DHRM

GOLDEN HUMANS

1005 - DCMA

Cost And Management Accounting

Learning objectives

1. Explain why accounting is important and list the users of accounting information.
2. Describe the organizations and that rules that govern accounting.
3. Describe the accounting equation and define assets.
4. Use the accounting equation to analyze transactions.
5. Prepare financial statements.
6. Use financial statements return on assets (ROM) to equate business performance.

Learning objectives 1

Explain why accounting is important and list the users of accounting information.

Why is accounting important?

- Accounting is the information system that;
  - Measures business activites
  - Processes the information into reports
  - Communicates the results to decision makers

Decision marking : The user of accounting information

Exhibit 1.2

Decision marking : Financial versus managerial accounting.

- External Decision makers. (Financial accounting)

Should I invest in the business?
Is the business production?
Should we lend money to the business?
Can the business pay us back?

- Internal Decision makers. (Managerial accounting)

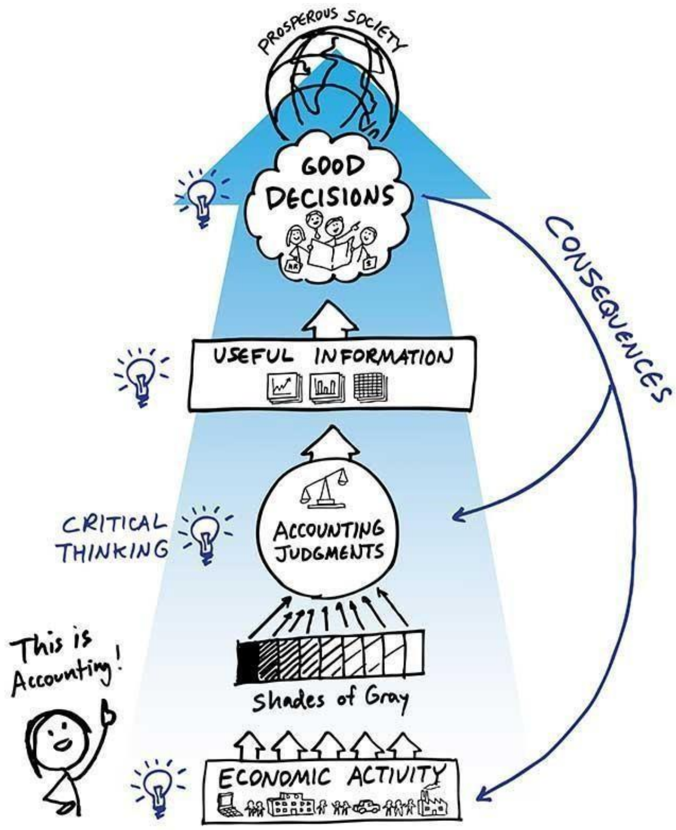
How much many should the business budget for production?
Should the business expand to a new location?

How do actual costs copare to budgeted costs?

- Financial accounting provides information for external decision makers, such as;

  - Investors who own a portion of the business.
  - Creditors to whom the business owes money.
  - Taxing authorities to whom the business owes taxes.

- Managerial accounting provides information to internal decision makers.



PROSPEROUS SOCIETY
GOOD DECISIONS
USEFUL INFORMATION
ACCOUNTING JUDGMENTS
CRITICAL THINKING
Shades of Gray
This is Accounting!
ECONOMIC ACTIVITY
CONSEQUENCES

The Accounting Profession

- Types of accounting

  - Certified public accountants (CPA) / charted accounting (CA) serve the general pubic.
  - Certified management accountants (CMA) / CIMA / ACCA specialize in management accounting and financial management knowledge and work for a company.

- Accounting positions :

  - Public
  - Private
  - Governmental

Learning objective 2

Describe the organizations and rules that govern accounting.

What are the organizations and rules that govern accounting?

- Goveorn organizations ;

  - Institute of chareted accountants sri lanka (ICASL) / financial accounting standards board (FASB) oversees creation and goverance of accounting standords.
  - Securities and exchange commission (SEC) oversees the sri lanka financial makets.

What are the organization and rules that govern accounting

- Accounting guide leiness are called generally accept accounting principles (GAAP) useful accounting information must be ;

- Relevant
- Faithfully representative

The economic entity asscimption

- An organization that stands apart as a separate economic unit follows the economic entity ossumption.

