

# **Financial Accounting with Tally**

## **Unit-I**

### **Meaning of Accounting**

Accounting can be defined as the process of systematically recording, analyzing, summarizing, and reporting financial transactions and information about a business or organization. It involves organizing financial data in a way that allows for the interpretation of a company's financial health, performance, and position. The main motive of accounting is to ascertain the profit & loss of the business.

### **Process of Accounting**

**Identifying Transactions:** The process begins with identifying and recognizing all financial transactions that occur within the organization. These transactions can include sales, purchases, expenses, revenues, investments, borrowings, and more.

**Measurement:** Accounting measurement is the representation of data in terms of a specific method, such as currency, hours, or units. The same data can be measured in a variety of ways.

**Recording Transactions:** Once identified, transactions are recorded systematically using the principles of double-entry accounting. Each transaction affects at least two accounts, with one account debited and another credited. This step ensures that the accounting equation ( $\text{Assets} = \text{Liabilities} + \text{Equity}$ ) remains balanced.

**Classifying Transactions:** After recording, transactions are classified into appropriate accounts based on their nature (e.g., cash, accounts receivable, inventory, accounts payable, etc.). This classification helps organize financial data for analysis and reporting purposes.

**Summarizing Transactions:** Periodically, typically at the end of an accounting period (e.g., monthly, quarterly, or annually), transactions are summarized into financial statements. The most common financial statements include the balance sheet, income statement, and cash flow statement.

**Analyzing Financial Data:** Financial statements are analyzed to assess the financial performance, position, and health of the organization. This analysis may involve comparing current financial data with historical data, industry benchmarks, or competitor performance to identify trends, strengths, weaknesses, opportunities, and threats.

**Interpreting Results:** The analyzed financial data is interpreted to derive meaningful insights and conclusions. This interpretation helps stakeholders, including management, investors, creditors, regulators, and others, understand the organization's financial standing and make informed decisions.

**Communicating:** Finally, the results of the accounting process are communicated to stakeholders through various financial reports and statements. These reports provide transparency and accountability and are essential for decision-making, compliance, and external communication.

## Objectives of Accounting

**Recording Transactions:** One of the fundamental objectives of accounting is to systematically record all financial transactions that occur within an organization. This process ensures that a comprehensive and accurate record of business activities is maintained.

**Financial Reporting:** Accounting aims to generate financial reports and statements, such as the balance sheet, income statement, and cash flow statement, to provide stakeholders with relevant and timely information about the organization's financial performance, position, and cash flows.

**Decision Making:** Accounting information plays a crucial role in decision-making processes for management, investors, creditors, and other stakeholders. By providing insights into the financial health and performance of the organization, accounting assists in evaluating investment opportunities, formulating strategies, setting goals, and allocating resources effectively.

**Facilitating Planning and Control:** Accounting helps organizations plan for the future by providing historical data and financial forecasts. It also aids in controlling and monitoring financial activities by comparing actual results with budgeted figures, identifying variances, and implementing corrective measures as necessary.

**Ensuring Accountability and Transparency:** Accounting promotes accountability and transparency by providing a clear and accurate representation of the organization's financial affairs. Financial reports and statements enable stakeholders to evaluate the organization's stewardship of resources and hold management accountable for their actions.

**Facilitating Communication:** Accounting serves as a common language for communicating financial information to various stakeholders, including investors, creditors, employees, regulators, and the public. Clear and understandable financial reports enable effective communication and foster trust and confidence in the organization.

## Scope of Financial Accounting

### Records Financial Transactions

Financial accounting records each and every financial transaction taking place in the business organization. It maintains a clear and systematic record of all information in the form of journals and various subsidiary books. It avoids any confusion or loss because if any problem arises these records can be easily checked. All transaction cannot be just memorized by humans without recording them and that makes the financial accounting important part of every business.

### Classify and Summarize Information

Information collected and recorded by financial accounting is properly categorized according to their nature. Financial accounting involves classifying and summarizing all financial information recorded at the initial step. All transactions of similar nature are grouped together under one head by making accounts like Sales, Purchase, Rent, Salaries, Interest etc. Grouping of same nature transactions together adds convenience in understanding of information collected.

### **Prepares Financial Statements**

Financial accounting prepares financial statements like cash flow statement, income statement, balance sheet etc. These financial statements depict the true financial position of business. Financial statements are the result of various information collected and analysed in overall process of financial accounting. All financial strength and weakness of business are determined by preparation of financial statements.

### **Interprets Financial Information**

Financial accounting interprets information from several analysis conducted and financial statements prepared. It understands and explains the results of several relationships establishes by analysis to different users for easy understanding and decision making. It simplifies the accounting information so that it is well understood by persons having limited or no knowledge of accounting subject.

### **Communicates All Outcomes**

Financial accounting serves the needs of all external stakeholders by delivering them true and accurate picture of the company's financial affairs. It communicates them all financial information by providing them with financial reports routinely. All interested parties to business are fully aware of all business financial matters and this helps them in making conclusions. It helps them in knowing profitability and future growth aspects through these reports.

### **Determines and Maintains Financial Position**

Financial accounting determines fair and actual image of financial position of business. Finance is termed as lifeline of business activities and its management is quite important for every organization. Mismanagement of financial resources may have adverse effects on the company's performance. Financial accounting records and analyzes each financial aspect of business.

## **Nature of Financial Accounting**

### **Accounting Is First Step**

Accounting is start when a financial transaction takes place. It records the financial transaction after that communicates this information to its users. Then the user this information for their decision making.

### **Accounting Is An Art And Science:**

Accounting is an Art and Science as well. Accounting is an art of recording, classifying and summarizing of financial transactions. Accounting is science as well as it requires certain principles (accounting principle).

### **Accounting Is a Process**

Accounting is a process recording of financial transaction, summarizing, analyzing, and reporting to the user of accounting information.

## Limitation of Accounting

**Historical Data:** Accounting primarily deals with past transactions and events. While historical data is valuable for decision-making, it may not always accurately predict future performance or market trends.

**Complexity:** Accounting standards can be complex and challenging to understand, especially for individuals without a financial background. This complexity can lead to errors or misinterpretation of financial statements.

**Costs vs. Benefits:** The cost of implementing sophisticated accounting systems and hiring qualified accountants can be high for small businesses, potentially outweighing the benefits.

**Non-Financial Factors:** Accounting primarily focuses on financial transactions and may not fully capture non-financial factors such as employee morale, customer satisfaction, or brand reputation, which can also impact an organization's performance.

**Manipulation:** Despite regulations and auditing processes, there is still a risk of manipulation or creative accounting practices aimed at presenting financial statements in a more favorable light, leading to potential fraud or misleading information.

**External Factors:** Accounting does not exist in a vacuum and can be influenced by external factors such as changes in regulations, economic conditions, or technological advancements, which may not always be accurately reflected in financial statements.

**Limited Scope:** While accounting provides valuable insights into financial performance, it may not encompass all aspects of an organization's operations or impact on society, such as environmental sustainability or social responsibility.

## Branches of Accounting

Here are some of the main branches of accounting:

**Financial Accounting:** This branch focuses on the preparation of financial statements for external users, such as investors, creditors, regulators, and the general public. Financial accounting ensures that the financial information presented is accurate, reliable, and in accordance with generally accepted accounting principles (GAAP) or international financial reporting standards (IFRS).

