Assignment

Financial Accounting

Program

MBA (Non Business)

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Q: 1 Explain accounting cycle step by step, also produce the diagram.

What is the accounting cycle?

The accounting cycle (also commonly referred to as a “bookkeeping cycle”) is a multi-step process of recording and processing all business transactions of a company and converting them into useful financial statements. An accounting cycle starts with the recording of individual transactions and ends with the preparation of financial statements and closing entries.

One of the main responsibilities of a bookkeeper is to keep track of the full accounting cycle from start to finish. The term “cycle” indicates that these procedures must be repeated continuously to enable the business to prepare new up-to-date financial statements at reasonable reporting intervals.

Companies can prepare their financial statements on a quarterly or annual basis. Companies doing it quarterly will have an accounting cycle of three months while the annual companies will have a one-year accounting cycle.

Understanding the accounting cycle

The accounting cycle can be simplified into an eight-step process for completing a company’s bookkeeping tasks. It provides a comprehensive guideline for recording, analyzing and reporting a business’ financial activities.

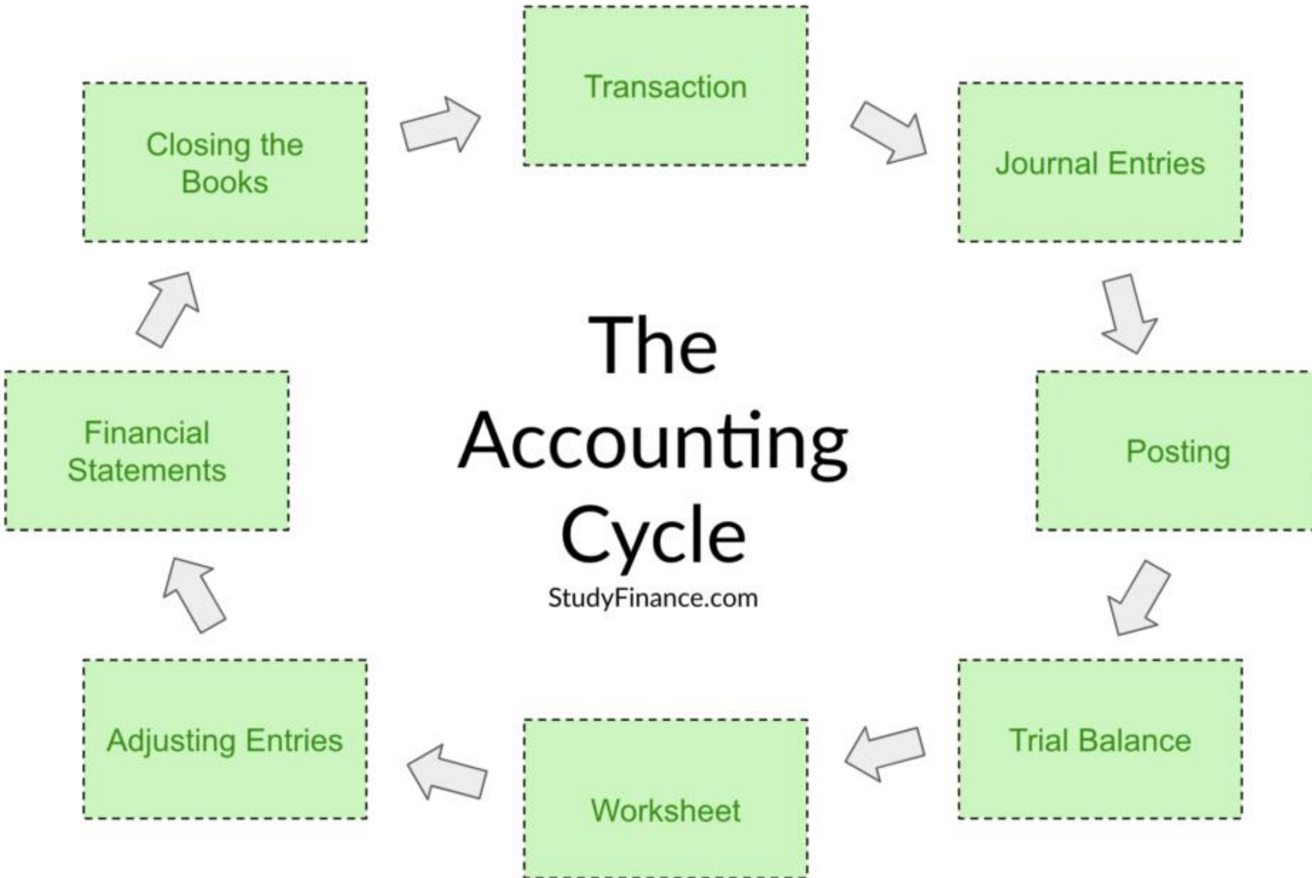
The sequential process of the accounting cycle ensures that the financial statements a company produces are consistent, accurate and conform to official accounting standards (such as IFRS or GAAP).

