

UNIT I INTRODUCTION

1. What is Management Accounting? Discuss the objectives of Management Accounting.

Ans. Management accounting (also known as Managerial accounting) is a branch of accounting that is concerned with the identification, measurement, analysis, and interpretation of accounting information so that it can be used to help managers to make necessary decisions to efficiently manage a company's operations.

The Institute of Cost and Management Accountants, London, has defined Management Accounting as: "The application of professional knowledge and skill in the preparation of accounting information in such a way as to assist management in the formulation of policies and in the planning and control of the operation of the undertakings.

Objectives of Management Accounting:

The fundamental objectives of management accounting are to enable the management to maximize profits or minimize losses. The evolution of managerial accounting has given a new approach to the function of accounting.

The main objectives of management accounting are as follows:

(i) Planning and policy formulation: Planning involves forecasting based on available information, setting goals; framing policies determining the alternative courses of action, and deciding on the program of activities. Management Accounts can help greatly in this direction. It facilitates the preparation of statements in light of past results and gives estimation for the future.

(ii) Interpretation process: Management Accounts to present financial information to the management. Financial information is technical. Therefore, it must present in such a way that it is easily understood. It presents accounting information with the help of statistical devices like charts, diagrams, graphs, etc.

(iii) Assists in the Decision-making process: With the help of various modern techniques management accounting makes the decision-making process more scientific. Data relating to cost, price, profit, and savings for each of the available alternatives are collected and analyzed and provides a base for making sound decisions.

(iv) Controlling: It is useful for managerial control. Their tools like standard costing and budgetary control help control performance. Cost control is effected through the use of standard costing and departmental control is made possible through the use of budgets. The performance of every individual is controlled with the help of managerial accounting.

(v) Reporting: Management Accounts keeps the management fully informed about the latest position of concern through reporting. It helps management to take proper and quick decisions. The performance of various departments is regularly reported to the top management.

(vi) Facilitates Organizing: "Return on Capital Employed" is one of the tools of Management Accounts. Since managerial accounting stresses more on Responsibility Centre's to control costs and

responsibilities, it also facilitates decentralization to a greater extent. Thus, it helps set up an effective and efficient organization framework.

(vii) Facilitates Coordination of Operations: Management accounts provide tools for overall control and coordination of business operations. Budgets are an important means of coordination.

(viii) Motivating Employees: Management accounting helps the management in selecting best alternatives of doing the things. Targets are laid down for the employees. They feel motivated in achieving their targets and further incentives may be given for improving their performance.

2. Explain the nature/characteristics of management accounting.

Ans. It is matter of fact that management accounting is the backbone for every organization. Because it assists the management of organization through providing the relevant and accurate information at the right time for taking rational decisions to short out the business problems. Thus, it is clear that a management accounting should possess these essential characteristics:

(1) Providing Financial Information: The main emphasis of management accounting is to provide financial information to management. The information is provided in a manner suitable to various levels of management for reviewing policies and decision making.

(2) Cause and Effect Analysis: Financial accounting confines itself to presentation of P&L account and Balance Sheet. Management accounting analyses the cause and effect of the facts and figures thereon. If there is loss causes for the losses are investigated. If there is profit the variable affecting the profit are also analysed. The amount of profit is compared with expenditure, sales, capital employed, etc., to draw appropriate conclusions relating to the effect of those items on profit.

(3) Use of Special Techniques and Concepts: Management accounting employs special techniques like standard costing, budgetary control, marginal costing, fund flow, cash flow, ratio analysis, responsibility accounting, etc. to make accounting data more useful and helpful to the management. Each of these techniques or concepts is a useful tool for specific purpose in analysis and interpretation of data, establishing control over operations, etc.

(4) Decision Making: Main objective of management accounting is to provide relevant information to management to take various important decisions. Historical information provides a base on which the future impact is predicted, alternatives are developed and decisions are made to select to select the most beneficial course of action.

(5) No Fixed Conventions: Financial accounting has various established principles and rules in preparing the financial accounts. Management accounting has no such fixed rules. The tools or techniques applied by the management accounting are same but application of these techniques various from concern to concern and situation to situation.

(6) Assist in Achieving Objectives: Management Accounting is always assist organization in achieving its predetermined goals. Because it provides detailed information in regarding the weakness and the strength of organization in the form of report, on the basis of that any organization can eliminate recognized weakness (business problems) and may achieve its goal easily.

