MANAGEMENT ACCOUNTING

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Brief Contents

Detailed Contents

1 Introduction to Management Accounting

Learning Objectives

After reading this chapter, you will be able to:

- Trace the historical roots of the accounting profession in India
- Understand the development of the accounting profession in India
- Identify the difference between a management accountant and a financial accountant
- Get acquainted with the principles of management accounting
- Understand the role of a management accountant
- Recognize the role of a management accountant as a change agent

Case Study 1.1 Accounting in Vedic India

'Sufficient evidence exists to lead one to conclude that the art and practice of accounting, as a highly developed system, was in vogue in India even during the times of the Vedas, Sutras, and the Upanishads.'

The discussions in the Vedas about matters like the system of land tenure, currency, trade, various occupations, as well as the general social and economic conditions in those times are indicative of the existence of a highly developed system of record keeping.

'Sale appears to have regularly consisted in barter in Rig Veda; 10 cows are regarded as a possible price for an image of Indra to be used as a fetish. The haggling of the market was already familiar in the days of the Rig Veda, and a characteristic hymn of the Atharvaveda, is directed to procuring success in trade. Price was referred to as *Vasna* and the merchant, *Vanij*.'

'An arithmetical progression of some interest is found in the Panchavimsa Brahmana, where occurs a "list of sacrificial gifts" in which each successive figure doubles the amount of the preceding one.'

Vikraya is found in the Atharvaveda and the *Nirukta* denoting 'sale'. *Sulka* in the Rig Veda clearly means 'price'. In the Dharma Sutras it denotes a 'tax'.

Rna meaning debt is repeatedly mentioned from the time of the Rig Veda onwards having apparently been a normal condition among the Vedic Indians. Reference is often made to debts contracted at dicing. To pay off a debt was *Rnam Samni*. Allusion is made to debit contracted without intention of payment.

The trade and industry of the period were characterized by a highly developed organization and the institution was called 'Sreni'. It was a corporation of men following the same trade, art, or craft and resembled the guilds of medieval Europe.

A keen business instinct characterized the society, and trade, commerce, and industry flourished in ancient India to a very large degree. This extensive scale of trading operations could not have been carried on without systematic record keeping. Indeed, archaeologists have found abundant remains of the ancient commercial records, but the historians have seldom indicated any interest in these embryonic accounting records. These, no doubt, do not much resemble modern accounting records, but they constitute evidence that commercial record keeping enjoyed its infancy even in such a civilization.

Source: http://www.icai.org/resource_file/102691526.pdf. *History of Accounting Profession in India* – Vol. I, 1526/The Chartered Accountant/April 2006.

Questions

1. Compare 'Sreni' with present-day industry associations.
2. Compare the terminology used for price, sale, tax, and debt—Vedic times with today's time.

1.1 EVOLUTION OF ACCOUNTANCY PROFESSION

Over centuries, accounting has been considered mainly as a technique of recording financial transactions after they have taken place. A village money lender needs to keep track of his transactions and as such maintains a record chronologically and in a way that he can understand. Shakespeare in his *Merchant of Venice* describes Shylock, the Jew, the money lender who asked for a 'pound of flesh' as a guarantee in the event of a default. Emile Zola in his *Venus of the Counting House* describes the working of counting houses, which was the beginning of the present-day banking industry. Over the years, recording of financial transactions was on a single-entry basis and the books were kept purely on the basis of *receipts* and *payments* and *cash basis*.

Later on, the concept of double-entry book keeping revolutionized the recording of financial transactions and evolved into *financial accounting* to include accrual concepts as well. However, even today, financial transactions are maintained by many governments on cash basis only and accrual concepts getting introduced latterly. The purpose of recording the transaction has undergone a sea change with the evolution of business and trade. At any point of time, it is not only necessary to know the status of debits and credits but also the requirement of external stake holders such as shareholders, debtors, creditors, and statutory authorities has to be taken into account.

Again, the basic axiom of any business is to maintain profitability and solvency for continuance. In regard to this aspect, books of accounts have had to lay bare the viability and financial stability of the individual, firm, or corporate body. Towards this, the financial accounting records are developed to present trial balance, profit and loss account, and a balance sheet. The trial balance concept brings into focus the accuracy of records to be assured before a profit and loss account and a balance sheet are prepared.

The revenue account presents a true picture of profit earned or loss incurred and the balance sheet gave a true and fair view of the state of affairs as at the end of an accounting period, say, financial year. These records, mainly, the profit and loss account and the balance sheet, help external stakeholders to know their obligations and rights vis-à-vis the firm or the company. The debtors know what they have to pay a company as also the goods and services received by them from the firm. The creditors also know of their company's dues to them in relation to goods and services offered by them to the company.

