CHAPTER

12

Bookkeeping and Accounting and Financial Statements

Any business activity, be it manufacturing, servicing or trading, involves monetary transactions. At the end, if the total money received is more than the total money spent, the business is said to have generated a 'surplus' or `profit'. If it is otherwise, the business is said have been in 'deficit' or `loss'. Every business intends to generate a surplus or profit. Therefore, the promoter(s) is/are always interested in knowing the outcome of the economic activity.

Several transactions take place in the course of business. To remember all of them is almost impossible. A business therefore, needs to record all such transactions to find out the outcome of the business activity. A methodical and systematic science has been developed which helps the promoter record all economic transactions properly and know the outcome of the business dealings. This science is called "Financial Accounting."

Accounting is a name given to the system which measures, records, analyses and reports the effect of business transactions and events taking place in a business enterprise. Since such reporting is in financial units, the system is also known as financial accounting. It has been defined as the art and science of recording business transactions in a methodical manner so as to show (a) the true state of affairs of a business at a particular time, and (b) the surplus or deficiency, which has accrued during a specified period.

Thus Financial Accounting involves (a) data recording and (b) data presenting technique used for recording various transactions. This is called 'Bookkeeping'. The data recorded is summarised and systematically arranged and presented to various users in the form of Financial Statements.

WHAT IS BOOKKEEPING?

'Bookkeeping' is one of the functions of financial accounting. Bookkeeping entails maintaining proper records and books for recording complete details of transactions made during the course of business. Business transactions can be classified into several major activities/groups e.g. sales, purchases, assets, etc. Separate books for recording transactions pertaining to these activities are maintained, registering in them the details of respective transaction. This exercise is called Bookkeeping.

Why are Books of Accounts Maintained?

It is extremely important to have the latest information about what is happening in business. This helps in taking appropriate and timely action. A doctor needs details about the physiological conditions of a patient to diagnose the illness, its causes and its remedies. Just like that the owner of the business, creditor, or banker needs to know about the latest financial health of the business for taking suitable decisions about the future course of action. Bookkeeping helps in maintaining and providing the latest financial position of the business and, therefore, assumes great significance. It is advisable to maintain books of accounts for the following reasons as well:

- They provide up-to-date information about the business.
- They reflect the outcome of transactions made during the period under review.
- They give information about the state of affairs of the business at regular intervals.
- They help governments and other authorities to decide about the incidence of various taxes.
- They help analyse the performance of the business.
- They help compare the performance of several business firms.

The accounting information of business is required not only by the owner of the business but by various other parties too. They are the government, suppliers, creditors, bankers, investors, shareholders, auditors, etc. They depend on the information prepared by financial accounting for taking various decisions pertaining to their activities. This emphasises the need for writing books of accounts in a systematic and methodical way. Though, as an owner of the business one has the prime responsibility to write and maintain the books of accounts, one is not free to write the accounts, the way one likes. They have to be written as per the norms and principles of techniques and systems of accounting used the world over. There are a few accounting techniques available for writing accounts but the Double Entry Bookkeeping System has universal acceptability and credibility. It is the modern and scientific accounting system designed to reflect the true and fair position of the business.

Double Entry Bookkeeping

The concept of the Double Entry Bookkeeping System is based on the principle that every economic transaction has two effects, which are exactly opposite to each other. Any transaction can have only two effects: 'debit' and `credit', and they are always equal. As a result, at the end of the accounting period, the accounts should 'tally', meaning thereby that both 'total debits' and 'total credits' should tally with each other. Double entry bookkeeping is designed in such a way that, while entering the credit entry of a particular transaction, the details of the corresponding debit entry is also given.

Writing Accounts Under Double Entry Bookkeeping

Transactions

In business, the promoter does several transactions. The effect of these transactions on the business is recorded in the books of accounts. Only those transactions, which result in exchange of money or exchange of goods or services, whose value can be measured in monetary terms, need accounting treatment. Transactions may be of the following nature:

a. Exchange of goods against cash/credit

b. Exchange of services against cash/credit

c. Exchange of assets against cash/credit

d. Payment of cash to creditors

e. Receipt of cash from debtors

f. Exchange of goods against assets

g. Exchange of goods against services

Thus several types of transactions take place in business and they form the starting point of accounting. There are two types of transactions: (i) Cash transactions and (ii) Credit transactions. Cash transaction results in exchange of cash, while credit transaction results in an obligation to pay / receive cash in the future.

