Chapter : 1

Introduction to Accounting & Double Entry Book-Keeping

- Book-keeping is related with recording of business transactions. Business enterprise and other organizations deal in activities which involve exchange of money or money's worth. All these activities are recorded for the purpose of taking important decisions as to whether the activities are feasible, profitable and are to be continIntroduction to Accounting & Double Entry Book-Keeping
- ued or not. Information about the business and other organizations is required not only by the proprietors and managers of business and other organizations but also to various other stakeholders such as the government, investors, customers, employees and researchers.
- Account : An account is a summarized record of transactions relating to a particular person asset,liability,particular head of expense or income recorded at one place. In day-to-day business activity large number of business transaction take place .It affect the several accounts at the end of certain period of time, it is necessary for the Businessman to balance the accounts to find out the information like total capital, total liabilities and assets, total income and expenses etc. of the business.
- "And account is summarize record of transaction affecting one person one kind of property for one class of Gain or loss" - G.R. Batliboi
- **Capital :** Capital is a broad term that can describe any thing that confers value or benefit to its owner, such as a factory and its machinery, intellectual property like patents, or the financial assets of a business or an individual. ... A business in the financial industry identifies trading capital as a fourth component.
- The capital means **the assets and cash in a business**. Capital may either be cash, machinery, receivable accounts, property, or houses. Capital may also reflect the capital gained in a business or the assets of the owner in a company.
- Capital can also refer to money invested in a business to purchase assets. Businesses can raise capital through owner contributions of cash or property, which are called equity contributions, or through loans, called loan capital.
- **Assets :** Any physical thing or right owned that has a monetary value is called as an asset. The ownership of the Asset must be with business unit. E.g Land, Goodwill, Patents, Computers etc.
- **Types of Assets:**
- a) Fixed Assets/Non current Assets : The assets which give long term benefit to the business are known as fixed assets e.g Land and Building, Plant & Machinery, Goodwill etc. These assets may be tangible or intangible.

- b) Current Assets : Assets which are held in the business for the operating year and can be converted into cash very easily are called as current assets. e.g Debtors, Bills Receivable Cash in Hand, Cash at Bank, Stock etc.
- c) Fictitious Assets : These assets are not represented by tangible possession or property. They are imaginary assets but do not have any realizable value. e.g Deferred revenue expense like advertisement paid for 4 years.
- **Liabilities :** Amount payable by the business to others is known as liability. It is a debt or amount due from the business to others for the benefit received by the business unit. e.g Loan taken, Creditors, Bank Overdraft, Outstanding Expenses etc.
- **Types of Liabilities:**
- a) Fixed Liabilities : One of the major source of funds in the business is fixed liabilities. It may be in the form of capital, secured loans, long term loans from banks and from financial institutions etc.
- b) Current Liabilities: Short term liabilities payable within a year are called current liabilities. Current liabilities arise in the regular current operations of the business. These liabilities are not normally secured. E.g. Creditors, Bills Payable etc.
- **Drawing :** The amount of cash or value of goods, assets, etc., withdrawn from the business by the owner for personal use called as drawings.
- E.g. : A proprietor pays colleges fees of his son, or pays for his medical expenses, mobile bills etc, from the business.
- **Goods:** The term 'goods' refers to merchandise, commodities, articles or things in which a trader trades. These are purchased or manufactured for the purpose of sale and to earn profit.
- e.g i) Medicines are goods for the chemist. ii) Vegetables are goods for the vegetable vendor. iii) Parts like tyres, engine gearbox, cables are produced by a vehicle manufacturer like Bajaj Auto, Hero Motors.
- **Debtors :** A person who has to pay to the business for getting goods and services on credit is known as debtor. A debtor is a person who owes money to the business.
- **Creditor:** A person to whom business has to pay for getting goods or services on credit is known as creditor. A creditor is a person to whom business owes money
- **Solvent and Insolvent:**
- i) **Solvent:** If a person's assets are more than his liabilities, or equal to his liabilities, he is called as a solvent person. Solvent person is financially sound and is in a position to pay off all his debts.
- E.g. : A person's total assets have been calculated to ` 50,00,000/- and his total debts were ` 30,00,000/- since his position is sound he is able to pay off his debts therefore he is called Solvent.

- **ii) Insolvent:** A person whose liabilities are more than his assets is an insolvent person. Such person's liabilities are more than his assets.
- E.g. : A person's total assets or property have been calculated to ` 20,00,000/- and his total debts were ` 50,00,000/- and if he is not in a position to get any amount from any sources and if the court is so satisfied then he will be declared as an insolvent person
- **Purchases: Purchases** in accounting is **the cost of buying inventory or goods during a period with the aim** of resale in the ordinary course of the business. Hence, Purchases is a kind of expense and it is therefore included in the income statement within the cost of goods sold.
- **Sales :** A **sale** is a transaction between two or more parties in which the buyer receives tangible or intangible goods, services, or assets in exchange for money.
- **Bad Debts** : An irrecoverable amount from a debtor is known as "Bad Debts". It is a revenue loss to the business.
- **Accounting** is a system meant for measuring business activities, processing of information into reports and making the findings available to decision-makers. The documents, which communicate these findings about the performance of an organization in monetary terms, are called financial statements.
- Accounting is the process of summarizing analyzing and reporting the financial transactions in a manner that adheres to certain accepted standard formats, helping to evaluate a past performance, present condition and future prospects as well.
- **<u>Accounting helps answering questions like:</u>**
- .Am I making or losing money from my business?
- How much am I worth.
- Should I put more money in my business or sell it and go into another business
- How can I change the way I operate to make more profit?
- **Nature of Accounting:**
- We know Accounting is the systematic recording of financial transactions and presentation of the related information of the appropriate persons. The basic features of accounting are as follows:
  1. Accounting is a process: A process refers to the method of performing any specific job step by step according to the objectives, or target. Accounting is identified as a process as it performs the specific task of collecting, processing and communicating financial information. In doing so, it follows some definite steps like collection of data recording, classification summarization, finalization and reporting.
  2. Accounting is an art: Accounting is an art of recording, classifying, summarizing and finalizing the financial data. The word 'art' refers to the way of performing something. It is a behavioral knowledge involving certain creativity and skill that may

help us to attain some specific objectives. Accounting is a systematic method consisting of definite techniques and its proper application requires applied skill and expertise. So, by nature accounting is an art.

3. Accounting is means and not an end: Accounting finds out the financial results and position of an entity and the same time, it communicates this information to its users. The users then take their own decisions on the basis of such information. So, it can be said that mere keeping of accounts can be the primary objective of any person or entity. On the other hand, the main objective may be identified as taking decisions on the basis of financial information supplied by accounting. Thus, accounting itself is not an objective, it helps attaining a specific objective. So it is said the accounting is 'a means to an end' and it is not 'an end in itself.'
4. Accounting deals with financial information and transactions; Accounting records the financial transactions and date after classifying the same and finalizes their result for a definite period for conveying them to their users. So, from starting to the end, at every stage, accounting deals with financial information. Only financial information is its subject matter. It does not deal with non-monetary information of non-financial aspect.
5. Accounting is an information system: Accounting is recognized and characterized as a storehouse of information. As a service function, it collects processes and communicates financial information of any entity. This discipline of knowledge has been evolved out to meet the need of financial information required by different interested groups.

