UNIT-V
Definition of Accounting:

Smith and Ashburne: "Accounting is a means of measuring and reporting the results of economic activities."
R.N. Anthony: "Accounting system is a means of collecting summarizing, analyzing and reporting in monetary terms, the information about the business.

American Institute of Certified Public Accountants (AICPA): "The art of recording, classifying and summarizing in a significant manner and in terms of money transactions and events, which are in part at least, of a financial character and interpreting the results thereof."

Thus, accounting is an art of identifying, recording, summarizing and interpreting business transactions of financial nature. Hence accounting is the **Language of Business**.

2.3 Branches of Accounting:

The important branches of accounting are:

1. **Financial Accounting:** The purpose of Accounting is to ascertain the financial results i.e. profit or loass in the operations during a specific period. It is also aimed at knowing the financial position, i.e. assets, liabilities and equity position at the end of the period. It also provides other relevant information to the management as a basic for decision-making for planning and controlling the operations of the business.
2. **Cost Accounting:** The purpose of this branch of accounting is to ascertain the cost of a product / operation / project and the costs incurred for carrying out various activities. It also assist the management in controlling the costs. The necessary data and information are gatherr4ed form financial and other sources.
3. **Management Accounting:** Its aim to assist the management in taking correct policy decision and to evaluate the impact of its decisions and actions. The data required for this purpose are drawn accounting and cost-accounting.
4. **Inflation Accounting:** It is concerned with the adjustment in the values of assest and of profit in light of changes in the price level. In a way it is concerned with the overcoming of limitations that arise in financial statements on account of the cost assumption (i.e recording of the assets at their historical or original cost) and the assumption of stable monetary unit.
5. **Human Resource Accounting:** It is a branch of accounting which seeks to report and emphasize the importance of human resources in a company's earning process and total assets. It is concerned with the process of identifying and measuring data about human resources and communicating this information to interested parties. In simple words, it is accounting for people as organizational resources.

3. FUNCTIONS OF AN ACCOUNTANT

The job of an accountant involves the following types of accounting works :

1. **Designing Work :** It includes the designing of the accounting system, basis for identification and classification of financial transactions and events, forms, methods, procedures, etc.
2. **Recording Work :** The financial transactions are identified, classified and recorded in appropriate books of accounts according to principles. This is "Book Keeping". The recording of transactions tends to be mechanical and repetitive.
3. **Summarizing Work :** The recorded transactions are summarized into significant form according to generally accepted accounting principles. The work includes the preparation of profit and loss account, balance sheet. This phase is called 'preparation of final accounts'
4. **Analysis and Interpretation Work:** The financial statements are analysed by using ratio analysis, break-even analysis, funds flow and cash flow analysis.
5. **Reporting Work:** The summarized statements along with analysis and interpretation are communicated to the interested parties or whoever has the right to receive them. For Ex. Share holders. In addition, the accou8nting departments have to prepare and send regular reports so as to assist the management in decision making. This is 'Reporting'.
6. **Preparation of Budget:** The management must be able to reasonably estimate the future requirements and opportunities. As an aid to this process, the accountant has to prepare budgets, like cash budget, capital budget, purchase budget, sales budget etc. this is 'Budgeting'.
7. **Taxation Work:** The accountant has to prepare various statements and returns pertaining to income-tax, sales-tax, excise or customs duties etc., and file the returns with the authorities concerned.
8. **Auditing:** It involves a critical review and verification of the books of accounts statements and reports with a view to verifying their accuracy. This is 'Auditing'

This is what the accountant or the accounting department does. A person may be placed in any part of Accounting Department or MIS (Management Information System) Department or in small organization, the same person may have to attend to all this work.

4. USERS OF ACCOUNTING INFORMATION

Different categories of users need different kinds of information for making decisions. The users of accounting can be divided in two board groups (1). Internal users and (2). External users.

4.1 Internal Users:

Managers: These are the persons who manage the business, i.e. management at he top, middle and lower levels. Their requirements of information are different because they make different types of decisions.

Accounting reports are important to managers for evaluating the results of their decisions. In additions to external financial statements, managers need detailed internal reports either branch division or department or product-wise. Accounting reports for managers are prepared much more frequently than external reports.

Accounting information also helps the managers in appraising the performance of subordinates. As such Accounting is termed as "the eyes and ears of management."

4.2 External Users:

1. **Investors:** Those who are interested in buying the shares of company are naturally interested in the financial statements to know how safe the investment already made is and how safe the proposed investments will be.
2. **Creditors:** Lenders are interested to know whether their load, principal and interest, will be paid when due. Suppliers and other creditors are also interested to know the ability of the firm to pay their dues in time.
3. **Workers:** In our country, workers are entitled to payment of bonus which depends on the size of profit earned. Hence, they would like to be satisfied that he bonus being paid to them is correct. This knowledge also helps them in conducting negotiations for wages.
4. **Customers:** They are also concerned with the stability and profitability of the enterprise. They may be interested in knowing the financial strength of the company to rent it for further decisions relating to purchase of goods.
5. **Government:** Governments all over the world are using financial statements for compiling statistics concerning business which, in turn, helps in compiling national accounts. The financial statements are useful for tax authorities for calculating taxes.
6. **Public :** The public at large interested in the functioning of the enterprises because it may make a substantial contribution to the local economy in many ways including the number of people employed and their patronage to local suppliers.
7. **Researchers:** The financial statement, being a mirror of business conditions, is of great interest to scholars undertaking research in accounting theory as well as business affairs and practices.

