Financial and Cost Accounting

CB

CT-258

Lecture 13,14,15

Income Statement



- Income statement is generally a one page statement of a specific format, which summarizes the profitability of a business entity over a specific period of time.
- This specific period of time, covered by an income statement is called accounting period (which usually is a year).

Time period Principle

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Time period Principle: To provide the users of financial statement with timely information, net income is measured for relatively short accounting periods of equal length. This concept is called time period principle.

Income Statement

Paul's Guitar Shop, Inc. Income Statement For the Year Ended December 31, 2015				
Revenues				
Merchandise Sales	\$	24,800		
Music Lesson Income	_	3,000		
Total Revenues:			\$	27,800
Expenses				
Cost of Goods Sold		10,200		
Depreciation expense		2,000		
Wage expense		750		
Rent expense		500		
Interest expense		500		
Supplies expense		500		
Utilities expense		400		
Total Expenses:				14,850
Net Income			Ś	12,950

Revenue



- Revenue is the price of goods sold and/or services rendered during a given accounting period.
- Rarning revenue causes an increase in owner's equity.
- Revenue is the gross increase in owner's equity resulting from positive operations of the business.
- Revenue, fees revenue, rent revenue, ticket revenue etc.

Expense

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Expenses are the cost of goods and services used up in the process of earning revenue

Examples include Electricity expense, Utility expense, Fuel expense, Depreciation expense, Salaries expense, Insurance expense, advertising expense and Interest expense etc.

Net Income

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Net Income is measure of economic performance.

Net Income is an increase in owner's equity, resulting from profitable operations of the business.

Net loss in a decrease in owner's equity, resulting from the unprofitable operations of the business.

- Net income is determined by comparing, over a specific duration
 - 1. sales price of goods sold and/or services rendered by a business (Revenue)
 - 2. the cost to the business of the goods and/or services used up in business operations.(Expenses)

In simplest form

Net Income = Revenue - Expenses

Revenue Recognition Principle

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When to record revenue?

The Realization Principle also known as Revenue recognition Principle

The Revenue earned by selling Merchandise is recognized when the goods are sold. Revenue earned by rendering services to customers recognized in the period in which the services are rendered.

And when is the revenue considered to be earned when the goods are provided and/or when the services are rendered.

Matching Principle

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The Matching Principle (When to record an expense)

There is a significant relationship between revenue and expense.

Expenses are incurred for the purpose of producing revenue. To measure net income for a period, the revenue should be offset by all the expenses incurred in producing the revenue. This concept of offsetting expenses against revenue on the basis of 'cause and effect' is called the matching Principle.

Timing is an important factor in matching revenue with the related expenses. This month's expense against this month's revenue.

Accounting Equation

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Assets = Liabilities
Increase Decrease

Either or both of these effects occur when income is earned

Liabilities + Owner's Equity

Decrease Increase

Effect of earning net income

Debit and credit Rules



- □ Debit and Credit Rule for Owner's Equity
- Oecreases in Owner's Equity are recorded by debits

Debit and credit rules for Revenues and Expenses are a direct extension of the debit and credit rule for owner's equity

Debit and credit Rule for Revenue: Revenue increases owner's equity: therefore revenue is recorded by credit.

Debit and credit Rule for Expenses: Expenses decrease owner's equity: therefore expenses are recorded by debit

Debit and credit Rules



- ☐ Drawings or withdrawals by the owners reduce owner's equity and are recorded by debits
- □ Contra-equity account
 □ Contra-equity accou

Investments and withdrawals by owner



- Investment and withdrawals by the owner in an unincorporated business cause changes in the owner's equity but these are not considered revenue or expenses of the business.
- Investment of assets by the owner are recorded by debiting asset account and crediting the owner's capital account. This is not revenue because the business has not sold merchandise or rendered any services against the asset received.

