratio is computed with one variable from income statement and another variable from balance sheet, it is called Composite Ratio.
   For example, ratio of credit sales to debtors and bills receivable

<u>Alternative classification/ Functional classification</u>
It is based on the purpose for which a ratio is computed.

1. **Liquidity Ratios**:
   The ability of the business to pay the amount due to stakeholders as and when it is due being known as liquidity, and the ratios calculated to measure it are known as 'Liquidity Ratios'. They are essentially short-term in nature.

2. **Solvency Ratios**:
   Solvency of business is determined by its ability to meet its contractual obligations towards stakeholders, particularly towards external stakeholders, and the ratios calculated to measure solvency position are known as 'Solvency Ratios'. They are essentially long-term in nature.

3. **Activity (or Turnover) Ratios**:
   This refers to the ratios that are calculated for measuring the efficiency of operation of business based on effective utilization of resources. Hence, these are also known as 'efficiency ratios'.

4. **Profitability Ratios:**
   It refers to the analysis of profits in relation to sales or funds (or assets) employed in the business and the ratios calculated to meet this objective are known as 'Profitability Ratios'.

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There are several hundred possible ratios that can be used for analysis purposes, but only a small core group is typically used to gain an understanding of an entity. These ratios include:

1. **Current Ratio:** Compares current assets to current liabilities, to see if a business has enough cash to pay its immediate liabilities.
   CURRENT RATIO= CURRENT ASSET / CURRENT LIABILITY
   The excess of current assets over current liabilities provides a measure of safety margin available against uncertainty in realization of current assets and flow of funds. The ratio should be reasonable. It should neither be very high or very low. Both the situations have their inherent disadvantages it is advocated to have this ratio as 2:1.

2. **Quick Ratio or Acid-Test Ratio**
   In this we consider the only most liquid assets like Cash and Cash equivalents and Receivables, then it should provide us with a better picture on the coverage of short-term obligations.
   Quick ratio = Quick Assets / Current Liabilities
   The ratio provides a measure of the capacity of the business to meet its short-term obligations without any flaw. It is to be safe to have a ratio of 1:1

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3. Cash Ratio

In this we consider only the Cash and Cash Equivalents.

CASH RATIO= CASH AND CASH EQUIVALENTS / CURRENT LIABILITIES

If the company has a higher cash ratio, it is more likely to be able to pay its short-term liabilities.

4. Debt-Equity Ratio or Leverage Ratio

It measures the relationship between long-term debt and equity.

DEBT TO EQUITY RATIO = TOTAL LONG-TERM DEBT / EQUITY FUND

This ratio measures the degree of indebtedness of an enterprise and gives an idea to the long-term lender regarding extent of security of the debt. The prescribed ratio is limited to 2:1.

5. Inventory Ratio

It means how many times the inventories are restored during the year.

INVENTORY RATIO = COST OF GOODS SOLD / INVENTORY

Cost of goods sold (COGS) refers to the direct costs of producing the goods sold by a company. This amount includes the cost of the materials and labor directly used to create the good.

6. Proprietary ratio

It expresses relationship of proprietor or shareholders' funds to net assets.

Proprietary Ratio = Shareholders Funds / Capital employed or net assets.

Higher proportion of shareholder's funds in financing the assets is a positive feature as it provides security to creditors.

7. Working Capital Ratio

It shows the relationship between working capital and revenue from operations. It shows the number of times a unit of rupee invested in working capital produces sales.

WORKING CAPITAL RATIO = REVENUE FROM OPERATIONS / WORKING CAPITAL

8. Total Assets to Debt Ratio

This ratio measures the extent of the coverage of long-term debt by assets.

Total assets to Debt Ratio = Total assets/Long-term debt.

This ratio primarily indicators the rate of external funds in financing the assets and the extent of coverage of their debt is covered by assets.

9. Interest Coverage Ratio

It deals with the servicing of interest on loan. It expresses the relationship between profits available for payment of interest and the amount of interest payable.

Interest Coverage Ratio = Net Profit before Interest and Tax/ Interest on long term debt

It reveals the number of times interest on long-term debt is covered by the profits available for interest.

10. Net Profit Ratio

Calculates the proportion of net profit to sales; a low proportion can indicate a bloated cost structure or pricing pressure.

NET PROFIT RATIO = NET PROFIT / REVENUE FROM OPERATIONS

It reflects the overall efficiency of the business, assumes great significance from the point of view of investors.

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11. Earnings Per Share

EPS = Profit available for equity shareholders/ No. of Equity Shares

This ratio is very important from equity shareholders point of view and so also for the share price in the stock market. This also helps comparison with other firms to ascertain its reasonableness and capacity to pay dividend.

12. Return on Investment or Capital Employed

It helps in assessing whether the firm is earning a higher return on capital employed as compared to the interest rate paid.

Return on Investment or Capital Employed = Profit before Interest and Tax/ Capital Employed × 100

It reveals the efficiency of the business in utilization of funds entrusted to it by shareholders, debenture-holders and long-term liabilities.

13. Dividend Pay-out Ratio

This refers to the proportion of earning that are distributed against the shareholders.

Dividend Pay-out Ratio = Dividend Per Share/ Earnings Per Share

This reflects company's dividend policy and growth in owner's equity.

14. Price Earnings Ratio

It reflects investors expectation about the growth in the firm's earnings and reasonableness of the market price of its shares.

P/E Ratio = Market price of a Share/Earnings per Share

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Financial Audit

What is a Financial Audit?

A financial audit is an independent examination and evaluation of the financial statements and information of an organization, whether profit oriented or not, and irrespective of its size and legal form, to make sure that the financial records are a fair and accurate representation of the transactions they claim to represent.

OBJECTIVES OF FINANCIAL AUDIT:

1. The objective of a financial statement audit is to obtain reasonable assurance that the financial statements are free of material misstatement.
2. For the above stated objective, an audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements.
3. It also includes an assessment of the accounting principles used, and significant estimates made, by management as well as an evaluation of the overall financial statement presentation.
4. SA-200 which states "Overall Objectives of the Independent Auditor".

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AUDIT PROCEDURES

Audit procedures are the processes, technique, and methods that auditors perform to obtain audit evidence which enables them to make a conclusion on the set audit objective and express their opinion.
Auditors normally prepare audit procedures at the planning stages once they have identified audit objectives, audit scope, audit approach, and audit risks.

TYPES OF AUDIT PROCEDURES:

1. Analytical Review

It consists of evaluation of financial information made by a study of plausible relationships among both financial and non-financial data.
It encompasses the investigation identified fluctuations and relationships that are inconsistent with other relevant information or deviate significantly from predicted amounts.
For example, when auditor found there is unusual transactions or event as the result of using analytical review, then the auditor will use other procedures that are applicable to obtain evidence.

2. Inquiry

It consists of seeking information of knowledgeable persons, both financial and non-financial, within the entity or outside the entity.

It is used extensively in addition to other audit procedures.
For example, the auditor can inquire the management of the treatment adopted for recording/disclosing the contingent liability.

3. Observation
It consists of looking at a process or procedure being performed by others.
For example, the auditor can observe the inventory counting by entity's personnel.

4. Inspection
It involves the examination of records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset.
For example, inspection of records for evidence of authorization.

5. External Confirmation
It represents the audit evidence obtained by the auditor as a direct written response to the auditor from a third party (Confirming Party), in paper form or by electronic or other medium.
For example, the auditor may request confirmation of terms of agreements or transactions an entity has with third parties.

6. Recalculation and Re-performance
Recalculation consists of checking the mathematical accuracy of documents or records, performed either manually or electronically
Re-performance involves auditor's independent execution of procedures or controls that were originally performed as part of entity's internal control.
For example, the auditor may re-perform the reconciliation of bank statements or the aging of accounts receivable.

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HOW AUDITORS ARE APPOINTMENTS?

1. Section 139(6) Companies Act, 2013 deals with the Appointment of first Auditor in case of **every company except government company** or those companies which are owned or controlled by the state or central government.

2. It states that the First auditor of a company, other than a Government Company, shall be appointed by the **Board of Directors within thirty (30) days** of the date of Incorporation of a company.

3. The auditor so appointed, shall hold office until the conclusion of the first annual general meeting

If the Board Fails to appoint the first auditor, it shall inform the members of company, who shall **within 90 days** at an Extra Ordinary General Meeting shall appoint auditor.

AUDIT REPORTS AND ITS TYPES

The auditor's report is a written letter from the auditor containing the opinion whether a company's financial statements comply with generally accepted accounting principles (GAAP). The independent and external audit report is typically published with the company's annual report. The auditor's report is important because banks and creditors require an audit of a company's financial statements before lending to them.

Basic Elements of Audit Report:

1. Title
2. Addressee
3. Auditor's Opinion
4. Basis for Opinion
5. Going Concern
6. Key Audit Matters
7. Responsibilities for Financial Statements
8. Auditor's Responsibilities for Audit F/S
9. Other Reporting Responsibilities
10. Signature and Address of Auditor and Date

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TYPES OF Reports/ Opinion:

- **Qualified Opinion**

The Auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements are material but not pervasive.

- **Adverse Opinion**

The Auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive.

- **Disclaimer Report**

The Auditor shall disclaim an opinion when he is unable to obtain sufficient appropriate audit evidence, and he concludes that the possible effects on the financial statements of undetected misstatements could be both material and pervasive.

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- **Unqualified Report**

An unqualified report is also called a clean report. Issued by the external auditors, this report states that the company affairs and statements are valid and are free from any manipulation. Moreover, it also shows that the company stands true to its overall stakeholders, and a sense of trust gets build over time.

Practice Questions:

Q.1 Which of the following is not a Time-Adjusted Techniques?

A. Present Value index
B. Internal Rate of Return
C. Payback Period
D. Discounted Payback Period

Q.2 ______________ is the dealing with and analyzing money and investments for a person or a business to help make business decisions?

A. Financial Analysis
B. Financial Statement
C. Financial Management
D. Financial Audit

Q.3 Which of the following type of audit procedure involves the examination of records or documents?

A. Inquiry
B. Inspection
C. Recalculation
D. External Examination

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Q.4 Which of the following ratio provides a measure of the capacity of the business to meet its short-term obligations without any flaw?

A. Current Ratio
B. Acid Test Ratio
C. Cash Ratio
D. Leverage Ratio

Q.5 Which of the following are the activities that constitute the primary or main activities of an enterprise?

A. Operating Activities
B. Investing Activities
C. Financing Activities
D. Both A and B

Q.6 _____________ is the return expected by the providers of capital.

A. Leverage
B. Capital Budgeting
C. Cost of Capital
D. Working Capital Management

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Partnership definition:

A partnership is a kind of business where a formal agreement between two or more people is made and agreed to be the co-owners, distribute responsibilities for running an organization and share the income or losses that the business generates.

In India, all the aspects and functions of the partnership are administered under 'The Indian Partnership Act 1932'. This specific law explains that partnership is an association between two or more individuals or parties who have accepted to share the profits generated from the business under the supervision of all the members or behalf of other members.

As per Section 4 of the Indian Partnership Act 1932, partnership is the relation between persons who have agreed to share the profit of a business carried on by all or any of them acting for all.

Main Characteristics of a partnership:

1. Contract or Formation – A firm having multiple owners must have a legal agreement between all the partners. So, it is compulsory to have a partnership contract to establish a partnership firm.

2. Unlimited Liability – All the partners are liable for the payment of the debts, even if they have to liquidate their personal assets.

3. Continuity – In the context of death, bankrupt, and retirement of any partners, etc., the partnership will be dissolved, and the remaining partners must make a fresh agreement amongst each other. Similarly, a son cannot inherit his father's partnership, but with the agreement of other partner members, he can be added as a new partner.

4. Number of Members – There is no specific number as to the maximum number of members a partnership firm can have. However, according to the Companies Act, 2013, for banking only 10 members are allowed. For other firms, the maximum member should not exceed more than two hundred.

5. Mutual Agency- This means all the partners should take responsibility for a firm's operation. But sometimes one partner on behalf of the rest of the partners can supervise or take actions.

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Brief overview of Indian Partnership Act 1932

Most of the businesses in India adopt a partnership business, so to monitor and govern such partnership, The Indian Partnership Act was established on the 1st October 1932. Under this act, an agreement is made between two or more person who agrees to operate the business together and distribute the profits they gain from this business.

The five important elements of The Indian Partnership Act 1932 are:

- **Agreement for Partners** – It is an association of two or more individuals and a partnership arises from an agreement or a contract. The agreement (accord) becomes the basis of t he association between the partners. Such an agreement is in the written form. An oral agreement is also legitimate. In order to avoid controversies, it is always good, if the partners have a copy of the written agreement.
- **Two or More Persons** – In order to manifest a partnership, there should be at least 2 persons possessing a common goal. To put it in other words, the minimal number of partners in an enterprise can be 2. However, there is a constraint on their maximum number of people.

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- **Sharing of Profit** – Another significant component of the partnership is, the accord between partners has to share gains and losses of a trading concern. However, the definition held in the Partnership Act elucidates – partnership as an association between people who have consented to share the gains of a business, the sharing of loss is implicit. Hence, sharing of gains and losses is vital.
- **Business Motive** – It is important for a firm to carry some kind of business and should have a profit gaining motive.
- **Mutual Business** – The partners are the owners as well as the agent of their firm. Any act performed by one partner can affect other partners and the firm. It can be concluded that this point act as a test of partnership for all the partners.

Partnership Deed:

A partnership deed also called as a partnership agreement, is a record that outlines in detail the rights and functionalities of all parties to a business operation. It has the force of law and is designed to guide the partners in the conduct of the business.

All the rights and responsibilities of each member are documented in a document known as Partnership Deed. This deed can be oral or written, however, an oral agreement is of no use when the firm has to deal with the tax.

Broad contents of partnership deed:

- The name of the firm.
- Name and addresses of the partners.
- Nature of the business.
- The term or duration of the partnership.
- The amount of capital to be contributed by each partner.
- The drawings that can be made by each partner.
- The interest to be allowed on capital and charged on drawings.
- Rights of partners.
- Duties of partners.
- Remuneration to partners.
- The method used for calculating goodwill.
- Profit and loss sharing ratio

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Provisions of Partnership Act in absence of Partnership Deed:

It is not compulsory to have a partnership deed for a partnership firm. Hence if a firm is not having any written agreement or a partnership deed or if partnership deed is there but it is silent on certain issues the following provisions of the Indian Partnership Act 1932 will be applicable.

1) Profit sharing Ratio: Profits and losses would be shared equally among partners.
2) Interest on capital: No interest on capital would be allowed to partners.
3) Interest on drawings: Interest on drawings is the amount charged to partner's current account on their drawings. No interest on drawings would be charged from partners. The interest on drawings is debited to partner's current account
4) Salary: No salary or commission is to be allowed to partners.
5) Interest on Loan: If a partner has provided any Loan to the firm, he would be paid Interest at the rate 6% p.a. This interest on loan is a charge against profits i.e. it is to be allowed even if there are losses to the firm.

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6) Admission of a new partner: A new Partner can be admitted only with the consent of all the existing partners.
7) Right to participate in the business: Each partner has a right to participate in the proceedings of the business.
8) Inspection of the accounts of the firm: Each partner has the right to inspect the accounts of the firm and can have a copy of the same.
9) Any of the above provisions can be changed by the partners after an agreement.

Types of Partners:

The partnership Act does not specifically define the types of partners, however the definition of partner depends upon their characteristics. Following are the type of partners

1. Active Partner:

An active partner is also known as Ostensible Partner. As the name suggests he takes active participation in the firm and the running of the business. He/she carries on the daily business on behalf of all the partners.

2. Dormant/sleeping partner:

This is a partner that does not participate in the daily functioning of the partnership firm, i.e. he/she does not take an active part in the daily activities of the firm. He/she is however bound by the action of all the other partners.

3. Nominal Partner:

This is a partner that does not have any real or significant interest in the partnership. So, in essence, he/she is only lending his name to the partnership. He/she will not make any capital contributions to the firm, and so he/she will not have a share in the profits either. But the nominal partner will be liable to outsiders and third parties for acts done by any other partners.

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4. Partner by Estoppel:

If a person holds out to another that he/she is a partner of the firm, either by his words, actions or conduct then such a partner cannot deny that he/she is not a partner. This basically means that even though such a person is not a partner he/she has represented him/herself as such, and so he becomes partner by estoppel or partner by holding out.

5. Partners in profit only:

This partner will only share the profits of the firm, he/she will not be liable for any liabilities. Even when dealing with third parties he/she will be liable for all acts of profit only, he/she will share none of the liabilities.

6. Minor Partner:

A minor (person below 18 years of age) cannot be a partner of a firm according to the Contract Act. However, a partner can be admitted to the benefits of a partnership if all partners give their consent for the same. He/she will share profits of the firm but his/her liability for the losses will be limited to his/her share in the firm i.e. Limited liability.

Such a minor partner on attaining majority has six months to decide if he/she wishes to become a partner of the firm. He/she must then declare his/her decision via a public notice. So whether he/she continues as a partner or decides to retire, in both cases he/she will have to issue a public notice.

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Basics of Accounting of partnership firm

Capital Account

Capital account is opened for each partner. When partner brings in money, the partner's capital account is credited and when he takes out the money, capital account is debited or a separate account called drawings account will be debited and finally the drawings account will be transferred to partner's capital account.

Profit & Loss statement

The profit and loss statement is prepared and finally the profit or loss is transferred to respective partner's capital account as per the terms of partnership deed. If there is no agreement, the profits will be distributed amongst the partners equally. If partnership deed provides for payment of salary & allowance of interest on capital, then the same shall be deducted from profits. The remaining profits will divided amongst partner. If a partnership deeds says specific ratio, then the profits will be divided in that ratio.

Profit & Loss appropriation Account

Once the profit is arrived in the profit and loss account, the balance of profit is transferred from debit side of profit and loss account to the credit side of profit and loss appropriation account. The adjustment such as interest on capital, salary, drawings and loans are adjusted before transferring the profits to capital account of partners.

Methods of accounting:

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There are two methods of accounting:

1. Fixed capital method: Initially capital contribution by the partners are credited to partners capital account and all subsequent transaction such as profits, interest on capital, partner's salary and drawings are done through another account known as current account. In this case initial capital account is not changed.

2. Fluctuating capital method: All transactions and events are passed through capital accounts. The capital account balance fluctuates.

Goodwill and its treatment:

Over a period of time, a business firm develops a good name and reputation among the customers. This help the business earn some extra profits as compared to a newly set up business. In accounting, capitalized value of this extra profit is known as goodwill.

It is intangible asset. The valuation of goodwill is required in following circumstances

- Due to change in profit sharing ratio
- New partner is admitted
- Partner retire or dies
- Business is dissolved or sold

Accounting standards requires business to recognize the goodwill as an intangible asset, if certain conditions are satisfied.

- Intangible must possess characteristics of an asset. It means that it must have some value and clearly identifiable.
- Future economic benefits should flow to the business enterprise out of the intangible.
- Cost of the asset is measurable reliably
- Goodwill should be recorded in the books only when some consideration in money or money's worth has been paid for it.

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Self or internally generated goodwill are not recorded.

Methods of calculation of Goodwill:

1. Simple Average Profit Method:

- Under this method, average of the profits of certain given years is calculated.
- The value of the goodwill is calculated at an agreed number of years purchase of the average profit. Thus, the goodwill is calculated as follows:

Value of goodwill = Average Profit × Number of years of purchase

For example, the average profits of a firm of say 7 years is Rs. 50,000 and the goodwill is to be calculated at 5 years purchase of the average profit.

The value of the goodwill will be Rs. 2,50,000 [50,000 × 5].

Thus, **Goodwill = average profits × Number of years purchase.**

2. Super Profit method:

- Super profit is the excess of actual profit over the normal profit. If a new business earns certain percentage of the capital employed, it is called 'normal profit'.
- The value of the goodwill is calculated at an agreed number of years purchase of super profit by multiplying the Super Profit by the certain number of years.
- Normal profit is that profit which is, earned by other business unit of the same business. Normal profit will be calculated as follows:

Normal profit = Capital employed × normal rate of return/100

Actual Profit: These are the profit earned during the year or it is also taken as the average of the last few years profit.

Super Profit = Actual Profit – Normal Profit

For example, a firm earns profit of Rs. 70,000 on a capital of Rs. 4,00,000 and the normal rate of return in similar business is 10%. Then the normal profit is Rs. 40,000 [10% of the Rs. 4,00,000].

The actual profit is Rs. 70,000.

Thus, Super profit = Actual profit – Normal profit

= 70,000 – 40,000

= 30,000

If value of Goodwill is calculated by 2 years' purchase of super profit, then

goodwill is equal to Rs. 60,000 [30,000 × 2].

3. Weighted average method:

- This method is a modified version of average profit method. In this method each year profit is assigned a weight i.e. 1, 2, 3, 4 etc.
- Thereafter each year profit is multiplied by the weight and find product.
- The total of products is divided by the total of weight. As a result, we find the weighted average profit.
- After this the value of goodwill is calculated multiplying the weighted average profit by the agreed number of year's purchase.
- Thus, the goodwill is calculated as follows,

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Weighted average profit = Total product of profit / Total of weights

Value of goodwill = Weighted average profit × number of years of purchase

(Note: This method is used when we observe that there is a tendency to increase the annual profits. Latest year profit is assigned the highest weight.

Illustration:

The profit of ABC firm for past years were as follow:

Year	Profits (Rs.)
2014	80,000
2015	75,000
2016	92,000
2017	1,05,000
2018	1,20,000

The weight to be used are 1, 2, 3, 4, and 5 for the years from 2014 - 2018

Calculation of Goodwill based on three year's purchase of weighted average profit.

Year	Profits	Weight	Products
2014	80,000	1	80,000
2015	75,000	2	1,50,000
2016	92,000	3	2,76,000
2017	1,05,000	4	4,20,000
2018	1,20,000	5	6,00,000
	Total:	**15**	**15,26,000**

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Weighted Average Profit = 15,26,000/15 = 127,166.667

Goodwill = 127,166.667 × 3 = 381,500

Goodwill = Rs. 381,500

4. Capitalisation Method:

- ₹ In this method, goodwill is the amount of capital saved. Normally businessmen invest capital to operate business activities and earn profit with the efficient utilisation of capital.
- ₹ If the business earns more profit by investing lesser amount of capital as compared to other business, who earned same amount of profit with more amount of capital, the saved amount is assumed to be goodwill.

Under this method, the Goodwill is calculated in two ways:

i. Capitalisation of Average profit: In this method, the value of goodwill is assumed to be excess of the capital value of average profit over the actual capital employed.

Capital employed = Total Assets – Outsider Liabilities

Capitalised Value of Profit = Average Profit × 100/ Normal Rate of Profit

Goodwill = Capitalised Value of Profits – Capital Employed

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Illustration:

A firm earned average profit during the last few years is Rs. 70,000 and the normal rate of return in similar business is 10%. The total assets are Rs. 10,60,000 and outside liabilities is Rs. 7,50,000.

Capital employed = Total assets - Outside liabilities

= 10,60,000 – 7,50,000

= 3,10,000

Capitalised value of average profit = Average Profit × 100/ Normal rate of profit

= 70,000 × 100/10

= 7,00,000

Goodwill = Capitalised value – Capital employed

= 7,00,000 – 3,10,000

= 3,90,000

Goodwill = Rs. 3,90,000

ii. Capitalisation of Super Profit: In this method, the value of goodwill is calculated on the basis of super profit method. Goodwill is the capitalised value of super profit.

Goodwill = Super Profit × 100/Normal Rate of Profit

Illustration:

A firm earns a profit of Rs. 56,000 and has invested capital amounting to Rs. 2,00,000. In the same business normal rate of earning profit is 20%.

