



UGC-NET

MANAGEMENT

National Testing Agency (NTA)

PAPER - 2 || VOLUME - 2



UGC NET PAPER – 2 (MANAGEMENT)

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IV UNIT

Corporate Accounting, Costing & Financial Management

Accounting Principles and Standards, Preparation of Financial Statements

1. Accounting Concepts (Fundamental Assumptions)

1.1 Business Entity Concept

Meaning

- ✓ Business is treated as a separate legal and accounting entity distinct from its owner.

Implications

- ✓ Owner's capital is treated as liability
- ✓ Personal transactions are excluded

Example

- ✓ Owner withdraws ₹10,000 → recorded as Drawings, not expense

Exam Insight

- ✓ Important for distinguishing capital vs revenue transactions

1.2 Going Concern Concept

Meaning

- ✓ Business is assumed to continue indefinitely in the future

Implications

- ✓ Assets recorded at cost, not liquidation value
- ✓ Depreciation is applied

Exception

- ✓ If business is closing → assets valued at realizable value

1.3 Money Measurement Concept

Meaning

- ✓ Only transactions measurable in monetary terms are recorded

Limitation

- ✓ Ignores qualitative factors (e.g., employee skill, goodwill not purchased)

1.4 Accounting Period Concept

Meaning

- ✓ Business life is divided into fixed time periods

Importance

- ✓ Helps in periodic reporting
- ✓ Basis for taxation and performance evaluation

1.5 Cost Concept (Historical Cost)

Meaning

- ✓ Assets recorded at original purchase price

Implication

- ✓ No adjustment for inflation
- ✓ Provides objectivity

1.6 Dual Aspect Concept

Meaning

- ✓ Every transaction has two aspects (Debit & Credit)

Equation

- ✓ $\text{Assets} = \text{Liabilities} + \text{Capital}$

Example

- ✓ Purchase machinery for cash → Asset increases, Cash decreases

1.7 Accrual Concept

Meaning

- ✓ Transactions recorded when earned/incurred, not when cash flows

Example

- ✓ Salary due but unpaid → recorded as expense

1.8 Matching Concept

Meaning

- ✓ Expenses matched with related revenues of the same period

Importance

- ✓ Accurate profit measurement

1.9 Realisation Concept

Meaning

- ✓ Revenue is recognized when it is earned, not when cash is received

2. Accounting Conventions

2.1 Conservatism (Prudence)

Rule

- ✓ “Anticipate no profits but provide for all losses”

Application

- ✓ Provision for doubtful debts
- ✓ Stock valued at cost or market value, whichever is lower

2.2 Consistency

Meaning

- ✓ Same accounting methods should be used over time

Importance

- ✓ Ensures comparability

2.3 Materiality

Meaning

- ✓ Only significant items are disclosed

Example

- ✓ Pen purchase may not be separately recorded

2.4 Full Disclosure

Meaning

- ✓ All relevant information must be disclosed in financial statements

Part-B: Accounting Standards (As 1–32)

Accounting Standards Table (AS 1–32)

| AS No. | Name of Standard | Key Focus / Explanation |
|--------|--|---|
| AS 1 | Disclosure of Accounting Policies | Requires disclosure of significant accounting policies used |
| AS 2 | Valuation of Inventories | Inventory valued at cost or NRV (whichever lower) |
| AS 3 | Cash Flow Statements | Classification into operating, investing, financing |
| AS 4 | Contingencies & Events | Treatment of events after balance sheet date |
| AS 5 | Net Profit or Loss | Classification of extraordinary and prior period items |
| AS 6 | Depreciation Accounting (Withdrawn) | Methods of depreciation (now covered in AS 10) |
| AS 7 | Construction Contracts | Revenue recognition in long-term contracts |
| AS 8 | Research & Development (Withdrawn) | Now covered in AS 26 |
| AS 9 | Revenue Recognition | Revenue recognized when earned and measurable |
| AS 10 | Property, Plant & Equipment | Accounting for fixed assets and depreciation |
| AS 11 | Effects of Foreign Exchange | Exchange rate changes and adjustments |
| AS 12 | Government Grants | Treatment of subsidies and grants |
| AS 13 | Investments | Valuation of current & long-term investments |
| AS 14 | Amalgamation | Accounting for mergers and acquisitions |
| AS 15 | Employee Benefits | Gratuity, pension, leave encashment |
| AS 16 | Borrowing Costs | Interest capitalization in asset cost |
| AS 17 | Segment Reporting | Reporting by business/geographical segments |
| AS 18 | Related Party Disclosures | Disclosure of related party transactions |
| AS 19 | Leases | Finance lease vs operating lease |
| AS 20 | Earnings Per Share | Calculation of EPS |
| AS 21 | Consolidated Financial Statements | Group accounts of parent & subsidiary |
| AS 22 | Taxes on Income | Deferred tax assets and liabilities |
| AS 23 | Investment in Associates | Equity method accounting |
| AS 24 | Discontinuing Operations | Disclosure of discontinued business segments |
| AS 25 | Interim Financial Reporting | Quarterly/half-year reporting |
| AS 26 | Intangible Assets | Goodwill, patents, trademarks |
| AS 27 | Joint Ventures | Accounting for joint ventures |
| AS 28 | Impairment of Assets | Reduction in asset value due to loss |
| AS 29 | Provisions & Contingent Liabilities | Recognition and measurement rules |
| AS 30 | Financial Instruments (Not mandatory) | Recognition & measurement of financial instruments |
| AS 31 | Financial Instruments Presentation | Classification of financial instruments |
| AS 32 | Financial Instruments Disclosure | Disclosure requirements |

