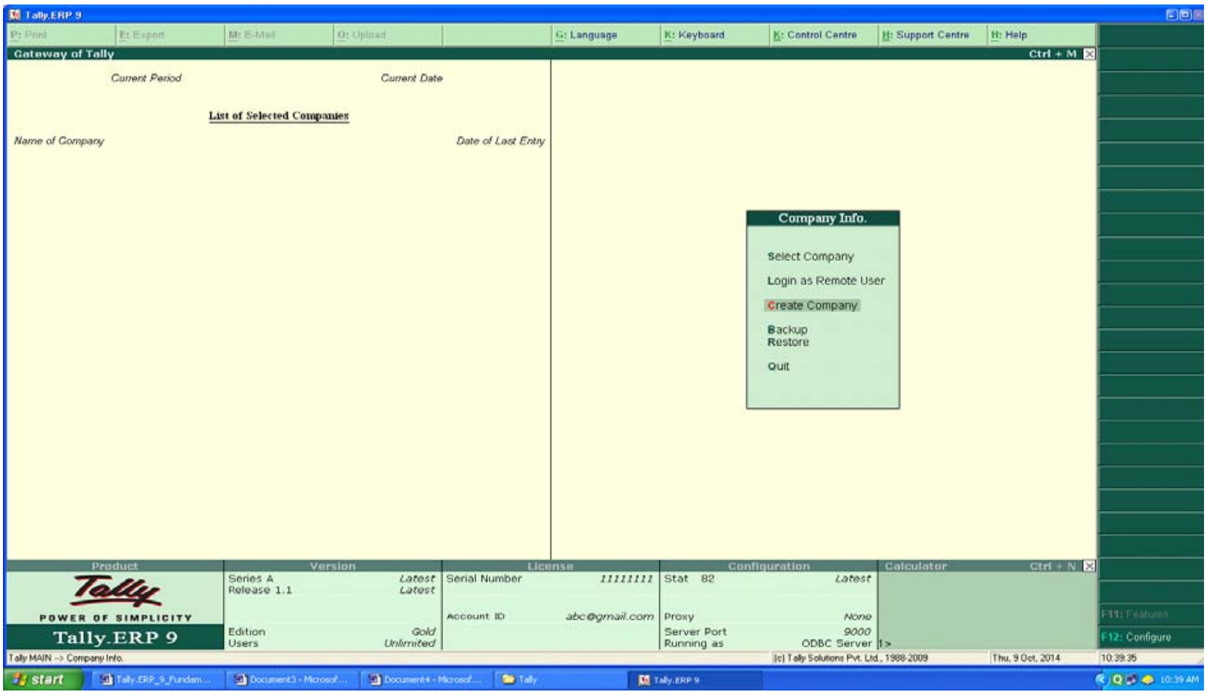
Implementing Accounts in Tally - Basics of Accounting, Golden Rules of Accounting, Voucher Entry, Ledger Posting, Final Accounts Preparation

Objectives: At the end of this lesson you shall be able to
- **explain the tally software screen**
- **understand accounting, its types, terms used**
- **understand golden rules of Accounting**
- **state about the journals, ledgers with entry posting methods**
- **prepare cash book, bank book etc.**
- **know shortcut keys.**

Tally Software : In Gateway of Tally the following option is display. (Fig 1)

Fig 1



Screen of the Tally

Tally Screen: Tally screen can be divided into following four broad parts.

1 Product info

2 Button bar

3 Calculator

4 Work area

Product info: Product info bar in Tally.ERP9 consisting of the information about the product.

1 Developer company

2 Software version and Release

3 Software Serial Number

4 Single or Multiple User

5 System Day and Date

6 System Time

Button Bar: Buttons appearing in the button bar (at right of the screen) provide quick access to different options. Buttons on the button bar is context sensitive, different buttons appear at different screens.

Calculator: By default the work area becomes active and calculator remains inactive. Press Ctrl + N that would activate the calculator when calculator is active, we can enter value and operators.

The calculator follows BODMAS rule that indicates the execution sequence: Bracket, Power, Division, Multiplication, Addition and Subtraction.

Work area

The work at Gateway is broadly separated into two sections.

1 The right hand side contains the popup menu, where we would select instructions to Tally.

2 The left hand side displays list of selected companies.

On left part of the screen

Current Period

Financial period with which we are working is displayed for reference. To change the Financial period click "F2:period" button in the button bar or press <Alt> + <F2>.

Current Date

It is not the calendar date but the date we worked last during the current period. Vouchers will have the same date as of current date. To change current date click "F2:Date" button in the button bar or press F2.

List of selected companies

Name of all selected companies with last date voucher entry is displayed here. If we select more than one company, the active company is shown at the top of list in bold face and others appear next in normal fonts.

On right part of the screen

Gateway of Tally menu

Primary choices of menu is displayed. The menu operations are dependent on selection/activation of operations. In some cases, we may find some operations grayed indication that the option is not active.

For example, upon selecting a company maintaining Accounts only, Inventory Info and stock summary options would be grayed.

Selections of menu

We can select a menu in either of the following mode:

1 Press the highlighted character. For example, to select create company, press 'C' the highlighted character.

2 Move highlight bar on the option with Up/Dn arrow key and press<Enter>.

3 Using mouse double click the option. (We have to click twice very fast).

Company Info Menu

On loading Tally, by default, Company Info menu appear to select a company we wish to work with. If we are installing Tally first time. select company option would remain inactive and by default cursor would appear on Create Company option.

Buttons at gateway

Help (Hotkey: Alt+H): This button launches "Tally Reference Manual. This is a compiled HTML Help file. Normally on clicking this button, the relevant content in respect of the screen would be displayed. If no context sensitive Help exists, contents would be displayed. We can select the topic we wish to view.

Web browser (Hot key: Alt+W)

This button launches the default installed web browser. For example, internet explorer is the default web browser, on clicking the button IE will be loaded. The browser will appear within the work area of the tally screen. All other areas of Tally screen still remains in the screen.

F1- Select cmp (Hoy key: F1)

This button will display the list of companies. Move the highlight bar and press <Enter> key to select a particular company. Or simply press F1 key on the keyboard.

Introduction to Accounting

It is the language of business through which normally a business house communicates with the outside world.

Accounting may be defined as "the art of recording, classifying summarising and analysing transactions in the books of accounts".

Accounting and accountancy are often synonymous terms.

Accounting can be classified into two parts.

1 Financial accounting

2 Management Accounting

Financial Accounting

The accounting for revenues, expenses assets and liabilities that is commonly carried on in the general offices of a business is termed as Financial Accounting.

Its aim is to ascertain the profit or loss and to state the financial position of the business as at a particular date.

Scope of Financial Accounting

1 Recording information in account books like journals, cashbooks etc

2 Classifying the accounts using ledger.

3 Summarising the information as statements like (1) Trial balance (2) Income statement and (3) Balance sheet

Management Accounting

The term management accounting refers to accounting for the management. The management accounting provides information to the management so that planning, organising directing and controlling of business operations can be done in an orderly manner.

Scope of Management Accounting

Following areas are identified within management accounting

1 Financial accounting

2 Cost accounting

3 Revaluation accounting

4 Budgetary control

5 Inventory control

6 Statistical methods

7 Interim Reporting

8 Taxation

9 Office services

10 Internal Audit

Accounting terms

Business transaction

A business transaction is "The movement of money and money's worth form one person to another" or exchange of values between two parties.

Purchase means goods purchased by a businessman from suppliers.

Sales is goods sold by a businessman to his customers.

Purchase Return or Rejection in or Outward Invoice

Purchase return means the return of the full or a part of goods purchased by the businessman to his suppliers.

Sales Return or Rejection out or Inward Invoice

Sales return means the return of the full or a part of the goods sold by the customer to the businessman.

Assets

Assets are the things and properties possessed by a businessman in business.

Two types of Assets

Fixed Asset means the asset remain in business of use and not for resale. Eg. A shop owner purchase buildings, typewriter, showcases

Current Asset means the things and properties for resale ie. The asset converts into cash. Eg. A cloth shop owner buys cloth for resale. Stock of cloth is current asset.

Liabilities

All the amounts payable by a business concern to outsiders are called liabilities.

Capital

Capital is the amount invested for starting a business by a person.

Debtor

Debtor is the person who receives benefit without giving money or moneys worth immediately, but liable to pay in future. i.e. the person owes amounts to the businessman.

Creditor

Creditor is the person who gives benefit without receiving money or money's worth immediately but ot claim in future. i.e. the personto whom amounts are owed by the businessman.

Debit: The receiving aspect of a transaction is called debit or Dr.

Credit: The giving aspect of a transaction is called credit or Cr.

Drawings

Drawings are the amounts withdrawn (taken back) by the businessman from his business for his personal, private and domestic purpose. Drawings may be made in the form cash, goods and assets of the business.

Receipts

It is a document issued by the receiver of cash to the giver of cash acknowledging the cash received voucher.

Account

Account is a summarized record of all the transactions relating to every person, everything or property and every type of service.

Ledger

Ledger is the main book of account. It is the book of final entry where accounts lie.

Journal

Journal is a book of first entry. Transactions are entered in the journal before taken to the appropriate ledger accounts.

Trial Balance

It is a statement of all the ledger account balances prepared at the end of particular period to verify the accuracy of the entries made in books of accounts.

Profit

Excess of credit side total amount over debit side total amount.

Loss

Excess of debit side total amount over credit side total amount.

Profit and loss account

It is prepared to ascertain actual profit or loss of the business.

Balance Sheet

To ascertain the financial position of the business. It is a statement of assets and liabilities.