5. ADVANTAGES FROM ACCOUNTING

The role of accounting has changed from that of a mere record keeping during the 1st decade of 20th century of the present stage, which it is accepted as information system and decision making activity. The following are the advantages of accounting.

1. **Provides for systematic records:** Since all the financial transactions are recorded in the books, one need not rely on memory. Any information required is readily available from these records.
2. **Facilitates the preparation of financial statements:** Profit and loss accountant and balance sheet can be easily prepared with the help of the information in the records. This enables the trader to know the net result of business operations (i.e. profit / loss) during the accounting period and the financial position of the business at the end of the accounting period.
3. **Provides control over assets:** Book-keeping provides information regarding cash in had, cash at bank, stock of goods, accounts receivables from various parties and the amounts invested in various other assets. As the trader knows the values of the assets he will have control over them.
4. **Provides the required information:** Interested parties such as owners, lenders, creditors etc., get necessary information at frequent intervals.
5. **Comparative study:** One can compare the present performance of the organization with that of its past. This enables the managers to draw useful conclusion and make proper decisions.
6. **Less Scope for fraud or theft:** It is difficult to conceal fraud or theft etc., because of the balancing of the books of accounts periodically. As the work is divided among many persons, there will be check and counter check.

7. **Tax matters:** Properly maintained book-keeping records will help in the settlement of all tax matters with the tax authorities.
8. **Ascertaining Value of Business:** The accounting records will help in ascertaining the correct value of the business. This helps in the event of sale or purchase of a business.
9. **Documentary evidence:** Accounting records can also be used as an evidence in the court to substantiate the claim of the business. These records are based on documentary proof. Every entry is supported by authentic vouchers. As such, Courts accept these records as evidence.
10. **Helpful to management:** Accounting is useful to the management in various ways. It enables the management to asses the achievement of its performance. The weakness of the business can be identified and corrective measures can be applied to remove them with the helps accounting.

6. LIMITATIONS OF ACCOUNTING

The following are the limitations of accounting.

1. **Does not record all events:** Only the transactions of a financial character will be recorded under book-keeping. So it does not reveal a complete picture about the quality of human resources, locational advantage, business contacts etc.
2. **Does not reflect current values:** The data available under book-keeping is historical in nature. So they do not reflect current values. For instance, we record the value of stock at cost price or market price, which ever is less. In case of, building, machinery etc., we adopt historical cost as the basis. Infact, the current values of buildings, plant and machinery may be much more than what is recorded in the balance sheet.
3. **Estimates based on Personal Judgment:** The estimate used for determining the values of various items may not be correct. For example, debtor are estimated in terms of collectibility, inventories are based on marketability, and fixed assets are based on useful working life. These estimates are based on personal judgment and hence sometimes may not be correct.
4. **Inadequate information on costs and Profits:** Book-keeping only provides information about the overall profitability of the business. No information is given about the cost and profitability of different activities of products or divisions.

7. BASIC ACCOUNTING CONCEPTS

Accounting has been evolved over a period of several centuries. During this period, certain rules and conventions have been adopted. They serve as guidelines in identifying the events and transactions to be accounted for measuring, recording, summarizing and reporting them to the interested parties. These rules and conventions are termed as **Generally Accepted Accounting Principles.** These principles are also referred as standards, assumptions, concepts, conventions doctrines, etc. Thus, the accounting concepts are the fundamental ideas or basic assumptions underlying the theory and practice of financial accounting. They are the broad working rules for all accounting activities developed and accepted by the accounting profession.

Basic accounting concepts may be classified into two broad categories.

1. Concept to be observed at the time of recording transactions.(Recording Stage).
2. Concept to be observed at the time of preparing the financial accounts (Reporting Stage)

GENETALLY ACCEPTED ACCOUNTING PRINCIPLES
BASIC ACCOUNTING CONCEPTS

Accounting is a system evolved to achieve a set of objectives. In order to achieve the goals, we need a set of rules or guidelines. These guidelines are termed here as “BASIC ACCOUNTING ONCEPTS”. The term concept means an idea or thought. Basic accounting concepts are the fundamental ideas or basic assumptions underlying the theory and profit of FINANCIAL ACCOUNTING. These concepts help in bringing about uniformity in the practice of accounting. In accountancy following concepts are quite popular.

1. BUSINESS ENTITY CONEPT: In this concept “Business is treated as separate from the proprietor”. All the Transactions recorded in the book of Business and not in the books of proprietor. The proprietor is also treated as a creditor for the Business.
2. GOING CONCERN CONCEPT: This concept relates with the long life of Business. The assumption is that business will continue to exist for unlimited period unless it is dissolved due to some reasons or the other.
3. MONEY MEASUREMENT CONCEPT: In this concept “Only those transactions are recorded in accounting which can be expressed in terms of money, those transactions which can not be expressed in terms of money are not recorded in the books of accounting”.
4. COST CONCEPT: Accounting to this concept, can asset is recorded at its cost in the books of account. i.e., the price, which is paid at the time of acquiring it. In balance sheet, these assets appear not at cost price every year, but depreciation is deducted and they appear at the amount, which is cost, less classification.

