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FACULTY OF COMMERCE & MANAGEMENT

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LECTURE: 1

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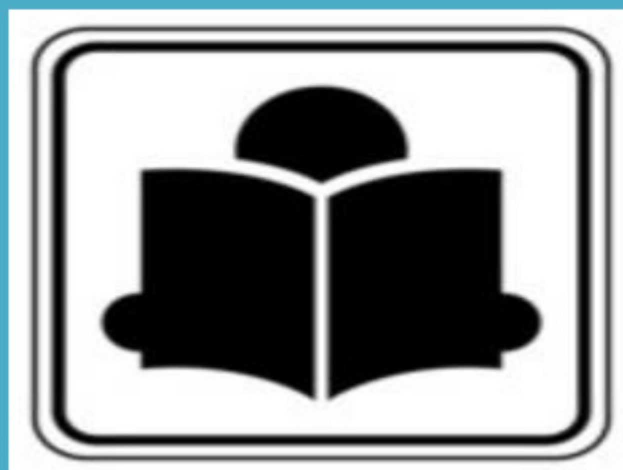
Lecture-1



Introduction to Accounting

Chapter 1: Introduction to Accounting

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Objectives

After studying this Chapter, you will be able to:

- Describe management accounting as an area of accounting
- Identify the branches of accounting and it's inter relationships
- Discuss the role of management accountants

Introduction

Accounting is a business language that elucidates the various kinds of transactions during the given period of time. Accounting is defined as either recording or recounting the information of the business enterprise, transpired during the specific period in the summarized form. The American Institute of Certified Public Accountants Association defines the term accounting as follows: "**Accounting is the process of recording, classifying, summarizing in a significant manner, of transactions which are financial in nature and finally interpreting the results.**"

Management accounting is the accounting system for making decisions of the business enterprise. Management accounting furnishes the necessary information to assist the business enterprise to make rational decisions through the development of policies and procedures in order to meet the day to day commitments of the enterprise.

Did u know? Is accounting an equivalent function to book-keeping?

No, accounting is broader in scope than the book-keeping; the former cannot be equated to the later.

1.1 Management Accounting as an Area of Accounting

Management accounting as a new branch of accounting is of recent origin. Financial accounting recorded business transactions on double-entry basis and helped ascertainment of profit or loss for the given period and valuation of stock of assets and liabilities on a given date. Financial accounting enabled the concern with the liabilities and safeguard the assets entrusted and therefore,

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was also known as custodial or stewardship accounting. Basically meant for consumption of owners, creditors, statutory authorities, the reporting was for a concern as a whole.

In olden days, when the concern was small and catering to the local area of operation, the proprietor who managed the show was aware of all the happenings and could control the business well without additional information. But as businesses grew bigger, and the area of operations widened, there came into existence a separate cadre of people called the management. Since the rewards of management were entirely dependent on performance, they wanted a lot of information on the concern and outside, which was necessary to be effective. They also wanted information quickly, which made financial accounting inadequate.

The need for a new type of accounting was felt. This gave birth to cost accounting. The emergence of cost accounting to large extent satisfied the need of management. Cost accounting identified expenses to the origin (product, department or territory) by classifying them as direct or indirect expenses and depending upon their variability, categorised them as variable or fixed expenses. These helped the cost assembly, planning, fixing of standards and monitoring of variance and made it an easy job to control cost through responsibility accounting.

Responsibility accounting apart from serving as a control mechanism was also a motivational tool for achievement and rewards. Since management knew the incidence of expense and its origin, early steps for correction could be taken promptly. Meaningful reports to suit the hierarchy were instituted for periodical submission. People lower down the order got all the information quantitatively; middle management both quantity and value. The higher echelons got reported on the basis of exceptions on monetary values. Computerization also took place to process voluminous data and for timely submission of reports. In course of time, cost accounting assimilated techniques from various other disciplines like operations research, statistics, economics, behavioural science and techniques of management to aid decision making.
The term cost accounting brings to mind only the function of cost finding and therefore, this large comprehensive discipline was renamed management accounting or managerial accounting. Recently, finance has also been brought under this umbrella.

