CHAPTER 1
MANAGEMENT ACCOUNTING: AN OVERVIEW

Introduction

Accounting is the language of business. It is indispensable for any form of business organisation irrespective of nature and size. It performs a variety of functions like recording, classifying, summarizing and interpreting of business transactions and communicating the same to the decision centres and users both within and outside the organisation. The principal function of accounting, therefore, lies in communicating economic information to permit informed judgments and decisions by the users of the information.¹

In business world, the future, by and large, is unpredictable and the competition is ever growing and intensifying. Hence, decision-making plays a key role in day-to-day operations of the business. But then, the process of decision-making is much more complex. Taking a right decision at a right time largely depends on provision of right information at right time. Business organizations, therefore, have started relying more and more on internal sources of information and the people who could provide accurate information.

Accounting is the most reliable source of information and the finance controllers and accountants become the first line advisors to the management. Accounting, within a few decades, has transformed itself from a mere score-keeping activity into an information system and a service activity with advisory capacity. As a service activity accounting provides quantitative financial

¹Accounting, as defined by American Institute of Certified Public Accountants, is "an art of recording, classifying and summarising in a significant manner and in terms of money, transactions and events, which are in part at least of a financial character and interpreting the results thereof."
information to interested parties that help them in making decisions regarding the deployment and use of resources in the business operations. As an information system it collects and communicates economic information to all whose decisions and actions affect the performance of the organisation. Accounting has now reached a stage where the function of dissemination of information for informed judgment and decision-making forms the nucleus of accounting system. All other activities which consume a major portion of the time of the accountants are primarily undertaken to facilitate reporting of information.

Accounting does not mean financial accounting alone, it also includes cost accounting, management accounting, human resources accounting, tax accounting, depreciation accounting, social accounting and so on. With its extended scope, accounting has come to be considered as a significant tool even by non-trading and not-for-profit organizations.

Keeping in view the various benefits and uses of accounting, individuals and institutions of various hues started evincing keen interest and giving more and more importance to accounting in their organizational set-up as a service activity catering to the informational needs of the managers.

Management Accounting: Historical Background

Different views have been expressed over the evolution of management accounting. Many believe that it dates back to the period of the Industrial Revolution. Cost accounting is the earliest form and a part of management accounting, traces of which could be found from the records of textile industries and from Rail Road accounting. While tracing the rise of accounting in UK Management, Armstrong stated that the dispersal of shares among many owners,

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and active capital markets, by the early years of this century had led to auditing becoming an important activity. From this base the accounting profession extended its intervention in enterprises. With the emergence of large scale enterprises (requiring vast amounts of money and manpower) there arose a need for a group of specialists styled as managers/administrators to manage the affairs of the companies. Under the owner-manager combination, the managers were expected to report to the owners on how the firms and companies were using the resources and protecting the interests of the owners. This was done through the process of score-keeping and reporting.

In course of time managers realized that the information demanded by the investor-owners was also useful for managing the firm's affairs and resources. Since then the management started consulting the accountants in matters of decision-making. This is how the subject Management Accounting evolved.

However, the subject got into shape during the period when the Certified Public Accountants (CPAs), were consulted by the management frequently. The accountants further gained importance in reporting the impact of economic slumps in the 1920s and the depression of the 1930s. By virtue of their constant touch with the working of the client firms, they were able to meet the advisory requirements of the firms. They interpreted corporate crises in terms of problems of profitability and liquidity and recommended tight financial controls. The firms strongly recognized accounting sources as an indispensable and more reliable source of information. The firms, as a result, instead of availing the consultancy services of the CPAs started appointing them as service staff with advisory capacity. This resulted in the emergence of Management Accounting as a separate discipline. It is, however, during the sixties that the academics evinced keen interest in the then emerging subject of Management Accounting and many

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The involvement of academics and the establishment of international bodies helped to promote Management Accounting as an important management control tool. They also helped to make the subject dynamic by incorporating new accounting statements, rules, tools, and techniques in order to meet effectively the challenging decision-making needs of the organizations in the context of evergrowing competition and technological developments which revolutionized the industrial and business world. Thus, as Armstrong explained, the rise of accounting in management control is the outcome of successful strategies by the accounting profession to promote the services of its members to enterprises. Beginning with the issues of resource allocation—regulating both external investment (financial accounting) and divisional investments (management accounting)—the role of accounting spread more widely in management control. Management control systems, no doubt, today, are in a state of revolution and if Management Accounting is to be relevant in future, it must support very different control requirements as corporations become transformed due to changes in the production technology and in the market place.

