resources and claims to those resources.

4. Financial reporting should provide information about an enterprise's financial performance during a period. The primary focus of financial reporting is information about an enterprise's performance provided by measures of earnings and its components.
5. Financial reporting should provide information about how an enterprise obtains and spends cash, about its borrowing and repayment of borrowing, about its capital transactions, including cash dividends and other distributions of enterprise resources to owners, and about other factors that may affect an enterprise's liquidity or solvency.
6. Financial reporting should provide information about how management of an enterprise has discharged its stewardship responsibility to owners (stockholders) for the use of enterprise resources entrusted to it.
7. Financial reporting should provide information that is useful to managers and directors in making decisions in the interests of owners.

Elements of Financial Statements of Business Enterprises

Elements of financial statements are the building blocks with which financial statements are constructed—the classes of items that financial statements comprise. The items in financial statements represent in words and number certain enterprise resources, claims to those resources, and the effects of transactions and other events and circumstances that result in changes in those resources and claims. The Statement of Financial Accounting Concept defines 10 interrelated elements that are directly related to measuring performance and status of an enterprise.

1. **Assets** are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.
2. **Liabilities** are probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events.
3. **Equity** is the residual interest in the assets of an entity that remains after deducting its liabilities. In a business enterprise, the equity is the ownership interest.
4. **Investments by owners** are increases in net assets of a particular enterprise resulting from transfers to it from other entities of something of value to obtain or increase ownership interests (or equity) in it. Assets are most commonly received as investments by owners, but that which is received may also include services or satisfaction or conversion of liabilities of the enterprise.
5. **Distributions to owners** are decreases in net assets of a particular enterprise resulting from transferring assets, rendering services, or incurring liabilities by the enterprise to owners. Distributions to owners decrease ownership interests (or equity) in an enterprise.
6. **Revenues** are inflows or other enhancements of assets of an entity or settlements of its

liabilities (or a combination of both) during a period from delivering or producing goods, rendering services, or other activities that constitute the entity's ongoing major or central operations.

7. **Expenses** are outflows or other using up of assets or incurrence of liabilities (or a combination of both) during a period from delivering or producing goods, rendering services, or carrying out other activities that constitute the entity's ongoing major or central operations.
8. **Gains** are increases in equity (net assets) from peripheral or incidental transactions of an entity and from all other transactions and other events and circumstances affecting the entity during a period except those that result from revenues or investments by owners.
9. **Losses** are decreases in equity (net assets) from peripheral or incidental transactions of an entity and from all other transactions and other events and circumstances affecting the entity during a period except those that result from expenses or distributions to owners.

<u>Closing the Books</u>

For the purpose of closing the accounts at the end of a particular period, accounts are classified into two types e.g., Permanent and Temporary Accounts.

Permanent Accounts are balance sheet accounts (i.e., assets, liabilities, and equity). They are not closed each period. Their balances are carried forward into the next period. Permanent accounts are also called *Real Accounts*. In contrast, revenue, expense, and distribution accounts are Temporary Account. At the end of a period, amounts in **Temporary Accounts** are transferred to Income Statement. Thereby, Temporary Accounts must have zero balances at the end of one accounting period (after closing the books) and at the beginning of the following period. Temporary accounts are also called *Nominal Accounts*.

Temporary Accounts are closed at the end of each period. The process of transferring the balances from the temporary accounts to the Permanent Account and Retained Earnings is referred to as closing the accounts or *closing the books*.

<u>Preparation of Financial Statements</u>

The four General-Purpose Financial Statements are:

- Income Statement
- Statement of Changes in Equity
- Balance Sheet
- Statement of Cash Flows

Exercise: From the following Trial balance prepare Income Statement and Balance Sheet at the end of 2005.

Trial Balance of a Company
as at 31 December, 2005

Accounts	L.F.	Debit (Tk)	Credit (Tk)
Opening Stock		41,000	
Purchases		1,10,000	
Drawings		18,000	
Sales Returns		6,000	
Wages		5,400	
Salaries		9,000	
Traveling		950	
Rent, Rates and Taxes		2,400	
Purchase Returns			1,500
Interest Paid		1,200	
Discount Allowed		800	
Insurance Charges		600	
Bad Debts		600	
Sales			1,80,000
Sundry Debtors		14,000	
Fixed Assets		35,000	
Creditors			62,500
Cash		8,200	
General Expenses		1,200	
Advertisements		900	
Capital			8,750
Investments		3,500	
Bank Overdraft			5,000
Commission Received			1,000
Total		**2,58,750**	**2,58,750**

