Managerial Accounting

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Lecture - 05
Profit and Loss A/C

Welcome back to the 4th session. So, far we have done 3 sessions, to take a very, very brief recap. In the 1st session, we have seen what is management accounting? Then, we started with discussion on, what are the financial statements? We have also seen in our 2nd session, what is a balance sheet? We saw the format of balance sheet. Then, we continued in the 3rd session, on solving a few problems or few cases on the balance sheet.

So, we have seen step by step. If you give a series of transactions, how you can make balance sheet from those transactions? And in our last that is 3rd session, we have started on profit and loss account. So, today we will continue from that. We will do a few problems on P and L account. And we will also see some of the concepts, on which these statements have been made.

Once the concepts are understood, we will go more into technical aspects as to, how the recording is actually done in the books of accounts? So, let us start with P and L account now. We have seen last time, that profit and loss account is a statement which shows results of the entity.

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So, result is obviously, the profit or loss.

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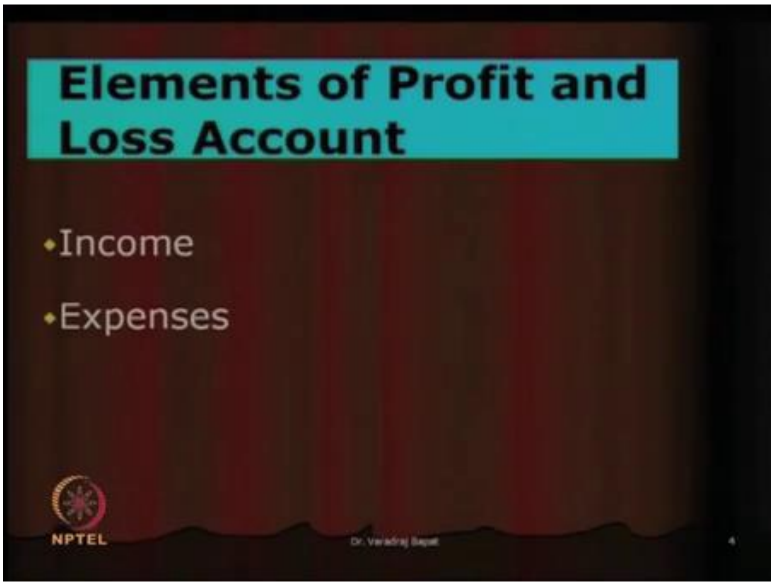

Now, to know the profit or loss, we need to know the income and expense. So, P and L account, list down all the incomes and the expenses.

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The net result is here. This was the format, we have seen. This is a brief format. So, your sales, less cost of goods sold, you get gross profit. From that, you deduct expenses and taxes to get the net profit.

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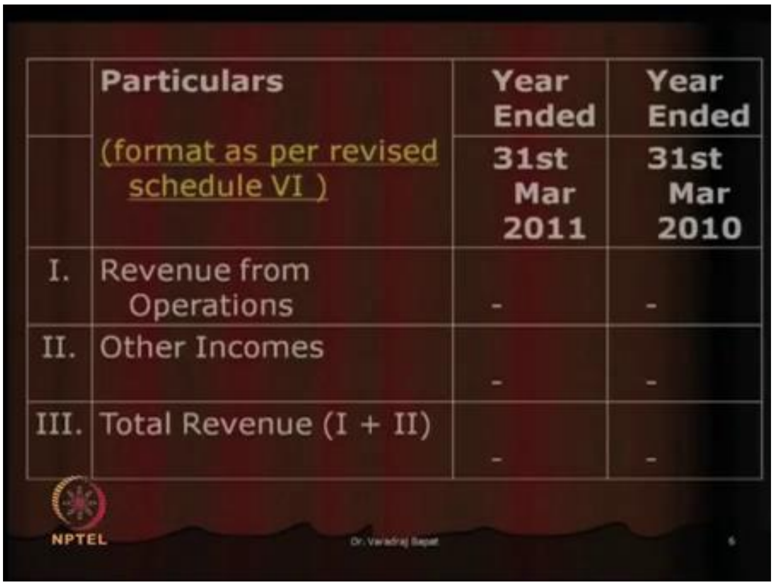

After this, we had gone for the format as per the company law. Now, here little more elaboration exists.

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So, revenues are shown. From the revenue, expenses are deducted. They have been categorized into different categories. The first one are known as manufacturing expenses.

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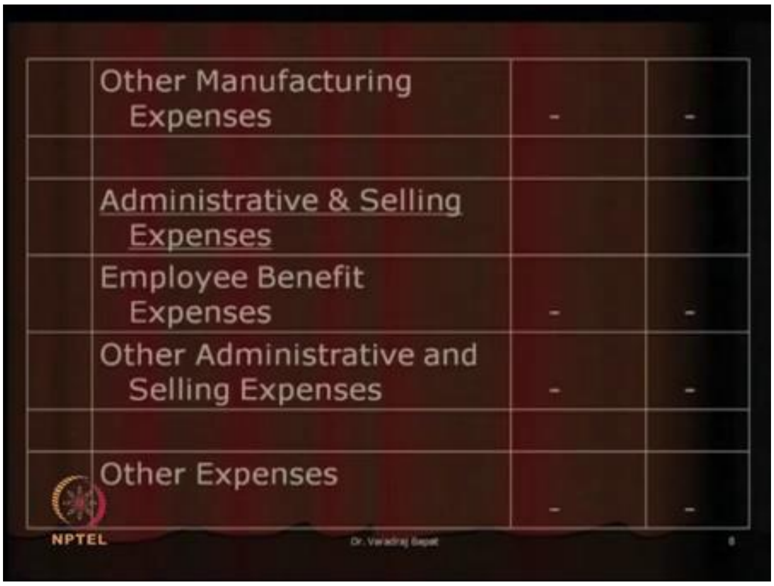

The second are admin and selling expenses. Then, you also deduct other expenses.

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Then, we have to deduct finance cost. We have to deduct depreciation and amortization expense. So, revenue minus total expenses, gives me profit before exceptional and extraordinary items.

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I also reduce these items to get profit before tax. Now, you may have a question in mind as to, what is this exceptional and extraordinary items? Now, as the name suggests, these items do not happen regularly. They do not happen frequently. So, if they happens sometimes, it is better we show their effects separately. So, that our regular P and L account is not affected. Can you think of some extraordinary item?

For example, if there is a major fire in the factory of the company. So, lots of goods are destroyed. Even fixed assets are destroyed. Company, may have to spend extra money for getting the premises redone. Operations are stopped for some days. So, this huge loss I should not club with our regular profit and loss account. Because, I will not be able to compare, my result with earlier results, if I unnecessarily club this loss with normal items.

That is why, it could be treated as an exceptional and or extraordinary item and it will be shown separately. Same way, now you all know that developed countries US and Europe. They are facing lot of recession. Suppose, our company is doing a major export in Europe and we lost a very big order. And we have also lost, some of the customers. Now, if this event is not going to recur and we have some way to protect it now, in the next periods but, currently some losses are happened.

And we would not like to show them with our normal losses. Then, this could be treated as a extraordinary or exceptional item. Now, if you go back to the format ((Refer Time: 04:59)), we arrive at revenue minus expenses to get profit before exceptional and extraordinary item. From this separately, exceptional and extraordinary items are reduced. We get profit before tax.

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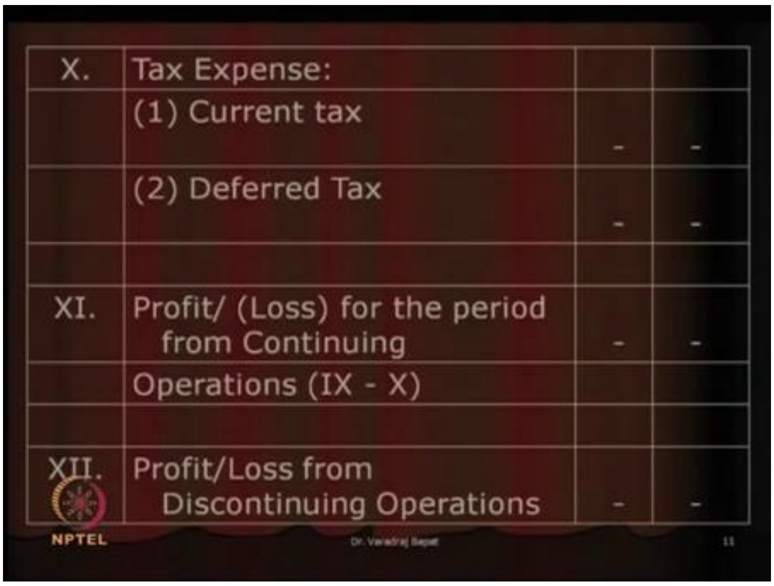

Now, from profit before tax, the taxes are reduced. Now, you can see the taxes are also divided into current tax and deferred tax. Naturally, the question which will come into your mind is, what is this deferred tax? Now, the taxes which you pay for the current period is obviously, current tax. So, if I have an 100 rupees and my tax rate is 30 percent. I have to pay a tax of 30 rupees. That becomes my current tax.

Now, what is a deferred tax? Now, what happens is, instead of paying taxes today, there are some tax provisions, which allow me a tax benefit by which I reduce my tax. But, that tax becomes payable in future. So, actually my tax is not reduced. But, it is deferred. So, instead of paying now, I may have to pay after 5 years. Such taxes are known as deferred tax. Now, I will not go into too much detail, because right now we are not learning really taxation.

But, one example I would like to give. What happens is, company is able to show depreciation and claim the benefit from tax purposes. Let us suppose, I purchase a pollution control equipment. Now, government allows 100 percent tax benefit, on pollution control equipment. So, suppose today I invest 1 crore in pollution control equipment. Entire 1 crore, I can reduce from my income for tax purposes and I reduce the tax.

But, that much of tax is added, in the years to come. So, currently my tax is going down. So, my current tax will be reduced. But, my deferred tax I will have to show. So, what will happen is? From profit before tax, both current and deferred tax are reduced. And that gives me, profit after tax. But, here again instead of sharing profit after tax, I call it profit from continued operation. Now, the question which may arise in your mind is, what is this continued operation?

Now, usually if your business is on. Whatever activities, you are doing is known as continued operation. But, suppose you discontinue a part of the business or some factory or let us say some shop. Then, that is known as discontinued business. Now, discontinued business, you have to show the profits and losses from such business, separately. So, suppose one factory is closed I have four more factories, where my business is on. But, one factory is closed.

Then, the expenses of that closed factory, I will show separately. And that will be treated as, losses from discontinued operation. So, you can see the format. Now, if I reduce tax expense, I get profit or loss for the period from discontinued operation, from which I adjust my profit or losses from discontinued operation.

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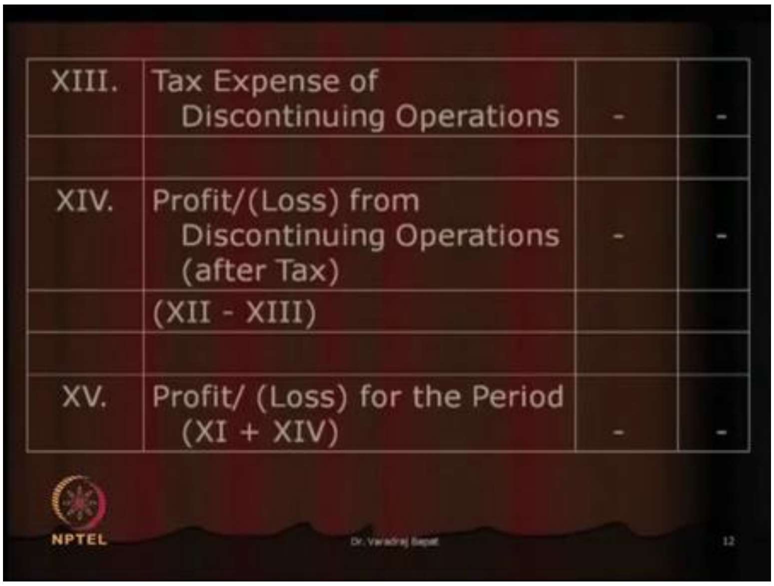

XIII.	Tax Expense of Discontinuing Operations	-	-
XIV.	Profit/(Loss) from Discontinuing Operations (after Tax)	-	-
	(XII - XIII)		
XV.	Profit/ (Loss) for the Period (XI + XIV)	-	-

First, I will get profit from continuing operation. Then, I will adjust the profit or loss from discontinued operation. I will also adjust the tax expenses of discontinued operation, if any. That gives me profit from discontinued operation. And that is a final profit or loss. So, which is a total of continued operation plus discontinued operation. So, this was a detailed format. I just go back for your clarity ((Refer Time: 09:05)).

