

# UNIT-1

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## Objectives of the Unit

- To understand the meaning of Management Accounting and its applications.
- To be familiar with the characteristics, uses, advantages, merits, functions, etc. of Management Accounting
- To gain better insight in to various aspects of Management Accounting
- To have knowledge of the concept of Management Accounting and its comparison with Financial Accounting and Cost Accounting
- To understand the role of Management Accountant for economic growth and development

### Structure

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- 1.2 Meaning
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- 1.4 Characteristics of Management Accounting
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## 1.1 Introduction

In today's complex business environment a manager has to take timely and good decisions to lead the business into profits and by having competitive edge over its competitors, consolidates the financial positions of the business organization and in this way he not only runs the business efficiently and effectively but also fulfills the corporate social responsibility towards various stakeholders of the business such as owners, managers, employees, bankers, creditors, customers, Govt., and society, etc. The decisions can be good only if they are based on true, fair and timely information. If the decisions are not based on correct information or no information then there are chances of having them as wrong decisions. Hence every good organization has an information system to assist the management at different levels in decision making by providing information from various sources.

## 1.2 Meaning

Management Accounting which is also known as Accounting for Managers is a process of collecting information (both qualitative and quantitative) from various sources such as Financial Accounting, Cost Accounting, Tax Accounting, Human Resource Accounting, etc. selecting the important ones out of the total, analyzing them with the help of certain tools or techniques and then pass on to the management for taking decisions in the interest of the organization and the parties interested into it. Therefore it can be said that the Management Accounting is selective in nature where only important information are supplied to the management which have been collected from different sources. The management takes both routine and strategical decisions with the help of the information. Actually the Management Accounting works two ways – one the management is capable of knowing each and every thing about its organization, finds out the strong and weak points and accordingly takes decisions for grabbing the opportunities available to the organization in the external environment by facing the challenges and on the other hand the performance of the management can also be evaluated by various stakeholders during a particular time period by going through the financial statements of the organization.

## 1.3 Definition

The Management Accounting has been defined by various scholars/authorities from time to time. The following are some important definitions of Management Accounting:

- The Institute of Chartered Accountants of England and Wales. "Any form of accounting which enables a business to be conducted more efficiently can be regarded as Management Accounting".
- Anglo-American Council on Productivity. "Management Accounting is the presentation of accounting information in such a way as to assist management in the creation of policy and the day to day operation of any undertaking".
- R.N. Anthony. "Management Accounting is concerned with accounting information that is useful to management".
- J. Batty. "Management Accounting is the terms used to describe the account methods, systems and techniques which, coupled with special knowledge and ability, assist management in the task

of maximizing profits or minimizing losses”.

- Chartered Institute of Management Accountants, London. “Management Accounting is the application of professional knowledge and skill in the preparation of accounting information in such a way as to assist management in the formation of policies and in the planning and control of the operations of the undertaking”.
- Association of Certified and Corporate Accountants. “Management Accounting is the application of accounting and statistical techniques to the specified purpose of producing and interpreting information designed to assist management in its functions of promoting maximum efficiency and in envisaging, formulating and co-coordinating their execution”.

## 1.4 Characteristics of Management Accounting

On the basis of the meaning and definitions, the following are the main characteristics of Management Accounting:

- Future Oriented:** Under Management Accounting various information from different sources are collected and passed on to the management to take decisions. The management decides the future courses of actions based on the information and try to attain the same by adopting various suitable controlling techniques such as marginal costing, standard costing and budgetary control system, etc.
- Talent Based:** The concept of Management Accounting is totally based on the talent or abilities of management and no defined set rules/procedures are there to assist the managers. After analyzing the available information, the managers have to take decisions which are totally based on their personal experience, education, knowledge and wisdom.
- Rationale behind Decisions:** When the decisions are taken by the management on the basis of information, the same is needed to be explained as to why and how these decisions are taken by giving suitable arguments and cause and effect relationship of the future outcomes.
- Selective:** A lot of quantitative and qualitative information are collected under the process of Management Accounting but after the appropriate study of the same only a selective/important information are passed on to the concerned manager so that he/she may take appropriate decision in the interest of the organization. Therefore it can be said that all information collected are not used for taking decisions by the management.
- Means Not the End:** Under the concept of Management Accounting, the information are collected and supplied only by the Management Accountant to the management for taking timely and good decisions, therefore it is clear from the above that decisions are not provided to the management but only the required/important information. Hence Management Accounting is a means and not an end or substitute of the management.
- Tools/Techniques:** After collecting the data from various sources, the management accountant uses various statistical tools/techniques to study the same and to select the information to be handed over to the managers for taking decisions.

