MASTER OF BUSINESS ADMINISTRATION (MBA)

ACCOUNTING FOR MANAGERS

Sub code-CP-106

Unit- I

What Is Financial Accounting?

Financial accounting is a specific branch of accounting involving a process of recording, summarizing, and reporting the myriad of transactions resulting from business operations over a period of time. These transactions are summarized in the preparation of financial statements—including the balance sheet, income statement, and cash flow statement—that record a company's operating performance over a specified period.

Work opportunities for a financial accountant can be found in both the public and private sectors. A financial accountant's duties may differ from those of a general accountant, who works for themself rather than directly for a company or an organization.

- Financial accounting is the framework that dictates the rules, processes, and standards for financial recordkeeping.
- Non-profits, corporations, and small businesses use financial accountants to prepare their books and records and generate their financial reports.
- Financial reporting occurs through the use of financial statements, such as the balance sheet, income statement, statement of cash flow, and statement of changes in shareholder equity.
- Financial accounting differs from managerial accounting, as financial reporting is for reporting to external parties, while managerial accounting is for internal strategic planning.
- Financial accounting may be performed under the accrual method (recording expenses for items that have not yet been paid) or the cash method (only cash transactions are recorded).

concepts in accounting

1. Business entity concept

The business entity, economic entity or separate entity concept assumes that a business is independent of its owner. A business may not record its owner's personal expenses, income, liabilities and assets. It aids in tracking a business's expenses, incomes and tax deductions without any ambiguity. In addition, it safeguards a business owner's personal finances and helps build their creditworthiness. It reflects cash flow and financial position more accurately.

2. Going concern concept

Going concern concept prescribes that accountants prepare financial statements on the assumption that a business may continue its operations for the foreseeable future. Under this concept, the definition of a foreseeable future is a period of 12 months from the end date of the reporting period. If a business owner or the management is invested in scaling down business operations to zero, they cannot apply the going concern concept for accounting.

3. Money measurement concept

This is an accounting concept based on assumption, and it stipulates that companies record only those transactions that they can quantify and measure in terms of money. If they cannot assign a monetary value to a transaction, they do not record it in their annual financial statement. Though these transactions affect a company's financial performance, they may not find a place in financial statements, as monetising them can be challenging.

4. Accounting period concept

The accounting period concept prescribes a timeframe within which a business records and reports its financial performance for the purview of internal and external stakeholders. An accounting period of a company may coincide with the fiscal year. A company can determine a timeframe for internal reporting, like three or six months, or prepare monthly financial reports to analyse their cash flow positions.

5. Accrual concept

Accrual is a fundamental concept that guides how a business can record cash or credit transactions. Under this concept, a business records a financial transaction in the period it occurs. It does not consider whether the business pays or receives cash at the time of the transaction, or if it pays cash after a certain period.

Importance of Financial Accounting

Companies engage in financial accounting for a number of important reasons.

- Creating a standard set of rules – By delineating a standard set of rules for preparing financial statements, financial accounting creates consistency across reporting periods and different companies.
- Decreasing risk – Financial accounting does this by increasing accountability. Lenders, regulatory bodies, tax authorities, and other external parties rely on financial information; financial accounting ensures that reports are prepared using acceptable methods that hold companies accountable for their performance.
- Providing insight to management – Though other methods such as managerial accounting may provide better insights, financial accounting can drive

strategic concepts if a company analyses its financial results and makes reactionary investment decisions.

- Promoting trust in financial reporting – Independent governing bodies oversee the rules of financial accounting, making the basis of reporting independent of management and a highly reliable source of accurate information
- Encouraging transparency – By setting rules and requirements, financial accounting forces companies to disclose certain information on how operations are going, and what risks the company is facing, painting an accurate picture of financial performance regardless of how well or poorly the company is doing.

Scope of Accounting

Reporting the account statement to various stakeholders highlights the scope of accounting. Various parties in various forms use this information for their benefit and the benefit of the company.

Financial accounting keeps the company's various stakeholders updated about its financial health. It should help each stakeholder make decisions regarding the company's business. For example, it allows shareholders to understand the profit-making subsidiaries of the business. To indirect and direct investors, it gives them an idea of whether the company is worth investing in or not. Employees need to stay updated about it too, so they know whether the company they are working in is in good financial health or not.