So, we started from here. So, this is a format as per schedule, 6 of companies act. So, you take first, revenues. You reduce all the expenses. Then, you adjust for extraordinary exceptional items. You adjust for taxes, which gives me profit from continued operation. I also calculate, profit or loss from discontinued operation. And a total is profit or loss for the period. I hope, you are getting it.

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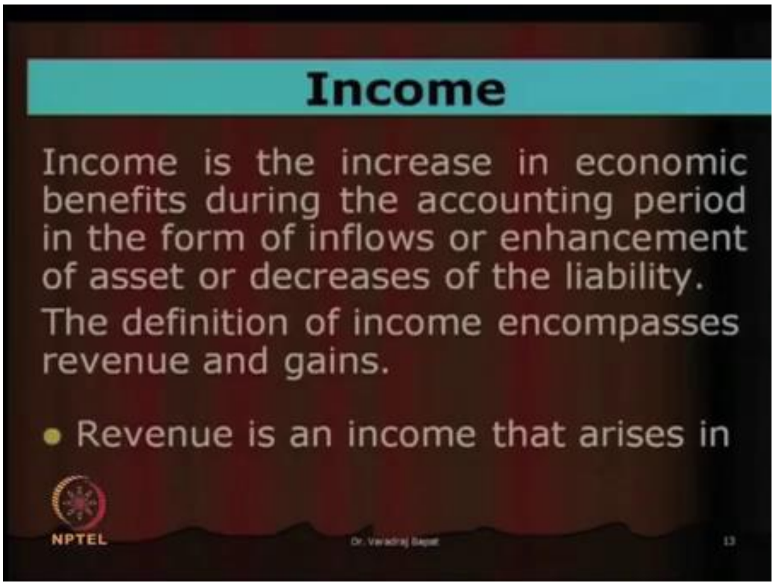

Now, let us try to understand what is meant by income? Now, as you can see in the slide. This is the increase in the economic benefit, during a particular accounting period in the form of either cash inflows or enhancement of asset or liabilities. Now, what could be the example of the income? Of course, the simplest example is sales. If I sale my goods to the customer, I will receive the income.

Or if I am a service provider, I provide service I receive income. Sometimes, if I have given a loan or if I put a deposit in the bank, bank gives me interest. That is also my income. So, you can see examples. The prominent example is of course, revenue.

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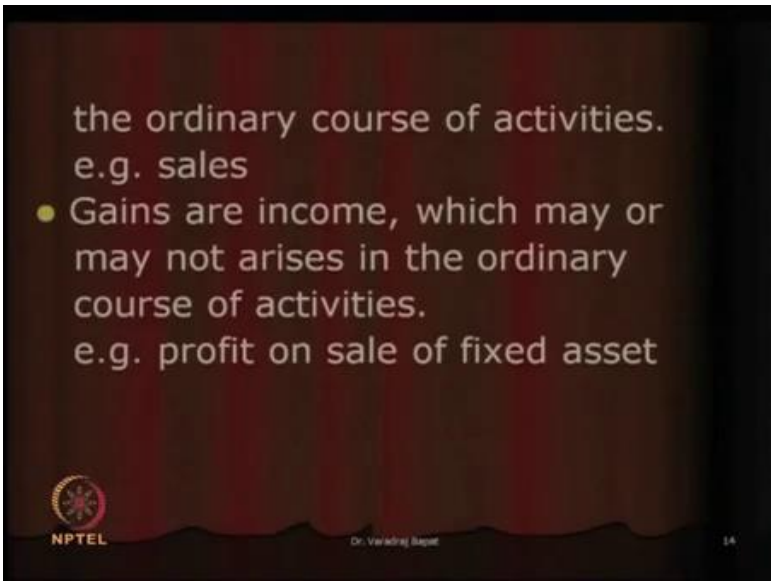

There are some gains. So, sometimes if I sale my fixed asset. Let us say, if I sale land. I make lot of profit. That will be known as gains.

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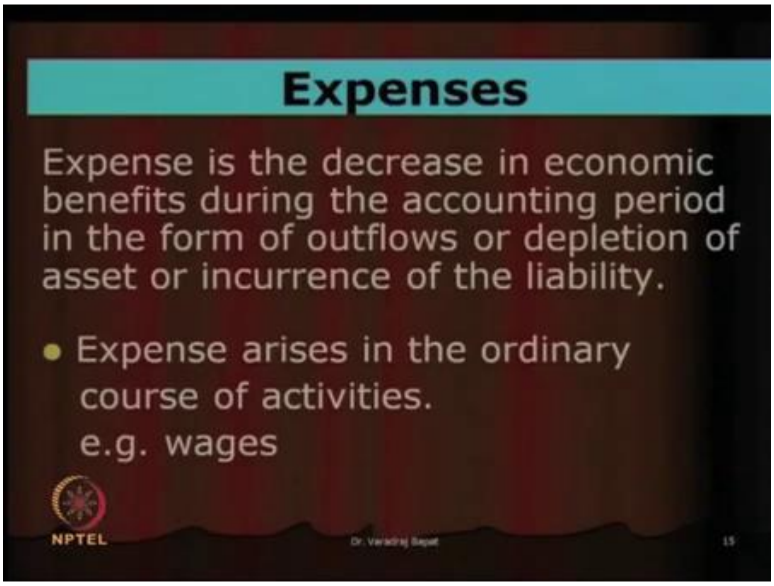

Now, let us go to the next item, that is expenses. You know that, profit is income minus expense. So, what is an expense? Expense is a cost, which I bought. It is defined as decrease in the economic benefit during the accounting period, in the form of outflow or depletion of asset or incurrence of a liability. So, what will happen is? If I hire an employee, I will have to pay salary. So, it is an outflow.

Suppose, I purchase the asset I do not have to pay the rent. But, when I use the asset, the value of asset falls, that is also my expense. Sometimes, what happens is? Let us say, I use the electricity. I do not pay with the bill immediately. But, the liability has happened. In future, I will have to pay the bill. So, that is also my expense. That is why, it is defined as an outflow or depletion of asset or increase of liability. All these three represent my expenses.

Now, what could be the examples? I have given you, two three. Can you think of any other example? As you can see here, when the wages become due in the ordinary course of business, that is an expense.

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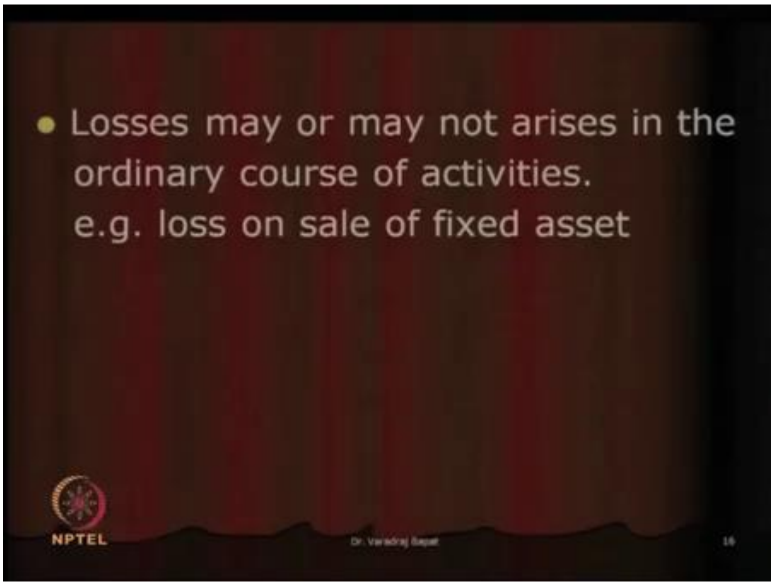

Sometimes, losses may happen. So, if I sale my fixed asset, let us say I sale out my old computer. Naturally, I will get very, very minimal value. So, there will be a loss on sale of asset. That will also be recorded. So, if you have understood now the basic of income and expense. Before going for some problems or cases, let us understand a few concepts in accounting. The first concept is entity concept.

Even before going for the concept, what is meant by the concept? These are the fundamental principles. Now, the accounting is based on certain basic fundamental principles, which are known as concepts. Now, the first concept you can see here is entity concept.

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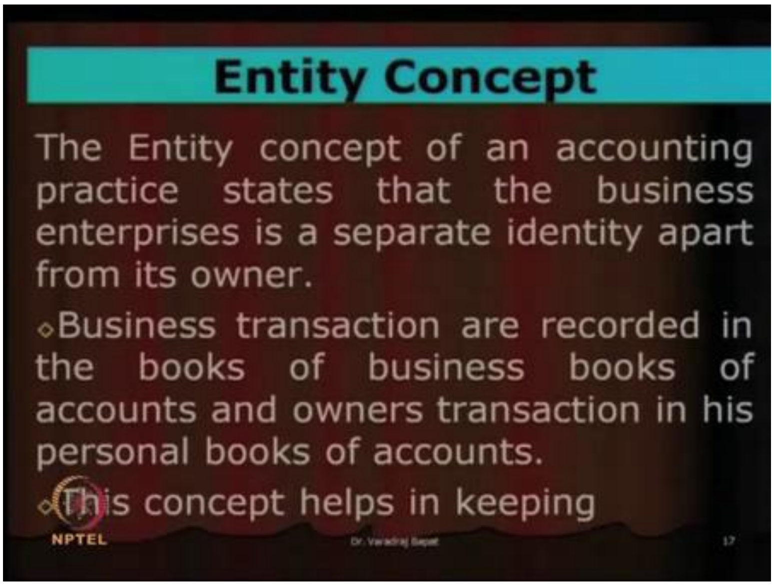

Now, entity concept of accounting states that, business enterprise is a separate entity from the owner. And business transactions are recorded in the books of business. And owners transactions are recorded in a personnel books. So, you we do not mix up the personnel transactions with the business transactions.

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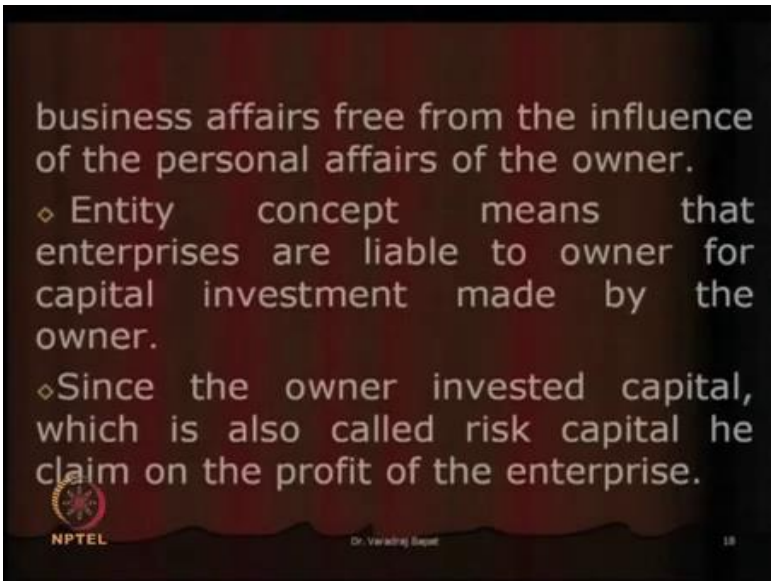

Now, why it is important? Because, business affairs should be very, very clearly shown from the personnel affairs. Now, because of this entity concept when owners food capital in the company or in the partnership form it is shown as a liability in the books of the form. Since, the owners invest the capital. It is also called as a risk capital. And they get the claim, on the profit from the enterprise. That is why, the total of capital plus reserves is shown as a owners fund on the liability side.

If you remember our discussion in the balance sheet, you might have still had a problem as to, why our profit is shown as a liability. So, what happens is? Profit is generated. It is added to reserves. And those reserves are to be paid to the owners. So, we assume that, owner is a separate entity. Business is a separate entity. That is nothing but, an entity concept. Is it clear? Let us go to the next concept.