It also ensures that all the money passing through the business is properly documented and “accounted” for.

Many companies have these steps automated through accounting software and the use of technology. Depending on the system capabilities, a bookkeeper might be needed to intervene at some stages. Therefore, it is important for them to understand the steps involved in the overall process to better tackle any situation they might be faced with.

The 8-step process

Below are the major steps involved in the accounting cycle



Step 1: Identifying transactions

An accounting cycle starts when a business transaction takes place. If there are no transactions, there won't be anything to keep track of. Companies will have many transactions throughout their accounting cycle. The nature of transactions may include sales, purchase of raw materials, debt payoff, acquisition of an asset, payment of any expenses etc.

Recordkeeping of these transactions is essential so that they can be reflected in the final presentation in the form of financial statements. To make record keeping easier, companies will link their books to point of sale systems to collect sales data. Besides revenue, companies will also record expenses which may be of varying nature such as rent, wages, fuel, transportation costs, etc.

Step 2: Record transactions in a journal

The second step in the cycle is to create journal entries for each transaction in chronological order. Point of sale technology can assist in combining steps 1 and 2, but companies might still have to track items like expenses separately.

The bookkeeper will have a choice between cash accounting and accrual accounting depending on his company's requirements. This choice will determine when the transactions are officially recorded.

In cash accounting, transactions are recorded based on when cash is paid or received.

Accrual accounting, on the other hand, requires that revenues are matched with related expenses so that both are recorded at the time of sale.

The objective behind the matching concept is to prevent misstating the earnings. For example, if company XYZ records a sale of a product in a certain period but fails to record the expenses that related to that sale in the same period, the company will be overstating its profits for that period.

Transactions can also be recorded using single-entry accounting or double-entry accounting. Double-entry bookkeeping requires creating two entries (debit and credit entry) in order to arrive at a fully developed income statement, balance sheet and cash flow statement. A single-entry system is comparable to managing a cheque book as it only reports balances as positive and negative and does not require multiple entries.

Step 3: Posting to the general ledger

Transactions once recorded are then posted to individual accounts in the general ledger. The general ledger gives a breakup of all accounting activities by account. This gives the bookkeeper the ability to monitor balances and positions by account. An example of an account in the general ledger is the cash account which shows the total inflows and outflows relating to that account during an accounting period.

Step 4: Unadjusted trial balance

Preparing an unadjusted trial balance is the next step of the accounting cycle in which a total balance is calculated for all the individual accounts.

Step 5: Worksheets

Evaluating a worksheet and identifying adjusting entries is the fifth step of the process. A worksheet is prepared to ensure that debits and credits are equal to each other. Adjustments can be made to fix any errors.

In addition to fixing errors, adjusting entries might also be needed to incorporate revenue and expense matching principle when using accrual accounting.

Step 6: Adjusting entries

At the end of the accounting period, adjusting entries must be posted to account for accruals and deferrals. Their main objective is to match incomes and expenses to the relevant accounting periods.