- Reporting to shareholders: Shareholders are entities who invest their money in the business seeking profit from their investment. Since they have invested their own money in the business, they need to be reported on the overall financial position of the company involving the number of outstanding loans, assets, expenses, revenue streams, and so on.
- Reporting to the Public: The companies listed on the stock exchange are the ones in which the general public can also invest. Since the public also becomes an investor, account statements have to be made public so that they are fully aware of their investment choices.
- Reporting to Government: It is necessary for tax purposes. Governments need to be aware of the financial position of the businesses which come under their jurisdiction.
- Reporting to employees: Employees are indirect stakeholders and they must know about the company's financials which helps them stay informed regarding their job security.

Principles of Financial Accounting

- Revenue Recognition Principle – This states that revenue should be recognized when it has been earned. It dictates how much revenue should be recorded, the timing of when that revenue is reported, and circumstances in which revenue should not be reflected within a set of financial statements.
- Cost Principle – This states the basis for which costs are recorded. It dictates how much expenses should be recorded for (i.e. at transaction cost) in addition to properly recognizing expenses over time for appropriate situations (i.e. a depreciable asset is expensed over its useful life).
- Matching Principle – This states that revenue and expenses should be recorded in the same period in which both are incurred. It strives to prevent a company from recording revenue in one year with the associated cost of generating that revenue in a different year. The principle dictates the timing in which transactions are recorded.
- Full Disclosure Principle – This states that the financial statements should be prepared using financial accounting guidance that includes footnotes, schedules, or commentary that transparently report the financial position of a company. It dictates the amount of information provided within financial statements.
- Objectivity Principle – This states that while financial accounting has aspects of estimations and professional judgement, a set of financial statements should be prepared objectively. It dictates when technical accounting should be used as opposed to personal opinion.

What is double-entry accounting?

Double-entry accounting is a system of bookkeeping where every financial transaction is recorded in at least two accounts. A double-entry system provides a check and balance for each transaction, which helps ensure accuracy and prevent fraud. This accounting system also allows you to track business finances more effectively, and make better decisions about where to allocate your resources.

Account types

The five main types of accounts used in double-entry bookkeeping are:

- Asset accounts represent the resources of a business, such as cash, inventory, and equipment.
- Liability accounts represent the debts of a business, such as loans and accounts payable.
- Income accounts represent the revenue of a business, such as sales and interest income
- Expense accounts represent the costs of a business, such as rent and utilities.
- Equity accounts represent the funds invested in a business and the amount of profit left after operation costs, also known as, retained income.

Ledger Accounting

A ledger in accounting refers to 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.

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.

Ledger Format

The ledger consists of two columns prepared in a T format. The two sides of debit and credit contain date, particulars, folio number and amount columns. The ledger format is as follows.

Name of the Account

Dr. **Cr.**

Date	*Particulars*	*J.F.*	*Amount* ₹	*Date*	*Particulars*	*J.F.*	*Amount* ₹

Preparation of Trial Balance

Preparation of trial balance is the third step in the accounting process. First, we record the transactions in the journal. And then we post them in the general ledger. Then we prepare a trial balance to verify that the debit totals equal to the credit totals. Let us take a look at the steps in the preparation of trial balance.

1. To prepare a trial balance we need the closing balances of all the ledger accounts and the cash book as well as the bank book. So firstly every ledger account must be balanced. Balancing is the difference between the sum of all the debit entries and the sum of all the credit entries.
2. Then prepare a three column worksheet. One column for the account name and the corresponding columns for debit and credit balances.
3. Fill out the account name and the balance of such account in the appropriate debit or credit column

4. Then we total both the debit column and the credit column. Ideally, in a balanced error-free Trial balance these totals should be the same

5. Once you compare the totals and the totals are same you close the trial balance. If there is a difference we try and find and rectify errors. Here are some cases that cause errors in the trial balance

- A mistake in transferring the balances to the trial balance
- Error in balancing an account
- The wrong amount posted in the ledger
- Made the entry in the wrong column, debit instead of credit or vice versa
- Mistake made in the casting of the journal or subsidiary book

Rules for Preparation of Trial Balance

While preparation of trial balances we must take care of the following rules/points

1] The balances of the following accounts are always found on the debit column of the trial balance

- Assets
- Expense Accounts
- Drawings Account
- Cash Balance
- Bank Balance
- Any losses

2] And the following balances are placed on the credit column of the trial balance

- Liabilities
- Income Accounts
- Capital Account
- Profits

MASTER OF BUSINESS ADMINISTRATION (MBA)
ACCOUNTING FOR MANAGERS
Sub code-CP-106
Unit- II

Financial Statement Overview

Financial statement preparation is a crucial aspect of a company's financial management, involving the recording and reporting of its financial transactions and activities.

