Decision making using financial accounting
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Lecture - 13
Lone Pine Cafe (Case)

Now, that we have moved out of what is called as your P & L statement out there and balance sheet, no doubts on P & L statement balance sheet right. You guys go back and how many of you tried the exercises? You have tried right you guys would have tried no not tried Navya says no.

Student: Slightly.

Slightly, it is all, it is very simple out there.

Student: One problem want to.

No, I would suggest you try it today also, if you have some doubts on your exercise problems next class I will address it. Next class that is tomorrow; tomorrow I can address it, not in a virtual class tomorrow's class I can address specifically any of the exercise problems in chapter 2 and chapter 3 what I have given out there.

It will all take maximum 1 hour for you to do it fine. Now, we move to the other aspects out there what we have actually planned Maynard Company A and B you guys will do it. Try if you have a problem come back, I will redo it not a problem, if you guys have a problem come back, but you have to tell me that you have a problem.

Today what we will do is? Spend time, is we will become a little typical accountants out here. We will become typical accountants and we look at what we saw is the final statement which is presented to the public or which you will get it as managers to view and interpret and make decisions. But what goes behind the scene? What goes behind the scene is what we are going to sort of try and take a look at it, Prateeksha is feeling very happy, because we are getting in her territory.

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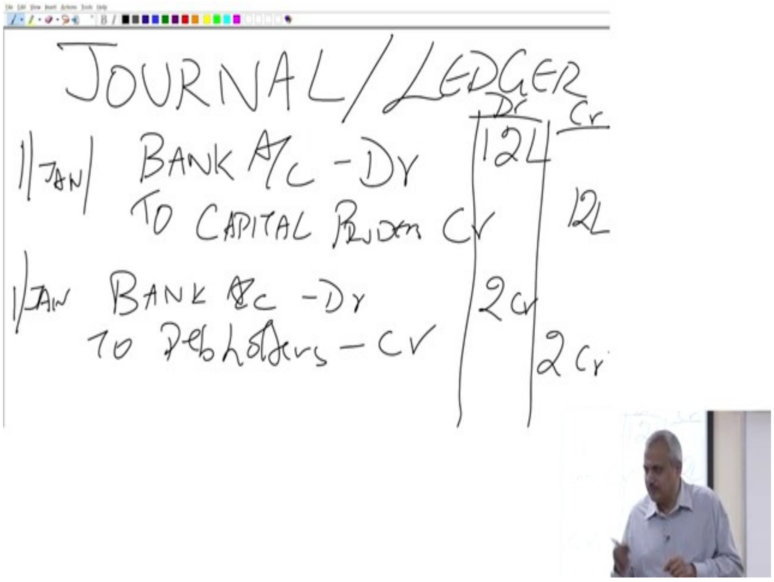

What typically we normally call it as what we say is journal, I am just going to get spend few minutes on this and the other aspect out here is what is called as ledger , journals and ledger. Journal it is more for knowledge, not from the point of view of an examination do not expect any question on journal and ledger in the examination, no I am not talking about it. More from the point of view of you have to understand what goes behind this before for the next half an hour we are going to spend time on that.

First and foremost; if you look at journal, journal is the book of primary entry. Primary entry that is the first book of the entry, moment a transaction takes place. A transaction is entered in the form of debit and credit only in a journal, a typical ledger account book you would have seen. Today of course, you have tally so you do not do it separately, but typically if you look at the as erstwhile age old accounting. Typically there is what is called as your ledger account and you will write what is account to be debited what is the account to be credited etcetera.

Now, let me pick up some transactions from that and let me sort of a try and record it if I can, I think that transaction sheet is there with you.

Student: Yes sir.

Open it get, get it, first transaction unit what is the where is that transaction sheet we will just go back to the same thing. Is particular case, I am just going to pick up some transactions I am not going to do all and let me make that very clear I am going to just pick a few transactions out here.

