

## Management Accounting

### Accounting Ratio:

Accounting ratio, also known as the financial ratio, is the comparison of two or more financial data which are used to evaluate a business condition. It is an effective business tool that is used by shareholders, creditors, and all kinds of stakeholders to understand the profitability, strength, and financial status of a business. Accounting ratio are also widely used to examine business performance and accordingly business decisions can be made.

### Different Types of Accounting Ratio

Ratios are classified into two types namely traditional classification and functional classification. The traditional classification is based on the financial statement to which the determinants belong. Based on the traditional classification, ratios are classified as:

#### 1. Statement of Profit and Loss Ratio:

A ratio of two variables from the profit and loss statements is termed the statement of profit and loss ratio. For example, the ratio of gross profit to revenue generated from business operations is referred to as the gross profit ratio. It is calculated using both the figures derived from the profit and loss statement.

#### 2. Balance Sheet Ratio:

If both the variables of the ratio are from the balance sheet, then it is classified as the balance sheet ratio. For example, the ratio of current assets to current liabilities is termed the current ratio. It is calculated using both the figures derived from the balance sheet.

#### 3. Composite Ratio:

If the ratios are calculated using one variable from the financial statement and another variable from the balance sheet, then it is termed composite ratio. For example, the ratio of credit revenue from business operations to trade receivables is termed the trade receivable turnover ratio. It is calculated using one variable from the profit and loss statement (credit revenue from business operations) and another variable (trade receivables) from the balance sheet statement.

On the Basis of Functional Classification, Ratio Are Classified as:

1. **Liquidity Ratio:** To meet business commitments, the business needs liquid funds. The ability of a business to pay the due amount to stakeholders as to when it is due is known as liquidity; the ratio calculated to measure it are known as liquidity ratio. The liquidity ratio are short-term in nature. They are calculated to measure the short-term solvency of the business i.e. the firm's ability to meet its current obligations. The most common type of liquidity ratio are:

- Current Ratio
- Quick or Liquid Ratio

2. **Solvency Ratio:** The business solvency is determined by its ability to meet its contractual obligations towards stakeholders, specifically towards external stakeholders, and the ratio calculated to measure the business solvency positions are known as the solvency ratio. The solvency ratios are long-term in nature. The most common type of solvency ratio for calculating the business solvency are:

- Debt-Equity Ratio
- Debt to Capital Employed Ratio
- Proprietary ratio
- Total Asset to Debt Ratio
- Interest Coverage Ratio

3. **Activity or Turnover Ratio:** These are the ratios that are calculated for measuring the efficiency of business operations based on the effective utilization of resources. Hence, these are also termed efficiency ratios. A higher turnover ratio means better

utilization of assets and signifies improved business efficiency and profitability. The most important types of activity ratios are:

- Activity Turnover Ratio
- Trade Receivable Turnover Ratio
- Trade Payable Turnover Ratio
- Net Asset or Capital Employed Turnover Ratio
- Fixed Asset Turnover Ratio, and
- Working Capital Turnover Ratio

**4. Profitability Ratio:** Profitability ratio are referred to as analysis of business profits in relation to the revenue generated from the business operations ( or funds) or assets used in the business and the ratios calculated to meet its objectives are termed as profitability ratios. The most common types of profitability ratios that are used to analyse the profitability of the business are:

- Gross Profit Ratio
- Operating Ratio
- Operating Profit Ratio
- Net Profit Ratio
- Return on Investment (ROI) or Return on Capital Employed (ROCE)
- Return on Net Worth (RONW)
- Earnings Per Share
- Book Value Per Share
- Dividend Pay out Ratio
- Price Earning Ratio

#### **Accounting Ratio Formulas**

Here, we will list the formulas of all the accounting ratio on the basic functional classification discussed above:

<b>Liquidity Ratio Formulas</b>	
Current Ratio	Current Asset/Current Liabilities
Quick Ratio	Quick Asset/Current Liabilities
Liquid Ratio	Liquid Asset/Current Liabilities
<b>Solvency Ratios</b>	
Debt Equity Ratio	Long - Term Debts/Shareholders Funds
Debt to Capital Employed Ratio	Long - Term Debts/Capital Employed or Net Assets
Proprietary ratio	Shareholders Funds/Capital Employed or Net Assets
Total Asset to Debt Ratio	Total Assets/Long - Term Debts
Interest Coverage Ratio	Net Profit Before Interest And Tax/Interest on Long - Term Debts
<b>Activity or Turnover Ratio</b>	

