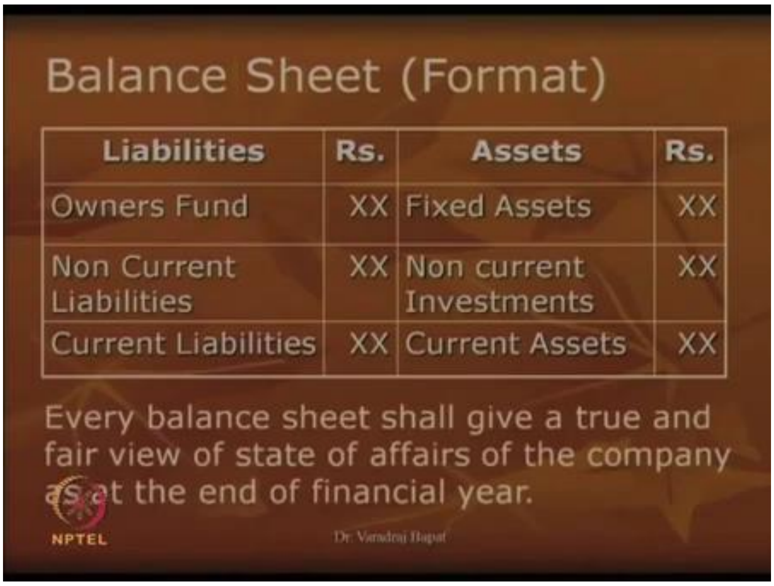
Managerial Accounting
Prof. Dr. Varadraj Bapat
Department of School of Management
Indian Institute of Technology, Bombay

Lecture - 4
Balance Sheet

Hello everyone, let us start with our third session of Management Accounting. If you remember in our first two sessions, we have seen what is management accounting? Why should we learn it? After that, we have gone into financial statements to understand broadly, what is a financial statement? What are the major statements? And in that, we were learning balance sheet into the depth. To have a brief recap, let us look at the balance sheet format for once. As you know balance sheet is basically a statement, which shows the financial position as on a particular day.

(Refer Slide Time: 00:55)



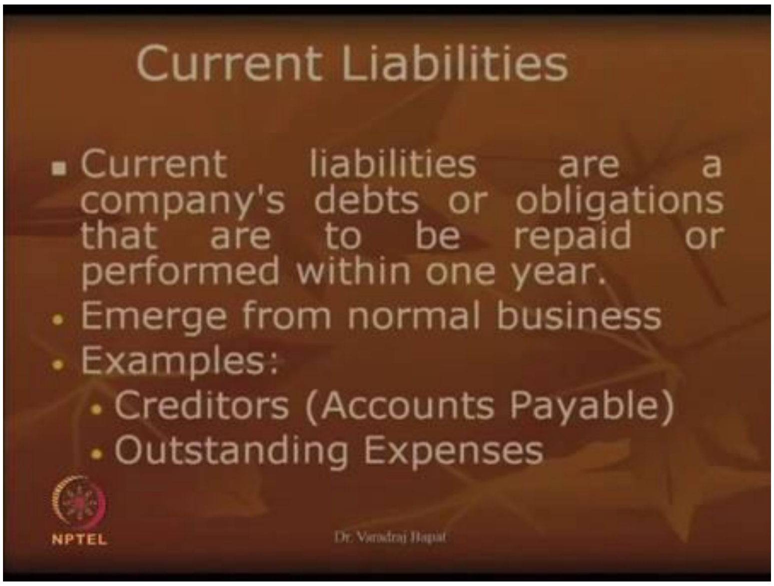
So, it has two sides. One is liabilities, other is assets. Asset represents, the resources of the organization. And they could be broadly categorized into fixed assets, non-current investments and current assets. Fixed assets are the assets, which are for long term use of the organization. Noncurrent investment is basically, money put outside our regular business. Current assets represents the day to day trading assets.

They arise from the normal operating activities of the business. On liability side, the first item as you can see is owners fund. As the name tells you, this is the money which owners have put in. In the form of capital plus, the profit which is accumulated by the business. Second item is noncurrent liabilities. Noncurrent liabilities represent the loans, which are taken for a long term for the activities of the business.

Current liabilities are the items, which arise from day to day business activities. Like, outstanding salary or outstanding electricity bill and so on. We have also dealt with some of the items, in little more elaboration. We will go in now from starting from current liabilities. As you can see here, we had seen this format as per company law.

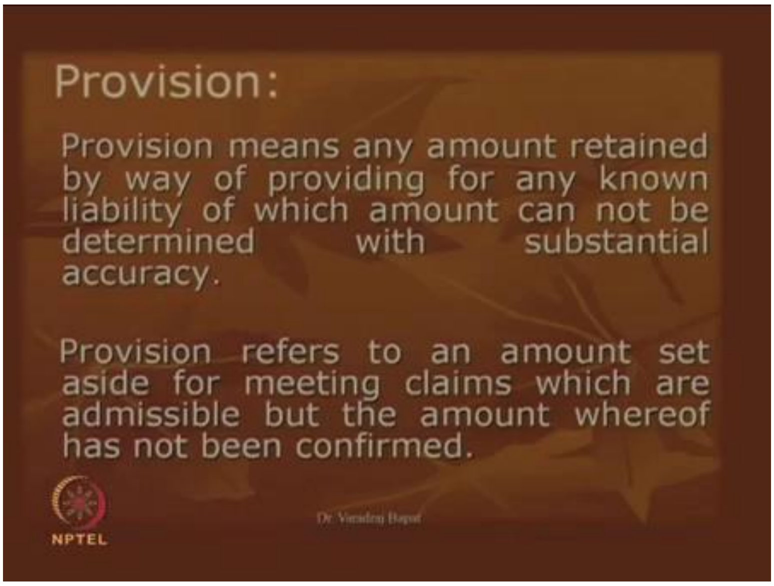
I will not go into format now. After format, we have seen what is assets in little more in depth. The types of assets tangible, intangible, then current assets which can be divided into monetary, non monetary. Then, we have seen what is a liability, long term liabilities, current liabilities. Up to this, we have covered.

(Refer Slide Time: 02:53)



So, as you can see here, current liability has two prominent examples. One is creditors, other is outstanding expenses.

(Refer Slide Time: 03:08)



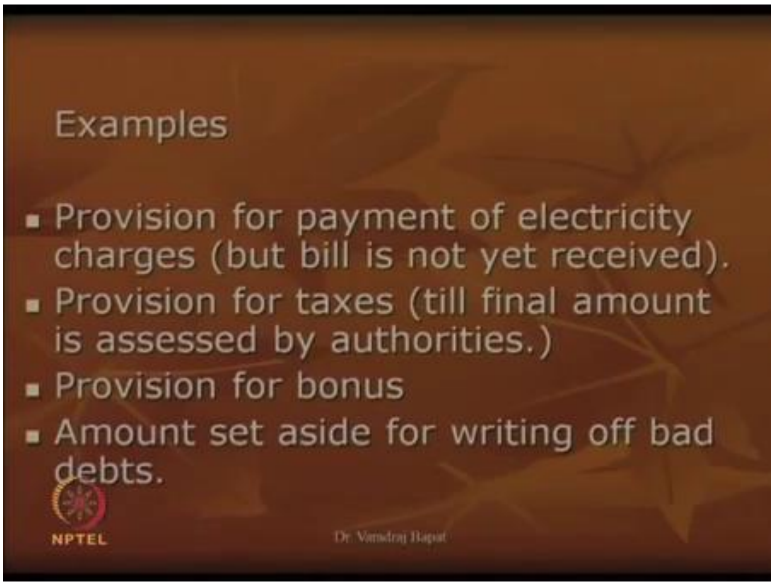
Now, let us go into another type of current liability, that is known as provision. Now, provision is a liability where the amount of it, is not substantially defined with proper accuracy. For example, let us assume that we pay electricity bill every month. Now, we are making balance sheet as on 31st March. But, as on 31st March we have not yet received the electricity bill for the month of March. But, we know that, since we are consuming electricity, we have to pay something. But, we do not know the amount.

So, what we may do is, we will take the average for last 11 months. And we may make a provision for the month of March. Now, here the term provision is used because, I still do not know exactly the amount of bill of electricity, which will come for the month of March. But, based on the estimate I am trying to make some provision. In a sense, I am trying to show some liability in the balance sheet.

One more example also can be, in case of payment of taxes. Now, what happens is, the taxes are always paid by the SSC. That is, by the company on the basis of their estimates. But, the final amount of tax payable is decided by the government authorities. Hence, the tax which we calculate and for which we assume, that is our liability is known as provision for tax.

Ultimate decision will come, when the government authorities will take a call and make what is known as an assessment. So, government officer will say that, this is the amount of tax which you are supposed to pay. Then, it will get converted into current liability. As long as that, it does not happen. We call it a provision.

(Refer Slide Time: 05:09)



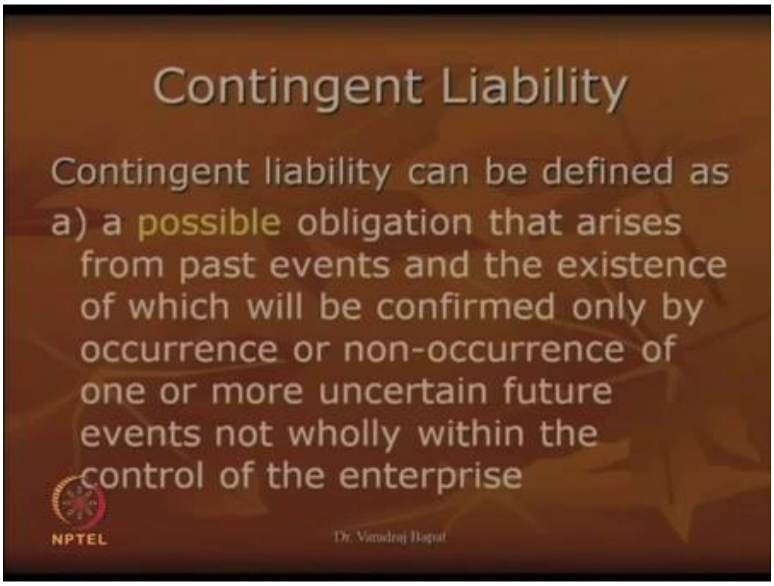
So, here you can see some of the examples. So, one example is payment of electricity bills, second is provision for tax, third is payment of provision for bonus. Now, in case of bonus or incentive, again what happens is, as at the end of the year, company is not sure how much is the incentive payable. As for as salary is concerned, we know how much is salary payable? So, salary which is not paid is categorized as, outstanding salary.

