***B.COM 4th SEMESTER (NON-CBCS)***

***COST AND MANAGEMENT ACCOUNTING (MANAGEMENT MAJOR)***

***PAPER - 405***

***GROUP- B: MANAGEMENT ACCOUNTING***

***UNIT – IV***

***INTRODUCTION TO MANAGEMENT ACCOUNTING***

**MEANING AND DEFINITION OF MANAGEMENT ACCOUNTING**

**Management Accounting (MA) -**  Management Accounting is the presentation of accounting information in such a way as to assist the management in the creation of policy and the day-to-day operation of an undertaking. Thus, it relates to the use of accounting data collected with the help of financial accounting and cost accounting for the purpose of policy formulation, planning, control, evaluation of performance and decision-making by the management.

* “Management Accounting is a system of collection and presentation of relevant economic information relating to an enterprise for planning, controlling and decision-making.”
* **Institute of Cost Accountants of India**
* “Management Accounting is concerned with accounting information that is useful to management.”
* **Robert N. Anthony**

**NATURE OF MANAGEMENT ACCOUNTING**

Management Accounting is that part of accounting which facilitates the management process of decision making. Hence, it has the following characteristics or nature:

1. **Decision Making System** – It provides information to the management which assists it in the creation of policy and day-to-day operations of the undertaking.
2. **Systematic Approach to Planning and Control** – It provides information to the management for a system of setting standards, plans or targets and reporting variances between planned and actual performance for corrective plans.
3. **Futuristic in Nature** – It helps the management to evaluate future through the use of standard costs and budgets.
4. **Providing Data** – It provides accounting data for projection and planning future.
5. **Providing tools and techniques** – It provides various tools and techniques for control of business operations, improvement of overall efficiency in using economic resources and maximization of profit.
6. **Cause and Effect Relationship** – It shows cause and effect relationship through variance analysis technique and enables the management in taking remedial measures.

**SCOPE OF MANAGEMENT ACCOUNTING**

The main concern of management accounting is to provide necessary quantitative and qualitative information to the management for planning and control. For this purpose it draws out information from accounting as well as non-accounting sources.

Hence, its scope is quite vast and it includes within its fold almost all aspects of business operations. However, the following areas may rightly be pointed out as lying within the scope of management accounting.

**i. Financial Accounting:** The major function of management accounting is the rearrangement or modification of data. Financial accounting provides the very basis for such a function. Hence, management accounting cannot obtain full control and coordination of operations without a well-designed financial accounting system.

**ii. Cost Accounting:** Planning, decision-making and control are the basic managerial functions. The cost accounting system provides necessary tools such as standard costing, budgetary control, inventory control, marginal costing, and differential costing etc., for carrying out such functions efficiently. Hence, cost accounting is considered a necessary adjunct of management accounting.

**iii. Budgeting and Forecasting:** Budgeting and forecasting measures and expresses the plans, policies and goals of an enterprise for a definite period. Management accountant helps the departmental heads in preparing their respective budgets and their execution.

**iv. Statistical Methods:** Statistical tools such as graph, charts, diagrams and index numbers etc., make the information more impressive and comprehensive. Other tools such as time series, regression analysis, sampling techniques etc., are highly useful for planning and forecasting.

**v. Analysis and Interpretation**: Accounting data are analyzed and interpreted and are made understandable and useable to the management in order to enable it to fix responsibilities and to bring about necessary changes in the organization.

**vi. Taxation:** This includes computation of income tax as per tax laws and regulations, filing of returns and making tax payments. In recent times, it also includes tax planning.

**vii. Organization and Methods [O&M]:**O&M deal with organizations reducing cost and improving the efficiency of accounting, as also of office systems, procedures, and operations etc.

**viii. Office Services**: This includes maintenance of proper data processing and other office management services, communication and best use of latest mechanical devices.

**ix. Law:** Most of the management decisions have to be taken in a legal environment where the requirements of a number of statutory provisions or regulations are to be fulfilled.

Some of the Acts, which have their influence on management decisions, are as The Companies Act, MRTP Act, FEMA, SEBI Regulations, etc.

**x. Internal Audit:** This includes the development of a suitable system of internal audit for internal control.

**xi. Internal Reporting:** This includes the preparation of quarterly, half yearly, and other interim reports and income statements, cash flow and funds flow statements, scarp reports, etc.