Next concept is known as accrual basis of accounting. Now, if you remember when we were discussing the transactions, sometimes have told you that we have sold goods on cash. Still, we record that transaction today only. We do not wait, till we receive the cash. Now, why we do not wait? Because, even if you have not yet received your cash, the transaction has actually happened. And once it has happened, it leads to be recorded. This conceptually is known as accrual basis of accounting.

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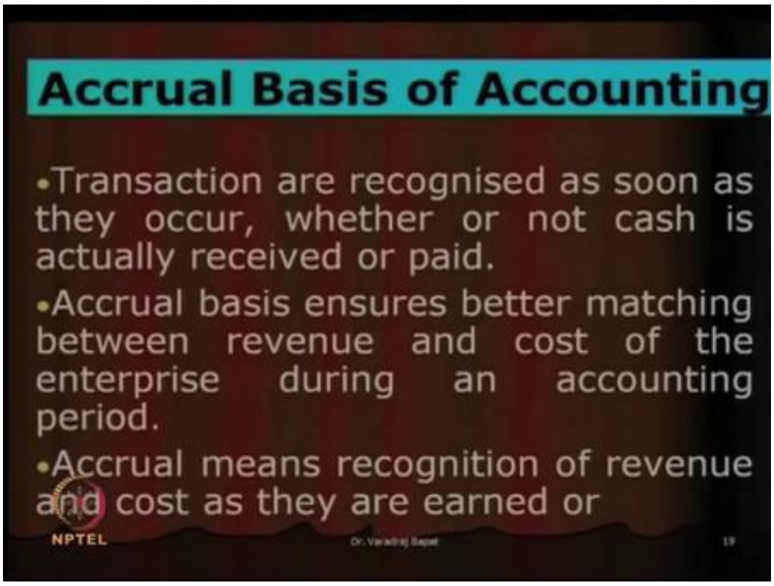

Now, here the transactions are recorded, as soon as they occur. Whether or not, cash is actually received. Now, accrual basis ensure that, there is proper matching between revenue and cost of the enterprise, during a particular period. Now, how does it ensure? Can you think of any example? Now, what happens is? Suppose, I have purchase the goods today, I will record it as an expense. I have purchased and I have paid.

I have also sold goods. But, customer does not pay me cash, immediately. Customer will pay me the cash, next month. Should I record sale? If I do not record, what will happen is, I have record that expense, because I paid cash. But, I have not recorded an income, because I am yet to receive cash. So, expenses and revenues of the same period are not matched. So, I will not get correct picture of profit or loss, of this month.

This month, I show loss because lot of expenses but, very little income. Next month, this month's money will receive in the next month. That time, I will show lot of profit because, there is more revenue shown. So, there is an inconsistency. That is why, it is very important that as soon as expense happens, it should be recorded. As soon as income accrues, it should be recorded.

Even, if we do not receive cash or we do not pay cash, we need to record. And this happens, because of the fundamental concept known as accrual basis of accounting. So, accrual basis means that, recognition of revenue and cost, as they are earned or incurred and not, as when the money is received.

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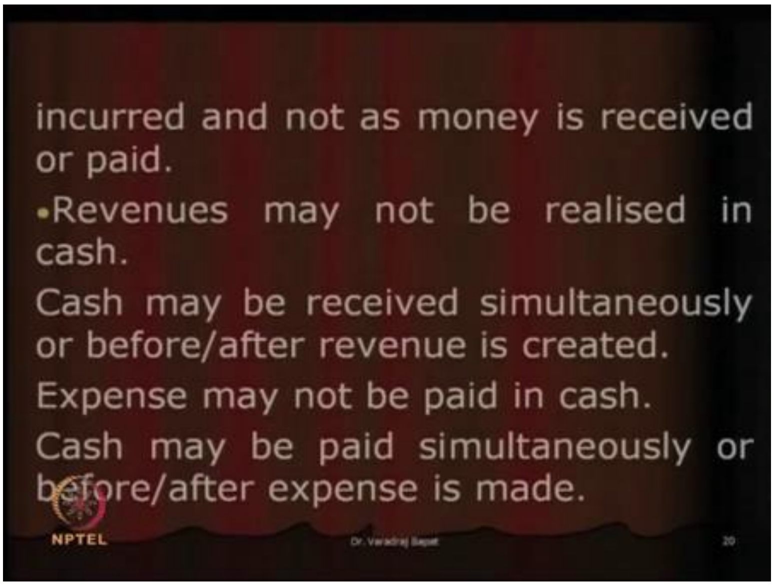

So, as we have already discussed. What happens is revenue, many times is not received in cash or expenses are not paid in cash. But, they all need to be properly recorded.

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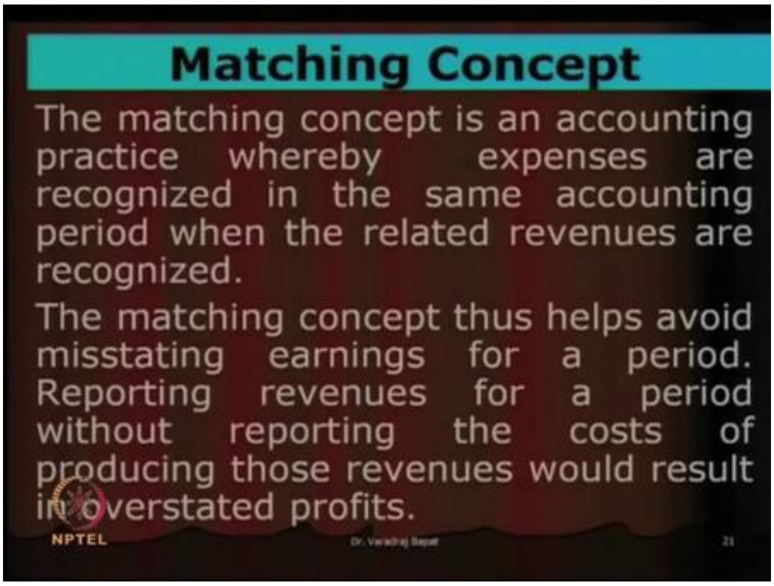

Now, let us go to next concept. That is known as matching concept. So, matching concept tells us that, whenever the expenses are recorded in a particular period, the related revenues should also be recognized. Now, matching concepts helps us in avoiding misstating income or revenue or earning for a period and reporting of revenue of one period in the next period, without reporting the cost.

We have just now seen an example, where we record purchases. But, if we records, we do not record sales, there will be a misstatement. There will be an understatement of profit. Can you think of any other example? Suppose, you have a software company. You have hired employees and you provide services. So, what is happening is as you are providing services, revenue is coming.

And it is getting recorded. But, salary is going to be paid, in the next month. If I do not record salary this month, there will be a big problem. Because, I am already recording revenue but, I am not recording expense. So, even if the salary is not paid, it needs to be recorded. So, matching concept is a very simple concept. It tells you that, revenues and expenses should be matched in the same period. Let us go ahead.

Because of matching concepts, there is a basis or there is a concept of prepaid and outstanding expenses. So, if the expense for the next period or the next month is paid now. I will show it as a prepaid expense.

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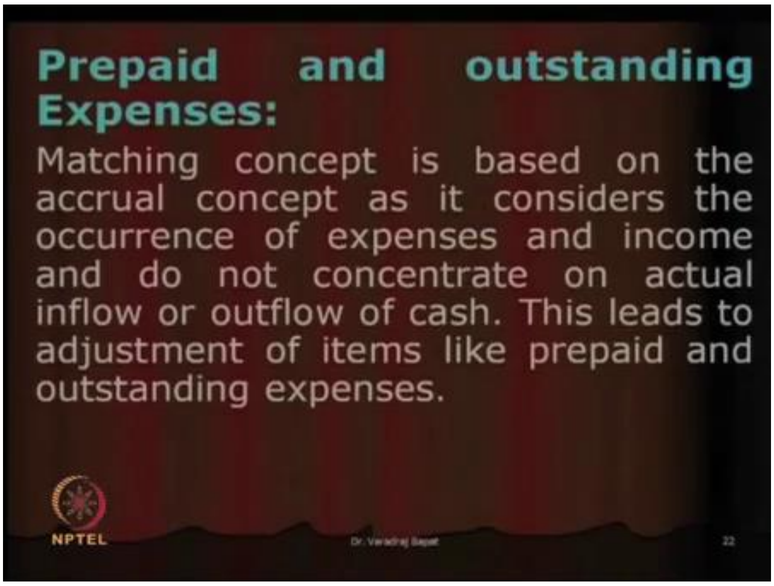

Can you think of any example, of a prepaid expense? Now, the example of prepaid expense is, if the insurance is paid in advance. So, for next month’s insurance premium I am paying now. So, I will have to record it, today itself. And it will be shown as a prepaid expense. I will not record it as a expense, for this month. I will record it as a prepaid expense and it will be transferred to the balance sheet.

Same way, if the expense is incurred like salary is incurred. But, not yet paid. Still I record it as current salary, not yet paid. So, it will be a liability in the books as outstanding salary. That is why, in the balance sheet items like prepaid expense and outstanding liabilities do arise. Now, let us go to the next concept. That is known as realization concept.

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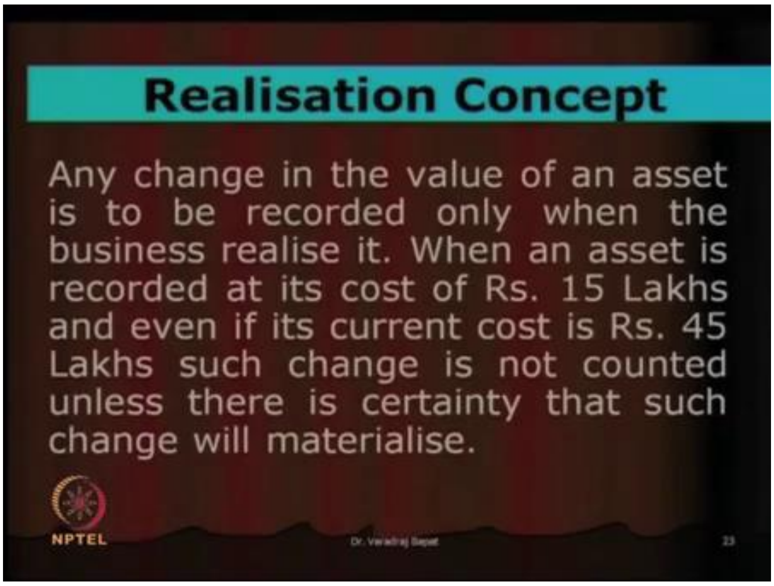

As you can see here, any change in the value of an asset is to be recorded, only when the business realizes it. Whereas, an asset is recorded at a cost of 15 lakhs and even though its current cost is 45 lakhs. Such change is not counted. Unless, there is a certainty that such change will materialize. Now, when can such an example happen? That, I have purchased an assets for 15 lakhs. It is current market price is 45 lakhs.

I think, it can particularly happen, in case of land. If I have purchase land, few years back. Now, the land values are increased. I purchased, it for 15 lakhs. Current value is 45 lakhs. Should I show it, in the balance sheet at 45 lakhs? The answer is no, because I am not dealing in the land. I am not buying and selling the land. It was purchased at 15. I will continue to show it at 15. If I want to sell, I get a customer.

And the transaction of sale is already agreed up on. Then, I will show it at 45 lakhs. But, otherwise in the normal course, my assets will be continued to be shown at 15. Same way, you can also think of other way also. Suppose, I buy some computer for 30,000, after two months next model comes. And new model, the value of computer has gone down. So, I purchased at 30 but, it is current price after three months is only 25.

Should I show at 30 or at 25? The answer is, I have to show at 30. Because, I have not decided to sell it at 25. I want to use it and it is still usable. So, transaction will not be shown unless, it is realized.