Types of accounts

Accounts can be divided into two major types.

Personal Accounts

Impersonal Accounts

Impersonal Accounts can be further divided into two types.

1 Real Account

2 Nominal Account

Personal accounts are the accounts of persons, firms, concerns and institutions which the businessmen deal.

Principles: Debit the receiver, Credit the giver

Real Account: These are the accounts of things, materials, assets & properties. It has physical existence which can be seen & touch. Ex. Cash, Sale, Purchase, Furniture, Investment etc.

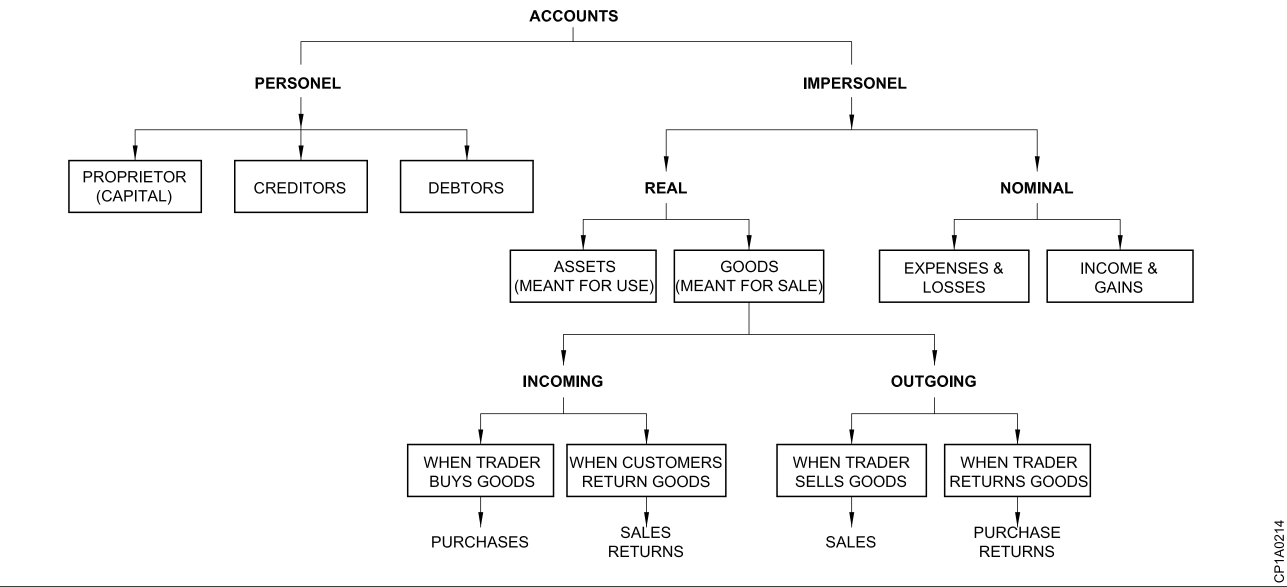
Principles: Debit what comes in, Credit what goes out

Nominal account: Nominal account is the account of services received (expenses and Losses) and services given (income and gain) Ex. Salary, Rent, Wages, Stationery etc.

Principles: Debit all expense/losses, Credit all income/gains

We can clearly understand the classification of accounts in the following Figure 1.

Fig 1



GOLDEN RULES OF ACCOUNTING

Account type	Rules	
Personal Accounts	Debit the Receiver	Credit the Giver
Real Accounts	Debit what comes in	Credit what goes out
Nominal Accounts	Debit all expenses & losses	Credit all incomes & gains

Account Layout

An account has two sides. The left hand side is known as 'Dr' or 'Debit' side. The right hand side is known as 'Cr' or 'Credit' side.

The benefits received by the account are recorded on the left hand side. The benefits imparted by the account are recorded on the right hand side.

The layout of an account looks like as under.

ACCOUNT

Dr Cr

Date	Particulars	Amount	Date	Particulars	Amount
Benefits received			Benefits Imparted		

The receiving aspect which is known as 'Debit' is entered on the Debit side of the account. The giving aspect which is known as 'Credit' is entered on the Credit side of the accounts.

The principle under which both Debit and Credit aspects are recorded is known as the principle of Double entry. Every debit must have a credit and vice versa. If the accounts are not maintained under double entry system, then the records are incomplete and known as single entry.

Double Entry : A business transaction is a transfer of money or money's worth from one account to another. A transfer requires two accounts. A business transaction affects two account's in the opposite directions. If one account receives a benefit, the another account should impart the benefit.

The principle of Double entry is based on the fact that,

There is no giving without receiving and

There is no receiving without giving

DOUBLE ENTRY VS SINGLE ENTRY

Sl. No.	Double Entry	Single Entry
1	For every Debit there is a corresponding credit and vice versa	There are no credits and Debits here
2	Maintains a complete record of a Personal accounts b Real accounts and c Nominal accounts	An incomplete record. Only personal accounts and cash accounts are maintained
3	A balance sheet and profit and loss statement can be prepared conveniently, since the books of accounts present a complete picture	A balance sheet and profit and loss statement cannot be conveniently prepared since the accounting records are incomplete
4	Double Entry is a complete, scientific system of keeping books of accounts	Single Entry is not a system. It is incomplete and unscientific

Personal Account - Examples:

1 Sold goods to Selvan on credit Rs.1,100/-

Selvan account receives a benefit and hence should be debited

2 Returned damaged goods to Sami.

Sami account receives a benefit and hence should be debited

3 Proprietor Thiru Anbu withdraws cash Rs.500 for house hold expenses

Anbu - Drawing account receives a benefit and hence should be debited

In the above examples selvan a/c, Sami a/c, and Anbu - Drawings a/c are Personal accounts. They are receivers of benefits and hence should be debited.

4 Anbu started business with cash Rs.50,000/-

Anbu - Capital a/c gives benefit in the form of cash to business. Hence capital a/c should be credited

5 Bought goods from Somu on credit for Rs.1,700/-

Somu a/c gives a benefit and hence should be credited

6 Received five chairs from Godrej Co. at Rs.45 per chair on credit basis

Godrej Co a/c gives benefit in the form of 5 chairs. Hence godrej co a/c should be credited.

In the above examples capital a/c, Somu a/c and Godrej a/c are personal accounts. They are giving benefits. Hence their accounts should be credited.

Real Account - Examples

1 Bought five chairs [furniture] from Godrej Co. at Rs.45 per chair on credit basis.

Furniture worth Rs.225 have come into the business as per Rule, Debit what comes in. Since Furniture has come in, Furniture Account should be debited.

2 Anbu started business with cash Rs.50,000/-

Cash of Rs.50,000 has come into the business and hence cash account should be debited

3 Purchased goods from Somu on credit for Rs.1,700/-.

Goods are bought in the aspect of purchases. Hence purchases account should be debited.

In the above examples, Furniture Account, cash account and purchases account are real accounts. Since they have come into business, the accounts are debited.

4 Sale of goods to Selvan on credit Rs.1,100/-

Goods have gone out of the business hence sales account is credited

5 Paid cash to Somu Rs.1,700/-

Cash goes out of the business and hence cash account should be credited

6 Paid rent Rs.250/-

Cash goes out of the business and cash should be credited

In the above examples Sales Account Cash Accounts are real accounts. They are credited as per Rule.

Nominal Accounts Examples:

1 Paid Rent Rs.250/-

Rent is an expense account. Hence rent account should be debited

2 Paid salary Rs.1,200/-

Salary is an expense account. Hence salary account should be debited

3 Purchase of paper, pencils, ink, cover's etc., for Rs.250/-

These are stationary items and expense items. Hence stationery account should be debited

In the above three examples Rent account, salary account and stationery account all are nominal accounts. They are debited since they are expense items

4 Received commission Rs.500/-

Here commission is income to the business and hence commission account should be credited.

5 Received interest on loan given to B Rs.100/-

Interest is income to the business. Hence interest Account should be credited.

In the above two examples commission account and interest account are Nominal accounts. They have been credited since they are incomes.

Books of Accounts

Books of accounts can be generally classified into three categories.

1 Journal

2 Ledger

3 Subsidiary Books

Journal : Journal is a book of prime entry. When a transaction takes place, it is recorded in the Journal.

Layout of a Journal

Date (1)	Particulars (2)	L.F. (3)	Dr. (4)	Cr. (5)

L.F means Ledger Folio. The L.F column is meant for recording the page number of the concerned account in the Ledger. The transactions recorded in the journal will be posted to the appropriate accounts in the Ledger.

Journalising : Journalising is the process of analysing the business transaction under the heads of debit and credit and recording them in the journal.

When journalising a transaction the following steps to be followed.

1 What are the accounts affected? name them.

2 What type of accounts are they? Identify them. e.g., Personal, Real or Nominal

3 Apply the rules for debit and credit.

Account type	Debit	Credit
Personnal Accounts	The Receiver	The Giver
Real Accounts	What comes in	What goes out
Nominal Accounts	Expenses and Losses	Incomes and Gains

In Journalising a transcation, the debit aspect is shown first with observation "Dr" after the name of the account. The credit aspect is shown as a second item with the word "To" at the beginning. A brief description of the transaction known as "Narration" is given at the end of every entry in the journal.

Example 1

1st July 2003 : Received cash from Muthu Rs.500

1 What are the accounts affected?

Cash Account and Muthu Account

2 Types of Accounts

Cash account is a Real account

Muthu account is a personal account

3 According to Rule No.2 Cash Account should be debited because cash comes into the business.

According to Rule No.1, Muthu Account should be credited since Muthu has given benefit.

