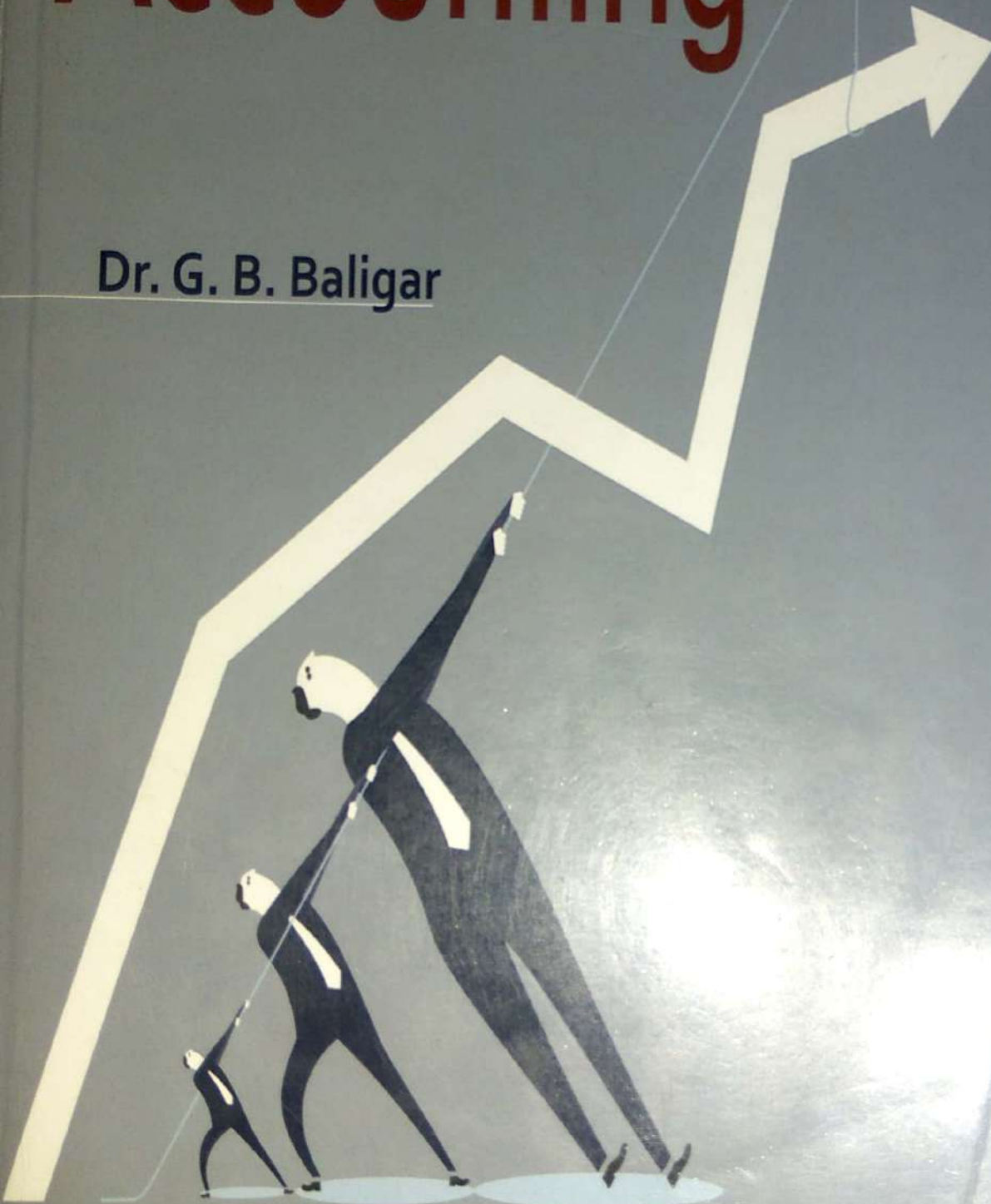


Principles of  
Management  
**Accounting**

Dr. G. B. Baligar



## CONTENTS

UNIT - 1 Introduction

UNIT - 2 Financial Ratio Analysis

UNIT - 3 Fund flow Statement

UNIT - 4 Cash flow Statement



# Management Accounting

## Introduction :

In the present scenario, the management of a business enterprises has to face complicated business situations because of the great impact of the advanced technology of computer and information on business. The solutions to these problems are possible only through the application of scientific techniques. These scientific techniques have been developed into **Management Accounting**. Management Accounting is of very recent origin and is used to solve different problems. Management Accounting is being practised in modern days by business concerns to stay in competitive market and to face new challenges i.e. to meet the situations in the past changing technological environment.

## Origin of Management Accounting :

The term Management Accounting was first used by the **British Team of Accountants** that visited the U.S.A. during May and June, 1950 under the sponsorship of **the Anglo American Productivity Council** to explain the utility of accounting as an effective management technique.

## Why the Management Accounting is required ?

Financial accounting and cost accounting suffer from various drawbacks. In order to remove the drawbacks Management Accounting has been evolved (i.e. Management Accounting has been developed **to cope up with the limitations of financial and cost accounting**)

Financial accounting suffers from the various limitations. In order to remove the drawbacks of financial accounting, cost accounting is evolved.