Actual profit = Rs. 56,000

Normal profit = 2,00,000 × 20/ 100 = 40,000

Super Profit = Actual Profit – Normal Profit

=56,000 – 40,000

= 16,000

Goodwill = Super profit × 100/normal rate of profit

= 16,000 × 100/20

= 80,000

Goodwill = Rs. 80,000

<u>Admission of Partner:</u>

New partner may be admitted when the firm needs additional capital or managerial help. According to the provisions of Partnership Act 1932 unless it is otherwise provided in the partnership deed a new partner can be admitted only when the existing partners unanimously agree for it.

Following adjustments are made while admitting the new partner:

- ✓ Recording the capital of a new partner
- ✓ Calculation of new profit-sharing ratio and sacrificing ratio
- ✓ Revaluation of assets & liabilities
- ✓ Transfer of undistributed profit and loss
- ✓ Treatment of accumulated reserves
- ✓ Treatment of goodwill

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New profit-sharing ratio & sacrificing ratio:

When new partner is admitted he acquires his share in profits from the old partners. In other words, on the admission of a new partner, the old partners sacrifice a share of their profit in favor of the new partner. *Sacrificing ratio is the ratio sacrificed by old partners as a course of inducting a new partner.*

Sacrificing Ratio = Old Ratio – New Ratio

Accounting treatment of goodwill in case of admission of partners:

- The goodwill to be recorded in the books only when some consideration in money or money's worth has been paid for it.
- Only purchased goodwill to be recorded in books.
- In case of admission of new partner, goodwill cannot be raised since no consideration in money or money's worth is paid for it.
- If the incoming partner brings premium over and above his capital contribution at the time of his admission, such premium should be distributed to other existing partners.
- When new partner is admitted to firm, the old partner will stand to lose the profit share.
- Therefore, the premium for goodwill brought in by new partners shall be given to existing partners in sacrificing ratio.

Revaluation of assets and reassessment of liabilities:

Whenever new partner is admitted, assets are revalued, and liabilities are reassessed. A revaluation account is opened for this purpose. This account is debited with all reduction in the value of assets and increase in liabilities and credited with increase in value of assets and reduction in value of liabilities. The difference reflects the profit or loss and the same is transferred to Capital accounts in old profit-sharing ratio.

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Transfer of undistributed profit or loss:

- Sometimes, the balance sheet of the partnership firm may show undistributed profits in form of profit and loss account in the liabilities side.
- The undistributed loss in the business is generally shown at the asset side of the old balance sheet.
- The new partner is not entitled to have any share in the undistributed profit or loss.
- Therefore, the undistributed profit or loss should be transferred to old partners in old profit-sharing ratio.
- Sometime, partners of firm may set aside a portion or percentage of the profit earned to meet the unexpected or unforeseen losses arise in future in the name of reserve.
- At the time of admission of a new partner if there is any reserve, it should be transferred to the capital accounts of the old partners in the old profit-sharing ratio.

<u>Illustration for Admission of Partner:</u>

The Balance Sheet of Vimal and Pavan who shared profits in the ratio of 3: 2 was as follows on Jan. 01, 2020.

Liabilities	Amount	Assets	Amount
Sundry Creditors	12,000	Cash in Hand	15,000
Partner's capital		Sundry Debtor – 12,000	
Vimal – 50,000		Less: Provision - 500	11,500
Pavan- 40,000	90,000	Stock	35,000
	1,02,000	Plant & Machinery	32,000
		Patents	8,500
Total	**1,02,000**	**Total**	**1,02,000**

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On this date Shivam was admitted as a partner on the following conditions:

1. He was to get 2/5 share of profit.

2. He had to bring in Rs 70,000 as his capital.

3. He would pay cash for goodwill which would be based on 2 years purchase of the profits of the past four years.

4. Vimal and Pavan would withdraw half the amount of goodwill premium brought by Shivam.

5. The assets would be revalued as: Sundry Debtors at book value less a provision of 10%; Stock at Rs 40,000; Plant and Machinery at Rs 40,000; and Patents at Rs 12,000.

6. Liabilities were valued at Rs 23,000, one bill for goods purchased having been omitted from books.

7. Profit for the past four years were:

2011 - 10,000 2012 - 17,000 2013 - 30,000 2014 - 20,000 Prepare and ledger accounts to record the above, and prepare the Balance Sheet after Shivam's admission.

The goodwill of the firm is Rs 38,500 worked out as under:

Year	Amount
2011	10,000
2012	17,000
2013	30,000
2014	20,000
Total	**77,000**

Average profits = Rs. 77,000/4 = Rs. 19,250/-

Goodwill at 2 years of purchase = Rs. 19,250 x 2=Rs. 38,500

Shivam's share of goodwill = Rs. 38,500 x 2/5 = Rs. 15,400

The new profit-sharing ratio will be:

- Vimal = (1-2/5) x 3/5 = 3/5 x 3/5 = 9/25
- Pavan= (1-2/5) x 2/5 = 3/5 x 2/5 = 6/25
- Shivam= 2/5 = 10/25

The new ratio is Vimal, Pavan and Shivam = 9:6:10.

Accounting treatment in case of goodwill and change in profit sharing ratio:

The value of goodwill should be determined and adjusted through capital accounts based on profit sharing ratio.

Sometimes, the partners of a firm decide to change their existing profit sharing ratio without any admission or retirement of a partner. This results in a gain of additional share in future profits of the firm for some partners while a loss of a part thereof for other partners.

For example, A, B and C are partners in a firm sharing profits in the ratios of 7:4:2.

It is felt that A will no more be able to actively participate in the affairs of the firm. Hence, with effect from April 1, 2007, they decided that, in future they will share the profits in the ratio of 4:5:4.

This results in A losing 3/13 (7/13-4/13) share in profits,

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B and C gaining 1/16 (5/13-4/13) and 2/16 (4/13-2/13).

Retirement of partners:

When a partner retires, his share in the properties of the firm has to be ascertained and paid off. Certain adjustments have to be made in the books to ascertain the amount due to him from the firm. These adjustments are similar to the adjustments given above for admission of partners. Following process are followed:

- ✓ Calculation of new profit sharing ratio and gaining ratio.
- ✓ Revaluation of assets and liabilities
- ✓ Transfer of undistributed profit or loss
- ✓ Transfer of accumulated reserves
- ✓ Treatment of goodwill
- ✓ Settlement of retiring partner's claim.

New profit-sharing ratio = Old share + Acquired share (gain)

Gain = New share – Old share.

- At the time of retirement of a partner, it is necessary to revalue the assets and liabilities of the firm.
- It is necessary that the retiring partner is given a share of all profits that have arisen till his retirement.
- Further, he is made to bear his share of losses that had occurred till his retirement.
- A Revaluation account is opened and credited with all the profit items and debited with all the loss items.
- The profit or loss on revaluation will be transferred to partners' capital accounts including the retiring partner in the old profit-sharing ratio.
- At the time of retirement of a partner, undistributed profit or loss of the old firm should be transferred to all partners' capital accounts in their old profit-sharing ratio.
- Any amount kept aside as Reserve, General reserve, Reserve fund, contingency reserve etc., at the time of retirement of a partner, should be transferred to the capital accounts of all partners including retiring partner in the old profit-sharing ratio.
- At the time of retirement of a partner, adjustment for goodwill of the firm, if any, has to be made as in admission. In retirement too, we confine to the Revaluation Method only.

Accounting treatment of goodwill in case of Retirement:

In case of retirement of a partner, the continuing partner will gain in terms of profit sharing ratio. They have to pay the retiring partner for his share of goodwill in the firm in gaining ratio.

Death of Partner:

Business of partnership may not come to an end due to death of partner as it is known as reconstitution of partnership.

The problems arising out of death of problem are same as that of retirement of partner viz. assets & liabilities have to be revalued and resultant profit or loss is transferred to the capital accounts of all partners including deceased partner.

Goodwill is dealt exactly in same way as that of retirement.

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Whether outgoing partner or representative of deceased partner is eligible for share of subsequent profits?

As per Section 37 of the Indian Partnership Act. where any member of a firm has died or otherwise ceased to be partner, and the surviving partners carry on the Business of the firm with the property of the firm without any final settlement of accounts as between them and outgoing partner or his estate in the absence of contract to contrary, the outgoing partner is entitled at the option of himself or his representatives to such share of profits made since he ceased to be a partner as may be attributable to the use of his share of the property of the firm or to interest at the rate of 6% per annum on the amount of his share in the property of the firm.

If an option is given to surviving partners to purchase the share of deceased & the surviving partners elects the option, then the outgoing partner or his representatives are not entitled to further or other share of profits

Accounting Treatment:

The accounting treatment in the event of death of a partner is similar to that in case of retirement of a partner, and that in case of death of a partner his claim is transferred to his executors and settled in the same manner as that of the retired partner

What are the amounts payable to Legal representative of died partner?

- ✓ Capital account of deceased partner
- ✓ Interest on capital, if provided in Partnership deed
- ✓ Share of goodwill
- ✓ Share of undistributed profits or reserves
- ✓ Share of profits on revaluation of assets & Liabilities
- ✓ Share of profits upto death
- ✓ Share of Joint life policy

How the profit is calculated upto death of partner?

Such profits are to be calculated through P & L suspense account. After ascertaining the amount due to deceased partner, it should be credited to Executor's account.

If the death of partner occurs during the year, the representatives of the deceased partner are entitled to his/her share of profits till the date of his/her death.

Company Accounts

Company is an artificial person created by law with the perpetual succession and a common seal. **The important features of a company are as follows:**

- ➢ A Company is incorporated. Without operation of law, a company cannot exist
- ➢ A Company is a separate legal entity and is not affected by any change. A company can contract, sue and be sued in its own name.
- ➢ It has perpetual existence
- ➢ The Company has common seal
- ➢ The liability of every shareholder is limited to the amount he has agreed to the pay to the Company on shares allotted to him.

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Distinction between a company and partnership firm

Basis of Difference	Company	Partnership Firm
1. Mode of Creation	By Registration under the Companies Act,2013	By agreement called Partnership Deed which may be written or oral. Registration under the Partnership Act, 1932 is not compulsory.
2. Legal Status	Legal entity distinct from members. Has a perpetual succession.	Firm and Partners are not separate. No perpetual succession. Thus having a uncertain life.
3. Liability of Members	Limited Liability	Unlimited Joint and several liabilities of partners.
4. Authority	Separation of ownership from management. It is managed by Board of directors who are the representatives of the member.	Ownership and Management are in common hands. Partners have the right to take part in the management. Each partner has implied authority to bind the firm by his/her dealing.
5. Number of Members	Public Company – minimum 7; maximum – unlimited. Private Company minimum- 2 ; maximum – 200.	Minimum-2 ; maximum – 50
6. Legal Formalities	Statutory books have to be maintained. Audit of accounts is compulsory. Documents and required information is to be file. Publication of accounts required.	No legal formalities. Registration is not compulsory. Audit is also not compulsory.
7. Resources	Large and unlimited resources especially in case of public companies as funds can be raised through public.	Limited Resources. Dependent on Partners personal account.
8. Dissolution	May be dissolved only according to the provisions of law- usually by an order of the court.	Dissolution by agreement, by notice, or by court. Death of the partner dissolves the partnership.

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Books of Accounts:

As per Section 128 of the Companies Act 2013,

- Every Company shall prepare and keep at its registered office books of accounts and other relevant books and papers and financial statements for every financial year which reflect true and fair view of the state of affairs of the Company.

- It shall be kept on accrual basis and according to the double entry system of accounting.

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The financial statement comprises of following:

1. A Balance sheet at the end of financial year
2. A profit and loss account, in case of company carrying on any activity not for profit, an income and expenditure account for the financial year.
3. Cash flow statement
4. Statement of changes in equity
5. Any explanatory note.

For Insurance Company, Banking Company, Electricity Company are governed by sector specific statue.

Compliance with Accounting Standards:

As per Section 129 of the Companies Act 2013, it is mandatory to comply with accounting standards notified by central government.

The financial statements are prepared in accordance with schedule III of the Companies Act 2013. It shall give true and fair view of the state of affairs of the Company or companies and comply with the accounting standards notified under Section 133.

Questions:

1) All the aspects and functions of the partnership are administered under__________
   a. The Limited Liability Partnership Act, 2008
   b. The Companies Act, 2013
   c. The Contracts Act, 1872
   d. None of the Above

2) ______________ is also known as Ostensible Partner.
   a. Dormant Partner
   b. Partner by estoppel
   c. Active Partner
   d. Nominal Partner

3) Which of the following amounts is/are payable to Legal representative of a deceased partner?
   a. Capital account of deceased partner
   b. Interest on capital
   c. Share of goodwill
   d. All of the Above

4) Partnership is defined under _____ section of the Indian Partnership Act,1932
   a. 4
   b. 2
   c. 3
   d. 5

Answer: 1 – d, 2 – c, 3 – d, 4 – a

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Ledger Accounts

A ledger is a book containing accounts in which the classified and summarized information from the journals is posted as debits and credits.

A ledger may be in the form of bound register, or cards, or separate sheets may be maintained in a loose leaf binder. In the ledger, each account is opened preferably on separate page or card.

The ledger contains the information that is required to prepare financial statements such as Trial Balance and Balance Sheet.

It includes accounts for assets, liabilities, owners' equity (capital), revenues and expenses. This complete list of accounts is known as the chart of accounts. The ledger represents every active account on the list.

A ledger is very useful and is of utmost importance in the organisation. The net result of all transactions in respect of a particular account on a given date can be ascertained only from the ledger.

Making Ledger Entry:

1. A general ledger is used to employ the double-entry system of book keeping method, which means that each financial transaction affects at least two general ledger accounts.

2. It also means each entry has a debit and a credit transaction.

3. Double-entry transactions are posted in two columns, with debit postings on the left and credit entries on the right, and the total of all debit and credit entries must balance.

4. Ledgers break up the financial information from the journals into specific accounts such as Cash, Accounts Receivable and Sales etc.

5. This allows you to see the details of all the transactions. For example, a cash account ledger will contain all the cash transactions of a business.

Features of Ledgers (Important)
▪ The ledger is known as **principle books of accounts.** It is a process of posting the journal into a T Account. ▪ A separate account is opened, and the journals are posted in the ledger. All debits on left side and all credits on right side. ▪ Difference between debits and credits are identified as balances. If the credit side is bigger than debit sides, it is credit balance. ▪ If debit side is more than credit side, it is debit balance. The credit balance is written on debit side as "to balance c/d". ▪ Then the credit balance is written on the credit side as "to balance b/d" as the opening balance of the new period. ▪ The nominal accounts are not balanced, and the balance is transferred to Profit and Loss account.

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Types of Ledger:

All ledger accounts are put into five categories namely, assets, liabilities, capital, revenues/gains and expense losses. All these accounts may further be put into two groups, i.e. permanent accounts and temporary accounts.

All permanent accounts are balanced and carried forward to the next accounting period.

The temporary accounts are closed at the end of the accounting period by transferring them to the trading and profit and loss account.

All permanent accounts appear in the balance sheet.

Thus, all assets, liabilities and capital accounts are permanent accounts and all revenue and expense accounts are temporary accounts.

1. Assets Ledger: It contains accounts relating to assets only e.g. Machinery account, Building account, Furniture account, Debtors, etc.

2. Liabilities Ledger: It contains the accounts of various liabilities e.g. Capital (Owner or partner), Loan account, Bank overdraft, Creditors etc.

3. Revenue Ledger: It contains the revenue accounts e.g. Sales account, Commission earned account, Rent received account, interest received account etc.

4. Expenses Ledger: It contains the various accounts of expenses incurred, e.g. Wages account, Rent paid account, Electricity charges account, etc.

5. General Ledger: It contains all those accounts which are not covered under any of the above types of ledger. For example, Landlord A/c, Prepaid insurance A/c etc.

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Let us understand Leger entry with an illustration:

Mr. ABC started a business in January 2021 and made following transactions.

Date	Transaction	Rs.
Jan 1	Commenced business with cash	50,000
Jan 3	Paid into bank	25,000
Jan 5	Purchased furniture for cash	5,000
Jan 8	Purchased goods and paid by cheque	15,000
Jan 8	Paid for carriage	500
Jan 14	Purchased Goods from Mr. SK	35,000
Jan 18	Cash Sales	32,000
Jan 20	Sold Goods to Mr. Raj on credit	28,000
Jan 25	Paid cash to Mr. SK in full settlement	34,200
Jan 28	Cash received from Mr. Raj	20,000
Jan 31	Paid Rent for the month	2,000
Jan 31	Withdrew from bank for private use	2,500

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Now let journalize these transactions:

Sl. No	Date 2021	Particulars	L.F.	Debit Amount (Rs.)	Credit Amount (Rs.)
1	Jan 1	Cash A/c To Capital A/c (Commenced business with cash)	1 5	50,000	 50,000
2	Jan 3	Bank A/c To cash A/c (Being Cash paid into the Bank)	2 1	25,000	 25,000
3	Jan 5	Furniture A/c To Cash A/c (Being purchased furniture for cash)	3 1	5,000	 5,000
4	Jan 8	Purchase A/c To Bank A/c (Being goods purchased by cheque)	7 2	15,000	 15,000
5	Jan 8	Carriage A/c To Cash A/c (Being cash paid for carriage charges)	8 1	500	 500
6	Jan 14	Purchase A/c To Mr. SK A/c (Being goods purchased for Credit)	7 6	35,000	 35,000
7	Jan 18	Cash A/c To Sales A/c (Being goods sold for cash)	1 10	32,000	 32,000
8	Jan 20	Mr. Raj A/c To Sales A/c (Being Goods sold to Mr. Raj on credit)	4 10	28,000	 28,000
9	Jan 25	Mr. SK To Cash A/c To Discount A/c (Being cash paid to Mr. SK and discount allowed by them)	6 1 11	35,000	 34,200 800
10	Jan 28	Cash A/c To Mr. Raj (Being cash received from Mr. Raj)	1 4	20,000	 20,000
11	Jan 31	Rent A/c To Cash A/c (Being Cash paid for rent)	9 1	2,000	 2,000
12	Jan 31	Drawings A/c To Bank A/c (Being Cash withdrawn from bank for private use)	12 2	2,500	 2,500

L.F.: Ledger Folio

Now let us post these transactions into ledgers.

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Asset Legers (Real Accounts):

Dr. Cr.

1. Cash Account

Date	Particulars	J.F	Rs.	Date	Particulars	J.F	Rs.
2021				**2021**			
Jan 1	To Capital A/c	1	50,000	Jan 3	By Bank A/c	2	25,000
Jan 18	To Sales A/c	7	32,000	Jan 5	By Furniture A/c	3	5,000
Jan 28	To Mr. Raj A/c	10	20,000	Jan 8	By Carriage A/c	5	500
				Jan 25	By Mr. SK A/c	9	34,200
				Jan 31	By Rent A/c	11	2,000
				Jan 31	By Balance c/d		35,300
	Total:		**1,02,000**		**Total:**		**1,02,000**
Feb 1	To Balance b/d		35,300				

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Dr. Cr.

2. Bank A/c

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2021				**2021**			
Jan 1	To Cash	2	25,000	Jan 8	By Purchase	4	15,000
				Jan 31	By Drawings	12	2,500
	Total		**25,000**		**Total**		**25,000**
Feb 1	To Balance b/d		7500				

Dr. Cr.

3. Furniture A/c

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2021				**2021**			
Jan 1	To Cash	3	5000	Jan 31	By Balance c/d		5000
	Total		**5000**		**Total**		**5000**
Feb 1	To Balance b/d		5000				

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Debtors Ledger (Personal Account):

Dr. Cr.

4. Mr. Raj A/c							
Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2021				2021			
Jan 20	To Sales A/c	8	28,000	Jan 28	By Cash	10	20,000
				Jan 31	By Balance c/d		8,000
	Total		**28,000**		**Total**		**28,000**
Feb 1	To Balance b/d		8,000				

Liabilities Ledgers (Personal Accounts):

Dr. Cr.

5. Capital A/c of Mr. ABC							
Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2021				2021			
Jan 31	To Balance C/d		50,000	Jan 1	By Cash	1	50,000
	Total		**50,000**		**Total**		**50,000**
				Feb 1	By Balance B/d		50,000

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Creditors Ledger (Personal Account):

Dr. Cr.

6. Mr. SK A/c							
Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2021				2021			
Jan 25	To Cash	9	34,200	Jan 14	By Purchase	6	35,000
Jan 25	To Discount	9	800				
	Total		**35,000**		**Total**		**35,000**

Expenses Ledgers (Nominal Accounts):

Dr. Cr.

7. Purchase A/c							
Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2021				2021			
Jan 8	To Bank	4	15,000		By Trading A/c		50,000
Jan 14	To Mr. SK	6	35,000				
	Total		**50,000**				**50,000**

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Dr. Cr.

8. Carriage A/c							
Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2021				**2021**			
Jan 8	To Cash	5	500		By Trading A/c		500
	Total		**500**		**Total**		**500**

Dr. Cr.

9. Rent A/c							
Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2021				**2021**			
Jan 31	To Cash A/c	11	2000		By Profit and Loss A/c		2000
	Total		**2000**		**Total**		**2000**

Revenue Ledgers (Nominal Accounts):

Dr. Cr.

10. Sales A/c							
Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2021				**2021**			
	To Trading A/c		60,000	Jan 18	By Cash	7	32,000
				Jan 20	By Mr. Raj	8	28,000
	Total		**60,000**		**Total**		**60,000**

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Dr. Cr.

11. Discount A/c							
Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2021				**2021**			
	To Profit and Loss A/c		800	Jan 25	By Mr. SK	9	800
	Total		**800**		**Total**		**800**

General Ledger:

Dr. Cr.

12. Drawing A/c							
Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2021				**2021**			
Jan 31	To Bank	12	2,500	Jan 31	By Balance c/d		2,500
	Total		**2,500**				**2,500**
Feb 1	To Balance b/d		2,500				2,500

J.F.: Journal Folio

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Balancing of Account:

1. Balancing of an account is the process of finding out the difference between the total of debits and total of credits of an account.

2. If debit side total is more than the credit side, the account shows a debit balance. Similarly, the balance will be credit balance if the credit side total of an account is more than the debit side total.

3. This process of ascertaining and writing the balance of each account in the ledger is called balancing of an account.

4. You know that an account has two sides – debit and credit.

5. Items by which this account is debited are entered on its debit side and items by which this account is credited are entered on its credit side so all items related to an account are shown at one place in the ledger.

6. To know the net effect of this account i.e. the balance between its debit amount and credit amount, the following steps are following in balancing the ledger:

- ✓ Total the two sides of an Account on a separate rough sheet.
- ✓ Determine the difference between the two sides. If the credit side is more than the debit side, the balance calculated is a credit balance.
- ✓ Put the difference on the 'Shorter side' of the account such that the totals of the two sides of the account are equal.
- ✓ If the difference amount is written on debit side (i.e., if credit. side is bigger) then write as "Balance c/d" (c/d stands for carried down).
- ✓ If difference is written on the credit side (i.e., if debit side is bigger) then write it as "Balance c/d.
- ✓ Finally, at the end of the year all the ledger accounts are closed by taking out the balance of each account.
- ✓ The Balance then should be brought down or carried forward to the next period.
- ✓ If the difference was put on credit side as "Balance c/d" it should now be written on the debit side of the account as "Balance b/d" (b/d stands for brought down) and vice-a-versa.
- ✓ Thus, debit balance will automatically be brought down on the debit side and a credit balance on the credit side.

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Balancing of Different Types of Accounts:

Items	Balancing Effect
Assets	All asset accounts are balanced. These accounts always have a debit balance.
Liabilities	All Liability accounts are balanced. All these accounts have a credit balance.
Capital	This account is always balanced and usually has a credit balance.
Expenses and Revenue	These Accounts are not balanced but are simply totaled up. (Recall the rules for nominal account) The debit total of Expense/Loss will show the expense/Loss. In the same manner, credit total of Revenue/Income will show increase in income.