Caution The term 'Management Accounting' refers to accounting for the management. Management accounting provides necessary information to assist the management in the creation of policy and in the day-to-day operations. It enables the management to discharge all its functions, i.e., planning, organization, staffing, direction and control efficiently with the help of accounting information.

Self Assessment

Fill in the blanks:

…………………. recorded business transactions on double-entry basis and helped ascertainment of profit or loss for the given period and valuation of stock of assets and liabilities on a given date.

Financial accounting enabled the concern with the liabilities and safeguard the assets entrusted and therefore was also known as …………………. accounting.

…………………. identified expenses to the origin by classifying them as direct or indirect expenses and depending upon their variability, categorised them as variable or fixed expenses.

1.2 Branches of Accounting and its Interrelationships

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The main objectives of accounting are to record the business transactions and to provide the necessary information to the internal and external users of the financial statements. In order to achieve the above objectives, the accounting is classified into followings branches:

Financial Accounting: It is the original form of accounting. It refers to the recording of daily business financial transaction. Recording of the transaction is done in such a way that the profit of the business may be ascertained after a definite period and the picture of the financial position of the business may be presented.

Cost Accounting: As the name indicates, this accounting is related with the ascertainment of cost of the product in a period. Under this system, record of raw materials used in production, wages and labour paid and other expanses incurred on production are kept to control the costs.

Management Accounting: The accounting which provides the necessary information to the management is called management accounting. Under this, the analysis and interpretation of the accounts, prepared by financial accounting, are done in a manner so that the managers may forecast, plan for future and frame the policy.

Tax Accounting: Under tax accounting, the accountants prepare the accounts as per the provisions of taxation. The accounts prepared as per taxation provisions may differ from the accounts prepared as per financial accounting.

Inflation Accounting: The financial statements are prepared on the basis of historical cost which do not present the true picture of the financial position and correct profit or loss of the business due to inflation. Thus, the fresh financial statements are prepared keeping in mind the price level changes under inflation accounting.

Human Resource Accounting: Human Resource Accounting means the accounting for human being as now in an organization human being is treated as an asset like other physical assets. It is recorded in the books like other assets. HRA deals with the measurement of costs on recruiting, selecting, hiring, training, placing and development of the employees in one side and on the other side it deals with the present economic value of the employees. For the determination of the value of human being different methods are used under HRA.

Responsibility Accounting: Responsibility accounting is a special technique of management under which accountability is established according to the responsibility delegated to the various levels of management. A management information and reporting system is instituted to give adequate feedback in terms of the delegated responsibility. Under this system, Chapters of an organization, under a specified authority in a person, are developed as responsibility center and evaluated individually for their performance.

Relationship of Financial, Cost and Management Accounting

The ICMA, London, defines management accounting as "the application of professional knowledge and skill in the preparation and presentation of accounting information in such a way as to assist management in the formulation of various policies and in the planning and control of the operation of the undertaking".

The American Accounting Association, committee on management accounting, defines management accounting as "the application of appropriate techniques and concepts in processing the historical and projected economic data of an entity to assist management in establishing a plan for reasonable economic objectives and in the making of rational decisions with a view towards achieving these objectives".

