

Unit - 1

Nature and scope of Management Accounting

Meaning of Management Accounting

Management Accounting is the presentation of accounting information to management in order to formulate the policies and assist in its day-to-day activities . In other words, it help the management to perform all its functions including planning, organizing, staffing, directing and control.

Definition of Management Accounting

The Institute of cost and Management Accountants, London, has defined Management Accounting as, "the application of professional knowledge and skill in the preparation of accounting information in such a way as to assist management in the formulation of policies and in planning and control of the operation of the undertaking."

According to R.N Anthony, " Management Accounting is concerned with accounting information that is useful to management

Objectives of Management Accounting

The objectives of management accounting are as follows:

- (i) To present financial information to the management in a way that is easily understandable
- (ii) To supply necessary data to the management for formulating future plans. The data includes statements pertaining to past results and estimates for the future.
- (iii) To help in keeping the actual performance as per the plans made by the management.
- (iv) To establish a strong, working relationship amongst different individuals pertaining to different departments, of the same organization.
- (v) To maximize the wealth of the organization

- (Vi) To motivate the employees, by fixing targets and providing incentives“
- (Vii) To keep the tax burden of the organization minimum
- (viii) To keep the management fully informed about the latest position of the organisation

Nature of Management Accounting

- (i) Mainly concerned with future : Planning is the process of looking ahead by taking the reference of the past. The process of management accounting is driven towards the future course of action with proper planning based on the analytical financial details other past. It considers the budgets to forecast the future revenue and expenditure and inflow and out follow of funds.
- (ii) Recent origin: Management accounting has been well recognized in the modern business houses due to increasing customer base and market complexity. Modern managerial decisions need much quantitative organized information rather traditional form of financial statements for making effective decisions.
- (iii) Management need oriented: Management Accounting is highly personalized service and Subjective in nature. It is basically intended for the use of internal managerial decisions. It provides necessary information as per the need of the management in therequired format and ensures that the information's are sufficient to make effective decisions.
- (iv) Information as per Management need: There is no hard and fast rule in the preparation of management reports and statement, it always as per the situationalrequirement of the management and based on the availability of the data for analysis and interpretation.
- (v) Provides data and not the decisions: Management accounting discipline is not an replacement of management. It provides just information to the managerial decisions. It facilitates decisions since majority of the decisions are made considering the facts and figures provided by the management accountants. But at the same time these data itself cannot form the decisions of the management.
- (vi) Objective oriented: Management accounting present data in such a way that it enables the management to formulate policies and programme so as to achieve the managerial or organizational goals in most efficient and effective manner.
- (vi) Financial and cost accounting information: Management accounting is all about the analysis

and interpretation of financial and cost accounting data, to generate such reports and statements which can prove useful to management in decision making.

(vii) Increases efficiency: Management accounting is concerned with providing, the needed information to the Management in the proper manner and assisting in the policy formulation and managerial control. This enables the management to increase efficiency of its operation and ensures the optimum profits with minimum operational risk

Apart from the above unique features Management Accounting is also characterized by the following:

- a) It does not follow any fixed norms or formats.
- b) Basically concerned with forecasting
- c) Mainly used for Internal purpose.
- d) Useful in managerial decision making.
- e) It is not compulsory as the any other disciplines like financial accounting and cost accounting. It is purely optical to the management .
- f) It is an interdisciplinary subject since it mainly depends on the financial and cost accounting

Scope of Management Accounting

(i) Financial Accounting : Accounting is the process of systematic recording of financial transactions so as to determine the true and fair financial position of a concern. Management accounting derives the necessary data from the financial accounting. For instance when fund flow statement or Ratio statement are to be prepared, financial statements are very essential without which the preparation and decision about fund flow and ratios are not possible.

(ii) Cost Accounting: Management accounting uses certain technique and tools of cost accounting as well. Cost accounting provides the various techniques of costing, viz, Marginal Costing, Standard Costing, Differential Cost Analysis etc. which plays significant role in the operation and control of the enterprise It assists management in measuring the operational efficiency of the management and achieving managerial goals.