Distinction between Journal and Ledger

Following points of comparison are worth noting:

1. The Journal is the book of first entry (original entry); the ledger is the book of second entry.
2. The Journal is the book for chronological record; the ledger is the book for analytical record.
3. The Journal, as a book of source entry, gets greater importance as legal evidence than the ledger.
4. Transaction is the basis of classification of data within the Journal; Account is the basis of classification of data within the ledger.
5. Process of recording in the Journal is called Journalising; the process of recording in the ledger is known as Posting.

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Practice Questions

Q.1 The ledger is also known as?

A. Income Statement
B. Book of First Entry
C. Subsidiary books of accounts
D. Principle books of accounts

Q.2 Prepaid insurance A/c will be classified under which of the following head of ledger accounts?

A. General Ledger
B. Expenses Ledger
C. Liabilities Ledger
D. None of the above

Q.3 The process of recording in the ledger is known as?

A. Journalising
B. Posting
C. Both A and B
D. Neither A nor B

Answers:

1- D; 2- A; 3 - B

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Cash Book, and Financial Audit

There are many books opened for accounting purpose. Instead of journalizing all the transactions in one register, one can categorize the entries on the basis of type of transactions and that is the reason for subsidiary books. Hence subsidiary book is part of journalizing the transaction.

The transactions are recorded in the book & then the ledgers are prepared. Subsidiary books are also called books of **prime entry/ daybooks.** The subsidiary books help in dividing the accounting work between different staffs.

Types of subsidiary books:

1. Cash book – records receipt and payment of cash.
2. Purchase book – to record credit purchase.
3. Purchase return book – to record return of goods and material previously purchased.
4. Sales books – to record sales.
5. Sales returns book – to record the returns made by the customer.
6. Bills receivable books – to record the receipts on accrual basis.
7. Bills payable book - to record payables on accrual basis.
8. Journal proper- to record transactions which cannot be entered in above book.

Cash Book:

Cash book is a book in which all transactions relating to cash receipts and cash payments are recorded. It starts with the cash or bank balances at the beginning of the period. Generally, it is made on monthly basis. This is a very popular book and is maintained by all organisations, big or small, profit or not-for profit. It serves the purpose of both journal as well as the ledger (cash) account. **It is also called the book of original entry.** When a cashbook is maintained, transactions of cash are not recorded in the journal, and no separate account for cash or bank is required in the ledger.

Here transactions are recorded in the cash book and then the ledger is prepared.

For example, if goods for Rs. 10,000 have been purchased for cash, then this is transactions is entered in cash book and a ledger entry is passed in purchase account.

Therefore, cash book is a subsidiary book. The balance in cash book is entered in the trial balance directly. The cash books forms part of ledger. Hence the cash book is also treated as principle book.

- The receipts are entered on left side and the payments are entered on the right side
- The total of debit side is always higher than credit side since the payment cannot exceed the cash balance.
- Cash book performs the functions of both journal and ledger at the same time.

Cash Book with Bank Column:

The double column cash book has two money columns on both debit and credit sides – one to record cash transactions and one to record bank transactions.

The cash column is used to record all cash transactions and works as a cash account whereas bank column is used to record all receipts and payments made by checks and works as a bank account.

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Both the columns are totalled and balanced at the end of an appropriate period.

Why Double Column cash book?

Since a double column cash book provides cash as well as bank balance at the end of a period, some organizations prefer to maintain a double column cash book rather than maintaining two separate ledger accounts for recording cash and bank transactions.

Double Column Cash Book Format:

Cash Book (Double Column)

For the month ended ....

Receipts					Payments				
Date	*Description*	*Ref*	*Cash*	*Bank*	*Date*	*Description*	*Ref*	*Cash*	*Bank*

Recording Transactions in Double Column Cash Book:

Recording cash transactions:

1. All cash receipts are recorded in cash column on the debit side and all cash payments are recorded in cash column on credit side of the double column cash book.

2. If cash is received from a debtor or customer and is deposited into the bank account on the same date, the entry will be made in the bank column on the debit side, not in the cash column.

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Recording bank transactions:

1. When a cheque is received and the same is deposited into the bank account on the same date, the amount is entered in the bank column on the debit side.

2. When an amount is withdrawn from the bank, the entry is made in the bank column on the credit side and in the cash column on debit side. It is called a contra entry.

3. When a cheque is issued, the amount of the cheque is entered in the bank column on the credit side.

Recording contra entries:

1. The contra entry involves a cash account and a bank account, and which is recorded on both debit and credit sides of the double column cash book at the same time.

2. This entry is not posted to any ledger account because both debit and credit aspects of transaction are handled within the cash book and the double entry work is completed.

3. In posting reference column, the letter "C" is written to denote that the entry is a contra entry and will not be posted to any ledger account.

Petty cash book:

For a business, several small payments such as stationeries, cab etc. has to be made. Normally, the Company have ceiling for disbursing petty cash. Any amount given up to the ceiling is accounted in petty

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cash book. The person who deals with petty cash is called petty cashier.

The petty cashier works on the Imprest system. Under this system, a definite sum, say Rs. 1,000 is given to the petty cashier at the beginning of a certain period. This amount is called imprest amount. The petty cashier goes on making all small payments out of this imprest amount and when he has spent the substantial portion of the imprest amount say Rs. 870, he gets reimbursement of the amount spent from the head cashier. Thus, he again has the full imprest amount in the beginning of the next period.

Financial Audit

What is a Financial Audit?

A financial audit is an independent examination and evaluation of the financial statements and information of an organization, whether profit oriented or not, and irrespective of its size and legal form, to make sure that the financial records are a fair and accurate representation of the transactions they claim to represent.

OBJECTIVES OF FINANCIAL AUDIT:

1. The objective of a financial statement audit is to obtain reasonable assurance that the financial statements are free of material misstatement.

2. For the above stated objective, an audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements.

3. It also includes an assessment of the accounting principles used, and significant estimates made, by management as well as an evaluation of the overall financial statement presentation.

4. SA-200 which states "Overall Objectives of the Independent Auditor".

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HOW AUDITORS ARE APPOINTMENTS?

1. **Section 139(6) Companies Act, 2013** deals with the Appointment of first Auditor in case of **every company except government company** or those companies which are owned or controlled by the state or central government.

2. It states that the First auditor of a company, other than a Government Company, shall be appointed by the **Board of Directors within thirty (30) days** of the date of Incorporation of a company.

3. The auditor so appointed, shall hold office until the conclusion of the first annual general meeting

If the Board Fails to appoint the first auditor, it shall inform the members of company, who shall **within 90 days** at an Extra Ordinary General Meeting shall appoint auditor.

Financial Auditing Process:

Generally, the financial audit of a business has four main phases:

1. **Planning The Audit**
   The process of financial audit begins with a plan that involves the

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method of collecting data to form an opinion about the organization or company's financial status. A way is planned to collect a sample reflecting a point in time in the life of the company or organization. The financial transactions and documents are then looked at.

It's also worth mentioning that sample should show compliance with GAAP.

2. Setting Internal Controls

The next step involves giving a look at the internal controls. The auditor demands info, looks closely at the records, and watches financial procedures in action. Without these steps, it would be difficult for the auditor to come up with an accurate report of the organization's financial status.

3. Testing

Testing implies checking whether the internal controls are working or not. An auditor requests more info, returns to the company for more inspections, and watches how financial procedures are being performed. If the evidence demonstrates GAAP compliance, the auditor determines that the company successfully detects and prevents the errors.

4. Reporting

The final step in financial audit involves giving a conclusion on how the company adheres to accounting standards. The audit from a CPA gives the organization an unqualified approval, a qualified approval, a disclaimer, or an adverse finding. The unqualified approval is considered as the best result and the adverse finding is considered to be the worst result.

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AUDIT REPORTS AND ITS TYPES

The auditor's report is a written letter from the auditor containing the opinion whether a company's financial statements comply with generally accepted accounting principles (GAAP). The independent and external audit report is typically published with the company's annual report. The auditor's report is important because banks and creditors require an audit of a company's financial statements before lending to them.

Basic Elements of Audit Report:

I. Title
II. Addressee
III. Auditor's Opinion
IV. Basis for Opinion
V. Going Concern
VI. Key Audit Matters
VII. Responsibilities for Financial Statements
VIII. Auditor's Responsibilities for Audit F/S
IX. Other Reporting Responsibilities
X. Signature and Address of Auditor and Date

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TYPES OF Reports/ Opinion:

➢ Qualified Opinion

The Auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements are material but not pervasive.

➢ Adverse Opinion

The Auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive.

➢ Disclaimer Report

The Auditor shall disclaim an opinion when he is unable to obtain sufficient appropriate audit evidence, and he concludes that the possible effects on the financial statements of undetected misstatements could be both material and pervasive.

➢ Unqualified Report

An unqualified report is also called a clean report. Issued by the external auditors, this report states that the company affairs and statements are valid and are free from any manipulation. Moreover, it also shows that the company stands true to its overall stakeholders, and a sense of trust gets build over time.

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AUDIT PROCEDURES

Audit procedures are the processes, technique, and methods that auditors perform to obtain audit evidence which enables them to make a conclusion on the set audit objective and express their opinion.

Auditors normally prepare audit procedures at the planning stages once they have identified audit objectives, audit scope, audit approach, and audit risks.

TYPES OF AUDIT PROCEDURES:

1. Analytical Review

It consists of evaluation of financial information made by a study of plausible relationships among both financial and non-financial data.

It encompasses the investigation identified fluctuations and relationships that are inconsistent with other relevant information or deviate significantly from predicted amounts.

For example, when auditor found there is unusual transactions or event as the result of using analytical review, then the auditor will use other procedures that are applicable to obtain evidence.

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2. Inquiry

It consists of seeking information of knowledgeable persons, both financial and non-financial, within the entity or outside the entity.

It is used extensively in addition to other audit procedures.
For example, the auditor can inquire the management of the treatment adopted for recording/disclosing the contingent liability.

3. Observation
It consists of looking at a process or procedure being performed by others.

For example, the auditor can observe the inventory counting by entity's personnel.

4. Inspection
It involves the examination of records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset.
For example, inspection of records for evidence of authorization.

5. External Confirmation
It represents the audit evidence obtained by the auditor as a direct written response to the auditor from a third party (Confirming Party), in paper form or by electronic or other medium.
For example, the auditor may request confirmation of terms of agreements or transactions an entity has with third parties.

6. Recalculation and Re-performance
Recalculation consists of checking the mathematical accuracy of documents or records, performed either manually or electronically

Re-performance involves auditor's independent execution of procedures or controls that were originally performed as part of entity's internal control.

For example, the auditor may re-perform the reconciliation of bank statements or the aging of accounts receivable.

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Practice Questions

Q.1 Which of the following is the second step of a financial audit?

A. Planning the audit
B. Testing
C. Setting internal controls
D. Reporting

Q.2 The petty cashier works on which of the following system?

A. Imprest system
B. Express System
C. Both A and B
D. Neither A nor B

Q.3 Which of the following statement about the Cash book is correct?

A. Cash Book is also called as the book of original entry
B. It serves the purpose of both journal as well as the ledger account
C. Both A and B
D. Neither A nor B

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Elements of Double Entry Book Keeping

The accounting starts with transactions or events and ends with preparation and presentation of financial statements & communicating to relevant stakeholders.

Before understanding about the accounting process step by step, let us understand about some basics of accounting.

Double entry system:

Double entry system is based on the principle of "Dual Aspect".

In every transaction, there are two aspects viz. Credit and Debit and both the aspects are being recorded in the books of accounts.

For instance, if a business acquires something, then it must have been given by someone or it must have been acquired by giving up something.

For example, if a business purchases furniture, either it must be paying by cash or on credit which increases the liability of the business.

In case of purchase of furniture by cash, the business gets the furniture which is debited into a furniture account and it pays by cash which is credited from the cash account.

So, here two aspects of the transaction are recorded one is debt of the furniture and the credit of the cash, this system of accounting practice is termed as Double entry system.

How it is recorded?

T- Accounts:

A T-account is an informal term for a set of financial records that uses double-entry bookkeeping. The term describes the appearance of the bookkeeping entries.

The visual appearance of the ledger journal of individual accounts resembles a T-shape, hence why a ledger account is also called a T-account.

Example of T-Account with illustration figures:

Cash Account

Dr. (Rs.)		Cr. (Rs.)	
1. Sales:	20,000	**1. Furniture:**	**5000**
		2. Salary:	3000
		3. Purchase:	5000

Furniture Account

Dr. (Rs.)		Cr. (Rs.)	
1. Cash:	5000		

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Here the debit (Dr) denotes an entry passed on left side of any account and credit (Cr.) to denote an entry on the right side of any account.

In the Cash Account, all the outgoing cash is recorded in the credit side while incoming cash is recorded in the debit side.

The rules of Debits & Credits are as follows: (Important for journalizing a transaction)

- **Increases in assets are debits; decrease in assets are credits**
- **Increase in liabilities are credits; decreases in liabilities are debits**
- **Increase in owner's capital are credits; decrease are debits**
- **Increase in expense are debits; decrease in expense are credits**
- **Increase in revenue/sales are credits; decrease in sales are debts**

Types of Transactions

1. Personal transactions

2. Transactions related to assets and properties

3. Transactions related to expenses, losses, incomes and gains.

Types of Accounts:

Based on the type of transaction, the accounts are classified into personal account and impersonal account.

Personal Account	Impersonal account
In this type of account, transaction related to persons, trade receivable or trade payables are recorded.	Here transactions which are not personal such as transactions related assets and properties, expenses, losses incomes and gains recorded.
Further classified into natural personal accounts (individual), legal personal accounts (legal entity such as company), representative personal accounts such as outstanding liability, prepaid expense, capital account, drawing account.	Further classified into **Real accounts** (accounts relating to asset) and **Nominal accounts** (Accounts relating to expenses, losses, gains and revenue). The net results of nominal account are reflected as profit or loss and transferred to capital account

Golden Rules of Accounting	
1. Personal Account	Debit the receiver and credit the giver.
2. Real account	Debit what comes in and credit what goes out.
3. Nominal account	Debit all expenses and losses, credit all incomes and gains

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Advantages of Double Entry Accounting system

- As both the personal and impersonal accounts are maintained under the double entry system, both the effects of the transactions are recorded.
- It assures arithmetical accuracy of the books of accounts, for every debit, there is a corresponding and equal credit. This is arrived by preparing a trial balance periodically or at the end of the financial year.
- Prevents and minimizes frauds. Frauds can be even detected early.
- Errors can be checked and rectified easily.
- The outstanding balances of receivables and payables are determined easily since the personal accounts are maintained.
- Businesses can compare the financial position of the current year with that of the past year/s.
- Helps to justify the standing of business on the valuation date in comparison with the previous years' purchase, sales, and stocks, incomes and expenses with that of the current year figures.
- The calculated net operating results can be ascertained by preparing the trading and profit and loss A/c for the year ended and the financial position can be ascertained by the preparation of the balance sheet.
- Government can easily decide on the tax to be calculated on the businesses net earnings.
- Outsiders and stakeholders like suppliers, banks, holders of equity etc take a proper decision regarding grant of credit or loans or subscribing for the shares.

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Practice Questions

Q.1 Which of the following is the golden rule for personal account?

A. Debit what comes in and credit what goes out.
B. Debit the receiver and credit the giver.
C. Debit all expenses and losses, credit all incomes and gains.
D. None of the above

Q.2 Double entry system is based on the principle of

A. Going Concern
B. Matching Concept
C. Cost Concept
D. Dual Aspect

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Trial Balance

A trial balance is a list of closing balances of ledger accounts on a certain date and is the first step towards the preparation of financial statements.

Trial Balance is usually prepared at the end of an accounting period to assist in the drafting of financial statements. However, an organisation may prepare a trial balance at the end of any chosen period, which may be monthly, quarterly, half yearly or annually depending upon its requirements.

Ledger balances are segregated into debit balances and credit balances. Asset and expense accounts appear on the debit side of the trial balance whereas liabilities, capital and income accounts appear on the credit side.

If all accounting entries are recorded correctly and all the ledger balances are accurately extracted, the total of all debit balances appearing in the trial balance must equal to the sum of all credit balances.

Features of Trial Balance:

1) Trial balance is basis for preparation of financial statements (Profit & Loss account and Balance Sheet).
2) Trial balance is prepared after ledger posting is done.
3) Trial Balance helps to establish arithmetical accuracy of the books.
4) Trial Balance is the summary of ledger accounts.

Methods of preparing Trial Balance:

A trial balance can be prepared in the following three ways:

(i) Totals Method
(ii) Balances Method
(iii) Totals-cum-balances Method

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Total Method

In this method, the total debit and credit balance of all ledger accounts are transferred to trial balance. This method is not commonly used as it cannot help in the preparation of financial statements.

Balanced method:

This is the most widely used method in practice.

Under the balance method, every ledger is balanced, and the balances are transferred to the trial balance. This method helps the accountants in preparation of financial statements.

If there is a mismatch in trial balance after transferring the ledger accounts, the same is tallied by transferring the difference between debits and credits account to suspense account.

Totals-cum-balances Method

This method is a combination of totals method and ballances method. Under this method four columns for amount are prepared. Two columns for writing the debit and credit totals of various accounts and two columns for writing the debit and credit balances of these

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accounts. However, this method is not used in practice because it is time consuming and hardly serves any additional or special purpose.

Preparation of Trial Balance:

1. All the closing balance of all ledger accounts, cash book and bank book is required. So, every ledger account must be balanced.

2. Balancing is the difference between the sum of all the debit entries and the sum of all the credit entries.

3. Then prepare a three-column worksheet. One column for the account name and further columns for debit and credit balances. (as shown in the example)

4. The account name column need to be filled and the balance of such account in the debit or credit column appropriately.

5. The total of both the column need to be same.

Let's understand with an example:

Look at the following trial balance of M/s ASW Ltd.

Trial Balance of M/s ASW Ltd. on 31st March 2020

Particulars	Debit	Credit
Cash	Rs.90,000	
Furniture	Rs.20,000	
Purchase	Rs. 40,000	
Sales		Rs.75,000
Rent	Rs.5,000	
Salary	Rs.10,000	
Capital (ASW)		Rs.1,00,000
Receivables	Rs.35,000	
Payables	-	Rs. 25,000
	2,00,000	**2,00,000**

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Basically, the Trial balance shows the closing balance of respective accounts.

It shows that M/S ASW Ltd. has following balances:

1. It has cash balance of Rs. 90,000

2. Furniture worth Rs. 20,000

3. It made purchases worth Rs. 40,000

4. It sold goods for Rs. 75,000

5. It paid rent and salary of Rs. 5,000 and Rs. 10,000 respectively.

6. The proprietor ASW has a capital of Rs. 1,00,000

7. The business has receivables of Rs. 35,000 which means it has sold goods on credit.

8. The business owes Rs. 25,000 which means it has brought goods on credit.

Significance of Agreement of Trial Balance

It is important for an accountant that the trial balance should tally. Normally a tallied trial balance means that both the debit and the credit entries have been made correctly for each transaction. However, the trail balance is prepared based on ledger. The debits

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and credits in the trial balance are tallied. If they are not tallied, it is due to errors. The errors can be identified by having checks and processes.

The errors could occur due to following reasons:

1) Wrong entry – Can occur due to posting wrong numbers.
2) Casting errors – Totaling errors may arise due to wrong entry or totaling error.
3) Wrong posting – The error occurs due to wrong posting in some other book.

Types of Errors:

1. Error of Commission: When transactions are recorded incorrectly. For example, cash sales are entered as Rs. 19,000 instead of Rs. 1,000.

2. The error of Omission: When a transaction is omitted.

3. Transposition Error: When digits are reversed. For example, 6789 is entered instead of 9876.

4. Rounding Errors: When rounding of figures creates a series of errors. For example, 25.625 is entered instead of 25.6236

5. Errors of Principle: A transaction that incorrectly uses an accounting principle is called an error of principle. In this error, though the number is correct, it is recorded in the wrong account.

For example, personal expenses are accidentally recorded as business expenses in the books.

Wages paid for the installation of machinery debited to wages account is also a type of principle error.

6. Errors of Reversal: When an entry is debited instead of being credited, or vice versa, this is an error of reversal.

7. Compensating Errors: When two or more errors are committed in such a way that the net effect of these errors on the debits and credits of accounts is nil, such errors are called compensating errors.

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Identification and Rectification of Errors:

I. Before preparation of trial balance

Before preparing trial balance, sometimes the entries are rechecked made in the journal, ledger accounts, amounts carried forward and balancing of ledger accounts with the intention of ensuring their correctness, hence errors are spotted.

Consider the examples:

1. Sales book is undercast by Rs. 90.

- The total of sales book is posted to the credit side of sales account in the ledger.
- The under casting has resulted in under-crediting of sales account by Rs.90.
- The error is only in sales account, so it is rectified by crediting sales account by Rs.90.

2. Purchases returns book is undercast by Rs. 400: Here Purchases returns account should be credited with Rs. 400

3. Purchases returns book is overcast by Rs. 500: here Purchases returns account should be debited with Rs. 500

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4. A sum of Rs. 9,000 written off as depreciation on buildings has not been posted to depreciation account- Depreciation account should be debited with Rs. 9,000.

5. Payment of wages Rs. 10,000 to Raghav was posted twice to wages account: Wages account should be credited with Rs. 10,000.

II. At the time of preparing trial balance:

While preparing the trial balance, if the total of debit balances and credit balances are not the same, there is disagreement of trial balance.

It shows that there are errors in the books of accounts. As a consequence, the accountant may start locating error.

In such cases the one-sided errors are rectified as illustrated in the above examples. Rectifying journal entries are not required to be passed in the books. In such cases, errors can be rectified by giving an explanatory note in the affected account.

III. After preparation of trial balance but before finalization of accounts

If there is a difference between debit and credit balance of trial balance, it is tallied by opening a suspense account.

Suspense Account
A suspense account is a general ledger account in which amounts are temporarily recorded. The suspense account is used because the appropriate general ledger account could not be determined at the time that the transaction was recorded.

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For example, the credit side of trial Balance is Rs. 1,15,000 and debit side of trial balance is Rs. 1,10,000, the difference of Rs. 5000 is debited from Suspense Account to tally the Trial Balance.

The suspense account is used to rectify such errors so that the difference in trial balance placed to that account gets adjusted. Once all the one-sided errors are completely rectified, the balance in the suspense account gets eliminated.

Let's understand with above illustration, to tally the trial balance, Rs. 5000 has been debited to Suspense account, but later it was found that Salary paid in cash was not recorded in salary account.

Now the salary account will be debited with Rs. 5000, and Suspense Account will be credited with Rs. 5000, hence the suspense account will be cleared off.

Practice Questions

Q.1 How many methods can be used for preparation of a trail balance?

A. 2
B. 3
C. 4
D. 6

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Trading Account

Trading and Profit and Loss account, also known as Income statement, shows the financial performance in the form of profit earned or loss sustained by the business.

The trading account ascertains the result from basic operational activities of the business. The basic operational activity involves the manufacturing, purchasing and selling of goods. It is prepared to ascertain whether the selling of goods and/or rendering of services to customers have proved profitable for the business or not. Purchases is one of the main constituents of expenses in business organisation.

Preparation of Trading Account:

The objective of trading account is to arrive at gross profit/gross loss. Below is the formulae for gross profit/loss.

Gross Profit = Net sales − Cost of goods sold

Cost of goods sold = Net purchases + Opening Stock + Direct Expenses − Closing stock

Net Sales = Gross Sales − Sales Returns

Net Purchase = Gross purchases − Purchase returns

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Expenses: Expenses can be classified as direct expenses and indirect expenses.

Direct Expenses:

- Direct expenses are completely related and assigned to the core business operations of a business.
- They are mainly related to purchases and production of goods/services. Direct expenses are a part of the prime cost or the cost of goods/services sold by a company.
- Direct expenses are directly related to the production of the product sold or service rendered, they may differ for different types of companies, such as manufacturing companies, construction companies, service companies, etc.
- **All the direct expenses are included in the Trading Account to arrive at gross profits.**
- Examples of direct expenses are: Wages, factory rent, Cost of raw materials, fuel, carriage inwards, purchases etc.

