

UNIT - 4
BASIC FINANCIAL ACCOUNTING

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4.1 LEARNING OBJECTIVES

After going through this unit you will be able to:

- Describe the meaning, scope and objects of Accounting
- Define the various terms used in accounting
- Explain the meaning of Cash Book and Bank Reconciliation Statement
- Explain the meaning of Financial Statements

4.2 INTRODUCTION

In the earlier three units you have learnt about the theory of production and cost; market structure and pricing of products and theory of distribution and pricing of factors. All these have been described in the context of a business firm. These firms perform numerous economic activities related to their business. These economic activities take place everyday. But it is impossible for a businessman to keep in memory all such activities for a long period of time. Hence, the recording of these activities is necessary. If you are a businessman, keeping accurate and organised, records is vital to the success of your business. Developing good record keeping habits can save you thousands of rupees. From such records, the businessman may collect necessary information regarding his business as and when required. For example, a businessman can ascertain the amount receivable from various parties, or the amount payable to the suppliers of goods from the records. He can also ascertain result of the business, i.e., profit or loss; and the financial position of his business at the end of a given period. He can supply such information to other interested persons like bankers to meet their varied needs. Besides, he can use such information to get finance from the banks. From memory it is not possible to do all these unless proper records are maintained. Accounting takes care of all these functions.

In this unit we shall discuss meaning, scope and objects of accounting, concept of cash book and bank reconciliation statement, concept of financial statements and cash flow statement.

4.3.1 MEANING OF ACCOUNTING

Now let us explain the meaning of 'Accounting'. Accounting refers to the system involved in making a financial record of business transactions and in the preparation of statements concerning the assets, liabilities, capital and operating results of the business. It deals with ascertainment of business income and values of assets, liabilities and capital. Again, 'Accounting' in business is conceived as a system that provides information on the financial condition and the transactions which have led to that status. This system starts with recording of business transactions and ends with interpreting the results thereof. Accountants engage themselves in recording business transactions and in preparing financial statements. They also provide information on costs and gains from new technologies, mergers and acquisitions; track financial performance, tax strategy, and health care benefits etc to the management. Hence accounting is defined by the Committee on Terminology of the American Institute of Accountants (later on known as American Institute of Certified Public Accountants, AICPA) as, *"Accounting is the art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character, and interpreting the results thereof."*

4.3.2 SCOPE OF ACCOUNTING

Accounting covers the following areas:

1. Recording of business transactions and maintenance of the books of account,
2. Preparation of accounts,
3. Preparation of Trial Balance,
4. Preparation of financial statements, viz., trading account, profit and loss account, balance sheet, cash flow statement,
5. Interpretation of the operating and financial results,
6. Preparation of the reports for the management.

4.3.3 OBJECTS OF ACCOUNTING

Keeping in view the above scope, the objects of accounting may be list out as below:

1. To record business transactions,
2. To maintain proper books of account,

3. To prepare the required accounts,
4. To prepare Trial Balance to ensure arithmetical accuracy,
5. To find out values of assets and liabilities.
6. To ascertain the amount of capital,
7. To prepare financial statements, viz., trading account, profit and loss account, balance sheet, cash flow statement,
8. To interpret the operating and financial results,
9. To prepare the reports for the use by management.

CHECK YOUR PROGRESS 1

Explain the meaning of Accounting.

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4.3.4 LIMITATIONS OF ACCOUNTING

The following are the limitations of accounting:

- (i) Recording of transactions is possible if it is a financial transaction. So the important limitation of accounting is that it fails to record non-monetary transactions.
- (ii) Accounting assumes no inflation. In other words it does not take increase or decrease in money value.
- (iii) Accounting is based on certain principles which may vary from time to time or place to place. This limits the comparability of accounting information among business units.
- (iv) In accounting provision or reserves are maintained which are estimated on certain assumptions. This may lower the acceptability of accounting information.

4.4.1 MEANING OF ACCOUNT

After knowing the meaning, of accounting you should be able to define the meaning of 'Account'. An account is a summary record of transactions of similar nature for a

certain period. Summary record of transactions relating to a particular person is account of that person for the period concerned; summary record of transactions relating to a particular asset is account of that asset for the period concerned and so on. A businessman should classify and summarise all the business transactions of similar nature under respective groups. Each such group or head is known as an 'Account' or 'Account heads'. For example, all business transactions with 'KK Enterprise' are recorded under the heading 'Account of KK Enterprise' or 'KK Enterprise Account'. All transactions related to stationery are recorded under the heading 'Account of stationery' or 'stationery Account'. Account is abbreviated as 'A/C' or 'a/c'.

Definition of Account:

The term 'Account' has been defined by different authorities. One of the most important definitions of account has been given by R.N Carter.

According to R.N Carter, 'An account is a ledger record, in summarised form, of all the transactions that have taken place with the particular person and the value specified'. It is a device to record transactions of one single type of item. It may be better explained with the help of its format.

Format of Account:

An account is generally prepared in "T" shape having two sides, left hand and right hand side. A specimen form of an account is given below.

Salary Account ('T' Shape)

Dr.								Cr.
	Date	Particulars	J. F	Amount Rs.	Date	Particulars	J. F	Amount Rs.

All accounts are divided into two sides. The left hand side of the account is called 'debit side'. It is indicated by 'Dr.' (abbreviation for debit) on the top corner of the left hand side. Right hand side of the account is called 'credit side'. It is indicated by 'Cr.' (abbreviation for credit) on the top corner of the right hand side of the account. The name of the account is written at the top in the centre. The word 'Account' or its abbreviation A/c is added to the name of the

account. For example, Building A/c, Furniture A/c, Salary A/c, etc. The term 'J. F' means 'Journal Folio', i.e., the concerned folio (page) number in the Journal.

There is another type of format used generally by the businessman to record transactions. This format is called 'horizontal format'. This is shown below.

