

UNIT– I: INTRODUCTION TO ACCOUNTING, ACCOUNTING SYSTEM AND PROCESS

Meaning of Financial Accounting, advantages and limitations of accounting, Accounting standards in India and International (outline), Branches of Accounting, Brief introduction on IFRS & IND AS (Only list of Indian accounting standards), Accounting concepts and conventions, Accounting concept of income and expenditure, Classification of capital and revenue- expenditure and income, accounting equation of assets equals capital and liabilities, accounting process, contingent assets and liabilities, Fictitious assets.

Introduction

Financial accounting is a branch of accounting that focuses on the preparation of financial statements—such as the balance sheet, income statement, and cash flow statement—for external users. These statements are prepared in accordance with standardized rules (like GAAP or IFRS) to ensure transparency and comparability.

Definition:

1. The American institute of certified public accountants describe accounting as ‘accounting is an art of recording classifying and summarizing in a significant manner and in terms of money the transactions and events which are in part at least of financial character and interpreting the results there of.’
2. Accounting Standards Board (ASB), UK: "Financial accounting is the process of identifying, measuring and communicating economic information to permit informed judgments and decisions by users of the information."
3. Robert N. Anthony (Author & Professor): "Financial accounting is concerned with the reporting of financial information to various external users, including investors, creditors, and regulatory agencies."

Advantages of Financial Accounting:

1. It helps to record each and every transaction of the business for future reference.
2. It provides information relating to various types of accounts which helps in controlling them.
3. It helps to determine profitability of the business for example gross profit and net profit.
4. It provides true and fair value of the business financial position. It provides clear idea of assets, Liabilities and capital at the end of the period through balance sheet.
5. It enables the comparison of results of current year with that of past year by maintaining and preserving records. Also, it is helpful for interfirm comparison to analyse the plans and policies of future activities.

6. The statements and the various accounts prepared through accounting are authentic and correct. Hence these statements are trusted by various authorities and various departments like sales tax, income tax etc .
7. The data generated through preparation of accounts is communicated with external parties of the firm like bankers, investors, creditors to enable them to take various decisions.
8. Accounting is helpful during detection of errors and frauds related with cash or goods and taking corrective measures to control the same.
9. Accounting enables management to make day to day decision and plans and policies related with long term planning.
10. The data provided by accounting statements is prepared with great accuracy and is appropriately authenticated by appropriate authority which helps the statements to be used as evidence in the court if necessity occurs.

Limitations of Financial Accounting:

1. Historical in Nature: It records past transactions and does not reflect current or future financial conditions.
2. Ignores Non-Monetary Aspects: Qualitative factors like employee satisfaction, brand value, or customer loyalty are not recorded.
3. Based on Estimates and Judgments: Some figures (like depreciation, bad debts) are based on estimates, which may not be fully accurate.
4. Not Suitable for Internal Decision-Making: Financial accounting is designed for external reporting, not for detailed internal analysis or planning.
5. No Focus on Cost Control or Efficiency: It does not provide information about cost management or operational efficiency like cost accounting does.
6. Inflation Not Considered: Assets and liabilities are recorded at historical cost and not adjusted for inflation, which can distort the true value.
7. Delay in Reporting: Financial statements are usually prepared at the end of an accounting period, which may delay timely decision-making.
8. Possibility of Manipulation: Accounting policies and principles may be used to manipulate profits legally (e.g., through creative accounting).

Branches in Accounting:

1. Financial Accounting:

Financial accounting is the branch concerned with recording, summarizing, and reporting the financial transactions of a business. Its primary purpose is to provide accurate and standardized financial information to external users such as investors, creditors, government agencies, and other stakeholders. This branch follows established accounting standards like GAAP or IFRS, and produces financial statements such as the Balance Sheet, Profit and Loss Account, and Cash Flow Statement, typically at the end of an accounting period.

2. Management Accounting:

Management accounting, also known as managerial accounting, focuses on providing relevant financial and non-financial information to internal users—mainly the management. This branch helps in planning, controlling, and decision-making within an organization. Reports generated include budgets, performance evaluations, cost analyses, and forecasts. Unlike financial accounting, management accounting is forward-looking and is not bound by standardized formats or regulations.

3. Cost Accounting:

Cost accounting deals with the calculation and control of costs. It involves recording, classifying, and analyzing costs associated with production or service delivery. The main goal is to determine the actual cost of products or services and to assist in cost control and reduction. This branch helps businesses in pricing decisions, budgeting, and improving operational efficiency by analyzing fixed and variable costs, break-even points, and variances.

4. Tax Accounting:

Tax accounting is focused on matters related to taxes and tax returns. It involves preparing tax reports and ensuring compliance with various tax laws and regulations. This branch deals with the computation of income tax, GST, and other levies as per the laws applicable in a country. Tax accounting helps organizations in effective tax planning, reducing tax liabilities legally, and avoiding penalties by staying compliant.

5. Auditing:

Auditing is the independent examination of financial records and statements to ensure accuracy, fairness, and compliance with accounting standards and laws. It may be internal or external. Internal auditors work within the organization to improve internal controls, while external auditors assess the fairness of financial statements for stakeholders. The audit process builds trust in financial reporting and helps detect errors or fraud.

6. Forensic Accounting:

Forensic accounting combines accounting, auditing, and investigative skills to examine financial information for use in legal proceedings. It is often used in cases of fraud, embezzlement, or financial disputes. Forensic accountants analyze financial data to uncover hidden assets, trace illicit transactions, and support litigation through expert testimony and detailed reports.

7. Government Accounting:

Government accounting deals with the process of recording and managing financial transactions related to public funds. It ensures transparency, accountability, and efficiency in the use of public resources. This branch follows specific rules and formats, such as those prescribed by the Government Accounting Standards Advisory Board (GASAB) in India, and is essential for preparing government budgets, monitoring expenditures, and financial reporting by various departments.

8. Social Responsibility Accounting:

Also known as social or environmental accounting, this branch focuses on reporting the social and environmental effects of business activities. It includes measuring corporate social responsibility (CSR) efforts, sustainability initiatives, and ethical practices. The aim is to inform stakeholders about a company's broader impact on society and the environment, beyond just financial performance.

An Outline to Accounting standards in India and International:

Accounting standards are rules and guidelines for the preparation and presentation of financial statements. Its main purpose is to ensure consistency, reliability, comparability, and transparency in financial reporting.

Accounting Standards in India:

It is regulated by Institute of Chartered Accountants of India (ICAI) and Standards issued by the Accounting Standards Board (ASB) of ICAI. Types of Standards in India are:

- Accounting Standards (AS): Traditional standards for non-Ind AS entities.
- Indian Accounting Standards (Ind AS): Converged with International Financial Reporting Standards (IFRS); applicable to large and listed companies.

Accounting standards are classified into two parts AS (1–32) – For small and medium enterprises (SMEs) and non-Ind AS companies and Ind AS (101–116) – For listed and large companies (based on net worth thresholds).

Its applicability depends on the type of entity like listed companies or net worth thresholds or voluntary adoption allowed

List of Indian Accounting Standards

Sr. No.	Ind AS No.	Title of the Standard
1.	Indian Accounting Standard (Ind AS) 1	Presentation of Financial Statements
2.	Indian Accounting Standard (Ind AS) 2	Inventories
3.	Indian Accounting Standard (Ind AS) 7	Statement of Cash Flows
4.	Indian Accounting Standard (Ind AS) 8	Accounting Policies, Changes in Accounting Estimates and Errors
5.	Indian Accounting Standard (Ind AS) 10	Events after the Reporting Period

6.	Indian Accounting Standard (Ind AS) 12	Income Taxes
7.	Indian Accounting Standard (Ind AS) 16	Property, Plant and Equipment
8.	Indian Accounting Standard (Ind AS) 19	Employee Benefits
9.	Indian Accounting Standard (Ind AS) 20	Accounting for Government Grants and Disclosure of Government Assistance
10.	Indian Accounting Standard (Ind AS) 21	The Effects of Changes in Foreign Exchange Rates
11.	Indian Accounting Standard (Ind AS) 23	Borrowing Costs
12.	Indian Accounting Standard (Ind AS) 24	Related Party Disclosures
13.	Indian Accounting Standard (Ind AS) 27	Separate Financial Statements
14.	Indian Accounting Standard (Ind AS) 28	Investments in Associates and Joint Ventures
15.	Indian Accounting Standard (Ind AS) 29	Financial Reporting in Hyperinflationary Economies
16.	Indian Accounting Standard (Ind AS) 32	Financial Instruments: Presentation
17.	Indian Accounting Standard (Ind AS) 33	Earnings per Share
18.	Indian Accounting Standard (Ind AS) 34	Interim Financial Reporting
19.	Indian Accounting Standard (Ind AS) 36	Impairment of Assets
20.	Indian Accounting Standard (Ind AS) 37	Provisions, Contingent Liabilities and Contingent Assets
21.	Indian Accounting Standard (Ind AS) 38	Intangible Assets
22.	Indian Accounting Standard (Ind AS) 40	Investment Property
23.	Indian Accounting Standard (Ind AS) 41	Agriculture
24.	Indian Accounting Standard (Ind AS) 101	First-time Adoption of Indian Accounting Standards
25.	Indian Accounting Standard (Ind AS) 102	Share-based Payment
26.	Indian Accounting Standard (Ind AS) 103	Business Combinations

