

ACCOUNTING FOR MANAGERS (434C1D) – COURSE MATERIAL

VISION & MISSION STATEMENTS

Vision

To be an oasis of knowledge to the seeker, to nurture one's creativity and research acumen, and to instil a unique blend of leadership, innovative spirit and empathy in response to the ever-evolving business ecosystem.

Mission

- Provide a pedagogy that blends academic rigor and experiential learning.
- Inculcate an entrepreneurial mindset through curated activities
- Establish a conducive environment for research.
- Foster a culture of innovation and collaboration to progress in a dynamic business landscape.
- Promote humanistic values to produce socially responsible leaders.

Program Educational Objectives (PEOs)

PEO 1 – Employability: To develop students with industry specific knowledge & skills to meet the industry requirements and also join public sector undertaking through competitive examinations.

PEO 2 - Entrepreneur: To create effective business service owners, with a growth mindset by enhancing their critical thinking, problem solving and decision-making skills.

PEO3 – Research and Development: To instil and grow a mindset that focusses efforts towards inculcating and encouraging the students in the field research and development.



PEO 4 – Contribution to Business World: To produce ethical and innovative business professionals to enhance growth of the business world.

PEO 5 – Contribution to the Society: To work and contribute towards holistic development of society by producing competent MBA professionals.

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.

PO4 - Communication Skill; Ability to understand, analyze 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.



Program Specific Objectives

PSO 1: Finance: The students should demonstrate proficiency in analyzing financial statements, evaluating investment opportunities and making financial decision to maximize shareholders' value.

PSO 2: Marketing: Students should be able to create a comprehensive marketing plan that integrates effective communication strategies, leading to customer success and the accomplishment of marketing objectives.

PSO 3: Logistics: Students will acquire knowledge of inventory management for domestic and global supply chains, thereby developing problem-solving skills in logistics to optimize supply chain efficiency.

PSO 4: Business Analytics: The students should able to analyze data, communicate insights, take data-driven decisions and solve business problems effectively.



ACCOUNTING FOR MANAGERS (434C1D) SYLLABUS

Subject Code	Subject Name	Category	L	T	P	O	Credits	Inst. Hours	Marks	
									CIA	Total
	Accounting For Managers	Core	Y	-	-	-	4	4	25	100
Course Objectives										
C1	To acquaint the students with the fundamentals of principles of financial, cost and management accounting									
C2	To enable the students to prepare, analyse and interpret financial statements									
C3	To acquaint the students with the tools and techniques of financial analysis									
C4	To enable the students to take decisions using management accounting tools.									
C5	To enable the students to prepare the reports with the accounting tools and facilitate managerial decision making.									
UNIT	Details						No. of Hour	Course Objective		
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); International Accounting Standards – IFRS						12	C1		



II	Financial Statement Analysis- Objectives- Techniques of Financial Statement Analysis: Common Size and Comparative Financial Statements, Trend analysis, Ratio Analysis. 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–problem.	12	C2
III	Marginal Costing-Definition- distinction between marginal costing and Absorption costing- Break- even 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	C3
IV	Budget, Budgeting, and Budgeting Control - Types of Budgets - Preparation of Flexible and fixed Budgets, master budget and Cash Budget - Problems -Zero-Base Budgeting.	12	C4
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. Reporting-Accounting Standards and Accounting Disclosure practices in India; Exposure to Practical Knowledge of using Accounting software- Open Source.	12	C5
Total		60	
Course Outcomes			
Course Outcomes	On completion of this course, students will;	Program Outcomes	



CO1	Be able to understand the fundamentals of principles of financial, cost and management accounting	P O 6
CO2	Be able to prepare, analyze and interpret financial statements	PO1, PO2, PO4, PO6, PO7
CO3	Be able to use the tools and techniques of financial analysis.	PO1, PO2, PO3, PO6, PO7
CO4	Be able to take decisions using management accounting tools.	PO1, PO2, PO6, PO7
CO5	Be able to prepare the reports with the accounting tools and facilitate and take managerial decisions.	PO2, PO3, PO4, PO6, PO7, PO8

Reading List

1.	http://files.rajeshindukuristudyplace.webnode.com/200000014-9621c971b8/accounting%20for%20managers.pdf
2.	http://shodhganga.inflibnet.ac.in/bitstream/10603/70588/9/09_chapter%201.pdf
3.	http://educ.jmu.edu/~drakepp/principles/module6/capbudtech.pdf
4.	https://www.researchgate.net/publication/313477460_concept_of_working_capital_management

**References
Books**

1.	Gupta, A., Financial Accounting for Management: An Analytical Perspective, 5 th Edition, Pearson, 2016.
2.	Khan, M.Y. and Jain, P.K., Management Accounting: Text, Problems and Cases, 8 th Edition, Tata McGraw Hill Education Pvt. Ltd., 2021.
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., 16 th Edition, Pearson, 2013
5.	Noreen, E., Brewer, P. and Garrison, R., Managerial Accounting for Managers, 13 th Edition, Tata McGraw-Hill Education Pvt. Ltd., 2009.



6.	Rustagi,R.P., Management Accounting, 2 nd Edition, Taxmann Allied Services Pvt. Ltd, 2011	
Methods of Evaluation		
Internal Evaluation	Continuous Internal Assessment Test	25 Marks
	Assignments	
	Seminars	
	Attendance and Class Participation	
External Evaluation	End Semester Examination	75 Marks
Total		100 Marks
Methods of Assessment		
Recall (K1)	Simple definitions, MCQ, Recall steps, Concept definitions	
Understand/ Comprehend (K2)	MCQ, True/False, Short essays, Concept explanations, Short summary or overview	
Application (K3)	Suggest idea/concept with examples, Suggest formulae, Solve problems, Observe, Explain	
Analyze (K4)	Problem-solving questions, Finish a procedure in many steps, Differentiate between various ideas, Map knowledge	
Evaluate(K5)	Longer essay/ Evaluation essay, Critique or justify with pros and cons	
Create (K6)	Check knowledge in specific or offbeat situations, Discussion, Debating or Presentations	

	PO 1	PO 2	PO 3	PO 4	PO 5	PO 6	PO 7	PO 8
CO 1						M		M
CO 2	S	S		S		S	M	
CO 3	S	S	S			S	M	
CO 4	S	S				S	S	
CO 5		S	S	S		S	M	M

ACCOUNTING FOR MANAGERS (434C1D) – COURSE MATERIAL**Unit - 1****Meaning of Management Accounting**

Management Accounting is the presentation of accounting information to management in order to formulate the policies and assist in its day-to-day activities. In other words, it helps the management to perform all its functions including planning, organizing, staffing, directing and control.

Definition of Management Accounting

The Institute of cost and Management Accountants, London, has defined Management Accounting as, "the application of professional knowledge and skill in the preparation of accounting information in such a way as to assist management in the formulation of policies and in planning and control of the operation of the undertaking."

According to R.N Anthony, "Management Accounting is concerned with accounting information that is useful to management

Objectives of Management Accounting

The objectives of management accounting are as follows:

- (i) To present financial information to the management in a way that is easily understandable
- (ii) To supply necessary data to the management for formulating future plans. The data includes statements pertaining to past results and estimates for the future.
- (iii) To help in keeping the actual performance as per the plans made by the management.

- (iv) To establish a strong, working relationship amongst different individuals pertaining to different departments, of the same organization.
- (v) To maximize the wealth of the organization
- (vi) To motivate the employees, by fixing targets and providing incentives
- (vii) To keep the tax burden of the organization minimum
- (viii) To keep the management fully informed about the latest position of the organisation

Nature of Management Accounting

- (i) **Mainly concerned with future** : Planning is the process of looking ahead by taking the reference of the past. The process of management accounting is driven towards the future course of action with proper planning based on the analytical financial details other past. It considers the budgets to forecast the future revenue and expenditure and inflow and out follow of funds.
- (ii) **Recent origin**: Management accounting has been well recognized in the modern business houses due to increasing customer base and market complexity. Modern managerial decisions need much quantitative organized information rather traditional form of financial statements for making effective decisions.
- (iii) **Management need oriented**: Management Accounting is highly personalized service and Subjective in nature. It is basically intended for the use of internal managerial decisions. It provides necessary information as per the need of the management in the required format and ensures that the information's are sufficient to make effective decisions.
- (iv) **Information as per Management need**: There is no hard and fast rule in the preparation of management reports and statement, it always as per the

situational requirement of the management and based on the availability of the data for analysis and interpretation.

(v) **Provides data and not the decisions:** Management accounting discipline is not a replacement of management. It provides just information to the managerial decisions. It facilitates decisions since majority of the decisions are made considering the facts and figures provided by the management accountants. But at the same time these data itself cannot form the decisions of the management.

(vi) **Objective oriented:** Management accounting present data in such a way that it enables the management to formulate policies and programme so as to achieve the managerial or organizational goals in most efficient and effective manner.

(vii) **Financial and cost accounting information:** Management accounting is all about the analysis and interpretation of financial and cost accounting data, to generate such reports and statements which can prove useful to management in decision making.

(viii) **Increases efficiency:** Management accounting is concerned with providing, the needed information to the Management in the proper manner and assisting in the policy formulation and managerial control. This enables the management to increase efficiency of its operation and ensures the optimum profits with minimum operational risk. Apart from the above unique features

Management Accounting is also characterized by the following:

- a) It does not follow any fixed norms or formats.
- b) Basically concerned with forecasting
- c) Mainly used for internal purpose.
- d) Useful in managerial decision making.

- e) It is not compulsory as the any other disciplines like financial accounting and cost accounting.
- f) It is an interdisciplinary subject since it mainly depends on the financial and cost accounting

Scope of Management Accounting

(i) **Financial Accounting:** Accounting is the process of systematic recording of financial transactions so as to determine the true and fair financial position of a concern. Management accounting derives the necessary data from the financial accounting. For instance when fund flow statement or Ratio statement are to be prepared, financial statements are very essential without which the preparation and decision about fund flow and ratios are not possible.

(ii) **Cost Accounting:** Management accounting uses certain technique and tools of cost accounting as well. Cost accounting provides the various techniques of costing, viz, Marginal Costing, Standard Costing, Differential Cost Analysis etc. which plays significant role in the operation and control of the enterprise It assists management in measuring the operational efficiency of the management and achieving managerial goals.

(iii) **Budgetary Control:** Budgetary control is a system of controlling Costs thorough establishment of standards. It controls the activities of the business and measures the variance by comparing the actual with the budgeted figures and enquires into the reasons of such variance at each and every step, so that the adverse variance may not be repeated in future.

(iv) **Tax Planning:** It is concerned with the computation of taxable income according to Income- Tax Act, and filing of returns and the payment of tax. It is

one of the core functions of the modern management accountant, facilitating management in proper tax planning and accounting.

(v) **Analysis and Interpretation of Accounts:** Financial statement can be better understood through comparative study. The primary duty of the management accountant is to explain the data relating to the management and assist management in taking decisions.

(vi) **Reporting:** Management accounting uses the technique of statistics wherever necessary for effective analysis and interpretation. Sometimes reports on various aspects of the business are to be submitted by the management accountants. At the time of preparation of the statement or Repots, they use different statistical techniques, viz, Line Chart, Pie Chart, Index Numbers etc. in order to be more attractive and intelligible.

(vii) **Internal audit and control:** Management accountants depend on the internal audit and use that for generating reports on various financial issues for decision making.

(viii) **Budgetary Control:** Budgetary control is a system of controlling costs thorough establishment of standards. It controls the activities of the business and measures the variance by comparing the actual with the budgeted figures and enquires into the reasons of such variance at each and every step, so that the adverse variance may not be repeated in future.

(ix) **Tax Accounting :** It is concerned with the computation of taxable income as per Income Tax Act, and filing of returns and the payment of tax. It is one of the core functions of the modern management accountant, facilitating management in proper tax planning and accounting.

(x) **Analysis and Interpretation of Accounts:** Financial statement can be better understood through comparative study. The primary duty of the management

accountant is to explain the data relating to the management and assist management in taking decisions.

(xi) **Management Information System:** It is very difficult to imagine organisations without computers in the globalized corporate environment. Information's are stored and supplied to the management with the help of computers for managerial decisions. The advancement in the technology has made management accountants job much easier and effective and has made more depended on the technology from time to time.

Tools and Techniques used in Management Accounting

The important tools and techniques are briefly explained below.

1. Financial Planning

The main objective of any business organization is maximization of profits. This objective is achieved by making proper or sound financial planning. Hence, financial planning is considered as best tool for achieving business objectives.

2. Financial Statement Analysis

Profit and Loss account and Balance Sheet are important financial statements. These statements are analyzed for different period. This type of analysis helps the management to know the rate of growth of business concern. This analysis is done through comparative financial statements, common size statements and ratio analysis.

3. Cost Accounting

Cost accounting presents cost data in product wise, process wise, department Wise branch wise and the like. These cost data are compared with predetermined one. This comparison of two costs enables the management to decide the reasons responsible for the difference between these costs.

4. Fund Flow Analysis

This analysis find out the movement of fund from one period to another. Moreover, this analysis is very useful to know whether the fund is properly used or not in a year When compared to the previous year. The working capital changes and funds from operation are also find out through this analysis.

5. Cash Flow Analysis

The movement of cash from one period to another can be find out through this analysis. Besides, the reasons for cash balance and changes between two periods are also find out. It studies the cash from operation and the movement of cash in a period.

6. Standard Costing

Standard costing is predetermined cost. It provides a yard stick for measuring actual performance. It is used to find the reasons for the deviations if any.

7. Marginal Costing

Marginal costing technique is used to fix the selling price, selection of best sales mix, best use of scarce raw materials or resources, to take make or buy decision, acceptance or rejection of bulk order and foreign order and the like. This is based on the fixed cost, variable cost and contribution.

8. Budgetary Control

Under Budgetary control techniques, future financial needs are estimated and arranged according to an orderly basis. It is used to control the financial performances of business concern. Business operations are directed in a desired direction.

9. Ratio Analysis

It is used to management in the discharge of its basic functions of forecasting, planning, coordination, communication and control. It paves the way for effective

control Of business operations by undertaking an appraisal of both the physical and monetary targets

10. Revaluation Accounting

The fixed assets are revalued as per the revaluation accounting method so that the capital is properly represented with the assets value. It helps to find out the fair return On capital employed.

11. Decision-making Accounting

A business problem can be solved by choosing any one of the best and most profitable alternative. To select such alternative, the relevant costs are compared. Thus, accounting information are used to solve the business problem which are arising out of increasing complexity of nature of business.

12. Management Information System

The free flow communication within the organization is essential for effective functioning of business. Hence, the management can design the system through which every employee of an organization can assess the information and used for discharging their duties and taking quality decisions.

Difference between Financial Accounting and Management Accounting

Basis	Financial accounting	Management Accounting
Users	Mainly intended to serve external users like share-holders, bankers, creditors and government.	Mainly intended to serve internal users like management



Legality	Statutorily compulsory as per different acts such as companies act of 1956 income tax act of 1961 etc.	Not compulsory
Development	It is well developed and very old system in practice	It is of recent development
Subject matter	It deals With preparation of financial statements through systematic recording and determines the financial position of a concern.	It deals with presentation of needed information for management for effective decisions.
Standard	There is specific standard for Preparation as per the act and reports are practice.	Preparation of statements and reports are not standardized
Dependency	It is an independent discipline . discipline.	It is an inter dependent.
Publications	It is compulsory to publish the financial reports of the concern.	It is not compulsory.
Statement and report prepared	Generally Trading and profit and loss account and balance sheet are prepared	It prepares the funds and cash flow statement,



		budgetary reports, ratio statements etc,
Consideration	It considers only monetary transactions.	It sometime considers non monetary aspect also like quality, machine hours, number of people working etc.
Auditing	Audit of books of accounts by a qualified chartered accountant is compulsory	It is not necessary to get audited the records of management accounting,

Difference between Cost Accounting and Management Accounting

Basis	Cost Accounting	Management Accounting
Functions	Basically executes the function of identification and recording of cost and cost control in the operation.	It basically assists management in decision making through providing necessary information.
Statutory compulsions	It is necessary to maintain cost records in a systematic way in certain manufacturing industries as per the notification of the notification	It is purely optional to management



Focus	It is focused on cost identification and cost control.	It is focused on the effective decisions for optimum managerial efficiency and objective attainment.
Users of the information	It is used by both internal as well as external parties.	Used by only internal parties.
Data used	It derives certain data from financial records.	It derives data from financial books, cost books as well as certain other sources.
Scope and coverage	The scope of this discipline is limited to the extent of cost recording and Reporting	The scope of this discipline is broader and covers various aspects like finance, costing, taxation, audit
Tools and techniques used	It follows well developed tools and techniques for identification and recording of cost.	It doesn't have well developed tools or technique.