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Relevant Items in Trading Account

Items on the debit side:

1. **Opening stock:** It is the stock of goods in hand at the beginning of the accounting year. This is the stock of goods which has been carried forward from the previous year and remains unchanged during the year and appears in the trial balance. In the trading account it appears on the debit side because it forms the part of cost of goods sold for the current accounting year.
2. **Purchases less returns:** Goods, which have been bought for resale appears as purchases on the debit side of the trading account. They include both cash as well as credit purchases. Goods which are returned to suppliers are termed as purchases return. It is shown by way of deduction from purchases and the computed amount is known as Net purchases.
3. **Wages:** Wages refer to remuneration paid to workers who are directly engaged in factory for loading, unloading and production of goods and are debited to trading account.
4. **Carriage inwards/Freight inwards:** These expenses are the items of transport expenses, which are incurred on bringing materials/goods purchased to the place of business. These items are paid in respect of purchases made during the year and are debited to the trading account.
5. **Fuel/Water/Power/Gas:** These items are used in the production process and hence are part of direct expenses.
6. **Packaging material:** Cost of packaging material used in the product are direct expenses as it refers to small containers which form part of goods sold.

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Items on the credit side

Sales less returns: Sales account in trial balance shows gross total sales (cash as well as credit) made during the year. It is shown on the credit side of the trading account. Goods returned by customers are called return inwards and are shown as deduction from total sales and the computed amount is known as net sales.

Trading Account			
Particulars	**Amount**	**Particulars**	**Amount**
To Opening Stock		By Sales	
To Purchases		*(Less Sales Returns)*	
(Less Return Outwards)		By Closing Stock	
To Wages (Adjust O/S & Prepaid)		*By Gross Loss (Transfer to P&L A/C)*	
To Carriage Inwards			
To Freight, Octroi & Cartage			
To Fuel & Power			
To Gross Profit (Transfer to P&L A/C)			

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Trading Account is Nominal Account, which means debit all expenses and losses and credit all income and gains.

Closing Entries

The preparation of trading account requires that the balances of accounts of all concerned items are transferred to it for its compilation.

1. Opening stock account, Purchases account, Wages account, Carriage inwards account and direct expenses account are closed by transferring to the debit side of the trading account, this is done by recording the following entry:

Trading A/c Dr.

To Opening Stock A/c

To Purchases A/c

To Wages A/c

To Carriage Inwards A/c

To All other direct expenses A/c

2. The purchases return or return outwards are closed by transferring its balance to the purchases account. The following entry is recorded for this purpose:

Purchases return A/c Dr.

To Purchases A/c

3. The sales returns or returns inwards account is closed by transferring its balance to the sales account as:
   Sales A/c Dr.
   To Sales return A/c
4. The sales account is closed by transferring its balance to the credit side of the trading and profit and loss account by recording the following entry:
   Sales A/c Dr.
   To Trading A/c

Practice Questions:

Q.1 Which of the following is the correct treatment for Opening Stock?

A. Debited to Trading Account
B. Credited to Trading Account
C. Debited to Profit and Loss Account
D. Credited to Profit and Loss Account

Q.2 Trading Account is a________ account.

A. Real Account
B. Personal Account
C. Nominal Account
D. Real and Nominal Account

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Profit and Loss Account and Balance Sheet

The profit and loss account is created to determine the net profit of the business. The starting point for the profit and loss account is the balance carried down from the trading account which is the gross profit.

Each nominal account is closed and transferred to the profit and loss account in the general ledger.

Profit and Loss Account Formula

The profit and loss account shows the net profit which is the determined by deducting the expenses of the business from the trading account gross profit and adding other income.

Net profit = Gross profit – Expenses + Other income

Indirect Expenses:

- Indirect expenses are not directly related and assigned to the core business operations of a firm.
- However, indirect expenses are necessary to keep the business running, but they are not directly related to the cost of the core revenue-generating products or services.
- Indirect expenses can be different for different types of business. These are usually shared costs among different departments/segments within the firm.
- **All the indirect expenses are included in the Profit and Loss Account to arrive at net profits.**
- Examples of indirect expenses are salaries, rent, interest paid, advertisement cost, Packing etc.

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Items on the debit side:

1. Packing refers to the big containers that are used for transporting the goods and is regarded as an indirect expense debited to profit and loss account.
   Note: Cost of packaging material is regarded as direct expenses. It is included in the Trading Account, and not Profit and Loss Account.

2. Salaries: These include salaries paid to the administration, godown and warehouse staff for the services rendered by them for running the business. If salaries are paid in kind by providing certain facilities (called perks) to the employees such as rent free accommodation, meals, uniform, medical facilities should also be regarded as salaries and debited to the profit and loss account.

3. Rent paid: These include office and godown rent, municipal rates and taxes, factory rent, rates and taxes. The amount of rent paid is shown on the debit side of the profit and loss account.

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4. Interest paid: Interest paid on loans, bank overdraft, renewal of bills of exchange, etc. is an expense and is debited to profit and loss account.

5. Commission paid: Commission paid or payable on business transactions undertaken through the agents is an item of expense and is debited to profit and loss account.

6. Repairs: Repairs and small renewals/ replacements relating to plant and machinery, furniture, fixtures, fittings, etc. for keeping them in working condition are included under this head. Such expenditure is debited to profit and loss account.

7. Miscellaneous expenses: Though expenses are classified and booked under different heads, but certain expenses being of small amount clubbed together and are called miscellaneous expenses. In normal usage these expenses are called Sundry expenses or Trade expenses.

Items on the credit side:

Incomes: Besides salaries and other gains and incomes are also recorded in the profit and loss account. Examples of such incomes are rent received, dividend received, interest received, discount received, commission received, etc.

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Income Statement or Profit & Loss Account			
Particulars	**Amount**	**Particulars**	**Amount**
To Gross Loss (Brought From Trading A/C)		*By Gross Profit (Brought From Trading A/C)*	
To Salaries (Adjust O/S & Prepaid)		By Rent Received	
To Rent, Rates & Taxes		By Discount Received	
To Travelling Expenses		By Interest Earned (Accruals Adjusted)	
To Stationery & Printing		By Bad Debts Recovered	
To Postage		By Commission Earned	
To Audit & Legal Charges		By Dividends Received	
To Telephone Expenses		By Income From Other Sources	
To Insurance Premium (Prepaid Adjusted)		*By Net Loss (Transferred to Capital A/C)*	
To Marketing & Advertisement			
To Interest Paid			
To Discount Allowed			
To Sundry Expenses			
To Carriage Outwards			
To Bad Debts			
To Depreciation			
To Repairs & Renewals			
To Commission			
To Other Expenses			
To Loss by Fire or Theft			
To Net Profit (Transferred to Capital A/C)			

Adjustments: An accounting adjustment is a business transaction that has not yet been included in the accounting records of a business as of a specific date. Adjusting entries, are entries that are made in the general journal at the end of an accounting period to bring account balances up-to-date.

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What happens to the Profit or losses from the Profit and Loss accounts?

The profits earned or losses suffered is transferred to the capital account, because it is belonging to the owner of the business firm, in some cases, a separate profit and loss account is maintained, where the profits (or losses) is transferred and drawings by the owner is also recorded.

Such type of practice keeps the capital account intact unless additional capital is added, or excess capital is withdrawn.

Closing Entries

1. Items of expenses, losses, etc. are closed by recording the following entries:

   Profit and Loss A/c Dr.
   To Expenses (individually) A/c
   To Losses (individually) A/c

2. Items of incomes, gains, etc. are closed by recording the following entry:

   Incomes (individually) A/c Dr.
   Gains (individually) A/c Dr.
   To Profit and Loss A/c

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BALANCE SHEET

The basic balance sheet is one of the main accounting statements. It is a snapshot of the assets, liabilities and capital of the business at a specific point in time, usually at the end of an accounting period.

It is also referred as **'Statement of Financial Position'**.

Balance Sheet is a financial statement, and not a part of accounting cycle. Unlike profit and sales account, transactions are not transferred here. In Balance sheet, the balance of every account is mentioned.

Balance Sheet Equation:

Assets = Liabilities + Capital

This formula denotes that: A business entity has to pay for all the things it owns (assets) by either borrowing money (taking on liabilities) or taking it from capital.

There is no prescribed form of Balance sheet, for a proprietary and partnership firms. However, Schedule III Part I of the Companies Act 2013 prescribes the format and the order in which the assets and liabilities of a company should be shown.

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Relevant Items in the Balance Sheet

1. Assets:

An asset is a resource with economic value that an individual, or corporation, owns or controls with the expectation that it will provide a future benefit. Assets are reported on a company's balance sheet and are bought or created to increase a firm's value or benefit the firm's operations.

Current Assets: Current assets are those which are either in the form of cash or a can be converted into cash within a year. The examples of such assets are cash in hand/bank, bills receivable, stock of raw materials, semi-finished goods and finished goods, sundry debtors, short term investments, prepaid expenses, etc.

I. **Cash and cash equivalents** are the most liquid assets and can include Treasury bills and short-term certificates of deposit, as well as hard currency.
II. **Marketable securities** are equity and debt securities for which there is a liquid market.
III. **Accounts receivable** refers to money that customers owe the company, perhaps including an allowance for doubtful accounts since a certain proportion of customers can be expected not to pay.
IV. **Inventory** is goods available for sale, valued at the lower of the cost or market price.
V. **Prepaid expenses** represent the value that has already been paid for, such as insurance, advertising contracts or rent.

Fixed Assets: Fixed assets are those assets, which are held on a long-term basis in the business. Such assets are not acquired for the purpose of resale, e.g. land, building, plant and machinery, furniture and fixtures, etc.

Sometimes the term 'Fixed Block' or 'Block Capital' is also used for them.

Long-term investments are securities that will not or cannot be liquidated in the next year.

Intangible assets include non-physical (but still valuable) assets such as intellectual property and goodwill. In general, intangible assets are only listed on the balance sheet if they are acquired, rather than developed in-house. Their value may thus be wildly understated – by not including a globally recognized logo, for example – or just as wildly overstated.

Liabilities:

liabilities are the money that a business owes to outside parties such as bills payable, outstanding loans, unpaid expenses etc. Liabilities can be divided into two types.

Current Liabilities: Current liabilities are those liabilities which are expected to be paid within a year and which are usually to be paid out of current assets. The examples of such liabilities are bank overdraft, bills payable, sundry creditors, short-term loans, outstanding expenses, etc.

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Long-term Liabilities: All liabilities other than the current liabilities are known as long-term liabilities. Such liabilities are usually payable after one year of the date of the balance sheet. The important items of long term liabilities are long-term loans from bank and other financial institutions.

- **Long-term debt**: interest and principal on bonds issued
- **Pension fund liability**: the money a company is required to pay into its employees' retirement accounts
- **Deferred tax liability**: taxes that have been accrued but will not be paid for another year (Besides timing, this figure reconciles differences between requirements for financial reporting and the way tax is assessed, such as depreciation calculations.)

Capital

- Capital is the money attributable to a business' owners, who can be sole proprietor, partners or shareholders.
- It is also known as "net assets," since it is equivalent to the total assets of a company minus its liabilities, that is, the debt it owes to owners.
- It also includes money invested by the owners and the accumulated profits of the business.

1. Retained earnings are the net earnings a company either reinvests in the business or use to pay off debt; the rest is distributed to shareholders in the form of dividends.
2. Treasury stock is the stock a company has repurchased. It can be sold at a later date to raise cash or reserved to repel a hostile takeover

Capital + Liabilities = Assets

Capital + Long term Liabilities = Fixed assets + Current assets – Current Liabilities.

Capital = Total Asset- Total Liabilities

Effect of Drawings on Capital

Amount withdrawn by the proprietor is termed as drawings and has the effect of reducing the balance on his capital account. Therefore, the drawings account is closed by transferring its balance to his capital account. It is shown by way of deduction from capital in the balance sheet.

Marshalling of Assets and Liabilities

In a balance sheet, the assets and liabilities are arranged either in the order of liquidity or permanence. Arrangement of assets and liabilities in a particular order is known as Marshalling.

In case of permanence, the most permanent asset or liability is put on the top in the balance sheet and thereafter the assets are arranged in their reducing level of permanence.

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Opening Entry

The balances of various accounts in balance sheet are carried forward from one accounting period to another accounting period. In fact, the balance sheet of an accounting period becomes the opening trial balance of the next accounting period. Next year an opening entry is made which opens these accounts contained in the balance sheet. E.g.

Furniture A/c Dr.

Debtors A/c Dr.

Bank's A/c Dr.

Cash A/c Dr.

To Capital A/c

To 10 % Long-term loan A/c

To Creditors A/c

Adjustments and classification of items at a glance

1. **Closing Stock**
   It represents the cost of unsold goods lying in the stores at the end of the accounting period.

   It is shown on the assets side of balance sheet.

2. **Outstanding Expenses**
   When expenses of an accounting period remain unpaid at the end of an accounting period, they are termed as outstanding expenses. Such items usually are wages, salaries, interest on loan, etc.

   It is shown on the liabilities side of the balance sheet.

3. **Accrued Income**
   It may happen that certain items of income such as interest on loan, commission, rent, etc. are earned during the current accounting year but have not been actually received by the end of the same year. Such incomes are known as accrued income.

   Accrued income will appear on the asset side of the balance sheet.

4. **Income Received in Advance**
   Sometimes, a certain income is received but the whole amount of it does not belong to the current period. The portion of the income which belongs to the next accounting period is termed as income received in advance or an Unearned Income

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4. **Income Received in Advance**
   Sometimes, a certain income is received but the whole amount of it does not belong to the current period. The portion of the income which belongs to the next accounting period is termed as income received in advance or an Unearned Income

   It is shown as a liability in the balance sheet.

5. **Depreciation**
   Depreciation is the decline in the value of assets on account of wear and tear and passage of time.

   In the balance sheet, the asset will be shown at cost minus the amount of depreciation.

6. **Bad Debts**
   Bad debts refer to the amount that the firm has not been able to realise from its debtors. It is regarded as a loss and is termed as bad debt.

   In the balance sheet, the debtors will be shown at cost minus bad debts.

7. **Further Bad Debts**

   It is shown as a deduction from the debtors on the asset side of the balance sheet.

8. **Provision for Bad and Doubtful Debts**
   It is not possible to accurately know the amount of such bad debts. Hence, we make a reasonable estimate of such loss and provide the same. Such provision is called provision for bad debts and is created by debiting profit and loss account.

   Provision for doubtful debts is also shown as a deduction from the debtors on the asset side of the balance sheet.

9. **Provision for Discount on Debtors**
   Provision for discount is made on good debtors which are arrived at by deducting further bad debts and the provision for doubtful debts.
   In the balance sheet, it will be shown as a deduction from the debtors to portray correctly the expected reliable value of debtors.

10. **Manager's commission**

    It is shown as a liability in the balance sheet.

11. **Interest on capital**
    It is shown as addition to capital in the balance sheet.

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SOCIAL ACCOUNTING AND SOCIAL AUDIT

It is being observed that traditional financial reporting remains quiet and ignores reporting regarding social activities of the business. It does not provide any reporting about socio economic situations under which a business functions and hence the annual report does not mention about social parameters like housing, medical, educational, tax payments, environmental protection, etc.

But now with the passage of time this notion is changing and with the development of corporate concept of orgnisations and their important role in the society this has given way to reporting on social responsibilities in their annual report. Government has also made mandatory regulations in this concern.

Social accounting is an accounting report social activities carried out by the business concerns for the good of the society. As both need each other for their existence; every business entity is required to furnish accounting report of its social activities.

Social accounting is meant by the reporting of various social responsibilities of the business which have been mentioned as above, hence social accounting is the report of social expenditure and social benefits of the business entities.

Social accounting is the measurement and at the same time reporting of the social activities of business units either in monetary terms (quantitative) or in non-monetary terms (qualitative).

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Various definitions:

Sybil Mobley defines social accounting as "it refers to the ordering, measuring and analysis of the social and economic consequences of government and entrepreneurial behaviour."

According to David Linows used the word 'socio economic accounting' and said that it is the application of accounting in the field of social sciences.

Objectives of Social Accounting:

Today it has been established that the corporate activities have booth economic and social impacts. As said earlier both business and society are closely interrelated to each other. The major objectives of social reporting are as follows:

1. To know the involvement of individual firms towards the society.

2. To find out the firm's policies and practices directly affecting the relative sources.

3. To make aware the society about firm's objectives and policies.

4. To present the models of quantification and proper presentation of social costs and benefits of an organisation.

The objectives of corporate social accounting can be classified into two classes:

(A) Social contract, and (B) Objectives based on quality of life.

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Objectives Based on Social Contract

The corporate social accounting which is mainly based on the argument of social contract, the main objects of social reporting are as under:

1. To establish and measure the periodic net social contribution of individual business enterprise towards the society

2. To aid and assist in knowing whether public enterprises are consistent with widely shared social priorities or not.

3. To make available relevant information about business entity's goals, policies, programmes and contribution towards society.

Objectives based on quality of life:

This approach relates corporate social responsibility with the quality of life. If quality of life or standard of living is increasing, it means that corporations are performing their social responsibilities efficiently and effectively. In corporate management the social cost of economic development is increasing on an ongoing basis, influencing the dimensions of quality of life. However if the business concern does not perform its social responsibilities, its activities may have neutral or negative impact on the society.

Need for social accounting

1. Changes in public need: Due to changing public need, social expectations of business have also changed.

2. Moral duty: Business should be socially responsible because responsible actions are right for its own sake.

3. Limited number of resources: Since the planet of earth has limited resources, so business must act responsibility to protect the plants from pollution like air and water, pollution by utilizing its wastes.

4. Improvement in social atmosphere: Business should aid in solving the various social problems.

5. Incongruity with further government regulations: If business is socially responsible towards the society, it will discourage and ignore additional regulation of economic policies made by the government.

6. Balancing of responsibility with power: Social accounting is needed to make balance between responsibility and power

7. Public image: Social accounting is necessary to improve the public image in the society.

8. For managerial use: Social responsibility information or social accounting is very much useful to corporate management also.

9. Peripheral uses: Social accounting is much required by external users as well. Various groups, very much interested in company's activities, like public investors, customers, government bodies, public interest groups, professional organisation require social reporting to judge the performance of business entity.

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Social Accounting in India:

Sachaar committee recognized the need for social reporting through the following words, "In the environment of modern economic development the corporate sector no longer functions in isolation. Profit is still necessary part of the total picture, but it is not primary purpose. The company must accept obligations to be socially responsible and to wish for larger benefits of the community."

In India, the Tata Iron and Steel Company Limited was the first company to prepare corporate social reporting which published its `Social Audit' report in 1979-80.

Apart from this a good number of large companies both in public and private sectors, such as Cement Corporation of India, Metals and Minerals Trading Corporation of India. Oil and Natural Gas Commission, Steel Authority of India Ltd., Bharat Heavy Electrical Ltd. etc. have started publishing their social performances in their annual reports without no uniform format in the presentation of their report.

The Bureau of Public Enterprise now changed to Department of Public Enterprise has made social reporting mandatory, therefore making it imperative for each public enterprise to disclose its social expenses.

Social Audit

Social auditis to study and to report, up to what extent the company has been able to meet out the objectives regarding its social and moral responsibilities to shareholders, society and the local community.

It provides explanation of the company's contribution towards employer and employees relation, consumers, shareholders, community development and social welfare programme, rural development programme.

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Social Audit is a tool with which government departments can plan, manage and measure non financial activities and monitor both, internal and external consequences of the department/organization's social and Commercial operations. It is an instrument of social accountability for an organisation.

In other words, Social Audit may be defined as an in-depth scrutiny and analysis of the working of any public utility and its socialrelevance. Social Audit gained significance especially after the 73rd Amendment of the constitution relating to Panchayati Raj Institutions.

Objectives:

(i) Assessing the physical and financial gaps between needs and resources available for social aims and objectives.

(ii) Creative awareness among beneficiaries and providers of local, social and private services.

(iii) Increasing efficiency and effectiveness of local development programmes.

(iv) Scrutiny of various policy decisions, keeping is view stakeholders interest and priorities, particularly of rural and poor.

(v) Estimation of the opportunity cost for stakeholder not getting timely access to public service.

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MAJOR AREAS OF SOCIAL AUDIT:

The National Association of accountant (NAA) committee on accounting for corporate social performance, in report (1974) has identified various social audits and reporting. Four major areas of social reporting identified were:

1) Community Development

2) Human Resources

3) Physical Resources and Environmental Contribution

4) Product or Service Contribution

Social audit tries to make the traditional economic and technical values as two-sub system within the larger social system social audit primarily tries to cover the following areas:

(I) **ETHICAL ISSUES:** They offer basis for determining what is right and what is wrong in terms of a given situations. A few such examples can be price discrimination, unfair trade practices, cheating customers, pirating employee's ideas, learning the job without observing the contract.

(II) **EQUAL OPPORTUNITIES:** A second relevant social issue, which comes under social audit, is the enquiry of treatment in employment and a fair justice system in the organisation employment decisions in an organisation should be based on merit and ability and not on the basis of arbitrary quotas based on gender, race or religion.

(III) **QUALITY OF WORK LIFE**: Besides demands for safe, healthy and human work environment people are seeking greater meaning in their lives greater responsibility, growth, freedom and flexibility fair reward system are a few things which employees have preference for.

(IV) **CONSUMERISM**: Business has a special obligation towards the consumer as the business exists to serve and satisfy the needs of the consumers. It is the principal duty of business to make available to the consumer items of daily needs in the right quantity at a right time, and price of the right quality. However many Indian products are not safe at all and the consumer suffers at hands of corrupt and dishonest corporate houses.

(V) **ENVIRONMENTAL PROTECTION**: Growing water, air and environmental pollution by various industries in recent times has led to a public outcry demanding environmental protection at any cost.

Corporate Social Responsibility (CSR):

India is the first country in the world to make corporate social responsibility (CSR) mandatory, through the Companies Act, 2013.

According to the Companies Act, 2013, following companies need to spend at least 2% of their average net profits of the three years on CSR –

1. Companies with a net worth of Rs. 500 crores or more, (or)

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2. An annual turnover of Rs. 1000 crores or more, (or)

c. Net profit of Rs. 5 crores or more.

Businesses can invest their profits in areas such as education, poverty, gender equality, and hunger as part of any CSR compliance.

Prior to 2014, the CSR clause was voluntary for companies mandatory to disclose their CSR spending to shareholders. CSR includes but is not limited to the following:

1. Projects related to activities specified in the Companies Act; or

2. Projects related to activities taken by the company board as recommended by the CSR Committee, provided those activities cover items listed in the Companies Act.

However, expenses towards CSR are not eligible for deduction in the computation of taxable income.

CSR amendments under the Companies (Amendment) Act, 2019:

Prior to this amendment, if a company were unable to fully spend its CSR funds in a given year, it could carry the amount forward and spend it in the next fiscal, in addition to the money allotted for that year.

The new amendment require companies to deposit the unspent CSR funds into a fund prescribed under Schedule VII of the Act within the end of the fiscal year.

This amount must be utilized within three years from the date of transfer, failing which the fund must be deposited in to one of the specified funds.

It also prescribes monetary penalty and imprisonment in case of non-compliance. The penalty ranges from Rs. 50,000 to Rs. 25 lakhs and the defaulting officer of the company may be liable to imprisonment for up to three years, or a fine up to Rs. 5,00,000 or both.

The CSR methodology

CSR is the procedure for assessing an organization's impact on society and evaluating their responsibilities. It begins with an assessment of the following aspects of each business:

1. Customers,

2. Suppliers,

3. Environment,

4. Communities,

5. Employees.

The most effective CSR plans ensure that while organizations comply with legislation, their investments also respect the growth and development of marginalized communities and the environment. CSR should also be sustainable – involving activities that an organization can uphold without negatively affecting their business goals.

