CHAPTER I

MEANING OF ACCOUNTING

Accounting is the recording of business transaction for getting final results i.e.. Profit or loss. It is the process recording all the financial transactions of the firm in order to find out profitability and financial position of the business organization.

LIMITATIONS OF ACCOUNTING

- It provides only past data
- It does not show profit of each job
- It fails to measure control over resources
- It does not measure organizational efficiency
- It fails to provide adequate data for price fixation
- It does not provide data for comparison of costs
- It fails to take into account the price level changes
- It cannot disclose controllable & uncontrollable costs
- It provide only limited information for management for decision making

Management accounting

Management accounting is the accounting information that is useful to management for decision making.

It is the process of identifying, analyzing, interpreting and presenting financial and& non-financial information to be used by the management to plan & control activities.

Definition

According to Robert Anthony " management accounting is concerned with accounting information which is useful to management"

Nature of management accounting

- Provides accounting information
- Decision making
- Studies cause & effect relationship
- Use special techniques
- Quantitative & qualitative
- Accounting for future
- No fixed form allowed
- Assist management
- Increase efficiency

Scope of Management accounting

- **Financial accounting** : financial accounting is the base for preparing financial statements. It supplies maximum data to management
- **Cost accounting** : cost accounting is the technique of ascertaining costs. Many cost accounting tools like budgetary control, standard costing etc are also the tools of management accounting.
- **Budgeting and forecasting** : budgeting means expressing plans for a definite period of time. Forecasting is a prediction of what will happen as a result of a given set of condition
- **Cost control techniques** : one of the objectives of management accounting is cost control. It is done with the help of inventory control, standard costing, budgeting etc.
- **Interpretation of financial data** : comparative balance sheet, common size balance sheet, trend analysis, ratio analysis etc helps for interpreting financial data.
- **Statistical methods** : today management accountants use statistical tools like LPP, game theory etc in the decision making process.
- **Tax accounting** : tax planning also an important part of management accounting.
- **Reporting** : basic responsibility of management accountant is to prepare report.
- **Office service**
- **Internal auditing**

Objectives of management accounting

- to help for planning
- to help in interpreting financial data
- to assist in controlling activities
- to help in co-ordination
- to motivate employees
- to help in decision making
- communication
- help in organizing
- to help in policy formulation
- to report

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Difference between management accounting and financial accounting

Financial accounting	Management accounting
Purpose is to ascertain profit or loss	Provide accounting information to management for decision making
Records historical data	Concerned with future plans and operations
Compulsory	Optional
Lays more emphasis on accuracy	Emphasis on quick and prompt reporting
Based on accounting principles	Not based on accounting principles
Prepared for a particular period	No specific period
Limited scope	Wide scope
External parties are the users	Internal parties are the users
Auditing is compulsory	Not compulsory

Basic principles of management accounting

- **principles of management by exception** : time and effort of managerial personnel are precious. So management by exception should be introduced
- **principles of objective** : objectives of the organization should be considered
- **consistent** : when presenting information uniform policy should followed for same activity.
- **Principles of relevancy** : focuses its attention on relevant data.
- **Principles of integration** : management accounting is based on the integration of all managerial information.
- **Principle of revaluation of accounting :** management accounting uses the principles of revaluation accounting in order to keep the data up to date.
- **Principles of utilization** : should reveal whether or not resources of the business are profitably used.
- **Principle of accuracy** : accuracy in information process should be maintained.
- **Forward looking approach** :

Functions of management accounting

- Planning and forecasting
- Modification and verification of data
- Analysis and interpretation of data
- Communication
- Helping in co-ordination
- Helping in decision making

Difference between management accounting and financial accounting

Cost accounting	Management accounting
Purpose is to ascertain and control cost	Provide accounting information to management for decision making
include only cost ascertainment and control	Includes financial accounting, cost accounting, budgeting etc
Use only quantitative information	Both quantitative and qualitative information
Deals with cost	Deals with both cost and revenue
Based on both historical and current data	Concerned with future plans and operations
Precedes management accounting	Start where cost accounting ends

