MEASI INSTITUTE OF MANAGEMENT
CHENNAI-14

Approved by All India Council for Technical Education and Affiliated to the University of Madras, ISO 9001:2015 Certified Institute

ACCOUNTING FOR MANAGERS - PMF1D

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VISION & MISSION STATEMENTS

VISION:

- To emerge as the most preferred Business School with Global recognition by producing most competent ethical managers, entrepreneurs and researchers through quality education.

MISSION:

- **Knowledge through quality teaching learning process**: To enable the students to meet the challenges of the fast challenging global business environment through quality teaching learning process.
- **Managerial Competencies with Industry institute interface**: To impart conceptual and practical skills for meeting managerial competencies required in competitive environment with the help of effective industry institute interface.
- **Continuous Improvement with the state of art infrastructure facilities**: To aid the students in achieving their full potential by enhancing their learning experience with the state of art infrastructure and facilities.
- **Values and Ethics:** To inculcate value based education through professional ethics, human values and societal responsibilities.

PROGRAMME EDUCATIONAL OBJECTIVES (PEOs)

PEO 1: Placement: To equip the students with requisite knowledge skills and right attitude necessary to get placed as efficient managers in corporate companies.

PEO 2: Entrepreneur: To create effective entrepreneurs by enhancing their critical thinking, problem solving and decision-making skill.

PEO 3: Research and Development: To make sustained efforts for holistic development of the students by encouraging them towards research and development.

PEO4: Contribution to Society: To produce proficient professionals with strong integrity to contribute to society.

Program Outcome:

PO1: Problem Solving Skill: Apply knowledge of management theories and practices to solve business problems.

PO2: Decision Making Skill: Foster analytical and critical thinking abilities for data-based decision making.

PO3: Ethical Value: Ability to develop value- based leadership ability.

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PO4: Communication Skill: Ability to understand, analyse and communicate global, economic, legal and ethical aspects of business.

PO5: Individual and Leadership Skill: Ability to lead themselves and others in the achievement of organizational goals, contributing effectively to a team environment.

PO6: Employability Skill: Foster and enhance employability skills through subject knowledge.

PO7: Entrepreneurial Skill: Equipped with skills and competencies to become an entrepreneur.

PO8: Contribution to community: Succeed in career endeavors and contribute

significantly to the community.

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Subject Code	Subject Name	L	T	P	S	C
PMF1D	**ACCOUNTING FOR MANAGERS**	**3**	**1**	**-**	**0**	**4**

Course Objectives

C. No	Objectives	Program Outcomes
C2	To enable the students to prepare, analyses and interpret financial statements	PO1, PO2, PO4, PO6, PO7
C3	To acquaint the students with the tools and techniques of financial analysis	PO1, PO2, PO3, PO6, PO7
C4	To enable the students to take decisions using management accounting tools.	PO1, PO2, PO6, PO7
C5	To enable the students to prepare the reports with the accounting tools and facilitate managerial decision making.	PO2, PO3, PO4, PO6, PO7, PO8

SYLLABUS

Unit. No.	Details	Hours
Unit I	Financial Accounting – Meaning - Objectives - functions. Branches of Accounting: Financial, Cost and Management Accounting - Accounting Concepts and conventions. Journal – Ledger – Trial Balance – Preparation of Final Accounts: Trading, Profit and Loss Account and Balance Sheet (problems)	12
Unit II	Financial Statement Analysis - Objectives - Techniques of Financial Statement Analysis: Accounting Ratios- Classification of Ratios: Profitability, Liquidity, Financial and Turnover Ratio - problems. Fund Flow Statement - Statement of Changes in Working Capital - Preparation of Fund Flow Statement - Cash Flow Statement Analysis- Distinction between Fund Flow and Cash Flow Statement - problems	12
Unit III	Marginal Costing - Definition - distinction between marginal costing and absorption costing - Breakeven point Analysis - Contribution, p/v Ratio, margin of safety - Decision making under marginal costing system-key factor analysis, make or buy decisions, export decision, sales mix decision-Problems.	12
Unit IV	Budget, Budgeting, and Budgeting Control - Types of Budgets - Preparation of Flexible and fixed Budgets, master budget and Cash Budget - Problems -Zero Base Budgeting. Standard costing and variance analysis.	12
Unit V	Cost Accounting: meaning– Objectives - Elements of Cost – Cost Sheet (Problems) – classification of cost – Cost Unit and Cost Centre – Methods of Costing – Techniques of Costing. Standard costing and variance analysis Reporting to Management – Uses of Accounting information in Managerial decision-making.	12

Reference Books

1.	Gupta, A., Financial Accounting for Management: An Analytical Perspective, 4th Edition, Pearson, 2012.
2.	Khan, M.Y. and Jain, P.K., Management Accounting: Text, Problems and Cases,

	5th Edition, Tata McGraw Hill Education Pvt. Ltd., 2009.
3.	Nalayiram Subramanian, Contemporary Financial Accounting and reporting for Management – a holistic perspective- Edn. 1, 2014 published by S. N. Corporate Management Consultants Private Limited
4.	Horngren, C.T., Sundem, G.L., Stratton, W.O., Burgstahler, D. and Schatzberg, J., 14th Edition, Pearson, 2008.
5.	Noreen, E., Brewer, P. and Garrison, R., Managerial Accounting for Managers, 13th Edition, Tata McGraw-Hill Education Pvt. Ltd., 2009.
6.	Rustagi, R. P., Management Accounting, 2nd Edition, Taxmann Allied Services Pvt. Ltd, 2011.
Institute Course Material	
Course Material	Feedback & Suggestions
Case Studies	
Question Bank	
University Question Paper Samples	
E-Sources	
1.	http://www.sxccal.edu/TwinningProgramme/downloads/MBA-AccountingManagers-1stYear.pdf
2.	https://www.pdfdrive.com/accounting-for-managers-interpreting-accounting-information-for-decision-making-e13151347.html (Accounting for Managers: Interpreting accounting information for decision-making Paul M. Coller)
3.	https://www.scribd.com/doc/41713800/Accounting-for-Managers-Notes
4.	http://files.rajeshindukuristudyplace.webnode.com/200000014-9621c971b8/ACCOUNTING%20FOR%20MANAGERS.pdf
5.	https://www.researchgate.net/publication/313477460_CONCEPT_OF_WORKING_CAPITAL_MANAGEMENT
6.	http://14.139.206.50:8080/jspui/bitstream/1/4336/1/Working%20capital%20management.pdf
7.	http://shodhganga.inflibnet.ac.in/bitstream/10603/70588/9/09_chapter%201.pdf
8.	http://educ.jmu.edu/~drakepp/principles/module6/capbudtech.pdf
Assessment Tools Used	
1.	Assignment
2.	Internal Assessment Test
3.	Model Exams
4.	Seminar
5.	Case studies
6.	Group discussion
7.	Class room Exercises
8.	Homework
9.	Practice problems
10.	Quiz
Content Beyond Syllabus	
1.	Working Capital Management
2.	Capital Budgeting Techniques
3.	Significance of Computerized Accounting System – Codification and Grouping of Accounts – Maintaining the hierarchy of ledgers – Pre-packaged Accounting Software.

Additional Reference Books	
1.	Capital Budgeting: Theory and Practice (Frank J. Fabozzi Series) by Pamela P. Peterson (Author), Frank J. Fabozzi (Author) Publisher- Wiley
2.	Jan Williams, Financial and Managerial Accounting – The basis for business Decisions, 13th edition, Tata McGraw Hill Publishers, 2005.
3.	Horngren, Surdem, Stratton, Burgstahler, Schatzberg, Introduction to Management Accounting, PHI Learning, 2008.
4.	Stice&Stice, Financial Accounting Reporting and Analysis, 7th edition, Cengage Learning, 2008.
5.	SinghviBodhanwala, Management Accounting -Text and cases, PHI Learning, 2008.

Course Outcomes	
On completion of this course successfully the students will;	
C104.1	Be able to understand the fundamentals of principles of financial, cost and management accounting
C104.2	Be able to prepare, analyze and interpret financial statements
C104.3	Be able to use the tools and techniques of financial analysis.
C104.4	Be able to take decisions using management accounting tools.
C104.5	Be able to prepare the reports with the accounting tools and facilitate and take managerial decisions.

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UNIT 1

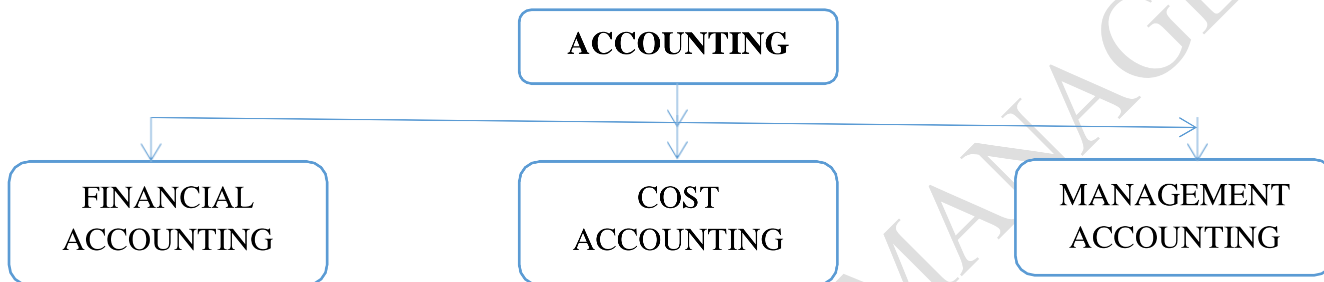
A. ACCOUNTING

American Association Accounting defines accounting as "the process of identifying, measuring and communicating economic information to permit informed judgment and decision by users of the information"

1. ACCOUNT

Account is a summary of relevant business transaction at one place relating to a person, assets, expenses or revenue named in the heading. An account has two sides called debit side and credit side.

2. BRANCHES OF ACCOUNTNG



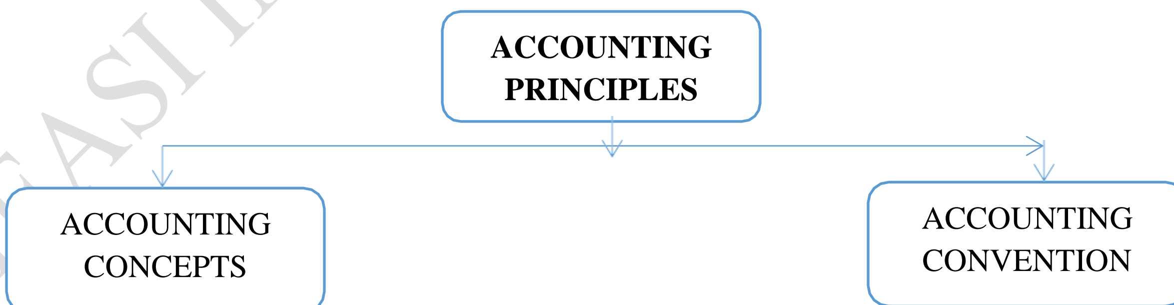
Financial Accounting: It is concerned with recording of business transaction in the books of accounts in such a way that operating results of particular period and financial position on a particular date can be known.

Cost Accounting: It relates to collection, classification and ascertainment of the cost of production or job undertaken by the firm.

Management Accounting: It relates to the use of accounting data collected with the help of financial accounting and cost accounting for the purpose of policy formulation, planning, control and decision making by the management.

3. ACCOUNTING PRINCIPLES

Accounting Principles are a set of rules, concept and guidelines used in the preparation of financial accounting reports. Accounting principles can be classified in to two categories



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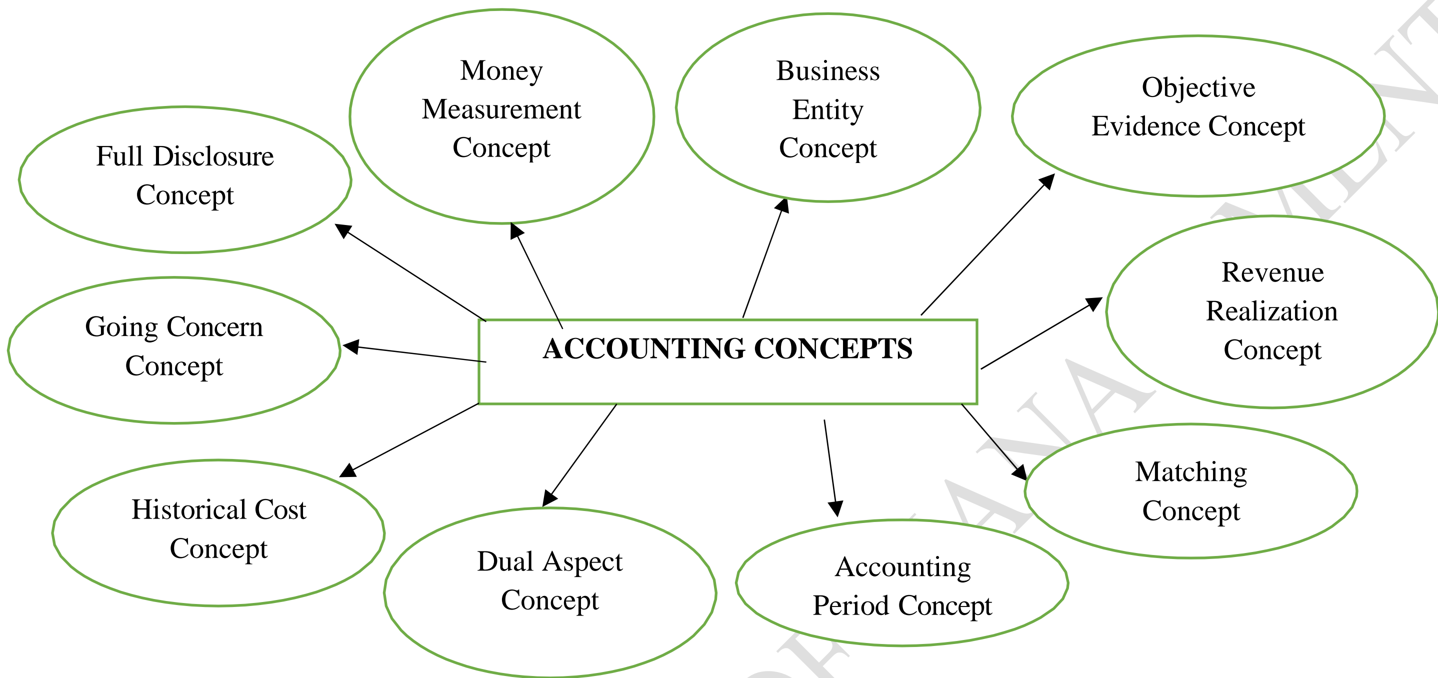
3.1 ACCOUNTING CONCEPTS:

It may be considered as postulates i.e. basic assumption and condition upon which the science of accounting is based. The following are the different concepts of accounting



- **Business Entity Concept**

  The proprietor of a business concern is always considered to be separate and distinct from the business which he controls. All the business transactions are recorded in the books of accounts from the view point of the business. Even the proprietor is treated as a creditor to the extent of his capital.

- **Money Measurement Concept**

  In accounting, only those business transactions and events which are of financial nature are recorded

- **Going Concern Concept**

  As per this assumption, the business will exist for a long period and transactions are recorded from this point of view. There is neither the intention nor the necessity to wind up the business in the foreseeable future.

- **Historical Cost Concept**

  Under this concept, assets are recorded at the price paid to acquire them and this cost is the basis for all subsequent accounting for the assets. For example, if a piece of land is purchased for Rs.5,00,000 and its market value is Rs.8,00,000 at the time of preparing final accounts the land value is recorded only for Rs.5,00,00

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- **Dual Aspect Concept**

  Dual aspect principle is the basis for Double Entry System of book-keeping. All business transactions recorded in accounts have two aspects - receiving benefit and giving benefit. For example, when a business acquires an asset (receiving of benefit) it must pay cash (giving of benefit).

- **Accounting Period Concept**

  The users of financial statements need periodical reports to know the operational result and the financial position of the business concern. Hence it becomes necessary to close the accounts at regular intervals. Usually a period of 365 days or 52 weeks or 1 year is considered as the accounting period.

- **Matching Concept**

  Matching the revenues earned during an accounting period with the cost associated with the period to ascertain the result of the business concern is called the matching concept. It is the basis for finding accurate profit for a period which can be safely distributed to the owners.

- **Revenue Realization Concept**

  According to this concept, revenue is considered as the income earned on the date when it is realised. Unearned or unrealised revenue should not be taken into account

- **Objective Evidence Concept**

  This principle requires that each recorded business transactions in the books of accounts should have an adequate evidence to support it. For example, cash receipt for payments made. The documentary evidence of transactions should be free from any bias

- **Full Disclosure Concept**

  Accounting statements should disclose fully and completely all the significant information. Based on this, decisions can be taken by various interested parties. It involves proper classification and explanations of accounting information which are published in the financial statements

3.2 ACCOUNTING CONVNETIONS:

The term convention denotes circumstances or tradition which guides the accountant while preparing the accounting statement.

ACCOUNTING CONVENTIONS

Convention of Consistency

Cost Benefit Principle

Convention of Conservatism

Conventions of Materiality

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- **Convention of Consistency**

  The aim of consistency principle is to preserve the comparability of financial statements. The rules, practices, concepts and principles used in accounting should be continuously observed and applied year after year.

- **Cost Benefit Principle**

  This modifying principle states that the cost of applying a principle should not be more than the benefit derived from it. If the cost is more than the benefit then that principle should be modified.

- **Convention of Conservatism**

  Prudence principle takes into consideration all prospective losses but leaves all prospective profits. The essence of this principle is "anticipate no profit and provide for all possible losses". For example, while valuing stock in trade, market price or cost price whichever is less is considered.

- **Convention of Materiality**

  The materiality principle requires all relatively relevant information should be disclosed in the financial statements. Unimportant and immaterial information are either left out or merged with other items

4. JOURNAL

The word journal is originally derived from the French word "Jour" which means "a day". Journal is the book of original entry in which transaction are originally recorded in chronological order according to the principles of double entry system

4.1 JOURNALISING & JOURNAL ENTRY

The process of analyzing the business transaction under the heads of debit and credit and recording them in journal is called as journalizing. An entry made in the journal is called as journal entry

5. LEDGER

The book which contains a classified and permanent record of all the transaction of business is called ledger.

