

# **COST AND MANAGEMENT ACCOUNTING – IV**

**(For Undergraduate Classes)**

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## **PREFACE**

This Text-Book of **Cost and Management Accounting-IV** is specially prepared for Undergraduate classes students. It is prepared in accordance with the latest syllabus given in this book.

I do not claim any originality in the subject-matter of this book. I have drawn immense material from many standard books on this subject. Yet, this book is original in the exposition and presentation of the subject-matter. The subject-matter has been dealt with exhaustively and in very simple language.

I express my profound gratitude to **United Publishers** for bringing out this book.

I shall consider my efforts amply rewarded if this book is found useful by the teachers and the students.

Suggestions for improvement of this book will be gratefully accepted.

**Mangalore,**

**B.S. Raman**

## **SYLLABUS**

### **COST & MANAGEMENT ACCOUNTING - IV**

<b>CHAPTER I - FUND FLOW ANALYSIS</b>	<b>10 Hrs</b>
« Concept of fund and flow	
« Identification of flow of funds	
« Fund flow statement	
« Statement of changes in working capital	
« Sources of funds and application of funds	
« Uses of fund flow statement	
« Drawback of fund flow statement	
<b>CHAPTER II : CASH FLOW ANALYSIS-as per AS(R3)</b>	<b>10 Hrs</b>
« Concept of cash flow	
« Cash flow Vs Fund flow	
« Uses of Cash flow and limitations of cash flow.	
« Sources and Application of funds	
<b>CHAPTER III: MARGINAL COSTING</b>	<b>10 Hrs</b>
« Nature, merits and limitations	
« Marginal costing Vs Absorption costing	
« Cost-Volume-Profit relationship	
« Marginal cost equations and Break-even Analysis	
computation of Break-even point, P/V ratio, Margin of safety.	
<b>CHAPTER IV: BUDGETARY CONTROL</b>	<b>10 Hrs</b>
« Nature and scope	
« Procedure in Budget Preparation	
« Types of Budget: Sales Budget, Production Budget, Production Cost Budget and Purchase Budget with problems	
<b>CHAPTER V: STANDARD COSTING</b>	<b>10 Hrs</b>
« Meaning	
« Standard costing Vs Budgetary control	
« Merits and demerits of standard costing	
<b>CHAPTER VI: VARIANCE ANALYSIS</b>	<b>10 Hrs</b>
« Material and labour cost variances and their computation	

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**Introduction:**

The balance sheet of a concern just reveals its financial status as on a particular date. It does not indicate the change that has taken place in the financial position of the concern during the financial year. As such, the usefulness of the balance sheet to a financial executive is limited. For financial analysis and planning, the financial executive must know how the financial position of the concern has changed during the financial year. The fund flow statement serves this purpose. Hence, the fund flow analysis has been evolved.

Fund flow analysis is a technique of analysing the movement of funds in and out of an undertaking. The movement of funds in and out of an undertaking is analysed through a statement known as **fund flow statement**.

**Concept of Fund and Flow :**

**The term 'fund' may be interpreted in various ways, viz., (a) as cash, (b) as total financial resources in the form of men, money, materials, machinery and other things, (c) as total current assets and (d) as net current assets or net working capital.** Though the term 'fund' can be interpreted in different ways, for the purpose of fund flow statement, **the term 'fund', generally, means net current assets or net working capital (i.e., current assets minus current liabilities).**

**Concept of Flow of Fund:**

**Flow of fund means change in the amount of fund or net working capital.** There is a said to be flow of fund when a business transaction results in a change, either in an increase or in a decrease in the amount of fund or net working capital. If a transaction results in an increase in the amount of fund (i.e., net working capital), it (i.e., the transaction) is considered as a source of fund. If a transaction results in a decrease in the amount of fund, it is taken as an application of fund or use of fund. If a transaction does not cause any change in the amount of fund, then, there is no flow of fund (i.e., there is neither a source of fund nor an application of fund).

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## **IDENTIFICATION OF FLOW OF FUNDS OR SOURCES AND USES OF FUNDS**

### **Sources and Uses of Funds:**

As stated earlier, fund flow means change in the amount of fund or working capital. The change in the amount of fund may be an increase in the amount of fund or working capital, or a decrease in the amount of fund or working capital. **The increase in the amount of fund or working capital is called a source of fund, and the decrease in the amount of fund or working capital is called a use of fund.**

### **Sources of Fund:**

**Transactions which result in an increase in the amount of fund or working capital are called sources of fund.**

**The usual sources of fund (i.e., the usual transactions which result in an increase in the amount of fund or working capital) are:**

#### **1. Fund from operations, operating profit or trading profit:**

Fund from operations, operating profit or trading profit is a major source of fund for any business undertaking. It is an internal source of fund. In fact, it is the only internal source of fund.

**Fund from operations, operating profit or trading profit refers to the profit made by a business concern from its normal and regular business or trading operations. In other words, it is the net profit for the year before adjusting non-fund and or non-operating expenses and losses, and non-fund and or non-operating incomes and gains.**

#### **2. Non-operating incomes:**

Non-operating incomes are one of the important sources of fund.

Non-operating incomes include dividend received on investments on shares, interest received on investments, rent received, gifts received, donations received, damages received under legal suits, etc.

#### **3. Refund of Income-tax received:**

Refund of income-tax received is a source of fund. It is a non-operating income, and so, it becomes a source of fund.