5. ACCOUNTING PERIOD CONCEPT: every Businessman wants to know the result of his investment and efforts after a certain period. Usually one-year period is regarded as an ideal for this purpose. This period is called Accounting Period. It depends on the nature of the business and object of the proprietor of business.
6. DUAL ASCEPT CONCEPT: According to this concept "Every business transactions has two aspects", one is the receiving benefit aspect another one is giving benefit aspect. The receiving benefit aspect is termed as "DEBIT", where as the giving benefit aspect is termed as "CREDIT". Therefore, for every debit, there will be corresponding credit.
7. MATCHING COST CONCEPT: According to this concept "The expenses incurred during an accounting period, e.g., if revenue is recognized on all goods sold during a period, cost of those good sole should also Be charged to that period.
8. REALISATION CONCEPT: According to this concept revenue is recognized when a sale is made. Sale is Considered to be made at the point when the property in goods posses to the buyer and he becomes legally liable to pay.

ACCOUNTING CONVENTIONS

Accounting is based on some customs or usages. Naturally accountants here to adopt that usage or custom. They are termed as convert conventions in accounting. The following are some of the important accounting conventions.

1 FULL DISCLOSURE: According to this convention accounting reports should disclose fully and fairly the information. They purport to represent. They should be prepared honestly and sufficiently disclose information which is if material interest to proprietors, present and potential creditors and investors. The companies ACT, 1956 makes it compulsory to provide all the information in the prescribed form.
2 MATERIALITY: Under this convention the trader records important factor about the commercial activities. In the form of financial statements if any unimportant information is to be given for the sake of clarity it will be given as footnotes.
3 CONSISTENCY: It means that accounting method adopted should not be changed from year to year. It means that there should be consistent in the methods or principles followed. Or else the results of a year Cannot be conveniently compared with that of another.
4 CONSERVATISM: This convention warns the trader not to take unrealized income in to account. That is why the practice of valuing stock at cost or market price, which ever is lower is in vague. This is the policy of "playing safe"; it takes in to consideration all prospective losses but leaves all prospective profits.

ACCOUNTING PROCESS

The main object of any Business is to make profit. Every trader generally starts business for the purpose of earning profit. While establishing Business, he brings his own capital, borrows money from relatives, friends, outsiders or financial institutions, then purchases machinery, plant, furniture, raw materials and other assets. He starts buying and selling of goods, paying for salaries, rent and other expenses, depositing and withdrawing cash from Bank. Like this he undertakes innumerable transactions in Business.

The number of Business transactions in an organization depends up on the size of the organization. In small organizations the transactions generally will be in thousands and in big organizations they may be in lacks. As such it is humanly impossible to remember all these transactions. Further it may not be possible to find out the final result of the Business with out recording and analyzing these transactions.

Accounting came in practice as an aid to human memory by maintaining a systematic record of Business transactions.

ACCOUNTS CYCLE

When a transaction takes place its recording passes through a series of steps to post it in various books and statements. A simple definition of the accounting cycle is the process of recording and processing a transaction through various accounting books, journals or ledgers.

[A]. SOURCES OF DOCUMENT BOOK KEEPING:

Book keeping involves the chronological recording of financial transactions in a set of books in a systematic manner According to G.A.Lee the Accounting system has two stages. First stage is Book keeping and the second stage is accounting.

KEY WORDS IN BOOK-KEEPING

1. **TRANSACTIONS**: Any sale or purchase of goods of services is called the transaction.
   Transactions are two types.
   [a]. cash transaction: cash transaction is one where cash receipt or payment is involved in the exchange.
   [b]. Credit transaction: Credit transaction will not have cash, either received or paid, for something given or received respectively.

2. **GOODS:** Fill those things which a firm purchases for resale are called goods.

3. **PURCHASES:** Purchases means purchase of goods, unless it is stated otherwise it also represents the Goods purchased.

4. **SALES:** Sales means sale of goods, unless it is stated otherwise it also represents these goods sold.

5. **EXPENSES:** Payments for the purchase of goods as services are known as expenses.

6. **REVENUE:** Revenue is the amount realized or receivable from the sale of goods or services.

7. **ASSETS:** The valuable things owned by the business are known as assets. These are the properties Owned by the business.

8. **LIABILITIES:** Liabilities are the obligations or debts payable by the enterprise in future in the term Of money or goods.
9. **DEBTORS:** Debtors means a person who owes money to the trader.
10. **CREDITORS:** A creditor is a person to whom something is owned by the business.
11. **DRAWINGS:** cash or goods withdrawn by the proprietor from the Business for his personal or Household is termed to as “drawing”.
12. **RESERVE:** An amount set aside out of profits or other surplus and designed to meet contingencies.
13. **ACCOUNT:** A summarized statements of transactions relating to a particular person, thing, Expense or income.
14. **DISCOUNT:** There are two types of discounts.
15. **Cash discount:** An allowable made to encourage frame payment or before the expiration of the period allowed for credit.
16. **Trade discount:** A deduction from the gross or catalogue price allowed to traders who buys them for resale.