Preparation of Financial Statements

1. Meaning of Financial Statements

- ✓ Financial Statements are structured reports prepared at the end of an accounting period to present the financial performance and position of a business.

Definition

- ✓ Financial statements are “formal records of financial activities, prepared in accordance with accounting principles and standards.”

2. Objectives of Financial Statements

- ✓ To ascertain profit or loss
- ✓ To determine financial position
- ✓ To provide information for decision-making
- ✓ To ensure legal compliance
- ✓ To facilitate comparison and analysis

3. Types of Financial Statements

3.1 Income Statement (Profit & Loss Account)

Purpose

- ✓ To determine Net Profit or Net Loss

Structure

- ✓ Trading Account (Gross Profit)
- ✓ Profit & Loss Account (Net Profit)

3.2 Balance Sheet

Purpose

- ✓ To show financial position (Assets & Liabilities)

3.3 Cash Flow Statement

Purpose

- ✓ To show cash inflows and outflows

4. Trading Account

4.1 Meaning

- ✓ A Trading Account is prepared to calculate Gross Profit or Gross Loss.

4.2 Items Included

Debit Side

- ✓ Opening Stock
- ✓ Purchases (– Purchase Returns)
- ✓ Direct Expenses (Wages, Freight, Carriage inward)

Credit Side

- ✓ Sales (– Sales Returns)
- ✓ Closing Stock

4.3 Formula

- ✓ Cost of Goods Sold (COGS) =
 $\text{Opening Stock} + \text{Purchases} + \text{Direct Expenses} - \text{Closing Stock}$
- ✓ Gross Profit = Sales – COGS

4.4 Format

| Debit (Dr.) | Amount | Credit (Cr.) | Amount |
|--------------------------|--------|---------------|--------|
| Opening Stock | xxx | Sales | xxx |
| Purchases | xxx | Closing Stock | xxx |
| Direct Expenses | xxx | | |
| Gross Profit (balancing) | xxx | | |

5. Profit & Loss Account

5.1 Meaning

- ✓ Prepared to calculate Net Profit or Net Loss

5.2 Items Included

Expenses

- ✓ Salaries
- ✓ Rent
- ✓ Depreciation
- ✓ Insurance
- ✓ Interest

Incomes

- ✓ Commission
- ✓ Interest received
- ✓ Discount received

5.3 Formula

- ✓ Net Profit = Gross Profit + Other Income – Indirect Expenses

5.4 Format

| Debit (Dr.) | Amount | Credit (Cr.) | Amount |
|------------------------|--------|--------------|--------|
| Expenses | xxx | Gross Profit | xxx |
| Depreciation | xxx | Other Income | xxx |
| Net Profit (balancing) | xxx | | |

6. Balance Sheet

6.1 Meaning

- ✓ A Balance Sheet shows the financial position at a specific date.