Note: Closing Stocks are not included in the Trial Balance

From the following Trial Balance of Jibon Ltd. of December 2005. prepare a Profit & Loss Account for the year and a Balance Sheet:

	(Taka)	(Taka)
Capital		60,000
Drawings	10,000	
Plan and Machinery	80,000	
Purchases and Sales	60,000	1,75,000
Returns	1,000	750
Stock (1-1-05)	30,000	
Discount	350	800
Bank charges	75	
Sundry Debtors and Creditors	45,000	25,925
Salaries	6,800	
Manufacturing wages	10,000	
Carriage inwards	750	
Carriage inwards	1,200	
Provision for bad debt.		525
Rent and taxes	8,000	
Advertisement	2,000	
6% Mortgage Loan (1-7-05)		5,000
Commission		400
Cash in hand	900	
Cash at Bank	12,325	
	2,68,400	2,68,400

Adjustments:

1. Stock in trade on 31st December 2005 was Tk. 35,000. Included in stock were goods valued at Tk. 1,000 destroyed by fire, the insurance company has admitted claim to the extent of Tk. 800.
2. Sales omitted from being recorded Tk. 1,000.
3. Goods worth Tk. 510 was taken by the proprietor for his personal use.
4. Depreciate plant and machinery @ 10%.
5. Advertisement expense is to be written off in two years.
6. Salary Tk. 300 is outstanding and Rend prepaid is Tk. 200.
7. One-fourth of the commission has been received in advance.
8. Write off Tk. 500 as bad debts and make a provision for bad debt 5% on remaining debtors.

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Rent and taxes	8,000	
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CASH BOOK

Cash book is book where all cash receipts and payments (including bank deposits and withdrawals) are recorded first, in chronological order, for posting to general ledger. Cash Book serves dual role of a ledger as well as journal. Cash book is the account which keeps track of all the cash transactions of the business. It is a part of Ledger. Because of the enormously large amount of cash transactions in a typical business, this Cash Account is maintained as a separate book known as **CASH BOOK**. Cash book is also a **book of original entry**. Cash book consists of Cash Account and Bank Account. Cash book is regularly reconciled with the bank statements as an internal auditing measure.

- Cash Account is an Asset Account or Real Account and thus,
  - Any increase in Cash or Bank Account is debited to the account and;
  - Any decrease in Cash or Bank account is credited to the account.
  - Cash Book **always shows a debit balance.**

Types of Cash Book

- Single Column Cash Book
- Double Column Cash Book
- Triple Column Cash Book
- Petty Cash Book

Contra Entries

These entries are made to record:

1. **When money is withdrawn from the bank for office use:** It is recorded in cash column on its debit side by writing 'Bank account' in the column of particulars and in bank column of the same cash book but on its credit side by writing 'Cash account' in the column of particulars.

2. **When money is taken from Office cash and deposited into bank:** When cash is deposited into bank, it is recorded in the bank column of the cash book on its debit side by writing 'Cash account' in the column of particulars and in the cash column of the same cash book but on its credit side by writing 'Bank account' in the column of particulars.

Two entries are made in the Cash Book on the same page at the same time. The double entry for each transaction is complete. There will be no more postings of these entries to the ledger and these contra entries are indicated by a sign "c" in the folio column.

Cash Discount

A cash discount is a deduction from the amount due. It is given to encourage prompt payment of debts. Cash discount which is given by the trader to its customers is known as Discount allowed. Cash discount is allowed to the customers to encourage prompt payment of their debts. Discount allowed is recorded in the discount column on the debit side of the triple column Cash Book and posted individually to the credit side of the debtors accounts to which they relate.

Cash discount received by the trader from its supplier is known as Discount received. The trader ends up paying less by the amount of discount received. Discount received is recorded in the discount column on the credit side of the triple column Cash Book and posted individually to the debit side of the creditors accounts to which they relate.

Exercise on Cash Book

1. From the following transactions of Mr. Rahman prepare a single Column Cash Book for the month of January, 2008:

Jan 1	Opening balance of cash	Tk. 6,000
2	Cash brought as capital	10,000
4	Cash purchase of goods	4,000
6	cash Sales	8,000
7	Deposit into Bank	5,000
8	Paid karim by cheque	1,000
9	Received from Kamal	5,500
10	Paid electric bills	600
12	Purchased a still almirah	2,000
14	Received from Mr. A Aziz	1,800
15	Paid for advertisement	900
18	Paid telephone bill	250
20	Paid house rent	2,480
25	Withdrawn from bank	2,900
29	Paid salaries for the month	4,000

