

DegreeLive

FINANCIAL ACCOUNTING

B.Com Semester 2 – Calicut University

MODULE 1: PREPARATION OF FINANCIAL STATEMENTS OF SOLE PROPRIETORSHIP

Introduction to Accounting

1. Accounting is the process of recording, classifying, summarizing and interpreting financial transactions.
2. It helps determine profit or loss and the financial position of a business.
3. Accounting information is useful for owners, investors, creditors and government authorities.

Accounting Principles, Concepts and Conventions

Business Entity Concept

1. Business and owner are treated as separate entities.

Going Concern Concept

1. Business is assumed to continue for the foreseeable future.

Money Measurement Concept

1. Only transactions measurable in money are recorded.

Cost Concept

1. Assets are recorded at original purchase cost.

Dual Aspect Concept

1. Every transaction has two aspects (Debit and Credit).

Accounting Period Concept

1. Business life is divided into accounting periods for reporting.

Important Conventions

1. Conservatism.
2. Consistency.
3. Full Disclosure.
4. Materiality.

Income Statement (Profit and Loss Account)

1. Prepared to find profit or loss during an accounting period.
2. Records indirect expenses and indirect incomes.

Main Items on Debit Side

1. Salaries.
2. Rent.
3. Insurance.
4. Depreciation.
5. Bad Debts.
6. Office Expenses.

Main Items on Credit Side

1. Commission Received.
2. Discount Received.
3. Interest Received.
4. Other Incomes.

Calculation

1. **Net Profit** = Total Income – Total Expenses
2. **Net Loss** = Total Expenses – Total Income

3. Net profit is added to capital.
4. Net loss is deducted from capital.

Balance Sheet of Sole Proprietorship

1. Statement showing financial position on a particular date.
2. Shows Assets and Liabilities.

Liabilities Side

1. Capital.
2. Creditors.
3. Outstanding Expenses.
4. Bank Loan.

Assets Side

1. Cash.
2. Bank Balance.
3. Furniture.
4. Machinery.
5. Debtors.
6. Closing Stock.

Accounting Equation

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

Important Adjustments

Closing Stock

1. Appears in Trading Account and Balance Sheet.

Outstanding Expenses

1. Expense incurred but not paid.
2. Added to expense.
3. Shown as liability.

Prepaid Expenses

1. Paid in advance.
2. Deducted from expense.
3. Shown as asset.

Accrued Income

1. Income earned but not received.
2. Added to income.
3. Shown as asset.

Income Received in Advance

1. Income received before it is earned.
2. Deducted from income.
3. Shown as liability.

Depreciation

1. Reduction in value of fixed assets due to usage or time.

Bad Debts

1. Amount not recoverable from debtors.
2. Treated as expense.

Provision for Doubtful Debts

1. Estimated future bad debts.
2. Created as precaution.

Interest on Capital

1. Expense for business.

2. Added to capital.

Interest on Drawings

1. Income for business.
2. Deducted from capital.

MODULE 2: INTRODUCTION TO SINGLE ENTRY SYSTEM

Single Entry System

1. Incomplete system of accounting.
2. Some transactions are recorded while others are omitted.
3. Usually maintained by small businesses.

Objectives

1. Simple record keeping.
2. Low cost.
3. Suitable for small concerns.

Advantages

1. Easy to maintain.
2. Economical.
3. Requires less accounting knowledge.

Limitations

1. Incomplete records.
2. Difficult to detect errors.
3. Difficult to determine accurate profit.
4. Unsuitable for large businesses.

Single Entry vs Double Entry

Single Entry	Double Entry
Incomplete records	Complete records
Easy to maintain	More systematic
Less accurate	More accurate
Suitable for small firms	Suitable for all businesses
Difficult to detect errors	Easier error detection

Types of Single Entry

1. Pure Single Entry.
2. Simple Single Entry.
3. Quasi Single Entry.

Determination of Profit or Loss (Statement of Affairs Method)

Statement of Affairs

1. Similar to a Balance Sheet.

2. Prepared from incomplete records.

Capital Comparison Method

$$\text{Profit} = \text{Closing Capital} + \text{Drawings} - \text{Additional Capital} - \text{Opening Capital}$$

$$\text{Loss} = \text{Opening Capital} + \text{Additional Capital} - \text{Drawings} - \text{Closing Capital}$$

Steps

1. Prepare opening statement of affairs.
2. Calculate opening capital.
3. Prepare closing statement of affairs.
4. Calculate closing capital.
5. Compare capitals.