27.	Indian Accounting Standard (Ind AS) 104	Insurance Contracts
28.	Indian Accounting Standard (Ind AS) 105	Non-current Assets Held for Sale and Discontinued Operations
29.	Indian Accounting Standard (Ind AS) 106	Exploration for and Evaluation of Mineral Resources
30.	Indian Accounting Standard (Ind AS) 107	Financial Instruments: Disclosures
31.	Indian Accounting Standard (Ind AS) 108	Operating Segments
32.	Indian Accounting Standard (Ind AS) 109	Financial Instruments
33.	Indian Accounting Standard (Ind AS) 110	Consolidated Financial Statements
34.	Indian Accounting Standard (Ind AS) 111	Joint Arrangements
35.	Indian Accounting Standard (Ind AS) 112	Disclosure of Interests in Other Entities
36.	Indian Accounting Standard (Ind AS) 113	Fair Value Measurement
37.	Indian Accounting Standard (Ind AS) 114	Regulatory Deferral Accounts
38.	Indian Accounting Standard (Ind AS) 115	Revenue from Contracts with Customers
39.	Indian Accounting Standards (Ind AS) 116	Leases

International Accounting Standards

It is regulated by International Accounting Standards Board (IASB) – Under the IFRS Foundation. The main frame work of IASB is International Financial Reporting Standards (IFRS) and previously issued International Accounting Standards (IAS) – still in use if not replaced. The main objective to IASB is to create a common global language for business affairs so that financial statements are understandable and comparable across international boundaries.

Some of the examples of key IFRS standards are

- IAS 1 – Presentation of Financial Statements
- IAS 2 – Inventories
- IFRS 9 – Financial Instruments
- IFRS 16 – Leases

IFRS is adopted by over 140 countries. India has opted for convergence (Ind AS) and not full adoption of IFRS.

Key differences between Indian and International Standards

Basis	Indian Standards (Ind AS)	International Standards (IFRS)
Regulatory Body	ICAI / MCA	IASB
Legal backing	Companies Act, 2013	Not legally binding unless adopted by local law
Terminology	Indian context	Global context
Convergence vs Adoption	Converged (Ind AS)	Direct IFRS adoption

Accounting Concepts and Conventions:

Accounting Concepts and Conventions are the basic rules, assumptions, and guidelines followed in the preparation of financial statements. They ensure consistency, reliability, and comparability of accounting information. According to Bhattacharya and John Dearden, 'the basic accounting concepts and conventions are like grammar of the language which helps to understand the words and terms used in accounting in their proper technical sense. The concepts used in accounting signifies the necessary assumptions or conditions upon which accounting is based.'

Accounting Concepts:

1. Business Entity Concept:

This concept assumes that, for accounting purposes, the business enterprise and its owners are two separate independent entities. Thus, the business and personal transactions of its owner are separate. For example, when the owner invests money in the business, it is recorded as liability of the business to the owner. Similarly, when the owner takes away from the business cash/goods for his/her personal use, it is not treated as business expense.

2. Going Concern Concept:

This concept states that a business firm will continue to carry on its activities for an indefinite period of time. Simply stated, it means that every business entity has continuity of life. Thus, it will not be dissolved in the near future. This is an important assumption of accounting, as it provides a basis for showing the value of assets in the balance sheet.

3. Cost Concept:

It states that all assets are recorded in the books of accounts at their purchase price, which includes cost of acquisition, transportation and installation and not at its market price. It means that fixed assets like building, plant and machinery, furniture, etc are recorded in the books of accounts at a price paid for them.

4. Money Measurement Concept:

This concept assumes that all business transactions must be in terms of money, that is in the currency of a country. In our country such transactions are in terms of rupees. Thus, as per the money measurement concept, transactions which can be expressed in terms of money are recorded in the books of accounts. For example, sale of goods worth Rs.200000, Rent Paid Rs.10000 etc. are expressed in terms of money, and so they are recorded in the books of accounts. But the transactions which cannot be expressed in monetary terms are not recorded in the books of accounts.

For example, sincerity, loyalty are not recorded in books of accounts because these cannot be measured in terms of money although they do affect the profits and losses of the business concern.

5. Accrual Concept:

The meaning of accrual is something that becomes due especially an amount of money that is yet to be paid or received at the end of the accounting period. It means that revenues are recognised when they become receivable. Though cash is received or not received and the expenses are recognised when they become payable though cash is paid or not paid. Both transactions will be recorded in the accounting period to which they relate.

6. Dual Aspect Concept:

Dual aspect is the foundation or basic principle of accounting. It provides the very basis of recording business transactions in the books of accounts. This concept assumes that every transaction has a dual effect, i.e. it affects two accounts in their respective opposite sides. Therefore, the transaction should be recorded at two places. It means, both the aspects of the transaction must be recorded in the books of accounts. Thus, the duality concept is commonly expressed in terms of fundamental accounting equation:
Assets = Liabilities + Capital

7. Accounting Period Concept:

All the transactions are recorded in the books of accounts on the assumption that profits on these transactions are to be ascertained for a specified period. This is known as accounting period concept. Thus, this concept requires that a balance sheet and profit and loss account should be prepared at regular intervals. This is necessary for different purposes like, calculation of profit, ascertaining financial position, tax computation etc.

8. Matching Concept:

The matching concept states that the revenue and the expenses incurred to earn the revenues must belong to the same accounting period. So once the revenue is realised, the next step is to allocate it to the relevant accounting period. This can be done with the help of accrual concept. If the revenue is more than the expenses, it is called profit. If the expenses are more than revenue it is called loss. This is what exactly has been done by applying the matching concept.

Therefore, the matching concept implies that all revenues earned during an accounting year, whether received/not received during that year and all cost incurred, whether paid/not paid during the year should be taken into account while ascertaining profit or loss for that year.

9. Realization Concept:

This concept states that revenue from any business transaction should be included in the accounting records only when it is realised. The term realisation means creation of legal right to receive money. Selling goods is realisation, receiving order is not. In other words, it can be said that: Revenue is said to have been realised when cash has been received or right to receive cash on the sale of goods or services or both has been created. The concept of realisation states that revenue is realized at the time when goods or services are actually delivered.

10. Full Disclosure Concept:

The concept of full disclosure requires that all material and relevant facts concerning financial statements should be fully disclosed. Full disclosure means that there should be full, fair and adequate disclosure of accounting information. Adequate means sufficient set of information to be disclosed. Fair indicates an equitable treatment of users. Full refers to complete and detailed presentation of information. Thus, the convention of full disclosure suggests that every financial statement should fully disclose all relevant information.

11. Consistency Concept:

The concept of consistency means that same accounting principles should be used for preparing financial statements year after year. A meaningful conclusion can be drawn from financial statements of the same enterprise when there is comparison between them over a period of time. But this can be possible only when accounting policies and practices followed by the enterprise are uniform and consistent over a period of time. If different accounting procedures and practices are used for preparing financial statements of different years, then the result will not be comparable.

12. Conservatism Concept:

This concept is based on the principle that “Anticipate no profit, but provide for all possible losses”. It provides guidance for recording transactions in the books of accounts. It is based on the policy of playing safe in regard to showing profit.

The main objective of this convention is to show minimum profit. Profit should not be overstated. If profit shows more than actual, it may lead to distribution of dividend out

of capital. This is not a fair policy and it will lead to the reduction in the capital of the enterprise.

For example, valuing closing stock at cost or market price whichever is lower, creating provision for doubtful debts, discount on debtors, writing off intangible assets like goodwill, patent, etc. The convention of conservatism is a very useful tool in situation of uncertainty and doubts.

13. Materiality Concept:

The concept of materiality states that, to make financial statements meaningful, only material fact i.e. important and relevant information should be supplied to the users of accounting information. The question that arises here is what is a material fact. The materiality of a fact depends on its nature and the amount involved. Material fact means the information of which will influence the decision of its user.

Accounting Conventions:

1. Consistency Convention
2. Conservatism Convention
3. Full Disclosure Convention
4. Materiality Convention

Fundamental Accounting Assumptions:

1. Going Concern Concept
2. Consistency Concept
3. Accrual Concept

Various Accounting Terms:

1. Income:

In accounting, income refers to the increase in a company's net assets resulting from its operations and other activities during a specific period. It represents the financial benefit earned by a business, typically expressed as revenue minus expenses.

Income specifically refers to the net increase in net assets after deducting expenses.

2. Revenue:

This is the gross inflow of economic benefits during the period arising from the ordinary activities of a business. Revenue is a broader term that represents the gross inflow of economic benefits.

3. Expenditure:

In accounting, expenditure refers to the outflow of cash or other assets (like credit) used to acquire goods, services, or assets, essentially representing the cost of something acquired. It's the act of spending money or incurring a liability to obtain

something of value. Expenditures are recorded at the time of purchase or when a liability is incurred.

4. Expenses:

Expense is the consumption of an asset over time to generate revenue. For example, buying a machine is an expenditure (a purchase), but the depreciation of that machine over its useful life is an expense.