Financial statements provide a comprehensive overview of a company's financial performance, position, and cash flows, aiding in decision-making and financial analysis.

Proper financial statement preparation requires a thorough understanding of accounting principles, standards, and regulations, as well as attention to detail and accuracy in recording and reporting financial data.

Steps in Financial Statement Preparation

Identifying and Gathering Financial Data

The first step in financial statement preparation is identifying and gathering relevant financial data from a company's accounting records. This process involves collecting information on transactions, such as sales, expenses, investments, and borrowings, and organizing it in a systematic manner.

Adjusting and Classifying Transactions

After gathering financial data, accountants must adjust and classify transactions according to the appropriate accounting principles and standards.

Adjusting entries ensure that revenues and expenses are recorded in the correct accounting period, while classifying transactions involves grouping similar items into appropriate categories, such as assets, liabilities, revenues, and expenses.

Preparing Financial Statement Components

Once the transactions have been adjusted and classified, the next step is preparing the individual components of the financial statements, including the balance sheet, income statement, statement of cash flows, and statement of stockholders' equity.

Consolidation of Financial Statements (If Applicable)

If a company has subsidiaries or other related entities, it may need to prepare consolidated financial statements.

This process involves combining the financial information of the parent company and its subsidiaries to present a unified view of the entire corporate group's financial position and performance.

Finalizing and Presenting Financial Statements

After preparing the individual components and consolidating financial statements (if applicable), the final step is to review and finalize the financial statements.

This process ensures that all information is accurate, complete, and compliant with the relevant accounting standards. Once finalized, the financial statements are presented to the company's management, board of directors, and other stakeholders.

Profit and Loss Account and Balance Sheet

What is Profit and Loss Account- A profit and loss (P&L) statement, also known as an income statement, is a financial statement that summarizes the revenues, costs, expenses, and profits/losses of a company during a specified period. These records provide information about a company's ability to generate revenues, manage costs, and make profits.

What Is a Balance Sheet?

The term balance sheet refers to a financial statement that reports a company's assets, liabilities, and shareholder equity at a specific point in time. Balance sheets provide the basis for computing rates of return for investors and evaluating a company's capital structure.

Difference between the Balance Sheet and Profit & Loss Account

Balance Sheet	Profit & Loss Account
Definition	
A Balance sheet is a precise representation of the assets, equity and liabilities of the entity. This is outlined by every enterprise, a partnership enterprise or sole proprietorship firm. It reveals the financial security of the enterprise.	P&L a/c which also called a statement of revenue and expenses or an income statement. The account depicts the financial production of the enterprise in a specific time.
What exactly is it?	
Balance Sheet is a statement	P & L Account is an account
State of accounts	
Accounts added in balance sheet maintain their identity and are carried forward for the next accounting period	Accounts that get transferred to P & L account are closed and do not retain their identity
What does it represent?	
It represents the financial state of the business concern at a particular date	It represents the profit earned or the loss incurred by a business concern during an accounting period
What does it disclose?	
Capital of shareholders and the various assets and liabilities of the business	The gains and losses along with various incomes and indirect expenses taking place in the business during the accounting period
Order of creation	
Balance sheet is prepared after creating the P & L Account	P & L Account is prepared before creating the balance sheet

Depreciation Accounting

What Is Depreciation?

Depreciation is an accounting practice used to spread the cost of a tangible or physical asset over its useful life. Depreciation represents how much of the asset's value has been used up in any given time period. Companies depreciate assets for both tax and accounting purposes and have several different methods to choose from.

- Depreciation allows businesses to spread the cost of physical assets (such as a piece of machinery or a fleet of cars) over a period of years for accounting and tax purposes.
- There are several different depreciation methods, including straight-line and various forms of accelerated depreciation.
- Some methods of accounting for depreciation require that the business estimate the "salvage value" of the asset at the end of its useful life.

Depreciation is what happens when assets lose value over time until the value of the asset becomes zero, or negligible. Depreciation can happen to virtually any fixed asset, including office equipment, computers, machinery, buildings, and so on. One fixed asset that is exempt from depreciation is the value of land, which appreciates (increases) over time.

