

I MCA -I SEM – MANAGEMENT ACCOUNTANCY

Unit I

Principles Of Accounting: Nature And Scope of Accounting, Double Entry System Of accounting introduction To Basic Books Of Accounts Of Sole Proprietary Concern, closing of books of accounts and Preparation Of Trial Balance.

Final Accounts: Trading, Profit and Loss Accounts and Balance Sheet Of Sole Proprietary Concern with Normal Closing Entries. (With numerical problems)

Unit II

Ratio Analysis: Meaning, Advantages, Limitations, Types of Ratio and Their Usefulness. (Theory only) **Fund Flow Statement:** Meaning Of The Term Fund, Flow Of Fund, Working Capital Cycle, Preparation and Inter-preparation Of Statement.

Unit III

Costing: Nature, Importance and Basic Principles. Budget and Budgetary Control: Nature And Scope, Importance, Method Of Finalization And Master Budget, Functional Budgets. **Marginal Costing:** Nature, Scope, Importance, Construction Of Break Even Chart, Limitations And Uses Of Break Even Chart, Practical Applications Of Marginal Costing. (with numerical problems)

Unit IV

Introduction To Computerized Accounting System: Coding Logic And Codes Required, Master Files, Transaction Files, Introduction To Documents Used For Data Collection, Processing Of Different Files And Outputs Obtained.

MANAGEMENT ACCOUNTANCY

Accounting

Accounting may be defined as the process of collecting, recording, summarizing and communicating financial information.

Accounting is nothing but a means of communicating the results of business operations to various parties interested in or connected with the business, viz., the owner, creditors, investors, government, financial institutions and other agencies. Accounting is, therefore, rightly called as the language of business.

Management Accounting Definition

Management accounting also is known as managerial accounting and can be defined as a process of providing financial information and resources to the managers in decision making. Management accounting is only used by the internal team of the organization, and this is the only thing which makes it different from financial accounting. In this process, financial information and reports such as invoice, financial balance statement is shared by finance administration with the management team of the company. Objective of management accounting is to use this statistical data and take a better and accurate decision, controlling the enterprise, business activities, and development. The basic function of management accounting is to help the management make decisions. There is no fixed structure or format for it.

Book Keeping:

Book keeping is the part of accounting and concerned with record keeping or maintenance of books of accounts. It covers only the following four activities.

- a) Identifying the transactions and events.
- b) Measuring the identified transactions and events in a measuring unit.
- c) Rerecording the identified and measured transactions and events in proper books of accounts in chronological order.
- d) Classifying the recorded transactions and events in ledger

Limitations (or) Disadvantages of Accounting:

- a) It ignores qualitative element like quality of its manpower managerial skills of its administrators, public relatives etc.
- b) The financial statements are prepared on historical cost basis.
- c) It is also not free from personal bias when exercising the choice out of alternative available.
Eg: LIFO or FIFO or Average price methods.

Accounting Concepts and Conventions:

Accounting Concepts: It is used to denote accounting assumptions. The important accounting concepts are:

A. Business Entity Concept: All transactions of the business are recorded in the books of accounts from the points of view, the business not from the point of the owner.

B. Money Measurement Concept: According to this concept only those monetary transactions which are capable of being expressed in terms of money are included in the accounting records.

C. Cost Concept: According to this concept the transactions are recorded “at cost” in the books of accounts.

D. Going Concern Concept: This concept assumes that business will continue to exist for a fairly long in the books of accounts.

E. Dual Aspects Concept: This is one of the most fundamental concepts of accounting. It may be started that every debit there is a corresponding credit. Every transaction has a dual aspect. One is recovering aspects and the other is giving aspect. Their fore for every debit there is an equal corresponding credit.

Accounting Conventions: Accounting conventions means customs and traditions established after a long usage to guide the preparation and presentation of accounting statements. The following are the Importance accounting conventions.

1. Consistency: This convention emphasizes the use of uniform accounting practices from one period to another.

2. Disclosure: According to those conversions the financial statements must disclose all the relevant and reliable information fully and fairly from time to the shareholders, creditors, employees, government. Who are interested in the business?

3. Conservation or Prudence: According to this convention, the accountants should follow the rule of anticipating no profits but for all possible losses.

4. Relevance: As per this Convention, the from should give relevant accounting information Whenever required with documentary evidence look purchase or sale inverses, vouchers etc., as a documentary proof of a transaction.

5. Feasibility or Materiality: Whether something should be disclosed or not in the financial statements.

Advantages of Accounting:

- a) It facilitates to ascertain financial position of business.
- b) It facilitates to replace human memory by maintaining complete records of financial transactions.
- c) It facilitates the users to take decisions.
- d) It helps in determining cost of product or service.
- e) It helps the management in planning and controlling business activities and in taken decisions.

Nature and scope of accounting:

Scope of Accounting:

Accounting has got a very wide scope and area of application. Its use is not confined to the business world alone, but spread over in all the spheres of the society and in all professions. Now-a-days, in any social institution or professional activity, whether that is profit earning ornot, financial transactions must take place.

In the modern world, accounting system is practiced no only in all the business institutions but also in many non-trading institutions like Schools, Colleges, Hospitals, Charitable Trust Clubs, Co-operative Society etc.and also Government and Local Self-Government in the form of Municipality, Panchayat.

The professional persons like Medical practitioners, practicing Lawyers, Chartered Accountants etc.also adopt some suitable types of accounting methods. As a matter of fact, accounting methods are used by all who are involved in a series of financial transactions. The scope of accounting as it was in earlier days has undergone lots of changes in recent times.

Nature of Accounting:

We know Accounting is the systematic recording of financial transactions and presentation of the related information of the appropriate persons. The basic features of accounting are as follows:

1. Accounting is a process: A process refers to the method of performing any specific job step by step according to the objectives, or target. Accounting is identified as a process as it performs the specific task of collecting, processing and communicating financial information. In doing so, it follows some definite steps like collection of data recording, classification summarization, finalization and reporting.

2. Accounting is an art: Accounting is an art of recording, classifying, summarizing and finalizing the financial data. The word 'art' refers to the way of performing something. Accounting is a systematic method consisting of definite techniques and its proper application requires applied skill and expertise. So, by nature accounting is an art.

3. Accounting is means and not an end: Accounting finds out the financial results and position of an entity and the same time, it communicates this information to its users. The users then take their own decisions on the basis of such information. So, it can be said that mere keeping of accounts can be the primary objective of any person or entity. On the other hand, the main objective may be identified as taking decisions on the basis of financial information supplied by accounting. Thus, accounting itself is not an objective, it helps attaining a specific objective. So it is said the accounting is 'a means to an end' and it is not 'an end in itself.'

4. Accounting deals with financial information and transactions; Accounting records the financial transactions and date after classifying the same and finalizes their result for a definite period for conveying them to their users. So, from starting to the end, at every stage, accounting deals with financial information. Only financial information is its subject matter. It does not deal with non-monetary information of non-financial aspect.

5. Accounting is an information system: Accounting is recognized and characterized as a storehouse of information. As a service function, it collects processes and communicates financial information of any entity. This discipline of knowledge has been evolved out to meet the need of financial information required by different interested groups.

ACCOUNTING PROCESS:

Accounting cycle refers to the specific tasks involved in completing an accounting process. The length of an accounting cycle can be monthly, quarterly, half-yearly, or annually. It may vary from organization to organization but the process remains the same.

1. Journal: Recording day to day Transaction in a chronological order. It's a book of prime entry.

2. Ledger: A group of accounts is known as ledger. A ledger is a bound book containing many pages normally one page is attained to each account.

3. Trial Balance: This is a summary of ledger accounts. In this all the ledger items are transferred. In trial balance Debit is always equal to Credit.

4. Profit and Loss account: It is also called as Income statement. In this we compare the both Income and Expenditure items. If the expenses are more than the income it can be leads to loss for the organization.

5. Balance sheet: This is also called as financial statement .This is used to know the financial position of the company at the end of the year.

Accounting Process

The following table lists down the steps followed in an accounting process -



1	Collecting and Analyzing Accounting Documents	It is a very important step in which you examine the source documents and analyze them. For example, cash, bank, sales, and purchase related documents. This is a continuous process throughout the accounting period.
2	Posting in Journal	On the basis of the above documents, you pass journal entries using double entry system in which debit and credit balance remains equal. This process is repeated throughout the accounting period.
3	Posting in Ledger Accounts	Debit and credit balance of all the above accounts affected through journal entries are posted in ledger accounts. A ledger is simply a collection of all accounts. Usually, this is also a continuous process for the whole accounting period.
4	Preparation of Trial Balance	As the name suggests, trial balance is a summary of all the balances of ledger accounts irrespective of whether they carry debit balance or credit balance. Since we follow double entry system of accounts, the total of all the debit and credit balance as appeared in trial balance remains equal. Usually, you need to prepare trial balance at the end of the said accounting period.
5	Posting of Adjustment Entries	In this step, the adjustment entries are first passed through the journal, followed by posting in ledger accounts, and finally in the trial balance. Since in most of the cases, we used accrual basis of accounting to find out the correct value of revenue, expenses, assets and liabilities accounts, we need to do these adjustment entries. This process is performed at the end of each accounting period.
6	Adjusted Trial	Taking into account the above adjustment entries, we create adjusted trial

	Balance	balance. Adjusted trial balance is a platform to prepare the financial statements of a company.
7	Preparation of Financial Statements	Financial statements are the set of statements like Income and Expenditure Account or Trading and Profit & Loss Account, Cash Flow Statement, Fund Flow Statement, Balance Sheet or Statement of Affairs Account. With the help of trial balance, we put all the information into financial statements. Financial statements clearly show the financial health of a firm by depicting its profits or losses.
8	Post-Closing Entries	All the different accounts of revenue and expenditure of the firm are transferred to the Trading and Profit & Loss account. With the result of these entries, the balance of all the accounts of income and expenditure accounts come to NIL. The net balance of these entries represents the profit or loss of the company, which is finally transferred to the owner's equity or capital.
9	Post-Closing Trial Balance	Post-closing Trial Balance represents the balances of Asset, Liabilities & Capital account. These balances are transferred to next financial year as an opening balance.

Classification of Accounts:

(a) **Personal Account:** Personal Accounts related natural persons, artificial persons and representative persons. Ramesh's A/c, Khan's A/c – Natural Persons, Ram and Co A/c, Andhra Bank A/c – Artificial persons. Outstanding Salaries A/c and Rent receivable A/c – representative persons.

***Rule: Debit the Receiver
Credit the giver.***

(b) **Real Account:** Real accounts related to both tangible and intangible assets. *Tangible Assets:* Buildings A/c, Machinery A/c, cash A/c etc. *Intangible Assets:* Goodwill A/c, Copyrights A/c, Patents A/C

***Rule: Debit what comes in
Credit what goes out.***

(c) **Nominal Account:** Nominal accounts relates to expenses, losses, income and gains.

- i. Expenses: salary A/c, wages A/c, purchases A/c, etc.,..
- ii. Losses: Bad debts, stock lost by fire, abnormal loss.....
- iii. Income: Commission Received A/c, Interest received A/c, etc.
- iv. Gains: Bad debts recovered, increased in value of assets

***Rule: Debit all expenses and losses.
Credit all incomes and gains.***

Objects of Accounting:

- a) To Maintain Accounting Records: Now a day the volume of business transactions are so large, a human memory cannot absorb each and every business transactions.
- b) To Ascertain Results of Business Operations: Maintains of systematic records of all expenses and incomes enables the preparations of profit and loss account.
- c) To Ascertain The Financial Position Status of the Business: To evaluate the financial position of a business, balance sheet is prepared this shows the financial strength or weakness of an enterprise.
- d) To Generate and Communicate Information to Users: To accounting communication information to internal and external users.

Functions of Accounting:

- a) **Recording:** It is concerned with recording all the financial transactions. Transactions are recorded in “Journal” in chronological manner.
- b) **Classification:** It deals with the classification of recorded transactions so as to group similar transactions at one place. It is done in ledger.
- c) **Summarizing:** It involves presenting classified transactions in a manner useful to both its internal and external users. It involves preparations of financial statements i.e., profit and loss accounts and balance sheet etc.
- d) **Analysing:** The recorded data in financial statement is analysed to make useful interpretations.
- e) **Interpretation:** It deals with explaining the meaning and significance of the data simplified. The accountants should interpret the statement in a manner useful to the users.
Ex: Liquidity Position, Profitability Position, etc.,

Double entry system of accounting:

Double Entry System of accounting deals with either two or more accounts for every business transaction. For instance, a person enters a transaction of borrowing money from the bank. So, this will increase the assets for cash balance account and simultaneously the liability for loan payable account will also increase.