5. Capital Expenditure:

In accounting, capital expenditure (CAPEX) refers to the funds used to acquire, upgrade, or maintain long-term assets like property, buildings, or equipment that will be used in a business for more than one accounting period.

Example: Purchasing land, buildings, machinery, vehicles, or software, as well as significant upgrades or improvements to existing assets.

6. Capital Income:

In accounting, capital income refers to the gains or income derived from the sale of non-current assets or investments, rather than from a company's regular business operations. It's a type of income that is often non-recurring and typically not part of the company's main income stream.

Examples: Gains from selling a building, proceeds from selling a piece of equipment, gains from selling investments, dividends from investments.

7. Revenue Expenditure:

In accounting, revenue expenditure refers to the expenses a business incurs for its day-to-day operations and to maintain its existing assets, rather than for long-term investments. These expenses are typically short-term and are fully consumed within the accounting period they are incurred, directly impacting the income statement by reducing profits.

Examples: Salaries, rent, utilities, maintenance costs, and the cost of goods sold.

8. Revenue Income:

In accounting, revenue refers to the total income generated from a company's primary business activities, such as selling goods or services, before any expenses are deducted. It represents the top-line figure on the income statement and is a key indicator of a company's financial health. Essentially, it's the total amount of money a business brings in from its operations.

Examples: Revenue can include sales of goods, fees for services, interest income, and rental income.

9. Accounting Equation:

The accounting equation, also known as the basic accounting equation or balance sheet equation, is a fundamental principle in accounting that states a company's total assets are equal to the sum of its liabilities and owner's equity. This equation is the

foundation of the double-entry bookkeeping system and is used to prepare the balance sheet.

Equation: $\text{Assets} = \text{Liabilities} + \text{Owner's Equity}$

10. Contingent Assets:

In accounting, a contingent asset is a potential asset whose existence is uncertain because it depends on the occurrence or non-occurrence of a future event not wholly within the company's control. Essentially, it's a possible future economic benefit that might or might not materialize. These assets are not recorded on the balance sheet until their realization is virtually certain.

Example: Pending lawsuit settlement, expected insurance reimbursement, tax refunds.

11. Contingent Liabilities:

In accounting, a contingent liability is a potential future obligation that may or may not become an actual liability depending on the outcome of an uncertain future event. It represents a possible loss that a company might incur, but the exact amount and timing of the potential loss are not yet known.

Example: Lawsuits, product warranties and guarantees, workmen's compensation fund.

12. Fictitious Assets:

In accounting, fictitious assets are expenditures or losses that are recorded on the balance sheet as assets but do not represent tangible or valuable assets. They are essentially deferred expenses or losses that are not immediately written off against profits. These "assets" are carried forward and gradually amortized (written off) against future earnings.

Example: Preliminary expenses, promotional costs, accumulated losses

13. Accounting Process:

The accounting process is a systematic series of steps that a business follows to record, classify, summarize, and analyse its financial transactions. This process culminates in the creation of financial statements that provide insights into the company's financial health. It's essentially the mechanism by which a business tracks its financial activities.

Following are the steps involved in accounting process:

1. Identifying and analysing transaction
2. Recording transaction in journal
3. Posting transaction to ledger
4. Preparing an unadjusted trial balance
5. Making adjusting entries
6. Preparing an adjusted trial balance
7. Generating financial statements (income statement and balance sheet)
8. Closing the books of accounts

Unit – II: Recording transactions and Trial balance

Transactions -nature, Entry in Journal, Purchases, sales, Returns, Receivables, and payables, Inventory, Depreciation and amortizations, reserves, Intangible assets accounting, GST transactions, Entry in Ledger, Accounting accuracy through Trial balance, correction of errors.

Transaction:

A **transaction** is an event that has a **financial impact** on an organization and is recorded in its accounting records (books of accounts). A transaction is an economic event that involves an **exchange of value** (goods, services, or financial resources between two or more parties) and typically affects at least **two accounts** (following the **double-entry accounting** system). Transactions can be classified based on whether they involve cash, credit, or are internal or external to a business.

Nature of a Transaction:

1. **Exchange:** A transaction involves the transfer of something of value, such as money, goods, or services, between at least two parties.
2. **Monetary in Nature:** Only events measurable in money are considered transactions (e.g., selling goods, paying salaries).
3. **Dual Aspect:** Every transaction has a **give and take** aspect — for every debit, there is an equal credit.
4. **Documented Evidence:** Transactions should be supported by **source documents** like invoices, receipts, or contracts.
5. **Historical Event:** Transactions record events that have **already occurred**, not future intentions or estimates.
6. **Impact on Financial Statements:** Transactions change the **financial position** — affecting assets, liabilities, equity, revenue, or expenses.

Types of Transactions:

1. **Cash Transactions:** Involve the immediate exchange of cash for goods or services.
2. **Credit Transactions:** Involve the promise of future payment for goods or services.
3. **Internal Transactions:** Occur within a business, such as using supplies from inventory.
4. **External Transactions:** Involve parties outside the business, such as customers or suppliers.
5. **Financial Transactions:** Events that change the value of an asset, liability, or owner's equity.

Journal

The journal is the basic book of accounts. 'Journ' is a Latin word which means 'day'. So, journal means a day book which records daily transactions in the order in which they take place.

Definition

A journal is a basic book of accounts in which business transactions are recorded in their two-fold aspect for the first time in the order of their happening.

Format of Journal

Date	Particulars	L/f	Debit amount	Credit amount

Subsidiary Books

Subsidiary Books (also called books of original entry) are specialized accounting books where transactions of a similar nature are first recorded before they are posted to the ledger.

Instead of recording every transaction in the journal, large businesses use these subsidiary books to improve efficiency and accuracy in bookkeeping. Subsidiary books are prepared to **classify and record repetitive transactions** in a systematic way, saving time and reducing errors.

Types of Subsidiary Books:

1. **Cash Book** – for all cash and bank transactions.
2. **Purchases Book** – for credit purchases of goods.
3. **Sales Book** – for credit sales of goods.
4. **Purchases Returns Book** – for goods returned to suppliers.
5. **Sales Returns Book** – for goods returned by customers.
6. **Bills Receivable Book** – for bills received from customers.
7. **Bills Payable Book** – for bills issued to creditors.
8. **Journal Proper** – for miscellaneous transactions not recorded in other books.

Format:

Purchase Book

Date	Name of Supplier	Inward Invoice No.	L/f	Amount

Sales Book

Date	Name of Customer	Outward Invoice No.	L/f	Amount

Purchase Return Book

Date	Name of Supplier	Debit Note No.	L/f	Amount

Sales Return Book

Date	Name of Customer	Credit Note No.	L/f	Amount

Ledger

Journal test not fulfills the basic requirement of businessman to get useful data as and when required. Hence a separate book is maintained which is known as ledger which maintains a separate page for recording the transaction related to to a respective account.

Definition

1. **Account:** An account is a summarised statement of all transactions relating to to one particular person, asset, expense or income, written according to principles of double entry and showing their net effect.
2. **Ledger:** A book of accounts in which all accounts relating to persons, assets, good, expenses and income are kept it is known as ledger.

A **ledger** is a book or collection of accounts in which accounting transactions are recorded.

Each account has:

- an opening or brought-forward balance;
- a list of transactions, each recorded as either a debit or credit in separate columns (usually with a counter-entry on another page)
- and an ending or closing, or carry-forward, balance.

The ledger is a permanent summary of all amounts entered in supporting journals (day books) which list individual transactions by date.

Specimen of Ledger Account

Dr.

Cr.

Date	Particular	J/f	Amount	Date	Particular	J/f	Amount

The process of transferring a transaction from journal to ledger is known as posting. At the end of period all ledger accounts are closed and the total of amount column is made. The difference between the total amount of two sides two side of an account it is known as balance. Balance is difference between the total of debit and total of credit of an account. If total of debit side is greater than total of credit side the difference is called Debit balance. If the total of credit side is more than total of debit side the difference is called credit balance. Whereas if the total of both sides is equal then the account is said to be tallied.

Trial Balance:

A trial balance is a bookkeeping worksheet used in accounting to verify the mathematical accuracy of ledger entries. It lists all the general ledger accounts with their debit and credit balances at a specific point in time, typically at the end of an accounting period. The primary purpose is to ensure that the total debit balances equal the total credit balances, which indicates a balanced accounting system.

The trial balance serves as a check to ensure that the fundamental principle of double-entry bookkeeping (every debit has a corresponding credit) is correctly applied. It is typically presented as a two-column table, with one column for debit balances and another for credit balances. It helps in identifying errors in the bookkeeping process, such as incorrect entries or omissions, before preparing financial statements like the balance sheet and income statement. Trial balances are primarily used internally within a company's accounting department and are not typically distributed outside the company like financial statements.

While it confirms the mathematical accuracy of the accounting system, it doesn't catch all types of errors. For example, it won't detect errors where a transaction is entirely omitted or if an incorrect account is used for an entry.