6.2 Components

Liabilities

- ✓ Capital
- ✓ Creditors
- ✓ Loans
- ✓ Outstanding expenses

Assets

- ✓ Fixed Assets
- ✓ Current Assets
- ✓ Investments
- ✓ Prepaid expenses

6.3 Format

| Liabilities | Amount | Assets | Amount |
|----------------|--------|----------------|--------|
| Capital | xxx | Fixed Assets | xxx |
| Add: Profit | xxx | Current Assets | xxx |
| Less: Drawings | xxx | | |
| Creditors | xxx | | |
| Loans | xxx | | |

6.4 Equation

- ✓ Assets = Liabilities + Capital

7. Adjustments in Final Accounts

Adjustment Treatment Table

| Adjustment | P&L Effect | Balance Sheet Effect |
|------------------------------|---------------------|----------------------|
| Outstanding Expenses | Add to expense | Liability |
| Prepaid Expenses | Deduct from expense | Asset |
| Accrued Income | Add to income | Asset |
| Unearned Income | Deduct income | Liability |
| Depreciation | Expense | Reduce asset |
| Bad Debts | Expense | Reduce debtors |
| Provision for Doubtful Debts | Expense | Deduct from debtors |

8. Depreciation

Meaning

- ✓ Decrease in value of fixed assets due to use or time

Methods

- ✓ Straight Line Method (SLM)
- ✓ Written Down Value (WDV)

9. Cash Flow Statement

9.1 Activities

(i) Operating Activities

- Cash from business operations

(ii) Investing Activities

- Purchase/sale of assets

(iii) Financing Activities

- Loans, share capital

9.2 Methods

- ✓ Direct Method
- ✓ Indirect Method

10. Manufacturing Account (Advanced)

Purpose

- ✓ To calculate Cost of Production

Includes

- ✓ Raw materials
- ✓ Factory overheads
- ✓ Factory wages

12. Limitations of Financial Statements

- ✓ Based on historical cost
- ✓ Subject to manipulation
- ✓ Ignore inflation
- ✓ Do not show qualitative aspects

13. Integrated Flow

1. Trial Balance
2. Trading Account → Gross Profit
3. P&L Account → Net Profit
4. Balance Sheet → Financial Position

Financial Statement Analysis

1. Financial Statement Analysis – Meaning

- ✓ Financial Statement Analysis refers to the systematic examination and interpretation of financial statements to evaluate a firm's performance, profitability, liquidity, and financial stability.

1.1 Objectives

- ✓ Assess financial health
- ✓ Aid decision-making
- ✓ Evaluate profitability
- ✓ Compare performance over time
- ✓ Measure liquidity and solvency

2. Ratio Analysis – Meaning

- ✓ Ratio Analysis is a technique of analyzing relationships between financial statement items using ratios.

2.1 Advantages

- ✓ Simplifies financial data
- ✓ Helps in decision-making
- ✓ Facilitates comparison
- ✓ Identifies trends

2.2 Limitations

- ✓ Based on historical data
- ✓ Different accounting policies affect comparability
- ✓ Ignores qualitative factors

3. Classification of Ratios

1. Liquidity Ratios
2. Profitability Ratios
3. Solvency Ratios
4. Activity (Turnover) Ratios
5. Market Ratios

4. Liquidity Ratios

- ✓ Measure short-term financial strength

Liquidity Ratios Table

| Ratio | Formula | Interpretation |
|--------------------------|--|---------------------------------------|
| Current Ratio | Current Assets / Current Liabilities | Ability to pay short-term obligations |
| Quick Ratio (Acid Test) | (Current Assets – Inventory) / Current Liabilities | Immediate liquidity |
| Absolute Liquidity Ratio | (Cash + Marketable Securities) / Current Liabilities | Cash position |

5. Profitability Ratios

- ✓ Measure earning capacity

Profitability Ratios Table

| Ratio | Formula | Interpretation |
|-----------------------------------|---|--------------------------|
| Gross Profit Ratio | (Gross Profit / Net Sales) × 100 | Efficiency in production |
| Net Profit Ratio | (Net Profit / Net Sales) × 100 | Overall profitability |
| Operating Ratio | (Operating Cost / Net Sales) × 100 | Cost efficiency |
| Operating Profit Ratio | (Operating Profit / Net Sales) × 100 | Operating performance |
| Return on Capital Employed (ROCE) | (EBIT / Capital Employed) × 100 | Return on investment |
| Return on Equity (ROE) | (Net Profit / Shareholders' Equity) × 100 | Return to owners |