Accounts

Transactions involve ‘accounts’. Each transaction has to be done through an ‘account’. There are total three types of accounts:

i. Personal Account or Individual account: This group of accounts includes all accounts of individuals and organisations like a firm, a corporate entity, a society, etc.

ii. Assets Account: This group of accounts covers all types of assets. Assets mean all those investments made in tangible or intangible form of assets, which have utility value or use value. Moreover, these assets can also be disinvested and converted into cash.

iii. Income-Expenditure Account: This group of accounts encompasses all accounts, which represent revenue income and revenue expenditure of the business.

Rules of Debit and Credit

In the Double Entry Book-Keeping System, each transaction has two effects. One is called ‘Debit’ and the other is called ‘Credit’. Thus each transaction has minimum one debit effect and minimum one corresponding credit effect. There are prescribed rules for debiting and crediting various accounts, which are classified under three major groups as mentioned above. These rules form the basis of accounting under Double Entry Bookkeeping System. Below given are these rules:

(i) *Rule for ‘Personal Accounts’: "Debit the Receiver and Credit the Giver".*

Explanation: Any person involved in a transaction can either be a receiver of cash, asset or services, or be a giver of cash, asset or services, without any immediate consideration. The account of the person who receives is debited, while the account of the person who gives is credited.

(ii) *Rule for ‘Assets Accounts’: "Debit what comes in and Credit what goes out."*

Explanation: In business, goods and assets come and go. Whenever assets or goods come in the business its respective account is debited, while in the case of assets or goods going out of the business as a result of a transaction, its respective account is credited.

(iii) *Rule for 'Income-Expenditure Accounts': "Debit Expenses and Losses and Credit Incomes and Gains"*

Explanation: This group of accounts covers all revenue income and expenditure accounts. All those revenue incomes that are generated during the course of the business are credited in their respective accounts and all such revenue expenditures incurred during the course of the business are debited in their respective accounts.

Steps for Identifying Debit or Credit Effect

i. Decide whether the transaction needs accounting treatment.

ii. Determine which are the two accounts involved in the transaction.

iii. Apply the rules of debit and credit for the identified accounts as per their classification.

iv. It should be seen that there couldn't be both 'credits' and both 'debits' in a single transaction. Every transaction must have a debit and a corresponding credit.

The Journal Entry

A journal entry is the first noting in the books of accounts whereby debit and credit effects of each transaction on accounts are identified and noted along with proper description. Journal entries help in preparing several books of accounts. A suggestive format for maintaining a journal and writing journal entries is shown below:

Journal entries in the book of M/s.				
Date	Particulars	Ledger Folio No.	Debit (Amount)	Credit (Amount)

Explanation:

i. **Date:** The journal entries must be written date-wise in a chronological sequence. It is ideal to make entries of the transactions daily. The year, month and date of the transaction for which journal entry is made should be mentioned in the 'Date' column.

ii. **Particulars:** In this column, for each transaction, the account to be debited and the account to be credited is mentioned. The account, which is to be debited, is written first followed by the account to be credited. A word 'To' precedes the name of account, which is credited.

E.g. "Bank Account debited to Sales Account"

Subsequent to debiting and crediting the appropriate accounts, a brief narration of the transaction, if possible, in one line only is written in the 'Particulars' column.

iii. **Ledger Folio No.:** In the third column the folio number of the respective accounts in the ledger is mentioned. This helps trace the posting of each transaction and verify it.

iv. **Debit and Credit:** In this column the amount by which the respective account is debited and credited is mentioned. At the end of every page the total of debits and credits is made and is carried forward to the next page.