Salary Account (Horizontal Type)

Date	Particulars	J. F	Dr. Amount Rs.	Cr. Amount Rs.	Balance Amount Rs.		Remark
					Dr	Cr	

4.4.2 CLASSIFICATION OF ACCOUNTS

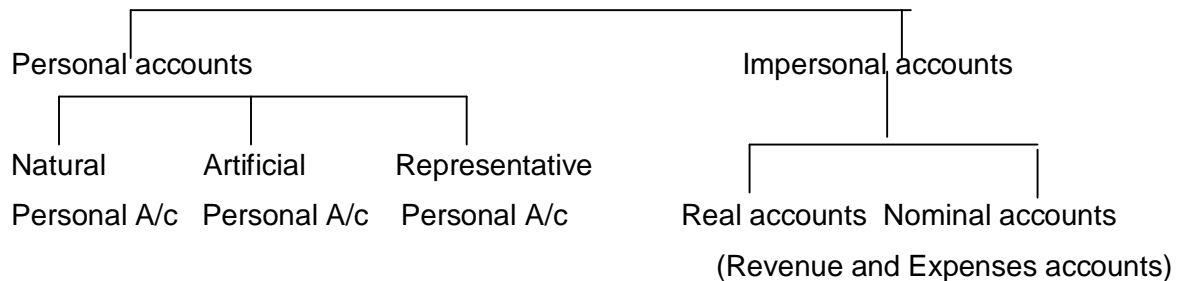
For the purpose of recording transactions, classification of accounts (i.e., account heads) are necessary. There are two approaches for classification of accounts. These are:

1. English Approach or Traditional Approach and
2. American Approach or Modern Approach

These are discussed below:

1. English Approach or Traditional Approach

English/Traditional Classification of Accounts



The above classification is explained below:

(a) Personal accounts: Account heads relating to persons, firms, companies, etc. are classified into the following categories.

i. Accounts of Natural persons:

Account heads recording the transactions of individual human beings fall into the category of natural persons, for example, accounts of Hem, Vikash, Suresh, Jayanata, Raju etc.

ii. Accounts of artificial persons: Accounts recording the transactions concerning a firm, company, institution, association, organisation etc. fall into this category. For example, Gauhati University A/c, Oil India Ltd. A/c, State Bank of India A/c, N.F Railway A/c, Guwahati Club A/c, etc.

iii. Representative Personal Accounts: Representative personal accounts are the accounts which represent a certain person or a group of persons although the name of the concerned person or persons are not mentioned in the account head. Such type of account head occurs in cases of outstanding expenses, prepaid expenses, income receivable and income received in advance. For example, outstanding Salary, Salary Prepaid, Unexpired Insurance or Insurance paid in advance, Commission Received in Advance etc.

(b) Real Accounts: The 'account heads' recording transactions relating to tangible things (which can be seen, touched or physically exchanged) such as goods, cash, land, building, machinery, etc. are classified as real accounts.

It may be mentioned here that there are some items which do not have a physical shape and which cannot be seen or touched but it can be bought and sold. For example, goodwill, patents, trademarks, copyrights, etc. also fall within the category of real accounts.

(C) Nominal Accounts: The accounts recording transactions relating to losses, expenses, incomes and gains are classified as nominal accounts. For example, Salaries, Wages, Rent paid, Discount Allowed, Discount Received, Commission Received, Interest Paid, Interest Received etc.

B. American Approach or Modern Approach:

According to the American approach or Modern approach, accounts are classified into five categories as under.

a. Assets Account: The meaning of asset is property. Assets account are the accounts of properties such as land, building, plant, machinery, stock, patents, cash in hand, cash at bank, investments, inventory, etc. held by an entity. This category also includes the accounts of debtors.

(b) Liabilities Account: Liability means obligation to pay. Liabilities accounts are the accounts pertaining to the obligation of the entity to lenders, creditors for goods, creditors for assets, creditors for expenses, etc.

(c) Capital Account: Capital is the amount with which the business is started. It is the account of the owner who invests money in the business as capital.

(d) Revenue Accounts: Revenue accounts are the accounts of incomes and gains. For example, sales, discount received, interest received, commission received etc.

(e) Expense Accounts: Expense accounts are the accounts of expenses incurred and losses suffered by an entity. For examples, purchases, wages paid, depreciation, rent paid, rates and taxes, etc.

However, in case of sole proprietorship or partnership form of business, another account called 'Drawings Account' is also maintained in order to record the transactions relating to withdrawals of cash or goods made by the proprietor or partners for their personal use.

4.5.1 DAY BOOKS OR CLASSIFICATION OF JOURNALS

A daybook is a descriptive and chronological record of day-to-day financial transactions maintained by business enterprises. Normally transactions are recorded in two sets of books step by step. Transactions are first recorded in **Journal**, which is also known as 'Day Books' or '**book of original entry**' or '**Primary Books**'. The next step of recording of transactions is in Ledger, which is also known as '**book of final entry**' or '**Secondary Books**'. These Books of accounts are specially printed and ruled books where the accounts of a firm can be written up. Daybooks include:

1. Purchases daybook, for recording all credit purchases made for resale.
2. Sales daybook, for recording all credit sales of the goods purchased as above (Serial No. 1).
3. Purchases Return book, for recording all credit purchase (Serial No. 1) returns to suppliers.
4. Sales Return book, for recording all credit sales (Serial No. 2) returns by customers.
5. Bills Book (i) Bills Receivables and (ii) Bills Payables.
6. Cash book for recording all cash transactions.

4.5.2 LEDGER AND ITS CLASSIFICATION

Without the knowledge of ledger it is not possible to understand the mechanism in accounting. In accounting all transactions are ultimately recorded in the ledger. Ledger is a book of account which contains a condensed and classified record of all transactions of the business. In other words, the book, which contains accounts, is known as the ledger. Ledger provides necessary information regarding various accounts. Personal accounts in ledger show how much money a firm owes to the creditors and the amount it can recover from its debtors. The real accounts show the value of properties and also the value of stock. Nominal accounts reflect the sources of income and also the amount spent on various items.

In this book, separate accounts are opened for each 'account head' and all transactions relating to a particular 'account head' will be posted in the concerned account. An account for each person, each type of revenue, expense, assets and liability is opened in the ledger. For example, all transactions relating to a particular supplier; say Bikash will be posted to the account of Bikash. All transactions relating to Rent will be posted to the Rent account.

In case of manually maintained accounting system 'Ledger' is generally maintained in the form of a bound register. First few pages of the ledger has ordinary horizontal ruling for indexing. Remaining pages are ruled like an account and is consecutively numbered. The index pages are used for writing the names of accounts and the Folio No. (Page No.) where a particular account has been opened for easy location.

Types of Ledger:

Three types of Ledgers are maintained. These are:

(i) Debtors' ledger, (ii) Creditors' ledger and (iii) General ledger.

(i) Debtor' ledger: It is also called Sales ledger In this ledger, the accounts of all Debtors for goods sold in normal course of business are maintained. Posting is made from Sales Day Book, Purchase Returns Book, Cash Book, Bills Receivable Book and Journal Proper for the transactions affecting the accounts of Debtors.

(ii) Creditors' Ledger: It is also called Bought Ledger. In this ledger, the accounts of all Creditors for goods purchased in normal course of business are maintained. Posting is made from Purchases Day Book, Purchase Returns Book, Cash Book, Bill Payment Book and Journal proper for the transactions affecting the accounts of Creditors.

(iii) General Ledger: This ledger contains all accounts other than the accounts of Debtors and Creditors for goods. All accounts falling in the category of Assets, Liabilities (except debtors and creditors for goods), Capital, Revenue and Expense are maintained in this proper ledger. For example, if a machine is sold to Shova on credit, her account will appear in General Ledger; again, if goods are sold to her on credit, her account will appear in the Debtors' Ledger.