Specimen of Trial Balance:

Trial Balance as on _____

Title of Accounts	Debit ₹	Credit ₹
Assets	xxx	
Expenses	xxx	
Drawings	xxx	
Losses	xxx	
Capital		xxx
Liabilities		xxx
Incomes		xxx

Provisions		xxx
Total	xxx	xxx

Trial Balance Errors:

Trial balance errors can be broadly categorized into those that are revealed by the trial balance and those that are not revealed. Errors revealed cause the debit and credit sides of the trial balance to be unequal, while those not revealed may result in an equal trial balance despite incorrect accounting.

Types of errors in a trial balance

1. **Error of Omission:** A transaction is completely omitted from the books. **Effect:** Trial balance still tallies.
2. **Error of Commission:** Entry is made in the correct type of account but the wrong individual account (e.g., wrong customer). **Effect:** Trial balance still tallies.
3. **Error of Principle:** A transaction is recorded against the wrong class of account (e.g., treating capital expense as revenue expense). **Effect:** Trial balance still tallies.
4. **Error of Original Entry:** Wrong amount is recorded in the books, but the same wrong amount is posted to both debit and credit. **Effect:** Trial balance still tallies.
5. **Compensating Error:** Two or more errors cancel each other out numerically. **Effect:** Trial balance still tallies.
6. **Error of Duplication:** A transaction is recorded more than once. **Effect:** Trial balance may or may not tally, depending on entries.
7. **Error of Reversal:** Correct amount, correct accounts, but debits and credits are reversed. **Effect:** Trial balance still tallies.
8. **Casting or Posting Error:** Mistake in totalling (casting) or posting to the ledger. **Effect:** Trial balance **does not** tally.
9. **Transposition Error:** Digits are reversed (e.g., 64 instead of 46). **Effect:** Trial balance may not tally.

Steps/Process of Rectification of Errors

Step 1: Write Wrong Journal Entry: Write the entry which has already been passed in the books, i.e. the wrong entry.

Step 2: Reverse of wrong entry: write the reverse of the above entry, the wrong entry, to notify the effect of wrong entry.

Step 3: Write Correct entry: write the entry which should have been passed, i.e. the correct entry.

Step 4: Rectifying entry: write the net effect in step 2 and step 3.

Goods and Service Act, 2018:

The Goods and Services Tax (GST) Act, implemented in India on July 1, 2017, is a comprehensive indirect tax reform that replaced multiple central and state taxes with a unified tax system. It was introduced to simplify the tax structure, eliminate the cascading effect of taxes, and create a common national market.

Key Features:

- **Unified Tax System:** GST subsumed various indirect taxes like central excise duty, service tax, VAT, and others, streamlining the taxation process.
- **Dual GST Model:** India adopted a dual GST structure:
CGST (Central GST) and SGST (State GST) for intra-state transactions.
IGST (Integrated GST) for inter-state transactions and imports.
UTGST (Union Territory GST) for union territory transactions.
- **Destination-Based Tax:** GST is levied at the point of consumption, meaning the tax revenue goes to the state where the goods or services are consumed.
- **Input Tax Credit:** Businesses can claim credit for the GST paid on inputs, reducing the overall tax burden and promoting transparency.
- **GST Council:** A governing body comprising representatives from the central and state governments was established to make decisions related to GST rates, exemptions, and policies.

The implementation of GST marked a significant shift in India's taxation landscape, aiming to foster economic growth and ease of doing business.

Journal entries of GST.

1. Purchase of goods with GST (Intra-State)
Purchases A/c Dr.
Input CGST A/c Dr.
Input SGST A/c Dr.
To Creditor's A/c

2. Purchase of goods with IGST (Inter-State)
Purchases A/c Dr.
Input IGST A/c Dr.
To Creditor's A/c

3. Sale of goods with GST (Intra-State)
Debtor's A/c Dr.
To Sales A/c
To Output CGST A/c
To Output SGST A/c

4. Sale of goods with IGST (Inter-State)
Debtor's A/c Dr.

To Sales A/c
To Output IGST A/c

5. Payment of GST to government

Output CGST A/c Dr.
Output SGST A/c Dr.
Output IGST A/c Dr.

To Input CGST A/c
To Input SGST A/c
To Input IGST A/c
To Bank A/c (for net payable)

Journal Entries:

1.		Purchase of Goods
	a.	Cash Purchase Purchase A/c Dr. To Cash A/c
	b.	Credit Purchase Purchase A/c Dr. To Suppliers A/c
2.		Sales of goods
	a.	Cash Sales Cash A/c Dr. To Sales A/c
	b.	Credit Sales Customers A/c Dr. To Sales A/c
3.		Purchase Returns (Return of goods to supplier)
	a.	When goods purchased on credit are returned Suppliers A/c Dr. To Purchase Return A/c
	b.	When goods purchased on cash are returned Cash A/c Dr. To Purchase Return A/c
4.		Sales Returns (Goods returned by customers)
	a.	When goods sold on credit are returned Sales Returns A/c Dr. To Customers A/c
	b.	When goods sold in cash are returned Sales Returns A/c Dr. To Cash A/c
5.		When payment is received from debtor (customer) Cash /Bank A/c Dr. To Debtors/Customers A/c
6.		If discount is given to debtor/customer

		Cash /Bank A/c Dr. Discount Allowed A/c Dr. To Debtors/Customers A/c
7.		If bad debts are written off Bad debts A/c Dr. To Debtors/Customers A/c
8.		When payment is made to the creditor/supplier Creditor's/Suppliers A/c Dr. To Cash/Bank A/c
9.		If discount is received from Suppliers/Creditors Creditor's/ Suppliers A/c Dr. To Cash/Bank A/c To Discount Received A/c
10.		When tangible Asset is purchased Asset A/c Dr. To Cash/Bank A/c
11.		Recording depreciation on asset Depreciation A/c Dr. To Asset A/c (Depreciation is the reduction in value of a tangible fixed asset .)
12.		Purchase of intangible asset Intangible Asset A/c Dr. To Cash/Bank A/c
13.		Recording amortization of intangible asset Amortization A/c Dr. To Intangible Asset A/c (Amortization refers to spreading the cost of intangible assets over time.)
14.		Owner invests cash, assets or liabilities into the business Cash A/c Dr. Assets A/c Dr. To Liabilities A/c To Capital A/c
15.		Owner withdraws assets for personal use Drawings A/c Dr. To Assets A/c
16.		Bank account opened and cash deposited Bank A/c Dr. To Cash A/c

17.		Cash withdrawn from bank Cash A/c Dr. To Bank A/c
18.		Expenses paid Expenses A/c Dr. To Cash/ Bank A/c
19.		Outstanding expenses Expenses A/c Dr. To Outstanding expenses A/c
20.		Incomes are received Cash/ Bank A/c Dr. To Income A/c
21.		Outstanding income Outstanding income Dr. To Income A/c
22.		Goods are given as donation/charity Charity A/c Dr. To Purchase A/c
23.		Goods distributed as free sample Advertisement expenses A/c Dr. To Purchase A/c
24.		Goods withdrawn for personal use Drawings A/c Dr. To Purchase A/c
25.		Goods stolen Loss by theft A/c Dr. To Purchase A/c
26.	a.	Goods destroyed by fire Uninsured goods Loss by fire A/c Dr. To Purchase A/c
	b.	Insured goods Insurance claim A/c Dr. Loss by fire A/c Dr. To Purchase A/c
	c.	Damaged goods sold as scrap Insurance claim A/c Dr. Cash A/c Dr. Loss by fire A/c Dr. To Purchase A/c

Unit-III Final Accounts

Final Accounts of Sole Trader (Numeric), Final accounts of Company as per Company Act 2013(Only Format)

Final Accounts of Sole Trader

Final Accounts of Sole trader covers the Preparation of Trading account, Profit and loss account and Balance sheet.

Trading Account

1. Trading Account is one of the financial statements prepared by the trading firms at the end of the year. These are prepared to find out the gross profit or gross loss accruing to the firm. This account records all the amounts related to the goods purchased and sold. It helps in providing all the material facts regarding the stock sold or remain unsold.
2. It is a Nominal Account. It records all the expenses on purchases on the debit side and income in the nature of the sales on credit side. The rule applies to this account is:
**“DEBIT ALL EXPENSES AND LOSSES
CREDIT ALL INCOMES AND GAINS”**
3. This Account shows the result of Gross Profit or Gross Loss by comparing the both sides Debit and Credit. Increase of debit over credit results in Gross Loss and increase of credit over debit results in Gross Profit.

