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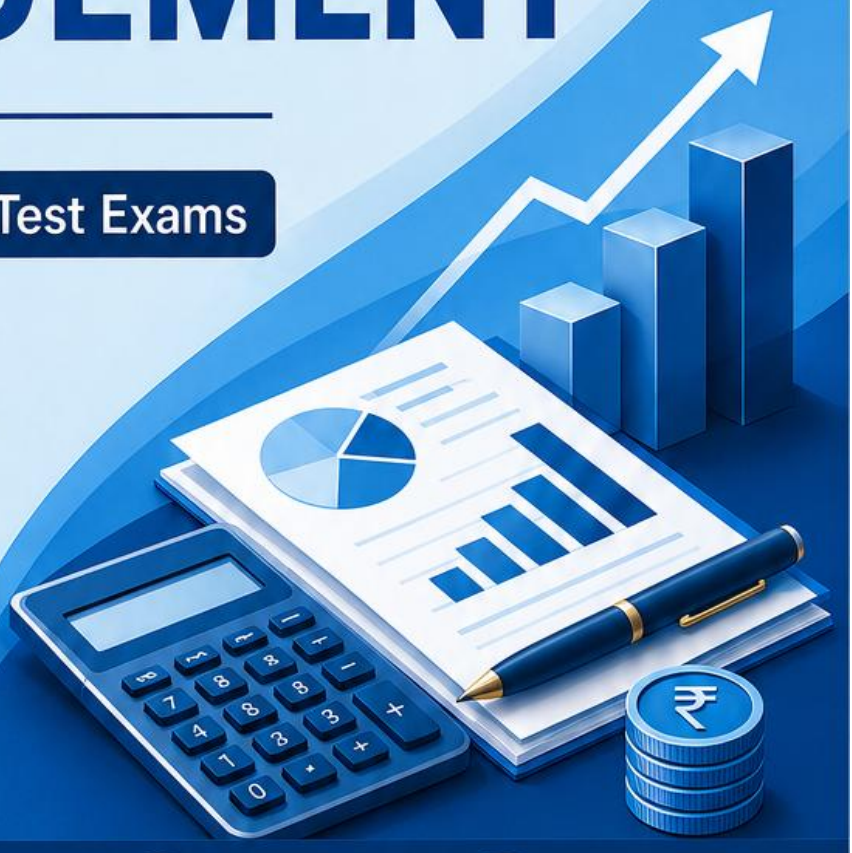
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PRINCIPLES OF ACCOUNTING & FINANCIAL MANAGEMENT

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This book is designed as an educational resource for aspirants preparing for competitive examinations (UPSC, RBI Grade B, NABARD, EPFO, State PSC, and management entrances) and for students of management.

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CRACKTARGET PUBLICATIONS

Principles of Accounting and Financial Management

UPSC DRDO Senior Administrative Officer
Grade-II Examination

Revised Second Edition • November 2026

Preface and Publication Information

This book starts with the everyday records of a small business and shows how those records become financial statements. It then explains how businesses use the numbers to decide what to buy, how to pay for it and how much money to return to their owners.

If this is your first accounting book, start with the opening example in each chapter. It introduces the idea before the full procedure or formula. Work through the example on paper, then try the questions and check the explanations.

About CrackTarget

CrackTarget Publications develops study materials and practice resources for competitive examinations. Visit the website for additional reading and practice.

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How to Use This Book

- If you are new to accounting, read Chapters 1–7 in order. Use a notebook to record transactions, check the totals and prepare the statements at the end of an accounting period.
- In Chapters 8–15, draw a timeline to show when money comes in or goes out. Write down the assumptions and label the amounts before you use a formula.
- Use Chapters 16–18 to find out whether a business is profitable, whether it can pay its bills and how it raises and uses money. Then try the mixed practice questions.
- Attempt each set before reading its explanations. Cover the solution when an answer follows the question directly.

