ENGINEERING ECONOMICS AND ACCOUNTANCY

Subject code: Hu 302

3RD SEMESTER

BRANCH: ELECTRICAL /MECHANICAL /CIVIL ENGINEERING

TOTAL DURATION: 45 HOURS

SYLLABUS

Part A: Engineering Economics - 21 hrs

Chapter No.	Chapter Title	Duration (in hours)	Distribution of Marks
1	Introduction to Economics	5	8
2	Demand and Supply	4	6
3	Production	5	8
4	Money	2	4
5	Banking organization-	3	5
6	Pricing	2	4
	Gross total		**35**

Part B: Accountancy - 21 hrs

Chapter No.	Chapter Title	Duration (in hours)	Distribution of Marks
7	Introduction to Book-keeping and Accountancy	5	8
8	Transaction	2	3
9	Journal and Ledger	4	7
10	Cash Book	4	7
11	Trial balance	3	5
12	Components of Final Accounts	3	5
	Gross total		**35**

Sessional: 30 marks

Class test-3 hours

All total: 100 marks

PART A: ENGINEERING ECONOMICS

CHAPTER –1

1.1 Definition of Economics, Its Utility and Scope of the study

1.2 Meaning and concept of Utility, Consumption, Value, Price, Goods and National Income

1.3 Wants – definition and characteristics

1.4 Wealth- Definition and meaning, types

1.1 Definition of Economics:

The analysis of economic environment requires the knowledge of economic decision making and hence the study of "Economics" is significant. There are 4 definitions of Economics.

(i) Wealth Definition: Adam Smith defined "Economics as a science which inquired into the nature and cause of wealth of Nations".

According to this definition —

- Economics is a science of study of wealth only;
- It deals with production, distribution and consumption;
- This wealth centered definition deals with the causes behind the creation of wealth, and
- It only considers material wealth.

Criticisms of this definition:

(a) Wealth is of no use unless it satisfies human wants.

(b) This definition is not of much importance to man and welfare.

(ii) Welfare definition: According to Alfred Marshall "Economics is the study of man in the ordinary business of life". It examines how a person gets his income and how he invests it. Thus on one side it is a study of wealth and on the other most important side, it is a study of well being.

Features:

(a) Economics is a study of those activities that are concerned with material welfare of man.

(b) Economics deals with the study of man in ordinary business of life. The study enquires how an individual gets his income and how he uses it.

(c) Economics is the study of personal and social activities concerned with material aspects of well being.

(d) Marshall emphasized on definition of material welfare. Herein lies the distinction with Adam Smith's definition, which is wealth centric.

(iii) Scarcity definition: This definition was put forward by Robbins. According to him "Economics is a science which studies human behavior as a relationship between ends and scarce means which have alternative uses.

Features:

a) human wants are unlimited
b) alternative use of scarce resources
c) efficient use of scarce resources
d) need for optimization

(iv)Growth Oriented definition: This definition was introduced by Paul. A. Samuelson. According to the definition "Economics is the study of how man and society choose with or without the use of money to employ the scarce productive resources, which have alternative uses, to produce various commodities over time and distributing them for consumption, how or in the future among various person or groups in society." It analyses costs and benefits of improving patters of resource allocation.

<u>Subject Matter of Economics:</u>

Economics is best described as the study of humans behaving in response to having only limited resources to fulfill unlimited wants and needs. Scarcity refers to the limited resources in an economy. Macroeconomics is the study of the economy as a whole. Microeconomics analyzes the individual people and companies that make up the greater economy.

The subject matter of economics is presently divided into two major branches i.e.Micro Economic and Macro Economics. These two terms have now become of general use in economics.

Micro Economics

- Micro economics studies the economic behaviour of individual economic units.
- The study of economic behaviour of the households, firms and industries form the subject-matter of micro economics.
- It examines whether resources are efficiently allocated and spells out the conditions for the optimal allocation of resources so as to maximize the output and social welfare.
- For example, micro economics is concerned with how the individual consumer distributes his income among various products and services so as to maximize utility.
- Thus, micro-economics is concerned with the theories of product pricing, factor pricing and economic welfare.

Macro Economics

- Macro economics deals with the functioning of the economy as a whole.
- For example, macro economics seeks to explain how the economy's total output of goods and services and total employment of resources are determined and what explains the fluctuation in the level of output and employment.
- It deals with the broad economic issues, such as full employment or unemployment, capacity or under capacity production, a low or high rate of growth, inflation or deflation.
- It is the theory of national income, employment, aggregate consumption, savings and investment, general price level and economic growth.

Nature of Economics :

Nature of economics refers to whether economics is a science or art or both, and if it is a science, whether it is positive science or normative science or both.

Economics as a Science —

- We have often stated that economics is a social science.
- Economics as a social science studies economic activities of the people.
- Economics is a systematic body of knowledge as it explains cause and effect relationship between various variables such as price, demand, supply, money supply, production, national income, employment, etc.
- Economic laws, like other scientific laws, state what takes place when certain conditions (assumptions) are fulfilled.
- This is the traditional Deduction Method where economic theories are deduced by logical reasoning.
- The law of demand in economics states that a fall in the price of commodity leads to a large quantity being demanded ‘given other things’, such as income of the consumer, prices of other commodities, etc., remaining the same.
- In economics we collect data, classify and analyse these facts and formulate theories or economic laws.
- The truth and applicability of economic theories can be supported or challenged by confronting them to the observations of the real world.
- If the predictions of the theory are refuted by the real-world observations, the theory stands rejected.
- If the predictions of the theory are supported by the real-world events, then the theory is formulated.
- The laws of economics or economic theories are conditional subject to the condition that other things are equal.
- Economic theories are seldom precise and are never final; they are not as exact and definite as laws of physical and natural sciences.
- The laws of physical and natural sciences have universal applicability, but economic laws are not of universally applicable.
- The laws of physical and natural sciences are exact, but economic laws are not that exact and definite.

Economics as an Art —

- Various branches of economics, like consumption, production, distribution, money and banking, public finance, etc., provide us basic rules and guidelines which can be used to solve various economic problems of the society.
- The theory of demand guides the consumer to obtain maximum satisfaction with given income.
- Theory of production guides the producer to equate marginal cost with marginal revenue while using resources for production.
- The knowledge of economic laws helps us in solving practical economic problems in everyday life.

Economics as a Positive Science —

- A positive science is that science in which analysis is confined to cause and effect relationship.
- Positive economics is concerned with the facts about the economy.
- It studies the economic phenomena as they exist.
- It finds out the common characteristics of economic events.
- It specifies cause and effect relationship between them.
- It generalizes their relationship by formulating economic theories and makes predictions about future course of these economic events.

Economics as a Normative Science —

- The objective of Economics is to examine real economic events from moral and ethical angles and to judge whether certain economic events are desirable or undesirable.
- Normative economics involves value judgment.
- It deals primarily with economic goals of a society and policies to achieve these goals.
- It also prescribes the methods to correct undesirable economic happenings.

Economics as a Science and an Art —

- Being a systematized body of knowledge and establishing the cause and effect relationship of a phenomenon, Economics is a scientific study.
- The laws of economics are conditional.
- Economics cannot predict with so much certainty and accuracy as the subject deals with the behaviour of human beings as such controlled experiment is not possible.
- Some economists prefer to treat economics as an art.
- Every science has an art or a practical side.
- Every art has a scientific side which is theoretical.
- Economics deals with both theoretical aspects as well as practical side of many economic problems we face in our daily life.
- Thus, Economics is both science as well as an art.

Scope of the study

Traditional Approach	• Economics is a social science. • It studies man's behaviour as a rational social being. • It considered as a science of wealth in relation to human welfare. • Earning and spending of income was considered to be end of all economic activities. • Wealth was considered as a means to an end – the end being human welfare.
Modern Approach	• An individual, either as a consumer or as a producer, can optimize his goal is an economic decision. • The scope of Economics lies in analyzing economic problems and suggesting policy measures. • Social problems can thus be explained by abstract theoretical tools or by empirical methods. • In classical discussion, Economics is a positive science. • It seeks to explain what the problem is and how it tends to be solved.

	• In modern time it is both a positive and a normative science. • Economists of today deal economic issues not merely as they are but also as they should be. • Welfare economics and growth economics are more normative than positive.

Economics Basics: Utility

The focus of economics is to understand the problem of scarcity: the problem of fulfilling the unlimited wants of humankind with limited and/or scarce resources. Because of scarcity, economies need to allocate their resources efficiently. Underlying the laws of demand and supply is the concept of utility, which represents the advantage or fulfillment a person receives from consuming a good or service. Utility, then, explains how individuals and economies aim to gain optimal satisfaction in dealing with scarcity.

Utility is an abstract concept rather than a concrete, observable quantity. The units to which we assign an "amount" of utility, therefore, are arbitrary, representing a relative value. Total utility is the aggregate sum of satisfaction or benefit that an individual gains from consuming a given amount of goods or services in an economy. The amount of a person's total utility corresponds to the person's level of consumption. Usually, the more the person consumes, the larger his or her total utility will be. Marginal utility is the additional satisfaction, or amount of utility, gained from each extra unit of consumption.

Although total utility usually increases as more of a good is consumed, marginal utility usually decreases with each additional increase in the consumption of a good. This decrease demonstrates the law of diminishing marginal utility. Because there is a certain threshold of satisfaction, the consumer will no longer receive the same pleasure from consumption once that threshold is crossed. In other words, total utility will increase at a slower pace as an individual increases the quantity consumed.

1.2 Meaning and concept of utility:

- Utility is the amount of benefit a consumer receives from a given good or service. Economists use utility to determine how an individual can get the most satisfaction out of his or her available resources.
- Utility, or usefulness, is the ability of something to satisfy needs or wants.
- Utility is an important concept in economics because it represents satisfaction experienced by the consumer of a good.
- Utility is a representation of preferences over some set of goods and services.
- One cannot directly measure benefit, satisfaction or happiness from a good or service, so instead economists have devised ways of representing and measuring utility in terms of economic choices that can be counted.
- Economists consider utility to be revealed in people's willingness to pay different amounts for different goods.
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- This decrease demonstrates the law of diminishing marginal utility.

Law of Diminishing Marginal Utility:

- This Law is a fundamental law of Economics.
- It relates to a man's behaviour as a consumer.
- The Law states that as a man gets more and more units of a commodity, marginal utility from each successive unit will go on falling till it becomes zero or negative.
- Marginal utility means the additional utility obtained from one particular unit of a commodity.

- It is expressed in terms of the price that a man is willing to pay for a commodity.
- The basis of the Law is satiability of a particular want.
- Although human wants are unlimited in number yet a particular one can be fulfilled.

The Law is based upon certain assumptions —

- It is assumed that the different unit consumed should be identical in all respects.
- Further it is assumed that consumer’s habit taste, preference remain unchanged.
- Thirdly, there should be no time gap or interval between the consumption of one unit and another unit.
- Lastly, the different units consumed should consist of standard units which are not too small or large in size.

Notion of the Law

The Law of Diminishing utility is not applicable in some cases. The Law may not apply to articles like gold, money where more quantity may increase the lust for them. Further the Law does not apply to music, hobbies. Thirdly, Marginal utility of a commodity may be affected by the presence or absence of articles which are substitutes or complements.

Consumption:

By consumption, we mean satisfaction of wants. It is because we have wants that we consume various goods and services. Moreover, it is assumed that, if we have wants, these can be satisfied only through the consumption of goods and services. Thus, consumption is defined as the satisfaction of human wants through the use of goods and services.

Determinants of Consumption Function

Consumption function depends on subjective and objective factors. Among objective factors we may mention a few:

(a) Tax Policy – A higher rate of tax will reduce personal income and to that extent consumption as well.

(b) The Rate of Interest – A higher rate of interest may induce more savings and so less consumption. However a higher interest income may raise consumption by raisingtotal income.

(c) Holding of Assets – If people want to hold moreassets, like property, jewellery etc. they will curtail consumption.

(d) Windfall Profits or Loss – Consumption level of those classes of people changes who gain windfall profit or incur heavy loss. Among subjective factors we may mention some motives that lead individuals to refrain from spending. Theseare motive of precaution, motive of foresight, motive of improvement, motive of avarice etc.

Other determinants of consumption:

Present income	It is the main determinant of consumption.
Expected future income	• Most people try to save for the future. • People display a low average propensity to consume when they are young. • A low propensity to save when they are old.
wealth	• A person may have a low income, but he may be • Wealthy • He may have a great amount of accumulated wealth, • In this case, he may have high consumption expenditure.

<u>Value:</u>

In economics, value is a measure of preference.

Modern Definition of Economic Value

- Dupuit (1844) The "maximum sacrifice expressed in money which each consumer would be willing to make in order to acquire an object "provides "the measure of the object's utility."
- Marshall (1879) The "economic measure" of a satisfaction is "that which a person would be just willing to pay for any satisfaction rather than go without it."

- Schwarz and Bilsky(1987) “values are (a) concepts or beliefs, (b) about desirable end states or behaviors, (c) that transcend specific situations, (d) guide selection or evaluation of behavior and events, and (e) are ordered by relative importance.”

Price:

In ordinary usage, price is the quantity of payment or compensation given by one party to another in return for goods or services.