5.1 FEATURES OF LEDGER

- Complete information at glance
- Arithmetical accuracy
- Result of business operation
- Accounting information

6. TRIAL BALANCE

It is a statement prepared with debit and credit balances of ledger accounts to test the arithmetical accuracy of the books

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6.1 OBJECTIVES OF TRIAL BALANCE

- To check the arithmetical accuracy of the ledger accounts
- To locate the errors
- To facilitate the preparation of final accounts

6.2 ADVANTAGE OF TRIAL BALANCE

- ✓ It helps to ascertain the arithmetical accuracy of the book keeping work done during the period.
- ✓ It supplies in one place ready reference of all the balances of the ledger account
- ✓ If any error is found out by preparing a trial balance the same can be rectified before preparing final accounts.
- ✓ It is the basis on which final accounts are prepared.

6.3 METHODS OF TRIAL BALANCE

- The Total Method
- The Balance Method

7. BASIS OF ACCOUNTING

- ❖ Cash basis of accounting
- ❖ Accrual basis of accounting
- ❖ Mixed accounting

8. GOLDEN RULES OF ACCOUNTING

- PERSONAL ACCOUNT
  - ➢ Debit the receiver
  - ➢ Credit the giver
- REAL ACCOUNT
  - ➢ Debit what comes in
  - ➢ Credit what goes out
- NOMINAL ACCOUNT
  - ➢ Debit all expenses and loses
  - ➢ Credit all income and gains

9. ACCOUNTING EQUATION

Accounting equation is based on dual aspect concept (debit and credit). It emphasizes on the fact that every transaction has a two-sided effect.

ASSETS = CAPITAL + LIABILITIES

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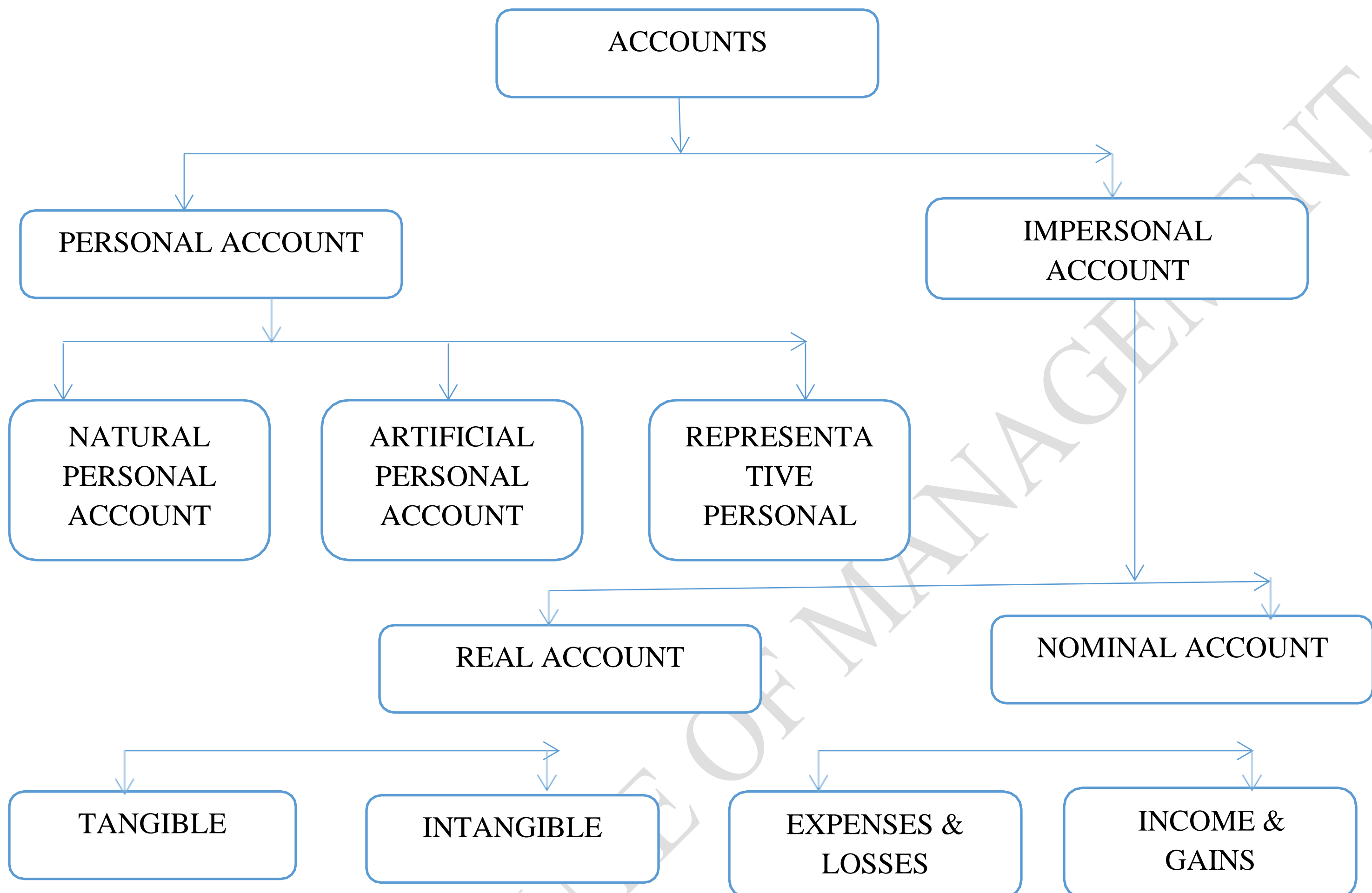
10. CLASSIFICATION OF ACCOUNTS



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11. ANALYSIS, INTERPRETATION AND USES OF ACCOUNTING STATEMENT BY THE MANAGEMENT

1. PREPARATION OF INCOME STATEMENT

The term income statement includes the following

- Trading account
- Profit and loss account

Trading account is prepared to calculate to know the trading results or gross margin on trading of the business.

Profit and loss account is prepared to calculate the net profit of the business.

A. INTERPRETAION AND USE OF TRADING ACCOUNT

- Information of gross profit or gross loss
- Gross profit ratio
- Comparison of closing stock with opening stock
- Fixation of selling price

B. INTERPRETAION AND USE OF PROFIT AND LOSS ACCOUNT

- Information of net profit or net loss
- Comparison of current profit with past profit
- Comparison of expenses
- Helpful in preparation of balance sheet
- Helpful in future growth of the business

2. BALANCE SHEET

A balance sheet is a statement prepared with a view to measure the financial position of a business on a certain fixed date. The right hand side is called as assets side and left hand side is known as liabilities side.

METHODS OF BALANCE SHEET

The balance sheet of a business concern can be presented in the following two forms

- Horizontal form or Account form
- Vertical form or Report form

CHARACTERISTIC OF BALANCE SHEET

- It is prepared on a particular date and not for particular period
- It is prepared after the preparation of trading and profit and loss account
- As assets must be equal to total liabilities, the two sides of the balance must have the same total.
- It shows the financial position of a business as a going concern
- It is a statement of assets and liabilities and not an account.

INTERPRETAION AND USE OF BALANCE SHEET

- The nature and the value of assets
- It shows the nature and extent of liabilities
- It shows the owners' equity
- It tells about the credit worthiness and solvency of the firm
- It reflects the liquidity of a firm

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B. FINANCIAL ACCOUNTING:

It is concerned with recording of business transaction in the books of accounts in such a way that operating results of particular period and financial position on a particular date can be known.

1. FUNCTIONS OF FINANCIAL ACCOUNTING

- Book keeping function
- Classification of Information
- Preparation of financial statement
- Segregating financial transaction
- Interpretation of financial data
- Reporting of information
- Providing accurate and reliable information

2. LIMITATION OF FINANCIAL ACCOUNTING

- Historical data
- Financial statement for the enterprise as whole
- Financial accounting fails to help in price fixation
- Financial accounting is not useful in cost control
- Evaluation of policies not possible
- Actual cost alone are recorded
- It does not provide information for strategic decision making
- It is complicated and technical subject
- Monetary nature
- There is a chance of manipulation and window dressing.

C. COST ACCOUNTING

It is the method of accounting for cost. The process of recording and accounting for all elements of cost is called as cost accounting.

1. NEEDS OF COST ACCOUNTING

- ✓ Fixation of selling price
- ✓ Control of cost
- ✓ Decision making from alternative choice

2. OBJECTIVES/ PURPOSE/ FUNCTION/ AIM OF COST ACCOUNTING

- Cost finding or cost ascertainment
- Control of cost
- Reduction of cost
- Fixation of selling price
- Providing information for framing business policy
- Production or discontinuation of a product

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- Utilization of idle capacity
- The most profitable sales mix
- Alternative based on key factor
- Export decision
- Make or buy decision

3. ADVANTAGE OF COST ACCOUNTING

- ✓ TO THE EMPLOYESS
  - Stability of tenure
  - Fair wage policy
  - Rewards for higher efficiency through incentives scheme.

- ✓ TO THE MANAGEMENT
  - Effective decision making
  - Measuring effectiveness
  - Cost reduction
  - Fixation of selling price
  - Effective cost control
  - Effective utilization of resources
  - Help in effective budgeting
  - Increase in efficiency
  - Effective inventory control
  - Reduction of wastage

- ✓ TO THE CREDITORS
  - Understanding the progress and profitability of the firm and future prospects of the firm

- ✓ TO THE GOVERNMNET
  - Granting of subsidies
  - Planning of resources
  - Utilization of scarce resources

- ✓ TO THE PUBLIC
  - Removal of wastage
  - Fair price for product
  - Employment opportunities

4. LIMITATION OF COST ACCOUNTING

- Lack of uniformity
- Second hand data
- Conventions
- Uncertainty

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- Costly
- Applicability
- Some items of cost and income are fully ignored in cost accounts where as they are shown in financial account

D. MANAGEMENT ACCOUNTING

It is the combination of various accounting systems and techniques which are designed to meet the needs of the management.

1. CHARACTERISTIC OF MANAGEMENT ACCOUNITNG

- Providing financial information
- Cause and effect analysis
- Use of special techniques and concepts
- Decision making
- No fixed convention
- Achievements of objectives
- Improving efficiency

2. SCOPE OF MANAGEMENT ACCOUNTING

- Financial accounting
- Cost accounting
- Budgeting and forecasting
- Inventory control
- Statistical analysis
- Analysis of data
- Internal audit
- Tax accounting
- Methods and procedures.

3. OBJETIVES/ PURPOSE/ FUNCTION/ ROLE OF MANAGEMENT ACCOUNTING

- To help in planning and policy formulation
- To help in the interpretation process
- To help in decision making
- To help in controlling performance
- To help in coordinating
- To help in organizing
- To help in expansion, diversification and strategic business policies.
- To help in motivating employees
- Reporting

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4. MERITS OF MANAGEMENT ACCOUNTING

- Planning
- Controlling
- Coordinating
- Organizing
- Motivating
- Communicating

5. LIMITATION OF MANAGEMENT ACCOUNTING

- Weakness of source records
- Consistent effort
- Management accounting is not a substitute
- Mixed discipline
- Resistance
- Costly installation
- Developmental stage
- Subjectivity

6. TOOLS AND TECNIQUES OF MANAGEMENT ACCOUTING

- Financial policy and accounting
- Analysis of financial statement
- Historical cost accounting
- Budgetary control
- Standard costing
- Marginal costing
- Management Information System.

7. FUNCTION / ROLES OF MANAGEMENT ACCOUNTANT

- Planning for control
- Reporting
- Evaluation
- Administration of tax
- Appraisal of external effects
- Protection of assets

8. DUTIES / RESPONISIBILITY OF MANAGEMENT ACCOUNTANT

- Collection of information
- Evaluation of information
- Interpretation of information
- Reporting of information

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DIFFERENCES BETWEEN FINANCIAL ACCOUNTING, COST ACCOUNTING AND MANAGEMENT ACCOUNTING

PARTICULARS	FINANCIAL ACCOUNTING	COST ACCOUNTING	MANAGEMENT ACCOUNTING
Purpose	The purpose of FA is to ascertain profit and loss by preparing profit and loss account and reveals the financial position through balance sheet.	The purpose of CA is to ascertain and control the cost of product or service.	The purpose of MA is to provide information to the management for decision g. makin
Reporting	FA is concerned with external reporting	CA is concerned with external as well as internal reporting	MA is concerned with internal reporting
Nature of information used	FA is historical and objective	CA is based on both historical and present data	MA is subjective and relates to the future
Analysis and interpretation of data	FA analyses data as a whole	CA uses only quantitative information	MA evaluates the performance of different department, division and product as per the requirement of the management
Flexibility	FA are prepared as per the guidelines laid down by companies act and income tax act	CA is flexible as per the requirement of the management	The management accountant has flexibility in following different standard set by the management
Legal Requirements	FA has become compulsory as per the statutory requirement	CA are maintained to fulfill the internal requirements of the management as per conventional guidelines.	MA is of voluntary adoption by the management to function effectively

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Frequency of Reporting	Periodic reporting is the feature of FA	CA are of continuous process and are prepared as per the requirement of management, may be daily, weekly, monthly, quarterly or annually	Frequency reporting of performance of various activities is the feature of MA
Emphasis of Principles	FA records transaction as per established convention and principles	CA lays emphasis on ascertainment of cost and cost control	MA does not have any set of rigid principles
Audit	Financial statement are audited by chartered Accountant	CA is audited by cost accountant.	MA statement and reports are meant for internal purpose and they are not audited
Unit of Account	FA considers the whole enterprise as a single unit of account	CA is concerned mainly with cost ascertainment and control	MA presents reports relating to whole concern and also division wise performance

DIFFERENCES BETWEEN JOURNAL & LEDGER

PARTICULARS	JOURNAL	LEDGER
Type of entry	Journal is a book of original entry	Ledger is a sources of secondary entry
Order of recording	In journal transaction are recorded in the chronological order	All the transaction pertaining to a particular account appear at one place
Importance as legal evidence	In case of dispute the journal as a book of source entry has greater weightage	For accounting purpose, ledger is the main source of information
Unit of classification of data	In case of journal the unit of classification of data is transaction	In case of ledger the unit of classification of data is the account

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Process of recording	Process of recording financial transaction is called as journalizing	Process of recording transaction in the ledger is called as posting
Timing of recording	Journalizing is continuous process, day after day	Ledger posting can be done according to convenience.

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UNIT 2

A. FINANCIAL STATEMENT ANALYSIS (FSA)

1. FSA is the process of establishing and identifying the financial weaknesses and strength of the firm. It is indicative of two aspects of a firm i.e. the profitability and the financial position and it is what is known as the objectives of the FSA.

2. Financial Statement Analysis will help business owners and other interested people to analyse the data in financial statements to provide them with better information about such key factors for decision making and ultimate business survival.

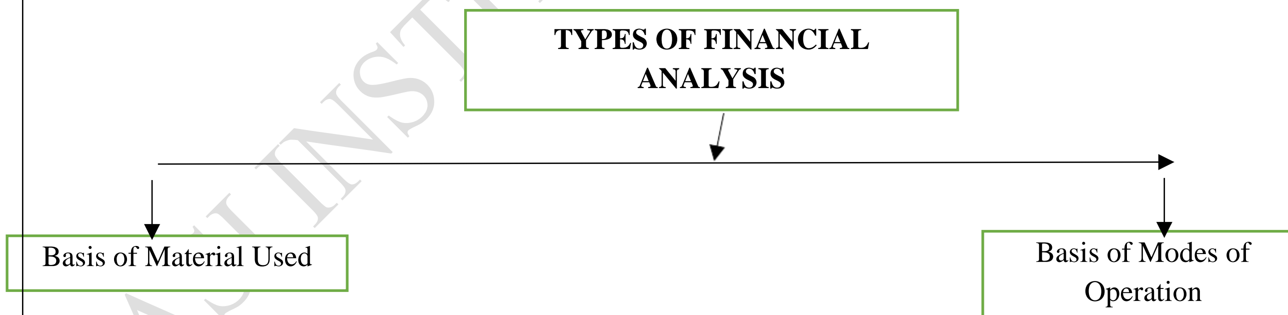
3. Financial Statement Analysis is the collective name for the tools and techniques that are intended to provide relevant information to the decision makers. The purpose of the FSA is to assess the financial health and performance of the company• FSA consist of the comparisons for the same company over the period of time and comparisons of different companies either in the same industry or in different industries.

1. OBJECTIVES OF FINANCIAL STATEMENT

- To assess the present profitability and operating efficiency of the firm as a whole as well as for its different departments and segments.
- To find out the relative importance of different components of the financial position of the firm.
- To identify the reasons for change in the profitability/financial position of the firm, and
- To assess the short term as well as the long term liquidity position of the firm

2. TYPES OF FINANCIAL ANALYSIS

Financial analysis can be classified into different categories depending upon
(1) the material used, and (2) the modus operandi of analysis.



1. **On the Basis of Material Used:** Under this category the financial analysis can be of two types: a) External Analysis; b) Internal Analysis

   A. **External Analysis:** The outsiders to the business carry out this kind of analysis, which includes investors, credit agencies, government agencies and other creditors who have no access to the internal records of the company. In the recent times this analysis has gathered momentum towards better

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corporate governance and government regulations for more detailed disclosure of information by the companies in their financial statements.

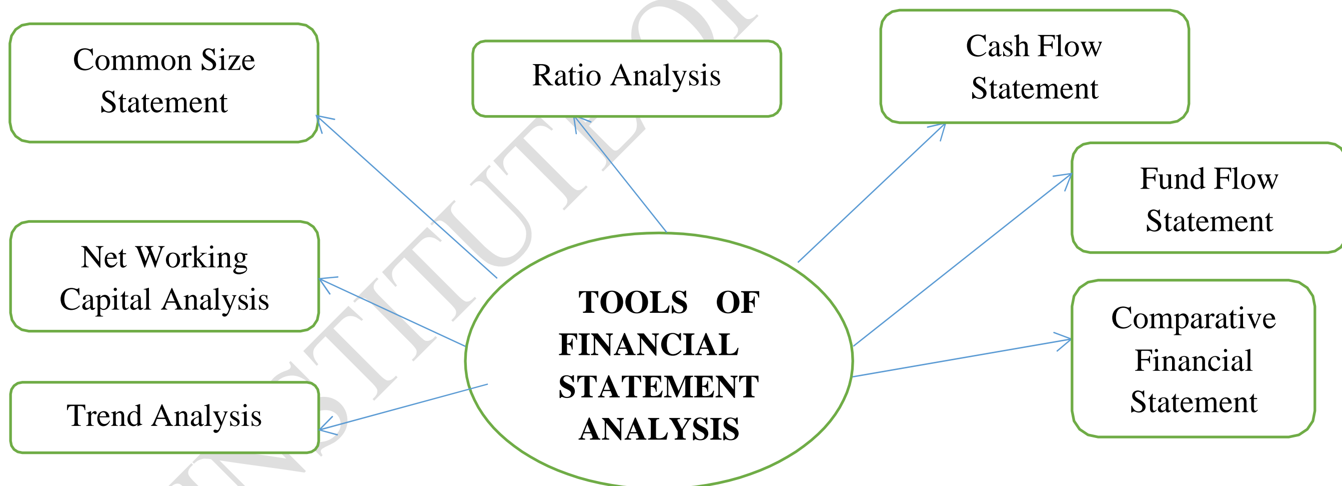
B. Internal Analysis: In contrary to the above this analysis is done by those who have access to the books of accounts and other information related to the business. The analysis is done depending upon the objective to be achieved through this analysis.

