**ACT – 619- Managerial Accounting**

**Answer of the question n. 1**

**Contribution margin ratio:**

The contribution margin ratio is the value of a company's sales minus its variable costs expressed as a percentage.

ontribution margin is calculated as Revenue - Variable Costs. The contribution margin ratio is calculated as (Revenue - Variable Costs) / Revenue.

The contribution margin is the difference between the sale price of a product and the variable costs associated with making the product.

The formula for the contribution margin is:

Contribution Margin = Revenue - Variable Costs

The contribution margin ratio represents a company’s revenue minus variable costs, divided by its revenue. In short, it is the proportion of revenue left over after paying for variable costs.

The formula for the contribution margin ratio is:

Contribution Margin Ratio = (Revenue - Variable Costs) / Revenue

If you already know the contribution margin, the contribution margin ratio formula can be simplified to:

Contribution Margin Ratio = Contribution Margin / Revenue

Suppose Company A has the following [income statement](https://www.careerprinciples.com/resources/how-to-prepare-an-income-statement) with revenue of 100,000, variable costs of 35,000, and fixed costs of 20,000.

To calculate the contribution margin, we take the revenue and subtract the variable costs. In this case, it is **100,000 - 35,000 =** **65,000.**

To calculate the contribution margin ratio, we take the revenue, subtract the variable costs, and divide the result by the revenue. In this case, it is **(100,000 - 35,000) / 100,000 = 0.65 or 65%.**

We can also calculate the contribution margin ratio with a more simplified formula if we already have the contribution margin. For this, the formula would simply be contribution margin divided by revenue. In this example, it is **65,000 / 100,000 = 0.65 or 65%.**

The fixed costs of 20,000 are not included in the calculation. However, they will play an important part in calculating the [net income formula](https://www.careerprinciples.com/resources/net-income-formula).

The contribution margin ratio is used by finance professionals to analyze a company’s profitability. It is often used for building a break-even analysis, which helps companies determine at what point a new business project will reach enough sales to cover the costs. In other words, reach a profit of exactly zero.

Doing this break-even analysis helps FP&A (financial planning & analysis) teams determine the appropriate sale price for a product, the profitability of a product, and the budget allocation for each project.

The best possible contribution margin ratio is 100%. However, this implies that a company has zero variable costs, which is not realistic for most industries. As such, companies should aim to have the highest contribution margin ratio possible, as this gives them a higher likelihood of covering its fixed costs with the money remaining to reach profitability.

While a high contribution margin ratio is impressive, it is important to note that companies should not sacrifice the quality of their product or service purely for the sake of increasing the contribution margin ratio. Striking a balance is essential for keeping investors and customers happy for the long-term success of a business.

**Operating leverage:**

Operating leverage is a cost-accounting formula that measures the degree to which a firm or project can increase operating income by increasing revenue. A business that generates sales with a high gross margin and low variable costs has high operating leverage.

Operating leverage occurs when a company has fixed costs that must be met regardless of sales volume. When the firm has fixed costs, the percentage change in profits due to changes in sales volume is greater than the percentage change in sales.

It is the percentage change in operating profit relative to sales. It is also known as the “Degree of Operating Leverage or DOL.” Please note that the greater use of fixed costs, the greater the impact of a change in sales on a company's operating income. Formula = % change in EBIT / % change in Sales.

If a business has a high degree of operating leverage, it's a reliable indication that its proportion of fixed to variable costs is high. As such, the business is using more fixed assets to support its core business. Ultimately, this means that the business will be able to expand its profit margin more quickly.

A high operating leverage means a company has a large proportion of fixed costs compared to its total costs. An example might be an airline company. They have large fixed expenses, including airplane maintenance and employee salaries, which stay relatively the same even as the number of sales varies.

The degree of operating leverage measures how much a company's operating income changes in response to a change in sales. The DOL ratio assists analysts in determining the impact of any change in sales on company earnings.

There are three proportions of leverage that are financial leverage, operating leverage, and combined leverage. The financial leverage assesses the impact of interest costs, while the operating leverage estimates the impact of fixed cost. There are two sorts of influence – operating leverage and financial leverage.

In addition to setting benchmarks for when to increase operating costs, you can improve operating leverage by cutting costs in a way that doesn't impair your ability to grow. For Murray, technology, especially in the finance and accounting side, is one way to do that.

This measure is directly proportional to a company's fixed costs. This means that it can be reduced by reducing fixed costs. Hence, by replacing automated equipment, which is a fixed cost, with direct labor, which is a variable cost, the fixed cost will be reduced and operating leverage will be reduced.