Let us take the first transaction itself, that is Prateek and Imran incorporated foreign company with each contributing about 600000 equity shares of 10 each on 1st of January. So, normally what happens is there is a date out there that is 1st of January. Now, what is happening in this particular case we saw that cash was coming in and there is a in the form of what is called as capital that is what did we do in the balance sheet we recorded cash as I cash at bank balances what it is called is an asset which is created And correspondingly there is a capital which you owe at the time of what is called as your dilution or closing none of your company that is what we created.

So, what happens there is we normally in accounting we always say debit always what comes to you, credit what goes out of you, that is the first and foremost as what we say. Debit what comes to you, credit what goes out of you. Now, the second aspect we also talk about is; debit the receiver; credit the giver out there; we also say debit the receiver, credit the giver out there, debit the receiver, credit the giver we also talk about that.

Now let us take the first one, debit what comes in, what is coming into you? Cash is coming into you cash or bank balance, bank account is coming into you; bank account debited. Now, debit what comes in credit what goes out is there anything going out, nothing is going out of there.

Now, go to the second, principal second principal says debit the receiver credit the giver out there, who is giving? Pran and what is called as a two partners who are basically giving the capital normally what I say to capital providers whatever is the name you can write providers credit.

Now, there will be normal 2 columns out here you can enter whatever is the column whatever is the 12 L out here and then 12 L out here. I can have a debit balance out here and I can have a credit balance out here in this particular case. Normally, what happens is there will be multiple columns in this particular case and that is all and below that you normally write what is called as a narration.

Typical accountant that is what is the purpose why etcetera. Now, this is how typically your transactions moment, every transaction moment that happens are basically entered. Pick up another cash transaction from this read any other cash transaction out here.

Student: 5.

5 ok, now look at transaction number 5, I am jumping to transaction number 5 here. The company issued 200000 debentures of 100 each on 1st of January and all the debentures are fully paid and subscribed. The company has issued debentures, again what is happening? There is cash or money that is coming in out there that is again on the date on 1st of January that is what is called as bank account debited to what is called as there is a giver right debit what comes in what is coming in; cash has come in I have debited.

Now, debit the receiver, credit the giver who has given? There is a what is called as there is a cash that I have I got it from basically the debenture holder debenture, holders have provided the money. So, I am crediting the debenture holder that is debenture holders credit out there whatever is the value what is the value?

Student: Sir (Refer Time: 07:11).

200000 into 100.

Student: Sir 2crore.

2crore out there roughly. Now what have I done? Every transaction like this I will record it in what is called as the book of primary entry that is what we call it as a journal ledger comes as a next stage of your account preparation, when I said next stage of your account preparation what do we do in a ledger is? I group all these accounts together, when I say I group all these accounts together. Now, there is one entry of the cash out here, there is another one with the cash out there. Imagine a company every minute they will be a 100s of transactions 100s of entries will be happening over a period of time.

Every week normally or every is frequent intervals at a time period out there what you do? You consolidate all these. So, what do I do? I pick up whichever transaction where there was a bank mentioned I group all of them together. Whichever transaction where there was capital mentioned I group them together, whichever transaction there was a purchase mentioned I group them together, whichever transaction there was a sale mentioned I group them together.

That is what I do and when the grouping of these together we call it as a T account out there how do we do it T account? Ledger account, it is called by various names out there. Now, how do we do that let us take that let us take an example of that.

Student: The personal account will be there.

Personal account we will come to that sir we will come to that every account every every transaction. For every transaction you will have an account, every transaction means every item in the transaction out there ok.

