ACCOUNTINGFORDECISION MAKING–STUDYMATERIAL

DEGREE–MASTEROFBUSINESSADMINSTRATION

Prepared By

Dr. S.T Anand

BA4104-ACCOUNTINGFORDECISIONMAKING

UNIT I FINANCIAL ACCOUNTING 9

Introduction to Financial, Cost and Management Accounting – Generally accepted accounting principles– Double Entry System – Preparation of Journal, Ledger and Trial Balance Preparation of Final Accounts: Trading, Profit and Loss Account and Balance Sheet - Reading the financial statements

UNIT II ANALYSIS OF FINANCIAL STATEMENTS 9

Financial ratio analysis, Interpretation of ratio for financial decisions- Dupont Ratios – Comparative statements - common size statements. Cash flow (as per Accounting Standard 3) and Funds flow statement analysis – Trend Analysis.

UNIT III COST ACCOUNTING 9

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UNIT IV MARGINAL COSTING 9

Marginal Costing and profit planning – Cost, Volume, Profit Analysis – Break Even Analysis – Decision making problems -Make or Buy decisions -Determination of sales mix - Exploring new markets - Add or drop products -Expand or contract.

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Budgetary Control – Sales, Production, Cash flow, fixed and flexible budget – Standard costing and Variance Analysis – (excluding overhead costing) -Accounting standards and accounting disclosure practices in India.

ACCOUNTINGFORMANAGEMENT–STUDYMATERIAL

UNITI FINANCIAL ACCOUNTING

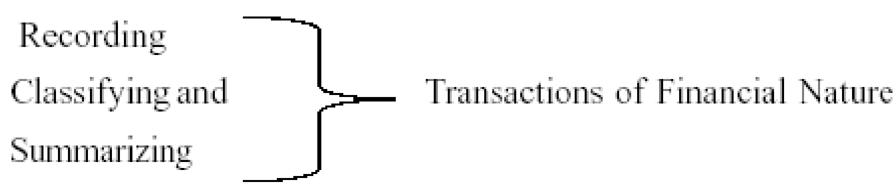
IntroductiontoFinancial,CostandManagementAccounting–Generallyacceptedaccounting principles– Double Entry System – Preparation of Journal, Ledger and TrialBalancePreparationofFinalAccounts:Trading,ProfitandLossAccountandBalanceSheet -Readingthefinancialstatements

Introduction

Accounting is a business language which elucidates the various kinds of transactionsduring the given period of time. Accounting is defined as either recording or recounting theinformation of the business enterprise, transpired during the specific period in the summarizedform.

Whatismeantbyaccounting?

Accounting isbroadlyclassified intothreedifferentfunctionsviz



AmericanInstituteofCertifiedPublicAccountantsAssociationdefinesthetermaccounting as follows "Accounting is the process of recording, classifying, summarizing in asignificantmanneroftransactionswhichareinfinancialcharacterandfinallyresultsareinterpreted."

MEANINGANDDEFINITIONOFBOOK-KEEPING

Meaning

Book-keepingincludesrecordingofjournal,postinginledgersandbalancingofaccounts. All the records before the preparation of trail balance is the whole subject matter ofbook-keeping.Thus,book-keepingmanybe definedasthe science andartofrecording transactions in money or money's worth so accurately and systematically, in a certain set ofbooks,regularlythatthetruestateofbusinessman'saffairscanbecorrectlyascertained.Hereitis important to note that only those transactions related to business are recorded which can beexpressedinterms ofmoney.

Definition

"Book-keepingistheartofrecordingbusinesstransactionsinasystematicmanner".

A.H.Rosenkamph.

