Accounting & Finance

We need to understand the meaning of the word w.r.t the literature which we are reading.

AICPA
American Institute of Certified Public accountants

AAA
American Accounting

1) Prepare your accounts & get it examined by a professional. (unbiased)
Chartered Accountants
Professionals who prepare the accounts or is an independent 'auditor (examining the accounts).

Accounting :-
Accounting is a art of recording, classifying and summarizing in a significant manner and in terms of money, transaction & events which are impart atleast of financial characters and interpreting the results thereof.

Steps of accounting :-

Book-Keeping { Recording, Classifying, Summarizing }
Interpreting

Preparation of Results must be done before Interpreting which is hidden.

Functions of an accountant → ① Preparation of results ② Interpretation of results

Subject matter is "Events with a financial character"
transaction

Recording requires a measurement ⇒ Measuring Stick (Money)
no other unit is required for measuring other than money ← (Money measurement concept)

Property of Money Measurement Concept :-

universally accepted.
consistent globally.

Why Recording?
facilitating functions for preparing & interpreting results.

Business :-

buying and selling of goods in order to make some profit. by the use of funds

① getting hold of the goods (by utilizing assets to manufacture goods)

Funds → Capital of the business
⇓
DEBT CAPITAL

② selling of goods for surplus of money.

Motives for holding cash :-

① to meet your expenses (transaction motive)
(i) As a precautionary measure, further money is required.
(2) Speculative motive
to take advantage of price change.

Liquidity :- ability to meet your respective obligations.

From the surplus generated by selling goods, we use it as a return for sacrificing liquidity by the investor.

Accuracy of results is more important to estimate surplus correctly.

Profit is a performance measure.
(performance evaluation
⇓
allow the entity to perform first
(Accounting Period)

After the accounting period, profit is calculated.

Performance does not only depend on the Profit but the capital invested

Profit = S.P. − C.P.

S.P. → One of the factor in the income category

C.P. → one of the factor in the expenditure category

In order to calculate profit/loss at the end of the year correctly, we need to record the transaction.
in a book of records
⇓
a journal
(journal entry ⟸ a transaction)
① heterogeneous (depends on the business)
② massive

∴ We can categorise datas w.r.t some unique characteristics

Classification → Categorizing

To categorize data, we need a separate book (other than journal) which is called Ledger. It consists of multiple pages.

Ledger Account Balancing

Summarizing → Reduction in size (still a representation of the account)

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AAA definition of Accounting :-

Accounting is the process of identifying, measuring and communicating economic information to permit informed judgements and decisions by the users of information.

Accounting activities ← 1) identifying
2) measuring
3) communicating

The subject matter is "Economic information"

→ what to communicate ? (economic information)
→ whom to communicate ? (to users of accounting information)
→ why should we communicate ? (I want this, u send me this)
(it helps in making the decision (facilitate the decision making process))

USERS :- ① Investors (interested in the business as they have a stake in the business)
→ Equity
→ Debt

Value of risk

stakeholder

② Govt. (tax collection)
③ Society (CSR ← Corporate Social Responsibility (directed towards upliftment of weaker section of society))
④ Customers
⑤ Suppliers (supply goods in credit (interested to get their due money))
⑥ Management of the Business
⑦ Owners of the business
⑧ Employees (they want their pay)

* Different categories of stakeholders do not require the same type of information

Suppose a company produces products A to Z in 3 shifts per day. Information required by CEO and ~~customer~~ supervisor are different.

CEO ← if we submit the files containing information about all shifts, all products, we may get fired. So, he requires small report on a large area.

Supervisor ← he requires information about 1st shift of product A. So, he requires large report on a small area.

INFORMATION :-

\# It is processed data which adds to the knowledge of the the recipient.

Valuable information :-

\# In financial ~~behavior~~ world, the apparent erratic behaviour is seen in the stock market.

↳ Entropy in Finance
(randomness in movement of molecule)

Almost certain event (Man is mortal, Sun rises in the east)

$$\text{Value of information} \propto \frac{1}{\left(\text{Probability of occurence of the event being reported}\right)}$$

Relevant information :-

\# At certain point of time, only those information is relevant which shoots up our objective.

Ex:- Suppose being a day scholar we are commuting to our home and we are hungry while travelling in the bus, one of our friend calls up and says you should come to Park street where Oxford Books is giving 70% discount on all books, since our stomach will not get filled by books, this is not a relevant information.

