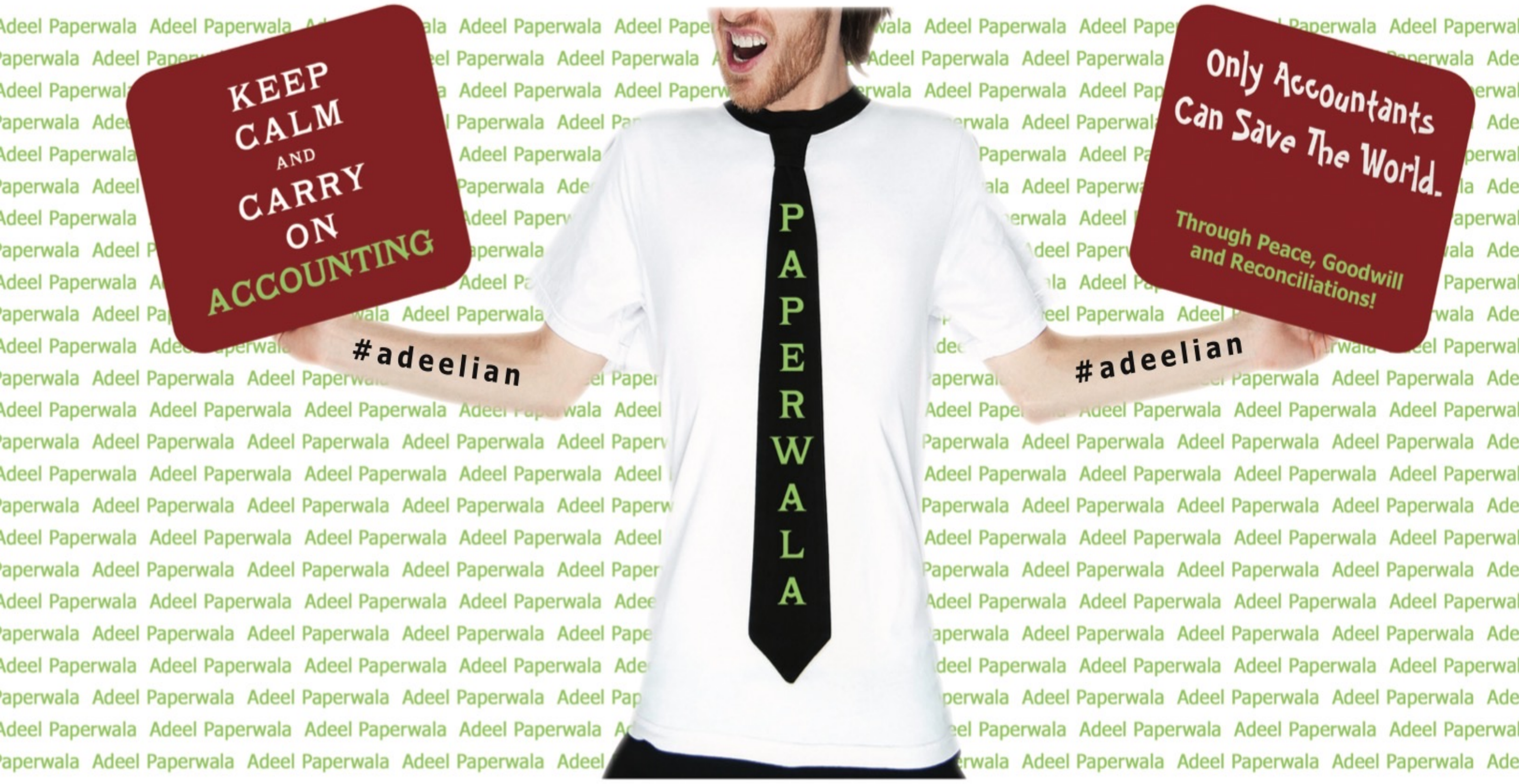
Topic 1



INTRODUCTION TO FINANCIAL ACCOUNTING

INTRODUCTION TO ACCOUNTING

Accounting :- The term accounting is derived from the word "account"

↓ means ↓ means

"Recording" record

↓ what?

"business transactions" $\xrightarrow{\text{How?}}$ as per 'dual aspect concept' { Debit / Credit

↓ - what type?

events containing monetary values

every transaction has 2 effects which are equal and opposite.

Money Measurement : A business records only those transactions which can be measured in monetary terms. Non monetary transactions such as motivation, integrity, honesty, hardwork, dedication can not be measured in monetary terms, hence cannot be recorded in business books of accounts.

Dual Aspect / Duality Concept :- Each and every transaction requires a debit effect and an equal amount of credit effect, and it is also referred as double entry system of book keeping.

Debit and Credit expresses change or movement, and these can be positive or negative change or movement

Debit can be ↑ or + change and it can be ↓ or (−) change

Credit can be ↑ or + change and it can be ↓ or (−) change defination as per books   listing

Accounting :- A systematic process of "recording", "summarizing", "analyzing" and "reporting" financial information.