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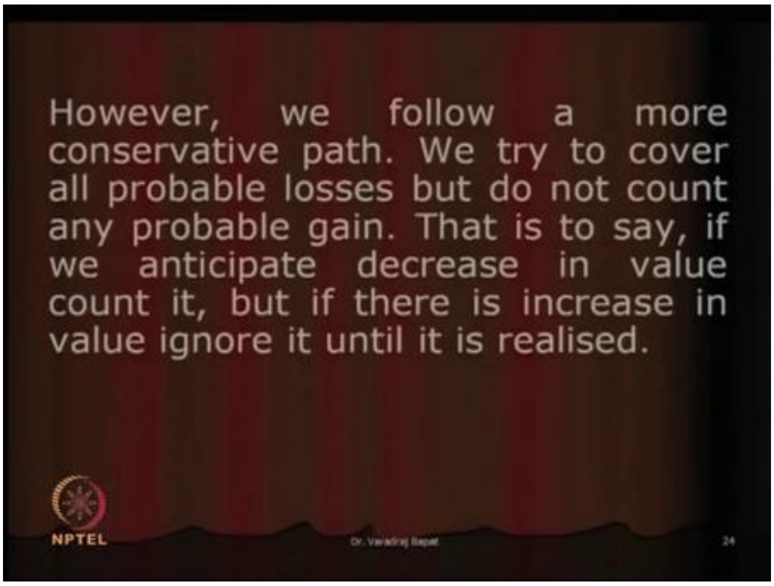

Let us go to you can see in this slide. So, we follow a more conservative path. And we try to cover all possible losses. But, we do not provide any possible gain. There it is, we want to say that. If we anticipate decrease in the value, we count it. But, increase in the value, we often ignore.

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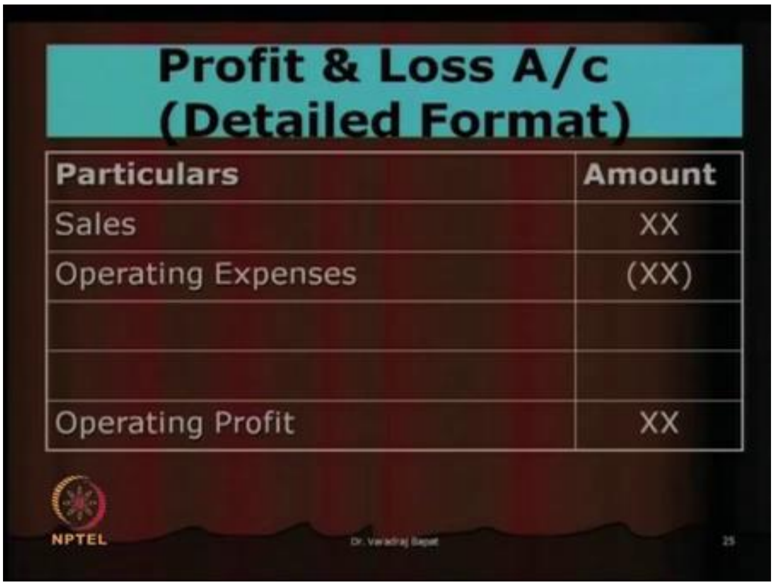

Now, let us understand one more format of P and L. A little more detailed then what brief format we show, we saw from earlier. So, from sales we reduce operating expenses. That gives me operating profit.

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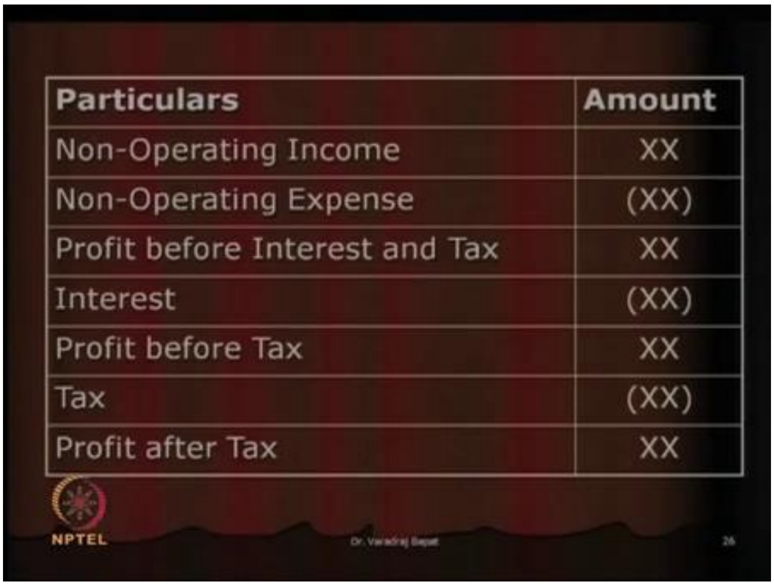

Particulars	Amount
Non-Operating Income	XX
Non-Operating Expense	(XX)
Profit before Interest and Tax	XX
Interest	(XX)
Profit before Tax	XX
Tax	(XX)
Profit after Tax	XX

From operating profit, I adjust for non-operating income and expenses. And we get, profit before interest and tax. Now, this is slightly different format from schedule VI format, which we have seen. But, it is not much different. Here, we have tried to categorize into operating and non-operating. Now, what is a non-operating expense or an income? For example, I am a dealer in stationary. So, I do not deal in let us say furniture.

But, suppose I sale of my old furniture and there is a lot of loss. Should that loss be clubbed with my stationary business? It should not be. That is why, my sale and purchase or regular expenses of stationary will be shown as operating expenses. Whereas, loss on sale of old furniture will may be shown as non-operating expense. So, you can see here. Sales minus operating expenses, I get operating profit.

I adjust non-operating incomes and expense to get profit before interest and tax. Now, what is a non-operating income? Can you think of an example? Same example, if we continue. I am a stationary dealer. I have sold of old furniture. That is an example of non-operating expense, the loss on sale of old furniture. What could be a non-operating income for me? Suppose, some of my money… My means, some of his business money, I deposit in a bank.

And I interest, I earn interests on it. Then, it is a non-operating income because, as a stationary dealer, interest earn is not from my day to day operating activities. So, first I will calculate operating profit. And I separately adjust, non-operating incomes and expenses. So, you can see in the format. That from operating profit, I adjust non-operating income and expense. I get profit before interest and taxes. Then, I reduce interest.

I get profit before tax. I reduce tax. I get profit after tax. Now, it is better if we show interest and taxes separately, because I come to know exactly, how much is my profit or loss from operations? How much is my profit and loss from non-operating items and interest, which is a finance cost, gets separately recorded. And tax, which is an out go to the government, also get separately recorded.

So, in this way, in this detailed format you get profit from tax. Again, you can use a variety of formats. I have just shown you, two three formats for your more clarity.

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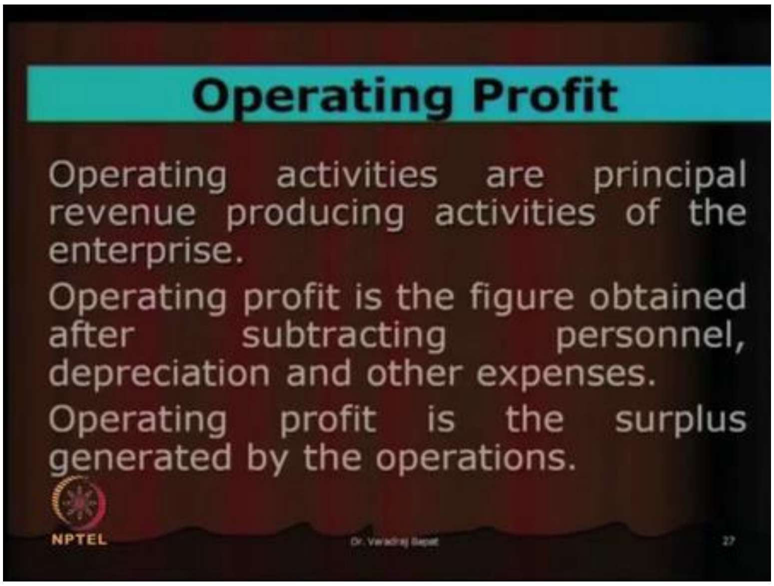

Now, let us see what is meant by operating profit. You can see here, that operating activities are defined as principal revenue producing activities of the enterprise. So, operating profit is a figure obtained after subtracting personnel, depreciation and other expenses from my normal business income. So, this is a surplus generated from operations.

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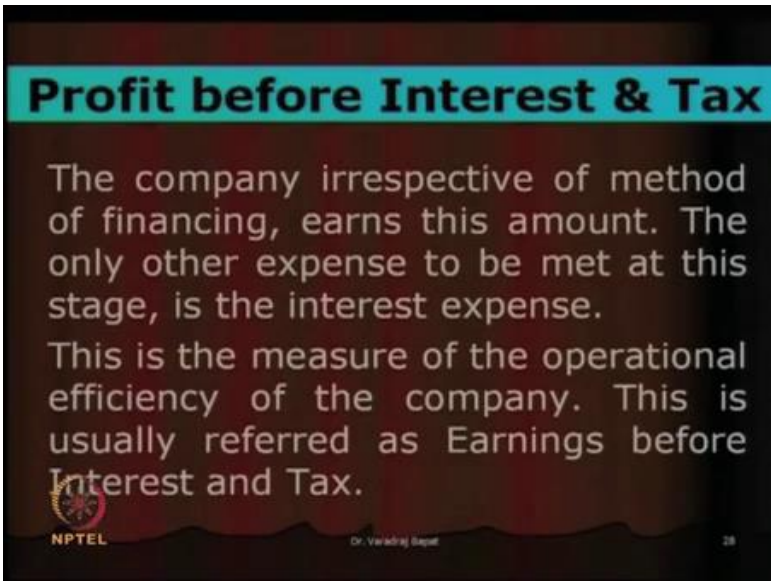

We have also seen this term, profit before interest and tax. Now, company irrespective of method of financing, what it earns is known as profit before interest and tax. Sometimes, we make a short form and we call it PBIT. Now, this major is very important. And it is calculated to know the operating efficiency of the business. Usually, if the company is to be taken over by somebody else, they will look at PBIT of the company. It is also known as earnings before interest and tax.

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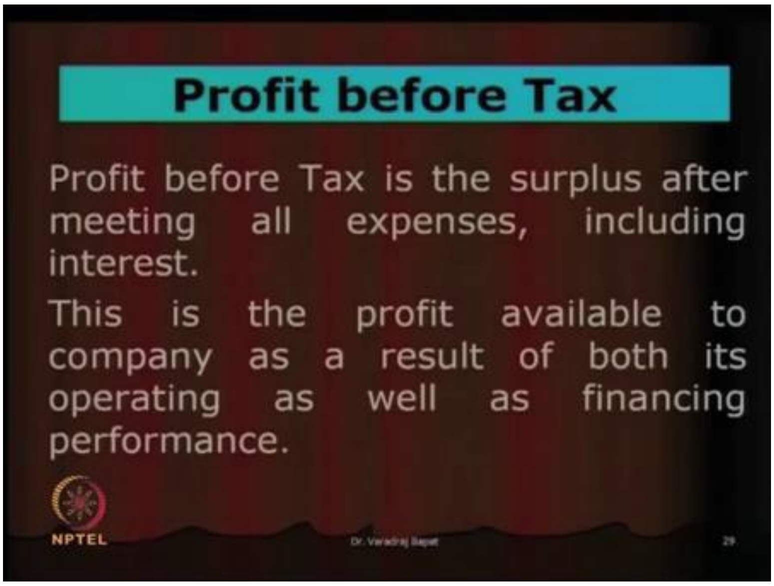

Now, next is profit before tax. So, this is the surplus, where all expenses are deducted. But, taxes are yet to be deducted.

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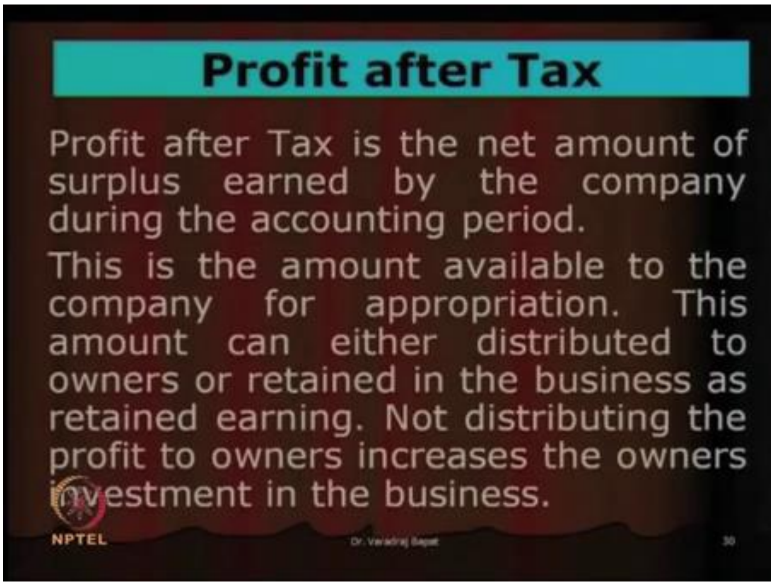

Then, we get profit after tax. So, profit before tax minus tax is profit after tax. This is a very important figure for the company, because this is the final amount which is available to the owners. Now, we say it is available to the appropriation. Because, now owners can decide whether it is to be paid as dividend or whether it is to be retained in the company. Now, if owners do not take the dividend or if they do not take back their money.

