

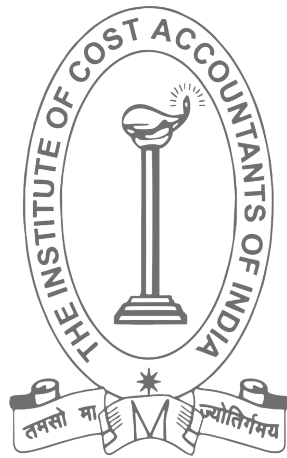
# INTERMEDIATE

## Paper 12

# Management Accounting

## Study Notes

## SYLLABUS 2022



The Institute of Cost Accountants of India  
CMA Bhawan, 12, Sudder Street, Kolkata - 700 016

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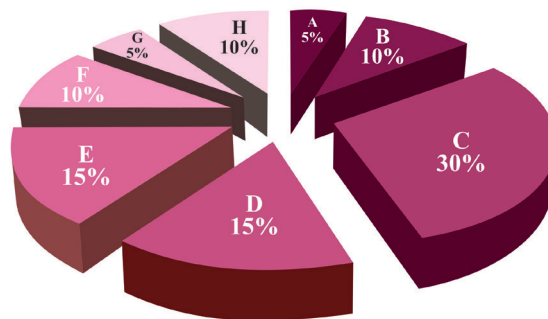
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# PAPER 12: MANAGEMENT ACCOUNTING

## Syllabus Structure:

The syllabus in this paper comprises the following topics and study weightage:

Module No.	Module Description	Weight
<b>Section A: Introduction to Management Accounting</b>		<b>5%</b>
1	Introduction to Management Accounting	5%
<b>Section B: Activity Based Costing</b>		<b>10%</b>
2	Activity Based Costing	10%
<b>Section C: Decision Making Tools</b>		<b>30%</b>
3	Marginal Costing	30%
4	Applications of Marginal Costing in Short Term Decision Making	
5	Transfer Pricing	
<b>Section D: Standard Costing and Variance Analysis</b>		<b>15%</b>
6	Standard Costing and Variance Analysis	15%
<b>Section E: Forecasting, Budgeting and Budgetary Control</b>		<b>15%</b>
7	Forecasting, Budgeting and Budgetary Control	15%
<b>Section F: Divisional Performance Measurement</b>		<b>10%</b>
8	Divisional Performance Measurement	10%
<b>Section G: Responsibility Accounting</b>		<b>5%</b>
9	Responsibility Accounting	5%
<b>Section H: Decision Theory</b>		<b>10%</b>
10	Decision Theory	10%



# Learning Environment

<b>Subject Title</b>	<b>MANAGEMENT ACCOUNTING</b>
<b>Subject Code</b>	<b>MA</b>
<b>Paper No.</b>	<b>12</b>
<b>Course Description</b>	<p>The subject Management Accounting offers an all-round coverage of important tools for management and control of costs and for decision management. It develops an in-depth understanding of the application of activity-based costing for rational allocation of overhead costs to cost objects. It elucidates important tools for managerial decision making in the sphere of cost optimisation, pricing, use of resources, product mix and profit planning. It also builds up detail understanding of transfer pricing to achieve goal congruence. The subject additionally offers sufficient knowledge on available tools for divisional performance evaluation and responsibility accounting and also offers in-depth coverage of the use of various cost control techniques such as standard costing and budgetary control in an organisation.</p>
<b>CMA Course Learning Objectives (CMLOs)</b>	<ol style="list-style-type: none"> <li>1. Interpret and appreciate emerging national and global concerns affecting organizations and be in a state of readiness for business management.             <ol style="list-style-type: none"> <li>a. Identify emerging national and global forces responsible for enhanced/varied business challenges.</li> <li>b. Assess how far these forces pose threats to the status-quo and creating new opportunities.</li> <li>c. Find out ways and means to convert challenges into opportunities</li> </ol> </li> <li>2. Acquire skill sets for critical thinking, analyses and evaluations, comprehension, syntheses, and applications for optimization of sustainable goals.             <ol style="list-style-type: none"> <li>a. Be equipped with the appropriate tools for analyses of business risks and hurdles.</li> <li>b. Learn to apply tools and systems for evaluation of decision alternatives with a 360-degree approach.</li> <li>c. Develop solutions through critical thinking to optimize sustainable goals.</li> </ol> </li> <li>3. Develop an understanding of strategic, financial, cost and risk-enabled performance management in a dynamic business environment.             <ol style="list-style-type: none"> <li>a. Study the impacts of dynamic business environment on existing business strategies.</li> <li>b. Learn to adopt, adapt and innovate financial, cost and operating strategies to cope up with the dynamic business environment.</li> <li>c. Come up with strategies and tactics that create sustainable competitive advantages.</li> </ol> </li> <li>4. Learn to design the optimal approach for management of legal, institutional, regulatory and ESG frameworks, stakeholders' dynamics; monitoring, control, and reporting with application-oriented knowledge.             <ol style="list-style-type: none"> <li>a. Develop an understanding of the legal, institutional and regulatory and ESG frameworks within which a firm operates.</li> <li>b. Learn to articulate optimal responses to the changes in the above frameworks.</li> <li>c. Appreciate stakeholders' dynamics and expectations, and develop appropriate reporting mechanisms to address their concerns.</li> </ol> </li> <li>5. Prepare to adopt an integrated cross functional approach for decision management and execution with cost leadership, optimized value creations and deliveries.             <ol style="list-style-type: none"> <li>a. Acquire knowledge of cross functional tools for decision management.</li> <li>b. Take an industry specific approach towards cost optimization, and control to achieve sustainable cost leadership.</li> <li>c. Attain exclusive knowledge of data science and engineering to analyze and create value.</li> </ol> </li> </ol>