- Features of a corporation

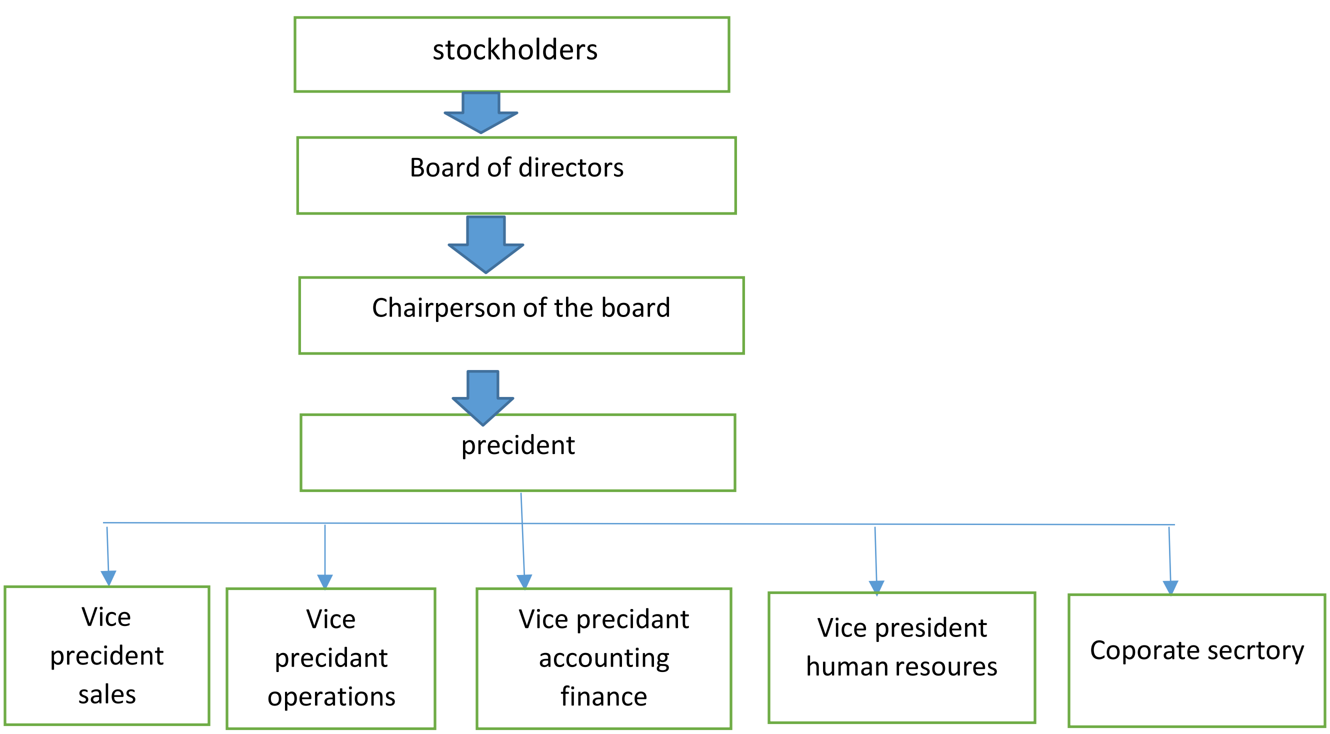
  - Separate legal entity
  - Continues life and transferability of owner ship
  - No mutual ogency
  - Limited liability of stockholders

- A stockholders is a person who owens stock.

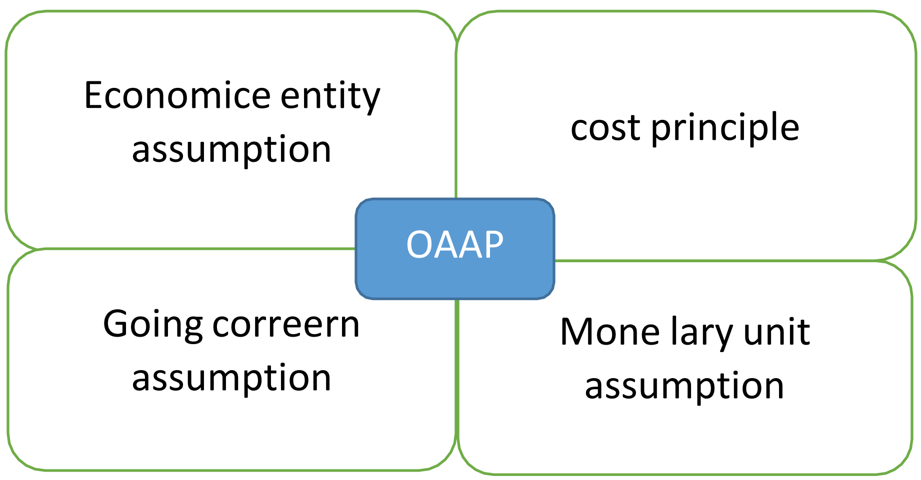
  - Separation of ownership and management