Journal

Date	Particulars	L.F.	Dr.		Cr.	
			Rs.	P.	Rs.	P.
2003 July 1st	Cash Account Dr. To Muthu Account (Being cash received from Muthu)	2 41	500	00	500	00

Example 2

July 7, 2003 : Bought goods for cash Rs.1543.

1 Purchase Account and Cash Account are affected.

2 Purchase Account and cash accounts are Real accounts.

3 Purchase Account should be debited since goods have come into business. Cash account should be credited since cash has gone out.

Date	Particulars	L.F.	Dr.		Cr.	
			Rs.	P.	Rs.	P.
2003 July 7th	Purchase Account Dr. To cash Accounts (Being cash purchases of goods)	35 4	1543	00	1543	00

Ledger

The ledger is the main book of business containing Personal, Real and Nominal accounts of the business. But transactions are not recorded in the Ledger directly. These are first entered in the Journal and then posted to the concerned accounts in the Ledger.

Layout of Ledger account

An account is divided in the middle and the two sides are called debit side and credit side respectively.

Kannan Account (Personal Account)

Dr.	Cr.
Debit Kannan when he receives goods, money or value from the business	Credit Kannan when he gives goods, money or value to the business

Furniture Account (Real Account)

Dr.	Cr.
Debit Purchase of Asset	Credit sale of asset

Salary Account (Nominal Account)

Dr.	Cr.
Debit expenses in normal account	

Interest received account (Nominal a/c)

Dr.	Cr.
	Credit gains in Nominal accounts

Posting in the Ledger : The technique of recording the journal entries into the ledger is known as posting.

The account end with "Dr" is to be debited in the Ledger. The account starts with "To" is to be credited in the Ledger. It is customary to write "To" on the debit side and "By" on the credit side.

Example:

Given the journal Entry

Date	Particulars	L.F.	Dr.		Cr.	
			Rs.	p.	Rs.	p.
2003 July 1st	Cash Account Dr. To Capital Account (Being the amount invested in business)		75,000	00	75,000	00

Capital account starts with "To". So the capital account is credited with the entry in the credit side as "By cash".

CAPITAL ACCOUNT

Dr. Cr.

Date	Particulars	Amount Rs. P.	Date	Particulars	Amount	
					Rs.	P.
			2003 July 1	By cash	75,000	00

JOURNAL VS LEDGER

S.No.	Journal	Ledger
1	The journal is a subsidiary book	The ledger is the main book of accounts
2	Transactions are first entered in Journal	Entries in the journal are posted in the Ledger.
3	Journal is a daily record. Business transactions are entered in this book in the order of dates	Posting from journal to Ledger is done periodically, may be weekly or fortnightly.
4	Entering the transaction in the journal is called journalising	The act of recording journal entries into ledger is called "Posting".

Subsidiary Books : Journal is sub-divided into smaller journals called subsidiary-journals. We can synonymously call subsidiary - journals as subsidiary books.

Categories of subsidiary book includes the following.

1 Purchase Book.

2 Sales Book.

3 Purchase Returns Books

4 Sales Returns Books

5 Cash book

1 Purchase Book

- This book is also called as "Purchase Day book", "Invoice Book", "Bought Book", "Purchases Journal".
- It is used for recording credit purchases of goods.
- Cash purchases are not recorded in this book.

Layout of purchase book

Date	Name of the Supplier	L.F.	Invoice No.	Amount

2 Sales Book

This book is also called as “Sales Journal”, “Sold Book”, “Sales Day Book”

– It is used to record credit sales of goods.

– Cash sales are not recorded in this sales book

– Sale of an old asset on credit is not recorded in the sales book

Layout of the Sales Book

Date	Name of the Customer	L.F.	Outward Invoice No.	Amount

3 Purchase Returns Book

– This book is also called as “Purchases Returns Journal”, “Returns Outwards Book”.

– It is used to record transactions relating to return of goods to suppliers.

Layout of Purchase Returns Book

Date	Name of Supplier	L.F.	Debit Notes Nos.	Amount

4 Sales Returns Book

– This book is also called as “Returns Inwards Book”, “Sales Returns Journal”.

– It is used to record particulars of goods returned by customers.

Layout of Sales Returns Book

Date	Name of Customer	L.F	Credit Note No.	Amount

5 Cash Book

– The purpose of the cash book is to record all cash receipts and payments and the sums deposited into and with drawn from the bank.

– Cash book looks just like a ledger.

Layout of Cash Book

Dr Cr

Date	Particulars	L.F.	Amount	Date	Particulars	L.F	Amount

Accounts Information - Grouping

Current Asset: It is converted into cash with in a year. Ex. Bills receivable.

Direct Expenses: These are the expenses which are directly related to manufacturing of goods. Ex. Wages, factory rent, heating, lighting etc.,

Indirect Expenses: These are the expenses which are indirectly related to manufacturing of goods. Ex. Salary, rent, stationery, advertisement, printing.

Depreciation: Decrease the value of the asset.

Sundry debtors: The person who is the receiver or customer.

Sundry creditors: The person who gives or supplier.

Expenses Outstanding or Unpaid expenses or Expenses due:

Expenditure incurred during current year but the amount on which is not yet paid. (Added to the expenditure on the debit side and entered on the liability side.)

Income received in advance or Income received but not earned.

Income received during the currentyear but not earned or a part of which relates to the next year. (Deducted from the concerned income on the credit side and entered on the liability side)

Prepaid advance or Expenses

Expenditure paid during current year but not incurred or a part of which related to the next year is called expenditure prepaid.

Income outstanding means income earned during the current year but the amount on which is not yet received.

Accounts information - Ledger - Grouping

Ledger	Group
Cash at bank	Bank Account
Bank overdraft	Bank OD
Capital	Capital Account
Cash in hand	Cash in hand
Other Liabilities	Current Liabilities
Bills receivable	Current Asset
Stock of stationery	Current Asset
Prepaid expenses	Current Asset
Income outstanding	Current Asset
Bills payable	Current Liabilities
Expense outstanding	Current Liabilities
Income received in advance	Current Liabilities
Fixed deposit at bank	Deposit
Fright charges	Direct Expenses
Carriage inwards or Purchases	Direct Expenses
Cartage and coolie	Direct Expenses
Octroi	Direct Expenses
Manufacturing wages	Direct Expenses
Coal, gas, water	Direct Expenses
Factory rent, insurance, electricity, lighting and heating	Direct Expenses
Loose tools	Fixed Asset
Fixtures and fittings	Fixed Asset
Furniture	Fixed Asset
Motor Vehicles	Fixed Asset
Plant and machinery	Fixed Asset
Land and building	Fixed Asset
Leasehold property	Fixed Asset
Patents	Fixed Asset
Goodwill	Fixed Asset
Salary	Indirect Expenses
Postage and Telegrams	Indirect Expenses
Telephone charges	Indirect Expenses
Rend paid	Indirect Expenses

Rates and taxes	Indirect Expenses
Insurance	Indirect Expenses
Audit fees	Indirect Expenses
Interest on bank loan	Indirect Expenses
Interest on loans paid	Indirect Expenses
Bank charges	Indirect Expenses
Legal charges	Indirect Expenses
Printing and stationery	Indirect Expenses
General expenses	Indirect Expenses
Sundry expenses	Indirect Expenses
Discount allowed	Indirect Expenses
Carriage outwards or sales	Indirect Expenses
Travelling Expenses	Indirect Expenses
Advertisement	Indirect Expenses

Shortcut Keys

F1	Select Company
Alt+F1	Shut Company
Alt+F3	Company information menu
Ctrl+A	To accept a form wherever you use the key combination the screen or report will be accepted as it is on this screen.
Alt+C	To create a master at a voucher screen.
Alt+D	To delete a voucher/To delete a master.
Ctrl+Enter	To alter a master while making an entry or viewing report.
F2	Date
Alt+F2	Change period
F11	Company features
F12 the	Configuration optionsare applicable to all companies in a data directory.
Ctrl+N	Calculator screen.
Ctrl+V	Voucher mode (Cr. Dr)/Invoice mode (name of item, rate, quantity, and amount)
F4 Contra	Records funds transfer between cash and bank accounts
F5 Payment	Record all bank and cash payments

F6 Receipt	Records all receipts into bank or cash accounts.
F7 Journal	Records adjustments between ledger accounts
F8 Sales	Records all sales.
Ctrl+F8	Credit note voucher
F9	Purchase Records all purchase.
Ctrl+F9	Debit note voucher
F10	Reversing Journal voucher
Alt+2	To duplicate a voucher
Alt+C	To create a Master at a voucher screen
Alt+E	To export the report in ASCII, SDF, HTML or XML Format
Alt+I	To insert a voucher
Alt+R	To remove a line in a report in reports screen
Alt+S	To bring back a line, you removed using Alt+R in reports screen
Alt+X	To cancel a voucher in Daybook/List of vouchers