Differences between Financial Accounting and Cost Accounting

Basis	Financial accounting	Cost accounting
1. Purpose	It serves the interest of business and other interested parties by	It renders information for the guidance of the management for the proper



	Providing suitable information in the financial statements.	planning control and decision making.
2. Options	F A is required to be kept as per the requirements Of the company act and income tax act.	CA is voluntarily kept to serve the management in the discharge of management functions.
3. Analysis	FA reveal the profit of the business as a whole.	CA shows the profit result of each business as a whole operations process and product
4. Recording	It consists of classification recording and analysis of transaction in a subjective manner i.e., according to the nature of expenditure.	It records in an objective manner i.e., according to which cost are incurred
5. Control	It lays emphasis on the recording aspect, no consideration is given to control aspect.	It provides for a detailed system of control with the help of standard costing and budgetary control.
6. Reporting	It involves reporting of business performance at the end of the accounting year.	There is a continuous flow of data information of cost report to management.

7. Obligation	This is to be maintained compulsory.	This is to be maintained voluntarily.
8. Audit	Audit of FA is statutory	Audit of CA is not compulsory.
9. Duration of	FA provides financial information once a year.	CA furnishes reporting cost data at frequent intervals.
10. Pricing	It fails to guide the formulation of pricing policy.	It provides adequate data for formulating pricing policy.
11. Valuation of Stock	Stock is valued at cost or marked price whichever is less.	Stock is always valued at cost

Limitations of Management Accounting

1. Data Dependency

Management accounting derives information from Financial accounting, Cost accounting and other sources. So, the conclusions arrived at by management accountants depend to a large extent on the accuracy of these two (Financial accounting and Cost accounting) records.

Therefore, if the past data which are collected from the financial and cost records are found inaccurate, the decisions suggested by the management accountants, on the basis of the above, also will be inaccurate.

2. Does not give the decision

Management accounting cannot replace the decisions. It can just assist the management in its operations through providing necessary analytical statements and advises management for better and efficient managerial functions.

3. Costly affair

Installation and maintenance of Management accounting system is suitable for those concerns which has significant amount of transactions generally large establishments. before, small concerns cannot afford to adopt this system.

4. No standardization as other disciplines

Management accounting is still in the development stage. So it has to face the problems fluidity of concepts, improvement of techniques etc. It does not have any strong principles like financial accounting and cost accounting. It does not follow any set rule and hence differs in its practices.

5. Danger of misleading

The information provided by Management accountants cannot be taken as full proof information for making any managerial decisions. Because the data used by management accountants itself may have window dressed data due to which the management accounts may mislead the management.

6. Needs human involvement for interpretation:

Management accounting involves people to make final reports or interpretations, due to which the interpretation may be of the personal opinion of the person Who has prepared it. It creates differences in the interpretations and becomes more subjective rather than objective in the analysis.

Accounting Concepts

What is accounting concepts?

“The term accounting concepts refer to basic rules, assumptions, and principles which act as a primary standard for recording business transactions and maintaining books of accounts”.

Objectives of the Accounting Concept:

- The primary aim of accounting is to maintain uniformity and regularity in the preparation of accounting statements.
- Accounting concepts act as an underlying principle that helps accountants in the preparation and maintenance of business records.
- It aims to understand the business rules and regulations that are required to be followed by all types of business entities, and hence simplifying the detailed and comparable financial information.

What are the Different Accounting Concepts?

Following are the different accounting concepts that are widely used all around the world and hence are termed as universally accepted accounting rules. The different accounting concepts are:

1. Business Entity Concept

This concept assumes that the organization and business owners are two independent entities. Hence, the business transaction and personal transaction of its owner are different. Thus, the accounting transactions are recorded in the books of accounts from the organization's point of view and not the person owning the business.

2. Accrual Concept

The term accrual means something is due, especially an amount of money that is yet to be paid or received at the end of the accounting period. It implies that revenue is realized at the time of sale through cash or not whereas expenses are recognized when they become payable whether cash is paid or not. Therefore, both the transactions are recorded in the accounting period in which they relate. In brief, the accrual concept states that revenue is recognized when realized and

expenses are recognized when they become due and payable irrespective of the cash receipt or cash payment.

3. Accounting Cost Concept

The accounting cost concept states all the business assets should be written down in the book of accounts at the price assets are purchased, including the cost of acquisition, and installation. The assets are not recorded at their market price. It implies that the fixed assets like plant and machinery, building, furniture, etc are recorded at their purchase price

4. Dual Aspect

The dual aspect is the basic principle of accounting. It provides the basis for recording business transactions in the books of accounts. This concept assumes that every transaction recorded in the books of accountants is based on dual concepts. This implies that the transaction that is recorded affects two accounts on their respective opposite sides. Hence, the transaction should be recorded at dual places. It implies that both aspects of the transaction should be recorded in the books of account. The duality of the transaction is commonly expressed in the terms of the following equation given below:

$$\mathbf{Assets = Liabilities + Capital}$$

The dual concept implies that every transaction has a similar effect on assets and liabilities in such a way that the value of total assets is always equal to the value of total liabilities.

5. Going Concepts

The Going concept in accounting states that business activities will be carried by any firm for an unlimited duration This simply means that every business has continuity of life. Hence, it will not be dissolved shortly. This is an important

assumption of accounting as it provides a base for representing the asset value in the balance sheet.

6. Money Measurement Concept

The money measurement concept assumes that the business transactions are made in terms of money i.e. in the currency of a country. In India, such transactions are made in terms of the rupee. Hence, as per the money measurement concept, transactions that can be expressed in terms of money should be recorded in books of accounts.

7. Accounting Period Concepts

Accounting period concepts state that all the transactions recorded in the books of account should be based on the assumption that profit on these transactions is to be ascertained for a specific period. Hence this concept says that the balance sheet and profit and loss account of a business should be prepared at regular intervals. This is important for different purposes like calculation of profit and loss, tax calculation, ascertaining financial position, etc. Also, this concept assumes that business indefinite life is divided into two parts. These parts are termed accounting periods. It can be one month, three months, six months, etc. Usually, one year is considered as one accounting period which may be a calendar year or financial year.

8. Realization Concept

The term realization concept states that revenue earned from any business transaction should be included in the accounting records only when it is realized. The term realization implies the creation of a legal right to receive money. Hence, it should be noted that selling goods is considered as realization whereas receiving order is not considered as realization. In other words, the revenue

concept states that revenue is realized when cash is received or the right to receive cash on the sale of goods or services or both have been created.

9. Matching Concepts

The Matching concept states that revenue and expenses incurred to earn the revenue must belong to the same accounting period. Hence, once revenue is realized, the next step is to assign the relevant accounting period. The matching concept implies that all the revenue earned during an accounting year whether received or not during that year or all the expenses incurred whether paid or not during that year should be considered while determining the profit and loss of the business for that year. This enables the investors or shareholders to know the exact profit and loss of the business.

Accounting Conventions

What are Accounting Conventions?

Accounting conventions are certain restrictions for the business transactions that are complicated and are unclear. Although accounting conventions are not generally or legally binding, these generally accepted principles maintain consistency in financial statements. While standardized financial reporting processes, the accounting conventions consider comparison, full disclosure of transaction, relevance, and application in financial statements.

Four important types of accounting conventions are:

- **Conservatism:** It tells the accountants to err on the side of caution when providing the estimates for the assets and liabilities, which means that when there are two values of a transaction available, then the always lower one should be referred to.
- **Consistency:** A company is forced to apply the similar accounting principles across the different accounting cycles. Once this chooses a



method it is urged to stick with it in the future also, unless it finds a good reason to perform it in another way. In the absence of these accounting conventions, the ability of investors to compare and assess how the company performs becomes more challenging.

- **Full Disclosure:** Information that is considered potentially significant and relevant is to be completely disclosed, regardless of whether it is detrimental to the company.
- **Materiality:** Similar to full disclosure, this convention also bound organizations to put down their cards on the table, meaning they need to totally disclose all the material facts about the company. The aim behind this materiality convention is that any information that could influence the person's decision by considering the financial statement must be included.

Accounting Principles

Accounting principles are a set of guidelines and rules issued by accounting standards like GAAP and IFRS for the companies to follow while presenting or recording financial transactions in the books of account. This enables companies to present a true and fair view of the financial statements.

What Are International Financial Reporting Standards (IFRS)?

International Financial Reporting Standards (IFRS) are a set of accounting rules for the financial statements of public companies that are intended to make them consistent, transparent, and easily comparable around the world.

Significance of IFRS:



- International Financial Reporting Standards (IFRS) were created to bring consistency and integrity to accounting standards and practices, regardless of the company or the country.
- They were issued by the London-based Accounting Standards Board (IASB) and address record keeping, account reporting, and other aspects of financial reporting.
- The IFRS system replaced the International Accounting Standards (IAS) in 2001.
- IFRS fosters greater corporate transparency.
- IFRS is not used by all countries; for example, the U.S. uses generally accepted accounting principles (GAAP).

Requirements of IFRS:

IFRS covers a wide range of accounting activities. There are certain aspects of business practice for which IFRS set mandatory rules.

- **Statement of Financial Position:** This is the balance sheet. IFRS influences the ways in which the components of a balance sheet are reported.
- **Statement of Comprehensive Income:** This can take the form of one statement or be separated into a Profit and loss statement and a statement of other income, including property and equipment.
- **Statement of Changes in Equity:** Also known as a statement of retained earnings, this documents the company's change in earnings or profit for the given financial period.



- **Statement of Cash Flows:** This report summarizes the company's financial transactions in the given period, separating cash flow into operations, investing, and financing.

FEATURES OF IFRS

- **FAIR PRESENTATION AND COMPLIANCE WITH IFRS:** Fair presentation requires the faithful representation of the effects of the transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the Framework of IFRS.
- **GOING CONCERN:** Financial statements are present on a going concern basis unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so.
- **ACCRUAL BASIS OF ACCOUNTING:** An entity shall recognize items as assets, liabilities, equity, income and expenses when they satisfy the definition and recognition criteria for those elements in the Framework of IFRS.
- **MATERIALITY AND AGGREGATION:** Every material class of similar items has to be presented separately. Items that are of a dissimilar nature or function shall be presented separately unless they are immaterial.

MERITS OF IFRS

- Improved Flow of Capital



- International Financial Reporting Standards, or IFRS, facilitates the convergence and transparency of accounting practices. This boosts the flow of capital across the international markets. Investors and other stakeholders find it
- more convenient to compare their business performance with other international companies. This makes it easier and cheaper for them to raise business capital from investors across the globe.
- Globalized Orientation
- Using IFRS frees a business from the restrictive scope of national-level accounting standards. Financial reports become automatically acceptable in IFRS-compliant countries, and companies don't need to prepare alternative sets of financial statements when pursuing business interests in these countries. This reduces a business's costs of preparing financial statements destined for international audiences.
- Generalized Standard-Setting
- IFRS stipulations are flexible to both expected and unexpected changes in the global business environment because they are based on broad principles. The generalized stipulations are designed to be applicable and accommodative to varying jurisdictional circumstances and traditions, with minimal interventions of the IASB. For example, the IASB does not recommend any specific formats for preparing financial statements. This gives a business the discretion of choosing the presentation format that best suits it and users of its financial reports.
- Enhanced Financial Reporting



- The use of IFRS enhances the quality of financial reports because it leaves little room for undermining the objectives of the set standards. This is unlike country-specific accounting rules that are susceptible to circumventions. Quality financial reports boost investor confidence in a business.

ADOPTION OF IFRS

- IFRS are used in many parts of the world, including the South Korea, European Union, India, Hong Kong, Australia, Malaysia, Pakistan, GCC countries, Russia, Chile, Philippines, South Africa, Singapore and Turkey, but not in the United States.
- It is generally expected that IFRS adoption worldwide will be beneficial to investors and other users of financial statements, by reducing the costs of comparing alternative investments and increasing the quality of information.
- Companies are also expected to benefit, as investors will be more willing to provide financing.
- Companies that have high levels of international activities are among the group that would benefit from a switch to IFRS.
- Companies that are involved in foreign activities and investing benefit from the switch due to the increased comparability of a set accounting standard.

Final Accounts

What are Final Accounts?

Final accounts are a group of key financial statements that present a clear summary of a business's financial activities over a specified period, usually a year.

These include the Trading Account, the Profit and Loss Account, and the Balance Sheet. Together, they provide detailed insights into how a business has performed, what earnings or losses have occurred, and the financial position of the company at the end of the period.

Meaning and Components of Final Accounts

Final accounts bring together all the accounting information recorded during the year to create a complete view of a business's operations and stability. The four major parts are:

- **Manufacturing Account:** The manufacturing account gives information on all the expenses and costs incurred in the preparation of the goods to be sold. This includes the expenses that are met in the path of preparing the goods but not the finished goods. Any type of expenses including the cost of raw materials, the cost of machines and their maintenance, the salaries and wages of both skilled and unskilled workers which are considered as the direct expenses of the manufacturing. Even the depreciation of the assets like costly machines and plants are also included under this account. This statement of account is very important for a manufacturing firm or plant to get an idea of the total profit or loss incurred throughout the year in the total process. The effectiveness and fixing of the cost price of the finished goods are based upon the statement of the manufacturing account. The statement of the manufacturing account does not have a prescribed format. It is only important to show the quantities and values clearly.
- **Trading Account:** Records direct revenues (mainly sales) and direct costs (such as purchases, wages, and other expenses directly tied to production).



Its main purpose is to calculate **Gross Profit or Loss** from core business activity.

- **Profit and Loss Account:** Prepared after the Trading Account, this statement considers all indirect incomes and expenses, like administrative salaries, depreciation, rent, and non-trading incomes. It determines the **Net Profit or Loss** of the business.
- **Balance Sheet:** A statement that captures the **financial position** of the business on a particular date, showing what the business owns (assets), owes (liabilities), and the investment made by owners (capital/equity).

Objectives and Benefits of Final Accounts

- They summarize financial performance, clearly showing revenues, costs, profits, and losses for comparison and analysis.
- They support better business decisions for management, investors, and creditors by clarifying cash flows, profits, and resource allocation.
- They ensure compliance with regulatory and professional standards for the transparent presentation of financial health.

Format and Structure: Proforma of Final Accounts

There is a standardized format for final accounts, which ensures consistency and ease of understanding. The typical proforma is shown below.

Manufacturing Account Format:



Manufacturing Account

Particulars	Units	Amount ₹	Particulars	Units	Amount ₹
To Raw Material Consumed:			By By-products at net realizable value		
Opening Inventory		By Closing Work-In- Process		
Add: Purchases		By Trading A/c		
Less: Closing Inventory	Cost of production		
To Direct Wages				
To Direct expenses:				
Prime cost				
To Factory overheads:					
Royalty				
Hire charges				
To Indirect expenses:				
Repairs & Maintenance				
Depreciation			
Factory cost				
To Opening Work-in-process				

Trading Account Format:

Trading Account Format		For the year ended.....	
To opening stock	xxx	By Sales	xxxx
To purchases	xxxx	Less returns	xx
Less returns	xxx		-----
	-----	By closing stock	xxx
To Direct expenses:	xxxx	By gross loss (if loss)	xxx
Carriage inward	xxx		
Freight	xxx		
Octroi	xxx		
Dock dues	xxx		
Excise duty	xxx		
Royalty	xxx		
Motive power	xx		
Coal, gas, water	xxx		
Factory expenses	xxx		
To Gross Profit (if profit)	xxx		
	xxxxx		xxxxx

Profit and Loss Format:



Profit & Loss Account (For the year ended...)				
Dr.	Particulars	Amount	Cr. Amount	
	To Gross loss b/d	Xxx	By Gross Profit b/d	Xxx
	To Salaries	Xxx	By Discount Received	Xxx
	To Office rent, rates and taxes	Xxx	By Commission Received	Xxx
	To Printing & stationery	Xxx	By Bank Interest	Xxx
	To Telephone expenses	Xxx	By Rent received	Xxx
	To Postage & telegram	Xxx	By Dividend on shares	Xxx
	To Discount Allowed	Xxx	By Interest earned on debentures	Xxx
	To Insurance	Xxx	By Profit on sale of asset	Xxx
	To Audit Fees	Xxx	By Net loss	Xxx
	To Electricity charges	Xxx		
	To Repairs & renewals	Xxx		
	To Depreciation	Xxx		
	To Advertisement	Xxx		
	To Carriage Outwards	Xxx		
	To Bad Debts	Xxx		
	To Provision for Bad debts	Xxx		
	To Selling commission	Xxx		
	To Bank Charges	Xxx		
	To Interest on loans	Xxx		
	To Loss on sale of asset	Xxx		
	To Net Profit	<u>Xxx</u>		
		<u>xxx</u>		<u>xxx</u>

Balance Sheet Format:



Balance Sheet of As at.....

Liabilities	Rs.	Assets	Rs.
Capital: Opening Balance xxxx Add: Net Profit xxxx (Less: Net Loss) Less: Drawings xxxx Long-term Liabilities: Loan Current liabilities: Income received-in-advance Sundry Creditors Outstanding Expenses Bills Payable Bank Overdraft		Fixed Assets: Good will Land Building Plant & Machinery Furniture & Fixtures Investment: Current Assets: Closing stock Accrued income Prepaid expenses Sundry Debtors Bills Receivable Cash at Bank Cash in Hand	

Difference between Manufacturing Account and Trading Account:

Basis	Manufacturing Account	Trading Account
Purpose	To find the cost of production of goods manufactured.	To find the gross profit or gross loss from buying and selling goods.
Content	Includes factory expenses (raw material consumed, wages, factory overheads, depreciation on factory machinery).	Includes sales, purchases, opening stock, closing stock, carriage inwards, direct expenses.