Format of a Ledger Account:

There are two types of forms for writing up Ledger Accounts namely

(a) Horizontal form and (b) Vertical or 'T' form. These are discussed below.

(a) Horizontal Ledger Account is ruled out as follows:

"Nameri Tea" Account

Date	Particulars	J. F	Debit Amount (Rs.)	Credit Amount (Rs.)	Debit Or Credit	Balance (Rs.)

In this form of ledger, balance is ascertained after every transaction. This method is generally used in bank. Where the accounts are maintained in computers through the use of accounting software like Tally, accounts are also prepared in this form.

(b) A vertical or 'T' shaped form is ruled as under:-

"Nameri Tea" Account

Dr.				Cr.			
Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
1	2	3	4	1	2	3	4

Closing and Opening Balance of account:

The balances of account ascertained at the end of a particular period are known as closing balances. These balances become the opening balances in the next period. While balancing an account; if Debit side is found to be heavier, the balance is called 'Debit balance' and if Credit side is found to be heavier, the balance is called 'Credit balance'

4.6.1 MEANING OF ASSET

Let us explain the meaning of 'Asset' in accounting. The common meaning of asset is property. In accounting, assets are economic resources from which benefits will flow to the enterprise from its usage. Assets may be tangible or intangible. These are owned or controlled by the firm to produce income or to generate services for use in generating income. Examples of assets are: land, building, plant, machinery, stock, patents, cash in hand, cash at bank, investments, inventory, etc.

From an accounting perspective, assets are divided into the following categories: current assets (cash and other liquid items of assets), long-term assets (real estate, plant, equipment), prepaid and deferred assets (expenditures for future costs such as insurance, rent, interest), and intangible assets (trademark, patents, copyrights, goodwill).

Again assets may be tangible and intangible. Tangible assets are physical resources like cash, real estate, plant, equipment etc. Intangible assets are nonphysical resources. Examples of intangible assets are trademark, patents, copyrights, goodwill, computer programmes etc.

Long-term assets are also called Fixed Assets. All Fixed assets are used in the business and subject to depreciation. The value of the fixed asset used up in the business in an accounting year is called depreciation. This depreciation (used up value) of the fixed asset is considered as business expense and charged to the income of the year. The balance value is shown in the Balance Sheet at the end of the year.

4.6.2 MEANING OF LIABILITY

Liability means obligation to pay. A **liability** is defined as an obligation of an entity arising from past transactions or events. Liabilities accounts are the accounts pertaining to the obligation of the entity to lenders, creditors for goods, creditors for assets,

creditors for expenses, etc. When goods or assets are purchased on credit a liability is created. When services are taken/used and payment for the service is delayed or postponed a liability is created. When a loan is taken a liability is created. As and when a liability is created a duty or responsibility to others is also created that entails settlement of such liability by future transfer or use of entity assets. Liabilities are sources of fund.

From accounting point of view there are two types of liabilities. These are long term liabilities and Short term liabilities. Liabilities payable within 12 months of its creation are Short term liabilities and Liabilities payable after 12 months of its creation are long term liabilities. Short term liabilities are commonly called 'Current Liabilities'. Liabilities are shown in the balance sheet.

4.6.3 MEANING OF CAPITAL OR EQUITY

Capital or Equity is the amount supplied or invested in the business by the owner of the business. Generally it is first supplied when the business is started. It is the account of the owner who invests money in the business as capital. Capital is invested in a business to generate income. Capital is represented by total assets less total liabilities. In the context of a company capital refers to share capital representing the owners' or shareholders' initial contribution to the business and the wealth that generates.

Capital is the major source of fund for any business. Capital is also called the residual amount of assets after the liabilities are paid off. In the Balance Sheet of a company it is the first item in the liability side.

4.6.4 INCOME AND EXPENSE

Incomes are the revenues generated by an enterprise by using its resources. For example, sales, discount received, interest received, commission received etc. Expenses are the costs incurred to generate incomes. For examples, purchases, wages paid, depreciation, rent paid, rates and taxes, etc. These expenses and incomes are

measured at the end of accounting year and compared to each other to ascertain profit or loss of the year.

It may be mentioned here that incomes and expenses may be measured either on cash basis or on accrual basis. In cash basis, incomes actually received in cash during the year are considered; and expenses incurred and paid during the year only are considered. In accrual basis all incomes, related to the accounting year, whether received in cash or not; and all expenses incurred, cash and credit both, related to the income of the concerned year are considered.

Incomes and expenses are shown in the Trading and Profit & Loss Account to find out profits.

4.6.5 REVENUE INCOME AND CAPITAL INCOME

Revenue income is the inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods, from the rendering of services, and from the use by others of enterprise resources yielding interest, royalties and dividends. Revenue is measured by the charges made to customers or clients for goods supplied and services rendered to them and by the charges and rewards arising from the use of resources by them. In an agency relationship, the revenue is the amount of commission and not the gross inflow of cash, receivables or other consideration (AS- 9).

Capital Income is the inflow of cash or other assets into the enterprise from the sources other than those explained above. For example: income from sale of capital assets like land, machinery etc.

4.6.6 REVENUE EXPENDITURE AND CAPITAL EXPENDITURE

Expenditure incurred for earning revenue income is called revenue expenditure. In other words these are the expenditure incurred in ordinary course of business. For example: purchase of raw materials, consumables, merchandise (saleable goods), payment of salary to the staff, payment of office rent, office expenses, selling expenses etc.

Expenditure incurred for acquiring long term assets like machinery, land, furniture etc are called capital expenditure. The object of capital expenditure is to increase the earning capacity. In other words, the expenditure, which results in increase in earning capacity of the firm, is called capital expenditure.

4.6.7 FUNDAMENTAL ACCOUNTING EQUATION

The Accounting Equation is related to the Elements of Financial statements, namely assets, liabilities, capital, incomes and expenses.

It is stated as below:

$$\text{Assets} + \text{Expenses} = \text{Capital} + \text{Liabilities} + \text{Income.}$$

Or, $\text{Assets} = \text{Capital} + \text{Liabilities} + \text{Income} - \text{Expenses}$

Or, $\text{Assets} = \text{Capital} + \text{Liabilities} + \text{Profit (since Income} - \text{Expenses} = \text{Profit)}$

Or, $\text{Assets} = \text{Capital} + \text{Liabilities} - \text{Loss (since Expenses} - \text{Income} = \text{Loss)}$

The owner will get profit and hence it will increase the capital. In the same way the owner will bear the loss and hence it will decrease the capital. Therefore these two items can be merged with capital. In such case we will the following equation:

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

This equation is called Fundamental Accounting Equation.