Equation can be: $ASSETS = LIABILITIES + EQUITY$

Double entry system records the transactions by understanding them as a DEBIT ITEM or CREDIT ITEM. A debit entry in one account gives the opposite effect in another account by credit entry. This means that the sum of all Debit accounts must be equal to the sum of Credit accounts. This method of accounting and book-keeping results in the accurate depiction of financial statements. Thus, it also lowers the rate of errors by detecting them on a timely basis.

Bookkeeping and accounting are ways of measuring, recording, and communicating a firm's financial information. A business transaction is an economic event that is recorded for accounting/bookkeeping purposes. In general terms, it is a business interaction between economic entities, such as customers and businesses or vendors and businesses.

Under the systematic process of accounting, these interactions are generally classified into accounts. There are seven different types of accounts that all business transactions can be classified:

- **Assets**

An asset is **anything that has current or future economic value to a business**.

Examples include patents, machinery, and investments.

- **Liabilities**

Liabilities are **any debts your company has, whether it's bank loans, mortgages, unpaid bills, IOUs, or any other sum of money that you owe someone else**. If you've promised to pay someone a sum of money in the future and haven't paid them yet, that's a liability.

- **Capitals**

Capital can be **any financial asset that is used**. The money made from its current activities is shown as capital on a company's balance sheet. Some examples are the money in a bank account, the money from selling stock shares, and the money from selling bonds.

- **Equities**

Equity is **the amount of money that a company's owner has put into it or owns**.

On a company's balance sheet, the difference between its liabilities and assets shows how much equity the company has. The share price or a value set by valuation experts or investors is used to figure out the equity value.

- **Revenue**

Revenue is **the total amount of income generated by the sale of goods or services related to the company's primary operations**.

Revenue, also known as gross sales, is often referred to as the "top line" because it sits at the top of the income statement. Income, or net income, is a company's total earnings or profit.

- **Expenses**

In accounting terms, expense is **the operational cost that is paid to earn business revenues**. It means the outflow of cash in return for goods or services. Expenses can also be written as the sum of all the operations that usually bring profit.

- **Gains**

A gain is **a general increase in the value of an asset or property**.

A gain arises if the current price of something is higher than the original purchase price.

- **Losses**

In financial accounting, a loss is **a decrease in net income that is outside the normal operations of the business**.

Losses can result from a number of activities such as; sale of an asset for less than its carrying amount.

- **Debits and Credits**

Debits and credits are essential to the double entry system. In accounting, a debit refers to an entry on the left side of an account ledger, and credit refers to an entry on the right side of an account ledger. To be in balance, the total of debits and credits for a transaction must be equal. Debits do not always equate to increases and credits do not always equate to decreases.

Journal

A journal entry is used to record a business transaction in the accounting records of a business. A journal entry is usually recorded in the general ledger; alternatively, it may be recorded in a subsidiary ledger that is then summarized and rolled forward into the general ledger. The general ledger is then used to create financial statements for the business.

The logic behind a journal entry is to record every business transaction in at least two places (known as double entry accounting). For example, when you generate a sale for cash, this increases both the revenue account and the cash account. Or, if you buy goods on account, this increases both the accounts payable account and the inventory account.

How to Write a Journal Entry

The structure of a journal entry is:

- A header line may include a journal entry number and entry date.
- The first column includes the account number and account name into which the entry is recorded. This field is indented if it is for the account being credited.
- The second column contains the debit amount to be entered.
- The third column contains the credit amount to be entered.
- A footer line may also include a brief description of the reason for the entry.

Format for Journal:

Date	Particulars L.F	Debit	Credit
------	-----------------	-------	--------

Sub division of Journal: The journal in way as the soul book of the original entry when the transaction are numerous the nature of operations and the one name of transaction in a particular business determined the number and type of journal needed the medium size business generally maintains the following types of subsidiary journal.

1. **Cash book** – To record cash transactions. All the transactions in which cash is involved, (whether the business has paid cash or receive cash) are recorded in this book.
2. **Sales pay book** – To record credit sales. When ever goods are sold to the customers on credit (without receiving cash immediately) , these are recorded in this book.
3. **Purchases book-** To record credit purchases Whenever goods are purchase by a business on credit , these are recorded in these books.
4. **Sales return book-** To record sales returns. The goods Sold on credit if subsequently return by the customers for some solid reasons are recorded in this book.

5. **Bills receivables book-** To record bills receivable. Sometimes debtors pay by means of accepting a bill of exchange instead of cash. All the bills (acceptance) received from the debtors are recorded in this book.
6. **Bills payable book-** To record bill payable. Sometimes creditors are paid by means of accepting bills drawn by them instead of cash. All the bills (acceptance) given to the creditors are recorded in this book.
7. **Petty cash book-** To record petty cash payments. Apart from cash book, for small or petty expenses, another book is maintained which is known as "**Petty Cash Book**". The expenses such as, **traveling , postage, etc.** are recorded in this book. It is a part of a cash book.

Advantages of Journal Entries:

- (a) **Chronological Order:** Transactions are recorded in a chronological journal. Hence, when any information is required.
- (b) **Explanation of Transaction:** Each journal entry entered in the journal gives brief narration explanation of transactions.
- (c) **Record of Both Aspects (Debit And Credit):** Both debit and credit aspect of a transactions are recorded in journal.

Ledger:

Ledger Account is a journal in which a company maintains the data of all the transactions and financial statement. Ledger is a book that contains the accounts. Any financial statement related to the financial position of the company emerges only from the accounts. Thus, this ledger is known as the principal book. So, the result of all this is that it is necessary to relate all the information for any account available is from the ledger. This book of accounts is the most important book for any business and that is why it is known as the king of all books. Also, the ledger book is also known as the book of the final entry.

Format for Ledger

Dr.				Cr.			
Date	Particulars	L.F	Amount	Date	Particulars	L.F	Amount
xxxx	To Balance b/d		xxx	Xxxx	By Balance b/d		xxx
xxxx	To Name of the debit account		xxx	Xxxx	By Name of Credit account		xxx
xxxx	To Balance c/d		xx	xxxx	By Balance c/d		xx

	Total		xxxx		Total		xxxx
--	--------------	--	-------------	--	--------------	--	-------------

The ledger consists of two columns prepared in a T format. The two sides of debit and credit contain date, particulars, folio number and amount columns

Ledger Posting: posting is the process of transferring transaction record in the books of original entry. Posting may be made on daily, weekly, monthly, according to the convenience and requirement of the enterprise.

Utilities or Advantages of Ledger:

The main utilities of a ledger are

- ❖ It provides complete information about all accounts in one book.
- ❖ It is easy to ascertain how much money is due to suppliers.
- ❖ It enables to ascertain, what are the main items of revenues / incomes and expenses.
- ❖ It facilitates preparation of trial balance and there after preparation of financial statement i.e. profits and loss accounts and balance sheets.

Trial Balance:

Multiple entries in various accounts will make a Ledger. Taking all the ledger balances and presenting them in a single worksheet as on a particular date is Trial Balance.

To understand a trial balance, we must first understand the following:

- Double entry system – Recording two entries for a single transaction that is equal and opposite in nature
- Journal – All transactions recorded in double entry system of bookkeeping
- Ledger – Summary of all journals of a similar nature.

A trial balance is a sheet recording all the ledger balances categorized into debit and credit. A typical trial balance will have name of ledger and the balances. This is prepared as at a particular date which can be financial year end or calendar year.

Advantages of Trial Balance

☐ **Arithmetical accuracy**

Given the nature of double entry system, every transaction will result in two entries of equal and opposite nature. Hence at any point in time all debit ledger totals will match to credit ledger totals. Since Trial Balance lists all the accounts as on a particular date, the debit total of a trial balance must match to the credit total.

☐ **Bird's-eye view**

A trial balance is a summary sheet listing all ledges and balances. Hence it provides a bird eye view of the accounting transactions of an organization.

☐ **Prerequisite for preparation of financial statements**

An organization needs to know profit or loss and financial position at year end. And thus to prepare financial statements, Trial Balance is prerequisite. All stakeholders also need this information. It is the first step towards closure of accounts for a particular period.

Purpose:

- At the end of the period, the accountant normally needs to prepare the

Example of Trial Balance

TRIAL BALANCE
(as on 31st January, 2007)

Particulars	Debit Rs	Credit Rs
Cash Account	12,000	
Capital Account		10,000
Purchase Account	4,000	
John		2,000
Sales Account		4,000
Total	16,000	16,000

1/10/2018

Dr. Amit Gupta

9

financial statements and other related financial reports for management use.

- The accountant needs to make sure that the ledgers are correctly records according to the accounting equation so that the financial statements are mathematically correct. This is one of the reasons why the accountant needs to prepare a trial balance.
- In short, the trial balance is prepared for the purpose of identifying and detecting errors that enter in general ledgers. It is also used as the working paper for accountants and auditors in drafting financial statements.
- As mentioned above, if the total balance of the debit side is not equal to the credit side, that means the accounting entry is not mathematically correct. In this case, the accountant needs to double-check his accounting entries and classification.
- Maybe the amount of the specific transaction is not equally entered between the debit side and the credit side. Or maybe the classification is not correctly classified respect to the accounting equation.

Preparation:**First Step:**

Close all the General Ledger's accounts that you have. This is the first thing you need to do.

Second Step:

Once you complete in closing all General Ledger, all you need to do is to transfer the carrying forward balance to trial balance. If the closing balance per general ledger is at debit, then post in a credit of TB.

Third step:

In this step, you need to reconcile the balance in credit and debit of your trial balance. If there is the difference between debit and credit, you need to double-check with the accounting entry in the general ledger.

Features of a Trial Balance:

- ❖ It is not an account; it is only a statement which is prepared to verify the arithmetical accuracy of ledger accounts.
- ❖ It contains debit and credit balances of ledger account.
- ❖ It prepares on particular date generally at the end of business year.
- ❖ It helps in preparing final accounts.
- ❖ Both debit and credit side of a trial balance are always equal.
- ❖ The preparation of balance is not compulsory.

Merits of Trial Balance:

- ❖ It helps in finding out the arithmetic accuracy of the accounts in the ledger.
- ❖ Trading, profit and loss accounts and balance sheet are prepared on the basis of trial balance.
- ❖ It helps in detecting the errors in the books of accounts and in their rectification.
- ❖ It helps in detecting the errors in the books of accounts in one place.

Demerits / Limitations of Trial Balance:

- ❖ It tallies even though errors are existing in the books of accounting.
- ❖ Only possible to prepare trial balance of an organization if the double entry is followed.
- ❖ Some transactions are omitted the balance tallies.

Closing of books of Accounts:

A business owner can close their books by zeroing out their income and expense accounts and then plugging net profit (or loss) into the balance sheet. Accounting software may create an automatic closing date as well as a password so transactions from before the closing date can't be changed.

8 Steps to Close the Books:

1. Transfer Journal Entries to the General Ledger

The journal is the first point of entry of all transactions. Journal entries are transferred to the general ledger when they're posted to an account, such as accounts receivable.

To close the books, post the account totals from your cash payments and your sales and cash receipts journal to the appropriate general ledger account. Cash payments (also known as "cash disbursements") actually include any payments made by cash, check or electronic fund transfer.

2. Sum the General Ledger Accounts

Add up all the transactions in each general ledger account. For example, add up all entries in accounts receivable. This gives you a preliminary ending balance for each account.

3. Make a Preliminary Trial Balance

Sum all of the preliminary ending balances from the last step to make a trial balance. A trial balance is a report that adds up all the credits and debits in your business. You want your total credits to be the same number as your total debits—if they aren't, go back and check your work. If the credits and debits are equal, your accounts balance and you're ready to go to the next step.

4. Enter Adjusting Journal Entries

Adjusting entries record items that aren't noted in daily transactions. These items include accumulation (known as "accrual" in accounting) of real estate taxes or accrual of depreciation and need to be recorded in order to close the books. Adjusting items are made in the general journal.

5. Make an Adjusted Trial Balance

Sum your general ledger accounts again to take into account the adjusted entries from the last step and then add them all together to make a new trial balance, making sure your debits and credits are again equal. If they aren't the same, go back and check your work.

6. Generate Financial Statements

If the total debits and credits in your trial balance are the same, you're ready to produce a balance sheet and income statement (also known as a "profit and loss report" or "P&L"). These reports can be generated automatically in your accounting software.

7. Enter Closing Entries

Zero out your revenue and expense accounts by using journal entries called "closing entries." Closing entries transfer the balances of these temporary accounts to permanent accounts.

8. Generate a Final Trial Balance

The final trial balance report will only have balance sheet accounts since you zeroed out your revenue and expense accounts in the last step. Again, the total debits and credits must match.