Ledger

A ledger is a book, which contains details of all accounts in which transactions are made. It contains a condensed and classified record of all business transactions transferred from the journal or subsidiary books. Ledger is the principal book under the double entry bookkeeping system. It contains up-to-date information about all accounts, e.g. if an owner wants to know how much he/she owes to Mr. X, he/she can learn this from Mr. X's account maintained in the Ledger. If such accounts were not maintained in the ledger, the owner would be required to go through each transaction involving Mr. X to find out the payment liability. This exercise is time-consuming and inconvenient. For businesses with a sizeable number of transactions, it is impossible to scan the primary books or journal every time to know the exact position of any account. It is, therefore, very important to maintain a ledger.

A suggestive format for maintaining an 'account' in the ledger is given below:

Debit Side	**Account (Name of the Account)**						**Credit Side**
Date	Particulars	Folio No.	Amount	Date	Particulars	Folio No.	Amount

Explanation:

It may be noticed from the format that a ledger account has two sides: debit side (left-hand side) and credit side (right-hand side). Each side is further divided into four sections, viz. 'Date', 'Particulars', 'Journal Folio Number'and 'Amount'.

i. **Date:** In this column, the date of a transaction as entered in the journal book from where the entry is brought to the ledger account, is mentioned.

ii. **Particulars:** In this column the name of the account in which the corresponding credit or debit (under the double entry principle) is found, is mentioned.

iii. **Journal Folio Number:** In this column the page number of the journal book or subsidiary book from where the transaction is brought to the account is mentioned.

iv. **Amount:** In this column the amount, with which the account is debited or credited, is mentioned.

Transactions

Transactions are entered, as and when they occur in the journal book or subsidiary books. From there necessary records are created in the ledger. The process of transferring entries from the journal or subsidiary books to the appropriate accounts in the ledger is called 'posting'. If an account is debited with an amount as entered in the debit column of the journal book, the same is posted to the debit side of the account in the ledger. Similarly, if an account is credited in the journal book, it is posted to the credit side of the account. While posting entries, care should be taken to see that the name of the account in which the entry is posted is not mentioned in the column of particulars. Instead the name of the other account, which is affected under the same transaction, should be mentioned. While posting, each entry to the debit side of an account should begin with the word 'To' (in the 'Particulars' column) and each entry to the credit side should begin with the word 'By'.

Balancing the Account

Normally as it happens, the total of all postings to the debit side and the credit side of the account is not equal. The amount by which the total of any side (debit or credit) is greater than the total of the other side is called the 'balance' of the account. If the total of debit side is greater, then the balance is called 'debit balance' and if it is vice versa, it is called 'credit balance.' For example:

i. Following accounts always have debit balances:

   a. Cash Account/Bank Account
   b. Asset's Account
   c. Debtor's Account
   d. Stocks Account
   e. Revenue Expenses Account
   f. Losses Account
   g. Investment Account

ii. Following accounts always have credit balances:

   a. Creditor's Account
   b. Revenue Income's Account
   c. Gain's or Profit's Account
   d. Bank Loan Account
   e. Interest Received

As seen earlier, the journal book is the first book required to be kept in the business where all transactions are recorded. It is the book of original entry. Likewise, the ledger is the most important basic book, which records all accounts. So long as the transactions in the business are limited and simple, it is possible to enter all transactions first in the journal book and then in respective accounts in the ledger. But with the size of a business and the number of transactions increasing, it becomes difficult to maintain a journal book for all the transactions and post them in the ledger. Under such circumstances, it becomes necessary to divide the journal books and the ledger into some separate subsidiary books, each of which is reserved for recording one particular class of transactions, e.g. purchase book, sales book, cash book, etc.

