

**MANAGEMENT ACCOUNTING PRACTICES OF
FINANCE COMPANY IN NEPAL**

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A Thesis Submitted to:

Office of the Dean

Faculty of Management

Tribhuvan University

In partial fulfillment of the requirements for the degree of

Masters in Business Studies (M.B.S)

Kirtipur Kathmandu

2014

VIVA-VOCE SHEET

We have conducted the VIVA-VOCE examination of the thesis

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Entitled

MANAGEMENT ACCOUNTING PRACTICES OF FINANCE

COMPANIES IN NEPAL

and found the thesis to be original work of the student written according to the prescribed format of faculty of Management, Tribhuvan University. We recommended the thesis to be accepted as partial fulfillment of the requirements for Masters Degree in Business Studies (M.B.S.).

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DECLARATION

I Hereby declare that this thesis work entitled **MANAGEMENT ACCOUNTING PRACTICES OF FINANCE COMPANIES IN NEPAL** submitted to Office of the Dean, Faculty of Management, Tribhuvan University, is my original work done in the form of partial fulfillment of the requirement for the degree of Masters of Business Studies which is prepared under the supervision of respected supervisor **Binod Shah** of Central Department of Management.

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ACKNOWLEDGEMENT

This is an attempt to present thesis entitled **MANAGEMENT ACCOUNTING PRACTICES OF FINANCE COMPANIES IN NEPAL** prepared for partial fulfillment of the requirement for the Degree of Master of Business Studies (MBS) is an outcome of continuous and immeasurable cooperation and support of several hands. I would like to express my heartfelt gratitude to all for their support.

I have great satisfaction and pleasure to express my appreciation and sincerity to my thesis supervisor **Binod Shah** of Central Department of Management, TU for their excellent and effective guidance and supervision. I will remain thankful to them for their valuable direction useful suggestion and comments during the course of preparing this thesis without their help this work would not have come in this form.

I highly appreciate to all the staff of finance companies, NRB library, and TU Central library for their valuable advices and support in collecting and presenting the necessary data.

I would also like to express my thankfulness to my friends, my family members as well as all known people who supported as well as inspired me directly or indirectly to complete this thesis.

Researcher
Dilli Kafle

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1.3 ABBREVIATIONS

A/C	= Account
ABB	= Activity Base Budgeting
ABC	= Activity Base Costing
AD	= Anno Domini
ARR	= Accounting Rate of Return
AV	= Average
B.S	= Bikram Sambat
BEP	= Break Even Point
BOD	= Board of Director
CFAT	= Cash Flow after Tax
CGS	= Cost of Goods Sold
CM	= Contribution Margin
CMA	= Certified Management Accountant
CMPU	= Contribution Margin per Unit
CPA	= Certified Public Accountant
CVP	= Cost Volume Profit
DLH	= Direct Labour Hour
DMH	=Direct Machine Hour
F.C	= Finance Companies
FC	= Fixed Cost
FIFO	= First In First Out
FY	= Fiscal Year
GAAP	=Generally Accepted Accounting Principle
GDP	= Gross Domestic Product
GM	=General Manager
HPPCL	=Herbal Production and Processing Company Limited
IMA	= Institute of Management Accountants
IRR	= Internal Rate of Return

ISO	= International Standard Organization
LIFO	= Last In First Out
Ltd.	= Limited
MA	= Management Accounting
MBS	= Master of Business Study
MCV	= Material Cost Variance
MOF	= Ministry of Finance
MOS	= Margin of Safety
NAS	= Nepal Accounting Standard
NCO	= Net Cash Outlay
NPV	= Net Present Value
NRB	= Nepal Rastra Bank
NSE	= Nepal Stock Exchange
NTC	= Nepal Telecom Corporation
P/E	= Price Earning
PFL	= Progressive Finance Limited
P/L	= Profit and Loss
PBP	= Pay Back Period
PI	= Profitability Index
PPC	= Profit Planning and Control
RDL	=Royal Drugs Limited
STD	= Standard
T.U	= Tribhuvan University
TPV	= Total Present Value
UFL	= Unique Finance Limited
UVC	= Unit Variable Cost
VCPU	= Variable Cost per Unit
WHO	= World Health Organization
WTO	= World Trade Organization
x^2	= Chi-Square
ZBB	= Zero Base Budgeting

CHAPTER – I

INTRODUCTION

1.1 Background of the Study

Today world has been oriented towards globalization and economic liberalization. A sound financial system is a hallmark of any developed economy. A well-developed financial system contributes to the society's well being and to raise the standard of living by channeling nation's wealth into the best and profitable uses. Commercial banks, finance companies, insurance companies, cooperative societies, development banks etc all form the part of financial system. The development of financial system virtually benefits all the members of the economy and country.

The rapid growth of finance companies has established them as an emerging force in mobilization of funds in the financial system of the country. Since, the operation were having a growing impact on domestic monetary situation, the government decided to bring them under the control of central supervisory authority, namely Nepal Rastra Bank through finance company act 2042 B.S to appropriately regulate and supervise the activities of all finance companies which accept deposits (other than current and saving account deposits) from public with main objectives of safeguarding the interest of depositors. The real growth of these finance companies aroused mainly due to inability of the commercial banks to compete for attracting deposits through interest rate.

As of mid July, 2014 (Licensed by NRB) there are 53 finance companies in Nepal. Finance companies, licensed under the finance company Act 2042 B.S are the second largest group of deposit taking financial institutions in Nepal. Through the finance companies act was published in gazette in 2042 B.S, the real establishment and functioning come only after the economic liberalization policy of the government in the 8th plan.

1.1.1 Finance Company

Finance Companies in Nepal have a very short history and in this short period, these companies have been able to contribute significantly towards the economy. Finance company in general provides higher interest rate than the commercial banks, which has encouraged the

people to save more and more. It is often seen a considerable percentage of deposits being saved in the finance companies. The finance companies have been paying a considerable amount of money as in the form of tax as wee. Finance Companies being in higher tax brackets as commercial banks, the contribution made by them cannot be ignored.

Finance Company has emerged with an aim to ease and facilitate people in financing business and other ventures. It was not very long ago when people have to spend a lot of time in arranging and getting the finance for their require needs. Finance companies provide loans in very short period of time and are also flexible in the requirement of papers. Previously, many projects were abandoned being delay in providing loans from commercial and developments banks. These days some very big projects have also been found financed by the Finance Companies. The Finance companies are also playing an important role in providing employment directly in the companies itself and also employing at large from the projects financed by them. The economy is well nourished with all the growing and developing prospects of Finance Companies.

1.1.2 Introduction of Selected Finance Companies

Progressive Finance Ltd. (PFL)

Progressive Finance Limited. is a public limited company which is established at 2051, Ashwin 14 under the company Act 2021 B.S. and approved by the Government of Nepal and Nepal Rastra Bank. Progressive Finance Limited is "C" class licensed institution from NRB under 2062, 3 '1' Act. It is located at heart of city Pako, New Road, Kathmandu. Its operation started at 14 Falgun 2052 B.S.

Progressive Finance Limited succeeds for establishing reputed and reliable financial institution in financial sector of Nepal by providing attractive interest and satisfying the customers/depositors of some extent.

The objective of Progressive Finance Limited is to fulfill the financial need of customer in easy way providing average interest rate with different scheme and facility and to secure the depositors life time saving by providing then attractive return of their saving.

Table: 1.1
Shareholders Pattern of PFL

S. N	Share holders	No. of Share (%)
1.	Nepal Government	-
2.	"Ka" Class Licensed Institutions	-
3.	Other Licensed Institutions	-
4.	Organized Institutions	-
5.	General Public	40.00
6	Other (Promoter – Individual)	60.00

(Source: Annual report of PFL, 2013/14)

Table: 1.2
Capital Amount of PFL

S. N	Types of Capital	Amount in Rs.
1.	Authorized Capital	400,000,000
2.	Issued capital	210,000,000
3.	Paid up Capital	120,000,000

(Source: Annual report of PFL, 2013/14)

Unique Finance Ltd.

Unique Finance Ltd. has come in the operation from October 9, 2007 (2064/06/22) as ‘C’ class financial institution licensed by NRB to provide best financing services to all people, firms, industries, corporations of the society. We are a newly established finance company promoted by local businessmen, doctors, engineers and bankers who have achieved unprecedented success in their professions and having high social standing. Our motto is to providing safe, seamless, quick and advance banking services and we are committed to meet the financial needs of our customers and exceed their expectations through innovative solutions. UFL is using contemporary banking technologies.

UFL is located at New Plaza, Putalisadak, Kathmandu, which is in all accepts immensely suitable for doing financial business. The main building has its own under-ground parking and easily availability of public transportation. UFL building has easy and many access to main place of Kathmandu, Patan and Bhaktapur.

It is our mission to deliver quality banking and stakeholder satisfaction in the true meaning of the word. UFL having local roots aims to achieve excellence in financial service, by providing best financial products to all categories of people for their progress and economic development of the country and to become the pioneer in the financial community committed to economic development of the society.

Table: 1.1
Shareholders Pattern of PFL

S. N	Share holders	No. of Share (%)
1.	Nepal Government	-
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3.	Other Licensed Institutions	-
4.	Organized Institutions	-
5.	General Public	40.00
6	Other (Promoter – Individual)	60.00

(Source: Annual report of UFL, 2013/14)

Table: 1.2
Capital Amount of PFL

S. N	Types of Capital	Amount in Rs.
1.	Authorized Capital	400,000,000
2.	Issued capital	223,000,000
3.	Paid up Capital	223,000,000

(Source: Annual report of UFL, 2013/14)

1.1.3 Role of Management Accounting

Management Accounting is that branch of accounting discipline which facilitates management by communicating necessary information to carry out management functions smoothly. Planning, organizing, staffing, leading and controlling are the routine functions of management. Management accounting is an accounting discipline that provides essential information to every hierarchy of management to perform management functions.

There is a general misconception that the management accounting is something new and complex and requires an expensive system capable of comprehension only by experts. This

contention is not true. A reference to the accounting literature would reveal that even in the past, the accountant went beyond figure work and discussed with his management the implications of events and trends in broad financial terms and that is what the management accounting does. Management accounting has been authoritatively defined by the Anglo-American Council on Productivity as “the presentation of accounting information in such a way as to assist the management in the creation of policy and operation of day-to-day undertaking”. It is, therefore, the provision, analysis, reporting and discussion of accounting information as a guide to management in the day-to-day running and future planning of the business, as distinguished from the recording part of the accounting function for historical and statutory purposes.

Organizations are social units established with certain objectives. To carry out economic activities the role played by them is significant. In the midst of growing competition, survival has been difficult for the organization. To get cut throat competition, the only reliable option is good management. It protects organization from the unexpected happenings. An organization with good management does well compare to other organizations with poor management. Organizations need economic information. They get it from management accounting which is a language that communicates economic information to people inside and outside the organization.

Corporate firms that carry economic activities are the backbone of the economy. Their activities impact the economy in one-way or the other. Every organization has limited resources. The main problem lies in better utilization of available resources so that competitive advantages can be achieved. Among the various tools and techniques, management accounting tools have proved beneficial in every aspect of management activities from planning to decision-making. The main objective of management accounting is to help managers in overall managerial activities by providing information and helping them in planning, controlling and decision-making. In most corporate firms, management accounting has been a strategic business partner in support of management’s role in decision making, planning and controlling (*Hilton, 1997:5-6*).

Management accounting is the term used to describe the accounting methods systems and techniques, which coupled with special knowledge and ability assist management in its task of maximizing profit or minimizing losses. It is essentially the application of managerial

"Principles" and "Know-how" to the planning, development execution and control of the corporate plan. Developing a financial structure and ensuring that the optimum use is made of business resources are just as vital as the marketing and production function. Without adequate finance and regulation of the necessary funds there is little hope of success. For most companies therefore, management accounting in the appropriate form is absolutely vital (*Batty, 1982:1-2*).

An efficient management strives to raise productivity by utilizing the available resources. Management, therefore, has to make important decisions from time to time. Management accounting plays an important role in this connection. Accounting is opinion expressed in numbers and since decisions are based on opinions, accounting is one of the most useful tools for decision-making. With sound data to base its decisions, management can operate more efficiently, more economically and more profitably (*Monga, et.al,1997:56*).

Management accounting would make its greatest contribution by helping management of business concern to set our civilization on a high economic level by maintaining control over multifarious and complex activities. This may be true not because the accounting is at the elbow of management in the role of servitor. It is because it has assumed the role of alter ego through the processes and techniques of management accounting properly applied, management is not merely informed. It is stimulated for action. Its thinking is provided with standard of references vehicles of judgment and forms in which to express these judgments and to bring changes. Thus management accounting has to be regarded as an integrate part of the personality management (*Gupta, 1995:8-9*).

1.2 Statement of the Problems

Finance companies of Nepal have achieved the main aim to some extent but they could not success in major streams despite the political instability of the country and various policies form by various government. The finance companies themselves have not been able to operate in a satisfactory manner. Success of any business enterprise is measured by capacity of surplus generation but the financial performance of finance companies in Nepal are quite gloomy and have not been able to contribute towards the generation of surplus.

Finance companies play a vital role for the national development. Although, most of the finance companies in Nepal have been suffering the problem of poor performance. So the reasons for the poor performance have to be studied. There may be different and various reasons for the poor performance of finance companies such as ignorance of objectives, communication gap between the managerial levels, preparation of long range and short range plan on ad-hoc basis, political instability, lack of taking accountability and responsibility, unnecessary competition between the companies themselves. Such reasons should be investigated & should be taken corrective actions for the improvement of their performance.

Thinking such a concrete fact Nepal Government has established a numbers of Finance Companies but their performances are quit dismal and have not been able to contribute towards the generation of surplus. The present study will try to analyze and examine the Management Accounting practice side of the finance companies and this study is mainly designed to solve the problems of finance companies in Nepal. The research questions posed in this research were:

- ❖ Do any major difficulties and prospectus arise in the application of management accounting tools?
- ❖ Whether Nepalese finance companies are practicing management accounting tools or not?
- ❖ Which tools of management accounting are mostly practice and which aren't practiced till now?

1.3 Objectives of the Study

The main objective of this research is to study and analyze the problem to implication the practice of management accounting tool in the finance companies in Nepal. The specific objectives were as follows:

- a. To locate the spot where the management accounting tools can be applied for strengthen the finance companies.
- b. To study and analyze the present practices of management accounting tools in the finance companies in Nepal.
- c. To make recommendations to overcome the difficulties in applying management accounting tools in Nepalese finance companies.

- d. To analyze the problems and prospects of management accounting tools in financial companies.

1.4 Importance of the Study

This research work is the study of the practice of Management Accounting tools in finance companies in Nepal. This Study will be important in the following ways.

- a. It provides information on the application of the tools under different situations and encourages the use of management accounting tools in decision-making.
- b. It examines the use of Management Accounting tools in finance companies.
- c. It explores the problems & potentialities of the finance companies. It will be useful to the potential investors, lenders, managers, policy makers and stakeholders of the Nepalese finance companies.
- d. Last but not the least, It provides literature to the researcher who wants to carry on further research in this field.

1.5 Limitations of the Study

The limitations of the present research are as follows:

- a. The research is focused on the finance companies. Thus the findings might not be applicable to other financial sector.
- b. The study is concerned with management accounting. It doesn't consider the economic aspects of the companies.
- c. The research is based on primary and secondary data have been used for the purpose of the study.
- d. The research pays attention to the practice of management accounting tools only. It doesn't consider the execution aspects of the tools.
- e. The finance companies within Kathmandu valley is taken as target population for primary data and two finance companies namely Progressive Finance Ltd. and Unique Finance Ltd. selected for secondary data.

1.7 Organization of the Study

The thesis has been divided into five chapters. They are as follows:

Introduction: The first chapter covers background of the study, role of management accounting, statement of the problem, research objectives, and significance of the study and limitations of the study.

Review of literature: The second chapter focuses on the review of literature. It contains the conceptual framework and past research literature on profit planning and control area of management accounting.

Research Methodology: The third chapter deals with the research methodology to be adopted for study consisting research design, sources of data, data gathering procedure, population and sample, research variable and data processing procedure.

Data Presentation and Analysis: The fourth chapter covers presentation, analysis and interpretation of data. It consists, analysis of questionnaires, and analysis of open-end opinions and major findings of the research.

Summary, conclusions and recommendations: The fifth and final chapter covers summary, conclusions and recommendations. Bibliography, appendix and other documents are also incorporated in this study.

1.3.1 CHAPTER – II

1.3.1.1 REVIEW OF LITERATURE

2.1 Conceptual Framework

Management accounting is the term used to describe the accounting methods systems and techniques, which coupled with special knowledge and ability assist management in its task of maximizing profit or minimizing losses. It is essentially the application of managerial "Principles" and "Know-how" to the planning, development execution and control of the corporate plan. Developing a financial structure and ensuring that the optimum use is made of business resources are just as vital as the marketing and production function. Without adequate finance and regulation of the necessary funds there is little hope of success. For most companies therefore, management accounting in the appropriate form is absolutely vital (*Batty, 1982:1-2*).

A business enterprise today operates in a dynamic environment, which involves many new forms of management problem. Due to the complex environment management has to carry out basic functions of cost minimization and maximization of profit in an atmosphere of uncertainty. The old technique of management by intuition is no longer considered dependable in a situation in which the modern management has realized that even a slight error in policy decision may mean either losing a lot of business opportunities or going out of competition. A second chance may not come or even if it does, it may be costly or risky. It, therefore, constantly strives to reduce the risk of mistakes in decision-making by keeping abreast of such quantitative information, which would help analyze its administrative action in order to reach judicious decisions. It is here that accounting is of importance. Management, therefore, constantly strives to reduce the risk of making mistakes by looking for and analyzing relevant information by means of which it hopes to take judicious decision and direct the administration in a better manner (*Shrestha, 1996:12*).

2.1.1 Concept of Accounting

Management Accounting is that branch of accounting discipline which facilitates management by communicating necessary information to carry out management functions smoothly. Planning, organizing, staffing, leading and controlling are the routine functions of management. Management accounting is an accounting discipline that provides essential

information to every hierarchy of management to perform management functions (*Yamesh M. Singh, 2004*).

Accounting plays a key role in serving this purpose. Its task is to analyze the financial transactions as they take place, to record them in orderly fashion, to group and arrange the information in terms of useful and understandable financial reports (e.g. balance sheet, income statement) and to assist in the process of interpretation (*Monga, et.al, 1997:296*).

A systematic and up-to-date record of varied and numerous business transactions is quite essential to obtain the required information in respect of profit or loss and assets, liabilities and capital of the business unit and also to exercise control over various items of expenditure for maximum profit. It may be noted that systematic recording of various transactions is equally important to non-profit making entities such as colleges, hospitals, cultural clubs etc.

2.1.2 Basic Assumptions of Accounting

Some of the important assumptions regarding accounting are underlying as:

-) The Business Entity Concept
-) The Going Concern Concept
-) The Money Measurement Concept
-) The Accounting Period Concept
-) The Accrual Concept
-) The Realization Concept

The Business Entity Concept: Accounting is concerned with a specifically defined entity. Thus, for accounting purposes, each business enterprise is considered as an accounting unit separate and apart from owner(s), creditor(s), and other entities. According to this concept, the business and businessman are two separate and distinct entities.

The Going Concern Concept: We know that death may come any time; yet we go on working as if we will be here tomorrow. Accountants make similar assumptions about business entities. Accounting system assumes that the business entity will continue to exist indefinitely; it will not dissolve in the immediate future, unless there is clear evidence to the contrary. Continuity of activity is to be true of all forms of business organizations. The business entities are therefore going concerns.

The Money Measurement Concept: In accounting, only those facts, events and transactions are recorded and reported that are expressed in money or can be translated in terms of money. Money means the currency of a country such as rupees in Nepal, dollars in U.S.A, pounds sterling in U.K. and so on.

The Accounting Period Concept: Accountants have developed this important concept for reporting the periodical or interim progress of a business entity. Accounting period is defined as interval of time at the end of which the income (or revenue) statement and balance sheet are prepared in order to show the results of operations and changes in resources which have occurred since the previous statements were prepared. The accounting periods vary in time intervals, quarters, years. However, the 'year' is the most common accounting period (time interval) as a result of established business practice, traditions and government requirements.

The Accrual Concept: The essence of the accrual accounting is that a mere promise on the part of a customer to pay money in future is considered revenue. Similarly, a promise on the part of the business entity to make payment in future can be considered as an expense. Therefore, in accounting business transactions occur also in accrual basis.

The Realization Concept: The essential meaning of realization is that no profit or gain shall be recognized unless a change in assets or liability has become sufficiently definite and objective for recognition in the books of accounts. Thus, realization of revenue occurs, when increase in the value of net assets becomes available for the entity's use in the form of cash or near cash assets such as debtors and bills receivable. However, increases in the value of stock of goods or plant and machinery cannot be said as realized because they are not available for the entity's use. In general accounting can be used for internal and external purpose. Internal and external party who uses the accounting information for decision-making includes: Users of accounting information

1.3.1.1.1 Internal Users:-

Managers/Management, Employees, Owners/Shareholders, Trade Union, Investment Analysts

External Users:-

Creditors/Suppliers, Government, Bankers/Lenders, Customers etc.

2.1.3 Concept of Management

a. Process of management:

Management is the process of planning, decision-making and control which is as follows:

Planning: Planning is the process of thinking in advance about future activities. It is a forward thinking process that contemplates to manage the uncertainties and risks. It is the act of controlling an organization from deviating from its goal. A well-set plan is the key to success for an organization. Planning should be such that it reflects the true picture and reality of the organization. Planning is done at both strategic and operational level. Strategy itself is a plan to lead the organization with a long-term vision. Planning is developing a detailed financial and operational description of anticipated operations (*Bajracharya, et.al, 2004:451*).

Decision Making: Decision-making is the process of selecting the best –perceived alternative from the available different options. It is to be done in all levels of management. Decision-making is all about choosing from the available alternatives. The management team often comes across situations where decisions need to be taken considering the best interest of the organization (*Bajracharya, et.al, 2004:462*).

Controlling: Controlling is the process, which assures the management that the organization is not deviating from its basic philosophy. It is applied basically in the operational level because the actualization of the plans and strategies is done in this level (*Bajracharya, et.al, 2004:560*).

2.1.4 Concept of Management Accounting

Corporate firms that carry economic activities are the backbone of the economy. Their activities impact the economy in one-way or the other. Every organization has limited resources. The main problem lies in better utilization of available resources so that competitive advantages can be achieved. Among the various tools and techniques, management accounting tools have proved beneficial in every aspect of management activities from planning to decision-making. The main objective of management accounting is to help managers in overall managerial activities by providing information and helping them in planning, controlling and decision-making. In most corporate firms, management

accounting has been a strategic business partner in support of management's role in decision making, planning and controlling (*Hilton, 1997:5-6*).

Management Accounting is the process of providing quantitative information about economic entities to aid users in making decisions concerning the allocation of economic resource. It is regarded as a cyclical process starting from the collection and recording the financial transactions and ending with the reporting the performance to the parties concerned. It is an art of recording, classifying and summarizing transactions of financial character in terms of money and finally interpreting the result thereof. It is a systematic means of collecting information, recording and communicating it by way of somewhat standardized report format (*Munankarmi, 2002:133*).

Management accounting is concern with the accounting information that is useful to management. Management accounting involves the preparation and use of accounting information for planning and controlling the operations of business. Management Accounting is the application of professional information in such a way to assist the management in the formation of policies and in the planning and control of the operation of the undertaking. Management Accounting is the application of accounting and statistical techniques to the specified purpose of producing and interpreting information designed to assist management in the function of promoting maximum efficiency and is envisaging, formulating and coordinating their execution.

2.1.5 A brief Historical Perspective of Management Accounting

So far as the question of origin of managerial accounting is concerned, there is not a definite answer. In the beginning, when the population of world was low, the financial accounting was sufficient for maintaining account. It was a complete system at that time. But due to increase in population, industrial development and introduction of scientific management, they affected the business activities and financial accounting became an incomplete system. The emergence and rapid growth of industries in the twentieth century is the main reason for developing management accounting system.

Many of the early developments were concerned with managerial product costing which traced out the profitability to individual products. These information were used for strategic decision-making. From 1925 to 1980, it was observed that the academic accountants used

extensively arbitrary full cost allocation. They gave importance to full cost allocation for pricing, incremental orders and product discontinuance decision. The production cost that had been constructed for financial reporting purposes were used seriously by execution for product profitability, pricing, product mix and management control decision.

In the 1950s and 1960s some efforts took place to improve the managerial usefulness of conventional cost system. Direct costing has been developed at that time for internal decision making and control procedure. The user decision-making approach was extended in the 1960s and 1970s by academics. They introduced formal analytic methods of managerial decisions. In the late 1960s the new school of management accounting has been developed. The user decision-making model approach was extended by new school of management accounting thought which is known as information-economic approach. The information-economic approach attempts to measure the demand for information, a demand based on the value of information and cost of supplying it.

From 1980s to 1990s major challenges emerged for management accounting. Many managers and firms felt that the traditional management accounting practices were no longer serving managerial needs. They demanded more accurate, more useful and details product costing to improve quality and productivity and to reduce costs. They cannot be provided by traditional management accounting. Hence efforts were made to develop a new management accounting system. The present economic environment demands the development of innovative and relevant management accounting practice. For this purpose the traditional tools of management accounting like product costing and performance evaluation have been augmented and updated with contemporary approaches such as activity-based costing, customer profitability analysis, value-chain analysis, target costing and strategic cost management.