**Managerial Accounting:** Also known as management accounting, this branch involves the preparation of financial information and reports for internal use by management to aid in

decision-making, planning, and control. Managerial accountants analyze costs, budgets, forecasts, and performance metrics to help management make informed business decisions.

**Cost Accounting:** Cost accounting is a subset of managerial accounting that focuses specifically on the analysis, allocation, and control of costs associated with producing goods or services. It helps businesses determine the cost of producing a product or providing a service, and aids in cost control and cost optimization strategies.

## Accounting Standards

Accounting standards are a set of guidelines, rules, and principles that dictate how financial statements should be prepared, presented, and disclosed. These standards ensure consistency, transparency, and comparability in financial reporting, allowing stakeholders to make informed decisions based on the financial information provided. Some of the key accounting standards include:

### Advantages of accounting standards

Accounting standards offer several advantages to various stakeholders in the financial reporting process. Here are some of the key advantages:

**Consistency and Comparability:** Accounting standards provide a uniform framework for preparing and presenting financial statements, ensuring consistency in reporting practices across different companies, industries, and countries. This consistency facilitates comparability, allowing users of financial statements to assess the financial performance and position of companies more effectively.

**Transparency and Disclosure:** Accounting standards require companies to disclose relevant financial information in their financial statements, notes, and disclosures. This transparency enhances the quality and reliability of financial reporting, enabling stakeholders to make well-informed decisions based on accurate and comprehensive information.

**Improved Decision-Making:** By promoting consistency, comparability, and transparency in financial reporting, accounting standards help investors, creditors, analysts, and other users of financial information make better decisions regarding investment, lending, and other economic activities. Access to reliable and relevant financial information reduces uncertainty and enhances confidence in decision-making processes.

**Enhanced Credibility and Trust:** Adherence to accounting standards enhances the credibility and trustworthiness of financial statements and reports. Companies that follow recognized accounting standards demonstrate a commitment to high-quality financial reporting practices, which can strengthen their reputation and relationships with investors, creditors, customers, and other stakeholders.

**Facilitation of Capital Allocation:** Accounting standards facilitate the allocation of capital by providing investors and creditors with consistent and reliable financial information about companies. This information allows capital providers to assess the risk and return characteristics of investment opportunities, allocate resources efficiently, and support the functioning of capital markets.

## Accounting Principles

Here are some key **Accounting Concepts**:

**Entity Concept:** The entity concept states that a business or organization is separate from its owners or stakeholders. It means that the financial transactions of the business should be recorded and reported separately from the personal transactions of its owners.

**Going Concern Concept:** The going concern concept assumes that a business will continue to operate indefinitely, unless there is evidence to the contrary. This concept underlies the preparation of financial statements, which are typically prepared on the assumption that the business will continue its operations for the foreseeable future.

**Money Measurement Concept:** The money measurement concept states that only transactions and events that can be expressed in monetary terms should be recorded in the accounting records. This concept allows for the quantification and measurement of financial transactions, facilitating their recording and reporting.

**Cost Concept (or Historical Cost Concept):** The cost concept states that assets should be recorded in the accounting records at their original cost, i.e., the amount paid to acquire them. This concept provides a reliable and objective basis for valuing assets and avoids subjective estimates of value.

**Dual Aspect Concept (or Dual Entry Concept):** The dual aspect concept is based on the accounting equation, which states that assets equal liabilities plus owners' equity. According to this concept, every transaction has two aspects: a debit and a credit, which are recorded in equal amounts to maintain the balance of the accounting equation.

**Revenue Recognition Concept or Realization Concept:** The revenue recognition concept specifies when revenue should be recognized in the accounting records. Generally, revenue is recognized when it is earned and realized or realizable, regardless of when cash is received. This concept ensures that revenue is recorded in the appropriate accounting period.

**Matching Concept (or Expense Matching Concept):** The matching concept states that expenses should be matched with the revenues they help generate in the same accounting period. This ensures that the costs associated with earning revenue are recognized in the same period as the revenue itself, facilitating accurate measurement of profitability.

**Conservatism Concept:** The conservatism concept advises accountants to err on the side of caution when making accounting estimates or judgments. It suggests that potential losses should be recognized as soon as they are reasonably possible, while potential gains should only be recognized when realized.

**Accounting period concept:** An accounting period concept is any time frame used for financial reporting. Transactions that fall within a given date range form part of the statements or reports for that accounting period. An accounting period, or reporting period, is often 12 months. There may be different accounting periods for various business tasks.

## Accounting conventions

**Consistency Convention:** The consistency convention states that once a company adopts an accounting method or practice, it should continue to use that method consistently from one period to another. Consistency enhances comparability of financial information over time, allowing users to analyze trends and make informed decisions.

**Materiality Convention:** The materiality convention suggests that financial information should only be disclosed if its omission or misstatement could influence the economic decisions of users of the financial statements. Materiality is assessed based on both quantitative and qualitative factors and immaterial items may be aggregated or omitted from disclosure.

**Full Disclosure Convention:** The full disclosure convention requires that all material information relevant to the financial statements be disclosed in the footnotes or supplementary notes accompanying the financial statements. This convention promotes transparency and helps users understand the financial position and performance of the business.

**Conservatism Convention:** The conservatism convention advises accountants to err on the side of caution when making accounting estimates or judgments. It suggests that potential losses should be recognized as soon as they are reasonably possible, while potential gains should only be recognized when realized. This convention helps prevent overstatement of assets and income.

## What is Double-Entry System of Accounting?

Double entry system started by Italian merchant named Lucas Pacioli. Double-entry accounting is a system of bookkeeping where every financial transaction is recorded in at least two accounts. A double-entry system provides a check and balance for each transaction, which helps ensure accuracy and prevent fraud. This accounting system also allows you to track business finances more effectively, and make better decisions about where to allocate your resources.

Under the double-entry system of accounting, each business transaction affects at least two accounts. One of these accounts must be debited and the other credited both with equal amounts. The total of all debit entries, therefore, is always equal to the total of all credit entries.

## Importance or Advantages of Double Entry System of Book-Keeping

The following are the main importance or advantages of double entry system of book-keeping:

1. **Keeps complete records of each transaction:** it is complete system of book-keeping. It records not only each and every transaction but also each aspect of the financial transaction.
2. **Ascertain the result of business operation:** This system helps to ascertain the true profit or loss of a business by preparing profit and loss account for the given period.
3. **Present financial position:** This system help to prepare balance sheet by providing details of assets and liabilities of the business, which helps to present the financial position of business.
4. **Check arithmetical accuracy:** It helps to check the arithmetical accuracy of recorded financial transaction by preparing a summary report called trial balance
5. **Facilitate comparison:** Under this system, separate recording is made for each year's transaction. It facilitates comparison of one item of one year with the similar item of previous year and help to know its progress from year to year.
6. **Reduce errors and other irregularities:** In this system, a transaction is recorded in two accounts. Therefore, it reduces the possibility of frauds, errors and manipulation of account.
7. **Decision making:** This system provides necessary information of business operation to the various users such as managers and creditors for their decision making purpose.
8. **Scientific system:** This system is scientific system of book-keeping. It has its own set of principles and rules. Under those principles and rules, two aspects of every financial transaction are recorded.
9. **Systematic system:** A systematic technique is followed in recording financial transaction in double entry system of book keeping. It record financial transaction in systematic and chronological order with suitable narration of financial transaction.
10. **Reliability:** Under this system, transactions are recorded in a scientific and systematic manner. Therefore, it provides an authentic record of all he transactions of business, which is accepted by the court, tax authority etc. as an authentic documents.