Balance Sheet vs Statement of Affairs

Balance Sheet	Statement of Affairs
Based on complete records	Based on incomplete records
Accurate	Approximate
Double entry system	Single entry system
Reliable	Less reliable

Profit & Loss Account vs Statement of Profit

Profit & Loss Account	Statement of Profit
Based on complete records	Based on capital comparison
More accurate	Less accurate
Double entry system	Single entry system

Conversion Method

1. Used to convert incomplete records into double-entry records.
2. Helps determine profit accurately.

MODULE 3: FINANCIAL STATEMENTS OF NOT-FOR-PROFIT ORGANISATIONS

Not-for-Profit Organisations (NPOs)

1. Formed to provide service rather than earn profit.

2. Examples: Clubs, Charitable Trusts, Hospitals, Educational Institutions.

Characteristics

1. Service motive.
2. No profit distribution.
3. Managed by committee or trustees.
4. Receives donations and subscriptions.

Records Maintained

1. Cash Book.
2. Receipts and Payments Account.
3. Income and Expenditure Account.
4. Balance Sheet.

Receipts and Payments Account

1. Summary of all cash and bank transactions.
2. Prepared from cash book.
3. Includes both capital and revenue items.
4. Includes past, present and future transactions.

Features

1. Real account.
2. Begins with opening balance.
3. Ends with closing balance.

Income and Expenditure Account

1. Similar to Profit and Loss Account.
2. Prepared on accrual basis.
3. Includes only current year's revenue items.

Surplus & Deficit

1. **Surplus:** Income > Expenditure
2. **Deficit:** Expenditure > Income

Features

1. Nominal account.
2. Excludes capital receipts and payments.

MODULE 4: ACCOUNTING FOR SHARES

Accounting for Shares

Share

1. Smallest unit of share capital.
2. Represents ownership in a company.

Types of Shares

Equity Shares

1. Ordinary shares.
2. Voting rights available.
3. Dividend not fixed.

Preference Shares

1. Fixed rate of dividend.
2. Preference in dividend and repayment.

3. Shows true operating result.

Balance Sheet of NPO

1. Shows financial position of organization.

Important Items

Subscriptions

Subscription Received:

1. **Current year** → Income.
2. **Advance** → Liability.
3. **Outstanding** → Asset.

Donations

1. **General donation** → Capitalized or treated as income depending on nature.
2. **Specific donation** → Added to specific fund.

Special Funds

Examples:

1. Building Fund.
2. Prize Fund.
3. Sports Fund.

Used only for specified purpose.

Capital Receipts

Examples:

1. Entrance fees.
2. Legacies.
3. Specific donations.

Usually added to capital fund.

Issue of Shares for Cash

Journal Entry

Bank A/c Dr
To Share Capital A/c
(Being share application money received)

Share Issue Process

1. Issue of Prospectus.
2. Receipt of Applications.
3. Allotment of Shares.
4. Calls on Shares.

Issue of Shares at Par, Premium and Discount

At Par

1. Issue price = Face value.
2. Example: ₹10 share issued at ₹10.

At Premium

1. Issue price > Face value.
2. Example: ₹10 share issued at ₹12.
3. Premium = ₹2.

At Discount

1. Issue price < Face value.
2. Example: ₹10 share issued at ₹9.
3. Discount = ₹1.
4. (Note: Issue at discount is generally restricted under current law.)

Calls in Arrears and Calls in Advance

Calls in Arrears

1. Amount due from shareholders but not yet received.
2. Example: Shareholder fails to pay allotment money.

Calls in Advance

1. Amount received before it becomes due.
2. Example: Shareholder pays future call money early.

Difference

Calls in Arrears	Calls in Advance
Unpaid amount	Advance payment
Asset-like balance	Liability of company
May attract interest from shareholder	Company may pay interest

Forfeiture and Reissue of Shares

Forfeiture of Shares

1. Cancellation of shares due to non-payment of calls.
2. Shareholder loses membership rights.

Conditions

1. Calls remain unpaid.
2. Proper notice is given.
3. Company follows Articles of Association.

Reissue of Shares

1. Forfeited shares may be issued again.
2. Usually reissued at par, premium or discount.

Importance

1. Helps company recover unpaid capital.
2. Restores share capital structure.