Introduction to Management Accounting
(As Per the Revised Syllabus of T.Y. B.Com., 2014-15, Sem. V, University of Mumbai)

Winner of “Best Commerce Author 2013-14” by Maharashtra Commerce Association

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Preface

It is a matter of great pleasure to present this new edition of the book on Introduction to Management Accounting to the students and teachers of Bachelor of Commerce B.Com started by University of Mumbai. This book is written on lines of revised syllabus instituted by the university. The book presents the subject matter in a simple and convincing language.

In keeping with the aims of the book, we have attempted to present the text in a lucid and simple style; the treatment is comprehensive and by and large non-mathematical. Another notable feature of this volume is that the discussions of the concepts and theories are invariably followed by exhaustive illustrative problems. To test the understanding of the readers as also to enable them to have sufficient practice, a large number of exercises have also been given at the end of the chapters.

The syllabus contains a list of the topics covered in each chapter which will avoid the controversies regarding the exact scope of the syllabus. The text follows the term wise, chapter-topic pattern as prescribed in the syllabus. We have preferred to give the text of the section and rules as it is and thereafter added the comments with the intention of explaining the subject to the students in a simplified language. While making an attempt to explain in a simplified language, any mistake of interpretation might have crept in.

This book is a unique presentation of subject matter in an orderly manner. This is a student-friendly book and tutor at home. We hope the teaching faculty and the student community will find this book of great use.

We are extremely grateful to Mr. K.N. Pandey of Himalaya Publishing House Pvt. Ltd., for their devoted and untiring personal attention accorded by them to this publication.

We owe a great many thanks to a great many people who helped and supported us during the writing of this book which includes Principal, HOD, and Students of B.Com Section.

We gratefully acknowledge and express our sincere thanks to the following people without whose inspiration, support, constructive suggestions of this book would not have been possible.

- Mr. Jitendra Singh Thakur (Trustee, Thakur College)
- Dr. Chaitaly Chakraborty (Principal, Thakur College)
- Mrs. Janki Nishikhant Jha

We welcome suggestions from students and teachers for further improvement of quality of book.

— Authors
## Syllabus

### Introduction to Management Accounting

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Modules</th>
<th>No. of Lectures</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Introduction to Management Accounting</td>
<td>04</td>
</tr>
<tr>
<td>2.</td>
<td>Analysis and Interpretation of Accounts</td>
<td>10</td>
</tr>
<tr>
<td>3.</td>
<td>Ratio Analysis</td>
<td>12</td>
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<td>Cash Flow Statement</td>
<td>10</td>
</tr>
<tr>
<td>5.</td>
<td>Working Capital Concept</td>
<td>09</td>
</tr>
<tr>
<td></td>
<td><strong>Total</strong></td>
<td><strong>45</strong></td>
</tr>
</tbody>
</table>

### Sr. No. Modules /Units

1. **Introduction to Management Accounting**

2. **Analysis and Interpretation of Accounts**
   - (a) Vertical Forms of Balance Sheet and Profit and Loss Account Suitable for Analysis.
   - (b) Trend Analysis.
   - (c) Comparative Statement.
   - (d) Common Size Statement.
   - **Note:** Simple Problems based on the above (a) to (d)

3. **Ratio Analysis and Interpretation Based on Vertical Financial Statements as above**
   - **Balance Sheet Ratios:** Current Ratio, Liquid Ratio, Stock to Working Capital Ratio, Proprietary Ratio, Debt-equity Ratio, Capital Gearing Ratio.