Statutory authorities like regulatory bodies and taxmen know the financial status of the company and their obligations in terms of payment of tax, adherence to laws of the land,

and so on. These financial statements in the form of annual reports from the company have undergone a metamorphosis to suit the changing requirements of statutory bodies, who have introduced many standards as well as regulations to protect the investors who have a stake in the companies. It would be useful to trace the continual change that has taken place in this respect and is continuing to take place in a later chapter. Suffice it to say that accounting standards, company law practices, disclosures, formatting, etc., have been tailored to the requirements of the external stakeholders, both for greater transparency and comprehension.

In the same manner, various businesses conducted by individuals, firms, or corporate bodies have evolved in the arena of consumer market to meet the challenges of competition. In the beginning, this competition was imminent from domestic trade and business. However, during the last century, cross-border financial transactions have gained great currency and are subjected to severe competition and adherence to international standards of quality and business. This has led to an intense introspection in almost all the companies to hone their skills and develop new cannons to meet competition at the market place. Empirical decisions and gut feeling have slowly given way to logical decision-making based on internal controls and reports. These requirements naturally have had to be properly formatted and the principles underlining them enunciated.

Thus, the concept of management accounting was born. The essential distinction between financial accounting and management accounting need to be understood too, before a proper approach for management accounting process can be formulated.

1.2 DEVELOPMENT OF ACCOUNTING PROFESSION IN INDIA

With the civilization dating back to 5000 years ago and with flourishing maritime trade with both the western and eastern countries, commerce in India had registered very strong fundamentals. Vedic text followed by historical data has clearly indicated indigenous systems which prevailed for centuries. With the British influence, the emergence of East India Company in 1600, the Indian financial system was influenced by the west significantly especially during the twentieth century when many important institutions started coming up for fostering and controlling the accounting profession.

In 1932, the Indian Accountancy Board (IAB) came into existence at the instance of the British Governor to advise the Governor General on the qualification and conduct of accountants. Membership to this body was offered under specific conditions. At the beginning, qualified accountants could be nominated for the membership but, subsequently, membership was on the basis of experience and also passing certain examinations.

Post-independence era saw the establishment of the Institute of Chartered Accountants of India (ICAI) in the year 1949 and has since grown enormously to encompass new areas of accounting and laying down standards (Accounting Standards 1 to 32). Subsequently, the institutes involved in introducing International Financial Reporting Standards (IFRS) from the next year. These developments have been accentuated due to globalization from the last decade of the twentieth century and progressively integrating the financial accounting procedures of various countries, keeping the indigenous requirements intact.

The government of India also accelerated the pace of professionalization of the accounting profession by addressing certain key areas. A strong legal regulation of accounting was also ushered through the enactment of the Companies Act, 1956, which has subsequently been updated with important amendments to keep up with contemporary requirements and practices. The profession of cost and management accountancy was established by a special act of the parliament, namely, the Cost and Works Accountant Act, 1959. With the passing of the act, the institute has been continuously contributing to the industrial and economic climate of the country. This institute is the only recognized statutory professional organization and licensing body in India, specializing exclusively in cost and management accountancy.

Maintenance of cost accounting records became a statutory requirement in selected industries and cost auditing was introduced by the government of India for self-regulation of companies in specific industries, which has been enlarged recently to encompass substantial spheres of activity. Cost audit has now become a very important tool for companies for self-regulation and appraisal, while the government of India has been using these records for computing retention prices through the Bureau of Industrial Costs and Prices.

1.3 MANAGEMENT ACCOUNTING VIS-À-VIS FINANCIAL ACCOUNTING

Growth of the accounting profession has clearly shown the necessity of meeting the aspirations of the stakeholders as also the obligations of the business entities to the stakeholders. These activities of accounting profession are polarized into financial accounting and management accounting areas to satisfy the internal and external stakeholders specifically. The distinctions between the two are given in Table 1.1:

Table 1.1 Distinction between management accounting and financial accounting

	Management accounting	Financial accounting
Stakeholders (internal and external)	Functional managers within the organization	Shareholders, creditors, vendors, other stakeholders of the company apart from statutory authorities such as the registrar of companies, SEBI, Ministry of Company Affairs, tax authorities, etc., being the external stakeholders
Freedom of options	Options are weighed, taking into consideration cost-benefit ratio of any option that is taken up for introducing and maintaining internal control systems	Options are broadly contained in GAAP accounting standards, company law, FEMA, and other such legislations and government notifications
Behavioural aspects	Detection, measurement, control, and regulation of deviations	Reports emanating from the company to the external

(*Contd*)