"Book-keepingisthescienceandartofcorrectlyrecordinginbooksofaccountallthose business transactions thatresult inthetransferofmoneyor money'sworth".***R.N.Carter***

ObjectivesofBook-keeping

I. Book-keeping providesapermanentrecordofeachtransactions.

II. Soundnessofafirmcan beassessedfromtherecordsofassetsand abilitiesonaparticulardate.

III. Entriesrelatedtoincomesandexpendituresofaconcernfacilitatetoknowtheprofitandlossfora givenperiod.

IV. Itenablestopreparealistofcustomersandsupplierstoascertaintheamounttobereceived orpaid.

V. Itisamethodgivesthat opportunitytoreviewthebusinesspoliciesinthelightofthepastrecords.

VI. Amendmentofbusinesslaws,provisionoflicenses,assessmentoftaxesetc.,arebasedonrecords.

Meaningof Accounting

Accounting,asaninformation system istheprocessofidentifying,measuringandcommunicatingtheeconomicinformationofanorganization toitsuserswhoneedtheinformation for decision making. It identifies transactions and events of a specific entity. Atransaction is an exchange in which each participant receives or sacrifices value (e.g. purchase ofraw material). An event (whether internal or external) is a happening of consequence to an entity(e.g. use of rawmaterial for production). An entity means an economic unitthatperformseconomic activities.

Definition ofAccounting

American Institute of Certified PublicAccountants (AICPA) which defines accountingas "the art of recording, classifying and summarizing in a significant manner and in terms ofmoney,transactionsandevents,whichare,inpartatleast,ofafinancialcharacterandinterpretingtheresultsthereof'.

ObjectivesofAccounting

Objective of accounting may differfrom business tobusiness depending upon theirspecificrequirements.However,the following are the generalobjectivesofaccounting.

i) Tokeepingsystematicrecord:Itisverydifficulttorememberallthebusinesstransactionsthattake place.Accountingservesthispurposeofrecordkeepingbypromptlyrecordingallthebusiness transactionsinthe booksofaccount.

ii) To ascertain the results of the operation: Accounting helps in ascertaining result i.e.,profit earned or loss suffered in business during a particular period. For this purpose, abusiness entity prepares either a Trading and Profit and Loss account or an Income andExpenditure account which shows the profit or loss of the business by matching the itemsofrevenueandexpenditureofthesameperiod.

iii) Toascertainthefinancialpositionofthebusiness:Inadditiontoprofit,abusinessman must know his financial position i.e., availability of cash, position of assetsand liabilities etc. This helps the businessman to know his financial strength. Financialstatementsarebarometers ofhealthofabusinessentity.

iv) To portray the liquidity position: Financial reporting should provide informationabout how an enterprise obtains and spends cash, about its borrowing and repayment ofborrowing,aboutitscapitaltransactions,cashdividendsandotherdistributionsofresourcesby theenterprisetoownersandaboutotherfactorsthatmayaffectanenterprise'sliquidityandsolvency.

v) To protect business properties: Accounting provides upto date information about thevarious assets that the firm possesses and the liabilities the firm owes, so that nobody canclaim a paymentwhich isnotdue tohim.To facilitate rational decision-making:Accounting records and financial statements provide financial information which help thebusiness in making rational decisions about the steps to be taken in respect of variousaspectsofbusiness.

vi) To satisfy the requirements of law: Entities such as companies, societies, public trusts arecompulsorily required tomaintain accounts as per thelaw governing their operationssuch as the Companies Act, Societies Act, and Public Trust Act etc. Maintenance ofaccountsisalsocompulsoryunderthe SalesTaxActandIncome Tax Act.

ImportanceofAccounting

i) **Owners:** The owners provide funds or capital for the organization. They possesscuriosity in knowing whether the business is being conducted on sound lines or not andwhetherthe capital is being employed properly or not. Owners,being businessmen,always keep an eye on the returns from theinvestment. Comparing the accounts ofvariousyearshelpsingettinggoodpiecesofinformation.

ii) **Management:** The management of the business is greatly interested in knowing theposition of the firm. The accounts are the basis; the management can study the merits anddemeritsofthebusinessactivity.Thus,themanagementisinterestedinfinancialaccounting to find whether the business carried on is profitable or not. The financialaccountingis the “eyes and ears of management andfacilitates in drawingfuture courseofaction,furtherexpansionetc.”