Activity Turnover Ratio	Cost of Revenue From Business Operations/Average Inventory
Trade Receivable Turnover Ratio	Net Credit Revenue From Business Operations /Average Trade Receivables Here, Average Credit Receivables = Opening Debtors and Bill Receivables + Closing Debtors and Bills Receivables/2
Trade Payable Ratio Turnover Ratio	Net Credit Purchase/Average Trade Payables Here, Average Credit Payables = Opening Debtors and Bill Payables + Closing Debtors and Bills Payables/ 2
Net Asset or Capital Employed Turnover Ratio	Revenue From Business Operations/Capital Employed
Fixed Asset Turnover Ratio	Net Revenue From Business Operations/Net Fixed Assets
Working Capital Turnover Ratio	Net Revenue From Business Operations/Working Capital
<b>Profitability Ratio</b>	
Gross Profit Ratio	Gross Profit/Net Revenue of Business Operations×100
Operating Ratio	Cost of Revenue From Business Operations + Operating Expense/Net Revenue From Business Operations×100
Operating Profit Ratio	Operating Profit/Revenue From Business Operations×100 Here, Operating Profit =Revenue From Business Operations/Operating Cost
Net Profit Ratio	Net Profit/Revenue From Business Operations×100
Return on Investment (ROI) or Return on Capital Employed (ROCE)	Profit Before Interest And Tax/Capital Employed×100
Return on Net Worth (RONW) or Return on Shareholder's Fund	Profit After Tax/Shareholders Fund×100
Earnings Per Share	Profit Available For Equity Shareholders/Number of Equity shares
Book Value Per Share	Equity Shareholders Fund/Number of Equity shares
Dividend Payout Ratio	Dividend Per Share/Earning Per Share
Price Earning Ratio	Market Price of Share/Earning Per Share

## Cash Flow Statement

A cash flow statement (CFS) is one of a business's most important financial reports. Unlike the income statement and balance sheet, which concentrate on accounting profits, a CFS deals with the cash component of a business. Since cash provides liquidity, it is decisive for the survival of a business.

A CFS records a firm's all cash-based transactions during a particular accounting period. In other words, it mirrors the availability and usage of business funds to reveal its current state of liquidity. Thus, it explains how well a corporate unit manages its resources (cash and cash equivalents) to ensure uninterrupted business functioning and generate profits.

Further, it is essential for corporate planning in the short run as it gauges a company's capacity to meet its short-term obligations. Besides, it is also crucial for business forecasting, determining liquidity status, dividend decision-making, borrowing in case of monetary shortage, and wisely allocating surplus funds.

Besides, it discloses vital information regarding the solvency of a business. As opposed to other financial statements, it is more difficult to manipulate and, therefore, more reliable. Hence it is widely sought after by the stakeholders of a business.

The cash flows in a business from three significant activities: operating, investing, and financing. Thus, a cash statement presents the cash generated and spent on all these activities individually and collectively.

Following are the basic steps to preparing a CFS:

1. Take the opening balance of cash and bank available at the beginning of the respective accounting year.
2. Add to it all the incoming cash from various sources like cash sale of goods or services, proceeds from the sale of assets or investments, the funds acquired by the issue of shares or through bank loans, etc.
3. Subtract the cash outflows from payments like salaries, dividends, rent, insurance, loan repayment, stock repurchase, taxes, etc. Also, deduct the money invested in business projects or offered as a loan.

Then the net amount so evaluated is the cash in hand remaining with the company.

### Cash Flow Statement Format

The CFS is subdivided into three categories:

#### 1 – Cash flow from Operating Activities

Cash Flow from Operating Activities includes cash used in or generated from the daily core business activities. The operational activities are the principal revenue-generating or expense-incurring activities of the company. It includes selling goods or services and payment towards expenses like salaries, taxes, etc. Some operating activities that result in cash inflows and outflows are listed below.

Cash flow from Operating Activities	
Cash Inflows	Cash Outflows
Sales revenue received from customers	Rent paid
The commission, brokerage, royalty, and other fees received	Cash payment to suppliers and vendors
Receipts from debtors	Salary, wages, and commission paid

	Taxes paid
	Purchase of stock in cash
	Freight and other expenses paid

**2 – Cash flow from Investing Activities:** Cash flow from Investing Activities represents the outgoing or incoming cash from acquiring or disposing of a company’s long-term assets and holdings. Assets include land, property, plant & equipment, investments in other companies, etc.

Listed below are some of the cash flows through investing activities:

Cash flow from Investing Activities	
Cash Inflows	Cash Outflows
Proceeds from the sale of fixed asset	Purchase of fixed assets
Cash is received from selling investments in other companies like bonds, fixed assets, equity, debentures, etc.	Buying of shares, debentures, and other long-term or short-term investment instruments issued by other companies
Money received on maturity of shares, debentures, and bonds.	
Dividends and interest received on investments.	

**3 – Cash flow from financing activities:** Cash Flow from financing activities shows the capital receipts and payments marked by the transactions with the corporate finance providers like banks, shareholders, and promoters.

Given below are some the examples of cash flows from financing activities:

Cash flow from Financing Activities	
Cash Inflows	Cash Outflows
Proceeds from borrowings from banks and other financial institutions	Repayment of borrowings or loan instalments
Proceeds from issuance of the shares and debentures	Buyback of debentures and shares

	Interest paid on loans and borrowings.
	Dividend paid on shares issued.