(*Table 1.1 contd*)

	directly influence internal stakeholders for better performance	stakeholders can impact investors in regard to the performance of their investment while statutory authorities will be monitoring the reports for fair and true view of the companies
Temporal focus	Past, present, and future in the sense that a business is a continuing activity. Drawing lessons from the past, concurrent analysis for control purposes, and preparation of budgets for futuristic performance can be examples	Evaluation of reports quarterly, half yearly, and annual emanating from the company evaluated *post facto*
Time span	Day-to-day, monthly, quarterly, and yearly (short-term) reports for banks and other financial institutions for medium-term loans and projects (medium-term), vision, mission, and corporate plan (long-term)	With SEBI's reforms, time span for reports from a company to external stakeholders has become quarterly, half yearly, and annual
Reports	Reports can be categorized as control and special reports. These reports utilize financial data already available from accounting sources within the company for control purposes, and special reports may draw both internal and external sources—financial, economic, technical, statistical, etc.	Reports reflect financial performance, corporate governance, corporate social responsibility, investors' grievances, etc.
Description of activities	Relates to interpretation, control, cross-functional, and strategic aspects of a company	Recording and presenting financial and accounting performance in formatted reporting system laid down by statutory authorities embellished by comments from management and statutory auditors

The earlier ramifications clearly call for adopting organizational structure to take care of the evolving accounting profession. The structure needs to be such as to provide empowerment as well as specialization while keeping the integrated approach alive. Figure 1.1 shows an organizational chart taking into consideration the earlier requirements.

The chief of financial accounting function (treasurer) and chief of management accounting function (controller) have definite areas to navigate. In India, following the British parlance, the terminology used was financial controller and chief accounts officer. Latterly, usage of terms such as chief financial officer and chief cost accounts officer are also in vogue. These can be distinguished as shown in Table 1.2:

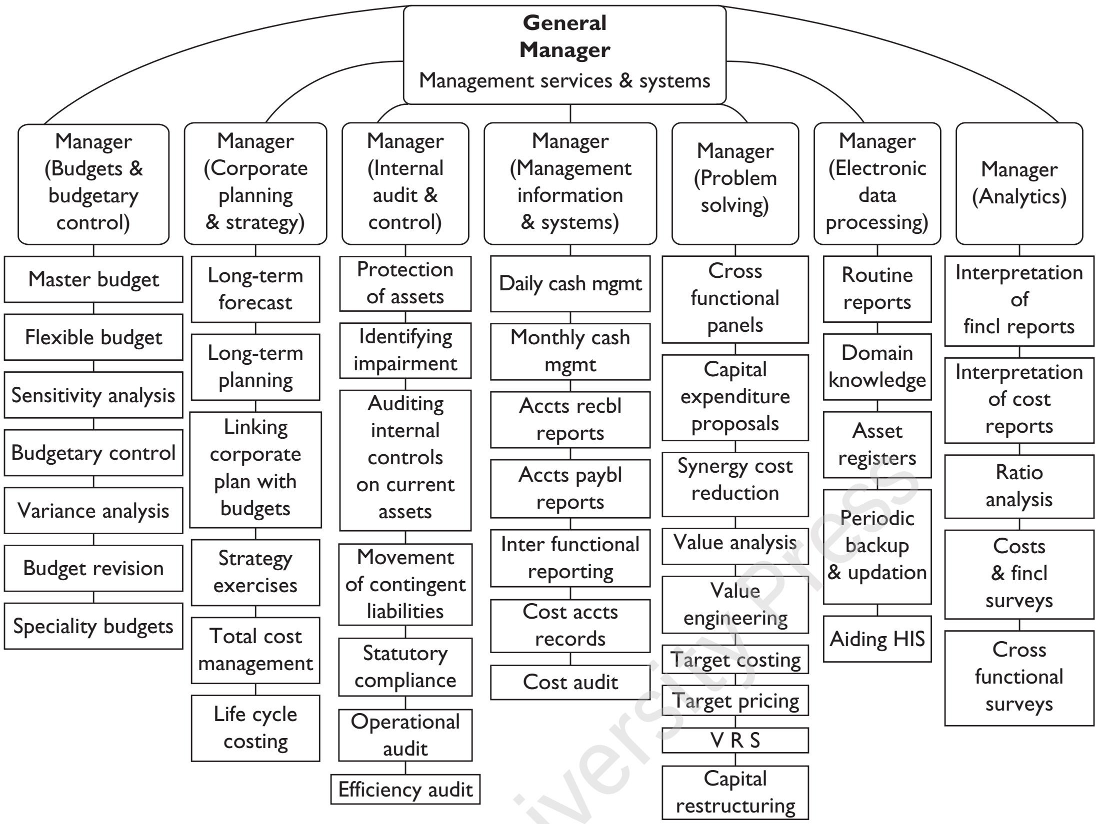

Fig. 1.1 Organizational chart of a management accounting division

Table 1.2 Treasurer vs controller

Treasurer	Controller
Providing capital	Planning for control
Investor relations	Interpretation and reporting
Short-term funding	Evaluating and controlling
Banking and collaterals	Protection of assets
Tax administration	Excise and customs duties evaluation and monitoring
Statutory financial audit	Maintenance of cost accounting records and cost audit
Investment accounting	Pricing decisions
Accounting for credits and collections	Budgetary and variance reporting
Risk accounting (insurance, hedging)	Risk appraisal
Accounting Standards IFRS on the presentation of accounting information	Impact of AS and IFRS on conduct of business
Reports relating to short term and long term	Reports relating to financial performance and budgetary control
Coordination with various functions in relation to provision of financial resources and accounting	Part of cross-functional team in performance appraisal, investment appraisal, and special reports

1.4 PRINCIPLES OF MANAGEMENT ACCOUNTING

As we have seen in the previous sections, management accounting is clearly *a process of identification, measurement, accumulation, collation, analysis, interpretation and finally communication* to the stakeholders on their relevant areas. This process can broadly be divided into three parts as follows:

(a) Record keeping
(b) Focus attention
(c) Problem solving

Record Keeping

Financial accounting records are maintained according to the Generally Accepted Accounting Principles (GAAP) with the statutory requirement under the companies act in order to comply with the Accounting Standards (AS). Now, recently, with the globalization of financial consultancy and reporting, it has become necessary both in practice and application compliance with International Financial Reporting Standards (IFRS).

With these requirements, mainly for the external stakeholders, the financial accounting information as available from the annual reports, quarterly reports, and so on, needs to be presented differently and maintained in a form that will be useful for internal control and governance, which is the main plank of management accounting.

Income and expenditure as represented in the books of financial accounts needs to be translated as costs, charges and expenses. After such arrangement, these costs need to be classified in a format which will lend them for better interpretation based on their behaviour of such costs. Management accounting principle also clearly involves including divorcing cost which forms a part of the total content of the product and charge. The divorcing cost is essentially a financial or fiduciary expenditure such as interest, bank charges, etc. There are certain other expenses that do not form a part of a product or service but have to be incurred necessarily and will continue to remain as expense.

In short, re-classification of financial accounting information as cost accounting information is the first step in creating records for management accounting purposes. Re-classification can be done as follows:

While this is a main re-classification to be made, presentation of such classification changes with the type of product or service offered to the customer. When a single product is produced, *unit costing method* is applied to present cost per unit of the product. When more than one product is produced from the same raw material, *process costing method* is employed.

In the similar manner, if services are offered, *operating costing method* is preferred. *Job costing method* is utilized for evaluating particular jobs rendered and *batch costing* is used when a batch of identifiable number of the same product is produced in a single batch. All these methods are based on *absorption costing* that means all the costs are absorbed into the product.

This classification can also be done in another way to connote the behaviour of such costs. Certain costs directly vary with the quantum of production, namely, raw materials, and are known as *variable costs*. Certain other costs show a dual behaviour both as variable and partly fixed in relation to the product. Such costs are classified as *semi-variable costs*. These show variation at different stages. Examples of such variable costs include power and fuel.

Direct materials	
Direct labour	
Direct expenses (if any)	
Prime cost (A)	
Factory overheads (B)	
Departmental	
General	
Services	
Factory cost of production	(A + B)
Admin cost (C)	
Selling and distribution costs (D)	
Total cost of sales	(A + B + C + D)

Fig. 1.2 Re-classification of financial accounting information

There are certain other costs which are independent of a product or service and exhibit a fixed nature. Such costs are identified as *fixed costs*, for example, rent and depreciation. This classification of variable, semi-variable, and fixed costs is done for arriving at certain vital information for decision making. The concept of *contribution*, namely, the difference between sales revenue and variable costs forms the basis for understanding *cost-volume-profit (CVP) analysis*. From the contribution, fixed costs are deducted to find out the *profit*.

In the CVP analysis, semi-variable costs are again split into variable and fixed components and added to either the variable costs or fixed costs as the case may be. Especially when decisions relating to increasing production, accepting new orders, and differential pricing are to be taken, this approach helps immensely for decision making. This approach also has a bearing on economic principle of marginal productivity and, as such, this method has become known as *marginal costing*. All these methods will be discussed in detail later in the relevant chapters.

Focus Attention

Management accountant as a controller has to perform his duty through identification of deviations from standards. The deviations are measured and compared with the standards to trace the reasons. These reasons are discussed in a cross-functional panel and corrective actions are taken. This activity is done to focus the attention of the relevant divisional head to the concerned issue, which is known as *variance analysis*.