Investments and withdrawals by owner



- Investment and withdrawals by the owner in an unincorporated business cause changes in the owner's equity but these are not considered revenue or expenses of the business.
- Withdrawals of assets by the owner are recorded by debiting asset account and crediting the owner's capital account. This is not revenue because the business has not sold merchandise or rendered any services against the asset received.
- Debits to the owner's drawing account results from transactions as
 - 1. withdrawals of cash.
 - 2. Withdrawals of assets.
 - 3. payment of owner's personal bills from the company's account.

Overnight's transaction in the month of July 2020

- **QUALTY SET UP:** ✓ **QUALTY SET UP:   QUALTY SET UP:** ✓ **QUALTY SET U**
- July 02: Purchase of radio advertising from FM101 to be aired in July, the cost was Rs4,700 payable within 30 days.an asset for cash.
- July 04: Purchased various shop supplies (such as nuts, bolts, grease and solvents used in a auto workshop) From NAPA Auto parts, cost amounting to Rs.14,000, due in 30 days. The supplies are expected to last for three to four months.
- July 15: Collected Rs.49,800 for repairs made to vehicles of Airport Shuttle Services
- July 23: Ahmed Ali, the owner withdrew Rs.31,000 cash from the company's bank account, for his personal use
- July 29: Ahmed Ali found that he did not need all the cash he has withdrawn on July 23rd, so he redeposited Rs.10,000 in Overnight's bank account
- July 30: Billed City Cab Co for Rs54,000, for maintenance and repair work done during July. The agreement with City Cab Co. calls for payment to be received Aug. 10, 2020.
- July 30: Paid employees wages for the month Rs.49,000

Recording Transactions in the General Ledger

03

☐ July 01 Paid daily news Rs3,600 cash for newspaper advertising to be run during July 2020.

Analysis: The cost of advertising is an expense

Asset Cash is reduced.

Debit and Credit rule: Expenses decrease owner's equity and are recorded by debits.