<b>Subject Learning Objectives [SLOB(s)]</b>	<ol style="list-style-type: none"> <li>1. To appreciate the fundamental concepts of management accounting and its role in a dynamic business environment. (CMLO 1a, b)</li> <li>2. To develop detail understanding of costing frameworks, tools, and techniques to facilitate managerial decision making for cost control and optimisation, and determination of prices with optimised product mix. (CMLO 2b, 3a, b)</li> <li>3. To attain detailed knowledge of measures to improve divisional performance and appreciate various methods of transfer pricing to ensure goal congruence and profit optimisation at entity level. (CMLO 3c, 4c)</li> <li>4. To gather in-depth knowledge of techniques and tools for profit planning, variance analyses, optimal utilization of resources and responsibility accounting. (CMLO 3b, 5a, 5b).</li> <li>5. To appreciate quantitative tools for decision making in dynamic environment shrouded with risks and uncertainties. (CMLO 2a, 2b)</li> </ol>
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<b>Subject Learning Outcome (SLOC) and Application Skill (APS)</b>	<p><u>SLOC(s)</u></p> <ol style="list-style-type: none"> <li>1. Students will be able to assist management in crafting policies, and deciding specific applications of costing frameworks, tools and techniques for rationalisation of activities, determination, optimisation and allocation of costs to products,</li> <li>2. They will be equipped with requisite knowledge and skills to guide leadership team in decision management and profit planning by providing required and relevant inputs and performing necessary analyses of competitive courses of actions with cost-benefit analyses.</li> <li>3. They will attain skills to apply appropriate tools and techniques to pinpoint the areas of inefficiencies, adverse variances with causative analyses and guide management to take corrective actions befitting the dynamic business environment shrouded with risks and uncertainties.</li> <li>4. They will be able to advise management for adopting measures to evaluate divisional performance and identify responsibility lapses for taking appropriate corrective actions.</li> </ol> <p><u>APS</u></p> <ol style="list-style-type: none"> <li>1. Students will apply attained skills for ABC and other costing and controlling tools to determine and allocate overhead costs based on cost pools and identified cost drivers that would help taking appropriate pricing decisions and monitoring performance.</li> <li>2. They will prepare customised reports through critical analysis of costs and associated issues for evaluation of alternative courses of actions and present the same for decisions by management to handle product specific pricing decisions and external environment driven issues impacting performance</li> <li>3. They will prepare analytical reports on product costs, divisional and/or product-wise profit, actual performance vs. plans/standards, responsibility accounting for functional managers, etc. to enable leadership team to frame sustainable strategic plans befitting the risky and dynamic business environment.</li> </ol>
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<b>Module wise Mapping of SLOB(s)</b>			
<b>Module No.</b>	<b>Topics and Sub-topics</b>	<b>Additional Resources (Research articles, case studies, blogs)</b>	<b>SLOB Mapped</b>
<b>Section A: Introduction to Management Accounting</b>			
1	Introduction to Management Accounting	Management Accounting in Support of the Strategic Management Process - CIMA <a href="https://www.cimaglobal.com/Documents/Thought_leadership_docs/Management%20and%20financial%20accounting/Academic-Research-Report-Strategic-Management-Process.pdf">https://www.cimaglobal.com/Documents/Thought_leadership_docs/Management%20and%20financial%20accounting/Academic-Research-Report-Strategic-Management-Process.pdf</a>	To appreciate the fundamental concepts of management accounting and its role in a dynamic business environment.
<b>Section B: Activity Based Costing</b>			
2	Activity Based Costing.	Activity based costing in China: a case study of Xu Ji Electric Co. Ltd. – CIMA <a href="https://www.cimaglobal.com/Documents/Thought_leadership_docs/6Activity-based-costing-China.pdf">https://www.cimaglobal.com/Documents/Thought_leadership_docs/6Activity-based-costing-China.pdf</a>	To develop detail understanding of costing frameworks, tools, and techniques to facilitate managerial decision making for cost control and optimisation, and determination of prices with optimised product mix.
<b>Section C: Decision Making Tools</b>			
3	Marginal Costing	The Strange Career of Marginal Cost Pricing – Fisher	To develop detail understanding of costing frameworks, tools, and techniques to facilitate managerial decision making for cost control and optimisation, and determination of prices with optimised product mix.
4	Applications of Marginal Costing in Short Term Decision Making	<a href="https://www.tandfonline.com/doi/abs/10.1080/00213624.1991.11505129?journalCode=mjei20">https://www.tandfonline.com/doi/abs/10.1080/00213624.1991.11505129?journalCode=mjei20</a>	
5	Transfer Pricing	Current Trends and Corporate Cases in Transfer Pricing – Tang <a href="https://scholarworks.wmich.edu/books/468/">https://scholarworks.wmich.edu/books/468/</a>	To attain detailed knowledge of measures to improve divisional performance and appreciate various methods of transfer pricing to ensure goal congruence and profit optimisation at entity level.
<b>Section D: Standard Costing and Variance Analysis</b>			
6	Standard Costing and Variance Analysis	Standard costing Insights from leading companies – CIMA <a href="https://www.cimaglobal.com/Documents/Thought_leadership_docs/StandardCosting2010Insightsfromcompanies.pdf">https://www.cimaglobal.com/Documents/Thought_leadership_docs/StandardCosting2010Insightsfromcompanies.pdf</a>	To gather in-depth knowledge of techniques and tools for profit planning, variance analyses, optimal utilization of resources and responsibility accounting.

**Section E: Forecasting, Budgeting and Budgetary Control**

7	Forecasting, Budgeting and Budgetary Control	Economic Incentives in Budgetary Control Systems – Demski & Feltham <a href="https://www.jstor.org/stable/245898">https://www.jstor.org/stable/245898</a>	To gather in-depth knowledge of techniques and tools for profit planning, variance analyses, optimal utilization of resources and responsibility accounting.
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**Section F: Divisional Performance Measurement**

8	Divisional Performance Measurement	Foundations of Economic Value Added – J. L. Grant <a href="https://books.google.co.in/books?hl=en&amp;lr=&amp;id=zQJazXm0HfIC&amp;oi=fnd&amp;pg=PP13&amp;dq=Economic+value+added&amp;ots=_0yBBmNgMZ&amp;sig=-gFGxwKs39QG6FvIFJieJ_--PJ4&amp;redir_esc=y#v=onepage&amp;q=Economic%20value%20added&amp;f=false">https://books.google.co.in/books?hl=en&amp;lr=&amp;id=zQJazXm0HfIC&amp;oi=fnd&amp;pg=PP13&amp;dq=Economic+value+added&amp;ots=_0yBBmNgMZ&amp;sig=-gFGxwKs39QG6FvIFJieJ_--PJ4&amp;redir_esc=y#v=onepage&amp;q=Economic%20value%20added&amp;f=false</a>	To attain detailed knowledge of measures to improve divisional performance and appreciate various methods of transfer pricing to ensure goal congruence and profit optimisation at entity level.
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**Section G: Responsibility Accounting**

9	Responsibility Accounting	Management and Cost Accounting – C Drury Cengage Publications	To gather in-depth knowledge of techniques and tools for profit planning, variance analyses, optimal utilization of resources and responsibility accounting.
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**Section H: Decision Theory**

10	Decision Theory	Revisiting Decision Trees - Coles, Rowley <a href="https://www.emerald.com/insight/content/doi/10.1108/00251749510093932/full/html">https://www.emerald.com/insight/content/doi/10.1108/00251749510093932/full/html</a>	To appreciate quantitative tools for decision making in dynamic environment shrouded with risks and uncertainties.
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**SECTION - A**  
**INTRODUCTION TO  
MANAGEMENT ACCOUNTING**



# Introduction to Management Accounting

1

**This Module includes:**

- 1.1. Conceptual Understanding
- 1.2. Relationship between Management Accounting and Cost Accounting
- 1.3. Role of a Management Accountant in Modern Business World

# Introduction to Management Accounting

## **SLOB Mapped against the Module**

To appreciate the fundamental concepts of management accounting and its role in a dynamic business environment. (CMLO 1a, b)

## **Module Learning Objectives:**

After studying this module, the students will be able to

- ▲ Appreciate the fundamental difference between cost accounting and management accounting.
- ▲ Conceptualize the stages of evolution of management accounting.
- ▲ Understand the crucial role of the management accountant in the modern day business world.