Adjusting entries can be one of the following types:

1. Accruals: These include revenues that have occurred, but the company has neither received nor recorded them yet. Expenses that relate to those revenues but have not been paid or recorded yet would also fall into this category. For example, interest expense due on a loan for the current period but not yet paid.
2. Prepayments: These include revenues that have been collected in advance and will be recorded as liabilities. They also include expenses that have been paid in advance and will be recorded as assets. Examples include prepaid insurance, office supplies, adjustments to unearned revenue, prepaid rent, etc.
3. Non-cash: These adjusting entries include recording non-cash items such as depreciation expense, bad debts, etc.

Step 7: Financial statements

After making the adjustment entries, a company will generate its financial statements as the next step. The most common financial statements include an income statement, balance sheet, cash flow statement and statement of shareholder’s equity.
Financial statements can be used to understand what the business is worth and how it got there. It will highlight and narrow down key areas or problems which the decision-makers can then use to make key decisions related to strategy, profitability, leveraging or deleveraging, cost-cutting, expansions etc.

Step 8: Closing temporary accounts via closing entries

A company ends the accounting cycle by closing its books on a specified closing date. Since the revenue and expense accounts are temporary accounts that show position for a certain period, therefore they are closed and zeroed out at the end of the accounting cycle. Balance sheet accounts are not temporary and therefore they are carried forward in the next accounting cycle.

Q:2 Explain the major components/ elements of in Balance Sheet:-

- Assets
- Liabilities
- Owner's (Stockholders') Equity

Following are the components of Balance sheet

Assets

Assets are resources as a result of past events and from which future economic benefits are expected to flow to the enterprise.

Anything tangible or intangible that can be owned to produce positive economic value is considered an asset. Examples are cash, inventory, machinery, etc.

Assets are recorded on the balance sheet. The accounting equation relating assets, liabilities, and owners' equity is: Assets = Liabilities + Owners' Equity.

Tangible assets are actual physical assets, and include both current and fixed assets. Examples are inventory, buildings, and equipment.

Intangible assets are nonphysical resources which give the firm an advantage in the marketplace. Examples are copyrights, computer programs, financial assets, and goodwill.

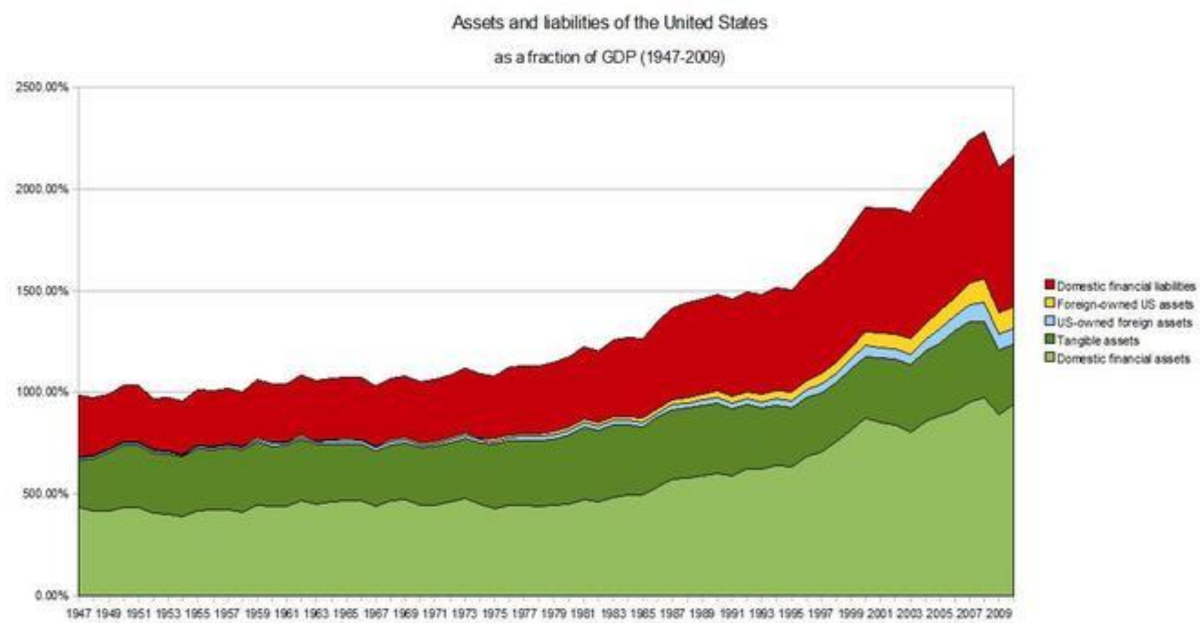
In financial accounting, assets are economic resources. Anything tangible or intangible that is capable of being owned or controlled to produce value and that is held to have positive economic value is considered an asset.

