**Course No.: 503** **MANAGEMENT ACCOUNTING (MAAC XIX)**

**(For B.Com General and Accounting & Finance)**

**Marks: 80** **Hours: 40**

**Objective:** This course provides the students an understanding of the application of accounting techniques for management.

**Course Contents**

**UNIT-I:** Management Accounting: Meaning, nature, scope, and functions of Management accounting in decision making; Tools and Techniques of Management accounting.
20: 10 hrs

**UNIT-II:** Cash flow Statements as per Indian Accounting Standard 3 (revised), fund flow statement.
20: 10 hrs

**UNIT-III:** Absorption & Marginal Costing: Marginal & differential costing as a tool for decision making –making or buy; change of product mix; Pricing; Break-even analysis; Exploring new markets; Shutdown decisions.
20: 10 hrs

**UNIT-IV:** Budgeting for profit Planning and Control: Meaning of budget and budgetary control; Objectives; Types of budgets; Fixed and flexible budgeting, Functional budgeting; Control ratios; Zero base budgeting; Responsibility accounting; Performance budgeting.
20: 10 hrs

**Text and references:**


1. Arora M.N.: Cost Accounting-Principles and Practices; Vikas, New Delhi.
2. Jain S.P. & Narang K.L: Cost Accounting; Kalyani, New Delhi
3. Anthony, Robert & Reece, et al: Principles of Management Accounting; Richard Irwin Inc.
4. Horngren, Charles, Forest and Datar et al: Cost Accounting- A Managerial Emphasis; Prentice Hall, New Delhi.
5. Sriram: Management Accounting and Financial Analysis, New Central Book Agency, Hyderabad.
6. Paul: Practical Cost and Management Accounting, New Central Book Agency, Hyderabad.

# Unit – 1: Introduction to Management Accounting

## Management Accounting:

**Meaning and Definitions:**

The term management accounting refers to accounting for the management. Management accounting provides necessary information to assist the management in the creation of policy and in the day-to-day operations. It enables the management to discharge all its functions i.e. planning, organization, staffing, direction and control efficiently with the help of accounting information.

**In the words of R.N. Anthony** "Management accounting is concerned with accounting information that is useful to management".

**Anglo American Council of Productivity defines** management accounting as "Management accounting is the presentation of accounting information is such a way as to assist management in the creation of policy and in the day-to-day operations of an undertaking".

**According to T.G. Rose** "Management accounting is the adaptation and analysis of accounting information, and its diagnosis and explanation in such a way as to assist management".

From the above explanations, it is clear that management accounting is that form of accounting which enables a business to be conducted more efficiently.

**Characteristics of Management Accounting**

**1) Helps in decision making:** It helps management in decision making. The information provided through management accounting is only for internal use of management and it not distributed to third parties.

**2) Technique of Selective Nature:** Management Accounting is a technique of selective nature. It takes into consideration only that data from the income statement and position state merit which is relevant and useful to the management. Only that information is communicated to the management which is helpful for taking decisions on various aspects of the business.

**3) It is an optional technique:** There are no statutory obligations regarding adoption of management accounting tool nor are there any obligations to furnish management accounting information. A firm may choose to adopt management accounting techniques totally depends upon its utility and desirability.

**4) Provides Data and not the Decisions: The** management accountant is not taking any decision but provides data which is helpful to the management in decision-making. It can inform but cannot prescribe. It is just like a map which guides the traveller where he will be if he travels in one direction or another. Much depends on the efficiency and wisdom of the management for utilizing the information provided by the management accountant.

**5) Concerned with Future:** Management accounting unlike the financial accounting deals with the forecast with the future. It helps in planning the future because decisions are always taken for the future course of action.

**6) Analysis of Different Variables:** Management accounting helps in analysing the reasons as to why the profit or loss is more or less as compared to the past period. Moreover, it tries to analyse the effect of different variables on the profits and profitability of the concern.

**7) Flexibility in presentation of information's:** Management accounting will not provide information in a prescribed proforma like that of financial accounting. It provides the information to the management in the form which may be more useful to the management in taking various decisions on the various aspects of the business.

