

# Accounting and Finance for Managers

By: Ankita Aggarwal

This reference book can be useful for  
BBA, MBA, B.Com, BMS, M.Com, BCA, MCA  
and many more courses for Various Universities



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# Sample Preview of The Chapter

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# ACCOUNTING AND FINANCE FOR MANAGERS

## ACCOUNTING FRAMEWORK



## Accounting and its Functions

### INTRODUCTION

Accounting has been defined in different ways by different authors and authorities. There is no unanimity among them because the concept of accounting has to be changed with the passage of time. On the basis of functions, accounting may be defined as the art of recording, classifying and summarising business transactions of a financial character and interpreting and communicating the results to the users to enable them to make decisions. Accounting is concerned with the recording of transactions which are measurable in

monetary terms in such a way that analysis and interpretation of business activities are possible. According to the latter definition of accounting is concerned with the recording of business transactions for better management of the concern and also reporting the true financial position of the concern.

The American Accounting Association (AAA) defines accounting as “*the process of identifying, measuring and communicating economic information to permit informed judgments and decisions by users of information*”.

### CHAPTER AT A GLANCE

### SCOPE OF ACCOUNTING

The scope of accounting can be explained in diagrammatic form:

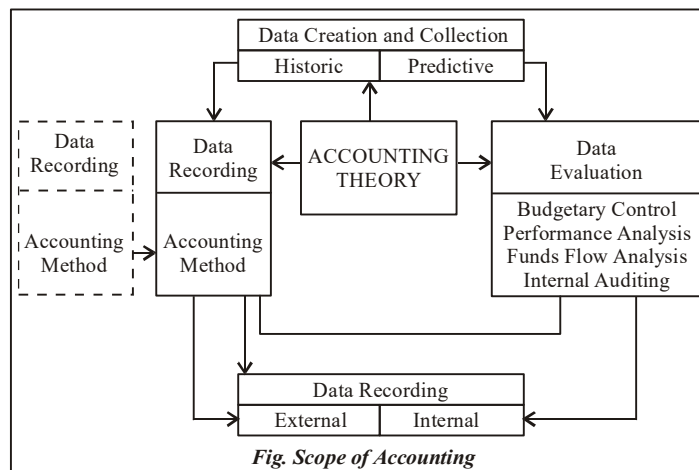


Fig. Scope of Accounting

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**Data creation and collection**

This area deals with providing the raw material for the accounting. The historic data collected refers to events which have already taken place. In early times, accounting was concerned with what had happened, rather than making attempt to predict the future and prepare for it. After collecting the historic data, it is recorded in accordance with generally accepted accounting theory. According to the classification scheme, a large number for transactions are added in the books of journals and ledgers. The substantial part of the total accounting work is the recording and processing of information. The processing method of recording can be manual, mechanical or electronic.

**Data evaluation**

The most important activity in accounting includes controlling the activities of business with the help of budgets and standard cost, evaluating the performance of business, analysing the flow of funds and analysing the accounting information for decision making purpose by choosing among alternative courses of action.

**The analytical interpretive work of accounting**

It can be used internally or externally and may range from sharp answers to elaborate reports produced by extensive research. Research based projects include capital project analysis, financial forecasts, budgetary projections and analysis for re-organisation, takeover and mergers.

**Data reporting**

Data reports are of two types, external and internal. External reporting means communication of financial information about the business to external parties like shareholders, government agencies and regulatory bodies of government. Internal reporting goes on with the communication of results of financial analysis and evaluation to management for decision-making purposes.

**EMERGING ROLE OF ACCOUNTING**

The history of accounting development reflects its changing business and social needs. It indicates the evolutionary pattern which reflects changing socio-economic conditions. At present there are four phases of evolution of accounting.

**(i) Stewardship Accounting:** In the earlier times, people who were wealthy employed stewards to manage their property. The stewards were accountable to their owners periodically. This notion lies at the base of financial reporting even today. It involves the orderly

recording of business transactions, commonly known as book keeping. The practices employed by the 15<sup>th</sup> century merchants of Italy are the origin of today's accounting concepts and principles. During the 19<sup>th</sup> century, European countries adopted the Italian method which specifically began to be known as 'double entry book keeping'. Stewardship accounting is linked with the need of business owners to keep records of their transactions, the property, the tools they owned, debts they owed and the debts other owed them.

**(ii) Financial Accounting:** Financial accounting involves preparation of financial reports, which provide summaries of a firm's financial condition. The main task of financial accounting is to prepare balance sheet and income statement, etc.

**(iii) Cost Accounting:** The main purpose of cost accounting is to ascertain the cost of production of goods and cost of running different departments to enable the management to fix the selling price.

**(iv) Management Accounting:** The main purpose of management accounting is to provide all the relevant informations that may be required by the management to take decisions in respect of various aspect for running the business enterprise. It is the tool in the hands of management for the purpose of making policy-decisions.

**(v) Social Responsibility Accounting:** Social responsibility accounting is a new phase in the development of accounting. The reason behind its birth is the increasing social awareness which has been particularly noticeable over the last two decades or so. It considers the social effects of the business along with the economic effects which widen its scope. The social scientists, statesmen and social workers works to draw the attention of their governments and people in their countries to the dangers posed to environment and the ecology by the unbridled industrial growth. These days, the management is responsible for contribution of business to social well being and progress and not just responsible for efficient conduct of business in terms of profitability.

**Some Recent Developments**

**Human resource accounting**

The first attempt to include figures on human capital in the balance sheet was made by Hermansson in 1964, it was later known as human resource capital. In 1990s, there has been a socio-economic shift with the emergence of the knowledge economy, a distinctive shift towards recognition of human and intellectual capital contrast to physical capital.