5 categories/heads of accounting

1. Assets :- Anything owned by a business.
2. Liabilities :- Anything owed by a business/debts of a business
3. Capital :- Investment
4. Revenue :- Income
5. Expenses :- Cost incurred to earn income.

THE ACCOUNTING EQUATION

"ASSETS = CAPITAL + LIABILITIES"

OR

"LIABILITIES = ASSETS − CAPITAL"

OR

"CAPITAL = ASSETS − LIABILITIES"

Assets: Economic resources owned and controlled by business entity

- owned ↓ title / ownership right
- controlled ↓ have risk & reward of asset
- business entity ↓ business organisation

Rent :- Right to use.

Substance Over Form: Transactions are always recorded on the basis of economic substance or commercial reality rather than legality.

Assets

long term > 1 year ↑ **Non Current Assets**

- Economic Resources;
- Useful life > 1 financial year (12 months); (signaficant)
- Possess material economic value;
- Helps in generation of economic benefits;
- Not bought with an intention to resale.

short term < 1 year ↑ **Current Assets**

- Economic Resources;
- Used or consumed within 1 financial year;
- Can be easily converted into liquid (cash)

E.g:- Inventory / Stock

- Trade Receivables / Debtors
- Other Receivables [Prepaid Expenses]
- Cash at bank
- Cash in hand / Petty Cash

(Cash at bank and Cash in hand / Petty Cash: cash and cash equivalent)

Non Current Assets

Tangible Non Current Assets
- Economic resources which can be seen, touched and have physical existence
- E.g:: land and building (Property / Premises),
  - Plant and Machinery
  - Motor Vehicles
  - Fixtures and Fittings
  - Furniture
  - Equipment

Intangible Non Current Assets
- Economic resources which cannot be seen, touched or have physical existence
- E.g:: Computer Software
  - Patents and Copyrights
  - Goodwill

Business Activity

1. Trading
- Business involved in buying and selling of goods.
- hold inventories of
  i. finished goods

2. Manufacturing
- Business involved in production of goods
- hold inventories of
  i. Raw materials
  ii. Work in Progress
  iii. Finished Goods

3. Service
- Businesses involved in providing of services and services are intangible
- Does not hold any inventory.

goods purchased with an intention to resale

= purchases [expense]

↓

if unsold [Asset] - closing inventory

Trade Receivables / Account Receivables / Trade Debtors :

They are our customers to whom we have sold goods on credit

Bad Debts [Expense]

The credit customers who are unable to settle their debts are called bad debts.

Reasons for bad debts

1. Fraud or untraceable customers
2. Bankrupt or insolvent

Other Receivables [Prepaid Expenses]

Expenses paid in advance (The advantage of expense payment to be utilised at future date).

Cash and Cash Equivalent

Cash at Bank

Any amount available as bank balance is called cash at bank

↓

Transactions

- withdrawal ↓ (payments)
- deposit ↑ (receipts)

Cash in hand (Petty Cash)

Any amount available in physical cash is called cash in hand.

↓

Transactions

- cash inflow ↑ (receipts)
- cash outflow ↓ (payments)

Dual Aspect / Duality Concept ∵ Each and every transaction requires a debit effect and an equal amount of credit effect, and it is also referred as double entry system of book keeping.

Debit and Credit expresses change or movement, and these can be positive or negative change or movement

Debit can be ↑ or + change and it can be ↓ or (−) change

Credit can be ↑ or + change and it can be ↓ or (−) change

Effects on assets

Nature of asset is debit

'↑' increase in asset or '+' positive change → 'Debit'

'↓' decrease in asset or '−' negative change → 'Credit'

Effects on Expenses

Nature of expenses is debit

'↑' increase in expenses or '+' positive change → 'Debit'

'↓' decrease in expenses or '−' negative change → 'Credit'

Effects on Capital

Nature of Capital is credit

'↑' increase in capital or '+' positive change → 'Credit'

'↓' decrease in capital or '−' negative change → 'Debit'

Effects on liability

Nature of liability is $\boxed{\text{credit}}$

'↑' increase in liability or '+' positive change → 'Credit'

'↓' decrease in liability or '−' negative change → 'Debit'

Effects on Revenue

Nature of Revenue is $\boxed{\text{credit}}$

'↑' increase in Revenue or '+' positive change → 'Credit'

'↓' decrease in Revenue or '−' negative change → 'Debit'

INTRODUCTION TO COST AND MANAGEMENT ACCOUNTING

Cost / Expense :- Outflow of resources.

Business Activities

Trading	Manufacturing	Services
• Businesses involved in buying and selling of goods	• Businesses involved in production of goods	• Businesses involved in providing services and services are intangible.
• Deal only in finished goods	• Purchase raw material • Converts them into finished	• Do not hold any inventory

Stages of Manufacturing

1. Input [raw material] → 2. Process → 3. Output [finished goods]

Conversion Cost

Labour + Overheads

Labour:
- manual [labour intensive]
- machine operator [capital intensive]

Labour intensive business :- Business organisations dependant on manual labour rather than technology and machinery

Capital intensive business :- Business organisations which are more dependant on machines rather than manual labour.