

E4-E5 (Management)

Corporate Accounts

for BSNL internal circulation only

Introduction



- Basic understanding of finance is very relevant to our lives.
 - Both in public and private sectors financial competence and understanding are essential for most managers and executives although many of them will have received no formal training.
 - Company wants its revenues to exceed its expenses so that it will earn profit.
 - Accounting helps executives measure the revenues, expenses, and profit or loss of the business.
-

Introduction .contd...



-
- Accounting is the information system that measures:-
 - business activities
 - processes that information into reports
 - communicates the results to decision makers

Introduction .contd...



-
- Business executive or interested parties while dealing with other business firms you would like to know their financial viability.
 - Balance Sheet is a financial statement that helps you to check the financial health of a firm. It has two sides Liabilities payable and Assets owned.
 - The total of these two sides is always equal. If it is so how can one judge that the financial health of a business firm/company is better or more sound than the other?
 - Given innumerable transactions how does it happen that the two sides of a Balance Sheet always tally?

Accounting Mechanism

- Accounting is essential in order to communicate:-
 - the results of the operations of a business
 - records business transactions
 - classifies them
 - summarizes and presents them in manner useful for interpretation.

Accounting Mechanism ..contd...



Various steps in the accounting procedures

- Transaction:
 - The starting point for accounting is a business transaction say the purchase of raw material.
 - Such a transaction is evidenced by a document called 'voucher' say material purchased bill.
 - It gives the details of the material purchased, the name of the party from whom goods purchased either on credit, or if purchased for cash, the fact that payment has been made.
 - Similarly 'receipt' for the payment of a rent is the voucher for the transaction of 'payment of rent'.
-

for BSNL internal circulation only

Accounting Mechanism ..contd...



- **Recording:**

- Transactions are recorded in various books of accounts on the basis of vouchers.
- Such books of accounts include cashbook and journal.
- The transaction of purchase of raw material on credit will be recorded in the purchase book
- Similarly the payment of rent will be recorded in the cash book.
- Transactions relating to credit sales will be recorded in the sales book.
- The journal is a book to record all those transactions which are not recorded in any specific book. It is also called non-cash transaction

Accounting Mechanism ..contd...

- **Classification:**

- The next step in the accounting procedure is to classify the transactions under appropriate heads like salaries, rent payments, raw material.
- This is done by analyzing the transaction recorded in the books of accounts and posting transactions of a similar nature under one head, called the 'ledger account'.
- The account book containing various account heads is called the ledger e.g. all transaction relating to 'salaries' may be posted in 'salaries account' or those relating to rent paid may be posted in rent payment account.

Accounting Mechanism ..contd...



- **Summarization :**

- The art of summarization relates to periodical presentation of the classified data in the form of ledger accounts balances in a statement called the trial balance.
- All ledger accounts are balanced periodically say at the end of a month
- The account balances are placed together in the form of a trial balance.
- In the trial balance the total of debit balances equals the total of credit balances and this enables to check the accuracy of the accounts books.

Accounting Mechanism ..contd...



- Financial statements:
 - The trial balance is normally the basis for the preparation of financial statements called Profit & Loss Account and Balance Sheet.

Accounting Mechanism ..contd...



- **Auditing:**
 - In the case of corporations accounts are required to be audited by an auditor.
 - The auditor is an independent person having expertise in accounting.
 - He examines the accuracy of the account books and records and gives his report on the balance sheet and profit and loss account.
 - Audited financial statements are required to be submitted to the Registrar of Companies
 - Such audited statement become public documents and this form becomes the means of reporting by the companies to various parties interested in the enterprise.

Accounting Mechanism ..contd...



- **Balance sheet :**
 - shows the financial position of the firm at a given point of time in terms of assets and liabilities.
- **Profit and loss statement :**
 - reflects the performance of the firm over a period of time.

Accounting Principles...contd.



- **Money Measurement Concept:-**

- Accounting records state only those facts about a business firm which can be expressed in monetary terms. In other words business events and facts that cannot be expressed in monetary terms howsoever important they may be are excluded.
- The operational implication of the Money Measurement Concept is that financial statements do not provide all information about the business.

Accounting Principles...contd.



- **Business Entity Concept:-**

- Business transactions of a sole proprietorship are separate from the business owner's personal transactions.
- For legal purposes a sole proprietorship and its owner are considered to be one entity but for accounting purposes they are considered to be two separate entities.

Accounting Principles...contd.



- **Going Concern Concept:-**

- The Going Concern Concept implies that the firm will continue to operate in the foreseeable future. The operational implication of this assumption is that assets are not shown in Balance Sheet at their realisable market value which implies liquidation value.
- Instead evaluation of assets is with reference to the value of goods and services they are likely to produce in future years to come.