## 1.1.1 Introduction

**A**ccounting is, primarily, the process of keeping records of financial transactions. It encompasses systematic recording, reporting, and analysis of the financial activity of an organisation. Interested parties can analyse 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 2014, Warren Buffet<sup>1</sup> gave valuable advice to a 17-year-old intern at an investment firm<sup>2</sup>. Buffet referred to accounting as the language of business, since much like a foreign language it must be learned before understanding. This captures the essence of the function of accounting. Language is the basis of communication between two people. So is accounting. It is the language in which the business communicates with the stakeholders, who are also referred as the users<sup>3</sup>. It is important to note that the users are either internal (managers, shareholders, employees, creditors) or external (potential investors and government).

The user considers the financial information communicated by the business through the language of accounting for purpose of decision making. Various users have various information needs. In the following lines some of the major users along with their financial information needs are given:

- ⊙ **Owners/investors** - The primary<sup>4</sup> 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.

<sup>1</sup>. Warren Edward Buffett is an American business magnate, investor, and philanthropist. He is currently the chairman and CEO of Berkshire Hathaway. He is one of the most successful investors in the world and has a net worth of over \$98 billion as of July 2022, making him the world's eighth-wealthiest person ([https://en.wikipedia.org/wiki/Warren\\_Buffett](https://en.wikipedia.org/wiki/Warren_Buffett))

<sup>2</sup>. <https://www.ageras.com/blog/accounting-the-language-of-business#:~:text=In%202014%2C%20Warren%20Buffet%20gave%20valuable%20advice%20to,in%20this%20comparison%20than%20originally%20meets%20the%20eye.>

<sup>3</sup>. The categorisation and other details of the users is taken up in Module 1 of Paper 8.

<sup>4</sup>. This depends on the nature of accounting which is discussed in the subsequent paragraph.

- ⊙ **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.

The above list is not exhaustive and there are various other stakeholders whose financial information need is varied. Thus, the list of actual and potential users of accounting information is exhaustive.

From the above, it is obvious that the accounting information need of the management is different from the others. The term *management* encompass the entire range of activities involved in running an organisation. There are basically three levels of the management; top level, middle level and lower level. Though the financial information need of the three levels varies but their essence is similar: decision making. The top level management is entrusted with the critical task of making effective and efficient decisions which is reflected in company performance measured in terms of profit and market share.

There are, as such, three branches of accounting:

- ⊙ Financial Accounting
- ⊙ Cost accounting
- ⊙ Management Accounting.

The above categorisation is on the basis of the presentation, legal requirements and the financial information each of them generate. Though the aspect is taken up in details in the next section of this module, in a nutshell it may be noted that the management accounting is concerned with the provision of accounting information to people within the organisation (internal users) to help them make better decisions and improve the efficiency and effectiveness of existing operations, whereas financial accounting is concerned with the provision of accounting information to external users. Thus, management accounting is often related to internal reporting<sup>5</sup> while financial accounting is related to external reporting. Though the scope of cost accounting is narrow, it is important as it discusses the nuances of the process of cost accumulation for fixation of sale price and valuation of inventory which are the most important aspects of management decision making.

### 1.1.2 What is Management Accounting?

Management Accounting comprise of two terms ‘management’ and ‘accounting’. While management is all about running an organisation in consonance with the strategic goal, accounting may be seen to encompass any of the activities that attempt to gauge the performance of an organisation. 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). In this sense, management accounting includes the production of all information useful in running the organisation. Information, as such, may be<sup>6</sup>:

- ⊙ financial or non-financial;

<sup>5</sup> Though absorption costing, a technique of the cost accumulation process, and as such an aspect of cost accounting is used for external reporting purpose, as and when required.

<sup>6</sup> The classification of ‘information’ is adopted from Management Accounting Principles and Applications by Hugh Coombs, David Hobbs and Ellis Jenkins, SAGE Publications Ltd.

- ⊙ 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;

Chartered Institute of Management Accounting (CIMA) have taken a more wide-ranging view of the scope of management accounting and have tended to take a broader ‘management consultancy’ view of the work of their members. CIMA provides a comprehensive definition of the term. CIMA official terminology<sup>7</sup> states that management accounting is the application of the principles of accounting and financial management to create, protect, preserve and increase value for the stakeholders of for-profit and not-for-profit enterprises in the public and private sectors. The document further states that management accounting is an integral part of management. The discipline requires the identification, generation, presentation, interpretation and use of relevant information to:

- 1) Inform strategic decisions and formulate business strategy
- 2) Plan long, medium and short-run operations
- 3) Determine capital structure
- 4) Design reward strategies for executives and shareholders
- 5) Inform operational decisions
- 6) Control operations and ensure the efficient use of resources
- 7) Measure and report financial and non-financial performance to management and other stakeholders
- 8) Safeguard tangible and intangible assets
- 9) Implement corporate governance procedures, risk management and internal controls.

The above nine points, thus, encompasses the scope and significance of management accounting.

Colin Drury<sup>8</sup> states that management accounting combines accounting, finance and management with the leading edge techniques needed to drive successful businesses. Professionals, in this discipline are functionaries who:

- ⊙ Advise managers about the financial implications of projects.
- ⊙ Explain the financial consequences of business decisions.
- ⊙ Formulate business strategy.

<sup>7</sup>. CIMA Official Terminology, 2005, The Chartered Institute of Management Accountants (CIMA Publishing, an imprint of Elsevier).

<sup>8</sup>. Management and Cost Accounting, Eighth Edition, by Colin Drury.

- ⦿ Monitor spending and financial control.
- ⦿ Conduct internal business audits.
- ⦿ Explain the impact of the competitive landscape and
- ⦿ Bring a high level of professionalism and integrity to business

From the above definition provided by CIMA it is obvious that Management Accounting refers to presentation of accounting information to management by the Management Accountant, in such a way as to assist them in their managerial functions of decision-making, planning and control. Thus, Management Accounting deals with creation and presentation of accounting information for managerial or other decision making purposes. The purpose of management accounting is to assist management in running the business in ways that will improve the performance of the business. Various authors have provided insights about what management accounting comprises of. The following four conceptualisation are noteworthy:

- 1) Garrison and Noreen (2000)<sup>9</sup> state that managerial accounting<sup>10</sup> is ‘concerned with providing information to managers – that is, people inside an organisation who direct and control its operations’. The authors further states that it ‘provides the essential data with which organisations are actually run’ and that it is ‘concerned with providing information to managers for use in planning and controlling operations and in decision making’.
- 2) Wilson and Way (1993)<sup>11</sup> state that ‘managerial accounting encompasses techniques and processes that are intended to provide financial and non-financial information to people with an organisation to make better decisions and thereby achieve organisational control and enhance organisational effectiveness’.
- 3) Johnson and Kaplan (1987)<sup>9</sup> explain that management accounting theory arises from the needs of manufacturing companies. They also explain that the development of management accounting happened mainly because of the need to measure and value the work-in-progress and inventory for financial statements and tax purposes which therefore raised a few issues to the service sector due to the absence of inventory.
- 4) Horngren, Datter and Rajan<sup>12</sup> (2015) argues that management accounting is the process of measuring, analyzing, and reporting financial and nonfinancial information that helps managers make decisions to fulfill the goals of an organization. Managers use management accounting information to:
  - (i) Develop, communicate, and implement strategies and
  - (ii) Coordinate product design, production, and marketing decisions and evaluate a company’s performance

The above mentioned definitions put forward by the authors sums up the discussion of what management accounting is.

