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PAPER- MANAGEMENT ACCOUNTING

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LECTURE NOTE

MANAGEMENT ACCOUNTING

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MANAGEMENT ACCOUNTING

Management Accounting is comprised of two words 'Management' and 'Accounting'. It means the study of managerial aspect of accounting. The emphasis of management accounting is to redesign accounting in such a way that it is helpful to the management in formation of policy, control of execution and appreciation of effectiveness. Management Accounting can be viewed as Management-oriented Accounting. Basically it is the study of managerial aspect of financial accounting, i.e. "accounting in relation to management function". It is developed mainly to help the management in the discharge of its functions and for taking various decisions. The primary task of management accounting is, therefore, to redesign the entire accounting system so that it may serve the operational needs of the firm. It furnishes definite accounting information—past, present or future, which may be used as a basis for management action. The financial data are so devised and systematically developed that they become a unique tool for management decision. Hence, Management Accounting involves the study of accounting information and techniques that managers use in analyzing information. Management Accounting is not a specific system of accounts, but could be any form of accounting which enables a business to be conducted more effectively and efficiently. Management Accounting, therefore, appears as the extension of the horizon of cost accounting towards emerging areas of management. Management Accounting is largely concerned with providing economic information to managers for achieving organizational goals. Managers use management accounting information to choose strategy to communicate it and to determine how best to implement it. They use management accounting information to coordinate their decisions about designing, producing and marketing a product or service.

DEFINITION OF MANAGEMENT ACCOUNTING:

Anglo-American Council of Productivity: "Management Accounting is the presentation of accounting information in such a way as to assist the management in creation of policy and the day to day operation of an undertaking". Institute of Chartered Accountants of England and Wales: "Any form of accounting which enables a business to be conducted more efficiently can be regarded as Management Accounting". American Accounting Association: "It includes the methods and concepts necessary for effective planning for choosing among alternative business actions and for control through the evaluation and interpretation of performances."

Institute of Cost and Management Accountants, London: "Management Accounting is the application of professional knowledge and skill in the preparation of accounting information in such a way as to assist management in the formulation of policies and in the planning and control of the operation of the undertakings". Institute of Management Accountants (IMA): "Management Accounting is a profession that involves partnering in management decision making, devising planning and performance management systems, and providing expertise in financial reporting and control to assist management in the formulation and implementation of an

organization's strategy" J. Batty: "Management Accountancy is the term used to describe the accounting methods, systems and techniques which, with special knowledge and ability, assist management in its task of maximizing profit or minimizing losses." Brown and Howard: "Management Accounting is that aspect of accounting which is concerned with the efficient management of a business through the presentation of management of such information as will facilitate efficient and opportune planning and control." Robert Anthony: "Management Accounting is concerned with accounting information which is useful to management" CIMA, London: "Management Accounting is an integral part of management concerned with identifying, presenting and interpreting information used for:

- (a) formulating strategy
- (b) planning and controlling activities
- (c) decision taking
- (d) optimizing the use of resources
- (e) disclosure to shareholders and others external to the entity
- (f) disclosure to employee
- (g) safeguarding assets".

NATURE /CHARACTERISTICS OF MANAGEMENT ACCOUNTING:

1. Grounded on Accounting Information Management Accounting is based on accounting information. Management Accounting is a service function and it provides necessary information to different levels of management. Management Accounting involves the presentation of information in a way that suits the managerial needs. The accounting data collected by accounting department is used for reviewing various policy decisions.
2. Cause and Effect Analysis The role of financial accounting is limited to find out the ultimate result, i.e., profit and loss, whereas management accounting goes a step further. Management Accounting discusses the cause and effect relationship. The reasons for the loss are probed and the factors directly influencing the profitability are also analyzed. Profits are compared to sales, different expenditures, current assets, interest payables, share capital, etc. to give meaningful interpretation.
3. Use of Special Techniques and Concepts Management Accounting uses special techniques and concepts according to necessity, to make accounting data more useful. The techniques usually used include financial planning and analyses, standard costing, budgetary control, marginal costing, project appraisal etc.
4. Aids in Taking Important Decisions It supplies necessary information to the management which may be useful for its decisions. The historical data is studied to see its possible impact on future decisions. The implications of various decisions are also taken into account.
5. Aims at Achieving Objectives Management Accounting uses the accounting information in such a way that it helps in formatting plans and setting up objectives. Comparing actual performance with targeted figures will give an idea to the management about the performance of various departments. When there are deviations, corrective measures can be taken immediately with the help of budgetary control and standard costing.
6. No Fixed Norms No specific rules are followed in management accounting as that of financial accounting. Though the tools are the same, their use differs from concern to concern. The deriving of conclusions also depends upon the intelligence of the management accountant. The presentation will be in the way which suits the concern most.