### Preparing Cash Flow Statement

There are two methods for calculating cash flows: direct and indirect. Note that the difference between the two methods lies in computing cash flows from operating activities. In contrast, the cash flows from investing and financing activities are treated similarly in direct and indirect methods.

#### 1 – Direct Method

Only the cash operating items are recorded under the direct method of preparing CFS. This method is relatively easy to understand as it considers the actual cash transactions. The cash from operating activities can be straightaway computed by adding all the cash receipts and deducting all the cash payments. Later the cash from all the three activities, i.e., operating, investing, and financing, can be summed up to get the closing balance of cash and cash equivalents.

Cash Flow Statement – Direct Method		
Particulars	Amount	Total amount
<b>Opening Cash Balance</b>		<b>XXXX</b>
<b>Cash flow from operating activities:</b>		
Receipts from sale of goods and services, royalties, etc.	XXXX	
Payment to employees, taxes, suppliers, etc.	(XXXX)	
Net cash from operating activities (A)	<b>XXXX</b>	
<b>Cash flow from investing activities:</b>		
Sale of investments, vehicles, property, etc.	XXXX	
Purchase of machinery, plant, equipment, etc.	(XXXX)	
Net cash from investing activities (B)	<b>(XXXX)</b>	
<b>Cash flow from financing activities:</b>		
Proceeds from issuing shares, borrowings from banks, etc.	XXXXXX	
Repayment of loan	(XXXX)	
Payment of dividends to shareholders	(XXX)	

Net cash from financing activities (C)	XXXX	
<b>Add: Net cash flow during the year (A + B + C)</b>		XXXX
<b>Ending Cash Balance</b>		XXXXX

The Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) suggest that companies record their cash flows through the direct method. But it is not a handy method for the organizations since various accrual incomes and outstanding expenses are equally significant in accounting.

## 2 – Indirect Method

The CFS prepared through an indirect method requires adjustment of the non-cash items which are earned but not yet received. These changes are made to the net profit or loss of the company in the particular accounting year. The non-cash and non-operating expenses are added back to the net profit/loss, while all the non-operating and accrued incomes are subtracted. Thus, it is the reverse treatment of the income statement and provides the operating profit before the working capital changes.

Cash Flow Statement – Indirect Method		
Particulars	Amount	Total amount
<b>Cash flow from operating activities:</b>		
Profits before tax	XXXX	
<b>Add:</b> Non-operating expenses		
Depreciation, accounts payable, accrued expenses, etc.	XXXX	
<b>Less:</b> Non-operating income		
Accounts receivable, prepaid expenses, unearned revenue, etc.	(XXXX)	
Operating profits before working capital changes	XXXX	
<b>Add:</b> Decrease in current assets and increase in current liability	XXXX	
<b>Less:</b> Decrease in current liability and increase in current assets	(XXXX)	
Net Cash from operating activities (A)		XXXX
<b>Cash flow from investing activities:</b>		

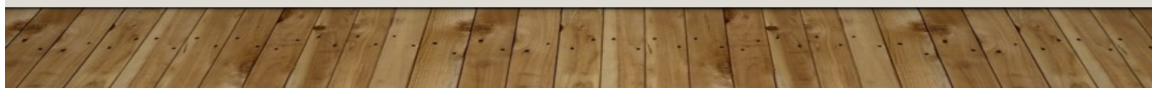
Proceeds from sale of fixed assets	XXXX	
Purchase of fixed assets	(XXXX)	
Net cash from investing activities (B)		XXXX
<b>Cash flow from financing activities:</b>		
Proceeds from issuing shares, borrowings from banks, etc.	XXXX	
Payment of borrowings, dividends, etc.	(XXXX)	
Net cash from financing activities (C)		XXXX
<b>Net cash flow during the year (A + B + C)</b>		<b>XXXX</b>
<b>Add: Opening cash balance</b>		<b>XXXX</b>
<b>Ending Cash Balance</b>		<b>XXXX</b>

The corporates widely use the indirect method since the books of accounts are on an accrual basis, thus making it a more practical approach.

### Variance Analysis

## Definitions

- **Standard Cost:** (CIMA) “Standard cost is the pre-determined cost based on the technical estimates for materials, labour and overhead for a selected period of time for a prescribed set of working conditions.”
- **Standard Costing:** (CIMA) “the preparation of standard costs and applying them to measure the variations from the actual costs and analyzing the causes of variations with a view to maintain maximum efficiency of the operations so that any remedial action may be taken immediately.





# VARIANCE ANALYSIS

- **Cost Variance:** is the difference between the standard cost and the actual costs.
- **Variance Analysis** is the resolution into constituent parts and the explanation of the variances.
- ❖ **Favorable & Unfavorable Variances.**
- ❖ **Controllable & Uncontrollable Variances**



## FAVORABLE & UNFAVORABLE VARIANCES

- Favorable variances F arise when actual costs are less than budgeted costs or actual sales/profit exceed budgeted.
- Un favorable variances U arise when actual costs exceed budgeted or actual sales/profit are less than budgeted.