Debit < Credit = Gross Profit

Debit > Credit = Gross Loss

FORMAT OF TRADING ACCOUNT

Dr.			Cr.		
Particulars	Amount	Amount	Particulars	Amount	Amount
To Opening Stock			By Sales (-) Sales Return		
To Purchases (-) Purchase return			By Goods burnt by fire		
To expenses relating to purchases			By Goods stolen		
To Wages			By Goods given as charity		
To carriage Inwards			By Goods distributed as free samples		
To railway Freight			By Goods withdrawn for personal use		
To Excise Duty			By Closing Stock		
To Octroi			By Gross Loss (transferred to P&L A/c)		
To Custom Duty					

To Unloading Charges					
To Demurrage					
To Clearing Charges					
To Dock/ Port Charges					
To Wharfage					
To Gross Profit (transferred to P&L A/c)					
Total			Total		

PROFIT AND LOSS ACCOUNT

1. Profit and Loss Account is an account prepared by the trading organizations to know about the net profit or net loss of the firm. This account records all the incomes on credit side and expenses on debit side of a particular year. This account is prepared at the end of the year.
2. This account is prepared after the preparation of Trading Account and starts with the balance i.e., Gross Profit or Gross Loss of Trading Account.
3. It is a nominal account. All the expenses are recorded on the debit side and all the incomes are recorded on the credit side. The rule applies to this account is:
**“DEBIT ALL EXPENSES AND LOSSES
CREDIT ALL INCOMES AND GAINS”**
4. This account is prepared on the accrual basis. It means all the items relating to the current year are recorded in this account. This leads to adjustments of the accrued income, income received in advance, outstanding expenses, prepaid expenses. No item related to past or next year is recorded in this account.
5. It shows the result of Net Profit or Net Loss by comparing the both sides Debit and Credit. Increase of debit over credit results in Net Loss and increase of credit over debit results in Net Profit.
Debit < Credit = Net Profit
Debit > Credit = Net Loss

FORMAT OF PROFIT AND LOSS ACCOUNT

Dr.			Cr.		
Particulars	Amount	Amount	Particulars	Amount	Amount
To Gross loss (transferred from trading account)			By Gross profit (transferred from trading account)		
To Administrative expenses: Salary P.F. contribution Rent & taxes Electricity Postage & Telegram			By Indirect incomes: Interest, dividend, rent, discount, commission, brokerage, apprentice premium received Sale of old newspaper Bad debts recovered		

Printing & Stationary Insurance premium Audit fees Legal expenses			Interest on drawings Profit on sale of assets		
To Selling Expenses: Advertisement Discount allowed Salesmen's salary & commission Showroom expenses Travelling expenses Bad debts			By Net loss transferred to Capital A/c		
To Distribution Expenses: Carriage outward Packing expenses Delivery Van expenses Warehouse expenses					
To Financial Expenses: Interest on capital, bank overdraft, loan Bank charges					
To MISC. expenses & losses: Depreciation on assets Loss by theft & fire Charity Loss on sale of assets					
To Net Profit transferred to Capital A/c					
Total			Total		

Vertical Balance Sheet

The accounting equation should always be remembered as the cornerstone of the accounting system:

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

Assets

Assets are divided into two categories:

1) Fixed or Non-Current Assets

Fixed assets are those assets used by the business that are of long a long life period. In addition, these assets are never bought with the intention of resale.

For example: buildings, machinery, motor vehicles, fixtures and fittings are considered to be fixed assets.

Fixed assets are listed starting with those the business will keep the longest, down to those that will not be kept for so long.

For instance: Fixed Assets 1- Land and Buildings 2- Fixtures and Fittings 3- Machinery 4- Motor Vehicles

2) Current Assets

Current assets are cash in hand, cash at bank. Stock and debtors.

They are listed separately because they are seen as the working part of the firm.

Current assets are listed starting with the asset furthest away from being turned into cash, finishing with cash itself.

The easier it is for a firm to change the asset into cash the more Liquid it is said to be.

For instance: Current Assets 1- Stock 2- Debtors 3- Cash at bank 4- Cash in hand

Capital and Liabilities

Liabilities are divided into three categories:

1) Capital

Capital denotes owner's investment into the business. Any profit incurred for the year belongs to the owner and therefore added to the Capital. Similarly, any amount/goods withdrawn by the owner is treated as drawings and deducted from the capital.

2) Non-Current Liabilities or Long-term liabilities

They are also referred to as long term liability and are those debts that take more than a year to redeem (pay back). This includes large loans – secured (collateral attached) or unsecured. For instance, loans which do not have to be repaid in the near future (having duration over one year).

3) Current Liabilities:

Items to be paid within the financial year (12 months). This includes:

Creditors, Bills Payable, Bank Overdraft, Other small loans, etc.

FORMAT OF BALANCE SHEET

Particulars	Amount	Amount
<u>A. Capital and Liabilities</u>		
Capital		
Add: Net profit		
Add: Increase in capital		
Add: Interest on capital		
Less: Net loss		
Less: Drawings		
Less: Increase in drawings		
Less: Interest on drawings		
<u>Long term liabilities:</u>		
Bank loan		
Other loan		

<u>Current liabilities:</u> Bank overdraft Sundry creditors Bills payable Pre-received income Outstanding expenses		
Total		
<u>B. Assets</u>		
<u>Intangible assets:</u> Goodwill Patents Trademark Copyrights, etc.		
<u>Tangible assets:</u> Land and building Plant and machinery Furniture, fixtures and fittings Leasehold properties Vehicles		
<u>Investments</u>		
<u>Current assets:</u> Sundry debtors Bills receivable Closing stock Stock of stationary Cash in hand Cash at bank Loans and advances given Prepaid expenses Outstanding income Deferred revenue expenses		
Total		

Effects of the Adjustments:

Adjustment	First effect	Second effect
Closing Stock	Trading Account: Show on the credit side	Balance Sheet: Show on the assets side
Outstanding Expenses	Trading Account & Profit & Loss Account (debit side): add to respective direct & indirect expense	Balance Sheet: Show on the liability side

Prepaid Expenses or Unexpired Expenses	Trading Account & Profit & Loss Account (debit side): deduct from respective direct & indirect expense	Balance Sheet: Show on the assets side
Accrued Income or Outstanding Income	Profit & Loss Account: Show on the credit side (Add to respective income)	Balance Sheet: Show on the assets side
Income Received in Advance or pre-received income	Profit & Loss Account: Show on the credit side (Subtract from the respective income)	Balance Sheet: Show on the liability side
Depreciation/amortisation on assets	Profit & Loss Account: Show on the debit side	Balance Sheet: Show on the asset side (subtract depreciation from the fixed asset)
Bad Debts	Profit & Loss Account: Show on the debit side (add to bad debts already written off)	Balance Sheet: Show on the asset side (subtract from sundry debtors)
Provision for Doubtful Debts	Profit & Loss Account: Show on the debit side	Balance Sheet: Show on the asset side (subtract from sundry debtors)
Provision for Discount on Debtors	Profit & Loss Account: Show on the debit side (calculate on good debtors i.e. after adjusting bad debts & provision for doubtful debts)	Balance Sheet: Show on the asset side (subtract from sundry debtors)
Note: The sequence of deducting above bad debts adjustment should be- i. bad debts written off, ii. Calculate on balance provision for bad debts and deduct it, iii. Calculate on balance provision for discount on debtors and deduct it.		
Provision for Discount on Creditors	Profit & Loss Account: Show on the credit side	Balance Sheet: Show on the liability side (subtract from sundry creditors)
Interest on capital	Profit & Loss Account: Show on the debit side	Balance Sheet: Show on the liability side (Add to owner's capital)
Interest on drawings	Profit & Loss Account: Show the credit side	Balance Sheet: Show on the liability side (deduct from owner's capital)
Unrecorded credit purchases	Trading account: Show on the debit side (deduct from purchases)	Balance Sheet: Show on the liability side (add in creditors)
Unrecorded credit sales	Trading account: Show on the credit side (deduct from sales)	Balance Sheet: Show on the assets side (add in debtors)

Assets sold and recorded in sales account	Trading account: Show on the credit side (deduct from sales) (sales value) Profit and loss account: If profit on sales- credit side (profit value) If loss on sale-debit side (loss value)	Balance Sheet: Show on the assets side (deduct from the asset) (book value)
Assets purchased and recorded in purchases account	Trading account: show in the debit side (deduct from purchases)	Balance sheet: show in the assets side (add in the asset)
Goods withdrawn for personal use	Trading account: show on the credit side as 'By Goods withdrawn for personal use A/c'	Balance Sheet: show on the liability side (deduct from capital)
Goods lost by theft	Trading account: show on the credit side as 'By Goods lost by theft A/c'	Profit and Loss Account: show on the debit side as 'To loss by theft A/c'
Goods distributed as free sample	Trading account: show on the credit side as 'By Goods given as free sample A/c'	Profit and Loss Account: show on the debit side as 'To Advertisement A/c'
Goods given for charity	Trading account: show on the credit side as 'By Goods given as charity A/c'	Profit and Loss Account: show on the debit side as 'To Charity/ donation A/c'
Goods lost due to fire (uninsured)	Trading account: show on the credit side as 'By Goods lost by fire A/c'	Profit and Loss Account: show on the debit side as 'To loss by fire A/c'
Goods lost by fire (insured)	Trading account: show on the credit side as 'By Goods lost by fire A/c'	Profit and Loss Account: show on the debit side as 'To loss by fire A/c' (loss amount) Balance Sheet: show on the Asset side 'Insurance Claim Receivable'
Stock of stationery	Profit and Loss Account: show on the debit side (deduct from the stationery)	Balance Sheet: show in the assets side
Expenses made on purchases of an Assets wrongly debited to expenses account	Trading Account/ Profit and Loss Account: show on the debit side (deduct from the expenses)	Balance Sheet: show on the Assets side (add to the respective asset)
Commission payable to the Manager on the profit	Profit and Loss Account: show on the debit side	Balance Sheet: show on the Liability side
Calculation of commission payable to manager on profit. Commission on profit before charging such commission $commission = net\ profit * rate\ of\ commission$ Commission on profit after charging such commission		

$$\text{commission} = \text{net profit} * \frac{\text{rate of commission}}{\text{rate of commission} + 100}$$

Final Accounts of a Limited Company

Schedule III of Companies Act, 2013 describes the format of financial statements of a limited company. According to section 2(40) the Companies Act, 2013, the company have two financial statements:

- i. Income Statement: showing profitability of the company
 - ii. Balance Sheet: showing true and fair financial position of the business.
- According to amendment made in 2013, the company has to follow vertical format of financial statements. The format is also provided by the Act.

