DegreeLive

BBA	SEMESTER VI	UNIVERSITY OF KERALA	COURSE CODE: UK6DSCMGT302

ACCOUNTING FOR MANAGERS

EXAM REVISION NOTES

JOIN WHATSAPP CHANNEL →

MODULE I

COST AND MANAGEMENT ACCOUNTING FOUNDATIONS

Evolutionary Architecture of Accounting Disciplines: Corporate accounting comprises three specialized, interrelated branches: **Financial Accounting** records historical financial transactions in monetary terms according to GAAP and legal statutes to ascertain period net profit and balance sheet position for external stakeholders; **Cost Accounting** classifies, records, and allocates manufacturing and operational expenditures to ascertain cost per unit of product, contract, or service and provide cost control mechanisms; **Management Accounting** synthesizes financial and cost data into prospective operational intelligence, supplying internal executives with strategic decision-support metrics, budgetary controls, and performance evaluation tools without statutory format constraints.

Philosophical Distinction across Three Accounting Systems: The systems diverge across core operational parameters: **Primary Users:** External investors, banks, and tax regulators for financial accounting; internal factory supervisors and cost managers for cost accounting; and strategic enterprise leadership for management accounting. **Time Horizon:** Financial accounting is strictly retrospective and historical; cost accounting integrates historical costs with standard forward benchmarks; management accounting is forward-looking and prospective. **Statutory Mandate:** Financial accounting is legally compulsory under the Companies Act; cost accounting is compulsory for designated manufacturing sectors; management accounting is entirely voluntary. **Data Composition:** Financial accounting is confined strictly to monetary figures; management accounting combines monetary data with qualitative behavioral indicators.

Strategic Mandate of the Modern Management Accountant: The role has evolved from clerical scorekeeper to strategic financial business partner. Primary responsibilities include: **Scorekeeping** (maintaining accurate operational transaction records); **Attention Directing** (highlighting operational bottlenecks, cost overruns, and variance anomalies via management-by-exception); **Problem Solving** (evaluating alternative capital projects, pricing strategies, and supply chain choices); **Budgetary Coordination** (aligning divisional operating budgets with master corporate goals); and **Corporate Governance** (safeguarding internal financial control systems and regulatory compliance).

Cost Classification Taxonomies across Functional Dimensions: Costs are classified systematically to serve specific managerial purposes: **By Nature or Element:** Materials, Labor, and Overheads. **By Traceability:** Direct Costs (traceable directly to a cost object, such as raw cotton in textile weaving) and Indirect Costs (common joint overheads, such as factory lighting). **By Operational Function:** Production Overheads, Administrative Overheads, Selling Overheads, and Distribution Overheads. **By Behavioral Responsiveness:** Fixed Costs (invariant with volume within the relevant range), Variable Costs (linear variation with production volume), and Semi-Variable Mixed Costs. **By Managerial Decision Relevance:** Opportunity Costs, Sunk Costs, Marginal Costs, Differential Costs, and Imputed Notional Costs.

Overheads Allocation, Apportionment, and Absorption: Managing factory overheads requires a three-stage methodology: **Overhead Allocation** charges whole items of cost directly to specific cost centers (e.g., salary of machine shop foreman); **Overhead Apportionment** distributes common indirect overheads among departments on equitable logical bases (e.g., factory rent apportioned by floor area; canteen expenses apportioned by employee headcount; electric power by kilowatt machine ratings); **Secondary Apportionment** redistributes service department costs to production departments using the Repeated Distribution Method or Simultaneous Equation Method. **Overhead Absorption** applies accumulated production overheads to individual cost units using predetermined absorption rates based on Direct Labor Hours or Machine Hours.

Under-Absorption and Over-Absorption of Factory Overheads: Occurs when absorbed overheads (Predetermined Rate multiplied by Actual Activity) differ from Actual Overheads incurred. If actual overheads exceed absorbed overheads, it represents **Under-Absorption** (under-recovery); if absorbed overheads exceed actual overheads, it represents **Over-Absorption** (over-recovery). Causes include inaccurate overhead estimation or unexpected capacity utilization fluctuations. Accounting disposal methods include: **Supplementary Overhead Rate** (adjusting cost of sales and finished inventory); **Transfer to Costing Profit and Loss Account** (standard treatment for abnormal variances); or **Carry Forward** to the subsequent financial period.