2.1.6 Functions of Management Accounting

The functions of managerial accounting that satisfy the various needs of management for arriving at appropriate business decision may be described as follows.

Managerial functions of planning, coordinating and control etc. are assisted by facts, figures and their interpretation provided by management accounting. The following is the brief description of managerial functions aided by the accounting department. An efficient management strives to raise productivity by utilizing the available resources. Management,

therefore, has to make important decisions from time to time. Management plays an important role in this connection. Accounting is opinion expressed in numbers and since decisions are based on opinions, accounting is one of the most useful tools for decision-making. With sound data to base its decisions, management can operate more efficiently, more economically and more profitably. Assisting the planning function of management with the aid of budgets and forecasts.

-) Controlling the operations by reporting on the plans.
-) Assisting in the development of new products and projects.
-) Coordinating the efforts by fixing responsibilities.

2.1.7 Objectives of Management Accounting

The main objective of managerial accounting is to provide relevant economic information to the top-level management to make strategic plans and decisions more competitive.

Providing information for planning and decision-making: Virtually all major plans and important decisions made by internal users (i.e. managers) rely largely on management accounting information. This information includes financial and non-financial data to help managers with strategic planning and decision-making (e.g. the cost of products, budgets, and cash flows).

Budgeting: one means of achieving goals is through budgeting. The budget indicates to p management's desire to allocate resources and emphasize certain activities.

Assisting in daily operation: Directing and controlling day to day operations require variety of data but the process of providing a good or service. The attention-directing function of management accounting information directs a manager attention to issues that need their attention (i.e., if highlights successful or problematic areas).

Controlling: The management team needs data about the lost of providing goods or services in order to set fees and prices management compares actual cost incurred with those specified in the budget (e.g. analyzing and comparing actual performance to budget plans).

Motivating managers and employees: A key purpose of management accounting is to motivate managers and other employees to direct their efforts toward achieving the organization's goals. This motivates manager to achieve the organization's goals by communicating the plans, providing a measurement of, how well the plan was achieved and prompting an explanation of deviation from the plan. Another was to motivate employees to assist in achieving the organization's goal is through empowerment. Employee empowerment is the concept of encouraging and authorizing workers to take. The initiative to improve operations, product quality and customer service and to reduce costs.

Measuring the performance of managers and sub-units within the organization: one way of motivating employees toward the organization's goal is to measure their performance in achieving their goals.

In addition to measuring the performance of people, management accountants measure the performance of an organization's sub units, such as divisions, product lines, geographical territories, and departments. Such measurements help top management decide whether a particular sub unit is a viable economic investment. Many large corporations compensate their executives, in part, on the basis of the profit achieved by the subunits they manage.

Assessing the organization's competitive position: A crucial role of management accounting is to continually assess how an organization compares with the competition, with an eye toward continuously improving.

Monitoring: This allows the firm to evaluate its financial and internal performance, customer satisfaction, and innovation compared to its goals, its own past records and that of other similar firms.

2.1.8 Distinction between Financial Accounting and Management Accounting

Main distinctions between financial accounting and management accounting can be drawn in the following elements:

Subject matter: In financial accounting, the enterprise as a whole is dealt with, while in managerial accounting attention is directed towards various parts of the enterprise, which is regarded mainly as a combinations of these segments.

Information dispatch: Since up to date information is absolutely essential for management action, there is more emphasis on furnishing information quickly in case of management accounting than in the case of financial accounting.

Nature: Financial accounting is concerned almost exclusively with historical records whereas management accounting is concerned with future plans and policies. Management's interest in the past is only to the extent that it will be of assistance in influencing company's future.

Type of data used: Financial accounting makes use of data, which is historical, quantitative, monetary and objective. Management accounting uses data, which is descriptive, statistical, and subjective relate to future.

Characteristics: Financial accounting places stress those equalities in information, which can command universal confidence like objectivity, validity, etc. management accounting emphasizes those characteristics, which enhance the value of information in its variety of uses, like flexibility, comparability etc. Financial accounting systems serve the interest of the various categories of Persons including external users (i.e. investors, creditors etc) where as management accounting serves the interest of internal users (i.e. management). Financial accounting is prepared and presented on the base of generally accepted accounting principles (GAAP) and standard rules. But the generally accepted accounting principles and standard rules are not considered in the case of management accounting.

2.1.9 Distinction between Cost and Management Accounting

Management accounting and cost accounting are different in their objective the primary objective of cost accounting is to ascertain the cost accounting is to ascertain the cost of production as well as to control the same after careful analysis whereas management accounting aims to supply the accounting information to the management for taking proper decision. In cost accounting accounts are prepared according to pre-determined standards and budget. But in management accounting reports are submitted to the management after measuring the variances between actual performance and the budget. As a result past error and defects may be rectified and there by efficiency is improved (*Paul, 1994:8*).

Management accounting is very closely linked to cost accounting linked to cost accounting so closely in fact that it is difficult to say where cost accounting ends and where management

accounting begins. Cost accounting simply aims to measure the performance of department's goods and services; however management accounting is much more compared to it (*Chadwick, 1996:4*).

2.1.10 Career Opportunity in Management Accounting

Managerial accountants are regarded as strategic business partners in an organization. Managerial accountants need the know-how of all functional areas of the business including; finance, production, marketing, personnel ., etc. Management accounting has become most demanding professional's course in recent years. A competent managerial accountant can begin his/her career in any areas,

-) Cost-management researcher
-) Profit planning manager in business organization
-) Financial analyst and consultant
-) Teacher and trainer

In recent years, increased interest in and demand for management accounting has led to the development of Certified Management Accountants (CMA) designation, the internal accountant's counter part to the Certified Public Accountants (CPA). The institute of Management Accountants (IMA) oversees the CMA program and is the largest U.S. professional organization of the organization of accountants whose major interest is management accounting. The CMA designation is recognized as the management accounting equivalent of the CPA (*Horngreen, et.al, 2002:654*).

2.1.11 Management Accounting in Nepal

The first king of Nepal in Lichhavi period, had circulated the first coin called "Mananka" during the period 464-491A.D. though, the history of account keeping in Nepal by the government is very old, written records to accounting have been traced back after 18th centuries in Nepal after the unification of the nation in 1768 A.D (1825 B.S) by king Prithivi Narayan Shah the Great, the chief of the district level soldiers used to keep the accounts of the government offices. In 2008 B.S., a weak practice of managerial accounting began in Nepal through the implementation of budgetary system, which was a tool of managerial accounting technique to plan revenue and control expenditure.

Managerial accounting is a new thing and it is still in a developing stage in the context of Nepal. The decisions that take place are usually based on intuition or behavior of the strategic manager. It can be said that the role of managerial accounting is yet to be recognized by Nepalese corporations. However, recently, with the country's entry into the World Trade Organization (WTO), the business people and companies in Nepal have realized the function and importance of managerial accounting too. Thus there is still plenty of scope for managerial accounting to be practiced by the Nepalese companies and it has almost become mandatory to understand and use the same so as to grow and sustain itself in today's rapidly changing and competitive global market.

2.2 A Brief Review of Management Accounting Tools

'Management Accounting' is the term used to describe the accounting methods, systems and techniques, which coupled with special knowledge and ability, assist management in minimizing losses. It is essentially the application of managerial principles and know-how to the planning, development, execution and control of corporate plans (*Batty, 1982:267*).

The main management accounting tools are cost classification and cost estimation, cost allocation, Product service costing method, Cost-Volume Profit analysis, budgeting for planning and control, management control system and responsibility accounting, standard costing: control of direct material and direct labor cost, flexible budgeting and overhead cost control, decision regarding alternatives in business operation, pricing decisions of product/services, long term investment decisions and management use of financial statement analysis. Tools and techniques provided by management accounting to discharge functions like; planning, controlling and organizing can be identified as follows:

2.2.1 Concept and Classification of Cost

a. Cost Concept:

Cost may be defined as the sacrifice or giving up of resources for a particular purpose. Monetary units that must be paid for goods and services frequently measure cost. Costs are initially recorded in Elementary form. Then these costs are grouped in different ways to help managers make decisions such as Evaluating subordinates and sub units of the organizations Expanding or deleting Equipments. To aid decisions managers want the cost of something.

This something is called a cost objective or cost object which may be defined as any activity for which a separate measurement of cost is desired (*Horngreen, 1991:65*).

The term cost is frequently used word that reflects a monetary measure of the resources sacrificed or forgone to achieve a specific objective, such as acquiring a good or service. However, the term must be defined more precisely before “the cost” can be determined. You will find that word cost is rarely used without a preceding adjective to specify the type of cost being considered (*Drury, 200:96-120*).

b. Cost Classification

Classification of an item is to define of as a certain kind. In other words, classification means to put an item or thing under a certain category. Cost classification is the process of grouping costs according to their common characteristics. The same cost figures sometimes can be classified according to different ways of costing depending upon the purpose to be achieved and requirements of particular concern. In management accounting with the purpose of assisting managers in managerial task, costs are classified on the following ground (*Garrison, 1985:27*).

c. Cost Relating to Income Measurement:

Product Cost: The cost of making a product is product cost. It is also known as the manufacturing cost. Product costs are taken for inventory valuation. Those expenses, which matter for the volume of production and inventory valuation, are product costs. Product costs become assets when incurred in the course of production and expensed, when the outputs are sold, direct material cost, direct labor cost, and manufacturing overheads are included in product cost.

Period Cost: Those expenses, which do not matter for the volume of production but are incurred in the passage of time or volume of sales, are period costs. All period costs are expensed at the time of occurrence. Period costs are expensed when they are incurred. Office/administrative and selling/distribution costs are period costs.

Absorbed Cost and Unabsorbed Cost: Fixed cost help to create value in the product. The benefit of fixed cost will lapse with the passage of time and must be absorbed by the Revenue of that period. The part of fixed cost which is absorbed during the Revenue of the particular period is known as absorbed cost. Absorbed cost is those cost which have been charged to

production. Costs which remain uncharged are known as unabsorbed cost (*Moore and Jacdicke, 1972:263-69*).

Expired and Un-expired Cost: An expired cost is one, which has no future service potentiality. In contrast, unexpired cost is one which can contribute to the production of future revenue e.g. unexpired cost is inventory, which can be sold in subsequent years and will influence total revenues. (*Khan and Jain, 1993:320*). Expired part of the prepaid expenses and business costs are expensed in income statement whereas the un-expired portion remains in asset side of the balance sheet.

Joint Product Cost and Separable Cost: Joint product costs are the cost of a single process or a series of processes that simultaneously produce two or more products of significant sales value. Such costs are not attributable to different individual products until after a certain stage of production known as the split of point. Separable cost that can be attributed exclusively and wholly to a particular product, process, division or department (*Horngreen, 1991:118*).

d. Cost Relating to Profit Planning:

Profit planning is associated with decision-making. Planning deals with the future. Future costs are relevant cost in profit planning function of management. The relevant cost concepts are;

Fixed Cost: Fixed costs are costs associated with those inputs, which do not vary with changes in volume of output or activity within a specified range of activity or output (Relevant Range). Fixed cost thus remains constant whether activity increases or decreases within a relevant range. Like other cost, fixed cost is subject to change over a period of time. As fixed costs are unaffected by volume changes any increase in volume implies that the costs will be allocated to greater number of units consequently fixed cost per unit will become progressively smaller as volume increases and vice versa (*Kaplan and Atkinson, 1998:13*).

Variable Costs: Variable costs are the cost that tends to vary in direct proportion or one to one relationship to changes in production activity, sales activity or some other measures of volume or cost driver. The cost of these inputs increase/decrease in proportion to increase/decrease in volume or cost driver (*Horngreen, foster and Datar, 1999:29*).

Semi Variable Cost/Mixed Cost: All cost which are neither perfectly variable nor absolutely fixed in relation to volume changes are semi variable cost. Semi-variable cost is also known as mixed cost as they consist both of fixed costs and variable cost. The fixed component of mixed cost consist the cost of providing capacity, where as variable component is caused by

using the capacity. The first part won't be affected by the changes in the volume/activity. But the later part will be affected by the change in activity. Ideally, Semi-variable costs should be bifurcated into fixed and variable cost as the functions of profit planning, cost control and decision, making assume that costs are either variable or fixed (*Khan and Jain, 1993:151-152*).

e. Segregation of Semi-variable Cost:

The methods of segregating Semi-variable cost are as:

The Two Point Method (High-Low Method): As the name suggest by this, method consider two level of activity, to bifurcate the cost. It consider the output at different levels i.e. High or low points is compared with amount of expenses incurred at these different periods (*Jain and Narang, 1992:2.226*). In the High-Low point method, the semi-variable cost is segregated into fixed and the variable components using exactly two data points. The two data points consist of selecting the periods of the highest and the lowest activity levels comprising changes in costs that result from the two levels.

$$VCPU = \frac{\text{Cost at high level activity} - \text{cost at low activity level}}{\text{High activity level} - \text{low activity level}}$$

$$\text{Fixed cost} = \text{Total Cost} - (\text{VCPU} \times \text{Activity Volume})$$

Where VCPU = Variable Cost Per Unit

The high-low point method is very simple and easy to apply, but if suffer from a major drawback in that if utilizes only two points in determining cost estimates.

Least Square Method: This method follows regression equation to segregate semi-variable cost into fixed and variable. General form of linear regression equation:

$$Y = a + bx$$

$$\text{Slope of regression line: } b = \frac{n(\sum XY) - (\sum X)(\sum Y)}{n(\sum X^2) - (\sum X)^2}$$

$$\text{Y-axis intercept: } a = \frac{\sum Y - b(\sum X)}{N}$$

Where,

Y= Dependent variable, total cost

a= Intercept coefficient, estimated fixed cost

b= Slope coefficient, estimated variable cost

x= Independent variable, level of activity

n= No of observations.

Analytical Method: This method is also known as “degree of variability” technique because the genesis of this method lies in measuring the extent of variability of costs on a careful analysis of each item to determine how far the cost varies with volume; variable overheads under this method computed as follow:

Variable Overhead = Budgeted Mixed Overhead | Degree of Variability

Future Costs: Future costs are relevant costs in profit planning function of management. Those costs, which are reasonably expected to be incurred at some future date as a result of a current decision, are called future costs. As they deal with a future period, they are estimated costs based on expectation. Future costs are controllable within a management. Future cost can be planned for and planned to be reduced if they are too high. This is not possible with historical cost (*Khan and Jain, 1993; 158-159*).

Budgeted Cost: When an operating plan involving future cost is accepted and incorporated formally in the budget for a specific period, such costs get converted to what may be referred to as budgeted costs. Budgeted costs are important elements in that they provide the basis for measuring the actual performance of different cost centre and therefore constitute an important input of responsibility accounting (*Khan and Jain, 1993:159*).

f. Cost Concept for Control

Responsibility Cost: Cost, which is incurred due to the responsible person of the responsibility center, is responsibility cost. This helps to localize the responsible person for the cause of cost when actual cost exceed to budgeted cost. For e.g. Purchase manager will be responsible for the purchase cost will be accountable incase actual cost exceed budgeted cost. The budgeted cost prepared by the head of management known as manager, and over which he has control to incur (*Khan and Jain, 1993:160*).

Controllable and Non-controllable Cost: An item of cost is controllable if the amount of cost incurred in responsibility center is significantly influenced by the actions of the manager of the responsibility centre other wise it is non controllable (*Anthony and Welsh1977:451*).

Direct and Indirect Cost: Different types of cost in a responsibility can be categorized as direct and indirect. Costs, which can be traced into the particular department or product, are direct cost. Those cost which are not lactometer into any particular department product or units is indirect cost. Indirect cost is the common cost. e.g. Salary of the manager is the common cost for all the departments. Such cost should be allocated to different units, subunits, departments and product as per the activity (*Cost driver*) (*Decoster, 1979:10*).

g. Cost for Decision Making

Relevant/Irrelevant Cost: Cost which is influenced by a decision is a relevant cost and hence is important for decision makers cost which is not affected by a decision is irrelevant cost. Such a cost is of no relevance to decision makers. These costs should be ignored while making decisions. Committed fixed costs are irrelevant that of additional fixed cost are of relevant. Relevant cost in true sense is incremental cost. Most of the variable cost are relevant cost for decision maker (*Khan and Jain, 1993:162*).

Incremental/Decremental Cost: Any cost which increases between the alternatives are incremental cost while which decreases is decremental cost. This cost is also known as differential cost. Both incremental and decremental costs are relevant in decision-making purpose (*Garrison, 1985:43*).

Out of Pocket Cost and Sunk Cost: Cost, which requires current or future cash expenditure as a result of a decision, is labeled as an out of pocket cost. In contrast, those cost which have already been incurred in the past and will not require any current cash expenditure is sunk cost. Sunk cost is the result of the past commitment. They should be ignored while making decision while out of pocket cost is relevant for decision-making purpose. Mostly sunk cost deserves fixed behavior while out of pocket cost deserves the variable behaviors. But in same situations, sometimes-sunk cost might be of variable while out of pocket cost bear to be fixed (*Decoster, 1979:10*).

Opportunity Cost and Imputed Cost: An opportunity cost can be defined as the potential benefit that is lost and sacrificed when the choice of one course of action requires the going up of an alternative course of action. Opportunity cost is not usually entered on the books of organization but it is a cost that must be expertly considered in every decision that a manager makes has some opportunity cost attached to it. In short, every alternative course of action facing a manager has a mixture of good and bad features. In rejecting a course of action, the good features must be given up along with the bad. The net good features of a rejected alternative become the opportunity costs of the alternative that is selected (*Garrison, 1985:44*).

2.2.2 Cost Allocation

Cost allocation is the process of assigning costs when direct measure does not exist for the quality of resources consumed by a particular cost object. Cost allocations involve the use of some apportionment bases rather than direct measures. Assignment of direct costs remains similar under any of the allocation system except the cases of joint products. Therefore the

term 'cost allocation' in other than the joint product, directly implies the indirect or overhead costs. Cost allocation, then, may be defined as the distribution of indirect or overhead costs to cost centers and the cost objects in a most appropriate basis.

Method of Allocation

Primary Allocation: In the first stage each element of overheads is assigned to cost centers in some appropriate basis. These cost centers comprise of the production department and the service departments.

Secondary Allocation: The second step is to reallocate the costs assigned to service departments to production department. Service departments are those departments that exist to provide services of various kinds to other units within the organization. The methods of reallocating the costs of service departments are:

Direct Allocation Method: The direct allocation method (often called the direct method) is the most widely used method of allocating support department costs; the benefit of the direct method is its simplicity. There is no need to predict the usage of support department services by other departments.

Step Down Allocation Method: Some organizations use the step down allocation method, which allows for partial recognition of the services rendered by support departments to other support departments. This method requires the support departments to be ranked in order the step-down allocation is to proceed. Different sequences will result in different allocations of support department costs to operating departments. A popular step-down sequence begins with the support department that renders the highest percentage of its total services to other support departments.

Reciprocal Allocation Method: The reciprocal allocation method allocates costs by explicitly including the mutual services provided among all support departments. Conceptually, the direct method and the step-down method are less accurate than the reciprocal method when support departments provide service to one another reciprocally.

Product Costing Method: Two popular methods drawn for product costing are variable costing (Direct/marginal costing) and Absorption costing (fixed costing). Variable costing and absorption costing are not the system of costing like process, operating, batch or job costing rather they are the tools or technique of product costing (*Khan and Jain, 1993:345*).

Variable/Direct Costing: Variable costing more accurately perceived as direct costing or marginal costing as it applies only the variable production cost to the product. This costing approaches that fixed manufacturing overhead is regarded as an expired cost to be

immediately changed against sales not as an unexpired cost to be held back as inventory and changed against sales later as a part of cost of goods sold. Further more the direct costing approach to the inventorying of costs is not confined to only direct material and labor. It also includes on indirect cost the variable manufacturing overhead as a part of product as a part of product cost (*Horngreen, 1991:539*).

Absorption Costing: Contrast to variable costing. Absorption costing assumes that fixed along with the variable cost constitutes to the product cost. It absorbs all cost necessary to production. It considers fixed manufacturing overhead as a part of product cost (*Horngreen, 1991:539*).

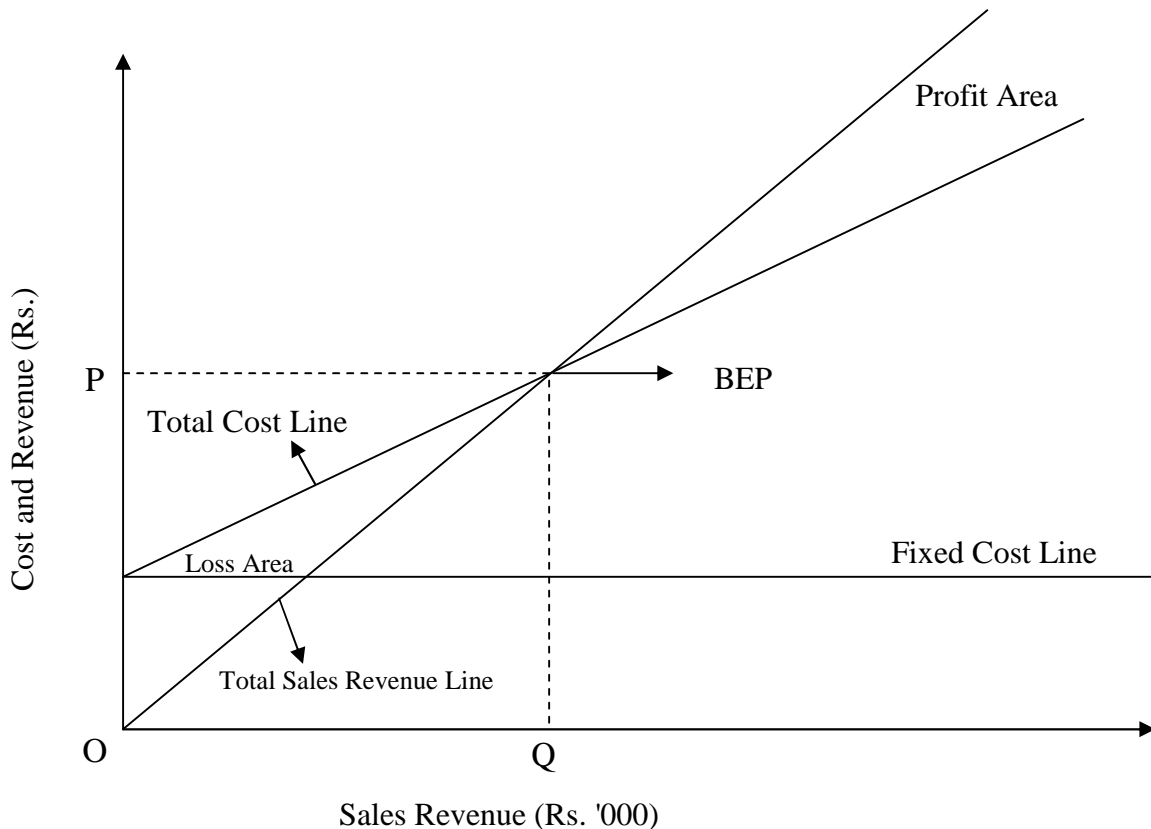
Use of Variable and Absorption Costing: Absorption costing is more widely used than variable costing. However, the growing use of the contribution approach in performance measurement and cost analysis has led to increasing use of direct costing for internal reporting purposes. Over half the major firms in the United States use direct costing for some internal reporting, and nearly a quarter uses it as the primary internal format. In contrast neither the public accounting profession nor the internal purposes. Thus all firms use absorption costing for there reports to shareholders and tax authorities (*Horngreen, 1991:538-539*).

2.2.3 Cost-Volume-Profit Analysis

Cost-Volume-Profit Analysis is a management accounting tool to show the relationship between the ingredients of profit planning. Profit planning is the functions of the selling price of unit sold of product units sold. The entire gamut of profit planning is associated with CVP relationships is break-even analysis. Break Even analysis is concerned with the study of revenues and total costs will be exactly as a point at which the firm's total revenues are exactly equal to total costs, yielding zero income. The "No profit" "No loss" point is a break-even point or a point at which losses cease and profits begin (Khan and Jain, 1996:494).

'No profit no loss' situation is a cornerstone of profit planning. This can be explained, through cost-volume profit graph as shown below:

Figure 2.1: Graphical Approach to CVP



CVP analysis is a supplementary tool of profit planning. It tells many things about the relationship between the business variables. Total variable costs are proportionate to the sales volume; whereas the total fixed costs remain unchanged within the relevant range of the output levels. That is why net incomes are not in proportion to sales knowing this relationship; one can assess the profit at forecasted sales volume.

Significance of Cost Volume Profit Relationship: An understanding of the inter-relationship between cost volume and profit is extremely helpful to management in a broad variety of problems involving planning and control the relationship between these three factors makes up the profit structure of an enterprise. It is only through the knowledge and intelligent use of such information that the prediction of probable impact of any number of contemplated action in made possible. This makes cost volume profit analysis relationship as one of primary planning.