Importance or advantages of management accounting

- Proper planning
- Effective control
- Quick decision making
- Increased efficiency
- Measurement of performance
- Maximizing profitability
- Increase in production
- Improve standard of living of people
- Economic development

Limitation of management accounting

- Based on accounting information
- Lack of knowledge

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- Not a substitute for management
- Personnel judgment
- Costly
- Evolutionary stage
- Resistance

Tools of management accounting

- **Financial accounting** :Financial accounting is essential for collecting the important information for the management.
- **Financial analysis** : financial analysis tools like comparative statements, common size statements, ratio analysis are used for interpreting financial statements.
- **Historical cost accounting** : the recording of actual cost after they are incurred is called historical cost accounting.
- **Budgetary control** : in this system expenditure and revenue are predetermined.
- **Standard costing** : in standard costing, costs are predetermined on scientific basis. The actual costs are compared with the standard to find out variations.
- **Marginal costing** : under marginal costing, costs are divided into fixed and variable. Variable costs are taken for decision making.
- **Decision accounting** : decision making is the process of selecting the best alternative from different alternatives. The cost of different alternatives are analyzed and most favourable alternatives are selected.
- **Revaluation accounting** : this is a method for overcoming the problem of replacement of assets in a period of rising prices.
- **Management information system(MIS):** it is a system that collect data, stores and process data and provides information to managers for planning, controlling and decision making.
- **Statistical techniques and operation research** : number of statistical techniques and operation research techniques like LPP, game theory, Networking, probability etc used in management accounting for planning and decision making.
- **Responsibility accounting** : it is a system of control in which responsibility is assigned to persons for the control of cost.
- **Other techniques** : like risk analysis, accounting for price level changes etc. also used in management accounting.

CHAPTER II

ANALYSIS AND INTERPRETATION OF FINANCIAL STATEMENTS

Financial statements

Financial statements are the final product of the accounting process. It containing financial information of a business enterprise. Financial statements include Profit and loss account and Balance sheet.

Objectives of financial statements

- Information about assets and liabilities
- Provide useful information to various parties
- Present true and fair view of the business
- Estimate earning capacity of the business
- Determine debt paying capacity of the firm
- Decide the future prospects of the concern

Importance or uses or utilities of financial statements

- **Importance to management:** management make use of financial statements for ascertaining the earning capacity, profitability, financial position etc.
- **Importance to investors** : FS provides information to investors regarding earning power, debt paying capacity, etc to determine whether to buy or sell the shares of the concerned company.

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- **Importance to creditors** : to analyze debt paying capacity and solvency position.
- **Importance to banks** : for granting loans, banks have to analyze the solvency and profitability position of the business.
- **Importance to customers** : to know whether the company will be able to supply the of goods and services to them.
- **Importance to employees** :employees want to know the profitability of the firm, whether they provide salary increment, bonus, fringe benefits etc.
- **Importance to Government** : to know how much the firm have to pay the tax to the government.

Limitations of Financial statements

- Not precise (due to based on assumptions and conventions)
- Influence of personal judgment
- Historical records
- Incomplete (only quantitative data)
- Ignore price level changes
- Static statement
- Lack of comparability
- They are dump (further data are required for further analysis)

Financial analysis:

The process of analyzing & interpreting financial statements such as income statement and balance sheet is called financial analysis

Meaning of analysis

Analysis here means, simplification of financial data in the financial statements. It refers to making the data to speak.

Meaning of interpretation

Here it means, explaining the meaning and significance of the data so simplified.

Purpose/ objects of financial analysis

- Helps in decision making
- To assess financial position
- Ascertain operating performance
- To determine solvency and liquidity of the business
- Determining the debt paying capacity
- To judge present and future profitability
- To make inter-firm comparison
- Measure managerial efficiency
- To solve the internal problems of the firm.

