MANAGERIAL ACCOUNTING

Dr. Poonam M. Khadke

Unit 1
Basic Concepts

- Forms of Business Organization
- Meaning & Importance of Accounting in Business Organization
- Basic Concepts & terms used in accounting
- Difference between Capital & Revenue Expenditure, Capital & Revenue Receipts
- Users of Accounting Information
- Accounting Concepts & Conventions
- Fundamental Accounting Equation, Journal, Ledger and Trial Balance.

Forms of Business Organization

- Sole Proprietorship
- Partnership Firm
- Joint Stock Company
- Co- Operative Organization or Society

Sole Proprietorship

Features

- Sole ownership
- Contribution of owned or borrowed capital
- Management & Control in the hands of proprietor
- No sharing of Profit & Losses
- No sharing of risk
- No special legislation

Partnership Firm

Features

- More Persons
- Profit and Loss Sharing
- Contractual Relationship
- Existence of Lawful Business
- Utmost Good Faith and Honesty
- More Capital Available
- sharing of risk

Joint Stock Company

Features

- Incorporated Association
- Artificial person
- Distinct Legal Entity
- Perpetual Succession
- Common Seal
- Free transferability of shares
- Limited Liability
- Separate Property

Co-Operative Organization or Society

Features

- Voluntary Membership
- Open membership
- Finance contributed by members
- Limited or Unlimited liability of members
- Runs on democratic principles
- Service motive

Meaning of Accounting in Business Organization

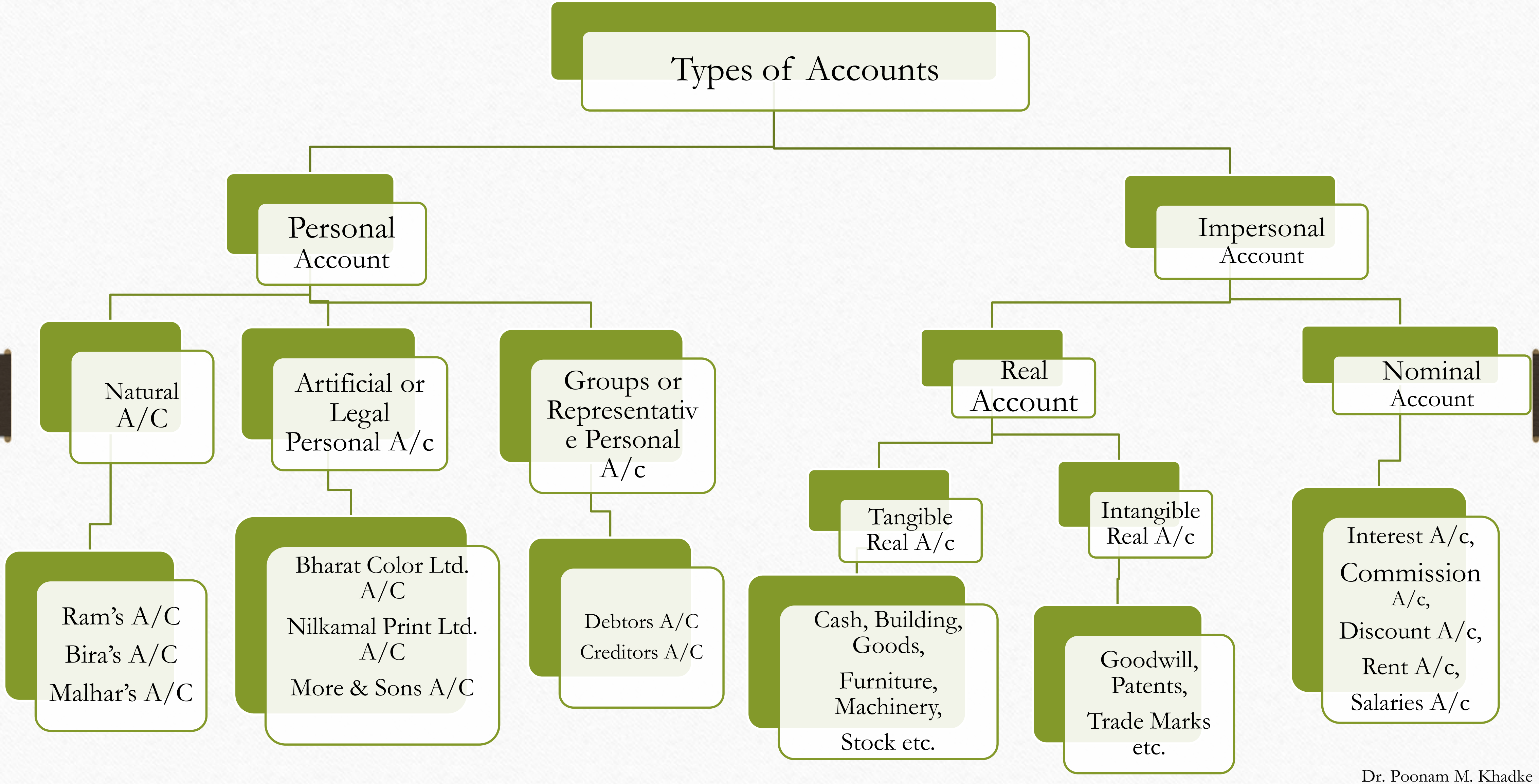
- Business accounting is the systematic recording, analyzing, interpreting and presenting of financial information. Accounting may be done by one person in a small business, or by different teams in large organizations.
- Accounting is the way a business keeps track of its operations. Accountants analyze the business finances so the owner can make better decisions. This information is organized into reports that show the financial health of a business.
- Accounting helps business owners meet their compliance obligations. It also helps them make smart decisions with their money.

