Module 1 - INTRODUCTION TO COST, FINANCIAL AND MANAGEMENT ACCOUNTING

LEARNING OBJECTIVES

- To understand the meaning and Process of Accounting
- To Ascertain the users of Accounting Information
- To know the meaning of Financial Cost and Management Accounting
- To analyze the benefits of Financial Cost and Management Accounting

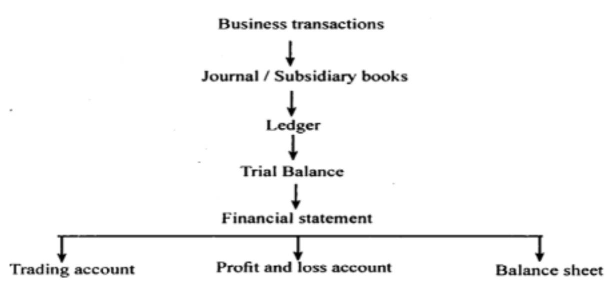
INTRODUCTION TO ACCOUNTING

In an organization, numerous transactions take place. It is not possible for the Businessman to memorize and recollect what are all the transactions took place in his day to day business activities. At the same time, it is essential for him and the Users of Financial Statements in knowing what the business owns and owes, how much profit the business has earned and the financial position of the business. To remove this hindrance, Accounting was developed. Accounting helps in knowing the true financial position of the business.

MEANING OF ACCOUNTING

Accounting is the process of recording, classifying, summarizing, analyzing and interpreting the business transactions which can be measured in terms of money. It is a permanent record of business transactions and provides valid financial information to owners, banks, customers, government and other outside parties to make correct decisions.

PROCESS OF ACCOUNTING



USERS OF ACCOUNTING INFORMATION

Accounting Information is used by different groups both inside and outside the organization to make certain decision.

Internal Users of Accounting Information

An internal user means people who are inside the organization and part of the business. The internal users of accounting information are:

- **Owners:** The sole trader or partners or shareholders who have contributed Capital to the organization and are interested to perform in its performance and progress are called owners. They use Accounting information for observing their capital invested and evaluating its upward or downward move, to know the revenues and expenses, profit or loss, return on investment, net worth and external liabilities and to keep an eye on the overall wellbeing of the business.
- **Management:** Management is done by Sole traders or partners of the business and incase of bigger companies, it is done by paid professionals. Management of a business involves making day to day decisions based on the situations and also policy decisions whenever needed. They use Accounting information to take investment decisions, budgeting and forecasting to take financial decisions and to compliance with all regulatory, statutory and external body.
- **Employees:** Employees are people working in the organization. They use Accounting information to know the profitability and financial health of the business because it in turn affects their remuneration, bonus, incentives, job security and working conditions. Their standard of living depends on the success or failure of the business.

External Users of Accounting Information

The external users are people outside the organization. They use Accounting information for various purposes. The external users of accounting information are:

1. **Investors:** They are interested to invest their surplus funds in the organization. They would like to know the financial condition of the Business for taking investment decisions whether to invest or not. They concentrate more on future earnings and risk.
2. **Creditors:** Suppliers of Goods and Services for credit are called Creditors. They use Accounting information to know the credit worthiness of the business for repaying their credit.
3. **Lenders:** Banks and Financial institutions fall under this category. They use Accounting information to know the liquidity position and repaying capacity of the business for repaying their loans.
4. **Tax Authorities:** Theyuse Accounting information for computation of Income Tax to be collected from the business.
5. **Researchers:** They use the published Financial Statements to evaluate the performance of the business for a specific objective.
6. **Public:** They like to know the financial health of the business to get an idea about the business.

Modern Accounting can be classified into three categories

1. **Financial Accounting**
2. **Cost Accounting**
3. **Management Accounting**

FINANCIAL ACCOUNTING

Financial accounting is mainly concerned with the recording of all financial transactions and is aimed towards preparation of necessary financial statements such as profit and loss account and Balance sheet in order to appraise the value of a business.

Definition of Financial Accounting

According to American Institute of Certified Public Accountants (AICPA) Accounting is "The art of recording , classifying and summarizing in a significant manner and in terms of money transactions and events which are in part at least of a financial character and interpreting the results thereof"

Objectives of Financial Accounting

The main objectives of Financial Accounting are:

1. Recording the transactions occurring in the business.
2. Preparation of necessary accounts and Balance Sheet as per the requirements of the law.
3. Ascertaining Profit or Loss and Financial position of the Business.

4. Providing Accounting information to the owner of the business and other interested parties.

Benefits of Financial Accounting

The benefits of Financial Accounting are as follows:

- A business man cannot remember all the transactions made in his business. Financial Accounting takes in charge of the task maintaining all the records of transactions made replacing human memory.
- Properly maintained Accounts can be treated as authentic evidence in the courts of law in the settlement of disputes.
- It is easy for the Business man to settle his tax liability if the accounts are properly maintained or he has to pay any amount of tax imposed by tax authorities.
- It helps to compare the various aspects of business such as financial position, profitand expenses, sales etc. with that of previous years and with the same type of competing firms in the market.
- If accounts are properly maintained, proper purchase price of the business can be determined in case the business man wishes to sell his business.
- Preparation of Financial Accounts helps to provide information to various parties such as owners, creditors, employees, investors, bank, financial institutions etc.

COST ACCOUNTING

The primary function of Cost Accounting is to ascertain the cost of the product and to help in controlling the cost. It relates to collection, classification, recording, allocation and summarization of cost and helps the management in controlling the cost.

