Basics of accounting

1) Accounting is the art of recording, classifying, summarizing, analyzing, interpreting and communicating the financial information of an entity. Accounting is language of business.

2) Accounting is the language of the business.

3) In case of transaction at least two persons are involved. In addition to business enterprise, at least some outsider involved, for example, sale and purchase of goods, payment of expenses, receipt of income.

4) Events are internal happenings of the business, for example, depreciation, valuation of closing stock.

5) Matching concept is relevant for ascertaining Profit or Loss of the business.

6) Conservatism Concept applies for valuation of inventory, making provision for expected losses and liability.

7) Dual aspect concept is concerned with recording transactions and events as per double entry system.

8) Realisation concept is related to recognition of income.

9) Consistency concept is concerned with continuity of accounting method and policy.

10) Due to Full disclosure concept, contingent liabilities are shown into books of accounts.

11) Periodicity concept is related to accounting period.

12) According to going concern concept, a business is viewed as unlimited life.

13) Accrual basis of accounting recognizes revenue as earned, when sale is completed.

14) Resources of an accounting entity are called Assets.

15) Long-term assets, where benefit in the operations of the firm is likely to extend beyond one accounting period, are known as fixed assets.

16) Assets, which are expected to be converted into cash or to be used in the business operations within one year, are known as current assets.

17) In a business enterprise ownership interest is known as equity.

18) Cash basis of accounting recognizes revenue as earned, when cash is realized against sales.

19) Measurement basis are:
(i) Historical cost (ii) Current cost (iii) Realisable value (iv) Present value

20) Any change in Accounting Policy should be disclosed while preparing Financial Statement.

21) Effect of change of Accounting Policy on the profit or loss of the business and on the values of the assets and liabilities should also be disclosed.

22) Selection of appropriate accounting policy will lead to either understatement or over statement of operating result and financial position of the business.

23) Changes in accounting policies have retrospective effect and change in accounting estimates have prospective effect.

24) Journal entries are made by following the dual aspect concept. This is known as Double Entry System.

25) Journal is the initial record (original entry) of transactions and events.

26) The documents on the basis of which transactions are recorded in the account books are known as 'Source Documents'.

27) The document related to sale return is credit note

28) The document related to purchase return is debit note.

29) There are three types of accounts:

(i) Personal Accounts, (ii) Real Accounts and (iii) Nominal Accounts.

30) Personal Accounts are classified into:

(a) Natural Persons:- Accounts of individuals, firm, company, society,

(b) Artificial Persons:- Bank Account, Loan Account, Advance Account, Bank Overdraft

(c) Representative Persons:- Outstanding expenses. Prepaid expenses, Accrued income and Advance income.

FINAL ACCOUNT

1. Final Accounts are known as Financial Statements. Final Accounts are prepared after preparation of Trial Balance.

2. Manufacturing Account, Trading Account and Profit and Loss Account are period statements. These are **Nominal Accounts.** Balance Sheet is a position statement.

3. Manufacturing Account **shows cost of production.** Trading Account **reveals Gross Profit.** Profit and Loss Account shows **Net Profit of the business.**

4. Gross profit is represented by **sales less cost of goods sold.**

5. Cost of goods sold is calculated as:

Opening stock (Raw material, work-in-progress and finished goods)

Add - Purchases

Add - Direct expenses on purchases

Add - Manufacturing expenses (except depreciation)

Less - Closing stock (Raw Material, W.I.P. and Finished Goods)

6. Closing Stock given in the Trial Balance is shown only in Balance Sheet.

7. Tangible Fixed Assets consist of: Land, Building, Plant and Machinery, furniture. Fixtures and Fittings, Vehicles, Railway sidings. Computers, Office equipments. Computer hardware.

8. Intangible Fixed Assets consist of: Goodwill, Patents, Trade Marks, Copyrights, Computer Software Technical Know-how, Brands.

9. Current Assets consist of: Cash, Bank, Stock, Sundry Debtors, Advances, Prepaid Expenses, Accrued Income, Bills Receivable, Tax Deducted at source (Dr)

10. Long-Term Liabilities consist of: Loans, Debentures

11. Current Liabilities consist of: Sundry Creditors, Bills Payable, Outstanding expense. Advance income, Provision for tax, Unclaimed dividend. Interest accured but not due, Tax deducted at source (Cr.)