	Profit	Revenue	Costs
Actual > Expected	F	F	U
Actual < Expected	U	U	F

## STANDARD COSTS



**Standard Costs are**

Based on carefully predetermined amounts.

Used for planning labor, material and overhead requirements.

The expected level of performance.

Benchmarks for measuring performance.



# MATERIAL COST VARIANCE

- Material cost variance arises due to variance in the price of material or its usage.
- This can be calculated by using the following formula,
  - **Material Cost Variance = (SQ x SP) – (AQ x AP) ,**
- **Where,**
  - SQ = Standard quantity for the actual output
  - SP = Standard price per unit of material
  - AQ = Actual quantity
  - AP = Actual price per unit of material
- A positive result implies favorable variance and a negative result implies unfavorable variance (adverse variance).

# MATERIAL PRICE VARIANCE

- Material price variance may arise due to number of reasons like fluctuations in market prices, error in buying due to wrong purchasing policy etc.,
- This can be calculated by using the following formula,
  - **Material Price Variance = (SP– AP) x AQ**
- **Where,**
  - SP = Standard price per unit of material
  - AQ = Actual quantity
  - AP = Actual price per unit of material
- A positive result implies favorable variance and a negative result implies unfavorable variance (adverse variance).

## MATERIAL USAGE VARIANCE

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- Material Usage variance is the difference between the actual quantities of raw materials used in production and the standard quantities that should have been used to produce the product,
- MUV may arise due to number of reasons like Pilferage of materials , Wastage Sub - standard or defective materials etc,
- This can be calculated by using the following formula,
- **Material Usage Variance = (SQ – AQ) x SP**

## MATERIAL MIX VARIANCE

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- MMV is calculated when a product uses mixture of different raw materials,
- MMV is that portion of the materials quantity variance, which is due to the difference between the standard and actual composition of a mixture.
- It can be represented by the following formula:
  - **Material mix variance =**  
*(Standard cost of actual quantity of the standard mixture – Standard cost of actual quantity of the actual mixture) or (Revised SQ – AQ) x SP*

## MATERIAL MIX VARIANCE

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- Material Mix Variance

$$= [\text{Revised St. Qty} - \text{Actual Qty}] \times \text{St. Price}$$

$$\text{Rev. St. Qty} = \frac{\text{St. Qty of 1 Mat} \times \text{Actual Total}}{\text{Standard Total}}$$

## LABOUR VARIANCES

- Labour Cost Variance       $\text{SH} \times \text{SR} - \text{AH} \times \text{AR}$
- Labour Usage/Efficie. Var       $(\text{SH} - \text{AH}_{\text{actual}}) \times \text{SR}$
- Labour Rate Variance       $(\text{SR} - \text{AR}) \times \text{AH}$
- Idle time Variance       $\text{SR} \times \text{Idle time}$

## LABOUR EFFICIENCY VARIANCE CAUSES



## OVERHEAD VARIANCES

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- Overhead variances arise due to the difference between actual overheads and absorbed overheads. The estimate of budget of the overheads is to be divided into fixed and variable elements. i.e.
  1. Variable overhead variances.
    - Variable overhead budget or expenditure variance, and
    - Variable overhead efficiency variance.
  2. Fixed overhead variances.

## FORMULAS

1. Variable overhead variances.  
(Standard variable over head for actual production – Actual variable o/h)
2. Variable overhead budget or expenditure variance, **(Budgeted variable overhead for actual hours – Actual variable overhead)**  
**i.e. AH \* BR – Actual Cost**
3. Variable overhead efficiency variance.  
**Standard variable overhead rate per hour [Std. hours for actual output – Actual hours] i.e. (SH - AH) \*SR**
4. Fixed Overhead Variance  
**Budgeted FO - AFO**

## SALES VARIANCES

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- Sales Margin Price Margin = ( AP - BP) \* AQ
- Sales Margin Volume variance = (AQ - BQ) \* BC
- Total Sales Margin variance = AQ \* AC – BQ \* BC

# DEFINITION

- **MARGINAL COST:**

Marginal Cost is defined as the cost of one more or one less unit produced besides existing level of production.

- **MARGINAL COSTING:**

Marginal Costing is defined by ICMA, "the ascertainment, by differentiating between Fixed and Variable Costs, of marginal costs, and of the effect on profit of changes in the volume and type of output."

# FEATURES

- Cost Classification
- Stock / Inventory Classification
- Marginal Contribution



## ADVANTAGES

- Easy to understand
- Constant in nature
- Realistic
- Relative profitability
- Aid to profit planning
- Break-even point
- Pricing Decisions
- Meaningful reporting

## LIMITATIONS

- Analysis of overheads
- Greater emphasis on sales
- Difficulty in application
- Less effective in capital intensive industry
- Elimination of fixed cost
- Incomplete information
- Useful only for short term assessment
- Not acceptable for tax .