Cost accounting records are also interpreted for normal and abnormal variations due to external agencies; for example, price of raw materials, services, and utilities. A continuing analysis over several accounting periods also shows up certain trends in profitability, productivity, and obesity. Such reports from the management accountant focus the attention of the senior management for strategic purposes.

Problem Solving

While being a part of routing record keeping and focusing attention continues to be the main plank of the management accountant, problems arise when his reports focus attention on certain trends discussed earlier. These problems may be tactical or strategic and, as such, require special investigation of the management accountant either individually or collectively as part of a cross-functional panel. Problems of pricing, maintaining margins against stiff competition, cost reduction, and value engineering require the services of a management accountant.

The management account is also called upon by the top management to develop scenarios from the past and present, and forecasts of profitability and productivity, purely for strategic purposes. Recasting corporate plans, evaluating technologies, and replacement of equipment and machinery requires the services of the management accountant for which the earlier principles enunciated are utilized along with more sophisticated techniques like target costing, life cycle costing, total cost management, reliability centred maintenance costing.

1.5 FUNCTIONS OF MANAGEMENT ACCOUNTANT

From the earlier discussion, it will be seen that the management accounting profession has assumed a very important position in an organization/company. It also has to follow the dictums of the management policy under various heads like planning, coordination, motivation, control, and innovation.

Management Accountant for Internal Control

The management accountant has to plan for the company to create control documents and then utilize the same for internal control. The following steps are followed in this regard:

(i) Plan a budget for the entire organization through coordination with various functions and establish an operating budget as control document. This forms the tool to establish norms, and properly document, maintain, and adhere to the format of the budget.
(ii) Implement the budget and communicate the necessity to record actual performance diligently to all the responsibility centres. Detect and measure any deviations seen from actual performance and the norms laid down in the budget.
(iii) Report the variances in performance under specific heads like material variances, price variances, overhead volume variance, and overhead efficiency variance. Identify reasons for variances and classify the same as controllable and uncontrollable and as also favourable and unfavourable.
(iv) These reports are periodical, say, monthly or quarterly, depending upon the preparation of financial accounting reports.
(v) Internal control systems and checks need to be adequate and it is a management accountant's function to evaluate the systems and utilize the same for protection of assets. Internal audit reports form interface with the statutory financial auditor and

as such assume greater importance. These internal control systems should not only be adequate but also be consistent with the size and operations of the company.

(vi) Identification of assessment and operating controls of financial reporting and legal / regulatory compliance processes with statutory authorities are yet another area of internal control.

(vii) While each business unit or functional head is responsible for the implementation of internal control system (his domain), the management accountant is primarily responsible for assisting the functional head for providing any resources or internal controls and oversees that accountability practices are in place.

Management Accountant for Decision Making

The success of a business depends primarily upon the skills and capabilities of the management to take meaningful decisions. These decisions should be based on well laid out plans and control concepts and techniques; for example, CVP analysis, incremental analysis, segmental reporting, inventory models, and capital budgetary models.

(viii) Decisions can be classified as strategic or tactical, long term or short term. However, the primary objective of any decision making is to realize optimum utilization of the business resources. In this regard, a management accountant is capable of providing information to all levels of management be it marketing, production, or financial decision.

(ix) The nature of accounting information should be such as to distinguish between fixed, semi-variable, and variable costs; historical, current, and future forecasts of profitability, cash forecasts, cash flows, etc. This information may have to be culled out using specific tools and present the information in the relevant format for decision making.

(x) Three major areas of decision making encompass marketing, production/service, and finance. Specific decision-making areas within those have been identified in Table 1.3:

Table 1.3 Decision-making areas

Marketing	Production/Service	Financial
Pricing of products/services	Purchase of capital equipment	Issue of stocks and bonds for capital formation
Sales forecast	Employees compensation	Short- and long-term loans from financial institutions
Sales organization and compensation	Overtime policy, implementation and control	Dividend policy
Portfolio of products/services	Replacements and renewal of equipment	Investments in securities
Advertising options with cost benefit analysis	Inventory management	Investments in new products
Credit policy	Service-level satisfaction	Voluntary retirement turnaround and restructuring of capital

Management Accountant for Interpretation of Financial Statements

Major financial statements like profit & loss account and balance sheet reflect the performance of any company in successes and failures. So these statements form the basis for decision making and also act as ready reckoner. A balance sheet is a status report relating to assets and liabilities and the balancing shareholders' funds.

Decisions are often related either to optimization of assets or reduction of liabilities and as such an analysis of balance sheet with tools such as ratio analysis, cash flow, fund flow, etc. aid decision making substantially. Tables 1.4 and 1.5 present some examples of decisions based on interpretation of the various items in the profit and loss account and balance sheet.