Importance of Accounting in Business Organization

- **Keeps a record of business transactions**
- **Facilitates decision-making for management**
- **TCommunicates results**
- **To Meets legal requirements**
- **To Prevents the misuse of assets**
- **To ascertain the operational profit or loss**
- **To ascertain the true financial position of business**

Basic Concepts & terms used in accounting

- Debtors
- Creditors
- Assets
- Liability
- Capital
- Drawings
- Goods
- Account
- Transaction
- Capital Expenditure
- Revenue Expenditure
- Capital Receipts
- Revenue Receipts



Dr. Poonam M. Khadke

Rules of Debit & Credit for various Types of Accounts

Sr. No.	Types of Accounts	Debit	Credit
1.	Personal A/C	The Receiver	The Giver
2.	Real A/C	What Comes In	What Goes Out
3.	Nominal A/C	All Expenses & Losses	All Gains & Income

PERSONAL A/C

Natural or living

1. Mr. Ramesh's A/c.
2. Miss Rati's A/c
3. Mrs. Kapoor's A/c
4. Mr. Ravi's A/c
5. Raj's A/c

Artificial or legal

1. N.L. College A/c
2. Bank of India A/c
3. Bank A/c
4. Paras Classes A/c
5. Suchak Hospital A/c
6. Clubs A/c
7. Tata Ltd A/c
8. Asian Paints Ltd A/c
9. Nutan School A/c
10. Western Railway A/c
11. Government of India's A/c
12. Unexpired Insurance A/c
13. Unpaid wages A/c

Representative or Group

1. Capital A/c
2. Drawings A/c
3. Debtors A/c
4. Creditors A/c
5. Outstanding Rent A/c
6. Interest Payable A/c
7. Prepaid Insurance A/c
8. Salary paid in advance A/c
9. Interest Receivable A/c.
10. Pre-received commission A/c
11. Rent received in adv. A/c

Note: Outstanding (O/s) (accrued)/ Receivable/ Payable/Pre-received/prepaid/received in advance paid in advance/unexpired (pre-paid) /unpaid.

Rule of Personal Account
Debit the Receiver
Credit the Giver

REAL OR PROPERTIES A/C

Tangible real A/c

1. Cash A/c
2. Goods A/c
3. Machinery A/c
4. Stock A/c
5. Building A/c
6. Furniture A/c
7. Motor Car A/c

Intangible real A/c

1. Goodwill A/c
2. Patent Right A/c
3. Trade Marks A/c
4. Copy right A/c

Rule of Real A/c

Debit what comes in
Credit what goes out

(b) Nominal Account

These are the accounts of expenses or losses and incomes or gains. These accounts are called fictitious accounts as they do not represent any tangible asset. They exist only in name and cannot be seen or touched. A separate account is maintained for each head of expense or loss or income or gain. For example; interest account, commission account, discount account, postage and telegrams account, rent account, salaries account etc.

Nominal A/cs or Fictitious A/cs

1. Bank charges A/c
2. Rent A/c
3. Salaries A/c
4. Clearing charges A/c
5. Wages A/c
6. Audit fees A/c
7. Insurance Premium A/c
8. Printing & Stationery A/c
9. Repairs A/c
10. Loss by fire A/c
11. Advertisement A/c
12. Import Duty A/c
13. Brokerage A/c
14. Commission A/c
15. Carriage A/c or Cartage A/c
16. Postage and Telegram A/c
17. Membership fees /Subscription A/c
18. Sundry Expenses A/c
19. Royalties A/c
20. Freight A/c
21. Travelling Expenses A/c
22. Discount A/c
23. Dividend A/c
24. Interest A/c
25. Electricity Charges A/c
26. Purchase A/c
27. Sales A/c
28. Purchase Return A/c
29. Sales Return A/c

Rule of Nominal Account
Debit all expenses & losses
Credit all incomes & gains.

Dr. Poonam M. Khadke

Users of Accounting Information

1. Shareholders & Investors
2. Creditors
3. Management
4. Employees
5. Government
6. Tax Authorities
7. Customers
8. Public at large

Accounting Concepts & Conventions

A] Various Concepts of Financial Accounting

1. Entity Concept
2. Realisation Concept
3. Going Concern Concept
4. Periodic Matching of Cost & Revenue Principle
   1) Revenue Realisation Principle
   2) Matching Cost Principle
1. Disclosure Concept
2. Measurement Concept
3. Accrual Concept
4. Continuity Concept
5. Conservatism Concept

B] Various Conventions of Financial Accounting

1. Convention of Consistency
2. Convention of Full Disclosure
3. Convention of Conservatism
4. Convention of Materiality

Fundamental Accounting Equation

Asset = Liabilities + Owner’s Equity (Capital)

Meaning of Journal

- A journal is a detailed record of all transactions done by a business.
- The information recorded in a journal is used to reconcile accounts.
- Entries are usually recorded using a double-entry method.
- The double-entry method records a transaction in two (or more) entries.
- Each entry identifies the account affected, and whether the account is a credit or a debit. The totals of credits and debits must be equal.
- Single-entry bookkeeping is rarely used.