# TERMINOLOGY

- CONTRIBUTION:-

Excess of selling price over variable cost.

- Formula :

$$C = S - V$$

Where,

C = Contribution

S = Sales

V = *Variable Cost*

- Profit-volume Ratio (P/V ratio) :-

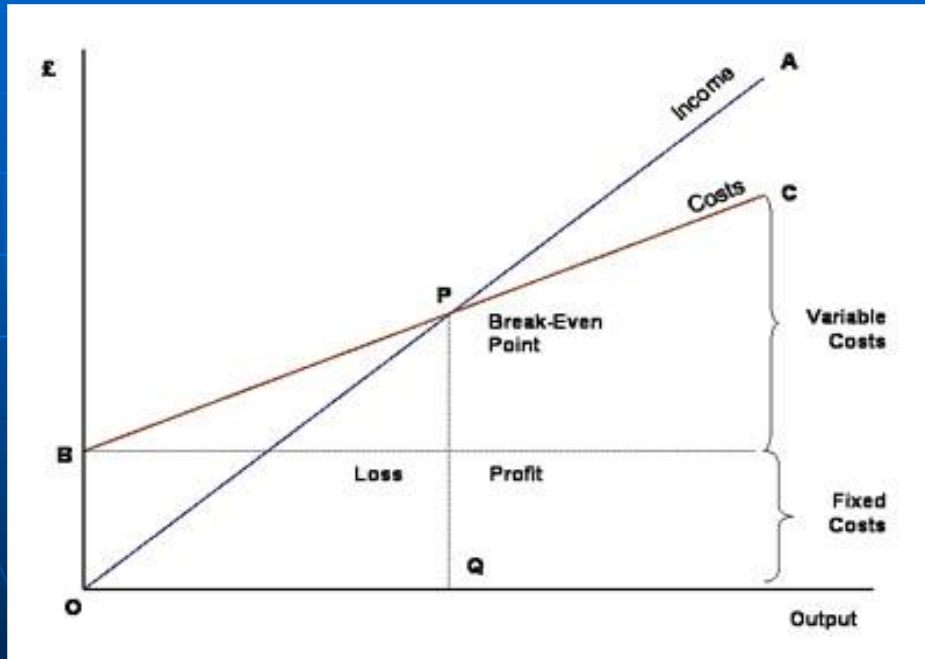
When the contribution from sales is expressed as a percentage of sales value, it is known as P/V ratio.

- Formula :

$$P/V \text{ ratio} = \frac{\text{Sales} - \text{Variable Cost}}{\text{Sales}} \times 100$$

$$\text{OR} = \frac{\text{Contribution}}{\text{Sales}} \times 100$$

# BREAK-EVEN POINT-GRAPH



## ■ BREAK-EVEN POINT:

It is the point at which total revenue is equal to total cost.

Formula:

$$\text{B.E.P. (units)} = \frac{\text{Fixed Cost}}{\text{Selling Price} - \text{Variable Cost}}$$

OR

$$= \frac{\text{Fixed Cost}}{\text{Contribution per unit}}$$

- **B.E.P. (Rs) =  $\frac{\text{Fixed Cost}}{\text{Contribution per unit}}$**

**OR =  $\frac{\text{Fixed Cost}}{\text{P/V Ratio}}$**

## **PROFIT**

- Profit is the excess of contribution over fixed cost.

- Formula:

$$\text{Profit} = \text{Contribution} - \text{Fixed Cost}$$

$$\text{OR} = \text{M.O.S} \times \text{P/V Ratio}$$

## ■ MARGIN OF SAFETY :

It is the excess of present sales value over the break even sales.

Formula:

$$\text{M.O.S} = \frac{\text{Profit}}{\text{P/V Ratio}}$$

$$\text{OR} = \text{Actual Sales} - \text{BEP Sales (Rs)}$$

$$\text{OR} = \text{Actual Sales(units)} - \text{BEP(units)}$$

## EXAMPLE

- Following is the data of Kedari Enterprises for the month of December 2009. They sold 2000 units of tablecloths in December.

Selling price p.u. Rs.10  
Variable cost Rs.10000  
Fixed Cost Rs.6000

Solution:

$$\begin{aligned}\text{Sales} &= \text{No. of units sold} \times \text{selling price p.u.} \\ &= 2000 \times 10 \\ &= \text{Rs. } 20000\end{aligned}$$

$$\begin{aligned} 1) \text{ Contribution} &= \text{Sales} - \text{Variable Cost} \\ &= 20000 - 10000 \\ &= \text{Rs. } 10000 \end{aligned}$$

$$\begin{aligned} 2) \text{ P/V Ratio} &= \frac{\text{Contribution}}{\text{Sales}} \times 100 \\ &= \frac{10000}{20000} \times 100 \\ &= 50\% \end{aligned}$$

$$\begin{aligned} 3) \text{ Profit} &= \text{Contribution} - \text{Fixed Cost} \\ &= 10000 - 6000 \\ &= \text{Rs. } 4000 \end{aligned}$$

$$\begin{aligned} 4) \text{ B.E.P.(R.s)} &= \frac{\text{Fixed Cost}}{\text{P/V Ratio}} \\ &= \frac{6000}{50\%} \\ &= \text{Rs. } 12000 \end{aligned}$$

$$\begin{aligned} 5) \text{ Margin Of Safety} &= \frac{\text{Profit}}{\text{P/V Ratio}} \\ &= \frac{4000}{50\%} \\ &= \text{Rs. } 8000 \end{aligned}$$

