

Unit : 1

Introduction to Cost and Management Accounting (10%)

Syllabus

*Definitions- Cost Accounting and Management Accounting.
Advantages and limitations of Management Accounting.
Relationship and differences between Cost accounting,
Management accounting and Financial Accounting.*

1.1) Definitions

(1) Cost Accounting

According to Prof. Van sickle—

“Cost Accounting is a science of recording and presenting business transactions pertaining to the production of goods and services, whereby these records become a method of measurement and means of control.”

(2) Management Accounting

“Management Accounting is the term used to describe the accounting methods, systems and techniques which coupled with special knowledge and ability, assist management in its task of maximizing profits or minimizing losses” — **J. Batty**

According to **American Accounting Association (AAA)** —

“Management Accounting is the application of appropriate techniques & concepts in processing historical & projected economic data of an entity, to assist management in establishing plans for reasonable economic objectives in the making of rational decisions with a view towards achieving these objectives”

1.2) Advantages of Management Accounting

The primary objective of Management Accounting is to enable the management to maximize profits or minimize the losses. Management accounting is needed in business because it has capacity to change the business performance and financial position. The following are some of advantages for business units those have adopted the system of Management Accounting.

(1) Maximizing Profitability:

Each and every business unit has primary goal to earn profit. External parties like shareholders, creditors, proposed investors, banks would be interested to have maximum profit from invested amount. To satisfy these objectives, Management Accounting provides certain technique like profitability ratios, budgetary control, variance analysis which will helpful in control over unnecessary expenditures. So the profit can be maximized.

(2) Helpful in planning and policy formulation:

The success of a business unit is very much dependent upon proper planning which the primary function of management. It includes analysis of available information & forecast based on available data. When the data is arranged in proper manner it helps the management in effective planning.

(3) Simplify the Financial Statements:

For taking different managerial decisions, management accountant provides deep technical reports with simple interpretations in which he mentions the facts of financial statements, after this, company's management officers understand what is in financial statement and how will they use this for company's progress.

(4) Motivates employees & Increases Efficiency:

Management accounting increases the efficiency of operation of company. Everything is done in management accounting with a scientific system for evaluating and comparing the performance. With this, we find deviations. We will take promotional decisions on this basis. Other employees will also be motivated with this because if their performance will be favorable, they get reward of this. Thus management accounting increases efficiency.

(5) Control of Business' cash flow:

It is one of important advantage of management accounting that it can be used for controlling of business's cash flow. We all know that cash in hand is better than in fixed properties if there is emergency to pay our loan or debt. So, management accountant deeply studies from where is money coming and where is it going by preparing statements like Fund Flow Statement & Cash Flow Statement. To check on misuse of money will surely control of business's cash flow.

(6) Helpful in Decision Making:

It is useful in finding solution of strategic business problems. Decision making is the basic function of Management Accounting.

The decision may relate to the expansion of business or continuation or diversification of the existing business, make or buy decision. Management Accounting helps in solving all such problems. It uses the accounting information to find the solution of various management problems.

It only informs the management & leaves the task of decision making to them. It uses the techniques of the Marginal Costing, Cost-Volume-Profit Analysis (CVP), standard costing & Capital Budgeting in arriving at the rational & sound decision.

(7) Helpful in Coordination:

Management Accounting is concerned with the efficiency of various stages of management. It helps in overall control & proper coordination of the business operations.

(8) Reporting to the different level of management:

Management accounting emphasis on different techniques like Marginal Costing, Standard costing, Fund flow analysis etc. All such reports are somewhere connected to the entire structure of business and provide scope to improve the performance. Thus such reports must be communicated to different level of management.

1.3) Limitation of Management Accounting

(1) Based on Historical Data:

Management Accounting uses the information from financial accounting & Cost accounting. FA & CA are based on past records. If they are not accurate, the future projection will not be reliable. Moreover, it is easy to record, analyze & interpret an historical event which is converted into monetary terms. But it is difficult to perform the same function in respect of future & unquantifiable situation in the light of past records.

(2) Lack of Wide knowledge:

The fusion of number of subjects like financial accounting, management, economics, statistics, engineering, taxation etc. has led to the emergence of Management Accounting. Under these circumstances it should be remembered that lack of knowledge & understanding of any one or more of subjects will have an impact on the fixation of standards as well as on decisions connected with the management performance.

(3) Complicated approach:

Management Accounting eliminates the intuitive decision making process of management & replace it with scientific decision making. Unfortunately, much management are prone to take easy & simple

path of intuitive decision making rather than complicated approach of Management Accounting.

(4) Developing (Evolutionary) stage:

Management Accounting is a new discipline & growing subject. It is in the teething stage & faces certain obstacles before achieving perfection. So the Management Accounting is not fully utilized in the organization. So it should be sharpening by implementing certain uniform techniques & removing unnecessary or misleading complicated techniques.

(5) It is not a substitute of management:

The reports of analysis carried out through Management Accounting techniques gives the information to management, and the task of choosing the most favorable alternative or making decision based on reports leaves to management.