Then, the owners fund in the business goes on increasing. Now let us go to the exercise. We have, I think you are now fairly clear, about the format and the structure of P and L. Let us go to one of the exercises.

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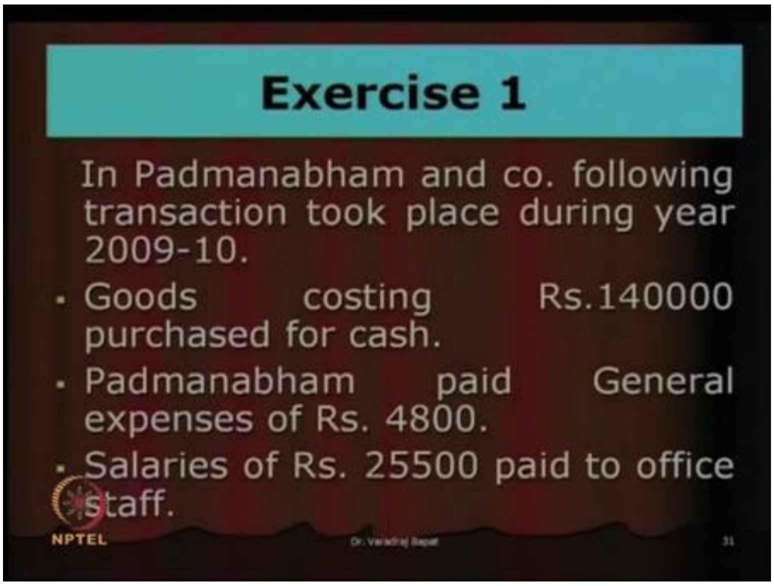

So, as you can see here. In Padmanabham and company, the following transactions are happened during year 9-10. The goods, costing rupees 1,40,000 were purchased. General expenses of 4800 are purchased. A paid salaries of 25,500 paid to office staff.

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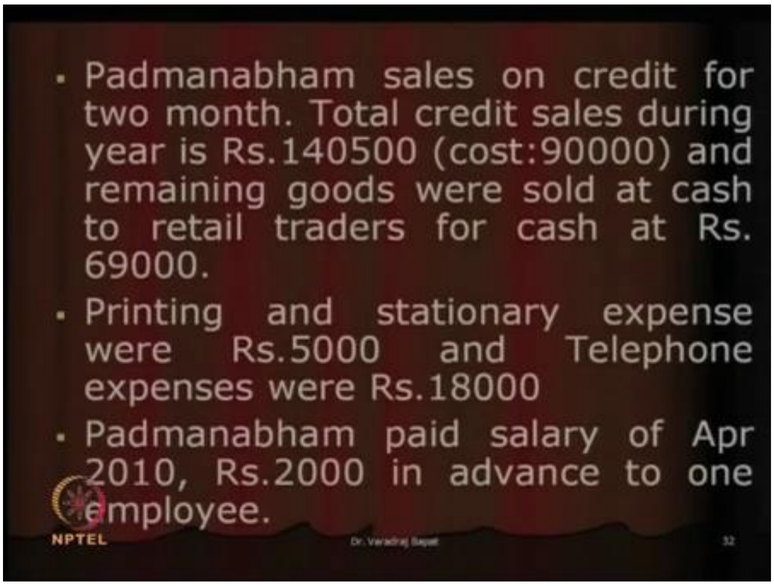

Now, this is the info about sales. Now, it is sales on credits for two months. Total credit sales during the year are 1,40,000. The cost is 90. And a remaining goods were sold at cash to the retail trade for cash of rupees 6,90,000. Printing and stationary expenses were

5000 and telephone 18,000. Now, the salary for the month of April 2010, rupees 2000 was paid in advance to one of the employees.

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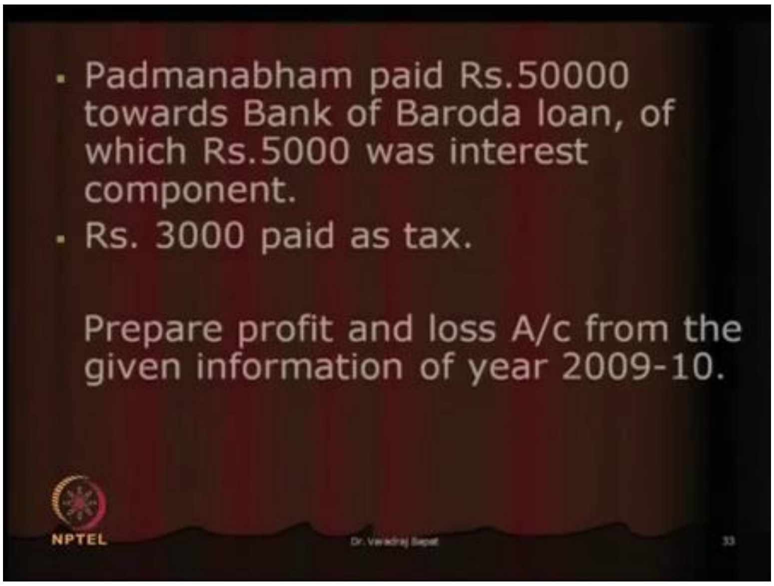

Padmanabham also paid 50,000 towards Bank of Baroda loan, of which 5000 is an interest component. 3000 is paid as a tax. Now, based on all these data, we have to prepare P and L account. Let us take a review at all the transaction, once again. ((Refer Time: 29:15)) Please look at the transactions carefully. So, there is a purchase of 140. Then, general expenses, salaries paid. There is a credit sale. There is a cash sale. Printing and stationary expenses are paid. Advance salaries paid. Loan installment is paid. Interest is paid.

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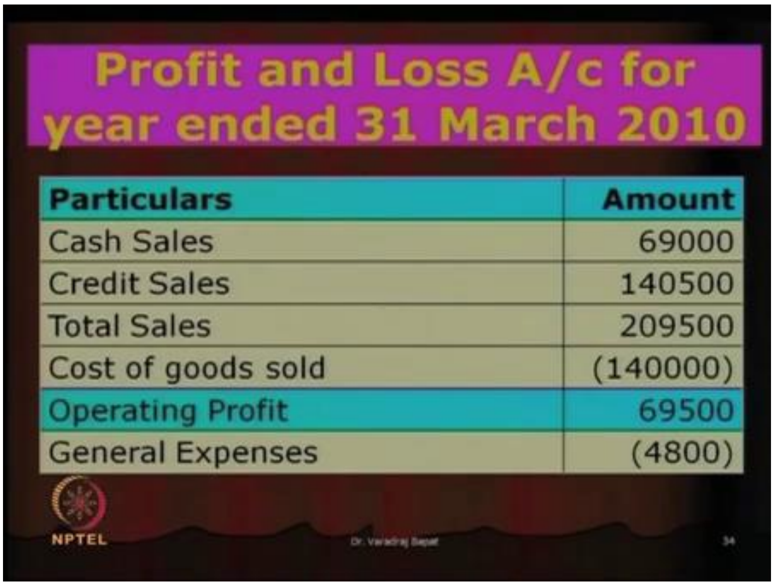

Now, let us look at P and L account. So, here you can see profit and loss account, for year ended 31st March. Your cash sales of 69,000 and credit sales of 1,40,000. I will take you back. ((Refer Time: 29:58)) Here, you have information about sales. Now, even if the amounts are I mean, the sales are made on a credit for 2 months. So, money will come only after 2 months. Still, we are going to record the entire amount as sales, today. And there is also, a cash sale of rupees 69,000.

So, the first thing we have shown is cash sales and credit sales of 69 and 1,40,500. From that, we reduced the cost of goods sold of 1,40,000. So, we get operating profit of 69,500. Then, general expenses 4800. ((Refer Time: 30:40)) If you remember, they had paid for general expenses of 48. They had also paid for printing and stationary. So, I am reducing general expenses of 4800.

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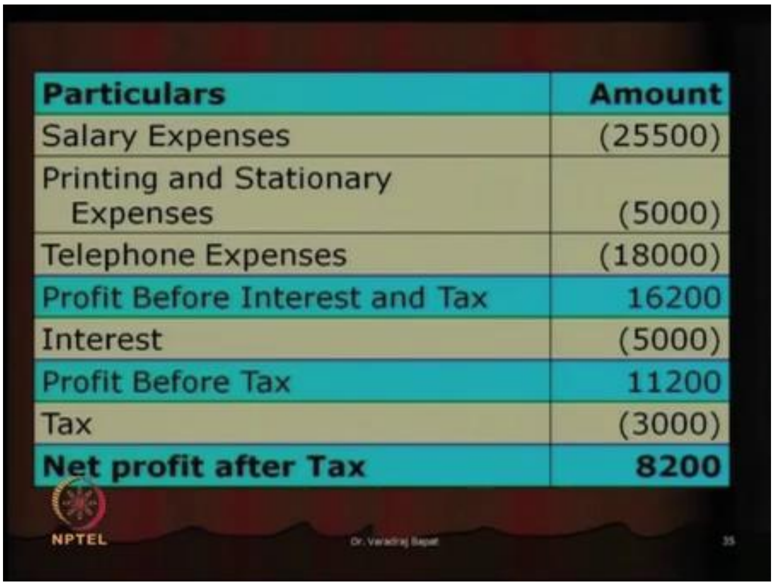

Particulars	Amount
Salary Expenses	(25500)
Printing and Stationary Expenses	(5000)
Telephone Expenses	(18000)
Profit Before Interest and Tax	16200
Interest	(5000)
Profit Before Tax	11200
Tax	(3000)
Net profit after Tax	**8200**

I reduced stationary, I reduce printing, I have also reduced telephone expenses. So, I get profit before interest and tax. I will just go back. ((Refer Time: 31:05)) You can see these items. Printing, telephone, etcetera they are all deducted. So, I am getting profit before interest and tax. Now, I have paid loan installment of 50,000. Should I reduce it? The answer is no, because loan installment includes repayment of loan of 45,000 and interest of 5000.

It is given that, out of 50 only 5 is interest. So, remaining 45 is repaying of my existing liability. That is loan. That is not my expense. But, interest of 5000 is my expense. So, if you look at a format, from PBIT of 16,200 I paid interest of 5000. I get PBT of 11,200 from which, I reduced the tax of 3000. So, I get net profit of 8200. ((Refer Time: 32:05)) Now, if you see I am not reducing, advance salary paid to one of the employees rupees 2000.

The reason is, it is not salary of this month. Though, it is paid in the month of March. Actually, it relates to April. So, I will not reduce it from my P and L, now. I will show in my asset side, in my balance sheet. If you remember, we have discussed matching concept. So, because of matching concept, I am not going to record this 2000 now. Let us go back to P and L again. ((Refer Time: 32:43)) So, you have got cash sale, credit sale.

You get operating profit. You reduce all the expenses. We get profit before interest and tax. Reduce interest reduce tax. So, you get net profit after tax. Is it clear? Now, if you have clearly understood, what is P and L account? I will, like to go into somewhat more detail into recording of transactions. Of course, we have seen just two examples of balance sheet and one example of P and L, which is not enough.

So, I will request you to look at books or look at, some other resources to get little more practice into balance sheet or P and L. You can also look at the rep-course, which gives you some more examples. Now, let us go to some transactional aspects, wherein we will record the transactions. So, we will start with module 3, which deals with recording financial transactions.