Stage	Prepared first (before Trading A/c).	Prepared after Manufacturing A/c (or directly, if not a manufacturing concern).
Result	Shows cost of goods manufactured.	Shows gross profit/gross loss.
Applicability	Only in manufacturing firms.	In both trading and manufacturing firms.

Difference between Trading Account and Profit and Loss Account

Basis	Trading Account	Profit & Loss Account
Purpose	To determine gross profit or gross loss.	To determine net profit or net loss.
Content	Records direct expenses and direct incomes (purchases, sales, opening/closing stock, direct wages, carriage inwards).	Records indirect expenses and indirect incomes (salaries, rent, office expenses, commission, discount received).
Nature	Deals with core buying and selling of goods.	Deals with administration, selling, distribution, and financial results.
Order	Prepared before P&L A/c.	Prepared after Trading A/c.
Output	Gross Profit/Loss.	Net Profit/Loss.



Difference Between Profit and Loss Account and Balance Sheet

Basis	Profit & Loss A/c	Balance Sheet
Purpose	To show net profit or loss for a period.	To show financial position on a specific date.
Nature	It is a nominal account (records incomes & expenses).	It is a statement (not an account) showing assets, liabilities, and capital.
Period	Prepared for a particular accounting period (e.g., April–March).	Prepared on the last date of accounting period (e.g., 31st March).
Contents	Expenses (debit side), Incomes (credit side).	Assets (left side) and Liabilities + Capital (right side).
Output	Net profit or net loss.	Financial position (what business owns vs. what it owes).

Difference between Balance Sheet and Income Statements:

Basis	Balance Sheet	Income Statement
Purpose	To show financial position of the business at a particular date.	To show performance (profitability) over a period of time.
Nature	Static (snapshot on one date).	Dynamic (covers a period, e.g., one year).
Content	Assets, Liabilities, Capital.	Revenues, Expenses, Gains, Losses.



Output	Net worth of business at a point in time.	Net profit or net loss for a period.
Example	"As on 31st March 2025."	"For the year ended 31st March 2025."

Understanding Adjustments in Final Accounts

Adjustments ensure accurate reporting by recording revenues and expenses in the correct period. Key examples include:

- **Accrued Income:** Interest or income earned but not yet recorded, added to the Profit and Loss Account.
- **Prepaid Expenses:** Advance payments for next period (e.g., rent paid ahead), subtracted from expenses and shown as assets.
- **Outstanding Expenses:** Salaries or costs due but unpaid, added to expenses and shown as liabilities.
- **Depreciation:** Systematic reduction in asset value (e.g., plant and machinery), recorded as an expense.
- **Provision for Bad Debts:** An estimate for customer debts likely to remain unpaid, reducing income accordingly.

Treatment of Adjustment Entries in Final Accounts

Adjustment Item	Treatment in P&L/Trading A/c	Treatment in Balance Sheet
Closing Stock	Credited to Trading A/c	Shown as Asset
Outstanding Expenses (e.g., salary due, rent due)	Added to respective expense in P&L A/c	Shown as Current Liability



Prepaid Expenses (e.g., insurance paid in advance)	Deducted from respective expense in P&L A/c	Shown as Current Asset
Accrued Income (earned but not received)	Added to respective income in P&L A/c	Shown as Current Asset
Income Received in Advance	Deducted from respective income in P&L A/c	Shown as Current Liability
Depreciation	Debited to P&L A/c	Deducted from concerned Asset
Provision for Bad & Doubtful Debts	Debited to P&L A/c	Deducted from Debtors
Provision for Discount on Debtors	Debited to P&L A/c	Deducted from Debtors (after BDR adjustment)
Provision for Discount on Creditors	Credited to P&L A/c	Deducted from Creditors
Interest on Capital	Debited to P&L A/c	Added to Capital in Balance Sheet
Interest on Drawings	Credited to P&L A/c	Deducted from Capital in Balance Sheet

Stepwise Preparation of Final Accounts

1. Gather and verify all financial documentation and data.
2. Prepare a trial balance to ensure that total debits equal credits.
3. Record required adjustments such as accruals, prepayments, depreciation, and provisions.

4. Create the Trading Account to find Gross Profit or Loss.
5. Prepare the Profit and Loss Account to determine Net Profit or Loss.
6. Draft the Balance Sheet to present the business's assets, liabilities, and equity.

Importance and Use of Final Accounts

Final accounts allow management, investors, and other stakeholders

- To judge business health
- Evaluate performance, and make informed decisions.
- Help ensure regulatory compliance and support good financial planning.
- By following standardized formats and recording all adjustments, businesses maintain transparency and trust.

Unit - 2

FINANCIAL STATEMENT ANALYSIS

Meaning of Financial Statement

Financial statements are the essential documents of business. They are the outputs of financial accounting. They are the final products of the accounting process. They are statements containing financial information of a business enterprise. They convey certain message to feel financial pulse of an organization. The basic purpose of preparing financial statements is to convey information about financial position of the enterprise to owners, creditors and the investors.

Objectives of Financial Statements

Financial statements serve as a horoscope of a business. This is so because they enable readers to measure financial position of a concern. The main objective of financial statements is to provide information about the financial position and performance of an enterprise that is useful to users in making decisions. The other objectives are summarized below:

- 1 To provide information about assets and liabilities of a firm.
- 2 To provide useful information to various parties interested in financial statements
- 3 To present true and fair view of the business.
4. To estimate the earning capacity of the enterprise.
- 5 To determine the debt capacity of the concern.
6. To decide about the future prospects of the business.

Thus, the ultimate Objective of financial statements is to get better insight about the financial strengths and weakness of the firm.

Nature of Financial Statement

The following characteristics of financial statements indicate their nature:

1. Recorded Facts

The term recorded facts refers to the data drawn from accounting records. Only those facts which have been recorded in the books are shown in the financial statements.

2. Accounting Principles

In the preparation of financial statements, certain accounting principles, concepts and conventions are followed. For example: The principle of cost price or market price whichever is less is followed for valuation of stock.

3. Assumptions

Business transactions are recorded on certain assumptions. For example: In preparing financial statements, the accountants make many assumptions like that the value of money remains constant, going concern concept etc.

4. Personal Judgment

The financial statements are affected by the personal judgment of accountants. For example: The method of stock valuation, method of depreciation etc. depend on the personal judgment of the accountant. The accountant can select one of the available methods of stock valuation, depreciation etc.

Essential of Financial Statements

The financial statements should possess the following essential qualities:

1. Understandability

Financial statements should be easily understandable by users. For this, the information contained in these statements should be clear and simple.

2. Relevance

The financial statements must contain only relevant information. Then only the users can evaluate past, present and future events and can take wise decisions.

3. Reliability and Accuracy

Financial statement should disclose information in such a way that the users can compare the current year's progress with that of previous year. Users must also be able to compare the financial performance of reporting company with that of other companies.

4. Comparability

Financial statements should disclose information in such a way that the users can compare the current year's progress with that of previous year. Users must also be able to compare the financial performance of reporting company with that of other companies.

5. Completeness

The information contained in the financial statements should be complete in all respects. This means all information should be shown in these statements. It further means that the information shown in the financial statements should not mislead creditors, investors and other users.

6. Timeliness

The financial statements should be prepared within a reasonable time after the accounting period is over. If the statement are not prepared and presented in time, they cannot be properly used. Beside, the firm cannot formulate plans for future.

Meaning of Analysis and Interpretation of Financial Statement

The term "analysis" can be understood as the process of splitting the facts or data found in the financial statements into simple elements. The term "interpretation" can be understood as the explanation of the meaning and significance of the

financial data, so simplified with a view to throw light on the profitability and financial position of an enterprise.

In the word of Myers, "Financial statement analysis is largely a study of relationship among the various financial factors in a business as disclosed by a single set of statements, and a study of the trend of these factors as shown in a series of statements".

Types of Financial Statement Analysis

1. on the basis of modes operating

a) **Horizontal Analysis:** Financial analysis is done for number of years, it is known as horizontal analysis. Such analysis set a trend wherein the figures of various years are compared with base year. Decision based on the trend percentage example: Trend percentage and Comparative financial statement. It is also known as dynamic analysis as it measures the change of position of the business over a number of years.

b) **Vertical Analysis:** Analysis is made for data covering one year's periods it is known vertical analysis. Example: Ratios and Common size financial statement. It is also known as static analysis as it measures the statement of affairs of the business as on given period of time.

2. On the basis of material used

a) **External Analysis:** Financial statements analysis is made by outsiders who have no access to the books of accounts they have depend on the published accounts. Example: Shareholders, Creditors, Government agencies etc.

b) **Internal Analysis:** Financial statements analysis is made by internal parties who have access to the books of accounts such as management, employees etc.

Types of Analysis and Interpretation of Financial Statements

Financial Statements can be analyzed by using the any one of the following method.

1. Comparative financial statement analysis.
2. Common-size statement analysis.
3. Trend analysis
4. Ratio analysis.
5. Fund flow analysis.
6. Cash flow analysis.

1. Comparative Financial Statements Analysis:

Under this method the financial statements of the different period of the same concern will be compared in order to derive significant change in the financial and profitability position of the concern. It denotes the changes (i.e increase or decrease) in the financial figures between two or more years, in terms of money value and as well as in term of percentages. In other words, they are those financial statements which summarizes and present relative accounting data for a number of years, incorporating therein the changes in individual items of accounting figures.

Comparative Statement Analysis can be :

- (i) Comparative Income Statement Analysis
- (ii) Comparative Balance Sheet Analysis

Objectives or Purposes of Comparative Financial Statements

1. To make the data simpler and more understandable.

2. To ascertain the changes occurring year by year in financial position and performance of the enterprise.
3. To find out the strength and weakness of liquidity, solvency and profitability..

2. Common Size Financial Statement Analysis:

In Common-size financial statements the data or figures presented in the statements are converted into percentages, taking some common base. The total of Assets or, Liabilities and capital is taken as 100% and all the items in the balance sheet are expressed as a percentage of this total. In case of the common size income statement, the Net sales figure is taken as 100% and all other items of the income statement are expressed as a percentage of Net Sales.

Common-size financial statements mainly include; Common size income statement and common size Balance sheet. In case of common size income statement, the net sales figure is taken as 100% and all other items of the income statement are expressed as a percentage of Net Sales. It enables to know relative contribution of each element of the income statement on sales and profit of the concern. It also facilitates for the effective controlling of the operations so as optimize the return on investments.

3. Trend Analysis

Sometimes, it becomes necessary to known the trend changes in the financial position of the concern When a concern needs to know the profitability trend of the organization only profit and loss account independently may not serve the purpose. In such case, it is necessary to prepare a statement of the profit or loss or Balance sheet for many years and taking any previous year as base the trend or changes in the financial position can be prepared. When the financial

statements of a number of years are analyzed, the analysis is called trend analysis. It is also called as horizontal analysis since it is prepared for many years taking any previous year as base year. In other words, horizontal analysis is a type of analysis in which there is comparison of the trend of each item in the financial statements over a number of years.

Trend analysis as a tool of Decision-making

Statement of trend analysis helps in many managerial decisions. It enables to find out the growth or decline percentage or the pattern of changes that are taking place in an organization. It enables managers to take necessary measures to curb the unhealthy trends in the organisations. It is also useful to investors, Bankers and creditors to make effective financial decisions on the company.

Its uses is outlined below:

- (i) Sales trend in the organization can reflect on the efficiency of the sales department.
- (ii) Sales trend enables management to take necessary steps wherever required to improve the overall operational efficiency.
- (iii) Trend on cost of operation facilitates to take decisions on cost control and improving profitability.
- (iv) Trend in the profitability reflects the overall efficiency of the organization in utilizing its resources and optimizing the return on investments.

RATIO ANALYSIS

MEANING OF RATIO:

A ratio is a mathematical number calculated as a reference to relationship of two or more numbers and can be expressed as a fraction, proportion, percentage and a number of times.

OBJECTIVES OF RATIO ANALYSIS:

1. To know the areas of the business which need more attention;
2. To know about the potential areas which can be improved with the effort in the desired direction;
3. To provide a deeper analysis of the profitability, liquidity, solvency and efficiency levels in the business;
4. To provide information for making cross-sectional analysis by comparing the performance with the best industry standards; and
5. To provide information derived from financial statements useful for making projections and estimates for the future.

ADVANTAGES OF RATIO ANALYSIS:

1. **Helps to understand efficacy of decisions:** The ratio analysis helps to understand whether the business firm has taken the right kind of operating, investing and financing decisions. It indicates how far they have helped in improving the performance.
2. **Simplify complex figures and establish relationships:** Ratios help in simplifying the complex accounting figures and bring out their relationships. They help summarise the financial information effectively and assess the managerial efficiency, firm's credit worthiness, earning capacity, etc.
3. **Helpful in comparative analysis:** The ratios are not be calculated for one year only. When many year figures are kept side by side, they help a great deal in

exploring the trends visible in the business. The knowledge of trend helps in making projections about the business which is a very useful feature.

4. **Identification of problem areas:** Ratios help business in identifying the problem areas as well as the bright areas of the business. Problem areas would need more attention and bright areas will need polishing to have still better results.

5. **Enables SWOT analysis:** Ratios help a great deal in explaining the changes occurring in the business. The information of change helps the management a great deal in understanding the current threats and opportunities and allows business to do its own SWOT (Strength- Weakness-Opportunity-Threat) analysis.

6. **Various comparisons:** Ratios help comparisons with certain bench marks to assess as to whether firm"s performance is better or otherwise. For this purpose, the profitability, liquidity, solvency, etc., of a business, may be compared: (i) over a number of accounting periods with itself (Intra-firm Comparison/Time Series Analysis), (ii) with other business enterprises (Inter-firm Comparison/Cross-sectional Analysis) and (iii) with standards set for that firm/industry (comparison with standard (or industry expectations)).

LIMITATIONS OF RATIO ANALYSIS:

1. **Limitations of Accounting Data:** Accounting data give an unwarranted impression of precision and finality. In fact, accounting data "reflect a combination of recorded facts, accounting conventions and personal judgements which affect them materially. For example, profit of the business is not a precise and final figure. It is merely an opinion of the accountant based on application of accounting policies. The soundness of the judgement necessarily depends on the competence and integrity of those who make them and on their adherence to

Generally Accepted Accounting Principles and Conventions". Thus, the financial statements may not reveal the true state of affairs of the enterprises and so the ratios will also not give the true picture.

2. Ignores Price-level Changes: The financial accounting is based on stable money measurement principle. It implicitly assumes that price level changes are either non-existent or minimal. But the truth is otherwise. We are normally living in inflationary economies where the power of money declines constantly. A change in the price-level makes analysis of financial statement of different accounting years meaningless because accounting records ignore changes in value of money.

3. Ignore Qualitative or Non-monetary Aspects: Accounting provides information about quantitative (or monetary) aspects of business. Hence, the ratios also reflect only the monetary aspects, ignoring completely the non-monetary (qualitative) factors.

4. Variations in Accounting Practices: There are differing accounting policies for valuation of inventory, calculation of depreciation, treatment of intangibles Assets definition of certain financial variables etc., available for various aspects of business transactions. These variations leave a big question mark on the cross-sectional analysis. As there are variations in accounting practices followed by different business enterprises, a valid comparison of their financial statements is not possible.

5. Forecasting: Forecasting of future trends based only on historical analysis is not feasible. Proper forecasting requires consideration of non-financial factors as well.

TYPES OF RATIOS

There is a two way classification of ratios: (1) traditional classification, and functional classification. The traditional classification has been on the basis of financial statements to which the determinants of ratios belong. On this basis the ratios are classified as follows:

1. „**Statement of Profit and Loss Ratios:** A ratio of two variables from the statement of profit and loss is known as statement of profit and loss ratio. For example, ratio of gross profit to revenue from operations is known as gross profit ratio. It is calculated using both figures from the statement of profit and loss.

2. **Balance Sheet Ratios:** In case both variables are from the balance sheet, it is classified as balance sheet ratios. For example, ratio of current assets to current liabilities known as current ratio. It is calculated using both figures from balance sheet.

3. **Composite Ratios:** If a ratio is computed with one variable from the statement of profit and loss and another variable from the balance sheet, it is called composite ratio. For example, ratio of credit revenue from operations to trade receivables (known as trade receivables turnover ratio) is calculated using one figure from the statement of profit and loss (credit revenue from operations) and another figure (trade receivables) from the balance sheet.

Although accounting ratios are calculated by taking data from financial statements but classification of ratios on the basis of financial statements is rarely used in practice. It must be recalled that basic purpose of accounting is to throw light on the financial performance (profitability) and financial position (its capacity

to raise money and invest them wisely) as well as changes occurring in financial position (possible explanation of changes in the activity level).