Simply stated, assets represent ownership of value that can be converted into cash (although cash itself is also considered an asset). The balance sheet of a firm records the monetary value of the assets owned by the firm. It is money and other valuables belonging to an individual or business. Two major classes are tangible assets and intangible assets.

Comparison : current assets , liquid assets and absolute liquid assets

Current assets	Liquid assets	Absolute liquid assets
Stocks		
Prepaid expenses		
Debtors	Debtors	
Bills receivable	Bills receivable	
Cash in hand	Cash in hand	Cash in hand
Cash at bank	Cash at bank	Cash at bank
Accrued incomes	Accrued incomes	Accrued incomes
Loans and advances (short term)	Loans and advances (short term)	Loans and advances (short term)
Trade investments (short term)	Trade investments (short term)	Trade investments (short term)

Comparison of Various types of Assets: Current assets vs. liquid assets vs. absolute liquid assets.



Assets and Liabilities of the US: Assets and liabilities of the US as a fraction of the GDP 1945-2009.

Tangible assets contain various subclasses, including current and fixed assets. Current assets include inventory, while fixed assets include such items as buildings and equipment.

Intangible assets are nonphysical resources and rights that have a value to the firm because they give the firm some kind of advantage in the market place. Examples of intangible assets are goodwill, copyrights, trademarks, patents, computer programs, and financial assets, including such items as accounts receivable, bonds and stocks.

The accounting equation relates assets, liabilities, and owner's equity:

Assets = Liabilities + Stockholders ' Equity (Owners' Equity)

That is, the total value of a firm's assets are always equal to the combined value of its "equity" and "liabilities. " In other words, the accounting equation is the mathematical structure of the balance sheet.

Probably the most accepted accounting definition of asset is the one used by the International Accounting Standards Board. The following is a quotation from the IFRS Framework:

"An asset is a resource controlled by the enterprise as a result of past events and from which future economic benefits are expected to flow to the enterprise. "

Liabilities

A "liability" is an obligation of an entity, the settlement of which may result in the yielding of economic benefits in future.

Liabilities in financial accounting need not be legally enforceable, but can be based on equitable obligations or constructive obligations.

Liabilities on the balance sheet are split into two categories: current liabilities, and long-term liabilities.

Current liabilities are those expected to be liquidated within a year.

Long-term liabilities are those which will not be liquidated in the coming year.

liabilities: An amount of money in a company that is owed to someone and has to be paid in the future, such as tax, debt, interest, and mortgage payments.

