Financial and Management Accounting

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IMPORTANCE AND LIMITATION OF ACCOUNTING

IMPORTANCE

Accounting plays an vital role in running a business because it helps us to track income & expenditure, insure statutory compliance, and provide investors, management, and government with quantitative financial information which can be used in making business decisions.

FEW MORE POINTS:

- Accounting keeps you organized
- It backs up your tax returns
- We need is to get investment or loans
- Systematic records
- Protects business protection
- Helps in forecasting
- Helps in decision making
- Compliance with statutory provision
- Ascertainment of the financial position of the business

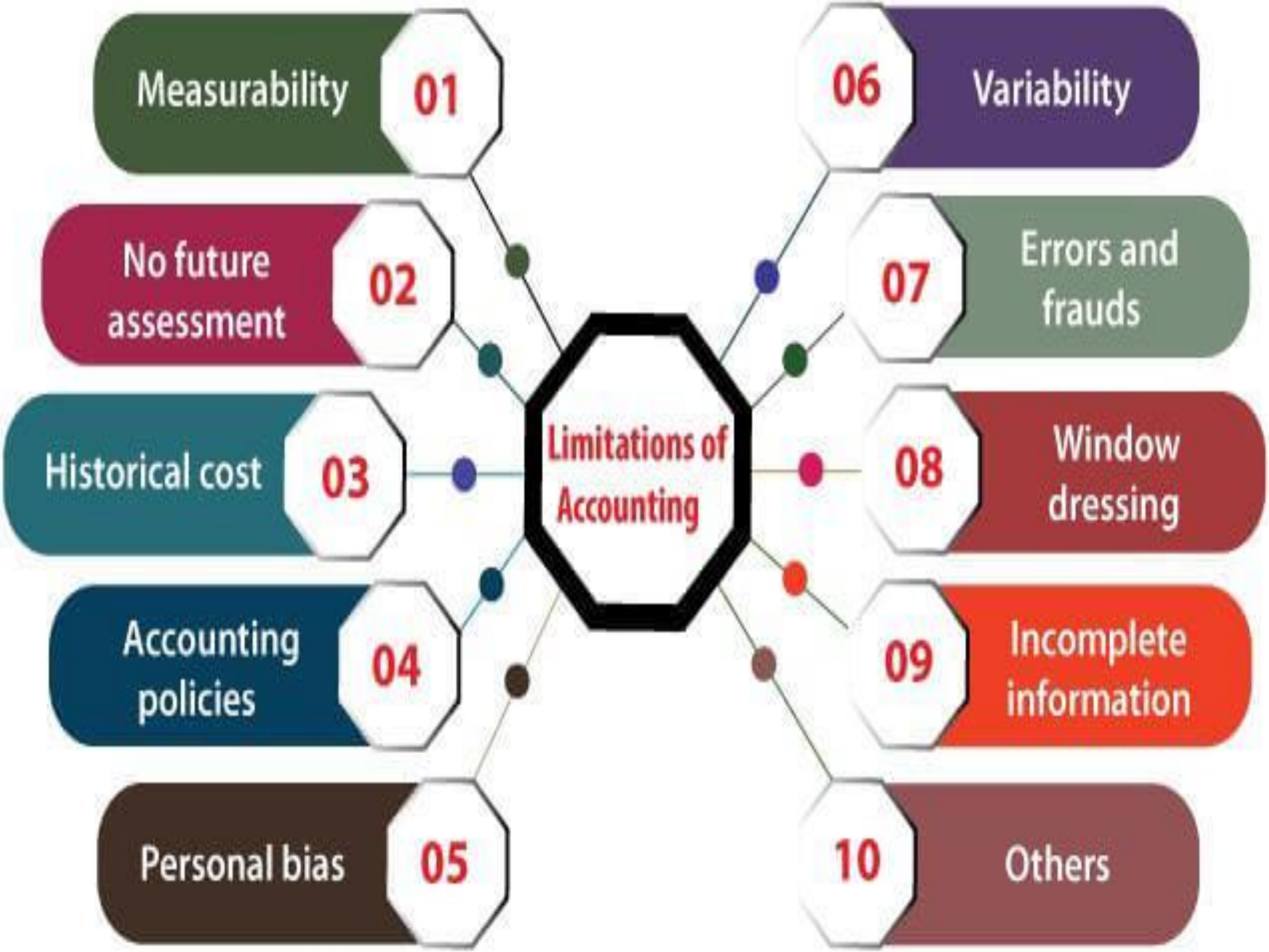
LIMITATIONS

One of the biggest limitations of accounting is that it cannot measure things/ events that do not have a monetary value.

If a certain factor; no matter how important, cannot be expressed in money it finds no place in accounting

FEW MORE POINTS:

- Accounting is not fully exact
- Accounting ignores the qualitative elements
- Accounting ignores effect of price level changes
- Accounting is unrealistic in information
- Accounting is historical in nature
- Accounting gives overall profitability


Limitations of Accounting
01 Measurability
02 No future assessment
03 Historical cost
04 Accounting policies
05 Personal bias
06 Variability
07 Errors and frauds
08 Window dressing
09 Incomplete information
10 Others

ACCOUNTING PRINCIPLES
{CONCEPT AND CONVENTIONS}

GENERALLY ACCEPTED ACCOUNTING PRINCIPLES:-
(GAAP or US GAAP) are a collection of commonly- followed accounting rules and standards for financial reporting

CONCEPTS ← PRINCIPLES → CONVENTIONS / TRADITION

CONCEPTS

- Consistency
- Accrual
- Going concern

Also known as
FUNDAMENTAL ACCOUNTING CONCEPTS

CONVENTIONS / TRADITION

- Business entity concept
- Money Measurement
- Accounting Periods
- Cost Concept
- Dual Aspect Concept
- Revenue Recognition
- Matching Concept
- Objectivity Concept
- Full Disclosure Concept
- Materiality Concept
- Concept Of Conservatism

CONCEPTS

CONSISTENCY CONCEPT:

This describes that accounting principles and methods should remain consistent in order to enable the management to compare the results of the two These principles should not be changed year after year.

GOING CONCERN CONCEPT:

This assumes that the business will continue to exist for a long period in the future There is neither the necessity nor the intention to liquidate it.

ACCRUAL CONCEPT:

This helps in relating the expenses to revenue for a given accounting.

CONVENTION

BUSINESS ENTITY CONCEPT:

A business and its owner should be treated separately as far as their financial transactions are concerned.

ACCOUNTING PERIOD CONCEPT:

According to this the entire life of the concern is divided in time intervals for the measurement of profit at frequent

MONEY MEASUREMENT CONCEPT:

Only business transactions that can be expressed in terms of money are recorded in accounting, though records of other types of transactions may be kept separately.

CONVENTION

COST CONCEPT:

The fixed assets of a business are recorded on the basis of their original cost in the first year of accounting. Subsequently, these assets are recorded minus depreciation. No rise or fall in market price is taken into account. The concept applies only to fixed assets.

MATCHING CONCEPT:

This principle dictates that for every entry of revenue recorded in a given accounting period, an equal expense entry has to be recorded for correctly calculating profit or loss in a given period.

DUAL ASPECT CONCEPT:

According to this, every transaction has two sides at least. If one account is debited, any other account must be credited. Every business transaction involves duality of effects. (i) Yielding of that benefit (ii) The giving of that

FULL DISCLOSURE METHOD:

According to this , accounting reports should disclose fully and fairly the information they purport to represent. The information which are of material interest to.

MATERIALITY CONCEPT:

The accountant should attach importance to material details and ignore insignificant.

CONVENTION OF CONSERVATISM:

According to this, in the books of accounts all anticipated losses should be recorded and all anticipated gains should be.