Anatomy and Sequential Architecture of the Cost Sheet: The Cost Sheet is a standardized analytical accounting statement that consolidates manufacturing and operating expenditures into a progressive cost hierarchy: **Prime Cost** equals Direct Materials Consumed plus Direct Labor plus Direct Chargeable Expenses; **Works (Factory) Cost** equals Prime Cost plus Factory Overheads plus Opening Work-in-Progress less Closing Work-in-Progress; **Cost of Production** equals Factory Cost plus Administrative Overheads related to production; **Cost of Goods Sold (COGS)** equals Cost of Production plus Opening Finished Goods less Closing Finished Goods; **Total Cost (Cost of Sales)** equals COGS plus Selling and Distribution Overheads. **Profit or Loss** represents the balancing difference between Total Cost of Sales and Net Sales Revenue.

Inventory Valuation Mechanics in Cost Ascertainment: Cost Sheets track inventory flows across three stages: **Raw Materials Consumed** equals Opening Raw Materials plus Purchases plus Freight Inward less Closing Raw Materials; **Work-in-Progress Inventory** is adjusted at the factory stage because factory overheads have already been applied to uncompleted goods; **Finished Goods Inventory** is adjusted after administrative production overheads are added, ensuring inventory carrying values reflect full factory and production absorption costs.

Cost Centers and Cost Units Foundations: A **Cost Center** is a distinct location, person, or equipment item for which costs are segregated and controlled, divided into **Production Cost Centers** (where manufacturing physically occurs, e.g., machining shop) and **Service Cost Centers** (providing auxiliary support, e.g., boiler house, maintenance crib). A **Cost Unit** is a standardized physical unit of product or service in terms of which costs are expressed (e.g., per tonne of steel, per barrel of petroleum, per passenger-kilometer in transport, per patient-bed-day in hospitals).

MODULE II

MARGINAL COSTING AND COST-VOLUME-PROFIT ANALYSIS

Theoretical Foundations of Marginal Costing: Marginal costing (variable costing) charges only variable manufacturing costs (direct materials, direct labor, direct expenses, variable factory overheads) to production units as inventoriable product costs. **Fixed Overheads** are treated strictly as **Period Costs** and expensed in full against the revenue of the period in which they accrue. Finished goods inventory is valued exclusively at marginal cost, eliminating misleading net profit fluctuations caused by changing inventory volumes under absorption costing.

Cost Behavior and Mathematical High-Low Segregation: Semi-variable mixed costs contain fixed baseline overheads plus variable volume-linked costs. Under the high-low method, unit variable cost equals the difference between total costs at highest and lowest activity divided by the difference in activity units; total fixed cost equals total cost at highest activity minus the product of unit variable cost and highest activity units. Under marginal costing, variable cost per unit remains constant while fixed cost per unit declines inversely with output expansion.

DegreeLive

Contribution Margin and the Fundamental Profit Equation: Contribution represents the excess of sales revenue over total variable cost. It first liquidates fixed costs; once fixed costs are recovered, each additional rupee of contribution directly increases net profit. The fundamental profit equation establishes: **Sales minus Variable Cost equals Fixed Cost plus Profit**, or **Contribution equals Fixed Cost plus Profit**. When contribution is less than fixed cost, the enterprise incurs an operating loss.

Profit-Volume (P/V) Ratio Mechanics: The P/V ratio expresses contribution as a percentage of sales revenue, calculated as Contribution divided by Sales multiplied by 100, or unit contribution divided by unit selling price. Across two consecutive accounting periods with identical cost structures, P/V ratio equals the change in profit (or contribution) divided by the change in sales revenue multiplied by 100. A high P/V ratio indicates strong profit generation per rupee of sales growth.

Break-Even Point (BEP) Determination: The break-even point is that operating volume where total sales revenue exactly equals total operational costs, yielding zero profit and zero loss. **BEP in Physical Units** equals Total Fixed Costs divided by Unit Contribution. **BEP in Sales Value (Rupees)** equals Total Fixed Costs divided by the P/V Ratio. To earn a target pre-tax profit, required sales value equals Total Fixed Costs plus Target Profit divided by the P/V Ratio.

Margin of Safety (MOS) and Angle of Incidence: The Margin of Safety represents the surplus of actual or projected sales over break-even sales, indicating the buffer by which sales can decline before the firm incurs losses. **MOS in Value** equals Actual Sales minus Break-Even Sales, or Net Profit divided by the P/V Ratio. In break-even graphical charts, the **Angle of Incidence** is the angle formed between the Total Sales Line and the Total Cost Line at the break-even intersection; a wide angle combined with a high MOS signifies exceptional profit-earning velocity beyond break-even.

Safety Margin Enhancement Strategies: Management can structurally widen the Margin of Safety through four proactive interventions: (1) raising selling prices when market demand elasticity permits; (2) engineering product formulations and procurement to lower variable input costs; (3) rationalizing avoidable fixed overheads to depress the break-even threshold; and (4) steering the sales mix actively toward high-contribution product lines.