therefore debit Advertising Expense by Rs3,600

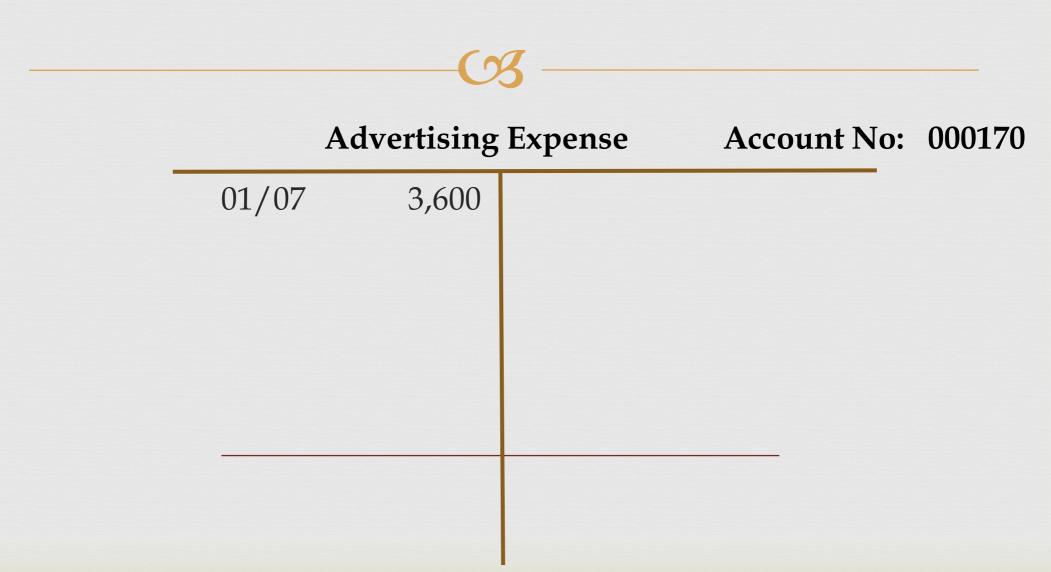
decrease in asset is recorded by credit

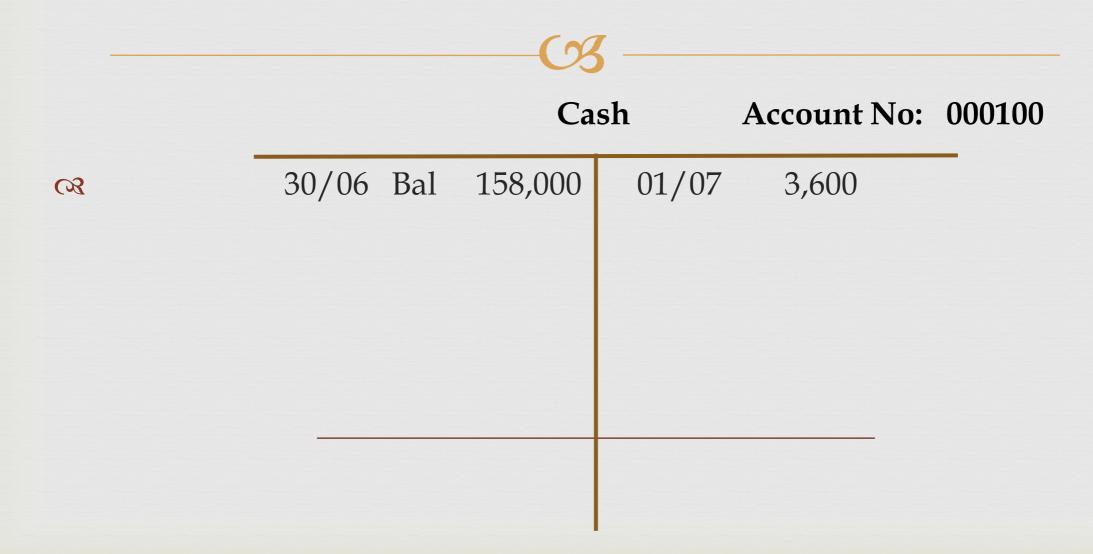
therefore credit Cash by Rs3,600

General Journal Entry:

01/07 Advertising Expense 3,600

Cash 3,600





Recording Transactions in the General Ledger

03

July 02: Purchase of radio advertising from FM101 to be aired in July, the cost was Rs4,700 payable within 30 days.an asset for cash.

Analysis: Cost of advertising is an expense

Liability Accounts Payable is incurred

Debit and Credit rule: Expense decreases owner's equity and is recorded by debits.

therefore debit advertising expense by Rs4,700

Increase in liability is recorded by credit

therefore credit accounts payable by Rs4,700

Accounts Payable 4,700



	Advertising	Expense	Account No	: 000170
01/07 03/07				

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	Accoun	ts Payab	le	Account No:	000132
CS.		30/06	Bal.	70,000	
CCS		30/06 03/07		4,700	

Recording Transactions in the General Ledger

03

July 04: Purchased various shop supplies (such as nuts, bolts, grease and solvents used in a auto workshop) From NAPA Auto parts, cost amounting to Rs.14,000, due in 30 days. The supplies are expected to last for three to four months.

Analysis: As these supplies are expected to last for several months, these are an asset not an

expense.

Liability Accounts Payable is incurred

Debit and Credit rule: Increase in asset is recorded by debit

therefore debit Shop Supplies by Rs14,000 Increase in liability is recorded by credit

therefore credit accounts payable by Rs14,000

Journal Entry: July 04 Shop Supplies 14,000

Accounts Payable 14,000



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Account	s Payabl	e	Account N	o:	000132
	30/06	Bal.	70,000		
	03/07		4,700		
	30/06 03/07 04/07		14,000		

Recording Transactions in the General Ledger

03

□ July 15: Collected Rs.49,800 for repairs made to vehicles of Airport Shuttle Services

Analysis: Asset Cash is increased

Revenue has been earned.