How to calculate depreciation

There are three main depreciation methods that anyone trying to find out how to calculate depreciation should familiarise themselves with. We'll explore these different types of depreciation in the next section. But before you can start to work out depreciation, you'll need to know a couple of key pieces of information:

- Useful life – This is essentially the length of time that an asset is considered to be productive. Beyond its useful life, it's no longer cost-effective to continue using the asset.
- Salvage value – After the useful life of the asset has concluded, you may wish to sell the asset at a reduced rate. This is referred to as the salvage value of the asset.
- Cost of asset – This is the full cost of the asset, including taxes, setup expenses, and shipping.

By including depreciation in your accounting records, your business can ensure that it records the right profit on the balance sheet and income statement. As depreciation is a highly complex area, it's always a good idea to leave it to the experts. Ensure that your company's accountant handles all calculations relating to depreciation. In addition, accounting software like Xero can do the maths automatically.

Types of depreciation

There are a couple of different depreciation methods that you can use. Here's a quick rundown of the three main types of depreciation:

1. Straight-line depreciation

This is the simplest depreciation method. Essentially, the value of the asset depreciates by the same amount each year, until it reaches zero. So, if an asset has a useful life of 10 years, its value would depreciate by 10% every year. You can calculate straight-line depreciation using the following formula:

Straight-Line Depreciation = (Asset Cost – Residual Value) / Useful Life

2. Units of production depreciation

In some cases, it makes more sense to calculate depreciation by measuring the work the asset does, rather than the time it serves. So, in this depreciation method, equal expense rates are assigned to each unit of production, meaning that depreciation is based on output capacity rather than number of years. There are two steps you'll need to go through to calculate units of production depreciation.

Firstly, you need to calculate the per-unit depreciation:

Per-Unit Depreciation = (Asset Cost – Residual Value) / Useful Life in Units of Production

Then, you'll need to calculate the total depreciation, based on the actual units that have been produced:

Total Depreciation = Per-Unit Depreciation x Units Produced

3. Double declining depreciation

Double declining depreciation is an accelerated form of depreciation, where a higher percentage of value is lost in the early stages of the asset's useful life. This is particularly useful when assets are consumed more rapidly during the first few years. You can calculate double declining depreciation as follows:

Depreciation = 2 x Straight-Line Depreciation Rate x Book Value at the Beginning of the Year

Why does depreciation matter?

Ultimately, depreciation accounting gives you a much better understanding of the true cost of doing business. To gain a more accurate picture of your company’s profitability, you’ll need to know depreciation, because as assets wear down and become less valuable, they’ll need to be replaced. Depreciation helps you understand how much value your assets have lost over the years, and if you don’t factor it into your revenue, it could mean that you’re underestimating your costs.

In addition, depreciation plays a key role in tax. Put simply, lower profits = lower taxes. If you aren’t accounting for depreciation, you could end up paying more tax. Gradually, you may be able to claim the entire value of a particular asset off your taxes. Depreciation is also important for valuing your business, as a depreciation in the value of your assets could mean that your business loses value as well. Plus, assets are often used to secure financing, so as they lose value, you may find it harder to get a loan.

MASTER OF BUSINESS ADMINISTRATION (MBA)
ACCOUNTING FOR MANAGERS
Sub code-CP-106
Unit- III

What Is Financial Statement Analysis?

Financial statement analysis is the process of analysing a company's financial statements for decision-making purposes. External stakeholders use it to understand the overall health of an organization and to evaluate financial performance and business value. Internal constituents use it as a monitoring tool for managing the finances.

What is a Comparative Statement?

A comparative statement is a document used to compare a particular financial statement with prior period statements. Previous financials are presented alongside the latest figures in side-by-side columns, enabling investors to identify trends, track a company's progress and compare it with industry rivals.

How Comparative Statements Work

Analysts, investors, and business managers use a company's income statement, balance sheet, and cash flow statement for comparative purposes. They want to see how much is spent chasing revenues from one period to the next and how items on the balance sheet and the movements of cash vary over time.

Cash Flow Statement

Every business must generate sufficient cash inflows to pay for operations. For example, managers may compare the ending balance in cash each month over the past two years to determine if the ending cash balance is increasing or declining. If company sales are growing, the manufacturer requires more cash to operate each month, which is reflected in the ending cash balance.