As such, the alternative classification (functional classification) based on the purpose for which a ratio is computed, is the most commonly used classification which is as follows:

1. **Liquidity Ratios:** To meet its commitments, business needs liquid funds. The ability of the business to pay the amount due to stakeholders as and when it is due is known as liquidity, and the ratios calculated to measure it are known as „Liquidity Ratios“. These are essentially short-term in nature.

2. **Solvency Ratios:** Solvency of business is determined by its ability to meet its contractual obligations towards stakeholders, particularly towards external stakeholders, and the ratios calculated to measure solvency position are known as „Solvency Ratios“. These are essentially long-term in nature.

3. **Activity (or Turnover) Ratios:** This refers to the ratios that are calculated for measuring the efficiency of operations of business based on effective utilisation of resources. Hence, these are also known as „Efficiency Ratios“.

4. **Profitability Ratios:** It refers to the analysis of profits in relation to revenue from operations or funds (or assets) employed in the business and the ratios calculated to meet this objective are known as Profitability Ratios

Fund flow statement

Meaning of fund

The term fund can be used in three different ways. They are:

- In narrow sense: It means cash or money.
- In broad sense: It means all financial resources.

In the context of funds flow statement, the term fund means working capital. It is the excess of current assets over current liabilities.

Meaning of Fund Flow Statement

Fund flow statement is a statement in a summary form depicting the changes in the items of financial position between two balance sheet dates and showing sources and application of funds.

Objectives or purposes of Fund Flow Statement

- To know the changes in working capital during the period.
- To understand the working capital position of the firm.
- To assess the financial condition of the firm.
- To anticipate the working capital position.
- To reveal the most important changes those have taken place during a particular period.
- To provide a basis for budgeting.

Importance or uses or benefits of fund flow statement

1. Useful to share holders

- a. It provides information regarding the availability of funds in the business.
- b. It indicates the earning capacity of the business.
- c. It enables to know the ability of the company to pay the dividend.

2. Useful to long term creditors and debenture holders

- a. It helps to understand whether the money borrowed is utilized or not.
- b. It enables to judge the capacity of the company to repay the loan or debentures.

3. Useful to short term creditors, banks and financial institutions

- a. It helps to know whether the money borrowed is utilized or not.
- b. It helps to know whether the company can pay interest and to repay the principal in time.

4. Useful to management

- a. Planning temporary investment of funds.
- b. Evaluating proper utilization of funds.
- c. Formulating sound dividend policy.
- d. Estimating future working capital requirement.
- e. Testing whether working capital is effectively utilized.
- f. Taking appropriate decisions regarding purchase of assets.
- g. Identifying any necessary investment in fixed assets.
- h. Understanding the reason for financial difficulties, if any.
- i. Planning for redemption of long term debts.
- j. Ascertaining funds from operation.

Limitations of fund flow statement

1. It shows what happened in the past. Hence, it is historical in nature.
2. It is only a rearrangement of data given in financial statements. Hence, it is not original.
3. It cannot reveal continuous changes.

4. It does not take into account those transactions which do not affect the working capital.
5. It is not as useful as cash flow statement.
6. It does not reveal the cash position of a firm.

Steps involved in preparation of Fund flow statements

Step -1 : Preparation of schedule of changes in working capital.

Step -2 : Prepare necessary ledger accounts to identify the hidden transactions from the non- current assets and non-current liabilities.

Step-3: Compute funds from operations from revenue expenses and incomes.

Step-4: Preparation of Fund Flow Statement.

Treatment of special items

Proposed dividend: It may be treated as non-current liability .the proposed dividend for the current year should be debited to Adjusted P&L A/c in order to find out funds from operation. The dividend paid will be shown as application in fund flow statement. Dividend proposed in last year is assumed to have been paid during the year.

Dividend paid: Sometimes proposed dividend is not given in the balance sheet. But dividend paid is given under adjustment. In such cases, it is added back to net profit while calculating fund from operation. It should also be taken the fund flow statement as an application.

Interim dividend : It is always as additional information. It should be added back to net profit while calculating fund from operation. It should also be taken as application in fund flow statement.

Provision for taxation: It is treated as non-current liability. In this case, a ledger account is prepared for this item in the work sheet, the closing balance figure (on credit side) being the provision made during the year, should be taken to the debit side of 'Adjusted P&L A/c' for calculating funds from operation. The amount of tax paid will be shown as application in the Fund Flow Statement.

Cash Flow Statement

Introduction

A cash flow statement is a statement which shows the change in cash position from one period to other. This statement helps in short term financial planning.

Definition of cash fund Cash

Cash comprises cash on hand and demand deposits with banks.

Cash equivalents

There are short term, highly liquid investments which can be readily converted into cash without a decline in their value. Examples of cash equivalents are treasury bill, commercial paper, short term deposits, marketable securities etc.

Cash flows

Cash flows are inflows and outflows of cash and cash equivalents. When there is a change in any transaction, there will be flow of cash. If the effect of transaction results in increase of cash and its equivalents, it is called an inflow. If it results in decrease of cash, it is called outflow.

Meaning of Cash Flow Statement

In the cash flow statement the term fund is used to mean cash only and does not include even most liquid current assets. A cash flow statement shows the impact of transactions on cash position of the firm and includes all transactions having a direct impact upon cash. It explain the changes in cash position between two periods

Note: According to AS 3 (revised) all manufacturing and finance companies which are listed in a stock exchange or all commercial or industrial and business enterprise whose sales are more than 50 crores per year, must prepare and publish CFS by indirect method. This is made compulsory from April 1, 2001 onwards.

Objectives of cash flow statement

1. Useful in cash planning: It is very useful to management by providing a basis to evaluate ability of a company to generate cash. A cash flow statement prepared on an estimated basis for the next accounting period enables the management to know how much cash can be generated internally and how much it should arrange from outside. Such estimated amounts are used for preparing cash budget.

2. Assess cash flow from operating activities: It provides information about cash generated from operating activities. It provides explanation for the difference net profit and cash from operations. Cash provided by operating activities is very important to assess the cash generated by internal sources.

3. Payment of dividends: Decisions to pay dividends cannot be based on net profit only. Availability of profit in the form of cash is also important for dividend disbursement.

4. Cash from investing and financing activities: It provides information not only about cash provided by operating activities but also by non-operating activities under two heads, namely investing activities and financing activities. This helps to explain the overall liquidity position of the enterprises and its ability to meet its cash commitments.

5. Explain reasons for shortage or surplus of cash: A business may have made profit and yet running short of cash. Similarly a business may have suffered a loss and still has sufficient cash at bank. A cash flow statement discloses reasons for such increase or decreases of cash balance.

Advantages or importance of Cash Flow Statement

1. Planning and co-ordination of financial operations: It is useful in evaluating financial policies and current cash position. Since cash is the basis for carrying operations, the cash flow statement will enable the management to plan and co-ordinate the financial operations probably.

2. A control device: It is also a control device for the management. A comparison of cash flow statement for previous year with the budget for the year would indicate to what extent the resources of the enterprise were according to plan.

3. Useful to internal financial management: Since it gives a clear picture of cash inflow from operations it is therefore, very useful to internal financial management in considering the possibility of retiring long term debts, in planning replacement of plant facilities or in formulating dividend policies.

4. Profit and cash position: It enables the management to account for situation when business has earned huge profits yet run without money or when it has suffered a loss and still has plenty of money at the bank.

5. Short term finance position: It helps the management in taking short term financial decisions.

Differences between Fund Flow Statement and Cash Flow Statement

Fund Flow Statement	Cash Flow Statement
Fund means working capital	Fund refers to actual cash or cash inflow
It is concerned with all items constituting funds	It deals with cash transaction only
It shows the causes for changes in working capital	It shows the causes for the change in cash
FFS is for a long term planning	CFS is a tool for short term financial planning
There are no opening or closing balances in FFS	CFS starts with the operating cash balance and ends with closing cash balance
Schedule of changes in working capital is prepared	Calculations of cash from operations is prepared

Limitations of CFS

1. As the enterprise shifts from strictly cash basis, enters into credit transactions as well takes into account prepaid and accrued items, the net income no doubt would generally represent an increase in working capital, yet equating net income to cash flow for such enterprise would be inaccurate and misleading since a number of non-cash items affect the net income of the firm.
2. The cash balance too easily influenced by postponing purchase and other payment.

UNIT 3

MARGINAL COST AND MARGINAL COSTING

Marginal cost is defined as cost of producing one additional unit. Thus, marginal cost is the amount by which total cost changes when there is a change in output by one unit.

Marginal Cost means Variable Cost. Marginal cost per unit remains unchanged irrespective of the level of activity or output. Marginal cost is the sum total of direct material cost, direct labour cost, variable direct expenses and all variable overheads.

Under Marginal Costing technique, only variable costs are charged to cost units, the fixed costs attributable to a relevant period are written off in Costing Profit & Loss Account against the contribution for that period. Under Marginal Costing Technique, fixed costs are treated as period costs.

Marginal Costing is also known as:

- **Contributory Costing**
- **Variable Costing**
- **Comparative Costing**

ABSORPTION COSTING

Under Absorption Costing Technique, both variable cost and fixed costs are charged to cost units. Under Absorption Costing Technique, fixed cost is treated as product cost. In short, the cost of a finished unit in inventory will include direct materials, direct labour, and both variable and fixed manufacturing overhead.

Absorption Costing is also known as:

- **Full Costing**

- **Full Absorption Method**

STOCK VALUATION

Value of closing stock under Absorption Costing Technique will be higher as compared to value of closing stock under Marginal Costing Technique because of fixed cost element.

DISTINCTION BETWEEN MARGINAL COSTING AND ABSORPTION COSTING

MARGINAL COSTING	ABSORPTION COSTING
Only variable cost is charged to products and inventory valuation.	Total cost (both fixed and variable) is charged to the cost of products and inventory valuation.
Fixed cost is not included in the cost of products. It is transferred to Costing Profit and Loss Account.	Fixed cost is included in the cost of products.
Stocks are valued only at variable costs. Stock values are lower in Marginal costing than in Absorption costing.	Opening and closing stocks are valued at total cost which includes both fixed and variable costs. Stock values in Absorption costing are, therefore, higher than in Marginal costing.
Profitability is judged by the contribution made by various products or departments.	Profitability is measured by profit earned by various products or departments.

Cost data helps to know the total contribution and contribution of each product.	Cost data is arrived on conventional pattern and hence is only the net profit for each product that is arrived at.
Difference in valuation of opening and closing stock does not affect the unit cost of Production	Valuation of opening and closing stock is affected due to the fixed costs.

ADVANTAGES OF MARGINAL COSTING

1.Simplified Pricing Policy

Since marginal (variable) cost per unit remains constant from period to period over a short span of time, firm's decisions on pricing policy can be taken.

2. Proper recovery of overheads

Overheads are recovered in costing on the basis of pre-determined rates. Under marginal costing technique, fixed overheads are excluded and hence there will be no problem of under or over recovery of overheads.

3. Shows Realistic Profit

Under Marginal costing technique, the stock of finished goods and work-in-progress are carried on variable cost basis and the fixed expenses are written off to profit and loss account. This shows the true profit of the period.

4. How much to produce

Marginal costing helps in the preparation of break-even analysis which shows the effect of increasing or decreasing production activity on the profitability of the company.

5. Helps in decision making

Marginal costing helps the management in taking a number of business decisions like make or buy, discontinuance of a particular product, replacement of machines etc.

LIMITATIONS OF MARGINAL COSTING

- Sales staff may make mistake of marginal cost for total cost and sell at a price which will result in loss or profits. Hence, sales staff should be cautioned while giving marginal cost.
- Overheads of fixed nature cannot be altogether excluded particularly in large contracts, while valuing the work-in-progress.
- Some of the assumptions regarding the behaviour of various costs are not necessarily true in realistic situation. For example: the assumption that fixed cost will remain static throughout is not correct.
- Marginal cost ignores time factor and investment. The marginal cost of two jobs may be the same but the time taken for their completion and the cost of machines used may differ. The true cost of a job which takes longer time and uses costlier machine would be higher. This fact is not disclosed by marginal costing.

COST-VOLUME-PROFIT ANALYSIS AND ITS OBJECTIVES

It is a technique that may be used by the management to evaluate how costs and profits are affected by changes in the volume of business activities. Managers are quite often faced with decisive situations involving sales level, sales mix, selling prices and the right combination of these factors that will produce acceptable profits. As a result of change in operating conditions or change in economic environmental factors, the value of and the relationship among these variables also change.

Cost Volume Profit analysis is the analysis of three variables i.e. cost, volume and profit. Such an analysis explores the relationship between costs, revenue, activity levels and the resulting profit. It aims at measuring variation in cost and volume.

Importance of CVP analysis

- The behaviour of cost in relation to volume.
- Volume of production or sales, where the business will break even.
- Sensitivity of profits due to variation in output.
- Amount of profit for a projected sales volume.
- Quantity of production and sales for a targeted profit level.

An understanding of CVP analysis is extremely useful to management in budgeting and profit planning. It elucidates the impact of the following on the net profit:

- Changes in selling prices
- Changes in volume of sales
- Changes in variable cost
- Changes in fixed cost

ASSUMPTIONS OF COST VOLUME PROFIT (BREAK EVEN) ANALYSIS

- All costs are easily classified into fixed costs and variable costs.
- Both revenue and cost functions are linear over the range of activity under consideration.
- Prices of output and input remains unchanged.
- Productivity of the factors of production will remain the same.
- The state of technology and the process of production will not change.
- There will be no significant change in the levels of inventory.
- The company manufactures a single product.
- In case of a multi-product company, the sales mix will remain unchanged.

PROFIT VOLUME RATIO

The Profit volume (PV Ratio) is the relationship between contribution and sales. It is also termed as contribution to sales ratio.

Significance of PV Ratio

- PV Ratio is considered to be the basic indicator of the profitability of the business.
- The higher the PV Ratio, the better it is for a business. In the case of a firm enjoying steady business conditions over a period of years, the PV Ratio will also remain stable and steady.
- If PV Ratio is improved, it will result in better profits.

Improvement of PV Ratio

- By reducing the variable cost
- By increasing the selling price
- By increasing **the share of products with higher PV Ratio in the overall sales ratio**

Uses of PV Ratio

- To compute the variable costs for any volume of sales
- To measure the efficiency or to choose a most profitable product line. The overall profitability of the firm can be improved by increasing the sales or output of a product giving a higher PV Ratio
- To determine break-even point and the level of output required to earn a desired profit
- To decide **more profitable sales-mix**

MAIN USES OF BREAK EVEN CHART

Break even chart facilitates:

- Break even point

- Margin of safety
- Angle of incidence
- Sales required to earn desired amount of profit
- Fixed Cost, Variable Cost, Total Cost, Sales, Profit at various levels of operations.
- Inter firm comparisons
- Change in sales volume
- Change in Selling price
- Change in Variable Cost
- Change in fixed cost

LIMITATIONS OF BREAK EVEN ANALYSIS

- All costs cannot be separated into variable and fixed costs with accuracy.
- Fixed costs may change because of change in management policy or after a range of activity.
- Selling price may change because of increase or decrease in output, market demand & supply, competition etc.
- In case of multiple products, the sales mix need not necessarily be constant.
- Entire production need not necessarily be sold in practise
- Time value of money is ignored.

ANGLE OF INCIDENCE

It is the angle of intersection between total sales line and total cost line drawn in the case of break even chart. It indicates the rate at which profits are earned. The larger the angle, the higher the rate of profit or vice versa.

KEY FACTOR OR LIMITING FACTOR

Key factor is a factor which limits the activities of an undertaking. The extent of its influence must first be assessed while preparing functional budgets and taking decisions about the profitability of the product. Some of the examples of key factor are:

- Shortage of Raw Material
- Shortage of Labour
- Plant Capacity available (Machines)
- Sales Capacity Available
- Cash Available

UNIT 4

Budget and Budgetary Control

Introduction:

A budget is an accounting plan. It is a formal plan of action expressed in monetary terms. It could be seen as a statement of expected income and expenses under certain anticipated operating conditions. It is a quantified plan for future activities – quantitative blue print for action.

Meaning and Definition:

Budget:

According to CIMA (Chartered Institute of Management Accountants) UK, a budget is "A plan quantified in monetary terms prepared and approved prior to a defined period of time, usually showing planned income to be generated and, expenditure to be incurred during the period and the capital to be employed to attain a given objective."

In a view of Keller & Ferrara, "a budget is a plan of action to achieve stated objectives based on predetermined series of related assumptions."

G.A.Welsh states, "A budget is a written plan covering projected activities of a firm for a definite time period."

Characteristics of budget are...

- It is mainly a forecasting and controlling device.
- It is prepared in advance before the actual operation of the company or project.
- It is in connection with definite future period.
- Before implementation, it is to be approved by the management.

- It also shows capital to be employed during the period.

Budgetary Control:

Budgetary Control is a method of managing costs through preparation of budgets. Budgeting is thus only a part of the budgetary control. According to CIMA, "Budgetary control is the establishment of budgets relating to the responsibilities of executives of a policy and the continuous comparison of the actual with the budgeted results, either to secure by individual action, the objective of the policy or to provide a basis for its revision."