- vii) **Planning and Controlling:** Under Management Accounting the information are collected from various sources, analyzed and decisions are made for future to run the business effectively. To decide about the future course of action for the attainment of predetermined goals or objectives is known as planning. The decision are implement and actual performance is measured which is compared with the estimated performance. The differences/deviations are calculated and corrective measures are taken for the accomplishment of the objectives. Hence it can be said that Management Accounting helps not only in planning but also in controlling the business activities of an organization.

## 1.5 Principles of Management Accounting

Management Accounting is based on the following principles:

1. **Business Entity:** According to this principle, the business organization is a separate entity in comparison to its stakeholders like, owners, managers, workers, creditors, government, bankers and society, etc. and decisions are made for business only.
2. **Objectivity over Subjectivity:** It is thought that various statements and reports under Management Accounting are prepared objectively which are free from personal biases of individuals or managers. Hence, it works on the principle of objectivity over subjectivity.
3. **Permanency:** It is presumed under Management Accounting that the practices, procedures and methods, etc. will remain the same and generally no changes are made in them until it is necessary to do so for the sake of scientific comparisons and decision making. It is also known as the principle of consistency.
4. **Classification of costs:** This principle of Management Accounting divides the costs into normal and abnormal costs. The normal costs are bound to happen in every case but they need to be controlled. The abnormal costs are the costs which happen due to uncontrollable factors like, natural calamities, fire or theft, etc.
5. **Flexibility over Rigidity:** The methods or systems adopted under Management Accounting should be flexible which may be changed as per changed circumstances and not the rigid ones which become useless in alternate conditions.
6. **Surplus:** Under this principle of Management Accounting, the systems should be used only up to the extent they prove to be profitable for the organization. They should be abandoned or changed as soon as they become unprofitable for the business.
7. **Management by Exception:** It's a principle of control used by Management Accounting according to which the actual performance of individuals is compared with the targeted performance and if negative deviations are observed, the corrective or remedial actions are initiated. But in case of no deviation, no actions are recommended.
8. **Forward looking:** This principle of Management Accounting helps in making forecasts regarding the future of the firm and is tried to make it more efficient and profitable.

9. **Optimum use of resources:** This principle of Management Accounting ensures the best possible use of scarce available resources by controlling the wastages or leakages.
10. **Information:** This principle says that the information should be collected, analyzed, interpreted and presented to the management with the help of an authentic source having a minimum cost.
11. **Nature of costs:** This principle of Management Accounting underlines the need of differentiation between controllable and uncontrollable cost by the concerned managers.
12. **Principle of Prudence:** This principle is also known as the principle of conservatism where all future possible losses should be treated as the losses while all future possible gains or profits should not be considered until they are received. This principle helps in bringing about more efficiency in the organization.

## 1.6 Techniques or Tools of Management Accounting

The following are the main tools or techniques of Management Accounting:

1. **Common-size Statements:** Common-size statements are the statements under which the items of financial statements (Income Statement and Balance Sheet, etc.) are converted into percentage by taking a common base which is equal to 100. After that, percentage of individual items is calculated by dividing it by the total and multiplying by 100. For example, the cost of machinery in the Balance Sheet may be Rs. 1 lakh and the total of asset side Rs. 10 lakh, then machinery is 10 per cent of the total assets. In this way, various items of financial statement may be compared year-over-year through common-size statement.
2. **Comparative Statements:** Comparative Income Statement and Balance Sheet are prepared under Management Accounting to see the changes of items therein over a period of two years and increase or decrease is calculated in absolute terms and then in percentages; so that the management may note the changes and their impact on the financial position of the firm and make take the decisions accordingly.
3. **Ratio Analysis:** To study the financial statements seriously and systematically with the help of ratios is known as ratio-analysis. The profitability, financial position (short-term and long-term) and the pace of the business is ascertained with the help of profitability, Balance Sheet ratios and with the help of turnover ratios, respectively.
4. **Trend Analysis:** The possibility of happening or non-happening of something in the long-run is known as the trend and to study the same statistically is known as trend analysis. The trends may be increasing, decreasing, constant or fluctuating. The study of trend helps the management significantly in taking the decisions regarding the business organization.
5. **Cash Flow Statement:** It is a statement prepared in the end of the financial year to see the changes in cash position in between two dates (In the beginning and in the end of the financial year) by taking into consideration operating, financing and investing activities. The cash which is

thought to be the life blood of a business organization can better be managed with the help of cash flow statement.