Cash Break-Even and Cost Indifference Point Dynamics: The **Cash Break-Even Point** identifies sales volume needed to cover cash fixed costs only, calculated as Cash Fixed Costs (Total Fixed Costs minus Depreciation and Amortization) divided by Cash Contribution per Unit. The **Cost Indifference Point** identifies the specific operational volume where two alternative production technologies incur identical total costs, calculated as the Difference in Total Fixed Costs divided by the Difference in Unit Variable Costs. Above the indifference point, the high-fixed-cost automated option yields superior operating leverage.

Managerial Decision-Making Applications: Marginal costing provides differential cost intelligence for vital decisions: **Make or Buy:** In-house manufacture is justified if incremental marginal cost is lower than vendor purchase price under idle capacity; if capacity is constrained, opportunity cost (forgone contribution) must be added to make cost. **Key / Limiting Factor:** When an input resource (machine hours, scarce materials) is restricted, products are ranked and prioritized based on Contribution per Unit of the Limiting Factor. **Special Order Pricing:** Special low-price export orders are accepted if the offered price exceeds variable cost and domestic markets are uncompromised. **Plant Shutdown Point:** A factory should continue operating at a temporary loss if sales exceed the shutdown point (Avoidable Fixed Costs divided by Unit Contribution), because contribution offsets unavoidable fixed costs.

MODULE III

ANALYSIS AND INTERPRETATION OF FINANCIAL STATEMENTS

Conceptual Framework of Financial Statement Analysis: Financial statement analysis is the systematic process of evaluating relationships among items in the balance sheet, income statement, and cash flow statement to assess short-term liquidity, long-term solvency, operating efficiency, and overall profitability. Analysis transcends absolute monetary figures to reveal operational quality, financial health, risk exposures, and future enterprise earning potential.

Core Methodological Techniques of Analysis: Financial analysts deploy three classical comparative tools: **Comparative Financial Statements (Horizontal Analysis)** present two or more consecutive years of financial figures side-by-side, displaying absolute monetary changes and percentage shifts to track directional trends; **Common-Size Financial Statements (Vertical Analysis)** express all balance sheet line items as a percentage of Total Assets (100%) and all income statement line items as a percentage of Net Sales (100%), facilitating inter-firm size-neutral comparisons; **Trend Analysis (Base-Year Index Analysis)** establishes an initial base year as 100, expressing subsequent years as index percentages to trace long-term secular growth trajectories.

Liquidity and Short-Term Solvency Ratios: Liquidity ratios measure the enterprise's ability to satisfy immediate current obligations: **Current Ratio (Working Capital Ratio)** equals Total Current Assets divided by Total Current Liabilities, with an ideal benchmark of **2:1**; **Quick Ratio (Acid-Test Ratio)** equals Quick Assets (Current Assets minus Inventories and Prepaid Expenses) divided by Current Liabilities, with an ideal benchmark of **1:1**; **Absolute Cash Ratio** equals Cash, Bank Balances, and Marketable Securities divided by Current Liabilities, with an accepted standard of **0.5:1**.

Long-Term Capital Solvency and Leverage Ratios: Solvency ratios evaluate capital structure leverage and debt-servicing safety: **Debt-Equity Ratio** equals Long-Term Debt divided by Shareholders Equity (Net Worth), measuring creditor risk exposure relative to owners' funds (standard 2:1 or 1:1); **Proprietary Ratio** equals Shareholders Equity divided by Total Assets, indicating the proportion of assets financed by owners (ideal > 50%); **Interest Coverage Ratio (Times Interest Earned)** equals Earnings Before Interest and Tax (EBIT) divided by Fixed Interest Charges, indicating the operating profit safety margin for debt servicing (standard > 3.0 to 5.0 times).

Operating Efficiency and Asset Turnover Ratios: Turnover ratios measure the speed at which enterprise assets are converted into sales: **Inventory Turnover Ratio** equals Cost of Goods Sold divided by Average Inventory, indicating stock conversion velocity; **Inventory Holding Period** equals 365 divided by Inventory Turnover; **Debtors Turnover Ratio** equals Net Credit Sales divided by Average Trade Receivables, measuring credit collection velocity; **Average Collection Period (DSO)** equals 365 divided by Debtors Turnover; **Working Capital Turnover Ratio** equals Net Revenue divided by Net Working Capital.

