MGT101 SHORT NOTES

Lesson-1
BASIC CONCEPTS OF ACCOUNTING

Accounting:-

Accounting is the art of recording, summarizing, reporting, and analyzing financial transactions.

OR

Accounting is the art of recording, classifying, summarizing,in significant manner and in terms of money, Transaction and events which are in part of at least and Interpreting the results there of .

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Transactions:-

In accounting or business terms, any dealing between two persons involving money or a valuable thing is called transaction.

Barter Transaction:-

Every transaction where goods are exchanged for goods is called a "Barter Transaction".

Types of Business Organizations:-

1. **Sole Proprietorship**

According to D.W.T. Stafford, "It is the simplest form of business organization, which is owned and controlled by one man"

- Easy Formation
- Unlimited Liability
- Ownership
- Profit
- Management
- Easy Dissolution

2. **Partnership**

According to Partnership Act, 1932, "Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all."

- Legal Entity
- Profit and Loss Distribution
- Unlimited Liability
- Transfer of Rights
- Management
- Number of Partners

3. **Joint Stock Company**

According to S. E. Thomas, "A company is an incorporated association of persons formed usually for the pursuit of some commercial purposes"

- Creation of Law
- Separate Legal Entity
- Limited Liability
- Transferability of shares
- Number of Members

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- Common Seal

Lesson-2
RECORD KEEPING AND SOME BASIC CONCEPTS

Types of Business Entities:-

Commercial Organizations (Profit Oriented)

- Sole proprietor
- Partnership
- Limited companies

Non-Commercial Organizations (Non-Profit Oriented)

- NGO's (Non-government Organizations)
- Trusts
- Societies

Goodwill:-

This is simply the value attached to the good reputation earned through good and clean conduct of business over a number of years. This good reputation also has a value and becomes part of investment in business

Budget:-

Budget Is a plan of income, expenses & other financial operation for a future period.

Lesson-4
SINGLE AND DOUBLE ENTRY RECORD KEEPING

Single Entry Book Keeping/cash accounting:-

In Single Entry Book Keeping Only one aspect of the transaction is recorded.

Double Entry Book Keeping/commercial accounting:-

In Double Entry Book Keeping every transaction has two aspects i.e. receiving a benefit and giving a benefit.

Debit:-

It signifies the receiving of benefit. In simple words it is the left hand side.

Credit:-

It signifies the providing of a benefit. In simple words it is the right hand side.

Dual Aspect of Transactions:-

For every debit there is an equal credit. This is also called the dual aspect of the transaction.

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Lesson-5

Account:-

Record that summarizes movement in an individual item is called an Account.

Classification of Accounts:-

The accounts are classified into following heads:

- Assets
- Liabilities
- Income
- Expenses (further divided into capital and revenue expenses)

Assets:-

Assets are the properties and possessions of the business to pay in future. Can be amount payable for material purchased, expenses etc.

Properties and possessions can be of two types:

- **Tangible Assets** that have physical existence (are further divided into Fixed Assets and Current Assets)(Furniture, vehicle etc).
- **Intangible Assets** that have no physical existence (copyright, Good will etc).

Liabilities:-

Liabilities are the **debts** and **obligations** of the business. Liability is the obligation of the business to provide a benefit or asset on a future date.

Asset vs liability:-

Asset is a right to receive and liability is an obligation to pay, therefore, these are opposite to each other.

Income & Expenses:-

- Income/revenue is **the value of goods and services** that a business charges from its customers.
- Expenses are **the costs incurred to earn the revenue.**

Accounting Equation:-

Assets = Liabilities + Owner's equity

Capital Expenditure:-

It is the expenditure to create an asset that helps in generating future income and its life is more than 12 month. For example machinery purchases, furniture purchases etc.

Revenue Expenditure:-

It is the day to day expenses whose benefit is drawn immediately. For example, salary of the employee, rent of the building, etc.

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Lesson-6
FLOW OF TRANSACTIONS

Event:-

Event is the happening of any thing but in accounting we discuss monetary events

Monetary Events:-

If the financial position of a business is change due to the happening of event that Event is called Monetary Event

The Voucher:-

Voucher is documentary evidence in a specific format that records the details of a transaction.

The General Journal:-

The Journal is used to record financial transactions in chronological (day-to-day) order. All vouchers were first recorded in books of accounts. It was also called the Book of Original Entry or Day Book.

Ledger:-

It is a book that keeps separate record for each account (Book of Accounts).

