SYLLABUS

FINANCIAL ACCOUNTING

Paper - IV **Max. Marks : 100**
Time : 3 Hours

The objective of this paper is to help the students to understand the importance of Financial Accounting, and acquire conceptual knowledge.

UNIT - 1: Financial Accounting

Origin, growth, meaning, definition, objectives, functions, limitations; users of accounting information; financial accounting – science or art; book keeping versus accounting, accounting versus accountancy; branches of accounting -financial accounting , cost accounting and management accounting; Basis of accounting – cash basis, mercantile basis, mixed basis; terms used in financial accounting; double entry system of accounting; types of accounts, rules of accounting, accounting equation; accounting concepts and conventions; accounting standards

UNIT - 2: Journal and Subsidiary Books

Journal, journalizing, types of journal entries – simple, compound, opening and closing entries; books of prime entry; subsidiary books, cash book, posting of simple cash book, two columnar cash book, three columnar cash book, petty cash book, Purchases book, Purchases Returns book, Sales book, Sales Returns book, Bills Receivable book, Bills Payable book; Bank Reconciliation Statement

UNIT - 3: Ledger; Errors; Preparation of Final Accounts

Ledger; ledger account; difference between journal and ledger; ledger posting, balancing; Preparation of trial balance; types of errors, and their rectification; Capital expenditure versus revenue expenditure, deferred capital expenditure, capital receipt versus revenue receipt, capital profit versus revenue profit, capital loss versus revenue loss; Provision and reserve, secret reserve, general reserve, specific reserve; Adjustments; Final accounts of sole proprietorships- trading account, profit & loss account, horizontal form of balance sheet

UNIT - 4: Joint Stock Company; Company Final Accounts

Company - definition, characteristics, types of companies, steps in formation of company; Shares, share capital, rights shares, bonus shares; Accounting entries with respect to - issue of shares at premium or at discount, calls in advance, calls in arrears, issue, forfeiture, surrender, reissue ; Debentures, accounting entries with respect to issue of debentures; Company final accounts; adjustments in company final accounts

UNIT - 5: Depreciation and Inventory Valuation

Depreciation - definition, causes, need for providing depreciation; depreciable assets, methods of recording depreciation, depreciation methods– straight line method, diminishing balance method, sum of years digits method, annuity method, depreciation fund method, insurance policy method, machine hour rate method, revaluation method, depletion method; Inventory systems – periodic system, perpetual system; Inventory valuation methods – FIFO, LIFO, simple average, weighted average method

REFERENCES:

1. P.C. Tulsian, Financial Accounting, Pearson Education, 2003
2. Jain S.P., K.L. Narang, Principles of Accounting, Volume 1, Kalyani Publishers,2007
3. T.P. Ghosh, Fundamentals of Accounting, Sultan Chand & Sons
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CONTENTS

INTRODUCTION TO ACCOUNTING

STRUCTURE

OBJECTIVES

At the end of this chapter the reader should be able to understand:

- the concepts of business
- the nature of the inputs going into a business activity
- the meaning of accountancy, accounting , and book keeping

1.1 INTRODUCTION

The term **'business'** is understood in two ways. In its general sense, business refers to a state of being busy or busy-ness covering all those activities undertaken by an individual to earn his or her livelihood. The activities of a teacher, doctor, an advocate, the value of whose services cannot be measured in terms of money will fall under this category. In its commercial sense, business covers all those activities involving buying and selling the goods and services with a profit motive.

In the words of L.H. Haney *'Business may be defined as human activity directed towards providing or acquiring wealth through buying and selling'* According to Wheeler

'Business is an institution organized and operated to provide goods and services to the society under the incentive of private gain'. Therefore, the term **'Business'** includes all those activities, which are related to the production and distribution of goods and services. It also includes all those activities which indirectly help in production and exchange of goods such as transport, insurance, banking, warehousing, etc.

1.2 TYPES OF BUSINESS

Businesses can be classified in two ways – according to the nature of activity, and according to ownership. On the basis of the **nature of the business**, firm may be either manufacturing or trading. A manufacturing business firm buys raw materials, transforms the same into finished goods and sells them for a profit, while a trading business firm acts as the middleman or agent, by buying the goods from the manufacturers and selling them to the wholesalers, or retailers or the final customers. On the basis of **ownership and control**, the business firms can be classified into five categories - Sole trader, Partnership, Joint stock company, Hindu undivided family and Cooperative society. Irrespective of the nature and ownership &control, every business concern requires a mechanism to show the results of its activities and the financial position. This mechanism is Accounting.

1.3 IMPORTANCE OF FINANCE

In every commercial business activity, there are several basic inputs, namely, Men, Materials, Machines, Methods, Money. The primary purpose of a business firm is to produce and distribute goods/services to the society in which it exists. The achievement of this goal requires the performance of such business functions as production, distribution and finance. However, in a monetized modern economy, production and distribution cannot take place unless there is finance. Thus, finance is described as the king-pin of the whole business activity. Dealing with money is called Financial Management.

Executive Financial Management is practiced at the top and middle levels of management. It involves financial decisions that are non-routine or non-recurring in nature. It is concerned with the questions such as, what are the sources from which money can be raised for the business ? How much to raise from each source? What is the amount of money to be invested in the fixed assets? What is the amount of capital to be invested in the current assets? At the lower and lower middle levels of management, the above decisions are implemented. It involves the following activities

a) Maintenance of systematic record of cash flows: Everyday there are cash inflows and cash outflows in every business. To maintain a systematic record of those flows is an important function of the financial manager.

b) Safeguarding important financial documents such as loan agreements, vouchers, insurance policies, etc.: All the documents relating to equipments, loans, transactions, etc., are to be maintained by the finance and accounts department in an organization.

