

24BA1104

ACCOUNTING BUSINESS DECISION

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COURSE OBJECTIVES

- Acquire the basic concept of financial accounting.
- To analyze the financial statements.
- Understand the concept of Cost accounts and Marginal Cost.

UNIT I FINANCIAL ACCOUNTING

12

Introduction to Financial, Cost and Management Accounting – Generally accepted accounting principles– Double Entry System – Preparation of Journal, Ledger and Trial Balance- Preparation of Final Accounts: Trading, Profit and Loss Account and Balance Sheet - Reading the financial statements-Accounting standards and accounting disclosure practices in India - Digital Accounting.

UNIT II ANALYSIS OF FINANCIAL STATEMENTS

12

Accounting ratio - Classification of ratios: Profitability, Liquidity, Financial and Turnover ratio – Comparative statements - common size statements. Cash flow (as per Accounting Standard 3) and Funds flow statement analysis – SWOT Analysis in Financial statements.

UNIT III COST ACCOUNTING

12

Cost Accounting: Meaning – Objectives – Classification of cost – Cost sheet preparation – Costing methods: Job cost sheet – Job order costing – Process costing – (excluding Interdepartmental Transfers and equivalent production) – Joint and By Product Costing– Activity Based Costing, Target Costing.

UNIT IV MARGINAL COSTING

12

Marginal Costing and profit planning – Cost, Volume, Profit Analysis – Break Even Analysis – Decision making problems -Make or Buy decisions -Determination of sales mix - Exploring new markets - Add or drop products -Expand or contract.

UNIT V BUDGETING AND VARIANCE ANALYSIS

12

Budgetary Control – Sales, Production, fixed and flexible budget –overheads - Standard costing and Variance Analysis.

TOTAL: 60 PERIODS

TEXT BOOKS

1. R. Narayanaswamy, Financial Accounting, PHI, sixth edition, 2017.
2. T.S.Reddy & A. Murthy, Financial Accounting, Margham Publications, 2014
3. S.P.Jain and P.K.Narang, Financial Accounting, Kalyan Publisher, 2017

REFERENCES

1. M.Y.Khan & P.K.Jain, Management Accounting, Tata McGraw Hill, 8th edition, 2018.
2. JanWilliams, Susan Haka, Mark S Bettner, Joseph V Carcello, Financial and Managerial Accounting - The basis for business Decisions, 18th edition, Tata McGraw Hill Publishers, 2017
3. Charles T. Horngren, Gary L.Sundem, David Burgstahler, Jeff Schatzberg, Introduction to Management Accounting, PHI Learning, 2014, 16th edition.
4. Marshal B Romney, Paul J Steinbart, Accounting Information System, Pearson, 16th Edition, 2020
5. Jerry.J, Weygandt, Paul D kimmel, Donald. E.Kieso, Financial Accounting, Wiley, 2020

Mapping of COs and POs COs			POs		
PO1	PO2	PO3	PO4	PO5	
CO1	3	2	1	1	1
CO2	2	3	2	1	2
CO3	3	2	3	2	1
CO4	2	3	3	3	2
CO5	3	2	2	2	3
AVG	2.60	2.40	2.20	1.80	1.80

S24BA1104

ACCOUNTING BUSINESS DECISION

Introduction to Financial, Cost, and Management Accounting

1. Financial Accounting:

- Focus: Recording, summarizing, and reporting an organization's financial transactions.
- Goal: Provide financial information for external stakeholders (investors, regulators).
- Core Elements: Compliance with GAAP, preparation of **final accounts** (Profit and Loss Account, Balance Sheet).

2. Cost Accounting:

- Focus: Analyzing costs for internal decision-making.
- Goal: Optimize cost efficiency, pricing, and profitability.
- Techniques: Marginal costing, standard costing, activity-based costing.

3. Management Accounting:

- Focus: Providing actionable insights for management.
- Goal: Assist in strategic planning, budgeting, and performance evaluation.
- Tools: Ratio analysis, cash flow projections, and variance analysis.

Generally Accepted Accounting Principles (GAAP)

- **Definition:** A set of accounting standards and principles ensuring uniformity and transparency.
- **Key Features:**
 - **Consistency:** Same accounting methods applied across periods.
 - **Relevance:** Provide useful and timely information.
 - **Reliability:** Free from material errors.

- **Comparability:** Facilitates benchmarking across firms.
 - **Indian Context:** India follows IND AS converging with IFRS
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Double Entry System

- **Principle:** Every transaction has dual effects—debit and credit.
 - **Accounting Equation:**
$$\text{Assets} = \text{Liabilities} + \text{Equity}$$
 - **Key Rules:**
 - Debit: Increase in assets/expenses; decrease in liabilities/income.
 - Credit: Decrease in assets/expenses; increase in liabilities/income.
 - **Example:**
 - Purchased inventory for ₹10,000 on credit:
 - Debit: Inventory (Asset) ₹10,000
 - Credit: Accounts Payable (Liability) ₹10,000
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Preparation of Journal, Ledger, and Trial Balance

1. **Journal:**
 - Records day-to-day transactions chronologically.
 - Format: Date, Accounts Involved (Dr./Cr.), Amount, Narration.
 2. **Ledger:**
 - **Purpose:** Classifies journal entries into individual accounts.
 - **Structure:** T-Accounts with Debit and Credit sides.
 3. **Trial Balance:**
 - **Goal:** Verify mathematical accuracy (total debits = total credits).
 - **Steps:**
 - Extract ledger balances.
 - Arrange in debit/credit columns.
 - Ensure totals match.
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Preparation of Final Accounts

1. Trading Account:

- Calculates **gross profit**:
Gross Profit = Sales - (Cost of Goods Sold)
Includes direct expenses like purchases and wages.

2. Profit and Loss Account:

- Calculates **net profit**:
Net Profit = Gross Profit - Indirect Expenses + Other Incomes

3. Balance Sheet:

- Presents financial position as of a specific date:
 - **Assets**: What the company owns.
 - **Liabilities**: What the company owes.
 - **Equity**: Owner's interest in the business.

