

Unit 1: Concept of Management Accounting

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- Concept, Objectives, Features, Functions and Limitations of Management Accounting
- Controllership Functions and Responsibility

After the completion of this unit, you should be able to:

- Understand the meaning of management accounting
- Describe objectives, features, functions and limitations of management accounting
- Explain controllership functions and responsibility

1.1 Concept of management accounting

The management accounting consists of two words, 'Management' and 'Accounting'. The main functions of 'Management' are planning, organising, directing and controlling. Similarly, the main function of accounting is to record the business transactions and communicate the accounting information to the users. Thus, management accounting is the study of managerial aspect of accounting. The accounting system which assists management in carrying out its functions more efficiently may be termed as Management Accounting. The redesigning of accounting in such a way as to assist management in creation of policy and day-to-day operation of undertaking is Management Accounting. To be more precise, Management Accounting is a specialised branch of accounting for assisting management in its functioning.

According to the American Accounting Association "Management Accounting includes the methods and concepts necessary for effective planning, for choosing among alternative business actions and for control through the evaluation and interpretation of performances." Additionally, American Accounting Association explained that "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 decision with a view towards those objectives."

Similarly, in 2008, the institute of Management Accountants defined "Management Accounting is a profession that involves partnering in management decision making, devising planning and performance management system, and providing expertise in financial reporting and control to assist management in the formulation and implementation of an organization's strategy".

From the above definitions, it becomes clear that Management Accounting is concerned with reframing the accounting information to make it useful for the management. The above definitions also indicate that any system of accounting which assists management in carrying out its functions more efficiently may be termed as Management Accounting.

Management Accounting is not designed to appraise and monitor the past performance of a concern, but to assist managerial decision affecting the future.

The following points can be observed in Management Accounting :

- To prepare the accounting information so that it is helpful to management.
- To analyse and interpret the accounting information.
- To present the accounting information to the management.
- To assist the management in controlling and making decision for various business activities.

Conclusively, it can be said that Management Accounting is reframing, analysing and presenting the financial data turning into information to management in such a way that they are helpful in solving various problems.

1.2 Objectives of management accounting

The basic objective of Management Accounting is to assist the management by managing the organization effectively. Management Accounting supplies accounting information to the management for planning, decision making and controlling. Hilton and Platt (2014) mentioned five major objectives of the management accounting, such as,

- (1) Providing information for decision making and planning, and proactively participating as part of the management team in the decision-making and planning processes,
- (2) Assisting managers in directing and controlling operational activities,
- (3) Motivating managers and other employees toward the organization's goals,
- (4) Measuring the performance of activities, subunits, managers, and other employees within the organization, and
- (5) Assessing the organization's competitive position, and working with other managers to ensure the organization's long-run competitiveness in its industry.

In particular, manager that management team need management accounting information for the following reasons:

(a) Assistance in Planning and Formulating Future Policies

Management Accounting information helps to assist management in either for short or long term planning. Planning is related to taking decision for future forecasting, setting goals and deciding alternative course of action. Thus, the information supplied by Management Accounting helps management in planning and policy formulation.

(b) Help in the Interpretation of Financial Information

Data contain more figures and do not speak anything. Analysis and interpretation are necessary to utilise these data. The objective of Management Accounting is to present financial information to the management in a simple way. Management Accounting helps for presenting those details to management in a non-technical language. It also helps for analysing and interpreting those data.

(c) Helpful in Controlling Performance

To assist the management in controlling the business activities and cost is also an important aspect of Management Accounting. For controlling purpose, firstly the standards of various departments and individuals are set up. Then it is compared with actual performance. All these

can be made possible through standard cost and budgetary control system. The standard cost and budgetary control system are thus integral part of Management Accounting.

(d) Helps in Organising

Management Accounting is also to help management in organising. Management Accounting stresses on the use of budgeting, cost-centres, responsibility accounting, cost-control technique, internal control etc. All these help to establish a sound organization structure.

(e) Helpful in Making Decision

To choose one best alternative among different alternatives is an important aspect of decision making. Management Accounting assists the management for decision-making by providing significant information relatively to various alternatives in terms of cost and revenue. Such information can be collected with the help of techniques such as Marginal costing, Break-even analysis.