Format of Financial Statements **Schedule III of Companies Act 2013** **Part I form of Balance Sheet**

Name of the Company.....

Balance Sheet as at.....

(Rupees in)

Particulars	Note no.	Amount	Amount
[A] Equity and Liabilities:			
[1] Shareholders Fund:			
a. share Capital	1		
b. Reserves and Surplus	2		
c. Money received against share warrants			
[2] Share Application Money Pending Allotment			
[3] Non-current Liabilities:			
a. Long Term Borrowing	3		
b. Deferred Tax Liabilities (Net)			
c. Other Long-Term Liabilities	4		
d. Long Term Provisions	5		
[4] Current Liabilities:			
a. Short Term Borrowings	6		
b. Trade Payables	7		
c. Other Current Liabilities	8		
d. Short Term Provisions	9		
TOTAL			

[B] Assets:			
[1] Non-current Assets:			
a. Fixed Assets:			
i. Tangible Assets	10		
ii. Intangible Assets	11		
iii. Capital Work in Progress			
iv. Intangible Assets under Development			
b. Non-current Investments	12		
c. Deferred Tax Assets (Net)			
d. Long Term Loans and Advances	13		
e. Other Non-current Assets	14		
[2] Current Assets:			
a. Current Investments	15		
b. Inventories	16		
c. Trade receivables	17		
d. Cash and Cash Equivalents	18		
e. Short Term Loans and Advances	19		
f. Other Current Assets	20		
TOTAL			
Contingent Liabilities	21		

Part II Form of Income Statement

Name of the Company.....

Balance Sheet as at.....

(Rupees in)

Particulars	Note no.	Amount	Amount
[A] Income:			
Revenue from operation	22		
(add) Other Income	23		
Total Revenue			
[B] Expenses:			
a. Cost of Material Consumed	24		
b. Change in Inventories	25		
c. Employee Benefit Expenses	26		
d. Finance Cost	27		
e. Depreciation and Amortization	28		
f. Other Expenses	29		
Total Expenses			
Profit or loss before exceptional, extraordinary items and tax			
Add/Less: Exceptional Items	30		

Profit or loss before extraordinary items and tax			
Add/Less Extraordinary Items	31		
Profit before Tax			
Less Tax Expenses (Current and Deffered)			
Net Profit to be transferred to Reserves and Surplus			

Unit-IV Elements of Cost Accounting

Conceptual Meaning of Cost Accounting (CA), Advantages and Limitations of CA, Concepts of Costs, Methods of Costing, Preparation of Cost Sheet (Numeric), Stock Register (First In First Out Method, Last In First Out Method, Weighted Average Method) (Numeric).

Introduction:

Today business is a dynamic organism. Every businessman has to face tough competitions, uncertainty & risk prevailing in the trade. The accounting information received from Profit & Loss A/c & Balance Sheet is mainly concerned with external reporting which is used by owners, shareholders, bankers, agencies, government etc. But the management needs more & more information which the financial accounting fails to give.

Hence cost accounting has developed out of the limitations of financial accounting. Cost accounting tells management about cost of production per unit of each product manufactured. By use of cost accounting, management would be able to take corrective actions and achieve economy.

Definition:

1. The Institute of Cost & Works Accountants, India:

"Cost accounting is the technique and process of ascertainment of costs. Cost accounting is the process of accounting for costs, which begins with recording of expenses on the basis on which they are calculated and ends with preparation of statistical data."

2. The Institute of Cost & Works Accountants, U.K.:

"Cost accounting is the application of costing and cost accounting principles, methods & techniques to the science, art and practice of cost control and ascertainment of profitability. It includes the presentation of information derived therefrom for the purpose of managerial decision making."

Advantages of Cost Accounting

1. To the Management:

a) Guide in Reducing Prices:

During the depression or slump, it becomes necessary to reduce the price even below the total cost. Hence, cost accounting helps management in this direction.

b) Measuring Efficiency:

With the use of comparisons & analysis of the differences, cost accounting will enable a concern to measure the efficiency & then to maintain & improve it.

c) Action against Unprofitable Activities:

It reveals unprofitable activities, inefficiencies which enable management to concentrate on profitable jobs & consider change or closure of unprofitable jobs.

d) Facilitates Decision Making:

It provides necessary data along with information to the management to take decisions on any matter relating to the business.

e) Assist in Fixing Price:

The various types of cost accounting are much helpful in fixing the cost & selling price of the product.

f) Improves Efficiency:

Through the standard cost & budgetary control, remedial action can be chosen in order to improve the efficiency & implement new principles.

g) Facilitates Cost Control:

It facilitates cost control possible by product-wise or firm-wise comparison by using techniques like standard costing & budgetary control.

h) Inventory Control:

An effective system & check are provided on all materials & stores, which help in proper handling, issuing, storing & controlling inventory.

i) Prevents Fraud:

An effective costing system prevents fraud & manipulation, & supplies reliable cost data to the management.

j) Measuring Tools:

It records the performance of different groups of workers, plant & machinery etc. which helps in measuring their comparative efficiency.

2. To the Employees:

a) Sound Wage Policy:

Cost accounting introduces wage schemes, bonus plans, etc. which brings better rewards to sincere & efficient workers.

b) Higher Bonus Plans:

It leads to an increase in productivity, lowering of costs & increase in profitability. Workers share in profits in the form of bonus. Hence, higher profit leads to higher bonus plans.

c) Distinction between Efficient & Inefficient Workers:

It provides standards for measuring efficiency of workers. Hence, efficiency of workers is recognised, rewarded, even such workers can be promoted to higher level of management.

3. To the Public:

- a) It removes wastages & inefficiencies & hence goods are available at better quality & cheaper rates.
- b) Development & prosperity of industries will create employment opportunities.
- c) It helps in curbing inflationary trends in economy.

4. To the Government:

The proper cost accounting systems are of great use in the preparation of national plans, economic development, etc.

Limitations of Cost Accounting:

a) Expensive:

In the initial stage, introduction of cost accounting involves considerable amount of expenditure, like maintaining a double set of accounts books.

b) Unnecessary:

It is argued that development of cost accounting is recent. Many companies have grown & are prospering further without implementing cost accounting. Hence, it is considered as unnecessary.

c) Heavy Paper Work:

Reporting of the costing information to the management involves use of number of forms, filing of such forms is a monotonous work which leads to unnecessary paper work.

d) Failure of Costing System:

In many cases, it is claimed that costing fails to achieve good or desired results. In such cases, costing is considered faulty.

e) Not Applicable to Many Industries:

Modern methods & techniques of cost accounting cannot be applied to certain types of industries.

f) Not Reliable:

Cost accounting is based on standards & estimates. If the costing system fails to achieve its desired target, or if estimates are wrongly framed, in such cases, it is not reliable.

g) Complicated:

A costing system is complicated. An average employee does not understand the cost accounts & hence the system may prove to be unprofitable.

h) Not Useful to Monopolist:

Monopolist is the single seller of the product & he is free to decide the price of the product. Hence, he does not need cost accounting system.

Classification of Cost

Basis of Classification	Types of Costs
Nature of Expenses/ Element wise classification	Material, Labour, Expenses
Relation to Cost Object	Direct (material, labour and expenses) Indirect Cost/Overheads (factory, administration, selling and distribution)
Functions	Factory, Administration, Finance, Selling, Distribution, Research & Development
Behaviour	Fixed Cost, Variable Cost, Semi-Variable Cost
Purpose of Decision Making	Opportunity Cost, Marginal Cost, Relevant Cost, Differential cost, Sunk cost
Production Process	Batch Cost, Process Cost, Operation Cost, Joint Cost, Prime Cost,
Time Period	Historical, Predetermined, Standard, Estimated Cost
Controllability	Controllable Cost, Uncontrollable Cost
Normality	Normal Cost, Abnormal Cost

Cost Concepts

1. Cost:

When the value of resources used in producing goods or services is expressed in monetary terms, it is called “cost.” The ICMA has defined cost as, “The amount of expenditure (actual or notional) incurred on or attributable to a specified thing or activity.” In general terms, it is defined by some adjective, purpose, or different circumstances in which it is incurred.

2. Cost Unit:

A cost unit is a unit of product, service, or time in relation to which cost may be ascertained. The unit of measurement must be clearly defined and selected before the process of cost finding can be started. The cost ascertainment necessitates the determination of a unit in terms of which costs can be ascertained or expressed.