Operating Cycle and Cash Conversion Cycle (CCC): The **Operating Cycle** is the time span between raw material acquisition and final cash collection from customers, calculated as Days Inventory Outstanding (DIO) plus Days Sales Outstanding (DSO). The **Cash Conversion Cycle (CCC)** deducts the Days Payables Outstanding (DPO), measuring net days operational cash is tied up before recovery. A compressed or negative CCC reflects superior working capital bargaining power over suppliers.

Profitability and Investment Return Ratios: Profitability ratios evaluate operational returns relative to sales and capital employed: **Gross Profit Ratio** equals Gross Profit divided by Net Sales multiplied by 100; **Net Profit Ratio** equals Net Profit After Tax divided by Net Sales multiplied by 100; **Operating Ratio** equals Cost of Goods Sold plus Operating Expenses divided by Net Sales multiplied by 100; **Return on Capital Employed (ROCE / ROI)** equals EBIT divided by Capital Employed (Net Worth plus Long-Term Debt) multiplied by 100; **Return on Equity (ROE)** equals Net Profit After Tax divided by Shareholders Equity multiplied by 100.

The DuPont Deconstructive Performance Framework: The classical **DuPont 3-Stage Model** breaks down Return on Equity into three operational drivers: **ROE equals Net Profit Margin multiplied by Total Asset Turnover multiplied by Equity Multiplier** (Profitability multiplied by Efficiency multiplied by Financial Leverage). The advanced **DuPont 5-Stage Model** isolates Tax Burden (PAT divided by EBT), Interest Burden (EBT divided by EBIT), Operating Margin (EBIT divided by Sales), Asset Turnover (Sales divided by Assets), and Financial Leverage Multiplier (Assets divided by Equity).

Financial Reporting Integrity and Forensic Solvency Diagnostics: Forensic financial analysts evaluate corporate reporting quality and structural distress risk using established predictive frameworks: The **Altman Z-Score Model** synthesizes working capital liquidity, cumulative retained earnings, operating profitability, financial leverage, and asset turnover into a composite bankruptcy index, where a score below 1.81 warns of imminent insolvency. Analysts scrutinize **Quality of Earnings** by comparing operating cash flow against reported net profit, flagging red flags such as unbilled revenue surges, aggressive capitalization of operating expenses, and deteriorating asset quality indices.

MODULE IV

FUNDS FLOW STATEMENT

The Concept of Funds on a Working Capital Basis: In financial statement analysis, funds is defined technically as **Net Working Capital**, representing the surplus of Total Current Assets over Total Current Liabilities. The **Flow of Funds** denotes a net movement (increase or decrease) in working capital. The governing rule establishes that a flow of funds occurs *if and only if* a transaction affects simultaneously **one Current Account and one Non-Current (Permanent) Account**. Transactions between two current accounts (e.g., paying creditors in cash) or between two non-current accounts (e.g., purchasing machinery by issuing shares) cause **No Flow of Funds**.

Schedule of Changes in Working Capital: This schedule lists all current assets and current liabilities for opening and closing dates to calculate the net increase or decrease in working capital. The governing mathematical rules establish: **An increase in a Current Asset increases Working Capital; a decrease in a Current Asset decreases Working Capital. An increase in a Current Liability decreases Working Capital; a decrease in a Current Liability increases Working Capital.** The net balancing change derived in this schedule must equal the net increase or decrease derived in the final Funds Flow Statement.

Calculation of Funds from Operations (FFO): Accounting net profit reflects non-cash and non-operating debits and credits that do not represent operational working capital movements. FFO reconstructs genuine operational funds generated by core business activities. In the Add-Back Statement Method, FFO is calculated as: **Closing Surplus minus Opening Surplus plus Non-Cash / Non-Operating Debits (Depreciation, Goodwill Amortized, Loss on Sale of Fixed Assets, Tax Provision, Transfers to Reserves, Proposed Dividend) minus Non-Operating Credits (Profit on Sale of Fixed Assets, Dividend Received).** If the resulting figure is negative, it represents **Funds Lost in Operations**.

Classification of Sources and Applications of Funds: The Funds Flow Statement balances total long-term capital inflows against long-term capital deployments: **Sources of Funds:** Funds from Operations (FFO), Fresh Issue of Equity and Preference Shares for Cash, Issue of Debentures, Raising of Long-Term Loans, Sale Proceeds from Disposal of Fixed Assets and Long-Term Investments, and Net Decrease in Working Capital. **Applications of Funds:** Funds Lost in Operations, Redemption of Preference Shares and Debentures, Repayment of Long-Term Loans, Purchase of Fixed Assets and Investments, Payment of Corporate Income Taxes, Payment of Dividends, and Net Increase in Working Capital.