6. Solvency Ratios

- ✓ Measure long-term financial stability

Solvency Ratios Table

| Ratio | Formula | Interpretation |
|-------------------------|-------------------------------------|-------------------------|
| Debt-Equity Ratio | Total Debt / Shareholders' Equity | Financial leverage |
| Proprietary Ratio | Shareholders' Funds / Total Assets | Owner's stake |
| Interest Coverage Ratio | EBIT / Interest | Ability to pay interest |
| Capital Gearing Ratio | Fixed Cost Capital / Equity Capital | Capital structure |

7. Activity (Turnover) Ratios

- ✓ Measure operational efficiency

Activity Ratios Table

| Ratio | Formula | Interpretation |
|--------------------------|--|------------------------|
| Inventory Turnover Ratio | Cost of Goods Sold / Average Inventory | Stock movement |
| Debtors Turnover Ratio | Net Credit Sales / Average Debtors | Collection efficiency |
| Creditors Turnover Ratio | Net Credit Purchases / Average Creditors | Payment efficiency |
| Working Capital Turnover | Net Sales / Working Capital | Use of working capital |
| Fixed Asset Turnover | Net Sales / Fixed Assets | Asset utilization |

8. Market Ratios

- ✓ Important for investors

Market Ratios Table

| Ratio | Formula | Interpretation |
|----------------------------|---|-----------------------|
| Earnings Per Share (EPS) | Net Profit / No. of Shares | Profit per share |
| Price-Earnings Ratio (P/E) | Market Price per Share / EPS | Investor expectations |
| Dividend Payout Ratio | Dividend / Net Profit × 100 | Dividend policy |
| Dividend Yield Ratio | Dividend per Share / Market Price × 100 | Return to investors |

9. Key Relationships

- ✓ Current Ratio ideal = 2:1
- ✓ Quick Ratio ideal = 1:1
- ✓ Higher ROE = better performance
- ✓ Lower Debt-Equity = lower risk

10. Practical Insights

- ✓ High liquidity ≠ always good (idle funds)
- ✓ High leverage → high risk + high return
- ✓ Profitability must be analyzed with efficiency

11. Limitations of Ratio Analysis

- ✓ Ignores inflation
- ✓ Affected by accounting policies
- ✓ Window dressing possible
- ✓ Not useful alone

Funds Flow

1. Meaning of Funds Flow Statement

1.1 Meaning

- ✓ Funds Flow Statement is a statement showing the movement of funds (working capital) between two balance sheet dates.
- ✓ It explains where funds came from (sources) and how they were used (applications).

1.2 Definition

- ✓ Funds Flow Statement is “a statement that highlights the changes in financial position of a firm by analyzing the sources and uses of funds.”

2. Concept of Funds

- ✓ Funds = Working Capital
- ✓ Working Capital = Current Assets – Current Liabilities
- ✓ So, funds flow means change in working capital.

3. Objectives of Funds Flow Statement

- ✓ To analyze changes in financial position
- ✓ To identify sources and uses of funds
- ✓ To evaluate working capital management
- ✓ To assist in financial planning

4. Flow of Funds

Funds flow occurs only when there is:

- ✓ Increase in non-current liabilities
- ✓ Decrease in non-current assets
- ✓ Change in working capital

5. Types of Transactions

5.1 Transactions Causing Flow of Funds

| Transaction | Effect |
|--------------------------|---------|
| Issue of shares | Inflow |
| Sale of fixed assets | Inflow |
| Purchase of fixed assets | Outflow |
| Repayment of loan | Outflow |

5.2 Transactions NOT Causing Flow of Funds

- ✓ Depreciation
- ✓ Provision for tax
- These are non-fund items
- ✓ Transfer to reserves

6. Schedule of Changes in Working Capital

6.1 Purpose

- ✓ To calculate increase or decrease in working capital

6.2 Format

| Particulars | Previous Year | Current Year | Increase | Decrease |
|---------------------|---------------|--------------|----------|----------|
| Current Assets | | | | |
| Current Liabilities | | | | |

- ✓ Increase in CA → Increase in WC
- ✓ Increase in CL → Decrease in WC

7. Funds Flow Statement Format

Funds Flow Statement

| Sources of Funds | Amount | Application of Funds | Amount |
|-----------------------|--------|-----------------------------|--------|
| Issue of shares | xxx | Purchase of assets | xxx |
| Long-term loans | xxx | Repayment of loan | xxx |
| Sale of assets | xxx | Payment of dividend | xxx |
| Funds from operations | xxx | Increase in working capital | xxx |