The main features of budgetary control are:

1. Establishment of budgets for each purpose of the business.
2. Revision of budget in view of changes in conditions.
3. Comparison of actual performances with the budget on a continuous basis.
4. Taking suitable remedial action, wherever necessary.
5. Analysis of variations of actual performance from that of the budgeted performance to know the reasons thereof.

Objectives of Budgetary Control:

Budgeting is a forward planning. It serves basically as a tool for management control; it is rather a pivot of any effective scheme of control.

The objectives of budgeting may be summarized as follows:

1. **Planning:** Planning has been defined as the design of a desired future position for an entity and it rests on the belief that the future position can be attained by uninterrupted management action. Detailed plans relating to production, sales, raw-material requirements, labour needs, capital additions, etc. are drawn out. By

planning many problems estimated long before they arise and solution can be thought of through careful study. In short, budgeting forces the management to think ahead, to foresee and prepare for the anticipated conditions. Planning is a constant process since it requires constant revision with changing conditions.

2. **Co-ordination:** Budgeting plays a significant role in establishing and maintaining coordination. Budgeting assists managers in coordinating their efforts so that problems of the business are solved in harmony with the objectives of its divisions. Efficient planning and business contribute a lot in achieving the targets. Lack of co-ordination in an organization is observed when a department head is permitted to enlarge the department on the specific needs of that department only, although such development may negatively affect other departments and alter their performances. Thus, co- ordination is required at all vertical as well as horizontal levels.

3. **Measurement of Success:** Budgets present a useful means of informing managers how well they are performing in meeting targets they have previously helped to set. In many companies, there is a practice of rewarding employees on the basis of their accomplished low budget targets or promotion of a manager is linked to his budget success record. Success is determined by comparing the past performance with previous period's performance.

4. **Motivation:** Budget is always considered a useful tool for encouraging managers to complete things in line with the business objectives. If individuals have intensely participated in the preparation of budgets, it acts as a strong motivating force to achieve the goals.

5. **Communication:** A budget serves as a means of communicating information within a firm. The standard budget copies are distributed to all management people provide not only sufficient understanding and knowledge of the

programmes and guidelines to be followed but also give knowledge about the restrictions to be adhered to.

6. **Control:** Control is essential to make sure that plans and objectives laid down in the budget are being achieved. Control, when applied to budgeting, as a systematized effort is to keep the management informed of whether planned performance is being achieved or not.

Advantages of Budgetary control:

In the light of above discussion one can see that, coordination and control help the planning. These are the advantages of budgetary control. But this tool offer many other advantages as follows:

1. This system provides basic policies for initiatives.
2. It enables the management to perform business in the most professional manner because budgets are prepared to get the optimum use of resources and the objectives framed.
3. It ensures team work and thus encourages the spirit of support and mutual understanding among the staff.
4. It increases production efficiency, eliminates waste and controls the costs.
5. It shows to the management where action is needed to remedy a position.
6. Budgeting also aids in obtaining bank credit.
7. It reviews the present situation and pinpoints the changes which are necessary.
8. With its help, tasks such as like planning, coordination and control happen effectively and efficiently.
9. It involves an advance planning which is looked upon with support by many credit agencies as a marker of sound management.

Limitations of Budgetary control:

1. It tends to bring about rigidity in operation, which is harmful. As budget estimates are quantitative expression of all relevant data, there is a tendency to attach some sort of rigidity or finality to them.
2. It being expensive is beyond the capacity of small undertakings. The mechanism of budgeting system is a detailed process involving too much time and costs.
3. Budgeting cannot take the position of management but it is only an instrument of management. „The budget should be considered not as a master, but as a servant.“ It is totally misconception to think that the introduction of budgeting alone is enough to ensure success and to security of future profits.
4. It sometimes leads to produce conflicts among the managers as each of them tries to take credit to achieve the budget targets.
5. Simple preparation of budget will not ensure its proper implementation. If it is not implemented properly, it may lower morale.
6. The installation and function of a budgetary control system is a costly affair as it requires employing the specialized staff and involves other expenditure which small companies may find difficult to incur.

Essentials of Effective Budgeting:

1) Support of top management: If the budget structure is to be made successful, the consideration by every member of the management not only is fully supported but also the impulsion and direction should also come from the top management. No control system can be effective unless the organization is convinced that the management considers the system to be important.

2) Team Work: This is an essential requirement, if the budgets are ready from “the bottom up” in a grass root manner. The top management must understand

and give enthusiastic support to the system. In fact, it requires education and participation at all levels. The benefits of budgeting need to be sold to all.

3) Realistic Objectives: The budget figures should be realistic and represent logically attainable goals. The responsible executives should agree that the budget goals are reasonable and attainable.

4) Excellent Reporting System: Reports comparing budget and actual results should be promptly prepared and special attention focused on significant exceptions i.e. figures that are significantly different from expected. An effective budgeting system also requires the presence of a proper feed-back system.

5) Structure of Budget team: This team receives the forecasts and targets of each department as well as periodic reports and confirms the final acceptable targets in form of Master Budget. The team also approves the departmental budgets.

6) Well defined Business Policies: All budgets reveal that the business policies formulated by the higher level management. In other words, budgets should always be after taking into account the policies set for particular department or function. But for this purpose, policies should be precise and clearly defined as well as free from any ambiguity.

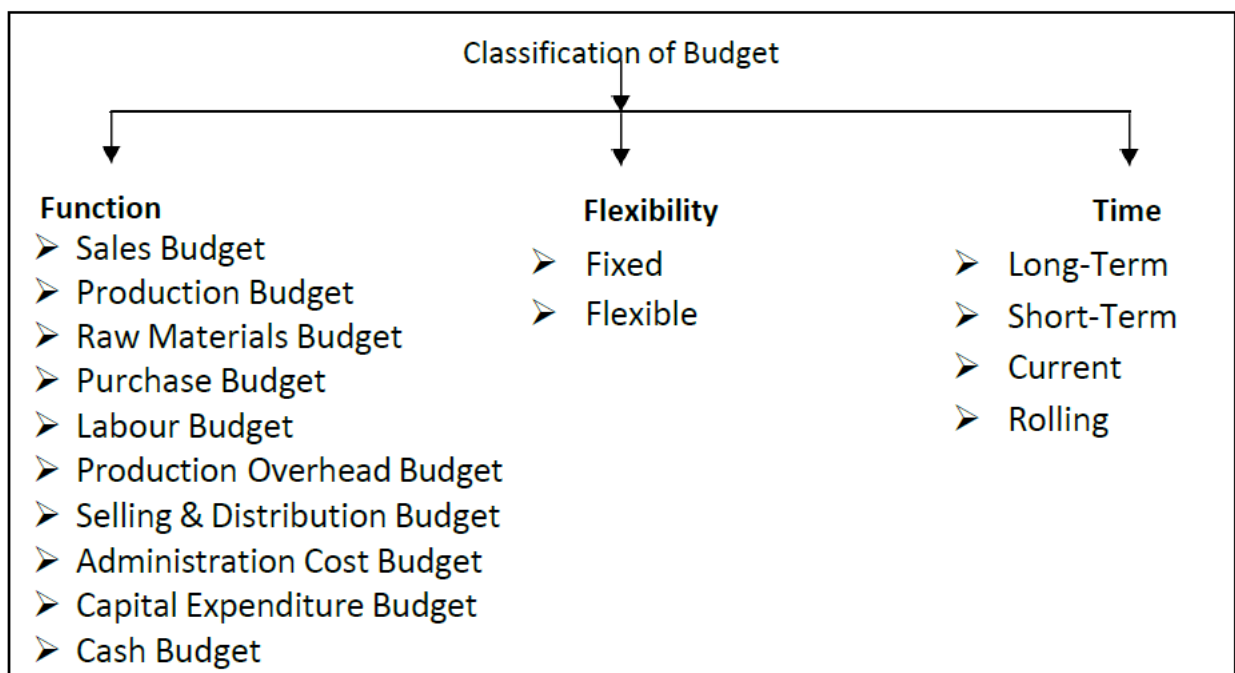
7) Integration with Standard Costing System: Where standard costing system is also used, it should be completely integrated with the budget programme, in respect of both budget preparation and variance analysis.

8) Inspirational Approach: All the employees or staff other than executives should be strongly and properly inspired towards budgeting system. Human beings by nature do not like any pressure and they dislike or even rebel against anything forced upon them.



Classification of Budget:

The extent of budgeting activity varies from firm to firm. In a smaller firm there may be a sales forecast, a production budget, or a cash budget. Larger firms generally prepare a master budget. Budgets can be classified into different ways from different points of view. The following are the important basis for classification:



Functional Classification:

SALES BUDGET:

The sales budget is an estimate of total sales which may be articulated in financial or quantitative terms. It is normally forms the fundamental basis on which all other budgets are constructed. In practice, quantitative budget is prepared first then it is translated into economic terms. While preparing the Sales Budget, the Quantitative Budget is generally the starting point in the operation of budgetary control because sales become, more often than not, the principal budget factor.

The factor to be consider in forecasting sales are as follows:



- Study of past sales to determine trends in the market.
- Estimates made by salesman various markets of company products.
- Changes of business policy and method.
- Government policy, controls, rules and Guidelines etc.
- Potential market and availability of material and supply.

PRODUCTION BUDGET:

The production budget is prepared on the basis of estimated production for budget period. Usually, the production budget is based on the sales budget. At the time of preparing the budget, the production manager will consider the physical facilities like plant, power, factory space, materials and labour, available for the period. Production budget envisages the production program for achieving the sales target. The budget may be expressed in terms of quantities or money or both. Production may be computed as follows: Units to be produced = Desired closing stock of finished goods + Budgeted sales – Beginning stock of finished goods.

PRODUCTION COST BUDGET:

This budget shows the estimated cost of production. The production budget demonstrates the capacity of production. These capacities of production are expressed in terms of cost in production cost budget. The cost of production is shown in detail in respect of material cost, labour cost and factory overhead. Thus production cost budget is based upon Production Budget, Material Cost Budget, Labour Cost Budget and Factory overhead.

RAW-MATERIAL BUDGET:

Direct Materials budget is prepared with an intention to determine standard material cost per unit and consequently it involves quantities to be used and the rate per unit. This budget shows the estimated quantity of all the raw materials and components needed for production demanded by the production budget.

Raw material serves the following purposes:

- It supports the purchasing department in scheduling the purchases.
- Requirement of raw-materials is decided on the basis of production budget.
- It provides data for raw material control.
- Helps in deciding terms and conditions of purchase like credit purchase, cash purchase, payment period etc.

It should be noted that raw material budget generally deals with only the direct materials whereas indirect materials and supplies are included in the overhead cost budget.

PURCHASE BUDGET:

Strategic planning of purchases offers one of the most important areas of reduction cost in many concerns. This will consist of direct and indirect material and services. The purchasing budget may be expressed in terms of quantity or money.

The main purposes of this budget are:

1. It designates cash requirement in respect of purchase to be made during budget period; and
2. It is facilitates the purchasing department to plan its operations in time in respect of purchases so that long term forward contract may be organized.

LABOUR BUDGET:

Human resources are highly expensive item in the operation of an enterprise. Hence, like other factors of production, the management should find out in advance personnel requirements for various jobs in the enterprise. This budget may be classified into labour requirement budget and labour recruitment budget. The labour necessities in the various job categories such as unskilled, semi-skilled and supervisory are determined with the help of all the head of the departments. The labour employment is made keeping in view the requirement of the job and its qualifications, the degree of skill and experience required and the rate of pay.

PRODUCTION OVERHEAD BUDGET:

The manufacturing overhead budget includes direct material, direct labour and indirect expenses. The production overhead budget represents the estimate of all the production overhead i.e. fixed, variable, semi-variable to be incurred during the budget period. The reality that overheads include many different types of expenses creates considerable problems in:

- 1) Fixed overheads i.e., that which is to remain stable irrespective of vary in the volume of output,
- 2) Apportionment of manufacturing overheads to products manufactured, semi variable cost i.e., those which are partly variable and partly fixed.
- 3) Control of production overheads.
- 4) Variable overheads i.e., that which is likely to vary with the output.

The production overhead budget engages the preparation of overheads budget for each division of the factory as it is desirable to have estimates of manufacturing overheads prepared by those overheads to have the responsibility for incurring them. Service departments cost are projected and allocated to the

production departments in the proportion of the services received by each department.

SELLING AND DISTRIBUTION COST BUDGET:

The Selling and Distribution Cost budget is estimating of the cost of selling, advertising, delivery of goods to customers etc. throughout the budget period. This budget is closely associated to sales budget in the logic that sales forecasts significantly influence the forecasts of these expenses. Nevertheless, all other linked information should also be taken into consideration in the preparation of selling and distribution budget. The sales manager is responsible for selling and distribution cost budget. Naturally, he prepares this budget with the help of managers of sub-divisions of the sales department. The preparation of this budget would be based on the analysis of the market condition by the management, advertising policies, research programs and many other factors. Some companies prepare a separate advertising budget, particularly when spending on advertisements are quite high.

ADMINISTRATION COST BUDGET:

This budget includes the administrative costs for non-manufacturing business activities like director's fees, managing directors' salaries, office lightings, heating and air condition etc. Most of these expenses are fixed so they should not be too difficult to forecast. There are semi-variable expenses which get affected by the expected rise or fall in cost which should be taken into account. Generally, this budget is prepared in the form of fixed budget.

CAPITAL- EXPENDITURE BUDGET:

This budget stands for the expenditure on all fixed assets for the duration of the budget period. This budget is normally prepared for a longer period than the other functional budgets. It includes such items as new buildings, land, machinery and intangible items like patents, etc. This budget is designed under the observation of the accountant which is supported by the plant engineer and other functional managers. At the time of preparation of the budget some important information should be observed:

- Overfilling on the production facilities of certain departments as revealed by the plant utilization budget.
- Long-term business policy with regard to technical developments.
- Potential demand for certain products.

CASH BUDGET:

The cash budget is a sketch of the business estimated cash inflows and outflows over a specific period of time. Cash budget is one of the most important and one of the last to be prepared. It is a detailed projection of cash receipts from all sources and cash payments for all purposes and the resultant cash balance during the budget. It is a mechanism for controlling and coordinating the fiscal side of business to ensure solvency and provides the basis for forecasting and financing required to cover up any deficiency in cash. Cash budget thus plays a vital role in the financing management of a business undertaken.

Cash budget assists the management in determining the future liquidity requirements of the firm, forecasting for business of those needs, exercising control over cash. So, cash budget thus plays a vital role in the financial management of a business enterprise.

Function of Cash Budget:

- It makes sure that enough cash is available when it is required.
- It designates cash excesses and shortages so that steps may be taken in time to invest any excess cash or to borrow funds to meet any shortages.
- It shows whether capital expenditure could be financed internally.
- It provides funds for standard growth.
- It provides a sound basis to manage cash position.

Advantages of Cash Budget:

1. Usage of Cash: Management can plan out the use of cash in accord with the changes of receipt and payment. Payments can be planned when sufficient cash is available and continue the business activity with the minimum amount of working capital.

2. Allocation for Capital Investment: It is dual benefits such as capital expenditure projects can be financed internally and can get an idea for cash availability of capital investment.

3. Provision of Excess Funds: It reveals the availability of excess cash. In this regard management can decide to invest excess funds for short term or long term according to the requirements in the business.

4. Pay-out Policy: This budgetary system may help the management for future pay-out policy in the form of dividend. In case the cash budget liquid position is not favourable, the management may reduce the rate of dividend or maintain dividend amount or skip dividend for the year.

5. Provision for acquiring Funds: It gives the top level management ideas for acquiring funds for particular time duration and sources to be explored.

6. Profitable Use of Cash: Business person can take decision for the best use of liquidity to make more profitable transaction. It can be used at the time of bulk purchase payments and one get the benefit of discount.

Limitation of Cash Budget:

1. Complex Assumption: Business is full of uncertainties, so it is very difficult to have near perfect estimates of cash receipts and payments, especially for a longer duration. It can be predicted for short duration such as of three to four months.

2. Inflexibility: If the finance manager fails to show flexibility in implementing the cash budget, it will incur adverse effects. If the manager follows strictly adheres to the estimates of cash inflow it may negatively result in losing customers. Likewise, loyalty in payments may lead to deterioration of liquid position.

3. Costly: Application of this technique necessitates collecting of statistical information from various sources and expert personnel in operation research would be the costliest deal. It becomes expensive which may not be affordable to small business houses. In addition, finding out experts is not always possible. In this situation the long term predictions do not prove correct.

Methods:

1. Receipt and payment: It is most popular and is universally used for preparing cash budget. The assumption of statistical data is arrived at calculated on the basis of requirements like monthly, weekly or fortnightly. On account of elasticity, this method is used in forecasting cash at different time periods and thus it helps in controlling cash distributions.

(a) Cash receipts from customers are based on sales forecast. The term of sale, lag in payment etc., are generally taken into consideration.

(b) Cash receipts from other sources, such as dividends and interest on trade investment, rent received, issue of capital, sale of investment and fixed assets.