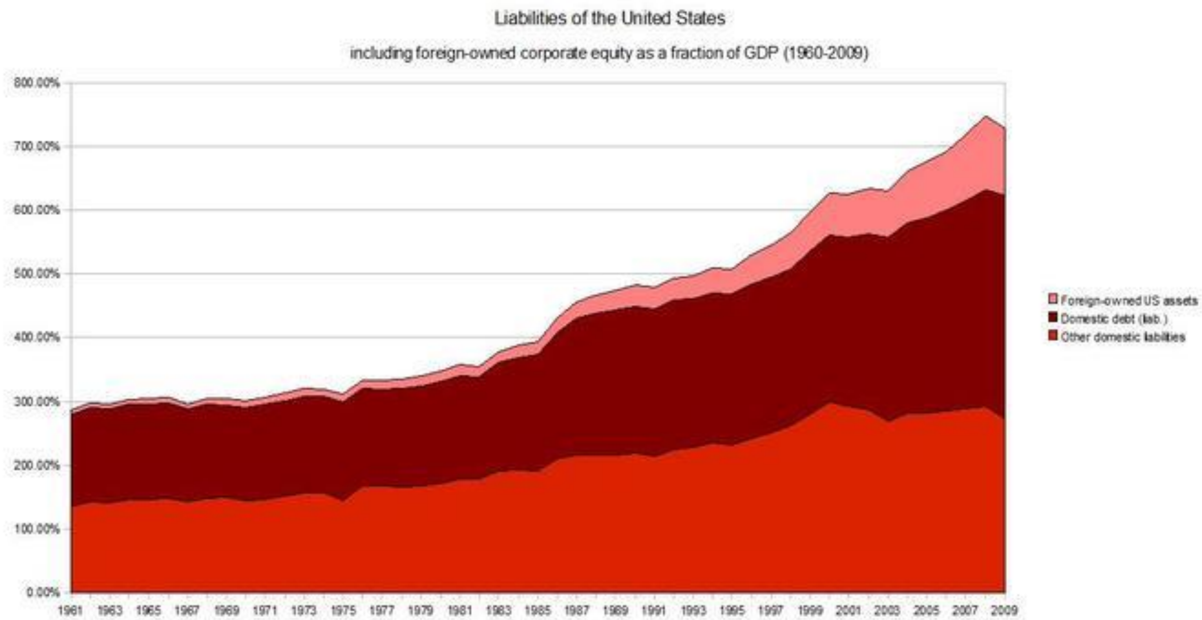
current liabilities: In accounting, current liabilities are often understood as all liabilities of the business that are to be settled in cash within the fiscal year, or the operating cycle of a given firm, whichever period is longer.

In financial accounting, a liability is defined as an obligation of an entity arising from past transactions or events, the settlement of which may result in the transfer or use of assets, provision of services or other yielding of economic benefits in the future. A liability is defined by the following characteristics:

- Any type of borrowing from persons or banks for improving a business or personal income that is payable during short or long time
- A duty or responsibility to others that entails settlement by future transfer or use of assets, provision of services, or other transaction yielding an economic benefit, at a specified or determinable date, on occurrence of a specified event, or on demand
- A duty or responsibility that obligates the entity to another, leaving it little or no discretion to avoid settlement
- A transaction or event obligating the entity that has already occurred

Liabilities in financial accounting need not be legally enforceable, but can be based on equitable obligations or constructive obligations. An equitable obligation is a duty based on ethical or moral considerations. A constructive obligation is an obligation that is implied by a set of circumstances in a particular situation, as opposed to a contractually based obligation. Examples of types of liabilities include money owing on a loan, money owing on a mortgage, or an IOU. Liabilities are debts and obligations of the business they represent that creditors claim on business assets. Liabilities are reported on a balance sheet and are usually divided into two categories:

- Current liabilities: these liabilities are reasonably expected to be liquidated within a year. They usually include payables such as wages, accounts, taxes, and accounts payables, unearned revenue when adjusting entries, portions of long-term bonds to be paid this year, short-term obligations (e.g., from purchase of equipment).
- Long-term liabilities: these liabilities are reasonably expected not to be liquidated within a year. They usually include issued long-term bonds, notes payables, long-term leases, pension obligations, and long-term product warranties.



Owners' Equity

Shareholders' equity is the difference between total assets and total liabilities.

Define owners' equity

Shareholders ' equity tells you the "book value", i.e., what is left over for shareholders after the company has paid off all its debt.

Shareholders' Equity = Total Assets – Total Liabilities.

If liabilities exceed assets, then negative equity exists.