Reading Financial Statements

1. **Income Statement (P&L)**: Evaluates profitability.
2. **Balance Sheet**: Assesses financial stability.
3. **Cash Flow Statement**: Tracks cash inflows and outflows.
4. **Key Ratios**:
 - Liquidity Ratios: Current ratio.
 - Profitability Ratios: Net profit margin.
 - Solvency Ratios: Debt-to-equity ratio.

Accounting Standards and Disclosure Practices in India

- **Accounting Standards (Ind AS)**:
 - Set by ICAI and mandated for specific entities.
 - Examples:
 - **Ind AS 1**: Presentation of Financial Statements.
 - **Ind AS 7**: Statement of Cash Flows.
- **Disclosure Practices**:
 - Transparency through detailed notes on accounting policies.

- Compliance with Companies Act and SEBI guidelines.

Digital Accounting

- **Definition:** Use of technology to automate accounting tasks.
- **Examples:**
 - Cloud-based platforms (e.g., QuickBooks, Zoho Books).
 - Blockchain for immutable records.
 - AI for predictive analytics and fraud detection.
- **Benefits:**
 - Enhanced accuracy and real-time reporting.
 - Scalability for businesses.

What is a Journal?

1. **Definition:**
 - A **journal** is the primary book of accounting where all financial transactions are recorded chronologically using the **double-entry system**.
2. **Purpose:**
 - Ensure accurate recording of transactions.
 - Serve as the foundation for preparing ledgers and financial statements.
 - Provide a detailed, traceable history of all transactions.

Rules for Debit and Credit

The **double-entry system** requires every transaction to have equal debit and credit impacts. The rules are based on the nature of accounts:

Type of Account	Debit	Credit
Assets	Increase	Decrease
Liabilities	Decrease	Increase
Equity (Capital)	Decrease	Increase
Income/Revenue	Decrease	Increase

Type of Account **Debit** **Credit**

Expenses Increase Decrease

Journal Entry Format

A journal entry consists of the following components:

1. **Date:** The date the transaction occurred.
2. **Account Titles:** Clearly mention the accounts being debited and credited.
3. **Debit and Credit Columns:** Specify the amounts for each account.
4. **Narration:** A brief explanation of the transaction.

Format Example:

Date	Particulars	Debit (₹)	Credit (₹)
YYYY-MM-DD	Account to be Debited	XXXX	
	To Account to be Credited		XXXX
	(Narration)		

Practical Examples

☐ Capital Investment

Transaction: The owner invests ₹1,00,000 in the business.

Date	Particulars	Debit (₹)	Credit (₹)
YYYY-MM-DD	Cash A/c	1,00,000	
	To Capital A/c		1,00,000
	(Being capital introduced)		

☑ Purchase of Goods on Credit

Transaction: Goods worth ₹20,000 are purchased on credit from XYZ Traders.

Date	Particulars	Debit (₹)	Credit (₹)
YYYY-MM-DD	Purchases A/c	20,000	

Date	Particulars	Debit (₹)	Credit (₹)
	To XYZ Traders A/c		20,000
	(Goods purchased on credit)		

❖ Cash Sales

Transaction: Goods worth ₹15,000 are sold for cash.

Date	Particulars	Debit (₹)	Credit (₹)
YYYY-MM-DD	Cash A/c	15,000	
	To Sales A/c		15,000
	(Cash sales recorded)		

❖ Payment of Expenses

Transaction: Paid office rent of ₹5,000.

Date	Particulars	Debit (₹)	Credit (₹)
YYYY-MM-DD	Rent A/c	5,000	
	To Cash A/c		5,000
	(Rent payment recorded)		

❖ Receipt from Debtors

Transaction: Received ₹10,000 from a customer towards outstanding dues.

Date	Particulars	Debit (₹)	Credit (₹)
YYYY-MM-DD	Cash A/c	10,000	
	To Debtors A/c		10,000
	(Payment received from customer)		

Tips for Accurate Journal Preparation

- Understand the Transaction:** Analyze the nature of the transaction before determining accounts to be debited and credited.
- Follow the Rules:** Apply debit and credit rules consistently.

3. **Chronological Order:** Record entries in the order they occur.
 4. **Use Narrations:** Always provide a concise explanation for better traceability.
 5. **Double-Check Totals:** Ensure total debits equal total credits in each entry.
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UNIT II

Accounting Ratios: Classification What are Final Accounts?

1. Definition:

- Final accounts provide a comprehensive summary of an entity's financial performance and position over an accounting period.
- Composed of:
 - **Trading Account:** Calculates gross profit or loss.
 - **Profit and Loss Account:** Determines net profit or loss.
 - **Balance Sheet:** Shows the financial position (assets, liabilities, equity) as of a specific date.

2. Purpose:

- Assess business performance.
 - Guide stakeholders in decision-making.
 - Ensure compliance with statutory requirements.
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Steps for Final Account Preparation

☐ Start with the Trial Balance

- The trial balance lists all ledger account balances, separated into debit and credit columns.
- Verify that total debits = total credits.

☐ Adjustments to be Considered

Adjustments ensure accrual accounting principles are followed. Common adjustments include:

- **Outstanding Expenses:** Add to expenses and create a liability.

- **Prepaid Expenses:** Deduct from expenses and create an asset.
- **Depreciation:** Record as an expense and reduce asset value.
- **Bad Debts:** Deduct from receivables and create an expense.
- **Accrued Income:** Add to income and create an asset.
- **Unearned Income:** Deduct from income and create a liability.

❏ Prepare the Trading Account

- **Purpose:** Calculate gross profit or gross loss.
- **Formula:**
$$\text{Gross Profit} = \text{Net Sales} - \text{Cost of Goods Sold (COGS)}$$

Format Example:

Particulars	Amount (₹)	Particulars	Amount (₹)
Opening Stock	XXXX	Sales	XXXX
Add: Purchases	XXXX	Less: Sales Returns	XXXX
Add: Direct Expenses (wages)	XXXX		
Less: Closing Stock	XXXX		
Gross Profit (Balancing Fig)	XXXX		XXXX

❏ Prepare the Profit and Loss Account

- **Purpose:** Calculate net profit or net loss by adjusting indirect expenses and other incomes.
- **Formula:**
$$\text{Net Profit} = \text{Gross Profit} - \text{Indirect Expenses} + \text{Other Incomes}$$

Format Example:

Particulars	Amount (₹)	Particulars	Amount (₹)
Gross Profit (from Trading A/c)	XXXX	Indirect Expenses:	
Add: Other Incomes	XXXX	Rent, Admin Costs	XXXX
		Depreciation	XXXX
		Interest Paid	XXXX

Particulars	Amount (₹)	Particulars	Amount (₹)
		Net Profit (Balancing Fig)	XXXX

5 Prepare the Balance Sheet

- Purpose: Show financial position as of a specific date.
- Format: Based on the accounting equation:
 $\text{Assets} = \text{Liabilities} + \text{Equity}$

Format Example:

Liabilities	Amount (₹)	Assets	Amount (₹)
Capital	XXXX	Fixed Assets (Net)	XXXX
Add: Net Profit	XXXX	Current Assets:	
Less: Drawings	XXXX	Inventory (Closing Stock)	XXXX
Long-Term Liabilities	XXXX	Accounts Receivable	XXXX
Current Liabilities:		Cash & Bank Balances	XXXX
Outstanding Expenses	XXXX		
Unearned Income	XXXX		
Total Liabilities	XXXX	Total Assets	XXXX

Comprehensive Example

Trial Balance:

Particulars	Debit (₹)	Credit (₹)
Opening Stock	20,000	
Purchases	1,00,000	
Sales		1,50,000
Wages	10,000	
Rent	5,000	

Particulars	Debit (₹)	Credit (₹)
Machinery	50,000	
Accounts Receivable	40,000	
Accounts Payable		30,000
Cash	25,000	
Capital		70,000
Total	2,50,000	2,50,000

Adjustments:

1. Closing Stock = ₹30,000.
2. Depreciation on Machinery = ₹5,000.
3. Outstanding Rent = ₹2,000.

Solution:

1. Trading Account:

Particulars	Amount (₹)	Particulars	Amount (₹)
Opening Stock	20,000	Sales	1,50,000
Purchases	1,00,000	Closing Stock	30,000
Wages	10,000		
Gross Profit (Balancing Fig)	50,000		
Total	1,80,000	Total	1,80,000

2. Profit and Loss Account:

Particulars	Amount (₹)	Particulars	Amount (₹)
Rent	5,000	Gross Profit	50,000
Add: Outstanding Rent	2,000		
Depreciation	5,000		
Net Profit (Balancing Fig)	38,000		

Particulars	Amount (₹)	Particulars	Amount (₹)
Total	50,000	Total	50,000

3. Balance Sheet:

Liabilities	Amount (₹)	Assets	Amount (₹)
Capital	70,000	Machinery (Net)	45,000
Add: Net Profit	38,000	Accounts Receivable	40,000
Less: Drawings	0	Closing Stock	30,000
Current Liabilities:		Cash	25,000
Outstanding Rent	2,000		
Accounts Payable	30,000		
Total Liabilities	1,40,000	Total Assets	1,40,000

Accounting ratios help analyze financial health and performance. They are broadly classified into:

□ Profitability Ratios:

- **Purpose:** Measure the company's ability to generate profits relative to revenue, assets, or equity.
- **Examples:**
 - **Gross Profit Ratio** = $(\text{Gross Profit} / \text{Net Sales}) \times 100$
 - **Net Profit Ratio** = $(\text{Net Profit} / \text{Net Sales}) \times 100$
 - **Return on Assets (ROA)** = $(\text{Net Income} / \text{Average Total Assets}) \times 100$
 - **Return on Equity (ROE)** = $(\text{Net Income} / \text{Shareholder's Equity}) \times 100$

Liquidity Ratios:

- **Purpose:** Assess the company's ability to meet short-term obligations.
- **Examples:**
 - **Current Ratio** = $\text{Current Assets} / \text{Current Liabilities}$
 - **Quick Ratio (Acid Test)** = $(\text{Current Assets} - \text{Inventory}) / \text{Current Liabilities}$

Financial Ratios (Solvency):

- **Purpose:** Evaluate long-term financial stability and debt management.
- **Examples:**
 - **Debt-to-Equity Ratio** = Total Debt / Total Equity
 - **Interest Coverage Ratio** = EBIT / Interest Expense

Turnover Ratios (Activity Ratios):

- **Purpose:** Indicate operational efficiency in utilizing assets.
- **Examples:**
 - **Inventory Turnover Ratio** = Cost of Goods Sold / Average Inventory
 - **Debtors Turnover Ratio** = Net Credit Sales / Average Debtors
 - **Asset Turnover Ratio** = Net Sales / Average Total Assets

Comparative Statements

- **Definition:** Statements comparing financial data over two or more periods to identify trends.
- **Format:** Presented in a side-by-side columnar format.
- **Key Use:**
 - Analyze revenue growth or decline.
 - Identify expense patterns and anomalies.
 - Example: Comparing net profit for FY 2022 and FY 2023.

What are Comparative Statements?

1. Definition:

- Comparative statements present financial data for two or more periods side by side to facilitate trend analysis and performance comparison.
- Typically used for **Income Statements** and **Balance Sheets**.

2. Purpose:

- Identify trends in revenue, expenses, assets, and liabilities.
 - Evaluate performance over time.
 - Support decision-making and strategy formulation.
-

Steps to Prepare Comparative Statements

1. Choose Periods for Comparison:

- Select two or more periods (e.g., FY 2022 and FY 2023).

2. Extract Data from Financial Statements:

- For Income Statements: Focus on revenues, costs, and profits.
- For Balance Sheets: Focus on assets, liabilities, and equity.