The cost units are of two types:

- **Simple Unit:** i.e. single unit
- **Compound Unit or Composite Unit**

The unit adopted must be practicable and realistic; i.e. the unit of production should neither be too small nor too large. The cost of unit should be one adaptable to the industry readily understood and accepted by all persons concerned.

Example:

- **Simple unit:** Fruit – per pen, pencil – per dozen, ice cream – per kilogram, water – per litre
- **Compound unit:** Hospital – per patient per bed, Transport – per passenger per kilometre, Electricity – per kilowatt per hour

3. Cost Centre

A cost centre is a location, person, item of equipment, or group of these for which cost may be ascertained and used for the purpose of cost control. The cost centre may be a department, a machine, person i.e., employees or labour on a particular work. Each cost centre is given charge under personnel for controlling the cost, accumulation of cost & its allocation.

Cost centres are subdivided into the following categories:

- a) **Personal Cost Centre:** Consist of a person or group of persons
- b) **Impersonal Cost Centre:** Consist of locations or items of equipment
- c) **Operational Cost Centre:** Consists of machines or persons carrying operations
- d) **Process Cost Centre:** Consists of specific process or continuous sequence of operations

4. Expenses

Expenses are costs which are applied against revenue of a particular accounting period. They are matched against the revenue of the period to which they are related.

Example: Salary or rent paid or payable

5. Loss

The sacrifice against which there is no corresponding return. Loss is the cost less. Here cost is a sacrifice made to get some other value. In accounting language, if the cost or expenses exceed the income of a particular period, it is called **loss**.

6. Cost Driver

A cost driver is any factor that affects cost. If there is any change in cost driver, the total cost is also changed. **Similarly:** The number of customers, the number of advertisements, the number of salesmen is all **cost drivers**.

7. Conversion Cost

Conversion cost is the total of all cost incurred on labour, expenses & factory overhead for converting raw material into finished goods. Conversion cost can be calculated by deducting **cost of raw material** purchased from the **factory cost**. Conversion cost does not include cost of raw material as it is purchased from outside.

8. Contribution

The excess of **selling price over variable or marginal cost** is called **contribution**. Contribution is the amount contributed towards profit.

For eg:

Selling Price of a unit = ₹100

Variable Cost = ₹60

Contribution = S.P. – V.C. = 100 – 60 = ₹40

METHODS OF COSTING

1. Unit Costing:

It is also known as **Output Costing** or **Single Costing**.

This method is used in the manufacturing unit where production is continuous, units are identical, and products are measured in definite units.

It is a system of costing in which the cost per unit of output is determined, showing each element of cost which constitutes the total cost.

Here, a cost sheet is prepared for a definite period showing various elements of cost and the total cost, which is divided by the number of units produced.

It gives **cost per unit**.

This method is used in brick making industries, paper mills, cement factories, etc.

2. Job Costing:

A job is a special work undertaken as per the order of a customer and for that purpose.

The method of **Job Costing** is used in the industries where the work is not of repetitive nature but undertaken on receiving orders from customers.

This method is used to ascertain **cost of job** or specific order. A distinct job number is given to each job and all expenses incurred on the job are debited to that particular job account.

This method is used in **printing press, garages**, etc.

3. Contract Costing:

Contract costing is used for big jobs like construction of buildings, roads, bridges, etc.

This method is used to find out the cost of such constructions.

In this method of costing, a contract account for each contract is separately opened & all the expenses are debited while contract price is credited.

If contract is expected to last for a long time, then the full contract price is not credited to

contract account, but the value of work done is credited and profit ascertained is transferred partially to P&L A/c & rest is reserved for future contingencies.

4. Batch Costing:

When unit of cost is batch, i.e., group of units produced, and method of costing used to ascertain the total cost of such batches is known as **Batch Costing**. Here, orders are arranged in batches convenient for production. Here, cost of each batch is ascertained separately. This method is used in **pharmaceuticals, medicines, food products**, etc.

5. Process Costing:

When production can be divided into distinct processes, the cost of production is ascertained at each stage. Such method of costing is known as **Process Costing**.

In this method, separate **Process A/c** are opened for each process & all expenses, wastage & losses are charged to that respective process. Output of one process becomes input of next process.

This method is usually used in **sugar industry, textile industry, oil refineries**, etc.

6. Operation Costing:

This method is used in manufacturing of **mechanical products**. Such products pass through distinct operations during production. Here, cost is ascertained operation-wise. The total cost of different operations determines cost of that product.

7. Operating Costing:

Where the firm is rendering service instead of manufacturing product, **Operating Costing** is used. In this method, cost per unit is ascertained for the services rendered.

Generally, composite cost unit is used in this method.

For example, in electricity companies, transport undertakings, hospitals, etc.

8. Multiple / Composite Costing:

It is actually a combination of various costing methods used in the same business unit.

In industries where the final product consists of assembly of a number of spare parts, multiple costing is used.

For example, in manufacture of motor car, cycles, typewriters, etc.

Techniques of Costing

1. Uniform Costing:

Where several undertakings of the same industry follow the same costing principles & practices, they are said to employ **uniform costing**.

This technique is useful for inter-firm comparison & for making representations before government, etc.

2. **Historical Costing:**

Where costs are ascertained after they are already incurred, the method used is termed as **Historical Costing**.

For example, cost of production of January month is calculated in month of February.

3. **Standard Costing:**

The preparation & use of standard costs, their comparison with actual costs & the analysis of variance to their causes and point of incidence is known as **Standard Costing**.

Standard Costing is a technique which is used for cost control.

In this technique, the cost of each element is predetermined on the basis of previous data.

Then actual costs are compared with these standard costs.

During comparison, if certain differences are found, then reasons for such variances are found and corrective actions are taken by management to prevent such variance.

This is the full process of **Standard Costing**.

For example: In a company, standard is set for its various elements per unit:

- Cost as: Material – ₹25
- Wages – ₹10
- Other expenses – ₹3.22

The following statement will be prepared:

Particular	Actual Cost	Standard Cost	Variance
Material	26	25	1
Wages	40	35	5
Other Expenses	22	20	2
Total	88	80	8

This statement shows that the actual cost is ₹88, which is more than standard cost, i.e., ₹80.

The reason is **increase in material cost by ₹1, wages ₹5 and other expenses ₹2**.

Hence the reason analysis is made to find the **causes of difference** and corrective steps are suggested.

It is one of the most important techniques used for control.

4. Marginal Costing:

The ascertainment by differentiating between fixed costs & variable costs and the effect on profit of changes in volume or type of output is known as **Marginal Costing**.

This is the technique which is concerned with cost determination in terms of variable cost like **Direct Material, Direct Labour, Direct Expenses and other variable overheads**, etc.

Here, fixed costs are not considered as they are not related with & do not change with production.

This technique is used by the management for appropriate decision-making.

Here:

Marginal Cost = Prime Cost + Total Variable Overhead

OR

Marginal Cost = Total Cost – Fixed Cost

For Example:

At 8000 units, variable costs are ₹40,000 & fixed cost is ₹10,000.

Variable cost per unit is ₹5.

Then total cost will be:

Total Cost = V.C. + F.C.

= 40,000 + 10,000

= ₹50,000

If **1 additional unit** is manufactured, following will be the change:

- Variable cost = $(8001 \times ₹5) = ₹40,005$
- (+) Fixed cost = ₹10,000
- **Total cost = ₹50,005**

Hence **Marginal cost for one unit** in this example is ₹5.

UNIT COSTING

Unit costing is also known as **output costing** or **single costing**. It means the ascertainment of the cost of producing a unit of output. This method of costing is also adopted in the following circumstances:

1. Industries carry out manufacturing of a product.
2. Manufacturing is a continuous process.
3. A single product or more products of similar type are manufactured.
4. All units of the product are similar and identical.
5. The product can be measured in definite units.

This method of costing is advantageously applied to **sugar mills, paper mills, brick fields, cement factories, shipyards**, etc. The main object of this method is to ascertain the **cost per**

unit of output and to determine the amount of each element which makes up such cost. The **total cost per unit** is calculated by dividing total cost with number of units.

If only one product is manufactured, **detailed analysis of expenditure** is not necessary. But if there are different sizes or grades in the same product, then a detailed analysis of expenditure is necessary.

COST SHEET

A statement is prepared to calculate the total cost of the product manufactured. It is called **Statement of Cost** or **Cost Sheet**. The financial accounting provides the information for finding out cost of production. While preparing cost sheet, the various costs are classified element-wise, i.e., into:

1. **Direct Material**
2. **Direct Labour**
3. **Direct Expenses**
4. **Indirect Elements:**
 - (i) Factory Overhead
 - (ii) Administrative Overhead
 - (iii) Selling and Distribution Overhead

A **cost sheet is prepared periodically**, i.e., weekly, monthly or at other convenient intervals. For preparing periodic cost sheet, each element of expenditure is divided by number of units produced during that period to disclose **cost per unit**. Moreover, cost sheet should provide **figures of the previous period for comparison purposes**.

Work In Progress

In manufacturing units where production is continuous, at the end of a particular period, some units are incomplete as some process is yet to be done on it. Hence, partly finished units or incomplete units at the end of a particular period is known as **Work in Progress**. It is also known as **Unfinished Goods** or **Works in Process**.