2. **On the basis of Modus Operandi:** In this case too, the financial analysis can be of two types: a) Horizontal Analysis; b) Vertical Analysis

A. Horizontal Analysis: Under this financial statements for a number of years are reviewed and analyzed. The current year's figures are compared with standard or base year.

B. Vertical Analysis: Under this type of analysis a study is made of the quantitative relationship of the various items in financial statements on a particular date. For example, the ratios of different items of costs for a particular period may be calculated with the sales for that period. These types of financial analysis are useful in comparing the performance of several companies in the same group, or divisions or departments in the same company.

3. TECHNIQUES/TOOLS OF THE FINANCIAL STATEMENT ANALYSIS



- **Ratio Analysis**

The ratios analysis is the most powerful tool of financial statement analysis. Ratios simply means one number expressed in terms of another. A ratio is a statistical yardstick by means of which relationship between two or various figures can be compared or measured. Ratios can be found out by dividing one number by another number. Ratios show how one number is related to another.

- **Cash Flow Analysis (CFA)**

CFA depicts the inflows and outflows of cash. Cash Flow Statement (CFS) is the device for such analysis. It highlights causes which bring changes in cash position between two balance sheet dates.

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- **Fund Flow Analysis (FFA)**

Fund Flow Statement signifies the sources and application of funds. The term "funds" refers to working capital. FFA clearly shows the internal and external sources of working capital and the way funds have been used. FFA helps in judging credit worthiness, financial planning and budget preparation.

- **Comparative Financial Statement**

These statement summarize and present related data for number of years, incorporating therein changes in individuals items of financial statement. These statements normally comparisons of comparative balance sheet, comparative profit and loss account. They help in making inter period and inter firm comparison and also highlight the trends in performance efficiency and financial position.

- **Common Size Statement**

Common size statement indicate the relationship of various items with some common items. In the income statement the sales figure is taken as basis and all other figures are expressed as percentage of sales. Similarly in the balance sheet the total of assets and liabilities is taken as base and all figures are expressed as percentage of this total.

- **Net Working Capital Analysis**

Net working capital statement or schedule of changes in working capital is prepared to disclose net changes in working capital on two specific dates. It is prepared to show the net increase or decrease in working capital.

- **Trend Analysis**

It is carried out by calculating trend ratios (percentage) and or by plotting the accounting data on graph paper or chart. Trend analysis is significant for forecasting and budgeting. Trend analysis discloses the changes in financial and operating data between specific periods.

4. LIMITATION OF FINANCIAL STATEMENT ANALYSIS

- Based on past data
- Financial statement analysis cannot be substitute for judgment
- Reliability of figures
- Different interpretation
- Changes in accounting methods
- Price level changes
- Limitation of tools of analysis

B. RATIO ANALYSIS

1. RATIO

A ratio is a mathematical relationship between two items expressed in a quantitative form

2. RATIO ANALYSIS

- It is the process of computing, determining and presenting the relationship of items or group of items of financial statement.

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- THE **MODES OF EXPRESSION** OF RATIO AS

  a. In times

  b. In percentages

  C. In proportion

- THE **OBJECTIVES OF RATIO ANALYSIS**

  a. To test the profitability

  b. To know the financial position

  C. To determine the operating efficiency of a concern.

3. ADVANTAGES OF RATIO ANALYSIS:

- Forecasting
- Managerial control
- Facilitates communication
- Measuring efficiency
- Measuring financial solvency
- Inter firm comparison

4. LIMITATIONS OF RATIO ANALYSIS:

- Practical knowledge
- Ratio are means
- Inter relationship
- Non availability of standards
- Accuracy of financial information
- Consistency in preparation of financial statement
- Change in price level

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5. CLASSIFICATION OF RATIOS:

TYPES OF RATIOS

LIQUIDITY RATIO	SOLVENCY RATIO	TURNOVER RATIO	PROFITABILITY RATIO
Current Ratio	1.Proprietary Ratio	1.Stock turnover ratio	1.Gross Profit Ratio
Quick Ratio	2.Debt equity Ratio	2.Debtors turnover ratio	2.Net profit Ratio
Cash position Ratio	3.Fixed Asset Ratio	3.Creditors turnover ratio	3.Operating profit Ratio
	4.Capital gearing ratio	4.Working capital turnover ratio	4.Return on Investment Ratio
		5.Capital turnover ratio	5.Expenses Ratio
			6.Earnings per share Ratio
			7.P/E Ratio

I. LIQUIDITY RATIO:

It measures the firms ability to pay off current dues or repayable within a year.it is otherwise known as "Short term solvency Ratios".

1. **Current Ratio**: The Ratio of current assets to current liabilities is called current ratio. Current ratio indicates the ability of a concern to meet its current obligation as and when they are due for payment.

2. **Quick Ratio:** This ratio is used to assess the firms short term liquidity. The relationship of liquid assets to current liabilities is known as Quick ratio. It is otherwise called as acid test ratio.

3. **Cash Position Ratio:** This ratio measures liquidity in terms of cash and near cash items and short term current liabilities. This ratio is otherwise called as absolute liquidity ratio.

II. SOLVENCY RATIO:

It measures the firm ability to meet its long term obligations. It is used to analyze to find judicious use of funds. In includes all ratios which express financial position of the concern.

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1. **Proprietary Ratio:** It shows the relationship between shareholders funds and total tangible assets. This ratio shows the general soundness of the company.

2. **Debt Equity Ratio:** It indicates the proportion between long term debts and shareholders' funds. This ratio indicates the extent to which the firm depends upon outsiders for its existence.

3. **Fixed Asset Ratio:** This ratio establishes the relationship between fixed assets and long term funds. The objective of calculating this ratio is to ascertain the proportion of long term funds invested in fixed assets.

4. **Capital gearing Ratio:** This ratio establishes the relationship between fixed interest and dividend bearing funds and equity shareholder funds. It is used to analyze the capital structure of the company.

III. PROFITABILITY RATIO:

It measures the profit earning capacity of the business concern. It analysis of profit margin ratio and Ratio of return ratio.

1.Gross Profit Ratio: This ratio indicates the efficiency of trading activities. It indicates the difference between sales and direct cost.

2.Net Profit Ratio: It is a measure of management efficiency in operating the business successfully from the owners' point of view. It indicates the return on shareholder investment.

3.Operating Profit Ratio: It is the ratio of profit made from operating sources to the sales. It shows the operational efficiency of the firm and is a measure of the management efficiency in running the routine operation of the firm.

4. Operating Ratio: This ratio determines the operational efficiency of the business. Operating ratio measures the amount of expenditure incurred in production, sales and distribution of output.

5.Return on investment Ratio: It measures the sufficiency or otherwise of profit in relation to capital employed.

6.Expenses Ratio: It is better for the concern to know how it is able to save or waste over expenditure in respect of the different items of expenses.

7.Earnings Per Share Ratio: It is helpful in determining market price of equity share. It reflects upon the capacity of the concern to pay dividend to its equity share holder.

8.P/E Ratio: This ratio is use to prospective investors to decide whether to invest in the equity shares of a company at a particular market price or not.

9.Payout Ratio: This ratio also indirectly throws light on the financial policy of the management in ploughing back

10. Dividend Yield Ratio: In this ratio the dividend is related to the market value of the share.

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IV. TURNOVER RATIO:

Activity ratio indicates the performance of the business. The performance of a business is judged with its sales. This ratio highlights the operational efficiency of the business concern.

1.**Stock Turnover Ratio**: This ratio is calculated to ascertain the efficiency of inventory management in terms of capital investment. It shows the relationship between cost of goods sold and the amount of average inventory.

2.**Debtors Turnover Ratio**: This Ratio measures the number of times the receivables are rotated in a year in terms of sales. This indicates the efficiency of credit collection and efficiency of credit policy.

3.**Creditors Turnover Ratio:** The Ratio indicates the number of times the payable rotates in a year. This indicates the credit purchases and average accounts payable.

4.**Working Capital Turnover Ratio**: It measures the relationship between cost of sales and working capital. This ratio measures the effective utilization of working capital.

5.**Capital Turnover Ratio:** The relationship between sales and capital employed is called capital turnover ratio. This ratio shows the number of times the capital has been rotated in the process of carrying on the business.

6.**Fixed Asset Turnover Ratio:** This ratio determines efficiency of utilization of fixed assets and profitability of a business concern. The relationship between sales and fixed assets is called fixed assets turnover ratio.

6. THE FOLLOWING RATIOS ARE USEFUL IN ANALYSING FINANCIAL POSITION OF THE COMPANY

Financial statement ratios are measures of the efficiency and productivity of a business that are calculated using information found on the financial statements.

There are five basic financial statement ratios that we can use to see how well a company is performing. They are the

- Current ratio
- Quick ratio
- Earnings per share
- Debt-to-assets ratio, and
- Return on equity.

The first ratio is called the **current ratio**, or the **working capital** ratio. This ratio measures the amount of current liabilities that a company has for every one dollar of current assets. It is calculated by dividing current assets by current liabilities.

The second ratio that is specific to information found on the balance sheet is the **quick ratio**. The quick ratio measures the number of dollars in cash and accounts receivables that there are for every one dollar in liabilities. It is calculated by adding cash and accounts receivable together and dividing that total by the amount of current liabilities.

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The third ratio is **earnings per share**. Earnings per share, which is generally called **EPS**, measures how much net income is earned per share of a company's common stock. This ratio is calculated by dividing net income by the weighted average shares of common stock outstanding.

Debt-to- assets is a fourth ratio that's important to a company. It tells how many assets a company has that are financed by debt, and it's calculated by dividing total liabilities by total assets. The lower the debt-to-assets ratio is, the better off the company is.

The last member of the common financial statement ratios is the return on equity. **Return on equity** is a measure of the return on each dollar invested by stockholders. The way to calculate this is to divide net income by the average stockholder's equity. It is very important to note that the information you need to calculate these ratios comes from both the balance sheet and income statement of a company.

C. FUNDS FLOW STATEMENT:

- ❖ Flow means change.
- ❖ Fund is interpreted as working capital.
- ❖ This fund flow is changes in working capital.
- ❖ Flow of funds implies any changes in working capital.
- ❖ It can be inflow or outflow of working capital.

1. OBJECTIVES OF FUND FLOW STATEMENT:

- ✓ Indication of financial results
- ✓ Emphasis on significant changes
- ✓ Illustration of relationship
- ✓ Revealing financial strength and weakness
- ✓ Distinguish internal and external sources
- ✓ Giving performance to dynamic concept of business.

2. IMPORTANCE/USES/BENEFITS OF FUND FLOW STATEMENT:

- ❖ It provides a detailed analysis and understanding of changes in the distribution of financial resources between two balances dates.
- ❖ It shows how the funds were obtained and used during a period.
- ❖ It gives indication of any weakness or strength in the general financial position of a firm.
- ❖ It throw light on the financial consequences of business operation.

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- ❖ It provides an understanding about the utilization of resources in the past.
- ❖ It is helpful in the rearrangement of capital structure, formulating long term financial plans and policies.
- ❖ It can be compared with the relevant budget to assess the usage of funds as per plans.

3. LIMITATION OF FUND FLOW STATEMENT

- Fund flow statement is historical in nature. It shows what happened in the past. So necessarily, it value is limited from the point of view of future operation.
- It is secondary data. So its accuracy and reliability depends on the accounting department
- The effect of transaction between current assets and current liabilities is not shown in this statement
- It is not generally considered as a sophisticated techniques or financial analysis
- It ignores transaction between long term aspects and liabilities.

4. PROCEDURE FOR PREPARING FUND FLOW STATEMENT

Step 1: Schedule of changes in working capital

Step 2: Adjusted profit and loss account

Step 3: Fund flow statement

D. CASH FLOW STATEMENT

A cash flow statement is a statement which portrays the changes in the cash position between two accounting periods.

1. ADVANTAGES/ UTILITY/ BENEFITS OF CASH FLOW STATEMENT

- Historical analysis ad guide to forecasting
- Effective cash management
- Formulation of financial policy
- Preparation of cash budget
- Short term financial decision

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- Liquidity
- Revelation

2. LIMITATION OF CASH FLOW STATEMENT

- CFS discloses inflows and outflows of cash alone. Thus it scope is very limited compared to FFS
- CFS reveals the cash balances. But it can be easily altered by postponing payments for purchase or delaying collection of receivables etc.
- Since non-cash items of expenses and incomes are excluded, it cannot provide a comprehensive picture of a firm financial position.

3. PURPOSE OF PREPARING CASH FLOW STATEMENT

The term *cash flows* refers to the receipts and payments of cash. Companies periodically disclose the cash flows arising from its various activities in the form of a statement. This statement is known as **statement of cash flows** (or cash flow statement).

The main purposes of preparing a statement of cash flows are as follows:

❖ **Explanation of the changes in cash:**

CFS explains the reasons of the change in company's cash and cash equivalents during a particular accounting period by showing the details of cash generated and cash used to perform operating, investing and financing activities of the business.

❖ **Anticipation of future cash flows:**

The management, creditors, actual and perspective investors and competitors of the company are interested to know the ability of the company to generate positive cash flows in future. The CFS enables these parties to understand how company manages cash and to anticipate the impact of current cash receipts and cash disbursements on future cash flows of the business.

❖ **Legal requirements:**

In some countries, the companies are legally required to prepare and present financial statements in accordance with international financial reporting standards (IFRSs). As the statement of cash flows (SCF) is one of the basic components of financial statements, its presentation is legally required in some countries.

❖ **Information about non-cash investing and financing activities:**

Companies also engage in various investing and financing activities that do not require the use of cash. Such activities are known as non-cash investing and financing activities. Sometime these activities have a significant impact on the future cash flows of the entity and therefore their disclosure to the users of financial statements becomes necessary. For this purpose, a company that performs any significant non-cash investing

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and financing activity during the accounting period must disclose it either in the statement of cash flows or in the footnotes to the financial statements.

The examples of non-cash investing and financing activities that may become significant for a company are given below:

- Purchase of land for issuing common stock.
- Issuance of common stock to discharge a liability.
- Purchase of equipment for issuing a note.

❖ **The difference between net income and net cash flows from operating activities:**

The CFS explains the reasons of the difference between the net income and the related net cash flows from operating activities.

DIFFERENCE BETWEEN FUND FLOW STATEMENT AND BALANCE SHEET

FUND FLOW STATEMENT	BALANCE SHEET
It shows changes in working capital between two balance sheet date	It shows the position of assets and liabilities on a specific date
It shows only those items which cause change in working capital	It shows the real and personal account of a business, reflected in the assets and liabilities
It aims at presenting flow of funds over a period	It aims at depicting the financial position of the business
It is a tool for financial analysis generally useful to management	It is meant for general purpose and used for various stakeholders
It is based on the data forming part of the income statement and balance sheet.	It is based on the trial balance and additional information relating to a firm
It is prepared after the financial accounts are completed	It is prepared after income statement is completed

DIFFERENCE BETWEEN FUND FLOW STATEMENT AND CASH FLOW STATEMENT

PARTICULARS	FUND FLOW STATEMENT	CASH FLOW STATEMENT
Basis of preparation	FFS is based on the working capital concept of funds	CFS is based on the cash concept of funds
Basis of accounting	FFS is based on accrual basis of accounting	CFS is based on cash basis of accounting

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Changes shown	FFS shows the various changes in working capital position over a period of time	CFS reveals the causes for changes in the cash position over the period of time
usefulness	FFS is more useful for decision making in the long run	CFS is more useful in the short run
Short term solvency	FFS indicates short term solvency of the firm because it considers all the current assets and current liabilities	CFS does not reveal the short term solvency of the firm because it ignores all other current assets and current liabilities other than cash
Based on technique	There is no balance in preparation of FFS	CFS starts with opening cash balance and ends with closing cash balance

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UNIT 3

MARGINAL COST

Marginal cost is the additional cost of producing an additional unit of a product

1. MARGINAL COSTING

The ascertainment of marginal cost and of the effect on profit of changes in volume or type of output by differentiating between fixed cost and variable cost.

2. FEATURES OF MARGINAL COSTING

- ✓ Marginal costing is a technique of control or decision making
- ✓ Under marginal costing the total cost is classified as fixed cost and variable cost
- ✓ Fixed cost are ascertained separately and excluded from the cost of the product
- ✓ The stock of work in progress and finished goods are valued at variable cost
- ✓ Contribution is ascertained by reducing the marginal cost from the selling price
- ✓ The profitability of products, department or processes is determined on the basis of contribution
- ✓ Profit is ascertained by reducing the fixed cost from the contribution of all the products
- ✓ The profitability of various level of activity is ascertained by calculating cost volume profit relationship.

3. ASSUMPTION OF MARGINAL COSTING

- All the cost should be divided in to two categories fixed cost and variable cost
- Fixed cost remains constant at all level of output
- Variable cost vary in total but they remain constant per unit
- Variable cost remains unchanged
- Selling price remains constant at different level of activity
- No change in manufacturing process

4. ADVANTAGE OF MARGINAL COSTING

- ❖ Simplicity
- ❖ Stock valuation
- ❖ Meaningful reporting
- ❖ Effects of fixed cost
- ❖ Profit planning
- ❖ Cost control and cost reduction
- ❖ Pricing policy
- ❖ Helpful to management

5. DISADVANTAGE OF MARGINAL COSTING

- Classification of cost
- Not suitable for external reporting
- Lack of long term perspective
- Undervaluation of stock
- Automation
- Production aspect is ignored
- Not applicable to all types of business
- Less scope for long term policy decision

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6. COST VOLUME PROFIT (CVP) ANALYSIS

CVP analysis is the analysis of three variables i.e. cost, volume and profit. This analysis measures variation of cost and volume and their impact on the profit. Profit is affected by several internal and external factors which influence sales, revenue and cost.