Example:

Mr. X started a business and invests Rs. 2,00,000. He took a bank loan of Rs. 50,000. Thus he had Rs. 2,50,000 as his fund. Thus Mr. X had Cash Rs. 2,50,000 from Capital Rs. 2,00,000 and Loan Rs. 50,000. Loan is a Liability and Cash is Asset.

This may be expressed in the form of equation:

$$\text{Asset Rs. 2,50,000} = \text{Capital Rs. 2,00,000} + \text{Liability Rs. 50,000}$$

Or, $\text{Asset} = \text{Capital} + \text{Liability}$

This is Fundamental Accounting Equation.

After doing some business suppose, he earns Rs. 30,000 income and spends Rs. 17,000 for expenses. This means, he gets Rs. 30,000 cash and spends Rs. 17,000

cash. So, now he has total cash of Rs. 2,50,000 + Rs. 30,000 – Rs. 17,000 = Rs. 2,63,000 cash.

Now, the equation may be written as below:

Asset Rs. 2,63,000 + Expenses Rs. 17,000 = Capital Rs. 2,00,000 + Liability Rs. 50,000 + Income Rs. 30,000

Or, Asset Rs. 2,63,000 = Capital Rs. 2,00,000 + Liability Rs. 50,000 + Income Rs. 30,000 - Expenses Rs. 17,000

Or, Asset Rs. 2,63,000 = Capital Rs. 2,00,000 + Liability Rs. 50,000 + Profit Rs. 13,000

Or, Asset Rs. 2,63,000 = Capital Rs. 2,13,000 + Liability Rs. 50,000 (Profit can be merged with capital)

4.6.8 DOUBLE-ENTRY SYSTEM

The **Double-entry system** of accounting is based on Dual Aspect concept. According to this concept, every financial transaction involves two – fold aspect – (a) receiving of a benefit (b) giving of a benefit. For example, if a business has acquired an asset, it must have given up some other asset such as cash. Thus a giver necessarily implies a receiver and a receiver necessarily implies a giver. These two aspects are known as '**Debit**' aspect and '**Credit**' aspect. Thus Double entry system states that each transaction has two fold aspects, debit and credit. The effects of these two fold aspects are opposite in nature. If one aspect, called account, receives a benefit, there must be another aspect or an account to impart that benefit. *The system of accounting under which both the aspects of every transaction is recorded in the books of account is known as 'Double-entry system'.*

The rules for 'Debit' and 'Credit' as applicable under Modern approach

Sl no.	Type of Account	To be debited in case of	To be credited in case of
(a)	Assets Account	Purchase/Increase	Sale/Decrease
(b)	Liabilities Account	Paid/Decrease	Owed/Increase
(c)	Capital Account	Withdrawn/Decrease	Added/Increase
(d)	Income Account	Decrease	Earned/Increase
(e)	Expense Account	Incurred/Increase	Decrease
(f)	Drawings Account	Made/Increase	Decrease

CHECK YOUR PROGRESS 2

What is Double Entry System of Accounting?

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4.6.9 BOOKS OF ACCOUNTS

The book, which contains accounts, is known as the Books of Accounts. In other words, it means the khata or books in which the businessman keeps the records of business transactions.

Normally transactions are recorded in two sets of books step by step. Transactions are first recorded in **Journal**, which is also known as '**book of original entry**' or '**Primary Books**'. The next step of recording of transactions is in Ledger, which is also known as '**book of final entry**' or '**Secondary Books**'. These Books of accounts are specially printed and ruled books where the accounts of a firm can be written up.

In Journal transactions are recorded as and when they occur in chronological order (in order of date) from source documents. Recording in journal is made showing the accounts to be debited and credited in a systematic manner. Thus, the journal provides a date-wise record of all the transactions with details of the accounts and amounts debited and credited for each transaction with a short explanation, which is known as narration.

4.6.10 LEDGER AND ITS CLASSIFICATION

Ledger is a book of account which contains a condensed and classified record of all transactions of the business posted from the journal. It is also called the **book of final entry**. In other words, the book, which contains accounts, is known as the ledger, also called the Principal Book. Ledger provides necessary information regarding various accounts. Personal

accounts in ledger show how much money firm owes to the creditors and the amount it can recover from its debtors. The real accounts show the value of properties and also the value of stock. Nominal accounts reflect the sources of income and also the amount spent on various items.

In accounting all transactions are ultimately recorded in the ledger. In this book, separate accounts are opened for each 'account head' and all transactions relating to a particular 'account head' will be posted in the concerned account. An account for each person, each type of revenue, expense, assets and liability is opened in the ledger. For example, all transactions relating to a particular supplier; say Vivek will be posted to the account of Vivek. This helps in ascertaining the amount due to Vivek.

When Ledger is maintained manually it is generally in the form of a bound register. First few pages of the ledger has ordinary horizontal ruling for indexing. Remaining pages area ruled like an account and is consecutively numbered. The index pages are used for writing the names of accounts and the Folio No. (Page No.) where a particular account has been opened for easy location. The ledger may also be maintained in loose-leaf form instead of one bound book.

Sub-divisions of Ledger:

Ledgers may be sub-divided in the following manner:

- A. Personal Ledger
 - (i) Debtors' ledger or Sales Ledger and
 - (ii) Creditors' ledger or Bought Ledger.
- B. General or Nominal Ledger.

These are explained below:

A. Personal Ledger: The ledger which contains the accounts of persons, firms or organisations to whom goods are sold on credit or from which goods are bought on credit, is known as personal ledger. Generally personal ledgers are sub-divided into

- (i) Debtors' ledger or Sales Ledger and
- (ii) Creditors' ledger or Bought Ledger.

(i) Debtor' ledger or Sales ledger: In this ledger, the accounts of all Debtors for goods sold are maintained. Posting is made from Sales Day Book, Purchase Returns Book, Cash Book, Bills Receivable Book and Journal Proper for the transactions affecting the accounts of Debtors.

(ii) Creditors' Ledger or Bought Ledger: In this ledger, the accounts of all Creditors for goods purchased are maintained. Posting is made from Purchases Day Book, Purchase

Returns Book, Cash Book, Bill Payment Book and Journal proper for the transactions affecting the accounts of Creditors.

(B) General Ledger: This ledger contains all accounts other than the accounts of Debtors and Creditors for goods. All accounts falling in the category of Assets, Liabilities (except debtors and creditors for goods), Capital, Revenue and Expense are maintained in this proper ledger. For example, if a machine is sold to Ram on credit, his account will appear in General Ledger; again, if goods are sold to him on credit, his account will appear in the Debtors' Ledger. General Ledger is also known as Impersonal Ledger or Nominal Ledger.

4.7.1 CASH BOOK AND PASS BOOK

Every organization requires cash for its various activities. So it has to keep proper account of cash received and cash expended. Most of the business transactions relate to receipt of cash, payments of cash, sale of goods and purchase of goods. So it is necessary to have proper books for each of such transactions. Cash book is a subsidiary book which records the receipts and payment of cash. With the help of cash book cash and bank balance can be checked at any point of time.