Journalize the following transactions

1 Commenced business with cash Rs.50,000/-

2 Deposit into bank Rs.15,000/-

3 Bought office furniture Rs.3,000/-

4 Sold goods for cash Rs.2,500/-

5 Purchased goods form Mr. X on credit Rs.2,000/-

6 Sold goods to Mr. Y on credit Rs.3,000/-

7 Received cash form Mr. Y on account Rs.2,000/-

8 Paid cash to Mr. X Rs.1,000/-

9 Received commission Rs.50/-

10 Received interest on bank deposit Rs.100/-

11 Paid into bank Rs.1,000/-

12 Paid for advertisement Rs.500/-

13 Purchased goods for cash Rs.1,500/-

14 Sold goods for cash Rs.1,500/-

15 Paid salary Rs.5,000/-

Gateway of Tally - Account info - Ledger - Create

Gateway of Tally - Account voucher

Sl.No.	Key	Voucher	Ledger	Group	Types of account	Principles	Amount
1	F6	Receipt	Cr. Capital	Capital account	Personal	Giver	50,000
			Dr. Cash	Cash in hand	Real	Comes in	50,000
2	F4	Contra	Cr. Cash	Cash in hand	Real	Goes out	15,000
			Dr. Bank	Bank account	Real	Comes in	15,000
3	F5	Payment	Dr. Furniture	Fixed asset	Real	Comes in	3,000
			Cr. Cash	Cash in hand	Real	Goes out	3,000
4	F8	Sales	Dr. Cash	Cash in hand	Real	Comes in	2,500
			Cr. Sales	Sales account	Real	Goes out	2,500
5	F9	Purchase	Cr. X	Sundry creditor	Personal	Giver	2,000
			Dr. Purchase	Purchase account	Real	Comes in	2,000
6	F8	Sales	Dr. Y	Sundry debtors	Personal	Receiver	3,000
			Cr. Sales	Sales account	Real	Goes out	3,000
7	F6	Receipt	Cr. Y			Giver	2,000
			Dr. Cash	Cash in hand	Real	Comes in	2,000
8	F5	Payment	Dr. X			Reciever	1,000
			Cr. Cash	Cash in hand	Real	Goes out	1,000
9	F6	Receipt	Cr. Commission	Indirect income	Nominal	Credit all income	50
			Dr. Cash	Cash in hand	Real	Comes in	50
10	F6	Receipt	Cr. Interest on bank deposit	Indirect income	Nominal	Credit all income	100
			Dr. Bank	Bank account	Real	Comes in	100
11	F4	Contra	Cr. Cash	Cash in hand	Real	Goes out	1,000
			Dr. Bank	Bank account	Real	Comes in	1,000
12	F5	Payment	Dr. Advertisement	Indirect expenses	Nominal	Debit all expenses	500
			Cr. Cash	Cash in hand	Real	Goes out	500
13	F9	Purchase	Cr. Cash	Cash in hand	Real	Goes out	800
			Dr. Purchase Cr. Cash	Purchase account	Real	Comes in	800
14	F8	Sales	Dr. Cash	Cash in hand	Real	Comes in	1,500
			Cr. Sales	Sales account	Real	Goes out	1,500
15	F5	Payment	Dr. Salary	Indirect expense	Nominal	Debit all expenses	5,000
			Cr. Cash	Cash in hand	Real	Goes out	5,000

Financial Accounting Reports

Objectives: At the end of this lesson you shall be able to
- **understand financial accounting**
- **understand book-keeping**
- **prepare trading account, profit and loss account & balance sheet.**

Introduction: The accounting for revenues, expenses, assets and liabilities that is commonly carried on in the general offices of a business is termed as Financial Accounting.

Its aim is to ascertain the profit or loss of the business and states the financial position of the business as at a particular date.

Financial accounting includes the following activities.

i Book keeping

ii Preparation of Trading Account

iii Preparation of profit and loss account

iv Preparation of Balance Sheet

Book-keeping : Book-keeping is the art of recording business transactions in a systematic manner. Main objective of book-keeping is to calculate the profit or loss of a business accurately.

We have discussed various types of Books of accounts in the previous chapter.

Advantages of Book-Keeping

1 Book-keeping provides reliable record of transactions essential for ready reference.

2 Profit or loss is ascertained using Books of accounts

3 Calculation of due amount the businessman has to pay others is done using Books of accounts

4 Borrowings and Assets are controlled.

5 Financial position and growth of business is ascertained

6 Do's and Don'ts are identified

7 Book-keeping is used for taxation and fixing selling price.

Final Account : Trading, Profit and Loss account, Balance sheet are prepared at the end of the year or at the end of the part. So it is called Final Account.

– Trading, Profit & loss account is prepared to find out profit or loss of the organisation

– Balance sheet is prepared to find out the financial position of the organisation

Trading Account : Trading refers to buying and selling of goods. Trading account shows the result of buying and selling of goods. This account is prepared to find out the difference between the selling price and cost price.

– If the selling price exceeds the cost price, it will bring Gross Profit. For example, If the goods of cost price Rs.50,000 are sold for Rs.60,000 that will bring in Gross Profit of Rs.10,000.

– If the cost price exceeds the selling price, it will bring Gross loss. For example, if the goods of cost price Rs.60,000 are sold for Rs.50,000, that will result in Gross Loss of Rs.10,000

Thus Gross Profit or Gross Loss is indicated in Trading Account.

Items appearing in the Debit side of Trading account

1 **Opening Stock :** Stock on hand at the commencement of the year or period is termed as the opening stock

2 **Purchases :** It indicates total purchases both cash and credit made during the year

3 **Purchases returns or Returns outwords :** Purchases Returns must be subtracted from the total purchases to get the net purchases. Net purchases will be shown in the trading account.

4 **Direct Expenses on Purchases :** Some of the Direct Expenses are

a **Wages:** It is also known as productive wages or Manufacturing wages

b **Carriage or carriage Inwards:**

c **Octroi Duty :** Duty paid on goods for bringing them within municipal limits

d Customs duty, Dock duty, clearing charges, Import duty etc.,

e Fuel, Power, Lighting charges related to production

f Oil, Grease and Waste

g **Packing charges:** Such expenses are incurred with a view to put the goods in a saleable condition.

Items appearing on the credit side of trading account

1 **Sales:** Total sales (Including both - cash and credit) made during the year or period

2 **Sales Returns or Return Inwards:** Sales returns must be subtracted from the Total sales to get Net sales. Net sales will be shown

3 **Closing stock:** Generally, closing stock does not appear in the Trial Balance. It appears outside the Trial Balance. It represents the value of goods at the end of the trading period.

Specimen form of a trading a/c

Dr. **Trading Account for the year ending** **Cr.**

Particulars	Amount Rs. P.	Amount Rs. P.	Particulars	Amount Rs. P.	Amount Rs. P.
To Opening stock		xxxx	By sales	xxxx	
To Puchase	xxxx		Less: Returns		
Less : Returns-outwards	xxxx		Inwards	xxxx	xxxx
To wages		xxxx	By closing stock		xxxx
To Freight		xxxx	By Gross loss		xxxx
To Carriage Inwards		xxxx	(to be transferred to P&L A/c)		
To Clearing charges		xxxx			
To Packing charges		xxxx			
To Dock dues		xxxx			
To Power		xxxx			
To Gross Profit		xxxx			
(to be transferred to P&L A/c)					
		xxxx			xxxx

Balancing of Trading Account : The difference between the two sides of the Trading account, indicates either Gross Profit or Gross loss. If the total on the Credit side is more, the difference represents Gross Profit. On the other hand, if the total of the debit side is high, the difference represents Gross loss. The Gross Profit or Gross Loss is transferred to Profit & Loss A/c.

Closing Entries of Trading A/c : Trading account is a ledger account. Hence no direct entries should be made in the trading account. Several items such as purchases, sales are first recorded in the journal and then posted to the ledger. The same accounts are closed by transferring them to trading account. Hence it is called as closing entries.

Advantages of Trading Account

1 The results of purchases and sales can be clearly assertained.

2 Gross profit ratio to sales could also be easily ascertained. It helps to determine price

3 Gross profit ratio to direct expenses could also be easily ascertained. And so, unnecessary expenses could be eliminated

4 Comparison of trading account details with previous year details help to draw better administrative policies.

Example 1

Prepare a trading account from the following informations of a trader

i Total purchases made during the year 2002 Rs.20,000

ii Total sales made during the year 2002 Rs.25,000

Trading account for the year ending 31st December 2002

Dr Cr.

Particulars	Amount Rs. P.	Particulars	Amount Rs. P.
To purchases	20,000	By sales	25,000
To Gross profit c/d	5,000		
	25,000		25,000

Example 2

Prepare a Trading Account from the following informations of a trader.

i 2002 Jan 1 Opening stock Rs.5,000

ii Purchases Rs.16,100

iii Sales Rs.30,600

iv 2002 Dec 31 Closing Stock Rs.3,500

Trading Account for the year ending 31-12-2002

Dr Cr.

Particulars	Amount Rs. P.	Particulars	Amount Rs. P.
To opening stock	5,000	By sales	30,600
To purchases	16,100	By Closing stock	3,500
To Gross profit c/d (Transferred to P&L a/c)	13,000		
	34,100		34,100

PROFIT and LOSS Account : Trading account reveals Gross profit or Gross loss. Gross profit is transferred to credit side of profit and loss account. Gross loss is transferred to debit side of the profit and loss account. Thus profit and loss account is commenced. This profit & loss account reveals Net Profit or Net loss at a given time of accounting year.

Items appearing on Debit side of the P& L Account:

The expenses incurred in a business is divided into two parts. One is Direct expenses which are recorded in the trading account. Another one is indirect expenses which are recorded on the debit side of profit & loss account.

Indirect Expenses are grouped under four heads:

1 **Selling Expenses :** All expenses relating to sales such as carriage outwards, travelling expenses, advertising etc.,

2 **Office Expenses :** Expenses incurred on running an office such as office salaries, rent, tax, postage, stationery etc.

3 **Maintenance Expenses :** Maintenance expenses of assets. It includes repairs and renewals, depreciation etc.,

4 **Financial Expenses :** Interest paid on loan, discount allowed etc., are few examples for Financial expenses.

Items appearing on credit side of P & L account : Gross profit is appeared on the credit side of Profit and Loss account. Also other gains and incomes of the business are shown on the credit side. Typical of such gains are items such as Interest received, Rent received, Discounts earned, Commission earned.