And it is shown as the current liability. But, the amount of provision is required to be made for incentive or bonus, which may be paid. So, based on the estimates some incentive or bonus is provided. Here, again we use the term provision. We can also see the fourth item that is amount, which is set aside for writing off bad debts. In case of bad debts, what happens is? When we sale the goods on credit, we assume that customers will pay.

At the same time, we know that one or two percent of the customers, may not pay us. For that one or two percent, we make a provision for doubtful debts or provision for bad debts. I think, the concept of provision is now cleared to you. Now, let us go to next liability, which is known as contingent liability. In case of contingent liability, what happens is? We do not know, whether the liability will arise or not arise.

So, it is not a liability in true sense. At the same time, there is a possibility that liability may arise. So, it is known as contingent liability.

(Refer Slide Time: 06:58)

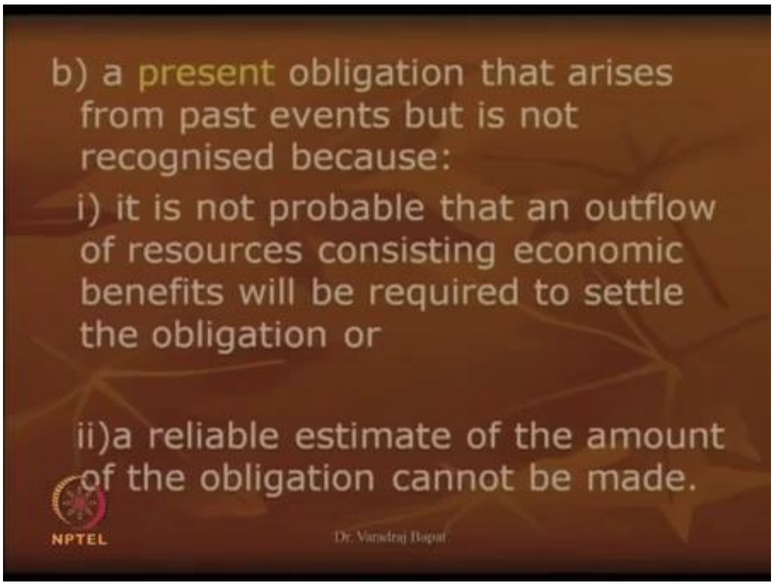


Can you think of an example, of a contingent liability? If you give a little bit thought, you will realize that suppose, we provide some service to the customer. Customer is not happy with our service. So, customer files suit against us, to claim the damages. On our part, we feel that we will win the case. And we will do not have to pay any damages. But, there is a possibility that by chance, if customer wins we will have to pay some compensation.

So, this is a case where a contingent liability will be recorded. As you can see here, there is no actual liability which we accept and which has actually realized. So, we do not show contingent liability in the balance sheet. However, we have to show contingent liability, as a foot note to the balance sheet. So, just below the balance sheet, we will make a mention, that there is a possibility that liability may become payable, which is known as a contingent liability.

Let us look at, some of the definitions of contingent liability. As first, you can see it is a possible obligation, which may arise from the past events. But, it depends on future uncertain event.

(Refer Slide Time: 08:26)



B, you can see here. It is a present obligation that arises, from the past events. But, it is not recognized. Because, it is not probable that outflow is enforced. Now, a reliable estimate of the amount also cannot be made. That is also one of the reasons that, we are not able to make any specific calculation for contingent liability. Now, it is required that company must give the best possible estimate. I would also like to give, one more example.

One example we can see is, we have already discussed is customer filing a suit against us, for recovery of some amount. Another example I can give you is, suppose I have a friend. My friend wants to have, go for a housing loan. So, he approaches me, to be the guarantor of his housing loan. And I agree and I sign the bank loan papers, as a guarantor. Now, do I have any liability or any obligation?

Since loan, I have not taken the loan. My friend has taken the loan. Basically, I do not have any liability to repay the loan. At the same time what happens is, though I do not have any liability to repay the loan. If at all my friend defaults, then bank will come to me and from me, recover the amount. So, there is a possibility that, liability may arise. So, this is a situation of contingent liability. So, if my friend defaults, I may have to pay the part of the loan, which is unpaid.

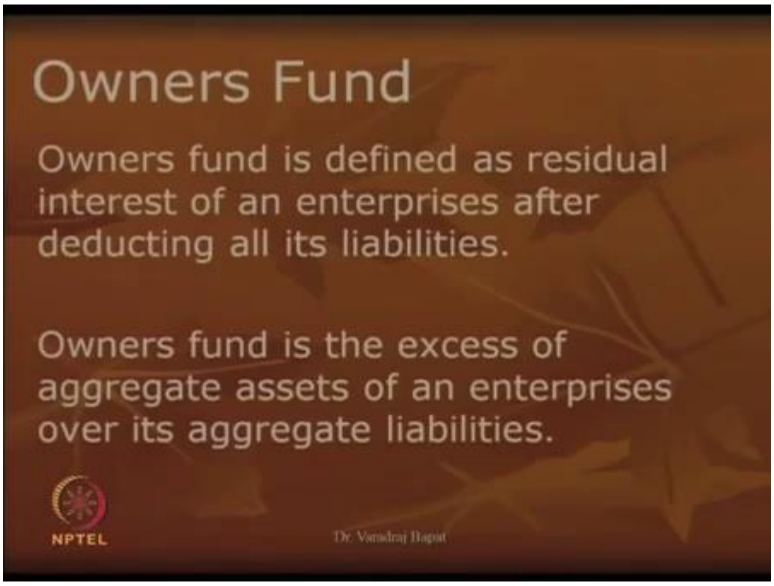
So, such liabilities are shown by way of foot note. And they are known as contingent liabilities. So, to make a comparison, let us understand the three terms once again.

Suppose, we have hired an employee but, we do not pay the salary at the end of the month. This is a case of outstanding salary. So, it is a current liability. Second case, we have an employee. However, we do not know how much bonus will pay at the end of the year.

But, some bonus may be payable. So, we will make a provision for bonus. So, this is a second case. It is a provision. Both, contingent liability and provision will be shown in the balance sheet. Third case, suppose we remain guarantor for the employees loan, so it is not our liability. However, if employee defaults, we will have to pay. So, this is a case of contingent liability. I hope, all the three types are clear to you.

Contingent liabilities are not shown in the balance sheet. They are shown as a foot note to the balance sheet. Now, let us go to the next type that is, owner's fund. As we know, we have basically two types of funds or two types of resources, from which the money may come. The first is from outsiders that is, known as long term loans. The second one is the owner's fund. So, this is the money which company or the organization has to pay back to the owners. That is known as owner's fund.

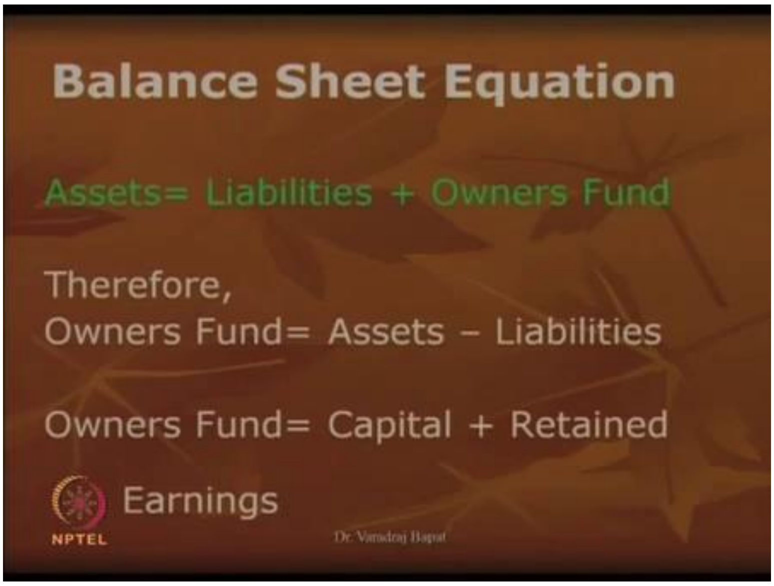
(Refer Slide Time: 11:59)



Owners fund: it is also can be understood as an excess of aggregate assets of an enterprise, over it is aggregate liabilities. So, if you take all assets. Reduce all liabilities, something extra will remain. That something extra is nothing but, the owners fund. Now, from the balance sheet items, if you look at owners fund, it will consist of two things. One the money, which owners has put into business. That is known as capital.