Format of Journal

In the books of Ananth

Journal entries

Date	Particulars		L.F.	Debit ₹	Credit ₹
2018					
Jan. 1	Cash A/c	Dr.		70,000	
	To Ananth's capital A/c				70,000
	(Commenced business with cash)				
2	Purchases A/c	Dr.		30,000	
	To X and Co. A/c				30,000
	(Credit purchases made)				
3	Bank A/c	Dr.		40,000	
	To Cash A/c				40,000
	(Cash deposited into bank)				
4	Buildings A/c	Dr.		95,000	
	To L and Co. A/c				95,000
	(Building bought on credit)				
5	Cash A/c	Dr.		5,000	
	To Bank A/c				5,000
	(Cash withdrawn from bank for office use)				

Meaning of Ledger

- A ledger in accounting is a book that contains different accounts where records of transactions pertaining to a specific account is stored.
- It is also known as the book of final entry or principal book of accounts.
- It is a book where all transactions either debited or credited are stored.
- A ledger account is a combination of all the ledgers and contains information related to all the accounting activities of an organisation.
- It is regarded as the most important book in accounting as it helps in creating a trial balance that acts as a precursor to the preparation of financial statements.

Meaning of Ledger

- The information stored in a ledger account contains both starting and ending balances which are adjusted during the course of the accounting period with respective debits and credits.
- A ledger contains different components which include the various transaction elements such as date, amount, particulars and l.f (ledger folio).

Ledger Format

Name of the Account

Dr.							Cr.
Date	Particulars	J.F.	Amount ₹	Date	Particulars	J.F.	Amount ₹

- **Following are some examples of ledger accounts**

1. Accounts receivable
2. Cash
3. Depreciation
4. Accounts payable
5. Salaries and wages
6. Revenue
7. Debt
8. Inventory
9. Office Expenses

Sr. No.	Transaction	Journal Entry	Type of Account	Effect
1.	Started a Business with Cash	Cash A/c ___________Dr. To Capital A/C	Real Personal	Comes in Giver
2.	Started business with a capital of – Plant, Bank , Stock	Plant A/c Dr. Bank A/c Dr. Stock A/c Dr. To Capital A/c	Real Personal	Comes in Giver
3.	Bought goods for cash	Purchase A/C ___________Dr. To Cash A/C	Nominal Real	Expenses Goes Out
4.	Bought goods on credit from Y	Purchase A/C ___________Dr. To Y's A/C	Nominal Personal	Expenses Giver
5.	Goods purchased and amount paid by cheque.	Purchase A/C ___________Dr. To Bank A/C	Nominal Personal	Expenses Giver
6.	Sold goods for cash	Cash A/C ____________Dr. To Sales A/C	Real Nominal	Comes in Income
7.	Goods sold to Pankaj Stores on credit	Pankaj Stores' s A/c ________Dr. To Goods A/C	Personal Real	Receiver Goes out
8.	Received interest on Investment	Cash A/C _______________Dr. To Interest A/C	Real Nominal	Comes in Income
9.	Paid Salary	Salary A/C ____________Dr. To Cash A/C	Nominal Real	Expenses Goes Out
10.	Paid rent out of personal cash	Rent A/C _______________Dr. To Capital A/c	Nominal Personal	Expenses Giver
11.	Paid to Rajnikant by Cash.	Rajnikant's A/C ________Dr. To Cash A/C	Personal Real	Receiver Goes out

Problem No.-1

Journalise the following transactions in the books of Mr. Roy

2015

April

1	He started business with a capital of – Plant ₹ 10,000, Bank ₹ 8,000, Stock ₹ 12,000
2	Bought furniture for resale ₹ 5,000
3	Paid rent out of personal cash for ₹ 2,000
8	Sold furniture out of those for resale ₹ 6,000
12	Paid Salary to Mr. X for ₹ 1,200
15	Purchased goods from Mr. Mukherjee for cash ₹ 3,000
18	Sold goods to Mr. Sen on credit for ₹ 8,000
20	Mr. Sen returned goods valued ₹ 1,000
22	Received cash from Mr. Sen of ₹ 6,500 in full settlement
28	Bought goods from Mr. Bose on credit for ₹ 5,000
30	Returned goods to Mr. Bose of ₹ 500 and paid to Mr. Bose ` 4,000 in full settlement.

In the Books of Mr. Roy
Journal Entries

Date	Particulars	L. F.	Debit (₹)	Credit (₹)
2015 Aprl.1	Plant A/c Dr.		10,000	
	Bank A/c Dr.		8,000	
	Stock A/c Dr.		12,000	
	To, Capital A/c			30,000
	[Being Plant, Bank, Stock introduced to the business]			
2	Purchase A/c Dr.		5,000	
	To, Bank A/c			5,000
	[Being furniture purchased for resale]			
	Furniture A/c Dr.		3,000	
	To, Bank A/c			3,000
	[Being furniture purchased for office decoration]			
3	Rent A/c Dr.		2,000	
	To, Capital A/c			2,000
	[Being rent paid out of personal cash]			
8	Cash A/c Dr.		6,000	
	To, Sales A/c			6,000
	[Being furniture out of those meant for resale are sold]			
12	Salary A/c Dr.		1,200	
	To, Bank A/c			1,200
	[Being salary paid to Mr. X]			