#### **4. Issue of shares for cash or for any other current asset:**

Shares, whether preference shares or equity shares, issued for cash or for any other current assets become a source of fund. In fact, issue of shares for cash or for any other current asset is one of the important sources of fund for any joint stock company.

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**5. Issue of debentures for cash or for any other current asset:**

Debentures issued for cash or for any other current asset become a source of fund. Like shares, debentures issued for cash or for any other current asset become an important source of fund for any joint stock company.

**6. Long-term and medium-term loans borrowed:**

Long-term and medium-term loans borrowed (i.e., loans borrowed for a period of more than one year) are one of the important sources of fund for any business undertaking.

**7. Long-term and medium-term deposits accepted:**

Long-term and medium-term deposits accepted (i.e., deposits accepted for a period of more than one year) are one of the important sources of fund for any business undertaking.

**8. Sale of long-term investments for cash or for any other current asset:**

Sale proceeds of long-term investments sold for cash or for any other current asset (whether sold at a profit or at a loss) are one of the important sources of fund for any business undertaking.

**9. Sale of fixed assets for cash or for any other current asset:**

Sale proceeds of fixed assets like lands, buildings, machinery, vehicles, furniture, etc. for cash or for any other current asset (whether sold at a profit or at a loss) are one of the important sources of fund for every business undertaking.

**Comment on identification of sources and uses of Funds :-**

(a) If both the accounts involved in a given transaction belong to current account category that transaction does not cause any flow of fund.

(If both the accounts involved in a given transaction belong to non-current category, that transaction does not cause any Flow of fund.

(c) If one of accounts in the given transaction belong to current account category and the other account belongs to non-current category that transaction causes aflow of fund.

(d) If a transaction causing a flow of fund, if the account belonging to the current account category is debited the implication is that there is a source of fund.

On the other hand if the account belonging to the current account category is credited, the implication is that there is use of fund.

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**Uses of Fund:**

**Transactions which result in a decrease in the amount of fund or net working capital are called uses of fund.**

**The usual uses of fund (i.e., the usual transactions which result in a decrease in the amount of fund or working capital) are:**

**1. Fund lost in operations, operating loss or trading loss:**

Fund lost in business operations, operating loss or trading loss is one of the uses of fund.

**Operating loss or trading loss refers to the loss suffered by a business in the normal and regular business or trading operations. In other words, it is the net loss for the year before adjusting the non-fund and or non-operating expenses and losses, and non-fund and or non-operating incomes and gains.**

**2. Non-operating expenses:**

Non-operating expenses paid are one of the uses of fund.

Non-operating expenses include dividend paid on shares, income-tax paid, charities given, donations given, fines paid, damages paid in legal suits, etc.

**3. Redemption of redeemable preference shares in cash or in any other current asset:**

Redemption of redeemable preference shares in cash or in any other current asset is an important use of fund for every joint stock company.

**4. Redemption or repayment of debentures in cash or in any other current asset:**

Redemption or repayment of debentures in cash or in any other current asset is one of the important uses of fund for any joint stock company.

**5. Repayment of long-term and medium term loans in cash or in any other current asset:**

Repayment of long-term and medium-term loans in cash or in any other current asset is an important use of fund for every business undertaking.

**6. Repayment of long-term and medium-term deposits in cash or in any other current asset:**

Repayment of long-term and medium-term deposits in cash or in any other current asset is one of the uses of fund for any business concern.

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**7. Purchase of long-term investments for cash or for any other current asset:**

Long-term investments purchased for cash or for any other current asset is one of the important uses of fund for every business firm.

**8. Acquisition or purchase of fixed assets for cash or for any other current asset:**

Acquisition or purchase of fixed assets like lands, buildings, plant and machinery, vehicles, furniture, etc. for cash or for any other current asset is one of the uses of fund for every business undertaking.

**9. Drawings:**

In the case of a sole trader or a partnership firm, drawings by the sole trader or the partners in cash or in any other current asset becomes one of the uses of fund.

**Illustration 1.**

State whether the following transactions increase or decrease or do not affect the working capital and give reasons:

- A company issues Rs. 1,00,000 worth of shares for cash.
- Redemption of debentures worth Rs. 2,00,000.
- Amount received from debtors Rs. 50,000.
- Amount paid to creditors Rs. 20,000.
- Plant sold for Rs. 40,000.
- Raw material purchased worth Rs. 50,000 from X & Co. on credit basis.
- Furniture purchased worth Rs. 40,000.
- Purchased plant worth Rs. 1,00,000 by issuing equal amount of debentures of Rs. 500 each.
- Paid Rs. 20,000 towards the cost of issue of shares.
- Debentures worth Rs. 1,00,000 redeemed by raising a long-term loan of equal amount from the U.T.I.

**Solution:**

- The two accounts involved in this transaction are (i) cash and (ii) share capital. Cash is a current asset, and share capital is a non-current liability item. As one item is a current asset, and the other item is a non-current liability item, this transaction affects working capital. As it is a source of fund, it will increase the working capital by Rs. 1,00,000.
  - The two accounts involved in this transaction are (i) Debentures and (ii) Cash. Debentures are a non-current liability. Cash is a current asset. As one item is a non-current liability and the other is a current asset, this transaction affects working capital. As it is a use of fund, it will decrease the working capital by Rs. 2,00,000.
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