	Sole Proprietorship	Partnership	Corporation	Limited-Liability Company (LLC)
Definition	A business with a single owern	A business with two or more owners and not organized as a corporation	A business organized under state law that is a separate legal entity	A company in which each member is only libale for his or her own actions
Number of ~~organization~~ owners	one (called the Porperietor)	Two or more (called partners)		
Relife of the organization	Terminates of owern's choice or death	Terminates at a Partners choice or death	one or more called stockholders)	one or more (called members or partners)
Personal liability for the business debts	~~owenr~~ owner is porsenally ~~libility~~ libole	Partner are personally liable	Indefinite	Indefinite
Taxation	Not separete taxable entities The ower pays ~~tha~~ tax on the proprietorship's earnings.	Partnership ~~tax~~ is not taxed Instead partners pay tax on their share of the earnings	stockholders are not personally	Members are not Personally
Type of business	Small business	Professional organizations of physicians, attorneys, and accountants.	separate taxable entity. cornoration pays tay	LLC is not taxed. members pay tax on their share of earnings

Exhibit 1.5 / Stracture of a corporation



<u>Rules that govern accounting</u>



Rules the govern accounting

- International financial reporting standards (IFRS)
  - Principles – based standards
  - Used or required by more than 120 nations
  - Published by the International accounting strandards board (IASB)

- Ethics in accounting and business
  - An audit is an evamination of a company's financial statements are records.
  - The Sarbanes – ovley act (SOX) requires companies to review internal controls.

Learning objective 3

Describe the accounting equation and define assets , liabilities

The accounting equation

- The accounting equation is the basic tools of accounting , measuring the resources of the business and the claims to those resources.

$$\boxed{\text{Assets} = \text{liabilities} + \text{equity}}$$

Assets

- An assets in an economic resource that is expected to benefit the business in the future.

  Examples :

  - Cash

- Merchandise inventory
- Furniture
- Land

Liabilities

- Liabiities are debts that are owed to creditors.
- Many liabilities have the word payable in their tites.

- Examples :

  - Accounts payable
  - Notes payable
  - Salaries payable

Equity

- The owers claims to the assets of the business are called equity.
  - Also called stockholders equity
- Increases in equity result from :
  - Con tribute capital (owner can tributions)
  - Revenues

- Decreases in equity result from :
  - Dividends (owner disitributions)
  - Expenses

Equity

The accounting equation is erponded to slow the components of equity :

<u>Assets</u> = <u>liabilities</u> + <u>Equity</u>

contributed Capital + retained earnings

Common stock – dividends + rever – expues - enses

- Net income / profit

  Revenues > expenses

- Net lost

  Revenues < expenses

Learning objective 4

use the accounting equation to analyze transactions.

How to you analyze a transaction?

A transaction is any event that affects the financial position of the business and can be measured with faithful representation.

Is it a transaction?

✓ Buying a computer for the office for $ 2000 cash

✖ Hiring a new employee

Transaction analysis for smart touch learning

Transaction 1 – owner contribution

Sheena bright contributes $ 30000 cash to smart touch learning , a corporation in exchange for stock. The effect of this transaction on the accounting euation is .

➢ Transactions 1

ASSETS		**~~LIABILITIE~~+**	**~~EQUIT~~**
			Contributed
Cash	=		toc
(1 +30,00			+30,00

➢ Transactions 2 Purchase of Land for

Smart Touch Learning purchases land for an office location. , paying cash of

~~ASSETS~~				**~~LIABILITIE~~**	**+**	**~~EQUIT~~**
Cash	+	Land				Contributed Common
Bal. $30,000			=			$30,00
(2 -2 ,000		+20,00				
Bal. $10,000 +		$20,000				30,00

Transcation analysis for smart touch learning

Transcation 3 – purchase of office suppies on account

Smart touch learning buys office supplies on account which is a libiity called accounts paybe agreeing to pay $ 500 with or 30 days.

Assets					liabilities + equality		
Cash	+	office	+	land		contributed capita	retained earnings
		Suppies			accounts payble	common stock	
Bal.$ 10,000	+			$ 20,000	+$500	+	
(5)		$500			$500	$ 30,000	
Bal.$10,000	+	$500	+	$20,000			