The primary role of cost volume profit relationship is to pave the way for devising the most profitable admixture of operating factors. Such combination is known as profit planning and represents balance management of an enterprise requiring intelligent for potential profit coupled with the necessary co-ordination and meet changing conditions this analysis is great

helpful in managerial decision making specially cost control and profit planning. Generally it provides response to such inquiry such as:

-) What sales volume is needed to avoid losses?
-) What sales volume is needed to earn a desired profit?
-) What product or product mix is most profitable?
-) Which product or operation of a plant should be discounted?

Management uses of cost - volume- Profit Analysis, its usefulness to management are as follows:

Management plans future operation with cost volume profit analysis. Profit do not just happen they must be managed and planned by estimating what the selling price, unit variable cost, total fixed costs, and sales volume will be next period, management can estimate the next period or future profit by using several approach management can estimate. Management uses the budgeted amount to control operation. Management should use cost volume profit analysis to determine the probable effects of various alternatives, which may be considered.

Management uses cost volume profit analysis to analyses past performance: management should determine the reason for differences, or variances between budgeted and actual result. Cost volume Profit analysis in an integral part of management administrative function. It can make an important contribution to planning, organizing, and controlling. It also can use to control current operation by comparing actual with planned results (*Lynch and Williamson 1983: 118-121*).

2.2.4 Budgeting as a Tool of Planning and Control

In modern era the business enterprises as well as other non- profit concerned organizations are preparing budget every year or for certain period. A budget is a formal statement of the financial resources to be used for an organization planned activities for a given period of time. Budgets serve the organization in the planning but they have key role in organizing and controlling function as well. The vignette demonstrates how important budgets are to small as well as large corporations.

Budgeting, as a tool of planning and control is closely related to the broader system of planning and control is an organization. Planning involves the specification of the basic objectives that the organization will pursue and fundamental policies that will guide it. In operational terms it involve the step of setting objectives, specifying goals, formulating

strategies and expression budgets. A budget is a comprehensive and co-ordinate plan, expressed in financial terms, for the operations and resources of an enterprise for some specified period in the future (*Khan and Jain, 1993:296*).

A budget is a detailed plan expressed in quantitative terms that specifies how resources will be acquired and used during a specific period of time. The procedures used to develop a budget constitute a budgeting system. (*Hilton, 2003:205*).

Budgeting is a tool of achieving management objectives. Simply stated the process of preparing and using budgets to achieve management objectives is called budgeting. More specifically a comprehensive planning and control or budgeting is a systemic and formalized approach for stating and communicating the firms expectations and accomplishing the planning co-ordination and control, responsibilities of management to maximize the use and control responsibilities of management in such a way as to maximize the use of given resources (*Pandey, 1987:89*).

In summary, the budget involves the statement of plans, the co-ordinations of these plans into well-balanced programs and the constant watching of actual operations to ensure that they are kept in line with the predetermined plans. In this way limits are set on expenditure, standards of performance are established, and forward thinking is made an essential part of the business management. Care must be taken however not to fall the error of regarding the budget as an end in itself. It is means to an end. It is not a method of business management, but an aid to clear thinking and its fundamental object is to enable considered intention to be substituted for opportunism in management.

2.2.4.1 The Budgeting Process

The main objective of a business firm is to make an excess of revenue over expenses so as to maximize profits. But it is not a matter of dream or chance. There is no magic formula of boosting the figure of profit overnight. Budgeting, if followed properly, can increase the chances of making profit within the given environment. A systemic budgeting should encompass the following procedures: (*Welsh, Hilton and Gordon, 2000:73-88*)

-) Identification and evaluation of external variables.
-) Development of broad objective of the enterprises.

-) Development of specific goals for the enterprises.
-) Development and evaluation of company strategy.
-) Executive management planning instructions.
-) Preparation of evaluation of project plan.
-) Development and approval of strategic and tactical profit plans.
-) Implementation of profit plans.
-) Use of periodic performance reports.
-) Implementation and follow up.

2.2.4.2 Requirement for Effective Budget

Support of Top Management: The budget program can only be successful when top management offers the wholehearted support and when all managers are motivated about the implementation of budget program.

Clearly Defined Organization: Business organization should be defined as to provide maximum benefits. There should be a sound plan with well defined and adequately maintained responsibilities. Records should be clear consistently departmentalized and established in such a manner as will indicate definite responsibility on each unit or section of the business.

Accurate Accounting System: Accounting system should be developed so far to hold each part of the organization, to its responsibilities. The budget fosters coordinated action and whenever this is broken down or interfered with the responsible factor should be unmistakably related.

Unambiguous Policy: A budget programmer is always based on certain fundamentals, the collection of which is called the “policy” of the business. Naturally, therefore, no programmer can be prepared without the knowledge of the business policy to adopt during the period covered by two budgets.

Preparation by Responsible Executives: Formation of budget in the participation of executive who are entrusted with the performance and in complementation is one of the essentials of effective budgeting.

Logical Sequence in the Budget Preparation: It is essential that proper procedures should be evolved for the preparation, submission, examination and review of budget figures in logical sequence.

Constant Vigilance: An effective system of budgetary control requires that provision must be made for the comparisons of budget and actual results at frequent intervals. As soon as unfavorable trends are detected immediate action should be taken to remedy them.

Continuous Budget Education: An essential condition for the success of budgeting is that it must be able to sustain the interest of those who should bear the responsibility of putting budget proposal into effect. This needs continuous “budget education” which is concerned with briefing the employees of the undertaking on the objectives, potentials and techniques of budgeting as well as making them understand its uses and limitations.

A Degree of Flexibility: Flexibility for both possible and unforeseen circumstances requires essentially in budgeting.

2.2.4.3 The Master Budget

The master budget is a networking consisting of many separate budgets. A complete set of financial plan for a business firm is often called the master budget. The master budget consists of many functional budgets including a sales budget, a production budget, a purchase budget, an expenses budget, equipment purchase budget and a cash budget. Once all of these budgets are completed, the master budget for the entire firm is prepared when all budgets have been prepared, and the budgeted profit and loss account and balance sheet provide the overall picture of the planned performance for the budget period. The type of budgets or profit plans depends upon the nature of the business entity. The master budget is a networking consisting of many separate budgets that are interdependent. A master budget normally covers three areas: operational sectors budget, cash budget and budgeted financial statements.

a. Operating Budget:

Operating budget relates to the physical activities/operations of a firm such as sales, production, purchasing, debtors collection and creditors payment schedule. In specific terms an operating budget has the following terms.

Sales Budget: A sales budget is a detailed schedule of expected sales for the coming period. It is usually expressed in both amounts and units. Once the sales budget has been set, a decision can be made on the level of production that will be needed to support sales and the production budget can be set well. The sales budget is constructed by multiplying the expected sales in units by the sales price. Generally, sales budget is accompanied by computation of expected cash receipts for the forthcoming budget period. This computation is needed to assist in preparing the cash budget for the year. Expected cash receipts are

composed of collections on sales made to customer in prior periods plus collection on sales made in the current budget period (*Garrison, 2000:145*).

Sales budget is the starting point in the preparation of the comprehensive master budget. All the other plans and budgets are dependent upon the sales budget. The budget is usually presented both in units and rupees of the sales revenue or sales volume. The preparation of a sales budget is based upon the sales forecast. A variety of methods are used to forecast the sales for the planning period.

Production Budget: After the sales budget has been prepared, the production requirement for the forth-coming period can be determined and organized in the form of a production budget. Sufficient goods will have to be available to meet sales need and provide for the desired ending inventory. A portion of these goods will already exist in the form of beginning inventory. The remainder will have to be produced, thus, production need can be determined by adding budgeted sales units to the desired ending inventory and deduction by adding budgeted sales units to the desired ending inventory and deduction the beginning inventory from the total (*Hornsgreen, et.al, 1999:182*).

Planned production units = planned sales units + desired ending finished goods inventory units – beginning finished goods inventory

Merchandise Purchase Budget: In case of Merchandising firm, instead of preparing production budget it would prepare a merchandise purchase budget showing the amount of goods to be purchased from its suppliers during the period. The merchandise purchase budget is in the same basic format as the production budget, except that it shows goods to be purchased rather than goods to be produced.

Purchase budget in units = Planned material consumption + Desired ending inventory of Raw material – beginning inventory of raw material.

Direct Material Budget: After production needs have been computed, a direct material budget should be prepared to show the materials that will be required in the production process. Sufficient raw materials will have to be available to meet production needs and to provide for the desired ending raw material inventory for the budget period part of this raw materials requirement will already exist in the form of a beginning raw material inventory. The remainder will have to be purchased from supplier.

Direct Labor Budget: The direct labor budget is also developed from the production budget. Direct labor requirements must be computed so that the company will know whether sufficient labor time is available to meet production needs. Just knowing in advance, the company can develop plan to adjust the labor force as the situation may require. Direct labor

requirement can be computed multiplying product to be produced by each period by the number of direct labor-hours required to produce a single unit. Many different types of labor may be involved. If so, then computation should be type of labor needed. The hours of direct labor time resulting from these computations can then be multiplied by the direct labor cost per hour to obtain budgeted total direct labor cost.

Manufacturing Overhead Budget: The manufacturing overhead budget provides a schedule of all costs of production other than direct material and direct material and direct labor. These costs should be broken down by cost behavior for budgeting purposes and predetermined overhead rate developed. This rate will be used to apply manufacturing overhead to units of product throughout the budget period.

Manufacturing overheads are the part of the total production cost, which is not directly identifiable with specific products or jobs. Manufacturing overheads include many dissimilar expenses; therefore, they cause problems in the allocation of these costs to products. There two distinct types of responsibility centers in most manufacturing companies, production and service. Responsibility for the operation of each department should be classified separately in this chart of accounts used by the cost accounting department; finally, the expenses of each department should be planned and controlled separately.

Selling and Distribution Overhead: The selling and distribution overhead contains a listing of anticipated expenses for the budget period that will be incurred in areas other than manufacturing. Selling and distribution expenses include all costs related to selling, distribution and delivery of products to customers. In many companies, this cost is a significant percentage of the total expenses. Careful planning of such expenses affects the profit potential of the firm.

Administrative Overhead: Administrative expenses include those expenses other than manufacturing and distribution. They are incurred in the responsibility centers that provide supervision of and service to all functions of the enterprise, rather than in the performance of any one function. Because large portions of administrative expenses are fixed rather than variable, the notion persists that they cannot be controlled. Aside from certain top manager's salaries, most administrative expenses are determined by management decision.

Cost-of-goods-sold Budget: The Cost-of-goods sold budget clearly distinguishes the total costs of goods manufactured and cost of goods sold from the value of inventory. Indeed, it tells us how much of the costs of goods manufactured should be expensed this year and how much cost should be carried to the next year with the inventory. The cost-of-goods sold budget facilitates the making of the income statement and the balance sheet.

The cost of goods sold is the making cost of the sold units. In case of manufacturing business the cost of goods sold include the direct material, direct labor and the variable manufacturing costs.

b. Financial Budget:

Financial budgets are concerned with expected cash receipts/disbursement financial position and results of operations, the component of financial budgets are:

Cash Budget: Cash budget is a most significant device for planning and control of cash in an organization. The cash budget is plan of future cash receipts and payments. In other word, a summary statement of the firm's expected cash inflows and outflows over the projected time period is known as cash budget. The cash budget is composed of four major sections:

-) The receipt sections
-) The disbursement sections
-) The cash excess or deficiency section
-) The financing section

A cash budget is developed after all the operational budgets and capital expenditure out days has been accomplished. A cash budget shows the planned cash inflows, outflows and ending position by interim periods for a specific time span. Most companies should develop both long term and short term plan about their cash flows. The short-term cash budget is included in the annual profit plan. A cash budget, basically, includes two parts,

-) The planned cash receipts
-) The planned cash disbursements.

Planning cash inflows and outflows gives the planned beginning and ending cash position for the budget period. Planning the cash inflows and outflows will includes (a) the need for financing probable cash deficits or (b) the need for investment planning to put excess cash for profitable use.

Budgeted Income Statement: The budgeted income statement is one of the key schedules in the master budget. It is the document that tells how profitable operations are anticipated to be in the forth- coming period. After it has been prepared, it stands as a benchmark against which subsequent company performance can be measured (*Garrison, 2000:718*).

Budgeted Balance Sheet: Beginning with the current balance sheet and adjusting it for the data contained in the other budgets develop the budget balance sheet. (*Garrison, 2000:353*) The balance sheet is is a statement of assets and liabilities prepared after the preparation of

functional and financial budgets. It is based on functional budgets, cash budget, projected income statement and previous year's assets and liabilities. It can be prepared in horizontal or vertical format. The budgeting techniques are as follows:

Incremental Budgeting: Most of the running organizations start budgeting for the next year based on previous budgets or the actual results. If the budgets for a given time are based on the budget or actual data of the same unit of previous time, this technique is called the incremental budgeting or base budgeting. The main idea of incremental budgeting is to make an increase over the past year figures to give budget allowance for the next year. This means that existing operations and the current budgeted allowance for existing activities are taken as the starting point for preparing the next annual budget. The base is then adjusted for changes which are expected to occur during the new budget period. This approach is called incremental budgeting; since the budget process is concerned mainly with the increment is an operation or expenditure that will occur during the fourth coming budget period.

The major disadvantage of the incremental approach is that majority of expenditures, which is associated with the 'base level' of activity, remains unchanged. Thus, the cost of non-unit level activities becomes fixed and past inefficiencies and waste inherent in the current way of doing things is perpetuated (*Drury, 2001:145*).

2.2.4.4 Zero-base Budgeting

Under zero-base budgeting, every budget is constructed on the premise that every activity in the budget must be justified. It starts with the basic premise that the budget for the next year is zero and that every expenditure, old and new, must be justified on the basis of its costs and benefits. The discipline of zero-base budgeting takes a different approach – in fact a reverse approach to this problem of justifying everything. What it says is begin with where you are and establish a business usual and budget for the next year in the same way and with the same things you would do if you were not concerned about constraints and total justification.

Zero-base budgeting (also known as priority-based budgeting) emerged in the late 1960: as an attempt to overcome the limitations of incremental budgets. This approach requires that all activities are justified and prioritized before decisions are taken relating to the amount of resources allocated to each activity. Besides adopting a 'zero-based' approach zero-base budgeting (ZBB) also focuses on program or activities instead of functional departments based on line items, which a feature of traditional is budgeting (*Drury; 2001:149*).

Zero-based budgeting though is not really concept; it is the review of departmental costs. Managers are advocating for long, an in-depth review of departmental costs. This review should be done annually, zero-based budgeting lays down whereas critics of zero based budgeting say it should done every five years or so. The only difference is the frequency of the review of departmental cost (*Garrison, 1985:231*).

2.2.4.5 Activity-based Budgeting

Activity-based costing can lead to improved decision making. Activity –based costing principles extend budgeting. Activity-based budgeting focuses on the lots of activities to produce and sell products and services. It separates indirect costs into separate homogenous activity cost pools. Management uses the cause and effect criterion to identify the cost drivers for each these indirect cost pools. To manage costs more effectively organizations that have implemented activity-based costing (ABC) have also adopted activity based budgeting (ABB). The aim of ABB is to authorize the supply of only those resources that were needed to perform activities required to meet the budgeted production and sales volume.

Four key steps in activity-based budgeting are:

-) Determine the budgeted costs of performing each unit of activity at each activity area.
-) Determine the demand for each individual activity based on the budgeted production.
-) Computer the costs of performing each activity.
-) Describe that budget as the costs of performing various activities.

And activity-based budgeting is facilitated by activity-based costing. The benefits that can be enjoyed from activity-based budgeting are:

-) Ability to set a more realistic budget
-) Better identification of resource needs
-) Linking of cost output
-) Clear linking of cost with staff responsibilities
-) Identification of budgetary slack (*Horngreen, et.al, 1999:190*).

ABB involve the following stages:

-) Estimate the production and sales volume by individual products and customers.
-) Estimated the demand for organizational activities.
-) Determine the resources that are required to perform organizational activities.
-) Estimate for each resource the quantity that must be supplied to meet the demand.

-) Take action to adjust the capacity of resources to much the projected.

2.2.5 Management Accounting Control System

Management consists of the basic functions of planning, decision-making and control. Control is the function of management that ensures the proper implementation of plans and policies to achieve to organizational objective. Management control systems focus on motivating managers for the sake of enhancing total profitability of the organization.

Control involves the process of establishing results and performance targets, measuring performance and providing rewards or punishments based on an employee's ability to achieve the performance target. A management control system is a logical integration of techniques to gather and use information to make planning and control decisions, to motivate employee behavior, and to evaluate performance. The purposes of management control system are;

-) To clearly communicate the organization's goals.
-) To ensure that managers and employees understand the specific actions required of them to achieve organizational goals.
-) To communicate results of actions in the organization
-) To ensure that the management control system adjusts to changes in the environment
(*Horngreen, et. al, 2004: 345*).

2.2.6 Standard Costing

Control is very significant functions of management. Through control, management ensures that the performance of organization confirms to its plan and objectives. Analysis of variances is helpful in controlling the performance and achieving the profits that have been placed (*Horngreen, et. al, 1999*). Control of costs is one of the most important objectives of cost and management accounting and cannot be achieved without some standard against which the actual one can be compared. The use of standard costs increases cost consciousness among management and employees and can improve business profits by providing a base for performance evaluation. (*Jawahar Lal, 2003:106*)

Standard cost for a given job is the predetermined cost to complete the job as per specifications. Standard costing is a system before starting the production and then

comparing this with the actual costs of the job after completing the production. The difference between the predetermined or standard costs and the actual costs is termed as 'variance'.

2.2.6.1 Control through Standard Cost

Standard costing is a management accounting tool for management control. Controlling is the process of comparing actual results with the planned objectives and determining where adjustments should be made. The management control process encompasses the following steps (*Bajracharya, et.al, 2004:348*).

1.3.1.1.2 Setting Standards

The first step in management control process is to set performance standards. Especially cost control, the estimated cost to be manufacturing a single unit of product or to perform a service called the standard cost. Prime cost, direct material and direct labor cost is determined by the multiplication of a physical factor by a monetary factor. Because of the variety of the component parts and productive operations in a unit of a given product, the cost factors must be examined in detail before a standard cost for a unit of product can be determined.

Once the management has established the design and manufacturing process that will produce the desired output and has determined which input resources will be used, quantity and price standards can be developed. Developing the standards is sensitive tasks, which, later on, affect the entire management process including the budgeting, decisions, and the performance measurement. The sources of information for developing standards are determined from different angles depending on the nature and the moment of the job. Most usual sources include;

-) Past experience: for a running business
-) Trial production: for a new business
-) Lab studies, time and motion studies: for a large – scale new manufacturing
-) Tear down analysis: functional analysis of competitor's products.
-) Bench marking: practice of the world class product.
-) National standards: e.g., Nepal standard mark
-) International standards: e.g. ISO standards
-) Health product: WHO standards.
-) Actual performance measurement

After setting the cost standards, the actual result of material, labor and overhead costs of a batch of production are collected. Information is most important for actual performance measurement. Such information is available with the related cost centre. For example, actual labor cost data is available in the payroll department. Therefore, a well-structured responsibility accounting system is the pre-requisite for cost control through standard costing system.

1.3.1.1.3 Analysis of Variance

The derivation of the actual cost or profit or sales from the standard cost or profit or sales is termed as variance. When the actual cost is less than standard cost or actual profit is better than standard profit, it is known as favorable variances and such a variance is usually a sign of efficiency of the organization. On the other hand when actual cost is more than standard profit is called unfavorable variances and is usually an indicator of inefficiency of the organization. The favorable and unfavorable variances are also known as credit and debit variances respectively. The expression of this relationship can be seen in the simple formula:

$$\text{Actual cost} = \text{Standard cost} + \text{Variance}$$

By rearranging the terms in the formula, we can determine the variance if we know standard and actual costs:

$$\text{Variance} = \text{Actual costs} - \text{Standard costs}$$

1.3.1.1.4 Corrective Action

If a deviation between the actual performance and the standard performance is significant, understanding the causes is crucial to determine whether it should be changed or some other remedy should be attempted. One main application of standard costing system is to measure the performance of different cost centers. Employee training, promotion transfer and economic incentives should be based on the performance, revealed by the comparison of actual results with the standards. Though the past is not much relevant as it has already passed, the purpose of corrective action is to ensure that the past mistakes will not be repeated in future.

2.2.6.2 Benefits of Implementing Standard Costing

Improved cost control: Companies can gain greater cost control by setting standards for each type of cost incurred and then by highlighting exceptions or variance-instances where things did not go as planned. Variances provide a starting point for judging the effectiveness of managers in controlling the costs for which they are held responsible.

Useful information for managerial planning and decision-making: When management develops appropriate cost standards and succeeds in controlling production costs, future actual costs should be close to the standard. As a result, management can use standard costs in preparing more accurate budgets and in estimating costs for bidding on jobs. A standard cost system can be valuable for top management in planning and decision making.

Cost saving in record-keeping: Standard costing needs no special calculations to determine actual unit costs during the period. Instead, companies may print standard cost sheets in advance showing standard quantities and standard unit costs for the materials, labor, and overheads needed to produce a certain product. More reasonable and easier inventory measurement: Under a standard cost system, the company would not include such unusual costs in inventory. Rather, it would charge these excess costs to variance accounts after comparing actual cost to standard cost. Thus in a standard cost system, a company assumes that all units of a given product produced during a particular time period have the same unit cost. Logically, identical physical units produced in a given time period should be recorded at the same cost.

Reduction in production cost: A standard cost system may lead to cost savings. The use of standard costs may cause employees to become more cost conscious and to seek improved methods of completing their tasks. Only when employees become active in reducing costs can companies really become successful in cost control.

2.2.7 Flexible Budgets and Overhead Cost Control

A flexible budget calculates budgeted revenues and budgeted cost based on the actual output level in the budget period. A flexible budget is calculated at the end of the period. When the actual output is known; a static budget is developed at the start of the budget period based on the planned output level for the period (*Horngreen, et.al, 2003:520*).

A flexible budget estimates expenses at different possible levels of future operations. A flexible budget is not based on only one level of activity. A flexible overhead budget is defined as a detailed plan for controlling overhead costs-a plan that is valid in the firm's relevant range of activity (*Hilton, 2000:215*).

Since some of the factory overhead cost elements remain constant per activity and others remain constant per period. We can simplify the flexible cost statement by summarizing all factory overhead costs in a general formula, known as flexible budget formula.

Total factory overheads (y) = Fixed costs (per period) + Variable cost (per activity) x

$$Y=FC + UVC \times LA$$

Here, Y'-stands for the budget allowance(BA) for the factory overheads for any given level of output or activity (X), a-stands for the fixed costs and b-stands for the variable costs per unit.

Factory overhead cost standards are much more complex than those of direct material and direct labor. By nature, direct material and direct labor costs are variable costs, whereas factory overheads are partly fixed and partly variable. Since direct materials and direct labor costs are directly traceable to the output units, standards can be determined as per unit of output. As fixed factory overhead costs are of mixed nature, it is difficult to express the cost per unit of output. For the over cost control purpose, following standard data are required.

-) Normal capacity to ascertain the fixed overhead rate.
-) Standard/machine labor hours per unit of output
-) Segregation of factory overheads into fixed and variable components
-) Standard overhead rate

The first and the foremost thing to define in case of overhead cost control is the appropriate cost driver for the factory overheads. Leaving the question of activity-based costing for the moment; we, at least, have to choose one common cost driver for the total factory overhead. Factory overhead costs are incurred in the course of converting the raw materials into finished production. Raw materials are processed either through labor or through machinery. Yet, the labor and the machines are not mutually exclusive factors. The only question is whether the process is more labor-based or more machined. Depending upon the nature, direct labor hours (DLH) or the direct machine hours (DMH) should be chosen as the cost driver for the factory overhead costs.

The main objective of analyzing the factory overhead variance is to determine whether the total manufacturing overheads are over or under applied in the cost of production for the given level of output. The 'Three-way analysis system' allows management to break down

the total overhead variance into three principal areas: the portion caused by efficiency factors, and the portion caused by rate or spending factors.

2.2.8 Decision Making

Decision-making is that function under which the management is involved in selecting a best alternative from among the several courses of action available. Decision-making is a logical approach to solving problems. Therefore identifying the problem is the first step in the process of effective decision-making. If there are no alternatives there will be no choice. To make the selection, there must be at least two or more alternatives. But the number of alternatives should be and economic to analyze. Business decisions should not focus only on maintaining profits. Rather, they should focus on the maximization of profits, which gives happiness to the stockholders. But one should always note that business profit is not a matter of chance like gambling, it is to be managed.

While making decisions in business, managers should be economically rational. Long-term profit maximization is the core of business decisions. Therefore, financial feasibility is the prime determinant in selecting the best alternative. The course of action, which maximizes profits by increasing revenues or minimizing costs, is considered as the most economic one. Opportunity costs, which are the benefits foregone in the next best alternative, must be counted in the alternative to be undertaken.

As cost is the key factor for decision, the cost general can be classified as relevant and irrelevant from decision perspective. All the cost which are avoidable or which changes with the change in alternatives are relevant and vice versa. Variable cost, opportunity cost, avoidable cost and differential cost are relevant cost where as sunk cost, committed cost etc. are irrelevant cost from decision-making perspective.