Ownership equity may include both tangibles and intangibles, such as intellectual property or goodwill.

shareholders' equity: The remaining interest in assets of a company, spread among individual shareholders of common or preferred stock.

owners' equity: the remaining interest in all assets after all liabilities are paid

equity financing: funding obtained through the sale of ownership interests in the company

capital surplus: A balance sheet item under shareholders' equity. Increases by the value above an original par value per share that newly-issued shares are sold for.

In accounting and finance, equity is the residual claim or interest of the most junior class of investors in assets, after all liabilities are paid. If liability exceeds assets, negative equity exists.

In an accounting context, shareholders' equity (or stockholders ' equity, shareholders' funds, shareholders' capital or similar terms) represents the remaining interest in assets of a company, spread among individual shareholders of common or preferred stock.

At the start of a business, owners put some funding into the business to finance operations. This creates a liability on the business in the shape of capital as the business is a separate entity from its owners. Businesses can be considered, for accounting purposes, sums of liabilities and assets. After liabilities have been accounted for, the positive remainder is deemed the owners' interest in the business.

This definition is helpful in understanding the liquidation process in case of bankruptcy. At first, all the secured creditors are paid against proceeds from assets. Afterward, a series of creditors, ranked in priority sequence, have the next claim/right on the residual proceeds. Ownership equity is the last or residual claim against assets, settled only after all other creditors are paid. In such cases where even creditors could not get enough money to pay their bills, nothing is left over to reimburse owners' equity; which is thus reduced to zero. Ownership equity is also known as risk capital or liable capital.

In financial accounting, equity capital is the owners' interest on the assets of the enterprise after deducting all its liabilities. It appears on the balance sheet/statement of financial position, one of the four primary financial statements. Ownership equity includes both tangible and intangible items (such as brand names and reputation/goodwill). Accounts listed under ownership equity include (for example):

Share capital (common stock)

Preferred stock

Capital surplus

Retained earnings

Treasury stock

Stock options

Reserve

[edit]

Sample Small Business Balance Sheet[10]

Assets		Liabilities and Owners' Equity	
Cash	$6,600	**Liabilities**	
Accounts Receivable	$6,200	Notes Payable $30,000	
Tools and equipment	$25,000	Accounts Payable	
		Total liabilities	$30,000
		Owners' equity	
		Capital Stock $7,000	
		Retained Earnings $800	
		Total owners' equity	$7,800
Total	$37,800	*Total*	$37,800

Q: 3. Define and explain different type of cash book.

Cash Book

Definition: A cash book is that unique book of accounts which fulfils the objective of both, a journal and a ledger. Like a journal, it is the first book which records all the cash transactions of the business. It also acts as a subsidiary book to post all the cash transactions, similar to a cash account in the ledger.

It can be broken down into two words, i.e., 'cash' and 'book'. *Cash* is a real monetary instrument like currency, i.e., coins or notes used as a medium of exchange for acquiring goods and services. *Book* refers to a compiled record of the information available in the written or printed form.

Thus, we can say that cash book is the record of all the business transactions in the form of notes or coins, taken place in a particular period.