(f) Helps for Co-ordinating

For smooth running of a business concern, the co-ordination among the different departments is very essential. The objective of Management Accounting is to help for co-ordinating those departments by communicating about the targets and performances of different departments to them from time to time.

(g) Helping in Motivating Employees

Management Accounting help to management in motivating their employees. The setting of goals, planning, decision making, measuring performance, all these things increase the effectiveness of the organization and motivate the members of organization.

(h) Helps in Communication

Management accounting turns data into information as a strong communication to various personnel of the organization and outsider. For this purpose, Management Accounting prepares and presents the report for different levels of management. It also communicates the business affairs and facts to the outsiders such as Investors, creditors, Bankers, Government Agencies etc., by publishing annual accounts and other statements.

(i) Use of Qualitative Information

Management may need qualitative information in non-monetary form. There is no restriction for management to use monetary data only. Management Accounting aims at providing non-monetary information such as the character and integrity of the management, future availability of raw-material, availability of basic inputs, policy of the government etc.

1.3 Management Accounting Vs. Financial Accounting

	Financial Accounting	Management Accounting
Primary users	External users	Internal users
Types of reports	Financial statements	Internal reports
Frequency of reports	Quarterly and annually	As frequently as needed
Purpose of reports	General-purpose	Special-purpose information for a particular user for a specific decision
Reporting standards	Generally accepted accounting principles	Relevance to decision
Verification	Audit by auditor	No independent audits

1.4 The changing role of managerial accounting in a global business environment

- Management Accountants serve a crucial function in virtually any enterprise.
- As the information providers, they are often in touch with the heartbeat of the organization.
- Management Accountants interact frequently with sales personnel, finance specialists, production people and managers at all levels.
- Management Accountants must be knowledgeable not only in accounting but in the other major business disciplines as well.
- Strong oral and written communication skills are important for success as a managerial accountant.

1.5 Controllership functions and responsibility

CFO or controller

- In many organizations, the designation given to the top managerial and financial accountant is the *chief financial officer (CFO)*
- This individual is also called the *controller*

CFO or controller responsibilities

- For supervising the personnel in the accounting department and preparing the information and reports used in both managerial and financial accounting
- Interprets accounting information for managers and participates as an integral member of the management team
- Most controllers are involved in planning and decision making at all levels and across all functional area of the enterprise
- Broad role – managerial accountants to rise to the top of their organizations

Treasurer and Responsibility

- Treasurer is responsible for raising capital and safeguarding the organization's assets
 - The management of its investment
 - Its credit policy
 - Its insurance coverage

Internal Auditor and Responsibility

- Internal auditor is responsible for reviewing the accounting procedures, records and reports in both the controller's and the treasurer's area of responsibility
 - Expresses an opinion to top management regarding the effectiveness of the organization's accounting system

1.6 Case¹

Rosemary Worth was talking about the consequences of a theft that had recently occurred at the business she owned, Private Fitness, LLC. Private Fitness was a small health club located in Rancho Palos Verdes, California, an upscale community located in the Los Angeles area. The club offered personal fitness training and fitness classes of various types, including aerobics, spinning, body sculpting, air boxing, kick boxing, hip pop, step and pump, dynamic stretch, Pilates, and yoga. Personal training clients paid \$50 per hour for their instructor and use of the club during prime time. During slower times (between 9:00 a.m. and 4:00 p.m.) the price was \$35 per hour. The price per student for each hour-long fitness class was \$12. Some quantity discounts were offered to clients who prepaid. Unlike the large health clubs, Private Fitness did not offer memberships for open access to fitness equipment and classes.

Prior to starting Private Fitness, Rosemary had been working as an aerobics instructor and fitness model. She had won many local fitness competitions and was a former finalist in the Ms. Fitness USA competition. She wanted to go into business for herself to increase her standard of living by capitalizing on her reputation and knowledge in the growing fitness field and to have more time to spend with her two young children. Private Fitness had been operating for six months.