7. Improves Efficiency The purpose of using accounting information is to increase efficiency of the concern. The performance appraisal will enable the management to pin-point efficient and inefficient spots. Efforts are made to take corrective measures so that efficiency can be improved. The constant review will make the staff cost conscious.

8. Delivers Information and not Decision Management accountant is only to guide to take decisions. The data is to be used by the management for taking various decisions. 'How is the data to be utilized' will depend upon the caliber and efficiency of the management.

9. Involved in Forecasting The management accounting is concerned with the future. It helps the management in planning and forecasting. The historical information is used to plan future course of action. The information is supplied with the object to guide management for taking future decisions.

SCOPE OF MANAGEMENT ACCOUNTING

The advancement in information technology and the ever growing appetite of information consumers in this information age has broadened the scope of management accounting to include things that were not included in the discipline some ten years ago. Management Accounting has moved from a mere information gathering and processing system to an all-encompassing business solution box. Management Accounting is concerned with presentation of accounting information in the most useful way for the management. Its scope is, therefore, quite vast and includes within its fold almost all aspects of business operations. However, the following areas can rightly be identified to be within the ambit of management accounting:

(i) Financial Accounting: Management Accounting is mainly concerned with the rearrangement of the information provided by financial accounting. Hence, management cannot obtain full control and coordination of operations without a properly designed financial accounting system.

(ii) Cost Accounting: Standard costing, marginal costing, opportunity cost analysis, differential costing and other cost techniques play a useful role in operation and control of the business undertaking.

(iii) Revaluation Accounting: This is concerned with ensuring that capital is maintained intact in real terms and profit is calculated with this fact in mind.

(iv) Budgetary Control: This includes framing of budgets, comparison of actual performance with the budgeted performance, computation of variances, finding their causes, etc.

(v) Inventory Control: It includes control over inventory from the time it is acquired till its final disposal.

(vi) Statistical Methods: Graphs, charts, pictorial presentation, index numbers and other statistical methods make the information more impressive and intelligible.

(vii) Interim Reporting: This includes preparation of monthly, quarterly, half yearly income statements and the related reports, cash flow and funds flow statements, scrap reports, etc.

(viii) Taxation: This includes computation of income in accordance with the tax laws, filing of returns and making tax payments.

(ix) Office Services: This includes maintenance of proper data processing and other office management services, reporting on best use of mechanical and electronic devices.

(x) Internal Audit: Development of a suitable internal audit system for internal control.
(xi) Management Information System [MIS]: Management Accounting serves as a centre for collection and dissemination of information. MIS is an essential part of Management Accounting.

OBJECTIVES OF MANAGEMENT ACCOUNTING

The fundamental objective of management accounting is to enable the management to maximize profits or minimize losses. The evolution of management accounting has given a new approach to the function of accounting. The main objectives of management accounting are as follows:

1. Planning and Policy Formulation Planning involves forecasting on the basis of available information, setting goals, framing policies, determining the alternative courses of action and deciding on the programme of activities. Management accounting can help greatly in this direction. It facilitates the preparation of statements in the light of past results and gives estimation for the future.

2. Interpretation Process Management Accounting is to present financial information to the management. Financial information is technical in nature. Therefore, it must be presented in such a way that it is easily understood. It presents accounting information with the help of statistical devices like charts, diagrams, graphs, etc.