Measurement:-

The goal is to quantify something. (usually by comparing against standardised units)

Ex:- In case of Debate competition in our school days, Suppose we were graded 9 out of 10 as a measurement of our performance. So, there is no standard units here.

Communication:-

sharing of thoughts b/w parties

Exchange is a two way traffic.

Components of a communication system:-

Transmitter:- transmits signals.

Receiver:- receives the signal and decode it.

Channel:- medium to transmit signals.

Information delayed is information denied.

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Structure of the business got changed after development of science and technology (new products and services)

Financial accounting failed to cater the need.

↳ (discusses business as a point of view of financial matters)

But, It is still used alongside Cost Accounting, Management Accounting (improved version)

Strategies to employ for profit making products should be different for loss making products. (this is not taken care by Financial Accounting)

When we produce a no. of products, we need some inputs. Some of the inputs that need to procured varies with different products. Similarly, there may be input that is required by ~~making~~ multiple products.

∴ Division of costs, on the basis of the benefits used.
total costs to run the company premises.

If the benefit consumed by the input is wholly used by a product, we will charge the lumpsum amount of money for the benefits used ⇐ COST ALLOCATION (Direct Cost)

If the benefit consumed by the input is partially used by each of multiple products, costs will be divided based on the benefits used ⇐ COST APPORTIONMENT (Indirect Cost or Overhead)

RESOURCE

Scarce

Ubiquitous (present everywhere)
Ex:- Sunlight

COST:-
Quantity of Scarce resource to be sacrificed in order to achieve a specific objective.

COSTING:-
Process of determining cost

COST UNIT :-

Unit against which cost is measured and calculated.
Suppose, we have been told the cost of manufacturing refrigerator is ₹10,500. Then, it does not make sense here, as the quantity is not mentioned.

SERVICE INDUSTRY ← the selection of cost unit becomes most difficult

We are taking a benefit of transport industry everyday.
Suppose consider the goods transport industry.

PROBLEM
In case of goods transport, we can express cost unit in terms of weight that can be carried or in terms of distance goods have been carried.

i.e Cost of transporting 1 tonne for 1 km = Cost of transporting 1kg for 1km
(which is illogical)

SOLUTION

∴ We must combine both terms ⇒ Cost /(tonne * km)
(COMPOSITE UNIT)

• CENTRALISED ORGANISATION :-

DECENTRALISED ORGANISATION :-

COST CENTRE :-

Cost centre ← Limited Autonomy
(not accountable for all the profits)

Profit centre (accountable for the profits)

When aiming at cost reduction, we must understand different class of costs.

Cost according to elements (Inputs) :-
Production function :- $O/P = f(I/P)$

Ex:- Printing & Publishing :-
If we study the inputs, some of them will be physical.
(MATERIAL INPUT)
⇓ cost incurred
MATERIAL COST

Physical exertion by human being (wages to operators) ⇐ LABOR COST

Electricity Bill, Rent, Royalty to the author ⇐ EXPENSES

DIRECT COST

if the cost incurred is only benefitting a particular subset of products (one-to-one mapping)
charged lumpsum

OVERHEAD

cost incurred is not only benefitting an exclusive subset of products
costs will be divided based on the benefits

* Management of overhead / indirect cost is more complex.
Complexity depends on :-
1) More and more items in overhead category.
2)

Cost according to Behaviour :-

Fixed cost
we can change the quantity of the input, but there are scenarios where it takes time.

Variable cost

Semi-Variable / Semi-Fixed cost
we segregate them into fixed and variable portions

Cost, in general behaviour is variable.
It depends on → a) the price
b) quantity of the product
Suppose, we went to a chocolate shop and bought a Cadbury Silk chocolate for ₹100. We went with ₹500, so we bought back ₹400 with us. Say, next day we did the same, but we bought back ₹100 with us
This can happen because a) price changes
b) increased the quantity of the product.

* Example of Fixed cost :–
Unskilled labour
Short Run :– period until which the cost of inputs are fixed.
Long Run :– Period after short run.

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COST COMPUTATION METHOD :–
Due to limitation of financial accounting, cost accounting came into the picture.
Product wise profit must be calculated in case of multiproducts producing companies.
Strategies to be taken for profit making products should be different from loss making products.
And, in financial accounting, product wise profit can't be calculated. So, it fails here.