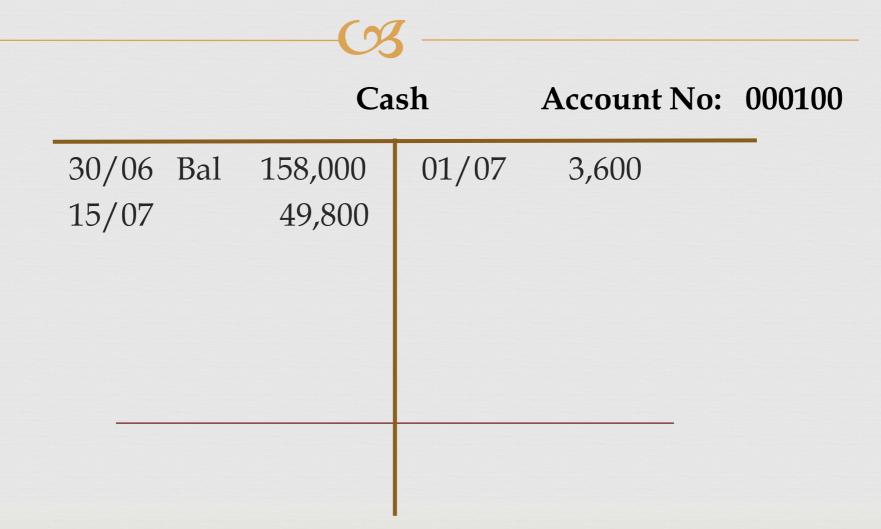
Debit and Credit rule: Increase in asset is recorded by debit

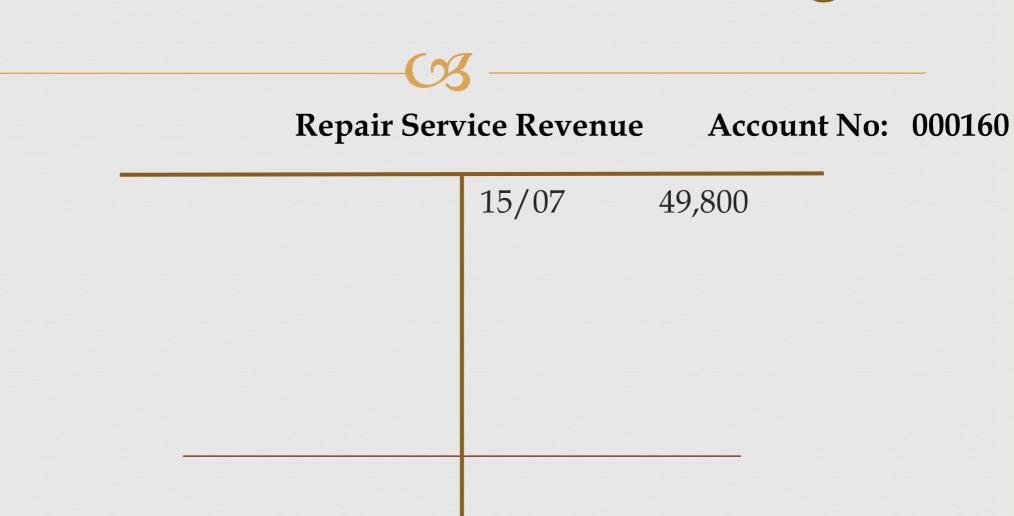
therefore debit Cash byRs49,800

Revenue increases Owner's Equity and Revenue is recorded by credit

therefore credit Repair Service Revenue by Rs49,800

Repair Service Revenue...... 49,800





Recording Transactions in the General Ledger

03

☐ July 23: Ahmed Ali, the owner withdrew Rs.31,000 cash from the company's bank account, for his personal use