Uses of financial analysis

- Importance to shareholders- return
- Importance to creditors – to know position of business
- Importance to management- decision making
- Importance to employees- profitability
- Importance to government- tax matter

Limitations of financial analysis

- Limitation of financial statements
- Ignore price level changes
- Ignore qualitative aspects
- Spots the symptoms but not diagnosis
- Personal judgment

Types of financial analysis

On the basis of material used

- **External analysis** : analysis is done by outsiders like investors, creditors etc.
- **Internal analysis** : done by the management.

On the basis of objectives of the analysis

- **Short term analysis**: to determine short term solvency, liquidity and earning capacity of the business.
- **Long term analysis** : to determine long term solvency, stability and future earing capacity etc.

On the basis of modes operandi

- **Horizontal analysis** : FS for number of years are analyzed, it is called horizontal analysis eg . comparative balance sheet, comparative income statement, trend analysis, FFS, CFS etc.
- **Vertical analysis** : this refers to the study of relationship of various items in the FS for one accounting period. Eg : common size statements, ratio analysis etc.

Procedures of financial analysis

- Re arrangement of financial statements
- Comparison

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- ❖ Analysis
- ❖ Interpretation

Tools Of Financial Analysis

Comparative income statement

Under comparative income statement two years' expenses and incomes are compared by analyzing the increase or decrease in each item. It also discloses percentage of changes.

Comparative balance sheet

The CBS shows the different assets and liabilities of the firm on different dates to make comparisons of absolute balances and also of changes if any, from one date to another. The CBS may be helpful in analyzing and evaluating the financial position of the firm over a period of number of years.

Common Size Balance sheet

A statement in which balance sheet items are expressed as the ratio of each asset to total assets and the ratio of each liability is expressed as a ratio of total liabilities is called common-size balance sheet. The common size balance sheet can be used to compare companies of differing size.

Common size Income statement

The items in Income statement can be shown as percentages of sales to show the relation of each item to sales. A significant relationship can be established between items of income statement and volume of sales.

Trend Analysis

It is used when 3 or more years' comparison is given.

Ratio analysis

A ratio is a simple arithmetical expression of the relationship of one number to another.

Fund flow analysis

Analysis and interpretation of fund or working capital changes for the particular period is called Fund flow analysis

Cash flow analysis

Analysis and interpretation of cash or cash equivalents changes for the particular period is called cash flow analysis

CHAPTER III

RATIO ANALYSIS

Ratio

A ratio is a simple arithmetical expression of the relationship of one number to another. In simple language ratio is one number expressed in terms of another and can be worked out by dividing one number into the other. A ratio can be expressed in the form of a fraction, number of times, percentage or in proportion.

Expression of ratio

- Proportion
- Percentage
- Times
- Fraction

Ratio analysis

Analysis of financial statement with the help of accounting ratios is called ratio analysis.

Importance or advantages of ratio analysis

{a} Managerial uses of Ratio analysis

- Helps in decision making
- Helps in financial forecasting and planning
- Helps in communicating
- Helps in co-ordination
- Helps in control

{b}Utility to Shareholders/ Investors

An investor is particularly interested to know about the Long term financial position and profitability position

{c}Utility to Creditors

The creditors or suppliers extend short term credit to the concern. They are interested to know whether financial position of the concern warrants their payments at a specified time or not.

{d}utility to the Employees

The employees are also interested in the financial position of the concern especially profitability because their wage increases and amount of fringe benefits are related to the volume of profits earned by the concern.

{e}Utility to government

Government is interested to know the overall strength of the industry.

limitations of ratio analysis

- Limited use of a single ratio.
- Lack of adequate standards

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- Inherent limitations of accounting
- Change of accounting procedure
- Window dressing
- Personal bias
- Incomparable
- Price level changes.
- Ratios no substitutes.