8. Funds from Operations

8.1 Meaning

- ✓ Funds generated from regular business operations

8.2 Calculation

- ✓ Adjusted Profit & Loss Method

| Particulars | Amount |
|----------------------------|--------|
| Net Profit | xxx |
| Add: Non-cash expenses | |
| Depreciation | xxx |
| Loss on sale of assets | xxx |
| Less: Non-operating income | |
| Profit on sale of assets | xxx |
| Funds from Operations | xxx |

9. Key Adjustments

9.1 Non-Cash Items

- ✓ Depreciation
- Added back to profit
- ✓ Amortization

9.2 Non-Operating Items

- ✓ Profit/loss on sale of asset
- Adjusted accordingly

10. Important Concepts

10.1 Increase in Working Capital

- ✓ Application of funds

10.2 Decrease in Working Capital

- ✓ Source of funds

11. Difference: Funds Flow vs Cash Flow

| Basis | Funds Flow | Cash Flow |
|---------|--------------------|----------------------|
| Concept | Working capital | Cash |
| Scope | Wider | Narrow |
| Use | Long-term analysis | Short-term liquidity |
| Focus | Sources & uses | Cash inflow/outflow |

12. Advantages

- ✓ Shows financial changes
- ✓ Helps in planning
- ✓ Identifies fund sources

13. Limitations

- ✓ Ignores cash position
- ✓ Based on historical data
- ✓ Complex calculations

14. Steps in Preparation

1. Prepare Balance Sheets
2. Prepare Schedule of Working Capital
3. Calculate Funds from Operations
4. Prepare Funds Flow Statement
- 5.

Key Points

- ✓ Funds = Working Capital
- ✓ Increase in WC = Application
- ✓ Decrease in WC = Source
- ✓ Depreciation = Non-fund item
- ✓ Profit \neq Funds

Cash Flow

1. Meaning of Cash Flow Analysis

1.1 Meaning

- ✓ Cash Flow Analysis refers to the study of inflow and outflow of cash and cash equivalents in an organization over a period

1.2 Definition

- ✓ A Cash Flow Statement is “a statement showing the movement of cash under operating, investing, and financing activities.”

2. Objectives of Cash Flow Analysis

- ✓ To assess liquidity position
- ✓ To analyze cash management efficiency
- ✓ To evaluate ability to meet obligations
- ✓ To assist in financial planning and decision-making

3. Components of Cash Flow Statement

3.1 Operating Activities

Meaning

- ✓ Cash flows from core business operations

Examples

- ✓ Cash from sales
- ✓ Cash paid to suppliers
- ✓ Salaries paid

3.2 Investing Activities

Meaning

- ✓ Cash flows from purchase and sale of long-term assets

Examples

- ✓ Purchase of machinery (outflow)
- ✓ Sale of investments (inflow)

3.3 Financing Activities

Meaning

- ✓ Cash flows related to capital structure

Examples

- ✓ Issue of shares
- ✓ Dividend payment
- ✓ Loan repayment

4. Format of Cash Flow Statement

Cash Flow Statement (Basic Format)

| Particulars | Amount |
|-------------------------------------|--------|
| Cash Flow from Operating Activities | xxx |
| Cash Flow from Investing Activities | xxx |
| Cash Flow from Financing Activities | xxx |
| Net Increase/Decrease in Cash | xxx |
| Opening Cash Balance | xxx |
| Closing Cash Balance | xxx |

5. Methods of Preparing Cash Flow (Operating Activities)

5.1 Direct Method

Meaning

- ✓ Shows actual cash receipts and payments

Format

| Particulars | Amount |
|------------------------------|--------|
| Cash received from customers | xxx |
| Less: Cash paid to suppliers | xxx |
| Less: Salaries paid | xxx |
| Net Cash from Operations | xxx |

5.2 Indirect Method (Most Important for Exam)

Meaning

- ✓ Starts from Net Profit and adjusts for non-cash and non-operating items

Indirect Method Format

| Particulars | Amount |
|------------------------------------|--------|
| Net Profit before tax | xxx |
| Add: Non-cash expenses | |
| Depreciation | xxx |
| Less: Non-operating income | |
| Profit on sale of asset | xxx |
| Adjust: Changes in Working Capital | |
| Increase in Current Assets | (-) |
| Increase in Current Liabilities | (+) |
| Net Cash from Operations | xxx |