4. **Preparation of Cash Flow Statement with Reference to Accounting Standard No. 3 (Indirect Method Only)**

5. **Working Capital Concept**
   - Estimation/Projection of Working Capital Requirements in Case of Trading and Manufacturing Organisation.
**Scheme of Examination**

Credit Based Grading System Scheme of Examination

- **Internal of Assessment – 25%**  
  25 Marks

- **Semester end Examinations – 75%**  
  75 Marks

**Question Paper Pattern**

Duration: 2½ Hrs.  
Maximum Marks: 75

All Question are Compulsory Carrying 15 marks each.  
Questions to be Set: 05

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Marks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Q.1 Objective Questions</td>
<td></td>
</tr>
<tr>
<td>(a) Sub Questions to be asked 10 and to be answered any 08</td>
<td>15 Marks</td>
</tr>
<tr>
<td>(b) Sub Questions to be asked 10 and to be answered any 07</td>
<td></td>
</tr>
<tr>
<td>(*Multiple choice/True or False/Match the column, Fill in the blanks)</td>
<td></td>
</tr>
<tr>
<td>Q.2 Full Length Practical Question</td>
<td>15 Marks</td>
</tr>
<tr>
<td>OR</td>
<td></td>
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<tr>
<td>Q.3 Full Length Practical Question</td>
<td>15 Marks</td>
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<tr>
<td>OR</td>
<td></td>
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<tr>
<td>Q.4 Full Length Practical Question</td>
<td>15 Marks</td>
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<tr>
<td>OR</td>
<td></td>
</tr>
<tr>
<td>Q.5 (a) Theory Questions</td>
<td>08 Marks</td>
</tr>
<tr>
<td>(b) Theory Questions</td>
<td>07 Marks</td>
</tr>
<tr>
<td>OR</td>
<td></td>
</tr>
<tr>
<td>Q.5 Short Notes</td>
<td>15 Marks</td>
</tr>
<tr>
<td>To be asked 05</td>
<td></td>
</tr>
<tr>
<td>To be answered 03</td>
<td></td>
</tr>
</tbody>
</table>

**Note:** Full length question of 15 marks may be divided into two sub questions of 08 and 07 marks.
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INTRODUCTION

Financial Accounting is the basic form of accounting. The main purpose of financial accounting is the preparation of Financial Statements of an organisation. Profit and Loss account and the Balance Sheet are the two Financial Statements. Financial accounting provides complete information of the results of business operations and its financial position.

Today, the management is not interested in knowing only the profit or loss and the financial position of business, but also requires other information too to take important decisions and tackle the problems if any. Thus, to provide necessary information to management in taking important decision, Management Accounting system was introduced.

The term ‘Management Accounting’ was first used by the British team of Accountants that visited the United States in 1950 under the auspices of Anglo-American Productivity Council. In November 1950, the team defined the nature of management accounting as ‘The presentation of accounting information in such a way as to assist management in the creation of policy and in the day-to-day operations of an undertaking’.

MEANING AND DEFINITIONS OF MANAGEMENT ACCOUNTING

Management accounting refers to adoption and analysis of accounting information for diagnosis and explanation in such a way so as to assist management in policy framing and taking important decisions. It involves presentation of financial information in such a way so as to assist the management in planning, controlling and decision-making. It is a modern concept of accounting and also an effective tool of forecasting. The management has to carry out different functions such as planning, organising, coordinating, directing and controlling. At every level, the management needs to take certain decision which is possible only if the information is available to the management. Management accounting helps in providing the information by analysing and presenting financial information which helps in the interpretation of financial statements.

Definitions of Management Accounting

According to J. Batty, “Management Accounting is the term used to describe the accounting methods, systems and techniques which coupled with special knowledge and ability, assists management in its task of maximising or minimising losses.”
According to Broad and Camichael, “Management Accounting covers all those services by which the accounting department can assist the top management and other departments in the formation of policy control of execution and appreciation of effectiveness.”

Institute of Chartered Accountants, England and Wales has defined Management Accounting as “Any form of accounting which enables a business to be conducted more efficiently can be regarded as Management Accounting.”

According to American Accounting Association, “Management Accounting includes the methods of concepts necessary for effective planning for choosing among alternative business actions and for control through the evaluation and interpretation of performance.”

According to Brown and Howard, “Management accounting is concerned with the efficient management of a business through the presentation to management of such information as will facilitate efficient planning and control.”

According to T.G. Rose, “Management Accounting is the adaption and analysis of accounting information and its diagnosis and explanation in such a way as to assist management.”