There have been some significant changes during the last few decades, like enhanced global competition, deregulation, growth in the service industries, decline in product life cycles, advances in manufacturing and information technologies, changing dimension of the environmental issues and companies becoming more customer driven to sustain in the competitive environment these issues have changed the fundamental nature of the business environment. These changes have significantly altered the ways in which firms operate, which in turn, have resulted in changes in management accounting practices. In order to survive in today’s competitive environment, companies have had to become more customer driven and have started recognizing that customers are crucial to the success of the companies. This has resulted in companies making customer satisfaction an overriding priority and to focus on identifying and achieving the

<sup>9</sup> Garrison, Noreen and Brewer: Managerial Accounting, 11th Edition, The McGraw–Hill Companies, 2006

<sup>10</sup> This term is synonymously used for management accounting, but some authors offer a distinction between the two terms. For the purpose of this study note the two terms are used interchangeably.

<sup>11</sup> <https://www.studocu.com/in/document/university-of-hull/management-accounting/management-accounting-essay/1530206>.

<sup>12</sup> Horngren, Charles T, Srikant M. Datar and Madhav V. Rajan (2015). Cost accounting: a managerial emphasis, Fifteenth edition.

key success factors that are necessary to be successful in today's competitive environment. Management accounting, which focuses on decision making, is becoming increasingly important as efficient and effective decision making is key to realizing strategic goal which is all important in the new VUCA<sup>13</sup> environment.

### 1.1.3 Scope of Management Accounting

The scope of management accounting is very wide and broad-based. It includes all information which is provided to the management for financial analysis and interpretation of the business operations.

- (i) **Financial Accounting:** Financial accounting though provides historical information but is very useful for future planning and financial forecasting. Designing of a proper financial accounting system is a must for obtaining full control and co-ordination of operations of the business.
- (ii) **Cost Accounting:** It provides various techniques of costing like marginal costing, standard costing, differential and opportunity cost analysis, etc., which play a useful role in operation and control of the business undertakings.
- (iii) **Budgeting and Forecasting:** Forecasting on the various aspects of the business is necessary for budgeting. Budgetary control controls the activities of the business through the operations of budget by comparing the actual with the budgeted figures, finding out the deviations, analysing the deviations in order to pinpoint the responsibility and take remedial action so that adverse things may not happen in future. Both the techniques are necessary for management accountant.
- (iv) **Cost Control Procedures:** These procedures are integral part of the management accounting process and includes inventory control, cost control, labour control, budgetary control and variance analysis, etc.
- (v) **Reporting:** The management accountant is required to submit reports to the management on the various aspects of the undertaking. While reporting, he may use statistical tools for presentation of information as graphs, charts, pictorial presentation, index numbers and other devices in order to make the information more impressive and intelligent.
- (vi) **Methods and Procedures:** It includes in its study all those methods and procedures which help the concern to use its resources in the most efficient and economical manner. It undertakes special cost studies and estimations and reports on cost volume profit relationship under changing circumstances.
- (vii) **Tax Accounting:** It is an integral part of management accounting and includes preparation of income statement, determination of taxable income and filing up the return of income etc.
- (viii) **Internal Financial Control:** Management accounting includes the internal control methods like internal audit, efficient office management, etc.
- (ix) **Interpretation:** Management accounting is closely related to the interpretation of financial data to the management and advising them on decision-making.
- (x) **Office Services:** The management accountant may be required to maintain and control office services in some organizations. This function includes data processing, reporting on best use of mechanical and electronic devices, communication, etc.

<sup>13</sup> VUCA is the abbreviation for volatility, uncertainty, complexity and ambiguity. For details readers may refer to [https://digitalleadership.com/blog/vuca-world/#VUCA\\_stands\\_for%E2%80%A6](https://digitalleadership.com/blog/vuca-world/#VUCA_stands_for%E2%80%A6).

<sup>14</sup> The appraisal of proposed investments of an organisation and their implication for the value of the firm is referred as capital investment decision.

- (xi) **Evaluating the Performance of the Management:** Management accounting provides methods and techniques for evaluating the performance of the management. It evaluates the performance of the management in the light of the objectives of the organisation. Thus, it helps in the implementation of the principle of management by exception.

### 1.1.4 Evolution of Management Accounting

Management accounting is an offshoot of financial accounting and has specific linkages with cost accounting. With advent of time the discipline of Management accounting developed as a faculty and it has evolved as a profession. Financial literature suggest that the beginning of management accounting is linked with the requirement for accounting information to optimize economic resources during the Industrial Revolution in the United Kingdom. Creation of large corporations and increased competition put pressure on corporations to internalize transactions that were previously priced by the market. This is yet another reason for the development of the discipline of management accounting. The International Accounting Federation (IFAC, 1998) has described the evolution of managerial accounting through four phases.

- a) First stage (prior to 1950s)
  - b) Second stage (1950s – 1965)
  - c) Third stage (1965 – 1985)
  - d) Fourth stage (1985 – till date<sup>16</sup>)
- ⊙ The **first stage** (prior to 1950) which is also referred as the ‘classical era’ is the period where the focus was on cost determination and financial control. At this stage, the development of managerial accounting was oriented to determining costs and financial control of business processes. IFAC describes this period of Management accounting as ‘the technical activity needed to achieve organizational objectives. Managerial accounting before the 1950s was mainly focused on determining the cost of the product. Production technology was relatively simple, with products passing through a number of distinct processes. Societies produced relatively homogeneous products that consumed the same amount of resources and identifying the cost of work and material was easy and the processes were driven by the speed of manual operations.
  - ⊙ The **second stage** (1950-1965) is referred as the age of information for management planning and control. During this period the main focus of managerial accounting was to provide information on planning and control issues. This phase is characterized by the use of traditional accounting management techniques that support decision making and responsibility accounting. Management accounting techniques such as: Standard Costs and Profitability Analysis were introduced during this period. The second phase is described as ‘management activity, but in the role of staff<sup>17</sup>. During this period, the management was focused on the company’s production process and internal analysis and paid less attention to external business environment.
  - ⊙ During the **third stage** (1965 - 1985), management accounting focussed on reduction of waste of resources in production processes by eliminating ‘no-value activities<sup>17</sup>. During this period, Japan’s economic progress

<sup>15</sup>: For the purpose of this course, capital investment appraisal which is also referred as capital budgeting is included in Strategic Financial Management (Paper 14).

<sup>16</sup>: Since the stage wise categorisation was published by International Accounting Federation in the year 1998, the fourth stage extended till 2000 in the original document, but in the research paper titled The Development of Cost and Management Accounting: A Historical Perspective, published in European Journal of Humanities and Social Sciences. 34(1), the argument is furthered and the period is given as 2015 which is the year of publication of the paper.

<sup>17</sup>: IFAC. (1998). Management accounting concepts: International Management Accounting Practice Statement. New York.

and rapid technological developments contributed to the growth of global competition. The priority for the companies was to adapt to the new business environment. Companies began to seek both cost reduction and quality improvement at the same time. The use of robotics and computer-controlled processes enabled companies to improve their quality and in many cases impact on cost reduction.