To open the club, Rosemary had to use almost all of her personal savings, plus she had to take out a bank loan. The building Rosemary rented, located in a convenient strip mall with ample parking, had formerly been operated as a fresh food market. Rosemary sent about \$150,000 to renovate the facility and to buy the necessary fitness equipment. The club was comprised of five areas: an exercise room, a room containing aerobic equipment (e.g., treadmills, stair

¹ Anthony, Hawkins, & Merchant (2012), page 472-473

climbers, and stationary bicycles, cross country ski machines), a room containing weight machines and free weights, men's and ladies' locker rooms, and an office.

Rosemary contracted with five instructors whom she knew to run the classes and training sessions. The instructors were all capable of running personal training sessions, but they each tended to specialize in teaching one or two types of fitness classes. Rosemary herself ran most of the spinning classes and some of the aerobic classes. The instructors were paid on commission. The commission, which ranged between 20 percent and 50 percent of revenue, varied depending on the instructor's experience and on whether the instructor brought the particular client to Private Fitness.

As manager of the business, Rosemary hired Kate Hoffman, one of the instructors and a long-time friend. Kate's primary task includes marketing, facility up-keep, scheduling of appointments, and record keeping. Kate was paid a salary plus a commission based on gross revenues. During normal business hours when Kate was teaching a class, one of the other instructors, or sometimes part-time clerical employee, was asked to staff the front desk in return for an hourly wage. Private Fitness was open from 5:30 a.m.-9:00 p.m., Monday through Friday. It was also open from 6:00 a.m.-noon on Saturday and noon-3:00 p.m. on Sunday.

Rosemary was still in the process of building the volume necessary to operate at a profit. Typically, one or two private fitness clients were in the facility during the prime early morning and early evening hours. A few clients came in at other times. Classes were scheduled throughout the times the club was open. Some of these classes were quite popular, but many of them had only one or two students, and some classes were cancelled for lack of clients. However, Kate's marketing efforts had been proving to be effective. The number of clients was growing, and Rosemary hoped that by the end of the year the business would be earning a profit.

As the quote cited above indicates, however, Rosemary gradually realized that Kate Hoffman was stealing from the club. One time when Rosemary came to club she noticed \$60 in the cash drawer, but she noticed when she was leaving the drawer contained only \$20. She asked Kate about it, and Kate denied that there had been \$60 in the drawer. Rosemary wondered if other cash amounts had disappeared before they had been deposited into the bank. While some clients paid by credit card or check, others, particularly those attending fitness classes, often paid with cash.

Rosemary became very alarmed when, during a casual conversation with one of the instructors, the instructor happened to mention to Rosemary some surprising "good news." The good news was that Kate had bought in a new private fitness client who was working out in a new 1:00-2:00 p.m. time period on Monday, Wednesday, and Friday. Kate was doing the training herself. However, Rosemary checked the records and found no new revenues recorded because of this

news client. She decided to come to the club during the 1:00-2:00 hour to see if this client was indeed working out. Since the client was there and no revenue entry had been made, she confronted Kate. After first explaining that she had not yet gotten around to making the bookkeeping entry, Kate finally admitted that this client had been writing her checks out to Kate directly, in exchange for a discount. Kate said that she was very sorry and that she would never be dishonest again.

Rosemary realized she had two major problems. First, she had to decide what to do with Kate. Kate was a valuable instructor and a long-time friend, but her honesty was now in question. Should she forgive Kate or fire her? Second, Rosemary also realized that she had an operating problem. She did not want to step in and assume the managerial role herself because she had significant family responsibilities to which she wanted to be able to continue to attend. But how could she ensure that her business received all the revenues to which it was entitled without being on-site at all-time herself? Should she leave Kate, who promised not to steal again, in the manager position? Or should she hire one of the other instructors, or perhaps a non-instructor, to become the manager? And in the either case, where there some procedures or controls that she could use to protect her business's assets?

Questions

- (a) What is (are) the major issue(s) of the case?
- (b) What kind of information is (are) required to Rosemary from prospective of Managerial Accounting? Explain.
- (c) What should Rosemary do? Critically explain with reasons.

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