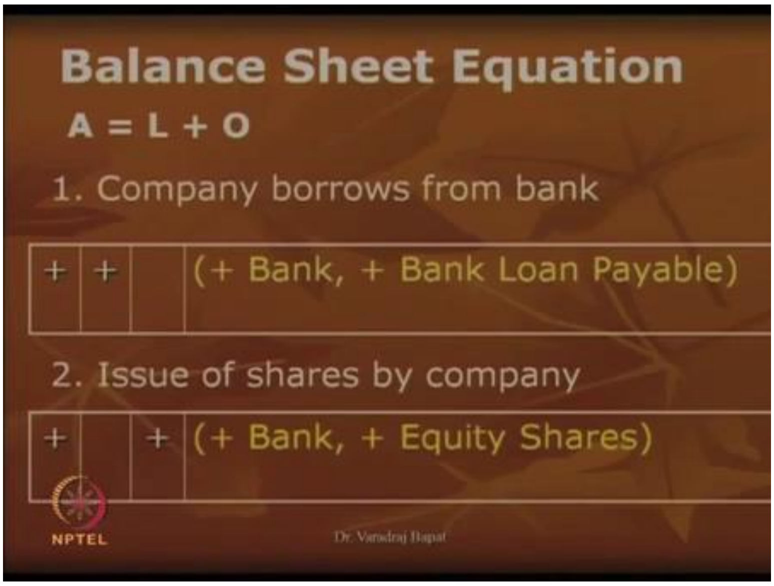
The second is profit, which is generated by the business. It belongs to the owners. So, if it is paid back, then no problem. But, if it is not paid back, it will have to be paid in future. It is known as reserves. So, owner fund consist of capital plus reserves. Let us go to the next thing, now. You can write this balance sheet, in the form of balance sheet equation. So, as you know there are two sides. One is assets, other is liabilities and owners fund. And assets should always match, the sum of liabilities plus owners fund.

(Refer Slide Time: 13:09)



So, equation becomes assets equal to liability plus owner fund. You can also say, owner fund is assets minus liabilities. As we have seen just now, owners fund is also capital plus retained earnings.

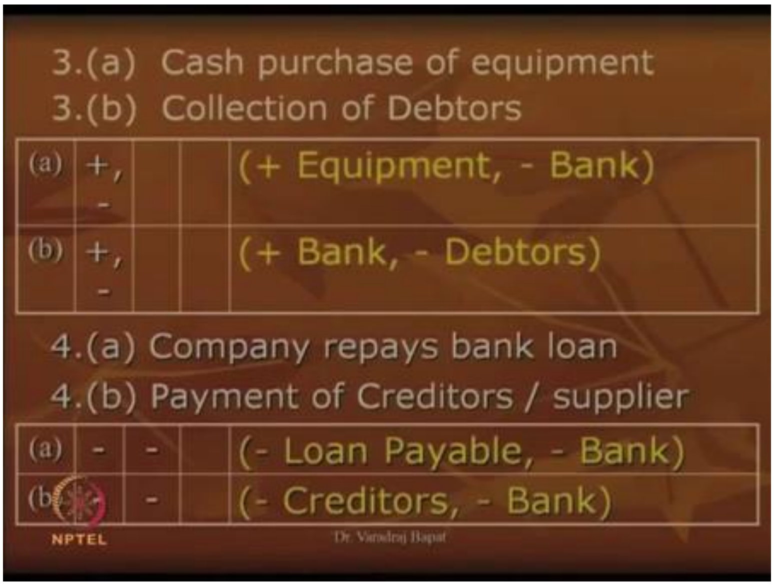
(Refer Slide Time: 13:28)



Now, let us try to see some of the transactions, in terms of balance sheet equation. Now, the 1st transaction which you can see is? Company borrows from bank. Now, if company borrows from bank, the bank loan will increase and bank loan payable will also increase. 2nd is issue of shares by the company. Now, give a thought, as how will it affect the balance sheet equation? Now, if company has issued shares, capital will increase.

In other words, owners fund will increase and company will get money. So, cash will increase, assets will increase. As you can see here, so it is plus in bank plus in equity shares. In other words, plus in A and plus in O.

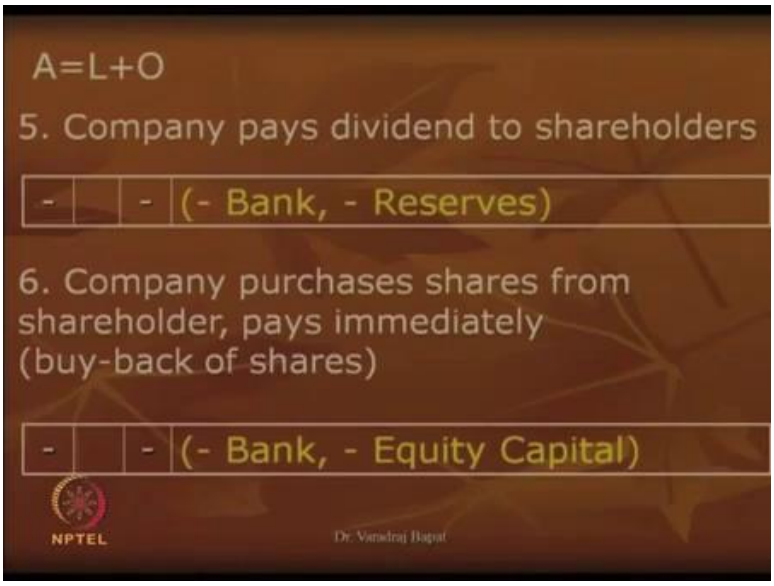
(Refer Slide Time: 14:26)



Now, let us think the 3rd case. 3rd case is cash purchase of equipment or you can also see it as, collection of debtors. Now, what will happen here is, I get equipment but, I give cash. Or I have some outstanding dues from customers. So, customer balance is go down, I get cash. So, in both the cases, it is more like an exchange of cash. So, what will happen is, equipment balance increasing, cash balance or bank balance decreasing.

Or 2nd case 3 b, bank will increase debtors will decrease. In both the cases, it is plus and minus in assets. Now, let us go to the 4th one. Now, in 4th what happens is? Company repays the bank loan or creditors are paid back. Now, in both the cases what is happening is? As you can see here, loans payable reduce and bank balance reduces. Or creditors reduce, bank balance reduce. So, assets are going down, liabilities are also going down. So, you can see in the chart. A is also minus, L is also minus.

(Refer Slide Time: 15:49)



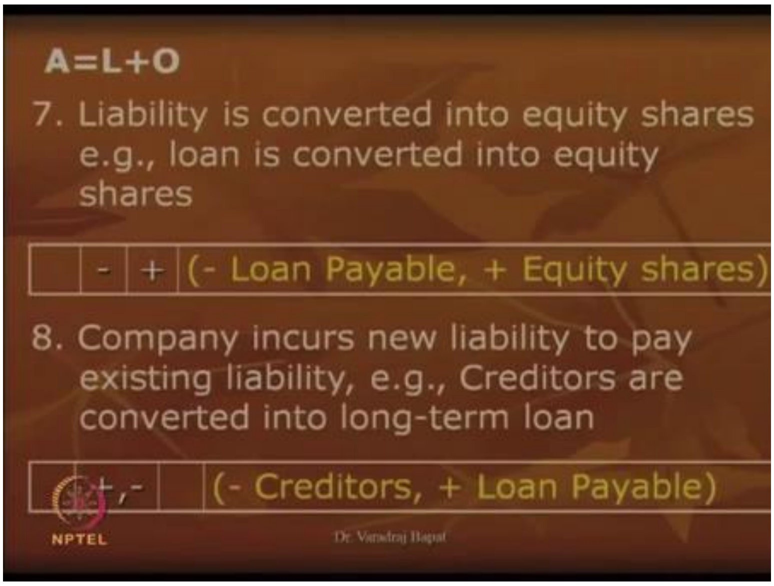
Now, let us go to 5th phase. Now, company pays dividend to the shareholders. Now, first of all, are you aware what is meant by dividend? As company earns profits, it may repay it to the owners. This distribution of profit to the owners, is known as dividend. So, whenever company earns profit, it is reserves increase or owners fund increase. And when it decides to pay dividend, it reduces it is reserves and it pays the money to the shareholders, in the form of cash or bank.

So, you can see here. This is minus in bank and minus in reserves. So, what happens is asset balance reduces and owners fund balance also reduces. Now, let us go to the next. Now, next what happens? Company, purchases shares from shareholders and pays immediately. This is a unique transaction. It is also known as buy back of shares. So, when the initially company has issued shares, what company has done is?

Company give shares and takes money from the owners or the shareholders. In this case what has happened is, company pays back the money, takes back the shares and cancels the shares. This type of transaction is known as buy back of share. Now, you can give a thought as to, what will happen to the balance sheet following the buy back.

As you can see here, now the equity capital balance will reduce and bank balance will also reduce. So, it is minus in A and minus in O. So, you can see here. Transaction 5 as well as 6, in both the cases minus A minus O.

(Refer Slide Time: 17:56)



Let us go to the next one now. Now, next one is liability is converted into equity shares. Example is, loan converted into equity shares. Now, give a thought as to what will happen to balance sheet. As you can see here, liability is getting converted. So, liability balance will go down. In exchange of that, I am giving my shares. So, when I give shares, the equity capital balance will increase. So, what will happen is minus in loan payable and minus and plus in equity shares, in other words minus L plus O. Let us go to the 8th one. Now, in 8th transaction company incurs new liability to pay the existing liability. Example is, creditors are converted into long term loans. Now, this is a case which will happen when company does not have enough money to pay their liabilities. So, suppose I am a company. I have purchased goods on credit.

So, creditors arise. But, I do not have enough money to pay them. What I may offer them is, ok I cannot pay you immediately. So, instead of keeping the amount pending without interest, let us convert these creditors balance into loan. We will start paying you interest on time. So, creditors can get converted into loan. You can see it here. In this case, what will happen is minus is creditors and plus in loan payable. In other words, it is a exchange of liabilities.

So, plus and minus both happens in liabilities. I would like to give you, one more example also. You might have, heard of the term debenture. Now, what is a debenture? Debenture also is a type of loan, which company takes. But, typically loan is taken from a bank. In case of debenture what happens is, company distributes its debentures to many people. And from many people, it takes money in the form of loan. And I mean, it takes money and gives debenture certificate.

So, this transaction is known as issue of debentures. Now, here what may happen is… From many people, company has some amount which company should pay. It is unable to pay. So, what it may do is… Instead of that loan, it may convert that loan into debenture. So, again exchange of liability. Loan gets converted into debenture. Let us see the 9th transaction, now.