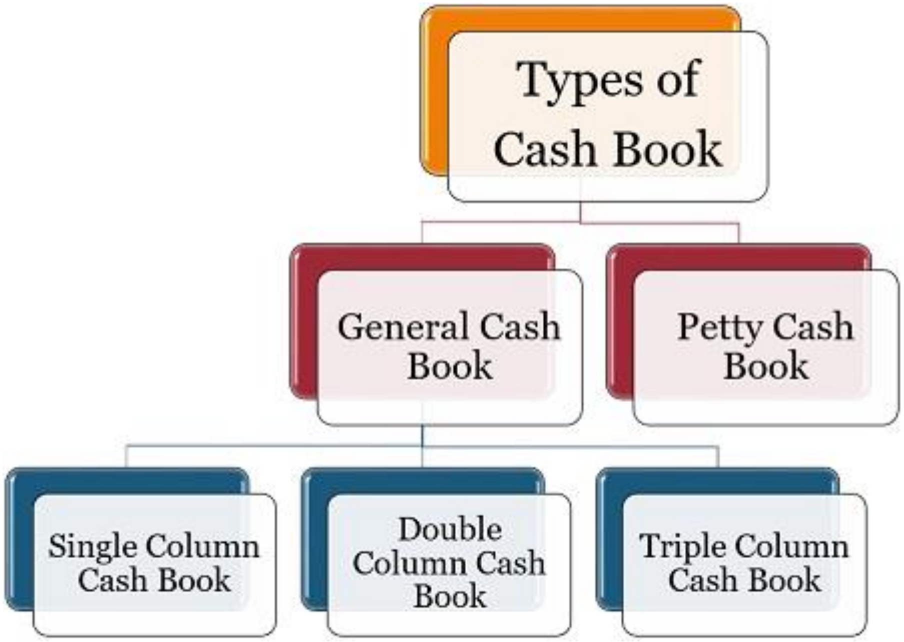
A cash book excludes the following type of transactions:

- **Payments received or made through cheques**: All the bank related transactions and exchange of cheques for making or receiving payments.
- **All non-cash transactions**: Any business transaction taking place in kind or for which the payment is due.

- **Discount received or given**: Any discount received on making purchases or discount allowed on carrying out sales of goods or services.

Types of Cash Book

A cash book varies based on its complexity and the needs and requirements of the business. Following are the two major categories into which a cash book can be bifurcated:



General Cash Book

The cash book, which serves as a journal for the first recording of the cash transactions and also replaces the cash account in a ledger, is called a general cash book.

It is further subdivided into three different categories:

- **Single Column Cash Book**: A single column or simple cash book is that type of cash book which is used to note down only the cash transactions.
- **Double Column Cash Book**: A double column cash book records two types of transactions under two separate columns. Here, one is compulsorily cash column, and the other can be either a discount column or a bank column.
- **Triple Column Cash Book**: This type of cash book records transactions related to three different types of accounts, i.e., cash, bank and discount. Thus, it substitutes the creation of cash account, bank account, discount received and discount allowed in the ledger.

Petty Cash Book

The small cash transactions taking place a significant number of times daily if recorded in a general cash book may make it bulky and difficult to handle.

Therefore such numerous business operations involving a minimal amount of transactions can be written down in a separate book called a petty cash book and the person responsible for maintaining it, is called a petty cashier.

Cash Book Format

Now that we know about the different kinds of cash book, we should go through the different formats of each of these types below:

Single Column Cash Book or Simple Cash Book Format

A simple column cash book purely records cash transactions and is a substitute for cash related journal entries and cash account.

Following is the format depicting a single column cash book:

Dr. **Format of a Single Column or Simple Cash Book** *Cr.*

Date	Particulars	V. No.	L.F.	Amount	Date	Particulars	V. No.	L.F.	Amount

Double Column Cash Book Format

A dual column cash book can be of two types, the one which has cash and discount columns and the other which has cash and bank columns. However, double column cash book (with the discount column) is widely used.

Given below is the format of a double column cash book (with the discount column):

Dr. **Format of a Double Column Cash Book (with Discount)** *Cr.*

Date	Particulars	V. No.	L.F.	Discount	Cash	Date	Particulars	V. No.	L.F.	Discount	Cash

Triple Column Cash Book Format

The triple column cash book is a compact form of cash book in which all the three columns, i.e., cash, bank and discount, are included. Here all the cash and bank-related transactions are recorded along with the discount on sales or purchase of goods.

The format of a triple column cash book is given below:

Dr. **Format of a Triple Column Cash Book** Cr.

Date	Particulars	V. No.	L.F.	Discount	Cash	Bank	Date	Particulars	V. No.	L.F.	Discount	Cash	Bank

Petty Cash Book Format

A petty cash book records small cash transactions in separate accounts.