Definition of Cost Accounting

I.C.M.A has defined Cost Accounting as “The process of accounting for cost from the point at which expenditure is incurred or committed to the establishment of its ultimate relationship with cost centres and cost units. In its widest usage it embraces the preparation of statistical data, the application of cost control methods and the ascertainment of the profitability of activities carried out or planned.

Objectives of Cost Accounting

The main objectives of Cost Accounting are:

1. Ascertaining and analyzing the cost and income by product, function and responsibility.
2. Accumulating and utilizing the cost data to effectively manage the expenses, to have a control over the cost incurred.
3. Helping Management in Decision Making.

Benefits of Cost Accounting

The benefits of Cost Accounting are as follows:

- It is useful for fixation of prices. It enables the business man to find out the accurate cost per unit of output and the expenses contributing to the corresponding cost.
- It has the ability to manage the cost efficiently and control the cost without reducing the level of production.
- Cost control can be done through Cost comparison from the same units or factory or other factories in the industry.
- It provides valuable data that enables the management to decide to which extent prices can be reduced to prevent or minimize loss in case of depression.
- It helps in preparation of budgets so that productions can happen in a planned and systematic manner. It gives an idea priory and helps to know how much cost will incur in the overall business process, cost of each department, operating costs and production costs.
- It can help in better decision making in the formation of strategies, level of production to be carried out, to allocate finances etc.
- It helps to know the accurate and true measurement of cost and expenses.

- It helps in preventing manipulation, misappropriation and frauds in the process of production.

MANAGEMENT ACCOUNTING

The term Management accounting is concerned with description of accounting methods, systems and techniques with a special knowledge and ability to help the management in the objective of maximizing profit or minimizing loss.

Definition of Management Accounting

"Management Accounting is the term used to describe accounting methods, systems and techniques which coupled with special knowledge and ability, assists management in its task of maximizing profits or minimizing losses. Management Accounting is the blending together into a coherent whole, financial accounting, cost accountancy and all aspects of financial management." - Batty

Objectives of Management Accounting

The main objectives of Management Accounting are:

i. Presenting Accounting information in a form that enables the Management to analyze the Financial Statements and make decisions.
ii. Helps in Planning and Policy formulation in the business.
iii. Helps in organizing and controlling the performance of the organization.
iv. Keeping the Management fully informed about the latest positions of the organization.

Benefits of Management Accounting

The benefits of Management Accounting are as follows:

- It helps in decision making in the areas of pricing, make or buy, acceptance of additional orders, selection of suitable product mix etc.
- It helps in planning activities like profit planning, preparation of budgets, capital investment and financing.
- It helps to define the goals of every department clearly and coordinate as well.
- It helps to evaluate and control the performance of the organization through accounting ratios and Variance analysis and thus the efficiency of the departments can be measured.
- It assists the Management in location of weak spots and in taking corrective actions.
- It presents financial information in simple and purposeful manner and that supports quick decision making

DIFFERENCES BETWEEN FINANCIAL ACCOUNTING AND COST ACCOUNTING

Basis of Distinction	Financial Accounting	Cost Accounting
Purpose	It provides information regarding profitability and financial position of the business.	It guides the Management for proper planning, operation, coordination, control and decision making.
Recording	Records are kept in a subjective manner i.e. according to the nature of the expenditure.	Records are kept in an objective manner i.e. according to the purpose for which costs are incurred.
Items of costs	Items of costs are expressed in totals.	Items of costs are calculated in cost per unit.
Analysis of Profit	It reveals the profits of the whole business.	It reveals the result of each operation, process, job or product.
Control	It concentrates only on recording and does not give importance to control aspect.	It provides a detailed system of cost control with the help of standards and budgets.
Periodicity	Accounts are prepared at the end of the Accounting year.	It is a continuous system of Accounting and the reports can be submitted to the Management as and when they need it.
Nature	It records all commercial transactions and transactions with third parties.	It is concerned with internal transactions relating to manufacturing activities.
Inventory Valuation	Inventory is valued at cost or market price whichever less is.	Inventory is valued at cost price.
Figures	Figures mainly deal with actual figures.	It deals partly with actual figures and partly with estimates.

DIFFERENCES BETWEEN COST ACCOUNTING AND MANAGEMENT ACCOUNTING

Basis of Distinction	Cost Accounting	Management Accounting
Nature	It deals with ascertaining, allocating, apportioning and accounting aspect of costs.	It deals with the effect and impact of costs on the business.
Information type	It is Quantitative.	It is both Quantitative and Qualitative.
Objective	To ascertain the cost of Production.	To provide information to managers to take decisions.
Base	It acts as a base for Management Accounting.	It is derived from both Cost Accounting and Financial Accounting.
Role	It is helpful in collecting costing data for Management.	It plays a role in Decision making.
Tools and techniques	It has standard costing, variable costing, break even analysis etc. as the basic tools and techniques.	It has funds and cash flow statements, ratio analysis etc. along with Cost Accounting tools and techniques.
Scope	It does not include Financial Accounting, Tax Planning and Tax Accounting.	It includes Financial and Cost Accounting, Tax Planning and Tax Accounting.
Interdependency	It can be installed without Management Accounting	It cannot be installed without Cost Accounting.

LEARNING OUTCOMES

- Determination of various types of Accounting
- Meaning and definition of Financial Cost and Management Accounting
- Objectives of Financial Cost and Management Accounting
- Differences between Financial and Cost, Cost and Management, Financial and Management accounting