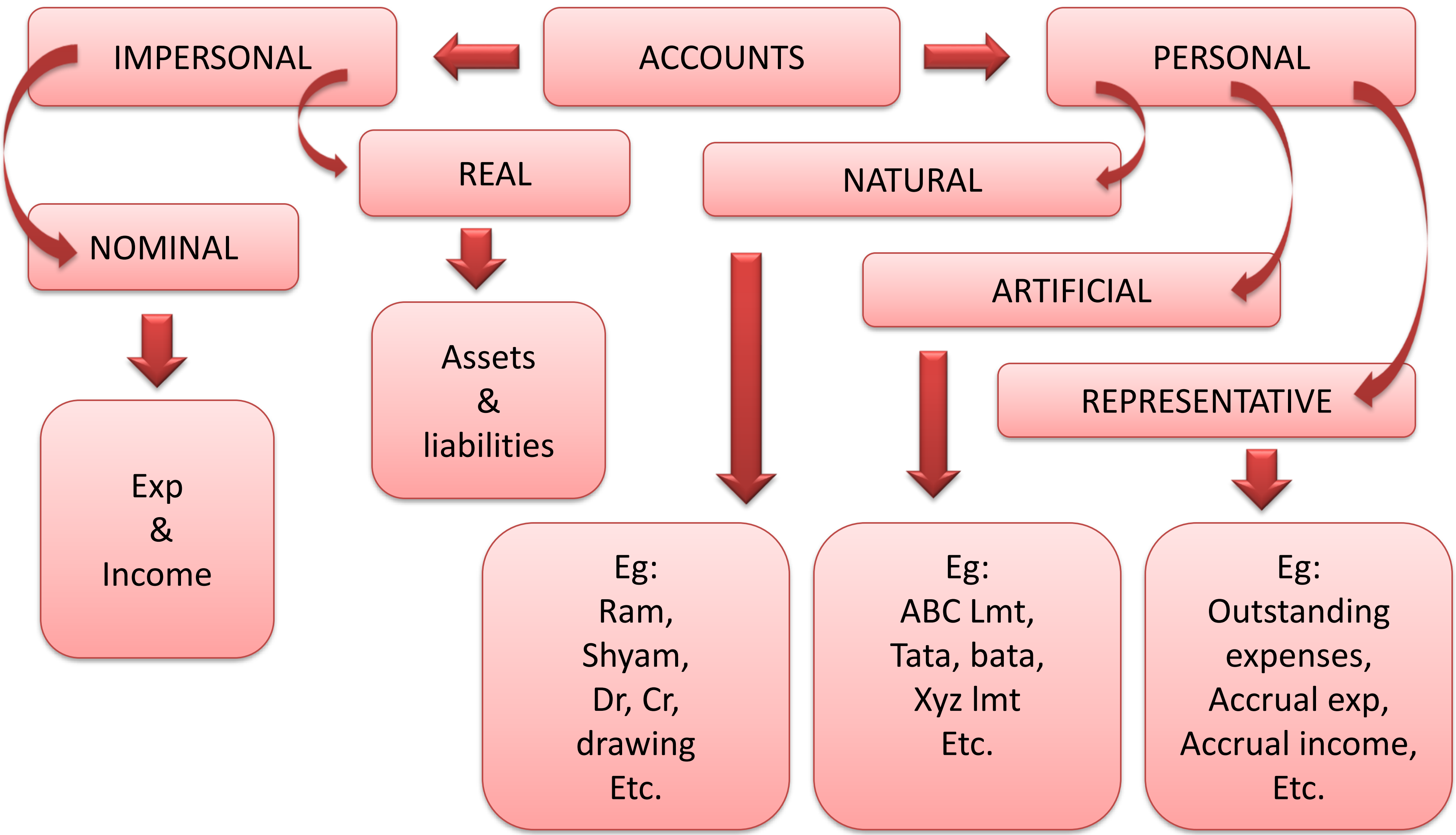
OBJECTIVITY CONCEPT:

This means that all accounting transactions that are recorded in the books of accounts should be evidenced and supported by business.

REVENUE RECOGNITION:

According to this, revenue is recognized when sale is made and sale is considered to be made when a goods passes to the buyer and he becomes legally liable to pay for.

TYPES OF ACCOUNTS AND THEIR RULE



EXPLAINED ABOVE MENTIONED TERMS

PERSONAL A/C:

A Personal account is a General ledger account connected to all persons like individuals, firms and associations. An example of a Personal Account is a Creditor Account.

ARTIFICIAL PERSONAL ACCOUNTS:

Personal accounts which are created artificially by law, such as corporate bodies and institutions, are called Artificial personal accounts.

REPRESENTATIVE PERSONAL ACCOUNTS:

Accounts which represent certain person or group directly or indirectly.

NATURAL PERSONAL ACCOUNTS:

Natural Persons are human beings. Therefore, we include the accounts belonging to them under this head. For instance, Debtors, Creditors, Capital A/c, Drawings A/c, etc.

EXPLAINED ABOVE MENTIONED TERMS

IMPERSONAL A/C:

Accounts which are not held in the name of person are known as impersonal accounts. Any account other than personal account being classified as real account or nominal accounts is known as impersonal account.

REAL IMPERSONAL ACCOUNTS:

A Real Account is a general ledger account relating to Assets and Liabilities other than people accounts. These are accounts that don't close at year-end and are carried forward. An example of a Real Account is a Bank Account.

N**OMINAL IMPERSONAL ACCOUNTS:**

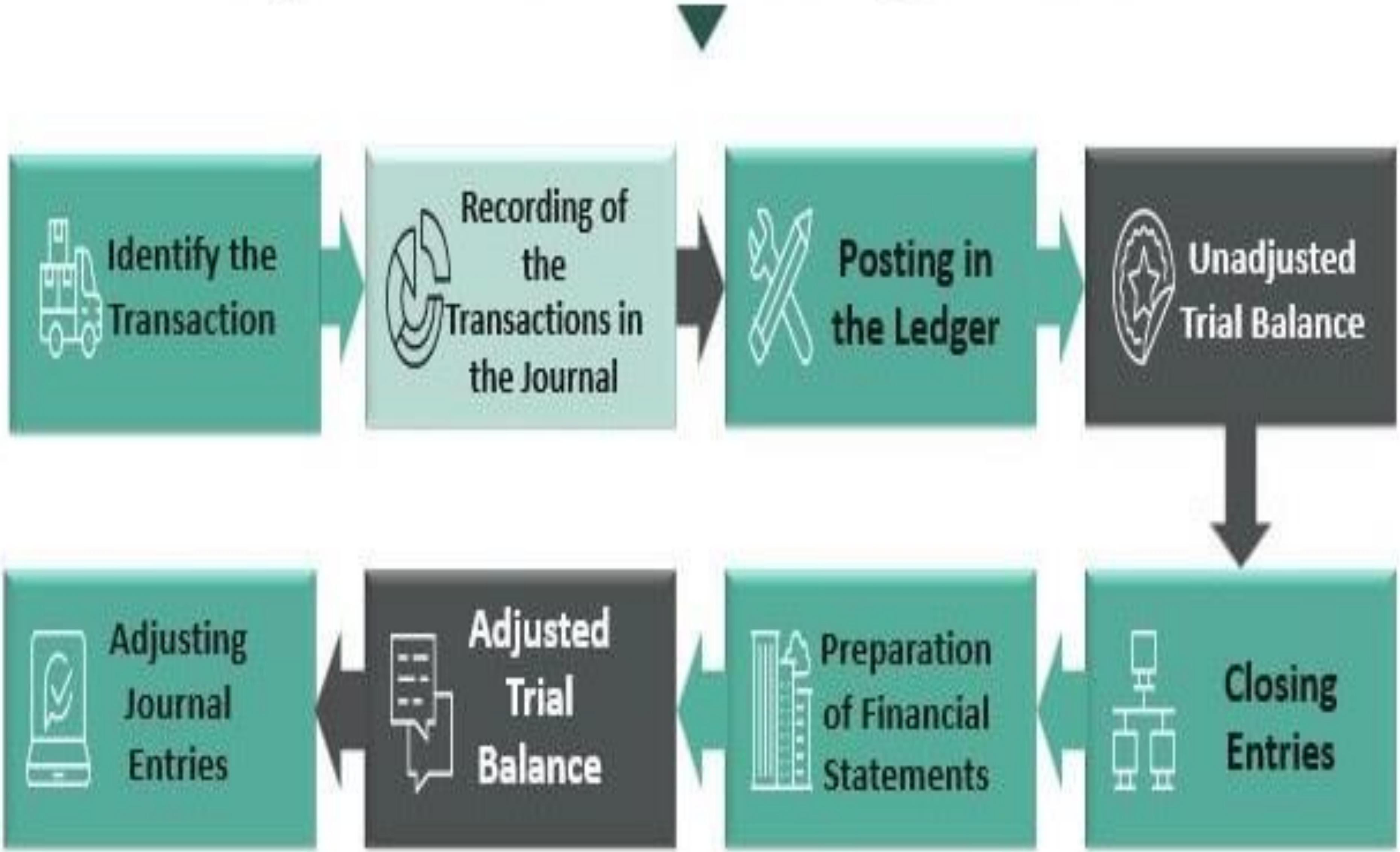
A nominal account is an account in which accounting transactions are stored for one fiscal year. At the end of the fiscal year, the balances in these accounts are transferred into permanent accounts