Similarly, cost accounting suffers from the various drawbacks. In order to remove the drawbacks of cost accounting management accounting has been evolved.

Thus, first of all we must know the limitations of financial accounting and cost accounting.

## Limitations of Financial Accounting :

Financial Accounting suffers from the various drawbacks. They are as follows :

- 1. Collective Information :** Financial Accounting supplies the information regarding profit and loss to the management collectively where in the whole industry is treated as one unit. But it is a difficult task for controlling or reducing the cost. Because if the factory is under loss in any year or profit is decreased, then the management is to locate the reasons, and also the person responsible. But in financial accounting, no one is responsible because every person escapes from his responsibility stating that his department is not responsible.

But in cost accounting, the records are maintained units-wise, process wise or job wise and the responsibility can be fixed. It helps for controlling and reducing the cost.



**2. Historical in nature :** Financial accounts are prepared at the end of the year. It means, for the whole year expenditure is incurred, then after closing the accounts or at the end of the accounting year calculation of how much expenditure is incurred and what will be the cost per unit is made. There is no proper system of control and calculation of the day to day cost.

Financial accounting is like a **thermometer which can tell us only the temperature of the body but cannot diagnose the disease.**

**3. Materials and supplies are not properly controlled.**

(No proper methods for the control of materials and supplies)

There is no proper method for controlling of materials and supplies, which leads to loss, wastage, deterioration, excessive scraps and misappropriation of the materials.

**4. Expenses are not classified :** Expenses are not classified, such as Controllable and Uncontrollable, Direct and Indirect and Fixed and Variable. These classifications help in controlling and reducing the cost. For example : If the profits of the company are decreased as compared to the previous year, the management has to find out the reasons as to why the profits are decreased, whether it was due to direct expenditure or indirect expenditure. But when the expenses are not classified, it is a difficult task to control or reduce the cost.

**5. Fails to help in cost reduction :** It is not possible to maximise the profits, since cost reduction is not possible under the financial accounting system. In the modern era, profits can be maximised only by increasing the volume of sales and sales can be increased if the prices charged are competitive and comparatively low.

**6. Fails to provide cost information in price fixation :** It is very difficult to fix the prices of production on services, or tenders because the financial accounting do not provide detailed cost information.

**7. Labour cost is not recorded Job wise :** In financial accounting, labour costs are not recorded process wise or job wise. It is very difficult to find out the cost per unit or process or job. There is no system of incentives which may easily be used to compensate the workers for their above standard performance.

**8. Fails to provide information for appraisal and comparison :** Financial accounting does not provide information to the management for appraisal and comparison of the profits under alternative methods. Not only this, even it fails to provide useful information to management for taking vital decisions such as replacement of labour, introduction of new techniques or make or buy the products, etc.

#### **Disadvantages of cost accounting :**

1. Absence of a ready made system.
2. Cost differences.
3. Cost data have no usefulness in themselves. (Cost data are in vain by themselves.
4. It is not true or exact cost.



(1) **Absence of ready made system** : In cost accounting, there are no fixed rules for ascertaining the cost because the different techniques are adopted for ascertaining the cost of production by cost accountants.

(2) **Cost differences** : Since the uniform procedure is not followed by the cost accountants in ascertaining the cost of production, there will be difference in the cost arrived by one cost accountant to the other.

The following are the reasons for the differences :

- (a) Inclusion or exclusion of certain items.
- (b) Use of different methods for pricing of materials.
- (c) Use of different methods of classification of expenses.
- (d) Use of different methods of payment of wages.
- (e) Use of different methods of absorption of overheads.

(3) **Cost data have no usefulness in themselves** : The cost data becomes useful if the management takes actions at right time, otherwise such data will not be of any use. So the success or failure of cost accountant depends upon the management ability and willingness to take the proper decisions at right time.

(4) **It is not true or exact cost** : Cost ascertained by the cost accountant is not a true or exact cost because the cost statements are mainly on the basis of estimations and omission of certain items of incomes and expenses therein.

### **MANAGEMENT ACCOUNTING :**

The term Management Accounting consists of two words "Management" and "Accounting".

#### **Management :**

Management is a technique of managing the men.

In other words, management is the art of getting things done by others.

Management has to take various decisions. For which the information is required. Such information is provided by accounting.

#### **Accounting :**

Accounting is the process of identifying, measuring and communicating economic information to management and outsiders. Such accounting information helps the management for decision making.

Thus, Accounting involves the collection, recording, classifications and presentation of financial data to the management and outsiders such as shareholders, creditors and bankers.

#### **Branches of Accounting :**

The word accounting can be classified in to three categories.

- 1) Financial Accounting
- 2) Cost Accounting
- 3) Management Accounting

### **MEANING OF MANAGEMENT ACCOUNTING :**

(What is Management accounting?)

The Accounting Department of a business organisation provides various accounting information to the management. Such information helps the management in smooth running of the business.