# NOTES

# MANAGEMENT ACCOUNTING & CONTROL

# RMB205

**CONCEPT OF MANAGEMENT ACCOUNTING:** Management Accounting is a new approach to accounting. The term Management Accounting is composed of two words — Management and Accounting. It refers to Accounting for the Management.

## MANAGEMENT ACCOUNTING – DEFINITION

Different authorities have provided different definitions for the term 'Management Accounting'. Some of them are as under:

"Management Accounting is concerned with accounting information, which is useful to the management". — Robert N. Anthony

"Management Accounting is concerned with the efficient management of a business through the presentation to management of such information that will facilitate efficient planning and control". —Brown and Howard

"Any form of Accounting which enables a business to be conducted more efficiently can be regarded as Management Accounting" — The Institute of Chartered Accountants of England and Wales

The Certified Institute of Management Accountants (CIMA) of UK defines the term 'Management Accounting' in the following manner:

"Management Accounting is an integral part of management concerned with identifying, presenting and interpreting information for:

1. Formulating strategy
2. Planning and controlling activities
3. Decision taking
4. Optimizing the use of resources
5. disclosure to shareholders and others, external to the entity
6. disclosure to employees
7. safeguarding assets

From the above definitions, the management accounting is concerned with that accounting information, which is useful to the management. The accounting information is rearranged in such a manner and provided to the top management for effective control to achieve the goals of business. Thus, management accounting is concerned with data collection from internal and external sources, analyzing, processing, interpreting, and communicating information for use, within the organization, so that management can more effectively plan, make decisions, and control operations. The information to be collected and analysed has been extended to its competitors in the industry. This provides more meaningful clues for proper decision-making in the right direction.

The information in the management accounting system is used for three different purposes:

1. Measurement

2. Control and

3. Decision-making

## OBJECTIVES OF MANAGEMENT ACCOUNTING

The basic objectives of management Accounting are to help management in the creation of policy and regular operation of the business. It provides relevant accounting information to the management for use in planning, organising, decision- making and control at the appropriate time.

The main objectives of management accounting may be enumerated as follows:

1. Providing management with accounting, costing, and other statistical data for use in planning and decision- making

2. Computing and presenting to the management the financial results of alternative courses of action to decide on the best alternative

3. Translating the management plans covering all financial activities of business

4. Verifying the figures for business activities to judge consistency and practicability for need of revision of plans, if any

5. Financial interpretation of plans to pinpoint individual responsibilities

6. Measuring actual performance against standards, and reporting the results of the operations to the appropriate level of management

7. Measuring and reporting on the effectiveness of the enterprise

## ROLE OF MANAGEMENT ACCOUNTING IN MANAGEMENT PROCESS

An enterprise would operate, successfully, if it directs all its resources and efforts to accomplish its specified objective in a planner manner, rather than reacting to events.

Organisation must be both efficient and effective. Organisation is effective when the planned objective is achieved. However, the firm is efficient only when the objective is achieved, with minimum cost and resources, both in physical and monetary terms. The role of Management Accounting is significant in making the firm both efficient and effective. Management Accounting has brought out clear shift in the objective of accounting. From mere recording of transactions, the emphasis is on analyzing and interpreting to help the management to secure better results. In this way, Management Accounting eliminates intuition, which is not at all dependable, from the field of business management to the cause and effect approach.

The basic functions of management are:

1. Planning,

2. Organising,

3. Controlling,

4. Decision-making and

5. Staffing

Management accounting plays a vital role in the managerial functions performed by the managers.

(1) Planning: Planning is the real beginning of any activity. Planning establishes the objectives of the firm and decides the course of action to achieve it. It is concerned with formulating short-term and long-term plans to achieve a particular end. Planning is a statement of what should be done, how it should be done and when it should be done. While planning, management accountant uses various techniques such as budgeting, standard costing, marginal costing etc for fixing targets. For example, if a firm determines to achieve a particular level of profit, it has to plan how to reach the target. What products are to be sold and at what prices? The Management Accountant develops the data that helps managers to identify more profitable products. What are the different ways to improve the existing profits by 25%? Management Accounting throws various alternatives to achieve the goal.

(2) Organising: Organising is a process of establishing the organizational framework and assigning responsibility to people working in the organization for achieving business goals and objectives. The organizational structure may not be the same in all organizations, some may have centralized, while others may be decentralized structures. The management accountant may prepare reports on product lines, based on which managers can decide whether to add or eliminate a product line in the current product mix.

