Cost & Management Accounting

A: Cost Accounting: Meaning

Cost accounting is an important branch of accounting. It has developed due to the limitations of financial accounting. It provides to management with cost data relating to products, processes, jobs and operations and helps the management to control the cost & maximise the operational efficiency. It also guides the management in decision making.

Definitions

Cost Accounting has been defined by several authorities and institutions as follows :

1. *"Cost Accounting is the classifying, recording and appropriate allocation of expenditure for the determination of the cost of products or services."*- **H. J. Wheldon.**

2. *"Cost Accounting is the process of accounting for cost, from the point at which expenditure is incurred or committed to the establishment of its ultimate relationship with cost centers and cost units. In its widest usage, it embraces the preparation of statistical data, the application of cost control methods and the ascertainment of the profitability of activities carried out or planned"*- **I.C.M.A.(England).**

3. *"Cost Accounting is the body of concepts, methods and procedures* used to measure, analyze or estimate the cost, profitability and performance of individual products''**- Van Sickle.**

In short, cost accounting refers to the process of accounting which begins with recording of the expenditure and ends with ascertainment of costs and profitability of individual products, departments, processes, operations and others segments of company's working. It enables the management to use these costs for the purpose of control and also guides the management in making important decisions.

Objectives or Functions of Cost Accounting

Cost Accounting was initially developed to overcome the limitations of the financial accounting. In the early stages, the only objective or function of cost accounting was to ascertain the cost of goods or services produced by the firm. But in latter stages, the cost accounting was fruitfully applied to serve several objectives. Following are the important objectives (or functions) of the modern cost accounting.

1. **Cost Ascertainment :** The prime objectives of cost accounting is to ascertain the cost of production of each unit, job, process, operation, department and other segments of an organisation. In other words, the main function of the cost accounting is to provide the timely and reliable information about (a) the prices and quantities of inputs-(i.e. materials, labour and overheads that are consumed in production process) (b) the cost of output or products manufactured. Such costs of units produced enable the management to fix or quote the prices of goods and services produced and to do the valuation of inventory and find the exact amount of profits earned during a period.

2. **Cost control :** The cost ascertainment was the main objective of costing in olden days. *But in modern times the control of cost is becoming more important function of costing than the cost ascertainment.* This does not mean that the cost ascertainment function is completely relegated to the background. In fact, the cost ascertainment is the first step of cost control.

Once the costs are ascertained by the application of cost accounting principles, the standards of costs (i.e. material, labour and overheads) required for a products are set, Standards express what the costs should be. Then, from time to time the actual costs of production are computed and compared with the standards. And if the actual costs are more than the standards set, the steps are taken to remove the causes of such difference. In short, once the costs are ascertained they are used for the purpose of cost control.

3. Assistance in managerial decision making: The main function of management of every concern is to make important decisions. Decision making is a process of selecting the best alternative among the various available alternative courses of action. While making the choice of alternatives, it is essential to compare the revenue and costs of each alternative. The cost accountant supplies the data about cost and revenues of various alternative courses and enables management to make an intellectual choice among different alternatives. Thus cost accounting aids tactical managerial decision making such as closing down or continuing a department, making or buying a product, a profitable product mix, utilisation of idle capacity, price reduction during depression etc.

4. Evaluation of operating efficiency : Cost accounting records the cost of various products, processes, operations, departments and other cost centers. This enables the management to do *intra-firm* comparison and *inter-firm* comparison and evaluate the operating efficiency of the various segments of a concern.

5. Disclosure of wastages : The cost accounting reveals the inefficiencies and wastages in various forms, existing in the different areas of business such as wastages of materials, labour, expenses, idle capacity, idle time, under-utilisation of plant and equipment etc., so that management can take remedial measures to minimise the waste and maximise the efficiency.