## Disadvantages of the Double Entry System

The double-entry accounting system is the standard for businesses worldwide but has disadvantages. Here are some of the drawbacks associated with the double-entry system:

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1. **Complexity:** The double-entry system is a formalized accounting system that requires specialized training to use correctly. It is more complex than many other accounting systems and requires a higher level of expertise to ensure that all transactions are recorded accurately.
  2. **Cost:** The complexity of the double-entry system means that it can be more expensive. It usually requires more staff to operate and maintain, which increases the overhead costs associated with the system.
  3. **Time:** The double-entry system is a time-consuming process. It requires the entry of a lot of information and can be tedious to go through each transaction. It can be a significant drag on the overall efficiency of a business.

4. **Errors:** The double-entry system is vulnerable to errors, such as double-entry or recording errors. It can have a considerable impact on the accuracy of the accounting records and can lead to incorrect financial statements.
5. **Security:** The double-entry system is vulnerable to fraud, requiring two entries for each transaction. If one of the entries needs to be corrected, we can only detect it with a thorough review of the records.

## Bookkeeping accounting and accountancy

### Book-keeping

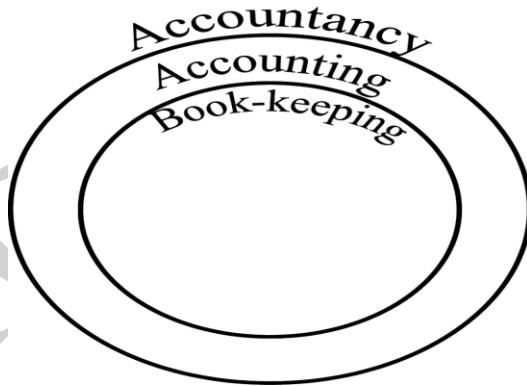
Book-keeping is an art of recording in the books of accounts, the monetary aspect of commercial and financial transactions. It is a part of accounting. It is concerned with identifying, recording and classifying economic transactions and events.

### Accounting

Accounting is a wider concept than book-keeping. It starts where book-keeping ends. It is concerned with summarizing the economic transactions, analysis, and interpretation of economic transactions and events and communicating the results of final users.

### Accountancy

'Accountancy' refers to the entire body of the theoretical knowledge of accounting. It is the theory part of accounting, whereas accounting relates to applying the knowledge of accountancy. Diagrammatically, the relationship can be viewed as:

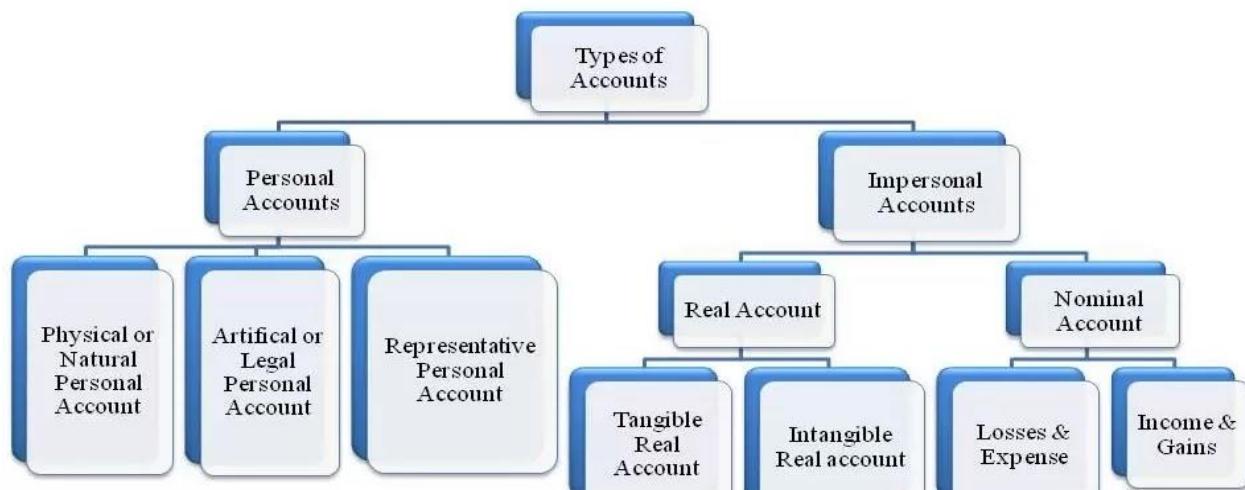


### Account

An account is a detailed description of the transactions carried out by a certain business in relation to a specific person, company, or their representatives or objects. When a business conducts transactions with both consumers and suppliers, for example, both suppliers and customers are referred to as separate accounts. Similarly, businesses may purchase physical

goods like land, machinery, plants, buildings, and so on, and each of these tangibles is considered as a separate account, even if they are all tied to things.

## Types of Account



### Personal Account

- Personal Representative Account
- Personal Artificial Account
- Personal Natural Account

### Real Account

- Real Intangible Account
- Real Tangible Account

### Nominal Account

### Personal Account

As previously said, personal accounts are accounts that are associated with an individual, a company, a firm, or a collection of associations, among other things. These people could be natural people, artificial people, or representatives, depending on the situation. Eg. Charitable trusts, ABC Bank Ltd, X company Ltd., etc. Company Ltd., etc.

### Rules for This Account

- The Receiver is debited

- The Giver is credited.

### **Real Account**

Accounts that deal with assets, properties, or possessions are known as real accounts. These properties could be physical or non-physical in nature. This necessitates the development of two different sorts of genuine accounts: Intangible Real Accounts and Tangible Real Account

#### **Rules for this Account**

- What comes in is to be debited
- What goes out is to be credited.

### **Nominal Account**

Nominal accounts are those that are associated with any type of revenue or spending, gain or loss. For instance, rent a/c, salary a/c, wage a/c, and so on.

#### **Rules for this Account**

- Expenses and losses related to the business must be debited in full.
- All forms of business income and gains, if any, must be credited.

## **Journal**

A journal is a detailed record of all transactions done by a business. The information recorded in a journal is used to reconcile accounts. Entries are usually recorded using a double-entry method. The double-entry method records a transaction in two (or more) entries.

### **Rules for Journalize the Transactions**

Bookkeeping is only one aspect of financial accounting. Every transaction in accounting has two entries: debit and credit. It is critical to determine which accounts must be credited and which must be debited. This is the dual entry accounting system.

