

# MANAGEMENT ACCOUNTING

## MODULE NAME – INTRODUCTION TO MANAGEMENT ACCOUNTING

### Concept-1 Introduction

Accounting is, primarily, the process of keeping records of financial transactions. It encompasses systematic recording, reporting, and analysis of the financial activity of an organization. Interested parties can analysis the financial performance of companies using accounting information which is the end product of the process of accounting. Accounting information is used by the stakeholders of the company, namely the employees, shareholders, creditors, banks and other lenders, regulatory agencies and tax authorities, etc. for decision making purpose. It is also the language through which the organizations can communicate with the external world.

In the following lines some of the major users along with their financial information needs are given:

- **Owners/investors –**

The primary objective of accounting is to provide necessary information to the owners/ investors relating to their business. The shareholders of a company are interested in the accounting information with a view to ascertaining the profitability and financial strength of the company.

- **Management –**

Generally, there is a separation of the ownership and management functions. The managements require a different set of financial information which helps them in their internal decision making.

- **Creditors –**

Trade creditors, debenture holders, bankers, and other lending institutions are interested in knowing the short-term as well as long-term position of the company. The financial statements provide the required information for ascertaining such position.

- **Regulatory Agencies –**

Various governments and other agencies use accounting reports not only as a basis for tax assessment but also in evaluating how well the business are operating under regulatory framework.

- **Government –**

Governments use financial statements for compiling statistics concerning business units, which, assist compilation of national accounts.

- **Potential Investors –**

Potential investors use the information in accounting reports to a greater extent in order to determine the relative merits of various investment opportunities.

- **Employees –**

Employees are interested in the earnings of the enterprise because their remuneration depend on the quantum of profits earned.

- **Researchers –**

Research scholars in their research in accounting theory as well as business affairs and practices also use accounting data.

**There are, as such, three branches of accounting:**

- Financial Accounting
- Cost accounting
- Management Accounting.

## **Concept-2 What Is Management Accounting?**

Management accounting is an accounting branch that is used by managers for making decisions to benefit the management. It is a method of accounting through which accountants create statements, reports, and documents related to business performance. This accounting branch is used for the organisation's internal purposes to help accomplish business goals.

Management Accounting comprise of two terms 'management' and 'accounting'. While management is all about running an organization in consonance with the strategic goal, accounting may be seen to encompass any of the activities that attempt to gauge the performance of an organization. It includes the traditional 'accounting' roles of stewardship, control and audit. In a nutshell, management accounting is accounting (i.e. producing useful information) for management (people with the task of running the business).

- financial or non-financial;
- accurate, or broadly correct;
- actual (certain) or estimated (uncertain);
- based in the past or the future;
- detailed, or in a highly aggregated form;
- presented in any of a variety of spoken or written forms, such as numbers, tables, and graphs;
- Related to profits/losses, costs/incomes, volumes, quality indicators, trends, etc.

On the other, 'management' may include the activities of individuals in a number of positions, for example:

- senior managers;
- mid-level managers;
- lower-level managers;
- executive directors with management responsibilities;

## **Concept-3 Scope of Management Accounting**

1. Budgeting, planning and forecasting Measuring organisational,
2. divisional and departmental performance
3. Comparing results and performance within and between organisations
4. Assisting in the process of increasing effectiveness and efficiency

5. Assessing the performance of past and future capital investments
6. Advising on decisions about product mix, markets to be served and selling prices
7. Advising on decisions on whether to outsource products, components, activities and services
8. Advising on decisions involving the investment of scarce funds between a range of possible alternatives
9. Assisting in the making of a wide range of strategic decisions

The above mentioned are some of the relatively precarious activities of the higher level management. While the fundamental activities of management accounting would include calculating

- the profitability of products, services and operations,
- allocating costs to products,
- setting inter-divisional transfer prices.

### Concept-4 Relationship Between Financial & Management Accounting

Basis for Comparison	Financial Accounting	Management Accounting
Purpose	Financial Accounting classifies, analyses, records, and summarizes the financial transactions of a particular period of the company.	Management accounting helps management make effective decisions about the business.
Application	Financial accounting is prepared to reflect true and fair picture of financial affairs.	Management accounting helps management to take meaningful steps and strategize.
Scope	The scope is pervasive, but not as much as the management accounting.	The scope is much broader.
Information type	Quantitative.	Quantitative and qualitative.
Inter dependence	It is not dependent on management accounting.	Management accounting is basically decision making accounting and depends on information created by Financial Accounting as well as Cost Accounting.
	It is legally mandatory to prepare financial accounts of all companies. (for example in the Indian Context Companies Act 2013, relevant rules of	Management accounting has no statutory requirement.

Statutory requirement	Accounting standards furnishes the statutory requirements)	
Format	Financial accounting has specific formats for presenting and recording information.	There's no set format for presenting information in management accounting.
Users	Mainly for potential investors as well as all stakeholders.	Only for management.
Verifiable	The information presented is verifiable.	The information presented is predictive and not immediately verifiable.