Transcation analysis for smart touch learning

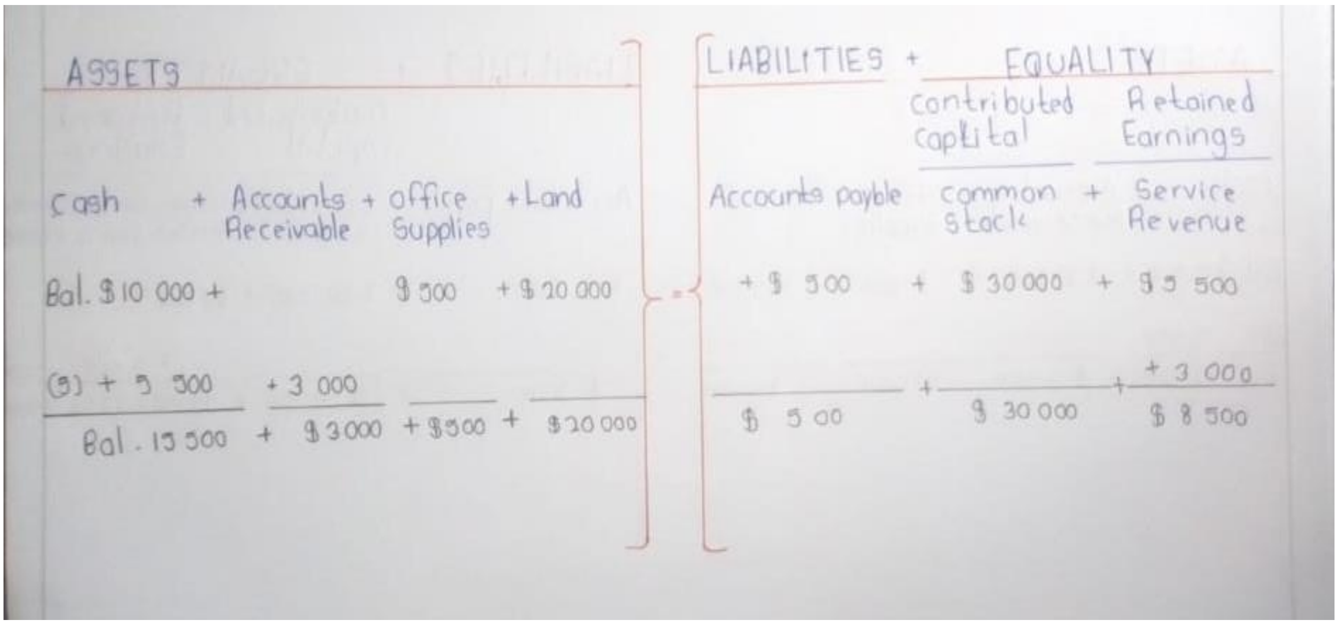
Transcation 4 – Earning of service revenue for cash

Smart touch learning earns service revenue by providing traninng services for clients the business collects 5,500 in cash.

Assets					liabilities + equality		
Cash	+	office Supplies	+	and		contributed capital	retained earnings
					accounts payble	common stock	+ service revenue
Bal. $10,000	+	$500	+	$20,000			
(4)							
Bal. 10,000	+	$ 500	+	$20,000	+ $500	+ $ 30,000	+ 5,500

- Transaction 5 – Earning of Service Revenue on Account

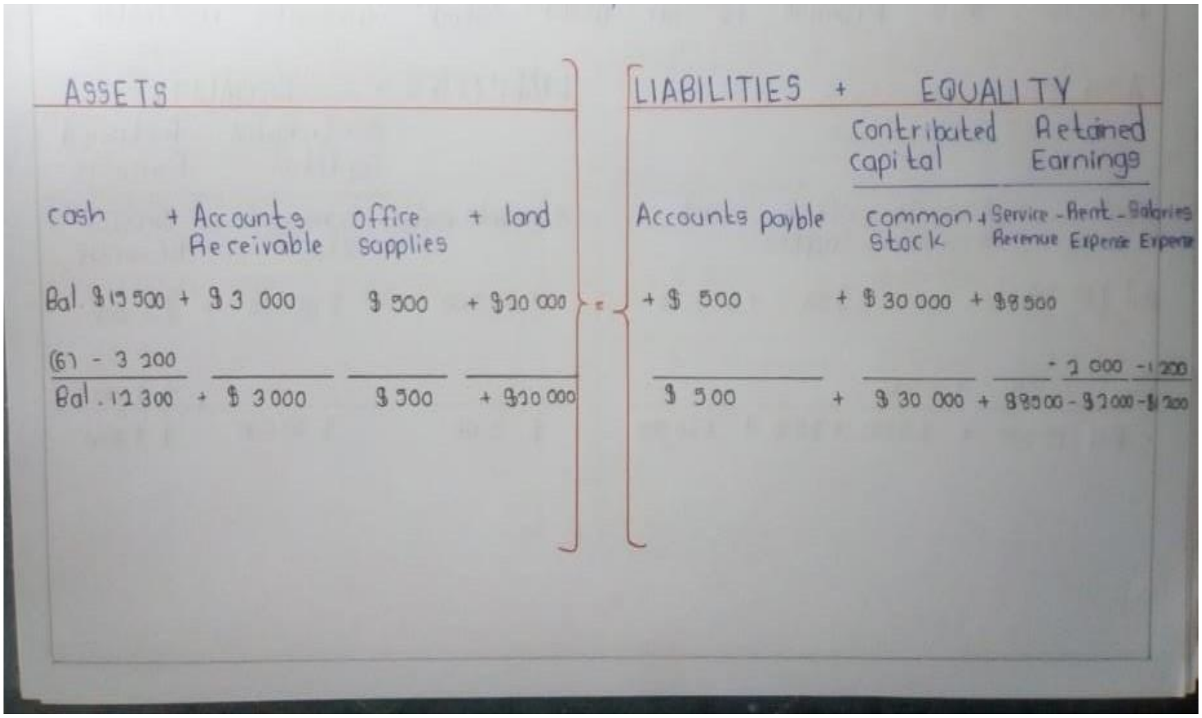
- Smart Touch Learning performs a service for clients who do not pay immediately. The clients Promise to pay $3,000 within one month. This promise is an asset called account receivable.