If they do, your general ledger account balances are correct and you're all set for the next accounting period.

FINAL ACCOUNTS:

Final accounts are those accounts that are prepared by a joint stock company at the end of a fiscal year. The purpose of creating final accounts is to provide a clear picture of the financial position of the organisation to its management, owners, or any other users of such accounting information.

Final account preparation involves preparing a set of accounts and statements at the end of an accounting year. The final account consists of the following accounts:

1. Trading Account
2. Balance Sheet
3. Profit and Loss account

Objectives of Final Account preparation

Final accounts are prepared with the following objectives:

1. To determine profit or loss incurred by a company in a given financial period.
2. To determine the financial position of the company.
3. To act as a source of information to convey the users of accounting information (owners, creditors, investors and other stakeholders) about the solvency of the company.

1.Trading Account: Trading account is a statement which is prepared by a business firm. It shows the gross profit of business activities during a specific period. It is a part of the final accounts of the entity. In other words, the trading account gives details of total sales, total purchases and direct expenses relating to purchase and sales. Trading account format for the year contains Particulars, Amount, Dr., Cr., Purchases, Sales, etc.

Advantages of Preparing Trading Account Format

- It is a very important statement from the cost point of view of the goods. By preparing the Trading account entities can take the decision for continuing or discontinuing a particular product. It helps to earn the maximum profit or reduce the losses.
- With the help of a trading account, Sales tax authorities can easily see the correct purchases and correct sales as per the sales tax return submitted by a business firm.
- It also helps the Excise authorities to assess the excise duties of business firms.
- The management decides the price of the product with the help of a trading account, after keeping in mind the market competition.

Trading Account of					
Dr.			Cr.		
For the year ending					
Particulars		Amt Rs.	Particulars		Amt Rs.
To Opening Stock		****	By Sales	****	
To Purchases	****		Less: sales return	***	****
Less: purchase return	***	****	By Closing stock		****
To Carriage inward		****	(By Gross loss c/d)		****
To Custom duty		****			
To Import duty		****			
To Octroi		****			
To Excise duty		****			
To Clearing charges		****			
To Duck charges		****			
To Royalties		****			
To Other direct expenses		****			
To Wages		****			
To Factory rent		****			
To Heating and lighting		****			
To Coal and coke		****			
To Factory insurance		****			
To Store consumed		****			
To Cleaning charges		****			
To Other factory expenses		****			
(To Gross profit c/d)		****			
		*****			*****

Sales=Total(cash+credit) sales

closing Stock = Opening Stock + Net Purchases - Net Sale

Gross Profit = Sales - Cost of Goods Sold

Operating Profit = Gross Profit - Total Operating Expenses

Net Profit = Operating Profit - (Taxes + Interest)

Profit And Loss Account

Every company prepares a Profit and Loss Account/statement at the end of the year generally, to get the visibility of the income, earning, expenses and loss incurred in a specific range of period. It is important to prepare Profit and Loss statement because this information helps an organisation to take the right business decision like where should we do the cost-cutting, from where can a business generate more profit and in which part business is suffering the loss.

PROFIT AND LOSS ACCOUNT (Horizontal Form)
for the year ended.....

Dr			Cr.
Particulars	₹	Particulars	₹
To Gross Loss b/d*	xxx	By Gross Profit b/d*	xxx
Office and Administrative Expenses:		Other Income :	
To Salaries (Administrative)	xxx	By Commission Earned	xxx
To Office Rent, Rates & Taxes	xxx	By Discount Received	xxx
To Lighting	xxx	Non Trading Income :	
To Legal Charges	xxx	By Interest Received	xxx
To Postage	xxx	By Dividend Received	xxx
To Printing	xxx	Abnormal Gains :	
To Insurance	xxx	By Gain on	
To Audit Fees etc.	xxx	Sale of Fixed Assets	xxx
Selling and Distribution Expenses :		By Insurance Claims	xxx
To Carriage Outward	xxx	By Net Loss †	xxx
To Advertisement Expenses	xxx	(Transferred to capital account)	
To Godown Rent	xxx		
To Commission	xxx		
To Brokerage	xxx		
To Bad Debts	xxx		
To Provision for bad debts etc.	xxx		
Financial Expenses :			
To Interest on loans	xxx		
To Bank Charges	xxx		
To Legal Charges for arranging loans	xxx		
To Discounts and Rebate on Bills etc.	xxx		
Maintenance Expenses :			
To Repairs & Renewals	xxx		
To Depreciation	xxx		
Abnormal Losses :			
To Loss on Sale of Fixed Assets	xxx		
To Loss by Fire etc	xxx		
To Net Profit †	xxx		
(Transferred to capital account)	xxx		xxx

*: † Only one figure will appear in the account

BALANCE SHEET

Balance sheet is a financial statement that reports a company's assets, liabilities and shareholders' equity at a specific point in time, and provides a basis for computing rates of return and evaluating its capital structure. It is a financial statement that provides a snapshot of what a company owns and owes, as well as the amount invested by shareholders.

The balance sheet is used alongside other important financial statements such as the income statement and statement of cash flows in conducting fundamental analysis or calculating financial ratios.

The balance sheet adheres to the following accounting equation, where assets on one side, and liabilities plus shareholders' equity on the other, balance out:

$$\text{Assets} = \text{Liabilities} + \text{Shareholders' Equity}$$

Name of the Entity

Balance Sheet as on 31st March, _____

Liabilities	Amount	Assets	Amount
Capital		Fixed/Non-Current Assets	
Add: Net profit		Building	
interest on Capital		Land	
Less: Drawings		Plant & machine	
Net Loss		Furniture & fixture	
		Goodwill	
Non-Current Liabilities			
long terms loans		Current Assets	
Debentures		Inventories	
		Bills payable	
Current Liabilities		Sundry Debtors	
Trade Creditors		Prepaid Expenses	
Bills Payable		Accrued Incomes	
Outstanding Expenses		Cash in hand	
Advance/Unearned Incomes		Cash at Bank	
Short term loans			

UNIT-2

RATIO ANALYSIS

MEANING: Ratio is an expression of relationship between two or more items in mathematical terms. Exhibition of meaningful and useful relation between different accounting data is called Accounting Ratio. Ratio may be expressed as a:b (a is to b), in terms of simple fraction, integer, or percentage.

If the current assets of a concern is Rs 4,00,000 and the current liabilities is Rs 2,00,000, then the ratio of current assets to current liabilities is given as $4,00,000 / 2,00,000 = 2$. This is called simple ratio. Multiply a ratio by 100 to express it in terms of percentage.

Ratios are extremely useful in drawing the financial position of a concern.

Ratio Analysis and its Applications

Ratio analysis is a medium to understand the financial weakness and soundness of an organization. Keeping in mind the objective of analysis, the analyst has to select appropriate data to calculate appropriate ratios. Interpretation depends upon the caliber of the analyst.

Ratio analysis is useful in many ways to different concerned parties according to their respective requirements. Ratio analysis can be used in the following ways:

- To know the financial strength and weakness of an organization.
- To measure operative efficiency of a concern.
- For the management to review past year's activity.
- To assess level of efficiency.
- To predict the future plans of a business.
- To optimize capital structure.
- In inter and intra company comparisons.
- To measure liquidity, solvency, profitability and managerial efficiency of a concern.
- In proper utilization of assets of a company.
- In budget preparation.

Advantages of Ratio Analysis

- It is powerful tool to measure short and long-term solvency of a company.
- It is a tool to measure profitability and managerial efficiency of a company.

- It is an important tool to measure operating activities of a business.
- It helps in analyzing the capital structure of a company.
- Large quantitative data may be summarized using ratio analysis.
- It relates past accounting performances with the current.
- It is useful in coordinating the different functional machineries of a company.
- It helps the management in future decision-making.
- It helps in maintaining a reasonable balance between sales and purchase and estimating working capital requirements.

Limitations of Ratio Analysis

Although Ratio Analysis is a very useful accounting tools to analyze and interpret different accounting equations, it comes with its own set of limitations:

- If the data received from financial accounting is incorrect, then the information derived from ratio analysis could not be reliable.
- Unauthenticated data may lead to misinterpretation of ratio analysis.
- Future prediction may not be always dependable, as ratio analysis is based on the past performance.
- To get a conclusive idea about the business, a series of ratios is to be calculated. A single ratio cannot serve the purpose.
- It is not necessary that a ratio can give the real present situation of a business, as the result is based on historical data.
- Trend analysis is done with the help of various calculated ratios that can be distorted due to the changes in the price level.
- Ratio analysis is effective only where same accounting principles and policies are adopted by other concerns too, otherwise inter-company comparison will not exhibit a real picture at all.
- Through ratio analysis, special events cannot be identified. For example, maturity of debentures cannot be identified with ratio analysis.
- For effective ratio analysis, practical experience and knowledge about particular industry is essential. Otherwise, it may prove worthless.
- Ratio analysis is a useful tool only in the hands of an expert.

Types of Ratio

Ratios can be classified on the basis of financial statements or on the basis of functional aspects.

Classification on the Basis of Financial Statement

Balance Sheet Ratios

Ratios calculated from taking various data from the balance sheet are called balance sheet ratio. For example, current ratio, liquid ratio, capital gearing ratio, debt equity ratio, and proprietary ratio, etc.

Revenue Statement Ratio

Ratios calculated on the basis of data appearing in the trading account or the profit and loss account are called revenue statement ratios. For example, operating ratio, net profit ratio, gross profit ratio, stock turnover ratio.

Mixed or Composite Ratio

When the data from both balance sheet and revenue statements are used, it is called mixed or composite ratio. For example, working capital turnover ratio, inventory turnover ratio, accounts payable turnover ratio, fixed assets turnover ratio, return of net worth ratio, return on investment ratio.

Classification of Ratios on the Basis of Financial Statements		
Balance Sheet Ratios	Profit and Loss A/c Ratios	Composite or Mixed Ratios
<ul style="list-style-type: none">• Current Ratio• Liquid Ratio• Absolute Liquid Ratio• Debt Equity Ratio• Proprietorship Ratio• Capita Gearing Ratio• Assets Proprietorship Ratio• Capital Inventory to Working Capital Ratio• Ratio of Current Assets to Fixed Assets	<ul style="list-style-type: none">• Gross Profit Ratio• Operating Ratio• Operating Profit Ratio• Net Profit Ratio• Cash Profit Ratio• Expenses Ratio• Interest Coverage Ratio	<ul style="list-style-type: none">• Stock Turnover Ratio• Receivable Turnover Ratio• Payable Turnover Ratio• Fixed Assets Turnover Ratio• Total Assets Turnover Ratio• Working Capital Turnover Ratio• Capital Turnover Ratio• Return on Capital Employed• Return on Equity Ratio• Return on Shareholders Fund

- Capital Turnover Ratio

Classification on the Basis of Financial Aspects

Ratios can be further classified based on their functional aspects as discussed below.

Liquidity Ratios

Liquidity ratios are used to find out the short-term paying capacity of a firm, to comment short term solvency of the firm, or to meet its current liabilities. Similarly, turnover ratios are calculated to know the efficiency of liquid resources of the firm, Accounts Receivable (Debtors) Turnover Ratio and Accounts Payable (Creditors).

Long-Term Solvency and Leverage Ratios

Debt equity ratio and interest coverage ratio are calculated to know the efficiency of a firm to pay long-term debts and to meet interest costs. Leverage ratios are calculated to know the proportion of debt and equity in the financing of a firm.

Activity Ratios

Activity ratios are also called turnover ratios. Activity ratios measure the efficiency with which the resources of a firm are employed.

Profitability Ratios

The results of business operations can be calculated through profitability ratios. These ratios can also be used to know the overall performance and effectiveness of a firm. Two types of profitability ratios are calculated in relation to sales and investments.

FUNCTIONAL CLASSIFICATION OF RATIOS			
Liquidity Ratios	Long-Term Solvency and Leverage Ratios	Activity Ratios Asset Management Ratios	Profit Abilities Ratios
(A) <ul style="list-style-type: none"> • Current Ratio • Liquid Ratio • Absolute Liquid or Cash Ratios • Interval 	<ul style="list-style-type: none"> • Debt/Equity Ratio • Debt to total Capital Ratio • Interest Coverage Ratio • Cash Flow/ Debt 	<ul style="list-style-type: none"> • Inventory Turnover Ratio • Debtors Turnover Ratio • Fixed Assets Turnover Ratio • Total Assets Turnover Ratio • Working 	(A) In relation to sales <ul style="list-style-type: none"> • Gross Profit Ratio • Operating Ratio • Operating

Measure	<ul style="list-style-type: none"> Capital Gearing 	Capital Turnover Ratio <ul style="list-style-type: none"> Payable Turnover Ratio Capital Employed Turnover Ratio 	Ratio <ul style="list-style-type: none"> Operative Profit Ratio Net Profit Ratio Expenses Ratio
(B)			(B) In relation to Investments <ul style="list-style-type: none"> Return on Investment Return on Capital Return on Equity Return on Total Resources Earnings per Share Price Earnings Ratio
<ul style="list-style-type: none"> Debtors Turnover Ratio Creditor Turnover Ratio Inventory Turnover Ratio 			

FUND FLOW STATEMENT

Definition of fund flow statement:

A fund flow statement is a statement prepared to analyze the reasons for changes in the financial position of a company between two balance sheets. It portrays the inflow and outflow of funds i.e. sources of funds and applications of funds for a particular period.