- **1. Keeps a record of business transactions-** Accounting is important, as it keeps a systematic record of the organization's financial information. Up-to-date records help users compare current financial information to historical data. With full, consistent, and accurate records, it enables users to assess the performance of a company over a period of time.
- **2. Facilitates decision-making for management-** Accounting is especially important for internal users of the organization. Internal users may include the people that plan, organize, and run companies. The management team needs accounting in making important decisions. Business decisions may range from deciding to pursue geographical expansion to, instead, improving operational efficiency.
- **3. Meets legal requirements-** Proper accounting helps organizations ensure accurate reporting of financial assets and liabilities. Tax authorities, such as the U.S. Internal Revenue Service (IRS) and the Canada Revenue Agency (CRA), use standardized accounting financial statements to assess a company's declared gross revenue and net income. The system of accounting helps to ensure that a company's financial statements are legally and accurately reported.
- **4. Communicates results-** Accounting helps to communicate company results to various users. Investors, lenders, and other creditors are the primary external users

of accounting information. Investors may be deciding to buy shares in the company, while lenders need to analyze their risk in deciding to lend. It is important for companies to establish credibility with these external users through relevant and reliable accounting information.

- **OBJECTIVES OF ACCOUNTING**
- 1. **To maintain a systematic record of business Transactions:**
- The main objective of accounting is to identify the financial transactions and events of the business and to record them into proper books of accounts in a systematic manner.
- **2. To ascertain Profit or Loss:**
- The next main objective of accounting is to determine the financial performance, i.e. profit earned or loss suffered by the business during a particular period. For this purpose, Trading and Profit and Loss Account or Statement of Profit and Loss Account (by companies) is prepared at the end of each accounting
- **3. To determine Financial Position:**
- Another main objective of accounting is to assert: the financial position of the business concern. Financial Position can be known fn the Balance Sheet, which depicts the position of assets, liabilities and capital of the period.
- **4. To provide information to various users:**
- Another objective of accounting is to communicate the accounting information to various interested parties like owners investors, creditors, employees, government authorities, etc. Such information helps them in making sound decisions about the business entity.
- **5. To assist the Management:**
- Another objective of accounting is to provide financial information to the management. Management requires it for decision making and for exercising effective control. owners.
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- **ADVANTAGES OF ACCOUNTING**
- **Provides Information about Financial Performance:**
- Accounting helps in providing information about the Financial Performance, i.e. net results of business activities of an accounting period.
- **Provides assistance to Management:**

- Accounting provides information about the financial performance and financial position of the business, which is needed by the management for planning and controlling the business.
- **Facilitates Comparative Study:**
- By keeping a systematic record of the business transactions, accounting helps in making comparisons. • It facilitates Intra-firm Comparison', i.e. comparison of the financial performance of an enterprise for two or more accounting periods. • It also facilitates 'Inter-firm Comparison', i.e. comparison of financial results of one firm with that of another.
- **Helps in settlement of Tax Liability:**
- Properly maintained accounting records are helpful in the settlement of various tax liabilities.
- **Helpful in Raising Loans:**
- Accounting facilitates raising loans from banks or other financial institutions as such institutions grant loans to firms on the basis of appraisal or financial statements of the firm.
- **Evidence in Court:**
- Systematic accounting records provide documentary evidence m the court in case of any dispute.
- **10. Helpful in Decision Making:**
- Management has to take a number of decisions at regular intervals. Accounting provides useful information to the management for taking such decisions.
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Debits and Credits:

- Debits and credits are essential to the double entry system. In accounting, a debit refers to an entry on the left side of an account ledger, and credit refers to an entry on the right side of an account ledger. To be in balance, the total of debits and credits for a transaction must be equal. Debits do not always equate to increases and credits do not always equate to decreases.
- A debit may increase one account while decreasing another. For example, a debit increases asset accounts but decreases liability and equity accounts, which supports the general accounting equation of Assets = Liabilities + Equity. On the income statement, debits increase the balances in expense and loss accounts, while credits

decrease their balances. Debits decrease revenue and gains account balances, while credits increase their balances.

Rules Of Record Journals Entries

- **1. Debit what comes in**

  Credit What goes out

2. Debit the receiver

Credit the giver

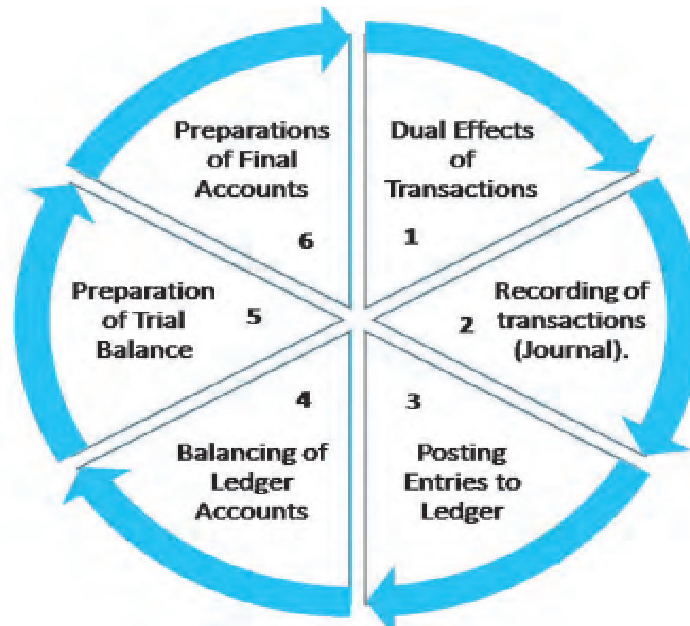
3. Debit all expenses & Loss

Credit all Income & Gain

DOUBLE ENTRY SYSTEM

- **Double Entry System** is the most scientific method of recording all business transactions in the books of accounts. Under this system double or two fold effects of each transaction is recorded. According to Double Entry Book-keeping System, one account is to be debited and another account is to be credited with equal amount.
- **Definition of Double Entry System is as follows-** "Every business transaction has a two fold effect and that it affects two accounts in opposite directions and if a complete record is to be made of each such transaction it would be necessary to debit one account and credit another account. It is this recording of two fold effect of every transaction that has given rise to the term Double Entry." – **J.R. Batliboi.**

Important Elements of Double Entry Book-keeping System:



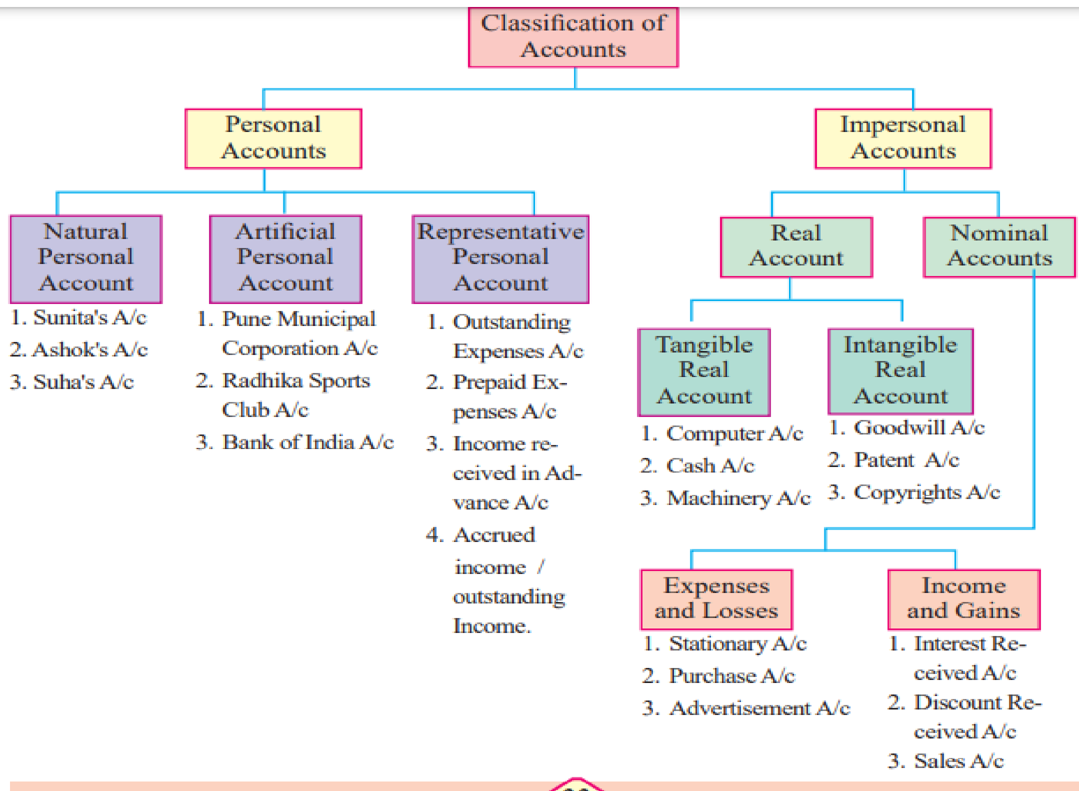
Advantages of Double Entry Book-keeping System:

1. **Complete Record:** Under this system all business transactions are recorded. This method is scientific and records both the aspects of each transaction.
2. **Accuracy:** In this system both aspects are recorded in the books of accounts so it gives complete accuracy in accounting work. It also checks arithmetical accuracy.

- **3. Business Results:** All expenses, losses, income, gains, liabilities, assets, debtors and creditors all these transactions are recorded, therefore it helps to find out accurate business results of particular accounting period.
- **4. Common Acceptance:** It is widely accepted since it follows universal accounting principles. Double Entry System is accepted by financial institutions, government authorities etc

NATURE OF DOUBLE ENTRY SYSTEM:

- In the double-entry system, transactions are recorded in terms of debits and credits. Since a debit in one account offsets a credit in another, the sum of all debits must equal the sum of all credits.
  A double-entry bookkeeping system is where a corresponding entry is made for every transaction, i.e. debits and credits. The basis of the double-entry bookkeeping system is that every transaction has two parts and affects two ledger accounts


Classification of Accounts
Personal Accounts
Impersonal Accounts
Natural Personal Account
Artificial Personal Account
Representative Personal Account
Real Account
Nominal Accounts
1. Sunita's A/c
2. Ashok's A/c
3. Suha's A/c
1. Pune Municipal Corporation A/c
2. Radhika Sports Club A/c
3. Bank of India A/c
1. Outstanding Expenses A/c
2. Prepaid Expenses A/c
3. Income received in Advance A/c
4. Accrued income / outstanding Income.
Tangible Real Account
Intangible Real Account
1. Computer A/c
2. Cash A/c
3. Machinery A/c
1. Goodwill A/c
2. Patent A/c
3. Copyrights A/c
Expenses and Losses
Income and Gains
1. Stationary A/c
2. Purchase A/c
3. Advertisement A/c
1. Interest Received A/c
2. Discount Received A/c
3. Sales A/c

CHAPTER 2:

BOOKS OF ACCOUNT JOURNAL:

- The word “Journal” is derived from the French word “JOUR” which means a “Day”. Therefore journal means a “daily record”. A journal contains a daily record of business transactions and hence it has been named so, as soon as a transaction takes place its debit and credit aspects are analyzed and first of all recorded chronologically i.e. In the order of their occurrence(taking place). Journal is a book of original entry or primary entry

NEEDS OF JOURNAL:

- Journal is an important book in Book-keeping. All business organisations, keep the Journal. The importance and utility is as follows:-
- 1) This is the principal book of account. It includes all types of accounts of business
- 2) It shows all necessary information regarding transactions.
- 3) The Journal has date wise record of all the transactions with details about accounts it helps to understand the events when its took place.
- 4) The Journal is subsidiary book in which all the day to day transactions are recorded first in chronological order in debit and credit form and with the amount of each transaction.
- 5) Accounting procedure is followed on the basis of accounting documents.
- 6) The narration provides a brief explanation about the transactions .It helps to increase the clarity of every transactions.
- 7) It helps to find and prevent errors.

  8) It helps to check arithmetical accuracy of the transactions.

  9) It helps in preparation of Final Accounts

Advantages & limitation of journal

- **Advantages:**
- A. It reduce the possibility of error
- B. It provides an explanation of error
- C. It provides a chronological record of all the transaction
- **Limitations:**
- A. Too lengthy as all transaction are recorded.
- B. cannot find the balance of accounts easily from the journal
- C. As we maintain subsidiary books, the use of journal is limited

CHAPTER 3 :

LEDGER

- The word **'LEDGER'** is derived from **Latin word 'Ledger'** which means 'to contain' As the ledger is the collection of all the accounts so 'it contains' and hence the name signifies.
- 1. " A Ledger Account may be defined as a summary, statement of all the transactions relating to persons, assets, expenses or incomes which have taken place during a given period to time and shows their net effect".- **S. P. Jain, K. L. Narang –Advanced Accountancy**
- 2. "Main record of the accounts of a business, traditionally, a ledger was a large book with separate pages for each account. In modern systems ledger may consist of separate cards or computer records'- **Oxford Dictionary**

Importance of Ledger:

- 1. It is the summarised record of all the transactions in form of Asset A/c, Liabilities A/c, Expenses A/c, Income A/c etc.
- 2. The ultimate object of Book-Keeping is to ascertain with the least trouble, what is the amount owed to the supplier, what is the amount receivable from the customer and so on. In the process of posting information collected is condensed in form of Debtors A/c ,Creditors A/c to get the ready results
- 3. It is necessary for preparation of Trial Balance.
- 4. The financial position of the business can be easily known with the help of various types of Assets A/c and Liabilities A/c
- 5. It is possible to prepare various types of income statement on the basis of balances shown by different ledger Accounts.
- 6. Ledger can be used as a control tool as it shows accounts of various expenses with the balance.
- 7. On the basis of the results shown in the Ledger it is useful for the management to forecast or plan the future plan of action.

Balancing of Ledger Accounts

- 1. Personal Account
- 2. Real Account
- 3. Nominal Account

- Balancing of Personal Account
- These accounts may have debit balance or credit balance or nil balance. A personal account having debit balance is a Debtor and credit balance is a Creditor. Balance of these accounts is carried forward.
- a) Debit balance: If the debit side total of ledger Account is more than the credit side total it
- indicates a debit balance.
- b) Credit balance: If the total of credit side of an account is more than debit side it indicates credit
- balance.
- **Balancing of Real Account**
- Accounts which are related to assets and properties are real accounts. e.g.: Cash A/c, Furniture A/c etc. Real Account always shows a debit balance
- **Balancing of Nominal Account**
- Nominal Accounts means the accounts which are related to expenses, incomes, losses and gains. This account may have a debit balance or a credit balance. At the end of the accounting year the balances of all Nominal Accounts are transferred to Trading or Profit and Loss Account.
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◆ CHAPTER 4
◆ SUBSIDIARY BOOK & Cash Book

- A small business may be able to record all transactions in single Journal but as the business expands the number of transactions becomes so large, that the Journal is required to be sub-divided into Special Journals which are called Subsidiary Books.
- **Meaning :** The sub division of Journal on the basis of nature of transaction is known as Subsidiary Books. These books are also called as Books of Original entries or Prime entries because the transactions are first recorded in Subsidiary Books and then posted in the Ledger.