Specimen Form:

Profit & Loss Account for the year ended 31st March 2002

Dr Cr.

Particulars	Amount Rs. P.	Particulars	Amount Rs. P.
To Trading a/c (Gross loss)	xxxx	By Trading a/c (Gross profit)	xxxx
To Salaries	xxxx	By Commission earned	xxxx
To Rent & Taxes	xxxx	By Rent received	xxxx
To Stationaries	xxxx	By Interest received	xxxx
To Postage expenses	xxxx	By Discounts received	xxxx
To Insurance	xxxx	By Net loss (Capital account)	xxxx
To Repairs	xxxx		
To Trading expenses	xxxx		
To Office expenses	xxxx		
To Interest	xxxx		
To Bank charges	xxxx		
To Establishment expenses	xxxx		
To Sundry expenses	xxxx		
To Commission	xxxx		
To Discount	xxxx		
To Advertisement	xxxx		
To Carriage Outwards	xxxx		
To Travelling expenses	xxxx		
To Distribution expenses	xxxx		
To Bad debts	xxxx		
To Depreciation	xxxx		
To Net profit (transferred to Capital a/c)	xxxx		
	xxxx		xxxx

Example 3

Prepare profit and loss account from the following balances of Dharani Enterprises for the year ending 31.12.2012

i Office rent Rs.3,000 Salaries Rs.8,000

ii Printing expenses Rs.2,200 Sationeries Rs.2,400

iii Tax, Insurance Rs.1,400 Discount allowed Rs.600

iv Discount received Rs.400

v Travelling expenses Rs.2,600

vi Advertisement Rs.3,600

vii Gross profit transferred from the trading account Rs.25,000

Profit and Loss Account of Dharani Enterprises for the year ending 31st Dec 2012

Dr Cr.

Particulars	Amount Rs. P.	Particulars	Amount Rs. P.
To Salaries	8,000	By Gross profit	25,000
To Office rent	3,000	(transferred from Trading a/c)	
To Stationaries	2,400	By Discount received	400
To Printing expenses	2,200		
To Tax, insurance	1,400		
To Discount allowed	600		
To Travelling expenses	2,600		
To Advertisement	3,600		
To Net profit	1,600		
(Capital account)			
	25,400		25,400

Example 4

Prepare trading and Profit - Loss account for the year ending 31st March 2012 from the books of Swamy & Co.,

	Rs.
Stock (15-01-1994)	15,000
Carriage Outwards	4,000
Purchases	1,65,000
wages	10,000
Purchase returns	10,000
Sales Returns	5,000
Postage	300
Salaries	5,000
Discount received	500
Stationaries	1,000
Bad debts	100
Interest	800
Sales	3,00,000
Insurance	400
Closing stock	80,000

Trading and Profit and Loss account of Swamy & Co., for the year ending 31st March 2012

Dr Cr.

Particulars	Amount Rs. P.	Particulars	Amount Rs. P.
To Stock (15.01.1994)	15,000	By sales 3,00,000	
To Purchases 1,65,000		Less returns 5,000	2,95,000
Less Returns 10,000	1,55,000	By closing stock	80,000
To Wages	10,000		
To Gross Profit	1,95,000		
	3,75,000		3,75,000
To Salaries	5,000	By Gross profit	1,95,000
To Postage	300	(transferred from trading a/c)	
To Bad depts	100	By discount received	500
To Carriage outwards	4,000		
To Stationaries	1,000		
To Interest	800		
To Insurance	400		
To Net profit	1,83,900		
(Capital a/c)	1,95,500		1,95,500

If trial balance shows trading expenses as well as office expenses, the Trading expenses should be shown in the trading account and office expenses should be shown in profit and loss account. On the otherhand if the trial balance shown only a trading expenses, it should be shown in the profit and loss account

In the trial balance, wages are clubbed with salaries as 'wages and salaries'. This item is shown in Trading account. On the other hand, it appears as salaries and wages and this item is shown in the profit & Loss account.

Income tax : Income tax paid by a proprietor is considered as personal expenses. So instead of debited to Profit and Loss account, it should be debited to the capital account.

Balance sheet

– Trading account provides the details of Gross Profit or Gross Loss

– Profit and Loss account provides the details of the Net Profit or Net Loss

– Besides the above, the proprietor wants

i to know the total assets invested in business

ii To know the position of owner's equity

iii To know the liabilities of business

Definition : The word "Balance Sheet' is defined as " a statement which sets out the assets and liabilities of a business firm and which serves to ascertain the financial position of the same on any particular date".

– On the left hand side of this statement, the liabilities and capital are shown

– On the right hand side of this statement, all the assets are shown

– Hence both the sides of the balance sheet must be equal

– Capital arrives assets exceeds the liabilities

Objectives of Balance sheet

1 It shows accurate financial position of a firm

2 It shows various transactions took place at a given period

3 It indicates that, whether the firm has sufficient assets to repay in liabilities

4 The accuracy of final accounts is verified by this statement

5 It shows the profit and loss arrived, through profit & Loss account

SPECIMEN FORM OF A BALANCE SHEET:
BALANCE SHEET OF SUNIL ENTERPRISES AS AT 31.12.2012

Dr Cr.

Liabilities	Amount Rs. p.	Amount Rs. P.	Assets	Amount Rs. P.	Amount Rs. P
Sundry creditors		xxxx	Cash in hand		xxxx
Bills payable		xxxx	Cash at Bank		xxxx
Bank overdraft		xxxx	Bills receivable		xxxx
Loans		xxxx	Sundry Debtors		xxxx
Mortgage		xxxx	Closing stock		xxxx
Reserve Fund		xxxx	Furniture & Fittings		xxxx
Outstanding exp.		xxxx	Investments		xxxx
Capital	xxxx		Plant & Machinery		xxxx
Add: Net profit (or)			Loose tools		xxxx
Less: Net loss	xxxx		Land and Buildings		xxxx
	xxxx		Business premises		xxxx
Less: Drawings	xxxx		Horses & carts		xxxx
	xxxx		Prepaid exp.		
Less : Income tax	xxxx	xxxx	Patents & Trade marks		xxxx
			Good will		xxxx
		xxxx			xxxx

The Balance sheet contains two parts.

1 Left hand side the liabilities

2 Right hand side the assets

Assets : Assets represent everything which a business owns and has money value. Assets are always shown as debit balance in the ledger. Assets are classified as follows:

1 **Tangible Assets :** Assets which can be seen and felt by touching are called Tangible assets. Tangible assets are classified into two:

a **Fixed Assets :** Assets which are durable in nature and used in business over and again are known as Fixed assets. E.g., Land and building, machinery, trucks, etc.,

b **Floating Assets or Current Assets :** Current Assets are

i Meant to be converted into cash

ii Meant for resale

iii Likely to undergo change

E.g: Cash, Bank Balance, stock, sundry debtor

2 **Intangible Assets :** Assets which cannot be seen and has no fixed shape. E.g., Good will, Patent

3 **Fictitious Assets :** Assets which have no real value and will appear on the assets side of balance sheet are known as fictitious assets.

Ex: Preliminary expenses, Discount on creditors

Liabilities : All that the business owes to others are called liabilities. It means that any amount which a business concern has to pay legally. It also includes proprietor's capital. They are known as credit balances in ledger.

Liabilities are classified as follows.

1 **Long term liabilities :** Liabilities which will be redeemed after a long period of time say 10 to 15 years. e.g., capital, Long-term Loans

2 **Current Liabilities :** Liabilities which are redeemed within a year are called current liabilities or short term liabilities e.g., Trade creditors, Bank Loan

3 **Contingent Liabilities :** Liabilities which have the following features are called contingent liabilities. They are :-

a Not actual liability at present

b Might become a liability in future on condition that the contemplatted event occurs. e.g., Liability in respect of pending suit

Equation of Balance sheet

Capital	=	Assets - Liabilities
Liabilities	=	Assets - Capital
Assets	=	Liabilities + Capital

Trial Balance : When the transactions are recorded under double entry system, there is a credit for every debit. When one account is debited, another account is credited with equal amount.

If a statement is prepared with debit balances on one side and credit balances on the other side, the totals of the two sides will be equal such a statement is called Trial Balance.

Advantages:

1 It is the shortest method of verifying the arithmetical accuracy of entries made in the ledger. If the Trial balance agrees, it is an indication that the accounts are correctly written up. But it is not a conclusive proof.

2 It helps to prepare the trading account, Profit and loss account and balance sheet

3 It presents to the business man a consolidated list of all Ledger Balances.

Sundry Debtors : There may be large number of deptors to a trader. All the deptor's names are not written in the trial balance. A list of debtors with their individual debit balances are prepared and totalled. The total is written under the heading "Sundry Debtors" which appears in the Trial Balance.

Sundry Creditors : There are a number of parties from whom the Trader buys goods on credit basis. All these creditors names are not written in the Trial Balance. A list of creditors with the balances due to them is prepared and totalled. The total is written under the heading "sundry creditors" which appears in the Trial Balance.

Preparation of Balance sheet : Once the Trial Balance is arrived, using that Trading account, Profit and Loss account and Balance Sheet can be casted.

Trial Balance Vs Balance sheet

Trial Balance	Balance Sheet
1 It shows the balances of all ledger accounts	It shows the balances of personal and real accounts only
2 It is prepared after the completion of the ledger accounts or arrival of the balances	It is prepared after the completion of trading and profit and loss account
3 Its object is to check the arithmetical accuracy	Its object is to reveal the financial position of the business
4 Items shown in the trial balance are not in order	Items shown in Balance sheet must be in order
5 It shows Opening Stock	It shows Closing Stock
6 It has the headings, debit and credit.	It has the headings of Assets and Liabilities

Example 5

From the follwing trial balance extracted from the books of Sundar & Sons as on 31.12.2012. Prepare i. Trading and Profit and Loss account and ii. Balance sheet.