If we have only one method for computing cost, it can only calculate for some type of industries. So, we must have ~~different~~ multiple methods for computing costs. (Industries differ from each other because of unique

Characteristics that can influence cost).

How to decide what should be the method of cost computation?
depends on the types of industries.
Type of Industries :-
1. ~~MSME industries~~ Large Scale Industry.
2. Medium Scale Industry.
3. Small Scale Industry.

} does not require any attention for diff. methods of cost computations (only the raw materials are increased)

Type of Industries :-
1. Service Industry
2. Manufacturing Industry

In Service Sector, we have a problem of choice of cost unit. But in manufacturing sector, there is no such problem.

Operation Costing
Ex:- Transportation, Hotel, Hospital
(wages paid to driver, helper) (Salary paid to chef) (Salary paid to nurse).

Standardised goods	Non-standardised goods
# Same items, same cost	# manufacturing products depends on specification provided by the customer
Ex:- Ready made garments.	Ex:- Tailor made garments.
UNIT COSTING (IN SYLLABUS)	
# Total cost will be divided by the number of units.	# Products will be different
# Applying concept of averaging ⇐ Calculation becomes simple.	# The different costs for computing total costs are ~~not~~ addible but no. of units are not addible.

Standardised goods

We can have multiple processing stages.

Suppose we are providing raw material, we are getting five different types of products.

↳ PROCESS COSTING (NOT IN SYLLABUS)

Non Standardised goods

JOB COSTING

observe each item and compute cost item-to-item basis.

for each job, a job no. is assigned and a separate cost sheet is maintained.

CONTRACT COSTING :-

It takes a long period of time to complete one single order, that case it becomes difficult.

Ex:- Construction Industry (Bridge)

~~D~~Depending upon % of work completed, the parties are paid.

↳ In case of disputes, intervention by third party certification (architect or civil engineer) can be done.

↳ Also, some amount of money can be kept back so the contractor is not able to leave the project (RETENTION COST)

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Process Costing / Contract Costing are more complicated than the others.

Scanned with CamScanner

Ex:-

Cost Sheet

For the period ended... (month/week/year)

Particulars	Amount (Rs) (for adjustments)	Amount (Rs) (for final figure)
Direct Material		
Direct Wages		
Factory overheads		

Sales = Total Cost ~~Price~~ ± P(L)

Total Cost = Direct Cost + Indirect Cost
= Direct Cost + Overheads

Direct Cost = Direct Material + Direct Wages + Direct Expenses = Prime Cost

Overheads = Factory overheads + Administrative overheads + Selling & Distribution overheads.

Prime Cost + Factory Overheads = Worst Cost or Factory cost.

Worst Cost + Administrative overheads = Cost of Production

Cost of Production + Selling & Distribution overheads = Cost of Sales.

Cost of Sales + Profit = Sales (figure)

* We are following the idea of value addition.

Assumptions:—

* There is no leftover item at the end of the period. (But in real scenario, we always purchase more raw material than we require).
* Unless we don't have stock left and we are not getting it from the market, there will be a stock out situation.

~~CLOSING STOCK~~

On the basis of % of completion, stocks can be classified as:—

1) Raw material
2) Work in Progress
3) Finished goods.

On the basis of time, stocks can be classified as:—

1) Opening Stocks → during beginning of period
2) Closing Stocks → during end of period.

	Opening Stock	Closing Stock
Raw material	(+)	(−)
Work in Progress	(+)	(−)
Finished goods	(+)	(−)
	Overstatement of profit, so we need to add it ~~from to prime cost.~~	Understatement of Profit, so we have to subtract it ~~from prime cost~~

Opening Stock of Raw Material
\+ Purchase of Raw Material
− Closing Stock of Raw Material

Direct Material Consumed

(Work in Progress should not have left the factory premises)

Worst Cost or Factory Cost
\+ Opening Stock of Work in Progress
\- Closing Stock of Work in Progress
Adjusted Factory Cost / Adjusted Worst Cost.

(Finished goods must have left the factory premises, but can be yet to be sold)

Cost of Production
\+ Opening Stock of Finished goods
\- Closing Stock of Finished goods
Cost of Goods Sold