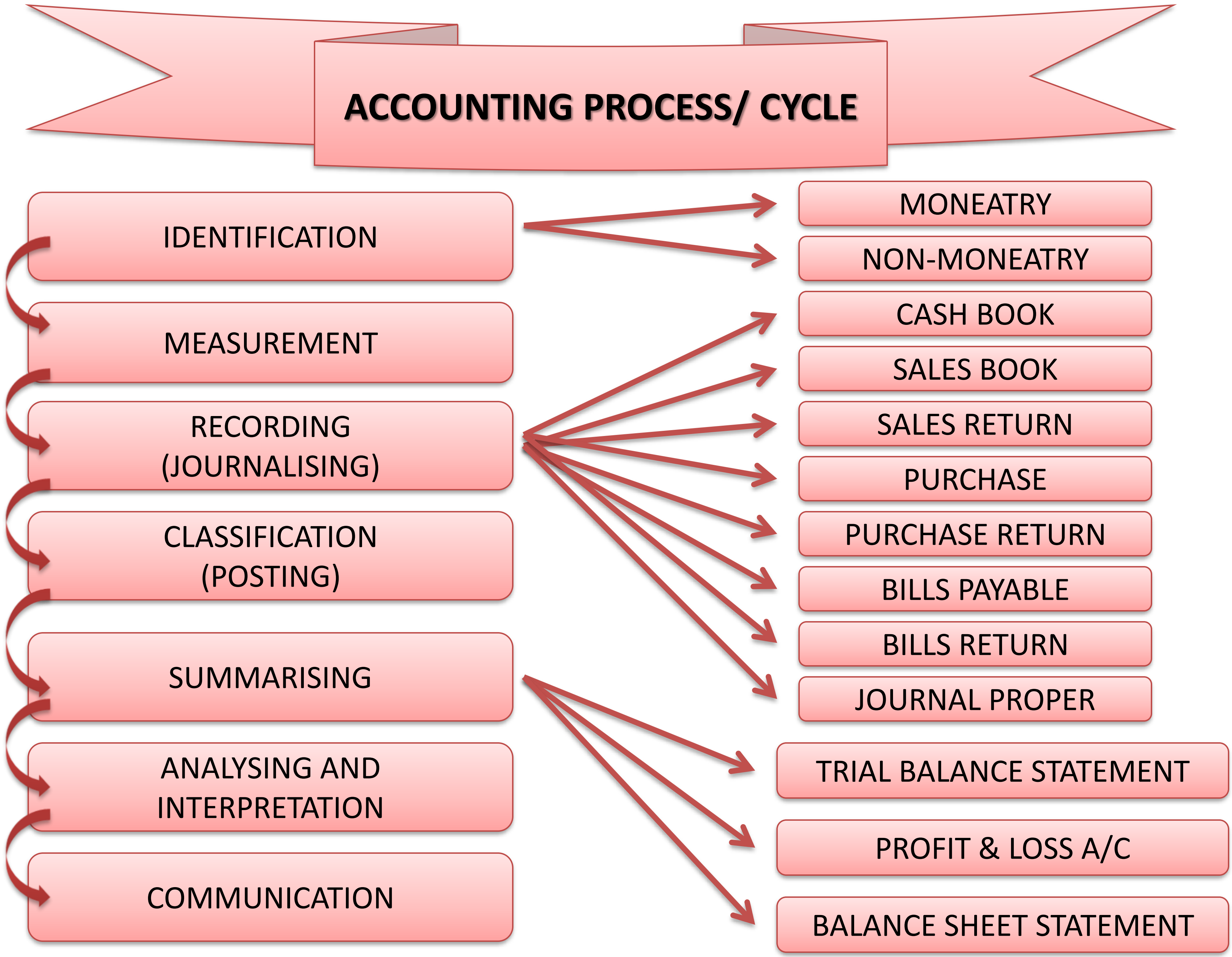
Dr. And Cr. Rule

- **PERSONAL A/C:** Debit the receiver, Credit the giver
- **REAL A/C:** Debit all the expenses & losses, Credit all the income & gains
- **NOMINAL A/c:** Debit what comes in, Credit what goes out

	INCREASE	DECREASE
Assets	Dr	Cr
Liability	Cr	Dr
Capital	Cr	Dr
Income	Cr	Dr
Expenses	Dr	Cr

Steps in Accounting Process




ACCOUNTING PROCESS/ CYCLE
IDENTIFICATION
MEASUREMENT
RECORDING (JOURNALISING)
CLASSIFICATION (POSTING)
SUMMARISING
ANALYSING AND INTERPRETATION
COMMUNICATION
MONEATRY
NON-MONEATRY
CASH BOOK
SALES BOOK
SALES RETURN
PURCHASE
PURCHASE RETURN
BILLS PAYABLE
BILLS RETURN
JOURNAL PROPER
TRIAL BALANCE STATEMENT
PROFIT & LOSS A/C
BALANCE SHEET STATEMENT

EXPLAINED ABOVE MENTIONED TERMS

Identification: It means to determine what transactions to record.

Measurement: It means quantification (including estimates) of business transactions into financial terms by using monetary unit.

Recording: It means recording the identified financial transactions in the books of accounts in monetary terms and in a chronological order.

Classifying: The classifying phase of accounting involves sorting and grouping similar items under the designated name, category or account. This phase uses systematic analysis of recorded data in which all transactions are grouped in one place.

EXPLAINED ABOVE MENTIONED TERMS

Summarizing: involves posting from ledger to prepare a trial balance and then the items of trial balance are posted in profit and loss account from which we get the net profit of the firm.

Analysis and Interpretation: refers to a systematic and critical examination of the financial statements. It not only establishes cause and effect relationship among the various items of the financial statements but also presents the financial data in a proper manner

Communication: The information is regularly communicated through accounting reports. These reports provide information that are useful to a variety of interested users.

FORMAT OF PROFIT & LOSS A/C AND BALANCE SHEET

BALANCE SHEET

Balance Sheet of ………… As at………….