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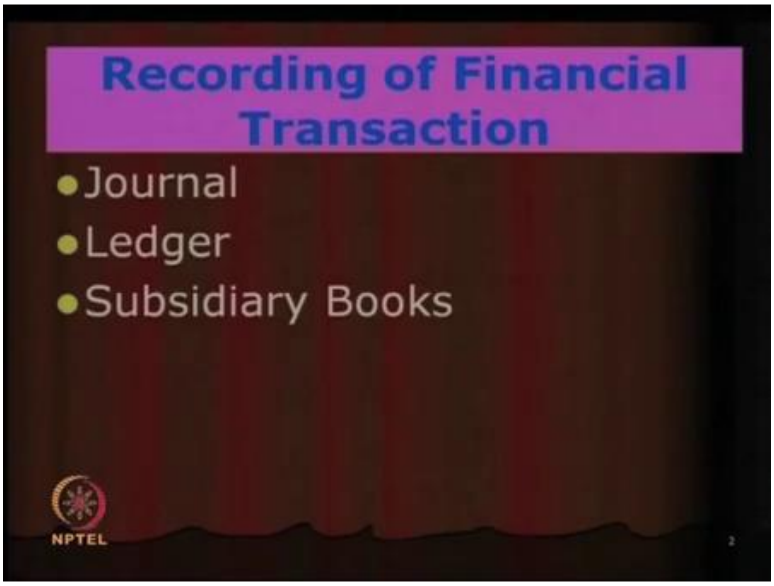

We are going to look at some of the books of account, as they are called. There are three books, which we will see. One is a journal, then ledger and subsidiary books.

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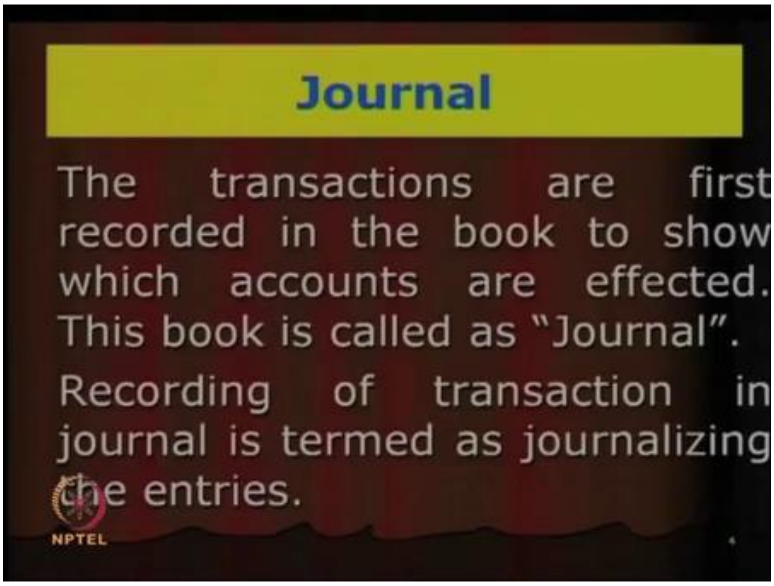

Now, journal. Now, the transactions are first recorded in the book known as journal to show, which accounts are affected. Recording of transactions in the journal is termed as journalizing the transactions.

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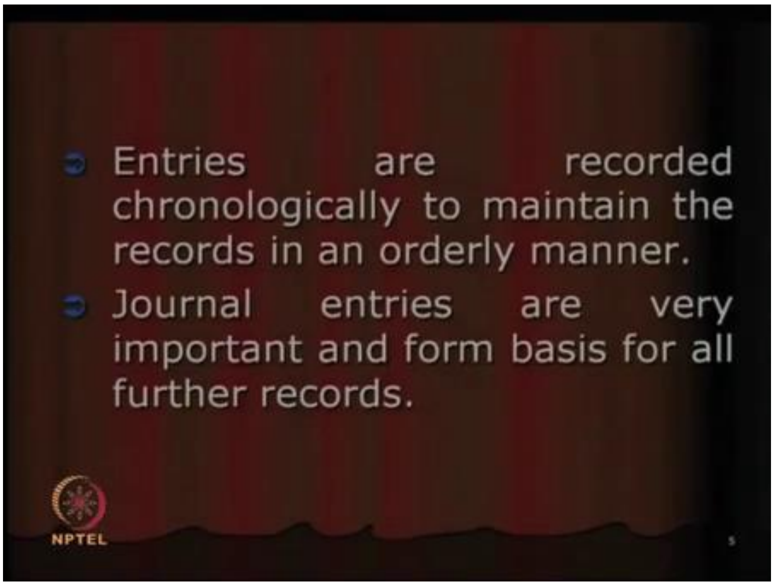

Entries are recorded chronologically to maintain the records in an orderly manner. And journal entries are very important because, they formed basis of all further records. Now, here we do not worry about the nature of transaction. So, suppose first I make cash purchase. Then, I make credit purchase. Then, I make sale. Then, I pay salary. Then, again I make purchase. Then, I say pay telephone bill. Then, again I sell something.

So, I do not record all sales together or all purchase together. I just record, all the transactions chronologically. So, that I do not miss out anything. And this chronological recording is known as journalizing the transaction. This is the base, where first entries made. Now, from here I will transfer them to know, what are my total sales? I will transfer them to purchases to know the total purchase and so on. Now, let us understand what, how does the journal look like?

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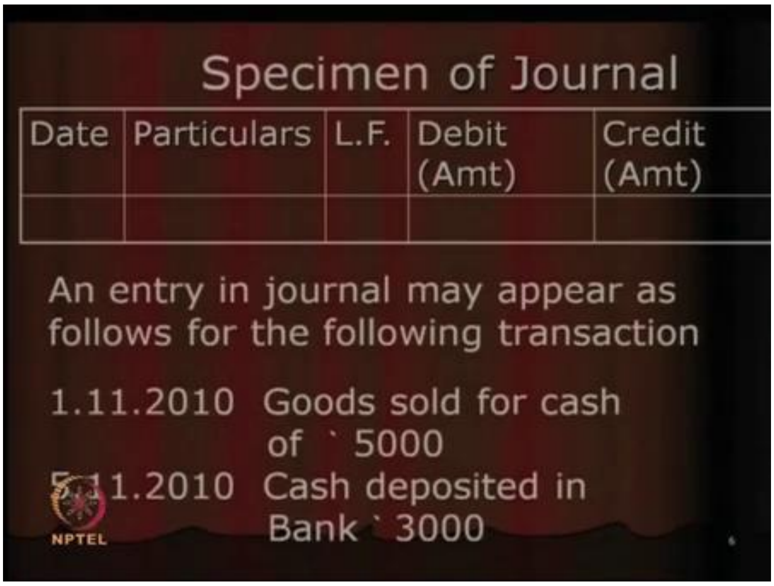

So, here you can see specimen of journal. So, we record date. We record particulars. We record LF. LF is Ledger Folio. Then, we record debit amount and we also record credit amount. All entries in the journal, appear as follows. So, we will try to see now, actually how do you record? I know, you are still not aware about, what is LF? LF stands for Ledger Folio. Now, from the journal, the transactions are going to be transferred to something else, which is known as ledger.

Now, first thing an entry will try to take some entries and see how they are recorded? On 1-11-2010, goods sold for cash rupees 5000. 5-11-2010, cash deposited in bank rupees 2000. Now, only two transactions. So, that you understand the journal entry clearly.

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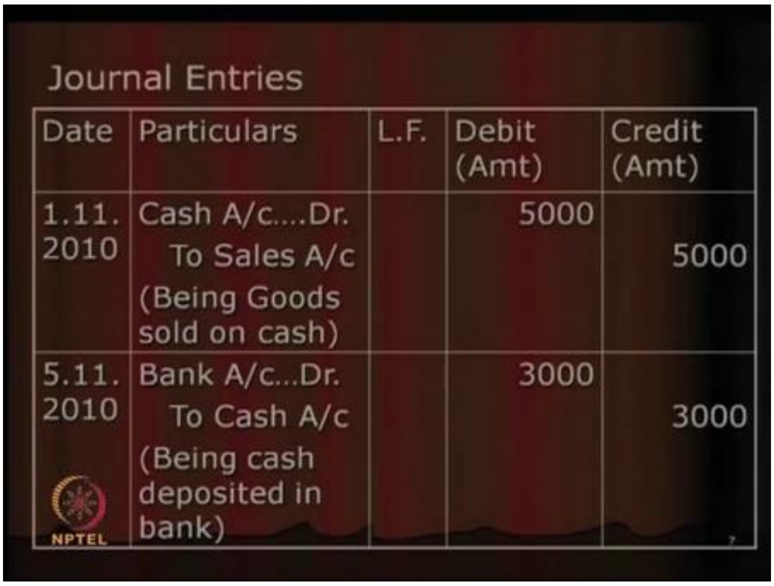
Journal Entries

Date	Particulars	L.F.	Debit (Amt)	Credit (Amt)
1.11. 2010	Cash A/c....Dr. To Sales A/c (Being Goods sold on cash)		5000	5000
5.11. 2010	Bank A/c...Dr. To Cash A/c (Being cash deposited in bank)		3000	3000

Now, the cash account is debited by 5000 and sales account is credited by 5000. Here, goods are sold for cash. So, what has happened is cash comes in, my cash balance increases. That is why, I say cash account is debited. And when I sell the goods, sales is created. So, my sale account is credited. So, my sales should increase by 5000. Now, on 5.11. Now, cash part. A part of this cash is deposited in bank.

So, my bank balance increases my cash balance reduces. So, it is known as bank account debit and cash account credit. So, you can see here. The transactions are recorded date wise. There is something known as ledger folio. Now from here, from these journal, the transaction is going to be transferred to some other book, which is known as ledger. So, I will write down the page number of that book, in the journal. That is known as ledger folio.

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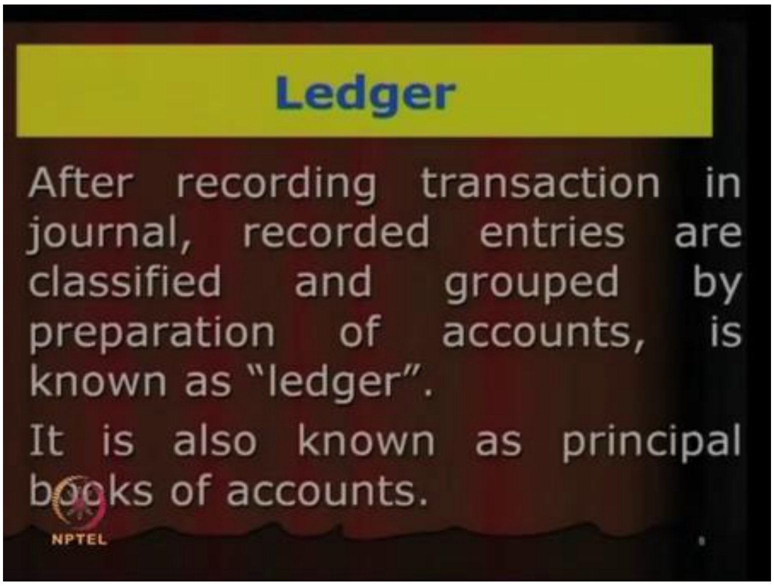

Now, let us understand what is a ledger? As I told you just now, after recording the transaction in the journal, the entries are classified and grouped. And they are transferred to another book, that is known as ledger.

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This is the format. So, in the ledger you show date, particulars. JF is a Journal Folio, from where this entry has come and the amount. You can see here, there are two sides known as debit and credit. So, if the balance is increasing, I will write on debit side. If the balance is decreasing, I will write on credit side. This is of course, I am telling you in brief. We are going to see, a few transactions where you will recognize. Recognize actually, how the entries are recorded. Separate account is opened in the ledger book for different set of transactions.