According to The Institute of Chartered Accountants of India, “Such of its techniques and procedures by which accounting mainly seek to aid the management collectively have come to be known as Management Accounting.”

NATURE AND SCOPE OF MANAGEMENT ACCOUNTING

Management accounting is mainly concerned with accounting information which is useful to management for decision-making. The nature of management accounting has changed over the years. Earlier, the focus was on information for management planning and control. Now, the focus is on resource management. Now, management accounting is used to create, protect and preserve the value of stakeholders. The scope of management accounting is very wide and covers all the areas where the management accounting has to function. Following systems and techniques fall within the scope of management accounting:

- **Financial Accounting:** It is concerned with the recording and summarising of business transactions. Maintenance of books of accounts helps in preparation of financial statements. These statements are analysed in management accounting. Financial statements are the base for management accounting.

- **Cost Accounting:** With the help of various techniques like standard costing, marginal costing, etc., it helps in knowing the deviations in the costs. Marginal costing is the most important tool in decision-making. Management accounting makes use of cost data in taking managerial decisions.

- **Budgetary Control:** Budgets are prepared and compared with actual performance. The variance is ascertained and suitable measures are taken for prevention in future. Budgetary control is the system of controlling the cost with the help of budgets.

- **Statistical Techniques:** The management accountant makes use of statistical techniques like regression, correlation, probability, standard deviation, etc. to present the reports to the management more accurately.

- **Forecasting:** Planning is based on forecasting. Budgets are prepared on the basis of forecasting. Both budgetary control and forecasting helps management accounting in taking important decisions.

- **Taxation:** Tax accounting includes the computation of tax liability. Tax accounting is an important aspect of management accounting. Tax planning has become an integral part of management in the present scenario.
Introduction to Management Accounting

- **Internal Audit:** Management accounting includes internal audit. Internal audit helps the management in fixing individual responsibility for internal control.

- **Methods and Procedures:** Management accounting is also concerned with the use of modern technology. It includes maintaining an efficient system for data processing and effective reporting of necessary data in time. This improves the office operations and develops a smooth conduct of office service.

### FUNCTIONS OF MANAGEMENT ACCOUNTING

- **Planning:** The main aim of any business organisation is to earn profits. The same can be achieved if there is proper planning in making optimum utilisation of resources. The planning function of the management is facilitated by management accounting making relevant information available.

- **Analysis and Interpretation of Data:** Management accounting involves analysis and interpretation of financial data. Several tools are used for the analysis and interpretation such as ratio analysis, trend analysis, common size statements, etc.

- **Forecasting:** Management accounting makes short-term and long-term forecasts and plan future operations. Management accounting provides necessary information in forecasting.

- **Budgeting:** A budget provides complete estimated details about the utilisation of resources. The management accountant prepares different budgets and compares it with the actual performance.

- **Facilitates Management Control:** Management accounting facilities management in controlling the various functions of the organisation. It acts as a coordinating agent between different departments. Comparing the actual performance with the standards set helps the management in controlling the overall performance of the organisation.

- **Organising:** Management accounting helps organising human and other resources.

- **Reporting:** Management accounting plays a vital role in reporting the financial information to the management. It makes use of different tools of analysis and interprets the financial statements. It acts as an important medium of communication by preparation and submission of various reports to the management.

- **Coordination:** Management accounting provides necessary facts and figures to the management which helps in increasing the efficiency of the organisation. It helps the management in coordination of various departments.

- **Tax Management:** Management accounting helps in tax planning. The management accountant gives advice on tax effects and helps the management in taking important decisions in tax planning.

### DECISION-MAKING PROCESS

The management accountant plays a vital role in providing the necessary information to the management in decision-making. Decision-making always involves a choice between alternative options available. Managerial decisions are based on information. The management accountant makes available the necessary facts and figures available to the management. He collects data, evaluates it and then provides it to the management. The management accountant analyses the financial statements and gives interpretations on it. He prepares report on the financial statements and provides it to the management. He makes use of different techniques of analysis such as trend analysis, ratio analysis, etc. The information within the organisation is analysed according to three types of management activities, i.e., strategic, tactical and operational. Strategic information is used by top level management to plan their objectives. Tactical information is used by middle level of management. Operational information is used by lower level of management. The information must be accurate, complete, up-to-date, relevant, brief and significant.
MANAGEMENT ACCOUNTING AND FINANCIAL ACCOUNTING

Both Management accounting and Financial accounting plays a vital role in management decision-making. Financial accounting provides the result and the position of an organisation. Management accounting makes use of different techniques to analyse and interpretate the financial statements.