(7) Improving Efficiency: It also plays an essential role in increasing efficiency of organization. As we know that in this competitive business age it is difficult for every organization to carry out its entity

forever. Hence to survive for long run it is important for organization to increase its efficiency by finding the errors and removing it through management accounting techniques (standard costing, budgetary control, control accounting).

(8) Forecasting: Management accounting is concerned with taking decisions for future implementation. This involves prediction and forecasting of future. It is helpful in planning and laying down of objectives.

(9) Providing of Information and not Decisions: It only provides required data and information to the management, not the decision. It is up to the management that how they utilize the available data and information to resolving the business problems through taking effective decisions.

3. Discuss the scope of management accounting.

Ans. The scope of management accounting is very wide and broad-based. It includes all information which is provided to the management for financial analysis and interpretation of the business operations.

(i) Financial Accounting: Financial accounting though provides historical information but is very useful for future planning and financial forecasting. Designing of a proper financial accounting system is a must for obtaining full control and co-ordination of operations of the business.

(ii) Cost Accounting: It provides various techniques of costing like marginal costing, standard costing, differential and opportunity cost analysis, etc., which play a useful role in the operation and control of the business undertakings.

(iii) Budgeting and Forecasting: Forecasting on the various aspects of the business is necessary for budgeting. Budgetary control controls the activities of the business through the operations of budget by comparing the actual with the budgeted figures, finding out the deviations, analysing the deviations in order to pinpoint the responsibility and take remedial action so that adverse things may not happen in future.

Both the techniques are necessary for management accountant.

(iv) Cost Control Procedures: These procedures are integral part of the management accounting process and include inventory control, cost control, labour control, budgetary control and variance analysis, etc.

(v) Reporting: The management accountant is required to submit reports to the management on the various aspects of the undertaking. While reporting, he may use statistical tools for presentation of information as graphs, charts, pictorial presentation, index numbers and other devices in order to make the information more impressive and intelligent.

(vi) Methods and Procedures: It includes in its study all those methods and procedures which help the concern to use its resources in the most efficient and economical manner. It undertakes special cost studies and estimations and reports on cost volume profit relationship under changing circumstances.

(vii) Tax Accounting: It is an integral part of management accounting and includes preparation of income statement, determination of taxable income and filing up the return of income etc.

(viii) Internal Financial Control: Management accounting includes the internal control methods like internal audit, efficient office management, etc.

(ix) Interpretation: Management accounting is closely related to the interpretation of financial data to the management and advising them on decision-making.

(x) Office Services: The management accountant may be required to maintain and control office services in some organizations. This function includes data processing, reporting on best use of mechanical and electronic devices, communication, etc.

(xi) Evaluating the Performance of the Management: Management accounting provides methods and techniques for evaluating the performance of the management. It evaluates the performance of the management in the light of the objectives of the organisation. Thus, it helps in the implementation of the principle of management by exception.

4. Discuss the techniques of management accounting.

Ans. In order to discharge all functions like, planning, organising, staffing, direction and control properly and efficiently, it is the duty of the Management Accountant to supply necessary information to the management. For this purpose, the Management Accountant takes the helps from the following:

(i) Financial Planning: The main objective of any business organization is maximization of profits. This objective is achieved by making proper or sound financial planning. Hence, financial planning is considered as best tool for achieving business objectives.

(ii) Financial Statement Analysis: Profit and Loss account and Balance Sheet are important financial statements. These statements are analyzed for different period. This type of analysis helps the management to know the rate of growth of business concern. This analysis is done through comparative financial statements, common size statements and ratio analysis.

(iii) Fund Flow Analysis: This analysis find out the movement of fund from one period to another. Moreover, this analysis is very useful to know whether the fund is properly used or not in a year when compared to the previous year. The working capital changes and funds from operation are also finding out through this analysis.

(iv) Cash Flow Analysis: The movement of cash from one period to another can be find out through this analysis. Besides, the reasons for cash balance and changes between two periods are also find out. It studies the cash from operation and the movement of cash in a period.

(v) Standard Costing: Standard costing is predetermined cost. It provides a yard stick for measuring actual performance. It is used to find the reasons for the deviations if any.

(vi) Marginal Costing: Marginal costing technique is used to fix the selling price, selection of best sales mix, best use of scarce raw materials or resources, to take make or buy decision, acceptance or rejection of bulk order and foreign order and the like. This is based on the fixed cost, variable cost and contribution.

(vii) Budgetary Control: Under Budgetary control techniques, future financial needs are estimated and arranged according to an orderly basis. It is used to control the financial performances of business concern. Business operations are directed in a desired direction.