(3) Controlling: Control is the process of monitoring, measuring, evaluating and correcting actual results to ensure that a firm's goals and plans are achieved. Control is achieved through the process of feedback. Feedback allows the managers to allow the operations continue as they are or take corrective action, by some rearranging or correcting at midstream. The use of performance and control reports serve the function of controlling. For example, a production supervisor may receive weekly or daily performance reports, comparing actual material cost with planed costs. Significant variances can be isolated for corrective action. In the normal course, periodical reports are submitted, appraising the performance against the targets set. Reports for action are given to the top management, following the principle of management by exception. Performance and control reports do not tell managers what to do. These feedback reports identify, where attention is needed to help managers to determine the required course of action.

(4) Decision-making: Decision-making is a process of choosing among competing alternatives. Decision-making is inherent in all the above three functions of management-planning, organizing and controlling. There may be different methods or objectives. The manager can plan or choose only one of the competing plans. Similarly, in organizing, decision can be made whether the organizational structure should be centralized or decentralized. In control function, manager can decide whether variance is worthy to investigate or not.

(5) Staffing: Staffing is the process of recruitment, selection, development, training, compensation and overseeing employee in an organisation. Staffing, like all other managerial functions, is the duty which is vest on the management to perform. The role of the management accounting in this regard is manning the entity structure through proper and effective selection, appraisal, and development of the personnel to fill the role assigned to the employer. Moreover, the management accountants have to reduce the labour turnover and to control the overall employee cost.

**FUNCTIONS OF MANAGEMENT ACCOUNTING**

The primary objective of Management Accounting is to maximize profits or minimize losses. This is done through the presentation of statements in such a way that the management is able to take corrective policy or decision. The manner in which the Management Accountant satisfies the various needs of management is described as follows:

(1) Storehouse of Reliable Data: Management wants reliable data for Planning, Forecasting and Decision-making. Management accounting collects the data from various sources and stores the information for appropriate use, as and when needed. Though the main source of data is financial statements, Management Accounting is not restricted to the use of monetary data only. While preparing a sales budget, the management accountant uses the past data of the products sold from the financial records and makes projections based on the consumer surveys, population figures and other reliable information to estimate the sales budget. So, management accounting uses qualitative information, unlike financial accounting, for preparing its reports, collecting and modifying the data for the specific purpose.

(2) Modification and Presentation of Data: Data collected from financial statements and other sources is not readily understandable to the management. The data is modified and presented to the management in such a way that it is useful to the management. If sales data is required, it can be classified according to product, geographical area, season-wise, type of customers and time taken by them for making payments. Similarly, if production figures are needed, these can be classified according to product, quality, and time taken for manufacturing process. Management Accountant modifies the data according to the requirements of the management for each specific issue to be resolved.

(3) Communication and Coordination: Targets are communicated to the different departments for their achievement. Coordination among the different departments is essential for the success of the organisation. The targets and performances of different departments are communicated to the concerned departments to increase the efficiency of the various sections, thereby increasing the profitability of the firm. Variance analysis is an important tool to bring the necessary matters to the attention of the concerned to exercise control and achieve the desired results.

(4) Financial Analysis and Interpretation: Management accounting helps in strategic decision making. Top managerial executives may lack technical knowledge. For example, there are various alternatives to produce. There is always a choice for the sales mix. Management 344 Accounting for Managers Accountant gives facts and figures about various policies and evaluates them in monetary terms. He interprets the data and gives his opinion about various alternative courses of action so that it becomes easier to the management to take a decision.

(5) Control: It is absolutely essential that there should be a system of monitoring the performance of all divisions and departments so that deviations from the desired path are brought to light, without delay and are corrected then and there. This process is termed as control. The aim of this function 'control' is to facilitate accomplishment of the goals in an efficient manner. For the discharge of this important function, management accounting provides meaningful information in a systematic and effective manner. However, the role of accountant is misunderstood. Many consider the accountant as a controller of their performance. Many accountants themselves misunderstand their own role as controllers. The real role of control is effective communication and assists the managers in achieving their goals, as efficiently as possible.

(6) Supplying Information to Various Levels of Management: Every level of management requires information for decision-making and policy execution. Top-level management takes broad policy decisions, leaving day-to-day decisions to lower management for execution. Supply of right information, at proper time, increases efficiency at all levels. The MIS provides relevant and timely information related to both internal and external to the organisation to enable management at all levels to take decisions. Decisions include cost optimisation, price fixation, implementation of any plan related with product, process, marketing etc.

(7) Reporting to Management: Reporting is an important function of management accounting to achieve the targets. The reports are presented in the form of graphs, diagrams and other statistical techniques so as to make them easily understandable. These reports may be monthly, quarterly, and half-yearly. These reports are helpful in giving constant review of the working of the business.