## Budgeting

### Budget

- ▶ Is a short- term financial plan which acts as a guide to achieve the pre-determined targets.
- ▶ It is a comprehensive and coordinated plan, expressed in financial terms, for the operations and resources of an enterprise for some specific period in the future.
- ▶ It is a predetermined detailed plan of action developed and distributed as a guide to current operations and as a partial basis for the subsequent evaluation of performance

### Budget-Definition

- ▶ **The Chartered Institute of Management Accountants, London** defines budget as "a financial and/or quantitative statement, prepared prior to a defined period of time, of the policy to be pursued during the period for the purpose of attaining a given objective."
- ▶ **Kohler in 'A Dictionary for Accountants'** defines budget as any financial plan serving as an estimate of and a control over future operation, any estimate of future costs and any systematic plan for the utilisation of manpower, material or other resources.

### Elements of Budget

1. It is a comprehensive and coordinated plan of action prepared in advance and based on a future plan of action
2. It is a plan for the firm's operations and resources.
3. It is based on objectives to be attained.
4. It is related to specific future period the periodicity may be month, quarter, half year, a year or even more than that
5. It is expressed in monetary values (like Rupees Dollars etc) and/or physical units (expressed as kilos or tonnes or quintals)

### Reasons for producing budgets

- ▶ Aid in the planning of annual operations
- ▶ Communicate plans to different responsibility centres
- ▶ Coordinate the activities of various parts of the firm & to ensure different parts operate in harmony with each other
- ▶ Motivate managers to strive to achieve organisation goals
- ▶ Control and evaluate the performance of managers



## Budgeting

- ▶ Budgeting is the process of preparing and using budgets to achieve management objectives. It is the systematic approach for accomplishing the planning, coordination, and control responsibilities of management by optimally utilizing the given resources.

### Elements of Budgeting:

- ▶ Clearly state the firm's expectations and facilitate their attainability.
- ▶ Should utilize various persons at different levels while preparing the budgets.
- ▶ Authority and responsibility should be properly fixed.
- ▶ Realistic targets are to be fixed.
- ▶ A good system of accounting is also essential.
- ▶ Wholehearted support of the top management is necessary
- ▶ Proper reporting system should be introduced.

## Forecast & Budgeting

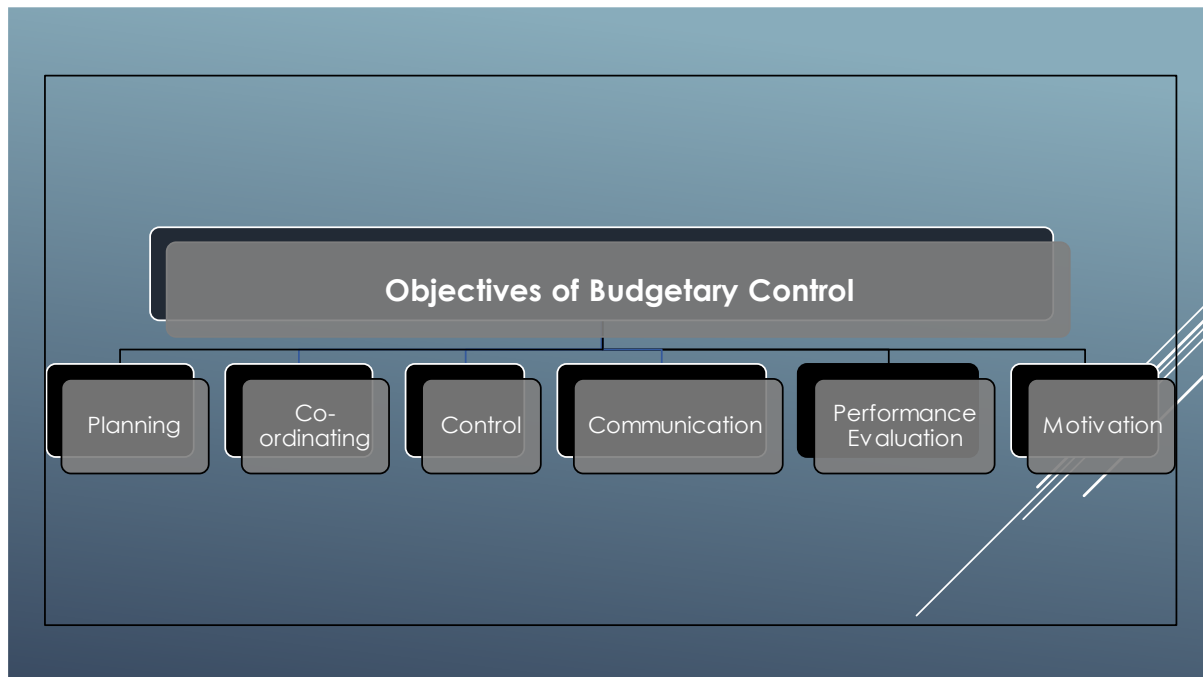
Forecast	Budget
<b>Forecast is a mere estimate of what is likely to happen. It is a statement of probable events which are likely to happen under anticipated conditions during a specified period of time.</b>	Budget shows that policy and programme to be followed in a future period under planned Conditions
<b>Forecasts, being statements of future events, do not connote any sense of control.</b>	A budget is a tool of control since it represents actions which can be shaped according to will so that it can be suited to the conditions which may or may not happen.
<b>Forecasting is a preliminary step for budgeting. It ends with the forecast of likely events.</b>	It begins when forecasting ends. Forecasts are converted into budgets
<b>Forecasts have wider scope, since it can be made in those spheres also where budgets cannot interfere.</b>	Budgets have limited scope. It can be made of phenomenon non capable of being expressed quantitatively.