6. **Funds Flow Statement:** It is a statement to be prepared in the end of the financial year to know the changes in working capital in between two dates (In the beginning and in the end of the financial year). It helps in the better management of working capital by observing the uses and applications of funds.
7. **Standard Costing:** It is a cost controlling technique where the standards (benchmarks) are fixed for various elements of cost (Material, labour and expenses), the same are implemented or executed and the actual performance is measured. Then the actual performance is compared with the standard performance and deviations/ changes/ differences are noted down which may be favourable or adverse and consequently the remedial actions are taken by the management for the better performance.
8. **Budgetary Control:** It is also a cost controlling technique adopted by Management Accounting where different business activities are controlled with the help of budgets. Under the technique, the budgets are prepared and implemented for different activities of the organization, actual performance is compared with the budgeted performance and deviations are noted down which may be favourable or adverse and consequently the corrective actions are taken by the management for the better performance.
9. **Marginal Costing:** Marginal costing is also a cost controlling technique which takes into consideration only the variable or marginal cost while taking decisions by the management. The fixed cost is put aside as non-controllable cost. The contribution is calculated by subtracting the variable cost from sales and break-even point is calculated with the help of the same by dividing fixed cost with contribution per unit or profit-volume ratio. Break-even point is a point of sales of a business where there is no profit no loss.
10. **Responsibility Accounting:** It is an important technique used by Management Accounting where the performance of management is accessed on the basis of the work assigned and the actual performance of the individuals. It helps in fixing the responsibility and accountability of individual manager which helps in increasing the overall efficiency of the organization.

### 1.7 Objectives/Uses/Merits/Purposes/Advantages of Management Accounting

When someone puts a question before you as why do you eat the food or what are the objectives/uses/Merits/Purposes/Advantages of eating the food, most probably your answer will be the same in every case. Hence when we have to give the objectives, uses, merits, purposes and advantages of Management Accounting, the same things are to be explained every time but definitely according to the language of the question. The following are the main Objectives/Uses/Merits/Purposes/Advantages of Management Accounting:

- i) **Prompt and Good Decisions:** Any decision which is taken without having information may prove to be wrong but alternatively the decisions based on correct and timely information generally helps the organization in leading towards good directions. Since under Management Accounting information are collected from various sources and the important ones are sent to the managers for taking decisions. In this way it becomes easier for management in taking good and timely decisions by assessing the strong and weak points of their own organizations and threats and opportunities of the external environment.
- ii) **Increase in Profits:** Under Management Accounting the relevant data from financial statements is collected, analyzed and interpreted to the management so that proper planning and control may be adopted at appropriate level of activity/activities to boost the profits of the organizations which is the ultimate objective of an organization.
- iii) **Strong Financial Position:** Through Management Accounting it is possible to enhance the financial position of the business organization in the form of sound capital based, surged reserve and surplus, etc. by controlling or avoiding the wasteful activities.
- iv) **Cost Control:** The success of any business organization depends on the cost control up to a great extent and it is the Management Accounting which helps in doing the same by providing correct and timely information regarding various business activities and hence by adopting a judicious planning and controlling system, the leakages/wastages are reduced to the minimum which helps in increasing the net income of the organization.
- v) **Competitive Selling Price:** Since the Management Accounting helps in controlling the cost of goods or services of the organization by having a better control on various elements of costs such as material, labour and expenses consequently the total cost of the products remains at low and therefore it is easy and comfortable to decide a low selling price by adding sufficient profits to the cost in comparison to the products of competitors.
- vi) **More Revenue Generation:** It is the law of demand which says that the demand of the product increases having low selling price and vice-versa. It is possible for the business organization to keep the selling price at low level in comparison to its competitors by adopting the technique of Management Accounting which helps in increasing the sales of the organization resulting into the more revenue generation.
- vii) **Expansion and Modernization:** The cost control with the help of Management Accounting results into high revenue generation and profits. It gradually consolidates the financial position of the business organization with enlarged capital based. With the availability of surplus funds in the hands of the organization it becomes easy to expand the business activities by adopting latest technology. The concept can easily be understood by taking example of Maruti Udyog Ltd. which started its operations by producing a single car (Maruti

800) during 1980s and now it has diversified its activities with latest technology and having variety of products. It is India's largest Car Manufacturer and Leader in the area now a day.