➢ Transaction 6 – Payment of Expenses with Cash

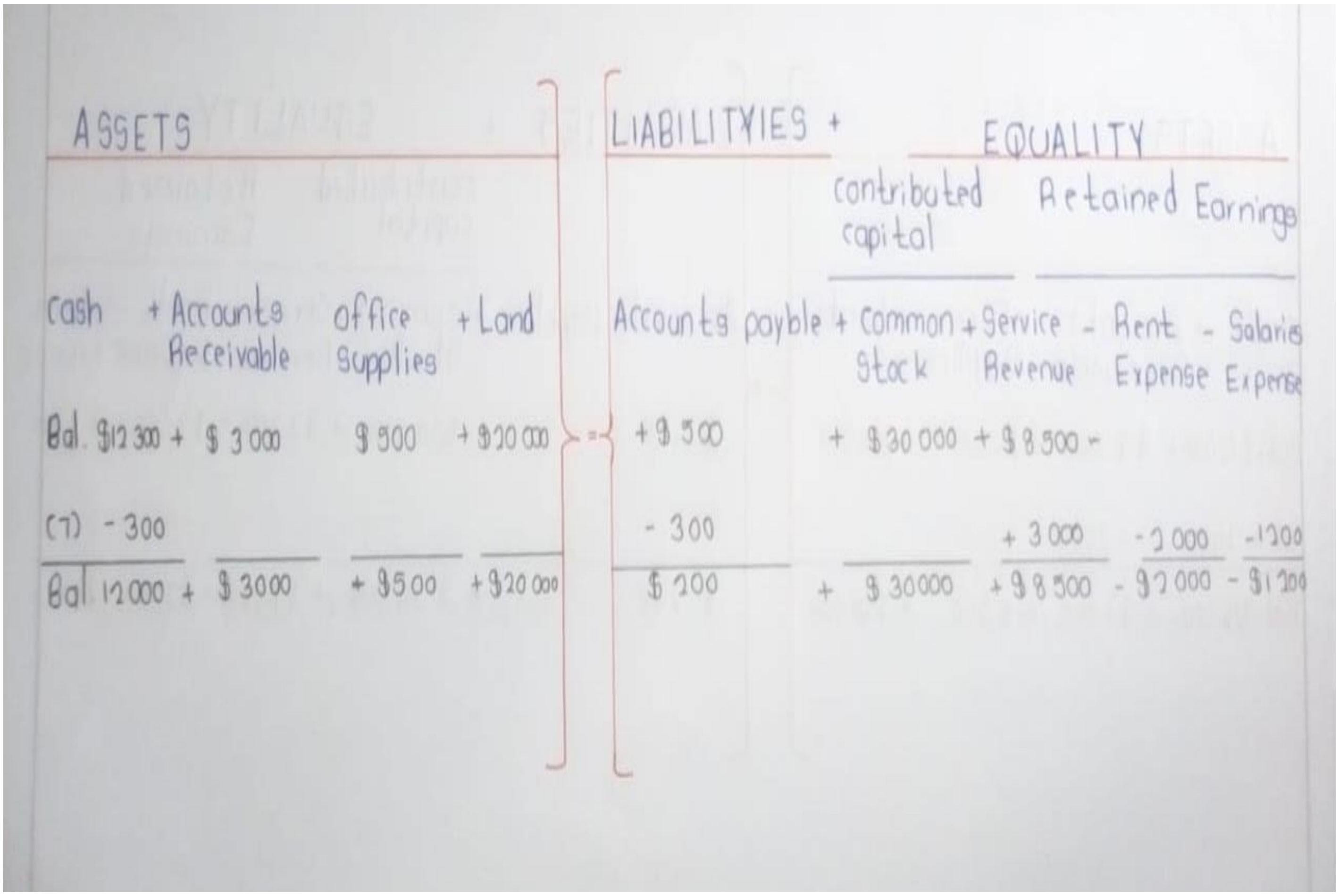
- Smart Touch Learning pays $3,200 in cash expenses:

$2,000 for office rent and $1,200 for employee salaries.