JOURNAL ENTRIES

Journal entries are an important part of accountancy. A journal entry, into accounting, is the logging of a transaction in accounting journal items. The journal entry can consist of several recordings, each of which is either a debit or a credit. The total of the debits must equal the total of the credits or the journal entry is said to be "unbalanced". Journal entries can record unique items or recurring items such as depreciation or bond amortization. In accounting software, journal entries are usually entered using a separate module from accounts payable, which typically has its own sub ledger that indirectly affects the general ledger. As a result, journal entries directly change the account balances on the general ledger.

Journal entries format

Date	Particulars	Ledger folio	Debit	Credit
01.01.2010	**Cash a/c ----- Dr.** **To capital a/c** **(Being business commenced with cash)**		**xxx**	 **xxx**

CLASSIFICATION OF BUSINESS TRANSACTIONS

All business transactions are classified into three categories:

1. Those relating to persons
2. Those relating to property(Assets)
3. Those relating to income & expenses

Thus, three classes of accounts are maintained for recording all business transactions. They are:

1. Personal accounts
2. Real accounts
3. Nominal accounts

1. **Personal Accounts:** Accounts which are transactions with persons are called "Personal Accounts" .
   A separate account is kept on the name of each person for recording the benefits received from ,or given to the person in the course of dealings with him.
   E.g.: Krishna's A/C, Gopal's A/C, SBI A/C, Nagarjuna Finance Ltd.A/C, ObulReddy & Sons A/C , HMT Ltd. A/C, Capital A/C, Drawings A/C etc.

2. **Real Accounts:** The accounts relating to properties or assets are known as "Real Accounts" .Every business needs assets such as machinery, furniture etc, for running its activities .A separate account is maintained for each asset owned by the business.
   E.g.: cash A/C, furniture A/C, building A/C, machinery A/C etc.

3. **NominalAccounts:** Accounts relating to expenses, losses, incomes and gains are known as "Nominal Accounts". separate account is maintained for each item of expenses, losses, income or gain.
   E.g.: Salaries A/C, stationery A/C, wages A/C, postage A/C, commission A/C, interest A/C, purchases A/C, rent A/C, discount A/C, commission received A/C, interest received A/C, rent received A/C, discount received A/C.

Before recording a transaction, it is necessary to find out which of the accounts is to be debited and which is to be credited. The following three different rules have been laid down for the three classes of accounts….

1. Personal Accounts: The account of the person receiving benefit (receiver) is to be debited and the account of the person giving the benefit (given) is to be credited.

Rule: "Debit----The Receiver
Credit---The Giver"

2. Real Accounts: When an asset is coming into the business, account of that asset is to be debited .When an asset is going out of the business; the account of that asset is to be credited.

Rule: "Debit----What comes in
Credit---What goes out"

3. Nominal Accounts: When an expense is incurred or loss encountered, the account representing the expense or loss is to be debited. When any income is earned or gain made, the account representing the income of gain is to be credited.

Rule: "Debit----All expenses and losses
Credit---All incomes and gains"

24)Explain about ledgers?

B. LEDGER

All the transactions in a journal are recorded in a chronological order. After a certain period, if we want to know whether a particular account is showing a debit or credit balance it becomes very difficult. So, the ledger is designed to accommodate the various accounts maintained the trader. It contains the final or permanent record of all the transactions in duly classified form. “A ledger is a book which contains various accounts.” The process of transferring entries from journal to ledger is called “POSTING”.

Posting is the process of entering in the ledger the entries given in the journal. Posting into ledger is done periodically, may be weekly or fortnightly as per the convenience of the business. The following are the guidelines for posting transactions in the ledger.

1. After the completion of Journal entries only posting is to be made in the ledger.
2. For each item in the Journal a separate account is to be opened. Further, for each new item a new account is to be opened.
3. Depending upon the number of transactions space for each account is to be determined in the ledger.
4. For each account there must be a name. This should be written in the top of the table. At the end of the name, the word “Account” is to be added.
5. The debit side of the Journal entry is to be posted on the debit side of the account, by starting with “TO”.
6. The credit side of the Journal entry is to be posted on the debit side of the account, by starting with “BY”.

Proforma for ledger: **LEDGER BOOK**

Particulars account

Dr. Cr.

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

TRIAL BALANCE

The first step in the preparation of final accounts is the preparation of trial balance. In the double entry system of book keeping, there will be credit for every debit and there will not be any debit without credit. When this principle is followed in writing journal entries, the total amount of all debits is equal to the total amount all credits. A trial balance is a statement of debit and credit balances. It is prepared on a particular date with the object of checking the accuracy of the books of accounts. It indicates that all the transactions for a particular period have been duly entered in the book, properly posted and balanced. The trial balance doesn’t include stock in hand at the end of the period. All adjustments required to be done at the end of the period including closing stock are generally given under the trial balance.

DEFINITIONS:

“A trial balance is a list of all the balances standing on the ledger accounts and cash book of a concern at any given date.” SPICER AND POGLAR “A trial balance is a statement of debit and credit balances extracted from the ledger with a view to test the arithmetical accuracy of the books.” J.R.BATLIBOI Thus a trial balance is a list of balances of the ledger accounts’ and cash book of a business concern at any given date.