(Refer Slide Time: 20:51)

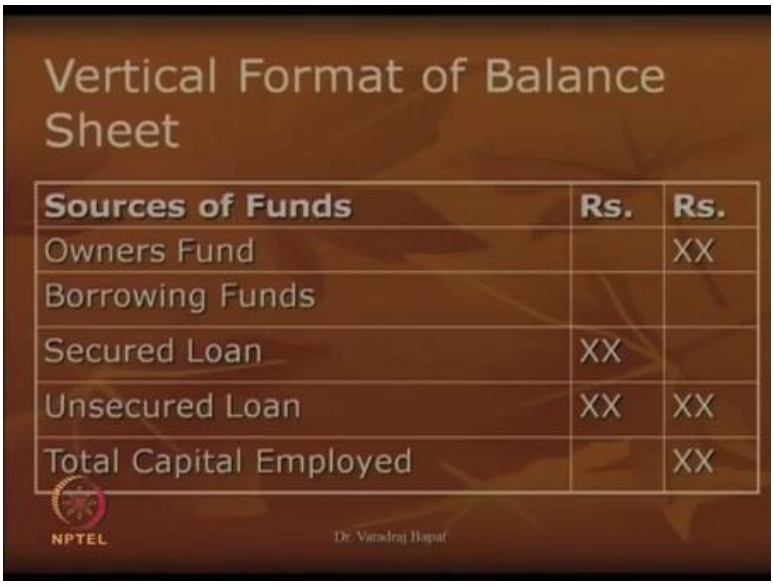
In 9th transaction, what happens is… Company, distributes stock dividend to stockholders. Now, this particular feature is also known as bonus share. I hope, you have heard of bonus share. So, in case of bonus shares what happens is, if I am a company and there are many shareholders, I give them shares free of cost. So, it is known as bonus share. So, if I have to give my capital, free of cost. So, free of cost means, I do not get cash and I give shares.

But, I give shares myself. So, when I give shares myself, actually I am reducing the reserves. And converting that reserves into equity capital and giving the fresh shares to the shareholders. So, now you give a thought as to, what will be the impact on balance sheet, because of it. Will the cash balance, increase or decrease? It will not be affected.

Because, these shares are given, free of cost. No asset is affected. In fact, no liabilities also affected.

Because, there is no transaction with outsiders like, taking loan or giving loan. So, what is happening is, as you can see here. Equity capital increases and in exchange, the reserves go down. So, this was in brief, 9th transactions which we have seen. Now, after having see in these nine important transactions, let us understand the vertical format of balance sheet.

(Refer Slide Time: 22:37)



As you can see here, in the vertical format instead of using the term liabilities and assets, liabilities the name is now changed and it is known as sources of funds. Owners fund is same. So, you have one item is owners fund, second item is borrowed funds. Now, borrowed funds may be divided into secured loan and unsecured loan. And total loan is known as total capital employed. So, by capital employed what we mean is, the total money, which a particular business is using.

Money may come from two sources. One, it comes from owners. Second, it comes from outsiders in the form of loan. What comes from owners is known as owner’s fund. What come from outsiders, in the form of loan is known as borrowed fund. This total is total sources of funds or it is known as total capital employed.

(Refer Slide Time: 23:37)

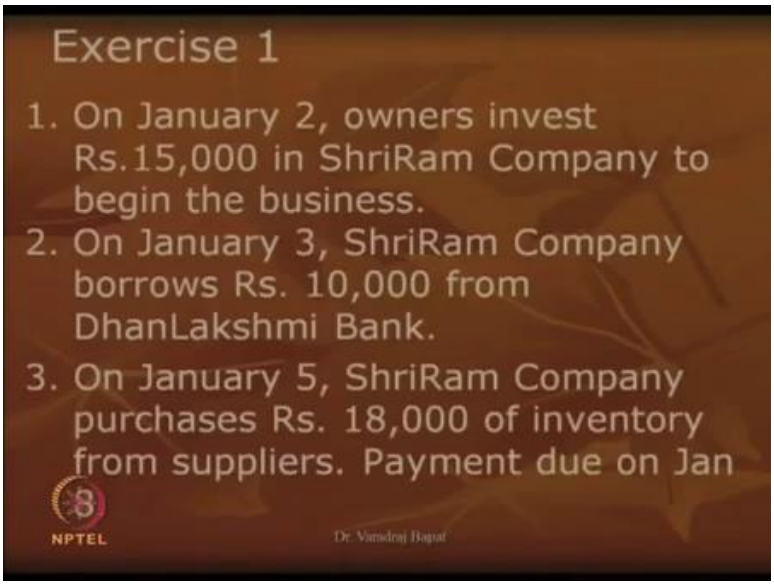
Now, on the other side of balance sheet, you have got application of funds. As we were seeing in the horizontal format, here we have fixed assets investments. But, instead of current assets, here we show working capital which is current assets minus current liability. As you might be knowing, working capital represents the day to day funds, the capital, which is used for day to day activities. So, it is calculated as current assets minus current liabilities.

And net working capital is taken to the outer column. So, here in total assets employed your fixed assets plus investments plus total working capital. And of course, total of capital employed and total of assets employed, should match.

(Refer Slide Time: 24:26)

Now, as per company law, every company has to prepare the balance sheet, in part I schedule VI of companies act. Now, let us go to one example, to understand how we can make balance sheet from a very simple transaction.

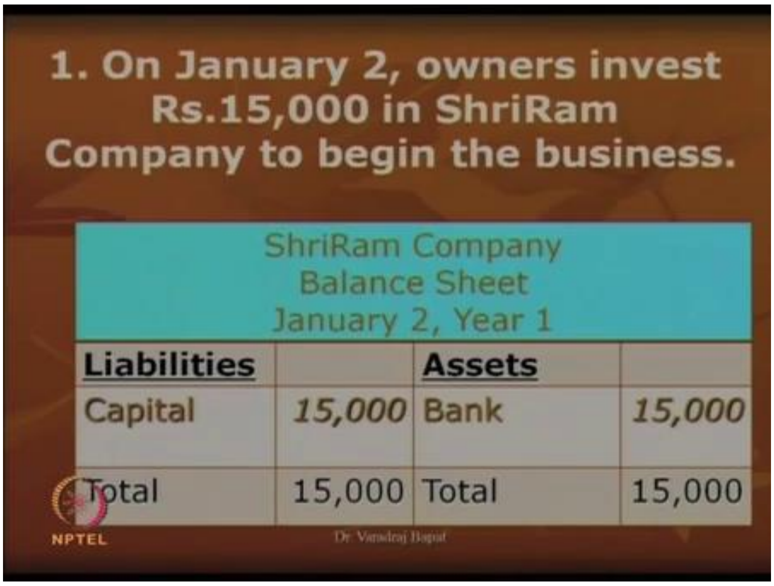
(Refer Slide Time: 24:42)



So, you can see the example here. Item number 1, I have taken. On January 2nd, owners invest rupees 15,000 in Shriram company to begin the business. Now, what will be the balance sheet following, this transaction. What we are going to do is, we will see a series of transactions. And we will try to make, balance sheet after each transaction. As you know balance sheet is a cumulative statement. So, after each transaction the balance sheet will go on adding assets and liabilities.

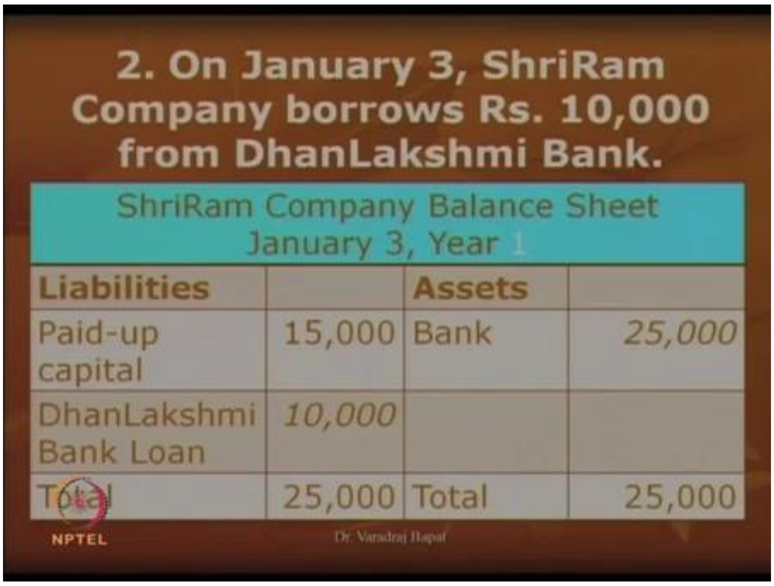
Let us go to the 1st transaction, which says that on January 2nd owners invest 15,000 in Shriram company to begin the business. So, 2nd, 3rd, 4th, I have first listed all the transactions. Now, we will see the solution for after each transaction.

(Refer Slide Time: 25:38)



Now, this is how the balance sheet will look like. On January 2nd of year 1, on capital we have got 15,000 and bank balance is 15,000. So, the balance sheet total is exactly 15,000. Now, we learn series of transactions.