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Though some number of differences can be identified between cost accounting and management accounting, the line of difference is very thin. Because, cost accounting, at present, comprises of some of the advanced techniques and systems of costing such as budgetary control, marginal costing, standard costing, etc. and therefore, it tends to conform to management accounting. Consequently, not much difference can be found between the two. The main differences between cost accounting and management accounting are given as under:

Table 1.1: Cost Accounting vs. Management Accounting

Sl.No.	Point of Difference	Cost Accounting	Management Accounting
1.	Objectives	Its main purpose is to ascertain the cost.	Its major objective is to make decisions through supplement presentation of accounting information.
2.	Scope	It deals only with the cost and related aspects.	It not only deals with the cost but also revenue. It is wider than cost accounting.
3.	Utilisation of Data	It uses only quantitative information pertaining to the transactions.	It uses both qualitative and quantitative information for decision- making.
4.	Utility	It ends only at the presentation of information.	It starts from where cost accounting ends; meaningful cost informations are major inputs for decision-making.
5.	Nature	It deals with the past and present data.	It deals with future policies and course of actions.

The cost accounting is very closely-related to financial accounting. Few authorities of accounting consider cost accounting to be the branch of financial accounting. But it may be said that cost accounting is complementary to financial accounting. Financial accounting and cost accounting are both similar in various ways. The main relationship between financial accounting and cost accounting are given as under:

The fundamental principles of double entry system are applicable in financial accounting as well as cost accounting.

The results of business or organisation are revealed by both the systems of accounts.

The determination of future business activities and policy is guided by both accounting systems.

A basis for comparison of expenditures is being provided by both the accounting systems.

The invoices and vouchers constitute the common basis for recording transactions under both the systems of accounting.

The causes for losses and wastages of a business or industry are provided by financial and cost accounting.

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The main differences between financial accounting and cost accounting are given as under:

Table 1.2: Financial Accounting vs. Management Accounting

Sl.No	Point of Difference	Financial Accounting	Management Accounting
1.	Objectives	The supply of information about the enterprise through P&L A/c and balance sheet to outside parties – Mainly for external use.	Information is supplied with the purpose of making decisions – for internal use only.
2.	Analysis of performance	It extends over the total performance of the firm in general.	It deals with detailed analysis of performance of each and every department of the organisation.
3.	Utilisation of Data	It handles only the past data of the enterprise.	It envisages the future policies and plans.
4.	Nature	It is a measurement of performance, i.e. more objective.	It is a judgment of performance—more subjective.
5.	Accuracy of results	It has to ensure the accuracy forever.	It need not, instead it is mainly for internal use depends upon approximation.
6.	Legal responsibility	Compulsory for joint stock companies – Accounting period concept.	It is not compulsory but optional.
7.	Limitation on transactions	It provides room only for the monetary transactions.	It considers both monetary and non- monetary transactions at a time together—Qualitative changes are considered.
8.	Exercise the path of control	Being the contributory of past information; not able to monitor the plans properly.	It is able to highlight the deviations of the actual from the plans and earmark the reasons for the deviations.

Task Prepare the proforma of key financial statements prepared under financial accounting and cost accounting.

Self Assessment

Fill in the blanks:

1 The fundamental principles of .... are applicable in financial accounting as well as cost accounting.

2 .... deals with detailed analysis of performance of each and every department of the organisation.

3 Main purpose of .... is to ascertain the cost.

4 .... uses only quantitative information pertaining to the transactions.

5 The causes for losses and wastages of a business or industry are provided by .... and cost accounting.

6 Few authorities of accounting consider cost accounting to be the branch of .... accounting.

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10. The major objective of .... is to make decisions through supplement presentation of accounting information.
11. The key objective of .... is to supply information about the enterprise through P&L A/c and balance sheet to outside parties-Mainly for external use.

1.3 Role of Management Accountants

A management accountant is a very important key person in the organization. His main job in the organization is planning and control.

Planning is of two types. One is a short-term plan known as a budget. A budget is a quantitative expression of management's short-term intentions. Budget serves also as a tool for co-ordinating the various activities and to the extent the actuals compared to budget works as a tool of control.

The other type of planning is called long-term plan or corporate plan or strategic plan. This type of plan is usually prepared for three to five years. Long-term plans indicate the management's intent where the organization should reach in that time span. By a series of budgets, long-term plans are reached.