Economists sometimes define price more generally as the ratio of the quantities of goods that are exchanged for each other.

In modern economies, prices are generally expressed in units of some form of currency. (For commodities, they are expressed as currency per unit weight of the commodity, e.g. euros per kilogram.) Although prices could be quoted as quantities of other goods or services this sort of barter exchange is rarely seen. Prices are sometimes quoted in terms of vouchers such as trading stamps and air miles. In some circumstances, cigarettes have been used as currency, for example in prisons, in times of hyperinflation, and in some places during World War 2. In a black market economy, barter is also relatively common.

In many financial transactions, it is customary to quote prices in other ways. The most obvious example is in pricing a loan, when the cost will be expressed as the percentage rate of interest. The total amount of interest payable depends upon credit risk, the loan amount and the period of the loan. Other examples can be found in pricing financial derivatives and other financial assets. For instance the price of inflation-linked government securities in several countries is quoted as the actual price divided by a factor representing inflation since the security was issued.

Price sometimes refers to the quantity of payment requested by a seller of goods or services, rather than the eventual payment amount. This requested amount is often called the asking price or selling price, while the actual payment may be called the transaction price or traded price. Likewise, the bid price or buying price is the quantity of payment offered by a buyer of goods or services, although this meaning is more common in asset or financial markets than in consumer markets.

Goods:

In the eighteenth century **Adam Smith (1776)** stated that goods have exchangeable value and so a characteristic of a good is that its ownership rights can be established and exchanged. Goods can be considered as embodying specialised knowledge in a way that is highly advantageous for promoting the division of labour .**(Smith 1776; Demsetz 1993). Nassau Senior (1863)** described goods as material things, meaning that goods are tangible and have physical dimensions. These concepts were still accepted over 100 years later when The **System of National Accounts (SNA) (1993)** defined goods as physical objects for which a demand exists, over which ownership rights can be established and whose ownership can be transferred from one institutional unit to another by engaging in transactions on markets. **Hill (1999)** summed up the major characteristics of goods as an entity that exists independently of its owner and preserves its identity through time; his definition supporting of that of the SNA. Following these definitions we can outline a set of attributes for goods:

- Physical objects for which a demand exists
- Their physical attributes are preserved over time
- Ownership rights can be established
- They exist independently of their owner
- They are exchangeable
- Unit ownership rights can be exchanged between institutions
- They can be traded on markets
- They embody specialised knowledge in a way that is highly advantageous for
- promoting the division of labour.

Economic goods are defined by their "physical" characteristics or properties. These physical characteristics, which have to be taken in a very broad sense, may include all forms of services. But economic goods often feature other aspects than their physical properties. For example, the location and the date of delivery of an economic good are sufficiently important to be specified for each economic good. The conditions under which delivery takes place is also specified in many general equilibrium models, especially those that involve uncertainty. In these models, the delivery may depend on the realization of some state of nature. Such goods are known as contingent goods. To sum up, economic goods are defined by their characteristics, which may include many more things than just the physical properties of the goods.

Types of Goods - Related to Income:

Inferior good: goods for which demand decreases as consumer income rises. Thus, it's "income elasticity" will be negative. Example: Inter-city bus service and inexpensive foods such as bologna, hamburger, and frozen dinners.

Normal good: goods for which demand increases as consumer income rises. Thus, it's "income elasticity" will be positive. Most goods are normal goods, hence the name "normal."

Superior good: goods that will tend to make up a larger proportion of consumption as income rises. As such, they are an extreme form of normal good. Thus, a superior good's "income elasticity" will be both positive and greater than 1. A superior good might be a luxury good that is not purchased at all below a certain level of income, such as a luxury car.

Luxury good: a more colloquial term that is synonymous with "superior good."

Types of Goods - Related to Price:

Ordinary good: goods for which quantity demanded increases as the price for the good drops; conversely, quantity demanded decreases as the price for the good increases, ceteris paribus (all other things being equal).

Giffen good: a good that will experience an increase in quantity demanded in response to an increase in price. In order to be a true Giffen good, price must be the only thing that changes to prompt a change in quantity demand. Conspicuous consumption (such as found with Veblen goods) is not a factor. The classic example is of inferior staple foods, whose demand is driven by poverty that makes their purchasers unable to afford superior foodstuffs. As the price of the cheap staple rises, consumers can no longer afford to supplement their diet with superior foods, and must consume more of the staple food.

Veblen good (aka ostentatious goods): often confused with Giffen goods, Veblen goods are goods for which increased prices will increase quantity demanded. However, this is not because the consumers are forced into buying more of the good due to budgetary constraints (as in Giffen goods). Rather, Veblen goods are high-status goods such as expensive wines, automobiles, watches, or perfumes. The utility of such goods is associated with their ability to denote status. Decreasing their price decreases the quantity demanded because their statusdenoting utility becomes compromised.

Types of Goods - Related to Consumption Ability:

Rival good (aka rivalrous good): goods whose consumption by one consumer prevents simultaneous consumption by other consumers. For example, food, cars, and clothing.

Non-rival good: goods that may be consumed by one consumer without preventing simultaneous consumption by others. Most examples of nonrival goods are intangible goods. For example, television and radio are nonrival goods.

Excludable good: goods or service that enable a seller to prevent non-paying customers from enjoying the benefits of it. Market allocation of such goods is feasible. Examples: public transportation, haircuts, movie theatre, food, clothing, housing, rental accommodations.

Non-excludable good: goods or service whereby it is impossible to prevent an individual who does not pay for that thing from enjoying the benefits of it. Market allocation of such goods is not feasible. Examples: beautiful scenery, fresh air.

Public good: goods those are non-excludable as well as non-rival. This means it is not possible to exclude individuals from the good's consumption. Fresh air may be considered a public good as it is not generally possible to prevent people from breathing it. However, technically speaking such goods should be called pure public goods.

Private good: goods those are both excludable and rival. Example: bread (eaten by a given person cannot be consumed by another [rival], and a baker can refuse to sell [excludable]).

Club good: goods those are excludable but non-rivalrous, at least until reaching a point where congestion occurs. Examples of club goods would include private golf courses, cinemas, cable television, access to copyrighted works, and the services provided by social or religious clubs to their members.

Common-pool resource: goods those are non-excludable but rivalrous. Examples of common-pool resources include irrigation systems, fishing grounds, pastures, and forests. A pasture, for instance, allows for a certain amount of grazing occurring without the core resource being harmed. In the case of excessive grazing, however, the pasture may become more prone to erosion and eventually yield less benefit to its users. Thus, the core resource is vulnerable to the problems of congestion, overuse, pollution, and potential destruction unless harvesting or use limits are devised and enforced.

National income:

Concept of National Income

- The value of aggregate output produced by different sectors during a given time periods.
- In real terms — it is the flow of goods and services produced in an economy in a particular period- a year.

Concepts associated with National Income

Gross National Product (GNP)	• the market value of all final goods and services; • These are produced by domestically owned factors of production in a country in that year.
Net National Product (NNP)	• NNP at market price = GNP minus depreciation of capital stock. • The productive power of physical capital stock diminishes gradually because of the wear and tear that it undergoes in the process of production.
NNP at factor cost or National Income	• NNP at factor cost = NNP at market price minus Indirect Business Tax minus Non tax liabilities minus Business Transfer Payments plus Subsidy from Government = National Income.
Gross Domestic	• the sum total of values of all goods and services produced within the

Product (GDP)	geographical boundary of the country; • These are without adding the factor income received from abroad.

Distinction between Gross National Product and Gross Domestic Product –

Gross National Product (GNP) is different from Gross Domestic Product (GDP) in following respects:

(a) GNP refersto the total market value of all the final goods and services produced in a country during a givenyear, plus net factor income from abroad. But GDP refers to the total market value of all the goods and services produced in the given year within the domestic territory of the country.

(b) GNP includes all income earned by the country in abroad (including foreign investments). But GDP does not include the income earned by the country from abroad. .

1.2Wants – definition:

It is human nature to have many goods in life. There would be an endless list of such wishes. Let us call these wishes as 'desires'. One may desire a good house, a car, a computer, good food, decent clothes and so on. How can one get all of these? One may have these things if he/she has money. If one does not have enough money, then only one or two of these or none of these could be purchased. Which of our desires are to be fulfilled depends upon our capacity to pay or purchasing power. That is why not all desires can be met as we need money to satisfy them. The desires which are backed by money and willingness to purchase may be called wants. A beggar may desire to have a car but this desire cannot be called a want as it is not backed by adequate money. However, if a rich man desires to have a car and is willing to purchase it, the desire can be turned into a want.

Want for a good or a service =

Desire for a good or Service + Money to purchase and willingness to purchase

Characteristics of Wants:

The following are the most important characteristics of wants.

(i) Wants are unlimited:

Famous economist Marshall has rightly said that human wants are countless in number and are varied in kind As soon as one want is satisfied another want takes its place. This endless circle of wants continues throughout life. For example, a person who has never used a fan would wish to have a fan. When this want is satisfied, he would wish to get an air cooler and a scooter. Once these wants are satisfied, then he would wish to have an air conditioner, a car and so on. Thus, we see wants never come to an end.

(ii) A single want is satiable

Each want taken separately can be satisfied. It has rightly been said that there is a limit to each particular want. For example, if a man is thirsty he can satisfy his thirst by taking one, two or three glasses of water and after that he does not want water at that point of time.

(iii) Some wants arise again and again

Most wants recur. If they are satisfied once, they arise again after a certain period. We eat food and hunger is satisfied but after a few hours, we again feel hungry and we have to satisfy our hunger again with food. Therefore, hunger, thirst etc. are such wants which occur again and again.

(iv) Varying nature of wants

Wants vary with time, place and person. They are also influenced by many factors like income, customs, fashion, advertisement etc. For example, we want medicines only when we are sick. Ice is needed in summer season only. We need woollens even in summer at a place like Srinagar. Similarly, people have started using things like T.V.Sets, mobile phones, car and many other luxury goods due to increase in their income and change in fashion. Thus, wants have been found to vary and to multiply with the economic development of a country.

(v) Present wants are more important than future wants:

Present wants are more important. A person uses most of his limited resources for the satisfaction of present wants. He does not worry much about his future wants because future is uncertain and less urgent. For example, providing for the education of children in the present is more important than providing for old age security in future.

(vi) Wants change and expand with development

A simple example to show how wants are changing is the telephone. Earlier, in the rural areas there were not many telephones, but today telephone has become a necessity for everybody for keeping in touch with their near and dear ones. People using telephone earlier, are now using mobile phones. They want more and more facilities in their mobile phones such as, Camera, Internet and so on

How do wants arise and grow

Wants are a part of our living. They arise with the birth of man. Man in ancient times was satisfied while living in forests, drinking water from the streams, plucking fruits from trees or eating animal flest to satisfy hunger. He had limited wants which were related to food, Sheller and clothing. Over a period of time, these wants have grown. How did it happen?

With the discovery of fire man started cooking food. This led to the discovery of new food items. Man's taste grew and expanded. A large variety of food stuffs came into existence. Today you can find different varieties of tastes, colours and shapes in food items.

As regards clothing, man has moved from unstiched animal skins and tree leaves to a variety of clothes. In order to live better, man discovered and invented new items of clothing. As knowledge, taste and fashion are increasing, new and better products in clothing are emerging.

In a similar fashion, need for housing has also undergone a tremendous change. Man has moved from caves to huts made of straw and pucca houses made of bricks. Now a days, houses made of wood, pucca houses, bungalows and palaces with fancy doors, windows and all sorts of decorative paints and fixtures are in use.

However, some wants may be necessary for the existence of life. For example, food, clothing and shelter. These are called basic wants or necessities. There are some other wants which make our life easy and comfortable. These are called comforts. Examples of comforts may be coolers, scooter etc. Some goods give us pleasure but they are very costly. For example, luxurious cars, diamond jewellery etc. such good are called luxuries.

1.4 Wealth- Definition and meaning:

The word wealth comes from the Old English words "weal" (well-being) and "th" (condition) which taken together means "the condition of well-being".

"Wealth" is the present value of the expected stream of future utility [human happiness] that an "infinitely lived individual or a dynasty" [or a nation] could hope to extract from the real resources available now and in the indefinite future, assuming these real resources are allocated and managed now, and over time, so as to maximize that present value of future utils (at the "proper" discount rate)

The economist's definition of "wealth" is entirely forward-looking: the wealth we believe to possess today is a function strictly of expectations about future streams of utility (and nothing else)

The modern concept of wealth is of significance in all areas of economics, and clearly so for growth economics and development economics yet the meaning of wealth is context-dependent. At the most general level, economists may define wealth as "anything of value" that captures both the subjective nature of the idea and the idea that it is not a fixed or static concept. Various definitions and concepts of wealth have been asserted by various individuals and in different contexts.

Defining wealth can be a normative process with various ethical implications, since often wealth maximization is seen as a goal or is thought to be a normative principle of its own.

Wealth has been defined as a collection of things limited in supply, transferable, and useful in satisfying human desires. Scarcity is a fundamental factor for wealth. When a desirable or valuable commodity (transferable good or skill) is abundantly available to everyone, the owner of the commodity will possess no potential for wealth. When a valuable or desirable commodity is in scarce supply, the owner of the commodity will possess great potential for wealth.