(viii) Revaluation Accounting: The fixed assets are revalued as per the revaluation accounting method so that the capital is properly represented with the assets value. It helps to find out the fair return on capital employed.

(ix) Decision-making Accounting: A business problem can be solved by choosing any one of the best and most profitable alternative. To select such alternative, the relevant costs are compared. Thus, accounting information is used to solve the business problems which are arising out of increasing complexity of nature of business.

(x) Statistical Techniques: There are a lot of statistical techniques used in removing management problems. Methods of least square, regression and quality control etc. are some examples of statistical techniques.

(xi) Ratio Analysis: It is used to management in the discharge of its basic functions of forecasting, planning, coordination, communication and control. It paves the way for effective control of business operations by undertaking an appraisal of both the physical and monetary targets.

6. Distinguish between Cost Accounting and Management Accounting.

Ans.

Basis	Cost Accounting	Management Accounting.
(i) Deals with	It deals with ascertainment, allocation, apportionment and accounting aspect of cost.	It deals with the effect & impact of cost on the business.
(ii) Base	It provides a base for management accounting.	It is derived from both cost accounting & financial accounting.
(iii) Status	The Status of cost Accountant comes after the Management Accountant	Management Accountant is senior in position to Cost Accountant.
(iv) Role	It is helpful in collecting costing data for the management.	It is helpful in analyzing as costing data for decision making.
(v) Out look	Cost accountant has a narrow approach. He has to refer to economy and statistical data for analyzing cost effects.	Management accountant responds the effect of cost on the business along with cost analysis.
(vi) Tools & Techniques	It has standard costing/ variable costing; breakeven analysis etc. has the basic tools & techniques.	Along with these, the management accountant has funds and cash flow statement, Ratio analysis etc. as his accounting tool & techniques.
(vii) Scope	It does not include financial accounting, tax planning and tax accounting.	It includes financial & cost accounting and tax accounting.
(viii) Installation	It can be installed without management accounting	It needs financial and cost accounting as its base for its installation.

7. What is cost control? Explain the main essentials for success of cost control. Name the techniques of cost control.

Ans. Cost Control is a process which focuses on controlling the total cost through competitive analysis. It is a practice which works to maintain the actual cost in agreement with the established norms. It ensures that the cost incurred on an operation should not go beyond the pre-determined cost.

Cost Control involves a chain of functions, which starts from preparation of the budget in relation to the operation, thereafter evaluating the actual performance, next is to compute the variances between the actual cost & the budgeted cost and further, to find out the reasons for the same, finally to implement the necessary actions for correcting discrepancies.

The Chartered Institute of Management Accountants, London defines cost control as:

“The regulation by executive action of the cost of operating an undertaking particularly where such action is guided by cost accounting.”

Essentials for Success of Cost Control:

The following steps should be taken in an effective system of cost control:

1. For an effective system of cost control, the firm should have a definite plan of organisation. Authority and responsibility of each executive should be clearly defined. Targets for performance of work as well as the cost to be incurred for the purpose should be laid down for each area of responsibility so that responsibility may be fixed for the deviation of actual cost from the predetermined cost.

2. Costs should be collected for each area of responsibility. One of the recent developments in the field of managerial accounting is the responsibility accounting which is helpful in exercising cost control. It tries to control cost in terms of the persons responsible for their incurrence.

It is a method of accounting in which costs are identified with persons responsible for their control rather than with products or functions. Reporting of efficiency or inefficiency displayed by each person should be prompt. Information delayed is information denied.

If a considerable time elapses between happening of events and reporting, opportunity for taking appropriate action may be lost or some wrong decisions may be taken by management in the absence of information.

3. The report should draw management's attention to exceptionally good or bad performance so that management by exception may be carried out effectively. The aim should be to bring to light the factors leading to increase in cost rather than to punish people to take the remedial action to improve the performance in future.

4. Good performance should be handsomely rewarded so that workers may be motivated towards better performance.

5. For an effective system of cost control, there should be effective budgetary control and there should be proper setting of standards. Budgets and standards should be fixed with realism. Cooperation of all persons who are to achieve the budgeted results or standards should be secured in preparing budgets or setting up standards to get their willing involvement in achieving the desired results.

Techniques of Cost Control:

Among the techniques which have become popular for ensuring cost control are:

(a) Material Control, (b) Labour Control, (c) Overhead Control, (d) Budgetary Control, (e) Standard Costing, (f) Control of Capital Expenditure, (g) Responsibility Accounting, (h) Productivity and Accounting Ratios.