(iii) Budgetary Control: Budgetary control is a system of controlling Costs thorough establishment of standards. It controls the activities of the business and measures the variance by comparing the actual with the budgeted figures and enquires into the reasonsof such variance at each and every step, so that the adverse variance may not be repeated in future.

(iv) Tax Planning: It is concerned with the computation of taxable income according to Income-Tax Act, and filing of returns and the payment of tax. It is one of the core functions of the modern management accountant, facilitating management in proper tax planning and accounting.

(v) Analysis and Interpretation of Accounts: Financial statement can be better understood through comparative study. The primary duty of the management accountant is to explain the data relating to the management and assist management in taking decisions.

(vi) Reporting: Management accounting uses the technique of statistics wherever necessary for effective analysis and interpretation. Sometimes reports on various aspects of the business are to be submitted by the management accountants. At the time of preparation of the statement or Repots, they use different statistical techniques, viz, Line Chart, Pie Chart, Index Numbers etc. in order to be more attractive and intelligible.

(vii) Internal audit and control: Management accountants depend on the internal audit and use that for generating reports on various financial issues for decision making.

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(ix) Tax Accounting : It is concerned with the computation of taxable income as per Income Tax Act, and filing of returns and the payment of tax. It is one of the core functions of the modern management accountant, facilitating management in proper tax planning and accounting.

(x) Analysis and Interpretation of Accounts: Financial statement can be better understood through comparative study. The primary duty of the management accountant is to explain the data relating to the management and assist management in taking decisions.

(xi) Management Information System: It is very difficult to imagine organisations without computers in the globalized corporate environment. Information's are stored and supplied to the management with the help of computers for managerial decisions. The advancement in the technology has made management accountants job much easier and effective and has made more depended on the technology from time to time.

Tools and Techniques used in Management Accounting

The important tools and techniques are briefly explained below.

1. Financial Planning

The main objective of any business organization is maximization of profits. This objective is achieved by making proper or sound financial planning. Hence, financial planning is considered as best tool for achieving business objectives.

2. Financial Statement Analysis

Profit and Loss account and Balance Sheet are important financial statements. These statements are analyzed for different period. This type of analysis helps the management to know the rate of growth of business concern. This analysis is done through comparative financial statements, common size statements and ratio analysis.

3. Cost Accounting

Cost accounting presents cost data in product wise, process wise, department Wise branch wise and the like. These cost data are compared with predetermined one. This comparison of two costs enables the management to decide the reasons responsible for the difference between these costs.

4. Fund Flow Analysis

This analysis find out the movement of fund from one period to another. Moreover, this analysis is very useful to know whether the fund is properly used or not in a year When compared to the previous year. The working capital changes and funds from operation are also find out through this analysis.

5. Cash Flow Analysis

The movement of cash from one period to another can be find out through this analysis. Besides, the reasons for cash balance and changes between two periods are also find out. It studies the cash from operation and the movement of cash in a period.

6. Standard Costing

Standard costing is predetermined cost. It provides a yard stick for measuring actual performance. It is used to find the reasons for the deviations if any.

7. Marginal Costing

Marginal costing technique is used to fix the selling price, selection of best sales mix, best use of scarce raw materials or resources, to take make or buy decision, acceptance or rejection of bulk

order and foreign order and the like. This is based on the fixed cost, variable cost and contribution.

8. Budgetary Control

Under Budgetary control techniques, future financial needs are estimated and arranged according to an orderly basis. It is used to control the financial performances of business concern. Business operations are directed in a desired direction.

9. Ratio Analysis

It is used to management in the discharge of its basic functions of forecasting, planning, coordination, communication and control. It paves the way for effective control Of business operations by undertaking an appraisal of both the physical and monetary targets

10. Revaluation Accounting

The fixed assets are revalued as per the revaluation accounting method so that the capital is properly represented with the assets value. It helps to find out the fair return On capital employed.