In order to deposit, receive, withdraw, pay any amount through a bank, an account is opened in the bank. The account holder as well as the bank keeps records of all such deposits and withdrawals. Records of such deposits and withdrawals are made known to the account holder by the bank through a book. This book is called Pass Book. The account holder cannot make entries in the pass book but he can verify the entries with his records in the cash book.

Types of cash book:

The type of cash book is dependent upon the type of transactions we want to record in it. Thus the types of cash book may be as below-

- (A) Single column Cash Book
 1. Cash book having one column for Cash
 2. Cash book having one column for Bank
- (B) Double Column Cash Book
 1. Cash Book having two columns, one for cash and another for bank.

2. Cash book having two columns – one for cash, another for discount.

3. Cash book having two columns – one for bank, another for discount.

(C) Triple Column Cash Book

1. Cash book having three columns – first for cash, second for bank and third for discount.

(D) Multiple columns Cash Book:

Here we shall illustrate Single column Cash Book and Double Column Cash Book having two columns, one for cash and another for bank only.

CHECK YOUR PROGRESS 3

Explain the meaning of Pass Book.

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4.7.2 BANK RECONCILIATION STATEMENT

Bank Reconciliation Statement is a statement prepared to analyse the differences between Pass Book balance and Cash Book balance in order to reconcile the difference. It is an important segment of Final Accounts. Actually on a particular date the *cash balance in bank as per pass book entry* **should be equal** to *the cash balance in bank as per cash book entry*. But there are certain reasons for which there is disagreement between Pass Book balance and Cash Book balance. The **Causes of differences are listed below. The causes are grouped into two classes:**

Group A causes --- These are the causes for which the balance in the Pass Book is shown higher than the balance in the Cash Book; Or causes for which the balance in the Cash Book is shown lower than the balance in the Pass Book. Example:

1. Cheque issued for payment but not presented to bank.
2. Interest and dividend credited in the Pass Book but not recorded in the cash book.
3. Any cash and cheque directly deposited into bank by any person without any information.
4. When cash is deposited into bank but no entry is passed in the cash book.

Group B causes --- These are the causes for which the balance in the Pass Book is shown lower than the balance in the Cash Book; or causes for which the balance in the Cash Book is shown higher than the balance in the Pass Book. Example:

1. Cheque paid into bank for collection but not yet collected.
2. Bank charges and interest on overdraft debited in the Pass Book but no record is made in cash book.
3. Cheques and bills receivable discounted dishonoured and no record is made in cash book.
4. Cheque received is recorded in cash book as deposited into bank but actually no deposit is made.

CHECK YOUR PROGRESS 4

List out the three causes of disagreement of cash book balance and pass book balance. .

- 1.....
.....
- 2.....
.....
- 3.....
.....

4.8.1 MEANING OF FINANCIAL STATEMENTS

Let us now explain the meaning and components of financial statements. Financial Statements are the end products of the accounting system. So these are also called Final Accounts. These include (i) Trading and profit and loss A/c (ii) Balance sheet and (iii) Cash Flow Statement. All these are also called financial statements. But Trading and profit and loss account are prepared to find out the profit or loss of the concerned accounting period. These are also called as Income Statement. The Balance sheet portrays the financial position of the firm on a particular date. It is also called as Position Statement. These two statements i.e. Trading and P&L account and Balance sheet are prepared to give the final results of the business that is why both are collectively called as Final Accounts. Final Accounts are prepared from the figures appearing in Trial Balance and additional

information. Cash Flow Statement is prepared to show the inflow and outflow of fund during the period of accounting.

Components of 'financial statements':

Following are the components of financial statements:

(i) Income statement which is divided into two parts:

- (a) **Trading Account** which shows the gross profit or gross loss;
- (b) **Profit and Loss Account** which shows the net profit or net loss; and

(ii) Balance Sheet.

(iii) Cash Flow Statement

If the business entity carries on manufacturing activities, a Manufacturing account is also prepared by such business entity before the preparation of Trading Account.

Check Your Progress 5

What are the components of financial statements?

.....

4.8.2 PREPARATION OF FINAL ACCOUNTS

In this part we shall concentrate to the preparation of final accounts.

Preparation of Final Accounts involves the preparation of:

- (a) Trading Account;
- (b) Profit and Loss Account; and
- (c) Balance Sheet.

4.8.3 TRADING ACCOUNT

Meaning and Purpose:

Trading account is an account which is prepared for ascertaining the overall result of trading i.e. buying and selling of goods. Ascertainment of overall result of trading is the ascertainment of gross profit earned or gross loss incurred as a result of the trading activities by a business

during a particular accounting period. In other words, it is prepared to show the result of buying and selling of goods. Hence, Trading account is an account which is prepared to find out the Gross Profit or Gross Loss of a certain accounting period. The formula for G.P is:

$$\text{Gross Profit} = \text{Sales} - \text{Cost of goods sold (COGS)}$$
$$\text{COGS} = \text{Opening Stock} + \text{Purchases} + \text{all direct expenses} - \text{Closing Stock.}$$

If the amount of sales exceeds the total amount of purchases and expenses directly connected with such purchases, the difference is termed as **gross profit**. On the contrary, if the total of purchases and direct expenses exceed the sales, the difference is called **gross loss**. In this account, the amount of purchases of goods and also the expenses which are incurred in bringing those goods to a saleable state are recorded. In other words, all expenses which relate to either purchase of raw material or manufacturing of goods, called 'Direct Expenses', are recorded in the Trading Account. Thus, Trading account is a part of Income Statement.

Contents of Trading Account:

Trading Account is an account like any other account. It has two sides – Debit and Credit. All expenses which relate to either purchase or manufacturing of goods are written on the Debit side of the Trading Account.

Items shown on the Debit side of the Trading Account:

- (1) **Opening Stock (Opening Inventory)**
- (2) **Purchases,**
- (3) **Purchases Returns ,**
- (4) **Direct Expenses,**
 - I. Wages,
 - II. Carriage or Carriage Inward or Freight,
 - III. Manufacturing Expenses
 - IV. Dock Charges
 - V. Import Duty or Custom Duty
 - VI. Excise Duty
 - VII. Octroi :

VIII. Royalty

IX. Packing Charges/Packing Expenses :

Items shown on the Credit side of the Trading Account:

- (1) Sales
- (2) Sales Returns
- (3) Closing Stock (Closing Inventory)

(a) Where the amount of Closing Stock is stated outside the Trial Balance: Closing stock account will be posted to the credit side of the trading account and on the other hand, debit aspect of the closing stock account will be shown on the Assets side of the Balance Sheet, in order to complete the double entry.