Analysis: Withdrawals by the owner decreases owner's equity

Asset Cash is reduced

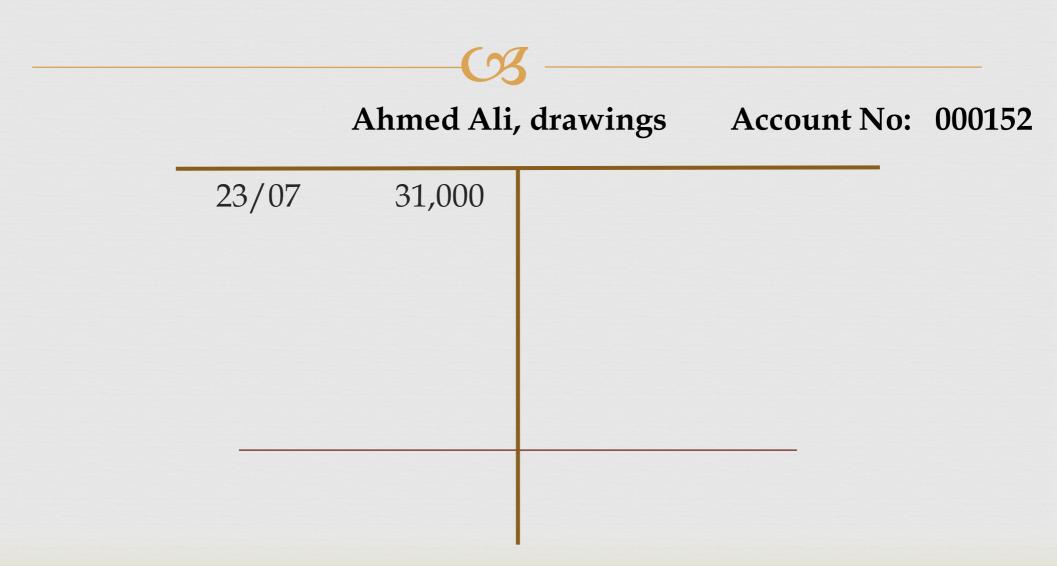
Debit and Credit rule: decrease in owner's equity is recorded by debit

therefore debit Ahmed Ali, drawings by Rs31,000

decrease in asset is recorded by credit

therefore credit Cash by Rs31,000

Journal Entry: July 23 Ahmed Ali, drawings...... 31,000





		Ca	sh	Account No:	000100
30/06 15/07	Bal	158,000 49,800	01/07 23/07	3,600 31,000	

Recording Transactions in the General Ledger

03

✓ July 29: Ahmed Ali found that he did not need all the cash he has withdrawn on July 23rd, so he redeposited Rs.10,000 in Overnight's bank account

Analysis: asset cash is increased.