2. From the following cash and bank transactions of Mr. M Mannan prepare a Cash Book for the month of June, 2009:

June 1	Opening balance of cash Opening balance of bank	Tk. 6,000 1,00,000
2	Cash withdrawn from bank	15,000
3	Cash purchase	16,000
5	Paid to Mr. X by cheque	25,000
7	Cash sales	20,000
10	Bonus to employees	12,000
9	Creditors paid by cheque	15,500
10	Paid electric bills	1,600
12	Purchased a still Almirah by cheque	2,000
14	Cheque received from Mr. A Aziz	1,800
15	Paid for advertisement	900
18	Paid telephone bill by cheque	250
20	Paid cash for house rent	2,480
25	Cheque deposited to bank	2,900
29	Paid salaries for the month by cheque	4,000

Capital Expenditure versus Revenue Expenditure

Capital expenditure is an amount spent to acquire or improve a long-term asset such as equipment or buildings. Usually the cost is recorded in an account classified as Property, Plant and Equipment. The cost (except for the cost of land) will then be charged to depreciation expense over the useful life of the asset.

Capital expenditure occurs when a business gets a long term advantage due to that expenditure. It is usually incurred for accusation of an asset. These expenditures do not occur in the regular day to day transactions of the business.

Common examples

- Purchase of furniture, office building etc.
- Purchase of additional furniture or machinery
- Expenditure incurred in connection with the purchase of a fixed asset. For example, carriage paid of machinery purchased.
- Purchase of patent right, copy rights etc.

Revenue Expenditure

Expenditure which is not for increasing the value of fixed assets, but for running the business on a day to day basis, is known as revenue expenditure.

Revenue expenditure is an amount that is expensed immediately—thereby being matched with revenues of the current accounting period. Routine repairs are revenue expenditures because they are charged directly to an account such as Repairs and Maintenance Expense. Even significant repairs that do not extend the life of the asset or do not improve the asset (the repairs merely return the asset back to its previous condition) are revenue expenditures.

Difference between Capital and Revenue expenditure.

Buying a car is capital expenditure because its benefit to the business will be spread over a long time. Fuel cost for running this car is revenue expenditure and it will be used up in few days and does not add to the value of the fixed asset.

It's important to understand the basic difference between Capital and Revenue expenditure. Appended below, in tabulated form, the characteristic and some salient points to understand the difference:

CAPITAL EXPENDITURE
Outlay resulting in the increase or acquisition of an asset or INCREASE in the earning capacity of a business
REVENUE EXPENDITURE
Outlay as is necessary for the MAINTENANCE of earning capacity including the upkeep of the fixed assets in a fully efficient state.
SALIENT POINTS TO NOTE
1. Accounting fraud occur because management choose to classify should be revenue expenditure as capital expenditure. The revenue expenditure should be taken up into the Income Statement but instead now being suspended or deferred into the Balance Sheet. In the process, lesser expenses are being charge into the Income Statement, hence profit are overstated to impress the investors or outsiders

2. Strong GAAP and Accounting standards have classified what should be assets, what should be deferred in the balance sheet so that there should be a clearer demarcation between Capital and Revenue expenditure

3. We need to note that certain expenses are recognized as being of a capital nature, although no tangible property may have been acquired as a result. Examples are Research and Development Expenditure, Pre-Incorporation and Preliminary Expenses, Interest on Borrowings for Building, Legal Expenses to Acquire Property, additional Renovations to Properties and Others

4. The classification of what is capital expenditure of a company might not applies to another company that is not in the same industry. Say in a property based company, most land and buildings are revenue expenditure as they are purchase with the intent for re-sale.

5. As we learned from the above, when the purpose of expenditure is to Maintain the business it is revenue and if it is to Improve the business it is capital. However, at times in a company, the classification of pure capital or revenue expenditure in a company is not so straightforward especially when there is a mixture of both capital and revenue expenditure in nature.

Capital Receipts and Revenue Receipts

Capital receipts consist of

- additional payments made to the business either by owner or shareholder of the business; or
- from sale of fixed assets of the business.

On the other hand, all receipts in the normal running or through day to day transactions of the business are categorized as Revenue receipt. Sales receipts of the business are revenue receipts.

Difference between Capital Receipts and Capital Revenues:

Capital Receipts	Revenue Receipts
(a) Receipts derived from activities which are not part of the normal trading activities of the business	(a) Receipts related to NORMAL ACTIVITIES of the business
(b) Appears as capital or liabilities in the Balance Sheet	(b) Credited as revenue to Trading and Profit & Loss Account
© Examples: receipts of cash brought in by partners, shareholders, debenture holders and bank loans	© Examples: receipts from sales of goods and services, rent, commission and interest on bank deposits received by the business.