A downward trend in the ending cash balance means that the accounts receivable balance is growing and that the firm needs to take steps to collect cash faster.

Income Statement

A percentage of sales presentation is often used to generate comparative financial statements for the income statement — the area of a financial statement dedicated to a company's revenues and expenses. Presenting each revenue and expense category as a percentage of sales makes it easier to compare periods and assess company performance.

Comparative Statement Example

Assume, for example, that a manufacturer's cost of goods sold (COGS) increases from 30% of sales to 45% of sales over three years. Management can use that data to make changes, such as finding more competitive pricing for materials or training employees to lower labor costs. On the other hand, an analyst may see the cost of sales trend and conclude that the higher costs make the company less attractive to investors.

Comparative Statement Limitations

Comparative statements are less reliable when companies undergo huge changes. A big acquisition and move into new end markets can transform businesses, making them different entities from previous reporting periods.

For example, if Company A acquires Company B it may report a sudden sharp jump in sales to account for all the extra revenues that Company B generates. At the same time, profit margins might tighten at an alarming rate because Company B has a less lean manufacturing process, spending more money to produce the goods it sells.

What is Common Size Statement?

Common size statement is a form of analysis and interpretation of the financial statement. It is also known as vertical analysis. This method analyses financial statements by taking into consideration each of the line items as a percentage of the base amount for that particular accounting period.

Common size statements are not any kind of financial ratios but are a rather easy way to express financial statements, which makes it easier to analyse those statements.

Types of Common Size Statements

There are two types of common size statements:

1. Common size income statement
2. Common size balance sheet

1. Common Size Income Statement

This is one type of common size statement where the sales is taken as the base for all calculations. Therefore, the calculation of each line item will take into account the sales as a base, and each item will be expressed as a percentage of the sales.

Use of Common Size Income Statement

It helps the business owner in understanding the following points

1. Whether profits are showing an increase or decrease in relation to the sales obtained.
2. Percentage change in cost of goods that were sold during the accounting period.
3. Variation that might have occurred in expense.
4. If the increase in retained earnings is in proportion to the increase in profit of the business.
5. Helps to compare income statements of two or more periods.

6. Recognises the changes happening in the financial statements of the organisation, which will help investors in making decisions about investing in the business.

2. Common Size Balance Sheet:

A common size balance sheet is a statement in which balance sheet items are being calculated as the ratio of each asset in relation to the total assets. For the liabilities, each liability is being calculated as a ratio of the total liabilities.

Common size balance sheets can be used for comparing companies that differ in size. The comparison of such figures for the different periods is not found to be that useful because the total figures seem to be affected by a number of factors.

Standard values for various assets cannot be established by this method as the trends of the figures cannot be studied and may not give proper results.

Common Size Income Statement Format

The common size income statement format is as follows:

Common Size Income Statement
for the years ended ...

Particulars	Absolute Amounts		Percentage of Revenue from Operation (Net Sales)	
	Previous Year (₹)	Current Year (₹)	Previous Year (%)	Current Year (%)
(1)	(2)	(3)	(4)	(5)
I. **Revenue from Operations** (Net sales)	...	...	...	...
II. **Other Income**	...	...	...	...
III. **Total Revenue** (I + II)	...	...	...	...
IV. **Expenses**				
(a) Cost of Materials Consumed	...	...	...	...
(b) Purchases of Stock-in-trade	...	...	...	...
(c) Changes in Inventories of Finished Goods, Work-in-progress and Stock-in-trade	...	...	...	...
(d) Employess Benefit Expenses	...	...	...	...
(e) Finance Cost	...	...	...	...
(f) Depreciation and Amortisation	...	...	...	...
(g) Other Expenses	...	...	...	...
Total Expenses	...	...	...	...
V. **Profit before Tax** (III – IV)	...	..	..	...
VI. (–) Income Tax	...	...	...	...
VII. **Profit after Tax**	...	...	...	...

Preparing Common Size Balance Sheet

(1) Take the total of assets or liabilities as 100.

(2) Each individual asset is expressed as a percentage of the total assets, i.e., 100 and different liabilities are also calculated as per total liabilities. For example, suppose total assets are around Rs. 4 lakhs, and inventory value is Rs. 1 lakh. In that case, it will be counted as 25% of the total assets.

Limitations of Common Size Statement

Following are the limitations discussed

1. It is not helpful in the decision-making process as it does not have any approved benchmark.
2. For a business that is impacted by fluctuations due to seasonality, it can be misleading.