3. Calculate Absolute Changes:

- **Formula:**
Absolute Change = Current Period Value - Previous Period Value

4. Calculate Percentage Changes:

- **Formula:**
Percentage Change (%) = (Absolute Change / Previous Period Value) × 100

5. Create a Tabular Format:

- Include columns for:
 - Previous Period
 - Current Period
 - Absolute Change
 - Percentage Change (%)

Comparative Income Statement Example

Data:

Particulars	FY 2022 (₹)	FY 2023 (₹)
Net Sales	5,00,000	6,00,000
Cost of Goods Sold	3,00,000	3,50,000
Gross Profit	2,00,000	2,50,000
Operating Expenses	50,000	60,000
Net Profit	1,50,000	1,90,000

Comparative Income Statement:

Particulars	FY 2022 (₹)	FY 2023 (₹)	Absolute Change (₹)	% Change
Net Sales	5,00,000	6,00,000	1,00,000	20%
Cost of Goods Sold	3,00,000	3,50,000	50,000	16.67%
Gross Profit	2,00,000	2,50,000	50,000	25%
Operating Expenses	50,000	60,000	10,000	20%
Net Profit	1,50,000	1,90,000	40,000	26.67%

Comparative Balance Sheet Example

Data:

Particulars	FY 2022 (₹)	FY 2023 (₹)
Fixed Assets	10,00,000	12,00,000
Current Assets	5,00,000	6,50,000
Total Assets	15,00,000	18,50,000
Long-Term Liabilities	5,00,000	6,00,000
Current Liabilities	3,00,000	3,50,000
Equity	7,00,000	9,00,000

Comparative Balance Sheet:

Particulars	FY 2022 (₹)	FY 2023 (₹)	Absolute Change (₹)	% Change
Fixed Assets	10,00,000	12,00,000	2,00,000	20%
Current Assets	5,00,000	6,50,000	1,50,000	30%
Total Assets	15,00,000	18,50,000	3,50,000	23.33%
Long-Term Liabilities	5,00,000	6,00,000	1,00,000	20%
Current	3,00,000	3,50,000	50,000	16.67%

Particulars	FY 2022 (₹)	FY 2023 (₹)	Absolute Change (₹)	% Change
Liabilities				
Equity	7,00,000	9,00,000	2,00,000	28.57%

Analysis and Interpretation

1. Income Statement Insights:

- Net Sales increased by 20%, indicating growth.
- Gross Profit grew faster (25%), suggesting improved cost efficiency.
- Operating Expenses increased by 20%, matching sales growth.
- Net Profit increase of 26.67% reflects strong overall performance.

2. Balance Sheet Insights:

- Fixed and Current Assets grew significantly, indicating expansion.
- Long-Term Liabilities rose by 20%, possibly due to additional financing.
- Equity growth of 28.57% indicates strong retained earnings or fresh investments.

Common Size Statements

- **Definition:** Financial statements where all items are expressed as a percentage of a base value.
- **Purpose:**
 - Facilitate inter-company comparison.
 - Highlight structural changes in financial statements.
- **Key Uses:**
 - In the income statement: Each item as a percentage of net sales.
 - In the balance sheet: Each item as a percentage of total assets or liabilities.
- **Example:**
 - Net Sales = ₹10,00,000, Gross Profit = ₹4,00,000 → Gross Profit Percentage = $(\frac{₹4,00,000}{₹10,00,000}) \times 100 = 40\%$.

What are Common Size Statements?

1. Definition:

- Common size statements express each item in financial statements as a percentage of a base value.
- Income Statement:** Items are presented as a percentage of **Net Sales**.
- Balance Sheet:** Items are presented as a percentage of **Total Assets or Liabilities**.

2. Purpose:

- Standardize financial data for better comparison across time periods or with other companies.
- Highlight structural changes in financial performance or position.

Steps to Prepare Common Size Statements

1. Choose the Financial Statement:

- Decide whether to prepare a common size **Income Statement** or **Balance Sheet**.

2. Select the Base Amount:

- Income Statement:** Use **Net Sales** as the base (100%).
- Balance Sheet:** Use **Total Assets or Liabilities** as the base (100%).

3. Calculate Percentages:

- Formula:**

$$\text{Common Size Percentage} = (\text{Item Value} / \text{Base Value}) \times 100$$

4. Create a Tabular Format:

- Include columns for:
 - Absolute Value (₹)
 - Common Size Percentage (%)

Common Size Income Statement Example

Data:

Particulars	Amount (₹)
Net Sales	6,00,000
Cost of Goods Sold	3,50,000
Gross Profit	2,50,000
Operating Expenses	60,000

Particulars	Amount (₹)
Net Profit	1,90,000

Common Size Income Statement:

Particulars	Amount (₹)	% of Net Sales
Net Sales	6,00,000	100%
Cost of Goods Sold	3,50,000	58.33%
Gross Profit	2,50,000	41.67%
Operating Expenses	60,000	10%
Net Profit	1,90,000	31.67%

Analysis:

- Cost of Goods Sold constitutes 58.33% of Net Sales, indicating production efficiency.
- Net Profit forms 31.67% of Net Sales, reflecting profitability after expenses.

📄 Common Size Balance Sheet Example

Data:

Particulars	Amount (₹)
Fixed Assets	12,00,000
Current Assets	6,50,000
Total Assets	18,50,000
Long-Term Liabilities	6,00,000
Current Liabilities	3,50,000
Equity	9,00,000

Common Size Balance Sheet:

Particulars	Amount (₹)	% of Total Assets
Fixed Assets	12,00,000	64.86%

Particulars	Amount (₹)	% of Total Assets
Current Assets	6,50,000	35.14%
Total Assets	18,50,000	100%
Long-Term Liabilities	6,00,000	32.43%
Current Liabilities	3,50,000	18.92%
Equity	9,00,000	48.65%

Analysis:

- Fixed Assets form 64.86% of Total Assets, reflecting a capital-intensive business model.
- Equity accounts for 48.65% of Total Assets, showing a balanced capital structure.

Significance of Common Size Statements

1. Trend Analysis:

- Evaluate changes in the financial structure over multiple periods.

2. Inter-Company Comparison:

- Compare financial metrics with competitors or industry benchmarks.

3. Structural Insights:

- Understand the proportion of costs, revenues, or liabilities within total values.

4. Decision-Making:

- Highlight areas needing improvement (e.g., cost control, liquidity).

Cash Flow Statement Analysis (As per AS 3)

Definition:

Tracks cash inflows and outflows under three categories:

1. Operating Activities: Core business operations.

- Example:** Cash receipts from sales, payment to suppliers.

2. Investing Activities: Purchase and sale of assets or investments.

- Example:** Sale of equipment, purchase of securities.

3. **Financing Activities:** Activities affecting equity and debt.

- **Example:** Issuing shares, repaying loans.

Key Ratios Derived from Cash Flow:

- **Operating Cash Flow Ratio** = Cash Flow from Operations / Current Liabilities.
- **Free Cash Flow** = Operating Cash Flow - Capital Expenditure.