- viii) **More Employment Generation:** The profit making organizations are bound to be strong financially over the period of time as explained earlier. It further leads to the expansion and modernization where more manpower is needed by the organization to cope with the enhanced capacity. Therefore more employees are added to the existing strength of the human resource of the organization. In this way it is clear that by adopting Management Accounting system we can generate more employment opportunities in the economy.
- ix) **Helps in Removing Poverty:** By creating more demand for human resource through increased economic activities, employment opportunities are created which result into elevation of the poverty from the economy. Therefore the Management Accounting technique is a great help in resolving the issue of poverty through expansion of business activities.
- x) **Better Standards of Living:** It is evident from the above discussion that the Management Accounting not only helps in removing of poverty but also helps in generating employment opportunities which ultimately helps the people around to have better food, clothing and housing facilities. In this way the standard of living of the society improves significantly.
- xi) **Overall Economic Growth and Development:** It is definite that more and more organizations are adopting globally the concept of Management Accounting for last couple of decades due to the merits of the system which result into several benefits such as reduced cost, increased revenues/profits, a better financial position, expansion of business activities, etc. Therefore it can safely be said that it is the Management Accounting technique which helps substantially in increasing the economic activities of the respective organizations and consequently the respective economy in which such type of organizations are operating.
- xii) **Proper Utilization of Resources:** The resources of the organization are always scares which are never to be wasted or misutilized for the sake of the good health of the organization. It is the Management Accounting technique which ensures the best possible use of limited resources by controlling the undesired activities or wastages.
- xiii) **Increases the Efficiency:** To do or perform a task or work in the best possible manner with the help of the available resources is known as efficiency. It is the Management Accounting which ensures better efficiency by providing legitimate and timely information clubbed with suitable statistical techniques and hence helping in taking good decisions at different levels of management.
- xiv) **Enhanced Goodwill:** The goodwill is the good name and fame of a business organization which is earned through efficient and effective business operations which lead the business into profits and sound financial position. The Management Accounting helps the management in doing so and hence result into the increase in the goodwill of the organization.



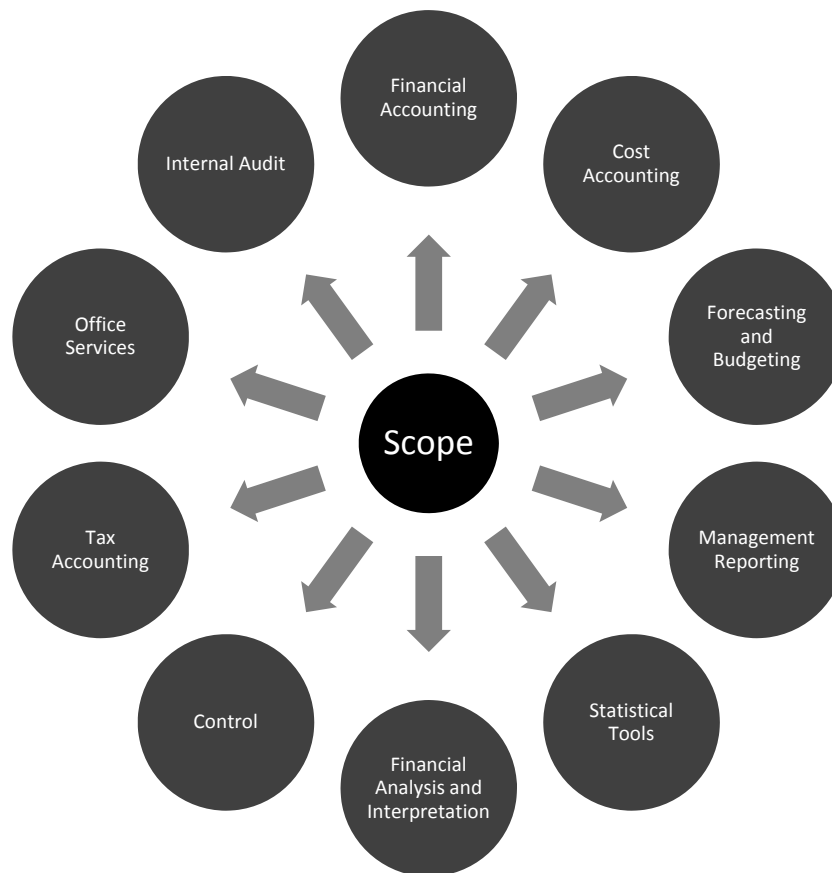
- xv) **Consumer Satisfaction:** A consumer feels more satisfied if he gets the products or services of his choice at reasonable price and having good quality. The modern business organizations are doing the same with the help of Management Accounting to satisfy their customers.
- xvi) **Cooperation and Coordination:** The management accountant reports the strong and weak points of the organization to the management at various levels. If there is lack of cooperation and coordination among the employees or activities of the organization, the same may be rectified by introducing the revised concept of cooperation and coordination.
- xvii) **Better Communication:** With the help of the information received from the management accountant, the management may take decisions regarding better communication among employees sitting at various levels, if it is needed to do so, in general interest of the organization by removing various bottlenecks in the way of effective communication.