Books needed to be maintained for a Simple Accounting System

For a small industrial enterprise, the usage of the simple financial accounting system is recommended. Such businesses must maintain a set of books as suggested below. By doing so, the businesses can get a correct and fair picture of the activities speedily.

a. **Journal:** All transactions (except those which are to be recorded in subsidiary books) are properly recorded here.

b. **Subsidiary books (for journal)**

  i. **Purchase book**: In the purchase book, all transactions pertaining to purchases, be it on credit or by cash, are recorded. Transactions of purchase returned are also recorded here separately.

  ii. **Sales book:** In the sales book, all transactions pertaining to credit or cash sales are recorded. Transactions of sales returned are also recorded separately.

  iii. **Ledger:** All accounts involved in the transactions recorded in the journal or its subsidiary books are maintained here, and necessary posting is made.

  iv. **Cash book:** The cashbook is a subsidiary book of the ledger where the account of `cash' is maintained. Transactions involving ‘petty cash’ are also posted here separately.

  v. **Bank book:** The bankbook is a subsidiary book of the ledger where the account of `bank' is maintained.

  vi. **Stock register:** This is a register where the movement of stock is maintained.

The formats for the journal book and the ledger accounts were discussed earlier. The formats of subsidiary books like purchase book, sales book, cashbook, bankbook and stock register are given here along with a brief explanation for its usage.

Format of a Purchase Book

Date	Party's Name	Bill No.	Ledger Folio	Item Name	Quantity	Rate	Amount	Terms
	Total							

***Explanation*:**

i. **Date:** The date on which the purchase was made is mentioned here.

ii. **Particulars:** The name of supplier of the materials and necessary details of the invoice are mentioned here.

iii. **Bill No.:** The number of the bill of the supplier is mentioned here.

iv. **Ledger Folio:** The folio number of the ledger, on which either the supplier's account (if credit purchase) or cash account (if cash purchase) is credited, is mentioned here.

v. **Amount:** The net amount of purchase made is mentioned here.

vi. **Terms:** The terms of purchase, as on cash terms or credit terms, etc., are mentioned here.

Format of a Sales Book

Date	Party's Name	Bill No.	Ledger Folio	Item Name	Quantity	Rate	Amount	Terms
	Total							

Explanation:

i. **Date:** Date on which the sales transaction took place is mentioned here.

ii. **Particulars:** The name of the purchaser of the goods and necessary details of the transaction are mentioned here.

iii. **Bill No.:** The number of the bill given to the buyer is mentioned here.

iv. **Ledger folio:** The folio number of the ledger on which either the buyer account (if credit sales) or cash account (if cash sales) is debited is mentioned here.

v. **Amount:** The amount of sales done through this transaction is mentioned here.

vi. **Terms:** The terms of sales transactions like, ‘cash or credit’ is mentioned here.

Format of a Cash Book

Debit side(Receipts)				Credit side (Payments)			
Date	Particulars	Journal Folio	Amount	Date	Particulars	Journal Folio	Amount
					Closing Balance		
	Total				Total		

Explanation:

The 'Cash Book' is nothing but a cash account. Like other asset accounts, this account is also required to be mentioned in the ledger. However, because of the multiplicity of cash transactions and for convenience, cash account is not maintained in the general ledger but maintained as a separate account and named as cash book. All the rules of maintaining accounts in ledger apply to this account also.

Format of a Bank Book

Debit side(Receipts)				Credit side (withdrawals)			
Date	Particulars	Journal Folio	Amount	Date	Particulars	Journal Folio	Amount
					Closing Balance		
	Total				Total		

Explanation:

Like cash book, bank book is nothing but the bank account required to be maintained in the ledger. Since the transactions involving bank are increasing, it is convenient and proper to keep a separate bank account where all transactions involving the bank are posted. This account, therefore, is separately maintained and named bank book. All rules of making posting in other ledger accounts are applicable to this account as well.

Format of a Stock Register

Date	Particulars	S.B./ P.B. Folio No.	Receipts		Issues		Balance	
			Quantity	Value	Quantity	Value	Quantity	Value

Explanation:

The stock register is very similar to the stock account. It tells us about the actual closing stock available with the business to help the owner physically verify and place further orders.

i. **Date:** The date of transactions resulting in movement of stock is put here.

ii. **Particulars:** The details of transactions due to which the stock changes, are narrated here.

iii. **Sales Book/Purchase Book Folio number:** The page number of the sales book or purchase book where the particular transaction resulting in addition or deduction of stock is put here.

iv. **Addition:** Purchase resulting in addition of stock. The quantity of stock purchased along with its value is put here.

v. **Deduction:** Sales result into deduction of stock. The quality of stocks sold along with its value is put here.

vi. **The Closing Balance:** The amount that accrues, as a result of addition or deduction is calculated and put here.

vii. Itemwise separate page is to be kept in Stock Register.