12. Adjusted purchase = Op. stock + Purchase – Cl.stock.

13. Sale of scrap is **credited to Manufacturing Account.**

14. Net amount to be shown in Profit and Loss Account in respect of Bad debts and Provision is: Bad Debts + New Provision for bad debts - Old Provision for bad debts

15. Provision for Discount on Sundry Debtors is calculated **on sundry debtors after deducting provision for bad debts from sundry debtors.**

16. Creation of Provision for bad debts and provision for discount on Debtors is **done in compliance conservative concept of accounting.**

17. Creation of Reserve for Discount on Creditors is **against the Realization Principle of accounting.**

18. In Balance Sheet Real Accounts and Personal Accounts are shown.

Capital and revenue expenditure

S.N.	Item of Expenditure	Nature of Expenditure	Reason for Classification
1.	Expenses on a Foreign Tour to purchase a machinery	Capital	These are incurred to acquire a capital asset.
2.	Cost of Machinery Purchased. Insurance & Freight on Machinery. Purchased. Custom Duty on Imported Machinery. Wages for erection of Machinery.	Capital	These are incurred to acquire a capital asset
3	Interest on a term loan for the purchase of machinery pertaining to a period prior to the use of asset.	Capital	These are incurred to acquire capital asset & the commercial production has not yet begun.
4	Interest on a term loan for the purchase of machinery pertaining to a period after the asset put into use.	Revenue	The commercial production has already begun.
5	Repairs of Machine after the machine is put to use. Amount spent for replacement of worn out part of machine	Revenue	These are incurred to maintain the capital asset.
6	Amount spent for replacement of a petrol driven engine by CNG Kits	Capital	These are incurred to reduce the operating costs and thereby increasing the profit.
7	Overhauling expenses for the engine of a motor car to get better fuel efficiency	Capital	These are incurred to reduce the operating costs and thereby increasing the profit.
8	Legal expenses to acquire a building	Capital	These are incurred to acquire ownership right of

			the capital asset.
9.	Legal Expenses to defend a suit claiming that firm's factory site belongs to plantiff	Revenue	These are incurred to maintain the capital asset.
10.	Amount spent on repainting an old building for the first time on purchase	Capital	These are incurred to put the capital asset to use.
11.	Annual Renewal fee of license for next year.	Revenue / Prepaid Expenses	These are incurred to maintain the capital asset, (i.e. right to carry on business).
12.	Amount spent for the construction of temporary huts for storing building material while constructing a building	Capital	These are incurred for the construction of building and hence to be capitalised with the cost of building.
13.	Expenses for removal of stock to a new site	Revenue	Such expenditure is neither bringing enduring benefit nor enhancing the value of capital asset.
14.	Fines Imposed / Penalties Imposed	Revenue	Such expenditure is neither bringing enduring benefit nor enhancing the value of capital asset.
15.	Inauguration Expenses on opening of a new branch of an existing business Free gift to customers Or Tournament Sponsoring Exp. Or Advertisement campaign to launch a new product.	Revenue	Such expenditure is not enhancing value of capital asset. Since it has an enduring effect on the future revenue generating capability of business, it may be treated as deferred revenue expenses.
16.	Amount spent on demolition of Building to construct a bigger building on the same site.	Capital	These are incurred for the construction of a new building.
17.	Purchase of a Patent Right, goodwill, technical know-how	Capital	This is incurred to acquire capital asset.

BILLS OF EXCHANGE AND PROMISSORY NOTES

1. **Promissory note, Bills of exchange and cheques are negotiable instruments.** It can be transferred to any other person.

2. **Promissory note has two parties and bills of exchange and cheques have three parties.**

3. Cheque is a bills of exchange in which **drawee is always a banker.**

4. The person, who has to receive money from other person, draws the Bill. **He is known as 'Drawer'.** The person, who has to pay money to other person, accepts bill of exchange. **He is known as 'Drawee'.** The person who receives payment on due date **is known as 'Payee'.**

5. Bill may be discounted by the Drawer. Discount charges are calculated for the unexpired period.

6. **On dishonour of Bill, noting charges are paid by the holder of Bill.** Each party recovers the amount of noting charges from its preceding party. Noting charges are paid to have evidence of presentation of Bill and non-payment. **Ultimate burden of noting charges falls on the Drawee.** Noting charges are recorded as 'Expense' in the books of drawee.

