

# MANAGERIAL ACCOUNTING

## CHAPTER ONE: NATURE AND PURPOSE OF MANAGEMENT ACCOUNTING

### **Definitions Managerial Accounting**

Management accounting is the application of the professional knowledge and skills in preparation and presentation of accounting information in such a way as to assist management in formulation of policies and planning and control of the operations of undertakings. It measures and reports financial and non-financial information that helps managers make decision to fulfill the goals of an organization.

It is focused on internal reporting.

It is concerned with the provision of information to people within the organization so as to help them make decision and improve efficiency and effectiveness of existing operations.

Management accounting provides information required by management for such purposes as: -

1. Formulation of policies
2. Planning and controlling activities of the enterprises
3. Decision making on alternative causes of action.
4. Disclosure to those external to the entity
5. Disclosure to employees
6. Safeguarding assets

The above involves participative management to ensure that there is effective:-

1. Formulation of long term plans to meet objectives
2. Formulation of short term operation plans
3. Recording of actual transactions

**Exercise:** A hospital records show that the cost of carrying health checks in the last five accounting periods has been as follows;

| Period | No of patients seen | Total cost |
|--------|---------------------|------------|
| 1.     | 650                 | 17,125     |
| 2.     | 940                 | 17,800     |
| 3.     | 1260                | 18,650     |
| 4.     | 990                 | 17,980     |
| 5.     | 1150                | 18360      |

Required: Estimate the cost of carrying out health checks on 850 patients using

i) Regression model

ii) High – low method

| Period | No of patients seen | Total cost        | $x^2$                    | $x y$                    |
|--------|---------------------|-------------------|--------------------------|--------------------------|
| 1.     | 650                 | 17,125            | 422,500                  | 11,131,250               |
| 2.     | 940                 | 17,800            | 883,600                  | 16,732,000               |
| 3.     | 1260                | 18,650            | 1,587,600                | 23,499,000               |
| 4.     | 990                 | 17,980            | 980,100                  | 17,800,200               |
| 5.     | 1150                | 18,360            | 1,322,500                | 21,114,000               |
|        | $\Sigma x=4990$     | $\Sigma y=89,915$ | $\Sigma x^2 = 5,196,300$ | $\Sigma xy = 90,276,450$ |

i) **Regression analysis method**

An alternative formula of solving for “a” and “b” is:

$$b = \frac{n \sum xy - \sum x \sum y}{n \sum x^2 - (\sum x)^2}$$

$$a = \frac{\sum y}{n} - \frac{b \sum x}{n}$$

$$b = \frac{5 \times 90,276,450 - 4,990 \times 89,915}{5 \times 5,196,300 - 4990^2}$$

$$b = \frac{451,382,250 - 448,675,850}{25,981,500 - 24,900,100}$$

$$b = \underline{2.5}$$

|                                     |  |               |  |               |
|-------------------------------------|--|---------------|--|---------------|
| <i>Cost of sales</i>                |  | <u>28,800</u> |  | <u>38,400</u> |
| <i>Contribution to gross profit</i> |  | 19,200        |  | 9,600         |
| <i>Less fixed cost</i>              |  | <u>12,000</u> |  | <u>Nil</u>    |
| <i>Unadjusted profit</i>            |  | <u>7,200</u>  |  | <u>9,600</u>  |
| <i>Add over recovery of o/h</i>     |  | Nil           |  | 2000          |
| <i>Net profit</i>                   |  | <u>9200</u>   |  | <u>11,600</u> |

### 6.7 Activity Based Costing (ABC)

ABC System refines costing system by focusing on individual activities as the fundamental cost objects. An activity is an event, task or unit of work with a specified purpose e.g. designing product, setting up machines operating machines and distributing products.

ABC systems calculates the cost of individual activities and assigns costs to cost objects such as products and services on the bases of the activities undertaken to produce each product and services.

ABC Seeks to attribute overhead costs to product on a more realistic basis rather than production volume and also attempts to show the relationship between the overhead cost and the activities that caused them.

The main steps in ABC are:

- i) Identify the main activities in the organization e.g. production planning, material ordinary, material handling, dispatch of goods, machine assembly etc.
- ii) Identifying the factors which determine the cost of an activity called cost drivers.
- iii) Collect the cost of each activity into a cost pool
- iv) Charge the support overheads to products on the basis of the usage of the activity. Mainly expressed as a percentage of the chosen driver.

In ABC overheads can be classified into three mainly:

- a) Short term variable overhead - which varies with the volume of the activity.
- b) Long term variable overhead – which is fixed in the short term but varies in the long term
- c) Fixed overheads – which do not vary

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