Preparing the Trial Balance

Preparing the trial balance is the process of totaling the debits and credits in your chart of accounts, then making sure that the sum of all debits equals the sum of all credits — that the two amounts balance. The trial balance is a vital step in the accounting cycle, being the first step in the "end of accounting period" process.

Steps to Prepare the Trial Balance

Here are the steps you will undertake to prepare the trial balance:

For each ledger account — Cash, Accounts Payable, etc. — total your credits and debits.

- If the credit total is larger, subtract the debit total from the credit total to get your ledger account total which goes in the credit column of the trial balance
- If the debit total is larger, subtract the credit total from the debit total to get your ledger account total which goes in the debit column of the trial balance
- Put the ledger account total in the credit or debit column of your trial balance (as identified above).
- When you have debit or credit totals for each ledger account, add all of your credit totals to get a credit grand total.
- Add your entire debit totals to get a debit grand total. This is your trial balance.

PROFORMA OF TRIAL BALANCE:

Trial balance for Mr…………………………………… as on ………..

PARTICULARS	DEBIT (RS.)	CREDIT (RS.)

FINAL ACCOUNTS

In every business, the business man is interested in knowing whether the business has resulted in profit or loss and what the financial position of the business is at a given time. In brief, he wants to know (i)The profitability of the business and (ii) The soundness of the business.

The trader can ascertain this by preparing the final accounts. The final accounts are prepared from the trial balance. Hence the trial balance is said to be the link between the ledger accounts and the final accounts. The final accounts of a firm can be divided into two stages. The first stage is preparing the trading and profit and loss account and the second stage is preparing the balance sheet.

TRADING ACCOUNT

The first step in the preparation of final account is the preparation of trading account. The main purpose of preparing the trading account is to ascertain gross profit or gross loss as a result of buying and selling the goods.

Trading account of MR……………………. for the year ended ……………………

Particulars	Amount	Particulars	Amount
To opening stock	Xxxx	By sales xxxx	
To purchases xxxx		Less: returns xxx	Xxxx
Less: returns xx	Xxxx	By closing stock	Xxxx
To carriage inwards	Xxxx		
To wages	Xxxx		
To freight	Xxxx		
To customs duty, octroi	Xxxx		
To gas, fuel, coal, Water	Xxxx		
To factory expenses			
To other man. Expenses	Xxxx		
To productive expenses			
To gross profit c/d	XXX		
Total	Xxxx	Total	Xxxx

Finally, a ledger may be defined as a summary statement of all the transactions relating to a person , asset, expense or income which have taken place during a given period of time. The up-to-date state of any account can be easily known by referring to the ledger.

PROFIT AND LOSS ACCOUNT

The business man is always interested in knowing his net income or net profit.Net profit represents the excess of gross profit plus the other revenue incomes over administrative, sales, Financial and other expenses. The debit side of profit and loss account shows the expenses and the credit side the incomes. If the total of the credit side is more, it will be the net profit. And if the debit side is more, it will be net loss.

PROFIT AND LOSS A/C OF MR……………………FOR THE YEAR ENDED………..

PARTICULARS	AMOUNT	PARTICULARS	AMOUNT
TO office salaries	Xxxxxx	By gross profit b/d	Xxxxx
TO rent,rates,taxes	Xxxxx	Interest received	Xxxxx
TO Printing and stationery	Xxxxx	Discount received	Xxxx
TO Legal charges		Commission received	Xxxxx
Audit fee	Xxxx	Income from investments	
TO Insurance	Xxxx	Dividend on shares	
TO General expenses	Xxxx	Miscellaneous investments	Xxxx
TO Advertisements	Xxxxx	Rent received	Xxxx
TO Bad debts	Xxxx		
TO Carriage outwards	Xxxx		xxxx
TO Repairs	Xxxx		
TO Depreciation	Xxxxx		
TO interest paid	Xxxxx		
TO Interest on capital	Xxxxx		
TO Interest on loans	Xxxx		
TO Discount allowed	Xxxxx		
TO Commission	Xxxxx		
TO Net profit-------→ (transferred to capital a/c)	Xxxxx		
	xxxxxx		Xxxxxx

BALANCE SHEET

The second point of final accounts is the preparation of balance sheet. It is prepared often in the trading and profit, loss accounts have been compiled and closed. A balance sheet may be considered as a statement of the financial position of the concern at a given date.

DEFINITION: A balance sheet is an item wise list of assets, liabilities and proprietorship of a business at a certain state.

J.R.botliboi: A balance sheet is a statement with a view to measure exact financial position of a business at a particular date.

Thus, Balance sheet is defined as a statement which sets out the assets and liabilities of a business firm and which serves to as certain the financial position of the same on any particular date. On the left-hand side of this statement, the liabilities and the capital are shown. On the right-hand side all the assets are shown. Therefore, the two sides of the balance sheet should be equal. Otherwise, there is an error somewhere.

BALANCE SHEET OF ………………………… AS ON ………………………………….