Table 1.4 Examples of related decisions

Profit and loss account items	Related decisions
Sales turnover	Pricing, segmental/sectoral decisions
Contribution	Make or buy decisions
Operating profit	Cost control and reduction decisions
Interest	Optimizing finance costs
Profit before tax (PBT)	Interest cover, debt servicing
Profit after tax (PAT)	Dividend policies, appropriations

Table 1.5 Decision related to balance sheet items

Balance sheet items	Decision
Cash	Optimum level/idle cash
Accounts receivable	Ageing/credit policy
Inventory	Optimum level/order cost
Fixed asset	Replacement/expansion/synergy
Term loans	Interest rates/debt servicing/capacity to borrow

Interpretation of financial statements while aiding decision making also lays bare the company's credentials and its position vis-à-vis competitors. Company analysis can identify the excellence or otherwise of the company's character, cash, capital, collateral, and conditions. Especially the continuing character of a business comes under scrutiny when five-year annual reports are analyzed by the management accountant and that analysis can help in understanding the strengths and weaknesses of the company.

The management accountant is called upon to provide not only sufficient information but also alternatives so that the best alternative can be chosen. The process of this analysis can be as follows:

(i) Develop various alternatives for a particular decision requirement
(ii) Compare the various alternatives on the basis of certain key factors
(iii) Quantify the results achievable from the various alternatives under the chosen conditions
(iv) Choose the best alternative and suggest implementation

(v) If implemented by the management, the management accountant should monitor the process of implementation and evaluate the results comparing them with the original estimates.

Management Accountant for Maintenance of Cost Accounting Records and Cost Audit

The Companies Act, 1956, deals with the books of accounts to be maintained by a body corporate as in Section 209. Clause (d) of sub-section (1) of Section 209 was inserted to ensure that in respect of companies engaged in production, processing, manufacturing, or mining activities, which may be specified by notification issued by the central government, proper records relating to utilization of material and labour are available which would make the efficiency audit possible. The management accountant functionally is responsible for maintaining costing records to aid efficiency audit.

Maintenance of cost accounting records in itself requires a structured cost accounting function. The need for cost accountancy and its impact on cost reduction, optimum utilization of resources, and, thereby, bringing price levels lower cannot be overemphasized. The management accountant with the use of cost data helps in formulating a proper policy as also for the purpose of controlling its activities.

Determination of cost through a continuous process emerging from a cost accounting plan assists in recording the operation of various activities within an organization and is presented in a cost format. This helps to portray the actual operational levels achieved and the resources utilized during a particular period in a distinct manner. Exhibit 1.1 gives information on the cost accounting function.

Exhibit 1.1 Cost Accounting Function

Cost accounting is a function entirely different from general or financial accounting. Cost accountancy covers a wide range of subjects with special emphasis on cost accounting, factory organization and management, engineering techniques, and knowledge of the working of the factories. A cost accountant performs services involving pricing of goods, preparation, verification, certification of cost accounts and related statements, or recording, presentation, or certification of cost facts or data.

In a manufacturing concern, the management accountant works out the economical cost of production and evaluates its progress at each stage of production. In mass production enterprises, he points out wastage of manpower due to overstaffing or inefficient organization and indicates the output, the capacity of the machines and labour, the stock position, the movement of stores, and weaknesses in the production process.

Systematic determination of cost in every single and distinct process of manufacturing provides a continuous check on the margin of waste in the processing of raw and semi-finished materials, on the utilization of machinery installed, on manpower expended, and the percentage of rejection of finished products. This also pinpoints the particular process in which defects and deficiencies exist, thereby enabling immediate remedial measure being taken.

Costing, in short, aims at making the organization efficient and economical, by providing the minimum of labour and material and getting the full capacity of the machine output. The cost accountant, therefore, is concerned solely and mainly with the internal economy of the industry, and renders services essential to the day-to-day management of the undertaking.

Source: Adapted from http://cmaindia.informe.com/forum/viewtopic.php?f=127&t=6641. Lok Sabha Debates, Vol. XXIV, dated 20 December 1958, pp.6608-09.

Section 233B was inserted by Section 23 of the Companies (Amendment) Act, 1965, in order to enable the government to issue necessary direction for conducting cost audit of companies engaged in production, processing, manufacturing, or mining activities. See Exhibit 1.2.

Exhibit 1.2 Cost Audit

What is cost audit? Cost audit is quite different from the financial audit. It is to see whether the labour is sufficient or not, whether the industry has provided efficient labour or the labour that is required by that industry is less than what is required, whether every material and every part of the machinery is used to the optimum, whether any material is wasted, and so on.