Trial Balance as on 31-12-2012

Dr. Cr.

Debit balances	**Amount Rs. P.**	**Credit Balances**	**Amount Rs. P.**
Cash in hand	2,000	Capital	2,00,000
Machinery	60,000	Sales	2,54,800
Stock	50,000	Sundry Creditors	40,000
Bills receivable	1,600	Bank overdraft	22,000
Sundry Debtors	50,000	Return outwards	3,000
Wages	70,000	Discounts received	1,800
Land	40,000	Bills payable	1,800
Carriage inwards	2,400		
Purchases	1,80,000		
Salaries	24,000		
Rent	4,000		
Postage	1,000		
Return inwards	3,200		
Drawings	10,000		
Furniture	18,000		
Interest	600		
Cash at Bank	6,600		
	5,23,400		5,23,400

Stock as on 31-12-2012 is Rs.1,00,000

Trading, Profit & Loss account of Sundar & Sons for the year ending 31-12-2012

Dr Cr.

Particulars	**Amount Rs. P.**	**Particulars**	**Amount Rs. P.**
To stock (1-1-2012)	50,000	By sales 2,54,800	
To purchases 1,80,000		Less Returns 3,200	2,51,600
Less returns 3,000	1,77,000	By closing stock	1,00,000
To wages	70,000		
To carriage inwards	2,400		
To Gross Profit c/d	52,200		
(Transferred to P&L a/c)	3,51,600		3,51,600
To salaries	24,000	By Gross Profit b/d	52,200
To Rent	4,000	(Transferred from Trading a/c)	
To postage	1,000	By discount received	1,800
To interest	600		
To Net Profit	24,400		
(capital a/c)			
	54,000		54,000

Balance sheet of Sundar & Sons as at 31.12.2012

Dr Cr.

Liabilities	Amount Rs. P.	Assets	Amount Rs. P.
Sundry creditors	40,000	Cash in hand	2,000
Bank overdraft	22,000	Cash at bank	6,600
Bills payable	1,800	Machinery	60,000
Capital 2,00,000		Bills receivable	1,600
Add: Net profit 24,400		Sundry debtors	50,000
Less: Drawings 2,24,400	2,14,400	Furniture	18,000
		Land	40,000
		Closing stock	1,00,000
	2,78,200		2,78,200

Costing Systems

Objectives: At the end of this lesson you shall be able to
- **understand costing, its types and cost classification**
- **differentiate budgeting and standard costing**
- **cost centre, cost category, cost centre reports**
- **inventory accounting with tally**
- **inventory report, inventory books, statement of inventory.**

Introduction : Costing refers to fixing the costs of a product. The factors which determines the cost of a product are known as elements of cost.

Elements of cost : There are three cost elements exist in costing. They are

1 Material cost

2 Labour cost

3 Expenses

- Material cost refers to the cost of raw materials used for production of a product.
- Labour cost refers to the wages paid to the workers in the manufacturing department.
- Expenses refers to the expenditure by the way of rent depreciation and power cut.

Concept of Direct and Indirect costs : The total expenditure may be classified as Direct cost and Indirect cost.

Direct cost : The expenditure which can be conveniently allocated to a particular job or product or unit of service is known as direct cost.

Direct expenditure is made up of

1 Direct materials

2 Direct labour

3 Direct expenses

Indirect cost : The expenditure which cannot be conveniently allocated to a particular job or product or unit of service is known as indirect cost.

In a firm productinga a larger variety of articles most of the expenditure apart from materials and labour will be indirect.

Indirect expenditure is made up of

1 Works of factory expenses

2 Office and administrative expenses

3 Selling and distributive expenses

Cost classification : Cost classification is the process of grouping costs according to their common characteristics.

Costs may be classified according to their nature and number of characteristics such as function, variability, controllability and normality.

1 Nature : Costs are classified according to their nature as

a Materials cost

b Labour cost

c Expenses

2 Function : According to the divisions of activity, costs can be classified as

a Production cost

b Admistrative cost

c Selling cost

d Distribution cost

3 Variability : According to their behaviour in relation to changes in the volume of production cost can be classified as

a Fixed cost

b Semi fixed cost

c Variable cost

4 Controllability : Costs are classified according to their influences by the action of a given member of an undertaking as

a Controllable cost

b Uncontrollable cost

5 Normality : Costs are classified according to the costs which are normally incurred at a given level of output as

a Normal cost

b Abnormal Cost

Presentation of total cost : The presentation of total cost according to their nature is shown here.

Statement of total cost

	Rs.
Direct material cost	------------------
Direct wage	------------------
Direct expenses	------------------
"A" Prime cost	------------------
Add : Works on cost or	
Factory expenses	------------------
"B" works cost	------------------
Add: Office and administrative	
Expenses	------------------
"C" cost of production	------------------
Add: Selling and Distribution	
expenses	------------------
"D" Cost of sale	------------------
Add: Profit or Less: loss	------------------
"E" Selling price	------------------

The presentation of total cost according to their variability is shown under.

Statement of total costs

	Rs.
Direct Material cost	....
Direct wages	....
Direct Expenses	....
"A" prime cost	....
Add: Variable expenses	....
"B" Marginal cost	....
Add: Fixed overhead	....
"C" Total cost	....

Fixed and variable costs : Fixed costs are those costs which remain constant at all levels of production within a given period of time. In other words, a cost that does not change in total but become, progressively smaller per unit when the volume of production increases is known as Fixed Cost. It is also called "Period Costs".

E.g., Rent, salary, Insurance charges, etc.,

Variables costs are those costs which vary in accordance with the volume of output.

Absorption costing and Marginal Costing : Absorption costing is also termed as Traditional or Full Cost method. In this method, the cost of a product is determined after considering both fixed and variable costs. In absorption costing all costs are identified with the manufactured products.

Marginal costing is a technique where only the variable costs are considered while computing the cost of a product. The marginal cost of a product is in variable cost. In this method only variable costs are changed to the cost units. Fixed cost is written against contribution for that period.

Hence we can derive a formula for contribution as under:

Contribution = sale price - marginal cost

Standard costing : Standard costing is a specialised technique of costing. In this costing standard costs are pre-determined. Actual costs are compared with pre-determined costs. The variations between the two are noted and analysed. Measures are taken to control the factors leading to unfavourable variations. Standard costing serves as an effective tool in the hands of the management for planning, coordinating and controlling of various activities of the business.

Budgeting Vs Standard costing

	Budgeting	**Standard costing**
1	Budgeting considers operation of the business as a whole Hence it is more extensive.	Standard costing considers only the control of the expenses. Hence it is more intensive.
2	Budget is a projection of financial accounts.	Standard cost is the projection of cost accounts.
3	It does not involve with standardisation of products.	It requires standardisation of products.
4	Budgeting can be operated in part also.	It is not possible to operate this system in parts.
5	Budget can be operated without any standards.	Standard costing cannot exist without budget.
6	Budgets are maximum target of expenses above which actual expenses should not rise.	Standards are minimum targets which are to be attained by actual performance at specific efficiency level.

Cost Centres : Cost Centre is a location, person or item of equipment, in relation to which costs may be ascertained and used for the purposes of cost control.

Any raw material, labour or other input used by an organisation for the manufacturing process is cost which is allocatable as direct or indirect costs to cost centres.

1 **Direct Cost :** A cost which is allocated to a cost centre is a direct cost of that particular cost centre.

2 **Indirect Cost :** A cost which is apportioned to different cost centres on a suitable basis is an indirect cost of that particular cost centre.

Cost Category: Cost Categories are useful for organisations that require allocation of Revenue and Non-Revenue Items to parallel sets of Cost Centres. The examples of Cost Categories can be Region-wise, Grade-wise, Department-wise and so on.

For example, a company has three departments such as Marketing, Finance and Production. Each department has been identified as a cost centre. The wages paid to the respective workers of the department concerned is the direct cost of that particular cost centre(department). However, if the rent of the building in which the production departments are located is apportioned to the departments on a scientific basis, then it is termed as an indirect cost of the cost centre.

This is the example of use of Cost Categories. The Salesmen A, B and C can be Cost Centres under a Category Executive. Similarly, you can create a new Cost Category projects under which Cost Centres such as Airport construction, Road construction and Buildings may be created. So that the classification appears as following

Cost Categories	Departments	Executives	Projects
Cost Centres	Marketing	Salesman A	Airport Construction
	Manufacturing	Salesman B	Road Construction
	Finance	Salesman C	Buildings

Analysis using Cost Centres : Cost centre performance can be measured using volume or relative percentage. For example. Direct variable cost can be monitored as a percentage of sales or even as a percentage of cost of production if there are effective process controls. Indirect expenses can be monitored by creating a reasonable limit on the amount to be spent.

The following elements have to be kept in mind while measuring cost performance.

1 Overall objective of the business.

2 Changes in the business environment.

3 Ground realities.

Cost Centres in Tally : In Tally's cost centre allow for multi dimensional analysis of financial information. The cost centre feature in Tally allows you to allocate a transaction to a particular cost entre, gives the cost centre break-up of each transaction as well as details of transaction for each cost centre. A Profit and Loss Statement of every cost centre can also be obtained.

Cost Centre Reports : These are the following reports -

Category Summary : This report displays the summary of all the cost centers under a cost category.