7. In case of renewal of Bill, **old Bill is cancelled (treated as dishonoured).** Interest on renewal of the Bill is paid for the tenure of the new Bill.

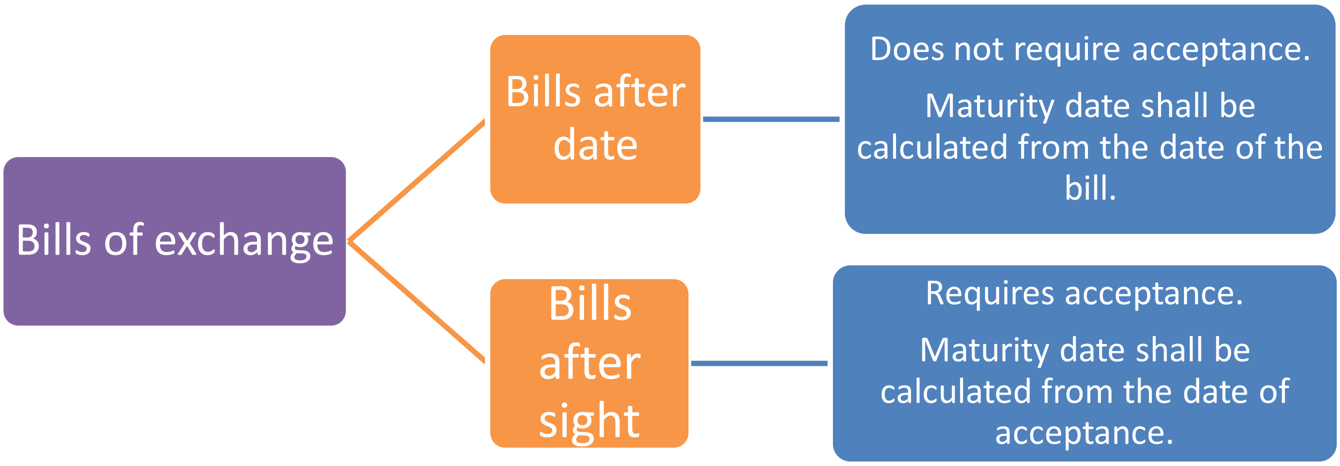
8. **If Bill is paid before due date, rebate is allowed to Drawee.** Such rebate is calculated for the unexpired period. Rebate is income for Drawee and expense for Payee.

9. In case of **insolvency of drawee,** Bill is treated as **dishonoured.**

10. In case of accommodation bill, there is no amount due between parties before drawing the Bill. **Such Bill may be drawn for the financial assistance of drawer only or of drawee or both.** When proceeds are shared after discounting the bill,

11. discount should also be shared in the same proportion.

12. Bills are of two types: - Bills after date and bills after sight.



13. If nothing is provided, bill is considered as bill after date. If acceptance is required than, it must be specifically provided.

14. Important points while calculating maturity date:-

	Case	Due Date
(a)	When the bill is made payable on a specific date.	(a) That specific date will be the due date
(b)	When the bill is made payable at a stated number of months (s) after date.	(b) That date on which the term of the bill shall expire will be the due date. **Note:-** The term shall expire on that day of the month which corresponds with the day on which the bill is dated. If the month in which the period terminates has no corresponding day, the period shall be deemed to expire on the last day of a month.
(c)	When the bill is made payable at a stated number of days after date.	(c) That date which comes after adding stated number of days to the date of bill. **Note:-** The date of Bill is excluded.
(d)	When the due date is a public holiday.	(d) The preceding **business** day will be the due date.
(e)	**When the due date is an emergency/ unforeseen holiday**	**(e) The succeeding** business **day will be the due date.**

The term of a Bill after Sight commences from the date of acceptance of the bill whereas the term of a Bill after date commences from the date of drawing a bill.

In case of time or tenor bills, **three days** (called days of grace) are added to the due date to arrive at the date of maturity.