6. Other objectives (functions) : In addition to the main objectives stated above cost accounting serves several other purposes as follows :

a) To reveal sources of economy in the production process.

b) To provide an effective system of materials and stores.

c) To provide necessary data to develop standard costs and exercise the system of budgetary control.

d) To assist the special studies and investigations such as pricing of new products and services, expansion or contraction of projects, change in the methods of production and distribution, wage compensation plan and other such problems which may arise from time to time.

Thus cost accounting which emerged as a science to ascertain the cost of a product has proved to be an indispensable potent tool for effective operation of any business undertaking.

Advantages of Cost Accounting

(I) Advantages to the Management :

Cost Accounting helps the management in the efficient performance of all its functions such as planning, budgeting, decision making, organising, control & pricing. In fact cost accounting is so closely linked with the management that it is difficult to indicate where the work of cost accountant ends and where managerial control begins. The cost accounting collects and classifies the cost in different ways and serves the management in following ways :

1. It discloses the profitable and unprofitable activities to the management.
2. It provides information which is useful in preparing tenders & estimates & fixation of selling price.
3. It enables the management to ascertain & improve the operating efficiency.
4. It enhances the profitability of business.
5. The perpetual inventory facilitates periodical determination of profit or losses.

6. It provides the information about the exact causes of any increase and decrease in profits of the firm.
7. If enables the comparison of cost in different periods, in different departments, in different establishments and at different levels of activity.
8. It guides future production policies.
9. It enables the control of materials, labour and overhead cost by minimising the wastages and losses.
10. It guides management in taking vital decisions.
11. It enables the optimum use of firm's resources.
12. It informs management about 'Special Factors' such as idle labour time, idle machine capacity, seasonal variations in cost and production, optimum profitability etc.
13. The standard costing & budgetary control serve as best instruments of managerial control**.**

II. Advantages to workers

1. It provides suitable wage plans which provide incentives to workers to improve their efficiency & standard of living.
2. A good costing system enhances the operating efficiency of firm and ensures better wages & security of services to workers.
3. It reduces labour turnover and improves labour relations.

III. Advantages to creditors & owners

1. It increases the profitability hence the rate of return on investment of owners is improved.
2. It enables the creditors to judge financial strength of business.

IV. Advantages to Government

1. It facilitates the government in assessment of excise duty, income tax and sales tax in industries.
2. It facilitates government in formulation of policies regarding industry, import & export, taxation etc.
3. It provides ready figures for use by Government for application in problems like price fixation, wage level fixation, tariff protection, price control etc.

V. Advantages to General Public/Consumers

1. It enables the consumers to obtain the good quality products at fair prices.
2. It creates confidence in the minds of consumers about fairness of price quoted and improves buyer-seller relations.

Limitations of Cost Accounting

1. In case of small firms, cost of installation of costing system exceeds the benefits derived there from.
2. The lack of uniformity in costing procedures creates artificial cost differences. The cost ascertainment by any two accountants based on from the same information, differs due to different methods & techniques used in computation of cost, this may lead to self destructive bidding among the firms.

B : Management Accounting : Meaning and Definitions :

Management Accounting has been defined by different authorities in different ways. Some important definitions are :

1) **Institute of Chartered Accountants of England and Wales :**

"Any form of accounting which enables a business to be conducted more efficiently, can by be regarded as management accounting ".

2) **Robert N. Antomy :**

"Management Accounting is concerned with accounting information which is useful to management".

3) **The Institute of Cost & Management Account, London :**

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

From the above definitions it is clear that *management accounting refers to the accounting for management.* It is presentation of necessary accounting information to the management for discharging its functions such as planning, organizing, actualizing and controlling more efficiently. The management accountant analyses, interprets the information revealed by financial accounts, costs accounts and other books & records maintained by the business and presents it to the managerial personnel at different levels for the help in decision making.

Functions of management accounting :

Management accounting facilitates the management of an enterprise to perform its functions of planning, organising, actualising and control in effective way performance of each of its functions. The functions are planning, organising, actualising and control. The functions of management accounting may be summed up as under

(1) Provision of data : Management accounting ensures continuous flow of accounting information to the management which enable them to frame the future policies and plans with reasonable accuracy and perform the managerial functions in efficient manner.