Concept of Management Accounting

Accounting systems are designed to produce financial information about an economic entity to supply to those who need it and to those who have a right to receive it. The ultimate objective of accounting system is, therefore, the use

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8See for example, The Institute of Cost and Works Accountants (UK) established in the year 1919 was renamed as the Institute of Cost and Management Accountants in 1972 and then as Chartered Institute of Management Accounting in 1986, stressing the shifting and changing emphasis of the organisation.


10Gerald H.B.Ross, Revolution in Management Control: the JIT World can't be run by layers of Supervision and control, Management Accounting, 11, Nov. 1990, pp. 23-27.

of information generated through the process of book-keeping, its analysis and interpretation. The branch of accounting that fulfils the informational needs and rights of the internal parties of the organisation is termed as internal accounting and more commonly as Management Accounting.

The Chartered Institute of Management Accountants, London, defines 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 formation of policies and in the planning and control of the operations of the undertaking".

The Management Accounting Team of the Anglo-American Council of Productivity has also defined it in a more-or-less similar fashion. For the Council, Management Accounting is the presentation of accounting information in such a way as to assist management in the creation of policy and in the day-to-day operations of an undertaking. The American Accounting Association (AAA) defines Management Accounting slightly in a different way. According to the Association, "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 the making of rational decisions with a view towards achieving these objectives".

Besides the purpose and aim, the AAA's definition stresses two important points. First, Management Accounting uses certain tools and techniques for the purpose of generating accounting information; and, secondly, it does not restrict itself to the use of historical data alone. It also uses the projected future data and non-accounting information in the decision-making process.

From the foregoing analysis it is clear that Management Accounting is a process of generating accounting information by applying appropriate accounting tools and techniques and communicating the information so generated to the interested internal parties especially to the management to facilitate policy formulation, planning and controlling the activities of the organisation.
Steps in Management Accounting

The process of accounting information generation involves a sequence of steps. A functional definition given by the International Federation of Accountants vividly lists the various steps involved. A brief description of each of the steps, as stated in the preface of the Statements of International Management Accounting will be in order.

Identification: the recognition and valuation of business transactions and other economic events for appropriate accounting actions.

Measurement: the quantification, including estimates, of business transactions or other economic events that have occurred or may occur.

Accumulation: the disciplined and consistent approach to recording and classifying appropriate business transactions and other economic events.

Analysis: the determination of the reasons for and the relationship of the reported activity with other economic events and circumstances.

Preparation and Interpretation: the meaningful coordination of accounting and/or planning data to satisfy the need for information presented in a logical format and, if appropriate, to include the conclusion drawn from that data.

Communication: the reporting of pertinent information to management and others for internal and external use.

Functions of Management Accounting

The ultimate purpose of Management Accounting is to provide information to the management that helps them make decisions. Management Accounting performs certain functions to fulfil the purpose. The functions may be briefly stated as shown hereunder.

Generates information: Data and information from financial and cost accounting records are identified, measured and assembled in a meaningful and presentable manner.

Rearranges and Modifies data: In the process of generation of data and information, figures as found in the financial accounting and cost accounting records are properly classified, rearranged, modified wherever necessary and compiled in a useful manner.

Analyses and interprets data: In order to make the accounting data more useful to the management, it is normally presented in a comparative formal. Moreover, the data is complemented with simple and useful interpretation of the figures. Such interpretations are made after thorough analyses of facts and figures using the various financial analysis tools and techniques like ratio analysis, trend analysis, etc.

Serves as a means of communication: Management Accounting provides a means of communication within the organisation. It links almost all the departments/sections while generating and disseminating accounting information inside the organisation. It facilitates and fortifies the understanding of sectional heads not only about their own section but also about the organisation as a whole.

Facilitates planning and controlling: Management Accounting helps in formulating objectives and strategies, in translating them into specified goals to be attained within a fixed timeframe. It also assures and secures effective accomplishment of these goals through facilitating control measures using various accounting control techniques like budgetary control, standard costing and variance analysis.

Uses qualitative information: Management Accounting does not restrict itself to financial and costing records alone for reporting to management. It uses other sources of information also. Non-monetary information and data are used by the Management Accountants. Unlike the accountants in charge of financial accounting and cost accounting, the Management Accountants are expected to
provide narrative and qualitative reports on the performance and other management aspects of the organisation.