iii) **Creditors:** Creditors are the persons who supply goods on credit, or bankers orlenders of money.Itis usual thatthese groups are interested toknow the financialsoundness before granting credit. The progress and prosperity of the firm, two whichcredits are extended, are largely watched by creditors from the point of view of securityand further credit. Profit and Loss Account and Balance Sheet are nerve centres to knowthe soundness ofthefirm.

iv) **Employees:** Payment of bonus depends upon the size of profit earned by the firm.The more important point is that the workers expect regular income for the bread. Thedemand for wage rise, bonus, better working conditions etc. depend upon the profitabilityof the firm and in turn depends upon financial position. For these reasons, this group isinterestedinaccounting.

v) **Investors:** The prospective investors, who want to invest their money in a firm, ofcourse wish to see the progress and prosperity of the firm, before investing their amount,by going through the financial statements of the firm. This is to safeguard the investment.Forthis,thisgroupiseagertogothroughthe accountingwhichenablesthemtoknowthe safetyofinvestment.

vi) **Government:**Governmentkeeps a close watch on the firms whichyieldgoodamountof profits.The state and central Governments are interested in the financialstatementstoknowtheearningsforthepurposeoftaxation.Tocompilenationalaccountingis essential.

vii) **Consumers:**These groups are interested in getting the goods at reduced price.Therefore, they wish to know the establishment of a proper accounting control,which inturn will reduce to cost of production, in turn less price to be paid by the consumers.Researchersare alsointerestedinaccountingforinterpretation.

viii) **ResearchScholars**:Accountinginformation,beingamirrorofthefinancialperformance of a business organization, is of immense value to the research scholar whowants to make a study into the financial operations of a particular firm. To make a studyinto the financial operations of a particular firm, the research scholar needs detailedaccounting information relating to purchases, sales, expenses, cost of materials used,currentassets,currentliabilities,fixedassets,long-term liabilitiesandshare-holdersfundswhichisavailableinthe accountingrecordmaintainedbythefirm.

FunctionsofAccounting

i) **Record Keeping Function**: The primary function of accounting relates to recording,classification and summary of financial transactions-journalisation, posting, and preparation offinal statements. Thesefacilitate to know operating results andfinancial positions.The purposeof this function is to report regularly to the interested parties by means of financial statements.Thusaccountingperformshistoricalfunctioni.e.,attentiononthepastperformanceofabusiness;andthisfacilitatesdecisionmaking programmeforfutureactivities.

ii) **Managerial Function**: Decision making programme is greatly assisted by accounting.The managerial function and decision making programmes, without accounting, may mislead.The day-to-day operations are compared with some predetermined standard. The variations ofactual operations with pre-determined standards and their analysis is possible only with the helpofaccounting.

iii) **Legal Requirement function:** Auditing is compulsory in case of registered firms.Auditingisnotpossiblewithoutaccounting.Thusaccountingbecomescompulsorytocomply with legal requirements. Accounting is a base and with its help various returns, documents,statementsetc.,areprepared.

iv) **Language of Business:** Accounting is the language of business. Various transactionsare communicated through accounting. There are many parties-owners, creditors, government,employeesetc.,whoareinterestedinknowingtheresultsofthefirmandthiscanbecommuni cated only through accounting. The accounting shows a real and true position of thefirmorthebusiness.

AdvantagesofAccounting

Thefollowingaretheadvantagesofaccountingtoabusiness:

i) Ithelpsinhavingcompleterecordofbusinesstransactions.
ii) It gives information about the profit or loss made by the business at theclose of a yearand its financial conditions. The basic function of accounting is to supply meaningfulinformationaboutthefinancialactivitiesofthebusinessto theownersand themanagers.
iii) Itprovidesusefulinformationfrommakingeconomicdecisions,
iv) It facilitates comparative study of current year's profit, sales, expenses etc., with those ofthe previousyears.
v) It supplies information useful in judging the management's ability to utilize enterpriseresourceseffectivelyinachievingprimaryenterprisegoals.
vi) It provides users with factual and interpretive information about transactions and otherevents which are useful for predicting, comparing and evaluation the enterprise's earningpower.
vii) It helps in complying with certain legal formalities like filing of income- tax and sales-taxreturns.Iftheaccountsareproperlymaintained,theAssessment oftaxesisgreatly facilitated.