7. FIXED COST

It is the total of all those cost which are termed as periodic cost. Fixed costs are fixed in total but variable per unit. Fixed cost are incurred irrespective of the actual activity or operation.

8. VARIBALE COST

These are the cost which increases or decreases in proportion to the level of output. The variable costs vary in total but they remain constant per unit. They include all the direct cost.

9. CONTRIBUTION

It is the difference between sales and marginal cost

10. PROFIT VOLUME RATIO

This is the ratio of contribution to sales. This ratio analysis the relationship between sales and contribution. A high p/v ratio indicates high profitability and low p/v ratio indicates low profitability.

11. MARGIN OF SAFETY

Margin of safety is the difference between actual sales and break even sales. Margin of safety indicates the value/ volume of sales which directly contribute to profit as fixed cost have been already recovered at break-even point.

12. ANGLE OF INCIDENCE

The angle at which the sales line crosses the total cost line is called as angle of incidence

13. BREAK EVEN ANALYSIS

At certain level of production and sales activity, the total cost incurred and total revenue received is equal

14. BREAK EVEN POINT

The break-even point is that point of activity where total revenue a total expenses are equal. It is the point of zero profit and zero loss or no profit and no loss.

15. BREAK EVEN CHARTS

Break even charts shows the inter relationship between cost, volume and profit. The graph clearly shows the break-even point and profit or loss at various volume and level of activity.

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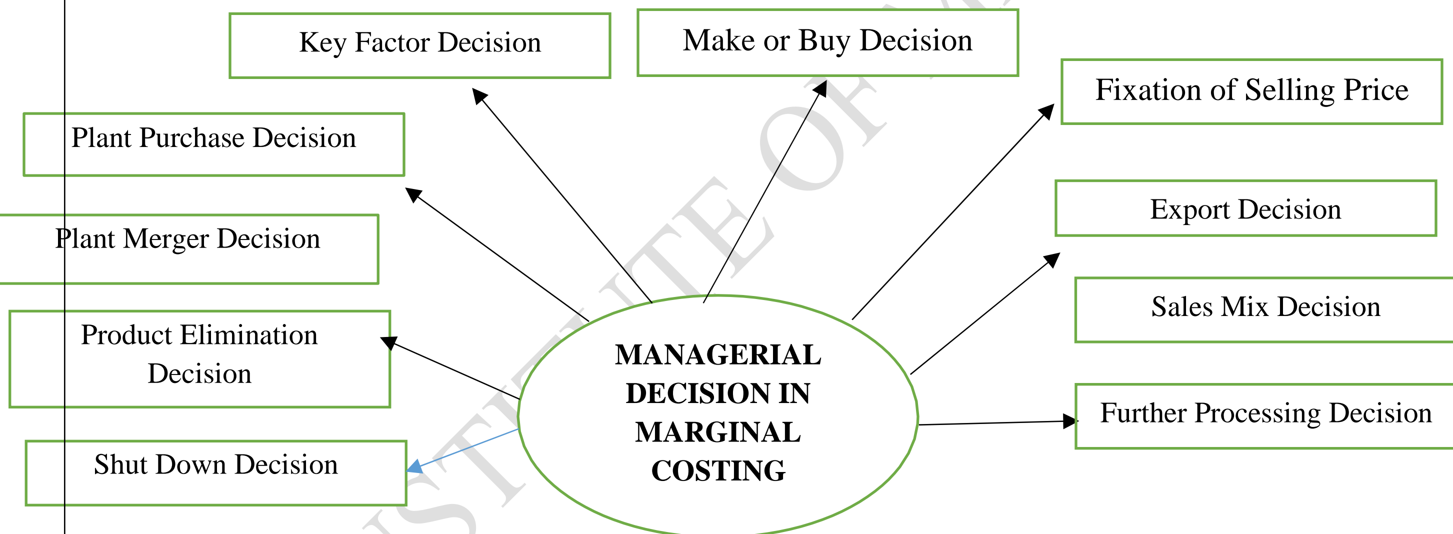
16. USES OF BREAK EVEN ANALYSIS

- ✓ Total cost, variable cost and fixed cost can be determined
- ✓ Break even sales units and value can be ascertained
- ✓ Cost volume profit relationship can be analyzed thoroughly which is useful to the management for decision making
- ✓ Break even analysis is helpful in inter firm comparison
- ✓ Break even analysis is helpful in profit forecasting and planning
- ✓ Break even analysis is helpful in cost control

17. LIMITATION OF BREAK EVEN ANALYSIS

- Selling price may not remain constant in practice
- Detailed cost information cannot be known from break even analysis
- Significance of opening and closing stock is ignored be valuing them at marginal cost
- Different product and sales mix cannot be studied
- Capital employed, market aspects, impact of government policy are ignored
- If business condition changes break even analysis become unusable since it assumes constant business condition.

18. APPLICATION/ USES OF MARGINAL COSTING IN MANAGERIAL DECISION MAKING



- ❖ Key factor/ limiting factor
  - ♦ Any factor concerned with production or sales which imposes "limits" on the production or sales can be called as "Limiting Factor" or "Key Factor"
  - ♦ Key factor can be any one of the following
    - ✓ Sales potential may be limited. It may be due to severe competition or lack of demand.
    - ✓ The limit on sales can be in terms of quantity or value

- ❖ Make or buy decision
  - ♦ Many durable products are assembled by using a large number of parts or components. Some of them may be made by the firm which is assembling the product. It may buy some of the parts from outside.
  - ♦ When assembling firm receives an offer from outside for a component it is already making, the "Make or Buy Decision" must be taken.

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- Fixation of selling price
  - Marginal costing technique is widely applied in the area of determining selling price.
  - Prices may have to be fixed in different situation, under specific constraints such as
    - ✓ Selling below cost
    - ✓ Competitive pricing
    - ✓ Pricing based on idle capacity
    - ✓ Penetration pricing
    - ✓ Pricing of export

- Export decision
  - When idle capacity exists, exporting is usually the most profitable strategy.
  - The great advantage with exports to foreign counties is that export price will not adversely affect the local price.
  - So companies which have already recovered their fixed cost from local sales can export just above their variable cost and still make good profit.
  - This generally termed as "Dumping"
  - Export price should be above variable cost. It need not be linked to domestic price.

- Sales mix decision
  - When a firm sells two or more products, the ratio of different products in the total sales is called as sales mix or product mix.
  - The objective should always be to have "the most profitable product mix"

- Product elimination decision
  - When two or more product is sold by a firm as a sales mix, situation may arise where it may be felt that particular product has to be eliminated.
  - This elimination can be done in two ways
    - ✓ Elimination without Replacement: This is advisable in case of product which provide negative contribution
    - ✓ Elimination with Replacement: Here one or more product with lower P/V ratio may be discontinued in favour of one or more new productwhich possess higher P/V ratio.

- Plant merger decision
  - Two or more plant may be operating under the same management producing similar product.
  - It may be possible for one firm to acquire another competing firm.
  - It is possible that
    - ✓ Each plant may be operating at a particular capacity level either at 100% capacity or less
    - ✓ The selling price, variable costs and fixed costs may be different

- Plant purchase decision
  - Purchasing plant is a long term capital expenditure decision involving investment and the required return on investment.
  - Plant purchase situation:
    - ✓ When a single model of plant is available and the decision is whether to buy it or not, the effective contribution from the plant and the contribution as a percentage on investment are the deciding factors
    - ✓ When one of the two models of plant or equipment has to be chosen, the least cost option should be made

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- Further processing decision
  - Two or more products may be produced in a joint process.
  - They have a market at the split off point itself.
  - It may be possible to further process one or more of the products to enhance their market value.
  - The decision to further process or not depends on the overall contribution received.
  - If further processing can result in additional contribution from the product, it is desirable

- Shut down decision
  - When a firm is operating at loss for some time, the management may have to decide upon its shut down.
  - The following are two ways of shut down
    - ✓ Complete shut down: The firm may be permanently closed without any intention to revive it.
    - ✓ Partial or Temporary shut down: Here the intention is to close down for sometime and reopen the firm when circumstances favour it.

DIFERENCE BETWEEN ABSORPTION COSTING AND MARGINAL COSTING

PATICULARS	ABSORPTION COSTING	MC/ VC/ DC
Classification of cost	Cost are classified as direct and indirect cost	Cost are classified as fixed and variable cost
Treatment of cost	Direct cost are identifiable with a particular product and hence charged directly. Indirect cost are first identified and apportioned to the cost centre and absorbed in the product units on some basis	Variable cost are charged to the product while the fixed cost are not absorbed in the product line
Valuation of stock	The year-end inventory of finished goods are valued at total cost	The year-end inventory is valued at variable cost
Treatment of fixed overhead	The fixed overhead may create some problem like over/ under absorption. This happens because of the overhead absorption rate which is predetermined	The fixed overheads are charged directly to the costing profit or loss account in the product units. Hence there is no question of under/ over absorption of overheads.
Distortion of profit and cost	Due to the inventory valuation, which is done at the full cost, the costs relating to the current period are carried forward to the	Fixed cost are not taken in to consideration while valuing the inventory and hence there is no distortion of profit.

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	subsequent period. This will distort the cost of production	
Fixation of selling price	The total cost of production is charged to the product. The selling price is thus fixed on the basis of total cost	Only variable cost are charged to the cost of production and therefore selling price is based on variable cost only.
Emphasis	It lays emphasis on production	It emphasis on selling aspects
Purpose	It is suitable for long term decision making	It is suitable for short term managerial decision making

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UNIT IV

A. BUDGETING

1. BUDGET

A financial and quantitative statement, prepared prior to a defined period of time, for the policy to be pursued during that period for the purpose of attaining a given objectives.

2. BUDGETING

The entire process of preparing a budget is known as "budgeting".

3. BUDGETORY CONTROL

Budgetary control is a system of coordinating cost which includes the preparation of budget, coordinating the works of department and establishing responsibilities, comparing the actual performance with budgeted and acting upon result to achieve maximum profitability.

4. OBJECTIVES OF BUDGETORY CONTROL

- Planning
- Coordination
- Efficiency and economy
- Increase in profitability
- Anticipation of future capital expenditure
- Control
- Deviation

5. ADVANTAGES / IMPORTANCE OF BUDGETORY CONTROL

- ✓ Maximization of profit
- ✓ Effective coordination
- ✓ Evaluation of executive performance
- ✓ Clear cut goals and target
- ✓ Economy in operation
- ✓ Revelation of ineffectiveness
- ✓ Correlation of performance continuously
- ✓ Introduction of incentive scheme of remuneration
- ✓ Shutting down of unprofitable product and activities.

6. LIMITATION OF BUDGETORY CONTROL

- Prediction of uncertain future
- Changes of conditions
- Complacence
- Difficulty in coordination
- Conflict among different department

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7. ESSENTIALS OF SUCCESSFUL BUDGETORY CONTROL

- Top management support
- Clearly defined organizational structure
- Efficient accounting system
- Reporting of deviation
- Motivation
- Realistic target
- Participation of all department concerned
- Flexibility

8. STEPS INVOLVED IN BUDGETORY CONTROL

STEP 1: PREMILIARY STEP

- Organization for budgeting
- Budget controller
- Budget committee
- Budget center
- Budget manual
- Budget period
- Determination of key factor

STEP 2: PREPARATION OF BUDGET

- Determination of key factor
- Making forecast
- Evaluation of alternative combination of factor
- Preparation of various functional budget
- Preparation of master budget.

STEP 3: FIXATION OF RESPONSIBILITY

STEP 4: COMPARISON OF ACTUALS WITH BUDGETED

STEP 5: TREATMENT OF DEVIATIONS AND FOLLOW UP ACTI

9. DIFFERENT TYPES OF FUNCTIONAL BUDGET

The budget relate to various function of the concern is known as functional budget. The following are the different functional budget.

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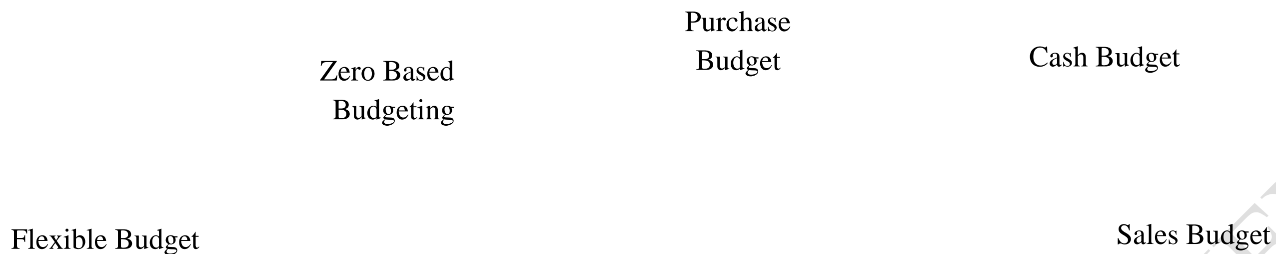

TYPES OF BUDGET

Master Budget

Production Budget

Material Budget

- PURCHASE BUDGET
  - ✓ The budget forecast the quantity and value of purchase required for production. It gives quantity wise, money wise and period wise information about the material to be purchased.

- CASH BUDGET
  - ✓ It is most important budget. It estimates the amount of cash receipts and cash payments and the balance of cash during a specific period. The aim of the cash budget is to provide requirement of cash and avoid accumulation of cash.

- SALES BUDGET
  - ✓ In the budgeting process, sales are a starting point as sales is a key factor in many cases.
  - ✓ The sales budget may be prepared in five different ways
    - ❖ Product wise
    - ❖ Territory wise
    - ❖ Period wise
    - ❖ Customer wise
    - ❖ Sales mix wise
  - ✓ The sales budget is generally prepared by the sales manager of the business concern.
  - ✓ This budget is prepared by taking several factors in to account like policies, economic situation, discount and other terms.

- PRODUCTION BUDGET
  - ✓ This budget is based on sales budget, unless production itself is a key factor. It has two parts one showing the output for the period and other showing production cost.

- <u>MATERIAL BUDGET</u>
  - ✓ This budget is prepared in coordinating with production budget
  - ✓ It consists of two parts

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    - ❖ Material consumption budget
    - ❖ Material purchase budget
  - ✓ Material consumption budget is prepared on the basis of the production budget
  - ✓ Material purchase budget is prepared on the basis of material consumption budget.

- MASTER BUDGET
  - ✓ The master budget is the summary budget, incorporating its functional budget
  - ✓ It is a combined budget summarizing all other budget
  - ✓ It is prepared by the budget committee and it remains with the top management
  - ✓ This budget is helpful in coordinating activities of various functional departments.

10. FLEXBILE BUDGET AND ITS SIGNIFICANCE

Flexible budget is a budget prepared for various level of activity by classifying the expenditure under fixed, variable and semi fixed expenses.

SIGNIFICANCE:

- ❖ Variance reporting is one the essential components of budgetary control system.
- ❖ If actual performance is at a level which is below or above the budget level, comparison of actuals with a fixed budget fails to reflect the cause of variation
- ❖ The variance may be due to the change in the activity level or due to managerial failure. A flexible budget solves this problem because it is adjusted for changes in the volume of output.
- ❖ It is based on the knowledge of cost of behviour pattern
- ❖ A fixed budget is prepared for only one level of activity. A flexible budget is prepared for a range of activity level.

11. ZERO BASED BUDGETING (ZBB)

Zero base budgeting is a new technique of budgeting. It is designed to meet the needs of the management in order to ensure the operational efficiency and effective utilization of the allocated resources of a concern. This technique was originally developed by Peter A. Phyhrr, Manager of Taxas Instrument during 1969. This concept is widely used in USA for controlling their state expenditure when Mr.Jimmy Carter was the president of the USA. At present the technique has for its global recognition for many countries have implemented in real terms.

According to Peter A. Phyhrr ZBB is defined as an “Operative planning and budgeting process which requires each manager to justify his entire budget in detail from Scratch (hence zero base) and shifts the burden of proof to each manager to justify why we should spend any money at all”.

In zero-base budgeting, a manager at all levels, have to justify the importance of activity and to allocate the resources on priority basis.

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IMPORTANT ASPECT OF ZBB

Zero-based budgeting involves the following important aspects:

1. It emphasises on all requisites of budgets.
2. Evaluation on the basis of decision packages and systematic analysis, i.e., in view of cost benefit analysis.
3. Planning the activities promotes operational efficiency and monitors the performance to achieve the objectives.

STEPS INVOLVED IN ZBB

` The following are the steps involved in zero base budgeting:

1. No previous year performance of inefficiencies is to be taken as adjustments in subsequent year.
2. Identification of activities in decision packages.
3. Determination of budgeting objectives to be attained.
4. Extent to which zero base budgeting is to be applied.
5. Evaluation of current and proposed expenditure and placing them in order of priority.
6. Assignment of task and allotment of sources on the basis of cost benefit comparison.
7. Review process of each activity examined afresh.
8. Weightage should be given for alternative course of actions.

ADVANTAGES OF ZBB

1. Utilization of resources at a maximum level.
2. It serves as a tool of management in formulating production planning.
3. It facilitates effective cost control.
4. It helps to identify the uneconomical activities.
5. It ensures the proper allocation of scarce resources on priority basis.
6. It helps to measure the operational inefficiencies and to take the corrective actions.
7. It ensures the principles of management by objectives.
8. It facilitates co-operation and co-ordination among all levels of management.
9. It ensures each activity is thoroughly examined on the basis of cost benefit analysis.

B. STANDARD COSTING

1. STANDARD

A standard is a norm or measure or yard stick with which comparison can be made.

2. STANDARD COST

Standard cost is a predetermined cost which is calculated from the management standards of efficient operation and the relevant necessary expenditure.

3. STANDARD COSTING

Standard costing is the preparation and use of standard cost, their comparison with actual cost and the analysis of variance to their causes and point of incidence.

4. STEPS IN STANDARD COSTING

(a) Preparation and use of standards;

(b) Comparison of actual costs with standards to determine the variance; and

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(c) Investigating the variance and taking appropriate actions where necessary.