Accounting Principles...contd.



- **Dual aspect:-**
 - Every business transaction has a dual effect one receiving of a benefit and the other giving of a benefit. e.g when a firm acquires an asset (receiving of a benefit) it has to pay cash (giving of a benefit).
 - Two accounts are to be opened in the books of account one for receiving the benefit and the other for giving the benefit.
 - There will be a double entry for every transaction.
 - For each and every debit, there should be a corresponding credit and vice-versa.
 - This is nothing but the principle of double entry system of accounting which in other words is known as dual aspect concept.

Accounting Principles...contd.



- Another accounting implication of the dual aspect concept is that the initial amount is contributed by the owner. If additional funds are required bank loans are taken. As per the dual aspect concept all these receipts create corresponding obligations for their repayment. In other words a contribution to the business either in cash or kind not only increases its resources (assets) but also its obligations (liabilities) corresponding. Thus at any given point of time the total assets and the total liabilities should be equal. This equality is called "balance sheet equation" or "accounting equation."
- $\text{Liabilities} = \text{Assets}$ or, $\text{Capital} + \text{Liabilities} = \text{Assets}$
or
- $\text{Assets} - \text{Liabilities} = \text{Capital}$

Accounting Principles...contd.



- **Conservative Concept:-**

- As the name suggests Conservative Concept warrants use of conservatism in business records. In relation to Income Statement the principle is "anticipate no profits unless realised but provide for all probable future losses". Stock of finished goods is valued at the cost of the market price whichever is lower.
- Likewise it is normal for the firms to provide for likely irrecoverable sum from debtors by creating provisions for bad and doubtful debts at the end of accounting year. This assumption safeguards over-estimation of profits.

Accounting Principles...contd.



- **Accrual (Realization) Concept:-**

- Accrual Concept is a fall-out of Accounting Period concept. This concept requires that expenses incurred for a particular accounting period should be reckoned in the same period irrespective of the fact whether these expenses have been paid in cash or not in that year.
- The same holds true for revenues i.e. revenues earned in a specific accounting period are construed as incomes of the same period irrespective of their receipts.
- In the absence of Accrual accounting the Income Statement may indicate more profit in one year at the cost of the profits of some other year which is entirely inappropriate and illogical.
- In other words cash basis of expense recognition will hamper comparison of profit figures over the years. Clearly there is a very strong case for a business firm to adopt accrual basis of accounting known as Accrual accounting to determine correct profits.

Accounting Principles...contd.



- **Materiality:-**

- It states that if the value of any asset is very low it might be expensed in the year of purchase itself rather than amortizing over its useful life (through depreciation).

Balance Sheet



- Balance Sheet shows the financial position of a business firm at a particular point of time. It is also known as the statement of financial position or statement of financial condition.
- The major elements of the Balance Sheet are Assets and Liabilities. These two counter balancing elements form the Balance Sheet Equation.

Balance Sheet Equation:

$$\text{Assets} = \text{Liabilities}$$

Assets

- Assets are valuable resources owned by the firm and Liabilities are obligations payable by it.
- Liabilities are sources of financing assets.
- Liabilities are broadly classified into two categories namely External Liabilities (consisting of creditors and lenders) and Internal Liabilities (consisting of owners' contribution/equity).
- Owners' equity consists of initial capital provided by them and retained earnings accumulated over the years from the firm's profitable operations.
- External liability-holders have first claim on the assets of the firm and owners have a residual claim. It is for this reason owners' capital is known as Risky Capital.
- Profits since payable to owners, are liabilities from the perspective of the firm and losses, since recoverable from them are its assets. This is as per Separate Entity concept.

Assets

- Total Assets are always equal to total Liabilities. This is as per the Principle of Duality. Therefore the fundamental accounting equation is:

$$\text{Owners' equity} + \text{Liabilities (external)} = \text{Assets}$$

- Balance Sheet is always with reference to a point of time (say 31st March). It is a snapshot of financial position of a firm at a specific date in terms of Assets owned and Liabilities owed.
- Whereas income statement indicates profits earned (or losses suffered) during the accounting period.

Profit & Loss Account



- Profit & Loss (abbreviated to P&L) Account/Income Statement reports the revenues and expenses of a firm of an accounting period.

In broad terms Revenue as the name suggests is the income that mainly accrues to the firm either by the sale of goods and services or by investing the resources of the firm outside.

- In contrast Expenses are the costs incurred in earning revenues.
- P&L Account is concerned with matching the revenues of a specified period with the expenses of that period.
- Greater the accuracy of this matching procedure more correct is the income determination. Preparation of a P & L account is based on the *Matching Principle*.

Thanks