## 1.8 Scope of Management Accounting

Scope covers the area of operations for performing a particular task. As under Management Accounting the management accountant has to gather the quantitative and qualitative information from various sources which further enables him in selecting the important ones to be sent to the management for making appropriate decisions. All the sources from where such information is collected constitute the scope of the Management Accounting which includes the following:

- i) **Financial Accounting:** The financial accounting is a process of identifying, recording, classifying, summarizing, analyzing and interpreting the financial results of a business organization. It is also known as art and science. Under financial accounting, the financial statements in the form of income statements, financial statements, etc. are prepared to impart various information to different stakeholders of the business organization and which are duly audited and certified by the auditor of the concern. Therefore, the important information is derived from the financial accounting for the help of the management.
- ii) **Cost Accounting:** The cost accounting is a process of calculating cost of goods or services by using different methods or techniques. It determines the total cost of the product and the selling price by adding sufficient profit into it. It also includes the cost controlling techniques such as budgetary control, marginal costing, standard costing, etc. The management accountant collects information from the cost accounting from time to time and supplies the same to the management.
- iii) **Budgeting and Forecasting:** Budgeting is a process of preparing budgets by taking various steps for the attainment of predetermined objectives while forecasting is an

### Scope of Management Accounting



estimation regarding long future for making assessment of future opportunities and threats available for the organization. The management accountant derives information out of budgeting and forecasting from time to time which he thinks are important for the organization and decisions are required to be made in this respect by the management.

- iv) **Management Reporting System:** It is a system which is adopted and implemented by modern organizations these days for free and prompt information sharing so that the required updating is brought about and the management get ready to transform the organization and its structure to cope with the changes in the internal and external environments. The management accountant also takes help of Management Reporting System to have information for the managers.
- v) **Tax Accounting:** Every business organization has tax liabilities which are calculated, planned and paid from time to time. The tax laws have a tendency of fast changes year or year due to tax authorities or the concerned Govt. The management accountant derives information from tax accounting system for managers so that they can take appropriate decisions for tax planning and controlling.

- vi) **Human Resource Accounting:** It is that branch of accounting which maintains records of the employees/human resource of an organization right from the date of their joining the organization and up to their retirement/death/leaving the organization. Every aspect regarding the employees is taken care of such as the wages or salaries paid to them, expenses incurred on their training, growth and development, the value of human resource based on their expertise, knowledge and talent, etc. As the human resource is the most important resource of any organization, therefore by having information regarding the same the management can make better plans regarding its utilization for the benefit of the organization.
- vii) **Financial Analysis:** The data collected from various sources are studied with the help of appropriate statistical techniques such as mean, mode, median, CAGR, Ratios, common size statements, trends, break-even point, etc. so as to draw the conclusions for further decisions making. The results so derived are also presented with the help of graphs, diagrams, etc. to make them more understandable.
- viii) **Interpretation:** Interpretation is the expression of financial results in simple language which are derived after making the analysis of financial statements to the various stakeholders including the management. After having the simple explanation regarding a problem or results the management may take corrective actions for vaulting the performance of the organization.
- ix) **Audit:** The financial statements (Income Statement and Balance Sheet, etc.) of the organization are checked and verified by the auditors and they issue the certificate regarding their true and fair nature. In this way the authentic information can be had from the financial statements for making decisions.
- x) **Internet/Print Media:** These days a lot of information are taken from the internet or print media regarding the latest developments in business or economic environment of a country and hence it helps the management in taking the appropriate decisions to cope up with the changing environment.

## 1.9 Meaning of Financial Accounting

Financial Accounting is a process of identifying, recording, classifying, summarizing, analyzing and interpreting the financial results of a business organization. It is also known as art and science.

### 1.10 Meaning of Art

To do/performance something (task, activity, work, etc.) in the best possible manner by applying theoretical knowledge into practical

### 1.11 Meaning of Science

Science is a systemized knowledge based on certain principles which explain the cause and effect relationship and are universally testable /applicable.

## 1.12 Features/Characteristics of Accounting

1. **Recording of Financial transactions:** there may be two types of transactions- qualitative and quantitative. Since, the qualitative transactions or events are not measurable in to the terms of money; therefore, they are not recorded under accounting for example, honesty, dishonesty,

loyalty, hard working, etc. They affect the business environment and the performance but as they cannot be measured, they find no place in the books of accounts. On the other hand, the transactions which can be measured in terms of money such as, purchase or sales of goods or assets, payments of expenses, receipt of incomes, etc. are recorded into the books of accounts.