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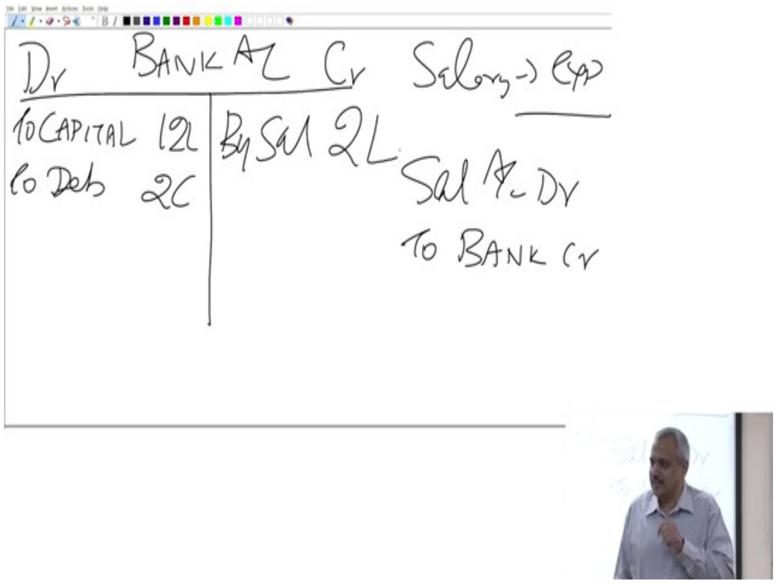

Now, let us look at it, so what do you do when you grouping? I will say I create what is called as a bank account I typically create 2 sides of a bank account. This is normally the credit side of an account; this is a debit side of an account. In the first transaction what has happened bank account was debited by what? By because of capital.

So, what happens there bank account debited to capital whatever is the amount out here. And of course, this also has a date there is one more column which will be a date column I have not mentioned it out there. What is the second transaction? The second transaction in this particular case is bank account debited to debentures providers some 2 crores out there. So, like this everywhere there is a bank account coming in your basically you are going to keep on adding to it. Now, there is a bank with a payment read another transaction.

Student: Transaction number 8.

Transaction number 8, let us look at transaction number 8. If we look at transaction number 8.

Student: Or 6 also.

Or transaction number 8 itself that is not a problem, no problem you can take a break.

Student: Ok.

Do not; do not so not worry do not worry; do not worry perfectly fine. Let us say the transaction number 8, when transaction number 8 what happens? There is a monthly salary being paid of 10000 each took the two partners. Let us take salary for the for example, salary for a period of 6 months or whatever it is. So, if you take a salary for period of 6 months you have paid, then typically what would or every month when you take the salary what is the typical journal entry?

Student: Journal.

Debit the receiver credit the giver, who is receiving? Partners are receiving, so partner salary is it so, am I right.

Student: Right the credit.

There is one more aspect out there, normally pertaining to expenditures and losses, expenditures losses and incomes. When you talk about expenditure losses and income, we always say debit all the?

Student: Expenses.

Debit all the expenditures and losses, credit all the incomes and gains we will come to it. Now, what will you say normally these are divided into 3 basic groups out there. Now, he said that first aspect we talk about assets, when you talk about assets we will say what comes in? Debit what comes in, credit got goes out, we normally call it is a real account principal, am I right?

Student: Yes sir.

Debit what comes in, credit what goes out; we talk about personal account principal that is what mister Srinivasan said. The personal account principal, we talk about debit what the receiver, credit the giver out there; debit whatever whoever is receiving the money, credit whoever is giving the money.

3rd a principal what we normally talk about is nominal account principal, that is debit all expenses and losses, credit all incomes and gains out there. Debit all expenses and losses why do you debit all expenses and losses sir? Somebody says credit is good, debit is good etcetera.

Student: Sir this is expense.

Simple, expenditure losses moment there is an expenditure the money what you owe to the basic investor is basically given reducing out there that is how, where that is a basic a statement.

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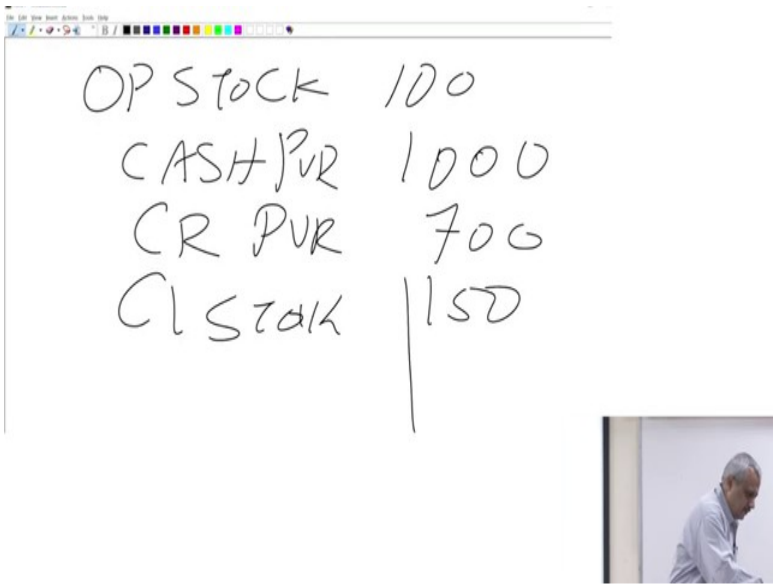