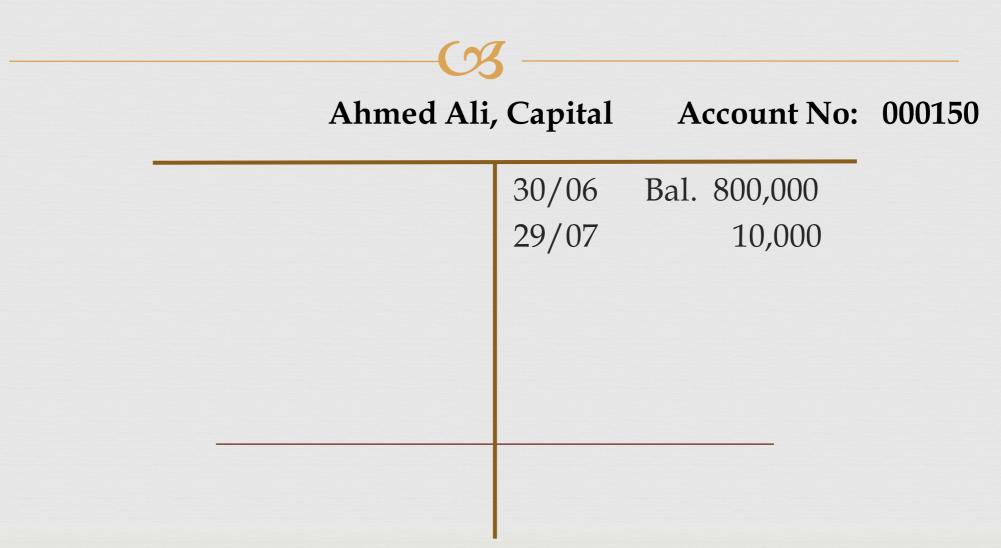
Owner's Equity is increased

Debit and Credit rule: Increase in asset is recorded by debit

therefore debit Cash byRs10,000

increases in Owner's Equity is recorded by credit therefore credit Ahmed Ali, Capital by Rs10,000

Ahmed Ali, Capital...... 10,000





		Ca	sh	Account No:	000100
30/06	Bal	158,000	01/07	3,600	
15/07		49,800	23/07	31,000	
29/07		10,000			

Recording Transactions in the General Ledger

03

✓ July 30: Billed City Cab Co for Rs54,000, for maintenance and repair work done during July. The agreement with City Cab Co. calls for payment to be received Aug. 10, 2020.

Analysis: Asset Account Receivable in increased

Revenue has been earned.

Debit and Credit rule: Increase in asset is recorded by debit

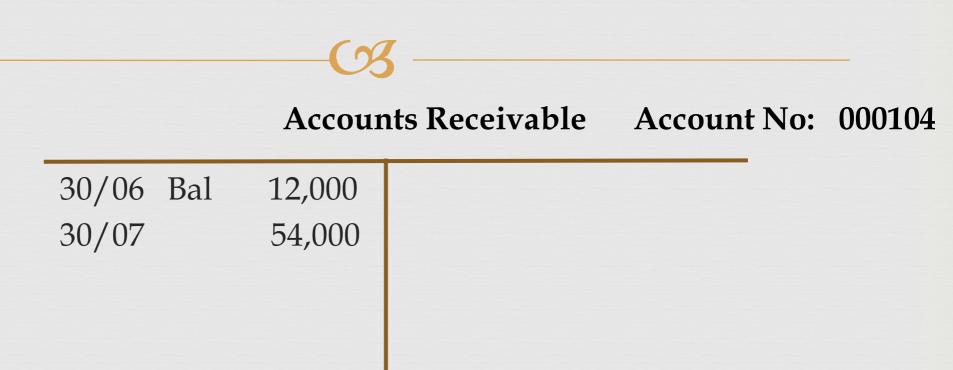
therefore debit Accounts Receivable by Rs54,000

Revenue increases Owner's Equity and Revenue is recorded by credit

therefore credit Repair Service Revenue by Rs54,000

Journal Entry: July 30 Accounts Receivable...... 54,000

Repair Service Revenue...... 54,000





Recording Transactions in the General Ledger

03

✓ July 31: Paid employees wages for the month Rs.49,000

Analysis: Wages to employees is an expense

Asset Cash is reduced

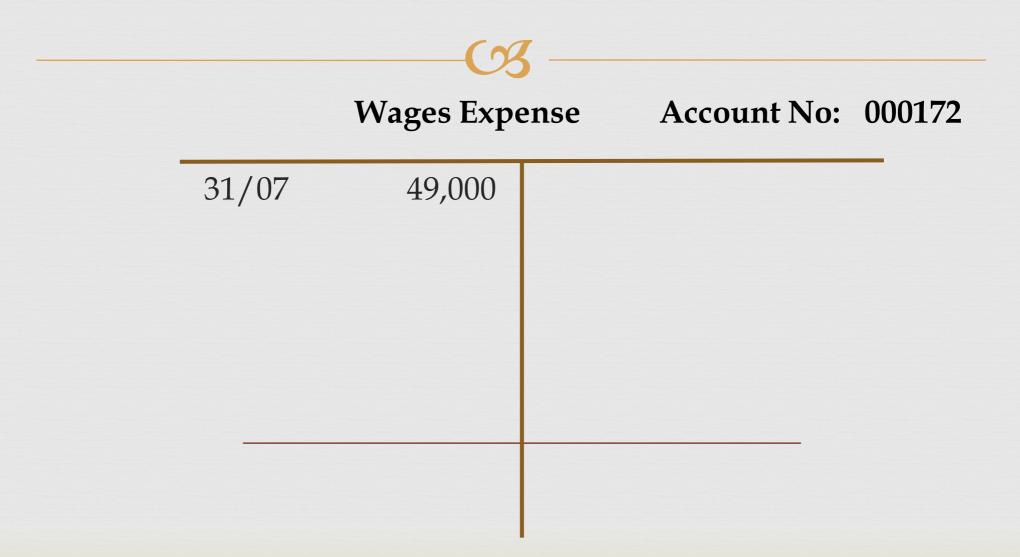
Debit and Credit rule: Expense causes decrease in owner's equity, is recorded by debit