5. APPLICABILITY OF STANDARD COSTING

Standard costing is a system or technique of cost accounting, which can be used in conjunction with process, job or operating costing without any difficulty, whatsoever.

Industries where standard costing is more suitable and used can be listed as under:

1. Process industries where the method of production and nature of output are the same.

Examples: Chemical works, Paper mills, Oil refineries, etc.

2. Industries where the methods of manufacture are repetitive and products are homogeneous.

Examples: Agricultural and food products.

3. Service industries where operating or operation costing system is also applicable.

Examples: Transport, Water, Gas, and Electricity, etc.

4. Engineering and textile industries where a large range of products are produced.

5. Extraction industries such as coal, oil, and timber, etc.

6. UTILITY OF STANDARD COSTING AS A MANAGEMENT TOOL:

Standard costing aids management in making correct predictions and provides a framework for judging business performance. The utility of standard costing to management is as follows:

1. It acts as a valuable guide to management in the formulation of price and production policies. For example, it assists management in the field of inventory pricing, product pricing and profit planning, etc.

2. It provides a stable and sound basis for comparison of actual costs with standard costs according to different elements of costs separately. It also shows places where remedial action is necessary and how far improvement is possible in the long run.

3. It creates an atmosphere of cost consciousness among the office and managerial staff and workmen of the business. It also provides incentives to workers, middle and top-level executives for efficiency.

4. It helps to formulate tighter, more accurate and effective budget for the coming years.

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5. Standard costing assists management in the delegation of authority and responsibility to control the affairs of various departments.

6. With the use of standard costing, the principle of 'management by exception' can be practiced with ease and more effectively.

7. It assists management to put the men, machines and materials more effectively and reap the benefits of better economy, efficiency, and higher productivity.

8. Budgetary control system becomes far more effective when used in conjunction with the standard costing system. Standard costs being scientifically determined are very much useful for better planning and control.

7. ADVANTAGES OF STANDARD COSTING:

1. Compiling standard costs more carefully can eliminate the weakness of the traditional costing system.

2. Standard costs can be used as a yardstick against which actual costs can be compared. It is an effective tool for planning production costs. Hence, cost control is greatly facilitated.

3. Variance analysis helps management to have regular as well as better checks over costs incurred. It makes the application of the principle of management by exception more easy. That is, the management can concentrate its attention on variances only, leaving the other aspects of cost control to be taken care of at the lower level.

4. It is a valuable guide to management in the formulation of production and price policies in advance with certainty. It also assists management in the areas of profit planning, product pricing, and inventory pricing, etc.

5. Standard costing makes the reporting of operating data more meaningful and also fast. This makes the interpretation of management reports easy.

6. As the emphasis of standard costing is more on cost variations, it makes the entire organization cost conscious. It makes the employees to recognize the importance of efficient operations so that costs can be reduced by joint efforts.

7. Men, machines and materials can be effectively used, and economies can be effected in addition to increased productivity. Standards may also be used as the basis for introducing incentive schemes. Wastage and inefficiency are curtailed, eliminated and reduced in all aspects of manufacturing process over a period of time if standard costing is in continuous operation.

8. Management can easily fix up responsibility through variance analysis. Variance analysis can determine the persons responsible for each variance; shifting or evading responsibility is not so easy under this system.

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8. LIMITATIONS OF STANDARD COSTING:

1. Setting of standards is a very difficult task. It requires a lot of scientific studies such as time-study, motion-study, fatigue study etc. and therefore it is very costly. Small firms may find it very difficult to operate such system.

2. Standards are very rigid estimates and once set, are not changed for a considerable time. This makes the standards highly unrealistic in certain industries, which face fluctuations in prices of products due to frequent changes in material and labour costs. Revision of standards is also not easy; in case of revision, costs would be high.

3. The utility of variance analysis depends much more on the standards set. While a loosely set standard may be ridiculed, the very high standards may create frustration in the minds of workers. At the same time setting of correct standards is also very difficult.

4. It is not suitable for industries producing non-standardized products. It is of little value in job or contract costing. Also it is difficult to apply this system when production takes more than one accounting period.

5. Fixation of responsibility to a particular person, process or production becomes very difficult as it may not be possible to identify the controllable and non-controllable factors easily.

6. Normally the system is strongly opposed by managers and others as they see it as a threat to their freedom of action. Standards may sometimes create adverse psychological effects on managers and workers, who are operating the system.

C. VARIANCE ANALYSIS

Variance analysis is the difference between a standard cost and the comparable actual cost incurred a period.

SIGNIFICANCE

- ✓ Variance analysis sub divides the total variance based on different contributory causes. This gives the clear picture of different reason for overall variance
- ✓ The sub division of variance establishes and highlights the inter relationship between different variance
- ✓ Variance analysis emphasis the causes for each variance. It paves way for fixing responsible for all variance
- ✓ It highlights inefficient performances and the extent of inefficiency
- ✓ It is a powerful tool leading to cost control
- ✓ It segregates variances in to controllable and uncontrollable
- ✓ It acts as a basis for profit planning

By revealing each and every deviation along with the causes, variance analysis creates nurtures cost consciousness among the employees

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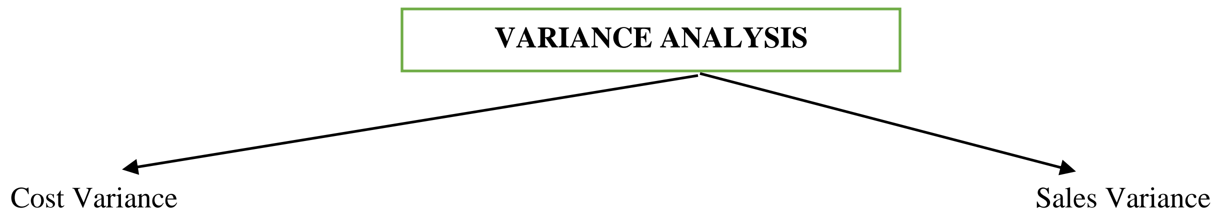
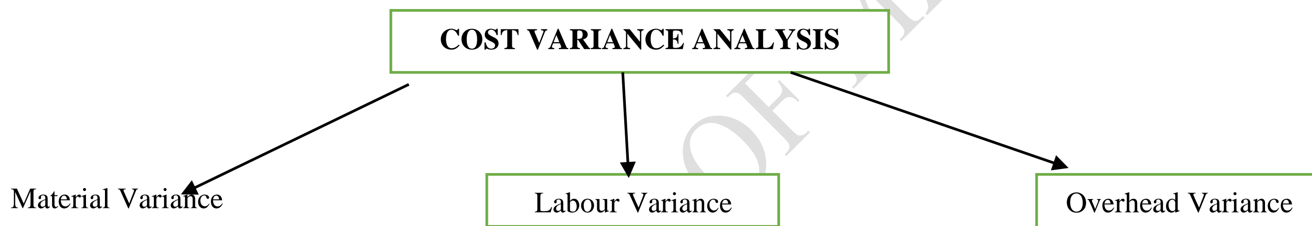
Variance can be broadly divided in two categories



COST VARIANCE:

The total cost variance is the difference between standard cost for actual output and the actual total cost incurred. The total cost variance can be sub divided as follows



A. MATERIAL VARAINCE

1. Material Cost Variance:

- It is the difference between standard material cost for the actual output and the actual cost of the material used.
- Standard material cost is the product of standard price per unit of material and the standard quantity of material for actual output.

2. Material Price Variance:

- It is the portion of the direct material cost variance which is due to the difference between the standard price specified and the actual price paid.

3. Material Usage Variance

- It is the difference between the standard cost of standard quantity of material for actual output and the standard cost of the actual material used.

4. Material Mix Variance:

- It is that portion of that direct material usage variance which is due to difference between standard and actual composite of mixture

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- The mix variance has to be computed only when two or more material are used.

5. Material Sub Usage Variance
    - Material sub usage variance is calculated in cases where material yield variance cannot be calculated.
    - Material mix variance and sub usage variance, together will be equal to material usage variance.

6. **Material Yield Variance**
    - It is that portion of direct material usage variance which is due to the difference between the standard yield specified and actual yield obtained.

B. LABOUR VARIANCE

1. **Labour Cost Variance:**
    - It is the difference between direct labour cost allowed for the actual output and the actual direct labour cost incurred.

2. **Labour Rate Variance:**
    - It is that portion of the direct wages variance which is due to the difference between the standard rate of pay specified and actual rate paid.

3. **Total Labour Efficiency Variance:**
    - It is the portion of the difference between the total time for which workers are paid and the time effectively used for production as per the standard of efficiency.

4. **Labour Efficiency Variance:**
    - This variance is that portion of the total direct labour efficiency variance which is the result of causes other than idle time.

5. **Labour Idle Time Variance**
    - Idle time variance is due to time lost abnormally on account of strikes, lockouts, power failure, machine breakdown, etc.
    - Time wasted due to such causes on which the individual workers have no control should be separately accounted for and should be shown as a separate variance.

6. **Labour Mix Variance:**
    - This variance arises only when two or more kinds of labour perform some work as a group or gang.
    - Mix variance reflects the cost of any change in the composition of labour groups.
    - It may be favourable if more cheaper labour is used in place of costly labour and vice versa.

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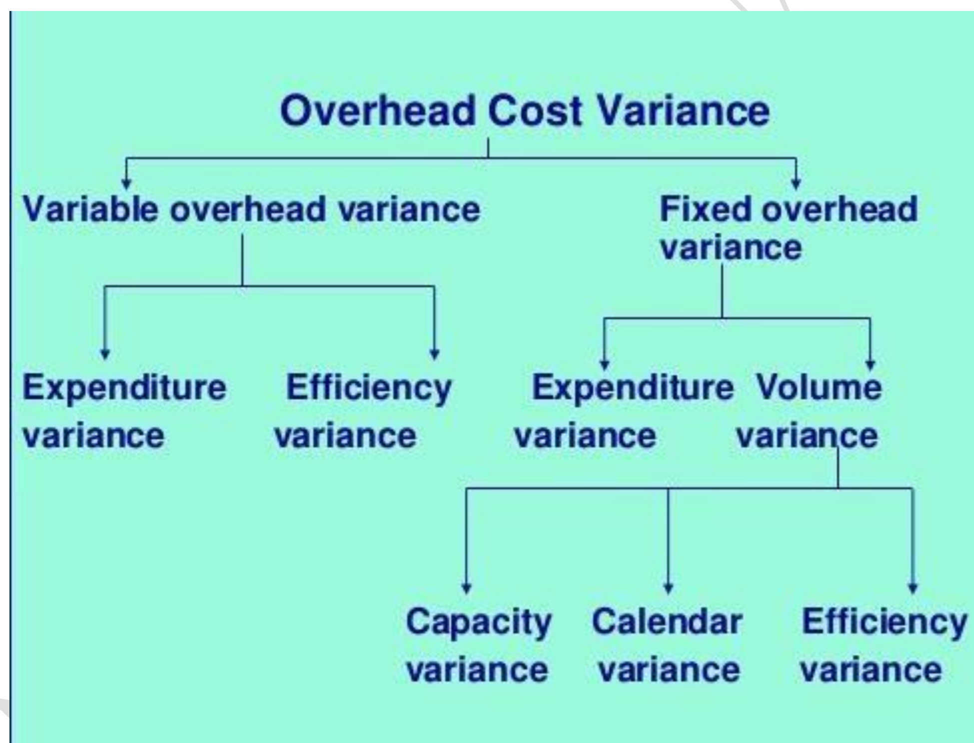
7. **Revised Labour Efficiency Variance:**
   - When a labour mix variance is calculated, the balance of labour efficiency variance must be due to the actual efficiency or inefficiency of the worker.

8. **Labour Yield Variance:**
   - This variance is calculated on the same lines as material yield variance.
   - It is the variation in the labour cost on account of increase or decrease in yield or output as compared to the relative standard.

C. OVERHEAD VARIANCE
   - This variance shows the extent of recovery of total overhead from the output.
   - Total overhead consists of variable overhead and fixed overhead
   - Total Overhead variance is classified in to following things



I. <u>Variable Overhead Variance:</u>

1. **Variable Overhead Cost Variance:**
   - It is the difference between standard overhead cost for actual output and the actual variable incurred

2. **Variable Overhead Expenditure Variance:**
   - It is the difference between the standard variable cost allowed for the actual time worked and actual variable overhead incurred.

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3. **Variable Overhead Efficiency Variance:**
    - It is the difference between the variable overhead recovered from the output and the standard variable overhead for actual time

II. Fixed Overhead Variance:

1. **Fixed Overhead Cost Variance:**
    - It is the difference between the standard fixed overhead recovered on actual output and the actual fixed overhead incurred.

2. **Fixed Overhead Expenditure Variance:**
    - It is difference between the amount of fixed overhead as per the budget and the actual fixed overhead incurred.

3. **Fixed Overhead Volume Variance:**
    - It is the difference between the fixed overhead recovered on the actual output and the budgeted fixed overhead for budgeted output.
    - The volume variance arise due to the difference in actual output and budgeted output.

4. **Fixed Overhead Capacity Variance:**
    - Capacity in terms of hours or days may vary due to sundry causes like unexpected holidays, stoppage of work due to accidents, strikes, break down, power failure, absenteeism of workers etc.

5. **Fixed Overhead Efficiency Variance:**
    - This variance reveals higher or lower work done during a budget period due to efficiency or inefficiency of the workers.
    - Since the effect of more or less time worked on output is separated through capacity variance, the balance of volume variance indicates the outcome of the efficiency factor

6. **Calendar Variance:**
    - This variance is part of fixed overhead capacity variance.
    - Capacity variance reveals the effort of working more or less time due to all causes.
    - Calendar variance is restricted to the time lost or gained due to working more or less days than the scheduled working days in the budget period.
    - This variance may occur due to unexpected holidays or working on scheduled holidays.

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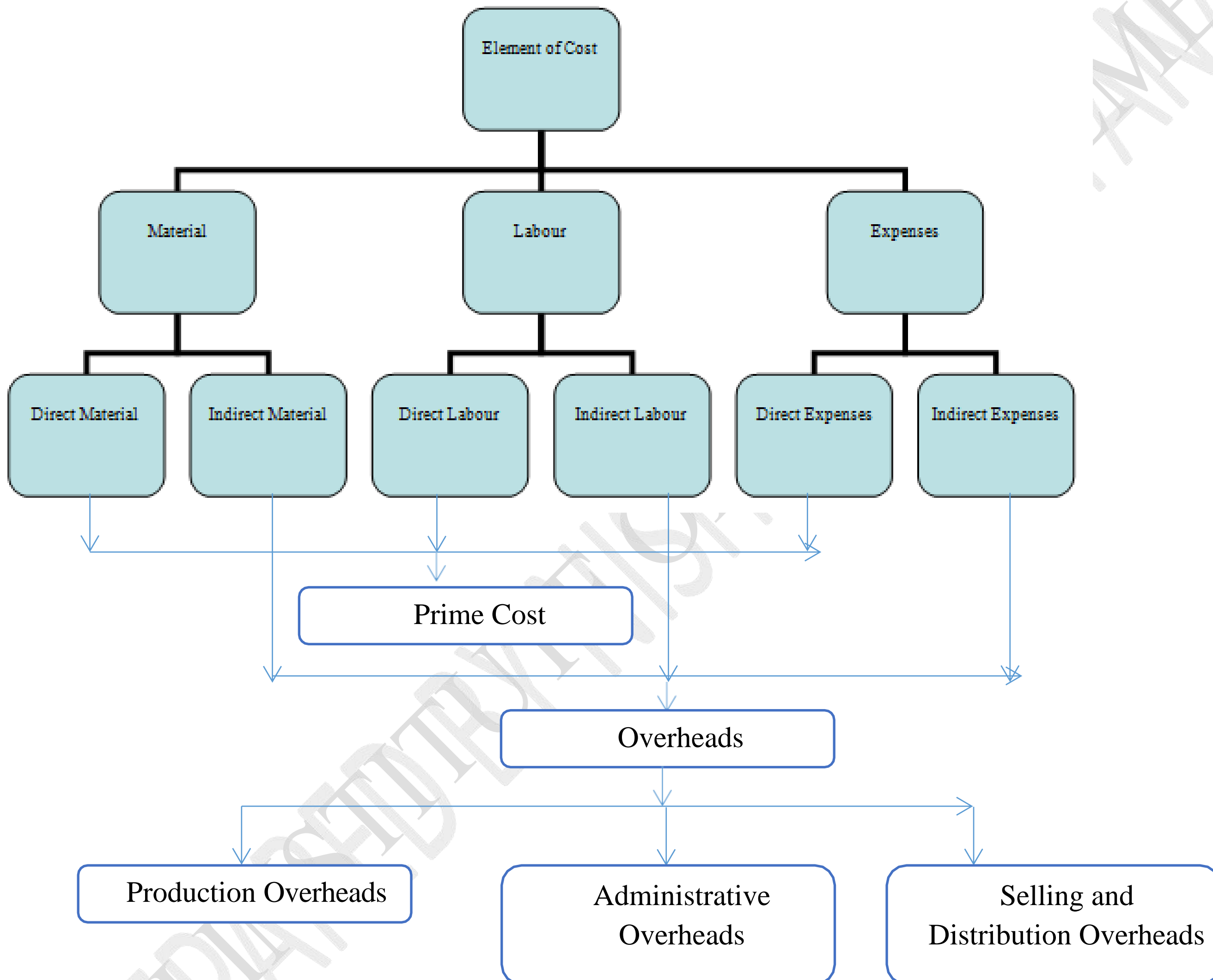
UNIT 5

A. COST ACCOUNTING

It is the method of accounting for cost. The process of recording and accounting for all elements of cost is called as cost accounting.

1. ELEMENTS OF COST



✓ **MATERIALS**

The material cost is the cost of commodities supplied to an undertaking

Direct Material: The material which can be identified with units of output or service is known as direct material cost. Example: Cotton used in the production of cloth

Indirect Material: The material cost which cannot be identified with a product is known as indirect material cost. Example: Small tools, office stationery used in works

✓ **<u>LABOUR</u>**

The labour cost is the cost of remuneration of the employees of an undertaking

<u>Direct Labour:</u> It is the cost of labour directly engaged in production cost. <u>Example:</u> Workmen engaged in assembling parts and carpenter engaged in furniture making etc.