'Wealth' refers to some accumulation of resources (net asset value), whether abundant or not. 'Richness' refers to an abundance of such resources (income or flow). A wealthy individual, community, or nation thus has more accumulated resources (capital) than a poor one. The opposite of wealth is destitution. The opposite of richness is poverty.

Types or classifications of Wealth:

Wealth can be classified as personal wealth, social wealth or collective wealth, national wealth, and cosmopolitan wealth.

Personal Wealth (Individual Wealth)

The wealth of a person consists of both material and non-material goods. Thus the wealth of the person includes such material things as land, houses, furniture, machinery and so on. Not only that, if a person has some shares in companies or bonds which require others to pay money to him, they should be included in his personal wealth. On the other hand, if he owes some debt to others, it should be regarded as negative wealth and so subtracted from his gross wealth. Then we get the net wealth of a person.

Suppose a person is running a firm. The goodwill of his firm may be considered as his immaterial wealth. We have to remember one thing, namely that wealth is external. The personal or internal qualities of a person should not be considered as wealth. For example, a play-back singer may have an excellent voice. It is a personal quality and internal to the person. The voice of the singer is not wealth because it is internal. It is not wealth but it may be the source of wealth to the singer. Another example of internal quality is the ability of a surgeon.

Social Wealth (Collective Wealth)

Social wealth consists of all these goods that can be enjoyed by all members of a society. Social wealth includes public roads, public parks, public schools, government hospitals, public libraries, museums and so on. In short, it includes all kinds of public property and ownership. Most of these things are called collective goods, i.e., goods that are not in private ownership.

National Wealth

National wealth includes individual wealth as well as the collective wealth of its members. That is, it includes besides individual wealth all kinds of public property, such as roads and canals, buildings and parks and water works.

Some writers include even free goods in the wealth of a nation. For example, Marshall considered that even the rivers of a country should be taken into account in considering national wealth. The Thames river in England is a free gift of nature. But he says that we must consider the Thames a part of England's wealth. Some writers, however, do not agree with this view. For instance, according to Seligman, "rivers and climate do not constitute wealth. They enable a country to acquire wealth, just as intelligence or strength enables a man to acquire wealth. They are the source of wealth but they are not wealth".

Further, in calculating the national wealth of a country, one should deduct the debts, which a nation owed to other countries. Of course, we must add to the national wealth, the money or goods that are due to us from other nations.

The wealth of a nation can be increased by hard work of its people, labor is an important source of wealth. That is why Adam Smith believed that the wealth of a nation can be increased by a proper division of labor. Japan, for instance, is an Asian country. Though most of the countries of Asia are poor today, Japan is wealthy and enjoys a high standard of living comparable to that of a western country because its people work hard. They are industrious and diligent.

Cosmopolitan Wealth

Cosmopolitan wealth is the wealth of the world. It belongs to no one nation in particular. A common example of cosmopolitan wealth is the ocean. As Marshall put it, "Just as rivers are important elements of national wealth, the ocean is one of the most valuable properties of the world." Again, scientific knowledge and mechanical inventions may also be considered as cosmopolitan wealth. For, scientific knowledge wherever discovered, soon becomes the property of the world. So it is better to consider it as cosmopolitan wealth rather than as national wealth. The same thing is true of mechanical inventions, for example, the mechanical inventions that were made in England during the Industrial Revolutions soon became the property of the world.

Characteristics of wealth:

1. Anything to be considered wealth should possess the following characteristics:
2. It must possess utility: That is, it must have the power to satisfy a want. As Marshall says, 'they must be desirable'.
3. It must be limited in supply. For example, air, sunshine are all essential for life. In fact, man cannot live without them. They possess great utility but they are not considered wealth because they are available in large quantities. Their supply is not limited. In other words, there is no scarcity of those goods. Such goods are known as free goods.
4. It should be transferable. That is it must be possible for us to transfer the ownership of such economic goods, which form wealth, from one person to another. For example, take a house. House is wealth. For it has money value. If I pay some money to you and buy it, I can transfer the ownership rights of house in my name.
5. It must have money value.
6. It may be external. For example, the goodwill of a business is external wealth. Certain firms enjoy a lot of goodwill of the customers. The copyright of a book is another example of the point that wealth is external.
7. Thus utility, scarcity and transferability are the important characteristics of wealth. Because an economic good possesses utility and is scarce in relation to demand and is capable of being transferred from one person to another, it has money value and so it is considered as wealth.

CHAPTER -2

DEMAND AND SUPPLY

2.1 Meaning and type of demand.

2.2 The Law of Demand, its limitation.

2.3 Preparation of Demand schedule.

2.4 Meaning of supply.

2.5 Law of Supply, its Limitation.

2.1 Meaning of demand:

In the ordinary sense, demand means desires.

- Demand in Economics means both the willingness as well as the ability to purchase a commodity by paying a price and also its actual purchase.
- A man may be willing to get a thing but he is not able to pay the price. It is not demand in the economic sense.
- Demand is related to price.
- Generally demand for a commodity depends upon the price of the commodity.
- Generally the relation between price and demand is inverse.
- When price of a particular commodity goes up, its demand falls and vice-versa.
- But in exceptional cases the two variables may move in the same direction.
- There are other factors that may influence the quantity demanded for a quantity.
- One such factor is the income of the consumer.
- If a man's income increases, obviously he will be able to demand more of the goods at a given price.
- Except that, demand for a commodity depends upon the taste and preference of the consumers, the price of substitute goods etc.

Definitions of Demand:-

In words of Ferguson, “Demand refers to quantities of a commodity that the consumers are able and willing to buy at each possible price during a given period of time, other things being equal.”

According to Meyers, “The demand for a commodity is a schedule of the amounts that buyers would be willing to purchase at all possible prices at any one instant of time.”

On the basis of the above definitions, following features can be defined of demand:

- There is an effective demand for a commodity.
- The quantity of a commodity is there.
- The quantity of a commodity is demanded at a given price.
- The commodity is demanded at a given time.

2.2 The Law of Demand:

The law of demand expresses the functional relationship between the price of commodity and its quantity demanded. It states that the demand for a commodity tends to vary inversely with its price this implies that the law of demand states- Other things remaining constant, a fall in price of a commodity will lead to a rise in demand of that commodity and a rise in price will lead to fall in demand.

Assumption:

i. Income of the people remaining unchanged.
ii. Taste, preference and habits of consumers unchanged.
iii. Prices of related goods i.e., substitute and complementary goods remaining unchanged.
iv. There is no expectation of future change in price of the commodity.
v. The commodity in question is not consumed for its prestige value.

Importance of Law of Demand

1. **Basis of the Law of Demand**: The law of Demand is based on the consumers that they are prepared to buy a large quantity of a certain commodity only at a lower price. This results from the fact that consumption of additional units of a commodity reduces the marginal utility to him.

2. **Basis of consumption Expenditure:** The law of Demand and the law of equi-marginal utility both provide the basis for how the consumer should spend his income on the purchase of various commodities.
3. **Basis of Progressive Taxation**: Progressive Taxation is the system of Taxation under which the rates of tax increase with the increase in income. This implies that the burden of tax is more on the rich than on the poor. The basis of this is the law of Demand. Since it implies that the marginal utility of Money to a rich man is lower than that to a poor man.
4. **Diamond-water paradox:** This means that through water is more useful than diamond. Still the price of diamond is more than that of water. The explanation lies in law of diminishing marginal utility. The price of commodity is determined by its marginal utility. Since the supply of water is abundant the marginal utility of water is very low and so its price. On the contrary, supply of diamond is limited so the marginal utility of diamond is very high, therefore the price of diamond is very high.

Types of demand:

Demand is generally classified on the basis of various factors, such as nature of product, usage of product, number of consumers of a product, and suppliers of a product.

The demand for a particular product would be different in different situations. Therefore organizations should be clear about the type of demand for their products.

The different types of demand are discussed as follows-

i. Individual and market demand: - it refers to the classification of demand of a product based on the number of consumers in the market. Individual demand can be defend as a quantity demanded by an individual for a product at a particular price and within the specified period of time. For example,Mr X demands 200 units of a product at Rs. 50 per unit in a week .The individual demand of a product is influenced by the price of a product, income of customers, and their tastes and preferences. On the other hand, the total quantity demanded for a product by all individuals at a given price and time is regarded as market demand.

In simple terms, market demand is the aggregate of individual demands of all the consumers of a product over a period of time at a specific price, while other factors are constant. For example, there are four consumers of oil (having a certain price). These four consumers consume 30 liters, 40 liters, 50 liters, and 60 liters of oil respectively in a month. Thus, the market demand for oil is 180 liters in a month.

ii .Organization and Industry Demand:

It refers to the classification of demand on the basis of market. The demand for the products of an organization at given price over a point of time is known as organization demand. For example, the demand for Toyota cars is organization demand. The sum total of demand for products of all organizations in a particular industry is known as industry demand.

For example, the demand for cars of various brands, such as Toyota, Maruti Suzuki, Tata, and Hyundai, in India constitutes the industry' demand. The distinction between organization demand and industry demand is not so useful in a highly competitive market.

This is due to the fact that in a highly competitive market, organizations have insignificant market share. Therefore, the demand for an organization's product is of no importance. However, an organization can forecast the demand for its products only by analyzing the industry demand.

iii. Autonomous and Derived Demand:

It refers to the classification of demand on the basis of dependency on other products. The demand for a product that is not associated with the demand of other products is known as autonomous or direct demand. The autonomous demand arises due to the natural desire of an individual to consume the product.

For example, the demand for food, shelter, clothes, and vehicles is autonomous as it arises due to biological, physical, and other personal needs of consumers. On the other hand, derived demand refers to the demand for a product that arises due to the demand for other products.

For example, the demand for petrol, diesel, and other lubricants depends on the demand of vehicles. Apart from this, the demand for raw materials is also derived demand as it is dependent on the production of other products. Moreover, the demand for substitutes and complementary goods is also derived demand.

iv. Demand for Perishable and Durable Goods:

It refers to the classification of demand on the basis of usage of goods. The goods are divided into two categories, perishable goods and durable goods. Perishable or non-durable goods refer to the goods that have a single use.For example, cement, coal, fuel, and eatables. On the other hand, durable goods refer to goods that can be used repeatedly.

For example, clothes, shoes, machines, and buildings. Perishable goods satisfy the present demand of individuals. However, durable goods satisfy both present as well as future demand of individuals. Therefore, consumers purchase durable items by considering its durability.

In addition, durable goods need replacement because of their continuous use. The demand for perishable goods depends on the current price of goods and customers' income, tastes, and preferences and changes frequently, while the demand for durable goods changes over a longer period of time.

v. Short-term and Long-term Demand:

It refers to the classification of demand on the basis of time period. Short-term demand refers to the demand for products that are used for a shorter duration of time or for current period. This demand depends on the current tastes and preferences of consumers.

For example, demand for umbrellas, raincoats, sweaters, long boots is short term and seasonal in nature. On the other hand, long-term demand refers to the demand for products over a longer period of time.

Generally, durable goods have long-term demand. The long-term demand of a product depends on a number of factors, such as change in technology, type of competition, promotional activities, and availability of substitutes. The short-term and long-term concepts of demand are essential for an organization to design a new product.

2.3 Preparation of Demand schedule:

Demand Schedule: It is a numerical tabulation, showing the quantity that is demanded at selected prices. A demand schedule can be of 2 types; Individual Demand Schedule, Market Demand

Individual Demand Schedule: It shows the quantity of a commodity that one consumer or a particular household will buy at selected prices, at a given time period.

Price of x (Rs.)	Quantity demanded of x(units)
100	4
50	2
20	10
10	15
5	20

Market Schedule: When we add the individual demand schedule of various household, we get the market demand schedule. For example, there are four households in the market and their demand schedules at different prices are given below:

Price	Quantity Demanded				Market Demand
	A	B	C	D	
100	1	2	1	2	6
50	2	5	2	4	13
20	10	10	5	10	35
10	15	15	10	15	55

5	20	20	15	20	75

Determinants of demand - There are many factors other than price that can affect the level of quantity demanded. This defines demand function.

(i) **Price of the Commodity :** There is an inverse relationship between the price of the commodity and the quantity demanded. It implies that lower the price of commodity, larger is the quantity demanded and vice-versa.

(ii) **Income of the consumers:** Usually there is a direct relationship between the income of the consumer and his demand. i.e. as income rises his demand rises and vice-a-versa.

The income demand relationship varies with the following three types of commodities:

(a) Normal Goods: In such goods, demand increases with increase in income of the consumer. For eg. Demands for television sets, refrigerators etc. Thus income effect is positive.

(b) Inferior Goods: Inferior Goods are those goods whose demand decrease with an increase in consumes income. For e.g. food grains like Malze , etc. If the income rises demand for such goods to the consumers will fall. Thus income effect is negative.

(c) Giffen goods: In case of Giffen goods the demand increases with an increase in price but it decreases with the rise in income. Thus income effect is negative.

(iii) Consumer's Taste and Preference: Taste and Preferences which depend on social customs, habit of the people, fashion, etc. largely influence the demand of a commodity.