In this particular case what happens the salary, in this particular case the salary what I pay is an expenditure, please understand. When I say debit all expenditures and losses, I will say salary account debited.

Student: Sir to bank account.

To why what debit what comes in, credit what goes out your asset is going out. So, what happens to bank account credited that is all what is happening, salary account that salary is an expenditure; salary account debited, bank account basically credited in that particular case. So, what I do? Bank account is credited by what? By my salary.

Whatever is a amount I will just right there. Now, when I prepare a balance sheet in this particular case in the case of example what we took what did we do? We took the bank account in the balance sheet adjusted the bank account for every transaction that we had. But a typical account that is not going to do that, what is going to do as of today what is the bank balance?

Supposing I say the total salary paid is 2 lakhs, what are the bank balance as of today after the 3 transactions I have taken 12 lakhs plus 2 crores minus whatever is the 3 lakhs that is basically the bank balance out there. So, that will directly you will enter in the balance sheet if he is preparing a balance sheet as of today as the bank balance am I with you on this.

Student: Yes.

Student: Sir (Refer Time: 14:40) banks.

Sir moment you are issued you moment you have issued that we will take care of what we call it as a bank reconciliation statement that is your statement and bank statement can differ always. Because cheques in transit etcetera, moment you have issued a cheque, it is recorded by you as that amount does not belong to you it is gone.

Student: Not till it is gets.

Not till it gets you know it does not, because moment you have write a cheque out there because you do not know when it is getting or a when it is getting (Refer Time: 15:11) for example, you might send me a cheque.

Student: Post dated cheque.

Post dated cheque is for post dated cheque you will not that on the day the cheque becomes honourable the cheque can be what is called a cheque becomes valid I would use the word there, to a post dated cheque is an invalid. Supposing I give a post dated cheque on the by the time the cheque is the by the time the date appear that person pops off then the cheque is invalid, because account will; obviously, be closed right.

So, that is as good as till the day the cheque becomes valid, it is only a piece of paper for me. So, till that says you do not record, but the day it becomes valid you might give me a cheque I may presented today I may presented 45 days later.

But we represented 45 days later and money is not there still I can come and file execute against you right. Because you again the cheque which should be valid, so that is basically the principal. So, what we record is? Moment the cheque is issued basically that is what basically what we do what have I done out here, all the bank transactions I have grouped it out here.

So, as of today if I need to know what is the bank balance, I will just look at the bank account the ledger account of bank, I have the total of debits, debits is money that you are receiving, I have the total of credits. The difference is basically the balance which should actually match with your bank account out there yes sir.

Student: This nomenclature is quite confusing sir.

That is why I did not start off with this sir.

Student: Like for example, one in this spontaneous is a it is debited bank account, but whereas.

I will come to that; I will come to that; I will come to that I know that. Your all be worry that salary is credited not debited.

Student: Yes.

Student: Yes.

Student: Yes.

Student: Sir if debited from the company (Refer Time: 17:07).

Companies are go do not worry, bank tells you what banks tells you we are worried only bank see there are multiple things you worry about, you can worry about only one thing I will worry only about bank. Now, he says what comes in is what comes to my account I am debiting whereas, on money comes to bank when it comes to money comes to the account bank is crediting it why? What is it when money comes to your account?

Student: No sir.

It what is it called let us look at the first 4 aspect for asset, liability, income, expenditure what is it for you?