#### **1) Rule One**

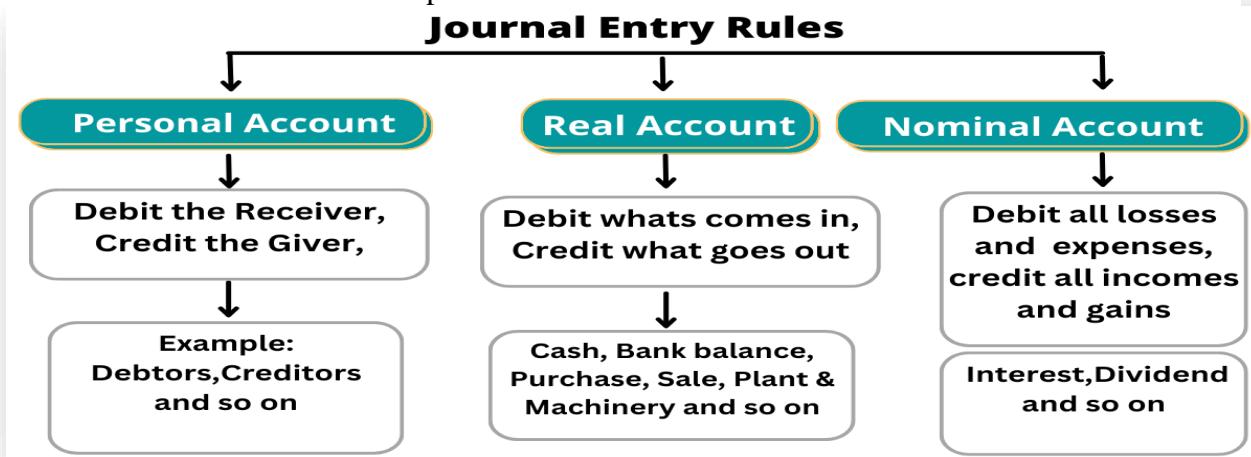
"Debit what comes in - credit what goes out."

#### **2) Rule Two**

"Credit the giver and Debit the Receiver."

#### **3) Rule Three**

"Credit all income and debit all expenses."



## What is the format of the journal?

The standard format contains five columns:

**Journal Entries**

Date	Particulars	L.F.	Amount(Dr.)	Amount(Cr.)
Year	Name of the Account to be Debited	Dr.	XXXX	
Month Date	To Name of the Account to be Credited			XXXX
	(.....Narration.....)			

## Journal Entry Format

JOURNAL				
Date	Particulars of Business Transactions	Folio	Debit (USD)	Credit (USD)
15-Oct-19	Furniture A/c Dr.		\$1,000.00	
	To Bank A/c Cr.			\$1,000.00
	(Furniture Purchased for Business)			

JOURNAL				
Date	Particulars of Business Transactions	Folio	Debit (USD)	Credit (USD)
7-Feb-19	Rent A/c Dr.		\$250.00	
	Insurance A/c Dr.		\$400.00	
	To Bank A/c Cr.			\$650.00
	(Rent and Insurance Paid)			

## Ledger Posting

The process of transferring the entries from journal to respective ledger accounts is called ledger posting. Balancing of ledgers is carried to find out differences at the end of the year. Ledger posting is entering information in the ledger, in respective accounts from the journal for individual records.

### What is the rule of ledger?

The amount shown on the credit side in the journal must be posted on the credit side of the general ledger. The amount shown on the debit side in the journal must be posted on the debit side of the general ledger. In particulars, the account head must start with the “To” and “By.”

### Format of Ledger

Dr.					Cr.			
Date	Particulars	J.F.	Amt (₹)	Date	Particulars	J.F.	Amt (₹)	
2019				2019				
Feb. 1	To balance b/d		8,000	Feb. 5	By Telephone Charges A/c		750	
3	To Sales A/c		700	9	By Purchases A/c		800	
6	To Interest A/c		600	28	By Balance c/d		9,250	
8	To Jayashree's A/c		1,500				10,800	
			10,800					
Mar. 1	To Balance b/d		9,250					

### What is Trial Balance?

A trial balance is a bookkeeping worksheet in which the balances of all ledgers are compiled into debit and credit account column totals that are equal. A company prepares a trial balance periodically, usually at the end of every reporting period. The word trial means a test of the performance, qualities, or suitability of someone or something.

The rules for preparing a trial balance are as follows:

Debit side	Credit Side
All Assets	All Liabilities
Purchases	Sales
Sales Return	Purchases Return
Drawings	Capital
All expenses & losses	All Income & Gain
Opening Stock	XXXXXXX

### Format of Trial Balance

S. No.	Name of the account	L.F.	Debit balance ₹	Credit balance ₹
1.	Opening stock		1,00,000	
2.	Salaries		36,000	
3.	Creditors			1,32,000
4.	Bank		35,000	
5.	Carriage inwards		18,000	
6.	Rent received			9,000
7.	Discount allowed		6,000	
8.	Purchases		3,48,000	
9.	Bills payable			66,000
10.	Debtors		45,000	
11.	Carriage outwards		15,000	
12.	Capital			1,63,000
13.	Return inward		9,000	
14.	Discount received			12,000
15.	Trade expenses		18,000	
16.	Sales			3,68,000
17.	Building		1,14,000	
	<b>Total</b>		<b>7,44,000</b>	<b>7,44,000</b>

## Final Accounts/Financial statement

Final accounts refer to the financial statements and reports prepared at the end of an accounting period to summarize the financial performance and position of a business. These accounts are crucial for stakeholders, including management, investors, creditors, and regulatory authorities, to understand the financial health and profitability of the organization.

Final accounts typically include the following:

- Trading Account:** This account is used primarily by manufacturing and trading businesses to calculate the gross profit or loss for the period. It includes revenue from sales and the cost of goods sold (COGS).
- Profit and Loss Account (Income Statement):** This account shows the net profit or loss by accounting for all revenues and expenses over the accounting period. It provides insight into the operational efficiency of the business.
- Balance Sheet:** This statement provides a snapshot of the company's financial position at a specific point in time. It lists the company's assets, liabilities, and equity, showing what the company owns and owes.

## Format of Final Accounts:

Dr	<b>Trading and Profit and Loss Account</b> as on 31st March, 2011			Cr
	Amt. (₹)	Particulars		Amt. (₹)
To Opening Stock	50,000	By Sales	4,21,000	
To Purchase	3,50,000	(-) Sales Return	5,000	4,16,000
To Carriage on Purchase	12,000	By Closing Stock	2,500	
To Wages	8,000	By Gross Loss c/d (b/f)	1,500	
	4,20,000			4,20,000
To Gross Loss b/d	1,500	By Commission	4,000	
To Rent	15,000	By Net Loss	41,500	
To Bad Debts	7,000			
To Stationery	6,000			
To Travelling Expenses	2,000			
To Insurance	7,000			
To Discount	5,000			
To Office Expenses	2,000			
	45,500			45,500

**Balance Sheet**  
as on 31st March, 2011

Liabilities	Amt. (₹)	Assets	Amt. (₹)
Capital	3,00,000	Cash in Hand	32,000
(-) Net Loss	41,500	Furniture	1,28,000
	2,58,500	Debtors	1,40,000
(-) Drawings	24,000	Plants	60,000
	2,34,500	Closing Stock	2,500
Creditors	1,00,000		
Bank Overdraft	28,000		
	3,62,500		3,62,500

## What is the financial statement analysis?

Financial statement analysis involves a comprehensive examination of a company's financial statements, including the income statement, balance sheet, and cash flow statement. Analysts assess revenue, earnings, assets, liabilities, and cash flow to gauge financial health and performance. It includes followings:

1. Ratio Analysis
2. Funds Flow Statements
3. Cash Flow Statements

## Ratio Analysis

Although there are many financial ratios businesses can use to measure their performance, they can be divided into four basic categories.