**8) Based on financial statements:** It makes use of information and reports from financial accounting, cost accounting, tax accounting and other accounting disciplines to help management to forecast, plan and take better decisions.

**9) Cause and effect relationship:** Management Accounting emphasizes, specially, on cause and effect relationship.

**Objectives of Management Accounting**

The primary objective is to enable the management to maximize profits or minimize losses. The fundamental objective of management accounting is to assist management in their functions. The other main objectives are:

**1) Planning and policy formulation:** planning is one of the primary functions of management. It involves forecasting on the basis of available information.

**2) Help in the interpretation process:** The main object is to present financial information. The financial information must be presented in easily understandable manner.

**3) Helps in decision making:** Management accounting makes decision making process more modern and scientific by providing significant information relating to various alternatives.

**4) Controlling:** The actual results are compared with pre determined objectives. The management is able to control performance of each and every individual with the help of management accounting devices.

**5) Reporting:** This facilitates management to take proper and timely decisions. It presents the different alternative plans before the management in a comparative manner.

**6) Motivating**: Delegation increases the job satisfaction of employees and encourages them to look forward. so it serves as a motivational devise.

**7) Helps in organizing:** "Return on capital employed" is one of the tools if management accounting. All these aspects are helpful in setting up effective and efficient organization.

**8) Coordinating operations:** It provides tools which are helpful in coordinating the activities of different sections. Scope of Management Accounting The field of management accounting is very wide. The main purpose of management accounting is to provide information to the management to perform its functions of planning directing and controlling.

**Management accounting includes various areas of specialization to render effective service to the management.**

**a) Financial Accounting**: Financial Accounting deals with financial aspects by preparation of Profit and Loss Account and Balance Sheet. Management accounting rearranges and uses the financial statements. Therefore it is closely related and connected with financial accounting.

**b) Cost Accounting:** Cost accounting is an essential part of management accounting. Cost accounting, through its various techniques, reveals efficiency of various divisions, departments and products. Management accounting makes use of all this data by focusing it towards managerial decisions.

**c) Budgeting and Forecasting:** Budgeting is setting targets by estimating expenditure and revenue for a given period. Forecasting is prediction of what will happen as a result of a given set of circumstances. Targets are fixed for various departments and responsibility is pinpointed for achieving the targets. Actual results are compared with preset targets and performance is evaluated.

**d) Inventory Control:** This includes, planning, coordinating and control of inventory from the time of acquisition to the stage of disposal. This is done through various techniques of inventory control like stock levels, ABC and VED analysis physical stock verification, etc.

**e) Statistical Analysis:** In order to make the information more useful statistical tools are applied. These tools include charts, graphs, diagrams index numbers, etc. For the purpose of forecasting, other tools such as time series regression analysis and sampling techniques are used.

**f) Analysis of Data:** Financial statements are analysed and compared with past statements, compared with those of other firms and with standards set. The analysis and interpretation results in drawing reports and presentation to the management.

**g) Internal Audit:** Internal audit helps the management in fixing individual responsibility for internal control.

**h) Tax Accounting:** Tax liability is ascertained from income statements. Knowledge of tax provisions helps the management in meeting the tax liabilities and complying with other legislations like Sales tax, Companies Act and MRTP Act.

**i) Methods and Procedures:** In includes keeping of efficient system for data processing and effective reporting of required data in time.

**Functions of Management Accounting**

Main objective of management accounting is to help the management in performing its functions efficiently. The major functions of management are planning, organizing, directing and controlling. Management accounting helps the management in performing these functions effectively.

**Management accounting helps the management is two ways:**

I. Providing necessary accounting information to management

II. Helps in various activities and tasks performed by the management.

**I. Providing necessary accounting information to management:**

**(a) Measuring:** For helping the management in measuring the work efficiency in different areas it is done on the past and present incidents with context to the future. In standard costing and budgetary any control, standard and actual performance is compared to find out efficiency.

**(b) Recording**: In management accounting both the quantitative and qualitative types of data are included and this accounting is done on the basis of assumptions and even those items which cannot be expressed financially are included in management accounting.

**(c) Analysis:** The work of management accounting is to collect and analyze the fact related to the managerial problems and then present them in clear and simple way.