Business organizations in India have recognized that besides growing their businesses, it is also important to shape responsible and supportable relationships with the community at large.

Companies now have specific departments and teams that develop specific policies, strategies, and goals for their CSR programs and set

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separate budgets to support them.

Most of the time, these programs are based on well-defined social beliefs or are carefully aligned with the companies' business domain.

CSR trends in India

Since the CSR was made mandatory in 2014, the CSR spending by corporate India has increased significantly. In 2018, companies spent 47 percent higher as compared to the amount in 2014-15.

Listed companies in India spent Rs. 10,000 crores in various programs ranging from educational programs, skill development, social welfare, healthcare, and environment conservation, and the Prime Minister's Relief Fund.

The education sector received the maximum funding (38 percent of the total) followed by hunger, poverty, and healthcare (25 percent), environmental sustainability (12 percent), rural development (11 percent). Programs such as technology incubators, sports, armed forces, reducing inequalities saw negligible spends.

Practise Questions:

1. Which is the first company to prepare corporate social reporting in India?

a. Bharat Heavy Electricals Limited

b. Oil India Limited

c. Tata Iron and Steel Company Limited

d. State Bank of India

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2. Social reporting is mandatory for which among the following entities in India?

a. Private Companies

b. Listed Companies

c. Public enterprises

d. Cooperative Society

3. Consider the following conditions.

I. Companies with a net worth of Rs. 500 crores or more,

II. An annual turnover of Rs. 1000 crores or more,
III. Net profit of Rs. 50 crores or more.

Companies with which of the above conditions are mandated for the Corporate Social Responsibility in India?

a. I only

b. I or II

c. I or II or III

d. II or III

4. The National Association of Accountant has identified which among the following major areas of social audits and reporting?

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PUBLIC FINANCIAL MANAGEMENT SYSTEM

The Public Financial Management System (PFMS), earlier known as Central Plan Schemes Monitoring System (CPSMS), is a web-based online software application developed and implemented by the Office of Controller General of Accounts (CGA).

History:

PFMS was initially started during 2009 as a Central Sector Scheme of Planning Commission with the objective of tracking funds released under all Plan schemes of Government of India (GoI), and real time reporting of expenditure at all levels of Programme implementation. Subsequently in the year 2013, the scope was enlarged to cover direct payment to beneficiaries under both Plan and non-Plan Schemes.

The latest enhancement in the functionalities of PFMS commenced in late 2014, wherein it has been envisaged that digitization of accounts shall be achieved through PFMS and the additional functionalities would be built into PFMS in different stages.

Beginning with Pay & Accounts Offices payments, the CGA did further value addition by proposing to bring in more financial activities of the Go in the ambit of the project.

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Objectives:

- Monitoring of flow of funds from Centre to the lowest level of implementation- both for fund flows to State Consolidated Funds and to the Implementing Agencies.
- Registration, along with their bank accounts, of all agencies receiving plan funds - at all tiers of operation
- Payment to ultimate beneficiaries through banking channel
- Reduction of float/ funds in the agency bank accounts
- "Just in time" provision of funds to agencies, based on floats/ funds available.
- Capturing component-wise expenditure on real time basis at all tiers of implementation, including at Panchayat and village levels
- Decision Support System (DSS) to all levels of programme administration (Centre, State, District & Local Government, i.e. Panchayat / Municipality)
- Enhance transparency & accountability in public expenditure.

PMFS and Banking:

The biggest strength of PFMS is its integration with the Core banking system in the Country. As a result, PFMS has the unique capability to push online payments to almost every beneficiary/vendor.

At present, PFMS interface is having interface in addition to the Core Banking System (CBS) of all Public Sector Banks, Regional Rural Banks, major private sector banks, Reserve Bank of India, India post and Cooperative Banks.

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Timeline for Treasury Interface implementation by states

Stages	States/UT with legislature	Target Date
Stage 1	Assam, Bihar, Jharkhand, Kerala, Madhya Pradesh, Maharashtra, Odisha, Puducherry, Rajasthan, and Uttar Pradesh	31-08-2016
Stage 2	Andhra Pradesh, Arunachal Pradesh, Chhattisgarh, Goa, Gujarat, Himachal, Haryana, Manipur, Meghalaya, Punjab, Sikkim, Tamil Nadu, Telangana, Uttarakhand, West Bengal	31-12-2016
Stage 3	Delhi, Jammu & Kashmir, Karnataka, Mizoram, Nagaland, Tripura	31-03-2017

Various Stakeholders:

1. NITI Aayog as owner of project.
2. Office of the Controller General of Accounts as implementing Agency
3. Program Divisions in Ministries as Scheme Owner
4. Pay and Accounts Office/Drawing and Distribution Office as fund release and accounting entity
5. RBI as banker to the Centre and State governments.
6. State Finance and other Departments
7. Treasuries Payment units of State Governments
8. Banks
9. Post Office
10. National Payment Corporation of India (NPCI) and Institute for Development & Research in Banking Technology (IDRBT) as intermediaries in financial transaction settlement system
11. Scheme Implementing Agencies at all level.
12. Comptroller and Auditor General as external auditor

Practise Questions:

1. Which among the following is an objective of PMFS?

a. Monitoring of flow of funds from Centre to State Consolidated Funds and United Nations.

b. Payment to ultimate beneficiaries through crypto currency

c. Increase in float/ funds in the agency bank accounts

d. Enhance transparency & accountability in public expenditure

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a. Monitoring of flow of funds from Centre to State Consolidated Funds and United Nations.

b. Payment to ultimate beneficiaries through crypto currency

c. Increase in float/ funds in the agency bank accounts

d. Enhance transparency & accountability in public expenditure

2. Jammu & Kashmir is in which stage of Treasury Interface implementation?

a. Stage 1

b. Stage 3

c. Stage 2

d. None of the above

3. Who among the following is not a stakeholder in PMFS?

a. Election Commission of India

b. Comptroller and Auditor General

c. Banks

d. RBI

Answer: 1 – d, 2 – b, 3 – a

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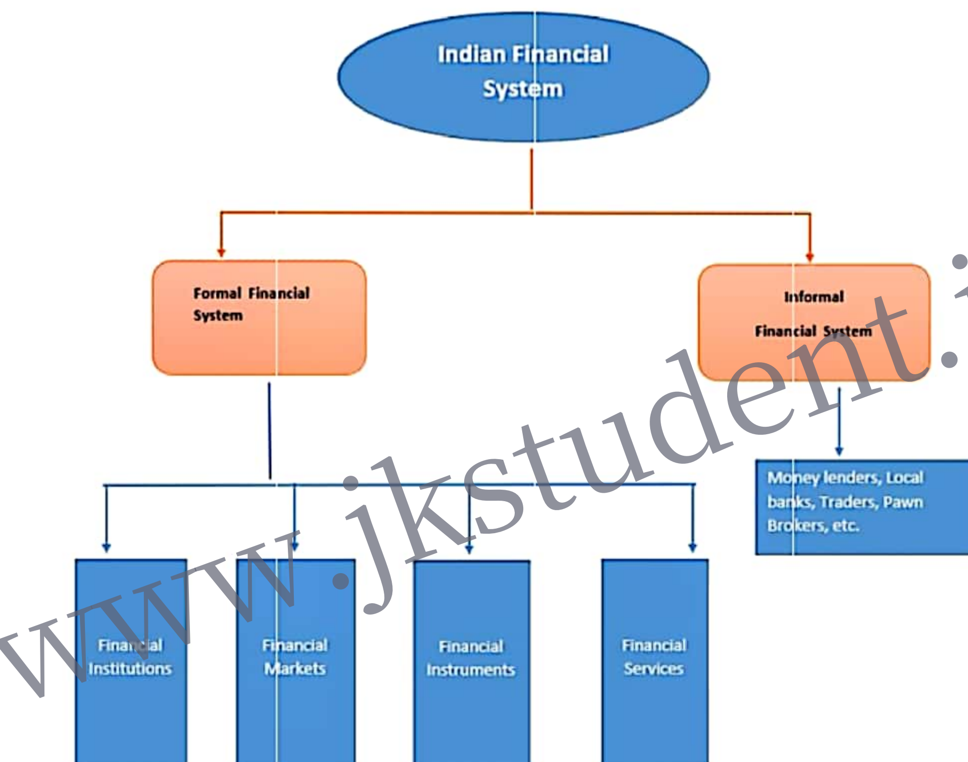
Introduction

The financial system is possibly the most important institutional and functional vehicle for economic transformation. Further, for mobilization of savings and their efficient, effective and equitable allocation for investment, it is the success with which financial system performs its functions that sets the pace for the achievement of economic growth and development of a nation.

What is a Financial System?

Financial system is a system of interrelated activities that work together to achieve a predetermined goal. It includes financial market, financial institutions, financial services and financial instrument which influence the generation of savings, investment, capital formation and growth.

Indian Financial System



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Informal Financial System

From the above diagram, it can be easily understood that the Indian Financial System can be categorized into formal and informal financial system. The Informal financial system consists of moneylenders; Associations, funds, clubs, committees etc. These people have a system and they have their own rules on how they should function in their day to day activities.

Moreover, informal financial system responds quickly to short term financing opportunities and allowed low income people access to service not available to them through the formal channel. Another advantage is that in informal financial system, loans were given quickly to the lenders. Also, informal financial markets are not subject to interest rate regulation. They do not incur legal expenses and their cost of lending and deposit taking tends to be lower than that of formal financial institutions. However, the formal financial system is always preferable because it is systematic and transparent and offers numerous benefits.

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Formal Financial System

a. Financial Institutions

Financial Institutions can be classified as banking and non-banking financial institutions. Banks are creators and providers of credit. While non-banking financial companies are only providers of credit. Financial institutions can be specialized financial institutions like Export Import Bank of India (EXIM), Tourism Finance Corporation of India (TFCI), the Infrastructure Development Finance Company (IDFC) etc. They can also be sector based such as National Bank for Agriculture and Rural Development (NABARD) and the National Housing Bank (NHB). Further, Unit Trust of India (UTI) which is in the business of mutual fund, Life Insurance Corporation (LIC) and General Insurance Corporation (GIC) and its subsidiaries are also classified as financial institutions. Therefore, the financial institutions can be categorized into banking institutions and non-banking institutions.

b. Banking Financial Institutions

Banking institutions are those institutions, which participate in the country's payment system, i.e. they provide transaction services. They play an important role in the mobilization of deposits and distribution of credit to various sectors of the economy. A sound banking system ensures that deposits accumulated from people are productively utilized. Banking sector is dominant in India as it accounts for nearly half of the total financial assets in the financial sector.

Banking Financial Institution can be classified into Commercial banks (Private Sector Banks, Public Sector Banks, RRBs, Foreign Banks), and Co-operative Banks.

c. Non-Banking Financial Institutions

Non-banking financial institutions are those institutions which act as mere providers of credit and they do not create credit e.g., LIC, UTI, and IDBI.

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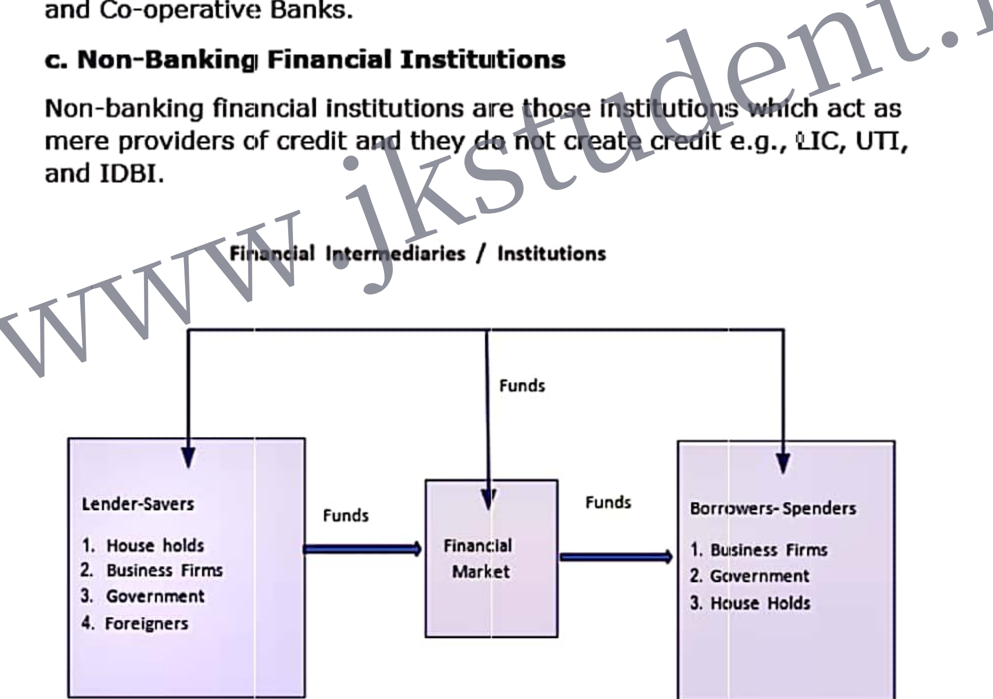

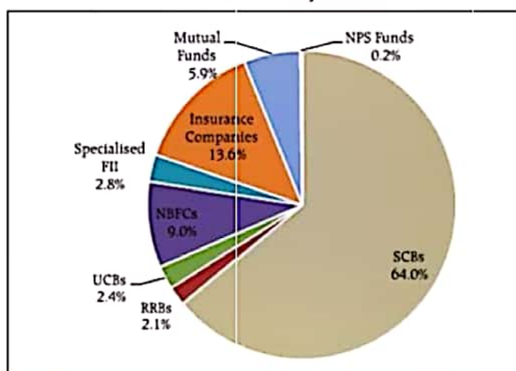

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d. Financial Markets

The financial market is a market where trading of securities including equities, bonds, currencies and derivatives takes place. Financial market can be divided into money market and capital market. Money market is a market for short term securities having a maturity period of less than one year. Capital Market is a market for long term securities having a maturity period of more than one year. Further, capital market can be divided into primary market and secondary market. In primary market, securities (shares, bonds, debentures) are issued to the public for the first time. While in secondary market, trading (purchase and sale) takes place in those securities are already issued to the public.

e. Financial Instruments

Financial instruments are those instruments which have a monetary value. These instruments can be classified into debt based securities and equity based securities. Equity based securities consist of equity share capital which is ownership based securities and represents risk capital. Debt based securities consists of bonds and debentures. Debenture is an acknowledgement of debt which has to be repaid in full in certain number of years mentioned at the time of issue of debenture itself. On the other hand, bonds are financial instruments issued by companies which are basically a financial contract between a company (borrower) and investors (lenders). Bonds are generally used by companies, municipalities, states and sovereign governments to raise money and finance a variety of projects and activities. Owners of bonds are debt holders or creditors of the issue.

Short-term debt-based financial instruments are issued for one year or less. Securities of this kind come in the form of T-bills and commercial paper. Long-term debt-based financial instruments are issued for more than one year. These are bonds, debentures and loans.

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f. Financial Services

Financial services are services which involves investment, lending, and management of money and assets. Financial services are needed for the Borrowing and lending, Investing, Buying and selling securities, Making and enabling payments and settlements, and Managing risk.

The producers of financial services are financial intermediaries or institutions such as banks, insurance companies, mutual funds and stock exchanges. These financial institutions provide financial services such as merchant banking, leasing, hire purchase, factoring and credit rating. Financial services rendered by financial institutions bridge the gap between lack of knowledge on the part of investors and latest trends in the financial instruments and markets. These financial services are essential for the creation of new business, expansion of existing industries and economic growth.

The various types of financial services are:

i. Investment Banking

Companies need cash in order to grow and expand their businesses; Investment banks sell securities to public investors in order to raise the cash. These securities come in the form of stocks or bonds. Thus, Investment banks are essentially financial intermediaries, who assist their clients in raising capital either by underwriting their

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shares or bonds or by acting as an agent (merchant banker) in the issuance of securities.

ii. Credit Rating

Credit Rating means an assessment made from credit-risk evaluation, translated into a current opinion as on a specific date on the quality of a specific debt security issued or on obligation undertaken by an enterprise in terms of the ability and willingness of the obligator to meet principal and interest payments on the rated debt instrument in a timely manner.

iii. Consumer finance

Consumer credit provides short term/medium term loans to finance purchase of goods or services for personal use. There are four important sources of consumer finance viz manufacturers/sellers/dealers, finance companies, banks, and credit card companies.

iv. Housing Finance

The volume and growth rate across time periods are in housing loans are viewed as one of the important barometers of measuring growth in an economy. The demand for Housing Finance comes from:

Salary earners and self-employed professionals with their basic need of a roof over their head.

Non-residents having an eye on capital appreciation of the asset or with an eye to their possible resettlement in India for NRIs.

The supply of loans comes from:

LIC, National Housing Bank in the government sector.

Private Sector housing companies viz. HDFC, Commercial Banks etc.

Non-Banking Finance Companies, Nidhis and Chit funds, Co-operative and Credit Societies, employers extending staff loans for housing, beside private money lenders.

v. Asset Restructuring/Management Company

Asset reconstruction company's (ARC) first task is to manage and convert the sick companies or those companies whose NPA's rose to a significant level into profitable ones.

Asset Management Companies (AMC's) pool large amount of funds from various source of investors and invest these pooled resources in diverse securities by paying out proportional returns to the investors. Simply put, they help their client to invest money and buy securities.

vi. Depository Services

Depository system is concerned with conversion of securities from physical to electronic form, settlement of trades in electronic segment, electronic transfer of ownership of shares and electronic custody of securities. All securities in the depositories are identical in all respects and are thus fungible. The ownership and transfer of securities take place by means of book entries, avoiding the risks associated with paper.

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vii. Debit Cards

Debit cards are also known as cheque cards. A debit card is a plastic card that provides the cardholder electronic access to his or her bank account(s) at a financial institution. When one uses a debit card his money is immediately deducted from his account.

viii. Online Share Trading

Online stock trading is an internet based stock trading facility where investor can trade shares through a website without any manual intervention from the broker. It also provides investors with rich, interactive information in real time including market updates, investment research and robust analysis.

Functions of a Financial System

I. **Mobilization of savings:** Savings are done by millions of people. But amount saved are of no use unless they are mobilized into financial assets, whether currency, bank deposits, post office savings deposits, life insurance policies, mutual funds, bonds or equity shares.

II. **Allocations of savings**: Amount of savings mobilized through millions of people will then be allocated among the needy sectors. Direct lending by the general public has been made possible through corporate bonds and equities. Besides, there are banks, insurance companies, and other financial institutions. They serve as financial intermediaries between the ultimate lender and the ultimate borrower. They mobilize savings of the lender by selling their own liabilities which are deposits, insurance premium amount etc. and make these funds available to needy borrowers at their own risk.

III. **A financial system provides a mechanism for the pooling of funds to invest in large- scale enterprises.**

IV. **Provide payment and settlement system**: Banks provide this mechanism by means of a payment facility based upon cheques, promissory notes, credit and debit cards. The payment mechanism is now being increasingly made through electronic means. The clearing and settlement mechanism of the stock market is done through depositories and clearing corporations.

V. **Monitor corporate performance:** A financial system not only helps in selecting the projects to be funded but also motivates the various stakeholders of the financial system to monitor the performance of the investment. Financial markets and institutions help to monitor corporate performance and exert pressure on the corporates to continuously improve their performance

VI. **Provide price related information:** Financial markets provide information which enables the investors to make an informed decision about whether to buy, sell or hold a financial asset. This information dissemination facilitates valuation of financial assets.

How Financial System is Managed in India?

Different components of Indian Financial System are managed by different financial regulators. After understanding the Financial System of India and its Functions, let us now get acquainted with these Financial Regulators.

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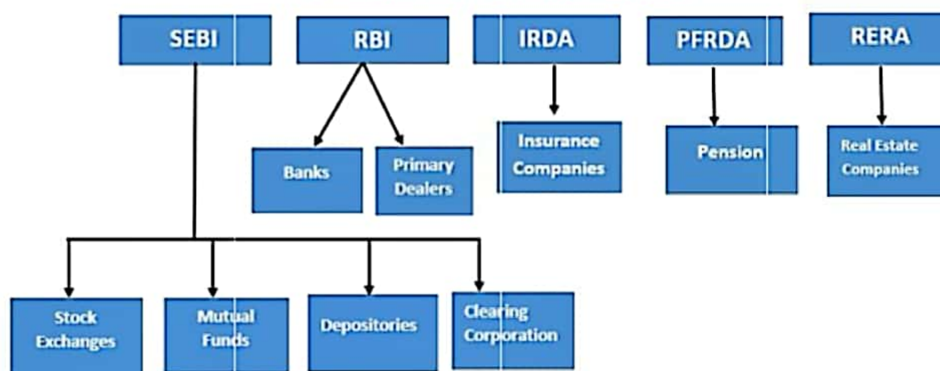

Securities and Exchange Board of India (SEBI)

SEBI was established in 1992 to protect the interest of investors in securities, promote the development of securities market, and to Regulate the securities market.

Following are the functions of the SEBI:

1. To regulate the business in stock exchanges and any other securities markets.
2. To register and regulate the working of stock brokers, sub-brokers, share transfer agents, bankers to an issue, trustees of trust deeds, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisers and such other intermediaries who may be associated with securities markets in any manner.
3. To register and regulate the working of the depositories, participants, custodians of securities, foreign institutional investors, credit rating agencies and such other intermediaries as the Securities and Exchange Board of India may, by notification, specify in this behalf.
4. To register and regulate the working of venture capital funds and collective investment schemes, including mutual funds.
5. To promote and regulate self-regulatory organizations.
6. To prohibit fraudulent and unfair trade practices relating to securities markets.
7. To promote investors' education and training of intermediaries of securities markets.
8. To prohibit insider trading in securities.
9. To regulate substantial acquisition of shares and take-over of companies.
10. To call for information from, undertaking inspection, conducting inquiries and audits of the stock exchanges, mutual funds, other persons associated with the securities market intermediaries and self- regulatory organizations in the securities market.
11. To call for information and record from any bank or any other authority or board or corporation established or constituted by or under any Central, State or Provincial Act in respect of any transaction in securities which is under investigation or inquiry by the Securities and Exchange Board of India.
12. To perform such functions and exercising such powers under the provisions of the Securities Contracts (Regulation) Act, 1956, as may be delegated to it by the Central Government;
13. To levy fees or other charges for carrying out the functions.

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14. To conduct research for the above purposes.

15. To call from or furnish to any such agencies, as may be specified by the Securities and Exchange Board of India, such information as may be considered necessary by it for the efficient discharge of its functions;

Reserve Bank of India (RBI)

The Reserve Bank of India was established in 1935 with the provision of Reserve Bank of India Act, 1934. Though privately owned initially, in 1949 it was nationalized and since then fully owned by the Government of India. The preamble of the Reserve Bank of India describes its main functions as to regulate the issue of Bank Notes and keeping of reserves with a view to secure the monetary stability in India and to operate the currency and credit system of the country to its advantage.

RBI performs three types of functions:

A. Banking Functions

Issuer of Bank Notes: The Reserve Bank of India has the sole right to issue bank notes of all denominations. The distribution of one rupee notes and coins and small coins all over the country is undertaken by the Reserve Bank as agent of the Government.

To act as government banker, agent and adviser: The second important function of the Reserve Bank of India is to act as Government banker, agent and adviser.

Bankers' Bank and Lender of the Last Resort: The commercial banks always look up to RBI in case of any need for funds. Therefore, RBI is called as the bankers' bank and lender of the last resort.

Controller of Credit: The Reserve Bank of India is the controller of credit i.e. it has the power to influence the volume of credit created by banks in India. It can do so through changing the Bank rate or through open market operations. RBI is also the selective controller of credit. It can direct the banks not to lend to certain people or group of people on the basis of certain types of securities. RBI also has the power to control the money market in India.