Liabilities and capital	Amount	Assets	Amount
Creditors	Xxxx	Cash in hand	Xxxx
Bills payable	Xxxx	Cash at bank	Xxxx
Bank overdraft	Xxxx	Bills receivable	Xxxx
Loans	Xxxx	Debtors	Xxxx
Mortgage	Xxxx	Closing stock	Xxxx
Reserve fund	Xxxx	Investments	Xxxx
Capital xxxxxx		Furniture and fittings	Xxxx
Add:		Plats&machinery	
Net Profit xxxx		Land & buildings	Xxxx
-------		Patents, tm ,copyrights	Xxxx
xxxxxxx		Goodwill	Xxxx
--------		Prepaid expenses	
		Outstanding incomes	Xxxx
Less:			Xxxx
Drawings xxxx	Xxxx		Xxxx
---------	XXXX		XXXX

Advantages: The following are the advantages of final balance .

1. It helps in checking the arithmetical accuracy of books of accounts.
2. It helps in the preparation of financial statements.
3. It helps in detecting errors.
4. It serves as an instrument for carrying out the job of rectification of entries.
5. It is possible to find out the balances of various accounts at one place.

Ratio Analysis Introduction Ratio analysis involves the calculation and interpretation of key financial performance indicators to provide useful insights.
Financial information is always prepared to satisfy in some way the needs of various interested parties (the "**users of accounts**").

Classification of financial ratios
Generally, financial ratios are classified on the basis of function or test, on the basis of financial statements, and on the basis of importance. These three classifications are briefly discussed below:

Classification of financial ratios on the basis of function:
On the basis of function or test, the ratios are classified as liquidity ratios, profitability ratios, activity ratios and solvency ratios.

Liquidity Ratios:
Liquidity ratios measure the adequacy of current and liquid assets and help evaluate the ability of the business to pay its short-term debts. The ability of a business to pay its short-term debts is frequently referred to as short-term solvency position or liquidity position of the business. Generally a business with sufficient current and liquid assets to pay its current liabilities as and when they become due is considered to have a strong liquidity position and a businesses with insufficient current and liquid assets is considered to have weak liquidity position. Short-term creditors like suppliers of goods and commercial banks use liquidity ratios to know whether the business has adequate current and liquid assets to meet its current obligations. Financial institutions hesitate to offer short-term loans to businesses with weak short-term solvency position. **Four commonly used liquidity ratios are given below:**

1. Current ratio or working capital ratio
2. Quick ratio or acid test ratio
3. Absolute liquid ratio
4. Current cash debt coverage ratio

Unfortunately, liquidity ratios are not true measure of liquidity because they tell about the quantity but nothing about the quality of the current assets and, therefore, should be used carefully. For a useful analysis of liquidity, these ratios are used in conjunction with activity ratios (also known as current assets movement ratios). Examples of activity ratios arereceivables turnover ratio, accounts payable turnover ratio and inventory turnover ratio etc.

Profitability ratios:

Profit is the primary objective of all businesses. All businesses need a consistent improvement in profit to survive and prosper. A business that continually suffers losses cannot survive for a long period. **Profitability ratios** measure the efficiency of management in the employment of business resources to earn profits. These ratios indicate the success or failure of a business enterprise for a particular period of time. Profitability ratios are used by almost all the parties connected with the business. A strong profitability position ensures common stockholders a higher dividend income and appreciation in the value of the common stock in future. Creditors, financial institutions and preferred stockholders expect a prompt payment of interest and fixed dividend income if the business has good profitability position. Management needs higher profits to pay dividends and reinvest a portion in the business to increase the production capacity and strengthen the overall financial position of the company. **Some important profitability ratios are given below:**

1. Net profit (NP) ratio
2. Gross profit (GP) ratio
3. Price earnings ratio (P/E ratio)
4. Operating ratio
5. Expense ratio
6. Dividend yield ratio
7. Dividend payout ratio
8. Return on capital employed ratio
9. Earnings per share (EPS) ratio
10. Return on shareholder’s investment/Return on equity
11. Return on common stockholders’ equity ratio

Activity ratios:

Activity ratios (also known as turnover ratios) measure the efficiency of a firm or company in generating revenues by converting its production into cash or sales. Generally a fast conversion increases revenues and profits. Activity ratios show how frequently the assets are converted into cash or sales and, therefore, are frequently used in conjunction with liquidity ratios for a deep analysis of liquidity. **Some important activity ratios are:**

1. Inventory turnover ratio
2. Receivables turnover ratio
3. Average collection period
4. Accounts payable turnover ratio
5. Average payment period
6. Asset turnover ratio
7. Working capital turnover ratio
8. Fixed assets turnover ratio

Solvency ratios:

Some frequently used long-term solvency ratios are given below:

1. Debt to equity ratio
2. Times interest earned (TIE) ratio
3. Proprietary ratio
4. Fixed assets to equity ratio
5. Current assets to equity ratio
6. Capital gearing ratio

Funds Flow and Cash Flow Statements

Meaning of Funds Flow Statement:

Funds flow statement is a statement which discloses the analytical information about the different sources of a fund and the application of the same in an accounting cycle. It deals with the transactions which change either the amount of current assets and current liabilities (in the form of decrease or increase in working capital) or fixed assets, long-term loans including ownership fund. It gives a clear picture about the movement of funds between the opening and closing dates of the Balance Sheet. It is also called the Statement of Sources and Applications of Funds, Movement of Funds Statement; Where Got—Where Gone Statement: Inflow and Outflow of Fund Statement, etc. No doubt, Funds Flow Statement is an important indicator of financial analysis and control. It is valuable and also helps to determine how the funds are financed. The financial analyst can evaluate the future flows of a firm on the basis of past data.