11. Decision-making Accounting

A business problem can be solved by choosing any one of the best and most profitable alternative. To select such alternative, the relevant costs are compared. Thus, accounting information are used to solve the business problem which are arising out of increasing complexity of nature of business.

12. Management Information System

The free flow communication within the organization is essential for effective functioning of business. Hence, the management can design the system through which every employee of an organization can assess the information and used for discharging their duties and taking quality decisions.

Difference between Financial Accounting and Management Accounting

Basis	Financial accounting	Management Accounting
Users	Mainly intended to serve external users like share holders, bankers, creditors and government.	Mainly intended to serve internal users like management
Legality	Statutorily compulsory as per different acts such as companies act of 1956 income tax act of 1961etc.	Not compulsory
Development	It is well developed and very old system in practice	It is of recent development

Subject matter	It deals With preparation of financial statements through systematic recording and determines the financial position of a concern.	It deals with presentation of needed information for management for effective decisions.
Standard	There is specific standard for Preparation as per the act and reports are practice.	Preparation of statements and reports are not standardized
Dependency	It is an independent discipline . discipline.	It is an inter dependent.
Publications	It is compulsory to publish the financial reports of the concern.	It is not compulsory.
Statement and report prepared	Generally Trading and profit and loss account and balance sheet areprepared	It prepares the funds and cash flow statement, budgetary reports, ratio statements etc,
Consideration	It considers only monetary transactions.	It sometime considers non monetary aspect also like quality, machine hours, number of people working etc.
Auditing	Audit of books of accounts by a qualified chartered accountant iscompulsory	It is not necessary to getaudited the records of management accounting,

Difference between Cost Accounting and Management Accounting

Basis	Cost Accounting	Management Accounting
Functions	Basically executes the function of identification and recording of cost and cost control in the operation.	It basically assists management in decision making through providing necessary information.
Statutory compulsions .	It is necessary to maintain cost records in a systematic way in certain manufacturing industries asper the notification of the notification	It is purely optional to management
Focus	It is focused on cost identificationand cost control.	It is focused on the effective decisions for optimum managerial efficiency and objective attainment.
Users of the information	It is used by both internal as well as external parties.	Used by only internal parties.
Data used	It derives certain data from financial records.	It derives data from financial books, cost books as well as certain other sources.
Scope and coverage	The scope of this discipline is limited to the extent of cost recording and reporting	The scope of this discipline is broader and covers various aspects like finance, costing, taxation, audit

		and investments
Tools and techniques used	It follows well developed tools and techniques for identification and recording of cost.	It doesn't have well developed tools or technique.

Differences between Financial Accounting and Cost Accounting

Basis	Financial accounting	Cost accounting
1. Purpose	It serves the interest of business and other interested parties by Providing suitable information in the financial statements.	It renders information for the guidance of the management for the proper planning control and decision making.
2. Options	F A is required to be kept as per the requirements Of the company act and income tax act.	CA is voluntarily kept to serve the management in the discharge of management functions.
3. Analysis	FA reveal the profit of the business as a whole.	CA shows the profit result of each business as a whole operations process and product
4. Recording	It consists of classification recording and analysis of transaction in a subjective manner i.e., according to the nature of expenditure.	It records in an objective manner i.e., according to which cost are incurred
5. Control	It lays emphasis on the recording aspect, no consideration is given to control aspect.	It provides for a detailed system of control with the help of standard costing and budgetary control.
6. Reporting	It involves reporting of business performance at the end of the accounting year.	There is a continuous flow of data information of cost report to management.
7. Obligation	This is to be maintained compulsory.	This is to be maintainedvoluntarily.
8.Audit	Audit of FA is statutory	Audit of CA is not compulsory.
9. Duration of	FA provides financial information once a year.	CA furnishes reporting cost data at frequent intervals.
10. Pricing	It fails to guide the formulation of pricing policy.	It provides adequate data for formulating pricing policy.
11. Valuation of Stock	Stock is valued at cost or marked rice whichever is less.	Stock is always valued at cost price.