BALANCE:-

The difference between the debit and the credit sides, known as the **BALANCE**.

Lesson-7

Accounting Period:-

- Accounting period is any period for which a Financial Statements are prepared. The length of the accounting period can be anything between one day to one year.
- The legal or statutory definition of accounting year is a maximum of one year.
- The only exception in this case is the
- Formation of a new company which is formed before the start of accounting period.

Financial year (A period of 12 month duration):-

In Pakistan, financial year starts from 1st of July and ends on 30th of June.

Debit Balance:-

If debit side of a ledger is greater than credit side, the balance will be written on the credit side and it will be called Debit Balance.

Credit Balance:-

If credit side is greater than debit side, the balance will be written on the debit side. This balance is called Credit Balance.

Trial Balance:-

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At the end of accounting period, a list of all ledger balances is prepared. This list is called trial Balance.

Lesson-8

Income & Expenditure Vs Profit & Loss Account:-

- Income and Expenditure Account is used for Non-Profit Organizations like Trusts, NGOs
- Profit and Loss Account is used for Commercial organizations like limited companies.

Profit & Loss Account:-

Profit & Loss account is an account that summarizes the profitability of the organization for a specific accounting period.

- First part is called **Trading account** in which Gross Profit is calculated**.** Gross profit is the excess of sales over cost of goods sold in an accounting period.
- 2nd part is called **Profit & Loss account** in which Net Profit is calculated. **Net Profit** is what is left of the gross profit after deducting all other expenses of the organization in a specific time period.

Profit:-

It is the excess of income over expenses in a specified accounting period.

Profit= Income - expenses

Administrative expenses:-

Administrative expenses are the expenses incurred in running a business effectively. Main components of this group are:

- Payment of utility bills
- Payment of rent
- Salaries of employees
- General office expenses
- Repair & maintenance of office equipment & vehicles.

Selling expenses:-

Selling expenses are the expenses incurred directly in connection with the sale of goods. This head contains:

- Transportation/carriage of goods sold
- Tax/freight paid on sale

Financial expenses:-

Financial expenses are the interest paid on bank loan & charges deducted by bank on entity's bank accounts. It includes:

- Mark up on loan
- Bank charges

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Lesson-9

Accounts payable:-

All businesses have liabilities; even the most successful companies' purchase stocks, supplies and receive services on credit. The liabilities arising from such purchases are called **Accounts payable.**

Capital:-

It is the funds invested by the owners of the business. Business has a liability to return these funds to the owner.

Lesson-10

Debtor:-

A person or organization from whom money is receivable by the business is called a debtor.

Creditor:-

A person or organization to whom money is payable by the business is called a creditor.

Lesson-11

Rules of Debit & Credit:-

- Any account that obtains a benefit is Debit.
- Anything that will provide benefit to the business is Credit.

- **Expenditure**
  - Increase in Expenditure is Debit
  - Decrease in Expenditure is Credit
- **Income**
  - Increase in Income is Credit
  - Decrease in Income is Debit
- **Assets**
  - Increase in Asset is Debit
  - Decrease in Asset is Credit
- **Liability**
  - Increase in Liability is Credit
  - Decrease in Liability is Debit

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Lesson-12
The Accounting Equation

Capital:-

The amount of resources supplied by the owner is called capital.

Asset:-

The actual resources which are in the business are called assets.

Asset = Capital

Long Term Assets:-

These are the assets of the business that are receivable after twelve months of the balance sheet date. For example, if business has invested some money for two years in any saving scheme or has purchased saving certificates for more than one year, it is a long term asset.

Liabilities:-

It is the name given to the amounts owing to these people for these assets.

Assets = Capital + Liabilities

Long Term Liabilities:-

These are the liabilities that will become payable after a period of more than one year of the balance sheet date. For example, if business has taken a loan from bank or any third person and it is payable after ten years, it will be treated as a long term liability for the business.

Working Capital:-

It is the net value of current assets and current liabilities.

Current Assets:-

Current assets are the resources of the business that are expected to be received within 12 months in an accounting cycle.

Current liabilities:-

Current liabilities are the amount owing to the business that is expected to be paid within one year In a financial year.

Working capital = current Assets – current liabilities

Stock:-

It is the value of goods available to the business that are ready for sale.

OR

It is the quantity of unutilized or unsold goods.

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Opening Stock:-

It is the value of goods available for sale in the beginning of an accounting year.