Profitability increases with operating leverage. Because firms' fixed and quasi-fixed costs do not increase at the same rate as their revenues, their operating leverage further increases their profitability in good times.

The operating leverage calculation helps you measure what percentage of your business’s total costs are constituted by fixed and variable costs. This enables you to determine how effectively your company is using fixed costs to generate profits. Consequently, you can use the operating leverage equation to determine your firm’s [breakeven point](https://gocardless.com/guides/posts/what-is-break-even-analysis/) and understand the degree to which your company can increase its [operating income](https://gocardless.com/guides/posts/what-is-operating-income/) by increasing revenue.

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High operating leverage businesses will need to maintain high sales to cover their fixed costs. A low degree of operating leverage points the other way, indicating that the firm uses more variable assets to support the core business, leading to a lower gross margin.

Generally speaking, high operating leverage is better than low operating leverage, as it allows businesses to earn large profits on each incremental sale.

Having said that, companies with a low degree of operating leverage may find it easier to earn a profit when dealing with a lower level of sales. In addition, high operating leverage may be more vulnerable to changing macroeconomic conditions.

While the economy is in good shape, these firms may experience increased profitability. However, an economic downturn can lead to plummeting earnings due to their high fixed costs.

The operating leverage calculation is necessary because it can help understand the appropriate price-point for covering costs and generating a profit. Furthermore, it can help understand how effectively business can use fixed-cost items, such as machinery or warehousing, to generate profits. Simply put, if can eke more profits from your fixed assets, can be able to improve operating leverage.

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Companies with high operating leverage can benefit from economies of scale and achieve higher profit margins, but they also face risks and limitations, such as the risk of losses if sales volume decreases and limited flexibility in their cost structure.

**Answer of the question n. 2**

**Term cost:**

[Incremental](https://www.lawinsider.com/dictionary/term-cost) Term Commitment means, with respect to any Lender, the commitment, if any, of such Lender, established pursuant an Incremental Facility Agreement and Section 2.21, to make Incremental Term Loans of any Series hereunder, expressed as an amount representing the maximum principal amount of the Incremental Term Loans of such Series to be made by such Lender.

Time cost broadly refers to the amount of time it takes to complete a project, from its planning to completion.

Term Cost means an amount equal to the annual cost of current life insurance protection payable to the Participant's beneficiary under the Policy measured by the lesser of (1) the P.S. 58 rates as published by the Internal Revenue Service or (2) the Insurer's most favorable 1-year term rates offered to the public.

Cost, a frequently used word in all types of organizations- manufacturing, non-manufacturing, business, service and retail. The process of management functions involves planning, control, decision making as well as co-ordination.

One of the most important inputs in managerial decision making is cost data. Managerial decision making is the process of choosing among alternative courses of action; if there is no alternatives, there is no decision to make. Before communicating information effectively to others, management accountants must clearly understand the differences among various types of costs, their computations, and their usage.

Successful managers are certainly aware that it is the level of cost relative to revenue that determines the firm's overall profitability. Different types of costs are used in different situations. So in any business activity concerned with making maximum

profit from available resources, some information on cost is essential.

An important first step in studying management accounting is to gain an understanding of the various types of costs incurred by organizations. In this unit we will learn the widely recognized cost terms, concepts, and their classifications that is necessary to understand and communicate cost and management accounting information.

**Different types of manufacturing and non-manufacturing costs:**

There are three major categories of manufacturing costs, according to Simple Studies: direct labor, direct material, and manufacturing overhead. Nonmanufacturing, also known as "period" costs, consists of selling and administrative expenses.

Manufacturing costs fall into three broad categories of expenses: materials, labor, and overhead. All are direct costs.

The manufacturing cost is classified into three categories: direct materials cost, direct labor cost and manufacturing overhead. It is a factor in total delivery cost.

osts that are not related to the production of goods are called nonmanufacturing costs23; they are also referred to as period costs. These costs have two components— selling costs and general and administrative costs —which are described next.

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Three key types of manufacturing are make to stock (MTS), make to order (MTO) and make to assemble (MTA). Manufacturing systems are tailored to different product volumes and customer requirements, from systems for custom small-batch products to fully automated, high-volume factories.

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The three general categories of costs included in manufacturing processes are direct materials, direct labor, and overhead. Note that there are a few exceptions, since some service industries do not have direct material costs, and some automated manufacturing companies do not have direct labor costs.