Indirect Labour: It is the remuneration paid for labour engaged to help the production operation. Example: Inspector, watchman, storekeeper and sweeper etc.

✓ **EXPENSES**

The cost of service provided to an undertaking and the notional cost of the use of owned assets.

Direct Expenses: The expenses which can be directly identified with a unit of output or process. Example: Hire charges of special plant used for a job

Indirect Expenses: The expenses which cannot be directly identified with units of output or operation. Example: Rent, Lighting etc.

2. BASIS OF ALLOCATION

An *allocation base* is the basis upon which an entity allocates its overhead costs. An allocation base takes the form of a quantity, such as machine hours used, kilowatt hours consumed, or square footage occupied. Cost allocations are mostly used to assign overhead costs to produced inventory, as required by several accounting frameworks.

The typical allocation process in a multi-department company is:

1. Allocate service department costs to operating departments.
2. Assign operating department costs (including the allocations from service departments) to products and services.

The allocation base should be a cause, or driver, of the cost being allocated. A good indicator that an allocation base is appropriate is when changes in the allocation base roughly correspond to changes in the actual cost. Thus, if machine usage declines, so too should the actual cost incurred to operate the machine.

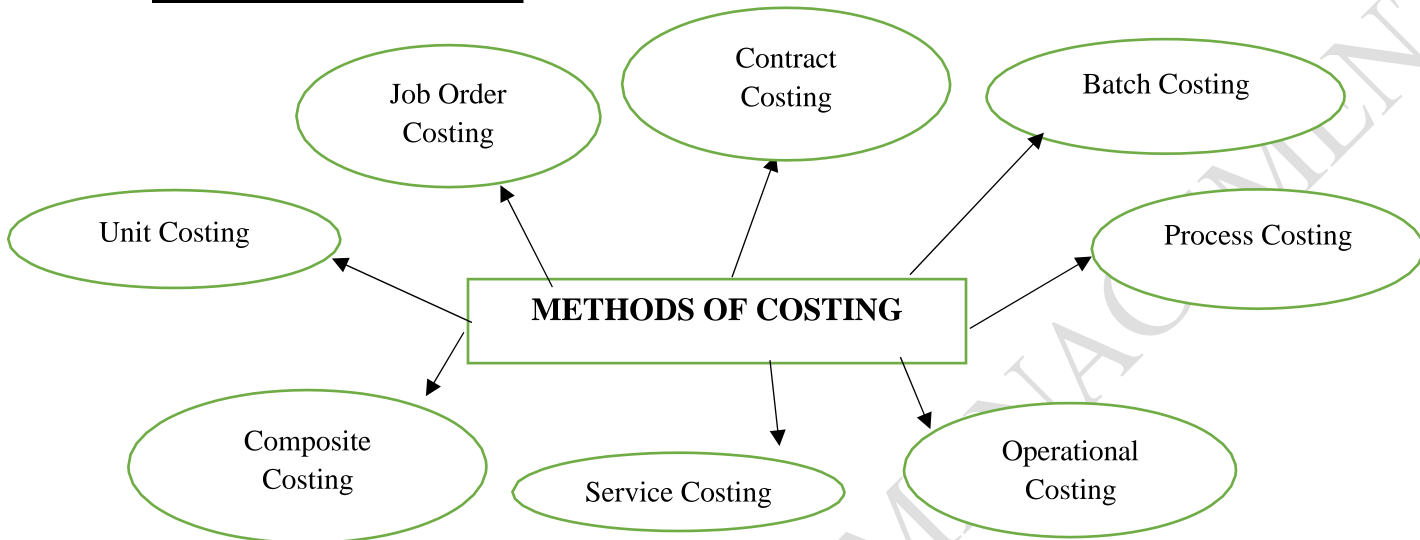
Here are several examples of appropriate allocation bases:

- The computer services department allocates its expenses based on the number of personal computers used by each operating department, or by the number of service calls to each operating department.
- The janitorial department allocates its expenses based on the square footage occupied by each operating department.
- The human resources department allocates its expenses based on the number of employees working in each operating department.

Most organizations use a very small number of allocation bases to allocate overhead costs, though a detailed activity-based costing system may use quite a large number of them.

Managers should be aware of every allocation base being used, since it is the basis for overhead charges being assigned to their departments. They may alter the activities of their departments to reduce their use of each allocation base, thereby reducing the costs assigned to their departments.

3. METHODS OF COSTING



- **Job order costing**

  Job costing is concerned with the finding of the cost of each job or work order. This method is followed by these concerns when work is carried on by the customer's request, such as printer general engineering work shop etc. under this system a job cost sheet is required to be prepared find out profit or losses for each job or work order

- **Contract costing**

  Contract costing is applied for contract work like construction of dam building civil engineering contract etc. each contract or job is treated as separate cost unit for the cost ascertainment and control.

- **Batch costing**

  A batch is a group of identical products. Under batch costing a batch of similar products is treated as a separate unit for the purpose of ascertaining cost. The total costs of a batch is divided by the total number of units in a batch to arrive at the costs per unit. This type of costing is generally used in industries like bakery, toy manufacturing etc.

- **Process costing**

  This method is used in industries where production is carried on through different stages or processes before becoming a finished product. Costs are determined separately for each process. The main feature of process costing is that output of one process becomes the raw materials of another process until final product is obtained. This type of costing is generally used in industries like textile, chemical paper, oil refining etc

- **Operation costing**

  This is suitable for industries where production is continuous and units are exactly identical to each other. This method is applied in industries like mines or drilling, cement works etc.

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Under this system cost sheet is prepared to find out cost per unit and profits or loss on production.

- **Service costing**

This method is used in those industries which rendered services instead of producing goods. Under this method cost of providing a service is also determined. It is also called service costing. The organisation like water supply department, electricity department etc. are the examples of using operating costing.

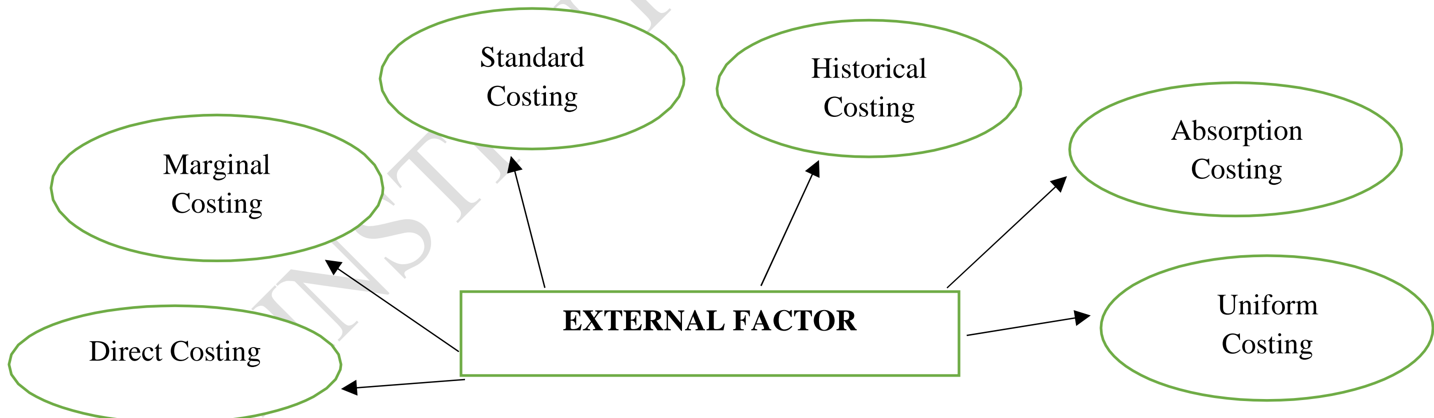
- **Composite costing**

It means combination of two or more of the above methods of costing. Where a product comprises many assembled parts or components (as in case of motor car) costs have to be ascertained for each component as well as for the finished product for different components, different methods of costing may be used. It is also known as composite costing. This type of costing is applicable to industries producing motor vehicle, aeroplane, radio, T.V. etc

- **Unit Costing**

This method is also known as "single output costing." This method of costing is used for products that can be expressed in identical quantitative units. Unit costing is suitable for products that are manufactured by continuous manufacturing activity: for example, brick making, mining, cement manufacturing, dairy operations, or flour mills. Costs are ascertained for convenient units of output.

4. TECHNIQUES OF COSTING



- ✓ **Standard costing**

A comparison is made of the actual cost with a pre-arranged standard cost and the cost of any deviation (called variances) is analyzed by causes. This permits the management to investigate the reasons for these variances and to take suitable corrective action.

- ✓ **Historical Costing**

A comparison is made of the actual cost with a pre-arranged standard cost and the cost of any deviation (called variances) is analyzed by causes. This permits the management to investigate the reasons for these variances and to take suitable corrective action.

- ✓ **Marginal costing**
  It is the ascertainment of marginal cost by differentiating between fixed and variable cost. It is used to ascertain the effect of changes in volume or type of output on profit.

- ✓ **Absorption costing**
  It is the practice of charging all costs, both variable and fixed to operations, processes or products. This differs from marginal costing where fixed costs are exclude.

- ✓ **Uniform costing**
  It is the use of same costing principles and practices by several undertakings for common control or comparison of costs.

- ✓ **Direct Costing**
  It is the practice of charging all direct costs, variable and some fixed costs relating to operations, processes or products leaving all other costs to be written off against profits in which they arise.

5. ABC COSTING

Activity-based costing is a way to allocate costs based on the amount of resources a product or service consumes. The use of ABC is especially important to businesses that provide customized products or services. A customized production environment requires ABC's allocation of actual indirect costs to a product to identify its true cost.

Significance of Activity Based Costing

- **Cost Reduction:** - ABC measures how much activities that are costly and then take steps to reduce their costs by changing the productions process or outsourcing those activities.

- **Product pricing** and decisions of whether to continue producing a product or keeping a particular customer. ABC implementers generally believe that that ABC provides more accurate cost information than conventional costing does. Management can use this information to negotiate price increases with customers or to drop unprofitable products.

- **Budgeting and performance measurement:** - Management can use more accurate cost information to improve budgets and measures of department and division performance.

Limitations of Activity Based Costing

- More time consuming to collect data
- Cost of buying, implementing and maintaining activity based system
- In some cases, the establishment of cause and effect relationship between cost driver and costs not be a simple affair.
- ABC does not conform to generally accepted accounting principles in some areas.

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DIFFERENCE BETWEEN JOB COSTING AND PROCESS COSTING

PROCESS COSTING	JOB COSTING
Production is continuous	Production is intermittent
Production is homogeneous	Production is against specific order
Output is anticipation of demand	Output differs from order to order significantly
Cost control is easier	Cost control is more difficult
Less paper work is involved	More paper work is involved
Work in progress is always there	Work in progress will not be there
Cost of processes is transferred to the next process	There is no transfer of cost
Cost ascertainment is for specific period like month or quarter	Cost ascertainment is for each job

DIFFERENCE BETWEEN STANDARD COSTING AND BUDGETTARY CONTROL

PARTICULARS	STANDARD COSTING	BUDGETARY CONTROL
Time frame	Standards have no specific time frame. They can be used over a long period.	Budgets are for specific time periods beyond which they have no relevance.
Interdependence	Standard costing is based on budget during any specific period.	Budgetary control can be carried on without standards. It is not dependent on standard costing.
Basis for preparation	Standard are based on technical assessment	Budgets are usually the past actual figures adjusted for future changes.
Approach	Standards are more intensive and concentrate on each element of cost, operation etc.	Budget are extensive are set for department, function etc.
Scope	Standards are mainly for cost. Revenue is not the focus of standard costing	Both income and expenses form a part of budgetary control

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Criterion	Standards are the goals or target to be attained	Budget set the maximum limits for expenses which are expected to be exceeded.
Origin	Standards are purely cost oriented. Standards costing is a projection of cost account	Budgets are projection of financial accounts. Overall business efficiency, both in the areas of income and expenditure is the goal of budgetary control
Nature of cost used	Standard cost are the norms or what cost should be under specified circumstances	Budgets are estimated cost. They what the cost will be
Use for forecasting	Standard cost cannot be used for forecasting material required etc. because they are like goals and not what cost will be	Budgeted figures can be used for forecasting because they are the expected cost and revenues.

B. REPOTING TO THE MANAGEMENT

'Management Reporting' may be defined as "A system of communication, normally in the written form, of facts which should be brought to the attention of various levels of management who use them to take suitable action." In other words the process of providing information to the management is known as Management Reporting. The word "Information" refers to the data processed or evaluated for a specific purpose.

1. OBJECTIVES OF MANAGEMENT REPORTING

- To obtain the required information relating to the business to discharge its managerial functions of planning. organizing, controlling, directing, and decision making etc. efficiently and effectively.
- To ensure the operational efficiency of the concern.
- To facilitate the maximum utilization of resources.
- To secure industrial understanding among people who are engaged in various aspects of work of enterprise.
- To enable to motivating improving discipline and morale.
- To help the management for effective decision making.

2. ESSENTIALS OF GOOD REPORTING SYSTEM

The following are the essentials of a good management reporting system:

- **Proper Form:** A good report should have a comprehensive form with suggestive title, heading, sub heading and number of paragraphs as and where necessary for easy and quick reference.

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- **Contents:** Simplicity is one of the requisites of reporting in relation to the contents of a report. Further the contents should follow a logical sequence. Wherever necessary the contents should be represented in the form of visual aids such as charts and diagrams etc.

- **Promptness:** It means that the system should ensure the preparation and submission of report at the proper time. It facilitates business executives to make suitable decisions based on quick reports without delay.

- **Accuracy:** Information conveyed should be accurate. This means that the person responsible for reporting should have sufficient care in preparing the report as correctly as possible within the parameters of possible accuracy in this regard.

- **Comparability:** In order to ensure that the furnished information is useful, it is essential that reports are also meant for comparison. The report should provide information about both the actual and the budgeted performance of the budget period. So that meaningful comparison can be made to find out the deviations and to initiate appropriate action.

- **Consistency:** In order to make a meaningful and useful comparison, uniform accounting principles and procedures should be followed on consistent basis over a period of time for collection, classification and presentation of accounting information.

- **Relevancy:** The report should be presented with relevant data to disclose the fact in unambiguous terms. Because, inclusion of both the relevant and the irrelevant data in the management reports may result in faulty decisions. Therefore, the contents expressed therein should reveal the reporter's greater consciousness of expression with reference to length and time in particular.

- **Simplicity:** The report should be as far as possible in simple form. In other words, the report should avoid technical jargons, duplication of work and presented in a simple style.

- **Flexibility:** The system should be capable of being adjusted according to the requirement of the users.

- **Cost-Benefit Analysis:** Cost-Benefit Analysis should be made and the cost of reporting should commensurate with the expenditure involved.

- **Principle of Exception:** Since the time and effort of managerial personel are precious, the principle of management by exception has become the rule of the day instead of exception. It is necessary therefore to draw the attention of management, through reports, only towards exceptional matters.

- **Controllability:** It is necessary that every report should be addressed to a responsibility centre and analysed the factors into controllable and uncontrollable separately. So that the head of the responsibility centre can be held responsible only for controllable variance but not for variances which are beyond his control.

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3. CLASSIFICATION OF MANAGEMENT REPORTING

Basically, there are two ways to report to the management. They are (1) Oral Report and (2) Written Report. The Written Reports may be classified into number of ways. The following are the important types:

I. According to objects/ Purpose:

(A) External Reports

(B) Internal Reports

(1) Reports Meant for Top Management

(2) Reports Meant for Middle Level Management

(3) Reports Meant for Junior Level Management

II. According to Period:

(1) Routine Reports

(2) Special Reports

III. According to Functions:

(A) Operating Reports

(1) Control Reports

(2) Information Reports

(3) Venture Measurement Reports

(B) Financial Reports

(1) Static Reports

(2) Dynamic Reports

I. ACCORDING TO OBJECT OR PURPOSES

(A) External Reports: These reports prepared for persons outside the business such as Government. shareholders. bankers. investors and financial institutions etc. External Reports usually represent published annual reports. Annual Reports of Trading. Profit and Loss Accounts and Balance Sheet of the Indian Companies are to be prepared in terms of Schedule VI of the Indian Companies Act of 1956.

(B) Internal Reports: Internal Reports are those which are prepared for internal uses of different level of management. It is also called as Management Reports. These reports are not meant for disclosure to those who are outsiders to the business. They do not have to comply with any statutory requirements. From the managerial point of view the reports can be classified into the following categories:

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(1) Report Meant for the Top Level of Management

(2) Report Meant for the Middle Level of Management

(3) Report Meant for the Junior Level of Management

- **Report Meant for the Top Level of Management**

Top Level Management is concerned with the formulating policies planning and setting goals and objectives. This level of management consisting of the Board of Directors including Chairman. Managing Directors. General Manager or any other chief executive as the case may be. The report to this level of management should be specifically summarized with all aspects of operating performance together with a comparison of actuals with budgeted performance. The usual reports sent to this level of management are:

(a) Reports on budgeted and actual profit

(b) Reports on sales and production

(c) Capital budget

(d) Master budget

(e) Periodical financial reports

(f) Plant utilization report

(g) Machine and labour utilization report

(h) Reports on research and development activities

(i) Project evaluation report

(J) Report on stock of raw materials, work in progress and finished goods

(k) Overhead cost absorption and efficiency reports

(I) Reports on selling and distribution overhead.

- **Reports Meant for Middle Level Management**

The Middle Management is constituted of the heads of all departments such as production department headed by production manager. Marketing department headed by marketing manager and so on. This level of management is concerned with the functioning and control of their departments. They act mainly as coordinating executives to administer policies directly through operating supervisors and evaluate their performance. Hence. They may require more detailed information about their departments and at frequent intervals. Generally. The middle level management should receive the following reports at different intervals:

(a) Purchase Manager:

(1) Reports on material price and usage variance

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(2) Reports on material carrying cost, loss of material in the storage etc.

(3) Reports on trends in the pertaining of various items of materials.

(b) Materials Manager:

(1) Reports on stock of raw materials, work in progress and finished goods

(2) Reports on material wastage and losses

(3) Reports on stock of materials planning and control

(4) Reports on level of materials stock at the stores

(5) Reports on surplus and deficiency report.

(c) Production Manager:

(1) Reports on budgeted and actual production

(2) Reports on overtime work and ideal time

(3) Reports on labour utilization statement

(4) Reports on machine utilization statement

(5) Reports on scrap production cost

(6) Reports on any accident causing dislocation of activity.