Accounting Adjustments in Funds Flow Statement: Key operational ledger treatments include: **Provision for Taxation:** When treated as an appropriation (non-current liability), current year tax provision is added back in FFO, while actual tax paid is an Application of Funds. **Proposed Dividend:** Previous year proposed dividend is assumed paid during the current year (Application), while current year proposed dividend is added back in FFO. **Interim Dividend:** An interim dividend declared and paid within the identical financial period is simultaneously added back to Net Profit in FFO and recorded as an Application of Funds. **Asset Disposal with Provision for Depreciation:** Disposed asset gross cost is credited to the asset account; accumulated depreciation on the disposed asset is debited to depreciation provision; cash sale proceeds is a Source of Funds; loss on sale is added back in FFO; and depreciation provided for surviving assets is added back in FFO. **Non-Fund Transactions:** Transactions that do not impact working capital (e.g., issue of equity shares for purchase of machinery, conversion of debentures into equity shares) are excluded from the Funds Flow Statement and disclosed via footnotes.

MODULE V

CASH FLOW STATEMENT (AS 3 / IND AS 7)

Regulatory Architecture and Statutory Mandate: Governed in India by **Accounting Standard 3 (AS 3)** and **Indian Accounting Standard 7 (Ind AS 7)**, the Cash Flow Statement is a statutory financial document mandated under Section 133 of the Companies Act, 2013 for all listed entities and corporate enterprises. While income statements operate on the accrual basis of accounting (recognizing revenues earned and expenses incurred irrespective of cash receipt or payment), the Cash Flow Statement operates strictly on the **Cash Basis of Accounting** to explain movements in liquid financial resources.

Cash and Cash Equivalents Definition: Under AS 3 and Ind AS 7, cash flows encompass movements across: **Cash:** Cash in hand and demand deposits with commercial banking institutions. **Cash Equivalents:** Highly liquid short-term investments readily convertible into known amounts of cash with insignificant risk of value fluctuation, carrying an original maturity of **three months (90 days) or less** from acquisition date (e.g., 91-day Government Treasury Bills, commercial paper, money market liquid mutual funds).

Tripartite Classification of Corporate Cash Flows: Every corporate cash movement is classified into one of three standardized activities: **Operating Activities:** Principal revenue-generating activities of the enterprise, reflecting cash collections from customer sales and cash payments to merchandise suppliers, employees, and tax authorities. **Investing Activities:** Acquisition and disposal of long-term property, plant, equipment, intangible assets, and non-current financial securities. **Financing Activities:** Activities that alter the size and composition of equity capital and enterprise borrowings, including share allotments, debenture issues, loan drawdowns, loan repayments, and dividends paid.

Direct versus Indirect Operating Cash Flow Methodologies: Direct Method: Analyzes major classes of gross operational cash receipts (cash collected from customers) and gross operational cash payments (cash paid to suppliers, employees, operating expenses, and income tax paid). **Indirect Method:** Reconciles Net Profit Before Tax and Extraordinary Items by: adding non-cash charges (depreciation, amortization) and financing costs (interest paid); deducting non-operating gains (profit on asset sales); adjusting for operational working capital changes (adding decreases in current assets and increases in current liabilities; deducting increases in current assets and decreases in current liabilities); and finally deducting direct corporate taxes paid.

Industry Classification of Interest and Dividends: Under AS 3 and Ind AS 7: For **Non-Financial Manufacturing/Trading Enterprises**, Interest Paid and Dividends Paid are classified as **Financing Activities**, while Interest Received and Dividends Received are classified as **Investing Activities**. For **Financial Enterprises (Banks / NBFCs)**, Interest Paid, Interest Received, and Dividends Received are classified as **Operating Activities**, while Dividends Paid remains a **Financing Activity**.

Cash Flow Life-Cycle Diagnostics and Free Cash Flow: Corporate life-cycle health is diagnosed by evaluating cash flow directionality: **Start-Up:** Operating (-), Investing (-), Financing (+); **Growth:** Operating (+), Investing (-), Financing (+); **Mature Cash Cow:** Operating (+), Investing (-), Financing (-); **Distress:** Operating (-), Investing (+), Financing (-). **Free Cash Flow to Firm (FCFF)** represents Operating Cash Flow minus Mandatory Capital Expenditures (CapEx). **Free Cash Flow to Equity (FCFE)** equals FCFF minus net debt repayments minus after-tax interest payments, measuring discretionary cash flow attributable to equity holders. **Cash Flow Diagnostic Ratios: Cash Flow Margin** equals Operating Cash Flow divided by Net Sales multiplied by 100; **Cash Debt Coverage** equals Operating Cash Flow divided by Total Debt; and **Earnings Quality Index** equals Operating Cash Flow divided by Net Profit After Tax.

DegreeLive