The valuation of work in progress is very important and difficult, as various units are at different stages of production. If the units are in the initial stage of production, only raw material cost is considered. If work in progress is valued on the basis of **Prime Cost**, and units are near completion, along with raw material cost, **wages and share of factory overheads** are taken into account while valuing work in progress under works cost.

The **opening stock of work in progress** is added to **Prime Cost of Works Cost**, and **closing stock** of it is deducted from the same.

Finished Goods Stock

All the units manufactured during a particular period are not fully sold out, so the unsold units of the product are known as **stock of finished goods**. It is adjusted before computing **Cost of Goods Sold**. The **opening stock of finished goods** is added to **Cost of Production**, and the **closing stock** is excluded from **Cost of Production**.

Procedure of Computing Cost

1. **Raw Material Consumed**
= (Opening stock + Purchases + Expenses incurred on purchases – Closing stock)
2. **Direct Labour / Wages**
3. **Direct Expenses**
4. **Indirect Expenses**
(classified into Factory Overhead, Administration Overhead, Selling & Distribution Overhead)
5. **Total Cost of Production**
6. **Profit or Loss**
(by charging sales value)

FORMAT

COST SHEET

for the period ended

(number of units produced:.....)

Particulars	Cost per unit	Total amount	Total amount
Material Consumed			
Opening Stock of Raw Material		xxx	
(add) Purchases of Raw Material		xxx	
(add) Expenses of Raw Material		xxx	
(less) Purchase Return of Raw Material		xxx	
(less) Closing Stock of Raw Material		xxx	
		xxx	
A. COST OF MATERIAL CONSUMED			xxx
(add) Direct Labour			xxx
(add) Direct Expenses			xxx
B. PRIME COST			xxx
(add) Factory Overheads:			
1. Indirect Material & Consumable Stores (Coal, grease, cotton waste, etc.)		xxx	

2. Indirect / Unproductive Wages (Salary to gatekeeper, foreman, works manager, etc.)		xxx	
3. Power & Fuel (<i>coal, oil, gas, water, electricity, etc.</i>)		xxx	
4. Repairs & Renewals of Plant & Machinery		xxx	
5. Depreciation of Plant & Machinery			
6. Factory Expenses (<i>rent, rates, insurance, lighting & heating, etc.</i>)		xxx	xxx
			xxx
(add) Opening Stock of work in progress			xxx
			xxx
(less) Closing Stock of work in progress			xxx
C. WORKS COST			xxx
(add) Administration Overheads:			
1. Office Expenses (<i>rent, rates, heating, lighting, electricity, etc.</i>)		xxx	
2. Salary to Clerical & Administrative Staff		xxx	
3. Printing & Stationery		xxx	
4. Postage & Telegram		xxx	
5. Depreciation of Office Building, Furniture, Equipment, etc.		xxx	xxx
D. COST OF PRODUCTION			xxx
(add) Opening Stock of Finished Goods			xxx
			xxx
(less) Closing Stock of Finished Goods			xxx
E. COST OF GOODS SOLD			xxx
(add) Selling & Distribution Overhead:			
1. Sales Office Salaries, Rent, Rates, Insurance, Lighting, Electricity, etc.		xxx	
2. Salaries to Salesman		xxx	
3. Travelling & Conveyance Charges		xxx	
4. Sales Commission		xxx	
5. Discount Allowed		xxx	
6. Advertisement Expenses		xxx	
7. Warehouse Rent, Rates, Insurance, Lighting, Electricity, etc.		xxx	
8. Packing Charges		xxx	
9. Carriage Outward		xxx	
10. Maintenance of Delivery Van		xxx	xxx
F. TOTAL COST			xxx
(add/less) Profit /Loss			xxx
G. TOTAL SALES			xxx

Items Excluded from Cost Accounts

Cost data is received from information derived from Financial Accounts. But certain items shown in Financial Accounts are **not considered** while preparing Cost Accounts. Such items are called **Non-Cost Items**. Following is the list of the non-cost items:

1. Appropriation of Profit

- a) Provision for Taxation
- b) Transfer to General Reserve & Other Reserves
- c) Dividend on Share Capital

2. Non-trading & Non-recurring Income & Expenditure

- a) Rent, Commission, Brokerage Receivable
- b) Profit / Loss on Sale of Investment or Fixed Assets
- c) Share Transfer Fees
- d) Fines & Penalties

3. Items of Purely Financial Nature:

- a) Interest on investment or bank deposits
- b) Interest on debentures or bank loan

4. Written Off of Intangible & Fictitious Assets:

- a) Goodwill, Patents, Trade Mark, Copyrights, etc. written off
- b) Preliminary Expenses, Discount on issue of shares or debentures, underwriting commission, Advertisement campaign, etc. written off.

STOCK / INVENTORY VALUATION

Materials or goods are purchased at specific amount; hence the question of its valuation does not arise. But where goods are purchased in different lots at different prices, hence the question arises regarding the issue rate of material & valuation of closing stock.

Different methods are available to solve this question. Various methods as per requirement and goods' nature can be used to find out issue price of material and valuation of stock.

Methods of Pricing:

1. Specific Cost Method:

When material purchased at different prices are stored separately, this method is applicable. Here, issues are made at the purchase price. This method is **useful for job order industries**.

2. Identifiable Cost Method:

This method is also used in job order industries. It is applicable only when different lots of materials purchased are separately stored & identification of material issued is possible. They are priced at actual price paid for it. This method is **not useful in large scale organizations**.

3. First In First Out Method (FIFO):

In this method, it is assumed that **materials that are purchased first are issued first**. Pricing of the issue are made on that assumption, i.e., till the first lot is been issued, purchase price of it will be its issue price, then the price of second lot and so on. It is one of the **easy & most popular methods** used for issue pricing.

Merits:

1. Materials are charged at actual cost.
2. Useful for **perishable products which are to be issued in proper order**.
3. The **value of inventory will be nearer the current market price**.

Demerits of FIFO Method:

1. This method involves complicated calculations and much clerical work.
2. This method is not useful in falling prices or jobs of similar nature started at different intervals.
(i.e., the costing of both the jobs are different though same nature materials are used at different jobs.)
3. Fluctuations in prices of material is not considered.

Despite the above demerits, this method is very popular and is recommended by the **International Accounting Standard Committee**.

4. Last In First Out Method (LIFO):

This method is the **reverse of FIFO method**.

In this method, it is assumed that the **material purchased last is issued first**. Hence, the **latest purchase price is the issue price** of first lot till it is used completely.

Merits:

1. **Cost of production reflects the current market price** as materials are issued at latest price.
2. It retains the principle of charging the material at **actual cost**.
3. It seems easy for storing the material as the material purchased last will be issued first (i.e., material stored above will be issued first).

Demerits:

1. It involves complicated calculations and increases clerical errors.
2. Inventory is valued at **old rates** which fails to reflect **correct value of closing stock**.
3. It is **not useful for perishable items**.

Weighted Average Method

In this method, it is assumed that the material loses its identity when it is purchased and stored in godown.

This method is used to overcome the effects of price fluctuation.

The average price is considered for calculating the issue price.

There are two types of averages:

a) Simple Average:

It is the average of price at which various lots of material is purchased.

Here only **price of purchases** are considered; the **quantity of purchase is not taken into account**.

Simple average is calculated by adding the purchase prices of different lots and dividing it by the number of prices so added.

This method is **suffering from certain limitations** like ignoring towards quantity purchased, and prices charged are not at actual cost.

So profit or loss may arise in Stores Ledger A/C.

b) Weighted Average:

This method is **more practical than the simple average method**.

It gives **weightage to quantity purchased** of material.

Here, average is calculated by dividing **total value of items available with total quantity**.

Hence, average is calculated fresh in every fresh supply or issue of material.

Merits:

1. Value of goods issued is reasonable as **quantity and total value is considered**.
2. This method **reduces the effect of frequent fluctuation of prices**.
3. This method is **approved by International Accounting Standard Committee**.

Demerit:

- In case of frequent purchases made, **this method involves large number of calculations**.

FORMAT OF STORES LEDGER

Date	Particulars	Receipts			Issues			Balances		
		Quantity	Rate	Amount	Quantity	Rate	Amount	Quantity	Rate	Amount

Importance of Inventory Valuation

Inventory valuation means computation of cost of inventory stock to determine the value of closing stock. Inventory usually consists of finished goods, raw material & works in progress, stores, spares, consumables. Inventory should be valued at cost or net realisable value, whichever is lower.

Importance of Inventory Valuation:

1. It helps in determination of cost of inventories on hand.
2. It helps in determination of net realisable value of inventories.
3. It helps in comparison between cost & net realisable value of inventory.
4. It helps in determination of issue price of inventory by use of different methods.
5. It helps in accuracy of income statement like Trading & P&L A/c as inventory on hand affects gross profit as it is recorded in Trading A/c.
6. It also helps in accuracy of financial statement like Balance Sheet as result of income statement & value of inventory on hand is recorded in B/S.
7. It determines the accurate value of inventory on hand and aids in decision during the period.
8. It helps in reduction of over stocking and under stocking of inventory.
9. Different methods of inventory valuation help to know the period from which the inventory is kept in store.
10. It helps to properly handle perishable inventory.