(2) Modification of data : The management accounting modifies the financial and cost accounting data and rearranges the same in the form of suitable tables, graphs, charts etc. so that managerial people can draw quick inferences there from. For example, the sales figures may classified area wise, product wise, product-wise, month-wise, year-wise etc. to make it more meaningful for decision making.

(3) Analysis and interpretation of data : Management accounting also analyses the accounting data for effective planning & decision making. For this purpose it uses various tools of analysis like ratio analysis, comparative financial statements, common size statements, funds flow & cash flow analysis & even some times the tools of statistical analysis. Even future trends are projected on some occasions.

(4) Means of communication : Management Accounting reports serve as means of communicating management plans throughout the organization. While compiling the reports the information from various segments of business are consulted. In later stages management accountant keeps all the parties informed about the plans of the enterprise.

(5) Helps managerial control : Through the techniques of standard costing and budgetary control the management accounting helps in translating the long term objectives and strategies of an enterprise into short term goals and securing the effective accomplishment of those goals. Thus it helps effective managerial control of various activities.

(6) Deals with qualitative information : Management accounting does not only deal with the financial and cost data but it obtains lots of technical and non monetary information useful for managerial decisions through special surveys, productivity reports, statistical compilation, case studies, engineering records, minutes of meeting, government legislations, strategies of competing firms etc.

Role or Objectives of Management Accounting

The basic objective of management accounting is to assist the management in performing various managerial functions such as planning, organising, directing and controlling in an effective manner. However, the objectives of management accounting can be summarised as under :

i) To assist in planning and formulation of business policies:

Management accounting helps management in planning the various activities of the business. Planning is deciding the course of action in advance. It involves forecasting, setting goals, framing policies, determining the alternative course of action. The management accounting provides the factual information in easily intelligible manner to the management on the basis of which all these activities of planning could be performed in an effective manner.

ii)To help in interpretation of financial information :

The financial accounting information is of immense use in guiding the managerial decisions. But the managerial people may not necessarily possess the skill to understand the accounting information in its raw form. Hence the management accountant modifies the available accounting data in an intelligible and non technical manner and present the same to managerial people while making crucial decisions.

iii) To provide qualitative information :

Mere analysis, interpretation and presentation of accounting & financial data is not sufficient for effective managerial decision making and control. The management needs qualitative (i.e. non-monetary) information as well. Management accountant collects the required qualitative information (such as idle time, under utilisation of capacity, change in government policies & statutes, changes in political, technological, economic environment of business etc.) from various sources such as special surveys, productivity reports, statistical compilations, engineering records, case studies, minutes of meetings, government agencies etc., and provides the same to guide the managerial decisions.

iv) To satisfy the informational needs of management at different levels: The managerial personnel at different levels need different types of information. The top management needs precise information, covering all the fields of business activities at relatively long intervals. The middle level management needs technical information at regular intervals. The lower level management needs elaborate information about even the smallest activities at very short intervals. The management accounting has to cater all these needs in an efficient way.

v)To facilitate management control : Management accounting helps the management in controlling the performance of the organisation by the use of standard costing, budgetary control, accounting ratios, cost reduction programme, evaluation of capital investment proposals, funds flow statement, etc.

vi) To help in co-ordinating the operations : The management accounting helps the management in co-ordinating the various activities of the business through the functional budgeting and integrating the functional budgets into a master budget.

vii) To provide solutions to strategic business problems : Whenever the management faces the strategic business problems such as starting a new business, expanding or diversifying the existing business, replacement of manual technique by automatic or mechanical techniques of production etc. The management accountant provides the accounting data pertaining to the various alternatives involved in decision making & helps in solving such problems with reasonable accuracy.