Limitations of Management Accounting

1. Data Dependency

Management accounting derives information from Financial accounting, Cost accounting and other sources. So, the conclusions arrived at by management accountants depend to a large extent on the accuracy of these two (Financial accounting and Cost accounting) records. Therefore, if the past data which are collected from the financial and cost records are found inaccurate, the decisions suggested by the management accountants, on the basis of the above, also will be inaccurate.

2. Does not give the decision

Management accounting cannot replace the decisions. It can just assist the management in its operations through providing necessary analytical statements and advises management for better and efficient managerial functions.

3. Costly affair

Installation and maintenance of Management accounting system is suitable for those concerns which has significant amount of transactions generally large establishments. before, small concerns cannot afford to adopt this system.

4. No standardization as other disciplines

Management accounting is still in the development stage. So it has to face the problems fluidity of concepts, improvement of techniques etc. It does not have any strong principles like financial accounting and cost accounting. It does not follow any set rule and hence differs in its practices.

5. Danger of misleading

The information Provided by Management accountants cannot be taken as full proof information for making any managerial decisions. Because the data used by management accountants itself may have window dressed data due to which the management accounts may mislead the management.

6. Needs human involvement for interpretation Management accounting involves people to make final reports or interpretations, due to which the interpretation may be of the personal opinion of the person Who has prepared it.

It creates differences in the interpretations and becomes more subjective rather than objective in the analysis

Unit 2

Ratio analysis

Meaning of ratio analysis

Ratio analysis is one of the important technique of financial analysis where ratios are used as a yard stick for evaluating the financial condition and performance of a firm.

According to accountants hand book by Winson Kenn and Bed Ford "A ratio is an expression of the quantitative relationship between two numbers"

Uses or advantages of ratios

1. It simplifies the financial statement.
2. It facilitates inter firm comparison.
3. It helps in planning.
4. It makes intra firm comparison possible.
5. The ratios can assist the management in its basic functions of planning, forecasting, co-ordination, control and communication.

Classification of ratios

Various Accounting ratios can be classified as follows

1. Traditional ratios
2. Functional ratios

1. Traditional ratios: It consists of

- a. Balance sheet ratios
 - b. Revenue sheet ratios or P&L A/c ratios
 - c. Composite or inter statement ratios
- a. **Balance sheet ratios:** ratios calculate on the basis of the figures or information's of balance sheet only are known as balance sheet ratios. Example: current ratio, liquid ratio, debt equity ratio etc.
 - b. **Revenue sheet ratios or P&L A/c ratios:** ratios calculated on the basis of the information's or the figures of profit and loss account are called revenue ratios or profit and loss account ratios. Example: gross profit ratio, net profit ratio, stock turnover ratio etc.

- c. **Composite or inter statement ratio:** ratios based on the figures of balance sheet as well as the profit and loss account are known as composite ratio. Example: return on proprietor's fund, earning per share etc.
- 2. **Functional ratios:** on the basis of function or tests accounting ratios are broadly classified as under.
 - a. **Liquid ratios:** It includes
 - Short term solvency ratios
 - Long term solvency and leverage ratio
 - Activity ratio
 - Profitability ratio etc.

Liquidity ratio refers to the ability of the concern to meet its current obligation as when they arrives liquidity ratios are the ratios which measures the short term solvency of the firm.

The sufficiency or insufficiency of the current asset should be assessed by comparing them with short term liquidity.

Significance of ratio analysis

1. It is an useful and important technique to check upon the efficiency with which working capital is being used in the enterprise.
2. It helps in cost control.
3. It is a medium of communication of financial position of a concern.
4. It is very helpful in financial forecasting.
5. It facilitates for comparison.
6. Financial ratios are very helpful in the diagnosis and financial health of a firm.