LimitationsofAccounting

i) Accounting is historical in nature. It does not reflect the current financial position orworthofabusiness.
ii) Transactions of non-monetary nature do not find place in accounting. Accounting islimitedtomonetarytransactionsonly.Itexcludesqualitativeelementslikemanagement,re putation,employeemorale,labourstrike etc.
iii) Factsrecordedinfinancialstatementsaregreatlyinfluencedbyaccountingconventionsandp ersonaljudgementsoftheAccountantorManagement.Valuation

of inventory, provision for doubtful debts and assumption about useful life of an assetmay,therefore,differfromone business house toanother.

iv) Accounting principles are not static or unchanging-alternative accounting proceduresare often equally acceptable. Therefore, accounting statements do not always presentcomparable data

v) Costconceptisfoundinaccounting.Pricechangesarenotconsidered.Moneyvalueis boundtochangeoftenfromtimetotime.This isastronglimitationofaccounting.

vi) Accountingstatementsdonotshowtheimpactofinflation.

vii) Theaccountingstatementsdonotreflectthoseincreaseinnetassetvaluesthatarenotconsider edrealized.

MethodsofAccounting

Businesstransactionsarerecordedintwodifferentways.

1. SingleEntry
2. DoubleEntry

SingleEntry: Itisincompletesystemofrecordingbusinesstransactions.Thebusinessorganization maintains only cash book and personal accounts of debtors and creditors. So thecompleterecording oftransactionscannotbemadeand trailbalancecannot beprepared.

Double Entry: It this system every business transaction is having a two fold effect of benefitsgiving and benefit receiving aspects. The recording is made on the basis of both these aspects.Double Entry is an accounting system that records the effects of transactions and other events inatleasttwoaccounts withequaldebits andcredits.

StepsinvolvedinDoubleentrysystem

(a) **Preparation of Journal**: Journal is called the book of original entry. It records theeffect ofalltransactionsforthefirsttime.Here thejobofrecording takesplace.

(b) **Preparation of Ledger:** Ledger is the collection of all accounts used by a business.Here the groupingofaccountsisperformed.Journalispostedtoledger.

(c) **TrialBalancepreparation**:Summarizing.Itisasummaryofledgebalancespreparedinthe formofalist.

(d) **Preparation of Final Account**: At the end of the accounting period to know theachievements of the organization and its financial state of affairs, the final accountsareprepared.

AdvantagesofDoubleEntrySystem

i) **Scientific system**: This system is the only scientific system of recording businesstransactionsinaset ofaccountingrecords.It helpstoattaintheobjectivesofaccounting.

ii) **Complete record of transactions**: This system maintains a complete record of allbusinesstransactions.

iii) **A check on the accuracy of accounts**: By use of thissystem the accuracy ofaccountingbookcanbe establishedthroughthe device calleda Trailbalance.

iv) **Ascertainment of profit or loss:** The profit earned or loss suffered during a periodcanbeascertained togetherwithdetailsbythepreparationofProfitand LossAccount.

v) **Knowledge of the financial position of the business**: The financial position ofthe firm can be ascertained at the end of each period, through the preparation of balancesheet.

vi) **Fulldetailsforpurposesofcontrol**:Thissystempermitsaccountstobepreparedorkept inasmuchdetailasnecessaryand,therefore,affordssignificantinformationforpurposes ofcontrol.

vii) **Comparative study is possible:** Results of one year may be compared with thoseofthe previousyearandreasonsforthe changemaybeascertained.

viii) **Helps management in decision making**: The management may be also obtaingoodinformationforitswork,especiallyformakingdecisions.

ix) **No scope for fraud**: The firm is saved from frauds and misappropriations sincefullinformationaboutallassets andliabilitieswillbe available.