Liabilities	Rs.	Assets	Rs.
		Fixed Assets:	
Capital:		Good will	
Opening Balance xxxx		Land	
Add: Net Profit xxxx		Building	
(Less: Net Loss)		Plant & Machinery	
Less: Drawings xxxx		Furniture & Fixtures	
Long-term Liabilities:		Investment:	
Loan		Current Assets:	
Current liabilities:		Closing stock	
Income received-in-advance		Accrued income	
Sundry Creditors		Prepaid expenses	
Outstanding Expenses		Sundry Debtors	
Bills Payable		Bills Receivable	
Bank Overdraft		Cash at Bank	
		Cash in Hand	

PROFIT & LOSS A/C

Dr. **Profit and loss account for the year ended ....** Cr.

Particulars	₹	Particulars	₹
To Gross loss b/d	xxx	By Gross profit b/d	xxx
To Office and administrative expenses:		By Indirect incomes:	
Salaries	xxx	Rent earned	xxx
Rent, rates and taxes	xxx	Discount received	xxx
Printing and stationery	xxx	Commission earned	xxx
Postage	xxx	Interest on investments	xxx
Legal charges	xxx	Dividend on shares	xxx
Audit fees	xxx	Bad debts recovered	xxx
Establishment expenses	xxx	Profit on sale of fixed assets	xxx
Trade expenses	xxx	Apprenticeship premium	xxx
General travelling expenses	xxx	Miscellaneous receipts	xxx
Lighting	xxx	By Net loss*	xxx
Insurance premium	xxx	(transferred to capital account)	
To Selling and distribution expenses:			
Carriage outwards	xxx		
Advertisement	xxx		
Commission	xxx		
Brokerage	xxx		
Bad debts or provision for bad debts	xxx		
Export duty	xxx		
Packing charges	xxx		
To Other expenses and losses:			
Repairs	xxx		
Depreciation	xxx		
Interest charges	xxx		
Discount allowed	xxx		
Provision for discount on debtors	xxx		
Bank charges	xxx		
Interest on capital	xxx		
Donation and charity	xxx		
Loss on sale of fixed assets	xxx		
Abnormal loss due to fire, theft etc. not covered by insurance	xxx		
To Net profit*	xxx		
(transferred to capital account)			
	xxx		xxx

* The balance will be either net profit or net loss.


Annual Report
Components of Annual Report
Notes to Financial Statements
Financial Highlights
Information on Corporate Governance
Management Discussion and Analysis
Statement of Cashflows
Income Statement
Statement of Financial Position
WallStreetMojo

IFRS

IFRS (International Financial Reporting Standards) is a set of rules and guidelines that every firm has to adhere to ensure their financial statements are consistent with other firms worldwide.

OBJECTIVES

- Establish universal language for companies to prepare accounting statements.
- Establish accounting rules to make it easier for stakeholders to interpret financial statements.
- Make the accounting statements credible and transparent.
- Assist companies appropriately categorize and report financial data.
- Make international comparisons & analysis an easy task.

TOPICS COVERED IN IFRS

Financial statements presentation; Borrowing costs; Income taxes; Investment in associates; Revenue recognition; Employee benefits; Inventories; Intangible assets; Retirement benefit plans; Foreign exchange rates; Operating segments; Fixed assets; Business combinations; Subsequent events; Leases; Industry-specific accounting (agriculture).

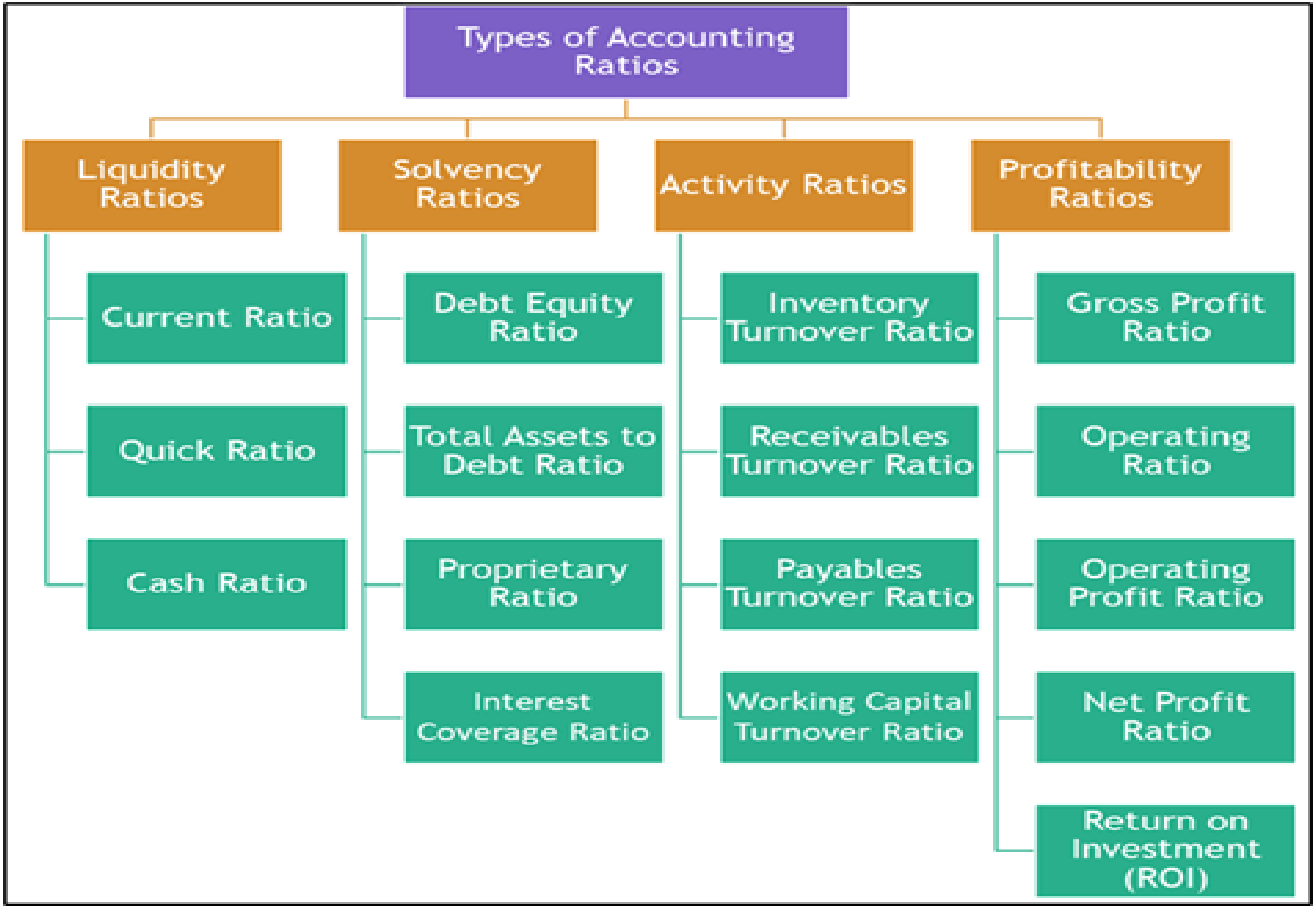
KEY FIN. STATEMENTS

- Statement of Financial Position
- Statement of Comprehensive Income
- Statement of Changes in Equity
- Statement of Cash Flow

IFRS ASSUMPTIONS

- Going Concern
- Units of Constant Purchasing Power
- Accrual Basis
- Stable Measuring Unit

IFRS	US GAAP
IFRS is suggestive & principle based.	US GAAP is more rule based approach.
IFRS requires firms to report revenue early.	US GAAP does not support early revenue declaration.
Presentation of Extra Ordinary Item can be made anywhere.	Presentation of Extra Ordinary items below income statement.