Human resource accounting is a branch of accounting which includes reporting and emphasising the importance of human resources like knowledge, loyalty and commitment of employees. It is the process of identifying, measuring and communicating the data related to human resources to interested parties. It involves accounting for investment in people and their replacement costs as well as accounting for the economic values of people to an organization. Generally the method used for valuing and accounting for human resources are either based on costs or on economic value of human resources. However providing adequate and valid information on human assets which are outside the concept of ownership, in figures is very difficult. Nevertheless, HRA is a managerial tool providing valuable information to the top management to take decisions regarding adequacy of human resources and thus encouraging managers to consider investment in manpower in more positive way.

#### **Inflation Accounting**

Inflation accounting refers to the adjustment in the value of assets (current and fixed) and of profit in the light of changes in the price level. It is concerned with overcoming of limitations in the financial statements on accounts of the cost assumption and the assumption of stable monetary unit. Hence, it is directed at correcting the distortions in the reported results caused by price level changes. Rise in the price during inflation generally have the distortion influence of overstating the profit. Various approaches have been suggested to deal with this problem in inflation accounting.

#### **ACCOUNTING AS AN INFORMATION SYSTEM**

Accounting includes series of activities which are linked with each other i.e. collecting, recording, analysing and evaluating the data and in the last communicating information to the users. Information has no meaning unless it is linked with a certain purpose.

Accounting as a social science can be seen as an information system as it has all the features of the system. It has its input (raw data), processes (men and equipment), and outputs (reports and information). Considering accounting as an information system, we are in a position to make some important observations. First, providing information which meets the needs of the users is the aim of the system. If we can identify the needs of the users, we can specify the nature and the character of the outputs of the system. Secondly, the output requirements determine the type of data to be

selected as the inputs for processing into information output.

Several groups of people having stake in a business organisation managers, shareholders, creditors, employees, customers etc. are there. Such stake holders need following type of information:

#### **Shareholders and investors**

Shareholders invest their money in the business and so they are bothered about the profitability of the enterprise, the soundness of their investment and growth prospects of the enterprise.

#### **Creditors**

There can be short-term creditors who provide raw materials, goods and services and long-term creditors who lent money for long period. Creditors are concerned about the credit worthiness of the enterprise and its ability to meet the credit obligation.

#### **Employees**

Employees have a stake in the outcomes of the several managerial decisions. They are interested in matters related to wages, bonus, and profit sharing on adequate disclosure of relevant facts.

#### **Government**

Government is responsible to direct the operation of the economic system in a way that it subserves the common good in the mixed economy. Various government agencies collect information regarding levels of outputs, profits investments, costs and taxes etc. All this information helps in evolving policies for managing the economy.

#### **Management**

Management process of all the organizations are almost same, no matter it is a profit organisation or non-profit organisation. Management process involves planning, organising, controlling etc. Management has to perform all these functions efficiently and effectively which has considerably extended the demand for accounting information.

#### **Consumers and others**

Other people who are interested in condensed accounting information are consumer organisations, media, welfare organisation.

The community at the large has economic and social interest in the activities of such organisations. This interest is expressed at the national level by the concern of government in various aspects of the firms' activities.

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**ROLE AND ACTIVITIES OF AN ACCOUNTANT**

Below are some statements which describe who an accountant is:

- An accountant is responsible for account keeping.
- An accountant is a functionary who aids control.
- An accountant holds the conscience of an organisation.
- An accountant is a professional whose primary duties are related to information management for internal and external use.
- An accountant is a fiscal advisor.
- An accountant produces an income statement and a balance sheet for an accounting period and maintains all supporting evidence and classified facts that lead to final accounting statements.
- An accountant verifies, authenticates and certifies accounts of an entity.

**ACCOUNTING PERSONNEL**

An accountant is a professional who is responsible for the processing of financial data, score keeping, attention directing and problem solving purposes. He has a persuasive role which involves a wide range of activities. There are two broad activities in which accountants are divided, those who are in public practice and those who are in private employment.

**(a) Accountant:** Accountants may be in various business or non-business organisations to perform a variety of accounting and management control activities. Public accountants are generally member of professional bodies like the Institute of Chartered Accountants of India or the Institute of Cost and Works Accountants of India. Accountant also provides consultancy services for improving accounting and management control system in every organisation.

**(b) Chief Accountant or Controller:** The other name for the controller is the Chief Accountant. He is

usually the head of the whole area of accounting, including internal audit. He is overall in-charge of all activities like financial accounting, cost accounting, management accounting, tax accounting etc. He exercises both for accounting within the organisation and for external reporting. The external reports comprise reports to government revenue collecting and regulatory bodies, such as Company Law Board and Income tax Department. He may also be responsible for the supervision of the company's internal audit and control systems. He process historical data and is expected to supply a good deal of accounting information to top management concerning future operations, in line with the management's planning and control needs. Also, he is expected to supply detailed information to managers in different functional areas like production, marketing etc. and at different levels of an organization.

We can state the functions of the controller as follows:

- Designing and operating the accounting system
- Preparing financial statements and reports
- Establishing and maintaining systems and procedures
- Supervising internal auditing and arranging for external audit
- Supervising computer applications
- Overseeing cost control

**(c) Treasurer:** He is the manager and the custodian of all the cash and near cash resources of the firm. The treasurer handles credit reviews and sets policy for collecting receivable. Also, he is responsible for handling the relationships with bank and other lending or financial institutions.

The Financial Executive Institute (of United States of America) makes the following distinction between controllership and treasurership functions:

Controllership	Treasurership
Planning and control	Provision of capital
Reporting and Interpreting	Investor Relations
Evaluating and Consulting	Short term Financing
Tax administration	Banking and Custody
Government Reporting	Credit and Collections
Protection of Assets	Investments
Economic Appraisal	Insurance