Scope of Management Accounting

The scope of Management Accounting cannot be restricted to certain limited activities alone. It has a vast scope. It has to be so, for it is designed to assist the management in the core activity of decision-making. Decision-making is a continuous activity and is imperative in planning, implementation and controlling. Any decision is an outcome of a rational process of selecting a course of action from among the available alternatives. Selection is always based on the available information about each of the alternatives. There are certain accounting techniques and tools which are used in this process. Fisher and McCutcheon et al.,\textsuperscript{13} have undertaken a content analysis of five most frequently referred to books on Management Accounting written and published after 1984. The analysis has revealed that decision-making, planning and control formed the core of the subject. The contents of the books were grouped under six headings. They are: (i) Decision-making; (ii) Planning and control; (iii) Capital budgeting; (iv) Product costing; (v) Quantitative methods (which is not available in the Garrison and Garrison et al., book); and, (vi) Basis of financial accounting for managers (See Table 1.1). These areas, by and large, constitute the scope of Management Accounting.

Another way to understand the scope of Management Accounting is to look at the functions performed by Management Accounting. The functions include: (i) accounting for current planning and control (budgets, analysis of performance and cost identification and control); (ii) General accounting (score keeping); (iii) internal audit; (iv) tax planning; (v) systems and procedures, electronic data processing; and, (vi) special reports and studies.\textsuperscript{14}


Table 1.1
Scope of Management Accounting - An Analysis of the Content of Recent Textbooks on Management Accounting

|---------------------------------------------|----------------|---------------------------|-------------------------------|-----------------|-----------------------------------|

**Decision Making**
- Perspective
- Introduction to cost volume relations
- Introduction to manufacturing costs
- Relevant costs and special decisions

**Planning and Control**
- Master budget: overall plan
- Flexible costs and standards for control
- Variations of cost behaviour patterns
- Responsibility accounting and cost allocation
- Profit centres and transfer pricing

**Capital Budgeting (CB)**
- CB an introduction
- CB: Taxes and inflation

**Product Costing**
- Process costing systems
- Job costing and overhead application
- Overhead application:
  - direct and absorption costing

**Quantitative Methods**
- Influences of QT on Management Accounting

**Basic Financial Accounting for Managers**
- Basic Accounting:
  - concepts, techniques and conventions
- Understanding corporate annual reports
- Difficulties in measuring annual reports

| ✔ | denotes included | ✗ | denotes omitted |

From the foregoing analysis, the scope of Management Accounting can be summarized as here under:

(i) Financial accounting (score-keeping);
(ii) Cost accounting;
(iii) Budgeting and Budgetary control;
(iv) Internal audit;
(v) Financial reporting; and,
(vi) Taxation and revaluation accounting.

Recent Trends in Management Accounting

Effective Management Accounting must reflect the value-creating activities of companies and firms in operations, in marketing and sales and in product and process development. In particular, they can not be developed and maintained in isolation from the organisation and technology of a company's manufacturing processes. If substantial changes are taking place in manufacturing processes, the Management Accounting Systems must also change if they are to provide relevant information for managerial decisions and control.\(^{15}\)

Although Management Accounting information cannot guarantee success in the critical organizational activities, inadequate and distorted signals from Management Accounting System will cause companies to encounter severe difficulties. Effective Management Accounting Systems can create considerable value by providing timely and accurate information about the activities that are required for the success of the organisations.\(^{16}\) It is, therefore, imperative on the part of the accountants to prepare themselves to adapt to the changing conditions and to equip themselves to face the challenges in the context of changing business and manufacturing technology.


It is undeniable that many of the Management Accounting practices used today were developed around 1925 and today's Management Accounting is too late, too aggregated and too distorted to be relevant for managers in their planning and control decisions. In view of the above facts Kaplan argued that Management Accounting had not responded to changes after 1925 and had thus lost its relevance\(^{17}\) in today's globally competitive and technologically challenging environment.

However, it is unequivocally true that, in recent years, Management Accounting has broadened its scope and coverage by adopting newer techniques and methods in information generation and provision. Traditionally, Management Accounting information has been financial in nature; that is, it has to be denominated in a currency such as Dollars or Deustch Marks, but the domain of Management Accounting increasingly has expanded to encompass operational or physical (non-financial) information, such as quality and process times as well.\(^{18}\) Thus, Management Accounting information is shifting away from its historical emphasis on controlling the actions of employees. The information is now being used to inform and empower the employees to facilitate their continuous improvement of activities.\(^{19}\)

In all, Management Accounting is increasingly regarded as an integral part of the strategy process providing crucial and continuous information. It is taking on a number of more dynamic and flexible forms including Activity Based Costing and Time Based Analysis. Such new interpretations and techniques bring Management Accounting into the mainstream of information provision and strategy formulation while distancing it from financial accounting. The important recent trends include Activity Based Costing, Strategic Management Accounting, Time Based and Asset Based Analysis, Target Cost, Just-in-Time and Multiplexed Analysis, etc.\(^{20}\)


\(^{18}\)Anthony A. Atkinson et al., Op.cit., p.4

\(^{19}\)Ibid.p.26.