Types of Accounting Ratios
Liquidity Ratios
Solvency Ratios
Activity Ratios
Profitability Ratios
Current Ratio
Quick Ratio
Cash Ratio
Debt Equity Ratio
Total Assets to Debt Ratio
Proprietary Ratio
Interest Coverage Ratio
Inventory Turnover Ratio
Receivables Turnover Ratio
Payables Turnover Ratio
Working Capital Turnover Ratio
Gross Profit Ratio
Operating Ratio
Operating Profit Ratio
Net Profit Ratio
Return on Investment (ROI)

Cash Flow Statement (Direct Method)

Particulars	₹	₹
I. Cash from Operating Activities:		
A. Operating cash receipts:		
Add: Cash sales	xxxx	
Cash received from customers	xxxx	
Trading commission received	xxxx	
Royalties received	xxxx	xxxx
B. Operating cash payments:		
Less: Cash purchase	(xxxx)	
Cash paid to the supplier	(xxxx)	
Cash paid for business expenses	(xxxx)	(xxxx)
C. Cash generated from operation (A – B)		xxxx
Less: Income tax paid		(xxxx)
Cash flow before extraordinary items		xxxx
Adjusted extraordinary items (+/–)		xxxx
Net cash flow from (or used in) operating activities		**xxxx**

Cash Flow Statement of __________ Ltd.
for the year ended__________

Particulars	Details	Amount
A. Cash Flow from Operating Activities:		
Net Profit before Tax	-	
Adjustments for non-cash and non-operating items:		
Add: Depreciation		
Preliminary Expenses/Discount on issue of Debentures written off		
Goodwill, Patents and Trademarks Amortised		
Interest paid on short term and long-term Borrowings		
Interest paid on Bank Overdraft/Cash Credit		
Loss on Sale of Fixed Assets		
Increase in Provision for Doubtful Debts		
Less: Interest Income		
Dividend Income		
Rental Income		
Gain (Profit) on Sale of Fixed Assets		
Decrease in Provision for Doubtful Debts		
Operating Profit before Working Capital Changes		
Add: Decrease in Current Assets		
Increase in Current Liabilities		
Less: Increase in Current Assets		
Decrease in Current Liabilities		
Cash generated from operations		
Less: Income Tax paid (Net of Tax Refund received)		
Net Cash from operating activities	-	-
B. Cash flows from Investing Activities:		
Proceeds from Sale of Tangible Fixed Assets		
Proceeds from Sale of Intangible Fixed Assets like goodwill		
Proceeds from Sale of Non-Current Investment		
Interest and Dividend Received		
Rent Received		

COST BEHAVIOR

COST BEHAVIOR is the change in the behavior of a cost(s) due to a change in the business activity.

Before analyzing behavior of costs, manager needs to understand crucial business activities that may impact costs.

IMPORTANCE OF ANALYSIS

- Knowledge of cost behavior would enable the manager to understand the impact of decline or rise with the change in the business activity.
- Understanding of cost behavior is necessary for cost-volume-profit analysis (CVP analysis).
- It also enables planning and controlling costs.

TYPES OF COST BEHAVIORS

VARIABLE COSTS : Such costs vary directly (or in direct proportion) with the change in the business activity.

FIXED COSTS : These costs do not change with any business activity change.

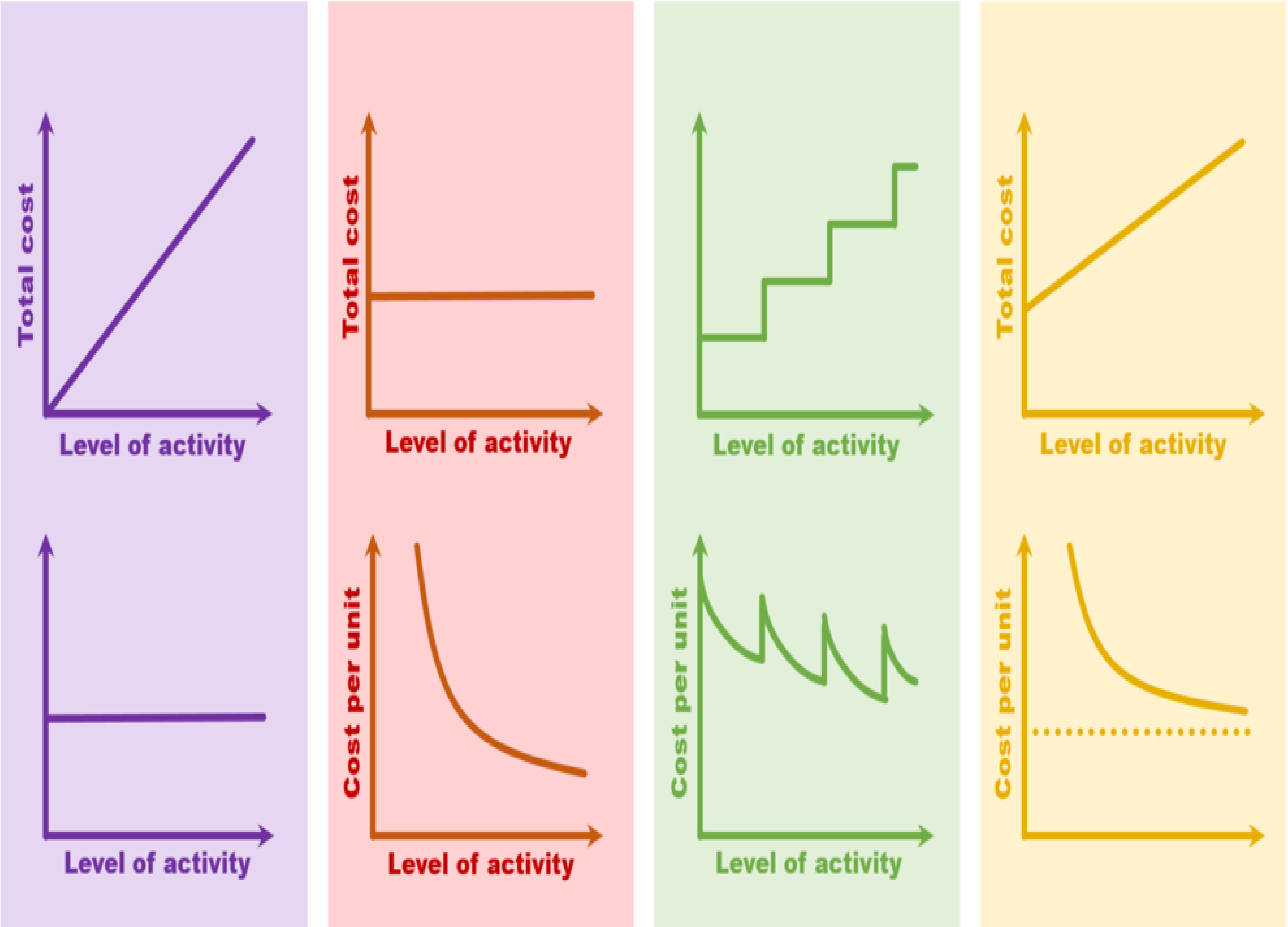
SEMI VARIABLE : Such costs are a mixture of fixed and variable costs.

COST FUNCTION

- **Cost Function** is a mathematical function to study cost behavior which can be plotted on a graph.
- **y = MX + b** where b is the fixed cost, x is the number of units, and m is the variable cost or the slope.