(Refer Slide Time: 26:01)

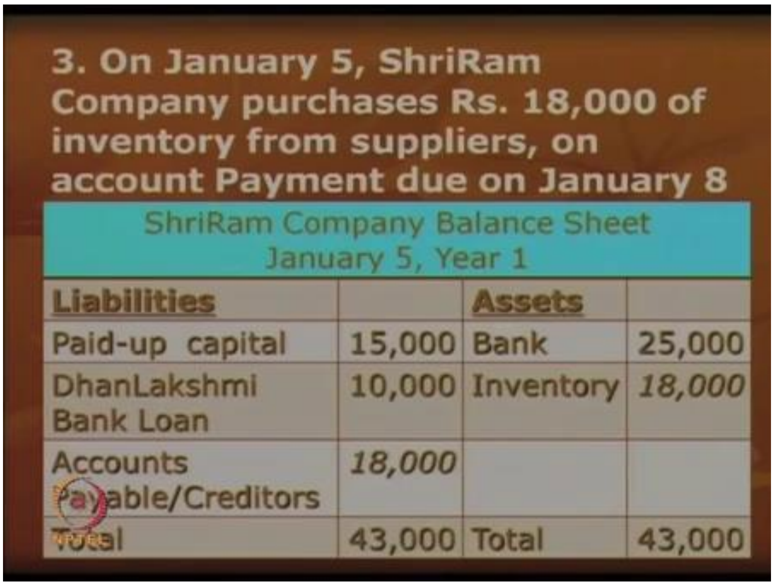


Liabilities		Assets	
Paid-up capital	15,000	Bank	*25,000*
DhanLakshmi Bank Loan	*10,000*		
Total	25,000	Total	25,000

Now, second on January 3rd, Shriram Company borrows 10,000 from Dhanlaksmi Bank. Now, what will be the balance sheet, after this? So, company has taken loan. So, loan balance will increase by 10,000 and bank balance will also increase by 10,000. So, here you can see the balance sheet, at it will happen. On the asset side, you can see bank has become 25, now. It was 15 earlier, 15 plus 10, 25. On liability side, Dhanlaksmi Bank loan a new amount of 10,000 has come.

Capital which will remain intact. It will not change and it will be 15,000. Only thing is, I have used a different term now. I have used the term, paid up capital. So, what it means is… This is the amount of capital, which owners have paid to the company. And again you can see. Of course, the total of balance sheet tallies to 25,000.

(Refer Slide Time: 27:10)



Liabilities		Assets	
Paid-up capital	15,000	Bank	25,000
DhanLakshmi Bank Loan	10,000	Inventory	*18,000*
Accounts Payable/Creditors	*18,000*		
Total	43,000	Total	43,000

Now, let us go to the 3rd transaction. Now, 3rd transaction is… On January 5th, Shriram Company purchases rupees 18,000 of inventory from suppliers. On account, the payment will be made of January 8th. Now, what is meant by on account? On account indicates that, this is a credit purchase. Cash purchase means I pay cash, I take goods. In case of credit purchase, I take goods but, I do not pay immediately. I just give a promise that, I will pay after 3 days, 4 days, 1 month whatever.

So, in credit purchase the question is, should we record the transaction today or it will be recorded only when the payment is made. Now, if you are following a cash system of accounting, you will record it only when the payment is made. But, that is not a scientific way. Because, as soon as we have booked order and received the goods, we need to record that as a liability, because we will have to pay it in future.

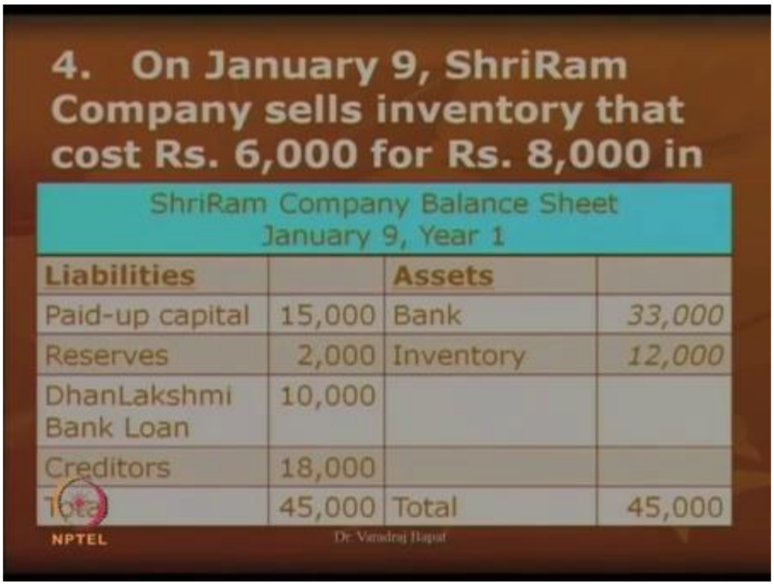
So, you can see here, how the balance sheet will show. Now, since the goods are purchased from credit, it will be shown in the balance sheet, as accounts payable. And goods which have come in, will become the inventory of the concern. So, this is how the balance sheet will look like. You can see here, inventory is shown in italics, because it is a new item. Inventory 18,000 accounts payable, it is also known as creditors.

They will also become 18,000. Other items, on assets and liabilities remain unchanged. Asset side, you have got bank 25,000. On liability side, you have paid up capital 15 and Dhanlaksmi Bank Loan 10. These items will remain unchanged. I hope you are getting it.

Because, now slowly the balance sheet is getting build up. What happens is, balance sheet is a cumulative statement. So, when you have transaction number 2, it does not happen that you just record transaction number 2.

You have transaction 1 effect plus transaction 2 plus transaction 3 and so on. So, the size of the balance sheet goes on increasing. All the earlier assets and liabilities, you will continue to show. Let us go to transaction 4th, now.

(Refer Slide Time: 29:42)



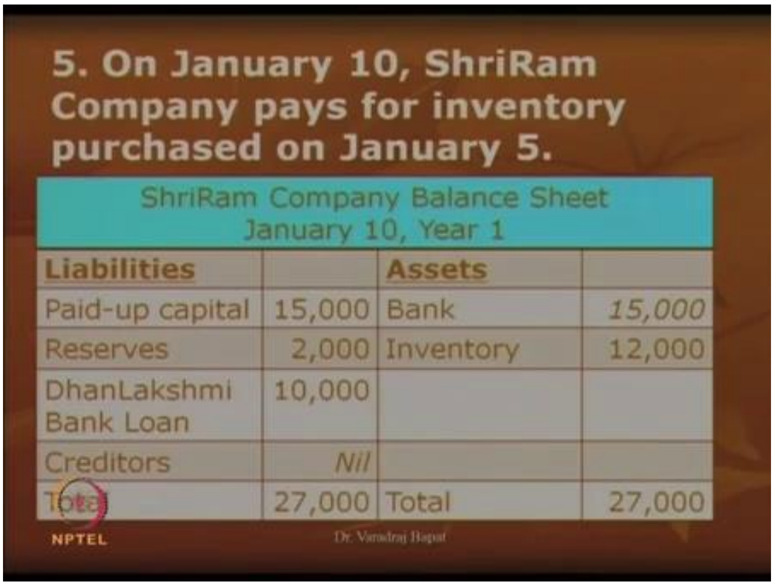
Now, the 4th transaction is on January 9th Shriram company sells the inventory, that was costing rupees 6000. But, it sold it for 8000 and the sale has happened in cash. So, now you can give a thought as to, what will be the change in the balance sheet. It is obvious that, we have sold goods for 8000. So, 8000 worth of goods come in. I think, 8000 worth of cash comes in, that is very clear. As for as the goods is concerned, goods of 6000 go out, because goods of 6000 are sold and we got back 8000.

So, cash will increase by 8 goods will reduce by 6 only. So, there is a difference of two. Now, where will you show this difference? So, what is happened is, we have earned a profit of 2000, because goods of 6 are sold for 8. So, there is a margin of 2000 which we have earned. In the balance sheet, this profit will be shown as reserves. Reserves mean the accumulated profit, which is earned by the company and kept in the balance sheet.

Now, let us see how the balance sheet will look like. So, you can see here, my bank balance has increased by 8. So, from 25 it has become 33. Inventory from 18, gone down by 6. So, it has become 12. Both the items have shown change. So, they are shown in italics. Liability side, paid up capital is same. Dhanlakshmi bank loan will same. Creditors is same. But, a new liability called reserves has come, which is for 2000.

So, the total is 45. Now, a question which may arise in your mind is, why is this 2000 shown as reserves. It is true that, this 2000 is not going to be paid to anybody outsider. It is a profit earned by the company. But, this profit also should be paid back to the owners. And that is why we are showing reserves is 2000 on the liabilities. Are you getting? So, now the balance sheet tallies, which is at 45,000. Now, let us go to the 5^{th} transaction.

(Refer Slide Time: 32:15)

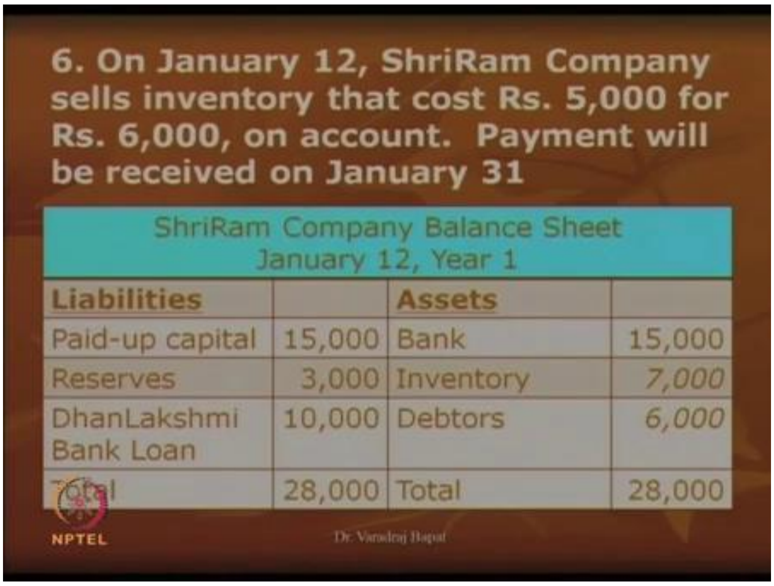


Now here, as you can see on January 10th, company has paid for the inventory which is purchased earlier. I will just take you back ((Refer Time: 32:27)) If you remember, on Jan 5th, they have purchased the inventory that is goods and payment was due on Jan 8. But, nothing was paid on January 8th. So, there is no transaction on January 8. However, the amount is paid on 10th January. So, 5th transaction has happen on 10 January.

One thing you should keep in mind that, just because the payment was due, we have not recorded anything. Now, the company has actually paid the amount to suppliers. Now, what will be the change in the balance sheet? When the payment is made, of course the bank balance will reduce and the suppliers balance will also reduce. So, both the liabilities will go down. You can see in the balance sheet, now. So, bank balance has reduced by 18,000.