Financial Statements

The main objective of bookkeeping is to record all transactions according to the accepted accounting principles and practices. But only proper recording of transaction is not adequate. Unless the various accounts recorded are properly classified for summary, it becomes difficult to visualise the total picture of the business. It is, therefore, very essential to summarise all those accounting details recorded by maintaining various books and to present them in an acceptable form. Financial statements are such forms in which all accounting details are presented for the use of various users like owners, bankers, creditors, tax authorities, government, suppliers, etc. With the support of the financial statements, one can understand the financial position of the business meaningfully.

Various Financial Statements

Normally at the end of the financial period for which the accounts are written, the ledger accounts are closed and balances are drawn for preparing final accounts. The statements known as final accounts are:

i. Trial Balance

ii. Profit and Loss Account

iii. Balance Sheet

(i) Trial Balance

The first step in preparing final accounts is to prepare a trial balance. The main objective of the trial balance is to determine the arithmetical accuracy of the entries made in the ledger. The fundamental principle of Double-Entry Bookkeeping is that every transaction has two equal and opposite effects. It means, every debit has a corresponding credit and vice-versa. Hence the total of all those accounts having a 'debit balance' and the total of all those accounts, which have a 'credit balance' at the end of the accounting period, should tally. They should be equal; otherwise the accounts would be inaccurate.

While preparing the trial balance, the accounts, which have debit balances, are placed in the debit column, while the accounts, which have credit balances, are placed in the credit column. In every trial balance, the total of the debit column must tally with the total of the credit column, unless some mistakes in posting, casting or compilation have been committed. The agreement of the totals of debit and credit columns of the trial balance ensures only arithmetical accuracy of the accounting, but it is not a conclusive evidence of the accounting accuracy as there are some mistakes which a trial balance cannot detect. A suggestive format of trial balance is given below:

Format of a Trial Balance

Trial Balance of M/s. ------------ for the year -----------

Ledger Folio	Name of Account	Debit closing balance	Credit closing balance
	Total		

Explanation:

i. **Ledger Folio:** In this column the folio number (page number) of the ledger or its subsidiary books where a particular account is maintained, is written. This helps in crosschecking the accuracy of accounts.

ii. **Name of Account:** In this column, the name of the account whose closing balance is being brought to the trial balance is written.

iii. **Debit/Credit closing balance:** In these columns, the amount of debit and credit closing balances of individual account is mentioned. It may be noted that a single account at a time cannot have both debit and credit balances. If an account has a debit closing balance the amount of that balance is mentioned in the debit column of the trial balance against the name of the respective account. Similarly, if an account has a credit closing balance, it is mentioned in the credit column of the trial balance.

iv. **Total:** When the closing balances of all accounts from the ledger and its subsidiary books are brought to the trial balance one by one, the totals of account in the debit column and the credit column are made and tallied. One should remember that:

a. Closing balances of all 'Assets Accounts', 'Revenue Expenses Accounts' and 'Losses Accounts' are always debit balances.

b. Closing balances of all 'Revenue Income Accounts' and 'Gain Accounts' are always credit balances.

c. Accounts of individuals to whom the business owes money always have credit balances and accounts of individuals who owe money to the business always have debit balances.

d. 'Loan (Taken) Accounts' always have credit balances.

e. 'Cash Account' always has debit balance.

If the totals of debit and credit columns of the trial balance do not agree, it means there is some mistake in preparing the accounting books. The mistake/s, traced and rectified would tally the trial balance. However, there are a few mistakes, which cannot be detected by trial balance, such as:

i. Errors of Principle

ii. Errors of Omission

iii. Errors of Commission

iv. Compensating Errors

After the trial balance is tallied, necessary adjustment entries need to be made for closing stocks, outstanding expenses, transfer provisions, etc.