Classification or Types ratios

On the basis of accounting statement

- Balance sheet or financial ratios : these ratios are calculated by using balance sheet items. Eg : current ratio, fixed asset ratio etc.
- Profit and loss account ratio : calculated by using P & L a/c. eg : Net profit ratio, G/P ratio etc.
- Combined ratio : by using both balance sheet and P&L a/c. eg : stock turnover ratio

On the basis of importance

- **Primary ratios :** the success of any business is measured by the amount of profit earned. Eg : NP ratio, GP ratio
- **Secondary ratios :** these ratios are mainly used to explain primary ratios.

On the basis of function

Liquidity ratios –

The term liquidity refers to the firm's ability to meet its current liabilities when they become due. Liquidity ratios are used to measure the liquidity position or short term financial position of the firm.

- **Current ratio** – it defined as the ratio of current assets to current liabilities. It shows the relationship between total current assets and current liabilities
- **Quick ratio / Liquid ratio**–liquid ratio is the ratio of liquid assets to current liabilities. It is the measure of the instant debt paying ability of the business.
- **Absolute quick ratio/super quick ratio –**it is the ratio of absolute liquid asset to current liabiltities.it is uses to analyze cash position of business
- to meet its current liabilities.

Solvency ratios or Leverage ratios –

The term solvency refers to the ability of a firm to pay its outside liabilities(both long term and short term). Solvency ratios are used to analyze the long term financial position of a business.

- **Debt equity ratio-** This ratio indicates the relative proportion of debt and equity in financing the assets of a firm.it expresses the relationship between debt and equity.
  it may be two types such as **long term debt equity & total debt equity ratio.**
- **Proprietary ratio** – proprietary ratio establishes the relationship between shareholders' fund and total asset. This shows how much fund have been contributed by the shareholders in the total assets of the firm.

Fixed asset ratio – it is the ratio of fixed to long term fund or capital employed. The objective calculating this ratio is to ascertain the proportion of long term funds invested in fixed assets.

- **Total asset to total debt ratio** –

This ratio expresses the relationship between total asset and total liabilities. Total assets include total fixed and total current assets. Total liabilities include total outside liabilities. It measures the overall solvency of the firm.

Turnover ratios /activity ratios –

Turnover ratios show how efficiently a firm uses its available resources or assets. These ratios indicate efficiency in asset management.

- **Stock turnover ratio** –

Inventory or stock turnover ratio shows the relationship between costs of goods sold and average inventory or stock. It indicates the number of times the stock is converted in to sales.

  - **Stock velocity** – generally stock turnover ratio is expresses in times. It can also expressed in months or days. Then it is called stock velocity.

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- **Debtors turnover ratio** –

Debtors turnover ratios explains the relationship between net credit sales and average debtors including bills receivables. This shows how quickly debtors are converted in to cash. It indicates how efficiently the firm collects cash from debtors.

  - **Average collection period** – it means the number of days or months for which debtors remain outstanding.

- **Creditors turnover ratio** –

Creditors turnover ratio shows the relationship between net credit purchase and average creditors including bills payable. It indicates the number of times the creditors are paid.

  - **Average payment period** -It means the credit period enjoyed by the firm in paying creditors.

- Working capital turnover ratio
- Fixed asset turnover ratio

Profitability ratios - the term profitability refers to the ability of a firm to earn maximum profit. Profitability ratio measure the ability of the firm to earn an adequate return on sales.

- **Gross profit ratio** - this is the ratio of gross profit to sales expressed in percentage. The main objective of computing this ratio is to determine the efficiency in trading or production activity.
- **Net profit ratio** – Net profit ratio is the ratio of net profit earned by a business and its net sales. The objective of calculating this ratio is to measure the overall profitability.
- **Operating ratio** – operating ratio express the relationship between operating cost and sales. It indicates the overall efficiency in operating the business.
- **Operating profit ratio** – operating profit ratio explains the relationship between operating profit and sales.

Rule of thumb or standard for ratios

The ideal or standard ratio fixed by the different experts for different ratios is called rule of thumb.