CONSIGNMENT ACCOUNTS

1. Goods are sent by consignor to consignee to sell such goods on his (consignor's) behalf.

2. Relationship between consignor and consignee is that of principal and agent.

3. At performa invoice is sent by consignor to consignee giving description and value of goods sent.

4. No accounting entry is made by consignee on receipt of such goods.

5. Consignee receives commission as a consideration of his services. Consignee incurs expenses on behalf of consignor.

6. Consignee may receive Del credere commission. In such case, loss of bad debts will be borne by consignee.

7. Consignor prepares consignment account to find out profit or loss on consignment.

8. Nature of consignment account is Nominal Account. Nature of consignee's account is personal account.

9. Loss of consignment stock is borne by consignor, unless such loss occurs due to negligence of consignee.

10. Any loss occurred due to natural calamities, theft or negligence is treated us abnormal loss. Abnormal loss is debited in the General Profit and Loss Account of the consignor.

11. Loss of stock due to inherent characteristics of the goods is normal loss. Such loss is unavoidable. No accounting is made for normal loss of stock. Consignment profit is not reduced by the amount of normal loss. Cost of normal loss shall be spreaded over good units.

12. Closing stock of consignment remains in the possession of consignee, but it is the property of consignor. Consignment stock is valued at cost or net realizable value, whichever is less.

13. Ownership of goods remains with consignor. Possession remains with consignee.

14. A periodical statement is sent by consignee to consignor showing details of sales, his expense and commission and net amount payable to consignor. Such statement is known as 'Accounts Sales'

JOINT VENTURE ACCOUNTS

1. Joint venture is a partnership for a specific venture. There should be at least two persons for a joint venture. Joint venture dissolves after completion of venture.

2. Joint Venture Account is prepared to find out profit or loss of the business. **Nature of Joint Venture Account is Nominal Account.**

3. Going concern, periodicity and matching concepts are not followed in joint venture.

4. No accounting is made when goods are transferred by one co-venturer to the other.

5. No accounting is made for loss of stock. However, amount of claim is credited to Joint Venture Account.

DEPRECATION ACCOUNTING

1. Depreciation is an amortised expenditure. **Depreciation is charged to comply matching concept. Depreciation is treated as non-cash expense. Depreciation is a charge and not appropriation. Therefore, depreciation should be charged, even if there is insufficient profit or there is loss.**

2. "AS 10 - Property, Plant and Equipment" deals with depreciation. Sch. II of the companies Act 2013 prescribes rate of depreciation.

3. Total depreciable amount is equal to cost of assets less salvage value, it any

4. Amount of annual depreciation **is equal under.**

a. Straight line method

b. Annuity method

c. Depreciation fund or Sinking Fund method

d. Insurance policy method

5. The term amortization is used for
(i) Intangible Assets (ii) Deferred Revenue Expenses.

6. The term Depletion is used for **wasting assets (natural resources).**

7. Land is treated as non-Depreciable Asset. However, leasehold land is treated as depreciable asset.

8. Depreciation is charged over the period of useful life of asset, instead of physical life of asset.

9. Change in method of depreciation will be treated as change in accounting estimates.

BANKING TRANSACTIONS AND BANK RECONCILIATION STATEMENT

1. BRS is prepared to **find the reasons, which create difference between balance as per bank column of cash book and balance as per Pass Book/Bank Statement**

2. Pass Book is the copy of **customer's account** maintained by bank.

3. For the purpose of financial statement (Balance Sheet) corrected balance of cash book is calculated.

4. BRS is prepared by the business enterprises; it is not prepared by Bank. BRS is a memorandum statement.

PARTNERSHIP ACCOUNTS

1. In the absence of any agreement, partners are not entitled for any interest on capital or interest on drawings. In the absence of any agreement, partners are entitled for interest on partners loan @ 6% p.a.

2. In the absence of any agreement, partners are entitled to share profit or loss of the business equally.

3. When **partners' capital is fluctuating,** current accounts are not maintained. Only Capital Accounts are maintained.

4. When **capitals are fixed, drawings, interest on capital and interest on drawings** will be transferred to current Accounts.

5. When capitals are **fluctuating, drawings, interest on Capital and interest on drawings** will be transferred to capital Accounts.