- Creation of value through effective resource use is the epitome of the **Fourth Stage** (1985-2000). During this period, technological innovations were at the forefront and competition was intensified. Companies, as they were faced with major business uncertainties were made to focus on value creation through effective use of resources, which could be achieved ‘with the use of technology that drives companies to create customer value, shareholder value, and organizational innovations’<sup>17</sup>. The managerial accounting techniques that dominated this period are: Activity-based Cost (ABC); Production just in time (JIT); Target cost; balanced scorecard; Value chain analysis and strategic management accounting.

The evolution of management accounting as discussed in the previous lines may be pictorially represented as follows:

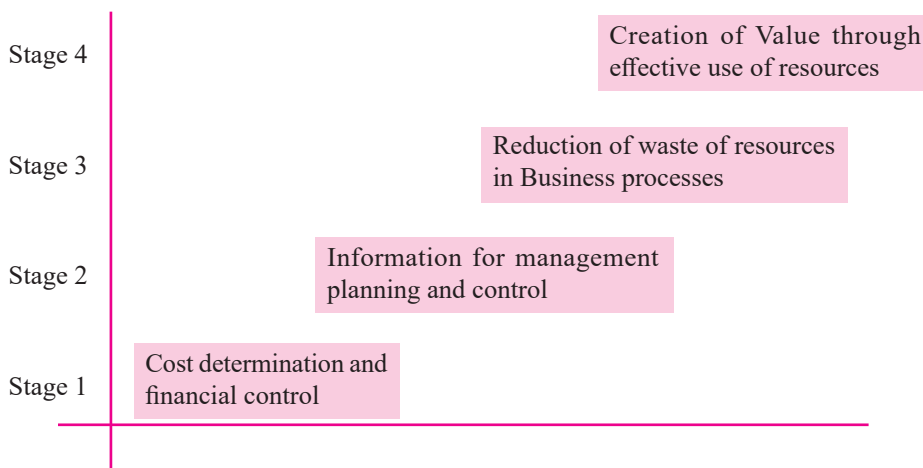


Figure 1.1 Evolution of Managerial Accounting<sup>18</sup>

The distinction between Stage 2, Stage 3 and Stage 4 is the shift of focus from providing information to management in the form of loss reduction to and value creation. The focus on providing information in Stage 2, however, did not disappear, but is refreshed in Stage 3 and 4. Information becomes a resource, along with other organizational resources. Management Accounting in Stage 3 and 4 is seen as, ‘An integral part of the management process because timely information is directly attributed to management and the distinction between staff and management of the first line becomes invisible’<sup>17</sup> (IFAC, 1998). The use of resources to create value today is an essential part of the management process in contemporary organisations.

One very conceptual summarization of the evolution of the various tools and techniques of management accounting is found in the study of Gliubiccas (2012)<sup>19</sup>. The various tools and techniques developed in various stages is being contextualised in the study. In the following lines a pictorial representation is presented which is self-explanatory.

<sup>18</sup> Adopted from Historical Evolution of Managerial Accounting by Vlora Berisha available at <https://www.researchgate.net/publication/344106466>.

<sup>19</sup> Gliubiccas, D. (2012). The Research of Management Accounting Evolution in The Context Of Economic Changes. *Economics and Management*, 17(1), 22–29. Available at <https://doi.org/10.5755/j01.em.17.1.2247>

Focus	Cost determination and financial control	Information for planning and control	Reduction of waste of resource in Business operation	Creation of Value through effective resource use
Stages →	1760 -1950	1950 -1965	1965 -1985	1985 - till date
Methods ↓				
Cost determination and accounting	Cost determination	Standard cost accounting - developments		
	Standard costing	Marginal costing		
	Direct Costing	Target costing		
	Records of cost accounting		Activity based costing	
	allocation of indirect cost		Activity based management	
	Uniform costing			
	Absorption costing			
Planning	Budgeting	Application of discounted cash flow		
		Transfer costing		
Controlling	Return on investments (ROI)	Responsibility accounting	Application of Kaizen	
	ton -mile ratio	Gentani system	Just in time system	
		Kaizen costing		
Strategic analysis			Life Cycle costing	Value chain analysis
				Five Forces Model
				PEST, SWOT analysis
				Customer profitability analysis
				Competitors analysis
				Balanced scorecard

**Table 1.1 Results of the evolution of management accounting [adopted from Gliubiccas (2012)<sup>19</sup>**

It is evident from the above table that till the second stage, more or less traditional management accounting techniques were prevalent but with the advent of the 3<sup>rd</sup> stage and especially in the 4<sup>th</sup> stage the focus shifted to strategic analysis and various contemporary tools and techniques were adopted into the management accounting discipline which primarily focussed on strategic analysis. In the following lines a classification of some of the traditional and contemporary accounting management techniques is presented, which is derived from the discussion.

Traditional Techniques	Contemporary Techniques
Financial statement analysis	Target Cost
Cash Flow analysis	Just in time
Marginal Costing	Total Quality Management
Absorption Costing	Theory of Constraints
Standard Costing	Value chain analysis
Opportunity Cost	Benchmarking
Budgeting	SWOT analysis
Cost-volume-profit (CVP) analysis	Balanced scorecard
Activity based costing (ABC)	Kaizen (continuous improvement)

<sup>20</sup> Gliubic, D. (2012). The Research of Management Accounting Evolution in The Context Of Economic Changes. *Economics and Management*, 17(1), 22–29. Available at <https://doi.org/10.5755/j01.em.17.1.2247>

# Relationship between Management Accounting and Cost Accounting

## 1.2

**F**inancial accounting, cost accounting and management accounting are branches of the discipline of Accounting. Any discussion on management accounting and cost accounting is incomplete if the broader aspect of accounting and the important classification of it, namely financial accounting, is set aside. In the below mentioned lines a comparative analysis of the three branches of accounting is considered. The focus being on Management Accounting and Cost Accounting<sup>21</sup>.

Financial accounting, generally, provides information on financial transactions that have occurred in the past, while management accounting provides financial and non-financial information that influences future decision making. Management accounting is not subject to externally-imposed reporting rules (e.g., provisions of Companies Act, 2013 regarding preparation and presentation of financial statements and Ind AS).

Information provided by management accounting is much more detailed and multidisciplinary than the information generated by financial accounting. Both are part of the overall accounting information system. Financial accounting and management accounting cannot exist independently though they make up two different areas of study. Both the areas of study provide useful accounting information. Financial accounting aids recording of countless transactions, and compare an entity's performance between two or more periods or performance comparison between two entities. In contrast, management accounting helps analyse and evaluate performance, which enables management to make effective judgments regarding the establishment of strategy, plans, and policies for the future.

From the above analysis, the difference between financial accounting and management accounting is obvious as the disciplines are well demarcated. Though the difference between financial accounting and management accounting has been discussed in module 1 of paper 8, it is reiterated below for easy referencing.

The key difference between financial accounting and management accounting is that financial accounting is the preparation of financial reports for the analysis by the external users interested in knowing the company's financial position. In contrast, management accounting is the preparation of financial and non-financial information, which helps managers (internal user) make policies and strategies for the company. The distinguishing features of the two are presented in a tabular format in the next few line.