It is also righteous to say that a fund flow statement is prepared to explain the changes in the working capital position of a company.

(OR)

The flow of funds represents the movement of funds, i.e., the change in economic resources from one asset or liability to another. In this way, the fund flow statement implies a method of analyzing the changes in the firm's financial position, between two balance sheet dates.

Objectives of fund flow statement

A question arises as to why prepare fund flow Statement when we already prepare profit and loss and balance sheet. The need here arises because the profit and loss and balance sheet will not explain the reasons for a change in the financial position.

Profit and loss a/c and balance sheet will give two years figures i.e., current years and previous years. But it will not explain as to why the movement has happened, let's say, the extent of use of long-term funds for a long-term needs and the use of short-term funds for a long term and short term. Here is why fund flow statement is prepared.

Broadly, a fund flow statement will give us the following two information:

- **Sources of funds** - From where the funds have come in
- **Application of funds** - Where these funds have been used

Components of a fund flow statement

A fund flow statement comprises of :

- **Sources of funds:** It talks about the extent of funds availed from
 - Owners
 - Outsiders
- **Application of funds:** It talks about how the funds have been utilized
 - Funds deployed in Fixed assets
 - Funds deployed in Current assets

WORKING CAPITAL CYCLE

The working capital cycle focuses on the management of 4 key elements viz. cash, receivables (debtors), payables (creditors), and inventory (stock). A business needs to have complete control over these four items to have a fairly controlled and efficient working capital cycle. Let us look at an example to enable a better understanding of the concept of the working capital cycle.

Broadly, there are two types of capital required for a business:

- Fixed Capital
- Working Capital

Fixed capital requires investing in long term investments of business to create production facility through purchase of fixed assets such as building, plant, machinery, furniture etc. Investment in these assets means permanent blockage of capital or for a long term fixed term blockage of funds.

Capital is required for short term purposes to purchase raw material, payment of day to day needs of organization, routine business expenditure, payment of salaries, wages, taxes etc. These funds are called working capital. Working capital refers to capital to finance short term or current assets such as cash, securities, debtors and inventories.

Gross Working Capital and Net Working Capital

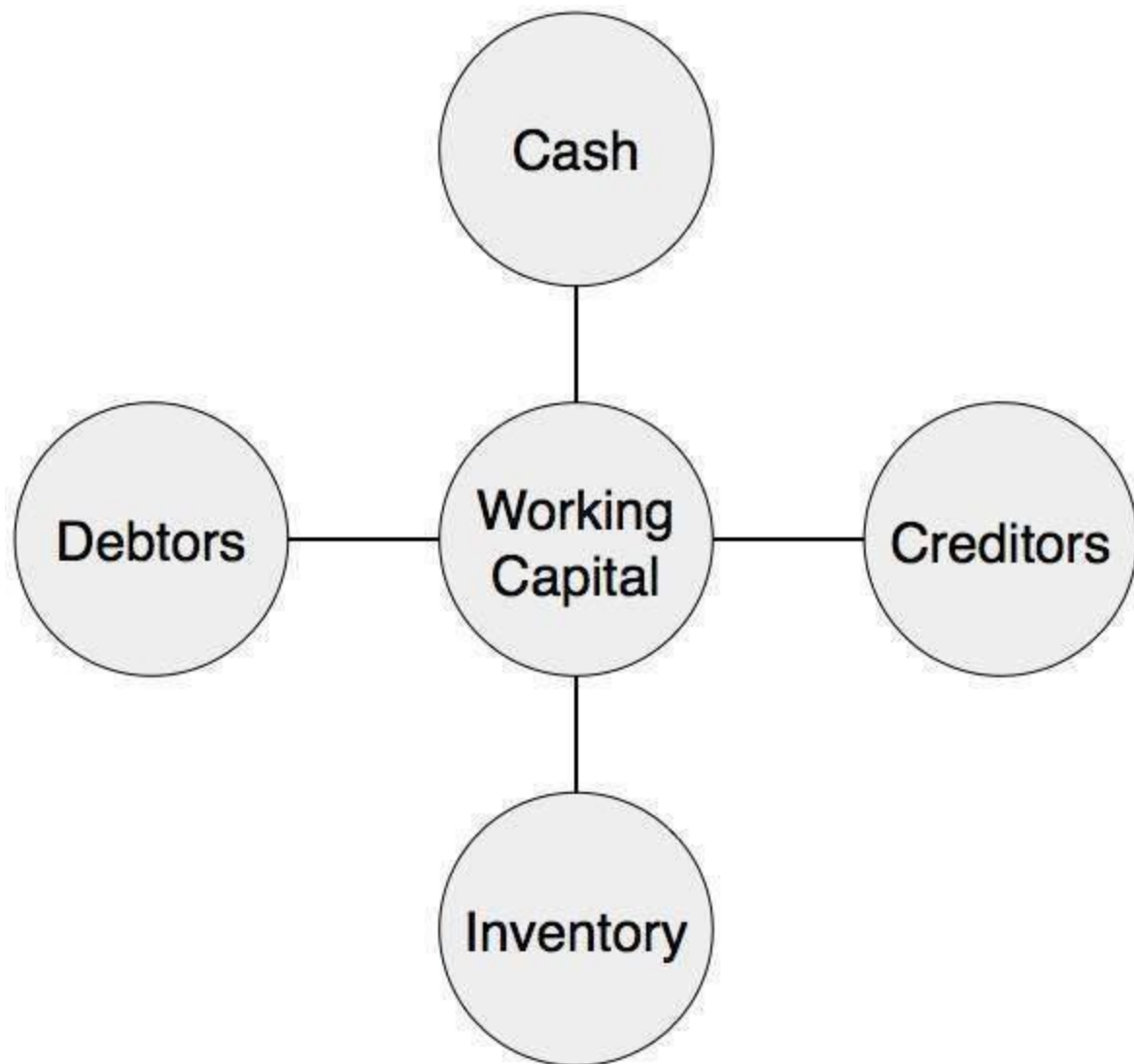
Gross working capital means the investment in current assets, whereas the Net working capital means the difference of current assets and current liabilities. Net working capital can be positive or negative.

NET WORKING CAPITAL	
(A) Current Assets	
Cash in hand	XXX
Cash at Bank	XXX
Sundry Debtors	XXX
Bills receivables	XXX
Inventories of Stock	
<div> Raw Material XXX Work-in-Process XXX Finished Goods <u>XXX</u> </div>	XXX
Short Term Investments	XXX
Prepaid Expenses	XXX
Accrued Incomes	XXX

Total Current Assets	XXXXX
(B) Less: Current Liabilities	
Sundry Creditors	XXX
Short term Loans, advances and deposits	XXX
Bank Overdraft	XXX
Bills payable	XXX
Provisions	XXX
Expenses Payable	XXX
Total Current Liabilities	XXXX
Working Capital (A - B)	XX

Working Capital Cycle

Generation and disbursement of cash is carried out in the manner depicted by the following diagram:



FINANCIAL STATEMENT PREPARATION:

The preparation of financial statements involves the process of aggregating accounting information into a standardized set of financials. The completed financial statements are then distributed to management, lenders, creditors, and investors, who use them to evaluate the performance, liquidity, and cash flows of a business. The preparation of financial statements includes the following steps (the exact order may vary by company).

Step 1: Verify Receipt of Supplier Invoices

Compare the receiving log to [accounts payable](#) to ensure that all [supplier](#) invoices have been received. [Accrue](#) the expense for any invoices that have not been received.

Step 2: Verify Issuance of Customer Invoices

Compare the shipping log to [accounts receivable](#) to ensure that all [customer](#) invoices have been issued. Issue any invoices that have not yet been prepared.

Step 3: Accrue Unpaid Wages

Accrue an expense for any wages earned but not yet paid as of the end of the reporting period.

Step 4: Calculate Depreciation

Calculate depreciation and amortization expense for all fixed assets in the accounting records.

Step 5: Value Inventory

Conduct an ending physical inventory count, or use an alternative method to estimate the ending inventory balance. Use this information to derive the cost of goods sold, and record the amount in the accounting records.

Step 6: Reconcile Bank Accounts

Conduct a bank reconciliation, and create journal entries to record all adjustments required to match the accounting records to the bank statement.

Step 7: Post Account Balances

Post all subsidiary ledger balances to the general ledger.

Step 8: Review Accounts

Review the balance sheet accounts, and use journal entries to adjust account balances to match the supporting detail.

Step 9: Review Financials

Print a preliminary version of the financial statements and review them for errors. There will likely be several errors, so create journal entries to correct them, and print the financial statements again. Repeat until all errors have been corrected.

Step 10: Accrue Income Taxes

Accrue an income tax expense, based on the corrected income statement.

Step 11: Close Accounts

Close all subsidiary ledgers for the period, and open them for the following reporting period.

Step 12: Issue Financial Statements

Print a final version of the financial statements. Based on this information, write footnotes to accompany the statements. Finally, prepare a cover letter that explains key points in the financial statements. Then assemble this information into packets and distribute them to the standard list of recipients.

UNIT-3

COSTING:

Cost: Cost is also defined as by the experience incurred to produce a given good or service. The cost will be the expenditure that is attributable to something.

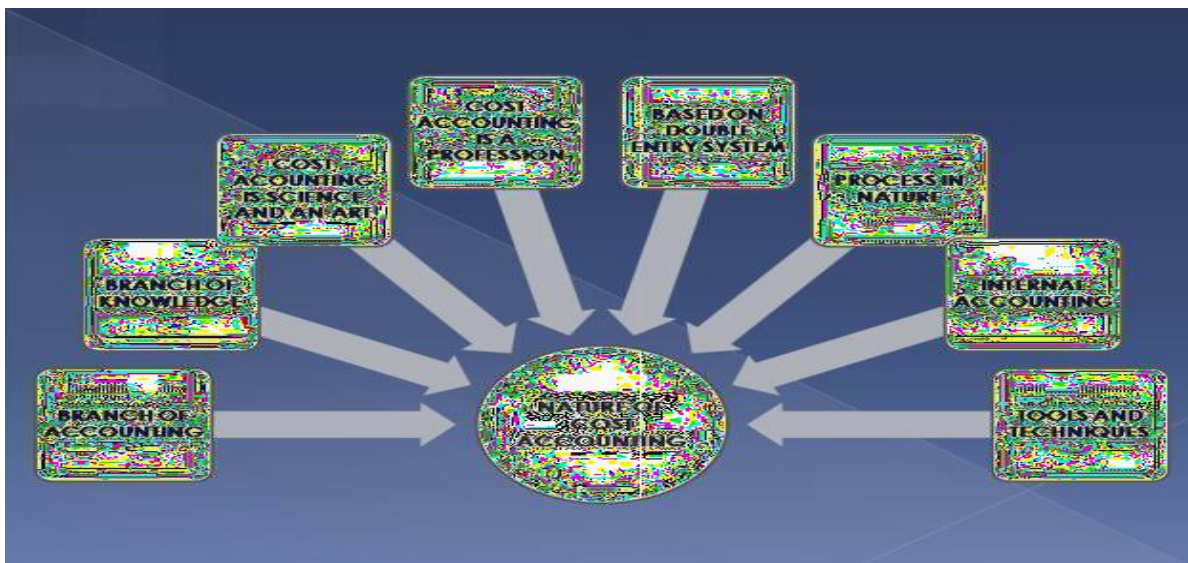
COSTING: Costing is essentially a technique via which we assign or costs to various elements of the business. It is a system of ascertaining costs.

Cost Accounting: Cost Accounting is a business practice in which we record, examine, summarize, and study the company's cost spent on any process, service, product or anything else in the organization. This helps the organization in cost controlling and making strategic planning and decision on improving cost efficiency. Such financial statements and ledgers give the management visibility on their cost information. Management gets the idea where they have to control the cost and where they have to increase more, which helps in creating a vision and future plan. (OR)

It is a process via which we determine the costs of goods and services. It involves the recording, classification, allocation of various expenditures, and creating financial statements. This data is generally used in financial accounting.