(c) Cash requirements for purchase of materials, labour and salary cost and overhead expenses based on purchasing, personnel and overhead budgets.

(d) Cash requirements for capital expenditure as per the capital expenditure budget.

(e) Cash requirements for other purposes such as payment of dividends, income-tax liability, fines and penalties.

(i) Estimating Cash Receipts: Generally main sources of cash receipts are sales, interest and dividend, sales of assets and investments, capital borrowings etc. The Company estimates time-lag on the basis of past experience of cash receipts on credit sales while cash sales can be easily determined.

(ii) Estimating Cash Payments: It can be decided on the basis of various operating budgets prepared for the payment of credit purchase, payment of labour cost, interest and dividend, overhead charges, capital investment etc.

2. Adjusted Profit and Loss Account: This method is based on cash and non-cash transactions. This method estimates closing cash balance by converting profit into cash. The hypothesis of this method is that the earning of profit brings equal amount of cash into the business. The net profit shown by profit and loss account does not signify the actual cash flow into the business. This also leads to another assumption, that is the business will remain static, i.e. there will be no wearing out or increase of assets and changes of working capital so that the total cash on hand for the business would be equal to the profit earned.

3. Budgeted Balance Sheet Method: This method looks like the Adjusted Profit and Loss Account method only, except that in this method a Balance Sheet is projected and in that method Profit and Loss Account is adjusted. In this method



Balance Sheet is prepared with the projected amount of all assets and liabilities except cash at the end of budget period. The cash balance will find out balancing amount. If assets side is higher than liability side it would be the bank overdraft while liability side is higher than assets side it gives bank balance. This method is used by the stable business houses.

Working Capital Differential Method: It is based on the estimate of working capital. It begins with the opening working capital and is added to or deducted from any changes made in the current assets except cash and current liabilities. At the end of the budget period balance shows the real cash balance. This method is quite similar to the Balance Sheet method.

Model of Cash Budget

Particular	January	February	March
Opening Balance	-	-	-
Add: Receipts:			
Cash Sales	-	-	-
Receipts from Debtors	-	-	-
Interest and Dividend	-	-	-
Sale of fixed assets	-	-	-
Sale of Investments	-	-	-
Bank Loan	-	-	-
Issue Shares & Debenture	-	-	-
Others	-	-	-
Total Receipts (A)	-	-	-
Less: Payments			
Cash Purchases	-	-	-
Payment to creditors	-	-	-
Salaries & wages	-	-	-
Administrative expenses	-	-	-
Selling expenses	-	-	-
Dividend payable	-	-	-
Purchase of Fixed Assets	-	-	-
Repayment of Loan	-	-	-
Payment of taxes	-	-	-
Total Payments (B)	-	-	-
Closing Balance (A - B)	-	-	-

FIXED AND FLEXIBLE BUDGET:

1. FIXED BUDGET:

A fixed budget is prepared for one level of output and one set of condition. This is a budget in which targets are tightly fixed. It is known as a static budget. It is firm and prepared with the assumption that there will be no change in the budgeted level of motion. Thus, it does not provide room for any modification in expenditure due to the change in the projected conditions and activity. Fixed budgets are prepared well in advance.

This budget is not useful because:

1. The conditions go on the changing and cannot be expected to be firm.
2. The management will not be in a position to assess, the performance of different heads on the basis of budgets prepared by them because to the budgeted level of activity.
3. It is hardly of any use as a mechanism of budgetary control because it does not make any difference between fixed, semi-variable and variable costs
4. It does not provide any space for alteration in the budgeted figures as a result of change in cost due to change in the level of activity.

2. FLEXIBLE BUDGET:

This is a dynamic budget. In comparison with a fixed budget, a flexible budget is one "which is designed to change in relation to the level of activity attained." An equally accurate use of the flexible budgets is for the purposes of control.

Flexible budgeting has been developed with the objective of changing the budget figures so that they may correspond with the actual output achieved. It is more sensible and practical, because changes expected at different levels of activity are

given due consideration. Thus a budget might be prepared for various levels of activity in accord with capacity utilization.

Flexible budget may prove more useful in the following conditions:

1. Where the level of activity varies from period to period.
2. Where the business is new and as such it is difficult to forecast the demand.
3. Where the organization is suffering from the shortage of any factor of production. For example, material, labour, etc. as the level of activity depends upon the availability of such a factor.
4. Where the nature of business is such that sales go on changing.
5. Where the changes in fashion or trend affects the production and sales.
6. Where the organization introduces the new products or changes the patterns and designs of its products frequently.
7. Where a large part of output is intended for the export.

Uses of Flexible Budget:

In flexible budgets numbers are adjustable to any given set of operating conditions. It is, therefore, more sensible than a fixed budget which is true only in one set of operating environment. Flexible budgets are also useful from the view point of control. Actual performance of an executive should be compared with what he should have achieved in the actual circumstances and not with what he should have achieved under quite different circumstances. At last, flexible budgets are more realistic, practical and useful. Fixed budgets, on the other hand, have a limited application and are suited only for items like fixed costs.

Preparation of a Flexible Budget

The preparation of a flexible budget requires the analysis of total costs into fixed and variable components. This analysis of course is, not unusual to the flexible 12

budgeting, is more important in flexible budgeting than in fixed budgeting. This is so because in flexible budgeting, varying levels of output are considered and each class of overhead will be different for each level. Thus the flexible budget has the following main distinguishing features:

- It is prepared for a range of activity instead of a single level.
- It provides a dynamic basis for comparison because it is automatically related to changes in volume.

The formulation of a flexible budget begins with analyzing the overhead into fixed and variable cost and determining the extent to which the variable cost will vary within the normal range of activity.



Model of Flexible Budget

Particulars	Capacity Utilization		
	60%	80%	100%
1. Prime Cost:			
- Direct Material	-	-	-
- Direct Labour	-	-	-
- Direct expenses (if any)	-	-	-
Total (A)	-	-	-
2. Variable overheads:			
- Maintenance & repairs	-	-	-
- Indirect Labour	-	-	-
- Indirect Material	-	-	-
- Factory overheads	-	-	-
- Administrative Overheads	-	-	-
- Selling & distribution O/H	-	-	-
Total (B)	-	-	-
3. Marginal Cost (A + B)	-	-	-
4. Sales	-	-	-
5. Contribution (Sales - MC)	-	-	-
6. Fixed cost			
- Factory overheads	-	-	-
- Administrative Overheads	-	-	-
- Selling & distribution O/H	-	-	-
Total (C)	-	-	-
7. Profit or Loss (C- FC)	-	-	-

Zero Base Budgeting (ZBB):

The term "Zero-Base" refers to a „nil-budget" as the starting point. It starts with a presumption that the budget for the next period is „zero" until the demand for a function, process, or project is not justified for single penny. The assumption is that without such justification, expenditure will be allowed. In effect, each manager or functional head is required to carry out cost-benefit analysis of each of the activities, etc. under his control and for which he is responsible. The method of ZBB suggests that the business should not only make decision about the proposed new programmes but it should also, regularly, review the suitability of

the existing programmes. This approach of preparing a budget is called incremental budgeting since the budget process is concerned mainly with the increases or changes in operations that are likely to occur during the budget period.

This method for the first time was used by the Department of Agriculture, U.S.A. in the 19th century. Other State Governments of the U.S.A. found this method helpful and so almost all the states took deep interest in the ZBB method. A number of states of America use this technique even today. The ICAI has brought out a research in the form of a monograph showing the application of the ZBB method that worries in tandem with the concerns for national environment and its requirements. In India, however, the ZBB approach has not been fully accepted and actualized.

"ZBB is a management tool, which provides a systematic method for evaluating all operations and programmes, current or new, allows for budget reductions and expansions in a rational manner and allows re-allocation of sources from low to high priority programmes." - David Lieninger

ZBB is a planning, resource allocation and control tool. It, however, presupposes that

- (a) There is an efficient budgeting system within the enterprise.
- (b) Managers can develop quantitative measures for use in performance evaluation.
- (c) Among the new suggestions and programmes, along with old ones are put to a strict scrutiny.
- (d) Funds are diverted from low-priority suggestions to high priority suggestions.

Procedure of Zero-base Budgeting:

(1) Determination of the objective: This is an initial step for determining the objective to introduce ZBB. It may result into the decreased cost in personnel overheads or debunk the projects which do not fit in the business structure or which are not likely to help accomplish the business objectives.

(2) Degree at the ZBB is to be introduced: It is not possible every time to evaluate every activity of the whole business. After studying the business structure, the management can decide whether ZBB is to be introduced in all areas of business activities or only in a few selected areas on the trial basis.

(3) Growth of Decision units: Decision units submit their data as to which cost benefit analysis should be done in order to arrive at a decision that helps them decide to continue or abandon. It could be a functional department, a programme, a product-line or a sub-line. Here the decision unit exist independent of all the other units so that when the cost analysis turns unfavourable that particular unit could be closed down.

(4) Growth of Decision packages: Decision units are to be identified for preparing data relating to the proposals to be included in the budget, concerned manager analyzes the activities of his or her own decision units. His job is to consider possible different ways to fulfill objectives. The size of the business unit and the volume of goods it deals with determine the number of decision units and packages. The decision package has to contain all the information which helps the management in deciding whether the information is necessary for the business, what would be the estimated costs and benefits expected from it.

(5) Assessment and Grading of decision packages: These packages invented and formulated are submitted to the next level of responsibility within the organization for ranking purposes. Ranking basically decides as to whether or not

to include the proposals in the budget. The management ranks the different decision packages in the order from decreasing benefit or importance to the organization. Preliminary ranking is done by the unit manager himself and for the further review it is sent to the superior officers who consider overall objectives of the organization.

(6) Allotment of money through Budgets: It is the last step engaged in the ZBB process. According to the cost benefit analysis and availability of the funds management has ranks and thereby a cut-off point is established. Keeping in view reasonable standards, the approved designed packages are accepted and others are rejected. The funds are then allotted to different decision units and budgets relating to each unit are prepared.

Advantages:

1. ZBB rejects the attitude of accepting the current position in support of an attitude of inquiring and testing each item of budget.
2. It helps improve financial planning and management information system through various techniques.
3. It is an educational process and can promote a management team of talented and skillful people who tend to promptly respond to changes in the business environment.
4. It facilitates recognition of inefficient and unnecessary activities and avoid wasteful expenditure.
5. Cost behavior patterns are more closely examined.
6. Management has better elasticity in reallocating funds for optimum utilization of the funds.



Disadvantages:

1. It is an expensive method as ZBB incurs a huge cost every in its preparation.
2. It also requires high volume of paper work; hence sometimes it becomes a tedious job.
3. In ZBB there is a danger of emphasizing short-term benefits at the expenses of long term ones.
4. This is not a new method for evaluating various alternatives, and cost-benefit analysis.
5. The psychological effects can also not be ignored. It holds out high hopes as a modern technique, claiming to raise the profitability and efficiency of the business

UNIT-5

COST ACCOUNTING

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Prepared by

Dr.D.Charumathi

MEASI Institute of Management

Meaning:

Cost Accounting: Cost accounting is the classifying, recording and appropriate allocation of expenditure for the determination of the costs of products or services.

Cost Accounting is a business practice in which we record, examine, summarize, and study the company's cost spent on any process, service, product or anything else in the organization. This helps the organization in cost controlling and making strategic planning and decision on improving cost efficiency. It includes the ascertainment of the cost of every order, job, contract, process, service or unit as may be appropriate. It deals with the cost of production, selling and distribution.

Definition of cost accounting:

Cost Accounting may be regarded as "a specialized branch of accounting which involves classification, accumulation, assignment and control of costs."

The costing terminology of **C.I.M.A**, London defines cost accounting as "the process of accounting for costs from the point at which expenditure is incurred or committed to the establishment of its ultimate relationship with cost centers and cost units. In its widest usage, it embraces the preparation of statistical data, the application of cost control methods and the ascertainment of profitability of activities carried out or planned".

Wheldon defines cost accounting as "classifying, recording and appropriate allocation of expenditure for determination of costs of products or services and for the presentation of suitably arranged data purposes of control and guidance of management". It is thus a formal mechanism by means of which costs of products or services are ascertained and controlled.

Objectives of Cost Accounting:

Cost accounting aims at systematic recording of expenses and analysis of the same so as to ascertain the cost of each product manufactured or service rendered by an organization. Information regarding cost of each product or service would enable the management to know where to economize on costs, how to fix prices, how to maximize profits and so on. Thus, the main objectives of cost accounting are the following.

1. To analyse and classify all expenditure with reference to the cost of products and operations.
2. To arrive at the cost of production of every unit, job, operation, process, department or service and to develop cost standard.
3. To indicate to the management any inefficiencies and the extent of various forms of waste, whether of materials, time, expenses or in the use of machinery, equipment and tools. Analysis of the causes of unsatisfactory results may indicate remedial measures.
4. To provide data for periodical profit and loss accounts and balance sheets at such intervals, e.g. weekly, monthly or quarterly as may be desired by the management during the financial year, not only for the whole business but also by departments or individual products. Also, to explain in detail the exact reasons for profit or loss revealed in total in the profit and loss accounts.
5. To reveal sources of economies in production having regard to methods, types of equipment, design, output and layout. Daily, Weekly, Monthly or Quarterly information may be necessary to ensure prompt constructive action.
6. To provide actual figures of costs for comparison with estimates and to serve as a guide for future estimates or quotations and to assist the management in their price fixing policy.

7. To show, where Standard Costs are prepared, what the cost of production ought to be and with which the actual costs which are eventually recorded may be compared.
8. To present comparative cost data for different periods and various volume of output and to provide guidance in the development of business. This is also helpful in budgetary control.
9. To record the relative production results of each unit of plant and machinery in use as a basis for examining its efficiency. A comparison with the performance of other types of machines may suggest the necessity for replacement.
10. To provide a perpetual inventory of stores and other materials so that interim Profit and Loss Account and Balance Sheet can be prepared without stock taking and checks on stores and adjustments are made at frequent intervals. Also to provide the basis for production planning and for avoiding unnecessary wastages or losses of materials and stores.

Scope of Cost accounting:

Cost accounting refers to the process of determining the cost of a particular product or activity. It provides useful data both for internal and external reports reporting.

1. **Cost Determination:** This is the first step in the cost accounting system. It refers to determining the cost for a specific product or activity. This is a critical activity since the other three activities, explained below, depend on it.
2. **Cost Recording:** Its is concerned with recording of costs in the cost journal and their subsequent posting to the ledger. Cost recording may be done according to

integral or non-integral system a separate set of books is maintained for costing and financial transactions.

3. **Cost Analyzing:** It is concerned with critical evaluation of cost information to assist the management in planning and controlling the business activities. Meaningful cost analysis depends largely upon the clear understanding of the cost finding methods used in cost accounting.

The link between Financial Accounting, Cost Accounting and Management Accounting

- Cost accounting is about determining the cost of providing a service or physical product. Once you know **your** cost, you can decide where you want to price your product/service. (Or perhaps whether you want to provide it at all given the market price.)
- Financial accounting tends to be concerned with reporting to external stakeholders (banks, shareholders, major suppliers etc.). As a result, financial accounts are prepared in keeping with regulated standards which are often very detail oriented.
- Management accounting is about providing information to managers that assists them to make the best decisions about managing the business. Part of this is minimising the delay between the activity and the reporting. Accuracy is often traded for timeliness, and the analysis and commentary on the numbers are paramount. The management accountant performs a type of “translation” service between the numbers and the operations focused managers.

Cost Audit

Meaning and Definitions:

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Prepared by
Dr.D.Charumathi

MEASI Institute of Management

Cost Audit is a critical review undertaken to verify the correctness of Cost Accounts and to check that cost accounting principles and planning have been efficiently followed. It is noteworthy that India is the only country which has introduced statutory cost audit to regulate about 45 vital industries of the country.

Cost Audit has been defined by the Chartered Institute of Management Accountants (CIMA) of Landon as “the verification of cost accounts and a check on the adherence to the cost accounting plan.”

CWAI defines Statutory Cost Audit as a **“system of audit introduced by the Government of India for the review, examination and appraisal of the cost accounting records and added information required to be maintained by the specified industries”**.

Objectives of Cost Audit

1. General objectives,
2. Social objectives.

General objectives of Cost Audit:

The general objectives of cost audit can be enlisted as follows:

1. Detection of errors and frauds.
2. Verification of the adequacy of the books of accounts and the accounting system.
3. Correct valuation of work-in-progress.
4. Verification of the total cost of each product, process, operation, and job.
5. Verification of inter-company transactions and the reasonableness of the price charged for inter-company transfers.

6. Providing assistance to the management by bringing out the deficiencies to its notice and thereby avoid inefficient use of resources like capital, labour, raw material, etc

Social Objectives of Cost Audit:

The cost audit has certain well-defined social objectives, which are as follows:

1. Protection of the interest of the investors and other shareholders.
2. Efficient utilization of resources.
3. Ensuring quality of the functioning of the corporate management.
4. Overall improvement in the socioeconomic structure.