15	Purchase A/c Dr. To, Cash A/c [Being goods purchased]		3,000	3,000
18	Mr. Sen A/c Dr. To, Sales A/c [Being goods sold on credit to Mr. Sen]		8,000	8,000
20	Returns Inward A/c Dr. To, Mr. Sen A/c [Being goods returned from Mr. Sen]		1,000	1,000
22	Cash A/c Dr. Discount Allowed A/c Dr. To, Mr. Sen A/c [Being cash received from Mr. Sen in full settlement]		6,500 500	7,000
28	Purchase A/c Dr. To, Mr. Bose A/c [Being goods purchased from Mr. Bose on credit]		5,000	5,000
30	Mr. Bose A/c Dr. To, Cash A/c To, Returns Outward A/c To, Discount Received A/c [Being goods returned to Mr. Bose and paid cash in full settlement]		5,000	4,000 500 500

Meaning of Trial Balance

- A Trial Balance is a statement that keeps a record of the final ledger balance of all accounts in a business.
- It has two columns – debit and credit.
- Trial Balance is prepared at the end of a year and is used to prepare financial statements like Profit and Loss Account or Balance Sheet.
- The main objective of a Trial Balance is to ensure the mathematical accuracy of the business transactions recorded in a company’s ledgers.

Features of Trial Balance

- It is a list of the various ledger account balances whether debit or credit.
- It is prepared in the form of a statement.
- A firm prepares a trial balance in order to check the arithmetical accuracy of the ledger accounts.
- The arithmetical accuracy established by a trial balance is not proof that there are no mistakes in the books of accounts.
- A trial balance is usually prepared at the end of the accounting year. However, a firm may prepare it weekly, monthly, quarterly or half-yearly also.
- It does not form a part of the final accounts.
- It provides a summary of the ledger accounts.
- It serves as a link between the books of accounts and Trading & Profit and Loss A/c and Balance Sheet.

Format of Trial Balance

Stephan & Co.			
Trial Balance as on 31st April, 2023			
		Amount	
Sr. No.	Particulars	Debit (Dr.)	Credit (Cr.)
1	Cash-in-Hand	$12,000	
2	Accounts Receivable	$3,500	
3	Raw Materials	$5,000	
4	Equipment Purchase	$17,000	
5	Accounts Payable		$7,000
6	Common Stocks		$13,900
7	Employee Salaries		$2,900
8	Goods Sales		$19,500
9	Utility Expenses	$900	
10	Factory Lease	$1,900	
11	Loan Interest	$3,000	
	Total	$43,300	$43,300

Unit 2
Financial Statements

- Meaning of Financial Statements
- Importance and Objectives of Financial Statements
- Preparation of Final Accounts of sole proprietary firm

Concept

Financial statements are the Last stage of the Accounting Process

From Trial balance (list of all Expenses ,Incomes , Assets & liabilities), final A/cs are prepared.

Trial Balance : divided into two parts

Trading & P&L A/c	Balance Sheet
(Summary of all Incomes/expenses)	(Summary of Assets/Liabilities)
(Provides Net result)	(Provides Accumulated financial position)


Coverage
Final Accounts of a sole proprietorship concern
(Business of a Single owner)
Trading Industries
Manufacturing Industries
Trading A/c
Balance Sheet
Manufacturing A/c
(along with Trading, P&L A/c & Balance sheet)
P&L A/c
Note : Final accounts of Companies & Partnership will be discussed separately.

Manufacturing Account

Prepared by **manufacturing industries** (Conversion of raw material into Finished Goods)before preparation of Trading, P&L A/c

A Nominal A/c (records all the manufacturing expenses like Raw material Consumed, Wages, Manufacturing expenses)

Provides the **total Cost of goods produced- transferred to Trading A/c**

Also called as "Cost of Production" A/c

[Does not give any profit/loss]

Trading & P&L Account

Summarize all the Nominal Accounts

Periodic statements/Income Statement/Statement of Profit & Loss

Matching & Accrual Principle is needed to be followed

Consists all the revenue receipts(incomes) & expenditures(expenses)

Trading A/c
(Consists Direct transactions of goods)

P&L A/c
(indirect expenses & incomes)

Trading A/c

shows the operating performance of the business

Incomes & expenses directly relating to the goods/operations of the business
(Direct Incomes & Expenses)

For a Non Manufacturing concern, the direct expenses relating to goods come in trading Account (like Wages)

This gives the Gross Profit/Loss (specifically from Trading of Goods/Inventory)

Format

Format for Trading A/c

Trading A/c of ....for the Period Ending

Dr. Particulars	Amount Rs.	Particulars	Cr. Amount Rs.
To Opening Stock	--------	By Sales	--------
+ Purchases	--------	Less Returns inwards	--------
Less Returns outwards	--------	Closing Stock	--------
Direct Expenses	--------	Gross Loss transferred to P&L A/c	--------
Wages	--------		
Carriage inwards	--------		
Gross Profit Transferred to P&L A/c			
	--------		--------

Notes-Trading A/c

From Purchases: recoverable taxes/duties paid are to be deducted (Cenvat Credit: Current Asset)

From Sales: Indirect tax(Sales Tax) recovered from customer is to be included (payable to Govt.-Current Liability)

As per AS-2, the direct expenses: the expenses for bringing the goods to their factory location and making them marketable (finished goods)

e.g. Carriage inwards, freight, wages, insurance, power & fuel, etc.