2. **Recording is based on certain principles:** The recording of monetary business transactions is made on the basis of principles of double entry system throughout the globe. The transactions are classified into personal, real and nominal accounts and are recorded on the basis of rules framed for each type of accounts under the system. They are recorded date-wise and systematically.
3. **Classification:** the recorded transactions in the books of original entry (Journal) are posted to ledger accounts (Ledger) on the basis of their individual nature. In this way, different accounts are prepared to know the exact balances to/from be paid or received from various parties of the business organization.
4. **Summary:** Under accounting, in the end of the financial year a summary is prepared in the form of financial statements (Income Statement, Balance Sheet, etc) to know the profitability, short-term and long-term financial position and other important information regarding business organization.
5. **Analysis:** After the preparation of summary of financial transactions in the form of financial statements, the same (financial statements) are studied seriously and systematically with the help of certain tools or techniques so as to reach on certain results or conclusions, is known as financial analysis which is an integral part of financial accounting.
6. **Interpretation of results:** After making analysis by the financial analyst of the financial statements, the results are expressed in simple language to the various stakeholders of the business organization so that after having the related information they make take their own decisions to protect their individual interests.
7. **Accounting is an Art:** Under accounting, the business records and books are maintained in such a manner so that the business results may be found out accurately without any problem or mistake. To do something in the best possible manner by theoretical knowledge into practical is known as art and because same is applied in doing accounting therefore, it is said that accounting is an art.
8. **Accounting is science:** Science is a systematized knowledge based on certain principles which explain the relationship between cause and effect and are universally applicable and acceptable. Similarly, the accounting is also a systematized knowledge based on the principles of double entry system which are applicable and accepted universally; hence, it can safely be said that accounting is a science also.

### 1.13 Advantages/ Objectives/Functions/ Merits/ Uses of Accounting

The following are the various uses/ advantages/ objectives/ merits of accounting

1. **Complete and systematic records:** First of all, the financial transactions of a business organization are identified and then recorded into the books of accounts systematically. In this

way, a complete record of all the financial transactions is prepared completely with all sorts of awareness and same provide the basis for running the business properly without committing mistakes.

2. **Ascertainment of profit or loss:** The profit or losses are the main indicators of success or failure of the business organization. Therefore, they are calculated by every business organization regularly without failure. It is the second important function of accounting to calculate the profit or loss of the business organization by preparing a summary of business transactions in the form of Profit and Loss Account or Income Statement and the same is shared with various parties interested in a business organization as an important information.
3. **Finding out the financial position:** Accounting performs another important function by finding out the short-term and long-term financial position of a business organization by preparing Balance Sheet in the end of every financial year and the same is communicated as important information to various stakeholders.
4. **Detection of errors/ mistakes:** Under financial accounting, a statement is prepared with the help of the balances of different types of accounts in the end of the financial year which is known as Trial Balance to detect different types of mathematical errors, if any. In this way, it scans the accounts to purify them.
5. **Provides information to stakeholders:** It is one more important function of accounting to prepare information and imparting the same with various stakeholders (owners, managers, employees, customers, bankers, competitors, government, society, etc.) of the business organization to fulfil their respective requirements of having the same.
6. **Helps in decision making:** The management is responsible for taking decisions and running the business into profits with a sound financial position. The decisions are thought to be better and rationalized if they are based on the correct and timely information. The accounting system provides the same to the management and helps them in taking good and timely decisions to run the business smoothly.
7. **Legal formalities:** Under the provisions of various acts of a particular nation, all sorts of business organizations (particularly registered ones) are to prepare the books of accounts legally and have to get them audited and further the important information in the form of annual reports are submitted with the competent authorities as compliance of the law.

## 1.14 Limitations of Accounting

The accounting is having certain limitations, which are as follows:

1. **Personal Biases:** The principles of accounting are not so pure as they are in case of exact sciences (Physics, Chemistry, etc) and hence, there remains a scope of making judgment by a person to introduce his own views into the system and hence, the results are affected as per his will which defeats the purpose of having pure accounting information on the basis of which the planning and decisions are to be made for the proper functioning of the organization.

2. **Application of concepts and conventions:** The accounting system is based on various concepts and conventions which compel the accountants to present the things as per their requirements which sometimes mislead the person who is having the information under the accounting system for example, the assets are shown in the Balance Sheet at their book value and not at their market value as per the requirement of going concern concept.
3. **Incomplete in nature:** The accounting system deals only with the financial transactions which are measurable into the terms of money but never takes into consideration the work environment, value system, honesty, dishonesty, loyalty and hardworking of employees and shirking of work, etc. which affects the performance of the organization up to a great extent but, they are of qualitative nature and hence, never become a part of the accounting system which remain incomplete in this way.
4. **Historical Cost:** The accounting system records only the original cost of the assets and the same are depicted through the financial statements which may mislead the users of financial statements in making decisions.
5. **Window dressing:** Sometimes, the accounts in the form of financial statements are changed or fabricated purposefully to show-off the profitability or financial position better though actually it is not to have the favor from the various stakeholders by misinforming them as was done several years back by Satyam Computers Ltd. In India.