(i) **Price of Related Goods**: Related Goods can be classified as substitute and complementary goods.

(ii) **Substitute Goods :** In case of such goods, if the price of any substitute of commodity rises, then the commodity concern will become relatively cheaper and its demand will rise. The demand for the commodity will fall if the price of the substitute falls. eg. If the price of coffee rises, the demand for tea will rise.

(iv)Complementary Goods : In case of such goods like pen and ink with a fall in the price of one there will be a rise in demand for another and therefore the price of one commodity and demand for its complementary are inversely related.

(v) Consumer's Expectation: If a consumer expects a rise in the price of a commodity in a near future, they will demand it more at present in anticipation of a further rise in price.

(vi) Size and Composition of Population: Larger the population, larger is likely to be the no. of consumers. Besides the composition of population which refers to the children, adults, males, females, etc. in the population. The demographic profile will also influence the consumer demand.

Exceptions to the law of demand:

(i) **Conspicuous goods**: These are certain goods which are purchases to project the status and prestige of the consumer. For e.g. expensive cars, diamond jewellery, etc. such goods will be purchased more at a higher price and less at a lower price.

(ii) **Giffen goods:** These are special category of inferior goods whose demand increases even if with a rise in price. For eg. coarse grain, clothes, etc.

(iii) **Share's speculative market**: It is found that people buy shares of those companies whose price is rising on the anticipation that the price will rise further. On the other hand, they buy less shares in case the prices are falling as they expect a further fall in price of such shares. Here the law of demand fails to apply.

(iv) **Bandwagon effect:** Here the consumer demand of a commodity is affected by the taste and preference of the social class to which he belongs to. If playing golf is fashionable among corporate executive, then as the price of golf accessories rises, the business man may increase the demand for such goods to project his position in the society.

(v) **Veblen effect:** Sometimes the consumers judge the quality of a product by its price. People may have the expression that a higher price means better quality and lower price means poor quality. So the demand goes up with the rise in price for eg. : Branded consumer goods.

2.4 Meaning of supply:

Supply is defined as a quantity of a commodity offered by the producers to be supplied at a particular price and at a certain time.

Individual Supply and Market Supply

Individual Supply	• It refers to the quantity of a commodity which a firm is willing to produce and offer for sale. • An individual supply schedule shows the different qualities of a commodity that a producer of a firm would offer for sale at different prices.
Market Supply	• The quantity which all producers are willing to produce and sell is known as market supply. • A market supply schedule shows the various quantities of a commodity that all the firms are willing to supply at each market price during a specified time period.

Factor Determining Supply or Supply Function:

(i) **Price of the commodity**: When the price of a commodity in the market rises, seller increases the price. The cost of production remaining constant the higher will be the profit margin. This will encourage the producers to supply more at higher prices. The reverse will happen when the price fall.

(ii) **Goals of the firm :** Firms may try to work on various goals for eg. Profit maximization, sales maximization, employment maximization. If the objective is to maximize profit, then higher the profit from the sale of a commodity, the higher will be the quantity supplied by the firm and vice-versa. Thus, the supply of goods will also depend upon the priority of the firm regarding these goals and the extent to which it is prepared to sacrifice one goal to the other.

(iii) **Input Prices :** The supply of a commodity can be influenced by the raw materials, labour and other inputs. If the price of such inputs rises leading to a lower profit margin becomes less. This will ultimately lead to a lower supply. On the other hand, if there is a fall in input cost firm, will be ready to supply more than before at a given price level.

(iv) **State of Technology**: If improved and advanced technology is used for the production of a commodity, it reduces its cost of production and increases the supply. On the other hand, the supply of those goods will be less whose production depends on unfair and old technology.

(v) **Government policies:** The imposition of sales tax reduces supply and grant of subsidy on the other hand increases the supply.

(vi) **Expectation about future prices** : If the producers expect an increase in the price of a commodity, then they will supply less at the present price and hoard the stock in order to sell it at a higher price in the near future. This will be opposite in case if they anticipate fall in future price (eg. fruit seller).

(vii) **Prices of the other commodities** : Usually an increase in the prices of other commodities makes the production of that commodity whose price has not risen relatively less attractive we thus, expect that other things remaining the same, the supply of one commodities falls as the price of other goods rises. For eg. Suppose a farmer produces wheat and pulses in his firm. If the price of pulses increases he grows less wheat. Hence the supply of wheat decreases.

(viii) **Number of firms in the market:** Since the market supply is the sum of the suppliers made by individual firms, hence the supply varies with changes in the number of firm in the market and increases the supply. An decreases in the number of firm reduces the supply.

(ix) **Natural factor:** In case of natural disorders flood, drought, etc. the supply of a commodity specially agricultural products is adversely affected.

Elasticity of Supply: Elasticity of supply is defined as the degree of responsiveness of quantity supplied of a commodity due to change in its price. Elasticity of supply is expressed as :

$$Es = \% \text{ changes in qty. supplied} / \% \text{ changes in price}$$

$$= (dq/q \times 100) / (dp/p \times 100)$$

$$= (dq/dp \times p/q)$$

Where d = change, q = original quantity supplied, p = original price.

Determinants of Elasticity of Supply

(i) Nature of the commodity : The supply of durable goods can be increased or decreased effectively in response to change in price and hence durable goods are relatively elastic. On the other hand the perishable goods cannot be stored and thus supply cannot be altered significantly in response to change in their price. Hence the price of the perishable goods are relatively less elastic.

(ii) Time Factor: A price change may have a small response on the quantity supplied because output may change by small quantity in the short period since the production capacity may have been limited. Therefore, in the short run supply tends to be relatively inelastic. On the other hand in the long run production capacity may be increased or supply may also be raised therefore in the long run supply is elastic.

(iii) Availability of facility for expanding output : If producers have sufficient production facilities such as availability of power, raw materials, etc, they would be able to increase their supply in response to rise in price. On the other hand if there is a shortage of such facilities then expansion of supply will not be possible due to rise in price.

(iv) Change in cost of production: Elasticity of supply depends upon the change in cost. If an increase of output by a firm in an industry causes only a slight increase in the cost then supply will remain fairly elastic. On the other hand if an increase in output bring about a large increase in cost due to rise in price of inputs etc, then supply will be relatively inelastic.

(v) Nature of inputs: Elasticity of supply depends upon the nature of inputs for the production of a commodity. If the production requires inputs that are easily available, then its supply will be relatively elastic. On the other hand, if it uses specialized inputs then its supply will be relatively inelastic.

(vi) **Risk Taking:** If entrepreneurs are willing to take risk, then supply will be more elastic and if they are reluctant to take risk then supply would be inelastic.

2.5 Law of Supply:

Exceptions to the Law of Supply :

(i) **Agricultural Goods :** In case of such goods the supply cannot be adjusted to market conditions. The production of agriculture goods is largely dependent on natural phenomenon and therefore its supply depends upon natural factors like rainfall, etc. Moreover the supply of such goods is mostly seasonal and therefore it cannot be increased with a rise in price.

(ii) **Rare objects :** These are certain commodities like rare coins, classical paintings old manuscripts, etc. whose supply cannot be increased or decreased with the change in price.

(iii) **Labour Market:** In the labour market, the behavior of the supply of labour goes against the law of supply. In case of such labourers, if the wages rise the workers will work for less hour, so as to enjoy more leisure.

CHAPTER- 3

PRODUCTION

3.1 Meaning of factors of Production.

3.2 Factors that determine efficiency of Labour.

3.3 Division of Labour.

3.4 Factor that Determine Capital formation.

3.5 Savings,

3.1 Meaning of factors of Production:

The goal of production is to satisfy our wants. These goods and services produced can be sold in markets or can be provided by the government to public at nominal charge. Therefore Production is defined as creation of utility.

Production activities involve making of goods and services. People who make and sell these goods and services are known as producers. The producers combine the factors like land, labour, capital and entrepreneurship along with raw materials in order to transform them into various goods and services. Land, labour, capital and entrepreneurship are called the factors of production. The producers try to produce maximum amount of goods and services by using various combination of factors of production. Let us know more about these factors of production.

1. Land: Land is a gift of nature. It includes plain region, mountains and plateau region. The plain region is useful for agriculture and industrial activities. Mountains ensure flow of rivers into the plain region and provide facilities for tourism. Plateau region possesses reserves of minerals, fossil fuels and forests. Production of food grains, vegetables, fruits etc require agricultural land in the plan region. Along with this people also carry out animal husbandry, fisheries and forestry which are called allied activities. In India rural area is known for carrying out agricultural and allied activities. Some amount of land in the plain region is specially developed to establish industries and urban areas such as towns and cities.

2. Labour: - In general labour implies the human effort through physical and mental exertions in the production of goods and services. A person working on the agricultural field is said to provide his physical labour while a writer of a book is said to provide his mental labour. People who provide labour are known as human resources. Production activities require both skilled and unskilled labour. Purely physical labour such as loading and unloading, ploughing on the field etc do not require special skill. But to become an engineer, doctor, teacher, lawyer, mechanic, electrician or tailor etc one must acquire skill through education and training.

3. Capital: By capital, we mean all manmade appliances and all types of wealth used in production. Capital consists of machinery, tools, buildings, materials etc. Whereas land is a natural resource, capital is a man made resource. Capital is used to increase the efficiency of other factors of production like land or labour. The efficiency of land can be increased by use of better irrigation facilities and machines. However, capital is a passive factor of production and cannot be used without employing labour to work. Capital has a limited span of life, and becomes obsolete after a certain period. Small tools like, screwdrivers, calculators to heavy machines like engines, tractors,ships are all examples of fixed capital, as they can be used in production for many years. Fixed capital also includes the buildings and heavy machines. The working capital includes raw materials like cotton yarn, clay, seeds, fertilizers, which are usedup in the process of production.

4. Entrepreneurship: Somebody must take the initiative to start the process of production of goods or services by bringing land, labour and capital together in right proportion. He will be responsible for choosing the right type of land, labour and capital and take important decisions with respect to quantity to be produced, money to be spent to buy the factors and raw materials, marketing the output produced etc. Entrepreneurship is the art of organizing the production activity. The person who makes the decisions and controls the production process and bears the risks and uncertainties involved in production is called an entrepreneur. He/She should be knowledgeable, courageous and should possess leadership qualities. The objective of an entrepreneur is to get maximum production by using the given resources and make arrangements for the sale of the finished products. He/she is also responsible to make payments to other factors of production.

He/she pays wages to the labourers, rent to the landlords and interest to the owner of capital in return for their productive services. Similarly, they earn profit for their productive activity. Since these payments, rent, wages, interest and profits are received by the factors for their productive services, they are termed as factor incomes.

3.2 Factors that determine efficiency of Labour:

1. Personal Qualities :- Some people have some personal qualities and they are suitably built foe certain heavy labour. On other hand some people are very suitable for mental labour. Family background also pays very important role in this regard.

2. Education: - It is the basic and essential element which determines the efficiency of labour. Educated labourer is more efficient as compared to the illiterate worker.

3. Training and Skill: - The modern world requires highly skilled labourers. A labourer with sound technical training will be more effective as compared to a labourer who has no training. It increases the efficiency of the labourer.

4. Climatic Conditions: - Climates also plays an important role in increasing or decreasing the efficiency. Hot weather has a vital factor for the low efficiency of labour in Asia and Middle East. On other hand cold weather is an important element for increasing the efficiency in labour in U.S.A and Europe.

5. Wages and Benefits: - If wages, allowances, bonuses and other frigs benefits are given to the workers, then their working efficiency increases. Labourer works very hard if he has attractive salary. On other hand if wages rate is low then efficiency of the labourer will be also low.

6. Combination of Production Factors: - If the other three factors of production combination is ideal then efficiency of labourer will be high otherwise low.

7. Working Hours: - If working hours of labourer are reasonable then the efficiency will be high. If the working time is very long and without extra payment then efficiency of the worker will be low.

8. Environment: - If the working environment is pleasant then efficiency of labourer will be high. It is observed that labourer working in air conditions rooms and healthy conditions are more efficient as compared to others.

9. Racial Qualities: - By birth some races are very hard working and strong built so they are more efficient as compared to other races.

Factors promoting efficiency of Labour:-

Following are the important factors which promote the efficiency of labour.

1. Increase in Wages: - Increase in wages and fringe benefits promote the efficiency of labour. When wages and incentives will increase it will make the labourer hard worker and efficient.

2. Technical Education: - Vocational, technical and commercial colleges, should be opened to provide technical skill to the people. Modern industry, agriculture, banking, transport and commerce require highly skilled persons. Such type of training and skill is provided in the colleges and universities.

3. Care of Health: - Health facilities should be provided to the labourers. A healthy worker can work more efficiently as compared to sick worker. All the factory owners should opened the health clinics in their factories and regular medical check-up should be compulsory.

4. Increases in Allowances: - Various types of allowances like dearness and bonus must be increased. Special allowances should be given to the efficient workers.

5. Labour Laws: - Government should also frame the strict labour laws. In case of accident special compensation should be given. In case of industrial dispute courts should be established. This step will provide the security to the labourers and they will work with full concentration.

6. Special Stores: - To provide the goods on lower rates to the labourers special stores should be opened for the workers.