Student: Income.

Student: Income (Refer Time: 17:38).

When money comes to your accounts.

Student: Yes sir.

Forget about income, you do not know where you it, it can be borrowing also right, you can borrow on money can come into your account.

Student: Sir.

What is ?

Student: Cash.

Student: Cash.

Student: Cash.

That is what I wanted, when money comes to your account it what is it for the bank?

Student: Ah.

Student: (Refer Time: 17:53).

Student: Expenditure.

Student: Expenditure.

Student: Expenditure.

When money comes to your account what is it for the bank?

Student: Liability.

Student: Sir its liability.

Bank owes you the money right, as in more money you keep depositing in your account bank is becoming more and more liable to you right.

Student: Yes sir.

Please understand from the bank point of view please understand from the bank point of view what comes in? Debit the receiver, credit the giver out there. In the whole process you are not receiving the money, you are giving the money to the bank, when you are giving the money to the bank what is it say? They follow credit the giver.

Student: Yeah.

So, what are you doing? They are only crediting you.

Student: Yes.

Please look at it from the banks point of view, do not look at it from your point of view that is why I did not start with this.

I can do that for a fresher, because they do not have operated a bank account I mean so much, so it is otherwise we are so used to it. So, look at it, see you always prepare from your point of view, bank prepares their statement from their point of view more and more money in your account more and more liability for the bank.

Student: Yeah.

More and more deposits in the account for example, deposits, fixed deposit asset for your very happy what is an asset for a bank? Is it fixed deposit or a loan.

Student: Loan.

Loan is an asset for them, fixed deposit is not an asset for them. Fixed deposit is a bloody liability for them right.

Student: Yes sir.

Student: Yes sir.

Are you getting the principle ?

Student: Yes.

Student: Yes sir.

So, that is where you will say salary is credited salary is credited, do not think about it, think about from your point of view do not think from a bank point of view bank point of view bank will think. I do not think there is anybody from the bank here, there is one person yeah only one person I know Natesh am I right Mister Natesh. So, do not think for the bank point of view as of now in the class Natesh will thing only from his point of view not from the banks point of view.

So, debit the receiver, credit the giver debit what comes in, when money is coming into your account your in the bank is holding an account your account. Debit the receiver I will receiving money from your account, no what are you doing? You are giving the money to your account somebody is giving the money in your account debit the credit the giver, so I am crediting him, understand.

Student: Sir.

Student: Company which is giving me salary what does it for that?

Sir, so for them it is an expenditure, they are giving you a salary here what is it? Expenditure. They will write it as expenditure account debited to wherever they are giving, if they are giving cash; cash account credited nominal cash it is bank; bank account credited out there. Because money is going out of their bank account whereas, for the companies bank if you look at what is it? Money reducing from the companies bank account it is basically a debit for them.

Student: Yes sir.

Right for the companies bank there are 4 entities out here; company, companies bank, you, your bank. Company expenditure debited, bank account credited because money going out. Companies bank what is it say? They are not worried about it a salary or not they are not worried what they are worried? Money getting out of your account, they are liabilities reducing, what do they do? They will debit it, what do you do? Salary I am earning fantastic. So, salary it is an income, debit all incomes and income and losses and credit all what you say what is a statement principal is a?

Student: Debit all income.

Debit all.

Student: Debit all expenses and losses.

Student: Expenses.

Student: Expenses.

Student: Expenses and losses.

Debit all expenses and losses and credit all incomes and gain. So, what happens for you? Money coming in debit what comes in, cash has come in, bank account debited. It is coming because of what? Because of a salary, bank account debited salary account credited or income account created, your bank money is going into your account liabilities increasing. So, what do they do your bank your account? They will credit your account over there, confused I know. Patiently go back think through it very simple, yes Srinivasan.

Student: Intellectual property rights will not all used.

Sir intellectual property rights unless it has to be valued normally unless it is bought we do not worry about it, as if now let us not worry about it. So, these are basically what did I what I displayed out here bank account and out here the journal part of it these are all books journal is a book of primary entry. What you do every transaction keeps happening.