### 1.15 Meaning of Cost Accounting

The cost accounting is a process of calculating cost of goods or services by using different methods or techniques. It determines the total cost of the product and the selling price by adding sufficient profit into it. It also includes the cost controlling techniques such as budgetary control, marginal costing, standard costing, etc.

### 1.16 Objectives/Advantages/Uses/Functions of Cost Accounting

1. **Helps in finding out cost of production:** Under cost accounting, we prepare cost sheet to find out different types of costs such as, prime cost, works cost, cost of production and total cost, etc. and by dividing the above said costs by the number of units produced, we are able to find out the cost per unit.
2. **Determination of selling price:** It is easy to fix the selling price if we have the total cost of the goods or services produced by an organization by adding into it the reasonable profit as per the circumstances. In this way, the cost accounting helps the management in the determination of selling price of goods or services.
3. **Cost control:** To control the cost of goods or services produced by an organization one must have details regarding the elements of cost and their uses. There are cost accounting techniques such as, budgetary control system, standard costing and marginal costing, etc which help the management in controlling the cost of the products.

4. **Decision making:** The decisions are bound to be good if they are based on true and fair information. The cost accounting system provides the necessary information to the management from time-to-time which helps the management in taking good and timely decisions in the interest of the organization.
5. **Framing policies:** The accounting information derived from the cost accounting system helps the management in framing and reframing the production policies which serve as the guidelines for the management and the workers for the better performance.
6. **Strong and weak points:** By maintaining a cost accounting system, the management is capable of having information regarding the strong and weak points of the organization and by controlling the weak points and improving the strong ones, they are able to control the wastages and high costs of products and consequently able to produce good quality products at cheaper rates.
7. **Better allocation of resources:** The resources are always scarce and are not to be wasted. The management can ensure the optimum use of resources by using cost accounting system.
8. **Profitability and financial position:** By controlling the cost and optimum use of resources through cost accounting system, the management is able to increase the profits of a business organization year-over-year which also helps in the consolidation of the financial position of the business organization in long-run.

### 1.17 Difference between Financial Accounting and Management Accounting

Basis of difference	Financial Accounting	Management Accounting
<b>Approach</b>	It adopts the backward looking approach i.e. focuses on past events or activities	It adopts the forward looking approach i.e. focuses on the projection for future events or activities
<b>Users</b>	Here information are intended to assist outside users such as shareholders, government, creditors, etc.	Here information are meant for insiders i.e. management, owners, etc.
<b>Static</b>	It provides a static picture of the organisational activities	It provides a non-static view of the organisational activities
<b>Structure</b>	There is defined structure for reporting financial information	There is no defined format for reporting management information. Format varies with the usage of management information.
<b>Performance</b>	It provides information of whole organisation	It provides information of particular product/segment/business/department.
<b>Criterion</b>	Here information is meant to be fair and true	Here information is meant to be useful for management in making decision
<b>Compulsory</b>	Reporting of financial information is	Reporting of management information

	mandatory under the statute	is completely optional. There is no statutory obligation
<b>Promptness</b>	There is no urgency of reporting financial information	Prompt reporting is required for taking timely decision
<b>Rules framers</b>	Outside body regulate the reporting of financial information through enactment of laws and issuance of rules and regulations	Management formulates rules that fit its needs/pre-requisite
<b>Content nature</b>	It reports information of monetary nature	It reports information of monetary as well as non-monetary nature
<b>Users</b>	Here users are large and diverse	Here users size is small
<b>Regulations</b>	Financial information is communicated through financial statement by following GAAP	There are no such principles and rules that govern reporting of management information
<b>Frequency of reporting</b>	Here reporting is quarterly and annually	Here reporting frequency varies with requirement of management
<b>Precision of information</b>	Information is accurate and precise, under the financial accounting	There are many approximation in Management Accounting

### 1.18 Difference between Management Accounting and Cost Accounting

<b>Management Accounting</b>	<b>Cost Accounting</b>
It developed due to the limitations of the Cost Accounting	It developed due to the limitations of the financial accounting
Its scope is broader than Cost Accounting	Its scope is narrow than Management Accounting
It gets its information from Cost Accounting and Financial Accounting, etc.	It get its information from Financial Accounting
It involves short-term as well as long-term planning decisions	It only involves short-term planning decisions

### 1.19 Pre-requisites of Successful Management Accounting System

The following are the preconditions to be adopted by an organization to make the Management Accounting a success;

- i) **Team Work:** The persons who are the part of the team of management accountant in performing the Management Accounting must have a feeling of cooperation, help, and faith among all for having better results.
- ii) **Well Expressed Objectives and Policies:** The objectives and policies of the organization must be well defined and communicated to each member of the organization for the better implementation of the plans and easy accomplishment of organizational objectives.