From 33, it has become 15. There is no change in the inventory. No change in other liabilities. But, creditors have become nil. So, from 18,000 now creditors have become zero. The total of balance sheet is 27. I hope, now gradually you are understanding, how the balance sheet is getting build up.

(Refer Slide Time: 33:48)


6. On January 12, ShriRam Company sells inventory that cost Rs. 5,000 for Rs. 6,000, on account. Payment will be received on January 31

ShriRam Company Balance Sheet
January 12, Year 1

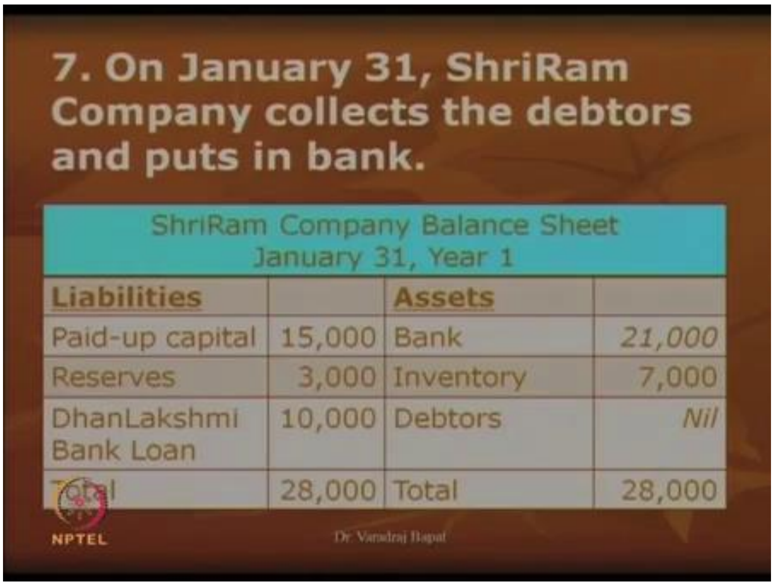
Liabilities		Assets	
Paid-up capital	15,000	Bank	15,000
Reserves	3,000	Inventory	*7,000*
DhanLakshmi Bank Loan	10,000	Debtors	*6,000*
Total	28,000	Total	28,000

Let us go to the 6th transaction. Now, on January 12th Shriram company sells inventory that cost 5000 for rupees 6000 on account. And payment will be received on 31st of January. Now, this is a case of credit sale. It sales on account that means, it will sell the goods, the money will come later. Shall we record the transaction today or we will record only when the money is received? As we have discussed in case of purchase, we will not do really a proper accounting, if we do not record it on January 12th, because what has happened is… Though money is not received, we have already given the goods. And we have created an asset for us, because we will receive the money in future. So, we need to record the transaction today only. Now, what has happened is… Goods of 5000 are given out for rupees 6000. So, my inventory will reduce by 5000 and my account receivables or debtors will increase by 6000.

So, one asset reduces other asset is exchange. Shall I record all the 6000 today or I will record only 5000 today. Now, what happens is… Entire 6000 is going to be record from the customer and I know, the customer is going to pay me in future. So, there is no point in only recording 5000. I will record the whole 6000. So, my inventory will reduce by 5. My debtors will increase by 6. There is a difference of 1000, where will that go?

What does that represent? That 1000 is nothing but the profit earn because, goods of 5 are sold for 6. So, profit of 1000 is earned and that profit will be added to reserves. You can see the balance sheet now. As you can see here, a new asset called debtors is created for 6000. Inventory as reduced by 5 and on reserves, reserves have increased from 2 to 3. So, total of the balance sheet is now 28,000. Let us go to the next transaction.

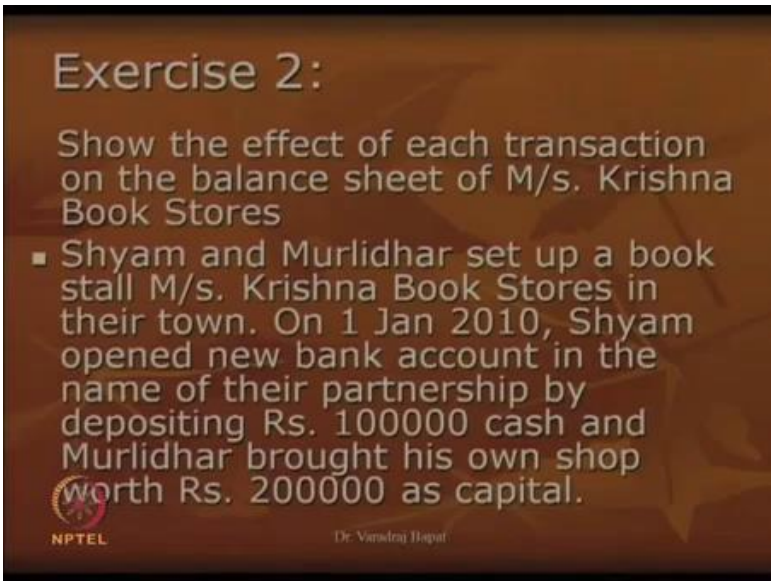
(Refer Slide Time: 36:21)



Now, 7th transaction, this is the last day of this month. On January 31st Shriram company collects the debtors and puts it, in the bank. So, now debtors are paying us the money. So, my bank balance will increase and a balance of debtor will decrease. It is a simple transaction of exchange of asset. So, you can see the balance sheet. So, now the debtors I am recording as nil. And bank balance, which was 15 has become 21.

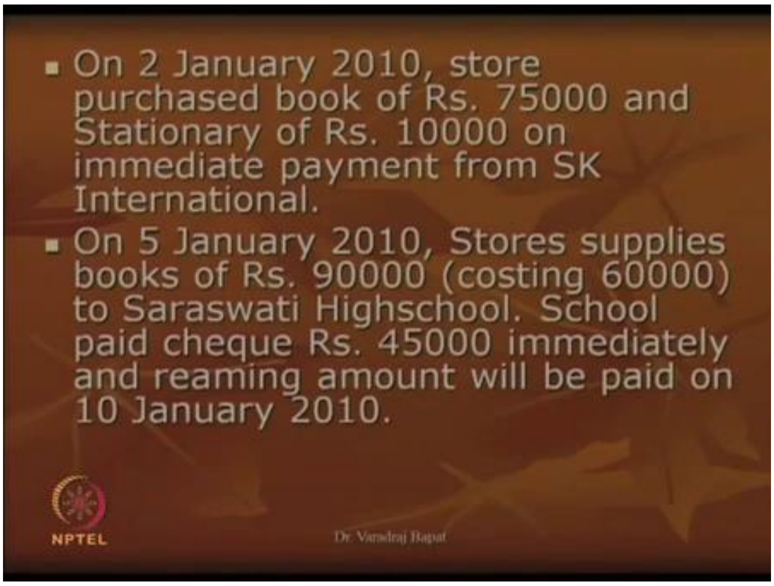
The balance sheet tallies at 28,000. This is the last balance sheet. I hope, now you have understood that how from series of transactions, you can make up a balance sheet. Shall we go to exercise 2? I hope you are very clear. Now, again I am going to show you a series of transactions. And from these transactions, we will try to make the balance sheet.

(Refer Slide Time: 37:22)



Let us see the transactions. Now, in the books of Mrs. Krishna stores, Shyam and Murlidhar set up a stall known as Mrs. Krishna book stores, in their town. On 1st January 2010, Shyam opened a new bank account in the name of their partnership firm and deposited 10,000 in cash. Murlidhar brought his own shop, worth rupees 20,000 as a capital. So, Murlidhar brought in his shop, whereas Shyam brought in some cash. And they started with the partnership concern.

(Refer Slide Time: 37:59)



Now, series of transactions are given. Next transaction is, stores purchased books of rupees 75,000 and stationary of rupees 10,000 on immediate payment from SK International. So, this is a case of cash purchase.

(Refer Slide Time: 38:18)

Now, let us see what will be the balance sheet, at the end of first two transactions. Now, you can see here, on Jan 1st. It is a very first transaction. Shyam brought in a capital of 1 lakh. Muralidhar brought in a capital of 2 lakhs. Shop premises will be shown in the book as 2 lakhs and bank balance is 1 lakh. The balance sheet tallies and it is shown at 3 lakhs.

(Refer Slide Time: 38:49)

Balance Sheet as on 2 Jan 2010

Liabilities	Amount	Assets	Amount
Capital			
Shyam	100000	Shop Premises	200000
Murlidhar	200000	Bank	15000
		Inventory	85000
	300000		300000

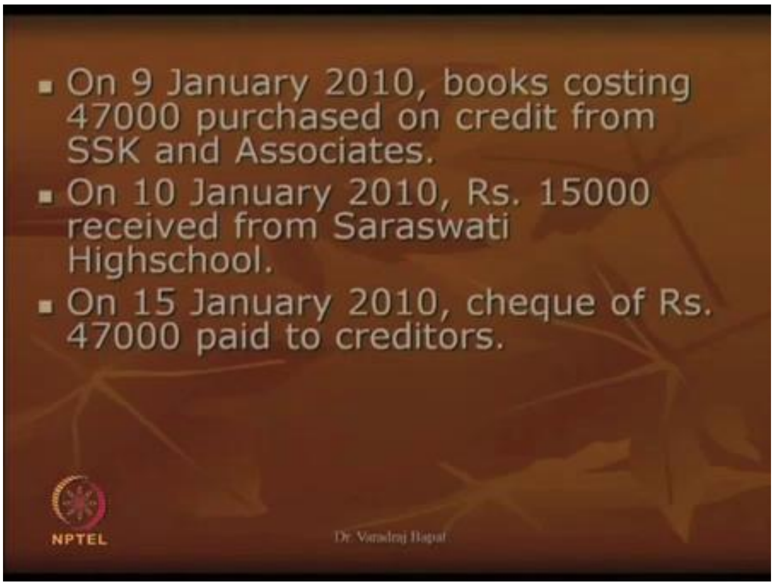
Now, the 2nd transaction. 2nd transaction was the credit purchase. So, you can see here. Both, books and stationaries are my inventory. So, now the inventory has become 85,000 and bank balance has reduced to 15,000. The balance sheet tallies at 3 lakhs. Now, on 5th January, see the transaction number 3. Stores supplies, books of rupees 90,000 costing rupees 60,000 to Saraswati High School. School paid cheque of 45,000 immediately and the balance will be paid on 10th Jan. So, what has happened is?

