

UDHNA COLLEGE

TYBCOM SEM-5

ADVANCED ACCOUNTING & AUDITING
PAPER-6

THEORY CHAPTER-1 &2

Mgt accounting

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

Mgt accounting

- (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

Mgt accounting

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 reasons of such variance at each and every step, so that the adverse variance may not be repeated in future.

Mgt accounting

(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.

(viii) 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 reasons of such variance at each and every step, so that the adverse variance may not be repeated in future.

(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

Mgt 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

Mgt accounting

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 1961 etc.	Not compulsory
Development	It is well developed and very old system in practice	It is of recent development

Mgt accounting

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

Mgt accounting

		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 maintained voluntarily.
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 price whichever is less.	Stock is always valued at cost price.

Mgt accounting

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

Mgt accounting

Unit - 2

FINANCIAL STATEMENT ANALYSIS

Meaning of Financial Statement

Financial statements are the essential documents of business. They are the outputs of financial accounting. They are the final products of the accounting process. They are statements containing financial information of a business enterprise. They convey certain message to feel financial pulse of an organization. The basic purpose of preparing financial statements is to convey information about financial position of the enterprise to owners, creditors and the investors.

Objectives of Financial Statements

Financial statements serve as a horoscope of a business. This is so because they enable readers to measure financial position of a concern. The main objective of financial statements is to provide information about the financial position and performance of an enterprise that is useful to users in making decisions. The other objectives are summarized below:

- 1 To provide information about assets and liabilities of a firm.
- 2 To provide useful information to various parties interested in financial statements
- 3 To present true and fair view of the business.
4. To estimate the earning capacity of the enterprise.
- 5 To determine the debt capacity of the concern.
6. To decide about the future prospects of the business.

Thus, the ultimate Objective of financial statements is to get better insight about the financial strengths and weakness of the firm.

Nature of Financial Statement

The following characteristics of financial statements indicate their nature:

1. Recorded Facts

The term recorded facts refers to the data drawn from accounting records. Only those facts which have been recorded in the books are shown in the financial statements.

Mgt accounting

2. Accounting Principles

In the preparation of financial statements, certain accounting principles, concepts and conventions are followed. For example: The principle of cost price or market price whichever is less is followed for valuation of stock.

3. Assumptions

Business transactions are recorded on certain assumptions. For example: In preparing financial statements, the accountants make many assumptions like that the value of money remains constant, going concern concept etc.

4. Personal Judgment

The financial statements are affected by the personal judgment of accountants. For example: The method of stock valuation, method of depreciation etc. depend on the personal judgment of the accountant. The accountant can select one of the available methods of stock valuation, depreciation etc.

Essential of Financial Statements

The financial statements should possess the following essential qualities:

1. Understandability

Financial statements should be easily understandable by users. For this, the information contained in these statements should be clear and simple.

2. Relevance

The financial statements must contain only relevant information. Then only the users can evaluate past, present and future events and can take wise decisions.

3. Reliability and Accuracy

Financial statement should disclose information in such a way that the users can compare the current year's progress with that of previous year. Users must also be able to compare the financial performance of reporting company with that of other companies.

4. Comparability

Mgt accounting

Financial statements should disclose information in such a way that the users can compare the current year's progress with that of previous year. Users must also be able to compare the financial performance of reporting company with that of other companies.

5. completeness

the information contained in the financial statements should be complete in all respects. This means all information should be shown in these statements. It further means that the information shown in the financial statements should not mislead creditors, investors and other users.

6. Timeliness

The financial statements should be prepared within a reasonable time after the accounting period is over. If the statements are not prepared and presented in time, they cannot be properly used. Besides, the firm cannot formulate plans for future.

Meaning of Analysis and Interpretation of Financial Statement

The term "analysis" can be understood as the process of splitting the facts or data found in the financial statements into simple elements. The term "interpretation" can be understood as the explanation of the meaning and significance of the financial data, so simplified with a view to throw light on the profitability and financial position of an enterprise.

In the words of Myers, "Financial statement analysis is largely a study of relationship among the various financial factors in a business as disclosed by a single set of statements, and a study of the trend of these factors as shown in a series of statements".

Types of Financial Statement Analysis

1. on the basis of modes operating

a) Horizontal Analysis: Financial analysis is done for number of years, it is known as horizontal analysis. Such analysis sets a trend wherein the figures of various years are compared with base year. Decision based on the trend percentage example: Trend percentage and Comparative financial statement.

It is also known as dynamic analysis as it measures the change of position of the business over a number of years.

b) Vertical Analysis: Analysis is made for data covering one year's periods it is known as vertical

Mgt accounting

analysis. Example: Ratios and Common size financial statement

It is also known as static analysis as it measures the statement of affairs of the business as on given period of time.

2. On the basis of material used

a) External Analysis: Financial statements analysis is made by outsiders who have no access to the books of accounts they have depend on the published accounts. Example: Shareholders, Creditors, Government agencies etc.

b) Internal Analysis: Financial statements analysis is made by internal parties who have access to the books of accounts such as management, employees etc.

Types of Analysis and Interpretation of Financial Statements

Financial Statements can be analyzed by using the any one of the following method.