CHAPTER IV

FUND FLOW ANALYSIS

Fund = working capital

Working capital=Current assets – current liabilities

In a narrow sense it means cash and in a broader sense it is capital or all financial resources of a business. But the fund is commonly used in its popular sense as working capital or net current assets. Thus for accounting purpose and for preparing funds flow statements , the term fund means working capital of the excess of current assets over current liabilities.

meaning and concept of flow of funds

The term flow means movement and includes both inflow and outflow of fund. The term flow of funds means the transfer of economic values from one asset of equity to another.

Objectives/ purpose of FFS

- Tool for managing working capital
- To know the changes in working capital
- Reveal short term financial strength and weakness
- Anticipate working capital position
- Reveal important changes have taken place
- Provide a base of budgeting
- Assess growth of the firm.

Importance of fund flow statement

1.It helps in the analysis of financial Operations

2.It gives answers to many questions like happening of N.P, proceeds of sale of F.A etc.

3. It helps in the proper allocation of resources

4. It acts as a guide for future to the management.

5. It helps in appraising the use of working capital

6. It helps in knowing the overall credit worthiness of the firm

7. It states how much funds has been generated from operations during the year

8. It helps the management in framing financial

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policies like dividend policies, issue of shares etc.

9.Creditors and financial institutions who have lend money to the firm can assess the financial strengths and repayment capacity based on funds.

Limitations of FFS

- Based on historical data
- Only rearrangement of data
- Cannot reveal continuous changes
- Does note account those do not related with working capital.

Difference between fund flow statement and balance sheet

Fund flow statement	**Balance sheet**
Statement of changes in assets and liabilities	It is the statement of assets and liabilities.
Prepared to show the sources and uses of fund during a period of time.	Prepared to ascertain financial position of the firm
Prepared after balance sheet is prepared	Prepared at the end of an accounting period
No legal compulsory	Required to prepare.
Useful to internal management	Useful to external parties
There is no prescribed format	There is prescribed format.

Steps in preparing fund flow statement

1.Statement or schedule of changes in working capital

Working capital means the excess of current assets over current liabilities. Statement of changes in working capital is prepared to show the changes in the working capital between the two balance sheet dates.

Working capital = Current assets - Current liabilities

- An increase in current assets increases the working capital
- The decrease in current assets decreases the working capital
- An increase in current liabilities decreases the working capital
- A decrease in current liabilities increases working capital

1. **Preparation of ledger accounts to show hidden transactions**
2. **Preparation of fund from operation**
3. **Fund flow statement**

CHAPTER V

CASH FLOW ANALYSIS

Cash flow statements

Cash flow statement is a statement which describes the inflows and outflows of cash and cash equivalents in an enterprise during a specified period of time. It explains the reasons for changes in a firm's cash position during an year.

classification of cash flows

- Cash flows from operating activities
- Cash flows from investing activities
- Cash flows from financing activities

Importance of CFS

- Helps in short term planning
- Helps in formulating financial policies
- Base for cash budget
- Reveal liquidity and solvency
- Helps in efficient cash management
- Show the changes in cash position
- Helps in cash control
- Helps in short term financial decision

Limitations of CFS

- Ignores non cash items
- Historical nature
- Limited scope
- Easily influenced by managerial decision
- Does not present true picture.

Difference between cash flow statement & funds flow statement

1.CFSt is a statement which discloses the inflows and outflows of cash during a period, FFS is a statement which discloses the sources and uses of funds or working capital during a period

2. CFS is prepared on cash basis, FFS is prepared on working capital basis

3. CFS is mainly used for cash planning and managing liquidity, .FFS is mainly used for long term financial planning

4.CFS explains reasons for shortage or surplus

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of liquid cash at the end, FFS explains reasons for a net increase or decrease in working capital

5. it is presented in prescribed format as per AS-3, . Not presented in prescribed format.

6. In CFS a schedule of changes in working capital is not required. In FFS a schedule of changes in working capital is prepared to ascertain the net increase or decrease in working capital

CHAPTER VI

MARGINAL COSTING

Marginal cost

additional cost incurred due to producing an additional unit is called marginal cost.