Closing Entries–Trading A/c

Trading Account Dr.
To Opening Inventory Account
To Purchases Account
To Wages Account
To Direct expenses

Sales Account Dr.
Closing Inventory Account Dr.
To Trading Account

Trading Account Dr.
To P& L Account
(Trf of Gross Profit)

P&L A/c Dr.
To Trading A/c
(Trf of Gross Loss)

Trading Relations(Cost, Sales , Profit)

(Goods Sold at S.P.)
Sales

(Goods Sold at Cost)
Cost of goods Sold

Gross Profit

Cost of goods Sold : Op. Stock + Net Purchases + Direct Expenses – Closing Stock

Adjusted Purchases : Net purchases + Op. Stock – Cl. Stock

Stock Turnover Ratio(in times) : COGS/Avg. Stock

Gross Profit Ratio : GP/Sales *100

GP : on Sales/Cost

GP %age, needs to be reviewed : on Sales or On Cost

If given on a base, which is not available, to be calculated on other base

Assume the base of GP %age as 100

& correspondingly calculate the other base

If GP is 7.5% on Sales; Sales: 100, GP: 7.5, Cost(COGS): 92.5

If the GP %age is divisible by 100, say 25% on Sale

If GP is 1/x on sale, then $\frac{1}{x-1}$ on cost

If GP is 1/x on cost, then $\frac{1}{x+1}$ on sale

Profit & Loss A/c

Gross Profit/Loss in Trading A/c is Transferred to P&L

Records the business expenses & incomes not directly related to goods/operations
(Indirect Expenses/Incomes)

The expenses of P&L can be categorized as
Administrative, Finance, Depreciation , Selling & Distribution expenses
[Expenses: not in Trading A/c]

Profit & Loss A/c

Personal expenses(Drawings) should not be included, to be deducted from Capital A/c (Debited)

If Income(Cr. Side) > Expenses(Dr. Side): Net Profit
Net Loss if vice versa

Net Profit : Added to Capital A/c (Credited)
Net Loss : Deducted from Capital A/c (Debited)

Format

Particulars	Amount	Particulars	Amount
To Gross Loss b/d		By Gross Profit b/d	
Management expenses:		**Other income:**	
To Salaries		By Discount received	
To Office rent, rates and taxes		By Commission receive	
To Telephone charges		**Non-trading income:**	
To Postage and telegrams		By Bank interest	
To Insurance		By Rent of property let-out	
Maintenance expenses:		By Dividend from shares	
To Repairs and renewals		**Abnormal gains:**	
To Depreciation		By Profit on sale of machinery	
Selling and distribution expenses:		By Net Loss (transferred to Capital A/c) (Balancing Figure)	
To Carriage outwards			
To Bad debts			
To Provision for bad debts			
To Selling commission			
Financial expenses:			
To Bank charges			
Abnormal losses:			
To Loss on sale of machinery			
To Loss on sale of investment			
To Net Profit (transferred to Capital A/c) (Balancing Figure)			

Closing Entries

P&L A/c Dr.
To Salaries A/c
To Rent A/c
To Interest A/c
To Other Expenses A/c
(Items-debited)

Discount Received A/c Dr.
Bad debts Recovered A/c Dr.
To P&L A/c
(Items- Credited)

P&L A/c Dr.
To Capital A/c
(Net Profit)- Cr. Balance

Capital A/c Dr.
To P&L A/c
(Net Loss- Dr. Balance)

Balance Sheet

This is the last statement to be prepared in the Accounting Process/Final Accounts

(Not an A/c)

A Point Statement (depicts the accumulated financial position of the business since starting)

"Position Statement/ Statement of affairs"

"A Statement which sets out the assets & liabilities of a firm or an institution as at a certain date"

Balance Sheet

This provides the Accounting Equation

"Assets = Liabilities + Capital (Owner's equity)"

Every Transaction ultimately affect the Balance Sheet

Concepts used in B/S : **"Historical Cost & Separate business entity"**

This includes the balances of real & personal accounts.

Arrangement of Balance Sheet

Known as " Marshalling of Balance Sheet"

In Liquidity Order
(Short term assets:
easily be converted into cash
to Long term assets)

Permanence order
(Long term assets to Liquid assets)

Note : Generally the Permanence order is used.

Format (in Permanence order)

Liabilities	Amount	Assets	Amount
Capital Add : Net profit Less : Drawings **Long term Loans** Term Loans Loans on mortgages **Current Liabilities** Outstanding expenses Bank overdraft Sundry creditors Bills payable **Provision** Provision for taxation		**Tangible Fixed assets** Land and building Plant and machinery Furniture and fixtures **Intangible Fixed Assets** Goodwill Patents **Investments** **Current Assets** Stock Sundry debtors Investments Bills receivable Cash at bank Cash in hand	

Problem No. 1

The following trial balance has been extracted from the books of Mahesh on 31st March, 2017.

Debit balance	₹	Credit balance	₹
Drawings	44,000	Capital	1,76,000
Plant and machinery	1,00,000	Cash sales	1,72,000
Opening stock	20,000	Provision for bad and doubtful debts	2,000
Purchases	2,70,000	Bank overdraft	20,000
Wages	62,000	Discount received	6,000
Salaries	70,000	Credit sales	3,00,000
Insurance	45,000	Sundry creditors	24,000
Rent and taxes	17,000		
Sundry debtors	50,000		
Suspense A/c	22,000		
	7,00,000		7,00,000

The following adjustments are to be made:

(a) Stock on 31st December, 2017 was ₹ 28,000

(b) Unexpired insurance was ₹ 15,000

(c) Provision for doubtful debts is to be maintained at 5% on sundry debtors.

(d) Depreciate plant and machinery at 20%.