6. Key Adjustments

6.1 Non-Cash Items

- ✓ Depreciation
- ✓ Amortization
- Added back

6.2 Non-Operating Items

- ✓ Profit/loss on sale of assets
Adjusted accordingly

6.3 Working Capital Changes

| Item | Increase | Decrease |
|---------------------|----------|----------|
| Current Assets | Deduct | Add |
| Current Liabilities | Add | Deduct |

7. Cash and Cash Equivalents

Includes:

- ✓ Cash in hand
- ✓ Bank balance
- ✓ Short-term investments

8. Advantages of Cash Flow Analysis

- ✓ Shows real liquidity
- ✓ Helps in cash planning
- ✓ Useful for investors and creditors

9. Limitations

- ✓ Ignores non-cash transactions
- ✓ Not a measure of profitability
- ✓ Historical in nature

10. Difference: Cash Flow vs Funds Flow

| Basis | Cash Flow | Funds Flow |
|---------|-----------|--------------------|
| Concept | Cash | Working capital |
| Scope | Narrow | Broad |
| Focus | Liquidity | Financial position |

11. Important Points

- ✓ Indirect method is most asked
- ✓ Depreciation → always added
- ✓ Increase in CA → decrease cash
- ✓ Increase in CL → increase cash
- ✓ Profit ≠ Cash

12. Practical Interpretation

- ✓ Positive operating cash → good sign
- ✓ Negative investing cash → expansion
- ✓ Negative financing cash → repayment

1. Meaning of DuPont Analysis

1.1 Meaning

- ✓ DuPont Analysis is a financial performance framework that breaks down Return on Equity (ROE) into its key components to identify the drivers of profitability.

1.2 Definition

- ✓ DuPont Analysis is “a method of analyzing a company’s financial performance by decomposing ROE into profitability, efficiency, and leverage components.”

2. Origin of DuPont Analysis

- ✓ Developed by DuPont Corporation (USA)
- ✓ Used for performance evaluation and strategic decision-making

3. Basic DuPont Formula (3-Step Model)

ROE Decomposition

- ✓ $ROE = \text{Net Profit Margin} \times \text{Asset Turnover} \times \text{Financial Leverage}$

Table: 3 Components

| Component | Formula | Meaning |
|--------------------|-----------------------|---------------|
| Net Profit Margin | Net Profit / Sales | Profitability |
| Asset Turnover | Sales / Total Assets | Efficiency |
| Financial Leverage | Total Assets / Equity | Leverage |

4. Expanded DuPont Model (5-Step Model)**Formula**

$$\checkmark \text{ ROE} = (\text{Net Profit} / \text{EBT}) \times (\text{EBT} / \text{EBIT}) \times (\text{EBIT} / \text{Sales}) \times (\text{Sales} / \text{Assets}) \times (\text{Assets} / \text{Equity})$$

Detailed Components Table

| Component | Formula | Interpretation |
|--------------------|------------------|----------------------|
| Tax Burden | Net Profit / EBT | Impact of tax |
| Interest Burden | EBT / EBIT | Impact of interest |
| Operating Margin | EBIT / Sales | Operating efficiency |
| Asset Turnover | Sales / Assets | Efficiency |
| Financial Leverage | Assets / Equity | Capital structure |

5. Step-by-Step Interpretation**5.1 Profitability (Net Profit Margin)**

✓ High → Good cost control

✓ Low → High expenses

5.2 Efficiency (Asset Turnover)

✓ High → Efficient use of assets

✓ Low → Underutilized assets

5.3 Leverage (Financial Leverage)

✓ High → More debt, higher risk

✓ Low → Conservative financing

6. DuPont Identity (Important)

$$\checkmark \text{ ROE} = \text{ROA} \times \text{Financial Leverage}$$

Where:

$$\checkmark \text{ ROA} = \text{Net Profit} / \text{Total Assets}$$

7. Example (Conceptual)**If:**

Profit margin = 10%

Asset turnover = 2 times

Leverage = 1.5

$$\text{ROE} = 10\% \times 2 \times 1.5 = 30\%$$

8. Advantages of DuPont Analysis

✓ Identifies source of profitability

✓ Useful for comparison

✓ Helps in strategic decision-making

✓ Breaks down complex ratios

9. Limitations

✓ Based on accounting data

✓ Can be manipulated

✓ Ignores external factors

✓ Not suitable alone

10. DuPont vs Traditional Ratio Analysis

| Basis | DuPont | Traditional |
|---------|---------------------|-----------------|
| Focus | Integrated analysis | Separate ratios |
| Insight | Deep | Limited |
| Use | Strategic | Basic |