Advantages of Cost Accounting:

1. Elimination of Wastes, Losses and Inefficiencies

A good cost accounting system eliminates wastes, losses and inefficiencies by fixing standard for everything.

2. Cost Reduction

New and improved methods of production are followed under cost accounting system. It leads to cost reduction.

3. Identify the reasons for Profit or Loss

A good cost accounting system highlights the reasons for increasing or decreasing profit. If so, the management can take remedial action to maintain profitability of the concern. There is no possibility of shutting down of any product or process or department.

4. Advises on Make or Buy Decision

On the basis of cost information, the management can decide whether make or buy a product in open market. The management can rightly choose the best out of many alternatives. Sometimes, spare capacity can be used profitably.

5. Price Fixation

The total cost of a product is available in the costing records. It is highly useful for price fixation of a product.

6. Cost Control

Budgets are prepared and standards are fixed under cost accounting system. The expenses are not permitted beyond the budget amount. The actual performance is compared with standard to find the variation. If there is any variation, reasons are found out and the management can exercise control. Period to period cost comparison also helps cost control.

7. Assist the Government

Government can collect reasonable tax from the company and exercise price control.

8. Fixation of Responsibility

Responsibility centers are fixed under cost accounting system. If responsibility is fixed, it becomes difficult to evade responsibility of performance and leads to effective performance.

9. Helps to Prepare Financial Accounts

The information like value of closing materials, work in progress and finished goods are necessary to prepare financial accounts. This information is supplied by the costing records and helps to prepare financial accounts without any further delay.

10. Prevention of Frauds

Introducing cost audit can prevent frauds. If so, correct and reliable data was available from the costing records which are highly useful to the government, share-holders, the creditors and the like.

1. The cost of previous year is not same in the succeeding year. Hence, cost data are not highly useful.
2. The cost is ascertained on the basis of full utilization of capacity. If capacity is partly utilized, the cost may not be true.
3. Installation of Cost Accounting System requires the maintenance of many costing records. If results in heavy expenditure.
4. Delay in receiving costing information does not result in taking quality decision by the management.
5. Rigid Cost Accounting System does not serve all purposes.
6. Cost Accounting fails to solve the problems relating to work study, time and motion study and operation research.
7. Financial character expenses are not included for cost calculation. Hence, the calculated cost is not correct always.

COST CONCEPTS AND CLASSIFICATIONS

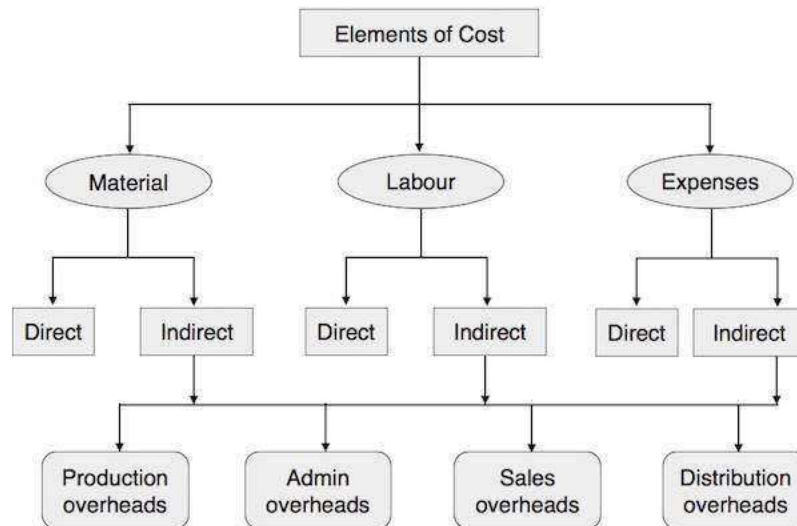
Concept of Cost:

According to the Chartered Institute of Management Accountants, cost is “the amount of expenditure (actual or notional) incurred on or attributable to a specified thing or activity.” Similarly, according to Anthony and Wilsch “cost is a measurement in monetary terms of the amount of resources used for some purposes.”

Classification of Cost:

Classification of costs implies the process of grouping costs according to their common characteristics. A proper classification of costs is absolutely necessary to

mention the costs with cost centers. Usually, costs are classified according to their nature, viz., material, labour, over-head, among others.



The above chart shows the various elements of cost and how they are classified.

Direct or Indirect Materials

The materials directly contributed to a product and those easily identifiable in the finished product are called direct materials. For example, paper in books, wood in furniture, plastic in water tank, and leather in shoes are direct materials. They are also known as high-value items. Other lower cost items or supporting material used in the production of any finished product are called indirect material. For example, nails in shoes or furniture.

Direct Labour

Any wages paid to workers or a group of workers which may directly co-relate to any specific activity of production, supervision, maintenance, transportation of material, or product, and directly associate in conversion of raw material into

finished goods are called direct labor. Wages paid to trainee or apprentices does not come under category of direct labor as they have no significant value.

Overheads are classified as:

- Production or manufacturing overheads
- Administrative expenses
- Selling Expenses
- Distribution expenses
- Research and development expenses

Cost, Costing and Cost Accountancy:

Cost, costing, and cost accounting, are normally used interchangeably but they are not synonyms of each other. The meaning of these terms is related and similar but there are differences.

- Cost is a sacrificed resource to obtain something.
- Costing is a process of determining costs. It may be called a technique for ascertaining the cost of production of any product or service in the business organization.
- Cost accounting is a technique to assist management in establishing various budgets, standards; etc Cost Accounting is basically the next step to costing. Cost accounting involves the preparation of various budgets for an organization, determining standard costs based on technical estimates, finding and comparing with actual costs, ascertaining the reasons of by variance analysis etc.

Cost Centre :

A cost centre is a type of responsibility centre that is called accountable for the incurrence of the costs, which are under its control. Cost centers are typical business units that incur costs but only indirectly contribute to revenue

generation. cost center is an organizational subunit that incurs cost but does not directly contribute to the company's profits. In fact, a cost center may not generate any revenues at all.

Cost Unit:

A cost unit refers to the unit of quantity of product, service or time (or combination of these) in relation to which costs may be ascertained or expressed. While preparing cost statements and accounts, a specific measurement unit is required to be chosen, so as to identify the expenses accurately and allocate the cost conveniently and in this way, cost unit comes into the picture. A cost unit is unit of a product or a service to which production costs can be traced. It is important to identify cost unit in order to properly charged the costs incurred in every production processes.

MANAGEMENT REPORT WRITING

INTRODUCTION

The words report denotes a form of upward communication as the term „report“ is normally used for formal communication providing the relevant information about the performance of functional areas of the organization by a lower level to a higher level of authority on the other hand the word communication refers to form of downward communication i.e. from higher level to lower level.

Meaning and Definition of Management Reporting

Management reporting is refers to 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.

According to **R.L Smith** reports may be defined as " Instruments of communication the nervous system of organizational anatomy. Accounting reports consists of financial data and may take the character of draft, schedules, statements, charts, graphs, diagrams and any other statistical presentations"

Methods of reporting

Management reporting is always need based. It takes a form as per the situational need of the organization. Reports to the management may be presented in the following forms.

1. Written reporting
2. Oral reporting
3. Graphic reporting

1. Written reporting –These are formally presented in writing. This is the most common mode of reporting. It may be in form of letter, circular or manual. It facilitates for easy reference and act as an evidence or support for managerial decisions. It creates record for the organization in support of decisions. These include,

- a.** Balance sheet
- b.** Fund flow statement
- c.** Cash flow statement
- d.** Sales reports
- e.** Performance reports of the departments
- f.** Ratio analysis reports
- g.** Budgetary reports etc.

2. Oral reporting –These are presented in a discussions or dialogue form. Such presentation of information is more informative and can clarify many aspects through the person who is presenting the report. It is helpful only to a limited extent and does not act as an evidence or support for managerial decision in the later dates. It includes,

- a. Group meetings
- b. Conferences with individuals
- c. Interviews

3. Graphic reporting –The reports may be presented in the form of charts, diagrams and pictures. These reports have the advantages of quick grasp of trends of information presented. A look at the chart or diagram may enable the reader to have an idea about the information. In the modern times graphs and charts are becoming more popular mode of presenting any kind of information. This is the most effective medium of reporting removes dullness and confusions which we usually find in other forms of reporting. The following are the types,

- a. Bar charts
- b. Pie charts
- c. Zee charts
- d. Break-even point
- e. Flow chart
- f. Control chart
- g. Progress chart

Requisites of a good reporting

1. **1.Promptness** –Submission of timely reports to management is an important requisite of management reports as the management initiates the process of taking decision only on the receipt of reports. Hence the system should ensure

the preparation and submission of reports to the management on time. If there is any delay in the submission of reports, it results in the further delay in the decisions and cost.

2. **2. Simplicity** –A report should be simple and easy to understand. The presentation of operating information should be simple and clear. This requires exact and simple definitions of financial terms. Simplicity of reporting to top management can be attained by elimination of data using schedules. The use of graphical devices makes it possible to indicate.
3. **3. Consistency** –It is necessary to present the information in a consistent manner to the various operating levels of management because very often, the same statistical data are compiled in different needs to the top and lower management levels. In the absence of consistency, there cannot be any proper comparison.
4. **4. Comparability** –The report should contain the information about both the budgeted performance and actual performance for the reporting period. This is necessary to compare the actual performance with the budgeted and to determine the deviation which is more useful for managerial decisions. It also enables the management to take appropriate measures to improve the corporate performance. Further the reports may also include the performance statistics for the immediately preceding period so that management can ascertain whether the performance has improved during current period when compared to the previous period.
5. **5. Readability** –It is another face of simplicity, which is of equal importance. The rounding off of figures, for instance also helps in readability. Approximations can give better clarity to figures.
6. **6. Updated** –A report should be up to date. It must reflect the recent information of the concern.

7. **7. Good Format** –The effectiveness and usefulness of management reports depends upon the format in which the reports are presents. Hence, the report to the management should have proper format with suggestive title, heading, sub-heading, paragraph divisions, required number of columns and rows with relevant captions etc. as the reports are sent to different levels of management, the format of reports should be designed to suit the requirement of respective levels.
8. **8. Attractiveness and accuracy** –A report should be accurate in its data presentation. It should consist more tables, graphs charts and figures which can support for immediate attention and speedy decisions.
9. **9. Concise** –A concise report is more appreciated by the managers. It saves time and facilitates for fast decisions. However it should be covering all aspects are materiality significant for making decisions.
10. **10. Key factors** –A report should highlight on the key aspects of the situation. It should catch the attention of top level management on those factors which has significant effect on the organization and which needs immediate action.
11. **11. Principles of Exception** –As the time and efforts of management are precious, it is not necessary to draw the attention of management for all aspects. It is sufficient if the reporting draws the attention of management only towards the exceptional aspects.
12. **12. Controllability** –A good report must support for controlling the situations. It should prescribe the standards, compare actual with the standards, should mention the variations and suggestions to avoid unhealthy variations in the performances.
13. **Kinds of reports**
14. **Managerial reports can be classified**

1. On the basis of purpose of the management
2. On the basis of period of submission
3. On the basis of operations of the organization
4. On the basis of administrative needs of the management

1. Classification of reports according to the users or purpose or need or the situation:

a. Internal reports –Reports prepared for the use of the internal people like director, managers, supervisors etc. for the purpose of decision making is said to be internal reports.

b. External reports–Reports prepared for the use of outsider is known as external reports. Reports meant for persons outside the business, such as the government, creditors, shareholders, banks and financial institutions, stock exchanges etc.

2. Classification of reports according to the period of submission:

a. Routine reports–Reports prepared on a certain periods is said to be routine reports. It covers the day to day aspects of the departmental activities.

b. Special reports –Special reports are those, which are prepared for the specific purpose. It is generally situation based. For instance, when there is a drop in sales of a brand in a particular market a report probing into the reasons for such fall is known as special report.

3. Classification of reports according to the function or operation:

a. Functional reports –Functional or operating reports are reports which provide information about the operations at different functional levels of the concern.

b. Financial reports–It is a report on financial performance of a concern on given accounting date. It provides useful information about the financial position of the concern. It includes financial statements like balance sheet, cash flow statement, fund flow statement, income statement etc.

4. Classification of reports according to the administrative needs

a. Enterprise report – It is a report, which gives detailed information of an enterprise since its inception. Example-balance sheets, employment reports, income tax returns etc

COST SHEET

Definition:

A cost sheet is a statement which represents the various costs incurred at different stages of business operations, in a tabular format. It determines the total cost or expenditure made by the organization, along with the cost incurred on each unit of a product or service in a particular period.

A **cost sheet** is a report which is accumulated all of the **costs** associated with a product or production job. A **cost sheet** is used to compile the margin earned on a product or job, and can form the basis for the setting of prices on similar products in the future.

A Cost Sheet depicts the following facts:

- Total cost and cost per unit for a product.
- The various elements of cost such as prime cost, factory cost, production cost, cost of goods sold, total cost, etc.
- Percentage of every expenditure to the total cost.
- Compare the cost of any two periods and ascertain the inefficiencies if any.
- Information to management for cost control

- Calculate and summarize the total cost of the product.

Components of cost sheet

- Prime Cost
- Works Cost
- Cost of Production
- Total Cost

1. PRIME COST:

The initial cost made for manufacturing a product, i.e., raw material, labour wages and other production-related expenses, is termed as prime cost.

Following is the equation for computing the prime cost:

$$\text{Prime Cost} = \text{Direct Material} + \text{Direct Labour} + \text{Direct Expenses}$$

Where direct material is calculated with the help of the following formula:

$$\text{Direct Material} = \text{Material Purchased} + \text{Op. Stock of Raw Material} - \text{Cl. Stock of Raw Material}$$

2. WORKS COST OR FACTORY COST:

The works cost is calculated by summing up the prime cost with the factory overheads and simultaneously adjusting the opening and closing stocks of work in progress. It can

be denoted as:

$$\text{Works Cost} = \text{Prime Cost} + \text{Factory Overhead} + \text{Op. Stock of WIP} - \text{Cl. Stock of WIP}$$

The various indirect overheads incurred at the factory premises can be computed with the help of the following formula:

$$\text{Factory Overhead} = \text{Indirect Material} + \text{Indirect Labour} + \text{Indirect Expenses}$$

Indirect Material

The indirect material includes all the additional items used for manufacturing products, but not directly contribute as a raw material for the finished goods. It can be anything like the oil, fuel, coal, stationery items and other factory utilities. Also, the items which are though directly used for making a product, but are inexpensive and small, are considered as indirect material. These include thread, pins, cello tape, nails, nuts, etc.

Indirect Labour

The labour or human resource engaged in all the activities other than manufacturing of goods or services which are essential to carry out the business and assist the production operations is called indirect labour.

It includes salary paid to cleaning staff, security staff, drivers, etc.

Indirect Expenses

All the other overheads which are neither directly contributing to the production operations, nor they can be termed as labour or material expense, are called indirect expenses. These are the expenses made for running the business operations smoothly. These includes depreciation, rent, electricity, insurance, taxes, repairs and maintenance, etc.

3. COST OF PRODUCTION:

The cost of production includes all the direct and indirect cost, including the material, labour and other expenses, i.e., production cost, factory cost and office or administration cost.

The following formula denotes the computation of cost of production:

Cost of Production = Works Cost + Administration Overhead

After making an adjustment of the opening finished goods and the closing finished goods to the cost of production, we acquire the cost of production of goods sold.

Further, to calculate the cost of production of goods sold, the opening and closing stocks of finished products are adjusted with the cost of production. Its formula is:

$$\text{Cost of Production of Goods Sold} = \text{Works Cost} + \text{Administration Overhead} + \text{Finished Goods(Opening)} - \text{Finished Goods(Closing)}$$

$$\text{Profit} = \text{Sales} - \text{Total Cost}$$

4. TOTAL COST

The final value of a product or service can be determined after adding all the selling and distribution expenses to the cost of production of goods sold. The formula to find out the total cost or cost of sales is:

$$\text{Total Cost} = \text{Cost of Production of Goods Sold} + \text{Selling and Distribution Overhead}$$

If the sales price of the products or service is known, the following method can be used to determine the profit:

$$\text{Profit} = \text{Sales} - \text{Total Cost}$$

The companies which have their production or manufacturing units along with office premises and also carry out sales and distribution of goods, require a systematic cost accounting procedure to determine the cost, profit and sales price.

ITEMS EXCLUDED FROM COST SHEET: The following items are of financial nature and thus not included while preparing a cost sheet:

1. Cash discount

2. Transfer to reserves
3. Interest paid
4. Donations
5. Preliminary expenses written off
6. Income-tax paid
7. Goodwill written off
8. .Dividend paid
9. Provision for taxation
10. Profit/ loss on sale of fixed assets
11. Provision for bad debts
12. Damages payable at law, etc.