ABC uses the idea that activities such as order entry or batch set-up may have very different impacts on different products, and/or on different customers. One should cost one-off or small orders, and one may find them very expensive at times indeed. What one can do about this is a complex matter.

Strategic Management Accounting uses the idea that longer term and non-accounting goals may be as important as short-term profit. Strategic goals may require the reporting of non-accounting numbers and of some variables which have limited impact on short-term profit.

Time based analysis and Asset Based Analysis are a break from the traditional western obsession with the profit and loss account and with direct labour cost. It uses the logic:

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\text{Return on Assets} = \frac{\text{Margin on Sales} \times \text{Assets Turnover}}{}.
\]

If we boost the assets turnover sufficiently high, the size of the profit margin can be as low as we like and the business will then earn a high return on assets at very competitive prices, and will need little cash to fund its growth. Key goals include flexibility and speed of assets movement rather than cost per se.

Multiplexing belies the fiction that nothing affects anything else. Multiplexing uses database technology to look directly at interactions and to simulate major policy changes.

Designing of Management Accounting System

The effectiveness of a Management Accounting System depends not only on the appropriateness of its technical characteristics to the particular organizational and environmental circumstances to which it is applied, but also on the way in which organizational participants make use of the information that it provides\(^{21}\). The formal organizational set-up should be such that it not only facilitates free flow of information but also provides conducive climate to make

Fig. 1.1
Steps in Designing of MAS

1. Studying the Organisational Structure
2. Preparation of organisational Manual
3. Implementation of the System
   - Input from Different Departments
   - Output to user Departments
4. Deciding the MAS location
5. Deciding the structure of the system: Isolated or integrated systems
6. Preparation of Different Proforma statements
7. Feedback (Changes in Proforma)
   - Nature and the Level of the System
     - Nature: Manual or Electronic
     - Level: Data base predictive
     - Decision-Making
     - Decision-Taking
use of such information in the management of the organisation. Therefore, the
design of the Management Accounting System and the use and interpretation of
the Management Accounting information, that is, the output from these systems,
are critical to the success of both manufacturing and service organizations\textsuperscript{22} in
today's competitive business environment. While designing the Management
Accounting System, the undermentioned factors should be given due
consideration.

Designing proper organizational structure: The relationship between
different sections and departments should be studied and understood thoroughly,

Preparation of an organizational manual: In the absence of an
organizational manual, efforts should be made to prepare a manual clearly
indicating the duties and responsibilities of the different heads of departments.
The organisation manual should give clear idea about who needs what information
and from where such information can be generated. That is, organisational manual
would help in deciding the generation and utilization points of information in the
organisation.

Deciding the location of the Management Accounting System
department: The location of the Management Accounting System should facilitate
the relationship between the users and the Management Accounting personnel.

Deciding the type of system: It has to be decided whether to have separate
systems for financial, costing and Management Accounting or to have an integrated
system which could serve all these purposes, taking into account the cost
effectiveness of each alternative.

Preparing proforma: Different and suitable proforma statements and reports
in which information is to be supplied should be prepared according to the
informational needs of the different sections.

Deciding the nature and level of the system: It should also be decided in
advance, whether to have manual system or to have electronic system. The

Fig. 1.2
Different Levels of Decision-Making in Cooperatives

Decision outcome

General Body

Board Directors

Paid Executives

Employees

Operational Decisions

Managerial Decisions

Strategic or Goal Decisions

Management Team

Information

Information Sources

Registrar of Coops

Accounting Information

Generate

Implementation

Information


technological level of the system, data base, predictive, decision-making and decision-taking should also be decided before implementation of the system.

The System should be designed in such a way that it allows flexibility and remains dynamic to adopt changes as and when there is a need (Fig. 1.1).