Scope of Management Accounting :

The main task of management accounting is to provide the relevant quantitative and qualitative information to the management at different levels in the most intelligible manner to enable it to discharge its functions most effectively. Hence it draws the information from accounting as well as non-accounting sources. Therefore, the scope of management accounting is wide. The following *fields* are included *in the scope of management accounting.*

1) **Financial Accounting :**Financial accounting provides historical record of business transactions. But it is very useful for future planning and forecasting. Management accountant is mainly concerned with modification and rearrangement of the financial accounting information. Thus financial accounting falls within the scope of management accounting.

2) **Cost Accounting :** The techniques of cost accounting such as marginal costing, standard costing, differential costing, budgetary control etc., must be known to the management accountant. Because by the use of these techniques, lot of cost data is generated which is of great use to the management accounting.

3) **Budgetary Control :** Budgetary control involves framing of budgets for various activities of the business, comparison of actual performance with the budgeted performance, computation and analysis of variances and taking remedical measures for the control of expenses. The knowledge of budgetary control is necessary for management accountant.

4) **Cost control procedure :**The management accountant should be well versed with the various cost control techniques and procedures like inventory control, material control, labour time control, standard costing, budgetary control etc.

5) **Reporting :** Management accountant should possess proficiency in the skills of reporting because he has to send different kinds of reports to the managerial persons at different levels. Hence he should have a precise knowledge of various techniques of presentation of data.

6) **Statistical Methods :** For proper analysis and presentation of quantitative and qualitative data to the managerial people, the management accountant should have complete knowledge of statistical methods of collection, analysis and presentation of data. Statistical methods and tools such as measures of central tendency, measures of dispersion, diagrammatic & graphic representation, correlation & regression analysis, etc.

7) **Operations Research :** Modern business houses face complex problems. Scientific solutions for such problems can be found through operations research techniques such as linear programming, queuing theory, decision theory etc. Management accountant should have knowledge of such sophisticated operations research techniques.

8) **Office Services :** Office services refer to data processing devices, office management services, computer operations, reporting on best use of mechanical and electronic devices,

communication, etc. Management Accountant may be required to maintain & control office services in some organisations.

9) Law : Some of the managerial decisions are taken in the light of regulations or provisions of various statutes such as Companies Act, MRTP, FERA etc. Management Accountant, therefore, should be well versed with such regulations affecting managerial decisions.

10) Internal Financial Control :Management Accountant should also know internal control methods like internal audit, internal checks, continuous audit etc., while guiding the managerial decisions.

11) Inventory Control : Mangement accounting is also concerned with inventory control. Inventory control refers to the control over the investments in inventory form the time it is acquired till its final disposal.

12) Revaluation Accounting : Management accounting covers even the revaluation accounting. Revaluation accounting is mainly concerned with ensuring that capital is maintained in tact in real term and profit is calculated with this fact in mind.

13) Organisation Methods : Management accounting is also concerned with organization and method. Management accountant has to streamline the working of the organization and its various systems, procedures and operations and improve the efficiency of work.

14) Internal audit : Internal audit is concerned with the maintenance of accuracy in accounting and internal control. Management accounting has also to deal with internal audit system.

15) Interim reporting of financial results : Interim refers to periodical reporting on various aspects of business to the management. The reports such as cash flow, funds flow statements, idle time, capacity utilization, defective production, labour absenteeism etc. are sent to the management for control of business. Management accounting also deals with such interim reports.

Thus *management accounting* covers wide areas within its ambit. It covers everything under the sun.

Distinction between Financial Accounting & Management Accounting :

Point of Distinction	**Financial Accounting**	**Management Accounting**
1) Age	It is several centuries old.	It is few decades old.
2) Objective	To report the profitability and financial position of business to interested parties.	To assist the management in performing its functions in efficient manner.
3) Subject matter	It covers all the activities of the business evalvates its overall performance.	It concentrates deep into specific activities of the business and in crucial matters.
4) Compulsion	It is compulsory for all business and non commercial organisations.	It is purely optional, though it is of Immense use.
5) Users of data	It is intended for external use i.e.for owners,creditors, investors, government etc.	It is designed for internal use of management.

