



FINANCE AND ACCOUNTING

CHAPTER 3



FINANCE AND ACCOUNTING

- Any organization can not be successful unless its finances are soundly managed.
- In this chapter, those aspects of finance and accounting with which the newly graduated software engineer is most likely to come into contact are emphasized.

CONTENTS

- The need for capital
- Sources of funds
- Budgeting and monitoring
- Sales and order intake
- Costing
- Annual statements
- Auditing

THE NEED FOR CAPITAL

- It is not uncommon for recent graduates in computing to start their own company that provide software services.
 - Contract hire services that is, to offer their services as programmers charging a daily fee
 - Develop packages to meet perceived gaps in the market
- They will be in need of some money to start the venture.

THE NEED FOR CAPITAL

- Capital will be needed for
 - Salaries
 - Rents and bills
 - Equipments
 - Costs of advertising
 - Interests on any money borrowed

THE NEED FOR CAPITAL

- Present a business plan to potential funders. This plan should include
 - Description of what the company will be doing, together with information to show that it is technically feasible and founders of the company have the necessary expertise.
 - Assessment of the size of market and competition
 - Prediction of financial performance of the company

Sources of Funds

Grant

Loan

Sale
of
Equity

SOURCES OF FUNDS

- A **grant** is a sum of money given to the company.
- Company is obliged to demonstrate that it has been used for the purposes for which it was intended.
- Grant is never paid back to the organization which gave it.

SOURCES OF FUNDS

- A **loan** is a sum of money lent to the company.
- Interest is payable on it, at a rate that may be fixed or variable.
- Loan is usually for a fixed period.
- The company is liable to pay back the loan, and if company dissolves, the lender is entitled to recover the loan from the sale of company's assets.

SOURCES OF FUNDS

- **Equity capital** is money paid to the company in exchange for a share in the ownership of the company.
- Task
 - Advantage/ disadvantage

BUDGETING AND MONITORING

- A **budget** is a financial plan for a **defined** period of time, usually a year.
- It is an estimation of revenue and expenses over a specified period of time; it is compiled and re-evaluated on a periodic basis.
- Budgets can be made for a person, a family, a group of people, a business, a government, a country, a multinational organization or just about anything else that makes and spends money.
- A budget is a prediction of the future financial position of an organization covering usually the current or the next financial year.

BUDGETING AND MONITORING

- Budgeting is an iterative process.
- First version of the budget is likely to show expenditure exceeding income.
- Adjustments are made repeatedly until a situation is reached where sales exceed expenditure with a reasonable profit margin.

BUDGETING AND MONITORING

- Budget is mostly used as a basis for monitoring the organization's performance.
- The figures in the budget are split into monthly or weekly figures.
- When the actual figures of a month become available, they are compared with the budgeted figures.
- If real expenditure of any field exceeds the budgeted value, reason is determined quickly and remedial action is taken.

SALES AND ORDER INTAKE

- A **sale** is a transaction between two parties where the buyer receives goods and services in exchange for money.
- **Order intake** is a measure of company production in terms of customer offers to buy products or services, it refers to receiving or processing a customer's **order**.