2.2.8.1 Process of Decision Making

The managerial decision-making is the art of selecting the best alternatives among the various alternatives available to solve the given problem. In case of business organization the best alternative is one, which is likely to provides maximum profit and involve a minimum cost without violating the social responsibilities. In the management accounting decision process involves the following basis steps:

- 1) Recognize and define the problem

-) Identify the appropriate alternatives to solve the problem
-) Collect the relevant information of alternatives
-) Make differential revenue/cost analysis
-) Consider the opportunity costs and qualitative factors
-) Select the best alternative
-) Implement the selected alternatives
-) Evaluation and follow up the decision
-) Cost factors in decision making
-) Cost refers the amount of expenses spent to generate product or services.

There is inverse relationship between the cost and revenue. If the cost increase the revenue will goes down and vice versa. That's why, management must be considered the various costs while making the managerial decisions. These costs are underlying as:

-) Relevant cost and irrelevant
-) Avoidable and unavoidable cost
-) Incremental and differential cost
-) Future cost and past cost
-) Sunk cost
-) Out of pocket cost
-) Opportunity cost

2.2.8.2 Decision Situation

There are various situations available in the process of decision-making. The managers have to choose the best alternative course of action. Some of the decision situation are underlying as:

Decision to Continue or Drop a Product Line: When a firm is divided into multiple sales outlet, product lines, divisions, departments, it may have to evaluate their individual performances to decide whether or not to continue operations of each of these segments or whether to add a new segment. The decision criterion would be the segment margin. The segment margin equal's the segment's contribution margin less fixed costs that are directly traceable to that segment (*Garrison, 1985:235*). The decision criterion in an operate or shut down situation will be based on the comparisons of the shut down losses and the losses associated with continuing operations (*Khan and Jain, 1992:451*).

Decision to Accept or Reject the Special Order: A special order is one that has been offered for a bulk volume at a reduced price. Opportunity to consider an order for a quantity of its regular product at a special price, usually less than that charged to regular customers, frequently arises for a management. When there is idle capacity; such an offer may be attractive. The basis of decision-making should be the difference that it will make in the overall profit of the company. Essentially, if there is idle capacity, the special order is advantageous if the price amounts exceed out of pocket cost and the opportunity cost (*Bajracharya, et.al, 2004:633*). The decision for this purpose is based entirely on differential cost and contribution margin of product by considering both special offer and without special offer.

Decision to Make or Buy: Buying is the process of acquire goods from outside suppliers instead of producing the same goods within the organization. Decision on whether to produce components within the organization or to get them form outside suppliers are called make or buy decision. Many firms have to choose between manufacturing certain components themselves and acquiring them form outside suppliers. Incremental analysis provides a solution to this kind of decision problem. The relevant information is the one regarding the committed/avoidable costs if the firm has adequate idle capacity to make the component. This is so because the firm wouldn't be required to incur fixed costs to produce the components. If however, there is a need to enlarge the capacity of the existing plant or the existing capacity of the plant is diverted for the production of the components, opportunity costs in terms of the lost contribution will be relevant to the decision analysis. (*Hornngren, et.al, 1996*)

Decision to Replacement of Assets: One of the most important decisions relating to business is whether or not to replace the existing equipment by new and more sophisticated equipment. Generally, the economic advantages offered by such an investment is the realization of operating cost savings, which are translated into increased profits. These cost saving involve a number of future years, and this temporal dimension adds an additional complication to the capital expenditure decision. A decision regarding the replacement of assets is a long term capital investment decision that requires the use of discounted cash flow techniques. These techniques are discussed in detail in the chapter investment analysis but one aspect of asset replacement decisions, which is to be understood clearly at this stage, is how to treat the book value of old equipment.

Decision to Further Process Joint Products: Joint products are those products, which are produced in single production process but are not identifiable as individual products until some definite point in the manufacturing process.

A decision to be made by the management is whether to sell joint outputs at the split-off point or to process them further. The decision criterion should be to choose the alternatives, which will maximize the total contribution of the various joint products to the common processing costs. As the common processing costs before the split-off point are sunk costs that have already been incurred to create the joint products, they are irrelevant and will not be considered in the decision making process. The only relevant cost will be the additional common processing costs. A related short-term decision involves selecting an alternative-processing plan for joint products when the proportion of the output from the common processing cost can be varied (*Hornngren, et.al, 2004:512*).

Decision Regarding Leasing Versus Buying: Leasing is the contract between an owner (lessor) and a hirer (lessee) for the hiring of the specific asset. In exchange for the lease rentals, the lessee obtains possession and use of the asset, while the lessor retains legal ownership. The lessee has no right to acquire exercise right over the assets during the period of the contract. Leasing is an important source of financing for long-lived assets. Some assets are financed for intermediate-term and some are for long-term.

A lease is a contract whereby the owner of an asset (the lessor) grants to another party (the lessee) the exclusive right to use the asset in return for the payment of rent. For example properties like apartments, cars, and telephones are often available on a rental basis. For the lessor it is a business and the lessee entertains the use of assets without making down payment or creating a liability for the cost price of so big assets (*Bajracharya, et.al, 2004:655*).

2.2.9 Pricing Decision Regarding Product and Services

A business sells some sort of products; tangible object or services. Selling a product needs a well-set price. The more is the price-the less is the chance of market success. The less is the price-the cost of the product remain uncovered. Therefore, setting an exact price is a tough decision. The price of the product must not be more than the competitor's price. On the other hand the price must be in an enough figure to cover all the coast of the product. Many firms that produce substitute products like that of the competitors have no pricing problem at all. For their product, market prices already exist. They cannot charge more than the market price. They do not need the calculation of price for the product as they simply charge the price that the market directs it to accept. But there are firms who face the problem of pricing decisions (*Bajracharya, et.al, 2004:710*).

Pricing decisions are the decisions that the managers make about what to charge for the products and services they deliver. The pricing of a product is not just a marketing decision or a financial decision, rather it is a decision touching on all aspects of a firm's activities and as such it affects the entire enterprise. As the prices charged on product largely determines the quantities that customers are willing to purchase, the setting of both low and high prices dictates the inflows of revenues consistently failing to cover all the costs of the firm, and then in the long run, the firm cannot survive (*Garrison, 1985:189*).

Pricing of products and services is one of the most challenging decisions face by management. Many influences affect pricing decisions. Chief among these are customer demand, the actions of competitors, and the costs of the product or the services. Other factors such as political, legal, and image-related issues also effect pricing decisions.

Not all pricing can be approached in the way as economics theory describes. Some pricing of standard products that are sold to customers in the routine day to day conduct of business activities. Other pricing decisions relate to special orders of standard or near products and still others relate to the pricing of the special products that have been taken in an effort to fill out unused productive capacity. The ways of pricing special products are:

-) Cost plus pricing
-) Target cost pricing
-) Variable cost pricing
-) Full cost (Absorption cost) pricing (*Garrison, 1985:505-507*).

2.2.9.1 Cost Plus Pricing

In pricing standard product, it should be recognized that selling prices should be sufficient enough to cover every type of cost in the long run (*Garrison, 1985:23*).

The approach in cost plus pricing is to compute cost and then to add predetermined mark-up to arrive at a target-selling price.

The cost plus pricing sets the price of a product or service at an amount equal to its standard manufacturing cost plus a 'normal' mark up. This mark up is intended to cover marketing and administrative costs and net profit before taxes.

Selling price per unit = cost per unit of the cost base + mark-up

Where, mark-up = cost per unit of the cost base x markup%

Determining the Mark-up Percentage: The mark-up is the margin of profits to be added to the costs base. Mark-up covers the uncovered costs by the costs base plus the desired profit. The desired profit again should cover the minimum required return on invested capital. The appropriate mark up percent is one that must cover the costs not included in the cost base and the target profit for the minimum required return on the invested capital. The mark-up percentage can be ascertained applying the following general formula:

$$\text{Mark-up percentage} = \frac{\text{Cost Uncovered by the Cost Base} \Gamma \text{ Desired Profit}}{\text{Cost Per Unit of the Cost Base} \mid \text{Normal Volume}}$$

$$\text{Desired profit} = \text{Total Invested Capital} \mid \text{Required Return on Investment}$$

2.2.9.2 Target Cost Pricing

A target pricing is the estimated price for a product or service that potential customers will be willing to pay. This estimate is based on an underwriting of customers perceived value for a product and competitor's responses. A target operating income per unit is the income that a company wants to earn on each unit of a product sold. The target price leads to target cost. a target cost per unit is the estimated long run cost per unit of a product that when sold at the target price enables the company to achieve the target operation income per unit. Subtracting the target operating income per unit from the target price derives target cost per unit.

Developing target prices and target cost requires the following:

-) Develop the product that satisfies the needs of potential customer
-) Choose a "target price" based on customers perceived value for the product and prices completions charge and a target operating income per unit
-) Drive a target cost per unit by subtracting the target operating
-) Income per unit from the target price
-) Perform value engineering to achieve target cost (*Horngren, et.al, 1999:430*).

Variable cost pricing under variable cost pricing method, pricing of the product is determined by adding mark-up to the variable expenses, the conditions under which a price based on variable cost is appropriate are as follows:

-) When idle capacities exists
-) When operating under distress conditions and
-) When faced with sharp competition on particular orders under a competitive bidding system.

2.2.9.3 Full Cost Pricing

In long run, the price must cover all costs and a normal profit margin. Basing the cost plus formula only the variable costs could encourage the managers to set too low price in order to boost sales. If the price is set too close to variable manufacturing cost, the firm will fail to cover its fixed costs. Ultimately, such a practice could result in the failure of the business. For external reporting purpose also, it is always better to communicate the full cost based pricing formula because it makes public to feel all the costs of the product that they pay for. Communicating just the variable costs may cause a feeling of exploitation by the company's by charging a high markup on selling price (*Bajracharya, et.al, 2004:720*).

2.2.9.4 Pricing under Activity-based Costing

An activity-based costing (ABC) system does measure the extent to which each product line drives costs in the key production-support activities. An activity-based costing (ABC) system can be particularly helpful as product design engineers try to achieve a product's target cost. ABC enables designers to break down the production cost improvement in particular activities to bring a new product's projected cost in line with its target cost.

2.2.9.5 Transfer Pricing

Transfer pricing is the principal tool of financial control in decentralized organization (*Kaplan and Atkinson, 1998:442*).

A transfer price is the price on subunit of an organization charges for product or services supplied to another submit of the same organization. The transfer price creates revenue for the selling subunits and a purchase cost for the buying subunit, affecting operating income numbers for both subunits. The operating income can be used to evaluate the performance of each subunit and to motivate managers (*Horngreen, et.al, 1999:904*).

Decentralization: The first essence in transfer pricing (*Bajracharya, et.al, 2004:731*). Decentralization refers to the downward delegation of the decision-making authority to submit managers. A decentralized organization is composed of operational unit led by managers who have some autonomy in decision-making. The degree to which a company is decentralized depends on top management philosophy and the unit managers abilities to perform independently. Decentralization provides the opportunity for the managers to develop leadership, qualities, creative problem-solving abilities, and decision-making skills. It also lets the individual most closely tune in with the operational unit and its immediate

environment make the decisions for that unit and reduces the time spent in communicating and making decisions.

Goal Congruence in Transfer Pricing: When two or more parties, persons or organizations, achieve their objectives at the same time from a decision, it is called the goal congruence. Goal congruence means to be benefited unanimously doing an action. In case of a decentralized business organization, goal congruence is obtained when the managers of subunits throughout an organization, goal congruence is obtained when the managers of subunits throughout an organization effort to achieve the goals set by the top management. For example, if a subunit manager accepts a special order that maximizes the profits of his/her division and at the same time maximizes the profits of the total organization, the decision is said to be in goal congruence (*Bajracharya, et.al, 2004:732*).

Transfer Pricing Methods:

General transfer-pricing rule

Transfer Price = Additional Outlay Cost Per Unit Incurred because Goods are Transferred + Opportunity Cost Per Unit to the Organization because of the Transfer

Outlay costs will include the direct variable costs of the product or service and any other outlay costs that are incurred only as a result of the transfer. The second component in the general transfer-pricing rule is the opportunity cost incurred by the organization as a whole because of the transfer (*Hilton, 1999:451*).

Transfer Price based on External Market Price: A transfer price can be set based on the external market price. In such a case the transfer price equals to the price in the external market. When the producing division has no excess capacity and perfect competition prevails, where no single producer can affect the market price, the general transfer-pricing rule and the external market price yield the same transfer price. But, if the transferor division has excess capacity or the external market is perfectly competitive, then the transfer price under the external market price method and the general transfer price rule differ significantly.

Negotiated Transfer Prices: In some cases, the subunits of a company are free to negotiate the transfer price between them and then to decide whether to buy and sell internally or deal with the outside parties. The subunits may use information about cost and market prices in these negotiations but there is no requirement that the chosen transfer price bear any specific relationships to either the cost or market-price data. The negotiated transfer prices are often employed when the market prices are volatile and change occurs constantly. Then the

negotiated transfer price is the outcome of a bargaining process between the selling and buying divisions (*Hornsgren, et.al, 1999: 249*).

The negotiated transfer price is meaningful only when there is a possibility of cost economies in inter-company transfers in relation to the outside transaction.

Cost based Transfer Prices: The transfer price based on the costs of producing the product in question. The examples include variable manufacturing costs, manufacturing (Absorption) costs, as well as the costs from other business functions such as research and development design, marketing, distribution and customer service. The costs to budget in cost-based transfer price can be actual costs or budgeted costs (*Bajracharya, et.al, 2004:737*).

Transfer-pricing in the Service Industry: Service industry firms and non profit organizations also use transfer pricing when service are transferred between responsibility centers. For example, in banks the interest rate at which depositors funds are transferred to the loan department is a form of transfer price.

2.2.10 Capital Budgeting

Capital budgeting is the process of making those long-term planning decisions for investment that focuses primarily on projects or programmes whose effects span multiple time periods (*Hornsgren, et.al, 1999:104*).

The main exercise involved in capital budgeting is to relate the benefits to costs in some reasonable manner, which would be consistent with the value maximizing objectives of the business. Capital budgeting decision is the most important area of managerial decisions as it involves more extended estimation and prediction of things to come requiring a high order of intellectual ability of their economic analysis. Heavy spending on capital assets since the Second World War has stimulated a genuine and lively interest on the part of the economists' financial analysis, and accountants in managerial approaches to capital budgeting decisions (*Goyal and Man Mohan, 1997:451*).

A major issue in planning capital expenditure is the problem of ensuring that the company has the capacity to produce, acquire or be able to deliver the goods and services that will be needed to meet its sales and services plans. A major issue in controlling the actual expenditure of funds is the problem of ensuring that the actual expenditure are consistent with the plans and that funds are available when the expenditures are incurred (*Welsch, et.al, 1992:450*).

Capital budgeting process involves the following three major stages (*Bajracharya, et.al, 2004:783*).

-) Estimating the project's net cash flows.
-) Measurement of benefit of the investment
-) Evaluation of risks associated with the investment

2.2.10.1 Estimating the Project's Net Cash Flow

Cash flow generally indicates a cash outflow analysis is to focus exclusively on the difference in expected future cash flows that result from implementing a project. All cash flows are treated as the same whether they arise from operations, purchase or sale of equipment or investment in or recovery of working capital. The opportunity cost and the time value of money are tied to the cash flowing in or out of the organization and not to the source of the cash (*Khan and Jain, 1993:256*). Estimation of the net cash flows in an investment project should cover:

-) The initial investment (start-up cost)
-) The cash flows over the running life of the project
-) Terminal cash flows at the end of the project

2.2.10.2 Relevant Information for Investment Decision

Investment analysis decisions require information relating to initial investment costs, terminal cash flows, annual revenues, annual operating expenses and tax rate. All these cash flows should be the incremental due to the project in consideration. The cash flows, which do not affect the present cash flows, either in terms of outlays or benefits, are irrelevant. For example, the supervisor cost that the company has been paying for factory supervision and will not change with the new equipment is irrelevant.

Investment Projects Evaluation Techniques: More proposes for projects are at the threshold of the business firm comparing to its ability and willingness to finance some proposals are good, other are different and yet other poor. A screening process has to be devised for finding out the real content of such proposals method of differentiating them should be developed (*Goyal and Man Mohan, 1997:451*).

For this purpose numerous methods of measuring the economic value of an investment can be found. The methods of appraising capital expenditure proposal can be classified into two broad categories.

-) Unsophisticated or traditional methods
-) Sophisticated or time adjusted methods

The latter are, more popularly known as discounted cash flow techniques as they take the time factor into account. The first category includes

-) Payback period method (PBP)
-) Average rate of return (ARR)

The second category includes

-) Net present value method (NPV)
-) Internal rate of return (IRR)
-) Profitability index (PI)

The payback period method is the traditional method of capital budgeting. It is the simplest and perhaps the most widely employed quantitative method for appraising capital expenditure decisions. This method answers the questions: how many years will it take for the cash benefit to pay the original cost of an investment, normally disregarding salvage value? Cash benefit here represents CFAT ignoring interest payment. Thus PBP measures the number to years required for the CFAT to pay back the original out lay required in an investment proposal.

$$\text{PBP} = \frac{\text{Investment}}{\text{Constant annual cash flow}}$$

The second method is used when projects cash flows are not equal but vary from year to year. In such a situation, PBP is calculated by the process of cumulating cash flows till the time when cumulative cash flows become equal to the original investment outlay.

Accept-Reject Criterion: The payback period can be used as a decision criterion to accept or reject investment proposals. One application of this technique is to compare the annual payback with a pre-determined pay back i.e. the pay back set up by the management in terms of the maximum period during which initial investment must be recovered. If the actual pay back period is less than the pre-determined pay back, project would be rejected. Alternatively the pay back can be used as a ranking method. When mutually exclusive projects are under consideration, they may be ranked according to the length of the pay back period. Thus the project having the shortest pay back may be assigned rank one followed in that order so that the project with the longest pay back would be ranked last, the term mutually exclusive refers to proposal out of which only one can be accepted to the exclusion of others. Obviously projects with shorter pay back period will be selected (*Khan and Jain, 1996:192*).

Limitations of Payback: Payback has two very serious errors. The first is that it tells nothing about the profitability of the investment. It ignores the size of cash flows after the payback period.

The second serious error of the payback method is that it ignores the timing of the expected future cash flows and so ignores the time value of money. This can lead to poor decisions.

Accounting Rate of Return (ARR): The accounting rate of return (ARR) of evaluating a proposed capital expenditure is also known as the average rate of return method. It is based upon accounting information rather than cash flow. There is no unanimity regarding the definition of the rate of return. There are a number of alternative methods for calculating the ARR. The most common usage of the average rate of return (ARR) presented as follows:

$$\text{ARR} = \frac{\text{Average Annual Expected Income}}{\text{Average Book Investment}}$$

Accept-Reject Criterion: With the help of the ARR, the financial decision-maker can decide whether to accept or reject an investment proposal. According to the ARR, as an accept-reject criterion, the actual ARR will be compared with a predetermined or a minimum required rate of return or cut off rate- a project will qualify to be accepted if the actual ARR is higher than the minimum desired ARR. Otherwise, it is liable to be rejected (*Khan and Jain, 1996:191*).

Net Present Value Method (NPV): Net present value (NPV) method is a discounted cash flow approach to capital budgeting that discounts all expected future cash flows to the present using a minimal desired rate of return. To apply the net present value, (NPV) method to a proposed investment proposal a manager first determines some minimum desired rate of return. The minimum rate is called the required rate of return, hurdle rate, discount rate or cost of capital, then all expected cash flows from the project are discounted to the present, using this minimum desired rate. If the sum of the present values of the cash flow is zero, or positive, the project is desirable and if negative it is undesirable. When choosing from among several investments. The one with the largest net present value is the most desirable (*Hornigren, et.al, 2004:241*). This method requires the determination of three items for a project:

-) Initial cash outflow
-) Future net cash inflow and
-) Minimum required rate of return.

Accept-Reject Criterion: The decision rule for a project under NPV is to accept the project if the NPV is positive and reject if it is negative. Zero NPV implies that the firm is in a dilemma as to accepting or rejecting the project. However, in practice, it is rare the project is

accepted as such a situation simply implies that only the original investment has been recovered. As a decision criterion this method can also be used to make a choice between mutually exclusive projects on the basis of the NPV method the various proposals are ranked in the order of the net present values. The project with the highest NPV will be assigned the first rank, followed by others in the descending order (*Khan and Jain, 1996:201*).

Discounted Payback: A major limitation of payback is that it does not take the time value of money into account. However, this limitation can be overcome through the use of a discounted payback. The NPV criterion leads to an acceptance of a project as long as its NPV is at least zero. If a project complies with this requirement then it does pay back within the discounted pay back criterion period. Thus the discounted payback is not more than a shortened version of NPV. Instead of calculating the project's NPV over the whole of its life, the NPV is effectively calculated up to some specified cut off point.

Internal Rate of Return (IRR): IRR technique is also known as yield-on-investment, marginal efficiency of capital, marginal productivity of capital, marginal efficiency of capital rate of return, time adjusted rate of return and so on. Like the present value method, this method also considers the time value of money by discounting the cash streams. The basis of the discount factor however is different in both cases. In the case of the present value method, the discount rate, usually the cost of capital, and its determinants are external to the proposal under consideration. The IRR on the other hand, is based on facts, which are internal to the proposals, in other words, while arriving at the required rate of return for finding out the present values, the cash flow, inflows as well as outflows are not considered but the IRR depends entirely on the initial outlay and the cash proceeds of the projects, which are being evaluated for acceptance or rejection it is therefore, appropriately referred to as an internal rate of return.

The internal rate of return (IRR) is usually the rate of return that a project earns. It is defined as the discount rate, which equates the aggregate present value of the net cash inflows (CFAT) with the aggregate present value of the cash outflows of a project. In other words, it is that rate which gives the project NPV zero (*Khan and Jain, 1996:204*).

Accept-Reject Criterion: The use of the IRR, as a criterion to accept the capital investment decisions involves a comparison of the actual IRR with the required rate of return also known as the cut off rate or Hurdle rate. The project would qualify to be accepted if the IRR(r) exceeds the cut-off rate (k). If the IRR and required rate of return are equal the firm is indifferent as to whether to accept or reject the project (*Khan and Jain, 1996:204*).

Profitability Index: The profitability index (PI), which is also termed, as benefit cost ratio is a time-adjusted capital budgeting technique. It is similar to the NPV approach. PI approach measures the present value of return per rupee invested, while the NPV is based on the difference between the present value of future cash inflows and the present value of cash outlays. Profitability Index may be defined as a ratio which is obtained dividing the present value of future cash inflows by the present value of cash outlays.

$$PI = \frac{\text{Present value of cash inflow}}{\text{Present value of cash outflow}}$$

Profitability index is the discounted cash flow benefit cost ratio. It is similar to the NPV approach. It is the ratio, which is obtained by dividing the present value of future cash inflows by the present value of cash investment.

This method is also known as the benefit-cost ratio because the numerator measures benefits and the denominator costs.

Accept-Reject Criterion: In the PI value exceeds one, the proposal is worth accepting. When profitability indeed equals one (1), the firm is indifferent to the projects, when the profitability index is greater, equal to, or less than one, the net present value is greater, equal or less than zero respectively. In other words, NPV will be positive when the profitability index is greater than one; and will be negative when the profitability index is less than one. Thus, the NPV and profitability index approaches give the same results regarding the investments proposals.

The selection of the projects with the profitability index method can be made on the basis of ranking too. The highest rank will be given to the project with the highest profitability index followed by others in the same order (*Khan and Jain, 1996:213*).

1.3.1.1.5 Table 2.1: Decision Criteria

S.N.	Method	Criteria	1.3.1.1.5.1 Result
1	NPV	Excess cover	Accepted
2	IRR	Higher the IRR	Accepted
3	PBP	Lower the PBP	Accepted
4	ARR	Higher the ARR	Accepted
5	PI	PI>1	Accepted

2.2.10.3 Risk and Uncertainty in Capital Budgeting

The analysis of risk and uncertainty is an important element in the capital budgeting decisions. The term risk refers to the variability of the actual returns from the expected returns in terms of cash flow (*Khan and Jain, 1993:214*).

The capital budgeting decision is based on the benefits derived from the project. These benefits are measured in terms of cash flow. The estimation of future returns is done on the basis of various assumptions. The actual return in terms of cash inflow depends on variety of factors such as price, sales volume, effectiveness of the advertising campaign, competition, cost of raw materials, manufacturing cost and so on, each of these in turn depends on other variable like the state of the economy the rate of return inflation etc. the accuracy of the estimates of the future returns and therefore the reliability of the investment decision would largely depend upon the precision with which these factors are forecast. What so ever techniques are followed for forecasting precisely actual can never tally to estimation? As the result actual results vary from the estimation. This variation technically referred to risk. The term risk with investment term can therefore be defined as the variability in the actual returns emanating from a project in future over its working life in relation to the estimated return as forecast at the time of initial capital budgeting decision (*Hornngren, et.al, 1999:247*).

The risk situation is one in which the probabilities of a particular event occurring are known. These probabilities are not known under the uncertainty situation. The difference between risk and uncertainty therefore lies in the fact that the variability is less in risk than in the uncertainty.