6) Approach	It is historical in its approach.	It is futuristic in approach.
7) Objectivity	It is more objective as it is based more on measurement than judgment.	It is more subjective as it is based more on judgement rather measurement.
8) Standardisation	Its forms & procedures are standardised.	Its forms, procedures & methods are flexible.
9) Precision	As the information provided is meant for external use it is accurate & precise.	The information provided is for internal use hence it may be approximate.
10) Publication & audit	Financial statements are audited & published for the use of public.	Statements prepared by management accountant are meant for internal use Hence not published.
11) Data presented	It records only the monetary transactions hence generates monetary information.	It deals with monetary as well as non- -monetary data such as competition, , technical changes, methods of publication etc.

Distinction between Cost Accounting & Management Accounting:

Point of Distinction	**Cost Accounting**	**Management Accounting**
1) Functions	It is primarily concerned with ascertainment of cost, profitability & control of cost.	It is mainly concerned with provision of all sorts on of information for Managerial decision making.
2) Scope	It deals with mainly with cost data.	It deals with cost, revenue, financial accounting financial management, taxation, statistical methods, Operations research etc. and what not.
3) Decision making	While selecting the best alternative in decision making it considers only the cost.	It considers cost as well as non cost factors while deciding upon the alternatives.
4) Period	Normally the period of cost accounts does not exceed an year.	The management accounting may Project its view over number of years in past as well in future
5) Status	The status of cost accountant comes after the management accountant.	Management Accountant is in senior position to cost accountant.
6) Tools &	It is based on tools & techniques such as	It is based on accounting ratio analysis,

techniques	marginal costing, standard, costing, differential costing etc.	funds flow & cash flow statements etc., in addition to costing tools & techniques.
7) Assistance	It assists but does not evaluate the management.	It assists as well as evaluates the management.
8) Approach	It is historical in its approach.	It is futuristic in its approach as well.
9) Installation	It can be installed without management accounting	It needs financial & cost accounting as its base for installation.
10) Parties interested	It serves the interest of both internal & external parties	It serves the interest of only the internal party (i.e. management)

Importance *or* advantages of Management Accounting

Management accounting is a potent tool which enables the management to perform its each and every activity with utmost efficiency. It assists the management in performance of its functions of planning, controlling, co-ordinating, organising, motivating and communicating as explained below.

1) **Planning :** Planning refers to the setting up of the objectives and formulation of appropriate policies and programmes for the achievement of those objectives. Management accounting furnishes the relevant data in proper form at appropriate time to help the management in scientific decision making instead of going in for intuitive decision making & thus achieve accurate planning.

2) **Controlling :** Controlling refers to the effective implementation of plans through comparison of actual results with planned performance and taking up the remedical measures to minimise the deviations if any. Management accounting through the techniques of budgetary control and standard costing helps the management to do the effective control of operations.

3) **Co-ordinating :** Management accounting through the departmental budgets and master budgets helps the management to bring about perfect co-ordination among the various departments of an enterprise such as production, purchase, sale, finance & personnel etc.

4) **Organising** : Organising refers to grouping of activities, fixation of responsibility and delegation of authority within the organisation. This can be achieved by dividing the organisation into suitable cost and profit centres. Management accounting helps the management in establishing such cost and profit centres and a sound system of internal control and internal audit.

5) **Motivating :** Motivation refers to realising the entire work potential of employees by proper encouragement and maintenance of high degree of morale. Management accounting enables the management to judge the performance of personnel through periodical departmental Profit & Loss A/c., budgets and reports.

6) **Communicating :**Transmission of orders and instructions from top management (i.e. superiors) to the middle and lower levels of management (i.e. subordinates) and reporting of the results and requirements of middle level and lower level management should be reported to the top management. Management accounting helps the management in communication by developing a suitable report system.

The management accounting helps the management in performance of each and every function in effective manner.