7. Establishment of the Canteen: - Lunch and dinner facility should be provided to the workers. On the lower rates food should be provided during the working interval. In this way time of the workers will be saved and their efficiency will increase.

Saving:

Definition

Excess of income over expenditure on consumption.

The unconsumed part of national income of all members of the community represents, National Savings.

Total domestic savings = households' savings + business sector's savings + government's savings.

- Saving is defined as income minus consumption.
- Whatever is left in the hands of an individual after meeting consumption expenditure is the individual's saving.
- The sum-total of funds in the hands of an individual is obtained by accumulating the saving of the past years.
- Saving is generated out of current income of an individual.
- Savings are created out of past income of an individual.

Determinants

(i) Income:

- Savings is functionally related to income S=f (Y).
- The saving income ratio tends to rise with increase in income.
- The savings function is a stable function of income in the short run.
- Savings as such is not a stable function of income.
- Marginal propensity to save (ds/dy) is always greater than zero but less than unity.
- People save part of additional income but not the entire income.

The saving function is explained by three income concepts in macro economics.

(a) Absolute Income – current savings depend on current disposable income i.e. income minus taxes paid.

(b) Relative Income – savings of an individual depends upon his percentile position in the total income distribution.

(c) Permanent Income – it is current income plus the expected income received over a period of time.

Distribution of income:

- Inequality of income distribution helps the process of savings.
- "Demonstration effect",that is man's desire to imitate the superior consumption standard of neighbours or relatives.
- This induces a man to buy expensive goods and so saving decline.

(ii) Sound financial instruments and the rate of interest:

- A higher rate of interest motivates us to save more.
- Existence of diverse type of financial instruments gives people incentive to save more.

(iii) Subjective or psychological factors:

- A man's attitude towards savings depends on his farsightedness, his desire to bequeath a fortune, to enjoy a better living in future or to possess some physical asset.

• A man saves or insures as a precaution against future uncertainty and insecurity.

Income:

The income of a person means the net inflow of money (or purchasing power) of this person over a certain period. For instance, an industrial worker's annual income is his salary income over the year. A businessman's annual income is his profit over the year.

Wealth and income: The difference between wealth and income must be clearly understood. A person (or a nation) consumes a part of the income and saves the rest. These savings are accumulated in the form of wealth. Wealth is a stock. It is stock of goods owned at a point of time. Income is a flow; it is the inflow of money (or purchasing power) over a period of time.

Investment:

Investment means an increase in the capital stock. For a country, as a whole, investment is the increase in the total capital stock of the country. For an individual, investment is the increase in the capital stock owned by him.

Definition

Investment has dual aspect. It implies the production of new capital goods like plants and equipments. Secondly, a change in inventories or stocks of capital of a firm between two periods.

Determinants:

- There are two determinants — (a) the marginal efficiency of capital (MEC) and (b) the rateof interest.
- MEC implies the prospective yield from the capital asset and the supply price of this asset.
- Symbolically C = Q/P. Where Q is the prospective yield from capital asset and P is the supply of this asset.

- In considering a particular investment project the investor must have some idea of future returns that is yields from the real asset in its life span.
- To find the present value of all expected future returns we have to discount all future returns.
- Generally there exists a negative relation between interest rate and investment expenditure.
- A fall in the rate of interest may induce an increase in investment expenditure whereas a higher rate, investment is likely to be less.
- At a higher interest rate, a firm instead of using funds for capital equipments may invest in financial assets.
- Thus the level of investment is a negative function of the rate of return.
- Risk, uncertainty and instability tend to discourage businessto undertake investment projects.
- A firm may expand investment outlay for innovation viz. introducing a new good or a new technique.

Economists talk of two types of investment: real investment and portfolio investment.

(a) Real investment: Real investment means an increase in the real capital stock, i.e., an addition to the stock of machines, buildings, materials or other types of capital goods.

(b) Portfolio investment: Portfolio investment essentially means the purchase of shares of companies. However, it is only the purchase of new shares issued by a company that can properly be termed as investment (because the company will use the money for expanding its productive capacity, i.e., the company's real capital stock will increase). Purchase of an existing share from another shareholder is not an investment because in this case the company's real capital stock does not increase.

Gross investment and net investment:

In any economy, the aggregate investment made during any year is called gross investment. The gross investment includes

(a) Inventory investment and

(b) Fixed investment.

Investment in raw materials, semi-finished goods and finished goods is referred to as inventory investment. On the other hand, investment made in fixed assets like machineries, factory sheds etc. is called fixed investment. By deducting depreciation cost, of capital from the gross investment, we get new investment.

So, Net investment = Gross investment – depreciation cost.

3.4 Concept of Capital Formation, Factor that Determine Capital formation:

Concept of Capital formation:

Capital formation is a term used to describe the net capital accumulation during an accounting period for a particular country, and the term refers to additions of capital stock, such as equipment, tools, transportation assets and electricity. Countries need capital goods to replace the current assets that are used to produce goods and services, and if a country cannot replace capital goods, production declines. Generally, the higher the capital formation of an economy, the faster an economy can grow its aggregate income.

Factors Affecting Capital Formation: Demand Side & Supply Side

The following points highlight the two main factors that affect capital formation of an economy. They are:

1. Demand Side, and

2. Supply Side.

1. Demand Side:

The demand for capital mostly depends upon the incentives for investment in an economy. It will be high if the incentive to invest is strong, while it will be low if it is weak.

The incentive to invest almost depends on the rate of profitability of investment. In under-developed countries, lack of demand for capital is marked by an acute shortage of capital. Lack of demand only refers to the demand for capital of the private investors and not considered from the point of view of the economy as a whole.

Therefore, lack of incentives for private investment arises primarily from the small size of the domestic market. If the people are poor and size of the market is small, private investment will not be very profitable and incentives for investment will automatically be poor.

In under developed countries, lack of demand for capital arises from low production and small purchasing power of the common man. But in developed countries, the problem is of different nature. In such countries, the shortage of demand for capital comes from the deficiency of aggregate effective demand which is due to over saving.

This type of shortage can be remedied through money expansion. Here, it must be kept in mind that monetary expansion in under-developed countries will lead to inflation because there is always shortage of demand arising from the shortage of supply of goods and services in the market.

In fact, small size of the market is responsible for lack of incentives for investment and entrepreneurs do not find it profitable to set up modern industries. Therefore, the size of the market can also be enhanced by the method of public expenditure, salesmanship, adjustment and formation of custom duties or free trade agreements etc.

Thus, rise in productivity is a crucial determinant of the size of the market. Prof. Ragnar Nurkse also proposes simultaneous investment in a number of industries to expand the size of the market in under developed economies. In addition to the small size of the market, there are other factors which limit the demand for capital in under developed countries.

They are listed as under:

(i) Lack of Entrepreneurship:

Generally, in under developed countries, there is acute shortage of efficient, dynamic and daring entrepreneur who are capable of taking risks in business. In the absence of such qualities of entrepreneurs, the saving of the people cannot be properly utilised in speculative activities, thus, fails to create further capital accumulation.

(ii) Lack of Availability of Skilled Labour:

Under developed countries always suffer from the availability of skilled and trained labour. Due to their backwardness in technology, it inhabits the demand for capital.

(iii) Shortage of Basic Facilities:

Investment is hindered by the shortage of basic facilities like power, transportation, communication and research institutions etc. The limit the scope for higher investment.

(iv) Availability of Cheap Labour:

There is abundant labour supply in under developed countries due to the higher population and mass unemployment. This leads to the adoption of labour intensive techniques rather than capital intensive techniques which, in turn, decreases the demand for capital.

(v) Primitive and Out-dated Agriculture:

In under developed countries, the main occupation of the people is agriculture. About 70 per cent people directly or indirectly are dependent on agriculture for their livelihood. They use primitive and out-dated methods of cultivation.

The holdings are uneconomical, subdivided and fragmented. The land tenure system is defective which discourages investment in this sector. They do not apply scientific methods of cultivation.

(vi) High Interest Rates:

Another reason which limits the demand for capital is that there is comparatively high interest rate in poor and under-developed countries. High interest rates adversely affect the marginal efficiency of capital which, in turn, discourages investment in a country.

(vii) Taxation Policy:

In most of under developed countries, higher taxation policy has been adopted as a planned strategy for mobilisation of additional resources to meet the needs of the development and to decrease the gulf between the poor and the rich. Extremely higher taxes on income and profit hamper the incentive to make investment in an economy.

(viii) Unstable Political Environment:

In under developed countries, unstable political environment is witnessed which is greatly responsible for low demand for capital. These countries have backward and traditional systems which fail to develop suitable environment for making favourable investment in the country.

(ix) Lack of National Feelings:

In the present days, under-developed countries also lack national feelings which discourage new investment. In fact, security of life and property are the basic needs for capital formation.

Supply Side:

In an economy, supply of capital is always determined by the availability of investible funds which represent a surplus over the consumption requirements of the people.

There are two sources of supply of money:

(i) Domestic supply of money; and

(ii) imported capital (foreign capital).

Therefore, the total supply of money is made up of domestic savings and net capital imports. Without saving, there is no accumulation of capital. There are three sources, from where savings emerge.

They are:

(a) Saving by individuals and house-holds

(b) Saving by business enterprise and joint stock companies

(c) Saving by governments

The inadequate supply of capital in under-developed countries is largely due to the under-mentioned reasons:

(i) Low level of per capita income because majority of people live on subsistence level.

(ii) Common people lack saving habits.

(iii) Lack of banking and investment opportunities..

(iv) People are more interested in Purchase of Gold, Jewellery and Land Etc.

(v Unfavourable cultural and institutional set up.

(vi) Rapid increase in population.

(vii) Other reasons—wasteful practices, lack of desire of progress, demonstration effects and lack of foresightedness, in congenial environment etc.

CHAPTER-4

MONEY

4.1 Meaning of Money.

4.2 Types of Money.

4.3 Functions of Money.

4.1 Meaning of Money:

Definition

- A medium of exchange.
- With the help of money any exchange of goods and services can take place.
- Money is said to be the most liquid asset among all the assets of a man.
- It has general acceptability as a means of payment and liquid characteristic. Keynes called this liquidity preference.
- Generally money is created by the Central Bank or the Government of a country.
- These are legal tender money as there is legal compulsion for their acceptance.
- They also called as Cash Money.
- Another considerable flow ofmoney is Credit Money —created by the commercial banks by their loan transactions.

Value of Money

- It means Exchange Value.
- It implies how much of goods and services can be obtained in exchange of a unit of money.
- Value of money is inverse of price.
- When price level increases, the value of money decrease and vice versa.

4.2 Types of Money:

Forms of Money

- The total money supply of a country can broadly be classified into two groups—Cash Money and Credit Money.
- It also includes all other financial assets.
- The degree of moniness varies widely from asset toasset.

The Components of Money Supply —

Paper Money and Coins	• Theseas Currency are issued by the Centralbank or Government. • They have cent percent acceptability as a means of payment. • Their acceptability is based on a 'promise to pay bearer'gold and foreign exchange in exchange.
Demand deposit	• A bank is legally bound to pay money on demand. • The 'moniness' in currency and demand deposits is highest.
Near Money or money substitute	• The well known near money is bank cheque (savings account). • A bank cheque is a means of payment for transaction. • There is no legal compulsion behind their acceptance.
Term deposit	• It is less liquid than savings bank deposit. • They cannot be used before a fixed period.
Other forms of financial assets	•Theseare issued by non-bank financial intermediaries. • They are not so much in liquid as bank deposits.

4.3 Functions of Money:

Static functions	**Medium of Exchange**	• In an exchange economy money has an intermediary role. • The invention of money has made the exchange system smooth and convenient.
	Measure of value	• Things are said to be cheap or expensive on the basis of amount of money required for

		their possession. • This makes exchange mutually profitable.
	Standard of deferred payment	• It implies the role of money in borrowing and lending. • Money taken as loan is usually repaid after a time gap. • This delayed payment is done through money.
	Store of value	• Purchasing power of money can be stored by keeping a part for future use, called monetary savings. • Current income can be used for current consumption as well as future consumption by savings.
Dynamic Functions		• Money activated idle resources and puts them into productive channels. • It thus, helps in increasing output, employment and income. • It helps in converting savings into investment. • Creation of new money governments of modern economies can spend more than what they can.

CHAPTER -5

BANKING ORGANISATION

5.1 Central Bank- Its Functions.

5.2 Commercial Banks- Its functions.

BANK

- A bank is said to be a financial intermediary.
- It stands midway between the savers and the users of fund.
- There are different types of bank having some common and some special functions.
- Banks may be of various types such Central Bank, commercial banks, development banks, cooperative banks, rural banks etc.
- The Central Bank, the commercial banks and the development banks are of primary importance.

5.1 Central Bank- Its Functions:

Central Bank is an apex institution which supervises controls and regulates the activities of commercial banks and money supply in the country. It is generally under Government ownership and controls and implements economic policy of the Government.

Central Bank may be defined as an institution charged with the responsibility of managing the expansion and contraction of the volume of money supply for general Economic Welfare. The Central Bank is the apex institution in the banking and financial structure of the country.

Functions of Central Bank :

Central Bank plays a leading role in organizing, running, supervising, regulating and developing the banking and financial structure of the country.