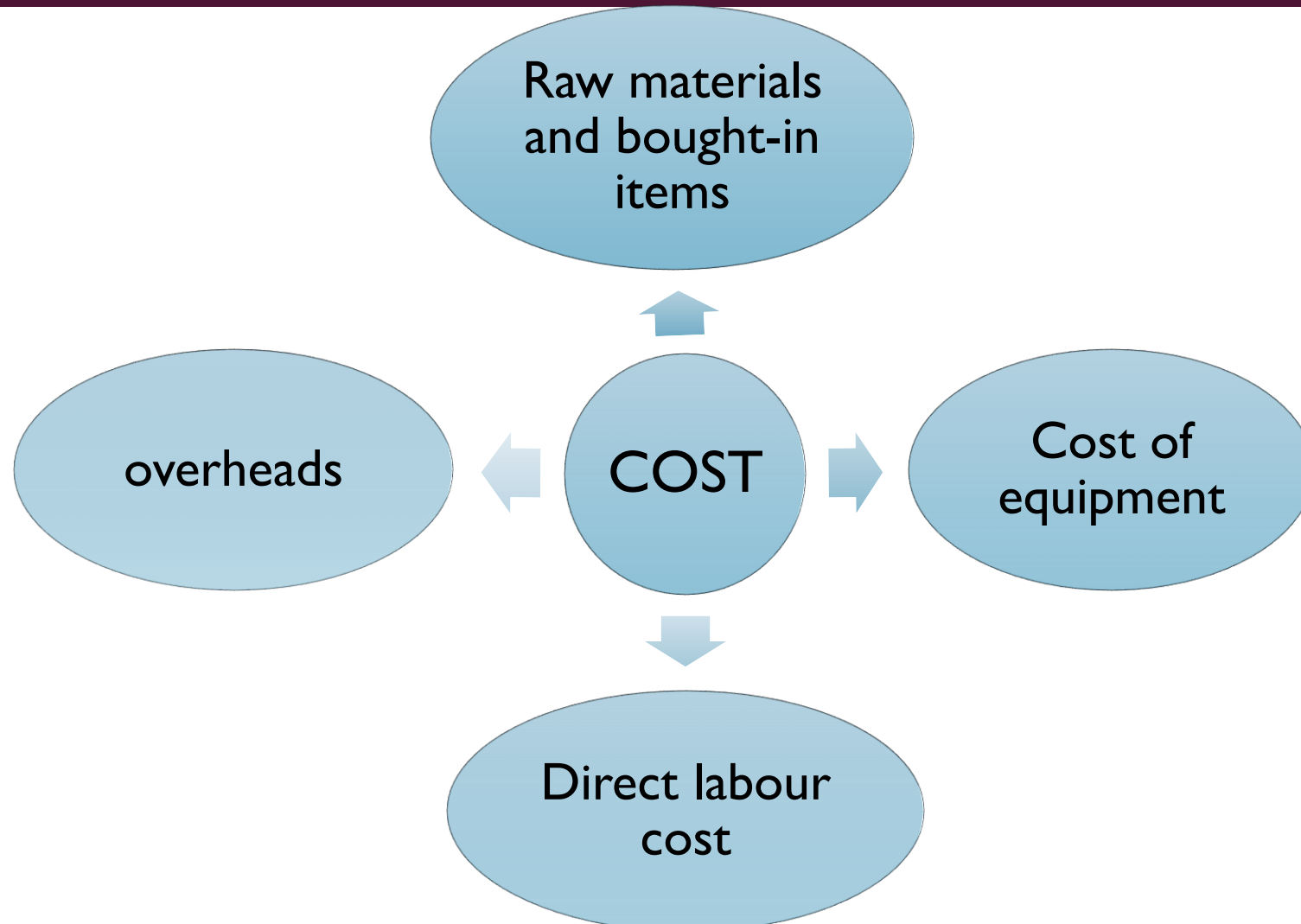
SALES AND ORDER INTAKE

- A company's cost, its pricing and the level of overheads that it can afford, all depends critically on the level of sales.
- Monitoring the level of sales is therefore a very important managerial activity.

COSTING

- The price at which an organization decides to sell a product or a service depends on
 - The cost of producing and providing it
 - Market conditions
 - Price and availability of competing products
 - Elasticity of demand

COSTING



COSTING

- Materials which are bought by a company and processed as part of the company's manufacturing process are called *raw materials*.
- *Brought-in items* are those items that are bought by a company and incorporated into their products, as it is (unchanged).

COSTING

- The **cost of equipment** for a company is simply how much the company paid for the equipment.
- The **cost of labour** is the sum of all wages paid to employees.

COSTING

- **Overheads** are the costs that cannot be directly associated with specific products or services, direct labor, direct materials, and direct expenses but must still be covered by the total revenue.
- Examples are marketing costs, manager's costs and costs related to preparation of bids, insurance, interest, legal fees, labor burden, rent, repairs, supplies, taxes, telephone bills, travel expenditures, and utilities..

COSTING

- *Departmental overheads* are associated with specific parts of the organization and should be covered by the revenue earned by those parts.
- *Corporate overheads* are associated with the whole organization.

ANNUAL STATEMENTS

Company accounts should include

- The balance sheet
- A profit and loss account
- The auditor's report

ANNUAL STATEMENTS



What is an Asset?

A personal asset is anything that you own that has monetary value. If you own it and you can sell it, it is an asset.



What is a Liability?

A liability is anything that you owe. everything that you have to eventually pay back is a liability. for example a mortgage or credit card debt



What is your Net Worth?

If you would sell all your assets and use the cash you gained to pay off all your liabilities, your net worth is what would remain.

$$\text{Assets} - \text{Liabilities} = \text{Net Worth}$$

ANNUAL STATEMENTS

- A **balance sheet** is a snapshot of financial state of an organization at a single instant, normally at the end of an organization's financial year.
- It shows the values of organization's assets and its liabilities.
- Normally a balance sheet also shows the twelve months previously position for comparison purpose.
- As the name suggests....a balance sheet must balance: the total assets and total liabilities should be equal.

ANNUAL STATEMENTS

Personal Balance Sheet

Assets		Liabilities	
Cash (Contingency Funds)		Secured Loans	
Saving Bank Accounts	₹ 50,000	Home Loan	₹ 19,00,000
Fixed Deposits	₹ 1,00,000	Car Loan	₹ 1,00,000
Liquid Mutual Funds	₹ 1,50,000	Unsecured Loans	
Investments		Education Loan	₹ 0
PF/PPF/Bonds etc.	₹ 5,00,000	Personal Loan	₹ 0
Debt/Bond MFs	₹ 3,00,000	Credit Card Loan	₹ 0
Gold, Gold MFs	₹ 3,00,000	Other Payables	
Stocks, Equity MFs	₹ 10,00,000	Loan from family/friend	₹ 0
Real Estate	₹ 40,00,000	Other dues	₹ 0
Other Assets		Total	₹ 20,00,000
Car	₹ 4,00,000	Net Worth	
Jewelry	₹ 2,00,000	Assets	₹ 70,00,000
Loan to family/friends	₹ 0	Liabilities	₹ 20,00,000
Other receivables	₹ 0	Assets - Liabilities =	₹ 50,00,000
Total	₹ 70,00,000		

ANNUAL STATEMENTS

- A **profit and loss account** records the money received and money spend.
- It is also called an income and expenditure account.

ANNUAL STATEMENTS

INCOME	
Contribution from Parents	1,000.00
Income from Summer Job	1,851.35
Total Income	2,851.35
EXPENDITURE	
Course Fees	1,025.00
Hall Fees	1,980.00
Transport	125.78
Food	1,203.40
Entertainment	1,261.33
Depreciation	30.00
Total Expenditure	5,600.51
EXCESS OF EXPENDITURE OVER INCOME	(2,749.16)

AUDITING

- Financial auditing is the process of examining an organization's financial records to determine if they are accurate and in accordance with any applicable rules , regulations, and laws.
- The company accounts should be accompanied by an auditor’s report.
- Purpose of the report is to provide members of the company and public with an assurance that accounts give a “true and fair view” of the state of the affairs of the company.

AUDITING

- The primary responsibility for preventing and detecting fraud lies with the directors of the company, not with the auditors.
- However auditors are also expected of finding anything seriously misleading in the financial statements.
- If they find evidence of fraud , they have a duty to report it to directors.