Closing Stock:-

It is the value of goods unsold at the end of accounting year.

Treatment of depreciation:-

In profit and loss Account it is considered as expense and in balance sheet it is deducted from the concerned asset.

Drawing:-

Sometimes, the owner wants to take cash or kind out of the business for personal use. This known as drawing. Any money taken out as drawings will reduce capital.

Lesson-13

Voucher:-

It is the first document to record an entry.

- Receipt Voucher:-
  It is used to record cash or bank receipt.
- Payment Voucher:-
  It is used to record a payment of cash or cheque.
- Journal Voucher:-
  It is used to record transaction that do not affect cash or bank.

Debit balance when carried forward, is writer on the debit side. Credit balance when carried forward, is written on the credit side.

Difference between expenses & Purchases:-

- If business purchases items for its own use (items that are not meant to be resold) are charged to expense account.
- If business purchases items for resale purposes are charged to purchases account.

Raw material:-

It is the basic part of an item, which is processed to make a complete item.

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Work in process:-

At the end of the year, some part of raw material remains under process, I-e, it is neither in shape of raw material nor in shape of finished goods.

Finished Goods:-

It contains items that are ready for sale, but could not be sold in that accounting period.

Purchase of stock:-

Debit: Stock Account
Credit: Cash/supplier/creditor Account

Payment to creditors:-

Debit: cost of goods sold
Credit: Stock Account

Cost of goods sold:-

- In trading concern, It is the value of goods unsold
- In manufacturing concern, it is the value of raw material consumed plus any other manufacturing cost

Lesson-15
Stock

Journal Entries:-

(In case of Trading Concern)

Purchase Of Goods:
Debit: Stock/Material Account
Credit: Cash/Bank/Creditor

Consumption of goods:
Debit: Cost of goods sold
Credit: Stock

Payment in case of credit purchase:
Debit: Creditors Account
Credit: Cash/Bank

(In case of Trading Concern)

Purchase of raw material:
Debit: Stock/Material Account
Credit: Cash/Bank/Creditors

Other direct costs incurred:
Debit: Relevant cost/Expenses Head

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Credit: Cash/Bank/Payables

Raw material issued and other costs allocated to production of units:

Debit: Work in process
Credit: Stock Material Account

Debit: Work in process
Credit: relevant expense head Account

When production is completed:

Debit: Finished Goods Stock Account
Credit: Work in process Account

Entry for cost of sale:

Debit: Cost of Goods sold Account
Credit: finished Goods stock Account

Entry for sale of goods:

Debit: cash/Account receivable Account
Credit: Sale account

Return of Purchase Material:

Debit: Goods return Account
Credit: stock material Account
And
Debit: Cash/Bank Account
Credit: Goods Return Account

If our suppliers supplies us some other material in exchange of material returned:

Debit: Raw material Stock Account
Credit: Goods return Account

Lesson-16

COST OF GOODS SOLD STATEMENT

cost of goods sold statement**:-**

The statement shows the value of raw material consumed, amount spent on labor and other factory expenses, finished goods produced and goods unsold (in stock).

Standard format of cost of goods sold statement is given below:

Raw Material: O/S Raw Material
+ Purchases
+ Cost Incurred to Purchase RM
- C/S Raw Material
Cost of Material Consumed

Conversion Cost: + Direct Labor Cost

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	+ Factory Overheads
	Total Factory Cost
Work in Process:	+ O/S of WIP
	- C/S of WIP
	Cost of Goods Manufactured
Finished Goods:	+ O/S of Finished Goods
	- C/S of Finished Goods
	Cost of Good Sold

Cost of material consumed:-

It is the cost of material used for consumption that has been put in the production process.

Over Heads:-

Over Heads are the other costs incurred in relation of manufacturing of goods. Examples are factory utilities, supervisor salaries, equipment repairs etc.

Total factory cost:-

It is the cost of material consumed plus labor and over heads. In other words it is the total cost incurred in the factory.

Cost of goods manufactured:-

It is total factory cost plus opening stock of work in process less closing stock of work in process.

Cost of goods sold:-

It is the cost of goods manufactured plus opening stock of finished goods less closing stock of finished goods.

Prime/Basic Cost = Cost of Direct Material Consumed + Direct Labor cost

Conversion cost:-

It is the cost incurred to convert raw material to finished goods.