## Concept-5 Relationship Between Cost & Management Accounting

The basis for Comparison	Cost Accounting	Management Accounting
Meaning	Cost accounting revolves around cost computation, cost control, and cost reduction.	Management accounting helps management make effective decisions about operations of the business.
Application	Cost accounting prevents a business from incurring costs beyond budget.	Management accounting offers a big picture of how management should strategize.
Scope	The scope is much narrower.	The scope is much broader.
Measuring grid	Quantitative.	Quantitative and qualitative.
Sub-set	Cost accounting is one of the many sub-sets of management accounting.	Management accounting is the universal set.
Basis of decision making	The task of decision making very less. Even if there is some, it is based on historic information	Historic and predictive information is the basis of decision-making.
Statutory requirement	Statutory audit of cost accounting is a requirement in some specified industries <sup>23</sup>	The audit of management accounting has no statutory requirement.
Dependence	Cost accounting isn't dependent on management accounting to be successfully implemented.	Management accounting is dependent on both cost & financial accounting for successful implementation.

**Used for**

Management, shareholders, and vendors.

Only for management.

## Concept-6 Functions Of The Management Accountant

The management accountant is responsible for the installation, development and efficient functioning of the management accounting system. They are an important part of an organisation's decision-making process. They are responsible for ensuring that managers on behalf of the businesses make well-informed decisions.

### (a) **Planning and Accounting -**

Management accountants prepare an accounting system covering costs, sales forecasts, profit planning, production planning, and allocation of resources. It should also include capital budgeting, short-term and long-term financial planning. They also prepare the procedures necessary to implement the plan effectively.

### (b) **Controlling -**

Management accountants assist in the control of an organisation's performance through the use of standard costing, budget control, accounting ratios, funds flow statements, cost-cutting initiatives, and assessing capital expenditure proposals and returns on investment.

### (c) **Reporting -**

Management accountants assist the top management in finding out the root cause of an unfavorable operation or event by identifying the real reasons for the adverse events as well as the responsible parties and comprehensively reporting them.

### (d) **Coordinating -**

Management accountants improve an organisation's efficiency and profits by providing various coordination tools such as budgeting, financial reporting, financial analysis and interpretation, and so on. These tools aid management by comparing cost and financial records, preparing financial budgets and establishing standard costs, and analyzing cost deviations to enable management by exception.

### (e) **Communication -**

Management accountants create a wide range of reports to communicate results to the superiors. Through published financial statements and returns, they also inform the outside world about their company's success.

### (f) **Financial evaluation and Interpretation -**

Management accountants analyze the data and present it to the management in a non-technical approach, together with their comments and ideas, so that the shareholders and senior management can understand it and make informed decisions.

### (g) **Tax Administration -**

Management accountants are in charge of tax policies and processes. They make the reports that are required by various authorities. Further, they ensure that quarterly tax payments are made in advance, as required by the relevant Act, to prevent the payment of penal interest on late tax payments.

### (h) **Evaluation of external effects -**

There may be changes in government policy and existing laws. These amendments and policy changes can affect business goals. Management accountants assess the extent of any impact of these external factors on the business and report it to the stakeholder to take necessary precautionary measures.

## Concept-7 The Management Accountant And The Modern Business World

- **Global competition -**

Prior to the era of globalization, many organizations operated in a protected competitive environment. Globalization ushered in changes where there have been reductions in tariffs and duties on imports and exports as well as dramatic improvements in transportation and communication systems. This has facilitated firms to operate globally and resulted in stiff competition from the very best organisations worldwide. Business operations also changed significantly.

- **Changing product life cycles -**

Changing profile of the customer along with behavioural issues have contributed to drastically reduce the product life cycle. First mover advantage is critical and every organisation is desperately seeking the advantage by increasing their investment in research and development.

- **Advances in manufacturing technology -**

In order to compete effectively, companies must be able to manufacture high quality innovative products at a low cost, and also provide a first-class customer service. Flexibility to cope with short product life cycles, demands for greater variety of product, more discriminating customers and increasing international competition has created enormous pressure on the operational activities of the business.

- **The impact of information technology -**

The use of information technology (IT) to support business activities has increased dramatically. Along with electronic business communication technologies known as e-business, e-commerce or internet commerce have also developed significantly. Consumers have become more discerning in their purchases as in online transactions it is relatively easy to compare the merits of different products and services. This has a significant impact on the work of management accountants.

- **Environmental and sustainability issues -**

In recent times, ESG27 has become the focal point in the operations of the company. Along with this, ethical issues have also come to the forefront as the business has to deal with customers who are more aware of these issues than they were a decade back. Thus, there is a desperate need for organisations to be run in a suitable way. Sustainable development, where it is acknowledged that environmental resources are limited and should be preserved for future generations, is the order of the day.

- **Deregulation and privatization -**

Prior to the era of globalization, companies in many industrial sectors were government-owned monopolies and operated in a highly regulated, protected and non-competitive environment. Thus the organisations, especially those incurring losses, were not under any pressure to improve the quality and efficiency of their operations and to improve profitability by adding or dropping particular products or services from their array of product or service.

- **Focus on value creation -**

The scope of management accounting is enormous. Managers who are in charge of the operations of the organisations depend on the management accountants in realisation of the strategic goal of the organisations. With the advent of time, the role of the management accountant has changed from merely interpreting, managing and recording costs to creating value.

- **Customer orientation -**

In the new business environment, gaining competitive advantage has become the singular goal of every business organisation. Companies have realized that in order to sustain in today's competitive environment they need to become more customer driven and recognize that customers are crucial to their future success.