As we all know, we are short of material and foreign exchange and so a lot of material is imported. It is very essential that there should be a cost audit, especially in case when we are short of foreign exchange. In fact, it should be introduced in almost all the industries, but the government is trying this in certain cases only. So by this we will know whether there is a proper utilization of the material or not. It is very essential, no doubt, and in factories and industries, everywhere, this cost audit should be emphasized.

Source: Adapted from *Proceedings of Rajya Sabha*, 14 September 1965, Columns 3944 and 3945. http://cma-india.informe.com/forum/viewtopic.php?f=127&t=6641.

Thus, it should be seen that the management accountant in an organization performs all the important functions for maintaining cost accounting records and also assists the external cost auditor to conduct efficiency audit. The management accountant subsequently utilizes the cost audit report to present the salient features of the cost audit report to the board of directors for improvement of the company's profitability.

Management Accountant as a Strategist

Strategic decisions are almost always a result of cross-functional exercise, especially because strategy involves the entire company and as such different players have their roles tailored. While strategic decisions may have different groups of cross-functional teams, every such team has to have a management accountant as a member. For, any strategic decision needs to be expressed in terms of value and quantification of quantifiable data. When qualitative data need to be projected into a decision, this aspect has to be expressed in terms of financial implications. Strategic decisions are broad based, which include long-term goals and objectives as follows:

(i) *Corporate planning* is a strategic exercise and involves long-term projections both physically and financially. The time horizon selected will decide the parameters and the variables that will impact the projections. While the selection of parameters and variables emerge as part of a consensus, the tools and techniques to be applied for developing a corporate plan are entirely in the domain of the management accountant.

(ii) *Specific strategic exercises* for marketing, production, human resource development, and so on, have their own range of variables, but all of them will have to be collated and presented in a coherent picture, quantifying the prospects of such a strategy along with the milestones. In these cases also, such strategic exercises include a management accountant to compute the positive or negative impact of such an exercise on the prospects of the company over a period of time.

(iii) *An exercise relating to sustainable competitive advantage* again takes into consideration a comparison between companies, their varying problems and advantages, and then reduces all those into a single denominator, viz., costs and profit in terms of money. Such an exercise involves both mathematical and economic models using discounting techniques, probability, and forecasting.

As part of strategy, it is necessary to keep all the stakeholders satisfied depending on their requirements. Also, as a long-term exercise, this involves three dimensions, viz., quality, cost, and time, forming a strategic triangle.

These three strategic objectives should develop a strategic value over the time horizon involved. Towards this, the management accountant has to systematically develop an accounting system for strategy alone along the following lines:

i) Day-to-day activities cannot be standalone activities but should be an extension of a strategic plan. In other words, any short-term exercise will have to be dovetailed to a long-term plan of a company. This can be done in physical and value terms by the management accountant.
ii) This linkage exercise helps the company's managers to understand the requirements of all the stakeholders.
iii) This linkage also brings into focus the long-term objectives to the entire organization in physical and financial terms.

1.6 MANAGEMENT ACCOUNTANT AS A CHANGE AGENT

Five Forces Theory of Michael Porter clearly espouses the necessity for monitoring all the five forces, viz., internal rivalry, bargaining power with the vendors, bargaining power with the customers, threat from new entrants, and threat from changing technology and substitutes. Thus, we require for a company to update itself in regard to all these areas on a continuous basis.

As a management accountant is already the depository of management information, updating the same is also his function. It is necessary for the management accountant to keep abreast of new developments and changing environments. From time to time, a management accountant has to develop scenarios to assess the impact of changing environment as also suggest innovative approaches for maintaining competitive edge.

These scenarios form the basis for a company's think tank to evolve new approaches to bring about a change in the company's strategy. Thus, the management accountant by his periodic reports on the various aspects of organic and inorganic expansion of the company has chosen to become the change agent. This aspect will be elaborated in a later chapter with examples.

The role of a change agent involves a systematic approach in updating information as well as scanning the environment periodically for the lurking changes. The following steps are normally followed by the management accountant to produce periodical reports on the new developments and changing environment:

1. Constantly engage in benchmarking exercise in comparison with the competitors of the same industry. This will bring up new approaches that are being practiced by competitors.

2. A continuous analysis of the company's financial and physical performance over the years to be carried out to pinpoint declining profitability, declining demand, impairment of assets, and technological obsolescence as evidenced by the financial indicators in the company's performance over the time span.
3. Scan the environment globally for any major change in the fortunes of the particular industry due to efflux of time, change in behavioural patterns of customers, emergence of substitutes, etc., impacting on the financial parameters of the industry.
4. As a continuing business, every company has to chalk out its strategy for expansion, both through organic and inorganic routes. This would require the management accountant to analyze the fortunes of similar companies that have embarked on organic expansion or inorganic acquisitions.
5. Continuance of a business in the same activity has also seen a decline due to life cycles. So, management accountants should always be on a lookout for identifying areas for diversification of business that have synergies with the existing activities or find out exit routes from the present business route to unrelated diversifications. This is done by the management accountant through analysis of financial reports of various contemporary companies on a regular basis.