Need for maintaining Subsidiary Books :

- **1) Specialisation :** When the staff is appointed for same type of work it leads to specialisation and increase in efficiency.
- **2) Time saving and economical :** Different accounting procedures can be taken up at the same time. This will save time and prove to be economical.
- **3) Division of work :** The writing of Subsidiary Books can be conveniently divided among different clerks. Hence it is easy to keep the Books upto date.
- **4) Quick information and future reference :** Subsidiary Books gives quick information relating to the accounts and makes future reference easy.
- **5) Internal check :** Verification of correctness can be made more effectively.

Advantages of subsidiary books:

1. **Division of work:** The accounting work may be divided among number of clerks.
2. **Specialization and efficiency:** As the work of maintaining different subsidiary books is given to many Clarks they acquire full knowledge of it and become efficient in handling it
3. **Saving time** : As the work is divided various accounting work can be undertaken simultaneously, which, in turn ,save time
4. **Availability of information :** Since separate books are kept for each class of transaction, the information relating to each class of transaction will be available at one place.
5. **Facility in checking :** Errors and frauds can be checked by the use of various subsidiary books.

6.

Types of Subsidiary books

- **Following are the important types of Subsidiary Books.**
- **1) Cash Book.**
- **2) Petty Cash Book.**
- **3) Purchase Book**
- **4) Purchase Return Books (Return Outward Book)**
- **5) Sales Book**
- **6) Sales Return Book (Return Inward Book)**
- **7) Journal Proper**

Cash Book:

- All Cash and Bank transactions are recorded in the Cash Book. The Cash Book has two sides where the left hand side is Receipt Side (Debit-side) and the right hand side is Payment Side (Credit side). When amount is received details are recorded on the Receipt side and when payments are made details are recorded on the Payment side. Cash Book a Journal since it is a Book of Original entries and it also a ledger since it constitutes a classified record of all cash transactions in the form of Ledger and helps in finding out Cash and Bank balance at the end of particular accounting period. Thus, it can be said that cash book serves dual purpose of journal as well as ledger.
- Contra Entries : Certain transaction affects Cash Account and Bank Account simultaneously but with opposite effect. It may decrease the cash balance and increase bank balance or increase the cash balance and decrease bank balance at the same time. In columnar Cash Book, Cash Account and Bank Account appear under the same heading of cash book. To record increase in bank balance, bank account is debited and to record decrease in cash balance, cash account is credited and vice versa. Entries recorded on both the sides of Cash Book are called as "Contra Entries". It occurs only when Cash Account and Bank Account are simultaneously affected in a transaction. Contra entries are denoted by the capital letter "C" in the Ledger Folio column.

Types Of Bank Accounts:

- **Types Of Bank Accounts**

Whether you are a housewife or a college student, a business owner or a business house, a retired professional or Indian living abroad, not having a bank account is unimaginable. Based on the purpose, frequency of transaction, and location of the account-holder, banks offer a bouquet of bank accounts to choose from. Here is a list

of some of the **types of bank accounts in India**.

1. Current account
A current account is a deposit account for traders, business owners, and entrepreneurs, who need to make and receive payments more often than others. These accounts hold more liquid deposits with no limit on the number of transactions per day. Current accounts allow overdraft facility, that is withdrawing more than what is currently available in the account. Also, unlike savings accounts, where you earn some interest, these are zero-interest bearing **accounts**. You need to maintain a minimum balance to be able to operate current accounts.

- **2. Savings account**

A savings bank account is a regular deposit account, where you earn a minimum rate of interest. Here, the number of transactions you can make each month is capped. Banks offer a variety of Savings Accounts based on the type of depositor, features of the product, age or purpose of holding the account, and so on. .There are regular savings accounts, savings accounts for children, senior citizens or women, institutional savings accounts, family savings accounts, and so many more.

You have the option to pick from a range of savings products. There are zero-balance savings accounts and also advanced ones with features like auto sweep, debit cards, bill payments and cross-product benefits. A cross-product benefit is when you have a savings account with a bank and get to avail special offers on opening a second account such as a demat account.

- Apply for Savings Account here.
- 3**. Fixed deposit account**

To park your funds and earn a decent rate of interest on it, there are **different types of accounts** like fixed deposits and recurring deposits.

A fixed deposit (FD) account allows you to earn a fixed rate of interest for keeping a certain sum of money locked in for a given time, that is until the FD matures. FDs range between a maturity period of seven days to 10 years. The rate of interest you earn on FDs will vary depending on the tenure of the FD. Generally, you cannot withdraw money from an FD before it matures. Some banks offer a premature withdrawal facility. But in that case, the interest rate you earn is lower.

4. Recurring deposit account

A recurring deposit (RD) has a fixed tenure. You need to invest a fixed sum of money in it regularly -- every month or once a quarter -- to earn interest. Unlike FDs, where you need to make a lump sum deposit, the sum you need to invest here is smaller and more frequent. You cannot change the tenure of the RD and the amount to be invested each month or quarter. Even in the case of RDs, you face a penalty in the form of a lower interest rate for premature withdrawal. The maturity period of an RD could range between six months to 10 years.

◆ Types of cheques

◆ 1. Bearer cheques

◆ It is also known as an open cheque or an uncrossed cheque. This cheque can be transferred by mere delivery and needs no endorsement. he cheque is negotiable from the date of issue up to three months. It turns stale after the completion of three months and needs to be revalidated before presenting to the bank.

◆ 2. Self-Cheques

◆ It comes under bearer cheque where instead of writing the name, the account holder writes “self” to receive money physically from the branch where he holds the account.

◆ 3. Account Payee Cheques

◆ A bearer cheque becomes an account payee cheque by writing “Account Payee” or crossing it twice with two parallel lines on the left-hand side top corner.

◆ 4. Post dated cheque

◆ It is a type of crossed or accounts payee cheque but it is post-dated to meet the obligation at a future date. It is valid from the date of the issue up to three months

◆ **Purchase Book (Bought Day Book) :**

◆ Goods purchased on credit for manufacturing or for resale are only recorded in purchase book. Cash purchases are not recorded in purchase book. Similarly credit purchases other than goods like purchase of office equipment, furniture, stationary and building are not recorded in purchase book. For example, a business dealing in machinery spare parts will record only credit purchase of machinery spare parts in purchase book. This book is also known as Purchase Journal Goods purchased on credit are always recorded at net value.

◆ **Purchase Return Book.**

◆ In this book, purchases return of goods are recorded. Sometimes goods purchased are returned to the supplier for various reasons such as the goods are not of the required quality, or are defective. For every return, a debit note (in duplicate) is prepared the original one is sent to the supplier for making necessary entries in his book. The supplier also prepare a note, which is called the credit note. It is also called as Purchase return Journal or Returns Outward Book.