Marginal costing

It is the technique of costing in which only marginal costs or variable are charged to output or production. The cost of the output includes only variable costs .Fixed costs are not charged to output.

Features of marginal costing

- Method of costing
- All cost are classified into fixed and variable
- Only variable costs are charged
- Tock are valued at variable costs

Absorption costing

It is the conventional technique. Under this both fixed cost and variable cost are taken into consideration. No difference is made between the fixed and variable. It is also known as full cost or total cost technique.

Limitation of absorption costing

- ❖ Not helpful in selection of product mix, make or buy decision etc.
- ❖ Not helpful for planning and controlling costs.
- ❖ Not helpful in flexible budget, tendor or quotation.
- ❖ Cost per unit will change due to existence fixed cost.

Contribution

Excess of sales over variable cost is called contribution.

Contribution= sales – variable cost

Difference between absorption costing and marginal costing

Absorption costing	Marginal costing
Both fixed and variable costs are charged.	Only variable costs are charged
Stock of finished goods and work in progress are valued at total cost	Stock of finished goods and work in progress are valued at marginal cost
Profit is the basis for decision making	Contribution is the base for decision making
Suitable for external reporting	Suitable for internal reporting
When the production increases cost per unit reduces	Cost per unit remains the same at all levels of production.
For long term pricing policy	For planning, controlling and decision making in short run
Emphasis on production	Emphasis on selling and pricing aspects

Determination of profit under marginal costing

Sales	XXX
Less variable cost	XXX
Contribution	XX
Less fixed cost	XX
Profit	XX

CVP analysis/Cost profit volume analysis

It is the study of relationship between cost, profit and volume of production.

Importance of marginal costing/CVP analysis

- ➢ Profit Planning
- ➢ Cost control
- ➢ Decision making
- ➢ Fixation of selling price
- ➢ simple valuation of stock
- ➢ ascertainment of profitability

Limitation of marginal costing

- ❖ Difficult in separating cost
- ❖ Difficult in application
- ❖ Undervaluation of stock
- ❖ Short run analysis
- ❖ Time factor ignored

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- ❖ Wrong basis for pricing
- ❖ More emphasis on sales

Tools of CVP analysis

1. **Break even analysis**

Every business is interested in ascertaining the breakeven point. It is the level of operation where total revenue or sales are equal to total cost. It is the point of no profit or no loss. BEP is the point at which contribution is equal to fixed cost.

2. **Margin of safety**

Margin of safety represents the strength of the business to face an adverse market condition. It is the excess of actual sales over break even sales.

3. **Profit volume ratio [P/V ratio].**

Contribution is an absolute measure of profitability but it cannot be used for comparison of two products or departments. Therefore, the contribution is related to volume of sales.

Break Even Chart

BEP can also be calculated with the help of graph by putting sales line, fixed cost line and total cost line. Under BE chart BEP is the point at which sales line cuts total cost line.

Angle of incidence

The angle at which BEP or at which sales line cuts total cost line is called angle of incidence.

Assumptions in CVP analysis and marginal costing

- Cost can be classified into fixed and variable components.
- Total fixed cost remain constant at all levels of output
- The variable cost change in direct proportion with the volume of output
- The selling price per unit remains the same at all the levels of sales
- Entire units are sold.

Application of marginal costing or marginal costing and decision making

- ❖ **Fixation of selling price** : marginal costing helps for fixing selling price at depression stage, under special conditions etc.
- ❖ **Profit planning** : profit planning can be done in the light of increase or decrease in fixed cost, variable costs, selling price etc.
- ❖ **Selection of suitable** : marginal costing uses the different techniques to select a suitable sales which gives more profit to the firm.
- ❖ **Problem of key factor** : marginal costing determine the profitability when there will be a key factor problem like time, capital, workers etc.
- ❖ **Make or buy decision** : marginal costing helps to make decision, whether the firm want to make or buy the products and estimates which will give more profit to the firm.
- ❖ **Shut down decision** :While taking decision to shut down the going concern, the behavior of costs should be considered

  When a plant is shut down temporarily, there are some avoidable fixed cost like salaries of sales man, salaries of temporary workers etc. at the same time there also will be some unavoidable cost like depreciation, rent of office etc. this unavoidable cost is called shout down cost.