MeaningofDebit andCredit

Theterm‘debit’issupposedtohavederivedfrom‘debit’andtheterm‘credit’from‘creditable’. For convenience ‘Dr’ is used for debit and ‘Cr’ is used for credit. Recording oftransactions require a thorough understanding of the rules of debit and credit relating to accounts.Both debit and credit may represent either increase or decrease, depending upon the nature ofaccount.

TypesofAccounts

The object of book-keeping is to keep a complete record of all the transactions that placein the business. To achieve this object, business transactions have been classified into threecategories:

(i) Transactionsrelatingtopersons.

(ii) Transactionsrelatingtopropertiesandassets

(iii) Transactionsrelatingtoincomesandexpenses.

The accounts falling under the first heading are known as 'Personal Accounts'. Theaccounts falling under the second heading are known as 'Real Accounts', The accounts fallingunderthe thirdheadingarecalled'NominalAccounts'.

PersonalAccounts

Accounts recording transactions with a person or group of persons are known as personalaccounts. These accounts are necessary, in particular, to record credit transactions. Personalaccountsareofthefollowingtypes:

(a) **Naturalpersons:**Anaccountrecordingtransactionswithanindividualhumanbeing is termed as a natural persons' personal account. eg., Kamal's account, Mala'saccount,Sharma'saccounts.Bothmalesandfemalesareincludedinit

(b) **Artificial or legal persons:** An account recording financial transactions with anartificial person created by law or otherwise is termed as an artificial person, personalaccount,e.g.Firms'accounts,limitedcompanies'accounts,educationalinstitutions'a ccounts,Co-operativesocietyaccount.

(c) **Groups/Representative personal Accounts**: An account indirectly representing a personor persons is known as representative personal account. When accounts are of a similarnature and their number is large, it is better to group them under one head and openrepresentative personal accounts e.g., prepaid insurance, outstanding salaries, rent, wagesetc.

When a person starts a business, he is known as proprietor. This proprietor is representedby capital account for that entire he invests in business and by drawings accounts for all thatwhich he withdraws from business. So, capital accounts and drawings account are also personalaccounts.

Theruleforpersonalaccountsis: Debitthereceiver

Creditthegiver

RealAccounts

Accountsrelatingtopropertiesorassetsareknownas'RealAccounts',Aseparateaccountismain tainedforeachassete.g.,CashMachinery,Building,etc.,Realaccountscanbe furtherclassifiedintotangibleandintangible.

(a) **Tangible Real Accounts**: These accounts represent assets and properties which canbeseen,touched,felt,measured,purchasedandsold.e.g.Machinery accountCashaccount,Furnitureaccount,stockaccountetc.

(b) **Intangible Real Accounts:** These accounts represent assets and properties whichcannotbe seen,touchedorfeltbutthey canbemeasuredin terms of money.e.g.,Goodwillaccounts,patentsaccount,Trademarksaccount,Copyrightsaccount,etc.

TheruleforRealaccountsis:Debitwhatcomesin

Creditwhatgoesout

NominalAccounts

Accounts relating to income, revenue, gain, expenses and losses are termed as nominalaccounts. These accounts are also known as fictitious accounts as they do not represent anytangible asset. A separate account is maintained for each head orexpense or loss and gain orincome. Wages account, Rent account, Commission account, Interest received account are someexamplesofnominalaccount

Therule forNominalaccountsis: Debitallexpensesandlosses

Credit allincomesandgains

DISTINCTIONBETWEENBOOK-KEEPINGANDACCOUNTING

Thedifferencebetweenbook-keepingandaccountingcanbesummarizedinatabularfromas under:

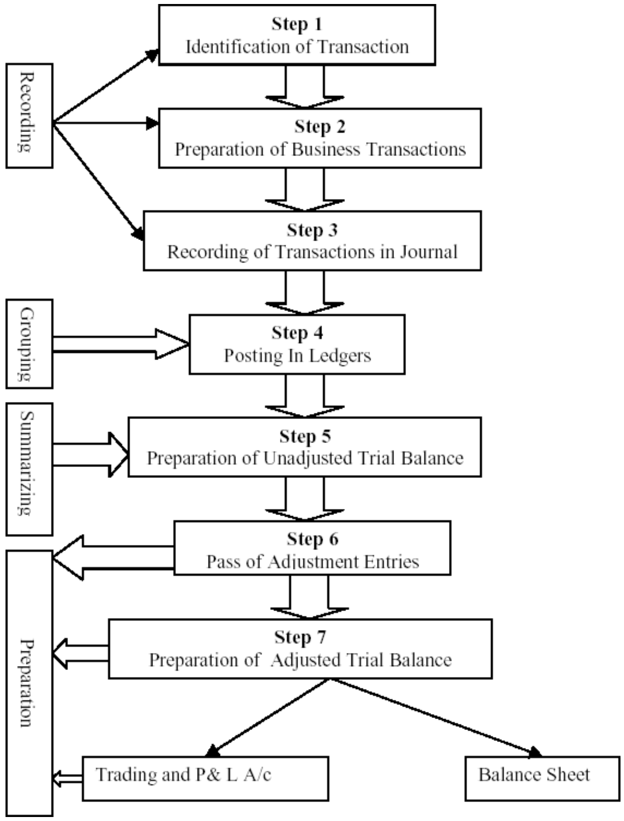
Basisofdifference	**Book-keeping**	**Accounting**
Transactions	Recordingoftransactionsinbooksof originalentry.	To examine these recorded transactionsinordertofindout
Posting	Tomakepostinginledger	Toexaminethis postinginorder toascertainitsaccuracy.

TotalandBalance	Tomaketotaloftheamountinjournalandaccountsofledger.Toascertain	Topreparetrialbalancewiththehelp of balances of ledger
Income Statement andBalanceSheet	Preparationoftrading,Profit&lossaccountandbalancesheetisnotbook	Preparationoftrading,profitsandlossaccountandbalance
Rectification of	Thesearenotincludedinbook-keeping	These are included in
Special skill andknowledge	Itdoesnotrequireanyspecialskillandknowledgeasinadvancedcountries	It requiresspecialskillandknowledge.
Liability	A book-keeper is not liable for accountantwork.	Anaccountantisliableforthe workofbookkeeper.

ObjectivesofAccounting

1. Systematicandscientificrecordofevents
2. Findouttheoperationalefficiency
3. Effectivecontroloverinflowsandoutflows
4. Helpthedifferentpartiesrelatedtothebusiness

<u>**PROCESSOFACCOUNTING**</u>



PRINCIPLESOFACCOUNTINGI

NTRODUCTION

The word ‘Principle’ has been differently viewed by different schools of thought. Theword ‘principle’ as a general law of rule adopted or professed as a guide to action; a settledgroundorbasisofconductofpractice”

Accounting principles refer, to certain rules, procedures and conventions which representaconsensusviewbythoseindulgingingoodaccountingpracticesandprocedures.Theaccountingprincipleas“thebodyofdoctrinescommonlyassociatedwiththetheoryandprocedure of accounting,servingasanexplanationof currentpracticesasaguidefortheselection of conventions or procedures where alternatives exist. Rules governing the formation ofaccountingaxiomsandtheprinciplesderivedfromthemhavearisenfrom commonexperiences, historicalprecedent,statementsbyindividualsandprofessionalbodiesandregulation sofGovernmental agencies”. To be more reliable, accounting statements are prepared in conformitywith these principles. If not, chaotic conditions would result. But in reality as all the businessesare not alike, each one has its own method of accounting. However, to be more acceptable, theaccountingprinciplesshouldsatisfythefollowingthreebasicqualities,viz.,relevance,objectivity and feasibility. The accounting principle is considered to be relevant and useful to theextent that it increases the utility of the records to its readers. It is said to be objective to theextent that it is supported by the facts and free from personal bias. It is considered to be feasibletotheextentthatitispracticablewith theleastcomplication orcost.Though accountingprinciplesaredenotedbyvarioustermssuchasconcepts,conventions,doctrines,tenets,assumptions, axioms, postulates, etc., itcan beclassifiedinto twogroups, viz., accountingconceptsandaccountingconventions.