This helps us calculate the costs of the various goods. It also involves a suitable presentation of this data for the purposes of cost control and guidance to the management.

It deals with the cost of every unit, job, process, order, service, etc, whichever is applicable and includes the cost of production, cost of selling and cost of distribution.



A BRANCH OF ACCOUNTING:

Cost Accounting is a branch of accounting that deals specifically with the determination of costs of the products and services being manufactured. It deals with those techniques, tools, processes and methods which are associated with the determination of costs, their classification and analysis. It is an accounting which is done internally to the organization and is optional.

BRANCH OF KNOWLEDGE:

It is an important branch of knowledge and emerges as a discipline in itself. It is an organized body of knowledge which has its own tools and techniques like

- Job costing
- Process costing
- Standard costing
- Marginal costing
- Variance analysis
- Unit costing
- Batch costing
- Activity based costing
- Budgetary control
- Contract costing etc.

Types of Costing

Job costing: It applies to an industry which produces definite article or unit or batch of articles or units against individual orders from customer. It shows the cost per unit or article produce. It can also be called as special order costing where the costing is based on one single order for one article or a batch of articles. Job costing is suitable for industries which produce a definite article or unit or batch of articles or units against individual order from customers. It can also be called as 'special order costing' when the costing is based on one single order for one article or a batch of articles Eg. Machinery Manufactures. In job costing a separate account is maintained for each job to which all the expenditure incurred there on is debited. This method is suitable for contractors, builders; printer construction engineers ship building, garages, film studios etc. Eg. Machinery Manufactures.

Main features of job costing: The following are the main features of Job Costing.

- (a) Production is undertaken only against the customer orders.
- (b) The cost is ascertained for each job.
- (c) Each job is different from the job.
- (d) A separate cost sheet is maintained for each job. The cost sheet gives the details regarding details of costs incurred, the date of commercial, completion of the job etc.

Single or output costing: It applies to an industry or concern which produces a single product of uniform type. The cost is based on natural unit of output. Eg. Flour Mills, Brick Works.

Batch Costing: It enables to ascertain this cost of groups or batches of similar products. It applies to industries manufactures aero engines and components.

Process costing: It applies to industries where raw material passes through different stages or processed before becoming a finished product. It is important where-by-products, residuals or wastage occurs. It shows the cost each stage works, paint works, oil industries, paper mills etc.

Operating costing: It is also called as “working” or running costing. It applies to concerns reduced services rather than manufacturing goods. The cost is based on a specified unit like train – passenger – mile or kilowatt hour etc. It apply to transport companies like railways, termers as well as to electricity concerns.

Marginal Costing: It is called also as variable or direct costing. It shows the total of an article comprising only the cost of direct materials, direct labour, direct expenses and variable overheads like variable factory expenses and variable selling expenses. Job and **contract costing:** Contract costing is a method of costing applied to ascertain the cost of each contract and profit earned or loss sustained on each contract.

Contract costing is applicable to those business establishment which undertaking big contracts. Eg. Contracts for construction of buildings, bridges, roads, vans, ships, powerhouses etc. Contract costing resembles of job costing. The principles of job costing are applicable to contract costing also. A job is a small contract and a contract is a big business. In job costing, unit is relatively small. In contract costing the cost unit is relatively big. Contract costing is also known as terminal costing. **Features of Contract**

Costing:

- a. Work is generally carried outside the promotion of the contractor.
- b. Each contractor carries out small number of contractor. This is because the size of each contract is large.
- c. Each contract is a cost unit. Separate contract account is opened by for each contract. All expenses relating to that contract are debited and the contract price is credited. The difference is either profit or loss.
- d. Contracts are generally large and thus they continue from more than one year. e. Most of the material is specially purchased for each contract. Some material may also be drawn from stores.
- f. Normally most of the expenses and labour is direct.

Advantages of contract costing:

- 1) Many of the expenses are direct and they are directly charred to contract account.
- 2) Separate set of books need not be maintained for contract costing. Separate contract accounts are opened in the ledger. The various expenses of the contract are debited to the concerned contract account.
- 3) If the contract is not completed within agreed period the contractor has to pay penalty. Hence the contractor will try to complete the contract within the stipulated time.
- 4) The expenses of contracts at various stages can be standardized. Thus, controlling of various expenses is possible.

Under contract costing we have 3 steps they are

- a. Work- in- progress: The outlay on material, labours, direct expenses and the current proportion of indirect expenses and contract which has not yet been completed is known as work- in- progress. The work- in- progress may be segregated in two one representing the certified work in progress and the other representing the uncertified work- in- progress.
- b. Certified work in progress: Work certified is the work approved by contracted architect or survey or engineer. Generally contractor advises on the basis of work certified to contractor, say 80% of work certified.
- c. Un certified work in progress: Work complete but not certified by architect or survey or engineer is known as uncertified work. It is valued at cost. Work certified and work uncertified will appear on the credit of contract account under the heading work- in- progress

COST ACCOUNTING IS SCIENCE AND AN ART:

Cost accounting is both science and an art but not a perfect science.

It is science as it is a body of systematic knowledge relating to not only accounting but also to a wide variety of subjects such as law, office practices, data processing, production and material control etc.

It is an art as it involves the use of the skills and experience of cost accountant in collection, classification and analysis of the costs of the products.

COST ACCOUNTING IS A PROFESSION:

Cost accounting is not a pure profession by nature but it is emerging as a profession. The set up of various specialized institutions like

- Institute of Cost and Management Accountants in UK
- Institute of Cost and Work Accountants in India

Is a way long to make cost accounting as a profession.

BASED ON DOUBLE ENTRY SYSTEM:

Cost accounting is based on the double entry system. It follows the rule of 'every debit has equal credit.' All transactions that are recorded in the cost accounting records have two fold aspect.

A PROCESS IN NATURE

Cost accounting is a process in nature. It is a process that involves the following steps:

- Identification of costs
- Recording of costs
- Classification of costs
- Analyzing the costs
- Interpreting the results
- Communicating the results to the management.

It is a forward looking approach that aims at improving the efficiency of the manufacturing activities.

TOOLS AND TECHNIQUES

Cost accounting has its own tools and techniques of standard costing and variance analysis, contract costing, process costing, job costing, unit costing, batch costing, marginal costing etc. cost accounting make use of such techniques in preparing the accounting records with full accuracy and also fix the standards of performance for future.

INTERNAL ACCOUNTING

Costing accounting is an internal accounting. There is no compulsion on the organization to prepare the cost accounting records and publish them. It is totally option to prepare the cost accounting records. These are prepared to provide for the internal use by the management and manufacturing departments.

Importance of Cost Accounting to Management

Cost accounting has many advantages. It holds importance to many different parties of business. Management, investors, employees, government and even consumers themselves benefit from cost accounting.

1] Classification of Costs

Cost is a very generic term, it needs to be classified to be of further use. Cost accounting involves the recording and classification of such costs.

Some costs are prime cost, direct cost, factory cost, selling cost etc. Such classification allows the management to control the costs and ascertain the profitability of any such processes and activities. It also helps in calculating efficiency.

2] Cost Control

An efficient business focuses on controlling the cost of inventory, labor, and various other overhead costs. Cost accounting allows them to do so.

For example to achieve maximum efficiency in their inventory management they can adopt the EOQ technique which is a costing technique.

Similarly, by analyzing costs of labor and capacity of machinery their efficiency can be improved also. Cost accounting also classifies overheads into fixed, variable or controllable, uncontrollable to achieve cost control.

3] Price Determination

Cost accounting makes the basic distinction between fixed and variable costs. This is then used by management to fix the prices of products, according to the costs of the product.

This allows the management to find the most ideal price for the product or the service, not too high and not too low.

4] Fixing of Standards

Organizations use standards to make estimates and budgets for the future. They use these as a basis to measure the actual efficiency of the process or department.

There is an entire branch in cost accounting known as Standard Costing dedicated to this process.

Importance of Cost Accounting to Others

- **Workers:** One of the biggest uses of cost accounting is that it helps us calculate efficiency. This will help the company come up with an incentive scheme for workers who show efficiency in their work, and thus they will be awarded accordingly. It is also an incentive for workers with lower efficiency to do better.
- **Government:** Costing helps the government when assessing for income tax or any other such government liabilities. It also helps set industry standards and helps with price fixing, tariff plans, cost control etc.

- Customers: The main aims of costing are cost control and improvement in efficiency. Both of these are very beneficial to the company. And ultimately this benefit passes on to the customers of the products or services.

General Principles of Cost Accounting:

Following are the main principles of Cost Accounting:

1. Cause-Effect Relationship:

Cause-effect relationship should be established for each item of cost. Each item of cost should be related to its cause as minutely as possible and the effect of the same on the various departments should be ascertained. A cost should be shared only by those units which pass through the departments for which such cost has been incurred.

2. Charge of Cost Only after its Incurrence:

Unit cost should include only those costs which have been actually incurred. For example unit cost should not be charged with selling cost while it is still in factory.

3. Past Costs Should not Form Part of Future Costs:

Past costs (which could not be recovered in past) should not be recovered from future costs as it will not only affect the true results of future period but will also distort other statements.

4. Exclusion of Abnormal Costs from Cost Accounts:

All costs incurred because of abnormal reasons (like theft, negligence) should not be taken into consideration while computing the unit cost. If done so, it will distort the cost figures and mislead management resulting in wrong decisions.

5. Principles of Double Entry Should be Followed Preferably:

To lessen the chances of any mistake or error, cost ledgers and cost control accounts, as far as possible, should be maintained on double entry principles. This will ensure the correctness of cost sheets and cost statements which are prepared for cost ascertainment and cost control.

Classification of Costs:

1] Classification by Nature

This is the analytical classification of costs. Let us divide as per their natures. So basically there are three broad categories as per this classification, namely Labor Cost, Materials Cost and Expenses. These heads make it easier to classify the costs in a cost sheet. They help ascertain the total cost and determine the cost of the work-in-progress.

1. Material Costs: Material costs are the costs of any materials we use in the production of goods. We divide these costs further. For example, let's divide material costs into raw material costs, spare parts, costs of packaging material etc.
2. Labor Costs: Labor costs consists of the salary and wages paid to permanent and temporary employees in the pursuit of the manufacturing of the goods
3. Expenses: All other expenses associated with making and selling the goods or services.

2] Classification by Functions

This is the functional classification of costs. So the classification follows the pattern of basic managerial activities of the organization.

The grouping of costs is according to the broad divisions of functions such as production, administration, selling etc.

- Production Costs: All costs concerned with actual manufacturing or construction of the goods
- Commercial Costs: Total costs of the operation of an enterprise other than the manufacturing costs. It includes the admin costs, selling and distribution costs etc.

3] Classification by Traceability

This aspect one of the most important classification of costs, into direct costs and indirect costs. This classification is based on the degree of traceability to the final product of the firm.

- Direct Costs: So these are the costs which are easily identified with a specific cost unit or cost centers. Some of the most basic examples are the materials used in the manufacturing of a product or the labor involved with the production process.

- **Indirect Costs:** These costs are incurred for many purposes, i.e. between many cost centers or units. So we cannot easily identify them to one particular cost center. Take for example the rent of the building or the salary of the manager. We will not be able to accurately determine how to ascertain such costs to a particular cost unit.

4] Classification by Normality

This classification determines the costs as normal costs and abnormal costs. The norms of normal costs are the costs that usually occur at a given level of output, under the same set of conditions in which this level of output happens.

- **Normal Costs:** This is a part of the cost of production and a part of the costing profit and loss. These are the costs that the firm incurs at the normal level of output in standard conditions.
- **Abnormal Costs:** These costs are not normally incurred at a given level of output in conditions in which normal levels of output occur. These costs are charged to the profit and loss account, they are not a part of the cost of production.

BUDGET AND BUDGETARY CONTROL:

A budget is a blue print of a plan expressed in quantitative terms. Budgeting is a technique for formulating budgets. Budgetary control .On the other hand, refers to the principles, procedures and practices of achieving given objectives through budgets.

Budgetary control is the process of determining various budgeted figures for the enterprises for the future period and then comparing the budgeted figures with the actual performance for calculating variances, if any. First of all budgets are prepared and then actual results are recorded. The comparison of budgeted and actual figures will enable the management to find out discrepancies and take remedial measures at a proper time. The budgetary control is a continuous process which helps in planning and co-ordination. It provides a method of control too. A budget is a means and budgetary control is the end-result.

The importances of budgetary control system are usually summarized under five heads:

1. Planning
2. Coordination
3. Control
4. Optimal employment of capital, and
5. Responsibility accounting.

1. Planning:

A budget is nothing but a plan. Budgeting involves drawing up detailed plans relating to different functions like production, sales, raw materials requirements, labour requirements, research programs, etc. When plans are made in advance, many problems are anticipated long before they arise and solutions can be sought through careful study.