To get a clear picture of how it looks, go through the following format:

Petty Cash Book

Cash Received	C.B. Folio	Date	Particulars	V. No	Total Payment	Postage & Stamp	Cartage	Stationery	Travelling Expense	Misc. Expenses

The elements of a cash book can be understood as follows:

Date: The date of each transaction is recorded in this column. On the top of the column, the year is noted down. This is to avoid repetitive entry (below the year, the month can be written to simplify the work further). The day of a particular is written in front of the related transaction.

Particulars: In the particulars column of a cash book, the second account involved in a transaction other cash, is mentioned. It is preceded by a 'By' when the particular account is debited and 'To' if it is credited.

V.No. (Voucher Number): While receiving any payment in cash from the debtor or customer, the company issues a cash receipt or memo or receipt voucher. This voucher number is recorded in front of the particular transaction under the V.No. Column.
Similarly, while making a cash payment for any expense or purchase, the company receives a cash memo known as payment voucher, which is recorded under the V.No. Column, in front of the related transaction.

L.F. (Ledger Folio Number): The second account or the account which is opposite to the cash account in a particular transaction, has its separate ledger account.
Thus, the page number of the ledger where the given transaction is recorded in the respective second account, is written under the L.F. in front of that transaction.

Amount: In a simple cash book, there are two amount columns. One is on the debit side to record all the cash receiving and the other on the credit side to record all the cash payments.

Cash: The cash columns replace the amount columns in the double column and triple column cash books. In which again, the cash column on the left side is used to enter all the cash receiving. Whereas the credit side cash column notes down all the cash payments.

Bank: Payments made or received through cheques or any other bank transaction is recorded either in a double column cash book (with bank column) or a triple column cash book. It is a replacement of a bank account made in ledger.

Discount: The discount received while making payment for purchases and the discount allowed to customers while collecting the amount of sales are written down under the respective discount column (i.e., discount received on debit side discount column and discount allowed on credit side discount column), in the double column cash book or triple column cash book.

Q: 4 Define and explain different type of shares.

The Definition of a Share

The definition of a share includes the capital or stock of a company. Each business has a share capital requirement. A share is a single unit within the entire capital of the company.

A share is also a type of security. It is often measured by its liability and interest. Members that own shares of a company are referred to as shareholders. They are investors that have invested funds into the business. In return, they will receive dividends on the profits of the business.

Types of Shares

There are also different types of shares available within a company:

- **Preference shares:** Preference shares have preferential rights to dividends if a business closes. Preference shares do not have voting rights available, except in specific situations.
- **Equity shares:** Equity shares do not have preferential rights. Instead, they receive payment from dividends and repayment of capital after preference shares' claims were settled. The specific rate of return is decided by the board members and directors. Equity shares are often used to raise money for the company and are referred to as the owner's funds. It is possible that an equity share will not pay any dividends if the business does not profit. While preference shareholders get a fixed rate, equity shareholders may receive varying payments each year. Equity shareholders are often owners of the company and have regular voting rights available. They may also be subject to things like deferred shares or founder's shares.
- **Cumulative preference share:** A cumulative preference shareholder does not receive payment when a profit is not made. However, cumulative shares may be paid through unpaid dividends. A cumulative preference shareholder is only paid after other

shareholders have been paid. If no funds remain, then they will not receive a payment that year.

- **Non-cumulative preference shares:** Non-cumulative preference shareholders have preferential shareholder rights and receive a fixed dividend payment. However, they are only paid if profits remain. If no profits left, the owed amount is not carried over to the following years.
- **Redeemable preference shares**: Any capital collected from selling shares is not paid to a shareholder. But, any capital raised through preference shares can be paid to the shareholder at the end of the period. There may be time limits on these redeemable shares, which sometimes exceed 10 years or more.
- **Participating/Non-participating preference shares:** These shares are paid through a combination of profits and fixed rates. Once all profits have been paid to shareholders, any extra money is divided equally among these shareholders.
- **Convertible preference shares:** Convertible preference shares can be converted into equity shares at a present time. All conversions must be approved based on the regulations set in the company Articles of Incorporation.