In your organization every second there is a transaction, move on to every second there is a transaction you keep recording what is debit, what is credit, what is debit, what is credit, and then keep on recording that with the date and the narration. At frequent intervals say about every week are depending on the size of the organization, some organization will do it every month depending on the size of the organization what do you do? You group this, what did I do? I grouped all the bank transactions here.

So, there will be numerous items out there, I can group all they now sales, I can group all the bank, I can group all the purchases, I can group all the money that I owe to the supplier, I can group all the money that I sort of paid for wages, I can group all the money that I paid for repairs and maintenance, I can group all the money that I paid for or what is called as my transportation etcetera; etcetera. I mean the number of ledger accounts can run into numerous hundreds out there, so each will have a separate ledger account, 1 second Srinivasan.

And at any point of time I need to know what is the balance? I just had the debit and credit debit side and credit side I will always have the balance. For example, sales account, sales account can never have a debit balance, why? Because sales means what? Goods is going out, in a sale goods cannot come in. So, sales account will always have a credit balance; purchases; purchases will always have a debit balance, because purchases means what? Goods always coming in, you can never have a credit balance am I with you on this?

Student: Yes sir.

Only your cash and bank will always have a debit and credit balance out there in the process yes Srinivasan.

Student: (Refer Time: 24:17).

Yeah.

Student: (Refer Time: 24:22).

A scarp what we sell we will get added to your income sales, sales service income and then sales income, service income and other related income, other totally other income there can be 4 kinds of incomes out there.

For example an automobile company, there can be a sales income, there can that is selling of the vehicle, Second kind of income there can be selling of spare's. Third kind of income there can be selling of what is called as dealing with services out there. Forth kind of income there can be scrap sale scrap whatever generated. Fifth kind of income I generate income based on my investments also.

Student: Investments.

So, that there can be multiple kinds of incomes out there what we talk about.

Student: (Refer Time: 25:10) petty cash where there.

Petty cash, cash is an asset it can you can call it petty cash.

Student: So, we use with the not it is.

It is an as of today if it is not utilized it is an asset sir, it can be petty cash is a name what you call it that is all. I can call it petty cash, or a macro cash or a micro cash whatever it is you can call it anywhere you want, but cash is an asset that is all for you. Even if it is a borrowed cash it is still an asset for you, because the cash is yours borrowing is a liability.

Student: In case of purchase return in case of purchase return (Refer Time: 25:43).

In case of purchase return, now he will say oh in case of purchase return they will be a credit entry. Now, when will we make purchases account we will make it separate, purchase returns account we will make it separate why? Because I need to know what is the returns I am making.

If I am making a purchases of 100 and my return is also going to be sizable huge, then what happens and I know I have to change my vendor. If I have purchase and purchase retune mixed in an account, then I will never be able to detect what is the quantum of purchase returns same thing happens with sales and sales returns also, so these two accounts are different.

So, a purchase returns account will always have only credit balance it will never have a debit balance right. Because what am I trying to do I need to know what is the transaction that is happening with the bank, with the salaries, with the out standings etcetera. Multiple yeah not 4 in this case 4 for we will have 400 different accounts out there if we typically look at it.

Purchase account, purchase returns, see each is a separate different activity, purchases different activity an account for that, salary is a different activity different account for that, wages is a different activity for a different activity you pay wages account a separate, purchase return is a separate activity there is a separate account for that. He said scrap account there is a scrap, I can maintain scrap sale there is a separate account for that can go on numerous.

Student: Sir how can we return sale account.

Which one?

Student: Bank book and our passbook.

There is a bank reconciliation statement which we do that typically accountants do that let that is not part of this course.

Student: Not this something which is always (Refer Time: 27:19).

There is always a reconciliation statement which is done which will which is not part of this course. But if you want me to teach you I will teach you, but not in the regular fourteen sessions you have to come on an extra day I will certainly do that not a problem, but bank reconciliation, because he has asked me I will just give you a brief of it. The day on which you should cheque your recording it as a expenditure out there, your bank balance if I do this calculation and calculate the amount might be very different from what is the if I do if I get a what is called a bank statement the amount will be very different from the bank statement.