TYPES OF COSTS

BASIS OF CLASSIFICATION	
NATURE OF EXPENSES	Material, Labour and Other Overhead Cost
RELATION TO COST OBJECT	Direct and Indirect Cost
FUNCTIONS	Production, Admin, Finance, Selling, Distribution, R&D, Quality etc.
BEHAVIOUR	Fixed Cost, Variable Cost and Semi Variable Cost
PURPOSE OF DECISION MAKING	Opportunity Cost, Marginal Cost, Imputed Cost, Relevant Cost etc.
PRODUCTION PROCESS	Batch Cost, Process Cost, Operation Cost, Joint Cost, Prime Cost etc
TIME PERIOD	Historical, Predetermined, Standard and Estimated Cost

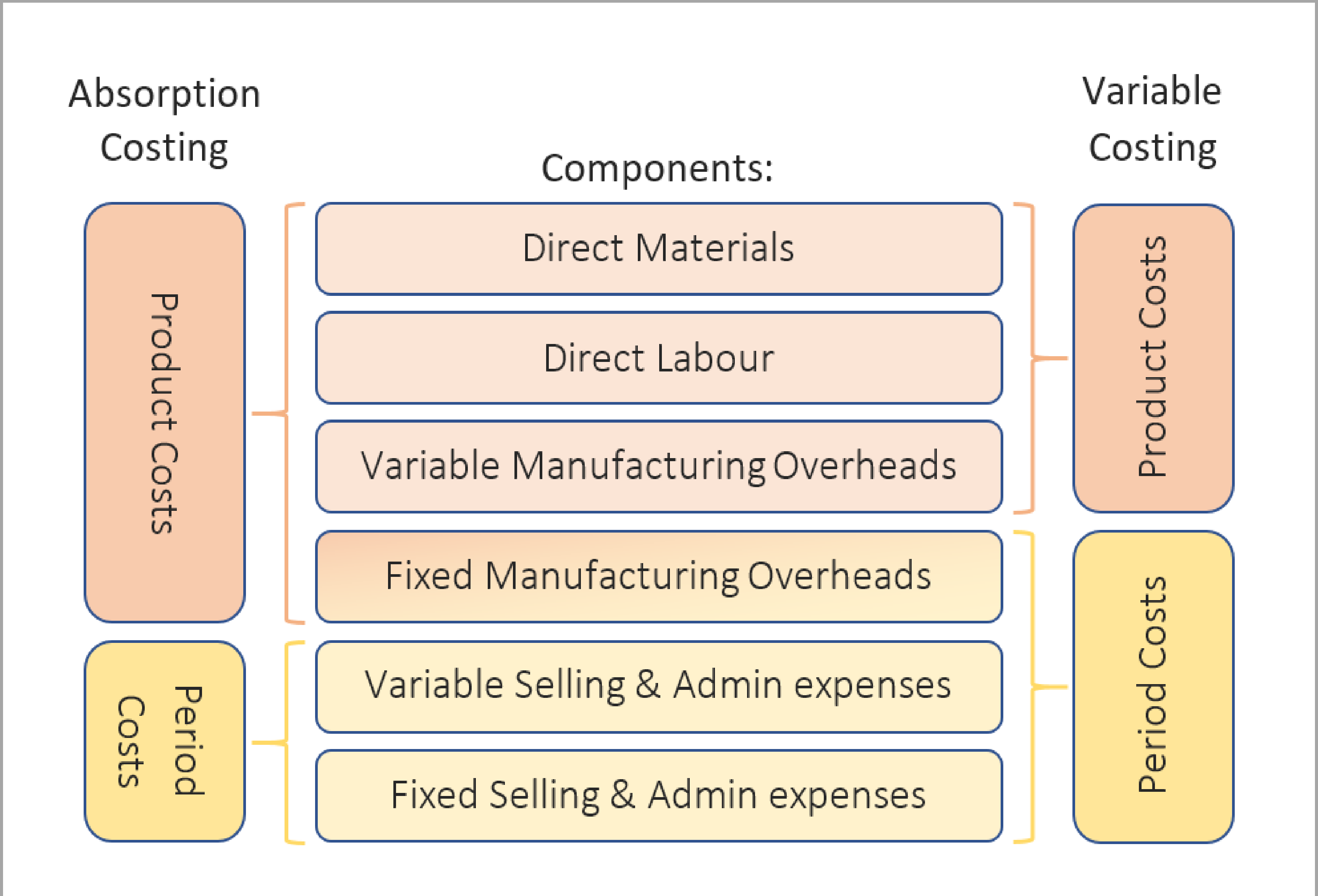

Total cost
Level of activity
Level of activity
Total cost
Level of activity
Cost per unit
Level of activity
Level of activity
Cost per unit
Level of activity
Total cost
Level of activity
Cost per unit


Basis of Cost Classification
Nature
Relation to Cost Centre
Functions
Behaviour
Management Decision Making
Production Process
Time

Difference between absorption costing and variable costing methods pertains mainly to allocation of manufacturing costs and its effect on reporting of net income.

Variable Versus Absorption Costing

Absorption Costing		Variable Costing	
Direct Material Cost	Product Cost	Direct Material Cost	Product Cost
Direct Labour Cost		Direct Labour Cost	
Variable Manufacturing Overheads		Variable Manufacturing Overheads	
Fixed Manufacturing Overheads		Fixed Manufacturing Overheads	Period Cost
Variable Selling and Administrative Expenses	Period Cost	Variable Selling and Administrative Expenses	
Fixed Selling And Administrative Expenses		Fixed Selling And Administrative Expenses	



Absorption Costing
Components:
Variable Costing
Product Costs
Period Costs
Direct Materials
Direct Labour
Variable Manufacturing Overheads
Fixed Manufacturing Overheads
Variable Selling & Admin expenses
Fixed Selling & Admin expenses
Product Costs
Period Costs

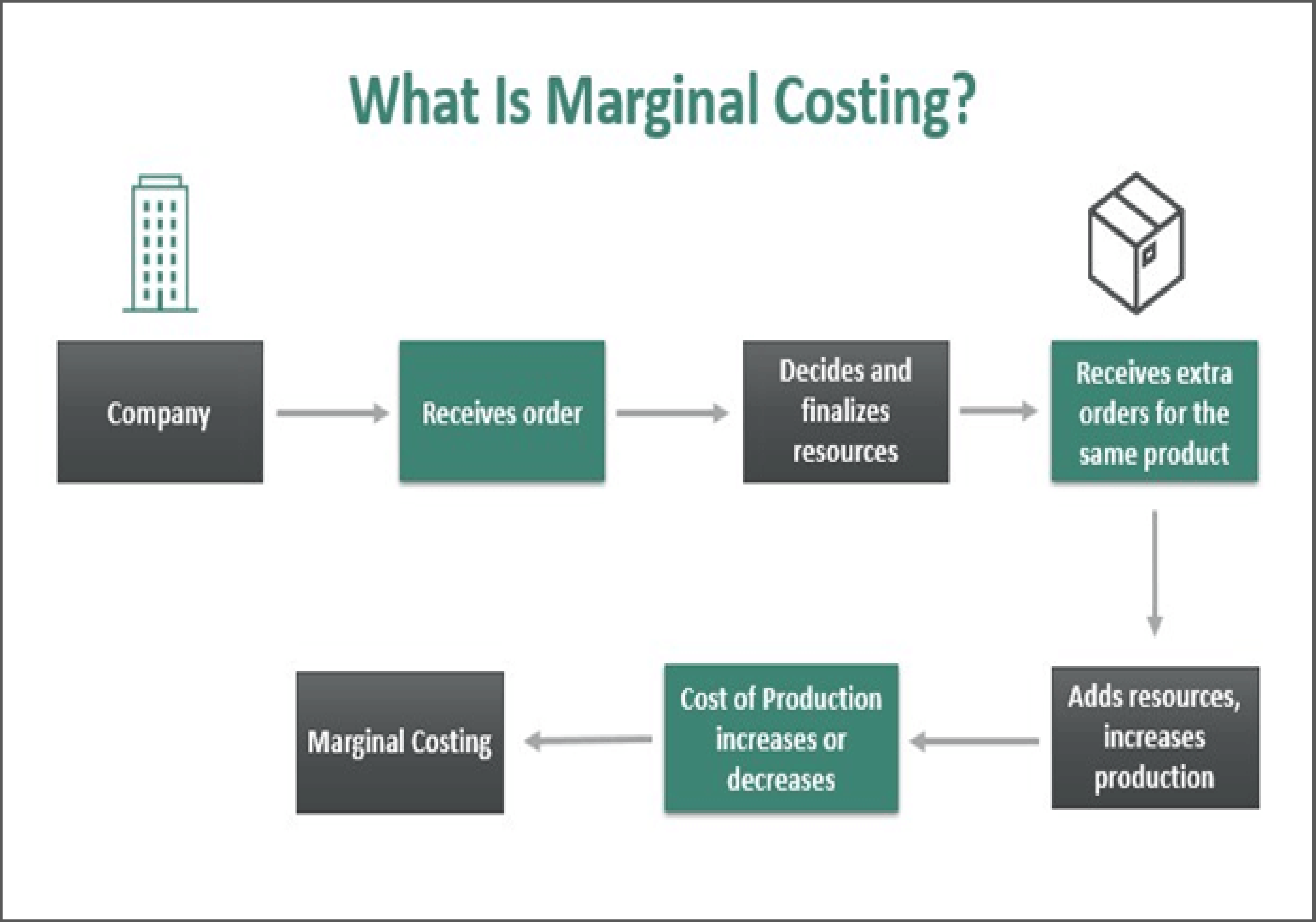
	Marginal Costing	Absorption Costing
1.	Only variable costs are considered for product costing and inventory valuation.	Both fixed and variable costs are considered for product costing and inventory valuation.
2.	Fixed costs are regarded as period costs. The Profitability of different products is judged by their P/V ratio.	Fixed costs are charged to the cost of production. Each product bears a reasonable share of fixed cost and thus the profitability of a product is influenced by the apportionment of fixed costs.
3.	Cost data presented highlight the total contribution of each product.	Cost data are presented in conventional pattern. Net profit of each product is determined after subtracting fixed cost along with their variable costs.
4.	The difference in the magnitude of opening stock and closing stock does not affect the unit cost of production.	The difference in the magnitude of opening stock and closing stock affects the unit cost of production due to the impact of related fixed cost.
5.	In case of marginal costing the cost per unit remains the same, irrespective of the production as it is valued at variable cost	In case of absorption costing the cost per unit reduces, as the production increases as it is fixed cost which reduces, whereas, the variable cost remains the same per unit.