Period costs include all non-manufacturing costs, such as the price of the office space and general expenses. This means that costs like salary, advertisement, interest, rent, salespeople's commission, accounting and audit fees and depreciation of office assets are part of period costs.

A manufacturing entity incurs a plethora of costs while running its business. While manufacturing or production costs are the core costs for a manufacturing entity, the other costs are also just as important as they too [affect](https://www.termscompared.com/effect-vs-affect/) overall profitability. Thus, [management](https://www.termscompared.com/difference-between-leadership-and-management/) attention must be focused on both the core and the ancillary costs to control and manage them with a view to maximize profitability on long term basis.

This article looks at meaning of and differences between two main cost categories for a manufacturing entity – manufacturing cost and non-manufacturing cost.

Manufacturing cost is the core cost categorization for a manufacturing entity. It encompasses the costs that must be incurred so as to produce marketable inventory. Entities may manufacture several types of products and the sum total of all the costs involved in producing those products is termed as manufacturing cost.

[Direct materials cost](https://www.termscompared.com/direct-vs-indirect-materials-cost/) includes all materials and supplies that are used as input in the production process and whose usage can be directly traced to the final product(s) manufactured by the entity. It primarily include raw materials and packing materials. The fabric, buttons, thread, packing boxes etc. used by a manufacturer of garment products are all examples of direct materials. Similarly, the total cost of fruit pulps, sugar, flavors, and food preservatives used by Mitchells food factory to produce various varieties of jam is also an example of direct materials cost.

[Direct labor cost](https://www.termscompared.com/direct-vs-indirect-labor-cost/) includes the wages and all other monetary [benefits](https://www.termscompared.com/compensation-vs-benefits/) paid out to those personnel who work in the manufacturing process and whose work can be directly traced to the products manufactured. In a garment factory, the sum of all the wages and benefits paid to pattern cutters, tailors, sewing machine operators, folders and packers is an example of direct labor cost.

**Manufacturing overheads** include all other costs involved in the manufacturing process but that cannot be directly traced to the final products. These can include rent of factory, [depreciation](https://www.termscompared.com/difference-between-depreciation-and-amortization/) of factory building, depreciation of plant and machinery, insurance and maintenance costs related to plant and machinery and costs associated with factory maintenance staff etc.

**Manufacturing (direct materials, direct labor, factory overhead) and non-manufacturing costs; product and period costs; raw materials, work-in-process and finished goods; cost of goods manufactured and cost of goods sold; cost accounting cycle.**

Manufacturing costs refer to those that are spent to transform materials into finished goods. Manufacturing costs include direct materials, direct labor, and factory overhead.

Direct materials - cost of items that form an integral part of the finished product. They refer to the major parts or ingredients. Examples include wood in furniture, steel in automobile, water in bottled drink, fabric.

Non-manufacturing costs refer to those incurred outside the factory or production department. These are costs are not needed in transforming materials into finished goods. Non-manufacturing costs include: selling expenses and general expenses.

**Answer of the question n. 7**

**Managerial accounting :**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

**Marginal analysis:** This assesses profits against various types of costs. It primarily deals with the benefits of increased production. It involves calculating the break-even point, which requires knowing the contribution margin on the company’s sales mix. Here, sales mix is the proportion of a product that a business has sold when compared to the total sales of that business. This is used to determine the unit volume for which the business’ gross sales are equal to total expenditures. This value is used by managerial accountants to determine the price points for various products.

**Constraint analysis:** Managerial accounting monitors the constraints on profits and cash flow with respect to a product. It analyzes the principal bottlenecks and the problems they cause, and calculates their impact on revenue, profit, and cash flow.

**Capital budgeting:** This is an analysis of information in order to make decisions related to capital expenditures. In this analysis, the managerial accountants calculate the net present value and internal rate of return to help managers with capital budgeting decisions like calculating payback period or calculating accounting rate of return.

**Inventory valuation and product costing:** This deals with determining the actual cost of goods and services. The process generally involves computing the overhead charges and assessment of direct costs associated with cost of goods sold.

**Trend analysis and forecasting:**This primarily deals with variations in product costs. The resulting data is helpful in identifying unusual patterns and finding efficient ways to identify and resolve the underlying issues.

Management accounting helps in analysing and recording financial information which can be used by a company to increase its efficiency and productivity. It presents the financial information in regular intervals using easy-to-understand techniques such as standard costing, marginal costing, project appraisal, and control accounting.