SUMMARY

Evolution of keeping track of financial transactions can be traced to Vedic ages in India and to the medieval period in the West. With the cross-border transactions and globalization of economy, new aspects of accountancy profession have come into play. As distinct from financial accountancy, which takes care of financial records to comply with statutory requirements and other external stakeholders, necessity to constantly monitor the competitive edge of the company in relation to competitors has brought about the importance of the management accountancy profession.

A management accountant has many important functions, viz., internal control, decision making, interpretation of financial statements, maintenance of cost accounting records and cost audit, strategist, and change agent. These functions call for special skills as well as special tools. A management accountant has to be necessarily well versed in cost accountancy and use of sophisticated models and tools like life cycle costing, target costing, activity-based costing, enterprise costing, total cost management, and so on.

KEY WORDS

Accounting standards (AS) There are 32 accounting standards laying down the standards for presenting of accounting information in Schedules to profit and loss account and balance sheet apart from valuation of inventories and foreign exchange transactions.

Controller Major functions are planning, protection of assets, cost audit, investment appraisal, pricing, budgets and budgetary control, variance analysis, etc.

Corporate planning and strategy On the basis of the vision and mission of a company, a corporate plan is drawn up to identify goals and the strategy to achieve the same over a long term.

Cost account records Maintenance of cost accounting records became a statutory requirement in selected industries.

Cost audit It has now become a very important tool for companies for self-regulation and appraisal, apart from statutory requirement of the company law board.

Cross-functional panels These panels consist of senior executives from different functions along with the management accountant coming together for a specific project or problem.

International Financial Reporting Standards (IFRS) These standards are a further improvement and lead to greater transparency of financial accounts and comparability internationally.

Retention prices These are computed for protecting the viability of an industry by allowing reasonable return on capital employed.

Treasurer Major functions are providing capital, funding, tax administration, statutory financial audit, compliance with accounting standards, preparation of financial accounts, and disclosures according to SEBI.

EXERCISES

Concept Review Questions

1. Review the evolution of the accountancy profession and the development of the concept of a management accountant.
2. While developing a SWOT analysis, the management accountant of a company provides necessary financial information. Discuss conceptually.
3. Competitive edge of a company can be improved only through an internal analysis of the company's performance. Do you agree?
4. A management accountant vouches for the company's internal efficiency in utilization of resources. Discuss.

Critical Thinking Questions

1. Abolition of managing agency system in India led to the introspection of many managing agents for improving their efficiency through cost reduction and restructuring. Discuss.
2. An employee of a company being one of the important internal stakeholders has to translate the physical norms he is supposed to achieve in terms of financial implications for full comprehension. Discuss.
3. The management accountancy profession is at crossroads in the twenty first century in the context of globalization of markets and liberalization of economies in developing countries like India. Critically review.

Project Assignments

1. Develop an organization chart for the controllers department in a service industry like the hospitality industry?
2. As a management accountant, develop a report on the declining profitability of your company over the last five years due to increase in competition and stagnating demand.
3. Develop a report and present it to your management on possible related diversifications to improve the profitability of your company. Assume your own product.

Case Study 1.2 Requiem for Reel Tape

Reel Tape was a great company to work for in the 1960s. They were one of the premiere companies in the reel-to-reel tape business. There was little competition on the West Coast, and had the region pretty much to themselves. When cassettes came in, they switched their product line but not the attitudes. They still did business the old way. But, the market had changed. There was competition from the Europeans, the Japanese, and from other Far East producers.

These competitors were pricing products below their costs. They had also improved their quality, were delivering products on time, and were introducing new products such as high-bias chromium oxide tapes before Reel Tape did. By the time Reel Tape woke up, it was too late. They discovered that they had lost touch with their customers. Many had left or were leaving them.

Why did Reel Tape not wake up earlier?

There could be many reasons, but an important one was the lack of a good management accounting system. They thought of the accounting system as a necessary evil for external financial and tax reporting. As long as they were making money, no one cared.

When they began to address the problems seriously, they found out that their accounting system had no information on many of the questions the management needed to know.

The point is they mistook the profits they were showing on their external financial statements for profits they could sustain!

Question

How should the management accountant of the company approach the problem?

Source: Adapted from http://college.cengage.com/accounting/ansari/management/1e/students/modules/mod11.pdf.

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