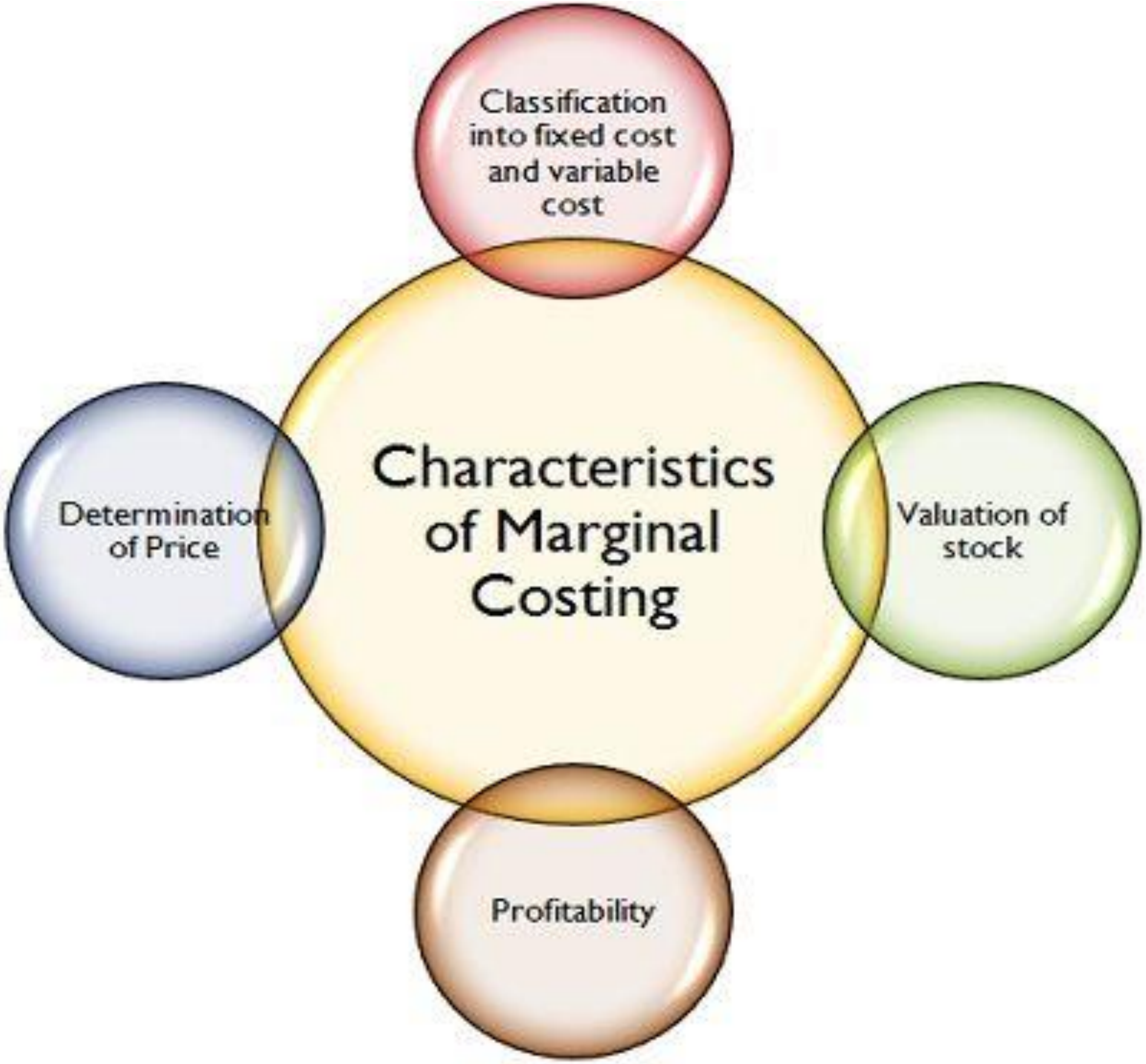
Definition of Marginal Cost

- Marginal cost is the additional cost of producing an additional unit of a product.
- According to I.C.M.A. London as "the amount to any given volume of output by which aggregate costs are changed if the volume of output is increased or decreased by one unit". In practice, this is measured by the total variable cost attributable to one unit.
- Thus, Marginal Cost = Prime cost+ Total variable overheads

(or)

Total cost – Fixed cost.


What Is Marginal Costing?
Company
Receives order
Decides and finalizes resources
Receives extra orders for the same product
Adds resources, increases production
Cost of Production increases or decreases
Marginal Costing


Classification into fixed cost and variable cost
Determination of Price
Characteristics of Marginal Costing
Valuation of stock
Profitability

COST ACCOUNTING TYPES

STANDARD COST ACCOUNTING

Standard Costing is an accounting system used by manufacturers to identify and analyze the differences between the actual costs of producing goods and the costs that should have occurred to produce those goods.

ACTIVITY BASED COST ACCOUNTING

Activity-based costing is a costing method in which various activities in the firm are identified and then costs are allocated to different products and services based on the actual consumption of each.