◆ **Sales Book.**

◆ Goods sold on credit are only recorded in Sales Book. Cash sales are not recorded in Sales Book. Similarly goods assets news paper sold on credit are not recorded in Sales BookE.g. A businessman dealing in furniture will recorded only credit sale of Furniture in sales book. Cash sales of Furniture will not be recorded in sales book. It is also known as Sales Journal

- **Sales Return Book (Return Inward Book) :**
- When goods sold on credit are not according to specifications, sample or are damaged in transit, buyer or debtor can return them to seller. Such return of goods sold on credit only is recorded in Sales Return Book. Return of goods sold for cash is not recorded in this book. It is also known as Sales Return Journal. On receipt of goods from the customer, a credit note is prepared. The difference between the credit and the debit note is that the former is prepared by the seller and the later is prepared by the buyer

BANK RECONCILIATION STATEMENTS

- A businessman maintains a Cash Book with bank column in his ledger, wherein he records all banking transactions. The bank column in his Cash Book represents bank current account. Bank being the other party records these transactions in their ledger known as Pass Book. When businessman deposits money or cheque into bank for collection it is recorded in the Cash Book on the debit or receipt side. Bank records this on the credit or receipt side of Pass Book. Similarly, when businessman issues cheque for making payments, it is recorded on the credit or payment side of Cash Book. Bank records this transaction on the debit side or payment side of Pass Book / bank statement. Thus, whatever is recorded by businessman in the Cash Book is invariably recorded in the Pass Book / bank statement. Ideally then, Cash Book bank balance and Pass Book balance should be the same. The only difference would be that if Cash Book has a debit balance the Pass Book will have a credit balance and vice versa.
- **Definition:**
- "A statement which reconciles the Bank balance as per Cash Book and the balance as per Pass
- Book showing all causes of difference between the two."
- "A statement showing the causes of disagreement between the balance shown by the bank Pass
- Book and the balance shown by the Cash Book under the bank column at the end of the specific
- period or month, is called Bank Reconciliation Statement."

Need and importance of Bank Reconciliation Statement

- 1) It explains and clarifies the causes of disagreement between bank balance as per Cash Book and Pass Book.
- ii) It helps in detecting errors and omission made in Pass Book and Cash Book.
- iii) It reduces the chance of fraud by the staff dealing in cash.
- iv) It helps to check whether the bank makes proper entries for banking transactions.
- v) It helps to have a moral check on the staff of business organisations to keep Cash Book up to
- date.
- vi) It is an important mechanism of internal check and gives information of cash inflow and outflow.

Reasons for difference between Cash Book balance and Pass Book balance.

- **Time difference:**
- Transaction cannot be recorded in the Cash Book and Pass Book at the same time. There is a time gap between recording transaction in the two books. For example, when businessman deposits a cheque into bank for collection, it is a transaction for him and he immediately records it in his Cash Book. On the other hand, bank will record it in Pass Book only after collecting the amount of cheque. At this point of time entry for transaction appears only in Cash Book thereby creating a difference in the balance of the two books which is to be reconciled.
- ii) Errors and omission made by businessman or bank- Differences in balance may also arise due to errors committed by bank or businessman. For example, bank charges debited by bank ` 540 is recorded as ` 450 in Cash Book. Here the transaction appears in both the books but with wrong amount causing a difference in the balance of the two books

Causes of difference in Cash Book and Pass Book

I. Due to time difference.

a) Transaction that appears in Cash Book but not in Pass Book.
   i) Cheque issued but not presented.
   ii) Cheque deposited but not collected.

b) Transaction that appears in Pass Book but not in Cash Book.
   i) Interest credited by bank.
   ii) Direct collection of income on behalf of customer.
   iii) Direct payment of expenses by bank.
   iv) Bank charges, interest on overdraft, commission charged by bank.
   v) Dishonour of cheques or Bills of exchange.
   vi) Amount directly deposited in the bank account.

II. Due to errors and omission made by bank or business.

i) Recorded on wrong side.
ii) Recording wrong amount.
iii) Wrong balancing and totalling.
iv) Double recording.
v) Omission of a transaction.

-

6.4 Specimen of Bank Reconciliation statement.

Bank Reconciliation Statement

As on __________

Particulars	Amount (₹)	Amount (₹)
Bank balance / Overdraft as per Cash Book / Pass Book		xxx
Add: Reasons which would increase balance of the other book		
1.	xxx	
2.	xxx	xxx
Less : Reasons which would decrease balance of the other book		
1.	xxx	
2.	xxx	
3.	xxx	xxx
Bank balance / Overdraft * as per Pass Book / Cash Book		xxx

Preparation of Bank reconciliation Statement.

- Procedure for finding the causes of difference and effects thereof: When there is a difference between balance as per Pass Book and Cash Book following steps are required to find the causes of difference-
- 1. Compare the items appearing on the debit side of the Cash Book with those on the credit side of the Pass Book (deposit column) and tick mark those items appearing in both the books.
- 2. Compare the items appearing on the credit side of the Cash Book with those on the debit side of the Pass Book (withdrawal column) and tick mark those items appearing in both the books.
- 3. Make a list of the items that are unticked in both the books. These are the items responsible for the difference in the balance shown by Cash Book and Pass Book.
- 4. Analyse the causes of difference.
- 5. Select the date for preparation of Bank Reconciliation Statement. Bank reconciliation month because Cash Book balance and Pass Book balance are readily available on that date.
- 6. Prepare Bank Reconciliation Statement by taking balance as per Cash Book or Pass Book as starting point.
- 7. Adjust the starting point with other balances by adding or subtracting the unticked items as found in step 3. If balance as per Cash Book has been taken as the starting point, then balance as per Cash Book is to be adjusted according to entries passed in the Pass Book or vice versa.

Reasons for discrepancy	When bank balance is given as per Cash Book Dr. Bal	When bank balance is given as per Pass Book Cr. Bal	When overdraft balance is given as per Cash Book Cr. Bal	When overdraft balance is given as per Pass Book Dr. Bal
1. Cheque deposited into bank but not credited.	(-)	(+)	(+)	(-)
2. Cheque issued but not presented for payment.	(+)	(-)	(-)	(+)
3. Bank charges debited in Pass Book.	(-)	(+)	(+)	(-)
4. Interest credited in Pass Book only	(+)	(-)	(-)	(+)
5. Interest debited in Pass Book only.	(-)	(+)	(+)	(-)
6. Payments made by the bank recorded in Pass Book only.	(-)	(+)	(+)	(-)
7. Direct payment by customer in bank recorded in Pass Book.	(+)	(-)	(-)	(+)

-

TRIAL BALANCE

- A trial balance can be defined as a statement showing the balance ,or total of debits and credits , of all the accounts in the ledger with a view to verifying the arithmetical accuracy of posting into the ledger.

FEATURES OF TRIAL BALANCE

The features of trial balance are as follows:

1. Trial balance can be prepared anytime during the accounting period.
2. It is prepared to check the arithmetical accuracy of posting of entries from journal to ledger. In other words, it is an instrument for carrying out the job of checking and testing.
3. It is not a part of the double entry system of bookkeeping, but only for checking the accuracy of posting. However, it does not reveal all errors.

Table 7.1 Various A/cs Appearing in a Trial Balance

Name of Account	*L/F*	*Dr. Balance*		*Cr. Balance*	
		₹	*Ps.*	₹	*Ps.*
Capital					
Sundry Creditors				xxx	
Bills Payables				xxx	
Any Liabilities				xxx	
Purchase Returns				xxx	
Sales				xxx	
Drawings		xxx			
Bank A/c		xxx			
Sundry Debtors		xxx			
Cash A/c		xxx			
Purchases		xxx			
Opening Stock		xxx			
Investments		xxx			
Any Assets		xxx			
Bills Receivables		xxx			
Any Expenses		xxx			
Any Income				xxx	
Total		xxx		xxx	

Final Account

- Final accounts are considered as one of the essential elements of the organization. It is prepared at the final stage of the accounting process
- The primary aim of accounting is assessment of business performance for the benefit of all stakeholders (such as owners, employees, suppliers, customers, financiers etc.) which will also help them to form their opinions on the financial position of their business concerns. For this purpose, various accounting reports are prepared in the form of Final Accounts at the end of every financial year. In brief, Final Accounts are financial statements that validate and explain working results and financial status for a specific period of time on a particular date. It is a set of Trading Account, Profit and Loss Account and Balance Sheet. Balancing figure of Trading Account is Gross Profit or Gross Loss. In case of Profit and Loss Account the balancing figure is Net Profit or Net Loss. Whereas Balance Sheet shows financial position of assets and liabilities at a given period of time.