Shut down point : when the sales are at the point where the operating losses are equal to shut down costs it is called shut down point. If the business are operating below shut down point, the firm is better to shut down temporarily.

- ❖ **Acceptance of bulk orders** : deciding whether to accept bulk orders at less than the normal selling price is affordable.

CHAPTER VII

RESPONSIBILITY ACCOUNTING

Responsibility accounting is a system of collecting and reporting accounting information in terms of responsibility centres. It is an accounting system that holds each manager responsible for those activities and cost which are under his control.

It is an accounting system of control where

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responsibility is assigned for the control of costs. This means that persons are made responsible for the control of costs.

Definition :

H.G Johnson defines "responsibility accounting is a system of accounting in which costs and revenues are accumulated and reported to managers on the basis of the manager's control over these costs and revenues".

Features of responsibility accounting

- Fixation of responsibility
- Assignment of costs
- Division of costs
- Performance report
- Clear cut organization structure
- Controllable and uncontrollable costs
- Accounting function
- Human aspect

Steps in responsibility accounting

- Division of work
- Assign the charge of responsibility centres to a particular manager
- Fix a target for each responsibility centres
- Introduce an effective communication system
- Specify controllable and uncontrollable cost clearly
- Compare actual performance with the target
- Analyze the variance
- Take corrective actions
- Prepare performance report

Basic assumption of the responsibility accounting system

- Decentralization
- Managers are held responsible
- Participation in setting goals
- Achievable targets should be set
- Well defined authority and responsibility
- Effective reporting system
- Monetary terms

Essentials of responsibility accounting

- Sound organization structure
- Responsibility centres
- Realistic budget
- Performance reporting
- Support of top management
- Healthy organization environment

Advantages of responsibility accounting

- Delegation of authority
- Cost control
- Evaluation of performance
- Prompt reporting
- Efficient budgetary control
- Improves profitability
- Management by exception
- Improve performance

Problems and limitations of responsibility accounting

- Practical difficulties
- Conflict of interest
- Elaborate communication system is essential- costly
- Preparation of report is not an easy task
- Resistance form workers
- Difficult to fix responsibility

Responsibility centre

Responsibility centre refers to any organizational unit which is headed by a responsible person.

Types of responsibility centres

- **Cost centre :** a cost centre is a responsibility centre whose manager is responsible for costs incurred by the segment.
- **Revenue centre** : it is a segment of the organization which primarily responsible for generating sales revenue
- **Profit centre** : it is a centre in which inputs are measures in terms of expenses and outputs are measures in terms of revenue.
- **Investment centre** : it is a responsibility centre in which the manager is responsible for the proper utilization of assets.
- **Contribution centre** : it is a segment of activity for which both revenue and variable cost are accumulated.

ABC (ACTIVITY BASED COSTING)

ABC is a new practice of allocating costs to products or jobs. Under ABC, the costs are collected according to activities in business. Cost of each activity is ascertained separately.