1. Liquidity ratios.
2. Profitability ratios.
3. Activity ratios/Turnover Ratio (also called efficiency ratios)
4. Leverage ratios/Capital Structure Ratio.

## 1. Liquidity ratios

### Accounting Liquidity

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

$$\text{Quick Ratio} = \frac{\text{Current Assets} - \text{Inventories}}{\text{Current Liabilities}}$$

$$\text{Cash Ratio} = \frac{\text{Cash and Cash Equivalent} + \text{Short term Investments}}{\text{Current Liabilities}}$$

## 2. Profitability ratios.

### Gross Profit Ratio

$$\text{Gross Profit Ratio} = \frac{\text{Gross Profit}}{\text{Net Sales}} \times 100$$



### Net profit after tax

$$\text{Net profit ratio} = \frac{\text{Net profit after tax}}{\text{Net sales}} \times 100$$

## 3. Activity ratios/Turnover Ratio (also called efficiency ratios)

$$\text{Inventory Turnover Ratio} = \frac{\text{Cost of Goods Sold (COGS)}}{\text{Average Inventory}}$$

$$\text{Debtor's Turnover Ratio} = \frac{\text{Net Credit Sales}}{\text{Average Trade Receivables}}$$

$$\text{Creditor's Turnover Ratio} = \frac{\text{Net Credit Purchases}}{\text{Average Trade Payables}}$$

$$\text{Average Collection Period} = \frac{\text{Accounts Receivable}}{\text{Net Credit Sales}} \times 365 \text{ Days}$$

$$\text{Average Payment Period} = \frac{\text{Average Accounts Payable}}{\text{Credit Purchases} \div \text{Number of Days in Period}}$$

#### 4. Leverage ratios/Capital Structure Ratio.

$$\text{Debt to Equity Ratio (D/E)} = \frac{\text{Total Debt}}{\text{Total Shareholders Equity}}$$

$$\text{Proprietary Ratio} = \frac{\text{Proprietors' Funds or Shareholders' Funds}}{\text{Total Assets}}$$

**Solvency Ratio Formula**





$$\text{Solvency Ratio} = \frac{(\text{Net Income} + \text{Non-Cash Expenses})}{(\text{Short Term Liabilities} + \text{Long Term Liabilities})}$$

#### Gearing Ratio Formula

$$1) \text{ Gearing Ratio} = \frac{\text{Total Debt}}{\text{Total Equity}}$$

$$2) \text{ Gearing Ratio} = \frac{\text{EBIT}}{\text{Total Interest}}$$

$$3) \text{ Gearing Ratio} = \frac{\text{Total Debt}}{\text{Total Assets}}$$



## Funds flow statement

A funds flow statement, also known as a statement of changes in financial position or a statement of sources and uses of funds, is a financial document that provides a detailed analysis of how a company's working capital has changed between two balance sheet dates. It explains the changes in financial position by highlighting the sources from which funds were obtained and the uses to which these funds were put.

$$\text{Working Capital} = \text{Current Assets} - \text{Current Liabilities}$$

## Components of a Funds Flow Statement

### 1. Sources of Funds:

- **Operations:** Net income after taxes and adjustments for non-cash items like depreciation.
- **Sale of Fixed Assets:** Proceeds from selling property, plant, and equipment.
- **Issue of Shares:** Funds raised from issuing equity or preference shares.
- **Long-term Loans:** Loans or other long-term borrowings.
- **Non-operating Income:** Income from non-operational activities such as interest, dividends, or sale of investments.

### 2. Uses (Applications) of Funds:

- **Operations:** Any losses incurred.
- **Purchase of Fixed Assets:** Capital expenditure on acquiring property, plant, and equipment.
- **Repayment of Loans:** Repayment of long-term borrowings.
- **Payment of Dividends:** Distribution of dividends to shareholders.
- **Investments:** Purchase of long-term investments.

## Steps to Prepare a Funds Flow Statement

### 1. Prepare a Schedule of Changes in Working Capital:

- Identify current assets and current liabilities from the balance sheets of the two periods.
- Calculate the increase or decrease in each item.
- Determine the net change in working capital.

### 2. Determine Sources and Uses of Funds:

- Identify transactions that increase funds (sources) such as profits, issue of shares, or sale of fixed assets.
- Identify transactions that decrease funds (uses) such as losses, purchase of fixed assets, or repayment of debt.

### 3. Prepare the Funds Flow Statement:

- List all sources of funds.
- List all uses of funds.
- Ensure that the total sources equal the total uses, reflecting the change in working capital.

## Format of Schedule of Changes in Working Capital

Particulars	2019 (\$)	2020 (\$)	Effects on Working Capital	
			Increase (\$)	Decrease (\$)
<b>Current Assets</b>				
Stock	75,000	60,000		15,000
Debtors	90,000	100,000	10,000	
Cash	30,000	60,000	30,000	
Short-term Investments	20,000	15,000		5,000
<b>Total Current Assets (A)</b>	<b>215,000</b>	<b>235,000</b>		
<b>Current Liabilities</b>				
Creditors	15,000	55,000		40,000
<b>Total Current Liabilities (B)</b>	<b>15,000</b>	<b>55,000</b>		
Working capital (A) - (B)	200,000	180,000		
<b>Net Decrease in Working Capital</b>		20,000	20,000	
<b>Total</b>	<b>200,000</b>	<b>200,000</b>	<b>60,000</b>	<b>60,000</b>

## Format of Funds Flow Statement

### Funds Flow Statements (for the year ended \_\_\_\_)

Sources of Fund	Amount(₹)	Application of Funds	Amount(₹)
Funds from Operations		Funds Lost in Operations	
Issue of Shares Capital		Redemption of Preference Share Capital	
Issue of Debentures		Redemption of Debentures	
Raising Long-term Loans		Payment of Long-term Loan	
Sale of Fixed Assets		Purchase of Fixed Assets	
Sale of Long-term Investment		Purchase of Long-term Investments	
Non-Trading Income (such as Dividend)		Payment of Dividend	
Decrease in Working Capital		Payment of tax (if treated as appropriation of profit)	
	xxxxxx	Increase in Working Capital	xxxxxx

# Cash Flow Statement

A cash flow statement is a financial report that provides aggregate data regarding all cash inflows a company receives from its ongoing operations and external investment sources. It also includes all cash outflows that pay for business activities and investments during a given period.

## Components of a Cash Flow Statement

The cash flow statement is divided into three main sections:

1. **Operating Activities**
2. **Investing Activities**
3. **Financing Activities**

### Detailed Explanation

#### 1. Operating Activities:

- o **Net Income:** Starting point, reflecting the company's profit.
- o **Adjustments for Non-Cash Items:** Add back non-cash expenses like depreciation.
- o **Changes in Working Capital:** Adjust for changes in accounts receivable, inventory, and accounts payable.

#### 2. Investing Activities:

- o Include cash outflows for purchases of long-term assets (capital expenditures) and inflows from the sale of assets.

#### 3. Financing Activities:

- o Include cash inflows from issuing shares or borrowing, and outflows for repaying debt and paying dividends.