**(d) Reporting:** For the use of management various reports are prepared. Generally two types of reports are prepared:-

a. Regular Reports

b. Special Reports.

**II. Helping in Managerial works and Activities:**

The main functions of management are planning, organizing, staffing, directing and controlling. Management accounting provides information to the various levels of managers to fulfill the above mentioned responsibilities properly and effectively. It is helpful in various management functions as under:-

**(a) Planning**: Through management accounting forecasts regarding the sales, purchases, production etc. can be obtained, which helps in making justifiable plans. The tools of management accounting like standard costing, cost -volume-profit analysis etc. are of great managerial costing, help in planning.

**(b) Organizing:** In management accounting whole organization is divided into various departments, on the basis of work or production, and then detailed information is prepared to simplify the thing. The budgetary control and establishing cost centre techniques of management accounting helps which result in efficient management.

**(c) Staffing:** Merit rating and job evaluation are two important functions to be performed for staffing. Generally only those employs are useful for the organization, whose value of work done by them is more than the value paid to them. Thus by doing cost-benefit analysis management accounting is useful in staffing functions.

**(d) Directing:** For proper directing, the essentials are co-ordination, leadership, communications and motivation. In all these tasks management accounting is of great help. By analyzing the financial and non financial motivational factors, management accounting can be an asset to find out the best motivational factor.

**(e) Co-ordination:** The targets of different departments are communicated to them and their performance is reported to the management from time to time. This continual reporting helps the management in coordinating various activities to improve the overall performance.

**The advantages of management accounting are summarized below:**

**a) Helps in Decision Making:** Management accounting helps in decision making such as pricing, make or buy, acceptance of additional orders, selection of suitable product mix etc. These important decisions are taken with the help of marginal costing technique.

**b) Helps in Planning:** Planning includes profit planning, preparation of budgets, programmes of capital investment and financing. Management accounting assists in planning through budgetary control, capital budgeting and cost-volume-profit analysis.

**c) Helps in Organizing:** Management accounting uses various tools and techniques like budgeting, responsibility accounting and standard costing. A sound organizational structure is developed to facilitate the use of these techniques.

**d) Facilitates Communication:** Management is provided with up-to-date information through periodical reports. These reports assist the management in the evaluation of performance and control.

**e) Helps in Co-coordinating:** The functional budgets (purchase budget, sales budget, and overhead budget etc.) are integrated into one known as master budget. This facilitates clear definition of department goals and coordination of their activities.

**f) Evaluation and Control of Performance:** Management accounting is a convenient tool for evaluation of performance. With the help of ratios and variance analysis, the efficiency of departments can be measured which assists management in the location of weak spots and in taking corrective actions.

**g) Interpretation of Financial Information:** Management accounting presents information in a simple and purposeful manner. This facilitates quick decision making.

**h) Economic Appraisal:** Management accounting includes appraisal of social and economic forces and government policies. This appraisal helps the management in assessing their impact on the business.

**Limitations of Management Accounting**

Management accounting, being comparatively a new discipline, suffers from certain limitations, which limit its effectiveness. **These limitations are as follows:**

**1. Limitations of basic records:** Management accounting derives its information from financial accounting, cost accounting and other records. The strength and weakness of the management accounting, therefore, depends upon the strength and weakness of these basic records. In other words, their limitations are also the limitations of management accounting.

**2. Persistent efforts.** The conclusions draws by the management accountant are not executed automatically. He has to convince people at all levels. In other words, he must be an efficient salesman in selling his ideas.

**3. Management accounting is only a tool:** Management accounting cannot replace the management. Management accountant is only an adviser to the management. The decision regarding implementing his advice is to be taken by the management. There is always a temptation to take an easy course of arriving at decision by intuition rather than going by the advice of the management accountant.

**4. Wide scope:** Management accounting has a very wide scope incorporating many disciplines. It considers both monetary as well as non-monetary factors. This all brings inexactness and subjectivity in the conclusions obtained through it.

**5. Top-heavy structure:** The installation of management accounting system requires heavy costs on account of an elaborate organization and numerous rules and regulations. It can, therefore, be adopted only by big concerns.