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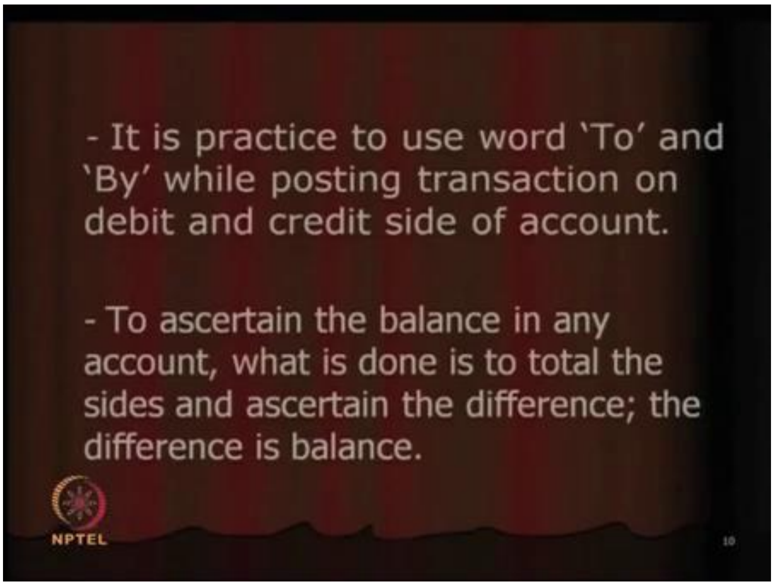

Usually, we record the transaction on debit side, which starts with TO and on credit side, which starts with BY. To ascertain the balance in any account, we take the total of debit and credit and difference is known as balance of account.

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Now, let us take a very small case. Prepare the ledger account from the following details. Opening balances are given. Cash is 1500, creditors 800, debtors 1200, capital is 1900. I hope, now you remember what is cash? What is creditors? What is debtors and what is capital? So, creditor refers to I have purchased the goods on credits. I have to pay back the supplier. Debtors means, I have sold goods on credits, I have to recover from customer.

So, it is a customer balance and what is capital. So, there are owners. They have put in money into business. The money, which they have put in is known as capital. So, these are the opening balances of the business, your cash, creditors, debtors and capital.

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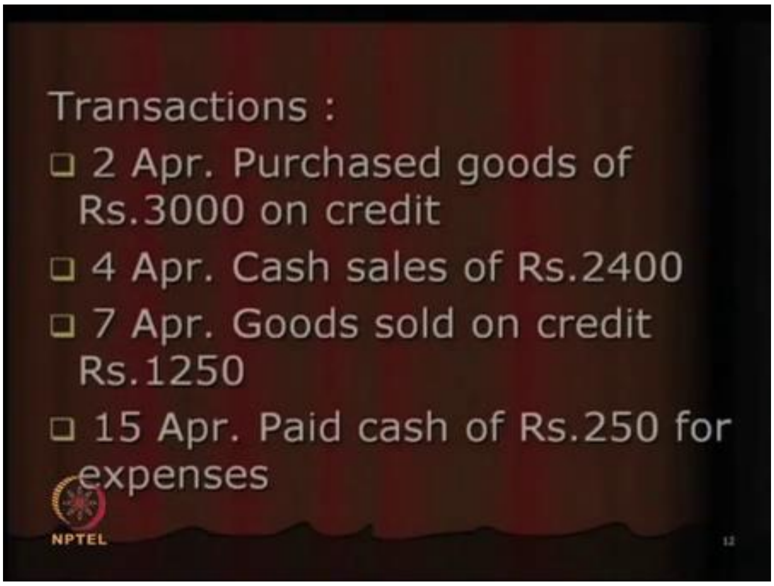

Then, take a look at transaction. On 2nd April, purchase of goods of rupees 3000 on credit. 4th April, cash sales of 2400, 7th April goods sold on credit 1250, 15th April cash paid to 250 for expenses.

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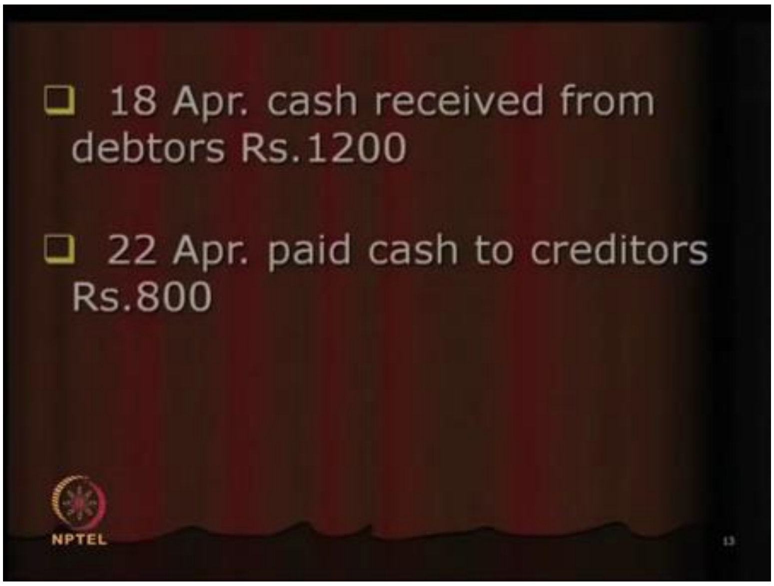

Two more transactions, 18th April cash received from debtors 1200 and 22nd April, paid cash to creditors rupees 800. ((Refer Time: 40:14)) Let us look at the transactions, once again. Now, we are trying to make ledger. So, entries are not going to be chronologically recorded. They are chronologically recorded in journal. In ledger, we will classify the entry. So, all purchases will be shown together. All sales will be shown together. So, I am requesting you to have a view at all the entries. Then, we will see how they are recorded in the ledger.

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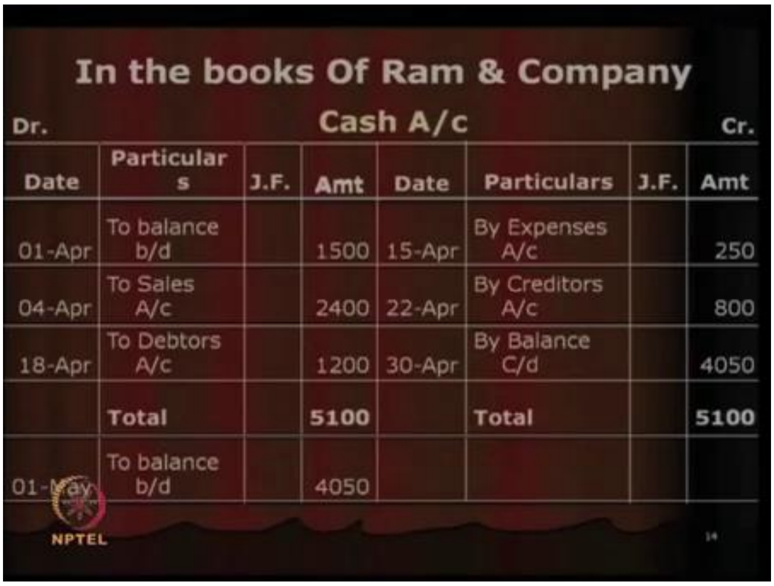

Date	Particulars	J.F.	Amt	Date	Particulars	J.F.	Amt
01-Apr	To balance b/d		1500	15-Apr	By Expenses A/c		250
04-Apr	To Sales A/c		2400	22-Apr	By Creditors A/c		800
18-Apr	To Debtors A/c		1200	30-Apr	By Balance C/d		4050
	Total		**5100**		**Total**		**5100**
01-May	To balance b/d		4050				

So, we will say in the books of Ram and company, cash account. Now, all transactions related to cash are recorded in the cash account. So, if you remember, there was a balance of 1500 in cash. I will just go back to make it more clear to you. So, opening balances had cash of 1500. So, in the cash account. First, we start with opening balance of 1500. ((Refer Time: 41:09)) Going back, you can see on 4th April, there was cash sale of 2400.

So, on 4th April we recorded to sales account 2400. I had told you that, on debit side usually we start the entry by saying to. So, like this here it is to balance brought down. And then, to sales account 2400 ((Refer Time: 41:35)). Now, tell me which is a next cash transaction? On 15th April, cash of rupees 250 as paid as expenses. So, you can see here on 15th April in the cash account, we had said by expenses account 250.

So, what it means is. 250 is paid as expense. So, my cash balance reduces by 250. So, you can see here. We have recorded transactions of 4th and 15th. Now, any other cash transaction is here? 18th April, cash received from debtor 1200. So, cash balance is going to increase. That is why, on debit side I have written. 18th April, to debtors account 1200. Now, the last entry 22nd April, paid cash to creditors 800.

Now, the cash balance will reduced by 800. That is why, on credit side we have said 22nd April by creditors account. I hope now, you are clear with all the entries. So, now you can see that from the transactions, all transactions related to cash were classified and they were recorded in what is known as cash account. Now, since all transactions are over. On 30th April, I will make the balance. So, if I take the total on the debit side, it is 5100.

My expenses are 250 and 800, which I will reduce. So, I get the balance of 4050. And it is shown as by balance carried down. Next month at the beginning, on 1st May I will say to balance brought down 4050. Have you understood, what is a ledger account? Now, this is not only for cash. We are going to make ledger accounts, for all the items. So, if you look back at these transactions, there are opening balances and various transactions.

Using them, we have to make various accounts ((Refer Time: 43:47)). If you look at opening balances, we had cash, creditors, debtors, capital. So, we will try to make all these accounts. Now, I trust you have understood cash account. On similar lines, there are other accounts.

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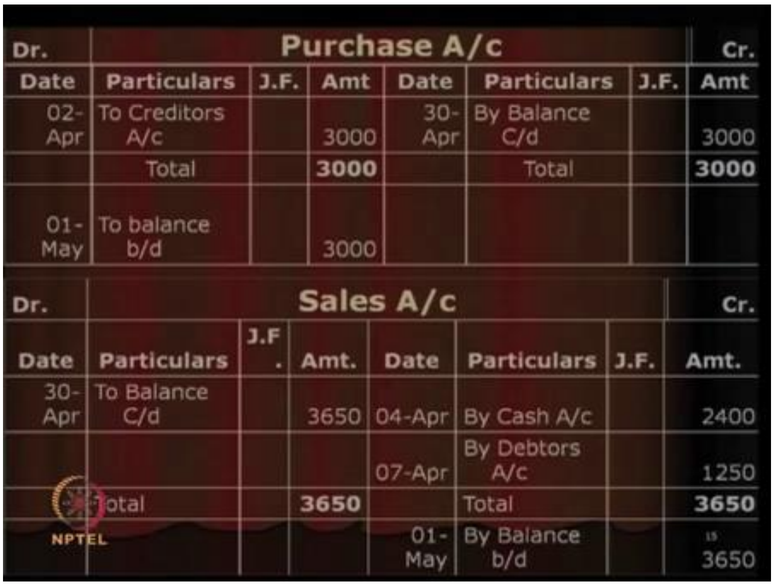

Dr.		Purchase A/c					Cr.
Date	Particulars	J.F.	Amt	Date	Particulars	J.F.	Amt
02-Apr	To Creditors A/c		3000	30-Apr	By Balance C/d		3000
	Total		3000		Total		3000
01-May	To balance b/d		3000				

Dr.		Sales A/c					Cr.
Date	Particulars	J.F.	Amt.	Date	Particulars	J.F.	Amt.
30-Apr	To Balance C/d		3650	04-Apr	By Cash A/c		2400
				07-Apr	By Debtors A/c		1250
	Total		3650		Total		3650
				01-May	By Balance b/d		3650

Now, let us look at purchase account. If you remember, there was only one purchase entry on 2nd April, to creditors account which is 3000. I will carry that balance. For sales, there were two entries. There was one cash sale. There was one credit sale. So, by cash 2400, by debtor 1250. This is how the sales account will look like. Let us go back and have a look at transactions, once again ((Refer Time: 44:33)).

So, you can see here. There was one credit purchase and one cash sale, one credit sale. All this was recorded into a cash account, purchase account and also sales account. I hope, you are getting me.