Management Accounting vs. Financial Accounting

<table>
<thead>
<tr>
<th>No.</th>
<th>Management Accounting</th>
<th>Financial Accounting</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Involves analysis and interpretation of financial statements.</td>
<td>Involves preparation of financial statements.</td>
</tr>
<tr>
<td>2.</td>
<td>It serves the management, hence internal interest.</td>
<td>It serves outsiders like shareholders, creditors, etc., hence external interest.</td>
</tr>
<tr>
<td>3.</td>
<td>Voluntary in nature.</td>
<td>Mandatory under law.</td>
</tr>
<tr>
<td>4.</td>
<td>It is concerned with the assessment of activities of various units or departments.</td>
<td>It is concerned with the assessment of result of the whole organisation.</td>
</tr>
<tr>
<td>5.</td>
<td>It is prepared as frequently as required for decision-making.</td>
<td>It is prepared at the end of the financial year.</td>
</tr>
<tr>
<td>6.</td>
<td>It provides data for comparison and important decision.</td>
<td>It provides data showing the results and position of the organisation.</td>
</tr>
<tr>
<td>7.</td>
<td>It makes use of different analysis such as ratio analysis, trend statement analysis, etc.</td>
<td>It is done as per the accounting rules.</td>
</tr>
<tr>
<td>8.</td>
<td>Reports are based on management needs.</td>
<td>Reports are based on Generally Accepted Accounting Principles.</td>
</tr>
<tr>
<td>10.</td>
<td>It is concerned with both monetary and non-monetary aspects.</td>
<td>It is concerned with only monetary aspects.</td>
</tr>
</tbody>
</table>

FINANCIAL STATEMENTS

The term financial statements refers to the statements which the accountants prepare at the end of a period of time for a business enterprise. They are the:

2. Income Statement, i.e., Profit and Loss Account.

Financial statements are the collection of financial results based on current facts and figures. For financial planning and control, financial statements have great importance. The following are the most common forms of financial statements:

1. Manufacturing, Trading and Profit and Loss Account
2. Balance Sheet
3. Cash Flow Statements
4. Funds Flow Statements.

Importance of Financial Statements

1. Requirements of lenders: In case of borrowings from banks and financial institutions, they insist the borrowers to furnish financial statements in order to assess their profitability.
2. **Guides future course of action**: Financial statements guides the management about the proper way to expand and prosper including in which area and to what extent expansion is possible.

3. **To understand the future**: Based on projected financial statements, the management will be in a better way to understand the future.

4. **To exercise control**: The management can exercise better control if clear about the position of the organisation.

5. **Better awareness about the present position**: For preparing the financial statements, a good knowledge about the present situations is a must. Thus, in the process of preparation of financial statements, management is made aware about the present situation.

6. **Arithmetical accuracy to the future plans**: In case of financial statements, everything is put down on paper in terms of rupees. Thus, it is very useful for control and corrective actions.

7. **Acts as a base for future actions**: Financial statements are the basis on which the management will act.

### Uses of Financial Statements

1. It helps to reveal the changes in the various items in the Balance Sheet from the past to the present.

2. Financial statements help to measure the profitability.

3. Financial statements provides a concise summary of the firms revenues and expenses during the date or series of dates.

4. The financial statements reports the effect of the plan of operations on the assets, liabilities and capital of the company.

A profit and loss account summarises the income earned and expenses incurred during a particular period. A balance sheet is a statement of balances of assets and liabilities as at a particular date.