## Format of Cash flow statement

Gary's Garden Furniture Cash Account July		
Operations		
<b>NET INCOME</b>		<b>36,000</b>
<b>Adjustments</b>		
Depreciation	2,000	
Accounts Receivable	3,000	
Decrease in Prepaid Expenses	1,000	
Decrease in Inventory	3,000	
Increase in Accounts Payable	3,000	
<b>Cash Provided By (Used For) Operations</b>		<b>12,000</b>
 <b>INVESTING</b>		
Capital Expenditures	(3,000)	
Short Term Investments Sold	2,000	
<b>Cash Provided By (Used For) Investments</b>		<b>(1,000)</b>
 <b>FINANCING</b>		
Bank Debt	1,000	
Dividends Paid	(6,000)	
<b>Cash Provided By (Used For) Financing</b>		<b>(5,000)</b>
 <b>Net Cash Flow (Drain)</b>		<b>6,000</b>
Add Balance of Cash at Beginning of Period		8,000
 <b>Balance of Cash at End of Period</b>		<b>14,000</b>

# Introduction to Inventory

Inventory management is a critical aspect of supply chain management that involves overseeing the ordering, storing, and using a company's inventory. This includes managing raw materials, components, and finished products, as well as warehousing and processing such items. Effective inventory management helps businesses maintain the right balance of stock to meet customer demands while minimizing costs and inefficiencies.

## What is Inventory?

**Inventory** refers to the goods and materials a business holds for the purpose of resale, production, or utilization. It includes:

## Inventory Types

- **Raw Materials:** Basic inputs used in the manufacturing process.
- **Work-In-Progress (WIP):** Items that are in the production process but not yet completed.
- **Finished Goods:** Products that are completed and ready for sale.

## Techniques of Inventory

### 1. Economic Order Quantity (EOQ)

**EOQ** is a formula used to determine the optimal order quantity that minimizes the total costs associated with ordering and holding inventory.

- **Formula:**

$$EOQ = \sqrt{\frac{2 \times S \times D}{H}}$$

- D = Demand rate (units per period)
- S = Ordering cost per order
- H = Holding cost per unit per period

- **Purpose:** Balances ordering costs with holding costs to minimize total inventory costs.

### 2. Just-In-Time (JIT)

**JIT** is an inventory strategy where materials are ordered and received only as they are needed in the production process.

- **Benefits:**
  - Reduces holding costs
  - Minimizes waste
  - Increases efficiency
- **Challenges:** Requires accurate demand forecasting and reliable suppliers to prevent stock outs.

### 3. ABC Analysis

**ABC Analysis** categorizes inventory into three groups based on their value and importance.

- **Categories:**
  - **A Items:** High-value, low-frequency items (require tight control and accurate records)
  - **B Items:** Moderate-value, moderate-frequency items (require regular review)
  - **C Items:** Low-value, high-frequency items (require simple controls)
- **Purpose:** Helps prioritize management focus and resources on the most important items.

### 4. VED Analysis

VED is Vital Essential and Desirable. It is a simple but effective way to classify inventory items into three categories based on their importance to the business: vital, essential, and desirable.

#### Categories in VED Analysis

1. **Vital (V):**
  - Items classified as Vital are crucial for the operation of the organization.
  - A stock out of these items can halt production, cause significant operational disruptions, or compromise safety.
  - Examples: Life-saving drugs in hospitals, key raw materials in manufacturing.
2. **Essential (E):**
  - Items in this category are important for the smooth operation of the organization but not as critical as vital items.
  - A stock out of Essential items can cause minor disruptions and inefficiencies but is not as critical as vital items.
  - Examples: Maintenance parts, certain tools, and supplies.
3. **Desirable (D):**
  - Items classified as Desirable are those whose absence would not significantly affect operations.
  - Stock outs of these items might cause inconvenience but do not halt operations or cause significant disruptions.
  - Examples: Office supplies, non-critical spare parts.

## What is Tally.ERP 9?

Tally.ERP 9 is one of the most popular business management software used in India. It is complete enterprise software for small & medium enterprises.

Tally.ERP 9 is a perfect business management solution with an ideal combination of function, control, and in-built customizability.