therefore debit Wages Expense by Rs49,000

decrease in asset is recorded by credit

therefore credit Cash by Rs49,000

Journal Entry: July 31 Wages Expense...... 49,000





		Ca	sh	Account No:	000100
30/06	Bal	158,000	01/07	3,600	
15/07		49,800	23/07	31,000	
29/07		10,000	31/07	49,000	

Debit and Credit



An account had three elements

- 1. Title of account is the name of that particular account and an account Number that uniquely identifies the account.
- 2. A Left or Debit side
- 3. A right or credit side

Title of Account Account Number______

Left Right

Credit side

General Ledger



- A ledger account is a means of accumulating in one place all the information about changes in a specific asset, liability or owner's equity.
- General Ledger is a collection of loose leaflet of a specific format.
- There are two formats of posting into the ledger
- 1. Self Balancing format or running balance format

Self Balancing Form or Run Balancing Form

	Cash		Account	No:	
Date	Explanation	Ref	Debit	Credit	Balance

General Ledger



There are two formats of posting into the ledger

2. T-Accounts

example General Ledger T Account

	Cash		
11/1	80,000	11/3	52,000
11/25	600	11/5	6,000
		11/30	6,800
	80,600		64,800
11/30 Balance	15,800		

Overnight Auto Repair Services Trial Balance July 31, 2020

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Cash	s134,200	
Accounts Receivable	66,000	
Shop Supplies	14,000	
Land	520,000	
Building	360,000	
Tools and Equipment	120,000	
Notes Payable		Rs300,000
Accounts Payable	••••••	88,700
Ahmed Ali, Capital		. 810,000
Ahmed Ali, drawings		
Repair Service Revenue		103,800
Advertising Expense	8,300	
Wages Expense	49,000	

.Rs<u>1,302,500</u>

Rs<u>1,302,500</u>

Overnight Auto Repair Services Trial Balance July 31, 2020

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Cash	s134,200	
Accounts Receivable	66,000	
Shop Supplies	14,000	
Land	520,000	
Building	360,000	
Tools and Equipment	120,000	
Notes Payable		Rs300,000
Accounts Payable	••••••	88,700
Ahmed Ali, Capital		810,000
Ahmed Ali, drawings		
Repair Service Revenue		103,800
Advertising Expense	8,300	
Wages Expense	49,000	

.Rs<u>1,302,500</u>

Rs<u>1,302,500</u>

Cash basis of accounting



Recording in accounting on the basis of inflow and outflow of cash. Revenue is recognized when cash is received and expenses are recognized when cash is paid, during a period. Cash basis of accounting is an alternative to accrual basis of accounting. It measures the amount of cash received and paid out but it does not provide a good measure of the profitability of the operations.

Accrual basis of accounting



Accrual basis of accounting, in accordance with the GAAP, is the policy of recognizing revenue when it is earned(Revenue Recognition Principle) and recognizing expenses when the related goods and/or services are used or incurred (Matching Principle).