11. Practical Insights (Exam-Oriented)

- ✓ ROE ↑ due to:
 - Higher profit margin
 - Higher leverage
 - Better asset utilization
- ✓ High ROE ≠ always good
 - Could be due to excessive debt

Preparation of Cost Sheet, Marginal Costing, Cost Volume Profit Analysis

1. Meaning of Cost Sheet

1.1 Meaning

- ✓ A Cost Sheet is a statement showing the detailed breakdown of total cost of production and cost per unit for a specific period

1.2 Definition

- ✓ Cost Sheet is “a statement prepared to present the various components of cost in a systematic manner.”

2. Objectives of Cost Sheet

- ✓ To determine cost of production and cost per unit
- ✓ To assist in pricing decisions
- ✓ To analyze cost components
- ✓ To control costs
- ✓ To compare performance

3. Elements of Cost

3.1 Material Cost

- ✓ Direct Material
- ✓ Indirect Material

3.2 Labour Cost

- ✓ Direct Labour
- ✓ Indirect Labour

3.3 Expenses

- ✓ Direct Expenses
- ✓ Indirect Expenses

4. Classification of Cost

| Type | Components |
|--------------------|---|
| Prime Cost | Direct Material + Direct Labour + Direct Expenses |
| Factory Cost | Prime Cost + Factory Overheads |
| Cost of Production | Factory Cost + Office Overheads |
| Cost of Sales | Cost of Production + Selling & Distribution Overheads |

5. Preparation of Cost Sheet (Step-by-Step)

Step 1: Prime Cost

- ✓ Prime Cost = Direct Material + Direct Labour + Direct Expenses

Step 2: Factory Cost (Works Cost)

- ✓ Factory Cost = Prime Cost + Factory Overheads

Step 3: Cost of Production

- ✓ Cost of Production = Factory Cost + Office/Admin Overheads

Step 4: Cost of Goods Sold

- ✓ COGS = Cost of Production + Opening Stock (FG) – Closing Stock (FG)

Step 5: Cost of Sales

- ✓ Cost of Sales = COGS + Selling & Distribution Overheads

Step 6: Profit

- ✓ Profit = Sales – Cost of Sales

6. Cost Sheet Format (Detailed)

Cost Sheet

| Particulars | Total Cost | Per Unit |
|---------------------------------------|------------|----------|
| Direct Material | xxx | xxx |
| Direct Labour | xxx | xxx |
| Direct Expenses | xxx | xxx |
| Prime Cost | xxx | xxx |
| Add: Factory Overheads | xxx | xxx |
| Factory Cost (Works Cost) | xxx | xxx |
| Add: Office Overheads | xxx | xxx |
| Cost of Production | xxx | xxx |
| Add: Opening Stock (FG) | xxx | |
| Less: Closing Stock (FG) | xxx | |
| Cost of Goods Sold | xxx | |
| Add: Selling & Distribution Overheads | xxx | |
| Cost of Sales | xxx | |
| Add: Profit | xxx | |
| Sales | xxx | |

7. Adjustments in Cost Sheet

Adjustment Table

| Item | Treatment |
|------------------------------|-----------|
| Opening Stock (Raw Material) | Add |
| Closing Stock (Raw Material) | Less |
| Opening WIP | Add |
| Closing WIP | Less |
| Opening Finished Goods | Add |
| Closing Finished Goods | Less |

8. Cost of Material Consumed

✓ $\text{Material Consumed} = \text{Opening Stock} + \text{Purchases} - \text{Closing Stock}$