(6) Costly installation:

For the installation of Management Accounting elaborate organization & a large number of manual are very essentials. It requires the proper development of Management information system (MIS) which increases the cost of establishment & only large organizations afford such high cost of installation.

(7) Resistance from Staff:

Management Accounting brings radical changes in the management's approach towards solving day to day problems. This requires reorganization of personals as well as re-orientation the activities. This is bound to attract an opposition from the labour force who may think it to be a tool of exploitation. Constant education & awareness about the benefits of such techniques will remove the fear of staff.

1.4) Difference of Management Accounting with Financial & Cost Accounting

Point	Financial Accounting	Management Accounting
Definition	Accounting is an art of recording, classifying, summarizing business transactions, events at least in financial character and interpretation thereof.	Management accounting is arrangement of accounting information is such a way that it will assist to managers in decision making process.

Users	Reports of Financial accounting is used by external users like shareholders, creditors, govt. authorities etc.	Reports of management accounting are used by internal management; e.g. top management and employees.
Accounting Method	It is based on double entry system for recording business transactions.	It is not based on double entry book keeping or any other system.
Statutory Requirements	Under Company act 1956/2013 & Tax laws, financial accounting is obligatory to satisfy various provisions.	Management accounting is optional.
Analysis of Cost and profit	It shows the profit/loss of business as whole. It does not show the cost and profit for individual products, processes or departments etc.	It provides detailed information about individual products, plants, departments or any other centers.
Past & Future data	It is concerned with recording transactions which have already taken place so it shows historical records.	It is future oriented and concentrates on what is likely to happen in future.
Time duration	Financial reports are prepared usually on a year to year basis.	Its reports are prepared frequently i.e., these may be monthly, weekly or even daily depending on managerial needs.
Accounting Standards	Companies are required to prepare financial accounting according to Accounting Standards issued by The Institute of Chartered Accountants of India (ICAI)	Management accounting is not bound by standards.

Types of Statements	It prepares general purpose statements like Profit and loss account and Balance Sheet.	In management accounting special reports are prepared i.e., Performance report of sales manager, Fund Flow statement etc.
Publication and Audit.	Financial reports are published for general public and also sent to shareholders. These are required to be audited by the Chartered Accountants.	Management accounting reports are for internal use and thus neither published nor to be audited.
Measurement.	Financial accounting provides information in terms of money measurement.	Management accounting may apply monetary or non-monetary units of measurement. i.e., information may be expressed in terms of Rs. or units of quantity, machine hours, labour hours etc.

“Modern cost accounting is often called management accounting. Because cost accountants look at their organization through manager’s eyes.” Though the distinction may be made on the basis of following points

Point	Cost Accounting	Management Accounting
Scope	Scope of Cost Accounting is limited to providing cost information for managerial uses.	Scope of management accounting is broader than cost a/c as it provides all types of information, i.e., cost a/c as well as financial a/c for managerial uses.

Emphasis	Main emphasis is on cost determination and cost control to ensure maximum profit.	Main emphasis is on planning, controlling and decision-making to maximize profit.
Techniques Employed	Various techniques used by cost a/c include standard costing and variance analysis. Marginal costing, CVP analysis, budgetary control, uniform costing etc.	Management A/c uses all these techniques of cost a/c in addition to that it uses like ratio analysis, fund flow and cash flow statement etc.
Evolution	Evolution of cost a/c is mainly due to the limitation of financial a/c	Evolution of management a/c is due to the limitations of cost a/c
Statutory Requirements	Maintenance of cost records has been made compulsory in selected industries as notified by government	Management a/c is purely voluntary.
Data base	It is based on data derived from financial a/c	It is based on data derived from cost a/c, financial a/c and other sources.
Status in organization	In the structure of organization, cost accountant is placed at a lower level in hierarchy than the management accountant.	Management accountant is generally placed at higher level than cost accountant
Installation	Cost a/c system can be installed without management a/c	Management a/c cannot be installed without proper system of cost a/c

QUESTION BANK**Short Questions**

1. What is Cost Accounting?
2. What is Management Accounting?
3. State one objective of Management Accounting.
4. Name any two techniques of Management Accounting.
5. Give any two advantages of Management Accounting.
6. State any two limitations of Management Accounting.
7. Who are the users of Financial Accounting?
8. Is Management Accounting compulsory?
9. What is the basis of Financial Accounting?
10. State one difference between Cost Accounting and Management Accounting.

Long Questions

1. Explain the advantages of Management Accounting.
2. Explain the limitations of Management Accounting.
3. Differentiate between Financial Accounting and Management Accounting.
4. Differentiate between Cost Accounting and Management Accounting.
5. Explain the difference between Financial Accounting and Cost Accounting.

**2.3) Definitions :**

1. Marginal Cost: Marginal cost is the additional cost of production of one additional unit. It is composed of all direct costs and variable overheads. According to CIMA (Chartered Institute of Management Accountants) "The amount of any given level of output."