You are required to prepare trading and profit and loss account for the year ended 31st December, 2017 and a balance sheet as on that date.

Solution

In the books of Mahesh

Trading and Profit and Loss Account for the year ended 31st March, 2017

Dr. **Cr.**

Particulars	₹	₹	Particulars	₹	₹
To Opening stock		20,000	By Sales: Cash	1,72,000	
To Purchases		2,70,000	Credit	3,00,000	4,72,000
To Wages		62,000	By Closing stock		28,000
To Gross profit c/d		1,48,000			
		5,00,000			5,00,000
To Salaries		70,000	By Gross profit b/d		1,48,000
To Insurance	45,000		By Discount received		6,000
Less: Unexpired	15,000	30,000	By Provision for bad		
To Rent and taxes		17,000	and doubtful debts		
To Depreciation on plant			(opening)	2,000	
and machinery		20,000	Less: Closing		
(1,00,000 × 20%)			provision	1,000	1,000
To Net profit (transferred					
to capital A/c)		18,000			
		1,55,000			1,55,000

Balance Sheet as on 31st March, 2017

Liabilities	₹	₹	Assets	₹	₹
Capital	1,76,000		Plant & Machinery	1,00,000	
Add: Net profit	18,000		Less: Depreciation	20,000	80,000
	1,94,000		Stock-in-trade		28,000
Less: Drawings	44,000	1,50,000	Sundry debtors	50,000	
Sundry creditors		24,000	Less: Provision		
Bank overdraft		20,000	for bad and doubtful		
			debts (2%)	1,000	49,000
			Unexpired insurance		15,000
			Suspense A/c		22,000
		1,94,000			1,94,000

Unit 3
Cost Accounting

- Basic Concepts of Cost Accounting
- Objectives, Importance and Advantages of Cost Accounting
- Cost Centre, Cost Unit, Elements of Cost
- Classification and Analysis of Costs, Relevant and Irrelevant Costs
- Differential Costs, Sunk Cost, Opportunity Cost
- Preparation of Cost Sheet

Basic Concepts of Cost Accounting

1. Cost
2. Revenue & Expenses
3. Cost Accountancy
4. Costing
5. Cost Centre & Cost Unit
    a) Production or Producing Cost Centre
    b) Service Cost Centres

6. Profit Centre
7. Cost Control

Components of a Cost Sheet

Let us see what the different costs mean on a cost sheet:

1. **Prime Costs**

Under this header, you have to record all the expenses involved in the production process. This is also known as basic or first cost.

For example, if you have a textile store, your prime costs will be the costs of purchasing fabric from weavers, employee salaries, packaging, implements needed to measure and cut cloth, etc.

The formula for calculating prime costs is:

Prime Costs= Direct Labour + Direct Raw Material+Direct Expenses

2. **Works Cost**

Works cost is the sum of prime costs and overhead costs including factory expenses. Overhead costs are those costs that are not directly related to the production of a product but are required nevertheless. For example, you need to pay electricity bills to keep your production going. Similarly, there are several other taxes and utility costs that fall under the overhead costs category.

3. Cost of Production

Under this header, you should include all the expenses involved in business operations, including rents and work costs. The formula for calculating the cost of production is:

Cost of Production= (Work Costs)+(Administration Overhead Costs)-(Opening and Closing Stock of Finished Goods)

4. Cost of Sales

Cost of sales or total cost contains the details of all the expenses involved in the production and other costs involved in selling and distribution. This value will help you understand how much you spend on a product according to the resources used for producing it. You can decide your selling price according to the cost of sales and know how much profit you will earn from it.

Different Types of Costs

Costs are of four types:

1. **Fixed costs**

These costs are fixed, that is, they do not change according to the number of products. The price of your land or equipment are some examples of fixed costs.

2. **Variable costs**

These costs vary according to the number of products. Raw material and labour are some examples of variable costs.

3. **Operating costs**

Your business incurs these costs to maintain production daily. Utility costs, office supplies, travelling costs, etc. fall under this category.

4. **Direct costs**

These costs are directly connected to production. For example, if a car company produces a car in four days, the raw materials and labour involved in the production form the direct cost of the car.

How to Prepare a Cost Sheet?

Here is a step-by-step guide to preparing a cost sheet:

Step 1:

Prime Cost = Direct Material Consumed + Direct Wages + Direct Expenses

Direct Material Consumed = Direct Material Purchased + OP Stock of Raw Material – CL Stock of Raw Material

Step 2:

Works Cost = Prime Cost + Factory Overheads + OP Stock Work in Progress – CL Stock Work in Progress

Step 3:

Cost of Production = Works Cost + Office and Administration Overhead + OP Stock of Finished Goods – CL Stock Finished Goods

Step 4:

Total Cost = Cost of Production + Selling and Distribution Overheads

Profit: Sales – Total Cost

Unit 4

Short Term Business Decision Techniques – Marginal Costing

- Meaning, Principles, Advantages and Limitations
- Contribution, P/V Ratio, Break-Even Point (BEP), Cost Volume Profit (CVP) Analysis
- Short Term Business Decisions–Product Mix Decisions
- Make or Buy (Outsourcing) Decisions
- Accept or Reject Special Order Decisions, Shutting Down Decisions.