Format of Cost Sheet

Units produced..... <i>Particulars</i>	Total cost Rs.	Cost per unit Rs.
Opening Stock of Direct Raw Materials		
<i>Add : Purchases</i>		
<i>Add : Carriage Inward</i>		
<i>Add : Octroi, Customs Duty and other expenses on purchases</i>		
<i>Less : Closing Stock of Direct Raw Materials</i>		



<p>Cost of Direct Materials Consumed</p> <p>Direct or Productive Wages</p> <p>Direct (or Chargeable) Expenses</p> <p>Prime Cost</p>		
<p>Add : Works or Factory Overheads</p> <p>Indirect Materials Indirect Wages Leave Wages</p> <p>Overtime Premium Fuel and Power Coal</p> <p>Factory Rent and Taxes Insurance</p> <p>Factory Lighting Supervision Works Stationery</p> <p>Canteen and Welfare Expenses Repairs</p> <p>Haulage (the commercial transport of goods)</p> <p>Works Salaries</p> <p>Depreciation of Plant & Machinery Works Expenses</p> <p>Gas and Water Technical Fees Laboratory Expenses</p> <p>Works Telephone Expenses Internal Transport Expenses</p>		
<p>Less : Sale of Scrap</p>		
<p>Add : Opening Stock of Work-in-progress</p>		
<p>Less : Closing Stock of Work-in-progress ...</p>		
<p>Works Cost</p>		
<p>Add : Office and Administrative Overheads</p> <p>Office Salaries</p> <p>Director's Fees</p> <p>Office Rent and Rates</p> <p>Office Stationery and Printing Sundry Office Expenses</p> <p>Depreciation and Repairs of Office Equipment</p> <p>Depreciation of Office Furniture</p> <p>Subscription to Trade Journals Office Lighting</p> <p>Establishment Charges</p> <p>Director's Travelling Expenses</p> <p>Postage</p> <p>Legal Charges Audit Fees</p>		



<i>Cost of Production</i>		
<i>Add : Opening Stock of Finished Goods</i>		
<i>Less : Closing Stock of Finished Goods</i>		
<i>Cost of Goods Sold</i>		
<i>Add : Selling and Distribution Overheads</i>		
<i>Advertising Showroom Expenses Bad Debts</i>		
<i>Salesmen's Salaries and Expenses</i>		
<i>Packing Expenses Carriage Outward</i>		
<i>Commission of Sales Agents Counting House Salaries</i>		
<i>Cost of Catalogues Expenses of Delivery Vans Collection Charges Travelling</i>		

In the above format, we have assumed that the cost sheet is being prepared for a month. However, the period of a cost sheet may vary according to the preference of the company, i.e., it can be made for a week, a month, a quarter or a year.

We can also determine the rate of profit, with the help of a cost sheet or a cost statement, if the sales price is known to us.



Cost Sheet of _____ for the month of _____

Particulars	Details	Total Cost	Cost/Unit
Direct Material (Raw Material Consumed):			
Opening Stock of Raw Material	X		
Add: Material Purchased	X		
Add: Carriage Inward	X		
	X		
Less: Closing Stock of Raw Material	(X)	X	X
Direct Labour		X	X
Direct Expenses		X	X
Prime Cost		X	X
Add: Factory Overhead:			
Indirect Material	X		
Indirect Labour (Wages)	X		
Factory Rent and Rates	X		
Power and Fuel	X		
Factory Lighting and Supervision	X		
Factory/Works Manager Salary	X		
Factory Water Supply	X		
Factory Insurance	X		
Factory Stationery	X		
Factory Cleaning			
Drawing Office Expenses	X		
Depreciation of Plant and Machinery	X		
Cost of Research and Equipment	X		
Other Factory Expenses	X		
	X		
Less: Sale of Scrap	(X)	X	X
		X	X
Add: Opening Stock of Work-in-Progress		X	X
		X	X
Less: Closing Stock of Work-in-Progress		(X)	X
Works Cost		X	X
Add: Office or Administration Overhead:			
Office Rent and Rates	X		
Office Lighting	X		
Office Stationery	X		
Depreciation and Repairs of Office Furniture	X		
Office Salaries	X		
Management Expenses	X		
Office Telephone and Postage Charges	X		
Legal Charges	X		
Bank Charges and Commission	X		
Office Cleaning	X		
Audit Fees	X		
Office Insurance	X		
Other Office Expenses	X	X	X
Cost of Production		X	X
Add: Finished Goods (Opening)		X	
		X	
Less: Finished Goods (Closing)		(X)	
Cost of Production of Goods Sold		X	X
Add: Selling and Distribution Overhead:			
Salesmen Salaries	X		
Salesmen Commission	X		
Showroom Expenses	X		
Showroom Rent and Rates	X		
Advertisement	X		
Sales Office Rent and Rates	X		
Travelling Expenses	X		
Warehouse Rent and Rates	X		
Warehouse Staff Salaries	X		
Depreciation and Repairs of Delivery Vehicle	X		
Carriage Outwards	X		
Debt Collection Charges	X		
Other Selling and Distribution Expenses	X	X	X
Total Cost / Cost of Goods Sold		X	X
Profit / Loss (difference of Sales and COGS)		X / (X)	X
Sales		X	X

STANDARD COSTING

DEFINITION OF STANDARD COST:

Standard Cost is defined by the Institute of Cost and Management Accountant, London "is the Predetermined Cost based on technical estimate for materials, labour and overhead for a selected period of time and for a prescribed set of working conditions."

DEFINITION OF STANDARD COSTING:

Chartered Institute of Management Accountants England defines Standard Costing as "the Preparation and use of standard costs, their comparison with actual costs and the analysis of variances to their causes and points of incidence."

ADVANTAGES OF STANDARD COSTING:

The following are the advantages of standard costing:

1. It guides the management to evaluate the production performance.
2. It helps the management in fixing standards.
3. Standard costing is useful in formulating production planning and price policies.
4. It guides as a measuring rod for determination of variances.
5. It facilitates eliminating inefficiencies by taking corrective measures.

LIMITATIONS OF STANDARD COSTING:

The following are the disadvantages of standard costing:

1. Standard costing is expensive and a small concern may not meet the cost.
2. Due to lack of technical aspects it is difficult to establish standards.

3. Standard costing cannot be applied in the case of a- concern where non-standardised products are produced.
4. Fixing of responsibility is' difficult. Responsibility cannot be fixed in the case of uncontrollable variances.
5. Frequent revision is required while insufficient staff is incapable of operating this system.

STEPS INVOLVED IN STANDARD COSTING:

1. **Establishment of Cost Centres:** Establishment of cost centres with clearly defined areas of responsibility is the first step for establishing a standard costing system.
2. **Classification of Accounts:** Classification of accounts for the purpose of identifying each expense and revenue by function and deciding the responsibility of such expenses and revenues.
3. **Types of Standards:** Standards may be set out as per the situation and according to suitability of their achievement. In this context, generally five types of standards are available, viz. Basic Standard, Current Standard, Ideal Standard, Normal Standard and Expected/Practical Standard.
4. **1. Basic Standard:** Basic standard is a standard which is established for us over a long period of time. This type of standard remains constant over a long period of time. In this type of standard, a base year is chosen for comparison purpose.
1. **2. Current Standard:** Current standard is established for a short period and for current condition.
2. **3. Ideal Standard:** Ideal Standard is a standard which may be attained under most favourable conditions. This standard is based on the best possible operation conditions.

3. 4. **Normal Standard:** Normal standard is a standard which can be achieved under normal operating conditions this standard is difficult to set as it require significant degree of forecasting.
4. 5. **Expected or Practical Standard:** Expected or practical standard is a standard which is based on expected operating performance after making a reasonable allowance for unavoidable losses. This is an attainable and realistic standard.

VARIANCE ANALYSIS:

MEANING OF VARIANCE:

The term "Variances" may be defined as the difference between Standard Cost and actual cost for each element of cost incurred during a particular period. The term "Variance Analysis" may be defined as the process of analyzing variance by subdividing the total variance in such a way that management can assign responsibility for off-Standard Performance. The variance may be favourable variance or unfavourable variance. When the actual performance is better than the Standard, it resents "Favourable Variance." Similarly, where actual performance is below the standard it is called as "Unfavourable Variance."

ACCOUNTING STANDARDS

Accounting standards are written policy documents issued by expert accounting body or by government or other regulatory body covering the aspects of- recognition, treatment, measurement, presentation and disclosure of accounting transactions and events in financial statements.

Accounting Standards in India

In INDIA, Accounting Standards are issued by ICAI – Accounting Standards Board(ASB) which was formed on 21st April,1977 as ICAI being premier accounting body in the country, took upon itself the leadership role by constituting the ASB

- In India, 32 Accounting Standards are issued as IAS under NACAS now known as NFRA.
- 31 Accounting standards in force or useful.
- AS-8 Research and Development is withdrawn pursuant to AS-26 Intangible assets on 1st April,2003.
- Accounting Standards in Different Nations
- As per International system, there are 41 Accounting Standards called as IFRS
- Adopted by 8 countries in the world
- 70 to 80 countries planning to adhere IFRS

Objectives of Accounting Standards

- Standardize the diverse Accounting Policies, valuation norms and disclosure requirements.
- Eliminate the non-comparability of financial statements and thereby improving the reliability of financial statements.
- Eradicate baffling variation in treatment of accounting aspects.
- Facilitate inter-firm and intra-firm comparison

Evolution of Accounting Standards

Accounting Standards	Initiation
1. AS 1 to AS 15	1979 to 1995
2. AS 16 to AS 29	2000 to 2007
3. AS 30 to AS 32	Later part of 2007

Accounting Software

Accounting software describes a type of application software that records and processes accounting transactions within functional modules such as accounts payable, accounts receivable, payroll, and trial balance. It functions as an accounting information system.

History of Accounting Software

- Till 1970-80 accounting transaction was recorded by manually. It was a book with assigned pages for each account such as cash, receivables, payables, stockholder equity. Everyday transactions were recorded by hand into a journal. All these processes were inefficient, slow, and manual. Even a minor mistake in these processes led to long time spent for recalculations.
- In 1983 company Intuit introduced a computerized computing program for personal finance Quicken. At this point for development of accounting technologies, manual journal records were left in the past and computer technologies access in this time. Accounting software gave an opportunity to professional accountants to do their job faster and more productive.

Types of Accounting Software

- Spreadsheet
- Commercial Accounting software
- Enterprise Accounting software
- Custom Accounting software



- **Spreadsheet:** To help with bookkeeping, businesses often use spreadsheet programs such as Microsoft Excel or Google Spreadsheets. You can adapt a spreadsheet to almost any basic accounting need.
- **Commercial Accounting software:** It such as QuickBooks or Peachtree can handle most of a small- to mid-size business's accounting needs. Its often includes graphs that summarize data, reports that provide a picture of a business's health.
- **Enterprise accounting software:** Larger companies may have enormously complex operations, and enterprise accounting software helps in managing this complexity.
- **Custom accounting software:** Sometimes, a business creates its own accounting software, this are called custom accounting software.

Modules of Accounting Software

- Accounts receivable—where the company enters money received
- Accounts payable—where the company enters its bills and pays money it owes
- General ledger—the company' "books"
- Billing—where the company produces invoices to clients/customers
- Stock/Inventory—where the company keeps control of its inventory
- Purchase Order—where the company orders inventory
- Sales Order—where the company records customer orders for the supply of inventory

Non Core Module



- Debt Collection—where the company tracks attempts to collect overdue bills (sometimes part of accounts receivable)
- Electronic payment processing Expense—where employee business-related expenses are entered
- Inquiries—where the company looks up information on screen without any edits or additions
- Payroll—where the company tracks salary, wages, and related taxes \
- Reports—where the company prints out data
- Timesheet—where professionals (such as attorneys and consultants) record time worked so that it can be billed to clients
- Purchase Requisition—where requests for purchase orders are made, approved and tracked

Software Catagories

- Low End Software
- Mid Market Software
- High End (ERP Software)
- Vertical Market
- Personal Accounting

Origin of Accounting Software

- VisiCalc was the first spreadsheet program available for personal computers. It may well be the application that turned the microcomputer from a hobby for computer enthusiasts into a serious business tool.
- VisiCalc sold over 700,000 copies in six years.

Comparison between Manual Accounting and Computerized Accounting



BASIS FOR COMPARISON	MANUAL ACCOUNTING	COMPUTERIZED ACCOUNTING
Meaning	Manual Accounting is a system of accounting that uses physical registers and account books, for keeping financial records.	Computerized Accounting is an accounting system that uses an accounting software, for recording financial transactions electronically.
Recording	Recording is possible through book of original entry.	Data content is recorded in customized database.
Calculation	All the calculation is performed manually.	Only data input is required, the calculations are performed by computer system.
Speed	Slow	Comparatively faster.

PACKAGE OF COMPUTERISED ACCOUNTING

- Tally
- Spreadsheet programs like Lotus, MS excel
- Bank 2000 for banking transaction
- Quick FA

Tally:

- It's a business accounting software which Was first introduced in 1986
- It was designed by a Bangalore based multinational company Tally Solutions Pvt. Ltd. It is a private company that used to deal with ERP software at that time



- Tally was developed by Shyam Sunder Goenka and Bharat Goenka
- Its is accounting software used by both small and large companies.
- Tally has made complex business calculation easier and time savings.

Advantages

- Enables effortless data Movements
- Less expenses on data collection and data transfer of files
- Fast data files transaction • Human errors is eliminated on the data
- To get easy and fast documents accesses
- Promotes business development activities
- For better sales promotion's
- Industry specific software sides
- Web enabled services
- Easy to use and handle

Enables effortless data Movements

The main benefit of accounting software is when the data is entered through the Application; it is updated throughout the Programs. For example: If a person makes some entries in stock, the data has been updated at every department level and in every management. The employers can view the updated data files at their software terminal. No need to move the data file from one department to other. Everything happens automatically at the main server or at the main database, as the information has been automatically updated.

Less expenses on data collection and data transfer of files

The data of inventory and accounting is required at almost every business unit be it a small business or a corporate businesses, and accounting software helps you

to save money and time consuming also spend on maintenance of paper files and accounting data.

Fast data files transaction

The manual process of accounting and spend more time on calculations is prevented through accounting software.

Human errors is eliminated on the data

The software does its job on time without error and the company officials get time to concentrate on core business activities. If a company gets exact file information and exact figure on time all activities, it can make forecast for further processes and make strategies documents to improve the business. The time spent on handling accounting books and resources is reduced and non -mistakable of errors.

To get easy and fast documents accesses

Each and every data entry gets updated in the software and you can make easy way of getting reports of every week, month, quarter or year in minutes.

Promotes business development activities

Around Business areas improved through accounting software's for sales, inventory management, merchant accounts, budget, asset management, taxation and payroll. Some accounting software, providing legal services and important dates files are flashed to remind of the priorities in a minute.

For better sales promotion's

Accounting software not only benefits for the business owners, but the employees and customers are also benefited from the features. The process of monetary transaction speeds up on the use of a software and customer are satisfied to get quick services and getting more value on the services.

Industry specific software sides

There are many of industries specific accounting software, designed for manufacturing or construction sector, etc.

Web enabled services

Web enabled accounting software can be used if the company has branches at many geographical locations, in that time it reduce the time consuming problems.

Easy to use and handle

Conduct everyday business transactions through accounting software and can even make payment online through the software to clients or receive payment through online transaction.

Disadvantages

- Not User-Friendly
- Single window software
- No Useful Upgrades
- Is not ideal for Multi-branch
- Not Flexible
- No Central Support
- Low Security
- No Customization

- Risk of Data Loss and intrusion

Not User-Friendly

Tally fails to be user friendly software. It does not help to use it with ease. It is of course a simple software but not everyone can grasp the knowledge of accounting soon after installing. Hence it fails to guide its users in a simple way on how to use it when there is lack of much knowledge about accounting.

Single window software

It does not allow to open the same transaction screen from multiple computers. Therefore, it becomes time consuming unlike other software that allows to work on more than one ledger at a time. Tally allows only one ledger at a time which makes it difficult for the user to view other things in it at once.

Is not ideal for multi-branch

In case of multiple branches, Tally becomes way too expensive to run. It requires investment in Servers and LAN bundled with Tally.net. Furthermore, the sync is not real-time. It needs manual sync and the data is not updated if the accountant is not available in any of the branches to sync manually.

Not Flexible

The default setting button is not provided. In case to change the setting after the configuration settings are done. Then restart and delete all the ledgers and start again from the beginning. Once it has created the journal voucher it is not possible to make changes in it. In Tally ERP once the level of the items is set in the inventory it cannot set the level once again after the reorder. This makes it very rigid and difficult to use.



No Central Support

The support system of this software is still lagging behind and that makes it difficult for the users to find support when there is any issue with the software. It makes the users find even more difficult in operating it as there are no good supports from the other side to help them out with the training on how to use it.

Low Security

Be very careful with the password as well. Once the user password is lost or forgot the retrieving of data is very difficult and quite time consuming. Also, there is alarming possibility of losing the data in case of a virus or hard disk crash.

Bad Integration of Invoicing Modules

Tally does not have any modules that can call as an extra feature that results automatically when using a feature that already exists independently. It does not provide account payable, receivable, etc; unlike QuickBooks and other software.

Risk of Data Loss and intrusion

As it is an offline software therefore it has no backup in case of system crash or some mishap takes place. Therefore separate back up of data gives birth to extra work.