- Transaction 7 – payment on account (account payable)

Smart touch learning pays $ 300 to the store from witch it purchased office supplies in transaction 3



➢ Transaction 8 – collection on account (accounts receivable)

Smart touch learning now collects $ 2,000 from the client from transaction 5.

ASSETS = LIABILITIES + EQUALITY

ASSETS				LIABILITIES	EQUALITY: contributed capital	EQUALITY: Retained Earnings		
cash	+ Accounts Receivable	office supplies	+ Land	Accounts payble	+ Common Stock	+ Service Revenue	- Rent Expense	- Salaries Expense
Bal. $12000	+ $3 000	+ $500	+ $20 000	$200	+ $30 000	+ $8500	- $2000	- $1 200
(8) + 2000	- 2000							
Bal. $14 000	+ $1 000	+ $500	+ $20 000	$200	+ $30 000	+ $8500	- $2000	- $1 200

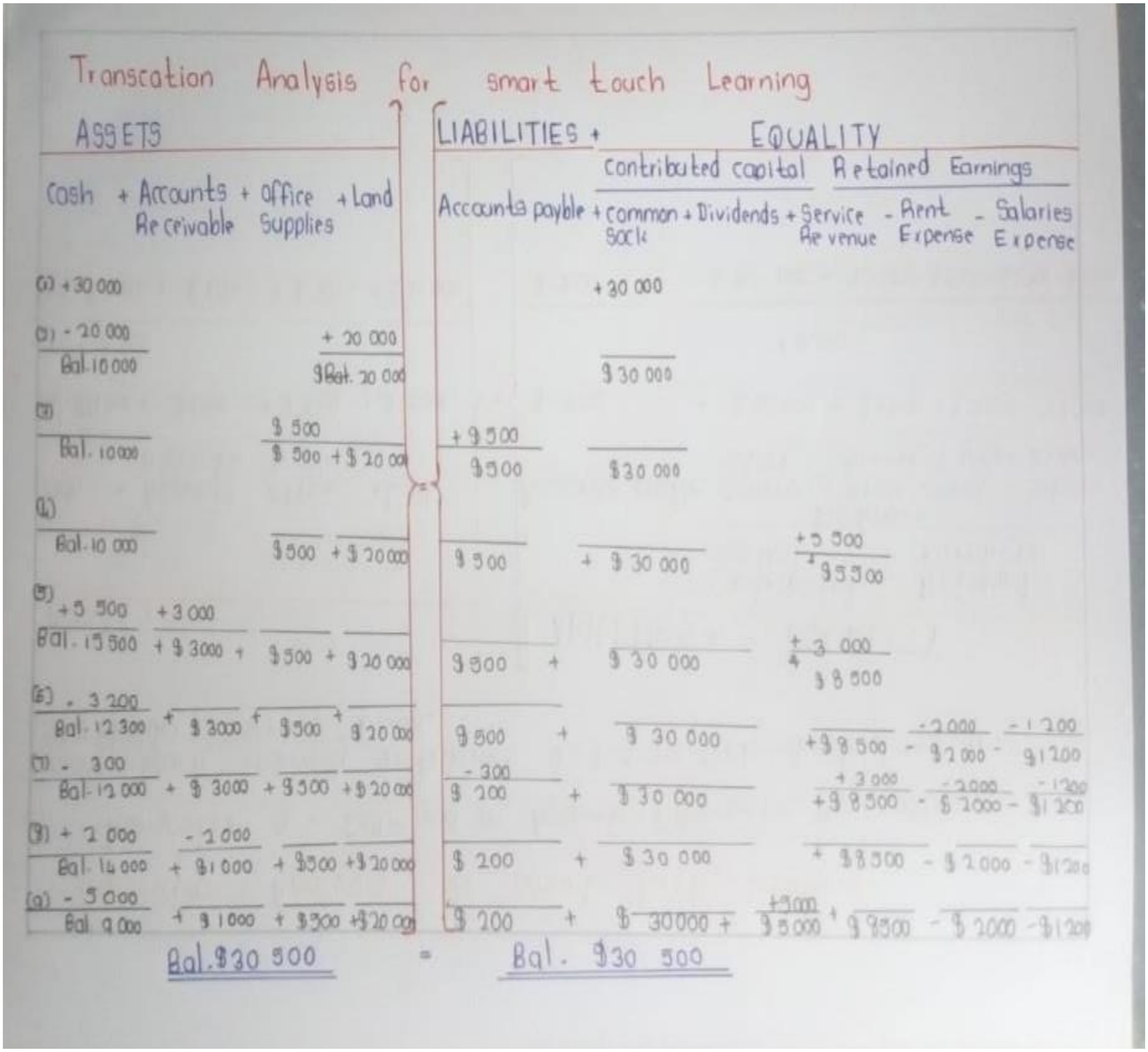
➢ Transaction 9 – Payment of Cash Dividend

- Smart Touch Learning distributes a $5,000 cash dividend to the stockholder, Sheena Bright.