Cost Centre Break-up: This report displays Ledger and Group summary information for the selected cost centre.

Ledger Break-up: This report displays the summary information of all Cost Centers for the selected Ledger.

Group Break-up: This report displays the summary information of all Cost Centers for the selected Group.

Inventory Accounting With Tally : Inventory accounting includes recording stock details, the purchase of stock, the sale of stock, stock movement between storage Location or Godowns, and providing information on stock availability. With Tally it is possible to integrate the inventory and accounting systems so that financial statements reflect the closing stock value from the inventory system.

The inventory system operates in much the same way as the accounting system.

- First you set up the inventory details, which is a similar operation to creating the chart of accounts although, in this case, there are No pre-defined set of stock groups.
- Second, you create the individual stock items, which is similar to setting up the ledgers.
- Finally, you are ready to use vouchers to record the various stock transaction.

The Inventory features comprises of configurations/ functionality pertaining to Inventory transactions and reports. The Inventory features are further sub-divided into seven sections:

General

Storage & Classification

Order Processing

Invoicing

Purchase Management

Sales Management

Other Features

Inventory Reports : Tally generates inventory reports based on vouchers entries made. You can use the customised reports to compare inventory data between different companies, periods of the financial year and so on. There are Inventory Books and Statements of Inventory.

Inventory Books : In inventory books there are stock item, group summary, stock transfers, physical stock register.

1 **Stock Items :** Stock item refers to goods in which you deal-that is, goods that you manufacture or trade(sell and purchase). It is the primary inventory entity. Similar to ledgers being used in accounting transactions - you have to use Stock Item in Inventory transactions. Therefore, Stock Items are important in Inventory like how Ledgers are important in Accounting.

2 **Units of Measure :** Stock items are mainly purchased and sold on the basis of quantity. The quantity is measured by units. In such a case, it is necessary to create the unit of measure. Units of measure can be simple units such as nos., meters, kilograms, pieces, or compound units, e.g. box of 10 pieces. Create the units of measure before creating the stock items.

3 **Stock Groups :** Similar to Groups in Accounting Masters - these are provided for the purpose of classification of stock items. Classification is done based on some common behavior. Grouping stock items enables easy identification and reporting of stock items in Statements. The group summary statement shows the closing balances of accounts under the selected group upto the current date. For example, items of a particular brand can be grouped together so that you can get the inventory details of all items of that brand. It is NOT necessary to group items.

4 **Stock Transfers :** Stock transfer report display entries made using stock journal vouchers.

5 **Physical Stock Register :** Physical stock register is used to record actual stock available, i. e. Stock found on conducting a stock check. It is not unusual to find a discrepancy between the actual stock and the computer recorded stock figure. If inventory vouchers have been configured to ignore physical stock differences, these physical stock vouchers will be useful for recording purposes.

Statements of Inventory : There are Godown, stock categories, stock query, reorder status, purchase bills pending, sales bills pending.

1 **Godown :** A place where stock items are stored is referred to as Godowns. You can specify where the stock items are kept, e.g. warehouse, shelf or rack, etc, and obtain stock reports for each Godown, and account for movement of stock between locations/ Godowns.

2 **Stock Categories :** This is a feature, which offers a parallel classification of stock items. Like Stock Groups, classification is done based on some similar behavior. The advantage of categorizing items that Tally allows you to classify stock items (based on functionality) together - across different stock groups, enabling you to obtain reports on alternatives or substitutes for a stock item.

3 **Stock Query :** Stock query allows you to obtain all information about a stock item. It displays all the necessary real time information about an item that you may require to help negotiate order with a customer on a single screen. It also display cost and price details of alternative items.

4 **Purchase Bills Pending :** Purchase bills pending displays all instance of incomplete purchases where goods may have been received, but not fully invoiced. It also displays instances of invoices received, but goods have not been received.

5 **Sales Bills Pending :** Sales bills pending displays all instance of incomplete sales where goods may have been delivered, but not fully invoiced. It also displays instances of invoices raised, but goods have not been delivered.

Budgeting systems, Scenario management and Variance analysis

Objectives: At the end of this lesson you shall be able to
- **understand the meaning of budget & budget manual**
- **know the budget period, classification of budgets and its types**
- **understand scenario management**
- **understand variance analysis.**

Introduction : Planning has become the primary function of management these days. Budgets are nothing but the expressions, largely in financial terms of management's plan for operating and financing the enterprise during specific periods of time.

A budget is a detailed plan of operations for some specific future period. It is an estimate prepared in advance of the period to which it applies. It acts as a business barometer as it is complete programme of activities of the business for the period covered.

Essentials of a Budget

a It is prepared in advance and is based on a future plan of actions

b It relates to a future period and is based on objectives to be attained

c It is a statement expressed in monetary and / or physical units prepared for the implementation of policy formulated by the management.

Budget manual : The budget manual is a written document or booklet which specifies the objectives of the budgeting organization and procedures.

The following are the important matters covered in a budget manual

1 A statement regarding the objectives of the organisation and how they can be achieved through budgetary control.

2 A statement regarding the functions and responsibilities of each executive regarding preparation of budget and execution of budget.

3 Procedures to be followed for obtaining the necessary approval of budgets.

4 Time table for all stages of budgeting.

5 Reports, statements, forms and other records to be maintained.

6 The accounts classification is to be employed.

Responsibility for Budgeting : There are two things responsible for budgeting. They are the budget controller and the budget committee.

1 **Budget controller :** The chief executive is ultimately responsible for the budget programme. But large part of the supervisory responsibility is deligated to an official designated as budget controller or budget director. The budget controller should have knowledge of the technical side of the business and should report direct to the president of the organisation.

2 **Budget committee :** The Budget controller will be assisted in his work by the Budget committee. The budget committee will consists of heads of the various departments as production, sales, finance, etc., Budget controller is the chairman of the committee. It will be the duty of the budget committee to submit, discuss and finally approve of the budget figures. Each Head of the Department will have his own sub-committee with executive working under him as in members.

Fixation of the Budget Period : Budget period means the period for which a budget is prepared and employed.

The budget period will depend upon the following:

1 The nature of the business and

2 The control techniques to be applied

For example, a seasonal industry will budget for each season. An industry requiring long periods to complete work will budget for 3 or 4 or 5 years. But Budget period should not be longer than that of what is necessary.

Budget Procedure

Determination of key factor : Key factor indicates whose influence must first be assessed in order to ensure the accomplishment of the functional budgets. Functional budget is related to different functions of a business, e.g., sales, production, purchases, cash, etc.,

The budget related to the key factor should be prepared first. Then the other budgets.

General list of key factors in different industries are given below:

	Industry	Key factor
1	Motor car	Sales demand
2	Aluminium	power

3	Petrolium Refinery	Supply of crudeoil
4	Electro optics	Skilled technicians
5	Hydral power generation	Monsoon

Making of forecasts : A forecast is the statement of facts likely to occur that may affect the flow of budget. Forecast is done before the budgeting starts. Forecasts are made regarding sales, production cost and financial requirements of the business.

Consideration of alternative combination of forecasts: Alternative combinations of forecasts are considered with a view to obtain the most efficient overall plan so as to achieve maximum profit.

Preparation of Budgets : After finalising the forecasts, the actual budgets will be prepared. One budget may be prepared on the basis of the other budget. For example production budget will be prepared on the basis of the sales budget.

Classification of Budgets

Budgets can be classified into three most common types

1 Time based Budget

2 Function based budget

3 Flexibility based budget

Time based budget : In terms of time, the budget can broadly be classified into four categories

a **Long term Budget :** A budget designed for a long period is termed as long term budget. The period may be from 5 to 10 years

b **Short term budget :** A budget designed for a period generally not exceeding 5 years is termed as short term budget

c **Current budgets :** A budget which is prepared for a very short period, say a month or a quarter is termed as current budget

d **Rolling Budgets :** A budget which is designed for a year in advance is termed as Rolling Budgets or Progressive Budgets

Function Based Budget

a **Sales Budget :** This budget forecasts total sales in terms of quantity, value, items, periods, area, etc.,

b **Production Budget :** This budget is based on sales budget. It forecasts quantity of production in terms of items, periods, areas, etc.,

c **Cost of Production budget :** This budget forecasts the cost of production, separate budgets are prepared for different elements of costs.

d **Purchase Budget :** This budget forecasts the quantity, and value of purchases required for production. It gives quantity -wise, money-wise and period - wise information about the materials to be purchased

e **Personnel Budget :** This budget anticipates the quantity of personnel required during a period for production activity

f **Research Budget :** This budget relates to the research works for improvement in quality of products or research for new products.

g **Capital Expenditure Budget :** This budget provides a guidance regarding the amount of capital that may be required for procurement of capital assets during the budget period

h **Cash Budget :** This budget forecasts the cash position by time period for a specific duration of time

i **Master Budget :** This is a summary budget incorporating all functional budgets in a capsule form.

Flexibility based Budget

a **Fixed Budget :** A budget prepared on the basis of a standard or a fixed level of activity is called a fixed budget. It does not change with the change in the level of activity

b **Flexible Budget :** A budget designed in a manner so as to give the budgeted cost of any level of activity is termed as a flexible budget.

Accounting Features : The Accounting Features consists of configurations / functionality, which generally affects accounting transactions and reports. The accounting features are further sub-divided into six sections, namely:

General

Out standings Management

Cost /Profit Centers Management

Invoicing

Budgets / Scenario Management

Other Features

Scenario Management: This is a management tool which displays of accounts and inventory related information, by selectively including certain types of vouchers. It is a forecasting tool which forecast the expenses using provisional Vouchers and includes them in the reports.

