ACCOUNTING FOR DECISION MAKING

UNIT - I

ACCOUNTING FOR DECISION MAKING: Introduction

Every business firm is created with certain objectives. The objectives may be earning profit, increasing productivity through effective cost control, acquiring larger share of the market resources, growth through innovation and rendering `service to society. Among the various objectives, earning maximum profit is usually considered as the ultimate objective of undertaking any business venture.

The system of accounting that serves the first purpose is called „Financial Accounting‟ and the system that serves the second purpose is called Management Accounting

Financial Accounting is the basic from of accounting. The accounting for revenues, Expenses, assets and liabilities that is commonly carried on in the general office of a business is termed as „ Financial accounting

Meaning

The term Management Accounting refers to accounting for management. IN ordinary language, it refers to adoption and analysis of accounting information for diagnosis and explanation in such a way as to assist management in the decision making function.

Definition of Management Accounting

Harper W.M. “Management Accounting is concerned with management.

Nature & Scope of Management Accounting

If we carefully analyse the above definitions, we can clearly identity certain characteristics or leading features of management accounting as a distinct discipline of its own kind

- Information supplier
- Cause and effect analyzer
- Forecaster
- Vehicle of efficiency
- No fixed norms
- Decisions-making
- Subjective orientation
- Techniques and concepts
- Internal use

Scope of Management Accounting

However, following systems and techniques fall definitely within the scope of management accounting

- Financial Accounting
- Cost accounting
- Budgetary control and forecasting
- Statistical and quantitative techniques
- Tax accounting
- Inventory control
- Internal audit
- Interim Reporting

Meaning Management Accounting

Meaning

The term Management Accounting refers to accounting for management. IN ordinary language, it refers to adoption and analysis of accounting information for diagnosis and explanation in such a way as to assist management in the decision making function.

Characteristics

1. Providing accounting information
2. Cause and effect analysis
3. Use of special techniques and concepts
4. Taking important decisions
5. Achieving of objectives
6. No fixed norms followed
7. Increase in efficiency
8. Supplies information to decision making
9. Concerned with forecasting

Function of Management Accounting

Management accounting performs the following functions to satisfy the accounting needs of Management.

- ✓ Forecasting and planning
- ✓ Modification of data
- ✓ Analysis and interpretation of data
- ✓ Co-ordination
- ✓ Facilitates control
- ✓ Using qualitative information

Objectives of Management Accounting

The Objectives of management accounting are

i) To assist the management inpromoting efficieny. Efficiency includes best possible services to the customers, investors and employees.
ii) To prepare budgets covering all functions of a business
iii) To analyse monetary and non- monetary transactions.
iv) To compare the actual performance with plan for identifying deviations and their causes.
v) To interpret financial statements to enable the management to formulate future policies
vi) To submit to the management at frequent intervals operating statements and short trm financial statements
vii) To arrange for the systematic allocation of responsibilities
viii) To provide as suitable organization for discharging the responsibilities

Importance Management Accounting

Management accounting performs the following functions to satisfy the accounting needs of Management.

- ✓ Forecasting and planning
- ✓ Modification of data
- ✓ Analysis and interpretation of data
- ✓ Co-ordination
- ✓ Facilitates control
- ✓ Using qualitative information

Limitation of Management Accounting

Though the system of management accounting plays an important role in the changing world of management and adapting to the changes, due to its flexibility. It suffers from the following limitations

- ✓ Evolutionary stage
- ✓ High cost
- ✓ Wide scope
- ✓ Lack of knowledge
- ✓ Lack of objectivity
- ✓ Psychological factors

Distinction between financial Accounting & Management Accounting

The following are the main difference between financial accounting and management accounting

Objectives:

The main objective of financial accounting is to supply information in the form of pofit and loss account and balance sheet to outside parties like shareholder, creditors, government etc.

But the objective of management accounting is ot provide information for the internal use of management

- **Performance Analysis**
  - Financial accounting is concerned with the overall performance of the business
  - Management accounting is concerned with the department.
- **Data used:**
  - Financial accounting is mainly concerned with the recording of pas events
  - Management accounting is concerned with future plans and policies
- **Nature**
  - Financial accounting is based on measurement while management accounting is based on judgment
  - Financial accounting is more objective and management accounting is more subjective
- **Accuracy**
- Accuracy is an important factor in financial accounting
- But approximations are widely used in management accounting
- **Legal**
- Financial accounting is compulsory for all joint stock companies
- Management accounting is only option
- **Monetary Transactions**
- Financial accounting records only those transactions which can be expressed inters of money.
- Management accounting records not only monetary.