	ASSETS					LIABILITIES +	EQUITY				
							Contributed Capital +	Retained Earnings			
	Cash	+ Accounts Receivable	+ Office Supplies	+ Land	=	Accounts Payable	+ Common Stock	– Dividends	+ Service Revenue	– Rent Expense	– Salaries Expense
Bal.	$14,000	+ $1,000	+ $500	+ $20,000		$200	+ $30,000		+ $8,500	– $2,000	– $1,200
(9)	-5,000							-5,000			
Bal.	$9,000	+ $1,000	+ $500	+ $20,000		$200	+ $30,000	– $5,000	+ $8,500	– $2,000	– $1,200

Exhibit 1-6 | Analysis of Transactions, Smart Touch Learning

1. Smart Touch Learning received $30,000 cash and issued common stock to Sheena Bright, stockholder.
2. Paid $20,000 cash for land.
3. Bought $500 of office supplies on account.
4. Received $5,500 cash from clients for service revenue earned.
5. Performed services for clients on account, $3,000.
6. Paid cash expenses: office rent, $2,000; employee salaries, $1,200.
7. Paid $300 on the accounts payable created in Transaction 3.
8. Collected $2,000 on the accounts receivable created in Transaction 5.
9. Paid cash dividends of $5,000 to stockholders, Sheena Bright.



Transcation Analysis for smart touch Learning

	ASSETS					LIABILITIES +	EQUALITY				
							Contributed capital		Retained Earnings		
	Cash	+ Accounts Recivable	+ office Supplies	+ Land		Accounts payble	+ common Sock	+ Dividends	+ Service Revenue	- Rent Expense	- Salaries Expense
(1)	+30 000						+30 000				
(2)	-20 000			+ 20 000							
	Bal.10 000			$Bal. 20 000			$30 000				
(3)			$ 500			+ $ 500					
	Bal. 10000		$ 500	+ $ 20 000		$500	$30 000				
(4)									+5 500		
	Bal. 10 000		$500	+ $ 20000		$ 500	+ $ 30 000		+ $5500		
(5)	+5 500	+3 000							+ 3 000		
	Bal. 15 500	+ $ 3000 +	$500 +	$ 20 000		$500 +	$ 30 000		+ $ 8 500		
(6)	- 3 200									-2 000	- 1 200
	Bal. 12 300	+ $ 3000	+ $500	+ $ 20 000		$ 500 +	$ 30 000		+ $ 8 500	- $ 2 000	- $1 200
(7)	- 300					- 300					
	Bal. 12 000	+ $ 3000	+ $ 500	+ $ 20 000		$ 200 +	$ 30 000		+ $ 8 500	- $ 2000	- $1 200
(8)	+ 2 000	- 2 000									
	Bal. 14 000	+ $1 000	+ $500	+ $ 20 000		$ 200 +	$ 30 000		+ $ 8 500	- $ 2000	- $1200
(9)	- 5 000							+5000			
	Bal 9 000	+ $ 1 000	+ $ 500	+ $ 20 000		$ 200 +	$ 30000 +	$ 5 000	$ 8500	- $ 2000	- $1200
	Bal. $30 500				=	Bal. $30 500					

Reading and Understanding Basic Financial Statements

Primary Financial Statement

Basic Financial Statements:

1. Balance Sheet
2. Income Statement
3. Statement of Retained Earning
4. Statement of Cash Flows

The Balance Sheet

- Summary of the financial position of a company at a particular date.
- Assets: cash, accounts receivable, inventory, land, buildings, equipment And intangible items.
- Liabilities: accounts payable, notes payable and mortgages payable. Owners' Equity: net assets after all obligations have been satisfied.

The Income Statement

Revenue

- Assets (Cash or AR) created through business operations.

Expenses

- Assets (Cash or AP) consumed through business operations.

Net Income or (net loss)

- Revenues – Expenses

Statement of Cash Flows

- Reports the amount of cash collected and paid out by a company in Operating, investing and financing activities for a period of time.
- How did the company receive cash?

- How did the company use its cash?
- Complementary to the income statement.
- Indicates ability of a company to generate income in the future.

Notes to the Financial Statements

- Notes are used to convey information required by GAAP or to provide further explanation.

What are the Fundamental Concepts and Assumptions?

- Separate Entity Concept
- Arm's-Length Transactions
- Cost Principle
- Monetary Measurement Concept
- Going Concern Assumption

The Cost Principle

- All transactions are recorded at historical cost.
- Historical cost is assumed to represent the fair market value of the item at the date of the transaction because it reflects the actual use of resources by independent parties.