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.

<sup>21</sup> For an introductory but comprehensive discussion on the issue, students are advised to recapitulate Module 1 of Paper 8.

Basis for Comparison	Financial Accounting	Management Accounting
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.
Statutory requirement	It is legally mandatory to prepare financial accounts of all companies. (for example in the Indian Context Companies Act 2013, relevant rules of Accounting standards furnishes the statutory requirements)	Management accounting has no statutory requirement.
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.

### 1.2.1 Cost Accounting and Management Accounting – a comparative analysis

The difference between cost accounting and management accounting are not so well defined and the demarcation line is not clearly drawn. Management accounting is very closely linked to cost accounting; so closely, in fact, that it is difficult to say where cost accounting ends and where management accounting begins. They overlap with each other. A study of the literature reveals that the distinction between cost accounting and management accounting is not clear cut and the two terms are often used synonymously. But it is apparent that cost accounting deals with the process of cost accumulation for inventory valuation to meet the requirements of external reporting and to some extent, profit measurement as computation of cost and sale price fixation are integral aspects of cost accounting. Whereas management accounting relates to the provision of suitable information for decision-making, planning, control and performance evaluation<sup>22</sup>. Point wise comparison of the cost accounting and management accounting is presented below:

<sup>22</sup> For the purpose of this course, the discipline of cost accounting and the discipline of management accounting is clearly demarcated. Students are introduced to the nuances of cost accounting in Paper 8. While various issues of management accounting are the topic of this paper (Paper 12). The strategic aspects of cost and management accounting is dealt in Paper 16.

Cost Accounting and Management Accounting – A comparison:

- (i) The scope of management accounting is broader than that of cost accounting.
- (ii) It is not legally binding to have cost and management accounting systems installed in the organisations as the information generated by both cost accounting and management accounting are for the use of the internal users only.
- (iii) Cost accounting provides only cost information for managerial use whereas management accounting provides all types of accounting information i.e., cost accounting as well as financial accounting information.
- (iv) In Cost accounting, the main emphasis is on cost ascertainment and cost control whereas in management accounting the main emphasis is on decision-making.
- (v) Cost Accounting is a part of Management Accounting whereas Management accounting is an extension of managerial aspects of cost accounting with the ultimate intention to protect the interests of the business.
- (vi) The tools and techniques of cost accounting and management accounting differs.

A comparative analysis between the two is presented in tabular format in the below mentioned lines:

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

Thus, it may be inferred that management accounting greatly assists the management in achieving better results by making a clear shift in emphasis from mere recording of transactions to an analysis and interpretation of the transactions which provide a new dimension to the management in their decision making efforts. The tools and

<sup>23</sup> In the Indian context, Section 148 (1) of the Companies Act 2013, read with Rule 3 Companies (Cost Records and Audit) Rules, 2014, prescribes maintenance of cost records and statutory cost audit for certain companies engaged in the production of goods or production of services.

techniques of management accounting focuses primarily on formulation of budgets and pre-setting of standards as well as evaluation of deviations in actual performance and also implementation of prompt remedial measures. Management Accounting involves the interpretation of accounting information intended specifically to aid management in running the business. It is concerned with the presentation of accounting information and not with its preparations. Managers use this information in setting the company's overall goals, evaluating the performance of departments and individuals, deciding whether to introduce a new line of products etc. Much of the management accounting information is financial in nature and is prepared in a manner suitable to the making of the decision on the table. Financial information, as such, comprises the largest component of every management information system. The simple reason is that every economic decision involves financial consideration.

# Role of a Management Accountant in Modern Business World

## 1.3

The business world has radically changed from what it used to be a few decades ago and accordingly the role of the management accountant has evolved substantially. The functions of management accountants are dictated by their job positions, agreement with the organisation, knowledge, and capabilities. Before sketching the role of the management accountant in the modern business world, it is pertinent to look into the traditional function of the management accountant which are given in the below mentioned lines.

### 1.3.1 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. Financial analysis of management information is provided by management accountants. This is accomplished through preparing, developing, and analyzing financial data which enables strategic and operational decisions to be made by the organization. The functions of a management accountant can be categorized as below:

- 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.
- i) **Economic appraisal** - When the government makes regular announcements about the country's economic situation, management accountants is entrusted with making the economic study and determine the influence of current economic conditions on the company's operations. They compile a report containing their observations and present it to high management.
- j) **Asset Protection** - Management accountants separate fixed asset registers for each type and provide internal checks and controls to protect the company's assets. They also create the rules and regulations for each type of fixed asset and get insurance coverage for all types of fixed assets.

On the basis of the above discussion it is evident that the role of the management accountant is broad and includes identifying and managing risk, analyzing information, and using it to make plans, and budgets which are cordial to making informed business decisions. The roles of management accountants can be classified as:

- a) To consult with the segments of management responsible for policies and procedures and look into the effectiveness of those policies and procedures.
- b) To make comparisons to the operational plan and standards, as well as to report and evaluate operational outcomes to all levels of management and the business owners.
- c) Establish, coordinate, and execute an adequate plan of operation and control as an inherent aspect of management. Such a plan would include spending budgets, profit planning, sales forecasts, and capital investment and financing program, as well as the procedures necessary to carry out the plan.
- d) To ensure the financial security of the company's assets through effective internal controls and adequate insurance coverages.

### 1.3.2 The Management Accountant and the Modern Business World

The word 'modern' is a misnomer and cannot be defined precisely. So is the concept of 'modern business world'. It is ever changing and cannot be precisely set within a time frame. As such, the era of globalization may be considered as a not-so-precise definition of the 'modern business world'. The term 'globalization' was proposed for the first time in 1983, by Theodore Levitt<sup>24</sup>, when he talked about the convergence of the markets around the world. The International Monetary Fund defined globalization as the 'growing economic interdependence of countries worldwide through increasing volume and variety of cross-border transactions in goods and services, free international capital flows and also more rapid and widespread diffusion of technology'<sup>25</sup>. Thus, cross border transaction of goods and services or free trade, free international capital flows and diffusion of technology may be considered as the three pillars of globalisation. With the emergence of globalization, more and more companies started going global by undertaking business activities across their national frontiers.

Under the circumstances there has been a paradigm shift in the role of the management accountant in the era of globalisation. The focus shifted to strategic analysis. This ushered in the fourth stage of the evolution of management accounting (this is discussed in previous section of this module). It is observed that conventional management

<sup>24</sup> Professor Theodore Levitt was a former professor at the Harvard Business School is credited with coining the term 'globalization'. (<https://www.nytimes.com/2006/07/06/business/06levitt.html>)

<sup>25</sup> Ayuba, A. (2012) The Roles and Responsibilities of Management Accountants in the Era of Globalization.

accounting of the earlier stages did not provide the financial information required to monitor existing strategies or support strategy formulation. Strategic management accounting seeks to remedy this situation by providing the financial analysis to support the formulation of successful competitive strategies. On the basis of this there was severe criticism regarding the use of management accounting in the business. Authors have opined that most of the management accounting practices used, were actually developed by 1925, and for the next 60 years there was a slowdown, or even a halt, in management accounting innovation. Thus, the third stage is often referred as the period of lost relevance<sup>8</sup>. In response to the criticisms, the CIMA Report<sup>26</sup> identified strategic management accounting as a potential area of development that would enhance the future contribution of management accounting. They identified the need for management accounting to adopt a more strategic perspective by reporting information relating to a firm's markets and its competitors.