What Is Ratio Analysis?

Ratio analysis is a quantitative method of gaining insight into a company's liquidity, operational efficiency, and profitability by studying its financial statements such as the balance sheet and income statement. Ratio analysis is a cornerstone of fundamental equity analysis.

Types of Ratio Analysis

The various kinds of financial ratios available may be broadly grouped into the following six silos, based on the sets of data they provide:

1. Liquidity Ratios
Liquidity ratios measure a company's ability to pay off its short-term debts as they become due, using the company's current or quick assets. Liquidity ratios include the current ratio, quick ratio, and working capital ratio.

2. Solvency Ratios
Also called financial leverage ratios, solvency ratios compare a company's debt levels with its assets, equity, and earnings, to evaluate the likelihood of a company staying afloat over the long haul, by paying off its long-term debt as well as the interest on its debt. Examples of solvency ratios include: debt-equity ratios, debt-assets ratios, and interest coverage ratios.

3. Profitability Ratios

These ratios convey how well a company can generate profits from its operations. Profit margin, return on assets, return on equity, return on capital employed, and gross margin ratios are all examples of profitability ratios.

4. Efficiency Ratios

Also called activity ratios, efficiency ratios evaluate how efficiently a company uses its assets and liabilities to generate sales and maximize profits. Key efficiency ratios include: turnover ratio, inventory turnover, and days' sales in inventory.

5. Coverage Ratios

Coverage ratios measure a company's ability to make the interest payments and other obligations associated with its debts. Examples include the times interest earned ratio and the debt-service coverage ratio.

6. Market Prospect Ratios

These are the most commonly used ratios in fundamental analysis. They include dividend yield, P/E ratio, earnings per share (EPS), and dividend payout ratio. Investors use these metrics to predict earnings and future performance.

For example, if the average P/E ratio of all companies in the S&P 500 index is 20, and the majority of companies have P/Es between 15 and 25, a stock with a P/E ratio of seven would be considered undervalued. In contrast, one with a P/E ratio of 50 would be considered overvalued. The former may trend upwards in the future, while the latter may trend downwards until each aligns with its intrinsic value.

Cash Flow vs. Fund Flow: An Overview

There are generally four different kinds of financial statements in accounting: the balance sheet, the income statement, the cash flow statement, and the fund flow statement. Here, we delve into the final two.

In financial accounting, the statement of cash flows refers to the change in a company's cash and equivalents from one period to the next. The fund flow, however, has two different meanings. One is for accounting purposes, while the other serves investment purposes.

- A company's cash flow and fund flow statements reflect two different variables during a specific period of time.
- The cash flow will record a company's inflow and outflow of actual cash (cash and cash equivalents).
- The fund flow records the movement of cash in and out of the company.

Cash Flow

Cash flow is recorded on a company's cash flow statement. This statement—one of the main statements for a company—shows the inflow and outflow of actual cash (or cash-like assets) from its operational activities. It is a required report under generally accepted accounting principles (GAAP).

This is different from the income statement, which records data or transactions that may not have been fully realized, such as uncollected revenue or unpaid income. The cash flow statement, on the other hand, will already have this information entered and will give a more accurate portrait of how much cash a company is generating.

Cash flow sources can be divided into three different categories on a cash flow statement:

- Cash flows from operating activities: Cash generated from the general or core operation of the business would be listed in this category.
- Cash flows from investing activities: This section would cover any cash flow spent on investments like new equipment.
- Cash flows from financing activities: This category includes any transactions involving debtors, such as proceeds from new debts or dividends paid to investors.

Fund Flow

On the accounting side, the fund flow statement was required by GAAP between 1971 and 1987. When it was required, the statement of fund flow was primarily used by accountants to report any change in a company's net working capital, or the difference between assets and liabilities, during a set period of time. Much of this information is now captured in the statement of cash flow.

The fund flow highlights the movement of cash only—that is, it reflects the net movement after examining inflows and outflows of monetary funds. It will also identify any activity that might be out of character for the company, such as an irregular expense.

MASTER OF BUSINESS ADMINISTRATION (MBA)
ACCOUNTING FOR MANAGERS
Sub code-CP-106
Unit- IV

What is management accounting?

Managerial accounting, also called management accounting, is a method of accounting that creates statements, reports, and documents that help management in making better decisions related to their business' performance. Managerial accounting is primarily used for internal purposes.