6. If dates of drawings are not given, interest on drawings will be calculated **for 6 months on total drawings.**

7. When minimum guarantee for profits is given to a partner, any

shortfall will be borne by other partners in their respective profit sharing ratio.

8. There are four methods of valuation of goodwill:
(a) Average Profit Method (b) Super Profit Method
(c) Annuity Method (d) Capitalization Method

9. Super Profit is the excess of future maintainable profit (Average profit) over normal profit.

10. Normal Profit = Average capital employed x Normal Rate of Return.

11. Capital employed = Net Assets, excluding non-trade investments. (Net Assets = Assets - Liabilities)

12. Annuity method of goodwill valuation represents present value of super profit.

13. Current Account of a partner may have either debit balance or credit balance.

14. All profits and losses up to the date of admission should be transferred to capital accounts of old partners in old ratio

15. Increase in value of assets or decrease in value of liabilities will represent profit.

16. Decrease in value of assets or increase in value of liabilities will represent loss.

17. Existing balance of reserves and profit and loss account will be transferred to capital accounts of old partners in old ratio.

18. When new partner brings cash for his share of goodwill in cash,

such amount is credited to old partners in the ratio of sacrifice.

19. If goodwill account is written off after admission, total value of goodwill is debited to capital accounts of all the partners in new ratio.

20. If amount of goodwill is paid privately by new partner, no accounting is made in the books of firm.

21. Unless otherwise agreed, ratio of sacrifice is equal to old ratio.

22. Any profit or loss on revaluation of asset and liabilities is transferred to capital accounts of old partners in old ratio.

23. Any balance of Reserve and Profit and Loss Account is transferred to capital accounts of old partners in ratio.

24. If goodwill account is to be written off, total value of goodwill is credited by debiting capital accounts in remaining partners in new profit sharing ratio.

25. In case of retirement of a partner, surrender value of the Joint Life Policy is taken into consideration.

26. In case of death of a partner, total value of policy is taken into consideration.

27. If amount due to retiring partner is not paid in cash immediately, balance (due will be transferred to retiring partner’s loan account. In case of death, amount due will be transferred to deceased partner's executor's loan account.

28. In the absence of any agreement regarding settlement of account of retiring or deceased partner, provision of Sec 37 of the Partnership Act will be applicable.

INTRODUCATION TO COMPANY ACCOUNT & ISSUE FORFEITURE AND REISSUE OF SHARES

1. Following are some characteristics of company:

Incorporated Association	Common seal
Artificial Person	Limited liability
Separate legal entity	Separation of ownership from management
Perpetual succession	

2. In private company, rights to transfer shares are restricted.

3. Reserve capital means that portion of uncalled capital which shall not be capable of being called up except in the event and for the purpose of the company being wound up. Reserve capital is not disclosed in the company's balance sheet.

4. When a public intends to raise capital by issuing its shares to the public, it invites the public to make an offer to subscribe its shares through a **document called prospectus.**

5. The premium on issue of share is a capital receipt.

6. As per **Sec.52 of the Companies Act 2013,** the securities premium may be applied only for the following purposes.

A] In paying up un-issued securities of the company to be issued to members of the company as fully paid bonus securities.

B] To write off preliminary expenses of the company.

C] To write off the expenses of, or commission paid, or discount allowed on any of the securities or debentures of the company.

D] To pay premium on the redemption of preference securities or debentures of the company.

7. No company cannot issue the shares at discount.

8. Section **128 along with Schedule III to the Companies Act, 2013** deal with the preparation and presentation of statement of profit and loss and the balance sheet. Section 129 requires that final Accounts of a company shall give a true and fair view of the state of affairs of the company and statement of profit and loss should give a true and fair view of the profit and loss of the company and balance sheet should be prepared.

9. **Balance sheet of a company should be in format set out in Part I of Schedule III and Statement of Profit and Loss should be in format set out in Part II of Schedule III.**

REDEMPTION OF PREFERENCE SHARES

1. **Only fully paid up preference shares** can be redeemed.