Relationship between cost & Management Accounting

- **Objective**
- ✓ The objective of cost accountings the ascertainment and control of costs of produces or service.
- ✓ The objective of management accounting is to help the management in decision making, planning, control etc.
- Scope
- ✓ Cost accounting deals primarily with cost data
- ✓ Management accounting deals with both cost and revenue
- Data use
- ✓ In cost accounting, only those transactions which can be expressed in figures are taken
- ✓ Management accounting uses both quantitative and qualitative information
- Nature
- ✓ Cost accounting uses both past and present figures
- ✓ Management accounting is concerned with the projection of figures for future.

Tools & Techniques of Management Accounting

The important tools and techniques used in management accounting are discussed below:

- Financial Planning
- Analysis of financial statements
- Historical cost accounting

- Budgetary control
- Standard costing
- Marginal costing
- Decision accounting
- Revaluation accounting
- Control accounting
- Management information system

Process of Meaning

The Objectives Process are

i) To assist the management in promoting efficiency. Efficiency includes best possible services to the customers, investors and employees.

ii) To prepare budgets covering all functions of a business

iii) To analyse monetary and non- monetary transactions.

iv) To compare the actual performance with plan for identifying deviations and their causes.

v) To interpret financial statements to enable the management to formulate future policies

vi) To submit to the management at frequent intervals operating statements and short trm financial statements

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viii) To provide as suitable organization for discharging the responsibilities

Financial Statement Analysis

Following are the two balances of Xco.and Y co. as on 31 dec 1990

Particulars	**X co Ltd**	**Y co Ltd**
Assets		
Cash	27	72
Sundry debtors	220	226
Stock	100	174
Prepaid expenses	11	21
Other current assets	10	21
Total current assets	**368**	**514**
Fixed Assets	635	513
Total	**1003**	**1,027**
Liabilities		
Current Liabilities		
Sundry Creditors	42	154
Others	78	62
	120	**216**
Fixed Liabilities	225	318
Total Liabilities	345	534
Capital	658	493
Total	**1,003**	**1,027**

1. From the above data , prepare a common size balance sheet

Solution

Particulars	**X co ltd**		**Y co ltd**	
	Amt	**% of total amount**	**Amt**	**% of total amount**
Current Assets				
Cash	27	2.69	72	7.01
Sundry debtors	220	21.93	226	22.01
Stock	100	9.97	174	16.94
Prepaid expenses	11	1.10	21	2.05
Other current assets	10	1.00	21	2.05
Total current assets	**368**	36.69	**514**	50.05
Fixed Assets	635	63.31	513	49.95
Total	**1003**	100.00	**1,027**	100.00
Current Liabilities				
Sundry Creditors	42	4.19	154	15.00
Others	78	7.78	62	6.04
	120	11.96	**216**	21.03
Fixed Liabilities	225	22.43	318	30.96
Capital	658	65.60	493	48.00
Total	**1,003**	100.00	**1,027**	100.00

2. From the following balance sheet of X Ltd, you are required to prepare a comparative balance sheet:

LIABILITIES	**2009**	**2010**	**ASSETS**	**2009**	**2010**
Equity capital	400	400	Land & buildings	400	370
6% pref. capital	300	300	Plants & machinery	400	410
Reserves	200	245	Stock	200	300
8% debentures	100	150	Debtors	200	300
Bills payable	50	75	Cash	100	140
Sundry creditors	250	350			
Total	1300	1520	Total	1300	1520

Financial Statement Analysis

Calculate the trend rations from the following figures of MPM company ltd. Taking 1994 as thebase and comment there on

Year	Sales	Stock	Profit before tax
1994	1,80,000	70,000	32,000
1995	2,30,000	78,100	43,500
1996	2,65,000	81,500	45,700
1997	3,02,000	94.400	52,700
1998	3,76,000	1,15,000	67,300

Solution

Year	Sales		Stock		Profit before tax	
	Rs	Trend ratio	Rs	Trend ratio	Rs	Trend ratio
1994	1,80,000	100.00	70,000	100.00	32,000	100.00
1995	2,30,000	127.77	78,100	111.57	43,500	135.94
1996	2,65,000	147.22	81,500	116.43	45,700	142.81
1997	3,02,000	167.77	94.400	134.86	52,700	164.69
1998	3,76,000	208.88	1,15,000	164.29	67,300	210.31

Interpretation

The following points are points are worth nothing from the trend ratios:

i) Sales have registered a continuous increase in all the fiveyears . This is a favourable tendencyas success for business depends on sales

ii) Although there is an increase in quantity of stock during the last five years

iii) Profit before tax has increased substantially

iv) The overall performance of MPM company is really good.