**OJECTIVES OF MANAGEMENT ACCOUNTING**

The primary objective of management accounting is to enable the management to maximize profits or minimize losses. This is done through the presentation of statements in such a way that management is able to take correct policy decisions. The following are the important objectives of management accounting:

1. **Planning and Formulation of Future Policies:** Management accounting assists management in planning the activities of the business. Planning is deciding in advance what is to be done, when it is to be done, how it is to be done and by whom it is to be done. It involves forecasting on the basis of available information, setting goals, framing policies, determining the alternative courses of actions and deciding on the programme of activities to be undertaken. This forecasting is based on facts. Facts are provided by past accounts on which forecast of future transactions is made. Management accounting helps management in its function of planning through the process of budgetary control.
2. **Helps in the Interpretation of Financial Information**: Accounting is a technical subject and may not be easily understandable by everyone till the user has a good knowledge of the subject. Management may not be able to use the accounting information in its raw form due to lack of knowledge of accounting techniques. Management accountant presents the information in an intelligible and non-technical manner. This will help the management in interpreting the financial data, evaluating alternative courses of action available and guiding the management in taking decisions and having the most desired financial results.
3. **Helps in Controlling Performance**: Management accounting is a useful device of managerial control. The whole organisation is divided into responsibility centres and each centre is put under the charge of one responsible person. He will be associated with the planning and framing of the budgets and be required to execute the plans and standards and deviations are analyzed in order to pinpoint the responsibility.

Thus, management accountant helps in controlling the performance of the different responsibility centres and take suitable actions in order to correct the adverse deviations by revising the budgets if need be. Management accounting assists management in location of weak spots and in taking corrective actions against such spots which are not in conformity with the budgeted performance. Thus, management accounting helps management in discharging its control function successfully through budgetary control and standard costing.

1. **Helps in Coordinating Operations**: Management accounting helps the management in co-coordinating the activities of the concern by getting prepared functional budgets in the first instance and then co-coordinating the whole activities of the concern by integrating all functional budgets into one known as master budget. Thus, management accounting is a useful tool in co­ordinating the various operations of the business.
2. **Reporting to Management**: One of the primary objectives of management accounting is to keep the management fully informed about the latest position of the concern. This helps management in taking proper and timely decisions. The management is kept informed through regular financial and other reports. The performance of various departments is also regularly communicated to the top management.
3. **Helps in Motivating Employees**: The managementaccountant by setting goals, planning the best and economical course of action and then measuring the performance tries his best to increase the effectiveness of the organisation and thereby motivate the members of the organisation.
4. **Communicating Up-to-date Information**: Management accounting assists management in communicating the financial facts about the enterprise to the persons who are interested in these facts so that they may be guided to a line of action to be pursued. Management needs information for taking decisions and for evaluating performance of the business. The required information can be made available to the management by means of reports which are an integral part of the management accounting. Reports are means of communication of facts which should be brought to the notice of various levels of management so that they may be guided for taking suitable action for the purposes of control.

**FUNCTIONS OF MANAGEMENT ACCOUNTING IN DECISION MAKING**

Management Accounting is closely associated with the process of management control. Management control is the process of arranging resources and using them effectively in the accomplishment of an organization’s objective. The basic function of management accounting is to assist the management in performing its functions effectively. Thus management accounting function includes all activities associated with collecting, processing, interpreting and presenting data to the management in the process of decision making i.e. the planning, coordination and in control. It includes the following functions:

1. **Planning and Forecasting** - Management fixes various targets to b e achieved by the business in future. Planning and forecasting are essential. They can help greatly in this process through various techniques such as budgeting, standard costing, fund flow statement, profitability trend analysis, etc. Thus it helps the management in short-term and long-term forecasts and planning the future operation of the business.
2. **Modification of Data** - Financial accounting as such is not suitable for managerial decision making and control purposes. Management accounting modifies the available financial and cost accounting data by re-arranging them in such a way that they become easily understandable and useful to the management. Example: if sales data are required, they can be classified according to product, area or season wise or type of customer wise.
3. **Financial Analysis and Interpretation** - Accounting data are analyzed and interpreted meaningfully for effective planning and decision making. Interpretation is the most important function of the management accounting. Financial data are expressed in technical terms and the top management very often does not understand them in their raw form. Management accounting selects the useful data, analyses it and presents the interpretation before the management in a non-technical manner along with comments and suggestions. Thus analysis and interpretation of data are considered as backbone of management accounting.
4. **Communication** – Management accounting is the important medium of communication. Different levels of management, such as top, middle and lower levels, need different types of information and the management accounting provides them with necessary information as and when they need.
5. **Facilitating Management control** – Management accounting provides to the management various techniques for the purpose of controlling performance. As for example, standards of various departments and individuals are set up. Actual performances are compared with standards and deviations are calculated. These deviations are analyzed, causes are found out and responsibilities are fixed. This analysis report known as performance report is presented to the management for its controlling purpose.
6. **Use of Qualitative Information** – Financial data alone are not sufficient for decision making purposes. Qualitative data has strategic impact on decision making process and management accounting provides relevant qualitative information to the management to use it along with quantitative information taken from financial accounting. As for example- in making sales budget, not only the past performance is considered but also the quality of the sales personnel is also equally taken into consideration.

Thus management accounting provides to the management engineering records, case studies, special service, productivity reports, etc. for its consideration.