Because many of them would not have cashed the cheque it are wont I have received a cheque I recorded as a receipt out there, but I have deposited it will take 2 days to collect. So, imagine if it is a non payable at for cheque and if it is outstation cheque it will take 15 days to collect also, so what happens there is a difference between your balance and the bank balance. So, what do you do you reconcile that you go back and look at what are the differences that is what we call it as bank reconciliation, 1 second doctor that is what we call it as reconciliation statement that is a separate statement by itself that is a separate part of it.

Student: Sir in this problem indeed cheques we have to cheque from which is problem one for (Refer Time: 28:37).

No, cheque free is perfectly fine, but what happens is even if you look at what you call it as any easiest payment also there could be a time delay, there could be a time lag whatever time lag. Supposing I make a sale today bank is working yeah today it is working I make a sale today at 5 o'clock I recorded it. But money credited only on Monday tomorrow bank holiday, today if I reconcile there will be a difference right. So, if you do go somebody can say net payment net payment you can do it, but if it is RTGS it valid only in the during the bank working hours.

Student: Working hours (Refer Time: 29:15).

Whatever I mean I do not do much of this, but something around this right. So, there could be this kind only thing is supposing without cheque the time lag is reduced, but there will be a difference, move on the credit card bill comes I will say expenditure is so much, but I given a ECS to my bank. So, bank will debit my account only on the last day and the due date, but as of today for me it is an expenditure agreed that much of cash I have to keep it aside mentally am I with you sir.

Student: Today the regularly or it is one demand.

Which one?

Student: Bank reconciliation.

Reconciliation statement at every frequent intervals the company will prepare sir because they need to know why what is the difference. For example, dividend warrants I have done the ECS of dividend sir, dividends for all my shareholders. Some guy one of the shareholder as close his account and gone, the amount though it is easiest it will be in limbo.

It will never get credited to his account and neither is he claiming nor he is changing the account maybe as popped off that amount will always be in limbo and there will always a difference between the bank because as far as your concerned ECS dividend payment you reduce that amount. But money has not gone out it is still in your account out there, suspense is very different sir do not suspense where did you pick up the suspense for account sir number names sir, I never use suspense account till today's class, but I want to no understand.

Student: (Refer Time: 30:40).

Ah.

Student: From an accountant point of view you cannot maintained at.

Sir suspense account is something what happens is if it is really not traceable. There is a problem you are just not able to trace it despite racking your brain and they having the best debit credit accountants. Normally, the best chartered accountants we call them debit credit, they are accountant because they will be perfect in finding out what is the flaw.

So, despite having the best officers I am not able to find within that stipulated time period then I park it in a suspense account and suspense account I cannot carry it for lifelong. I will not resolve it very soon that is what is suspense account there is not even worry about suspense account.

Normally, we were taught when we were learning accounts it was a balance it does not balance put the remaining in suspense account and leave it that is what we were taught, but that is not learn from her.

Student: Um.

Interest is an expenditure principal repayment is that just reduced; reduced from your liability that is all fine. You have some basic idea about your I mean there is again I said not from an exam point of view, but more for you to know what happens behind the scenes right. What happened when the scene we have clear accounts like this and then consolidate and take it to the balance sheet out there. Now, why I have not spent a lot of time on journal, ledger, etcetera reason?

You are learning not doing your executive MBA not to prepare a balance sheet, not to prepare what is called a accounting statement or a balance sheet or a P & L. A balance sheet or a P & L just pops up on your table you should be able to look at it and not feel scared about it you should be able to at least look at some numbers and interpret some numbers out there. So, that is where we started from the balance sheet and then trickled down to the P & L and so on and so forth. For online class what we will do is, I given you the annual report of Maruti Udyog if I am not wrong.

Student: Yes sir.

We will go page by page and interpret it. So, what happens it is a lecture mode if you have questions you can always put in the questions and he will be there to looking at the questions out there, so I will be interpreting it. So, there is no teaching of numbers per say. So, it will be that.

Thank you.