Objective of Final Accounts:

- The basic objectives of Final Accounts is to determine Gross Profit /Gross Loss and Net Profit or Net Loss of the business during the financial year.
- Final Accounts shows the true and correct financial position of business.
- It informs the operating results and exact financial position of the business to the stake holders to take financial decisions.
- It enables to control financial activities of business effectively.

Importance of Final Account

1. Final accounts assist the **shareholders** to evaluate their investments which help them to make accurate decisions. Shareholders are more interested to know the **liquidity position** of the organization and the amount of profit and dividends earned by them.

2. Final accounts are essential for the **tax department** to make sure that the organization makes the *payment of various taxes and additional duties* on time without any delay. Therefore preparation of final accounts (Income statement) is very important for computing tax.

3. Final accounts provide important **facts and figures** regarding performance, liquidity, progress and deposition of an enterprise. This helps the **internal management** to make quick, informed and accurate future decisions on the various aspects of the organization.

- 4. Final accounts allow **lenders** and **creditors** to have a look at the financial health and soundness of the organization. Creditors use the following information to assess the risk**,** credibility and its ability to repay the debt on the agreed date.

- 5. Final accounts help the **employees** to know about the **company's profitability** and its adverse effects on job security, remuneration, transfers, salary hikes, incentives and various other bonuses.
- 6. Final accounts play an important role in helping the organization to achieve **steady growth** and development by deploying various techniques and strategies for improving **revenue**, developing a strong **customer base** and providing more employment opportunities.

Purpose of preparing final accounts-

- The following are the main purpose of preparing final accounts-
- 1. Final accounts are prepared to determine the net profit or net loss incurred by the organization within one accounting period.
- 2. Gross Profit and Net Profit of the current accounting period are compared with the previous years' profit. This helps in determining the progress of the business. This information further helps in framing future decisions and policies for the organization.
- 3. Final accounts facilitate the preparation of trading accounts and profit & loss accounts which provides details regarding all the expenses and incomes (direct or indirect) of an organization. This helps the organization in applying various tactics for reducing expenses and strengthening incomes.
- 4. Final accounts serve as a purpose and facilitate the preparation of financial ratios by using trading and profit & loss accounts information. For example- Gross Profit Ratio, Net Profit Ratio, Operating Ratio etc.,
- 5. Final accounts are prepared to **ascertain** the **financial** and liquidity **position** of an organization on a certain date by providing and reflecting the exact value of assets and liabilities. The current values shown under the various heads of the balance sheet is used for comparing it with the previous years' figures to evaluate changes in the financial position.
- 6. Final accounts are prepared with an objective to **determine the solvency position** of the business. It states that businesses must have the ability to meet short-term solvency by calculating the Current Ratio and Liquidity Ratio. Similarly, long-term solvency can be achieved by computing the Debt-equity Ratio and the Proprietary Ratio.
-
-
-
-
-

◆ Need of Final account:

- Why do we need a final account?
- The main need for preparing the final account is to keep a track of all the business activities of an organization by the end of every accounting period. Every organization is required to record financial transactions, prepare financial reports, analytics and information.
- Final accounts data is considered as extremely crucial information for the organization and administration for making informed judgments. Final accounts are needed by various users of the financial statements such as shareholders, lenders, creditors, suppliers, customers and government.
- **Final accounts include**
- 1) Manufacturing Accounts
- 2) Trading Account
- 3) Profit and Loss Accounts
- 4) Profit & Loss Appropriation Account
- 5) Balance sheet

  - **Trading Account** is an account which gives the overall preview of all trading activities. The expenses and losses relating to trading activities are debited to this account and all outward movements of goods and stock of goods at the end of the year are recorded to the credit side of this account.

Specimen of Trading Account

Trading Account for the year ended ....

Dr. Cr.

Particulars	Amount (₹)	Amount (₹)	Particulars	Amount (₹)	Amount (₹)
To Opening Stock		xxxx	By Sales	xxxx	
To Purchases	xxxx		Less : Sales Return (Return Inward)	xxxx	xxxx
Less : Purchase Return (Return outwards)	xxxx	xxxx	By Goods distributed as free sample		xxxx
To Direct Expenses		xxxx	By Goods taken by proprietor for personal use		xxxx
To Freight & Carriage Inward		xxxx	By Closing Stock		xxxx
To Custom Duty		xxxx	By Gross Loss c/d		xxxx
To Wages		xxxx			
To Coal, Gas, Fuel etc.		xxxx			
To Royalties		xxxx			
To Factory expenses		xxxx			
To Gross Profit c/d		xxxx			
		xxxx			xxxx

◆ Profit and Loss Account:

- This account is main Account of final Accounts which gives the final working results of business.
- It is prepared on the basis of indirect expenses and indirect incomes of the business concern. Profit and Loss Account is maintained to ascertain Net Profit or Net Loss. The debit side of Profit and Loss Account includes all indirect expenses such as office or administrative expenses, financial expenses, selling or distribution expenses etc. The credit side of profit and Loss Account includes indirect incomes like commission received, rent received, discount earned etc. When the credit side of this account is greater than debit side it is called Net Profit and when debit side of this account is greater than credit side it is called as Net Loss. Net Profit/Loss is transferred to Capital Account. Profit and Loss Account is a Nominal Account.

Profit & Loss Account for the year ended ....

Dr. Cr.

Particulars	Amount (₹)	Amount (₹)	Particulars	Amount (₹)	Amount (₹)
To Gross Loss b/d (if any)		xxxx	By Gross Profit b/d (if any)		xxxx
To Salaries & Wages		xxxx	By Rent received		xxxx
To Rent Rates & Taxes		xxxx	By Commission received		xxxx
To Insurance		xxxx	By Interest on Investment		xxxx
To Bank Charges		xxxx	By Interest on Deposits		xxxx
To Discount (allowed)		xxxx	By Misc. Income		xxxx
To Audit fees		xxxx	By Discount received		xxxx
To Depreciation on			By Net Loss		xxxx
Land & Building	xxxx		(transferred to Capital A/c)		xxxx
Plant & Machinery	xxxx				
Furniture etc.	xxxx	xxxx			
To Travelling expenses		xxxx			
To Advertisement		xxxx			
To Printing & Stationery		xxxx			
To Interest (paid)		xxxx			
To Loss by fire		xxxx			
To Loss by theft		xxxx			
To Packing expenses		xxxx			
To Commission		xxxx			
To Bad Debts (old)	xxxx				
Add : New bad debts	xxxx				
Add : New RDD	xxxx				
	xxxx				
Less : Old RDD	xxxx	xxxx			
To Net Profit		xxxx			
(Transferred to Capital A/c)					
		xxxx			xxxx

Balance Sheet

- Balance Sheet is a statement showing financial position of a business concern.
- Balance Sheet has no debit or credit side as it is a statement and not an account. Left hand side of Balance sheet is "Liability side"and Right hand side "Asset side". Both sides of Balance Sheet should be of equal amount. A Balance sheet shows assets & liabilities of the business.
- All Debit balances of Personal and Real Accounts are shown on the Asset Side and All Credit Balances of Personal Accounts are shown on Liability side. No Nominal Account will appear in the Balance Sheet

Balance Sheet

In the books of M/s

Balance Sheet as on 31st March.....