(ii) Profit and Loss Account

The preparation of a trial balance is a step towards preparing the remaining two more important financial statements correctly viz. profit and loss account and balance sheet. However, its use remains to a great extent limited to detecting arithmetical accuracy. From the financial accounting system, the user would like to know about the profitability of the business operations for a specified period and the position of the business at the end of the period. A statement that reveals the profitability of the business operations for the accounting period is called 'Profit And Loss Account' (P & L A/c.).

Contents of P & L A/c.

From all the balances mentioned in the trial balance, the accounts that are for revenue expenditures, revenue type of losses, revenue income and revenue type of gains, are taken to P&L A/c. By doing so, it becomes possible to learn whether the business at the end of the accounting period has generated a surplus or deficit. All accounts of revenue income and gains are brought to the credit side, whereas all accounts of revenue expenditure and losses are brought on the debit side of the P&L A/c. If the total income is more than the total expenditure, the business is said to have generated surplus or profit. But if the total expenditure exceeds the total income during the accounting period, the business is supposed to have made losses. If the P & L A/c. has a credit balance, it signifies net profit and on the other hand, if the P&L A/c. has a debit balance, it denotes net loss of the business during the accounting period. A suggestive format of the profit and loss account is given below:

Format of Profit and Loss Account

Profit and Loss A/c. of M/s.-------------------------;

For the period -------------------------

Debit side **Credit Side**

Particulars	Amount	Particulars	Amount
Net Profit (Balance Figure)		Net Loss (Balance Figure)	
Total:		**Total:**	

Explanation:

i. **Particulars:** In this column, on the debit side, names of the following accounts are mentioned individually:

   a. All accounts of revenue expenditure
   b. All accounts of revenue losses

Names of the following accounts are mentioned on the credit side:

   a. Sales account
   b. Closing stock account (if it is adjustment entry)
   c. Accounts having credit effect of adjustment entries

ii. **Amount:** The respective amount of debit and credit balances of the accounts, which are brought to the P&L account, is mentioned in these columns on debit and credit side against the names of their respective account head.

One should also keep in mind the following:

   i. The P & L account contains all "Income and Expenditure Accounts". Not a single account from either individual, 'Personal Accounts or Asset Accounts' can be brought to the P & L account. All accounts of 'Income and Expenditure Accounts' get closed when they are brought to P & L account while the balance of 'Personal/Individual Accounts' and 'Asset Accounts' get carried forward to the subsequent year. All income generated and expenditure incurred during the whole period is mentioned in the P & L account.

   ii. Subsequent to bringing all balances of the accounts to concerned debit and credit sides, the total of their balances is made. If the total of credit side is more than the total of debit side then the business is said to have made net profit. The amount by which the total of the credit side exceeds the total of the debit side of the P&L account is called the 'Net Profit' generated during the accounting period. Similarly, the amount by which the total of the debit side exceeds the total of the credit side of the P & L account is called 'Net Loss' generated by the business during the year. Thus both figures of net profit and net loss are balancing figures. Adding them up with the total of the debit or credit side as the case may be would make the totals of both the sides tally. This is a situation where total income is equal to total expenses.

Thus, if

i. Total of credit side > Total of debit side of P&L A/c. of P&L A/c. = Profit

ii. Total of credit side < Total of debit side of P&L A/c. of P&L A/c. = Loss

iii. Total of credit side = Total of debit side of P&L A/c. of P&L A/c. = No profit/no loss

Net profit or net loss is the result of business operations during the accounting period. They are transferred to the balance sheet where the capital account representing the financial involvement of the promoter is increased or decreased appropriately by the figures of net profit or net loss.

iii. Balance Sheet

A balance sheet is a statement prepared for measuring the true financial position of a business at a certain point of time (normally the last day of the accounting period). It is essential to prepare the balance sheet (i) to ascertain the results of business operations during the accounting period; and, (ii) to know the financial position of the business at a particular point of time. The profit and loss account serves the former objective while the balance sheet serves the latter.