However, the information required to make managerial decisions depends completely on financial statements. Hence it becomes important to maintain error free records. Besides several disadvantages, it acts as a useful tool for better management of business.

The managerial accounting provides various information and it will helps the managers to take necessary decisions. The main objective of the managerial accounting is decision making.

Management accounting covers a wide range of areas, such as financial accounting, cost accounting, budgeting, and taxes. The primary goal is to assist management in performing its planning, directing, and managing tasks.

**Features of managerial accounting:**

Its key features include cost accounting, budgeting and forecasting, performance management, decision-making, strategic planning, risk management, and communication. Management accounting provides financial and non-financial information to aid in planning, controlling, and decision-making activities.

There are many functions of management accounting like Decision making, Coordinating, Planning and Control performance. Cost accounting is a type of accounting which focuses on cost calculation, cost control, and cost reduction.

Accounting is a systematic process of recording, summarizing, analyzing, and interpreting financial transactions and information. It plays a crucial role in providing relevant and reliable financial information to stakeholders for decision-making purposes.

There are two types of accounting systems: The first is a Single Entry System where a small business records every transaction as a line item in a ledger. The other is a Double Entry System, where every transaction is recorded both as a debit and credit in separate accounts.

The Importance of management accounting is that it allows businesses to gain insights into their competition. By tracking competitors' pricing strategies, product positioning and other factors related to performance, managers can identify opportunities for improvement and outpace the market share of their rivals.

Management accounting professionals can gather information to make accounting decisions and evaluate the company's operations. This ensures that these professionals ensure accountability of company resources. This ensures profit maximization.

Managerial accounting focuses on internal users—executives, product managers, sales managers, and any other personnel within the organization who use accounting information to make important decisions. Managerial accounting information need not conform with U.S. GAAP. In fact, conformance with U.S. GAAP may be a deterrent to getting useful information for internal decision-making purposes. For example, when establishing an inventory cost for one or more units of product (each jersey or hat produced at Sportswear Company), U.S. GAAP requires that production overhead costs, such as factory rent and factory utility costs, be included.

However, for internal decision-making purposes, it might make more sense to include nonproduction costs that are directly linked to the product, such as sales commissions or administrative costs.

Managerial accounting often focuses on making future projections for segments of a company. Suppose Sportswear Company is considering introducing a new line of coffee mugs with team logos on each mug. Management would certainly need detailed financial projections for sales, costs, and the resulting profits (or losses). Although historical financial accounting data from other product lines would be useful, preparing projections for the new line of mugs would be a managerial accounting function.

Another characteristic of managerial accounting data is its high level of detail. As noted in the opening dialogue between the president and accountant at Sportswear Company, the financial information in the annual report provides a general overview of the company’s financial results but does not provide any detailed information about each product. Information, such as product profitability, would come from the managerial accounting function.

Finally, managerial accounting information often takes the form of nonfinancial measures. For example, Sportswear Company might measure the percentage of defective products produced or the percentage of on-time deliveries to customers. This kind of nonfinancial information comes from the managerial accounting function.

Accounting incorporates various tasks that companies must perform to deal with financial transactions. This process involves recording, summarizing, analyzing, and reporting financial information. However, the most relevant branch of accounting is financial accounting. Within this branch, companies seek to prepare financial statements. These statements provide details of a company’s operations and activities for a period.

For most companies, accounting is a part of the finance department. This department is responsible for maintaining and handling financial records. Usually, it also overlooks other financial functions, such as budgeting, forecasting and capital decisions. However, this area does not fall under the scope of financial accounting. Companies perform this process internally and do not present this data for external usage.

Apart from financial accounting, the accounting field also incorporates many other branches or areas. One such area is managerial accounting, also known as the management accounting. This branch differs significantly from financial accounting. However, there are some overlaps within both areas. Managerial accounting has several features and characteristics that differentiate it from financial accounting.

The features and characteristics of managerial accounting are crucial to understanding its essence. However, it is vital to define what managerial accounting is first.

Every branch within accounting has its features and characteristics. These features set the branch apart from the others. For companies, it is crucial to understand them since it dictates the best usage for the specific accounting branch. The features and characteristics of managerial accounting differ significantly from other areas. More specifically, it is very different from financial accounting.

Some of the features and characteristics of managerial accounting include the following.

One of the most critical characteristics of managerial accounting is its emphasis on future activities. As stated above, managerial accounting primarily covers the decisions made by managers. These decisions relate to a company’s future and its activities. Therefore, this branch primarily focuses on future activities. While it uses past results and figures, it still emphasizes future operations. Tools such as budgeting and forecasting are essential to this process.