1. **Decision Making** – Management accounting analyses and ranks different proposals on the basis of their profitability and submits the appraisal report to the management for investment decision. Thus it ensures the efficient use of scare resources of an enterprise.
2. **Co-ordination** - Co-ordination is an important part of management control. Management accountant acts as a coordinator among the different functional departments. It is done through budgeting and performance appraisal reports. Thus it facilitates the management to direct all department activities towards the common goal.

**TOOLS AND TECHNIQUES OF MANAGEMENT ACCOUNTING**

The various tools and techniques used in management accounting for assisting the management in decision making are discussed below:

1. **Financial Planning** –Financial planning involves determining both long-term and short-term financial objectives of an enterprise, formulating financial policies and developing financial procedures to achieve the objectives. Thus management has to take strategic decisions like – fund raising, fund allocation, capital structuring, etc. Management accounting provides techniques for such financial planning.
2. **Analysis of Financial Statements** – Analysis and interpretation of financial statement are an attempt to determine the significance and meaning of financial statement so that a forecast may be made of the prospects for future earning ability to pay debts and probability of a sound dividend policy. Techniques used are comparative financial statement, ratios, funds flow statement, trend analysis, etc.
3. **Historical Cost Accounting** – Financial accounting records actual costs which are used in operating a standard costing system and determining variance.
4. **Standard Costing** – It is an important tool of cost control. It involves the preparation of standard costs, their comparison with the actual costs and analysis of the differences. It is also necessary for performance appraisal.
5. **Budgetary Control** – It is a system where budgets are used as a tool for planning and control. Functional budgets are prepared on the basis of actual data and future possibilities. They are compared with the actual performance and differences are analyzed for corrective actions.
6. **Marginal Costing** – It is a method of costing which is concerned with the change in costs resulting from the change in volume of production. It is concerned with variable costs. It is used in utilizing idle capacity in maximizing profits or maximizing loss.
7. **Decision Accounting** – Decision making is the primary function of the top management. It involves a choice from various alternatives. Decision accounting assesses the profitability of various proposals. It facilitates the correct selection of a proposal.
8. **Revaluation/Replacement Accounting** – Preserving of capital is an important object of management. Profits are to be calculated in such way that capital is preserved in real terms. Revaluation accounting is used to denote the method employed for overcoming the problems connected with fixed assets replacement in a period of rising prices. It ensures proper utilization of funds in capital assets.
9. **Control Accounting** – It refers to different systems of control devices such as standard costing, budgetary control, internal check, internal audit etc. Management accounting evaluates departmental performances through these devices and submits reports to the relevant levels of management for taking appropriate actions where necessary.

## DIFFERENCE BETWEEN COST ACCOUNTING AND MANAGEMENT ACCOUNTING

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| **BASIS OF COMPARISON** | **COST ACCOUNTING** | **MANAGEMENT ACCOUNTING** |
| **Meaning** | **The recording, classifying and summarizing of cost data of an organisation is known as cost accounting.** | **The accounting in which the both financial and non-financial information are provided to managers is known as Management Accounting.** |
| **Information Type** | **Quantitative.** | **Quantitative and Qualitative.** |
| **Objective** | **Ascertainment of cost of production.** | **Providing information to managers to set goals and forecast strategies.** |
| **Specific Procedure** | **Yes** | **No** |
| **Recording** | **Records past and present data** | **It gives more stress on the analysis of future projections.** |
| **Planning** | **Short range planning** | **Short range and long range planning** |
| **Interdependency** | **Can be installed without management accounting.** | **Cannot be installed without cost accounting.** |

**DIFFERENCE BETWEEN FINANCIAL ACCOUNTING AND MANAGEMENT ACCOUNTING**

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| **BASIS FOR COMPARISON** | **FINANCIAL ACCOUNTING** | **MANAGEMENT ACCOUNTING** |
| **Meaning** | **Financial Accounting is an accounting system that focuses on the preparation of financial statement of an organization to provide the financial information to the interested parties.** | **The accounting system which provides relevant information to the managers to make policies, plans and strategies for running the business effectively is known as Management Accounting.** |
| **Is is compulsory?** | **Yes** | **No** |
| **Information** | **Monetary information only.** | **Monetary and non-monetary information** |
| **Objective** | **To provide financial information to outsiders.** | **To assist the management in planning and decision making process by providing detailed information on various matters.** |
| **Format** | **Specified** | **Not specified** |
| **Time Frame** | **Financial Statements are prepared at the end of the accounting period which is usually one year.** | **The reports are prepared as per the need and requirements of the organization.** |
| **User** | **Internal and external parties** | **Only internal management.** |
| **Reports** | **Summarized Reports about the financial position of the organization** | **Complete and Detailed reports regarding various information.** |
| **Publishing and auditing** | **Required to be published and audited by statutory auditors** | **Neither published nor audited by statutory auditors.** |

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