Marginal cost is defined as the aggregate of variable costs that is prime cost and variable overheads. Total cost of production =

Direct Labour		
+ Direct Material		
+ Direct Expenses	= Prime Cost	
+ Variable Overhead	=Prime Cost+ Variable Overhead	=Variable Cost/ Marginal Cost
+ Fixed Overhead	= Variable Cost +Fixed Overhead	=Total cost of Production

DEFINITION & MEANING

- **Definition :-**
  Marginal Costing is defined as the amount at any given volume of output by which aggregate costs can be changed if the volume of output is increased or decreased by one unit.

- **Meaning :-**
  Marginal Costing is the technique of controlling by bringing out the relationship between profit & volume.

INTRODUCTION

- The concept of Marginal Costing is also known as variable costing because it is based on the behavior of costs that vary with the volume of output

- Hence, Marginal Costing classifies costs into 2 :-
  1. Fixed Cost
  2. Variable Cost

FIXED COST & VARIABLE COST

- **Fixed Cost :-**
  The expenditure remains same irrespective of output. This includes costs which a firm has to incur irrespective of units of production
  - ✓ Eg :- Building rent

- **Variable Cost :-**
  As the name suggests variable cost varies directly with output. It is directly proportional to volume of production
  - ✓ Eg :- Cost of raw materials

CONCEPT OF CONTRIBUTION

- Contribution is the profit before adjusting fixed cost
- It is an assumption that excess of sales over variable cost contributes to a fund not only which covers fixed cost but also provides some profit
- If, Contribution = Fixed cost, company achieves breakeven
- This concepts helps in taking Decisions like :-
  - Whether to produce or discontinue
  - Fixing up selling price of bulk orders

CONTRIBUTION = SALES – VARIABLE COST

MARGINAL COST INCOME STATEMENT

PARTICULARS	AMT (Rs.)	COST PER UNIT
SALES	1000	10
- VARIABLE COST	- 400	4
CONTRIBUTION	600	6
- FIXED COST	300	3
PROFIT	300	3

PROFIT VOLUME RATIO

- It is popularly known as P/V Ratio
- It expresses relationship between Contribution & Sales

$$\text{P/V RATIO} = \frac{\text{CONTRIBUTION}}{\text{SALES}} \times 100$$

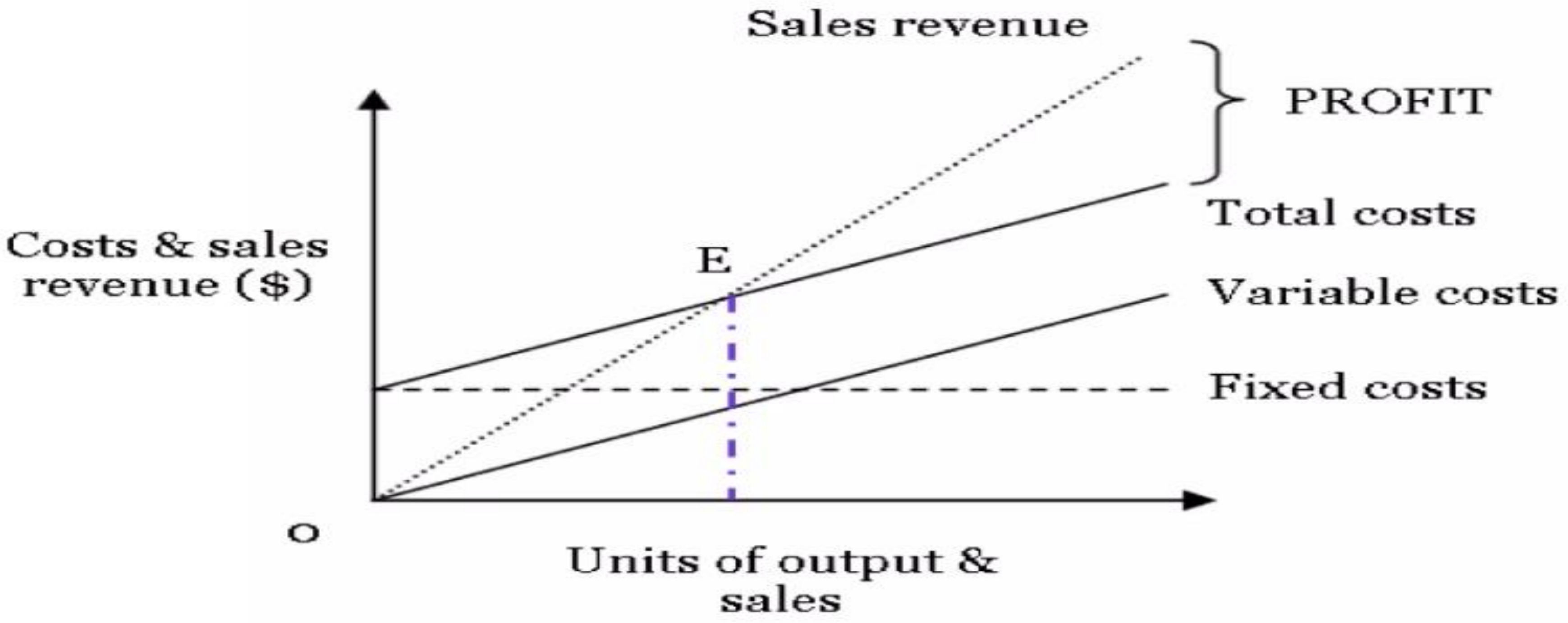
BREAK EVEN POINT

- It is that stage where firm is making NO PROFIT, NO LOSS
- Total sales revenue = Total costs incurred

$$\text{Breakeven Point (Units)} = \frac{\text{Total Fixed Cost}}{\text{Contribution per unit}}$$

$$\text{Breakeven Point (Rs.)} = \frac{\text{Total Fixed Cost}}{\text{P/V Ratio}} \times 100$$