## Budgetary Control

- ▶ The use of budgets to control firms' activities is known as budgetary control.
- ▶ It is a system in which budgets are prepared & the actual results are compared with the forecasted one with the purpose of fixing up responsibility for the deviation.
- ▶ Budgetary Control can be defined as a system of controlling costs which includes the preparation of budgets, coordinating the department and establishing responsibilities, comprising actual performance with the budgeted and acting upon results to achieve maximum profitability
- ▶ CIMA, London defines budgetary control as, "the establishment of the budgets relating to the responsibility of executives to the requirements of a policy and the continuous comparison of actual with budgeted result either to secure by individual action the objectives of that policy or to provide a firm basis for its revision"
- ▶

## Elements of budgetary control:

1. Establishment of budgets for each function and division of the organization.
2. Regular comparison of the actual performance with the budget to know the variations from budget and placing the responsibility of executives to achieve the desired result as estimated in the budget.
3. Taking necessary remedial action to achieve the desired objectives, if there is a variation of the actual performance from the budgeted performance.
4. Revision of budgets when the circumstances change.
5. Elimination of wastes and increasing the profitability.



#### Reference Books:

- Management Accounting – Dr K. L. Gupta(Sahitya Bhawan Publications)
- Management Accounting- R.S.N. Pillai & Bhagavati (S. Chand Publications)
- Management Accounting – T.S. Reddy & Hari Prasad Reddy (Margham Publications)

#### YouTube Video links:

- <https://youtube.com/playlist?list=PLLhSIFfDZcUWafSuXeR7wIUG3fSGKhpnl>
- [https://youtube.com/playlist?list=PLLy\\_2iUCG87D6w12QCXDGfaEa-r\\_eVY33](https://youtube.com/playlist?list=PLLy_2iUCG87D6w12QCXDGfaEa-r_eVY33)

### QUESTION BANK

#### UNIT – 1

1. The term Management accounting refers to accounting for the **Management**.
2. Management accounting helps to prepare **Budgets** covering all functions of a business.
3. Management accounting analyses **Monetary and non – Monetary** transactions.

4. Management accounting is a convenient tool for evaluation of **Performance**.
5. The officer entrusted with the management accounting functions in an organization is called **Management Accountant**.
6. Management accountant is also called as **Management Controller**.
7. Publications of management accounting statement are not **Compulsory**.
8. Management accounting is suitable for large **industrial and trading concerns**.
9. Management accounting depends on **financial** accounting which is its main source of information.
10. Management Accounting helps the management in **decision making**.
11. The Balance sheet and income statements are **Traditional** financial statements.
12. A **Comparative Balance Sheet** shows the value of assets and liabilities on two different dates.
13. The statement which report the figures as a percentage of some common base are called **Common Size** statements.
14. The relationship between two figures expressed mathematically is called a **Ratio**.
15. **Ratio analysis** is a technique for analysis and interpretation of financial statements.
16. Ratios calculated on the basis of the figures of the balance sheet are called **Balance sheet Ratios**.
17. **Gross profit ratio** express the relationship between gross profit and net sales.
18. The Ideal current ratio is **2:1**
19. Quick ratio is also called as **Acid – test** ratio.
20. **Trend** analysis is significant for forecasting and budgeting.

## UNIT – 2

1. A **Fund flow** statement is a report on the movement of funds or working capital.
2. The main purpose of fund flow statement is to analyses the **Financial operations** of the business.
3. Fund flow statement is a **Post** balance sheet exercise.
4. Transactions that increase the working capital are called **Sources of funds**.
5. Transactions that decrease the working capital are called **Applications of funds**.
6. **Working capital** is the difference between current assets and current liabilities.