Conversion cost = Labor cost + factory overhead

Valuation of Stock:-

Any manufacturing organization purchases different material through out the year. The prices of purchases may be different due to inflationary conditions of the economy. The question is, what item should be issued first & what item should be issued later for manufacturing. For this purpose, the organization has to make a policy for issue of stock. All the issues for manufacturing and valuation of stock are recorded according to the policy of the organization.

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Mostly these three methods are used for the valuation of stock:

- First in first out (**FIFO**)
- Last in first out (**LIFO**)
- Weighted average

First in first out (FIFO)
The FIFO method is based on the assumption that the first merchandise purchased is the first merchandised issued. The FIFO uses actual purchase cost.

Last in first out (LIFO)
The LIFO method is based on the assumption that the recently purchased merchandise is issued first. The LIFO uses actual purchase cost.

Weighted average method
This average cost is computed by dividing the total cost of goods available for sale by the number of units in inventory.

Lesson-17
DEPRECATION

Fixed Assets:-

Fixed Assets are those assets which are:

- Of long life
- To be used in the business to generate revenue
- Not bought with the main purpose of resale.

Fixed assets are also called "**Depreciable Assets**"

Accumulated Depreciation:-

It is the depreciation that has been charged on a particular asset from the time of purchase of the asset to the present time.

Amortization:-

No depreciation is charged for 'Land'. In case of 'Leased Asset/Lease Hold Land' the amount paid for it is charged over the life of the lease and is called **Amortization.**

Methods of calculating Depreciation:-

1: Straight line method/**Original cost** method/**Fixed installment** method:-

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Depreciation = (cost – Residual value) / Expected useful life of the asset

Residual value:
It is the cost of the asset after the expiry of its useful life.

2: Write Down value/**Reducing** method/**diminishing** method:-

WDV = Original cost of fixed asset – Accumulated Depreciation

Entries for Recording Disposal:-

Debit: Fixed Asset Disposal A/c
Credit: Fixed Asset Cost A/c
(With the cost of asset**)**

Debit: Accumulated Dep. A/c
Credit: Fixed Asset Disposal A/c
(With the depreciation accumulated to date)

Debit: Cash / Bank / Receivable A/c
Credit: Fixed Asset Disposal A/c
(With the price at which asset is sold)

Lesson-19
METHODS OF CHARGING DEPRECIATION

Capital Work in Progress Account:-
If an asset is not completed at that time when balance sheet is prepared, all costs incurred on that asset up to the balance sheet date are transferred to an account called **Capital Work in Progress Account.**

Debit: Relevant asset account
Credit: Capital work in progress account

Lesson-21
REVALUATION OF FIXED ASSETS

Fair Value:-
It is the value, at which an asset would bring to the management, when sold to a knowledgeable party in a fair deal.

Rules for Revaluation:-
- Revaluation has to be carried out at regular intervals
- The change in the value should be permanent
- Whole class of asset has to be revalued

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Capital Expenses / Capitalized:-

Capital Expenses are those expenses for which benefit is enjoyed for more than one accounting period. For example, the business has bought a car. Now, car will be used for many years. So, it is a capital expense.

Capital Expenditures are incurred in two ways:

- When an asset is acquired, and
- When an improvement is made in an existing asset.

Revenue / Deferred Expenses / Charged Off:-

Revenue Expenses are those expenses for which, the benefit is enjoyed within one accounting period. For example, the business has purchased stationery for office use. Now, the stationery is used within one year in the office. So, this will be a revenue expense.

Revenue Expenses are those expenses that are:

- Incurred in day to day running of the business.
- Incurred to maintain fixed assets in their original / useable condition.

Prepaid Expenses:

Prepaid Expenses are amounts that are paid in advance to a vender or creditor for goods and services. E-g. insurance.

Capital Receipts:-

Receipts which are non-recurring and whose benefits are enjoyed over a long period are called 'Capital Receipts'. For instance, Capital invested, Loan from bank, Sale proceed of fixed assets etc. Capital receipts are shown on the liability side of the balance sheet.

Revenue Receipts:-

Receipts which are recurring by nature and which are available for meeting all day to day expenses of a business concern are known as 'Revenue Receipts'. For example, sale proceeds of goods, interest received, rent received etc.

Lesson-22

BANK RECONCILIATION STATEMENTS

Bank statement:-

It is the detail of transactions in one's account provided by the bank.

Unpresented Cheques:-

a cheque is issued but it has not been presented

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in the account, such kind of cheques are called Un-presented Cheques.

Un-Credited Cheques:-

a cheque that has not been cleared in the bank
account as yet.

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