(b) Where the amount of Closing Stock is stated inside the Trial Balance: Closing Stock will not be shown in the Trading Account but will appear only on the Assets side of the Balance Sheet.

Again, the Closing Stock may be given both on the debit side and credit side of the Trial Balance. In such a case, the debit balance will be shown on the asset side of the balance sheet and the balance appearing on the credit will be shown on the credit side of the Trading account.

Check Your Progress 6

How is Gross Profit ascertained?

.....

Format of Trading Account:
Trading Account of M/s
For the year ended on.....

Dr.		Cr.	
Particulars To Opening Stock	Amount (Rs.)	Particulars	Amount (Rs.)
To Purchases <i>Less: Purchase Returns</i> or Returns outward To Wages To Wages & Salaries To Direct Expenses To Carriage, or Carriage inward, or Carriage on Purchase To Duty on Purchase To Gas, Fuel and Power To Freight/ cartage To Manufacturing Expenses or Productive Expenses To Factory Expenses, Factory Lighting Factory Rent etc. To Octroi To Dock charges To Clearing charges To Import Duty or Custom Duty To Excise Duty To Insurance Premium (factory) To Royalty on production To Profit and Loss A/c <i>(Gross Profit transferred)</i>		By Sales <i>Less: Sales Returns</i> or Returns inward By Closing Stock By Profit and Loss A/c <i>(Gross loss transferred)</i> (Balancing figure)	

Illustration

From the following information of M/S Goswami Brothers prepare a Trading Account for the year ended 31st March, 2011.

	Rs.
Stock on 1st April, 2007	8,000
Purchases	30,230
Sales Return	86
Purchases Return	530
Sales	67,500
Wages	7,000
Carriage Inward	400
Manufacturing Expenses	5,000
Stock on 31st March, 1999	7,550
Wages outstanding	50
Carriage outward	400

Solution:

In the books of M/S Goswami Brothers
Trading Account
For the year ended 31st March, 2011

Dr.		Cr.
Particulars	Rs	Particulars
		Rs
To Opening stock	8,000	By Sales 67,500 Less: Sales Return <u>86</u>
		67,414
To Purchases 30,230 Less: Purchases Return <u>530</u>	29,700	By Closing stock
		7,550
To Wages 7,000 Add: Outstanding 50	7,050	
To Carriage Inward	400	
To Manufacturing expenses	5,000	
To Profit and Loss A/c (Gross Profit transferred)	24,814	
	74,964	74,964

Note : Normally, Manufacturing Expenses are taken to Manufacturing A/c., but from the question it appears that the firm is engaged in Trading activities and hence the same has been taken to Trading A/c.

4.8.4 PROFIT AND LOSS ACCOUNT

According to R. N. Carter:

“A Profit & Loss Account is an account into which all gains and losses are collected, in order to ascertain the excess of gains over the losses or *vice-versa*”.

Profit and Loss Account is a part of Income Statement. In this account, all indirect expenses such as administrative, selling, distribution and non-operating expenses are charged with the total of gross profit/gross loss and non-operating income in order to ascertain the Net Profit/Net Loss of the business.

A Profit and Loss Account starts with the amount of gross profit or gross loss brought down from the Trading Account. As such, all those expenses and losses which have not been debited to the Trading Account will now be debited to Profit & Loss Account. These expenses include administrative expenses, selling expenses, distribution expenses etc. These are called ‘Indirect Expenses’. Profit and Loss Account is a Nominal Account and as such, all the expenses and losses are shown on its debit side and all the incomes and gains are shown on the credit side of this account.

Items shown on the Debit side of Profit & Loss Account :

(1) Gross Loss

(2) Indirect Expenses

(a) **Office and Administrative Expenses** : Expenses such as salary of office employees, office rent, lighting, postage, printing, stationery, audit fee, legal charges etc. are treated as Office and Administrative Expenses.

(b) **Selling and Distribution Expenses** : Expenses such as advertisement charges, commission, carriage outwards, bad-debts, packing charges etc. are treated as Selling and Distribution Expenses.

(c) **Financial charges** : Expenses such as interest on loan, interest on capital, interest on overdraft etc. are treated as financial charges.

(d) **Miscellaneous Expenses** : Expenses such as interest on loan, interest on capital, repair charges, depreciation, charity etc. are treated as Miscellaneous Expenses.

(e) **Other Losses** : Such as loss by fire, loss due to accident etc.

(f) **Provisions** : Such as Provision for Doubtful Debts, Provision for Discount on Debtors etc.

Items shown on the Credit side of Profit & Loss Account :

(1) **Gross Profit :**

(2) **Other Incomes and Gains :** All items of incomes and gains such as income from investments, rent received, discount received, commission earned, interest received, bad debts recovered etc. are shown on the credit side of the Profit & Loss Account.

A general format of a Profit and Loss Account is shown below in the table:

Check Your Progress 7

Explain the meaning of Net Profit?

.....

Format of Profit and loss Account:
 Profit and loss Account of M/s
 For the year ended on.....

By Trading A/c (Gross Loss transferred) Office & Administrative Expenses To Salaries To Salaries & Wages To Rent, Rates & Taxes To Printing & Stationery To Postage & Telegram To Lighting To Insurance Premium (office) To Telephone Charges To Legal Charges To Audit Fees To Travelling Expenses To Establishment Expenses To Trade Expenses [see note (ii)] To General Expenses To Royalty on sales To Establishment To Commission to Office Manager Selling and Distribution Expenses: To Carriage Outwards, or	By Trading A/c (Gross Profit transferred) By Rent (Cr.) By Rent of premises sub-let By Discount received Or Discount (Cr.) By Commission Received By Interest on Investments By Dividend on Shares By Sundry Receipts By Bad Debts Recovered By Profit on sale of assets By Income from other Sources By Apprenticeship Premium By Sale of Scraps By Royalty Received By Subsidy from Govt. By Interest on Drawings By Capital A/c [Net Loss Transferred to]
---	--

<p style="text-align: center;">Carriage on Sales</p> <p>To Advertisement</p> <p>To Commission</p> <p>To Discount</p> <p>To Rebate</p> <p>To Brokerage</p> <p>To Bad debts</p> <p>To Export duty</p> <p>To Packing charges</p> <p>To Delivery Van Expenses.</p> <p>To Wages (Unproductive)</p> <p>To Commission to Sales Manager</p> <p>Financial Charges :</p> <p>To Interest on Loan</p> <p>To Bank Charges</p> <p>To Interest on Overdraft</p> <p>Sundry expenses :</p> <p>To Sales Tax</p> <p>To Repairs</p> <p>To Depreciation on fixed assets</p> <p>To Entertainment Expenses</p> <p>To Contingencies</p> <p>To Conveyance Expenses</p> <p>To Donation and Charity</p> <p>To Loss on Sale of Assets</p> <p>Provisions :</p> <p>To Provision for Doubtful Debts</p> <p>To Provision for Discount on Debtors</p> <p style="text-align: center;">To Capital A/c (Net Profit Transferred)</p>	
--	--