**6. Opposition to change:** Management accounting demands a break away from traditional accounting practices. It calls for a rearrangement of the personnel and their activities, which is generally not like by the people involved.

**7. Evolutionary stage:** Management accounting is still in its initial stage. It has, therefore, the same impediments as a new discipline will have, e.g., fluidity of concepts, raw techniques and imperfect analytical tools.

**8. Intuitive Decisions:** Management accounting helps in scientific decision making. Yet, because of simplicity and personal factors the management has a tendency to arrive at decisions by intuition.

**Difference between Cost accounting and Management Accounting**

Cost accounting and Management accounting are two modern branches of accounting. Both the systems involve presentation of accounting data for the purpose of decision making and control of day-to-day activities.

Cost accounting is concerned not only with cost ascertainment, but also cost control and managerial decision making.

Management accounting makes use of the cost accounting concepts, techniques and data. The functions of cost accounting and management accounting are complimentary.

In cost accounting the emphasis is on cost determination while management accounting considers both the cost and revenue. Though it appears that there is overlapping of areas between cost and management accounting, the following are the differences between the two systems.

**Basis Cost accounting Management accounting**

**a) Purpose** The main objective of cost accounting is to ascertain and control the cost of products or services. The function of management accounting is to provide information to management for efficiently performing the functions of planning, directing, and controlling.

**b) Emphasis** Cost accounting is based on both historical and present data. Management according deals with future projections on the basis of historical and present cost data.

**c) Principles** Established procedures and practices are followed in cost accounting. No such prescribed practices are followed in Management accounting.

**d) Data** Cost accounting uses only quantitative information. Management accounting uses both qualitative and quantitative information.

**e) Scope** Cost accounting is concerned mainly with cost ascertainment and control. Management accounting includes, financial accounting, cost accounting, budgeting, tax planning and reporting to management.

**f) Status** The Status of cost accountants comes after management accountant. Management accountant is senior in position to cost accountant.

**g) Tools and techniques** It has standard costing, variable costing, break even analysis etc. as the basic tools and techniques. Along with these, management accountant has funds and cash flow statements, ratio analysis etc. as his tools and techniques.

**h) Installation** It can be installed without management accounting. It needs financial and cost accounting as its base for its installation.

**Difference between Financial Accounting and Management Accounting**

The accounting system concerned only with the financial state of affairs and financial results of operations is known as Financial Accounting. It is the original form of accounting. It is mainly concerned with the preparation of financial statements for the use of outsiders like creditors, debenture holders, investors and financial institutions. The financial statements i.e., the profit and loss account and the balance sheet, show them the manner in which operations of the business have been conducted during a specified period.

Management accounting makes use of the cost accounting concepts, techniques and data. The functions of cost accounting and management accounting are complimentary. In cost accounting the emphasis is on cost determination while management accounting considers both the cost and revenue.

Though it appears that there is overlapping of areas between cost and management accounting, the following are the differences between the two systems.

**Basis Financial accounting Management accounting**

**a) Objectives** : The main objective of financial accounting is to supply information in the form of profit and loss account and balance sheet to outside parties like shareholders, creditors, government etc. The main objective of management accounting is to provide information for the internal use of management.

**b) Performance** : Financial accounting is concerned with the overall performance of the business. Management accounting is concerned with the departments or divisions. It report about the performance and profitability of each of them.

**c) Data** : Financial accounting is mainly concerned with the recording of past events.

Management accounting is concerned with future plans and policies.

**d) Nature** : Financial accounting is based on measurement.

Management accounting is based on judgment.

**e) Accuracy:** Accuracy is an important factor in financial accounting.

Approximations are widely used in management accounting.

**f) Legal Compulsion:** Financial accounting is compulsory for all joint stock companies.

Management accounting is optional.

**g) Monetary transactions:** Financial accounting records only those transactions which can be expressed in terms of money.

Management accounting records not only monetary transactions but also non- monetary events.

**h) Control:** Financial accounting will not reveal whether plans are properly implemented.

Management accounting will reveal the deviations of actual performance from plans. It will also indicate the causes for such deviations.

**i) Stock Valuation:** In cost accounts stocks are valued at cost.

In financial accounts, stocks are valued at cost or realisable value, whichever is lesser.