9. Types of Cost Sheet

✓ Historical Cost Sheet

✓ Estimated Cost Sheet

10. Advantages of Cost Sheet

✓ Helps in cost control

✓ Facilitates comparison

✓ Useful for pricing decisions

✓ Identifies inefficiencies

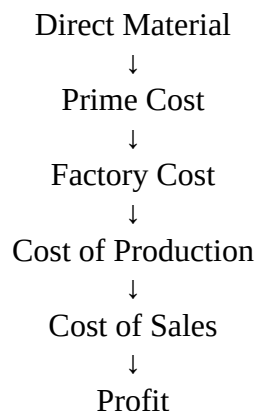
11. Limitations

✓ Based on estimates

✓ Ignores qualitative factors

✓ Not part of financial accounts

13. Shortcut Flow



14. Numerical Insight (Conceptual)

If:

- ✓ Cost of Production = ₹1,00,000
- ✓ Closing Stock = ₹10,000
- ✓ Opening Stock = ₹5,000
- ✓ COGS = 1,00,000 + 5,000 – 10,000 = ₹95,000

Marginal Costing

1. Meaning of Marginal Costing

1.1 Meaning

- ✓ Marginal Costing is a technique of costing where only variable costs are charged to products, and fixed costs are treated as period costs.

1.2 Definition

- ✓ Marginal Costing is “the ascertainment of marginal cost and the effect on profit of changes in volume or type of output.”

2. Key Concepts

2.1 Marginal Cost

- ✓ Cost of producing one additional unit

2.2 Contribution

- ✓ Contribution = Sales – Variable Cost

It contributes towards:

- ✓ Fixed Cost recovery
- ✓ Profit

2.3 Profit Equation

- ✓ Profit = Contribution – Fixed Cost

3. Important Formulas (Marginal Costing)

| Concept | Formula |
|---------------|-------------------------------------|
| Contribution | Sales – Variable Cost |
| Profit | Contribution – Fixed Cost |
| Sales | Variable Cost + Fixed Cost + Profit |
| P/V Ratio | (Contribution / Sales) × 100 |
| Variable Cost | Sales – Contribution |

4. Profit–Volume (P/V) Ratio

Meaning

- ✓ Shows relationship between contribution and sales

Formulas

| Method | Formula |
|---------------|--|
| Basic | Contribution / Sales × 100 |
| Change method | Change in Profit / Change in Sales × 100 |

Importance

- ✓ Measures profitability
- ✓ Used in BEP calculation

5. Advantages of Marginal Costing

- ✓ Helps in decision-making
- ✓ Facilitates break-even analysis
- ✓ Useful for pricing

6. Limitations

- ✓ Ignores fixed cost in product costing
- ✓ Not suitable for long-term decisions
- ✓ Assumes cost behavior is linear

Cost–Volume–Profit (CVP) Analysis

1. Meaning of CVP Analysis

- ✓ CVP Analysis studies the relationship between cost, volume, and profit.

2. Assumptions of CVP

- ✓ Costs are classified as fixed and variable
- ✓ Selling price remains constant
- ✓ Output = Sales
- ✓ Efficiency remains constant

3. Break-Even Analysis (BEP)

3.1 Meaning

- ✓ Point where Total Revenue = Total Cost
- ✓ Profit = Zero

BEP Formulas

| Type | Formula |
|-------------------|------------------------------------|
| BEP (Units) | Fixed Cost / Contribution per unit |
| BEP (Sales Value) | Fixed Cost / P/V Ratio |

4. Margin of Safety (MOS)

Meaning

- ✓ Excess of actual sales over break-even sales

Formula

| Concept | Formula |
|---------|---|
| MOS | Actual Sales – BE Sales |
| MOS % | $(\text{MOS} / \text{Actual Sales}) \times 100$ |

5. Angle of Incidence

- ✓ Shows rate of profit earning
- ✓ Larger angle = higher profit

6. Target Profit Analysis

Formulas

| Concept | Formula |
|---------------|---|
| Sales (Units) | $(\text{Fixed Cost} + \text{Target Profit}) / \text{Contribution per unit}$ |
| Sales (Value) | $(\text{Fixed Cost} + \text{Target Profit}) / \text{P/V Ratio}$ |

7. Key Relationships

- ✓ High P/V ratio → High profitability
- ✓ Low BEP → Low risk
- ✓ High MOS → Safe position

8. CVP Graph (Concept)

- ✓ X-axis: Output/Sales
- ✓ Y-axis: Cost/Revenue
- ✓ Intersection = BEP

9. Decision-Making Applications

- ✓ Pricing decisions
- ✓ Make or buy
- ✓ Shutdown decisions
- ✓ Product mix