1. Comparative financial statement analysis.
2. Common-size statement analysis.
3. Trend analysis
4. Ratio analysis.
5. Fund flow analysis.
6. Cash flow analysis.

comparative Financial Statements

Under this method the financial statements of the different period of the same concern will be compared in order to derive significant change in the financial and profitability position of the concern. It denotes the changes (i.e increase or decrease) in the financial figures between two or more years, in terms of money value and as well as in term of percentages. In other words, they are those financial statements which summarizes and present relative accounting data for a number of years, incorporating therein the changes in individual items of accounting figures.

Comparative Statement Analysis can be :

- (i) Comparative Income Statement Analysis
- (ii) Comparative Balance Sheet Analysis

Common Size Balance Sheet of Madern Computer Ltd. as at 31st march, 2016 and 2017

Particulars	Note No.	Absolute Amounts		Percentage of Balance Sheet	
		2016	2017	2016	2017
I. Equity And Liabilities:					
1. Shareholder's Funds					
(a) Share Capital		3,00,000	3,00,000	25	20
(b) Reserve and Surplus		4,36,000	6,50,000	36.33	43.33
2. Non-Current Liabilities					
(a) Long term Borrowings		2,00,000	2,50,000	16.67	16.67
3. Current Liabilities					
(a) Trade Payables		2,40,000	2,85,000	20	19
(b) Short-term provisions		24,000	15,000	2	1
Total		12,00,000	15,00,000	100.00	100.00
II. Assets:					
1. Non-Current Assets					
(a) Fixed Assets		5,00,000	5,00,000	41.67	33.33
(b) Non-current investments		1,96,000	3,10,000	16.33	20.67
2. Current Assets					
(a) Inventories		2,58,000	3,69,000	21.50	24.60
(b) Trade Receivables		1,98,000	2,25,000	16.50	15.00
(c) Cash and Cash Equivalents		48,000	96,000	4.00	6.40
Total		12,00,000	15,00,000	100.00	100.00

In the books of Amazon INC				
Comparative Balance Sheet For the Year ended 31st Dec'2018 and 2017				
Particulars	2018 Amount (\$)	2017 Amount (\$)	Change in Absolute Value	Change in Percentages
Equity and Liabilities				
Shareholder's Fund				
a. Share Capital	100000	100000	-	0%
b. Reserve & Surplus	25000	20000	5000	25%
Non - Current Liabilities				
a. Long term Borrowings	30000	35000	-5000	-14%
Current Liabilities				
a. Trade Payables	45000	40000	5000	13%
b. Short Term Borrowings	10000	9000	1000	11%
Total	210000	204000	6000	
Assets				
Non Current Assets				
a. Fixed Assets	70000	80000	-10000	-13%
b. Investment	55000	50000	5000	10%
Current Assets				
a. Trade Receivables	35000	25000	10000	40%
b. Inventory	30000	39000	-9000	-23%
c. Cash & Bank	20000	10000	10000	100%
Total	210000	204000	6000	-

Mgt accounting

Objectives or Purposes of Comparative Financial Statements

1. To make the data simpler and more understandable.
2. To ascertain the changes occurring year by year in financial position and performance of the enterprise.
3. To find out the strength and weakness of liquidity, solvency and profitability.
4. To help the management in forecasting and planning.

common-size Financial Statements Analysis

In Common-size financial statements the data or figures presented in the statements are converted into percentages, taking some common base. The total of Assets or, Liabilities and capital is taken as 100% and all the items in the balance sheet are expressed as a percentage of this total. In case of the common size income statement, the Net sales figure is taken as 100% and all other items of the income statement are expressed as a percentage of Net Sales.

common-size financial statements mainly include;

1. Common-Size Income Statement and
2. Common-Size Balance Sheet

Common-size Income Statement

In case of common size income statement, the net sales figure is taken as 100% and all other items of the income statement are expressed as a percentage of Net Sales. It enables to know relative contribution of each element of the income statement on sales and profit of the concern. It also facilitates for the effective controlling of the operations so as optimize the return on investments.

Trend Analysis

Sometimes, it becomes necessary to know the trend changes in the financial position of the concern. When a concern needs to know the profitability trend of the organization only profit and loss account independently may not serve the purpose. In such case, it is necessary to prepare a statement of the profit or loss or Balance sheet for many years and taking any previous year as base the trend or changes in the financial position can be prepared. When the financial statements of a number of years are analyzed, the analysis is called trend analysis.

Mgt accounting

It is also called as horizontal analysis since it is prepared for many years taking any previous year as base year. In other words, horizontal analysis is a type of analysis in which there is comparison of the trend of each item in the financial statements over a number of years.

Trend analysis as a tool of Decision-making

Statement of trend analysis helps in many managerial decisions. It enables to find out the growth or decline percentage or the pattern of changes that are taking place in an organization. It enables managers to take necessary measures to curb the unhealthy trends in the organisations. It is also useful to investors, Bankers and creditors to make effective financial decisions on the company. Its uses is outlined below:

- (i) Sales trend in the organization can reflect on the efficiency of the sales department.
- (ii) Sales trend enables management to take necessary steps wherever required to improve the overall operational efficiency.
- (iii) Trend on cost of operation facilitates to take decisions on cost control and improving profitability.
- (iv) Trend in the profitability reflects the overall efficiency of the organization in utilizing its resources and optimizing the return on investments.