MARGINAL COST ACCOUNTING

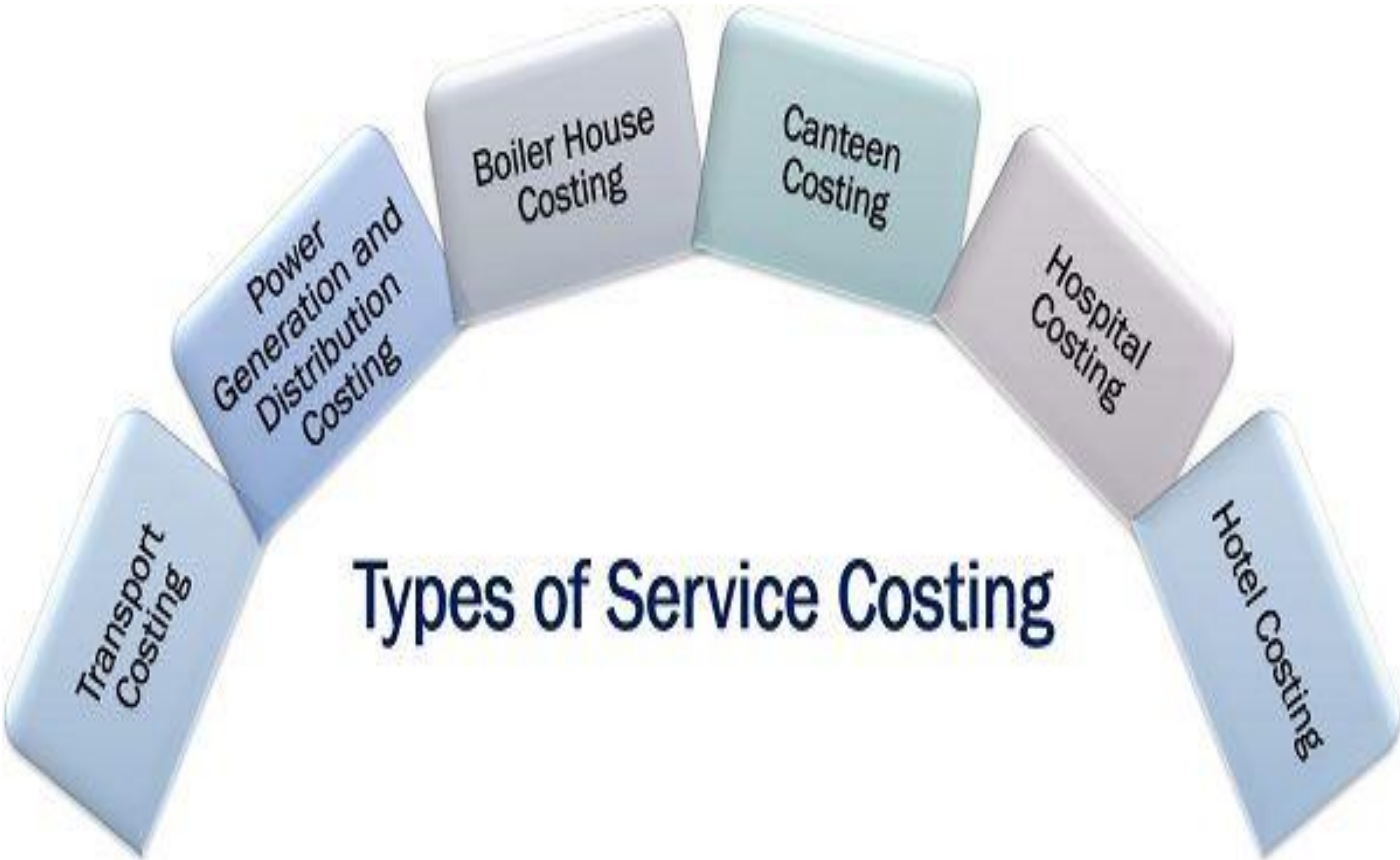
Marginal Costing is the type of costing in which only variable costs are assigned to the product while the fixed costs are considered as the costs for the period. Fixed costs are directly put into the income statement.

LEAN ACCOUNTING

Lean accounting takes this into account and defines efficiency, not in terms of how many units are produced in a month, rather, it defines efficiency in terms of how much times was taken to fulfill an order.

SERVICE COSTING

Where is Service Costing Applied?


Transport Costing
Power Generation and Distribution Costing
Boiler House Costing
Canteen Costing
Hospital Costing
Hotel Costing
Types of Service Costing


Intangible Products
Collection of Cost Data
Unique and Standard Service
Less Working Capital
Cost Per Unit
Internal or External Service
Cost Classification by Behaviour
Periodic or Order Wise Computation
Features of Service Costing

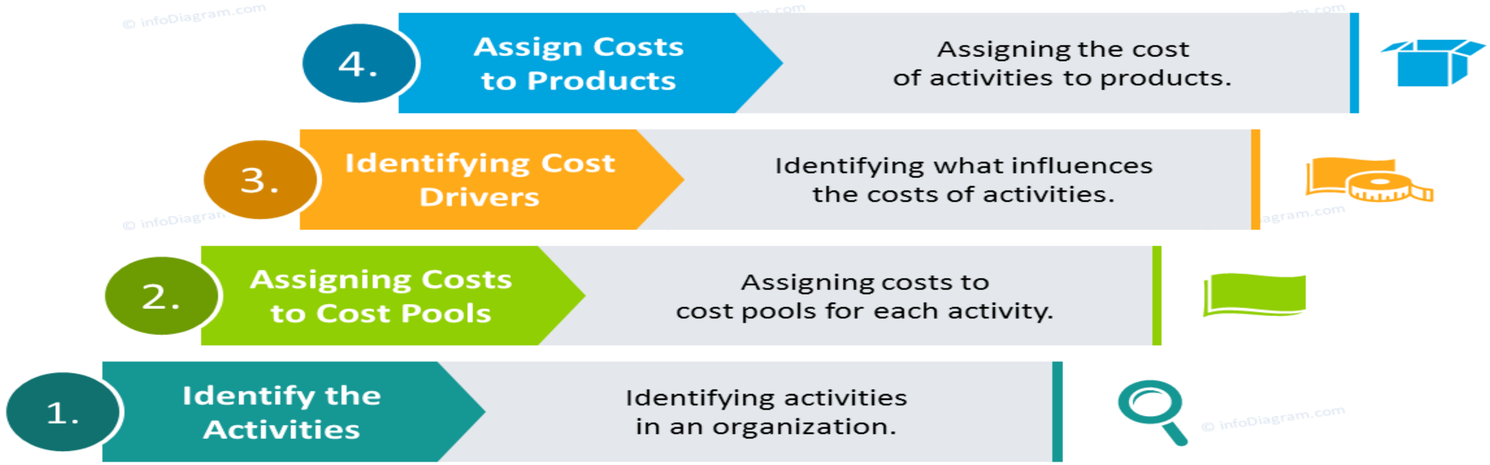
Activity-Based Costing

[ˈak-ˈti-və-tē ˈbāst ˈkȯst-iŋ]

A costing method that assigns overhead and indirect costs to related products and services.

Activity-Based Costing Implementation Steps Diagram

Identify Activities, Cost Drivers, Assign Costs to Pools and Products



Benefits of Activity-Based Costing

ABC Improves the accuracy of product costing by:

- Increasing the number of cost pools used to accumulate overhead costs.
- Using activity cost pools that are more homogeneous than departmental cost pools.
- Assigning overhead costs using activity measures that cause those costs, rather than relying solely on direct labor hours.

Activity-based costing also highlights activities that could benefit most from process improvement efforts, such as Six Sigma.

Definition: Activity Based Costing (ABC) is a 2 step method of costing whereby costs are first allocated to 'identified activities' of a business and then from activities they are assigned to products or services.

Benefits of Using ABC Costing

- Broad Averages
- Over / Under Costing
- Product Cross-Subsidization
- Complications of Processes
- Product Customizations
- Increase in Indirect Costs
- Competition
- Cost Saving Opportunities
- Product Mix Optimization

Disadvantages of Using ABC Costing

- Need Specialized Knowledge
- Deep Understanding of the Organizational Process
- Heavy use of Information Technology
- Time Consuming

THANK YOU