Examination and Reporting Scope

This study resource is designed for candidates preparing for the Senior Administrative Officer Grade-II recruitment in DRDO. UPSC Advertisement 04/2026 lists 29 vacancies under vacancy number 26050408409. Refer to the vacancy-specific UPSC notice for the applicable recruitment test scheme and syllabus. The MCQs in this edition are practice material.

The worked accounts use simplified teaching assumptions where stated. In a reporting or examination question, identify the applicable accounting framework and entity type before choosing a treatment.

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CHAPTER 01

Introduction to Accounting

How to read the numbers of a small business

Imagine you open a stationery shop. You buy notebooks, sell some for cash and let one customer pay later. At the end of the week, three questions matter. How much did you earn? How much money is in the till? How much does the customer still owe? The answers can differ. Accounting gives each question its own record.

Start with a single event, such as a sale. Identify the amount, the date and the evidence, such as the invoice. Use that record to prepare reports about the business.

Key terms. A transaction is a business event that can be recorded in money. Revenue is what the business earns. An expense is a cost used to earn income or run the business. Profit is what remains when the relevant expenses are deducted from revenue.

Meaning and Definition of Accounting

Accounting is often called the language of business. Just as we use language to communicate ideas, accounting is used to communicate financial information about a business or organisation to those who need it.

Accounting records business events in money. It groups those records into categories and summarises them in reports so people can understand how a business is doing.

Two well-known definitions

American Institute of Certified Public Accountants (AICPA): “Accounting is the art of recording, classifying and summarising 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.”

American Accounting Association (AAA): “Accounting is the process of identifying, measuring and communicating economic information to permit informed judgements and decisions by users of the information.”

From these definitions we can see that accounting is both an art
(it requires skill and judgement) and a process (it follows a systematic series of steps).

Objectives of Accounting

Accounting is not done just for the sake of keeping records. It has clear objectives. The main objectives are explained below in simple language:

To maintain a systematic record of transactions

Every business has hundreds of transactions every month – purchases, sales, payments, receipts, expenses, etc. Accounting ensures that all these transactions are recorded in a proper and systematic manner so that nothing is missed or forgotten.

To ascertain the profit or loss of the business

At the end of a period (usually one year), the owner wants to know whether the business has earned profit or suffered loss. This is done by preparing the Profit & Loss Account (also called Income Statement).

To ascertain the financial position of the business

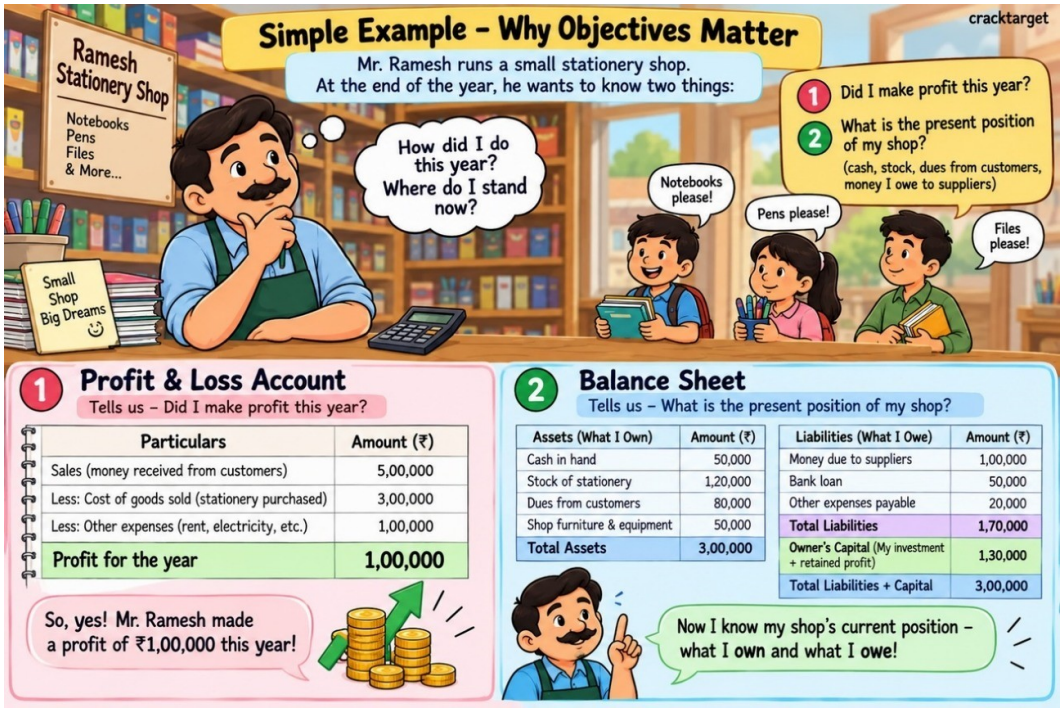
Apart from profit, the owner also wants to know what the business owns (assets) and what it owes (liabilities) on a particular date. This information is provided by the Balance Sheet.