(i) Monopoly of Note Issue: The Central Bank enjoys the exclusive power of note issue. In India the RBI issues all notes except Re 1 notes and coins. Re 1 note are issued by the Government of India under the guidance of RBI. The currency notes issued by the Central Bank are declared unlimited legal tender throughout the country. The Central Bank has to keep reserve of Gold, Silver and foreign securities for issuing notes.

(ii) Banker, agent, advisor to the Government: The Banking A/c of the government both central and state are maintained by the Central Bank as the commercial bank does for its customers. As a banker and to the government it helps the government in short term loans and advances for temporary requirements and floats public loans for the government.

(iii) Banker's Bank: All commercial banks keep part of their cash balances as deposits with the Central Bank of the country. This is either because of convention or legal compulsion. The commercial banks regularly draw currency during the busy season and paying in surplus during the slack season. Part of these balances are meant for clearing purposes i.e.; all commercial banks keep deposit account with the Central Bank. The deposit balances of the Central Bank are considered as cash reserves for general purpose. Under the Banking Regulations Act of 1949, the Central Bank of India has been empowered with the right to supervise and control the activities of various scheduled commercial banks. These powers are related to licensing, branch expansion, liquidity of assets and methods of working of the Bank.

(iv) Clearing House Facility: By virtue of its unique position in dealing with domestic and foreign funds the Central Bank has a special position for conducting:

(a) Clearing house operation;

(b) Interbank transfer of funds;

(c) Settlement of accounts. Clearing house facility means providing an opportunity to member commercial banks to settle their claims on each other mutually. E.g. : Indian Bank has to pay to SBI a sum of 2 lakh and SBI has to pay to Indian bank `1,50,000. This can be settled with a check of 50,000 by Indian Bank on the RBI in favour of SBI. As a result Indian Banks accounts will be debited and SBI's account will be credited.

(v) Custodian of Foreign Exchange Reserves: Under this system the RBI controls both receipts and payments of foreign exchange. A country have in its foreign trade favourable or un-favourable balance. Favourable balance helps to bring foreign exchange to the country while unfavourable balance means paying foreign exchange out. As custodian of Foreign Exchange, Central Bank keeps a constant watch on the same so that the value of the home currency does not riseor fall adversely in relation to foreign currency. During times of emergency the Central Bank may impose restrictions to control on buying or selling of foreign currencies in the market.

(vi) Credit Control: In order to ensure price stability and Economic growth of a country, the CentralBank undertakes the responsibility of controlling credit. The Central Bank ensures price stability and avoids inflationary and deflationary tendencies by several monetary methods such as regulation of Bank rate, open market operation, change in variable reserve ratio, etc.

Credit Control by Central Bank

Credit money created by commercial banks and other non-banking financial institutions constitutes a significant portion of total money supply in an economy.

- Their shortages and excesses may have profound impact upon an economy.
- The flow of credit should be regulated in such a way that they may raise or fall according to the needs of an economy. This is what we generally mean by credit control.
- This is done by the central bank in its role of a banker's bank.
- The objective of credit control is generally two fold.
- A central bank may encourage member banks to expand credit, known as expansionary monetary policy, which is adopted to lift an economy out of depression and unemployment.
- It may restrict credit-creating power of banks and non-banks which is known as restrictive policy to fight inflation and to achieve financial stability.
- In the context of growth with stability a central bank is to deal with both aspects increasing credit flow for more investment and, at the same time, restrict flow of credit so that it may not generate inflation.

5.2 Commercial Banks:-

A commercial bank is an institution which offers full banking services to industry, trade and people of a country. These banks accept deposits from and lend them to borrowers by charging some interest on the amount lent to them.

Concept of Commercial Banks

- A commercial bank is a financial intermediary.
- Its central objective is commercial that is, profit making.
- It takes money from a surplus unit by paying a low rate of interest and lends the same fund to a deficit unit at a higher rate of interest and thus makes profit.
- It is said to be a dealer in credit.
- It may be organized privately or by the Government.
- The two primary functions of such a bank are Deposit function and Loan function.
- Deposits may be of three types: Demand or current, Savings and Fixed or Time deposit.
- The funds thus obtained from various classes of people are pooled together and lend to users of capital.
- In its loans and advances, banks maintain a diversified portfolio in order to seek a balance between liquidity and profitability.

Functions of a Commercial Bank:

Modern commercial banks perform a variety of functions and provide a number of services to their customers. They are regarded as departmental – store banks because they provide a wide variety of services to their customers. Various functions performed by commercial banks are as follows:

1. Acceptance of deposits —People who have surplus funds with them would like to deposit these with commercial banks. Banks accept mainly three types of deposits:

Current Account	• Deposits in current account are payable on demand. • Current accounts are also known as demand deposits. • These accounts are mostly held by traders and businessmen. • Bank does not pay any interest on these accounts. • Banks provide various services to the current account holders, such as making payment through cheques, collection of payment of cheques, issuing drafts on behalf of the account holders etc. • Banks, in fact, levy certain service charges on the customers for the services rendered by them.
Savings Bank Account	• Here deposits are payable on demand and money can be withdrawn by cheques. • Banks impose a limit on the amountand number of withdrawals during a particular period. • These accounts are held by households who have idle cash for a short period. • Deposits in this account earn interest at nominal rates.

Fixed Deposits	• The money is deposited for a fixed period, viz., 6 months, one year, two years, five years or more. • These deposits are not payable on demand. • These deposits are also known as time deposits since the money deposited in them cannot be withdrawn before the maturity of the period for which the deposit is made. • These are interest-earning deposits. • The rate of interest varies with the length of time for which the deposit has been made. • Recurring (or cumulative) deposits are one type of fixed deposits. A depositor makes a regular deposit of a given sum for a specified period. • Recurring deposits aredesigned to motivate the small savers to save a particular amount regularly.

2. Advancing of Loans — The second primary function of the commercial banks is to extend loans and advances. Lending is the most profitable business of a bank. Banks charge interest from the borrowers which are morethan the interest they pay to their depositors. Banks these days extend loans and advances to their customers in the following ways:

Outright Loans (Term Loans)	• Banks provide outright loans for a fixed period.

	• The entire amount of the loan sanctioned is credited to the borrower's current account. • The borrower pays interest on the entire amounthe has borrowed.
Cash credit	• The entire sanctioned amountof loan by the bank is not given to the borrower at a particular time. • The bank opens an account ofthe borrower and allows him to withdraw the borrowed amount as and when he required the money. • The bank charges interest, not on the amount of loan sanctioned, but on the actual amount withdrawn from the bank.
Overdraft facilities	• The customer is allowed to draw cheques in excess of the balance standing to his credit to the extent of the amountof overdraft. • For a businessman, the overdraft facility is the easiest and most convenient method of borrowing from banks.

Discounting Bills of Exchange	• A bill of exchange is drawn by a creditor on the debtor specifying the amountof debt and also the date when it becomes payable. • Such bills of exchange are normally issued for a period of 90 days. • The creditors cannot get it en cashed from the debtors before the maturity of the 90 -day's period. • If the creditor needs money before the expiry of this 90—days period, he can get it discounted from a commercial bank. • The bank makes payment to the creditor after deducting its commission. • When the bill matures, the bank will get payment fromthe debtor.

3. Facilitation of payments through cheques — Banks have provided a very convenientsystem of payment in the form of cheques. The cheque is the principal method of payment in business in recent times. It is convenient, cheap and safe means of making payments.

4. Transfer of funds — Banks help in the remittance or transfer of funds from one placeto another through the use of various credit instruments like cheques, drafts, mail transfers and telegraphic transfers.

5. Agency Functions — Banks provide various agency functions for theircustomers.The banks charge commission orservice charge for such functions. The main agency functions are :

(i) The commercial banks collect cheques, drafts, bills of exchange, hundies and other financial instruments for their customers.

(ii) They make and collect various types of payments on behalf of their customers, such as insurance premia, pensions, dividends, interest, etc.

(iii) The commercial banks act as agents for the customers in the sale and purchase of securities. They provide investment services to the companies by acting as underwriters and bankers for new issues of securities to the public.

(iv) They render agency services of various types, such as obtaining foreign currency for customers and sale of foreign exchange on their behalf, sale of national savings certificates and units of U.T.I.

(v) The commercial banks act as trustees and executors. For instance, they keep the wills of their customers and execute them after their death.

6. Credit Creation — A very important and unique function of the commercial banks is that they have the power of credit creation. In the process of acceptance of deposit and granting of loans, commercial banks are able to create credit. This means that they are able to grant more loans than the amount of initial or primary deposits made by the customers.

Credit creation depends upon the amount of loan given. If society does not borrow, as it happens in a period of economic depression, bank can neither lend, nor can create credit. If borrowers cannot offer security against loan, bank cannot lend.

CHAPTER- 6

Part B: Accountancy

CHAPTER- 7

A: INTRODUCTION TO BOOK-KEEPING AND ACCOUNTANCY

7.1 Definition and Objective of Book-keeping.

7.2 Need and Advantages of Book Keeping.

7.3 Definition of Accounting.

7.4 Difference between Book keeping and Accounting.

7.5 Double entry system.

7.6 Advantages and disadvantages of Double Entry System.

7.1 Definition and Objective of Book-keeping:

Concept of Book keeping:

Book-keeping is that branch of knowledge which tells us how to keep a record of business transactions. It is often routine and clerical in nature. It is important to note that only those transactions related to business which can be expressed in terms of money are recorded. The activities of book-keeping include recording in the journal, posting to the ledger and balancing of accounts.

Book-Keeping is a systematic manner of recording transactions related to business in the books of accounts. In Book-Keeping, transactions are recorded in the order of the dates. An Accountant is a person who records the transactions in the books of the business and is expected to show the financial results of a business for every financial year. A financial year in India is followed from 1st April to 31st March.Book-Keeping is an art as well as a science. It is the art of recording day to day business transactions in the books of accounts in a scientific and systematic manner.

Definitions:

J. R. Batliboi: Book-Keeping is an art of recording business dealings in a set of books.

R.N Carter: Book-Keeping is an art of recording in the books of accounts, all those business transactions that result in transfer of money's worth.

According to R.N. Carter. "Book- Keeping is the science and art of correctly recording in the books of account all those business transactions that result in the transfer of money or money's worth."

Objective of Book-keeping:

The objectives of book-keeping are

- **i.** to have permanent record of all the business transactions.
- **ii.** to keep records of income and expenses in such a way that the net profit or net loss may be calculated.
- **iii.** to keep records of assets and liabilities in such a way that the financial position of the business may be ascertained.
- **iv.** to keep control on expenses with a view to minimise the same in order to maximise profit.
- **v.** to know the names of the customers and the amount due from them.
- **vi.** to know the names of suppliers and the amount due to them.
- **vii.** to have important information for legal and tax purposes

7.2 Need and Advantages of Book Keeping:

- **i.** Book-Keeping is recording transactions in a systematic manner. It may not be realistic for a businessman to remember all the transactions over a period of time. Thus Book-Keepin g ensures that the record of all the transactions is kept on a permanent basis.

- **ii.** Book-Keeping records the financial activities of a business. This financial record helps in generating financial information of the business regarding the Assets, Liabilities, Profit, Loss, Stock Investment etc.
- **iii.** All the information provided by Book-Keeping helps the company, business or bu sinessman to make decisions for successful business operations.
- **iv.** Management uses the financial records of business to manage and control the business op erations in a smooth manner. Such financial records are available from Book-Keeping.
- **v.** Book-Keeping records can be used as legal evidence in Courts as all the recorded transac tions of a business are recorded from source documents which act as evidence in case of any disputes.
- **vi.** Record of transactions in the books of accounts helps businesses to compare their financi al positions year after year and with other business units.
- **vii.** Book-Keeping helps the businessman in ascertaining the amount payable for Sales Tax, Property Tax, Income Tax etc.

7.3 Define Accounting:

American Accounting Association defines accounting as "the process of identifying, measuring and communicating economic information to permit informed judgements and decision by users of the information".

According to R.N. Anthony, "Nearly every business enterprise has accounting system. It is a means of collecting, summarizing, analyzing, and reporting in monetary terms, informations about business.

The main objectives of accounting are

- i. to maintain accounting records.
- ii. to calculate the result of operations.
- iii. to ascertain the financial position.
- iv. to communicate the information to users.

7.4 Difference between Book keeping and Accounting :

Basis	Book keeping	Accounting
Object	Record the business transaction	Classify summaries and interpret the business transaction to find out the accuracy of recorded data.
Scope	Its scope is limited.	It has wider scope as compared to book- keeping.
Level of work	The clerical works relating to recording etc. is done at this level.	Accounting is related to reporting and interpretation of recorded data.
Usefulness	It is useful for recording and preservation of transactions.	It is useful for managerial decision making purpose.
Information System	It is a primary record of the business transactions.	Accounting is a source of financial information.

Objectives of Accountancy

1) To know the complete and permanent record of each transactions of the business for future reference.
2) To ascertain the amount of debtors and creditors.
3) To ascertain the profit or loss of the any organization at any given period of time.
4) To ascertain the financial position of the organization a\on any particular date.
5) To ascertain the tax liability of the organization under the Income Tax Act 1961.