8. What is cost reduction? Explain the main essentials for success of cost reduction. Name the techniques of cost reduction.

Ans. Cost Reduction is a process, aims at lowering the unit cost of a product manufactured or service rendered without affecting its quality by using new and improved methods and techniques. It ascertains substitute ways to reduce the cost of a unit. It ensures savings in per unit cost and maximisation of profits of the organisation.

Cost Reduction aims at cutting off the unnecessary expenses which occur during the production, storing, selling and distribution of the product. To identify cost reduction, the following are the major elements:

- Savings in per unit cost.
- No compromise with the quality of the product.
- Savings are non-volatile in nature.

The Chartered Institute of Management Accountants, London defines cost reduction as follows:

“Cost reduction is to be understood as the achievement of real and permanent reduction in the unit cost of goods manufactured or services rendered without impairing their suitability for the use intended or diminution in the quality of the product.”

Essentials for success of cost reduction

Cost reduction aims at improvement of human efforts. In a business organisation several persons are engaged in diverse activities. It may be a short-term or long-term under special problems such as reduction in profit, specific inefficiencies in certain spots (or fall in production).

A special cost reduction programme is geared into action to meet the situation and improve the position. Long-term cost reduction plans improve major reductions in costs and may involve capital expenditure.

Steps taken for Success of Cost Reduction Programme:

a. A cost reduction programme must be appropriate to the organisation.

- b. A cost reduction programme should not be taken as a onetime activity. It is a continuous activity aimed at reducing cost continuously by innovating new ideas from time to time. Cost reduction is a corrective function based on the philosophy that every human action can be improved by continuous effort.
- c. Cost reduction should not be done by arbitrary cost slashing. It should be real and permanent reduction in cost.
- d. To make cost reduction programme acceptable to the employees of the organisation, the example of cost reduction should be first set by top executives. The success of cost reduction programme depends upon the co-operation of all persons involved in the programme.
- e. Persons giving innovative ideas for cost reductions should be suitably rewarded by giving raise in wages and salaries, promotion and special awards.
- f. A cost reduction programme should not merely take into consideration reduction in cost but it should also consider all other factors (i.e. social and legal aspects) which will be affected by the programme of cost reduction.
- g. A cost reduction programme should be evolved with the idea that even the most efficient firms incur unnecessary costs, that is, there is always scope for cost reduction in every firm.
- h. There should not be any overlap between the cost reduction measures, that is, there should not be double counting of cost reductions.



Tools and Techniques of Cost Reduction:

The various techniques and tools used for achieving cost reduction are practically the same which have been suggested for cost control.

Some of these are:

- (i) Budgetary control, (ii) Standard costing, (iii) Standardisation of products and tools and equipment's, (iv) Simplification and variety reduction, (u) Improvement in design, (vi) Material control, (vii) Labour control, (viii) Overhead control, (ix) Production planning and control, (x) Automation, etc.

9. What are the advantages and disadvantages of cost reduction?

Ans. Advantages of Cost Reduction: There are many advantages of cost reduction. Some of these are:

- a. Cost reduction increases profit. It provides a basis for more dividends to the shareholders, more bonuses to the staff and more retention of profit for expansion of the business which will create more employment and overall industrial prospects.
- b. Cost reduction will provide more money for labour welfare schemes and thus improve men-management relationship.

- c. Cost reduction will help in making goods available to the consumers at cheaper rates. This will create more demand for the products, economies of large scale production, more employment through industrialisation and all-round improvement in the standard of living.
- d. Cost reductions will be helpful in meeting competition effectively.
- e. Higher profit will provide more revenue to the government by way of taxation.
- f. As a result of reduction in cost, export price may be lowered which may increase total exports.
- g. Cost reduction is obtained by increasing productivity. Therefore, a developing country, like India, which suffers from shortage of resources, can develop faster if it makes the best use of resources by increasing productivity.
- h. Cost reduction lays emphasis on a continuous search for improvement which will improve the image of the firm for long-term benefits.