2. Coordination:

Coordination is the process whereby different sections of a business work towards achievement of the common goal. Budgets provide a means of coordination for the business as a whole. While making budgets, various factors like production, sales, etc., are balanced and coordinated.

3. Control:

Control is the action necessary to ensure that planned objectives are being achieved. Budgetary control makes control possible by comparing the actual performance against planned performance and taking action on the basis of variations between the two.

4. Optimum employment of capital:

The resources for achieving the firm's objectives are estimated and are made available.

5. Responsibility accounting:

Each individual is entrusted with well-defined responsibilities and they are made accountable.

Nature of Budget

The nature of a budget is to arrange for how cash is to be spent. It is to live inside your methods and to distribute assets accurately. A Budget also known as a financial plan predicts costs and earnings for a precise timeframe. A financial plan is a rundown of the costs you will make and the measure of cash you will utilize. It is more similar to an arrangement to make sense of the amount that can be spared and go through without running over the edge with money. This specific technique is utilized anyplace from enormous organization's to own one of a kind family unit which can help keep you less stresses over getting to be paying off debtor. In order for an organization to maintain a profit, it is insightful to put limitations on how much a worker or division of the organization can spend to accomplish its objective. So they are given a financial plan and relied upon to remain inside it.

Scope:

1. **Budgets** are prepared for different functions of business such as production, sales etc. Actual results are compared with the budgets and control is exercised. Standards on the other hand are complied by classifying, recording and allocation of the expenses to cost units. Actual costs are compared with standard costs.
2. Budgets have a wide range of coverage of the entire organization. Each operation or process is divided into number of elements and standards are set for each such element.
3. Budgetary control is concerned with origin of expenditure at functional levels. Standard costing is concerned with the requirements of each element of cost.
4. Budget is a projection of financial accounts whereas standard costing projects the cost accounts.

Types of Budgets:

As budgets serve different purposes, different types of budgets have been developed. The following are the different classification of budgets developed on the basis of time, functions, and flexibility or capacity.

(A) Classification on the basis of Time:

1. **Long-Term Budgets:** Long-term budgets are prepared for a longer period varies between five to ten years. It is usually developed by the top level management. These budgets summarize the general plan of operations and its expected consequences. Long-term Budgets are prepared for important activities like composition of its capital expenditure, new product development and research, long-term finance etc.
2. **Short-term Budgets:** These budgets are usually prepared for a period of one year. Sometimes they may be prepared for shorter period as for quarterly or half yearly. The scope of budgeting activity may vary considerably among different organization.
3. **Current Budgets:** Current budgets are prepared for the current operations for the business. The period of a budget generally in months or weeks. As per ICMA London, "Current budget is a budget which is established for use over a short period of time and related to current conditions."

(B) Classification on the basis of function:

1. **Functional budget:** The functional budget is one which relates to any of the functions of an organization. The number of functional budgets depends upon the size and nature of business. The following are the commonly used:

- Sales Budget
- Purchase Budget
- Selling and Distribution Cost Budget
- Labour Cost Budget
- Cash Budget
- Capital Expenditure Budget

2. **Master Budget:** The Master Budget is a summary budget. This budget encompasses all the functional activities into one harmonious unit. The ICMA England defines a Master Budget as the summary budget incorporating its functional budgets, which is finally approved, adopted and employed.

(C) Classification on the Basis of Capacity:

1. **Fixed Budget:** A fixed budget is designed to remain unchanged irrespective of the level of activity actually attained.

2. **Flexible Budget:** A Flexible Budget is a budget which is designed to change in accordance with the various level of activity actually attained. The flexible budget also called as Variable Budget or Sliding Scale Budget, takes both fixed, variable and semi fixed manufacturing costs into account.

What Is a Master Budget?

The master budget is a comprehensive financial planning document. It usually includes all of the lower-level budgets within the operating budget and the financial budget.

The operating budget shows the income-generating activities of the firm, including revenues and expenses. The result is a budgeted [income statement](#).

The financial budget shows the inflows and outflows of cash and other elements of the firm's financial position. The inflows and outflows of cash come from the cash budget. As such, the result of the financial budget is the budgeted balance sheet.

What a Master Budget Includes

These are the most often used elements within the master budget of companies. Some firms may not use one or another of the budgets, but most use some form of all of them. Service firms, for example, do not typically use production budgets.

Sales Budget

The first schedule to develop is the [sales budget](#), which is based on the sales forecast. The sales budget is not usually the same as the sales forecast but is adjusted based on managerial judgment and other data.

Production Schedule

The second schedule for budget planning is the production schedule. The company must determine the number of sales the company expects to make in the next year. Then, it must budget how many sales in units it needs to make to meet the sales budget and meet-ending inventory requirements. Most companies have an ending inventory they want to meet every month or quarter so that they don't stock out.

Direct Materials, Labor, and Overhead Budget

The next schedules are the [direct materials purchases budget](#), which refers to the raw materials the firm uses in its production process; the direct labor budget, which estimates how many hours of work and how many workers a company needs; and the overhead budget, which includes both [fixed and variable overhead costs](#).

Finished Goods Inventory and Cost of Goods Sold Budget

The ending finished goods inventory budget is necessary to complete the cost of goods sold budget and the balance sheet. This budget assigns a value to every unit of product produced based on raw materials, direct labor, and overhead.

Administrative Budget

The selling and administrative expense budget deal with non-manufacturing costs such as freight or supplies.

Cash Budget

The cash budget states cash inflows and outflows, expected borrowing, and expected investments, usually on a monthly basis. Any item that is not in cash, such as depreciation, is ignored by the cash budget.

Budgeted Balance Sheet

The budgeted balance sheet gives the ending balances of the asset, liability, and equity accounts if budgeting plans hold true during the budgeting time period.

Capital Expenditures

The budget for capital expenditures contains budgetary figures for the large, expensive fixed assets for the business firm.

The budget satisfies different purposes. Thus different types of budgets are commonly used. The budget can be grouped as:

1. Time budget. Short period or long period budget.
2. Functional budget.

Functional Budgets:

Functional budget is that budget which is associated with the functions of an organization. For example :[sales budgets](#), production budgets, labor budgets, cost budgets, overhead budgets, capital expenditure budgets, and [cash budgets](#) etc.

Types of Functional Budgets:

(1). Sales Budgets

It is the first budget which is an estimate of sales during the [budget period](#). It is also known as the backbone of the organization. The sales budget is the starting point for budgeting; all other budgets are based on the sales budget. The sales manager is responsible for preparing the sales budget. The procedure of sales budget is as:

(i).Data for past sales: The sales budget is based on past sales figures into the account. The sales of the last many years speak about ups or downs in the sale values.

(ii). Production budget: The Production budget is based on the sales budget. Once the sales quality and values are determined, then arises the problem of how much to produce to meet the budget sales. The production budget is an estimate of the quality of goods that must be produced during the budget period. While preparing production budget, the sales forecast, stock of closing stock and opening stock, plant capacity, purchase of other related part are taken into account.

(2). Production Cost Budget:

The production cost budget shows in detail the estimated cost of carrying out the production plans as per the production budget. It represents the cost of various elements involved in production, such as materials, labor, and [overheads](#) (fixed, variable, and semi-variable). The cost can be expressed based on each product or department-wise.

(3).Purchase Budget:

The purchase budget is concerned with [purchases](#) for the period of the budget. It is referred to the purchase of raw materials, fixed assets, and services such as electricity and gas etc. The main objective of the purchase budget is to establish a plan that will allow all purchases to take place at a minimum cost.

(4).Labor Cost Budget:

The labor cost budget lays emphasis on the labor needed to meet the company's demand during the budget period. The labor cost budget always focuses on direct and indirect labor costs. Labor requirements are specified by the human resources department, which is responsible for recruiting, training, and promoting employees.

(5)Promotion Overhead Budget:

This budget represents the forecast of all production overheads to be incurred during the budget period. The factory overheads are classified as fixed, variable and semi-variable. When preparing this budget, consideration should be given toward the level of equality that is likely to be achieved.

(6).Capital Expenditure Budget:

This budget indicates the plans for further [capital expenditure](#) (e.g., acquiring fixed assets, improving old assets, and replacing fixed assets). Examples include the addition of a new plant or new buildings.

(7)Cash Budget:

The cash budget represents the cash requirements of the [business](#) during the budget period. It compares the estimated cash receipts and estimated cash payments of the company during the budget period. It ensures that sufficient cash is available when required.

(8)Master Budget:

This budget combines all functional budgets into one harmonious unit. It is a summary plan of the proposed operations developed by the management for the company, covering a specific period. It is a summary budget incorporating any functional budgets that have been finally approved, adopted, and employed. This budget contains the details of sales budget, production budget, cash budget, and the other main functional budgets. When the master budget is complete, the budget committee will review its details and, if approved, it will be submitted to the board of directors. Once it is accepted and approved, it will become the target for the company during a specific period to achieve the desired target.

Marginal Cost: The term marginal cost refers to the amount at any given volume of output by which the aggregate costs are charged if the volume of output is changed by one unit. Accordingly, it means that the added or additional cost of an extra unit of output. Marginal cost may also be defined as the “cost of producing one additional unit of product.” Thus, the concept marginal cost indicates wherever there will

be some change in the total cost. It is concerned with the changes in variable costs. Fixed cost is treated as a period cost and is transferred to profit and loss account.

Marginal Costing:

Marginal Costing may be defined as “the ascertainment, by differentiating between fixed costs and variable costs, of marginal cost and of the effect of profit of changes in the volume or type of output.” According to J.Batty, marginal costing is a “a technique of cost accounting pays special attention to the behavior of costs with changes in the volume of output.” In other words, Marginal costing may be defined as the technique of presenting of presenting cost data wherein variable costs and fixed costs are shown separately for managerial decision-making. It should be clearly understood that marginal costing is not a method of costing like process costing or job costing. Rather it is a method or technique of the analysis of cost information for the guidance of management.

Nature and Scope:

-Marginal costing is a technique or working of costing, which is used in conjunction with other methods of costing (process or job).

-Fixed and variable costs are kept separate at every stage. Semi-variable costs are also separated into fixed and variable.

Features of Marginal Costing:

1. All elements of costs are classified into fixed and variable costs.
2. Marginal costing is a technique of cost control and decision making.
3. Variable costs are charged as the cost of production.
4. Valuation of stock of work in progress and finished goods is done on the basis of variable costs.
5. Profit is calculated by deducting the fixed cost from the contribution, i.e., excess of selling price over marginal cost of sales.
6. Profitable of various levels of activity is determined by cost volume profit analysis.

Importance of Marginal Costing:

1. The marginal costing technique is very simple to understand and easy to operate.
2. The current year fixed costs is not carried forward to the next year. As such, cost and profit are not vitiated. Cost comparisons become meaningful.
3. The contribution is used as a tool in managerial decision making.
4. Marginal costing shows more clearly the impact on profit of fluctuations in the volume of sales.
5. The marginal costing technique can be combined with standard costing.
6. The prevailing relationship between cost, selling price and volume are properly explained in clear terms.
7. The management can take short run tactical decisions with the help of marginal costing information.
8. This method helps in optimum allocation of resources.

Break – Even Chart

Break – Even Analysis: The success of a business is measured in term of the profit. The profit of any firm depends on three elements namely.

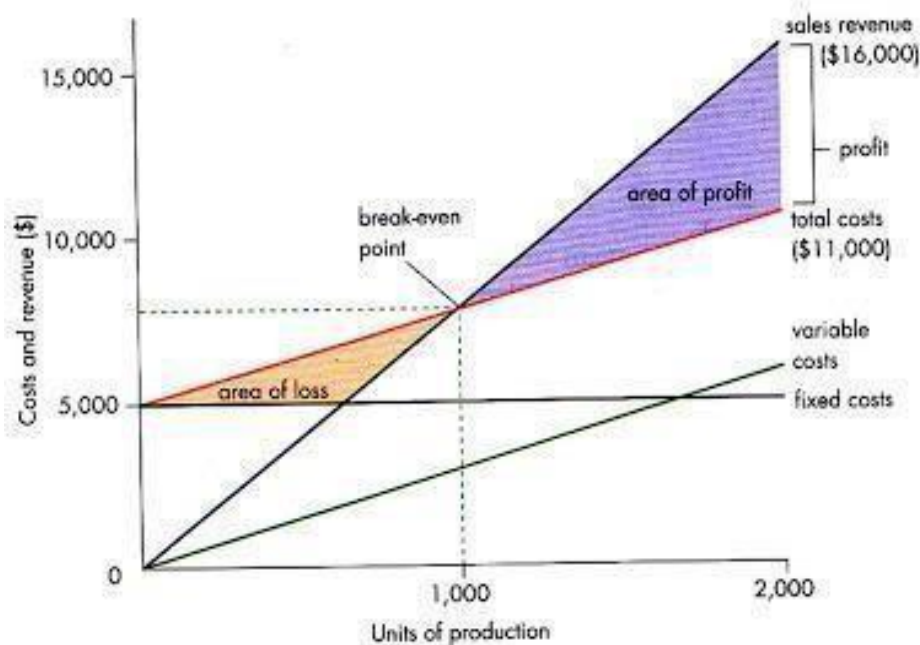
- a. Cost of production.
- b. Selling price and
- c. Volume of sales.