Custodian of Foreign Reserve: The foreign exchange regulations under the law required that all foreign exchange receipts whether on account of export earnings, investment earnings, or capital receipts, whether on private account or on government account, must be sold to the RBI either directly or through authorized dealers (mostly commercial banks). This resulted in centralization of country's foreign exchange reserves with the RBI and facilitated planned utilization of these reserves, because all payments in foreign exchange were also controlled by the authorities.

B. Supervisory Functions

The Reserve Bank Act, 1934, and the Banking Regulation Act, 1949, have given the RBI wide powers of supervision and control over commercial and co-operative banks, relating to licensing and establishments, branch expansion, liquidity of their assets, management and methods of working, amalgamation, reconstruction and liquidation. Further, the RBI is authorized to carry out periodical inspection of the banks and to call for returns and necessary information from them. Therefore, the supervisory functions of RBI have forced the banks to do their job on sound lines and to improve

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the methods of their operation.

C. Promotional Functions

The RBI now performs a variety of developmental and promotional functions, which, at one time, were regarded as outside the normal scope of central banking. So, the Reserve Bank was asked to promote banking habit amongst the people. People are encouraged to open Jan Dhan Account in urban and rural areas on the basis of their Aadhar Card. Now, people are asked to resort to online banking as the Government is promoting cashless economy. Banks are also gearing up to this challenge as they will need the required infrastructure to enable the customers to transact through online banking only.

Insurance Regulatory and Development Authority of India

IRDA Act was passed in 1999. The aim of the Insurance Regulatory and Development Authority of India is to protect the interest of holders of Insurance policies to regulate, promote and ensure orderly growth of Insurance industry & for matters connected therewith or incidental thereto.

Importance of Insurance Regulatory and Development Authority:

a. Regulation of Insurance Sector

IRDA has a significant effect on the overall regulation of Indian Insurance Sector. In order to keep the proper protection of the policy holder's interests, Insurance Regulatory and Development Authority (IRDA) closely observe the different activities of insurance sector in India.

b. Protection of Policyholders Interests

The core objective or purpose of the Insurance Regulatory and Development Authority is to protect the interests of policyholders.

c. Awareness to Insurance

In order to increase the awareness of insurance in the society, IRDA is trying to convince the prospective investors about the transparency of the system and the effort being put by the regulator to put this into practice.

d. Insurance Market

Insurance sector has grown leap and bounds due to the concerted efforts of Insurance Regulatory and Development Authority with respect to marketing of insurance products, competition & customer awareness.

e. Development of Insurance Product

Insurance Regulatory and Development Authority (IRDA) has brought a revolution in the development of insurance products. The development of ULIPs (Unit-Linked Insurance Plans) is the result of privatization of the insurance sector.

f. Competition in the Insurance Sector

After the advent of privatization in the insurance sector by inviting private players, competition in the insurance sector has increased significantly leading to comparatively cheaper services and greater customer satisfaction.

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g. Saving and Investment of Individual

Insurance Regulatory and Development Authority has made insurance a popular & profitable mode of investment and inculcate saving habits among various sections of the society.

h. Banks and Post Offices

Insurance sector is now giving security against any kind of uncertainty or risk, so the insurance sector has now become a popular medium for savings & investments and is gradually diverting the flow of funds from banks & post offices to insurance industry.

i. Stock Market

Private players in the insurance have developed ULIPs (Unit-Linked Insurance plans) in order to attract more customers. ULIP is a by-product of modern insurance market. Therefore, insurance products have made it simple for the companies to raise funds and have also attracted various sections of the society to invest in the stock market indirectly.

Pension Fund Regulatory and Development Authority

The aim of PFRDA is to be a model Regulator for promotion and development of an organized pension system to serve the old age income needs of people on a sustainable basis.

Real Estate Regulatory Authority

Real Estate Regulatory Authority was established for the regulation and promotion of the real estate sector and to ensure sale of plot, apartment or building, as the case may be, or sale of real estate project, in an efficient and transparent manner and to protect the interest of consumers in the real estate sector and to establish an adjudicating mechanism for speedy dispute redressal.

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Practice Questions

1. Market for short term securities having a maturity period of less than one year is known as?

    1) Capital Market
    2) Revenue Market
    3) Money Market
    4) Flexible Market

2. Which of the following entity is responsible for regulating Mutual Funds in India?

    1) RBI
    2) SEBI
    3) IRDA
    4) Both 1 and 2

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Taxation, Tax Laws- Direct, Indirect

Taxation is the means by which a government or the taxing authority imposes or levies a tax on its citizens and business entities.
From income tax to goods and services tax (GST), taxation applies to all levels.

Before understanding about Direct and Indirect Tax, it is important for us to understand what is tax.

Tax is a pecuniary burden laid upon individuals or property owners to support the Government, a payment exacted by legislative authority. It is not a voluntary payment or donation, but an enforced contribution, exacted pursuant to legislative authority. Taxes are considered to be the "cost of living in a society".

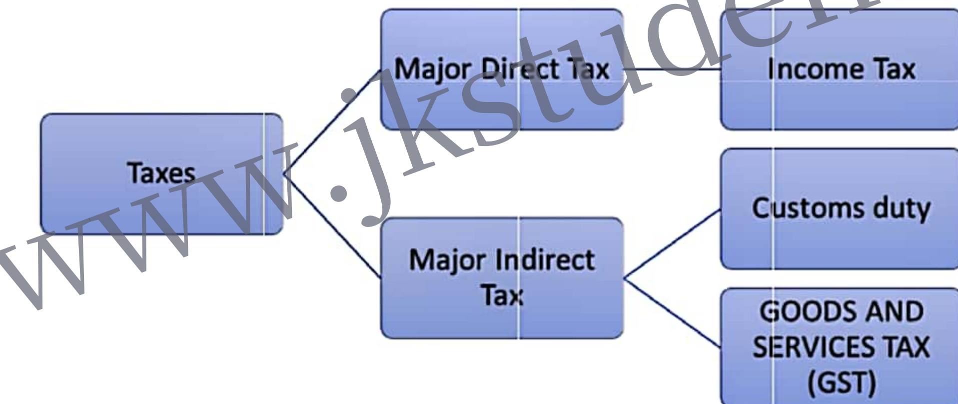
Tax structure in India is a three tier federal structure. The central government, state governments, and local municipal bodies make up this structure. Article 265 of the constitution states that "No tax shall be levied or collected except by the authority of law".
The Tax structure in India consists of 3 federal parts:

1. Central Government
2. State Governments
3. Local Municipal bodies

According to Article 265 of the Indian Constitution: "No tax shall be levied or collected except by the authority of law".
Taxes are determined by the Central and State Governments along with local authorities like municipal corporations. The government cannot impose any tax unless it is passed as a law.

Classification of Taxes

Taxes are broadl-y classified into direct and indirect taxes.



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Direct Taxes: Burden of tax borne by the person himself

A direct tax is a kind of charge, which is imposed directly on the taxpayer and paid directly to the Government by the persons (juristic or natural) on whom it is imposed. A direct tax is one that cannot be shifted by the taxpayer to someone else. A significant direct tax imposed in India is income tax.

Income-tax is the most significant direct tax. **Entry 82 of the Union List** i.e., List I in the Seventh Schedule to Article 246 of the Constitution of India has given the power to the Parliament to make laws on taxes on income other than agricultural income.

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The levy of income-tax in India is governed by the Income-tax Act, 1961, which extends to whole of India.

Income Tax Act came into force on 1st April, 1962.

The Income-tax Act, 1961, undergoes change every year with additions and changes brought in by the Annual Finance Act passed by Parliament. Sometimes, legislative amendments are made for amending the provisions of the Income-tax Act, 1961, through legislations like Taxation Laws (Amendment) Act, 2019.

Levy of Income-tax

Income-tax is a tax levied on the total income of the previous year of every person.

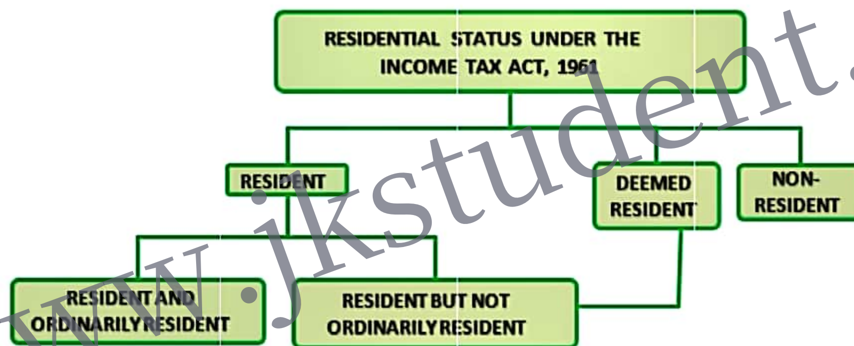
A person includes an individual, Hindu Undivided Family (HUF), Association of Persons (AOP), Body of Individuals (BOI), a firm, a company, etc.

Total Income and Tax Payable

Income-tax is levied on an assessee's total income. Such total income has to be computed as per the provisions contained in the Income-tax Act, 1961.

Determination of residential status

The residential status of a person has to be determined to ascertain which income is to be included in computing the total income.



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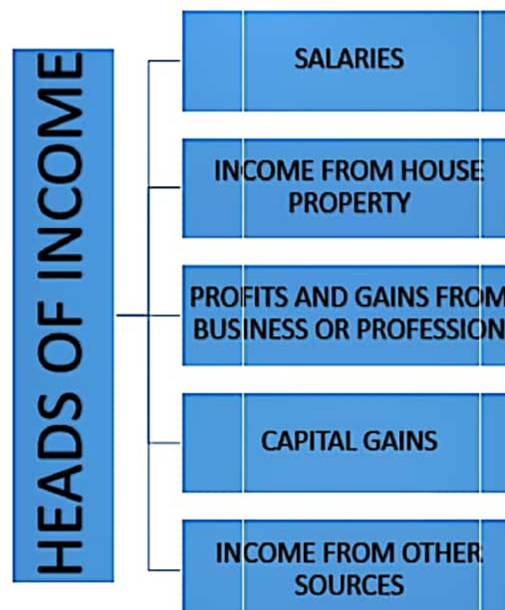
Classification of income under different heads

A person may earn income from different sources. Under the Income-tax Act, 1961, for computation of total income, all income of a tax payer are classified into five different heads of income.



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1- Salary, pension earned is taxable under the head **"Salaries".**

2- Rental income is taxable under the head **"Income from house property".**

3- Income derived from carrying on any business or profession is taxable under the head **"Profits and gains from business or profession".**

4- Profit from sale of a capital asset (like land) is taxable under the head **"Capital Gains".**

5- The fifth head of income is the residuary head. Income which is chargeable to tax but not taxable under the first four heads will be taxed under the head **"Income from other sources".**

Clubbing of income of spouse, minor child etc.

In case of individuals, income-tax is levied on a slab system on the total income. The tax system is progressive i.e., as the income increases, the applicable rate of tax increases. Some taxpayers in the higher income bracket have a tendency to divert some portion of their income to their spouse, minor child etc. to minimize their tax burden.

In order to prevent such tax avoidance, clubbing provisions have been incorporated in the Act, under which income arising to certain persons (like spouse, minor child etc.) have to be included in the income of the person who has diverted his income for the purpose of computing tax liability.

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Gross Total Income

The final figures of income or loss under each head of income, after allowing the deductions, allowances and other adjustments, are then aggregated, after giving effect to the provisions for clubbing of income and set-off and carry forward of losses, to arrive at the gross total income.

What is Exemption and Deduction?

Exemptions: There are certain incomes which are wholly exempt from income-tax, e.g. agricultural income. These incomes have to be excluded and will not form part of Total Income.

Also, some incomes are partially exempt from income-tax e.g. House Rent Allowance, Education Allowance.

Deductions: There are deductions and allowances prescribed under each head of income. For example, while calculating income from house property, municipal taxes and interest on loan are allowed as deduction.

Total Income:

The income arrived at, after claiming the above deductions from the Gross Total Income is known as the Total Income. It should be rounded off to the nearest multiple of Rs. 10 as per section 288A.

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Return of Income

The Income-tax Act, 1961 contains provisions for filing of return of income. Return of income is the format in which the assessee furnishes information as to his total income and tax payable. The format for filing of returns by different assessees is notified by the CBDT.

Assessee

"Assessee" means a person by whom any tax or any other sum of money is payable under this Act. In addition, it includes –

Every person in respect of whom any proceeding under this Act has been taken for the assessment of his income; or

the income of any other person in respect of which he is assessable; or

the loss sustained by him or by such other person; or

the amount of refund due to him or to such other person.

Every person who is deemed to be an assessee under any provision of this Act;

Every person who is deemed to be an assessee-in-default under any provision of this Act.

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Assessment

This is the procedure by which the income of an assessee is determined.

Assessment year

The term has been defined under section 2(9). This means a period of 12 months commencing on 1st April every year. The year in which income is earned is the previous year and such income is taxable in the immediately following year which is the assessment year. Income earned in the previous year 2020-21 is taxable in the assessment year 2021-22.

Assessment year always starts from 1st April and it is always a period of 12 months.

Previous year

The term has been defined under section 3. It means the financial year immediately preceding the assessment year.

Business or profession newly set up during the financial year –

In such a case, the previous year shall be the period beginning on the date of setting up of the business or profession and ending with 31st March of the said financial year.

If a source of income comes into existence in the said financial year, then, the previous year will commence from the date on which the source of income newly comes into existence and will end with 31st March of the financial year.

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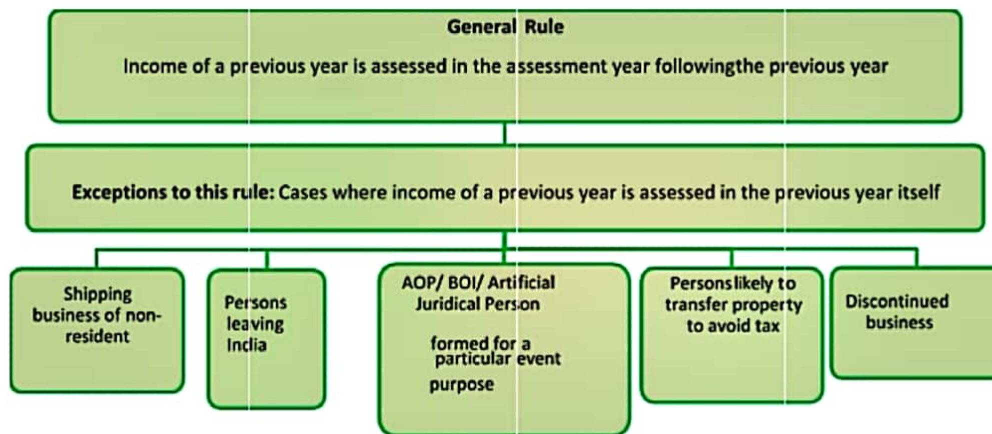
Certain cases when income of a previous year will be assessed in the previous year itself



CHARGE OF INCOME TAX

Section 4 of the Income-tax Act, 1961 is the charging section which provides that:

Tax shall be charged at the rates prescribed for the year by the Annual Finance Act or the Income-tax Act, 1961 or both.

The charge is on every person specified under section 2(31);

Tax is chargeable on the total income earned during the previous year and not the assessment year. (There are certain exceptions provided by sections 172, 174, 174A, 175 and 176);

Tax shall be levied in accordance with and subject to the various provisions contained in the Act.

This section is the back bone of the law of income-tax in so far as it serves as the most operative provision of the Act. The tax liability of a person springs from this section.

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Rates of Tax

Income-tax is to be charged at the rates fixed for the year by the Annual Finance Act.

The slab rates applicable for A.Y. 2021-22 are as follows:

Individual/ Hindu Undivided Family (HUF)/ Association of Persons (AOP)/ Body of Individuals (BOI)/ Artificial Juridical Person

Income	Rate
where the total income does not exceed Rs. 2,50,000	NIL
where the total income exceeds Rs. 2,50,000 but does not exceed Rs. 5,00,000	5% of the amount by which the total income exceeds Rs. 2,50,000
where the total income exceeds Rs. 5,00,000 but does not exceed Rs. 10,00,000	Rs. 12,500 *plus* 20% of the amount by which the total income exceeds Rs. 5,00,000
where the total income exceeds Rs. 10,00,000	Rs. 1,12,500 *plus* 30% of the amount by which the total income exceeds Rs. 10,00,000

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As per section 115BAC, individuals and HUFs have an option to pay tax in respect of their total income (other than income chargeable to tax at special rates under Chapter XII) at following concessional rates, if they do not avail certain exemptions/deductions like Leave Travel Concession, standard deduction under the head "Salaries", interest on housing loan on self-occupied property, deductions under Chapter VI-A (other than 80CCD (2) or section 80JJAA) etc.

Income	Rate
Upto Rs. 2,50,000	Nil
From Rs. 2,50,001 to Rs. 5,00,000	5%
From Rs. 5,00,001 to Rs. 7,50,000	10%
From Rs. 7,50,001 to Rs. 10,00,000	15%
From Rs. 10,00,001 to Rs. 12,50,000	20%
From Rs. 12,50,001 to Rs. 15,00,000	25%
Above Rs. 15,00,000	30%

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For Example: Mr. A has a total income of Rs. 6,00,000 for P.Y. 2020-21.

Assessment of Mr. A's taxable income is as follows:

First ₹2,50,000 – Nil

Next ₹2,50,001 to ₹5,00,000 - @ 5% of ₹2,50,000 = ₹12,500

Next ₹5,00,000 to ₹6,00,000 - @10% of 1,00,000 = ₹10,000

Taxable income = ₹22,500

Firm/LLP

On the whole of the total income- 30%

Local authority

On the whole of the total income- 30%

Marginal relief

The purpose of marginal relief is to ensure that the increase in amount of tax payable (including surcharge) due to increase in total income of an assessee beyond the prescribed limit should not exceed the amount of increase in total income.

Surcharge

Surcharge is an additional tax payable over and above the income-tax.

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Indirect Taxes

Burden of tax shifted to another person

If the taxpayer is just a conduit and at every stage the tax incidence is passed on till it finally reaches the consumer, who really bears the brunt of it, such tax is indirect tax. An indirect tax is one that can be shifted by the taxpayer to someone else.

It is also called consumption taxes. They are regressive in nature because they are not based on the principle of ability to pay.

All the consumers, including the economically challenged bear the brunt of the indirect taxes equally.

Indirect taxes are levied on consumption, expenditure, privilege, or right but not on income or property.

FEATURES OF INDIRECT TAXES

1. An important source of revenue: Indirect taxes are a major source of tax revenues for Governments worldwide and continue to grow as more countries move to consumption oriented tax regimes. In India, indirect taxes contribute more than 50% of the total tax revenues of Central and State Governments.
2. Tax on commodities and services: It is levied on commodities at the time of supply or manufacture or purchase or sale or import/export thereof. Hence, it is also known as commodity taxation. It is also levied on supply of services.
3. Shifting of burden: There is a clear shifting of tax burden in respect of indirect taxes. For example, GST paid by the supplier of the goods is recovered from the buyer by including the tax in the cost of the commodity.
4. No perception of direct pinch: Since, value of indirect taxes is generally inbuilt in the price of the commodity, most of the time the tax payer/consumer pays the same without actually knowing that he is paying tax to the Government. Thus, tax payer does not perceive a direct pinch while paying indirect taxes.
5. Inflationary: Tax imposed on commodities and services causes an all-round price spiral. In other words, indirect taxation directly affects the prices of commodities and services and leads to inflationary trend.
6. Wider tax base: Unlike direct taxes, the indirect taxes have a wide tax base. Majority of the products or services are subject to indirect taxes with low thresholds.
7. Promotes social welfare: Higher taxes are imposed on the consumption of harmful products (also known as 'sin goods') such as alcoholic products, tobacco products etc. This not only checks their consumption but also enables the State to collect substantial revenue.
8. Regressive in nature: Generally, the indirect taxes are regressive in nature. The rich and the poor have to pay the same rate of indirect taxes on certain commodities of mass consumption. This may further increase the income disparities between the rich and the poor.

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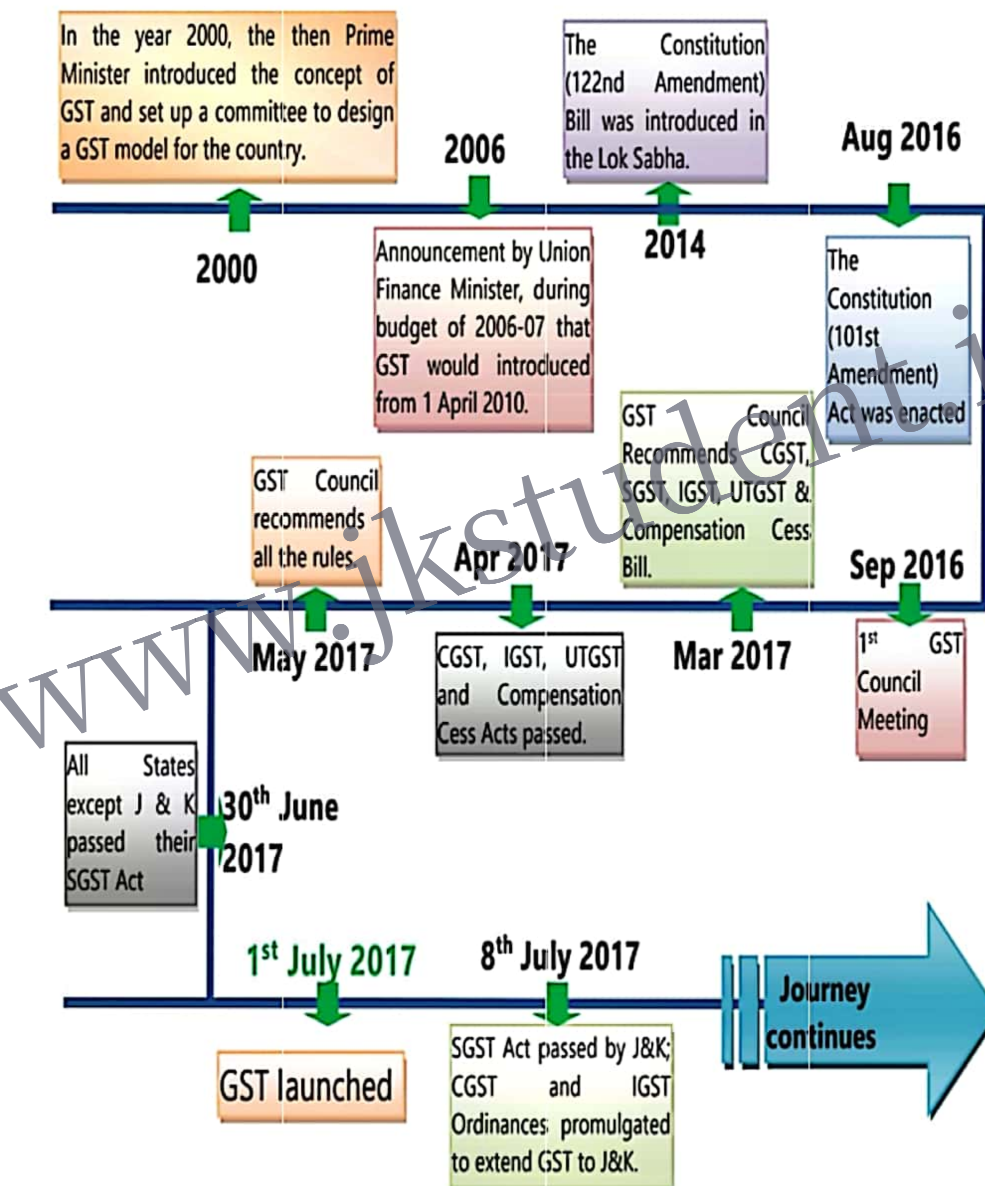
Goods and Services Tax

Introduction

GST is a destination based tax on consumption of goods and services. It is to be levied at all stages right from manufacture up to final consumption with credit of taxes paid at previous stages available as setoff.