Disadvantages of Cost Reduction:

The possible dangers of any cost reduction plan may be as follows:

- (a) Quality may be sacrificed at the cost of reduction in cost. To reduce cost, quality may be reduced gradually and it may not be detected till it has assumed alarming proportion. Quality may be reduced to such an extent that it may not be accepted in the market and the business may be lost to the competitors.
- (b) In the beginning cost reduction programme may not be liked by the employees and danger may be poised to the programme because success of any cost reduction plan depends upon the willing cooperation and active participation of the employees.
- (c) It is possible that reduction in cost may not be real and permanent. It may not be based on sound reasons and may be short lived and cost may come back to the original cost level when temporary conditions (i.e. fall in prices of materials) due to which cost has reduced disappear.
- (d) There may be a conflict between individual objective and organisational objective. It is possible that a head of a particular department may follow activities which may reduce the cost of his department but may lead to increase in cost for the organisation as a whole.

10. Distinguish between Cost Control and Cost Reduction.

Ans.

Basis	Cost Control	Cost Reduction
1. Aim	Cost control aims at achieving the predetermined costs.	Cost reduction aims at reduction of costs by finding new ways or methods to have continuous economy on costs.
2. Exercise	Cost control is a routine exercise which is carried out for attainment of	Cost reduction aims at permanent and real savings by a continuous

	operational efficiency.	search for improvement.
3. Nature	Cost control follows a conservative procedure and lacks a dynamic approach.	Cost reduction is dynamic and innovative in nature.
4. Concerned with	The process of cost control is to lay down a target, ascertain actual performance, compare it with the target and take corrective action.	Cost reduction is not concerned with maintenance of performance according to the predetermined standards.
5. Approach	Cost control seeks adherence to standards whereas cost reduction is a challenge to the standards themselves.	Cost reduction assumes that there are chances of improvements in predetermined standards.
6. Function	The aim of cost control is to see that actual costs do not exceed the predetermined costs; so it is a preventive function.	Cost reduction is a corrective function because it challenges the predetermined costs and seeks to improve the performance by reducing cost of increasing production. It is a continuous function of self-analysis for making more and more improvement in performance.
7. Applicability	Cost control is generally applicable to items of costs which have standards.	Cost reduction is applicable to every activity of the business.
8. Tools of Techniques	Budgetary Control and Standard Costing are important tools of cost control.	Cost reduction makes use of techniques like value engineering/value analysis, work study, operation research, simplification and standardisation, ABC analysis, etc
9. When Achieved	Cost control is achieved once the costs do not exceed the standards whereas cost reduction is never ending.	In fact cost reduction begins when cost control ends.
10. Operation/Research Oriented	Cost control is operation oriented.	Cost reduction is research oriented, always trying to reduce costs through planned research.

11. What is Cost Management? Explain the importance/significance of Cost Management.

Ans. Cost management is a method of reducing operating or production expenses in order to provide less expensive products or services to consumers. In other words, it's the process management uses to analyze its production and streamline its operations to keep costs low and manage expenses in the future.

The purpose of cost management is to ensure adequate supply of funds from the right source at the right cost and at the right time to the firm to meet its funding needs. In this connection a cost benefit analysis of various alternative sources must be made before acquiring funds from any particular source. Financial activities have undergone tremendous changes, the cost management, therefore gained much importance over the time.

Significance of Cost Management

(i) Determinant of Business Success- Sound cost management is the index of the success of an enterprise, its existence and growth. Cost management makes possible the use of available resources in the form of men, materials and machines more effectively. Thus, it helps in preparation of plans for development & expansion and their successful executions.

(ii) Focal point of Decision making- It provides scientific analysis of facts and figures. This helps on evaluating the profitability of the project in the given circumstances so that a proper decision may be taken to minimize the risk involved in the project.

(iii) Measurement of performance- The performance of the firm can be measured by its financial results i.e. by the size of its earnings. Risk and profitability are two major factors which jointly determine the value of the firm. Financial decisions which increase the risk will reduce the value of the firm, and on the other hand, financial decision which increases the profitability will enhance the value of the firm. Therefore, risk and profitability are two essential ingredients of a business concern as observed, financial decision affect the size of earnings stream or profitability and the riskiness of the firm. Policy decision affects risk and profitability.

(iv) Advisory Role- It plays a very important role in the success of a business organization by advising top management. It represents important facts and figures regarding financial position and performance of various segments of the firm to evaluate the progress of the firm and to amend suitably the principles of the firm.

(v) Optimal Utilization of Resources- Sound cost management emphasizes the optimum utilization of resources of the enterprise. In fact, the failure of a business enterprise is not always the result of inadequate finance but it is the result of defective management of funds. Effective cost management plays the important role in the maximum exploitation and utilization of the enterprise resources. Effective utilization of financial resources is of great significance. It gives maximum returns by increasing the productivity of capital funds.