It is the responsibility of the management accountant to prepare both the type of plans and watch their actual performance. For this purpose, he has to re-classify the accounting data and assemble them to suit the user department's need. He also has to scan the environment for external information. He has to be particularly careful of the performance of his competitors and try and obtain information about their long-term strategy.

The management accountant should arrange for various reviews of the budget and corporate plan in order to take action on deviations. If the deviation or variances are seasonal he may not take steps to correct the plans; otherwise he should modify the plan in consultation with the top management.

The management accountant will undertake a number of special studies for capital expenditure; make or buy decisions, lease or buy decisions.

It will be the responsibility of the management accountant to establish a good system for the use of management, devise all paper work and prescribe the periodicity of reports and manner of submission.

We have already seen the management accountant's role as a purely staff function, in relation to other departments. In view of the great use of management accounting, the controller now attends all important policy meetings and participates. As one foreign publication has stated, "the management accountant participates as the part of management in assuring that the organization operates as a unified whole in its long-run, intermediate and short-run best interests."

We may sum up saying, 'the management accountant's role is that of purveyor, processor and presenter of information and also a planner for the achievement of corporate goals both short and long-run.'

Self Assessment

State whether the following statements are true or false:

A budget is a qualitative expression of management's short-term intentions.

Long-term plans indicate the management's intent where the organization should reach in that time span.

Short-term plans are also called strategic plans.

15. Budget serves as a tool for co-ordinating the various activities and to the extent the actuals compared to budget works as a tool of control.

1.4 Summary

Financial accounting recorded business transactions on double-entry basis and helped ascertainment of profit or loss for the given period and valuation of stock of assets and liabilities on a given date.

Management accounting is the accounting system for making decisions of the business enterprise.

Cost accounting is related with the ascertainment of cost of the product in a period.

Human Resource Accounting means the accounting for human being as now in an organization human being is treated as an asset like other physical assets. It is recorded in the books like other assets.

Responsibility accounting is a special technique of management under which accountability is established according to the responsibility delegated to the various levels of management.

Management accounting is based on the past or yesteryear information of cost accounting and financial accounting which influences the effectiveness of the entire management accounting.

The cost accounting is very closely-related to financial accounting.

Few authorities of accounting consider cost accounting to be the branch of financial accounting.

The fundamental principles of double entry system are applicable in financial accounting as well as cost accounting.

1.5 Keywords

Cost Accounting: This helps management to conduct performance appraisal and also facilitates in formulating price policies.

Financial Accounting: Financial accounting is a traditional method of accounting that supplies historical information about the firm during the past.

Human Resource Accounting: Human Resource Accounting means the accounting for human being as now in an organization human being is treated as an asset like other physical assets. It is recorded in the books like other assets.

Management Accounting: Management accounting provides necessary information to assist the management in the creation of policy and in the day-to-day operations.

Responsibility Accounting: Responsibility accounting is a special technique of management under which accountability is established according to the responsibility delegated to the various levels of management.

1.6 Review Questions

Do you think management accounting is different from financial accounting? Discuss.

Elucidate the various functions of management accounting.

Write brief notes on the key branches of accounting.

4. Distinguish between the management accounting and cost accounting.

List out the contradictory areas of interest in between management accounting and financial accounting.

Management accounting is the accounting system for making decisions of the business enterprise. Discuss.

"Management accounting serves as a tool to management." Analyze this statement.

Analysis the scope of management accounting.

Write briefly of the evaluation of management accounting.

The cost accounting is very closely-related to financial accounting. Give some suggestions to support the above statement.

Answers: Self Assessment

1. Financial accounting
2. custodial or stewardship
3. Cost accounting
4. double entry system
5. Management Accounting
6. Cost accounting
7. Cost accounting
8. financial
9. financial
10. Management accounting
11. Financial accounting
12. False
13. True
14. False

True

1.7 Further Readings

Books

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