Globalisation brought about significant changes in the business environment. Along with the changes the roles of the management accountant had to be redefined. In the following lines some of the impacts of the new business environment on management accounting is discussed:

- 1. Global competition** - Prior to the era of globalisation, many organizations operated in a protected competitive environment. Globalisation 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. The new competitive environment has increased the demand for information relating to quality and customer satisfaction. Customer profitability analysis and value analysis are important issues being incorporated in the arena of management accounting.
- 2. 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. In this respect, the management accountant plays a crucial role as in order to compete successfully, companies must be able to manage their costs effectively at the design stage, have the capability to adapt to new environment, different and changing customer requirements and reduce the time to market of new and modified products.
- 3. 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. Some internationally reputed manufacturing companies have responded to these by replacing traditional production systems with lean manufacturing systems that seek to reduce waste by implementing just-in-time (JIT) production systems, focusing on quality, simplifying processes and focussing on advanced manufacturing technologies (AMTs).
- 4. 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. The role of the management accountant as a gatherer and processor of information is lost as the managers can directly access the management accounting system on their personal computers to derive the information they require for decision making. Management accountants have now become more involved in interpreting the information generated from the accounting system and providing business support for managers.

<sup>26</sup>. Authored by Bromwich and Bhimani (1989)

**5. Environmental and sustainability issues** – In recent times, ESG<sup>27</sup> 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 this issues then they were a decade back. Thus, there is 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. Management accounting with specific focus on environmental issues is becoming increasingly important in organizations as environmental costs are large in many organisations. There are three specific reasons for this:

- ▲ Environmental costs are often high in the many manufacturing organisations.
- ▲ Regulatory requirements often impose huge fines for non-compliance.
- ▲ Companies are increasingly realizing that being socially and environmentally responsible improves their image and this has positive impact on their bottom line.

The above mentioned changes impacted the management of the companies and the managers have realized that they need to develop system for measuring and reporting environmental costs along with preparation of detailed report on the consumption of scarce environmental resources, hazardous materials used and pollutants emitted to the environment.

**6. 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. Thus trivial attention was given to developing management accounting systems that accurately measured the costs and profitability of individual products or services. Globalization ushered in the privatization and deregulation which resulted in the elimination of pricing and competitive restrictions. Thus, companies were compelled to design an elaborate management accounting system that made them to realize their cost base and determine the source of profitability for their products, customers and markets.

**7. Focus on value creation** – The scope of management accounting is enormous. Managers who are in charge of the operations of the organisations depends 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. Though cost reduction still remains as the basic function of the management accountant as it has specific impact on selling price fixation which impacts customer value. The new business environment resulted in management accounting distinguishing between value-added and non-value-added activities.

There is another aspect of new business paradigm which the management accountant has to consider as they develop the company’s management accounting system. Intangibles<sup>28</sup> have increased manifold. This presents a challenge to management accountants as to how to identify, measure and report on the value of intangibles.

**8. Customer orientation** – In the new business environment, gaining competitive advantage<sup>29</sup> has become the

<sup>27</sup> Environmental, social, and governance (ESG) criteria are a set of standards for a company’s behaviour used by socially conscious investors to screen potential investments. Environmental criteria consider how a company safeguards the environment, including corporate policies addressing climate change.

<sup>28</sup> Resources at the disposal of an enterprise are either tangible or intangible. With the advent of time, the proportion of intangible resources has increased manifold. According to a report in the past few years due to rapid change in the technology, intangible resources have become more important and the ratio has increased from 37% to 63% whereas for tangible assets it has decreased from 67% to 34%. (<https://www.ukessays.com/essays/marketing/intangible-resources-are-important-marketing-essay.php>)

<sup>29</sup> A competitive advantage is an attribute that enables a company to outperform its competitors. This allows a company to achieve superior margins compared to its competition and generates value for the company and its shareholders. (<https://corporatefinanceinstitute.com/resources/knowledge/strategy/competitive-advantage/>)

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. This has made the companies realize that customer satisfaction is one of the most important critical success factor (CSF) which helps companies realize their strategic goal. Customer satisfaction is relational to cost, quality, reliability, delivery and the choice of innovative new products.

Discussion made in this section regarding the role of the management accountant in the new business world is reflected in the developments in the arena of management accounting during the fourth stage in the evolution of management accounting (Creation of Value through effective resource use) which ushered in after 1985. This is discussed at length in the previous section of this module. The focus has shifted to strategic analysis. Thus the two collides and the newer tools and techniques which are aligned to the value chain and are thus relational to the attainment of the strategic goal of the organisation have changed the focus of management accounting to strategic management accounting.

## EXERCISE

### Theoretical Questions

#### ⊙ Multiple Choice Questions

- 1) Management Accounting
  - A. Accumulates, summarizes and analyses the available data.
  - B. Is primarily concerned with the requirements of the management.
  - C. Makes Corporate Planning and Strategy effective.
  - D. All of the above
- 2) Management accounting can be viewed as \_\_\_\_\_.
  - A. Marketing-oriented Accounting
  - B. Management-oriented Accounting
  - C. Accounting-oriented Management
  - D. Manager-oriented Accounting
- 3) The main objective of management accounting is \_\_\_\_\_.
  - A. To maintain the accounting records
  - B. To know the amount due from customers and suppliers
  - C. To ascertain analyse and interpret the results of business operations
  - D. To record all the business transactions
- 4) \_\_\_\_\_ is the study of managerial aspects of financial accounting
  - A. Cost accounting
  - B. Financial accounting
  - C. Management accounting
  - D. Business accounting
- 5) The purpose of management accounting is to help \_\_\_\_\_ make decisions
  - A. Managers
  - B. Investors
  - C. Marketers
  - D. Banks
- 6) Management accounting assists the management in \_\_\_\_\_.
  - A. Planning
  - B. Directing
  - C. Controlling
  - D. All of the above

- 7) 'Period of lost relevance' is the \_\_\_\_\_ of the evolution of management accounting.
- A. 1<sup>st</sup> stage
  - B. 2<sup>nd</sup> stage
  - C. 3<sup>rd</sup> stage
  - D. 4<sup>th</sup> stage
- 8) Creation of value through effective use of resources is the focus area of the \_\_\_\_\_
- A. 1<sup>st</sup> stage
  - B. 2<sup>nd</sup> stage
  - C. 3<sup>rd</sup> stage
  - D. 4<sup>th</sup> stage
- 9) Just in time management and Activity based costing developed during the \_\_\_\_\_
- A. 1<sup>st</sup> stage
  - B. 2<sup>nd</sup> stage
  - C. 3<sup>rd</sup> stage
  - D. 4<sup>th</sup> stage
- 10) Management accounting deals with \_\_\_\_\_ data
- A. Qualitative
  - B. Quantitative
  - C. Both qualitative and quantitative
  - D. Non-financial
- 11) Which personnel of a financial firm play a key role in management accounting?
- A. Investors
  - B. Managers
  - C. Suppliers
  - D. Customers
- 12) What are the instruments/ tools related to management accounting?
- A. Marginal costing
  - B. Standard costing
  - C. Budget control
  - D. All of the above
- 13) Where is management accounting applied?
- A. Small trading organisations
  - B. NPOs