BREAKEVEN ANALYSIS



MARGIN OF SAFETY

- It is the actual sales over & above the breakeven sales

- Thus it is the difference between actual & breakeven sales

Margin Of Safety = Actual Sales – Breakeven sales

$$\text{Margin Of Safety} = \frac{\text{Profit}}{\text{P/V Ratio}}$$

Unit 5

Exercising Control - Budgetary Control & Standard Costing: Budgetary Control

- Meaning of Budget and Budgeting, Importance, Advantages and Disadvantages
- Functional Budgets–Raw Material Purchase & Procurement Budget, Cash Budget and Flexible Budget
- **Standard Costing**: Meaning, Importance, Advantages and Disadvantages
- Cost Variance Analysis.
- **Material Variances**– Material Cost Variance, Material Rate Variance, Material Usage Variance, Material Mix Variance and Material Yield Variance.
- **Labour Variances** –Labour Cost Variance, Labour Rate Variance, Labour Efficiency Variance, Labour Mix Variance, Labour Idle Time Variance and Labour Yield Variance.

INTRODUCTION AND MEANING

- 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.
- Budgeting is a management device used for short-term planning and control rather than purely an accounting exercise.

WHAT IS THE BUDGET ..?

Budget is the systematic plan for utilization of all types of resources, at its command. |It acts as a barometer of a business as it measures the success from time to time, against the standard set for achievement.

Characteristics of Budget:

- Comprehensive Business Plan
- Prepared in Advance
- Definite period of time
- Expressed in quantitative form, physical or monetary terms, or both.
- System of proper Fixation of Authority & Responsibility has to be in place.

CLASSIFICATION OF BUDGETS…

On the basis of:-

- Time period:-
  - a) Long term budget:-(longer than one year)
  - b) Short term budget:-(less than one year)
- Conditions:-
  - a) Basic budget:- (unaltered over a period of time)
  - b) Current budget:-(use over a short period of time & related on current conditions)

CLASSIFICATIONS CON….

- Capacity:-

  a) Fixed budget:-(remain unchanged)

  b) Flexible budget:-(changed as per level of activity attained)

- Coverage:-

  a) Functional budget:-(relate to the individual function in organization)

  b) Master budget:-(consolidated summary of the various functional budgets)

TYPES OF FUNCTIONAL BUDGETS..

1. Sales Budget.
2. Production Budget.
3. Production Cost Budget.
4. Raw Materials Budget.
5. Purchases Budget.
6. Labour Budget.
7. Production Overhead Budget.
8. Selling and Distribution Cost Budget.
9. Administration Cost Budget
10. Capital Expenditure Budget.
11. Cash Budget.

WHAT IS BUDGETARY CONTROL..

According to Chartered Institution of Management Accountants, London:

" The establishment of budget relating to the responsibilities of executives to the requirements of a policy, and the continuous comparison of the actual with the budgeted result, either to secure by individual action the objective of the policy or to provide a basis for its revision"

Objectives of Budgetary Control..

- **Planning :** Budgetary control forces the management at all levels to plans, in time, all the activities to be done during the future period.

- **Coordination :** The Functions, be it production or marketing, are to be performed in a greater coordination for smooth completion & better results. Budget exercise develops team spirit amongst the employees to work in a coordinated manner.

  Budgetary Control forces executives to think & think as a group

OBJECTIVES OF BUDGETARY CONTROL..

- **Communication :** A budget is communication device. Budget cannot be achieved without communicating to the concerned, what is expected of them to achieve.

- **Control:** Control refers to that action, necessary to bring the performance according to the original plan.

Requisites for successful Budgetary Control

- Determination of the Objectives
- Proper delegation of Authority & Responsibility
- Proper Communication
- Participation of all employees
- Flexibility
- Motivation

ADVANTAGES OF BUDGETARY CONTROL

- Communication
- Motivation
- Management by Exception
- Overall Efficiency

LIMITATIONS OF BUDGETARY CONTROL

- Uncertainty of future
- Problem of co-ordination
- Discourage efficiency
- Timely revision required
- Conflict among different department
- Depend upon support of top management

FLEXIBLE BUDGET

The expenses for the production of 5,000 units in a factory are given below:- (as per unit rate)

Materials	50
Labour	20
Variable overhead	15
Fixed overhead(50,000)	10
Admin exp(5% variable)	10
Selling exp(20% fixed)	6
Distribution exp(10% fixed)	5
Total cost per unit	116

Required budget for prepare for the 7,000 units & 9,000 units.

Production Activity per unit Rs.	7,000 units	9,000 units
Variable cost:		
Material cost	3,50,000	4,50,000
Labour cost	1,40,000	1,80,000
Variable overheads	1,05,000	1,35,000
Admin exp@0.50 p.u	3,500	4,500
Sell. exp@4.80 p.u	33,600	43,200
Distr'n exp@4.50 p.u	31,500	40,500
Total variable cost	6,63,600	8,53,200
Fixed cost		
Fixed overheads	50,000	50,000
Admin exp	47,500	47,500
Selling exp	6,000	6,000
Distribution exp	2,500	2,500
Total Fixed cost	1,06,000	1,06,000
Total cost of sale	7,69,600	9,59,200