Managerial accounting focuses on qualitative information. Other accounting branches may cover figures and values. While managerial accounting also does that, it emphasizes the quality of the underlying data more. On top of that, managerial accounting only focuses on providing information. Interpreting and judging depend on a manager. Similarly, this branch does not make a decision. Managers do that instead.

**Answer of the question n. 8**

**The importance of managerial accounting:**

Managerial accounting helps managers make operational decisions–intended to help increase the company's operational efficiency–which also helps in making long-term investment decisions.

[Managerial accounting](https://www.investopedia.com/terms/m/managerialaccounting.asp) is the type of accounting that provides financial information to managers and decision-makers within a company or organization. Managerial accounting, such as weekly or daily [budgeting](https://www.investopedia.com/ask/answers/042215/whats-difference-between-budgeting-and-financial-forecasting.asp), is used to help managers make decisions that increase the organization's operational effectiveness and efficiency.

Managerial accounting is different from [financial accounting](https://www.investopedia.com/terms/f/financialaccounting.asp) in that financial accounting is centered on providing quarterly or yearly financial information to investors, shareholders, creditors, and others outside the organization. Conversely, managerial accounting is used internally to make efficiency improvements within the company.

Managerial accounting is the type of accounting that provides financial information to managers and decision-makers within a company.

Managerial accounting often involves various financial metrics, including revenue, sales, operating expenses, and cost controls.

Managerial accounting helps companies plan, forecast, and budget at an enterprise-wide level to ensure the company's long-term success.

There are a number of common scenarios in which managerial accounting is appropriate. The first applies to those situations in which a company competes in a fast-paced and highly-competitive business environment.

Managerial accounting often involves several aspects of the company's financial results, including revenue, sales, operating expenses, and cost controls. A company's executive management team needs to plan and forecast at an enterprise-wide level. Below are three high-level areas that managerial accounting is often employed to enhance the internal financial metrics of a company.

Managerial accounting involves [forecasting](https://www.investopedia.com/ask/answers/042215/whats-difference-between-budgeting-and-financial-forecasting.asp) and planning to project the financial direction of the company in the coming months and years. These plans often involve projections for revenue but also costs as well. Typically, this high-level planning involves creating a [capital budget](https://www.investopedia.com/terms/c/capitalbudgeting.asp), which details the costs of any investments to be done in the future. The budget might outline the costs and projections for new equipment purchases and acquisitions.

The high-level plans, forecasts, and budgets need to be continuously tracked, monitored, and, if necessary, changed to meet the changing landscape. Below are a few of the types of analysis involved in managerial accounting to achieve a company's high-level objectives.

Managerial Accounting is also known as cost accounting and management accounting. It is a branch of accounting that deals with the process of identification, measurement, interpretation, analysis, and communication of information to managers for the pursuit of organizational goals. Managerial Accounting is different from financial [**accounting**](https://leverageedu.com/blog/accounting-courses/)as its aim is to assist the management to make well-informed decisions. The scope of Managerial Accounting is wide as well. Keep reading to know more about the importance of managerial accounting, its objectives, jobs, and salary.

Managerial accounting aims to assist the management of an organization to effectively perform its functions such as planning, organizing, directing, and controlling. They help the management to carry out these tasks in an efficient way by performing their roles. Some of them are listed below.

Managerial Accounting delivers accurate data which is helpful in planning.

They deal with the analysis of data. The data is presented after calculating the ratios and projecting trends. It is then used for decision-making. For example, categorizing items on the basis of supplier, and territory.

Managerial Accountant assists to conduct meaningful discussions in a company. For example, they explain the organizational feasibility of various segments of a plan, the progress of the plan, and the roles played by different groups to implement the plan.

They help in transforming a company’s strategy and objectives into feasible business goals.  For example, by implementing budget control and standard costing.

Managerial Accounting also deals with qualitative information that can’t be measured in the form of money. For example, industry cycles, and research and development strength can be collected by conducting surveys.

Gather and analyze the data through which the experts can identify the company’s growth and market trends.

Gather information that is helpful to make accounting decisions and evaluate the company’s operations. Thus, helping in profit maximization.

Assist in making appropriate business decisions. The information provided by the managerial accountant is used to strategize business plans for the benefit of the company and identity the areas where improvement is required.

With the help of financial documents trends analysis help in identifying inconsistencies. It will help the management to change the existing methods to reach the business goals.