France was the first country to implement VAT/GST in 1954. Presently, more than 160 countries have implemented.
GST is a path breaking indirect tax reform which attempts to create a common national market. GST has subsumed multiple indirect taxes like excise duty, service tax, VAT, CST, luxury tax, entertainment tax, entry tax, etc.

Journey of GST in India



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Characteristics of Goods and Services Tax

1. GST is a common law and procedure throughout the country under single administration.

2. GST is a destination based tax and levied at a single point at the time of consumption of goods and services by the end consumer.

3. GST is a comprehensive levy and collection on both goods and services at the same rate with benefit of input tax credit or subtraction of value.

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4. Minimum number of rates of tax does not exceed two.

5. There is no scope for levy of cess, resale tax, additional tax, turnover tax etc.

6. There is no multiple levy of tax on goods and services, such as sales tax, entry tax, octroi, entertainment tax or luxury tax etc.

Framework of GST in India

India has adopted a Dual GST model in view of the federal structure of the country. Consequently, Centre and States simultaneously levy GST on taxable supply of goods or services or both, which takes place within a State or Union Territory. Thus, tax is imposed concurrently by the Centre and States, i.e. Centre and States simultaneously tax goods and services.

Taxes Subsumed by GST

Central Taxes

- Central Excise Duty & Additional Excise Duties
- Service Tax
- Excise Duty under Medicinal & Toilet Preparation Act
- CVD & Special CVD
- Central Sales Tax
- Central surcharges & Cesses in so far as they relate to supply of goods & services

State Taxes

- State surcharges and cesses in so far as they relate to supply of goods & services
- Entertainment Tax (except those levied by local bodies)
- Tax on lottery, betting and gambling
- Entry Tax (All Forms) & Purchase Tax
- VAT/ Sales tax
- Luxury Tax
- Taxes on advertisements

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Components of GST

Central Goods and Services Tax (CGST)- levied and collected by Central Government.

State Goods and Services Tax (SGST)- levied and collected by State Governments/Union Territories with Legislatures.

Union Territory Goods and Services Tax (UTGST)- levied and collected by Union Territories without Legislatures, on intra-State supplies of taxable goods and/or services.

Integrated Goods and Services Tax (IGST)- It is divided between Central and State Government as per the rates specified by the Government. IGST is charged on transfer of goods and services from one state to another. Import of goods and services are also covered under IGST.

Classification of Goods and Services

Harmonised System of Nomenclature is used for classifying the goods under the GST.

A new Scheme of Classification of Services has been devised wherein the services of various descriptions have been classified under various sections, headings and groups. Each group consists of various

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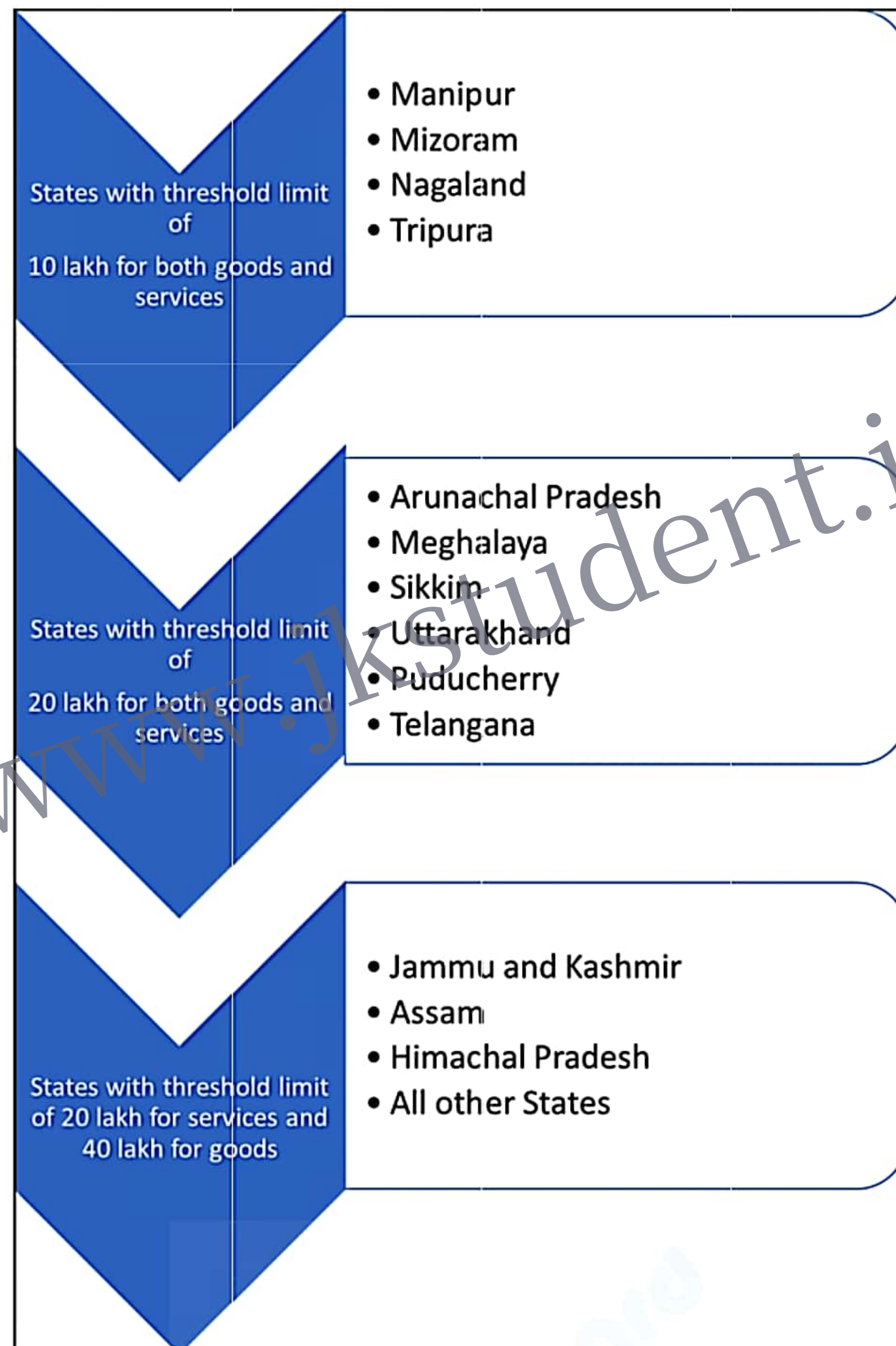
Service Codes (Tariff).

Registration

Every supplier of goods and/ or services is required to obtain registration in the State/UT from where he makes the taxable supply if his aggregate turnover exceeds the threshold limit during a FY. Different threshold limits have been prescribed for various States and Union Territories depending upon the fact whether the supplier is engaged exclusively in supply of goods, or exclusively in supply of services or in supply of both goods and services.



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Composition Scheme

For providing relief to small businesses, primarily manufacturers, suppliers of food articles, traders, etc., making intra-State supplies, and small service providers a simpler method of paying taxes is prescribed, known as Composition Levy.

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Compensation Cess

A GST Compensation Cess at specified rate has been imposed under the Goods and Services Tax (Compensation to States) Cess Act, 2017 on the specified luxury items or demerit goods, like pan masala, tobacco, aerated waters, motor cars etc., computed on value of taxable supply. Compensation cess is leviable on intra-State supplies and inter-State supplies with a view to provide for compensation to the States for the loss of revenue arising on account of implementation of the GST. Compensation is to be provided to a State for a period of 5 years from the date on which the State brings its SGST Act into force.

Extent of GST

GST is levied on all goods and services, except:

1. Alcoholic liquor for human consumption
2. Petroleum crude, diesel, petrol. ATF and natural gas
3. Real estate sector

It is noteworthy that tobacco is subject to GST as well as central excise duty, and Opium, Indian hemp and other narcotic drugs and narcotics are subject to GST as well as State excise duties.

Goods Exempted from GST

Under GST, everyday items used by the common man have been included in the list of exempted items.

Items such as unbranded atta /maida/ besan, unpacked food grains, milk, eggs, curd, lassi and fresh vegetables are among the items exempted from GST.

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Advantages of GST

1. Introduction of GST has resulted in the abolition of multiple types of taxes in goods and services.

2. GST widens the tax base and increased revenue to Centre and State thereby reducing administrative cost for the Government.

3. GST has reduced compliance cost and increases voluntary compliance.

4. GST has affected rates of tax to the maximum of two floor rates.

5. GST has removed the cascading effect on taxation.

6. GST will result in enhancing manufacturing and distribution system affecting the cost of production of goods and services and consequently the demand and production of goods and services will increase.

7. It will eventually promote economic efficiency and sustainable long term economic growth as GST is neutral to business processes, business models, organisational structure and geographical location.

8. GST would help to extend competitive edge in international market for goods and services produced in the country leading to increased exports.

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Cost Management-Budgetary control

Before understanding the term Budgetary Control and concepts related to it, we shall give us a moment to see what does the term prefixed to it means, i.e., Cost Management.

Cost is nothing but the amount of expenditure incurred on or attributable to specified goods or services, and the process by which these costs are estimated, allocated or controlled is known as Cost Management.

Budgetary Control

Meaning:
Budgetary control is an essential tool that is frequently used by the business executives for the purpose of planning, execution and control of business activities.

In the words of Brown and Howard Budgetary Control is "a system of controlling costs which includes the preparation of budgets, co-ordinating the departments and establishing responsibilities, comparing actual performance with the budgeted and acting upon results to achieve maximum profitability."

In other words, Budgetary Control is a process with the help of which, managers set financial and performance goals, compare the actual results with the budgets, and adjust performance, as it is needed.

From the definition provided above, we can ascertain the following:

1. Establishment of budgets
2. Continuous comparison of actuals with budgets for achievement of targets.
3. Revision of budgets after considering the changes in the circumstances.
4. Fixation of the responsibility for failure to achieve the budget targets.

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Do you know: Budget is an estimation of revenues and expenses over a specified future period of time which needs to be compiled and re-evaluated on a periodic basis based on the needs of the organisation.

After getting familiar with the meaning of Budgetary control, it is vital for us to understand what are the objectives for which Budgetary Control System is required, are there any components of Budgetary Control, what are its advantages, and are there any limitations to it, etc.

Objectives of Budgetary Control System:

1. Portraying with precision the overall aims of the business and determining targets of performance for each section or department of the business.
2. Laying down the responsibilities of executives and other personnel.
3. Providing a basis for the comparison of actual performance with the predetermined targets and investigation of deviation, if any, of actual performance and expenses from the budgeted figures. This naturally helps in adopting corrective measures.

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4. Ensuring optimum use of available resources to maximise profit or production
5. Co-ordinating various activities of the business, and centralising control and yet enabling management to decentralise responsibility and delegate authority in the overall interest of the business.
6. Providing a basis for revision of current and future policies.
7. Drawing up long range plans with a fair measure of accuracy.
8. Providing a yardstick against which actual results can be compared.

Steps for Establishing Budgetary Control

The following steps are necessary for establishing a good budgetary control system:

1. Determining the objectives to be achieved, over the budget period, and the policy or policies that might be adopted for the achievement of these objectives.
2. Determining the activities that should be undertaken for the achievement of the objectives.
3. Drawing up a plan or a scheme of operation in respect of each class of activity, in quantitative as well as monetary terms for the budget period.
4. Laying out a system of comparison of actual performance by each person, or department with the relevant budget and determination of causes for the variation, if any.
5. Ensuring that corrective action will be taken where the plan has not been achieved and, if that is not possible, for the revision of the plan.

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Who is Responsible for introduction and implementation of Budgetary Control?

The responsibility for successfully introducing and implementing Budgetary Control System rests with the Budget Committee acting through the Budget Officer. The Budget Committee would be composed of all functional heads and a member from the Board to preside over and guide the deliberations.

Components of Budgetary Control System

The policy of a business for a defined period is represented by the master budget, the detailed components of which are given in a number of individual budgets called functional budgets. These functional budgets are broadly grouped under the following heads:

1. Physical budgets: Those budgets which contain information in quantitative terms such as the physical units of sales, production etc. This may include quantity of sales, quantity of production, inventories, and manpower budgets are physical budgets.

2. Cost budgets: Budgets which provides cost information in respect of manufacturing, administration, selling and distribution, etc. for example, manufacturing costs, selling costs, administration cost, and research and development cost budgets are cost budgets.

3. Profit budgets: A budget which enables the ascertainment of profit. For example, sales budget, profit and loss budget, etc.

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4. Financial budgets: A budget which facilitates in ascertaining the financial position of a concern, for example, cash budgets, capital expenditure budget, budgeted balance sheet, etc.

Do you know: Budget Manual is a document which sets out the responsibilities of the persons engaged in, the routine of, and the forms and records required for, budgetary control.

Budgetary Control Schemes

Feedback and Feed-forward are two types of budgetary control schemes for systems that react automatically to changing environmental dynamics. Each utilizes sensors to measure important factors and a set of rules to react to changes in those factors. Feedback and Feedforward Controls may coexist in the same system, but the two designs function in very different ways.

1. Feedback Control

Feedback as the name suggests is a reaction after an action has taken place. It identifies an error that has already taken place, by comparing the actual historical results with the budgeted results, therefore it works as a detective tool.

Once an error (undesirable result) is detected, this control mechanism response a part of output to the system/process to obtain the desired output. At this stage, this mechanism drives to correct the error and is therefore referred to as corrective tool. Corrective actions are necessary in order to ensure that future results match up to the budgeted figures.

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Types of Feedback:

Primary: Could be reported to line management in the form of control reports, comparing actual and budgeted result

Secondary: Where feedback is sent to a higher level in an organisation and can lead to a plan being reviewed and possibly changed.

Positive: Taken to reinforce a deviation from standard

Negative: Feedback taken to reverse a deviation from standard.

2. Feed-forward Control

Feed-forward Control is defined as the 'forecasting of differences between actual and planned outcomes and the implementation of actions before the event, to avoid such differences.'

The rationale behind feed- forward control is to foresee potential problems and take corrective action to ensure that the final output is as expected. Feed-forward controls are desirable because they allow management to prevent problems rather than having to cure them later

Feed-forward Control is also referred to as a preventive control.

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Do you know: A Budget Centre is a section of an organisation developed for the purpose of budgetary control, and is intended to facilitate formulation of various budgets with the help of head of the department.

Advantages of Budgetary Control System

i. Efficiency

The use of budgetary control system enables the management of a business entity to conduct its business activities in an efficient manner.

Control on expenditure:

It is a powerful instrument used by business entity for the control of their expenditure. It provides a yardstick for measuring and evaluating the performance of individuals and their departments.

ii. Finding deviations

It reveals the deviations of the actual from the budgeted figures after making a comparison and communicating the deviation to management.

iii. 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 these into account.

iv. Revision of plans

It helps in the review of current trends and framing of future policies.

v. Implementation of Standard Costing system

It creates suitable conditions for the implementation of standard costing system in a business organisation.

vi. Cost Consciousness

Budgetary control system encourages cost consciousness and maximum utilisation of available resources.

Limitations

i. Expensive

For successful implementation of the budgetary control, proper organisation structure with responsibility is prerequisite. Budgeting process start from the collection of information to for preparing the budget and performance analysis. It consumes valuable resources (in terms of qualified manpower, equipment, etc.) for this purpose; hence, it is an expensive process.

ii. Co-operation Required

Staff co-operation is usually not available during the initial budgetary control exercise. 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 is required. The success of the budgetary control depends upon willing co-operation and teamwork.

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Behavioural aspects of Budgetary Controls
Many of the conflicts arise due to the human nature of a budgetary control system. Managers do not always follow organisational goals, they do not always think long term, they may be wary of moving away from the plan etc. This provides a conflict between many of the goals of a budgetary control system which needs to be considered at a strategic level when implementing such a system.

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Practice Questions

1. Which of the following Budgetary Control Scheme is also referred to as a preventive control?
1) Feedback Control
2) Feed Forecasting Control
3) Feed-Forward Control
4) Feed Vigilantism Control

2. A document which sets out the responsibilities of the persons engaged and the forms and records required for budgetary control is known as:
1) Budgetary Committee Report
2) Budget Manual
3) Budget Prospectus
4) Budget Centre Report

3. Which of the following is not a component of Budgetary Control System?
1) Cost budgets
2) Physical budgets
3) Loss budgets
4) Profit budgets

Answer Key:

1- C; 2- B; 3- C.

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Meaning of Cost, and Cost Accounting

Cost accounting is a method of managerial accounting which aims to capture the total production cost of a business by measuring the variable costs of each production phase as well as fixed costs, such as a lease expense.

Cost is the amount of expenditure incurred on a specified article, product or activity.

Objectives of Cost Accounting:

I. **Ascertainment of Cost:** The main objective of cost accounting is accumulation and ascertainment of cost. Costs are accumulated, assigned and ascertained for each cost object.

II. **Determination of Selling Price:** Cost accounting provides base for determination of selling price of company's product by ascertaining the cost of each product. It helps the management to fix the selling price of products and services.

III. **Cost Control:** Maintaining discipline in expenditure is one of the main objective of a good cost accounting system. It ensures that expenditures are in consonance with predetermined set standard and any variation from these set standards is noted and reported on continuous basis.

IV. **Cost Reduction:** It defined "as the achievement of real and permanent reduction in the unit cost of goods manufactured or services rendered without impairing their suitability for the use intended or diminution in the quality of the product."

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V. **Assisting management in decision making:** Cost accounting by providing relevant information, assist management in planning, implementing, measuring, controlling and evaluation of various activities.

Cost Object

Cost object is anything for which a separate measurement of cost is required. Cost object may be a product, a service, a project, a customer, a brand category, an activity, a department or a programme etc.

Cost Driver

A Cost driver is a factor or variable which effect level of cost. Generally, it is an activity which is responsible for cost incurrence.

CLASSIFICATION OF COSTS

It means the grouping of costs according to their common characteristics. The important ways of classification of costs are:

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1. By Nature / Element:

A. Direct Materials: Materials which are present in the finished product (cost object) or can be economically identified in the product are called direct materials.

B. Direct Labour: Labour which can be economically identified or attributed wholly to a cost object is called direct labour.

C. Direct Expenses: It includes all expenses other than direct material or direct labour which are specially incurred for a particular cost object and can be identified in an economically feasible way.

D. Indirect Materials: Materials which do not normally form part of the finished product (cost object) are known as indirect materials.

E. Indirect Labour: Labour costs which cannot be allocated but can be apportioned to or absorbed by cost units or cost centres is known as indirect labour.

F. Indirect Expenses: Expenses other than direct expenses are known as indirect expenses.

G. Overheads: It is the aggregate of indirect material costs, indirect labour costs and indirect expenses.

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2. By Functions

Under this classification, costs are divided according to the function for which they have been incurred. It includes the Direct Material Cost, Direct Employee (labour) Cost, Direct Expenses, Production/ Manufacturing Overheads, Administration Overheads, Selling Overheads, Distribution Overheads, Research and Development costs, etc.

3. By Variability or Behavior

According to this classification costs are classified into three group viz., fixed, variable and semi-variable.

A. Fixed costs– These are the costs which are incurred for a period, and which, within certain output and turnover limits, tend to be unaffected by fluctuations in the levels of activity. E.g. Rent, Insurance of factory building, etc.

B. Variable Costs– These costs tend to vary with the volume of activity. Any increase in the activity results in an increase in the variable cost and vice- versa. For example, cost of direct labour, etc.

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C. **Semi-variable costs–** These costs contain both fixed and variable components and are thus partly affected by fluctuations in the level of activity. Examples of semi variable costs are telephone bills, gas and electricity etc.

4. By Controllability

Costs here may be classified into controllable and uncontrollable costs.

A. **Controllable Costs**: - Cost that can be controlled, typically by a cost, profit or investment centre manager is called controllable cost. E.g. direct costs comprising direct labour, direct material, direct expenses, etc.

B. **Uncontrollable Costs** - Costs which cannot be influenced by the action of a specified member of an undertaking are known as uncontrollable costs.

5. By Normality

According to this basis cost may be categorised as Normal Cost, and Abnormal Cost.

A. **Normal Cost** - It is the cost which is normally incurred at a given level of output under the conditions in which that level of output is normally attained.

B. **Abnormal Cost** - It is the cost which is not normally incurred at a given level of output in the conditions in which that level of output is normally attained. **It is charged to Costing Profit and loss Account.**

6. By Costs for Managerial Decision Making

According to this basis cost may be categorised as follows:

A. **Pre-determined Cost** - A cost which is computed in advance before production or operations start, on the basis of specification of all the factors affecting cost, is known as a pre-determined cost.

B. **Standard Cost** -A pre-determined cost, which is calculated from managements 'expected standard of efficient operation' and the relevant necessary expenditure.

C. **Marginal Cost** -The amount at any given volume of output by which aggregate costs are changed if the volume of output is increased or decreased by one unit.

D. **Estimated Cost** – It is the expected cost of manufacture, or acquisition, often in terms of a unit of product computed on the basis of information available in advance of actual production or purchase. Estimated costs are **prospective costs** since they refer to prediction of costs.

E. **Differential Cost** - It represents the change (increase or decrease) in total cost (variable as well as fixed) due to change in activity level, technology, process or method of production, etc.

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F. Imputed Costs - These costs are **notional costs** which do not involve any cash. Interest on capital, the payment for which is not actually made, is an example of imputed cost. These costs are similar to opportunity costs.

G. Capitalized Costs -These are costs which are initially recorded as assets and subsequently treated as expenses.

H. Product Costs - These are the costs which are associated with the purchase and sale of goods. In the production scenario, such costs are associated with the acquisition and conversion of materials and all other manufacturing inputs into finished product for sale.

I. Opportunity Cost - This cost refers to the value of sacrifice made or benefit of opportunity foregone in accepting an alternative course of action.

J. Explicit or Out-of-pocket Cost - It is that portion of total cost, which involves cash outflow. This cost concept is a short-run concept and is used in decisions relating to fixation of selling price in recession, make or buy, etc.

K. Shut down Costs - Those costs, which continue to be, incurred even when a plant is temporarily shut-down e.g. rent, rates, depreciation, etc. In other words, all fixed costs, which cannot be avoided during the temporary closure of a plant, will be known as shut down costs.

L. Sunk Costs - Historical costs incurred in the past are known as sunk costs. They play no role in decision making in the current period.

M. Absolute Cost - These costs refer to the cost of any product, process or unit in its totality. When costs are presented in a statement form, various cost components may be shown in absolute amount or as a percentage of total cost. Here the costs depicted in absolute amount may be called absolute costs.

N. Discretionary Costs – Such costs are not tied to a clear cause and effect relationship between inputs and outputs. They usually arise from periodic decisions regarding the maximum outlay to be incurred.

O. Period Costs - These are the costs, which are not assigned to the products but are charged as expenses against the revenue of the period in which they are incurred. All non-manufacturing costs such as general & administrative expenses, selling and distribution expenses are recognised as period costs.

P. Engineered Costs - These are costs that result specifically from a clear cause and effect relationship between inputs and outputs.

Q. Implicit Costs - These costs do not involve any immediate cash payment. They are not recorded in the books of account. They are also known as economic costs.

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TECHNIQUES OF COSTING

1. Uniform Costing

When a number of firms in an industry agree among themselves to follow the **same system of costing** in detail, adopting common terminology for various items and processes they are said to follow a system of uniform costing.

2. Direct Costing

In this technique all the direct costs incurred for a particular product, process or project are charged to it and the indirect costs are written off to profit and loss.

3. Marginal Costing

Marginal costing (sometimes called cost-volume-profit analysis) is the impact on the cost of a product by adding one additional unit into production.

It is defined as the ascertainment of marginal cost by **differentiating between fixed and variable costs**.