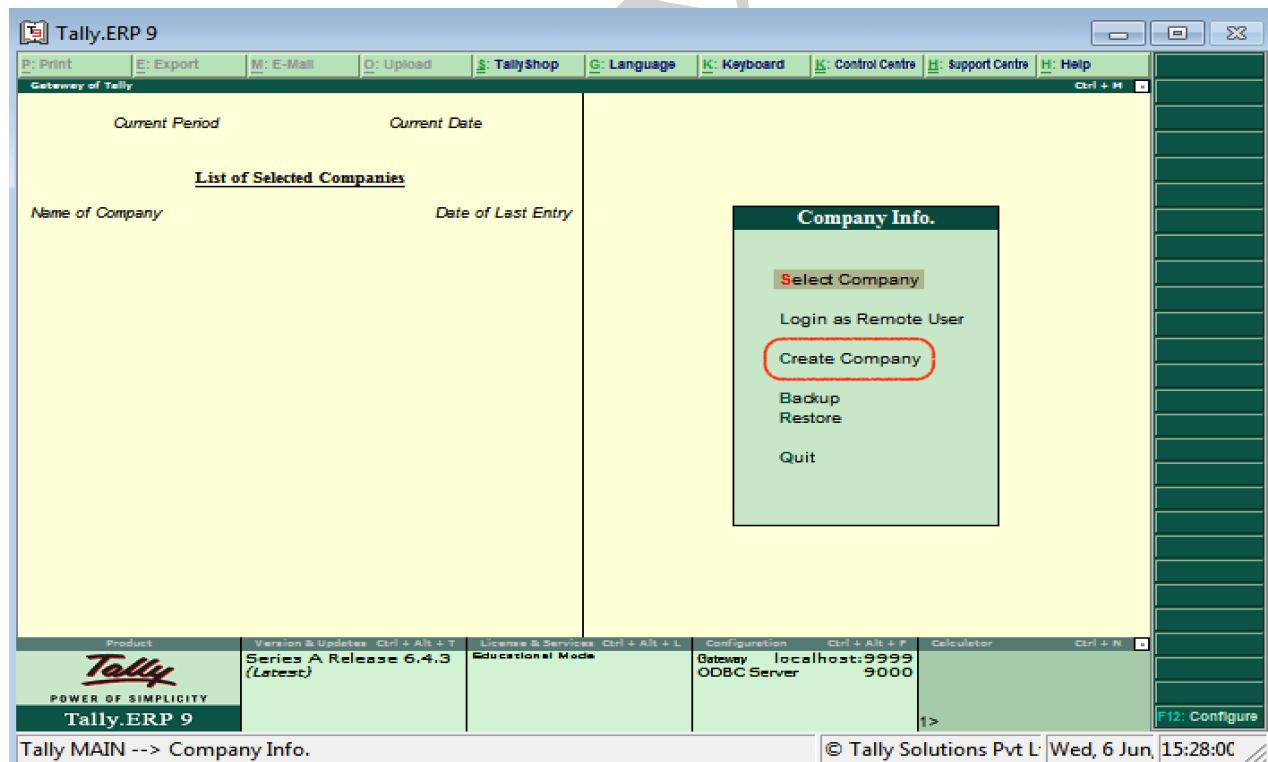
How to create a company in Tally

### Step-by-Step Guide to Create a Company in Tally ERP 9

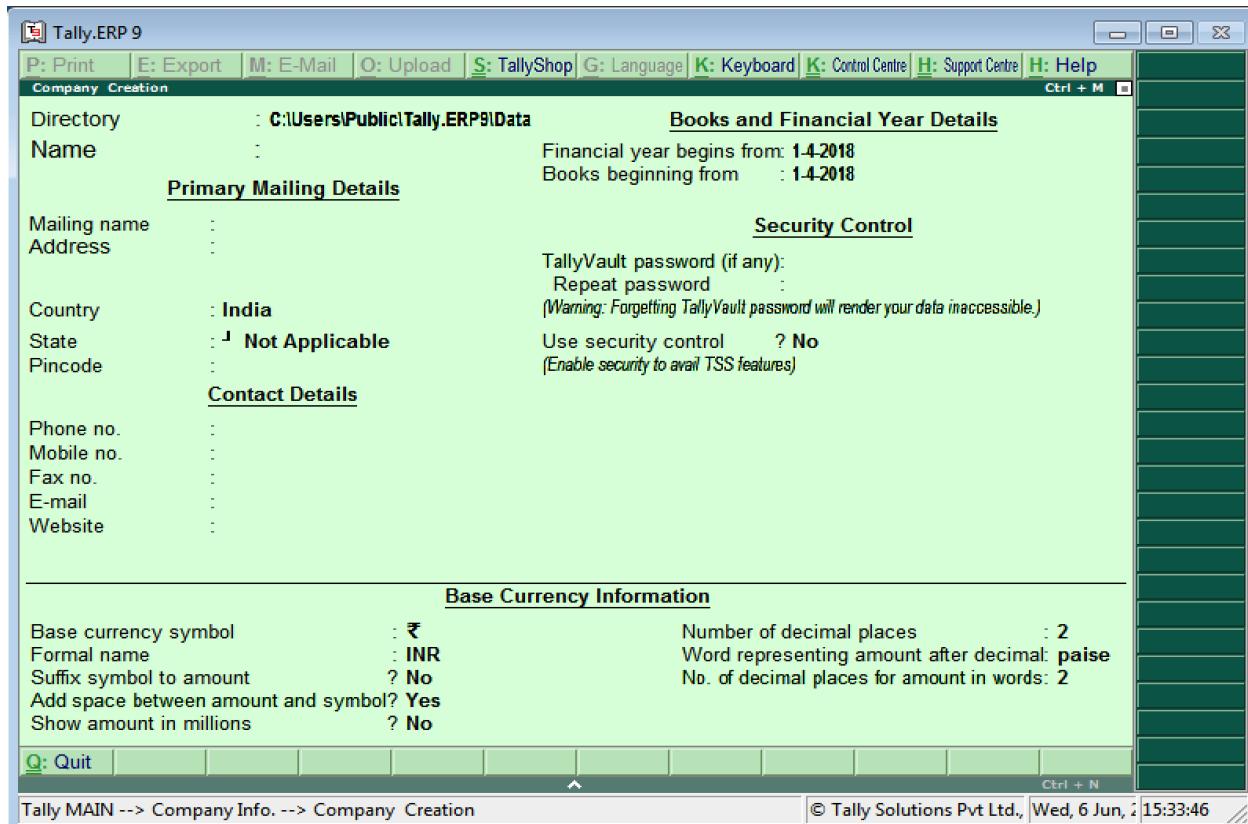
1. **Launch Tally ERP 9** on your computer.
2. **Select 'Create Company'** from the Company Info menu or press Alt + F3 to open the Company Information screen and then select 'Create Company'.

**Step 1:** In tally, after login double click on the create company option under company information. The following navigation path is used to create the company in Tally:

**Gateway of Tally → Company Info → Create Company**



**Step 2:** The following screen displays the company creation window:



**Step 3:** Enter the "Company's Mailing Name". This is an important field because it shows all the printouts.

**Step 4:** Enter the "Company's Full Address". This is shown on all printouts. Thus it is an important field.

**Step 5:** Choose the "Name of the Country" as India from the given countries list.

**Step 6:** Choose the "State" from the given list of states.

**Step 7:** Update the "Company's Pin Code", where it is located.

**Step 8:** Update the "Telephone Number"/ landline of the company.

**Step 9:** Update the "E-Mail id" and "Website" of the company.

**Step 10:** Update the financial year starting date of the company. In India, the financial year of the company starts on 1<sup>st</sup> April and ends on 31<sup>st</sup> March.

**Step 11:** Update the date from which accounting is allowed in Tally. Generally, this date and the starting date of the financial year are the same. But if the company has been formed on any other date of the year, that date will be mentioned.

**For example:** If books have been set to begin from 1-Dec 2019, the Tally will not allow the entries for the 1-April-2019 to 30-Nov-2019.

**Step 12:** If we want to use Tally Vault, enter a password. It is a secure feature that encrypts data.

**Step 13:** Repeat the password of Tally Vault. Tally ERP matches this password with the previously entered password to ensure that the password we typed previously was the intended password, which means there is no typing error.

Here the bar indicates the password strength. Strong passwords indicate with a green bar. A strong password is better.

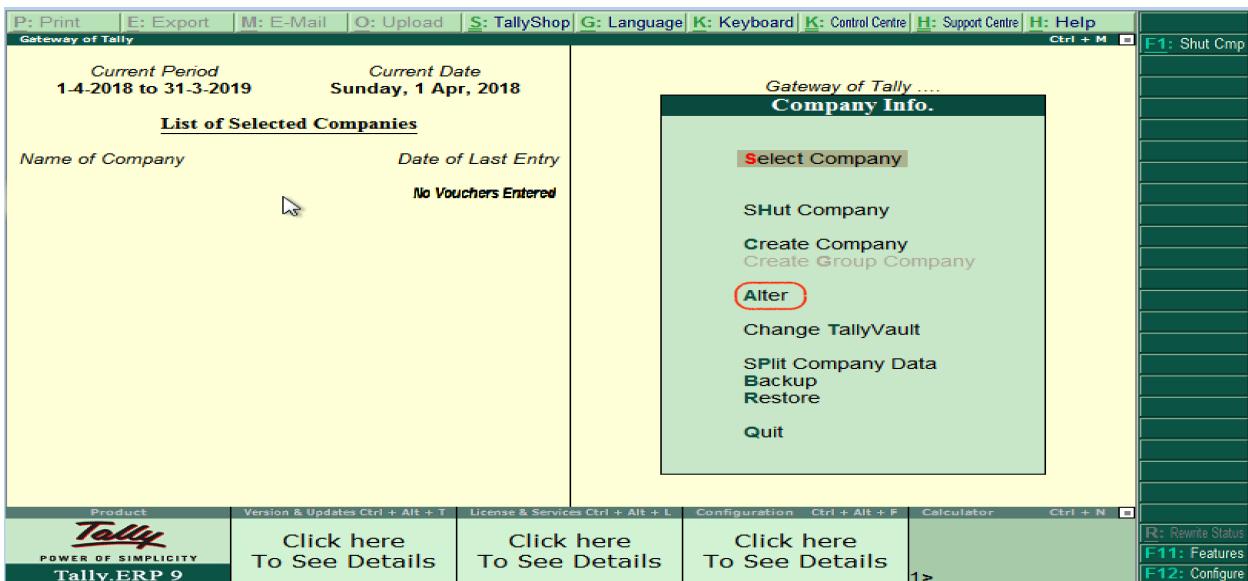
**Step 14: Base Currency Information:** Fill in details such as the symbol, formal name, and suffixes for amounts.