Limitations of ratios

1. Ratios are based on many assumptions and hence these may mislead the decision makers.
2. Ratios are meaningful only when they are studied with other ratios. A ratio alone cannot be meaningless by itself.
3. Understanding of ratios needs professional knowledge. Hence, it cannot be used by common people.
4. Ratios alone are not adequate for judging the financial position of a business.
5. Ratios will not give decisions: It is just information to make effective decisions.
6. There is no standardization in ratios.
7. Does not reflect the qualitative aspects.
8. It is based on financial statements.

Unit-3

Fund flow statement

Meaning of fund

The term fund can be used in three different ways. They are:

In narrow sense: It means cash or money.

In broad sense: It means all financial resources.

In popular sense: In the context of funds flow statement, the term fund means working capital. It is the excess of current assets over current liabilities.

Meaning of Fund Flow Statement

Fund flow statement is a statement in a summary form depicting the changes in the items of financial position between two balance sheet dates and showing sources and application of funds.

Objectives or purposes of Fund Flow Statement

- ❖ To know the changes in working capital during the period.
- ❖ To understand the working capital position of the firm.
- ❖ To assess the financial condition of the firm.
- ❖ To anticipate the working capital position.
- ❖ To reveal the most important changes those have taken place during a particular period.
- ❖ To provide a basis for budgeting.

Importance or uses or benefits of fund flow statement

1. Useful to share holders

- a. It provides information regarding the availability of funds in the business.
- b. It indicates the earning capacity of the business.
- c. It enables to know the ability of the company to pay the dividend.

2. Useful to long term creditors and debenture holders

- a. It helps to understand whether the money borrowed is utilized or not.
- b. It enables to judge the capacity of the company to repay the loan or debentures.

3. Useful to short term creditors, banks and financial institutions

- a. It helps to know whether the money borrowed is utilized or not.
- b. It helps to know whether the company can pay interest and to repay the principal in time.

4. Useful to management

- a. Planning temporary investment of funds.
- b. Evaluating proper utilization of funds.
- c. Formulating sound dividend policy.
- d. Estimating future working capital requirement.
- e. Testing whether working capital is effectively utilized.
- f. Taking appropriate decisions regarding purchase of assets.
- g. Identifying any necessary investment in fixed assets.
- h. Understanding the reason for financial difficulties, if any.
- i. Planning for redemption of long term debts.
- j. Ascertaining funds from operation.

Limitations of fund flow statement

1. It shows what happened in the past. Hence, it is historical in nature.
2. It is only a rearrangement of data given in financial statements. Hence, it is not original.
3. It cannot reveal continuous changes.
4. It does not take into account those transactions which do not affect the working capital.
5. It is not as useful as cash flow statement.
6. It does not reveal the cash position of a firm.

Steps involved in preparation of Fund flow statements

Step -1 preparation of schedule of changes in working capital.

Step -2 prepare necessary ledger accounts to identify the hidden transactions from the non-current assets and non-current liabilities.

Step-3 compute funds from operations from revenue expenses and incomes.

Step-4 preparation of Fund Flow Statement.

Treatment of special items

Proposed dividend It may be treated as non-current liability .the proposed dividend for the current year should be debited to Adjusted P&L A/c in order to find out funds from operation. The dividend paid will be shown as application in fund flow statement. Dividend proposed in last year is assumed to have been paid during the year.

Dividend paid –Sometimes proposed dividend is not given in the balance sheet. But dividend paid is given under adjustment. In such cases, it is added back to net profit while calculating fund from operation. It should also be taken the fund flow statement as an application.

Interim dividend –It is always as additional information. It should be added back to net profit while calculating fund from operation. It should also be taken as application in fund flow statement.

Provision for taxation –It is treated as non-current liability. In this case, a ledger account is prepared for this item in the work sheet, the closing balance figure (on credit side) being the provision made during the year, should be taken to the debit side of 'Adjusted P&L A/c' for calculating funds from operation. The amount of tax paid will be shown as application in the Fund Flow Statement.

Cash Flow Statement

Introduction

A cash flow statement is a statement which shows the change in cash position from one period to other. This statement helps in short term financial planning.

Definition of cash fund

Cash

Cash comprises cash on hand and demand deposits with banks.