- C. Cooperative societies
  - D. Large industrial and trading organizations
- 14) Which of the following options is not characteristic of management accounting?
- A. Future-oriented
  - B. Accounting information
  - C. Compulsory accounting.
  - D. Management oriented
- 15) Who stated the definition of management accounting as “Management Accounting is concerned with accounting information which is useful to management”?
- A. Robert Anthony
  - B. Michael Porter
  - C. J. Batty
  - D. James H Bliss
- 16) Management accounting is used as .....
- A. Compulsory
  - B. Optional
  - C. Mandatory
  - D. Any of the above

**Answer:**

**1-D; 2-B; 3-C; 4-C; 5-A; 6-D; 7-C; 8-D; 9-C; 10-C; 11-B; 12-D; 13-D; 14-C; 15-A; 16-B;**

⊙ **State True or False**

- 1) Management Accounting is primarily not concerned with the requirements of the management.
- 2) One of the main characteristic of Management Accounting is cause and effect analysis
- 3) Management accounting is mainly past oriented.
- 4) The primary objective of management accounting is to manage company account and improves sales.
- 5) Key success factors- also known as competitive emphasis.
- 6) Benchmarking is a process of measuring the performance of a company’s products, services, or processes against those of another business considered to be the best in the industry.
- 7) In organizations, there are typically three levels of management: top-level, middle-level, and first-level.
- 8) Management accounting concentrates on post-mortem analysis.
- 9) Management Accounting is concerned with the adjustment in the value of assets, and of profit in the light of changes in the price level.

- 10) Management accounting furnishes useful accounting data and statistical information for the decision – making process.
- 11) Management Accounting is not based on double - entry system.
- 12) Evaluation and control of performance is not a limitation of Management accounting.
- 13) Deregulation- the act or process of removing legislative controls or restrictions from an industry, commodity, etc.

**Answer:**

**1-False; 2-True; 3-False; 4-False; 5-True; 6-True; 7-True; 8-False; 9-False; 10-True; 11-True; 12-True; 13-True;**

### ◎ Fill in the blanks

- 1) Lean manufacturing systems that seek to reduce waste by implementing \_\_\_\_\_ production systems and focussing on \_\_\_\_\_
- 2) There has been a paradigm shift in the role of the management accountant in the era of globalisation. The focus shifted to \_\_\_\_\_
- 3) Management accounting ensued with the simple aspect of \_\_\_\_\_
- 4) Strategic management accounting provides the financial analysis to support the formulation of successful \_\_\_\_\_.
- 5) \_\_\_\_\_ criteria are a set of standards for a company’s behaviour used by socially conscious investors to screen potential investments
- 6) Financial \_\_\_\_\_ ensures effective utilization of available financial resources in the long period.
- 7) The important objective of \_\_\_\_\_ accounting is to organize the accumulated financial data into meaningful information.

**Answer:**

- 1) just-in-time (JIT) production systems, advanced manufacturing technologies (AMTs), 2) strategic analysis
- 3) Cost determination and financial control, 4) competitive strategies, 5) Environmental, social, and governance (ESG), 6) Management, 7) Management.

### ◎ Short Essay Type Questions

- 1) Mention two point of difference between cost accounting and management accounting
- 2) identify and describe the elements involved in the decision-making, planning and control process.
- 3) Justify the view that a major objective of commercial organizations is to broadly seek to maximize future profits.
- 4) Explain the important changes that have taken place in the business environment that have influenced management accounting practice.
- 5) Outline the key success factors that directly affect customer satisfaction.

- 6) Identify and describe the functions of a cost and management accounting system.

### ◎ Essay Type Questions

- 1) Identify and describe the different users of accounting information.
- 2) Describe the differences between management accounting and financial accounting.
- 3) Though management accounting is very closely linked to cost accounting, there is clear demarcation between the two – elucidate.
- 4) Explain each of the elements of the decision-making, planning and control process.
- 5) Explain how the business environment that businesses face has changed over the past decades and discuss.
- 6) Elucidate the various functions of management accounting.
- 7) Do you think management accounting help in planning and forecasting?
- 8) Management accounting is the accounting system for making decisions of the business enterprise – Discuss.
- 9) Management accounting serves as a tool to management – elucidate.
- 10) Write note on the four stages of evolution of management accounting.
- 11) Compare and contrast between the tools and techniques used in traditional and contemporary management accounting.
- 12) Identify current trends in management accounting.

### ◎ Unsolved Case<sup>30</sup>

Medical devices are normally associated with use by hospitals and medical practices. Some devices are used by normal consumers and, according to an article on the Medical Device and Diagnostic Industry website are proliferating<sup>31</sup>. The market for devices such as insulin pumps and blood pressure monitors has become more consumer-driven and is putting pressure on manufacturers to design better products and get them to the market faster. According to the article, ‘patients want their medical devices to have the same kind of design and appeals as iPods’. This convergence of medical and mass consumer electronics is creating many challenges for medical device manufacturers. These challenges include widely divergent product life cycles, varying scenarios of use and safety, and efficacy concerns. The typical life cycle of a consumer device is likely to be measured more in months than years. Compare this to the long approval cycles of drug and medical device regulatory authorities – which, according to the article<sup>32</sup>, can be anything from 27 to 36 months in the USA depending on the type of medical device. During this timeframe, an iPod/iPad has probably gone through at least two generations, and smart devices are now the norm. It may be that medical devices will never get as savvy as a consumer iPad due to regulatory concerns and device efficacy. However, increasing consumer-driven requirements are likely to shorten the product life cycle over coming years as devices move further towards personal smart devices. As of April 2016, for example, a Financial Times<sup>31</sup> article notes there are more than 1,65,000 health and fitness apps available at the Apple App Store. While Apple’s devices are not medical devices they do pose a competitive threat.

<sup>30</sup> The case is adopted from Management and Cost Accounting, 10th Edition by Colin Drury.

<sup>31</sup> mddiadmin (2009) Developing medical devices in a consumer-driven market, MDDI, 1 February. Available at [www.mddionline.com/article/developing-medical-devices-consumer-driven-market](http://www.mddionline.com/article/developing-medical-devices-consumer-driven-market)

<sup>32</sup> Financial Times (2016) Healthcare apps battle to be taken seriously. Available at [www.ft.com/content/ed3268f2-e620-11e5-a09b-1f8b0d268c39](http://www.ft.com/content/ed3268f2-e620-11e5-a09b-1f8b0d268c39)

**Questions**

- a) Do you think the costs of the electronic components in a smart device such as an iPod/iPad are more or less than those in a medical device like a blood pressure monitor?
- b) Would decreasing the product life cycle of medical devices, or medical devices being more like consumer electronics, pose any risks for manufacturers?