To provide information to various users for decision-making

Different people need different information. Owners need it to judge performance, lenders need it to decide whether to give loan, government needs it for tax purposes, and management needs it for planning and control. Accounting supplies this information through financial statements and reports.

To help the management in planning and controlling the business

Modern accounting also helps management in preparing budgets, comparing actual results with planned results, and taking corrective action. This part is mainly covered under Management Accounting.



Gross profit, net profit and the balance sheet

Users of Accounting Information

Some readers of accounts work inside the business. Others, such as lenders and tax authorities, use the accounts from outside.

Internal Users

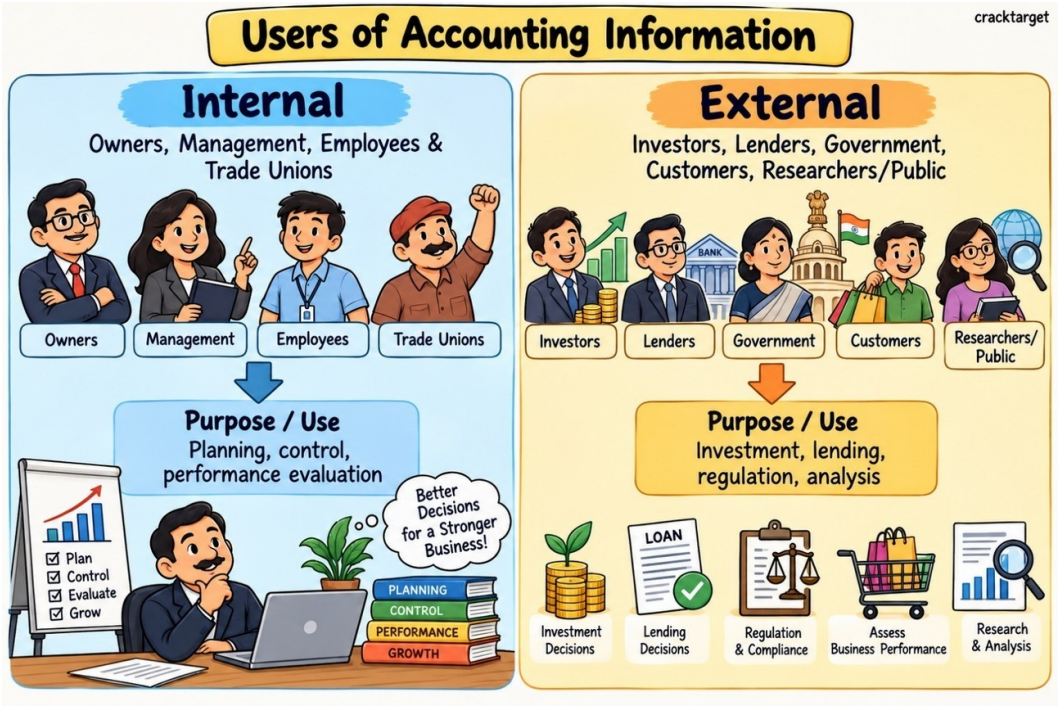
These are the people who are inside the organisation and use accounting information for managing the business.

- Owners and shareholders use the accounts to see how much the business earned and how their investment is doing.
- Managers use accounts to plan spending, set prices and check how departments are doing.
- Employees and trade unions use financial results to understand job stability and discuss wages or bonuses.