-) Measure of Risk
-) Sensitivity analysis
-) Risk adjusted discount rate
-) Certainty-equivalent coefficients
-) Probability distribution approach
-) Standard deviation
-) Coefficient of variation
-) Normal probability distribution
-) Decision tree approach

2.2.11 Responsibility Accounting

Responsibility accounting is a system of dividing an organization into smaller units, each of which is to be assigned particular responsibilities. These units may be set up in the form of

divisions, segments, departments, branches, product lines etc. each department comprises individuals who are responsible for particular tasks or managerial functions. The managers of the departments should ensure that the people in their departments are doing well to achieve the goal. Responsibility accounting refers to the various concepts and tools used by managerial accountants to measure the performance of people and departments in order to ensure the achievement of the goals set by the top management.

In today's complex environment, it is almost impossible to control a big organization centrally. Responsibility Accounting is a process of decentralization under which the authority and the responsibility are delegated to the respective responsibility centre. It is a concept of dividing an organization into subunits so that a manager of the unit could be made accountable for the given job. Responsibility accounting collects and reports planned and actual accounting information about the inputs and outputs of responsibility centers. Processes of responsibility accounting are as follows:

-) Identifying the responsibility centers.
-) Delegation of authority and responsibility or decentralization
-) Controllability of the object,
-) Establishing performance evaluation criteria

2.2.12 Financial Statement Analysis

Financial statements depict the actual position of the firm in terms of monetary value at a particular point of time. Financial statements such as income statement and balance sheet are the two most important statements that business firms prepare at regular intervals. The public companies are required to publish these statements at least once a year. Besides, there are other special types of statements such as statements of retained earnings, statement of cash flow and statement of sources and uses of funds.

Financial statement analysis is a technique of answering various questions regarding the performance of a firm in the past, present and the future. Analysis of financial statement means a study of relationship among the various financial sectors. It is a process of classifying and arranging mass data of financial statement.

2.2.12.1 The Statement of Cash Flows

'Cash flow' is a phrase that is used to describe both cash receipts (inflows) and cash payments (outflows). Cash and cash equivalents include currency, coins, and highly liquid short-term investments, such as treasury bills, money market funds, and commercial paper. For purposes of preparing a statement of cash flows, money held in cash equivalents is still viewed as cash. Thus transfers between a bank account and cash equivalent are not considered receipts or disbursement of cash.

The statement of cash flows is an important financial statement in terms of providing information for investors and creditors. It shows how the accrual accounting information is converted into cash-based information and arranges the information so that investors and creditors can better understand the cash effects of a company's operating, investing, and financing activities. The cash flow statement information helps to assess the solvency of a business and to evaluate its ability to generate positive cash flows in future periods, pay dividends and finance growth.

The statement of cash flows tells many things about the financial health of an enterprise. It clearly depicts the stage of life cycle the firm is in. more importantly, the statement of cash flows reveals the solvency position of the enterprise. Furthermore, information on the statement of cash flows can be used to evaluate the efficiency of treasurer in the enterprise. All this information has equal value for the strategic manager of an enterprise and the outside investors.

1.3.1.1.6 Methods of Preparing Cash Flow Statement

Direct Method: Direct method of cash flow statement calculates the cash flows from direct incomes and direct expenses of cash. It is started from sales revenue. This method of cash flow statement calculates the receipts of cash and disbursements of cash from operating, investing, and financing activities. If income statement and balance sheet is given as information then direct method must be used.

Indirect Method: Indirect method of cash flow statement is such type of method, which calculates the cash flow from operating activities by considering the non-cash items. It is started from net profit for the period. The non-cash expenses are add on net profit and non-cash income is deducted from net profit. The change in working capital is also considered. The other activities remain same as direct method. If the method is specified, we have to use direct method. Nepal accounting standard (2004) has recommended preparing the cash flow statement by using direct method. But the indirect method is an alternative acceptance.

2.2.12.2 Ratio Analysis

Ratio, in general, involves a process of standardization. They can be used to standardize reporting methods, financial statements, and other relevant variables, allowing for comparisons over time and cross-sectional between firms. The second purpose of ratios, however, is the more important and meaningful one. Ratios measure a firm's crucial relationships by relating its inputs (costs) with outputs (benefits) and facilitate comparisons of these relationships over time and across firms (White, et.al, 1984:245). Ratio analysis is a tool of scanning the financial statements of the firm. Through this, one comes to know in which areas of the operation the organization is strong and in which areas it is weak.

Types of Ratio

a. Liquidity Ratio

Liquidity ratios indicate a firm's ability to pay short-term obligations. Liquidity ratios include current ratio, acid-test ratio and cash ratio.

b. Debt to Ratio/Solvency Ratio

A firm's financing is obtained from debt and equity. The greater the proportion of debt in relation to the equity, the greater is the risk to the firm as a whole. Two important factors should be noted: (1) the relative debt levels themselves and (2) the trend over time in the proportion of debt to equity.

c. Activity Ratio/ Turnover Ratio

To carry out one's operations, a firm needs to invest in both short-term (inventory and accounts receivable) and long-term (property, plant, and equipment) assets. Activity ratios describe the relationship between the firm's level of operations (usually defined as sales) and the assets needed to sustain the activity.

d. Profitability Ratio

Profitability is an important measure of a company's operating success. There are two areas for judging profitability; (1) relationships in the income statement that indicate a company's ability to recover costs and expenses, (2) relationships of income to various balance sheet measures that indicate the company's relative ability to earn income from the assets employed. The first measure is the profit margin and the second one is the return on investment. The stockholder's primary concern is the profitability measure of the firm. Lenders also desire a minimum return on the borrower's investment to be on the safe side.

Performance Analysis: Performance analysis of a company is directly concerned with financial performance. Since its efficiency is measured by liquidity position in terms of solvency, profitability from operations in terms of earning power and cash flow generation, capital structure position, judgment ability to meet fixed obligations, activity in terms of turnover of assets and overall market value maximization determined by company's track record of dividend paying ability, retained earning for re-investment and growth etc. Among various financial tools, the commonly used tool is ratios that have predictive value to project the success or failure of company by taking the combined effects of ratios.

2.3 Review of Previous Studies

Sharma (2002) has accomplished a research work entitled, "*Management Accounting Practice in the Listed Company in Nepal*", in the partial fulfillment of the requirement for the degree of MBS (TU). Sharma had focused on the present practice of management accounting tools in the listed companies as stated in Nepal stock exchange. He had used stratified sampling procedure to draw a sample with 27% and 41% of total population and target population. The data and necessary information regarding this research has been collected from the primary sources by using a scheduled questionnaire. MR. Sharma has pointed out the various findings but some remarkable findings were presented as follows:

-) While examining the MA tools practiced in listed companies for planning, controlling and decision-making, it was found that capital budgeting, cash flow statement, ratio analysis and annual budgeting were widely practiced MA tools in the listed companies of Nepal with 100%. Similarly cost segregation, breakeven analysis, standard costing, long-term budgeting was partially in practice and activity based costing, responsibility accounting was not practiced in the listed companies in Nepal.
-) Master budget has widely practiced in listed companies in Nepal with 70% or more. Almost 87% listed companies used past actual expenses as a base to prepare the budget. Similarly short-term budget is widely in practice in listed companies with 90%.
-) Almost 100% companies measured their performance on the basis of profit and loss made by them during the period. Other techniques like budgeting control, standard costing and ratio analysis were slightly in practice of listed companies.

-) Pay back period and net present value was widely practicing techniques for long-term investment decision in listed companies in Nepal. Similarly 55% companies were practicing risk adjustment techniques for investment period.
-) Cost based pricing techniques have widely in practiced in listed companies in Nepal for pricing the product/service. Target return on investment has also in practice for this purpose. Similarly market price and cost price based transferred pricing techniques were slightly in practice for transferred pricing purpose.
-) 100% listed companies were practiced the past trend analysis to forecast the future costs of revenues of the company. Market survey and judgment analysis were also in practice of listed companies but in introduction stage. Nepalese listed companies were independent in practicing the MA tools.

Upprety (2005) had conducted a research in the topic “*Profit Planning in Manufacturing Public Enterprise; A Case study of Royal Drugs Limited and Herbal Production and Processing Company Limited.*” This research of Upprety was mainly focused with current practice of profit planning and its effectiveness in RDL and HPPCL. The data and other necessary information’s were collected by using secondary as well as primary sources of data. In this research Upprety has pointed out various findings. Some of the remarkable findings were presented as follows:

-) Inadequate planning’s of profit due to lack of skilled planner.
-) Inadequate authority and responsibility to planning department.
-) Failure in achievements due to inadequate evaluation of internal and external variables.
-) Failure due to inadequate forecasting system.
-) Lack of entrepreneurship and commercial concepts in overall operations of the enterprise.

Shrestha (2006) had conducted his research work entitled “*Profit Planning in Public Utility Enterprise; A Case Study of Nepal Telecommunication Corporation*”. Shrestha had mainly focused with the current practice of profit planning and its effectiveness in NTC. The data and necessary information’s were collected from using secondary sources of data. In this research Shrestha has pointed out various findings. Some of the remarkable findings were as follows:

-) Budget isn't prepared in detail and systematically.
-) Cost isn't classified and analyzed systematically.
-) Financial performance is not satisfactory.
-) No controlling activities are carried on for the betterment of the Organization.
-) Actual activities are more variable than budget activities.

Subedi (2001) had conducted a research work entitled "*Profit Planning in Commercial Bank; A Case Study of Rastriya Banijya Bank.*" Miss Subedi had focused her study in the investment policy of Rastriya Banijya Bank with the current practice of profit planning and its effectiveness in Rastriya Banijya Bank. The data and other information were collected through the secondary sources. In this research, Miss Subedi has pointed out various findings. Some of the remarkable findings were presented as follows:

-) Most of the investments made against the security of land, gold, and silver.
-) No specific and clear investment policy and functioning without any direction.
-) There is no manpower planning. This is causing problem of over staffing and extra cost burden.
-) No systematic application of budgeting.
-) Deposit mobilized is not properly utilized.
-) The rate of change in interest has no effect in business growth in deposit side or in investment side.
-) No. of branches have been increasing each year.

Bhattarai (2000) conducted a research on the topic "*Profit Planning in Central Zoo.*" The main focus of his research was the application of profit planning and control and its effectiveness in central zoo. The data and other necessary information were collected through secondary as well as primary sources. Mr. Bhattarai in his research had pointed out the various findings. Some of the remarkable findings were presented as follows:

-) Central zoo has no system of preparing strategic long-term profit plan before privatization but has prepared a master plan, which is gradually being applied by central zoo after privatization.
-) Goals and objectives of the central zoo aren't clearly communicated to the lower level and there is the lack of responsibility accounting system.

-) Participation of lower level in planning and decision-making is nil and there is still shortage of management by objectives technique.
-) The public participation approach, which helps for the entire wildlife conservation and environment protection.

Subedi (2001) Another study Mr. Keshab Subedi intends to examine the “*profit planning practices of Nepalese public enterprises in the case study.*” He took a sample of public enterprises two of them are manufactured and two of them are no manufacturing. He has explored five years data 2048-049 to 2052-053. The main findings of Keshab Subedi are as follows:

-) All the enterprise has positive co-relation between budget and actual sales But AIC and RDL have not.
-) The enterprises are suffering highly operation loss as indicated by their flexible budget.
-) Actual production, purchases of AIC and NTC are more variable as compared to their budget figures.
-) The least square straight line trend of profit shown that must of the enterprises are suffering in losses.
-) Cost volume profit analysis is not considered while setting plan.

2.4 Research Gap

There is a gap between the present research and previous research to some extent most of the previous research are conducted in the area of profit planning which only covered the budgeting practices in manufacturing companies especially in public enterprises. And negligence of research has been made in the area of management accounting. The previous researches in profit planning didn't disclose which of the management accounting tools are used and which aren't. Previous research earlier conducted in management accounting seems to be vague, because those researches try to cover the many sector of the economy, which doesn't provide the appropriate result. Thus to fulfill the gap current research is conducted. This research is conducted only in the single sector of the economy i.e. finance company which provide appropriate result. Therefore, this research might be superior to the other research conducted earlier. So this study will be fruitful to those interested Person, Scholars,

General Manager, Finance Chief, Teachers, Government, Businessman, Civil society and other stakeholders for academic and policy prospective.

1.3.2 CHAPTER - III

1.3.2.1 RESEARCH METHODOLOGY

In this chapter, efforts have been made to present and explain the specific research design for the sake of attaining the research objectives. It includes research design, nature of data, data gathering procedure, population and sample and data processing procedures.

3.1 Research Design

Research design is the specification of method and procedures for acquiring the information needed. It deals with what information is to be collected from which sources and by what procedures. If research design is good, it ensures that the information obtained is relevant to the research questions and collected by objective and economic procedures. To achieve the specific objective of the study, descriptive and analytical research has been carried out in terms of Management Accounting Practice in finance companies in Nepal.

3.2 Nature and Sources of Data

Data can be collected from primary sources and secondary sources. Data are collected in order to fulfill the objective of the study. Descriptive abstracts are taken from books, booklet, articles, news papers, magazine, reports etc. The sources of data can be divided into two parts:

3.2.1 Primary Data

Primary source of data are those that which is directly collected through questionnaire, interview and discussions.

3.2. 2 Secondary Data

To conduct this study, secondary data are taken from annual reports of related office and their websites. So the major sources and types of data include these published sources,

-) Financial statement of Progressive Finance Ltd. and Unique Finance Ltd.
-) Annual report of the finance companies.
-) Different previous studies
-) Related bulletins, reports, periodically published by various government

bodies.

3.3 Population and Samples

All the finance companies listed by Nepal Rastra Bank were considered as the total population. Out of them, the finance companies which were located in Kathmandu valley were considered as the target population for the study. A total of 53 finance companies were in existence till mid –July 2014 out of them 30 are operating in Kathmandu valley only. The study is based on judgmental sampling basis inside Kathmandu valley.

At present, there are 53 finance companies operating in Nepal. They constitute the population. Among of them Progressive Finance Limited and Unique Finance Limited are selected as a sample for the study for secondary data. Five years data are taken to conduct the study from 2009/10 to 2013/14.

3.4 Data Gathering Procedure

As the study was based on primary data, information was collected developing a planned questionnaire and distributing it to managers and finance chief who were available. To get more reliable information, discussions were also conducted with managers and finance chief. Information collected in this way was noted down to use during analysis and interpretation of data.

3.5 Data Processing Procedure

Data collected from questionnaires were in raw form. They were classified and tabulated in the required form. Simple arithmetical percentage tools were used for analysis. Major findings were based on the analysis and interpretation of data.

Tools Used

Major management accounting tools such as: cost volume profit analysis, budgeting, standard costing, ratio analysis, capital budgeting, activity based budgeting, and zero based budgeting and pricing techniques were the major research variables. Simple arithmetical tools and chi-square test were used to interpret data.

CHAPTER - IV

DATA PRESENTATION AND ANALYSIS

The basic objective of the study is to examine the present practice of management accounting tools in the finance companies in Nepal and to identify the spot where management accounting tools could be applied to strengthen the finance companies. This chapter presents the analysis and interpretation of the data.

To meet the objectives, all the finance companies with head office inside Kathmandu valley is taken as target population. Due to lack of time frame and difficult location only about 80% of the target population is taken as sample.

Questionnaires were distributed to 30 finance companies out of them only 24 finance companies show their response. Those finance companies to get the more information about the present practice of management accounting tools. Opinion of GM, Accountants, and Finance Chief are also included in this chapter.

Raw data were properly processed, tabulated and analyzed. They are presented in sixteen tables. Tables were developed based on question asked. Open-ended questions were arranged in a descriptive manner. Hypothesis was tested with chi-square statistical tools.

4.1 Analysis of Secondary Data

4.1.1 Analysis of Income Statement

Income Statement is a financial statement that measures a company's financial performance over a specific accounting period. Financial performance is assessed by giving a summary of how the business incurs its revenues and expensed through both operating and non-operating activities.

Table: 4.1
Income Statement of UFL

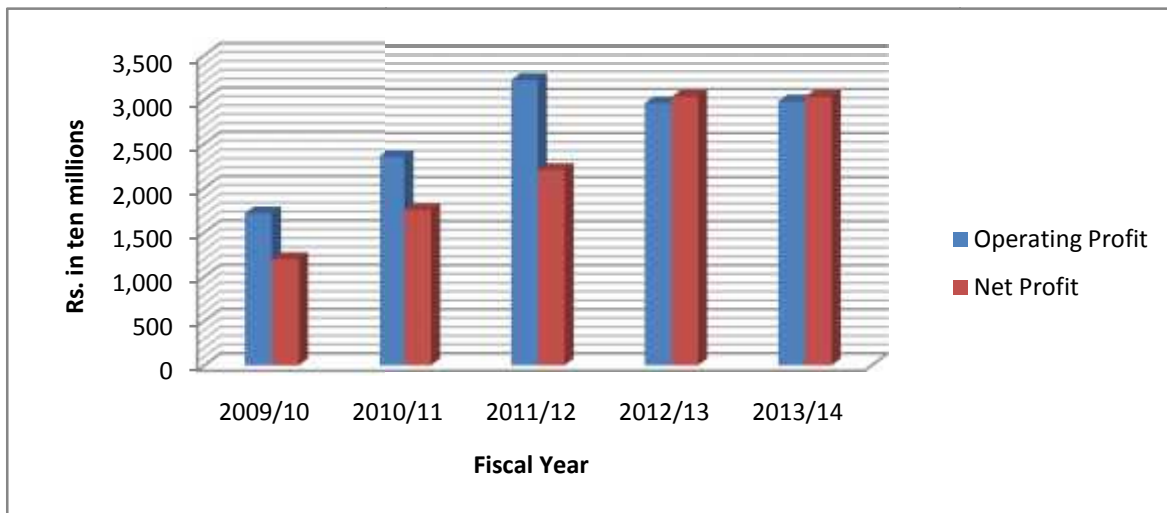
(Rs. In ten thousands)

S.N.	Particular	2009/10	2010/11	2011/12	2012/13	2013/14
1.	Interest Income	6,128	8,004	8,961	8514	8961
2.	Commission & Discount	127	85	20	59	102
A	Total Operating Income	6,255	8,089	8,981	8573	9063
3.	Less: variable Cost					
	Interest Expenses	3,413	4,604	4,573	4,315	4,682
	Variable Adm. Expenses	228	319	329	272	335
B	Total variable Cost	3,641	4,923	4,902	4,587	5,017
C	CM (A – B)	2,614	3,166	4,079	3,986	4,046
4.	Less: Fixed Cost,					
	Staff Expenses	366	325	439	506	548
	Fixed Adm. Expenses	532	478	402	505	502
D	Total Fixed Cost	898	803	841	1,011	1,050
E	Operating Profit (C – D)	1,716	2,363	3,238	2,975	2,996
5.	Add: Other Operating Income	338	407	313	397	597
	Non-Operating Income	-	-	-	1,519	1,348
	Exchange Fluctuation Income	-	-	-	-	-
	Exp written of Loan	-	-	-	-	-
F	Total Sundry Income	338	407	313	1,916	1,945
G	NIBP (E +F)	2,054	2,770	3,551	4,891	4,941
6.	Less: Provision,					
	Provision for Possible loss	164	-	69	102	147
	Provision for staff Bonus	172	252	316	435	436
	Provision for Income tax	519	756	949	1,307	1,312
	Written Back provision		-	-	-	-
H	Total Provision	855	1,008	1,334	1,844	1,895
I	(G - H)	1,199	1,762	2,217	3,047	3,047
	Profit/Loss From Extra Ordinary	-	-	-	-	-
	Net Profit	1,199	1,762	2,217	3,047	3,046

Source: Annual Reports of UFL

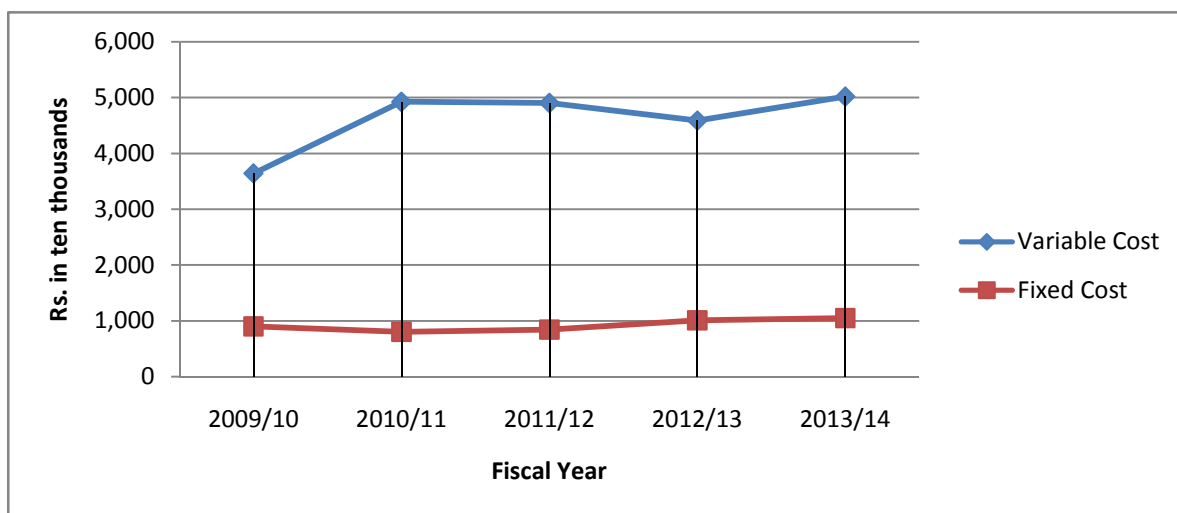
The five fiscal year income statement of the UFL shows that the all variables of income statement like operating income, variable cost, fixed cost, operating profit are in fluctuating trend but net profit is in increasing trend. The net profit of the finance is Rs. 1199, 1762, 2217, 3047 and 3046 ten thousands for the fiscal year 2009/10, 2010/11, 2011/12, 2012/13 and 2013/14 respectively. Similarly, the operating profit of the finance are also increasing trend except the year 2010/11. They are Rs. 1716, 2363, 3238, 2975 and 2996 ten thousands for the year 2009/10, 2010/11, 2011/12, 2012/13 and 2013/14 respectively. It is shows in the following figure.

Figure: 4.1
Trend of Operating Profit & Net Profit of UFL



The above figure shows that the operating profit is increasing trend except the year 2011/12. and net profit of the UFL is in increasing trend throughout the study period.

Figure: 4.2
Trend of Fixed Cost & Variable Cost of UFL



The above figure 4.2 shows that the fixed cost are 898, 803, 841, 1011, 1050 for the year 2009/10, 2010/11, 2011/12, 2012/13 and 2013/14 respectively. The fixed cost trend of UFL is fluctuating trend over the study period and variable cost are 3641, 4923, 4902, 4587 and 5017 for the year 2009/10, 2010/11, 2011/12, 2012/13 and 2013/14 respectively.