Financial Statement

Content

- Common Size Financial Statements
  - Horizontal Analysis
    - Two years change
    - Base year
  - Vertical Analysis

❖ Ration Analysis for SMEs ❖
Interpretation

Horizontal Analysis

Example

The following slides illustrate a horizontal analysis of clover corporation's December
31. 2005 and 2004, Comparative balance sheets and Comparative income statements.

Clover Corporation Comparative Balance Sheets December 31				
			Increase (Decrease)	
	2005	2004	Amount	%
Assets				
Current Sheets;				
Cash	$ 12,000	$ 23,500	$ (11,500)	(48.9)
Accounts Recievable, Net	60,000	40,000	20,000	50.0
Inventory	80,000	100,000	(20,000)	(20.0)
Prepaid Expenses	3,000	1,200	1,800	150.0
Total Current Assets	155,000	164,700	(9,700)	(5.9)
Property and Equipment Net				
Land	40,000	40,000	-	0.0
Building and Equipment Net	120,000	85,000	35,000	41.2
Total Property and Equipment	160,000	125,000	35,000	28.0
Total Assets	315,000	289,000	25,300	8.7

Clover Corporation
Comparative Income Statements
For the years ended December 31

	2005	2004	Increase (Decrease) Amount	%
Sales	$ 520,000	$ 480,000	$ 40,000	803
Cost of goods sold	360,000	315,000	45,000	14.3
Gross Margin	160,000	165,000	(5,000)	(3.0)
Operating Expenses	128,600	126,000	2,600	2.1
Net operating income	31,400	39,5000	(8,100)	(19.5)
Interest Expense	6,400	7,000	(600)	(8.6)
Net income before taxes	25,000	32,000	(7,000)	(21.9)
Less income taxes (30%)	7,500	9,600	(2,100)	(21.9)
Net income	17,500	22,400	(4,900)	(21.9)

Sales increased by 8.3% yet net income decreased by 21.9% .

There were increase in both cost of goods sold (14.3%) and operating expenses (2.1%) .

These increased costs more than offset the increase in sales, yielding an overall decrease in net income

Trend percentage

Trend percentage state several years Financial data in terms of a Base year, which equals 100 percent.

Trend Analysis

$$\text{Trend Percentage} = \frac{\text{Current year amount}}{\text{Base year amount}} \times 100\%$$

Example

- Look at the income information for Berry Products for the years 2001 through 2005. We will do a trend analysis on these amounts to see what we can learn about the company.

Berry Products Income Information For the years Ended December 31					
Item	Year				
	2005	2004	2003	2002	2001
Sales	$ 400,000	$ 355,000	$ 320,000	$ 290,000	$ 275,000
Cost of goods sold	285,000	250,000	225,000	198,000	190,000
Gross margin	115,000	105,000	95,000	92,000	85,000

The Base year is 2001, and its amounts will equal 100%

Berry Products Income Information For the years Ended December 31					
Item	Year				
	2005	2004	2003	2002	2001
Sales	145%	129%	116%	105%	100%
Cost of goods sold	150%	132%	118%	104%	100%
Gross margin	135%	124%	111%	108%	100%

By Analyzing the trends for Berry Products, We can see that Cpst of goods sold is increasing faster than sales,

Which is slowing the increase in gross margin.

Common-Size Statements

- Vertical Analysis focuses on the relationship among financial statement items at a given point in time. A Common-Size financial statement is a vertical Analysis in which each financial statement item is expressed as a percentage.

- In Income statements, all items are usually expressed as a Percentage of sales.

Gross Margin Percentage

$$\text{Gross Margin Percentage} = \frac{\text{Gross Margin}}{\text{Sales}}$$

❖ This measure indicates how much of each sales doller is left after deducting the Cost of goods sold to cover expenses and provides a profit.

- ❖ In balance sheets, all items are usually expressed as a percentage of total Assets.

Example

- ➢ Let's take another look at the information from the Comparative income statements of Clover Corporation for 2005 and 2004.

  This time let’s prepare Common-Size statements.

Clover Corporation Comparative Income Statement For the year Ended December 31				
			Common-Size Percentages	
	2005	2004	2005	2004
Sales	520,000	480,000	100.0	100.0
Cost of goods sold	360,000	315,000	69.2	65.6
Gross Margin	160,000	165,000	30.8	34.4
Operating expenses	128,600	126,000	24.8	26.2
Net operating income	31,400	39,000	6.0	8.2
Interest expenses	6,400	7,000	1.2	1.5
Net income before taxes	25,000	32,000	4.8	6.7
Less income taxes (30%)	7,500	9,600	1.4	2.0
Net income	17,500	22,400	3.4	4.7