**j) Analysis of Profit and Cost:** Cost accounts reveal Profit of Loss of different products, departments separately.

In financial accounts, the Profit or Loss of the entire enterprise is disclosed into.

**Tools and Techniques Used in Management Accounting**

Management accountant supplies information to the management so that latter may be able to discharge all its functions, i.e., planning organization, staffing, direction and control sincerely and faithfully. For doing this, the management accountant uses the following tools and techniques.

**a) Financial planning:** Financial planning is the act of deciding in advance about the financial activities necessary for the concern to achieve its primary objectives. It includes determining both long term and short term financial objectives of the enterprise, formulating financial policies and developing the financial procedure to achieve the objectives. The role of financial policies cannot be emphasized to achieve the maximum return on the capital employed. Financial policies may relate to the determination of the amount of capital required, sources of funds, govern the determination and distribution of income, and act as a guide in the use of debt and equity capital and determination of the optimum level of investment in various assets.

**b) Analysis of financial statements:** The analysis is an attempt to determine the significance and meaning of the financial statement data so that a forecast may be made of the prospects for future earnings, ability to pay interest and debt maturities and profitability of a sound dividend policy. The techniques of such analysis are comparative financial statements, trend analysis, funds flow statement and ratio analysis. This analysis results in the presentation of information which will help the business executive, investors and creditors.

**c) Historical cost accounting:** The historical cost accounting provides past data to the management relating to the cost of each job, process and department so that comparison may be make with the standard costs. Such comparison may be helpful to the management for cost control and for future planning.

**d) Standard costing:** Standard costing is the establishment of standard costs under most efficient operating conditions, comparison of actual with the standard, calculation and analysis of variance, in order to know the reasons and to pinpoint the responsibility and to take remedial action so that adverse things may not happen again. This aspect is necessary to have cost control.

**e) Budgetary control:** The management accountant uses the total of budgetary control for planning and control of the various activities of the business. Budgetary control is an important technique of directing business operations in a desired direction, i.e. achieve a satisfactory return on investment.

**f) Marginal costing:** The management accountant uses the technique of marginal costing, differential costing and break even analysis for cost control, decision-making and profit maximization.

**g) Funds flow statement:** The management accountant uses the technique of funds flow statement in order to analyze the changes in the financial position of a business enterprise between two dates. It tells wherefrom the funds are coming in the business and how these are being used in the business. It helps a lot in financial analysis and control, future guidance and comparative studies.

**h) Cash flow statement:** A funds flow statement based on increase or decrease in working capital is very useful in long-range financial planning. It is quite possible that these may be sufficient working capital as revealed by the funds flow statement and still the company may be unable to meet its current liabilities as and when they fall due. It may be due to an accumulation of investments and an increase in trade debtors. In such a situation, a cash flow statement is more useful because it gives detailed information of cash inflow and outflow. Cash flow statement is an important tool of cash control because it summarizes sources of cash inflow and uses of cash outflows of a firm during a particular period of time, say a month or a year. It is very useful tool for liquidity analysis of the enterprise.

**i) Decision making:** Whenever there are different alternatives of doing a particular work, it becomes necessary to select the best out of all alternatives. This requires decision on the part of the management. The management accounting helps the management through the techniques of marginal costing, capital budgeting, differential costing to select the best alternative which will maximize the profits of the business.

**j) Revaluation accounting:** The management accountant through this technique assures the maintenance and preservation of the capital of the enterprise. It brings into account the impact of changes in the prices on the preparation of the financial statements.

**k) Statistical and graphical techniques**: The management accountant uses various statistical and graphical techniques in order to make the information more meaningful and presentation of the same in such form so that it may help the management in decision-making. The techniques used are Master Chart, Chart of sales and Earnings, Investment chart, Linear Programming, Statistical Quality control, etc.

**l) Communication (or Reporting):** The success for failure of the management is dependent on the fact, whether requisite information is provided to the management in right form at the right time so as to enable them to carry out the functions of planning controlling and decision-making effectively. The management accountant will prepare the necessary reports for providing information to the different levels of management by proper selection of data to be presented, organization of data and selecting the appropriate method of reporting.