Illustration

From the following particulars, prepare a Profit & Loss Account of M/s Dutta & Sons for the year ending 31st March, 2011 :

Particulars	Rs.	Particulars	Rs.
Gross Profit	3,62,000	Discount allowed	2,000
Trade Expenses	2,000	Lighting	780
Carriage on Sales	10,000	Commission Received	840
Office Salaries	65,800	Bad-debts	1,200
Postage and Telegram	820	Discount (Cr.)	700
Office Rent	8,500	Interest on Loan	2,200
Legal Charges	400	Wages (Unproductive)	1,400
Audit fee	1,600	Export Duty	2,300
Donation	1,100	Miscellaneous Receipts	500
Sundry Expenses	360	Advertisement	4,100
Selling Expenses	5,320	Travelling Expenses	2,500

Solution:

In the books of M/s Dutta & Sons
Profit and Loss Account
For the year ending on 31st March, 2011

Dr.				Cr.
	Particulars	Amount Rs.	Particulars	Amount Rs.
	To Trade expenses	2,000	By Trading Account	3,62,000
	To Carriage on sales	10,000	(Gross Profit transferred)	
	To Office Salaries	65,800	By Commission received	840
	To Postage & Telegram	820	By Discount	700
	To Office Rent	8,500	By Miscellaneous Receipts	500
	To Legal charges	400		
	To Audit Fee	1,600		
	To Donation	1,100		
	To Sundry expenses	360		
	To Selling expenses	5,320		
	To Discount allowed	2,000		
	To Lighting	780		
	To Bad Debts	1,200		
	To Interest on Loan	2,200		
	To Wages (Unproductive)	1,400		
	To Export duty	2,300		
	To Advertisement	4,100		
	To Travelling expenses	2,500		
	To Net Profit	2,51,660		
		3,64,040		3,64,040

4.8.5 BALANCE SHEET

According to A. Palmer: The Balance Sheet “is a statement at a particular date showing on one side the trader’s property and possessions and on the other hand the liabilities.”

According to Karlson : “A business form showing what is owed and what the proprietor is worth, is called a Balance Sheet.”

According to J. R. Batliboi : “A Balance Sheet is a statement prepared with a view to measure the exact financial position of a business on a certain fixed date.”

After ascertaining the net profit or loss of the business enterprise at the end of a particular period, the businessman would also like to know the financial position of his business as on that date. For this purpose a statement, wherein all the Assets and Liabilities of the business enterprise are included, is prepared. The statement so prepared is called a Balance Sheet. After the transfer of all Revenue and Expense accounts either to the Trading Account or Profit & Loss Account, the balances of all accounts of Assets, liabilities are grouped and shown in the balance sheet. The balance sheet has two sides – Assets side and the Liabilities side. Assets are shown on the right hand side and the liabilities are shown on the left hand side of the Balance Sheet. The balance sheet is based on the equation that what an entity owns on a given date must be equal to what it owes on that date. The total of both sides of the balance sheet i.e. assets side and the liabilities side will always be equal. As this statement shows the position of assets and liabilities of an entity on a particular date, it is also known as 'Position Statement'. The definition of Balance Sheet as given by some authors are as follows :

A Balance Sheet is prepared mainly for the following purpose:

- (i) To ascertain the true financial position of the business at a particular point of time,
- (ii) To find out whether the business entity is solvent or not,
- (iii) To ascertain the nature and value of various assets and liabilities of the business at the end of the financial year.
- (iv) To know the exact amount of capital at the end of the year and the addition or deduction made into it in the current year.

The steps for preparation of a balance sheet are as follows:

- (i) All accounts of Assets appearing on the debit side of the trial balance will be shown on the 'Assets side of the balance sheet' **except drawings account which will be shown on the liabilities side as a deduction from Capital account.**
- (ii) All the accounts of appearing on the credit side of the trial balance will be shown on the 'Liabilities side of the balance sheet'.
- (iii) Net profit / Net Loss as shown by the Profit and Loss Account will be added / deducted from capital on the liabilities side of the balance sheet.
- (iv) The assets and liabilities should be shown under proper groups.
- (v) The assets and liabilities should be shown in certain order.

The assets and liabilities as shown in the balance sheet are generally grouped under certain heads. The term 'grouping' means putting similar items under a common heading. The assets are grouped as (i) Fixed assets; (ii) Current assets; and (iii) Fictitious Assets. The liabilities are grouped as (a) Internal liabilities (Capital, net profit reserve etc.); and (b) External liabilities.

Following is the Proforma of a Balance Sheet

BALANCE SHEET <i>as on or as at.....</i>	
LIABILITIES	ASSETS
<p>Capital <i>Add: Net Profit/</i> <i>Less: Net Loss</i> <i>Less: Drawings</i> Reserves</p> <p>Fixed Liabilities : Long term loans</p> <p>Current Liabilities : Unearned Income Outstanding expenses Bills Payable Sundry Creditors Bank Overdraft</p>	<p>Fixed Assets : Goodwill Patents Land and Building Plant and Machinery Furniture Motor Vehicle Loose Tools Long Term Investments</p> <p>Current Assets : Prepaid Expenses Accrued Income Closing Stock Sundry Debtors Short Term Investments Bills Receivable Cash at Bank Cash in hand</p>

There are two different formats for preparation of balance sheet. They are (i) Horizontal form; and (ii) Vertical form.

(i) Horizontal form: Horizontal form is also called 'T form' under which the assets are shown on the right hand side and liabilities are shown on the left hand side. The total of both the sides of a balance sheet must be equal. Generally, non-corporate entities prepare their balance sheets in horizontal form.

(ii) Vertical form: Vertical form is a form under which liabilities and assets are shown one after another in vertical order. Under this form of presentation of balance sheet an additional column is provided to present figures of previous year along with current years figures. This helps in

comparison of business over a period of time. Now-a-days, **all the corporate entities present their balance sheet in vertical form.**

Illustration

From the following balances of M/S Bora Brothers, prepare a Balance Sheet as on 31st December, 2011.