Liabilities	Amt (₹)	Amt (₹)	Assets	Amt (₹)	Amt (₹)
Capital (opening)	xx		Cash in hand		xx
Add : Net Profit	xx		Cash at Bank		xx
Add : Interest on capital	xx		Bills Receivable		xx
	xxx		Sundry Debtors		xx
Less : Drawings	xx		Goodwill		xx
Less : Interest on Drawings	xx		Furniture		xx
Less : Net Loss	xx	xx	Plant & Machinery		xx
Bank Loan		xx	Land & Building		xx
Bank Overdraft		xx	Prepaid expenses		xx
Sundry Creditors		xx	Outstanding Income		xx
Bills Payable		xx	Closing Stock		xx
Outstanding Expenses		xx			
Pre-received Income		xx			
Total		xxx	Total		xxx

Components of Break-Even Analysis

Fixed costs

Fixed costs are also called overhead costs. These overhead costs occur after the decision to start an economic activity is taken and these costs are directly related to the level of production, but not the quantity of production. Fixed costs include (but are not limited to) interest, taxes, salaries, rent, depreciation costs, labour costs, energy costs etc. These costs are fixed irrespective of the production. In case of no production also the costs must be incurred.

Variable costs

Variable costs are costs that will increase or decrease in direct relation to the production volume. These costs include cost of raw material, packaging cost, fuel and other costs that are directly related to the production.

Semi-variable costs

Semi-variable costs are those which have the characteristics of fixed costs and variable costs, both. These costs vary with production but not in direct proportion to volume. Although semi-variable costs are neither wholly fixed not wholly variable in nature, they must ultimately be separated into fixed and variable components for the purpose of planning and control.

The fixed part of the semi-variable cost usually represents a minimum fee for making a particular item or service available. The variable portion is the cost charged for actual using the service.

Examples

Examples of semi-variable costs include repairs, monthly telephone charges, indirect materials, indirect labor, fuel and power. Telephone charges, for example, are made up of a service charge plus extra charges for extra telephones and long-distance calls.

What Is the Contribution Margin?

The term **contribution** refers to the excess of selling price over variable cost of a product. Thus, it is a difference between sale price and variable cost.

The contribution margin is the amount of money a business has to cover its fixed costs and contribute to net profit or loss after paying variable costs. It also measures whether a product is generating enough revenue to pay for fixed costs and determines the profit it is generating. The contribution margin can be calculated in rupees, units, or as a percentage.

Additionally, the contribution margin is used to determine the break-even point, which is the number of units produced or revenues generated to break even. It also lets you know how much a particular product is contributing to your overall business profit.

Example

When sale is $80,000 variable cost 40,000, fixed cost $30,000. Calculate contribution.

Contribution = Sales – Variable Cost

What is Profit Volume ratio?

The Profit Volume (P/V) Ratio is the measurement of the rate of change of profit due to change in volume of sales. It is one of the important ratios for computing profitability as it indicates contribution earned with respect of sales.

When P/V ratio is high it indicates the high profit margin. A low P/V ratio indicates low profit margin. In the cases of low margin, the company has to either increase the selling price to improve the PV ratio or increase the sales turnover to earn satisfactory profit in the business. The situation of high PV ratio is called profitable situation.

Let us assume a company's sales are Rs.1000000 @ Rs.10 per unit. Its fixed cost is Rs.250000 and variable cost is 600000.

Now let us calculate contribution* i.e. 1000000-600000= Rs.400000/-

P/V ratio =contribution x100/sales i.e. 400000×100/1000000=40%

PV ratio=40%

Break-Even Point (BEP)

The break- even point is a point of sales of a company wherein total sales covers exactly its total costs and there is no profit or loss at that point of sales. The company can make profit when its sales exceed breakeven point. The formula for calculating breakeven point (BEP) is as under.

Break-even point = Fixed cost/Price per cost – Variable cost

BREAK EVEN POINT = **FIXED COST**

(SELLING PRICE PER UNIT – VERIABLE COST)

It is that point where cost incurred and revenues derived are always equal. It is also known as Zero Point costs. Excess output and sales over BEP is an indicator of profit. BEP sales = Fixed expenses + variable costs BEP in untis :

1) What is Capital Expenditure?

Expenses incurred for purchase of fixed assets i.e. Land, Building, Plant & Machinery, Furniture, Equipment, Vehicles etc. i.e. capital assets are called Capital Expenditure. Such expenditure yields benefit over a long period and hence written in Assets. The expenditure amounts for an accounting period are disclosed in the cash flow statement. Capital expenditures normally have a substantial effect on the short-term and long-term financial standing of an organization. Therefore, making wise Cap Ex decisions is of critical importance to the financial health of a company. Many companies usually try to maintain the levels of their historical capital expenditure to show investors that the managers of the company are continuing to invest in the growth of the business.

Types of Capital Expenditures

There are normally two forms of capital expenditures: (1) expenses to maintain levels of operation present within the company and (2) expenses that will enable an increase in future growth. A capital expense can either be tangible, such as a machine, or intangible, such as a patent. Both intangible and tangible capital expenditures are usually considered assets since they can be sold when there is a need.

It is important to note that funds spent on repair or in conducting continuing, normal maintenance on assets is not considered capital expenditure and should be expensed on the income statement whenever it is incurred as repair and maintenance expense.

2) What is Revenue Expenditure?

The expenditure which is incurred on a regular basis for conducting the operational activities of the business are known as Revenue expenditure like the purchase of stock, carriage, freight, etc. Revenue Expenditures does not result in an increase in the earning capacity of the business but only helps in maintaining the existing earning capacity.

Example: Wages & Salary, Printing & Stationery, Electricity Expenses, Repairs and Maintenance Expenses, Inventory, Postage, Insurance, taxes, etc.

Revenue expenditure is referred to as the expenditure incurred by an organisation to manage the day-to-day functions of a business, which include employee wages, inventory, rent, electricity, insurance, stationery, postage, and taxes.

These are the expenditures that neither help in the creation of assets nor in reducing the liabilities of a business. It is recurring in nature and very essential to maintain the daily operations of a business or an organisation.

Revenue expenditures can be divided into two categories

3) What is Deferred Revenue Expenditure?

There are certain expenditures which are revenue nature but the benefit of which is likely to be derived over a number of years. Such expenditures are termed as “Deferred Revenue Expenditures”. The benefit of such expenditure generally lasts between 3 to 7 years.

For Example, Amount spent of Rs. 5,00,000 on advertising to introduce a new product in the market and it is estimated that the benefit will last for 5 years, then Rs. 1,00,000 will be charged every year

- Expenses incurred during one accounting year but are applicable wholly or in part in future periods.
- These expenditures are otherwise of a revenue nature.
- Benefit is not confined to one accounting year - it extends to future accounting year or years also.
- This expenditure does not result in the acquisition of any fixed asset.

Deferred Revenue Expenditure is an **expenditure** which is **revenue** in nature and incurred during an accounting period, but its benefits are to be derived from a number of following accounting periods.

Example of **Deferred revenue expenditure**.

Advertisement expenses is a **example** of **Deferred revenue expenditure**.

Preliminary expenses incurred before business incorporation include Legal cost, Professional fees, Stamp duty, Printing fees, etc.

Elements of Cost :

Raw materials are converted into finished products by a manufacturing concern with the help of labor, plants etc. The elements that constitute the cost of manufacturing are known as elements of cost. The elements of cost include the following:

- Material
- Labor
- Expenses

Each of these elements is again subdivided into direct and indirect

Direct material, direct labor and direct expenses are those which can be traced in relationship with a particular process, job, operation or product. Indirect material, indirect labor and indirect expenses are those which are of general nature and cannot be traced in relationship with a particular process, operation, job or product.