These three factors are independent. Cost determines the selling price. Break – even analysis is used in finding break – even point i.e., no profit or no loss point. At break – even point total sales are equal to total costs.

Assumptions of Break – Even Analysis:

- a. All elements of cost i.e., production administration selling and distribution can be segregated into fixed and variable.
- b. Costs and revenues are influenced only by volume.
- c. Selling price per unit remains unchanged or constant at all levels of output.
- d. Variable cost per unit is constant.
- e. Total fixed cost remains constant.
- f. There is synchronization between production and sales.

Construction of Break-Even Chart-Cost Volume Profit Analysis



The following steps are required to be taken while constructing the Break-even chart:

1. Sales volume is plotted on the x-axis. Sales volume can be shown in the form of rupees, units or as a percentage of capacity. A horizontal line is drawn spacing equal distances showing sales at various activity levels.
2. Y axis represents revenues, fixed and variable costs. A vertical line is also spaced in equal parts.
3. Draw the sales line from point o onwards. Cost lines may be drawn in two ways (i) fixed cost line is drawn parallel to x axis and above it variable cost line is drawn from zero point of fixed cost line. This line is called the total cost line (fig.1) (ii) in the second method the variable cost line is drawn from point o and above this, fixed cost line is depicted running parallel to the variable cost line. This line may be called total cost line. (fig.2)
4. The point at which the total cost cuts across the sales line is the break-even point and volume at this point is break-even volume.
5. The angle of incidence is the angle between sales and the total cost line. It is formed at the intersection of the sales and the total cost line, indicating the profit earning capacity of a firm. The wider the angle the greater is the profit and vice versa. Usually, the angle of incidence and the margin of safety are considered together to show that a wider angle of incidence coupled with a high margin of safety would indicate the most suitable conditions.

Break – Even Point:

Break – event point is a point where the total sales are equal to total cost. It is a point of no profit or no loss. At this point income of the business is exactly equal to its expenditure. Break – even point may be calculated in terms of physical units or in terms or sales value.

Computation of Break – Even Point: The break – even point can be determined by the following Methods.

- 1) Algebraic formula method.

2) Graphic or Chart method.

Algebraic formula method: The following are the important methods of determining break – even point under algebraic formula method.

- a) Break – even point in units.
- b) Break –even point in terms of budget or money value.
- c) Break –even point as a percentage of estimated capacity.

a) Break – even point in units: Break – even point is appoint where total sales are equal to total Costs. At this volume of sales there will be neither profit nor loss. The methods of break- even point in units are conveniently used in affirm which produce single produce. It can be calculated as follows

Break Even Point (in Units) = Fixed Cost/Selling Price per Unit – Variable Cost Unit.

(or)

= Fixed Cost / Contribution per Unit.

b) Break – Even Chart: A Break – Even Chart portrays a pictorial view of the relationships between costs, volume and profit. This chart shows the break – even point and also the estimated profit or loss at various levels of output. The break – even point as indicated in the chart is the point at which the total cost and total sales line intersect.

- 1) Fixed costs, variable cost and total costs.
- 2) Sales value.
- 3) Profit or loss.
- 4) Break –even point (no profit , no loss point)
- 5) Margin of safety.

Break – Even Chart – Advantages:

- (1) It is simple to construct and easy to understand. It presents the idea of the problem at a glance.
- (2) It is an useful guide to the management to study the relationship between cost, volume and profit.
- (3) It helps to determine the profit at various levels of output.
- (4) Break – even chart makes the inter – firm comparison possible.
- (5) The break – even chart helps in knowing and analysing the profitability of different products under various circumstances.

Margin of Safety: Margin of safety is an important concept in marginal costing approach. The excess of actual sales over the sales at break – even point is known as margin of safety. In other words it is difference between actual sales and the sales at break – even point.

Margin of Safety = Actual Sales – Sales at Break Even Point.

Margin of safety can also be expressed in percentage. Margin of safety in percentage is calculated by the following formula.

Margin of Safety in Percentage = Margin of Safety / Sales X 100
(or)

Actual Sales – Sales at Break Even point / Sales X 100

Margin of safety calculated in percentage is also known as margin of safety ratio. Margin of safety can also be calculated by the following formula.

Limitations:

- 1. A break even chart is based on a number of assumptions which may not hold good. Fixed costs vary beyond a certain level of output. Variable costs do not vary proportionately if the law of diminishing or

increasing returns is applicable in the business. Sales revenues do not vary proportionately with changes in volume of sales due to reduction in selling price as a result of competition or increased production.

In the break even chart, we have seen that the total cost line and the sales line look straight lines. This is possible only with a number of assumptions. But, in practice, the total cost line and the sales line are not straight lines because the assumptions do not hold good. Thus, there might be several break even points at different levels of activity.

2. A limited amount of information can be shown, in a break even chart. A number of charts will have to be drawn up to study the effects of changes in fixed costs, variable costs and selling prices.

3. The effect of various product mixes on profits cannot be” studied from a single break even chart.

4. A break even chart does not take into consideration capital employed which is a very important factor in taking managerial decisions. Therefore, managerial decisions on the basis of break even chart may not be reliable.

Advantages of Break Even Charts:

1. Information provided by the break even chart can be understood by the management more easily than contained in the Profit and Loss Account and the Cost Statements because a break even chart is the simple presentation of cost, volume and profit structure of the company.

2. A break even chart is useful for studying the relationship of cost, volume and profit. The chart is very useful for taking managerial decisions because it shows the effect on profits of changes in fixed costs, variable costs, selling price and volume of sales.

The chart is very useful for forecasting costs and profits at various volumes of sales.

3. A break even chart is a tool for cost control because it shows the relative importance of the fixed costs and the variable costs.

4. Profitability of various products can be studied with the help of these charts and a most profitable product mix can be adopted. Profits at different levels of activity can also be ascertained.

5. It is helpful in the determination of sale price which would give desired profits or a B.E.P.

6. It is helpful in knowing the effect of increase or reduction in selling price.

UNIT-4

COMPUTERIZED ACCOUNTING: Computerized Accounting system refers to the system of maintaining accounts using computers. IT involves the processing of accounting transactions through the use of hardware and software in order to keep and produce accounting records and reports.

Features of computerized accounting:

i.) Simple and integrated: It is designed to automate and integrate all the business operations, such as sales, finance, purchase, inventory and manufacturing. The CAS may be integrated with enhanced MIS (Management Information System), Multi-lingual and Data Organization capabilities to simplify all the business processes of the organization easily and cost-effectively.

ii.) Speed: It can perform functions at much higher speed than doing the same manually.

iii.) Accuracy: Computers perform functions with high degree of accuracy. If hardware, software and input by people are proper, the computerized accounting system can assure of accurate outcome.

iv.) Reliability: Computers are used to process large volumes of data and hence, data provided by it are reliable.

V.) Versatility: Computer and accounting software have the ability to perform diverse tasks. For example, by simply recording accounting entries through accounting software, one can get trial balance, trading account, profit and loss account, balance sheet and diverse reports.

vi.) Transparency: With computerized accounting, the organization enables processing of any volume of data in tune with the change in the size of the business.

Vii.) Scalability: Computerized accounting enables processing of any volume of data in tune with the change in the size of the business.

viii.) ON-line facility: Computerized accounting offers online facility to store and process transaction and data so as to retrieve information to generate and view financial reports in any part of the world.

ix.) Security: In Computerized accounting, only the authorized users are permitted to have access to accounting data. Under annual accounting system, it is very difficult to secure such information as it is open to inspection by any person dealing with the books of accounts.

Distinguish between Manual Accounting and Computerized Accounting

Manual accounting

- 1) Process of work consumes more time
- 2) Computer works accurate and reliable
- 3) Human being cannot work continuously
- 4) Manual records are not subject to manipulation
- 5) Manual accounting requires continuous recording from beginning to the preparation of Financial accounts
- 6) Manual accountings are visible
- 7) Computer knowledge is not required
- 8) High cost of operation.

Computerized accounting

- 1) Process of work consumes very less time
- 2) Human is subject to commit mistake
- 3) Computer can work continuously.
- 4) Computer records are subject to risk to manipulation.
- 5) Computer accounts requires only beginning records, then it generates final accounts of any other reports automatically.
- 6) Computer records are not easily visible.
- 7) Computer knowledge is necessary.
- 8) Low cost of operation.

Advantages of Computerised Accounting:

Following are the advantages of computerised accounting:

- a) Work is done with 'high speed'.
- b) Up to date information's are available to the management.
- c) Information's are quite accurate and reliable.
- d) The cost of operation of computer accounting is very low.
- e) Businessman can get final accounts report by feeding primary records in computer.
- f) A computerized accounting is error free.

- g) Multiple copies can be obtained from the initial feeding of the transactions.
- h) A quantum of accounting can be stored in computer.
- i) Computer has instant recall capacity.
- j) Computerized accounting ensures neat and clean accounting system.
- k) Computer accounting has provision for adding, deleting and modifying master file records.

Disadvantages of Computerised Accounting: Computerised accounting no doubt has many advantages but still suffers from following limitations.

- 1) Computerized accounting requires qualified professional to prepare speed programs to carry out accounting operations.
- 2) In initial stages computerized accounting system and its programs are costly.
- 3) Only technically qualified person can operate a computer so, to train the existing staff it involves the training cost.
- 4) A computer requires various peripherals like floppy, CD, printers and other stationery items that are costly.
- 5) Computer accounting requires regular back up on various storage devices such as hard disk, floppy, and magnetic tape to guard against possible loss of data.
- 6) Data in computer are subject to risk of computer viruses. The viruses may destroy the whole data in the computer and also those kept as back up.
- 7) There is greater possibility of risk of obsolescence due to change in technology.

Coding in accounting:

Coding in accounting is the process of assigning numbers or letters to data to create a fast-search database. Accounting codes are not universal as every accountant, accounting firm, institution or business may create its own coding system in accounting tailored to its own organizational needs. Some types of coding are simple and straight forward, while others require a manual to interpret.

Mnemonic coding

Mnemonic coding in accounting uses abbreviated letters that stand for a full word. For example, “ACCT” could stand for “account,” “DT” for “date” or “GTL” for “grand total.”

Sequential coding:

Also called serial coding, sequential coding in accounting uses numbers that have a consecutive order. In a bookkeeping ledger, a sequential code may run down the side of the page with one on every new line. An example of a sequential code is 00, 01, 02, 03 and so on.

Hierarchical coding:

Similar to a library's Dewey decimal classification system, hierarchical codes are those that an accountant could infinitely expand upon, if needed, in a manner that is structured and logical. For example, if an accountant wanted to create a main section in her accounting system, she would designate a number with each section like "808 Assets" and "809 Liabilities." Then, if she wanted to create sub-sections, she would do so with the use of a decimal, like "808.01 Financial Assets." The accountant could continue to add sub-sections to each sub-section as needed, such as "808.01.001 Financial Assets for 2001-2002."

Block Coding:

In accounting, block coding refers to numbers an individual may assign to general accounting terms while bookkeeping. For example, if a block code reads, "5,000: Fixed Assets, 6,000: Stocks," the 5,000 block is exclusively for anything dealing with fixed assets. Because these code blocks are 1,000 numbers apart, an individual could add up to 1,000 sub-block codes or sub-categories.

Faceted Coding:

A faceted code in accounting is a series of grouped numbers that represent different headings an accountant may use. If an accountant is keeping the books for a retail location, for example, she may state that Facet 1, or group 1, represents the different departments within the store; Facet 2 represents the different types of costs the store could incur; and Facet 3 contains subcategories of Facet 2.

Within each facet is a sequential code that represents a different item. In the example, Facet 1 may have the following fields: 00 Online Sales, 01 In-Store Sales and 02 Returns. Facet 2 could include the following fields: 00 Marketing Costs, 01 Office Supplies and 02 Labor Expenses. Then, Facet 3 could contain a series of block codes where the numbers 0000 to 01000 represent overhead costs, where the number 0050 represents the cost to purchase an

Internet domain. Therefore, if the accountant used a faceted code, the series of numbers that would represent the cost to promote the store online with a new website would read “00 00 0050.” Each section of this code represents each individual facet: 00 (Online Sales) 00 (Marketing Costs) 0050 (Cost of Internet Domain).