Advantages of Accountancy

1) With the proper books of account one should have easily ascertain the true picture of the organization.
2) Proper accounts help to find out the profit and loss of the organization on any particular date.

3) Financial Position of the organization has easily ascertained with the proper recording system.
4) A proper book of account is an evidence of legal matter.
5) Proper maintain the books of accounts help the management of the organization to planning, control and decision making process.

Limitation of accountancy

1) Its record only monetary terms so there is seen to be absence of qualitative information.
2) Different valuation of methods for depreciation and stock are based on personal judgments. Hence profit or loss is not reliable.
3) It provides incomplete records because profit or loss can be known only when the business is closed down.
4) It based on accounting principles like convention, going concern. Hence profit or losses of the business are not realistic.
5) Another major limitation it is based on historical cost only.

7.5 Concepts of Double Entry System:

Double Entry System states that every transaction has two fold aspects and the effects of these two fold aspects are opposite in nature. If one aspect, called account, receives benefit, there must be another aspect or an account to impart the benefit.

Features of Double Entry System

1) Changes are recognized from the point of view of the party in whose books of account recording is being done.
2) Changes are recorded in two related accounts in the books of the party in whose books recording is being done.

7.6 Advantages of Double Entry System:

1) It is a scientific system of recording business transaction as compared to other system.

2) Two aspects of every business transactions are recorded in their concerned accounts. Thus it makes a complete record of business transaction.
3) Under the system, as the accounts of revenue and expenses are maintained, a trading and profit and loss account can be prepared and gross profit or loss and net profit or loss can be ascertained.
4) Under the system, as the accounts of assets, liabilities and capital are also maintained; a balance sheet can be prepared in order to ascertain the financial position of the business on a given date.

Disadvantages Double Entry System :

1) Without expert knowledge it is not possible to maintain the transaction under double entry system.
2) It is very expensive in compare to other recording system.
3) For small organization it is very difficult to maintain the record under this system.

Concept of Computerised Accounting System :

Computerised Accounting System is a system of maintaining record of financial transaction in electronic form by processing them as per Generally Accepted Accounting Principles to supply accounting information in the form of reports as per user requirements.

Need for Computerised Accounting System:

1) Accounting data can be processed faster by using a computerized accounting system.
2) The possibility of error is eliminated by the use of computer in the accounting process if the primary accounting data is correctly entered.
3) The computers system performs the repetitive operations accurately.
4) The computer based accounting systems ensure better use of resources and time.

5) The computerized accounting system facilitates the generation of management information system, which helps management to monitor and control the business activity.

Difference between Manual Accounting and Computerised Accounting System

Basis	**Manual Accounting**	**Computerised Accounting System**
Recording	Recording of transaction data are done through manually.	Data of transactions are stored in a well designed accounting database.
Classification	Recorded transactions are classified by posting into ledger.	Classification is done automatically by accounting software.
Summarising	Summarising is done by ascertaining balance of various accounts, preparation of ledger is must.	Transaction are processed by the software and summary is available at the computer stored system.
Adjusting Entries	Adjusting Entries are passed to adhere to the principle of matching of cost with revenue.	Formal voucher are prepared and stored for adjustment entries for errors and rectification.
Financial Statements	Trial balance is required for preparation of financial statement.	Financial Statement can be prepared by processing the original stored data.

CHAPTER-8

TRANSACTION

8.1: Definition.

8.2: Meaning of Accounts.

8.3: Classification of Accounts-

- Traditional Approach
- Modern Approach

8.4: Meaning of Debit and Credit.

8.5: Rules of Debit and Credit.

<u>8.3: Classification of Accounts :</u>

It is necessary to know the classification of accounts and their treatment in double entry system of accounts. Broadly, the accounts are classified into three categories:

1) **Personal accounts**
2) **Real accounts**
   - **Tangible accounts**
   - **Intangible accounts**
3) **Nominal accounts**

Let us go through them each of them one by one.

1) <u>Personal Accounts</u>

Personal accounts may be further classified into three categories:

i) Natural Personal Account

An account related to any individual like David, George, Ram, or Shyam is called as a Natural Personal Account.

ii) Artificial Personal Account

An account related to any artificial person like M/s ABC Ltd, M/s General Trading, M/s Reliance Industries, etc., is called as an Artificial Personal Account.

iii) Representative Personal Account

Representative personal account represents a group of account. If there are a number of accounts of similar nature, it is better to group them like salary payable account, rent payable account, insurance prepaid account, interest receivable account, capital account and drawing account, etc.

2) Real Account

Every Business has some assets and every asset has an account. Thus, asset account is called a real account. There are two types of assets:

- Tangible assets are touchable assets such as plant, machinery, furniture, stock, cash, etc.
- Intangible assets are non-touchable assets such as goodwill, patent, copyrights, etc.

Accounting treatment for both type of assets is same.

3) Nominal Account

Since this account does not represent any tangible asset, it is called nominal or fictitious account. All kinds of expense account, loss account, gain account or income accounts come under the category of nominal account. For example, rent account, salary account, electricity expenses account, interest income account, etc.

8.4: Meaning of Debit and Credit :

Debit and Credit, are key parts of any accounting entry. These are the fundamental “effect” of each financial transaction. For maintaining correct accounting records, you must have full knowledge of what is Debit and what is Credit. In the double entry system of book keeping, you have two columns for entering your transactions. It is a basic understanding that an entry to the left side column is Debit and an entry to the right side column is Credit. Debit & Credit are shortly mentioned as Dr. and Cr respectively. Any kind of transaction has two effects. So for every debit there is a corresponding credit of equal amount.

8.5: Rules of Debit and Credit :

Under Traditional Approach

Types of Account	Account to be Debited	Account to be credited
Personal account	Receiver	Giver
Real account	What comes in	What goes out
Nominal account	Expense and loss	Income and gain

Under Modern Approach

Types of Account	Account to be Debited	Account to be Credited
Assets account	Increase	Decrease
Liabilities account	Decrease	Increase
Capital account	Decrease	Increase
Revenue account	Decrease	Increase
Expenditure account	Increase	Decrease

CHAPTER-9

JOURNAL AND LEDGER

9.1 Meaning of Journal :

A journal is a book in which transactions are recorded in the order in which they occur i.e. in chronological order. A journal is called a book of prime entry (also called a book of original entry) because all business transactions are entered first in this book. The process of recording a transaction in the journal is called journalising. An entry made in the journal is called a Journal Entry.

9.3 Meaning of Ledger:

Ledger is a principal book of accounts of the enterprise. It is rightly called as the 'King of Books'. Ledger is a set of accounts. An accounting system typically contains a large number of accounts and the number of accounts can be added as they are needed and anticipated. Ledger contains the various personal, real and nominal accounts in which all business transactions of the entity are recorded. The main function of the ledger is to classify and summarize all the items appearing in Journal and other books of original entry under appropriate head/set of accounts so that at the end of the accounting period, each account contains the complete entire information of all transaction relating to it. So ledger is a book of final entry wherein all the accounts find their place. Thus, to have a consolidated view of the similar transactions different accounts are prepared in the ledger. A ledger therefore is a collection of accounts and may be defined as a summary statement of all the transactions relating to a person, asset, expense or income which have taken place during a given period of time and shows their net effect.

9.4 Objectives and Utility of Ledger:

1) Ledger account keeps a permanent record of all financial transactions in a classified manner.
2) Ledger account shows detailed financial information of a business regarding debtors and creditors, assets, and incomes and expenses.
3) Ledger account helps to prepare a trial balance in order to check the arithmetical accuracy of the recording of the financial transactions of the business.
4) Ledger account helps to prepare profit and loss account so as to ascertain the profit or loss of the business.
5) Ledger account helps to prepare the balance sheet with a view to show the financial position of the business.

The following are main objectives of ledger accounts-

1. **To Provide Classified Financial Information-** the ledger is a permanent book of record which contains a number of accounts of different subjects. Its purpose is, therefore to provide classified financial information about the subjects such as a person, asset and an expense or income.

2. **To Provide Check an Arithmetical Accuracy** -The fundamental double-entry principle provides that debit is always equal to credit or vice verse. Since the ledger account is prepared under the **double-entry system**, it helps to prepare a **trial balance** that provides a check on the arithmetical accuracy of the recording transactions in the books of accounts.

3. **To Help Ascertain Profit or Loss -**The ledger is a book of accounts relating to all the financial transaction of the business. It contains the accounts of all expenses, losses, incomes and gains. Therefore it helps to prepare the profit and loss account of the business so as to ascertain the profit earned or loss suffered during a specified period.

4. To Help Reveal the Financial Position -The ledger also contains the accounts of the financial transactions relating to capital, all liabilities and assets of the business. With the help of the balances of these accounts and profit and loss of the business, a **balance sheet** may be prepared to show its financial position at a certain point in time.

9.5 Posting of Ledger :

Ledger posting is very important part of accounting system. As we know that to reach to any financial result, we have to go through so many processes. For example, first of all, we must know to maintain proper account records. To maintain proper account records, one must know proper accounting system. And proper accounting system includes following important steps to be followed:-

1. To prepare the vouchers.
2. To enter the vouchers in to different type of day books.
3. Posting the entries from day books to ledger.
4. Totaling and Balancing of ledgers.
5. To prepare the trial balance
6. To prepare Trading Account, Profit & Loss Account and Balance Sheet.

9.6 Distinction between Journal and Ledger :

Basis	Journal	Ledger
Meaning	The book in which all the transactions are recorded, as and when they arise is known as Journal	The book which enables to transfer all the transactions into separate accounts is known as Ledger.

What is it?	It is a subsidiary book.	It is a principal book.
Also known as	Book of original entry.	Book of second entry.
Record	Chronological record	Analytical record
Process	The process of recording transactions into Journal is known as Journalizing	The process of transferring entries from the journal to ledger is known as Posting.
How transactions are recorded?	Sequentially	Account-wise
Narration	Must	Not necessary.
Balancing	Need not to be balanced.	Must be balanced.
Debit and Credit	Columns	Sides

CHAPTER-10

CASH BOOK

10.1 Meaning and importance of Cash Book.

10.2 Characteristics and advantage of Cash Book.

10.3 Discount – Trade Discount and Cash Discount.

10.4 Different types of Cash Book

- Single column cash book
- Double column cash book
- Triple column cash book

10.1 Meaning and importance of Cash Book :

Cash book is a record of all the transactions related to cash. Examples include: expenses paid in cash, revenue collected in cash, payments made to creditors, payments received from debtors, cash deposited in bank, withdrawn of cash for office use, etc.

In double column cash book, a discount column is included on both debit and credit sides to record the discount allowed to customers and the discount received from creditors respectively.

In triple column cash book, one more column of bank is included to record all the transactions relating to bank.

In modern accounting, simple cash book is the most popular way to record cash transactions. The double column cash book or three column cash book is practically for academic purpose. A separate bank book is used to record all the banking transactions as they are more than cash transactions. These days, cash is used just to meet petty and routine expenditures of an organization. In most of the organizations, the salaries of employees are paid by bank transfer.

Importance of Cash Book :

1) To have systematic and permanent record of all cash and banking transactions in a separate book.
2) To obtain reliable and detailed information of all cash receipts and payments easily and immediately.
3) To keep effective control over misappropriation of cash and banking transaction.
4) To know the main sources and heads of payment of cash.
5) To help to prepare **cash budget** and to avoid the possibility of having **excess or shortage of cash**.
6) To make the cashier and other concerned officers accountable for all cash and banking transactions.

10.4 Different types of Cash Book :

1) **Single column cash book:**

Cash book is just like a ledger account. There is no need to open a separate cash account in the ledger. The balance of cash book is directly posted to the trial balance. Since cash account is a real account, ruling is followed, i.e. what comes in – debit, and what goes out – credit. All the received cash is posted in the debit side and all payments and expenses are posted in the credit side of the cash book.

2) **Double column cash book:**

Here, we have an additional Discount column on each side of the cash book. The debit side column of discount represents the discount to debtors of the company and the credit side of discount column means the discount received from our suppliers or creditors while making payments.

The total of discount column of debit side of cash book is posted in the ledger account of 'Discount Allowed to Customers' account as 'To Total As Per Cash Book'. Similarly, credit column of cash book is posted in ledger account of 'Discount Received' as 'By total of cash book'.

3) **Triple column cash book:**

When one more column of Bank is added in both sides of the double column cash book to post all banking transactions, it is called triple column cash book. All banking transactions are routed through this cash book and there is no need to open a separate bank account in ledger.

Contra entries

Transactions that relate to both cash and bank and is entered on cash column of one side and bank column of other side of Bank Column Cash Book. Recording of such transactions is known as 'Contra entries'.

CHAPTER-11

TRIAL BALANCE AND ERROR IN ACCOUNTING

11.1 Meaning and objects of Trail Balance :

A trial balance is a statement showing the balances, or total of debits and credits, of all the accounts in the ledger with a view to verify the arithmetical accuracy of posting into the ledger accounts. Trial balance is an important statement in the accounting process as it shows the final position of all accounts and helps in preparing the final statements. The task of preparing the statements is simplified because the accountant can take the balances of all accounts from the trial balance instead of going through the whole ledger. It may be noted that the trial balance is usually prepared with the balances of accounts.