Funds Flow Statement Analysis

- **Definition:** Tracks the movement of funds between different accounts.
- **Focus:**
 - Changes in working capital (current assets and liabilities).
- **Preparation:**
 - Sources of funds: Sale of fixed assets, equity issuance.
 - Application of funds: Purchase of assets, dividend payments.

COMPARATIVE STATEMENT PREPARATION

ChatGPT said:



Experts(s)

Financial Analysts, Accountants, Management Accountants, Corporate Financial Planners

Keywords

comparative statements, financial analysis, income statement comparison, balance sheet comparison, trend analysis, financial ratios, multi-period analysis

Experts(s)	Financial Analysts, Accountants, Management Accountants, Corporate Financial Planners
Improved Question	Explain the preparation of comparative financial statements, including the format and step-by-step process, with practical examples for income statement and balance sheet analysis.
Plan	Define comparative statements and their purpose. Outline the step-by-step process to prepare comparative statements for income statements and balance sheets. Explain calculations for absolute change, percentage change, and their significance. Provide detailed examples for both statement types and discuss how these aid in trend analysis and decision-making.
Verbosity	V=5: Exhaustive and descriptive

What are Comparative Statements?

1. Definition:

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- Typically used for **Income Statements** and **Balance Sheets**.

2. Purpose:

- Identify trends in revenue, expenses, assets, and liabilities.
- Evaluate performance over time.
- Support decision-making and strategy formulation.

Steps to Prepare Comparative Statements

1. Choose Periods for Comparison:

- Select two or more periods (e.g., FY 2022 and FY 2023).

2. Extract Data from Financial Statements:

- For Income Statements: Focus on revenues, costs, and profits.
- For Balance Sheets: Focus on assets, liabilities, and equity.

3. Calculate Absolute Changes:

- Formula:**
Absolute Change = Current Period Value - Previous Period Value

4. Calculate Percentage Changes:

- Formula:

$$\text{Percentage Change (\%)} = (\text{Absolute Change} / \text{Previous Period Value}) \times 100$$

5. Create a Tabular Format:

- Include columns for:
 - Previous Period
 - Current Period
 - Absolute Change
 - Percentage Change (%)

Comparative Income Statement Example

Data:

Particulars	FY 2022 (₹)	FY 2023 (₹)
Net Sales	5,00,000	6,00,000
Cost of Goods Sold	3,00,000	3,50,000
Gross Profit	2,00,000	2,50,000
Operating Expenses	50,000	60,000
Net Profit	1,50,000	1,90,000

Comparative Income Statement:

Particulars	FY 2022 (₹)	FY 2023 (₹)	Absolute Change (₹)	% Change
Net Sales	5,00,000	6,00,000	1,00,000	20%
Cost of Goods Sold	3,00,000	3,50,000	50,000	16.67%
Gross Profit	2,00,000	2,50,000	50,000	25%
Operating Expenses	50,000	60,000	10,000	20%
Net Profit	1,50,000	1,90,000	40,000	26.67%

Comparative Balance Sheet Example

Data:

Particulars	FY 2022 (₹)	FY 2023 (₹)
Fixed Assets	10,00,000	12,00,000
Current Assets	5,00,000	6,50,000
Total Assets	15,00,000	18,50,000
Long-Term Liabilities	5,00,000	6,00,000
Current Liabilities	3,00,000	3,50,000
Equity	7,00,000	9,00,000

Comparative Balance Sheet:

Particulars	FY 2022 (₹)	FY 2023 (₹)	Absolute Change (₹)	% Change
Fixed Assets	10,00,000	12,00,000	2,00,000	20%
Current Assets	5,00,000	6,50,000	1,50,000	30%
Total Assets	15,00,000	18,50,000	3,50,000	23.33%
Long-Term Liabilities	5,00,000	6,00,000	1,00,000	20%
Current Liabilities	3,00,000	3,50,000	50,000	16.67%
Equity	7,00,000	9,00,000	2,00,000	28.57%

Analysis and Interpretation

1. Income Statement Insights:

- Net Sales increased by 20%, indicating growth.
- Gross Profit grew faster (25%), suggesting improved cost efficiency.
- Operating Expenses increased by 20%, matching sales growth.
- Net Profit increase of 26.67% reflects strong overall performance.

2. Balance Sheet Insights:

- Fixed and Current Assets grew significantly, indicating expansion.
- Long-Term Liabilities rose by 20%, possibly due to additional financing.

- Equity growth of 28.57% indicates strong retained earnings or fresh investments.



What are Common Size Statements?

1. Definition:

- Common size statements express each item in financial statements as a percentage of a base value.
- **Income Statement:** Items are presented as a percentage of **Net Sales**.
- **Balance Sheet:** Items are presented as a percentage of **Total Assets or Liabilities**.

2. Purpose:

- Standardize financial data for better comparison across time periods or with other companies.
- Highlight structural changes in financial performance or position.

Steps to Prepare Common Size Statements

1. Choose the Financial Statement:

- Decide whether to prepare a common size **Income Statement** or **Balance Sheet**.

2. Select the Base Amount:

- **Income Statement:** Use **Net Sales** as the base (100%).
- **Balance Sheet:** Use **Total Assets or Liabilities** as the base (100%).

3. Calculate Percentages:

- **Formula:**
$$\text{Common Size Percentage} = (\text{Item Value} / \text{Base Value}) \times 100$$

4. Create a Tabular Format:

- Include columns for:
 - Absolute Value (₹)
 - Common Size Percentage (%)

Common Size Income Statement Example

Data:

Particulars	Amount (₹)
Net Sales	6,00,000
Cost of Goods Sold	3,50,000
Gross Profit	2,50,000
Operating Expenses	60,000
Net Profit	1,90,000

Common Size Income Statement:

Particulars	Amount (₹)	% of Net Sales
Net Sales	6,00,000	100%
Cost of Goods Sold	3,50,000	58.33%
Gross Profit	2,50,000	41.67%
Operating Expenses	60,000	10%
Net Profit	1,90,000	31.67%

Analysis:

- Cost of Goods Sold constitutes 58.33% of Net Sales, indicating production efficiency.
- Net Profit forms 31.67% of Net Sales, reflecting profitability after expenses.