2. Par value of preference shares can be redeemed either **out of divisible profits or out of the proceeds of new issue of shares (Equity or Preference).**

3. Premium payable on redemption may be provided **out of security premium or out of profits or revenue reserve.**

4. Profits used for par value of preference shares in be redeemed will be transferred to **capital redemption reserve. Capital redemption reserves can be used only for issue of fully paid up bonus shares.**

5. Premium received on new issue of shares or existing balance of security premium **cannot be used for redemption of par value of shares**

6. Dividend at a fixed rate is payable on preference shares. **However, in case of participating preference shares, extra dividend may he paid out of surplus profits.**

7. **Bonus shares cannot he issued to preference shareholders.**

ISSUE OF DEBENTURES

1. Debentures are creditors/loan for Company. Debentures may be issued at par, at a discount or at a premium. **Nature of Debenture Account is personal account.** Interest on Debentures is paid at a fixed rate.

2. **Discount on issue of Debentures is Capital Loss for Company. Premium on issue of debentures is capital profit for company.**

3. Interest on Debentures is treated as charge against profits. It means interest will be debited to profit am toss account whether there is profit or loss.

4. Tax deducted at source from interest on Debentures is payable to Government. Therefore, it is a liability for company (current liability)

5. Discount on issue of Debentures should be written off over the period, during which amount of debentures is used by the company.

6. Debentures may be issued:

(a) For cash (b) For a consideration other than cash (c) As collateral security

7. Debentures may be redeemed at par, at a discount or at a premium.

8. Premium on redemption of debentures is capital loss for the company. **This loss is recorded at the time of issue of debentures as under:**

Loss on Issue of Debentures A/c Dr.

To Premium on Redemption of Debentures A/c

9. Loss on issue of debentures A/c should be written off over the period during which amount of debenture is used.

10. Premium received on issue of debentures can be used for writing nil capital losses, hut it cannot be used to pay dividends.

11. When debentures are issued as collateral security and debenture suspense account is debited, it will appear in the assets side of the Balance Sheet

INVENTORY

1. **Inventory includes Raw material, WIP, Finished goods and consumables also. But it does not include machinery spares if their use is irregular in business.**
2. Inventory valuation effects tax liability but not affect cash flows.
3. AS 2 deals with Inventory. Inventory should be valued at Cost or Net realizable value whichever is lower.
4. **"Cost" excludes - Storage Costs, Interest costs, Abnormal Losses, Administration OH, Selling & Distribution OH**

5. **Net Realisable Value: Estimated Selling Price (Less) Estimated Costs of disposal / making the sales**

6. In case of inventory not ordinarily interchangeable, **Specific identification method** is useful. Actual cost specifically identified for each good and is useful for high value assets, Customised products etc.,

7. In balance sheet **stock as per books appears,** but **not as per physical stock verification.**

8. FIFO Vs LIFO Method:

9. Simple Average Cost Vs Weighted Average Cost:

10. **Difference between FIFO & LIFO:-**

Particulars	FIFO Method	LIFO Method
Assumption	Goods coming in first will go out first	Goods coming in later will go out first.
Closing Stock	Closing Stock consists of latest purchases	Closing Stock consists of earlier purchases
Valuation	Closing Stock will be valued at the Current market prices.	Closing Stock will be valued at the prices of initial purchases
Inflation - Prices Increase / rising prices	Value of Closing Stock will be higher Cost of Goods Sold will be lower	Value of Closing Stock will be lower Cost of Goods Sold will be higher
Deflation - Prices decrease /falling prices	Value of Closing Stock will be lower Cost of Goods Sold will be higher	Value of Closing Stock will be higher Cost of Goods Sold will be lower
Matching of costs	Current Costs are NOT matched with the current revenues	Current Costs are MATCHED with the current revenues
Recognition	Approved by AS-2	NOT approved by AS-2

11. **Inventory Systems**

Particulars	Perpetual	Periodic
Meaning	Continuous updating of stock records - Receipts & issues are immediately recorded	Ascertaining closing stock by taking actual physical count at a particular date. It is also called as Physical inventory system.

Stock value	Stock value can be known at any point of time	Stock value will be known only at end of fixed period
Nature	Stock Ledger maintained - FIFO, LIFO etc	Physical Verification of closing stock is made

Note: Inventory control system is possible only under perpetual inventory system.