- iii) **Effective Accounting System:** As most of the information is collected by management accountant from the accounting system of the organization itself hence the accounting system must be well maintained and sound this may provide authentic and timely information for better decision making.
- iv) **Humanity:** The men should be treated as human beings by the management in the organization who are performing the act of Management Accounting and not the machines. Their feelings sentiments, suggestions, complaints, incentives, motivates, etc. should be taken care of always for having good results.
- v) **Sound Management Reporting System:** Under Management Accounting important information are collected and shared continuously by the management accountant. If the management information system is good and having sufficient infrastructural facilities then better results are expected in comparison to the system having flaws.
- vi) **Forward Looking:** It is necessary to have a foresightedness forward looking approach of the management capable of scanning and analyzing the business environment for a successful Management Accounting system.
- vii) **Performance Appraisal:** The work done by the management accountant and his team must continuously be appraised from time to time to have better results.

## 1.20 Limitations of Management Accounting

Limitations do not mean necessarily the disadvantages of something but they are the limits beyond which that system will not be operating. The following are the main limitations of the Management Accounting:

- i) **Wide Scope:** Since the Management Accounting gathers information from many sources such as financial accounting, cost accounting, tax accounting, statistics, sociology, psychology, etc. which is a very big area. To have insight and such a big area and to understand it is a difficult task for anyone. Therefore some times, some information may be missing due to the lack of knowledge on the part of the management accountant.
- ii) **Emerging Area:** The Management Accounting is comparatively an emerging area of management where there is a possibility of introduction of new approach, new or modified principles and procedures, etc. Hence it can be said that there is a further scope of Management Accounting in the times to come and it has not yet been exploited fully.
- iii) **Change in the Organization:** It is necessary to make required changes for adopting Management Accounting in an organization which are generally opposed by its employees as per the human nature. This attitude of employees is to be tackled with very carefully while implementing the concept of Management Accounting.
- iv) **Expensive:** To adopt and implement the Management Accounting system is costly affair as requires a team of experts with necessary equipment in form of technology. Therefore small organizations can not adopt it due to small budget.

- v) **Personal Bias:** Sometimes the persons working under the Management Accounting system do not follow the rules or results of the analysis made with the help of statistical tools and take decisions on the basis of their personal whims and judgment but putting aside the principles of management which may affect adversely the fortunes of the organization.
- vi) **Not a substitute of Management:** The Management Accounting is a tool used by management in making better decisions which should not be confused as a substitute of management.

### 1.21 Management Accountant

The management accountant or the management controller or comptroller is a senior executive of an organization and is the head of the Management Accounting team. He is responsible for collecting information from within and outside the business organization which are analyzed further and the concrete results are shared with the management to take prompt and timely decisions for the growth and development of the organization.

### 1.22 Functions of Management Accountant

- Collection of data.
- Transcribing the collected data to make it more meaningful.
- Analyzing the data with appropriate techniques.
- Interpretation of results.
- Preparation of Reports.
- Sharing the reports with management.

### 1.23 Questions for Practice

#### Short Answer Type Questions

1. What do you understand by Management Accounting?
2. Explain the scope of Management Accounting.
3. What are the functions of Management Accounting?
4. Elucidate the functions of management accountant?
5. Define the objectives of Management Accounting.
6. Outline the limitations of Management Accounting.

#### Long Answer Type Questions

1. Elucidate the meaning, scope, objectives and limitations of Management Accounting.
2. “Management Accounting is the presentation of accounting information in such a way as to help the management in the creation of policy and in the day to day operation of the concern”, explain this statement.
3. “The past is history, the future is planning.” Explain this quotation from the point of view of management.
4. Explain various tool and techniques of Management Accounting and also give its advantages.

5. What are the role and responsibilities of management accountant?
6. What do you understand by Management Accounting? What are the difference among Management Accounting

**Suggested Readings:-**

1. J.K. Aggarwal, R.K. Aggarwal, M.L. Sharma – Accounting for Managerial Decisions– Ramesh Book Depot, Jaipur.
2. R. Kishore–Advance Management Accounting–Taxman allied Services Pvt. Ltd.
3. M.Y. Khan, P.K. Jain–Management Accounting–Tata McGraw Hill
4. Horngren, Sundem, Stratton–Introduction to Management Accounting–Pearson Education
5. S.N. Mittal–Accounting & Financial Management – Shree Mahavir Book Depot, Nai Sarak, New Delhi.
6. Anthony, Robat N., Hawkins and Merchant Management Ac.