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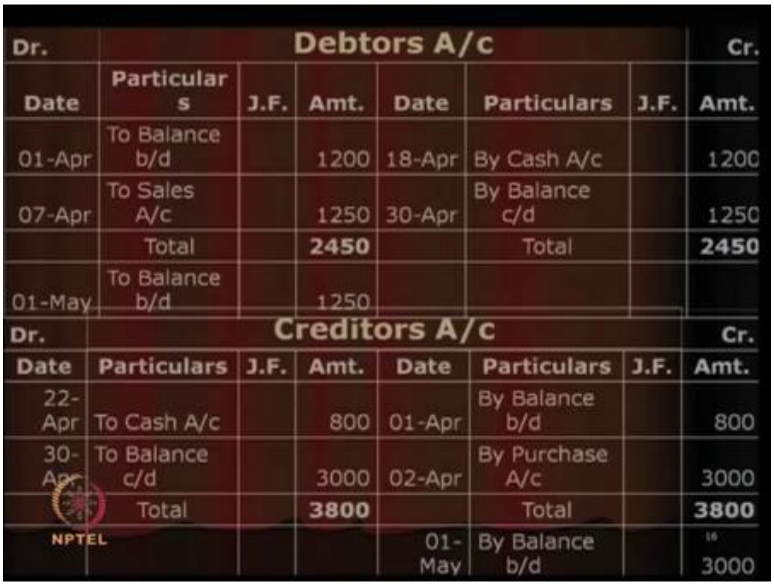

Dr.			Debtors A/c				Cr.
Date	Particulars	J.F.	Amt.	Date	Particulars	J.F.	Amt.
01-Apr	To Balance b/d		1200	18-Apr	By Cash A/c		1200
07-Apr	To Sales A/c		1250	30-Apr	By Balance c/d		1250
	Total		**2450**		Total		**2450**
01-May	To Balance b/d		1250				

Dr.			Creditors A/c				Cr.
Date	Particulars	J.F.	Amt.	Date	Particulars	J.F.	Amt.
22-Apr	To Cash A/c		800	01-Apr	By Balance b/d		800
30-Apr	To Balance c/d		3000	02-Apr	By Purchase A/c		3000
	Total		**3800**		Total		**3800**
				01-May	By Balance b/d		3000

Now, along with this, there are other accounts which are affected. They are debtors account and also the creditors account. So, you can see in debtors account, balance was 1200. There was a credit sale on 7th April. So, to sale 1250. On the credit side, on 18th April we have got by cash sale 1200. And based on these three transactions, the total on debit side was 2450. So, I have arrived this was a position.

I have arrived at a balance of 1250 and.1250. And that balance will be carried on 1st May, as to balance brought down 1250. Now, creditors account, there were two entries. There was a credit purchase of 3000 and cash of 800 is paid. So, there is a balance of 3000, that will be carried to next month. Have you understood, the account making now. I know, we are going very little bit in hurry.

I do not want to show you very much in detail, how do you make the account. But, just to have an idea as to, how does the journal look like and how does the ledger look like. We are doing this exercise.

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Dr.	Expenses A/c						Cr.
Date	Particulars	J.F.	Amt.	Date	Particulars	J.F.	Amt.
15-Apr	To Cash A/c		250	30-Apr	By Balance C/d		250
	Total		**250**		Total		**250**
01-May	To Balance b/d		250				

Dr.	Capital A/c						Cr.
Date	Particulars	J.F.	Amt.	Date	Particulars	J.F.	Amt.
30-Apr	To Balance c/d		1900	01-Apr	By Balance b/d		1900
	Total		**1900**		Total		**1900**
				01-May	By Balance b/d		1900

Now, let us look at expense account. 250 of expenses paid. So, to cash 250. In capital account, no entry throughout the period. Opening balance of 1900. Same balance, we will carry as a balance carried down. And it will go to next month, again as a opening balance brought down 1900. Is it fine? Have you understood now? Ledger. Now, to take a brief recap, we have looked at journal which is a book of original entry.

So, as soon as the entry happens serially in a chronological order or I write all the entries in the journal. From the journal, I classified entries and transfer them to respective accounts, known as ledger. Now, this practice is little bit cumbersome. Now, what has of course, computers are used. Nobody, is actually writing in the book journal ledger. So, what is done is certain transactions, which repeatedly happen I make some specialized books, which are known as subsidiary book.

So, for example, sales. Sales will happen 100 times in one day. So, instead of recording every time in the journal and ledger, I make a separate book known as sales book. Purchase, I will make a separate book known as purchase book. Like this, some separate books are known. Those books are known as subsidiary books.

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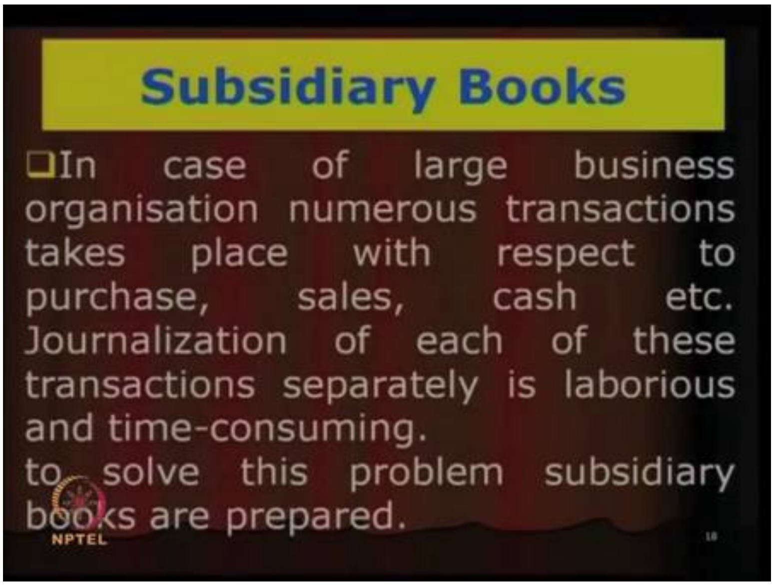

So, you can see here. So, in case of large business organization, instead of journalizing which is a laborious job. We will make specialized books, known as subsidiary books.

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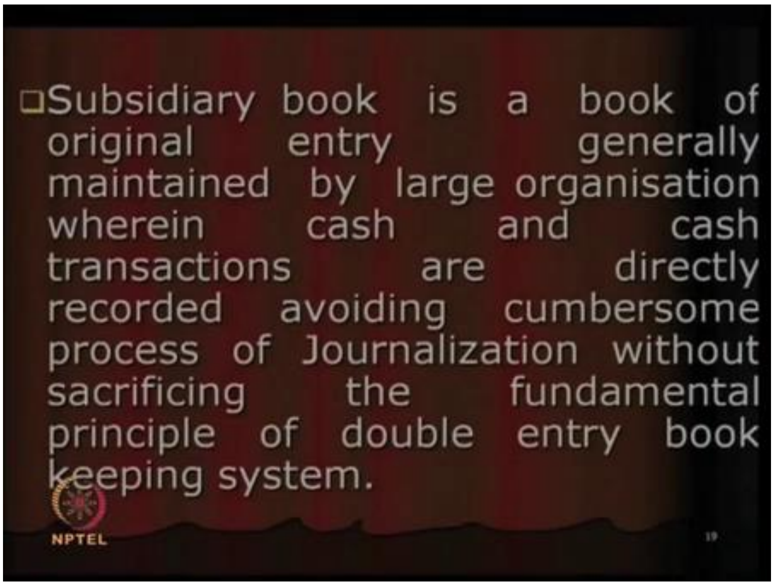

Now, subsidiary book is a book of original entry. Generally, maintained by large organization, where different types of transactions happen.

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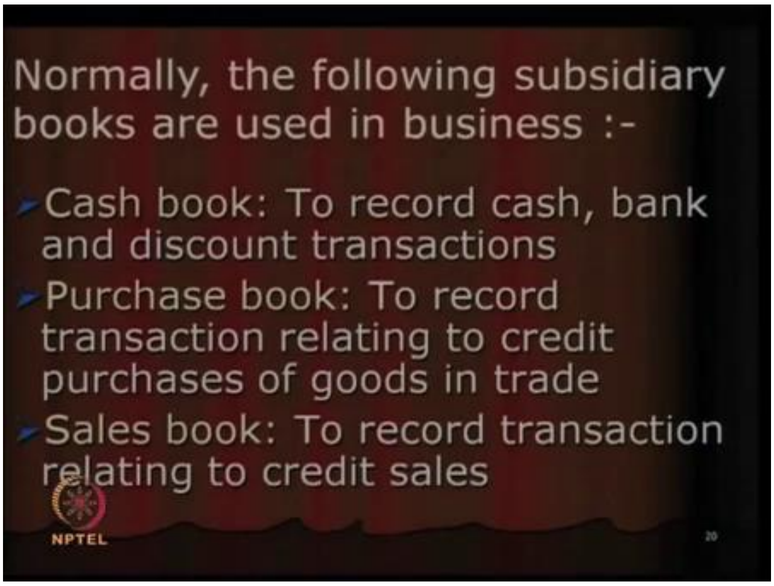

So, we have subsidiary books like this. We have a cash book, to record cash, bank and discount transactions. We have purchase book, which will record purchase related transactions, on credit. Sales book, which we will again record the transactions of credit sale. Cash sales, we do not record here because, they are already recorded in the cash book.

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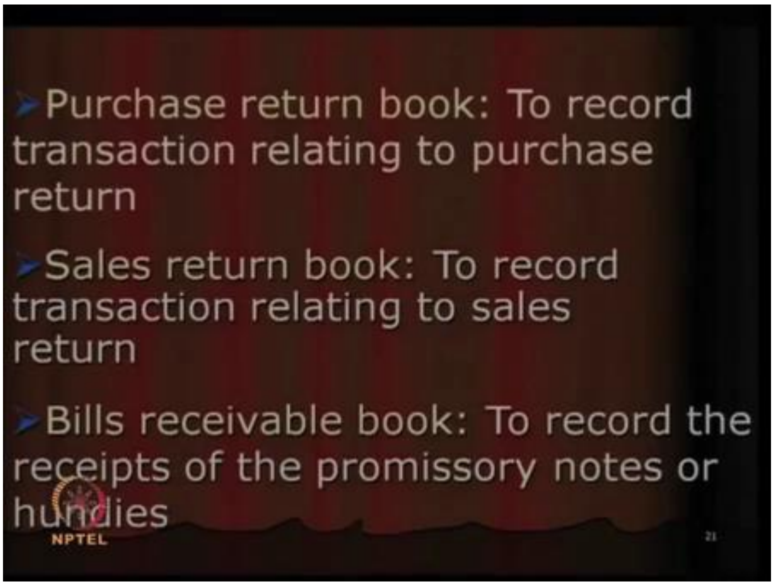

Then, purchase return book to record the return of goods. Sale return book to record the return of sale. Sold, items from the customers back to us. Sometimes, we also have a bill receivable book to record the receipt of promissory notes or hundies.

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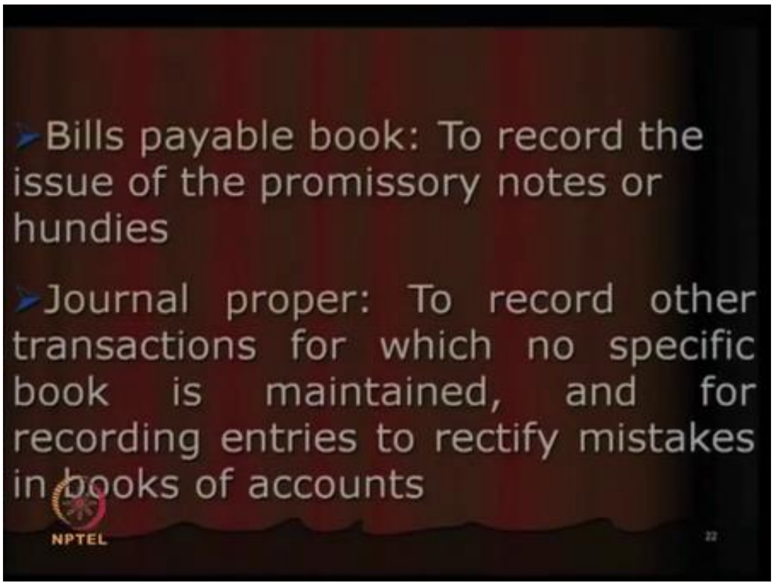

Then, bills payable book, where we may record the issue of promissory notes or hundies. There is one more book known as journal proper. Now, many of the transactions are already recorded in these books. Cash, purchase, sales but, what transactions do not get recorded in those books, get recorded in a separate book or a journal, which is known as journal proper. So, in this session now, we have done.

Initially, we have talked about a few cases of P and L account and try to understand P and L. And in this later part, we have tried to see recording of transactions. So, how the transactions are recorded in journal, in ledger and in the subsidiary books. So, thank you so much. Next session, we will go into further more details into recording of transactions. So, we will stop here.