Goods of 60 being sold for 90. So, the profit of 30 is earned. But, the payment will be made 45,000 today and remaining 45, will be paid after 5 days. Shall we record the entire transaction, today? The answer is yes. We have already seen the last time that, we do not record as and when the cash is received. Rather, we record the transaction as soon as it happens. Now, in this case we have sold goods of 60 for 90 and payment is going to come in installments. Let us see, the balance sheet effect.

(Refer Slide Time: 40:07)

So, here you can see what will happen. A new asset is created, known as sundry debtors for rupees 45,000. The bank balance will increase and it will become 60,000. And the inventory will become 25,000. So, the total on liability side is 3,30,000. Assets is also 3,30,000.

(Refer Slide Time: 40:33)



Next transaction is on 9 January. Now, books costing rupees 45,000 are purchased on credit. This is similar to our earlier purchase. Only difference is, this is a purchase on credit.

(Refer Slide Time: 40:46)


Balance Sheet as on 9 Jan 2010

Liabilities	Amount	Assets	Amount
Capital			
Shyam	100000	Shop Premises	200000
Murlidhar	200000	Bank	60000
Profit and Loss A/c	30000	Inventory	72000
Sundry Creditors	47000	Sundry Debtors	45000
	377000		377000

So, now what will be the balance sheet, after this? Now, sundry debtors a new liabilities created. The capital of Shyam and Muralidhar will remain same. P and L account or the reserves of 30,000 are there, because of profits. Sundry creditors of 47 are created. And in the inventory, now the balance has become 72,000. Shop premises, bank and sundry debtors will remain unchanged. So, totally is 3,77,000 ((Refer Time: 41:20)).

Let us see now the next transaction On January 10th, we have received a cheque of 15,000 from Saraswati High School. ((Refer Time: 41:33)) So, if you remember our earlier transaction, goods of 60 were sold for 90. Of that 90, 45,000 of payment was received immediately and remaining was due on 10th January. ((Refer Time: 41:47)) But, we have not received the remaining amount.

But, part of the amount that is, 15,000 we have received from Saraswati High School. So, what we will do is, they represents, our customers or debtors. Debtors balance will reduce and our cash balance will increase.

(Refer Slide Time: 42:03)


Balance Sheet as on 10 Jan 2010

Liabilities	Amount	Assets	Amount
Capital			
Shyam	100000	Shop Premises	200000
Murlidhar	200000	Bank	75000
Profit and Loss A/c	30000	Inventory	72000
Sundry Creditors	47000	Sundry Debtors	30000
	377000		377000

So, see the balance sheet on January 10th. You can see here, our sundry debtors have gone down to 30. And our cash balance or the bank balance has increased to 75. The total of balance sheet remains unchanged, because there is only an exchange of asset. ((Refer Time: 42:24)) Let us see now, the last transaction. Now, on January 15th the cheque of rupees 47,000 is paid to creditors.

(Refer Slide Time: 42:37)

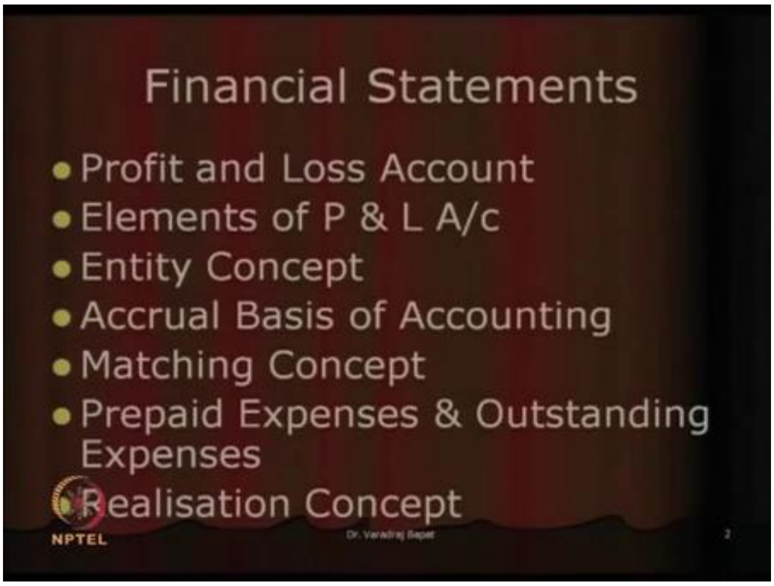

Balance Sheet as on 15 Jan 2010

Liabilities	Amount	Assets	Amount
Capital			
Shyam	100000	Shop Premises	200000
Murlidhar	200000	Bank	28000
Profit and Loss A/c	30000	Inventory	72000
		Sundry Debtors	30000
	330000		330000

So, you can see here what will happen is? My bank balance will reduce and my creditor balance will also reduce. So, this is a last balance sheet, which you can see. Now, my bank balance has become 28. And the item of creditors is not shown in the liability side, because the balance has become nil. So, this is the last balance sheet of this problem. I hope, you are understanding the flow. Now, what we are doing is?

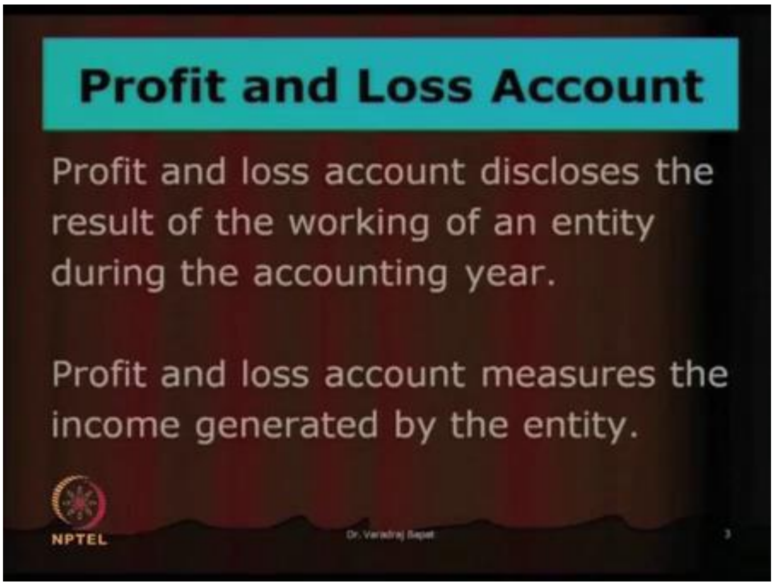
We are taking a series of transactions. And after each transactions, we are making a balance sheet. Now, in real life company may not make balance sheet, after every transaction. They make balance sheet, only at the end of the month or sometimes at the end of three months and so on. But, to make you understand clearly the effects of each transaction, we are actually making the balance sheet after each transactions. I hope you are understanding the effect. Now, let us go to the next thing. Now, we will try to learn little more detail about, what is a P and L account.

(Refer Slide Time: 43:51)



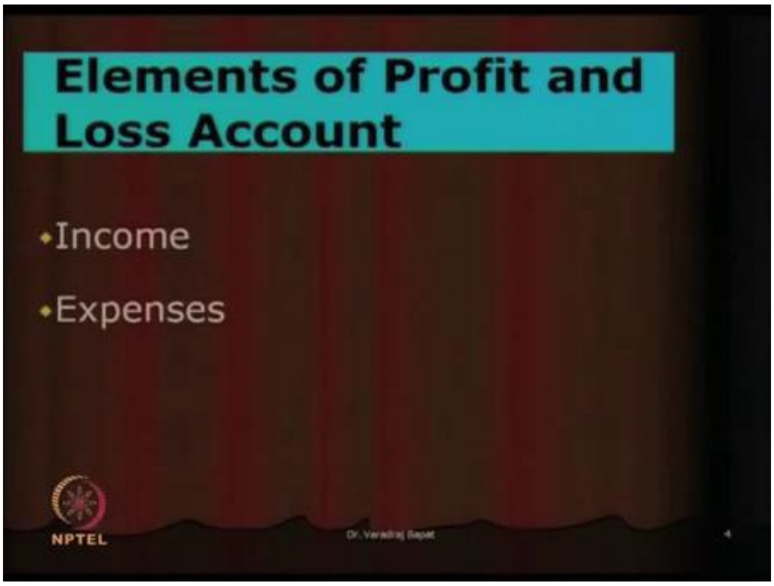
As in the beginning we have seen, the financial statement consist of balance sheet as well as P and L. Now, here we are going to learn, in more detail. P and L account, it elements and also some of the concepts.

(Refer Slide Time: 44:05)



Now, first of all, what is a P and L account? As you can see here, this is an account which discloses the result of the working of an entity. So, working of an entity may result in profit or loss and that is shown in P and L. That is why, it is known as P and L account. Now, profit and loss account measures the income generated by the entity.

(Refer Slide Time: 44:30)



Now, to know the profit naturally, you must know the incomes and expenses. So, we try to list down, all the revenues and we also list down all the expenses. The net result is the profit or loss. So, a P and L account must show all revenue schemes. It must also in detail show, all the expense items and the net result, which is net profit or net loss.