External Users

These are the people or agencies outside the organisation who need accounting information for their own decisions.

- Investors use the accounts to decide whether to buy, keep or sell a company's shares.
- Lenders and suppliers use the accounts to judge whether the business can repay loans and pay its bills on time.
- Government and tax authorities use financial records to assess taxes, including goods and services tax (GST), and to inform economic policy.
- Large customers sometimes check whether a supplier can keep delivering the goods or services they depend on.
- Researchers, financial analysts and members of the public use published accounts to study businesses and compare results.



Internal and external users of accounting information

Branches of Accounting

Accounting has developed into several specialised branches. For the UPSC DRDO SAO examination, you should clearly understand the difference between the main branches.

Branch	Main Purpose	Primary Users
Financial Accounting	Recording transactions and preparing general purpose financial statements (P&L, Balance Sheet, Cash Flow Statement)	External users + Owners
Cost Accounting	Finding out the cost of products, services or activities and controlling costs	Internal Management
Management Accounting	Providing information to management for planning, decision-making and control (budgets, variance analysis, etc.)	Internal Management
Tax Accounting	Calculation of taxable income and tax liability as per Income Tax and GST laws	Management & Tax Authorities
Auditing	Independent examination of financial statements to express an opinion on whether they show a true and fair view	Shareholders & Regulators

Advantages of Accounting

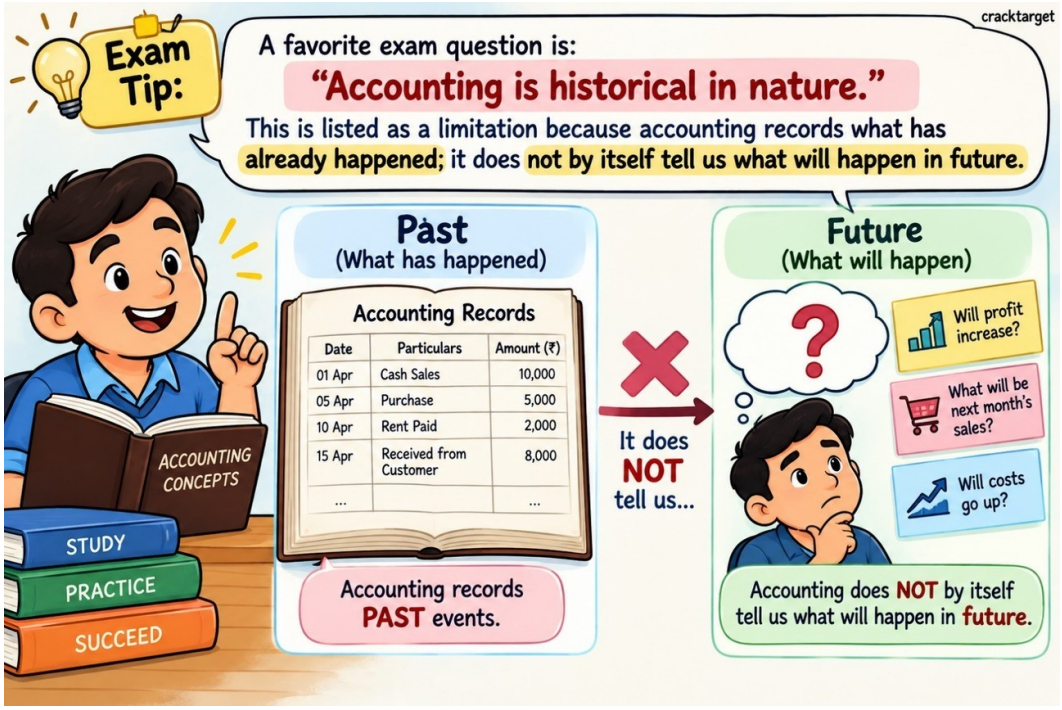
Accounting offers several important benefits:

- Complete and permanent record – All financial transactions are recorded systematically. This record remains available for future reference and can be used as evidence in case of disputes.
- Shows profit or loss clearly – The owner can easily know whether the business is making profit or loss and how much.
- Shows financial position – Balance Sheet tells what the business owns and what it owes on a particular date.
- Helps in comparison – Results of different years can be compared. Results of the business can also be compared with other similar businesses.
- Helps in raising loans – Banks and financial institutions ask for financial statements before giving loans. Proper accounts increase the chances of getting credit.
- Helps in tax assessment – Proper books of accounts make calculation of income tax and GST easier and reduce the chance of disputes with tax authorities.
- Helps in detection of errors and frauds – When accounts are properly maintained, it becomes easier to locate errors and prevent frauds.
- Acts as legal evidence – Books of accounts are accepted as evidence in a court of law.

Limitations of Accounting

Although accounting is very useful, it has some limitations that every student should know:

- Historical in nature – Accounting mainly records past transactions. It does not automatically predict the future (though analysis of past data helps in forecasting).
- Ignores non-monetary information – Quality of management, skill of employees, brand reputation, customer satisfaction, etc. are not recorded in the books because they cannot be measured in money.
- Based on personal judgement – Many items such as depreciation rate, provision for doubtful debts, and useful life of assets involve estimates. Different people may make different estimates.
- Window dressing is possible – Management can sometimes present a better picture of the business by choosing certain accounting policies within the permitted limits.
- Effect of inflation is ignored – Assets are usually shown at historical cost. The rise in price level (inflation) is not considered in traditional accounting.
- Alternative methods affect results – Different methods of depreciation or inventory valuation can show different profits for the same business.



Why accounting information is historical

Accounting as an Information System

In modern times, accounting is viewed as an information system. Just like any other system, it has three parts:

Input

The inputs are the business transactions and events that can be measured in money (purchase invoices, sales bills, payment vouchers, receipts, etc.).

Process

The processing involves recording the transactions in the books (Journal), classifying them (Ledger), summarising them (Trial Balance) and preparing the financial statements.

Output

The final output is the financial information presented in the form of Profit & Loss Account, Balance Sheet, Cash Flow Statement and other reports. This information is used by various users for making decisions.

The quality of decisions depends on the quality of accounting information. Therefore, accounting information should be relevant, reliable, comparable and understandable.

Chapter Summary

Accounting records, classifies and summarises transactions, then communicates the results. Financial accounting serves external reporting. Cost accounting measures costs, and management accounting supports internal decisions. Financial statements give users structured information, with limitations arising from measurement methods, estimates and historical data.

Practice Questions

1. What familiar name is often given to accounting?

(a) Language of economics
(b) Language of business
(c) Language of management
(d) Language of commerce

2. Which of the following is an internal user of accounting information?

(a) Creditors
(b) Tax authorities
(c) Management
(d) Investors

3. Which branch of accounting mainly serves people outside the business?

(a) Cost Accounting
(b) Management Accounting
(c) Financial Accounting
(d) Human Resource Accounting

4. Which of the following is a limitation of accounting?

(a) It provides systematic record of transactions
(b) It helps in ascertaining profit or loss
(c) It is historical in nature
(d) It helps in detection of frauds

5. What is the main purpose of financial accounting?

(a) Help management in day-to-day decisions
(b) Provide information to external users through financial statements
(c) Calculate the cost of products
(d) Prepare tax returns only

6. Which of the following is NOT an external user of accounting information?

(a) Banks
(b) Shareholders of the company
(c) Management of the company
(d) Government

Answers and Explanations

1. (b) Accounting communicates the financial effects of activities in a systematic form.

2. (c) Management works within the entity and uses information to plan and control operations.

3. (c) Financial accounting prepares general-purpose financial statements for outside users as well as owners.

4. (c) Financial accounting largely describes completed transactions. Users need further information for forecasts.

5. (b) Published financial statements provide information on performance, position and cash flows.

6. (c) Managers are internal users. Banks, outside shareholders and government authorities use information from outside the business.

Revision Check

Classify users by their decisions, then match each branch to the information it produces.

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