Importance of managerial accounting

The main objective of managerial accounting is to assist the management of a company in efficiently performing its functions: planning, organizing, directing, and controlling. Management accounting helps with these functions in the following ways:

1. **Provides data:** It serves as a vital source of data for planning. The historical data captured by managerial accounting shows the growth of the business, which is useful in forecasting.

2. **Analyses data:** The accounting data is presented in a meaningful way by calculating ratios and projecting trends. This information is then analysed for planning and decision-making. For example, you can categorise purchase of different items period-wise, supplier-wise and territory wise.

3. Aids meaningful discussions: Management accounting can be used as a means of communicating a course of action throughout the organization. In the initial stages, it depicts the organisational feasibility and consistency of various segments of a plan. Later, it tells about the progress of the plans and the roles of different parties to implement it.

4. Helps in achieving goals: It helps convert organizational strategies and objectives into feasible business goals. These goals can be achieved by imposing budget control and standard costing, which are integral parts of management accounting.

5. Uses qualitative information: Management accounting does not restrict itself to quantitative information for decision-making. It takes into account qualitative information which cannot be measured in terms of money. Industry cycles, strength of research and development are some of the examples qualitative information that a business can collect using special surveys.

Scope of managerial accounting

The main objective of managerial accounting is to maximize profit and minimize losses. It is concerned with the presentation of data to predict inconsistencies in finances that help managers make important decisions. Its scope is quite vast and includes several business operations. The following points discuss what management accounting can do to make a business run better.

1. Managerial accounting is a rearrangement of information on financial statements and depends on it for making decisions. So the management cannot enforce the managerial decisions without referring to a concrete financial accounting system.

2. What you can infer from financial accounting is limited to numerical results like profit and loss, but in management accounting you can discuss the cause and effect relationships behind those results.

3. Managerial accounting uses easy-to-understand techniques such as standard costing, marginal costing, project appraisal, and control accounting.

4. Using historical data as a reference, the management observes the current information to check the impacts of business decisions.

5. Management can use this type of accounting to set objectives, format plans to meet them, and compare the performance of various departments.

6. Managerial accounting is used for forecasting. It concentrates on supplying information that would ease the effect of a problem rather than arriving at a final solution.

Techniques in Managerial Accounting

In order to achieve business goals, managerial accounting uses a number of different techniques.

- **Marginal analysis:** This assesses profits against various types of costs. It primarily deals with the benefits of increased production. It involves calculating the break-even point, which requires knowing the contribution margin on the company's sales mix. Here, sales mix is the proportion of a product that a business has sold when compared to the total sales of that business. This is used to determine the unit volume for which the business' gross sales are equal to total expenditures. This value is used by managerial accountants to determine the price points for various products.
- **Constraint analysis:** Managerial accounting monitors the constraints on profits and cash flow with respect to a product. It analyses the principal bottlenecks and the problems they cause, and calculates their impact on revenue, profit, and cash flow.

- **Capital budgeting:** This is an analysis of information in order to make decisions related to capital expenditures. In this analysis, the managerial accountants calculate the net present value and internal rate of return to help managers with capital budgeting decisions like calculating payback period or calculating accounting rate of return.
- **Inventory valuation and product costing:** This deals with determining the actual cost of goods and services. The process generally involves computing the overhead charges and assessment of direct costs associated with cost of goods sold.
- **Trend analysis and forecasting:** This primarily deals with variations in product costs. The resulting data is helpful in identifying unusual patterns and finding efficient ways to identify and resolve the underlying issues.

What Is Cost Accounting?

Cost accounting is a form of managerial accounting that aims to capture a company's total cost of production by assessing the variable costs of each step of production as well as fixed costs, such as a lease expense.

- Cost accounting is used internally by management in order to make fully informed business decisions.
- Unlike financial accounting, which provides information to external financial statement users, cost accounting is not required to adhere to set standards and can be flexible to meet the particular needs of management.
- As such, cost accounting cannot be used on official financial statements and is not GAAP-compliant.
- Cost accounting considers all input costs associated with production, including both variable and fixed costs.
- Types of cost accounting include standard costing, activity-based costing, lean accounting, and marginal costing.