(Refer Slide Time: 45:03)

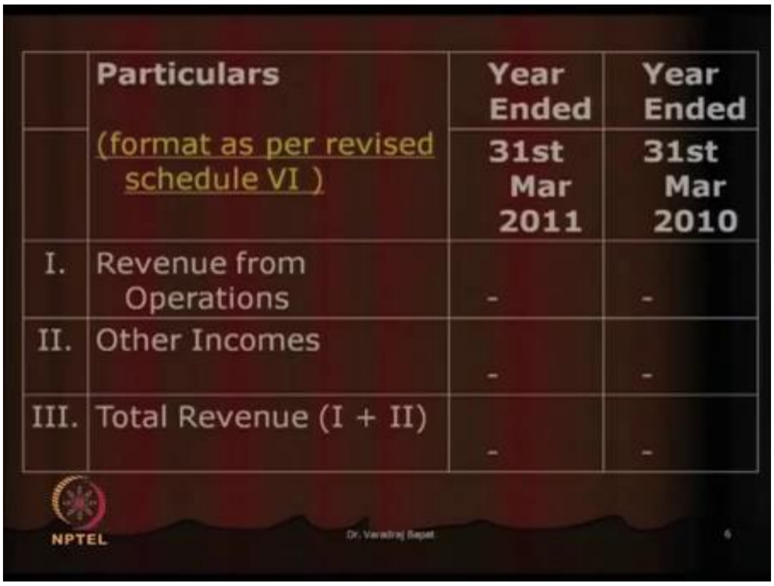
This is a simple format of P and L. Usually, we have we are starting with the sales. We will reduce the cost of goods sold, which gives me gross profit. Now, what is meant by cost of goods sold? Now, mostly for a manufacturing or a trading entity, when the sales happens, company gives out goods. So, all the cost which is incurred for purchasing, processing, manufacturing, packing of the goods is known as cost of goods sold.

In case of service industry, instead of cost of goods sold, it will be known as cost of services. The concept is same. So, we have to create higher staff. Provide certain basic facilities. Using them, we provide service. That total is known as cost of services. So, sales minus cost of goods sold or cost of services, as the case may be is known as gross profit. Now, from the gross profit we will reduce other expenses.

These other expenses could be for marketing. They could be for administration. They could be for R and D. We also reduce taxes. And the net amount is known as net profit. You can see here, cost of goods sold is showing in bracket. To show that, it is a negative figure. From sales will reduce cost of goods sold to get gross profit. From gross profit again, we will reduce other expenses and taxes to get the net profit.

So, this is a P and L format. In short, we will also see more in detail. But, this is showing in brief to few items in P and L. So, that you understand how the P and L flow is?

(Refer Slide Time: 46:58)

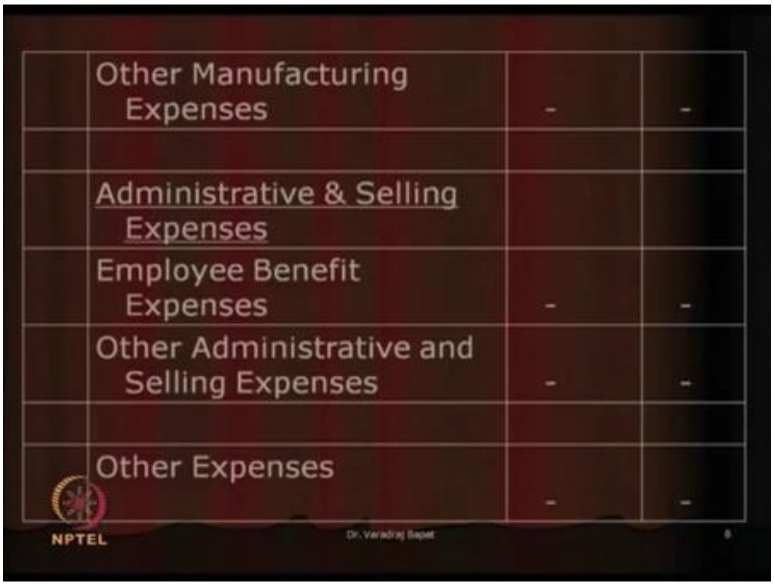


Now, we can also see a more detail format of P and L, which is required as per schedules VI of company act. So, it starts with item number I, which is known as revenue from operations, which is equivalent to sales in a simple terms. Then, we show other income. The total is known as total revenue.

(Refer Slide Time: 47:18)

From total revenue, certain expenses are reduced. Now, expenses have been categorized here. So, first category is manufacturing expenses, which cover these items. First one is cost of materials consumed, purchase of stock in trade, changes in inventories of finished goods, work in progress or stock in trade. So, we reduce the purchases. We also reduce the changes in inventories of finished goods, work in progress and even though raw material.

(Refer Slide Time: 47:59)

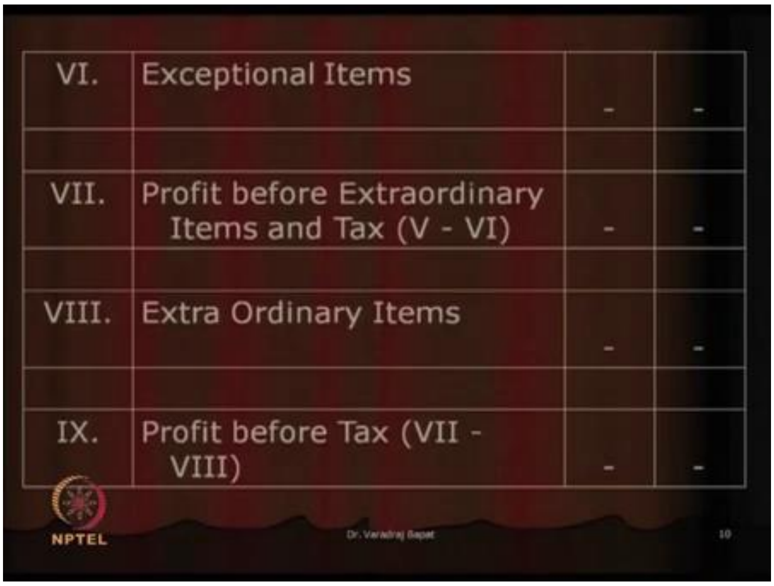


Now, the next is other manufacturing expenses. So, other manufacturing expenses include items like factory rent, factory power and so on. So, the first heading was manufacturing. The second heading is admin expenses. In admin expenses, you have got employee benefit expenses, administration selling expenses and so on.

(Refer Slide Time: 48:24)

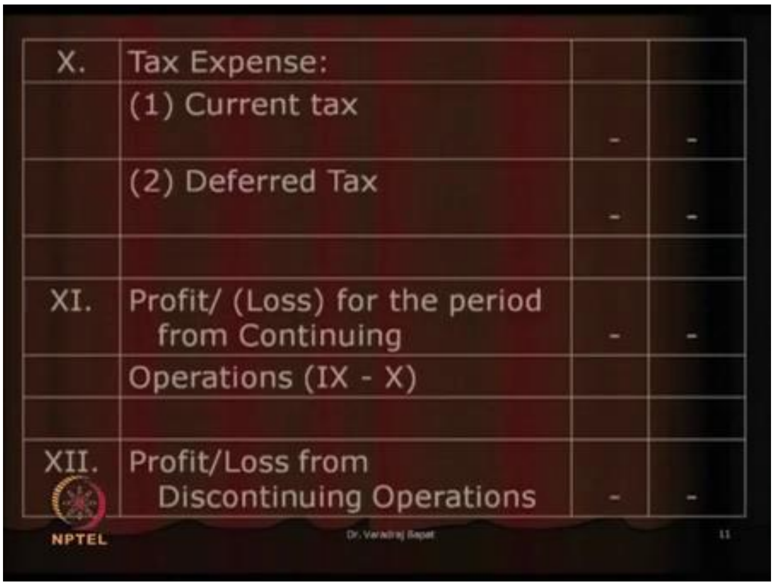
After reducing manufacturing and adminant selling expenses, the next item is finance cost. Now, what do you mean by finance cost. The main finance cost is the interest paid for the loans taken. So, when the loans are taken, company has to pay interest. It is known as finance cost. The next item is depreciation and amortization. Now, as you know whenever company uses its shown assets, the value of assets is falling and that fall is known as depreciation. So, we also reduce that depreciation to get the total expenses. Now, from the gross revenue, total expenses are reduced. We get profit, before exceptional and extraordinary items.

(Refer Slide Time: 49:15)



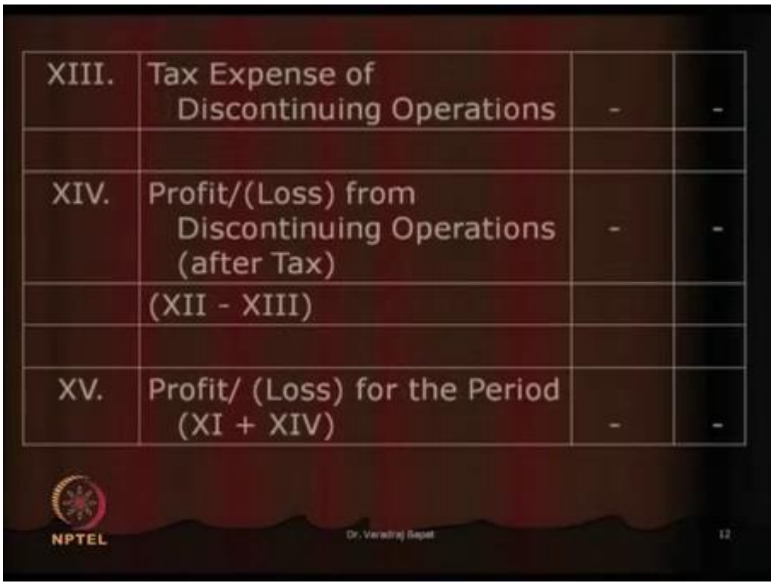
From these, exceptional items are reduced. Extraordinary items are reduced to give a profit before tax.

(Refer Slide Time: 49:23)



We also reduce taxes, which gives us the final profit.

(Refer Slide Time: 49:30)



We will see more in detail about P and L, in next session. So, right now you can see, how is the format of P and L, as per company law? We will see some more problems on P and L in the coming session.

Thank you.