Types of Computer Processing Files

There are numerous types of files used for storing data needed for processing, reference or back up. The main common types of processing files include

- Master files,
- Transaction,
- Reference,
- Backup, report and
- Sort file.

1. Master file

A master file is the main that contains relatively permanent records about particular items or entries. For example a customer file will contain details of a customer such as customer ID, name and contact address.

2. Transaction (movement) file

A transaction file is used to hold data during transaction processing. The file is later used to update the master file and audit daily, weekly or monthly transactions. For example in a busy supermarket, daily sales are recorded on a transaction file and later used to update the stock file. The file is also used by the management to check on the daily or periodic transactions.

3. Reference file

A reference file is mainly used for reference or look-up purposes. Look-up information is that information that is stored in a separate file but is required during processing. For example, in a

point of sale terminal, the item code entered either manually or using a barcode reader looks up the item description and price from a reference file stored on a storage device.

4. Backup file

A backup file is used to hold copies (backups) of data or information from the computers fixed storage (hard disk). Since a file held on the hard disk may be corrupted, lost or changed accidentally, it is necessary to keep copies of the recently updated files. In case of the hard disk failure, a backup file can be used to reconstruct the original file.

5. Report file

Used to store relatively permanent records extracted from the master file or generated after processing. For example you may obtain a stock levels report generated from an inventory system while a copy of the report will be stored in the report file.

6. Sortfile:

It stores data which is arranged in a particular order.

Used mainly where data is to be processed sequentially. In sequential processing, data or records are first sorted and held on a magnetic tape before updating the master file.

Introduction to documents used for data collection:

1. Cash Memo:

Sales and purchases are the main features of any business enterprise. For recording cash sales and cash purchases, cash memos serve as source documents. Cash memo is a source document in which all transactions pertaining to cash sales or purchases are to be recorded.

2. Invoice and Bill:

Invoice or bill records the credit transactions related to sale or purchase. This is prepared when a firm purchases or sells the goods on credit. At the time, when the goods are sold by the business enterprise on credit, sales invoice is prepared in which all details of the credit sales viz. the

quantity, rate and total amount etc. are mentioned. Usually, invoices are made in duplicate, the main copy (original) is sent to the purchaser and the another is kept by the business enterprise for record and future reference. Similarly, when goods are purchased on credit, the supplier prepares the invoice in duplicate. When the main copy is received by the purchaser, it becomes a bill.

3. Receipt:

Receipt is an evidence of making the payment on account of any business transaction. This source document is prepared for showing the proof of giving any cash to the party (who receives the cash) on account of any business transaction. At least two copies are made of any receipt. The original copy is prepared for giving it to the party who makes the payment and another copy is kept for record. The details about the business transaction on account of which the cash is received viz. date, amount, name of the party and the nature of payment etc. are given in this source document.

4. Pay in Slip:

This document serves the purpose of providing an evidence that on particular date, a specific amount has been deposited in the bank. When a depositor deposits money in the bank account, he fills up a form provided by the bank containing the information about the date, amount to be deposited and the name of the depositor etc.

5. Cheque:

A cheque is an instrument drawn upon a banker and payable on demand. The bank issues a booklet containing cheque forms to its account holders. Digits mentioned on the bottom of the cheques denote code of 'State', 'Bank', 'Branch', 'Cheque' and 'Type of Account' respectively.

6. Debit Note:

A debit note is a document which shows that the business enterprise has raised debit against the party to whom this document is sent in respect of any business transaction other than the credit sale. Business enterprise may make a debit note against the supplier for an amount which is to be recovered from him, when the business enterprise returns some goods which are defective in nature or not as per specifications.

7. Credit Note:

A credit note is a document which shows that the business enterprise has given the credit to the party to whom this document is sent in respect of any business transaction other than credit purchase. When a business enterprise receives back the goods sold earlier then it makes a credit note in favor of the purchaser showing that his account has been credited in the books of business enterprise.

8. Vouchers:

The documents prepared for the purpose of recording business transactions in the books of accounts are known as vouchers. Voucher is prepared on the basis of source documents. For recording business transactions in the books of accounts, source documents are further analyzed and conclusion is drawn as to which account is to be debited and which account is to be credited. The document on which this conclusion is written is known as voucher or accounting voucher.

Definition master file:

A collection of records pertaining to one of the main subjects of an information system, such as customers, employees, products and vendors. Master files contain descriptive data, such as name and address, as well as summary information, such as amount due and year-to-date sales.

Contrast with transaction file. Although there can be many more, following are the typical fields in a business master record. The "key" fields are generally indexed for matching against the transaction records as well as fast retrieval for queries. The account number is usually the primary key, but name may also be primary. There can be secondary indexes; for example, in an inverted file structure, almost all the fields could be indexed. See transaction file for examples of transaction records.

EMPLOYEE MASTER RECORD

key Employee account number

key Name (last)

Name (first)

Address, city, state, zip

Hire date

Birth date

Title

Job class

Pay rate

Year-to-date gross pay

CUSTOMER MASTER RECORD

key Customer account number

key Name

Bill-to address, city, state, zip

Ship-to address, city, state, zip

Credit limit

Date of first order

Sales-to-date

Balance due

VENDOR MASTER RECORD

key Vendor account number

key Name

Address, city, state, zip

Terms

Quality rating

Shipping method

PRODUCT MASTER RECORD

key Product number

key Name

Description

Quantity on hand

Location

Primary vendor

Secondary vendor

Definition of:transaction file

A collection of transaction records. The data in transaction files is used to update the master files, which contain the data about the subjects of the organization (customers, employees, vendors, etc.). Transaction files also serve as audit trails and history for the organization. Where before they were transferred to offline storage after some period of time, they are increasingly being kept online for routine analyses. See data warehouse, transaction processing and information system.

Following are the kinds of fields that make up a typical transaction record in a business information system.

There can be many more fields depending on the organization. The "key" fields below are the ones that are generally indexed for fast matching against the master record. The account number is usually the primary key, but name may also be used as a primary key. See [master file](#) for examples of typical master records.

EMPLOYEE PAYROLL RECORD

key Employee account number

Today's date

Hours worked

ORDER RECORD

key Customer account number

Today's date

Quantity

Product number

PAYMENT RECORD

key Customer number

Today's date

Invoice number

Amount paid

Check number

PURCHASE ORDER

key Purchase order number

Today's date

Department

Authorizing agent

Vendor account number

Quantity

Product number

Due date

Total cost

WAREHOUSE RECEIPT

key Purchase order number

key Invoice number

Today's date

Quantity

Product number

Master File

1. The data stored in these files are permanent by nature
2. This file is empty while nature
3. This files are updated only through recent transactions
4. This file stores large amount of data
5. Eg: customer ledgers, student database

Transaction File

1. The data stored in these files are temporary by nature
2. This file contains data only for period of time and send to the master file
3. Any data to be modified is done in this file
4. In this file the data to be modified is stored .
5. Eg: price of the products, customers order for the products, inserting new data to the database etc.

Record In Master File

Employee No.	12A004
Surname	Jones
Forenames	Anna Jane
Pay Rate	£7.50
Department	Accounts
Pay This Year	£5575.00

Record In Transaction File

Employee No.	12A004
Transaction Type	Hours Worked
Value	25

Sole Proprietorship:

1. Sole trade is the oldest and most commonly used form of business organization. It is as old as civilization.
2. With the development of science and technology the needs of the business also increased and new also known as sole – proprietorship, individual- proprietorship, single entrepreneurship.
3. He makes all the investments, shares all risks, takes all profits, manage and controls the business himself. A sole-trader manly depends up to his own resources.
4. The sole-trader moulds the fake of the concern. It is the competence of the proprietor which the future of the business.
5. The sole-trader must, however, be person competitors to enter into a contract. The business to be carried on should also be allowed by law.

Definition: The individual entrepreneurship is the form of business organization on the head of which stands an individual as the one who is responsible, who directs its operations, who alone runs the risk of failure.

A sole-trader is a person who carries on business exclusively by and for himself. He is not only the owner of the capital of the undertaking, but is usually the organizer and manager and takes all the profits or responsibility for losses.

The sole- trader is a person who carries on business off his own, that is, without the assistance of a partner. He brings in his own capital and uses all his labour. He also gets himself assisted by others to whom he pays a salary by way of remuneration.

Features:

1. **Individual Initiative:** This business is started by the initiative of a single person. All profits and losses are taken by the single individual.
2. **Unlimited Liability:** The sole-trader business liability is unlimited. The proprietor is responsible for all losses arising from the business.
3. **Management and Control:** The proprietor manages the whole business himself. He prepares various plans and executes them under his own supervision.
4. **Motivation:** one person is the sole owner of the business. He takes all profits and losses, if any. There is a direct relationship between efforts and reward.

5. **Secrecy:** All important decisions are taken by the own himself. He keeps all the business secret only to himself. Business secrets are very important for small business.
6. **Proprietor and Proprietorship are one:** Legally, the sole trader and business are separate entities. Loss in this business is his loss. Liabilities of the business are his Liabilities.
7. **Owner and business exist together:** In sole-trade business there is no separate existence of the business with the owner. The business and owner exist together.
8. **Limited area of Operations:** A Sole trade business has generally a limited area of operations, the reasons being the limited resources and managerial abilities of the sole-trader. He can arrange limited funds only and will be able to supervise a small business

Advantages of Sole-Proprietorship:

1. **Easy to Formation:** Sole- Proprietorship is the only form of organisation where no legal formalities are required to be performed. Anybody wishing to start a sole-trade concern can do so without loss of time. This business is absolutely free from legal formalities.
2. **Better control:** In this origination one man is responsible for all types of activities. He controls all functions of the business. He himself takes decision at appropriate time. The authority and responsibility life with one man.
3. **Flexibility in operation:** A sole- proprietorship concern is generally run on a small scale basis. In case a change in operation is required it can be possible without involving much expenditure.
4. **Retention of business secrets:** A sole-trader can maintain business secrets. Being the sole proprietor, he is not expected to share his trader secrets with anybody else.
5. **Easy to raise finance:** An individual entrepreneur is able to create good will for his business. This helps him to establish his creditworthiness in the market.
6. **Direct motivation:** The proprietor takes keen interest in the working of the business. He tries to put his heart and soul in the business so to earn as much profit as he can.
7. **Promptness in Decision Making:** All decision is taken by one person. He can take prompt decision.
8. **Direct Accessibility to consumers:** In sole-proprietorship the scale of operations is small. The owner can have known the relations and preferences of consumers.

9. ***Inexpensive Management:*** The sole-trader is the owner, manager and controller of the business. He does not appoint specialists for various functions. He personally supervises various activities and can avoid wastage in the business.
10. ***No legal restrictions:*** There are no legal requirements for starting a business. There is no special act governing the work of sole proprietors. The proprietor is not required to submit the results of his business to any authority.
11. ***Socially Desirable:*** One man business is generally on a small scale basis. Large number of sole traders has entered all types of business. It helps in avoiding concentration of wealth.
12. ***Self-employment:*** The sole proprietorship form of organisation offers the means of self employment to those who do not want to serve others.
13. ***Healthy relations with employees:*** A sole trader is in a position to maintain direct relations with his employees. This enables the employer and employees to understand and appreciate the difficulties of each other.
14. ***Benefits of inherited good will:*** A sole trader passes on the business goodwill to his successor.

Disadvantages of Sole Proprietorship:

1. ***Limited resources:*** The resources of a sole proprietor are limited. He makes investment from his family only. There is a limit to which a single person can invest. He tries to raise finance from financial institutions also.
2. ***Limited managerial ability:*** One person may not be expert in each and every function of the Business.. He will not be able to devote sufficient time for all types of activities. He will have to depend upon paid employees.
3. ***Unlimited liability:*** The liability of a sole proprietor is unlimited his private property can also be assigned for meeting business losses.
4. ***Uncertain continuity:*** The business continues as far as sole proprietor is there. In case of his mobility or death, the business is discontinued. The successor of the sole proprietor may not have an aptitude or ability to continue in the business. The closure of a business will cause inconvenience to the consumers.
5. ***Limited scope of employees:*** A sole traders cannot attract trained and quality person for reason of limited career opportunities.

6. No large scale economies: A small scale concern cannot economies in purchases productions and marketing. A large scale enterprise will be able to have favorable terms of purchasing and selling of goods.

7. More risk involved: A sole proprietor is to take all decisions by himself. So there is a possibility of taking wrong decisions.