The trial balance is prepared to fulfill the following objectives:

1) To Ascertain the Arithmetical Accuracy of Ledger Accounts:

As stated earlier, the purpose of preparing a trial balance is to ascertain whether all debits and credit are properly recorded in the ledger or not and that all accounts have been correctly balanced. As a summary of the ledger, it is a list of the accounts and their balances. When the totals of all the debit balances and credit balances in the trial balance are equal, it is assumed that the posting and balancing of accounts is arithmetically correct. However, the tallying of the trial balance is not a conclusive proof of the accuracy of the accounts. It only ensures that all debits and the corresponding credits have been properly recorded in the ledger.

2) To help in Locating Errors

When a trial balance does not tally (that is, the totals of debit and credit columns are not equal), we know that at least one error has occurred. The error (or errors) may have occurred at one of those stages in the accounting process: (1) totaling of subsidiary books, (2) posting of journal entries in the ledger, (3) calculating account balances, (4) carrying account balances to the trial balance, and (5) totaling the trial balance columns.

It may be noted that the accounting accuracy is not ensured even if the totals of debit and credit balances are equal because some errors do not affected quality of debits and credits. For example, the book-keeper may debit a correct amount in the wrong account while making the journal entry or in posting a journal entry to the ledger. This error would cause two accounts to have incorrect balances but the trial balance would tally. Another error is to record an equal debit and credit of an incorrect amount. This error would give the two accounts incorrect balances but would not create unequal debits and credits. As a result, the fact that the trial balance has tallied does not imply that all entries in the books of original record (journal, cash book, etc.) have been recorded and posted correctly. However, equal totals do suggest that several types of errors probably have not occurred.

3) To Help in the Preparation of the Financial Statements:

Trial balance is considered as the connecting link between accounting records and the preparation of financial statements. For preparing a financial statement, one need not refer to the ledger. In fact, the availability of a tallied trial balance is the first step in the preparation of financial statements. All revenue and expense accounts appearing in the trial balance are transferred to the trading and profit and loss account and all liabilities, capital and assets accounts are transferred to the balance sheet.

11.2 Main features of Trail Balance:

1. It is a tabular statement having separate sides/columns for debit balances and credit balances.

2. Closing balances of the various ledger accounts are brought to this statement.

3. It can be prepared at any date on which accounts are closed and balanced. But it is usually prepared at the end of the accounting year.

4. Trial balance is not an account. It is only a statement.

Advantage of Trail Balance

It presents to the businessman a consolidated list of all ledger balances.

2. It is the shortest method of verifying the arithmetical accuracy of entries made in the ledger.

3. If the total of debit side/column is equal to the total of credit side/column, the trial balance is said to agree. Otherwise, it is implied that some errors have been committed in the preparation of accounts.

4. It helps in the preparation of the final accounts i.e., Trading a/c. Profit and loss a/c and Balance Sheet.

11.3 Preparation of Trail Balance:

Theoritically spreading, a trial balance can be prepared in the following three ways:

1. **Totals Method**
2. **Balances Method**
3. **Totals-cum-balances Method**

1. Totals method

Under this method, total of each side in the ledger (debit and credit) is ascertained separately and shown in the trial balance in the respective columns. The total of debit column of trial balance should agree with the total of credit column in the trial balance because the accounts are based on double entry system. However, this method is not widely used in practice, as it does not help in assuming accuracy of balances of various accounts and and preparation of the fianancial statements.

2. Balances Method

This is the most widely used method in practice. Under this method trial balance is prepared by showing the balances of all ledger accounts and then totaling up the debit and credit columns of the trial balance to assure their correctness. The account balances are used because the balance summarises the net effect of all transactions relating to an account and helps in preparing the financial statements. It may be noted that in trial balance, normally in place of balances in individual accounts of the debtors, a figure of sundry debtors is shown, and in place of individual accounts of creditors, a figure of sundry creditors is shown.

3. Totals-cum-balances Method

This method is a combination of totals method and balances method. Under this method four columns for amount are prepared. Two columns for writing the debit and credit totals of various accounts and two columns for writing the debit and credit balances of these accounts. However, this method is also not used in practice because it is time consuming and hardly serves any additional or special purpose.

11.4 Types/Classification of Errors :

Keeping in view the nature of errors, all the errors can be classified into the following four categories:

1. **Errors of Commission**
2. **Errors of Omission**
3. **Errors of Principle**
4. **Compensating Errors**

1) Errors of Commission

These are the errors which are committed due to wrong posting of transactions, wrong totaling or wrong balancing of the accounts, wrong casting of the subsidiary books, or wrong recording of amount in the books of original entry, etc. For example: Raj Hans Traders paid Rs. 25,000 to Preetpal Traders (a supplier of goods). This transaction was correctly recorded in the cashbook.

But while posting to the ledger, Preetpal's account was debited with Rs. 2,500 only. This constitutes an error of commission. Such an error by definition is of clerical nature and most of the errors of commission affect in the trial balance.

2) Errors of Omission

The errors of omission may be committed at the time of recording the transaction in the books of original entry or while posting to the ledger. These can be of two types:

(i) error of complete omission

(ii) error of partial omission

When a transaction is completely omitted from recording in the books of original record, it is an error of complete omission. For example, credit sales to Mohan Rs. 10,000, not entered in the sales book. When the recording of transaction is partly omitted from the books, it is an error of partial omission. If in the above example, credit sales had been duly recorded in the sales book

but the posting from sales book to Mohan's account has not been made, it would be an error of partial omission.

3) Errors of Principle

Accounting entries are recorded as per the generally accepted accounting principles. If any of these principles are violated or ignored, errors resulting from such violation are known as errors of principle. An error of principle may occur due to incorrect classification of expenditure or receipt between capital and revenue. This is very important because it will have an impact on financial statements. It may lead to under/over stating of income or assets or liabilities, etc. For example, amount spent on additions to the buildings should be treated as capital expenditure and must be debited to the asset account. Instead, if this amount is debited to maintenance and repairs account, it has been treated as a revenue expense. This is an error of principle. Similarly, if a credit purchase of machinery is recorded in purchases book instead of journal proper or rent paid to the landlord is recorded in the cash book as payment to landlord, these errors of principle. These errors do not affect the trial balance.

4) Compensating Errors

When two or more errors are committed in such a way that the net effect of these errors on the debits and credits of accounts is nil, such errors are called compensating errors. Such errors do not affect the tallying of the trial balance.

For example, if purchases book has been overcast by Rs. 10,000 resulting in excess debit of Rs. 10,000 in purchases account and sales returns book is undercast by Rs. 10,000 resulting in short debit to sales returns account is a case of two errors compensating each other's effect. One plus is set off by the other minus, the net effect of these two errors is nil and so they do not affect the agreement of trial balance.

Financial statements are prepared to ascertain the profit or loss of the business, and to know the financial position of the company.

Trading, profit & Loss accounts ascertain the net profit for an accounting period and balance sheet reflects the position of the business.

CHAPTER-12

PREPARATION OF FINAL ACCOUNTS

12.1 Meaning and objectives of Trading Account.

12.2 Preparation of Trading Account.

12.3 Meaning and objectives of Profit and Loss Account.

12.4 Preparation of profit and loss Account.

12.5 Meaning of Depreciation, Revenue Expenditure and Capital Expenditure.

12.6 Preparation of Balance Sheet with simple adjustment

12.1 Meaning and objectives of Trading Account :

After the preparation of trial balance, the next step is to prepare Trading Account. Trading Account is one of the financial statements which show the result of buying and selling of goods and/or services during an accounting period. The main objective of preparing the Trading Account is to ascertain gross profit or gross loss during the accounting period. Gross Profit is said to have been made when the sale proceeds exceed the cost of goods sold. Conversely, when sale proceeds are less than the cost of goods sold, gross loss is incurred. For the purpose of calculating cost of goods sold, we have to take into consideration opening stock, purchases, direct expenses on purchasing or manufacturing the goods and closing stock. The balance of this account i.e. gross profit or gross loss is transferred to the Profit and Loss Account.

Objectives of Trading account

1) While fixing the selling price of merchandise, trader adds a fixed percent of cost as profit to the cost and later on by preparing the trading account verifies whether the projected profit has been earned or not.
2) It gross profit is found to be less than the projected profit its reasons are analyzed and proper control is exercised in future.
3) It Gross profit is more than projected profit, efforts are made to maintain it in future.

4) It Trading Account discloses loss then it will be prudent to close down the business may be temporarily till the conditions improve, otherwise, it is possible that losses may exceed.
5) Trading account also helps to ascertain the percentage of direct expenses over sales.
6) Trading account also provides the percentage of gross profit to sales.

12.3 Meaning and objectives of Profit and Loss Account:

Trading Account results in the gross profit/loss made by a businessman on purchasing and selling of goods. It does not take into consideration the other operating expenses incurred by him during the course of running the business. Besides this, a businessman may have other sources of income. In order to ascertain the true profit or loss which the business has made during a particular period, it is necessary that all such expenses and incomes should be considered. Profit and Loss Account considers all such expenses and incomes and gives the net profit made or net loss suffered by a business during a particular period. All the indirect revenue expenses and losses are shown on the debit side of the Profit and Loss Account, where as all indirect revenue incomes are shown on the credit side of the Profit and Loss Account. Profit and Loss Account measures net income by matching revenues and expenses according to the accounting principles. Net income is the difference between total revenues and total expenses. In this connection, we must remember that all the expenses, for the period are to be debited to this account - whether paid or not. If it is paid in advance or outstanding, proper adjustments are to be made (Discussed later). Likewise all revenues, whether received or not are to be credited. Revenue if received in advance or accrued but not received, proper adjustment is required.

 Know trading results: To know the trading results during the period studying profit and loss account is the essential way

 Relate the profits: Relate the profits to following

- The total capital (share capital, reserves etc., and ling term borrowings) employed in the concern which will indicate its overall profitability;
- The share capital which will indicate the profitability of the share capital employed in the business;

 The relation between profits and turnover: Objective of profit and loss account is to find out the relation between profits and turnover. It should be seen if, with the increase in sales, the same ratio of profitability has been maintained.

12.5 Meaning of Depreciation, Revenue Expenditure and Capital Expenditure:

Depreciation reduces the value of assets on a residual basis. It also reduces the profits of the current year. Depreciation indicates reduction in value of any fixed assets. Reduction in value of assets depends on the life of assets. Life of assets depends upon the usage of assets. There are many deciding factors that ascertain the life of assets. For example, in case of a building, the deciding factor is time. In case of leased assets, the deciding factor is the lease period. For plant and machinery, the deciding factor should be production as well as time. There can be many factors, but the life of assets should be ascertained on some reasonable basis.

Capital expenditures represent major investments of capital that a company makes to maintain or, more often, to expand its business and generate additional profits. Capital expenses are for the acquisition of long-term assets, such as facilities or manufacturing equipment. Because such assets provide income-generating value for a company for a period of years, companies are not allowed to deduct the full cost of the asset in the year the expense is incurred; they must recover the cost through year-by-year depreciation over the useful life of the asset. Companies often use debt financing or equity financing to cover the substantial costs involved in acquiring major assets for expanding their business.

Revenue expenses are shorter-term expenses required to meet the ongoing operational costs of running a business, and thus are essentially the same as operating expenses. Unlike capital expenditures, revenue expenses can be fully tax-deducted in the same year the expenses occur. In relation to the major asset purchases that qualify as capital expenditures, revenue expenditures include the ordinary repair and maintenance costs that are necessary to keep the asset in working order without substantially improving or extending the useful life of the asset. Revenue expenses related to existing assets include repairs and regular maintenance as well as repainting and renewal expenses. Revenue expenditures can be considered to be recurring expenses in contrast to the one-off nature of most capital expenditures.

12.6 Preparation of Balance Sheet with simple adjustment:

A Balance Sheet is a statement of financial position of a business concern at a given date. It is called a Balance Sheet because it is a sheet of balances of those ledger accounts which have not been closed till the preparation of Trading and Profit and Loss Account. After the preparation of Trading and Profit and Loss Account the balances left in the trial balance represent either personal or real accounts. In other words, they either represent assets or liabilities existing on a particular date. Excess of assets over liabilities represent the capital and is indicative of the financial soundness of a company.

A Balance Sheet is also described as a "Statement showing the Sources and Applications of Capital". It is a statement and not an account and prepared from real and personal accounts. The left hand side of the Balance Sheet may be viewed as description of the sources from which the business has obtained the capital with which it currently operates and the right hand side as a description of the form in which that capital is invested on a specified date.

Characteristics

The characteristics of a Balance Sheet are summarised as under:

(a) A Balance Sheet is only a statement and not an account. It has no debit side or credit side. The headings of the two sides are 'Assets' and 'Liabilities'.

(b) A Balance Sheet is prepared at a particular point of time and not for a particular period. The information contained in the Balance Sheet is true only at that particular point of time at which it is prepared.

(c) A Balance Sheet is a summary of balances of those ledger accounts which have not been closed by transfer to Trading and Profit and Loss Account.

(d) A Balance Sheet shows the nature and value of assets and the nature and the amount of liabilities at a given date.