7. The **Adjusted Profit and loss account** is prepared to ascertain the funds from operation.
8. Increase in working capital will appear on the **Application** side of fund flow statement.
9. Decrease in working capital will appear on the **Source** side of fund flow statement.
10. A **projected** fund flow statement is an instrument of allocation of resources.
11. The **Cash flow** statement shows the inflow and outflow of cash.
12. Cash flow statement helps in short – term financial decisions relating to **Liquidity**.
13. Increase in the amount of creditors results in **increase in cash**
14. The cash flow statement starts with **opening** cash balance and **ends** with closing cash balance.
15. Cash flow statement is prepared for **One** year.
16. Cash flow statement is significant for **Capital Budgeting** decisions.
17. In cash flow statement only **Cash receipts** and **Cash payments** are recorded.
18. **Increase** in current assets increase working capital.
19. Cash from operation is a **source** of cash.
20. **Cash form operation** is the result of cash from business activities and changes in current assets and current liabilities.

### UNIT – 3

1. Standard costing is a technique which aims at **Controlling** and **Reducing** Costs.
2. **Standard Costs** are predetermined cost.
3. Standard costing is an expensive technique for **Small** concern.
4. If the actual cost is less than the standard cost it is termed as **Favourable** variance.
5. If the actual cost is more than the standard cost is known as **Adverse** (or) **Unfavourable** variance.
6. The difference between the standard wages and actual wages is called **Labour cost variance**.
7. Labour rate variances arises due to **Unscheduled overtime**.
8. Material cost variance =  $(SQ*SP) - AQ*AP$ .
9. Material cost variance arises due to **Change in the price** of the materials.
10. Labour yield variance is a part of the **Labour efficiency** variance.
11. **Material Price Variance** is a part of material cost variance.
12. Labour efficiency variance =  $(SH-AH)*SR$ .

13. Material yield variance is a sub – variance of **Material usage** variance.
14. Variance are transferred to **Reserve** Account.
15. If the variance are favourable they are shown on **Liability** side of balance sheet.
16. If the variances are unfavourable they are shown on **Asset** side of balance sheet.
17. **Standard costing** is a cost control technique.
18. **Standard hours** represents output of different kinds expressed in terms of hours.
19. **Variance** is the difference between standard cost and actual cost.
20. Idle time variance represents the cost of **abnormal** wastage of time.

#### UNIT – 4

1. The excess of sales over the break even sales is known as **Margin of safety**.
2. The profit volume ratio is usually called as **P.V Ratio**.
3. **Key factor** is also known as limiting factor.
4. The difference between sales and cost of sales is known as **Profit**.
5. Expenses that do not vary with the volume of production are known as **Fixed expenses**.
6. Expenses that vary with the volume of production are called **Variable** expenses.
7. Contribution is also known as **Gross Margin**.
8. At break-even point the profits is **Zero**.
9. At break-even point the total cost is equal to **Total Revenue**.
10. The fixed and variable costs are charged to products in case of **Absorption** costing.
11. Under **marginal** costing, fixed cost is ignored for decision making.
12. Fixed cost is reduced from contribution is to find **profit**.
13. **Contribution** is excess of sales over variable cost.
14. Large angle of incidence indicates a **high** profit.
15. **Angle of incidence** is angle between sales and total cost lines.
16. **Break Even Point** is a point at which there is no profit or loss.
17. Marginal cost is alternatively called as **variable** cost.
18. **Break Even Chart** is a graphical representation of marginal costing.
19. Marginal costing is based on the principle of **variability of costs**.
20. **Make or buy** decision ignores fixed cost.

## UNIT -5

1. A **Budget** is a detailed plan of operation for specific future period.
2. **Budgeting** refers to the management action of formulating budgets.
3. Budgetary control enables the management to **decentralize** responsibility without losing control.
4. **Budget manual** lays down the objectives of the organization, responsibilities of all executives and the procedure to be followed for budgetary control.
5. Master budget is also called **summary** budget.
6. Budgets are **blue print** of the desired plan of action.
7. **Sales** budget is a budget of output to be sold.
8. A **Master** budget is a budget for operations of the entire organization.
9. Expand ZBB: **Zero Base Budget.**
10. Budgeting system **integrates** key managerial functions.
11. Budgetary control helps the management to plan and **control.**
12. Cash budget is a **short - term** budget.
13. Sales budget is a **functional** budget.
14. **Flexible** budget is prepared to know the costs at different levels of activity.
15. A **budget period** is the length of time for which a budget is prepared.
16. A budget which is prepared for more than one year is called **Long - term** budget.
17. **Control Ratios** are calculated for comparison of actual performance with budgets.
18. **Efficiency** Ratio shows the level of efficiency attained during a period.
19. **Budgetary control** is helpful in setting targets for the whole concern and achievement of the targets.
20. **Budget centres** are the specific segments of the organization for which budgets are prepared.