Table: 4.2
Income Statement of PFL

(Rs. In ten millions)

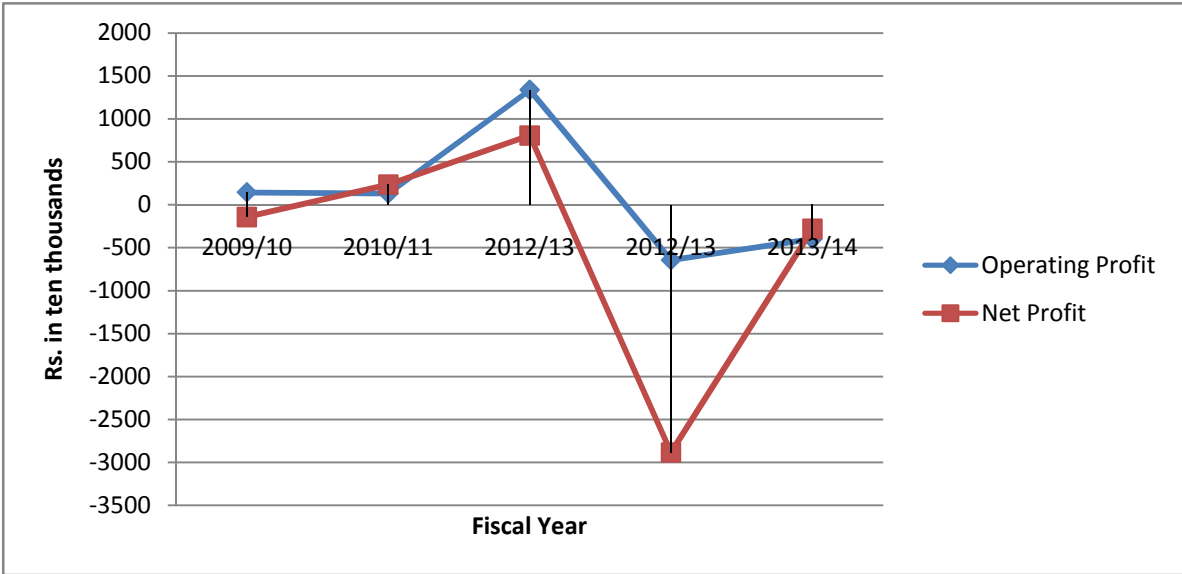
S.N.	Particular	2009/10	2010/11	2012/13	2012/13	2013/14
1	Interest Income	2,617	3,735	5,137	2,600	3,266
2	Commission & Discount	64	6	59	6	86
A	Total Operating Income	2681	3741	5196	2606	3352
3	Less: variable Cost					
	Interest Expenses	1,672	2,262	2,724	2,139	2,435
	Variable Adm. Expenses	269	499	334	391	433
B	Total variable Cost	1941	2761	3058	2530	2868
C	CM (A – B)	740	980	2138	76	484
4	Less: Fixed Cost					
	Staff Expenses	418	581	528	461	651
	Fixed Adm. Expenses	179	269	274	261	233
D	Total Fixed Cost	597	850	802	722	884
E	Operating Profit (C – D)	143	130	1336	(646)	(400)
5	Add: Other Operating	110	223	21	164	310

	Income					
	Non-Operating Income	-	-	4	126	149
	Exchange Fluctuation Income	-	-	-	-	-
	Written back provision loss	-	433	168	129	1064
F	Total Sundry Income	110	666	193	419	1523
G	NIBP (E +F)	253	796	1529	(227)	1123
6	Less: Provision					
	Provision for Possible loss	447	3	172	3,757	293
	Provision for staff Bonus	-	71	123	-	4
	Provision for Income tax	(52)	476	428	(1099)	320
H	Total Provision	395	550	723	2658	617
I	(G - H)	142	236	806	(2885)	506
	Profit/Loss From Extra Ordinary	-	-	-	-	(787)
	Net Profit	(142)	236	806	(2,885)	(281)

Source: Annual Reports of PFL

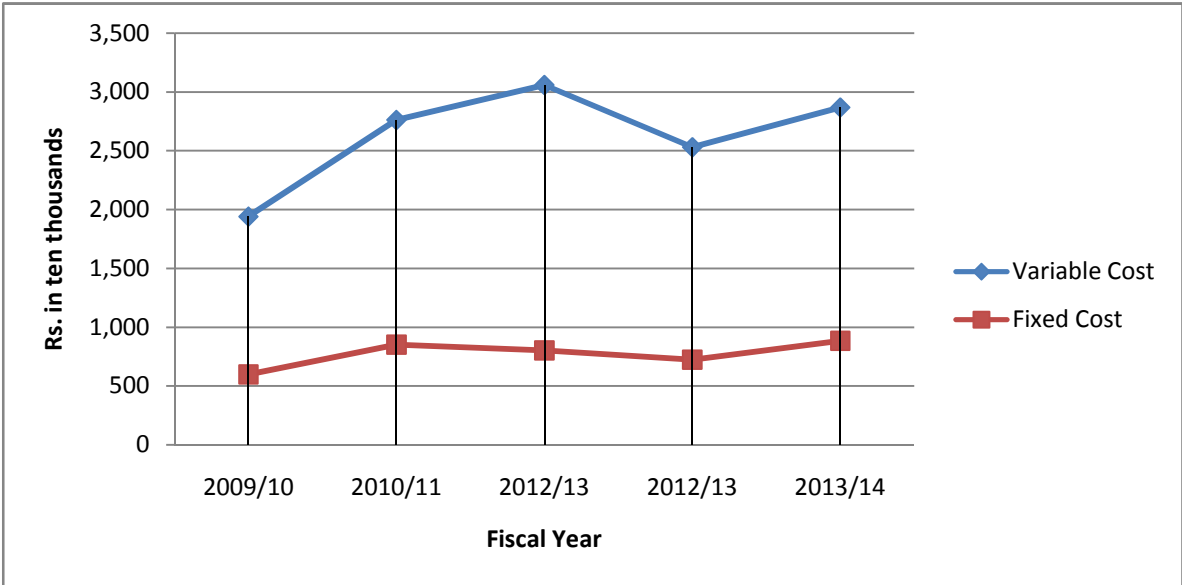
The above table five fiscal year income statement of the PFL shows that the all variables of income statement like operating income, variable cost, fixed cost, operating profit, net profit are in fluctuating trend. The net profit of the finance is Rs. (142), 236, 806, (2885) and (281) ten thousands for the fiscal year 2009/10, 2010/11, 2011/12, 2012/13 and 2013/14 respectively. Similarly, the operating profit of the finance are also fluctuating trend it is Rs. 143, 130, 1336, (646) and (400) ten thousands for the year 2009/10, 2010/11, 2011/12, 2012/13 and 2013/14 respectively. It is shows in the following figure.

Figure: 4.3
Trend of Operating Profit & Net Profit of PFL



The above figure shows that the operating profit and net profit of the finance are in fluctuating trend throughout the study period.

Figure: 4.4
Trend of Fixed Cost & Variable Cost of PFL



The above figure 4.4 shows that the fixed cost are fluctuating trend over the study period and variable cost also fluctuating trend. But variable cost is increasing or decreasing readily than fixed cost.

4.1.2 Analysis of PV Ratio/CM Ratio

The contribution margin approach to CVP analysis allows the preparation of Perform a statement from the available information. BEP & other required CVP relationships can be explained through a CM statement. It explained that all fixed costs are period costs that should be deducted from the CM of the same period. Only the VC varies proportionately with the level of output or income. CM is regarded as the excess of income price of a unit of output over its VC. It also can be defined as the excess of income amount over VC. PV Ratio is also known as CM Ratio. The full form is Profit Volume Ratio. It is important tool in studying profitability index. It can be obtained as following.

Table: 4.3
Contribution Margin of UFL and PFL

(Rs. In ten thousands)

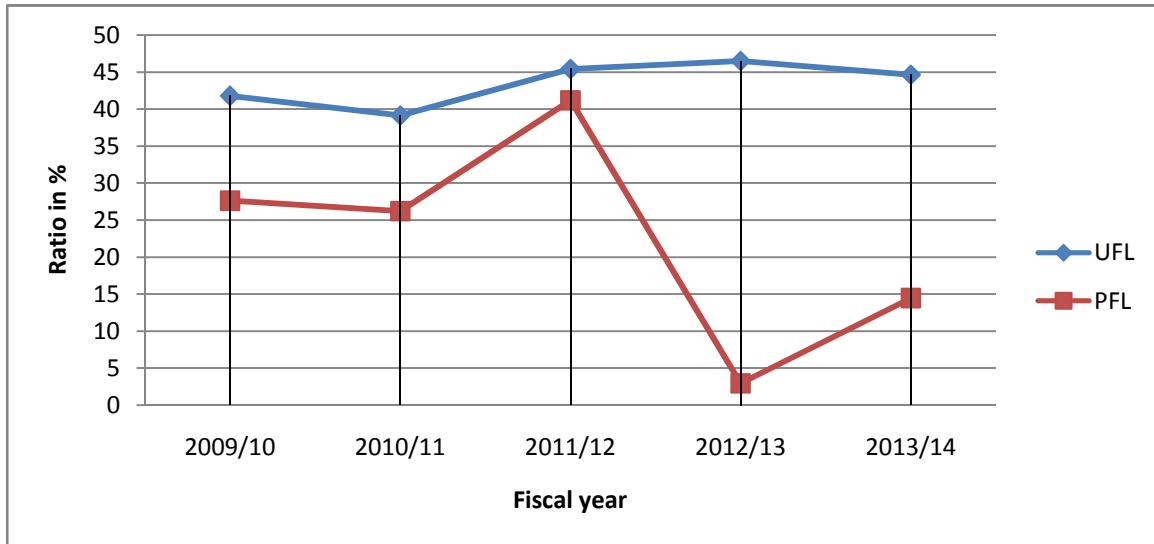
Name of Finance	year	Income (A)	VC (B)	CM (A - B)	CM Ratio
UFL	2009/10	6255	3641	2614	41.79
	2010/11	8089	4923	3166	39.14
	2011/12	8981	4902	4079	45.42
	2012/13	8573	4587	3986	46.49
	2013/14	9063	5017	4046	44.64
PFL	2009/10	2681	1941	740	27.6
	2010/11	3741	2761	980	26.2
	2011/12	5196	3058	2138	41.15
	2012/13	2606	2530	76	2.92
	2013/14	3352	2868	484	14.44

Source: Table no. 1 and 2

From above table 4.3 shows that CM ratio or PV ratio is in fluctuating trend in case of both finance. The lowest PV ratio is 39.14% of UFL in F/Y 2010/11 and the highest is 46.49%

in FY 2012/13. Similarly, in case of PFL lowest ratio and highest ratio are 2.92% and 41.15% in FY 2012/13 and 2011/12 respectively.

Figure: 4.5
CM Ratio/PV Ratio



4.1.3 Analysis of Break Even Point (BEP)

BEP is the powerful tool to analyze the profit making process. It is the specific way of presenting & studying the interrelationship between the costs. It is the most popular technique that indicates the level of income in which cost & revenue are in equilibrium position.

i.e. BEP = No Profit No Loss. BEP can be computed as

$$\text{BEP (U)} = \text{TFC} / \text{SPPU} - \text{VCPU}$$

$$\text{BEP (Rs)} = \text{TFC} / \text{PV Ratio} \quad \text{or} \quad \text{TFC} / (1 - \text{VC} / \text{SR})$$

Table: 4.4
BE Ratio

(Rs. In ten thousands)

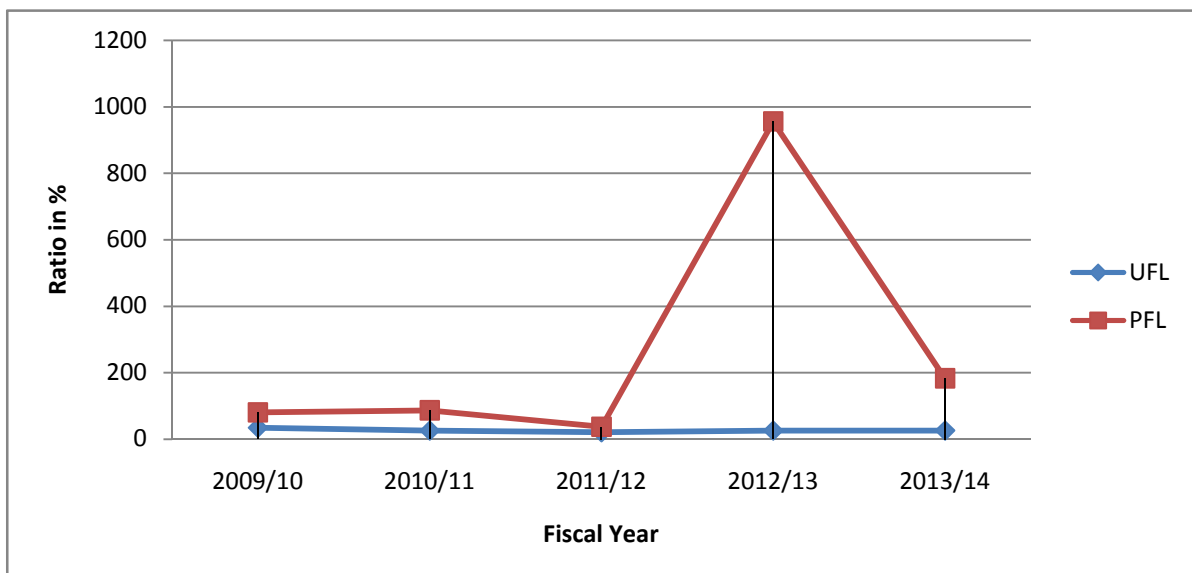
Finance	Year	TFC	PV Ratio	Income	BEP Income	BE Ratio
UFL	2009/10	898	0.417	6255	2153.48	34.43
	2010/11	803	0.391	8089	2053.71	25.39

	2011/12	841	0.454	8981	1852.42	20.62
	2012/13	1,011	0.465	8573	2174.19	25.36
	2013/14	1,050	0.446	9063	2354.26	25.98
PFL	2009/10	597	0.276	2681	2163.04	80.68
	2010/11	850	0.262	3741	3244.28	86.72
	2011/12	802	0.412	5196	1946.60	37.46
	2012/13	722	0.029	2606	24896.55	955.36
	2013/14	884	0.144	3352	6138.89	183.14

Source: Table 1 and 2

The above table 4.4 shows that the both finance income revenue is higher than BEP income in each year over the study period of UFL but in case of PFL income revenue is less than BEP income in FY 2012/13 and 2013/14. So, UFL is very good position but PFL is very bad positions . It means UFL is earning profit in each year but PFL is loss profit in FY 2012/13 and 2013/14.

Figure: 4.6
BE Ratio



4.1.4 Analysis of Margin of Safety (MOS)

Margin of safety is the excess of budgeted (or actual) income over the break even income volume. It is the difference between the budgeted or actual income revenue and the break-

even income revenue. MOS of UFL and PFL for the five fiscal year is as follows.

$$\text{MOS} = \text{Actual Income} - \text{B.E. Income}$$

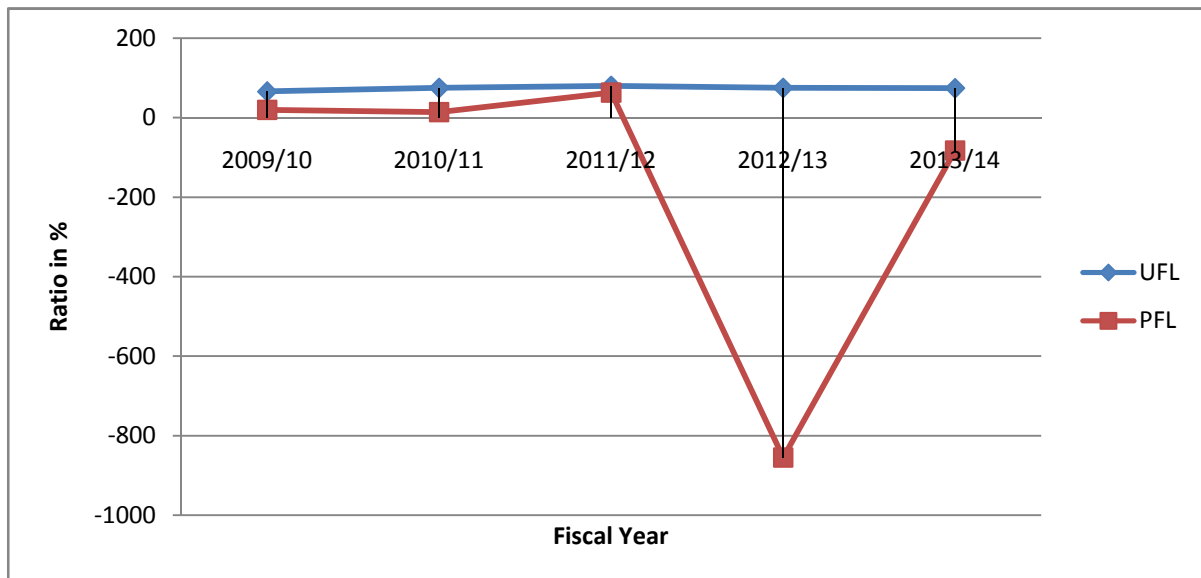
Table: 5
Margin of Safety

(Rs. In ten thousands)

Finance	Year	Actual Income	BEP Income	MOS	MOS Ratio (%)
UFL	2009/10	6255	2153.48	4101.52	65.57
	2010/11	8089	2053.71	6035.29	74.61
	2011/12	8981	1852.42	7128.58	79.37
	2012/13	8573	2174.19	6398.81	74.64
	2013/14	9063	2354.26	6708.74	74.02
PFL	2009/10	2681	2163.04	517.96	19.32
	2010/11	3741	3244.28	496.72	13.28
	2011/12	5196	1946.60	3249.4	62.54
	2012/13	2606	24896.55	-22290.55	-855.35
	2013/14	3352	6138.89	-2786.89	-83.14

Source: Table no. 1 and 2

Figure: 4.7
MOS Ratio



MOS ratio is in fluctuating trend in case of both finances. UFL has highest all over the selected sample years. PFL has lowest MOS ratio all over the sample years. The lowest

MOS ratio is 65.57% of UFL in F/Y 2009/10 and the highest is 79.37% of UFL in FY 2011/12. Similarly, the lowest MOS ratio is negative 855.35% of PFL in F/Y 2012/13 and the highest is 62.54% of PFL in FY 2011/12. It indicates the PFL finance company earning profit is very bad position. But UFL is very good position to compare PFL

4.1.5 Computation of Ratio Analysis

Ratio analysis is a technique of analysis and interpretation of financial statement through mathematical expression. It may be defined as the mathematical expression of the relationship between two accounting figures, which will be used to evaluate performance of an organization by comparing the ratios from the figures of different accounts ratio analysis. Ratio used for financial analysis of business can be classified into four categories. They are Liquidity Ratio, Leverage Ratio, Activity Ratio and Profitability Ratio. Mostly we have to use these ratios;

4.1.5.1 Determination of Liquidity Ratio

Liquidity Ratio is ability of a firm to pay short-term liabilities. Liquidity ratio reflects the short- term financial strength of a firm. This ratio is calculated by the help of current liabilities. Here the researcher is going to calculate the current ratio of UFL and PFL. Current ratio is calculated dividing current assets by current liabilities. The details of current assets and current liabilities shown on below table.

(Current Ratio = Current Assets/Current Liabilities)

Table 4.6
Current Ratio of UFL and PFL

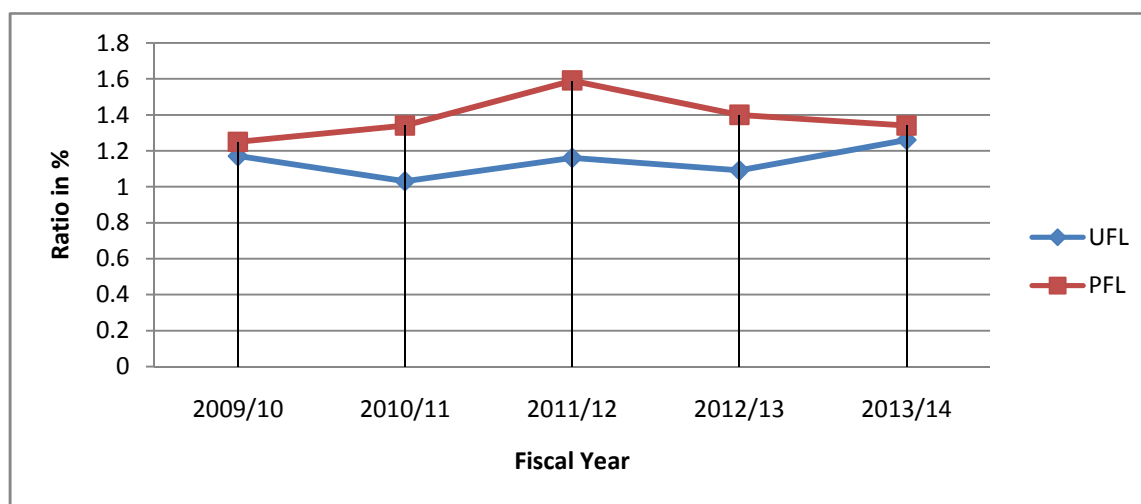
Name of Finance	Fiscal Year	Current Assets	Current Liabilities	Current Ratio
UFL	2009/10	46,784	39,432	1.17
	2010/11	41,599	40,391	1.03
	2011/12	48,081	41,331	1.16
	2012/13	52,890	48,514	1.09
	2013/14	65,965	52,472	1.26
PFL	2009/10	20,154	16,177	1.25
	2010/11	36,482	27,325	1.34

	2011/12	32,809	20,669	1.59
	2012/13	33,139	23,642	1.40
	2013/14	36,905	27,532	1.34

(Sources: Annual Report of UFL and PFL)

The following scatter diagram presents the trend of current ratio during five year study period.

Figure 4.8
current ratio of UFL and PFL



The above table and diagram shows the liquidity position of UFL and PFL. Higher the current ratio better the liquidity position for the many types of business 2:1 is considered to be an adequate ratio. If the current ratio of a firm is less than 2:1, it means the firm has difficulty in meeting current obligation. If the current ratio is more than 2:1 the company may have an excessive investment in current assets that do not produce satisfied return. In the time of study period current ratios are fluctuating trend from 2009/10 to 2013/14 of both finance.

4.1.5.2 Determination of Debt-equity ratio

The ratio showing the relationship between long- term debt and share holder's equity is called debt equity ratio. Debt-Equity ratio measures the long-term financial solvency of a business concern. It is calculated by dividing to long term debt by shareholder's equity. The Debt Equity Ratio can be calculated dividing to borrowings by shareholder equity.

(Debt-Equity Ratio=Borrowings/Shareholder's Equity)

Table 4.7

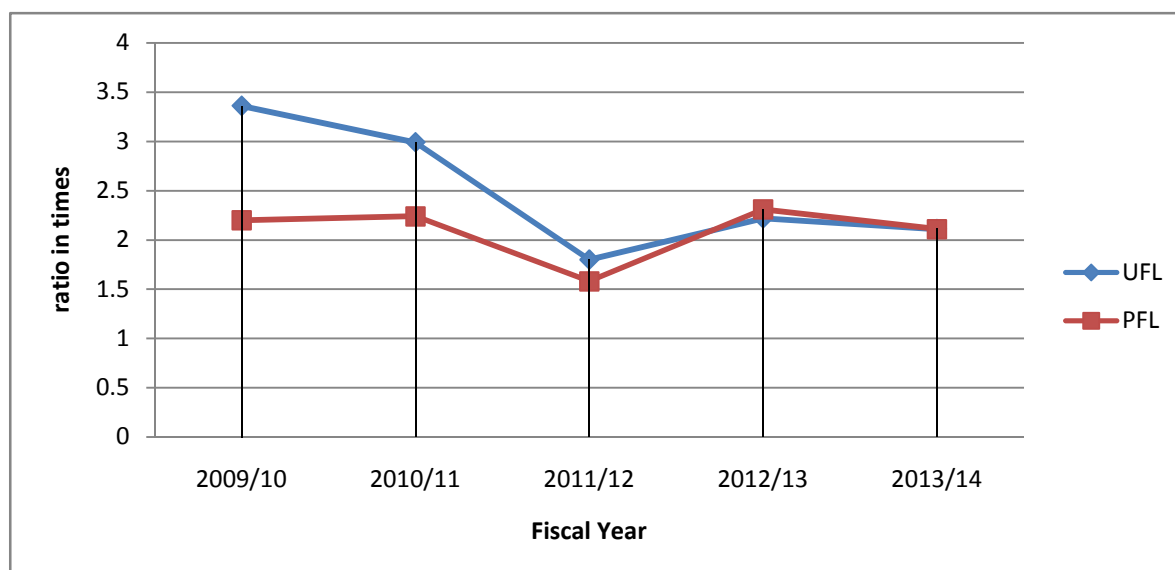
Debt Equity Ratio of UFL and PFL

Name of Finance	Fiscal Year	Total Debt	Total Equity	Ratio
UFL	2009/10	39,432	11,748	3.36
	2010/11	40,391	13,513	2.99
	2011/12	41,331	22,991	1.80
	2012/13	48,514	21,848	2.22
	2013/14	52,472	24,895	2.11
PFL	2009/10	16,177	7,365	2.20
	2010/11	27,325	12,211	2.24
	2011/12	20,669	13,107	1.58
	2012/13	23,642	10,222	2.31
	2013/14	27,532	9,943	2.11

(Sources: Annual Report of UFL and PFL)

Here the range of debt of debt equity ratio is fluctuating every year. UFL and PFL have portion of equity than long-term debenture where as for a finance sector fixed deposit also consider as long term obligation but in above analysis only borrowing have calculated as a long-term debt. The above table shows that UFL and PFL financial weakness are very poor it has not more internal fund to repay debt and shareholder's equity. The following Scatter diagram presents the trend of Debt-Equity ratio from 2009/10 to 2013/14.