Importance of Management Accounting in Cooperatives

As association of farmers, consumers or producers, a cooperative undertakes business activities in order to fulfil the socio-economic needs which are common to its members. Being conglomeration and collective organisations, cooperatives are managed by management teams whose members are drawn from the total membership. That is, their management is democratic in nature. Cooperatives apply democratic principle in the economic field/endeavour. As enterprise, the cooperatives are geared to the usual calculative values of profitability, expansion, diversification, organisational and human resource development like any other business organisation. These activities constitute the life of the cooperatives. They need to adopt functions of planning, monitoring and controlling in their day-to-day operations. Progress and development of their business and thereby the development of the socio-economic conditions of their member constituents entirely depends on the manner in which these activities are carried out by the cooperatives.

Cooperatives strive to achieve a multiplicity of objectives. They include: (i) promotion of the ideology of cooperation to bring about a better social and sound economic order; (ii) serving as a technique of community development; (iii) undertaking business activities like any other business organisation; and, (iv) serving as a delivery system of the government. This plurality of objective poses a severe problem to the management of the cooperatives. The fulfilment of all these objectives needs the adoption of modem and professional management with a cooperative zeal. Professional skill is indispensable to combine the modern management tools with cooperative ideology.

In cooperatives, authority and control are widely dispersed among different organs of the management team, viz., the General Body, the Board of Management
and the Executive. Of these three organs, although the General Body is the supreme authority, it does not involve so much in the day-to-day operations of the cooperatives. Its duties are policy making and overall assessment of the performance of the cooperative. The Board, on the other hand, has the power to make decisions, direct, supervise and review the functions and exercise general control over the working of the cooperative. The Executive—the paid staff of the cooperative—is responsible for the execution of the decisions to the satisfaction of the Board and the General Body. In this complex structure of management the Board and the Chief-Executive work in close cooperation with each other. Their task involves the critical function of management, viz., decision-making. In discharging these functions, "if is essential that a Board understands the key elements that add up to the success of the enterprise and be closely acquainted with the current and forecasted progress of the business. Board members should be familiar with the cooperative's purpose, its history, the market potential and the market share it enjoys, the strength of competition, the degree of obsolescence of physical assets, the sales volume of each product or service, the current value of financial assets and the long-term objective of the business. The Board should also have an opportunity to review periodically society's earnings, the soundness of its organisation, and the ability of the employees to meet current and future challenges".  

This important task needs proper and regular generation of business information for making the decision process more effective. Thus, the widespread authority at various levels in cooperatives requires a variety of information in different formats in order to cater to the differing needs of the different stake holders like, the General Body, the Board, the Chief Executive, the state government and the federal and financial institutions to make effective decisions which have bearing on the sustainability of the cooperative.

Therefore, the term Cooperative Management has wider connotation and it "is not meant to cover only those aspects of managing which constitute the tasks

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of employed managers interested in achieving a high degree of business success. Cooperative Management should rather be understood as a complex decision-making process within a three level management pyramid which aims at achieving a proper balance of success of the cooperative enterprise both as a business unit and as a social institution. In this context it is worth mentioning that cooperatives have the onerous responsibility of informing a variety of people with different levels of understanding. Their reporting should be able to meet the different needs of the different levels of the management team in the cooperatives (See Fig. 1.2).

Viewing Cooperatives as purely business organisations also requires planning and controlling of different activities. They need to plan their operations, products, and profit. Cooperatives have to plan their activities in such a way that the cost of their operations are at the possible minimum level in order to provide commodities and services at reasonable and competitive prices.

Controlling the cost of production is another area which calls for advance planning, periodical performance review and timely control measures. It is essential to equip personnel to attend to these functions in an effective manner. This, in turn, is possible in cooperatives where there is proper organisational arrangement, free flow of information from one department to another, adequate provision for generation of information, etc. Accounting being the most reliable source of information, cooperatives have certainly a lot to gain through adoption of modern Management Accounting practices.

Conclusion

Accounting, over the years, has grown from simple score-keeping and reporting to a subject with an advisory capacity to aid in a complex and continuous process of decision-making in large complex organizations. Today accountants have come to occupy corporate executive positions. Accounting knowledge

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and information processing are considered essential for effective and efficient performance of selecting the best course of action from among the available alternatives. As a developing subject with a dynamic nature it has come a long way from the mere use of traditional techniques and tools. At present, accounting is able to provide a more strategic business orientation. Management Accounting, if adopted and practised with all its features, would no doubt bring about better control and better performance in any kind of organisation. Cooperatives, especially in the developing countries, have so much to gain by adopting the Management Accounting tools and techniques in their day-to-day operations.