Scenario Analysis : Scenario planning is also called scenario analysis. It is a strategic planning method that some company use to make flexible long-term plans. Thus the scenario analysis is process of analyzing possible future events by considering alternative possible outcomes.

Several Scenarios are demonstrated in a scenario analysis to show possible future outcomes. It is useful to generate a combination of an optimistic, a pessimistic and a most likely scenario.

Variances : Variances can be computed for both costs and revenues.

The concept of variance is connected with planned and actual results. It is effect to the difference between those two on the performance of the company.

Variance Analysis : Variance analysis is a tool of budgetary control by evaluation of performance by means of variances between budgeted amount, planned amount or standard amount and the actual amount incurred/sold. Variance analysis is usually associated with explaining the difference (or variance) between actual costs and the standard costs allowed for the good output. For example, the difference in materials costs can be divided into a materials price variance and a materials usage variance. The difference between the actual direct labor costs and the standard direct labor costs can be divided into a rate variance and an efficiency variance. The difference in manufacturing overhead can be divided into spending, efficiency, and volume variances. Mix and yield variances can also be calculated.

Variance analysis helps the management to understand the present costs and thereafter control the future costs.

Concepts of Ratios, Analysis of financial statements

Objectives: At the end of this lesson you shall be able to
- **understand the concept of stock**
- **understand ratio analysis**
- **understand cash flow**
- **understand fund flow accounting**
- **explain the invoice.**

Introduction : In a trading business one of the current assets is stock. It represents goods owned by the company that are for sale to customers. The owners always aware of stock. Once a year the stock is counted and valued.

The system used for counting stock and evaluating the value of the stock is known as Inventory system. When business has a more extensive stock, Inventory system is used. Stock is controled with the Inventory system.

Closing stock and its valuation : Closing stock means closing stock of raw materials or goods manufactured. The closing stock must be valued and an entry passed at the end of the year.

– Suppose an article is purchased for Rs.100. If the article remains unsold at the end of the year, it will be included in the closing stock at Rs.100 even if the selling price is more

– But if the article can now be sold at Rs.95only, it should be included in the closing stock at Rs.95 only

– Goods which cannot be sold at all should not be included in the closing stock.

Casting stock Value : Stock value can be calculated in four methods. They are

1 First in First out (FIFO)

2 Last In First Out (LIFO)

3 Average

4 Base stock method

FIFO : In this case the earliest lots are exhausted first. The stock on hand is out of the latest consignments received and is valued accordingly.

Suppose following lots were received:

16th October 200 units @ Rs.10

20th November 300 units @ Rs.11

15th December 250 units @ Rs.11.50

The closing stock consists of 300 units . The value will be

250 units @ Rs.11.50	Rs.2,875
50 units @ 11.00	Rs. 550
Total	Rs.3,425

LIFO : In this case the latest consignments are used first. Hence the closing stock is supposed to be out of the earliest lots on hand. For the above example, the stock will be valued at Rs.3,100, as under:

200 units @ Rs.10	Rs.2,000
100 units @ Rs.11	Rs.1,100
	Rs.3,100

Average Method : In this case all the lots are merged together and value of the closing stock is calculated accordingly. The average may be simple or weighted.

Simple average Method : In this method, the average price for single unit is

$$= \frac{Rs.10 + Rs.11 + Rs.11.50}{3}$$

$$= \frac{32.50}{3}$$

$$= Rs.10.83$$

The value for closing stock is = 300 x 10.83 = Rs.3,249

Weighted Average method : Weighted average method is most suitable, since the quantities are also taken into account.

In this method the average price for single unit is Rs.10.90, calculated as under.

Number of units	price	Amount
	Rs.	Rs.
200	10	2,000
300	11	3,300
250	11.50	2,875
750	Total	8,175

Unit cost = $\frac{8,175}{750}$

= 10.90

The value of 300 units = 300 x 10.90

= Rs. 3,270

Base Stock Method : In this method, the minimum stock carried by the factory is valued at the price originally paid for it. The excess of actual stock over the minimum level is valued according to the current cost, calculated in one of the three methods given above.

Suppose the minimum stock is 200 units and the original price paid was Rs.8 per unit.

The value of stock of 200 units @ Rs.8 = Rs.1,600

The value of remaining 100 units is calculated with the unit price of Rs.11.50 or Rs.11.00 or 10.83 or 10.90

Statement of stock : M/s. Nanda & Bose close their financial books on 30th June 2001. Stock taking continues for two weeks after this date. In 2001, the value of stock came to Rs.20,500, without making adjustments for the following:-

1 Purchases made during the two weeks after 30th June 2001 were Rs.500

2 Sales made during these two weeks amounted to Rs.3000. The firm makes a gross profit of 33 1/3% on sales. Find out the value of closing stock on 30th June, 2001.

For this case the statement of stock can be calculated as under:

Statement of stock

Stock on 30th June 2001

	Rs.
Sales	3,000
Less 33 1/3% on sales	1,000
Sales at cost	2,000
Value of stock two weeks after 30th June 2001	22,500
Less:purchases during 2 weeks	500
Value of stock on 30th June 2001	22,000

Inventory control and Reordering : Inventory control system always monitors the availability of stock. In any business minimum stock should be maintained for uninterupted sale. If the minimum stock level falls, then the purchase order for that product is to be made.

The minimum stock level below which purchase order is to be made is known as reorderlevel. If the stock level falls below the reorder level purchase order is proposed.

Example

Item No.	Description	Stock	Reorder level	Reorder yes/no
10283	REXONA BIG	125	50	N
10284	REXONA SMALL	25	50	Y
10285	CINTHOL NEW	85	75	N
10286	CINTHOL OLD	15	25	Y
10287	VICCO PASTE 100	10	15	Y
10288	VICCO PASTE 50	00	15	Y
10289	VICCOTURMERIC	15	27	N

Purchase order should be made for the items 10284, 10286, 10287, 10288. Hence the purchase order can be proposed using the inventory control system.

Ratio Analysis : Ratio Analysis is used to evaluate various aspects of a company's operating and financial performance such as its efficiency, liquidity, profitability and solvency.

In Accounting, there are many standard ratios used to try to evaluate the overall financial condition of a corporation or other organization. It are also compared across different companies in the same sector to see how they stack up, and to get an idea of comparative valuations.

Types of Ratios :

1 **Financial Ratios :** These are categorized according to the financial aspect of the business which the ratio

measures. It allow for comparisons between companies, between industries, between different time periods for one company, between a single company and its industry average.

2 **Liquidity Ratios :** It is measure that the availability of cash to pay debt.

3 **Activity Ratios :** It is measure how to quickly a firm converts non-cash assets to cash assets.

4 **Debt Ratios :** It is measure the firm's ability to repay long-term debt.

5 **Profitability Ratios :** It is measure the firm's use of its assets and control of its expenses to generate an acceptable rate of return.

6 **Market Ratios :** It is measure the investor response to owning a company's stock and also the cost of issuing stock.

Cash Flow Accounting : In accounting cash flow is the difference between the amount of cash available at the opening balance (beginning of a period) and the amount at the closing balance (end of that period).

When Cash is coming in from customers or clients who are buying your products is called accounts receivable and when the cash is going out of your business in the form of payments for expenses like rent, loan payment is called accounts payable.

The net cash flow of a company over a period is equal to the change in cash balance over this period : positive if the cash balance increases, negative if the cash balance decreases. The total net cash flow is the sum of cash flows that are classified in three areas:

1 **Operational Cash Flows :** Cash received or expended as a result of the company's internal business activities. It includes cash earnings plus changes to working capital.

2 **Investment Cash Flows :** Cash received from the sale of long-life assets, or spent on capital expenditure.

3 **Financing Cash Flows :** Cash received from the issue of debt and equity, or paid out as dividends, share repurchases or debt repayments.

In financial accounting, a cash flow statement is also known as statement of cash flows which is a financial statement that shows how changes in balance sheet accounts and income affect cash and cash equivalents, and breaks the analysis down to operating, investing and financing activities. The cash flow statement is concerned with the flow of cash in and out of the business.

Fund Flow Accounting : These statements give the information of funds on a particular date. The purpose of preparation of funds flow statements is to know about from where funds are coming and where being invested. The fund flow stalemates is generally prepared from the data identifiable and profit and loss account and balance sheets. Fund Flow statement is also called as sources and application of funds. It shows the detail of funds business received from sources and the amount of funds the business used for different purpose in the year.

Invoice : While making a sale, the seller prepares a statement giving the particulars such as the quantity, price per unit, the total amount payable, any deductions made and shows the net amount payable by the buyer. Such a statement is called invoice.

An invoice is a statement of list of goods with their quantity and price.

An invoice is a business document which is prepared by sellers and given to buyers. Usually the invoice are prepared in triplicate one copy will be issued to the buyer. The after two copies will be retained by the seller.

Inward Invoice : To the buyer, he calls the invoice as 'inward invoice'. He enters the details of the invoice in his purchase book.

Outward Invoice : To the seller, he calls the invoice as 'outward invoice'. He enters the details of the invoice in his sales book.

Details of the Invoice : The invoice should give the following details:

1 Name and address of the seller

2 Name and address of the buyer

3 Invoice Number

4 The Date

5 Quantity, description, unit price, amount of the goods sold

6 Trade discount and cash discount, if necessary

7 Expenditure

8 Net amount

9 Signature of the invoicing authority

10 E. & O. E. at the left bottom corner of the invoice

E. & O. E. means Errors and Omission Excepted. This indicates that if errors and omissions are found out, the matter can be reported and settled and the seller under takes to correct them.