This statement supplies an efficient method for the financial manager in order to assess the:
(a) Growth of the firm, (b) Its resulting financial needs, and (c) To determine the best way to finance those needs. In particular, funds flow statements are very useful in planning intermediate and long-term financing.

Preparing Funds Flow Statement: Steps, Rules and Format
Steps for Preparing Funds Flow Statement:
The steps involved in preparing the statement are as follows:
1. Determine the change (increase or decrease) in working capital.
2. Determine the adjustments account to be made to net income.
3. For each non-current account on the balance sheet, establish the increase or decrease in that account. Analyze the change to decide whether it is a source (increase) or use (decrease) of working capital.
4. Be sure the total of all sources including those from operations minus the total of all uses equals the change found in working capital in Step 1.

Format of Funds Flow Statement:
A funds flow statement can be prepared in statement form or ‘T’ form.

Funds Flow Statement (Statement Form)

A.	**Sources of Funds:**
	(*i*) Funds from Business Operations
	(*ii*) Sale of Fixed Asset
	(*iii*) Issue of Shares
	(*iv*) Issue of Debentures
	(*v*) Long-term borrowings
	Total Sources
B.	**Application of Funds:**
	(*i*) Loss from Business Operation
	(*ii*) Payment of Dividend
	(*iii*) Payment of Tax
	(*iv*) Purchase of Fixed Asset
	(*v*) Payment of Long-term Loans
	(*vi*) Redemption of Debentures
	(*vii*) Redemption of Preference Shares
	Total uses
	Not increase/decrease in Working Capital (Total sources minus Total uses)

Funds Flow Statement (‘T’ Form)

Source of Funds	₹	Application of Funds	₹
(*i*) Funds from Business Operations		(*i*) Loss from Business Operations	
(*ii*) Sale of Fixed Assets		(*ii*) Payment of Dividend	
(*iii*) Issue of Shares		(*iii*) Payment of Tax	
(*iv*) Issue of Debentures		(*iv*) Purchase of Fixed Assets	
(*v*) Long-term Borrowings		(*v*) Payment of Long-term Loans	
(*vi*) Decrease in Working Capital (If application amount is more than the sources amount)		(*vi*) Redemption of Debentures	
		(*vii*) Redemption of Preference Shares	
		(*viii*) Increase in Working Capital (if sources are more than the application amount)	
Total		Total	

Schedule of Changes in Working Capital:
Many business enterprises prefer to prepare another statement, known as schedule of changes in working capital, while preparing a funds flow statement, on a working capital basis. This schedule of changes in working capital provides information concerning the changes in each individual current assets and current liabilities accounts (items).
This schedule is a part of the funds flow statement and increase (decrease) in working capital indicated by the schedule of changes in working capital will be equal to the amount of changes in working capital as found by funds flow statement. The schedule of changes inworking capital can be prepared by comparing the current assets and current liabilities at two periods.
The format of schedule of changes in working capital is as follows:

Schedule of Changes in Working Capital

Items	As on	As on	Changes	
			Increase	Decrease
A. Current Assets:				
Cash Balance				
Bank Balance				
Accounts Receivable (Debtors)				
Marketable Securities				
Stock				
Prepaid Expenses				
B. Current Liabilities:				
Bank Overdraft				
Accounts payable (Creditors) outstanding expenses				
Total				
Net increase/decrease in working capital				

Cash Flow Statement:
The money coming into the business is called cash inflow, and money going out from the business is called cash outflow. To show the affects on the inflows and outflows on a company, a statement of cash flow is used. The statement of cash flows is a cash basis report on three types of financial activities: operating activities, investing activities, and financing activities. Any non-cash activities are usually reported in footnotes.

THE CASH FLOW IMPORTANCE
Cash can come from both internal and external sources, and the Statement of Cash Flow helps companies and investors separate and observe the differences and extent of the cash inflows and outflows. Internal, as opposed to external cash sources, provide a company with successful attributes and assurances that include:
1) preventing and monitoring company debt
2) preventing unnecessary expenditures from interest, late payment penalties and debt costs
3) ensuring timely investment and cash available for investment opportunities **4)** ensuring timely payment of expenses and debts **5)** and most importantly – ensuring a level of regular business income without relying on outside investment or cash borrowing. Effectively managing and monitoring cash flows serves many purposes. The most significant reason is to provide owners and managers insight into the company's cash position. This knowledge better equips management to make informed decisions about regular business operations, the need for further investment in the business, and capital from equity or debt partners. Cash management is something most businesses of all sizes struggle to perfect. While the Cash Flow Statement is by no means the only method of monitoring cash flows, it is an integral part of the reporting statements and should not be overlooked by the financial statement users.