Figure 4.9
Debt-Equity ratio of UFL and PFL



4.1.5.3 Determination of Profitability Ratio

Profitability ratio is related to profit. It shows the overall efficiency of the business concern. The overall efficiency of the business concern. The earning capacity of a business is measured by profitability ratio. Maximization of profit is the main objectives of each and every business concern. It is very necessary to earn maximum profit for the successful running of a business concern. Here, this researcher going to measure of UFL and PFL profitability by net profit to total assets. It is computed by dividing to Net profit. Total

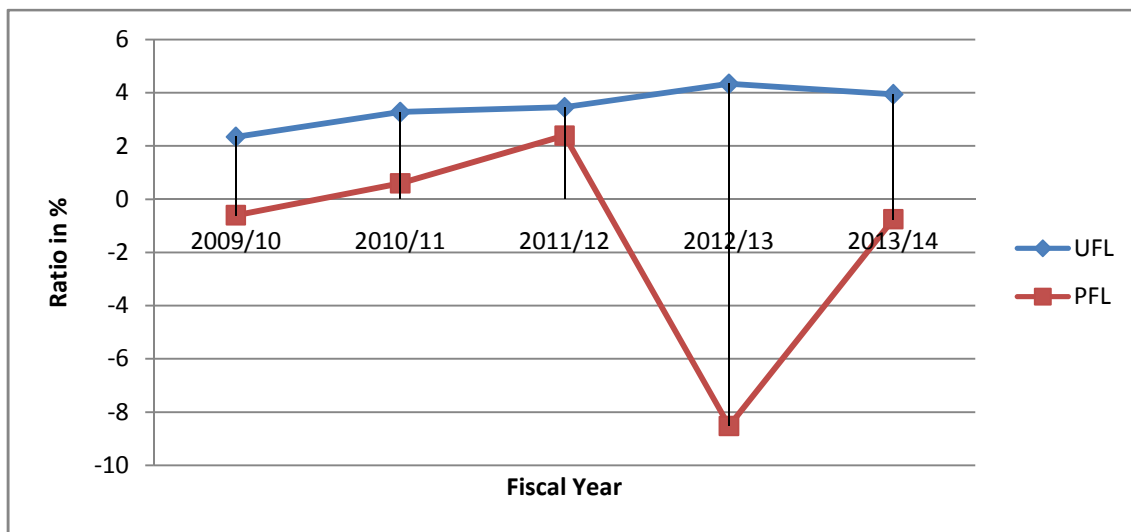
Table 4.8
Profitability ratio of UFL and PFL

Name of Finance	Fiscal Year	Net Profit	Total Assets	Ratio
UFL	2009/10	1,199	51,180	2.34
	2010/11	1,762	53,904	3.27
	2011/12	2,217	64,322	3.45
	2012/13	3,047	70,362	4.33
	2013/14	3,046	77,367	3.94
PFL	2009/10	(142)	23,542	-0.60
	2010/11	236	39,536	0.60
	2011/12	806	33,776	2.39
	2012/13	(2,885)	33,864	-8.52
	2013/14	(281)	37,475	-0.75

(Sources: Annual Report of UFL and PFL)

The above table shows the status profitability ratio of UFL and PFL. The ratio shows the relation of net profit after tax with the total assets an. The rate of return of assets of PFL is increasing trend, it is ranged between 2.34% to 4.33% throughout the five year period. It Similarly, in case of PFL it is fluctuating trend it has range 2.39 to -8.52%. It indicates the ROA is very poor position of PFL. Higher the ratio means the better earning position, Net profit on assets of UFL is better than PFL.

Figure 4.10
Profitability Ratio of UFL and PFL



4.1.6 Analysis of Trend Analysis

Here, In this heading the trend analysis ability and the financial condition are presented which is responsible to provide the future ability of the bank position. Trend analysis is done to predict the future scenario. This analysis is very important for business. Business environment is more complex and dynamic than ever before so firms want to know will- be scenario. This scenario helps to build strategies and tune to the unseen changes in the economy. So this statistical tool helps businessmen to estimate future. The estimation is based upon past data or information Among various methods of estimating trend the least square method is used in this research.

In this study, the method of least square is used for analysis the ability of the bank's total loan and advance trend and net profit trend.

- The main assumption is that other things being will remain unchanged until F/Y 2018/19.
- The bank will have same situation until 2018/19 as now.

- The economy of the surrounding until 2018/19 will remain same as present stage.
- The forecast will be true only when the limitation of least square method is carried out.

a) Trend Analysis of Loan and Advance of UFL and PFL

Loans are the major source of income for a finance. If it defaults, it is the loan portfolio which may lead to the insolvency of the finance. For the analysis purpose the trend value of loan and advance for five years from 2009/10 to 2013/14 calculated in Appendix-2 which presented in the table below and forecasted for next five years till next 2018/19. The following table shows the trend values of 10 years from 2009/10 to 2018/19 of UFL and PFL.

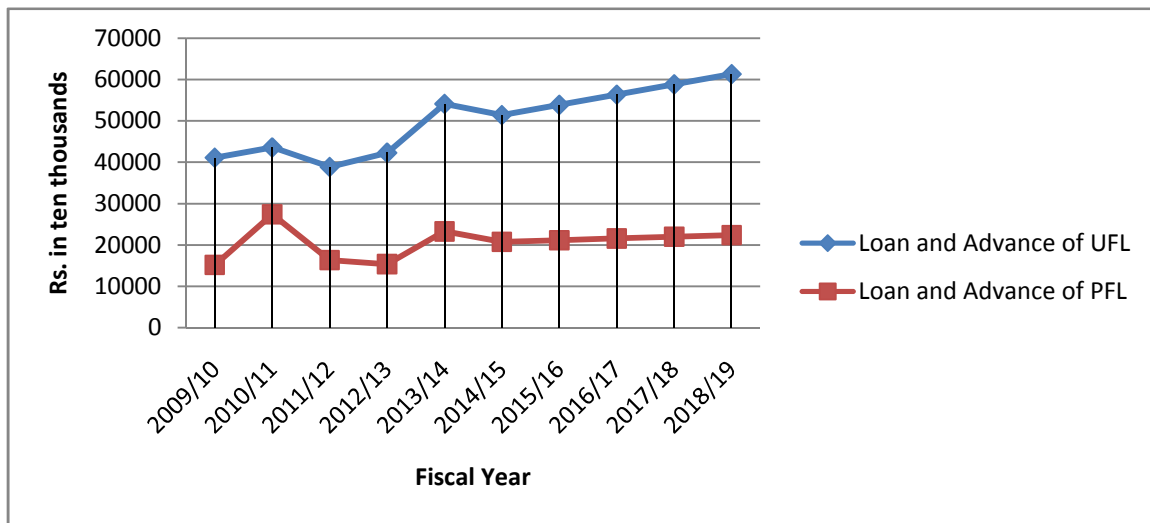
Table 4.9
Trend Value of Loan and Advance of UFL and PFL

Fiscal Year	Loan and Advance of UFL	Loan and Advance of PFL
2009/10	41119	15,165
2010/11	43594	27,369
2011/12	38879	16,318
2012/13	42297	15,337
2013/14	54133	23,240
2014/15	51423	20722
2015/16	53896	21134
2016/17	56369	21546
2017/18	58842	21958
2018/19	61315	22370

(Source: Appendix -iii)

Figure 4.11

Trend Values of Loan and Advance UFL and PFL



b) Trend Analysis of Net Profit of UFL and PFL

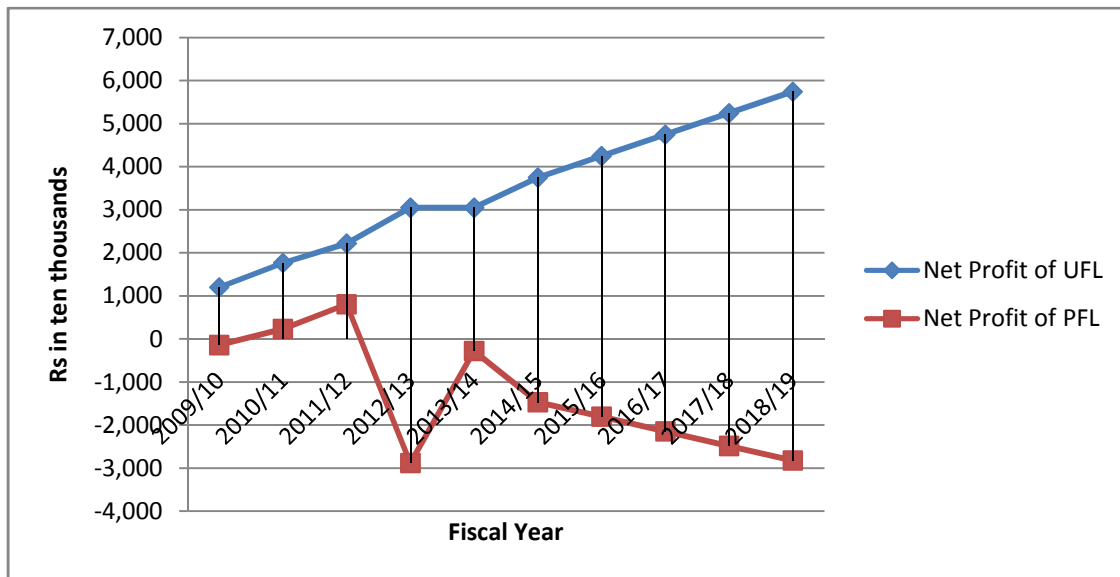
In this part by the actual data of UFL and PFL from 2009/10 to 2013/14 the trend of net profit estimated from 2014/15 to 2018/19

Table 4.10
Trend Value of Net Profit of UFL and PFL

Fiscal Year	Net Profit of UFL	Net Profit of PFL
2009/10	1,199	(142)
2010/11	1,762	236
2011/12	2,217	806
2012/13	3,047	(2,885)
2013/14	3,046	(281)
2014/15	3748	(1470)
2015/16	4246	(1809)
2016/17	4744	(2148)
2017/18	5242	(2487)
2018/19	5740	(2826)

(Source: Appendix -iv)

Figure 4.12
Trend Values of Loan and Advance UFL and PFL



4.2 Analysis of Primary Data

4.2.1 Percentage Scenario of Management Accounting Practice

Table 4.11: Practice of Management Accounting Tools in Finance Companies in Nepal

S.N.	Tools	No of Population	Target Population	Sample Drawn	No of Practitioner	Percent (%)
1.	Segregation of cost into fixed and variable	53	30	24	10	42
2.	Break even analysis	53	30	24	16	66.67
3.	Standard costing	53	30	24	-	-
4.	Ratio analysis	53	30	24	24	100
5.	Cash flow statement	53	30	24	24	100

6.	Capital budgeting	53	30	24	24	100
7.	Decision making	53	30	24	13	54.17
8.	pricing/Interest rate fixing decision	53	30	24	20	83.33
9.	Activity based costing	53	30	24	10	41.67
1.	Zero based budgeting	53	30	24	-	-

Sources: *Opinion Survey, 2015*

The above table shows the practice of management accounting tools in the finance companies in Nepal. Management accounting tools like cash flow statement, capital budgeting, ratio analysis are widely practiced in every finance companies in Nepal to perform various managerial activities.

Similarly 83.33% of finance companies were found practicing pricing/interest rate fixing decision, 66.67% were practicing break even analysis, 54.17% were practicing decision making, 42% each were practicing segregation of cost into fixed and variable and activity based costing. None of the finance companies were found practicing tools like standard costing and zero based budgeting.

1.3.2.1.1

1.3.2.1.2 Table 4.12: Budget Preparation System in Finance Companies in Nepal

S.N.	1.3.2.1.2.1 Outline of Budget	Total Population	Target Population	Sample Drawn	No. of Practitioner	Percent (%)
1.	Management committee	53	30	24	18	75
2.	Finance department	53	30	24	10	41.67
3.	Planning department	53	30	24	6	25
4.	Outside experts	53	30	24	-	-
5.	Others	53	30	24	-	-

Sources: *Opinion Survey, 2015*

The above table shows the scenario of budget preparation system in finance companies in Nepal. Most of the finance companies prepare their budget through management committee i.e. about 75 %. Similarly about 41.67% and 25% of the finance companies prepare their budget through finance department and planning department respectively. Some of the finance companies prepare their budget through mutual coordination between management committee, finance department and planning department.

Practice of hiring outside experts for preparing budget was almost nil in every finance companies due to lack of separate fund for hiring outside experts. Manpower inside the finance companies was liable for preparation of budget. Regarding preparation of budget, information were collected from various department and finally submitted to the concerned authorities and based on those information, budget preparation task was forwarded.

1.3.2.1.3 Table 4.13: Base for Preparation of Budget in Finance Companies in Nepal

S.N.	Base	Total Population	Target Population	Sample Drawn	No. of Practitioner	Percent (%)
1.	Historical budget	53	30	24	6	25
2.	Trend analysis	53	30	24	15	62.5
3.	Estimation by management	53	30	24	12	50
4.	Zero base budgeting	53	30	24	-	-
5.	Activity base budgeting	53	30	24	7	29.16
6.	Others	53	30	24	-	-

Sources: Opinion Survey, 2015

The above table shows the base for preparation of budget in finance companies in Nepal. As shown in above table the base for practicing budget in most of the finance companies were trend analysis and management estimation which were about 62.5% and 50% respectively. Activity base budgeting and historical budget are also practiced as well, which were about 29.16% and 25% respectively. 'Management estimation', Historical budget and Trend analyses were jointly used as basis for budget preparation in some of the finance company as

well. None of the finance companies were followed zero base budgeting as base for budget preparation.

Table 4.14: Budget Practice (on the basis of nature) in Finance Companies in Nepal

S. N.	Types of Budget	Total Population	Target Population	Sample Drawn	No of Practitioner	Percent (%)
1.	Overall master budget	53	30	24	18	75
2.	Cash budget only	53	30	24	-	-
3.	Operational budget only	53	30	24	6	25
4.	Others	53	30	24	-	-

Sources: Opinion Survey, 2015

The above table shows the types of budget practice in the finance companies in Nepal. Most of the finance companies (about 75%) practiced overall master budget where as some of the finance companies (25%) practiced operational budget only. The practiced of cash budget was not found in any of the finance companies.

Table 4.15: Budget practice (on the basis of time) in finance companies in Nepal

S.N.	1.3.2.1.3.1 Types of Budget	Total Population	Target Population	Sample Drawn	No of Practitioner	Percent (%)
1.	Annual budget	53	30	24	20	83.33
2.	Half-yearly budget	53	30	24	3	12.5
3.	Quarterly budget	53	30	24	2	8.33
4.	Monthly budget(others)	53	30	24	1	4.17

Sources: Opinion Survey, 2015

The above table shows the budget practice (on the basis of time) in the finance companies in Nepal. Most of the finance companies practiced 83.33% annual budget where as minimal finance companies practiced half-yearly budget (12.5%), quarterly budget (8.33%) and monthly budget (4.17%).

Table 4.16: Practice of Capital Budgeting Tools While Making Long Term Investment Decisions or Purchasing Fixed Assets

S.N.	Tools	Total Population	Target Population	Sample Drawn	No of Practitioner	Percent (%)
1.	Payback period	53	30	24	11	45.83
2.	Net present value	53	30	24	6	25
3.	Average rate of return	53	30	24	9	37.5
4.	Internal rate of return	53	30	24	7	29.16
5.	Profitability index	53	30	24	3	12.5
6.	Modified internal rate of return	53	30	24	-	-
7.	Others	53	30	24	-	-

Sources: *Opinion Survey, 2015*

The above table shows the practice of capital budgeting tools in the finance companies in Nepal. Among the capital budgeting tools, more practiced tools are payback period (45.83%), average rate of return (37.5%), internal rate of return 29.16% and net present value 25%. Few of the finance companies practiced profitability index and none of the finance companies has practiced modified internal rate of return for making long-term investment decision. Some of the finance companies are not able to make decision with a single tool so; they are practicing more than a single capital budgeting tool for making long-term investment decision.

Table 4.17: Practice of Risk Adjustment while Evaluating Capital Investment in Finance Companies in Nepal

S.N.	1.3.2.1.3.2 Tools	Total Population	Target Population	Sample Drawn	No of Practitioner	Percent (%)
1.	Higher IRR	53	30	24	3	12.5
2.	Sensitivity analysis	53	30	24	8	33.33
3.	Increased the required rate of return	53	30	24	4	16.67
4.	Estimate probability distribution of future cash flow	53	30	24	3	12.5
5.	Others	53	30	24	-	-

Sources: *Opinion Survey, 2015*

The above table shows the scenario of risk adjustment for evaluation of capital investment in finance companies in Nepal. More finance companies are aware about risk adjustment while evaluating capital investment. From the table it is obvious that 33.33% of the finance companies are practicing sensitivity analysis, 16.67% of the finance companies are practicing increased the required rate of return and 12.5% each are practicing higher IRR and estimate probability distribution of future cash flow. Some of the finance companies are unaware about the risk adjustment while making capital investment.

Table 4.18: Segregation of Mixed Cost into Variable and Fixed in Finance Companies in Nepal

S.N.	Segregation Method	Total Population	Target Population	Sample Drawn	No of Practitioner	Percent (%)
1.	High-low method	53	30	24	3	12.5
2.	Regression method	53	30	24		-
3.	Average method	53	30	24	12	50
4.	Others	53	30	24		-

Sources: Opinion Survey, 2015

Many of the finance companies are aware about segregating mixed cost into fixed and variable while some of the finance companies are unaware about it. From the above table it is obvious that 50% of the finance companies follow average method and 12.5% follow high-low method. None of the finance companies follow regression method.

1.3.2.1.4

1.3.2.1.5 Table 4.19: Practice of Pricing the Service in Finance Companies in Nepal

S.N.	1.3.2.1.5.1 Pricing Techniques	Total Population	Target Population	Sample Drawn	No of Practitioner	Percent (%)
1.	Cost-base pricing	53	30	24	8	33.33
2.	Going rate pricing (Market determined)	53	30	24	4	16.67
3.	Target return on investment pricing	53	30	24	3	12.5
4.	Activity based costing pricing	53	30	24	6	25
5.	Others	53	30	24		-

Sources: *Opinion Survey, 2015*

The above table shows the practice of pricing the service in finance companies in Nepal. As per above table 33.33% of the finance companies practice cost base pricing, 25% practice activity based costing pricing, 16.67% practice going rate pricing and 12.5% practice target return on investment pricing for pricing the service. Practice of pricing the service is not wide in finance companies in Nepal. Only some of the finance companies are aware about the pricing the service.

1.3.2.1.6

1.3.2.1.7 *Table 4.20: Practice of Transfer Pricing in Finance Companies in Nepal*

S. N.	Transfer Pricing Techniques	Total Population	Target Population	Sample Drawn	No of Practitioner	Percent (%)
1.	Market-price based	53	30	24	-	-
2.	Cost based	53	30	24	-	-
3.	Negotiated	53	30	24	-	-
4.	Others	53	30	24	-	-

Sources: *Opinion Survey, 2015*

The above table shows the scenario of the practice of transfer pricing in finance in Nepal. From the table it is clear that none of the finance companies in Nepal practiced transfer pricing. The main reason behind not practicing of transfer pricing in the finance companies is they directly rendered service to the customer rather than department to department. As there did not arise any option whether to render service to internal department or outside customer, thus there is no place for transfer pricing.

Table 4.21: Practice of Pricing for the Issue of Inventory in Finance Companies in Nepal

S.N.	Techniques	Total Population	Target Population	Sample Drawn	No of Practitioner	Percent (%)
1.	LIFO	53	30	24	-	-
2.	FIFO	53	30	24	-	-
3.	Weighted average	53	30	24	3	12.5
4.	Specific items	53	30	24	10	41.67
5.	Others	53	30	24	-	-

Sources: *Opinion Survey, 2015*

The above table shows the scenario of pricing for the issue of inventory in finance companies in Nepal. Most popular technique for pricing the issue of inventory LIFO and FIFO are still not in use in the finance companies. 41.67% of the finance companies were practicing specific items and 12.5% are practicing weighted average for pricing the issue of inventory.

1.3.2.1.8 Table 4.22: Joint Cost Allocation in Finance Companies in Nepal

S. N.	1.3.2.1.8.1 Techniq ues	Total Population	Target Population	Sample Drawn	No of Practitioner	Percent (%)
1.	Sales value method	53	30	24	-	-
2.	Negotiated method	53	30	24	6	25
3.	Others	53	30	24	-	-

Sources: Opinion Survey, 2015

The above table shows the practice of joint cost allocation in finance companies in Nepal. Very few finance companies practice joint cost allocation, which is followed by negotiated method only i.e. about 25% only. Most of the finance companies do not practiced joint cost allocation. On going through fruitful discussions with manager and finance chief it was known that the major expenditure for finance companies was operating expenditure and office expenditure. There was no occurrence of joint cost so no question arouse of allocating joint cost among the department in finance companies.

Table 4.23: Practice of Cost and Revenue Estimation in Finance Companies in Nepal

S. N.	1.3.2.1.8.2 Technique s	Total Population	Target Population	Sample Drawn	No of Practitioner	Percent (%)
1.	Past trend analysis	53	30	24	24	100
2.	Engineering analysis	53	30	24	-	-
3.	Market survey	53	30	24	6	25
4.	Zero based analysis	53	30	24	-	-
5.	Judgmental analysis	53	30	24	8	33.33
6.	Others	53	30	24	-	-

Sources: Opinion Survey, 2015

The above table shows the practice of cost and revenue estimation in finance companies in Nepal. Most of the finance companies follow past trend analysis to estimate the cost and revenue. Beside that judgmental analysis (33.33%) and market survey (25%) are also used for cost and revenue estimation. while zero based analysis and engineering analysis are found to

be nil in the process of cost and revenue estimation in finance companies. Some of the finance companies mutually followed “past trend analysis”, judgmental analysis and market survey in process of cost and revenue estimation.

Table 4.24: Type of Decision Making Practice in the Listed Finance Companies in Nepal

S. N.	Types of Decision Making	Total Population	Target Population	Sample Drawn	No of Practitioner	Percent (%)
1	Make of buy decision	53	30	24	-	
2	Special order offer decision	53	30	24	6	25
3	Drop or continue any product decision	53	30	24	-	
4	Lease or buy decision	53	30	24	18	75
5	Others	53	30	24	-	-

Sources: Opinion Survey, 2015

The above table shows the scenario of decision making practiced in the finance companies in Nepal. 75% of the finance companies followed by “lease or buy decision” while only 25% of finance companies has practiced “special order offer decision”. Few of the finance companies are unaware about the practice of decision-making.

Table 4.25: Tools Practiced in Finance Companies in Nepal for Measuring and Controlling the Overall Performance at the End of Accounting Period

S. N.	Tools Practiced	Total Population	Target Population	Sample Drawn	No of Practitioner	Percent (%)
1	Profit and loss a/c made by the company	Budgeted Sales and Actual Sales in Rs.	30	24	24	100
2	Ratio analysis	Budgeted Sales and Actual Sales in Rs.	30	24	6	25
3	Budgetary measure and control	Budgeted Sales and	30	24	3	12.5

		Actual Sales in Rs.				
4	Flexible budgeting	Budgeted Sales and Actual Sales in Rs.	30	24		-
5	Standard costing	Budgeted Sales and Actual Sales in Rs.	30	24		-
6	Others	Budgeted Sales and Actual Sales in Rs.	30	24	1	4.17

Sources: *Opinion Survey, 2015*

The above table shows the tools practiced by the finance companies in Nepal for measuring and controlling the overall performance. As shown in the table 100% of the finance companies measure and control their overall performance by the means of profit and loss a/c made by the company. 25% by ratio analysis, 12.5% by budgetary measure and control and 4.14% through other unspecified tools. While flexible budgeting and standard costing tools are not used for measuring and controlling the overall performance in finance companies in Nepal.

Table 4.26: Practice of Management Accounting Tools in the Financial Institutions in Nepal

S. N.	Tools	No of Sample		1.3.2.1.8.3 No of Practitioner		Percent	
		F. C.	Banks	Finance companies	Banks	Finance companies	Banks
1	NPV	24	10	6	5	25	50
2	Cost based pricing	24	10	8	3	33.33	33.33
3	Higher IRR	24	10	3	5	12.5	50

4	Sensitivity analysis	24	10	7	4	19.17	40
5	Estimate probability distribution of future cash flow	24	10	2	3	8.33	30

Sources: Opinion Survey, 2015

The above table shows the practice of management accounting tools in the finance companies and banks in Nepal. Above table shows the practice of NPV 50.00% in commercial banks where only 25.00% in finance companies, cost based pricing 33.33% in finance companies and 33.33% in banks, higher IRR 50.00% in and only 12.5% in finance companies, sensitivity analysis 40.00% in finance companies and 19.17% in finance companies and estimate probability distribution of future cash flow 30.00% in banks and very minimal (8.33%) in finance companies.

4.2.2 Analysis of Open-End Opinions of Manager and Finance Chief

Two open-ended questions were asked and discussions were made to the manager and finance chief of the finance companies under the study to take their opinions to identify the difficulties in applying management accounting tools and suggestions for the application of such tools. Some key opinions which were fruitful to be considered are presented as follows:

Regarding the difficulties in application of management accounting tools, the opinion of manager and finance chief are as:

Management accounting tools like; zero base budgeting and standard costing were completely nil in the case of application. Lack of information about such tools caused difficulties in the application of these tools.

In the application of break even analysis technique, it was difficult to determine major activities to compute contribution margin per activities or profit volume ratio in service sector like finance companies.

In case of cost-segregation into fixed and variable, application of “regression method” was found nil in any of the finance companies in Nepal. The major difficulties in the application of it were that it was purely a statistical tool which required manpower and expertise in

statistics. Finance companies were not in a position to hire an expert from outside due to cost burden.

Regarding estimation of forecasting of cost and revenue finance companies found difficulties in applying “engineering analysis” and “zero based analysis” because it was vague, time consuming and much expensive.

Because of price ceiling stipulated by central body of NRB, finance companies face difficulties to practice management accounting tools of pricing. Finance companies were forced to exercise price within the territory bounded by the central body of NRB.

In case of decision making due to external forces, decision could not be made based on management accounting principles.

Due to limited market and resources of the finance companies, they were not enabling to make expenditure for innovation. There were no research and development programme launched for the application of management accounting tools neither they could send their employees for training on their own cost.

From the opinion of the manager and finance chief of the finance companies it was clear that the main reason of not implementing management accounting tools was due to lack of information and cognizance about the tools. Besides these, limited market, nature of the business, size of the business and cost burden were other factors causing difficulties in the implementation of the tools.

Regarding suggestions to improve the application of management accounting tools the following opinions were cited:

- a. Efficient manpower should be produced in the country.
- b. Training institute should be developed to produce such manpower.
- c. Academicians should put effort to bring the new techniques and tools in the light
- d. Information about the new and advance techniques should be conveyed through different media
- e. Campaign should be carried out to increase awareness about such tools and techniques.
- f. Seminars, workshop should be conducted for companies managers so that they could be acquainted with new tools and its use and benefits.