Common Size Balance Sheet Example

Data:

Particulars	Amount (₹)
Fixed Assets	12,00,000
Current Assets	6,50,000
Total Assets	18,50,000
Long-Term Liabilities	6,00,000
Current Liabilities	3,50,000

Particulars	Amount (₹)
Equity	9,00,000

Common Size Balance Sheet:

Particulars	Amount (₹)	% of Total Assets
Fixed Assets	12,00,000	64.86%
Current Assets	6,50,000	35.14%
Total Assets	18,50,000	100%
Long-Term Liabilities	6,00,000	32.43%
Current Liabilities	3,50,000	18.92%
Equity	9,00,000	48.65%

Analysis:

- Fixed Assets form 64.86% of Total Assets, reflecting a capital-intensive business model.
- Equity accounts for 48.65% of Total Assets, showing a balanced capital structure.

Significance of Common Size Statements

1. Trend Analysis:

- Evaluate changes in the financial structure over multiple periods.

2. Inter-Company Comparison:

- Compare financial metrics with competitors or industry benchmarks.

3. Structural Insights:

- Understand the proportion of costs, revenues, or liabilities within total values.

4. Decision-Making:

- Highlight areas needing improvement (e.g., cost control, liquidity).

SWOT Analysis in Financial Statements

SWOT analysis provides a structured review of financial data to identify:

1. Strengths:

- Strong liquidity ratios.
- High profitability margins.
- Diversified revenue streams.

2. **Weaknesses:**

- High debt-to-equity ratio.
- Consistent operating losses.

3. **Opportunities:**

- Expanding markets.
- Technological advancements in operations.

4. **Threats:**

- Regulatory changes.
- Increasing competition.

UNIT III

Cost Accounting: Overview

1. **Meaning:**

- **Definition:** Cost accounting involves recording, classifying, and analyzing costs to assist management in decision-making and cost control.
- **Core Focus:** Cost efficiency, pricing strategies, and financial performance improvement.

2. **Objectives:**

- **Cost Control:** Identify inefficiencies and reduce waste.
- **Cost Analysis:** Evaluate cost structures and profitability.
- **Pricing Decisions:** Support in setting competitive and profitable prices.
- **Budget Preparation:** Assist in creating realistic financial plans.
- **Performance Evaluation:** Analyze cost variances and operational efficiency.

Classification of Costs

Costs are categorized to facilitate analysis and reporting. Key classifications include:

By Nature:

- **Direct Costs:** Directly attributable to production (e.g., raw materials, direct labor).

- **Indirect Costs:** Not directly traceable (e.g., factory rent, administrative salaries).

By Behavior:

- **Fixed Costs:** Do not change with production volume (e.g., depreciation, rent).
- **Variable Costs:** Change with production volume (e.g., raw materials).
- **Semi-variable Costs:** Partly fixed and partly variable (e.g., utility bills).

By Function:

- **Manufacturing Costs:** Incurred during production.
- **Administrative Costs:** Overhead costs related to management.
- **Selling and Distribution Costs:** Costs of marketing and delivering products.

By Traceability:

- **Product Costs:** Attributable to goods production.
- **Period Costs:** Linked to a specific accounting period (e.g., marketing expenses).

Cost Sheet Preparation

A **cost sheet** summarizes the costs incurred in production for analysis and pricing.

Format:

Particulars	Amount (₹)
Direct Materials	XXXX
Direct Labor	XXXX
Direct Expenses	XXXX
Prime Cost (Sum of Above)	XXXX
Factory Overheads	XXXX
Factory Cost	XXXX
Administrative Overheads	XXXX
Cost of Production	XXXX
Selling & Distribution Costs	XXXX
Total Cost (or Cost of Sales)	XXXX

Costing Methods

Costing methods vary based on the type of production and nature of operations.

Job Order Costing:

- **Definition:** Costs are assigned to specific jobs or orders.
- **Use Case:** Custom or batch production (e.g., construction projects).
- **Features:**
 - Unique cost allocation for each job.
 - Direct costs traced per job; overheads allocated proportionally.
- **Example:**
 - Total costs for Job A:
 - Direct Materials: ₹10,000
 - Direct Labor: ₹8,000
 - Overheads: ₹5,000 → Total Job Cost = ₹23,000

Process Costing:

- **Definition:** Costs are accumulated for each production process.
- **Use Case:** Mass production of homogeneous goods (e.g., cement, chemicals).
- **Steps:**
 1. Calculate total costs for each process.
 2. Divide by units produced to get cost per unit.
- **Example:**
 - Total Costs for Process 1: ₹2,00,000; Units Produced: 10,000 → Cost per Unit = ₹20

Joint and By-Product Costing:

- **Joint Products:** Products of equal importance derived from the same process.
 - Cost Allocation: Proportionate to market value or physical quantity.
- **By-Products:** Secondary products of lesser value.
 - Cost Allocation: Deduct revenue from by-products from total cost.

Activity-Based Costing (ABC):

- **Definition:** Allocates costs based on activities driving overheads.
- **Steps:**

1. Identify activities and assign costs.
 2. Allocate costs to products based on activity usage.
- **Use Case:** Complex manufacturing with diverse products.
 - **Example:**
 - Machine Setup Cost: ₹1,00,000; Products A and B require 20 and 80 setups respectively.
 - Cost Allocation: ₹20,000 to A and ₹80,000 to B.

Target Costing:

- **Definition:** Begins with a target selling price and works backward to determine allowable costs.
- **Formula:** $\text{Target Cost} = \text{Selling Price} - \text{Desired Profit}$
- **Use Case:** Competitive industries with fixed price expectations.

UNIT-IV

Marginal Costing and profit planning – Cost, Volume, Profit Analysis – Break Even Analysis – Decision making problems -Make or Buy decisions -Determination of sales mix - Exploring new markets - Add or drop products - Expand or contract. **Introduction to Financial, Cost, and Management Accounting.**

1. Financial Accounting:

- Focus: Recording, summarizing, and reporting an organization's financial transactions.
- Goal: Provide financial information for external stakeholders (investors, regulators).
- Core Elements: Compliance with GAAP, preparation of **final accounts** (Profit and Loss Account, Balance Sheet).