(d) Sales Manager:

(1) Reports on budgeted and actual sales

(2) Reports on sales efficiency

(3) Reports on orders received and orders executed

(4) Reports on cash sales and credit sales

(5) Reports on stock of finished goods

(6) Reports on market share and market potential

(7) Reports on sales promotion efficiency.

➢ **Reports Meant for Junior Level Management**

The lower level management is directly responsible for executing various policies assigned by top management. This level of management is constituted of Foremen, Supervisors and sectional in charges etc. They are in touch with the day-to-day performance of their section. The report meant for this level are mainly in terms of physical units. The usual reports sent to this level are:

(1) Reports on labour efficiency variance

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(2) Reports on ideal time, overtime and machine utilization

(3) Reports on materials usage variance

(4) Reports on credit collections and outstanding

II. According to period

(1) Routine Reports

These are the reports that pertain to matters repetitive in nature. Routine reports are prepared and presented to different levels of management at periodic intervals. The period covered may be a day, week, month, quarter, etc. reports on production, sales, stock, income, etc., are few examples of routine reports.

(2) Special Reports

These reports are prepared and presented to the management for any special purpose. Special reports are required for special purpose only. They have no definite periodicity. Special reports may deal with ideal time, over time, excessive spoilage, introduction of new product, technological changes, market analysis, etc.

III. According to Functions:

(A) Operating Reports

Operating reports are designed to highlight the operational efficiency of the concern. They provide information about the operation of the different levels of management. The operating reports consists of

(1) **Control Reports** – are prepared to ensure controlling of different activities of an enterprise.

(2) **Information Reports** – provide information for future planning and policy formulation. These reports are prepared and presented based on the outcome of special solution studies.

(3) **Venture Measurement Reports** – are meant for the result of specific venture or concern as a whole for a particular period of time.

(B) Financial Reports

These are reports prepared and submitted to the management about the financial position of the concern. Financial reports consists of

(1) **Static Reports** – highlights the financial soundness of the concern.

(2) **Dynamic Reports** – reveal the working capital movement of the concern. For example: Fund flow statement and cash flow statement.

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C. USERS OF ACCOUNTING INFORMATION

The basic objective of accounting is to provide information which is useful for persons and groups inside and outside the organization.

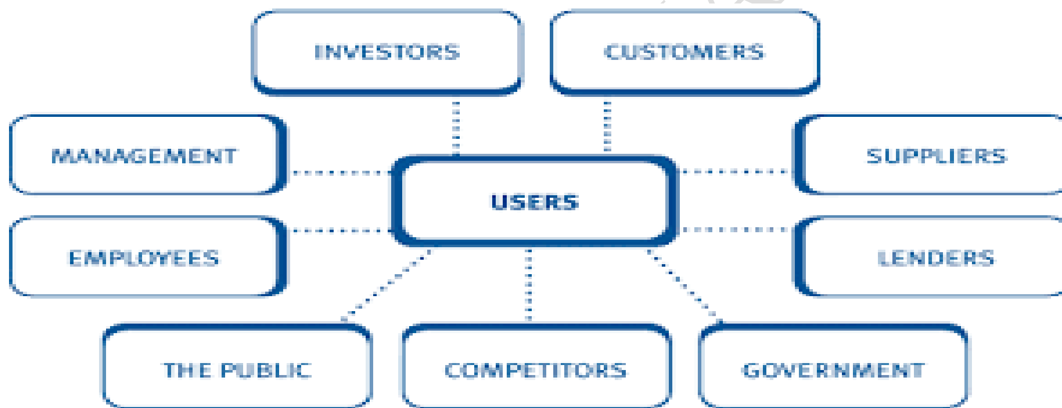
1. **INTERNAL USERS:**

   Internal users are those individuals or groups who are within the organisation like owners, management, employees and trade unions.

2. **EXTERNAL USERS:**

   External users are those individuals or groups who are outside the organisation like creditors, investors, banks and other lending institutions, present and potential investors, Government, tax authorities, regulatory agencies and researchers.

The users of the information are as follows:



USERS	NEED FOR INFORMATION
INTERNAL USERS	
1. Owners	To know the profitability and financial soundness of the business
2. Management	To take prompt decisions to manage the business efficiently.
3. Employees and Trade Unions	To form judgement about the earning capacity of the business since their remuneration and bonus depend on it
EXTERNAL USERS	

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1. Creditors, Bank and Other Lending Institutions	To determine whether the principal and the interest thereof will be paid in when due
2. Present Investors	To know the position, progress and prosperity of the business in order to ensure the safety of their investment
3. Potential Investors	To decide whether to invest in the business or not.
4. Government and Tax authorities	To know the earnings in order to assess the tax liabilities of the business.
5. Regulatory Agencies	To evaluate the business operation under the regulatory legislation.
6. Researchers	To use in their research work.

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UNIT I

FINAL ACCOUNTS FORMAT

ITEMS APPEAR ON THE DEBIT SIDE OF THE TRADING ACCOUNT

PARTICULARS	AMOUNT	PARTICULARS	AMOUNT
To Opening Stock		To Packaging	
To Wages		To Carriage Inwards	
To Manufacturing Expenses		To Freight Inwards	
To Octroi Duty		To Factory Expenses	
To Power		To Fuel & Gas	
To Coal & Water			
To Diesel & Oil			
To Clearing Charges			
To Dock Dues		**TO GROSS PROFIT C/D**	

ITEMS APPEAR ON THE CREDIT SIDE OF THE TRADING ACCOUNT

PARTICULARS	AMOUNT	PARTICULARS	AMOUNT
By Sales		**BY GROSS LOSS C/D**	
By Closing Stock			
By Scarp Sold			

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ITEMS APPEAR ON THE ASSESTS SIDE OF THE BALANCE SHEET

ASSETS	AMOUNT	ASSESTS	AMOUNT
Cash In Hand		Business Premises	
Cash at Bank		Horses & Carts	
Bills Receivable		Prepaid Expenses	
Debtors		Patent	
Closing Stock		Trade Mark	
Furniture & Fittings		Goodwill	
Investment		Computers & Laptop	
Plant & Machinery		Type Writers	
Loose Tools		Land & Building	
ITEMS WHICH WILL APPEAR ON THE LIABLILITES SIDE OF THE BALANCE SHEET			
LIABILITIES	**AMOUNT**	**LIABILITES**	**AMOUNT**
Sundry creditors		Capital	
Bills payable		Net profit	
Bank Over draft		- Drawings	
Mortgage		- Income tax	
Reserve fund			

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ITEMS APPEAR ON THE DEBIT SIDE OF THE PROFIT & LOSS ACCOUNT

PARTICULARS	AMOUNT	PARTICULARS	AMOUNT
TO GROSS LOSS B/D		To Rates & Taxes	
To Salaries		To Interest on Capital	
To Rent		To Interest on Loan	
To Commission		To Depreciation	
To Printing & Stationeries		To General Expenses	
To Postage & Telephone		To Freight Outwards	
To Insurance		To Carriage Outwards	
To Repairs		To Traveling Expenses	
To Trading Expenses *		To Distribution Expenses	
To Office Expenses *		To Bad Debt	
To Interest		To Salesman Commission	
To Bank Charges		To Discount	
To Establishment Expenses		To Advertisement	
To Sundry Expenses			
		TO NET PROFIT	

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ITEMS APPEAR ON THE CREDIT SIDE OF THE PROFIT & LOSS ACCOUNT

PARTICULARS	AMOUNT	PARTICULARS	AMOUNT
BY GROSS PROFIT B/D		By Gross Loss c/d	
By Commission Earned		By Interest Received	
By Rent Received		By Discount Received	
By Interest On Drawings		By Bad Debts Recovered	
		BY NET LOSS	

*If both trading expenses and office expenses are given in the same problem then trading expenses should come in trading account and office expenses should come in profit and loss account

*If any one of the expenses (trading expenses / office expenses) is given then it will come only in profit and loss account

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CHART SHOWING TREATMENT OF ADJUSTMENT IN PREPARATION OF FINAL ACCOUNTS

S.NO	PARTICULARS	TREATMENT OF ADJUSEMNT IN TRADING & P/L ACCOUNT	TREATMENT OF ADJUSEMNT IN BALANCE SHEET
1	Depreciation	*To be **debited** to P/L account	*To be **deducted** from the value of assets in the B/s
2	Closing Stock	*To be **credited** to trading account	*To be shown on the **assets** side of the B/S
3	Outstanding Expenses	*Amount to be **added** to the particular item in **trading** & **P/L account**	*To be shown on the **liabilities** side of B/S
4	Outstanding Income	*Amount to be **added** to the particular item in **P/L account**	*To be shown on the **assets** side of balance sheet

5	Prepaid Expenses	*Amount to be **deducted** from the particular item in **trading & P/L account**	*To be shown on the **assets** side of balance sheet
6	Income Received in Advance or Pre received Income	*Amount to be **deducted** from the particular item in **trading & P/L account**	*To be shown on the **liabilities** side of balance sheet
7	Interest on Capital	*To be **debited** to **P/L account**	*To be **added** to the **capital** on B/S
8	Interest on Drawings	*To be **credited** to **P/L account**	*To be **deducted** from the **capital** on B/S
9	Goods used by the proprietor for personal use	*To be **deducted** from the **purchases**	*To be **added** to the **drawings**
10	Bad debts written off	*Amount of bad debts to be **debited** to **P/L account**	*To be **deducted** from the **sundry debtors** in B/S
11	Reserve for doubtful debts	*To be **debited** to **P/L account**	*To be **deducted** from the **sundry debtors** in B/S
12	Reserve for discount on debtors	*To be **debited** to **P/L account**	*To be **deducted** from the **sundry debtors** in B/S
13	Reserve for discount on creditors	*To be **credited** to **P/L account**	*To be **deducted** from the **sundry creditors** in B/S
14	Interest on Loan	*To be **debited** to **P/L account**	Liabilities side of B/S by way of **addition** to particular **loan account**
15	Interest on Investment	*To be **credited** to **P/L account**	Assets side of B/S by way of **addition** to particular **investment**

NOTE

*All items given outside the trial balance will be shown two times i.e. (First in trading or profit and loss account and next in balance sheet).

*Adjustments will be given only outside the trial balance.

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UNIT II

1. RATIOS FORMULA

A. BASED ON SOLVENCY RATIO

- **CURRENT RATIO** = Current Assets (CA) / Current Liabilities (CL)

- **LIQUID / QUICK / ACID TEST** = CA – (Prepaid Expenses + Inventories) / CL

- **ABSOLUTE LIQUID RATIO** = Absolute Liquid Assets / Liquid Liabilities

Where, Absolute Liquid Assets = Cash, Bank, Short term Investment and Marketable Securities
Liquid Liabilities = Current Liabilities – Bank Overdraft

- **DEBT EQUITY RATIO** = Total Long Term Debt / Shareholders Funds (or)
  = External Equity / Internal Equity

Where Long Term Debt = Debentures, Long Term Loans from bank and Financial Institution
Shareholder Funds = Equity Share Capital, Preference Share Capital and Reserve & Surplus, P & L (Cr)

- **PROPRIETORY RATIO** = Shareholder Funds / Total Tangible Assets

Where Tangible Assets = All Assets – (Goodwill + Preliminary Expenses+ Copy Right+ Patent+ P & L (Dr))

- **FIXED ASSETS RATIO** = Fixed Assets / Long Term Funds

Where Long Term Funds = Shareholder Funds + Long Term Debts

- **CAPITAL GEARING RATIO** = (Long Term Loans +Debt + Preference Cap) / Eq. Cap

- **TOTAL DEBT RATIO =** Total Debt / Total Tangible Assets

B. BASED ON PROFITABILITY RATIO

- **GROSS PROFIT RATIO** = (Gross Profit / Net sales) * 100

Where Net Sales = Sales – Sales Returns
Cost of Goods Sold = Opening Stock + Purchases + Direct Expenses – Closing Stock
Cost of Goods Sold = Sales – Gross Profit
Gross Profit = Sales – Cost of Goods sold

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PREPARED BY NISHATH SULTANA

- **NET PRFIT RATIO** = (Net Profit / Net Sales) * 100

Where Net Profit = Gross Profit – (Administrative+ Selling & Distribution+ Financial Expenses)

- **OPERATING PROFIT RATIO** = (Operating Profit/ Sales) * 100

Where Operating Profit = Net Profit + Non-Operating Expenses – Non Operating Income

- **OPERATING PROFIT** = (Cost of Goods Sold + Operating Expenses) / Sales*100

- **EXPENSES RATIO** = (Individual Expenses Ratio / Net Sales) * 100

- **RETURN ON INVESTMENT** = (Operating Profit / Capital Employed) * 100

- **RETURN ON CAPITAL EMPLOYED** = (Net Profit before Interest, Tax / Capital Employed) * 100

- **RETURN ON SHAREHOLDER FUNDS** = (Net Profit after Interest & Tax) / Shareholder Funds) * 100

- **RETURN ON EQUITY SHAREHOLDER FUNDS** = (Net Profit after Interest, Tax & Preference Dividend) / Equity Shareholder Funds) * 100

- **RETURN ON TOTAL ASSETS** = [(Net Profit after Tax & Interest) / (Total Assets – Fictitious Assets)] * 100

- **EARNING PER SHARE** = (Net Profit after Interest, Tax & Preference Dividend) / Number of Equity Shares

- **PRICE EARNING RATIO** = Market Price Per Eq Share/ Earning per Eq Share

- **DIVIDEND PAYOUT RATIO**=(Dividend per Eq Share/Earning per Eq Share) *100

- **RETAINED EARNING RATIO** = (Retained Earning) / (Net Profit after Interest, Tax & Preference Dividend) * 100

- **INTEREST COVER RATIO** = Profit before Interest & Tax / Fixed Interest Charge

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- **FIXED DIVIDEND RATIO** = (Net Profit after Interest & Tax) / Preference Dividend
- **DIVIDEND YIELD RATIO** = (Dividend per share /Market Price Per Share) *100

C. **BASED ON TURNOVER RATIO**

- **CAPITAL TURNOVER RATIO** =Cost of Sale (or) Net Sales / Capital Employed

Where Capital Employed = Share Capital + Reserve & Surplus + Long Term Borrowed Funds

- **FIXED ASSETS TURNOVER RATIO** = Cost of Sale (or) Net Sales / Net Fixed Assets

Where Net Fixed Assets = Fixed Assets – Depreciation

- **STOCK TURNOVER RATIO** = Cost of Goods Sold / Average Stock

Where Average Stock = (Opening Stock + Closing Stock) / 2

- **STOCK TURNOVER PERIOD** = Days or Months in a year / Stock Turnover Ratio
- **STOCK TURNOVER PERIOD** = (Days or Months in a year / Cost of Goods Sold) * Average Stock

- **DEBTOR TURNVOER RATIO** = Net Credit Sales / Average Account Receivable

Where Account Receivable = Sundry Debtors + Bills Receivable
Average Account Receivable = (Opening Account Receivable +Closing Account Receivable) /2

- **DEBTOR COLLECTION PERIOD** = Days or Months in a year / Debtor Turnover Ratio
- **DEBTOR COLLECTION PERIOD** = (Days or Months in a year / Credit Sales) * Average Account Receivable

- **CREDITOR TURNVOER RATIO** = Credit Purchases/Average Account Payable

Where Account Payable = Sundry Creditor + Bills Payable
Average Account Payable = (Opening Account Payable +Closing Account Payable) /2

- **AVERAGE PAYMENT PERIOD** = Days or Months in a year / Creditor Turnover Ratio
- **AVERAGE PAYMENT PERIOD** = (Days or Months in a year /Credit Purchases) * Average Account Payable

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- **WORKING CAPITAL TURNOVER RATIO** = Cost of Sale (or) Sales / Net Working Capital

Where Net Working capital = Current Assets – Current Liabilities

- **OWNED CAPITAL TURNOVER RATIO** = Cost of Sale (or) Sales / Shareholder Funds

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TERMINOLOGY IN RATIO ANALYSIS

CURRENT ASSETS
1. Cash in Hand
2. Cash at Bank
3. Inventory
4. Sundry Debtors
5. Bills Receivable
6. Prepaid Expenses
7. Short term Investment
8. Marketable Securities
9. Trade Investments

CURRENT LIABILITIES
1. Bank Overdraft
2. Sundry Creditors
3. Bills Payable
4. Outstanding Expenses
5. Tax Payable
6. Provision for Tax
7. Proposed Dividend
8. Dividend Payable

TOTAL LONG TERM DEBTS
1. Debentures
2. Bonds
3. Long term loans from Banks and financial institution

SHAREHOLDER FUNDS
- Equity Share Capital
- Preference Share Capital
- Reserves & Surplus
- Profit and Loss (Cr)

LONG TERM FUNDS / CAPITAL EMPLOYED
- Debentures
- Bonds
- Long term loans from Banks and financial institution
- Equity Share Capital
- Preference Share Capital
- Reserves & Surplus
- Profit and Loss (Cr)

TOTAL DEBTS
- Long Term Debts
- Current Liabilities

INTANGIBLE/ FICTITIOUS ASSETS
- Goodwill
- Copyright
- Patent
- Preliminary Expenses
- Profit & Loss (Dr)

NON OPERATING INCOME
- Interest Received
- Dividend Received
- Profit on Sale of Assets
- Compensation Received

OPERATING EXPENSES
- Administrative Expenses
- Selling Expenses
- Distribution Expenses
- Depreciation

NON OPERATING EXPENSES
- Interest
- Loss on Sale of Assets
- Preliminary Expenses
- Goodwill Written off
- Discount on Debentures
- Discount on Shares
- Provision for Taxation
- Proposed Dividend
- Provision for Bad Debts
- Any other Reserves

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2. FUND FLOW STATEMENT

STEP 1: STATEMENT OF CHANGES IN WORKING CAPITAL

PARTICULARS	YEAR	YEAR	CHANGES IN WC	
			INCREASE	DECREASE
CURRENT ASSETS:				
Cash in Hand/ Cash at Bank				
Sundry Debtors				
Bills Receivable				
Prepaid Expenses				
Short Term Investment				
Trading Investment				
Marketable Securities				
Accrued Income				
Finished Goods				
Work in Progress				
CURRENT LIABILITIES				
Creditors				
Bills Payable				
Outstanding Expenses				
Short Term Loans				
Bank Overdraft				
Outstanding Expenses				
Pre Received Income				
Tax Payable				
Dividend Payable				
Provision for Taxation*				
Proposed Dividend*				
Provision for Doubtful Debts				
WORKING CAPITAL (A-B)				
NET INCREASE / DECREASE IN WC				
TOTAL				

NOTE:
Provision for Tax & Proposed Dividend is **Non – Current Liabilities** unless they are mentioned in the problems as **Current Liabilities**

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STEP 2: ADJUSTED PROFIT & LOSS A/C

PARTICULARS	AMOUNT	PARTICULARS	AMOUNT
To Depreciation on Fixed Asset*		**By Balance b/d (Opening Bal)**	
To Loss on sale of Fixed Asset		By Profit on sale of Fixed Asset	
To Loss on Sale of Investment		By Profit on Sale of Investment	
To Goodwill Written Off		By Income from Investment	
To Discount on Debentures W/o		By Income Tax Refund	
To Provision for Tax*		By Interest Received	
To Proposed Dividend*		By Dividend Received	
To Preliminary Expenses W/o			
To Patent / Copy Right W/o		**By Fund From Operation (Bal Fig)**	
To Discount on Share W/o			
To Interim Dividend			
To Balance c/d (Closing Bal)			
To Outflow of Funds on account of Operation (Bal Fig)			

Note: If Opening & Closing balance of Profit & Loss A/c is not given then Opening & Closing Balance of Reserve & Surplus or Retained Earnings should be taken.