3. Assists in Decision-Making Process With the help of various modern techniques, management accounting makes decision-making process more scientific. Data relating to cost, price, profit and savings for each of the available alternatives are collected and analyzed and thus it provides a base for taking sound decisions.

4. Controlling Management Accounting is a useful tool for managerial control. Management Accounting tools like standard costing and budgetary control are helpful in controlling performance. Cost control is affected through the use of standard costing and departmental control is made possible through the use of budgets. Performance of each and every individual operation is controlled with the help of management accounting.

5. Reporting Management Accounting keeps the management fully informed about the latest position of the concern through reporting. It helps management to take proper and quick decisions. The performances of various departments are regularly monitored and reported to the top management.

6. Facilitates Organizing Since management accounting stresses more on Responsibility Centre with a view to control costs and fixation of responsibilities, so it also facilitates decentralization to a greater extent. Thus, it is helpful in setting up effective and efficient organization framework.

7. Facilitates Coordination of Operations Management Accounting provides tools for overall control and coordination of business operations. Budgets are important means of coordination.

IMPORTANCE/FUNCTIONS OF MANAGEMENT ACCOUNTING

The basic function of management accounting is to assist the management in performing its functions effectively. The functions of the management are planning, organizing, directing and controlling. Management Accounting helps in the performance of each of these functions in the following ways:

- (i) Provides Data: Management Accounting serves as a vital source of data for management planning. The accounts and documents are a repository of a vast quantity of data about the past progress of the enterprise which are a must for making forecasts for the future.

(ii) **Modifies Data:** The accounting data required for managerial decisions is properly compiled and classified. For example, purchase figures for different months may be classified to know total purchases made during each period product-wise, supplier-wise and territory-wise etc.

(iii) **Analyses and Interprets Data:** The accounting data is analyzed meaningfully for effective planning and decision-making. For this purpose the data is presented in a comparative form. Ratios are calculated and likely trends are projected.

(iv) **Serves as a Means of Communicating:** Management Accounting provides a means of communicating management plans upward, downward and outward through the organization. Initially, it is a means of identifying the feasibility and consistency of the various segments of the plan. At later stages it keeps all parties informed about the plans that have been agreed upon and their roles in these plans.

(v) **Facilitates Control:** Management Accounting helps in translating given objectives and strategy into specified goals for attainment by a specified time and secures effective accomplishment of these goals in an efficient manner. All this is made possible through budgetary control and standard costing which is an integral part of management accounting.

(vi) **Uses also Qualitative Information:** Management Accounting does not restrict itself to financial data for helping the management in decision making but also uses such information which may not be capable of being measured in monetary terms. Such information may be collected from special surveys, statistical compilations, engineering records, etc.

ROLE OF MANAGEMENT ACCOUNTING

The role of management accounting can be summarized in following points:

1. **Helping Forecast the Future:** Forecasting aids decision-making and answering questions, such as: Should the company invest in more equipment? Should it diversify into different markets? Should it buy another company? Management Accounting helps in answering these critical questions and forecasting the future trends in business.
2. **Helping in Make-or-Buy Decisions:** Is it cheaper to procure materials or a product from a third party or manufacture them in-house? Cost and production availability are the deciding factors in this choice. Through management accounting, insights will be developed which will enable decision-making at both operational and strategic levels.
3. **Forecasting Cash Flows:** Predicting cash flows and the impact of cash flow on the business is essential. How much cost will the company incur in the future? Where will its revenues come from and will the revenues increase or decrease in the future? Management Accounting involves designing of budgets and trend charts, and managers use this information to decide how to allocate money and resources to generate the projected revenue growth.
4. **Helping Understand Performance Variances:** Business performance discrepancies are variances between what was predicted and what is actually achieved. Management Accounting uses analytical techniques to help the management build on positive variances and manage the negative ones.
5. **Analyzing the Rate of Return:** Before embarking on a project that requires heavy investments, the company would need to analyse the expected rate of return (ROR).