Types of Costs

- Fixed costs are costs that don't vary depending on the level of production. These are usually things like the mortgage or lease payment on a building or a piece of equipment that is depreciated at a fixed monthly rate. An increase or decrease in production levels would cause no change in these costs.
- Variable costs are costs tied to a company's level of production. For example, a floral shop ramping up its floral arrangement inventory for Valentine's Day will incur

higher costs when it purchases an increased number of flowers from the local nursery or garden center.

- Operating costs are costs associated with the day-to-day operations of a business. These costs can be either fixed or variable depending on the unique situation.
- Direct costs are costs specifically related to producing a product. If a coffee roaster spends five hours roasting coffee, the direct costs of the finished product include the labor hours of the roaster and the cost of the coffee beans.
- Indirect costs are costs that cannot be directly linked to a product. In the coffee roaster example, the energy cost to heat the roaster would be indirect because it is inexact and difficult to trace to individual products.

Types of Cost Accounting

Standard Costing

Standard costing assigns "standard" costs, rather than actual costs, to its cost of goods sold (COGS) and inventory. The standard costs are based on the efficient use of labour and materials to produce the good or service under standard operating conditions, and they are essentially the budgeted amount. Even though standard costs are assigned to the goods, the company still has to pay actual costs. Assessing the difference between the standard (efficient) cost and the actual cost incurred is called variance analysis.

If the variance analysis determines that actual costs are higher than expected, the variance is unfavourable. If it determines the actual costs are lower than expected, the variance is favourable. Two factors can contribute to a favourable or unfavourable variance. There is the cost of the input, such as the cost of labour and materials. This is considered to be a rate variance.

Additionally, there is the efficiency or quantity of the input used. This is considered to be a volume variance. If, for example, XYZ company expected to produce 400 widgets in a period but ended up producing 500 widgets, the cost of materials would be higher due to the total quantity produced.

MASTER OF BUSINESS ADMINISTRATION (MBA)
ACCOUNTING FOR MANAGERS
Sub code-CP-106
Unit- V

Costing for Decision Making-Meaning

Costing for Decision Making involves using costing techniques and concepts to make management decisions. The management can use various cost accounting tools to determine the company's expenses and understand how it spends its money. Following are some vital facts about the same.

- It is essential to conduct a cost analysis for decision making in every company.
- In every managerial plan or decision, accounting for the costs that would affect or be affected by the plan is essential.
- It allows for better business decisions and more effective cash flow management.
- The cost concepts for decision making are essential for a business. It ensures the management moves ahead with the best plan, leading to company profits.

What is Marginal Costing?

Marginal costing definition: Marginal Costing is a decision-making technique for determining the total cost of production.

In marginal costing, variable cost is treated as product cost and fixed cost as period cost. And this type of costing is also known as variable costing. This technique accounts for the variable costs associated with the extra units produced. In this technique, fixed expenses are not considered because they do not vary due to on-going changes.

What is Absorption Costing?

Absorption costing definition: Absorption costing is calculating product costs considering fixed and variable costs.

Absorption costing is GAAP compliant, and contribution per unit is considered. The cost of an abortion is primarily used for external reporting to the government, tax authorities, and shareholders.

Abortion costs include direct manufacturing costs, such as direct labour and materials, and fixed overhead costs incurred during the production process, such as utility costs. Let’s go through an example to understand the term “absorption costing” in a better way.

Differences Between Marginal Costing And Absorption Costing

Understanding the difference between marginal costing and absorption costing helps in choosing the most appropriate costing method for your business. Here are the top 10 key differences:

Aspects	Marginal Costing	Absorption Costing
Cost Components	Considers only variable costs.	Considers both variable and fixed costs.
Profit Calculation	Fluctuates with sales volume changes.	More stable as it includes fixed costs.
Stock Valuation	Lower, as only variable costs are considered.	Higher, as it includes both variable and fixed costs.
Cost Control	Easier, as costs are closely tied to output.	More challenging, as fixed costs are included.
Cost Apportionment	No apportionment is required.	Requires apportionment of fixed costs.
Decision Making	More useful for short-term decisions.	Better suited for long-term pricing strategies.
Break-even Point	Easier to calculate.	Complex due to fixed costs consideration.
Effect on Competitive Pricing	High as pricing is based on variable costs.	Low, as pricing also includes fixed costs.
Impact on Profit	Profit changes with sales level.	Profit is stable until production exceeds sales.
Reporting Standards	Not in accordance with GAAP or IFRS.	In line with GAAP and IFRS.