*PROVISION FOR TAXATION A/C

PARTICULARS	AMOUNT	PARTICULARS	AMOUNT
To Bank (Tax Paid) (Bal Fig)		By Balance b/d (Opening Bal)	
To Balance c/d (Closing Bal)		**By P & L A/C (Bal fig)**	

*PROPOSED DIVIDEND A/C

PARTICULARS	AMOUNT	PARTICULARS	AMOUNT
To Bank (Dividend Paid) (Bal Fig)		By Balance b/d (Opening Bal)	
To Balance c/d (Closing Bal)		**By P & L A/C (Bal fig)**	

ASSET A/C

PARTICULARS	AMOUNT	PARTICULARS	AMOUNT
To Balance b/d (Opening Bal)		By Depreciation (P&L A/c)*	
To Bank (Purchase) (Bal Fig)		**By Bank (Sale) (Bal Fig)**	
To Loss on Sale		By Profit on Sale	
		By Balance c/d (Closing Bal)	

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STEP 3: FUND FLOW STATEMENT

SOURCES OF FUNDS	AMOUNT	APPLICATION OF FUNDS	AMOUNT
Issue of Preference Share Capital		Repayment of Long Term Loans	
Issue of Equity Share Capital		Redemption of Preference shares	
Share Premium		Redemption of Debentures	
Sale of Fixed Asset		Purchase of Fixed Asset	
Sale of Investment		Tax Paid	
Issue of Debentures		Dividend Paid	
Long Terms Loan Borrowed		Investment Purchased	
Other Receipts (If Any)		Other Payment (If Any)	
Decrease of Working Capital		**Increase of Working Capital**	
Funds From Operation		**Outflow of Fund**	

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3. CASH FLOW STATEMENT

STEP 1: STATEMENT OF CHANGES IN WORKING CAPITAL

PARTICULARS	YEAR	YEAR	CHANGES IN WC	
			INCREASE	DECREASE
CURRENT ASSETS:				
Sundry Debtors				
Bills Receivable				
Prepaid Expenses				
Short Term Investment				
Trading Investment				
Marketable Securities				
Accrued Income				
Finished Goods				
Work in Progress				
CURRENT LIABILITIES				
Creditors				
Bills Payable				
Outstanding Expenses				
Short Term Loans				
Bank Overdraft				
Outstanding Expenses				
Pre Received Income				
Tax Payable				
Dividend Payable				
Provision for Taxation*				
Proposed Dividend*				
Provision for Doubtful Debts				
WORKING CAPITAL (A-B)				
NET INCREASE / DECREASE IN WC				
TOTAL				

NOTE:

Cash in Hand and Cash at bank should not be taken in statement of changes in working capital. Provision for Tax & Proposed Dividend is **Non – Current Liabilities** unless they are mentioned in the problems as **Current Liabilities**

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STEP 2: ADJUSTED PROFIT & LOSS A/C

PARTICULARS	AMOUNT	PARTICULARS	AMOUNT
To Depreciation on Fixed Asset*		**By Balance b/d (Opening Bal)**	
To Loss on sale of Fixed Asset		By Profit on sale of Fixed Asset	
To Loss on Sale of Investment		By Profit on Sale of Investment	
To Goodwill Written Off		By Income from Investment	
To Discount on Debentures W/o		By Income Tax Refund	
To Provision for Tax*		By Interest Received	
To Proposed Dividend*		By Dividend Received	
To Preliminary Expenses W/o			
To Patent / Copy Right W/o		**By Cash From Operation (Bal Fig)**	
To Discount on Share W/o			
To Interim Dividend			
To Balance c/d (Closing Bal)			
To Outflow of Cash (Bal Fig)			

Note: If Opening & Closing balance of Profit & Loss A/c is not given then Opening & Closing Balance of Reserve & Surplus or Retained Earnings should be taken.

*PROVISION FOR TAXATION A/C

PARTICULARS	AMOUNT	PARTICULARS	AMOUNT
To Bank (Tax Paid) (Bal Fig)		By Balance b/d (Opening Bal)	
To Balance c/d (Closing Bal)		**By P & L A/C (Bal fig)**	

*PROPOSED DIVIDEND A/C

PARTICULARS	AMOUNT	PARTICULARS	AMOUNT
To Bank (Dividend Paid) (Bal Fig)		By Balance b/d (Opening Bal)	
To Balance c/d (Closing Bal)		**By P & L A/C (Bal fig)**	

*ASSET A/C

PARTICULARS	AMOUNT	PARTICULARS	AMOUNT
To Balance b/d (Opening Bal)		By Depreciation (P&L A/c)*	
To Bank (Purchase) (Bal Fig)		**By Bank (Sale) (Bal Fig)**	
To Loss on Sale		By Profit on Sale	
		By Balance c/d (Closing Bal)	

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STEP 3: CASH FLOW STATEMENT

CASH INFLOWS	AMOUNT	CASH OUTFLOWS	AMOUNT
Issue of Preference Share Capital		Repayment of Long Term Loans	
Issue of Equity Share Capital		Redemption of Preference shares	
Share Premium		Redemption of Debentures	
Sale of Fixed Asset		Purchase of Fixed Asset	
Sale of Investment		Tax Paid	
Issue of Debentures		Dividend Paid	
Long Terms Loan Borrowed		Investment Purchased	
Other Receipts (If Any)		Other Payment (If Any)	
Decrease of Working Capital		**Increase of Working Capital**	
Cash From Operation		**Outflow of Cash**	

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UNIT III

MARGINAL COSTING

Sales	:	XXXX
Less Variable Cost	:	XXXX
Contribution	:	XXXX
Less Fixed Cost	:	XXXX
PROFIT	:	XXXX

1. PROFIT VOLUME RATIO

Profit Volume Ratio/ Contribution to sales = (Contribution / Sales)* 100

Profit Volume Ratio = Change in Profit / Change in Sales

2. BREAK EVEN POINT

Break Even Point (Value) = Fixed Cost / Profit Volume Ratio

Break Even Point (Units) = Fixed Cost / Contribution per Unit

Composite BEP (Value) = Total Fixed Cost / Composite Profit Volume Ratio

3. MARGIN OF SAFETY

Margin of Safety (Units) = Actual Sales – Break Even Sales

Margin of Safety (Value) = Profit / Profit Volume Ratio

Margin of Safety (Units) = Profit / Contribution per Unit

Margin of Safety Ratio = (Margin of Safety / Sales) * 100

4. REQUIRED SALES FOR GIVEN PROFIT / REQUIRED PROFIT FOR GIVEN SALES

Required Sales for Given Profit (Units) = (Required Profit+ Fixed Cost) / Contribution per Unit

Required Sales for Given Profit (Value) = (Required Profit+ Fixed Cost) / Profit Volume Ratio

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UNIT IV

VARIANCE ANALYSIS

A. MATERIAL VARIANCES

1. **Direct Material Cost Variance (DMCV)**
   = (Std. price * Std. qty. of material for actual output) – (Actual price * Actual qty. of material used)

2. **Direct Material Price Variance (DMPV)**
   = Actual Quantity * (Std. Price – Actual Price)

3. **Direct Material Usage Variance (DMUV)**
   = Std. Price * (Std. qty. – Actual qty.)

4. **Direct Material Mix Variance (DMMV)**
   = Std. Price * (RSQ – Actual qty.)

5. **Direct Material Sub Usage Variance (DMSUV)**
   = Std. Price * (Std. qty. – RSQ)

6. **Direct Material Yield Variance (DMYV)**
   = Std. cost per unit of output * (Std. yield for actual material – Actual yield)

NOTE

DMCV = DMPV + DMUV

DMUV = DMMV + DMYV

RSQ = (Total qty. of actual mix / Total qty. of standard mix) * Individual std. qty.

B. LABOUR VARIANCES

1. **Direct Labour Cost Variance (DLCV)**
   = (Std. rate * Std. time for actual output) – (Actual rate * Actual time)

2. **Direct Labour Rate Variance (DLRV)**
   = Actual Time * (Std. rate – Actual rate)

3. **Total Direct Labour Efficiency Variance (TDLEV)**
   = Std. rate * (Std. time – Actual time)

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4. **Direct Labour Efficiency Variance (DLEV)**
   = Std. rate * (Std. time – Actual time worked)

5. **Direct Labour Idle Time Varaince (DLITV)**
   = (Std. rate * Idle time)

6. **Direct Labour Mix Variance (DLMV)**
   = Std. rate * (RST – Actual time worked)

7. **Revised Labour Efficiency Variance (RLEV)**
   = Std. Rate * (Std. time – RST)

NOTE

DLCV = DLRV + TDLEV

TDLEV = DLEV + DLITV

DLEV = DLMV + DLYV

RSQ = (Total actual time worked / Total std. time) * Individual std. time

C. VARIABLE OVERHEAD VARIANCE

1. **Total Variable Overhead Variance (TVOHV)**
   = (Recovered Total Overhead – Actual Total Overhead)

****Recovered Total Overhead = Actual Output * (Budgeted Overhead/ Budgeted Output)

2. **VARIABLE OVERHEAD VARIANCE**

I. **Variable Overhead Cost Variance (VOHCV)**
   = Recovered Variable Overhead – Actual Variable Overhead

*****Recovered Variable Overhead = Actual Output * (Budgeted Variable Overhead/ Budgeted Output)

II. **Variable Overhead Expenditure Variance (VOHExV)**
   = Standard Variable Overhead – Actual Variable Overhead

***** Standard Variable Overhead = Actual Hours Worked * (Budgeted Variable Overhead/ Budgeted Hours)

III. **Variable Overhead Efficiency Variance (VOHEV)**
   = Recovered Variable Overhead – Standard Variable Overhead

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3. FIXED OVERHEAD VARIANCE

I. Fixed Overhead Cost Variance (FOHCV)

= (Recovered Fixed Overhead – Actual Fixed Overhead)

II. Fixed Overhead Expenditure Variance (FOHExV)

= Budgeted Fixed Overhead – Actual Fixed Overhead

III. Fixed Overhead Efficiency Variance (FOHEV)

= Recovered Fixed Overhead – Standard Fixed Overhead

IV. Fixed Overhead Volume Variance (FOHVV)

= Recovered Fixed Overhead – Budgeted Fixed Overhead

V. Fixed Overhead Capacity Variance (FOHCV)

= Standard Fixed Overhead – Budgeted Fixed Overhead

VI. Calendar Variance = (Budgeted Fixed Overhead/ Budgeted Number of Days) * Excess Days Worked

NOTE

FOHCV = FOHExV + FOHVV

FOHVV = FOHCV + FOHEV

*****Recovered Fixed Overhead = Actual Output * (Budgeted Fixed Overhead/ Budgeted Output)

***** Standard Fixed Overhead = Actual Hours Worked * (Budgeted Fixed Overhead/ Budgeted Hours)

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UNIT V

STATEMENT OF COST SHEET

PARTICULARS	AMOUNT	AMOUNT	COST PER UNIT
Opening Stock of Material	XXXX		
ADD: Purchase of Raw Material	XXXX		
ADD: Expenses, Taxes and Duties on Material Purchased	XXXX		
	XXXXXX		
LESS: Closing Stock of Material	XXXXX		
Direct Material Sold	XXXXX		
Direct material Consumed		XXXXX	XXXXX
ADD: Direct Wages		XXXXX	XXXXX
ADD: Direct Expenses		XXXXX	XXXXX
PRIME COST		**XXXXX**	**XXXXX**
ADD: Factory Overhead		XXXXX	XXXXX
ADD: Opening Work In Progress		XXXXX	XXXXX
		XXXXX	XXXXX
LESS: Closing Work in Progress		XXXXX	XXXXX
WORKS COST		**XXXXX**	**XXXXX**
ADD: Administrative Overhead		XXXX	XXXXX
COST OF PRODUCTION		**XXXX**	**XXXXX**
Add: Opening Stock of Finished Goods		XXXX	
		XXXX	
LESS: Closing Stock of Finished Goods		XXXX	
COST OF GOODS SOLD		**XXXXX**	
ADD: Selling and Distribution Expenses		XXXXX	XXXXXX
COST OF SALES		**XXXXX**	**XXXXX**
ADD: Profit		**XXXXX**	**XXXXX**
SALES		**XXXXX**	**XXXXX**

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TERMINOLOGY IN COST SHEET

FACTORY OVERHEAD

1. Indirect Material
2. Indirect Wages
3. Unproductive Wages
4. Factory Rent and Taxes
5. Power and Fuel
6. Factory Lighting
7. Factory Manager Salary
8. Works Manager Salary
9. Factory Insurance
10. Factory Stationery
11. Factory Cleaning
12. Drawing Office Expenses
13. Depreciation on Plant & Machinery
14. Cost of Research & Equipment
15. Other Factory Expenses

ADMINISTRATIVE OVERHEAD

9. Office Rent or Taxes
10. Office Lighting
11. Office Stationery
12. Depreciation of Office Furniture
13. Repairs of Office Furniture
14. Management Expenses
15. Office Telephone and Postage Charges
16. Legal Charges
17. Bank Charges & Commission
18. Office Cleaning
19. Audit Fees
20. Office Insurance
21. Other Office Expenses

SELLING & DISTRIBUTION OVERHEAD

4. Salesman Salary/ Commission
5. Showroom Expenses
6. Showroom Rent & Rates
7. Advertisement
8. Sales office Rent & Rates
9. Travelling Expenses
10. Warehouse Rent & rates
11. Warehouse Staff Salary
12. Depreciation & Repairs of Delivery Vehicle
13. Carriage Outwards
14. Debt Collection Charges
15. Other Selling & Distribution Expenses

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UNIT 1

1. State the various steps involved in preparation of balance sheet?
2. Discuss the nature, scope, objectives, merits and demerits of management accounting? **(or)** Management accounting is accounting for effective management? Explain **(or)** Explain the importance of management accounting as a tool of management decision making? **(or)**
   Management accounting aims at providing financial results of business to the management for taking decision? **(or)**
   Discuss the function of management accounting? **(or)**
   Define management accounting? Explain its importance?
3. Explain the roles and responsibilities of a management accountant in a large scale business enterprise
4. Explain the concepts and conventions governing the preparation of financial statement?
5. Distinguish between horizontal analysis and vertical analysis of financial statement?
6. Define accounting? State its rules?
7. Explain steps involved in preparing income statement?
8. How do management accounting and financial accounting differ – explain
9. State and explain the difference between cost accounting and financial accounting?

UNIT II

1. What do you understand by analysis and interpretation of financial statement?
2. Discuss the objectives of financial statement analysis?
3. Explain the methods of financial statement analysis?
4. Define ratios? What are the different classification of ratios?
5. How ratios are useful in analyzing the financial position of a company **(or)**
   Discuss some of the important ratios usually worked from financial statement showing how they would be useful to higher management?
6. Explain the principle uses of funds?
7. Differentiate fund flow analysis and cash flow analysis?
8. A fund flow analysis is a better substitute for an income statement – explain **(or)**
   Describe the importance of fund flow analysis?
9. Describe the limitations of ratio analysis?
10. Explain the limitation of fund flow statement?
11. Explain the procedure for preparing fund flow statement
12. Explain the purpose of preparing cash flow statement
13. Distinguish between fund flow statement and balance sheet

UNIT III

1. What is marginal costing? State its application **(or)**
   Explain the application of marginal costing technique in decision making
2. Define marginal costing? What are the assumptions, merits and demerits of marginal costing?

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3. What do you understand by the term break even analysis? Enumerates its uses? **(or)** Describe the advantage, importance and limitation of break-even charts?
4. What do you understand by direct costing? Explain its importance?

UNIT IV

1. What do you mean by budgeting? Explain the various types of budgeting? / discuss the methods of budgetary?
2. Differentiate between flexible budgeting and static budgeting?
3. Describe the steps involved in budgetary control system?
4. Explain zero based budgeting and its uses?
5. Explain how does budgeting process helps an organization to improve its profits?
6. What are the advantage arising out of the budgeting system?
7. Explain major problems involved in developing budgeting system?
8. What is meant by budgetary control? Briefly explain it objectives?
9. Describe the procedure for preparing flexible budget?
10. Distinguish between fixed and flexible budget?
11. What is standard costing and how would you distinguish it from budgetary control?
12. What is variance? And state its significance to the management?

UNIT V

1. What is activity based costing? State its importance?
2. Explain what is meant by the term cost centre and profit centre
3. Give an account on detail about the element of costing and pricing?
4. Importance of cost accounting?
5. List out the different methods of costing?
6. Discuss the main objectives, merits and demerits of costing?
7. Describes the general features of process costing?
8. Enumerate the basic requisite of good report **(or)** Discuss the essentials of good reporting system
9. Describe important periodical report usually presented to the management in an organization?
10. Explain the usefulness of reporting to the management?
11. Explain how the accounting information is useful in managerial decisions? **(or)** What do you mean by reporting to the management? Explain the uses of accounting information in managerial decision making
12. Explain the steps involved in the preparation of reports.
13. Explain different types of reports that are used for internal management of an enterprise
14. Accounting provides information to various users – discuss accounting as an information system?

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