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ACCOUNTING RATIOS	
LIQUIDITY RATIOS	
Current ratio	$\frac{current\ assets}{current\ liabilities}$
Quick or liquid ratio	$\frac{liquid\ assets}{current\ liabilities}$
Absolute liquid ratio	$\frac{absolute\ liquid\ assets}{current\ liabilities}$
SOLVENCY RATIOS	
Debt equity ratio	$\frac{Debt}{Equity}$
Proprietary ratio	$\frac{Shareholders\ fund}{Total\ assets}$
Total asset to total debt ratio	$\frac{Total\ assets}{Total\ debt}$
Fixed asset ratio	$\frac{Fixed\ assets}{long\ term\ fund}$
Fixed asset to Networth Ratio	$\frac{Fixed\ assets}{Shareholders\ fund}$
Capital gearing ratio	$\frac{Fixed\ income\ bearing\ funds}{equity\ shareholders\ fund}$
PROFITABILITY RATIO	
Gross profit ratio	$\left(\frac{Gross\ profit}{net\ sales}\right) X100$
Net profit ratio	$\left(\frac{Net\ profit}{net\ sales}\right) x\ 100$
Operating ratio	$\left(\frac{cost\ of\ goods\ sold + operating\ expenses}{net\ sales}\right) x\ 100$
Operating profit ratio	$\left(\frac{operating\ profit}{net\ sales}\right) x\ 100$
TURNOVER RATIOS	
Stock turnover ratio	$\left(\frac{cost\ of\ goods\ sold}{average\ sotck}\right)$
Stock velocity	$\frac{365}{stock\ turnover\ ratio}$
Debtors turnover ratio	$\frac{net\ credit\ sales}{average\ bills\ receivables + avg\ drs}$
Average collection period	$\frac{365}{debtors\ turnover\ ratio}$
Creditors turnover ratio	$\frac{net\ credit\ purchasess}{average\ bills\ payable + avg\ crs}$
Average payment period	$\frac{365}{creditors\ turnover\ ratio}$

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Working capital turnover ratio	$\frac{net\ sales}{working\ capital}$
Fixed asset turnover ratio	$\frac{net\ sales}{fixed\ assets}$
Coverage ratios	
Interest coverage ratio	$\frac{Profit\ before\ interest\ and\ tax}{Interests}$
Dividend coverage ratio	$\frac{Earning\ after\ tax}{Preference\ Dividend}$
Total or overall coverage ratio	$\frac{Profit\ before\ interest\ and\ tax}{total\ fixed\ charges}$
Profitability ratio based investment	
Return on investment (ROI)	$\left(\frac{\text{profit before interest and tax}}{\text{capital employed}}\right)\text{x } 100$
Return on shareholders fund	$\left(\frac{\text{NO after interest and tax}}{shareholders\ fund}\right)\text{x } 100$
Return on equity capital	$\left(\frac{\text{NP after tax and Preference dividend}}{equity\ shaeholders\ fund}\right)x\ 100$

Market test ratio	
Earning per share (EPS)	$\frac{NP\ available\ to\ equity\ shareholders}{Number\ of\ equity\ shareholders}$
Dividend Per Share (DPS)	$\frac{Dividend\ paid\ to\ equity\ shareholders}{Number\ of\ equity\ shareholders}$
Price Earning Ratio (P/E ratio)	$\frac{Market\ price\ per\ share}{EPS}$
MARGINAL COSTING EQUATIONS	
B.E. P in units	$\frac{Fixed\ Expenses}{Contribution\ per\ unit}$
Contribution	Sales – variable cost
B. E. P in sales	$\left(\frac{Fixed\ expenses}{contribution}\right)Xsales$ $\left(\frac{Fixed\ expenses}{contribution\ Per\ unit}\right)Xsales\ per\ unit$ $\left(\frac{Fixed\ expenses}{PV\ ratio}\right)$
P / V ratio	$\left(\frac{contribution}{sales}\right)X100$ $\left(\frac{changes\ in\ profit\ or\ changes\ in\ contribution}{changesin\ sales}\right)X100$

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Margin of safety	Actual sales - B.E.P sales
Number of units to be sold to earn a desired profit	$\left(\frac{F+P}{c\ per\ unit}\right)$
Amount of sales required to earn a desired profit	$\left(\frac{F+P}{C}\right)XS$ $\left(\frac{F+P}{C\ pu}\right)XS\ pu$
Profit at expected sales	$P=\left(\frac{expected\ sales\ x\ C}{S}\right)-f$

" ***IF YOU ARE NOT WILLING TO LEARN, NO ONE CAN HELP YOU !***

IF YOU ARE DETERMINED TO LEARN, NO ONE CAN STOP YOU !"

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