As seen earlier, all the accounts pertaining to the group of 'Income and Expenditure Accounts' are taken to the profit and loss account. The accounts pertaining to the remaining groups, viz. "Personal or Individual Accounts" and "Assets Accounts" are brought to the balance sheet. The accounts brought to the balance sheet are not closed. Their closing balances at the time of the balance sheet are carried forward to the subsequent accounting period. They are shown on the balance sheet only to apprise the users about the position of the accounts at that particular time. The balance sheet should be prepared in a prescribed format so that its understanding becomes easy. Given below is a prescribed format of the Balance Sheet.

Balance Sheet – Format

Balance Sheet of M/s. ---------------------- as on ------------

Liabilities	Amount	Assets	Amount
Capital Reserves & Surplus Secured Loans (Received) Unsecured Loans & Deposits (Received) Current Liabilities Provisions Profit Accumulated		Fixed assets Investments Loans and Advances (Given) Current Assests (i) Stocks ------ (ii) Debtors ------ (iii) Cash ------ (iv) Bank ------ Balance ------ Accumulated Losses	
Total		**Total**	

***Explanation*:**

It has been explained above that the balance sheet reveals the true and fair position of a business at a particular point of time. Thus, the balance sheet gives the details of what the business owns and what the business owes. Whatever the business owns is termed as 'Assets' and whatever the business owes is termed as 'Liabilities'. All liabilities are mentioned on the left-hand side of the balance sheet, while assets are shown on the right-hand side.

Assets

Assets are classified under the following broad heads:

i. **Fixed Assets:** Fixed assets are of permanent nature and the underlying motive of the business is to utilise them for value addition. The total value of fixed assets at the close of the accounting period is shown on the balance sheet.

ii. **Current Assets:** Current assets, unlike fixed assets, do not permanently maintain the same form. In whichever form they may be, they are likely to be converted in the form of 'Cash' or 'Bank Balance' in the near future.

Normally, the following accounts are termed as 'Current Assets':

a. **Stocks:** Closing stock of raw material, work in process and finished goods.

b. **Debtors:** Individuals from whom money is to be received (as a result of business transactions) are termed as 'Debtors' or 'Accounts Recei vables' and are also current assets.

c. **Cash Balance & Bank Balance:** Cash lying with the business, and balance in the bank account of the business are current assets.

iii. **Investments:** At times, the business invests in some other businesses or companies. The value of these investments is an 'Asset' for the business.

iv. **Loans & Advances (given):** At times, the business gives loans or advances to third parties. The value of such loans or advances is an 'Asset'. These are not similar to debtors (current assets) where the individual becomes liable to pay to the business due to his buying the product of the business on credit terms.

v. **Fictitious Assets:** Fictitious assets are not real and tangible assets but are debit balances of accounts like P&L A/c., Accumulated Losses A/c., Expenses Not Written Off A/c., etc.

Liabilities

On the liabilities side, all 'Personal' and 'Individual' accounts to whom the business owes are mentioned. Liabilities can be classified in the following broad groups:

i. **Capital:** Money invested by the promoter is a liability. Business owes that much to the owner.

ii. **Reserves and Surplus:** Accumulated profit, which is not withdrawn and is a part of profit, which is reserved for some specific purposes, also belongs to the promoter(s). Business owes that much to the owner. They are, therefore, liabilities.

iii. **Secured Loans (received):** Amount of loans taken by the business is a liability for the business. These loans are secured against some assets, which are offered to the institutions/person who have given loans, as security or collateral.

iv. **Unsecured Loans and Deposits (received):** Like secured loans, these loans are also liabilities for the business. However, these loans are not secured.

v. **Current Liabilities:** They are short-term funds taken for financing current assets. Normally, they are credits offered by suppliers of raw materials and the working capital loans given by banks.

vi. **Provisions:** They are liabilities in which case payment provision has been made by the business from the profits, e.g. provision for tax liability.

The total of the 'Liabilities' side and the 'Assets' side of the balance sheet must tally. If they don't, there are some mistakes in preparing the final accounts, which should be detected and rectified.