From the opinion of the managers and finance chief regarding the suggestion to implements the management accounting tools in the finance companies, it was clear that information about the tools, its cost and benefits should be disseminated to them. On the basis of cost-benefit analysis, if any tools suit in the company, they were ready to implement it.

4.2.3 Analysis of Hypothesis Test

Hypothesis 1:

Null Hypothesis H_0 : There is no significant relationship between the type of the financial institutions and practiced of net present value. Practiced of net present value and the type of financial institutions are independent.

Alternative Hypothesis H_1 : There is significant relationship between the type of financial institution and practiced of net present value. Practicing of net present value and type of financial institutions are dependent.

1.3.2.1.9

1.3.2.1.10 Table 4.27: Practicing of NPV tools

Particular	Yes	No	Total
Finance companies	6 a	18 b	24 (a+b)r1
Commercial banks	5 c	5 d	10 (c+d)r2
Total	11 (a+c)c1	23 (b+d)c2	34 = N

Source: Table no. 4.26

Now,

$$d.f = (r-1) (c-1) = (2-1) (2-1) = 1$$

$$x^2 = \frac{(ad-bc)^2 \times N}{r_1 \times r_2 \times c_1 \times c_2}$$

$$= \frac{(6 \times 5 - 18 \times 5)^2 \times 34}{24 \times 10 \times 11 \times 23}, = \frac{3600 \times 34}{60720}, = \frac{122400}{60720}, = 2.02$$

Tabulated value of x^2 at 5% level of significance for 1 degree of freedom (d.f.) is 3.84.

The calculated value of $x^2 = 2.02$

Decision: Since calculated value of $x^2 = 2.02$ is lesser than tabulated value of x^2 at 5% level of significance for 1 d.f is 3.84, null hypothesis is accepted. It means that practicing of NPV tools and type of financial institutions are independent.

Hypothesis 2:

Null Hypothesis H_0 : There is no significant relationship between the type of the financial institutions and practiced of risk adjustment technique. Practiced of risk adjustment technique and the type of financial institutions are independent.

Alternative hypothesis H_1 : There is significant relationship between the type of financial institution and practiced of risk adjustment technique. Practicing of risk adjustment technique and type of financial institutions are dependent

1.3.2.1.11

1.3.2.1.12 Table 4. 28 (a): Practicing of Risk Adjustment Technique

Particular	Yes	No	Total
Finance companies	7 a	17 b	24 (a+b)
Commercial banks	4 c	6 d	10 (c+d)
Total	11 (a+c)	23 (b+d)	34 = N

Source: Table no. 4.26

Since all the frequencies are not greater than and equal to 5, the use of pooling method will result in d.f = 0 (since d.f is lost in pooling) which is meaningless. X^2 must have at least d.f = 1. Yates correction for continuity consists in adding 0.5 the cell frequency, which is less than 5 and then adjusting in the remaining cell frequency accordingly, starting from 'd' cell, we get as:

1.3.2.1.13

1.3.2.1.14 Table 4. 28 (b): Practicing of Risk Adjustment Technique

Particular	Yes	No	Total
Finance companies	6.5 a	17.5 b	24 (a+b)
Commercial banks	4.5 c	5.5 d	10 (c+d)
Total	11 (a+c)	23 (b+d)	34 = N

Now, d.f. = (r-1) (c-1) = (2-1) (2-1) = 1

$$x^2 = \frac{(ad-bc)^2 \times N}{r_1 \times r_2 \times c_1 \times c_2}$$

$$= \frac{(6.5 \times 5.5 - 17.5 \times 4.5)^2 \times 34}{24 \times 10 \times 11 \times 23}$$

$$= \frac{1849 \times 34}{60720}, = \frac{62866}{60620}, = 1.04$$

Tabulated value of x^2 at 5% level of significance for 1 d.f is 3.84

The calculated value of $x^2 = 1.04$

Decision: Since calculated value of χ^2 1.04 is lesser than the tabulated value of χ^2 at 5% level of significance for d.f is 3.84, null hypothesis is accepted. It means that practicing of risk adjustment technique and type of financial institutions are independent.

4.3 Major Findings

On the basis of comprehensive analysis of data, the study has following findings can be drawn.

Major findings from Secondary Data

- a. Income statement of the UFL shows that the all variables of income statement like operating income, variable cost, fixed cost, operating profit are in fluctuating trend but net profit is in increasing trend. The net profit of the finance is Rs. 1199, 1762, 2217, 3047 and 3046 ten thousands for the fiscal year 2009/10, 2010/11, 2011/12, 2012/13 and 2013/14 respectively. Similarly, the operating profit of the finance are also increasing trend except the year 2010/11. They are Rs. 1716, 2363, 3238, 2975 and 2996 ten thousands for the year 2009/10, 2010/11, 2011/12, 2012/13 and 2013/14 respectively.
- b. Income statement of the PFL shows that the all variables of income statement like operating income, variable cost, fixed cost, operating profit, net profit are in fluctuating trend. The net profit of the finance is Rs. (142), 236, 806, (2885) and (281) ten thousands for the fiscal year 2009/10, 2010/11, 2011/12, 2012/13 and 2013/14 respectively. Similarly, the operating profit of the finance are also fluctuating trend it is Rs. 143, 130, 1336, (646) and (400) ten thousands for the year 2009/10, 2010/11, 2011/12, 2012/13 and 2013/14 respectively.
- c. The CM ratio or PV ratio is in fluctuating trend in case of both finance. The lowest PV ratio is 39.14% of UFL in F/Y 2010/11 and the highest is 46.49% in FY 2012/13. Similarly, in case of PFL lowest ratio and highest ratio are 2.92% and 41.15% in FY 2012/13 and 2011/12 respectively.
- d. The both finance income revenue is higher than BEP income in each year over the study period of UFL but in case of PFL income revenue is less than BEP income in FY 2012/13 and 2013/14. So, UFL is very good position but PFL is very bad positions. It means UFL is earning profit in each year but PFL is loss profit in FY 2012/13 and 2013/14.
- e. MOS ratio is in fluctuating trend in case of both finances. UFL has highest all over the selected sample years. PFL has lowest MOS ratio all over the sample years. The

lowest MOS ratio is 65.57% of UFL in F/Y 2009/10 and the highest is 79.37% of UFL in FY 2011/12. Similarly, the lowest MOS ratio is negative 855.35% of PFL in F/Y 2012/13 and the highest is 62.54% of PFL in FY 2011/12. It indicates the PFL finance company earning profit is very bad position. But UFL is very good position to compare PFL

- f. The liquidity position of UFL and PFL are less than 2:1, it means the firms have difficulty in meeting current obligation.
- g. The analysis of UFL and PFL financial weakness are very poor it has not more internal fund to repay debt and shareholder's equity.
- h. Higher the ratio means the better earning position, Net profit on assets of UFL is better than PFL.
- i. The trend analysis of loan and advance of both finance companies are increasing trend and forecasting trend also increasing trend. But in case of PFL net profit is fluctuating trend, it shows the forecasting trend is decreasing trend. In same case UFL forecasting trend is increasing trend.

Major findings from Primary Data

- a. While examining the tools practiced in the finance companies for planning , controlling and decision making it was found that “ratio analysis”, “cash flow analysis”, “capital budgeting”, “Annual Budgeting” and “pricing/Interest rate fixing decision” were widely practiced management accounting tools in finance companies in Nepal. 83.33% of finance companies were found practicing pricing/interest rate fixing decision, 66.67% were practicing break even analysis, 54.17% were practicing decision making, 42% each were practicing segregation of cost into fixed and variable and activity based costing. None of the finance companies were found practicing tools like standard costing and zero based budgeting.
- b. Regarding decision-making on long term investment and fixed assets purchase, payback period, average rate of return and internal rate of return are more practiced technique of capital budgeting. Some of the finance companies practiced net present value while minimal of the finance companies practiced profitability index and none of the companies practiced modified internal rate of return while making capital budgeting decisions.
- c. To adjust for risk while evaluating capital investment it was found that some of the finance companies preferred “sensitivity analysis” and some of them preferred

“increased the required rate of return” which are 33.33% and 16.67% respectively. Many of the finance companies are unaware about the risk adjustment while making capital investment.

- d. To carry out operational activities properly, finance companies mostly practiced preparation of master budget and annual budgeting. Some of the finance companies managed their activities with “operational budget, half-yearly budget and quarterly budget” also.
- e. While preparing budget, most of the finance companies prepared their budget on the basis of past trend and management estimation. Some of them followed historical budget and activity base budgeting as the basis of budget preparation, none of the finance companies use “zero base budgeting” as a basis for budget preparation. The reason behind not practicing “zero base budgeting” was lack of information and cognizance about the format and the way of developing it.
- f. While examining the budget preparation system, it was found that in most of the finance companies, it was management committee that prepared the budget. About 83.33% of the finance companies prepare their budget through management committee; some of the finance companies prepare their budget through mutual cooperation between management committee, finance department and planning department. While preparing budget all the management staffs are involved and there was no practice of consultancy services.
- g. Regarding types of budget practice in the finance companies in Nepal, it was found that most of the finance companies prepared annual budget where as few of the finance companies prepare half-yearly, quarterly and monthly budget
- h. Regarding performance measurement and control, most of the finance companies followed profit and loss criteria. Almost all the finance companies measured their performance on the basis of “profit and loss A/c” made by them during a year. Besides these, ratio analysis and budgetary control was also practiced tool for measuring and controlling activities. But none of the finance companies used standard costing and flexible budgeting for measuring and controlling the overall performance.
- i. For pricing the services, some of the finance companies followed ‘cost based pricing’ where as few of the finance companies followed ‘going rate pricing’, target return on investment, and activity based cost pricing.
- j. Due to nature of business transfer pricing was not practiced in any of the finance companies in Nepal.

- k. Regarding joint cost allocation among different departments, units and division only some of the finance companies (25%) were found practicing of “negotiated basis”. Besides that none of the finance companies take initiative about joint cost allocation.
- l. Regarding segregation of mixed cost in fixed and variable the technique of “least square method” was not practiced in any of the finance companies. 50% of the finance companies followed average method whereas few of them followed high-low method.
- m. Regarding cost and revenue estimation, 100% of the finance companies forecasted coming year cost and revenue on the basis of “past trend analysis”. Some of the finance companies mutually followed “past trend analysis”, market survey and judgmental analysis as a base for cost and revenue estimation practice of zero based budgeting and engineering analysis was nil in this regard.
- n. For pricing the issue of inventory some of the finance companies followed their specific items and few of them followed weighted average method. None of them practiced LIFO and FIFO method for pricing the issue of inventory. Besides that some of the finance companies do not practiced pricing the issue of inventory.
- o. In various finance companies, various types of administrative and technical decision were made. Administrative decision were governed by policy, rule and regulation of the finance companies, where as in case of technical decision making 75% of the finance companies practiced special order offer decision and 25% of them followed lease or buy decision. Make or buy decision and drop or continue any product/service line decision was not practiced at all because of the nature of the business.
- p. From the open-end analysis, the major difficulties for application of new advance management accounting tools were found as follows:
 -) Lack of information and knowledge about the tools
 -) Long procedure
 -) Lack of expertise and trend of follow-up traditional approaches.
 -) To solve these difficulties, managers of various finance companies requested academicians to bring tools and techniques into light through different media.
- q. From the hypothesis test, it was found that financial institutions (finance companies and banks) were independent in practicing management accounting tools. We conclude with the help of hypothesis test the types of financial institution and practicing of NPV tools are independent i.e. there is no significant relationship

between the type of financial institution and practiced of NPV tools. Similarly hypothesis 2 shows the types of financial institutions (finance companies and banks) and practicing of risk adjustment technique are independent i.e. there is no significant relationship between the type of financial institution and practiced of risk adjustment technique.

1.3.3 CHAPTER - V

1.3.3.1.1.1.1 SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary

The main objective of the present research was to observe the present practice of management accounting tools in the listed finance companies in Nepal and to identify the spot where management accounting tools can be applied to boost the company.

Management enhanced the effective uses of resources to achieve the targeted objective of an organization as per changing environment. Future is uncertain. It creates risk. It is difficult to cope with the sudden change. Through good management risk can be minimize, changed can be managed and targeted objective of the organization can be easily achieved.

Corporate firms that carryout the economic activities are the backbone of the economy. Their activities impact the economy in one-way or the other. Every organization has limited

resources. To utilize the limited resources in a better way, different tools and techniques have been developed. Among the various tools and techniques, management accounting tools have proved beneficial in different aspect of managerial activities. The main objective of management accounting is to help managers in overall managerial activities by providing information and helping in planning, controlling and decision making, this acts as a strategic business partner in support of management role in decision making.

This is survey type of research design which is followed by descriptive and analytical approach. Surveys of different companies are made. Questionnaire was distributed and table talks were made to gather information. Information is tabulated as per the requirement of the study.

From the analysis it is found that management accounting tools such as capital budgeting, annual budgeting, cash flow, ratio analysis are mostly practiced tools. Similarly pricing, activity based costing, segregation of cost, break even analysis are practiced to some extent in some of the finance companies. While zero base budgeting, value engineering and standard costing are totally nil in the listed finance companies in Nepal. Lack of information and extra cost burden are the main reason behind not practicing such tools.

From the hypothesis test; it was found that financial institutions were independently practicing the management accounting tools. There was no significant relationship between the types of financial institution and practice of management accounting tools.

5.2 Conclusions

Different types of management accounting tools, which are taught in the colleges and universities, are not found applied by the finance companies in Nepal. It shows gap between the theory and practice. Tools like capital budgeting, budget, ratio analysis and cash flow are in practice but application of new tools of management accounting are not in practice.

No finance companies in Nepal practice of hiring outside expert for carrying out various activities. Thus, it can be concluded that Nepalese finance companies are in beginning stage in practicing of management accounting tools. Nowhere in the finance companies can one find management accounting experts. They are with the concept that management accounting is similar to financial accounting. New tools of management accounting like zero base

budgeting, target costing, value engineering are widely practiced around the world but it seems in infant stage in the finance companies in Nepal. Lack of information and cognizance about management accounting tools are the main factors causing problem in the application of such tools.

5.3 Recommendations

Nepal is the member of World Trade Organization (WTO). Nepalese finance companies should fit with globe environment. Best fit managerial strategies should be developed. Managers of finance companies should think in global perspective information should be updated. For better utilization of the limited resources and achieving goal through cut throat competition, application of advance management accounting tools can be of great help. Thus the following recommendations based on the findings of the research study are presented as:

- a. Finance Companies should put effort to bring advance management accounting tools into the light by conducting national and international seminars. Short term training packages on management accounting should be offered for business managers for notify them with the appropriate techniques of management accounting and to up date their knowledge and skill.
- b. Finance companies are depending upon the traditional tools of management accounting such as past trend analysis. For the smooth operation of the activities traditional tools of management accounting should be changed, they should be motivated toward the application of new, advance and modern management accounting tools such as target costing, activity base costing, zero base budgeting.
- c. While preparing budgeting and planning activities, finance companies should hire outside professional expert.
- d. Budget preparation should not be based on “past expenses” and “management estimation” only. Beside that environmental factors should also be taken into consideration. It is because what happened in the past might not occur in the future.
- e. Interaction between academician and finance companies should be needed. It is recommended that the finance companies should create conducive environment of interaction between the academician and the finance companies. Finance companies can benefit from their knowledge about new tools and techniques of management accounting.
- f. Favorable environment should be needed to implement the tools. For this sake, a separate management accounting department should be established within an

organization. Management accounting expert should be hired. Those finance companies who cannot manage to establish separate department can manage it under their existing accounting, financing and planning department if the finance company cannot hire outside experts, it can send its existing employee for short term training.

- g. Academicians, who have sufficient knowledge about the tools, should put effort to bring advance management accounting tools in the light so that person related to this field gets more information about the implementation and benefit of the tools.
- h. For planning activities, tools like budgeting and cost volume profit analysis can be used. For controlling activities, budgetary control tool can be used. For decision making, marginal analysis can be used. While implementing any tools of management accounting, it is recommended to analyze cost and benefit of the tools. To build up the competitiveness of Nepalese listed finance companies and to carryout managerial activities, the uses of management accounting tools are recommended.
- i. Applications of management accounting tools need internal and external information. So finance companies are recommended to keep management accounting information system so that they can be informative through out the time about every aspects of management. Skill should be updated with the every changes taking place around the external environment. Skill can be developed through training.
- j. While making long term investment decision or purchasing fixed assets, finance companies are recommended to apply NPV tool of capital budgeting.
- k. Finance companies using “cost plus pricing” should use target cost pricing, activity based pricing tools as per the case.
- l. Out of profit made each year, some portion of it should be allocated for research and development program so that new tools and techniques can be developed and adopted in the finance companies.
- m. For future cost and revenue estimation, finance companies should not be based on “past trend” only. What happened in the past might not occur in the future. So, tools like “zero base budgeting”, market survey and statistical tools should be practiced. This helps the finance companies proper information.

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APPENDIX - I

Research Questionnaire

Dear, Sir/Madam

This questionnaire is concerned with the study on "Management Practices of Finance Companies in Nepal". It would be very much appreciated if you could spare some of your valuable time for filling this questionnaire. Please specify with tick mark (✓) for choosing the alternative or alternatives.

Q.No.1. (i) Do the following management accounting tools are used for planning, controlling and decision-making in your company?

	Yes	No
a) Segregation of cost into fixed and variable	42%	62%
b) Break-Even Analysis	66.67%	33.33%
c) Standard Costing	-	100%
d) Ratio Analysis	100%	-
e) Cash Flow Statement	100%	-
f) Capital Budgeting	100%	-
g) Decision making	54.17%	45.83%
h) Pricing/Interest Rate fixing decision	83.33%	16.67%
i) Activity-Based Costing	41.67%	58.33%
j) Zero Based costing	-	100%

(ii). If your company has not practiced any of the above mentioned tools, what might be the reasons?

- a) Lack of expertise [] b) Heavy cost []
c) Lack of information about the tools []

d) Please specify, if other _____

Q.No.2. Who is liable to prepare the budget in your company?

- a) Committee [] b) Finance department []
c) Planning department [] d) Outside experts []
e) Please specify, if other _____

Q.No.3. What is the basis for preparing budget in your company?

- a) Historical budget [] b) Trend analysis c) Zero base []
c) Estimation by management [] d) Activity base []
e) Please specify, if other _____

Q.No.4. What type of budget (on the basis of nature) does your company practice?

- a) Overall master budget [] b) Cash budget only []
c) Operational budget only []
d) Please specify, if other _____

Q.No.5. What type of budget (on the basis of time period) does your company practice?

- a) Quarterly budget [] b) Half-yearly budget []
c) Annual budget []
d) Please specify, if other _____

Q.No.6. Which of the following capital budgeting tools is practiced while making long term investment decisions or purchasing fixed assets?

- a) Pay back period [] b) Average rate of return []
c) Net present value [] d) Internal rate of return []
e) Profitability index [] f) Modified internal rate of return []
g) Please specify, if other _____

Q.No.7. What is the appropriate way to adjust risk while evaluating capital investment in your company?

- a) Higher IRR [] b) Sensitivity analysis []
c) Increased the required rate of return []
d) Estimate probability distribution of future cash flow []
e) Please specify, if other _____

Q.No.8. How does your company practiced to segregate mixed cost into variable and fixed?

- a) High-low-point method [] b) Regression method []
c) Average method []
d) Please specify, if other _____

Q.No.9. Which technique does your company practiced for pricing the service?

- a) Cost-base pricing [] b) Going-rate pricing (market determined) []
c) Target return on investment pricing [] d) Activity based costing pricing []
e) Please specify, if other _____

Q.No.10. Which transfer pricing technique is practiced in your company?

- a) Market-price based [] b) Cost based []

- c) Negotiated []
- b) Please specify, if other _____

Q.No.11.Which method does the company follow for pricing the issued of inventory (stock) in your company?

- a) LIFO [] b) FIFO [] c)Weighted Average []
- b) Please specify, if other _____

Q.No.12.What technique does your company is following to allocate the joint cost into various department?

- a) Sales value method [] b) Negotiated method []
- c) Please specify, if other _____

Q.No.13.Which method does the company used to forecast the costs and revenues of the company for the future periods?

- a) Past trend analysis [] b) Engineering analysis []
- c) Market survey [] d) Zero based analysis []
- e) Judgmental analysis []
- f) Please specify, if other _____

Q.No.14.What shot of Decision making technique have been carried out in tour company?

- a) Make or buy decision [] b) Special order
- c) Drop or continue decision [] d) Lease or buy decision []
- e) Others [] _____

Q.No.15.How does the company measures and controls the overall performance at the end of the accounting period?

- a) Profit and loss a/c made by the company [] b) Ratio analysis []
- c) Budgetary measure and control [] d) Flexible budgeting []
- e) Standard costing technique []
- f) Please specify, if other _____

Name of the company: _____

Designation of the respondent: _____

Name (optional) _____

Date: _____

1.3.3.2 "Thank You for Your Kind Co-operation"

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APPENDIX – II

1.4 Open-End Questionnaire

a. What is the main factor of major accounting related decision-making process in your company?



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b. What are the difficulties face by the company for the application of management accounting tools and techniques?



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Name of the company: _____

Designation of the respondent: _____

Name (optional): _____

Date: _____

1.4.1 "Thank You for Your Kind Co-operation"

APPENDIX - III Least Square of Linear Trend of Loan & Advances (Rs. In thousands)

Fiscal Year (t)	UFL				PFL			
	Loan & Advance (Y)	$X = t - \frac{2011/1}{2}$	X^2	XY	Loan & Advance (Y)	$X = t - \frac{2011/12}{2}$	X^2	XY
2009/10	41119	-2	4		15,165	-2	4	-30330
2010/11	43594	-1	1	-43594	27,369	-1	1	-27369
2011/12	38879	0	0	0	16,318	0	0	0
2012/13	42297	1	1	42297	15,337	1	1	15337
2013/14	54133	2	4	108266	23,240	2	4	46480
Sum(ϕ)	ϕy	0	10	$\phi xy =$	$\phi y =$	0	10	$\phi xy =$

	=220022			24731	97429			4118
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For UFL: $\phi_x = 0$, $a = \frac{\phi_y}{n} = \frac{220022}{5} = \text{Rs. } 44004$ & $b = \frac{\phi_{xy}}{\phi_x^2} = \frac{24731}{10} = \text{Rs. } 2473$

For PFL $\phi_x = 0$, $a = \frac{\phi_y}{n} = \frac{97429}{5} = \text{Rs. } 19,486$ & $b = \frac{\phi_{xy}}{\phi_x^2} = \frac{4118}{10} = \text{Rs } 412$

Substituting these values in the following formula,

$$y = a + bx$$

Year	UFL	PFL
2014/15	44004 + 2473 3 = Rs. 51423	19486 + 412 3 = Rs. 20722
2015/16	44004 + 2473 3 = Rs. 53896	19486 + 412 4 = Rs. 21134
2016/17	44004 + 2473 3 = Rs. 56369	19486 + 412 5 = Rs. 21546
2017/18	44004 + 2473 3 = Rs. 58842	19486 + 412 6 = Rs. 21958
2018/19	44004 + 2473 3 = Rs. 61315	19486 + 412 7 = Rs. 22370

APPENDIX - IV

Least Square of Linear Trend of Net Profit

(Rs. In ten thousands)

Fiscal Year (t)	UFL				PFL			
	net profit (Y)	X = t-2011/12	X ²	XY	net profit (Y)	X = t-2011/12	X ²	XY
2009/10	1199	-2	4	-2398	(144)	-2	4	288
2010/11	1762	-1	1	-1762	236	-1	1	-236
2011/12	2217	0	0	0	805	0	0	0
2012/13	3047	1	1	3047	(2,885)	1	1	-2885
2013/14	3046	2	4	6092	(279)	2	4	-558
Sum(d)	dy = 11271	0	10	dxy = 4979	dy = -2267	0	10	dxy = -3391

For UBL: $\phi_x = 0$, $a = \frac{\phi_y}{n} = \frac{11271}{5} = \text{Rs. } 2254$ & $b = \frac{\phi_{xy}}{\phi_x^2} = \frac{4979}{10} = \text{Rs } 498$

For PFL: $\phi_x = 0$, $a = \frac{\phi_y}{n} = \frac{-2267}{5} = \text{Rs. } -453$ & $b = \frac{\phi_{xy}}{\phi_x^2} = \frac{-3391}{10} = \text{Rs } -339$

Substituting these values in the following formula,

$$y = a + bx$$

Year	UFL	PFL
2014/15	$2254 + 498 \times 3 = 3748$	$-453 + (-339) \mid 3 = \text{Rs. } -1470$
2015/16	$2254 + 498 \times 3 = 4246$	$-453 + (-339) \mid 4 = \text{Rs. } -1809$
2016/17	$2254 + 498 \times 3 = 4744$	$-453 + (-339) \mid 5 = \text{Rs. } -2148$
2017/18	$2254 + 498 \times 3 = 5242$	$-453 + (-339) \mid 6 = \text{Rs. } -2487$
2018/19	$2254 + 498 \times 3 = 5740$	$-453 + (-339) \mid 7 = \text{Rs. } -2826$