

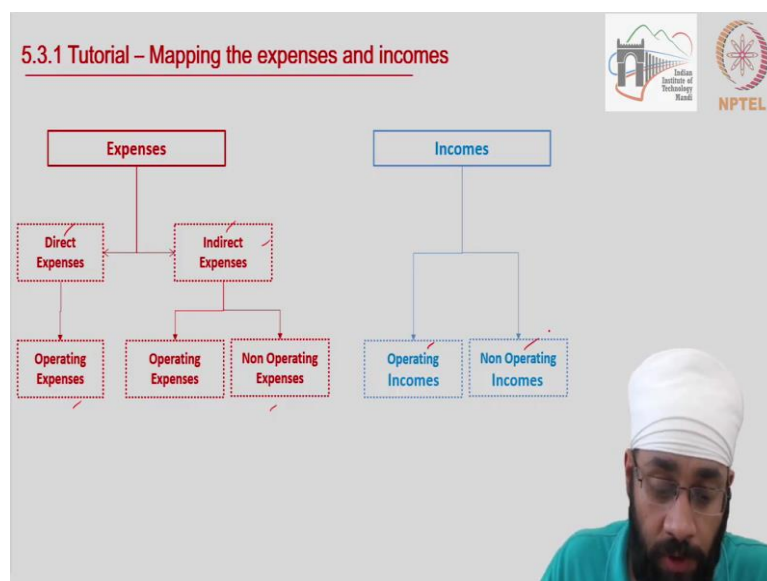
Financial Accounting
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Lecture – 53

5.3 Tutorial – Mapping operating and non-operating items to direct and indirect items

Hi, this is a tutorial. In the first few videos of the course, we spoke about a categorization of incomes and expenses, where we said expenses could be operating expenses or non-operating expenses, and incomes could also be operating or non-operating in nature. However, while discussing the final accounts, we have suddenly switched to another categorization, where we categorize the expenses into direct and indirect expenses. So, in this video, I am going to clarify the two different types of categories and try to map these two to each other, so that you understand the hierarchy, the typology.

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Expenses and incomes: these are the two components, two sides to the profit and loss account. Expenses are categorized into direct expenses and indirect expenses. All the direct expenses relate to manufacturing, and indirect expenses are post manufacturing expenses. Now, the direct expenses are typically operating expenses because the direct expenses are going to be the manufacturing cost of the product, which is primary to the business. So, all direct expenses are operating expenses. On the other hand, indirect expenses can be operating or non-operating in nature. This is how you think about the two types of typologies; you have the direct versus indirect, and operating versus non-operating.

All direct expenses are operating expenses while indirect expenses could take any of the two forms. On the other hand, as far as incomes are concerned, there is no categorization of direct or indirect income because the direct and indirect categorization is only for finding out the manufacturing cost. So, sales incomes work in a different manner. Only one categorization for incomes, which is operating income and non-operating income.

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5.3.2: Visual Mapping of the expenses and incomes

Dr		Cr	
Particulars	Dr. Amount	Particulars	Cr. Amount
To Opening Stock		By Sales	
To Purchase			
To Factory Expenses			
To Gross Profit c/d			
To Salaries		By Gross Profit b/d	
To Selling Expenses		By other incomes/gains	
To Administration Expenses			
To Finance Expenses			
To Taxes			
To Net Profit			

Let us also do a visual map here. This is the profit and loss account sample format; you have a credit side and you have a debit side. Now, in the first section all the items that you see are direct expenses in nature, and all the items are also operating in nature. So, broadly this is all direct expenses. These are all indirect expenses. All direct expenses are also operating expenses. So, let me just call these DE and OE. All indirect expenses cannot be only operating expenses. Some of these expenses are also non-operating. Let us identify those. Salaries are operating expenses; selling expenses operating; administrative again operating; finance expenses are non-operating expenses. So, these are the non operating expenses of the business. And taxes are essentially a mandatory payment that you have to do, to the government. So, you could just classify this into E; if you have to operate, you have to pay taxes, these are regular expenses of the business. And then, you have net profit which is just the balancing figure after taking out the expenses from the incomes. Thus, you have operating expenses and non-operating expenses in the second half of the profit and loss account.

On the other side, the incomes; you have operating income and here you have a non operating income, this one. Gross profit simply is the margin that you get from the first half of the account. This will become clearer, but I wanted to clarify this visually as well. When we go to the future videos, we are going to prepare a profit and loss account and at that time you should not get confused as to why and what is this direct, indirect, operating, and non-operating business. So, that is what I wanted to discuss in this video. I will see you in the next video.