2. Cost Accounting:

- Focus: Analyzing costs for internal decision-making.
- Goal: Optimize cost efficiency, pricing, and profitability.
- Techniques: Marginal costing, standard costing, activity-based costing.

3. Management Accounting:

- Focus: Providing actionable insights for management.
- Goal: Assist in strategic planning, budgeting, and performance evaluation.
- Tools: Ratio analysis, cash flow projections, and variance analysis.

Generally Accepted Accounting Principles (GAAP)

- **Definition:** A set of accounting standards and principles ensuring uniformity and transparency.
- **Key Features:**
 - **Consistency:** Same accounting methods applied across periods.
 - **Relevance:** Provide useful and timely information.
 - **Reliability:** Free from material errors.
 - **Comparability:** Facilitates benchmarking across firms.
- **Indian Context:** India follows INDIAN ACCOUNTING STANDARD converging with IFRS

Double Entry System

- **Principle:** Every transaction has dual effects—debit and credit.
- **Accounting Equation:**
$$\text{Assets} = \text{Liabilities} + \text{Equity}$$
- **Key Rules:**
 - Debit: Increase in assets/expenses; decrease in liabilities/income.
 - Credit: Decrease in assets/expenses; increase in liabilities/income.
- **Example:**
 - Purchased inventory for ₹10,000 on credit:
 - Debit: Inventory (Asset) ₹10,000
 - Credit: Accounts Payable (Liability) ₹10,000

Preparation of Journal, Ledger, and Trial Balance

1. **Journal:**
 - Records day-to-day transactions chronologically.
 - Format: Date, Accounts Involved (Dr./Cr.), Amount, Narration.
2. **Ledger:**
 - **Purpose:** Classifies journal entries into individual accounts.
 - **Structure:** T-Accounts with Debit and Credit sides.
3. **Trial Balance:**
 - **Goal:** Verify mathematical accuracy (total debits = total credits).

- **Steps:**
 - Extract ledger balances.
 - Arrange in debit/credit columns.
 - Ensure totals match.
-

Preparation of Final Accounts

1. Trading Account:

- Calculates **gross profit**:
Gross Profit = Sales - (Cost of Goods Sold)
Includes direct expenses like purchases and wages.

2. Profit and Loss Account:

- Calculates **net profit**:
Net Profit = Gross Profit - Indirect Expenses + Other Incomes

3. Balance Sheet:

- Presents financial position as of a specific date:
 - **Assets**: What the company owns.
 - **Liabilities**: What the company owes.
 - **Equity**: Owner's interest in the business.
-

Reading Financial Statements

1. **Income Statement (P&L)**: Evaluates profitability.
 2. **Balance Sheet**: Assesses financial stability.
 3. **Cash Flow Statement**: Tracks cash inflows and outflows.
 4. **Key Ratios**:
 - Liquidity Ratios: Current ratio.
 - Profitability Ratios: Net profit margin.
 - Solvency Ratios: Debt-to-equity ratio.
-

Accounting Standards and Disclosure Practices in India

- **Accounting Standards (Ind AS)**:
 - Set by ICAI and mandated for specific entities.

- Examples:
 - **Ind AS 1:** Presentation of Financial Statements.
 - **Ind AS 7:** Statement of Cash Flows.
- **Disclosure Practices:**
 - Transparency through detailed notes on accounting policies.
 - Compliance with Companies Act and SEBI guidelines.

Digital Accounting

- **Definition:** Use of technology to automate accounting tasks.
- **Examples:**
 - Cloud-based platforms (e.g., QuickBooks, Zoho Books).
 - Blockchain for immutable records.
 - AI for predictive analytics and fraud detection.
- **Benefits:**
 - Enhanced accuracy and real-time reporting.
 - Scalability for businesses.

Accounting ratio - Classification of ratios: Profitability, Liquidity, Financial and Turnover ratio – Comparative statements - common size statements. Cash flow (as per Accounting Standard 3) and Funds flow statement analysis – SWOT Analysis in Financial statements

Accounting Ratios: Classification

Accounting ratios help analyze financial health and performance. They are broadly classified into:

Profitability Ratios:

- **Purpose:** Measure the company's ability to generate profits relative to revenue, assets, or equity.
- **Examples:**
 - **Gross Profit Ratio** = $(\text{Gross Profit} / \text{Net Sales}) \times 100$
 - **Net Profit Ratio** = $(\text{Net Profit} / \text{Net Sales}) \times 100$
 - **Return on Assets (ROA)** = $(\text{Net Income} / \text{Average Total Assets}) \times 100$
 - **Return on Equity (ROE)** = $(\text{Net Income} / \text{Shareholder's Equity}) \times 100$

☐ Liquidity Ratios:

- **Purpose:** Assess the company's ability to meet short-term obligations.
- **Examples:**
 - **Current Ratio** = Current Assets / Current Liabilities
 - **Quick Ratio (Acid Test)** = (Current Assets - Inventory) / Current Liabilities

☐ Financial Ratios (Solvency):

- **Purpose:** Evaluate long-term financial stability and debt management.
- **Examples:**
 - **Debt-to-Equity Ratio** = Total Debt / Total Equity
 - **Interest Coverage Ratio** = EBIT / Interest Expense

☐ Turnover Ratios (Activity Ratios):

- **Purpose:** Indicate operational efficiency in utilizing assets.
- **Examples:**
 - **Inventory Turnover Ratio** = Cost of Goods Sold / Average Inventory
 - **Debtors Turnover Ratio** = Net Credit Sales / Average Debtors
 - **Asset Turnover Ratio** = Net Sales / Average Total Assets

Comparative Statements

- **Definition:** Statements comparing financial data over two or more periods to identify trends.
- **Format:** Presented in a side-by-side columnar format.
- **Key Use:**
 - Analyze revenue growth or decline.
 - Identify expense patterns and anomalies.
 - Example: Comparing net profit for FY 2022 and FY 2023.

Common Size Statements

- **Definition:** Financial statements where all items are expressed as a percentage of a base value.
- **Purpose:**
 - Facilitate inter-company comparison.

- Highlight structural changes in financial statements.
- **Key Uses:**
 - In the income statement: Each item as a percentage of net sales.
 - In the balance sheet: Each item as a percentage of total assets or liabilities.
- **Example:**
 - Net Sales = ₹10,00,000, Gross Profit = ₹4,00,000 → Gross Profit Percentage = $(\text{₹}4,00,000 / \text{₹}10,00,000) \times 100 = 40\%$.