1.4 ACCOUNTING

Accountancy is the systematic knowledge of Accounting. It explains 'how' to perform the tasks of recording, classifying and summarizing of transactions. Accounting involves maintaining the required records, so as to prepare financial statements of the business. The American Institute of Certified Public Accountants defined **Accounting** as *'an art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least of a financial character, and interpreting the result thereof'*.

Accounting is an art, because the accountant's ability and skill put accounting theory into practice. It is also an art because it cannot be put into practice by any one. The person must understand and digest accounting principles and then put them into practice. In accounting, all transactions of a business are recorded. A **transaction** is an exchange of money or money's worth between two or more persons or parties. Mere give and take is not a transaction, unless that exchange is measurable in terms of money.

Therefore Accounting involves recording of transactions; classifying the recorded transactions; and summarizing the recorded and classified transactions in order to compute their results. Accounting is the art of analyzing or interpreting the results of the transactions of financial nature. The interpretation helps us to know how well the business is performing. Has it made a profit? How much is the profit? Has the profit been increasing over the years? How well is the business performing compared to its competitors?

1.5 ACCOUNTING AND BOOK-KEEPING

Book-keeping refers to keeping accounts in a regular and systematic manner. It is performed by junior staff. Some people take book-keeping and accounting to be identical, but they differ each other. Book-keeping is mainly concerned with recording of financial data relating to the business operations in a significant and orderly manner. Accounting, on the other hand, is primarily concerned with designing the systems for recording, classifying and summarizing the recorded data and interpreting them for facilitating decision making relating to the internal and external operations of the business. The book-keeper is responsible for keeping all the records of a business or only of a minor segment and his work is of a clerical nature accomplished through the use of mechanical and electronic devices.

But an accountant is required to have a much higher level of knowledge, conceptual understanding and analytical skill than what is required for a book-keeper, as he often directs and reviews the work of the book-keepers. Book keeping is a part of Accounting. Thus it is said that Accounting begins where book-keeping ends. Accounting in turn, is a part of Accountancy.

1.6 SYSTEMS OF BOOK-KEEPING

There are two systems of book-keeping. They are the Single Entry and the Double Entry Systems.

Single Entry System: Under this system, only one aspect of the transaction, mainly cash aspect, will be recognized and recorded in the books of accounts. Only how much cash is received and to be received and how much cash is paid and to be paid will be known but the value of purchases and sales will not be readily available. It is not really a system because, under this, there may be no record of some of the transactions and only partial record of some others and proper results cannot be obtained. Therefore, under this system of book-keeping the information available is incomplete and therefore it does not facilitate decision making.

Double Entry System: Under this system, both aspects of each transaction are shown and therefore, the information available will be complete and comprehensive, and facilitates decision-making. In other words, this system makes a proper and full record of all transactions by recognizing the two aspects of a transaction and recording it in a proper manner.

1.7 ACCOUNTING SYSTEMS

An accounting system refers to the type of transactions that are recorded. Are only cash transactions recorded? Then this is the cash system of accounting. Are cash transactions as well as non cash transactions recorded? This is the mercantile system of accounting. These two accounting systems are described below:

1) *Cash System of Accounting*: It is a system of accounting wherein accounting entries are made only when cash is received or paid. No entry is made for the credit transactions, when a payment (or receipt) is due.

2) *Accrual System of Accounting*: It is a system of accounting wherein accounting entries are made on the basis of amounts having become due for payment (or receipt). This system recognizes the fact that if a transaction or an event has occurred, it's consequences cannot be avoided and therefore should be brought into account in order to present a true and fair picture of the results and financial position of the business firm concerned. This system is also known as 'Mercantile System of Accounting'.

1.8 SUMMARY

Business refers to the activities concerned with buying and selling the goods and services with a profit motive. In a business activity, resources are used for the earning of profit. A business concern has to make decisions with respect to money. Financial Management is the process of planning, organizing and controlling the financial resources in a business organization in such a way that we get more money for the money put into the business. Financial management is practiced at top and middle levels of management. Accountancy is the knowledge of how to record, classify, and summarize transactions. Accounting is the art of recording, classifying, and summarizing transactions of financial nature. Book keeping is a part of Accounting. Book-keeping refers to keeping accounts in a regular and systematic manner.

1.9 KEY WORDS

Business: It is defined as human activity directed towards providing or acquiring wealth through buying and selling.

Financial Management: Relates to executive and non executive decisions with respect to money.

Accounting: It is defined as the art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least of a financial character, and interpreting the result thereof

Mercantile System of Accounting: Cash as well as non cash transactions are recorded. So accounting entries are made on the basis of amounts having become due for payment or receipt.

Bookkeeping: It is the art of keeping accounts in a regular and systematic manner. It is mainly concerned with recording of financial data relating to business operations.

Double Entry System: a system of recoding both the aspects of each transaction

1.10 SELF ASSESSMENT QUESTIONS

1. What is meant by the term business?
2. What is accounting ?
3. Differentiate between cash system and mercantile system of accounting
4. What is book-keeping ?
5. Differentiate between Single entry book-keeping and Double entry book-keeping.