Debit balances	Amount Rs	Credit balances	Amount Rs
Land and Building	80,000	Bank Overdraft	20,000
Plant and Machinery	52,000	Creditors	21,000
Furniture	10,000	Bills Payable	7,000
Investments	27,000	Reserve	12,000
Cash in hand	3,000	Capital	1,60,000
Debtors	40,000	Net Profit	73,000
Bills Receivable	12,000		
Closing Stock	54,000		
Drawings	15,000		
	2,93,000		2,93,000

Solution:

M/S Bora Brothers
BALANCE SHEET
As on 31st December, 2011

Liabilities	Amount Rs	Assets	Amount Rs
Bank Overdraft	20,000	Cash in hand	3,000
Bills Payable	7,000	Bills Receivable	12,000
Creditors	21,000	Investments	27,000
Reserve	12,000	Debtors	40,000
Capital	1,60,000	Closing Stock	54,000
Add, Net Profit	<u>73,000</u>	Furniture	10,000
	2,33,000	Plant and Machinery	52,000
Less, drawings	<u>15,000</u>	Land and Building	80,000
	2,18,000		
	2,78,000		2,78,000

4.9 MEANING OF CASH FLOW STATEMENT

Cash Flow Statement (CFS) is the summary statement of a company's cash receipts and cash disbursements over a period of time. It also explains reasons for the changes

in cash position of the firm. It is a statement of movement of cash flows. Cash flows are cash inflows and outflows. Transactions which increase the cash position of the entity are called as inflows of cash and those which decrease the cash position as outflows of cash.

The cash flow statement is the financial tool that measures the cash flow of a company. It is statement, which shows the sources from which cash has been generated and how it has been spent during a period of time. In other words it is an analysis of all the changes that affect the cash account during an accounting period. These changes may be shown as either sources or uses of cash.

Cash Flow Statement is one of the mandatory financial statements of a company registered under Companies Act 1956. Cash Flow Statement is prepared by applying the norms given in the Accounting Standard 3 – ‘Cash Flow Statement’ issued by the Council of the Institute of Chartered Accountants of India.

Accounting Standard 3 requires that the cash flow statement of an enterprise should report cash flows during the period by grouping various activities into three broad classes. These classes of activities are operating, investing and financing activities. An enterprise shall present its cash flows from operating, investing and financing activities in a manner which is most appropriate to its business. For a business enterprise interest received on fixed deposit from a bank is regarded as investing activity while for a bank the interest paid on fixed deposit is regarded as operating activity. Again a single transaction may include cash flows from different activities. For example, when the instalment paid in respect of a fixed asset acquired on instalment payment basis includes both interest and loan, the interest portion is classified under financing activities and the loan portion is classified under investing activities.

Classification by activity provides information that allows users of the statement to assess the impact of those activities on the financial position of the enterprise and the amount of its cash and cash equivalents. This information may also be used to evaluate the relationships among those activities.

4.10 SUMMARY

In this unit we have discussed the following points –

- Meaning, scope and objects of Accounting. It is the *art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character, and interpreting the results thereof.*
- Transactions are first recorded in **Journal**, which is also known as ‘Day Books’ or ‘**book of original entry**’ or ‘**Primary Books**’. The next step of recording of transactions is in Ledger, which is also known as ‘**book of final entry**’ or ‘**Secondary Books**’.
- The **Double-entry system** of accounting is based on Dual Aspect concept: (a) receiving of a benefit (b) giving of a benefit. These two aspects are known as ‘**Debit**’ aspect and ‘**Credit**’ aspect.
- Financial Statements are the end products of the accounting system. So these are also called Final Accounts. Final accounts include (i) Trading and profit and loss A/c (ii) Balance sheet. All these are also called financial statements.
- Trading account is an account which is prepared for ascertaining the overall result of trading i.e. buying and selling of goods.
- A Profit & Loss Account is an account into which all gains and losses are collected, in order to ascertain the excess of gains over the losses or *vice-versa*.
- The Balance Sheet is a statement at a particular date showing the trader’s property and possessions and the liabilities. It is a statement prepared with a view to measure the exact financial position of a business on a certain fixed date.

4.11 GLOSSARY

- **Accounting:** Accounting refers to the system involved in making a financial record of business transactions and in the preparation of statements concerning the assets, liabilities, capital and operating results of the business.
- **Asset :** In accounting, assets are economic resources from which benefits will flow to the enterprise from its usage.
- **Liability:** A liability is defined as an obligation of an entity arising from past transactions or events.

- **Capital :** Capital or Equity is the amount invested in the business by the owner of the business. Capital is represented by total assets less total liabilities. In the context of a company capital refers to share capital representing the shareholders' contribution to the business.
- **Income:** Incomes are the revenues generated by an enterprise by using its resources.
- **Expense:** Expenses are the costs incurred to generate incomes.
- **Bank Reconciliation Statement:** Bank Reconciliation Statement is a statement prepared to analyse the differences between Pass Book balance and Cash Book balance in order to reconcile the difference.
- **Financial Statements :** Financial Statements are the end products of the accounting system. So these are also called Final Accounts. These include (i) Trading and profit and loss A/c (ii) Balance sheet and (iii) Cash Flow Statement.
- **Balance Sheet:** A Balance Sheet is a statement prepared with a view to measure the exact financial position of a business on a certain fixed date.
- **Cash Flow Statement:** Cash Flow Statement is prepared to show the inflow and outflow of fund during the period of accounting

4.12 ANSWERS TO CHECK YOUR PROGRESS

ANSWERS TO CHECK YOUR PROGRESS 1

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

ANSWERS TO CHECK YOUR PROGRESS 2

The system of accounting under which both the aspects of every transaction is recorded in the books of account is known as ‘Double-entry system’.

ANSWERS TO CHECK YOUR PROGRESS 3

1. Cheque issued for payment but not presented to bank.
2. Interest and dividend credited in the Pass Book but not recorded in the cash book.
3. Any cash and cheque directly deposited into bank by any person without any information.

ANSWERS TO CHECK YOUR PROGRESS 4

Records of bank deposits and withdrawals are made in a small book by the bank and given to the accountholder; this book is called Pass Book.

ANSWERS TO CHECK YOUR PROGRESS 5

The components of financial statements are :

- (i) Income statement which is divided into two parts:

(ii) Balance Sheet.

(iii) Cash Flow Statement

ANSWERS TO CHECK YOUR PROGRESS 6

If the amount of sales exceeds the total amount of purchases and expenses directly connected with such purchases, the difference is termed as **gross profit**.

ANSWERS TO CHECK YOUR PROGRESS 7

Net Profit = Gross Profit – (all indirect expenses such as administrative, selling, distribution and non-operating expenses).

4.13 SAMPLE QUESTIONS

1. Describe different types of Books of Account.
2. Explain the meaning of Asset, liability, Capital, Income and expense.
3. What is cash book?
4. What is Bank Reconcile Statement?
5. What are the causes of differences of cash book and pass book balances?
6. Give the meaning of Gross Profit and Net Profit?
7. What is a balance sheet?"

4.14 ADDITIONAL READINGS

1. Theory and Practice of Financial Accounting by B B Dam, H C Gautam and others; Capital Publishing House, Guwahati
2. Financial Accounting by Ashis Bhattacharya, Prentice hall of India Pvt. Ltd, New Delhi.
3. Financial Accounting, by S. N. Maheshwari, Vikash Publishing House Pvt. LTd., New Delhi.