### Formats of Financial Statements

1. **Conventional Format or Horizontal Format or “I” Form**:
   
   Here, the Balance Sheet and Income Statement is presented in the “I” form or the account form. In case of Balance Sheet, the left hand side indicates the “liabilities” and the right hand side “assets” and in case of profit and loss account, the left hand side indicates the “expenses” incurred and the right hand side indicates the “incomes” earned. The conventional form of financial statement is not suitable for financial analysis.

2. **Vertical Format**:
   
   The vertical format of financial statement is most suitable for financial analysis especially in case of ration analysis and for comparative analysis, common size analysis and trend analysis. It serves the purpose of other users such as potential investors or lenders also.

### Balance Sheet

```
<table>
<thead>
<tr>
<th>LIABILITIES</th>
<th>ASSETS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Owned Funds</td>
<td>Fixed Assets</td>
</tr>
<tr>
<td>Borrowed Funds</td>
<td>Long-term Investments</td>
</tr>
<tr>
<td></td>
<td>Working Capital = Current Assets minus Current Liabilities</td>
</tr>
</tbody>
</table>
```

A Balance Sheet is divided into 5 windows. The liabilities side consists of:

1. **Owned Funds**: Owned funds belong to the proprietors. It mainly consists of Share Capital + Reserves – Fictitious Assets. It indicates the owner’s stake in the business.
2. **Borrowed Funds**: Borrowed funds consists of long-term borrowings both secured as well as unsecured from outside sources. The repayment period of such funds are beyond one year from the date of Balance Sheet. It consists of debentures, term loans from banks and financial institutions, fixed deposits, etc.

The Assets side consists of:

1. **Fixed Assets**: Fixed assets are also termed as long-term assets and they act a major source of revenue to the business. It consists of land and buildings, plant and machinery, furniture and fixtures, vehicles, and also includes intangible assets such as goodwill, patent, copyrights, etc.

2. **Investments**: Long-term investments are investments whose maturity period is beyond one year from the date of the Balance Sheet. In case of the long-term investment, the intention of the investor is to retain such securities for a longer period of time. Such investments may even be trade investment. Trade investments means an investment by a company in shares and/or debentures of another company for the purpose of promoting the business or trade interests of the investing company. Long-term investments may even be in government securities.

3. **Working Capital**: Working capital is the excess of current assets over current liabilities, i.e., current assets less current liabilities. Investment in working capital gets converted into cash within a period less than a year. Current assets can be further split up into quick liabilities and non-quick liabilities.

**Exercise**

**Theory Questions**

1. What is Management Accounting? Give any three definitions.
2. Explain the nature and scope of Management accounting.

**Short Notes**

1. Management accounting
2. Scope of management accounting
3. Decision-making process
4. Financial accounting

**Fill in the Blanks**

1. The main purpose of ________ accounting is preparation of financial statements.
2. Profit and Loss account and ________ are the two financial statements.
3. The term ________ was first used by the British team of Accountants that visited the United States in 1950 under the auspices of Anglo-American Productivity Council.
4. ________ accounting helps in providing the information by analysing and presenting financial information which helps in the interpretation of financial statements.
5. Management accounting involves analysis and ________ of financial data.
6. The information within the organisation is analysed according to three types of management activities, i.e., strategic, tactical and ________.
7. Strategic information is used by ________ level of management.
8. Tactical information is used by _______ level of management.
9. Operational information is used by _______ level of management.
10. The main aim of any business organisation is to earn _______.
11. Tax accounting includes the computation of _______ liability.
12. _______ always involves a choice between alternative options available.

Books Authored by Nishikant Jha for B.Com.

1. Accountancy and Financial Management – I (F.Y.B.Com.)
   Nishikant Jha & Others
   Nishikant Jha & Others
   Nishikant Jha & Others
   Nishikant Jha & Others
5. Cost Accounting — Introduction and Basic Concepts (T.Y.B.Com.)
   Nishikant Jha & Others
6. Financial Accounting (T.Y.B.Com.)
   Nishikant Jha & Others
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8. Direct Taxation (T.Y.B.Com.)
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   Nishikant Jha & Others
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