Direct material

Direct labor **together constitute prime cost**

Direct expenses

Indirect material

Indirect labor of the factory **together constitute factory (or works)** Indirect expenses

Prime cost + Factory (or works) overhead = Factory cost or works cost

Factory cost + Administration overhead = Cost of production

Cost of production + Selling and distribution overhead = Total cost or cost of sales

ELEMENTS OF COST

The elements of cost are the factors on the basis of which expenditure is incurred. It may be defined as a group name of smaller costs of identical nature. Elements of cost make the analysis of the cost easy and facilitate maximum information regarding costs to the manufacturers.

COST

Cost refers to the expenditure incurred on producing the goods and services. It represents the sacrifice, foregoing or a release of something of value.

ACCORDING TO ICMA (Institute of Cost and Management Accountants), London

'Cost is the amount of expenditure (actual or notional) incurred on or attributable to a given thing."

Example: In manufacturing of automobiles, the expenditure incurred on its spare parts, painting and finishing, design, etc constitute the cost of the automobile.

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MATERIAL COST

DIRECT MATERIAL COST	INDIRECT MATERIAL COST
Direct material cost is the cost of those materials that can be easily identifiable in the finished product. ***Example:*** ▶Cost of leather in shoes. ▶Cost of glass in mirror. ▶Cost of iron in machinery.	Indirect Material Cost is the cost which is not directly attributable to the finished product. These costs are not absorbed or apportioned by the cost units or cost centers directly. ***Example:*** ▶Fuel or electricity needed for generating power. ▶Materials consumed for repair work.

Direct Material Variances/ Material Cost Variances (MCV): The Material Cost Variance is the difference between the Standard cost of materials for the Actual Output and the Actual Cost of materials used for producing actual output.

MCV = SC - AC

OR

MCV = (SQ x SP) - (AQ x AP)

Where,

SC = standard cost; AC = actual cost; SQ = standard quantity; SP = standard price; AQ = actual quantity; AP = actual price.

(1) **Material Price Variance (MPV) :** MPV is the difference between the standard cost of actual quantity and actual cost for actual quantity.

MPV = (SP - AP) x AQ

(2) **Material Usage Variance (MUV):** MUV is the difference between the standard cost of standard quantity of material for actual output and the Standard cost of the actual material used.

MUV = SP x (SQ - AQ)

(3) Material Mix Variance (MMV) : It is the portion of the material usage variance which is due to the difference between the Standard and the actual composition of mix.

Material Mix Variance is calculated under two situations as follows :

(a) When Actual Weight and Standard Weight of Mix are equal :

(i) The formula is used to calculate the Variance:

MMV = SP x (SQ - AQ)

(ii) In case standard quantity is revised due to shortage o

Standard Rate = Standard cost of standard mix / Net standard output.

Verification:

1. MCV = MPV + MUV

2. MUV = MMV + MYV

Notes- positive means favourable(F) and negative means adverse(A).

LABOR COST

Labor cost refers to the cost of remuneration of the workers employed in an organization. It includes the amount of wages, salaries, perquisites, allowances etc.

Example:

- **Salary paid to workmen**
- **Commission paid to agents**

LABOR COST

DIRECT LABOR COST	INDIRECT LABOR COST
These are also known as direct wages. This cost can be identified with and allocated to cost centers or cost units. ***Example:*** ▶Wages paid for spinning yarn in a spinning mill. ▶Wages paid to the driver and conductor of a bus.	These are also known as indirect wages. It refers to that part of labor cost which is not directly attributable to the cost centers or cost units. *Example:* Salary paid to the manager, Salary paid to the guard of the office.

EXPENSES

Expenses refer to the cost of services provided to an undertaking and the notional costs of the use of the assets owned by the business house.

***Example:* Deprecation on building, plant and machinery etc.**

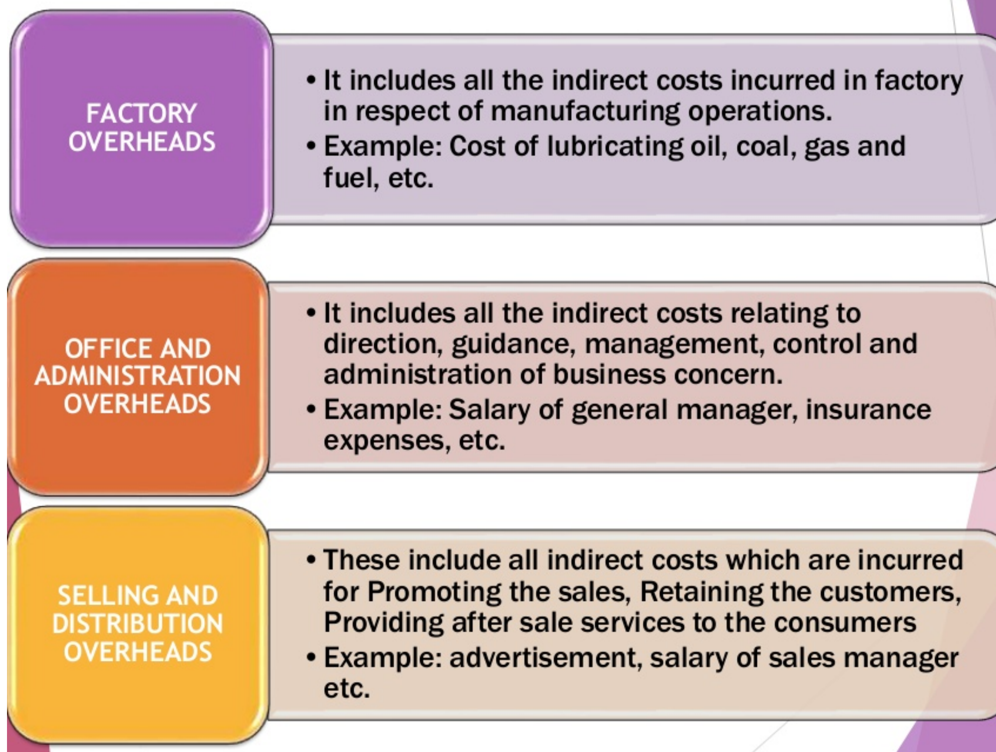
EXPENSES

DIRECT EXPENSES

- These expenses are also called chargeable expenses. These expenses can be directly identified to the cost centers or cost units.
- Example:
- Carriage and freight paid on direct materials purchased.
- Import duty
- Octroi duty etc.

INDIRECT EXPENSES (OVERHEADS)

- Expenses which cannot be allocated to the cost centers or units but can be apportioned by them are known as overheads or indirect expenses.
- Example:
- Rent, rates and taxes
- Repairs to machinery
- Factory lighting
- Office lighting
- Depreciation and insurance of showroom building etc.



Gross Profit

Gross profit is the total revenue less only those expenses directly related to the production of goods for sale, called the cost of goods sold (COGS) COGS represents direct labor, direct materials or raw materials and a portion of manufacturing overhead that's tied to the production facility.

COGS does not include indirect expenses, such as the cost of the corporate office. COGS is a key metric since it directly impacts a company's gross profit, which is calculated as follows:

Since COGS represents the cost of acquiring inventory and manufacturing the products, gross profit reflects the revenue left over to fund the business after accounting for the costs of production.

Gross profit = Revenue - Cost of Goods Sold

Operating Profit

If you're interested in calculating the true health of your business, examine your company's operating profits with these two methods:

EBIT – Earnings before Interest and Taxes

EBITDA – Earnings before Interest, Taxes, Depreciation, and Amortization

Net Profit

After setting aside all your company's costs (interest, taxes, amortization, depreciation, etc.) from your net sales, you can finally determine your net profit/net income:

Net Profit/Net Income = Gross Profit - (Total Operating Expenses + Interest + Taxes + Amortization + Depreciation)