Cash equivalents

There are short term, highly liquid investments which can be readily converted into cash without a decline in their value. Examples of cash equivalents are treasury bill, commercial paper, short term deposits, marketable securities etc.

Cash flows

Cash flows are inflows and outflows of cash and cash equivalents. When there is a change in any transaction, there will be flow of cash. If the effect of transaction results in increase of cash and its equivalents, it is called an inflow. If it results in decrease of cash, it is called outflow.

Meaning of Cash Flow Statement

In the cash flow statement the term fund is used to mean cash only and does not include even most liquid current assets. A cash flow statement shows the impact of transactions on cash position of the firm and includes all transactions having a direct impact upon cash. It explain the changes in cash position between two periods

Note: According to AS 3 (revised) all manufacturing and finance companies which are listed in a stock exchange or all commercial or industrial and business enterprise whose sales are more than 50 crores per year, must prepare and publish CFS by indirect method. This is made compulsory from April 1, 2001 onwards.

Objectives of cash flow statement

1. **Useful in cash planning:** It is very useful to management by providing a basis to evaluate ability of a company to generate cash. A cash flow statement prepared on an estimated basis for the next accounting period enables the management to know how much cash

can be generated internally and how much it should arrange from outside. Such estimated amounts are used for preparing cash budget.

2. **Assess cash flow from operating activities:** It provides information about cash generated from operating activities. It provides explanation for the difference net profit and cash from operations. Cash provided by operating activities is very important to assess the cash generated by internal sources.
3. **Payment of dividends:** Decisions to pay dividends cannot be based on net profit only. Availability of profit in the form of cash is also important for dividend disbursement.
4. **Cash from investing and financing activities:** It provides information not only about cash provides by operating activities but also by non-operating activities under two heads, namely investing activities and financing activities. This helps to explain the overall liquidity position of the enterprises and its ability to meet its cash commitments.
5. **Explain reasons for shortage or surplus of cash:** A business may have made profit and yet running short of cash. Similarly a business may have suffered a loss and still has sufficient cash at bank. A cash flow statement discloses reasons for such increase or decreases of cash balance.

Advantages or importance of Cash Flow Statement

1. **Planning and co-ordination of financial operations:** It is useful in evaluating financial policies and current cash position. Since cash is the basis for carrying operations, the cash flow statement will enable the management to plan and co-ordinate the financial operations probably.
2. **A control device:** It is also a control devise for the management. A comparison of cash flow statement for previous year with the budget for the year would indicate to what extent the resources of the enterprise were according to plan.
3. **Useful to internal financial management:** Since it gives a clear picture of cash inflow from operations it is therefore, very useful to internal financial management in considering the possibility of retiring long term debts, in planning replacement of plant facilities or in formulating dividend policies.
4. **Profit and cash position:** It enables the management to account for situation when business has earned huge profits yet run without money or when it has suffered a loss and still has plenty of money at the bank.
5. **Short term finance position:** It helps the management in taking short term financial decisions.

Differences between Fund Flow Statement and Cash Flow Statement

Fund Flow Statement	Cash Flow Statement
Fund means working capital	Fund refers to actual cash or cash inflow
It is concerned with all items constituting funds	It deals with cash transaction only
It shows the causes for changes in working capital	It shows the causes for the change in cash
FFS is for a long term planning	CFS is a tool for short term financial planning
There are no opening or closing balances in FFS	CFS starts with the operating cash balance and ends with closing cash balance
Schedule of changes in working capital is prepared	Calculations of cash from operations is prepared

Limitations of CFS

1. As the enterprise shifts from strictly cash basis, enters into credit transactions as well takes into account prepared and accrued items, the net income no doubt would generally represent an increase in working capital, yet equating net income to cash flow for such enterprise would be inaccurate and misleading since a number of non-cash items affect the net income of the firm.
2. The cash balance too easily influenced by postponing purchase and other payment.

Classification of cash flow

Cash flow from operating activities

Cash flow from investing activities

Cash flow from financing activities