It is useful for short-term economic decisions.

4. Historical Costing

It is the **ascertainment of costs after they have been incurred**. This type of costing has limited utility.

5. Absorption Costing

It is the practice of **charging all costs, both variable and fixed** to operations, processes or products. This differs from marginal costing where fixed costs are excluded.

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6. Standard Costing

Standard costing assigns "standard" costs, rather than actual costs, to its cost of goods sold (COGS) and inventory. The standard costs are based on an efficient use of labour and materials to produce the good or service under standard operating conditions, and they are essentially the budgeted amount. Even though standard costs are assigned to the goods, the company still has to pay actual costs. Assessing the difference between the standard (efficient) cost and actual cost incurred is called variance analysis.

7. Activity-Based Costing

Activity-based costing (ABC) identifies overhead costs from each department and assigns them to specific cost objects, such as goods or services.

8. Lean Accounting

The main goal of lean accounting is to improve financial management practices within an organization. Lean accounting is an extension of the philosophy of lean manufacturing and production, which has the stated intention of minimizing waste while optimizing productivity.

When using lean accounting, traditional costing methods are replaced by value-based pricing.

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METHODS OF COSTING

Different industries follow different methods of costing because of the differences in the nature of their work. The various methods of costing are as follows:

1. **Single or Output Costing**

Here the cost of a product is ascertained, the product being the only one produce like bricks, coals, etc.

2. **Job Costing**

In this method of costing, cost of each job is ascertained separately. It is suitable in all cases where work is undertaken on receiving a customer's order like a printing press, motor workshop, etc.

3. **Batch Costing**

It is the extension of job costing. A batch may represent a number of small orders passed through the factory in batch. Each batch here is treated as a unit of cost and thus separately costed. Here cost per unit is determined by dividing the cost of the batch by the number of units produced in the batch.

4. **Contract Costing**

Here the cost of each contract is ascertained separately. It is suitable for firms engaged in the construction of bridges, roads, buildings, etc.

5. **Process Costing**

In this method the cost of completing each stage of work is ascertained.

6. **Operating Costing**

The costs are incurred for services rendered like transport, supply of water, retail trade, etc.

7. **Multiple Costing**

It is a combination of two or more methods of costing.

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LIMITATIONS OF COST ACCOUNTING

1. **Expensive:** It is expensive because analysis, allocation and absorption of overheads require considerable amount of additional work, and hence additional money.
2. **Requirement of Reconciliation:** The results shown by cost accounts differ from those shown by financial accounts. Thus Preparation of reconciliation statements is necessary to verify their accuracy.
3. **Duplication of Work**: It involves duplication of work as organization has to maintain two sets of accounts i.e. Financial Account and Cost Account.
4. **Inefficiency:** Costing system itself does not control costs but its usage does.

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Developments in Accounting

Introduction

Accounting enjoys a remarkable heritage. The seeds of accounting were most likely first sown in Babylonia and Egypt around 4000 B.C. who recorded transactions of payment of wages and taxes on clay tablets. Historical evidences reveal that Egyptians used some form of accounting for their treasuries where gold and other valuables were kept. The in-charge of treasuries had to send day wise reports to their superiors known as Wazirs (the prime minister) and from there month wise reports were sent to kings. In Greece, accounting was used for apportioning the revenues received among treasuries, maintaining total receipts, total payments and balance of government financial transactions. Romans used memorandum or daybook where in receipts and payments were recorded and wherefrom they were posted to ledgers on monthly basis. (700 B.C to 400 A.D). China used sophisticated form of government accounting as early as 2000 B.C.

Accounting practices in India could be traced back to a period when twenty-three centuries ago, Kautilya, a minister in Chandragupta's kingdom wrote a book named Arthashasthra, which also described how accounting records had to be maintained.

Luca Pacioli's, a Franciscan friar (merchant class), book Summa de Arithmetica, Geometria, Proportion at Proportionality (Review of Arithmetic and Geometric proportions) in Venice (1494) is considered as the first book on double entry bookkeeping. A portion of this book contains knowledge of business and book-keeping. In his book, he used the present day popular terms of accounting Debit (Dr.) and Credit (Cr.). These were the concepts used in Italian terminology. Debit comes from the Italian debito which comes from the Latin debita and debeo which means owed to the proprietor. Credit comes from the Italian credito which comes from the Latin 'credo' which means trust or belief in the proprietor or owed by the proprietor.

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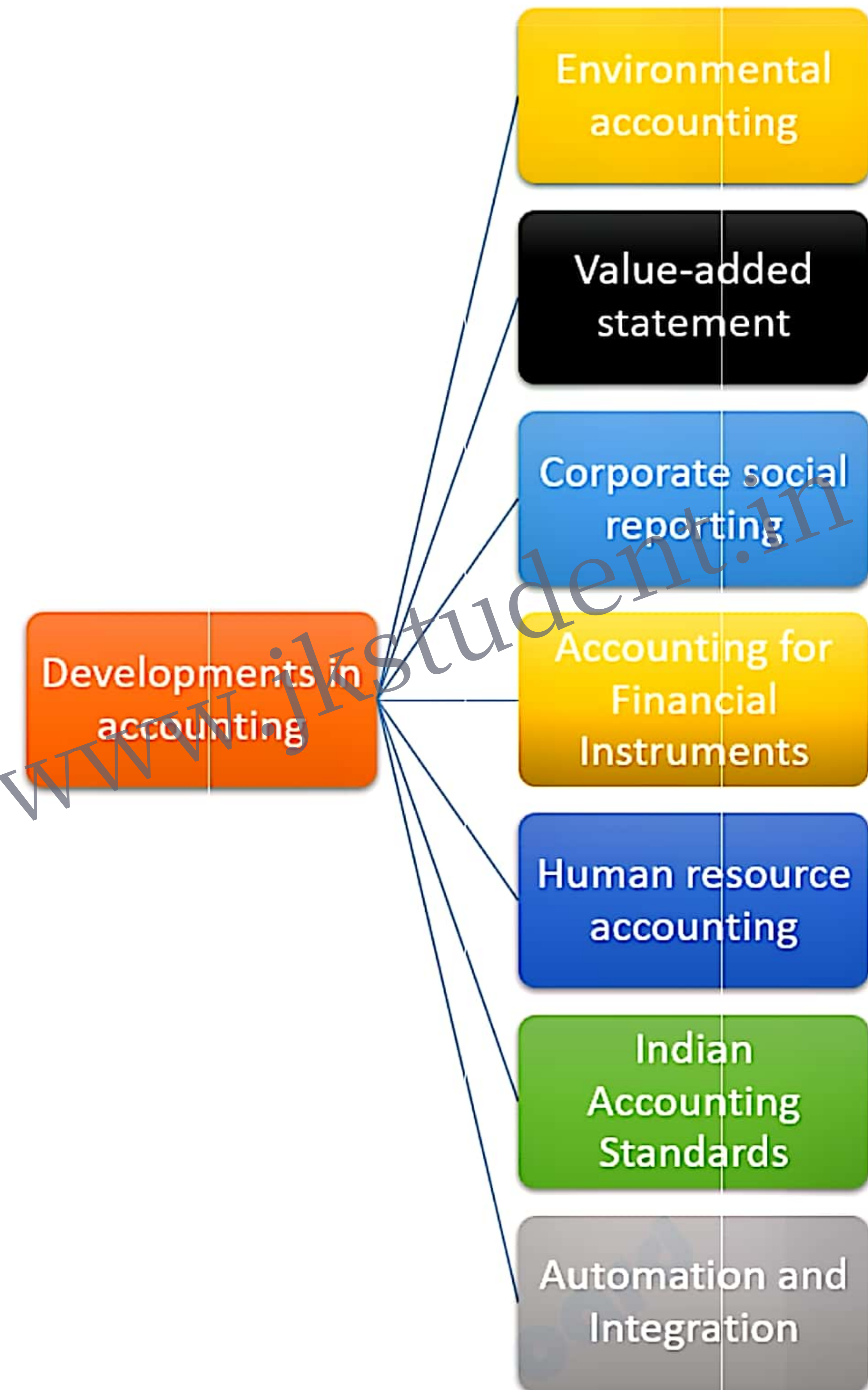
Luca Pacioli is regarded as the father of double-entry bookkeeping

After getting a glimpse of historical perspective and development of Accounting, let us sail towards developments in accounting.



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Human Resource Accounting

Human Resource Accounting is one of the concepts adopted by Indian companies in recent times.

According to the American Accounting Association "Human resource accounting is the human resources identification and measuring process and also its communication to the interested parties"

Human resource accounting aims at depicting the human resources potential in money terms while casting the organisation's financial statements. With the emergence of the knowledge economy, recognition of human capital as an important part of the total value of enterprises has gained importance.

Most of the enterprises which follow Human Resource Accounting spare a separate section in their annual reports for a detailed account of their human resources. Human asset reporting in India usually includes a profile of human assets, the compensation pattern, training and development, human asset productivity, human asset value, and the total wealth of the organization.

Reasons for Human Resource Accounting:

1. To improve human resource management
2. To retain qualified labour force.
3. To profile the enterprise and improve its image.
4. To attract future employees
5. To overcome the difficulties in providing sufficient information to investors in traditional balance sheets.
6. To redistribute social responsibilities between the public and the private sectors.
7. To overcome problems arising from the valuation of intangible assets.

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Methods of Human Resources Measurement and Accounting

1) **Acquisition Costs**: It represents the original cost of human resources in the conventional accounting sense, and includes such costs as personnel recruitment, training, and development. Under this method, the cost of acquisition i.e. selection, hiring, training costs of employees are capitalised and written off over the expected useful life of the employees.
2) **Learning Costs**: From the management accounting point of view, an accurate estimation of the learning factor is essential to obtain a good prediction of the product cost and is also important in the labour force. On the other hand, the enterprise can make decisions about its human resource investments if it knows which benefits will be reported. In this sense, the learning factor or experience curve provides information for decision making and resolution of problems regarding the rising costs of the labour force where new fabrication processes or specialized jobs are important.

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3) **Replacement Cost**: It is a current rupee measure of the expenditure required for a business entity to replace its existing investment in human resources.
4) **Opportunity Cost**: It is the value of an employee in his alternative use, as a basis for estimating the value of human resources. The opportunity cost value may be established by competitive bidding within the firm, so that in effect, managers must bid for any scarce employee.
5) **Economic value models**: Economic value refers to the appropriately discounted amount of net cash inflows generated by the human resources of a firm over their economic service lives.
6) **Standard Cost Method**: Under this method, standard costs of recruiting, hiring, training, and developing per grade of employees are determined annually. The total standard cost for all personnel of the company is the value of human resources.

Environmental Accounting

Responsibility towards environment has become one of the most crucial areas of social responsibility. Recent years have witnessed rising concern for environmental degradation, which is taking place mainly in the form of pollution of various types, viz. air, water, sound, soil erosion, deforestation, etc.

Environment Accounting also known as the Green Accounting is the subset of accounting purpose is to incorporate both economic and environmental information. It can be conducted at the corporate level or at the level of a national economy.

Environmental accounting needs to work as a tool to measure the economic efficiency of environmental conservation activities and the environmental efficiency of the business activities of company as a whole. In many contexts environmental accounting is taken to mean the identification and reporting of environment specific cost such as liability cost and waste disposal costs.

Forms of Environmental Accounting:

Environmental Management Accounting (EMA): Management accounting with a particular focus on material and energy flow information and environmental cost information.

Environmental Financial Accounting (EFA): Financial Accounting with a particular focus on reporting environmental liability costs and other significant environmental costs.

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Environmental National Accounting (ENA): National Level Accounting with a particular focus on natural resources stocks & flows, environmental costs & externality costs, etc.

Corporate Social Responsibility (CSR) Reporting

Corporate Social Responsibility ('CSR') is corporate initiative to assess and take responsibility for the company's effects on the environment and its impact on social welfare.

In other words, it is the process by which an organization thinks about and evolves its relationships with stakeholders for the common good, and demonstrates its commitment in this regard by adoption of appropriate business processes and strategies.

In India, the Companies Act, 2013 has statutorily recognised the concept of CSR. Section 135 of the Companies Act, 2013 read with Schedule VII thereto and Companies (Corporate Social Responsibility Policy) Rules, 2014 are the special provisions under the new company law regime imposing mandatory CSR obligations

What is CSR Reporting?

Corporate Social Responsibility (CSR) Reporting is an information communiqué with respect to discharge of social responsibilities of corporate entity. Through 'CSR Report' the corporate enterprises disclose the manner in which they are discharging their social responsibilities. More specifically, it is addressed to the public or society at large, although it can be squarely used by other user groups also.

Section 135 of the Companies Act, 2013 mandated the companies fulfilling the criteria mentioned in the said section to spend certain amount of their profit on activities as specified in the Schedule VII to the Companies Act 2013. Companies not falling within that criteria can also spend on CSR activities voluntarily. However, besides the requirements of constitution of a CSR committee and a CSR policy, the corporate entities should also take care that expenditure incurred for CSR should not be the expenditure incurred for the activities in the ordinary course of business. If expenditure incurred is for the activities in the ordinary course of business, then it will not be qualified as expenditure incurred on CSR activities.

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Accounting for Financial Instrument

With the changing landscape of Indian economy and more liberalization, raising funds in national and internal markets through different forms of instruments has gathered momentum. As companies expand their horizon, investors at the same time are getting cautious to invest through different means to achieve their intended objective, which could have fixed return like a debt instrument or a residual share in net assets like equity or both.

Under erstwhile Indian GAAP, there was no guidance on financial instruments except for Accounting Standard (AS) 13 'Accounting for Investments' and guidance on derivative contracts accounting incorporated in AS 11 'The Effects of Changes in Foreign Exchange Rates'.

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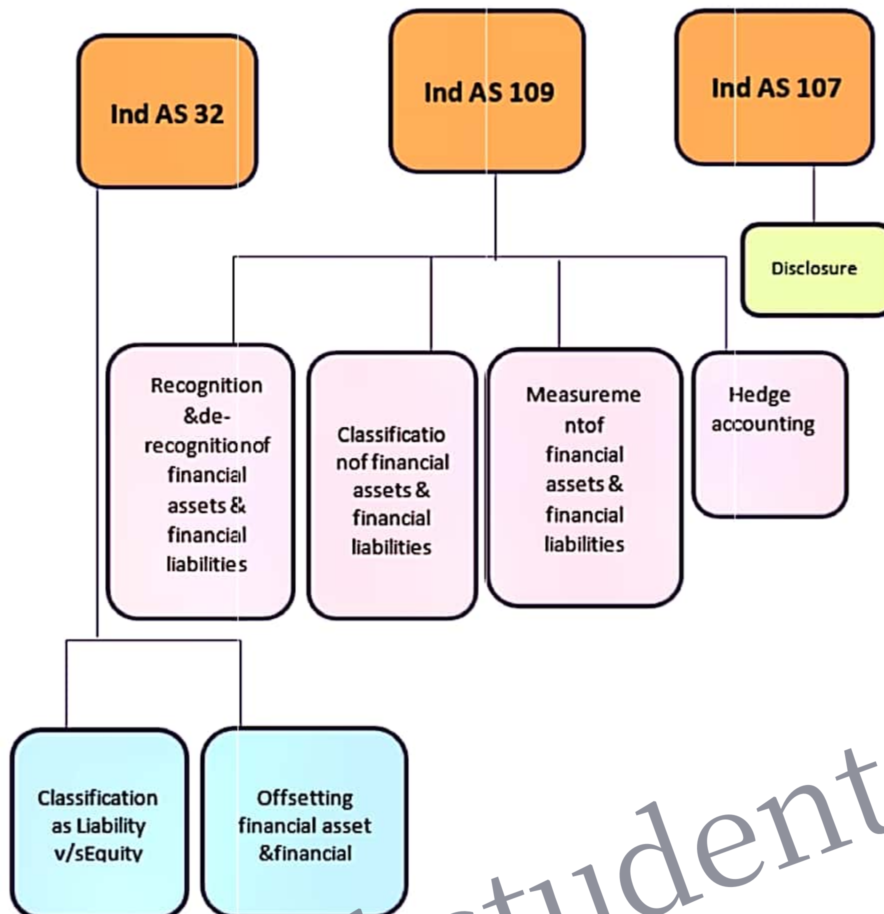
In order to cope up with the rising complexity of type of instruments being issued, Ministry of Corporate Affairs notified following Ind AS:

Ind AS 109 – Financial instruments

Ind AS 32 – Financial instruments: Presentation

Ind AS 107 – Financial Instruments: Disclosures



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A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

Value Added Statement

The value added statement has come to be seen with greater frequency in Europe and more particularly in Britain. The discussion paper 'Corporate Report' published in 1975 by the then Accounting Standard Steering Committee (now known as Accounting Standards Board) of the U.K. advocated the publication of value added statement along with the conventional annual corporate report. In 1977, the Department of Trade, U.K. published 'The Future of Company Reports' which stated that all substantially large British companies should include a value added (V.A.) statement in their annual reports. Also, a few companies in the Netherlands include V.A. information in their annual reports, but the disclosures often fall short of being a full V.A. statement and also the method of arriving at V.A. is grossly non-standardized. In India, Britannia Industries Limited and some others prepare value added statement as supplementary financial statement in their annual reports.

Value Added is the wealth a reporting entity has been able to create through the collective effort of capital, management and employees. In economic terms, value added is the market price of the output of an enterprise less the price of the goods and services acquired by transfer from other firms.

Gross Value Added is arrived at by deducting from sales revenue the cost of all materials and services which were brought in from outside suppliers

Net Value Added can be defined as Gross Value Added less depreciation

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Reporting – Value Added

The 'Corporate Report' of the U.K. advised the British companies to report Gross Value Added (GVA). The 'Report' did not consider the possibility of the alternative Net Value Added (NVA). As a result, the majority of British companies prefer to set forth their VA statement as a report on GVA, so that depreciation is an application of VA rather than a cost to be deducted in calculating VA. In India also GVA is more popular among reporting companies than NVA. The reasons for reporting GVA are as follows:

i. GVA can be derived more objectively than NVA. This is because depreciation is more prone to subjective judgement than are bought-in costs.
ii. GVA format involves reporting depreciation along with retained profit. The resultant sub-total usefully shows the portion of the year's VA which has become available for re-investment.
iii. The practice of reporting GVA would lead to a closer correspondence between VA and national income figures. This is because economists generally prefer gross measures of national income to net one.

However, there are also valid reasons for reporting NVA. They are:

i. Wealth Creation (i.e. VA) will be overstated if no allowance is made for the wearing out or loss of value of fixed assets which occurs as new assets are created.
ii. NVA is a firmer base for calculating productivity bonus than is GVA. The productivity of a company may increase because of additional investments in modernisation of plant and machinery. Consequently, the value added component may improve significantly. The employees of the company will naturally claim and be given some share of additional VA as productivity bonus. But if the share is based on GVA then no recognition is given to the need for an increased depreciation charge.
iii. The concept is of matching demands that depreciation be deducted along with bought-in costs to derive at NVA. GVA is inconsistent, for costs would be charged under the bought-in heading if the item has a life of less than or one year. But if the item has a longer life it would be treated as a depreciable fixed asset and its cost would never appear as a charge while arriving at GVA.

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Indian Accounting Standards

Indian Accounting Standards (Ind-AS) are the International Financial Reporting Standards (IFRS) converged standards issued by the Central Government of India under the supervision and control of Accounting Standards Board (ASB) of ICAI and in consultation with National Financial Reporting Authority (NFRA).They have been formulated keeping the Indian economic & legal environment in view and with a view to converge with IFRS Standards, as issued by and copyright of which is held by the IFRS Foundation.

From When Ind-AS are implemented/ Date of Enforcement:

Indian Accounting Standards (Ind AS) converged with International Financial Reporting Standards were implemented on **voluntary basis from 1st April, 2015** and **mandatorily from 1st April, 2016.**

Indian Accounting Standards (Ind AS) are Standards prescribed under Section 133 of the Companies Act, 2013.

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LIST OF INDIAN ACCOUNTING STANDARDS

Ind AS	Title of Ind AS
101	First Time Adoption of Indian Accounting Standards
102	Share Based Payment
103	Business Combinations
104	Insurance Contracts
105	Non-current Assets Held for Sale and Discontinued Operations
106	Exploration for and Evaluation of Mineral Resources
107	Financial Instruments: Disclosures
108	Operating Segments
109	Financial Instruments
110	Consolidated Financial Statements
111	Joint Arrangements
112	Disclosure of Interests in Other Entities
113	Fair Value Measurement
114	Regulatory Deferral Accounts
115	Revenue from Contracts with Customers
116	Leases
1	Presentation of Financial Statements
2	Inventories
7	Statement of Cash Flows
8	Accounting Policies, Changes in Accounting Estimates and Errors
10	Events after the Reporting Period
12	Income Taxes
16	Property, Plant and Equipment
19	Employee Benefits
20	Accounting for Government Grants and Disclosure of Government Assistance
21	The Effects of Changes in Foreign Exchange Rates
23	Borrowing Costs
24	Related Party Disclosures
27	Separate Financial Statements
28	Investment in Associates and Joint Ventures
29	Financial Reporting in Hyperinflationary Economies
32	Financial Instruments: Presentation
33	Earnings per Share
34	Interim Financial Reporting
36	Impairment of Assets
37	Provisions, Contingent Liabilities and Contingent Assets
38	Intangible Assets
40	Investment Property
41	Agriculture

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Road Map for Implementation of the Indian Accounting Standards (Ind As):

Phase I	**1st April 2015 or thereafter: Voluntary Basis for all companies (with Comparatives)**	
	1st April 2016: Mandatory Basis	
	(a)	Companies listed / in process of listing on Stock Exchanges in India or Outside India having net worth ≥ ` 500 crore
	(b)	Unlisted Companies having net worth ≥ ` 500crore
	(c)	Parent, Subsidiary, Associate and Joint venture of above
Phase II	**1st April 2017: Mandatory Basis**	
	(a)	All companies which are listed / or in process of listing inside or outside India on Stock Exchanges not covered in Phase I (other than companies listed on SME Exchanges)
	(b)	Unlisted companies having net worth of ` 250 crore or more
	(c)	Parent, Subsidiary, Associate and Joint venture of above
Non-Banking Financial Companies (NBFC's)		
Phase I:	From 1st April, 2018 (with comparatives)	
	▪ NBFCs (whether listed or unlisted) having net worth ` 500 crore or more	
	▪ Holding, Subsidiary, JV and Associate companies of above NBFC other than those already covered under corporate roadmap shall also apply from said date	
Phase II:	From 1st April, 2019 (with comparatives)	
	▪ NBFCs whose equity and/or debt securities are listed or are in the process of listing on any stock exchange in India or outside India and having net worth less than 500 crore	
	▪ NBFCs that are unlisted having net worth ` 250 crore or more but less ` 500 crore	
	▪ Holding, Subsidiary, JV and Associate companies of above other than those already covered under corporate roadmap shall also apply from said date	

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Automation and Integration

Automation in accounting is fuelled by software advancement. Accounting can be highly automated without the need for significant physical intervention. Latest accounting software has enabled organizations to minimize data entry. This will lead to efficient utilization of capital and better management of resources, and with the assistance of these accounting software, one can integrate

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Practice Questions

1. Which of the following Ind-AS deals with Financial Instruments?

   1) Ind-AS 34
   2) Ind-AS 38
   3) Ind-AS 108
   4) Ind-AS 109

2. Who among the following is regarded as the father of double-entry bookkeeping?

   1) Kautilya
   2) Luca Pacioli
   3) Louis Watson
   4) Kalyan Subramani Aiyar

3. Indian Accounting Standards (Ind AS) converged with International Financial Reporting Standards were implemented mandatorily from?

   1) 1st April 2015
   2) 1st April 2016
   3) 1st April 2018
   4) 1st April 2019

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Answer Key:

1-D; 2- B; 3- B.

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