Statement of Cash Flows

For the years ended December 31 (In millions)	General Electric Company and consolidated affiliates 2011	2010	2009
Cash flows – operating activities			
Net earnings	$ 14,443	$ 12,179	$ 11,225
Less net earnings attributable to noncontrolling interests	292	535	200
Net earnings attributable to the Company	14,151	11,644	11,025
(Earnings) loss from discontinued operations	(77)	873	(219)
Adjustments to reconcile net earnings attributable to the Company to cash provided from operating activities			
Depreciation and amortization of property, plant and equipment	9,185	9,786	10,617
Earnings from continuing operations retained by GECS	–	–	–
Deferred income taxes	(203)	930	(2,778)
Decrease (increase) in GE current receivables	(466)	(126)	3,273
Decrease (increase) in inventories	(1,168)	342	1,101
Increase (decrease) in accounts payable	1,235	883	(464)
Increase (decrease) in GE progress collections	(1,394)	(1,177)	(500)
Provision for losses on GECS financing receivables	4,083	7,176	10,585
All other operating activities	7,255	5,925	(9,828)
Cash from (used for) operating activities – continuing operations	32,601	36,256	22,812
Cash from (used for) operating activities – discontinued operations	758	(132)	1,605
Cash from (used for) operating activities	33,359	36,124	24,417
Cash flows – investing activities			
Additions to property, plant and equipment	(12,650)	(9,800)	(8,636)
Dispositions of property, plant and equipment	5,896	7,208	6,479
Net decrease (increase) in GECS financing receivables	14,652	21,773	36,665
Proceeds from sales of discontinued operations	8,950	2,510	–
Proceeds from principal business dispositions	8,877	3,062	9,978
Payments for principal businesses purchased	(11,202)	(1,212)	(7,842)
Capital contribution from GE to GECS	–	–	–
All other investing activities	6,094	10,249	3,758
Cash from (used for) investing activities – continuing operations	20,617	33,790	40,402
Cash from (used for) investing activities – discontinued operations	(735)	(1,354)	1,976
Cash from (used for) investing activities	19,882	32,436	42,378
Cash flows – financing activities			
Net increase (decrease) in borrowings (maturities of 90 days or less)	5,951	(1,228)	(26,114)
Net increase (decrease) in bank deposits	6,748	4,603	(3,784)
Newly issued debt (maturities longer than 90 days)	43,847	47,643	82,846
Repayments and other reductions (maturities longer than 90 days)	(85,706)	(99,933)	(83,290)
Repayment of preferred stock	(3,300)	–	–
Net dispositions (purchases) of GE shares for treasury	(1,456)	(1,263)	623
Dividends paid to shareowners	(6,458)	(4,790)	(8,986)
Capital contribution from GE to GECS	–	–	–
Purchases of subsidiary shares from noncontrolling interests	(4,578)	(2,633)	–
All other financing activities	(1,867)	(3,648)	(3,204)
Cash from (used for) financing activities – continuing operations	(46,819)	(61,249)	(41,909)
Cash from (used for) financing activities – discontinued operations	(44)	(337)	(1,604)
Cash from (used for) financing activities	(46,863)	(61,586)	(43,513)
Effect of exchange rate changes on cash and equivalents	(841)	(333)	795
Increase (decrease) in cash and equivalents	5,537	6,641	24,077
Cash and equivalents at beginning of year	79,085	72,444	48,367

Cash and equivalents at end of year	84,622	79,085	72,444
Less cash and equivalents of discontinued operations at end of year	121	142	1,965
Cash and equivalents of continuing operations at end of year	$ 84,501	$ 78,943	$ 70,479
Supplemental disclosure of cash flows information			
Cash paid during the year for interest	$ (15,571)	$ (17,132)	$ (19,601)
Cash recovered (paid) during the year for income taxes	(2,919)	(2,671)	(2,535)

Objectives of Cash Flow Statement:

(a) Measurement of Cash:

Inflows of cash and outflows of cash can be measured annually which arise from operating activities, investing activities and financial activities.

(b) Generating Inflow of Cash:

Timing and certainty of generating the inflow of cash can be known which directly helps the management to take financing decisions in future.

(c) Classification of Activities:

All the activities are classified into: operating activities, investing activities and financial activities which help a firm to analyze and interpret its various inflows and outflows of cash.

(d) Prediction of Future:

A Cash Flow Statement, no doubt, forecasts the future cash flows which helps the management to take various financing decisions since synchronization of cash is possible.

(e) Assessing Liquidity and Solvency Position:

Both the inflows and outflows of cash and cash equivalent can be known, and, as such, liquidity and solvency position of a firm can also be maintained as timing and certainty of cash generation is known, i.e. it helps to assess the ability of a firm to generate cash.

(f) Evaluation of Future Cash Flows:

Whether the cash flow from operating activities are quite sufficient in future to meet the various payments e.g. payment of expenses/debts/dividends/taxes.

(g) Supply Necessary Information to the Users:

A Cash Flow Statement supplies various information relating to inflows and outflows of cash to the users of accounting information in the following ways: (i) To assess the ability of a firm to pay its obligations as soon as it becomes due; (ii) To analyze and interpret the various transactions for future courses of action;

(iii) To see the cash generation ability of a firm; (iv) To ascertain the cash and cash equivalent at the end of the period.

(h) Helps the Management to Ascertain Cash Planning:

No doubt a cash flow statement helps the management to prepare its cash planning for the future and thereby avoid any unnecessary trouble.