**SIGNIFICANCE OF MANAGEMENT ACCOUNTING**

The various advantages that accrue out of management accounting are enumerated below:

(1) Delegation of Authority: Now a day the function of management is no longer personal, management accounting helps the organisation in proper delegation of authority for the attainment of the vision and mission of the business.

(2) Need of the Management: Management Accounting plays the role in meeting the need of the management

(3) Qualitative Information: Management Accounting accumulates the qualitative information so that management would concentrate on the actual issue to deliberate and attain the specific conclusion even for the complex problem.

(4) Objective of the Business: Management Accounting provides measure and reports to the management thereby facilitating in attainment of the objective of the business.

**LIMITATIONS OF MANAGEMENT ACCOUNTING**

Despite the development of Management Accounting as an effective discipline to improve the managerial performance, some of the limitations are as under:

(1) Accuracy is not Ensured: Management Accounting is largely based on estimates. It does not deal with actual, alone, and thus total accuracy is not ensured under Management Accounting.

(2) A Tool in the Hands of Management: Management Accounting is definitely a tool in the hands of management, but cannot replace management.

(3) Strength and Weakness: Management Accounting derives information from Financial Accounting, Cost Accounting and other records. The strength and weakness of these basic information providers become the strength and weakness of Management Accounting too.

(4) Costly Affair: The installation of Management Accounting is a costly affair so all the organizations, in particular, small firms cannot afford.

(5) Lack of Knowledge and Understanding: The emergence of Management Accounting is the fusion of a number of subjects like statistics, economics, engineering and management theory. Any inadequate grounding in any one or more of the subjects is bound to have an unfavourable effect on the consideration and solution of the problems, relating to management performance.

(6) Evolutionary Stage: Comparatively, Management Accounting is a new discipline and is still very much in a stage of evolution. Therefore, it comes across the same difficulties or obstacles, which a relatively new discipline has to face.

(7) Psychological Resistance: Adoption of a system of Management Accounting brings about a radical change in the established pattern of the activity of the management personnel. It calls for rearrangement of personnel as well as their activities. This is bound to encounter opposition from some quarter or other.

## RELATIONSHIP BETWEEN MANAGEMENT ACCOUNTING AND COST ACCOUNTING

**Relationship between Management Accounting and Cost Accounting:**

Management Accounting is primarily concerned with the requirements of the management. It involves application of appropriate techniques and concepts, which help management in establishing a plan for reasonable economic objective. It helps in making rational decisions for accomplishment of management objectives. Any workable concept or techniques whether it is drawn from Cost Accounting, Financial Accounting, Economics, Mathematics and statistics, can be used in Management Accountancy. The data used in Management Accountancy should satisfy only one broad test. It should serve the purpose that it is intended for. A management accountant accumulates, summarises and analysis the available data and presents it in relation to specific problems, decisions and day-to-day task of management. A management accountant reviews all the decisions and analysis from management's point of view to determine how these decisions and analysis contribute to overall organisational objectives. A management accountant judges the relevance and adequacy of available data from management's point of view.

The scope of Management Accounting is broader than the scope of Cost Accountancy. In Cost Accounting, primary emphasis is on cost and it deals with its collection, analysis, relevance interpretation and presentation for various problems of management. Management Accountancy utilizes the principles and practices of Financial Accounting and Cost Accounting in addition to other management techniques for efficient operations of a company. It widely uses different techniques from various branches of knowledge like Statistics, Mathematics, Economics, Laws and Psychology to assist the management in its task of maximising profits or minimizing losses. The main thrust in Management Accountancy is towards determining policy and formulating plans to achieve desired objective of management. Management Accountancy makes corporate planning and strategy effective.

From the above discussion we may conclude that the Cost Accounting and Management Accounting are interdependent, greatly related and inseparable. However, the difference between Cost Accounting and Management Accounting is briefly discussed hereunder:

**Difference between Cost Accounting and Management Accounting**

| Sl. No | Basis | Cost Accounting (CA) | Management Accounting (MA) |
|---|---|---|---|
| (i) | Nature | CA records the quantitative aspect only. | MA records both qualitative and quantitative aspect. |
| (ii) | Objective | CA records the cost of producing a product and providing a service. | MA provides information to management for planning and co-ordination. |
| (iii) | Area | CA deals with cost ascertainment only. | MA is wider in scope as it includes financial accounting, budgeting, taxation, planning etc. |
| (iv) | Recording of data | CA uses both past and present figures. | MA is focused with the projection of figures for future. |
| (v) | Development | Development of CA is related to industrial revolution. | MA has been developed in accordance to the need of modern business world. |
| (vi) | Rules and Regulation | CA follows certain principles and procedures for recording costs of different products. | MA does not follow any specific rules and regulations. |