Company Creation		Ctrl + M
Directory	: D:\tally\data	
Name	: Ganesh Trading Co	
<b>Primary Mailing Details</b>		<b>Books and Financial Year Details</b>
Mailing name	: Ganesh Trading Co	Financial year begins from : 14-2016
Address	: 14 Main, MG Road, Bangalore	Books beginning from : 14-2016
Country	: India	
State	: Karnataka	
Pincode	: 560001	
<b>Contact Details</b>		<b>Security Control</b>
Phone no.	: 080-22282982	TallyVault password (if any) : *****
Mobile no.	: 09929229828	Repeat password : *****
Fax no.	: 080-33330003	(Password strength: Strong)
E-mail	: graneshtrade@gmail.com	(Warning: Forgetting TallyVault password will render your data inaccessible.)
Website	: ganeshtrade.co.in	
		Use security control ? Yes (Enable security to avail TSS features)
		Name of administrator : admin
		Password : *****
		Repeat password : *****
		(Password strength: Good)
		Use Tally Audit features ? Yes
		Disallow opening in Educational Mode? Yes
<b>Base Currency Information</b>		
Base currency symbol	: ₹	Number of decimal places : 2
Formal name	: INR	Word representing amount after decimal : rupees
Suffix symbol to amount	? No	No. of decimal places for amount in words
Add space between amount and symbol	? Yes	
Show amount in millions	? No	
		Accept ?
		Yes or No

## How to Alter Company

After the company creation in Tally, the given information of the company can alter/ modify/ change as per requirement. Use the following steps to alter company in Tally:

**Step 1: Gateway of Tally → Press Alt+F3 → Alter**



**Step 2:** Under "List of Selected Company", select the company name and click on the name of company to alter.

**Step 3:** On the screen of company alteration, add and modify the required details. To save the details, use the Ctrl+A option.

## How to delete company

In Tally, if we delete the company, it can remove the company's complete information from Hard disk. All the directories and files that are associated with the company will be permanently deleted. This information cannot be reserved.

In Tally ERP 9, use the following path to delete the company:

**Gateway of Tally → Alt+F3 → Alter → Alt+D**

**Step 1:** The company information will display on the screen after using Alt+F3 keys. Here, the delete option will not be available. Now, click on the alter option.

**Step 2:** Now, click on Select Company and then click Alt+D. After this, click on the YES option to delete the company.

Name : Tutorial Kart	Books and Financial Year Details
Mailing name : Tutorial Kart	Financial year begins from : 1-4-2018
Address : Amaravathi Vijayawada	Books beginning from : 1-4-2018
Country : India	Security Control
State : Andhra Pradesh	Use security control : ? No (Enable security to avail TSS features)
Pincode : 522020	
Contact Details	
Phone no. : 08645 - 888888	
Mobile no. :	
Fax no. :	
E-mail : admin@tutorialkart.com	
Website : www.tutorialkart.com	
Delete ?	
Yes OR No	
Base Currency Information	
Base currency symbol : ₹	Number of decimal places : 2
Formal name : INR	Word representing amount after decimal : paiso
Suffix symbol to amount : ? No	No. of decimal places for amount in words : 2
Add space between amount and symbol : ? Yes	
Show amount in millions : ? No	

## How to Shut Company in Tally

In Tally, shut a company does not mean that delete a company, it means close. After working with the company, choose the "Quit" button to close the present company or press **Alt+F1** if we chose more than one company.

### List of Accounts (Chart of Accounts)

Tally.ERP 9 gives you great flexibility in setting up your chart of accounts. It allows you to group your ledger accounts right at the time of creating your accounts chart. Your reports and statements reflect the desired classification at all times.

**List of accounts** displays the existing **chart of accounts**, listed as **groups**, in alphabetical order.

#### To view list of accounts

- Go to **Gateway of Tally > Display > List of Accounts.**



## F11: Company Features in Tally.ERP 9

Different features of a company can be selected or modified by using the **Features** button. This button is available in almost all the screens of Tally.ERP 9 enabling the user to modify it as and when your requirements change.

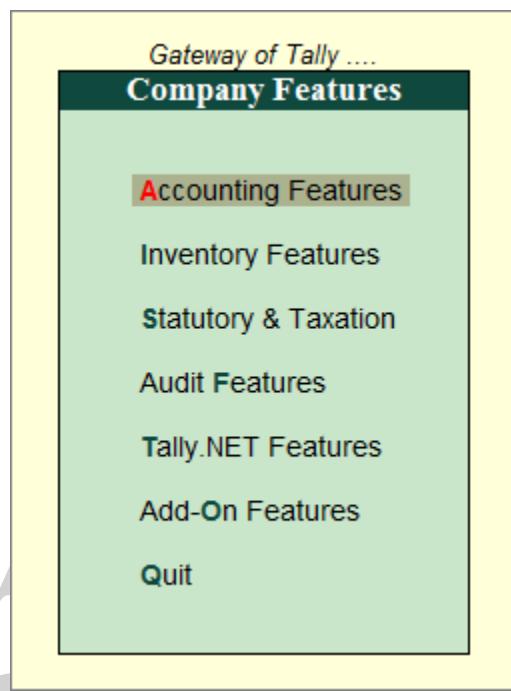
Unlike **F12: Configure**, **F11: Company Features** is specific to the current company only. Therefore, each company may have different active features. Configuration options, on the other hand, affect all companies maintained in the same Tally.ERP 9 directory and setting the

configuration for one company will affect the configuration of other companies in that particular data directory.

**Note:** Certain features like multi-currency and multi-locations, once set to Yes, cannot be modified if the feature has been used. However, other features like **Bill-wise details**, **Reversing Journals & Optional vouchers**, etc., can be modified even if they are used.

Go to **Gateway of Tally > F11: Features**

The **F11: Features** menu is displayed as shown.



## Tally ERP 9 Configuration

Tally ERP 9 configuration is applicable for all the companies that are located in the Tally data directory. The F12: Configurations may vary from menu to menu.

For example: If we press F12: Configuration from the voucher screen, then the respective screen displays on the screen.

How to Open Configuration in Tally

Gateway of Tally → Click on **F12: Configure** or Press Function Key **F12**

Voucher Entry Configuration

Accounts

Skip Date field during creation for faster entry	? Yes	Provide reference number in stock journal	? No
Use single entry mode for payment/receipt/contra vouchers?	Yes	Show compound unit of item based on rate	? No
Use payment/receipt as contra voucher	? No	Show full details of compound unit	? No
Use Cr/Dr instead of To/By during entry	? No	Warn on negative stock balance	? Yes
Enable cheque printing for contra voucher	? No	Show balances as on voucher date	? No
Warn on negative cash balance	? Yes	Show Godown-wise details	? Yes
Preallocate bills for payment/receipt/journal voucher?	No	Show batch-wise details	? Yes
Allow cash accounts in journal vouchers	? No		
Allow expenses/fixed assets in purchase vouchers?	No		
Allow income accounts in sales vouchers	? No	Allow modification of tax details for VAT	? No
Show inventory details	? Yes		
Show table of bills for selection	? Yes		
Show final balances of bill	? Yes		
Show bill-wise details	? Yes		
Expand into multiple lines	? Yes		
Show current balances of ledgers	? Yes		
Show balances as on voucher date	? No		

Inventory

Statutory