Cash Flow Statement Analysis (As per AS 3)

Definition:

Tracks cash inflows and outflows under three categories:

1. **Operating Activities:** Core business operations.
 - **Example:** Cash receipts from sales, payment to suppliers.
2. **Investing Activities:** Purchase and sale of assets or investments.
 - **Example:** Sale of equipment, purchase of securities.
3. **Financing Activities:** Activities affecting equity and debt.
 - **Example:** Issuing shares, repaying loans.

Key Ratios Derived from Cash Flow:

- **Operating Cash Flow Ratio** = Cash Flow from Operations / Current Liabilities.
- **Free Cash Flow** = Operating Cash Flow - Capital Expenditure.

Funds Flow Statement Analysis

- **Definition:** Tracks the movement of funds between different accounts.
 - **Focus:**
 - Changes in working capital (current assets and liabilities).
 - **Preparation:**
 - Sources of funds: Sale of fixed assets, equity issuance.
 - Application of funds: Purchase of assets, dividend payments.
 - **Use:** Highlights liquidity issues and sources of finance.
-

SWOT Analysis in Financial Statements

SWOT analysis provides a structured review of financial data to identify:

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- Diversified revenue streams.

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3. Opportunities:

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4. Threats:

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Cost Accounting: Meaning – Objectives – Classification of cost – Cost sheet preparation – Costing methods: Job cost sheet – Job order costing – Process costing – (excluding Interdepartmental Transfers and equivalent production) – Joint and By Product Costing – Activity Based Costing, Target Costing. v5

Cost Accounting: Overview

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Administrative Overheads	XXXX
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Costing methods vary based on the type of production and nature of operations.

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- Total Costs for Process 1: ₹2,00,000; Units Produced: 10,000 → Cost per Unit = ₹20

Joint and By-Product Costing:

- **Joint Products:** Products of equal importance derived from the same process.
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Target Costing:

- **Definition:** Begins with a target selling price and works backward to determine allowable costs.
 - **Formula:** **Target Cost** = Selling Price - Desired Profit
 - **Use Case:** Competitive industries with fixed price expectations.
-

UNIT V

Budgetary Control: Overview

1. Definition:

- **Budgetary Control:** A systematic approach to managing income and expenses through budgets. It ensures organizational objectives are met effectively.

2. Objectives:

- Coordinate activities across departments.
- Monitor and control costs.
- Enhance resource allocation and profitability.
- Enable corrective action through variance identification.

3. Key Components:

- **Budgets:** Plans expressed in monetary terms.
- **Control Mechanisms:** Comparison of actual performance with budgets.
- **Variances:** Deviations that highlight areas needing attention.

Types of Budgets

Budgets are categorized based on purpose, activity, and flexibility. Common types include:

▣ Sales Budget:

- **Definition:** Estimates expected sales in units and value.
- **Preparation:**
 - Analyze past sales trends.
 - Factor in market conditions, competition, and company goals.
- **Example:**
 - Product A: Expected sales = 5,000 units × ₹50/unit = ₹2,50,000.

▣ Production Budget:

- **Definition:** Plans production volume to meet sales and inventory needs.
- **Formula:** $\text{Production Units} = \text{Sales Units} + \text{Desired Closing Stock} - \text{Opening Stock}$
- **Example:**
 - Sales Units = 5,000; Closing Stock = 500; Opening Stock = 300 → Production Units = 5,200.

Fixed Budget:

- **Definition:** Prepared for a single level of activity.
- **Limitation:** Lacks flexibility for changes in activity levels.
- **Example:**
 - Fixed overhead costs = ₹10,00,000 at a production level of 10,000 units.

Flexible Budget:

- **Definition:** Adjusts for various activity levels.
- **Advantages:**
 - Useful in dynamic environments.
 - Provides realistic cost control.
- **Example:**

Activity Level	80%	100%	120%
Variable Costs	₹4,00,000	₹5,00,000	₹6,00,000
Fixed Costs	₹2,00,000	₹2,00,000	₹2,00,000
Total Costs	₹6,00,000	₹7,00,000	₹8,00,000

Overhead Budget:

- **Definition:** Projects indirect costs (e.g., rent, utilities, salaries).
- **Categories:**
 - Fixed Overheads: Remain constant (e.g., rent).
 - Variable Overheads: Change with activity level (e.g., power costs).
- **Example:**
 - Total overheads = Fixed (₹1,00,000) + Variable (₹2/unit × 10,000 units) = ₹1,20,000.

Standard Costing

1. Definition:

- Standard costing assigns predetermined costs to products or services, serving as a benchmark for actual cost comparison.

2. Components:

- **Standard Costs:** Pre-determined estimates for materials, labor, and overheads.
- **Actual Costs:** Incurred during production.
- **Variances:** Differences between standard and actual costs.

3. Advantages:

- Simplifies cost control.
- Enhances pricing decisions.
- Promotes efficiency.

Variance Analysis

1. Definition:

- Variance analysis identifies and investigates deviations from standards to ensure cost efficiency.

2. Key Types of Variances:

- **Material Variances:**
 - **Material Price Variance (MPV)** = (Standard Price - Actual Price) × Actual Quantity.
 - **Material Usage Variance (MUV)** = (Standard Quantity - Actual Quantity) × Standard Price.
- **Labor Variances:**
 - **Labor Rate Variance (LRV)** = (Standard Rate - Actual Rate) × Actual Hours.
 - **Labor Efficiency Variance (LEV)** = (Standard Hours - Actual Hours) × Standard Rate.
- **Overhead Variances:**
 - **Overhead Expenditure Variance:** (Standard Overhead - Actual Overhead).

3. Steps in Variance Analysis:

- Determine standards for costs and activities.
- Record actual performance.
- Compute variances.
- Analyze causes and implement corrective measures.

4. **Example:**

- Standard Material Cost: 10 kg @ ₹50/kg → ₹500
- Actual Material Cost: 12 kg @ ₹55/kg → ₹660
- **Material Price Variance** = $(50 - 55) \times 12 = ₹(60)$
- **Material Usage Variance** = $(10 - 12) \times 50 = ₹(100)$